



## Finance Committee Staff Report

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

**Meeting Date: April 23, 2024**  
Staff Report:2402-2603

### TITLE

Recommendation to the City Council to Adopt a Resolution: 1) Approving the FY 2025 Wastewater Collection Utility Financial Plan, Including Approval of a Short-Term Loan from the Fiber Optics Fund Reserve to the Wastewater Collection Fund Operations Reserve for FY 2024 and 2) Amending Rate Schedules S-1 (Residential Wastewater Collection and Disposal), S-2 (Commercial Wastewater Collection and Disposal), S-6 (Restaurant Wastewater Collection and Disposal) and S-7 (Commercial Wastewater Collection and Disposal – Industrial Discharger).

### RECOMMENDATION

The Utilities Advisory Commission and Staff request that the Finance Committee recommend that the City Council adopt a resolution (Attachment A):

1. Approving the Fiscal Year (FY) 2025 Wastewater Collection Financial Plan (Attachment A, Exhibit 1), including approval of a short-term loan from the Fiber Optics Fund Reserve to the Wastewater Collection Fund Operations Reserve not to exceed \$3,000,000 for FY 2024; and
2. Increasing Wastewater Collection Utility Rates Via the Amendment of Rate Schedules S-1 (Residential Wastewater Collection and Disposal), S-2 (Commercial Wastewater Collection and Disposal), S-6 (Restaurant Wastewater Collection and Disposal) and S-7 (Commercial Wastewater Collection and Disposal – Industrial Discharger) (Attachment A, Exhibit 2).

### EXECUTIVE SUMMARY

The fiscal year (FY) 2025 Wastewater Collection Utility Financial Plan (Attachment A, Exhibit 1) includes projections of the utility's costs and revenues through FY 2029. The Financial Plan anticipates costs will rise over the forecast horizon due to increasing treatment costs related to capital improvements and operational costs at the Regional Water Quality Control Plant (RWQCP), as well as increasing collection system operational and Capital Improvement Program (CIP) costs.

In 2023, the Council approved the first in a series of rate increases which incorporated expected costs for the City to accelerate its rate of sewer main replacements from 1 mile to 2.5 miles per

year by FY 2026 (implemented as a major sewer replacement project of 5 miles every other year). The accelerated rate of main replacement was calculated to replace all aging sewer mains within 8 years beyond their 100-year life expectancy. Additionally, in FY 2023 the Wastewater Utility accelerated by a year the most expensive sewer main replacement that the utility has ever completed ([Staff Report 2301-0808](#)<sup>1</sup>, May 8, 2023 approving contract for Sanitary Sewer Replacement Project 31, WC-19001 for \$8.36 million). Council approved transfers of all funds from the CIP Reserve (\$3.178 million) and from the Rate Stabilization Reserve (\$0.34 million) to the Operations Reserve to utilize all available funds to accelerate construction in coordination with Caltrans' repaving plans for the affected section of El Camino. Staff projected that expenditures related to Sanitary Sewer Replacement Project 31 would bring the Operations Reserve temporarily down to the minimum guideline range.

However, in FY 2023, costs were higher than forecasted, primarily for CIP-related costs (e.g., construction cost, CIP allocated costs, salaries and benefits not assigned to a specific CIP project) and transfers out to capital projects. Concurrently, revenue was lower than forecasted (primarily capacity fee revenue) and as a result, the Operations Reserve ended the year with a negative balance of \$0.7 million. Additionally, in the current year, the Wastewater Utility increased rates by 9% for non-residential customers, however revenues (other than restaurants) are projected to decline by 4% from FY 2023. This may be due to wet weather and reductions in winter water usage.

In an effort to increase the currently low reserve levels, staff recommends a 15% rate increase in FY 2025, which is equivalent to \$7.29 per month per residential customer. This proposal would include proceeding with a reduced-size main replacement in FY 2026 of 1.25 miles instead of 5 miles due to the low reserve and revenue levels. This would allow the highest priority mains to be replaced while allowing the reserves to gradually replenish before the next major project. The 5-mile sewer main replacement every other year would resume with construction scheduled in FY 2028. With this schedule of main replacement, the last remaining sewer main would be 110 years old at the time it is replaced instead of 108 years old.

