

Agenda Report

April 8, 2024

TO: City Council

THROUGH: Municipal Services Committee (March 26, 2024)

FROM: Water and Power Department

SUBJECT: SET A DATE OF JUNE 3, 2024, TO CONDUCT A PUBLIC HEARING FOR RECOMMENDED WATER RATE STRUCTURE AND RATE ADJUSTMENTS

RECOMMENDATION:

It is recommended that the City Council:

- 1) Find that the proposed action is not a project subject to the California Environmental Quality Act (CEQA) pursuant to Section 21065 of CEQA and Sections 15060(c)(2), 15060(c)(3), and 15378 of the State CEQA Guidelines and, as such, no environmental document pursuant to CEQA is required for the project; and
- 2) Set a public hearing for June 3, 2024, for the proposed water rate structure and rate adjustments, to be effective beginning July 1, 2024, or as soon as practicable thereafter; and
- 3) Direct the Water and Power Department to mail notices of the public hearing set for June 3, 2024, regarding the proposed water rate structure and rate adjustments.

MUNICIPAL SERVICES COMMITTEE RECOMMENDATION:

On March 26, 2024, with one member absent, the Municipal Services Committee ("MSC") unanimously approved the staff recommendation to the City Council.

BACKGROUND:

The Pasadena Water and Power Department ("PWP") is responsible for the operations and activities of the City's water system, which provides water services to customers within City limits and adjacent areas outside the City limits. In order to provide safe, reliable, and resilient service to its customers, the utility must secure sufficient revenues to ensure proper system operation and maintenance, capital improvements, and preservation of the utility's financial integrity. Revenues generated from water rates must adhere to cost-of-service principles in accordance with Proposition 218 and be

collected from rate structures that recover the cost of providing water service to all customers. The Water Fund is an enterprise fund, which is a self-sustaining, not-for-profit entity where all fees and charges are reinvested back into the utility.

PWP periodically conducts comprehensive cost-of-service analyses for its water and electric services. These assessments, which evaluate operating costs, capital investment and reserve requirements, customer characteristics, resource conditions and availability, legislative requirements, and rate design are generally completed every five to ten years. However, a comprehensive study of the Water Fund has not been completed since 2009.

Beginning in 2022, with independent consulting services provided by Financial Consultants, Inc., (“Raftelis”), staff conducted a comprehensive cost-of-service analysis and rate study for the water system. The study analyzed the cost of providing water service and indicated that adjustments are necessary to keep up with costs to serve water, recover costs equitably, and to continue the support of the City’s water conservation ethos.

On July 25, 2023, and February 13, 2024, staff provided an update on the study to the Municipal Service Committee (“MSC”). Staff presented a review of five potential rate designs and the Committee requested further analysis and information regarding a Budget-Based Tiered Rate structure (“BBTR”) prior to staff developing a recommended design. During the February 13, 2024, MSC meeting, staff presented a detailed discussion of a Tiered by Customer Type and Meter Size structure (“Tiered by Customer Class”) and a Budget-Based Tiered Rate structure (“BBTR”). Staff recommended the former as more suitable given the customer data and resources available at this time. Upon deliberation, the MSC provided direction to return with a full analysis of a Tiered by Customer Class structure. The Committee also requested that, after the implementation of Advanced Metering Infrastructure and the availability of additional data, staff will re-evaluate a BBTR structure.

EXECUTIVE SUMMARY:

Current Rate Structure

PWP’s current water rate structure is Tiered by Meter Size and is comprised of three separate components. Revenues generated from each component are committed to recovering specific costs. The Commodity Charge is an inclining tiered rate structure where the amount of water allocated in each tier is based on meter size, regardless of customer class. The Distribution & Customer Charge (“D&C”) is a monthly fixed charge based on the customer’s meter size connection, and the Capital Improvement Charge (“CIC”) is a flat rate based on the amount of water used.

