



## Finance Committee Staff Report

From: City Manager  
Report Type: ACTION ITEMS  
Lead Department: Utilities

Meeting Date: April 23, 2024  
Staff Report: 2402-2604

### TITLE

Finance Committee to Review and Recommend that City Council Adopt a Resolution Approving the Fiscal Year 2025 Water Utility Financial Plan, and Increase Water Rates by Amending Rate Schedules W-1 (General Residential Water Service), W-2 (Water Service From Fire Hydrants), W-3 (Fire Service Connections), W-4 (Residential Master-Metered and General Non-Residential Water Service), and W-7 (Non-Residential Irrigation Water Service) as Recommended by the Utilities Advisory Commission

### RECOMMENDATION

Staff recommends the Finance Committee review the Utilities Advisory Commission (UAC) recommendation and recommend the City Council adopt a resolution (Attachment A) for the FY 2025 Water Utility rates:

1. Approving the Fiscal Year (FY) 2025 Water Utility Financial Plan (Attachment A, Exhibit 1); and
2. Amending the following rate schedules to reflect increases effective July 1, 2024 (FY 2025) (Attachment A, Exhibit 2):
  - a. W-1 General Residential Water service,
  - b. W-2 Water Service from Fire Hydrants,
  - c. W-3 Fire Service Connections,
  - d. W-4 Residential Master-Metered and General Non-Residential Water Service, and
  - e. W-7 Non-Residential Irrigation Water Service

### EXECUTIVE SUMMARY

The City's water rate schedules consist of a volumetric charge for each CCF (100 Cubic Feet or 748 gallons) of water consumed during the billing period and a monthly service charge for each customer, based on water meter size. The volumetric charge has two parts: a wholesale commodity rate (or San Francisco Public Utilities Commission or SFPUC wholesale rate), and a customer volumetric rate. Water rates are designed to recover the City's costs of buying and distributing water while maintaining adequate financial reserves. The customer volumetric rate and the monthly service charge together are considered the distribution rates; revenue from those rates pay for the upkeep of Palo Alto's distribution system. Revenue from the wholesale commodity rate pays for the City's cost of buying water from the SFPUC.

The fiscal year (FY) 2025 Water Utility Financial Plan includes projections of the utility's costs and revenues for FY 2024 through FY 2029. The Financial Plan anticipates costs will rise by about 5.9% per year on average over the next several years. Due to the drought and water conservation efforts together with near record-setting precipitation and snowpack in the winter of 2022-2023, the water utility's sales revenue declined in FY 2023 by \$4.864 million or 10% compared with sales revenue in FY 2021. Funding from the Operations Reserve together with a \$3 million transfer from the Rate Stabilization Reserve to the Operations Reserve offset the revenue declines. Net of supply cost savings, water sales were \$2.4 million lower than forecasted. Demand recovery is projected to be slow, and as occurred following prior droughts, some conservation is projected to be permanent.

The Water Utility used available reserves to hold rates flat for two years (FY 2021 and FY 2022) and manage two years of drought-related sales revenue reductions so far (FY 2022 and FY 2023). The attached Financial Plan uses reserve funding from the Operations Reserve, Rate Stabilization Reserve and CIP Reserve together with rate increases to manage the continuing decreased sales revenue and increasing costs throughout the planning period. While these rate increases can be perceived as decreasing the benefit of conservation, bills for customers who conserve will be lower in the future than they would have been without conservation. Without the use of the Rate Stabilization Reserve in FY 2024 and FY 2025, water distribution rate increases of at least 22% would be needed in FY 2025. This Financial Plan projects that the Rate Stabilization Reserve will be exhausted by the end of FY 2026 and begin to be refilled in FY 2029.

Customers have a separate commodity rate for purchased water from the San Francisco Public Utilities Commission (SFPUC) relative to the rest of the distribution-related portion of the volumetric rates. This commodity charge was passed-through to customers for a five year period from July 1, 2020 through June 30, 2024 ([Resolution 9844<sup>1</sup>](#)). The commodity rate is currently \$5.21 per hundred cubic feet (CCF) and will increase to \$5.55 on July 1, 2024, according to SFPUC's February 15, 2024 forecast. The SFPUC will not determine its final wholesale customer rate for FY 2025 until May or June 2024. The Prop 218 process will be followed to request Council approval to increase the commodity rate in accordance with SFPUC's projections on July 1, 2024. Additionally, a recommendation for Council approval to re-authorize the pass-through provision for the water commodity charge for another five-year period from 2024 through 2029<sub>2</sub> for possible future commodity charge increases during that time period.

