



City Council Agenda Item Staff Report

CITY OF SAN BRUNO

DATE: February 28, 2023

TO: Honorable Mayor and Members of the City Council

FROM: Jovan D. Grogan, City Manager

PREPARED BY: Matthew Lee, P.E., Public Works Director

SUBJECT: Hold Study Session and Provide Direction Regarding the 2023 Water and Sewer Rate Study Findings and Rate Recommendations

BACKGROUND:

The Water and Wastewater Enterprise Funds account for all operational and capital expenditures needed to operate, maintain and improve these critical utility systems. The Funds operate without tax support as each is funded solely by ratepayers. The City Council last adopted a multiyear rate plan water and wastewater rates on May 23, 2017, setting rates for a five-year period through June 30, 2021. The 2017-21 rates for both the Water and Sewer enterprise Funds were based on a 10-year financial plan and adjusted the same amounts each year. The annual rate increases for both Water and Sewer were 5%.

The City Council cancelled the final year of the 5-year water and sewer rate increase schedule at the February 9, 2021 City Council Meeting.

The City entered into a professional services agreement in March 2022 with Bartle Wells Associates ("consultant") to update the City's water and sewer rate model to ensure revenues continue covering operational costs and necessary infrastructure improvements. Work on the study has been ongoing since that time and, as such, staff did not propose rate increases for the current FY 2022-23 fiscal year.

The combination of the cancellation of the 2021 rate increase and the fact that staff did not propose to increase rates in FY 2022-23, has resulted in water and sewer rates remaining unchanged since July 1, 2020.

On February 14, 2023 the City Council held a study session to review the preliminary Water and Sewer Rate Study findings. City Council received a presentation from staff and the consultant. A summary of the City Council questions, and the answers provided, are included as Attachment 2. Primary questions related to the following topics:

1. Sewer Bill: move from the City's bi-monthly bill to the County's property tax roll
2. Delinquent Utility Customers: request for the delinquency percentage and amount
3. Lateral Repair Assistance: consider financial assistance to customers for the repair of private sewer laterals

DISCUSSION:

After reviewing the fixed, operational, and capital improvement priorities, City staff and the consultant developed a comprehensive financial plan to adequately fund these costs over the next five years. The draft Water and Sewer Rate Study Report is provided as Attachment 1. Below is the proposed recommended five-year rate schedule for water and sewer utility rate payers.

Projected Sewer Rate Increases				
July 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027
5%	5%	5%	5%	5%

Projected Water Rate Increases				
January 1 2024	January 1 2025	January 1 2026	January 1 2027	January 1 2028
6%	6%	6%	6%	6%

The proposed rates provide necessary revenue to cover the projected operational and maintenance costs for the City's water and sewer utilities. The proposed rates also continue the Capital Improvement Program to provide for the necessary investment in improving and replacing the City's aging and deteriorating water and sewer infrastructure.

The proposed water rates reflect decreases in water consumption due to increased conservation, projected increases in the cost of purchased water from the San Francisco Public Utilities Commission, and continuation of the City's policy goal for replacing the City's mains and other infrastructure. Sewer system rates reflect decreases in water consumption, on-going treatment costs for the shared South San Francisco-San Bruno Water Quality Control Plant, costs for complying with the Regional Westside Basin Groundwater Storage and Recovery Project (GSR), and continuation of the City's policy objective for replacing sewer mains and other infrastructure.

The rate model also reflects the pace of CIP project implementation over the past few years due to the pandemic, reduced City staffing levels, and its effects as well as anticipated future implementation.

Why Increase Rates?

Reliable and safe water service and wastewater (sewer) collection and treatment are among the most fundamental and important services delivered to our community. These services are funded solely from water and sewer rates.

The drought and State conservation requirements have impacted customer water use and utility revenues. Total customer water consumption in 2022 was down 8% from 2021 and has decreased 22% since the 2014 drought. As water use decreases, revenues decrease proportionately, while the fixed costs to maintain system infrastructure increase with inflation, including maintenance, repair, and construction costs.

