



City of Sacramento City Council

915 I Street, Sacramento, CA, 95814
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Meeting Date: 1/10/2012

Report Type: Staff/Discussion

Title: Department of Utilities Water and Wastewater Program Update

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Location: Citywide

Recommendation: Receive and file.

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Department: Department Of Utilities

Division: Fiscal and Administration Svcs

Dept ID: 14001611

Attachments:

1-Description/Analysis

2 - Background

City Attorney Review

Approved as to Form
Janeth D. San Pedro
12/27/2011 4:12:44 PM

City Treasurer Review

Reviewed for Impact on Cash and Debt
Janelle Gray
12/23/2011 11:03:20 AM

Approvals/Acknowledgements

Department Director or Designee: Mike Malone - 12/27/2011 9:51:29 AM



Description/Analysis

Issue: On November 8, 2011 the Department of Utilities (DOU) presented its Financial Plan (Plan) to City Council. The Plan includes a 30-year Water and Wastewater Infrastructure Investment Program (Program) and addresses the needs of the solid waste and storm drainage funds as well as future development. The City Council conceptually approved the Water and Wastewater Infrastructure Investment Program and asked DOU to develop alternate water and wastewater program scenarios and present those scenarios to Council. This report discusses the alternate program scenarios developed based on input from the Utility Rate Advisory Commission (URAC) and the community. Detail of each program scenario is included in the Background section of this report.

Policy Considerations: The City Council, through its policy decisions and rate setting authority, ultimately determines the level of utility services to be provided, subject to applicable regulatory requirements. The alternate programs presented in this report provide the Council with water and wastewater service program options to consider in conjunction with the ongoing rate setting process.

Charging rates that generate revenue sufficient to invest in utility infrastructure and regulatory compliance at sustainable levels and deliver core services helps achieve the City's goals of improving and expanding public safety, achieving sustainability and livability, and supporting economic development throughout the City.

Environmental Considerations: The establishment and modification of utility service rates is exempt from the California Environmental Quality Act (CEQA) (Public Resources Code § 21080(b) (8)).

Sustainability: The Department's proposed Water and Wastewater Program is consistent with the City's sustainability targets to:

- Protect the ecological integrity of the City's primary drinking water source
- Implement the Statewide Urban Water Conservation Council's water conservation best management practices
- Reduce sanitary sewer overflows

Commission/Committee Action: The City Council formed a Utilities Rate Advisory Commission (URAC) 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 public hearings required by Proposition 218 when the City proposes to impose or increase utility rates. DOU will continue to work through the URAC to shape the Water and Wastewater Infrastructure Investment Program and hold the Proposition 218 hearing on the rate proposal prior to bringing the rate proposal with the URAC recommendation to the City Council for its consideration.

Rationale for Recommendation: On November 8, 2011, the City Council conceptually approved the Water and Wastewater Infrastructure Investment Program and asked DOU to develop alternate water and wastewater program scenarios and present those scenarios to Council. The DOU has prepared the alternate scenarios and is presenting them to City Council as an informational item.

Financial Considerations: This report presents alternative water and wastewater program scenarios and each represents a different financial impact. The actual financial impact will depend on the rates approved by the City Council following the URAC rate hearing and recommendation.

All scenarios presented comply with the Proposition 218 mandate which only allows utilities to charge rates sufficient to recover the cost of providing utility services.

Emerging Small Business Development (ESBD): Not applicable.

Background

Department of Utilities Financial Plan Overview

On November 8, 2011, the Department of Utilities (DOU) presented its Financial Plan (Plan) to City Council. The Plan included a 30-year Water and Wastewater Infrastructure Investment Program (Program), discussed in more detail below, and also discussed the needs of the solid waste and storm drainage funds as well as future development.

The Solid Waste Division is in the process of developing a business plan to guide its future operations. Once the business plan is complete, recommendations for solid waste services and operations will be brought forward for City Council consideration under the new leadership of the General Services Department. Regarding storm drainage, under Proposition 218, rate adjustments for this service require voter approval. DOU has retained consultant services to conduct a storm drainage rate study and make recommendations for a future storm drain rate design and structure. DOU will present the consultant's findings and recommendations to the City Council for its consideration at a future date.