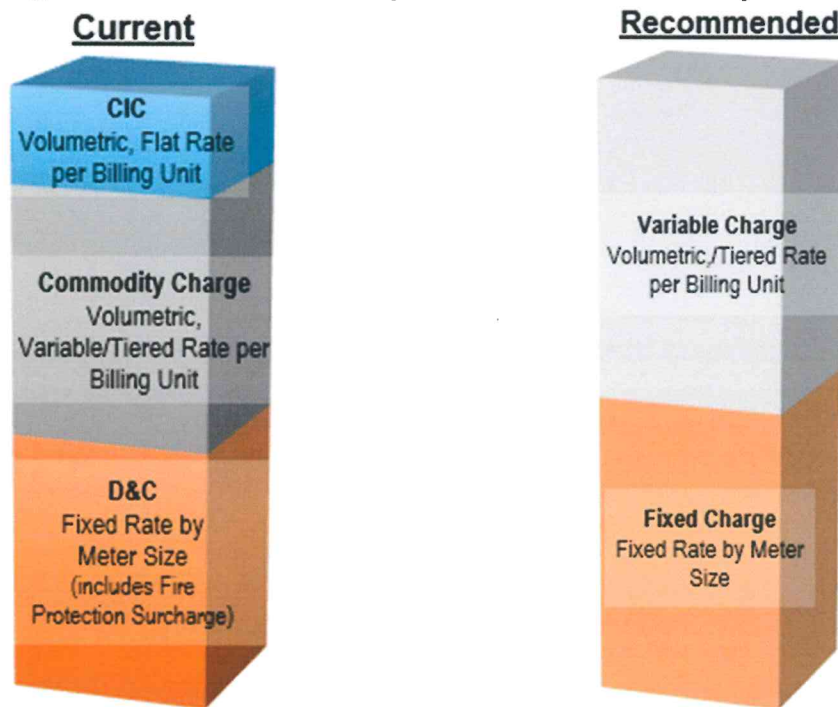
Recommended Rate Restructure

Staff recommends a Tiered by Customer Class rate structure. The rates were developed using the base extra capacity methodology as established in the M1 Manual

by the American Water Works Association and will recover the costs of service and continue to support the City’s water conservation goals. The rate structure includes the segmentation of rates by customer classes (Single Family Residential, Multi-Family Residential, and Commercial) for the volumetric portion of rates and by meter size for the fixed charge portion. Different customer classifications represent diverse water use purposes and patterns, with differing cost implications to the system. Blocks/tiers based on customer class uses allow for a more equitable approach to allocating volumetric costs to each customer sector as well as sending a conservation price signal based on the fact that the more water used, the higher the marginal price of that water usage.

In addition, staff recommends implementing a drought rate to encourage water conservation during periods of drought. The drought rate aims to further reduce overall demand and helps ensure sustainable water management during challenging environmental conditions. The drought rates are recommended to take effect at the discretion of PWP’s General Manager. Staff proposes integrating the CIC rate component into the Variable Charge and the Fixed Charge to streamline the rates and enhance water conservation signals. The current and recommended water rate components are illustrated in Figure 1.

Figure 1: Current and Proposed Water Rate Components



The costs recovered from the Variable Charge component include funding for imported water purchased from the Metropolitan Water District (“MWD”) and local groundwater production (pumping and power costs), testing, and treatment costs for local groundwater. The costs recovered from the Fixed Charge component include funding for operations and maintenance of the water system infrastructure, and customer service functions, including the call center, meter reading, billing, and collections. Both

the Variable and the Fixed Charge provide funding for water system capital improvement projects and a portion of the debt service on water system bonds. The detailed recommended rate structure and associated rates can be found in Attachment A.

Rate Adjustments and Revenue Requirements

Staff recommends rate adjustments that will provide additional revenue of \$41.6 over a five-year period, as described in Table 1.

