



# CITY COUNCIL STAFF REPORT



April 26, 2022

## ITEM TITLE

Sewer Rates: Consider Increase to Sewer Rates and Resolution Adopting Sewer Rate Increases and Approving Other Sewer Rate Study Recommendations

**Report Number:** 22-0007

**Location:** No specific geographic location

**Department:** Engineering

**Environmental Notice:** The activity is not a “Project” as defined under Section 15378 of the California Environmental Quality Act State Guidelines; therefore, pursuant to State Guidelines Section 15060(c)(3) no environmental review is required.

## Recommended Action

Adopt a resolution: (1) accepting the Sewer Rate Study (Study); (2) approving the Study’s recommendations for fiscal years 2021/22 through 2025/26; (3) adopting increased sewer rates and approving amendments to the Master Fee Schedule; (4) authorizing the pass-through of all future fees and charges imposed for wholesale charges for sewage treatment or wastewater treatment; (5) approving amendments to City Council Policy 220-04; (6) authorizing an increase to the service charge revenue allocations to the Sewerage Facilities Replacement Fund; and (7) appropriating 6 million dollars from the Trunk Sewer Capital Fund to the Sewer Service Revenue Fund to fund Metro capital expenses. **(4/5ths vote required)**

## SUMMARY

The City completed a comprehensive review of its sewer rates, conducted on behalf of the City by Willdan Financial Services (Willdan). The purpose of the review was to ensure that sewer rates will continue to provide adequate funding for the cost of wastewater treatment services outsourced to the City of San Diego’s Metropolitan Wastewater Sewerage System (Metro), the cost of operating and maintaining the city’s sewer collection system, investment in the infrastructure needed to provide the service consistent with applicable federal, state, and local laws, and ensure adequate reserves.

The independent financial consultant, Willdan, prepared the 2021 “Sewer Cost of Service Rate Study” (Study) after reviewing the current and projected sewer expenses and revenues. The purpose of the review was to develop a 10-year financial plan with the focus on the first 5-years, identifying the revenues and other

adjustments required to meet the costs of operating and maintaining an adequate sewer system and generate sufficient revenue for the systems objectives. The specific Study recommendations include the following: (1) increasing sewer rates to fund the costs of service; (2) implementing pass through rate adjustments for the expenses from City of San Diego Metropolitan Wastewater (Metro); (3) rescinding the US EPA Permit Renewal Liability Reserve (Permit Reserve) category; (4) increasing the service charge revenue allocations to the Sewerage Facilities Replacement Fund; and (5) allocating \$6 million from the Trunk Sewer Capital Fund for payment of a portion of the Metro capital expenses in FY2022/23. The proposed amended Master Fee Schedule Chapter 12-200 and Policy 220-04 updates are also recommended for approval.

### **ENVIRONMENTAL REVIEW**

The Director of Development Services has reviewed the proposed activity for compliance with the California Environmental Quality Act (CEQA) and has determined that the activity is not a “Project” as defined under Section 15378 of the State CEQA Guidelines because it will not result in a physical change in the environment; therefore, pursuant to Section 15060(c)(3) of the State CEQA Guidelines, the activity is not subject to CEQA. Thus, no environmental review is required.

### **BOARD/COMMISSION/COMMITTEE RECOMMENDATION**

Not applicable.

### **DISCUSSION**

#### **BACKGROUND**

The City provides sewer service to about 50,000 residential and commercial customers. Monthly sewer rates charged to system users (customers) are the primary source of revenue to operate and maintain the sewer system and are used for this purpose. Sewer rate revenue provides funding for operation and maintenance of the City-owned sewer collection and conveyance facilities, capital projects, debt service, administration, as well as costs related to prudent long-term operation and financial management of the utility system, such as maintaining adequate reserves and planning for contingencies. Since the City does not operate its own wastewater treatment facilities, sewer rate revenue is used to pay for wastewater treatment provided by the City of San Diego Metropolitan Wastewater Authority (Metro).

