



NEWPORT BEACH

City Council Staff Report

November 19, 2019
Agenda Item No. 23

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

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TITLE: Conduct a Proposition 218 Public Hearing and Consider a Water
Rate Increase

ABSTRACT:

Following the support of the Finance Committee, City Council conducted a study session on August 13, 2019 and approved the 2019 Water Rate Study on September 24, 2019. The completed Study analyzes the cost of services, the reserve policy, and recommends increases to the water rates. Water rates have not increased since 2014 and increases are needed to fund the increased costs to purchase and pump water, to operate the system and the increases to the Capital Improvement Program. Staff has noticed all affected property owners and customers per the State Law. City Council is asked to conduct a Public Hearing, tabulate the results of protest received and if a majority protest is not received, approve a five-year water rate increase effective January 1, 2020.

RECOMMENDATION:

- a) Conduct a public hearing to accept comments on the proposed water rates and at the conclusion of the hearing close the 45-day notice period;
- b) Determine this action is exempt from the California Environmental Quality Act (CEQA) pursuant to Sections 15060(c)(2) and 15060(c)(3) of the CEQA Guidelines because this action will not result in a physical change to the environment, directly or indirectly;
- c) Direct the City Clerk to tabulate the results of the protests received from property owners and customers and announce the findings;
- d) Waive full reading, direct the City Clerk to read by title only, and adopt Ordinance No. 2019-16, *An Ordinance of the City Council of the City of Newport Beach, California, Amending Chapter 14.12 (Water Rates and Charges) of the Newport Beach Municipal Code Setting Water Rates by Resolution and Other Related Changes*; and

- e) Adopt Resolution No. 2019-103, *A Resolution of the City Council of the City of Newport Beach, California, Establishing Water Charges Effective January 1, 2020 and Four Years of Phased in Increases Thereto.*

FUNDING REQUIREMENTS:

The current adopted budget includes sufficient funding for the Water Rate Study and the public noticing. The cost of the Study is approximately \$150,000 and the cost of the public noticing (Proposition 218 mailed notice) is approximately \$15,000. As currently budgeted, the Water Enterprise Fund is now operating at a structural deficit, drawing down on net working capital reserves. Increases to customer water rates are necessary to sustain funding for the water system including infrastructure replacements, costs to purchase/pump water and operational expenses. If City Council adopts the new water rates, rates would be adjusted and generally increase 7.4% each year for 5 years, beginning January 1, 2020. The rate increases will fund the necessary Capital Improvement Program, the increased cost of purchasing and pumping water and stabilize the Water Enterprise Fund. The Enterprise Fund budget for revenues will be adjusted in the upcoming fiscal year.

DISCUSSION:

On March 12, 2019, the City entered into an agreement with Raftelis Financial Consultants, Inc., to conduct a comprehensive Water Rate Study, which included a cost of service analysis, development of a 10-year financial plan, and thorough review of the City's Reserve Policy for the Water Enterprise Fund. The Study's findings and recommendations include water rate adjustments to cover operations and capital improvements, as well as provide funding to meet City Council Reserve Policy F-2, with modifications to the policy. The study addressed water operations, capital expenditures and revenue shortfalls, predicting the Water Fund reserve balances would dip below the minimum target over the next few years without the rate increases. A copy of the full 2019 Water Rate Study is available on the City's website at:

<https://www.newportbeachca.gov/government/departments/utilities/water-services/new-water-rates>

On May 16, 2019, and June 27, 2019, the Finance Committee delved into the water rate study financial analysis of the Water Enterprise Fund, including the reserve policy and preparing for future drought concerns. Also discussed were typical steps and decision points for evaluating water rates, the different types of water rate structures, and rate options concerning fixed and variable revenues. At the conclusion of the June presentation, following in-depth discussion, the Finance Committee unanimously recommended that the Water Rate Study be moved to City Council for further discussion and action.

On August 13, 2019, City Council held a study session to review the water rate study. Then, on September 24, 2019, the Utilities Department and Raftelis presented the findings and recommendations of the Final Water Rate Study for proposed water rate increases.