## **BACKGROUND**

Every year staff presents the UAC with Financial Plans for the Electric, Gas, Water, and Wastewater Collection Utilities. The Financial Plans recommend rate adjustments required to maintain the financial health of these enterprises. These Financial Plans include a comprehensive overview of the operations of each enterprise, both retrospective and prospective, and are intended to be a reference for UAC and Council members as they review the budget and rate recommendations. Each Financial Plan also contains a set of Reserve Management Practices describing the reserves for each utility and the management practices for those reserves.

All of the City's potable water comes from the SFPUC's Hetch Hetchy Regional Water System or Regional Water System. This same system serves San Francisco and other Bay Area cities. San

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<sup>1</sup> Resolution 9844 <https://www.cityofpaloalto.org/files/assets/public/v/1/city-clerk/resolutions/reso-9844.pdf?t=69020.51>

Francisco operates the system, but as much as two thirds of the water is used outside of San Francisco by 26 cities, water districts, and private utilities. These agencies, including the City, are frequently referred to as the “wholesale customers” (as compared to the SFPUC’s “retail customers” in San Francisco). The Bay Area Water Supply and Conservation Agency (BAWSCA) represents the water supply and conservation interests of wholesale customers and negotiates with the SFPUC on their behalf. BAWSCA also ensures contract compliance through regular review of the SFPUC’s accounting and capital expenditures.<sup>2</sup>

The Water Utility has two main costs: water supply costs (primarily the cost of water delivered to Palo Alto from the Regional Water System) and the costs of operating the distribution system (the system of pipes, pumps, reservoirs, and other infrastructure that carries water to Palo Alto customers). Both cost components have been increasing and are expected to continue to increase.

For many years, the largest cost increases have been on the water supply side. This is due primarily to major capital investments the SFPUC has made since 2010, which were undertaken partly due to pressure from wholesale customers. The Water System Improvement Program (WSIP) is a \$4.8 billion capital improvement program, one of the largest in the country, to rehabilitate and seismically strengthen the lower portions of the Regional Water System. One of the goals is to achieve the capability to return to service within 24 hours after a major earthquake. Although much of the work is complete, some of the projects are still under construction and bond financing of WSIP projects over the next several years will continue to drive wholesale rates up. The program has greatly improved the resiliency of the Hetch Hetchy Regional Water System but has also led water supply costs to approximately double. Additionally, reduced regional water demand as a result of drought and drought rebound together with relatively wet weather in 2023 has put upward pressure on wholesale rates. The third driver of wholesale rate increases is the wholesale customer balancing account; SFPUC used a balance in this account owed to wholesale customers to hold rates constant for five years and mitigate the need for rate increases during the drought. However, the account is projected to have a \$23.7 million balance owed to the City of San Francisco by the end of the current fiscal year.

CPAU’s operational costs for the water utility have increased by approximately 6.5% per year over the last five years; Resource Management, Customer Service, and Operations and Maintenance costs were the primary reasons for the increase. Capital costs have fluctuated from year to year and are projected to increase due to construction inflation as well as one-time capital needs to replace or rehabilitate two reservoirs. This Financial Plan projects increases in capital and operational costs that align similarly with the City’s Budget and Long-Range Financial Forecast and average approximately 4% - 6% per year over the next five years.

## **ANALYSIS**

The financial position of the City’s water utility is assessed annually to plan for adequate revenue to fund operations, in compliance with the cost of service requirements set forth in the California Constitution (Proposition 218). This includes making long-term projections of market conditions, the physical condition of the system, and other factors that could affect utility costs, and setting rates adequate to recover these costs. The current rate proposals are also based on

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<sup>2</sup> For a video summary of BAWSCA’s activities, see <https://vimeo.com/283596665/5619ce2c11>

the cost of service (COS) methodology in the 2019 report by Raftelis Financial Consultants titled “Proposed FY 2020 Water Rates,” (see [Attachment Q<sup>3</sup>](#) to staff report 10295<sup>4</sup>), which updated methodology originally described in the 2012 *Palo Alto Water Cost of Service & Rate Study*, and its subsequent updates in 2015

#### Proposed Actions

1. Increase rates for Rate Schedules W-1 (General Residential Water service), W-2 (Water Service from Fire Hydrants), W-3 (Fire Service Connections), W-4 (Residential Master-Metered and General Non-Residential Water Service), and W-7 (Non-Residential Irrigation Water Service); and
2. Transfer up to \$3.461 million from the CIP Reserve to the Operations Reserve in FY 2024.
3. Transfer up to \$2.069 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2024.

