

CITY OF SANTA ROSA
BOARD OF PUBLIC UTILITIES

TO: CHAIR AND BOARD MEMBERS
FROM: NICK HARVEY, DEPUTY DIRECTOR – ADMINISTRATION,
SANTA ROSA WATER
SUBJECT: 2024 WATER AND WASTEWATER COST OF SERVICE STUDY
AND PROPOSED FY25/26 THROUGH FY29/30 RATE
SCHEDULE

AGENDA ACTION: RESOLUTION

RECOMMENDATION

It is recommended by the Board of Public Utilities Budget Subcommittee and Santa Rosa Water that the Board of Public Utilities, by resolution, recommend that, after compliance with Proposition 218 and successful conclusion of a protest hearing, the City Council 1.) Enact increased rates for water services and 2.) Enact increased rates for wastewater services.

EXECUTIVE SUMMARY

In 2023, Santa Rosa Water (SRW) hired Hildebrand Consulting, LLC (HC), to develop a ten-year long-range financial plan, followed by a thorough cost of service analysis and recommendation of a new water and wastewater rate schedule. HC found SRW's financial health is such that at the end of the current rate schedule, set to conclude on June 30, 2025, moderate annual water and wastewater rate increases would be required. Proposed increases between 6-7% each year for water fixed and usage charges and 5% each year for wastewater fixed and usage charges are proposed to help ensure that SRW continues to meet all service and financial obligations. In addition, SRW is proposing the re-introduction of the pass-through rate increase to water rates. This would ensure that the annual increase for wholesale water rates through Sonoma Water would be passed through to the usage portion of customer water bills, ensuring that SRW is neither under nor over charging customers for the annual increase in the cost of wholesale water. Given the increased volatility in the price increases proposed by Sonoma Water in recent years, Santa Rosa recommends this approach. In terms of the billing impacts, in years where Sonoma Water's increase to the wholesale rate is larger than SRW's increase to the usage rate, the customer would see an impact slightly larger than the rate proposal on the usage portion of their bills,

and in years where Sonoma Water's increase to the wholesale rate is smaller than SRW's increase to the usage rate, the customer would see an impact slightly lower than SRW's increase to the usage rate.

BACKGROUND

Over the past year SRW staff has worked with HC to develop and maintain a comprehensive and detailed financial model that will be utilized by SRW over the next ten years to track revenues and expenditures and to help inform future financial planning. The data used in this modeling includes, but is not limited to: revenues, expenditures, debts service, capital improvement plans, development fees and various reserve balances. This model is the primary analytical tool for determining ongoing financial requirements for SRW and provides the basis for our recommended water and wastewater rate schedule.

There are two rate setting objectives that are primary and fundamental to guiding the rate-setting process, (1) water and wastewater rates must generate sufficient revenue to meet the utility's service and financial obligations for each enterprise, and (2) water and wastewater rates must be calculated consistent with the requirements of the California Constitution, Article XIID, section 6 (Proposition 218) and relevant case law. Other objectives include rates being viewed as fair and equitable by the public; rates should be simple, understandable, and easy to administer; and rates should strike an appropriate balance between fixed and usage-based charges.

After revenue needs are determined, a cost-of-service analysis is required to develop the rate schedule. This portion of the study analyzes SRW customer water and wastewater use data to determine the appropriate distribution of fixed, capacity and commodity costs between customer classes and the usage versus fixed charges. While there are changes based on customer data to the distribution of costs between customer classes, and between fixed and usage charges, the overall rate structure is not changing.

Although the rate structure is not changing, SRW is recommending the re-implementation of the wholesale pass-through rate increase for the cost of purchasing wholesale water from Sonoma Water via the Santa Rosa aqueduct. This proposal would affect the approach to determine water rates, but not wastewater rates. Over the past few years, there has been quite a bit of volatility in Sonoma Water's wholesale rate. After several years of steady, predictable increases to the wholesale rate, SRW decided to do away with the pass-through methodology, and just build the costs into our water rates. As such, there was no wholesale rate pass-through as part of our water rates effective FY21/22 through FY24/25. The budget cycle for fiscal years 2023/24 and 2024/25 brought a significant shift in Sonoma Water's wholesale rate increases, being 10.6% and 9.9% in those years, respectively. As a result, SRW's water budget absorbed approximately 4.6% and 3.9% in each of those years. Given the difficulty in

anticipating Sonoma Water's wholesale rate increases, re-introduction of the pass-through is the most prudent option for SRW, ensuring that water rates are neither punitive nor insufficient with respect to the wholesale cost of water.

PRIOR BOARD OF PUBLIC UTILITIES REVIEW

On December 5, 2024, the Board of Public Utilities held a study session on the recommended rates and the cost-of-service study.

ANALYSIS

Proposed Rate Schedule Factors

The ten-year financial model is the tool used to determine the appropriate rate schedule for covering Operation and Maintenance (O&M), Capital Improvement Projects (CIP), and Debt Service costs.

