



AGENDA STAFF REPORT

DATE: September 14, 2020

TO: Honorable Mayor and City Council

THRU: Jill R. Ingram, City Manager

FROM: Steve Myrter, P.E., Director of Public Works

SUBJECT: **Set Public Hearing Date for the Water and Sewer Rate Study**

SUMMARY OF REQUEST:

That the City Council adopt Resolution 7071 setting the Water and Sewer Rate Study Public Hearing Date for November 23, 2020.

BACKGROUND AND ANALYSIS:

City Water Utility

The City's water utility is funded entirely by fees it receives from the water ratepayers, as charged on the bimonthly utility bills sent to customers. This utility is an enterprise fund, meaning no revenue is received through City taxes. The water rate that customers and residents pay on their utility bill must fund all operating costs, infrastructure investments, and cash reserve funds for the City's water utility. Water rates are evaluated as part of the development of the City's annual budget to ensure anticipated projected water revenues are sufficient to cover all costs associated with operating the City's water system.

The City's last comprehensive water rate study and rate adjustment was approved in 2010. The results of this study implemented a total of four annual water rate adjustments with the last increase occurring in FY2014. Water rates have not been increased since 2014. Currently, the City's water rates are among the lowest in Orange County. However, the water utility revenues from rates last increased in 2014 are no longer sufficient to cover water system operating costs, resulting in an operating deficit in the Water Fund. Increased costs are thus driving the need for water rate adjustments based on the following:

- The total average annual citywide water demand since 2014 has been 3350 acre-ft. The rate study shows that costs to supply this amount of water are now approximately \$800,000 more expensive than it was in 2014. Looking out over the next 5 years that cost to supply water will continue to increase and thus continue to adversely impact O&M costs.
- In addition to water supply costs, the City's increased costs of personnel, treatment chemicals, and infrastructure repairs associated with water system operations have all continued to rise over the last six years.

- There is a critical need to make improvements to water infrastructure to ensure system reliability. The City plans to invest an average of \$3.28 million per year, over the next 5 years, starting in FY 2021, totaling \$16.4 million. Many of these critical projects have been placed on hold pending sufficient funding but can no longer be deferred.
- Increased water revenues alone will not solve the issue of funding CIP costs over the next 5 years. The City will need to consider the issuance of \$12 million in outside financing to help fund the 5-year CIP program. The current water rates do not generate sufficient revenue to meet bond coverage requirements, further necessitating an adjustment to water rates.

Given these increasing revenue needs, and the fact that rates have remained the same since 2014, the City concluded that a water and sewer rate study was needed. This also provided an opportunity to evaluate the City's current rate structure and make needed structural changes by implementing "textbook" rate setting principles to increase fairness and equity that is consistent with Proposition 218.

Raftelis Financial Consultants (Raftelis) was awarded a professional service agreement to prepare the City of Seal Beach Water, and Sewer Utility Rate Study at the November 12, 2019 City Council meeting. As part of this comprehensive Rate Study effort, Raftelis was charged with developing five year financial plans, Cost of Service Analyses, new rate designs, and Customer Impact and Sensitivity Analyses for the water and sewer utility enterprise funds. At the conclusion of these water and sewer rate studies and analyses, a final Rate Study Report will be prepared in accordance with Proposition 218 requirements.

In conjunction with staff, Raftelis completed these detailed study analyses as described above. An overview of the draft results and recommendations was incorporated into a PowerPoint presentation that was presented at the August 10, 2020 City Council Meeting. A copy of this presentation is provided as Attachment B. The final Water and Sewer Rate Study Report is scheduled to be completed and made available for public review in early October. This Report will help inform the public and City Council's consideration of the proposed rate adjustments.

The current City water rate structure is proposed to be changed to be more consistent with current industry practices. Current practices emphasize rates based on actual uses and increasing costs of supplying water to heavier users. The new structure groups water customers by the following customer classes: Single Family Residential (SFR), Multifamily Residential (MFR), Commercial, Irrigation, and City. The City's current rate structure is based on customer meter size. This new rate structure will result in a more fair and equitable approach and is consistent with current rate setting practices. Other new water rate structure changes include:

- Adjusting the tier widths within SFR to better align with average annual SFR water use.
- Creating a new MFR customer class with the 2nd tier water rate threshold being adjusted depending of the number of dwelling units at a particular address.
- Establishing a uniformed water rate for the Commercial, Irrigation, and City customer classes.

