



DATE: April 18, 2023

TO: Mayor and City Council

FROM: Director of Public Works

SUBJECT: Utility Rate Adjustments: Review Recommended FY 2024 and FY 2025 Water, Sewer, and Recycled Water Rates and Connection Fees

RECOMMENDATION

That Council reviews and comments on this report.

SUMMARY

Cost-of-service analyses have been prepared for providing water, sewer, and recycled water service to Hayward residents and businesses to calculate appropriate water, sewer, and recycled water rates and service charges for FY 2024 and FY 2025. This report provides an overview of cost-of-service issues, revenue requirements, and recommended FY 2024 and FY 2025 water, sewer, and recycled water service rates. The analyses were prepared by Raftelis Financial Consultants, Inc., (Raftelis), 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 June 20, 2023. If approved, the adopted rate adjustments would take effect on October 1, 2023 and 2024.

The Water Rate Study documents the City's water cost of service requirements for FYs 2024 and 2025, which will increase by a maximum of 10% in FY 2024 and are anticipated to increase by a maximum of another 10% in FY 2025. The recommended water rates for FY 2024 and FY 2025 include an overall 10% increase to both bi-monthly fixed service fees and commodity rates in each of the two years for both residential and non-residential customers. The proposed rate adjustments will allow the City to recoup some of the revenue losses and the use of reserves last year due to a 15.9% increase in the wholesale water rate from San Francisco Public Utilities Commission (SFPUC) and in anticipation of a further increase of 9.7% effective July 2023.

The Sewer Rate Study documents the City's sewer cost-of-service requirements for FYs 2024

and 2025, which will increase by 7% in FY 2024 and are anticipated to increase by another 7% in FY 2025. Staff recommends an overall increase of 7% across all customer classes per year, including all commercial and industrial customers. The proposed rate adjustments will allow the City to keep pace with the cost of sewer service collection, treatment, and disposal, including developing reserves to pay for upcoming capital costs, and ensure that costs are recovered equitably.

The Recycled Water Rate Study documents the City's recycled water cost of service requirements for FYs 2024 and 2025, which will increase by 10% in FY 2024 and are anticipated to increase by another 10% in FY 2025. The recommended recycled water rates for FY 2024 and FY 2025 include a 10% increase to the uniform volume charge per year. Staff recommends that the service fee be the same as the water service fee for potable water in FY 2024 and FY 2025. The recommended recycled water commodity rate at \$5.68 per CCF is 35% lower than the proposed potable water rate for irrigation at \$8.80 per CCF for the first 170 CCF of usage.

Water, Sewer, and Recycled Water connection fee analyses have also been prepared by Raftelis. Connection fees are typically paid at the time a new development requests water, sewer, and recycled water service. The water connection fees (also known as Water Facilities Fees) have not been adjusted since 2012 and sewer connection fees were last adjusted in 2011. While the analyses recommend a 23% increase for water connection fee and a 102% increase for sewer connection fee, staff is recommending phase-in increases of 10% for water and 25% for sewer fees in the interest of maintaining the economic recovery and fostering business development. For the recycled water connection fee, staff recommends the fee to be the same as the recommended water connection fee, as the City plans for expansion of the recycled water system and adding more customers.

The executive summary prepared by Raftelis, included as Attachment II to this report, provides information regarding all the proposed rate and fee adjustments.

BACKGROUND

Water Rates

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, bill processing, maintenance of the Advanced Metering Infrastructure and customer portal, 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 SFPUC, City operations and maintenance, and energy related expenses. The Council approved water rate adjustments in July 2021 for FY 2022 and FY 2023, which included adjustments to bi-monthly fixed service fees, along with modifications to tier rates to reflect new customer usage and improve equity. For an average single family residential customer, the adjustments resulted in a range of 0.8% to 1.5% in FY 2022, and a 3% increase in FY 2023.

Sewer Service Charges

Sewer service charges are established to pay for the cost of collecting, treating, and disposing of wastewater. Calculations are consistent with industry practices to ensure that sufficient

revenues are collected to operate and maintain the system and cover all obligations of the Wastewater Operating Fund. 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 3.8% increase in residential rates in FY 2022 and FY 2023, effective October 2021 and 2022, respectively.

Recycled Water Rates

Recycled water rates are established to pay for the costs of treatment and delivery of recycled water to customers and, similar to potable water rates, are determined through an assessment of revenue requirements and anticipated recycled water purchase volumes. The initial rate structure offered an incentive to recycled water customers while recovering costs over the life of the project. The Council adopted the initial recycled water rates four years ago, which included the same fixed bimonthly service fee as water and a commodity rate that was approximately 25% lower than the potable water rate at the time.

