



MEMORANDUM

TO: CITY COUNCIL

**FROM: DEBBIE MALICOAT, DIRECTOR OF ADMINISTRATIVE SERVICES
GEOFF ENGLISH, DIRECTOR OF PUBLIC WORKS
RYAN CORNELL, ACCOUNTING MANAGER
SHANE TAYLOR, UTILITY MANAGER**

**SUBJECT: CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN
AND IMPLEMENTATION OF TEMPORARY DROUGHT RATES**

DATE: MAY 10, 2016

RECOMMENDATION:

It is recommended the City Council: 1) schedule a public hearing to consider adjustments to water and wastewater rates via drought rates and; 2) direct staff to prepare and distribute a Proposition 218 notice for the proposed temporary water and wastewater drought rates.

IMPACT ON FINANCIAL AND PERSONNEL RESOURCES:

The proposed temporary drought rates would add a 10% surcharge to the current water and wastewater rates. It was initially projected that water and sewer revenue would total \$21.1 million and \$3.3 million, respectively, from FY 2016-17 to FY 2018-19. Due to the unprecedented reduction in consumption caused by the implementation of the Stage 1 Water Shortage Emergency program and the Governor's 28% mandatory reduction, the projected water revenue over the next three years is estimated to be \$17.9 million, a shortfall of approximately \$3.2 million. If the proposed drought rates are in effect through June 2019, the rates would generate approximately \$1.7 million towards this \$3.2 million shortfall, with the remaining \$1.5 million coming from fund reserves and reductions in expenditures. Wastewater revenues are now estimated to be \$2.8 million, a shortfall of approximately \$450,000 over the next three fiscal years. The proposed drought rate would generate \$200,000 over the next three fiscal years, reducing the shortfall to \$250,000.

BACKGROUND:

In March 2014, the City Council reviewed the Water and Wastewater Financial Plan and Rate Study prepared by Raftelis Financial Consultants, Inc. (RFC). The RFC study was intended to set rates for a 5-year period, beginning in July 2014 through June 2019. As a result of that study, the City Council also approved minimum fund balance reserves be increased to 90-days of operating expenses plus \$500,000 for a capital asset reserve plus 1-year of debt-service obligations (approximately \$1.4 million for the Water Fund). At the time, it was in the City's best interest to keep total reserves at approximately \$6 million due to capital project needs and water supply and conservation related project costs.

**CITY COUNCIL
 CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN AND
 IMPLEMENTATION OF TEMPORARY DROUGHT RATES
 MAY 10, 2016
 PAGE 2**

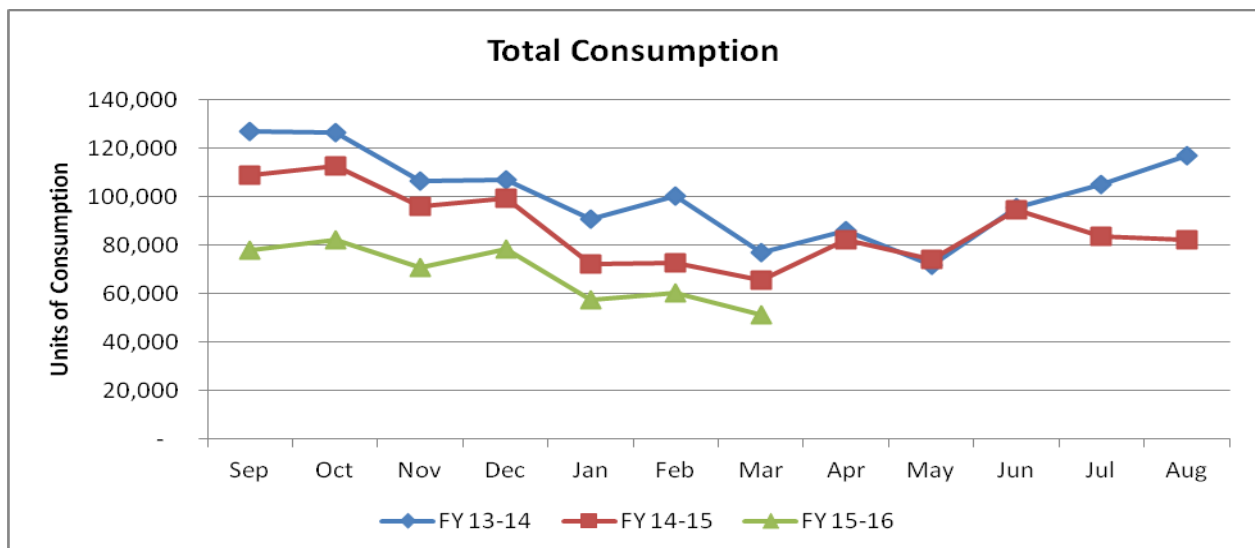
On May 26, 2015, the City Council adopted a Resolution declaring a Stage 1 Water Shortage Emergency and implemented restrictions on single and multi-family residences and dedicated irrigation water usage. Residential accounts are required to reduce consumption by 0%, 10%, 20% or 30%, depending on usage tier, when compared to the same billing period in 2014 and 25% for those accounts with dedicated irrigation meters. On April 1, 2015, California Governor Brown signed Executive Order B-29-15, enacting statewide mandatory water conservation requirements. The Governor’s Executive Order requires the City of Arroyo Grande to reduce consumption by 28% when compared to 2013.

