



REPORT TO COUNCIL

City of Sacramento

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PUBLIC HEARING
June 22, 2010

**Honorable Mayor and
Members of the City Council**

Title: Department of Utilities Proposed FY2010/11 Budgets

Location/Council District: Citywide

Recommendation: Conduct a public hearing on the Fiscal Year (FY)2010/11 Utilities Operating and Capital Improvement Program (CIP) Budgets, as amended, and upon conclusion adopt an intent motion to approve.

Contact: Jamille Moens, Business Services Division Manager, 808-5988

Presenters: Marty Hanneman, Director of Utilities, 808-7508

Department: Utilities

Division: Business Services

Organization No: 14001611

Description/Analysis

Issue: The Department of Utilities (DOU) proposes an Operating Budget of \$188.3 million, a CIP of \$23.3 million, and an amended budget increase to the Utilities CIP in the amount of \$0.6 million for a total Department budget of \$212.2 million. The CIP budget amendment of \$0.6 million is to provide funding for the repair and rehabilitation to ensure the safety of the Solid Waste facilities. Details of the Operating and CIP budgets are provided in the Background section of this report (Attachment 1).

Policy Considerations: The proposed FY2010/11 Utilities Operating and Capital Improvement budgets are balanced. The proposed budgets are consistent with the City of Sacramento's mission to protect, preserve, and enhance the quality of life for present and future generations. Approval of the proposed budgets as amended, are necessary to

maintain current utility services to City residents, meet regulatory requirements and improve vital infrastructure, helping to achieve the City's goals to improve and expand public safety, achieve sustainability and livability, and expand economic development throughout the City.

Committee/Commission Action: The City Council formed a Utilities Rate Advisory Commission in 2008 to provide recommendations to the Mayor and City Council on the City's utility service rates. The Commission is also charged with holding the public hearing required by Proposition 218 when the City proposes to impose or increase utility service rates.

Consistent with Proposition 218 mandates for utility service rate increases, the Commission held a public hearing on the proposed two-year rate increases on May 27, 2009. After conclusion of the public hearing, the Commission approved a two-year rate recommendation of an average increase of 12% for each year that was presented to City Council on June 9, 2009. On June 23, 2009, City Council approved an average increase of 9% for each year, and the proposed budget reflects the approved rate increases for FY2010/11.

Environmental Considerations:

California Environmental Quality Act (CEQA): The recommended actions constitute administrative and fiscal activities that will not have any significant effect on the environment, and that do not constitute a "project" as defined by the CEQA Guidelines [Sections 15061(b)(3); 15378(b)(2), (4) and (5)].

Sustainability Considerations: There are no sustainability considerations with this report.

Rationale for Recommendation: The Department of Utilities had a significant number of staff reductions and programmatic cuts in the current year budget (FY2009/10) as a result of lower than requested rate increases and increased labor costs, the result of current contractual obligations. As a result of these cutbacks, the Department has reduced routine and preventative maintenance activities, and our customers have experienced a delayed response for service requests. The proposed FY2010/11 budget includes a continuation of these staff reductions and reduced service levels that occurred this year. In addition, the Department has been experiencing a decline in revenues, particularly in the water fund for the last two fiscal years. The Department has been able to utilize some savings in the major cost drivers such as fuel, chemicals, utilities, and general services/supplies to offset these declining revenues as the costs have grown slower than originally projected as a result of the continuing economic recession.

The Department has also had to rely on fund reserves in order to continue mandated and essential services. The impact is that the majority of the Department's enterprise fund balances continue to steadily decline. The Department will not be able to restore these fund balances to the recommended 45 day prudent reserve without additional cuts to services or an increase in user fee rates.