Staff presented a 9% preliminary wastewater rate increase to the Utilities Advisory Commission<sup>2</sup> (UAC) in January. Commissioners suggested staff consider a higher rate increase to reduce the amount of capital deferral and to restore reserve balances. Commissioners noted Palo Alto's favorable sewer rates compared with neighboring agencies, the need to address low reserve levels, and the need to not further defer capital. Staff presented the 15% rate increase included in this staff report to the Finance Committee in February and to the UAC in March; Finance Committee members expressed support for the proposal and the UAC voted unanimously to approve the proposal. Nevertheless, to provide an alternative for the Finance Committee and Council to consider, the attached Financial Plan includes an alternative with a 9% rate increase each year that considers fully deferring sewer main replacement until FY 2028. This alternative

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<sup>1</sup> UAC [Staff Report 2309-2080](#) January 3, 2024 <https://www.cityofpaloalto.org/files/assets/public/v/2/agendas-minutes-reports/agendas-minutes/utilities-advisory-commission/archived-agenda-and-minutes/agendas-and-minutes-2024/01-jan-2024/01-03-2024-packet.pdf>

would provide below minimum reserves and sufficient funding for the last remaining sewer main to be 111 years old at the time it is replaced while maintaining Palo Alto's rates below the rates of neighboring agencies. Given the low reserves, and the projected levels of revenue and expenses, there is a risk that the short-term need for cash will exceed available cash in FY 2024 and/or FY 2025. Both the staff recommendation and the alternative assume of a potential short-term loan from the Fiber Optics Fund Reserve to the Wastewater Collection Fund Operations Reserve not to exceed \$3,000,000 for FY 2024. Operating wastewater assets past their useful life increases the likelihood of substantial pipe failures potentially resulting in additional repair and maintenance costs, sanitary sewer overflows, sinkholes, or other catastrophic impacts. Both of the alternative rate increases and their associated infrastructure delays presented here attempt to minimize ratepayer impacts while also prudently managing the City's infrastructure and maintaining an acceptable level of risk.

## **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 if necessary 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, Finance Committee, and Council members as they review the budget and staff's rate recommendations. Each Financial Plan also contains a set of Reserves Management Practices describing the reserves for each utility and the management practices for those reserves.

The City's sewer system collects wastewater from Palo Alto residents and delivers it to the RWQCP for treatment. The City of Palo Alto runs the RWQCP, which also treats wastewater for five other partner agencies (Stanford, East Palo Alto Sanitary District, Los Altos Hills, Los Altos, and Mountain View). Some of the wastewater for certain partner agencies is also transported across the City's wastewater collection system.

The Wastewater Collection Utility has two main costs: the costs of operating the collection system and Palo Alto's share of the cost of running the RWQCP (treatment costs).<sup>3</sup> Both cost components have been increasing and are expected to continue to increase. Increases in collection system capital costs are primarily driving the increased collection system costs. The utility is in the process of increasing the rate of sewer main replacement projects from 1 mile to 2.5 miles per year (going from 2 miles to 5 miles per project constructed every other year) to fulfill the goal of replacing pipes near their life expectancy. Staff's experience suggests that pipe can last around 100 years in Palo Alto's underground condition. At the conclusion of the currently ongoing main replacement, there will be 136 miles of original sewer mains to be replaced or rehabilitated and most of these are vitrified clay pipe originally installed between 1950 and 1970. Staffing and inspection capacity exists to replace 2.5 miles per year on average. Reducing the size

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<sup>3</sup> The costs associated with the RWQCP are shared among Palo Alto and the partner agencies based primarily on wastewater flows and the composition of the wastewater each agency sends to the treatment plant. Palo Alto's share varies from year to year but is roughly one third of the total cost.

of the sewer main replacement in FY 2026 and beginning the first 5-mile main replacement project in FY 2028, the ~60 year cycle of replacement will mean the last sewer main replaced is 110 years old at the time it is replaced. Additionally, staff expects construction cost inflation to impact future main replacement costs and assumes this alone will increase CIP costs 5.4% annually.

The RWQCP (Treatment Plant) has been in operation since 1934. Aging equipment, new regulatory requirements, and the movement to full sustainability will require rehabilitation, replacement and new processes. Debt service for the plant is expected to increase substantially in coming years as a major rehabilitation and replacement plan adopted in 2012 ([Long Range Facilities Plan<sup>4</sup>](#)) is implemented. For example, the \$193 million Secondary Treatment Upgrades capital project is in construction, and the \$51.7 million Headworks Facility is in engineering contract negotiations. The RWQCP is also beginning an update to the Long Range Facilities Plan and plans to begin this work in 2024 and complete the plan in 2026. The results of this work will direct future CIP work at the Treatment Plant. Additionally, the plan will re-evaluate the cost of service for annual operating shares and re-evaluate the fixed allocation capacity shares for each partner.

