



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Review of the Public Utilities Department FY 2025-2029 Five-Year Financial Outlook

OVERVIEW

The [Public Utilities Department Fiscal Year 2025-2029 Five-Year Financial Outlook](#) (PUD Outlook) was released on November 9, 2023, concurrent with the release of the General Fund Fiscal Year 2025-2029 Five-Year Financial Outlook (General Fund Outlook). Similar to the General Fund, [Council Policy 000-02: Budget Policies](#) states that the PUD Outlook is intended “to guide long-range planning and serve as the framework for the development of the next year’s Proposed Budget for the Water and Sewer Enterprise Funds.” While the General Fund Outlook has been an annual report since 2006, this is the fifth PUD Outlook and the fourth to be presented at a meeting of the full City Council.¹ In addition to projecting what may be included in future proposed budgets, the PUD Outlook also serves as the basis of needed expenditure projections and potential future revenue needs for the next set of proposed water and wastewater rates. While future rate changes will be detailed in a Cost of Service Study, this Outlook provides an estimate of the rate increase percentages which the Council will be asked to approve. The next anticipated Cost of Service Study is anticipated to be released in FY 2025 with proposed rates for FY 2026 both the water and wastewater system.

As discussed in our review of the General Fund Outlook (IBA Report 23-36), the Office of the Independent Budget Analyst (IBA) is charged with providing the City Council with review and analysis of all major budget reports including the financial outlooks, quarterly budget monitoring reports, Mayor’s Proposed Budget, Mayor’s May Revision to the Proposed Budget, and Capital Improvements Program (CIP) budget reports. While the City Council cannot change this PUD Outlook, City Council is the ultimate budget authority and can make changes to the Proposed Budget for PUD during its review of the FY 2025 Proposed Budget following its release in April

¹ The first PUD Outlook was released roughly five years ago, in January 2019, and was only presented to the Budget and Government Efficiency Committee.

2024. City Council will also review any proposed water and sewer rate cases, ultimately approving changes following the Proposition 218 process.

FISCAL/POLICY DISUSSION

The Public Utilities Department (PUD) operates two major utility systems, the City’s water system and the wastewater system, and the PUD Outlook has discrete sections for these two major functions. Each function is accounted for and budgeted in separate funds. Water rate revenues must be used to support the activities of providing water, while wastewater rate revenues are used to support the collection, treatment, and disposal of wastewater.² The PUD Outlook projects expenditures of approximately \$1.9 billion in FY 2025 for water and wastewater operations, baseline and Pure Water capital expenditures, debt service, and reserve requirements for both systems as summarized in the table below. Expenditure projections are highest in FY 2025, mostly due to the conclusion of major construction activity for Pure Water Phase 1. Otherwise expenditures overall remain relatively constant over the duration of the Outlook.

Summary of Public Utilities FY 2025-2029 Five-Year Financial Outlook Expenditures (in millions)						
	FY 2024 Adopted	FY 2025 Projection	FY 2026 Projection	FY 2027 Projection	FY 2028 Projection	FY 2029 Projection
Water Fund	\$ 1,129.9	\$ 1,104.6	\$ 1,138.3	\$ 1,172.6	\$ 1,175.5	\$ 1,184.1
Wastewater Funds	773.5	805.5	636.3	671.6	710.7	656.6
COMBINED	\$ 1,903.4	\$ 1,910.1	\$ 1,774.6	\$ 1,844.2	\$ 1,886.2	\$ 1,840.7

In contrast to the General Fund Outlook, PUD’s Outlook does not reflect a gap (deficit or surplus) between revenues and expenditures. While the City’s General Fund is constrained by available tax revenues to support expenditures, the water and wastewater systems are supported primarily by rates paid by customers using the systems. The PUD Outlook focuses first on projecting the costs of maintaining and operating the water and wastewater systems, and then estimates any revenue increases needed to fund those expenditures. The Outlook serves as the basis and first step for developing a Cost of Service (COS) study to determine expenditure projections and revenue needs which are the basis for the next set of water and wastewater rates. The PUD Outlook identifies the overall system needs, whereas the COS analysis further allocates the cost of those needs to different user classes.³

For this review of the PUD Outlook, our Office provides an analysis of the various factors that are driving increased costs, and consequently the need for increased revenue and rates. This analysis will also cover the major financial indicators and metrics that PUD utilizes to ensure that the enterprise funds are sound, and how those indicators may be impacted by spending and rate decisions. Finally, this report discusses potential mitigating actions Council could consider to minimize rate increases included within the PUD Outlook.

² Note that the Wastewater system is broken down into separate funds for the (1) collection of wastewater from municipal customers in the City of San Diego (the Muni Fund) and (2) treatment and disposal of wastewater, which is provided for City of San Diego customers as well as other agencies in the region that utilize our wastewater treatment system (the Metro Fund). For the purposes of the PUD Outlook, these two funds have been combined.

³ User classes for the Public Utilities system include Single-Family Domestic Customers, Multi-Family/Other Domestic Customers, Commercial and Industrial Customers, Temporary Construction, and Irrigation Customers.

Rate Increases

Water and wastewater rates are determined through a process prescribed by state law under Proposition 218, which requires a COS analysis, the opportunity for a majority protest by impacted parcels/customers, and approval of the legislative body (the City Council) of rate adjustments at a public hearing.⁴ COS studies provide detail on projected expenditures, determine the total revenue required to cover those expenditures, and allocate those revenue needs based on the system functions and the demands each customer class places on the water and wastewater systems.

As summarized in the table below, the PUD Outlook shows the need for rate increases to support the water and wastewater systems over the next five years. These percentages are at the aggregate, summary level for each system and do not reflect how costs would be allocated to customer groups. That level of detail will be included in the rate design portion of the appropriate COS study. It is important to note that rates could reflect higher percentage increases for some customer classes and lower increases – or even decreases – for others.

Summary of PUD Outlook Water and Wastewater Rate Increases FY 2025-2029						
	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Water ^a	10.2% ^c	8.7%	11.8%	8.9%	8.2%	7.4%
Wastewater ^b	4.0%	3.0%	7.0%	6.0%	6.0%	6.0%

^a FY 2024 and FY 2025 rates represent up-to rates increases approved by Council in September 2023.

^b FY 2024 through FY 2025 rates represent up-to rate increases approved by Council in September 2021.

^c FY 2024 rate increase will take place in two steps, with 5.2% effective December 1, 2023, and 5.0% effective July 1, 2024. All other increases assume a January 1 effective date for that fiscal year.

It's notable that over the Outlook period (FY 2025-2029), total rate increases are 53.8% for water and 31.3% for wastewater.

Wastewater – For the wastewater system, wastewater rates and corresponding revenues from a COS study approved in September 2021 are reflected in the Outlook for FY 2024 and FY 2025 at the maximum rates approved. Beginning with FY 2026, wastewater rates are projected to be between 6.0% and 7.0% for the remaining years of the PUD Outlook. This is higher than what was projected last year, when those rates ranged from 4.0% to 5.0%. As will be explained further, the PUD Outlook shows that increased costs in the wastewater system - particularly for operations and maintenance activities - require higher revenue levels during these years. Potential mitigations would likely require the deferral of near-term expenses to future years to build up cash reserves, most likely resulting in delayed CIP projects.

Water – As shown in the table above, the PUD Outlook includes water rate adjustments to support projected expenditures, fund reserves, and achieve targeted financial metrics, ranging from 7.4% to 11.8% over the five-year period. This includes water rates approved in September 2023 for FY 2024 and FY 2025. Of note, the Council action split the up-to rate increase for FY 2024 into two

⁴ Among other requirements, Proposition 218 requires a majority protest vote and public hearing before approval of proposed rates (Article XIII D, Section 6), and stipulates that rates charged to customers “must not exceed the proportional cost of the service attributable to the parcel or customer.” (Article XIII D, Section 6, Subdivision (b))

increases, with 5.2% on December 1, 2023, and 5.0% on July 1, 2024. PUD estimates this resulted in a loss of \$12 million in FY 2024 revenue.

