



# STAFF REPORT

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October 18, 2023  
File Number 1320-65

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## SUBJECT

### **PROPOSED WATER, WASTEWATER, AND RECYCLED WATER RATE ADJUSTMENTS**

## DEPARTMENT

Utilities Department

## RECOMMENDATION

It is requested that the City Council adopt Resolution No. 2023-131 approving:

1. Utility rate adjustments to increase Water Fund revenue by 8.0 percent effective January 1, 2024, followed by 7.5 percent on January 1, 2025, 7.5 percent on January 1, 2026, 6.5 percent on January 1, 2027, and 6.5 percent on January 1, 2028, and to align rates with the cost of providing service.
2. Utility rate adjustments to increase Wastewater Fund revenue by 3.5 percent effective January 1, 2024, followed by 5 percent on July 1, 2024, 5 percent on July 1, 2025, 4 percent on July 1, 2026, and 3 percent on July 1, 2027, and to align rates with the cost of providing service.
3. Annual adjustments through 2028 for all “pass-through” charges including: Readiness-to-Serve Charge levied by the Metropolitan Water District (MWD); and charges levied by the San Diego County Water Authority (MWD Capacity, supply reliability, customer service, emergency storage and infrastructure access charges).
4. Future adjustments through 2028 for “pass-through” volumetric charges imposed by the San Diego County Water Authority (SDCWA) for water supplies imported into Escondido.

It is additionally requested that the City Council receive and file the “2023 Cost-of-Service Utility Rate Study,” which is available for public review on the City’s website at:

<https://www.escondido.org/prop-218-notice>

Staff Recommendation: Approval (Utilities: Angela Morrow, Interim Director of Utilities)

Presenter: Angela Morrow, Interim Director of Utilities



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### FISCAL ANALYSIS

The City's Utility rate models evaluate the costs to provide water and wastewater service to all user classifications. The models are important tools for analyzing revenues and expenditures so that revenue needs may be projected several years into the future. The rates developed are necessary to provide safe, reliable, and sustainable utility service to the City's customers. The City's Utility rate models focused particularly on the Cost of Service (COS) for each customer class, and developed rates for each customer class that reflected each class' individual COS. ***Note: More analysis of the fiscal impacts of the rate proposals and COS adjustments can be found later in this report.***

### PREVIOUS ACTION

On February 1, 2017, the City Council adopted Resolution No. 2017-14RRR, authorizing the following actions:

- 1) Utility rate adjustments, effective March 1, 2017, to increase Water Fund revenue by 5.5 percent and Wastewater Fund revenue by 5.5 percent.
- 2) Future Utility rate adjustments, effective March 1 of each year from 2018 through 2021, to increase Water Fund revenue by an additional 5.5 percent annually and Wastewater Fund revenue by an additional 5.5 percent annually.
- 3) Annual adjustments through 2021 for two "pass-through" charges: (1) the Infrastructure Access Charge levied by the San Diego County Water Authority, and (2) the Readiness-to-Serve Charge levied by the Metropolitan Water District of Southern California.
- 4) Future adjustments through 2021 for "pass-through" volumetric charges imposed by the San Diego County Water Authority (SDCWA) for water supplies imported into Escondido.

### BACKGROUND

The City's Water and Wastewater Funds are separate from the General Fund. The Water and Wastewater Funds do not receive any funding from property or sales taxes, or tourist related taxes. Under California law, money collected from water and wastewater ratepayers may only be used to fund water and wastewater services, respectively.

The City periodically evaluates its water, wastewater, and recycled water rates to ensure that its revenues are sufficient to honor its commitment to long-term planning and appropriate infrastructure investment. This evaluation considers many factors that impact the cost of providing water and wastewater services including: the cost of imported water; requirements to maintain sufficient revenue to cover the City's water and wastewater debt service costs; the cost of operations, including employee and materials costs; the cost of future projects to maintain service reliability; and the cost of planned infrastructure maintenance and replacement. The City's Utility Rate Study is the product of this evaluation, and it guides the setting of specific rates for each customer class.



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The City has not increased its water or wastewater rates since March 2021. In the meantime, the City has experienced significant increases in the costs of materials and supplies used to operate, maintain, and replace the water, wastewater, and recycled water systems.

