



# Agenda Report

March 11, 2019

**TO:** Honorable Mayor and City Council

**THROUGH:** Municipal Services Committee (February 26, 2019)

**FROM:** Water and Power Department

**SUBJECT: SET A DATE OF MAY 13, 2019 FOR A PUBLIC HEARING FOR RECOMMENDED ADJUSTMENTS TO THE WATER RATES**

## **RECOMMENDATION:**

It is recommended that the City Council:

1. Find that the Public Hearing for the recommended adjustments to the water rates is exempt from the California Environmental Quality Act ("CEQA") pursuant to State CEQA Guidelines Section 15273 (Rates, Tolls, Fares, and Charges);
2. Establish a date of May 13, 2019 to conduct a public hearing on the recommended adjustments to the water rates to:
  - a. Eliminate the rate differentials in the Distribution and Customer ("D&C") Charge, Commodity Charge, and the Capital Improvement Charge ("CIC") for customers located outside the city limits to be effective June 1, 2019;
  - b. Eliminate the winter and summer ("seasonal") rate differentials in the Commodity and CIC charges for all customers to be effective August 1, 2019;
  - c. Increase the D&C Charge for all customers to generate annual revenue of \$3.4 million to be effective August 1, 2019;
  - d. Increase the D&C Charge for all customers to generate annual revenue of \$3.7 million to be effective July 1, 2020; and,
  - e. Increase the Commodity Charge to generate annual revenue of \$0.5 million to be effective July 1, 2020.

## **MUNICIPAL SERVICES COMMITTEE RECOMMENDATION:**

On February 26, 2019, the Municipal Services Committee approved the staff recommendation and directed staff to proceed to City Council to set a date of May 13, 2019 for a Public Hearing for Recommended Adjustments to the Water Rates.

The proposed rate adjustments are based on the current rate structure and not on the new rate structure that was discussed in FY2016 and FY2017. The new rate structure was suspended because of the uncertainty pending the class action lawsuit. It is not feasible to proceed with the rate structuring at this time because the necessary time to implement and stabilize the complex changes to the water rates would delay the Customer Information System replacement project by 6-12 months.

### **EXECUTIVE SUMMARY:**

In October 2018, the Los Angeles County Superior Court (“Court”) approved the settlement agreement of the class-action lawsuit *Howard Jarvis Taxpayers Assn. et al. v. City of Pasadena* (“City”) regarding the rate differential that the Pasadena Water and Power Department (“PWP”) had been charging to water customers located outside the city limits.

In compliance with the settlement terms, PWP is proposing to eliminate the rate differentials in the D&C, Commodity and CIC charges for customers outside of the city limits effective June 1, 2019. This elimination will increase overall average water rates for inside city customers by about 3%. Conversely, overall average water rates will decrease by about 17% for outside city customers. This disproportionate rate impact is the result of the cost shift associated with a relatively smaller number of outside city customers spread over a larger number of inside city customers. The net impact will not affect total revenues of the Water Fund.

In addition, to recover increased operating costs and provide an appropriate level of rate-associated funding for capital investment, PWP is recommending water rate actions for each of the next two fiscal years:

1. Effective August 1, 2019:
  - a. Eliminate the winter and summer rate differentials in Commodity and CIC charges. This action will not affect revenues of the Water Fund; and,
  - b. Increase D&C annual revenues by \$3.4 million, thereby increasing the system average rate by 5.7% for all customers; and,
2. Effective July 1, 2020:
  - a. Increase D&C annual revenues by \$3.7 million, thereby increasing the system average by 5.8% for all customers; and,
  - b. Increase Commodity annual revenues by \$0.5 million, thereby increasing the system average rate by 0.7% for all customers.

Additional information regarding the cost of service analysis, revenue and sales projections, water allocation blocks, and rate development methodology is included in Attachment A – Proposed Adjustments to the Water Rates. The information is also available online and can be accessed at this website:

[www.pwpweb.com/ProposedWaterRateAdjustments](http://www.pwpweb.com/ProposedWaterRateAdjustments).