Operational costs, such as personnel costs, maintenance supplies, as well as repair equipment, are increasing at a rate higher than the regional cost of living index. Separately, the cost of purchased water from the San Francisco Public Utilities Commission (SFPUC) is projected to increase by 21% over the next 5 years. When the Westside Basin aquifer is too low, underground extraction is limited and the City receives in lieu water supplies from SFPUC until the basin is replenished. For example, in 2020, the City obtained 97% of its water supply from SFPUC. In 2021, the Westside Basin aquifer had been sufficiently recharged and agencies returned to operating their Westside Basin wells. At the end of 2022, the City obtained 69% of water supplies from groundwater, 30% from SFPUC, and 1% from the North Coast County Water District.

The proposed rates address the City Council's commitment to rehabilitate and replace aging and deficient infrastructure. Additional work to repair and rehabilitate the infrastructure where needed is planned. The overall system condition and improvement needs have been carefully evaluated through the City's preparation of water and wastewater infrastructure master plans. Improvements are prioritized through this analysis and the City's work program is built around the identified priorities.

Below is a Water and Sewer CIP expenditure summary over the last five years. The higher level of Sewer expenditures reflects the City's priorities to meet infrastructure improvements required by the 2011 Baykeeper Consent Decree (CD) and Regional Water Board's Cease and Desist Order (CDO). The City's compliance obligations ended in 2021. The pandemic and staffing shortages limited capital project construction during FY2021-22.

Fiscal Year		Water CIP		Sewer CIP
2017-18	\$	2,291,412	\$	5,086,120
2018-19		1,433,693		6,677,943
2019-20		3,698,745		7,585,130
2020-21		3,210,857		3,633,794
2021-22		468,511		1,181,922
TOTAL	\$	11,103,218	\$	24,164,909

Sewer Capital Projects

Over the last five years, prioritization was given to wastewater projects to ensure compliance with the 2011 Baykeeper Consent Decree (CD) and Regional Water Board's Cease and Desist Order (CDO). Of the projects identified in the 2017 Rate Study, 80% were completed. For those projects not yet completed, 100% was due to delays caused by an outside entity.

Water Capital Projects

The prioritization of sewer capital projects and staffing levels resulted in delays to the water capital projects. Approximately 40% of the water capital projects were prioritized and completed over the last five years. For those projects not yet completed, 78% was due to staffing challenges and 22% was due to delays caused by an outside entity (see Chart 1 below).

Main Replacement Projects

In 2014, a workplan was developed to jointly complete water and sewer main replacements in the same location at the same time for efficiency in administrative costs and to minimize neighborhood disruptions. Over the last five years, approximately 45% of these coordinated main replacement capital projects were prioritized and completed. For those projects not yet completed, 79% was due to staffing challenges, 14% was due to the project being reprioritized, and 7% was due to delays caused by an outside entity (see Chart 2 below).

Chart 1: Water CIP - Causes for Delay

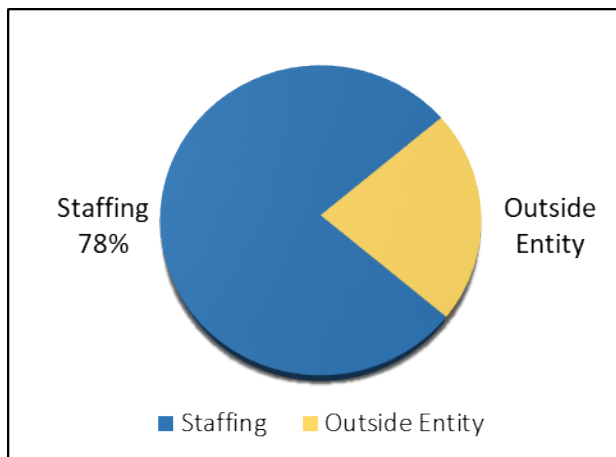
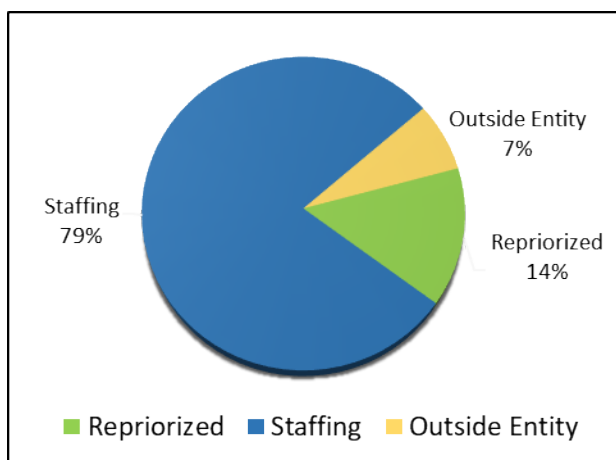


