Item No. 2

Supplemental Material

For

City of Sacramento

Utilities Rate Advisory Commission

Agenda Packet

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TITLE:

Measure B - Utilities Rate Hike Rollback Act of 2010 Impact

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REPORT TO UTILITY RATE ADVISORY COMMISSION
City of Sacramento

915 I Street, Sacramento CA 95814-2604

August 25, 2010

Honorable Chair and
Members of the Utility Rate Advisory Commission

Title: Measure B - Utilities Rate Hike Rollback Act of 2010 Impact

Location/Council District: All

Recommendation: Discussion and possible action on Measure B, the Utilities Rate Hike Rollback Act of 2010.

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Presenters: Marty Hanneman, Director of Utilities, 808-7508
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Jamille Moens, Business Services Manager, 808-5988

Department: Utilities

Division: Office of the Director

Organization No: 14001011

Description/Analysis

Issue: On May 21, 2010, the Sacramento County Taxpayers League submitted signed petitions to the City Clerk's Office to place the Utilities Rate Hike Rollback Act of 2010 ("Initiative") on the November 2, 2010 ballot. To qualify for the ballot, 5,420 valid signatures were 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. On June 22nd, City Council approved placement of the Initiative on the November 2, 2010 ballot, where the Initiative will be titled Measure B.

If Measure B receives voter approval, it would amend the Sacramento City Code (sections 13.04.720,13.08.400, and 13.10.130 pertaining to the authorization for the Sacramento City Council to set monthly rates for water, sewer, and garbage collection service) to repeal and cancel the Council approved utility rate increases that went into effect on July 1, 2010. This rate rollback would take effect on July 1, 2011 (FY2011/12), so that effective July 1, 2011 the water, sewer, and garbage collection service rates would be set at the rates in effect as of February 2010 (it is not entirely clear whether the measure applies to all solid waste rates rather than just garbage rates). Measure B does not apply to the City's storm drainage rates.

Passage of Measure B would allow the City Council to change the City's current rates for water, sewer, and garbage collection 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 increase in the U.S. Department of Labor's consumer price index (CPI) inflation rate for the previous year.

If Measure B is adopted, 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, and approximately $2 million in reductions in the General Fund. This projected $22 million reduction includes aproximately $15 million in lost revenue due to the rate rollback, and $7 million in projected increases for the 2011/12 fiscal year for operation and maintenance expenses that Measure B's one-year rate freeze would prevent the City from recovering by increasing rates. (These estimates are based on the application of Measure B to all solid waste rates.) Significant cuts in Utility programs and services as well as other City services will be required to achieve this $22 million reduction. The long term impact will be even more significant if costs of service increase at a rate exceeding the increase in the CPI and voters are unwilling to approve rate increases necessary to fund these costs.

Policy Considerations: The Department of Utilities is an Enterprise funded operation, i.e., a self-supporting operation funded primarily by user fees and charges for services provided to the public. Current law requires that utility rates be calculated based on the City of Sacramento's costs of providing the utility services. These costs include operation and maintenance costs (such as fuel, utilities, chemicals, and labor); costs to repair, replace, or improve utility infrastructure; and costs to comply with applicable regulatory and other governmental requirements. In addition, the cost of service includes an 11% general tax on utility charges that voters approved in 1998, which generates revenue that funds City services such as public safety, parks and youth and senior programs. By reducing the utility rates to the rates in effect on February 10, 2010, Measure B would reduce the revenues available to fund utility service costs as well as public safety costs and other City of Sacramento services.

In addition to the cost-of-service limitation described above, current law requires the City to follow specified notice, protest, and public hearing procedures prior to the

City Council's approval of increases for utility rates, but does not require voter approval of increases for water, sewer and solid waste rates. Measure B would impose a new limitation on the City's ability to increase utility rates, by requiring voter approval for rate increases that exceed the annual increase in the consumer price index specified in Measure B. If rate revenue is insufficient to fund the cost of utility services, the General Fund could be called upon to provide funding to the Utility funds, further impacting the General Fund's ability to fund existing General Fund programs.

