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DATE: August 7, 2023

TO: Honorable Mayor and Members of the City Council through City Manager

FROM: Christopher J Bolt, Director of Public Works & Utilities  
Brian Cochran, Assistant City Manager  
Corey Garberolio, Deputy City Manager / Finance Director

SUBJECT: Public Hearing on Water and Wastewater Services Charges and Resolution Adopting a New Rate Schedule for Water Service Repealing and Replacing Resolution 2017-076 N.C.S. and the Resolution Adopting a New Rate Schedule for Wastewater Service Repealing and Replacing Resolution 2017-075 N.C.S.

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### **RECOMMENDATION**

It is recommended that the City Council receive the Water & Wastewater Utility Rate Study, conduct the required Public Hearing, and following the conclusion of the Public Hearing and canvassing and reporting of the number of protests received related to parcels subject to the proposed rate schedules, assuming a majority protest does not exist, approve the Resolution Adopting a New Rate Schedule for Water Service Repealing and Replacing Resolution 2017-076 N.C.S. and the Resolution Adopting a New Rate Schedule for Wastewater Service Repealing and Replacing Resolution 2017-075 N.C.S.

### **BACKGROUND**

The City's utilities provide essential water, wastewater, and recycled water services to our residents, businesses, and organizations. The Department of Public Works and Utilities is responsible for maintaining and upgrading a wide variety of critical infrastructure necessary for ensuring the safe and effective delivery of these services to our community.

The City's water and wastewater utilities are accounted for as self-supporting enterprise funds with revenues derived primarily from water and wastewater service charges. As such, the water and wastewater utilities are required to have sufficient revenues to operate and fund capital improvements. The City of Petaluma is committed to providing high-quality services to its residents and businesses at a reasonable cost. Conducting a utility rate study is essential to achieving this goal and ensuring that the City's utility rates are fair, equitable, and reflect the cost of providing services.

The City of Petaluma last conducted a water and wastewater rate study in 2017, resulting in the adoption of annual rate increases. The recommended rates included overall rate increases as well as rate structure modifications designed to realign rates with the cost of providing service. To help provide rate relief during Covid, the City temporarily deferred water rate increases in 2020 and wastewater rate increases in 2020 and 2021. Current water rates have been effective since August 1, 2021, and current wastewater rates have been effective since March 1, 2022.

The purpose of the current Utility Rate Study is to develop water and wastewater rate recommendations for the next five years, with the first adjustment proposed to be effective on September 1, 2023, and subsequent adjustments effective on July 1 of each year. The proposed rates are designed to be phased in as gradually as possible to meet each utility's operating and capital funding needs while minimizing the annual impact on ratepayers.

Since the last rate study, there have been significant changes in the operating environment, including increased regulatory requirements, aging infrastructure, and fluctuations in the cost of supplies and labor. Additionally, the City has been developing updated water and sewer/wastewater master plans, along with a partially grant-funded recycled water master plan (now referred to as the Integrated Water Master Plan (IWMP)), to identify and prioritize future capital improvement needs for the City's aging water, wastewater, and recycled water infrastructure systems. As a result, there is a need to conduct a thorough analysis of the City's utility rates to ensure they are sufficient to cover the costs of providing services and to fund high-priority infrastructure improvements to support the continuation of safe and reliable services.

The City is facing a few financial challenges that require continuation of its historical practice of implementing gradual annual water and wastewater rate increases:

1. Aging Infrastructure Requires Significant Investment in Capital Improvements.

The City needs adequate funding to complete essential water, recycled water, and wastewater capital projects over the next five years. Many projects have already been deferred, and further delay will increase costs and risks to the integrity of system infrastructure and operational needs.

As mentioned above, the City has been working with an independent engineering consulting firm to develop updated water, sewer/wastewater, and recycled water master plans to evaluate and prioritize capital improvement needs. The City's systems are in need of substantial capital improvements to address current deficiencies and to rehabilitate, upgrade, and/or replace aging infrastructure to support safe and reliable service.

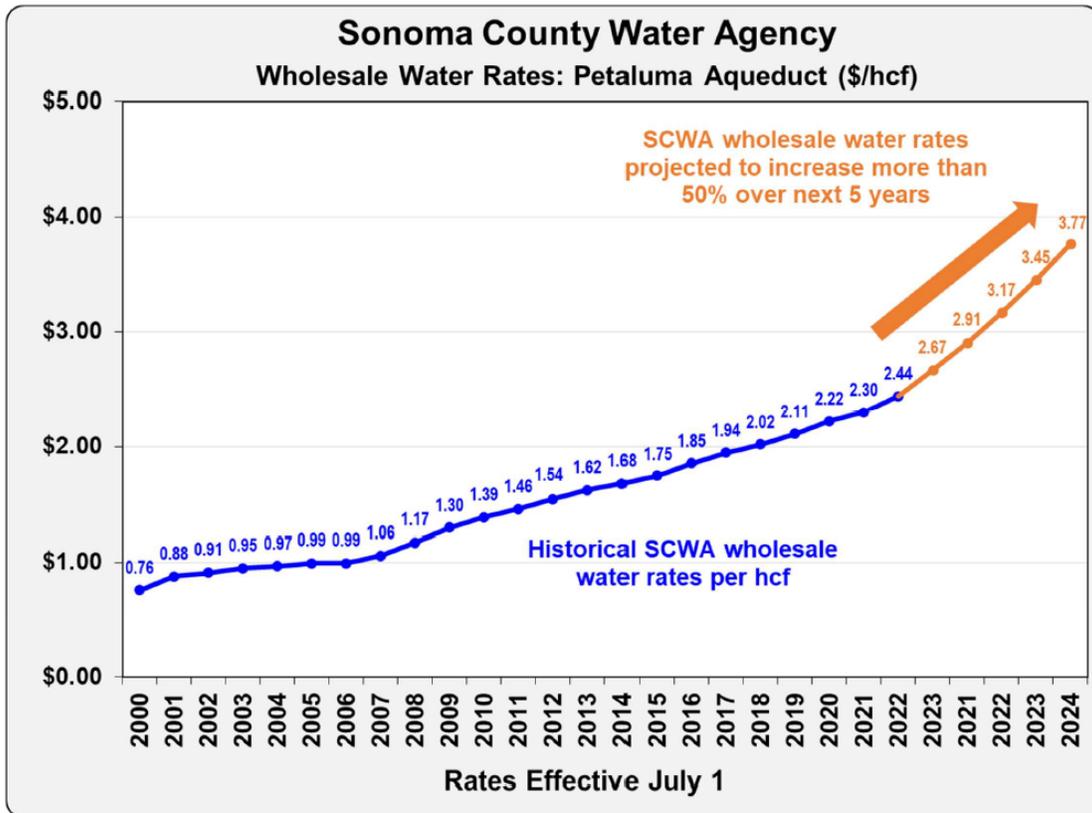
Updated capital improvement programs identify over \$150 million of utility infrastructure projects over the next five fiscal years. Fortunately, the City has been very successful in obtaining grant funding to help fund its projects. Efforts to identify and apply for additional grant fund opportunities are ongoing for all eligible projects.

2. Wholesale Water Rate Increases.

The City purchases almost all its water supply from the Sonoma County Water Agency (SCWA), and SCWA has gradually increased wholesale water rates in 19 of the past 20 years. These rates are scheduled to increase by 9.4% effective July 1, 2023, with similar increases projected in future years.

As shown below in Figure 4 (excerpted from the Rate Study), SCWA’s wholesale rates are projected to increase by more than 50% over the next 5 years. A copy of their March 20, 2023, presentation to City Council is attached for reference (Attachment 5).

Figure 4 – Historical & Projected SFPUC Wholesale Water Rates



### 3. Keep Up with the Cost of Inflation

The City’s utility enterprises are facing rising costs for operations, maintenance, and capital improvements due to inflation. Small annual rate adjustments are needed to keep up with the cost inflation.

Additionally, the cost of capital projects will continue to rise as inflation in the utility and heavy construction industry continues to outpace the Consumer Price Index.

City staff have been working with an independent rate consultant, Bartle Wells Associates, on this rate study since October 2022. Bartle Wells Associates also assisted the City with its 2017 rate

study. As part of the process, City staff and the consultant presented preliminary information to Council about the analysis and findings at their meetings on May 15, 2023, and June 19, 2023.