### Primary Drivers of the Proposed Rate Adjustments

The most significant drivers of the revenue increases are: (1) funding needs of the Water and Wastewater Capital Improvement Programs (CIPs); (2) funding the Water and Wastewater Fund emergency and debt reserves; (3) meeting debt obligations; and (4) operational costs, including imported water, materials, equipment replacement, and employee services. Of these factors, CIP funding is the dominant driver accounting for the majority of the requested increase.

In recent years, the City has secured several grants for water and wastewater projects totaling \$24.9M, and low-interest state/federal loans totaling \$98.5M. Approximately \$5M of the low-interest loans are covered by grant funding and loan forgiveness under State Proposition programs.

The City is in the process of applying for a federal Water Infrastructure Finance Initiative Act (WIFIA) loan in the amount of \$65M to partially fund the Wohlford Dam Replacement Project. The City had applied for a federal grant and an SRF loan for the Wohlford Dam Replacement Project, however, both were unsuccessful. The City continues to seek grant funds for water, wastewater, and recycled water projects. An application for two State grants has been submitted and the results are still pending.

### Utility Capital Improvement Program (CIP)

Following is a summary of the projects that are driving the need for additional revenue. The rate models used to develop these rates incorporates existing grants and loans, including the proposed WIFIA loan for Lake Wohlford Dam, and assumes that the remaining costs will be funded by money collected via rate increases on a pay-as-you-go, or PAYGO basis.

#### CIP – Water Fund

The Water Fund is moving forward with several important CIP projects in the next five years. These projects replace aging infrastructure, restore important water storage capability, and secure Escondido's access to its local water supplies. Several of the more important and costly future projects are:

<u>Project</u>	<u>Est. Cost</u>	<u>Status</u>
Lake Wohlford Dam Project	\$103M	Final Design
Treated Water Interconnection	\$7M	Design
Alley Utility Replacement Project	\$4M	Design

#### CIP – Wastewater Fund

Several important future projects within the system are:

<u>Project</u>	<u>Est. Cost</u>	<u>Status</u>
Lift Station #1 and Force Main Replacement	\$20M	Planning
Alley Utility Replacement Project	\$4M	Design



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### Pass-Through Charges

Historically, the City purchases about 75% of its water from the San Diego County Water Authority (SDCWA). The SDCWA purchases much of its water supply from the Metropolitan Water District (MWD). MWD imports water from two sources: the Colorado River via the Colorado River Aqueduct and Northern California via the California Aqueduct. Despite heavier than usual rains in early 2023, rainfall has been well below average for over a decade. Projects meant to further secure our water supply, for instance through additional storage, more recycling, and local supply development, will be beneficial in the long term, but will also apply upward pressure on water rates.

The Metropolitan Water District's (MWD's) Readiness-to-Serve charge decreased in 2021, and increased in 2022 and 2023. This charge includes a "Delta Surcharge" to cover costs to obtain water lost to environmental restrictions on the Sacramento River Delta. Since 2009, the City of Escondido has passed through changes in the Readiness-to-Serve charge. Annual changes are effective July 1 of each year.

The SDCWA fixed charges consist of the following: MWD capacity, supply reliability, customer service, emergency storage and infrastructure access charges. Since 2009, the City of Escondido has passed through increases in all of these charges. Annual changes are effective January 1 of each year.

In 2017 the City Council extended the pass-through adjustments of both the MWD Readiness-to-Serve and the SDCWA fixed charges. Staff recommends extending the pass-through of all these charges through 2028.

Staff also recommends pass-through of future adjustments to the SDCWA volumetric water supply charges. Escondido imports the majority of its water supply via the SDCWA. One of several fees and charges paid by the City to the SDCWA is a charge for unit volume of water imported (presently at \$1,085 per acre-foot of water). If the increases in the rate charged by the SDCWA are not passed on to customers until the next rate hearing, then money collected to fund the City's critical water infrastructure capital projects would instead be diverted to water supply purchases, thus delaying funding for critical Capital Improvement Projects. It is unknown when the SDCWA will again raise its volumetric supply rate. When it does raise the rate, notices will be sent to customers 30 days prior to the effective date of the rate change. Staff recommends authorizing pass-through of future adjustments to the SDCWA volumetric water supply charge through 2028.

