

EXHIBIT O

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May 2, 2006

Mr. Richard Rudnansky, Esq.
Interim City Attorney
1010 Tenth Street
Modesto, CA 95354

Dear Mr. Rudnansky:

I should like to address two aspects of yesterday's meeting, after first, of course, thanking you very much for the opportunity which you afforded Mr. Thomas and me to present our views.

The first aspect which I think I must address is the scope of your charge by the City Council. As I understand it, you are to investigate the alleged variance (deficit) in water revenue projected to be received by the Finance Dept., and what was projected in Table 7-1 of the Foresight study for FY2006. Mr. Padilla has stated that there will be a \$6.6M shortfall with respect to the Foresight projection. On two occasions (the most recent being on April 11) I have attempted to point out that the arithmetic in Table 7-1 is erroneous. Mr. Padilla and Mr. Baird have both heard me say that it is flawed, and on April 11 I pointed out the specific error which led to the assertion of a shortfall. In our presentation yesterday, Mr. Thomas and I were intent on covering that very error, and also on demonstrating the results when that error was eliminated. Because the scope of the meeting ran well outside your charge, I believe that our point was lost. I have attached a marked up copy of Foresight Table 7-1 (Attachment A) in which I have demonstrated the key error. If I have understood your charge correctly, then this demonstration will (in the narrowest sense) fulfill that charge, in that I show that what was alleged to be a shortfall is actually a surplus of \$2.18M. I am quite disappointed that Mr. Padilla and Mr. Baird both chose to ignore my demonstration on April 11; had I been wrong in my statement, either of them could have stopped me cold on the spot. Given the foregoing, I submit that within the scope of your charge, and most importantly, within the parameters of the Foresight study, the appraisal which Mr. Thomas and I have done is correct. We stand by it.

In the next to last sentence of the above paragraph I made reference to the parameters of the Foresight study; they are central to the second aspect which I wish to address. In preparing the charts which we presented, Mr. Thomas and I used the terminology of the Foresight study, i.e., "Revenue Requirement" as a synonym for expense. We did so expecting that all those involved in the review which you are conducting would be familiar with not only the terminology itself, but also the tables in which it appeared (4-1 & 7-1 in particular). That Mr. Padilla was wholly unfamiliar with both the term "Revenue Requirement", and Table 4-1, is not just a disappointment to me; it troubles me greatly. It was Mr. Padilla who raised the matter of additional expenses, and in particular the Capital Improvement Projects (CIP's). Had he taken the trouble to familiarize himself with the Foresight study (18 months after its implementation) he would know that the CIP's were specifically excluded from the Revenue Requirements, and that Mr. Clumpton (Foresight) recommended that reserves for future CIP's not be initiated until FY2010. (see Attachment B) I believe that the field upon which we are to play and the location of the goals must remain within the parameters of Foresight. If Mr. Padilla wishes to expand the field and move the goals, I think it must be done as a policy decision; that is, the Council must amend or set aside Foresight and undertake a new study. If I sound rather put out, I am; it was, after all, Mr. Padilla who recommended that Foresight's contract be terminated. In my view that action was both precipitous and uninformed; Mr. Padilla denigrated a person of whose

work he knew next to nothing. Again, if we remain within the parameters of the Foresight study, the appraisal which Mr. Thomas and I prepared will stand up.

In the event that you did not receive a complete copy of our appraisal, I have included another set.

I remain at your service,

A handwritten signature in cursive script, appearing to read "Eric Reimer".

Eric Reimer

Foresight Water Rate Study

Projected Revenues (flat/metered)

