



City of Sierra Madre Agenda Report

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

Nancy Shollenberger, City Clerk
George Enyedi, City Treasurer

TO: Honorable Mayor Mosca and Members of the City Council

FROM: Elaine I. Aguilar, City Manager
Karin Schnaider, Director of Administrative Services
Bruce Inman, Director of Public Works

DATE: October 26, 2010

SUBJECT: **DISCUSSION REGARDING SIERRA MADRE WATER RATE INCREASE**

SUMMARY

At a Special Council meeting held on October 19th, the City Council directed staff to place an item on the October 26th agenda to continue the water rate discussion, and to provide staff with policy direction. This report seeks the Council's direction to policy questions that were raised at the October 19th meeting.

Given the number of potential options, the need for Council policy direction, and the short time frame between the October 19th meeting and the deadline for preparation of this staff report (October 21st), it was not possible to include a detailed financial analysis of each of the potential options. For discussion purposes only, staff has attempted to provide a general discussion of the estimated results, but the actual, detailed analysis can only be completed by updating the Water System Program Plan (the Plan).

Staff is seeking Council direction regarding the policy questions. This direction will assist in identifying the Council's preferred option. The policy direction will be used to modify the original Water System Program Plan, and staff will return to a future meeting with an updated Plan.

ANALYSIS

After receiving input from the public, the City Council's subsequent discussion centered around seven basic policy questions. The answers to these policy questions will provide staff with direction regarding modifications to the Water System Program Plan.

FOR CITY COUNCIL AGENDA _____

AGENDA ITEM # _____

It is recommended that the Council first provide direction regarding the following issues:

1. Should the City comply with the bond obligation to achieve 120% net revenues ratio, achieved after operations, capital expenditures, and debt service? If yes, by which year should the ratio be achieved?
2. Should the Water Utility fund be self-supporting; meaning should the City General Fund subsidize the Water Utility? If yes, by how much?
3. Over the five year period, what dollar amount, if any, should be set-aside or accumulated toward capital projects?
4. What dollar amount (or percentage of fund reserves to operations) of cash reserves should be available to meet contingencies and emergencies?
5. Should the Water Utility have a tiered consumption rate structure? If yes, what is the preferred differential between the tiers? What is the preferred number of tiers?
6. Should the Water Utility continue to maintain different meter charges, based upon the size of the meter?
7. Should the Water Utility continue to maintain the same rate structure for all customers? Or, should rates be based upon type of use: I.e. commercial, single-family residential, multi-family, or agricultural?

Upon concluding a discussion regarding the policy questions, the Council may wish to evaluate and provide direction regarding the basic suggestions that were discussed at the October 19th meeting. City Council consensus on the policy questions will help frame discussion regarding the various options.

Below is a summary of the various options that were noted from the October 19th meeting. (Not listed in any particular order)

Original Proposal

This proposal is presented for comparison purposes only. The original proposal is the rate proposal that was included in the Water System Program Plan. Under this proposal rates were estimated to increase 15.75% in Year 1, followed by an average of 3.5% annual increases through year 5. With respect to the policy questions, the net revenue ratio is estimated to be achieved by year 2; the general fund would not need to subsidize the water utility; an estimated \$500,000 would be accumulated for capital projects over the five year period; by year 5, an additional \$1 million would be added to fund reserves; the tiered structure would be implemented; and the water utility would

continue to have six meter charges, based upon the meter size; and the charges would not differ based upon the type of customer.

Proposal to Achieve 120% Net Revenues in Year 1

Using the same assumptions applied in the original Water System Program Plan, it is estimated the percentage increase in year 1 would need to be slightly greater than the 15.75% originally proposed. It is important to note that this scenario was not recommended for implementation, but the inquiry was made for informational purposes only.

Proposal that Achieves 1.20 Debt Ratio, and funds Additional Capital Improvements

Using the same assumptions applied in the original Water System Program Plan, this proposal would result in the greatest percentage increase in rates. Again, it is important to note that this scenario is not recommended for implementation, this is only presented for comparison purposes because it is another possible option.

Proposal that "Levels-out" the Proposed Increase over the 5 Year Period

The general parameters for this option are: that at the end of the 5 year period, the cash reserves, fund balance, bond ratios, capital project funds, etc. would be equal to the estimates in the original Water System Program Plan, but the annual increases would be in equal amounts. (I.e. 6% or 7% per year for five years)

Generally speaking, this proposal would result in it taking a slightly longer period of time to satisfy the bond covenant; the General Fund would not need to subsidize the water utility -- However, it may be necessary to use some amount of Water Fund reserves in the initial few years; a slightly less amount of funding would be accumulated for capital projects over the five year period; a slightly less amount would be added to fund reserves. (This assumes that there are no changes to the other aspects of the original rate structure/proposal.)

