



DATE: June 1, 2021

TO: Mayor and City Council

FROM: Director of Public Works

SUBJECT FY22 and FY23 Water and Sewer Rates: Review and Provide Feedback on Recommended FY 2022 and FY 2023 Water and Sewer Rates

RECOMMENDATION

That Council reviews and comments on this report.

SUMMARY

Cost-of-service analyses have been prepared for providing water and sewer service to Hayward residents and businesses to calculate appropriate water and sewer rates and service charges for FY 2022 and FY 2023. This report provides an overview of cost-of-service issues, revenue requirements, and recommended FY 2022 and FY 2023 water and sewer service rates. Staff prepared the sewer cost-of-service analysis and recommended rates. The water analysis was prepared by Raftelis Financial Consultants, Inc., a consulting firm that specializes in financial advising for utilities and public agencies. Staff is bringing the proposed rates to Council to obtain comments. After receiving and addressing Council's comments, staff will implement appropriate and necessary public noticing procedures in accordance with state law prior to a public hearing, currently scheduled for July 20, 2021. The approved rate adjustments would take effect on October 1, 2021 and 2022.

The Water Rate Study prepared by Raftelis documents the City's water revenue requirements for FYs 2022 and 2023, as well as customer demand patterns and rate equity. For FY 2022, revenue requirements will be unchanged. The recommended water rates for FY 2022 incorporate the results of the cost-of-service analysis and include adjustments to bi-monthly fixed service fees, along with modifications to tier rates to reflect new customer usage and improve equity. The recommended water rate structure would result in an overall 1.2% increase for average residential water users in FY 2022. Commercial and industrial entities could see modest increases, and in some cases, small decreases in water fees. The revenue requirements for FY 2023 increase by 3%, and corresponding water rate adjustments are proposed. The executive summary prepared by Raftelis, included as an attachment to this report, provides information regarding the proposed adjustments.

Staff is proposing increases of 3.8% in residential sewer rates in each of the two years, with non-residential increases between 3.5% to 3.8% per year. Industrial customers with very large volume and/or varying degrees of complexity in their wastewater discharge, would likewise see

increases between 3.5% to 3.8% per year. Staff is further proposing to delay implementation of the sewer rate adjustment for restaurants, given the significant impact of the COVID-19 pandemic on this commercial sector. The proposed rate adjustments will allow the City to keep pace with the cost of sewer service collection, treatment, and disposal, including capital costs.

Regarding water and sewer connection fees, which are the fees typically paid at the time a new development requests water or sewer service, staff is not recommending adjustments in the next two years in the interest of maintaining the economic recovery and fostering business development. Staff will perform a comprehensive review of connection fees in two years.

BACKGROUND

Water rates are established to pay for the costs of purchasing and delivering water to customers and are determined through an assessment of revenue requirements and anticipated water purchase volumes. Bi-monthly water bills consist of two parts: 1) the fixed service fee, which pays for services that do not vary with the volume of water purchased, such as meter maintenance, meter reading, bill processing, and debt service; and 2) the water usage fee, which pays for costs associated with water consumption, such as the purchase of water from the San Francisco Public Utilities Commission, City operations and maintenance, and energy related expenses. The Council approved water rate adjustments in July 2019 for FY 2020 and FY 2021, which included no changes to the water usage fee, and a modest increase to the fixed service fee. The fixed service fee was last adjusted in January 2021, when the bi-monthly fee for a 5/8" meter (the standard size in most single-family residential homes) increased from \$28 to \$32. Similar percent increases were implemented for other meter sizes (Note: the second increase was delayed from October 2020 in response to COVID-19).

Sewer service charges are established to pay for the cost of collecting, treating, and disposing of wastewater. Calculations follow the guidelines developed by the State Water Resources Control Board to ensure that sufficient revenues are collected to operate and maintain the system, cover all obligations of the Wastewater Operating Fund, and equitably distribute costs of providing service among customer classes. Sewer service charges are billed as standard fixed amounts for residential customers and as a cost per hundred cubic feet (ccf) of water consumed for non-residential customers, based on the strength of the discharged wastewater. The Council last adopted adjustments to sewer service rates two years ago, which resulted in a 4.4% increase in residential rates in FY 2020 and FY 2021, effective October 2019 and 2020, respectively.

