



Department: Utilities
Cost Center: 6001; 6101
For Agenda of: 4/21/2025
Placement: Study Session
Estimated Time: 60 minutes

FROM: Aaron Floyd, Public Works & Utilities Director
Prepared By: Shane Whittington, Utilities Business Manager

SUBJECT: 2026 WATER AND SEWER RATE STRUCTURE STUDY

RECOMMENDATION

1. Receive a presentation and conduct a Study Session on the 2026 Water and Sewer Rate Structure Study;
2. Confirm the City's prioritization of rate design attributes; and
3. Confirm staff's recommendation to proceed with a four-year rate adoption period.

REPORT-IN-BRIEF

Staff typically begin the water and sewer rate study process in the second year of the financial plan. This Study Session is an early step in that process and does **not** involve adopting new rates. Instead, it allows Council to provide direction on key rate design elements before detailed analysis begins. Rate adoption will occur in the winter and spring of 2027 through a separate process that includes public outreach, noticing, and a public hearing in accordance with State law.

Staff is initiating the 2026 Water and Sewer Rate Structure Study to evaluate the City's water and wastewater rate design in accordance with State law, City policy, and prior Council direction. This Study Session provides an opportunity for Council to confirm the prioritization of rate design attributes and provide direction on the preferred rate adoption period. Council direction will guide development of cost-of-service and rate structure options to be considered at a future public hearing prior to adoption of any new rates.

A rate structure is the framework a utility uses to allocate the cost of providing water and sewer services among customers. It determines how charges are designed—such as fixed service charges and variable usage-based rates—to recover costs in a manner that is fair, understandable, legally compliant, and aligned with policy goals. In California, rate structures must comply with Proposition 218, which requires that rates reflect the proportional cost of service attributable to each parcel and revenue cannot exceed the reasonable cost of providing the property-related service. Well-designed rate structures also balance objectives such as revenue stability, conservation, and equity, while remaining legally defensible.

As part of this Study Session, staff request Council's direction on the following:

- **Overall Rate Design:** Confirm whether to generally maintain the existing rate structure. If significant changes are directed, staff will return for a second Study Session in August 2026.
- **Rate Adoption Period:** Confirm a preferred rate adoption period (e.g., two-year or four-year).

POLICY CONTEXT

The City periodically conducts water and wastewater rate studies to ensure utility revenues are sufficient, legally compliant, and aligned with City Council policy direction. Water and sewer rates must be designed and adopted in accordance with State law, the City's Municipal Code, and prior Council policy decisions regarding rate structure and cost recovery.

Utility rates for water and wastewater service are governed by [California Constitution Article XIII D](#), adopted by voters through Proposition 218 in 1996. Article XIII D establishes several key requirements for property-related fees and charges, including:

- Revenues derived from a utility rate may not exceed the funds required to provide the service.
- Revenues may only be used for the service for which the fee was imposed.
- Fees must not exceed the proportional cost of providing service to each parcel.
- Fees may not be imposed for general governmental services available to the public at large.
- Utilities must conduct a public noticing and protest hearing process prior to adoption of new or increased rates.

Because of these requirements, water and wastewater rate structures must be supported by a cost-of-service analysis demonstrating that rates are proportional to the cost of providing service.

California law also establishes expectations regarding the frequency and transparency of utility rate studies. California Government Code Articles [4.6](#), [4.6.5](#), and [4.7](#) require local agencies that charge water or wastewater service fees to periodically evaluate the adequacy of those fees and publicly report on the findings of that review. This requirement is intended to ensure that agencies:

- Regularly review whether rates generate sufficient revenue to fund operations, maintenance, and capital needs, and
- Provide public transparency regarding the basis for utility rates.

Consistent with this requirement and industry best practices, local governments commonly conduct rate studies on a multi-year cycle to maintain financial stability and compliance with Proposition 218.

The San Luis Obispo Municipal Code [§13.04.090](#) authorizes the City Council to establish water service rates and charges necessary to operate, maintain, and improve the municipal water system. The Municipal Code provides Council with the authority to adopt and periodically adjust rates to ensure the water utility remains financially sustainable and capable of meeting service obligations. Wastewater rates are similarly established by Council authority to ensure the wastewater utility can fund required operations, maintenance, regulatory compliance, and infrastructure investments.