The main drivers for the proposed rate schedule include:

- The most significant cost assumptions that affect rates include: O&M Expenditure increases at 3%; increase in general and construction inflation; salary and benefit increases of 9% in year 1 of the financial model, 4% in year 2 and 3.5% thereafter, incorporating the estimated impacts of the recently adopted Memorandum of Understandings between the City of Santa Rosa and employees (MOUs) and anticipated impacts of the classification and compensation study currently in process; 4% increases in chemicals and utility costs.
- Due to the proposed re-introduction of the pass-through rate increase for escalating wholesale water costs, our financial model is not currently predicting annual increases to the costs of wholesale water supply.
- Interest earnings are expected to remain at a modest 1%.
- Growth rates, which produce connection fee revenue, increases at 1.1%.
- Water demand is expected to remain stable. Water use has been consistent over the last 10 years and is being projected, for the purpose of rates, to remain within a stable range.
- Investment in the CIP Program will continue to increase at 3% for the Water and Wastewater enterprises through FY 2028. In FYs 2029-35, CIP investments will see a sharp increase for both water and wastewater, culminating in reaching target CIP investment levels of \$34 million per year and \$42 million per year by 2035, respectively. These amounts represent our current target CIP Program investment levels as identified in the 2022 Water Infrastructure report. After consideration of these amounts, and discussion with our consultant, it was decided that SRW should take a measured approach to reaching these target investment levels over the next 10 years, giving SRW the opportunity to address CIP project delivery efficiency while protecting its customers from sharp rate increases over the next 10 years. For the Regional Reuse Enterprise, SRW is

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assuming that the Regional partner agencies, including SRW, will continue to increase the annual cash CIP investments by \$1 million per year over the next 10 years.

- Existing debt service has been included in the model based on the existing repayment schedules.
- The model also assumes that the Regional Reuse enterprise will pursue the issuance of approximately \$35 million of revenue bonds at an assumed interest rate of 5.5% in FY 2026. This debt issuance will primarily be used to execute the electrical infrastructure replacement project at the Laguna Treatment Plant, which is key in improving safety and reliability at the plant.

Based on the Cost-of-Service study and financial assumption built into the 10-year financial model, the proposed Water and Wastewater is as follows, with increases applying equally to both fixed and usage rates:

	Baseline Water Rate Adjustments ²	Wastewater Rates Adjustment	Change in a Typical Single Family Utility Bill ³
July 2025 ¹	6.0%	5.0%	6.1%
July 2026	6.0%	5.0%	5.4%
July 2027	6.0%	5.0%	5.4%
July 2028	7.0%	5.0%	5.8%
July 2029	7.0%	5.0%	5.8%

¹ While the overall rate revenue adjustment for FY 2025/26 are reflected in the table above, actual changes to individual customers' utility bills may vary in FY 2025/26 due to adjustments to the rate structure.

² The final adjustment to Water rates will be dictated by the pass-through of Sonoma Water wholesale water costs.

³ Typical single family bill includes a 5/8" water meter, 7,000 gallons of monthly water use, and 4,500 gallons of wastewater.

Customer Impacts

The cost-of-service analysis determines how the costs are distributed between each component of the water and wastewater fixed and usage rates. The distribution to each component is based on actual customer usage data and adjusted with each update to rates. Due to the redistribution of the costs, the first year of increase affects customer classes at varied percentages. The increase percentage by customer class ranges from 4.9% to 8.1% as shown below. Following the first-year, increases will be consistent to all customer classes and components of the rate at the amounts shown in the rate increase table shown above.