Water and sewer connection fees are paid to connect a new development to the public water and sewer system, and are used to fund improvement and expansion of the water and sewer systems to accommodate the development and to defray the expenses paid by customers over the recent years for development and improvement of the systems. The fees also cover an incremental cost of future expansion and improvements necessary to accommodate new developments. The connection fees are developed using accepted procedures to ensure that costs are allocated fairly to new developments. Water connection fees were last adjusted in October 2015, with the

assessment methodology modified to distribute the cost of infrastructure improvements more equitably among new customers and commensurate with demand they place on the water system. Sewer connection fees have not been adjusted since October 2011.

DISCUSSION

Water Rates

The City entered into an agreement with Raftelis Financial Consultants Inc. to prepare a Water Rate Study, including development of a long-term financial plan, cost-of-service analysis, and rate recommendations consistent with industry standards and in compliance with Proposition 218.

The work consisted of four main tasks:

1. Developing a long-term financial plan that meets the water utility's revenue requirements, including operations and maintenance (O&M) expenses and the capital improvement plan (CIP), while adequately funding reserves in accordance with industry best practices and the City's historical practices.
2. Conducting a cost of service (COS) analysis that establishes a nexus between the cost to serve customers and the responsibility of each class, in compliance with Proposition 218 and based on industry standards.
3. Reviewing the current water rate structure and evaluating potential rate structure modifications, which include revising tier definitions, customer classes, and fixed and variable revenue recovery.
4. Developing five years of water rates that comply with Proposition 218 and ensuring financial sufficiency to fund operating and capital costs over the study period.

The executive summary for the Study, attached to this report, serves as a fuller discussion of proposed water rates for FY 2022 and FY 2023, and includes the current and proposed rates for the next two years (Attachment II). As a summary, no increases in the revenue requirement are anticipated in FY 2022. The cost-of-service analysis for this year indicates that revenue neutral adjustments to the fixed bimonthly service charges and the tiered water rates would be appropriate to harmonize the residential rate classes, better reflect usage patterns, and separate irrigation water use for non-residential users. As a result of these recommended changes, average residential users would see an overall increase of 1.2% in their water bills. Non-residential users could see similarly modest increases, or in some cases, decreases in their bills. The revenue requirement for FY 2023 is anticipated to increase by 3%. Thus, 3% rate adjustments are proposed for FY 2023.

Staff is also proposing to retain the low-income bi-monthly service fee for customers who meet certain income thresholds, a policy that has long been supported by the Council. Customers that qualify for this discount are charged a reduced bi-monthly water service charge, equal to 35% of the service charge for the 5/8" meter size. Revenues that are not generated from rates, e.g., revenue from water installation fees, are discretionary funds that the City may use to provide these discounts.

Sewer Service Charge

Staff is recommending increases in residential sewer rates in FY 2022 and FY 2023 of 3.8% in each year. The current monthly charge for a single-family residential property is \$35.81. The proposed increase would bring this charge to \$37.17, an increase of \$1.36, in FY 2022 and \$38.58, an increase of \$1.41, in FY 2023. The same percent increases are proposed for multi-family and mobile home community customers, as well as Lifeline and Economy customers. As a reminder, the reduced Lifeline and Economy rates are applied automatically to single-family residential bills when water usage in a billing period is 0-4 ccf or 5-8 ccf, respectively. These rates are intended to encourage water conservation and reward customers who use low amounts of water.

Non-residential customers would see increases over the two-year period between 3.5% and 3.8%, depending on the volume and strength of their wastewater discharge. Staff uses actual and anticipated sampling data to measure the impact of large industrial users and calculates appropriate rates based on their contribution to the wastewater system. Appropriate fees for other business customers, such as restaurants, are based on water consumption and standard waste strengths.

Factors Affecting Sewer Rates

Operating, Maintenance and Replacement Costs

The sewer service rate adjustments result primarily from the rising cost of providing wastewater collection, treatment, and disposal services. They are also designed to provide funding for planned required improvements to the sewer system primarily at the Water Pollution Control Facility. The total amount of revenue that must be recovered through sewer rates is about \$25,500,000. This total includes operational costs, debt service obligations, and capital replacement, and is an increase of about 2% over the costs on which the current sewer service rates are based. Staff anticipates that the proposed increases in each of the next two years will be sufficient to cover the additional expenses based on estimated costs through FY 2023.