It should be noted that this new rate structure will also allow the City to more readily comply with the State's recently enacted water conservation laws that will require all public water purveyors to establish an annual water budget and may impose fines should a public water purveyor exceed their allotted annual water supply budget. The State will be requiring annual water use data report showing compliance in traditional customer classes which this new rate structure will be implementing. The new rate structure fairly and equitably incentivizes conservation.

The required water utility revenue increases over the next 5 fiscal years are shown in the table on the following page. These proposed revenue increases were developed by projecting revenue and expenses and assessing if revenue was sufficient to cover costs and include the cost associated with the issuance of a \$12 million debt instrument to fund necessary capital improvements.

Proposed Water Enterprise Fund Revenue Increases

FYE 2021	FYE 2022	FYE 2023	FYE 2024	FYE 2025
Jan 1, 2021	July 1, 2021	July 1, 2022	July 1, 2023	July 1, 2024
14.0%	12.0%	8.0%	8.0%	8.0%

It must be emphasized that these proposed water revenue adjustments are not the same as customer bill impacts. The table above shows only the amount of increased revenue needed for the water utility as a whole. A cost-of-service analysis has been used to determine how to fairly and equitably distribute the cost to operate the water utility among the various water customer classes which ultimately determines individual customer class water rates.

The Single Family Residential ("SFR") customer class represents almost 90% of the City's total water customer accounts. Based on the new water rate structure the projected single family residential impact is shown in the table below. The table below shows that over 70% of single family residential customers will see an increase of \$10 or less in their bi-monthly bill (less than \$5 per month) once the proposed new rate structure takes effect on January 1, 2021. The proposed subsequent four annual water rate increase starting in July 1, 2022 as shown in the table above will further increase water rates directly proportional to the percentage proposed for that fiscal year.

The Table below shows the impact on the water portion of the customer's bill once the new proposed water rate structure takes effect in January 1, 2021.

Single Family Residential	
Bi-monthly SFR Water	
Bill Impact	No. of Customers
\$120	6
\$70	2
\$60	-
\$50	21
\$40	11
\$30	-
\$20	1,054
\$10	1,568
\$5	1,413
-\$50	1
Total Customers	4,076

Note: The large bill impacts at the top of the table likely the result of data base anomalies such as customer misclassifications.

Additional water rate impact details categorized by customer class can be viewed on slides 22 through 27 of the attached copy of the August 10, 2020 Water and Sewer Rate Study Overview Presentation.

City Sewer Utility

The City's sewer utility is also an enterprise fund, meaning no revenue is received through City taxes. The sewer rates that customers and residents pay on their utility bill must fund all operating cost and infrastructure investments for the City's sewer system. Sewer rates are evaluated as part of the development of the City's annual budget to ensure anticipated projected revenues are sufficient to cover all costs associated with operating the City's sewer system including funding the capital improvement program, and maintaining the sewer utility cash reserve funds.

The City's last sewer rate adjustment was approved in October of 2005. This rate adjustment retained a longstanding variable fee of 22% of the total bi-monthly water bill and established a fixed fee component that increased annually over a 12-year period starting in FY 2004-05. The last of these sewer rate adjustments were in July 2016 and has remained unchanged since then. These fees were imposed to pay for capital improvements which largely have been completed.

Rafetelis' Rate Study scope of services also included a comprehensive Sewer Utility Rate analyses. An overview of the draft results and recommendations of Rafetelis' sewer rate study analyses have also been incorporated into the attached PowerPoint presentation that was presented at the August 10, 2020 City Council Meeting. The final Water and Sewer Rate Study Report is scheduled to be completed and made available for public review in early October. The final report

will help inform the publics and City Council's consideration of the proposed rate adjustments.

The current sewer rate structure is being changed to be more consistent with current industry practices regarding rate setting. Major changes to the sewer rate include establishment of fixed fees based on estimated maximum use, not meter size. In addition, a volumetric charge applied to estimated actual use is being implemented. This proposed sewer rate structure is more equitable and more accurately reflects the cost of service for each customer class.