We raise two key points regarding water rates:

- The current PUD Outlook continues to assume substantial increases in water rates, including higher rates than the previous Outlook. As will be discussed below, increases are tied both to increased operating expenditure needs and to continued decreases in water demand assumptions, as conservation and local rainfall continue to lower the average annual water sales.
- Additionally, expenditure projections for the water system are heavily impacted by water purchase costs from the San Diego County Water Authority (CWA). For the years of the PUD Outlook (FY 2025-2029), roughly one-third of the proposed water rate increases are associated with increased CWA water rates. Uncertainties related to CWA's own rate increases are discussed in more detail following the mitigations discussion in this report.

Financial Policies and Rate Stabilization

The need for additional rate increases and additional revenue is in part driven by PUD's goal to maintain certain financial targets for each of the enterprise funds. These targets ensure sufficient cash to fund operations, debt payments, and reserves is available. This section will cover three of the main metrics that PUD monitors to ensure the enterprise funds have sufficient cash to meet the system's needs: Debt Service Coverage Ratios, the Rate Stabilization Fund, and days of Cash on Hand. It is important to note that metrics provided in the Outlook are *inclusive* of the assumed rate increases previously discussed. Any potential change in the assumed future rates would thus result in a change in these metrics.

Debt Service Coverage Levels

PUD uses a combination of cash funding and debt financing to support the ongoing water and wastewater capital improvement program (CIP).⁵ Debt service coverage ratios (DSCRs)⁶ are an important factor in the Outlook, because they impact the utility's credit rating, and a high credit rating is required to receive low interest rate financing. Existing PUD bond covenants require a minimum DSCR of 1.2x for senior debt and 1.1x for aggregate debt. PUD indicates that they generally target a DSCR of 1.5x for both the water and wastewater systems to maintain a high credit rating and receive low-cost borrowing. As shown in the table below, the Outlook includes a DSCR ranging from 1.36x to 1.66x for the water system and ranges from 1.36x to 1.40x for the wastewater system.

⁵ Debt payment obligations extend well beyond the period covered in the PUD Outlook.

⁶ The DSCR is a fund's revenues net of operating expenses divided by the total debt service owed. A DSCR less than 1.0 would indicate that the organization did not have enough revenues to support its debt payments through annual cash flows and would need to draw from fund balance or reserves or borrow additional funds in order to make debt payments.

Utility System Projected Debt Service Coverage Ratio (in millions)						
	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Water						
Net Systems Revenue	\$ 155.4	\$ 177.9	\$ 203.9	\$ 207.7	\$ 274.8	\$ 315.1
Debt Service	\$ 101.4	\$ 124.4	\$ 146.3	\$ 152.7	\$ 183.3	\$ 190.0
Debt service Ratio	1.53 x	1.43 x	1.39 x	1.36 x	1.50 x	1.66 x
Wastewater						
Net Systems Revenue	\$ 137.5	\$ 152.6	\$ 125.7	\$ 162.2	\$ 159.6	\$ 176.8
Debt Service	\$ 97.7	\$ 112.0	\$ 90.6	\$ 116.3	\$ 113.8	\$ 127.2
Debt service Ratio	1.41 x	1.36 x	1.36 x	1.39 x	1.40 x	1.39 x

Throughout the Outlook, the addition of debt results in DSCR levels below the management target of 1.5x during most years, and significant use of the Rate Stabilization Fund (RSF) is projected to keep the DSCR from falling below 1.36x. According to PUD, a significant portion of the large CIP funding need driving the DSCR is associated with the Pure Water program. Additionally, the Outlook assumes \$2.3 billion in expenditures for the baseline CIP to update and replace existing systems. The prudent use of debt can mitigate near-term rate shocks, though this must be balanced with long-term impacts of increasing fixed debt service costs and debt service coverage requirements, as well as potential interest rate increases which will impact long-term payment needs.

Rate Stabilization and Reserve Requirements

Reserve balances and targets are important factors in the PUD Outlook; reserves help ensure stable, reliable operations and are required to meet debt financing requirements. The Department maintains reserve funds in accordance with the City’s Reserves Policy ([Council Policy 100-20: Reserve Policy](#)). There are three reserves for both the Water and Wastewater Utility Funds: an Emergency Operating Fund, an Emergency Capital Reserve Fund, and

Council Policy 100-20: Reserve Policy

- Emergency Operating Reserves equivalent to 70 days of operations (for water, this is 70 days of operations less water purchase costs).
- Emergency Capital Reserves of \$5 million each (total \$10 million for Public Utilities) budgeted in the CIP each year.
- Rate Stabilization Fund Reserves equivalent to 5% of prior year’s operating revenue.
- Secondary Purchase Reserve (water only) equivalent to 6% of the annual water purchase budget.

a Rate Stabilization Reserve Fund. The Water Utility Fund also has a Secondary Purchase Reserve fund intended to mitigate risks associated with rainfall variability and unforeseen emergencies impacting supply. At the end of FY 2024 the Water and Wastewater Utility Funds are estimated to have total reserves of approximately \$173.4 million and \$147.3 million, respectively. Reserves are all projected to be funded at targeted levels throughout the Outlook, *with the exception of the Rate Stabilization Fund (RSF)*. The RSF is projected to go below target in FY 2026 for the water utility, and in FY 2027 for the wastewater utility, even after assuming projected rate increases.

The Rate Stabilization Reserve Funds each have high balances in FY 2024 due to several one-time revenue sources. For the Water RSF, this includes the proceeds from sale of the stadium site, one-time grant funding that offset other costs, and legal settlements from the Metropolitan Water

District (MWD) that allowed the City to make large contributions to the RSF in past years. Saving one-time revenue for use in the RSF is a financial best practice that allows funds to be used to provide one-time operating revenue to offset or mitigate the need for future rate increases. The PUD Outlook projects use of RSF reserves in FY 2024 through FY 2026 for the water system, with contributions then being made back into the RSF in FY 2027 through 2029. This results in the water RSF being below target in FY 2026 but funded at targeted levels in FY 2029.

Projections for the wastewater system assume use of the RSF during each year of the Outlook period, with the exception of FY 2026. The wastewater RSF falls below target in FY 2027 and goes further below target in FY 2029 without any replenishment. PUD notes that it plans to return the wastewater RSF to the targeted level in FY 2030. This strategy to draw down the RSF balance with a plan to restore the RSF reserve to the target amount in the following fiscal year is consistent with City policy.

Rate Stabilization Fund Reserves in PUD Outlook <i>(in millions)</i>						
	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Water						
Reserve Target	\$ 29.4	\$ 31.3	\$ 35.3	\$ 38.0	\$ 41.9	\$ 45.1
Estimated Funding Level	78.1	69.1	14.1	29.1	38.1	45.1
Amount Above Target	\$ 48.7	\$ 37.8	\$ (21.2)	\$ (8.9)	\$ (3.8)	\$ -
Wastewater						
Reserve Target	19.6	20.8	20.9	21.7	22.9	24.1
Estimated Funding Level	69.3	39.3	39.3	19.3	17.9	14.1
Amount Above Target	\$ 49.7	\$ 18.5	\$ 18.4	\$ (2.4)	\$ (5.0)	\$ (10.0)

Days of Cash on Hand

The final metric that PUD uses to judge the financial health of the utility enterprise funds is the number of days of Cash on Hand (CoH). This metric is derived from dividing the estimated ending fund balance of each fund by the total costs for operations and maintenance expenditures for that year, and then multiplying that by the number of days in a year. The Department strives to maintain 160 days of CoH every year.