### Summary of Finding of the Water, Wastewater, and Recycled Water Rate Study

The primary goal of the rate study was development of rates for each water and wastewater customer class that would generate revenue consistent with the cost of supplying service to each class. Each customer class has a unique cost of service based on its unique volume demands, peak use, water quality requirements, wastewater loading, etc. The rate study divided all the utility funds' costs into various categories and allocated these costs to each customer class depending on the class' contribution to the cost. Once this allocation was complete, rates were generated to collect enough revenue from a customer class to cover its cost of service, consistent with the requirements of California Proposition 218.



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The rates proposed in the 2023 Cost of Service Rate Study are shown in the Proposition 218 notice. The cost of service adjustment is done in the first rate increase in January 2024, resulting in large increases to some customer classes, notably Tier 1 Multifamily and Single-Family Residential, and Agricultural Customers.

The City Council Utilities Subcommittee met with staff three times to discuss the proposed increases and potential options to reduce the increases but keep the Water and Wastewater Funds financially stable. If no water revenue increases are approved at the Public Hearing, the Water Fund emergency and debt reserves would fall below the minimum requirement in FY2026, and would be depleted by FY2027. The debt coverage ratio would fall below the minimum required by the Funds' bond covenants in FY2025. If no wastewater revenues are approved, the Wastewater Fund emergency and debt reserves would fall below the minimum requirement in FY2026, and would be depleted by FY2027. The debt coverage ratio would fall below the minimum required by the Funds' bond covenants in FY2027.

Options explored include reducing the minimum reserves from 60 days to 30 days of operating expenses and reducing the capital reserve minimum from one year to a half year of annual capital depreciation. In addition, the CIP program was further reduced by delaying several proposed projects at least five years. Delaying capital replacement projects can come at a risk as some areas of the City's water and wastewater systems are well beyond their useful life, with some facilities having been installed in the 1920's and 1950's. Another measure proposed was to bring Escondido's water utility rates into alignment with the cost of service over a five-year period instead of in the first rate adjustment for certain customer classes, notably Tier 1 Multifamily and Single-Family Residential Customers, and Agricultural Customers.

With these options, the proposed revenue increases could be reduced from those listed in the Proposition 218 notice to the following: utility rate adjustments to increase Water Fund revenue by 8.0 percent effective January 1, 2024, followed by 7.5 percent on January 1, 2025, 7.5 percent on January 1, 2026, 6.5 percent on January 1, 2027, and 6.5 percent on January 1, 2028, and to align rates with the cost of providing service; and utility rate adjustments to increase Wastewater Fund revenue by 3.5 percent effective January 1, 2024, followed by 5 percent on July 1, 2024, 5 percent on July 1, 2025, 4 percent on July 1, 2026, and 3 percent on July 1, 2027, and to align rates with the cost of providing service. With these proposed adjustments, the Water Fund debt coverage ratio would remain above the minimum required by the Funds' bond covenants, and the emergency and debt reserves would not be depleted, however they would fall below the revised minimum requirement in FY2028. With these proposed adjustments, the Wastewater Fund debt coverage ratio would remain above the minimum required by the Funds' bond covenants, and the emergency and debt reserves would not be depleted, however they would dip slightly below the revised minimum requirement in FY2027. Staff believe the single year below the minimum in each fund can be managed with diligent oversight of the CIP and operating budgets.

### Proposed Rate Structures for Water, Wastewater and Recycled Water Services

The Utilities Subcommittee recommends adjusting all water, wastewater and recycled water charges and rates to those illustrated in Attachment "1" to this Staff Report and Exhibit "A" to Resolution 2023-131. These adjustments increase Water Fund revenue by 8.0 percent effective January 1, 2024, followed by 7.5 percent on January 1, 2025, 7.5 percent on January 1, 2026, 6.5 percent on January 1, 2027, and 6.5



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percent on January 1, 2028, and align rates with the cost of providing service; and increase Wastewater Fund revenue by 3.5 percent effective January 1, 2024, followed by 5 percent on July 1, 2024, 5 percent on July 1, 2025, 4 percent on July 1, 2026, and 3 percent on July 1, 2027, and align rates with the cost of providing service. Further increases after 2028 would require another publicly noticed hearing in compliance with the requirements of California Proposition 218.

