

Meeting Date: 1/27/2016

Report Type: Public Hearing

**Utilities Rate Advisory
Commission Report**

915 I Street, 1st Floor

www.CityofSacramento.org

Title: Four-Year Water and Wastewater Utility Service Rate Adjustments

Location: Citywide

Recommendation: Conduct a public hearing as required by Proposition 218 on the Department of Utilities' proposed four-year water and wastewater utility service rate increases, and approve recommendations to the Mayor and City Council.

Contact: Susan Goodison, Business Services Manager, 808-8995

Presenter: Bill Busath, Department of Utilities Director, 808-1434

Department: Utilities

Division: Business and Integrated Planning

Dept ID: 14001611

Attachments:

01 Description/Analysis

02 Background

Submitted By: Wally Cole

Adobe Signature:



Approved By: Bill Busath

Adobe Signature:



Attachment 01 – Description/Analysis

Policy Considerations: The City Council formed a Utilities Rate Advisory Commission (Commission) in 2008 to serve as an advisory body on the City's utility service rates and to conduct the public hearing required for utility rate adjustments under Proposition 218.

Economic Impacts: None.

Environmental Considerations: Not applicable.

Sustainability: Not applicable.

Commission/Committee Action: Not applicable.

Rationale for Recommendation: The city's water and wastewater infrastructure systems are aging and require significant investment to maintain, rehabilitate and address ever-increasing regulatory requirements. At the current rate of investment, the City will replace its entire water system every 280 years and its wastewater system every 410 years. According to United States Environmental Protection Agency and American Society of Civil Engineers established life cycles, a best practices approach to replacement would replace most of the water and wastewater infrastructure every 70 to 100 years in order to sustain it in a condition that can reliably deliver service. In addition to capital replacement, the City must also invest in capital improvements and operational and maintenance practices necessary to maintain compliance with federal, state, and local legislative and regulatory mandates.

Financial Considerations: The Department of Utilities (DOU) rate proposal complies with the Proposition 218 mandate which allows utilities to charge rates sufficient to recover the cost of providing utility services. DOU is proposing a rate adjustment at this time for water and wastewater services only.

Attachment 02 – Background

Background

In 2012, the City Council approved water and wastewater rate increases to fund needed infrastructure projects to ensure system reliability and sustainability as well as moving the City toward meeting industry best practices for infrastructure replacement and maintenance. The rate increases allowed the City to invest in capital improvements and operational and maintenance practices necessary to maintain compliance with federal, state, and local regulatory mandates. These rate increases took effect on July 1 of 2012, 2013, and 2014. City Council's approval of the rate increases also addressed, in part, the findings in the 2010 Citywide Financial and Operational Review conducted by Management Partners, Inc., and the 2011 City Auditor's Sacramento Department of Utilities Operational Efficiency and Cost Savings Audit, which found that the City's financial resources at the time were inadequate to maintain its water and wastewater systems.

Concurrent with the water and wastewater rate increases, DOU has implemented numerous efficiencies and received non-rate payer dollars that have reduced costs to ratepayers. Since 2012, DOU has obtained over \$15 million in federal, state, and local grants for water and wastewater projects.

The proposed Water and Wastewater Infrastructure Investment Program is a continuation of the long-term strategy, started in 2012, of investing in the City's water and wastewater capital and regulatory programs at levels that reduce the risk of infrastructure failures, maintain reliable and high quality service, and comply with legislative and regulatory mandates.

Water and Wastewater Infrastructure Investment Program Overview

The water and wastewater rate adjustments approved by City Council in March 2012 were the first step in DOU's long-term comprehensive financial plan to proactively invest in the City's aging utility infrastructure systems and address ever-increasing regulatory requirements while keeping operational costs as low as possible. The proposed water and wastewater programs include a 30-year Infrastructure Investment Program (Program), with a specific four-year Capital Improvement Program (CIP).

The specific regulatory and legislative mandates that require significant capital investment and/or operational activities include: a waste discharge requirements permit issued by the State Water Resources Control Board (SWRCB) which mandates capital investment and operational activities to eliminate sanitary sewer overflows (SSOs) in the separated wastewater system; a National Pollution Discharge Elimination System (NPDES) combined system permit issued under the authority of the Federal Clean Water Act and administered by the California Regional Water Quality Control Board, Central Valley Region, that mandates significant improvements in the combined wastewater system; and AB 2572, which requires the installation of water meters for all water services by the year 2025.

The proposed Program phases in infrastructure investment to achieve sustainable “Best Practice” levels over a period of 12-16 years. To meet the immediate needs of the City’s water and wastewater infrastructure and, as part of the proposed Program, a specific 4-year Capital Investment Program for water and wastewater is proposed. The Program includes the following components:

- A 30-year Water and Infrastructure Investment Program based on:
 - Industry best practices for system replacement
 - Meeting regulatory requirements
 - Sustainable financing
- A 4-year Capital Improvement Program for FY2016/17 through FY2019/20 for water and wastewater consisting of specific projects based on criticality and condition.
- A 4-year Rate Proposal to fund the proposed 4-year Capital Improvement Programs
- Compliance with new regulatory requirements
- Continuity of existing production, maintenance and regulatory activities

Rate Proposal

To continue implementation of the Program, DOU has proposed 4-year rate increases starting in FY2016/17 and lasting through FY2019/20. The proposed water and wastewater rates are as follows:

<u>Fiscal Year Rate Increase</u>	<u>Water</u>	<u>Wastewater</u>
• Year 1 (July 1, 2016-June 30, 2017):	10%	9%
• Year 2 (July 1, 2017-June 30, 2018):	10%	9%
• Year 3 (July 1, 2018-June 30, 2019):	10%	9%
• Year 4 (July 1, 2019-June 30, 2020):	10%	9%

The proposed wastewater rate increase would not apply to City residents who receive wastewater service from the Sacramento Area Sewer District instead of the City. This rate proposal was included in the Proposed Utility Rate Change Notice mailed to City utilities customers on December 2, 2015.