Cash on Hand in PUD Outlook <i>(days of cash)</i>						
	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Target	160	160	160	160	160	160
Water						
Days of Cash On Hand	200	233	87	92	148	134
Amount Above Target	40	73	(73)	(68)	(12)	(26)
Wastewater						
Days of Cash On Hand	168	210	148	264	91	184
Amount Above Target	8	50	(12)	104	(69)	24

For the Water Utility Fund, the days of CoH fall far below the 160-day target in FY 2026 to 87 days, and do not return to that target in the remaining years. For the Wastewater Utility Funds, the

days of CoH fall below the 160-day target in both FY 2026 and FY 2028 but returns to above the targets in each subsequent year.

Outlook Comparisons

As mentioned, the PUD Outlook continues to assume the need for increased rates in each of its five years, with the water rate increase going up by 2.0 percentage points in FY 2026 (from 9.8% to 11.8%), and wastewater rate increases going up by between 1.0 and 2.0 percentage points each year in FY 2026 – 2028 (from 5.0%, 5.0%, 4.0% to 7.0%, 6.0%, 6.0% respectively) compared to the previous PUD Outlook. The need for increased rates is mainly driven by the cashflow needs of each utility, as the cash derived from rates is needed to fund everyday operations of both utilities, pay for ongoing and new debt service, and keep CIP projects moving. The following tables show the total cash expenditures projected in the prior PUD Outlook and the current PUD Outlook for both the water and wastewater systems, as well as cash revenue projections and rate increase assumptions.

For the water system, total cash expenditures in the current PPUD Outlook have much larger ranges than those of the previous Outlook. The majority of these swings are related to the amount of cash that the CIP needs to fully fund projects in a given year, based on the debt assumptions and other revenue sources that fund the Water CIP. Water Purchases costs are lower in the near term as PUD expects to use more local water from the past rainfall season to lower these

Water Expenditures, Revenues, and Rates							
	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
FY 2024-2028 Outlook							
Water Purchases	263.7	290.0	309.2	329.9	317.1	316.1	
Operating Expenditures	252.5	269.8	293.1	318.0	338.4	319.6	
Debt Service	94.0	114.6	127.6	138.3	151.5	158.0	
CIP Cash	73.3	108.7	17.0	23.4	105.6	136.2	
Total Cash Expenditures	683.5	783.1	746.9	809.6	912.6	929.9	
Water Sales Rate Revenue	586.1	632.8	679.6	736.5	806.8	872.0	
Other Revenue	59.4	58.4	57.4	57.2	56.5	55.4	
Total Cash Revenue	645.5	691.2	737.0	793.7	863.3	927.4	
Rate Increase	2.5%	9.3%	7.6%	9.8%	8.9%	8.2%	
FY 2025-2029 Outlook							
Water Purchases	263.7	263.1	283.6	331.9	316.8	314.6	331.1
Operating Expenditures	258.8	290.0	311.2	331.6	347.9	356.7	365.2
Debt Service	89.7	101.3	124.7	146.9	153.7	185.5	192.5
CIP Cash	114.3	(18.1)	(47.7)	211.2	45.4	(22.5)	132.8
Total Cash Expenditures	726.5	636.3	671.8	1,021.6	863.8	834.3	1,021.6
Water Sales Rate Revenue	570.8	609.1	688.9	743.1	819.5	885.0	946.5
Other Revenue	55.4	58.4	60.0	57.1	52.8	55.1	56.9
Total Cash Revenue	626.2	667.5	748.9	800.2	872.3	940.1	1,003.4
Rate Increase	2.5%	10.2%	8.7%	11.8%	8.9%	8.2%	7.4%

Wastewater Expenditures, Revenues, and Rates							
	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
FY 2024-2028 Outlook							
Operating Expenditures	288.0	308.6	319.3	322.0	328.8	336.4	
Debt Service	114.8	100.9	102.8	105.4	105.4	112.4	
CIP Cash	(57.5)	125.4	145.7	(39.1)	89.4	(70.6)	
Total Cash Expenditures	345.3	534.9	567.8	388.3	523.6	378.2	
Wastewater Rate Revenue	295.0	306.8	318.1	332.0	359.1	374.3	
Other Revenue	111.9	113.9	111.7	111.3	111.6	112.3	
Total Cash Revenue	406.9	420.7	429.8	443.3	470.7	486.6	
Rate Increase	4.0%	4.0%	3.0%	5.0%	5.0%	4.0%	
FY 2025-2029 Outlook							
Operating Expenditures	286.7	329.1	337.8	351.4	361.7	370.9	381.4
Debt Service	115.4	97.3	111.9	89.3	102.5	113.8	127.2
CIP Cash	83.5	128.5	(53.2)	67.4	(100.8)	187.8	(80.9)
Total Cash Expenditures	485.6	554.9	396.5	508.1	363.4	672.5	427.7
Wastewater Rate Revenue	287.5	311.8	323.3	340.7	364.8	387.6	411.9
Other Revenue	127.3	126.3	115.6	115.8	117.8	116.5	115.1
Total Cash Revenue	414.8	438.1	438.9	456.5	482.6	504.1	527.0
Rate Increase	4.0%	4.0%	3.0%	7.0%	6.0%	6.0%	6.0%

expenditures, but this use runs out in FY 2026. Additionally, operating expenditures have also increased, mostly due to increased costs for employees, supplies, and energy.

Water revenues are below the previous PUD Outlook in FY 2023 and FY 2024 mainly due to decreased revenue from water sales associated with recent rainfall. There is also a revenue decrease in FY 2024 of approximately \$12 million due to the rate increase proposed earlier this year being split into two different increases. Other revenues remain relatively consistent.

For the wastewater system, total cash needs are relatively stable over the five years of the PUD Outlook period and are in line with the projections in the previous PUD Outlook. The largest changes are in CIP cash assumptions, as debt issuances have been moved back a year. Operating expenditures are also higher in the current Outlook, due to increases in employee pay, supplies, and energy costs. Revenues are somewhat higher in the current Outlook mostly due to increased flows based on the most recent actuals.

The next few sections of this report will dive deeper into each of the expenditure and revenue categories.

Revenues

Revenue assumptions are an important part of the PUD Outlook as they consider all of the revenues that the utility enterprise funds receive, both from rate revenues and other sources. Revenues for each of the utilities are heavily dependent on units of sale, with water demand determining both water sales revenue and calculated wastewater flows and revenues from direct City customers.

Water demand experiences high volatility, as it is subject to large swings due to changing weather conditions and water conservation.

Before moving deeply into a discussion of water demand, however, it is important to note that wastewater flows from outside agencies that send their wastewater to the City’s treatment plant will need to be closely monitored, as development of the East County Water Purification Project is likely to reduce the amount of wastewater flowing into the City through the Metropolitan Wastewater System. As such, what the contributing agencies that are part of the East County Joint Powers Authority (JPA) would be required to pay to the Metropolitan Sewer Fund may be different or lower. This would mean that, absent reduced costs to the system or a change in the methodology by which other agencies are charged, the City would need to make up for lost revenue through increased rates. For this Outlook, the contribution from the Metropolitan JPA agencies is kept flat at \$85 million per year in order to account for that coming change, but this will need to be monitored closely once the East County JPA water purification project comes online.

Water Demand Assumptions

As noted, water demand assumptions impact both projected rate revenues and water purchase costs. The projected water demand is influenced by several factors, including rainfall, population growth, regional demand, and the completion schedule for the Pure Water Program Phase 1. The Outlook states PUD delivered approximately 162,619 acre-feet (AF) of potable water per year for FY 2018-2022, which is a steep decrease from the previous five-year annual average of 176,950 AF for FY 2017–2021. Previous annual averages included 180,000 AF from FY 2015-2019, and 200,000 AF from FY 2014-2018.

The City has been preparing for lower levels of water sales by lowering the demand assumptions in the Outlook over the last couple of years. Previously, the water demand assumptions were based on the City’s [Urban Water Management Plan](#) (updated 2021), which estimated that total water use would be approximately 172,073 AF in FY 2025 and 179,065 AF in FY 2030. However, since that time water use has continued to decline, which the Department attributes to the conservation messaging related to droughts in both northern California and the Colorado River Basin. The Department expects this level of conservation to continue into the future. The table below provides a comparison of the water demand forecasts utilized in the Urban Water Management Plan as compared to the PUD Outlook.

