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WESTERN HILLS WATER DISTRICT RESPONSE TO DIABLO GRANDE COMMUNITY GROUP FINANCIAL ANALYSIS AND PER RESIDENT COST ANALYSIS

The following is the summary of the response of the Western Hills Water District (WHWD) to those findings and assumptions made by the Ad Hoc Water Committee (AHWC) in reaching its conclusion that the resident's fair share of the WHWD operations is \$45.00 per month. As will be explained in detail below, there were certain assumptions made and matters omitted from the computation that compromised the integrity of the conclusions reached by the committee. In part this is due to the fact that the Committee published its initial findings to the residents before having reviewed its assumptions and conclusions with WHWD. As a result, a number was published which turned out to be inaccurate for the reasons stated below. Once that number was published it became politically difficult for the Committee to come back to the residents and tell them of the significant financial impact of these omissions. The following is a brief summary of these omissions, their total financial impact and how it impacts each resident based on the actual number of current residents.

#1 - AHWC: TREATED VEOLIA FEE OF \$465,235 AS A FIXED COST.

WHWD FINAL RESPONSE: ALL OF VEOLIA

FINANCIAL IMPACT: INCREASE OF \$22.42 PER HOME/PER MONTH

AHWC concluded that no part of the management fee could be identified as a variable cost. Veolia's management contract is for the water treatment plant only.

Veolia Base Management Fee

WHWD agrees that the base management fee for the year 2009-2010 of \$397,139 is a fixed cost. (\$397,139/1400 homes/month) The fee is fixed regardless of the amount of water treated. WHWD disagrees that overtime charges are not variable. The AHWC failed to take into account any overtime charged by Veolia. Overtime is out of the scope of the management contract and billed separately and is directly related to water treated for the residents. These charges are considered variable. Any overages charged by Veolia are considered variable and is divided equally between 422 home.

WHWD has a contract with Quality Service, Inc., which allows WHWD to operate the distribution system. Operation of the raw water transmission and distribution system is done solely by WHWD

staff. Veolia staff does not operate raw water facilities or the water distribution system. Maintenance of the raw water facilities and distribution system is the responsibility of WHWD not Veolia.

**Financial Impact: \$20.09 per home/per month
Veolia Overtime Charges**

Veolia charged overtime hours incurred over the contracted regular hours. In the year mentioned above there was \$13,924.85 in overtime charged. The overtime charged from Veolia is a variable cost directly related to servicing the 422 residents. As a result each of the 422 homes share 1/422 of the variable costs of treatment. (\$13,925/422 homes/month)

Financial impact for each home \$2.33 per home/per month

To the extent that the services include additional charges for variable cost items such as chemicals, power, repair and maintenance, water tests, etc are not included in the Veolia fee and are 100% allocated to the treated water consumers including 422 homes, HOA accounts, and Troon/World.

The result of the above total charges is \$22.42. (\$20.09+\$2.33)

#2 - AHC: PAYROLL AND GENERAL ADMINISTRATIVE COSTS APPORTIONED 63 % TO WATER AND 37% TO OTHER ACTIVITIES.

WHWD FINAL RESPONSE:

63% IS ACCEPTABLE FOR GENERAL AND ADMINISTRATIVE EXPENSES BUT THE PAYROLL EXPENSE ALLOCATION SHOULD BE 72% TO OVERALL WATER EXPENSES

FINANCIAL IMPACT: SEE ANSWER #3

AHC's analysis was based on interviews with WHWD payroll personnel. AHC concluded that 63% of payroll hours charged to 2009/2010 operating costs were related to Treated Water and 37% related to other activities.

WHWD respectfully disagrees. The allocation of payroll is incorrect due to the fact it takes more man hours to run the water treatment plant than it takes to reroute water to golf courses or monitor and flush the sewer lines. Operation of the raw water pump stations take far less labor and monitoring than does the operation of the water treatment plant. All reporting and analytical lab testing are part of supplying treated water to Diablo Grande as required by the California Department of Public Health Permit. Monitoring and testing consume a great deal of time.

This is directly confirmed from the field crew task survey submitted by Stan Duck. The field crew task survey payroll indicates the following allocation of payroll: 36% water treatment plant (WTP), 36% pump stations, 14% sewer, 14% storm drain.

