

# Agenda Report

June 8, 2009

**TO:** City Council

**THROUGH:** Municipal Services Committee

**FROM:** City Manager

**SUBJECT:** Public Hearing for the Proposed Water Rate Increases and Implementation of Water Rate Proposal

**RECOMMENDATION:**

It is recommended that the City Council:

- 1) Open a Public Hearing to Receive Public Comment on the Proposed Water Rate Increases in accordance with the requirements of Proposition 218;
- 2) Have City Clerk or department representative report on timely written protests received; and
- 3) Continue the Public Hearing to June 22, 2009.

**EXECUTIVE SUMMARY:**

On April 13, 2009 the City Council established a date of June 8, 2009 to conduct a public hearing to consider public comment regarding proposed increases to water rates. Pursuant to the requirements of Proposition 218, a public notice was mailed on April 20, 2009 to all property owners and tenants of record regarding the date and time of the public hearing and the water rate proposal. The notice was subsequently amended due to typographic error and resent to all property owners and tenants on May 5, 2009.

During the public notice period, the Water and Power Department (PWP) conducted eight public meetings with residential and commercial customers and met one-on-one with 15 of its large customers to present information regarding the rate proposal. In response to feedback from its customers on the water rate proposal, PWP evaluated alternatives to the original proposal in order to lessen the financial impact of the water rate proposal on its customers. The original rate proposal and the alternatives are further described in this report.

## **BACKGROUND:**

During the past year, PWP conducted a revenue requirements analysis and completed a Water Cost of Service (WCOS) study, both of which determined that revenues from existing rates were insufficient to meet projected revenue requirements and that the water rate structure needed to be changed to reflect available local water supply. This condition created a structural imbalance in the Water Fund, particularly related to the adequacy of the revenues generated from Distribution and Customer Charge (D&C), which covers the ongoing fixed cost of water operations.

Since the Public Hearing date was set, PWP has been informing its water customers on the proposed water rate changes and providing information about the Public Hearing scheduled for June 8, 2009. PWP staff have conducted several public meetings, held one-on-one meetings with large commercial customers, made a presentation to the Altadena Town Council, met with members of the Pasadena Chamber of Commerce, and distributed informational materials to customers as well as posted related materials on its website. During this period, PWP received several comments from its customers regarding the impact of the proposed water rate changes. Many comments focused on the impact of the two additional higher priced commodity rate tiers that would be added to the water rate structure to encourage water conservation. Specifically, customers were concerned that they may not be able to sufficiently reduce water consumption to avoid the higher priced commodity rate tiers, which would significantly increase water bills. Customers were also concerned about the amounts and timing of the D&C rate increases.

## **WATER RATE PROPOSAL:**

The original staff recommendation was presented to the Municipal Services Committee on April 7, 2009. This recommendation provided for the implementation of the proposed D&C rate increases in two phases over a two-year period, and the addition of two higher priced commodity block rates to the existing three-tier block rates to encourage water conservation. It also provided a water rate structure that includes a pricing mechanism that is designed to reduce up to ten percent of total water consumption on a permanent basis. In addition, the recommendation included both the cost of service and water conservation elements outlined below including adjustments to the rate differential between inside and outside city customers and seasonal cost differentials.

### **Cost of Service Elements:**

1. Effective July 2009, increase the D&C revenue by \$4.1 million and the Fire Protection Surcharge (FPS) revenue by \$0.25 million for all customer groups, thereby increasing the overall water operating revenue by \$4.35 million or 10%;

2. Effective July 2010, increase the D&C revenue by an additional \$4.5 million for all customer groups, thereby increasing the overall water operating revenue by \$4.5 million or 8.7%;
3. Re-size the existing commodity block widths to reflect cost of service and resource availability;
4. Re-align pricing for Blocks 1, 2, and 3 to reflect the actual cost of providing water within each block;
5. Maintain the Purchased Water Adjustment Charge (PWAC) mechanism, combining the current PWAC into base commodity rate, and reset PWAC to zero (in a revenue neutral manner.) PWAC allows PWP to pass-through increased purchased water costs to customers;
6. Change the existing 35% rate differential between inside and outside city customers to 25% to reflect a rate of return comparable to that allowable for investor-owned utilities and the level of PWP's investments in its water system; and
7. Adjust the seasonal rate differential between winter and summer rates from 6% to 3% to reflect actual summer peaking cost (in a revenue neutral manner.)

**Conservation Elements:**

8. Redefine customer groups as residential, commercial, institutional, and industrial customers instead of by meter sizes only, and resize commodity block widths in accordance with the water conservation plan
9. Add two higher priced commodity block rates to the existing three commodity block rates for excessive water use to encourage conservation, provide necessary price signals, and achieve desired conservation objectives of reducing water demands by up to 10%
10. Adopt a water shortage pricing plan for implementation during periods of emergency water shortage to recover higher costs of water purchases in excess of the PWP's allocations from its wholesale water suppliers and recover associated conservation program costs.

**ALTERNATIVES TO ORIGINAL PROPOSAL**

At a special meeting of the Municipal Services Committee on June 4, 2009, staff presented three alternatives to the water rate proposal. The alternatives are described below and summarized in Attachment 1. The Committee did not take specific action on the alternatives.

**Alternative 1 – Eliminate or suspend implementation of new Blocks 4 and 5**

Variations of this alternative were also considered, including implementation of Block 4 only and alternate pricing options for Blocks 4 and 5, provided that the price for Blocks 4 and 5 must exceed the price for each of Blocks 1, 2, and 3.

