



# CITY OF SANTA BARBARA

## FINANCE COMMITTEE AGENDA REPORT

**AGENDA DATE:** April 9, 2024

**TO:** Finance Committee

**FROM:** Water Resources Division, Public Works Department;  
Environmental Services Division, Sustainability & Resilience  
Department

**SUBJECT:** Proposed Utility Rates

**RECOMMENDATION:** That Finance Committee:

- A. Receive a presentation on proposed water and wastewater rates for Fiscal Years 2025 - 2028, and solid waste rates for Fiscal Year 2025;
- B. Recommend that Council set a Public Hearing date for June 25, 2024, at 2:00 p.m., for consideration of increases to the City's water, wastewater, and solid waste rates; and
- C. Recommend that Council direct staff to send a Notice of Public Hearing to customers informing them of the Public Hearing and proposed changes to water, wastewater, and solid waste rates.

### **EXECUTIVE SUMMARY:**

The City operates water and wastewater utilities and administers a solid waste contract with Marborg Industries. The City recovers the costs for operating water, wastewater, and solid waste services through a monthly utility bill. The revenues from these services must be sufficient to meet the ongoing cost of operating each utility. The water and wastewater enterprises are a full-service operation, which includes all necessary staffing to operate and maintain the utility, ongoing investments in capital improvements, servicing long-term debt obligations, and maintaining adequate policy reserves to provide safe and reliable drinking water and discharge of wastewater effluent both meeting strict State and Federal requirements.

To evaluate water and wastewater utilities' revenue sufficiency, the City's rate consultant analyzed a 10-year planning period and a four-year rate setting period (Fiscal Years 2025-2028). Over the rate setting period, the total revenue requirements for the Water and Wastewater Funds are increasing due to inflation outpacing assumptions in previous water and wastewater rate models. The City has experienced significant increases in nearly all

aspects of operations including supplies, materials, electricity, chemicals, capital construction, property and liability insurance, and increased capital policy reserve minimums due to increases in operating and capital costs. As a result, the City's rate consultant is recommending increases in the City's water and wastewater rates to sufficiently meet the needs of the water and wastewater utilities over the next four years.

The factors affecting the proposed FY 2025 solid waste rates include most significantly an increase in County tipping fees, and also an adjustment to the Franchise Fee and changes to Clean Community program fees.

**DISCUSSION:**

Background

On October 3, 2023, City Council approved a contract with HDR Engineering Inc. (HDR) to conduct comprehensive water and wastewater rate studies and 10-year financial plans for each utility. The City regularly conducts water and wastewater rate studies, which include rate revenue projections for the next 10 years. The last water rate study was completed in 2021 and the last wastewater rate study was completed in 2022. HDR and staff have been presenting regularly to the Water Commission, Finance Committee, and City Council to receive feedback and input on the policy direction of the proposed rates. Included below is a summary of the public meetings:

<b>Meeting Date</b>	<b>Meeting Body</b>	<b>Meeting Summary</b>
September 21, 2023	Water Commission	Recommended that City Council authorize staff to execute a contract with HDR for a rate study.
October 3, 2023	City Council	Authorized staff to execute a contract with HDR for a rate study.
October 19, 2023	Water Commission	Introduced the governing principles and goals of the water and wastewater rate study.
January 18, 2024	Water Commission	Presented revenue requirement options for water and wastewater. The options for each utility included varying levels of capital funding and use of reserves below policy level. Received input from the Commission on which option to pursue.
February 27, 2024	Finance Committee	Presented revenue requirement options for water and wastewater. The options for each utility included varying levels of capital funding and use of capital reserves below policy level. Recommended that City Council direct staff to complete a cost of service analysis and return with a final rate notice.
February 27, 2024	City Council	Presented revenue requirement options for water and wastewater. The options for each utility included varying levels of capital funding

		and use of capital reserves below policy level. City Council directed staff to complete a cost of service analysis and return with a final rate notice.
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### **Wastewater Rate Changes for Fiscal Years 2025 - 2028**

The City’s wastewater system plays an essential role in protecting public health and the environment. Maintaining the City’s wastewater system requires a proactive commitment to investing in the capital infrastructure and resources necessary to keep this vital system operating 24 hours a day, 365 days per year. The City’s complex wastewater system includes 256 miles of sewer mains, 7 lift stations, 25 creek crossings, over 7,000 access structures (manholes and cleanouts), 2 miles of pressurized force mains, and the El Estero Water Resource Center (El Estero) – all of which must operate seamlessly to process approximately 2 billion gallons of wastewater annually.