WHWD asserts that 72% of all payroll related expenses are directly allocated to water expenses. (36% WTP + 36% pump stations)

Financial impact is answered in question #3.

#3 - AHC: PAYROLL AND GENERAL ADMINISTRATION WATER COSTS SHOULD BE ALLOCATED 50/50 TO TREATED / NON-TREATED WATER.

WHWD RESPONSE:

PAYROLL SHOULD BE 61% TREATED AND 39% NON-TREATED.

FINANCIAL IMPACT: INCREASE \$2.01 PER HOME/PER MONTH

In order to give final financial impact for the payroll assumption as stated in #2 above we need to consider these omissions in question # 3.

WHWD asserts that a 50/50 split between Treated and Non-Treated users is not reasonable. It takes more man hours to maintain the water treatment plant and make treated water than it does to redirect raw water to the ponds. There are hours directly related to work in the water treatment plant and hours directly related to pumping water up to Diablo Grande. Treated water runs through the plant and takes more man hours to move chemicals, check the plant, complete work orders for residents, replace parts, keep plant clean and pull water through the system.

Raw water is directly piped to the ponds. This is done by redirecting the water flow at Pump Station No. 4 by an operator pushing a button on the computer that controls the transmission and distribution systems. This can be completed within the 39% of hours allocated to raw water expenses from pump station hours.

The resulting amount of the 72%, as stated in question #2, is \$109,988. Of that amount 61% should be allocated to treated water and 39% should be allocated to raw water. Since 79% of water used is raw water then the same percentage of the pump stations labor hours should be allocated to raw water. We have considered 50 hours/week to WTP & 50 hours/week to pump stations for a total of 100 hours. Final financial impact is as follows:

- Raw water: (50hrs*79%) = 39 hours therefore 39% of the payroll expenses are for raw water.
- Treated water: (50hrs*21%) = 11hrs. Adding the 50hrs for WTP = 61hrs. Therefore 61% of payroll expenses should be allocated to treated water.

Financial Impact: \$2.01 increase per home/per month.

#4 - AHC: AHC RECOGNIZES THAT ~ \$2 MILLION ADDITIONAL EQUIPMENT WILL BE REQUIRED BY WHWD (\$1 MILLION) AND (\$1 MILLION) TO SUPPLY THE TOTAL WATER REQUIRED FOR 1400 HOMES.

WHWD RESPONSE:

THE AHC ANALYSIS NEEDS TO TAKE THIS ADDITIONAL \$2 MILLION EXPENDITURE INTO ACCOUNT IN ITS WATER COST ANALYSIS IN ORDER TO JUSTIFY THE APPORTIONMENT OF CURRENT FIXED COSTS TO 1400 HOMES.

FINANCIAL IMPACT: \$11.95 PER HOME/ PER MONTH

AHC concluded that the \$42 million already spent (Mello Roos bonds) are sunk costs expended for facilities that will be used for 1400 homes. Furthermore, the current fixed organizational and contract costs are set up for 1400-home water supply and do not decrease for supply to 422 homes. When the required additional \$2 million (~ 5% of the sunk \$42 million) is spent, this new fixed cost and associated financing should be apportioned over all existing and future WHWD users, including 1/1400 to each existing house, but the existing 422 homes should not be burdened for the \$2 million until the needed amount is actually spent.

WHWD response:

To prepare for the upcoming upgrade to service 1400 homes the \$2 million in question needs to be allocated as if it is a fixed cost. According to AHC all fixed costs are divided equally between 1400 homes. If the \$2 million in upgrades, to get to 1400 homes, is not considered a fixed cost, then the assumption of using 1400 homes as a divider is incorrect. Without this component all fixed costs would be considered using a divider of 700 not 1400. That number is the maximum capacity of the water treatment plant as of now. Without the additional funding the water treatment plant cannot sustain 1400 homes thus making divider of 1400 incorrect. If the true number of homes were considered in the equation, i.e. 700, the resident community's true fair share would double as 1400 was used as the divider.

This expense must be addressed now. Assuming 20 year financing and an increase in homes at a rate of 50/year a fixed amount of \$8.61per home/per month would be needed to cover the principal. This would not include interest. An additional \$3.34 per home/per month assuming 4% interest. In sum of \$11.95 per month would be needed in order to cover the debt service associated with the plant expansion required to provide service to the approximately 700 additional lots.

