

Terrace Lakes

Summary of Rate Study Findings

September 17, 2024

Introduction

Terrace Lakes Water Company requested assistance from Rural Community Assistance Corporation (RCAC) to conduct a comprehensive rate study for their drinking water system. The purpose of the study was to evaluate whether the current water rates meet the system's financial needs and to assess the impact of a \$2.7 million loan for necessary infrastructure upgrades on future rates. Additionally, Terrace Lakes is set to receive a \$3.7 million grant to aid in their water system improvements. This report presents the findings of RCAC's evaluation and offers recommendations for rate adjustments to ensure financial stability.

Methodology

This study is guided by the following three principles: Sustainability, Fairness, and Justifiability. Rates should cover the costs of the system to allow it to provide services now, and in the foreseeable future. The staff & board should stay aware of the changes to existing laws, community growth and demand which will require more water rights or further treatment, and therefore keep their capital replacement plan up to date. Rates should be fair to all rate payers. No single rate payer or group of rate payers should be singled out for different rates without logic & justification. The Town should not charge more for services than the cost to provide the service and save appropriately for future expenses, nor should customers be charged more for the sewer service than the reasonable cost to provide that service now and into the future. Unreasonably low rates for current customers will require unreasonably high rates for future customers, which should be avoided. To keep up with inflation, all scenarios considered in this study included an annual increase to the base rate year over year.

The following assumptions were made for these financial projections were made based on information provided by District staff:

- A growth factor of 1% annually
- An inflation factor of 4.0%

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Disclaimer: The recommendations contained in this study are based on financial information provided to RCAC by Terrace Lakes Water. Although every effort was made to assure the reliability of this information, no warranty is expressed or implied as to the correctness, accuracy or completeness of the information contained herein. Any opinions, findings, and conclusions or recommendations expressed in this material are solely the responsibility of the authors and do not necessarily represent the official views of HHS or USDA Rural Utilities Service. For accounting advice, a CPA should be consulted. For legal advice, the Town should seek the advice of their attorney.

Background: Terrace Lakes Water Company has not increased its water rates in several years, leading to ongoing financial deficits. The current infrastructure, particularly the distribution system, requires significant upgrades. Terrace Lakes has already completed a facility plan and has contracted with Keller Associates to carry out the engineering report and construction for the necessary upgrades.

At present, Terrace Lakes charges a flat fee of \$47 per month for residential water users and \$376 per month for commercial users. The water system has very few water meters in place, which limits the ability to promote water conservation or implement usage-based billing. RCAC strongly recommends installing water meters for every connection to facilitate future rate increases and encourage conservation.

Current Financial Situation: The water company currently has \$15,000 in its checking account and \$11,000 in its savings account. There is no dedicated emergency reserve fund, which puts the system at risk in the event of an unexpected failure of any critical asset. RCAC recommends establishing an emergency reserve fund of at least \$18,000 to provide financial protection in such cases.

The current annual operation and maintenance (O&M) costs for the water system total approximately \$290,000, which does not include payments existing loan. However, the revenue generated from water sales amounts to only \$270,000 per year, already creating a deficit before considering loan payments.

Findings and Recommendations:

1. **Rate Adjustments:** To eliminate the ongoing budget deficit and to ensure that the system can support its operating expenses, RCAC recommends a phased rate increase over the next three years:
 - **Year 1:** A 15% rate increase
 - **Year 2:** A 10% rate increase
 - **Year 3:** A 10% rate increase

This gradual approach will help balance the budget while avoiding sudden, steep increases that could burden residents and businesses.

2. **Water Meters Installation:** RCAC strongly recommends that Terrace Lakes Water Company install water meters on all customer connections. This would not only promote water conservation but would also allow for future rate increases based on actual usage, which can be fairer for all customers and better reflect the true cost of service.
3. **Emergency Reserve Fund:** Establishing an emergency reserve fund is critical to the system's long-term financial health. RCAC recommends setting aside at least \$18,000 in an emergency reserve fund to cover unforeseen costs related to asset failures.
4. **Future Rate Study:** Given the planned \$2.7 million loan for system upgrades, RCAC recommends conducting another rate study within the next three years. This will ensure that future rates are sufficient to cover both the loan repayments and ongoing operational costs.

Conclusion: Terrace Lakes Water Company faces several financial challenges that must be addressed to maintain and improve its water system. RCAC's recommendations, including phased rate increases, installation of water meters, and the establishment of an emergency reserve fund, will help the company balance its budget and meet its future financial needs. Additionally, a follow-up rate study in three years will ensure that Terrace Lakes is on track to handle its loan payments and future infrastructure needs. By implementing these changes, Terrace Lakes can position itself for long-term sustainability while continuing to provide reliable drinking water service to its community.