Water Demand Assumptions (AF)			
	FY 2020	FY 2025	FY 2030
Urban Water Management Plan	154,473	172,073	179,065
FY 2025-2029 Outlook	156,261	156,305	157,105
Difference	1,788	(15,768)	(21,960)

While water conservation efforts reduce PUD’s need to purchase water from outside sources, it is important to note that a significant portion of operating expenditures for the water system are fixed costs, which generally are not impacted by the volume of water use or conservation. For example, personnel, information technology, administrative, and debt service costs do not vary based on the level of water usage by customers. This presents challenges, as a significant portion of water rate revenues are collected based on water usage, and decreases in usage have disproportionately large impacts on revenues relative to expenditures.

Additionally, water sales dropped down to 150,327 AF in FY 2023 due to significantly above-average rainfall that the San Diego Region experienced during the winter of 2022-2023. PUD estimates that this year will also be quite wet, and the Outlook assumes the same level of water sales in FY 2024. While sales in the Outlook are projected to increase in FY 2025 (back closer to sales in FY 2022), they stay well below the previous projections, reflecting the impacts of ongoing conservation. It will be important to monitor sales and rainfall in FY 2024 to see where the year ends, because a drier year could lead to increased sales, and thus more revenue, in FY 2025. However, increased water demand by PUD customers would also require increased water purchases from CWA, since most of the available local water is already projected to be used, as described in the next section.

Expenditures

Water Purchase Assumptions

The City provides water primarily from two sources: (1) local supplies from rainfall and runoff that flow into reservoirs, which provide on average 10 – 15% of water needs, and (2) water purchased from its wholesaler, the CWA, which provides 85 – 90% of water needs. Because the City currently imports a significant percentage of its water supply – PUD’s water purchase costs represent \$263.1 million or 40.2% of the Water Utility Fund expenditures in FY 2024 – water purchase assumptions are a critical component of the PUD Outlook.

The PUD Outlook projects expenditures for imported water purchases will increase from \$283.6 million to \$331.1 million over the five-year Outlook period. The Outlook assumes that 25,000 AF each year will come from local supplies and rainfall/runoff, with additional supplies in FY 2024 and FY 2025 from increased rainfall capture at the City’s storage reservoirs. This assumes that they City will be utilizing additional rainfall out of the reservoirs almost as quickly as it is collected during FY 2024, and then will use a maximum amount of stored water in FY 2025 to drive down costs. While it may be prudent to save some of this rainfall for future years (this further is discussed as a mitigation), several of the City’s larger reservoirs are operating under dam height restrictions, including El Capitan and Lake Hodges, and lack the ability to move water to a different reservoir such as San Vicente that could store more water. Given those limitations, using local storage water to the maximum extent possible in order to not lose additional rainfall is appropriate.

Beyond rainfall and runoff, the Outlook assumes Pure Water Phase 1 will begin water deliveries toward the end of FY 2026, with full capacity being reached in FY 2027. As shown in the table below, water purchase volumes and expenses in FY 2027 and FY 2028 are projected to decline due to the shift toward local water supply produced from Pure Water Phase 1 to meet a portion of annual water demands.

Water Purchases Estimated in PUD Outlook							
	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Water Requirement (AF)	164,472	164,472	171,012	170,692	171,089	171,488	171,887
Local Water Supply (AF)	27,786	35,000	43,000	25,700	47,400	58,600	58,600
Purchased Supply (AF)	136,686	129,472	128,012	144,992	123,689	112,888	113,287
Estimated Cost (<i>in Millions</i>)	\$ 263.7	\$ 263.1	\$ 283.6	\$ 331.9	\$ 316.8	\$ 314.6	\$ 331.1

The decline in water purchase costs through FY 2028, however, is offset by forecasted increases in wholesale rates charged by CWA, as recently forecasted in the [CWA Long Range Financing](#)

[Plan](#). The Outlook projects the cost per AF to increase 43.9% during the PUD Outlook period, based on current guidance provided by CWA.

Operating Expenditures

Baseline Expenditures

Similar to the General Fund Outlook, the PUD Outlook starts with the FY 2024 Adopted Budget for operations and maintenance (O&M) costs and applies either a series of inflation factors or other discrete adjustments to develop the projection for O&M expenditures over the Outlook period. For the PUD Outlook, almost all of the inflation factors utilized in the General Fund Outlook were also applied to the PUD Outlook, including factors for personnel costs, fringe benefits, energy and utilities, and other categories.

The table above provides a comparison of operating costs for the water and wastewater system, inclusive of Critical Operating Expenditures and baseline adjustments for each Outlook. As will be discussed in the next section, Critical Operating Expenditures are relatively stable in both Outlooks. As shown in the table, operating costs for most expenditure categories are increasing in the near term when compared to the prior PUD Outlook.

Personnel expenditures for FY 2025 in the PUD Outlook are projected to be 23.1% higher than what was projected in the previous PUD Outlook for water and 16.7% higher for wastewater. These increases are mostly driven by recently approved salary increases for the Municipal Employees Association, Local 127, and unclassified employees. The Outlook accounts for

Operating Cost Comparison (\$ in millions)						
Water System	FY 24-28 Outlook			FY 25-29 Outlook		
	FY 2023	FY 2024	FY 2025	FY 2023	FY 2024	FY 2025
Personnel	\$ 59.2	\$ 61.2	\$ 63.3	\$ 62.4	\$ 73.7	\$ 77.9
Fringe Benefits	42.0	44.6	47.4	42.9	47.1	49.1
Supplies	17.7	18.8	19.6	21.6	23.0	23.7
Contracts	89.3	93.3	95.3	92.5	102.2	103.3
Information Technology	10.5	11.7	12.1	12.1	19.2	19.8
Energy and Utilities	15.1	15.7	16.5	19.0	21.5	22.3
Other	4.7	2.9	2.9	2.0	3.3	3.3
Total	\$ 238.5	\$ 248.2	\$ 257.1	\$ 252.5	\$ 290.0	\$ 299.4
Wastewater System	FY 24-28 Outlook			FY 25-29 Outlook		
	FY 2023	FY 2024	FY 2025	FY 2023	FY 2024	FY 2025
Personnel	\$ 64.2	\$ 66.1	\$ 67.2	\$ 64.5	\$ 74.2	\$ 78.4
Fringe Benefits	44.7	45.8	46.9	42.3	44.8	46.6
Supplies	33.2	35.6	37.4	43.2	45.8	47.1
Contracts	97.5	100.2	102.1	88.1	105.0	104.2
Information Technology	15.7	16.4	16.8	11.9	18.0	18.6
Energy and Utilities	26.0	27.6	28.5	31.8	36.4	35.3
Other	6.4	3.9	5.4	2.2	5.0	5.0
Total	\$ 287.7	\$ 295.6	\$ 304.3	\$ 284.0	\$ 329.2	\$ 335.2

negotiated pay increases through FY 2026 and assumes that salaries and wages will grow in FY 2027-2029 at 3.05%, which is consistent with the General Fund Outlook. The PUD Outlook also incorporated fringe benefit assumptions from the General Fund Outlook but makes adjustments for water and wastewater based on historical trends. It is important note that salary increases have significant impacts on both the General Fund *and* on the expenditures for the utility enterprise funds. Future salary increases will ultimately need to be paid with rate revenue.

Supply costs are also up dramatically in the current PUD Outlook compared to the previous PUD Outlook, increasing by 20.9% for water and 25.9% for wastewater in FY 2025. This is almost entirely due to increased costs for chemicals and other treatment supplies required for the City's water and wastewater treatment plants. Cost increases have been driven by global supply chain issues, which have required PUD to increase its costs for supplies in numerous contracts in order to maintain operations. While this trend has stabilized, these higher costs are now part of baseline expenditures for the Department.

