

City of Brea

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**COUNCIL COMMUNICATION**

**TO:** Honorable Mayor and City Council Members  
**FROM:** City Manager  
**DATE:** 10/06/2015  
**SUBJECT:** PROPOSED WATER RATE STRUCTURE

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**RECOMMENDATION**

Update the City's water rates to include "Conservation Rates" and maintain the City's existing four-tier residential water rate structure and set the public hearing in accordance with mandated notification requirements.

**BACKGROUND/DISCUSSION**

The City of Brea operates and maintains its own water distribution system and has a growing population of more than 43,300 residents. The water system has approximately 162 miles of potable water pipeline serving more than 13,000 customers and delivers approximately 10,700 acre-feet of water per year. Brea imports 100% of its wholesale treated water from the California Domestic Water Company - CDWC (70%) and the Municipal Water District of Orange County - MWDOC (30%). Staff has worked several months with its water rate consultant, Raftelis Financial Consultants, Inc. (RFC), gathering consumption history, water purchases, maintenance costs, etc., to determine the appropriate rate structure for Brea.

**May 5th Council Meeting**

At the May 5th Council Meeting, staff and RFC began a discussion with Council regarding Brea's water rates and pricing objectives. Topics discussed were the methodology used including the financial plan, cost of service, and Brea's current rate structure and design. Brea currently charges a base meter charge, or a readiness-to-serve fee, as well as a usage charge (charges based upon consumption). For residential customers, Brea has an inclining water rate structure or a tiered structure, and for all other major water classes, Brea charges a uniform rate based on customer type.

**Alternative Rate Structures**

There are other alternative rate structures such as: flat, uniform, seasonal, and water based budgets. RFC explained the advantages and disadvantages for the various structures.

**Uniform Rate**

The City Council requested further discussion of the rate structure including what a uniform rate would look like for all of its customers. Uniform rates are the easiest to understand and provide the most revenue stability. However, they are not equitable, do not provide conservation incentives, and are not affordable for essential use (low water use) customers.

## Water Based Budget

Water based budgets are used by a number of water agencies; however, this structure can be difficult to implement in a timely manner. Initial time estimates range from 1 to 1-1/2 years. This would include extensive research whereby individual customers would be surveyed on their lot size and number of persons in their household to determine that household's annual allotment of water. This would not only involve additional research by our consultants (approximately \$50-60K), but additional staffing to implement, maintain, and educate customers on this methodology. Furthermore, the current utility billing software would need to be re-programmed to meet the specifications of this new water rate structure.

## August 25th Special Council Meeting

At the August 25<sup>th</sup> Special Council Meeting, RFC presented a number of proposed rate structures, as well as water rates that were inclusive of 10% and 24% conservation given current drought conditions. Based upon this discussion, there was not an interest to change Brea's water structure to a uniform or flat rate. However, this information is provided later in this staff report. Brea's current residential rate structure is tiered and incorporates a blended water rate from the City's two sources of water. However, City Council expressed an interest in a differentiated rate which provides lower volume users less expensive rates based upon CDWC costs and higher volume users a more expensive rate based upon water costs from higher priced water purchased from MWDOC. Council asked RFC to provide additional information regarding the calculation of a differentiated rate and rates for both a 3-tiered and a 4-tiered structure.

## **FURTHER DISCUSSION**

There are a few topics that need to be addressed prior to determining the change in water rates. Significant policy changes will affect all proposed rates. Staff requests City Council's direction for the following: Lifeline rates, current drought conditions, and capital improvement projects.

## **Life Line Rates**

Currently, Brea offers its low income customers the opportunity to apply for the Life Line discount. This discount is granted to customers that provide documentation that they qualify for the Southern California Edison Discount (D-Care) or Southern California Gas Company's Care Discount. The 20% discount is applied on the fixed meter charge as well as the consumption charge at the first and second tiers. There are approximately 500 customers who receive this reduced rate, of which approximately 100 customers are from Lake Park Brea and Cresmont Mobile Estates. These two customer classes are technically billed at the multi-family residential rate. However, the associations work with City staff to obtain a credit for their low income residents. The approximate FY 2014-15 subsidy for the Lifeline program was \$45,650; \$9,930 is the cost related to subsidized meter or fixed charges and \$35,720 was attributed to discounted water usage at the first and second tiers.