A "yes" vote is in favor of enacting the ordinance rolling back the utility rates and preventing the City Council from adopting future rate increases that exceed the annual increase in a specified consumer price index unless approved by the voters. A "no" vote is against enacting the ordinance, and would leave unchanged the utility rates and the City's current rate setting authority. A majority of "yes" votes is required for the ordinance to be enacted.

Rationale for Recommendation: Measure B directly affects utility rates. The Utilities Rate Advisory Commission (Commission) is tasked with reviewing and commenting on proposed utility rates changes, holding public hearings on proposed rate adjustments, acting as a community liaison to help the public understand and participate in the rate setting process, and developing and providing recommendations on rates to the Mayor and City Council. Given the significance of Measure B on utility rates and rate setting, it is recommended that the Commission be informed of the issue and be provided the opportunity to take a position on Measure B if the Commission is so inclined.

In the short term, the rollback of the rates and one-year "rate freeze" 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 up to 80 FTE;
- Delayed response to sewer backups and water main breaks, and increased localized flooding, due to longer wait time for customer service support and reduction in crews on duty;
- Reduced water pressure (fire flows and business dependencies) from reduced pumping and well shutdowns;
- Reducing frequency of solid waste services;
- Suspension of memberships with critical partner agencies;
- Suspension of fluoridation;
- Cuts and suspended funding for Water Meter Program; and
- General Fund program reductions (public safety, parks, seniors).

Historically, utility service costs such as labor, fuel and chemicals have risen at a higher rate than the rate of inflation. As Measure B limits City Council's ability to adjust rates, without voter approval, to increases in the CPI, the long term impacts

of Measure B are likely to be even more significant than the short term impacts, if costs of service continue to increase at a rate exceeding the CPI increase, and voters are unwilling to approve rate increases necessary to fund these costs; this would lead to regulatory requirements (such as the water meter program) not being met, and aging infrastructure not being adequately maintained, repaired and/or replaced. Some of these longer-term potential impacts include the following:

- Significantly reduced ability to repair and replace large backlog of aging water, combined sewer, and sewer system facilities;
- Loss of grant opportunities due to lack of match funding;
- Inability to fund existing and "new" regulatory requirements;
- Inability to finance major capital projects (aging water treatment facilities and combined sewer system);
- Increased potential for regulatory fines, third party lawsuits and/or building moratoriums due to reductions in utility system maintenance, repair and improvement
- Cost of elections $24,000 – $1.5 million; and
- Additional cuts to General Fund programs such as public safety and parks if utility funds do not have sufficient reserves to cover utility costs and the General Fund becomes financially responsible

See Attachment 1 for more information on the Department of Utilities' infrastructure and regulatory environment.

Financial Considerations: It is projected that passage of Measure B would result in an initial revenue reduction of approximately $22 million to the affected utilities funds and the General Fund, which includes aproximately $15 million in lost revenue due to the rate rollback, and $7 million in projected increases for the 2011/12 fiscal year for operation and maintenance expenses that Measure B's one-year rate freeze would prevent the City from recovering by increasing rates. (These estimates are based on the application of Measure B to all solid waste rates.) The projected savings for an average single-family customer if Measure B passes is 28 cents per day.

Measure B would also impose a new limitation on the City's ability to increase utility rates, by requiring voter approval for rate increases that exceed the annual increase in the consumer price index specified in Measure B. If rate revenue is insufficient to fund the cost of utility services, and voters are unwilling to approve rate increases to cover the cost of the utilities, the General Fund could become financially responsible for the Utility funds. Furthermore, additional costs would be incurred for voter approval ranging from $24,000 to $140,000 for a consolidated election to $1 million to $1.5 million for a stand-alone special election.

