



City of Santa Barbara
Public Works Department

Memorandum

DATE: April 16, 2020

TO: Water Commission

FROM: Joshua Haggmark, Water Resources Manager

SUBJECT: Preliminary Estimates of COVID-19 Financial Impacts to Water and Wastewater Funds

RECOMMENDATION

That the Water Commission receive a presentation on staff's preliminary estimates of financial impacts to the Water and Wastewater Funds from the COVID-19 pandemic.

DISCUSSION

Water Fund

The largest impact to the Water Fund is expected to come from reduced rate revenues in the Commercial and Industrial rate classes. Although a portion of water use that was previously metered at commercial establishments will now be metered at residences, staff estimates that commercial water demand, which is driven by commuters and tourism, will experience a 90 percent reduction in the last quarter of the fiscal year – April, May, and June. This drop in commercial demand is estimated to reduce rate revenues by approximately \$1.5 million, or \$500 thousand per month. Should the Governor's stay-at-home order remain in place, staff would expect to see similar revenue impacts in the first quarter of Fiscal Year 2021. It is too early to predict the long-term revenue impacts from the COVID-19 pandemic, but staff would expect a continued reduction in projected commercial and industrial rate revenue throughout Fiscal Year 2021, as the economy rebounds from the eventual rescinding of the stay-at-home order. On top of this, staff projects additional lost revenue from tap and connection fees, but to a much lesser degree than rate revenue.

In anticipation of Council's desire to provide financial relief to community members, staff has modeled several different rate adoption scenarios to understand the cash flow impacts on the Water Fund. Prior to the COVID-19 pandemic, HDR Engineering, the City's water rate consultant, completed a preliminary analysis of the Water Utility's revenue requirement, including all operating and planned capital maintenance costs, and found that revenue increases of approximately 6% for Fiscal Years 2021, 2022, and 2023 would be necessary to meet the financial needs of the water utility. However, in light of recent economic news, staff is modeling scenarios where there is no rate increase in Fiscal Year 2021. It is important to note that rate increases have a compounding effect from one year to the next—small changes in the near term will have large impacts over the course of a 10-year financial plan. For example, no rate increase in Fiscal Year 2021 would equate to receiving approximately \$35 million less in revenue over a 10-year planning period, assuming all other rate increases occurred as recommended by the City's rate

consultant. Due to this, a pause on rates in Fiscal Year 2021 would require a combination of cutting back on funding for the water main replacement program, financing future pay-go capital projects, and looking at opportunities to reduce operating costs. Additionally, these analyses assume that a Water Supply Agreement with Montecito has been executed and the City begins receiving revenue from that agreement. Without the agreement in place, more significant cost reductions would need to occur over the 10-year financial plan. The above actions would allow the Water Utility to provide rate relief while still meeting debt coverage obligations and maintaining Council Policy reserve levels. The Water Fund has reserves in excess of Council Policy, which had been intended to buffer rate increases, but may also be used to supplement lost revenue from a pause on rate increases.

Wastewater Fund

The Wastewater Fund, like the Water Fund, will see the largest immediate financial impact from the COVID-19 pandemic in its commercial and industrial rate revenues. However, the Wastewater rate structure is more balanced between fixed and volumetric charges; therefore, reductions in water use are not as significant as in the Water Fund. Following from the projected 90 percent decrease in commercial and industrial water demand, staff estimates revenue losses of approximately \$200 thousand per month through the end of the fiscal year (June 2020). If the Governor's stay-at-home order is lifted by the start of the new fiscal year in July, staff projects revenue losses of \$100 thousand per month for July, August, and September, and a slow recovery after that as economic activity rebounds and commercial water demand picks up. Additionally, staff expects revenue declines in wastewater connections fees and high strength surcharges.

As with the Water Fund, staff is modeling several rate scenarios for the Wastewater Fund and evaluating the different outcomes. However, the Wastewater Fund has less flexibility to absorb reductions in revenue because it has already utilized capital reserves for the El Estero Electrical Renewal Project (Project). On June 11, 2019, Council adopted five percent increases in Wastewater rates for Fiscal Years 2020, 2021, and 2022, along with a 10-year financial plan for the wastewater system. The financial plan contemplates a two-year period during which capital project reserves are used to ensure that the Project is competitive for Clean Water State Revolving Fund Program funding. As a result, any reduction to planned rate increases would need to be offset by deferring or debt financing capital improvement and maintenance work. Should Council direct staff to pursue a zero percent rate increase in Fiscal Year 2021, there would be significant cuts to the capital program and likely require rate increases above five percent in future years to stabilize reserve levels.