



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: September 5, 2013 Updated REPORT NO: 13-070
ATTENTION: Council President and City Council Meeting of September 10, 2013
SUBJECT: Proposition 218 Noticing of Proposed Water Rate Adjustments
REFERENCE:

REQUESTED ACTIONS:

1. Council authorization to notice, pursuant to Proposition 218 to include the following:
 - a. Proposed water rate adjustments, increasing water system revenues by 7.25%, effective January 1, 2014, and 7.5%, effective January 1, 2015.
 - b. Proposed water base fee and commodity charge adjustments, consistent with the Water Cost of Service Study (COSS) recommendations to reflect a proportionate share of revenue between user classifications.
 - c. Proposed changes to the Single Family Residential (SFR) customer's tier structure based on recommendations of the COSS.
 - d. Proposed adjustments to the monthly Private Fire Service charge based on recommendations of the COSS; and
2. Set the public hearing date for a City Council vote on the proposed water rate adjustments for November XX, 2013; and
3. Accept the Water COSS.

STAFF RECOMMENDATION:
Approve the Requested Actions.

SUMMARY:

Noticing and Legal Requirements

On November 5, 1996, the voters of the State of California approved Proposition 218, the "Right to Vote on Taxes Act." Proposition 218, effective July 1, 1997, added Articles XIII C and XIII D to the State Constitution, which contain a number of provisions affecting the ability of local governments to levy and collect both existing and future taxes, assessments, fees and charges. Article XIII D, section 6(a)(1) imposes noticing procedures for imposing a new or increasing an existing property-related fee or charge. This initiative changed the way the public is notified of proposed fee increases. Specifically, it requires that notices be mailed to all property owners of record at least 45 days in advance of the date on which a proposed property related fee increase may be adopted. The Public Utilities Department's proposed noticing process adheres to all legal requirements associated with Proposition 218 and applicable sections of the Government Code and was prepared in consultation with the City Attorney's office.

The Public Utilities Department will mail notices (Attachment 1) on or before September 27, 2013 to all City water customers. This notice will advise customers of the adjustments to the water fees and rates and will provide information on the City Council hearing date for public comment. Included in the notice is a protest form which may be submitted via return mail to the City Clerk. The City Council will hold a public hearing on November XX, 2013 to consider adoption of the proposed revisions to existing water base fees, including Private Fire Protection, and commodity charges. If adopted, the revisions under this proposal will become effective January 1, 2014 and January 1, 2015.

Background

The City owns and operates a water system that provides water to a population of approximately 1.3 million. The City has operated this water system since 1901 after purchasing the privately owned San Diego Water and Telephone Company. Since then, the system has been expanded to supply approximately 270,000 accounts, delivering approximately 61,000 million gallons of water per year.

Local water sources are limited and in general, only 10-15 % of the City's water supply is derived from local water sources. The balance of the City's water supply is purchased from the San Diego County Water Authority (CWA). These purchases from the CWA include treated water that is delivered to the City's water distribution system and raw water that is transported to the City's water treatment plants. The City's water system currently consists of nine raw water storage facilities, three water treatment plants, 29 treated water storage facilities and over 3,300 miles of water lines. The three water treatment plants have a combined current capacity of 378 million gallons per day (MGD). The 29 treated water storage facilities ensure consistent delivery to the 90 different pressure zones with the aid of 49 pump stations.

The Water Utility's last COSS and rate case was performed in 2006, resulting in Council approved rate increases of 6.5% per year for Fiscal Years (FY) 2008 through 2011. The rate increases were needed to fund the Water Utility's ongoing capital program, including State and Federal mandates to update its water treatment facilities, replace cast iron water mains, and implement a wide variety of improvements throughout the water system. Furthermore, each year had rate increases to offset the increased cost to purchase water from the CWA during this time frame. To finance this capital program, the Water Utility issued a total of \$357 million in bonds and private notes, between January 2007 and June 2009 in addition to obtaining grants and low interest State Revolving Fund loans.