Connections Fees

Water, sewer, and recycled water connection fees are paid to connect a new development to the public water, sewer, and recycled water system, and are used to fund improvement and expansion of the 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 standard procedures to ensure that costs are allocated fairly to new developments. Water connection fees were last adjusted in October 2012, 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 were last adjusted in October 2011. The initial recycled water connection fee was adopted in October 2019. This fee was set to be the same as the water connection fee, as a placeholder, until additional consumption and financial data became available for a more comprehensive analysis.

DISCUSSION

The City entered into an agreement with Raftelis to prepare the Water, Wastewater, and Recycled Water Rate Studies and Connection Fee 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, which, among other provisions, requires that property-related fees are commensurate with the cost of services received.

The work consisted of five main tasks:

1. Developing a long-term financial plan that documents the water, sewer, and recycled 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 fees charged to each customer class, in compliance with Proposition 218 and based on industry standards.

3. Reviewing the current water, sewer, and recycled water rate structure and evaluating potential rate structure modifications, customer classes, and fixed and variable revenue recovery.
4. Developing five years of water, sewer, and recycled water rates that comply with Proposition 218 and ensuring financial sufficiency to fund operating, maintenance and capital costs over the study period.
5. Developing water, sewer, and recycled water connection fees to ensure new development fairly and adequately contributes to the cost of existing and planned infrastructure and compliance with Proposition 26.

The executive summary for the Studies, attached to this report, serves as a fuller discussion of the proposed utilities rates and connection fees for FY 2024 and FY 2025, including the current and proposed rates and fees for the next two years and comparisons with other water and wastewater agencies (Attachment II).

Water Rates

The high cost of purchasing wholesale water is the most significant issue impacting the Water Fund. Approximately two-thirds of the water revenue pays for the purchase of water. SFPUC's wholesale water rates increased by 15.9% in FY 2023 and a further increase of 9.7% is anticipated in FY 2024. A substantial amount of the Fund's working capital reserve has been spent down in FY 2023 in order to cushion the impacts of SFPUC's rate increases on City residents and businesses, and to not pass the increases on to ratepayers in the form of steep rate adjustments.

Cost of Service requirements are increasing by 10% in FY 2024 and anticipated to increase by another 10% in FY 2025. In addition, it is necessary to recover some of the revenue losses from FY 2023. Staff is recommending increases of 10% in fixed bimonthly service charges and water commodity rates across all customer classes in FY 2024 and FY 2025. As a result of these recommended changes, average residential users would see an overall increase of 10% in their water bills and non-residential users could see similar increases in their bills.

Staff is proposing to retain the low-income bi-monthly service fee for single-family residential 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", 3/4", and 1" meter sizes. 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.

Drought Surcharge

The Water Rate Study also includes a section on a drought surcharge in the event of a water supply shortage, or other local water use restriction. The purpose of the drought surcharge is to recover revenues that may be lost as a result of substantially reduced consumption or drought-related wholesale rate increases by SFPUC. Drought rates are not needed at this time as the reservoirs have been replenished from recent storms and the State has recently rescinded some of the water use restrictions. If such rates are required in the next two years,

staff will return to Council for a fuller discussion and recommendations.

Comparison with Other Agencies

Hayward customers continue to be among one of the lowest per-capita water users in the Bay Area. The median water consumption is 12 CCF per billing period, or 150 gallons per day.

“Figure A – Average Residential Consumption per Household” compares the Hayward resident’s median consumption with other neighboring agencies in FY 2022.

