



UTILITIES ADVISORY COMMISSION MEETING FINAL MINUTES OF MARCH 2, 2016

CALL TO ORDER

Chair Foster called to order at 7:03 p.m. the meeting of the Utilities Advisory Commission (UAC).

Present: Chair Foster, Commissioners Ballantine, Danaher, Eglash, Schwartz, and Council Liaison Scharff

Absent: Vice Chair Cook and Commissioner Hall

ORAL COMMUNICATIONS

David Carnahan, Deputy City Clerk, announced that the City is searching to fill openings on the City's boards and commissions, including the UAC. He encouraged community members to apply to serve on these boards and commissions and noted that applications are due March 18.

APPROVAL OF THE MINUTES

Commissioner Danaher moved to approve the minutes from February 3, 2016 UAC meeting as presented and Chair Foster seconded the motion. The motion carried unanimously (5-0) with Chair Foster, Commissioners Ballantine, Danaher, Eglash, and Schwartz voting yes and Vice Chair Cook and Commissioner Hall absent.

AGENDA REVIEW AND REVISIONS

Chair Foster advised that New Business Item #2 (Selection of Potential Topic(s) for Discussion at Future UAC Meeting) would be moved to after New Business Item #4 (Update and Discussion on Impacts of Statewide Drought on Water and Hydroelectric Supplies).

REPORTS FROM COMMISSION MEETINGS/EVENTS

Commissioner Schwartz reported that she participated as an expert on a California Public Utilities Commission panel on making time-of-use (TOU) rates the default rate for customers in 2019. The discussion was about the best practices across the country. She spoke about the coercion aspect of forcing all folks onto a particular rate. She said that it is preferable to provide customers a choice and would be relevant to our discussions of opt-in, opt-out with respect to the PaloAltoGreen Gas program. She said that what is relevant for Palo Alto is related to smart grid pilot programs and the feeling that we need to treat them like double blind science experiments. She said that makes no sense and people should be able to choose between options.

Commissioner Schwartz gave a webinar today on lessons from “shady” industries and how they use marketing targeted at low income consumers. She said the techniques offer lessons to utilities including Palo Alto, particularly with respect to opportunities for customers looking to establish or rehabilitate credit ratings. She said that CPAU should look to other industries to learn about good marketing ideas for CPAU when it markets its programs.

Commissioner Schwartz attended the March 1 Finance Committee meeting when Utilities staff presented the preliminary financial forecasts and had similar questions that the UAC did when it reviewed the forecasts at its February meeting. Committee members asked about the level of reserves and whether they could be further drawn down to reduce the rate increase. They were receptive to the idea of conducting customer usage analytics to identify who is affected most by the rate changes.

UTILITIES DIRECTOR REPORT

1. Finance Committee Actions on February 16

Two items were considered by the Finance Committee that the UAC recommended. The first was the Wilsona Solar Power Purchase Agreement with Hecate Energy. The Finance Committee joined the UAC in supporting this very low priced, long-term solar renewable energy contract.

The second item was the Palo Alto CLEAN program with staff’s and the UAC’s recommendation to continue the 16.5 cents per kilowatt-hour contract price for local solar projects. However, the Finance Committee voted unanimously to recommend that Council reduce the contract price to the avoided cost of 8.9 cents per kWh for a 20-year contract and 9.0 cents per kWh for a 25-year contract. The Finance Committee wanted to make sure that the five CLEAN applications already received would get the 16.5 cents per kWh price that was in place when they applied. The applications are for a local church and for four City-owned parking structures. These applications would result in almost 1.3 megawatts of local solar, or almost half of the 3 MW CLEAN program cap.

Council will consider the Finance Committee recommendations for both the Wilsona Solar agreement and the CLEAN program at its March 21 meeting.

2. Communications

Gas Safety Awareness Telephone Surveys – Beginning March 8, CPAU will participate in the federally mandated Gas Overall Awareness Level (GOAL) survey, a nationwide program to assess the public’s gas safety knowledge. This automated telephone polling survey administered by the American Public Gas Association is conducted to insure that people living along the pipeline have adequate gas safety information. Depending on the response rate, the survey should be completed by March 10.

Natural Gas Utility Worker Day is March 18 – The American Public Gas Association recognizes natural gas utility workers for their hard work and accomplishments. March 18 is the date of the New London, Texas school explosion in 1937 that led to the widespread odorization of natural gas and an increased emphasis on safety. Let’s celebrate our hardworking employees in Palo Alto who help us keep our burners lit and pipelines safe!