The Water Utility currently maintains AA ratings from Moody's Investors Service, Standard & Poor's Rating Services and Fitch Ratings. Maintaining a strong credit rating is imperative to obtain low cost funding for the Water Utility's future capital needs. Without the proposed rate increases, the Water Utility's covenanted debt coverage levels will significantly weaken in FY 2014, and fall below the legal requirement of 1.2x for senior liens, and 1.0x for all-in (aggregate) liens by FY 2015. Currently the Water Utility has over \$800 million in outstanding bond and State Revolving Fund (SRF) loan obligations. Additionally, the Water Utility will have insufficient revenue to meet its operating costs and will have to significantly reduce its capital program by FY 2015.

Wholesale Water Rate Pass Through

San Diego relies heavily upon imported water from Northern California and the Colorado River. The City currently purchases approximately 85-90 % of its water from the CWA, which in turn purchases its water from the Metropolitan Water District of Southern California (MWD). Historically, the CWA increases water rates annually. These increases are based on CWA costs for infrastructure, operations, maintenance, and water purchases from MWD. The increased costs are then passed through by CWA to the agencies that purchase water from CWA including the City of San Diego. These increased costs are known as "pass-throughs."

In April 2012 the MWD Board approved 5% wholesale increases to its member agencies for Calendar Year's (CY) 2013 and 2014, which followed a 7.5% increase for CY 2012. However, MWD's costs were distributed in such a way that a larger portion was allocated to transmission costs as opposed to water supply costs. The CWA is by far the largest user of MWD's transmission system and this resulted in cost increases to the CWA greater than 5%.

The CWA, in turn passes through these increased costs to its member agencies, of which the City is its largest customer. In an effort to provide temporary rate relief to City water customers during the economic downturn, the Water Utility absorbed the wholesale water rate increases from the CWA for CY's 2012 and 2013. Conservation and the Department's ability to draft a surplus of water from our local reservoirs due to the heavy rains in Fiscal Year 2011 were the main drivers behind this decision. In addition, the Department consolidated and streamlined operations and refinanced prior bond issuances. These measures resulted in savings of over \$35 million.

On June 27, 2013 the CWA Board approved wholesale water rate increases which will increase the City's water purchase costs an estimated \$7.2 million annually effective January 1, 2014. The Water Utility is no longer in a position to absorb these increases and is requesting rate increases to meet the operational costs of the utility, and to meet the coverage requirements for outstanding obligations.

Rate Case

Through the City's Request for Proposal (RFP) process, Black & Veatch Corporation (B&V) was selected to develop a multi-year rate case subsequent to an extensive COSS, as has been the past practice for both the Water and Wastewater Utilities of the Public Utilities Department. The Department concurs with B&V's recommendation that the rate case should be shortened to two years (FY 2014 and FY 2015), because of several significant complex issues facing the Department of which the full financial impact is unknown at this time. Over the next few years, the Department will be evaluating the costs associated with moving forward with an Indirect Potable Reuse project; negotiating a new permit for the Point Loma Wastewater Treatment Plant; and evaluating the cost for desalinated water that will become part of the CWA water supply portfolio.

The proposed rate increases (during this two year period) are designed to cover the increased cost of purchased water that has been temporarily absorbed by the Department since January 1, 2012, and to maintain sufficient debt service coverage (DSC) ratios. DSC ratios illustrate the

Department's ability to show it is producing enough operating revenue to cover all operating costs associated with providing drinking water to its customers on an annual basis, and additionally, has ample operating revenues remaining to pay its annual debt service. The Water Utility, along with B&V's recommendation, is targeting an aggregate DSC ratio of net annual revenues to annual debt service equal to 1.25x.

The following table illustrates projected DSC ratios with and without the proposed rate increases, excluding the Rate Stabilization reserve amount of \$20.5 million projected at fiscal year-end, 2014.

	FY 2014	FY 2015
DSC Ratios without Increases		
Senior DSC (Legal Requirement 1.2x)	1.74	0.99*
Aggregate DSC (Legal Requirement 1.0x)	1.03	0.60*
DSC Ratios with Increases		
Senior DSC (Legal Requirement 1.2x)	2.10	2.09
Aggregate DSC (Legal Requirement 1.0x)	1.25	1.25

*These ratios fall below the legal covenant requirements on the Water System's outstanding bond obligations and exclude the use of the Rate Stabilization Reserve.