## ANALYSIS

Staff completes an annual assessment of the financial position of the City's wastewater collection utility to ensure 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 rates proposed in this Financial Plan were developed based on the 2021 Cost of Service and Rate Study completed by Raftelis Financial Consultants, Inc., the "[City of Palo Alto 2021 Wastewater COS Report](#)."<sup>5</sup>

The FY 2025 Wastewater Collection Financial Plan describes Council's proposed actions in detail. Staff recommends increasing wastewater rates as shown in Table 1 below, effective July 1, 2024, with a system average rate increase of 15%, as shown in the amended rate schedules included as Attachment A, Exhibit 2. Additionally, staff added an alternative rate proposal with a 9% rate increase, which was the preliminary rate proposal presented to the UAC in January. This alternative is described in more detail in the FY 2025 Financial Plan (Attachment A, Exhibit 1).

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<sup>4</sup> Long Range Facilities Plan <https://www.cityofpaloalto.org/files/assets/public/public-works/water-quality-control-plant/lrfp-final-report-08-2012.pdf>

<sup>5</sup> A cost of service study is a study using industry-standard techniques to determine how the costs of running the utility should be recovered from its customers. Charges to each customer are set in proportion to the cost of serving that customer. <https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmrs/attachments/08-09-2021-id-12378-att-f-2021-wastewater-cos-report.pdf>

Table 2 below shows the residential bill impacts of the rate proposal compared to the alternative and includes a five-year projection of rates.

Residential customers pay a monthly fixed sewer service charge while commercial customers (other than restaurants) are billed monthly based on average winter water usage for the months of January, February and March, applied in the following July. This closely approximates non-irrigation water consumption, which represents sewer use. Restaurant customers are charged based on monthly water usage as they generally lack irrigation but are charged higher rates due to higher grease and oil discharges necessitating additional treatment costs. Currently there are no customers on the S-7 (Industrial) rate schedule; however, CPAU continues to maintain the S-7 rate schedule in case of future need.

**Table 1: Current and Projected Wastewater Collection Charges With 15% System Average Rate Increase in FY 2025**

		Current (as of 7/1/2023)	Proposed (effective 7/1/2024)	Change	
				\$	%
<b>Monthly Service Charges (\$/Month)</b>					
S-1 (Residential)	Service Charge	\$ 48.64	\$55.93	\$ 7.29	15%
<b>Water Quantity Rates (\$/CCF)</b>					
S-2 (Commercial)	Quantity Rates	9.08	10.44	1.36	15%
S-6 (Restaurant)	Quantity Rates	13.55	15.58	2.03	15%

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

**Table 2: Projected Residential Bill Impact, Rate Increase Percentage, Estimated Monthly Sewer Bill, and Net Difference in Monthly Bills FY 2025 to FY 2029**

	Alternatives	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
<b>Estimated Bill Impact for Residential Customers (\$/mo.) and Rate Increase Percentage (1)</b>	Proposal: 15% in FY 2025	7.29	5.03	5.48	5.31	5.02
		15%	9%	9%	8%	7%
	Alternative: 9% in FY 2025	4.37	4.77	5.20	5.66	6.17
		9%	9%	9%	9%	9%
<b>Estimated Monthly Sewer Bill (\$)</b>	Proposal: 15% in FY 2025	55.93	60.96	66.44	71.75	76.77
	Alternative: 9% in FY 2025	53.01	57.78	62.98	68.64	74.81
<b>Net Difference in Monthly Bills (\$)</b>	15% vs. 9% in FY 2025	2.92	3.18	3.46	3.11	1.96

(1) estimated impact on residential wastewater monthly bill, which is currently \$48.64.

The difference between the 15% and 9% scenarios is \$2.92 per residential customer per month in FY 2025 and ranges from \$3.46 in FY 2027 to \$1.96 per month per residential customer by the end of the forecast period.

The proposal would limit the duration the sewer main assets are operated past their estimated useful life and allow for the highest priority main to be replaced in FY 2026. Table 3 shows the alternate rate scenarios and estimated age of the last remaining sewer main replaced for each alternative, instead of 108 years as approved in the Financial Plan for FY 2024.

