



Agenda Report

Fullerton City Council

MEETING DATE: APRIL 2, 2019

TO: CITY COUNCIL / SUCCESSOR AGENCY

SUBMITTED BY: KENNETH A. DOMER, CITY MANAGER

PREPARED BY: MEG McWADE, PUBLIC WORKS DIRECTOR
TIFFANY FOO, ASSOCIATE WATER ENGINEER

SUBJECT: WATER RATE STUDY PRESENTATION

SUMMARY

Approval of Citizen Water Rate Ad Hoc Committee recommendations, as shown in the "Water Rate Recommendation" presentation and draft "Water Rate Study" report, along with authorization to mail the Proposition 218 Notification.

RECOMMENDATION

1. Approve water rate recommendations presented in the "Water Rate Recommendation" presentation and "Water Rate Study" report.
2. Authorize the mailing of the required Proposition 218 notice which starts the 45-day comment period related to the proposed rate structure changes and rate increases.
3. Set the Public Hearing for June 4, 2019 related to the water rate structure changes and adjustments.

PRIORITY POLICY STATEMENT

This item matches the following Priority Policy Statements:

- Fiscal and Organizational Stability
- Infrastructure and City Assets.

FISCAL IMPACT

The water rate study projects that the proposed water rate modifications will result in additional revenues of approximately \$5.6 million in Year 1 (Fiscal Year 2019-20) and reach \$19.4 million in Year 5 (Fiscal Year 2023-24). The additional revenue will provide for operational expenses, annual replacement of nine miles of pipeline by 2023, and

high priority reservoir, well, and pump replacements/upgrades. The future rates are designed to establish fiscal stability – through a restructuring that shifts an appropriate amount of fixed costs to the fixed meter charge.

In 2019-20, the rate for a single family residential (SFR) customer with a 5/8" meter using 11,000 gallons of water a month will be adjusted from the current \$51.16 to a proposed \$51.15, a reduction of 1 cent per month or 2 cents on a bi-monthly bill. The rates for a SFR customer with a 1" meter using 11,000 gallons per month will be adjusted from the current \$54.12 per month to the proposed \$66.38 per month. This is an increase of \$12.26 per month or \$24.52 on a bi-monthly bill. With the proposed increases for these customers, the City of Fullerton's rates remain in the lower half of the survey cities.

DISCUSSION

The City serves over 31,900 connections, providing potable water to our customers delivered to homes and businesses 24 hours a day, 365 days a year. In order to do this, Fullerton has an extensive and complex water system including ten active groundwater wells, 14 pump stations, six active Metropolitan Water District (import water) connections, 15 reservoirs (67.5 million gallons), four primary pressure zones with 12 sub-zones) and approximately 430 miles of distribution pipes (over half exceed 50 years in age) intended to provide a safe and reliable water supply. The City operates, maintains and improves this water system through water rate revenues. Water rates should be designed to meet anticipated ongoing maintenance and operation costs and provide sufficient funding for water system upgrades and replacement projects.

The last water rate study was completed in 2013 and included a phased five-year rate increase ending in FY 2017-18. Since the 2013 water rate increase, there have been many changes that necessitated a review of the rate design and system needs. The design of the rates in 2013 included a large portion of necessary operational and capital funding coming from revenue collected through the water usage charge. Additionally, the study assumed that the same high level of water usage the City experienced in 2011 and 2012 would continue during the next five year period. As a result, when the entire State of California - including the City of Fullerton - was required to dramatically reduce water usage due to the drought, the revenues were not adequate to meet the system's operational and capital needs. Additionally, the static "pass-through" policy adopted in 2013 underestimated the projected water charges from Metropolitan Water District of Southern California (MWD) and Orange County Water District (OCWD) resulting in costs that outpaced revenues.

Because of these factors, the City has not been able to perform pipeline replacement at an appropriate level and continues to experience an above-average rate of water pipe breaks. Most of Fullerton's infrastructure (pipelines, wells, pumps and reservoirs) is coming close to or has aged beyond its useful life and requires significant investment. Since the 2013 rate study, there have been court decisions (related primarily to Proposition 218) that have significantly increased the burden of proof required for the City to demonstrate that the rates being charged for utility services are proportionate to the cost of providing the utility service. These court decisions necessitated a complete review of the rate structure.