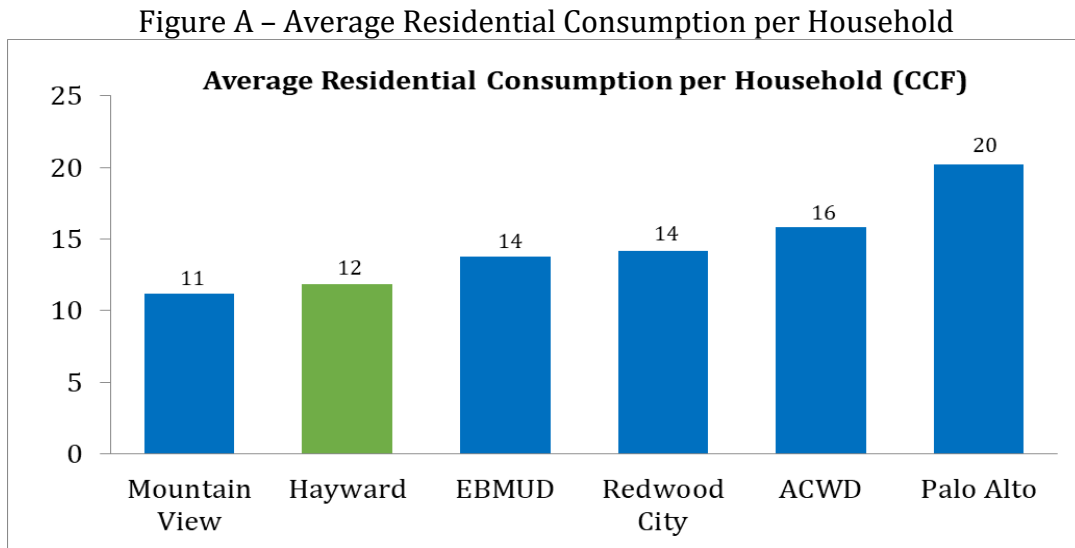


Figure B and Figure C below show how the City’s current and proposed water rates compare to other nearby agencies. While this comparison is provided in keeping with a long-standing practice and the Council’s desire to know how the City’s rates compare with neighboring agencies, some factors should be kept in mind when considering this information. First and foremost, the agencies in “Figure A – Immediate Area Agencies” either use no SFPUC water as part of their water supply (e.g., East Bay Municipal Utility District or SFPUC comprises only a small fraction of their total supply (e.g., Alameda County Water District). Therefore they are unaffected, or affected to a lesser degree, by the significant wholesale water rate increases that have been and will continue to be implemented by SFPUC.

Immediate Area Water Agencies - Bimonthly Water Bill Comparison

Figure B1

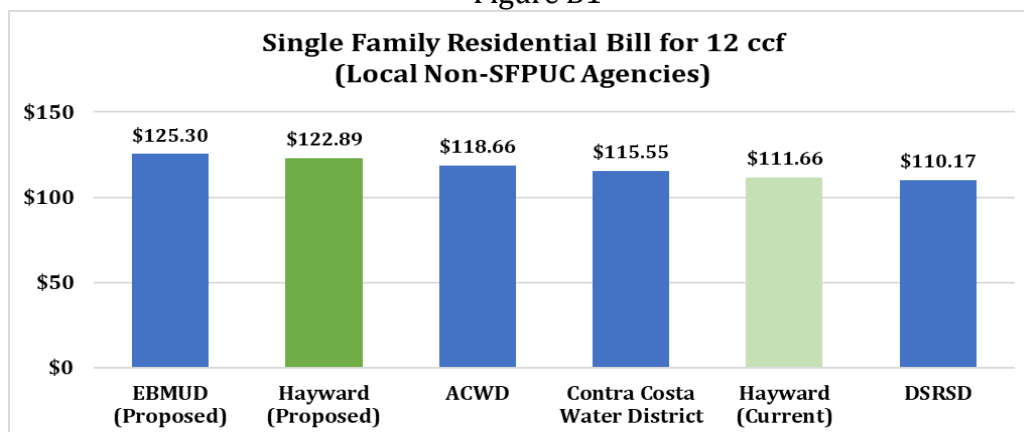
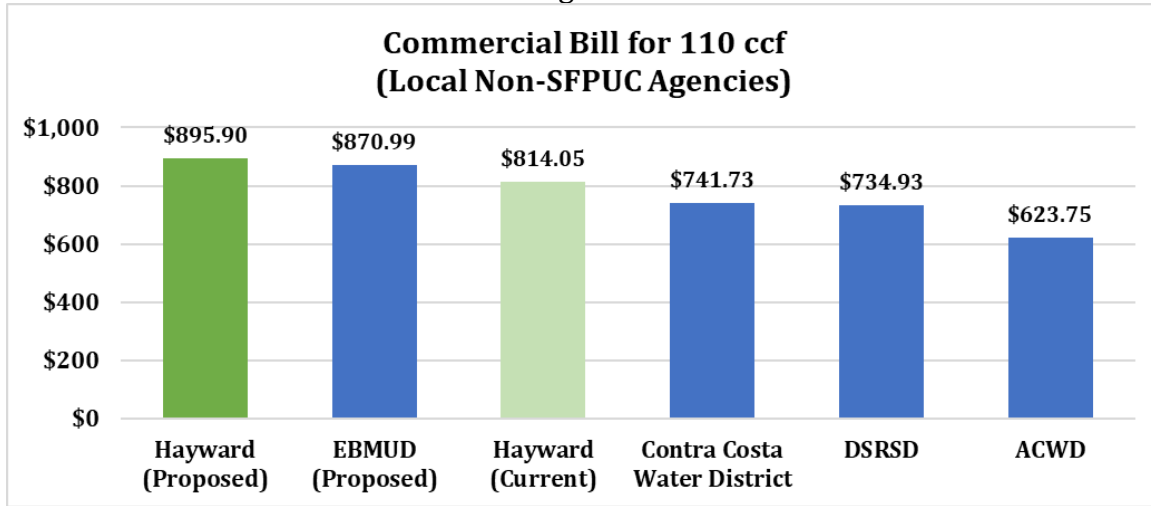
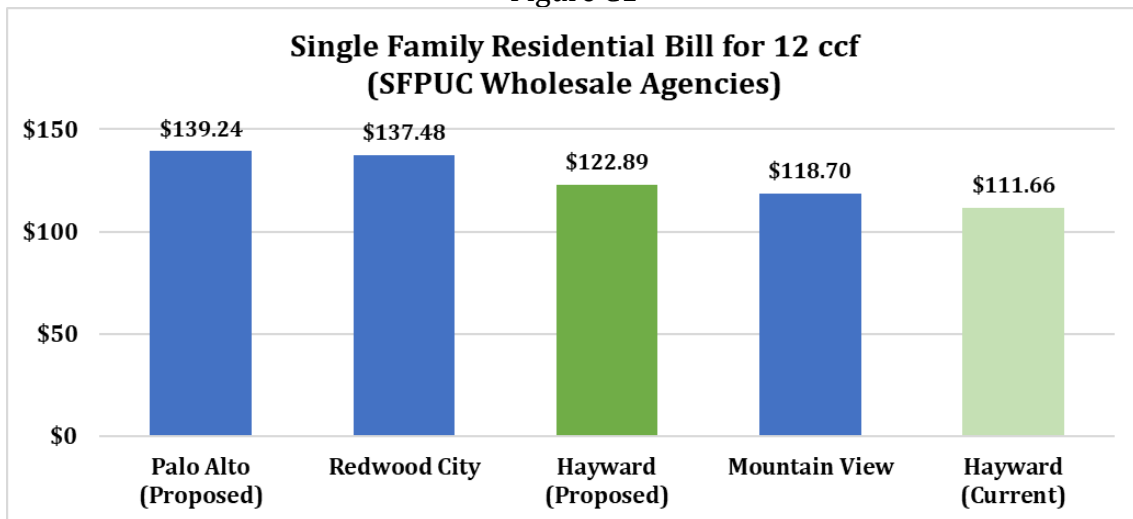