The increased cost of water from the CWA from calendar years 2012 and 2013, coupled with another CWA pass-through increase scheduled for January 1, 2014, requires an overall 7.25% increase on all City customers to take effect on January 1, 2014; and another increase of 7.50% on January 1, 2015. The proposed rate increase for 2014 is to recover a portion of the rate increases from CWA for calendar year 2012 and 2013 and the full increase from calendar 2014. This rate increase along with 7% of the proposed rate increase for 2015 is to offset the increased cost of water from our wholesaler CWA. Full recovery of the calendar year 2012 and 2013 pass through rate increase from CWA will be achieved with the proposed increase in 2015.

The following table illustrates the factors driving the proposed rate increases, which will primarily recover the CWA pass-through costs at a level to maintain a 1.25x aggregate DSC.

Purpose of Rate Increase	CY 2014	CY 2015
Recover prior year CWA pass-through costs	5.00%	4.75 %
Recover CY 2014 CWA pass-through	2.25%	
Recover CY 2015 CWA pass-through*		2.25%
Meet target aggregate DSC ratio of 1.25x		0.50%
Total Annual Increase	7.25%	7.50%

*The amount of the CY 2015 CWA pass-through increase is unknown at this time and the Water Utility is assuming a not to exceed increase of 2.25%. Only the actual cost of the CY 2015 CWA pass-through, up to a maximum of 2.25%, will be implemented as part of the proposed CY 2015 7.50% increase.

Cost of Service Study

The COSS (Attachment 2) is a comprehensive cost of service and rate design study that includes a review of revenue requirements, user classifications, cost of providing service, and recommendations regarding the design of user charge alternatives for the City's water service. The COSS recommends changes to user classifications and cost allocation charges which will serve to increase equity in the apportionment of system costs beginning in Fiscal Year 2014.

The Water Utility's costs of service were allocated to customer classes utilizing a cost causative approach endorsed by the American Water Works Association (AWWA) M1 rate setting manual. This allocation methodology produces cost of service allocations recognizing the projected customer service requirements for the City. The design of proposed rates is in accordance with allocated cost of service and local policy considerations, such as reserve funding levels. Additionally, this study evaluates the extent to which the existing rate structure recovers revenues from customer classes in accordance with cost of service allocations.

One of the primary components of the COSS is the development of the projected revenue and revenue requirements (costs) associated with providing water service to the City's customers. The projected revenue and revenue requirements are based on a combination of historical trends, knowledge and experience of both the City staff and consultants, and future assumptions. The following is a summary of the assumptions used in the Water rate model:

Growth Rates: The Water Utility has seen a significant decrease in its water sales since 2009, due mainly to drought and the recession. The Water Utility is assuming 0.0% growth for this rate case period and is based on FY's 2012 and 2013 levels.

Additional Financing: There is no additional financing of capital projects assumed in this rate case, as the capital program will be cash funded with a combination of current year revenues, SRF and grant proceeds, and the Dedicated Reserve for Efficiencies and Savings.

Capital Program: The program assumes an annual inflation allowance, from the FY 2014 budget of 2.27% based on the 5-Year Engineering News Record's historical average for Construction Cost indices.

Capacity Charges: Capacity charges are fees charged to developers to bring new connections into the existing water system. The model assumes a conservative estimate of approximately \$8 million per year (equivalent to FY 2012 actual receipts), due to the volatility of this revenue source.

Interest Earnings: Interest earnings, incorporated into the model, are invested by the City Treasurer's office, with an estimate of 0.3% earnings for FY 2014 and 0.75% for FY 2015.

Inflation: Since the recession, inflation has been minimal by historic standards. The model incorporates the assumptions used in the City's FY's 2014 – 2018 Five-Year

Financial Outlook, published on October 24, 2012, from FY 2014 budget for Supplies (1%), Contracts (1%), and Energy & Utilities (5%).

Personnel Expenses: Salary and Wage assumptions are based on the adopted FY 2014 budget. The Water Utility's proportionate share of pension costs is projected to be \$14.8M for FY14 and \$15.1M for FY15. FY14 projection is based on budget and FY15 is based on the San Diego City Employees Retirement System Actuarial Valuation as of June 30, 2012. The Water Utility's proportionate share of Retiree Health contributions is projected to be \$4M for FY14 and \$4M for FY15. The FY14 projection is based on budget and FY15 is based on the City's Five-Year Financial Outlook dated October 24, 2012.

