



THE CITY OF SAN DIEGO

MEMORANDUM

DATE: October 31, 2014

TO: Independent Rates Oversight Committee

FROM: Halla Razak, Director of Public Utilities

SUBJECT: Fiscal Year 2014 IROC Annual Report

On October 30, 2014, Independent Rates Oversight Committee (IROC) issued its Fiscal Year 2014 Annual Report with six Key Recommendations. In addition there were six Finance Subcommittee recommendations, nine Infrastructure & Operations subcommittee recommendations, and three Outreach & Communications recommendations.

The Department agrees with four of the key recommendations, and partially agrees with two key recommendations. The Department agrees with all six Finance recommendations; agrees with seven, and partially agrees with two Infrastructure and Operations recommendations; and agrees with all three Outreach & Communications recommendations (see attachment). We will update IROC periodically to keep you informed of our progress towards implementation.

I would like to express my gratitude on behalf of the Public Utilities Department for your insightful and wide ranging recommendations. Staff will continue to evaluate and consider all of IROC's recommendations.

A handwritten signature in blue ink, appearing to read "Halla Razak".

Halla Razak

DB/db

Attachment: Public Utilities Department Response to the Fiscal Year 2014 IROC Annual Report

cc: Honorable Mayor and City Council
Independent Budget Analyst
Scott Chadwick, Chief Operating Officer
Tony Heinrichs, Deputy Chief Operating Officer
Tom Zeleny, Chief Deputy City Attorney

**Public Utilities Department
Response to the Fiscal Year 2014 IROC Annual Report
10-31-14**

IROC's Key Recommendations

1. Enhance public understanding of the costs and benefits of the water and wastewater system, through consistent information and messaging, under a clear, compelling, value statement (e.g., "San Diego Water: Pure Value").

Department Response: The Department agrees with this recommendation.

The Department has incorporated cost, benefit and value messages into our key outreach programs including Waste No Water and Pure Water San Diego Outreach programs. Additionally, as part of the Department's branding effort, the value of the services provided will continue to be highlighted in our outreach efforts.

2. Consider much greater investment in conservation incentives (based on the proposition that conservation saves money by avoiding costs, both infrastructure and commodity at highest marginal price). *IROC believes that the public interest is better served, and conservation goals better met, through incentives to encourage water wise investments and behavior, than through the current intrusive and ineffective "Water Cop" approach.*

Department Response: The Department partially agrees with this recommendation.

The Department believes in incentives and has infused the Rebate Program with operating funds (from the Water Fund and the Stormwater Program), totaling an additional \$550,000 this fiscal year and plans to do so again in FY 2016. For customers who can afford capital outlay for landscape renovation and apply for a rebate, this is a great program. Some customers cannot afford the capital outlay, and some also prefer to be given specific action items on what they need to do to conserve. The "direct to the consumer" approach is for public education rather than issuing citations and fines. Both approaches work well as part of a diversified set of options for responding to the call for more water conservation.

3. Fully and timely fund system maintenance and replacement, based on ongoing condition assessments and other optimization tools. *Pipe breaks lose more than water; they lose public support for the investments needed to reduce pipe breaks.*

Department Response: The Department agrees with this recommendation.

The Department will continue to manage assets optimally through repair, rehabilitation, and replacement. The department has launched an aggressive condition assessment program for water and wastewater infrastructure as well as asbestos cement (AC) water mains. These assessments will determine the future Capital Improvement improvements and needs. The department has in place a 10–year CIP model and in the process of developing a user friendly SAP Enterprise Asset Management system.

4. Continue to press forward on all levels with the Pure Water San Diego Program (legislative, regulatory, educational, design, investment).

Department Response: The Department agrees with this recommendation.

The Department will continue to press forward on all levels related to Pure Water San Diego. As part of a Cooperative Agreement with the environmental community, the City has agreed to meet certain milestones related to environmental review, design and construction, and operation of facilities to produce 83 mgd of safe, reliable potable water by 2035.

5. Explore alternative rate structures that are fair (regionally/north-south, by customer class, by customer), consistent with long-range policy goals (especially conservation), and fiscally sound. Ensure sustainability while seeking opportunities to enhance fairness and affordability (including continuing to explore ways and means to provide a “lifeline” rate).

Department’s Response: The Department partially agrees with this recommendation.