#### **Revenue Requirement and Cost of Service Analysis**

During the rate setting period, revenues must be sufficient to meet the cost of the City’s wastewater system, including operations and maintenance expenses, capital improvements, mandated standards of treatment, principal and interest payments on existing debt, reserves, and other obligations. In addition, recent inflation has outpaced the assumptions in previous wastewater models for both operations and maintenance and capital costs. The wastewater utility is also experiencing significant increases in allocated costs including property and liability insurance, and increased reserve minimums due to increased operating and capital costs. The sum of these factors contributes to the need for an average annual revenue increase<sup>1</sup> of 9.5% for FY 2025 – FY 2028.

To help mitigate rate impacts to customers, capital reserves are being drawn down below minimum policy levels. This results in capital reserves dropping below City policy in multiple years, with a maximum of \$1.3M (~10%) below Council policy in FY 2028. Reserves are projected to return to City policy levels in FY 2030 (outside of this 4-year rate setting period) based on the 10-year financial plan assumptions, which include future wastewater rate adjustments.

The total revenue requirement less non-rate revenue from other sources is defined as the “cost of service” for any given fiscal year. After determining the cost of service, rates are then designed to apportion the cost of service among the customer classes, according to the proportionate share of costs of service attributable to each customer class. A cost of service analysis is forward-looking and determines the proportional distribution of the revenue requirement to the City’s customer classes of service (i.e., residential, commercial).

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<sup>1</sup> It is important to note that rate revenue increases do not equate precisely to rate increases or bill impacts to individual customer classes of service. For example, a single-family residence with average wastewater use may see different impacts than a commercial customer.

### Rate Structure

No changes to the City's wastewater rate structure are proposed for this study. Residential wastewater bills are made up of two components: (1) a volumetric charge based on water usage, and (2) a fixed monthly base charge based on the number of dwelling units served by the account. For single-family customers, wastewater volumetric charges are capped at 8 hundred cubic feet (HCF) of water use. The purpose of limiting the volumetric charges is to recognize that water use above this level is likely being used for outdoor watering, which does not enter the wastewater collection system or receive treatment at El Estero. The multi-family customer class does not exhibit a strong outdoor irrigation pattern, meaning most water usage is being used primarily indoors and discharged to the City's wastewater system. Therefore, there is no volumetric cap for multi-family residential customers.

There are two commercial classes of service: Commercial, and Commercial High Strength/Industrial. Both classes are charged the greater of their volumetric charges or minimum monthly bill amount based on water meter size.

The City has a High Strength Surcharges fee to cover the additional treatment costs associated with high strength wastewater streams. Discharges that fall in this category include, but are not limited to, domestic septic tank/portable restroom discharges, industrial laundry services, and alcohol beverage manufacturing (e.g., breweries, wineries, and distilleries). The cost of service analysis has determined the proportional allocation of costs on a per pound basis for Biochemical Oxygen Demand, Total Suspended Solids, and Ammonia. The vast majority of commercial customers do not receive High Strength Surcharges.

### **Water Rate Changes for Fiscal Years 2025-2028**

#### Revenue Sufficiency

On a long-term basis, revenues must be sufficient to meet the cost of the City's Water System, including operations and maintenance expenses, capital improvements, mandated standards of treatment, principal and interest payments on existing debt, Council policy reserves, and other obligations. Additional rate impacts are due to inflation outpacing assumptions in previous water rate models for both operations and maintenance and capital, significant increases in allocated costs including property and liability insurance, and increased reserve minimums due to increased operating and capital costs. The sum of these factors contributes to an annual revenue increase<sup>2</sup> of 10.5% for Fiscal Years 2025-2026 and 10% for Fiscal Years 2027-2028.

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<sup>2</sup> It is important to note that rate revenue increases do not equate precisely to rate increases or bill impacts to individual customer classes of service. For example, a single-family residence with average water use may see different impacts than a commercial customer.

Capital reserve funds are being drawn down to mitigate rate impacts to customers. This results in capital reserves dropping below City policy in multiple years, with a maximum of \$6.3M (~20%) below Council policy in FY 2026. Reserves are anticipated to return to City policy levels in FY 2029 (outside of this 4-year rate setting period) based on the 10-year financial plan assumptions, which include future water rate adjustments.

Upcoming capital improvements include replacing six miles of water main annually (2% of the system), transmission system upgrades, reservoir replacement, and water treatment facility upgrades. Continued investment in the water system is essential to providing safe and reliable drinking water to the City's customers. Additionally, the proposed rates will be sufficient to meet all financial obligations of the utility, including debt service and coverage requirements.

