



Agenda Report

June 3, 2024

TO: Honorable Mayor and City Council
FROM: Water and Power Department
SUBJECT: PUBLIC HEARING TO APPROVE RECOMMENDED WATER RATE ADJUSTMENTS

RECOMMENDATION:

It is recommended that the City Council:

1. Find that the recommended adjustments to the water rates are exempt from the California Environmental Quality Act ("CEQA") pursuant to State CEQA Guidelines Section 15273 (Rates, Tolls, Fares, and Charges);
2. Open a Public Hearing to receive public comment on the recommended water rate adjustments to the City of Pasadena ("City") water rates, and implement the Fiscal Year ("FY") 2025 through FY 2029 rate adjustments effective July 1 of each of these fiscal years, or as soon as practicable thereafter;
3. Close the Public Hearing and approve the recommended water rate structure and rate adjustments; and
4. Direct the City Attorney to prepare an ordinance amending the Water Rate Ordinance, Chapter 13.20 of the Pasadena Municipal Code, implementing the changes to the water rates as determined at this public hearing and described herein.

EXECUTIVE SUMMARY:

Pasadena Water and Power Department ("PWP") recommends implementation of water rate structure and rate adjustments. Staff seeks City Council's approval for the water rate structure to be effective July 1, 2024, and the rate adjustments to be effective on July 1 for each year beginning 2024 through 2028.

BACKGROUND:

On April 8, 2024, the City Council set the date of June 3, 2024, to conduct a public hearing to receive comments on the recommended water rate structure and rate

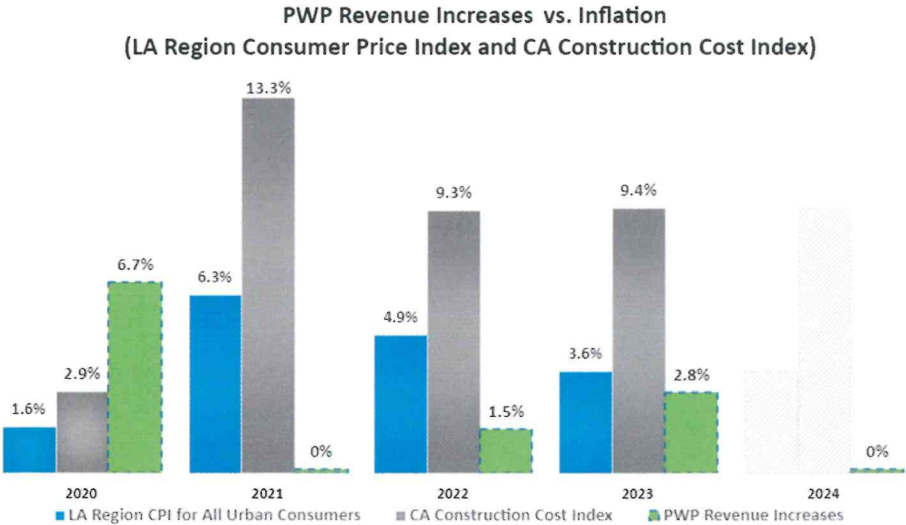
adjustments previously presented as an information item to the Municipal Services Committee (“MSC”) on July 25, 2023 and February 13, 2024. On March 26, 2024, MSC recommended that the City Council set the June 3, 2024 public hearing.

To meet the legal requirements for water rate adjustments in accordance with Proposition 218, it is necessary for the City Council to conduct a public hearing to receive comments regarding recommended changes to the Water Rate Ordinance, Chapter 13.20 of the Pasadena Municipal Code.

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. As a community owned, not-for-profit utility, all revenue collected is reinvested in 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. A compliance review of the cost-of-service components was completed in 2016 and again in 2018. The financial analysis is updated regularly and rate adjustments have been recommended and implemented accordingly. However, as shown in Figure 1, there has been unprecedented increases in consumer and construction cost indexes which have significantly impacted revenue requirements.

Figure 1: Cost Indexes vs. Revenue Increases



In March 2022, City Council adopted a two-year rate plan to keep up with revenue requirement increases in preparation for the cost-of-service study and rate study recommendations.

Beginning in August 2022, staff conducted a comprehensive cost-of-service analysis and rate study for the water system, with the assistance of independent consulting services provided by Raftelis Financial Consultants, Inc., (“Raftelis”). 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.

