

City of San Diego Water Rate Increase

January 2011

Board Action:

OPPOSE

Rationale:

Over the last few years, it has become customary to anticipate an annual water rate increase as the Metropolitan Water District and San Diego County Water Authority increase rates to cover costs. While the cost of water will undoubtedly increase until the San Diego region has a local, sustainable, and reliable water supply, more emphasis must be placed on local water agencies to reduce costs to minimize the impacts on ratepayers. If the rate increase is not approved, monies within the DRES account or Appropriated Reserve may be used to cover the increased water costs. As well, the City may forgo or delay non-essential capital projects financed on a cash basis to cover costs. Either way, the City must complete annual financial and performance audits of the PUD through the Independent Rates Oversight Committee as originally promised to SDCTA and ratepayers in 2007.

Background:

Pass-Through Rate Increases

Table 1: City of San Diego "Pass-Through" Rate Increases	
Date of Enactment	% Increase
1/1/2008	2.90%
1/1/2009	6.26%
1/1/2010	7.75%
1/1/2011	4.69% (proposed)
Total	23.34%

The City of San Diego is heavily reliant upon imported water, and is therefore subject to the water rates charged by both the Metropolitan Water District (MWD) and the San Diego County Water Authority (CWA). Beginning January 1, 2008, the City began a series of annual rate increases that were determined to be "pass-through" rate increases caused by the increased costs of water of both MWD and CWA.

On April 13, 2010, the MWD Board of Directors approved 7.5% rate increases for calendar years 2011 and 2012. The currently proposed rate increase of 4.69% is in response to the 2010 MWD increase, and the subsequent increase by CWA. Therefore, another rate increase can be anticipated to be proposed in the City for calendar year 2012 following a CWA adopted increase.

Infrastructure & IPR Related Rate Increases

On February 26, 2007, the Council approved a series of four (4) annual rate increases of 6.5% that would be dedicated to meeting Federal and State requirements to upgrade the water system. The annual rate increase initiated on July 1 of each year between 2007 and 2010.

On November 17, 2008, the Council approved a temporary rate increase of 3.08% to fund the Indirect Potable Reuse (IPR) demonstration project. Funding for this project has been achieved, and beginning in January 2011, customers will no longer be charged this additional rate.

Table 2: City of San Diego Infrastructure and IPR Rate Increases

Date of Enactment	% Increase
7/1/2007	6.50%
7/1/2008	6.50%
1/1/2009	3.08%
7/1/2009	6.50%
7/1/2010	6.50%
Total	32.60%

Financial & Performance Audits

Leading up to the 2007 rate case, there was a commitment for a detailed plan to safeguard water and wastewater rates which included annual independent performance audits for both the Water and Wastewater systems¹. Prior to the beginning of FY11, the Independent Rates Oversight Committee (IROC) had not retained an independent firm to conduct annual performance audits of the Department. Bid-to-Goal (B2G) Program reports have been used in lieu of comprehensive performance audits for the Department. Currently, costs to have the City Auditor conduct performance audits have been budgeted within the PUD, and efforts are underway to begin this review. An independent financial audit, separate from the Comprehensive Annual Financial Report conducted city-wide, that review PUD specific expenditures has not been started.

Proposal:

The San Diego City Council has approved holding a Proposition 218 hearing to increase the City’s water rate by an average of 4.69%. It is estimated the CWA pass-through rate increase are estimated to total \$25.2 million, which will be funded by the proposed City of San Diego water rate increase. At the November 29th City Council hearing, the Council approved setting a Proposition 218 hearing for January 24, 2011, and protest notices have been sent to San Diego ratepayers. At this hearing, the Council can decide to either approve or reject the rate increase, assuming a majority of protest votes by ratepayers are not submitted. If the rate increase is not approved, the Public Utilities Department (PUD) will need to identify \$25.2 million in reduced expenditures to offset the increased costs. If approved, the increase will take effect beginning March 1, 2011

Policy Discussion:

Past Rate Increases

Since 2007, a typical single family residential customer has experienced a 65.2% increase in their water bill. This overall increase does not take into account the IPR related increase, as this increase will no longer apply.

¹ “Mayor Sanders Details Plan to Safeguard Water and Wastewater Ratepayer Funds”, February 15, 2007.

