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Subject: Big Bear DWP
Review of Lake William Project Funding Alternatives

CDM is pleased to provide the following evaluation of funding options for a capital project at Lake William. Our intent is to provide information and analysis that will assist you and your Board of Commissioners in determining the financial effects of the various project options in your decision making process. We are available to answer questions and provide any further assistance you may require.

Methodology

CDM was asked to review the funding options for a defined capital project in the Lake William area of the DWP service area. This study is to review three funding options and to evaluate the costs and benefits of each option on DWP customers. The three funding options will include:

1. Distribution of capital costs to current and future customers throughout the Big Bear DWP service area.
2. Distribution of project costs to existing and future customers in the Lake William area.
3. Distribution of costs to all property owners within the Lake William area.

Along with the cost distribution analysis will be consideration of the service philosophy of the Department and the appropriateness and opportunity to allocate costs to all current and future DWP customers. Consideration of these policy issues is timely since the DWP is currently developing a Water Master Plan that is evaluating the water supply and reliability issues for the entire service area. When completed, this plan will identify a capital improvement program that will include projects that relate to the system condition, water supply and reliability, and provision of service to both current and future customers.

Background

The Big Bear DWP provides service to its customers by managing, maintaining and operating multiple water sub-systems. This utility system unification has established a community based service program that can provide a consistent and efficient perspective to water supply planning and operation. Through this organization, all areas of the service area receive the benefits of water supply planning, management and conservation. Water service costs are equalized throughout the system and the cost of capital facilities are supported equally by all customers, regardless of location or connection to any specific water sub system.

While there are four major water sub-systems (referred to as the Big Four), that provide water to the majority of Big Bear customers, the Lake William area is more remote and is served by a local well system. Despite, this geographic and system variation, the Lake William area is considered part of the DWP community service area and these customers pay the same fees and water rates that all other DWP customers pay.

As a component of its water supply management program, DWP has identified that the groundwater basin that provides water to the Lake William area can be affected by the drought in the region. Under non-drought conditions, it is believed that sufficient water is available for existing customers. Connection of additional users to this system and/or long periods of drought would tax the reliability of this water supply. Prudent planning has identified that the best alternative for provision of water supply reliability to this area would be installation of a pipeline that would link the area to the supply available from the Big Bear City Community Services District Erwin Lake system. Over the last few years, DWP has provided workshops and reports to area residents and the DWP Board of Commissioners in an effort to determine a plan of action for resolution of this issue.

Description of Lake William Water Reliability Facilities

The Lake William area consists of approximately 240 legal lots, of which 119 had been built on as of 2005. Development of property in this area is limited to 4 per year by DWP in recognition of the water reliability issues. The project option that has been identified as the preferred alternative is provision of transmission pipeline and pumping facilities between Erwin Lake and Lake William. Current cost estimates are that installation of this pipeline and related facilities would cost about \$1.5 million.

Options for Project Funding

During the development of this report, various options for funding this project were discussed which considered the evaluation of the current level of customer contribution, benefit and rational for distribution of costs. In order to have a complete picture of the current funding practices and other potential funding strategies the following brief summary of DWP revenues has been developed.

Table 1 DWP Sources and Uses of Funds as of January 2006		
Funding Source	Use	Current Value
Service Fees – System wide	Supports system debt (\$35.60), O & M (\$8.35) and System Rehab (\$14.27)	\$58.22 bi monthly
Standby Fees	Paid to support availability of service	\$53 per parcel/year
Water Commodity Rate	Pays for cost to produce and supply water, a commodity based fee	Tiered fee based on use
Connection Fees	Supports capital costs to build projects that provide water to new development	\$5,215 per connection
Supplemental Water Source Fee	Paid by new connections to build facilities that will yield additional water from a source that is otherwise not useable (i.e. requires additional treatment to meet potable standards)	\$1,055 per connection (Not paid by Rim Forest)
Water Demand Offset Capacity Charge	Paid to support water conservation program that is designed to reduce existing water demand so that supply is available for new users.	\$1,117 per connection (Not paid by Rim Forest)
Fund Reserves	Funds are used to handle emergency repairs and to assure system operation regardless of revenue stream variations.	Reviewed with Budget Development
Bond Proceeds	Issued upon approval of elected officials to support capital program that cannot be funded by "pay as you go" method.	None currently available
Developer Built Facilities	Water delivery systems built to serve a particular development. (These may include localized facilities that are at the cost of the developer and facilities built on behalf of the DWP to obtain water service)	Specific to development project

