



City of San Diego 2015 Cost of Service Study/ Rate Increase
October 2015

SDCTA Position: **SUPPORT**

Rationale for Position:

The City of San Diego and its residents have made great strides in conserving and recycling water in the face of an historic drought. Unfortunately, the City finds itself needing to charge water customers more for using less. This ironic situation is not only possible under the current system, but likely to reoccur. While the justification for these increases is well-argued by City staff, they will serve to increase the funding of a clearly imperfect system that operates with largely variable revenue funding largely fixed costs.

The rate case outlines the need for adjustment based on a reduction in water usage and department revenue and the need to maintain municipal credit ratings. SDCTA staff supports the inclusion of financial review periods prior to incremental increases over the next five years.

While SDCTA staff believes there is reason to support the City of San Diego's water rate increase, we can only do so with the strong recommendation that City staff work to innovate out of this cycle of penalty for prudence and wherever possible, institute more robust citizen engagement through education and open data on spending, progress, timelines, and budgets.

Title: 2015 City of San Diego Water Rate Increase

Jurisdiction: City of San Diego

Type: Rate setting

Vote: City Council

Status: Awaiting Council Hearing—November, 2015

Issue: Water/Rate setting

Description: If enacted, rates for water in the City of San Diego would increase for each year from FY 2016 to FY 2020.

Fiscal Impact: \$150,000 for printing and distribution of Proposition 218 notice of rate hearing to customers. The anticipated increase in Public Utilities Revenue generated by increased rates between FY 2016 and FY 2020 is approximately \$475 million.

Background:

The City of San Diego provides water to approximately 280,000 accounts, totaling around 65 billion gallons of water annually. Because local water sources are limited, the City's water supply is derived from a mix of purchased water, local sources and recycled water.

After four years of historic drought conditions, the City has only emergency reserve levels in its reservoirs and is projecting that it will not be able to draft any local supply in FY 2016. In

addition, on April 1, 2015, the Governor's call to action for urban water districts to cut water consumption by 25% included direction to the State Water Resources Control Board (SWRCB) to achieve this target. On May 5, 2015 the SWRCB assigned the City of San Diego a conservation standard that resulted in a reduction mandate of 16%.

Past Rate Increases

In 2006, the City of San Diego (City) approved a Cost of Service Study (COSS) and subsequent four-year 6% rate increase (Rate Case) to pay for Capital Improvement Program (CIP) projects for both the water and wastewater systems.

In 2008, the PUD proposed four years of 6.5% increases for FY 2008 – FY 2011. When that expired, the City then completed a Cost of Service Study and proposed a two-year rate increase of to comply with debt service coverage requirements for FYs 2014 and 2015. Based on revenue projections at the time, the water system required an increase in revenues of 7.25 percent in FY 2014 and an additional 7.50 percent in FY 2015. The wastewater system did not require an increase in revenues over these two fiscal years.

Past SDCTA Position

The San Diego County Taxpayers Association (SDCTA) supported the Rate Case proposed in 2006. SDCTA's support was contingent on the creation of the Independent Rates Oversight Committee to oversee the use of funds toward CIP projects.

SDCTA opposed the 2011 increase. SDCTA remained neutral and did not support or oppose the rate increases for FYs 2014 and 2015. In taking this position, staff argued that

- The Public Utilities Department had absorbed pass-through water rate increases over the previous two years, and revenues had then dropped to a level in which required debt service coverage ratios were at risk
- PUD had not fully spent revenue from the past rate case on capital projects needed throughout the city
- The public outreach associated with this rate increase was inadequate, and more should have been done to educate ratepayers

Additionally, SDCTA conditioned its neutral position on the desire to work with the PUD to prepare for the next rate case and ensure additional investments in CIP projects and alternative supply sources such as Water Reuse and Desalination were done in a manner that respected local ratepayers.

Following this rate case, SDCTA has been publicly supportive of many of the City of San Diego's efforts towards alternative supply and reuse strategies, most notably the City's PureWater project.