Respectfully Submitted by: _____
Jamille Moens
Business Services Manager

Approved by: _____
Marty Hanneman
Director of Utilities

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ATTACHMENT 1

BACKGROUND

UTILITIES' INFRASTRUCTURE AND REGULATORY ENVIRONMENT

Replacing or rehabilitating aging, dilapidated or failed infrastructure and complying with regulatory requirements are significant costs in operating the City's water, wastewater, drainage and solid waste systems, and funding these costs presents major challenges. Passage of Measure B, the Utility Rate Hike Rollback Act of 2010, would reduce the City's water, sewer and garbage rates, "freeze" these rates for one year, and require voter approval for any future rate increases that exceed the increase in an annual consumer price index. The passage of Measure B would reduce funding available for regulatory compliance and the Capital Improvement Program (utility infrastructure), and would restrict the City Council's authority to set future rates as needed to provide funding for utility needs for the City.

The magnitude and complexity of the utility infrastructure and regulatory environment for the Department of Utilities is significant. The City of Sacramento owns and operates water, wastewater and drainage systems that include thousands of miles of pipelines, over 150 pumping plants and several treatment facilities. Consistent with the age of the City, much of the infrastructure has exceeded its useful life, requires increasing levels of maintenance, and is in need of replacement or rehabilitation to ensure reliable operation. In addition, much of the infrastructure does not meet the performance standards set by the City Council and required by current regulations, and thus requires extensive improvements.

The Capital Improvement Programs (CIP) for the water, sewer, and storm drainage programs exist to address these three needs: replacement and rehabilitation, improvements to meet current standards, and compliance with regulatory requirements. The Department of Utilities has a CIP for each of its disciplines to address these needs and shortcomings.

One of the major aspects of the CIP program is funding to rehabilitate and replace aging water and sewer infrastructure. A significant portion of the City's infrastructure has exceeded its estimated life cycle and is increasingly likely to catastrophically fail. It is estimated that over 600,000 feet of water main serving the City is over 100-years old with a replacement value of over $125,000,000. According to the U.S. Environmental Protection Agency (USEPA) and the American Society of Civil Engineers (ASCE) the estimated life cycle for water mains is between 60 and 95 years. The City's Sacramento River Water Treatment Plant was originally constructed in the early 1920's. Today many components of that original facility are still in place and in need of replacement. A complete condition assessment has identified over $120,000,000 in replacement needs to restore the treatment plant's reliable capacity to meet existing demands.

The City's sewer system is unique among most other cities on the West Coast. The oldest part of the City - generally the downtown, East Sacramento and Land Park areas - is served by a combined sewer system (CSS) that was built with these neighborhoods and dates back in some cases to the late 1800's. Other parts of the City are served by a separated sewer system. The CSS is unique in that it collects both sanitary sewage and storm drainage in one pipe. The only other city in California with such a system is San Francisco but these systems are very common in the older urban areas east of the Mississippi River. Over 170 miles of the pipes serving the City's CSS exceed the USEPA and ASCE expected life cycle of 80-years old. The estimated replacement value of this life cycled infrastructure is over $300,000,000. During large storms, the CSS can become overwhelmed with storm runoff, and surcharge combined wastewater into the streets and cause treated or very rarely, untreated discharges to the Sacramento River. As a consequence of this potential, the CSS has been subject to regulatory actions that mandate significant improvements to the system. To date, over $150,000,000 in federal, state and local funds have been spent upgrading the system and reducing street flooding and river discharges. However, the National Pollutant Discharge Elimination System (NPDES) permit regulating the CSS obligates the City to continual upgrades to the system. The separated sewer system that serves the remainder of the City is geographically split between the City and the Sacramento Area Sewer District. The portions of the separated system managed by the City serve the Meadowview/Pocket area and North Sacramento east of Steelhead Creek. The City does not serve or collect revenue from the newer areas of North Natomas or Jacinto Creek. The City's share of the separated system is aging and has over 100 miles of sewer collection pipe over 80-years old with an estimated replacement value of $120,000,000. Recent State mandates requiring elimination of sanitary sewer overflows direct the City to inspect the entire 500 plus miles of sanitary sewer pipes over a seven year period. Where necessary to eliminate overflows, this program may potentially require thousands of feet of sewer mains to be replaced and upsized.

The City's water, sewer, drainage, and solid waste facilities and services are subject to an array of federal and state laws and regulatory programs. Compliance with these mandates is an ongoing obligation critical to the City's protection of public health and safety, economic development, environmental stewardship, and sustainability. As noted above with the CSS and separated sewer system, many of the regulatory programs require large capital investments, and all of them require a long-term commitment to adequate operation and maintenance of the City's infrastructure.