March 14-20 is “Fix a Leak” Week – Household leaks can waste more than 1 trillion gallons of water each year nationwide. EPA WaterSense sponsors this campaign to raise awareness about repairing leaks for water conservation. The City provides instructions and tips on how to read a water meter, check for leaks and find other easy ways to save at www.cityofpaloalto.org/water.

City of Palo Alto Utilities Recognized with the Tree Line USA Award - For the second year in a row, CPAU has been recognized with the Tree Line USA award by the National Arbor Day Foundation. Tree Line USA recognizes the Utility for demonstrating how trees and utilities can co-exist for community and citizen benefits by exceeding the five core standards criteria: quality tree care, annual worker training, tree planting and public education, tree-based energy conservation program and Arbor Day support.

Customer Engagement Portal for Energy and Water Use and Management –In partnership with Nexant, CPAU launched a new pilot online utility portal on February 1 for data management, analytics and customer engagement. Through the portal, residents will be able to better manage and control their energy and water usage. For instance, portal users will be able to view historical monthly consumption data, receive information on CPAU’s efficiency programs and rebates, and learn more about renewable energy and related program opportunities. Access the portal from Cityofpaloalto.org/smartenergy.

3. Upcoming Events

On March 17th, Palo Alto will host the second of five regional **Georgetown University Energy Prize workshops** at the Mitchell Park Community Center. This workshop is designed for elected officials and other community leaders to discuss strategies of how to engage people in energy efficiency measures. Mayor Burt will deliver the welcoming address and Chief Sustainability Officer Gil Friend will be the keynote speaker.

On March 26, there will be a **Rainwater Harvesting and Rain Barrel Workshop**

Commissioner Schwartz asked about the Georgetown workshop and whether granular data will be available since the City has only monthly data about usage, people can only do “straight conservation” so what is the plan for communicating ideas to customers. Assistant Director Jane Ratchye said that this is not CPAU’s workshop and is not for the general public, but is a forum for sharing ideas among the cities competing for the Georgetown University Energy Prize.

Chair Foster said that the Finance Committee has taken a different recommendation than UAC on the Palo Alto CLEAN program. He asked if there is any way for the UAC to do something about the issue. Senior Deputy City Attorney Jessica Mullan said that citizens can contact Council and provide comments at the Council meeting. Commissioner Danaher reminded Chair Foster that he was struggling with the justification for the high CLEAN price given the low prices obtained for long-term renewable contracts and advised him not to speak too vehemently when representing all commissioners at the Council meeting. Chair Foster asked that the minutes from the discussion could be send to him. Commissioner Ballantine said that the Palo Alto CLEAN program does nothing to improve the reliability of the City’s distribution system unless smart inverters are required.

COMMISSIONER COMMENTS

Chair Foster said that he would not be able to attend the next scheduled meeting on April 6 and noted that there may not be a quorum. Interim Director of Utilities Shikada said that staff will determine options for alternative days and poll commissioners.

Chair Foster appointed Commissioners Danaher and Ballantine to an ad hoc budget committee to review CPAU's FY 2017 CIP and operating budgets.

UNFINISHED BUSINESS

None.

NEW BUSINESS

ITEM 1: ACTION: Staff Recommendation that the Utilities Advisory Commission Recommend that the City Action Council Adopt: (1) a Resolution Approving the Fiscal Year 2017 Wastewater Collection Financial Plan; and (2) a Resolution Increasing Wastewater Rates by Amending Rate Schedules S-1 (Residential Wastewater Collection and Disposal), S-2 (Commercial Wastewater Collection and Disposal), S-6 (Restaurant Wastewater Collection and Disposal) and S-7 (Commercial Wastewater Collection and Disposal – Industrial Discharger)

Acting Rates Manager Eric Keniston provided a summary of the written report. He said that the forecast of costs and rate changes has not changed from what the UAC saw last month when it reviewed the preliminary financial projections. He said that the primary driver for the 9% rate increase requested as well as the rate increases projected for the next several years is that the costs of wastewater treatment are rising quickly. He noted that the Rate Stabilization Reserve would be exhausted by the end of fiscal year (FY 2016 and that the Operations Reserve is being drawn down as well. He said that the long-term rate projections assumed continuing increases in treatment costs as well as operational costs.