The City Council approved the 2019 Water Rate Study, set a public hearing for today, November 19, 2019, and authorized the mailing of notices to Newport Beach property owners and water customers to inform them of the proposed water rates in compliance with State law. According to the proof of mailing, on October 1, 2019, the City mailed 27,324 notices to Newport Beach property owners and water customers.

In accordance with Proposition 218, local agencies are required to provide a 45-day notice period whereby property owners may submit in writing a protest objecting to the proposed water rates. At the conclusion of the notice period, the City is required to conduct a public hearing and tabulate the protests received. In the absence of a majority of property owners objecting to the rate, City Council may adjust the rate and/ or structure. The 45-day period will conclude at the end of the public hearing on tonight's agenda, November 19, 2019.

Components of the 2019 Water Rate Study:

Executive Summary:

- The Water Enterprise Fund is now operating at a structural deficit, drawing down on net working capital reserves in order to fund the current Water System Capital Improvement Program.
- Water Rates have not increased since 2014.
- Increased replacement and rehabilitation of the water system pipes, wells and components (the Capital Improvement Program) are needed as recommended by the Water Master Plan (a 40% increase, averaging \$7.2-million per year).
- The cost of pumping groundwater has increased by 73% and the cost of purchasing imported water has increased by 18% since 2014. Operational costs for materials, supplies, labor, and electricity since 2014 have also increased.
- A comprehensive Water Rate Study has been completed and the Finance Committee has reviewed the information.
- Water rate increases are recommended to properly sustain the water system; 7.4% increases each year for 5 years.
- The average rate increase for the first year is approximately \$3.38/month or \$40.56/year per household

Water System Background:

The Utilities Department provides safe and reliable water for drinking, irrigation, and fire protection to Newport Beach residents, businesses and visitors. These essential services are accomplished through a strategic combination of dedicated in-house licensed staff operators (on-call 24 hours a day) and highly qualified contractors. Behind the scenes, the Department is responsible for all water purchases/production, treatment, disinfection, water quality testing, regulatory compliance, field customer service, and emergency response. The water system is supported by the Public Works Department for the Capital Improvement Program and the Finance Department for utility billing and customer service.

The system includes approximately 300 miles of water pipelines, 200 million gallons of water storage, 26,000 service connections (water meters), 17 water booster pumps, 42 pressure reducing stations, 2,700 fire hydrants, 8,100 water valves, 12 interconnects and 4 groundwater wells.

All revenue and expenditures related to water service provided by the City of Newport Beach is contained in the Water Enterprise Fund. The Enterprise Funds are separate from the General Fund or any other fund the City uses to operate the City. Funding for maintenance and replacement activities is collected from ratepayers through the Municipal Services bill.

Four main expenditure categories of the water enterprise are important to providing water service. Each of the four components also lists the percentage of the total annual water system expenditures (up to 98%):

- The **Cost to Purchase and Pump Water** (35%) includes the direct cost for the rights to pump groundwater and to buy imported surface water. Approximately 75% of Newport's water is pumped from groundwater and 25% is purchased from Metropolitan Water District primarily coming from the Colorado River and Lake Oroville.
- **Operations** (30%) includes day-to-day operations and maintenance and is comprised of salaries, contract maintenance, repairs, materials, permits, outside agency fees, electricity, and professional services.
- **Replacement** (21%) includes the annual capital replacement or rehabilitation of aging infrastructure and recommended improvements per the recently completed 2019 Water Master Plan. The Master Plan estimates approximately \$7.2 million in total annual capital improvements, a 40% increase from the previous 2009 Water Master Plan.
- **Customer Service, Billing, and Administration** (12%) includes the meter reading, invoicing, customer service, administration, and internal service charges.

In addition, a major component of the fund are the reserves:

- **Reserves** are established by City Council Policy F-2 where the minimum level is set annually at a dollar amount equal to fifty percent of the operations budget. The reserves provide rate stabilization, funding for needed capital improvements, and funding for a catastrophic failure of the infrastructure. Changes are recommended to the Reserve Policy and are discussed in the recommendation of the Study.

