
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Proposed Water Rate Increases to Offset Increased San Diego County Water Authority Rates

OVERVIEW

Currently, 85-90% of the City of San Diego's water supply is derived from purchases from the San Diego County Water Authority (CWA). On June 24, 2010 the CWA approved increases for its Melded Supply Rate, Melded Treatment Rate, Transportation Rate and other charges, following the Metropolitan Water District's (MWD) April 13, 2010 rate increases to the CWA and other MWD member agencies. The CWA subsequently made minor rate increase corrections on October 28, 2010.

The CWA rate increases charged to the City of San Diego will take effect January 1, 2011. The Public Utilities Department has calculated the effect of the CWA's rate increases, and is recommending "pass-through" rate increases for San Diego ratepayers.

On November 29, 2010, the City Council is being asked to approve Proposition 218 Noticing of the recommended rate increases and setting a public hearing date for a Council vote for January 24, 2011. Note that on September 8, 2010 the Natural Resources and Culture Committee forwarded this item to the full City Council without a recommendation. A City Council vote on the proposed rate increases will not occur during the November 29, 2010 Council meeting, but is expected at the January 24, 2011 meeting. The anticipated date for implementation of the proposed rate increases is March 1, 2011.

The Public Utilities Department is recommending approval of “Proposition 218 Noticing of proposed water rate increase of \$0.47 per equivalent dwelling unit based upon meter size and an increase of 5.92% applied to all customer classes and tiered water consumption rates in order to offset the increase in the wholesale cost of water purchased by the City from the...CWA.” The effective rate of the increase for a typical single family residence utilizing 14 HCF of water per month is 4.97%, as compared to current water rates. The total increased revenue resulting from the pass-through rate increases is estimated to be \$25 million.

The cost for the Proposition 218 Noticing is an estimated \$100,000, not including staff time.

FISCAL/POLICY DISCUSSION

Since the last CWA pass-through increase, effective January 1, 2010, rates have been changed twice:

- 6.5% increase on July 1, 2010 – which was approved by Council in February 2007 as part of the four-year capital improvement plan for the water system.
- Reversal of the 3.08% consumption rate increase related to the Indirect Potable Reuse Demonstration Project. This rate increase became effective January 1, 2009 and was reversed on September 1, 2010.

Additionally, rates are anticipated to be decreased effective January 1, 2011, to partially reverse the January 1, 2010 CWA pass-through. The January 1, 2010 CWA pass-through to San Diego ratepayers was designed to recover 16 months of the CWA rate increase over 12 months. The portion of the rate increase to San Diego ratepayers that is attributable to the four month period from September 1, 2009 to December 31, 2009 will be reversed effective January 1, 2011.

Because of this partial rate reversal, the water rates anticipated to be charged from January 1, 2011 through February 28, 2011 will be lower than current water rates. As a result, the March 1, 2011 anticipated rate increase due to the proposed CWA pass-through to San Diego ratepayers will be larger than the increase presented in the Public Utilities Department’s Report to Council 10-114 (revised November 5, 2010). The effective rate of the increase for a typical single family residence utilizing 14 HCF of water per month is 4.97%, as compared to current water rates; but as compared to water rates anticipated to be in effect at February 28, 2011, the effective rate of the increase would be 6.40%. The two charts on the next page represent the calculations for the rate increases described above.

**Projected Effect of CWA Rate Increases on
a Typical Single Family Residential Monthly Bill (14 HCF Usage)**

Compared to rates effective September 1, 2010 to December 31, 2010

Effective Rate Increase of 4.97%

	<u>September 1, 2010</u>	<u>March 1, 2011</u>	<u>Increase</u>
Base Fee			
3/4 inch meter	\$18.86	\$19.33	\$0.47
Consumption Rate			
7 HCF * Tier 1 Commodity Fee	\$23.87	\$25.28	\$1.41
7 HCF * Tier 2 Commodity Fee	<u>\$25.89</u>	<u>\$27.42</u>	<u>\$1.53</u>
TOTAL	<u>\$68.62</u>	<u>\$72.03</u>	<u>\$3.41</u>
		Percentage Increase	<u>4.97%</u>