The primary goal of the 2005 sewer rate increase was to raise sufficient funds to address failing sewer system infrastructure. Subsequently, a revenue bond in the amount of \$3.3 million was issued in 2011 to further help fund the sewer capital improvement program. Since the 2005 rate increase, a majority of the sewer capital projects have been completed and the sewer utility has accumulated sufficient funds for anticipated future CIP projects. With these capital funding goals having been met and reserve targets currently being exceeded, a one-time sewer enterprise fund revenue decrease of 25% is proposed in FY21 with no other sewer utility revenue adjustments proposed through FY25.

As noted previously, the proposed revenue adjustment decrease will be distributed to the various customer classes based the cost-of-service analysis which determines how to fairly and equitably distribute the cost to operate the sewer utility amongst the various water customer classes.

The Single Family Residential ("SFR") customer class represents over 90% of the City's total sewer customer accounts. The net effect of the new sewer rate structure will be a reduction in the bi-monthly sewer bill for almost all SFR customers as shown in the table below.

Single Family Residential	
SFR Bi-monthly	
Sewer Bill Impact	No. of Customers
\$5.0	3
\$2.5	9
\$0	118
-\$5	502
-\$10	1,126
-\$15	1,781
-\$25	489
-\$50	36
-\$100	11
-\$200	0
Total Customers	4,075

Additional sewer rate impact details categorized by customer class can be viewed on slides 39 through 42 of the attached copy of the August 10, 2020 Water and Sewer Rate Study Overview Presentation.

Combined Water and Sewer Bill Impacts

Based on the Seal Beach Water and Sewer Rate Study analyses, if the proposed water and sewer rates are approved, the combined bi-monthly water and sewer bill will result in a decrease for the majority for SFR customers in 2021 as a result of the new water rate structure and sewer rate structure taking effect on January 1, 2021. The table below shows that the anticipated combined SFR utility bi-monthly bill charge will vary dependent on a customer's actual water usage as illustrated below.

<i>FY 2020-21 Combined Single Family Water and Sewer Bill</i> <i>(Effective January 1, 2020)</i>			
Bi-Monthly Water Use (hcf)	Total Proposed Charge	Total Current Charge	Difference (\$)
5	\$87.11	\$103.11	-\$16.00
10	\$103.77	\$116.72	-\$12.94
15	\$122.77	\$130.32	-\$7.54
20	\$138.71	\$143.92	-\$5.21
25	\$157.29	\$157.52	-\$0.23

The proposed new water and sewer rate structures and corresponding rates take effect in January 1, 2020. Once in place the subsequent water rate percentage increases proposed for July 1, 2021, July 1, 2022, July 1, 2023, and July 1, 2024 will be applied directly to each customer class rate directly. Other than the initial sewer rate decrease that takes effect on January 1, 2021 there will be no additional sewer rate changes through fiscal year 2024-25.

Additional combined water and sewer impact details categorized by customer class can be viewed on slides 43 through 46 of the attached copy of the August 10, 2020 Water and Sewer Rate Study Overview Presentation.

Effective Dates of Proposed Rate Adjustments

The effective dates of the proposed water and sewer rate adjustments are:

FY 2021 -	January 1, 2021
FY 2022 -	July 1, 2021
FY 2023 -	July 1, 2022
FY 2024 -	July 1, 2023
FY 2025 -	July 1, 2024

Proposition 218 Protest Hearing Procedure

Water and sewer rate increases are subject to Proposition 218's public hearing and majority protest procedures. If the City Council directs staff to initiate the Proposition 218 process and set a public hearing, the public will receive a detailed mailed notice of the public hearing, and of their right to submit a protest of the rate adjustment by a certain date.

The City Clerk is responsible for tabulating the written protests received during the 45-day protest period. The City Clerk will report on the number of written protests received up to the time of the hearing. The Mayor will open the public hearing to receive additional written and oral protests. Property owners must provide their tax parcel identification numbers, so that an accurate tally can be made.

At the conclusion of the public hearing, the City Clerk will tabulate any additional protests. The final tabulation may take a few minutes, depending on the number of protests received at the hearing. The City Clerk will then report on the total number of protests received.