Figure B2



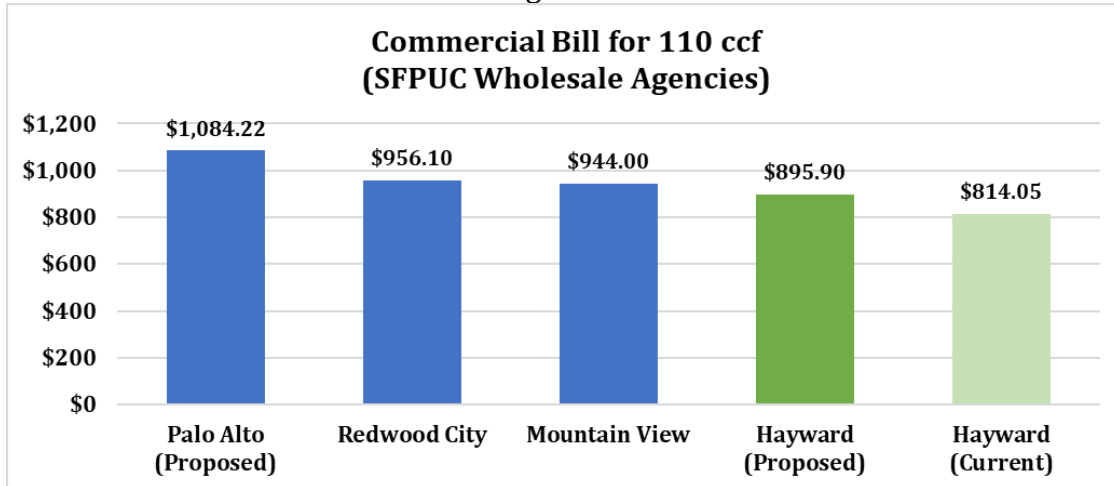
“Figure C – 100% SFPUC Wholesale Agencies” compares the City’s water rates to those agencies with the same water supply conditions. System size also plays a role in rate setting since large agencies benefit from economies of scale. Offering discounts to low-income residents, as the City does, which is not common, also affects the rates. Finally, a water agency’s rate should be considered in light of the system’s performance, its operational robustness, and its flexibility to operate in both normal and emergency situations.

