



City of Palo Alto

City Council Staff Report

(ID # 12378)

Report Type: Action Items

Meeting Date: 8/9/2021

Summary Title: FY 2022 Wastewater Rates

Title: PUBLIC HEARING/PROPOSITION 218: Adoption of two Resolutions: 1) Adopting the Fiscal Year (FY) 2022 Wastewater Collection Utility Financial Plan and Amending the Wastewater Collection Utility Reserve Management Practices; 2) Amending Utility 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)

From: City Manager

Lead Department: Utilities

Recommendation

Staff and the Finance Committee recommend that the City Council adopt the following Resolutions:

- a. The Fiscal Year (FY) 2022 Wastewater Collection Utility Financial Plan, and Amending the Wastewater Collection Utility Reserve Management Practices ([Attachment A](#));
- b. Amending Utility Rate Schedules S-1 (Residential Wastewater Collection and Disposal), S-2 (Commercial Wastewater Collection and Disposal), S-6 (Restaurant Wastewater City of Palo Alto Page 2 Collection and Disposal) and S-7 (Commercial Wastewater Collection and Disposal – Industrial Discharger) ([Attachment B](#));

Executive Summary

From February through April 2021, the Utilities Advisory Commission (UAC) and Finance Committee reviewed various rate changes recommended by staff for Fiscal Year 2022. This report summarizes the meetings that occurred, including all staff recommendations, for the wastewater collection utility. Estimates for retail revenue impacts are included in the FY 2022 budget assumptions. This report outlines the actions requested, transmits the resolutions from these reviews, and requests City Council approval and adoption. Approval of this item would result in the finalized rates for FY 2022, beginning September 1, 2021.

Utilities staff presented to the UAC on February 3, 2021 and the Finance Committee on April 6, 2021 a recommendation that Council adopt two resolutions:

1. Approving the FY 2022 Wastewater Collection Utility Financial Plan;
2. Amending the Wastewater Collection Utility Reserve Management Practices;
3. Approving the following transfers:
 - a. Up to \$2,200,000 in FY 2021 from the Operations Reserve to the Capital Improvements Projects Reserve;
 - b. Up to \$4,350,000 in FY 2022 from the Operations Reserve to the Capital Improvements Projects Reserve.
4. Approving a 3% overall revenue increase by amending Utility Rate Schedules S-1, S-2, S-6 and S-7. ([Linked Document](#))

In FY 2022, the increase in revenues corresponds to an average residential rate increase of 4.7%, an average commercial rate increase of 1.5% and a rate decrease for restaurant customers of 2.1%. Raftelis Financial Consultants, Inc. reviewed and updated the Wastewater Collection cost of service study and made recommendations that are incorporated into the attached Financial Plan to ensure costs are equitably allocated to each customer class; the report is titled “City of Palo Alto 2021 Wastewater COS Report” ([Linked Document](#)).

Background

Over the past 10 years the 15 industrial customers that used to be served by the Wastewater Collection Utility have either left the system, moved industrial operations out of Palo Alto, or are now considered commercial customers rather than industrial due to changes in operations. With the flow changes of those customers and other changes in the non-residential flows, residential customers have increased their relative percentage of wastewater flows while non-residential customers have decreased their relative contributions to wastewater flows. During the same time period, Palo Alto’s wastewater has also become more concentrated as water conservation has occurred system-wide. These changed usage patterns and concentration changes together with updated costs reflect the current cost of Wastewater Collection service.

As required by Article XIID of the State Constitution (added by Proposition 218), the City mailed a Notice of Public Hearing to property owners and customers on June 16, 2021 regarding the proposed wastewater collection rate changes. This notice informed the public that the proposed rate changes would be considered for Council adoption at a Public Hearing on August 9, 2021 at 6 pm. All residents and interested persons may submit written or oral testimony at the hearing, and may also submit written protests to any or all of the proposed rate increases. Council may consider and adopt the proposed wastewater rates unless written protests are filed by a majority of the affected customers. Any approved wastewater collection rate changes will become effective September 1, 2021. The Public Hearing at which Council will consider adoption of the proposed wastewater collection rates must be opened on August 9th as stated in the notice, but may be continued, if needed.

Discussion

From February through April 2021, the Utilities Advisory Commission and Finance Committee

received and reviewed various utility financial plans, transfer requests, and rate changes recommended by staff. This report outlines the actions requested, transmits the resolutions from these reviews, and requests City Council approval and adoption regarding the FY 2022 wastewater collection financial plan and rates.