Both presentations provided an overview of the Utility Rate Study process and scope, and presented preliminary findings and draft recommendations. Information was shared about financial challenges, including the potential for a continuation of gradual annual rate increases to support infrastructure improvements, rising wholesale water rates, and the ability to ensure that both utility systems remain financially stable and sustainable over well into the future.

A key component of the study involves the development of updated cash flow projections to identify future funding needs and evaluate rate increases. This analysis revealed that the City needs to continue its historical practice of implementing gradual annual rate increases to support operating and maintenance expenses, and to maintain the financial stability of the water and wastewater enterprise funds. Both enterprise funds also need to increase revenues to support necessary and important capital projects in the City's Capital Improvement Project (CIP) program.

As part of these meetings, the City Council and the public provided comments and questions for consideration. Staff subsequently worked with Bartle Wells Associates to conduct additional analysis, provide information, and formulate recommendations. This public hearing includes a presentation that summarizes the study, its findings, and highlights additional considerations.

Here is a summary of the overall process thus far:

1. **May 15, 2023** – Council received an introductory presentation and discussion of draft rate study findings & recommendations.
2. **June 19, 2023** – Council received the 2023 Draft Utility Rate Study, heard a presentation summarizing the study, and adopted an Authorizing Resolution to commence the Proposition 218 process and to set a public hearing date for increasing the City's water and wastewater rates.
3. **Mailing of Notices:** The Notice of Public Hearing on Proposed Water & Wastewater Rate Increases was mailed to all property owners and customers of record on June 23, 2023 (included as Attachment 4).
4. **July 31, 2023** – Public informational meeting (via Zoom)
5. **August 7, 2023** – Public hearing and consideration of resolutions authorizing new water and wastewater rates for the next 5 fiscal years.

Following presentation of the study at the public hearing (attached for review as Attachment 6), staff and Council will receive additional public comments and consider authorizing resolutions for the proposed rate increases.

Lastly, it is important to point out that water and wastewater rate increases do not require voter approval but are subject to "majority protest" proceedings under which affected ratepayers and property owners may file protests concerning the proposed rate adjustments. The City Council cannot adopt the proposed rate adjustments if written protests that meet Proposition 218 requirements are received on behalf of more than 50% of affected parcels. Accordingly, a full accounting of all written protests will be collected and presented as part of the Public Hearing.

## DISCUSSION

The following discussion provides a summary of key findings and recommendations from the rate study along with additional supporting analysis and information.

### Summary of Proposed Rate Increases

The table below provides a summary of proposed *base* water and wastewater rate increases. A 2.5% annual increase is proposed for water and 2.0% for wastewater. Inflationary pass-through adjustments are included for both utilities, as well as a pass-through of SCWA wholesale water rate increases for water rates.

Projected Base City Water & Wastewater Rate Increases					
	Sept 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027
<b>WATER</b>					
Base Rate Increases	2.5%	2.5%	2.5%	2.5%	2.5%
<i>Plus pass-through adjustments for a) SCWA wholesale water rates &amp; b) CPI inflation</i>					
<b>WASTEWATER</b>					
Base Rate Increases	2.0%	2.0%	2.0%	2.0%	2.0%
<i>Plus pass-through adjustments for CPI inflation</i>					

More detailed information regarding proposed water rates is provided below in Tables 13 and 14, excerpted from the draft rate study. It is important to note the pass-through of estimated inflationary costs as well as Sonoma Water’s wholesale rate increase. While the City’s base rate is proposed to increase by only 2.5%, the total increase after including the pass-through amounts is projected to be 8.8% during the first year, and 8.2% to 8.3% each year thereafter.

Table 14 – Projected Water Rate Increases

Projected Water Rate Increases with SCWA & Inflation Pass-Throughs					
	Sept 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027
Base City Rate Increases	2.5%	2.5%	2.5%	2.5%	2.5%
Est. Inflation Pass-Through	3.0%	2.5%	2.5%	2.5%	2.5%
SCWA Wholesale Rate Increase*	\$0.23	\$0.24	\$0.26	\$0.29	\$0.31
Net Increase	8.8%	8.2%	8.3%	8.3%	8.3%

\* Pass-through to Water Consumption Charges only.

Table 13 – Proposed Water Rates

Proposed Water Rates						
Current Water Rates	Proposed Rates Effective On or After					
	Sept 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027	
<b>FIXED MONTHLY CHARGES</b>						
<i>Fixed monthly charges billed per residential dwelling unit or based on non-residential meter size.</i>						
<b>Residential</b>						
Single Family: Up to 1-inch meter	\$18.98	\$20.03	\$20.54	\$21.05	\$21.58	\$22.11
Multi-Family: Per Dwelling Unit	11.39	12.02	12.32	12.63	12.95	13.27
<b>All Other Customers</b>						
5/8 & 3/4-inch meter	\$18.98	\$20.03	\$20.54	\$21.05	\$21.58	\$22.11
1-inch meter	30.13	31.81	32.60	33.41	34.25	35.10
1-1/2-inch meter	58.02	61.25	62.79	64.35	65.96	67.61
2-inch meter	91.47	96.57	98.98	101.46	103.99	106.58
3-inch meter	169.56	179.01	183.49	188.08	192.79	197.61
4-inch meter	281.10	296.77	304.19	311.79	319.59	327.58
6-inch meter	559.96	591.18	605.96	621.11	636.64	652.56
<b>WATER CONSUMPTION CHARGES</b>						
<i>Volumetric charges billed per hundred cubic feet (hcf) of metered water use.</i>						
<b>Single Family Residential</b>						
Tier 1 0 - 4 hcf	\$4.31	\$4.78	\$4.90	\$5.01	\$5.13	\$5.26
Tier 2 4.01 - 8 hcf	4.79	5.29	5.41	5.54	5.68	5.81
Tier 3 8.01 - 16 hcf	5.48	6.02	6.16	6.31	6.46	6.62
Tier 4 >16 hcf	6.42	7.01	7.17	7.35	7.52	7.71
<b>All Other Customers</b>	4.79	5.29	5.41	5.54	5.68	5.81
<b>Temporary Service &amp; Water Haulers</b>	7.18	7.81	8.00	8.19	8.39	8.59

Note: The Proposed Water Rates will be adjusted each year to account for annual pass-through rate increases for inflation and SCWA wholesale water rate increases.

Annual inflation pass-through rate adjustments will be based on the percentage change in the Consumer Price Index for the San Francisco Bay Area from the index for December 2022 to the index for December immediately preceding the upcoming fiscal year.

Annual pass-through adjustments for SCWA wholesale water rate increases will be based on the increase in SCWA's charges for the Petaluma Aqueduct rounded to the nearest one cent per hcf and applied to the City's Water Consumption Charges.

More detailed information regarding proposed wastewater rates is provided below in Tables 28 and 29, also excerpted from the draft rate study. The City's base rate is proposed to increase by only 2.0%, and the total increase after including the inflationary pass-through is projected to be 5.1% during the first year, and 4.5% to 4.6% each year thereafter.

Table 29 – Projected Wastewater Rate Increases

Projected Wastewater Rate Increases with Inflation Pass-Throughs					
	Sept 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027
Base City Rate Increases	2.0%	2.0%	2.0%	2.0%	2.0%
Est. Inflation Pass-Through	3.0%	2.5%	2.5%	2.5%	2.5%
<b>Net Increase</b>	<b>5.1%</b>	<b>4.6%</b>	<b>4.5%</b>	<b>4.5%</b>	<b>4.5%</b>