**Projected Effect of CWA Rate Increases on
a Typical Single Family Residential Monthly Bill (14 HCF Usage)**

Compared to rates effective January 1, 2011 to February 28, 2011

Effective Rate Increase of 6.40%

	<u>January 1, 2011</u>	<u>March 1, 2011</u>	<u>Increase</u>
Base Fee			
3/4 inch meter	\$18.86	\$19.33	\$0.47
Consumption Rate			
7 HCF * Tier 1 Commodity Fee	\$23.43	\$25.28	\$1.85
7 HCF * Tier 2 Commodity Fee	<u>\$25.41</u>	<u>\$27.42</u>	<u>\$2.01</u>
TOTAL	<u>\$67.70</u>	<u>\$72.03</u>	<u>\$4.33</u>
		Percentage Increase	<u>6.40%</u>

In its November 5, 2010 report, the Public Utilities Department noted “CWA pass-through rate increases were not part of the City’s four-year, 6.5% annual water rate increase approved by the City Council as part of the Public Utilities Water Branch’s four-year capital improvement plan in February 2007.” The Public Utilities Department’s objective with the proposed water rate increase is to “maintain cost/revenue neutrality and to maintain consistency with the City’s four-year water rate plan previously

approved.” This four-year capital improvement plan spans from FY 2008 through FY 2011. Capital improvement projects include repair and replacement of water pipelines and pump stations.

The Public Utilities Department anticipates that an increase in water rates for the capital improvements program will not be necessary for FY 2012. The reason that this type of rate increase will not be needed for FY 2012 is because the capital improvements projects anticipated in the FY 2008 through FY 2011 rate plan will not be fully completed and the funds from the associated rate increases will not be fully expended by the end of FY 2011. Thus, there is future capacity from the capital improvements program’s prior rate increases that can address capital improvement projects during FY 2012. A new water rate plan is under review by the Department, and a cost of service study is anticipated to begin in FY 2012.

With regard to the proposed CWA pass-through rate increases, cost/revenue neutrality is dependent upon projections of future water sales by the Public Utilities Department. Lower than expected sales could affect whether the Water Fund breaks even on the pass-through.

It should be noted that the cost increases from the CWA to the Public Utilities Department Water Branch are effective January 1, 2011, whereas the recommended effective date for the rate increases to San Diego ratepayers is March 1, 2011. According to Department staff, the two months in which City ratepayers would not pay increased rates associated with the CWA pass-through can be covered by one-time operational efficiencies anticipated during FY 2011.

One alternative that has been suggested as a way to mitigate the CWA pass-through rate increase is through utilization of certain Water Fund reserves – for example, the Dedicated Reserve from Efficiency and Savings (DRES) and the Rate Stabilization Reserve. The current DRES policy states that at the end of the four year rate plan, “any funds transferred into this reserve and not used for capital improvements will be used to lower future rates.”

However, rather than subsidize the CWA pass-through rate increase, the Public Utilities Department has indicated it would be more prudent to utilize the DRES reserves to fund future capital improvements. The IBA concurs with this approach for the currently proposed water rate increases. This approach will, in effect, lower future rate increases that would otherwise be needed to fund the future capital improvements program. The capital improvements program budget is \$105.7 million for FY 2011 and \$149.8 million for FY 2010. The FY 2009 balance in the DRES is expected to be approximately \$15 million, and is under review by the Comptroller’s Office.

The Rate Stabilization Reserve is established “to mitigate future rate increases,” and “use of the funds is to be limited only for the operation and maintenance of the water system.” The current balance in this reserve is \$20.5 million. A drawback to using this reserve is that it would need to be replenished in order to protect the Water Fund. Exhausting the Rate Stabilization Reserve could leave the Water Fund vulnerable to not meeting debt coverage ratios in the event that net system revenues do not meet the coverage levels required in the Water System’s bond installment purchase agreements.

CONCLUSION

This report provides background information regarding the pending CWA pass-through rate increases to San Diego ratepayers. With the proposed rate increases, the Public Utilities Department is attempting to maintain cost/revenue neutrality for the Water Fund. The IBA recommends approval for Proposition 218 Noticing and setting a public hearing date for Council vote on the proposed water rate increases for January 24, 2011.

[SIGNED]

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