Attached to this report are several documents, referenced throughout the recommendation language and the report. In addition, this report also includes links to the City's website for all the staff reports presented throughout the review process to the Utilities Advisory Commission, Finance Committee, and City Council.

Staff and the Finance Committee recommend that the City Council approve the Utility financial plan, reserve management practices and rate changes listed below.

Proposed Rate Changes and Financial Plan

The FY 2022 Wastewater Collection Utility Financial Plan ([Linked Document](#)) includes projections of the utility's costs and revenues through FY 2026. 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 Regional Water Quality Control Plant (RWQCP)¹. Both cost components have been increasing and are expected to continue to increase. A 3% overall revenue increase is needed in FY 2022 and FY 2023 and staff projects overall revenue increases of approximately 5% annually through FY 2026 to cover current and projected costs.

The RWQCP has been in operation since 1934. Aging equipment, new regulatory requirements, and the movement to full sustainability will require rehabilitation, replacement, and new processes. Palo Alto has seen increases in operational costs in recent years, and 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](#)) is implemented. Rehabilitation and replacement of plant equipment that has been in use for over 40 years is necessary to ensure the city can provide wastewater treatment safely and in compliance with regulatory requirements.

Collection system costs are also increasing, though not as much as treatment costs. This is primarily driven by increases in collection system capital costs: the cost of underground construction to replace aging sewer mains has nearly doubled since 2008. The Wastewater Collection utility undertakes a larger main replacement project every other year with the next project occurring in FY 2022. Undertaking a larger main replacement project every other year 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,

¹ The costs associated with the RWQCP are shared among Palo Alto and the partner agencies (Stanford, East Palo Alto Sanitary District, Los Altos Hills, Los Altos, and Mountain View) based 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.

gas and large development services projects. Other operational costs have also increased (e.g. salaries and benefits and overhead), but more slowly than treatment and collection infrastructure-related costs.

Staff also proposes modifications to the Wastewater Collection Utility Reserves Management practices ([Linked Document](#)). These changes will synchronize the reserve guidelines with the staggered main replacement schedule, as well as the capital program contributions to the CIP Reserve. In addition, the changes outline what actions staff must take if CIP Reserves are in excess of the maximum level. The new maximum and minimum CIP Reserve guideline levels as well as the funding plans are described in detail in the attached Financial Plan.

This year, Raftelis Financial Consultants, Inc. completed a Cost of Service and Rate Study titled “City of Palo Alto 2021 Wastewater COS Report” ([Linked Document](#)). This study recommends adjustments to ensure costs are equitably allocated to each customer class. The rates presented in Table 1 below and in the attached Financial Plan incorporate the results and recommendations of the study.

Table 1: Current and Proposed Wastewater Collection Charges

		Current (7/1/2019)	Proposed (7/1/2021)	Change	
				\$/mo.	%
Monthly Service Charges (\$/month)					
S-1 (Residential)	Service charge	\$41.37	\$43.32	\$1.95	4.7%
Quantity Rates					
S-2 (Commercial)	\$/CCF	7.97	8.09	0.12	1.5%
S-6 (Restaurant)	\$/CCF	12.33	12.07	(0.26)	(2.1%)

- (1) Monthly charges for S-1 (Residential) are fixed monthly charges.
- (2) For S-2 (Commercial) customers, the quantity charges are based upon the average water usage for the months of January, February and March and applied in the following July. For Restaurant customers, the quantity charges are based on monthly metered water usage. Estimated bills for S-2 and S-6 customers would be \$113.26 and \$675.92 respectively.
- (3) Currently there are no customers on the S-7 (Industrial) rate schedule; however, CPAU continues to maintain the S-7 rate schedule in case there is a need for the rate schedule in the future. The attached Financial Plan updates the S-7 Industrial rates to reflect the COS adjustments.

The cost-of-service study was updated to reflect actual winter (January – March) water usage patterns from associated water accounts (data reflects pre-COVID usage). Over the past 10 years the 15 industrial customers that used to be served by the Wastewater Collection Utility have either left the system, moved industrial operations out of Palo Alto, or are now considered

commercial customers rather than industrial due to changes in operations. Those customers accounted for approximately 11% of the estimated wastewater flows. With the flow changes of those customers and other changes in the non-residential flows, residential customers have increased their relative percentage of wastewater flows while non-residential customers have decreased their relative contributions to wastewater flows. This is a primary reason for the increases in rates for residential customers relative to commercial customers. The restaurant customer class pays for 5% of the total revenue both at current and proposed rates (see Table 2 below). However, because the customer class is so small, the approximately \$14,000 drop in revenue required leads to a 1.4% decrease in customer class revenue and a 2.1% decrease in restaurant rates.