We believe that the current rates fairly assign costs based on industry-recognized cost-of-service principles. During the last Cost of Service Study (COSS) the Department proposed and received approval to make several changes to the rate structure. To provide an incentive for those who conserve, the approved rate structure for Single Family Residential customers now includes a fourth tier. This new tier replaces the existing Tier 1 and is much smaller. The four units of water included in Tier 1 are priced at the lowest rate since it represents the City's least expensive source of water — local supply. In addition to expanding the number of tiers, the structure also adjusts the pricing differential between the tiers to reflect more accurately the costs for each tier. However, we agree that there are alternative ways to structure utility rates and that the department should evaluate the pro’s and con’s of various alternatives as part of its forthcoming cost of service studies for both the sewer and water systems. The department is also in the process

of completing a review of the charges associated with its recycled water service. The purpose of the review is to determine the degree to which more of the costs associated with the provision of recycled water should be borne by recycled water customers.

We are working on implementing a donation program for low income assistance (Proposition 218 compliant).

6. Alert Mayor and Council to pending vacancies in May 2015, when 5 members are termed out. Request that the Mayor and Council identify qualified candidates as soon as possible.

Department Response: The Department agrees with this recommendation.

Finance Subcommittee:

Recommendation: Continue monitoring of departmental costs to measure accuracy of assumptions used in the Cost of Service Study (COSS), develop a method to "true-up" costs for cost categories found to be significantly different than the assumptions used, and perform regular cost of service studies to be used for future rate adjustments. In addition, the department should continue working with others to provide programs or encourage assistance for low income users to address some of the needs they may have in respect to water bills.

Department Response: The Department agrees with this recommendation.

The Department will continue to monitor departmental costs and work with IROC on the format of the variance analysis. As stated above, we are working on implementing a donation program for low income assistance (Proposition 218 compliant).

Recommendation: The Committee continues to review updated fees and rate structure and monitor progress of the Department strategic initiative to review all rates and fees for departmental services.

Department Response: The Department agrees with this recommendation.

The Department will provide presentations on updated fees and rate structure including the next Cost of Service Study.

Recommendation: That the Committee continue to monitor budget expenditures throughout the year. It is also recommended that the Department provide the Committee a copy of the FY 2016 budget detail as soon as possible after release by the Mayor's Office, in addition to budget summaries normally prepared for the Committee.

Department Response: The Department agrees with this recommendation.

The Department will provide a copy of the FY16 budget and will provide a budget presentation when the budget is released.

Recommendation: Make changes to the IROC's mission and purpose to eliminate reference to the DRES fund.

Department Response: The Department agrees with this recommendation.

The Committee received a report from the Office of the City Auditor that recommended the elimination of the DRES Reserve. The City Reserve Policy which included elimination of this reserve was then reviewed by the Budget and Government Efficiency Committee on May 22, 2014 and approved by the City Council on July 1, 2014.

Recommendation: The Committee receive and review the updated study results in early FY 2015, in order to provide meaningful comments as part of an increased public outreach effort.

Department Response: The Department agrees with this recommendation.

On July 10, 2013, the Natural Resources and Culture Committee directed the Department to contract for an independent review and update of the rates from the Raftelis Study. This information is being presented to City Management. Upon approval, the Department will discuss with the various stakeholders and conduct additional outreach.

Recommendation: The Committee reviews departmental progress in implementing the approved Task Force Recommendations that fall within the responsibilities of IROC.

Department Response: The Department agrees with this recommendation. The department will provide progress updates to IROC related to the approved Water Policy Implementation Task Force recommendations that fall with the responsibilities of IROC.

Infrastructure and Operations Subcommittee:

Recommendation: IROC recommends that the Department continue to highlight significant CIP schedule and cost variances on the CIP Report to allow IROC and City Council oversight of the capacity to deliver projects on time and within budget.

IROC also recommends that the Department carefully monitor implementation of the CIP and make any adjustments that are needed to expeditiously accomplish planned infrastructure upgrades and replacements.

Department Response: The Department agrees with these recommendations.

Recommendation: Continue with and accelerate where reasonable, the ongoing program of System Condition Assessments to lead to a more effective CIP and maintenance program by providing better information on which infrastructure elements need repair, upgrading, replacement, increased maintenance, or no investment.

But we recommend that the Department not wait until the System Condition Assessments are complete to accelerate infrastructure replacement.

We recommend that the 2016 COSS identify the funds to accelerate replacement of our aging infrastructure, especially water pipes.

Department Response: The Department agrees with these recommendations.

Though the Department is at the last phase of completing a condition assessment and master plan for system-wide asbestos cement pipeline replacement program, staff has already identified approximately 200 miles of asbestos cement pipeline to be scheduled for infrastructure replacement. The expenditure projections will be included in the FY 16 COSS and the 10 year-financial outlooks.

