



## City of Sierra Madre Agenda Report

*Gene Goss, Mayor*  
*Rachelle Arizmendi, Mayor Pro Tem*  
*John Capoccia, Council Member*  
*Denise Delmar, Council Member*  
*John Harabedian, Council Member*

*Melinda Carrillo, City Clerk*  
*Michael Amerio, City Treasurer*

TO: Honorable Mayor Goss and Members of the City Council

FROM: Elaine I. Aguilar, City Manager 

INITIATED BY: Jose Reynoso, Deputy Director of Public Works   
Marcie Medina, Finance Director 

DATE: January 24, 2017

**SUBJECT: DISCUSSION OF A POTENTIAL CITY UTILITY WATER RATE STUDY**

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### **SUMMARY**

For a number of reasons, including increased conservation, water utility revenues have not kept pace with water expenses under the current rate structure adopted in 2014. The Water utility's financial picture is presented beginning on the next page of this staff report, along with further explanation of why the 2014 rate study did not meet the anticipated projections. The water utility is projected to run a deficit "Change in Net Position" as shown on page 3.

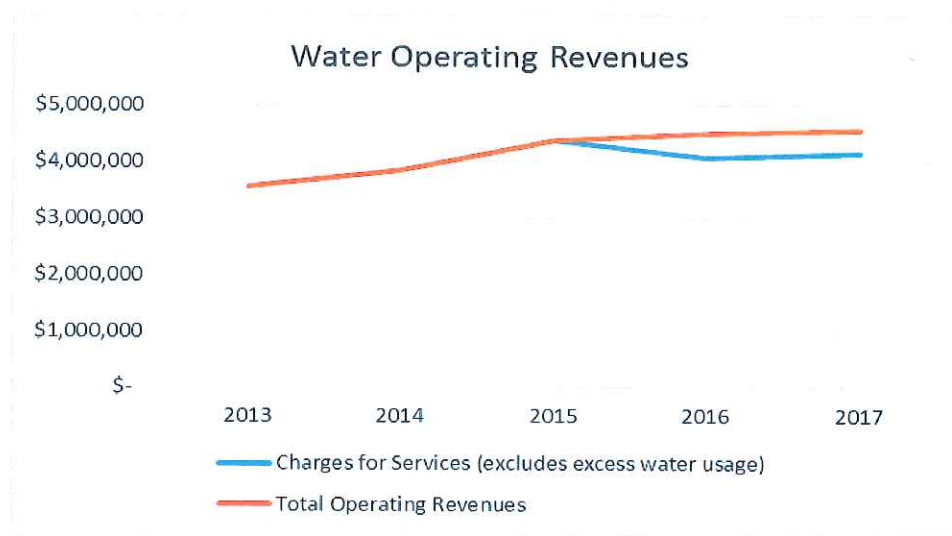
Staff is seeking direction from the City Council as to: 1.) Whether or not staff should initiate the rate study process by issuing a professional services Request for Proposal for preparation of a new rate Study, and 2.) If so, staff would need specific direction regarding the Scope of Services, in particular the rate structure.

This item is on tonight's agenda so that the Council can begin considering the various policy decisions necessary to initiate a new rate study.

### **FINANCIAL REVIEW**

The 2014 rate study covered a five year period of time, through Fiscal Year 2017/2018. (Rate increases in FY2014, FY2015, FY2016, FY2017, and FY2018.) There is one additional year left on the current rate study, with one additional rate increase (4%) to occur in July 2017. Staff is seeking direction now, because the financial trend is not positive, and because it takes a year or more to complete a new study, to provide adequate informational opportunities for the public, to conduct the Proposition 218 process, and for the City Council to approve new rates. It could take an even longer period of time if a different rate structure is desired. (The City's current rate structure is "Tiered Rates." This was a newly adopted rate structure in FY 2014.)

Both revenues, and expenditures have not met the projections included in the current rate study. Water revenues have not met the water rate study projections due to the increased rate of mandatory water conservation. The revenue trends used for the study were based on actual FY2012 data. The trend did not take into account the State mandatory conservation requirements. At the time of the study, the city had a 10% conservation goal, which was ultimately increased to 30% mandatory conservation. Revenues have increased since the FY2014 Rate Study, which was effective starting March 1, 2014. The revenue increases since FY 2015, are primarily attributed to excess use penalties and not to the water rates.



