



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

September 15, 2023

Attention: Nichol Bussey, Business Solutions and Support Manager

Castle Rock Water
175 Kellogg Ct.
Castle Rock, CO 80109

Dear Nichol,

Reference: Stantec Financial Review Services for Castle Rock Water's 2023 Rates and Fees Study, Volume 1 of 2, 2024 – 2028 Rates

As part of the 2023 Rates and Fees Study, Stantec Consulting Services Inc. (Stantec) was engaged by Castle Rock Water (CRW) to update the modeling tools used in the study with current data as well as provide review and feedback during the study of CRW's methodology and findings. In updating the modeling tools, Stantec has relied on the information and data presented by CRW without independent verification. During the course of the study, discussions with CRW staff focused on reasonableness of the data used, as well as financial policies and comparisons with 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.

In the financial planning models used to develop revenue requirements for each of CRW's enterprise funds, CRW provided balanced revenues and expenses for the five-year rate forecast 2024 - 2028. Financially sustainable utilities demonstrate that each enterprise fund meets financial targets such as minimum reserves every year and properly plans for future capital expenditures. During this year's Study, while operating cost projections were met, capital project funding was the primary focus. CRW's goal was to meet each fund's operating needs and determine the best mix of funding sources for substantial capital improvement plans while minimizing the impact on customer bills. CRW's reduced SFE for new connections was held as the standard equivalent for all new residential accounts, given the new turf limit requirements. Relying on lower SDFs for water and water resources affects the revenue available for projects. For the water resources fund, CRW faces capital funding needs that can be met by maintaining annual rate increases and borrowing in 2026.

To further balance revenue needs with expenditures, Stantec recommended in 2021 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 recommendation was followed in the 2023 Study. The next step for CRW is to track SDF revenues and expenses to provide improved accounting of SDF revenues for appropriate projects.

CRW's use of its internal 5-year financial forecast provides inputs to the Financial Analysis and Modeling System (FAMS) modeling tools. As a result, assumptions used to forecast the revenues and expenses are not transparent in the FAMS models. As previously recommended, if the internal forecast continues to be

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used, providing revenue and cost escalation assumptions for line items in the internal forecast could improve transparency in the financial planning models used for rate projections.

Following a cost-of-service based approach to establishing rates is recommended by the American Water Works Association (AWWA) and Water Environment Federation (WEF). CRW and Stantec discussed continuing across-the-board adjustments to rates for the funds. Across-the-board rate adjustments are changes to each rate component within each fund equal to the rate revenue increases determined in the financial planning models. A single test year of cost-of-service (COS) rates may result in different increases to different rate components based on cost allocation results and addressing revenue recovery objectives.

The COS process indicates higher monthly service charges and lower volume rates based on the current allocation of costs. It is a policy decision to adjust the current rates to reflect these findings, which may be counter to CRW's conservation focus. Stantec and CRW reviewed its water and wastewater cost allocations in the COS models early in 2023. Changes to these allocations may impact the resulting costs by class. CRW can consider reviewing cost allocations prior to 2024 and implementing the changes, if any, in the 2024 Rates and Fees Study.

In addition to focusing on updating the COS models, Stantec recommends monitoring the equity of CRW's rates and fees for its water and wastewater utilities. CRW has an Excel modeling tool, prepared by 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. Stantec proposes that the equity analysis is updated prior to the start of the 2024 Rates and Fees Study to better inform next year's study and assist in further evaluation of CRW's rates.

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 a rate design model that updates its 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.

Finally, Stantec provided CRW staff guidance on updated affordability metrics and data sources needed during this study. 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). We recommend CRW continues to update these calculations in the future.

Stantec's specific recommendations for CRW's rates are found in the Summary of the Volume 1 of 2 2024 – 2028 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.

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Nichol Bussey, Business Solutions and Support Manager
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Reference: **Stantec Financial Review Services for Castle Rock Water's 2023 Rates and Fees Study, Volume 1 of 2, 2024 – 2028 Rates**

Regards,

Carol Malesky
Principal, Financial Services

Phone: 330-271-9125
carol.malesky@stantec.com

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