



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kerrie Romanow

SUBJECT: SEE BELOW

DATE: June 1, 2023

Approved

Date

6/1/2023

COUNCIL DISTRICT: 2, 4, 7, 8

REPLACEMENT

**SUBJECT: SAN JOSE MUNICIPAL WATER SYSTEM POTABLE
(DRINKING) AND RECYCLED WATER RATES AND CHARGES**

REASON FOR REPLACEMENT

The purpose of this replacement memorandum is to provide updated information in the Cost Summary/Implications section based on the latest revenue and expenditure activities.

RECOMMENDATION

- (a) Hold public hearings on San José Municipal Water System potable and recycled water rates and charges effective July 1, 2023.
- (b) Adopt a resolution to increase the current San José Municipal Water System potable water rates and charges effective July 1, 2023, as identified in Attachment A to the staff memorandum.
- (c) Adopt a resolution to increase the current San José Municipal Water System recycle rates and charges effective July 1, 2023, as specified in Attachment A to the staff memorandum.
- (d) Approve an uncoded ordinance increasing the San José Municipal Water System potable and recycled water rates and charges effective July 1, 2023, as specified in the resolution.

SUMMARY AND OUTCOME

Approval of these recommendations will allow the San José Municipal Water System (SJMWS) to update potable and recycled retail water rates effective July 1, 2023, and revenue will be sufficiently generated to fund projected utility operating costs as reflected in the Fiscal Year (FY) 2023-2024 Proposed Operating Budget.

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 over 140,000 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, 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 the Santa Clara Valley Water District (Valley Water) 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.

In 2016, the City contracted with Raftelis Financial Consultants to conduct a cost-of-service analysis for the potable water enterprise of SJMWS. 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 their analysis at the City Council's May 9, 2017 meeting.

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 accurately establishes rates to match revenue requirements, the City contracted with HF&H Consultant, LLC (HF&H) in 2018 to conduct a cost-of-service analysis.

Proposed rates are based on the analysis performed as part of the Raftelis Financial Consultants' and HF&H's studies. Adoption of the resolution and approval of the ordinance will implement the rate changes for the potable (drinking) and recycled water rates, effective July 1, 2023.

ANALYSIS

Potable Water Rates and Charges

The two principal sources of revenue for SJMWS are water sales and fixed monthly meter service charges. Approximately 68% of SJMWS' potable water 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 total cost to operate, maintain, and rehabilitate the water utility system will be approximately \$65 million in FY 2022-2023 and \$68 million FY 2023-2024 as shown in the Statement of Source and Use of Funds for the Water Utility Fund included as part of the FY 2023-2024 Proposed Operating Budget. Changes to water rates are primarily related to the increased cost of wholesale water that SJMWS purchases from Valley Water and San Francisco Public Utilities Commission, as well as drought-related impacts on the water supply and usage. Additionally, there is a transfer of \$8.8 million to the Water Utility Capital Fund for planned infrastructure improvements, an increase of approximately \$1 million from the prior year's levels. SJMWS estimates that the total volume of water sold during FY 2023-2024 will be similar to FY 2022-2023.

A total budgeted revenue adjustment of approximately 14% is necessary to ensure the continued operation of the water utility system, including the purchase of wholesale water. This adjustment is distributed among all customers and amounts to an 8% base increase in fixed (meter) and quantity charges, with an additional increase in quantity charges in proportion to increased wholesale water supply costs to customers in each service area and elevation zones in the Evergreen/Edenvale service area. In February 2023, Valley Water notified property owners that wholesale rates for North County groundwater may increase by 15% in FY 2023-2024, and the San Francisco Public Utilities Commission informed wholesale customers of a recommended 11.6% rate increase for FY 2023-2024. On May 9, San Francisco Public Utilities Commission adopted a 9.7% increase in wholesale water rates, and on May 16, the Valley Water board adopted a 14.5% increase in wholesale water rates. These wholesale rate adjustments were added to the retail quantity charges as a passthrough rate adjustment.