The proposed rate adjustments to fund the Program will provide the revenue necessary to:

- Invest in and responsibly manage the City’s existing water and wastewater utility infrastructure at sustainable levels and improve it to meet future needs
- Continue to meet ever-increasing regulatory requirements and plan for future regulatory mandates in order to protect and enhance the environment
- Focus on economic development, investment, and sustainability
- Enhance legislative advocacy, regional participation, and community outreach efforts
- Provide the levels of service DOU customers want and have come to expect
- Provide predictable rates and financial stability for the water and wastewater funds
- Keep rates as low as possible

DOU is proposing rate increases at this time for water and wastewater services only. The Proposed Utility Rate Change Notice, mailed to City utilities customers on December 2, 2015, also included a

proposal to change and adjust the City's storm drainage service rates. However, the City has decided to postpone this proposal for approximately one year to avoid potential conflicts with forthcoming ballot initiatives and provide the opportunity to further inform customers about the storm drainage system condition, challenges, and budget realities. Accordingly, the DOU's proposed storm drainage service rate changes have been withdrawn and will not be presented or considered at this time. A new notice for any proposed storm drainage service rate changes will be mailed to all drainage service customers, in compliance with Proposition 218, before DOU presents any such changes at a public hearing.

Water and Wastewater Program Return on Investment and Economic Benefits

The proposed 4-year rate increases will generate enough revenue to begin to address infrastructure needs to ensure system reliability and sustainability as well as meet industry best practices for infrastructure replacement and maintenance. In addition to capital investments, the proposed rate increases will provide the revenue to invest in infrastructure, operations, and maintenance practices necessary to maintain compliance with federal, state, and local regulatory mandates. The proposed rate increase will generate enough revenue to finance the following projects:

- Accelerated residential water meter program scheduled for completion in 2020, four years ahead of the mandated state completion deadline of January 1, 2025, to encourage water conservation
- Continued mandated investment in improvements to the City's Combined Sewer System to reduce discharges to the Sacramento River and minimize overflows from the system onto private property and city streets
- Compliance with existing and anticipated new federal, state, and local regulatory mandates, as well as consent decree applicable to separated sewer system
- Gradual transition toward a 100-year replacement schedule of the City's water and wastewater infrastructure instead of the current 280 and 410-year schedules to improve system reliability and safety and minimize the risk of failures

Some of the specific returns on investment the proposed rate increase will fund include:

Water system

- Rehabilitating and replacing 8.5 miles of pipelines and rehabilitating water treatment plants and reservoirs
- Water Meter Program to install 41,000 water meters and replaces 76 miles of aged water pipelines located in backyards
- Improvements to the City's generators and water quality laboratory to comply with regulatory mandates
- Information Technology Program for the City's utility billing system, upgrades DOU's computer maintenance management systems, and implements new systems to manage capital projects planning and design
- Program support for new security systems, operations and maintenance and CIP contingency planning

Wastewater System

- Rehabilitating and replacing 4.2 miles of aged pipelines and rehabilitating 10 pump stations
- Constructing improvements to storage facilities and replace replacing undersized pipelines to comply with regulatory mandates
- Information Technology Program for the City's utility billing system, upgrades DOU's computer maintenance management systems, and implements new systems to manage capital projects planning and design
- Program support for new security systems, operations and maintenance and CIP contingency planning

DOU estimates that investing in the City's water and wastewater infrastructure at the levels proposed will create 829 total jobs (477 direct jobs and 352 jobs through indirect and induced activities) and create \$128 million in total economic output (\$81 million of direct output and another \$47 million of output through indirect and induced activities).

The indicated economic impacts are estimates calculated using a calculation tool developed by the Center for Strategic Economic Research (CSER). CSER utilized the IMPLAN input-output model (2009 coefficients) to quantify the economic impacts of a hypothetical \$1 million of spending in various construction categories within the City of Sacramento in an average one-year period. Actual impacts could differ significantly from the estimates and neither the City of Sacramento nor CSER shall be held responsible for consequences resulting from such differences.

Program Financing Approach and Methodology

As the infrastructure needs are significant and immediate, funding the water and wastewater program on a cash basis would cause dramatic rate spikes. The proposed funding plan proposes a mix of debt and cash financing that will allow the City to invest in its water and wastewater infrastructure and meet regulatory requirements while smoothing rate increases and avoiding rate spikes for utility customers. By smoothing rates, rate spikes are minimized from one year to the next. Cash flow and coverage requirements are accounted for in future years, and rates are set so they are roughly equal from year to year to meet these requirements in future years. This methodology provides predictable rates for the utility's customers and provides additional revenues in the near term which will reduce future debt issuance amounts, ultimately lowering rates in the long run.

Future Obligations

The 4-year proposal is essentially self-contained, and can be viewed as a stand-alone proposal as no additional rate increases would be needed to finance debt service for this proposal. It is likely that future rate increases will be necessary to continue to comply with regulatory requirements and to invest in rehabilitation and replacement of old infrastructure.

Next Steps

The next steps in the water and wastewater rate adjustment process are as follows:

- Community Engagement Activities (*Your Utilities. Your Community.*) – Ongoing (rate workshops, presentations, video/website)
- Presentation of Utility Rate Recommendation to City Council –March 2016
- If Adopted, New Water and Wastewater Rates Effective – July 1, 2016