The proposed budget for FY2010/11 includes:

- Defunding 55.5 FTE positions – these positions had been held as vacancies in FY2009/10 for labor savings of approximately \$4.4 million
- Incorporating Proposition 218 adjustments into the proposed budget – these adjustments provide savings and additional revenue of approximately \$2 million in FY 2010/11. A description of the adjustments and amounts is included in the Background (Attachment 1).
- Allocating additional funding for high priority needs identified as part of the Citywide Program Oriented Development (POD) budget process

Further discussion of the utility fund balances, Proposition 218 adjustments and funding priorities is provided in Attachment 1.

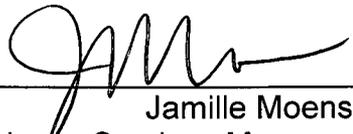
Financial Considerations: The Department of Utilities Proposed Operating Budget is \$188.3 million and 697.5 fulltime equivalent (FTE) positions. The Proposed Operating Budget reflects the rate increases approved by City Council on June 23, 2009 and includes augmentations for service and supplies based on priority operational needs.

In addition, there is a proposed amendment to the FY2010/11 Department of Utilities' CIP of \$23.3 million that was presented on June 1, 2010 to include a net increase of \$0.6 million for a total CIP Budget of \$23.9 million. The CIP Budget includes costs for the continued improvements and rehabilitation of Department of Utilities' infrastructure, and funding for the water meter retrofit program mandated by state law. Projects attributable to growth were funded by the Water and Sewer Development Impact Fee funds. The amendment to the CIP Budget is shown below:

TABLE 1

Fund	Project Number	Project Name	FY2010/11 Proposed Budget	Proposed Change	FY2010/11 Amended Budget	Description
6005	Z14009300	AMI: Meter Reading	845,000	(845,000)	-	To change the project number to Z14010000 to group with the Residential Meter Program projects
6005	Z14010000	Residential Water Metering Project	-	845,000	845,000	To change the project number from Z14009300 to Z14010000 so that it is grouped with the Residential Meter Program projects
6005	Z14006400	FWTP Low Lift Pumps	-	(749,000)	(749,000)	To transfer funding from the Low Lift Pump project to the Well Rehabilitation project
6005	Z14110100	Well Rehab Program	150,000	749,000	899,000	To increase the funding for the City groundwater well facilities that are in need of repair or rehabilitation
6007	Y14000900	Solid Waste Facility Repair and Rehab	-	560,000	560,000	To provide funding for the repair and rehabilitation of the Solid Waste facilities
		Total	995,000	560,000	1,555,000	

Emerging Small Business Development (ESBD): There are no ESBD considerations with this report.

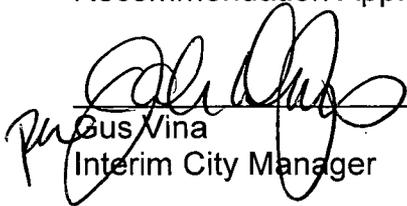
Respectfully Submitted by: 

Jamille Moens
Business Services Manager

Approved by: 

Marty Hanneman
Director of Utilities

Recommendation Approved:



Susana Vina
Interim City Manager

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Attachment 1

Background

The Department of Utilities provides and maintains water, sewer, solid waste, storm drainage, and flood control services and facilities. These essential services and facilities are provided for its customers, the ratepayers of the City, and are in place to safeguard the health and safety of the public and improve the quality of life in our City. The Department works in conjunction with other City departments, Sacramento County, regional, state and federal agencies in the development and rehabilitation of urban utility infrastructure.

The Department of Utilities is an enterprise operation self-supported through fee and charge revenues and consists of four funds: Water, Sewer, Storm Drainage and Solid Waste. The Fiscal Year (FY)2010/11 Proposed Operating and Capital Improvement Program (CIP) Budgets, as amended, for the Department total \$212.2 million and include 697.5 full time equivalent (FTE) positions.