The FY 2024 Water Utility Financial Plan describes these proposed actions in detail. Tables 1 through 4 below illustrate the current and proposed water distribution rates under the attached Financial Plan. The rates shown below are exclusive of the commodity rate charged to customers based on SFPUC supply charges. The commodity rate is currently \$5.21 per CCF. SFPUC’s proposed rate increase in FY 2025 is \$5.55 per CCF (6.5% increase); the current rate would increase on or around July 1, 2024. SFPUC is also proposing to increase the SFPUC meter charge but has not yet finalized the impacts on that charge.

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<sup>3</sup> Attachment Q <https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmr/attachments/attachment-q-6055187-water-cosa.pdf?t=48180.98>

<sup>4</sup> Staff Report 10295 <https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmr/year-archive/2019/id-10295-mini-packet-06.04.2019.pdf>

**Table 1: Current and Proposed Water Consumption Charges**

	Current (7/1/2023)	Proposed (7/1/2024)	Change (\$/CCF)	Change (%)
W-1 (Residential) Volumetric Rates (\$/CCF)				
Tier 1 Rates	2.72	3.07	0.35	13%
Tier 2 Rates	6.33	7.15	0.82	13%
W-2 (Construction) Volumetric Rates (\$/CCF)				
Uniform Rate	3.83	4.32	0.49	13%
W-4 (Commercial) Volumetric Rates (\$/CCF)				
Uniform Rate	3.83	4.32	0.49	13%
W-7 (Irrigation) Volumetric Rates (\$/CCF)				
Uniform Rate	5.83	6.58	0.75	13%

Table 2 and **Error! Reference source not found.** Table 3 show the current monthly service charges for rate schedules W-1, W-4 and W-7.

**Table 2: Current and Proposed Monthly Service Charges for Residential W-1**

Meter Size	Monthly Service Charge (\$/month based on meter size)		Change	
	Current (7/1/2023)	Proposed (7/1/2024)	\$	%
5/8"	21.48	24.27	2.79	13%
3/4"	21.48	24.27	2.79	13%
1"	21.48	24.27	2.79	13%
1 ½"	69.38	78.39	9.01	13%
2"	107.32	121.27	13.95	13%
3"	227.48	257.05	29.57	13%
4"	404.56	457.15	52.59	13%
6"	828.27	935.94	107.67	13%
8"	1,523.92	1,722.02	198.10	13%
10"	2,409.29	2,722.49	313.20	13%
12"	3,168.19	3,580.05	411.86	13%

**Table 3: Current and Proposed Monthly Service Charges for W-4 and W-7**

Meter Size	Monthly Service Charge (\$/month based on meter size)		Change	
	Current (7/1/2023)	Proposed (7/1/2024)	\$	%
5/8"	18.78	21.22	2.44	13%
3/4"	25.11	28.37	3.26	13%
1"	37.76	42.66	4.90	13%
1 ½"	69.38	78.39	9.01	13%
2"	107.32	121.27	13.95	13%
3"	227.48	257.05	29.57	13%
4"	404.56	457.15	52.59	13%
6"	828.27	935.94	107.67	13%
8"	1,523.92	1,722.02	198.10	13%
10"	2,409.29	2,722.49	313.20	13%
12"	3,168.19	3,580.05	411.86	13%

Table 4 shows the current and proposed monthly service charges for rate schedule W-3.

**Table 4: Current and Proposed Monthly Service Charges for Fire Services (W-3)**

Meter Size	Monthly Service Charge (\$/month based on meter size)		Change	
	Current (7/1/2023)	Proposed (7/1/2024)	\$	%
2"	4.42	4.99	0.57	13%
4"	27.38	30.93	3.55	13%
6"	79.51	89.84	10.33	13%
8"	169.45	191.47	22.02	13%
10"	304.74	344.35	39.61	13%
12"	492.24	556.23	63.99	13%

### Bill Impact of Proposal

Table 5 and Table 6 show the impact of the proposed July 1, 2024 rate changes on the median residential, commercial and irrigation bills including the SFPUC commodity pass-through rate increase of 6.5% or \$5.55 per CCF. The bill increases shown in Table 6 vary by usage because the SFPUC increase per CCF differs from the distribution rate increases.

**Table 5: Impact of Proposed Water Rate Changes on Residential Bills**

Usage (CCF/mo.)	Bill under Current Rates (7/1/2023)	Bill under Proposed Rates (7/1/2024)	Change	
			\$/mo.	%
<b>4</b>	\$53.20	\$58.75	\$5.55	10%
<b>(Winter median) 7</b>	\$80.60	\$88.69	\$8.09	10%
<b>(Annual median) 9</b>	\$103.68	\$114.09	\$10.41	10%
<b>(Summer median) 14</b>	\$161.38	\$177.59	\$16.21	10%
<b>25</b>	\$288.32	\$317.29	\$28.97	10%