Keniston noted that the 9% rate increase proposed is exactly what was projected in last year's Financial Plan. He noted that the rate trajectory in this year's Financial Plan result in the Operations Reserve going down to the minimum level in FY 2018 and FY 2019 before increasing to the target level by FY 2022. He said that the 9% increase is the same for all customer groups and that the increase for residential customers is \$2.88 per month.

Keniston said that at its meeting last month, the UAC asked for scenarios showing the Operations Reserve held to the minimum level and at the target level. He showed the in the minimum reserve scenario, the FY 2017 rate increase could be held to 5% instead of 9%, but that the rate increase for FY 2018 would be 19%. For the target reserve scenario, the FY 2017 rate increase would have to be 16% for FY 2017, following by a 9% increase in FY 2018 with somewhat lower rate increases in the following years. After developing these alternate scenarios, staff did not change its recommendation for a 9% rate increase for FY 2017.

Commissioner Danaher, noting that the reserve minimum is only about \$2 million, asked what would be done if the revenues were not sufficient and more money was needed. Keniston said that a rate increase would be pursued if that ever arose. Such a mid-year rate increase would

need to go through the normal review process starting with the UAC, then consideration by the Finance Committee—and the Proposition 218 45-day noticing process—with final decision by the Council. Commissioner Ballantine asked if there is always enough notice of what its needs are going to be. Keniston noted that in the Wastewater Collection Utility, the expense profile is fairly flat and known ahead of the year and there shouldn't be a surprise need for extra money.

Commissioner Ballantine asked if revenues could fall due to drought due to lowered water usage. Keniston said that rates for this fund are generally independent of water usage with only the commercial wastewater collection customers having revenues depend on relatively steady wintertime water usage. Residential revenues are the majority of the fund's revenues and are based on a flat monthly charge so there is no variability due to changes in water usage.

Commissioner Danaher asked, if usage falls, do costs go down. Keniston responded that the costs are fixed and revenues are also mostly fixed in the Wastewater Collection Utility and, therefore, not dependent on the flow rate. Keniston said that the residential rates have no element that is based on water flows.

Commissioner Eglash noted that the real cause for the dramatic rate increase seems to be the wastewater treatment costs. He asked why those costs rose so much from FY 2014 to FY 2015 and from FY 2015 to FY 2016.

Keniston introduced Jamie Allen, Regional Water Quality Control Plant Manager, to describe the components of the treatment plant costs that are passed on the plant partners, including Palo Alto. Allen explained that there was an accounting change that lowered the costs for one year in FY 2014 so that year's costs are anomalous. He said that the majority of the wastewater treatment costs are operations costs with two categories of capital improvement program (CIP) costs—"minor", or rate-funded CIP and major CIP debt service. Operations costs are expected to grow at the same rate it has for the last 5 years—at about 5.5% per year and CIP costs are discussed with the plant partners and minor CIP costs grow at about the rate of inflation, about 2.6% per year. Major CIP debt service is for planned plant upgrades.

Allen showed a breakdown of the FY 2017 wastewater treatment costs: 47% for salaries and benefits for operators, engineers, chemists, etc.; 12% for allocated charges for services provided by the City such as HR, attorney, IT, finance, etc.; 9% for utilities expenses (electric, gas, water); 11% for minor CIP projects; 7% for contract services; 3% for debt service for major CIP projects; and 10% for general expense and supplies and materials.

Commissioner Eglash summarized this to say that minor CIP are only modestly growing, major CIP expenses are growing from about \$0.5 million per year to \$2 million per year and that operations expenses are growing by 5.5% per year, a modest and steady rate. He noted that the charts showed that expenses were lower than revenues for FY 2014 and FY 2015, which replenished the reserves. In FY 2016, costs were above revenues. He said that rate increases on the order of 9% per year for the forecast horizon period don't make sense and are impossible to explain to the public when treatment costs are only rising 5.5% per year. Keniston said that CIP expenditures were lower for the wastewater collection (not for wastewater treatment) in FY 2014 and FY 2015, but that CIP costs are projected to increase over the forecast period.

Commissioner Eglash concluded that, based on the numbers, an increase in treatment cost is not the real cause of the high rate increases forecast, but instead there was a period of time when costs were rising, but no rate increases were put into place, which resulted in a drawing down of reserves. Keniston said that reserves will be drawn down in FY 2016 through FY 2018 until revenues balance expenses. Commissioner Eglash agreed that reserves have been depleted over time.