During the cost-of-service and rate study process, staff provided an update on July 25, 2023 to the Municipal Service Committee (“MSC”) and presented a review of five potential rate designs. MSC requested further analysis and information regarding a Budget-Based Tiered Rate structure (“BBTR”) prior to staff developing a recommended design. Staff returned to the MSC on February 13, 2024, and 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 MSC also requested that, after the implementation of Advanced Metering Infrastructure and the availability of additional data, staff will re-evaluate a BBTR structure.

Current Rate Structure

PWP’s current water rate structure 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 component 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 uniform rate based on the amount of water used.

Recommended Rate Structure

Staff recommends a rate structure which includes a variable and a fixed charge based on customer class and meter size. The variable charge is an inclining tiered rate structure based on customer class allocations and metered water used. The customer classes are Single Family Residential, Multi-Family Residential, and Commercial. The fixed charge is a flat rate charge per metered account.

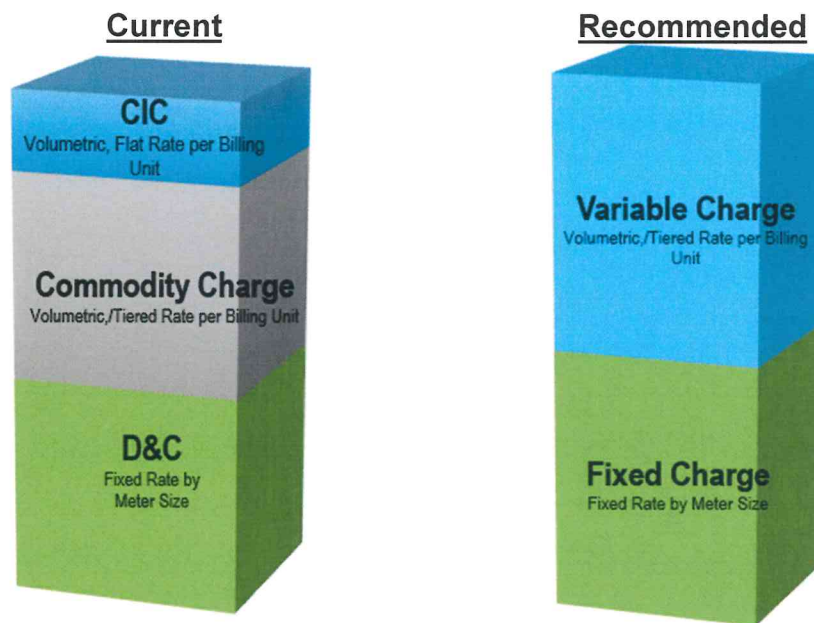
The rates were developed using the methodology as established in the M1 Manual by the American Water Works Association (“AWWA”)¹ and will recover the costs of service and continue to support the City’s water system goals. Different customer classifications represent diverse water use purposes and patterns, with differing cost implications to

¹ Principles of Water Rates, Fees, and Charges: M1 Volume 1 of AWWA Manual of Practice Manual of Water Supply Practices

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. The Water Financial Plan & Rate Study Final Draft Report provides the full details of the methodology and calculations used to derive staff's final recommended rates. The final report prepared by Raftelis is found in Attachment A.

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 2.

Figure 2: 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 the public hearing notice on Attachment B.

In addition, staff recommends including a drought rate to encourage water conservation during periods of drought. The drought rates are aligned with City Council’s adopted water shortage levels and the drought stages identified in the City’s Urban Water Management Plan (“UWMP”). California’s water shortage contingency plan stages are defined in the City’s UWMP. If City Council declares a drought level, the General

Manager has the option to add the drought rate percentages to the variable charge. The drought rate percentages are shown in Table 1.

Table 1: Drought Rate Percentages

Pasadena's Water Shortage Plan Levels	Level 1	Level 2		Level 3	Level 4	
California's Water Shortage Contingency Plan Stages	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6
Tier 1	0%	0%	10%	35%	58%	125%
Tier 2	11%	29%	52%	89%	152%	178%
Tier 3	17%	51%	77%	127%	175%	225%

Revenue Requirements and Rate Adjustments

Staff recommends rate adjustments that will provide additional revenue of \$42 million over a five-year period, as described in Table 2.