**Table 28 – Proposed Wastewater Rates**

<b>Proposed Wastewater Rates</b>						
Current Wastewater Rates	Proposed Rates Effective on or After					
	Sept 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027	
<b>FIXED MONTHLY CHARGES</b>						
<i>Fixed monthly charges billed per residential dwelling unit or based on non-residential meter size.</i>						
<b>RESIDENTIAL</b>						
<i>Fixed monthly charge per dwelling unit</i>						
Single Family Residential	\$37.93	\$39.85	\$40.64	\$41.46	\$42.29	\$43.14
Multi-Unit Residential	32.24	33.88	34.55	35.24	35.95	36.67
Unmetered Residential	100.88	105.99	108.11	110.27	112.48	114.72
<b>NON-RESIDENTIAL</b>						
<i>Fixed monthly charge based on meter size</i>						
Up to 3/4-inch meter	\$37.93	\$39.85	\$40.64	\$41.46	\$42.29	\$43.14
1-inch meter	62.43	65.59	66.90	68.24	69.61	71.00
1-1/2 inch meter	123.66	129.91	132.51	135.16	137.86	140.62
2-inch meter	197.15	207.12	211.26	215.49	219.79	224.19
3-inch meter	368.63	387.28	395.03	402.93	410.98	419.20
4-inch meter	613.30	644.34	657.22	670.37	683.78	697.45
6-inch meter	1,226.00	1,288.04	1,313.80	1,340.07	1,366.87	1,394.21
<b>METERED INDUSTRIAL</b>						
<i>Fixed monthly charge based on meter size</i>						
2-inch ultrasonic meter	\$552.36	\$580.31	\$591.92	\$603.76	\$615.83	\$628.15
10-inch ultrasonic meter	1,226.00	1,288.04	1,313.80	1,340.07	1,366.87	1,394.21
2-inch magnetic meter	368.63	387.28	395.03	402.93	410.98	419.20
3-inch magnetic meter	809.57	850.53	867.55	884.90	902.60	920.66
4-inch magnetic meter	1,287.24	1,352.37	1,379.42	1,407.00	1,435.14	1,463.85
6-inch magnetic meter	2,573.31	2,703.52	2,757.60	2,812.75	2,869.01	2,926.39
<b>WASTEWATER COMMODITY CHARGES</b>						
<i>Volumetric charges billed per hundred cubic feet (hcf) of estimated sewer discharge.</i>						
<b>RESIDENTIAL</b>						
<i>Based on a) average of two lowest of four low use months of metered winter water use or b) actual water use</i>						
Single Family Residential	\$8.99	\$9.45	\$9.63	\$9.83	\$10.02	\$10.22
Multi-Unit Residential	8.99	9.45	9.63	9.83	10.02	10.22
<b>COMMERCIAL</b>						
<i>Billed based on metered water use</i>						
Low Strength	\$8.66	\$9.09	\$9.28	\$9.47	\$9.65	\$9.85
Medium Strength	11.78	12.38	12.63	12.89	13.14	13.41
High Strength	16.01	16.82	17.16	17.50	17.85	18.21
<b>METERED INDUSTRIAL</b>						
<i>Based on metered use &amp; estimated wastewater loadings</i>						
Flow (\$/hcf)	\$7.44	\$7.82	\$7.97	\$8.13	\$8.29	\$8.46
BOD (\$/lb)	1.26	1.33	1.36	1.39	1.42	1.45
SS (\$/lb)	1.43	1.50	1.53	1.57	1.60	1.63

Note: The Proposed Wastewater Rates will be adjusted each year to account for annual pass-through rate increases for inflation based on the percentage change in the Consumer Price Index for the San Francisco Bay Area from the index for December 2022 to the index for December immediately preceding the upcoming fiscal year.

Table 5, below, shows projected monthly water and wastewater bills for single family homes with low, typical, and moderately-high levels of water and wastewater use. The combined water and wastewater bills for a typical single-family home are projected to increase by an average of 6% to 6.5% per year over the next 5 years.

Note that the bill projections shown here include estimates of future pass-through adjustments for SCWA wholesale water rate increases and inflation and are provided for informational purposes only. Actual bills will vary depending on future SCWA wholesale rate increases and the level of annual inflation adjustment implemented.

Table 5 – Projected Rate Impacts

Projected Monthly Water & Wastewater Bills							
	Use (hcf)	Current Year	Sept 1 2023	July 1 2024	July 1 2025	July 1 2026	July 1 2027
<b>Low Use</b>							
Water	4	\$36.22	\$39.15	\$42.05	\$45.12	\$48.44	\$51.93
Wastewater	3	<u>64.90</u>	<u>68.19</u>	<u>71.27</u>	<u>74.53</u>	<u>77.92</u>	<u>81.45</u>
Total		101.12	107.34	113.32	119.65	126.36	133.38
<b>Typical Use</b>							
Water	7	\$50.59	\$55.02	\$59.39	\$64.08	\$69.08	\$74.40
Wastewater	5	<u>82.88</u>	<u>87.08</u>	<u>91.02</u>	<u>95.17</u>	<u>99.51</u>	<u>104.01</u>
Total		133.47	142.10	150.41	159.25	168.59	178.41
<b>Mod-High Use</b>							
Water	12	\$77.30	\$84.39	\$91.37	\$98.88	\$106.88	\$115.41
Wastewater	8	<u>109.85</u>	<u>115.41</u>	<u>120.63</u>	<u>126.15</u>	<u>131.88</u>	<u>137.84</u>
Total		187.15	199.80	212.00	225.03	238.76	253.25

Note: Projected bills include base City rate increases plus estimates of future annual pass-through rate adjustments for wholesale water rate increases and inflation.

### Flexibility with Rate Increase Implementation

It is important to note that upon adoption of the proposed water and sewer rates, Council retains the authority to not implement the full rate increases as recommended in the rate study—it can choose to implement lesser (or no) rate increases after reviewing and considering the status of operational needs, capital projects, fund reserves, water shortages, and anticipated revenue trends.

The Proposition 218 process requires the City to provide notice of maximum proposed rate changes (a *not-to-exceed* amount); but adoption of the proposed rates does not commit the City to invoke full rate increases as noticed. Council may also choose to not pass inflationary increases along to customers.

A recent example of this flexibility in rate implementation occurred when Council acted to help provide rate relief during Covid when it temporarily deferred water rate increases in 2020 and wastewater rate increases in 2020 and 2021.

### Comparison with Other Utilities in the Region

Utility rates can vary widely from agency to agency due to a wide range of factors. Petaluma’s combined water and wastewater charges for a typical home are in the middle range compared to

other regional agencies (Figure 1, below), while charges for customers with lower levels of billable use are in the lower-middle range (Figure 2, below).

Based on analysis of water and wastewater utility billing data from recent years, a typical home uses 7 hundred cubic feet (hcf) of water per month (on average) and is billed for 5 hcf of wastewater based on use during two low-use winter months.