Financial Impact: \$11.95 increase per home/per month.

#5 – AHC FAILED TO CONSIDER ALL EXPENSES ASSOCIATED WITH MAINTAINING THE WHWD.

WHWD RESPONSE:

WORLD ALREADY CARRIES A NUMBER OF COST ITEMS THAT SHOULD PROPERLY BE ALLOCATED TO THE WHWD AND CONSIDERED IN THE "TRUE COST" PER RESIDENT.

FINANCIAL IMPACT: \$7.77 PER HOME/PER MONTH

There are a number of items omitted from the “resident cost calculation” that were simply ignored by the committee. Some examples include:

- No mention of \$9,589.00 payroll and related costs/month funded by World International Equates to \$4.93 per home/per month.
- New charges for Water Truck & Truck rental not in calculation in the amount of \$3,215.69/month. Since employees drive these vehicles we will use same percentage rate as payroll which calculates to \$2.84 per home/per month.

Financial Impact: \$7.77 increase per home per month.

PHASE IN TIME PERIOD

The committee studied the numbers and finances of WHWD to determine the “fair share” of the community’s actual and ongoing responsibility for treated water. As noted above, the community group chose to ignore certain economic realities the impact of which is described in detail above. Regardless of which number you adopt, the reality is that the community’s fair share obligation exists at this moment, has existed for some period of time and the community has benefited by the failure to act by previous owners.

The six year implementation is too long for the current expenses incurred by WHWD for the existing 422 homes. To phase in the community’s fair share over a six year period is unrealistic, fiscally irresponsible and ignores the fact that the community has already benefited by the fact that rates have not increased in 10 years. In the spirit of compromise the WHWD is willing to split the difference between the fair share that is due and owing today versus the six years proposed by the Community group and would accept a three year phase in so as to allow residents the opportunity to plan for the increase.

CONCLUSION

As demonstrated above the true “fair share” of the cost of the water district to each homeowner, taking into account all of the foregoing differences is \$117.72 per month which includes the costs of financing the additional improvements to service 1400 homes. This monthly total service fee is in line with what many water districts charge throughout the State of California, many of which have much higher user populations and which are not burdened with the unique transportation charges that apply to Diablo Grande. That said, the WHWD also recognizes that of these charges \$11.95 is attributable to expenses that have not been incurred and as a result need not be charged to

residents at this time. Deducting this amount the total true cost per resident is \$107.15/month. The following is a breakdown of these costs per home.

• Veolia Base Fee including Payroll Changes	\$98.00*
• Payroll expenses paid by World International	4.93*
• Water Trucks paid by World International	2.84*
• Cost of principle & interest on \$2M WTP upgrade	<u>11.95*</u>
Total	\$117.72*

*NOTE: All of the above calculations are based on 85% of actual costs. The remaining 15% is reserved for commercial use.

Now that the true cost has been determined the question remains what is the amount of increase necessary to cover these costs? The average amount paid by each homeowner in 2010 was approximately \$50.00 per household or \$55.77 shy of the true cost. The AHCW determined that an increase of \$45 per resident per month was appropriate. While we differ from their conclusion for the reasons stated above.

It bears noting that the AHCW and the conclusions set forth in this rebuttal does not address the ongoing capital replacement cost of the water infrastructure, now approaching its tenth year of operation and which is expected to require between +\$200,000 per year simply to maintain operations.

WHWD has been working with this community to address the unique issues that apply to this community for close to one year in an effort to find a mutually acceptable joint solution to these issues. That process will not stop now at the end after we have come this far. To that end, WHWD invites the AHCW or any members of the community to review the conclusions and observations set forth in this rebuttal and if so incline to review the underlying data upon which our conclusions were drawn. All of the underlying material will be available on our website so that members of the community can verify for themselves that these findings are objective and based on hard numbers.

In order to bring this process to a conclusion and hopefully achieve a consensus between the residents of Diablo Grande and the WHWD, a community meeting will be scheduled on Tuesday, April 19, 2011, 5:30 P.M. in the Diablo Grande Clubhouse (following the 4:00 P.M. WHWD Board Meeting) at which time rate increases, phase in periods etc., will be discussed and hopefully we can reach consensus between us concerning the nature, scope and phase in of the rate increases that are inevitable to allow the WHWD to continue to function in its current capacity.