



CITY OF SANTA BARBARA

COUNCIL AGENDA REPORT

ATTACHMENT 3

AGENDA DATE: April 15, 2014

TO: Mayor and Councilmembers

FROM: Water Resources Division, Public Works Department

SUBJECT: Stage Two Drought Water Rates

RECOMMENDATION: That Council:

- A. Hear a presentation on proposed Stage Two Drought Water Rates;
- B. Set a Public Hearing date for June 10, 2014, at 2:00 PM in the Council Chambers for Council consideration of increases in City water rates for Fiscal Year 2015; and
- C. Direct staff to send a Notice of Public Hearing to customers informing them of the hearing and proposed changes to water rates.

DISCUSSION:

On February 11, 2014, City Council declared a Stage One Drought Condition, which called for a voluntary 20% reduction in water usage by rate payers. While the Santa Barbara area has had some recent rainstorms, the rainfall has not been enough to end the area's persistent drought condition. Extraordinary conservation to meet the 20% demand reduction is needed. Staff anticipates the need to declare a Stage Two Drought Condition in May 2014.

On March 25, 2014, City Council authorized the execution of a contract with Raftelis Financial Consultants, Incorporated, (RFC) to provide drought water rate modeling services. RFC's work included performing drought water rate analyses, considering different water demand reduction scenarios, and investigating various drought rate alternatives. RFC focused on designing Stage Two Drought Water Rates that would best incentivize extraordinary water conservation by customers, while also ensuring sufficient revenues to meet operating and debt service requirements in order to maintain compliance with obligations to holders of City bonds. However, the proposed water rates will not generate enough revenue to cover the full cost of necessary drought-related capital projects. Therefore, it is expected that a combination of reserves and a reprogramming of existing capital projects already funded will be used to fund the additional drought-related capital costs in Fiscal Year (FY) 2015.

The proposed Stage Two Drought Rates are intended to address our current situation as of the end of the City's typical rainy season. Any changes in the level of drought condition would result in staff re-assessing the water rates and returning to Council.

Drought Water Rate Study

Revenues

On a long-term basis, revenue must be sufficient to meet the costs of operating the water system which includes costs for water purchases, treatment, operations and maintenance expenses, capital improvements, principal and interest payments on existing debt, and other obligations. Short-term differences between revenues and costs result in the use of, or contribution to, reserves. To generate sufficient funds for FY 2015, and achieve extraordinary conservation to meet the 20% demand reduction target, a more steeply inclined block rate structure and some use of reserves are needed.

The total revenues generated from rates for FY 2015 is expected to increase by 7 percent, compared with FY 2014, due to drought related costs associated with increasing available groundwater supplies and imported water purchases. Rates are recommended to be increased for all rate tiers, with the lowest increase (3%) being assigned to first-tier usage. However, the revenue generated from rates will not cover the full cost for necessary drought-related capital projects. Therefore, the additional costs will be funded from a combination of reserves, the reprogramming of already funded FY 2014 capital projects, and the postponement of planned FY 2015 capital projects, including main replacements, pump station improvements, and other maintenance projects.

Rates based on Cost of Service

Total revenue requirements, less revenue from other sources, such as payments made by other agencies that use the City's water treatment plant and interest earnings, are defined as the "cost of service". This cost is used as the basis for allocating costs to various customer classes by considering both the average quantity of water usage and peak water usage.

Rates are designed to ensure that customers pay their proportionate share of costs, based on the cost of service to supply water to that customer class. The water supply costs associated with each of the City's five water sources differ. In order to provide affordable water for basic health and sanitation and to sustain agricultural use, residential, parks and agricultural Tier 1 customers are allocated the least expensive sources of water. Remaining water supply sources are allocated to other customer classes, with more expensive water costs being assigned to the higher tiers in the block structure, because this usage is more discretionary water use, often for irrigating landscapes.

The changes to the proposed water rates are summarized below:

- Residential water customers are currently allocated water in three rate tiers. As increased usage moves a customer from one rate tier to the next, the amount charged per unit of water increases. The lowest cost rate tier (Tier 1) is set to meet basic health and sanitation needs; the next tier (Tier 2) is designed to meet the needs for an average-sized water wise landscape; and the third and most costly tier is considered to be discretionary use. Based on analysis in the recent 2012 Rate Study, approximately 16 hcf per month is sufficient for both indoor and outdoor needs of an average Single Family Residence household with water wise landscaping. With an additional 2 hcf allowance, the total combined allotment within Tier 1 and Tier 2 is currently 18 hcf (comprised of 4 hcf at Tier 1 rate and 14 hcf at the Tier 2 rate). Due to the drought condition, it is recommended that the additional 2 hcf allowance be removed, reducing the Tier 2 allotment from 14 HCF to 12 HCF.
- To send a message to high water users that extraordinary conservation is needed, the difference in rates between Tier 2 and Tier 3 residential water rates, Tier 1 and Tier 2 commercial/industrial rates, and Tier 1 and Tier 2 irrigation water rates is significantly increased.

Pursuant to State law established by Prop 218, the Right to Vote on Taxes Act, customers must be notified of any proposed increases to rates at least 45 days prior to the date of the public hearing for Council's consideration of the rate increases. Staff is recommending Council direction to mail the Proposition 218 rate notices to customers by April 24, 2014, in preparation for a June 10, 2014 public hearing. A copy of a draft Proposition 218 rate notice is attached.

BUDGET/FINANCIAL INFORMATION:

The proposed drought water rates have been developed to meet the 20% demand reduction target, while also meeting the revenue needs of the Water Fund, along with some use of reserves. The projected revenue from water sales has been set to maintain adequate debt service coverage, including sufficient revenue to cover debt service payments, debit service margin, and operating costs. Additional funding will be needed to cover the cost of necessary drought-related capital projects. Therefore, it is expected that the reserves will be used for Capital Program expenses. If the drought condition changes (either improves or worsens), staff will re-assess the financial plan and water rates at that time.

SUSTAINABILITY IMPACT:

Meeting the 20% demand reduction will assist the City in offsetting or delaying possible additional drought related water supply purchases and expenses.

ATTACHMENT: Notice of Proposed Changes to City Utility Rates

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SUBMITTED BY: Rebecca J. Bjork, Public Works Director

APPROVED BY: City Administrator's Office