The San Luis Obispo City Charter also establishes requirements regarding the use of utility revenues. Charter [Section 806](#) requires that all income derived from the operation of a City public utility be devoted exclusively to the expenses of operating, maintaining, improving, or bettering the utility system, and to the repayment of related debts and interest. This provision reinforces the principle that utility revenues must be used solely for utility purposes and supports the cost-of-service framework used in developing water and wastewater rates.

Collectively, these State constitutional provisions, statutes, and local ordinance and policies establish the legal and policy framework that constrains utility rate setting. Under this framework, water and wastewater rates must be based on the cost of providing service, may not generate profit, and revenues must be used exclusively for the operation, maintenance, and improvement of the water and sewer enterprises.

Within this policy framework, there are ten industry-standard rate design attributes that are considered in the development of public utility rates. Cost-of-service rate-making principles originate from Bonbright’s *Principles of Public Utility Rates* and are reflected in industry guidance such as American Water Works Association’s (AWWA) *Principles of Water Rates, Fees, and Charges* (M1) and Water Environment Federation’s (WEF) *Financing and Charges for Wastewater Systems* (MOP 27). These rate principles are meant to serve as guides in the development of sound rate design.

These rate attributes are described in Table 1.

Table 1 - Rate Design Attributes		
Rate Design Attribute	Plain Meaning	Example in Rates
1. Effectiveness in yielding total revenue requirements.	Rates should bring in enough money to run the system and recover the full cost to provide service.	Making sure fixed charges and usage rates together fully fund operations, maintenance, and infrastructure replacement.
2. Revenue stability and predictability (revenue the City receives).	The utility should receive steady income so it can plan, maintain service, and avoid sudden financial problems.	Having a reasonable fixed monthly charge so revenue doesn’t collapse during wet or drought years when water use alters.
3. Stability and predictability of rates (water rates that customers pay).	Customers shouldn’t see large or sudden swings in their bills from one year to the next.	Gradual rate adjustments over time instead of large one-time increases.
4. Promotion of efficient resource use.	Within the confines of the law (while still being cost-based),	Tiered pricing where higher usage matches the higher cost

	rates should encourage people to use water wisely, but not punish normal or necessary use.	per unit of delivering those services.
5. Reflect all present and future costs and benefits of providing utility service.	Rates should cover not only today's costs, but also long-term repairs, upgrades, and reliability needs.	Including funding for pipe replacement or treatment upgrades instead of waiting for failures.
6. Proportional distribution of total costs among the customer classes of service.	Different customer groups should pay based on what it costs to serve them.	Large irrigation users paying more if they drive peak demand or infrastructure sizing.
7. Avoidance of undue discrimination in rate relationships.	Customers in similar situations should be treated the same, and differences should be based on real cost differences.	Avoiding special discounts for one group unless there's a clear difference in the cost to provide service.
8. Dynamic in its ability to respond to changing supply and demand conditions and/or environmental concerns.	Rates should be flexible enough to respond to droughts, growth, or changing water supply conditions.	Drought surcharges or seasonal rates.
9. Simple and easy to understand; easy to administer.	Customers should be able to understand their bill, and staff should be able to run the system efficiently.	Limiting the number of tiers or keeping the bill format clear and consistent.
10. Freedom from controversy as to interpretation.	The rate structure should be clear enough that people don't constantly argue about what it means or how it works.	Using clear formulas and definitions so customers, staff, and auditors all interpret rates the same way.

The order of these rate design attributes does **not** indicate relative importance. Application of these attributes is constrained by State constitutional provisions, statutes, and local policies, which take precedence in the development of utility rates. In practice, the attributes may be complementary, overlapping, or at times even in conflict with one another, and must be balanced in the design of the rate structure.

DISCUSSION

Background

The current water rate structure consists of a monthly base fee and a volumetric usage charge.¹ Volumetric rates vary based on the cost of service for single-family residential, multi-family, non-residential, and landscape irrigation customers. Monthly base fees vary by meter size to reflect differences in system capacity requirements.

Tables 2 and 3 summarize the water rates approved by the City Council on June 17, 2025 ([Resolution No. 11582](#)), including the current volumetric usage charge shown in Table 2 as “Water Usage (Variable Per Unit Cost)” and the current monthly base fee shown in Table 3 as “Water Monthly Base Fees (Fixed Cost).”

