



Council Agenda Report

Item 7a

Department: Utilities
Cost Center: 6105
For Agenda of: 6/15/2021
Placement: Public Hearing
Estimated Time: 30 minutes

FROM: Aaron Floyd, Utilities Director
Prepared By: Jennifer Thompson, Utilities Business Manager

SUBJECT: WATER AND SEWER RATE HEARING

RECOMMENDATION

Adopt a resolution entitled "A Resolution of the Council of the City of San Luis Obispo, California, Establishing Water and Sewer Rates for Fiscal Years 2021-22 and 2022-23," effective July 1, 2021 and July 1, 2022.

DISCUSSION

Background

As enterprise funds, the Water and Sewer Funds finance the City's water and sewer operations almost entirely through rates charged for service. Water and sewer rates must be sufficient to cover operations, capital asset maintenance and improvements, debt obligations, and appropriate reserve levels to keep the Water and Sewer Funds healthy and prepared for unforeseen funding needs.

Recommended water and sewer rate increases for 2021-22 and 2022-23 are **lower** than originally projected. The Water Fund is requesting a rate increase of 3.5% effective July 1, 2021 and 3.5% effective July 1, 2022. The most recent rate study, conducted in 2018, projected the water rate increase would need to be 5.5% in 2021 and 5.5% in 2022. The Sewer Fund is requesting a rate increase of 3.5% effective July 1, 2021 and 3.5% effective July 1, 2022. The most recent rate study, conducted in 2018, projected the sewer rate increase would need to be 6.5% effective July 1, 2021 and 6.5% effective July 1, 2022.

The City's rate consultant recently completed a rate confirmation study to confirm or modify the originally forecasted rate increase estimates. As a result of additional revenue from Cal Poly and refined investment and impact fee revenue projections, the rate consultant has now recommended lower than previously projected rate increases.

Table 1: 2021-23 Proposed Rate Increases

	July 1, 2021	July 1, 2022
Water	3.5%	3.5%
Sewer	3.5%	3.5 %

Proposed Water Rate Increase

The water rate increase is driven primarily by the need to maintain consistent and reliable water treatment and delivery service, a high credit rating, and to maintain an adequate working capital balance to cover unanticipated expenses associated with aging infrastructure.

Long Term Fiscal Health and Infrastructure Maintenance

Both the City's source water and treated drinking water infrastructure are aging and need to be continually maintained. The amount of work needed to ensure continued service is high with source water supplied to the City from reservoirs as far as 50 miles away and with over 190 miles of publicly owned drinking water pipelines inside the community, the majority of which have not been replaced since their original construction.

The Water Fund has a bond issuance that requires the Fund to be evaluated and given a credit rating each year. The credit rating ("Fitch Rating") is an indicator of the Fund's overall health and its ability to meet its debt obligations and operating costs. The credit rating is important because it allows the City to access loans for infrastructure projects more readily and at lower interest rates which results in a saving to ratepayers. The Fitch Rating considers, among other things, whether the Water Fund is consistently adjusting rates to keep up with inflation, whether it is maintaining its progress on capital improvements (maintenance and new), and its capital reserve levels. Due to the unprecedented times, during its 2020 credit evaluation, the credit rating agency understood the City's decision to defer the adopted 2020 water rate increase temporarily. However, the credit rating agency noted in its report that future deferments of rate increases would lead to insufficient revenues needed to maintain infrastructure and could result in the Water Fund losing its AA credit rating.

The Water Fund aims to maintain a minimum \$10,000,000 working capital balance¹ to prepare the Fund for unforeseen emergencies. As mentioned above, the credit rating also considers reserve levels. The Utilities Department strives to anticipate upcoming capital improvement needs, but aging infrastructure occasionally leads to unexpected, emergency repairs. In recent years, working capital has been used for an emergency repair within the pipe gallery at the Water Treatment Plant and to procure an emergency generator to ensure the Water Treatment Plant can continue operating in the event of a Public Safety Power Shutoff (PSPS) event.

¹ The minimum fund balance is 90 days operating & maintenance expense (\$2.6 million) plus average annual capital investment (\$7.2 million).

An unreserved working capital that drops below minimum levels will jeopardize the Fund's ability to react to emergencies and maintain its high credit rating.

Staff recommends water rates be increased 3.5% effective July 1, 2021 and 3.5% effective July 1, 2022 to maintain the fund's credit rating, to mitigate the declining capital balance, and to continue to provide reliable essential services. This action would increase the water portion of the average residential bill by \$1.94² per month.

Proposed Sewer Rate Increase

The sewer rate increase is driven by the need to prepare for the cost of the Water Resource Recovery Facility (WRRF) upgrade, to maintain consistent sewer collection infrastructure and service, and to maintain an adequate working capital balance.