Figure 1 – Single Family Residential Water & Wastewater Rate Survey: Typical Use

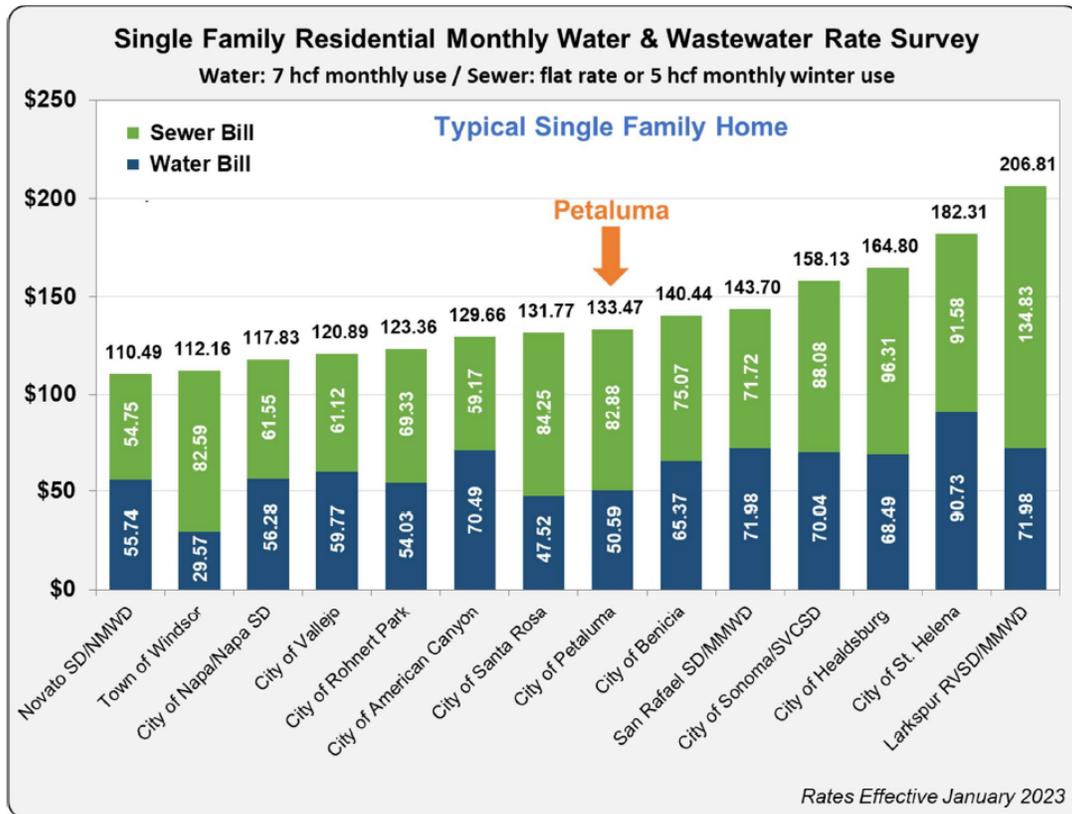
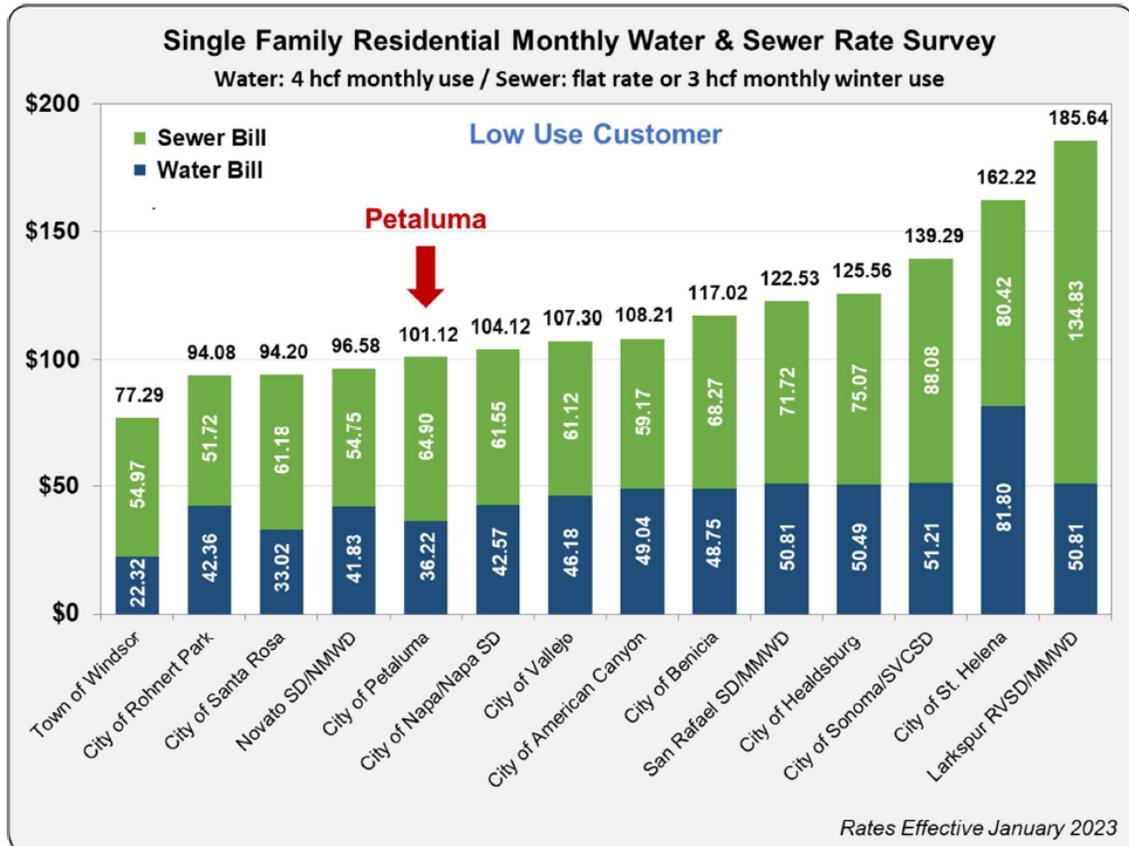


Figure 2 – Single Family Residential Water & Wastewater Rate Survey: Low Use



### Water Conservation Program

As part of the feedback and information received at the May 15<sup>th</sup> Council meeting, questions were raised about the City’s water conservation program. As we know, the City of Petaluma purchases most of its drinking water from Sonoma Water. As part of the Restructured Agreement for Water Supply between Sonoma Water and its water contractors including the City of Petaluma, the City must implement a water conservation program as well as participate in a regional water conservation program through the Sonoma Marin Saving Water Partnership.

The City of Petaluma has a robust water conservation program that has had participation by over 11,000 Petaluma water customers since 2010. The City’s year-round water conservation program offers water customers rebates, free water use evaluations, free water-saving devices, resources, tips, and more. Water conservation program information is available on the City’s website at <https://cityofpetaluma.org/water-conservation/>.

In addition to the year-round offerings the City’s water conservation program has available for water customers, the program includes robust outreach, public tabling events, customer service, and coordination with local non-profits. The water conservation program is funded by the water enterprise fund and is continuously being updated to increase water use efficiency over time. Since 2008 when the City’s water conservation program began, the City has effectively decreased per-

person water use through the various programs, outreach, and customer service the City's water conservation program offers. These efforts will continue and are funded as part of the proposed rate adjustments.

### **Water Shortage Contingency Rate Adjustments**

A key recommendation of the rate study is for the adoption of new Water Shortage Contingency Plan Rate Adjustments designed to support the financial stability of the City's water and wastewater enterprises during periods of drought or water shortage emergencies that result in a significant decline in water use and corresponding water and wastewater service charge revenues.

The goal is to enable the City to obtain authorization for the adjustments via the Proposition 218 rate increase process in order to give Council the authority to phase in rate adjustments as needed (up to the maximum levels adopted) in future years in response to escalating water shortage emergencies or droughts. These adjustments have been developed to correspond with the Water Shortage Contingency Plan Levels from the City's 2020 Urban Water Management Plan.

Water Shortage Contingency Plan Rate Adjustments are proposed for both water rates and wastewater rates as both enterprises would be financially impacted by a decline in billed usage. The maximum authorized level of the adjustments are shown below and would be adjusted each year based on increases in the City's water and wastewater usage rates.

It is important to note that adjustments to rates during water shortage periods are completely optional. Additionally, the rate structure could be tiered as part of Council's action to invoke them should they be needed (they just cannot exceed the amounts shown in the tables below).

It is important to note that the proposed rates are being included in the Proposition 218 process to provide Council with the flexibility and authority to implement these adjustments *up to* the amounts shown in Tables 6 and 7 for the corresponding Water Shortage Contingency Plan level. Of course, Council can elect to not implement adjustments, or to implement lower adjustments; however, this mechanism provides a safety valve should prolonged or repeated droughts occur that adversely impact the health of one or both enterprise funds. If this were to occur, a significant drawdown of reserve funds would be very problematic and require a substantial rate increases in the future along with deferment of critical and compelling capital projects.

**Table 6 – Water Shortage Contingency Plan Rate Adjustments**

<b>Proposed Maximum Water Shortage Contingency Plan Rate Adjustments</b>					
	<b>Water Shortage Level</b>				
	<b>Level 2</b>	<b>Level 3</b>	<b>Level 4</b>	<b>Level 5</b>	<b>Level 6</b>
<b>Water Shortage or Mandated Reduction</b>	Up to 20%	Up to 30%	Up to 40%	Up to 50%	> 50%
<b>Maximum Rate Adjustment %</b>	8%	16%	27%	41%	62%
<b>Maximum Rate Adjustment* Effective Sept-1, 2023 (\$/hcf)</b>	\$0.42	\$0.85	\$1.43	\$2.17	\$3.28

Note: 1 unit = one hundred cubic feet (hcf), or approximately 748 gallons.

\* Each year, the Maximum Water Rate Adjustments will be adjusted on July 1 based on a) the Maximum Rate Adjustment % corresponding each Water Shortage Level multiplied by b) the Water Consumption Charge implemented for All Other Customers resulting in c) Maximum Water Rate Adjustment per hcf that would be applied to the City's Water Consumption Charges.

**Table 7 – Wastewater Rate Adjustments for Water Shortages**

<b>Projected Maximum Wastewater Rate Adjustments for Water Shortages</b>					
	<b>Water Shortage Level</b>				
	<b>Level 2</b>	<b>Level 3</b>	<b>Level 4</b>	<b>Level 5</b>	<b>Level 6</b>
<b>Water Shortage or Mandated Reduction</b>	Up to 20%	Up to 30%	Up to 40%	Up to 50%	> 50%
<b>Maximum Rate Adjustment %</b>	5%	7%	10%	14%	20%
<b>Maximum Rate Adjustment* Effective Sept-1, 2023 (\$/hcf)</b>	\$0.47	\$0.66	\$0.94	\$1.32	\$1.89

Note: 1 unit = one hundred cubic feet (hcf), or approximately 748 gallons.