Staff is recommending that a Public Hearing be set on May 13, 2019 to receive public comment on the proposed changes to the water rates and that the City Council take action to implement the changes at that time.

**BACKGROUND:**

***Class-Action Litigation***

In 2014, a class-action lawsuit was initiated on behalf of water customers located outside of the city limits challenging PWP's rate differentials for Commodity and D&C charges applied to customers outside of the city limits (*ref: Howard Jarvis Taxpayers Assn. et al. v. City of Pasadena*). The lawsuit alleged that the rate differential resulted in rates that were not in compliance with Proposition 218. In accordance with the final settlement terms approved by the Court in October 2018, the City proposes to eliminate the rate differential imposed on customers who reside outside the city limits effective June 1, 2019.

- The settlement requires that within one year of the court's approval of the settlement, the City will eliminate the surcharge imposed on customers of Pasadena Water and Power who reside outside the City of Pasadena for Commodity and Distribution & Customer (D&C) charges.
- Within the same one year, the City will adopt a Capital Improvements Charge rate that eliminates the differential, or, if any differential is imposed on customers of Pasadena Water and Power who reside outside the City of Pasadena, it shall be calculated based on bona fide projected costs that the City would not otherwise incur when it makes capital improvements but for the fact such improvements are located in unincorporated County of Los Angeles.
- In addition, if the approved rates do eliminate the twenty-five percent (25%) surcharge, the City agrees it will not adopt a rate differential for Commodity or D&C charges unless the rationale for the differential applies consistently to customer classes without regard to whether the customers are located inside or outside the city limits.
- The City of Pasadena also agrees not to base any differential on the theory that inside city customers have superior rights to the City's adjudicated groundwater rights.

Additional information about the litigation and settlement terms is available at <http://howardjarvisvcityofpasadena.com>.

***Water Cost of Service Analysis and Rate Design***

In fiscal year ("FY") 2018, staff completed an internal water cost of service and rate design analysis. The analysis indicated that revenues from current rates were insufficient to cover annual D&C operating expenses and pay-go requirements for capital investments. The cost of service analysis indicated that revenues from existing D&C rates will result in a shortfall of \$4.6 million for FY 2019, and that the shortfall will increase to \$6.1 million by FY 2021 without a rate adjustment. Similarly, the study indicated that revenues from the existing Commodity rates will result in a shortfall of \$0.5 million by FY 2021. Details of this analysis are included in Attachment A.

The D&C charge recovers the cost of operating and maintaining the infrastructure that treats, stores and reliably delivers water to customers. This includes distribution mains and lateral pipes connecting to individual homes and businesses, pumping stations that boost water across various elevations in the City, and reservoirs at which water is stored and treated. The D&C also covers the costs of customer service functions, including call center services, meter reading, billing, and collections. Costs to provide these services, which include labor and materials, depreciation, fuel, postage and billing supplies, have increased.

The Commodity Charge covers the cost to purchase water from the Metropolitan Water District (“MWD”) and to extract groundwater from local supplies. It also recovers the cost of performing water quality testing and treatment to ensure that only high quality water is delivered to customers. Costs to procure water have increased, primarily driven by increased rates from the MWD for water purchased by Pasadena. Treatment costs have also increased due to changes in the blending of purchased water with locally produced groundwater.

Except for the removal of the rate differential charged to customers outside of the city limits in compliance with the litigation settlement, there are currently no proposed adjustments to the CIC rate. PWP is currently in the process of updating its Water System Resource Plan (“WSRP”), which will provide a roadmap for resource planning and capital investment for the water system over the next 20 years. When the WSRP is completed, a cost-of-service analysis will be prepared that will likely result in a proposed adjustment of the CIC rate.

Details of the internal water cost-of-service analysis and rate design study are included as Attachment A of this report. The study results and the proposed water rate adjustments have been reviewed and validated by the City’s outside legal firm for compliance with Proposition 218.

