TOWN HALL PRESENTATION

To the City Council and Community
Regarding the Claremont Water System

November 6, 2013
WELCOME

MAYOR

OPANYI NASIALI
OPENING REMARKS

CITY MANAGER
TONY RAMOS
Community’s History Of Concern With Golden State

- Community has voiced widespread concerns to the City Council
- City has allocated substantial resources to intervene in CPUC proceedings
- History of discussions with Golden State

1990’s                2000’s              Current
Topics To Be Covered

- Background on Golden State Water Company
- Key Considerations of Potential Acquisition

Golden State Water Rates

Public Control and Local Accountability

Claremont’s Water Supply
Topics To Be Covered

- Appraisal Process
- Operational Review
- Financial Review and Potential Rate Impacts
- Summary of Pros and Cons
BACKGROUND

GOLDEN STATE WATER COMPANY
Golden State Water Company

- Subsidiary of American States Water Company
- American States Water Company trades on the New York Stock Exchange
- Golden State provides water service in California and electric services in San Bernardino County
How American States Water Company Is Doing
On September 3, 2013, American States paid its quarterly dividend to shareholders

14.1% increase over prior year dividend

American States has paid dividends to shareholders every year since 1931

American States dividends have increased every year since 1954
Golden State Water Company

- In California, Golden State is organized and operated as an investor-owned utility regulated by the California Public Utilities Commission (CPUC)

- As a regulated water utility, Golden State has a government protected *private monopoly*
Golden State’s Region III

Region III includes portions of Los Angeles, San Bernardino, Imperial and Orange Counties.
Claremont Water System

- The Claremont system is part of Golden State’s Region III

- System covers City of Claremont and certain limited areas outside the City (Montclair; Pomona; Upland; L.A. County)
Claremont Water System

- Approximately 11,000 connections
- Serves roughly 35,000 people
- Represents 11.8% of Region III
- Claremont system rates are generally set on region wide basis
- Claremont ratepayers subsidize the region
Golden State files a rate application every three years (by statute)

Every Time Golden State Requests a Rate Increase

Every Time CPUC Approves Rate Increase
Golden State Rate Increases

- Based on CPUC decisions alone, residential rates in Claremont have gone up over 100% since 2004 (for 5/8” meters)

- This understates the amount of actual rate increases
Golden State Rate Increases

- Beyond the rate increases approved by CPUC decisions, additional rate increases are obtained by “advice letters” and “surcharges”
- These additional increases are not reflected in CPUC decisions
- CPUC does not track total rate increases
Claremont Rates Compared To Neighboring City Water Systems

Does not include Golden State rate increases approved by CPUC in May 2013

Source: Golden State presentation to Claremont City Council on November 8, 2011, information contained in the most recent Golden State Water rate application and discussions with staff
Why are Golden State’s Rates Higher?

- **Golden State Receives a Rate of Return**
  - Authorized by statute
  - Unique to CPUC regulated water utilities
  - 8.64% is the current CPUC approved rate (can be higher)

- **Golden State Pays Taxes**
Why are Golden State’s Rates Higher?

- **CPUC System Incentivizes Rate Increases**
  - Increased Rate Base can increase profits
  - Near automatic pass-through of costs

- **Rates Include Golden State’s Administrative Overhead**
  - Approximately 14% of rates
Why are Golden State’s Rates Higher?

- **CPUC Approves Rate Surcharges for Reduced Water Usage and Conservation**
  - Water Rate Adjustment Mechanism (WRAM)
- **CPUC Rates are Set Region-Wide Instead of Being Based Only on the Claremont System**
  - Approximately 15% Higher
- **CPUC Process is Costly and Inefficient**
KEY CONSIDERATIONS FOR POTENTIAL ACQUISITION
Publicly Owned Water Systems

In California, the overwhelming majority of water service is provided by municipal water systems and other public water agencies.
Public Control and Local Accountability

No rate of return (i.e., “profits”) in City-based rates

No taxes paid by City

No WRAM
Public Control and Local Accountability

- Costs & investments would be limited to the Claremont system rather than entire Region III
- City would be able to better control costs and capital investment – City has no profit incentive
- City and ratepayers would be able to establish local water management strategies and priorities
- Customer service and responsiveness would be in the hands of the City
Public Control and Local Accountability