Proposed Operating Budget

The FY 2010/11 Proposed Operating Budget is \$188.3 million and reflects the reduction in staffing and levels of service approved by City Council in the FY2009/10 budget. In FY2009/10, the Department had a significant number of staff reductions and programmatic cuts as a result of lower than requested rate increases and increased labor costs, the result of current contractual obligations. As a result of these cutbacks, we have not been able to keep up with scheduled and preventative maintenance activities, and our customers have experienced a delayed response for general customer inquiries and repair services. The FY2010/11 Proposed Operating Budget also reflects additional program cuts in the Solid Waste Division to comply with Proposition 218 (see separate discussion on Proposition 218 impacts below).

The additional revenue from the approved user fee rate increases and the savings realized from the slower than projected growth of our major cost drivers such as fuel, chemicals, utilities, and general services/supplies, allowed the Department to allocate resources to priority needs as identified below:

- \$1.7 million for unanticipated additional SCERS contributions,
- \$3 million for deferred fleet equipment replacements of old and aging equipment,
- \$350,000 for the water meter repair/replacement program,
- \$250,000 for the water conservation rebates/outreach program,
- \$4.7 million increase in the CIP,
- \$2.3 million increase in the Residential Water Meter CIP Projects, and
- \$1.4 million for operating contingencies to address unanticipated costs.

Proposed Capital Improvement Program Budget Amendment

The FY2010/11 Proposed CIP Budget for Utilities projects is \$23.9 million. This includes the \$23.3 million budget as presented on June 1, 2010 and an amendment to the CIP program of \$0.6 million. The CIP budget includes additional funding for the meter program, funding for drainage infrastructure, and improvements to the combined sewer system to comply with regulatory requirements. The amendment to the CIP budget of \$0.6 million is comprised of the following changes:

- Change a project number to group with the Residential Meter Program projects (no net change),
- Transfer funding from the Low Lift Pump project to the Well Rehabilitation project (no net change), and
- Provide funding for the repair and rehabilitation to ensure the safety of Solid Waste facilities (net increase in Solid Waste fund (6007) of \$560,000.

Meter Program

In 2004, the State Legislature adopted Assembly Bill 2572, mandating meters on all water service connections by January 1, 2025. In 2009, the Legislature adopted SBX7 7, which requires the City to achieve at least a 20% reduction in per capita water use by 2020, which will likely require that the City be substantially metered prior to 2020. The effort to transition customers to water meters is a significant undertaking involving installation of over 100,000 meters and replacement of miles of aging water mains, including the abandonment of aging backyard water mains and installation of new water mains in the streets for those locations.

Water user fees finance the majority of the projected \$500 million water meter and backyard main replacement program. For FY2010/11, the proposed meter funding is \$8.8 million and is included in the FY2010/11 Proposed CIP budget. In addition to user fees, the Department has been successful in obtaining grants for the program. In FY2009/10, the Department received \$22.6 million of funding from the American Recovery and Reinvestment Act (ARRA) of 2009. The Department continues to aggressively pursue state and federal grants and loans to help offset the costs and accelerate the installation of the meters. Continued funding of the meter program is necessary to ensure compliance with the State's meter retrofit mandate, comply with any matching grant requirements and to achieve the City's water conservation objectives.

Fluoride Program

The Department of Utilities is seeking grant funding from First 5 Sacramento Commission to study the current practices of water fluoridation of surface and ground water. The intent of the study is to reduce operation and maintenance (O&M) costs by evaluating best management practices and conducting a thorough comparison of similar agencies. The study will include

recommendations for capital improvements to the fluoridation system. Additional grant funding opportunities will be available for capital improvements identified in the study.