The analysis also recommended removing the minimum charge for commercial and restaurant customer classes, as the volumetric charge is an equitable way to capture the variability in sewer usage among non-residential customers. Commercial customers will be billed volumetrically based on average water usage for the months of January, February, and March, applied through the year starting in the following July.² New commercial customers without an applicable usage history will be conservatively presumed to have a usage of 4.8 ccf per month, the estimated residential wastewater flow per equivalent dwelling unit, until a water usage history is established. Restaurant customers' volumetric charge will be based each month on metered water use during the prior metered-read period.

Meanwhile, over the past 10 years, Palo Alto's wastewater has become more concentrated as water conservation has occurred system-wide. These changed usage patterns and concentration changes together with updated costs reflect the current cost of Wastewater Collection service. Based upon the analysis, the relative changes to customer class groups are shown in Table 2 below:

Table 2: Revenue Allocation by Customer Class in FY 2022

Customer Class	Customer Class Revenue		Difference	Customer Class Percentage of Total Revenue at Current Rates	Customer Class Percentage of Total Revenue at Cost of Service	Average Rate Impact % (from Table 1)
	At Current Rates	At Cost of Service				
Residential (S-1)	\$12,924,319	\$13,531,403	4.7%	63%	64%	4.7%
Commercial (S-2)	\$6,482,022	\$6,467,761	(0.2%)	32%	31%	1.5%
Restaurant (S-6)	\$1,031,313	\$1,017,018	(1.4%)	5%	5%	(2.1%)
Industrial (S-7)	\$0	\$0	\$0	0%	0%	0%
TOTAL	\$20,437,654	\$21,016,183	2.8%	100%	100%	-

As a result of the COS update together with the overall revenue increase of 3%, residential customers (S-1) will see a 4.7% rate increase (on average), Commercial (S-2) a 1.5% rate

² This is done since the rainy and cool winter months are the period when water use is well correlated to sewer use, and when fluctuations in water use due to landscape needs is minimized.

increase, and Restaurant (S-6) a 2.1% rate decrease. Individual customer impacts will vary for non-residential customers depending on usage. Note that although there is a rate increase of 1.5% for commercial customers, overall revenue from this class decreases by 0.2%. This is due to the elimination of the minimum charge.

Stakeholder Engagement

On June 16, 2021, the City mailed a Notice of Public Hearing for Proposed Wastewater Rate Changes to all residents and bill payers in the City of Palo Alto. A copy of this letter is included on the City's website at www.CityofPaloAlto.org/RatesOverview. Proposed rate changes will be considered by the City Council at a public hearing to be held: Monday, August 9, 2021 at 6:00 pm.

Pursuant to the provisions of California Governor's Executive Order N-29-20, issued on March 17, 2020, to prevent the spread of Covid-19, this meeting will be held by virtual teleconference only, with no physical location. To participate please use the following link: <https://www.cityofpaloalto.org/Departments/City-Clerk/City-Council-Agendas-and-Minutes> and click on "Join Zoom Meeting" or call 1(669) 900-6833.

The City welcomes your feedback at the hearing. All residents and other interested persons are invited to submit written or oral testimony at this hearing. You may also submit a written protest against any or all of the proposed charges outlined above. If you choose to submit a written protest, the City must receive your signed, written protest prior to the close of the public input portion of the public hearing on August 9, 2021.

Customer protests must include the City of Palo Alto Utilities account number(s) or street address(es). Protests by property owners must include the Assessor's Parcel Number(s) or street address(es) of the parcels for which protests are submitted. You may mail written protests in advance to: City Clerk, 250 Hamilton Avenue, Palo Alto, California 94301

Except for protests submitted during the public hearing, protests cannot be submitted electronically. If you wish to submit a protest during the public hearing, please announce over Zoom your intent to do so, and staff will give you instructions. All written protests must be received by the City Clerk no later than the close of the public input portion of the public hearing.

The City Clerk will follow the guidelines for the submission and tabulation of protests adopted by the City Council on May 12, 2008 as Resolution No. 8815. If written protests are filed by a majority of the affected wastewater customers or with respect to a majority of the parcels subject to the proposed rates, the wastewater rate increase will not be imposed.