Chart 2: Water Main Replacement Projects - Causes for Delay



Capital Projects – Next Steps

To directly address the backlog of projects, the City's Public Works Department has brought on five new staff since Fall 2022. The Department also increased contracting capacity with on-call design consultants and project managers throughout the year.

Additionally, during the prior Water and Sewer Rate Study, the full project amounts were allocated in the year that the project was set to begin. Given that certain CIP projects can

span multiple years, it did not reflect the actual cashflow needed during the various phases of the multi-year project. In future years, the City will explore planning and appropriated project funds over multiple years to reflect the actual cashflow needs of a project.

A five-year period allows for certainty for planning capital projects and reduces the significant administrative costs of more frequent rate setting.

Rate Study Highlights

Below are highlights of the Rate Study, including the current rate structure, funding needs, financial and rate projections, potential for collecting sewer rates on property tax rolls, and an upcoming schedule for further rate discussions and approval consideration:

Water and Sewer Rates

- The City's water and sewer utilities are self-supporting enterprises that rely predominantly on revenues from water and sewer rates to fund the costs of providing service.
- The City has provided good financial stewardship via adoption of gradual annual water and sewer rate increases most years for the past 15 years. These increases have put the water and sewer enterprises on a much stronger financial footing, helped keep rates aligned with the costs of providing service and supported a significant increase in funding for capital improvement needs.
- The City last conducted water and sewer rate studies in 2017 leading to adoption of 5 years of 5% annual water and sewer rate increases effective July 1, 2017 through 2021. However, the City cancelled the final 5% water and sewer rate increases that had been scheduled to become effective July 1, 2021, and has subsequently been able to defer raising rates. Current rates have been in effect since July 1, 2020.
- San Bruno's water and sewer rates are both currently in the middle range compared to other regional agencies in San Mateo County. The City's combined water and sewer charges for a typical single-family home were the median, with half of other agencies either higher or lower than San Bruno, based on a survey of 19 regional agencies.
- The City bills customers via a combined bi-monthly bill that includes water rates, sewer rates, garbage rates, and cable charges. This results in a single large bill that customers pay once every two months. Additionally, residents that subscribe to the City's cable, telephone, and internet service (CityNet) receive a separate monthly bill from the City.
- The City has received some customer complaints that its utility bills seem high compared to other agencies, but this may largely be due to the City's billing practices compared to a number of other regional agencies that only bill for some utility

services (e.g., only water or sewer service), bill customers every month, and/or collect sewer charges on the property tax rolls.

Capital & Operating Funding Needs

- While the City has completed a significant amount of capital improvements over the past 5 years, some projects were temporarily delayed due to staffing limitations and other factors including time needed for planning, design and permitting. These deferred costs helped enable the City to cancel its water and sewer rate increases that were scheduled to go into effect in 2021 and pass along the savings to customers via no rate increases for the past 2 years. However, the City has been proceeding with its capital program and has a number of large projects in design which will soon require funding.
- Both water and sewer enterprises are facing substantial capital improvement funding needs in upcoming years. The City currently anticipates funding roughly \$85 million of water system capital improvements and roughly \$54 million of wastewater system capital improvements over the next 5 years including a share of costs for improvements to the Water Quality Control Plant (WQCP). The improvements are needed to address existing deficiencies, rehab and/or replace aging infrastructure that has reached the end of its useful life, and to support safe and reliable service. In addition, the WQCP anticipates a future debt issuance to support a major upgrade to its biosolids handling process. San Bruno's share of debt service is estimated at approximately \$800,000 per year starting fiscal year 2026-27.
- Water capital improvements planned for the next 5 years include the replacement of three older water tanks as well as replacement of aging water pipelines and various other improvements to wells, pressure regulating stations, and pump stations.
- Sewer capital improvements primarily consist of rehabilitation and replacement of aging sewer pipelines but also include pump station improvements and the City's share of the capital improvement projects of the WQCP.
- Current rates do not support the projected capital funding needs over the next 5 years or projections of longer-term annual funding needs for rehabilitation and replacement of aging infrastructure.
- The water and sewer enterprises have both accrued healthy levels of fund reserves that include some excess reserves available for capital funding. A substantial amount of these fund reserves is projected to be drawn down in upcoming years to help fund the City's water and sewer capital improvement needs while rate increases are gradually phased in.
- The City is also facing ongoing increases to its water and sewer operating expenses:
 - Due to overcollection of revenues in prior years, the SFPUC accumulated fund reserves in a "balancing account" on behalf of its wholesale customers and was

