DATE: April 1, 2025

TO: Mayor and City Council

FROM: Director of Public Works

SUBJECT: Recommended FY 2026 and FY 2027 Water and Recycled Water Rates and Connection Fees

RECOMMENDATION

That the City Council reviews and comments on this report.

SUMMARY

Staff prepared a cost-of-service analyses for providing water and recycled water service to Hayward residents and businesses to calculate appropriate water and recycled water rates and service charges for FY 2026 and FY 2027. This report provides an overview of cost-of-service issues, revenue requirements, and recommended FY 2026 and FY 2027 water and recycled water service rates. Staff is bringing the proposed rates to City Council to obtain comments. After receiving and addressing City 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 17, 2025. If approved, the adopted rate adjustments would take effect on October 1, 2025, and 2026.

The City's water cost of service requirements for FYs 2026 and 2027 are proposed to increase by 6% in FY 2026 and by another 6% in FY 2027. The recommended water rates for FY 2026 and FY 2027 include an overall 6% 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 8.8% increase in the wholesale water rate from San Francisco Public Utilities Commission (SFPUC) and in anticipation of a further increase up to 5.6% effective July 2025.

The City's recycled water's current uniform volume charge is proposed to change to a two-tier rate structure starting in FY 2026 to make it consistent with the current rate structure for using potable water for irrigation. The recommended recycled water commodity rate is proposed to include two tiers, first tier at $7.70 per CCF for the first 170 CCF, and second tier at $9.80 per CCF

for over 170 CCF. While a few of the 31 current recycled water customers will see a jump of up to 31% in their recycled water cost in FY 2026, their cost will still be up to 25% below the cost of using drinking water for irrigation use. Similar to water service fees, the City's recycled water fixed service fee for FYs 2026 and 2027 are proposed to increase by 6% in FY 2026 and up to another 6% in FY 2027. Staff recommend that the fixed service fee remain the same as the water service fee for potable water in FY 2026 and FY 2027.

Water and recycled water connection fee analysis has also been prepared. Connection fees are typically paid at the time a new development requests water and recycled water service. For water connection fees (also known as Water Facilities Fees), staff recommend a 10% increase in FY 2026 and another 10% increase in FY 2027. For recycled water connection fee, staff recommend 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.

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 City Council approved water rate adjustments in June 2023 for FY 2024 and FY 2025, which included adjustments to bi-monthly fixed service fees and commodity rates. For an average single family residential customer, the adjustments resulted in a 10% increase in FY 2024, and a 10% increase in FY 2025. Customers that use more water will pay more per gallon than those who use less water.

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 incentive continues with the proposed rates.

Connections Fees
Water and recycled water connection fees are paid to connect a new development to the public water 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 September 2023, 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.

Proposition 218
Proposition 218, now a part of the California constitution, states that "property related fees and charges" may not exceed the proportional cost of providing the service to the customer and may not be used for any purpose other than providing said service to the customer and may not be used for any purpose other than providing said service. It affects the rate adoption process by requiring agencies to hold a public hearing to adopt rates. The agency must mail public hearing notices to all customers no fewer than 45 days prior to the public hearing. The public hearing notices must clearly show all proposed rate changes, provide information on the public hearing date/time/location, and provide instructions on how customers may protest the proposed rate changes. If a majority of customers submit a protest in writing, the proposed rate changes cannot be adopted.

DISCUSSION

Water Rates

The very high cost of purchasing SFPUC's 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 8.8% in FY 2025 and a further increase up to 5.6% is anticipated in FY 2026. A substantial amount of the Fund's working capital reserve has been spent down 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 expected to increase by 6% in FY 2026 and by another 6% in FY 2027. In addition, it is necessary to recover some of the planned revenue shortfalls from FY 2025. Staff is recommending increases of 6% in fixed bimonthly service charges and water consumption rates across all customer classes in FY 2026 and FY 2027. As a result of these recommended changes, average residential users would see an overall increase of 6% in their water bills, or $4.06 per month, 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 City Council. Customers that qualify for this discount are charged a reduced bi-monthly water service charge, equal to 35% of the service charge, or a 65% discount. Revenues that are not generated from rates, e.g., revenue from water installation fees, are discretionary funds, not subject to the strict requirements of Prop 218, that the City may use to provide these discounts.