Valley Water has identified that wholesale water rates are expected to continue increasing over the next 10 years, including another projected increase of a minimum 15% in FY 2024-2025, an 11.5% increase in FY 2025-2026, followed by seven years of approximately 10% annual increases. Furthermore, wholesale rate increases may be higher than currently projected if drought conditions return, wholesaler costs continue to escalate, and/or water use during FY 2023-2024 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 2023-2024 retail water rates would negatively impact fund health and lead to exponentially higher SJMWS rate increases in subsequent years.

In April 2023, 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 starting July 1, 2023. The notice contained the maximum meter charges and water quantity rates

that would be proposed for City Council consideration and approval. The rate increase is approximately 14%; however, actual rates will vary by customer. A representative sample increase on an average residential monthly bill based on water usage of 13 Hundred Cubic Feet (HCF) with a 3/4-inch water meter in the North San Jose/Alviso service area is an additional \$17 per month, but 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 approximately \$541,000 in Arrearages Program funding and an additional \$356,000 waived in Late Payment Charges.

Local implementation of the State's Low-Income Household Water Assistance Program began in summer 2022 and is currently scheduled to end in August 2023. Under this program, eligible State residents can receive up to \$15,000 to pay their water bills. Staff will continue to monitor for any additional customer assistance programs which could be implemented and will coordinate as necessary to ensure SJMWS customers are informed of and can participate and receive additional financial support where eligible.

Despite the financial hardship some customers may be experiencing, water service continues to be an affordable public commodity. Including the proposed rate increase, customers pay approximately \$0.01 per gallon of clean drinking water.

Water conservation continues to be the best practice for reducing the impact of higher water rates and saving money. 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 use 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 Bay Area have proposed water rate increases for FY 2023-2024 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, and do not include any drought surcharges that an agency may have in effect.

<u>City/Water Agency</u>	<u>Current Monthly Bill</u>	<u>Proposed Increase</u>	<u>Proposed Monthly Bill</u>
San Francisco	\$154.22	7%	\$165.68
Palo Alto	\$142.30	7%	\$151.82
San Jose Water Company	\$135.04	10%	\$148.54
City of San José - SJMWS¹	\$126.50	13%	\$143.10
Menlo Park	\$134.66	5%	\$141.39
Milpitas	\$126.71	4%	\$131.55
Redwood City	\$128.74	N/A	\$128.74
City of San José – SJMWS²	\$111.16	14.5%	\$127.24
Mountain View	\$114.93	8%	\$124.17
Foster City	\$106.97	5%	\$112.23
Santa Clara	\$95.29	9%	\$104.13
Sunnyvale	\$93.14	4%	\$96.87
Great Oaks Water Company	\$79.90	10.5%	\$88.26

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.

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 Council Resolution 79111 (continuing in effect Resolution 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 table below, SJMWS's recycled water customers will continue to realize a significant savings over potable water even with the 14% increase to retail recycled water rates. Rate details for recycled water are provided in Attachment A.

Monthly Bill with Proposed Rates effective July 1, 2023				
Example Customers	Current Recycled Water	Proposed Recycled Water	Proposed Potable Water	% Savings
Irrigation Customer: Evergreen Zone 3/4, 450 HCF/month, 2-inch meter	\$1,925.24	\$2,196.47	\$3,500.61	37%
Industrial Customer: North San José, 11,000 HCF/month, 10-inch meter	\$46,556.00	\$53,145.97	\$92,504.64	43%

Note: 1 HCF = 748 gallons

EVALUATION AND FOLLOW-UP

Staff will return annually to the City Council with any recommended changes for the following year's rates. A supplemental memorandum will be submitted to the City Council prior to the June 6, 2023 Public Hearing to report on the number of written protests and comments received by the City Clerk's Office in response to SJMWS' rate notice. Furthermore, there is a 120-day statute of limitations to challenge any new, increased, or extended fee or charge.

COST SUMMARY/IMPLICATIONS

The FY 2023-2024 Proposed Budget operating revenues for the Water Utility Fund assume an overall 14% increase, generating approximately \$8.9 million in FY 2023-2024 to recover the full cost of operating and maintaining the SJMWS distribution system that includes increased wholesale water costs and capital infrastructure needs. For FY 2023-2024, the transfer to the Water Utility Capital Fund will increase by \$1.0 million, from \$7.8 million to \$8.8 million to appropriately invest in the utility's infrastructure. The percentage increase to budgeted revenues is not necessarily representative of a customer's water charges or representative of a monthly increase, as rates vary customer to customer.