The City provides wastewater services as a self-supporting utility enterprise. The revenue generated by the collection of sewer fees is solely used to cover sewer related expenses, including the cost of operating and maintaining the wastewater infrastructure (sewer pipelines, maintenance holes, pump stations, etc.) owned by the City, charges for wastewater treatment services outsourced to Metro, the cost of system improvement projects and the administrative costs such as billing services. As described in more detail in this report several recommendations are proposed for the 5-year Study period (FY2021/22-FY2025/26) to address the regional system expenses, aging infrastructure, and increases in overall expenses. These recommendations include the following: (1) increasing the sewer rates to fund the costs of service; (2) implementing pass through rate adjustments for the expenses from City of San Diego Metropolitan Wastewater (Metro); (3) rescinding the US EPA Permit Renewal Liability Reserve (Permit Reserve) category; (4) increasing the service charge revenue allocations to the Sewerage Facilities Replacement Fund; and (5) allocating \$6 million from the Trunk Sewer Capital Fund to the Sewer Service Revenue Fund for payment of a portion of the Metro

capital expenses in FY2022/23. An update to the Master Fee Schedule Chapter 12-200 and City Council Policy 220-04 are also recommended for approval.

Ordinance 3155 allows the existing sewer rate to remain unchanged if fiscally prudent. After staff evaluated the enterprise funds and revenues, sewer rates have remained unchanged since July 1, 2018. As outlined in more detail below, staff now recommends implementing increases to the City’s sewer rates in accordance with the Study’s recommendations.

**BASIS OF SEWER RATE INCREASE**

In 2021, a financial rate study was completed by Willdan, an independent third-party financial consultant, to evaluate the financial condition of the sewer utility, specifically the ability of current sewer rates to generate sufficient revenue to cover the costs of the sewer utility. The proposed sewer rate increases are needed to fund the operation of the sewer utility, including costs to fund future capital expenditures, increased costs related to operations and maintenance and increasing payments for treatment costs from the City of San Diego’s Metro. In order to meet the projected costs identified in the Study, the proposed rate changes include zero change through June 30, 2022, followed by a rate increase of 4.5% starting July 1, 2022, an additional increase of 5% starting July 1, 2023, an additional increase of 5% starting July 1, 2024, and an additional increase of 5.5% starting July 1, 2025.

**SEWER SERVICE CHARGE**

The City’s Sewer Service Charge represents the ongoing charges to the sewer customers for use of the sewer. The Sewer Service Charge is structured around a **fixed service charge and a variable commodity charge**. The fixed service charge of the fee helps stabilize revenues from year to year, improving the utility’s ability to plan financially. The variable commodity charge of the rate is established based on volume of potable water usage with a rate of return component to account for water not returning to the sewer. Water usage is metered by the property’s water supplier.

The rate of return was established in a prior rate study for the City’s different customer classes. Subsequent rate studies provided reviews of the rate formulas and no recommendation has been made for rate of return adjustments. The rate of return is 90% for all customer classes except for multifamily. All multifamily potable water rate of return to sewer is assumed to be 79% except for mobile homes which are at 84%.

For the variable commodity charge, monthly usage along with the rate of return to the sewer is used. The City uses the winter average, or the average of the lowest two consecutive winter months (November through April), for single family residential customers to represent the monthly water consumption. This is a commonly used metric to represent indoor water usage in California.

The sewer billing equation used to calculate fees for single family residential customers is as follows:

$$\text{Fixed Service Charge} + \left( 90\% \text{ of Winter Avg Water Usage} \times \text{Volume Charge} \right) = \text{Sewer Service Charge}$$

The sewer service charge revenue goes into one of two sewer funds (1) Sewerage Facilities Replacement Fund – used for capital projects (rehabilitation and replacement of the sewer) and (2) Sewer Services

Revenue Fund – used mainly for the operations and maintenance of the system including the treatment of sewage by the City of San Diego.