Long Term Fiscal Health and Infrastructure Maintenance

Based upon aging wastewater infrastructure, the Sewer Fund needs to continue replacement of sewer mainlines to reduce inflow and infiltration into the collection system, reduce scheduled maintenance, increase capacity to allow for development, and reduce wastewater overflows. The Sewer Fund is also preparing for the costs of near-term projects including the potential relocation of the Wastewater Collection shop as it is projected to be impacted by the City's Prado Road Overpass project, operational costs associated with the WRRF upgrade, and a nearly \$6 million per year WRRF upgrade debt payment.

The Sewer Fund aims to maintain a minimum \$15,000,000 working capital balance³. This balance was increased over the past several years to manage the cash flow and financing requirements of the Water Resource Recovery Facility (WRRF) upgrade project. As the project nears completion, this amount will return to the \$15,000,000 target.

Staff recommends sewer rates be increased 3.5% effective July 1, 2021 to maintain the working capital balance for the WRRF upgrade, to prepare for the annual \$6 million debt payment, address the aging wastewater collection system, and to continue to provide essential services. This will increase the sewer portion of the average customers' bill by \$2.22⁴ per month.

Protest Procedures

The City sent out 19,947 written notices of the proposed assessment and ballots (see Attachment B) in late April 2021 in compliance with Proposition 218 (Prop 218). Under Prop 218, property owners and/or customers directly responsible for the payment of the rate subject to the proposed increase may submit a written protest against the proposed rate increases.

² Based upon 5 units of consumption.

³ The minimum fund balance is 90 days operating & maintenance expense (\$2.2 million) plus average annual rate-funded capital investment excluding the WRRF upgrade (\$12.8 million).

⁴ Based upon 5 units of consumption and a sewer cap of 8.

The protest must be submitted on the form provided by the City, received by the City Clerk at or before the June 15, 2021 public hearing, identify which rate, water and/or sewer, is being protested, and contain the address of the property receiving service. The party signing the protest must be listed on the account as the person responsible for payment of the water bill and/or the property owner. If a protest is submitted by the owner and by the tenant responsible for payment of the water bill, then one valid protest is counted for the account.

If written protests are filed by a majority (50% + 1), the proposed water rate structure and rates may not be imposed. A majority of the City's 15,794 water customers is 7,898. As of May 13, 2021, a total of 192 water and 196 sewer written protests were received by the Office of the City Clerk. All protests will need to be validated regarding property ownership and duplicate addresses. The City Clerk will provide an updated summary of the protests received at the conclusion of the public hearing on June 15, 2021.

Previous Council or Advisory Body Action

In May 2018, the City Council reviewed the "Comprehensive Water & Wastewater Rate Study." In June 2020, the City Council deferred the adopted 5.5% water and 5.0% sewer 2020-21 rate increase. In December 2020, the City Council implemented the adopted 2020-21 rate increase at a lower level: 3.6% for water and 3.6% for sewer.

Policy Context

Water and sewer rates are subject to the requirements of Article XIID, Section 6 of the California Constitution (Proposition 218).

Public Engagement

In compliance with the Proposition 218 noticing schedule, the City of San Luis Obispo mailed a notice to each property owner and water and sewer customer in the City in April 2021. The notice included the two years proposed rate increases, a summary of the purpose of the increase, and instructions on how to protest the proposed increase. Less than 800 of the 15,794 water and sewer customers had protested the proposed rate increase as of May 13, 2021.

If the rate increase is approved, customers will be notified of the July 1, 2021 rate increase via utility bill insert, social media, and the City website.

CONCURRENCE

The City's Finance Department concurs with the recommended action.

ENVIRONMENTAL REVIEW

Environmental Quality Act (CEQA) under Section 15273 of the CEQA Guidelines because the change in fees is not intended to fund expansion of capital projects not otherwise evaluated under CEQA. Therefore, no environmental review is required for this item.

FISCAL IMPACT

Budgeted: Yes

Budget Year: 2022 and 2023

Funding Identified: N/A

Fiscal Analysis:

Funding Sources	Current Rate Revenue Budget	Recommended Increase	Rate Revenue Budget with Increase
Water Fund	\$22,482,863	\$786,900	\$23,269,763
Sewer Fund	\$17,395,214	\$608,832	\$18,004,046
Total	\$39,878,077	\$1,395,732	\$41,273,809

The proposed rate increase will increase water sales revenue by \$786,900 in 2021-22 and will increase sewer sales revenue by \$608,832 in 2021-22. This additional revenue was included in the water and sewer budget adopted on June 1, 2021.

ALTERNATIVES

1. ***Do not approve implementation of the water and sewer rate increases.*** This is not recommended because the health of the Water and Sewer funds and their ability to provide essential services relies upon rate increases.
2. ***Approve a rate increase for water or sewer, not both.*** This is not recommended because the health of both the Water and Sewer funds and their ability to provide essential services relies upon rate increases.
3. ***Approve a rate increase that is less than 3.5%.*** This is not recommended because the health of the Water and Sewer funds and their ability to provide essential services relies upon rate increases. A lower rate increase now may drive the need for a higher rate increase in the future.

ATTACHMENTS

A – Draft Resolution

B – Proposition 218 Notification