\* Each year, the Maximum Wastewater Rate Adjustments will be adjusted on July 1 based on a) the Maximum Rate Adjustment % corresponding each Water Shortage Level multiplied by b) the Residential Wastewater Commodity Charge resulting in c) Maximum Wastewater Rate Adjustments per hcf that would be applied to all Wastewater Commodity Charges.

## **Recycled Water Rates and the City’s “One Water” Vision for the Future**

The proposed rate study would authorize the City to set recycled water rates up to 100% of the potable Water Consumption Charges for “All Other Customers” (recycled water sales fall under this rate class). This allows time to get a little further along with the City’s Integrated Water Master Plan (IWMP), which involves planning, prioritizing, and envisioning the future of our community’s recycled water program. This effort is just getting started and includes analysis of recycled water production costs and rate recommendations.

Currently, the recycled water rate for all customers (urban and agricultural) is up to half the potable rate (\$1,045/acre-ft., which is 50% of the potable rate). New customers are generally charged 50% of the potable rate, however, a few historic agricultural customers benefit from lower rates as part of long-term agreements. These agreements include storage requirements and easements for distribution infrastructure in exchange for reduced rates.

Recycled water demand for irrigation varies by year, however in general, increased production of recycled water allows for additional distribution and correspondingly increases consumption

charges. Recycled water demand is anticipated to increase over time, as the City continues to explore reuse options beyond irrigation.

Revenues from the City's recycled water program for the 3 years 2020-2022 are as follows: \$491,815.74 in 2020, \$729,873.52 in 2021, and \$829,873.58 in 2022.

Currently, the City can recycle 45% to 48% of its plant influent. In 2020 the City produced 735 million gallons of recycled water (45% of the total annual influent flow); in 2021 the City produced 804 million gallons of recycled water (48% of the total annual influent flow); and in 2022 the City produced 689 million gallons of recycled water (45% of the total annual influent flow).

Based on these revenues and consumptions, the *average* price per acre-ft. received is \$409.85, \$429.34, and \$436.78 for the years 2020, 2021, and 2022, respectively. These averages are skewed by the high volume of water used by agricultural users with long-term agreements (causing average unit prices to be well below 50% of the potable rate). As new users purchase recycled water and as these long-term agreements expire, this average unit price and recycled water revenues will continue to rise.

As part of this discussion, it is important to consider the historical context of these existing long-term agreements. Until the summer of 2013, the City *paid* agricultural users to take disinfected secondary effluent produced at ECWRF during the irrigation season. The City implemented agricultural irrigation to comply with an order from the San Francisco Bay Regional Water Quality Control Board (RWQCB) that restricts the City's treated wastewater discharges to the Petaluma River between May 1 and October 30. Agricultural users began paying the City a commodity charge in the summer of 2013 (in accordance with individual agreements), at which point the City replaced deliveries of secondary effluent to agricultural users with tertiary treated effluent.

Utility revenues fund a variety of projects and programs that enhance the City's resiliency to drought, mitigate risks, ensure support for emergency response activities, and maximize the conservation of water resources. The City anticipates ongoing water supply challenges as a result of climate variability and longer drought periods. We are addressing future water shortages and conservation of potable water resources by exploring new and innovative sources of potable water and by undertaking efforts to expand our recycled water program.

As such, the City's Ellis Creek Water Recycling Facility is a critical component of our water supply portfolio and will continue to be central to the holistic planning efforts undertaken as part of our Integrated Water Master Planning (IWMP) initiative. As we move closer to a so-called "One Water" concept, the conversion of all treated wastewater to potable uses has the potential to be a game-changer in stabilizing and enhancing our community's water supply resiliency. To that end, the proposed rates support a capital improvements plan that contains numerous projects, including the IWMP, that proactively take the next steps in moving our community forward.

Regarding the long-term vision and cost-effectiveness of recycled water, it is important to point out the importance and timeliness of the City's Integrated Water Master Plan (IWMP) initiative. This study is partially funded by grants and provides us with a unique opportunity to take a holistic view of all water supply development opportunities, including recycled water program expansion,

uses, and priorities. Through this effort, projects will be scored in a way that will represent a complete project cost to our decision-makers and community for their feedback and input on future planning.

As part of this effort, staff plans to perform a financial analysis of the recycled water program to determine the cost of recycled water production and program expansion, as well as review recycled water rates. As part of this recycled water rate analysis, staff plans to consider and recommend structured rate options for (1) urban recycled water customers, (2) agricultural recycled water customers, and (3) seasonal agricultural users that will incentivize recycled water storage during winter months. Given that the proposed rate study allows recycled water to be charged at up to 100% of potable rates, this new rate structure should fit well within our existing utility rate structure framework.

While the effluent from the Ellis Creek Water Recycling Facility was once considered to be something that needed to be “disposed of” in order to meet regulatory requirements (to not discharge between May 1 and October 30), high-quality tertiary treated recycled water is now considered to be a valuable commodity that is in demand and can be sold at a market rate determined by the City. Completion of the tertiary expansion project will ensure that the City is well-positioned in being able to produce, distribute, store, and sell recycled water for beneficial reuse. This is especially important as we continue efforts to improve the resiliency of our water supply during future droughts. The IWMP process is well underway and will soon involve community stakeholders and input from Council in helping to determine future recycled water demands, priorities for uses and distribution, and optimal recycled water rates.

In addition to the recycled water projects listed below in the next section, the City is planning its next phase of recycled water program expansion through the IWMP process. The State Water Resources Control Board (SWRCB) will adopt regulations for Direct Potable Reuse by the end of this year, and this will change the way we can use recycled water and provide opportunities for program expansion beyond use for irrigation only. As a result, current recycled water program study areas include:

- Additional non-potable reuse: urban and agricultural irrigation, dual-plumbing, industrial process water
- Recycled water storage for additional reuse
- Potable reuse options (Indirect Potable Reuse/Future Direct Potable Reuse)

Staff is planning to provide Council with a presentation about the IWMP process, scope, and schedule this fall. Community and City Council input will be absolutely essential to the process and its development.

### **Capital Improvement Plan Highlights**

The City needs adequate funding to complete essential water, recycled water, and wastewater capital projects over the next five years and beyond. Many projects under consideration have already been deferred, and further delay will increase costs and risks to the integrity of system infrastructure and operational needs. A summary of the Capital Improvement Plans (CIP) included

in the rate study analysis are shown in Tables 9, 23, and 24 for water, wastewater, and recycled water, respectively.

- The **Water CIP** (Table 9) identifies \$104 million of improvements through fiscal year 2033/34. With an estimated 3% construction cost inflation, total costs are projected at \$119 million, with approximately \$54 million needed over the next 5 fiscal years. The City has been successful in securing numerous grants for infrastructure upgrades (e.g., Advanced Metering Infrastructure, or AMI), and staff continues to pursue other funding opportunities. After considering current and potential grants, approximately \$33 million in CIP projects will need to be funded over the next 5 years.
- The **Wastewater CIP** (Table 23) identifies \$91 million of improvements through fiscal year 2033/34. With an estimated 3% construction cost inflation, total costs are projected at almost \$100 million, with approximately \$70 million needed over the next 5 fiscal years corresponding with the term of proposed wastewater rates.
- The **Recycled Water CIP** (Table 24) identifies \$67 million of improvements through fiscal year 2033/34. With an estimated 3% construction cost inflation, total costs are projected at roughly \$76 million, with approximately \$42 million needed over the next 5 fiscal years.

The City of Petaluma has been very successful in securing grant funding for the expansion of its recycled water system. The table below summarizes grants received for recycled water projects.

**Summary of Recycled Water Program Grant Funding**

<b>Project</b>	<b>Project Cost</b>	<b>Grant Funding Source</b>	<b>Grant Amount</b>
Maria Drive Recycled Water Pipeline Extensions (Urban)	\$3.218 M	2021 Reclamation Title XVI (NBWRA)	\$804,427
		2023 DWR SMGA Implementation (Petaluma Valley GSA)	\$2.6 M
Adobe Road Recycled Water Pipeline Extension (Agricultural)	\$5.608 M	2021 Reclamation Title XVI (NBWRA)	\$1.4 M
		2021 DWR Urban and Multibenefit Drought Relief Program	\$3.2 M
Tertiary Treatment Expansion Project	\$18.865 M (Grant App. Project Cost)	2021 Reclamation Title XVI (NBWRA)	\$4.716 M
		2019 IRWM Prop 1 (NBWRA)	\$3.6 M
Sonoma Mountain Alignment (Urban) - Completed	\$2.64 M	2017 State Water Resources Control Board (SWRCB) Prop 1	\$870,030
Recycled Water Facilities Planning (Recycled water portion of IWMP)	\$452,623	SWRCB Water Recycling Funding Program (2022)	\$226,311
<b>Total</b>			<b>\$16.42 M</b>

In total, grant funding has helped to offset about 50% of the total project costs for the projects listed above.