able to draw down reserves in order to defer wholesale water rate increases for 5 years. However, the balancing account was mostly depleted and SFPUC increased wholesale water rates by 16% effective July 1, 2022.

- Additional wholesale water rate increases are projected in upcoming years.
- The City is contractually responsible for paying its share of operating, maintenance and debt service expenses for the South San Francisco - San Bruno Water Quality Control Plant and effluent disposal system. Costs for wastewater treatment operations have increased in recent years, with no corresponding increases to the City's sewer rates, and are projected to continue to gradually increase in future years.
- In addition, the City faces ongoing cost inflation for its own operating and maintenance expenses. The City avoided some expenses in recent years due to unfilled staff positions and participation in the Groundwater Storage and Recovery Agreement with SFPUC. In addition to rate increases for capital needs and other purposes, small annual rate increases are needed over the next 5 years to support the City's own operating expenses and keep up with cost inflation.
- The City's prior rate increases put the water and sewer enterprises on a stronger financial footing but are not adequate to meet projected future operating and capital funding needs. Temporary deferral of some expenses enabled the City to pass along the savings to its customers by cancelling and deferring rate increases since July 1, 2021. However, staff and the consultant recommend the City Council adopt five-year sewer and water rate increases at the rates necessary to meet current operational and infrastructure needs.

Financial and Rate Projections

- The consultant developed 10-year financial projections to evaluate rate increases needed to support projected water and sewer enterprise funding needs in upcoming years. Rate increases are designed to be gradually phased in over 5 years in order to minimize the annual impact on ratepayers, with the goal of supporting balanced budgets and adequate funding for ongoing rehabilitation and replacement of aging pipelines and other water and sewer system infrastructure.
- The tables below summarize the overall level of projected water and sewer rate increases for the next 5 years. Due to minor adjustments to the City's water and sewer rate structures designed to realign rates with the cost of service, actual billing impacts to customers may vary a little depending on customer class, meter size, and water use.

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July 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027
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Projected Water Rate Increases				
January 1 2024	January 1 2025	January 1 2026	January 1 2027	January 1 2028
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- As shown on the tables above, water rate increases are proposed to become effective on January 1 of year, when water use is low, starting January 1, 2024. Sewer rate increases are proposed to become effective on July 1 at the beginning of each fiscal year starting July 1, 2023.
- Accounting for the cancellation and deferral of rate increases over the past 2 years, water and sewer rates with the proposed increases will remain below levels previously projected. For example, if the City had continued with gradual 5% rate increases each year, current rates would already be a little over 10% higher than they current are and would remain higher than projected rates in future years.
- BWA also evaluated the potential use of future debt financing to help fund the City's elevated level of water system capital needs over the next 5 years as the City's aging water tanks are replaced while enabling the City to phase in modest gradual rate increases. Water enterprise financial projections assume the City would first spend down a portion of its fund reserves prior to issuing debt in 2025 to fund \$20 million of capital improvements, which are elevated over the first 5 years. The actual timing and amount of any future debt issuance would vary based on actual future funding needs.

Potential for Collection of Sewer Rates on Property Tax Roles

- The City can consider the potential for collecting sewer service charges on the San Mateo County property tax rolls. Potential benefits include: a) removing sewer charges from the City's combined bi-monthly utility bills, b) San Mateo County is on the Teeter Plan under which the City would typically receive 100% of sewer billings regardless of property tax payment delinquencies. Some potential considerations would include: c) sewer charges currently paid by some tenants would transition to being collected via tax bills paid by property owners, d) the County charges a small administrative fee for collecting charges on the property tax rolls. Agencies can opt to use the property tax rolls to collect charges for a subset of customers such as: a) residential customers only, or b) to collect utility bill payments from delinquent accounts.

