Finance Committee
Staff Report

From: Kiely Nose, Assistant City Manager
Report Type: Action Item
Lead Department: Utilities

Meeting Date: March 7, 2023
Report #: 2301-1011

TITLE

Utilities Advisory Commission and Staff Recommendation That the Finance Committee Recommend the City Council Adopt a Resolution Approving the Fiscal Year 2024 Water Utility Financial Plan, Including Proposed Reserve Transfers, and Increasing 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)

RECOMMENDATION

The Utilities Advisory Commission (UAC) and Staff recommend that the Finance Committee Recommend the City Council:

1. Adopt a resolution (Attachment A):
    a. Approving the Fiscal Year (FY) 2024 Water Utility Financial Plan (Linked Document); and
    b. Approving a transfer of up to $3.746 million from the Capital Improvement Program (CIP) Reserve to the Operations Reserve in FY 2023; and
    c. Approving a transfer of up to $3.0 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2023; and
    d. Increasing Water Utility Rates Via the Amendment of 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) (Attachment B)

EXECUTIVE SUMMARY

The City's water rate schedules currently 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 FY 2024 Water Utility Financial Plan includes projections of the utility's costs and revenues for FY 2023 through FY 2028. The Financial Plan projects costs to rise by about 2-3% per year over the next several years. Despite the recent weather events, the drought remains ongoing[1] and customer response to state, regional and local calls for water conservation has reduced water sales revenue. In FY 2022, water sales revenue declined by 7% compared with FY 2021; the FY 2023 Financial Plan anticipated this level of reduction and there was adequate funding in the Operations Reserve as well as offsetting cost reductions due to lower water purchase costs. Staff expects the drought to continue at least through FY 2023, further reducing water sales relative to prior forecasts. Recovery is projected to be slow, and as in prior droughts, some conservation is projected to be permanent.

Other revenues also declined below prior forecast levels primarily due to reductions in water service connection and capacity fee revenue. These drought impacts put upward pressure on water rates. 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.

The Water Fund's healthy reserve levels allowed the Water Utility to hold rates flat for two years (FY 2021 and FY 2022) and provide adequate funding for the first year of drought-related sales revenue reductions in FY 2022. Additionally, staff propose for the Water Utility to use remaining reserves to mitigate distribution rate increases (rates that cover the cost to deliver water within the City) to 3% in FY 2024 and to 6% annually from FY 2025 through FY 2028 while still funding essential capital investments.

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 passes through SFPUC rate increases to customers (Resolution 9844). The pass-through commodity rate is currently $4.75 per hundred cubic feet (CCF) and will increase to $5.30 per CCF on July 1, 2023, according to SFPUC's February 2023 forecast. The SFPUC will not determine its final wholesale customer rate for FY 2024 until May or

[1] On November 23, 2021, the SFPUC declared a local water shortage emergency by Resolution No. 21-0177 calling for voluntary system-wide 10% water use reductions. On May 24, 2022 SFPUC increased the system-wide voluntary water use reduction to 11%. SFPUC serves retail customers in San Francisco as well as Palo Alto and 25 other Wholesale Customers in the Bay Area. Wholesale Customers' collective voluntary water purchase cutback level is 16% from FY 2020 levels while Palo Alto's voluntary water purchase cutback level is 8% from FY 2020 levels.

June 2023. If SFPUC's final rate for FY 2024 does increase, Palo Alto will notify customers 30 days in advance of the pass-through rate increase via their billing statements or by any other mailing by CPAU to the customer's regular billing address.

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 staff's 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. This same system serves San Francisco and other Bay Area cities. San 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 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.[2]

The Water Utility has two main costs: water supply costs (primarily the cost of water delivered to Palo Alto from the Hetch Hetchy 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 Hetch Hetchy 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 (the program was 98.7% complete as of September 2022), 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.