**Table 6: Impact of Proposed Water Rate Changes on Commercial Bills**

Usage (CCF/mo.)	Bill under Current Rates (7/1/2023)	Bill under Proposed Rates (7/1/2024)	Change	
			\$/mo.	%
Commercial (W-4) (5/8" meters)				
(Annual median) 12	\$127.26	\$139.66	\$12.40	10%
(Annual average) 64	\$597.34	\$652.90	\$55.56	9%
Irrigation (W-7) (1 ½" meters)				
(Winter median) 9	\$168.74	\$187.56	\$18.82	11%
(Summer median) 37	\$477.86	\$527.20	\$49.34	10%
(Winter average) 56	\$687.62	\$757.67	\$70.05	10%
(Summer average) 199	\$2,266.34	\$2,492.26	\$225.92	10%

Projections reflect the expected median quantities of water use to decrease from pre-drought levels, however, as calls for water conservation continue. Customers who conserve will experience less of a bill increase than those customers who are not reducing water consumption.

#### FY 2025 Financial Plan's Projected Rate Adjustments for the Next Five Fiscal Years

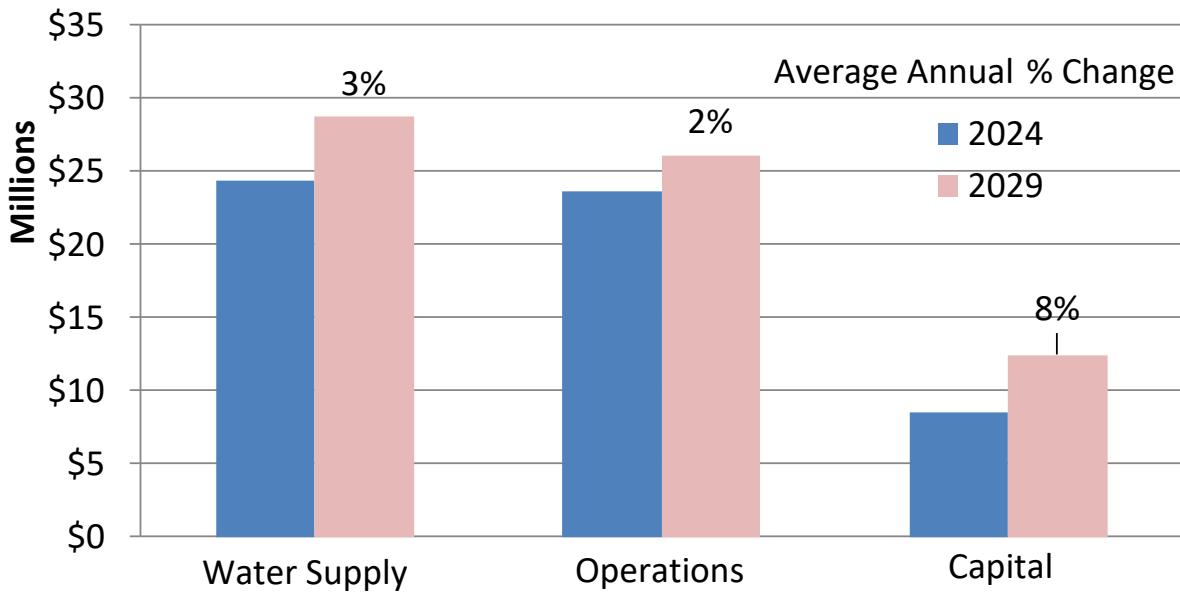
Table 7 shows the projected rate adjustments over the next five years and their impact on the annual median residential water bill for 5/8" customers. These projected rate adjustments include the impact of the commodity rate increasing consistent with SFPUC's rate projection from the February 15, 2024 Wholesale Customer meeting which forecasted a 6.5% in FY 2025 to \$5.55 per CCF followed by 1.4% in FY 2026, 5.3% in FY 2027, 7.4% in FY 2028 and 3.6% in FY 2029.

**Table 7: Projected Rate Adjustments, FY 2025 to FY 2029 (5/8" meter)**

Fiscal Year	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Water Utility	10%	8%	11%	11%	5%
Estimated Monthly Bill	\$114.09	\$123.78	\$137.45	\$152.35	\$160.12
Estimated Bill Impact (\$/mo) <sup>1</sup>	\$10.41	\$9.69	\$13.67	\$14.90	\$7.77
<i>1) estimated impact on median monthly residential water bill for customers with 5/8" meter, which is currently \$103.68.</i>					

Figures 1 and 2 below illustrate the projected increases in the Water Utility's costs between FY 2024 and FY 2029. Capital shown for FY 2024 includes an average of FY 2024 and FY 2023 and reflects CIP dollars budgeted in prior years carried forward to FY 2024. Capital costs are increasing more than supply and operations due to the replacement or rehabilitation of two reservoirs.