Table 7-1
Financial Plan - Projected Rate Increases and Revenue
 City of Modesto

	Current		Projected Revenue Requirements and Rate Increases			
	FY 03-04	FY 04-05	FY 05-06	FY 06-07	FY 07-08	FY 08-09
Annual Net Revenue Req'ts. (a)	\$30,668,000	\$33,493,944	\$37,913,564	\$38,330,590	\$48,027,000	\$51,806,657
Revenue from Rates						
Revenue from Current Rates (b)	\$27,366,000	\$28,322,000	\$28,775,000	\$29,235,000	\$29,703,000	\$30,178,000
Revenue from previous year rate incr.	\$ -	\$ -	\$ 10,071,250	\$ 18,125,700	\$ 25,633,689	\$ 28,854,895
Subtotal	\$27,366,000	\$28,322,000	\$38,846,250	\$47,360,700	\$55,336,689	\$59,032,895
Current Year Surplus/(Deficit)	(\$3,302,000)	(\$5,171,944)	\$932,686	\$9,030,110	\$7,309,689	\$7,226,038
Surplus/(Deficit) (No Rate Increases)	(\$3,302,000)	(\$5,171,944)	(\$9,138,564)	(\$9,095,590)	(\$18,324,000)	(\$21,628,657)
Annual Rate Increase	0.0%	35.0%	20.0%	15.0%	5.0%	5.0%
Cumulative Increase	0.0%	35%	62%	66%	96%	105%
REVENUE FROM INCREASES (c)						
Effective Dec 1: FY 04-05 (d)		\$ 3,855,305	\$ 10,071,250	\$ 10,232,250	\$ 10,396,050	\$ 10,562,300
Effective July 1: FY 05-06			\$ 7,769,250	\$ 7,893,450	\$ 8,019,810	\$ 8,148,060
Effective July 1: FY 06-07				\$ 7,104,105	\$ 7,217,829	\$ 7,333,254
Effective July 1: FY 07-08					\$ 2,766,834	\$ 2,811,081
Effective July 1: FY 08-09						\$ 2,951,835
Subtotal - Revenue from Increases	\$ -	\$ 3,855,305	\$ 17,840,500	\$ 25,229,805	\$ 28,400,523	\$ 31,806,329
Total Annual Rate Revenue	\$27,366,000	\$32,177,305	\$46,615,500	\$54,464,805	\$58,103,523	\$61,994,329

Projected Revenue \$27.4m \$32.2m \$46.6m \$54.5m \$58.1m \$62m

April 11, 2006 Water
 Rate Review Workshop

Rate Increase FY05-06 : 20% over FY04-05

Proj. Revenue FY04-05 : \$32,177,305

\$32,177,305 x .2 = \$6,435,461 NOT \$17,840,500

Proj. Revenue FY05-06 : \$32,177,305 + \$6,435,461 =
 (Foresight) \$38,612,766

Proj. Revenue FY05-06 : \$40,792,106
 (Finance Dept.)

