

Meeting Date: 10/27/2015

Report Type: Staff/Discussion

Report ID: 2015-00866

Title: Utilities Water, Wastewater and Storm Drainage Financial Plan and Rate Proposal

Location: Citywide

Recommendation: Pass a Motion referring to Budget and Audit Committee the Utilities Water, Wastewater and Storm Drainage Financial Plan and Rate Proposal.

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Department: Department Of Utilities

Division: Business & Integrated Planning

Dept ID: 14001661

Attachments:

1-Description/Analysis

2-Background

3-Attachment 1

City Attorney Review

Approved as to Form

Joe Robinson

10/21/2015 4:59:17 PM

Approvals/Acknowledgements

Department Director or Designee: Bill Busath - 10/20/2015 2:48:40 PM

Description/Analysis

Issue Detail: On March 27, 2012, the City Council approved water and wastewater rate adjustments 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 adjustments allowed the City to invest in capital improvements and operational and maintenance practices to improve service and reduce maintenance costs by replacing inadequate or deteriorated systems, and to maintain compliance with federal, state, and local regulatory mandates. City Council's approval of the rate adjustments also began to address 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 current financial resources and capital investment were inadequate to maintain the City's water and wastewater systems.

Simultaneously with the water and wastewater rate adjustments, the Department of Utilities (DOU) has implemented numerous efficiencies and received non-rate payer dollars that have reduced costs to ratepayers. Since 2012, DOU has obtained over \$18 million in federal, state, and local grants for water, wastewater, and storm drainage projects.

The water and wastewater rate adjustments approved by City Council in March 2012 were the first step in DOU's long-term financial plan to proactively invest in the City's aging utility infrastructure systems and address ever-increasing regulatory requirements.

According to the United States Environmental Protection Agency and the American Society of Civil Engineers' utility industry best practices, water and wastewater systems should be replaced every 70-100 years in order to sustain them in a condition that can reliably deliver service. In 2012, the City was on pace to replace its entire water system every 400 years and its wastewater system every 650 years. Based on the current level of infrastructure investment made possible by the rate adjustments approved by City Council in 2012, at the present rate of investment, the City's replacement rate has been reduced to 280 years for its water system, and 410 years for its wastewater system.

The storm drainage fund has not had a rate increase since 1996, which has resulted in two serious consequences:

1. The cost of operation and maintenance of the system now equals the rate revenue and will surpass it in the coming years.
2. Capital investment in the storm drainage infrastructure for the past several years has been minimal. At current rates of infrastructure investment, the City will replace its entire storm drainage system approximately every 2,800 years.

As a result, the fund balance has decreased and, if the current trend continues, it will be depleted by 2021.

The proposed water, wastewater, and storm drainage capital investment program includes the following:

- A 30-year Water, Wastewater and Storm Drainage Infrastructure Investment Program based on industry best practices for system replacement
- A 4-year Capital Improvement Program for FY2016/17 through FY2019/20 for water and wastewater and FY2017/18 through FY2020/21 for storm drainage
- Compliance with new regulatory requirements
- Continuity of existing production, maintenance, and regulatory activities

As the next step towards implementing the Department of Utilities long-term financial plan, DOU is proposing a water, wastewater, and storm drainage program and rate proposals to implement the program. Final rate proposals will be brought to City Council for approval in early 2016 following review of the proposal and recommendation by the Utilities Rate Advisory Commission (URAC), consistent with the Proposition 218 notice and public hearing process. In addition to the notice and hearing process, Proposition 218 requires voter approval for adjustments to storm drainage rates. To evaluate whether the current drainage rate is equitable to all customers and represents industry best practices, DOU worked with a consultant and community stakeholders to conduct a storm drainage rate study and make recommendations for a future storm drain rate design and structure.

The tables below describe the proposed rate adjustments for water, wastewater and drainage.