Table 2: Estimated Adjustment Summary (\$ in millions)

	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	Five-Year Increase
Variable Charge	\$7.5	\$7.9	\$6.6	\$6.5	\$6.1	\$34.6
Fixed Charge	\$1.5	\$1.6	\$1.4	\$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%	49%

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 conservation goals and extreme 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 has increased due to recent economic factors impacting all 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, adding to supply chain issues.

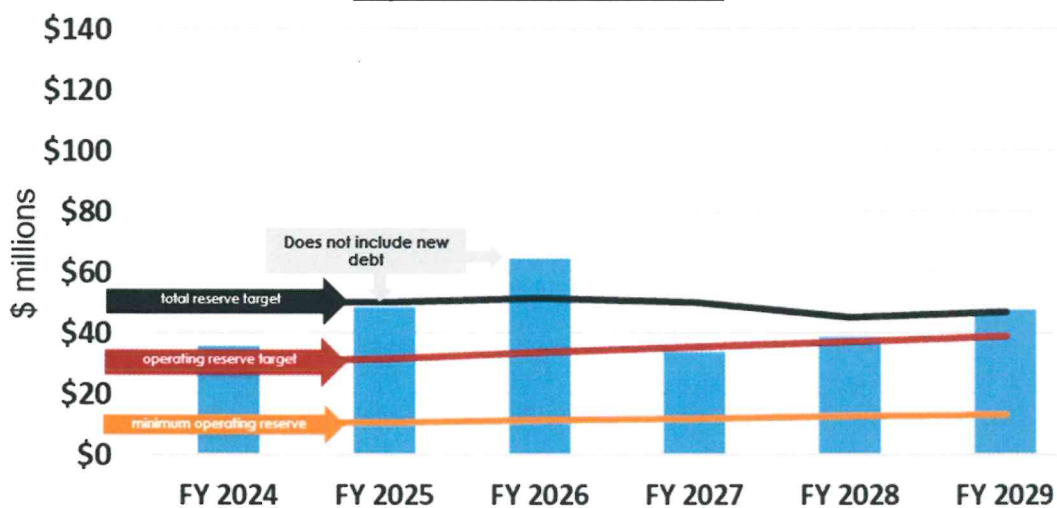
MWD has enacted significant increases to their rates that provide imported water supplies. Prior MWD Board approved rate increases were projected at 7%, however, the treated water rate for Pasadena is in the double-digits. The cost of important water is a significant driver of the increased revenue requirements, which are allocated to the upper tiers 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 significant capital outlay.

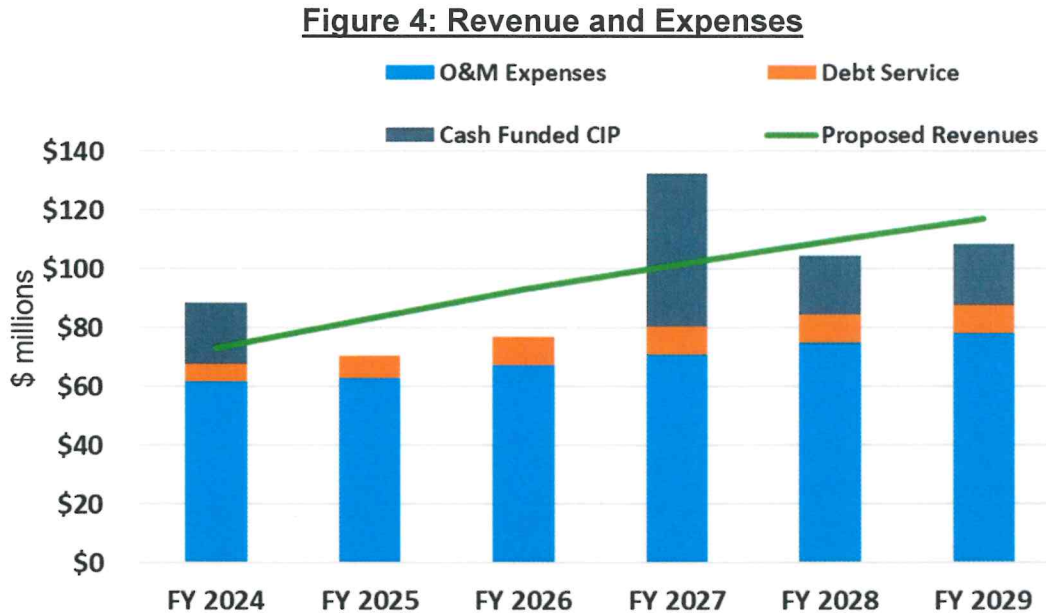
The final component driving the revenue requirement increases are related to the community’s diligence in conserving water and to the related decrease in sales. FY 2023 saw an 18 percent decrease in year-over-year water consumption leading to an undercollection of approximately \$4 million dollars compared to budget. The undercollection and rising costs are driving the increase 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 immediate revenue needs and to minimize rate shock to the customer. As depicted in the Figure 3 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 total target reserve (minimum operating reserve plus next year’s capital expenditure). The revenue plan also includes the issuance of \$65 million dollars in debt financing. The cash balances summary is shown in Figure 3 and shows an ending cash balance meeting reserve targets.