[2] For a video summary of BAWSCA's activities, see https://vimeo.com/283596665/5619ce2c11

CPAU's operational costs for the water utility have increased by approximately 4.8% per year over the last five years; allocated charges (charges allocated to the water utility for administrative services provided by the General Fund) and operations and maintenance costs (including engineering) costs were the primary reasons for the increase. Capital costs have fluctuated from year to year. This Financial Plan projects increases in capital and operational costs that align as much as possible with the City's Budget and Long-Range Financial Forecast and average approximately 3% per year over the next five years.

ANALYSIS

Staff completes an annual assessment of the financial position of the City's water utility 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 the cost of service (COS) methodology described in the 2012 *Palo Alto Water Cost of Service & Rate Study*, which was updated in 2015, and the 2015 Drought Rate memorandum completed by Raftelis Financial Consultants, and the 2019 update titled "Proposed FY 2020 Water Rates," (see Attachment Q to staff report 10295.[3])

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 $3.746 million from the CIP Reserve to the Operations Reserve in FY 2023.
3. Transfer up to $3.0 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2023.

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 in addition to the pass-through commodity rate charged to customers based on SFPUC supply charges. The pass-through commodity rate is currently $4.75 per CCF. SFPUC's proposed rate increase in FY 2024 is 11.6%; the current rate would increase on or around July 1, 2023 to $5.30 per CCF, with no additional increase projected in the SFPUC meter charge.

[3] A cost of service study (COS) 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.

Table 1: Current and Proposed Water Consumption Charges

	Current (7/1/2022)	Proposed (7/1/2023)	Change ($/CCF)	Change (%)
W-1 (Residential) Volumetric Rates ($/CCF)				
Tier 1 Rates	2.67	2.75	0.08	3%
Tier 2 Rates	6.21	6.39	0.18	3%
W-2 (Construction) Volumetric Rates ($/CCF)				
Uniform Rate	3.76	3.87	0.11	3%
W-4 (Commercial) Volumetric Rates ($/CCF)				
Uniform Rate	3.76	3.87	0.11	3%
W-7 (Irrigation) Volumetric Rates ($/CCF)				
Uniform Rate	5.72	5.89	0.17	3%

Table 2 and 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 (7/1/2022)	Proposed (7/1/2023)	$	%
5/8”	21.06	21.69	0.63	3%
3/4”	21.06	21.69	0.63	3%
1”	21.06	21.69	0.63	3%
1 ½”	68.02	70.06	2.04	3%
2”	105.22	108.37	3.15	3%
3”	223.02	229.71	6.69	3%
4”	396.63	408.52	11.89	3%
6”	812.03	836.39	24.36	3%
8”	1,494.04	1,538.86	44.82	3%
10”	2,362.05	2,432.91	70.86	3%
12”	3,106.07	3,199.25	93.18	3%

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 (7/1/2022)	Proposed (7/1/2023)	$	%
5/8"	18.42	18.97	0.55	3%
3/4"	24.62	25.35	0.73	3%
1"	37.02	38.13	1.11	3%
1 ½"	68.02	70.06	2.04	3%
2"	105.22	108.37	3.15	3%
3"	223.02	229.71	6.69	3%
4"	396.63	408.52	11.89	3%
6"	812.03	836.39	24.36	3%
8"	1,494.04	1,538.86	44.82	3%
10"	2,362.05	2,432.91	70.86	3%
12"	3,106.07	3,199.25	93.18	3%

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 (7/1/2022)	Proposed (7/1/2023)	$	%
2"	$4.34	$4.47	0.13	3%
4"	26.85	27.66	0.81	3%
6"	77.96	80.30	2.34	3%
8"	166.13	171.11	4.98	3%
10"	298.77	307.73	8.96	3%
12"	482.59	497.07	14.48	3%

Bill Impact of Proposal

Error! Reference source not found. and **Error! Reference source not found.** show the impact of the proposed July 1, 2023 rate changes on the median residential, commercial and irrigation bills including the SFPUC commodity pass-through rate increase of 11.6% or $5.30 per CCF. The bill increases shown in Table 5 and 6 vary by usage because the SFPUC increase per CCF is more than the distribution rate increases.