Table 1: Adjustment Summary (\$ in millions)

	Fiscal Year ("FY")					Five-Year Increase
	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	
Variable Charge	\$7.5	\$7.9	\$6.6	\$6.5	\$6.1	\$34.6
Fixed Charge	\$1.5	\$1.6	\$1.3	\$1.3	\$1.2	\$7.0
Revenue Increase	\$9.0	\$9.5	\$8.0	\$7.8	\$7.3	\$41.6
Revenue Adjustment %	13%	12%	9%	8%	7%	12%

Note: Immaterial rounding differences may exist.

The revenue increases are necessitated by higher costs of operations and maintenance ("O&M") activities including increased purchased water costs for the MWD; higher pumping and treatment costs of local groundwater; increased level of capital investment on infrastructure projects; and reduced sales due to City's assertive conservation goals and wet weather patterns. Both conservation and robust infrastructure to produce, treat, and distribute water are necessary for long-term reliability and sustainability of the high-quality water supply for the City's customers.

The O&M of the water system has increased due to recent economic factors impacting other water systems. The rate of inflation is one factor that has a significant impact on the cost of supplies and materials required for the maintenance of the water supply. Rising costs impact the materials and supply, energy costs, chemicals, labor, and other services and supplies required for the basic operations to support the water system; including groundwater supply and treatment. In addition, increased prices for commodities and fuel led to a change in purchasing behavior such as stocking increased inventory, which adds to supply chain issues.

MWD has proposed and enacted significant increases to the rates that provide imported water for up to 70 percent of Pasadena's water supplies. Prior MWD Board approved rate increases were projected at 7%, however, more current information has the treated water rate for Pasadena in the double-digits. The cost of imported water is a significant amount and driver for increased revenue requirements which are allocated to the upper tiers in the higher volumetric portion of customer's rates.

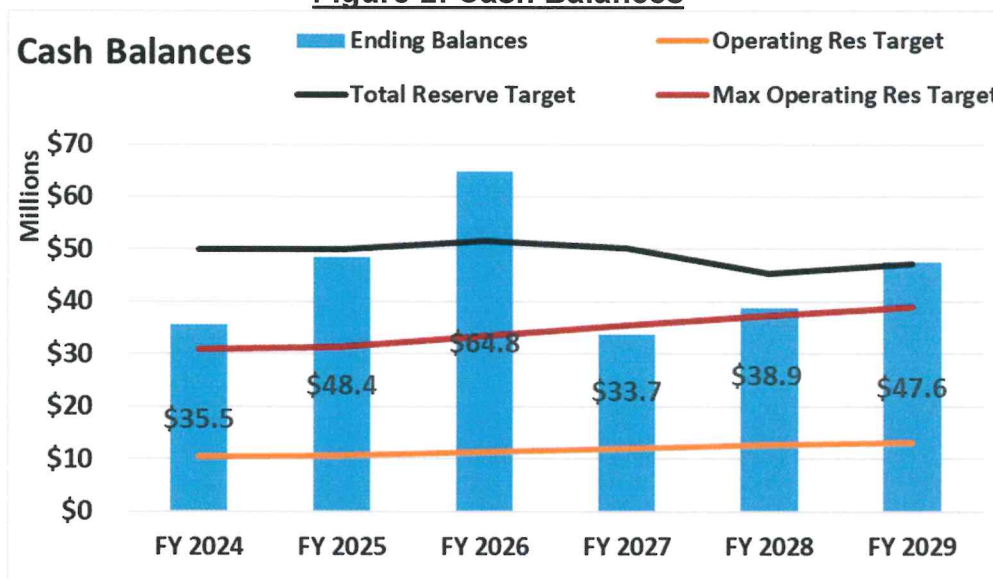
Pasadena is also a prudent investor in its own system and has aging reservoirs, pipes, treatment facilities, and other facilities requiring repair, rehabilitation, or replacement. To avoid the risk of failure and proactively reinvest in the system, there is a capital plan

which reflects the need and urgency of these expenditures. An example of a required capital investment is the 130-year-old Sunset Reservoir. The Sunset Reservoir is one of 14 aging reservoirs that serve a critical role in the City’s drinking water system. This project is in the design phase and requires approximately \$75 million in capital spending, primarily with construction expenses in FY 2026 and FY 2027. This major project, as well as future non-potable reuse projects and others will require expenditures.

