

Howard J. Woods, Jr. & Associates, L.L.C.

February 26, 2020

Mr. Richard Calbi, Jr., P.E., P.P.
Director of Operations
Ridgewood Water
131 North Maple Avenue
Ridgewood, N.J. 07450

Re: Proposed 2020 Budget

Dear Mr. Calbi:

I've reviewed the proposed budget for Ridgewood Water and it is my opinion that you have properly allocated shared Village expenses to the Water budget. The method you have used is consistent with the recommendations in my Water Utility Rate Study dated November 17, 2017 and my Supplemental Rate Study 2013-2016 dated December 29, 2017. In addition to the allocations of shared expenses, I have also reviewed your revenue calculations and the calculation of the available surplus revenue transfer up to 5% to the general fund. Here is a summary of my review and conclusions.

I've focused my attention on the overall revenue requirement and the allocations of Village costs to water. As a municipal water department, you have the advantage of being able to share certain expenses with the Village. These costs must be allocated equitably between the general fund and the water fund. In the Water Utility Rate Study, I developed fourteen allocation factors using the guidelines detailed in Seventh Edition of the Manual of Water Supply Practice M-1: Principles of Water Rates, Fees and Charges prepared by the American Water Works Association. In both the Water Utility Rate Study and the Supplemental Rate Study 2013-2016, I used these factors to allocate actual and budgeted general fund expenses to the water fund. The allocated expenses include the cost of the Village Central Garage, the water utility office space located in the Village Hall, property and casualty insurance, administrative support, governance and asset protection. In addition, a portion of the utility director's salary and benefits were allocated from the water fund to the general fund, recognizing that this position supports Village functions not related to water operations.

In developing your 2020 Water Fund budget, you used the 2018 audited expenses for the Village as the basis of your allocations. The audit represents the final statement of actual expenses for shared costs that must be allocated to the water budget. The

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2018 actual expenses are the most recent expenses that have been subjected to a financial audit, so these expenses form the most recent and reliable test period on which you can base your pro forma budget estimates. For each of the line items in your calculations, you used the appropriate allocation factor developed in the Water Utility Rate Study. The resulting allocation of approximately \$2.35 million is reasonable and appropriate. The Village expenses that are being allocated among the General Fund, the Parking Fund and the Water Fund amount to approximately \$50.6 million.¹ Therefore, only 4.6% of the General Fund expenses are being allocated to Water and 95.4% of those costs are retained in the General Fund or allocated to Parking.

The principal category of allocated expenses is insurance and pension benefits. This includes health insurance, workers compensation insurance, pensions and general liability insurance. Collectively, these expenses account for 61% of the total amount allocated to the Water Fund from the General Fund. Employee insurance and pension expenses are allocated based on the relative labor expense directly assigned to or shared with the Water Utility. Casualty and liability insurance is allocated on the basis of the relative value of Village and Water Utility fixed asset values and on the basis of the relative value of the Water Utility above ground assets and the assessed property values in the Village.

The next largest category of allocated expenses included salaries and wages. This accounts for another 33% of the total allocations to the Water Fund. Within this group, salaries and wages for direct support of the water utility operations from Engineering, Streets & Roads and the Central Garage, for example, are accounted for. The amount allocated to Water is approximately \$766,000. This is only 3.5% of the \$21.8 million salary & wage expense incurred by the Village General Fund.

The remaining shared expenses are for materials, supplies and services provided to support water utility operations and collectively, this accounts for only 6% of the total allocated to water.

N.J.S.A. 40A:4-35.1 permits the Water Utility to transfer surplus revenue collected to the General Fund. The amount cannot exceed 5% of the cost of operating the utility. This rule has been applied by the New Jersey Board of Public Utilities (“BPU”) in regulating municipal utility rates. Every municipality supplying electricity, gas steam or other product beyond its corporate limits is subject to regulation by the BPU (N.J.S.A. 40:62-24). In its regulation of municipal water utilities, the BPU has applied the 5% transfer as a surrogate for the return on equity capital earned by investor-owned utilities. Unlike investor-owned utilities, municipal utilities have no equity