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

Usage (CCF/mo.)	Bill under Current Rates (7/1/2022)	Bill under Proposed Rates (7/1/2023)	Change	
			$/mo.	%
4	$50.74	$53.89	$3.15	6%
(Winter median) 7	$76.54	$81.68	$5.14	7%
(Annual median) 9	$98.46	$105.06	$6.60	7%
(Summer median) 14	$153.26	$163.51	$10.25	7%
25	$273.82	$292.10	$18.28	7%

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

Usage (CCF/mo.)	Bill under Current Rates (7/1/2022)	Bill under Proposed Rates (7/1/2023)	Change	
			$/mo.	%
Commercial (W-4) (5/8" meters)				
(Annual median) 12	$120.54	$129.01	$8.47	7%
(Annual average) 64	$563.06	$605.85	$42.79	8%
Irrigation (W-7) (1 ½" meters)				
(Winter median) 9	$162.25	$170.77	$8.52	5%
(Summer median) 37	$455.41	$484.09	$28.68	6%
(Winter average) 56	$654.34	$696.70	$42.36	6%
(Summer average) 199	$2,151.55	$2,296.87	$145.32	7%

Staff expects 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 2024 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 projected changes to the pass-through commodity rate.

Table 7: Projected Rate Adjustments, FY 2024 to FY 2028 (5/8" meter)

Fiscal Year	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Water Utility	7%	3%	3%	3%	5%
Estimated Monthly Bill	$6.60	$3.45	$3.66	$3.89	$6.27
Estimated Bill Impact ($/mo)[1]	$105.06	$108.51	$112.17	$116.06	$122.33
1) estimated impact on median monthly residential water bill for customers with 5/8" meter, which is currently $98.46.					

Figures 1 and 2 below illustrate the projected increases in the Water Utility's costs between FY 2023 and FY 2028.

Figure 1: Projected FY 2023 and FY 2028 costs

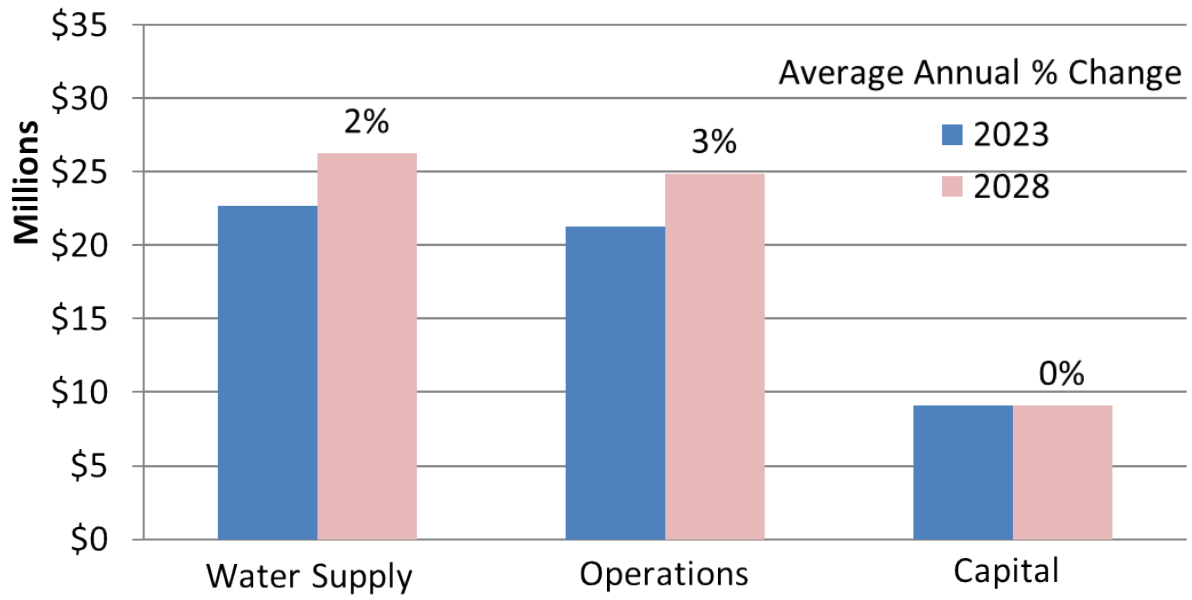
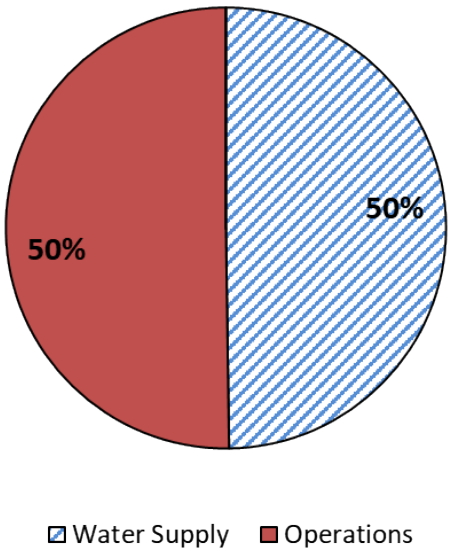