- Many other regional agencies collect sewer rates via the property tax rolls including South San Francisco, Pacifica, San Mateo, Colma, San Carlos, Hillsborough, East Palo Alto Sanitary District, West Bay Sanitary District (Menlo Park), Redwood City, Montara Water & Sanitary District, and others. Other regional agencies are also currently considering collecting sewer charges on the County property tax rolls.
- The collection of sewer charges on the property tax rolls is authorized by California Health and Safety Code 5473. Pursuant to the Code, agencies must annually prepare and adopt by resolution listing the charges that would be levied on each parcel prior to submission to the County for collection on the property tax rolls. Prior to authorizing collection via the property tax rolls for the first time, the City must send notice to affected property owners of the proposed change in billing method at least 45 days prior to holding a public hearing on the matter. Similar to the process for adopting water and sewer rate increases, adoption of resolution authorizing billing via the property tax rolls is not subject to a public vote but is instead subject to “majority protest” under which the City would not be able to consider adoption of the resolution if “written protests” were submitted by property owners representing more than 50% of affected parcels, with one written protest counted per parcel.

Council Input on Final Rates, Timeline, and Billing

At the February 28, 2023 City Council Meeting, staff seek final City Council input on the following major policy decisions:

1. Rates necessary to meet current operational and infrastructure needs:

- Sewer: 5% annual rates, starting July 1, 2023 through July 1, 2028
- Water: 6% annual rates, starting January 1, 2024 through January 1, 2029

2. Proposition 218 Process:

- Resolution (recommended / most time efficient)

OR

- Ordinance (Not recommended)

For the Proposition 218 rate setting process, should the City combine the Sewer and Water rate proposals together or separate and consider them individually? If they are separated, the City is required to advertise them individually, and they can be considered at the same or at different City Council meetings. Historically, they have been processed together and staff recommends continuing this approach as it is more efficient.

3. Placing Sewer Bills on the Property Tax Rolls

Staff recommends placing the sewer bills on property tax rolls. This could be transitioned with a one year transition period.

Once the City Council provides staff with final input on these items, staff will return at a future meeting to obtain City Council direction to formally initiate the Proposition 218 rate increase process.

Next Steps

The following section presents a draft schedule for moving forward with proposed recommended five-year water and sewer rates increases.

March/April 2023	<u>City Council Meeting</u> : Obtain Council direction to formally initiate the Proposition 218 rate increase process. (Date to be determined.)
March/April 2023	Mail Proposition 218 Notices of proposed rate increases to property owners and customers. Notices must be deposited in the mail at least 45 days prior to the date of the Public Hearing at which the proposed rates would be considered for adoption. (Date to be determined.)
May/June 2023	<u>City Council Meeting</u> : Hold the required Public Hearing, consider protests, and consider adoption of proposed water and sewer rates. Water and Sewer rate increases are not subject to a public vote but are subject to “majority protest” under which the City would not be able to consider adoption of the resolution if “written protests” were submitted by property owners representing more than 50% of affected parcels, with one written protest counted per parcel. (Date to be determined.)
July 1, 2023	New sewer rates become effective.
January 1, 2024	New water rates become effective.

FISCAL IMPACT:

There is no fiscal impact with receiving this study session. The FY2021-22 Operating Budget approved June 22, 2021 included funding for the preparation of the Water and Sewer Rate Study.

ENVIRONMENTAL IMPACT: .

The discussion of preliminary Water and Sewer Rate Study findings does not have the potential for creation of a significant environmental impact pursuant to the California Environmental Quality Act (CEQA), and as such are exempt from further environmental consideration per CEQA Guidelines Section 15061(b)(3).

RECOMMENDATION:

Receive a second presentation on preliminary Water and Sewer Rate Study findings and provide direction on rate recommendations and other related topics.

ALTERNATIVES:

None.

ATTACHMENTS:

1. Draft Water and Sewer Rate Study Report
2. Meeting Summary of City Council Study Session on February 14, 2023