Based upon the provisions of Proposition 218, all affected rate payers must receive written notice by mail at least 45 days prior to the City Council consideration of rate adjustments. The notice must include the amount of the fee, the basis on which the fee was calculated and the date, time and place of the public hearing and must clearly advise of the right to protest the fee increase. In order to implement potential adjustments as soon as possible, staff is requesting the City Council provide direction prior to notification of the public hearing and formal consideration of the rate adjustments, which is scheduled for July 26, 2016.

ANAYLSIS OF ISSUES:

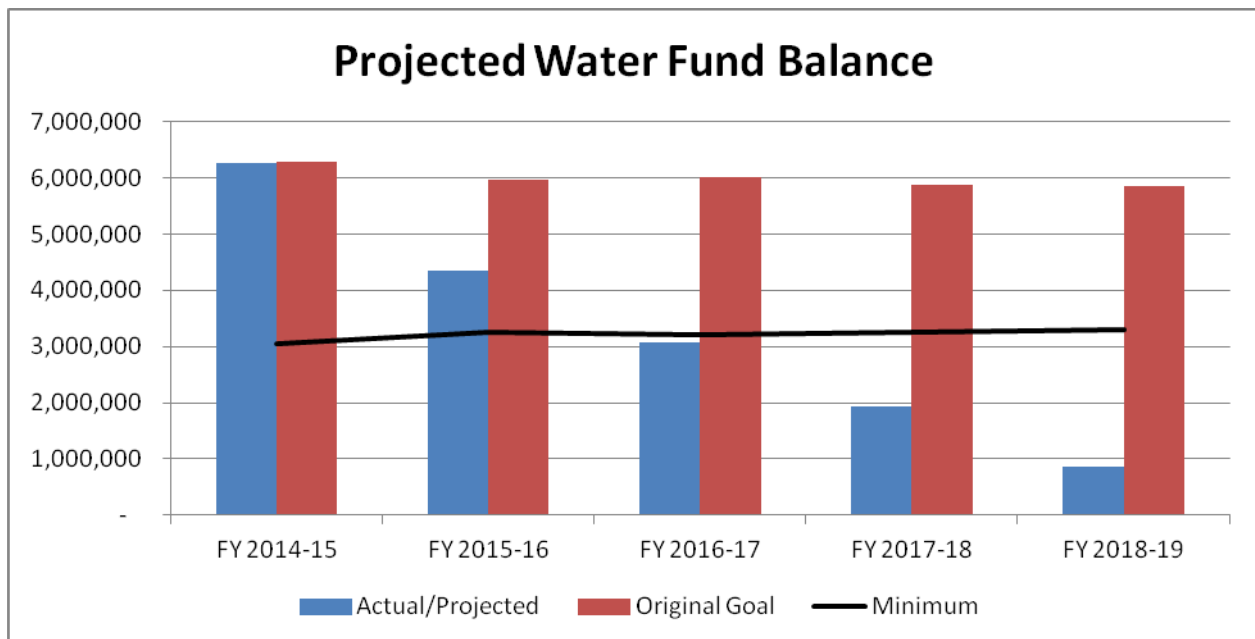
Water Fund

As reflected in the chart below, since the implementation of the Stage 1 Program, consumers have reduced water consumption by 24% compared to FY 2014-15 and 35% compared to FY 2013-14. Approximately 62% of the water fees charged to customers are based on the actual water consumed with the remaining 38% representing a flat fee per account. As a result, in FY 2015-16, revenues were originally anticipated to be \$6.9 million and are now projected to be \$5.7 million.