Finally, energy and utility costs are also up dramatically from the previous Outlook, increasing in FY 2025 by 35.2% for water and 23.9% for wastewater. These increases are primarily driven by increased costs for electricity and natural gas charged by San Diego Gas & Electric. More information on these costs and projections is provide in our Office's review of the General Fund Outlook.

Beyond the Critical Operating Expenditures discussed below, we note some additional costs that have not been included in the Outlook. One major potential future cost, which we also discuss in our report on the General Fund Outlook, is the cost to electrify the City fleet, which is a major part of the City's updated Climate Action Plan (CAP). The Fleet Services Division of the Department of General Services is currently working on a Fleet Electrification Strategy. A consultant conducted an initial assessment of the financial needs to more fully electrify the City Fleet, but these costs have not been finalized yet and thus have not been included in the PUD Outlook's baseline expenditures. As more information becomes available, and issues surrounding vehicle availability, electrifying City yards, and financing plans are addressed, it will be important to understand the impact that these costs will have on PUD's expenditures and rate needs.

Critical Operating Expenditures for Upcoming New Programs

The PUD Outlook includes critical operating expenses for upcoming new programs for both the water and wastewater system, including the addition of staff and related expenses, including non-personnel expenses for supplies, contracts, and energy and utilities. Altogether this includes 78.00 new FTEs and a combined total of \$33.3 million across both the water and wastewater systems, as shown in the table below.

Pure Water continues to be the largest Critical Strategic Expenditure, with a total of 22.00 FTEs and \$28.4 million in expenditures in FY 2029, primarily within the Water Fund. This includes all positions and other expenditures that are not in the FY 2024 Adopted Budget (some personnel that will operate the Pure Water system have already been added to PUD's budget). There are also expenses included for additional contractual costs for the Pure Water Phase 2 consulting and project management contract.

Critical Operating Expenditures Totals					
	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Water System					
Personnel					
FTE	31.16	38.86	46.56	51.26	51.26
Expense	\$ 3,223,467	\$ 3,962,161	\$ 4,801,827	\$ 5,332,773	\$ 5,472,823
Nonpersonnel					
Supplies	\$ 515,000	\$ 2,480,000	\$ 3,715,556	\$ 7,401,112	\$ 7,416,112
Contracts	\$ 2,465,956	\$ 2,487,585	\$ 151,532	\$ 118,468	\$ 121,532
Energy and Utilities	\$ -	\$ 7,241,181	\$ 14,482,361	\$ 14,482,361	\$ 14,482,361
Other	\$ 5,649,000	\$ 6,268,000	\$ 6,907,000	\$ 2,804,000	\$ 2,855,000
Total Non-personnel	\$ 8,629,956	\$ 18,476,766	\$ 25,256,449	\$ 24,805,941	\$ 24,875,005
Total Operating Expenses	\$11,853,423	\$22,438,927	\$30,058,276	\$30,138,714	\$30,347,828
Wastewater System					
Personnel					
FTE	9.84	15.14	20.44	26.74	26.74
Expense	\$ 941,462	\$ 1,400,391	\$ 1,881,896	\$ 2,506,795	\$ 2,571,465
Nonpersonnel					
Supplies	\$ 5,000	\$ 10,000	\$ 15,000	\$ 20,000	\$ 25,000
Contracts	\$ 1,234,261	\$ 974,061	\$ 702,124	\$ (757,876)	\$ (697,876)
Energy and Utilities	\$ -	\$ -	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
Other	\$ 619,000	\$ 638,000	\$ 57,000	\$ 76,000	\$ 95,000
Total Non-personnel	\$ 1,858,261	\$ 1,622,061	\$ 1,774,124	\$ 338,124	\$ 422,124
Total Operating Expenses	\$ 2,799,723	\$ 3,022,452	\$ 3,656,020	\$ 2,844,919	\$ 2,993,589
Combined Total	\$ 14,653,146	\$ 25,461,379	\$ 33,714,296	\$ 32,983,633	\$ 33,341,417

There is one new Critical Strategic Expenditure: support for the Street Preservation Ordinance. With the adoption of new regulations regarding the trenching of City streets, the administration is now considering having PUD take over the repair of City streets following trench work for PUD projects. Currently the Transportation Department, as part of a service level agreement (SLA), does this work for PUD and is reimbursed by PUD. Under the new system, PUD would hire its own asphalt repair teams and end the SLA with Transportation, allowing Transportation employees to focus on other work within the right of way. As there is a reduction in payments to the General Fund for this work, the overall change to the PUD budget is cost neutral for the water and wastewater systems through FY 2027. After that, the cost of personnel results in a total annual increase of approximately \$1.6 million, mostly within the wastewater system.

Capital Improvement Program (CIP)

Capital investments are a key driver of costs and revenue requirements in the PUD Outlook for both the water and wastewater systems and include two key categories of projects: (1) Pure Water (particularly Phase 1 construction costs), and (2) Baseline CIP (ongoing investments in infrastructure repairs, replacements, and improvements). As shown in the following table, Pure Water expenditures significantly decrease following FY 2025 as Phase 1 construction ends and the facilities go into production. Overall, CIP projections remain stable over the Outlook period and are consistent with previous PUD outlooks, although baseline CIP costs have increased overall. Spending on Baseline CIP projects is projected to increase over the five-year period for the water

system by \$151.5 million, while the wastewater system projects a baseline decrease of \$37.0 million.

Total CIP (in millions)							
	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	Total
Pure Water							
Water	\$ 349.3	\$ 140.2	\$ 50.6	\$ 26.2	\$ 32.6	\$ 38.3	\$ 287.9
Wastewater	\$ 230.6	\$ 166.0	\$ 43.6	\$ 20.0	\$ 16.9	\$ 17.2	\$ 263.7
Total Pure Water	\$ 579.9	\$ 306.2	\$ 94.2	\$ 46.2	\$ 49.5	\$ 55.5	\$ 551.6
Baseline CIP							
Water	\$ 144.2	\$ 249.7	\$ 319.8	\$ 304.0	\$ 274.7	\$ 247.9	\$ 1,396.1
Wastewater	\$ 128.7	\$ 216.7	\$ 147.7	\$ 191.1	\$ 208.3	\$ 131.9	\$ 895.7
Total Baseline CIP	\$ 272.9	\$ 466.4	\$ 467.5	\$ 495.1	\$ 483.0	\$ 379.8	\$2,291.8
Total CIP	\$ 852.8	\$ 772.6	\$ 561.7	\$ 541.3	\$ 532.5	\$ 435.3	\$ 2,843.4

With Pure Water Phase 1 nearing completion, attention will turn to Phase 2, which is currently in the early stages of design with a demonstration site under construction at the Point Loma Wastewater Treatment Plant. Similar to how Phase 1 used a specific financing package, including the use of low interest Water Infrastructure Finance and Innovation Act (WIFIA) loans and State Revolving Loan Fund (SRF) debt, it will be important to monitor how Phase 2 financing packages come together as it moves forward. At present most CIP expenditures for Phase 2 are assumed to be funded with cash for water and a combination of cash and SRF for wastewater.

Revenues and Sources for CIP Funding

The financing plan for the Baseline CIP is one of a major driver of cash needs for each of the utility enterprise funds, and impacts important financial metrics, including the DSCR, days of CoH, and others. The table below provides an overview of baseline CIP expenditures and funding sources for the Outlook period. For each system, the proposed financing contains a mixture of debt as well as cash and capacity fees, with the water system funded with 80.4% debt financing and the wastewater system with 74.8% debt financing. The various mechanisms used to fund needed capital improvements – such as commercial paper/bonds, loans, or cash – should align with the anticipated useful life and expected benefit of each improvement project; debt financing of one-time system upgrades and improvements promotes intergenerational equity by distributing project costs over the life of the new asset. The optimal combination of debt and cash funding can help balance the near- and long-term impacts to ratepayers while meeting PUD’s financial targets and ratings agencies’ benchmarks.

