



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: February 9, 2017

IBA Report Number: 17-06

Environment Committee Meeting Date: February 16, 2017

Item Number: 4

Review of UCAN Proposal for an Independent Water Rate Consultant

OVERVIEW

At its meeting on October 12, 2016, the Environment Committee heard a presentation from the Utility Consumers' Action Network (UCAN), in which UCAN proposed that the Independent Budget Analyst (IBA) be given the authority to hire a water rate consultant to review water rate cases from the Public Utilities Department (PUD), and to present its findings to the Independent Rate Oversight Committee (IROC) and the City Council. The proposal specifically requested that the scope of work for the consultant include review of the two reviews-of-funds that PUD committed to during the Council's consideration of increased water rates in November 2015.

At that Committee meeting, our office committed to preparing an analysis that examines the feasibility, cost, and scope of work of the UCAN proposal. This report includes a brief background and description of UCAN's proposal, examines the potential cost and appropriateness of the proposal, and further addresses potential alternatives to the proposal that might still accomplish the goals of increased IROC and Council oversight of PUD water rates.

Our office believes that a consultant with expertise in water rates could prove beneficial during Council's consideration of rate cases and cost of service studies, but that the benefits of and scope of work for such a consultant in analyzing PUD's reviews-of-funds would be more limited. Accordingly, we do not recommend hiring an independent consultant for the reviews-of-funds, but do note that Council could consider authorizing our office to hire a consultant on an as-needed basis to review the next full cost of service study and rate case that is anticipated in advance of FY 2021.

FISCAL/POLICY DISCUSSION

Background

Rate Increases Approved in 2015

Per state law, the City’s water rates can only be high enough to recover the costs associated with providing water delivery services. As such, PUD periodically hires consultants that prepare cost of service studies which detail the costs associated with water delivery and the water rates necessary to support that delivery. Each cost of service study (COSS) includes a number of assumptions, estimates, and forecasts that detail what is necessary to support PUD’s operational and capital needs.

In November 2015, the City Council heard a COSS prepared for PUD, and approved a corresponding multi-year schedule of potable water rate increases that cumulatively increase water rates by 39.7%, according to the following timeline:

January 1, 2016	July 1, 2016	July 1, 2017	July 1, 2018	July 1, 2019
9.8%	6.4%	6.4%	5.0%	7.0%

Significant factors impacting those rate increases included a decline in water sales due to drought conservation mandates, expected increases in the cost to purchase water from the County Water Authority (CWA), maintenance of debt-service-coverage ratios required by PUD’s bond covenants, and increased capital costs which were partially attributable to the City’s Pure Water potable-reuse program.

During the rate hearings, PUD committed to hiring an independent audit firm in July 2017 and July 2019 to conduct a review-of-funds to ensure that rate increases that have gone into effect are appropriate to ensure cost recovery.

UCAN Proposal

Largely in response to the increases in water rates requested by PUD and approved by Council in 2015, UCAN developed a proposal to make an additional independent consultant with expertise in water rates available to advise the City’s IROC and the City Council, with the goal of seeking the lowest possible water rates consistent with safe and reliable service.

The UCAN proposal requests that the Council authorize the IBA to hire, on an as-needed basis, a consultant that has expertise in water utility operations and rate-setting that would be able to: access all relevant information from PUD; interact with PUD officials when those officials make presentations to IROC, Council Committees, and the City Council; and to present the consultant’s own findings to those groups.¹

¹ The complete UCAN proposal is included as an attachment to this report.

The proposal specifically requests that the scope of work for such a consultant include providing expert advice and analysis of the two reviews-of-funds that PUD committed to during the last rate case.

Discussion

Consultant Scope of Work and Potential Cost

While rate-setting processes in other jurisdictions and at the state Public Utilities Commission often include independent consultant review of rates proposed by utilities, we were unable to identify other jurisdictions in which an independent consultant reviews and provides recommendations on interim reviews-of-funds that take place between full rate cases. As such, it is more difficult to determine the proper scope of work for a consultant analysis of a review-of-funds than it is a consultant review of a full COSS.

Based on the experience of other jurisdictions and informal estimates from consulting firms, the scope of work of a full analysis of a COSS, including interactions with committees and Council, would be expected to cost between \$200,000 and \$400,000. Such a review would include thorough analysis of a COSS and include an examination of PUD's programmatic and capital needs, assumptions regarding water costs and water demands, and the impacts those all have on rates.

The UCAN proposal, however, requests that a consultant be hired to analyze PUD's reviews-of-funds. These reviews represent a more limited look at PUD's revenues and rates, and a consultant review of these reviews-of-funds would be less intensive than a consultant analysis of a full COSS. The scope of work for a consultant analyzing these reviews-of-funds would therefore be smaller in what materials are reviewed, but the interactions with staff, committees, and Council would largely remain unchanged.

PUD indicates that its reviews-of-funds will consist of a review of revenues (which are derived from water fees charged to ratepayers for delivery of water), water costs (the costs associated with the wholesale purchase of water), and expenditures (programmatic and capital expenses) to ensure that these amounts are appropriate and accounted for, and to review how closely they match the assumptions and projections made in the most recent COSS. The review of funds will not, however, include a review of the overall programmatic and capital needs of the Department.²

Because the scope-of-work for a consultant here is less defined by past practices, cost estimates are more difficult to accurately provide. Informal estimates from large consulting firms largely track the costs of an analysis of a COSS, with potential costs ranging from \$150,000 to \$300,000. As the scope of analysis is smaller, however, an individual consultant might be more preferable to and affordable than a full consulting firm; recent expert consultants at the state Public Utilities Commission have charged between \$150 and \$250 an hour; this could reduce the costs to a range of \$50,000 to \$100,000 for the analyses of reviews-of-funds.