Commissioner Danaher asked for an explanation of the difference between wastewater treatment costs and wastewater collection costs. Keniston said that the wastewater treatment fund's expenses are paid by the plant partners including Palo Alto and that those wastewater treatment costs are an expense for the wastewater collection utility. Interim Utilities Director Shikada said that the wastewater conveyance is a Utilities activity and that wastewater treatment is a Public Works activity and that the combined costs are paid for by ratepayers. Wastewater Collection Utility expenses include the treatment costs, which are a pass through expense from the wastewater treatment plant.

Commissioner Schwartz noted that the wastewater collection operations costs increased significantly from FY 2015 to FY 2016. Keniston said that this was due to a one-year accounting anomaly. Assistant Director Jane Ratchye said that the three primary costs buckets for the wastewater collection fund include: 1) operations costs for wastewater collection, which are rising at 2-3% per year; 2) CIP costs for wastewater collection, which are rising at 2-3% per year; and 3) wastewater treatment costs, which are rising at 5-6% per year. The treatment costs that are passed through to the wastewater collection utility are the main driver for increasing costs—and, therefore, rates.

Allen pointed out that his breakdown of the wastewater treatment expenses showed the costs in terms of operations, minor CIP and major CIP debt service. He noted that there was a major jump in major CIP debt service in FY 2019 when the dewatering facility would go on line.

Commissioner Eglash reiterated the difficulty in explaining that total wastewater collection expenses are rising at 4-5% per year, but we are asking for rate increases of 9-10% per year without driving the reserves below the minimum. He said that a better explanation must be forthcoming or the projected expenses should be reduced.

Public Comment

Herb Borock said that wastewater treatment plant costs estimates for the future are increasing dramatically, but that no explanation has been provided for the CIP plans at the treatment plant. He said that Council has approved a plan to replace the incinerator with a dewatering and load-out facility and that the current plan is to have an anaerobic digester at the plant. He said that the cost for the anaerobic digester keep increasing dramatically. He said it's unclear what assumption is in the cost projections regarding what happens after the incinerator is dismantled – will we keep using the haul out facility, or will something be built on site to handle the sludge. Trying to predict future costs depends on the plan and how easy it would be for Council to change direction. He said that the long-term facilities plan at treatment plant should be reviewed again by Council since there are choices about what to do that have impacts on

greenhouse gas emissions. He also commented on the Proposition 218 noticing process saying that the Council should support the rate proposals prior to staff issuing the Proposition 218 notices.

Commissioner Eglash said that in order to support the proposal, he would need a better understanding of the revenues and expenses over the years. Ratchye pointed to page 24 of the Wastewater Collection Financial Plan (Appendix A: Wastewater Collection Financial Forecast Detail) that is attached to the UAC memo and reminded the UAC that the reserve structure was changed in FY 2015 to lower the reserve amounts and that at the time of the change, there was significant money in the reserves that was placed initially in the new Rate Stabilization Reserve, which would normally have a zero balance. Over FY 2015 and FY 2016, all the funds in the Rate Stabilization Reserve will be drawn down to zero. She said that reserves were being drawn down in FY 2011, FY 2012, and FY 2013, then there were two anomalous lower cost years—in FY 2014 when there was a one-year hiatus in new CIP budgeting and in FY 2015 when reduced operations expenses due to an accounting anomaly—when reserves were somewhat replenished. However, underlying those anomalies, costs were rising and revenues were not keeping pace. As shown on page 24 of the plan, reserves will be drawn down again in FY 2016, FY 2017 and FY 2018 before revenues catch up with expenses. She said that rate increases need to be significant to get revenues to the levels that are needed to cover expenses.

Commissioner Eglash said that his understanding from that explanation is that we've allowed revenues to fall below expenses during the last few years and we did that because costs were increasing steadily and we chose not to increase rates. The reason we did not increase rates is that reserves were available to draw on. In addition, there were two years with anomalously low cost that somewhat replenished reserves, but we are now at the point when we must increase revenues. He said that he can now see this on page 24 of the plan (line 20: into/(out of) reserves), which shows that reserves were drawn down in FY 2011 through FY 2013, were replenished in the anomalous years of FY 2014 and FY 2015, but that reserves will be drawn down again in FY 2016, FY 2017 and FY 2018 before revenues cover expenses. He said that reviewing line 18: (total uses of funds) shows that expenses increased slightly from FY 2012 to FY 2013, but increased about \$3.6 million from FY 2013 to FY 2016 ignoring the anomalous years of FY 2014 and FY 2015. Then costs increase by about 5% from FY 2017 and onward. He said that the costs increases have been hidden from customers. He said that even with adding \$4 million to reserves in FY 2014 and FY 2015, that a 9% increase in revenue is needed. He said that it seems like with costs increasing at about 5% per year, we should be fine with 5% per year rate increases. Ratchye pointed out that a one-time adjustment into reserves doesn't help much with ongoing cost increases whereas a 9% rate increase raises revenue to a new base level upon with a subsequent 9-10% rate increase will increase revenues even more with the power of compounding.