Figure 3: Cash Balances



In FY 2024, it is expected that funds spent will exceed the revenues collected. The proposed revenue increases in addition to debt issuances, enable the water system to remain financially stable while as gradually as possible, increasing customer rates. Figure 4 shows the cumulative O&M expense, cash funded CIPs, and debt service collected annually and the corresponding proposed revenue collection.



City Council’s fiscal discipline 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.

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 3.

Table 3 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 3: Sample Water Bills - Monthly

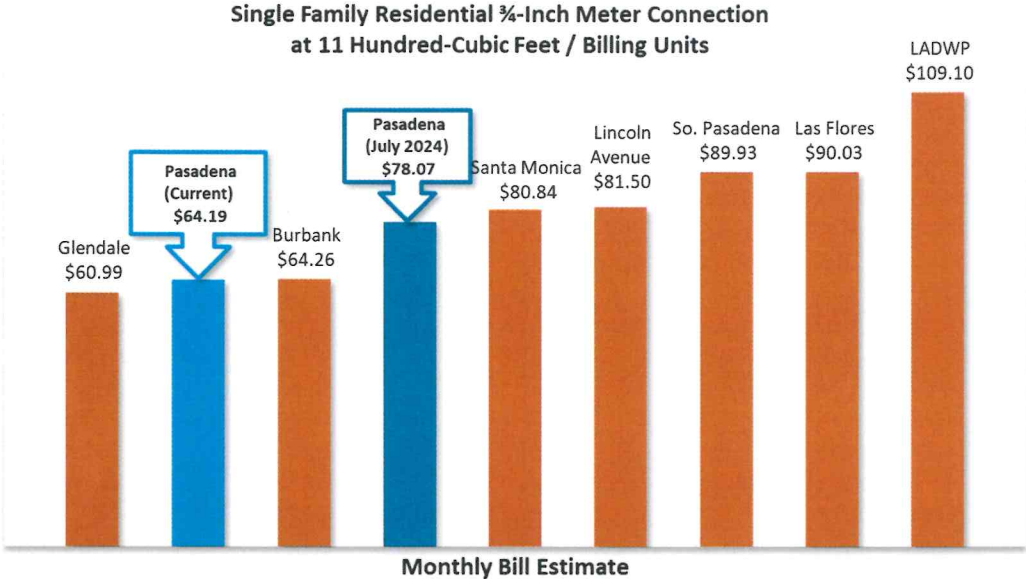
Customer Class	Meter Size	Usage	Approximate Current Bill	Approximate Bill at July 2024
		(in Billing Units*)		
Single Family Residential	¾ inch	7	\$47	\$54
Single Family Residential	¾ inch	11	\$64	\$78
Single Family Residential	1 inch	20	\$124	\$153
Multi-Family Residential - Small	¾ inch	17	\$93	\$102
Commercial - Medium	2 inch	75	\$508	\$431

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

The proposed rate increases are competitive with neighboring agencies. Figure 5 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 5: Estimated Monthly Water Bill Comparison with Other Utilities



Note: Information provided is based on publicly available information as of January 2024. Other organization's rates may be different at the time of rate adoption.