Figure 2: Percentage of Total Cost Increase from FY 2023 to FY 2028

Attributed to Supply, Capital, and Operations Costs



The "Capital" bars on Figure 1 reflect the capital program contributions to the CIP Reserve. Additionally, this Financial Plan includes a one-time transfer to the CIP Reserve to fund seismic reservoir replacement work. CIP funds available for projects that were budgeted in FY 2022 and prior years that are carried forward or reappropriated to FY 2023 will be used to offset the new CIP budget.

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 2024. 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 September 30, 2022, 48 of the 52 regional projects were complete or in close-out while three of the regional projects were under construction.[4] This has resulted and 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

[4] First Quarter FY 2022 - 2023 WSIP Regional Quarterly Report, https://www.sfpuc.org/sites/default/files/documents/Q1FY23_WSIP_Regional_Qtrly_Report_4_Web.pdf The additional regional projects do not include construction: Long-Term Mitigation Endowment and Watershed and Environmental Improvement Program.

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. The currently estimated WSIP completion date is February 7, 2027, as adopted by the SFPUC in April of 2022.

As the SFPUC completes WSIP projects, the SFPUC is pursuing a suite of other capital improvement work; dam safety improvements and Mountain Tunnel repairs are rate increase drivers during the next 10-year timeframe. Future and in-progress construction work will require bond funding, and the SFPUC's financial plans show debt service cost for the water enterprise growing by 32% between FY 2021 and FY 2026, and by 40% by FY 2028.[5]

Changes in usage due to drought, or recovery from drought, can make the magnitude of future increases difficult to predict. The SFPUC's costs to operate the Regional Water System are primarily fixed costs, so the water rate charged to wholesale customers like the City of Palo Alto is highly dependent on water usage by all users of the Regional Water System.

The SFPUC has been accumulating funds in its Wholesale Customer Balancing Account due to a variety of factors, including: SFPUC sold more wholesale water than the sales projection it used for rate setting, there were cost savings in the wholesale revenue requirement due to the SFPUC's debt refinancing, and BAWSCA's annual review of the wholesale revenue requirement resulted in credits applied to the balancing account. The SFPUC has been returning these funds to wholesale customers by using the balancing account funds to offset the required revenues from wholesale customers. Using this method, SFPUC held rates constant from FY 2017 through June 30, 2022. Because of the water use reductions expected during the ongoing drought conditions and calls for voluntary conservation (11% system-wide and 16% for the wholesale customers collectively), all of the available funding in the balancing account (approximately $86 million at year end FY 2021) is expected to be returned to wholesale customers in FY 2022 and FY 2023. Without the use of the balancing account, SFPUC's rate forecast would be higher.