WATER				
Fiscal Year	2017	2018	2019	2020
Percent Increase	10	10	10	10
Monthly Dollar Increase	4.57	5.03	5.53	6.09

WASTEWATER				
Fiscal Year	2017	2018	2019	2020
Percent Increase	9	9	9	9
Monthly Dollar Increase	2.02	2.20	2.40	2.61

STORM DRAINAGE				
Fiscal Year	2017	2018	2019	2020
Percent Increase	16	16	16	16
Monthly Dollar Increase	.058*	1.90	2.21	2.56

*Note: In addition to the proposed storm drainage rate adjustments, a rate structure change is also being proposed that results in minor decreases for residential customers and increases for non-residential customers.

As explained in the Financial Section below, the proposed storm drainage rate adjustment, if approved by the voters, would become effective in the fiscal year following the vote. It is currently anticipated that this vote would take place following council approval in early 2016 and the rate adjustments would be effective in 2017. If circumstances warrant however, the vote could take place in early 2017, in which case the rate adjustments would be effective in FY2018.

Another component of DOU's financial plan addresses development impact fees and the ability of the City to fund improvements necessary to support new growth. In order to meet this need, impact fees must reflect the current cost of constructing facilities needed to serve new development. DOU's proposed impact fees will be presented to City Council as part of the citywide Financial Plan at a future date. The proposed impact fees will reflect current development costs and better position the City for growth.

Policy Considerations: DOU's long-term financial plan incorporates the following community priorities and financial guiding principles:

- Continued high-level customer service
- Environmental stewardship
- Regulatory compliance
- Investment in infrastructure
- Cost efficiencies
- Plan for competitive credit rating/borrowing costs
- Competitive user rates, at-cost customer charges
- Maintenance of a minimum of 120 days fund reserve
- Compliance with debt service coverage requirements

The water, wastewater, and storm drainage program invests in infrastructure, meets existing and addresses new regulatory requirements, minimizes operating and maintenance cost increases, and proactively establishes a phase-in schedule to achieve a 100-year best-practices replacement cycle. The Water, Wastewater and Storm Drainage Infrastructure Investment Program and 4-year Capital Improvement Program can be found in the background section of this report.

The proposed rate adjustments to fund the program will provide the revenue necessary to do the following:

- Improve the City's competitiveness as a place of interest
- 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 infrastructure 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

The City Council, through its policy decisions and rate setting authority, ultimately determines the levels of utility services to be provided. In 2008, the City Council formed a Utilities Rate Advisory Commission (Commission) to review and comment on utility rate proposals and to provide recommendations to the Mayor and City Council on the City's utility rates. DOU staff will assist the Commission in its development of rate recommendations for City Council. 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.

Economic Impacts: Investing in basic infrastructure will make Sacramento more attractive to potential investors in housing and job-producing enterprises. Construction activity resulting from these rate adjustments will have a significant positive economic impact on 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 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 sources
- Implement the Statewide Urban Water Conservation Council's water conservation best management practices
- Reduce sanitary sewer overflows

Commission/Committee Action: The Utilities Rate Advisory Commission is charged with holding public hearings required by Proposition 218 when the City proposes to impose or increase utility rates. DOU will bring the rate proposal to the City Council for its consideration after the Commission holds the public hearing and adopts its recommendation.

Rationale for Recommendation: As has been mentioned, the City Council made a commitment in 2012 to invest in 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 investment also allowed the City to invest in capital improvements and operational and maintenance practices necessary to maintain compliance with federal, state, and local regulatory mandates. To ensure system reliability and sustainability as well as meet industry best practices, the City needs to continue to invest in its utility infrastructure. In addition to capital investments, the City must also continue to invest in operational and maintenance practices necessary to maintain compliance with federal, state, and local regulatory mandates.

The Department's water, wastewater, and storm drainage program moves the City toward achieving system reliability and sustainability and meeting best practices. DOU will use community meetings, websites, and social networking to educate the community about the City's capital and regulatory challenges. DOU will continue to meet with the community, share information about the program and funding plan, and seek input throughout the rate-setting process.