	FY 2007 (monthly)	14 HCF Usage	Proposed - Jan. 1, 2011	14 HCF Usage
Base Fee (3/4 inch)	15.87	15.87	19.33	19.33
Commodity Rate (0-7 HCF)	1.731	12.117	3.557	24.899
Commodity Rate (7-14 HCF)	2.162	15.134	3.858	27.006
		\$ 43.12		\$ 71.24
		% Increase	65.20%	
Data Sources	2/26/07 Public Notice		11/15/10 Public Notice	

¹HCF = Hundred Cubic Feet. 1 HCF totals 748 gallons

Date	Multi-Family Rate (per HCF)	Commercial/Industrial Rate (per HCF)
1/1/2008	2.461	2.357
1/1/2011 (Proposed)	3.915	3.755
Total	59.08%	59.31%

Assuming the City applies the same rate increase of 4.69% to customers next year, the average single-family residential customer will see an increase of \$3.34, and a total monthly bill of \$74.58. This amount would represent a 72.9% increase since 2007.

Multi-Family Residential customers and Commercial/Industrial customers have also experienced pass-through rate increases. Assuming the proposed rate increase becomes effective, these customers have experienced a 59% increase in commodity rates since January 1, 2008.

Department Reserves

The PUD currently has six (6) reserve accounts with a FY11 budget of approximately \$74.2 million.

Should the Council not approve the proposed pass-through rate increase, it appears two (2) reserve funds would be able to pay for a portion of the additional water costs: the appropriated reserve and the Dedicated Reserve from Efficiency & Savings (DRES) Fund. While the Rates Stabilization Reserve has a stated intent of mitigating rate increases, the fund is strictly used to maintain the required reserve for debt coverage. Any transfer of funds from this account could impact the City's bond rating and in valuation of their bond covenants.

By the end of FY08, the DRES had \$3.0 million in savings. According to the PUD, as of June 30, 2009, the fund had a total balance of approximately \$15.1 million. These funds can be used to offset any rate increase, or be used to complete additional capital projects that may need to be paid for by future rate increases. The exact list of projects that will be included within any future rate-case has yet to be determined.

Table 5: City of San Diego PUD Reserve Funds*

Fund	Description	Amount (millions)
Appropriated	Can fund operating or capital needs, including purchased water.	\$3.5
Operating	Limited to fund responses to emergency situations. Must be replenished by next fiscal year.	\$30.9
Capital	Specific to capital improvement costs and unanticipated capital needs	\$5.0
Rate Stabilization	Funds used to protect water system from defaulting on legal debt obligations and mitigate future rate increases. Required legal coverage ratio of 1.2x.	\$20.5
Secondary Purchase	Funds purchase of additional water supply, over and above City's regular purchases, in case of extended drought, unexpected interruption in service or contamination.	\$11.3
Dedicated Reserve from Efficiency & Savings (DRES)	Intended to offset capital costs and accelerate CIP schedules. Funded through savings from efficiencies. Can also be used to stabilize rates.	\$3.0**

*Description and funding amounts provided by City to SDCTA
** For Fiscal Year ending 2008

PUD Bid-to-Goal Program

The Bid-to-Goal (B2G) Program for the City's Water and Wastewater Departments is a combination of both a bid process and a gainsharing incentive program. The purpose of the bid process is to have each department compete with a benchmark established by a private contractor. If the department is able to exceed the benchmarks established and achieve savings, employees are eligible to receive bonuses.

On February 2, 2010, City Auditor Eduardo Luna released an audit report of the B2G Program. Below is a brief summary of the audit results:

- Between FY05 and FY08, payouts for B2G totaled approximately \$28 million.
- All participating departments have achieved actual costs below the employee bid with audited savings of approximately \$116.2 million. B2G has been closely linked with other systems and efforts and gainsharing goals have reflected mandatory requirements. In 2006, Wastewater Department incorporated Business Process Reengineering (BPR) into existing B2G program.
- In FY08, 1,463 Water and Wastewater employees (91%) received payouts.
- Departmental guidance establishes that gainsharing should incentivize performance above and beyond core service levels-stretch goals-and be measurable and auditable. For FY08 and FY09, the audit identified several goals that were not stretch goals, such as goals for hiring a consultant and for completing the annual B2G performance report.
- Between FY05 and FY08, B2G cost savings were overstated by \$10.7 million

- Water and Wastewater Departments incorrectly reported on gainsharing goal performance in 56 out of 140 goals tested between FY05 and FY08. Employees verify and report out on their own goals, posing an internal control weakness.