### Rate Structure

Water bills are made up of two components: (1) a volumetric charge based on water usage, and (2) a fixed monthly service charge based on meter size. Even though the majority (~85%) of costs to maintain and operate the water system are fixed, the City's water rate structure is designed to minimize increases to fixed charges and collect the majority (~70%) of revenue through volumetric charges, which are dependent on water usage. This gives customers an opportunity to reduce their water bill by decreasing water usage.

City Council has established priorities for allocating water sources to the different customer classes and tiers within the customer classes. The lowest-cost water sources are allocated to Tier 1 customers, and the more expensive water sources are allocated to the highest tiers, as water supplies are limited and higher water use is generally for discretionary purposes beyond efficient irrigation use and basic health and sanitation needs.

The City's tiered rate structure is supported by a diverse water supply portfolio, with different supply costs for each of the City's associated water sources. It is important to recognize that water used from the City's various water sources can change from year to year based on hydrology, availability, and operational and management objectives aimed to provide reliable and cost-effective water service. To improve stability in water rates, the City's rate consultant has calculated the volumetric water rates based on the estimated long-term potential supply yield from each of the City's water sources, subject to capacity or operational constraints. This approach reduces rate volatility resulting from year-to-year changes in supply sources without affecting the potential yields used in water rate calculations.

### **Rates Based on Proposition 218 Cost of Service Analysis**

The total revenue requirement, less non-rate revenue from other sources, such as payments made by other agencies that use the City's water treatment plant and interest earnings, is defined as the "cost of service." This cost of service is used as the basis for proportionally distributing costs to the City's customer classes. Rates, including tiers

within each customer class, are designed in accordance with Proposition 218 so that each customer class pays a proportionate share of costs, based on the cost of service to supply water.

The tables below show examples of wastewater and water bills for single family homes based on various usage levels.

**Wastewater**

Usage Level	Monthly Usage (HCF)	Current Bill	Proposed FY 25 Bill	Proposed FY 26 Bill	Proposed FY 27 Bill	Proposed FY 28 Bill
Low	4	\$44.12	\$48.02	\$52.58	\$57.57	\$63.06
Moderate	10	\$61.24	\$66.14	\$72.42	\$79.29	\$86.86
High	20	\$61.24	\$66.14	\$72.42	\$79.29	\$86.86
1 HCF = 748 gallons						

**Water**

Below example based on a 5/8" meter

Usage Level	Monthly Usage (HCF)	Current Bill	Proposed FY 25 Bill	Proposed FY 26 Bill	Proposed FY 27 Bill	Proposed FY 28 Bill
Low	4	\$53.00	\$58.17	\$64.25	\$70.69	\$77.77
Moderate	10	\$144.14	\$150.03	\$165.77	\$182.35	\$200.59
High	20	\$349.44	\$381.49	\$421.53	\$463.69	\$510.05
1 HCF = 748 gallons						

**Wastewater and Water Rate Outreach**

The City has been ramping up public outreach associated with the anticipated water and wastewater rate changes. Since potential bill increases are larger than have been experienced in recent years, staff is undertaking a heightened level of outreach to raise awareness and ensure customers understand the facts behind the rate study cost drivers. Key messages and talking points have been developed to guide communication efforts and touch on the most common questions.

In April, the Proposition 218 Notice that is required to be sent to customers (and is quite prescriptive), will also include a supplemental fact sheet that will discuss the infrastructure investments that are needed for our aging water and wastewater systems (see Attachment 2). The City has been including infrastructure investment information in the monthly utility bill insert, weekly City News in Brief email newsletter, and the quarterly Water Resources

email newsletter. Additional outreach will be sent through these avenues as the rate noticing period commences. Staff will create a webpage specific to the current rate changes and the reasons for the increases, as well as a frequently asked questions (FAQs) section. The supplemental fact sheet, webpage, and FAQs will be translated into Spanish. Social media outreach will be conducted on Facebook, Nextdoor, and X (formerly Twitter) as well as an announcement on the new WaterSmart customer portal. Additionally, staff are planning a public webinar for May 22, 2024 to share information about the rates process and gather feedback.

The City is not alone with the significant jump in costs of service. Many agencies locally and around the state are taking actions to increase rates to match the costs of service.

### **Solid Waste Rate Change for Fiscal Year 2025**

Several factors inform the proposed FY 2025 rates, as outlined below.

#### **Waste Processing and Disposal**

In 2016, the County of Santa Barbara and the Cities of Santa Barbara, Goleta, Buellton, and Solvang worked together to develop and build the ReSource Center at the Tajiguas Landfill. The ReSource Center is a state-of-the-art resource management facility that significantly increases the diversion of trash from landfill disposal, thereby extending the life of Tajiguas, and providing a long-term waste management solution for the South Coast.