The table on the next page illustrates the Water Fund Trends. While operating revenues have increased on average over 6% over the last five years, operating expenditures have increased at the same rate. The main increase being the purchase of water, in the amount of over \$500,000 a year starting on FY 2015.

Water Rate Study  
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	Actual 2013	Actual 2014	Actual 2015	Actual 2016	Budget 2017
Operating revenues:					
Charges for Services	\$ 3,558,161	\$ 3,834,017	\$ 4,373,849	\$ 4,068,080	\$ 4,148,100
Excess Water Charge	-	-	-	430,646	400,000
Total operating revenues	<u>3,558,161</u>	<u>3,834,017</u>	<u>4,373,849</u>	<u>4,498,726</u>	<u>4,548,100</u>
Operating expenses:					
Personnel services	700,686	669,678	683,350	924,572	696,800
Utility Billing	113,347	169,806	142,885	161,898	138,300
Contractual services	274,258	303,026	287,123	218,861	334,600
Materials and supplies	173,612	113,384	167,360	135,780	269,000
Purchased water	-	-	518,791	581,086	544,900
Utilities	460,491	409,499	352,834	391,301	599,500
Maintenance and operation	392,381	71,250	541,480	77,258	90,000
Cost Allocations	810,396	795,896	863,859	849,779	1,037,300
Depreciation	552,115	551,520	563,938	603,971	564,000
Total operating expenses	<u>3,477,286</u>	<u>3,084,059</u>	<u>4,121,620</u>	<u>3,944,506</u>	<u>4,274,400</u>
Operating income (loss)	80,875	749,958	252,229	554,220	273,700
Nonoperating revenues (expenses):					
Grant	316,930	258,882	242,500	46,234	70,000
Investment Income	-	4,488	4,270	7,673	-
Other Income/Expense	(25,620)	12,685	-	-	-
Loss on disposal of property	-	-	(52,749)	(26,712)	-
Interest expense	(477,178)	(458,033)	(438,012)	(417,072)	(399,900)
Total nonoperating revenues (exp)	<u>(185,868)</u>	<u>(181,978)</u>	<u>(243,991)</u>	<u>(389,877)</u>	<u>(329,900)</u>
Transfers in	-	-	13,772	16,020	14,000
Change in net position	<u>\$ (104,993)</u>	<u>\$ 567,980</u>	<u>\$ 22,010</u>	<u>\$ 180,363</u>	<u>\$ (42,200)</u>

Items not affecting the Income Statement, impact the Balance Sheet & Cashflows:

Debt Service - Principal	\$ 370,000	\$ 390,000	\$ 405,000	\$ 425,000	\$ 450,000
Capital Assets - Capitalized	\$ -	\$ 593,900	\$ 540,019	\$ 295,855	\$ 810,500

The Water Department has worked within its budget for all routine operational costs and has been successful in reducing in some areas. However, a State mandatory conservation requirement, high expense items such as the increased cost to purchase imported water, and the emergency replacement of water mains on Skyland Dr. and Michillinda Ave have impacted the Water Fund. Furthermore portions of the City's water infrastructure have exceeded their expected useful life and in their current condition are far more fragile. These areas are prone to frequent leaks. In fact in 2016 the Water Department repaired over 400 water leaks throughout the distribution system.

At present time, the City's Water Enterprise is not meeting reserve level targets set with the FY 2014 Rate Study. The Operating Reserve should be at \$986,000 and the Capital Reserve at \$604,000, for a total reserve target level of over \$1.5 million. However, the current total reserve is about \$415,000. The current Water Fund revenues provide adequate revenues to fund current operations and meet the debt reserve requirement of 125%, but does not provide for adequate reserves for ongoing operations and capital needs. The policy goal of reaching \$3 million in reserves by FYE 2018 is not attainable with the current funding levels.