As can be interpreted from the information in the table above, there is no outside or new source of funding for capital projects for DWP's Big Bear water system. Basically, all funding comes from the current and anticipated users of the system. Efforts can be made to allocate costs through monthly service fees which support the availability of the system to all property owners and through water commodity charges that pay for the more measurable operating costs of water provision. The connection fees that are charged to new development are designed to target the particular water supply problems that can be compounded by the addition of new customers to the system. The collection of all of these fees provides the financial basis for the operation of the whole DWP Big Bear water service system.

The current structure of fee collection within Big Bear DWP does not designate benefit zones. The one exception to this is the Rim Forest area, which has a higher service fee related to localized system improvements that were needed at the time that the area was purchased

Mr. Jerome D. Gruber
March 20, 2006
Page - 4 -

from So Cal Water. The decision to carry Rim Forest as a separate benefit zone occurred at the time of purchase of the Big Bear water system, because of its remoteness and also because the area already received State Project Water. It was also determined that Rim Forest would not pay the Supplemental Water Supply Fee or the Water Demand Offset Capacity Charge due to the availability of State Project water to this area.

Unlike Rim Forest, property in Lake William is subject to all the current development fees charged by the DWP, is not eligible for State Project water and has never been identified as a separate zone from the rest of the larger Big Bear DWP service area. This doesn't mean that this is not possible, it is just an option that must be considered carefully. The adoption of separate benefit zones brings with it more complex fee application and system management structure that can create confusion and perception of unfairness in relation to cost of service. In addition, the establishment of benefit zones could be viewed as a special assessment program that could require additional legal evaluation and potentially a vote of approval from the affected property owners.

When considering funding for the Lake William Project it is worth noting that the Big Bear DWP Water Master Plan that is being developed will soon be available, and will include a list of capital projects that have been identified for both maintenance, rehabilitation and water supply reliability for the Big Bear water system. As a part of the master plan, each of the projects will be analyzed to identify benefit to current and future users. That is, if a project is needed to replace a failing water line and when replaced, the pipeline size is increased to provide for additional capacity for future users, then a portion of the pipeline project cost can be allocated to current users (paid by user fees) and future users (paid by connection charges). This is a fairly straight forward process and the basis of fee development can be easily documented. In addition, sometimes projects that are completely growth related can be delayed until funding becomes available or until a developer is willing to finance the project in order to provide service to his development.

If one reviews the Lake William project as a component of the agency's larger master planning effort and Capital Improvement Program (CIP), it is a project that is essentially needed to provide water reliability. There is a component of the project that can be defined as benefit to future users, but in general, this project is needed to provide reliable water service to existing DWP users. When considered in conjunction with all of the other projects that will be included in the master plan, it would be reasonable to consider it to be part of a larger program of water reliability for the DWP service area. With that view, the cost of this project would be melded with all others, and customers from the whole service area would pay an equal share of the cost.

If this project were to be kept separate from the master plan and funded by only Lake William customers, then those customers could reasonably ask to be exempt from payment for any of the other rehabilitation or reliability projects that might serve other areas of the system. In

this evaluation, however, the three funding options assume that Lake William customers will continue to support all DWP operating and capital programs.

Financial Impact on Various Customer Groups

As noted in the beginning of this report, CDM was asked to evaluate the cost impacts of three funding options. These options are itemized in the table below with indication of potential cost impacts to system wide customers and Lake William customers.