Grants and low-interest State Revolving Fund (SRF) loans: Although the Department has been very successful in obtaining grants and SRF loans in past years, no new grant or SRF receipts are assumed in the rate case unless a finalized agreement is in place.

Reserves: The Water Utility's reserve balances comply with the City's Reserve Policy and consist of the following:

Operating Reserve: Intended to fund the Water Utility's daily operating expenses in case of a catastrophic event. Currently equal to 70 days of Operations and Maintenance expenses.

Secondary Purchase Reserve: Intended as a reserve restricted to the purchase of water in case of a severe drought, or some other emergency. It is set at 6% of current year's Water Purchase Budget.

Rate Stabilization Reserve: An amount set aside to maintain the legal covenant ratios in accordance with the bond installment purchase agreements. The City's Reserve Policy is \$20.5 million for the Water Utility. In FY 2012, the Water Utility transferred an additional \$29.8 million to the reserve. In accordance with the City's Reserve Policy and in order to stabilize DSC ratios, \$11.8 million was transferred back to the operating fund in FY 2013 and \$18 million will be transferred to the operating fund in FY 2014. By the end of FY2014, this reserve will be reduced back to \$20.5 million.

Emergency Reserve: \$5 million set aside for emergency capital expenditures.

Dedicated Reserve for Efficiencies and Savings (DRES): Established in FY 2008 to preserve savings from efficiencies, changing priorities or other actions related to reducing costs of the capital program or operations of the water system. The current balance of the DRES is \$29.9 million and will be used to partially fund the capital program for FY's 2014 and 2015.

The following tables identify the projected revenue and revenue requirement estimates used for the Water COSS.

Summary of Water Revenue

Line No.	Description	Fiscal Year Ending June 30,		
		Estimated	Projected	
		FY 13	FY 14	FY 15
		(\$)	(\$)	(\$)
Revenue				
Rate Revenue				
1	Revenue from Existing Rates	379,835,300	379,908,800	379,908,800
	Year Months Rate			
	Effective Adjustment			
2	FY 14 6 7.25%		13,771,700	27,543,400
3	FY 15 6 7.50%			15,279,500
4	Increased Revenue Due to Adjustments	0	13,771,700	42,822,900
5	Subtotal Rate Revenue	379,835,300	393,680,500	422,731,700
Other Operating Revenue				
6	Cal. American Sales	11,677,700	12,437,700	13,355,500
7	Other Water Sales	8,935,300	8,030,300	7,892,900
8	Service Charges	1,087,400	1,216,000	1,267,000
9	New Water Services	503,000	300,000	750,000
10	Contribution in Aid	707,600	0	0
11	Land and Building Rentals	5,893,300	5,809,000	5,867,100
12	Services Rendered Other Funds	7,525,700	6,236,000	6,218,000
13	Other Revenue	5,175,100	2,181,000	2,182,000
14	Subtotal Other Operating Revenue	41,505,100	36,210,000	37,532,500
Non-Operating Revenue				
15	Damages Recovered	270,700	225,000	225,000
16	Sale of Land	1,007,700	0	0
17	Earnings on Investments	1,946,700	2,494,500	3,664,000
18	Subtotal Non-Operating Revenue	3,225,100	2,719,500	3,889,000
Transfers				
19	From Operating Reserve	0	0	0
20	From Rate Stabilization Reserve	0	0	0
21	From Secondary Purchase Reserve	0	0	0
22	From DRES Reserve	0	0	0
23	Subtotal Non-Operating Revenue	0	0	0
24	Total Revenue	\$424,565,500	\$432,610,000	\$464,153,200

Summary of Revenue Requirements (Costs)

