NewGen Strategies & Solutions

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March 31, 2015
via email: kregister@bryantx.gov

Mr. Kean Register
City Manager
City of Bryan
300 South Texas Avenue
Bryan, Texas 77803

Subject: Proposal to Conduct Water and Wastewater Cost of Service and Rate Design Study

Dear Kean,

NewGen Strategies & Solutions LLC ("NewGen") appreciates the opportunity to propose our assistance to the City of Bryan ("City"). It is our understanding that the City is seeking a qualified consultant to conduct a comprehensive Water and Wastewater Cost of Service and Rate Design Study ("Study"). As part of the Study, we propose to utilize a five-year forecast of water and wastewater revenue requirements and develop accompanying rate scenarios that will meet the City's revenue recovery objectives. As an optional task, if desired, an electronic rate model will be provided as part of the Study deliverables.

Proposed Project Team

For this engagement, the proposed NewGen project team ("Project Team") will include Mr. Joe Mancinelli, Mr. Grant Rabon and Ms. Stephanie Crain.

Joseph Mancinelli

Mr. Mancinelli is the General Manager and President of NewGen's Energy Practice and has more than 25 years of COS and rate design experience for electric, water, wastewater, and natural gas utilities. He has worked closely with public utility commissions, senior management teams, utility boards, city councils, attorneys, and end-users with respect to the strategy and technical fundamentals of COS and rate design. He has taught numerous classes on COS and rate design methodology, including a COS and rate design course for Electric Utility Consultants, Inc., since 2004. He is an expert in approved industry methodologies adopted by the National Association of Regulatory Utility Commissioners, the American Public Power Association, and the American Water Works Association. He regularly speaks at conferences across the country on COS and rate issues.

Grant Rabon

Mr. Rabon has ten years of experience conducting cost of service and rate design studies for electric, water, wastewater and solid waste utilities. He has performed or managed in excess of twenty-five (25) COS and rate design studies for various utilities and has submitted expert testimony in regulated utility proceedings. His educational background, including a BS in Chemical Engineering and an MBA, facilitates a unique understanding of the financial implications for technical projects. Further, he is one of less than 30 individuals in the nation with an ASA designation in Public Utilities from the American Society of Appraisers

Stephanie Crain

Ms. Crain has over four years of experience providing financial analyses for various clients. Her area of focus primarily falls within utility cost of service, rate design, and financial analysis. She has earned a Bachelor of Arts in Mathematical Economic Analysis.

Proposed Work Plan

To perform the requested Study, the Project Team proposes the following work plan. Our proposed work plan closely follows the approaches and methodologies utilized by the Project Team members in virtually all of their water and wastewater cost of service and rate design studies. Therefore, the City can be assured that the work plan proposed by NewGen has been tested and proven in numerous studies across the state and nation. It is understood that, if selected, the Project Team will refine, customize, and finalize the work plan with the City upon award of the project.

Further, it is worth noting that NewGen maintains a strong and active presence before the State of Texas' rate regulatory authorities and is routinely requested to provide expert opinions on rate matters by legal counsels representing clients throughout the State of Texas. For NewGen to maintain its reputation and presence within the regulatory environment, our product must be of such quality to withstand intense scrutiny. The work product(s) developed by NewGen for this engagement will reflect this level of expertise.

Task 1 – Initiation of Initial Data Request

The Project Team will develop an initial data request to reflect the information that will be needed to adequately begin the review and evaluation of the City's retail water and wastewater rates. This data will include, but is not limited to, operating, financial, management, policy, and ordinance data. The purpose of the initial data request is to become more familiar with the City's operations and policies in order to maximize the effectiveness of our time with City representatives during the project kick-off meeting. The Project Team will issue the initial data request within five (5) days after receiving notice to proceed on the project.

Task 2 – Initial Data and Information Assessment

Once the City has submitted the initially requested data, the data will be reviewed for discussion during the project kick-off meeting. Throughout the course of the project, data received by the Project Team will be sampled and tested for accuracy. It is essential in the development of proper cost allocations and reliable revenue projections that the billing data be as accurate as possible. NewGen will work closely with the City's billing staff and/or software provider to extract the appropriate billing data. In addition, as necessary, the Project Team will conduct informal interviews with City staff during our review of the historical data to ensure that the Project Team understands the information provided.