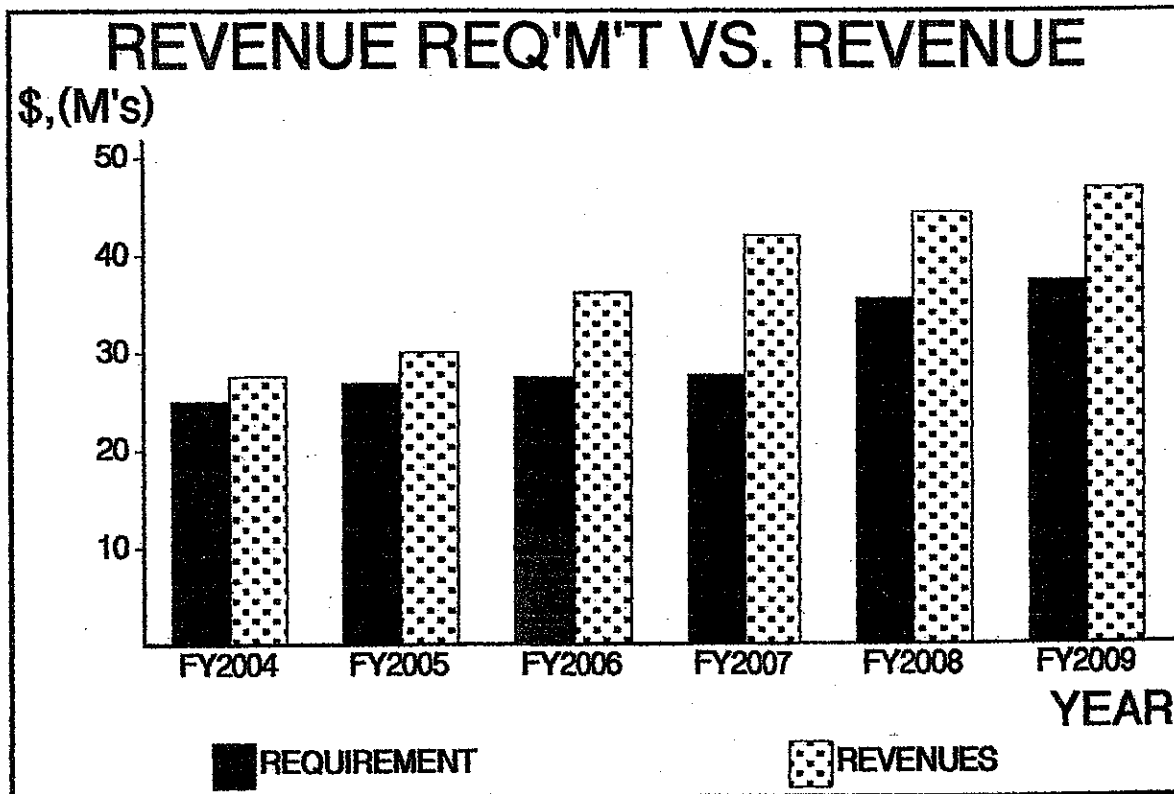
Surplus : \$ 2,179,340

3. The Annual Revenue Requirement of the City's Water Utility Will Increase Significantly Over the Next Five Years

The Water Fund's annual revenue requirement is projected to increase approximately 69% by 2008-09, increasing from a current amount of approximately \$30.7 million to more than \$51.8 million. This is primarily due to (1) the loss of numerous wells because of groundwater contamination, (2) debt service payments related to construction of a new MID surface water treatment plant, (3) funding the annual operation and maintenance of this new plant, and (4) construction of new downstream transmission and storage facilities. However, this does not include cash-funded CIP projects of approximately \$55 million that are allocated to existing customers, which will be paid out of reserve funds.

Future Capital Projects Reserve – City engineers have identified significant additional capital projects after 2008-09 that have not been included in the cash-funded CIP plans or reserves. These projects, which will be further evaluated when the City's updates its water master plan, include the metering conversion program and a potential Phase 3 of the MID treatment plant. It would be prudent for the City to begin building a separate capital reserve, starting in Year 6, for these projects in order to avoid another cash shortfall or unplanned rate increase.