Commissioner Eglash said that he was beginning to understand the issue by examining the lines on page 24 of the plan showing the "Total Sources of Funds" and the "Total Uses of Funds," which show that revenues have not been keeping up with expenses for years. Keniston says that revenues have not kept up with expenses for a period beyond the years shown on the chart on page 24 and was the case in FY 2009 and FY 2010 as well. Commissioner Eglash said that we have been in a long period when rates provided insufficient revenues to cover normal

year expenses (ignoring FY 2014 and FY 2015). He asked how revenues could lag expenses for up to 7 years. Ratchye said that the answer to that question is that reserves were high and that the anomalous two years of lower expenses made calling for rate increases hard to justify. In addition, the change to the reserve structure in FY 2015 lowered the amount of reserves that were considered sufficient—and this is the case for all funds, not just the Wastewater Collection Fund.

Commissioner Eglash said that the reserves were reduced when we realized that we had more than we needed and we've been slowing consuming them over the years and that all customers have been the beneficiaries for several years of holding the line on rates by using the financial reserves. The day of reckoning has been delayed due to the two anomalous years of low expenses. He said that with no rate increase, we would have a \$3 million deficit and we don't have enough reserves to cover that and we need to get back to a place where income covers expenses and staff's proposal phases in rate increases so that we don't get to that place until FY 2019.

Commissioner Schwartz agreed that the public has been insulated from the increasing costs so now we need to raise rates to cover costs. This can be presented as saving the customers over the last several years when rate increases were low.

Commissioner Eglash said that a chart comparing revenues to costs would show the years when there was a deficit and costs were not covered by revenues and for how long this went on. It is the same as if your salary was staying the same, but rent climbs and when you deplete your savings, you have a problem and can't afford the rent.

Chair Foster said that the Council made decisions in past to delay rate increases and now the rates must increase. He said that he recalls that in the past several years, moderate rate increases could have been proposed, but the case for them was somewhat borderline and that there was value in a zero rate increase for the community knowing that, sooner or later, the rates would have to increase. Ratchye agreed and recalled that these conversations occurred every year; for example, last year, staff proposed a 3% gas rate increase followed by a 4% increase the following year, but the feedback was that a 3% increase was so low that it's not worth it and would be better to have no rate increase and a 7% in the following year. Chair Foster said that there is a desire to insulate customers from rate increases and that, even with a delayed higher rate increase, the customers are not actually paying more over the whole period.

Commissioner Ballantine noted that (on the chart on page 24) the allocated charges (line 12) are anomalously low in FY 2015 and that for FY 2016 and forward, those costs are rising. He said that the low cost in FY 2015 could be due to an operational cost saving that year that could be found in future years, but the future forecasts do not include any cost savings that may actually accrue.

Commissioner Eglash pointed out the reduced cost for FY 2014 could be repeated in the future, but that the projections show costs only increasing, which may not reflect reality. Ratchye pointed out that the reduced CIP costs in FY 2014 was a cause for consternation in the past as

the UAC and Council was concerned that it signaled a slowdown in infrastructure replacement. However, it was only a pause in new funding for CIP to allow staff to catch up to CIP projects in the queue. She also pointed out that the allocated cost line item referred to by Commissioner Ballantine is not related to operational cost savings, but are the costs allocated from the services provided by the City such as HR, City attorney, finance department, etc. and that the reduced charges in FY 2015 were related to an accounting anomaly. Both these one-time cost reductions are not related to finding efficiencies were found and that these efficiencies won't be found in the future.

Commissioner Eglash said that he was now adequately satisfied with the explanations for the need for the rate increase and supports going forward with the staff recommendation.