Description	Fiscal Year Ending June 30,		
	Estimated	Projected	
	FY 13	FY 14	FY 15
	(\$)	(\$)	(\$)
Revenue Requirements			
<i>Operating & Maintenance</i>			
O&M Expenses	137,201,500	156,312,500	159,828,600
Water Supply	204,947,400	220,110,100	229,124,500
Subtotal O&M	342,148,900	376,422,600	388,953,100
<i>Debt Service</i>			
Existing Revenue Bonds	58,641,600	62,119,600	62,123,800
Existing SRF Loans	4,509,900	4,715,100	5,330,000
Proposed Revenue Bonds	0	0	0
Total Debt Service	63,151,500	66,834,700	67,453,800
<i>Transfers</i>			
To CIP Fund (PAYGO)	14,589,100	17,670,900	19,717,000
To CIP Fund (Other Capital Financing) [*]	30,486,500	22,971,900	70,896,000
To Operating Reserve	0	144,900	950,700
To Capital Reserve	0	0	0
To Rate Stabilization Reserve	0	0	0
To Secondary Purchase Reserve	0	40,600	1,203,000
To DRES	2,253,100	0	0
Total Transfers	47,328,700	40,828,300	92,766,700
Total Revenue Requirements	\$452,629,100	\$484,085,600	\$549,173,600

[*] "Other Capital Financing" consists of capital cash balances, transfers from operating, interest income, etc.

Proposed Rate Adjustments

In developing an equitable rate structure, the COSS allocates revenue requirements to the various customer classifications based on their proportionate demand on the system. The Water Utility generates revenue primarily from water sales. Water sales are composed of two user-charges: a monthly base fee (meter charge) and a commodity charge. The monthly meter charge reflects the estimated cost of service rate. It includes the allocated cost of billing, meter service, and some elements of water supply (fixed costs charged by the CWA). The meter charges also reflect the COSS recommendation of applying hydraulic capacity ratios to the meter sizes. The commodity charge is an amount based on units of consumption measured by the number of hundred cubic feet (HCF) of water consumed during the billing cycle. One HCF of water is approximately 748 gallons.

Base Fee Charges

The following table comparing existing Base Fee Charges to proposed charges illustrates that these charges are actually decreasing for all customers in 2014.

Existing and Proposed Base Fee Rates

Meter Size	Base Fee		
	Existing Rates	Proposed	Proposed
		1/1/2014	1/1/2015
	(\$/monthly)	(\$/monthly)	(\$/monthly)
5/8", 3/4"	19.33	18.89	20.31
1"	28.46	25.59	27.51
1.5"	49.34	40.89	43.96
2"	75.44	60.03	64.53
3"	136.74	104.98	112.86
4"	224.15	169.07	181.75
6"	440.73	327.86	352.44
8"	701.64	519.16	558.10
10"	1,006.94	742.99	798.72
12"	1,875.82	1,380.05	1,483.55
16"	3,267.86	2,400.67	2,580.72

Commodity Charges

Since the City’s last rate case, Southern California has experienced severe drought conditions. As a result, consumers are aware of the importance of conservation. Moreover, the increased use of water-efficient devices (toilets, dishwashers, washers, etc.) has helped customers conserve. To provide an incentive for those who conserve, the proposed rate structure for Single Family Residential customers now includes a fourth tier. This new tier replaces the existing Tier 1 and is much smaller. The four units of water included in Tier 1 are priced at the lowest rate since it represents the City’s least expensive source of water – local supply. In addition to expanding the number of tiers, the proposed structure also adjusts the pricing differential between the tiers to reflect more accurately the costs for each tier. Customers who have heeded the conservation message and those who already use low volumes, up to 9 HCF on a bi-monthly bill, will actually see a reduction in their total water charges in FY14.

The following table illustrates the existing rates and tier structure with the proposed rates and expanded tier structure.

Existing and Proposed Commodity Rates

Class	Existing Monthly Tiers [*]		Commodity	Proposed Monthly Tiers [*]		Commodity Proposed	
	From	To	Existing Rates	From	To	1/1/2014	1/1/2015
	hcf	hcf	\$/hcf	hcf	hcf	\$/hcf	\$/hcf
Single Family	0	7	3.61	0	4	3.64	3.91
	8	14	3.92	5	12	4.08	4.38
	15+		4.40	13	18	5.82	6.26
				19+		8.19	8.80
Multi-Family			3.92			4.34	4.67
Non Residential			3.76			4.17	4.49
Temp							
Construction			4.01			4.62	4.97
Irrigation			4.01			4.62	4.97

[*] Bi-monthly tiers are twice monthly allowances

Private Fire Service

Private fire protection services are allocated in a similar manner as other services. For example, a portion of water supply is allocated to fire protection for actual fire fighting and fire fighting training exercises. Fire protection requires that the Water system have the capability to provide large quantities of water for short durations of time at sufficient pressure. The proposed rate structure for fire protection is similar to that used in the development of the base fee, but a connection size and cost ratio is used in place of hydraulic capacities and the 1.5” connection serves as the standard.