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	Meter Size	Water Use (TGAL)	WW Use (TGAL)	Bills With Current Water/WW Rates			Bills With Proposed Water/WW Rates			Change in Total Bill	
				Water	Wastewater	Total	Water	Wastewater	Total	\$	%
Single Family Residential											
Low Water Use	5/8"	4	4	\$41.99	\$91.81	\$133.80	\$44.22	\$96.53	\$140.75	\$6.95	5.2%
Median Water Use	5/8"	7	4.5	\$64.02	\$99.83	\$163.85	\$68.90	\$104.88	\$173.78	\$9.93	6.1%
High Water Use	5/8"	12	6	\$100.15	\$123.89	\$224.04	\$109.22	\$129.91	\$239.13	\$15.09	6.7%
Very High Water Use	5/8"	20	7	\$159.19	\$139.93	\$299.12	\$175.44	\$146.60	\$322.04	\$22.92	7.7%
Duplex	5/8"	8	6	\$70.19	\$123.89	\$194.08	\$75.50	\$129.91	\$205.41	\$11.33	5.8%
Small Apartment (4 DUs)	1"	15	12	\$139.60	\$256.31	\$395.91	\$150.68	\$270.08	\$420.76	\$24.85	6.3%
Large Apartment (24 DUs)	2"	80	80	\$664.27	\$1,479.67	\$2,143.94	\$723.38	\$1,551.80	\$2,275.18	\$131.24	6.1%
Very Lrg. Apart. (100 DUs)	4"	320	320	\$2,558.82	\$5,739.26	\$8,298.08	\$2,792.98	\$6,011.12	\$8,804.10	\$506.02	6.1%
Small Retail	5/8"	6	6	\$57.43	\$106.73	\$164.16	\$61.34	\$112.99	\$174.33	\$10.17	6.2%
Large Retail	2"	80	80	\$664.27	\$1,250.87	\$1,915.14	\$723.38	\$1,326.20	\$2,049.58	\$134.44	7.0%
Office Building	1 1/2"	40	40	\$346.35	\$651.32	\$997.67	\$376.18	\$691.33	\$1,067.51	\$69.84	7.0%
Car Wash	2"	60	60	\$524.67	\$987.27	\$1,511.94	\$570.18	\$1,048.80	\$1,618.98	\$107.04	7.1%
Mixed Comm. w/ Food	1"	35	35	\$279.20	\$844.33	\$1,123.53	\$303.88	\$888.45	\$1,192.33	\$68.80	6.1%
Hotel w/ Restaurant	3"	200	200	\$1,592.18	\$4,825.28	\$6,417.46	\$1,737.78	\$5,081.42	\$6,819.20	\$401.74	6.3%
Restaurant	1 1/2"	50	50	\$416.15	\$1,239.12	\$1,655.27	\$452.78	\$1,306.03	\$1,758.81	\$103.54	6.3%
Supermarket	2"	160	160	\$1,222.67	\$3,057.27	\$4,279.94	\$1,336.18	\$3,219.80	\$4,555.98	\$276.04	6.4%
Mortuary	1"	20	20	\$174.50	\$509.83	\$684.33	\$188.98	\$537.60	\$726.58	\$42.25	6.2%
Small Winery	1"	10	10	\$104.70	\$286.83	\$391.53	\$112.38	\$303.70	\$416.08	\$24.55	6.3%
Sm. Irrig. (Wtr. Budg.=18 tg)	1"	20		\$172.50	(na)	\$172.50	\$186.44	(na)	\$186.44	\$13.94	8.1%
Lrg. Irrig. (Wtr. Budg.=250 tg)	4"	300		\$2,421.22	(na)	\$2,421.22	\$2,540.78	(na)	\$2,540.78	\$119.56	4.9%

Given the proposed pass-through policy, the ultimate water rate increases for each customer class will vary slightly from the table above, contingent upon the actual wholesale rate increase that is adopted by Sonoma Water for FY 2025/26.

FISCAL IMPACT

The proposed rate increases will ensure that Santa Rosa Water’s Water, Wastewater, and Regional enterprise funds continue to meet all service and financial obligations.

ENVIRONMENTAL IMPACT

Pursuant to CEQA Guidelines Section 15378, the proposed action is not a “project” subject to the California Environmental Quality Act (CEQA) because it does not have a potential for resulting in either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment. In the alternative, the proposed action is exempt from CEQA pursuant to CEQA Guidelines Section 15061(b)(3) because it can be seen with certainty that there is no possibility that the project may have a significant effect on the environment.

BOARD/COMMISSION/COMMITTEE REVIEW AND RECOMMENDATIONS

On November 6, 2024, the Budget Subcommittee of the Board of Public Utilities met to review the recommended rates and the cost-of-service study.

On December 5, 2024, The Board of Public Utilities held a study session on the recommended rates and the cost-of-service study.

NOTIFICATION

Proposition 218 Notice

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Proposition 218, also known as the “Right to Vote on Taxes Act” was approved by California voters in 1996. The proposition establishes a process for public notification when increasing property related fees or charges, including water and wastewater rates. The notification requires a minimum 45-day period for review and protest prior to the public hearing. Given widespread litigation challenging public agency rate processes and resulting legal risk and uncertainty, the California Legislature passed a new law that will be effective January 1, 2025, that requires prospective litigants “exhaust administrative remedies” by providing timely written objection specifying the grounds for alleged non-compliance with Proposition 218. Failure to timely submit a written objection precludes those same parties from later challenging the rate setting process. The written notice will include detailed information on the proposed rate increases, outline how to timely provide a written objection, and will specify the date, time and location of the public hearing by which written protests to the proposed rate change must be submitted. Assuming BPU and City Council concurrence on the proposed new rates, these notices will be mailed to customers in January to allow customers to submit written or verbal responses at the public hearing tentatively scheduled to occur at a City Council meeting in March 2025.

ATTACHMENTS

- Attachment 1 – 2024 Santa Rosa Water and Wastewater Rate Study
- Resolution

PRESENTER

Nick Harvey, Deputy Director – Administration, Santa Rosa Water