**Proposed Water Rate Adjustments**

Table 1 provides a summary of the projected annual revenue requirements compared to the projected revenues from current D&C and Commodity rates.

**Table 1: Existing Rate Structure - Cost of Service Revenue Requirements  
 (\$ millions)**

Rate Component	FY 2019 (Budget)			FY 2020 (Projected)			FY 2021 (Projected)		
	Rev. Rqm't	Rate Rev.	Income / (Loss)	Rev. Rqm't	Rate Rev.	Income / (Loss)	Rev. Rqm't	Rate Rev.	Income / (Loss)
D&C	\$23.6	\$19.0	(\$4.6)	\$24.4	\$19.0	(\$5.4)	\$25.1	\$19.0	(\$6.1)
Commodity	\$26.3	\$27.7	\$1.4	\$27.3	\$27.8	\$0.5	\$28.4	\$27.9	(\$0.5)
<b>Total</b>	<b>\$49.9</b>	<b>\$46.7</b>	<b>(\$3.2)</b>	<b>\$51.7</b>	<b>\$46.8</b>	<b>(\$4.9)</b>	<b>\$53.5</b>	<b>\$46.9</b>	<b>(\$6.6)</b>

Rev Rqm't. = Revenue Requirement

PWP is recommending a phased rate action plan to maintain fiscal responsibility, recover sufficient revenue to meet increased operating costs, and provide pay-go funding for capital investment that will also manage potential customer bill impacts.

**Effective June 1, 2019: Eliminate Outside City Rate Differential**

To comply with the settlement language approved by the Court, PWP is proposing to eliminate the rate differentials charged to customers outside the city limits to be effective June 1, 2019. While the elimination of this differential is not expected to generate additional revenue for the Water Fund, it will result in an increase of approximately 3% on the monthly water bills of customers located inside the city limits, while lowering bills for customers outside the city limits by approximately 17%.

**Effective August 1, 2019: Eliminate Seasonal Rate Differentials and Increase the D&C Charge**

PWP is proposing to eliminate the seasonal rate differentials with new normalized rates for Commodity and CIC for all customers effective August 1, 2019. This change will normalize rates between seasons and will have no fiscal impact on the utility. Details are provided in Attachment A, Table 15 and Table 16.

In addition, PWP is proposing to increase the D&C rates for all customers effective August 1, 2019. This increase will generate additional annual revenue of \$3.4 million when implemented for a full year. However, since the effective date of the rate implementation will occur on August 1, 2019, PWP will forego one month of the revenue associated with the proposed rate increase or about \$0.3 million in FY 2020.

**Effective July 1, 2020: Increase the D&C and Commodity Rates**

PWP is also proposing to increase the D&C charge and Commodity rates for all customers effective July 1, 2020. These increases will generate additional annual revenue of \$3.7 million and \$0.5 million, respectively.

The projected financial performance of the proposed rate adjustments is shown in Table 2.

**Table 2: Rate Plan Revenue Projections (\$ millions)**

Rate Component	FY 2020 Revenue Requirement	FY 2020 Planned Revenue	FY 2020 Income/ (Loss)	FY 2021 Revenue Requirement	FY 2021 Planned Revenue	FY 2021 Income / (Loss)
D&C	\$24.4	\$22.1	(\$2.3)	\$25.1	\$26.1	\$1.0
Commodity	\$27.3	\$27.8	\$0.5	\$28.4	\$28.4	\$0
<b>Total</b>	<b>\$51.7</b>	<b>\$49.9</b>	<b>(\$1.8)</b>	<b>\$53.5</b>	<b>\$54.5</b>	<b>\$1.0</b>

PWP completes periodic cost of service analyses to determine adequacy of rate performance. Rate adjustments are recommended only as needed to fund ongoing operations and provide adequate funds for capital investment. Table 3 summarizes the

per-billing unit impact of the proposed rate actions and previous rate actions from FY 2008 to the present.