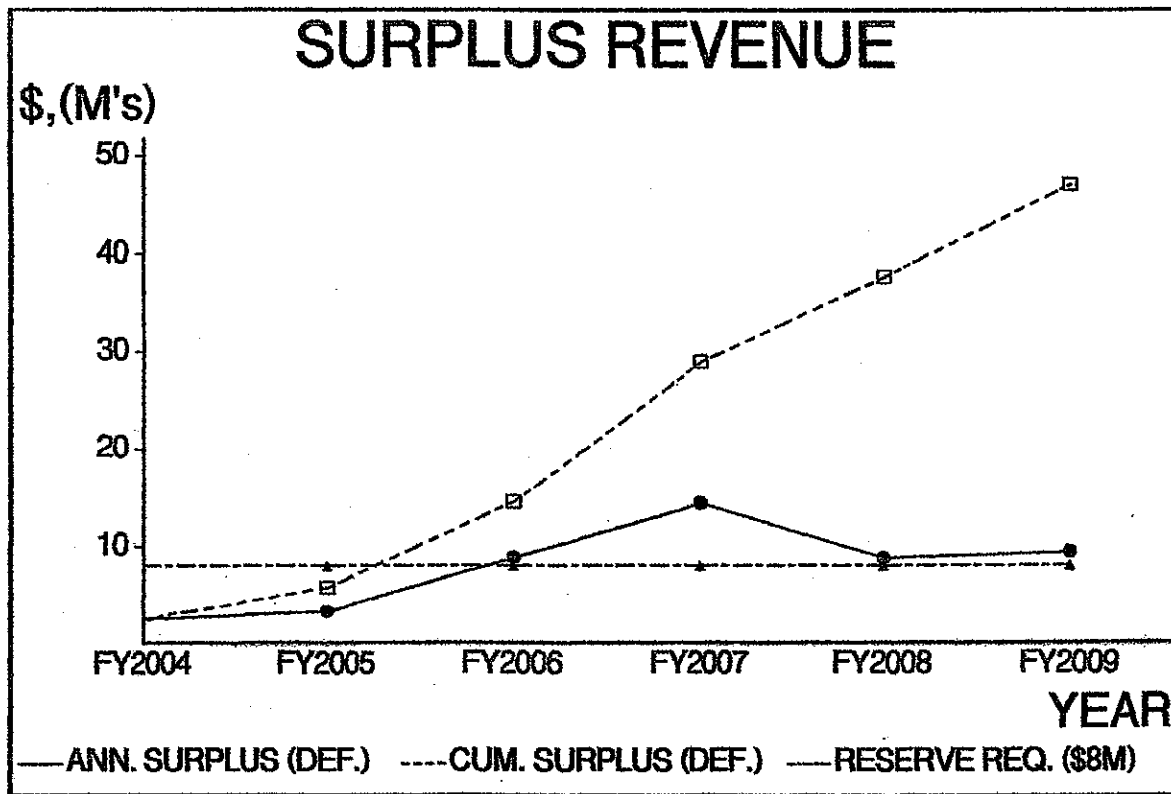
**CITY OF MODESTO
WATER UTILITY
EXPENSE AND REVENUE APPRAISAL**



REVENUE REQUIREMENT VS. REVENUE shows the Total Revenue Requirement as calculated in the table titled "PROJECTED WATER UTILITY BUDGETS", versus the Revenue actually received from Water Sales (FY04 & FY05) or projected to be received.

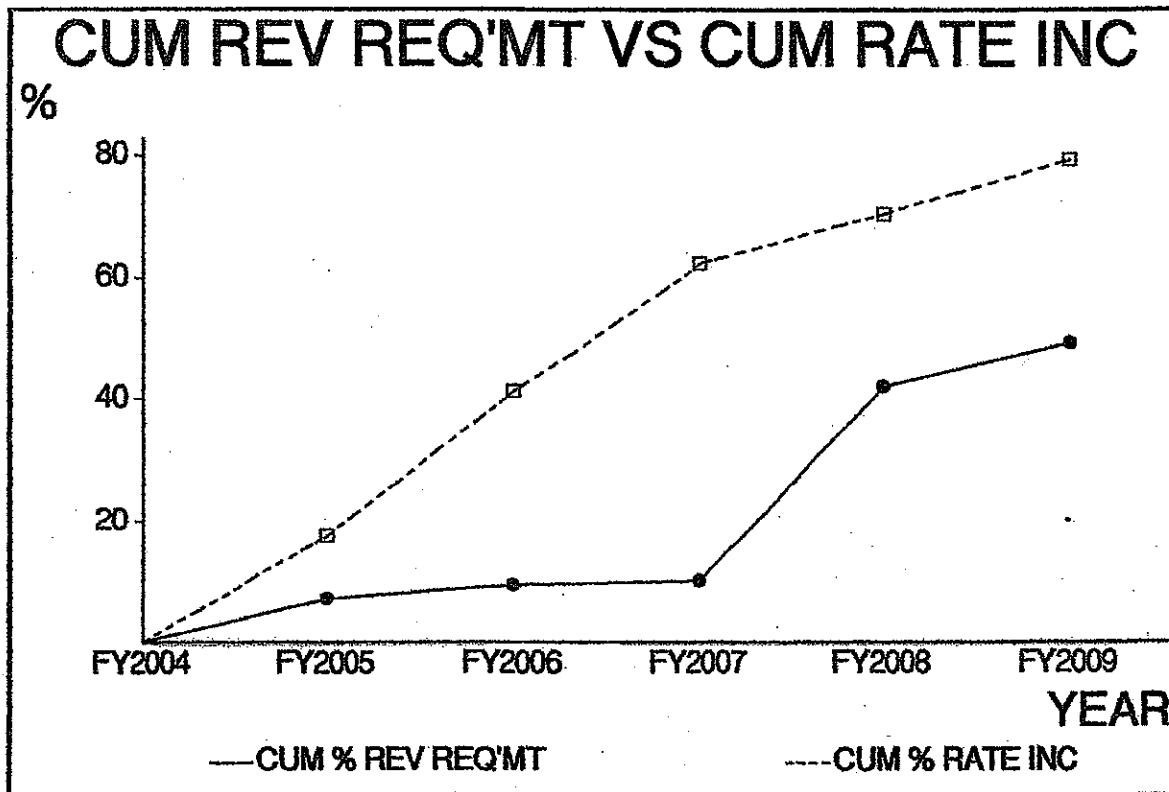
This chart uses the Revenue Rates which were established by Resolution by the City Council in November 2004; i.e., annual increases of 35, 20, 15, 5, 5 percent over FY04 rates.