**Table 3: Alternate Scenarios for Wastewater Rate Changes**

	FY 2025 – FY 2026 Main Replacement <sup>a</sup>		FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	Age of Last Remaining Sewer Main Replaced
	Budget	Length (miles)						
<b>Proposal: 15% in FY 2025</b>	\$3M	~ 1.25	15% <b>\$7.29</b>	9% <b>\$5.03</b>	9% <b>\$5.48</b>	8% <b>\$5.31</b>	7% <b>\$5.02</b>	110 years
<b>Alternative: 9% in FY 2025</b>	\$0	0	9% <b>\$4.37</b>	9% <b>\$4.77</b>	9% <b>\$5.20</b>	9% <b>\$5.66</b>	9% <b>\$6.17</b>	111 years

a) The estimated budget for a 5-mile sewer main replacement in FY 2025 – FY 2026 is \$11.6 million.

As noted above, one of the main drivers for the increase in the Wastewater Collection Utility's costs (and therefore rates) over the next several years is the cost for wastewater treatment. Treatment costs are projected to increase by an average of 3.7% annually from FY 2024 to FY 2029 (or 7.2% annually from FY 2024 to FY 2029 not including grant funding), as the City makes several upgrades to the aging RWQCP. Increases to capital expenses begin in FY 2024 with the Joint Intercepting Sewer Rehabilitation construction, funded on a pay-as-you-go basis. The Wastewater Utility begins to pay for debt service for major projects beginning with the Primary Sedimentation Tank in FY 2025, Outfall Line Construction in FY 2027, Secondary Treatment Upgrades in FY 2029 and Headworks in FY 2030.

Staff anticipates Wastewater Collection operations and CIP costs (excluding costs associated with treatment) will increase by approximately 9.6% annually from FY 2024 to FY 2029. The Wastewater Collection Utility undertakes a larger main replacement project every other year. This schedule allows staff to continue replacing wastewater mains that are in poor condition, while easing scheduling difficulties for inspection coverage due to shared staffing across water, wastewater, gas, and large development services projects. Over the last few years, main replacement costs have been increasing for utilities across Bay Area cities due to economic activity in the Bay Area causing construction cost inflation. Utilities has bid one sewer project

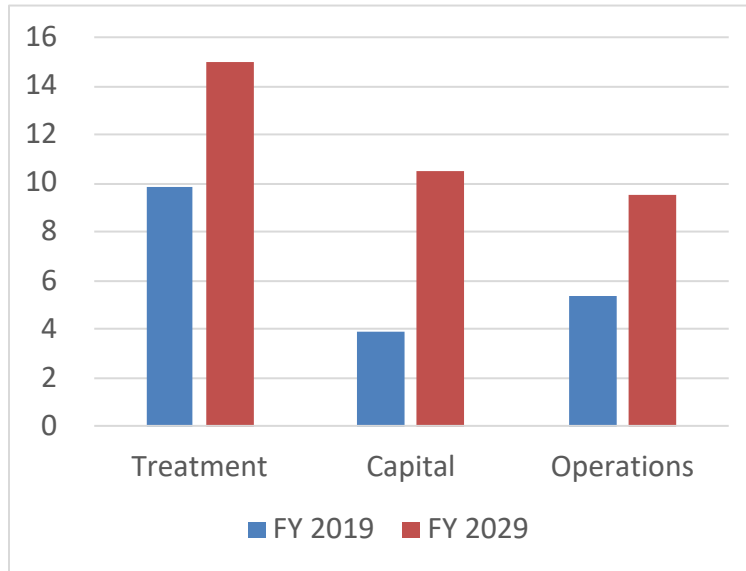
since the pandemic began. There are no indications of a decrease in construction costs in the near future.<sup>6</sup>

Figures 1 and 2 below illustrate the increase in the Wastewater Collection Utility's costs. RWQCP costs for the Wastewater Collection Utility are included in "Treatment," while "Capital" and "Operations" include only collection system costs. 31% of the increase from FY 2019 to FY 2029 is due to treatment cost increases, 25% is due to increases in operations costs, and collection capital costs are responsible for 44% of the increase.