Results and Recommendations of the Study:

Reserve Policy for the Water Enterprise Fund:

The previous 2009 Water Rate Study and City Council Policy F-2 established a dollar amount equal to fifty percent of the operations budget plus a capital contingency as the minimum reserve level for the fund. The Study and the Finance Committee reviewed this and recommended the following:

- **O&M Reserve** – for Operating Cash Flow
 - > 33% of operating expenses (or 4 months of expenses)
- **Capital Reserve** – for Capital Working Capital
 - > 75% of 5-year average CIP
- **Rate Stabilization Reserve** – for unexpected water demand reduction or unexpected water supply cost increases, emergencies, and non-budgeted CIP capital projects, causing net revenue loss for the Water Fund
 - > **Recommended Rate Stabilization Reserve Target Balance: \$2.7M**

The Water Rate Study was constructed with this proposed reserve policy. The Policy takes into account the different types of risk the water utility faces, including future cyclical drought conditions. The new Reserve Policy total amount is similar to the existing policy. However, it better articulates the types of reserve uses. As currently planned, the budget anticipates drawing down on net working capital reserves over the next three years along with the proposed rate increases to stay above the minimum reserve level.

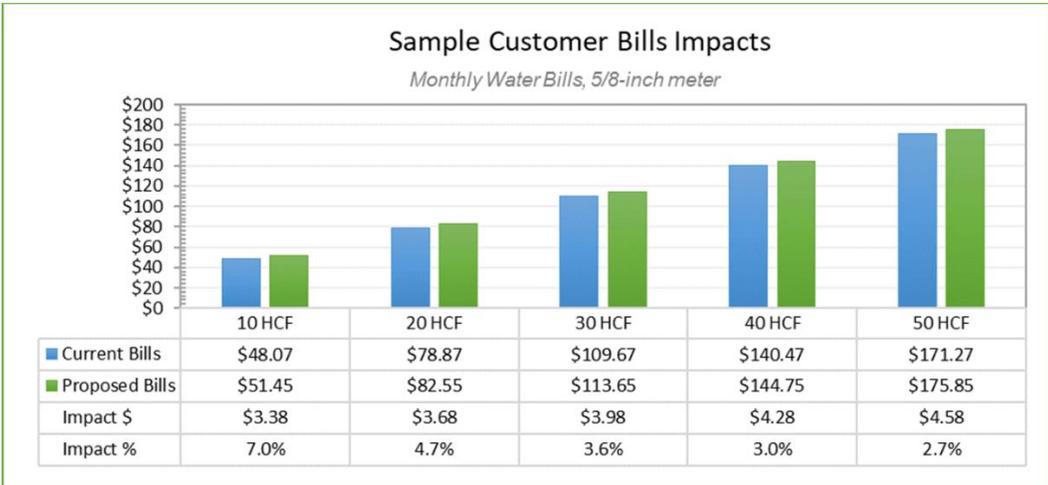
Financials, Rate Structure and Rate Increase:

Water users are billed for two components; the size of their meter, known as the fixed charge (or standby/ready to serve charge) and the commodity or water usage charge. In order to fairly and equitably recover the cost of providing water to our customers, the rate study looked at each of these charges, their proportionality and recommended structured rate levels consistent with industry standard. The Finance Committee recommended that most of the rate increase in the first year be adjusted in the fixed meter charges as opposed to the commodity charge. This better matches actual fixed expenditures, better stabilizes the Water Enterprise Fund and still maintains affordability and water conservation goals.

Water rates, as shown in Table 1 on the next page and in the report, are proposed to be adjusted proportionally and increased 7.4% each year for the next 5 years. The average residential customer, who uses approximately 10 billing units, is expected to see a \$3.38 per month increase during the first year on their water bill. Then, a 7.4% increase each year for the next four years. If rates had been adjusted over the last five years to match inflationary water costs, the annual percentage increase would have been much lower. (A billing unit is 1-HCF or 100-cubic feet or 748 gallons).