**CITY COUNCIL
 CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN AND
 IMPLEMENTATION OF TEMPORARY DROUGHT RATES
 MAY 10, 2016
 PAGE 3**

Due to the past management of the rate adjustments and cost control measures implemented by the City, the Water Fund has held a healthy fund balance. This fund balance has been sufficient enough to help absorb the shortfall in current year revenue. However, without any adjustments to revenues and expenses, by the end of FY 2016-17, fund balance will be \$111,000 below minimum reserve requirements, and in FY 2018-19, \$2.4 million below minimum reserve requirements and approximately \$500,000 below the contractually obligated minimum fund balance.



With the uncertainty of the length of the drought and the average rainfall received this past winter, the financial model shown above projects that consumption will remain at a reduced level, similar to consumption in FY 2015-16 for two years, with a very slight increase in the third year.

A number of items have been examined to help minimize the impact of the shortfall in revenue, including deferring Reservoir No. 3 and 4 exterior recoating and seismic evaluation project (\$640,000) and suspending the contribution to the Water Neutralization Fund (\$200,000 per year). These actions will reduce expenditures by approximately \$1.3 million over the next three fiscal years.

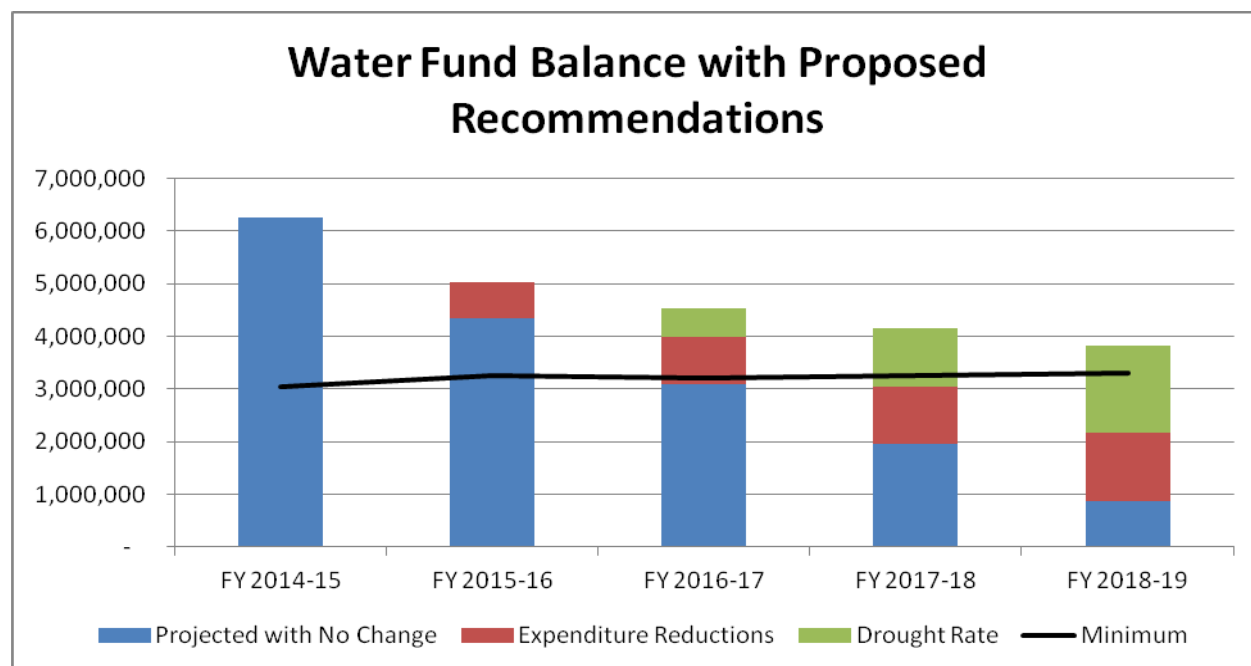
It is recommended that a temporary drought rate be added to the current rates to help offset the revenue shortfall caused by the dramatic reduction in consumption. These rates are temporary in nature, so that when the drought ends and consumption returns to “normal,” the revenues initially projected should return as well. Regardless, consumption habits have permanently been changed in some instances as demonstrated by the increased usage in the cash for grass and

