



City of Sierra Madre Agenda Report

Joe Mosca, Mayor
John Buchanan, Mayor Pro Tem
MaryAnn MacGillivray, Council Member
Josh Moran, Council Member
Nancy Walsh, Council Member

Nancy Shollenberger, City Clerk
George Enyedi, City Treasurer

TO: Honorable Mayor Mosca and Members of the City Council

FROM: Elaine I. Aguilar, City Manager
Sandra J. Levin, City Attorney

INITIATED BY: Bruce Inman, Director of Public Works
Karin Schnaider, Director of Administrative Services

DATE: June 22, 2010

SUBJECT: PROPOSITION 218 PROCESS AND PROPOSED WATER RATE INCREASE

SUMMARY

The City Council has directed staff to prepare a report explaining the Proposition 218 processes required for the implementation of water, sewer and storm drainage rate increases. Included in the City Council's direction to staff was a request for information clarifying the basis for the proposed tier structure and an explanation of the consequences of not raising the water rates. This staff report addresses the questions raised at the previous Council meeting. Staff is prepared to respond to any other questions.

Proposition 218

Proposition 218 the Right to Vote on Taxes Act was approved by California voters in November 1996. Prop 218 added Articles XIII C and D to the California Constitution. A State Supreme Court case, *Bighorn-Desert View Water Agency v. Beringson (July 2006)*, determined that utility rates (Water and Sewer) are subject to the requirements of Proposition 218. Specifically, Proposition 218 requires the City to provide notice and allow opportunity for a written protest prior to implementing a water rate increase; if a majority protest is received then the rate increase cannot be adopted. If no written protest is received, then the City may adopt the rate increase.

FOR CITY COUNCIL AGENDA _____

AGENDA ITEM # _____

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The process for adopting the rate increase is as set forth in the staff report of May 11, 2010:

1. The first step is providing staff the direction to initiate the process. An affirmative vote on this agenda item tonight (May 11th) does not raise the water rates; it simply directs staff to proceed with the process.

2. Mail notices at least 45 days before public hearing. The second step in the process of adjusting rates is to mail notices to all water customers within the City's service area. A standard letter will be sent out describing the amount of the rate adjustment, stating the effective date of the adjustment if approved, advising the customer of the protest procedure, and stating the date of the Public Hearing. The notices for water fees do not include ballots. Instead, those who wish to protest must submit a written protest (usually in the form of a letter). Guidelines for the submission and tabulation of protests are attached to this report as Exhibit D, and if the City Council acts to approve the initiation of the 218 process, approval the Guidelines is included in that action.

3. Hold Public Hearing. On the appointed date, the City Council will hold a public hearing and receive testimony on the matter of the proposed rate adjustment. If directed to proceed with the 218 process this evening (May 11th), the Public Hearing will be held July 13th.

4. First reading of ordinance at same meeting as hearing. Following the Public Hearing, if a majority protest has not occurred and the City Council approves of the rate increase, the City Council will receive first reading of an ordinance setting the adjusted rates.

5. Second reading at following meeting. Second reading and adoption of the rate adjustment takes place two weeks later. This is typically a consent calendar item."

With a unanimous vote, the City Council initiated the process at its May 11, 2010 meeting. At the June 8, 2010 City Council meeting the following questions were raised:

1. Must the UUT collected on the water rates be placed in the water fund? The UUT is a general tax and therefore can be placed directly into the general fund. Although it is calculated based upon the water and other utility bills, it is not a utility charge or a fee for service. Proposition 218 provides separate rules for the adoption of taxes (in Article XIII C) and, in particular, requires voter approval of taxes such as the UUT. Sierra Madre's UUT was voter-approved and is fully compliant with Proposition 218.

2. How much time is required after notice to the customers before the hearing may be held? The law specifies that the hearing may not be held for 45 days after notice is

provided. City staff sent notices on May 17, 2010 to all water customers, as well as the property owners identified on all water accounts. The July 13th hearing is thus 57 days after notice was provided, 12 days more than the 45 day notice provision.

3. Can the City charge more to some parcels than to others? Can the City charge higher rates to future development than to existing homes? Proposition 218 requires that the revenues derived from the fee "shall not exceed the funds required to provide the property related service" and that the amount of the fee "shall not exceed the proportional cost of the service attributable to the parcel." As a result, the rate structure must reflect a fair and proportional allocation of the cost of providing the service to the parcel. This is one of many reasons that a licensed engineer's report (such as the one provided by Bucknam Associates) is used to calculate, document and support the proposed rates. It is important to note that increased infrastructure costs, resulting from new development, is recovered by other fees, such as Development Impact fees.