Table 1: Proposed 5-year (Potable) Water Rates:

Rate Change	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
	Current Rates	Proposed	Proposed	Proposed	Proposed	Proposed
Water Meter Size (inches)						
5/8	\$17.27	\$20.35	\$21.86	\$23.48	\$25.22	\$27.09
3/4	\$17.27	\$20.35	\$21.86	\$23.48	\$25.22	\$27.09
1	\$28.79	\$31.54	\$33.88	\$36.39	\$39.09	\$41.99
1 1/2	\$57.58	\$59.47	\$63.88	\$68.61	\$73.69	\$79.15
2	\$92.12	\$93.00	\$99.89	\$107.29	\$115.23	\$123.76
3	\$172.73	\$246.68	\$264.94	\$284.55	\$305.61	\$328.23
4	\$287.88	\$422.71	\$454.00	\$487.60	\$523.69	\$562.45
6	\$575.76	\$897.73	\$964.17	\$1,035.52	\$1,112.15	\$1,194.45
8	\$921.22	\$1,568.33	\$1,684.39	\$1,809.04	\$1,942.91	\$2,086.69
10	\$1,655.90	\$2,350.70	\$2,524.66	\$2,711.49	\$2,912.15	\$3,127.65
12	\$2,663.48	\$2,965.44	\$3,184.89	\$3,420.58	\$3,673.71	\$3,945.57
Per Dwelling Unit Charge	\$1.00	N/A	N/A	N/A	N/A	N/A
Usage Charges						
Potable Water	\$3.08	\$3.11	\$3.35	\$3.60	\$3.87	\$4.16



Fire Service Water Rates:

The City's water system also has approximately 460 Fire Service customer connections. These are typically the large red above ground pipes and valves seen in front of businesses or in parking lots. This pressurized water is supplied on a standby basis to provide additional fire-fighting water if needed by the property. The Fire Service Water rates recovers the proportional cost to provide fire protection capacity, metering and billing. They have also been adjusted to be compliant with industry standards. Most fire services do not use water regularly. However, if water is used through the fire service, the standard commodity potable water rate is used. Fire Service Water Rates are shown in Table 2 below:

Table 2: Proposed 5-year Fire Protection Service Water Rates:

Rate Change	FY 2019 Current Rates	FY 2020 7.40% Proposed	FY 2021 7.40% Proposed	FY 2022 7.40% Proposed	FY 2023 7.40% Proposed	FY 2024 7.40% Proposed
Fire Service Connection (inches)						
5/8	\$3.13	\$10.41	\$11.19	\$12.02	\$12.91	\$13.87
1	\$5.00	\$10.59	\$11.38	\$12.23	\$13.14	\$14.12
1 1/2	\$7.50	\$11.07	\$11.89	\$12.77	\$13.72	\$14.74
2	\$10.00	\$11.87	\$12.75	\$13.70	\$14.72	\$15.81
2 1/2	\$12.50	\$13.09	\$14.06	\$15.11	\$16.23	\$17.44
3	\$15.00	\$14.76	\$15.86	\$17.04	\$18.31	\$19.67
4	\$20.00	\$19.78	\$21.25	\$22.83	\$24.52	\$26.34
6	\$30.00	\$37.72	\$40.52	\$43.52	\$46.75	\$50.21
8	\$40.00	\$68.70	\$73.79	\$79.26	\$85.13	\$91.43
10	\$50.00	\$115.28	\$123.82	\$132.99	\$142.84	\$153.42
12	\$60.00	\$179.85	\$193.16	\$207.46	\$222.82	\$239.31

Recycled Water System Rates:

The City provides recycled (non-potable) water to irrigate parks, certain landscaping, center medians, and golf courses encompassing 2-3% of the City's total water use. The City purchases recycled water from the Orange County Water District (OCWD) through the project known as Green Acres Project. The recycled water rates recover the direct costs to purchase the recycled water, and the proportional costs regarding capacity, metering, and billing. Certain users also have exclusive pump stations to increase the flow and pressure of the water to meet watering needs. Those users are charged the direct charges associated with the pump stations. In general, recycled water remains less expensive than potable water. Recycled Water Rates are shown in Table 3 on the next page:

Table 3: Proposed 5-year Recycled Water Rates:

Rate Change	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Recycled Water Services	Current Rates	7.40% Proposed	7.40% Proposed	7.40% Proposed	7.40% Proposed	7.40% Proposed
Water Meter Size (inches)						
5/8	\$20.47	\$10.34	\$11.11	\$11.94	\$12.83	\$13.78
3/4	\$20.47	\$10.34	\$11.11	\$11.94	\$12.83	\$13.78
1	\$34.13	\$14.85	\$15.95	\$17.14	\$18.41	\$19.78
1 1/2	\$68.25	\$26.10	\$28.04	\$30.12	\$32.35	\$34.75
2	\$109.19	\$39.61	\$42.55	\$45.70	\$49.09	\$52.73
3	\$204.75	\$101.54	\$109.06	\$117.14	\$125.81	\$135.12
4	\$341.24	\$172.47	\$185.24	\$198.95	\$213.68	\$229.50
6	\$682.48	\$363.88	\$390.81	\$419.73	\$450.80	\$484.16
8	\$1,091.97	\$634.09	\$681.02	\$731.42	\$785.55	\$843.69
RW Usage Charge	\$1.92	\$2.05	\$2.12	\$2.13	\$2.21	\$2.29
Pump Station Charge	\$0.39	\$0.53	\$0.57	\$0.62	\$0.67	\$0.72

Proposition 218 Procedures

Under the Proposition 218 requirements, the rates cannot be increased if a majority of the property owners submit valid written protests to the City Clerk by the close of the 45 day notice and protest period. At the conclusion of the public hearing, the City Clerk shall complete the tabulation of all written protests received, including those received during the public hearing and shall report the results to the City Council. The Clerk may advise the City Council of the absence of a majority protest without determining the validity of all protests. Notices were also sent to all water customers who may not be property-owning customers and City Council may consider their protests; however, they will not be counted as part of the requirement. Only one protest is allowed per property parcel. At this point, if a majority of property owners does not submit a valid written protest, City Council could vote to adopt the new rates and structure.

Implementation of Ordinance Changes

The existing rates are identified in the NBMC (Chapter 14.12). Notwithstanding a majority protest, City Council can consider verbal testimony from anyone and written protests from non-property owners and decide to approve the proposed rates. Should the proposed rates be approved, staff recommends Council conduct the second reading of Ordinance No. 2019-16, amending the municipal code to remove the existing rates from NBMC Chapter 14.12 and include them in the City's Master Fee Schedule or successor named document (currently, the Schedule of Rents, Fines and Fees).

A redlined version of the NBMC amendment showing the existing Chapter 14.12. (Attachment A) and a final, clean version of Chapter 14.12 (Attachment B) are attached for Council's review. In addition to the second reading of the ordinance, staff is presenting to Council Resolution No. 2019-103, adopting the water rates consistent with the Raftelis study. If the new water rates are approved, and the Ordinance and Resolution updating the City's water rates and charges amounts are adopted, the new water rates would become effective on January 1, 2020 and for every year thereafter with the final adjustment occurring on January 1, 2024

ENVIRONMENTAL REVIEW:

Staff recommends the City Council find this action is not subject to the California Environmental Quality Act (CEQA) pursuant to Sections 15060(c)(2) (the activity will not result in a direct or reasonably foreseeable indirect physical change in the environment) and 15060(c)(3) (the activity is not a project as defined in Section 15378) of the CEQA Guidelines, California Code of Regulations, Title 14, Chapter 3, because it has no potential for resulting in physical change to the environment, directly or indirectly.

NOTICING:

The agenda item has been noticed according to the Brown Act (72 hours in advance of the meeting at which the City Council considers the item).

Notice of this hearing was published in the Daily Pilot at least 10 days before the scheduled meeting, consistent with the provisions of the Municipal Code. The City mailed 27,324 (detailed and color copied) public hearing notices to all affected Newport Beach property owners and water customers. Utilities Department staff presented information regarding water rates at recent town hall, community association, and community group meetings. In addition to the Finance Committee and City Council meetings, staff also made formal presentations to the Chamber of Commerce and to the City's Water Quality/Coastal Tidelands Committee. The Water Rate Study has been posted on the City's webpage since August 29, 2019. A detailed webpage with chronology of the report and presentations is posted on the City's water rates webpage.

ATTACHMENTS:

- Attachment A – NBMC Chapter 14.12 (redline)
- Attachment B – Ordinance No. 2019-16
- Attachment C – Resolution No. 2019-103
- Attachment D – Presentation