



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

September 15, 2021

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 2021 Rates and Fees Study, Volume 1 of 2, 2022 – 2026 Rates

As part of the 2021 Rates and Fees Study, Stantec Consulting Services Inc. (Stantec) was engaged by Castle Rock Water (CRW) 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.

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. Stantec recommends that the equity analysis is updated prior to the start of the 2022 Rates and Fees Study to better inform next year's study and assist in further evaluation of CRW's rates.

CRW continues to review and revise its water and wastewater cost allocations. Due to changes in financial forecasts and staff changes, time did not allow these changes to be included in the 2021 COS models. CRW can consider implementing the changes, if any, in the 2022 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 for a long-term period. Financially sustainable utilities demonstrate that each enterprise fund meets financial targets such as minimum reserves every year and properly plans for future capital expenditures. Stantec advised CRW to consider omitting the beginning fund balance

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deduction of the 60 days of operating expenses in the first year of the operating fund cash balance, particularly in the Water Resources Fund. The additional deduction was artificially limiting the amount of cash available for expenses in the first year of the model forecast.

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 2020 Rates and Fees Study. This separation of rate revenues and growth-related revenues and expenses provides better tracking 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. We recommend either using the FAMS tools for near-term financing or providing revenue and cost escalation assumptions for line items in the internal forecast.

Stantec did not update affordability metrics 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.

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,

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Principal, Financial Services

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