Note that the storm drain fee is included in the bills with the sewer service charge, but is a separate fee which was not evaluated in this study. The details of the storm drain fee can be found in the City’s Master Fee Schedule. Additionally, there are other sewer revenues and sewer funds which were not evaluated in the Study because they are one-time fees (e.g. physically connecting to the system or the cost to purchase capacity in the system).

### **SEWER STUDY RECOMMENDATIONS**

In December of 2018, the City retained Willdan to prepare the “Sewer Cost of Service Rate Study” completed in July 2021 (Study) (Attachment A). The Study made several recommendations for revenue projections to meet the utility’s projected obligations during the next five fiscal years (FY2021/2022 to FY2025/2026). Additionally, the Study included projections over a ten-year period to provide for the continued fiscal health of the utility. Before reviewing each recommendation, the Study evaluated the ability of the current revenues to meet projected expenses.

The Study identified an annual deficit of \$6 to \$9 million and that the fund balance decrease would not meet the minimum reserve targets required.

The Study proposes the following recommendations to meet projected expenses and reserve targets while stabilizing rates:

1. Increase the sewer rates to adequately fund the costs of service
2. Implement pass through rate adjustments for the expenses from City of San Diego Metropolitan Wastewater (Metro)
3. Rescind the US EPA Permit Renewal Liability Reserve (Permit Reserve) category
4. Increase the service charge revenue allocations to the Sewerage Facilities Replacement Fund
5. Allocation of \$6 million from the Trunk Sewer Capital Fund to the Sewer Service Revenue Fund for payment of a portion of the Metro capital expenses in FY2022/23

#### **Increase the Sewer Service Charge (Sewer Rates)**

The costs to provide sewer service have increased due to several factors including higher energy, construction, material, and labor costs. As such, additional revenue is required from the sewer service charges and the Study proposes the increases necessary to adequately cover the increased costs to be 4.5% to 5.5% per year starting July 1, 2022. The proposed increases are included Table 2 (Study Table 4-7).

Table 2. CURRENT AND PROPOSED SEWER RATES FY2020/21 TO FY 2025/26 (Study Table 4-7)

<b>Table 4-7 Proposed Rates Fiscal Years Ending June 30</b>						
Meter Size	\$/Month					
	20-21	21-22	22-23	23-24	24-25	25-26
<b>Monthly Fixed Service Charge</b>						
Single Family	\$14.53	\$14.53	\$15.18	\$15.94	\$16.74	\$17.66
<b>All Others</b>						
5/8-inch	14.53	14.53	15.18	15.94	16.74	17.66
¾-inch	14.53	14.53	15.18	15.94	16.74	17.66
1-inch	28.49	28.49	29.77	31.26	32.82	34.63
1 ½-inch	51.77	51.77	54.10	56.80	59.64	62.93
2-inch	79.68	79.68	83.27	87.43	91.80	96.85
3-inch	154.15	154.15	161.08	169.14	177.59	187.36
4-inch	237.91	237.91	248.62	261.05	274.10	289.17
6-inch	470.61	470.61	491.79	516.38	542.20	572.02
8-inch	936.01	936.01	978.13	1,027.04	1,078.39	1,137.70
<b>Volume Charge \$/HCF <sup>(1)</sup></b>						
<b>Residential</b>						
Single Family	\$4.26	\$4.26	\$4.45	\$4.67	\$4.91	\$5.18
Multi-Family	4.26	4.26	4.45	4.67	4.91	5.18
Mobile Homes	4.26	4.26	4.45	4.67	4.91	5.18
<b>Non-Residential</b>						
Commercial - Low	4.26	4.26	4.45	4.67	4.91	5.18
Commercial – Med	6.02	6.02	6.29	6.61	6.94	7.32
Commercial – High	9.59	9.59	10.02	10.52	11.05	11.66
Special Users	Varies	Varies	Varies	Varies	Varies	Varies
(1) HCF – Hundred Cubic Feet						
Note – Rate include the Sewer Service Charge and Sewer Facilities Replacement Fee. The rates do not include the Storm Drain Fee.						