In January 2018, the City began working with Stantec Consulting Inc. (“Consultant”) to conduct a revenue sufficiency analysis, cost of service analysis, and rate structure analysis for the City of Fullerton’s Water Utility. To ensure a robust engagement process, the City authorized a Citizen’s Water Rate Study Ad Hoc Committee. As highlighted in the “Public Engagement” section of the report, over many months the Committee studied the water system, revenue requirements for operations/capital improvements and related rates. The analyses and Committee discussions led to recommended rate structure modifications and proposed water rate revenue increases, which are discussed in the draft “Water Rate Study” report (“Study”). The Study is attached to this report as Attachment 2.

On February 5, 2019, Stantec Consulting Inc. presented the preliminary recommendations stemming from the water rate study to City Council. City Staff and Consultant received feedback from City Council Members and the public during that meeting. Further review of the study resulted in the modified recommendations that are presented in this report and related attachments. The requests for information made by City Council Members and the Community are shown in Table 1 and addressed on the corresponding slides in the “Water Rate Recommendation” presentation. The presentation is included as Attachment 1 to this report.

Table 1: February 5, 2019 City Council Member Comments

Comment(s)	Slide(s)
Show 1” single family residential meters	Slides 32, 36 and 39
Show specific rate examples for customer classes and not averages. Show bill impacts.	Slides 36 through 41
Discuss State Revolving Fund Program	Slides 42 through 44

Public Engagement

City Staff, Consultant and the Water Rate Study Ad Hoc Committee met a total of eight times since August 2018, including twice since the February 5, 2019 meeting. The public was invited to all eight meetings, including an evening meeting to allow for more residents to attend. The meeting minutes are included as Attachment 3. The Committee worked with the Consultant and City staff in evaluating several alternative Capital Improvement Program (CIP) project schedules spanning the period from FY 2018-19 through FY 2027-28. These CIP alternatives were evaluated with the goal of balancing the need to address critical infrastructure deficiencies while minimizing water rate increases.

The following items were recommended and approved by the members of the Ad Hoc Committee:

- Recommended changes that are included in the draft Water Rate Study
- Recommended goal of nine miles of pipe replacement per year by 2023
- Proposed rate structure modifications and rate increases

- Direction to staff to pursue State Revolving Funds when possible
- Preparation of an annual capital report that summarizes the progress of the capital program; discusses receipt and opportunities for alternative sources of funding; and assesses the water funds' cash reserves to determine whether opportunities exist to delay or avoid previously-approved rate increases. The annual capital report would be submitted to the Infrastructure and Natural Resources Advisory Committee (INRAC) for review and forwarded to City Council for consideration.

Water Rate Recommendations

The proposed water rates were developed by a comprehensive cost-of-service analysis and are designed to meet the Water Utility's revenue needs over the next five years. These are proposed modifications to the City's existing water rate structure in order to more closely reflect the Water Utility's actual fixed versus variable cost structure. In addition to reflecting the City's cost of providing service, the modified rate structure will stabilize revenue by increasing the proportion of revenue that is collected through the fixed charge.

1. Refer to the fixed service charge as the "Fixed Meter Charge" and the consumption-based rate as the "Usage Rate".
2. Eliminate Outside City customer classes and other legacy customer classes.
3. Identify specific costs that are designated to be recovered through fixed vs. variable revenue.
4. Utilize the meter equivalency schedule (American Water Works Association standard).
5. Directly recover differing costs for the two sources of water supply through tiered and uniform Usage Rates.
6. Calculate uniform Usage Rates for all non-residential customers.
7. Establish a dynamic Pass-Through Policy using the following formulas, which update Usage Rates based on actual changes to wholesale water supply.

