



CITY OF

NEWPORT BEACH

City Council Staff Report

September 24, 2019
Agenda Item No. 22

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

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TITLE: Approval of 2019 Water Rate Study and Setting of Public Hearing
for Water Rates

ABSTRACT:

Following the support of the Finance Committee, City Council conducted a study session on August 13, 2019 regarding the 2019 Water Rate Study. 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 increased Capital Improvement Program to rehabilitate and maintain our water infrastructure for the long term. City Council is asked to approve the Study and set a Public Hearing for November 19, 2019, and authorize noticing to Newport Beach property owners and water customers in compliance with State Law.

RECOMMENDATION:

- a) 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;
- b) Approve the 2019 Water Rate Study;
- c) Direct staff to send a notice of proposed water rates to property owners and customers in compliance with Proposition 218 State Law; and
- d) Set the date of November 19, 2019 for the tabulation of protests and conduct a public hearing of proposed rates pending the results of the protest.

FUNDING REQUIREMENTS:

The current adopted budget includes sufficient funding for completion of this 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 estimated at \$15,000. As currently budgeted, the Water Enterprise Fund is now operating at a structural deficit, drawing down on net working capital reserves.

If water rate increases are approved, rates would be adjusted and generally increase 7.4% each year for 5 years, starting in January of 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.

DISCUSSION:

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 have also increased since 2014.
- 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 projects 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 rate payers through the Municipal Services bill.

There are four main expenditure categories of the water enterprise that 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, repair 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.

Rate Study Background:

Over the last 9 months, City Council has been presented with a variety of information regarding the water system including presentations from staff and from the Orange County Water District (groundwater basin), Capital Improvement Projects, and the 2019 Water Master Plan. On March 12, 2019, City Council approved an agreement to retain the consulting services of Raftelis Financial Consultants Inc., to prepare the 2019 Water Rate Study. 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. On August 13, 2019, City Council held a study session to review the water rate 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 has been 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.

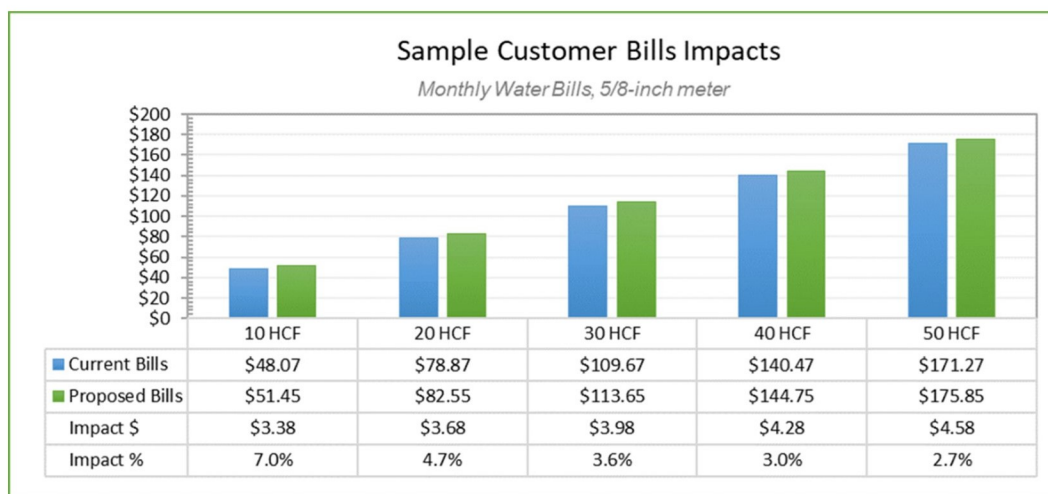
Financials, Rate Structure and Rate Increase:

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. The rate study looked at each of these charges, their proportionality and recommended structured rate levels consistent with industry standard, in order to fairly and equitably recover the cost of providing water to our customers. 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 the table below 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 5 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).

Proposed 5-year (Potable) Water Rates:

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Proposed Revenue Adjustments		7.40%	7.40%	7.40%	7.40%	7.40%
	Current Rates	Proposed	Proposed	Proposed	Proposed	Proposed
Water Services						
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. As seen in the table below, especially for the larger meter sizes, rates have been increased and adjusted to be compliant with industry "Proportionality" standards, ensuring compliance with Proposition 218. Simply put, the larger the pipe connection, the larger the burden on the system to meet peak demands. Proportionality is further explained in Section 6 of the Water Rate Study. 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 below:

Proposed 5-year Fire Protection Service Water Rates:

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Proposed Revenue Adjustments		7.40%	7.40%	7.40%	7.40%	7.40%
	Current Rates	Proposed	Proposed	Proposed	Proposed	Proposed
Fire Protection Services						
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. Proportionality standards also apply to these recycled meters and in this case, the fixed rates are adjusted and reduced. 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 below:

Proposed 5-year Recycled Water Rates:

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Proposed Rev Adjustments		7.40%	7.40%	7.40%	7.40%	7.40%
RW Services	Current Rates	Proposed	Proposed	Proposed	Proposed	Proposed
Meter Size						
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

Next Steps and Proposition 218 Requirements:

Upon incorporation of the City Council's recommendations and direction to send Proposition 218 notices, pursuant to California Constitution Article XIII D, Section 6, staff will prepare and send notices to all property owners (and as a courtesy to all customers, i.e. tenants) that receive water service from the City. There will be a 45-day public notice period at which time, property owners and customers may send written protests for consideration by the City Council. Protests from property owners will be tallied at the public hearing tentatively set for November 19, 2019. Notwithstanding a majority protest, City Council can consider verbal testimony from anyone and written protests from non-property owners and decide to approve the rates.

At the November 19, 2019 City Council meeting, staff will present an ordinance change removing the existing rates from the Municipal Code and propose a resolution amending the Master Fee schedule to include the new rates. If the rates are approved, and the ordinance and amended fee schedule adopted, the proposed water rates would become effective on January 1, 2020 and for every year thereafter with the final water adjustment occurring 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).

ATTACHMENT:

Attachment A – 2019 Water Rate Study