*Metro Cost Pass Through or Direct Cost Recovery*

The final proposed recommendation is to implement a Metro Pass Through or Direct Cost Recovery for the City of San Diego Metro Costs. The reason for the direct recovery is to ensure that actual costs are reflected more accurately and timely in the sewer rates. In prior rate studies, City of San Diego expenses were projected and set for the entire rate study period (up to 5-years). The proposed recommendation for direct cost recovery allows for annual adjustments for the City of San Diego actual billings. Each year the actual City of San Diego billing costs will be compared with the projected costs included in the rate study.

Differences will be reflected in a rate adjustment the following year. This ensures that rates remain smooth, reducing large spikes at the end of the rate period in 2026. Most of the sewer utilities using the Metro facilities have already adopted this approach which is commonly referred to as a pass through. Customers will be noticed at least 30 days prior to the changes.

### Removal of the Permit Reserve

The Permit Reserve Category was established on December 17, 2013, by City Council Resolution No. 2013-265, approving Policy 220-04, to ensure adequate monies would be available to fund the anticipated capital needs by Metro associated with maintaining the Point Loma Wastewater Treatment Plant (PLWWTP). At the time the reserve was established, Metro's PLWWTP permit waiver was being considered for renewal. If denied, Metro would need to develop and implement improvements to achieve secondary treatment level at PLWWTP.

If the waiver was not granted, the estimated costs of adding secondary level treatment was expected to be over \$1 billion in capital costs (2013 preliminary estimate). Of this, Chula Vista would be responsible for about 10%. In addition, the timing for when Chula Vista's share of their capital costs would be required by Metro was still uncertain. By actively establishing a reserve and planning for the upgrades to the regional treatment plant or alternative, Chula Vista would be in a stronger financial position to afford such costs while mitigating impacts to rate payers.

In the time since this reserve was established, the capital improvements need for the PLWWTP permit waiver have been identified and cost sharing established. Additionally, the City of San Diego provided five-year projections for the City's anticipated contributions. The City of San Diego's annual five-year cost projections eliminates the need for the City to maintain a large cash reserve on hand.

For the Rate Study and proposed rate increases, the City's share of the Metro upgrade costs is included. Another reason for eliminating the reserve category is that the Study's proposed recommendations include pass-through rate adjustments to account for fluctuations in Metro Costs. The pass through rate adjustments are described in more detail later in this report.

Adoption of the resolution would also approve changes to City Council Policy Number 220-04, Sewer Service Revenue Fund Reserve Policy to remove the Permit Reserve category. The proposed changes to the policy can be found in Attachment B.

## 2. Increase Allocations to the Sewerage Facilities Replacement Fund

The Study recommended that annual revenues into the Sewerage Facilities Replacement (SFR) Fund equal annual depreciation to ensure monies would be available for the system's capital needs. The prior Study included an annual revenue target of about 50% of annual depreciation. The increase in allocation of revenue to the SFR Fund was recommended over a ten-year period to maintain rate stability. An adequately funded repair, rehabilitation and replacement program helps to ensure a well-functioning, more reliable system with minimal costly unanticipated major repairs. The recommended allocation is shown in Table 1.