In addition to the grants listed above, the City of Petaluma was written into the 2021 Water Resources Development Act (WRDA) and expects to receive an additional \$13.7 M in wastewater infrastructure funding, including recycled water expansion projects. This represents a grand total of \$30.12 million in grant funding received for recycled water projects and initiatives at the time of this writing.

This success in securing grants, combined with potential increases in recycled water rates as part of the IWMP effort (again, adoption of the new rates allows recycled water rates to be set at up to 100% of the potable water rate), greatly reduces any burden on our community's rate payers in meeting zero discharge regulatory requirements during summer months and in treating and distributing recycled water.

### **Alternatives Analysis – Options for Possibly Reducing Rate Increases**

During the initial rate study analysis work in early 2023, staff worked with our consultant to develop preliminary CIPs for the water, wastewater, and recycled water systems. This initial effort included important improvements to our facilities but resulted in the need to issue bonds if they were all to be constructed in the next 5 years.

As a result, staff went back to the drawing board and evaluated the criticality of each project, deferring projects that *could* be deferred, and trimming away any projects from the 5-year plan that were not deemed to be absolutely essential. This revised CIP was incorporated into the draft rate study presented on June 19<sup>th</sup> and resulted in the base rate increases currently proposed.

Following the June 19<sup>th</sup> presentation to City Council, staff reignited this effort to review all of the CIP projects for criticality once again in an effort to see if there were any projects that could be eliminated or deferred in an effort to minimize rate increases (especially water rates).

This effort was undertaken with the hope of possibly coming up with another option:

- 1) The current CIP included in the draft rate study
- 2) A modified version that defers some projects that may not be critically important or as time sensitive

To do this, staff classified CIP projects into one of three categories:

1. *Essential* – the project is needed to meet regulatory requirements; comply with industry best practices; mitigate serious risks associated with safety, public health, and/or resiliency; achieve operational effectiveness and resilience; enhance emergency preparedness and responsiveness; comply with grant funding requirements; and/or to meet community goals and objectives
2. *Deferrable, but with Consequences* – the project is beneficial and will help achieve service improvements and certain objectives or operational efficiencies, but is not critically important or absolutely essential as defined above; consequences may include increased risks, increased project costs, or missing out on operational efficiencies (e.g., floating solar; metered automated water filling stations)
3. *Discretionary*

As staff took a holistic view in reviewing each project one by one, it became increasingly apparent how critically important each one of the projects are in addressing the City's water and sewer infrastructure needs. While many projects were classified as essential, only a few projects were deemed to be deferrable, but with consequences. No projects were identified as being discretionary or not needed (those would have been eliminated in the early 2023 analysis, as described above). Discussions revolved around the consequences of deferring projects that fell into the second category (e.g., identifying missed or delayed opportunities for achieving operational efficiencies; addressing deficiencies; and/or rehabilitating, upgrading, and/or replacing aging infrastructure to support safe and reliable service).

Key considerations in this analysis are summarized as follows:

- The current rate study already includes a refined CIP that includes essential projects and deferrable projects with serious consequences for additional delay
- Nearly all projects have a high degree of criticality and must be done even, if deferred with consequences
- Project costs will increase as inflation in the utility and heavy construction industry continues to outpace the general Consumer Price Index (CPI)
- Deferral has already occurred for many projects—criticality continues to increase
- Many projects need to synchronize with other projects to meet City goals and objectives (e.g., street improvement projects need to have water and sewer improvements completed prior to placing new pavement); therefore, deferrals have trickle-down effects on other non-utility projects
- Potential risks to the integrity and operability of our water and sewer infrastructure and operations increase with additional deferral of projects; our strategy is to be proactive, not reactive
- Operational efficiencies and service enhancements can be achieved with completion of most projects sooner rather than later (e.g., floating solar, increasing recycled water production)
- Grants are a very important consideration—some projects in the CIP are proposed along with grant funding to offset most or all of the capital cost
- Some CIP project costs are likely to increase as staff gets further into discovery and design—conditions are often worse than expected and project scopes must be amended
- While not necessarily desirable, the issuance of bonds to complete large capital projects, or groups of projects, can help level out peaks and stabilize rate increases

After considering these factors, staff worked with our consultant to provide an “Option 2” with a reduced 2.0% base increase to water rates, while preserving the 2.0% base rate increase to wastewater. This new option, shown below, would require deferral of a few CIP projects in the “deferrable, but with consequences” category, such as upgraded water filling stations, well water treatment systems, and the Oak Hill tank reconstruction. Of course, with deferral comes increased costs for implementation in the future due to inflation, along with the possibility of needing a more significant increase in the future as part of the next rate study.

## Option 2: Water Rate Schedule with 2% Base City Rate Increases

Future year rates subject to pass-through adjustments for  
a) inflation and b) SCWA wholesale water rate increases

<b>Water Rates</b>					
<b>Base Water Rates Effective On or After</b>					
	<b>Sept 1 2023</b>	<b>July 1 2024</b>	<b>July 1 2025</b>	<b>July 1 2026</b>	<b>July 1 2027</b>
<b>FIXED MONTHLY CHARGES</b>					
<i>Fixed monthly charges billed per residential dwelling unit or based on non-residential meter size.</i>					
<b>Residential</b>					
Single Family: Up to 1-inch meter	\$19.94	\$20.34	\$20.75	\$21.17	\$21.59
Multi-Family: Per Dwelling Unit	11.97	12.21	12.45	12.70	12.96
<b>All Other Customers</b>					
5/8 & 3/4-inch meter	\$19.94	\$20.34	\$20.75	\$21.17	\$21.59
1-inch meter	31.65	32.28	32.93	33.59	34.26
1-1/2-inch meter	60.96	62.17	63.42	64.68	65.98
2-inch meter	96.10	98.03	99.98	101.98	104.02
3-inch meter	178.14	181.70	185.34	189.05	192.83
4-inch meter	295.32	301.22	307.25	313.40	319.67
6-inch meter	588.29	600.06	612.06	624.29	636.78
<b>WATER CONSUMPTION CHARGES</b>					
<i>Volumetric charges billed per hundred cubic feet (hcf) of metered water use.</i>					
<b>Single Family Residential</b>					
Tier 1 0 - 4 hcf	\$4.76	\$4.85	\$4.95	\$5.04	\$5.13
Tier 2 4.01 - 8 hcf	5.27	5.37	5.47	5.58	5.68
Tier 3 8.01 - 16 hcf	5.99	6.10	6.21	6.34	6.46
Tier 4 >16 hcf	6.98	7.11	7.24	7.39	7.53
<b>All Other Customers</b>					
Temporary Service & Water Haulers	7.77	7.92	8.08	8.23	8.40

This second option results in water bills for a typical customer being a little lower each year, building up to a difference of about \$1.50 per month by year 5 (roughly a difference of 30 cents per month added each year).

Reducing the base water rate increase by 0.5% to 2.0% as shown above results in the need to reduce CIP expenditures by about \$1.8 million over the next 5 years. Moreover, revenues in year 5 will be lower by about \$650,000 per year in perpetuity as compared with the study's proposed 2.5% rate increase (based on the projections/assumptions with all other things held equal). Making up for this difference will require a more substantial increase in the future in order to adequately address system needs for our aging system, including the deferred CIP projects. Ultimately, this option also leaves less contingency for unknowns, including future droughts or critical unanticipated CIP projects that may need to be added in response to infrastructure failures, service needs, or changing regulatory requirements.

Even with this second option, it is very important to note that with adoption of Option 1 (the proposed base rates of 2.5% for water and 2.0% for wastewater), *Council always has the ability to set lower base rates each year, and/or to absorb all or a portion of the pass-through inflationary costs.* **As a result, staff and our consultant strongly recommend consideration of the rates as proposed in the study and the Proposition 218 notice.** The City has historically done an excellent job of gradually phasing in rate increases to minimize the annual impact to ratepayers. The proposed rates provide Council with flexibility and help to ensure the future long-term stability of our water and sewer utilities, and allow for further pursuit and implementation of our community’s “One Water” holistic vision as part of the IWMP initiative.