Changes in Industrial Wastewater Discharge

A critical factor that affects sewer rates are ongoing reductions in the industrial wastewater strengths and volume, which have the effect of shifting more of the cost to other customers to achieve the overall revenue target. This is related to a shift from industrial manufacturing and food processing industries to more housing and commercial uses. A significant change in this regard was the closure of Berkeley Farms in 2020. Berkeley Farms was one of the largest wastewater dischargers in the City, in terms of volume with significant revenue to the wastewater enterprise; thus, the impact of its closing on other customer classes is noteworthy. Some other industries are discharging less wastewater due to water conservation or making changes to their pretreatment processes, such that the discharged wastewater has less waste strength. Since most of the sewer system costs related to operations and maintenance are relatively constant, the overall effect of these changes is that some additional costs were shifted to residential customers.

Proposed Sewer Service Charges

The following table summarizes current and proposed monthly residential sewer service fees.

Residential Monthly Sewer Service Fees (Per Dwelling Unit)

Customer	Current	Proposed FY 2022	Monthly Change	% Change	Proposed FY 2023	Monthly Change	% Change
Single Family	\$35.81	\$37.17	\$1.36	3.8%	\$38.58	\$1.41	3.8%
Multi-Family	\$31.87	\$33.08	\$1.21	3.8%	\$34.34	\$1.26	3.8%
Mobile Home	\$25.06	\$26.01	\$0.95	3.8%	\$27.01	\$0.99	3.8%
Economy	\$16.78	\$17.41	\$0.63	3.8%	\$18.07	\$0.66	3.8%
Lifeline	\$8.39	\$8.71	\$0.32	3.8%	\$9.04	\$0.33	3.8%

The table below summarizes current and proposed non-residential wastewater component costs, as well as examples of current and proposed rates for some common types of businesses.

Non-Residential Sewer Service Fees

Customer	Current	Proposed FY 2022	% Change	Proposed FY 2023	% Change
Volume (per ccf of water)	\$3.08518	\$3.20168	3.8%	\$3.32258	3.8%
Carbonaceous Biochemical Oxygen Demand (per pound)	\$0.72029	\$0.74430	3.3%	\$0.76912	3.3%
Suspended Solids (per pound)	\$0.96338	\$0.99791	3.6%	\$1.03367	3.6%

Impacts on Businesses

Commercial businesses, such as restaurants, office buildings, laundries and similar, would see increases in the range of 7.2 to 7.7% over the next two years. Examples of impacts on common businesses are illustrated in the table below.

Examples of Impacts on Non-Residential Customers

Customer Type (without separate irrigation)	Current Rate/ CCF of Water	Proposed FY 2022	% Change	Proposed FY 2023	% Change
Restaurants (no grease interceptor)	\$10.08	\$10.44	3.5%	\$10.81	3.5%
Bakeries	\$10.08	\$10.44	3.5%	\$10.81	3.5%
Commercial Laundry	\$5.90	\$6.11	3.5%	\$6.33	3.5%
Offices and Retail Stores	\$5.83	\$6.05	3.8%	\$6.28	3.8%

Sewer service charges for “Critical Users”, which are industrial customers who, due to the volume and/or strength of their discharge, are charged for sewer service based on their actual measured flow and strength, would increase by an average of 7.4%, with a range of 7.1% to 7.6%, over the next two years.

Deferral of Sewer Rate Increase for Restaurants

One of the business sectors hardest hit by COVID-19 restrictions were restaurants. Due to limited options for providing service, restaurants had a difficult time retaining customers, especially smaller, independently owned establishments. Even as businesses have opened up and are expected to be back to full “normal” operation by the fall given that dining out is discretionary for many people, and that it may take time for customers to feel comfortable about patronizing restaurants, returning to pre-pandemic levels of restaurant activity will take time. Staff recommends that the FY 2022 sewer rate adjustments for restaurants be deferred by a full year until October 1, 2023, at which time, the full two-year increase would go into effect.

Comparisons with other Wastewater Agencies

As shown in the table and chart below, the proposed FY 2022 rates would continue to place Hayward in the low range compared to other nearby agencies. It must be noted that unlike the overwhelming majority of other sewer agencies, the City not only provides a lower rate for multi-family and mobile home units, but also, in effect, offers tiered sewer rates known as “Economy” and “Lifetime” to all single-family customers, based on water usage. While we compare the City’s standard rate to the other agencies, the overall average payment by all customers in the City is always less than the top rate.