Flat 5% for 5 Years

This proposal suggests that water rates be increased by a flat 5% per year for five years. Generally speaking, this proposal would result in it taking a longer period of time to satisfy the bond covenant; the General Fund would not need to subsidize the water utility – However, it may be necessary to use some amount of water fund reserves in the initial few years; less funding would be accumulated for capital projects over the five year period; fewer funds would be added to fund reserves. (This assumes that there are no changes to the other aspects of the original rate structure/proposal.)

Eliminate the Tier Structure

While the tier structure was proposed as a means of encouraging water conservation, the Council has received input that ranges from “eliminate the tier structure”, to “increase the cost differential between tiers.”

Because the Plan assumed a tiered structure, it is very difficult to estimate what rates would be without the tiers. An important piece of the analysis is missing -- Staff does not have direction regarding the percentage increases the Council prefers. For discussion purposes only, and so that staff can provide a rough estimate, the assumption being used is the rate proposal in the original Plan. If the tiers were eliminated, it is safe to assume that the first year increase would be greater than the 15.75% mathematically because all water is being sold at a “flat rate” instead of consumption rates that ranged from the proposed \$2.072 to \$2.148.

What this analysis demonstrates and an item to consider when evaluating the implementation of a tiered rate structure, is that low water users (if their water consumption falls within Tier 1 rates) generally will pay under a tiered rate structure, as compared to a flat rate structure; which also means they will experience a lower overall percentage increase, all other factors being equal.

Increase the Cost Differential Between Tiers

Another suggested proposal was to evaluate increasing the cost differential between tiers. As staff has mentioned previously, the original approach was to gradually introduce a tiered structure, without a major difference between tiers, because this is a new rate structure for Sierra Madre. However, this is ultimately a Council policy decision and staff can return with any option preferred by the Council. Conceivably, it may be possible to actually decrease Tier 1 rates, if the cost differential was greater for Tier 2 rates and 3 rates, all other factors being equal. For example, staff estimates that a Tier 1 rate of \$1.79 (no increase), coupled with a Tier 2 rate of \$2.02 (+12.84%) and a Tier 3 rate of \$2.25 (+25.69%) is estimated to achieve a target revenue equal to the Year One revenue of the original proposal. This information is provided for discussion purposes only, and the actual amounts could vary.

Implement a Flat meter rate

Another suggested proposal pertained to the implementation of a flat meter rate. This is a slightly easier estimate for staff to provide, but it assumes that same rate increases that were presented in the original Plan. It also assumes that the same amount of revenue is generated from the flat meter charge, as estimated in the original Plan. Based on these assumptions the following is the estimated result:

Meter Size	Current Rate	Proposed Rates Year 1	Proposed Rates Year 1 (Flat)
5/8"	\$40.00	\$46.30	\$47.17
3/4"	\$40.00	\$46.30	\$47.17
1"	\$46.68	\$54.03	\$47.17

Essentially, a flat meter rate would result the proposed meter rate increasing for 5/8" and 3/4" meters and reducing the proposed meter rate for 1" meters. Of course, the actual percentage increase would be a City Council policy decision, but the relative comparison of the effect of any increase "with and without flat meter rates" would remain unchanged, all other factors being equal. Additionally, approximately 75% of Sierra Madre's water customers have a 5/8th or 3/4th inch meter.

UUT

Lastly, it was acknowledged that regardless of the amount of any water rate increase, the Utility Users Tax (UUT) rate on water would be reduced so that the UUT revenues from water remain neutral. The amount of the UUT rate reduction would be determined once the actual rate increase proposal is identified.

Summary

The Council directed that this report be placed on this evening's agenda in order to receive additional input from the community regarding water rate increases and to discuss a possible rate increase proposal. The presentation of the policy questions, along with the general description of the currently identified options will facilitate further discussion regarding how to proceed. Staff is seeking Council direction in order to return with a more detailed analysis, a revised Water System Program Plan, and possible options for the next steps. Upon direction from the City Council, staff will work with Bucknam & Associates to revise the Plan and will return to a future Council meeting.

PUBLIC NOTICE PROCESS

This item has been noticed through the regular agenda notification process. Copies of this report were made available at the City Hall public counter and the Sierra Madre Public Library.

STAFF RECOMMENDATION

Staff recommends that the City Council provide staff with direction.

Attachment: Water System Program Plan