Revenue in excess of Requirement is used to fund the Reserve. (Reserve Requirement estimated to be \$8M.)



SURPLUS REVENUE shows the excess of Revenue over Requirement (first Bar Chart) both Annually and Cumulatively, and their relationship to the Reserve Requirement (horizontal line).

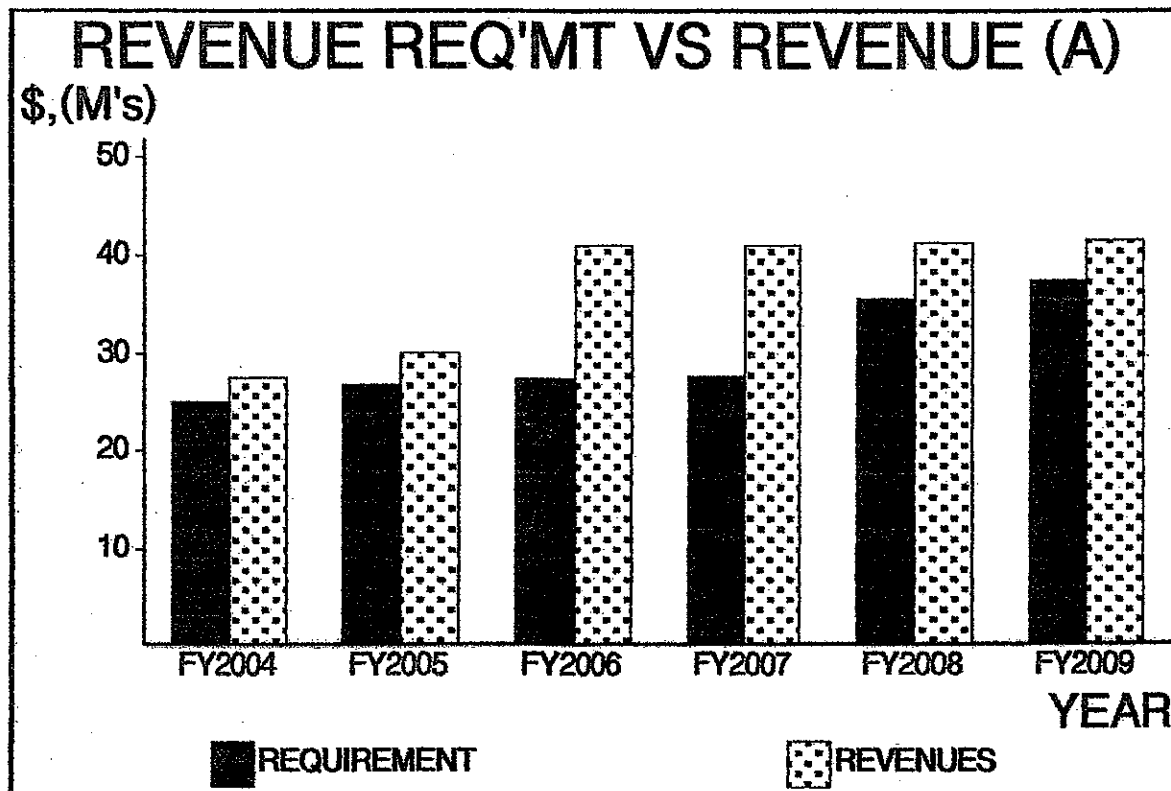
The calculation of the **SURPLUS REVENUE** amounts is detailed in the table titled "FINANCIAL RESULTS FROM RATES OF NOV. 2004"



CUMULATIVE % REVENUE REQUIREMENT VS. CUMULATIVE % RATE INCREASE shows the Total Revenue Requirement cumulative change over FY2004 (FY2005 requirement was up 7.1% over FY2004; FY2006 requirement was up 9.3% over FY2004; and so on.) versus the cumulative change in Rate Increases over FY2004.