ACTION:

Commissioner Danaher made a motion that the UAC recommend that the Council adopt resolutions approving the FY 2017 Wastewater Collection Financial Plan and increasing wastewater rates by amending Rate Schedules S-1 (Residential Wastewater Collection and Disposal), S-2 (Commercial Wastewater Collection and Disposal), S-6 (Restaurant Wastewater Collection and Disposal) and S-7 (Commercial Wastewater Collection and Disposal – Industrial Discharger). Commissioner Schwartz seconded the motion. The motion carried unanimously (5-0) with Chair Foster, Commissioners Ballantine, Danaher, Eglash, and Schwartz voting yes and Vice Chair Cook and Commissioner Hall absent.

ITEM 2. ACTION: Selection of Potential Topic(s) for Discussion at Future UAC Meeting

ACTION: None.

ITEM 3. ACTION: Staff Recommendation that the Utilities Advisory Commission Recommend that the City Council Adopt: (1) a Resolution Approving the Fiscal Year 2017 Water Utility Financial Plan; and (2) a Resolution Increasing Water Rates by Amending Rate Schedules W-1 (General Residential Water Service), W-2 (Water Service from Fire Hydrants), W-3 (Fire Service Connections), W-4 (Residential Master-Metered and General Non-Residential Water Service), and W-7 (Non-Residential Irrigation Water Service)

Interim Rates Manager Eric Keniston summarized the written report and noted that the wholesale cost of water from the San Francisco Public Utilities Commission (SFPUC) for FY 2017 was reduced since the February meeting when the UAC reviewed the preliminary financial forecast. That means that the rate increase proposed for FY 2017 is 6%, rather than the 9% projected in the preliminary forecast.

Keniston noted that, as in wastewater collection, expenses have been lower than revenues for several years and that there was a hiatus in new CIP funding in FY 2013, which lowered overall costs that year. The biggest driver for increasing water costs is the cost of SFPUC water due both to higher SFPUC costs and the impact of the drought. Reserves have been reduced over the last several years, but the Rate Stabilization Reserve will be exhausted by the end of FY 2016. Staff's rate proposal is to continue the drought surcharge that Council imposed as of September 1, 2015. The plan to separate out the cost of water supply is not being proposed this year, but will be revisited next year.

Keniston noted that the proposed 6% rate change for FY 2017 is less than the 8% rate adjustment that was projected in last year's financial plan, but a rate adjustment of 9% is projected for FY 2018, which is higher than the 8% FY 2018 rate increase projected in last year's financial plan. However, he cautioned that the rate projections are very dependent on the drought situation. The plan results in the Water Operations Reserve being above the minimum reserve level over the entire forecast period. The bill impact for the proposed rate increase will be almost the same for all customer classes and will add about \$4.73 per month for the median residential customer.

Keniston said that staff evaluated an alternate scenario with the Operations Reserve held at the minimum level. This would allow for no rate increase in FY 2017, but that would require an 18% rate increase in FY 2018, which staff does not recommend. A scenario with the Operations Reserve held at the target level would require a 3% rate increase in FY 2017 followed by a 20% rate increase in FY 2018, which staff does not recommend.

Public comment

Herb Borock said that under Proposition 218, residents can object to rate increases and, therefore, Council should be the one making a decision as to whether the rate proposal is the one that is noticed to property owners. Now this notice is sent out after Finance Committee weighs in, rather than before returning to Council. This comment goes to when the process should start. Now Council does not see the proposal until it's the final decision. An extra step of going to Council should be figured into the process and timing.

Commissioner Danaher referred to Appendix A of the FY 2017 Water Financial Plan and asked why line 25 (Other Revenues and Transfers in) was so variable over time. Keniston said that these transfers come from a large variety of sources and can range from reimbursement from other funds for projects or grant funds and that there can be large swings year to year for that line item. Pointing to line 29 (Water Purchases), Commissioner Danaher asked if this is for the water purchased from the SFPUC and asked if these costs were rising as the wholesale cost of water increased. Keniston confirmed that understanding. Commissioner Danaher noted that line 43 (Capital Program Contribution) rose in FY 2016 and asked if this was planned. Keniston confirmed that understanding. Commissioner noted that even after the proposed 6% rate increase, revenues would still be over \$5 million less than expenses in FY 2017. Keniston confirmed that conclusion. Commissioner Danaher asked if staff is comfortable with a 6% increase in FY 2017. Keniston said that staff is comfortable with the proposal at this point.

