STAFF REPORT

Meeting Type: Board of Directors

Title: Water Rate Setting Update

From: Bret Uppendahl, Finance Director BU

Through: Ben Horenstein, General Manager BH

Meeting Date: September 15, 2026

TYPE OF ITEM: Action X Information

RECOMMENDATION: Receive an update on the District's rate setting process

SUMMARY: As a municipal water district that relies on water rates to fund ongoing operations and capital improvements, the District is subject to the procedural requirements of Proposition 218 in order to modify or increase water rates and charges. These procedural requirements include providing written notice of the public hearing and proposed rate increases to each parcel and holding the noticed public hearing.

The substantive requirements of Proposition 218 provide that the proposed rates must be proportional to the benefit provided to each parcel and cannot exceed the cost of providing water service. The District last completed a cost of service rate study with Bartle Wells and Associates in 2023. That rate study supported the District's rate structure from Fiscal Year 2023-24 through Fiscal Year 2026-2027. To ensure that the District's rates are generating sufficient revenue for operating and capital expenditures and are reflective of current costs of service, staff is working with Water Resource Economics LLC to conduct a cost-of-service water rate study. The study is expected to provide recommended rate structure adjustments for the four-year period from 2027 to 2031. Staff anticipates that changes in the District's rate structure will be effective in July 2027.

The primary objectives of the Cost-of-Service Water Rate Study are to:

- Recover the costs of providing service, including operating, capital and debt funding needs
- Support the long-term operational and financial stability of the District
- Ensure the rate design is proportionate, fair and equitable to all customers
- Comply with substantive requirements of the California Constitution, Article 13D, Section 6 (approved by voters as Proposition 218)

Staff will provide an overview of the District's current rate structure, the preliminary financial plan and a high-level estimate of the revenue requirement.

DISCUSSION: The District's FY 2026-27 budget is $188 million, with operating expenditures of $119.7 million, capital expenditures of $64.8 million and $3.5 million in planned contributions to reserves. Staff is still in the process of finalizing the accounting for the prior fiscal year (FY 2025-26) and audited financial results will be available in late 2026; however, water sales and consumption data is now available. The total billed consumption in FY 2025/26 was 20,048 acre feet (AF), which represented a reduction of four percent compared to the prior year and was five percent below the amount incorporated in the FY 2025/26 revenue budget. The recent data, as well as that for the prior two years, indicates that projected water consumption levels will need to be reduced in the new cost-of-service study to reflect a sustained downward shift in local demand. Staff is working with Water Resources Economics to analyze water use patterns, seasonal impacts, and peaking trends in greater detail. Each of these factors will inform aspects of the cost-of-service study and may result in structural adjustments within the District's water rates.

Expenditure projections will also be incorporated in the cost-of-service study. The District's largest operating expenditure items include personnel costs, water purchases and utilities. Although each of these categories have different inflationary drivers, they are expected to increase at a higher rate than overall inflation over the next four years. For reference, inflation in the Bay Area, as measured by the Consumer Price Index (CPI-U) has ranged between two and four percent in recent months.

Personnel costs, which represent approximately 35 percent of the District's total budget, are largely driven by salaries and required retiree benefit obligations. Future wage increases, which are detailed in the District's current Memorandum of Understanding (MOU) and Salary Resolution, will be four percent in FY 2027/28 and an additional four percent in FY 2028/29. For planning purposes, staff assumes a three percent cost of living adjustment for staff salaries in FY 2029/30 and an additional three percent in FY 2030/31.

Retiree benefits and healthcare are the next largest line items within the personnel cost category. As a result of favorable investment market returns in recent years, the District's required pension contributions, as a percent of payroll, are projected to decline over time. It is worth noting that CalPERS utilizes smoothing methods which spread gains and losses over a multi-year period. Given that there have been four years of relatively positive gains since 2022, the smoothing formulas will continue to provide a buffer against potentially unfavorable market returns in the next few years. Assuming investment returns align with the current expectation of 6.8% per year, the CalPERS five-year projection for normal costs shows a gradual decline each year, from the current 10.6% of salary to 9.8% of salary by FY 2030-31. Required Unfunded Accrued Liability (UAL) payments are also benefitting from the recent investment earnings, however changes to CalPERS assumptions and the remaining smoothing from the investment market losses of 2022 have been an offset to any District savings on UAL payments.