The final component of the financial plan addresses impact fees and the ability of the City to fund improvements necessary to serve new growth. In order to meet this need, impact fees must reflect the current cost of constructing facilities needed to serve new development. At a future date, DOU will present an impact fee adjustment proposal to City Council that reflects current development costs and better positions the City for growth.

30-Year Water and Wastewater Infrastructure Investment Program Overview

On November 8, 2011, the City Council conceptually approved DOU's Water and Wastewater Infrastructure Investment Program (Program). The overall Program is not intended to function as a specific Capital Improvement Program, but rather as a long-term strategy of investing in the City's water and wastewater capital and regulatory programs at levels that sustains the health of the systems and guarantee continued reliable and high quality service the citizens of Sacramento have come to expect. The Program includes the following components:

- A 30-year Water and Wastewater Infrastructure Investment Program based on industry best practices for system replacement – given the long term nature of this Program, it is the Department's intent to remain flexible and adjust the Program as needed to respond to future circumstances and conditions
- A specific 5-year Capital Improvement Program for FY2012/13 through FY2016/17.
- Compliance with new regulatory requirements
- Continuity of existing production, maintenance and regulatory activities

Rate Proposal

To begin implementation of the Program, DOU has proposed 3-year rate increases of 10% per year for water, and 16%, 15% and 14% per year, respectively, for wastewater

(sewer). This will increase the overall monthly bill of a typical residential customer who receives both water and sewer service from the City by approximately 6% (equivalent to 19 cents per day) during the first year. Over the course of the next three years, the average single-family residential customer who receives both City water and wastewater service would see their monthly City utility bill rise approximately 19%, or \$19.06 (equivalent to 64 cents per day). The proposed sewer rate increase would not apply to City residents who receive sewer service from the Sacramento Area Sewer District instead of the City. This rate proposal was included in the Proposition 218 Rate Increase Notification Mailing sent to City utilities customers on December 8, 2011.

Future Obligations

The proposed 3-year rate increase finances a program that uses a mix of bond and cash financing that allows the City to invest in its infrastructure and meet regulatory requirements while smoothing rate increases and avoiding rate spikes for utility customers. The proposal is essentially self-contained, and can be viewed as a stand-alone proposal, because: (1) if the proposed 3-year rate increase is approved, this financing methodology would only necessitate an increase of water rates by approximately 2% and an increase of wastewater rates by approximately 1% in the fourth year (FY2015/16) in order to meet program bond requirements and debt service obligations; and (2) after FY2015/16, no additional rate increases would be needed to finance existing programs. However, that does not mean there would be no negative consequences if no rate increases are approved beyond FY2015/16, since this likely would result in noncompliance with regulatory requirements in future years which could result in costly fines, third party lawsuits and/or loss of local control among other things.

Return on Investment and Economic Benefits

The proposed rate increase will generate enough revenue to finance the following projects:

- Financing for the Sacramento River Water Treatment Plant rehabilitation project to ensure plant reliability
- Moving toward future investment in the City's water and wastewater infrastructure on a 100-year replacement schedule instead of the current 400 and 650-year schedules, to ensure system reliability and safety
- Compliance with existing and anticipated new federal, state, and local regulatory mandates
- Increased investment in the residential water meter program to comply with state law and encourage water conservation

DOU has contracted with the California State University, Sacramento College of Business Administration to determine the regional economic impact of the proposed DOU Water and Wastewater Infrastructure Investment Program. Preliminary results of that study indicate that investing in the City's infrastructure at the levels proposed will create approximately 6,446 new jobs in the first five years and 26,620 new jobs over the 30 year life of the program. DOU anticipates the final economic impact report to be

complete in early 2012 and will present the findings during the February 2012 rate adjustment process.

Regulatory Program Overview

Compliance with existing regulations and anticipated new requirements and mandates is the primary driver of the Program. The following information provides an overview of the major regulatory mandates funded in Program:

Water

The primary regulatory mandate affecting the water fund is the state mandate to have water meters installed on all the City's residential connections by January 1, 2025. On September 24, 2004, Governor Arnold Schwarzenegger signed Assembly Bill 2572 setting a deadline of 100% metering of all accounts by 2025. On May 24, 2005, the City Council adopted Resolution 2005-347, directing that water meters be installed throughout the City.

If the City cannot meet the requirements of this law, eligibility for state grants and low interest loans will be compromised, and the City's water rights and future diversions off the Sacramento and American Rivers may be adversely impacted.