Unlike development impact fees, Proposition 218 provides that fees for the provision of water service (i.e., water rates) may not be imposed unless that service is actually used by, or immediately available to, the property in question. "Fees or charges based on potential or future use of a service are not permitted." Thus, higher water rates cannot be charged based upon possible future costs or impacts. All customers must be charged a rate proportional to the actual cost of providing the service to that property. Although the agency has discretion to establish rates and there are a variety of rates and rate structures that will comply with Proposition 218, it is prudent and customary to use a rate structure that is established and supported by a professional engineer's report based upon data and analysis.

Proposed Water Rate – Questions and Answers

What is the proposed rate increase?

Similar to how the current water bill is calculated, there are two factors that go into the total water bill, and it may be helpful to briefly discuss customer billing.

1. Water Meter Size
2. Water Consumption, being proposed in a Tiered Rate Structure

Below is the analysis of the two cost factors.

1. Water Meter Size

A water meter is a device used to measure the volume of water demanded from the water system. There is a direct relation to size of the meter and the demands it places upon the City's infrastructure or water system. Therefore, it has been long a practice of setting a separate rate for different meter sizes on the basis that access to water would have a graduated level of demand on the overall water system over time. Based upon this, it is reasonable to spread those costs proportionally based on the presumed wear on the system.

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It has been argued that charging a higher fixed rate for larger meters and a higher rate for greater consumption is unfair. The nexus or link that connects a higher charge to a larger meter is not based upon the water that flows through the meter, but rather on the demand potential. The water rates will specifically address the issue of rate charges associated with consumption. The water meter charge strictly deals with demand capacity needed in the Water system infrastructure to supply water to all meters. A large meter will by its nature create more of a demand.

It is also important to note that there are capital and operational costs that remain fixed regardless of the amount of water used. The fixed meter rate is that portion of the rate structure that is meant to cover those fixed costs by being a stable source of revenue that does not fluctuate with consumption levels. Because of the correlation between meter size and water consumption, the meter rates have been set a graduated levels in order to spread those fixed costs proportionally based upon water usage and water demands.

As the table below demonstrates, the water meter rate combines the 3/4 inch and 5/8 inch as one meter group. These meters reflect almost 75% (2379 meters) of the total meters in the City. (Had the City chosen to use a flat rate method, these meters would be set at \$47.60) Please note that the rates proposed maintain the very-low income rate adjustments for water meters.

	Current	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15
Bi-Monthly Meter Charges						
5/8" & 3/4" meters	\$40.00	\$46.30	\$47.92	\$49.60	\$51.33	\$53.13
		15.75%	3.50%	3.51%	3.49%	3.51%
1" meter	\$46.68	\$54.03	\$55.92	\$57.88	\$59.91	\$62.00
		15.75%	3.50%	3.51%	3.51%	3.49%
1-1/2" meter	\$60.00	\$69.45	\$71.88	\$74.40	\$77.00	\$79.70
		15.75%	3.50%	3.51%	3.50%	3.51%
2" meter	\$86.68	\$100.33	\$103.84	\$107.48	\$111.24	\$115.13
		15.75%	3.50%	3.51%	3.50%	3.50%
3" meter	\$160.00	\$185.20	\$191.68	\$198.39	\$205.33	\$212.52
		15.75%	3.50%	3.50%	3.50%	3.50%
4" meter	\$233.34	\$270.09	\$279.54	\$289.33	\$299.45	\$309.94
		15.75%	3.50%	3.50%	3.50%	3.50%

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Bi-Monthly Meter Charges (Very-Low Income Discount)						
5/8" meter	\$26.00	\$30.10	\$31.15	\$32.24	\$33.37	\$34.53
		15.75%	3.49%	3.50%	\$3.51%	\$3.47%
3/4" meter	\$26.00	\$30.10	\$31.15	\$32.24	\$33.37	\$34.53
		15.75%	3.49%	3.50%	\$3.51%	\$3.47%
1" meter	\$32.68	\$37.83	\$39.15	\$40.52	\$41.94	\$43.41
		15.75%	3.49%	3.50%	3.50%	3.50%

The second notable issue is the large increase (15.75%) proposed the first year. Because it was determined that certain public utility rates were subject to the requirements of the Proposition 218, "Right to Vote" process, the City did not implement the 2005-2010 proposed rate increases that was needed to meet the financial needs of the water system. The annual increase is set to have a 3.5% steady increase to match the average consumer cost index and is applied equally over every meter size. The current year increase is larger than all other periods to bring the rate up to what the market costs are in 2010, since the rates were last increased in 2005.