100% SFPUC Wholesale Agencies - Bimonthly Water Bill Comparison
Figure C1



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Figure C2



Sewer Service Charge

The recommended sewer rates for FY 2024 include a 7% increase in revenue requirements, which is in part attributed to the global supply chain issues and inflation, escalating the cost of supplies and services, such as chemicals for wastewater treatment. Staff is proposing increases of 7% in sewer rates for all customer classes in each of the two years.

As a result of these proposed changes, average single-family residential users would see an overall increase of 7% in their sewer bills in FY 2024, and 7% in FY 2025. 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, compared with an estimated average discharge of 12 CCF from single-family homes. These rates are intended to encourage water conservation and reward customers who use low amounts of water.

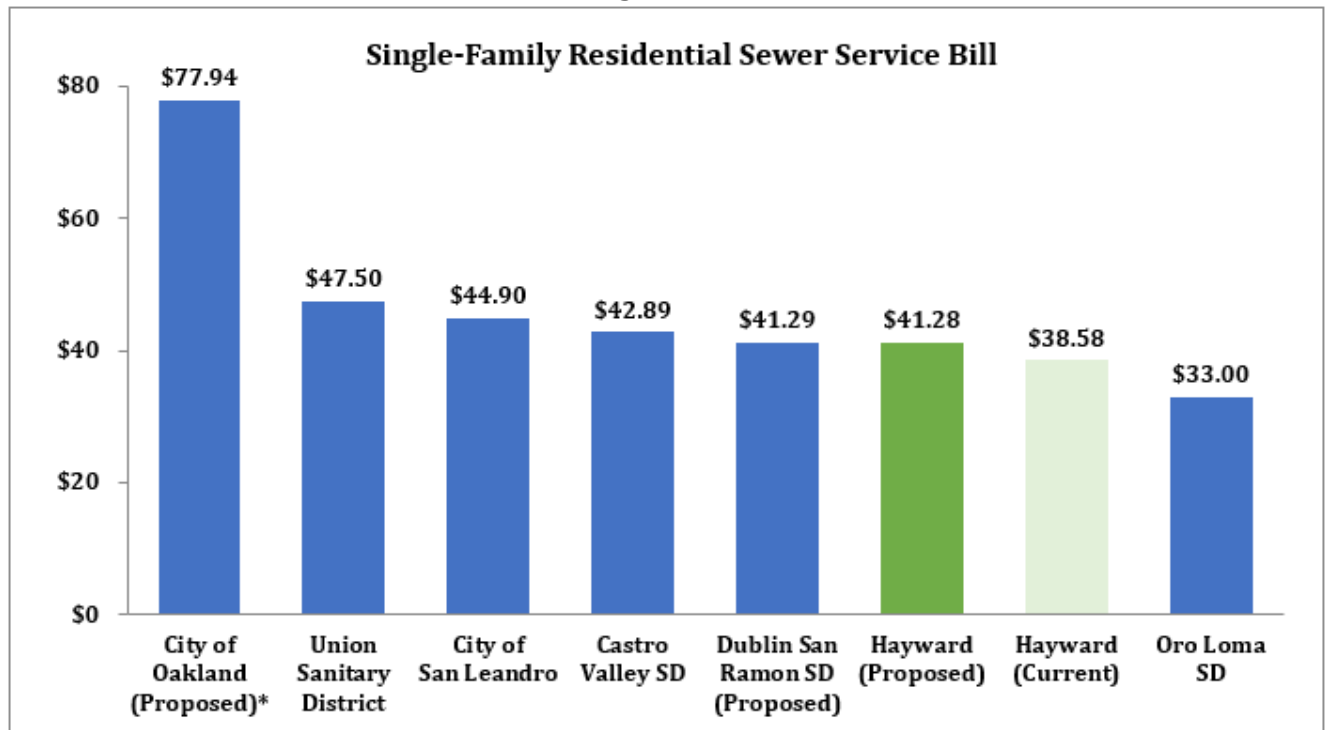
Non-residential customers would see an average of 7% increase per year. For large industrial users, staff uses actual and anticipated sampling data to measure their impact and calculates appropriate rates based on their contribution to the wastewater system. Appropriate fees for other business customers, such as restaurants, are based on water consumption and standard waste strengths. Examples of impacts on common businesses are illustrated in the table below.

Customer Type (without separate irrigation)	Current Rate/ CCF of Water	Proposed FY 2024	% Change	Proposed FY 2025	% Change
Restaurants (no grease interceptor)	\$10.62	\$11.37	7%	\$12.17	7%
Restaurants (with grease interceptor)	\$8.20	\$8.78	7%	\$9.39	7%
Commercial Laundry	\$6.33	\$6.78	7%	\$7.26	7%
Offices and Retail Stores	\$6.28	\$6.72	7%	\$7.19	7%

Comparisons with other Wastewater Agencies

As shown Figure D below, the proposed FY 2024 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 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.