Committee and Commission Review

The UAC reviewed preliminary financial forecasts for the Electric, Gas, Water and Wastewater

Collection utilities at its December 2, 2020 meeting ([Staff Report #11649](#)³), and the Finance Committee reviewed the same preliminary forecasts at its February 16, 2021 meeting ([Staff Report #11864](#)⁴).

The UAC reviewed staff's final recommendations for the Wastewater Collection utility at its February 3, 2021 meeting ([Staff Report #11882](#)⁵). The Wastewater Collection recommendation was passed unanimously by the UAC (7-0).

The Finance Committee reviewed staff's proposals for the following utilities at its April 6, 2021 meeting, which were all passed unanimously (3-0):

- a. Wastewater Collection ([Staff Report #11886](#)⁶)
- b. Electric ([Staff Report #11887](#)⁷)
- c. Gas ([Staff Report #11888](#)⁸)
- d. Water ([Staff Report #11889](#)⁹)

Timeline

After the August 9 Public Hearing is opened and testimony from members of the public, City Council will close the hearing and take action. Unless written protests are filed by a majority of affected wastewater collection customers, Council may vote on the proposed rate actions. If approved, the wastewater collection rates would become effective September 1, 2021.

Resource Impact

Effective on September 1, the projected normal year revenues for the Wastewater Collection Utility will increase by roughly 3%, or approximately a \$512,000 increase in revenues for FY 2022. This amount is less than the previously projected normal year revenue increase of approximately \$612,000 reflected in the FY 2022 Adopted budget. However, the \$100,000 difference in revenue will be less than half of one percent of overall revenue (\$20,600,000) so no budget adjustment is necessary at this time.

³ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/utilities-advisory-commission/archived-agenda-and-minutes/agendas-and-minutes-2020/12-02-2020-special/id-11649-item-no-3.pdf>

⁴ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/current-year/2021/id-11864.pdf>

⁵ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/utilities-advisory-commission/archived-agenda-and-minutes/agendas-and-minutes-2021/02-03-2021-special/id-11882-item-no-1.pdf>

⁶ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/current-year/2021/id-11886.pdf>

⁷ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/current-year/2021/id-11887.pdf>

⁸ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/current-year/2021/id-11888.pdf>

⁹ <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/reports/city-manager-reports-cmrs/current-year/2021/id-11889.pdf>

The Financial Plan and rate trajectories presented for the Wastewater Collection fund are projected to keep Operating Reserves within the minimum and maximum guideline levels over the entire forecast period.

Policy Implications

Policy Implications related to the proposed Wastewater Collection rate actions are detailed fully in the linked Finance Committee reports.

Environmental Review

Adoption of the attached Financial Plan and budgeted transfers does not meet the California Environmental Quality Act's definition of a project, pursuant to Public Resources Code Section 21065 and CEQA Guidelines Section 15378(b)(4) and (5), because it is a governmental fiscal and administrative activity which will not cause a direct or indirect physical change in the environment. Adoption of the proposed wastewater collection rates to meet operating expenses, purchase supplies and materials, meet financial reserve needs and obtain funds for capital improvements necessary to maintain service is not subject to the California Environmental Quality Act (CEQA), pursuant to California Public Resources Code Sec. 21080(b)(8) and Title 14 of the California Code of Regulations Sec. 15273(a). After reviewing the staff report and all attachments presented to Council, the Council incorporates these documents herein and finds that sufficient evidence has been presented setting forth with specificity the basis for this claim of CEQA exemption.

Attachments:

- Attachment A: Resolution Wastewater Financial Plan, Reserve Management Practices
- Attachment B: Resolution Approving FY 2022 Wastewater Rates

* NOT YET APPROVED *

Resolution No. _____

Resolution of the Council of the City of Palo Alto Approving the FY 2022
Wastewater Collection Utility Financial Plan and Amending the Wastewater
Collection Utility Reserves Management Practices

RECITALS

- A. Each year the City of Palo Alto (“City”) assesses the financial position of its utilities with the goal of ensuring adequate revenue to fund operations. 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. It does this with the goal of providing safe, reliable, and sustainable utility services at competitive rates. The City adopts Financial Plans to summarize these projections.
- B. The City uses reserves to protect against contingencies and to manage other aspects of its operations, and regularly assesses the adequacy of these reserves and the management practices governing their operation. The status of utility reserves and their management practices are included in Reserves Management Practices attached to and made a part of the Financial Plans.