SFPUC Pass-Through
Pursuant to California Government Code Section 53756, Hayward is proposing to pass through any additional increases in SFPUC wholesale water rates when the actual SFPUC rates exceed the estimates. Rate increases implemented by SFPUC are unpredictable and the anticipated 5.6% increase in FY 2026 could potentially be higher than what is projected. The pass-through will allow Hayward to pass the additional increase to rate payers to recoup costs as necessary. Prior to implementing a pass-through of the SFPUC wholesale water rates, Hayward will send written notification to all customers at least 30 days prior to the effective date. Rate payers were notified of the pass-through in the Proposition 218 notices sent in the previous rate

increase; however, Hayward did not implement any pass-through rate increases.

Drought Surcharge
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 in the event of a water supply shortage, or other local water use restrictions. Drought rates are not needed at this time as the reservoirs have been replenished from recent storms. SFPUC has stated they do not anticipate to call for mandatory cutbacks, and the State has rescinded some of the water use restrictions. If such rates are required in the next two years, staff will return to City Council for fuller discussion and make recommendations.

Comparison with Other Agencies

Hayward customers continue to be among the lowest per-capita water users in the Bay Area[1] with a residential per capita consumption of 44 gallons per person, per day in FY 2023, compared to other members of the Bay Area Water Supply and Conservation Agency (BAWSCA) in Figure A – Residential Per Capita and Total Consumption.

Figure A – Residential and Total Per Capita Consumption

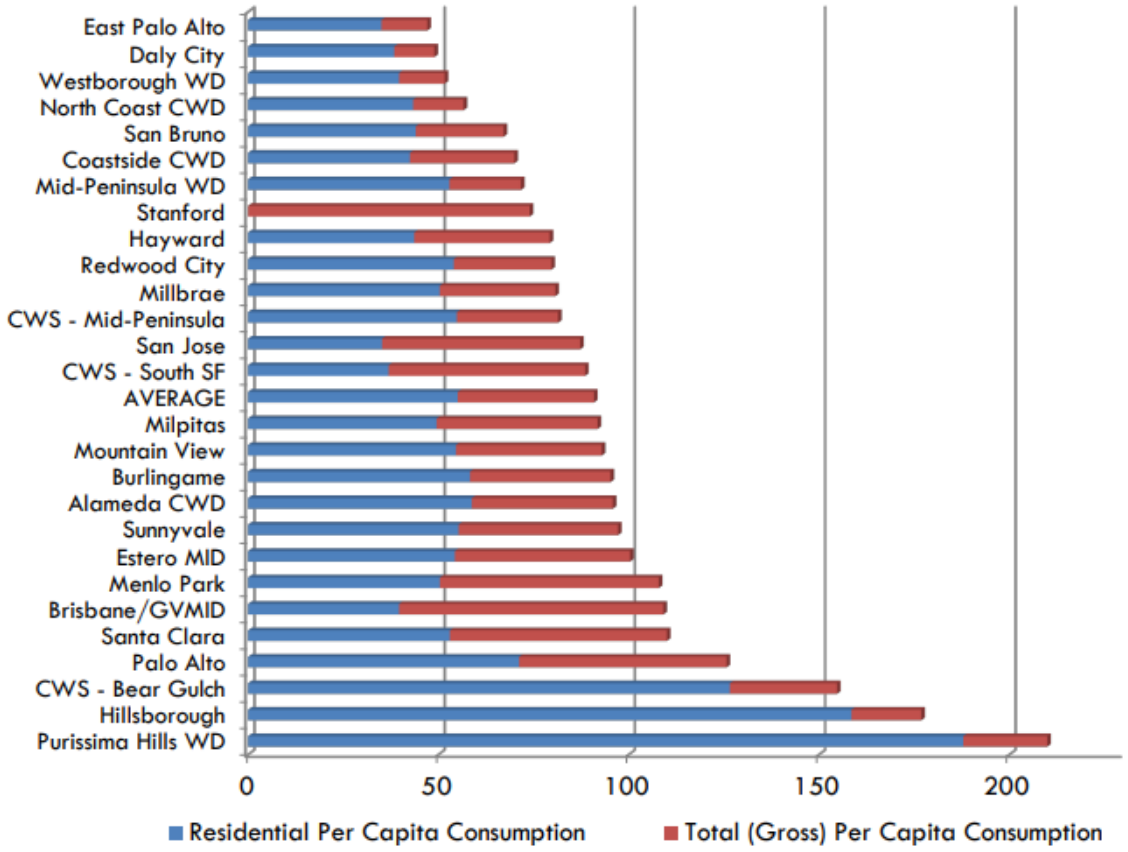


Figure B and Figure C show how the City's current and proposed water rates compare to other neighboring and nearby agencies. While this comparison is provided in keeping with a long-