2015 Rate Proposal:

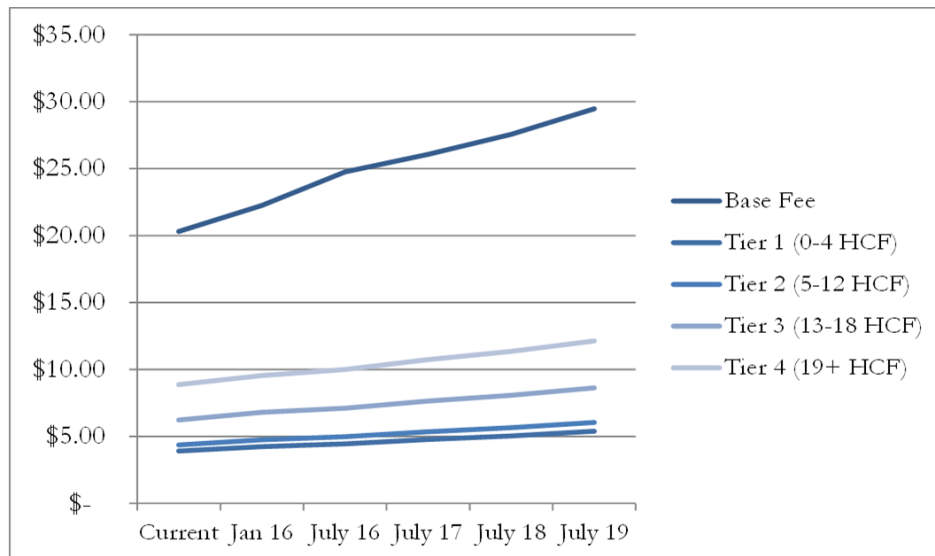
The 2015 Public Utilities Department proposal includes rate increases for potable water for FY 2016 to FY 2020. The residential increases are summarized below.

Fig 1: Proposed Rate Increases: Single Family Residential

| | Current | Jan 16 | July 16 | July 17 | July 18 | July 19 |
|---------------------------|----------|----------|----------|----------|----------|----------|
| Base Fee | \$ 20.31 | \$ 22.26 | \$ 24.75 | \$ 26.06 | \$ 27.56 | \$ 29.46 |
| Tier 1 (0-4 HCF) | \$ 3.90 | \$ 4.24 | \$ 4.44 | \$ 4.77 | \$ 5.04 | \$ 5.39 |
| Tier 2 (5-12 HCF) | \$ 4.36 | \$ 4.75 | \$ 4.98 | \$ 5.34 | \$ 5.65 | \$ 6.03 |
| Tier 3 (13-18 HCF) | \$ 6.23 | \$ 6.79 | \$ 7.11 | \$ 7.63 | \$ 8.07 | \$ 8.62 |
| Tier 4 (19+ HCF) | \$ 8.87 | \$ 9.55 | \$ 10.00 | \$ 10.73 | \$ 11.34 | \$ 12.12 |

Source: City of San Diego, 2015 Cost of Service Study

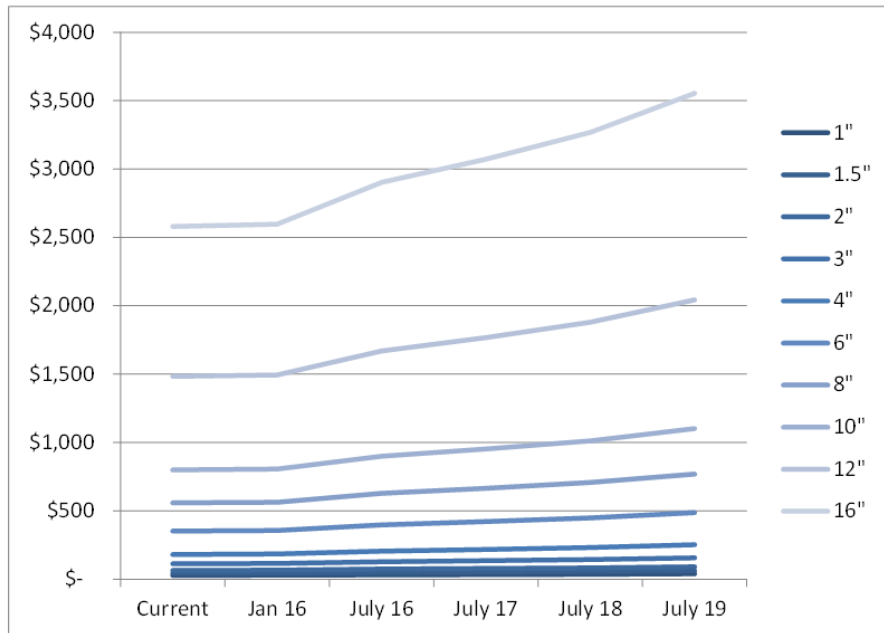
Fig 2: Proposed Rate Increases: Single Family Residential