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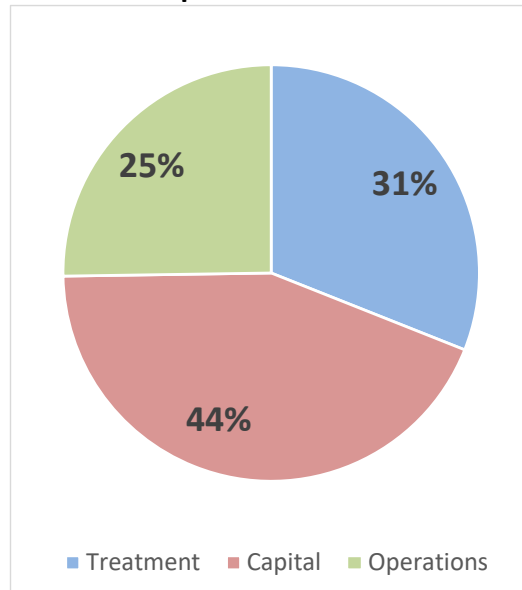
<sup>6</sup> As an additional reference, the California Construction Cost index from December 2022 to December 2023 was 9.4%. See: <https://www.dgs.ca.gov/RES/RESOURCES/Real-Estate-Services-Division-Resources-List-Folder/DGS-California-Construction-Cost-Index-CCCI>

**Figure 1: FY 2019 and FY 2029 Costs (\$ Millions)\***



\* In Figure 1, FY 2019 Capital represents an average of capital costs in FY 2019 and FY 2020 and the FY 2029 Capital represents the capital program contribution from the Operations Reserve to the CIP Reserve.

**Figure 2: Percentage of Cost Increase from FY 2019 to FY 2029 Attributed to Treatment, and Operations Costs**



To promote rate stability and provide continuity in collection system CIP expenditure levels, in 2021 the Council approved a steady annual capital program contribution from the Operations



Reserve to the CIP Reserve. The CIP Reserve would then absorb annual spending fluctuations, reducing the impact on the Operations Reserve. However, all of the funding was transferred out of the CIP Reserve in FY 2023 to pay for the ongoing sewer main replacement on El Camino, and the year-end FY 2023 Operations Reserve is low. In the short-term there is not sufficient funding to continue the annual Capital Program Contribution to the CIP Reserve. Furthermore, the Wastewater Collection Utility Reserves Management Practices state that if, at the end of any fiscal year, the minimum guideline is not met in the CIP or Operations Reserve, staff shall present a plan to the City Council to replenish the reserve.<sup>7</sup>

The attached Financial Plan recommends increasing rates necessary to cover rising costs and restore reserves over the five year forecast. Figure 3 below shows the projected CIP Reserve balances; the reserve would remain above the minimum guideline in FY 2030 and each subsequent year.

Given the low reserves, and the projected levels of revenue and expenses, there is a risk that the short-term need for cash will exceed available cash. For this reason, the attached Financial Plan recommends Council approve a short-term loan up to \$3 million from the Fiber Optics Fund Reserve for FY 2024 to cover the projected shortfall of cash in the Wastewater Collection utility. The Wastewater Collection utility would repay any such loan in FY 2026 (or sooner) at a rate equal to the City's portfolio rate each quarter plus 0.25%. This would reimburse the Fiber Optics fund for the interest the Fund would have otherwise earned on principal if the Fiber Optics Fund had not lent the principal to the Wastewater Collection Fund. Currently, the City's portfolio rate is 2.47% and this is expected to increase. The attached Financial Plan models the interest rate as a total of 3% (the City's current portfolio rate of 2.47% + 0.25% rounded up to account for the possible increase in the City's portfolio rate during FY 2025 and FY 2026). The amount of this interest is approximately \$90K per year for the duration of the loan (3% x \$3 million). The attached Financial Plan assumes a cost of \$90K each year in FY 2025 and FY 2026.

Assuming Council approves the short-term loan as proposed, then as part of the financial process to close FY 2024 (during the second half of calendar year 2024), staff will examine the Wastewater Collection Utility's total costs and revenues for FY 2024 and use the latest projections for FY 2025 to determine whether the full \$3 million loan is necessary or whether a smaller amount or no loan is needed. Staff would then complete the one-time, short-term loan at the end of FY 2024 up to \$3 million. After that time, if the Wastewater Collection Utility needs additional funds, staff will return to Council, provide updated information, and request additional Council approvals. If Council does not approve the loan as proposed, staff would research alternative funding sources that may be available and return to Council to propose alternative funding sources and/or expense reductions to cover the projected cash shortfall.

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<sup>7</sup> See Appendix C, Wastewater Collection Utility Reserves Management Practices Section 7(b) and 5(c).