The ReSource Center consists of a Materials Recovery Facility (MRF) that sorts trash and recovers recyclable commodities, as well as an anaerobic digester that converts organics recovered from the MRF into compostable material and biogas. In December 2018, the City executed a 22-year Materials Delivery Agreement (MDA) with the County that commits the City's waste and associated tipping fees for processing at the ReSource Center. The County is increasing tipping fees from \$176 per ton in FY 2024 to \$189 per ton in FY 2025 to keep up with inflation and other cost increases.

#### **Waste Collection and Hauling**

The City adopted its current solid waste franchise hauler agreement with MarBorg Industries (MarBorg) on April 18, 2023, which went into effect on June 8, 2023. As part of this agreement, MarBorg's base compensation for curbside cart collection and other collection services remains flat in FY 2025. In future years, increases to compensation will be based on inflation.

#### **Franchise Fees**

Franchise fees are paid by MarBorg to the City for the use of the City's rights-of-way and impact of the solid waste service on municipal infrastructure. These fees are part of the

negotiated franchise agreement and represent costs the City incurs for the right of use of City infrastructure. Franchise fees are incorporated into the rates.

### City Programs

In addition to paying for waste hauling and disposal, solid waste rate revenue also pays for various City programs managed by the Clean Community Division. These programs include abandoned waste removal in the public rights-of-way, maintenance of public containers (i.e., public trash cans), clean-up and abatement of encampments throughout the City, public education and outreach, compliance with City reserve policies, and other environmental programs that ensure the City complies with rapidly developing State regulations and maintains its status as an environmentally forward City.

### Fiscal Year 2025 Rate Increase

Several factors inform the proposed FY 2025 rates. As mentioned above, the increase of County tipping fees to \$189 per ton in FY 2025 will increase overall solid waste rates by 2.8%. An adjustment to the Franchise Fee will reduce overall rates by 0.2%. Changes to Clean Community program fees will decrease overall rates by 0.7%.

The combination of these adjustments results in a 1.9% total increase for solid waste rates, as shown in the table below.

<b>Santa Barbara Rate Increases Effective July 2, 2024</b>	
Hauler (MarBorg) Compensation	0.0%
Tipping Fee Increase (County)	2.8%
Other City Programs	-0.9%
<b>TOTAL Change to Customer Charges</b>	<b>1.9%</b>

### **BUDGET/FINANCIAL INFORMATION:**

The proposed rate schedules support the Water and Wastewater Funds budget submittals for Fiscal Year 2025, and aligns the funds with their 10-year financial plan. Over the four-year rate setting period, the proposed water and wastewater rates will generate necessary rate revenue, which when combined with non-rate revenue and use of reserves, will be sufficient to support the costs of operating and maintaining the water and wastewater systems. Under the proposed water and wastewater rate structures, the City will utilize non-rate revenue and capital reserves below policy level to reduce, or “buy down”, the revenue requirement, which is the total amount of funding that needs to be generated from rate payers in any given year.

The City has executed two long-term water supply agreements: (1) a Recycled Water Agreement with the La Cumbre Mutual Water Company, and (2) a Water Supply



Agreement (WSA) with Montecito Water District for the sale of potable water secured by the Charles E. Meyer Desalination Plant. Without these agreements, particularly the WSA, the City would need to either significantly increase rates above what is being proposed, reduce planned capital investments in aging infrastructure, or execute a combination of these actions. Continuous deferral of capital funding would lead to underinvestment in the water system, leading to more frequent emergency repairs and higher maintenance costs in the future.

Under the proposed solid waste rates, the City will fulfill its contractual obligations to the County for waste processing and to MarBorg for franchised waste hauling services. The proposed rates also enable compliance with State regulations and fund additional management of encampment and community clean-up.

**WATER COMMISSION RECOMMENDATION:**

The water and wastewater rates were presented to the Water Commission on March 21, 2024, and the Commission voted 4:0:1 in support of staff's recommendations.

**ATTACHMENTS:**            1. Draft Notices of Public Hearing on Utility Rates  
   2. Draft Supplemental Rate Fact Sheet

**PREPARED BY:**            Joshua Haggmark, P.E., Water Resources Manager/GC/Im  
   Dustin Merback, Environmental Services Specialist

**SUBMITTED BY:**        Clifford M. Maurer, P.E, Public Works Director  
   Alelia Parenteau, Sustainability and Resilience Director

**APPROVED BY:**        City Administrator's Office