If according to the final tabulation of the protest, protests submitted against the water rate increases exceed more than 50% of all the parcels in the City, a majority protest exists and the City Council shall not impose the increase in water rates. If the final tabulation is less than 50% of all the parcels in the City, the City Council would proceed to take action to implement the water rate increases effective January 1, 2021, and then on July 1 for each year from 2021 through 2024.

The public hearing is scheduled to be held on November 23, 2020.

Next Steps

In order to adjust water and sewer utility rates, the City must comply with Proposition 218 notice and hearing requirements. Following the September 14, 2020 City Council action, if directed to do so, Raftelis will finalize the Water and Sewer Financial Rate Report, prepare the Notice of Public Hearing, and mail the Notice of Public Hearing 45 days prior to the proposed November 23, 2020 Proposition 218 protest hearing date.

Proposed dates for completing the rate adjustment process are:

- Complete Water and Sewer Rate Study Financial Report October 5, 2020
- Mail and publish Notice of Public Hearing October 5, 2020
- Hold Community Workshops October, TBD
- Hold public hearing; approve rates November 23, 2020
- New water and sewer rate effective date January 1, 2021

ENVIRONMENTAL IMPACT:

There is no environmental impact related to this item.

LEGAL ANALYSIS:

The City Attorney has reviewed and approved as to form.

FINANCIAL IMPACT:

Water Utility

As noted previously in this staff report the required water utility revenue increases, as a percentage increase of the current projected revenue of \$4,728,763 over the next 5 fiscal years are shown in the table below including the corresponding projected increased total Water Utility revenues. These proposed revenue increases were developed by projecting revenue and expenses and assessing if revenue was sufficient to cover costs. The proposed revenue increases also includes the cost associated with the issuance of a \$12 million debt instrument.

Proposed Water Enterprise Fund Revenue Increases

	FYE 2021	FYE 2022	FYE 2023	FYE 2024	FYE 2025
<i>Effective Revenue Adjust Date</i>	Jan 1, 2021	July 1, 2021	July 1, 2022	July 1, 2023	July 1, 2024
<i>Prop. Annual Revenue Adjustment</i>	14%	12%	8.0%	8.0%	8.0%
<i>Total Projected Water Revenue</i>	\$5,059,77 7	\$6,037,68 5	\$6,520,70 0	\$7,042,35 6	\$7,605,74 5

Sewer Utility

The table below on the following page shows a one-time 25% Sewer Utility revenue decrease being proposed followed by no additional increases through FYE 2025. This revenue reduction, based on the current annual revenue projection of \$2,740,486, is being recommended since capital funding goals established in 2005 have been met and the sewer utility cash reserves are very healthy.

Proposed Sewer Enterprise Fund Revenue Increases

	FYE 2021	FYE 2022	FYE 2023	FYE 2024	FYE 2025
<i>Effective Revenue Adjust Date</i>	Jan 1, 2021	July 1, 2021	July 1, 2022	July 1, 2023	July 1, 2024
<i>Prop. Annual Revenue Adjustment</i>	<25%>	0%	0%	0%	0%
<i>Total Projected Sewer Revenue</i>	\$2,055,36 4	\$2,055,36 4	\$2,055,36 4	\$2,055,36 4	\$2,055,36 4

STRATEGIC PLAN:

The City of Seal Beach's Strategic Plan includes a goal of ensuring that water and sewer rates, as well as street sweeping and tree trimming fees, are properly set to provide the appropriate level of revenue and meet cost-of-service requirements. Completion of this Water and Sewer Rate Study contributes to this goal.

MEASURE BB:

This item is not applicable to Measure BB, the Seal Beach Neighborhood and Essential Services Protection Measure.

RECOMMENDATION:

That the City Council adopt Resolution 7071 directing staff to initiate the Proposition 218 process, and setting the Water and Sewer Rate Study Public Hearing Date for November 23, 2020

SUBMITTED BY:

Steve Myrter

Steve Myrter, P.E., Director of
Public Works

NOTED AND APPROVED:

Jill R. Ingram

Jill R. Ingram, City Manager

ATTACHMENTS:

A. Resolution 7071

B. Utility Rate Adjustment Presentation, August 10, 2020