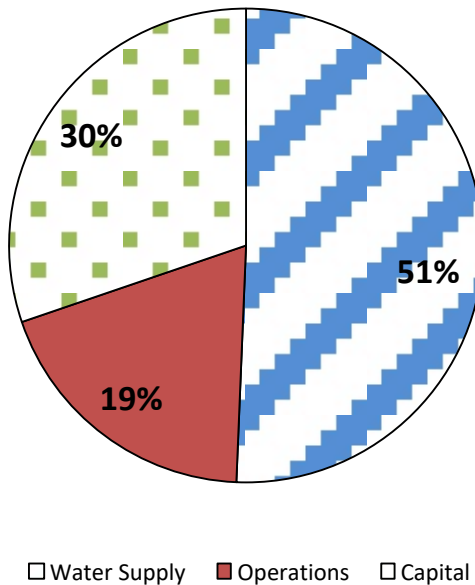
**Figure 1: Projected FY 2024 and FY 2029 costs**





**Figure 2: Percentage of Total Cost Increase From FY 2024 to FY 2029  
Attributed to Supply, Capital, and Operations Costs**

**Contribution to FY 2024 to FY 2029  
Cost Increases by Source**



**Water Supply Costs**

The cost of water is a major driver for the increase in the Water Utility's costs (and therefore rates) in FY 2025. Wholesale water costs are adopted by the SFPUC, and generally have changed on an annual basis. The SFPUC is currently engaged in a \$4.8 billion Water System Improvement Program (WSIP) for regional projects. As of June 30, 2023, 99.2% of the WSIP regional construction contracts are complete.<sup>6</sup> WSIP will continue to result in large increases in the annual debt service costs assigned to wholesale customers like Palo Alto. After each WSIP project is completed, wholesale customers must start paying the debt service costs within 3 to 4 years. For most of those costs, funded with bond financing, the costs will be paid off over approximately 30 years.

As the SFPUC completes WSIP projects, the SFPUC is pursuing a suite of other capital improvement work; dam safety improvements and Mountain Tunnel (a critical piece of infrastructure used to move water from the Hetch Hetchy Reservoir to the Bay Area) repairs are rate increase drivers during the next 10-year timeframe. Future and in-progress construction work will require bond funding.

**BAWSCA Revenue Bond Refunding**

On January 5, 2023, BAWSCA completed the settlement of BAWSCA's revenue bond series 2023A

to refund bonds issued in 2013 at a lower rate. BAWSCA locked-in the bond rates in October 2021 at an all-in true interest rate of 2.06%. The refunding bond transaction will generate approximately \$27.1 million in net present value savings over the term of the bonds, or an average of approximately \$2.5 million of savings per year for all Wholesale Customers, starting in fiscal year 2022-23. The estimated net present value of savings per year for Palo Alto is approximately \$175,000.

### Capital Projects & Reserves

The capital budget includes one-time seismic water system upgrades and/or replacements for the Park and Dahl reservoirs to improve earthquake resiliency. This work will improve protection from water loss at these reservoirs in a seismic event.

The attached Financial Plan also updates the transfer proposals due to project cost increases and available reserve balances. For CIP, the Financial Plan assumes funding from rates will cover \$7.461 million of planned CIP in FY 2024. This figure is the portion of planned CIP in FY 2024 that will not be paid for through funds collected in prior years (the FY 2024 Capital budget, less funds available in the Reappropriations and Commitments Reserves at FY 2023 year's end), shown in line 13 of Table 9 for FY 2024. This capital budget is projected to be funded by the capital program contribution of \$4 million in FY 2024 together with \$3.461 million from the CIP Reserve. Because withdrawals from the CIP Reserve for use on capital projects require Council action,<sup>7</sup> staff requests Council approval to transfer up to \$3.461 million from the CIP Reserve to the Operations Reserve. The need for each of the transfers will be re-evaluated once the year-end reserve balances for FY 2024 are known. The capital program contribution is lower than in future years because reservoir rehabilitation project moved from FY 2024 to FY 2028 which delayed the need for approximately \$6 million of the capital funding by four years. Figure 3 shows the CIP Reserve year-end balances.