Source: City of San Diego, 2015 Cost of Service Study

Base fees increase across consumer types. Notably, fees on larger meter sizes increase more rapidly, thereby penalizing heavy users.

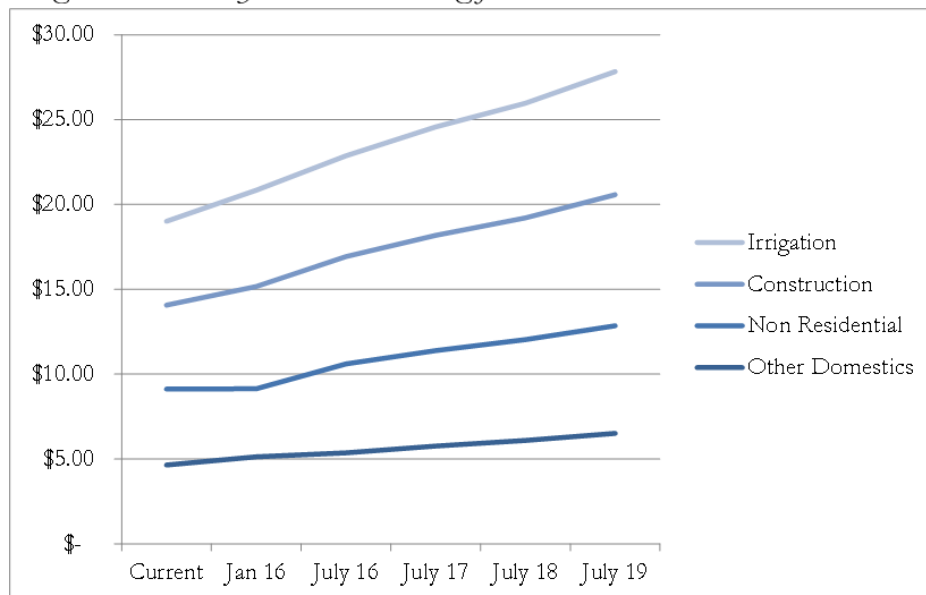
Fig 3: Increasing Base Fees Across Meter Sizes



Source: City of San Diego, 2015 Cost of Service Study

Non-residential users, multifamily residential and business, see increases in their commodity rate similar to those for single family residential users.

Fig 4: Commodity Rates Increasing for Non-Residential Users



Source: City of San Diego, 2015 Cost of Service Study

The PUD also recommends increasing the commodity rate for recycled water usage and the base meter fee. Under the current proposal, the cost of using recycled water would increase

from \$0.80 to \$1.73 for each Hundred Cubic Feet (HCF) of water. Some monthly meter-based charges would be decreased. New recycled water projects and connections coming online allow the PUD to lower these fees.