Lastly, and as described above, the City has been very successful in obtaining grant funds to help fund several expensive and important CIP projects. This is a tremendously important factor in stabilizing and supporting reasonable rates for our community while enhancing operational efficiencies and effectiveness. A great example of this is the Advanced Metering Infrastructure (AMI) project. The City was fortunate in receiving 90% of the funding needed to upgrade meter registers; and the project will greatly enhance operational efficiencies, improve customer service and awareness, and facilitate improvements to water conservation efforts. Moreover, the City’s 20,000+ Automated Meter Reading (AMR) meter registers are nearing the end of their life cycle and are rapidly requiring replacement.

### **Financial Assistance**

Staff proposes continuance of the federally funded LIHWAP assistance program, which helps low-income households pay utility bills. This program is administered by North Coast Energy Services, who also administer a similar LIHEAP energy assistance program. Information is available at [www.cityofpetaluma.org/billing-water-sewer](http://www.cityofpetaluma.org/billing-water-sewer). Staff initially explored the possibility of a local program funded with general fund dollars, but there are many unknowns and challenges with implementing such a program at this time. Moreover, the federal program is well-managed and readily available to residents.

### **PUBLIC OUTREACH**

This is the third public presentation of the draft Utility Rate Study to the City Council. An introductory presentation of preliminary findings occurred at the May 15, 2023, City Council meeting. On June 19, 2023, a second presentation occurred to share the draft Utility Rate Study and to seek authorization to issue Proposition 218 notices informing the community about the proposed rate increases and setting a public hearing for August 7, 2023.

The Public Hearing appeared on the City’s tentative agenda documents on July 17, 2023, which was a publicly noticed meeting.

The *Argus-Courier* featured an article about the proposed water and sewer rate increases on July 12, 2023 (available at: <https://www.petaluma360.com/article/news/petaluma-has-higher-water-rates-in-its-future/>).

Staff hosted an informational Public Outreach Meeting via Zoom on the evening of July 31<sup>st</sup> to share information, hear comments, and better understand public sentiment. This meeting was publicized via the City’s Community Update and social media channels.

Lastly, as a requirement of Proposition 218, individual notices were mailed to all affected property owners and/or customers at least 45 days before the date of this public hearing. These notices were mailed on June 23, 2023, and a copy is attached for reference. Water and wastewater rate increases do not require voter approval but are subject to “majority protest” proceedings under which affected ratepayers and property owners may file protests concerning the proposed rate adjustments. The City Council cannot adopt the proposed rate adjustments if written protests that meet Proposition 218 requirements are received on behalf of more than 50% of affected parcels.

### **COUNCIL GOAL ALIGNMENT**

The 2023 Utility Rate Study aligns with the City Council Goal of “A City That Works.” Specifically, Workplan Item # 171, “Complete Utility Rate Study to ensure rates support sustainable and resilient water distribution, wastewater collection and treatment, and recycled water systems.”

The City Council has also identified “Our Environmental Legacy” as one of its key strategic initiatives for 2021-2023.

- #46 – “Establish and promote a citywide sustainability program leading with exemplary environmental practices.”
- #42 – “Find ways for City operations to reduce greenhouse gas emissions, conserve water, decrease waste, and minimize the use of fossil fuels and investigate and pursue options for carbon sequestration.”
- #53 – “Continue to expand recycled water services to support local agriculture and groundwater and surface water resources.”
- #70 – “Continue to focus on water conservation and urban recycled water expansion.”

### **CLIMATE ACTION/SUSTAINABILITY EFFORTS**

The Petaluma Climate Action Framework Section 3, “Adaptation & Social Resilience” identifies the following climate action goal: “Develop resilient infrastructure and community readiness, including backup sources of water, power, and communications.” Projects funded by water and sewer rates are critical “backbone” elements necessary for achieving this goal by enhancing the reliability and resiliency of our water supplies and by supporting emergency fire response activities.

Adopting the proposed rate increases will help ensure adequate funding to support these goals, including projects that support the production of high-quality recycled water and move us closer to the reuse of all wastewater as part of a holistic “One Water” vision. This is being studied and explored as part of our Integrated Water Master Plan, a critically important project funded by a combination of grants and water/sewer rates. More information about *One Water* is available here:

<https://www.waterworld.com/drinking-water/potable-water-quality/article/16191451/one-water-concept-for-the-future>).

## **ENVIRONMENTAL REVIEW**

The proposed action is statutorily exempt from the requirements of the California Environmental Quality Act (CEQA) in accordance with CEQA Guidelines Section 15273 (Rates, Tolls, Fares, and Charges) as the adoption of revised rates and charges pursuant to these resolutions involves the establishment, modification, restructuring, or approval of rates and charges, as identified and analyzed in the rate study, including rates and charges to obtain funds for meeting operating expenses, purchasing or leasing supplies, equipment or materials, meeting financial reserve needs and requirements and/or obtaining funds for capital projects necessary to maintain service within existing service areas. Additionally, adopting a new rate schedule for water and wastewater services is categorically exempt pursuant to CEQA Guidelines Section 15061(b)(3) because there is no possibility that their adoption will have a significant effect on the environment. Therefore, the adoption of these resolutions setting rates and charges is not a project under CEQA pursuant to California Public Resources Code Section 21080(b)(8)(D) and 14 Cal. Code Regs. Section 15273 and Section 15061.

## **FINANCIAL IMPACTS**

The City has historically provided strong financial stewardship via the adoption of gradual annual water and wastewater rate increases most years over the past 20 years. These increases have helped keep rates aligned with the cost of providing service and putting the water and wastewater enterprises on a relatively strong financial footing.

The proposed rate increases intend to achieve fiscal sustainability for both utilities over the next 5 years and beyond. A detailed discussion of the impacts associated with implementing the new rates is contained in the Financial Plan sections of the report for each utility (Sections 2 and 3). The analysis provides background, the definition of funding and rate structures, cash flows, assumptions reflected in the analysis for the report, customer and account characteristics, capital improvement program funding, long-term debt, operating reserves, and conclusions and recommendations.

The study involved the development of 10-year enterprise fund cash flow projections for each utility. Table 11 on page 23 shows the 10-year water enterprise cash flow projection, and Table 26 on page 47 shows the 10-year wastewater enterprise cash flow projection. The results are graphically summarized in Figures 5 and 8, (pages 24 and 48, respectively), and are shown below for reference.