**Table 3: Rate Adjustments – Historical and Proposed**

Rate Adjustments per Billing Unit			
Period	D&C	Commodity	CIC
July 1, 2020 (proposed)	\$0.324	\$0.041	-
August 1, 2019 (proposed)	\$0.297	-	-
Historical Rate Actions per Billing Unit			
FY 2017	-	\$0.020	-
FY 2016	-	\$0.050	\$0.34
FY 2015	-	\$0.100	-
FY 2014	-	\$0.100	-
FY 2013	-	-	-
FY 2012	\$0.300	\$0.120	-
FY 2011	\$0.270	\$0.095	-
FY 2010	\$0.250	-	-
FY 2009		\$0.232	
FY 2008			\$0.12

Note: A billing unit of water is equal to 748 gallons or a hundred cubic feet of water (HCF)

**Customer Bill Impact**

The proposed rate changes will have various impacts on customer bills based on meter connection size and the amount of water used. After elimination of the rate differentials, the estimated average bill impact will be the same for inside and outside city customers for each meter size with identical usage as indicated below.

Estimated Average Bill Impact:	<u>June 1, 2019</u>	<u>August 1, 2019</u>	<u>July 1, 2020</u>
• Inside City	3.1%	5.9%	7.8%
• Outside City	(17.1%)	5.9%	7.8%

Examples of the bill impacts for each meter size are shown in Attachment A.

**Implementation Timeline**

PWP is recommending that a Public Hearing be set on May 13, 2019, to receive public comment on the proposed changes to the water rates. Table 4 outlines the proposed timeline and implementation schedule.

**Table 4: Proposed Water Rate Implementation Schedule**

<b>Date</b>	<b>Action Item</b>
March 11, 2019	Set Public Hearing Date by the City Council
March 15, 2019	Mail Water Rate Action Public Hearing Notice
May 3, 2019	45-day Advance Notice Requirement met
May 13, 2019	Public Hearing and City Council Rate Action / 1 <sup>st</sup> Reading of Water Rate Ordinance
May 20, 2019	2 <sup>nd</sup> Reading of Water Rate Ordinance

**COUNCIL POLICY CONSIDERATION:**

The recommendations are consistent with the City Council's goals to maintain fiscal responsibility and stability; improve, maintain, and enhance public facilities and infrastructure; and increase conservation and sustainability.

**ENVIRONMENTAL ANALYSIS:**

The proposed increases to the Distribution and Customer Charge and to the Commodity Charge are statutorily exempt from CEQA. Section 15273 of the State CEQA Guidelines identifies a statutory exemption for "Rates, Tolls, Fares, and Charges" and states (in part) that:

- a. CEQA does not apply to the establishment, modification, structuring, restructuring, or approval of rates, tolls, fares, or their charges by public agencies which the public agency finds are for the purpose of:
  1. Meeting operating expenses, including employee wage rates and fringe benefits,
  2. Purchasing or leasing supplies, equipment, or materials,
  3. Meeting financial reserve needs and requirements,
  4. Obtaining funds for capital projects, necessary to maintain service within existing service areas, or
  5. Obtaining funds necessary to maintain such intra-agency transfers as are authorized by city charter.

**FISCAL IMPACT:**

There is no direct fiscal impact as a result of setting the recommended public hearing date. If approved, the proposed increase to the D&C charge on August 1, 2019 will generate additional revenue of \$3.1 million in FY 2020 based on the partial year implementation. When implemented for a full year, annual revenue of \$3.4 million will be generated. In FY 2021, the second proposed increase to the D&C charge will generate additional annual revenue of \$3.7 million. Additionally, the proposed increase to the Commodity rate will generate added revenue of \$0.5 million in FY 2021. The action to eliminate the outside city rate differential and seasonal rates will not impact total revenue to the utility.

Respectfully submitted,



---

GURCHARAN S. BAWA  
General Manager  
Water and Power Department

Prepared by:



---

Shari M. Thomas  
Assistant General Manager  
Water and Power Department

Approved by:



---

STEVE MERMELL  
City Manager

**Attachments:**

Attachment A: Proposed Adjustments to the Water Rates