Proposition 218

On January 6, 2010, the Sacramento County Grand Jury issued a Grand Jury Report (entitled "The City of Sacramento and Proposition 218 – *The Law Is the Law*") regarding City practices pertaining to the use of utility enterprise funds that potentially do not comply with Proposition 218. In response to this Report, and the Department's continual review of programs and services for compliance with Proposition 218, the Department has proposed the following items in the FY2010/11 budget:

- Currently, a subsidized volumetric water rate is applied to parks and median strips for various City Departments. The Department will phase-in the standard volumetric water rate charged to the Parks & Recreation and Convention, Culture & Leisure Departments for City parks and the City cemetery, and will charge the full standard volumetric water rates for all other City departments.
- Solid Waste garbage, recycling and street sweeping services will be provided to City departments at standard rates with the exception of the Parks & Recreation Department which will receive a phased-in rate.
- Solid Waste will no longer fund illegal dumping, and litter can pickup services throughout the City with revenue from garbage collection rates.
- Solid Waste will no longer provide reimbursement for recycling services at City parks with revenue from Solid Waste rates.
- City parks will be billed for drainage services; billing will be based on impervious area, as City parks consist primarily of pervious surface area. Cemeteries are billed on the same basis.
- Increased fees will be charged for development review activities that provide for full cost recovery.
- The cost for green waste seasonal leaf season pickup in the Downtown area will be paid by the Storm Drainage fund, since this service directly benefits the drainage system.

The dollar amount and fund impact of the above items are reflected in Table 2 and are included in the FY2010/11 Proposed Operating budget (page 21).

TABLE 2

Proposition 218 Budget Adjustments		
Recommendation	FY2010/11 Budget Adjustment	Budget Impacts To DOU funds
Solid Waste garbage, recycling and street sweeping services will be provided to City departments at standard rates with the exception of the Parks & Recreation department which will receive a phased-in rate.	\$186,717	Solid Waste Fund (6007) increased revenue
Solid Waste will no longer provide illegal dumping (\$793,754) and litter can pickup services throughout the City (\$140,962)**	\$934,716	Solid Waste Fund (6007) - reduction in expenditures
Recycle bins will be removed from City parks as Solid Waste will no longer fund the recycling program.**	\$317,220	Solid Waste Fund (6007) - reduction in expenditures
Downtown leaf pickup if eliminated would create a significant impact on the City's storm drainage system and could result in flooding. Therefore, the cost for green waste seasonal leaf collection in the Downtown area will be absorbed by the Storm Drainage Fund (6011).	\$0	Solid Waste Fund (6007) - reduction in expenditures of \$84,000; Storm Drainage Fund (6011) - increase in expenditures of \$84,000
City parks will be billed for drainage services based on impervious areas.	\$295,726	Storm Drainage Fund (6011) - increased revenue
The department will phase-in the standard volumetric water rate for the Parks & Recreation and Convention, Culture & Leisure departments, and will charge the full standard volumetric water rates for all other City departments.	\$193,364	Water Fund (6005) - increased revenue
Increased fees for development review that provide for full cost recovery rates.	\$100,000	Water Fund (6005), Sewer Fund (6006) and Storm Drainage (6011) - increased revenue
Total:	\$2,027,743	

**Services can no longer be funded with Solid Waste collection rates

City staff continues to monitor for potential Proposition 218 issues and will bring forward any issues if they arise.

Fund Reserves

To determine the proposed budget, the Department considered its projected end of year fund balance for the current year, and projected expenditures and revenues for FY2010/11. The goal is to provide the same level of service while maintaining a minimum prudent reserve (equivalent to 45 days operating costs) in each fund in the event revenue is interrupted or the fund is faced with other unanticipated fiscal impacts. The calculation of the actual reserve amount necessary to cover 45 days is based on the operating budget and varies from fund to fund. The estimated ending fund balance for water, sewer, and solid waste in FY2010/11 are considerably less than the recommended minimum 45 day balance as shown in Table 3 and discussed below:

TABLE 3

Utility Fund Balances					
Fund	FY2011 Expenditure Budget	FY2010/11 Amended Undesignated Fund Balance	45-Day (12%) Prudent Reserve	Variance	Current Reserves as a % of Budget
Water	82,590	2,522	10,182	(7,660)	3%
Sewer	25,015	376	3,084	(2,708)	2%
Drainage	39,857	6,979	4,914	2,065	18%
Solid Waste	61,458	1,661	7,577	(5,916)	3%