The Council of the City of Palo Alto does hereby RESOLVE, as follows:

SECTION 1. The Council hereby adopts the FY 2022 Wastewater Collection Utility Financial Plan.

SECTION 2. The Council hereby approves the following transfers as described in the FY 2022 Wastewater Collection Utility Financial Plan:

- a. Up to \$2,200,000 in FY 2021 from the Operations Reserve to the Capital Improvements Projects Reserve; and
- b. Up to \$4,350,000 in FY 2022 from the Operations Reserve to the Capital Improvements Projects Reserve. Annual capital program contributions beyond FY 2022 will be approved by Resolution annually.

SECTION 3. The Council hereby approves the amendments to the Wastewater Collection Utility Reserves Management Practices as shown in Attachment D.

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SECTION 4. The Council finds that the adoption of this resolution does not meet the California Environmental Quality Act’s definition of a project under Public Resources Code Section 21065 and CEQA Guidelines Section 15378(b)(5), because it is an administrative governmental activity which will not cause a direct or indirect physical change in the environment, and therefore, no environmental review is required.

INTRODUCED AND PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

City Clerk

Mayor

APPROVED AS TO FORM:

APPROVED:

Assistant City Attorney

City Manager

Director of Utilities

Director of Administrative Services

* NOT YET APPROVED *

Resolution No. _____

Resolution of the Council of the City of Palo Alto Adjusting Wastewater Rates by 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)

R E C I T A L S

A. Pursuant to Chapter 12.20.010 of the Palo Alto Municipal Code, the Council of the City of Palo Alto may by resolution adopt rules and regulations governing utility services, fees and charges.

B. On August 9, 2021, the City Council held a full and fair public hearing regarding the proposed rate increase and considered all protests against the proposals.

C. As required by Article XIII D, Section 6 of the California Constitution and applicable law, notice of the August 9, 2021 public hearing was mailed to all City of Palo Alto Utilities wastewater customers by June 16, 2021.

D. The City Clerk has tabulated the total number of written protests presented by the close of the public hearing, and determined that it was less than fifty percent (50%) of the total number of customers and property owners subject to the proposed wastewater rate amendments, therefore a majority protest does not exist against the proposal.

The Council of the City of Palo Alto does hereby RESOLVE as follows:

SECTION 1. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule S-1 (Residential Wastewater Collection and Disposal) is hereby amended to read as attached and incorporated. Utility Rate Schedule S-1, as amended, shall become effective September 1, 2021.

SECTION 2. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule S-2 (Commercial Wastewater Collection and Disposal) is hereby amended to read as attached and incorporated. Utility Rate Schedule S-2, as amended, shall become effective September 1, 2021.

SECTION 3. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule S-6 (Restaurant Wastewater Collection and Disposal) is hereby amended to read as attached and incorporated. Utility Rate Schedule S-6, as amended, shall become effective September 1, 2021.

* NOT YET APPROVED *

SECTION 4. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule S-7 (Commercial Wastewater Collection and Disposal – Industrial Discharger) is hereby amended to read as attached and incorporated. Utility Rate Schedule S-7, as amended, shall become effective September 1, 2021.

SECTION 5. The Council finds that the revenue derived from the wastewater rates approved by this resolution do not exceed the funds required to provide wastewater service, and the revenue derived from the adoption of this resolution shall be used only for the purposes set forth in Article VII, Section 2, of the Charter of the City of Palo Alto.

SECTION 6. The Council finds that the fees and charges adopted by this resolution are charges imposed for a specific government service or product provided directly to the payor that are not provided to those not charged, and do not exceed the reasonable costs to the City of providing the service or product.

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* NOT YET APPROVED *

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SECTION 7. The Council finds that the adoption of this resolution changing wastewater collection rates to meet operating expenses, purchase supplies and materials, meet financial reserve needs and obtain funds for capital improvements necessary to maintain service is not subject to the California Environmental Quality Act (CEQA), pursuant to California Public Resources Code Sec. 21080(b)(8) and Title 14 of the California Code of Regulations Sec. 15273(a). After reviewing the staff report and all attachments presented to Council, the Council incorporates these documents herein and finds that sufficient evidence has been presented setting forth with specificity the basis for this claim of CEQA exemption.

INTRODUCED AND PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

City Clerk

Mayor

APPROVED AS TO FORM:

APPROVED:

Assistant City Attorney

City Manager

Director of Utilities

Director of Administrative Services