Currently, the Water Utility Fund (420) absorbs these costs. Proposition 218 requires that the City's General Fund (110) or an alternative funding source must pay for these subsidies. It is at City Council's discretion to continue with or modify the Life Line program. Should this program continue, staff recommends using the Affordable Housing Trust Fund (270) for the next two fiscal years. To date, the Affordable Housing Fund (270) has received sufficient loan repayments to cover this expense with \$98,000 available for use. Due to the uncertainties of these loan payments, staff will evaluate this available funding source on an annual basis. An

adjustment for this subsidy will be presented with the next round of quarterly budget adjustments.

### **Drought Conditions**

On April 1, 2015, the Governor issued an Executive Order for water reduction and a directive for mandatory water use reductions across California by 25%; Brea's reduction target is 24%. Brea's water customers have responded positively to this order by reducing consumption by 24% in the months of May and July and 14% in the months of June and August. These declines will vary based upon weather conditions. However, this reduction in sales affects the Water Utility Fund (420). Built in to the water rate structure is the assumption that the fund will generate enough revenue to sustain the necessary debt service coverage of 1.25 (per our bond indenture, net revenues should be at least 125% of annual bond payments), as well as fixed and on-going costs that are part of the water delivery system. These include capital improvement projects, maintenance, and customer service costs that are not fully recuperated in the fixed meter or ready to serve charge. Because of this reduction in revenue, the City must adjust its water rates.

With reduced sales, the City reduces its costs for purchased water, however, because sales are reduced by 24%, the City cannot recover all its costs, and as such, the rates need to be increased by 16%. Should the drought target for Brea be reduced, RFC has also calculated a 10% conservation rate which results in a 6% rate increase. Should drought conditions improve, the City has the option to automatically lower rates to the 10% conservation rates.

### **Capital Improvement Projects**

It is important that capital improvement projects be identified during the rate study process. Projects identified include foreseeable water main replacements as well as technological and environmental improvements to address the current drought conditions. Public Works staff has done an excellent job in working with other public utilities as well as other street projects to repair and maintain the City's water infrastructure. For instance, if a public utility requires the street to be trenched, staff will evaluate the need to replace the necessary water or sewer lines to avoid future duplication of work. The water fund only pays for its share of the project. However, the water fund operates on a pay-as-you-go system for its capital projects. Therefore, the cost of these projects are included in the water rates to provide project funding. In the recent past, City Council preferred not to issue debt to fund capital improvement projects.

### **Tiered Structure**

As requested, RFC has provided options and justification for both a 3-tier and 4-tier structure.

#### **3-Tiers**

Tier	Units	Justification
1	1-9	Water provided by CDWC rights and stocks
2	10-15	CDWC purchased above entitlement
3	16+	MWDOC water

#### **4-Tiers**

Tier	Units	Justification
1	1-10	Represents average indoor use
2	11-20	Represents average summer use
3	21-30	Represents 90 percent of the bills
4	31+	All other usage

#### **Options Available**

There are five rate options available:

1. 4-tier rates with blended supply (current rate structure)
2. 3-tier rates with blended supply
3. 4-tier rates with differentiated supply
4. 3-tier rates with differentiated supply
5. Uniform rate - \$3.46 per unit for all customer classes and all usage levels.

#### **Proposed Rates**

In the newly proposed rates, RFC has updated the water supply unit costs and water sales assumptions. It has also revised the calculation pertaining to the cost to deliver a unit or hundred cubic foot of water) and pass-through water supply cost changes in 2016. Furthermore, RFC has recalculated the reserve levels. Since the City has been unable to collect conservation rates for the first half of this fiscal year, the loss of revenue is impacting our current reserve levels. Based upon recommended fiscal policies and best practices, a capital reserve has been established for the Water Utility Fund (420). This reserve will hold one year's worth of Capital Improvement Projects. Furthermore, the capital improvement projects have been adjusted to better reflect a more reasonable timetable for completion.

Staff is proposing to increase fixed meter charges to be implemented over the next three fiscal years. The annual increases will cover the anticipated rise in fixed expenses during this period. These fixed meter charges are not affected by drought conditions. Since the drought conditions remain uncertain, staff recommends addressing rates at proposed 10% and 24% conservation levels.

If the State were not in a drought, the City would implement the rates presented in the "proposed" column. Unfortunately, due to the loss in sales, it currently needs to implement the rates provided in the "24% Conservation" column. There is no additional revenue generated in FY 2015-16; however, fixed water charges and water consumption rates would change based on the cost of service, with some rates decreasing and others increasing. For the first year (FY 2015-16), conservation rates would include a 24% conservation rate with a 10% conservation rate being an option beginning July 1, 2016. However, should current conditions continue, the City will retain the flexibility to continue with the 24% conservation level. Maintaining this flexibility allows the City to respond to the unpredictability of drought conditions and changes in State mandates. For future years, a 2.5% revenue adjustment is being proposed. These adjustments do not include any pass-through costs that are generated as a result of an increased cost of wholesale water from either Cal Domestic or MWDOC.