Impact of this alternative on customer bills:

- Will primarily reduce impact on largest water consumers
- Extends Block 3 pricing to all water consumed beyond Block 2
- Reduces conservation price signal

Impact on the Water fund:

- Reduces or eliminates mechanism to collect Metropolitan Water District (MWD) penalty rates from largest water consumers
- Cost of paying higher penalty rates to MWD will be distributed to all water customers using PWAC mechanism

**Alternative 2 – Suspend General fund transfer of incremental D&C revenues**

Impact of this alternative on customer bills:

- No significant impact on customer bills – maximum range from \$0.45 to \$0.50 per month per customer

Impact on Water fund:

- Incremental revenue from D&C increase would remain in Water Fund to support ongoing operations and increase net income to ensure support of remaining General Fund Transfer
  - 2 year implementation:

|         |           |                 |
|---------|-----------|-----------------|
| FY 2011 | \$258,000 | \$0.21/cust/mo. |
| FY 2012 | \$528,000 | \$0.45/cust/mo. |
  - 3 year implementation:

|         |           |                 |
|---------|-----------|-----------------|
| FY 2011 | \$180,000 | \$0.15/cust/mo. |
| FY 2012 | \$372,000 | \$0.30/cust/mo. |
| FY 2013 | \$594,000 | \$0.50/cust/mo. |

**Alternative 3 – Implement D&C increase over Three- Year Period (the D&C typically represents less than 25% a total residential customer bill)**

Impact of this alternative on customer bills:

- Smaller impact to customer for each of three years
  - Two-year implementation:
    - FY 2009 50%
    - FY 2010 31%
  - Three-year implementation:
    - FY 2009 35%
    - FY 2010 26%
    - FY 2011 25%

- Cumulative impact over three years is greater due to compounding effect of additional year

Comparative impacts on customer bills for each connection size are included in Attachments 3 and 4.

Impact on the Water Fund:

- Extends deficit condition by one year
  - FY 2010 deficit is \$2.4M instead of \$1.1M – revenue generated is \$1.3M less in FY 2010
- FY 2011 is approximately break-even instead of \$2.3M net income
- Net income may be insufficient to support full 6% General Fund Transfer in FY 2011 (FY 2011 transfer is based on FY 2010 net income)

The Water Fund operating budget has been reduced by \$1.5 million for fiscal years 2009 and 2010. The accumulated shortfall in operating revenue in the Water Fund is approximately \$18 million from fiscal year 2007 through 2009. Alternative 3 provides the very minimal funding from D&C revenues required for continued water delivery operations. Further reductions in revenue will require reduction of the operating budget, including staffing levels, which will impact service delivery. Comparative impacts of Alternative 3 to the operations portion of the Water Fund are included in Attachment 2.

### **WATER SHORTAGE PRICING PLAN**

**The proposed Water Shortage Pricing Plan is based on the original Water Rate Proposal developed by staff.**

The Water Conservation Ordinance approved by the City Council includes establishing a water pricing plan to be implemented during periods of emergency water shortage. This rate structure will be automatically invoked when the City Council makes a finding that there is a Water Shortage and establishes a Water Conservation Goal as defined in the Water Conservation Ordinance. The Water Shortage Pricing Plan is designed to recover higher costs of water purchases and to encourage conservation during shortage periods.

Under the proposed Water Shortage Pricing Plan, all water sold in Block 1 will be exempt from the water shortage pricing schedule. If the established Water Conservation Goal is greater than 10%, the water shortage rates will be applied as follows:

- Reduce water allocations for rate Blocks 2 through 5: The water allocations for Blocks 2 to 5 will be reduced by the same percentage as the declared Water Conservation Goal less 10%, rounded to nearest whole billing unit. For example, a 20% conservation goal would result in a 10% reduction in current block widths for Blocks 2 to 5.

- Increase water commodity rates for Blocks 2 through 5 to reflect increased water costs and targeted reduced sales volumes. The current rates would be increased in accordance with the following formula: Water Shortage Rate = Regular Rate x 1/(1-Water Conservation Goal).

**Water Shortage Rate Water - Commodity Rate Increases  
(As a % of the Baseline Block Rate)**

| <b>Water Shortage Rate</b>         | <b>Block 1</b> | <b>Blocks 2 – 5</b> |
|------------------------------------|----------------|---------------------|
| <b>20% Water Conservation Goal</b> | 0%             | 25%                 |
| <b>30% Water Conservation Goal</b> | 0%             | 43%                 |

**FISCAL IMPACT:**

The fiscal impact of the original proposed July 2009 D&C rate and FPS increases are expected to generate \$4.3 million annually, the proposed July 2010 D&C rate increases are expected to generate an additional \$4.5 million annually, to offset increased operation and maintenance costs of the water system. If the rate proposal is approved, the additional operating revenue will result in an increase to the General Fund Transfer of approximately \$261,000 in FY 2011, and \$528,000 in FY 2012.

If Alternative 1 is selected, the proposed July 2009 D&C rate and FPS increases are expected to generate \$3.0 million annually, the proposed July 2010 D&C rate increases are expected to generate an additional \$3.2 million annually, and the proposed July 2010 D&C rate increases are expected to generate an additional \$3.7 million annually to offset increased operation and maintenance costs of the water system. If the rate proposal is approved, the additional operating revenue will result in an increase to the General Fund Transfer of approximately \$180,000 in FY 2011, and \$372,000 and \$594,000 in FY 2012 and FY 2013, respectively.

Actual transfers to the General Fund would be reduced if Alternative 2 is selected.

Respectfully submitted,



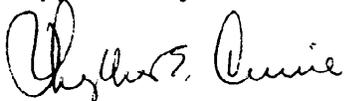
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