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%. What this means for Palo Alto is that its share of the debt service - approximately $1.74 million per year (or $0.36 per CCF) will decrease to an estimated $1.17 million per year (or $0.26 per CCF), a savings of $0.57 million annually through 2034 when the bonds will be paid off.

Staff projects the total water rate increase of 7% in FY 2024 for Palo Alto customers with the pass-through of the commodity rate increase and the Palo Alto distribution rate increase. This is equivalent to a monthly water bill increase of $6.60 for residential customers with annual median water usage.

[5] FY 2018-19 & FY 2019-20 Adopted SFPUC Budget, https://sfwater.org/modules/showdocument.aspx?documentid=13147

Capital Projects & Reserves

The Water Utility deferred some capital project spending in FY 2022 leading to lower capital costs than budgeted. Staff anticipates completing many of these capital projects in FY 2023. Despite these deferrals, the 5-year capital budget of $55.7 million (not including budgets carried forward from prior years) remained the same within 1% in the current Financial Plan at $56.4M. Customer rates still need to recover the full amount of revenue to pay for these costs over the 5-year timeframe. The capital budget includes one-time seismic water system upgrades and/or replacements for the Park and Dahl reservoirs to improve earthquake resistance. 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 Plan projects that rate funding needs to cover $12.846 million of planned CIP in FY 2023. This figure is the portion of planned CIP in FY 2023 that will not be paid for through funds collected in prior years (essentially the FY 2023 Capital budget, less funds available in the Reappropriations and Commitments Reserves), shown in line 12 of Table 8 for FY 2023. This capital budget is projected to be funded by the capital program contribution of $9.1 million together with $3.746 million from the CIP Reserve. Because withdrawals from the CIP Reserve for use on capital projects require Council action, [6] staff requests Council approval to transfer up to $3.746 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 2023 are known. Figure 3 shows the CIP Reserve year end balances.

[6] *See* Section 5(b) of the Water Utility Reserves Management Practices; Appendix C to the attached Water Financial Plan.

Figure 3: Actual FY 2022 and Projected Capital Reserve Balances FY 2023 to FY 2028

