

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kerrie Romanow

**SUBJECT: MUNICIPAL WATER SYSTEM
POTABLE AND RECYCLED
WATER RATES**

DATE: May 16, 2022

Approved

Date



5/25/2022

COUNCIL DISTRICT: 2, 4, 7, 8

RECOMMENDATION

- (a) Hold a public hearing on San José Municipal Water System 2022-2023 potable (drinking) and recycled water rates and charges on increases up to the amount in the hearing notices.
- (b) Adopt a resolution increasing San José Municipal Water System potable (drinking) water rates and charges in Attachment A to the staff memorandum, effective July 1, 2022, to the amount in the public notices.
- (c) Adopt a resolution increasing San José Municipal Water System recycled rates and charges in Attachment A to the staff memorandum, effective July 1, 2022, to the amount in the public notice.

OUTCOME

Approval of these recommendations will allow the San José Municipal Water System (SJMWS) to update retail rates and charges, effective July 1, 2022.

BACKGROUND

SJMWS is a rate-funded utility that is intended to operate at full cost recovery to provide water to approximately 26,000 customer accounts, serving a population of about 136,000 people in the North San José, Alviso, Evergreen, Edenvale, and Coyote Valley areas.

SJMWS purchases potable water for the North San José and Alviso areas from the San Francisco Public Utilities Commission (SFPUC), which delivers treated water through its Hetch Hetchy Aqueduct from the Sierra Nevada mountain range. Potable water for the Evergreen and Edenvale areas is purchased from Valley Water (formerly the Santa Clara Valley Water District) and comes from the Sacramento-San Joaquin River Delta, delivered through the State Water Project and Federal San Felipe Project, and local groundwater sources. SJMWS supplies all potable

water for the Coyote area from local groundwater sources. Recycled water is purchased from South Bay Water Recycling and is retailed to customers in all service areas.

Raftelis Financial Consultants conducted a cost of service analysis for the SJMWS potable water enterprise. The purpose of the analysis was to evaluate the utility's potable system revenue requirements through the development of a Financial Plan and an up-to-date Cost of Service evaluation. Raftelis Financial Consultants presented the result of its analysis at the City Council's May 9, 2017 meeting. Proposed rates for 2022-2023 are based on the results of the Raftelis Financial Consultants' study.

In addition to potable water, SJMWS also retails recycled water. The revenue requirements of retailing recycled water are collected from recycled water rates. To ensure that the City of San José (City) accurately establishes rates to match revenue requirements, the City contracted with HF&H Consultant, LLC (HF&H) to conduct a cost of service analysis.

ANALYSIS

Potable Water Rates and Charges

The two principal sources of revenue for SJMWS are water sales and fixed monthly meter service charges. Approximately 66 percent of SJMWS's revenue is used to purchase water from wholesalers and pay the Valley Water groundwater augmentation fee for groundwater pumped by SJMWS. It is estimated that the 2021-2022 total cost to operate the water utility system will be approximately \$47.9 million. In 2022-2023, it is estimated that the operating cost of the water utility system will increase to \$56.1 million, as shown in the 2022-2023 Proposed Operating Budget (in the Statement of Source and Use of Funds for the Water Utility Fund). Changes to water rates are primarily related to the projected increased cost of wholesale water and drought-related impacts on water supply and revenue. Additionally, smaller changes to costs of operating and maintaining the system include increased site security and personnel costs, and other minor infrastructure improvements. SJMWS estimates that the total volume of water sold during 2022-2023 will decrease compared to 2021-2022.

The additional revenue requirement associated with operating the water utility system, along with the necessity to maintain a reasonable fund balance to buffer further drought-related revenue impacts, were distributed among all customers and amounts to a 15 percent base increase in the fixed (meter) and quantity charges. SJMWS quantity charges were further adjusted in proportion to increased wholesale water supply costs. In February 2022, Valley Water notified property owners that wholesale rates for North County groundwater may increase by 15 percent in FY 2022-23. In April 2022, SFPUC notified customers of a recommended 15.9 percent rate increase. On May 10, 2022, the Valley Water Board of Directors adopted a 15 percent increase in water rates and SFPUC adopted a 15.9 percent increase in water rates. These wholesale rate adjustments were added to the retail quantity charges as a passthrough rate adjustment, with average monthly increase for SJMWS customers shown in the table below.

Valley Water has identified that rates are expected to continue increasing over the next 10 years, including another projected increase of 15 percent in FY 2023-2024, a 15 percent increase in FY 2024-2025, followed by seven years of approximately 10 percent annual increases. Furthermore, wholesale rate increases may be higher than currently projected if drought conditions continue, wholesaler costs continue to escalate, and/or water use during FY 2022-2023 is lower than wholesalers' estimates. Due to the projected rapid rise in wholesale water rates over the next several years, delaying increases or using reserves to offset FY 2022-2023 retail water rates would negatively impact fund health and lead to exponentially higher SJMWS rate increases in subsequent years.