Figure D



*City of Oakland includes the City's sewer collection system fee and EBMUD's treatment service fee.

Recycled Water Rates

Staff recommends continuing a rate structure that offers an incentive to utilize recycled water while adequately recovering costs over the life of the project. The cost-of-service analysis indicates increases of 35% in revenue requirements in FY 2024 and 10% in FY 2025, resulting in proposed adjustments to the fixed bimonthly service charges and the uniform tier commodity rate. Staff is proposing to charge the same bimonthly service charges as potable water. The recommended recycled water commodity rate at \$6.76 per CCF is 23% lower than the proposed potable irrigation water rate at \$8.80 per CCF for the first 170 CCF or 348 gallons per day, and 40% lower than proposed potable irrigation water rate at \$11.20 for over 170 CCF.

Comparisons with Other Water Agencies

Figure E1 and E2 below show how Hayward’s proposed recycled water usage rate compares to other nearby agencies. The proposed FY 2024 and FY 2025 rates would place Hayward in the mid to high-range of reduction from irrigation potable usage rate at 35% for the first 170 CCF and at 49% for over 170 CCF. Other nearby agencies reduction differences range from 0% to 44%, with an average reduction of 30%. It must be noted that most of the compared agencies charge the same fixed bimonthly service fee as potable water.

Usage Rate Difference between Potable and Recycled Water
Figure E1

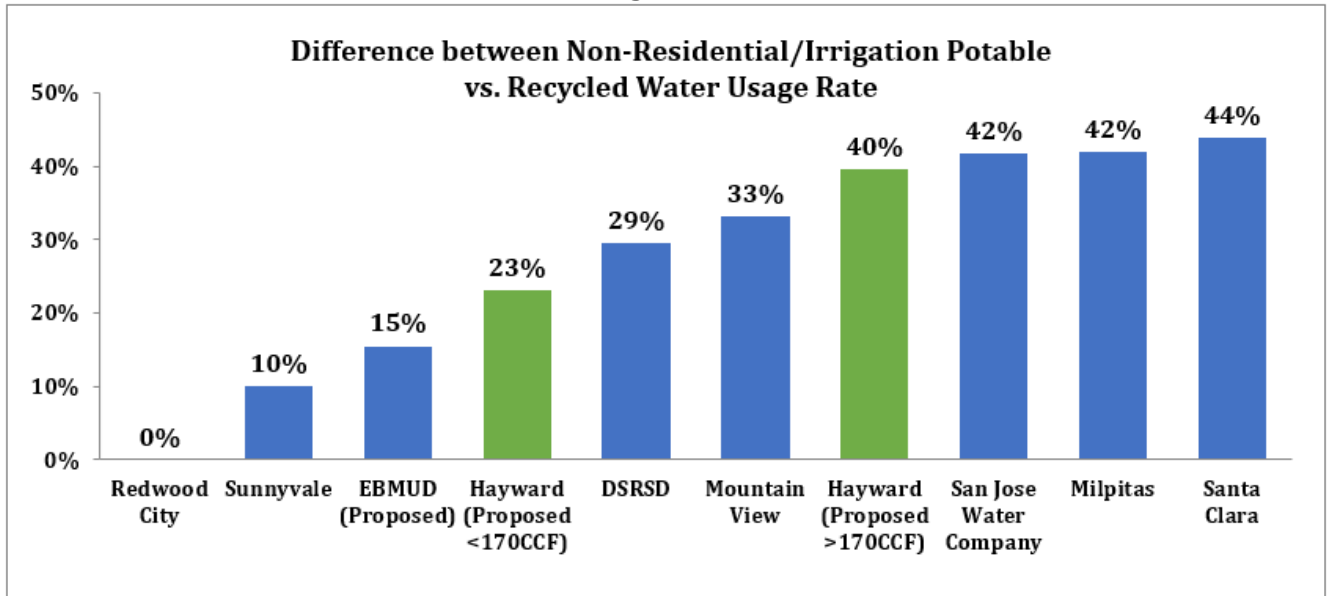
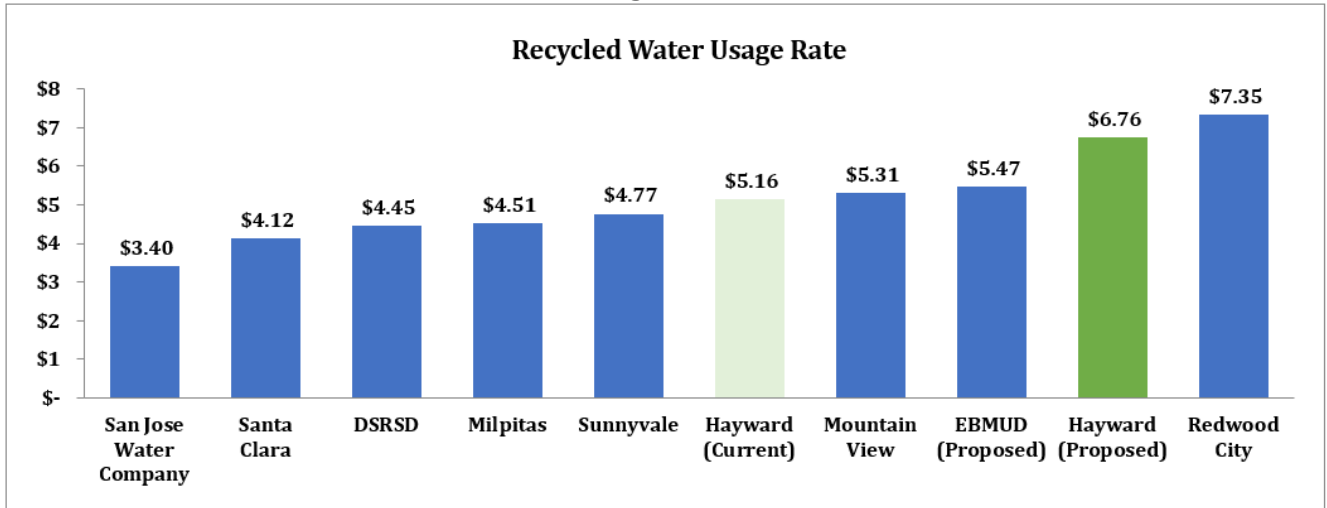