**Figure 3: Actual FY 2023 and Projected Capital Reserve Balances FY 2024 to FY 2029**

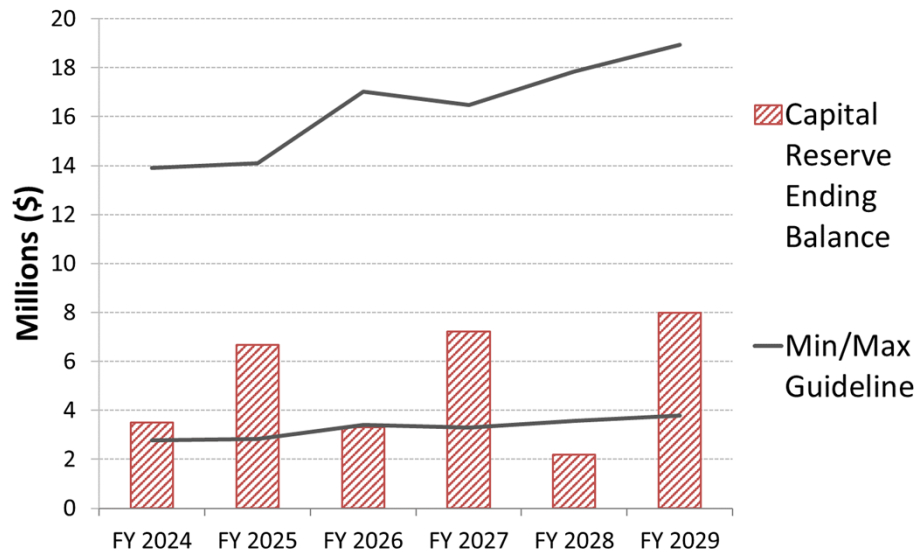
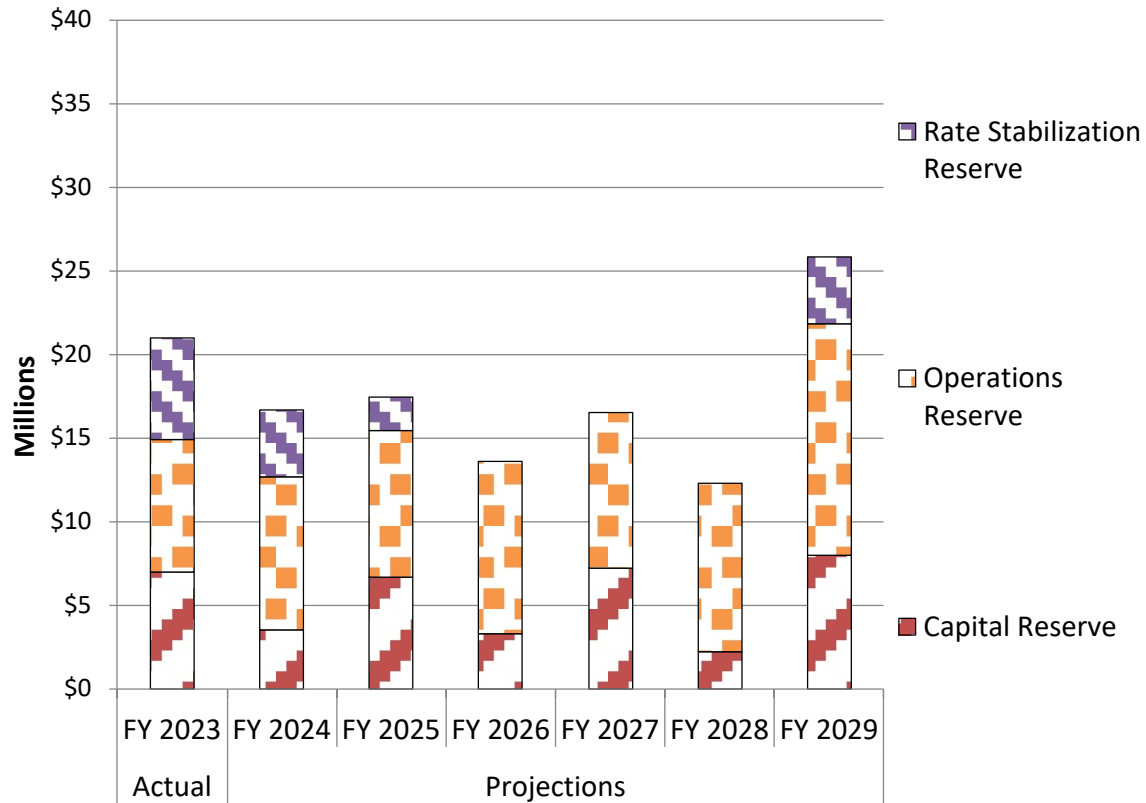


Figure 4 illustrates the year-end reserve balances for FY 2023 (actual) and projected through FY 2029. Although the CIP Reserve drops below the minimum guideline range in FY 2028, this is temporary and is due to one-time reservoir replacement as one of the planned reservoir seismic upgrades. The CIP Reserve returns to within the guideline in the following year and in all future years. In accordance with the Water Utility Reserves Management Practices Section 5(c) (included as Appendix C to the attached Financial Plan), the Council may approve a plan to address a CIP Reserve below the minimum level within one or more years.