Table 1. Fund Allocation for Sewer Service Charge (Study Table 4-6)



Table 4-6 Fund Allocation for Sewer Service Charges Fiscal Years Ending June 30							
	Budget	Projected					
	19-20	20-21	21-22	22-23	23-24	24-25	25-26
Sewer Service Revenue Fund 414	96%	96%	95%	94%	93%	91%	90%
Sewerage Facility Replacement Fund 428	<u>4%</u>	<u>4%</u>	<u>5%</u>	<u>6%</u>	<u>7%</u>	<u>9%</u>	<u>10%</u>
Total	100%	100%	100%	100%	100%	100%	100%

### 3. Money from Trunk Sewer Capital Fund

The Trunk Sewer Capital Fund represents revenue from capacity fees; the cost for new customers to buy into the sewer system. Per Chula Vista Municipal Code 3.14.010, the Trunk Sewer Capital Fund can be used for enlargement of sewer facilities and planning of area-wide sewage treatment and/or reclamation systems or facilities. With City Council approval, the money can be used for construction of sewage collection or treatment facilities. The cash balance of the Trunk Sewer Capital Fund as of June 30, 2020 was \$64.8 million. The Study recommended that \$6 million be used from the Trunk Sewer Capital Fund to pay for the capital project expenses during the Study Period to offset the amount used from the Sewer Service Revenue Fund. Staff is recommending that the \$6 million be used the first year of the rate approval, FY 2022/23. Authorization of the use of the \$6 million in FY2022/23 for the regional capital Metro expenses requires a 4/5ths vote by City Council.

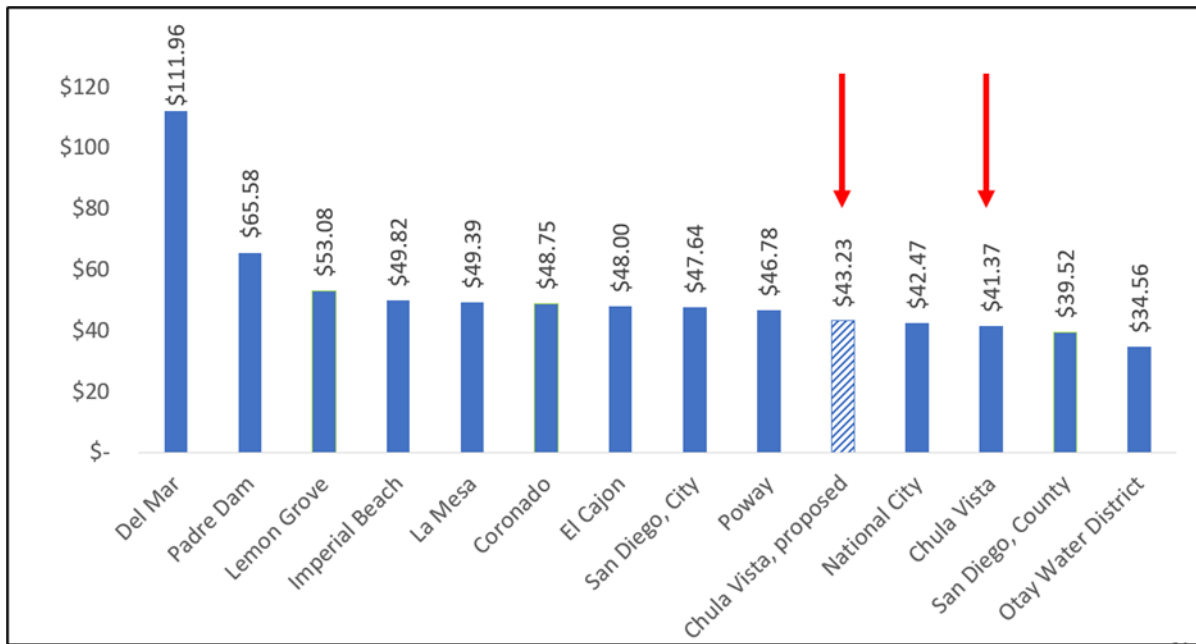
The use of the money from the Trunk Sewer Capital Fund meets the criteria of the fund use and is critical to ensuring the minimum reserve levels can be maintained.