The final component driving the revenue requirement increases are related to the community’s diligence in conserving water and to the related decrease in sales. FY 2023 saw an 18 percent decrease in year-over-year water consumption leading to a decrease in revenues of \$3.7 million dollars. This undercollection and rising costs are driving the decrease in the use of reserves and are reducing the amount of capital available to support the other increases to the water system.

Understanding that affordability is a challenge and that every penny counts, the plan for revenue adjustments was developed in an effort to balance the impact of immediate revenue needs and to avoid potential rate shock to the customer. As depicted in the graph below, the current rate plan keeps the water fund balance between the minimum reserve balance as stated in the City’s fund balance policy (60 days of operating reserve) and the target reserve policy. The revenue plan also includes the issuance of \$65 million dollars in debt financing, potentially through a low-interest federal loan program. Should the federal loan program not be secured, PWP will need to issue debt for cash flow needs. The cash balances summary is shown in Figure 2 and shows an ending cash balance meeting reserve targets.

Figure 2: Cash Balances



With the continuance of City Council’s fiscal discipline, which has garnered the current AAA credit ratings of the water system, PWP will continue to use its resources

efficiently, seek grants, and take advantage of other opportunities to mitigate rate impacts of its customers.

Staff will keep the MSC and Council apprised on the progress of the advanced metering infrastructure project (smart meters) and will revisit the plan as soon as practical upon completion of the installation of the project to provide options for continual improvement of the rate-setting process and a cost-of-service study.

Customer Bill Impacts

Individual customer bill impacts will vary depending on the customer class, the water meter size, and the amount of water used. Sample bill impacts for the common meter sizes for residential and commercial customers are shown in Table 2.

Table 2 depicts monthly billed amounts for simplicity, however, the majority of customers are billed on a bi-monthly basis. Residential and commercial customers have the opportunity to reduce their water bills by using less water through conservation.

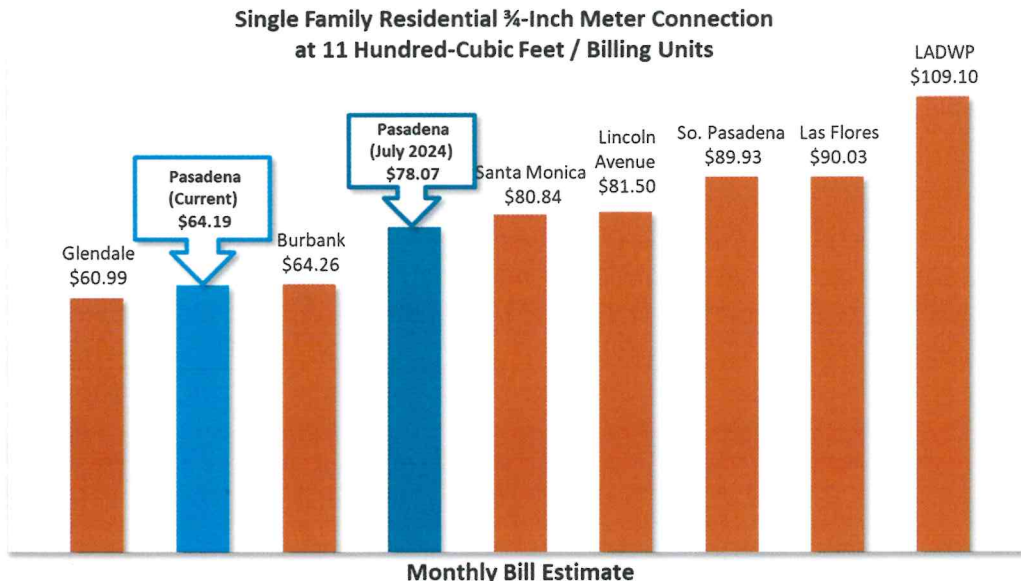
Table 2: Sample Bills - Monthly

Customer Class	Meter Size	Usage	Approximate Current Bill	Approximate Bill at July 2024
		(in Billing Units*)		
Single Family Residential	¾ inch	11	\$64	\$78
Multi-Family Residential - Small	¾ inch	17	\$93	\$102
Commercial - Small	1 inch	19	\$119	\$142