[1] Source: FY 2023 Bay Area Water Supply & Conservation Agency (BAWSCA) Annual Survey

standing practice and the City Council's desire to know how the City's rates compare with neighboring agencies, some factors should be considered about this information. First and foremost, the agencies in "Figure B – Immediate Area Agencies" either use no expensive (and high quality) SFPUC water as part of their water supply (e.g., East Bay Municipal Utility District) comprises only a small fraction of their total supply (e.g., Alameda County Water District). Therefore, they are unaffected, or affected to a much lesser degree, by the high cost and significant wholesale water rate increases that have been and will continue to be implemented by SFPUC.

Figure B - Immediate Area Water Agencies - Bimonthly Water Bill Comparison

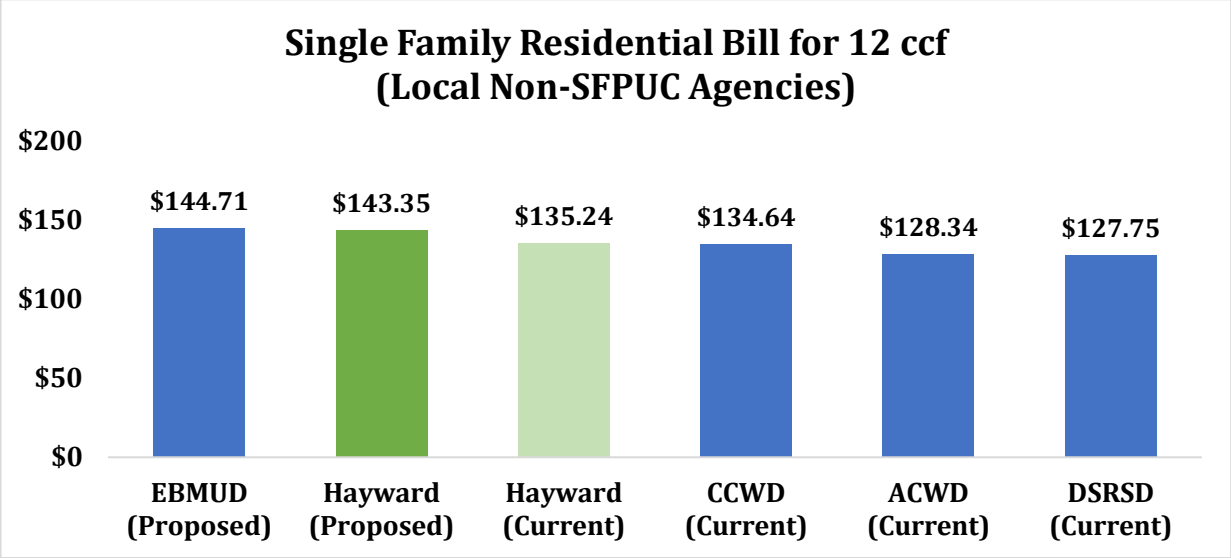


Figure C - Immediate Area Water Agencies - Bimonthly Water Bill Comparison

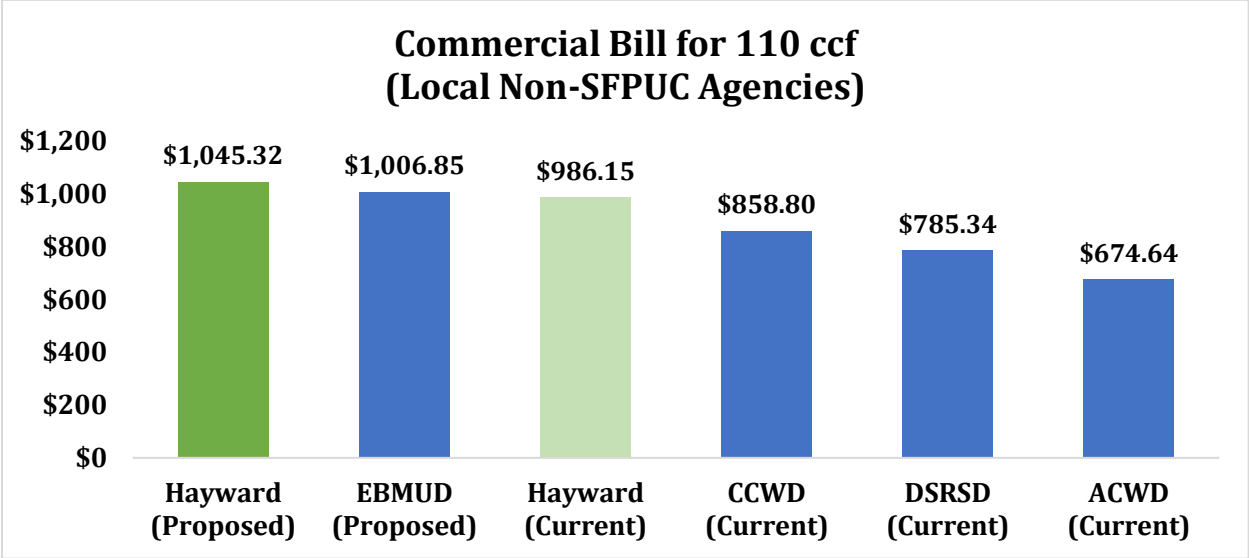


Figure D and Figure E compare the City's water rates to those agencies with the same water supply conditions. Compared with other SFPUC wholesale agencies, Hayward's proposed rates are the lowest. System size also plays a role in rate setting since large agencies benefit from

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.

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

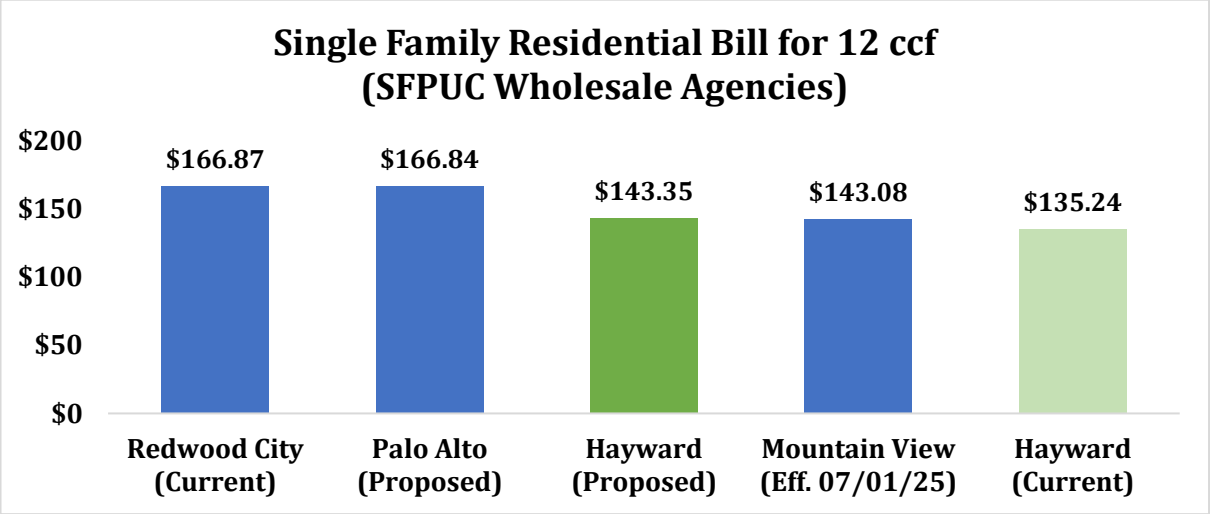
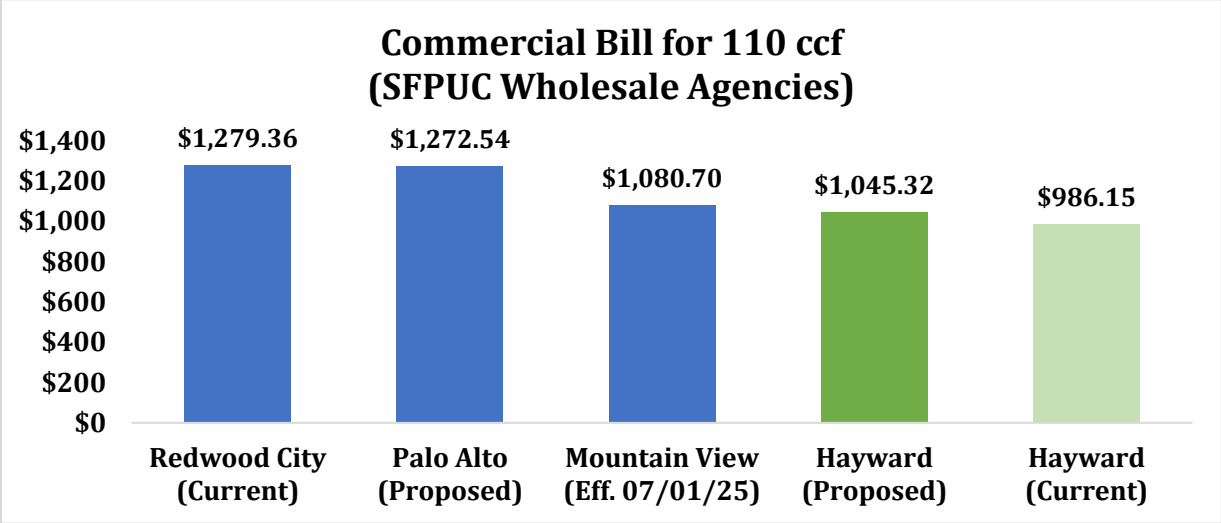