Task 3 – Project Kick-off Meeting

After receiving the initially requested data, the Project Team will work with the City to schedule a kick-off meeting. The primary reason for the kick-off meeting is to allow the key Project Team consultants and participants from the City to be introduced and lay the general framework for how the Study will be conducted. This meeting will also allow for the finalization of the proposed work approach, as well as discuss and clarify the information analyzed in Task 2.

In addition, the project kick-off meeting will allow for the Project Team to gain a better understanding of the goals and objectives, as well as expectations, the City desires to achieve from the Study. As part of the kick-off meeting, the Project Team members will also discuss:

- Political and customer views/opinions of current rates;
- Capital/operational demand changes anticipated over the Study's forecasted period;
- Initial rate design pricing objectives; and
- Initial strategies for implementing/communicating possible rate changes.

Task 4 – Review of Revenue Requirement Forecasts

We understand that the City has financial models that it utilizes to forecast revenue requirements for the water and wastewater utilities. NewGen plans to utilize these models for the purposes of developing cost of service and rate design analyses. Further, NewGen will work with the City to understand the development and assumptions underlying the financial models utilized by the City. NewGen will suggest changes to the financial forecast, as necessary, to better align with the needs of cost of service and rate design analyses.

Interviews with City staff may be conducted to gather additional data to complete this task, as necessary. During this task, it is crucial to thoroughly analyze the assumptions used in projecting the revenue requirements. These assumptions may include, but may not be limited to, growth rate, inflation rates, regulatory changes, conservation, increase in contractual obligations, and capital improvements. These assumptions will be supported by standard industry forecasting practices and available indices.

If desired by the City, NewGen can also independently develop a financial forecasting model for each utility that is customized to interface with the cost of service models as described in Tasks 4 through 8 below. This effort is an additional service and is not included in our cost estimate.

Task 5 – Determination of Realizable Revenue at Current Rates

The results of this task will provide the data to properly evaluate the cost of service, the magnitude of overall increases, if any, and the probability of redistribution of revenue responsibility between customer classes as well as providing the Project Team the ability to compare the actual cost to provide utility service with the anticipated billed revenues of the utility. In the revenue determination, adjustments will be made to the historical billing data to reflect normalized weather conditions and usage, as appropriate. This task will also provide a "check" of the data provided by City staff.

Task 6 – Functionalization of Revenue Requirements

Functionalization is the process of grouping costs based on the function, or type, of service provided. Discussions will be held with City staff to understand the types of services that are provided by the City (e.g., raw water supply, water treatment, transmission/distribution), and what system information is available from the City, to determine the appropriate functional cost categories to be utilized in the Study.

Task 7 – Classification of Revenue Requirements

After the development of the functionalized costs in Task 6, costs are classified into the components of utility service that are provided. For the water utility, it is proposed that costs be classified using the AWWA recommended Base Extra-Capacity method, where costs are classified as base, extra-capacity and customer related.

For the wastewater utility, based on the fact that the City has an active industrial pre-treatment program, it is proposed that costs be classified using the Water Environmental Federation ("WEF") recognized flow, BOD, TSS, and customer parameters. Classification of wastewater costs in the proposed manner will facilitate the evaluation of the City's current industrial strength surcharge and the ongoing management of the City's pretreatment program.

It should be noted that these are our proposed classification methods. Discussions will be held with City staff before the finalization of the agreement between the City and NewGen to determine the appropriate classification methods to utilize in recognition of the City's objectives and available system and billing data.

Task 8 – Allocation of Revenue Requirements

One of the most important considerations in the setting of fair and equitable rates for utility service is the establishment of the appropriate grouping of customers (i.e., customer classes for cost distribution after costs are classified). Generally, a customer class should only include those customers who: (a) are in a similar location in relation to the utility; (b) use the same or similar service from the utility; and (c) place similar demands upon the utility. As part of the City's request, the Project Team will analyze the usage patterns of the presently defined customer classes in the above context and evaluate whether a new classification of customers or amendment to the current classification should be recommended.