- **Under Golden State ownership:**
  - CPUC proceedings are in San Francisco and important meetings affecting rates are held behind closed doors
  - Golden State is not subject to the Brown Act, Public Records Act or other public laws
  - Golden State is not subject to Proposition 218 or Proposition 26 in setting rates and charges

- **Under City ownership:**
  - Water management and rate decisions would be open and public
Claremont’s Existing Water Supplies

Claremont Uses Two Sources of Water

Local Groundwater
(Six Basins and Chino Basin)

Imported Water
Managing Local Supplies Is Critical

- Maximizing the use of local water supplies (such as groundwater) is key to effective water management.
- Imported water is far less reliable than local groundwater supplies.
- Imported water is far more expensive than local groundwater supplies.
Long-Term Risks and Expense of Imported Water

- Imported water comes from the State Water Project (SWP) and the Colorado River

- Both SWP and Colorado River supplies face major challenges
SWP Supplies Becoming Less Reliable

Factors Reducing The Reliability Of SWP Supplies

- *Bay Delta ecosystem*
- *Court restrictions on water deliveries*
- *Drought*
- *Incomplete infrastructure*
- *Potential climate change impacts*
SWP Supplies Becoming Less Reliable

SWP Contractors (such as Metropolitan Water District) are receiving less of their requested SWP supplies
Colorado River Supplies Becoming Less Reliable

Lake Mead in December 2012

Down 95.4 Feet From 1998 Peak Elevation
Colorado River Supplies Becoming Less Reliable

Factors Reducing The Reliability Of Colorado River Supplies

- Prolonged drought conditions
- 2000-2007 runoff in Colorado Basin was lowest on record – Hydrologists forecast ongoing shortfalls
- Endangered species restrictions
- Water quality constraints
- Potential climate change impacts
- Use of water by Arizona/Nevada and other states
Imported Water Costs Have Doubled
Golden State is Not Maximizing Local Water Supplies

- Golden State is not fully using local groundwater rights
  - 2010 Urban Water Management Plan shows about 1,600 acre-feet of unused groundwater rights for the year 2010
  - One acre-foot of water can serve 2-4 households per year
- Golden State uses more imported water than necessary
APPRAISAL PROCESS
Appraisal Process

City retained appraiser who specializes in public utility appraisals

Appraiser inspected Claremont System with Golden State and gathered financial data regarding the system

Applied fair market value principles (highest price fully informed buyer and seller would agree under no pressure to buy or sell)
Appraisal Process

In accordance with the Eminent Domain Law, the Claremont system is being appraised as a water system, including infrastructure, real property, personal property, and intangible assets used and useful in providing water service within the system.
Valuation Approaches Considered

- Replacement cost new less depreciation
- Market approach
- Income approach (based on CPUC set rates)
  - *Income approach is the best indicator of fair market value – an informed buyer would not pay more for a business than the value of what it can earn*
  - *Indicated value under Income Approach: $55,094,000*
Regional vs. System Rates Impact on Valuation

Analyses show that valuation of the Claremont system is higher because of regional rates.

If rates were based on operational costs and rate base for the Claremont system alone, the indicated value under the income approach would be about $34,000,000 instead of $55,000,000.
City Offers to Golden State

- In November 2012, City made a formal offer to Golden State to purchase the Claremont system for $54,076,000
- On October 3, 2013, City made an updated offer to purchase the Claremont system for $55,094,000
- Golden State immediately rejected both offers stating the “system is not for sale”
OPERATIONAL REVIEW
Operational Review

- City staff researched and reviewed public documents for the Operation and Maintenance (“O&M”) costs of several local public water providers.