² A significant portion of the rate increases approved by Council in 2015 were driven by programmatic and capital goals. These include the Pure Water potable reuse program which was separately approved by Council.

That noted, because the reviews-of-funds are smaller in scope than a full COSS, the potential benefits of an additional third-party expert analysis in terms of impacting rates are also more limited. A significant portion of PUD's rate increases were driven by programmatic and capital needs, including the Pure Water program. As the reviews-of-funds do not include a reassessment or reevaluation of those goals, but are limited to looking at actual revenues and expenditures, a consultant analyzing a review-of-funds would not be analyzing one of the more significant drivers of rates. Additionally, as less expertise is necessary to evaluate actual revenues and expenditures against projections from the last COSS than is necessary to review the programmatic and capital assumptions and revenue projections in a full COSS, the added value of a consultant is reduced.

We therefore do not recommend that the City hire a consultant to analyze PUD's upcoming reviews-of-funds. However, we do note that Council could consider authorizing the IBA to hire a consultant, on an as-needed basis, to review the next water rate COSS that is anticipated in advance of FY 2021. In other jurisdictions – notably the City of Los Angeles – funding for similar consultants was provided from utility funds; PUD's Water Utility Operating Fund should be considered as a potential funding source if the Council elects to move forward with this option.

Additional Considerations

Regardless of whether a consultant is hired to review future rate cases or reviews-of-funds, Council, IROC, and public oversight and understanding of rate cases could be increased through additional education and outreach, and by making PUD's rate consultant more available and accessible. Council may wish to pursue expanding the scope of work in future PUD COSS consultant contracts to specifically include interactions with IROC and the City Council, so that there is a contractual obligation for consultants to meet with, receive input from, and respond to questions from those entities. Council may additionally consider adopting a Council Policy or ordinance that requires PUD to provide Council with requested information and/or forecasting models from their COSS consultant, and to consider and respond to additional Council input during rate cases.

We additionally note that during the last rate case, PUD committed to examining and reevaluating the tiers in its existing rate structure. While adjustments to PUD's rate structure would not directly impact PUD's programmatic and capital needs, they could have significant impacts on individual ratepayers depending on each ratepayer's use of water. Council may wish to request an update on this item, and request the opportunity to provide input here as well.

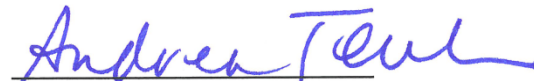
CONCLUSION

Our office appreciates the opportunity to review the UCAN proposal to authorize the hiring of a consultant to analyze PUD reviews-of-funds. While we do not recommend that a consultant be engaged to analyze those reviews-of-funds, we do believe that a consultant with water utility and rate expertise could add value to Council's deliberations in future rate cases. We also note

that Council could consider implementing additional policies to increase education and oversight during future rate cases. We therefore make the following recommendations:

1. Consider authorizing the IBA to engage a consultant on an as-needed basis to review the COSS anticipated in advance of FY 2021, with funding for that consultant to be reimbursed from the Water Utility Operating Fund.
2. Request PUD include additional Council and IROC outreach as part of the scope-of-work of future COSS consultant contracts.
3. Request PUD and the IBA work with appropriate Council staff and other entities to develop a Council Policy or ordinance that requires increased transparency and access to information during future rate cases.
4. Request PUD provide an update on the status of its evaluation of the existing tiered rate structure.


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ATTACHMENT: UCAN Proposal



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PROPOSAL FOR AN INDEPENDENT WATER RATE CONSULTANT FOR THE CITY OF SAN DIEGO

The City Council of San Diego should have independent expert advice on issues that affect the rates customers pay for water service. UCAN proposes that the City Council authorize the services of a consultant to advise the Council and the Independent Rates and Oversight Committee (IROC) on Public Utilities Department issues that affect rates of service.

UCAN is asking that:

1. The Council authorize the IBA, on an as needed basis, to obtain the services of a consultant who has experience in examining cost of service and rate design issues for a water utility and whose mission would be to seek the lowest possible water rates consistent with safe and reliable service.
2. That this consultant have access to all information needed from the Public Utilities Department (PUD) necessary to perform its duties.
3. Given the complexity of rate design and cost of service issues for a water utility that the IBA be given sufficient resources to consult any necessary independent subject matter expert needed to inform the City Council and IROC on PUD's cost of service and rate design issues.
4. That the consultant be able to interact with PUD officials when they appear before IROC about any issue that may affect water rates including cost of service issues and rate design.
5. That this consultant be given the opportunity to present any findings and expert opinions to both IROC and the City Council on issues that may affect water rates.
6. That the scope of work for this consultant be to provide expert advice for the two Review of Funds, provided for by the City Council in PUD's last water rate increase, after Fiscal Years 2016 and 2018.

UCAN asks that the Council refer our proposal to the IBA to conduct an assessment on the cost of this proposal given the scope of work defined in term #6 above and report back to the Environment Committee at its December meeting.

The need for an independent rate consultant should be apparent from the last water rate increase in November 2015. If the Council had the advice of an independent water rate consultant who had the mission to seek the lowest water rates consistent with safe and reliable service, with the ability to examine in detail the water department's assumptions, estimates and forecasts the City Council might have had other rate design alternatives to consider rather than the cumulative 41% five-year water rate increase that was approved.