## Table of Rates

The Proposed Fixed Charges are as follows:

<b>Meter Size</b>	<b>Current Rate</b>	<b>FY 2016 Proposed Rate</b>	<b>Difference (\$)</b>	<b>Percent (%) Increase</b>
5/8"	\$9.66	\$10.81	\$1.15	12%
3/4"	\$9.66	\$10.81	\$1.15	12%
1"	\$9.66	\$10.81	\$1.15	12%
1 1/2"	\$42.99	\$34.66	-\$8.33	-19%
2"	\$73.52	\$52.55	-\$20.97	-29%
3"	\$160.77	\$109.20	-\$51.57	-32%
4"	\$282.90	\$192.68	-\$90.22	-32%
6"	\$631.81	\$392.45	-\$239.36	-38%
8"	\$1,120.31	\$839.67	-\$280.64	-25%
10"	\$1,748.38	\$1,257.09	-\$491.29	-28%
12"	\$2,446.23	\$1,585.05	-\$861.18	-35%

The proposed water consumption charges for **Single Family Residences** are as follows:

### Option 1 - 4-Tier Blended Supply (Current Structure)

Tier	Units	Current	Proposed	10% Conservation	24% Conservation
1	1-10	\$2.79	\$2.68	\$2.83	\$3.14
2	11-20	\$3.92	\$3.67	\$3.88	\$4.30
3	21-30	\$4.99	\$5.01	\$5.29	\$5.86
4	31+	\$6.36	\$5.96	\$6.30	\$6.97

### Option 2 - 3-Tier Blended Supply

Tier	Units	Current	Proposed	10% Conservation	24% Conservation
1	1-9		\$2.65	\$2.80	\$3.08
2	10-15		\$3.30	\$3.48	\$3.84
3	16+		\$4.88	\$5.15	\$5.67

### Option 3 - 4-Tier Differentiated Supply

Tier	Units	Current	Proposed	10% Conservation	24% Conservation
1	1-10	\$2.79	\$2.08	\$2.21	\$2.49
2	11-20	\$3.92	\$4.31	\$4.58	\$5.15
3	21-30	\$4.99	\$5.98	\$6.36	\$7.15
4	31+	\$6.36	\$6.94	\$7.38	\$8.30

**Option 4 - 3-Tier Differentiated Supply**

Tier	Units	Current	Proposed	10% Conservation	24% Conservation
1	1-9		\$1.97	\$2.10	\$2.34
2	10-15		\$3.71	\$3.95	\$4.40
3	16+		\$5.85	\$6.22	\$6.94

**Option 5 – Uniform Rate**

Current	Proposed	10% Conservation	24% Conservation
N/A	\$3.46	\$3.61	\$3.61

**RECOMMENDED RATE STRUCTURE**

Staff recommends continuing with the City’s current rate structure (**Option 1: 4-Tier Blended Supply**). For the following two reasons:

1. Four tiered structure allows greater flexibility and more conservation incentives for residential customers as compared to a three tiered structure. Water usage will vary depending on the season. The four-tier structure considers such fluctuations and provide less impacts to the customer. It also enables customers to control their water usage and costs.

2. Easier to administer the pass through water rate increases which occur in January (MWDOC) and July (CDWC)

After careful staff analysis it has been determined the differentiated supply provides more complexities when applying delivery and pass-through costs.

For example, pass-through costs are typically applied in January for MWDOC and July for CDWC. With differentiated supply, the January pass-through cost would currently apply to 48% of tier 2; 100% to tiers 3 and 4.

The CDWC pass-through costs would currently apply to tier 1; 52% of tier 2; in other words, individual tiers would be subject to increases during different months throughout the year and will require greater customer education, whereas the increases for blended supply rates will occur uniformly for all tiers and customer classes. As mentioned, a 4-tiered blended supply is the City’s current methodology. As proposed it meets all legal requirements and maintains a consistent and more conservative approach for an inclining rate structure.

**SUMMARY/FISCAL IMPACT**

This proposed rate structure incorporates a 24% conservation rate in the first year; the revenue generated through the conservation rates is expected to offset the revenue reduction due to lower sales. The rates allow for the continuance of water service to Brea water users along with maintaining necessary operating and capital reserve fund levels.

**RESPECTFULLY SUBMITTED:**

William Gallardo, City Manager

Prepared by: Faith Madrazo, Revenue & Budget Manager



**Attachments**

Proposed Non-Residential Water Rates

Power Point

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