A third-party review of the gainsharing goals associated with the program was presented to the City's Audit Committee on September 13, 2010. The review determined the following:

- 70 percent of the goals are recommended for inclusion with minor/or no revisions
- 30 percent of the goals are recommended for inclusion with significant revisions
- 10 percent of the goals are not recommended for inclusion

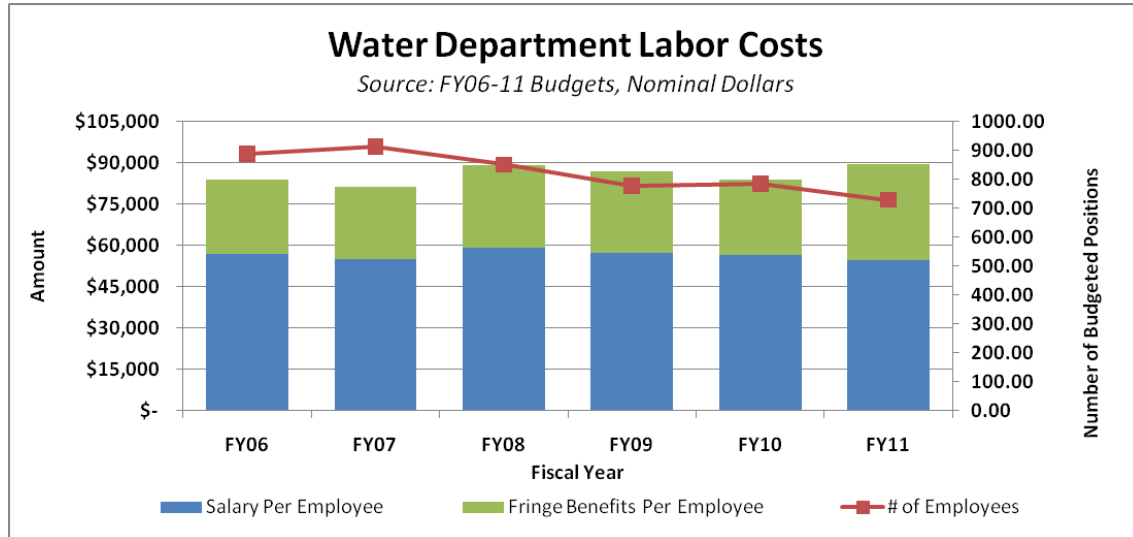
At this meeting, the Audit Committee referred the report to the City Auditor to answer the following questions:

1. Which of the goals contained in the Bid to Goal program have:
 - a. Clearly identified outcomes that benefit rate payers;
 - b. Specific and measureable performance measures that relate to the outcome of the goal; and
 - c. Clear targets that will indicate that exceptional performance will be achieved?
2. Of all the goals, which can be determined to have met criteria a, b, and c?

It is anticipated an extension of the program for employees will be presented to a Council Committee, to then be forwarded to the full Council for approval.

Labor Costs

Between FY06 and FY11, the Water Department has reduced the number of employees from 889 full-time equivalent employees (FTE) to 729 FTEs, a 22% reduction (Chart below). During this span, the cost per employee increased from \$83,732 to \$89,420, a 6.8% increase. While the salary per employee cost decreased by 4.3% during this time, the fringe benefit cost per employee increased by 30%. The Department has not reduced personnel expenditures per employee. Despite the reduction of employees within the Department the total departmental budget has increased FY08 levels.



Employee Transfers to Enterprise Funds

On September 8, 2010, Councilmember Carl DeMaio released a report that indicated 169 employees from the General Fund have been transferred to Enterprise Funds over a two-year period (Fiscal Years 2009 and 2010). Of these transfers, 38 were moved to the Water Department and 29 to the Metropolitan Wastewater Department. The report further stated:

“Transfers to these departments included moving employees from a wide variety of General Fund departments, including but not limited to Police, the City Attorney’s office, Community & Legislative Services, Fire Rescue, Library and the Ethics Commission.”

According to Councilmember DeMaio’s report, in total, over \$3.4 million in employee salaries were transferred from the General Fund to the Water and Wastewater Departments in FY09 and FY10.

Department	# of Employees	Salary - General Fund	Salary - Enterprise Fund
Water	38	\$ (2,016,746)	\$ 1,956,332
MWWD	29	\$ (1,533,276)	\$ 1,506,312

Source: "Water Rate Increases: The Need to Curb Wasteful Spending at Water Agencies" by Councilmember DeMaio. September 8, 2010

While the Department has been able to reduce the number of budgeted employees since FY06, these transfers have increased the personnel costs within the Department. Since these positions are being filled by current employees, the Department is not taking advantage of the new pension system that was adopted by the City and reducing costs. The Department has stated controls are in place limiting employees to only perform work within the enterprise fund. If employees are authorized to perform work for another department, employees are required to charge their time to that department under a Service Level

Agreement (SLA). The SLA allows the PUD to be reimbursed for the entire cost of providing these services.

Other Funding Options

The City Council does have the option to either reject, or minimize the size of the pass-through rate increase. Acting on either of these options would require additional funding to pay for the increased cost of purchasing water. As mentioned previously, funding from two (2) reserve accounts is eligible to cover the increased costs of water purchases. Should reserve funding be withdrawn, pay-as-you-go funding for the Capital Improvement Program can also be used to make up the remaining difference.