



# AGENDA REPORT

SAN CLEMENTE CITY COUNCIL MEETING

Meeting Date: September 5, 2017

Agenda Item 8-B

**Approvals:**

City Manager [Signature]

Dept. Head [Signature]

Attorney [Signature]

Finance [Signature]

**Department:** Finance & Administrative Services  
**Prepared By:** Erik Sund, Assistant City Manager

**Subject:** *WATER UTILITY COST-OF-SERVICE FEE STRUCTURE.*

**Fiscal Impact:** Yes. Upon the adoption of a new Water Rate Fee Structure a fiscal impact will be addressed.

**Summary:** Two rate structure options for Single-family residential accounts; a uniform and a two-tiered rate structure are being presented to City Council to seek direction on this key issue to complete the Water Rate Fee Study.

**Background:** The City engaged Carollo Engineers, Inc. (Carollo) on June 13, 2016 to conduct a Comprehensive Cost-of-Service Study for the City's Water Utility. Considerable work has been completed for the Study and on June 6, 2017, Carollo presented a number of key issues to City Council for consideration and direction. Council directed staff to further examine two alternative rate structures for single family customer classifications and return at a later time for additional discussion and direction.

Based on Council direction, the Cost-of-Service Study (" Study") will be finalized and the Prop 218 Notification will be generated and presented at the September 19<sup>th</sup> City Council meeting for final approval. The Prop 218 notifications will be mailed to property owners and utility customers in advance of the November 7, 2017 Public Hearing to consider modification of the City's Water rate structure.

**Discussion:** The Cost-of-Service Study analysis has now been completed by Carollo Engineers. Carollo presented preliminary findings and recommendations at the June 6<sup>th</sup> Council meeting, which addressed a number of policy issues aimed at accomplishing the original objectives of the Study. Those objectives included achieving full cost recovery, revenue stabilization, and simplification of the rate structure, while proportionately allocating the costs of service amongst the city's customer classes.

At the meeting, Council provided direction on the following issues:

- Eliminate seasonal rates
- Decouple water supply costs from current rates (pass-through approach)
- Increase the fixed percentage of total cost recovery
- Introduce "demand management rates"
- Establish water rates for a five-year period
- Implement uniform rates for multi-family and irrigation accounts

Two potential rate structures were discussed for single-family customer classifications: a uniform and a two-tiered rate structure. These two approaches were discussed and Council directed staff to provide additional information for Council consideration as soon as possible. Staff has worked with Carollo to develop that information, which has been made available to the public, and will be presented at this meeting for additional discussion. Staff recommends that the Council proceed with the uniform rate structure for single-family accounts because it is consistent with the uniform rate approach for all other customer classifications and provides greater revenue stability for the City in light of decreased residential customer demands at the higher tiers.<sup>1</sup> The uniform rate further simplifies the new rate structure and provides unlimited water to residential customers at a single flat rate per unit of water while achieving full cost recovery.

Carollo recommends a five year rate structure with rates comprised of both a fixed monthly service charge based on the size of the meter serving the property, plus a variable consumption-based (commodity) rate – see tables below. The Study explains that the City's fixed costs of providing water service are approximately 42%, but the current rate structure only recovered approximately 23% of the City's fixed costs with 77% recovered through the existing variable charge. Placing so much of the City's cost-recovery in the variable portion of the rate has left the City vulnerable to revenue instability. Carollo has projected that if the City's revenue is not stabilized and increased, the City will maintain negative cash flows over the next five years to pay for capital programs due to falling water demands and increased expenditures.

**TABLE 1**

CHARGE	METER <sup>(2)</sup>	Current Rates	PROPOSED RATE <sup>(1)</sup>				
			EFFECTIVE 1/1/2018	EFFECTIVE 1/1/2019	EFFECTIVE 1/1/2020	EFFECTIVE 1/1/2021	EFFECTIVE 1/1/2022
Monthly Service by Meter Size	3/4" & 1"	\$17.48	\$18.71	\$21.87	\$25.33	\$26.56	\$27.41
	1-1/2"	\$39.31	\$46.17	\$53.97	\$62.49	\$65.53	\$67.62
	2"	\$58.73	\$69.70	\$81.47	\$94.34	\$98.93	\$102.09
	3"	\$114.16	\$144.23	\$168.59	\$195.19	\$204.70	\$211.23
	4"	\$172.45	\$254.07	\$296.96	\$343.83	\$360.58	\$372.08
	6"	\$330.91	\$516.89	\$604.14	\$699.48	\$733.56	\$756.96

**Notes**

1. Current rate per billing unit. 1 billing unit = one-hundred cubic feet = 748 gallons.
2. Rates have been rounded up to the nearest \$0.01.

The proposed variable commodity rate will also include a pass-through component, decoupling water supply from current rates as authorized by Government Code section 53756, for imported water and operating costs from the Municipal Water

<sup>1</sup> As explained in the Study, in the Fiscal Year ending in 2016, single family residential water use in Tiers 2 and 3 dropped 40 percent.