### **REGIONAL RATE COMPARISON**

Chula Vista’s sewer rates remain some of the lowest in the region. While acknowledging that every agency’s cost for operating its wastewater collection system varies in accordance with its unique characteristics (size, age of system, etc.), Graph 1 compares the residential sewer bills from sewer utilities in the region. Shown are current rates for an average single-family sewer customer consuming 7 hundred cubic feet of water per month, for 2021. Both the current and proposed Chula Vista rates are included in the graph.

Customers can have some influence on their individual sewer bill by actively monitoring and conserving potable water usage. Residential customers with volume rates based on the winter average benefit from conserving during the winter months of November through April.

Graph 1. Regional Monthly Single-Family Residential Bill (Average Water Consumption, 7 HCF)



The graph was updated in September 2021. The proposed effective date for the proposed rate increases is July 1, 2022.

**IMPACT TO RATE PAYER**

The impact to the ratepayer would vary depending on their individual water consumption. The following is a sample bill calculation showing the actual dollar increase per year as the new rates are implemented. The sample calculation in Table 3 reflects three different customer classes (single family, multi-family, and commercial).

Table 3. SAMPLE SEWER CHARGES USING PROJECTED RATES

Average Sewer Monthly Bill	Meter Size [inches]	Water Usage [HCF]	FY 2021/22	FY 2022/23	FY 2023/24	FY 2024/25	FY 2025/26
			Existing	Proposed	Proposed	Proposed	Proposed
Rate of Increase			0%	4.50%	5%	5%	5.50%
Single Family Residence	N/A	7 HCF	\$ 41.37	\$ 43.22	\$ 45.36	\$ 47.67	\$ 50.29
SFR Increase				\$ 1.85	\$ 2.15	\$ 2.31	\$ 2.62
Multi-Family Residential*	1"	35 HCF	\$ 144.79	\$ 151.26	\$ 158.75	\$ 166.86	\$ 176.04
MFR Increase				\$ 6.47	\$ 7.50	\$ 8.11	\$ 9.18
Commercial (medium strength)	2"	70 HCF	\$ 458.94	\$ 479.54	\$ 503.86	\$ 529.02	\$ 558.01
Commercial Increase				\$ 20.60	\$ 24.32	\$ 25.16	\$ 28.99

\*Assumes multifamily is not a mobile home park.

**COMMUNITY OUTREACH**

Hard copy mailers. A formal Proposition 218 Notice of Public Hearing in both English and Spanish was mailed on November 22, 2021 to sewer customers based on billing record addresses. Notices went to both the service address and the owners addresses. The Sewer Rate Public Hearing date of February 8, 2022, noticed



in the November mailing was delayed after determining the use of owner addresses from County Tax Assessor Records is a more reliable means of reaching property owners.

A revised Proposition 218 Notice of Public Hearing was mailed using addresses from official County Tax Assessor Records. It was cross referenced with all the addresses in the initial mailing and both addresses from the Tax Assessor received a notice and addresses from the initial mailing received the second notice both. The mailing was sent February 10, 2022, which included 4 weeks to review and re-mail any undeliverable parcels, while ensuring the 45-day notice period would apply to re-mailing. Return mail received from the second mailing was reviewed and reasonable efforts were made to re-mail with a corrected address or forwarding address. Corrected and/or forwarded mail was sent out prior to March 11, 2022, more than 45 days prior to the Public Hearing on April 26, 2022. Copies of the first and second mailing are included in Attachment C. All notices were sent in both English and Spanish.

Informational Meetings. Public outreach meetings were held virtually on December 8 and 14, 2021, to ensure the safety of the public and staff. Details of the informational meetings were included in notices mailed on November 22, 2021, on the City's website ([www.chulavistaca.gov/SewerRates](http://www.chulavistaca.gov/SewerRates)) social media, and the City's calendar. The events were advertised in the Star News on December 10.