Costs within each utility will be allocated to the selected customer classes based on each customer class's level of service provided by the City. It is imperative that the factors that form the basis of costs incurred by the City to provide continuous and adequate service to its customers be appropriately identified. This identification requires a thorough understanding of the influencing conditions controlling the design and/or actual operation of a system. These conditions include normal and peak weather conditions. Members of the Project Team are thoroughly versed in appropriately identifying these costs. The factors for the allocation of costs to the customer classes will be dependent on the billing and system information available from the City.

In particular, we understand the City is interested in identifying and quantifying the additional costs associated with providing service to customers outside its City Limits. Further, the City is interested in knowing if a certain subset of the customers outside the City Limits should be charged differentiated rates pursuant to an agreement with another local water provider. These issues will be investigated by NewGen during the Study.

After the forecasted revenue requirements are allocated to the customer classes, the Project Team will compare the revenue requirements by customer class to each customer class's revenue generation under current rates. This will provide the City with the magnitude of the potential rate adjustments needed for each customer class to recover its cost of service.

Task 9 – Development of Rate Design

In the formulation of a rate design plan, a clear and distinct understanding of the City's overall goals and objectives should serve as the foundation for the development of options since rate design enables the utility to meet its service pricing objectives. Pricing objectives could include, but would not be limited to:

- Cost of Service Recovery
- Revenue Stability
- Affordability
- Equity
- Ease of Administration
- Regional Competitive Position
- Conservation
- Economic Development

The Project Team will discuss with City staff the potential rate design alternatives that meet the City's pricing goals and objectives. From these discussions, the Project Team will develop defensible rate structures that are reflective of industry accepted practices, procedures and rate regulations within the State of Texas and which balance the recovery of revenue between fixed charges and volumetric rates on an equitable basis.

Reclaimed Water Rate

The Project Team will also work with City staff to navigate the relevant policy issues in order to develop a reclaimed water rate. These type of rates are typically set by policy based on a percentage of the retail potable water rate.

Task 10 – Determination of Realizable Revenue with Rate Adjustments

The Project Team will analyze and compare the revenues forecasted to be generated under designed rate structures, by customer class, to the forecasted cost of service. This analysis will ensure the adequacy of the designed rate structures to meet the City's financial goals, including bond coverage requirements and operating and capital reserve requirements over the study period. To the extent the designed rates are projected to be inadequate, appropriate rate adjustments for each class will be calculated. In the revenue determination, adjustments will be made to the historical billing data to reflect normalized weather conditions and usage, as appropriate. Also, the monthly impact of rate adjustments on customer bills under the designed rate structures will be examined.

Task 11 – Draft Report Preparation

The Project Team will develop a draft report summarizing findings, conclusions, and recommendations of the Study. The report will include all methodologies, assumptions, and calculations in support of NewGen's recommendations. The Project Team is committed to ensuring that the City thoroughly understands the recommendations in the draft report and will be available to discuss findings, answer questions, and receive input. The Project Team will ensure that City staff has sufficient time to address their concerns and/or questions prior to finalizing the report.

Task 12 – Final Report Preparation and Presentation

Upon receipt of City staff comments, the Project Team will make appropriate changes and provide the City with a final report. After completion of the final report, the Project Team will assist the City in the presentation of the results of the Study to various stakeholders, including presenting the Study's findings, conclusions, and recommendations to the City Council, if desired.

OPTIONAL TASK – Finalization of Model and Training Session

The development of the financial forecasting and rate models will occur throughout the course of the project. Once the project has been finalized, if requested by the City, the Project Team will work to form these models into user-friendly programs for use by City Staff.