¹ A volumetric water charge is a utility pricing mechanism where consumers are billed directly proportional to the volume of water consumed (e.g., per gallon).

Table 2 - Water Usage (Variable Per Unit Cost)	Approved Rates Effective July 1, 2025	Approved Rates Effective July 1, 2026
Single Family Residential Tier 1: 0 to 5 units	\$9.01	\$9.51
Single Family Residential Tier 2: 6 to 12 units	\$10.38	\$10.95
Single Family Residential Tier 3: 13+ units	\$17.90	\$18.88
Multi-Family	\$10.11	\$10.67
Non-Residential	\$10.70	\$11.29
Landscape Irrigation	\$10.92	\$11.52

Table 3 - Water Monthly Base Fees (Fixed Cost)	Approved Rates Effective July 1, 2025	Approved Rates Effective July 1, 2026
Single Family Residential	\$31.91	\$33.67
Multi-Family, Non-Residential, and Landscape Irrigation by Water Meter Size		
0.75-inc or less meter	\$31.91	\$33.67
1-inch meter	\$53.28	\$56.21
1.5-inch meter	\$106.34	\$112.19
2-inch meter	\$170.17	\$179.53
3-inch meter	\$319.24	\$336.80
4-inch meter	\$532.19	\$561.46
6-inch meter	\$1,064.07	\$1,122.59
8-inch meter	\$1,702.61	\$1,796.25

The current sewer rate structure also consists of a monthly base fee and a volumetric usage charge. Volumetric sewer rates vary based on the cost of service for single-family residential and multi-family customers (subject to a [sewer cap](#)) and for non-residential customers. Monthly base fees vary by meter size.

Tables 4 and 5 summarize the sewer rates approved by the City Council on June 17, 2025 ([Resolution No. 11584](#)), including the current volumetric usage charge shown in Table 4 as “Sewer Usage (Variable Per Unit Cost)” and the current monthly base fee shown in Table 5 as “Sewer Monthly Base Fees (Fixed Cost).”

Table 4 - Sewer Usage (Variable Per Unit Cost)	Approved Rates Effective July 1, 2025	Approved Rates Effective July 1, 2026
Single Family and Multi-Family Residential Per Unit Cost (Up to Sewer Cap)	\$10.46	\$11.14
Non-Residential Per Unit Cost	\$10.94	\$11.65

Table 5 - Sewer Monthly Base Fees (Fixed Cost)	Approved Rates Effective July 1, 2025	Approved Rates Effective July 1, 2026
Single Family Residential	\$26.11	\$27.81
Multi-Family, Non-Residential, and Landscape Irrigation by Water Meter Size		
0.75-inc or less meter	\$26.11	\$27.81
1-inch meter	\$43.61	\$46.44
1.5-inch meter	\$86.93	\$92.61
2-inch meter	\$139.20	\$148.25
3-inch meter	\$261.15	\$278.12
4-inch meter	\$435.33	\$463.63
6-inch meter	\$870.40	\$926.98
8-inch meter	\$1,392.70	\$1,483.23
10-inch meter	\$2,002.22	\$2,132.36

The City's current water and wastewater rate structures reflect policy direction provided by the City Council during prior rate study sessions conducted on October 4, 2005 ([Item Bus 4](#)), June 14, 2011 (Item [PH 1](#) and [PH 2](#)), and January 9, 2018 ([Item 11](#)). During these meetings, Council identified the relative importance of rate design attributes to guide development of the rate structure. Table 6 summarizes Council's prioritization of the top five out of ten rate design attributes described in Principles of Public Utility Rates (Bonbright), with 1 representing the highest priority.

Table 6 - Council's Top 5 Rate Design Attributes			
Rate Design Attributes	October 4, 2005	June 14, 2011	January 9, 2018
1. Effectiveness in yielding total revenue requirements.	1	N/A - will be met for all rate design options	N/A - will be met for all rate design options
2. Revenue stability and predictability (revenue the City receives).		1	1
3. Stability and predictability of rates (water rates that customers pay).	4	2	3
4. Promotion of efficient resource use.	2	5	2
5. Reflect all present and future costs and benefits of providing utility service.			5
6. Proportional distribution of total costs among the customer classes of service.	5	4	4
7. Avoidance of undue			

Item 8a

discrimination in rate relationships.			
8. Dynamic in its ability to respond to changing supply and demand conditions and/or environmental concerns.			
9. Simple and easy to understand; easy to administer.	3	3	
10. Freedom from controversy as to interpretation.			