Water Utility Operation Reserve levels remain within guideline ranges at year-end FY 2023: the CIP Reserve ending balance was \$6.961 million and the Operations Reserve year-end balance for FY 2023 was \$7.957 million. There is also \$6.069 million available in the Rate Stabilization Reserve at year-end FY 2023. This Financial Plan uses reserve funding (from the Operations Reserve, Rate Stabilization Reserve and CIP Reserve) together with rate increases to manage the decreased sales revenue and increasing costs from FY 2025 through FY 2029.

**Figure 4: Actual Reserve Levels for FY 2023 and Projections through FY 2029**



#### Rate Stabilization Reserve

Rate Stabilization Reserve balances are used to buffer the impact of current and anticipated future rate increases. A transfer of \$2.069 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2024 and \$2 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2025, and in FY 2026 are forecasted. Utilizing the Rate Stabilization Reserve balances in this manner, along with the cost and revenue projections outlined in this Financial Plan, is anticipated to minimize the potential water distribution rate increases to a level lower than they would be otherwise. This approach allows for smoothing of rate increases across multiple years and ensures ongoing funding of crucial capital projects. This Financial Plan projects that the Rate Stabilization Reserve will be exhausted by the end of FY 2026 (see line 7 in Table 9).

**Table 9: Operations & Unassigned, Rate Stabilization and CIP Reserves Starting and Ending Balances, Revenues, Transfers To/(From) Reserves and Capital Program Contribution To/(From) Reserves Projected for FY 2024 to FY 2029 (\$000)**

		FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
	<b>Starting Balance</b>						
(1)	Operations/Unassigned	7,957	9,180	8,799	10,267	9,333	10,089
(2)	Rate Stabilization	6,069	4,000	2,000	-	-	-
(3)	CIP	6,961	3,500	6,679	3,312	7,233	2,190
	<b>Revenues</b>						
(4)	Total Revenue	49,904	55,887	61,743	67,713	74,059	76,834
(5)	Transfers In	342	353	363	373	389	400
	<b>Transfers</b>						
(6)	Operations/Unassigned	3,040	2,000	600	(6,100)	(6,500)	(4,000)
(7)	Operating Commitments	(971)	-	-	-	-	-
(8)	Rate Stabilization	(2,069)	(2,000)	(2,000)	-	-	4,000
(9)	CIP	-	-	1,400	6,100	6,500	-
	<b>Capital Program Contribution</b>						
(10)	Operations/Unassigned	(4,000)	(9,000)	(9,486)	(9,998)	(11,790)	(12,427)
(11)	CIP	4,000	9,000	9,486	9,998	11,790	12,427
	<b>Expenses</b>						
(12)	Total Expenses other than CIP	(46,341)	(49,141)	(50,991)	(52,157)	(54,631)	(56,252)
(13)	Planned CIP	(7,461)	(5,821)	(14,253)	(12,177)	(23,334)	(6,627)
(14)	Transfers Out	(1,721)	(480)	(761)	(765)	(770)	(775)
	<b>Ending Balance</b>						
(1)+(4)+(5)+(6)+(10)+(12)+(14)	Operations/Unassigned	9,180	8,799	10,267	9,333	10,089	13,869
(2)+(8)	Rate Stabilization	4,000	2,000	-	-	-	4,000
(3)+(9)+(11)+(13)	CIP	3,500	6,679	3,312	7,233	2,190	7,989
	<b>Operations Reserve Guideline Levels</b>						
(15)	Minimum Guideline Level	7,901	8,157	8,507	8,700	9,107	9,374
(16)	Maximum Guideline Level	15,801	16,314	17,014	17,399	18,214	18,749

\* Planned CIP (item 13) is reflected as an expense in the CIP Reserve and does not include CIP funded through Reappropriations or Commitments reserves. This will be funded with the \$4 million Capital Program Contribution (item 11) and \$3.461 million from the CIP Reserve.

### Water Bill Comparison with Surrounding Cities

Table 10 compares water bills for residential customers to those in surrounding communities as of January 2024 (under current the City's current water rates). Palo Alto customers have some of the highest monthly bills of the group, although bills for smaller water users are lower than in some surrounding communities. The bill difference between Palo Alto and neighboring communities has decreased over the past several years as other agencies invest more in capital improvement. It is unclear at this time what water rate changes may be implemented in surrounding communities for FY 2025. The average community rate calculated in the following table is the mean of the six surrounding communities listed. These communities are the same six that Palo Alto compares itself to in the annual budget across Water, Wastewater, Gas and Electric industries.