In April 2022, notices were sent to inform all SJMWS water customers that City Council would be holding a public hearing to consider a potential change in retail water rates and charges for 2022-2023. The notice contained the maximum meter charges and water quantity rates that would be proposed for the City Council's consideration and approval. Actual rates will vary by customer, but a representative sample increase on an average residential monthly bill based on water usage of 13 HCF with a 3/4-inch water meter in the North San José /Alviso service area is an additional \$24 per month, whereas the same representative sample residential service would see a \$16 per month increase in their monthly bill in the Evergreen/Edenvale-Zone 1 area.

Financial Assistance and Water Savings Tips

SJMWS has implemented programs to assist with water bill affordability. During early 2022, the City received funding from the California Water and Wastewater Arrearages Payment Program (Arrearages Program) to assist customers with delinquent water bills. Over 1,000 customers received \$541,000 in Arrearages Program funding and \$356,000 in waived late payment charges.

Local implementation of California's Low-Income Household Water Assistance Program (LIHWAP) is just beginning, under which eligible state residents can receive up to \$2,000 to pay their water bills. The City is enrolled in LIHWAP, which will make available further financial support to eligible SJMWS customers. Staff will continue to monitor for any additional state or federal customer assistance programs which may be implemented and will coordinate as necessary to ensure SJMWS customers can participate and receive additional financial support where eligible.

Despite the financial hardship some customers may be experiencing, safe and affordable drinking water remains a priority. Based on the cost per gallon of water, and including the proposed rate increase, customers will pay approximately \$0.01 per gallon of water.

Water conservation continues to be the best practice for reducing the impact of higher water rates, saving money, and responding to the drought emergency. In addition to ongoing outreach and messaging, the City's website (www.sjenvironment.org/waterefficiency) provides information to customers on water saving tips, along with updates to water rules for customers and businesses. SJMWS staff is available to assist customer inquiries and provide further resources.

Other Potable Water Agency Charges

Other water agencies within the San Francisco Bay Area have proposed water rate increases for 2022-2023 or may increase water rates to recover wholesale rate increases and other inflationary costs. The below monthly bill figures are representative of sample residential monthly bills based on water usage of 13 HCF (9,725 gallons) with a 3/4-inch water meter.

<u>City/Water Agency</u>	<u>Current Monthly Bill</u>	<u>Proposed Increase</u>	<u>Proposed Monthly Bill</u>
San Francisco	\$154.22	0%	\$154.22
San José Water Company ³	\$129.95	18%	\$153.35
Palo Alto	\$130.70	9%	\$141.91
Menlo Park	\$128.27	5%	\$134.66
Great Oaks Water Company ³	\$118.50	13%	\$133.31
Redwood City	\$128.74	TBD	\$128.74
Milpitas	\$120.33	5%	\$126.71
City of San José - SJMWS¹	\$102.91	23%	\$126.50
Mountain View	\$102.61	12%	\$114.93
City of San José – SJMWS²	\$95.37	16.6%	\$111.16
Foster City	\$103.65	3%	\$106.97
Santa Clara	\$86.97	10%	\$95.29
Sunnyvale	\$85.93	3%	\$88.51

¹ Represents monthly bill for customer in North San José/Alviso service area.

² Represents monthly bill for customer in Evergreen/Edenvale-Zone 1 area.

³ Includes drought surcharges for an average residential customer exceeding their water allocation

Recycled Water Charges

In 2018, HF&H examined the cost of service to retail recycled water, resulting in a slight change to the recycled water rate structure. Based on HF&H's analysis, retail recycled water rates were adjusted to a structure which provides increased revenue stability in recovering delivery fixed costs. Recycled water service charge rates were set equal to the potable water service charge rates. A uniform quantity charge rate was set for all retail recycled water customers.

HF&H's recommendation for future years was to continue to set recycled water service charges rates equal to potable water service charge rates, and to increase the uniform quantity charge rate proportional to the increase in wholesale water costs. Pursuant to City Council resolution no. 79111 (continuing in effect resolution no. 68377), recycled water quantity charges will continue to be automatically increased every year in proportion to any increase in wholesale recycled water costs.

As shown in the following table, SJMWS's recycled water customers will continue to realize a significant savings over potable water even with a change to retail recycled water rates. Rate details for recycled water are provided in the attachment to this memorandum.

Monthly Bill with Proposed 2022-2023 Rates			
	Potable Water	Recycled Water	% Savings
Irrigation Customer: Evergreen Zone 3/4 450 HCF/month, 2-inch meter	\$3,010.64	\$1,925.24	36%
Industrial Customer: North San José 11,000 HCF/month, 10-inch meter	\$80,568.00	\$46,556.00	42%

CONCLUSION

Potable and recycled retail water rates will be updated effective July 1, 2022, and revenue will be sufficiently generated to fund projected utility operating costs as reflected in the 2022-2023 Proposed Operating Budget.