### Bill Impacts of Rate Increases for Single Family Residential Customers

The following table shows the impacts of the proposed rate increases on an average Single-Family Residential customer as of January 2024. The sample customers' monthly water consumption volumes are 6,000 gallons; 9,000 gallons, and 12,000 gallons. Water use during the winter months is used to calculate wastewater bills, therefore the monthly water consumption of 3,000 gallons; 6,000 gallons, and 9,000 gallons is shown for wastewater.

Table 1. Projected Utility Billing Impacts for an average Single-Family Residence

<b>Water Use (gallons)</b>	<b>6,000</b>	<b>9,000</b>	<b>12,000</b>
Existing Bill	\$93.00	\$120.35	\$149.96
Proposed Bill	\$102.41	\$130.14	\$159.24
<i>Difference</i>	<i>\$9.41</i>	<i>\$9.79</i>	<i>\$9.28</i>
<b>Wastewater (gallons)</b>			
	<b>3,000</b>	<b>6,000</b>	<b>9,000</b>
Existing Bill	\$41.32	\$56.74	\$72.16
Proposed Bill	\$32.02	\$57.67	\$83.32
<i>Difference</i>	<i>(\$9.30)</i>	<i>\$0.93</i>	<i>\$11.16</i>
<b>Combined water and wastewater</b>			
Total Existing Bill	\$134.32	\$177.09	\$222.12
Total Proposed Bill	\$134.43	\$187.81	\$242.56
<i>Total difference</i>	<i>\$0.11</i>	<i>\$10.72</i>	<i>\$20.44</i>

### Rate Comparisons

To gain insight into the City's pricing policies, water and wastewater rates were compared to other local San Diego County water and wastewater agencies. Based on publicly available rates published by other agencies in the region, Escondido current rates and proposed January 2024 rates were compared to known rates of regional water and wastewater agencies. Based on average flows from actual water meter data in Escondido, a projected monthly water charge for customers consuming an average of 9,000



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gallons, and the projected monthly wastewater charge for customers consuming 6,000 gallons of potable water during winter months was used.

If the Council approves the proposed rate increase, the water charges for an average 9,000-gallon consumer would rank 4<sup>th</sup> out of 10 (where 1<sup>st</sup> is highest and 10<sup>th</sup> is lowest). The wastewater charges for an average 6,000-gallon consumer would rank 7<sup>th</sup> out of 10 (where 1<sup>st</sup> is highest and 10<sup>th</sup> is lowest). As in past years, some agencies will raise water and wastewater rates later in the year, so the results of this comparison may change in only a few months.

### Proposition 218 Notification

In compliance with Article XIII(D) of the California State Constitution and the Proposition 218 Omnibus Implementation Act, the City of Escondido mailed a notification of the proposed utility rate adjustments to all utility customers on August 31, 2023, more than 45 days prior to the date of the rate hearing. Additionally, notices were published in the Escondido Times Advocate on August 31, 2023, more than 45 days prior to the date of the rate hearing, and again on September 28, 2023, and October 12, 2023. Notices were also published in the San Diego Union Tribune on September 3, 2023, and again on October 1, 2023. Written protests to the rate adjustments have been collected through the City Clerk's office and will be summarized at the rate hearing. **A copy of the notices, in both English and Spanish, sent via regular mail have been included for reference at the end of this document as Attachments "2" and "3".**

Though not being requested today, rate increases for July 1, 2028 and beyond may be necessary. Additional notices under Proposition 218, as well as public hearings, will be required for any future proposed increases. All staff and consultant work on the current proposal has been conducted to meet the requirements of Proposition 218, which requires that rates and fees be justified by the costs to provide the service. Rates different from those proposed, whether adopted now or in the future, would have to meet the same legal test for relationship between the commodities and services provided, and the costs to provide these commodities and services.

### **RESOLUTIONS**

- A. Resolution No. 2023-131
- B. Resolution No. 2023-131 Exhibit "A"

### **ATTACHMENTS**

- A. Attachment "1" – Proposed Water, Wastewater, and Recycled Water Rate Adjustments
- B. Attachment "2" – Notice of Public Hearing (English)
- C. Attachment "3" – Notice of Public Hearing (Spanish)