Table 2
Evaluation of Three Funding Options and Allocation of Costs

Funding Options	Bi-monthly Service Fee						New Development Connection Charge		Estimate of Revenue Generated over 20 years
	All other DWP customers	change from current	Existing LW customers	change from current	All new LW customers	change from current	Lake Williams Development	change from current	
Current Charges	\$ 53.88		\$ 53.88		\$ 53.88		\$ 7,387		
Option 1 - DWP CIP	\$ 54.71	\$ 0.83	\$ 54.71	\$ 0.83	\$ 54.71	\$ 0.83	\$ 7,387	\$ -	\$ 1,500,000
Option 2 - 50% DWP 50% LW (all monthly fee) (calculated based on average of 167 cust per year)	\$ 54.30	\$ 0.42	\$ 91.74	\$ 37.86	\$ 91.74	\$ 37.86	\$ 7,387	\$ -	\$750,000 from LW, \$750,000 from all DWP customers
Option 2A - LW share existing over 20 years, new pay in full	\$ 54.30	\$ 0.42	\$ 80.78	\$ 26.90	\$ 54.30	\$ 0.42	\$ 10,565	\$ 3,178	
Option 3 - 100% LW (calculated based on average of 167 cust per year)	\$ 53.88	\$ -	\$ 128.76	\$ 74.88	\$ 128.76	\$ 74.88	\$ 7,387	\$ -	\$ 1,500,000
Option 3A - existing over 20 years, new pay in full	\$ 53.88	\$ -	\$ 106.84	\$ 52.96	\$ 53.88	\$ -	\$ 13,743	\$ 6,356	\$ 1,500,000

The above table presents the monthly service fee and connection fee impacts for Lake William customers for the various options identified. Options 1, 2 and 3 assume that the cost will be recovered via the bi-monthly service charges only over a 20 year period. The 2A and 3A options assume that the Lake William costs will be collected from the current customers via a surcharge on their bi-monthly service fee. New connections in Lake William will pay their parcel's share of the cost in full upon connection. This approach would require that Lake William have two classes of customers for billing purposes.

The option (2) that allocates 50% of the project cost directly to Lake William customers has the potential to add \$38 dollars per bi-monthly bill. Alternatively, if costs were charged up front to new connections (Option 2A), then \$3,178 would be added to the current \$7,387 connection fee, and the existing 119 customers would pay an additional \$27 per bi-monthly bill for 20 years.

The option (3) that allocates all project costs to Lake William customers has the potential to add \$75 dollars per bi-monthly bill. Alternatively, if costs were charged up front to new connections (Option 3A), then \$6,356 would be added to the current \$7,387 connection fee, and the existing 119 customers would pay an additional \$53 per bi-monthly bill for 20 years.

Decision Options

The following summarizes the DWP decision options:

1. No Project

Under this option, DWP could choose to take no action to provide an alternate water supply for this portion of the service area. If a shortage was to occur, then water supply would be provided via temporary methods such as bottled or trucked in water. Costs for such an event would depend on the term of the shortage and on the service options available at the time.

2. Approve Project in DWP CIP using traditional project funding approach

Under this option, the Lake William project would be included within the larger Capital Improvement program and would be supported by the Department's existing revenue stream provided by fees and payments made by all customers. There would be no distinction of benefit zones or varied fee structuring in the service area.

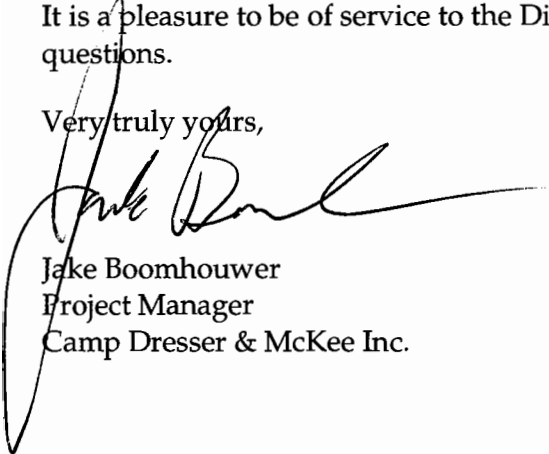
3. Approve Project in DWP CIP with special funding requirements of Lake William customers

Under this option, DWP would provide none or some share of funding through the normal CIP funding process. The remainder of the funding, while advanced by DWP, would be repaid via a surcharge to the bi-monthly service charge only or by an additional connection fee to be paid by new connections along with a bi-monthly service fee surcharge paid by existing customers in the Lake William area.

This option has been evaluated under four scenarios. Two options consider fully funding the share allocated to Lake William customers by an additional surcharge to the bi-monthly service fee. Alternatively, two options require that new customers pay the additional cost in full at the time of connection, and existing customers pay over 20 years through a surcharge on the bi-monthly service fee.

It is a pleasure to be of service to the District in this matter. Please call us if you have any questions.

Very truly yours,



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