The benefits of investing in the City’s water, wastewater, and storm drainage infrastructure systems at sustainable levels and the potential consequences of failing to make the necessary investments are outlined in the following table:

Benefits	Consequences
Preservation of property	Public health and safety threats
Continuity of high quality and reliable services	Service interruption and delays in repairs
Continued regulatory compliance	Regulatory non-compliance including fines, moratoriums and/or consent decrees
Maintain local control of utility systems	Federal/State enforcement of regulatory compliance and loss of local control
Environmental stewardship	Threats to public health and safety and natural environment
Supports economic development and job creation	Investments are made elsewhere
Financial stability	Lawsuits, risk claims, dependence on General Fund
System sustainability	Increased potential of system failure and increased maintenance costs

Financial Considerations: The financial plan and rate proposal complies with the Proposition 218 mandate which only allows utilities to charge rates sufficient to recover the cost of providing utility services. The Proposition 218 notification of rate increases for water and wastewater will be sent out in mid-November or early December, with the goal of bringing the rate proposals to the City Council for consideration and approval in early 2016, after the Utilities Rate Advisory Commission holds the public hearing and provides its rate recommendation. Water and wastewater rate adjustments are proposed to be effective July 1, 2016. Storm drainage rate adjustments, under Proposition 218, require voter approval and, should the voters approve the adjustments, will be effective shortly after the conclusion of the ballot process in either FY17 or FY18 depending on the date of the vote.

Four year annual rate adjustments of 10%, 9% and 16% are being proposed for water, wastewater and storm drainage respectively. These adjustments will fund the proposed \$367 million critical CIP program. This program will cover FY17-20 for water, wastewater and storm drainage.

The water, wastewater, and storm drainage program and funding plan framework are built on the following guiding principles that were developed in collaboration with the community as part of the outreach efforts undertaken in 2012:

- Continued high-level customer service
- Environmental stewardship
- Regulatory compliance

- Investment in infrastructure
- Cost efficiencies
- Plan for competitive credit rating/borrowing costs
- Competitive user rates, at-cost customer charges

As the infrastructure needs are significant and immediate, funding the water and wastewater program on a cash basis would cause dramatic rate spikes. Therefore, consistent with the above guiding principles, 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. While issuing bonds and receiving loans will increase the long-term cost of financing the City's capital and regulatory programs, issuing bonds and receiving loans in the near term will reduce increases in water and wastewater rates and more equitably spread the benefits and costs of the infrastructure and regulatory investment to utility customers over a longer term. Any such bond issuances or loan agreements are subject to approval by City Council. The storm drainage portion of the program is proposed to be cash financed. The long-term financing plan for all funds gradually builds up the cash funding portion and the debt component of the water and wastewater portion decreases to ultimately achieve a sustainable "pay-go" program.

Local Business Enterprise (LBE): Not Applicable

Background

The Department of Utilities (DOU) manages the City's municipal water, wastewater, and storm drainage systems.

DOU has developed a comprehensive financial plan that proposes a proactive approach for the City to invest in its utility infrastructure systems and address ever-increasing regulatory requirements while keeping operational costs as low as possible. The water, wastewater, and storm drainage programs include a 30-year Infrastructure Investment Program (Program), with a specific four-year Capital Improvement Program (CIP).

The specific mandated programs 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; an NPDES storm water permit that requires the minimization of pollutants discharged into waters of the US; and AB 2572, which requires the installation of water meters for all water services by the year 2025.

The proposed 30-year Water, Wastewater and Storm Drainage Infrastructure Investment 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, wastewater and storm drainage infrastructure and as part of the proposed 30-year Program, a specific 4-year Capital Investment Program for water, wastewater, and storm drainage is proposed.