### **ANALYSIS**

If the City Council decides that a new water rate study should be initiated, it is important that a Scope of Work be provided to the professional firms preparing proposals for the City. The level of analysis, the number of public meetings to attend, the number of rate options to consider, and other factors will have a direct bearing on the number of hours the respondents to a Request for Proposals will have to devote to the project. For that reason, staff is seeking City Council direction as to any particular rate structure options to be considered. It is acknowledged that rates will reflect projected capital improvement projects to some degree, and that the Council will soon be receiving a Water Infrastructure Strategic Plan. It is too early to provide specific direction regarding the finances needed for future capital improvement projects, but those amounts will be available in adequate time to include them in the rate study. A decision regarding capital projects can be made at a later date, as the study progresses.

Staff typically provides its proposal evaluation criteria in its RFP's. Therefore, it would be helpful for staff to know if there are any specific qualifications that the City Council would like staff to evaluate applicants on so that those qualifications can be listed in the RFP. For example, if the Council decides on a different rate structure, how important is it for the consultant to have implemented a similar rate structure.

### **ALTERNATIVES**

- 1.) The City Council may direct staff to prepare a Request for Proposals seeking professional services to assist the City in deciding on a new rate structure and for the preparation of a water rate study. The Council may further direct staff to include in the proposed Scope of Services any or all of the following items of work:
  - a. Include in expenses covered under the water rate, all operational expenses, including capital costs, and the costs to purchase water from SGVMWD.
  - b. Analyze multiple rate structures and provide recommendations to the City Council regarding the advantages and disadvantages of each:

#### **Customer Water-Budget-Based Rates**

Some water agencies have adopted water-budget-based rates. In this type of structure, each water customer is provided a water

budget. That budget is comprised of an indoor use location based on the number of occupants and an outdoor allocation based on the landscaped area of the customer's property. This water budget becomes the customer's base rate. Water consumption above that budgeted amount is billed at increasingly higher rates depending on the amount of exceedance.

#### Customer Water-Budget Based Rates, with "Pass Through Provisions"

This is a combination of water-budget based rates, with the items discussed in the "Pass Through" section below. Pass Through charges could be direct charges on customer bills for items such as purchased water, capital improvements, debt, etc.

#### Tiered Rates

Sierra Madre currently has a tiered water rate structure in place. Initiating greater differences between tier rates would better encourage conservation. Sierra Madre also currently has a combination rate. See "Combination Rate" below.

#### Rates with "Pass Through" Provision

The current tiered rate could be modified to include a 2 tier structure with a "Pass Through" second tier. Under this structure each account could receive an equal share of the current pumping allocation and the cost to produce, treat and distribute the base allocation. Additional water would be imported and charged at Tier 2 which would include all cost associated with the purchase and distribution imported water. This would allow for a pay as you go approach to importing water. In addition the Pass Through provision could include an adjustment to Tier 1 should the State make changes to mandatory conservation. Other water expenses could also be separated out of the rate and passed through to the customer, within the ability of the billing software to do so. For example, current bond payment costs, increased energy cost or an annual allocation for capital improvements might be added to the billing document, much as Edison does in breaking down its various charges to its customers.

#### Flat Rate based on water units consumed

Some agencies bill water consumption solely on the amount of water consumed. Under this structure, the rate must be set high enough to allow for coverage of system/operational costs as conservation increases.

Combination rate

The current Sierra Madre water rate structure is a combination structure. There is a flat rate charge for each account, the meter charge. There is also a tiered consumption charge based on the amount of water consumed.

- 2.) Similar to option # 1, the City Council may direct staff to prepare a Request for Proposals seeking professional services for the preparation of a water rate study. (This option requires the City Council to decide upon a specific rate structure, and does not ask the consultant to provide the pros and cons of various alternatives.) The Council would need to provide direction similar to the items under option #1.
- 3.) The City Council may direct staff to return with additional information at a future Council meeting.
- 4.) The City Council may select to take no action at this time.

It should be noted that rate studies for “flat rate structures” are the least expensive, while more complicated rate structures, such as “water-budget based rates” are more expensive. The last time the City undertook a rate study, the cost for a water-budget rate study was approximately double the cost of a flat rate structure study. The cost of the study can range from approximately \$35,000 to \$75,000.

**PUBLIC NOTICE PROCESS**

This item has been noticed through the regular agenda notification process. Copies of this report are available at the City Hall public counter and the Sierra Madre Public Library.

**STAFF RECOMMENDATION**

Staff recommends that the City Council provides staff with direction regarding the preparation of a water rate study.