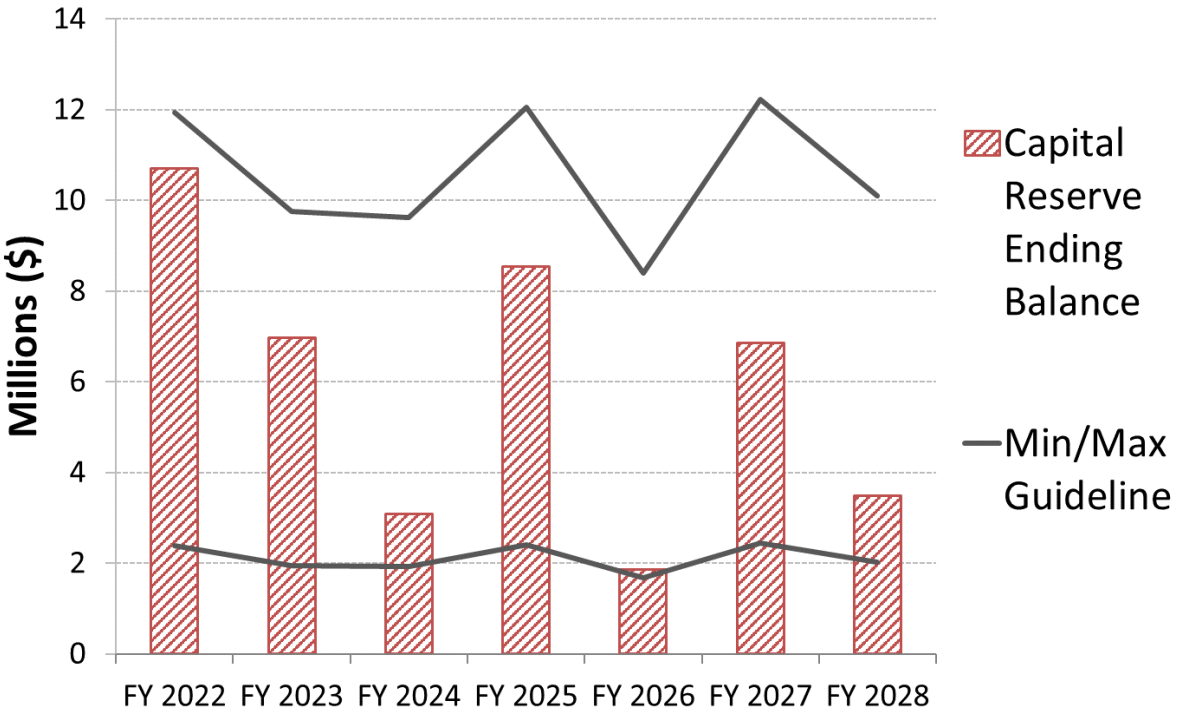
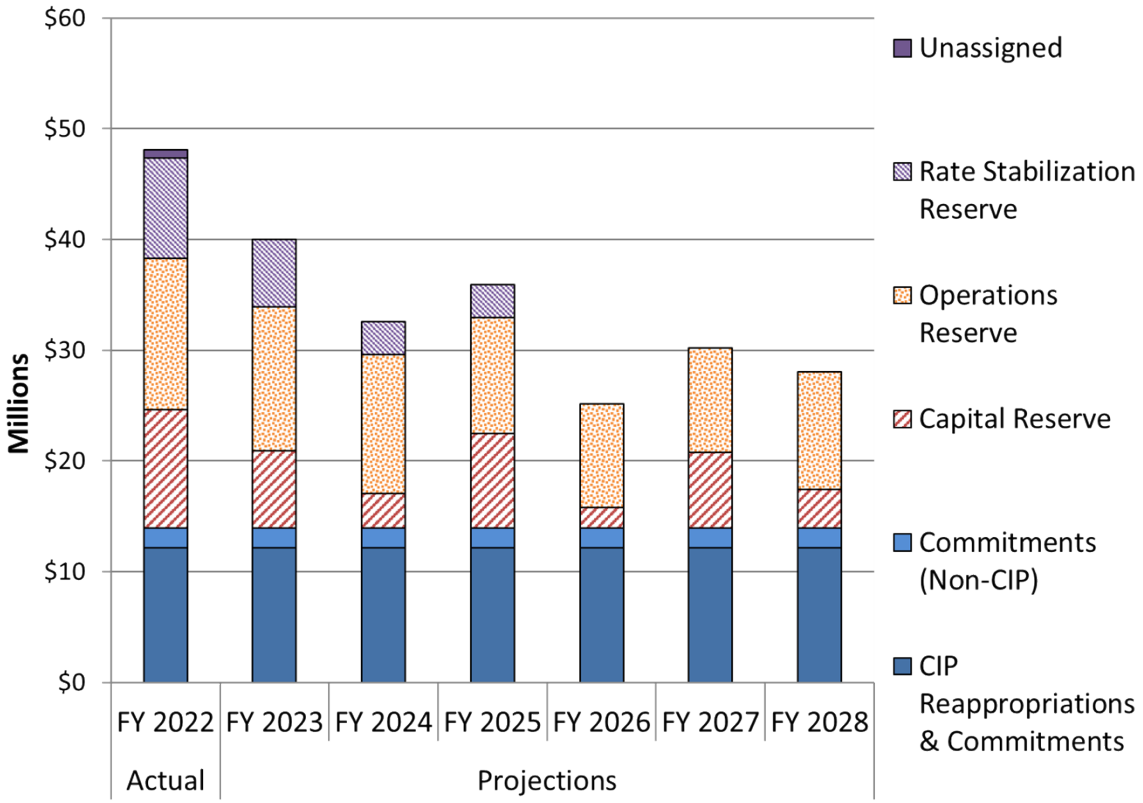