Between 2005 and the 2011 and 2018 study sessions, Council placed increased emphasis on revenue stability and predictability. This shift was influenced by drought conditions throughout the 2000s and 2010s, which resulted in reduced water consumption. At that time, the rate structure relied heavily on volumetric charges that varied directly with water use. As consumption declined, utility revenues decreased while the cost of operating the water system remained largely fixed. This resulted in structural revenue shortfalls and the need to implement temporary drought surcharges to maintain financial stability.

In response to these conditions, Council directed staff to develop a rate structure that provided greater revenue stability. Based on this direction, Council adopted a rate structure that included a monthly base fee in addition to volumetric charges on June 12, 2013 ([Item PH 4](#)). This change increased the portion of revenue recovered through fixed charges, improving the ability of the utility to meet revenue requirements during periods of reduced water use.

Across the 2005, 2011, and 2018 study sessions, Council's rate design priorities have remained generally consistent. In addition to revenue stability and predictability, Council has consistently prioritized:

- Stability and predictability of rates paid by customers;
- Promotion of efficient use of water resources; and
- Proportional distribution of costs among customer classes based on cost of service.

Although the relative ranking of these attributes has varied over time, the overall policy direction has remained consistent. Staff believe the current rate structure reflects these priorities and has been effective in maintaining financial sustainability, legal compliance, and alignment with Council policy direction.

These established rate design priorities are recommended by staff to provide the policy framework for the 2026 Water and Sewer Rate Study, which will evaluate potential adjustments to the rate structure while maintaining consistency with State law, City policy, and Council direction.

Public Engagement

On February 23, 2026, staff conducted a public information session regarding water and wastewater rate structure design to obtain community input. Prior to the meeting, staff advertised the public information session through two social media posts, one social media story, and direct email outreach to 159 organizations and contacts, including homeowner associations, property management companies, mobile home parks, multifamily property contacts, and community organizations and service providers.

Public Information Session - Outreach

1. **Social Media:** 2 posts, 1 story

2. **Direct Outreach:** AAPI SLO County , Access Central Coast, Building a Better SLO, Community Action Partnership of San Luis Obispo County, Inc (CAPSLO), Downtown SLO, Housing Authority San Luis Obispo, Latino Outreach Council , Lumina Alliance, Mujeres de Accion, NAACP SLO County Chapter, People's Self-Help Housing Corporation, REACH, SLO Association of Realtors, SLO Chamber of Commerce, SLO Tenants Union, Transitions Mental Health Association, United Way of San Luis Obispo County, Veterans' Services Office, Cal Poly ASI, 140 Individual Property Management, HOA, or Multifamily Contacts