**Figure 3: Projected Capital Reserve Balances, FY 2025 to FY 2029**

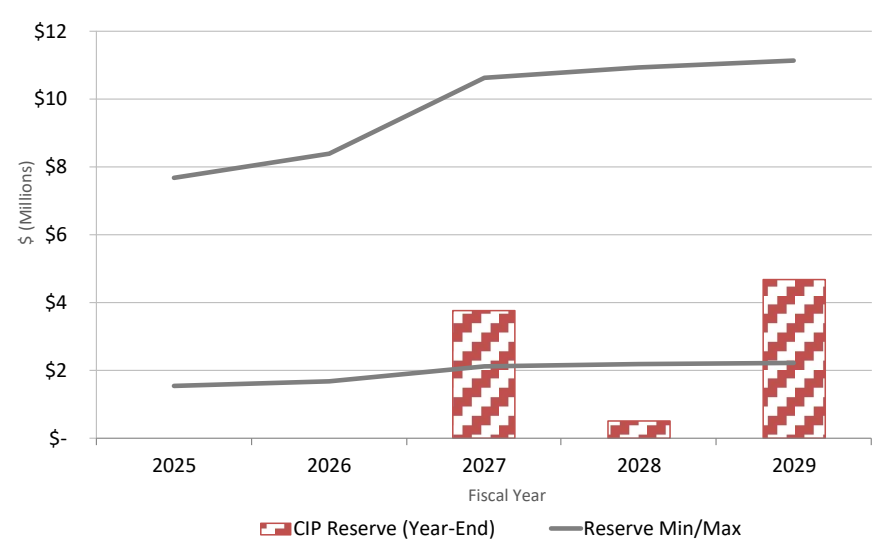
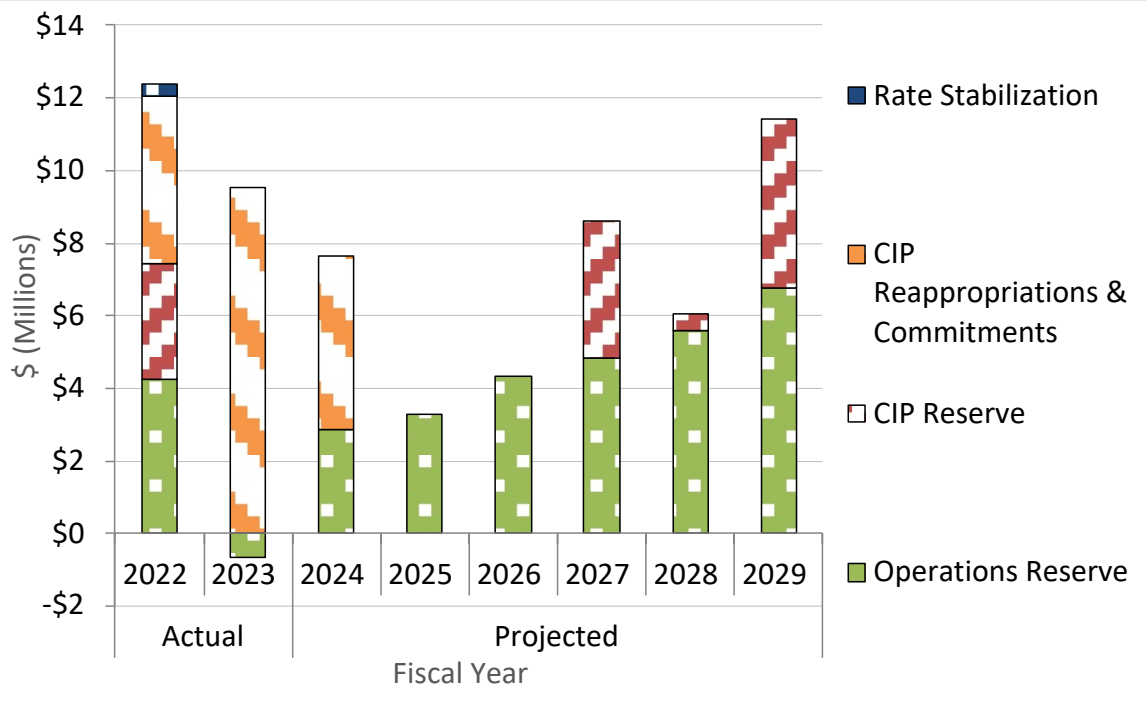


Figure 3 assumes a 15% rate increase for the Wastewater Collection Utility in FY 2025 and \$3 million short-term loan from the Fiber Optics Fund in FY 2024 that is repaid by the Wastewater Collection Utility during FY 2026. Additionally, it assumes a smaller sized Sewer Replacement in FY 2026.

Figure 4 below shows year-end reserve balance levels for each reserve from FY 2024 projected through FY 2029. Table 4 shows reserve starting and ending balances, revenues, transfers expenses, capital program contribution and operations reserve guideline levels from FY 2024 to FY 2029.