NewGen prides itself in developing user-friendly models which are specific to, and reflect the unique operational characteristics of, each client. While our Project Team utilizes standard best practices in developing rate models, each model we develop is unique and does not reflect a "canned" or "off-the-shelf" product. Given the unique nature of each of our clients, we believe it is important that the product produced as part of a rate study also be unique and reflective of our client's overall goals and objectives.

The City's model will allow staff to run "what-if" scenarios including, but not limited to, changes in operating or capital costs, customer and volume growth or decline, debt service structure, source costs, inflation, capital project financing, and funding sources. The model will allow the user to assess the impact various scenarios will have on an existing typical monthly bill for each class of customer. The model will also generate financial statistics such as debt coverage ratios and average dollar and percentage change for each customer class.

To ensure the model is fully useable by staff, the Project Team will conduct a hands-on training session with key model stakeholders upon delivery of the model and will discuss every worksheet within the model and fully demonstrate its functionality. As evidence of our commitment to the City, the Project Team also agrees to provide remote and on-site technical support on the model's functions and capabilities for a full year following the Study at no extra charge.

Project Coordination and Reporting

For a cost of service and rate design study to be successful, input into the project and ownership of the results by the City staff, City Council, and ratepayers must occur. Efforts to achieve this success include the enhancement of communication between the City and the Project Team through several coordination activities provided within the scope of services, such as the Project Kick-off Meeting to allow the project participants to finalize the work approach. In addition, after Tasks 8 and 10, the Project Team will conduct briefing presentations with City representatives on the Study's activities to-date. Also, the Project Team will assist City staff in the presentation of the Study's findings, conclusions and recommendations.

Project Timeline & Deliverables

The Project Team will provide the City with the following:

- Reports
    - Within 60 to 90 days of notification of award, given the timely receipt of the required financial and operational data, an electronic draft report will be provided for the City's review and comment that summarizes the Project Team's findings, conclusions, and recommendations.
    - A final report will be provided to the City within two weeks after delivery of the draft report, given the timely receipt of the City's comments.
- Meetings/Presentations
    - The Project Team will conduct four (4) meetings with City staff during the course of the engagement including: Project Kick-off Meeting, Project Update meetings after Tasks 8 and 10, and one presentation to the City Council. Additional meetings and/or presentations beyond those listed here will be provided on a time and expense basis.

Services requested by the City not specifically outlined within the proposed work plan, and which the Project Team is unable to provide within the proposed project pricing above, will be provided on a time and expense basis.

Resource Commitment by the City

For this project to be successful, NewGen will need the assistance of the City Manager, the City's Finance Department, and the department Director(s) responsible for water and wastewater operations. The bulk of staff time will be needed at the outset of the Study to gather required financial data, answer questions regarding the revenue requirement forecasts prepared by the City, and extract the utility billing data. NewGen will rely on the City to update and make changes to the City's financial forecast, as needed, to be appropriate for cost of service and rate design analyses.

The staff time needed to provide the necessary data for our analyses are highly dependent on the ease of accessing the requested information. Where possible, NewGen will work directly with the City's utility billing provider to extract the data necessary to complete the Study. Staff time will also be needed to provide guidance throughout the course of the project. Finally, the Project Team will require policy guidance from the City Council, either directly or through staff feedback, to ensure the Project meets the overall goals and objectives of the City.

Proposed Project Cost

Based on the work plan outlined herein, the Project Team agrees to perform the requested Study for a **not-to-exceed price of $48,500.** As an optional task, the Project Team will also provide the rate model and train City staff on its use for an additional **not-to-exceed amount of $3,250.** For an additional fee, NewGen can also independently develop a test year and revenue requirement forecast if desired by the City.

Our Project Team is committed to the success of the City and is seeking to develop a long-term relationship with the City – we desire a partnership with the City, not just an engagement.

Again, NewGen appreciates the opportunity to propose our assistance to the City and we stand ready to answer any questions or provide any additional information the City may need. If you should have any questions regarding this letter and/or require additional information, please contact Joe Mancinelli at (720) 633-9509 or via e-mail at jmancinelli@newgenstrategies.net.

Sincerely,

NewGen Strategies and Solutions, LLC

Joseph Mancinelli
General Manager