District of Orange County (“MWDOC”). Any increase in the water service fees due to MWDOC pass through charges would impact the rates of the Commodity Charge. If approved by the City Council, any increase to the rates as a result of pass through adjustments may be imposed annually; provided, however, that in no event will the rates be increased as a result of pass through adjustment by more than the cost of providing water service. The pass-through cost based on current MWDOC wholesale water costs would be calculated as follows:

$$Pass\ Through = \frac{Total\ Water\ Cost}{Forecasted\ Demand} = \frac{\$7.95\ M}{6,957\ AF} = \frac{\$1,143}{AF} = \$2.63\ per\ ccf$$

For the commodity rate, Carollo determined there should be four potable customer classes (single-family residential (SFR), multi-family residential (MFR), commercial potable, and irrigation potable) based upon water consumption data and grouping customers with similar peaking and usage characteristics into classes. A fifth customer class (Irrigation Non-potable) was identified for recycled water. The California courts, as well as accepted industry publications have supported this practice of setting rates by customer class. *Morgan v. Imperial Irrigation Dist.*, 223 Cal.App.4th 892, 908-909 (2014) (rejecting challenge to water rates that “differed among types of customers, creating rate classes” because: “There is nothing in section 6 that prohibits an agency from charging different rates to its customers as long as the fees paid by customers are proportional and the total amount the agency collects does not surpass the cost of providing the service.”); *Griffith v. Pajaro Valley Water Management Agency*, 220 Cal. App. 4th 586, 601 (2013) (“... method of grouping similar users together for the same augmentation rate and charging the users according to usage is a reasonable way to apportion the cost of service”).

TABLE 2

CUSTOMER CLASS	TIER	UNITS	PROPOSED RATE PER CCF <sup>(1)</sup>				
			EFFECTIVE 1/1/2018 <sup>(2)</sup>	EFFECTIVE 1/1/2019	EFFECTIVE 1/1/2020	EFFECTIVE 1/1/2021	EFFECTIVE 1/1/2022
SFR	Uniform	N/A	\$4.12	\$4.37	\$4.64	\$4.74	\$4.80
MFR	Uniform	N/A	\$3.99	\$4.21	\$4.46	\$4.55	\$4.61
Commercial Potable	Uniform	N/A	\$4.00	\$4.23	\$4.48	\$4.57	\$4.64
Irrigation Potable	Uniform	N/A	\$4.61	\$5.01	\$5.47	\$5.61	\$5.70
Irrigation Non-potable	Uniform	N/A	\$2.66	\$2.87	\$3.11	\$3.21	\$3.29

Notes

1. Current rate per billing unit. 1 billing unit = one-hundred cubic feet (CCF) = 748 gallons. **Please note that the rates shown include the additional pass through charge for MWDOC wholesale water purchases, which Carollo has estimated at \$2.63/ccf (see discuss above), so the actual total of the commodity charge will vary depending on the pass-through charge.** For more details, see pages 36-39 of the Study. The Non-potable Irrigation rates do not include the pass-through charge. For more details, see pages 45-46 of the Study.
2. Rates have been rounded up to the nearest \$0.01.

Based on feedback and direction from City Council, a final rate structure will be selected to begin the Prop 218 noticing and public hearing process with an anticipated public hearing on November 7, 2017. The Carollo Study will be finalized and presented, along with the Prop 218 notice, for Council approval on September 19, 2017.

### **Demand Management Rates**

In addition to the regular water rates, the Study developed "demand management" water rates to be used in periods of significant water use reduction to offset the associated loss of revenue (similar to a drought surcharge). As noted above, the City has fixed costs that are not impacted by changes in consumption, including debt service, maintenance of existing facilities, and administration costs. Adopting the proposed demand management rate structure now will allow the City, should it choose to do so in the future based on the drought status and revenue needs, to implement the drought rates without having to go through the Prop 218 notice process again. Having the ability to implement the demand management rates will protect the City from experiencing a significant loss in revenue that could impact its ability to provide safe and reliable water to customers. These demand management rates are discussed on pages 6 and 41-42 of the Study and are based on increased revenue needs to recover revenues lost with reduced water consumption so the City can cover its costs of service. For instance, a 10% demand reduction will result in a \$0.19 per CCF increase in the consumption rate for water over the proposed uniform water rates discussed above; a 20% reduction in water demand will result in a \$0.30 per CCF increase; and a water demand reduction greater than 20% will result in a \$0.57 per CCF increase. Again, the proposed demand management rates will only go into effect if the City Council finds there has been a demand reduction and that implementation of the demand management rates set forth in the Study and Prop 218 notice are necessary for the City to meet its cost of service needs.

A Public Hearing will be held on November 7, 2017 to consider adoption of the proposed water rates. If approved, the proposed rates would go into effect on January 1, 2018 and first appear on customer bills in early February 2018.

### **Recommended**

**Action:** STAFF RECOMMENDS THAT the City Council:

1. Approve the uniform rate structure for the single-family residential customer classification,
2. Authorize completion of the Cost-of-Service Study, and
3. Direct staff to prepare the Proposition 218 notice for a future Public Hearing regarding the proposed water rate structure changes.

**Attachments:** San Clemente Cost of Service Draft Report posted on the City's web site

### **Notification:**