Figure 4 illustrates the year end reserve balances for FY 2022 (actual) and projected through FY 2028. Water Utility reserve levels remain healthy at year end FY 2022: the CIP Reserve is at the maximum guideline level of $10.7 million and the Operations Reserve is also at the maximum guideline level of approximately $14 million with an additional $0.3 million above the maximum that is considered unassigned. In accordance with the reserve guidelines, any funds above the maximum guideline level must be assigned a specific purpose or be returned to ratepayers. The funds will be assigned and used to cover water utility operational and capital costs in FY 2023. There is also $9 million available in the Rate Stabilization Reserve at year end FY 2022. 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 2023 through FY 2028.

Figure 4: Actual Reserve Levels for FY 2022 and Projections through FY 2028



Rate Stabilization Reserve

Staff plans to use the Rate Stabilization Reserve balances to buffer rate increases. Staff expects to transfer $3 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2023 and $2 million from the Rate Stabilization Reserve to the Operations Reserve in FY 2024, FY 2025 and FY 2026. The use of the Rate Stabilization Reserve balances in this way, together with the cost and revenue projections in this Financial Plan, is expected to hold CPAU water distribution rate increases to 3% in FY 2024 and 6% annually from FY 2025 through FY 2028, while continuing to fund essential capital work. This Financial Plan projects that the Rate Stabilization Reserve will be exhausted by the end of FY 2026 (see line 7 in Table 8).

Table 8: 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 2023 to FY 2028 ($000)

		FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
	Starting Balance						
(1)	Operations/Unassigned	14,420	13,028	12,582	10,527	9,385	9,480
(2)	Rate Stabilization	9,069	6,069	3,000	3,000	-	-
(3)	CIP	10,707	6,961	3,088	8,533	1,861	6,847
	Revenues						
(4)	Total Revenue	48,343	52,911	55,766	57,105	58,523	61,046
(5)	Transfers In	332	342	353	363	374	385
	Transfers						
(6)	Operations/Unassigned	3,000	3,069	-	500	-	-
(7)	Rate Stabilization	(3,000)	(3,069)	-	(3,000)	-	-
(8)	CIP	-	-	-	2,500	-	-
	Capital Program Contribution						
(9)	Operations/Unassigned	(9,100)	(9,100)	(9,100)	(9,100)	(9,100)	(9,100)
(10)	CIP	9,100	9,100	9,100	9,100	9,100	9,100
	Expenses						
(11)	Total Expenses other than CIP	(43,825)	(47,523)	(48,923)	(49,245)	(48,932)	(50,372)
(12)	Planned CIP	(12,846)	(12,973)	(3,655)	(18,272)	(4,114)	(12,456)
(13)	Transfers Out	(142)	(146)	(151)	(765)	(770)	(775)
	Ending Balance						
(1)+(4)+(5)+(6)+(9)+(11)+(13)	Operations/Unassigned	13,028	12,582	10,527	9,385	9,480	10,664
(2)+(7)	Rate Stabilization	6,069	3,000	3,000	-	-	-
(3)+(8)+(10)+(12)	CIP	6,961	3,088	8,533	1,861	6,847	3,491
	Operations Reserve Guideline Levels						
(14)	Minimum Guideline Level	7,227	7,836	8,067	8,221	8,170	8,408
(15)	Maximum Guideline Level	14,455	15,672	16,134	16,442	16,340	16,815