Fig 5: Recycled Water Commodity and Monthly Meter Fees

| Meter Size | Current | Jan 16 | July 16 | July 17 | July 18 | July 19 |
|------------|------------|------------|-------------|-------------|-------------|------------|
| 1" | \$ 8.63 | \$ 21.55 | \$ 21.55 | \$ 21.55 | \$ 21.55 | \$ 21.55 |
| 1.5" | \$ 43.27 | \$ 39.05 | \$ 39.05 | \$ 39.05 | \$ 39.05 | \$ 39.05 |
| 2" | \$ 65.96 | \$ 60.06 | \$ 60.06 | \$ 60.06 | \$ 60.06 | \$ 60.06 |
| 3" | \$ 246.93 | \$ 126.52 | \$ 126.52 | \$ 126.52 | \$ 126.52 | \$ 126.52 |
| 4" | \$ 411.53 | \$ 224.50 | \$ 224.50 | \$ 224.50 | \$ 224.50 | \$ 224.50 |
| 6" | \$ 925.93 | \$ 493.94 | \$ 493.94 | \$ 493.94 | \$ 493.94 | \$ 493.94 |
| 8" | \$1,234.59 | \$ 843.86 | \$ 843.86 | \$ 843.86 | \$ 843.86 | \$ 843.86 |
| 10" | \$1,646.12 | \$1,333.75 | \$ 1,333.75 | \$ 1,333.75 | \$ 1,333.75 | \$1,333.75 |
| 12" | \$2,263.42 | \$1,753.65 | \$ 1,753.65 | \$ 1,753.65 | \$ 1,753.65 | \$1,753.65 |
| 16" | \$3,703.75 | \$3,503.24 | \$ 3,503.24 | \$ 3,503.24 | \$ 3,503.24 | \$3,503.24 |
| \$/HCF | \$ 0.80 | \$ 1.73 | \$ 1.73 | \$ 1.73 | \$ 1.73 | \$ 1.73 |

Source: City of San Diego, 2015 Cost of Service Study

The proposal also requests an increase for the fees charged for water use by private fire protection.

Rate Increase Rationale

The City defends the need for these rate increases based on three primary cost drivers:

- The PUD has experienced a significant drop in revenue because of increased local conservation and State and local drought restriction mandates
- The cost of purchased water has increased
- PUD has expanded its capital program including ongoing costs associated with the PureWater program
- Additional funding will be necessary to maintain bond covenants and credit rating

The PUD states that the outlined increases are necessary in order to ensure that department revenues are sufficient to maintain their current level of operations and the progress made so far in programs that will reap long-term cost savings, such as PureWater.

In response to historic drought conditions, Governor Brown has mandated reductions to local water usage by 25% of 2013 levels. San Diego's reduction goals were less than this at 16% because of a history of investment in drought preparedness. Even with this slightly smaller magnitude, drought conditions have contributed to lower water usage and thereby lower revenue for the PUD. The department's revenue drop from usage reductions is estimated at \$46 million from FY 2015-2016.¹

¹ 2015 Cost of Service Study

Additionally, costs associated with water purchased from the San Diego County Water Authority (SDCWA) are expected to increase for the term of the rate proposal. Investment in innovative projects, such as the Carlsbad desalination plant, may insure long term water resources but at significant initial expense. The SDCWA board approved increases in wholesale water rates in June of 2015. The most recent Cost of Service Study estimates these increases will raise PUD expenses by approximately \$12 million annually.

The PUD cites several examples of increased departmental efficiency in their defense of increased rates:

- Permanent staff reductions of 329 positions since 2007
- Energy cost reduction of \$12.1 million through green energy generation
- Use of grants & State Revolving Fund loans saving \$177.6 million since 2010

The PUD additionally points to recommendations in its most recent Cost of Service Study suggests increasing rates is necessary to comply with its bond covenants and maintain its credit rating.

The City’s COSS lists \$800 million in outstanding debt obligations in addition to estimated \$874 million additional capital costs from FY 2016 – FY 2020. Of these expenses, approximately \$354 million are associated with the implementation of the PureWater program. The COSS recommends that the PUD maintain a debt service coverage ratio (DSC) of 1.25%.

In 2009, the City of Oceanside rejected a rate increase proposal and failed to meet their debt coverage obligations, resulting in a drop in their credit rating.² Moody’s Investor Service has confirmed that failure to meet debt obligations could result in a similar drop for San Diego.

Finally, the PUD proposal includes financial review periods prior to increases in FY 2017 and 2019 that will require the department to confirm the continued need for increased revenue will allow adjustment of future increases.

Fiscal Impact

The proposed 2015 PUD rate increases would raise the cost of water usage across consumer types.