**CITY COUNCIL
 CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN AND
 IMPLEMENTATION OF TEMPORARY DROUGHT RATES
 MAY 10, 2016
 PAGE 4**

plumbing retrofit programs. The City will need to examine consumption habits after the drought to determine what the new level of normal consumption is, and then set rates accordingly. It is anticipated that rates will be reviewed in 2018, at the end of the current 5-year rate study.

Should the temporary rates remain in effect through FY 2018-19, it is anticipated that this will enable the fund balance for the Water Fund to remain above the minimum required by \$550,000.

The recommended approach relies on an increase in rates along with the deferral or elimination of expenditure programs and projects. However, an alternative that could be considered is to implement a higher drought rate, which could therefore provide enough revenue to allow for the expenditures to occur as planned.



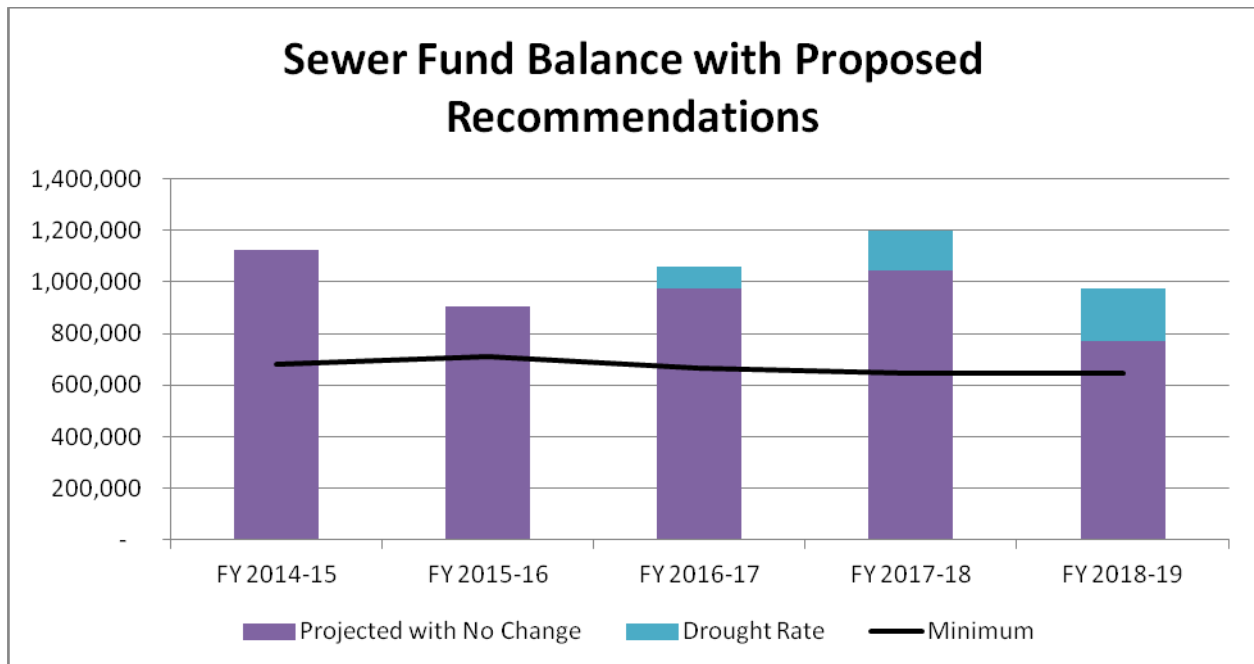
Sewer Fund

Similar to the Water Fund, the Sewer Fund revenue is performing less than initially projected due to the reduction in water consumption. A portion of sewer charges is based on the amount of wastewater generated, as measured by the amount of water consumed. In addition, there is a fixed fee. Prior to the Stage 1 Water Shortage Emergency Program, the average amount of wastewater added to the system was approximately 64 gallons per person per day. Due to conservation measures, the amount has been reduced to 55 gallons per person per day.