Wastewater

The City's Combined Sewer System (CSS) is governed by a State National Pollutant Discharge Elimination System (NPDES) Permit that prohibits dry weather discharges to the river and limits wet weather discharges to the river. The goals of the NPDES Permit are to eliminate pollution discharged to the river, reduce outflows and reduce flooding. The Permit requires treatment for discharges to the river; implementation of a Long Term Control Plan requiring an approximately \$10 million annual capital improvement program; extensive monitoring and data analysis; system-wide cleaning and inspection; a fats, oils and grease control program; and various other specific minimum control measures.

The City's separated sanitary sewer system is governed by the federal Clean Water Act, and Statewide General Waste Discharge Requirements (WDR) that prohibit sewer overflows and requires implementation of a management plan. The WDR requires system-wide cleaning, inspection and rehabilitation; a fats, oils and grease control program; a root control program; enforcement; and a short and long term capital improvement program.

Failure to comply with these permits could subject the City to Federal and State enforcement actions and third party lawsuits. Enforcement actions could include cease and desist orders, fines for violations (up to \$10,000 per day plus \$10 per gallon of discharge), and consent decrees and/or building moratoriums. Beginning in the next Fiscal Year, operation and improvement of the City's separated sanitary sewer system will be subject to the mandatory provisions of a 5-year consent decree that resulted from a Clean Water Act lawsuit brought against the City in early 2011 by the California Sportfishing Protection Alliance.

Alternate Program Scenarios

Per Council's direction, several alternate water and wastewater program scenarios were developed based on input from the Utility Rate Advisory Commission (URAC) and the community. Each program has two primary components: regulatory requirements and capital improvement projects. Because the water and wastewater financial plan is primarily regulatory-driven, existing regulatory programs are funded in each fund's alternate programs. In two scenarios, the funding level and project schedule for the water and wastewater capital programs is the primary difference between each fund's alternate programs. One scenario is a five-year status quo scenario that freezes operational and capital funding (except for the residential water meter program in the water fund) at FY2011/12 levels and does not fund new regulatory requirements for five years. The alternate scenarios for water and wastewater are as follows:

Water Program Scenarios:

- *Scenario A: Proposed*
 - Funds regulatory program
 - Funds water treatment plant project on schedule
 - Funds best practices infrastructure replacement program
- *Scenario B: Regulatory and Water Treatment Plant*
 - Funds regulatory program
 - Funds water treatment plant project on schedule
 - Delays best practices infrastructure replacement program five years
- *Scenario C: Regulatory Only*
 - Funds regulatory program
 - Delays water treatment plant five years
 - Delays best practices infrastructure replacement program five years
- *Scenario D: Current Path*
 - Freezes operational and capital programs at FY2011/12 levels for five years
 - Funds residential water meter program at an increasing rate of approximately 3% of total water revenue each year for five years (approximately \$2.5 million/year)
 - Does not fully fund existing regulatory requirements for five years

Wastewater Program Scenarios:

- *Scenario A: Proposed*
 - Funds regulatory program
 - Funds best practices infrastructure replacement program
- *Scenario B: Regulatory Only*
 - Fund regulatory program

- Delays best practices infrastructure replacement program five years
- Scenario C: Current Path
 - Freezes operational and capital programs at FY2011/12 levels for five years
 - Does not fully fund existing regulatory or any new regulatory requirements for five years

Program Financing Approach and Methodology

All of the water and wastewater program scenarios use a mix of bond and cash financing that allows the City to invest in its infrastructure and meet regulatory requirements while smoothing rate increases and avoiding rate spikes for utility customers. The five-year status quo scenario uses pay-go financing for the first five years of the program the bond/cash blend thereafter.

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. The rate increases are designed to gradually decrease over time. This methodology provides predictable rates for the utility's customers and provides additional revenues in the near term which will reduce future bond issuance amounts, ultimately lowering rates in the long run. Each scenario has 30 months of capitalized interest which delays the first repayment on any projected bond issuances by two years. This pushes out rate increases in the near term and increases overall costs and rates to the utility's customers in the long term.

Next Steps

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

- Community Engagement Activities – Ongoing (Rate workshops, presentations, video/website)
- URAC Public Rate Hearing – January 25, 2012
- Presentation of Utility Rate Recommendation to City Council – February 2012
- If adopted, new Water and Wastewater Rates Effective – July 1, 2012