$$\begin{array}{l}
 \text{Tiered Rates} \left\{ \begin{array}{l}
 \text{Tier 1 Rate Adjustment} \left(\frac{\$}{\text{TGAL}} \right) = \text{Change in OCWD Unit Costs} \left(\frac{\$}{\text{TGAL}} \right) \\
 \text{Tier 2 Rate Adjustment} \left(\frac{\$}{\text{TGAL}} \right) = \text{Change in MWD Unit Costs} \left(\frac{\$}{\text{TGAL}} \right) \\
 \text{Tier 3 Rate Adjustment} \left(\frac{\$}{\text{TGAL}} \right) = \text{Change in MWD Unit Costs} \left(\frac{\$}{\text{TGAL}} \right)
 \end{array} \right.
 \end{array}$$

$$\begin{array}{l}
 \text{Uniform Rates} \left\{ \begin{array}{l}
 \text{Uniform Rate Adjustment} \left(\frac{\$}{\text{TGAL}} \right) = \text{Tier 1 Rate Adjustment} \left(\frac{\$}{\text{TGAL}} \right) \times 75\% + \text{Tier 2 Rate Adjustment} \left(\frac{\$}{\text{TGAL}} \right) \times 25\% \\
 \text{(i.e. the weighted average of the adjustments to the tiered rates)}
 \end{array} \right.
 \end{array}$$

The tier allocations (i.e., the amount of water allowed in each respective tier) are calculated based on the amount of water available from each source of water supply.

To address critical infrastructure deficiencies, the five-year water rate revenue adjustment plan presented in Table 2 is recommended.

Table 2: Proposed Plan of Water Rate Revenue Increases

Rate Adjustment Date	Rate Adjustment
July 1, 2019	15.0%
July 1, 2020	14.0%
July 1, 2021	11.0%
July 1, 2022	5.0%
July 1, 2023	4.0%

Rates need to be adequate to recover the expenses, while ensuring that costs are equitably allocated, so that rates are fair and in proportion to the services received by the various customer classes. The rate study modeled the costs of operating and maintaining the water system for the next ten years. Current operating costs were based on recent actual and budgeted expenditures and those costs were inflated in order to forecast operating costs for future years. Capital expenditures were forecasted based on the City's capital spending forecast, which includes a significant increase in aging water pipe replacements.

Based upon the analyses and proposed rate structure modifications, **Tables 3** show the proposed rates for FY 2019-20. The complete list of rate schedules through FY 2023-24 are provided in the attached draft report. Note that the Pass-Through Policy would adjust rates in addition to the proposed rate revenue increases shown in **Table 2**.

Tables 3: Proposed Rates, Effective July 1, 2019

Fixed Meter Charges

Meter Size	Monthly Rate
5/8"	\$26.07
1"	\$41.30
1 1/2"	\$79.39
2"	\$125.08
3"	\$246.95
4"	\$384.04
6"	\$764.86
8"	\$1,221.84
10"	\$1,831.15
12"	\$2,573.75

Tiered Usage Rates (for residential accounts)

Tier	Rate (per TGAL)	Allocation (Single Family)	Allocation (Multi-Family) (per unit)
1	\$2.28	12,800 gal.	5,100 gal.
2	\$4.58	20,200 gal.	6,700 gal.
3	\$4.96	(na)	(na)

Uniform Usage Rates (for non-residential accounts)

Non-Residential Customer Classes	Rate (per TGAL)
Non-Residential	\$2.88

Without the proposed 5-year water rate revenue increases, the City will not be able to design and construct capital projects. In fact, the projects that have already been appropriated in FY 2018-19 and fiscal years prior will need to be reanalyzed with some of the projects removed. In addition, the City would not have sufficient reserves, which are vital for maintaining financial stability.

Proposition 218 Notice

Under California State law, the City is required to conduct a Public Hearing on water rate modifications and mail a notice to every property owner announcing the hearing 45 days in advance of the hearing date. A Proposition 218 Notice will be sent to all affected rate payers and is included as an attachment to this report (Attachment 4).

A Public Hearing regarding the proposed rates and rate structure changes is scheduled for June 4, 2019 at 6:30 p.m. in the City Council Chambers, City Hall, 303 W. Commonwealth Avenue, Fullerton, CA 92832. The Public Hearing process for water rate modifications follows the California Constitution's requirements for water rates. Therefore, if there is no majority (50% + 1) of property owners who file written protests against these proposed rate increases, the rate changes may be approved by City Council, and will take effect on July 1, 2019.

Attachments:

- Attachment 1 – Water Rate Study PowerPoint Presentation
- Attachment 2 – Draft Water Rate Study Report
- Attachment 3 – Ad Hoc Meeting Minutes
- Attachment 4 – Proposition 218 Notice