- Data were used to evaluate whether the Claremont system could be operated within the O&M costs reported by Golden State.
## Operational Review

<table>
<thead>
<tr>
<th>Major Components of O&amp;M Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water Demands (Standard)</td>
</tr>
<tr>
<td>Water Supply Costs (Standard)</td>
</tr>
<tr>
<td>Personnel Costs (Can Vary)</td>
</tr>
<tr>
<td>Capital, Repair &amp; Maintenance (Can Vary)</td>
</tr>
<tr>
<td>Mix of Water Resources Used to Serve the Claremont System (Can Vary)</td>
</tr>
</tbody>
</table>
Operational Review

Operational Options for City of Claremont

- Contract experienced local public agency
- Contract experienced water management team
Operational Review

Other Key Differences between Golden State and City-Owned Water System

- City would retain oversight
- Costs would be local and not regional
- No profits in rate setting
- Rate setting would be subject to Proposition 218
- No CPUC involvement
FINANCIAL REVIEW AND POTENTIAL RATE IMPACTS
Golden State Revenue Requirements and Rates vs. City-Owned Water System

<table>
<thead>
<tr>
<th>Standard Components</th>
<th>Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water Supply Mix/ Imported Water Costs</td>
<td>GSWC Rate of Return</td>
</tr>
<tr>
<td>Commodity Costs (e.g., fuel &amp; energy)</td>
<td>GSWC Taxes</td>
</tr>
<tr>
<td>Administrative and Overhead Costs</td>
<td>City Borrowing for Start Up Costs in Addition to Acquisition Price</td>
</tr>
<tr>
<td>Capital, Repair and Maintenance</td>
<td></td>
</tr>
</tbody>
</table>
## Major Assumptions for Projected Rates

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<tr>
<th></th>
<th>City-Owned</th>
<th>GSWC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Customer Growth</td>
<td>0.41%</td>
<td>0.41%</td>
</tr>
<tr>
<td>Average Water Use</td>
<td>Constant</td>
<td>Constant</td>
</tr>
<tr>
<td>Revenue Requirement</td>
<td>Based on City System and Financing Costs</td>
<td>Based on Regional Costs</td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>$3M Annual</td>
<td>$3M Annual</td>
</tr>
<tr>
<td>Purchased Water Cost Increase</td>
<td>5.5% Annually</td>
<td>5.5% Annually</td>
</tr>
<tr>
<td>Operating Cost Inflation</td>
<td>2.1% Annually</td>
<td>2.1% Annually</td>
</tr>
<tr>
<td>Rate of Return</td>
<td>N/A</td>
<td>8.64%</td>
</tr>
<tr>
<td>Financing Costs</td>
<td>5% for 30 Years</td>
<td>N/A</td>
</tr>
<tr>
<td>Start Up Costs</td>
<td>Finance Operating and Capital Reserves</td>
<td>N/A</td>
</tr>
</tbody>
</table>
System Financing Requirements

- Acquisition Price
- Acquisition Costs (Legal/Engineering/Financial)
- Working Capital Reserve (120 days’ expenses)
- Capital Reserve ($3 Million)
- Capital Expenses Years 1-2 ($5.6 Million)
- Other Start-Up Costs ($500,000)
- Bond Reserve Fund (1 Year of Debt Service on Bonds)
- Capitalized Interest (1st Year Interest on Bonds)
- Costs of Issuance
Revenue Requirements (in $Millions)
Golden State vs. City Acquisition - $55M
Potential Rate Impacts

- The City’s Appraisal concludes that the fair market value of the Claremont system is not more than $55,094,000

- Potential acquisition prices of $80M, $100M and $120M are being discussed tonight because Golden State is expected to assert the system is worth more, and the City should know what that could mean for rates
Revenue Requirements (in $Millions)
Golden State vs. City Acquisition - $80M
Revenue Requirements (in $Millions)
Golden State vs. City Acquisition - $100M

Break Even

Year 1 Year 5 Year 9 Year 10 Year 20 Year 30

City -$100M GSWC
Revenue Requirements (in $Millions)
Golden State vs. City Acquisition - $120M
Average Monthly Bill Comparison – Water Revenue Bonds
Golden State vs. City Acquisition - $55M

Year 1: City - $167, GSWC Regional Rates - $167
Year 5: City - $171, GSWC Regional Rates - $199
Year 10: City - $204, GSWC Regional Rates - $236
Year 20: City - $291, GSWC Regional Rates - $327
Year 30: City - $401, GSWC Regional Rates - $451
Financing of Acquisition Price Above $55 Million But Less than $80 Million

Existing Rates Support the Issuance of Water Revenues Bonds to pay an Acquisition Price (together with all necessary bond reserves) of up to $80 Million
Financing Options for Acquisition Price Above $80 Million