**Figure 4: Wastewater Collection Utility Year-End Reserve Levels, FY 2022 to FY 2029\***



\* note: Figure 4 assumes a 15% rate increase for the Wastewater Collection Utility in FY 2025 and \$3 million short-term loan from the Fiber Optics Fund in FY 2024 that is repaid by the Wastewater Collection Utility during FY 2026.

**Table 4: Operations, Rate Stabilization and CIP Reserves Starting and Ending Balances, Revenues, Transfers To/(From) Reserves, Expenses, Capital Program Contribution To/(From) Reserves, and Operations Reserve Guideline Levels for FY 2024 to FY 2029 (\$000) ^**

	Fiscal Year	2024	2025	2026	2027	2028	2029
	<b>Starting Balance</b>						
(1)	Operations	(674)	2,875	3,281	4,345	4,839	5,571
(2)	Rate Stabilization	0	0	0	0	0	0
(3)	CIP	0	0	0	0	3,757	500
	<b>Revenues</b>						
(4)	Short-Term Loan From Fiber Optics	3,000					
(5)	Revenue	23,678	26,382	29,033	31,863	34,370	36,746
	<b>Transfers</b>						
(6)	Operations	0	0	0	0	0	0
(7)	Rate Stabilization	0	0	0	0	0	0
(8)	CIP	0	0	0	0	0	0
	<b>Capital Program Contribution*</b>						
(9)	Operations	0	0	0	(10,200)	(11,659)	(11,139)
(10)	CIP	0	0	0	10,200	11,659	11,139
	<b>Expenses</b>						
(11)	Total Expenses (w/o CIP, Debt, or Loan)	(20,308)	(21,758)	(19,676)	(21,168)	(21,980)	(24,433)
	Short-Term Loan Principal Repayment						
(12)	to Fiber Optics Fund			(3,000)			
	Short-Term Loan Interest to Fiber						
(13)	Optics Fund		(90)	(90)			
(14)	Debt Service	(129)	0	0	0	0	0
(15)	Planned CIP	(2,691)	(4,128)	(5,202)	(6,443)	(14,916)	(6,951)
	<b>Ending Balance</b>						
(1)+(4)+(5)+(6)+(9)+(11)+(12)+(13)+(14)+(15)	thru FY 2026						
(1)+(5)+(6)+(9)+(11)+(14) in FY 2027 on	Operations	2,875	3,281	4,345	4,839	5,571	6,745
(2)+(6)	Rate Stabilization	0	0	0	0	0	0
(3)+(8)+(10)+(15) in FY 2027 on	CIP	0	0	0	3,757	500	4,687
	<b>Operations Reserve Guideline Levels</b>						
(16)	Minimum Guideline Level	3,360	3,591	3,742	3,480	3,613	4,016
(17)	Maximum Guideline Level	8,399	8,979	9,356	8,699	9,033	10,041
	* Capital Program Contribution to resume in FY 2027						

^ Table 4 assumes a 15% rate increase for the Wastewater Collection Utility in FY 2025 and \$3 million short-term loan from the Fiber Optics Fund in FY 2024 that is repaid by the Wastewater Collection Utility during FY 2026.

\* Planned CIP (item 12) is reflected as an expense in the CIP Reserve in FY 2027 – FY 2029 and does not include CIP funded through Reappropriations or Commitments reserves.

### Wastewater Bill Comparison with Surrounding Cities

The current monthly equivalent sewer bill for a Palo Alto resident is \$48.64, and 26% lower than the average neighboring community rate. Table 5 shows the monthly sewer bills at current and proposed rates for residential customers compared to what they would be in surrounding communities assuming no increases in rates in the surrounding communities. These communities are the same six cities that Palo Alto compares itself to in the annual budget across Water, Wastewater, Gas, and Electric utilities.