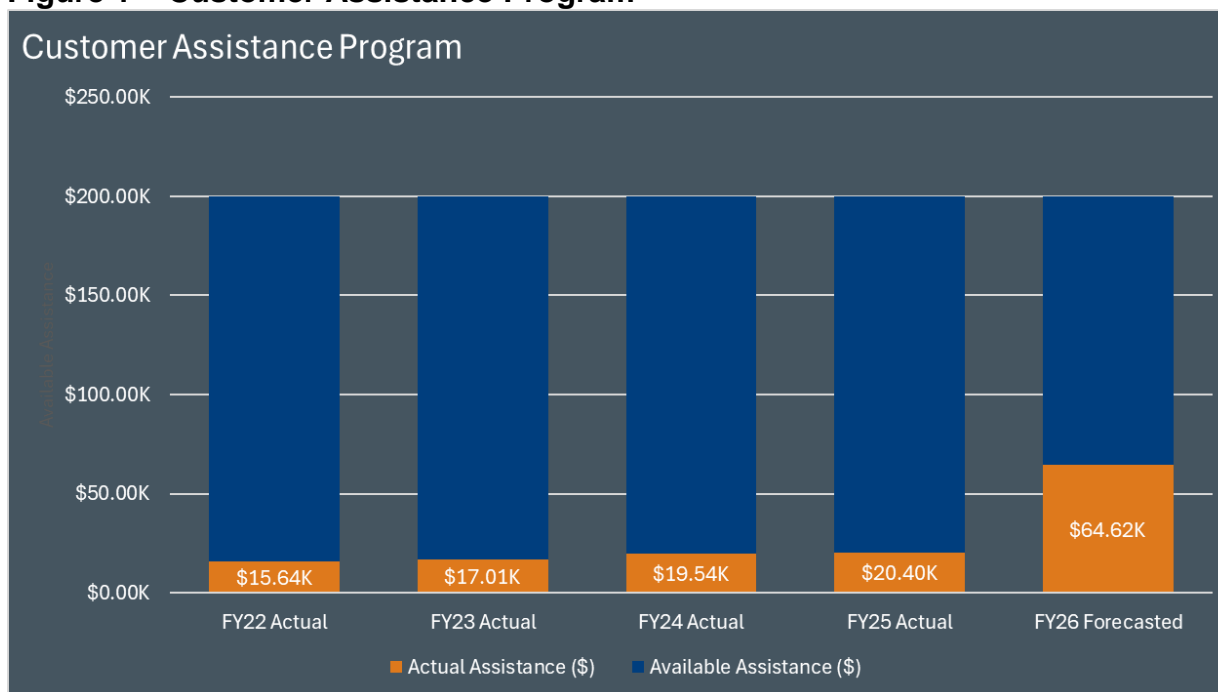
Despite the outreach, public participation was minimal and no written feedback forms identifying rate design priorities were submitted at the meeting. Verbal comments received at the meeting generally expressed support for maintaining the existing rate structure. Additional public outreach and opportunities for public engagement and input will be conducted by staff throughout the Water and Sewer Rate Study, including emails, postcard mailers, public postings, social media, and public meetings and hearings.

Customer Assistance Program

Although not part of the rate structure itself, the City's [Customer Assistance Program](#) (CAP) provides a mechanism to support qualified customers and is relevant to Council's consideration of rate affordability. No Council direction is requested on this program at this time. Staff are highlighting recent increases in participation and ongoing efforts to expand enrollment among eligible customers. The program is funded through late fees, which are not property-related charges and are therefore not subject to Proposition 218 requirements.

Following Council authorization in 2025 to increase the program discount from 15% to 20% ([Resolution No. 11583](#)) and expanded outreach efforts, program participation has increased. Over the last five years, enrollments are forecasted to increase by approximately 51%, and utilization of available assistance funds is forecasted to increase by approximately 313%.

Figure 1 summarizes assistance provided through the Customer Assistance Program from Fiscal Year 2021-22 through the Fiscal Year 2025-26 forecast.

Figure 1 – Customer Assistance Program

Staff will continue to evaluate opportunities to increase awareness of and participation in the program to ensure that available assistance reaches eligible customers, including potential program administration modifications that could provide pathways to users not currently able to participate in this program.

STUDY SESSION QUESTIONS

Based on the discussion above, Staff requests Council's consideration and direction regarding the following topics.

1. General Concurrence Regarding Rate Design Priorities.

As noted above, staff recommend the following prioritization of rate design attributes, consistent with prior Council direction:

1. Revenue stability and predictability (revenue the City receives).
2. Promotion of efficient resource use.
3. Stability and predictability of rates (water rates that customers pay).
4. Proportional distribution of total costs among the customer classes of service.
5. Reflect all present and future costs and benefits of providing utility service.

Staff request the City Council consider and confirm the existing rate design priorities or provide staff with direction on modifications to the rate design attribute prioritization.

If Council provides direction that significantly shifts rate design priorities, staff will return for a second Study Session in August 2026 to further explore those policy directions. The relationship between rate design attributes is complex, and changes are typically

implemented and evaluated over multiple rate cycles rather than through a single adjustment. While staff are not able to present specific rate impacts at this stage, different priorities can influence the structure in meaningful ways—for example, greater emphasis on revenue stability may increase the proportion of fixed charges, while greater emphasis on simplicity and ease of administration may result in fewer rate tiers or a more streamlined rate structure. Any resulting rate structure must be supported by a cost-of-service analysis and comply with Proposition 218 requirements. Table 1 provides general examples of how these attributes can be reflected in rate design.