By FY2009 the Revenue Requirement will be up 49%; the Rate Increase up 79%.

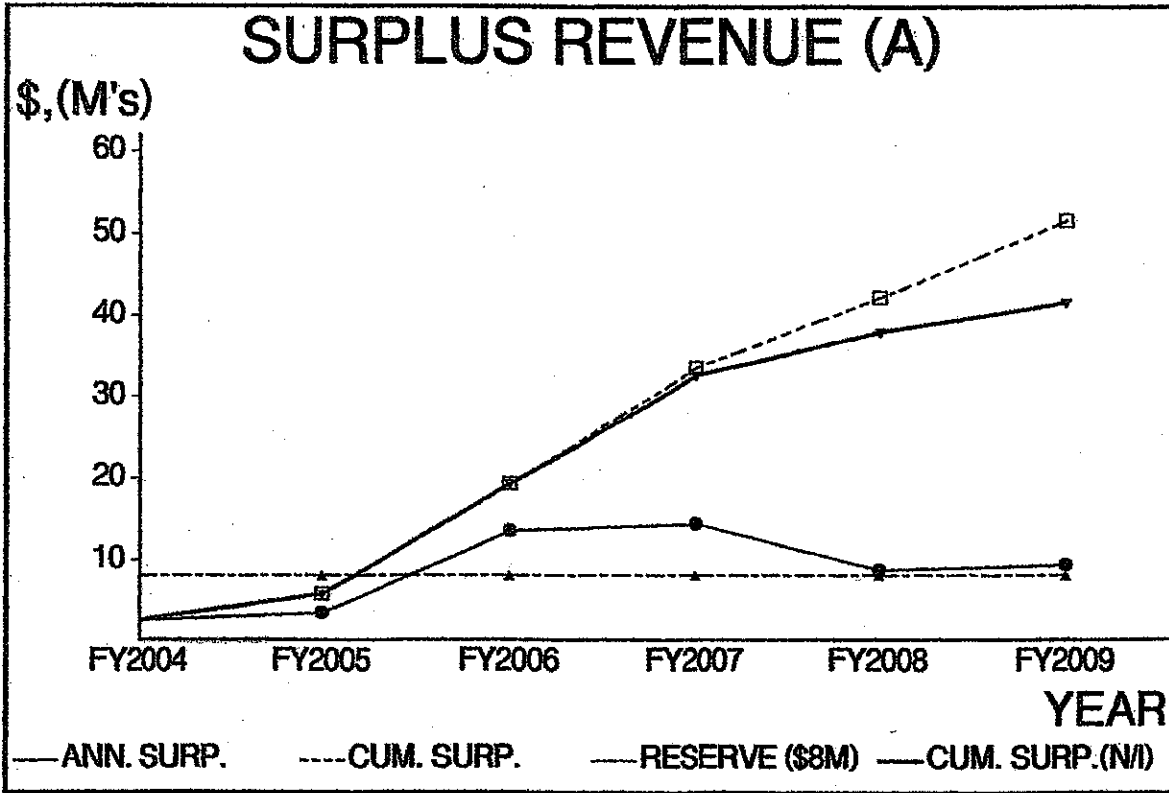
Revenue Requirement calculation appears in the table titled "PROJECTED WATER UTILITY BUDGETS"; RATE INCREASE calculation is in "FINANCIAL RESULTS FROM RATES OF NOV. 2004".



REVENUE REQUIREMENT VS. REVENUE shows the Total Revenue Requirement as calculated in the table titled "PROJECTED WATER UTILITY BUDGETS", versus the Revenue actually received from Water Sales (FY04 & FY05), and for FY06 and later years the Revenue projected by the City's Finance Dept. to be \$40.8M. (The \$40.8M revenue projection is kept constant for the purpose of constructing this chart.)