Baseline CIP Expenditures and Revenues (in millions)								
	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	Outlook Total
Water System								
Expenditures	\$ 133.5	\$ 144.2	\$ 249.7	\$ 319.8	\$ 304.0	\$ 274.7	\$ 247.9	\$ 1,396.1
Revenue Sources								
Commercial Paper/Bonds	\$ 30.0	\$ 127.0	\$ 273.0	\$ 50.0	\$ 190.0	\$ 260.0	\$ 100.0	\$ 873.0
SRF Loans	\$ -	\$ 1.8	\$ 29.9	\$ 48.1	\$ 78.4	\$ 54.8	\$ 38.4	\$ 249.6
Capacity Fees	\$ 18.0	\$ 16.9	\$ 15.0	\$ 15.0	\$ 15.0	\$ 15.0	\$ 15.0	\$ 75.0
Capacity Fees/Cash	\$ 85.5	\$ (1.6)	\$ (68.1)	\$ 206.7	\$ 20.7	\$ (55.1)	\$ 94.5	\$ 198.7
Total Revenue	\$ 133.5	\$ 144.1	\$ 249.8	\$ 319.8	\$ 304.1	\$ 274.7	\$ 247.9	\$ 1,396.3
Wastewater System								
Expenditures	\$ 119.4	\$ 128.7	\$ 216.7	\$ 147.7	\$ 191.1	\$ 208.3	\$ 131.9	\$ 895.7
Revenue Sources								
Revenue Bonds	\$ 70.7	\$ 2.5	\$ 210.0	\$ -	\$ 260.0	\$ -	\$ 200.0	\$ 670.0
SRF Loans	\$ 0.6	\$ 10.7	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Capacity Fees	\$ 26.1	\$ 23.2	\$ 23.2	\$ 23.2	\$ 23.2	\$ 23.2	\$ 23.2	\$ 116.0
Capacity Fees/Cash	\$ 22.0	\$ 92.3	\$ (16.5)	\$ 124.5	\$ (92.1)	\$ 185.1	\$ (91.3)	\$ 109.7
Total Revenue	\$ 119.4	\$ 128.7	\$ 216.7	\$ 147.7	\$ 191.1	\$ 208.3	\$ 131.9	\$ 895.7

Compared to the previous Outlook, overall debt financing has increased for both the water and wastewater systems. However, the timing of debt has changed, resulting in different cash needs in various years. For the water system, the amount of commercial paper and/or bonds has changed from even reimbursements throughout the five years to differently sized chunks, the largest being \$273 million in FY 2025 and \$260 million in FY 2028.

Revenue bonds for the wastewater system remain relatively consistent with the prior Outlook, but have shifted years, with large financing actions expected in FY 2025, FY 2027, and FY 2029, as opposed to in FY 2024, FY 2026, and FY 2028. The impact of these debt shifts will be discussed further in the Mitigations Section.

Additionally, SRF loans for water have decreased from \$377.7 million to \$249.6 million, and for wastewater from \$162.2 million to \$116.0 million, due to limited funding at the State level. This impacts overall debt service costs, as SRF loans not only typically have lower interest rates but also do not require payback until projects have completed construction.

Potential Mitigation Actions

The drivers of rate increases shown in the PUD Outlook are mainly increased operations expenditures, water purchase assumptions, CIP cash needs, and revenue adjustments. In this section, we discuss potential mitigation actions that the Council could consider to potentially reduce the rate increases or improve financial metrics shown in the PUD Outlook. For each of these mitigations, we also provide a summary of the impacts to financial metrics previously discussed, including the DSCR, impact to Rate Stabilization Fund targets, and days of CoH, to show the potential consequences for each action. For reference, the table below provides a summary of these metrics as they are presented in the Outlook without any mitigating actions. Based on our review of the PUD Outlook, the potential mitigation actions that we have identified are: smoothing out the rate increases to make them more consistent, changing the use of local water assumptions, changing the debt issuance assumptions in the CIP, and deferring CIP projects.

Additionally, we discuss the potential to influence County Water Authority operations to help mitigate increasing costs of purchasing water from the CWA.

Financial Metrics in Current Outlook						
Water System	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Debt Service Coverage Ratio	1.53 x	1.43 x	1.39 x	1.36 x	1.50 x	1.66 x
Above/(Below) Rate Stabilization Target	\$ 48.7	\$ 37.8	\$ (21.2)	\$ (8.9)	\$ (3.8)	\$ -
Days of Cash on Hand	200	233	87	92	148	134
Wastewater System	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Debt Service Coverage Ratio	1.41 x	1.36 x	1.36 x	1.39 x	1.40 x	1.39 x
Above/(Below) Rate Stabilization Target	\$ 49.7	\$ 18.5	\$ 18.4	\$ (2.4)	\$ (5.0)	\$ (10.0)
Days of Cash on Hand	168	210	148	264	91	184

Rate Increase Smoothing

The first mitigation action would be to potentially smooth out rate increases, particularly for water. For each utility system, our Office took the average rate increases assumed for FY 2026 through FY 2029, and applied the average of those the rate increases in each year, as shown in the table below. Impacts to corresponding financial metrics are also shown for each utility system.

Mitigation Action - Rate Smoothing						
Water	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Rate Increase - Outlook	10.2%	8.7%	11.8%	8.9%	8.2%	7.4%
Rate Increase - Smoothed	10.2%	8.7%	9.0%	9.0%	9.0%	9.0%
Debt Service Coverage Ratio	1.53 x	1.43 x	1.33 x	1.24 x	1.41 x	1.62 x
Above/(Below) Rate Stabilization Target	\$ 48.7	\$ 37.8	\$ (21.2)	\$ (8.5)	\$ (2.9)	\$ -
Days of Cash on Hand	200	233	82	76	124	105
Wastewater System	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Rate Increase - Outlook	4.0%	3.0%	7.0%	6.0%	6.0%	6.0%
Rate Increase - Smoothed	4.0%	3.0%	6.3%	6.3%	6.3%	6.3%
Debt Service Coverage Ratio	1.41 x	1.36 x	1.37 x	1.38 x	1.39 x	1.38 x
Above/(Below) Rate Stabilization Target	\$ 49.7	\$ 18.5	\$ 18.4	\$ (2.4)	\$ (5.0)	\$ (10.0)
Days of Cash on Hand	168	210	146	260	87	179

For the water system, instead of a high of 11.8% in FY 2026, followed by lower rate increases over the next three years, rates could be structured so that each year only had an aggregate increase of 9.0%. It must be noted that this approach would dramatically lower the DSCR and the days of CoH in FY 2027, although these metrics do partially recover by FY 2029. However, this recovery would require consistent increases, and could create financial and rating uncertainty for the water system as the metrics would be significantly lower than currently proposed. For the wastewater system, there are no drastic changes as the rates were already fairly smoothed out.

Changing Local Water Usage Assumptions

The next mitigation action only impacts the water system since it involves changing what years locally stored water will be used. As mentioned, PUD currently anticipates utilizing all of the excess stored water from the last rainy season, as well as the upcoming rainy season, over FY 2024

and FY 2025. For this mitigation action, we moved 8,000 AF of local water use from FY 2025 to FY 2026, as FY 2026 has one of the highest cash needs in the Outlook. The impact on water purchases and the financial metrics is provided in the table below.