2. Water Consumption based on a Tiered Rate Structure

The tiered rate structure that is proposed for implementation is designed to be a means of encouraging water conservation. Tiered rates are recommended by the California Water Plan 2009 and the "20 x 2020 Water Conservation Plan" released in February by the Department of Water Resources. Tiered rates have been found to be very effective in reducing water waste, particularly when there is a significant difference between tiers.

The setting of the 2010 Water System Program Plan's (WSPP's) three (3) tier rate structure was based upon an evaluation of actual water use data for the City's 5/8", 3/4" and 1" meter customers over a three (3) year period comprised of 2005, 2006 and 2007 of 18 ccf for 5/8", 25 ccf for 3/4", and 34 ccf for 1". However these averages are lower than the annual average of 2007 of 19 ccf for 5/8", 26 ccf for 3/4", and 37 ccf for 1". For this reason, 2007 was chosen as the base year model for water conservation. Despite reports of an ongoing drought, customer consumption in Sierra Madre has steadily increased over the last five years.

An assumption was made in the rate analysis that an average decrease of 10% in water usage would occur for each of the meter sizes from the 2007 unit averages. The rate analysis provides that the decreases would commence in FY2010-11 and continue over the planning period. These decreases amount to - 2 ccf for 5/8" meters, - 3 ccf for 3/4" meters and -4 ccf for 1" meters, respectively. Choosing the higher average as the base year was reasonable in light of the three year average, but still showed an overall goal of conservation without unreasonable expectations of the consumers.

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Applying each of the assumed decreases results in the new average uses for each meter size, as follows:

Projected Units per Month per Meter assuming 10% reduction from the base year:

Meter Size	2005-2007 Consumer Average	2007 Base Year	2010-2015 Proposed Tiers	<i>Water Conservation effort @ 10% over Base Year</i>
5/8" meter	18 ccf	19 ccf	17 ccf	<i>1-2 ccf reduction</i>
3/4" meter	25 ccf	26 ccf	23 ccf	<i>2-3 ccf reduction</i>
1" meter	34 ccf	37 ccf	33 ccf	<i>3-4 ccf reduction</i>

	Current	FY 2010- 11	FY 2011- 12	FY 2012- 13	FY 2013- 14	FY 2013- 14
Commodity Charges (per ccf)						
Tier 1 (<18ccf)	\$1.79	\$2.072	\$2.140	\$2.220	\$2.300	\$2.380
% increase		15.75%	3.28%	3.74%	3.60%	3.48%
Tier 2 (18-33 ccf)	\$1.79	\$2.126	\$2.200	\$2.280	\$2.360	\$2.440
% increase		18.77%	3.48%	3.64%	3.51%	3.39%
= Tier 3 (>33 ccf)	\$1.79	\$2.148	\$2.220	\$2.300	\$2.380	\$2.460
% increase		20.00%	3.35%	3.60%	3.48%	3.36%

The rates above reflect a monthly average. Therefore, when calculating at a bi-monthly rate, TIER 1 is 0-34 ccf; TIER 2 is 34.1-66 ccf; TIER 3 is 66.1ccf or more.

3. Customer Billing

Under the proposed water rates, there is a proposed increase of initially 15.75% for water meters and water consumption with a consumer cost index increase set at 3.5% over the next five years. The water consumption was set as a three tiered water rate with a water conservation effort set at 10% of the average 2007 consumer water bill.

The water meter rates and the water tiers were established based upon a comprehensive fee study. Alterations to the fees requires a new comprehensive fee study, whether that is adding or deleting tiers, modifying tiers, creating one meter rate or other changes. It is important to note (as demonstrated in the attached historical data) that a specific amount of funding is needed to operate the water system, make routine maintenance and upgrades, and ensure quality customer care. As part of the fee study, the first goal is to meet these operational needs. The second priority is to meet the debt obligations of the Water Fund, meaning repayment the bonds and loans that funded the

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recent \$20 million water infrastructure improvements. As demonstrated in the Projected Changes to Net Assets through FY 2014-15, current rates will not generate enough revenue to meet these demands, even if the entire water staff were to be laid off.