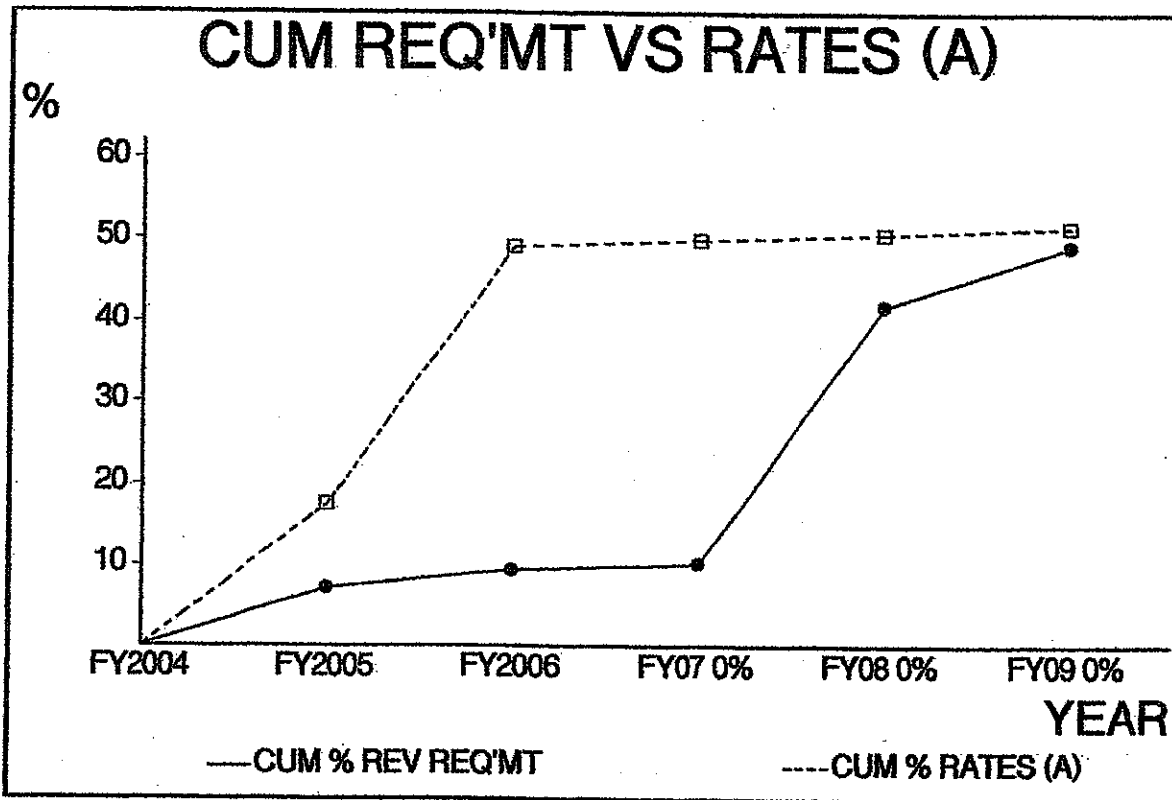
This chart illustrates that even without additional rate increases the FY06 revenue level is more than sufficient to cover revenue requirements thru FY09.

Revenue in excess of Requirement is used to fund the Reserve. (Reserve Requirement estimated to be \$8M.)



SURPLUS REVENUE (A) shows the excess of Revenue over Requirement (Bar Chart (A)) both Annually and Cumulatively, and their relationship to the Reserve Requirement (horizontal line). The heavy line which appears to start at FY07 represents the Cumulative Surplus which would result from FY06 revenue of \$40.8M held constant thru FY09 (as in Bar Chart (A)).

The calculation of the SURPLUS REVENUE amounts is detailed in the table titled "FINANCIAL RESULTS FROM RATES OF NOV. 2004", with addenda for the changes noted above.



CUMULATIVE % REVENUE REQUIREMENT VS. CUMULATIVE % RATE INCREASE shows the Total Revenue Requirement cumulative change over FY2004 (FY2005 requirement was up 7.1% over FY2004; FY2006 requirement was up 9.3% over FY2004; and so on), versus the cumulative change in Rate Increases for FY05 and FY06, but with no additional rate increases after FY06. The cumulative rate for FY06 represents the result of the revenue projection of \$40.8M for that year made by the City's Finance Dept.

By FY2009 the Revenue Requirement will be up 49%; the Rate Increase up 51.3%, even without additional rate increases after FY06.

Revenue Requirement calculation appears in the table titled "PROJECTED WATER UTILITY BUDGETS"; RATE INCREASE calculation is in "FINANCIAL RESULTS FROM RATES OF NOV. 2004" (with addenda).