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

Water Bill Comparison with Surrounding Cities

Table 9 compares water bills for residential customers to those in surrounding communities as of October 2022 (under 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 2023. 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 1: Residential Monthly Water Bill Comparison

Usage (CCF/month)	Residential monthly bill comparison ($/month)* As of October 2022							
	Palo Alto	Menlo Park	Mountain View	Hayward	Redwood City	Santa Clara	Los Altos	Average of Surrounding Communities
4	$50.74	$62.83	$43.47	$41.03	$54.04	$29.32	$53.29	$47.33
(Winter median) 7	76.54	87.32	67.29	63.23	76.09	51.31	$72.46	$69.62
(Annual median) 9	98.46	103.65	83.17	78.03	90.79	65.97	$85.24	$84.47
(Summer median) 14	153.26	148.02	122.87	123.48	138.94	102.62	$120.01	$125.99
25	273.82	257.41	257.81	223.47	267.39	183.25	$212.91	$233.71

*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.

Changes from Last Year's Financial Plan

Table 10 shows rate projections from the last two Financial Plans for FY 2022 and FY 2023 as well as the impact of SFPUC's wholesale rate increase projections when combined with Palo Alto's distribution rate increase.

Table 10: Proposed and Projected Water Revenue Changes for FY 2024 to FY 2028

Projection	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
FY 2024 Plan (Current)	7%	3%	3%	3%	5%
FY 2023 Plan	9%	3%	2%	0%	-
FY 2022 Plan	5%	5%	5%	-	-

Table 11 shows the proposed water rate increases broken out into the needed increases to commodity revenues, to cover the costs of purchasing water from SFPUC and separately the distribution revenue increases to pay for the upkeep of Palo Alto's water distribution system.

Table 11: Proposed Commodity and Distribution Water Rate Changes FY 2024 to FY 2028

Projection	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Commodity Rate (SFPUC Wholesale Rate)	11.6%	0%	0%	0%	4.5%
Distribution Rate	3%	6%	6%	6%	6%
Total Rate	7%	3%	3%	3%	5%

This plan uses the Rate Stabilization Reserve and CIP Reserve to stabilize rates while anticipating a large wholesale water rate increase in FY 2024 and funding needed for critical water CIP budgets.

NEXT STEPS

The Finance Committee plans to consider the recommended water rate changes in March. Assuming the Finance Committee supports the proposed rate adjustments, staff will send notification of the potential rate increases to customers as required by Article XIIID of the State Constitution (added by Proposition 218) expected in April 2023. The City Council will consider the proposed Financial Plans and amended rate schedules with the FY 2024 budget, expected in June, at which time the public hearing required by Article XIIID of the State Constitution will be held.

FISCAL/RESOURCE IMPACT

Staff projects estimated revenue for the Water Utility in FY 2024 to increase approximately 7% ($3.2 million) as a result of the proposed rate increases. The FY 2024 Budget is being developed concurrent with these rates and, depending on the final rates, adjustments to the budget may be necessary at a later time. See the FY 2024 Water Utility Financial Plan for a more comprehensive overview of the projected cost and revenue changes for the next five years.

POLICY IMPLICATIONS

The proposed water rate adjustments are consistent with Council-adopted Reserve Management Practices that are part of the Financial Plans. Staff developed the water rate adjustments using a cost-of-service study and methodology consistent with the cost of service requirements of Proposition 218.

STAKEHOLDER ENGAGEMENT

At the Utilities Advisory Commission (UAC) March 1, 2023 meeting, staff will present the attached Financial Plan. Staff will share the UAC vote on the motion to the Finance Committee. Staff, the UAC, and the Finance Committee's recommendation on the FY 2024 water rate increases will be presented to City Council in June during the budget adoption process.

ENVIRONMENTAL REVIEW

The Finance Committee's review and recommendation to Council on the FY 2024 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 Resolution FY 2024
Attachment B: Water Rate Schedules FY 2024

APPROVED BY:

Dean Batchelor, Director Utilities