Figure 5 – Water Utility Projected Revenues & Expenses

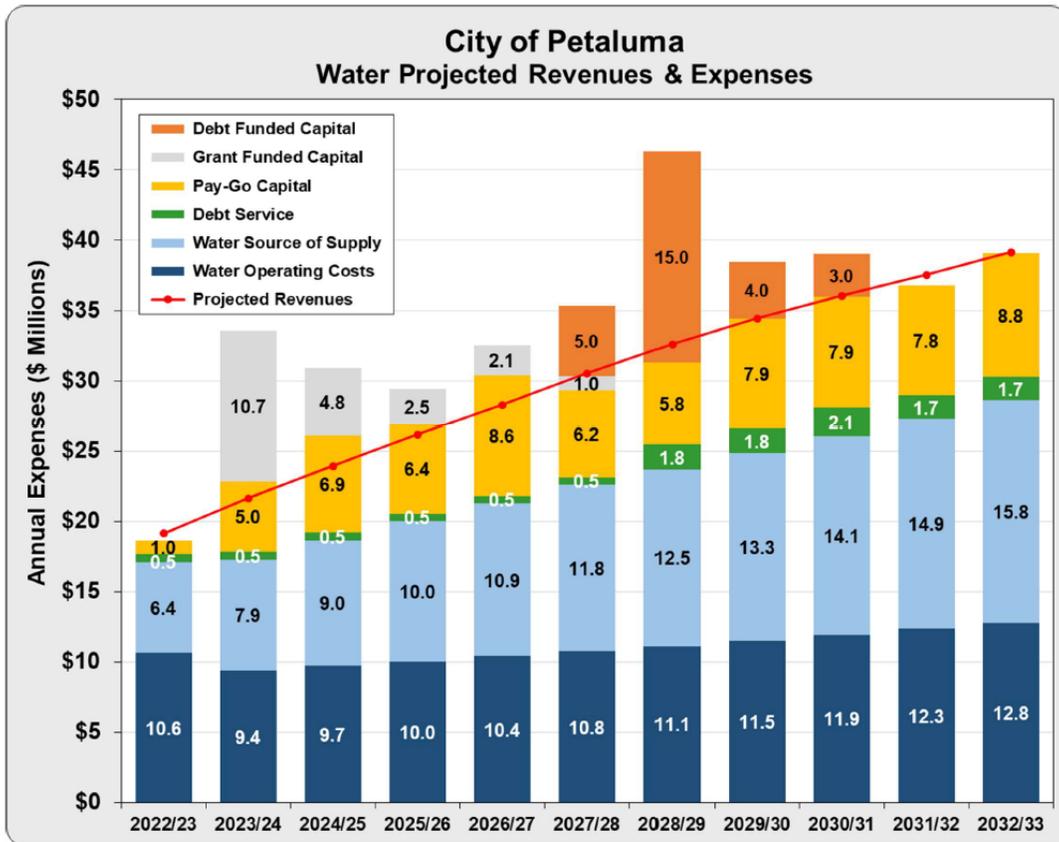
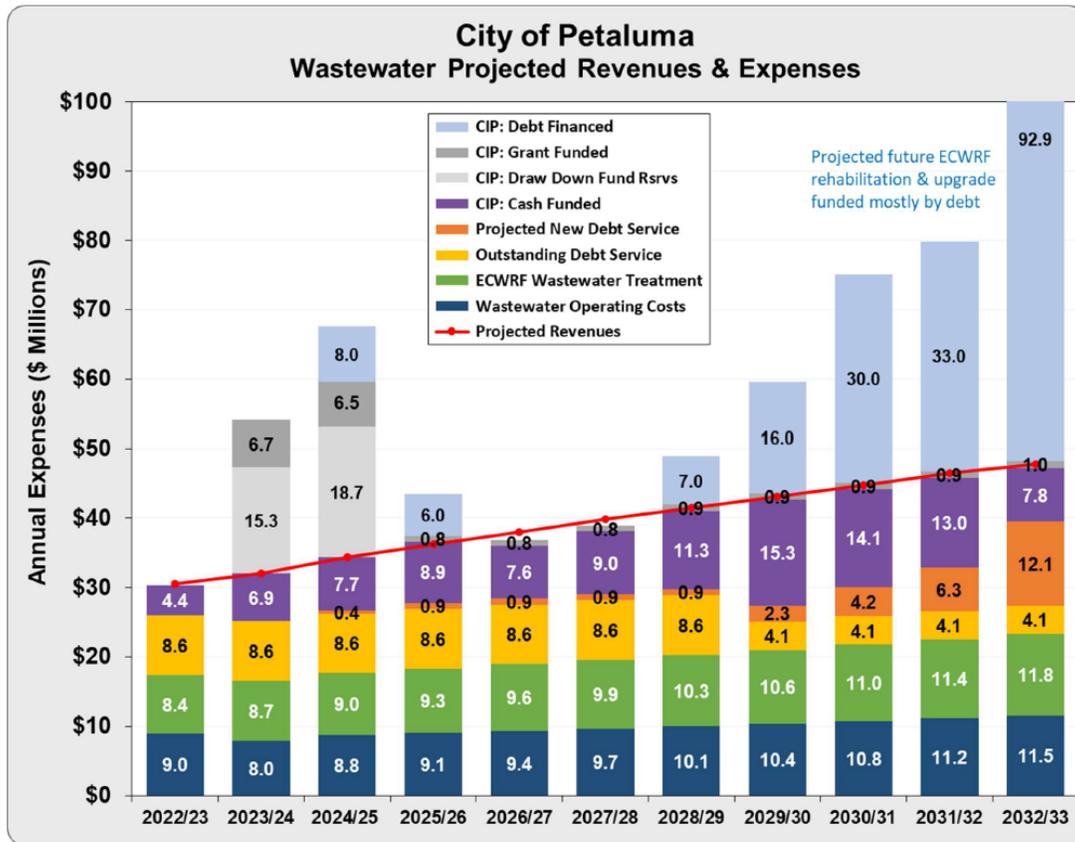


Figure 8 – Wastewater Utility Projected Revenues & Expenses



The projected revenues (shown by the red line) are intended to cover various operating and capital expenditures for each utility over the 10 years 2023 through 2033. Of course, a forecast of this nature requires numerous assumptions, which are all outlined in the study.

It is important to note that even with the adoption of the proposed rates on September 1, 2023, the City will need to draw down wastewater fund reserves in FY23/24 and 24/25 to cover expenditures and to cover the cost of capital improvements to our vital infrastructure. This is noted by the light gray bars that extend above the red revenue line.

This analysis demonstrates that, if approved, the proposed water and sewer rates will result in revenues necessary to support and sustain the future operating and capital needs of our water and wastewater utilities. Charging adequate rates for water and wastewater services ensures that the City can fund future operating and maintenance expenses, pay for wholesale water rate increases, and support required capital improvements to the City’s overall utility infrastructure, which in turn supports our community’s quality of life, economic vitality, and our climate action and sustainability efforts.

## ALTERNATIVES

As noted above, water and wastewater rate increases do not require voter approval but are subject to “majority protest” proceedings under which affected ratepayers and property owners may file protests concerning the proposed rate adjustments. The City Council cannot adopt the proposed rate adjustments if written protests that meet Proposition 218 requirements are received on behalf of more than 50% of affected parcels.

Should no rate increases be approved, the City would need to use existing rates with the drawdown of fund reserves to continue operations. Additionally, the recently adopted FY23/24 budget and capital improvement plan will need to be carefully reconsidered with the deferment of various essential capital projects necessary for the operation of the treatment facility.

As presented in the Discussion section, staff conducted a thorough review of the criticality for all capital projects contained in the rate study, and all were deemed to be essential or “deferrable, but with consequences.” The CIP projects contained in the rate study have been identified as being necessary for addressing aging infrastructure issues, meeting regulatory requirements, implementing best practices in the industry, and meeting Council’s goals and objectives. As explained therein, deferring CIP projects will likely increase construction costs due to inflation in the construction industry; increase risks to the system and community; slow drought/water supply resiliency efforts; and compromise the overall integrity of our water and sewer infrastructure.

After considering these factors, staff worked with our consultant to provide an “Option 2” that reduces the base water rate by 0.5%, down to 2.0%, while preserving the 2.0% base rate increase to wastewater. These rates for Option 2 are shown in the table provided in the Discussion section.

Reducing the base water rate increase by 0.5% to 2.0% results in the need to reduce CIP expenditures by about \$1.8 million over the next 5 years. This will require deferment of important CIP projects related to drought/water supply resiliency, such as upgraded water filling stations, well water treatment systems, and the Oak Hill tank reconstruction. Moreover, revenues in year 5 will be lower by about \$650,000 per year in perpetuity as compared with the study’s proposed 2.5% rate increase (based on the projections/assumptions with all other things held equal). Making up for this difference will require a more substantial increase in the future in order to adequately address system needs for our aging system, including the deferred CIP projects. Ultimately, this option leaves the City’s utility with less contingency for unknowns, including future droughts or critical unanticipated CIP projects that may need to be added in response to infrastructure failures, service needs, or changing regulatory requirements.

If the proposed water and sewer rates are adopted, it is important to note Council has the authority to implement the full rate increases, however, it can choose to implement lesser rates each year after reviewing and considering the status of operational and capital expenditures, fund reserves, and anticipated revenue trends. The Proposition 218 process requires the City to provide notice of maximum proposed rate changes (a *not-to-exceed* amount) but does not commit the City to invoke full rate increases as noticed. In other words, Council has the authority each year to adopt base rates less than those provided in the rate study and Notice of Public Hearing and Proposed Water & Wastewater Rate Increases; and Council may also choose to not pass inflationary increases

along to customers. For example, to help provide rate relief during Covid, the City temporarily deferred water rate increases in 2020 and wastewater rate increases in 2020 and 2021.

### **ATTACHMENTS**

1. Resolution Adopting New Water Rates
2. Resolution Adopting New Wastewater Rates
3. Exhibit A: Water & Wastewater Utility Rate Study – Final Draft
4. Notice of Public Hearing on Proposed Water & Wastewater Rate Increases
5. Sonoma Water Presentation: FY 2023-2024 Proposed Budget and Rates for the Water Transmission System
6. Utility Rate Study Presentation & Overview