PROJECTED WATER UTILITY BUDGETS
 Expense and Revenue Allocation
 FY 2004 Water Fund

Data from FY2004 CAFR (p.27)

Total Expense (PCE litigation excluded)	\$ 24,673,184
1997 COP's and CDWR Loan	2,045,000
MID Surface Water Purchase	<u>(10,600,545)</u>
Net Expense	16,117,639
Total Revenue (incl. Capital Contribution)	32,857,134
Revenue from Water Sales	27,372,941
% from Water Sales	83.3%

Since 83% of Revenue is from Water Sales, then 83% of Net Expense may be attributed to the production of revenue from Water Sales.

Operating Expense = \$16,117,639 x 89% = \$14,344,699
 89% chosen to match FY05

Total Revenue Requirement FY04: \$14,344,699 + \$10,600,545 (MID) = \$24,945,244

PROJECTED WATER UTILITY BUDGETS
Expense and Revenue Allocation
FY 2005 Water Fund

Data from FY2005 CAFR (p.27)

Total Expense (PCE litigation excluded)	\$ 27,004,185
1997 COP's and CDWR Loan	2,045,000
MID Surface Water Purchase	<u>(11,751,150)</u>

Net Expense 17,298,035

Total Revenue (incl. Capital Contribution) 33,694,251

Revenue from Water Sales	29,963,983
% from Water Sales	89%

Since 89% of Revenue is from Water Sales, then 89% of Net Expense may be attributed to the production of revenue from Water Sales.

Operating Expense = \$17,298,035 x 89% = \$15,395,251
 (to P.2 this table, Projected Water Utility Budgets)

PROJECTED WATER UTILITY BUDGETS

THIS CORRESPONDS TO FORESIGHT TABLE 4-1

	2004-05	2005-06	2006-07	2007-08	2008-09
Operating Expenses From Expense & Revenue Allocation for FY2005 (Op. Exp. growth @ 1%/yr.)					
Subtotal - Oper. Expen.	15,395,251	15,549,204	15,704,696	15,861,743	16,020,360
Treatment (MID T&DA O&M) (Water Purchases @ .5%/yr.) New Meter & Service O&M	4,607,800	4,630,839	4,653,993	4,677,263	4,700,649
		400,000	400,000	400,000	400,000
Total Operating Expenditures	20,003,051	20,580,043	20,758,689	20,939,006	21,121,009
Debt Service Payments					
MID T&DA Debt	6,721,000	6,715,000	6,715,000	6,715,000	8,715,000
New MID Treatment Plant	0	0	0	4,110,000	4,110,000
Tier 1 Downstream	0	0	0	3,618,000	3,618,000
Tier 2 Downstream					1,619,000
Subtotal - Debt Svc.	6,721,000	6,715,000	6,715,000	14,443,000	16,062,000
Total Revenue Requirement	26,724,051	27,295,043	27,473,689	35,382,006	37,183,009
% Increase (Yr.to Yr.)	7.1	2.1	.65	28.8	5.1
% Increase (Cum.)	7.1	9.3	10.1	41.8	49.0
% Increase (5 Yr. Mean)			8.3		

FY 2004 is the base year for % Increase calculations.

FINANCIAL RESULTS FROM RATES OF NOV. 2004

THIS CORRESPONDS TO FORESIGHT TABLE 7-1

	FY	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Total Revenue Requirement From Projected Budgets		24,945,244	26,724,051	27,295,043	27,473,689	35,382,006	37,183,009
Rate Increase (Eff.)			17.5%(35/2)	20%	15%	5%	5%
(Cum.)			17.5%	41%	62%	70%	79%
Revenue from Rates Previous Year				28,963,983	36,136,564	41,764,834	44,072,341
Rate Increase + Growth				6,172,581	5,628,270	2,307,507	2,434,997
Total Rate Revenue		Actual 27,372,941	Actual 29,963,983	36,136,564	41,764,834	44,072,341	46,507,338
Annual Surplus (Deficit)		2,427,697	3,239,932	8,841,521	14,291,145	8,690,335	9,324,329
Cum. Surplus (Deficit)		2,427,697	5,667,629	14,509,150	28,800,295	37,490,630	46,814,959