Over the past 20-years, the scope and complexity of the Department's regulatory programs have grown significantly, and the extent of resources and capital required to comply have grown commensurately. Compliance with these regulations provide several benefits to the City, including but not limited to: ensuring a safe and reliable drinking water supply, protecting the City's rivers and creeks, reduced flood risk, reduced flood and homeowners insurance costs for City property owners, recycling of natural resources, and maintaining healthy neighborhoods.

The following is a list of key programs the Department implements for compliance with federal, state, and local regulations:

Water	*Sewer*
• Drinking Water Regulatory Compliance • Source Water Protection Program • Water Treatment Plants Residual Management • Water Conservation • Water Meter Program • Water Supply Master Planning • Urban Water Management Planning • Groundwater Management Plan	• Combined Sewer System Program • Sewer System Management Plan

Drainage	*Solid Waste*
• Stormwater Quality Improvement Program • Floodplain Management Program, required by the Federal Emergency Management Agency (FEMA) • Maintenance Agreement with Department of Fish and Game • Levee Maintenance and Inspection	• Compliance with regulatory requirements for collection and disposal of garbage and yard waste • Solid Waste Recycling • Household Hazardous Waste Collection and Disposal • Legacy Landfill Management

In addition, many regulatory requirements bridge all aspects of the Department's operation. A non-inclusive list of some of those key mandates is shown below:

- Hazardous Materials Plans
- Air Quality Compliance
- Backup Power Generator Program
- Financial Reporting

The regulations dictate a large spectrum of requirements. Water regulations prescribe detailed specifications for operations, maintenance, and construction of water facilities; stringent monitoring and reporting programs; specialized staff certifications; and water conservation and meter requirements. Regulatory requirements for sewer include a

range of efforts, from planning and reporting, monitoring, and operations and maintenance, to major capital improvements for the Combined Sewer System and separate sewer system. Drainage regulatory requirements include an array of mandates, including water quality programs for new development, construction, industrial facilities, illegal discharges, and municipal activities; extensive monitoring; floodplain management program to address mandates for floodplain development, levee maintenance, flood preparedness, and specific requirements to receive reductions in flood insurance; and operations and maintenance of the drainage system. Solid waste requirements address activities from specific garbage collection activities, recycling, and waste diversion tonnage, to post closure environmental monitoring of legacy landfills. In addition there are regulations that cover all of these services, including requirements for public outreach, air quality compliance, and financial reporting to name a few.

These regulatory programs help protect public health and safety, the environment and the financial investments of the entire community. Compliance with regulations is imperative for the City's water system to reliably provide drinkable water and pressures that are also always ready to fight fires. Compliance with the CSS, sanitary sewer and stormwater requirements help protect the environmental and recreational attributes of the City's rivers and creeks. Collecting separated waste streams and diverting as much as possible from landfills and putting recyclables back into productive use are sustainable practices that also help improve the livability of the City's neighborhoods.

Not only does compliance with these regulations benefit the City in many positive ways but it also helps protect the utility enterprise programs and the City from regulatory and/or legal consequences such as fines, third part lawsuits, and building moratoriums that would negatively impact ratepayers and could potentially damage the City's economy and reputation as a leader in environmental stewardship and sustainability. The City faced such an impact in 1990 when the California Regional Water Quality Control Board (Board) issued a cease and desist order (CDO) against the City's combined sewer system. The CDO prohibited new development within the CSS area until 1995 when the Board approved the City's Long Term Control Plan to upgrade the CSS to minimize discharges to the river and flooding within the CSS service area. This long term commitment to improve the system continues today and the City has an ongoing obligation to improve the CSS or face the possibility of subsequent enforcement actions.

Enforcement actions are becoming more and more common as several communities in California and nationwide have been found in noncompliance with one or more of these regulations. These communities have been subjected to significant fines and/or consent decrees that have mandated the communities to invest billions of dollars into replacement and upgrades of their infrastructure.