



Stantec Consulting Services Inc.
370 Interlocken Boulevard Suite 300, Broomfield CO 80021-8012

August 13, 2020

Attention: Anne Glassman, Business Solutions Manager
Castle Rock Water
175 Kellogg Ct.
Castle Rock, CO 80109

Dear Anne,

Reference: Stantec Financial Review Services for Castle Rock Water's 2020 Rates and Fees Study, Volume 1 of 2, 2021 – 2025 Rates

As part of the 2020 Rates and Fees Study, Stantec Consulting Services Inc. (Stantec) was engaged by Castle Rock Water (CRW) as a third-party reviewer of CRW's methodology and findings. In preparing review comments and recommendations, Stantec has relied on the information and data presented by CRW without independent verification. The intent of our review was to provide an outside perspective of CRW's work products and models, as well as financial policies, based on our experience and best practices in the industry.

CRW's continued efforts to optimize capital project funding while maintaining reserves, meeting targets, and minimizing rate increases are in line with industry best practices. Additionally, by funding growth-related capital projects with impact fee and system development fee (SDF) revenue, CRW is making efforts to ensure "growth pays for growth," and is adhering to the industry standard of allocating costs to beneficiary parties.

Following a cost-of-service based approach to establishing rates is recommended by the American Water Works Association (AWWA) and Water Environment Federation (WEF). While CRW presents a five-year forecast of rate recommendations and a single test year of cost-of-service (COS) rates, CRW's annual updates to the COS models for water and wastewater allow for more detailed monitoring of the equity of CRW's rates and fees for its water and wastewater utilities. As a result, Stantec recommends that CRW continue to evaluate the equity among its customer classes. CRW has an Excel modeling tool, reviewed with Stantec, that compares costs of service by class calculated in the COS models with revenues collected from each class. This customer equity analysis provides feedback on projected cost recovery by customer class, projected accounts for the rate year, and consumption used in the COS models compared with actual revenues, accounts, and usage by class.

During this rate study, CRW reviewed and revised its water and wastewater cost allocations. These changes were not included in the 2020 COS models. A subsequent analysis could be a comparison of the impact on COS to determine if the updated allocations provide better alignment in terms of costs allocated to the base and volume charges. CRW can consider implementing the changes, if any, in the 2021 Rates and Fees Study.

In the financial planning models used to develop revenue requirements for each of CRW's enterprise funds, CRW fully balanced the models in the short term while maintaining a longer-term forecast of rates. Financially sustainable utilities demonstrate that each enterprise fund meets financial targets such as minimum reserves every year and properly plans for future capital expenditures. CRW may be more

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conservative in its minimum reserves and could consider omitting the beginning fund balance deduction of the 60 days of operating expenses in the first year of the operating fund cash balance. It effectively accounts for the reserve requirement twice in the first model year.

To further balance revenue needs with expenditures, Stantec recommends that CRW designate specific CIP funding rules to enable SDF or rate funding according to project designations of growth funded, rate funded or a combination of the two. This requires further tracking of SDF revenues and expenses as recommended in the 2019 Rates and Fees Study. This separation of rate revenues and growth-related revenues and expenses provides better tracking of SDF revenues for appropriate projects.

As indicated in 2019's recommendations, CRW can use the water, water resources, stormwater, and wastewater financial planning models' Key Performance Indicators (KPI) worksheets to obtain further insight into its financial standing relative to industry standards. Stantec will update the KPI worksheets to include CRW's tracking of its debt ratio (total liabilities/total assets), operating ratio (O&M costs/total operating revenue), cost of residential service (average monthly bill), and stormwater operating costs per total SFEs. Other metrics included on the KPI tabs are outstanding debt to operating revenues, total debt service coverage, service affordability, and days cash on hand. Affordability metrics can include the traditional approach that considers utility bills as a percentage of median household income (MHI), as well as more modern approaches such as the affordability ratio of the 20th income percentile (AR20) and the hours worked at minimum wage (HM). Stantec updated the affordability results for the AR20 and HM methods for 2020 and will include these in the KPI tabs. We recommend CRW continues to update these calculations in the future.

Finally, CRW's water budget-based rate structure remains an innovative approach in the industry for addressing water conservation. CRW is among a small group of utilities in Colorado that have successfully implemented such a structure. Stantec recommends CRW use the Conservation Impact Model (CIM) if future adjustments in water budget-based rates are desired and possible refinements to its water conservation goals need to be evaluated from a rate structure perspective.

Stantec's specific recommendations for CRW's rates are found in the Summary of the Volume 1 of 2 2021 – 2025 Rates Report.

As usual, we appreciate the opportunity to work with you and your staff on this study. Please contact me at (330) 271-9125 if you have any questions.

Regards,


Carol Malesky
Principal, Financial Services

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