The District's required healthcare premium costs have increased substantially in recent years, with annual increases ranging from eight to ten percent. These increases in healthcare premiums not only increase the District's costs for current employees, but they also impact the District's annual contributions toward retiree healthcare benefits. The most recent analysis shows that the District's actuarially determined contribution (ADC) for retiree healthcare benefits will increase by 12 percent in FY 2027/28 and by an additional two percent in FY 2028/29. CalPERS recently provided rates for 2027 that increased by just five percent. Staff is assuming that future healthcare premium costs will increase by approximately six percent per year over the next four to five years.

Aside from personnel costs, the District's largest operating expense is purchased water from the Sonoma County Water Agency (Sonoma Water). The District purchases approximately 25 percent of the service area's potable water from Sonoma Water. Each year, Sonoma Water updates its wholesale water rates and the District is contractually required to purchase at least 5,300 acre feet each fiscal year. In the past four years, the District has purchased approximately 5,750 acre feet per year. However, during dry years the District has purchased between 7,000 and 9,000 acre feet to supplement local supplies. Annual cost increases to imported water have averaged 7.5 percent since 2021, and staff expects this rate of inflation to continue over the next four to five years.

The cost of electricity is another notable line item in the District's budget, as the treatment process and distribution system require significant energy usage to move water from the reservoirs to the customer. Of the District's $7 million annual budget for utilities, approximately $6.3 million is for electricity, with approximately 75 percent of the District's electricity usage going toward water treatment. Over the past five years, the District's price per kilowatt hour ($/Kwh) has increased by over 50 percent, including two years where the price increased by more than 10 percent.

Overall, annual cost increases to the District's operating budget are expected to be an average of 4.5 percent over the next four years, which results in expenditure increases ranging between $5 million and $6.5 million annually. The Capital Improvement Program (CIP) also experiences annual cost increases; however, many of these costs are project-specific and difficult to predict with a high degree of certainty. Since FY 2022-23, the District has substantially increased annual investments in infrastructure improvements, including water supply projects and deferred maintenance. As such, the CIP has increased from $23.9 million in FY 2022-23 to $64.8 million in the current fiscal year. Within this total, the District also applies grants and Fire Flow revenues, which come from parcel taxes and are not funded by water rates. When excluding Fire Flow and grant-funded projects, the District's rate-funded CIP has grown from $18.7 million to $57.9 million in the past five years. Although deferred maintenance will remain an ongoing priority for the District, staff expects to reduce the rate-funded CIP by $5 to $7 million for the upcoming planning period.

Assuming the aforementioned water demand trends and inflationary assumptions for the District's operating budget hold true, and assuming a rate-funded CIP reduction of $5 to $7 million, the District will likely need to increase rate revenue by four to six percent per year over the next four years to maintain a balanced budget.

Finally, District staff has begun an initial comparison of rate structures in the region. Staff notes that the District's rate structure has more tiers than our regional comparators, both for residential and commercial customers. Staff has also found that the District's rate structure for Commercial, Industrial and Institutional customers, which is based on annual baselines, differs significantly from other agencies in the region, who largely utilize a uniform rate for all non-residential customers.

Staff is actively working with Water Resource Economics to further analyze the District's current rate structure and to refine long-term expenditure projections. Staff will be providing regular updates on the water rate study at Board meetings and Finance and Administration Committee meetings throughout the remainder of 2026. The District is planning to conduct a public hearing regarding proposed changes to the rate structure in the Spring of 2027

ENVIRONMENTAL REVIEW: Not applicable

FISCAL IMPACT: Not applicable

ATTACHMENT(S): None.