Comparison of Current and Proposed Single-Family Sewer Service Fees	
Agency	Monthly Single-Family Sewer Service Fee
City of Oakland (1)	
Collection (Oakland) – \$42.03	\$69.01
Treatment (EBMUD) – \$26.98	
Union Sanitary District (2)	\$40.91
Dublin San Ramon Services District (2)	\$40.50
City of San Leandro (3)	\$38.80
Castro Valley Sanitary District (3)	\$38.17
City of Hayward (Proposed)	\$37.17
City of Hayward (Current)	\$35.81
Oro Loma Sanitary District* (1)	\$26.50

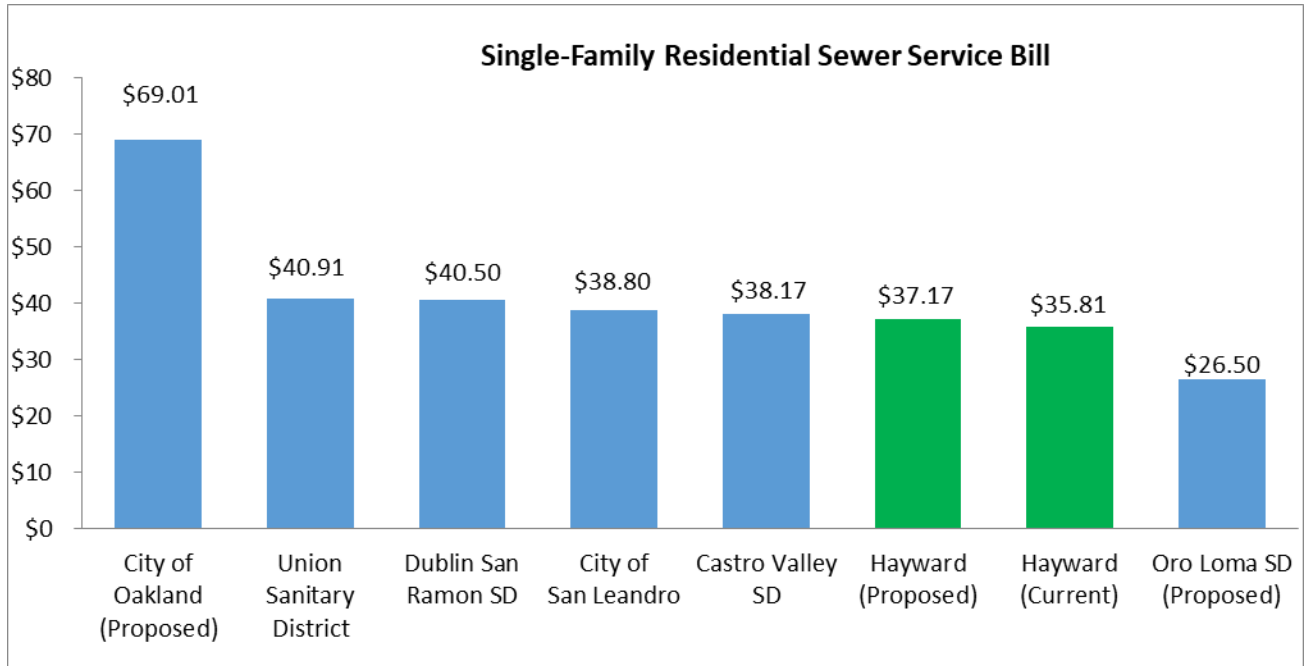
**Oro Loma SD also receives a lump sum payment from Castro Valley Sanitary District*

(1) Proposed rates. Will be effective July 1, 2021 if adopted.

(2) Adopted rates effective July 1, 2021

(3) Current rates. No information about proposed rate adjustments, if any.

Several of the above agencies have adopted or are considering multi-year rate adjustment schedules. Oro Loma Sanitary District has proposed 7.5% rate increases for FY 2022 through FY 2027, ending with a monthly rate of \$35.50. In 2020, Union Sanitary District approved a five-year rate adjustment schedule that will result in a 45% increase between 2020 and 2025, ending with a single-family monthly rate of \$50.96 in FY 2026. Dublin San Ramon Services District is at the end of a five-year rate increase schedule that was approved in 2017.



