SOME THOUGHTS ON THE PROPOSED MPSC RATE INCREASE – PART ONE

August 14, 2020

To the Massanutten Community:

We know there's a lot of concern – and no small amount of justifiable anger – regarding MPSC's proposed rate increase. We're fighting it, too – because even though it doesn't look like it, this is going to cost us more, too.

As such, we're offering two brief papers, so you can better understand what's going on. This, the first, addresses the rate increase itself. The second, which we'll post later, addresses common misconceptions about MPSC's wastewater treatment plant, why it was built, and some of the reasons we think MPSC's rate increase is excessive.

We view this as important because <u>your input to the The State Corporation Commission (SCC) is going to be important</u> if we're to keep rate increases to a reasonable level. We're familiar with the rate-setting process and we know how important comments from ratepayers are, so we strongly encourage you to file them. Your comments can be better informed if you understand the complicated process.

Regulated privately-owned utilities like MPSC are allowed, under Virginia law, to bill customers at rates designed to provide a Return on Equity (ROE). In other words, the rates are set so that the utility should profit up to a certain percentage of the owner's equity investment.

MPSC does so by charging for water and wastewater at rates per 1000 gallons. But as customers, residents and the resort alike aren't just paying for water and wastewater service. We also pay, one way or another, for the cost of wells, tanks, pumps, pipes, and other specialized facilities and equipment, and a profit on them.

Up until 2014, Great Eastern and area homeowners all paid the same rates per gallon for both potable water and wastewater. But that year, the SCC made a decision that set the stage for where we are today: they created several classes of rate payers – Residential, Hospitality, Commercial, and Waterpark.

After that change, it became evident that the return on equity was grossly disproportionate between classes. Homeowners were actually generating a NEGATIVE return on equity to MPSC, and the hospitality, commercial and waterpark classes were generating huge positive returns.

In the 2017 case, the SCC approved residential rates to generate a target 4.63% ROE, which would bring the residential class 50% to parity based on an overall MPSC system target ROE of 9.25%. Thus, all other classes would be subsidizing the Residential class's below-system-average ROE under the approved 2017 rates. The current result of the 2017 rates, however, are that they are not covering the utility's cost of service and are producing a system average ROE of -1.43% for water and +2.39% for sewer, much lower than the authorized ROE of 9.25% in the 2017 MPSC rate case.

Specifically, under the 2017 rates, the Commercial class currently generates an ROE of 9.79% for water and 15.15% for sewer; the Hospitality class ROEs are 0.46% for water and 2.93% for sewer, and the Waterpark produces whopping ROEs of 25.05% for water and 25.00% for sewer. At the same time, Residential rates currently generate NEGATIVE ROEs of 7.26% for water and 2.02% for sewer. Surprising as it may seem to you, those negative ROE numbers indicate that the Commercial, Hospitality and Waterpark classes are currently subsidizing residential homeowners; the 2017 movement to rate class parity in setting rates only reduced, but clearly didn't eliminate, the subsidies provided to the residential class.

Okay, so that's part of the differential. What else explains the differences in rates?

The difference fundamentally boils down to who paid for what parts of MPSC's infrastructure. The ski lodge, the clubhouse at the Mountain Greens course, a handful of other F&B related operations in the Kettle, and the pipes and infrastructure that serve homeowners were already in place when MPSC purchased the infrastructure from its previous owner. That investment is factored into the rate base. By contrast, most of the newer water and sewer infrastructure related to Great Eastern's subsequent developments was built or paid for and donated by Great Eastern under a development concept called Contribution In Aid of Construction, or "CIAC" (the wastewater treatment plant was also paid for by Great Eastern under CIAC, but we'll discuss that in the next installment).

This includes all timeshare developments, the Waterpark, the Woodstone building and so forth. The CIAC financing of this infrastructure means that MPSC owns assets that add to the company's overall valuation, but it cannot count them as equity to be paid for and profited on in setting rates. That's because they didn't put that equity into the system. They cannot generate ROE on the basis of assets that were given to them – either in our rates, or yours.

This is why the increases in Hospitality, Water Park and Commercial rates appear to be so much lower on a percentage basis, even though the ROE target will be at parity. MPSC proposes that the rate per thousand gallons will vary across the classes to pay for MPSC-installed infrastructure and the expense of serving each class. You could think of it this way: residential customers pay for their infrastructure over time. Great Eastern paid for most of its infrastructure up front.

That's why there's an apparent differential. But the bottom line is that under the proposed increase everyone pays more for water and wastewater service. Our rates are going up steeply, too – and that's why we're fighting this.

In our next post on this topic, we'll discuss the wastewater treatment plant and its financing. And we'll offer some thoughts as to why we believe MPSC's rate request is unreasonable.

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