Alternative Scenario and Option

Staff is in the process of pursuing a low-interest federal loan program known as Water Infrastructure Finance and Innovation Act (“WIFIA”) through the U.S. Environmental Protection Agency. The WIFIA loan is a competitive program and therefore was not included in financial model. Should PWP be awarded the loan, staff will return to City Council with a revised rate plan. The Proposition 218 Public Hearing notices will not be mailed as the revised proposed rates would be lower than the recommended staff proposal.

Staff also reviewed the implications of delaying capital investments to further minimize customer impacts, however it is not recommended. Projects capable of delay include Advanced Metering Infrastructure and distribution water mains. The delay of which postpone progress in key utility modernization strongly desired by customers and the City as well as introduce risk of costly emergency water main replacements in the future.

Customer Outreach and Proposition 218 Compliance

Pursuant to the requirements of Proposition 218, notices were mailed on April 12, 2024 to all property owners/customers of record of the public hearing regarding the changes

to the water rates and the date and time of the public hearing. The notice included the process by which written protests may be submitted, a quick-response (QR) code, and the following link: PWPweb.com/WaterRateDesign. The website includes public hearing information, a bill estimation tool, community meeting information, a community meeting recording, an explainer video, and other materials to educate and inform the public about this recommendation. A copy of the public hearing notice is included as Attachment B.

In addition to the notice of public hearing that was mailed to all water customers, PWP deployed a wide range of outreach options to provide information and education to the community about the recommended water rate changes. Information about the recommended water rate adjustments was made available on PWP's website and shared via news releases, newsletters, social media, flyers and public hearing notices to all libraries and community centers, and bill inserts.

PWP staff also hosted public meetings, both virtual and in-person to provide information to interested members of the community. In addition, information about these meetings were provided to all Council offices to share with their constituents. The schedule of public meetings and locations is shown in Table 4.

Table 4: Public Meetings

Date	Location
July 25, 2023	MSC – Water Cost-of-Service and Rate Design Update
February 13, 2024	
March 26, 2024	MSC – Recommend City Council to Set a Public Hearing date of June 3, 2024
April 8, 2024	City Council - Set a Public Hearing date of June 3, 2024
April 9, 2024	Environmental Advisory Committee – Water Talk
April 23, 2024	Key Account Representatives Meeting
April 24, 2024	Community Meeting – Virtual
May 1, 2024	Community Meeting – Victory Park Community Center
May 14, 2024	Environmental Advisory Committee
May 23, 2024	Community Meeting – Robinson Park Recreation Center

Proposition 218 stipulates that one written protest per parcel, filed by an owner or tenant of the parcel, shall be counted in calculating a majority protest. Receipt of written protests by a majority of property owners or ratepayers would prevent the proposed implementation of the water rate adjustments.

Outside specialty legal counsel, which was engaged through the Pasadena City Attorney's Office to review the cost-of-service analysis, provided an opinion on the adequacy of the methodology confirming compliance with the legal requirements of Proposition 218.

Key Action Items Timeline

The key action items timeline for the recommended rate changes is shown in Table 5.

Table 5: Key Action Items Timeline

Date	Action Item
April 12, 2024	Mailed 45-day Public Hearing Notice
April-May 2024	Customer Outreach and Education
June 3, 2024 (Today)	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 (effective July 1 of 2024 through 2028)

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 water rate structure and rate adjustments 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.

The aforementioned items are applicable to the rate actions as detailed in the agenda report.

FISCAL IMPACT:

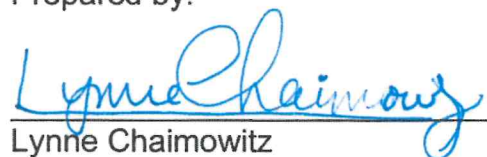
The recommended rate adjustments to be effective on July 1, 2024, through July 1, 2028, are expected to generate approximately \$42 million. The rate adjustments are sufficient to meet the projected revenue requirements as determined through the cost-of-service rate study.

Respectfully submitted,



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Water and Power Department

Prepared by:



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Approved by:



MIGUEL MÁRQUEZ
City Manager

Attachment A: Water Financial Plan & Rate Study Final Draft Report (Raftelis Report)

Attachment B: Public Hearing Notice – English Version