2. General Concurrence for a Four-year Rate Adoption.

Staff are proposing a four-year rate adoption period. Council has historically adopted two-year rate adjustments in alignment with the City’s financial plans. A four-year rate adoption period provides greater revenue stability, customer bill predictability, and administrative efficiency by reducing the frequency of rate studies, public noticing, and Proposition 218 proceedings. Longer adoption cycles also support multi-year capital planning and financial forecasting, allowing the City to align rate adjustments with planned infrastructure investment. This approach is commonly used by utilities when costs and operating conditions are reasonably predictable. State law allows for adoption of utility rates for up to five years (California Government Code [§ 53756](#)). Industry practice is to conduct rate studies on a one- to five-year cycle to ensure revenues remain sufficient, legally compliant, and aligned with community priorities.

The predictability of the current rate structure and its demonstrated ability to successfully maintain financial sustainability, legal compliance, and alignment with prior Council policy direction from 2005, 2011, and 2018 has given staff the comfort to recommend a four-year rate adoption concurrent with adoption of the 2027-29 Financial Plan. As a reminder, any rate adjustments require noticing, a public hearing, and Council authorization to adopt. If Council provides direction to significantly alter the existing rate structure, staff may return with a recommendation to only proceed with a two-year rate adoption as a new rate structure may not result in the revenue stability required for a longer rate adoption period.

NEXT STEPS

If Council provides direction that significantly shifts rate design priorities, staff will return for a second Study Session in August 2026 to further explore those policy directions. If Council generally confirms the existing rate design priorities, staff will proceed with development of the Water and Sewer Rate Study.

Public outreach for the rate setting process is anticipated to begin in winter 2027 and will include emails, public postings, social media, and public meetings. Staff anticipate returning to Council in spring 2027 to request authorization to initiate the Proposition 218 noticing process. The Proposition 218 public hearing and Council consideration of rate adoption is anticipated to occur in May or June 2027.

CONCURRENCE

The City’s Finance Department concurs with the staff recommendation.

ENVIRONMENTAL REVIEW

The evaluation and modification of rates and charges by public agencies is statutorily exempt from the California Environmental Quality Act (CEQA) under Public Resources Code §§ 21083 and 21080(b)(8) and State CEQA Guidelines § 15273, as it involves the establishment of rates to fund operating expenses and capital projects necessary to maintain service within existing service areas. The proposed Water and Sewer Rate Study would not result in the commitment to or funding of the expansion of capital projects not otherwise evaluated under CEQA. Therefore, no environmental review is required for this item.

FISCAL IMPACT

This item does not have a direct fiscal impact. The study session is intended to obtain Council direction to inform the upcoming Water and Sewer Rate Study. Funding for the rate study is included in the adopted budget for the Water and Wastewater Utilities. Any future fiscal impacts associated with rate adjustments will be evaluated and presented to Council as part of the rate study and Proposition 218 rate adoption process.

Budgeted: N/A

Budget Year: 2025-27

Funding Identified: N/A

Fiscal Analysis:

Funding Sources	Total Budget Available	Current Funding Request	Remaining Balance	Annual Ongoing Cost
General Fund	\$0	\$0	\$0	\$0
State				
Federal				
Fees				
Other:				
Total	\$0	\$0	\$0	\$0

ALTERNATIVES

- 1. Provide different direction on rate design priorities.** Council may provide direction regarding the prioritization of rate design attributes to be used in the development of the Water and Wastewater Rate Structure Study that differs from staff’s recommendation. Changes to the prioritization of these attributes may result in different rate structure options being evaluated and presented to Council at a future meeting. Significant changes to the prioritization ranking may affect the

Item 8a

predictability of the resulting rate structure, warranting a two-year rate plan rather than a four-year rate plan to monitor the effects.

- 2. Direct staff to prepare a two-year rate adoption instead of a four-year adoption.** Instead of confirming a four-year rate adoption period, Council may direct staff to prepare a two-year rate study. A shorter rate adoption period may provide greater flexibility to respond to changing financial, regulatory, or economic conditions but may result in more frequent rate studies and Proposition 218 proceedings. Industry standard guidance is to conduct rate studies every one to five years.
- 3. Defer direction and return at a later date.** Council may choose to defer direction on the rate study and request that staff return at a future meeting with additional information, analysis, or public outreach. Deferring direction may delay the rate study schedule and could affect the timing of future rate adjustments.