Figure E2



Water, Sewer, and Recycled Water Connection Fees

Capacity fee analyses have also been prepared for water, sewer, and recycled water connection fees, which are the fees typically paid at the time a new development requests water, sewer, and recycled water service. Water connection fees, also known as water system facilities fees, and sewer connection fees have not been adjusted for over a decade. While the recycled water connection fee was last adopted in 2019, the vast majority of recycled water customers, at the time, were existing water customers who were retrofitted to use recycled water at no upfront cost to the customer. Since then, no new recycled water customers have connected to the system due to the limitation of the distribution pipeline. At this time, there is limited opportunity for new customers to connect to the Recycled Water System. The CIP includes funding for preparation of a Recycled Water Master Plan in FY 2024 to determine the feasibility of expanding the System and adding customers.

The Connection Fee Study, prepared by Raftelis, indicates a 23% increase for water connection fee, a 102% increase for sewer connection fee, and a 425% increase for recycled water connection fee. Staff is recommending a phase-in approach for water and sewer connection fees, increasing 10% for water and 25% for sewer fees in the interest of maintaining the economic recovery and fostering business development. For recycled water connection fee, the calculated percentage of increase is high due to the significant capital investment and expenditures in recent years and near future over a small number of recycled water customers. Staff is proposing to use the same recommended water connection fee for the minimal number of new recycled water customers, as the City plans for expansion of the recycled water system and adding more customers. Appropriate connection fees will be calculated after development of Recycled Water Master Plan.

Comparisons with Other Agencies

Table 1 and 2 below show how Hayward’s proposed water and sewer connection fees compare to other agencies.

Water Connection Fee Comparison
Table 1

Agency	Water Connection Fee (1" meter)
Palo Alto	\$6,250
ACWD	\$8,556
Mountain View	\$12,206
Hayward (Current)	\$16,210
Hayward (Proposed)	\$17,831
EBMUD (1)	\$41,580
Contra Costa Water District	\$60,085
DSRSD (2)	\$129,928

(1) EBMUD Water Connection Fee for Region 2, Castro Valley Area

(2) DSRSD Water Capacity Fee includes fees for both water distribution services and Zone 7 water treatment services.

Sewer Connection Fee Comparison
Table 2

Agency	Sewer Connection Fee (Single Family Residential)
EBMUD (1)	\$2,950
City of San Leandro	\$4,393
Hayward (Current)	\$7,700
Hayward (Proposed)	\$9,625
Union Sanitary District	\$10,755
Castro Valley Sanitary District	\$15,518
DSRSD	\$17,669

(1) EBMUD Sewer Connection Fee for treatment services only

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.