*One billing unit is equal to 748 gallons or 100 cubic feet of water.

The proposed rate increases are comparable to neighboring agencies. Figure 3 provides water bill comparisons with neighboring agencies. It is important to note that rate structures differ between water agencies based on the source of water supplies, operating costs, the level of infrastructure investment, and other factors. The comparisons are based on research of publicly available information on approved water rate increases for the agencies shown.

Figure 3: Estimated Monthly Bill Comparison with Other Utilities



Note: Information provided is based on publicly available information at the time publication. Other organization's rates may be different at the time of rate adoption.

Customer Outreach on Bill Impacts

In addition to the legally required notification and hearing process, PWP will be engaging in other customer outreach efforts associated with these changes. The outreach efforts associated with the new rate structure and customer rate impacts will be done in coordination with Public Works where practical, given the sewer and refuse rate proposals to be effective July 1, 2024. PWP is the billing and customer service function for all three public services and will be developing a rate calculator so customers can get individualized results for their budgeting purposes. In addition to this function, the PWP website, www.PWPweb.com/WaterRateDesign, will be updated with material as well as explainer videos and other materials to educate and inform the public about this recommendation.

Proposition 218

To meet the legal requirements for water rate adjustments in accordance with Proposition 218, PWP is recommending that the City Council conduct a public hearing on June 3, 2024, to receive comments regarding recommended changes to the water rates.

Implementation Timeline

PWP is recommending that a Public Hearing be set for June 3, 2024, to receive comments on the recommended adjustments to the water rates. Following the City Council's action to set a date for the public hearing, a notice will be mailed to all water system customers that includes the recommended rate adjustments and provides information regarding the public hearing in compliance with the requirements of Proposition 218. A draft Public Hearing notice is shown in Attachment B. The actual format for the Public Hearing Notice that is mailed to water system customers may differ from the version shown in the attachment. Table 3 outlines the approximate timeline and implementation schedule for the proposed rate actions.

Table 3: Timeline

Date	Action Item
April 2024	Mail 45-day Public Hearing Notice
April-May 2024	Customer Outreach and Education
June 3, 2024	Water Rates Public Hearing and First Reading
June 10, 2024	Second Reading of Updated Water Rate Ordinance
July 1, 2024 or as soon as practicable thereafter	Effective Date of First Rate Action

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 establishment of a date to conduct a public hearing for the consideration of water rate adjustments is an administrative action that would not cause either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment. Therefore, the proposed action is not a "project" subject to CEQA, as defined in Section 21065 of CEQA and Section 15378 of the State CEQA Guidelines. Since the action is not a project subject to CEQA, no environmental document is required. Furthermore, the recommended water rate adjustments themselves would be 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:

The estimated cost to mail notices to all City of Pasadena water customers and property owners as mandated by Proposition 218 is approximately \$30,000. Funds are available in the Water Division operating budget in Account #49007920-8144.

The recommended rate increases to be effective on July 1, 2024, through July 1, 2028, are expected to generate approximately \$41.6 million annually. The incremental revenues will be used to offset increased O&M and capital costs of the water system and mitigate the impacts of a decrease in sales due to assertive conservation measures.

Respectfully submitted,




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Water and Power Department

Approved by:



MIGUEL MÁRQUEZ
City Manager

Attachment A: Current and Recommended Water Rate Adjustments
Attachment B: Draft Public Hearing Notice