¹ In the Water Utility Rate Study and in the Supplemental Rate Study 2013-2016, all Village general fund allocations to Water and Parking were reversed to establish a complete picture of the budget and actual expenses incurred by the Village. These expenses were then allocated among the General Fund, the Water Fund and the Parking Fund using the fourteen allocation factors.

capital in their debt structure. Only the debt service costs for bonds or notes exists and as a result, there is no direct method, using rate base rate of return regulation, to compensate the owners of such utilities for the risks and responsibilities they take on in raising capital and providing an essential service like potable water service. This transfer essentially becomes the replacement for the return on shareholder equity allowed in establishing investor-owned water utility rates. By way of comparison, I would like to note that the BPU is currently authorizing investor-owned utilities to earn 9.60% on equity capital so, while the 5% rule offers a municipal owner some compensation for risk, it is not on par with what investor-owned utilities are able to include in the rates they charge for service. I have reviewed the calculation of the 5% transfer amount in your proposed budget and it is my opinion that your calculation is consistent with the rule and the BPU application of the rule in practice.

With respect to revenues, I developed a linear regression analysis to predict consumption for your future years. I looked at rainfall, temperature, cooling degree days and Palmer-Z Index as potential variables to predict future consumption. None of these alone or in combination produced a strong correlation. With the exception of a peak in 2011, your water demands are trending down slightly. The downward slope is typical of what I see in other communities and it will likely continue into the future. More efficient appliances and plumbing devices are driving this and as customers replace older appliances or renovate kitchens and bathrooms, the trend will continue. The annual rate of decline I see over the 2005 through 2018 period for Ridgewood is about 0.59% per year. The addition of new customers and, in some cases re-purposing of existing properties and connections offsets part or all of this decline. Given the consistent system send-out for your water utility year over year, your use of a budget sales volume of 6.205 million gallons per day, which is equal to the average for the last five years, is appropriate.

Your method of budgeting revenues for 2020 is also consistent with the Department of Community Affairs ("DCA") guidelines. You are limited to last year's revenues plus the retained anticipated surplus. Any additional revenues required to cover the water fund revenue requirement must come from rate adjustments. Your budget makes a technical adjustment to the fixed service charge for 3-inch and 4-inch meters. This brings these charges in line with industry standards for establishing fixed service charges and ensures that all customers pay an appropriate amount towards the fixed costs of the utility. You have also calculated that an adjustment to the volumetric rate is needed in the second half of the year and that this adjustment should be 8%. The new volumetric rate you are proposing is \$5.22 per thousand gallons and this includes the \$0.01 per thousand gallons New Jersey water quality tax.

Your proposed rate compares favorably with the charges of other water utilities in the area and in New Jersey. I have attached a chart showing the anticipated annual water charge to a residential customer served through a 5/8-inch meter using 6,000 gallons of water per month. These charges are comparable to those charged by

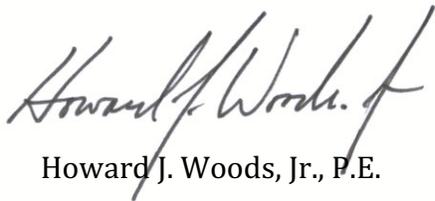
Passaic Valley Water Commission and are less than the charges levied by SUEZ Water New Jersey. What you have proposed results in annual charges very near the median value for the group of utilities shown in the chart.

Clearly, changing water quality regulations and the emergence of new but as yet unregulated contaminants will present challenges in the coming years. It is my opinion that the plans you have developed to augment treatment and obtain additional supplies will allow Ridgewood Water to continue its record of providing safe, adequate and proper water service. A key element of this plan is having adequate rates to support the necessary investments in utility facilities.

In summary, it is my opinion that the budget that you have proposed has been developed in a way that is consistent with industry standards and sound rate setting principles. The budgeted level of revenues is consistent with DCA guidelines and provides the Water Utility an opportunity to recover the full projected cost of providing service.

If you have any questions about my analysis, please feel free to give me a call.

Regards,

A handwritten signature in cursive script that reads "Howard J. Woods, Jr." followed by a stylized flourish.

Howard J. Woods, Jr., P.E.

Annual Charges of Select Water Utilities

Annual Charges Calculated for Average Monthly Use of 6,000 gallons/month. Current Tariff as of February 20, 2019