- Water Fund: The reserves have been decreased in the past few years due to revenue shortfalls and increased costs to maintain the current levels of service. The FY2010/11 proposed budget reflects a balanced budget without the use of reserves; however, the Department will not be able to increase the fund balance to the minimum 45 day reserve without future rate adjustments or significant cuts in operations.
- Sewer Fund: The reserves have been decreased in the past few years due to revenue shortfalls and increased costs to maintain the current levels of service. The FY2010/11 proposed budget includes a use of the reserves to balance the budget due to a structural deficit (revenues are insufficient to meet the operational and capital needs of the fund). The Department will not be able to increase the fund balance to the minimum 45 day reserve without future rate adjustments or significant cuts in operations.
- Solid Waste Fund: This fund operated in a deficit for the past several years. Through a combination of operational efficiencies and rate adjustments, the FY2010/11 proposed budget reflects a balanced budget that will restore the fund balance to approximately \$1.7 million in reserves. While this fund is now operating in the positive, it will require future rate adjustments or significant cuts in operations to achieve a fund balance reflecting a minimum 45 day reserve.
- Storm Drainage Fund: The reserves have been decreased in the past several years due in part to the fact that rates have not been increased since 1996, before the adoption of Proposition 218, which requires voter approval for drainage rate increases. Costs continue to increase to maintain the current levels of service and will result in a continual use of the fund balance each year in order to maintain existing services. The Department will not be able to maintain the fund balance at a minimum 45 day reserve without future rate increases or significant cuts in operations.

Utilities Rate Hike Roll Back Act of 2010

On May 21, 2010, the Sacramento County Taxpayers League submitted signed petitions to the City Clerk’s Office to place the Utilities Rate Rollback Act of 2010 (“Initiative”) on the November 2,

2010 ballot. To qualify for the ballot, 5,420 valid signatures are required. On June 7th, the County of Sacramento Registrar's Office notified the City that the petition had sufficient signatures to qualify the Initiative for the ballot. The proposed initiative does not apply to the City's storm drainage rates.

If the Initiative receives voter approval, the initiative would amend the Sacramento City Code to repeal and cancel the utility rate increases for water, sewer, and solid waste services scheduled to go into effect on July 1, 2010 that were approved by City Council in June 2009. This rate rollback would take effect on July 1, 2011 (FY2011/12), so that effective July 1, 2011 the water, sewer, and solid waste service rates would be set at the rates in effect as of February 2010 (established by initiative, which reflects the City's current rates for FY2009/10).

Passage of the Utilities Rate Rollback Act of 2010 would allow the City Council to change the City's current rates for water, sewer, and solid waste services without obtaining voter approval, beginning on and after July 1, 2012, but only if such changes do not increase any of the rates by a percentage amount that exceeds the U.S. Department of Labor's consumer price index (CPI) inflation rate for the previous year.

If the Initiative qualifies for the ballot and is adopted, the impact to Utility customers and to the City's infrastructure would be significant. In the short term, the rollback of the rates that would take effect on July 1, 2011 would require approximately \$20 million in reductions to the water, sewer and solid waste funds for FY2011/12. Significant cuts will be required to achieve this \$20 million reduction. Short term impacts may include, but are not limited to, the following:

- Workforce reduction of 80-100 FTE;
- Suspension of Memberships;
- Increased localized flooding/delayed response;
- General Fund revenues reduced;
- Suspension of fluoridation;
- Loss of grant opportunities due to lack of matching funds;
- Reduced Call Center hours;
- Reduced water pressure (fire flows and business dependencies) due to well shut-downs and/or reduced pump pressure;
- Potential for fines and building moratoriums;
- Inability to repair aging water treatment facilities and combined sewer system (cuts to Capital Improvement Programs); and
- Further depletion of fund reserves may impact the General Fund.

The long term impact will be even more significant if costs of service increase at a rate exceeding the CPI and voters are unwilling to approve rate increases necessary to fund these costs.