Mitigation Action - Local Water Usage						
Water	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Local Water Usage - Outlook	35,000	43,000	25,000	25,000	25,000	25,000
Rate Increase - Smoothed	35,000	35,000	33,000	25,000	25,000	25,000
Water Purchases - Outlook	\$ 263.1	\$ 283.6	\$ 331.9	\$ 316.8	\$ 314.6	\$ 331.1
Water Purchases - Smoothed	\$ 263.1	\$ 295.8	\$ 318.7	\$ 316.8	\$ 314.6	\$ 331.1
Debt Service Coverage Ratio	1.53 x	1.33 x	1.49 x	1.36 x	1.50 x	1.66 x
Above/(Below) Rate Stabilization Target	\$ 48.7	\$ 37.8	\$ (21.3)	\$ (9.0)	\$ (3.8)	\$ -
Days of Cash on Hand	200	222	90	93	150	135

As shown in the table, while reserving local water increases purchasing costs in FY 2025 by \$12.2 million, it saves \$13.2 million in FY 2026. Notably, this change would marginally improve the days of CoH in each year beginning in FY 2026, as well as improve the DSCR in FY 2026. A significant risk associated with this strategy, however, is the potential for another large rain year with rainwater and runoff exceeding the City’s storage capacity in FY 2025. This excess water would spill over the dams or have to be released due to dam safety restrictions and would thus be lost for future use.

CIP Debt Smoothing

One of the main drivers of cash needs is the amount of cash needed to fund the CIP. Cash need is impacted by anticipated debt proceeds in each year, as that determines whether cash is needed or if it can be used for other purposes. For this mitigating action, our Office considered accelerating \$50 million of Commercial Paper financing in the water system from FY 2027 up to FY 2026. Additionally, for the wastewater system we considered moving \$130 million in debt issuances from FY 2027 to FY 2026, and \$100 million from FY 2029 to FY 2028. In both instances, the total amount of debt utilized over the Outlook period is held constant. The comparison of the debt issuances and resulting financial metrics is provided below.

Mitigation Action - CIP Debt Smoothing						
Water	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Revenue Bonds - Outlook	\$ 127.0	\$ 273.0	\$ 50.0	\$ 190.0	\$ 260.0	\$ 100.0
Revenue Bonds - Smoothed	\$ 127.0	\$ 273.0	\$ 100.0	\$ 140.0	\$ 260.0	\$ 100.0
Debt Service Coverage Ratio	1.53 x	1.43 x	1.39 x	1.37 x	1.50 x	1.66 x
Above/(Below) Rate Stabilization Target	\$ 48.7	\$ 37.8	\$ (21.2)	\$ (8.9)	\$ (3.8)	\$ -
Days of Cash on Hand	200	233	115	92	149	134
Wastewater System	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Revenue Bonds - Outlook	\$ 2.5	\$ 210.0	\$ -	\$ 260.0	\$ -	\$ 200.0
Revenue Bonds - Smoothed	\$ 2.5	\$ 210.0	\$ 130.0	\$ 130.0	\$ 100.0	\$ 100.0
Debt Service Coverage Ratio	1.41 x	1.36 x	1.30 x	1.42 x	1.35 x	1.41 x
Above/(Below) Rate Stabilization Target	\$ 49.7	\$ 18.5	\$ 18.4	\$ (2.4)	\$ (5.0)	\$ (10.0)
Days of Cash on Hand	168	210	277	261	183	179

For the water system, the DSCR stays relatively stable in each year, although the days of CoH does improve dramatically in FY 2026, from 87 up to 115.

However, this mitigation action has more dramatic impacts on the wastewater system. The DSCR is lowered in the years with added debt, but the days of CoH is significantly higher. Potential drawbacks of this timing include the need to go out to bond markets more frequently, and the actual cost of debt could change depending on the utility’s financial metrics at the time of debt sale.

CIP Project Deferral

The last mitigation action involves the deferral of CIP projects. Many expenditures for both the water and wastewater systems are quite difficult to cut or defer, especially as operating expenditures for the utilities mostly involve regulatory and health/safety work. As such, the main place where costs could be deferred is within the CIP. For this mitigation, our Office postponed project schedules within the Baseline CIP for projects where significant spending would have begun in either FY 2025 or FY 2026. The magnitude of these deferrals, and the resulting financial metrics, are provided below.

Mitigation Action - CIP Deferral						
Water	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Baseline CIP - Outlook	\$ 144.2	\$ 249.7	\$ 319.8	\$ 304.0	\$ 274.7	\$ 247.9
Baseline CIP - Deferrals	\$ 144.2	\$ 203.0	\$ 272.2	\$ 306.7	\$ 288.3	\$ 249.9
Debt Service Coverage Ratio	1.53 x	1.44 x	1.41 x	1.38 x	1.51 x	1.66 x
Above/(Below) Rate Stabilization Target	\$ 48.7	\$ 37.8	\$ (21.2)	\$ (8.9)	\$ (3.8)	\$ -
Days of Cash on Hand	200	256	126	121	161	136
Wastewater System	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Baseline CIP - Outlook	\$ 128.7	\$ 216.7	\$ 147.7	\$ 191.1	\$ 208.3	\$ 131.9
Baseline CIP - Deferrals	\$ 128.7	\$ 212.3	\$ 129.3	\$ 182.1	\$ 209.7	\$ 117.5
Debt Service Coverage Ratio	1.41 x	1.36 x	1.39 x	1.41 x	1.41 x	1.40 x
Above/(Below) Rate Stabilization Target	\$ 49.7	\$ 18.5	\$ 18.4	\$ (2.4)	\$ (5.0)	\$ (10.0)
Days of Cash on Hand	168	215	175	299	114	206

Beginning with the water system, \$46.7 million (18.7%) in FY 2025 projects are deferred to later years, with an additional \$47.6 million (14.9%) in projects deferred out of FY 2026. FY 2027 through FY 2029 have higher costs, but some other CIP expenditures were moved beyond the scope of the Outlook. This results in increased days of CoH as well as improved DSCRs through the Outlook period.

For the wastewater system, only \$4.4 million (2.0%) of projects are deferred to a later year, with an additional \$18.4 million (12.5%) deferred out of FY 2026. This again has the impact of improving the DSCR and days of CoH.

However, CIP project deferrals come with significant downsides. Many of these projects are necessary to replace aging assets, including pipelines, transmission systems, and pump stations. Deferring these projects increases the risk of failure and flooding or sewage backups that are often more costly to clean up than to fix ahead of time.

San Diego County Water Authority (CWA) Rates

The largest single expenditure for PUD – and the largest non-personnel expense for the City – is the purchase of water from CWA. The City’s reliance on imported water leaves it susceptible to rate increases beyond its control. The City of San Diego is also the largest user of CWA water, accounting for about 40% of CWA’s water deliveries. Pure Water Phase 1 entering production will have a significant impact on the total regional demand for CWA water.

CWA’s Long-Range Financing Plan provides an “Annual All-in” range rate and increases forecasted between 2.6% and 11.3%; actual CWA rate increases will be implemented based on multiple rate and charge categories. Applicable rate and charge categories for the City include four fixed categories (Storage, Customer Service, Supply Reliability, and Infrastructure Access) and a volumetric rate based on the actual volume of water purchased by the City. For the purpose of the Outlook, PUD used the mid-point of the CWA’s guidance on rate increases. As shown in the table below, anywhere from one-third to almost half of the projected water rate increases would be needed to pay for increased CWA water rates. Increases in revenue necessary to support PUD water system operations range from 4.7% to 8.3% in each year of the Outlook period.

Projected Water Rate Increases by CWA Pass-through Costs and Water System Costs							
	12/1/2023	7/1/2024	1/1/2025	1/1/2026	1/1/2027	1/1/2028	1/1/2029
CWA Pass-through Costs	1.8%	1.8%	4.0%	3.5%	2.9%	2.2%	1.9%
Water System Costs	3.2%	3.4%	4.7%	8.3%	6.0%	6.0%	5.5%
Total Rate Increase	5.0%	5.2%	8.7%	11.8%	8.9%	8.2%	7.4%

Recent discussions of the CWA Board of Directors have included an evaluation of the CWA’s current rate structure, and in particular have focused on the need for CWA to increase the proportion of revenues that they recover from fixed charges. This is in response to projected decreases in demand associated with the City’s Pure Water program, as well as efforts by the East County JPA and the City of Oceanside to complete similar projects. This lowers the demand for CWA’s water.