If City Council approves a resolution changing SJMWS potable and recycled water rates and charges, as recommended in this memorandum, revenue will be generated to support increased utility operating and capital costs, and will ensure sufficient revenues to offset lower levels of revenues due to prior drought conditions and the anticipated write-off of a portion of unpaid bills incurred during the pandemic. Based on the latest information, actions to reduce the revenue estimates in 2022-2023 and 2023-2024 by a combined \$4.6 million are related to reduced water usage of approximately \$3.0 million, as well as anticipated write-offs of approximately \$1.6 million related to bad debt. Budget actions to align these revenue revisions will be brought forward as part of the Manager's Budget Addendum, *Recommended Amendments to the 2023-2024 Proposed Operating and Capital Budget*, released at the end of this month and *the 2022-2023 Year-End Clean-Ups* memorandum which will be released in June.

COORDINATION

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

PUBLIC OUTREACH

Between April 5-11, 2023, 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 6, 2023 and that there is a 120-day statute of limitations to challenge any new, increased, or extended fee or charge. Notices and FAQs were made available to potable/drinking water utility rate payers in five additional languages including Spanish, Korean, Vietnamese, Traditional Chinese, and Tagalog on the Environmental Services Department Proposed Rate Change webpage at SanJoseCA.gov/RateNotices. SJMWS published a notice in the Mercury News on May 16, 2023 and mailed a 'Where Your Dollar Goes' conservation postcard, in advance of City Council consideration of the proposed rate increases. As of May 13, 2023, the City Clerk's Office had received 140 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 Council Agenda website for the June 6, 2023 City Council meeting.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

CEQA

Statutorily Exempt, File No. PP17-005, CEQA Guidelines Section 15273, Rates, Tolls, Fares, and Charges.

HONORABLE MAYOR AND CITY COUNCIL

June 1, 2023

Subject: Municipal Water System Potable (Drinking) and Recycled Water Rates and Charges

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PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/

KERRIE ROMANOW

Director, Environmental Services

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

Attachment A - Proposed Rate Schedule

ATTACHMENT A
PROPOSED RATE SCHEDULE

Table 1: Monthly Meter Charge – Potable and Recycled Water

MONTHLY METER CHARGE <i>(based on meter size)</i>		
Meter Size	2022-23 Charges	New Charges Effective July 1, 2023
5/8-inch	\$35.37	\$38.19
3/4-inch	\$35.37	\$38.19
1-inch	\$62.54	\$67.54
1.5-inch	\$107.80	\$116.42
2-inch	\$162.14	\$175.11
3-inch	\$334.17	\$360.90
4-inch	\$587.71	\$634.72
6-inch	\$1,284.91	\$1,387.70
8-inch	\$2,190.36	\$2,365.58
10-inch	\$3,458.00	\$3,734.64

Table 2: Potable Monthly Quantity Charge

MONTHLY QUANTITY CHARGE <i>(per HCF*)</i>		
Service Area/Zone	2022-23 Charges	New Charges Effective July 1, 2023
Evergreen/Edenvale – Zone 1	\$5.83	\$6.85
Evergreen/Edenvale – Zone 2	\$5.95	\$6.98
Evergreen/Edenvale – Zone 3/4	\$6.33	\$7.39
Evergreen/Edenvale – Zone 5/6	\$6.81	\$7.91
North San José/Alviso	\$7.01	\$8.07
Coyote	\$2.60	\$2.81

Table 3: Potable Bimonthly Private Fireline Charge

BIMONTHLY PRIVATE FIRELINE CHARGE		
Service Size	2022-23 Charges	New Charges Effective July 1, 2023
2-inch	\$23.73	\$25.63
3-inch	\$35.58	\$38.43
4-inch	\$47.43	\$51.23
6-inch	\$71.13	\$76.83
8-inch	\$94.83	\$102.42
10-inch	\$118.55	\$128.04

ATTACHMENT A

Table 4: Recycled Monthly Quantity Charge

	2022-23 Charges	New Charges Effective July 1, 2023
Monthly Quantity Charge (per HCF*)	\$3.918	\$4.513

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