Figure E - 100% SFPUC Wholesale Agencies - Bimonthly Water Bill Comparison



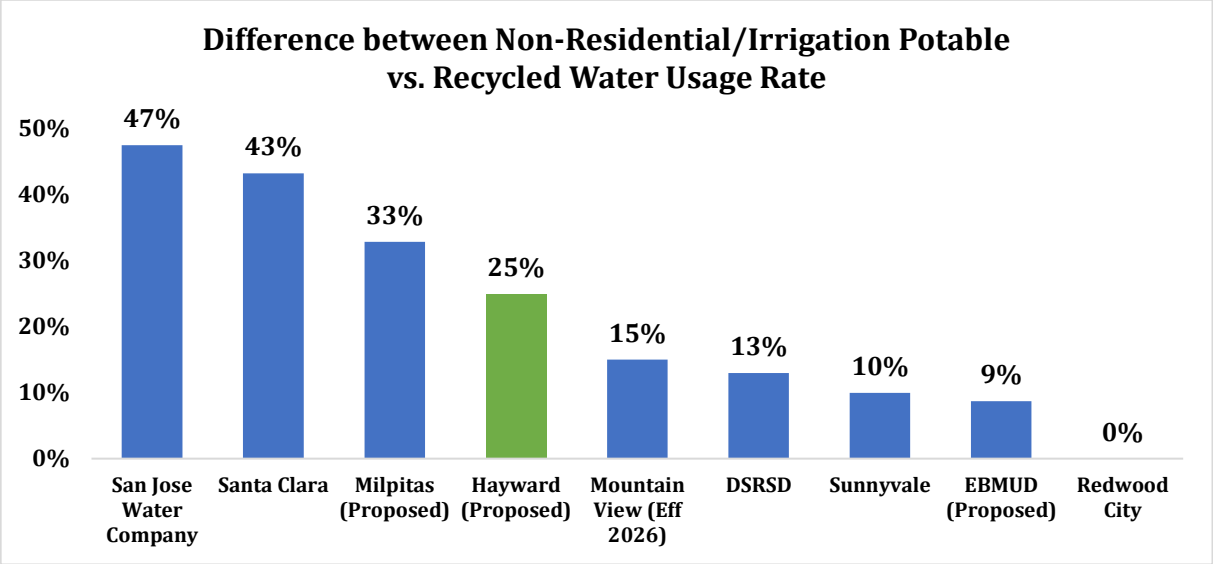
Recycled Water Rates

Staff recommend modifying to the uniform volume charge into a two-tier rate structure that offers an incentive to utilize recycled water while adequately recovering costs over the life of the project. Staff is proposing to charge the same bimonthly service charges as potable water in FY 2026 and FY 2027. The recommended recycled water commodity rate includes two tiers, first tier at $7.70 per CCF for the first 170 CCF, or 2100 gallons per day, and second tier at $9.80 per CCF for over 170 CCF. While a few of the 31 current recycled water customers will see a jump of up to 30% in their recycled water cost in FY 2026, their cost will still be up to 25% below the cost of using drinking water for irrigation use.