**Table 5: Residential Monthly Equivalent Sewer Bill Comparison (\$) at Palo Alto Current and Proposed Rates Compared to Neighboring Communities at Current Rates**

Palo Alto (FY 24)	Palo Alto (Proposed FY 25)	Neighboring Community Average	Neighboring Communities					
			Menlo Park	Redwood City	Santa Clara	Mountain View	Los Altos	Hayward
48.64	55.93	65.38	108.83	89.28	48.28	53.10	51.47	41.29

If Council adopts a 15% rate increase in FY 2025, and assuming other agencies do not change their sewer rates, Palo Alto's residential rates would remain 14% lower than the current average neighboring community in FY 2025. Given the similar ages of treatment and collection facilities in the Bay Area, it is likely that surrounding jurisdictions will experience rate increases in the coming years. If Council adopts the 9% wastewater rate increase alternative in FY 2025, and assuming other agencies do not change their sewer rates, Palo Alto's residential rates would remain 19% lower than the current average neighboring community. Staff has no information at this time as to whether or when the surrounding communities are planning wastewater rate changes. However, as most agencies are also requiring renovations to their respective treatment plants, increases at other agencies are likely. Note that as partners in the RWQCP, Mountain View and Los Altos will be affected by similar treatment cost increases as Palo Alto.

Table 6 shows the monthly sewer bills for Commercial and Restaurant customers. Palo Alto has higher commercial sewer rates than several surrounding cities but is not the most expensive jurisdiction. Palo Alto's commercial bills are 9% higher than the neighboring community average while Palo Alto's restaurant bills are 7% below the neighboring community average. If Council adopts the 15% water rate increase and assuming other agencies do not change their sewer rates, Palo Alto's commercial bills would be 26% higher than the current average of the neighboring community while Palo Alto's restaurant bills would be 7% higher than the current average. Table 8 assumes 14 units of average winter water use for general commercial customers and 38 units of average winter water use for restaurants.

**Table 6: Non-Residential Monthly Equivalent Sewer Bill Comparison (\$) at Palo Alto Current and Proposed Rates Compared to Neighboring Communities at Current Rates**

	Palo Alto (FY 24)	Palo Alto (Proposed FY 25)	Neighboring Community Average	Neighboring Communities					
				Menlo Park	Redwood City	Santa Clara	Mountain View	Los Altos	Hayward
General Commercial	127.12	146.16	116.17	147.28	117.74	82.18	166.18	89.54	94.08
Restaurant	514.90	592.04	553.44	842.08	765.70	520.60	517.18	243.02	432.06

#### Changes from Prior Financial Forecasts

Table 7 compares the projected overall rate changes in the current Financial Plan with the projected rate changes in the FY 2024 Financial Plans.

**Table 7: Proposed/Projected Wastewater Rate Changes for FY 2025 to FY 2029**

Projection	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Staff Proposal in Current Plan (FY 2025) 15% in FY 2025	15%	9%	9%	8%	7%
Alternative (FY 2025) 9% in FY 2025	9%	9%	9%	9%	9%
FY 2024 Financial Plan	9%	9%	8%	5%	N/A

### Next Steps

Staff plans to include the Finance Committee's recommendations for wastewater rate changes in the notification of potential rate increases to customers as required by Article XIID of the State Constitution expected in April 2024. Staff will send notification of the potential rate increases to customers as required by Article XIID of the State Constitution (added by Proposition 218) expected in April 2024. Staff will incorporate the Finance Committee's recommendations into the draft Financial Plan and attachments and bring those to the City Council in June. 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. If Council approves the proposed rate increases, they will become effective July 1, 2024.

### **FISCAL/RESOURCE IMPACT**

Staff anticipates normal year revenues for the Wastewater Collection Utility will increase by approximately \$3.3 million in FY 2025 as a result of a 15% rate increase. See the FY 2025 Wastewater Collection Utility Financial Plan for a more comprehensive overview of projected cost and revenue changes for the next five years. The FY 2025 budget is being developed concurrent with these rates and depending on final rates, adjustments to the budget may be necessary at a later time.

### **STAKEHOLDER ENGAGEMENT**

Staff discussed the preliminary proposals with the Finance Committee on February 21, 2024 and Finance Committee members expressed support for the proposal. Staff presented the full Wastewater Collection Utility Financial Plan to the UAC during the March UAC meeting and the UAC voted unanimously to recommend that the City Council adopt a resolution approving the 15% rate increase, including the not-to-exceed \$3 million short-term loan from the Fiber Optics Fund.

### **ENVIRONMENTAL REVIEW**

The Finance Committee's review and recommendation to Council on the proposed FY 2025 Wastewater Collection Financial Plan and rate adjustments do not meet the definition of a project, pursuant to Section 21065 of the California Environmental Quality Act, thus no environmental review is required.

### **ATTACHMENTS**

Attachment A: Wastewater FY25 Resolution

Attachment A Exhibit 1: Wastewater Financial Plan FY25

Attachment A Exhibit 2: Wastewater Rate Schedule FY25

### **APPROVED BY:**

Dean Batchelor, Director of Utilities