TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER DEPARTMENT: UTILITIES
ATTENTION: FINANCE COMMITTEE
DATE: APRIL 17, 2007 CMR: 203:07

SUBJECT: UTILITIES ADVISORY COMMISSION RECOMMENDATION TO APPROVE A RESOLUTION ADOPTING A WATER RATE INCREASE FOR FISCAL YEAR 2007-08, AND STAFF RECOMMENDATION TO APPROVE, IN CONCEPT, THE ADOPTION OF A WATER RATE INCREASE FOR FISCAL YEAR 2008-09

RECOMMENDATION
Staff and the Utilities Advisory Commission (UAC) recommend that the City Council adopt the attached resolution to:

(a) Approve a 10 percent increase to water retail rates, for Fiscal Year (FY) 2007-08, effective July 1, 2007, which will increase annual revenue by $2.2 million;

(b) Approve the changes to the Water Utility Rate Schedules, as attached;

(c) Approve the discontinuance of the current discounted rate for commercial, industrial and institutional irrigation customers; and,

(d) Approve a monthly “Customer Charge” for all customer classes, irrespective of their monthly water consumption, in order to collect a portion of the utility’s fixed operating costs.

In addition, for biennial budgeting purposes, staff recommends:

(e) Approval, in concept, of a 10 percent average system water rate increase for FY 2008-09, which will increase annual revenue by an additional $2.5 million.

DISCUSSION

Revenue
The City Council approved a 7 percent retail water revenue increase for FY 2006-07. During the budget process, staff informed the Council that if water sales remained flat or declined, or if there was a rise in wholesale water purchase costs from San Francisco Public Utility
Commission (SFPUC), a rate increase could become necessary. The Water Utility sales levels for Fiscal Year 2006-07 have remained flat, and projections for Fiscal Year 2007-08 and beyond assume the same. In addition, operating costs and wholesale supply costs from SFPUC are increasing.

Staff is recommending a 10 percent water rate increase for FY 2007-08 and a 10 percent increase for FY 2008-09. These increases represent annual revenue increases of $2.2 million and $2.5 million respectively. Staff will evaluate the necessity of the 10 percent increase for FY 2008-09 during the budget process.

The key driving factors for this rate increase is the decrease in sales volume, increases in the wholesale water rates from San Francisco Public Utilities Commission (SFPUC), and the increase in operating costs as stated in attached Utilities Advisory Commission report.

**Customer Charge**

Staff recommends the introduction of the monthly “Customer Charge” to collect some of the fixed customer costs not currently being recovered from low consumption users. This charge includes costs such as meter reading, billing and other administrative costs. A monthly “Meter Charge” was discontinued in July 2003. However, as sales volumes decline or fluctuate with weather patterns, the currently used “volumetric pricing” methodology results in uneven revenue streams. It also results in artificial and unfair subsidization of low volume water users. The monthly “Customer Charge” will achieve greater equity among customer classes and provides stability in recovering some of the fixed costs. A state survey of other water utilities, conducted by the California Municipal Utilities Association, indicates that most California water utilities have a fixed monthly meter or customer charge. The expected annual revenue which would be collected from the proposed monthly “Customer Charge” is approximately $1.6 million.

To avoid a sudden negative financial impact on the smaller water user, staff recommends that the “Customer Charge” be initially set at a level that does not fully collect all customer-associated fixed costs, but will increase over time to a fully allocated level. For example, a $5 monthly charge is proposed for most residential customers, which represents 48 percent of the fully allocated monthly customer costs based on the cost-of-service study of $10.40. For large customers, the monthly “Customer Charge” will be based on meter size, and be fully allocated among commercial customers effective July 1, 2007. The Customer Charge will range from $5 for the 5/8 inch meter to $383.67 for the 8 inch and 10 inch meters.