Commissioner Schwartz said that since this situation has been years in the making, it would be best to show more historical years on the charts. Also, is there a chance to time the rate increases so that they don't all come into place at the same time. She said that implementing a water rate increase in the summer when people use more water is more painful and implementing a gas rate increase in the winter when people use more gas is more painful and that, if there is some flexibility, timing the increases could be beneficial. Interim Director Shikada explained that the budgetary timing is important since the budgets are built on the idea of a full budget year of revenues as well as expenses. He said that the impact on the customers as well as the funds need to be considered, since if a rate increase is delayed, a larger increase may be required in the future. Commissioner Schwartz said that we need to be responsible and

cover our expenses, but timing could be considered. How does our water rates compare to other neighbors. Keniston referred to the bill comparisons in the Financial Plan (page 13) which shows that Palo Alto's current rates are higher than in the neighboring communities. Commissioner Schwartz said that, given the experience of Flint Michigan, we want to make sure to spend the money to continue to have the top quality water. We don't want to reduce expenses dramatically in this area. At the State of the City address by Mayor Burt, Commissioner Schwartz talked to someone who perceived that there have been large rate increases over the last several years, but when told that the increases were not large and sometimes zero, we are making sure costs are covered—this is something people can understand since it's something we have to responsibly do.

Commissioner Eglash asked why we have the highest monthly water bill. Keniston referred to a benchmark study done a couple of years ago, which showed that CPAU does more infrastructure improvements and system maintenance than other agencies. A recent large expense was the emergency water supply and storage project to rehabilitate wells, drill new wells and construct a new water storage reservoir increased costs as well. These proactive measures make a reliable system, but cause our rates to be higher.

Commissioner Eglash said that expenses rose 15% from FY 2015 to FY 2016 and rates did rise 12%, but revenues actually dropped by 4% since customers used much less water in response to the State's call for water use reductions in the drought. So, clearly, a significant gap is developing and this supports the recommendation for the 6% rate increase, which would avoid the problem we have with wastewater collection where we let a too large deficit develop requiring large continued rate increases. In the case of the water utility, this is exacerbated by the loss in revenue associated with reduced usage.

Commissioner Ballantine asked if the City has any lead pipe in its distribution system. Keniston said that the City has no lead pipes in its system.

Commissioner Ballantine asked why the bill impact shown in Table 8 of the Financial Plan (page 8) shows a smaller impact for the largest water users, but he did the math and found that the difference is not actually very in percentage terms. The 6% bill impacts shown actually range from 5.6% to 5.8% and the 5% impact for the largest users is actually 5.49%. Keniston confirmed that the chart rounds off the bill impact to the nearest whole number percentage value. Commissioner Ballantine asked if the difference from low users to high users is due to the fact that all customers must pay a fixed monthly service charge. Keniston confirmed that this is the case.

ACTION:

Chair Foster made a motion that the UAC recommend that the Council adopt resolutions approving the FY 2017 Water Financial Plan and increasing water rates by amending Rate Schedules W-1 (General Residential Water Service), W-2 (Water Service from Fire Hydrants), W-3 (Fire Service Connections), W-4 (Residential Master-Metered and General Non-Residential Water Service), and W-7 (Non-Residential Irrigation Water Service). Commissioner Danaher seconded the motion. The motion carried unanimously (5-0) with Chair Foster, Commissioners Ballantine, Danaher, Eglash, and Schwartz voting yes and Vice Chair Cook and Commissioner

Hall absent. The motion carried unanimously (5-0) with Chair Foster, Commissioners Ballantine, Danaher, Eglash, and Schwartz voting yes and Vice Chair Cook and Commissioner Hall absent.

ITEM 4. DISCUSSION: Update and Discussion on Impacts of Statewide Drought on Water and Hydroelectric Supplies

Assistant Director Ratchye provided an update on the ongoing drought. She said that there is not much new this month since February was very dry, but March should be wetter. Customers continue to save water and the City continues to exceed its state mandate for water use reduction for the compliance period of June 2015 through October 2016. The entire SFPUC service area has exceeded the combined savings goals as well. The precipitation at Hetch Hetchy is above normal through the middle of February. The impact of the drought on the electric utility, which normally gets about half its supplies from hydroelectric resources, is an increase in costs for FY 2016 costs of about \$9.6 million.

Meeting adjourned at 8:51 p.m.

Respectfully submitted,
Marites Ward
City of Palo Alto Utilities