Comparisons with Other Water Agencies

Figure F below show Hayward's proposed recycled water usage rate comparison to other nearby agencies. The proposed FY 2026 and FY 2027 rates would make Hayward comparable to nearby agencies and offer a reduction from irrigation potable usage rate by up to 25%. Other nearby agencies' reduction differences range from 0% for Redwood City, which has a long-established recycled water system, to 47% with an average reduction of 22%. It must be noted that most of the compared agencies charge the same fixed bimonthly service fee as potable water.

Figure F - Usage Rate Difference between Potable and Recycled Water



Water and Recycled Water Connection Fees

Capacity fee analyses have also been prepared for water and recycled water connection fees, which are the fees typically paid at the time a new development requests water and recycled water service. Both the water and recycled water connection fee were last adopted in 2023. Since then, no new recycled water customers have connected to the system due to the limitation of the City's recycled water 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 2025 to determine the feasibility of expanding the System and adding customers.

Comparisons with Other Agencies

Table 1 below shows how Hayward's proposed water connection fee compares to other agencies.

Table 1 - Water Connection Fee Comparison

Agency	Water Connection Fee (1" meter)
Palo Alto	$6,250
Mountain View	$13,941
Redwood City	$14,198
Hayward (Current)	**$17,831**
Hayward (Proposed)	**$19,614**
ACWD	$24,405
EBMUD (1)	$44,649
Contra Costa Water District	$60,920
DSRSD (2)	$133,687

(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.

Staff recommend a 10% annual increase for the water connection fee and a 10% annual increase for recycled water connection fee in each FY 2026 and FY 2027. Staff is proposing to use the same recommended potable water connection fee for the small 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 the Recycled Water System Master Plan.

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 $4.06 per month in water cost in the first year and $4.30 in the second year. About two-thirds of these pay for SFPUC's water purchases. While staff recognize 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 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 connection fees support Capital Improvement Program (CIP) projects in the Water Improvement Fund.

There are no impacts on the General Fund related to water and recycled water rate adjustments or connection fees.

Operating Fund

Water Fund
The Water Enterprise Fund reserves are 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 a reserve target of approximately 25% of operating and maintenance expenses in one year, 100% of the rolling average of five years of rate-funded capital, and 25% of commodity rate revenues. In general, it is recommended that the City maintains approximately one year of operating costs in reserve, which is approximately $40 million in FY 2025. However, a portion of the water fund's working capital reserve is anticipated to be spent down in FY 2025 and the use of reserve will continue in the next few years 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.

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 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.

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 Roadmap of improved infrastructure by providing the funding necessary to maintain and improve the water distribution 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.

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.

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 City 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. A new law, AB 2257, encourages written responses to written protests received before a public hearing. Therefore, notices will be sent sixty days in advance, currently scheduled for mailing on April 18, 2025, to accommodate sufficient time for delivery and for the City to prepare a written response to any written objections if needed. Although not legally required, in instances where a party, other than the property owner, such as a tenant, is the account holder on record, notice will also be sent to that party. The notice describes the proposed adjustments and recommended rates for FY 2026 and FY 2027, and the impacts on various customer classes. In addition, the notice will include information on the low-income discounts and resources on water conservation programs to the benefits of water customers. The notice will also discuss the property owners' right to protest the rates. City 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 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

City Council is scheduled to consider the rate adjustments and hold a public hearing at its June 17, 2025, meeting. If adopted, the water and recycled water rate adjustments would be effective on October 1, 2025, and October 1, 2026 and connection fee adjustments would be effective on September 1, 2025, and September 1, 2026. City Council has traditionally used October 1 as an effective date for the water and recycled water 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: Trang Nguyen, Management Analyst II

Recommended by: Alex Ameri, Director of Public Works

Approved by:

Dr. Ana M. Alvarez, City Manager