ECONOMIC IMPACT

The typical single-family residential customer, with average bi-monthly water use of 15 ccf (187 gallons per day), will see an increase of \$0.74 per month in water cost in the first year and \$2.00 in the second year. Monthly sewer increases for single family customers would be \$1.36 in the first year, and \$1.41 in the second year. This is a total for all increases of \$2.10 per month in the first year and a total of \$3.41 per month in the second year. Most commercial and industrial customers will likewise see modest increases in their utility bills. While staff recognizes that any rate increase will affect customers and should be minimized, it is critical that the City maintain reliable and robust utilities systems in the interest of economic viability, quality of life, maintaining public health, and meeting increasingly stringent regulations.

FISCAL IMPACT

The Water and Wastewater Funds maintain a working capital balance, or fund balance, in order to manage emergencies, maintain positive cash flows, the Fund's credit worthiness and, at times, smooth out needed rate adjustments so that the City is not forced to implement a significant increase in a single year, which can result in customer discontent. There are no impacts on the General Fund related to water and sewer rate adjustments.

Water Fund

The Raftelis report includes a discussion of appropriate Water Fund reserves recommended to manage operating costs, capital expenditures and rate stabilization to protect customers from steep rate adjustments in the event of larger-than-anticipated increases in wholesale water rates. In general, it is recommended that the City maintain approximately one year of operating costs in reserve, with a target working capital balance of about \$38 million. As described in the Raftelis report, the City will build these reserves over an 8- to 10-year planning horizon. As currently anticipated, proposed rate increases will range from 3% to 7% over the next five years, and the target reserve amount will be achieved in 2029.

Wastewater Fund

For the Wastewater Fund, given the stringent current and anticipated regulations and the wastewater treatment plant operation, it is also appropriate to achieve 100% of annual expenditures as a reserve target. Staff anticipates that ongoing rate adjustments in the range of 3% will be needed to maintain sufficient working capital balances and keep the fund in a positive situation.

STRATEGIC ROADMAP

The proposed rate adjustments align with the City's Strategic Priority of improved infrastructure by providing the funding necessary to maintain and improve the water distribution system and wastewater collection and treatment system. Reliable utility services support other priorities such as housing and economic growth.

SUSTAINABILITY FEATURES

Water conservation programs, such as the high efficiency fixture replacement and lawn replacement rebate programs, are funded through water rate revenue and provide customers with the tools to assist them in efficiently managing water usage. These, and other conservation programs, will continue to be funded in FY 2022 and FY 2023 (projected annual budget of \$500,000).

The proposed sewer rates will allow the City to continue to operate and maintain the sewer collection system and WPCF in a manner to meet all legal and regulatory requirements to protect public health and the environment. It will also enable the City to continue the operation of the existing green and renewable energy generation systems in sewer utility and their expansion over time. The Lifeline and Economy Sewer Rates for low water use may contribute to sustainability by incentivizing water conservation and efficient water use.

ENVIRONMENTAL REVIEW

The California Environmental Quality Act (CEQA) includes an exemption of environmental review for revisions to rates and charges that are for the purpose of 1) meeting operating expenses; 2) purchasing or leasing supplies, equipment, and materials; 3) meeting financial reserve requirements; or 4) obtaining funds for capital projects necessary to maintain services and system reliability within existing service areas. No additional CEQA review is required.

PUBLIC CONTACT

Following Council's comments on the proposed rates, staff will implement the legal noticing requirements of Proposition 218, which mandates written notice of the proposed rates to all affected property owners at least forty-five days in advance of the public hearing, currently scheduled for July 20, 2021. In instances where a party other than the property owner, such as a tenant, is the account holder of record, notice will also be sent to that party. The notice describes the proposed modifications to the water rate tier structure, recommended rates for FYs 2022 and FY 2023 and their impacts on various customer classes. Proposed sewer rates and impacts on residential and non-residential customers are described. The notice will also discuss the property owners' right to protest the rates. Council may not take action on the rates if a majority of affected property owners file written protests. Staff will also post the information on the City's website and publish the required notice in the newspaper.

NEXT STEPS

Council is scheduled to consider the rate adjustments and hold a public hearing at its July 20, 2021 meeting. If adopted, the rate adjustments would be effective on October 1, 2021 and October 1, 2022. Council has traditionally used October 1 as an effective date, rather than July 1 when the wholesale rate adjustment takes effect in order to avoid increasing rates during the time that water use is highest.

Prepared by: Marilyn Mosher, Senior Management Analyst

Recommended by: Alex Ameri, Director of Public Works

Approved by:



Kelly McAdoo, City Manager