The Department will review the ability to accelerate the replacement of our infrastructure including water pipes along with the available funding needs during the 2016 COSS.

Recommendation: Perform a long term projection (~20-30 years) of needs, costs, and revenues to make sure that future needs can be planned and accommodated, without unacceptable spikes in rates, in the face of uncertainties in future consumption, supply, and costs.

Consider whether financing 80% or some different portion of the CIP is optimum for the long run.

Department Response: The Department partially agrees with this recommendation.

The Department projections focus on the first 10 years for both CIP and O&M costs including CWA pass-through rate increases for water purchases, funding sources, projected debt coverage, cash balances, as well as major assumptions. While the Department prepares 10-year projections, 20- to 30-year projections may not be accurate or feasible since all of the improvements have not yet been indentified.

We review the financing sources when developing our COSS. The Department has a general policy to fund the CIP program 80 percent financing and 20 percent cash. With the 2014 COSS, the Department proposed and is cash funding the program for fiscal years 2014 and 2015. We will continue to evaluate the debt financing in the future with an emphasis on cash funding for main replacements when possible.

Recommendation: IROC recommends that the Department seriously consider for the next rate case, adopting a rate system that allows for greater rate stability, more fairness, and a greater incentive for conservation.

Department's Response: The Department partially agrees with this recommendation.

See response to IROC Key Recommendation No. 5.

Recommendation: Assemble and regularly update a report on the retention, recruitment, and anticipated retirement of employees, by specialties, within the Department.

Department Response: The Department agrees with this recommendation.

Recommendation: Recommend that the Department provide quarterly updates to IROC on progress being made on both CIP management and CIP performance as a result of this new partnering agreement, by January 2015.

Department Response: The Department agrees with this recommendation.

Recommendation: Continue with the aggressive Pure Water Program and its goal to provide for the potable reuse of 83 MGD by 2035.

Continue to pursue the possibility of implementing some level of direct potable reuse to reduce the cost and the time to implement the Pure Water program while moving ahead with the current plan.

Ensure that the Cost of Service Study for the 2016 water rates will provide adequate funding for the accelerated implementation of the Pure Water Program.

Department Response: The Department agrees with these recommendations.

Department staff is proposing to meet certain milestones related to environmental review, design and construction, and operation of facilities to

produce 83 mgd of safe, reliable potable water by 2035. The planning and design for the first 15 mgd phase of Pure Water, includes pursuit of parallel designs for both indirect and direct potable reuse. The Department will be reviewing the CIP Program including Pure Water San Diego in the 2016 COSS.

Recommendation: Continue with the effort to negotiate an agreement, or modify legislation, to allow meeting ocean discharge requirements by reducing discharge volumes through the Pure Water Program, instead of reducing them by modifying the Point Loma Wastewater Treatment Plant to achieve secondary treatment.

Department Response: The Department agrees with this recommendation.

The City is working with the Environmental Protection Agency to determine if there is an administrative process to allow for the approval of the concept of “secondary equivalency”, which would allow the City to meet the same annual total suspended solids limits, as it would have met had the existing 240 mgd Point Loma plant been converted to secondary treatment standards, through the implementation of Pure Water.

If this administrative process is not available, the City in consultation with the Metro Participating Agencies and the environmental community has already drafted legislative language to modify the Clean Water Act and is ready to pursue this option.

Recommendation: Move forward with the planned increases in the valve testing program.

Record every valve that cannot be operated when needed by a field worker and include that information in the valve testing data.

Use the data on inoperative valves to help prioritize which water distribution pipes should be replaced first.

Provide IROC with periodic summary information on the number of valves tested, number of inoperative valves found, and what will be done about them.

Department Response: The Department agrees with these recommendations.

For the third recommendation, the data on inoperative valves will be included as a sub-scoring factor under the pipe condition criteria as part of the AC Master Plan prioritization effort.

Outreach and Communications Subcommittee:

Recommendation: The Department provides a quarterly presentation to IROC detailing their outreach to the various community leaders in all areas of San Diego, and their engagement with them to help promote the Pure Water project outreach and awareness efforts.

Department Response: **The Department agrees with this recommendation.**

Recommendation: The Department continues to strengthen the “Water Conservation” campaign program messaging to ensure effectiveness and report back to IROC.

Department Response: **The Department agrees with this recommendation.**

Recommendation: The Department continues to monitor the CCS system to ensure excellence in customer service.

Department Response: **The Department agrees with this recommendation.**