The following table illustrates the proposed adjustments.

Existing and Proposed Fire Protection Rates

Fire Line Size	Fire Protection		
	Existing Rates	Proposed 1/1/2014	Proposed 1/1/2015
	(\$/monthly)	(\$/monthly)	(\$/monthly)
5/8", 3/4"			
1"	6.26	2.40	2.58
1.5"	6.26	2.40	2.58
2"	8.35	3.73	4.00
3"	12.53	14.42	15.50
4"	16.70	18.44	19.82
6"	25.05	27.23	29.27
8"	33.40	38.46	41.34
10"	41.75	49.68	53.41
12"	50.10	59.29	63.74
16"	66.80	96.14	103.35

Bill Impacts

The following table provides a look at the bill impacts for a range of customer types and usage amounts.

Example of Existing and Proposed Monthly Bill

	Existing Total Monthly Bill	Proposed monthly Bill 1/1/2014	Proposed monthly Bill 1/1/2015
All Classes			
Single Family			
4 hcf	\$33.78	\$33.45	\$35.95
12 hcf	\$64.20	\$66.09	\$70.99
25 hcf	\$120.44	\$158.34	\$170.15
Multi Family (2", 100 hcf)	\$467.44	\$494.03	\$531.53
Commercial/Industrial			
3/4" meter, 100 hcf	\$395.33	\$435.89	\$469.31
2" meter, 300 hcf	\$1,203.44	\$1,311.03	\$1,411.53
4" meter, 1,000 hcf	\$3,984.15	\$4,339.07	\$4,671.75
8" meter, 2,000 hcf	\$8,221.64	\$8,859.16	\$9,538.10
Temporary Construction / Irrigation (2" meter, 550 hcf)	\$2,280.94	\$2,601.03	\$2,798.03

FISCAL CONSIDERATIONS:

The cost of noticing all customers is approximately \$120,000.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

Presented Cost of Service Study Revenue Requirements to the Natural Resources and Cultural (NR&C) Committee on June 12, 2013. Presented the Cost of Service Study Update – Cost Allocation and Rate Design to the NR&C for consideration on July 10, 2013. Presented additional rate structures to NR&C on July 31, 2013 with approval to move the Item to full Council.

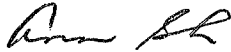
COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

The Department has been meeting with key stakeholder groups, including prominent business organizations, large businesses, industry consultants, education entities, hospitals, large hotels, etc. throughout the entire COSS process and will continue to do so up to the Public Hearing. The Department has also conducted several public meetings and workshops with the Independent Rates Oversight Committee (IROC) – 12 meetings; and with the Water Policy Implementation Task Force. Individual group meetings were held with the San Diego County Taxpayers Association, the San Diego Regional Chamber of Commerce, Building Owners and Managers Association, South County Economic Development Council and the National Association of Industrial and Office Properties (NAIOP).

Future outreach efforts to provide detailed information about the cost of service study conclusions and rate recommendations will include: direct mail to customers with detailed information about proposed rates; user-friendly information on the Public Utilities Department's website, including an online "water rate calculator"; utilizing Social Media to drive customers to the website; and presentations to interested community and stakeholder groups. In addition to these Department initiatives, the proposed rate increase recommendation is expected to garner digital and print media interest. The Department's media spokesperson will provide news organizations with the information they need to produce accurate news articles for the public.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

All City of San Diego potable water customers will receive the Proposition 218 notice of the public hearing to take place on November XX, 2013. This notice will also inform the customer how to register a protest against these rate adjustments. If adopted, the adjusted fees and rates would become effective January 1, 2014 and January 1, 2015.



Ann Sasaki
Interim Public Utilities Director
Business Support Branch

Attachments:

1. Final Proposition 218 Notice
2. Final 2013 Water Cost of Service Study