City of Santa Barbara
Public Works Department

Memorandum

DATE: May 21, 2020

TO: Water Commission

FROM: Joshua Haggmark, Water Resources Manager

SUBJECT: Fiscal Year 2021 Water and Wastewater Rates

RECOMMENDATION

That the Water Commission recommend that Council move forward with Wastewater rates as adopted for Fiscal Year 2021.

DISCUSSION

Wastewater Fund

On June 11, 2019, Council adopted five percent increases to Wastewater rates for Fiscal Years 2020, 2021, and 2022. The adopted rates were designed to generate revenue that is sufficient to meet the cost of the City's Wastewater System, including operations and maintenance expenses, capital improvements, mandated standards of treatment, principal and interest payments on existing debt, target reserve levels, and other obligations. Along with rates, Council adopted a 10-year financial plan for the wastewater system. The adopted financial plan contemplates a two-year period (Fiscal Years 2020 and 2021) during which capital project reserves are used to ensure that the El Estero Electrical Renewal Project (Electrical Project) is competitive for Clean Water State Revolving Fund Program funding. Because the Wastewater Fund has already utilized capital project reserves for the Electrical Project, drops in revenue cannot be absorbed through the use of reserves, and therefore, must be offset by scaling back operational expenses and pay-go capital projects.

The Wastewater Fund will see an immediate financial impact from COVID-19 in its commercial rate revenues. A portion of wastewater bills are dependent on water use, and as tourism and commuter water demand has taken a dip, so too has the revenue coming from commercial customers. When the Governor's stay-at-home order is lifted, staff foresees a slow recovery as economic activity rebounds and commercial water demand picks up. It may also be the case that account delinquencies rise and non-payment instances become more frequent; staff is closely tracking billing information. Lastly, there is an expected shortfall in wastewater connection fees and high strength surcharges.

As a result of these COVID-19 revenue impacts described above, the Braemar Lift Station Rehabilitation Project (Braemar Project) has been deferred due to insufficient funding. As a critical component to the operation of the Wastewater System, the Braemar Project should not be deferred for an extended period of time. For that reason, staff is now seeking to finance the project through the State Revolving Fund program, but this will increase the overall debt level for the Wastewater Fund and potentially increase rates in future years to ensure there is adequate debt coverage. If Council were to direct staff to adopt rates lower than the planned five percent increase in Fiscal Year 2021, the reduction in rate revenue would need to be offset by deferring additional pay-go capital improvement and maintenance work, such as repairing, rehabilitating, and replacing wastewater collection system pipes. The City has been successful in the last two years at meeting or exceeding the performance standard set forth by the consent decree for Sanitary Sewer Overflows (SSO). Deferring maintenance on the collection system may lead to an increase in SSOs and volumes of sewage making it to our creeks and ocean. Given the financial impacts that have already taken place as a result of COVID-19, and the consequence to public health and safety from reducing investment in the collection system and deferring critical projects, staff is recommending that Wastewater rates continue as planned in Fiscal Year 2021.

If Council chooses to reduce Wastewater rates for Fiscal Year 2021, action must be taken before the end of the fiscal year, otherwise the five percent increase will go into effect automatically on July 1, 2020. Council may adopt rates that are lower than the publicly noticed rates without holding a public hearing.

Water Fund

The largest immediate revenue impact to the Water Fund, like the Wastewater Fund, is expected to come from reduced rate revenues in the commercial customer class. As explained above, staff estimates that commercial water demand, which is highly influenced by commuters and tourism, will experience a 50 to 70 percent reduction in the last quarter of the fiscal year – April, May, and June. Staff is planning for a slow, multi-year recovery in commercial water demand as the economy rebounds from the eventual rescinding of Governor Newsom’s stay-at-home order. On top of this, staff projects additional lost revenue from tap and connection fees. These immediate revenue impacts will be absorbed through the use of Water Fund reserves.

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 and found that revenue increases of approximately six percent for Fiscal Years 2021, 2022, and 2023 would be necessary to meet the financial needs of the water utility. 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 likely require cutting water main replacement funding in half for a period of three years, dipping into Council Policy reserves, financing what would otherwise be pay-go capital projects, and raising the outlook for long-term rate increases. While this course of action will provide short-term relief for customers, the reduction in water main funding will increase long-term maintenance costs as infrastructure ages and emergency repairs become more frequent. Taking on more debt would likely require rate increases in future years to ensure that the Water Fund has sufficient net operating revenues to make debt payments, and meet coverage requirements. Staff's preliminary recommendation is to adopt three percent increases in water rates, which would provide some relief to customers but also limit the cuts to water main replacement funding, reduce debt financing, and assist with stabilizing reserves and the condition of our declining assets in the long term. With the added uncertainty of COVID-19, staff is recommending that a public hearing occur in December 2020 with rates to go into effect January 1, 2021. A mid-year rate adoption would effectively make the Fiscal Year 2021 rate increase be 1.5 percent.