



# CITY OF SANTA BARBARA

## COUNCIL AGENDA REPORT

### ITEM 6C

**ENDA DATE:** February 23, 2016

**TO:** Mayor and Councilmembers

**FROM:** Water Resources Division, Public Works Department

**SUBJECT:** Reserve Management Policy Direction For The Fiscal Year 2017 Water Rate Study

#### **RECOMMENDATION:**

That Council receive a presentation and provide direction on assumptions for the Fiscal Year 2017 Water Rate Study, specifically for the planned reserves management during continued drought conditions.

#### **DISCUSSION:**

On November 24, 2015, Council authorized the Public Works Director to execute a City Professional Services contract with Raftelis Financial Consultants, Inc. (Raftelis), in the amount of \$50,221 for the development of the Fiscal Year 2017 Water Rate Study (Study), and authorized the Public Works Director to approve expenditures of up to \$12,555 for extra services that may result from necessary changes in the scope of work.

The Study is being developed in preparation for continued drought conditions. The proposed Fiscal Year 2017 water rates will be structured to continue incentivizing reduction in customer water use to ensure that planned demand reductions are achieved. After the typical rainy season is over this spring, the water supply outlook and conservation target will be re-assessed. It is anticipated that the conservation target will increase, should dry conditions persist. Water rates are preliminarily being designed based on current conservation levels. If the water supply conditions improve, water rates can be adjusted accordingly prior to adoption.

Continued drought conditions could result in additional drought related expenses for supplemental water purchases, conveyance of State Water through Lake Cachuma, and extended full-production operation of the desalination facility. The financial plan is being developed with the assumption that these drought related costs will be necessary through Fiscal Year 2018. If the water supply condition improves, water rates can be adjusted accordingly prior to adoption.

## Reserve Management Scenarios

As of June 2015, reserve balances were approximately \$17.1 million. Projected use of Fiscal Year 2016 reserves is approximately \$6.385 million (based on adopted Fiscal Year 2016 budget and additional revenue from grants and reimbursements), resulting in a projected balance of \$XX.X on June 30, 2016. Under adopted financial policies, the Water Fund Policy reserves should total approximately \$XXX million in Fiscal Year 2016. Reserves are anticipated to be \$X.X million below policy at the end of Fiscal Year 2016.

Two reserve management scenarios are being proposed for discussion:

Scenario 1 – No Use of Reserves, and Short-Term Reserve Recovery: The first scenario assumes no use of any reserves to meet projected expenses for the four-year financial period starting in Fiscal Year 2016. This scenario assumes that all projected expenses will be met entirely with revenues recovered from water rates, and the water rates would generate revenue to restore the reserve balance to policy levels within a one-year period. This would result in a planned reserve balance of \$XX.XX million at the end of Fiscal Year 2017.

Scenario 2 – Some Use of Reserves, and Longer-Term Reserve Recovery: In this scenario, reserves are used for one-time drought expenses, and the reserve balance is planned to return to policy targets over a three-year period.

Preliminary results show that projected increase in revenue requirements range between approximately XX-XX percent for Fiscal Year 2017, depending on reserve management; however, the analysis continues to be refined.

Given the volatility in water demands and supply conditions, staff does not recommend water rate planning that assumes a drop of reserves below Council policy. Staff recommends the first scenario, in which rate planning is developed with the assumption that total reserve funds remain equal to or above Council policy.

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**APPROVED BY:** City Administrator's Office