EVALUATION AND FOLLOW-UP

Annually, staff will return to the City Council with recommendations for following year's rates. A supplemental memorandum will be submitted to the City Council prior to the June 7, 2022 Public Hearing to report on the number of written protests and comments received by the City Clerk's Office in response to SJMWS's rate notice.

CLIMATE SMART SAN JOSE

The recommendation in this memorandum has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

Between April 6-11, 2022, SJMWS sent Public Notices directly to all customers advising them of the proposed rate changes and that a public hearing on the proposed rate change is scheduled for June 7, 2022. SJMWS published a notice in the Mercury News on May 17, 2022, in advance of City Council consideration of the proposed rate increases. As of May 16, 2022, the City Clerk's Office had received 69 letters of protest to potable water rates from SJMWS customers, and no protests to recycled water rates, in response to the public notices. Written protests have been received by mail, fax, and email. This memorandum will be posted on the City's website for the June 07, 2022 City Council meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office, City Clerk's Office, and City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

FISCAL/POLICY ALIGNMENT

The recommended rates for 2022-2023 are consistent with the City Council policy that programs be self-supporting whenever possible.

COST SUMMARY/IMPLICATIONS

The proposed rates and charges reflect the current costs of providing water service to specific customer classes, service areas, and pressure zones. For the North San José/Alviso service areas, the rates in Attachment A result in an approximately \$24 increase to an average residential monthly bill, whereas in the Evergreen/Edenvale service area, the increase is approximately \$16.

The 2022-2023 proposed operating revenues for the Water Utility Fund assume an overall 12.2 percent increase to budgeted water utility revenue for 2022-2023 to recover the full cost of operating and maintaining the SJMWS distribution system, plus increased wholesale water costs. This percentage increase to budgeted revenue is a result of differing service areas, usage, wholesale rates, and drought-related impacts; it is not representative of a customer's water charges or representative of a monthly increase. If the City Council approves a resolution changing SJMWS potable and recycled water rates and charges, as recommended in this memorandum, revenue will be generated to address a projected overall increase in utility operating costs, as reflected in the 2022-2023 Proposed Operating Budget.

CEQA

Statutorily Exempt, File No. PP17-005, CEQA Guidelines Section 15273, Rates, Tolls, Fares, and Charges, Adjustment to Fees, Rates and Fares without changes to or expansion of services.

/s/
KERRIE ROMANOW
Director, Environmental Services

For questions, please contact Jeff Provenzano, Deputy Director, at (408) 277-3671.

Attachment A – 2022-2023 Proposed Rate Schedule

ATTACHMENT A
2022-2023 PROPOSED RATE SCHEDULE

Table 1: Monthly Meter Charge – Potable and Recycled Water

MONTHLY METER CHARGE <i>(based on meter size)</i>		
Meter Size	2021-22 Charges	2022-23 Charges
5/8-inch	\$30.89	\$35.37
3/4-inch	\$30.89	\$35.37
1-inch	\$54.62	\$62.54
1.5-inch	\$94.15	\$107.80
2-inch	\$141.60	\$162.14
3-inch	\$291.85	\$334.17
4-inch	\$513.28	\$587.71
6-inch	\$1,122.19	\$1,284.91
8-inch	\$1,912.97	\$2,190.36
10-inch	\$3,020.09	\$3,458.00

Table 2: Potable Monthly Quantity Charge

MONTHLY QUANTITY CHARGE <i>(per HCF*)</i>		
Service Area/Zone	2021-22 Charges	2022-23 Charges
Evergreen/Edenvale – Zone 1	\$4.96	\$5.83
Evergreen/Edenvale – Zone 2	\$5.06	\$5.95
Evergreen/Edenvale – Zone 3/4	\$5.39	\$6.33
Evergreen/Edenvale – Zone 5/6	\$5.81	\$6.81
North San José/Alviso	\$5.54	\$7.01
Coyote	\$2.26	\$2.60

Table 3: Potable Bimonthly Private Fireline Charge

BIMONTHLY PRIVATE FIRELINE CHARGE		
Service Size	2021-22 Charges	2022-23 Charges
2-inch	\$20.72	\$23.73
3-inch	\$31.07	\$35.58
4-inch	\$41.42	\$47.43
6-inch	\$62.12	\$71.13
8-inch	\$82.82	\$94.83
10-inch	\$103.53	\$118.55

Table 4: Recycled Monthly Quantity Charge

	2021-22 Charges	2022-23 Charges
Monthly Quantity Charge (per HCF*)	\$3.401	\$3.918

*HCF = hundred cubic feet; 1 HCF = 748 gallon