The 4-year water CIP includes funding for the mandated water meter retrofit program, Information Technology system (IT) upgrades, and pipe replacement in the distribution and transmission main systems, in an effort to phase in water infrastructure investment to achieve sustainable (best practices) levels. The 4-year wastewater program includes funding for projects in both the separated and combined systems to comply with regulatory mandates, IT upgrades, and a phasing-in of a sustainable "best practices" pipeline replacement program. The 4-year storm drainage CIP includes improvements to the system to meet council approved levels of service, IT upgrades, regulatory compliance projects, and pipe and pump station rehabilitation.

In addition to capital investment, the Program includes continuity of existing production, maintenance and regulatory activities, as well as addressing new regulatory

requirements that are performed as part of the Department's production and maintenance activities.

Along with costs for new regulatory requirements, DOU incurs other types of expense to continue providing the existing production, maintenance, and regulatory activities. Costs for items such as electricity and chemicals continue to rise. In addition, there are mandated nondiscretionary transfers and fixed costs such as the utility users tax, cost plan, and debt service.

Moreover, DOU will continue to implement audit recommendations, identify additional process improvements, and implement efficiencies to help offset increasing costs that DOU cannot control. DOU will continue to assess the condition of infrastructure to ensure maximizing the life of the system. Lastly, DOU is actively seeking grants to help fund infrastructure and regulatory programs.

In 2008, the City Council formed a Utilities Rate Advisory Commission (Commission) to review and comment on utility rate proposals and to provide recommendations to the Mayor and City Council on the City's utility rates. DOU staff will work closely with the Commission throughout this rate adjustment 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.

In March of 2012 City Council approved a Utility Rate Assistance Program in conjunction with the approved rate adjustments in water and wastewater. This program is funded by a portion of the General Fund Tax paid by DOU to the City General Fund. Current details of the program are:

- a. 1,527 customers are participating in the program for water and wastewater services
- b. Since inception of the program, \$330,000 has been expended on rate assistance for water and wastewater

DOU proposes that this program continue and that it be expanded to storm drainage.

DOU proposes the following timeline for the water, wastewater and storm drainage rate adjustment process:

- Community Engagement Activities – Ongoing (Rate workshops, presentations, video/website)
- URAC Workshop (Financing) – October 28, 2015

- Proposition 218 Notification Mailed –November/December 2015
- URAC Public Rate Hearing – January 2016
- Presentation of Utility Rate Recommendation to City Council – February/March 2016
- Storm Drainage Rate Recommendation Ballot - TBD
- New Water and Wastewater Rates Effective – July 1, 2016
- New Storm Drainage Rates Effective – At Conclusion of Balloting Process

**Department of Utilities Community Engagement Program
(*Your Utilities. Your Community.*) Summary**

The City of Sacramento Department of Utilities is engaging the community and seeking insights into the department's water, wastewater and storm drainage utilities to help prepare a finance plan and eventually a potential rate adjustment to address its biggest challenges: aging infrastructure and increasing regulations and mandates. This effort is being called *Your Utilities. Your Community.*

The Department has identified two goals as outcomes of the effort:

- Community engagement, understanding and feedback regarding the Department's aging infrastructure, increasing regulations and mandates and the need for rate adjustments
- City Council support for a finance plan and rate adjustment proposal, including authorization for a voter ballot for a storm drainage rate adjustment

The community engagement program will focus on fairness, financial stability, reliability and safety. The *Your Utilities. Your Community.* outreach process has five main components:

1. Educate customers and stakeholders about the state of the utilities systems and the need for water, wastewater and storm drainage system improvements to ensure safety, fairness and reliability as well as the importance of 1:100-year replacement cycles to meet industry best practices.
2. Demonstrate accountability and transparency by showing how past water and wastewater rate adjustments have been used and how future rate adjustments will be used.
3. Involve City Council in the rate outreach process and provide opportunities for communication and involvement with their constituents.
4. Engage the community and stakeholders in the rate outreach process by providing opportunities via a website and community meetings for two-way dialog for stakeholders and the community to ask questions and provide feedback and suggestions.
5. Provide factual, transparent information to the media on the need for continued investment in Sacramento's water, wastewater and storm drainage utilities for safe, reliable and financially stable utilities systems.