Fig 6: Annual PUD Revenue Projections

| | FY 2016 | FY 2017 | FY 2018 | FY 2019 | FY 2020 |
|------------------------------|----------------|----------------|-------------------------------------|----------------|----------------|
| Existing Rate Revenue | \$ 385,401,100 | \$ 388,626,500 | \$ 391,892,800 | \$ 395,200,800 | \$ 398,549,800 |
| Post Adjustment Revenue | \$ 18,865,400 | \$ 67,486,900 | \$ 99,790,500 | \$ 125,424,600 | \$ 163,240,000 |
| | | | FY 2016 - FY 2020 Increased Revenue | | \$ 474,807,400 |
| Other Operating Revenue | \$ 44,816,600 | \$ 48,694,800 | \$ 49,629,800 | \$ 50,374,100 | \$ 51,547,800 |
| Non-Operating Revenue | \$ 6,549,500 | \$ 8,446,400 | \$ 9,848,700 | \$ 11,825,100 | \$ 14,862,700 |
| Total Revenue, No Increase | \$ 436,767,200 | \$ 445,767,700 | \$ 451,371,300 | \$ 457,400,000 | \$ 464,960,300 |
| Total Revenue, With Increase | \$ 455,632,600 | \$ 513,254,600 | \$ 551,161,800 | \$ 582,824,600 | \$ 628,200,300 |

Source: City of San Diego, 2015 Cost of Service Study

² The Coast News Group. “[Failure to increase water rates makes it hard for city to pay bills.](#)”

In its documentation of the 2015 rate case, the PUD provides an approximation of its operating revenue from the current year until FY 2020. This data is illustrative of the total impact born by San Diego ratepayers.

Based on the COSS projections, for the period FY 2016 – FY 2020, PUD will generate approximately \$475 million in new revenue from the proposed rate increases. This is a direct fiscal impact to San Diego water users.

Policy Considerations: Recycled Water Increases

As presented, the PUD plan for rate adjustments includes increase to the price of recycled water for the department's customers. This water is used largely by commercial buildings, businesses, hospitals, HOAs and schools.

Complaints have been raised at numerous public forums regarding the PUD's approach to these increases with emphasis on the increases not being incremental and the PUD's approach to charging these rates uniformly across all recycled water customers.

Currently, the recycled water rate is set at \$0.80 per HCF and has been kept at this level since 2001. The increase to \$1.34 per HCF would set recycled water rates at approximately 34% of the proposed commercial potable water rate.

Increases in potable and recycled water rates are currently proposed to generate approximately \$475 million in new PUD revenue. Through its Cost of Service process, the department has established that this is the amount that is needed to cover their debt obligations and continue operating under their current credit rating paradigm. Were the increases to recycled water rates to increase incrementally, the total generated from the increase would be less and would have to be offset by an even higher increase to the potable water rates. Alternately, PUD could possibly increase the rates incrementally but by a higher overall percentage in order to generate the same amount of revenue.

Complaints have also been levied with regard to the equity of charging different recycled water customers—those using the North City and South Bay systems—the same rate for recycled water purchase.

The North system serves over 600 recycled water customers while the South serves seven. The PUD's proposal is based on an increased rate of \$1.73 per HCF for customers of each system. This rate will still not fully recover costs associated with providing recycled water because it is based on production and distribution and does not factor in costs associated with O & M. These costs are, in effect, subsidized by potable water sales.

Following a zoned pricing system would not change the total amount of new revenue generated but would instead increase rates an additional 24% for customers served by the North system. New zone rates would then equal \$1.17 per HCF for the South system and \$2.14 per HCF for the North. Customers in the North system that would be subject to this additional increase include the City of San Diego and the Olivenhain Water District which serves portions of Encinitas, Carlsbad and Solana Beach.



In discussing the questions surrounding both zone rates and phased increases, the San Diego City Attorney's office issues a memo advising that the PUD was not legally required to adopt zone rates and advising against increasing recycled water rates over time.³

Ratepayers in both the North and South systems benefit from users substituting recycled water for potable water in either system. Both systems additionally share the use of the metro wastewater system.

³ City of San Diego, Office of the City Attorney. "[Memorandum of Law: Recycled Water Rates.](#)" September 4, 2015.