Website Presence. The City's website ([www.chulavistaca.gov/SewerRates](http://www.chulavistaca.gov/SewerRates)), which is available in over 100 different languages through a site toggle, was updated with:

1. Notices of the sewer rate increase in English and Spanish
2. Instructions on how to file a protest and sample protest forms
3. Public information event links
4. Frequently Asked Questions
5. Water conservation information

A copy of the website is included as Attachment D.

Newspaper. Information on the Sewer Rate increase and public outreach events in December was published in the December 10, 2021 Star News.

Social Media. Several social media information postings were offered regarding the sewer rate information events and Public Hearing.

## **REGULATORY COMPLIANCE**

The City's ability to increase sewer fees is governed by Proposition 218, which requires written notice of (i) the location, time and date of the public hearing; (ii) the amount of the proposed fee increase; and (iii) the reasons and basis for the proposed fee increase. The City provided written notice to the affected property owners and rate payers. The notice included information on the public outreach meetings, frequently asked questions, sample calculations and information on how to obtain assistance from City staff regarding questions related to the proposed increase. A copy of the notices for the February 8, 2022 Public Hearing and the April 26, 2022 Public Hearing are included in Attachment C.

Proposition 218 requires that the City hold a "majority protest" public hearing prior to implementing an increase. If written protests are submitted for a majority of the affected parcels, the rate increase shall not be implemented. The number of accounts served by the sewer system is 49,828 as of June 2021. Note that

sewer customer numbers only increase due to the City's requirements to connect to the sewer. Thus, under Proposition 218, a majority protest would exist if written protests were submitted by property owners or customers on behalf of at least 24,915 parcels (a simple majority).

Based on Ordinance 2736, delinquent sewer accounts may have a lien placed on their property to ensure the payment of the sewer bills. To ensure this remains an available option for delinquencies, the owners of the properties were provided with the Proposition 218 Notice in addition to billed customers. All property owners within the jurisdictional area of the City of Chula Vista were noticed using official San Diego County Tax Assessor addresses.

### **AMENDMENT OF MASTER FEE**

The City's existing sewer service charges are set forth in the City's Master Fee Schedule. As these sewer service charges are amended, the Master Fee Schedule 12-200 would be amended accordingly (Attachment E).

### **AMENDMENT OF POLICY 220-04 SEWER SERVICE REVENUE FUND RESERVE POLICY**

The City's reserve policy for the sewer service revenue fund is set forth in Policy 220-04. As the recommendation is to rescind the Permit Reserve category, Policy 220-04 would be amended accordingly (Attachment B).

### **DECISION-MAKER CONFLICT**

Staff has reviewed the decision contemplated by this action and has determined that it is not site-specific and consequently, the real property holdings of the City Council members do not create a disqualifying real property-related financial conflict of interest under the Political Reform Act (Cal. Gov't Code § 87100, et seq.).

Staff is not independently aware and has not been informed by any City Council member, of any other fact that may constitute a basis for a decision-maker conflict of interest in this matter.

### **CURRENT-YEAR FISCAL IMPACT**

There is no impact to the Sewer Fund in the current fiscal year (FY2021/22) as approval of this action will affect sewer rate revenues for FY2022/23 through FY2025/26.

### **ONGOING FISCAL IMPACT**

The proposed rate increase is crucial to the City's ability to operate and maintain the City's wastewater collection system in a manner that continues the current high level of service. Approval of this action will increase sewer rate revenues for FY2022/23 through FY2025/26 to ensure sewer expenses are covered and reserves met.

### **ATTACHMENTS**

Attachment A – Sewer Cost of Service Rate Study 2021

Attachment B – Proposed Revisions Policy 220-04 Sewer Service Revenue Fund Reserve Policy

Attachment C - Proposition 218 Notices

Attachment D – Website Posting

Attachment E – Proposed Revisions Master Fee Schedule

*Staff Contact: William Valle, Director of Engineering and Capital Projects/City Engineer & Beth Gentry, Sr. Civil Engineer*