Similar to the City, the CWA’s revenues are also directly tied to the amount of water they sell. Despite the fact that recent CWA projections show the City would potentially save money in the short term **if fixed charges are increased to recover a greater share of revenue from fixed sources, in the out years of the Outlook this would result in the City being impacted substantially more than if CWA instead increased its volumetric rates.** The structural change being contemplated by CWA to recover more of its revenues from fixed costs would reduce the City’s cost savings associated with shifting a portion its water supply from CWA to Pure Water. This would potentially be even more acute in FY 2035 when the development of Pure Water Phase 2 is contemplated to be completed. The PUD Outlook does not make any assumptions on the outcome of this effort.

The City, and more directly the members of the CWA Board of Directors who represent the City, can have a major impact on how these potential rate changes impact the City’s cost to purchase water. The City currently has 10 members on the CWA Board of Directors, each of whom is to represent the City’s interests. If fixed charges are to be increased, the City’s directors should seek to identify ways to bring down the CWA’s own total costs. There are two main ways

to achieve this: limiting the amount of new capital projects that the CWA takes on, and lowering the costs of CWA's water purchases, either by swapping out more expensive water for cheaper sources, or potentially finding buyers for the CWA's excess supplies.

Limiting New Capital Projects

The CWA has been expanding its portfolio of projects in tandem with its efforts to improve the reliability of the region's water supply since 1991. Prior to 1991, the CWA mainly focused on delivering water to its member agencies that it purchased from the Metropolitan Water District of Southern California (MWD). Since 1991, however, the CWA has undertaken numerous projects that go beyond that initial scope, including building the new Olivenhain Reservoir, increasing the height of the San Vicente Dam, building the Twin Oaks Valley Water Treatment Plant, and partnering with a private company to build the desalination plant in Carlsbad. While these projects have improved the region's water reliability, the San Diego region now has sufficient water supplies, especially given ongoing conservation, and new projects to further increase the supply of imported water, or to store more imported water locally, are no longer cost effective. As an example, over the last several years the CWA had been studying the feasibility of building a Regional Conveyance System (RCS) to directly connect the San Diego region to the Colorado River. This project would not have added to local supplies (water originating in the Colorado river is a finite source and is already be conveyed to CWA through MWD infrastructure), but would have focused on reliability and independence. This project would have had considerable costs, and as the largest member agency, City of San Diego ratepayers would have been significantly impacted.⁷ While it appears that the RCS project is now on an indefinite pause, **the City's representatives on the CWA Board of Directors should remain focused on ensuring that additional CIP projects beyond those necessary to maintain and repair current systems are not authorized in order to prevent additional CWA cost escalation.**

Right-Sizing the CWA's Water Supplies

Beyond keeping CWA's CIP costs reasonable, the City's representatives should also focus on lowering the CWA's overall operating costs, including exploring opportunities to lower CWA's largest expense: water purchases. As with PUD, water purchases make up the vast amount of the CWA budget, at 81% in FY 2023. These purchases are primarily made through two agreements that CWA has for water supplies: the Quantification Settlement Agreement (QSA) and the agreement to purchase water from the Carlsbad desalination plant. The QSA provides CWA with a minimum of 277,700 AF of water every year, while the Carlsbad desalination plant agreement requires that CWA purchase a minimum of 48,000 AF of water per year. This provides CWA with a total minimum of 325,700 AF of water that it must purchase and/or is otherwise already paying for every year. However, CWA's water sales have been trending down and are rapidly approaching this minimum. Based on the recent [FY 2023 Annual Comprehensive Financial Report for CWA](#), water sales to member agencies totaled 346,881 AF of water, which included 145,528 AF for the

⁷ Based on [Black & Veatch's Regional Conveyance System Study Phase A Final Report](#) (August 2020), the City's ratepayers would need to contribute approximately \$500 million in pre-construction soft costs and \$5 billion in construction costs and resulting debt service expenses if the Regional Conveyance System moves forward.

City.⁸ The City is projecting to lower its purchases dramatically once Pure Water Phase 1 is completed, and absent any other changes, potential CWA sales would be below the minimums required by the QSA and desalination agreements.

CWA does appear to be addressing this, as recent reporting noted CWA is participating in an agreement with the Imperial Irrigation District (IID), MWD, and the federal government to conserve Colorado River water, including supplies that are part of the QSA, and instead purchase less expensive water from the State Water Project through MWD. This agreement would not only lower the volume of water that CWA is committed to buy each year, but it also swaps a more expensive water source for a cheaper one. However, this agreement only has a one-year term, and will only be in effect as long as the State Water Project remains at full capacity based on recent rainfall throughout the State.

Agreements such as the swap of QSA water for State Water Project water, or other agreements that lower the amount of water that CWA must take on, will be extremely important as the agency moves forward, and as additional potable reuse water supply projects come online. **The City's representatives should also focus on right-sizing CWA's water supply and purchasing costs, including swapping of more expensive supplies for cheaper ones, and selling excess supplies.**

CONCLUSION

This PUD Outlook continues to build on the work done in previous outlooks and continues to show a need for additional rate increases to support the provision of safe and reliable water and wastewater services to City residents. The PUD Outlook provides an initial basis for expenditure and revenue forecasts for subsequent COS studies, which will be required for the rate increases assumed in the Outlook from FY 2026 onwards.

The need for additional rate capacity continues to be driven by additional costs to utility systems, including increases in base operating costs due to increases in employee compensation, treatment supply costs, and energy bills. These increasing costs, combined with declining water sales and static wastewater flows from City residents, necessitate the need for increased rates to maintain the financial stability of the system, and to improve reliability and performance.

As the Pure Water systems begin to come online, we note that it will be *crucial* for the City's representatives on the CWA Board of Directors to keep the wholesaler's costs in check to ensure the City can realize financial savings from its own renewable source of potable water. **Our Office recommends that the City's representatives should remain focused on ensuring that only CIP projects needed to maintain and repair current systems are authorized in order to prevent additional CWA cost escalation, and to focus on right-sizing CWA's water supply and purchasing costs, including the potential swapping of more expensive water supplies for less expensive ones and selling excess supplies.**

⁸ The discrepancy between PUD's reported purchases and CWA's reported sales has to do with when water is purchased and accrued to each budget, as June is a time when the City is purchasing water that it will ultimately sell in July.


A variety of financial challenges and risks could impact projections contained in the PUD Outlook, including some that are outside of the City’s control. Risks and challenges include (but are not limited to) the following:

- The range of CWA rate increases for purchased water, especially given decreases in overall regional demand as Pure Water and similar regional projects come online.
- Changes to water demands from City customers, particularly decreases in demand and the associated impacts on supply costs and sales revenue.
- CIP funding strategies - including the use of cash, debt, capacity fees, and grants - to mitigate potential rate increases, and impacts on the ability to meet long-term DSCR requirements.
- Inflation, cost escalation, and interest rate risks given recent economic trends.
- Potential costs for CAP-related projects which are not included in this Outlook, most notably EV conversions for City fleet vehicles.

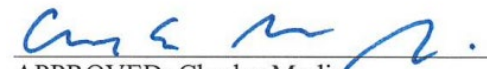
Council may also wish to ask about additional mitigating actions that could be taken to minimize rate increases shown in the Outlook and consider them during the upcoming FY 2025 Proposed Budget hearings. Several potential mitigating actions, and their potential impacts and risks, are discussed in this report, but they do not represent a comprehensive assessment of all potential mitigations.

As in the past, our Office will again contract with a consultant to conduct an independent review of water and wastewater COS studies and proposed rate increases anticipated in FY 2025. We believe this independent review was beneficial to Council and the public in understanding the assumptions and factors that went into the prior rate increases and laid out needed data for future studies.

We would like to thank PUD for responsiveness to our questions and discussions that went into the development of this report.



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