As mentioned below in the Consequences of Leaving the Water Rates Unchanged, the Water Infrastructure has several capital needs. The unfunded list is in the attachment. Without raising the rates, the City water system is at risk of failure or default.

Currently, the consumer is billed both a water meter charge and a consumption charge. Unfortunately, this is not broken out on the current bill for residents to see. Starting in September, the new accounting system will provide a detailed bill for the residents to see their bills based upon the meter size and water consumption. The actual bill itself is still in the development stages with Finance, but below is the general information staff intends to present to the customers for the average customer bill. (The sample bill is for a 3/4th " meter, with 40 units of consumption.) Providing this level of detail will make it easier for customers to see how far they may have gone into the next tier, in order to modify their water use and reduce their water bill.

DESCRIPTION	COST	NUMBER OF UNITS	EXTENDED COST
METER SIZE	\$46.30/BI-MONTHLY	3/4 INCH METER	\$46.30
TIER 1	\$2.072/UNIT	34	\$70.448
TIER 2	\$2.126/UNIT	6	\$12.756
TIER 3	\$2.148/UNIT	0	\$0.00
BIMONTHLY CONSUMPTION TOTAL		40	
SEWER	\$24.00/MONTH	RESIDENTIAL	\$48.00
ADDITIONAL UNITS	\$0.00/MONTH	SINGLE UNIT	<u>\$0.00</u>
TOTAL			\$177.50

Finance is working on providing graphical representations as well on the water bills.

Consequences of Leaving Water Rates Unchanged

It is not the policy of the City to unduly burden its residents and customers by needlessly increasing the cost of services. This is perhaps best exemplified by the very few number of water rate increases over the past 20 years. However, there does come a point in time where increasing the water rate must be considered, or else there can be major consequences. It is vitally important that rates for services, in this case water rates, keep up with the cost of providing those services. Should rates for services lag behind the cost of providing those services, significant consequences may result.

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It is also important to note that the water department is an Enterprise Fund, and as such it is run like a business. All of the expenses and revenues are kept separate from other city funds. It is also important to note that the City has always been very conservative in allocating costs to the water department, in order to keep rates as reasonable as possible. For example, many other municipal water departments will charge rent, or franchise fees to the water department. These can be significant charges, but the City of Sierra Madre has chosen not to maximize the charges that can legally be charged to the water department.

Below is explanation of a number of the potential consequences of water rates not keeping pace with the costs to operate the system.

- An example of the results of not taking timely action to adjust rates can be seen in the current situation. In FY 2006-7 through the present, previously recommended rate adjustments were not implemented. As a result we are currently experiencing the following repercussions:
 - Bond covenants are not currently met
 - There are insufficient funds to meet local match requirements for federal grant monies
 - There are insufficient funds available to replace aging water mains prior to street resurfacing.

In order to begin resolving those issues a substantial initial increase in rates will be required. Further delay in adjusting the rates will result in even more significant initial increases in the future.

- Although the deterioration in the water system is largely unseen, the water infrastructure is much like the visible street system in that maintenance deferred due to lack of funding will eventually create a backlog of necessary repairs that may be insurmountable. Unlike the street system, where infrastructure past it's service life results in a harsh ride and an unsightly community, failure of components of the water infrastructure can result in the City's inability to provide the water that is vital to every Sierra Madre water customer.
- There is considerable interest in repairing the City's streets. A large number of the City's streets are home to water mains or water services that are old and prone to leakage. It is not in the community's best interest to invest in resurfacing these streets while the mains and services under them remain in poor or failing condition. Without an increase in rates, water mains cannot be replaced.
- Reduction in staffing and other cost saving measures will result in a reduced level of service. In addition, reduction in Water Department manpower at a time when system deterioration of infrastructure is increasing will result in lengthier service outages for Sierra Madre customers or higher costs from outside professionals brought in when staff is no longer available to do repairs.
- Without adequate reserves, the City will not have the ability to make emergency repairs or alterations to the water system. For example, in summer of 2007, the