- Additional Water Revenue Bonds Paid by Increased Water Rates
  - Increase would vary based on usage

- Special Tax Bonds Paid by Fixed Taxes on Property
  - Fixed amount based on meter size

- General Obligation Bonds Paid by Ad Valorem Taxes on Property
  - Increase would vary based on home assessed value
Average Monthly Bill Comparison – Golden State vs. City Acquisition - $80M
Average Monthly Bill Comparison – Water Revenue Bonds
Golden State vs. City Acquisition - $80M And $100M
Average Monthly Bill Comparison – Water Revenue Bonds
Golden State vs. City Acquisition - $80M And $120M
## Comparison of Average Monthly Costs for Water Bonds and Special Tax Bonds (27 HCF)

<table>
<thead>
<tr>
<th>Year</th>
<th>Golden State Water Bill</th>
<th>Monthly Water Bill at $80M Price</th>
<th>Total Bill with $20M Add’l Water Bonds</th>
<th>Total Bill with $20M Add’l Special Tax Bonds</th>
</tr>
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<tr>
<td>Year 1</td>
<td>$167</td>
<td>$171</td>
<td>$179</td>
<td>$182</td>
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<tr>
<td>Year 5</td>
<td>$199</td>
<td>$188</td>
<td>$204</td>
<td>$199</td>
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<td>Year 10</td>
<td>$236</td>
<td>$219</td>
<td>$230</td>
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<tr>
<td>Year 20</td>
<td>$327</td>
<td>$301</td>
<td>$309</td>
<td>$312</td>
</tr>
<tr>
<td>Year 30</td>
<td>$451</td>
<td>$411</td>
<td>$420</td>
<td>$422</td>
</tr>
<tr>
<td></td>
<td>Will Vary Based on Water Usage</td>
<td>Will Vary Based on Water Usage</td>
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Potential Pre-Acquisition Costs

- Costs (in the millions) can be recovered from future operations but need to fund in advance of acquisition

- Options for Funding Costs
  - *Advance from the General Fund* – NOT recommended
  - *Residents could agree to a short-term special tax*

- No reimbursement if acquisition process was abandoned
Community Interaction

Claremont City Council and staff have remained engaged with residents and businesses

- Responses to citizen inquiries
- Responses to Golden State mailers and press pieces
- Responses to Public Records Act requests
- FAQs for General Rate Case and potential acquisition
- Cooperation with community groups
- Cooperation with local press
- Cooperation with community leaders
Review Under the California Environmental Quality Act (CEQA)

Generally, CEQA review must be completed where a public agency proposes to approve an activity that has the potential to have a significant impact on the environment.

The City will fully comply with all applicable requirements of CEQA in connection with the potential acquisition.
Summary of Potential Acquisition

**Potential Cons**

- Golden State will fight
- Acquisition price is uncertain and could be in the hands of a jury
- Litigation would be expensive and could take several years to resolve
- Rate containment could take time
- System operations and capital improvements become City obligation
- System condition not fully disclosed
- City’s administrative role would increase
Summary of Potential Acquisition

Potential Pros

- Contains future rate increases
  - Eliminates rate of return (i.e., “profit”) in water rates
  - Eliminates profit-driven O&M decisions
  - Eliminates CPUC rate application and approval process

- Rates based on costs of the Claremont system only instead of entire Region III

- Better cost control and efficiencies

- Public transparency
Summary of Potential Acquisition

**Potential Pros**

- No more CPUC process in San Francisco
- Local accountability with locally elected officials
- Local control over rate design and tiers
- Local control over water infrastructure projects
- Greater flexibility and control in using local groundwater and securing and managing future water supplies
- Greater responsiveness to customer complaints and needs
STAFF RECOMMENDATIONS
Staff Recommendations

Consider One or More of the Following Alternatives

1. Direct staff and legal counsel to proceed with CEQA, financial, and other legal documents necessary to pursue potential acquisition of the Claremont water system

2. Approve $350,000 for financial and other legal documents necessary to pursue the potential acquisition process

3. Ask for additional information

4. Direct staff to take no further action
PUBLIC COMMENT