**Table 10: Residential Monthly Water Bill Comparison**

Usage (CCF/month)	Residential monthly bill comparison (\$/month)* As of February 2024							
	Palo Alto	Menlo Park	Mountain View	Hayward	Redwood City	Santa Clara	Los Altos	Average of Surrounding Communities
4	\$53.20	\$65.20	\$46.95	\$45.17	\$64.16	\$31.88	\$58.71	\$52.01
(Winter median) 7	80.60	91.00	72.69	69.59	86.27	55.79	79.51	75.81
(Annual median) 9	103.68	108.19	89.85	85.87	112.31	71.73	93.38	93.55
(Summer median) 14	161.38	155.10	132.75	135.87	180.22	111.58	131.23	141.12
25	288.32	271.23	278.63	245.87	340.49	199.25	233.01	261.41

\*Based on the FY 2013 BAWSCA survey, the percentage of SFPUC as the source of potable water supply was 100% for Palo Alto, 95% for Menlo Park, 100% for Redwood City, 87% for Mountain View, 10% for Santa Clara and 100% for Hayward. Los Altos does not receive water supply from SFPUC.

Palo Alto purchases all of its potable water from the SFPUC, whereas some of the other surrounding communities utilize groundwater or other water sources that currently cost less per unit. SFPUC has invested approximately \$4.8 billion in improvements to the Regional Water System. Palo Alto benefits from these upgrades through more reliable, higher quality and seismically resilient water facilities that transport water to the Bay Area.

#### Changes from Last Year's Financial Plan

Table 11 shows rate projections from the last two Financial Plans for FY 2023 and FY 2024 as well as the impact of SFPUC's wholesale rate increase projections when combined with Palo Alto's distribution rate increase.

**Table 11: Proposed and Projected Water Revenue Changes for FY 2024 to FY 2028**

Projection	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
FY 2025 Plan (Current)	10%	8%	11%	11%	5%
FY 2024 Plan	4%	3%	4%	6%	-
FY 2023 Plan	3%	2%	0%	-	-

Table 12 shows the FY 2025 Plan proposed water rate increases across the five-year forecast period through FY 2029, separated out by increases to commodity revenues to cover the costs of purchasing water from SFPUC (Table 12 line 1), and by the distribution revenue increases necessary to pay for the upkeep of Palo Alto's water distribution system (Table 12 line 2). Key changes are the commodity increases projected by SFPUC, and for distribution rates, the reduced water sales in Palo Alto and cost increases both in operating and capital costs over the forecast period.

**Table 12: Proposed Commodity and Distribution Water Rate Changes FY 2025 to FY 2029**

Projection	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Commodity Rate (SFPUC Wholesale Rate increases to \$5.43 in FY 2025)	7%	1%	5%	7%	4%
Distribution Rate	13%	14%	15%	13%	6%
Total Rate	10%	8%	11%	11%	5%

This plan uses the Rate Stabilization Reserve to stabilize rates while anticipating 6.5% wholesale water rate increase in FY 2025 and funding needed for critical water CIP budgets.

#### **FISCAL/RESOURCE IMPACT**

Estimated revenue for the Water Utility in FY 2025 is projected to increase approximately 10% (\$4.9 million) as a result of the proposed rate increases. The FY 2025 Budget is being developed concurrent with these rates and, depending on the final rates, adjustments to the budget may be necessary. See the FY 2025 Water Utility Financial Plan for a more comprehensive overview of the projected cost and revenue changes for the next five years.

#### **STAKEHOLDER ENGAGEMENT**

Preliminary proposals were discussed with the Utilities Advisory Commission (UAC) and Finance Committee in January and February 2024, respectively, and the FY 2025 Financial Plan was reviewed with the UAC in March 2024. The UAC voted unanimously to recommend that the Council adopt a resolution approving the financial plan, including the rate increases described in this staff report and attached resolution. Assuming the Finance Committee supports the proposed rate adjustments, notification of the potential rate increases will be sent to customers as required by Article XIID of the State Constitution (added by Proposition 218) expected in April 2024. The City Council will consider the proposed Financial Plans and amended rate schedules with the FY 2025 budget, expected in June, at which time the public hearing required by Article XIID of the State Constitution will be held.

#### **ENVIRONMENTAL REVIEW**

The Finance Committee's review and recommendation to Council on the FY 2025 Water Financial Plan and rate adjustments does not meet the definition of a project requiring California Environmental Quality Act (CEQA) review under Public Resources Code Section 21065 thus no environmental review is required.

#### **ATTACHMENTS**

Attachment A: Water FY 25 Resolution

Attachment A Exhibit 1: Water Financial Plan FY25

Attachment A Exhibit 2: Water Rate Schedule FY25

#### **APPROVED BY:**

Dean Batchelor, Director of Utilities