**CITY COUNCIL
 CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN AND
 IMPLEMENTATION OF TEMPORARY DROUGHT RATES
 MAY 10, 2016
 PAGE 5**

It was originally anticipated that the City would receive \$3.3 million in sewer-related revenues from FY 2016-17 through FY 2018-19. It is now projected that revenues will be \$2.8 million over the same period, a shortfall of \$450,000.

Unlike the Water Fund, it is recommended that the capital projects anticipated to be constructed over the next 3-years should not be deferred to future years. The need to complete these projects is important to the overall infrastructure of the system and any deferrals could place the City at higher risk for system failure and result in higher project costs.



As shown in the chart below, without any additional rate increase, the Sewer Fund's balance will remain above minimum reserve. However, a 10% surcharge to the current rates is recommended because the minimum reserves are relatively small and are unlikely to be sufficient should a major system failure occur. Implementing drought rates for the Sewer Fund will result in a fund balance of just over \$1 million by the end of the 2018-19 fiscal year.

**CITY COUNCIL
 CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN AND
 IMPLEMENTATION OF TEMPORARY DROUGHT RATES
 MAY 10, 2016
 PAGE 6**

Effects to the Customer

The impact of the water rate recommendations on an average water customer will be approximately \$10 to \$18 per billing cycle (or \$5-\$9 per month). Nearly 80% of the single family residential customer base uses between 10 and 30 units of water on a 5/8" size water meter per billing period. The actual increase per usage level is shown below:

	FY 2016-17			FY 2017-18			FY 2018-19		
	Current Rates	Drought Rates	Increase	Current Rates	Drought Rates	Increase	Current Rates	Drought Rates	Increase
10-units	\$91.71	\$100.88	\$9.14	\$94.26	\$103.72	\$9.46	\$96.82	\$106.52	\$9.70
15-units	109.44	120.33	10.89	112.56	123.87	11.31	115.72	127.32	11.60
20-units	127.86	140.58	12.72	131.60	144.82	13.22	135.38	148.96	13.58
25-units	147.36	162.03	14.67	151.75	166.97	15.22	156.18	171.86	15.68
30-units	166.86	183.48	16.62	171.90	189.12	17.22	176.98	194.76	17.78

The impact of the sewer rate recommendations for an average customer will be approximately \$1 to \$3 per billing cycle (or \$0.50-\$1.50 per month). Unlike the water rates that already have approved rate increases for the next three years, the sewer rates remain the same for the next several years. As a result, the changes in the increase in the drought rates will remain the same until a detailed rate study is conducted. The actual increase per usage level is shown below:

	Current Rates	Drought Rates	Increase
10-units	\$11.50	\$12.68	\$1.18
15-units	14.85	16.38	1.53
20-units	18.20	20.08	1.88
25-units	21.55	23.78	2.23
30-units	24.90	27.48	2.58

ALTERNATIVES:

The following alternatives are provided for the Council's consideration:

1. Approve staff's recommendation;
2. Increase drought rates by 20% (which will maintain fund balances that were originally projected by the rate study);
3. Do not approve staff's recommendation and maintain the current rate schedule; or
4. Provide direction to staff.

ADVANTAGES:

Implementing the proposed water and wastewater rate increases will provide ongoing revenue needed to meet the next 3 years of operating, capital and debt expenditures and reserve policies in the Water Fund and Sewer Fund.

**CITY COUNCIL
CONSIDERATION OF WATER AND WASTEWATER FINANCIAL PLAN AND
IMPLEMENTATION OF TEMPORARY DROUGHT RATES
MAY 10, 2016
PAGE 7**

DISADVANTAGES:

Customers will experience higher water and sewer utility costs.

ENVIRONMENTAL REVIEW:

No environmental review is required for this item.

PUBLIC NOTIFICATION AND COMMENTS:

The Agenda was posted in front of City Hall on Thursday, May 5, 2016. The Agenda and report were posted on the City's website on Friday, May 6, 2016. No public comments were received.

THIS PAGE INTENTIONALLY LEFT BLANK