ECONOMIC IMPACT

The typical single-family residential customer, with average bi-monthly water use of 12 ccf (150 gallons per day), will see an increase of \$5.60 per month in water cost in the first year and \$6.20 in the second year. Monthly sewer increases for single family customers would be \$2.70 in the first year, and \$2.90 in the second year. The total for all increases of \$8.30 per month in the first year and a total of \$9.10 per month in the second year. Most commercial and industrial customers will likewise see 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 conformance with ever more stringent federal and state rules and regulations on the onset of the climate crisis, in the interest of economic viability, quality of life, and maintaining public health, and meeting increasingly stringent regulations.

FISCAL IMPACT

The Water, Wastewater, and Recycled Water Funds each 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. Water and Sewer connection fees support Capital Improvement Program (CIP) projects in the Water Improvement Fund and Sewer Improvement Fund. There are no impacts on the General Fund related to water, sewer, and recycled water rate adjustments or connection fees. None of these fee adjustments have an impact on the General Fund.

Operating Fund Reserves

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 maintains approximately one year of operating costs in reserve, with a target working capital balance of about \$36 to \$41 million (FY 2024 to FY 2028). As described in the report, the City will build these reserves over a 5-year planning horizon. As currently anticipated, proposed rate increases will range from 5% to 10% over the next five years, and the target reserve amount will be achieved in 2028.

Wastewater Fund

Given the stringent current and anticipated regulations, the onset of the impacts of the climate crisis, and the cost of operating and maintaining a wastewater treatment facility, it is also appropriate to achieve 100% of annual expenditures as a reserve target in the Wastewater

Fund. Staff anticipates that ongoing rate adjustments in the range of 7% will be needed to maintain sufficient working capital balances and keep the fund in a positive situation.

Recycled Water Fund

The Recycled Water Enterprise Fund is a separate enterprise with its own rate structure. Revenue and expense for delivering recycled water are tracked separately from water and sewer transactions. While the expenses and revenues in the Recycled Water Fund would be modest initially, they would increase as new customers are added and future project phases are implemented.

Capital Improvement Program

Water Improvement Fund

All revenues derived from Water Facilities Fees are deposited in the Water System Capital Improvement Fund and used only for planned existing and future capital projects related to improvement and expansion of the water system, such as the System Seismic Upgrades and New Emergency Well B2 projects.

Sewer Improvement Fund

Similarly, all revenues derived from Sewer Connection Fees are deposited in the Sewer Capital Improvement Fund and used only for planned existing and future capital projects related to expansion of the sewer system, such as the WPCF Nutrient Management Improvement and Main Electronical Distribution Rehabilitation projects.

The revenues derived from Recycled Water Connections Fees will be deposited into the Water or Sewer Improvement Fund, as appropriate, to fund projects related to expanding or improving the Recycled Water System.

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, wastewater collection and treatment system, and recycled water treatment and distribution 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 2024 and FY 2025 (projected annual budget of \$300,000).

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. This includes supporting the upcoming WPCF Nutrient Management Project, which will enhance the quality of the wastewater discharged, to bring positive impact on protecting the health of the San Francisco Bay. The revenue derived

from the proposed rates will also enable the City to continue funding the existing green and renewable energy generation systems at the WPCF 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.

The use of recycled water will reduce the demand for drinking water and improve the reliability and availability of drinking water, while providing a sustainable and drought-proof water supply for some irrigation and eventually industrial uses. It will also reduce the volume of wastewater and associated nutrients and residual pollutants discharged to San Francisco Bay, which is required to meet increasingly stringent discharge regulations.

PUBLIC CONTACT

Following Council's comments on the proposed rates, staff will incorporate any required modifications and 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 June 20, 2023. 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 adjustments and recommended rates for FY 2024 and FY 2025 and their impacts on various customer classes. Proposed sewer rates and impacts on residential and non-residential customers are also 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.

Capacity charges are one-time fees that were included in the connection fee study and are shown on Attachment II. They are not subject to Proposition 218 requirements and will not be included in the Proposition 218 notice, but staff will post the information on the City's website and publish notice of the proposed adjustment.

NEXT STEPS

Council is scheduled to consider the rate adjustments and hold a public hearing at its June 20, 2023 meeting. If adopted, the connection fee adjustments would be effective on September 1, 2023 and September 1, 2024, and utility rate adjustments would be effective on October 1, 2023 and October 1, 2024. Council has traditionally used October 1 as an effective date for the utility rates, rather than July 1 when the wholesale rate adjustment takes effect in order to avoid increasing rates during the summer period when water use is highest.

Prepared by: Elli Lo, Senior Management Analyst

Recommended by: Alex Ameri, Director of Public Works

Approved by:

A handwritten signature in black ink, appearing to read 'Kelly McAdoo', with a long horizontal stroke extending to the right.

Kelly McAdoo, City Manager