With the approval of the proposed 10 percent increase, the Water Rate Stabilization Reserve (W-RSR) balance is projected to be $12.4 million by the end of FY 2007-08 or $200,000 above the Maximum Guideline level approved by Council. This $12.4 million includes $8.5 million in funds returning from closed CIP projects. This amount would be used to provide partial funding for the City’s Emergency Water Supply project starting in FY 2008-09. The project is expected to cost approximately $40 million in total. With the proposed Fiscal Year 2008-09 rate increase, the W-RSR balance at the end of FY 2008-09, is expected to be $3.4 million, which is slightly...
below the Minimum Guideline level and below the Risk Assessment level of $3.6 million by $200,000.

**Proposition 218 Notice**
The City must give written notice to owners whose parcels will be subject to a new or increased water, sewer, or refuse utility rate before any such new or increased rate can be imposed. A public hearing on the new or increased rate must be held not less than 45 days after the mailing of notice to the affected owners. At the hearing, the Council must consider written protests against the imposition of any such new or increased rate. If a majority of the owners do object, the new or increased rate may not be imposed. Because property ownership is deemed to include tenancies in property where tenants are directly liable to pay for such utility service, the notice must be sent to tenants. A pending bill (AB 1260) would clarify that notice should be sent only to customers (whether owners or tenants) who receive the utility services.

**UTILITIES ADVISORY COMMISSION REVIEW AND RECOMMENDATIONS**
On April 4, 2007, the UAC voted 4 to 0, with one absent, to recommend that the City Council:

(a) Approve a 10 percent increase to water retail rates, for Fiscal Year (FY) 2007-08, effective July 1, 2007, which will increase annual revenue by $2.2 million;

(b) Approve the discontinuance of the current discounted rate for commercial, industrial and institutional irrigation customers; and,

(c) Approve a monthly “Customer Charge” for all customer classes, irrespective of their monthly water consumption, in order to collect a portion of the utility’s fixed operating costs.

The UAC voted to withhold recommending approval, in concept, of a 10 percent average system water rate increase, or $2.5 million revenue increase, for Fiscal Year 2008-09, due to the fact that future costs are too uncertain at the present time and wait for next year budget process to evaluate the necessary rate increase.

**ALTERNATIVES**
Staff evaluated the impact of alternative rate proposals to the proposed 10 percent increase for FY 2007-08. Any smaller rate increase would require reducing some combination of the operating budget, Capital Improvement Program (CIP), or depleting the W-RSR. Reducing the operating budget would negatively impact ongoing system maintenance, increase system water losses and lead to higher capital costs. Reducing the CIP would hinder water main replacement projects, where the infrastructure has exceeded its system design life. Withdrawals from the W-RSR are not recommended, since even the proposed rate increase will result in the reserve balance to be below both the Minimum Guideline level and the Risk Assessment target following allocation of reserve funds to the Emergency Water Supply Project. Any combination of alternatives would also result in a much higher rate increase recommendation for FY 2008-09.
RESOURCE IMPACT
Approval of this 10 percent rate increase will raise the Water Fund revenues by approximately $2.2 million for FY 2007-08. The “approve, in concept” 10 percent rate increase in FY 2008-09 will increase revenues by $2.5 million, and will slightly increase the funding of the W-RSR and bring its balance to the Minimum Guideline level approved by the Council of $5.9 million by FY 2009-10.

POLICY IMPLICATIONS
This proposed rate increase meets the Utilities Strategic Plan objective of providing superior financial performance to the City and investing in utilities infrastructure to deliver reliable service. These recommendations do not represent a change in current City policies.

ENVIRONMENTAL REVIEW
The adoption of the resolution does not constitute a project under the California Environmental Quality Act. Therefore, no environmental assessment is required.

ATTACHMENTS
A: Resolution
B. Water Rate Schedules W-1, W-2, W-4, and W-7
C. Report to the UAC from its April 4, 2007 meeting: Proposed Water Rate Increase
D. Minutes of the UAC meeting of April 4, 2007

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