



City of Arts & Innovation

City Council Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: DECEMBER 13, 2016
FROM: PUBLIC WORKS DEPARTMENT WARDS: ALL
SUBJECT: SEWER ENTERPRISE FUND – SERVICE RATE REVIEW

ISSUE:

Receive an update on the Fiscal Year 2015-16 annual review of the Sewer Enterprise Fund service rates.

RECOMMENDATION:

That the City Council receive and file an update on the Fiscal Year 2015-16 annual review of the Sewer Enterprise Fund service rates.

BACKGROUND:

The City of Riverside Public Works Department, Wastewater Division, is responsible for the collection and treatment of wastewater for over 93,000 customers within city limits. The facilities consist of over 800 miles of gravity sewers, 19 wastewater lift stations, and the Riverside Regional Water Quality Control Plant (RWQCP) which has the capacity to treat 46 million gallons per day. Additionally, the RWQCP provides wastewater treatment for the Edgemont, Jurupa, and Rubidoux Community Services Districts, and the unincorporated community of Highgrove.

On May 13, 2014, the City Council, approved a five year Sewer Services Rate Plan to address the sewer fund revenue shortfall created by the recession and to finance required sewer system capital improvements. The five-year Sewer Services Rate Plan was based on a February, 2014 Capital Improvement Program and Rate Study. The five-year rate plan was effective starting in fiscal year 2014/15 through fiscal year 2018/19.

The adopted five-year rate plan included 8.5% increases per year in monthly sewer service charges for residential and non-residential customers. Also included in the adopted five-year rate plan were sewer capacity charge (connection fees) increases for new development. This included a one-time capacity charge increase in July, 2014 and adjustments on an annual basis equal to the Engineering News Record Construction Cost Increase, 20-city average. As part of the plan approval, the City Council directed staff to annually review the rate structure and report back to the City Council as to whether the approved rate increase could be adjusted downward based on positive financial outcomes not known at the time of approval.

On October 6, 2015, staff presented to the City Council an analysis of actual operating revenues and expenditures for fiscal year 2014/15, the first year of the associated five-year rate plan.

Comparisons of actual activity to the revenues and expenditures projected in the 2014 Rate Study (Rate Study) is the basis of staff's analytical efforts. Fiscal year 2014/15 revenue and expenditure activity for the Sewer Fund were determined to be largely on target with projections from the Rate Study. Staff recommended that approved sewer rates were appropriate to meet the operating and capital needs for the Sewer Fund.

DISCUSSION:

The City Council has directed the Public Works Department to provide annual financial updates on Sewer Fund revenue and expenses in comparison to the 2014 Rate Study estimates. Below are the actual revenue and expenditure data for fiscal year 2015/16, the second year of the associated five-year rate plan, as compared to the Rate Study. In an effort to demonstrate the long range financial position of the Sewer Fund, the report also includes a revenue and expenditure projection for fiscal years 2016/17 through 2018/19. In addition, the report discusses financial aspects of the Sewer Enterprise Fund Capital Improvement Program and the City's wastewater treatment agreements with the Community Service Districts. Lastly, included is a fiscal impact summary of sewer service rates should they be adjusted downward based on current Sewer Fund financial information.

Fiscal Year 2015/16 – Actual Revenue and Expenditures

Table 1 (below) looks at the actual revenues generated for the 2015/16 fiscal year, the second-year of the five-year rate plan, and compares them to the estimated revenue for the same period as forecasted in the Rate Study. The analysis includes all of the sewer service fee revenue received from commercial and residential sewer accounts, Community Services Districts, and connection fees. Actual revenue is lower than the Rate Study estimate by \$3,078,650, or approximately a -5.5% shortfall. The outcome indicates that the 2014 Rate Study may have overestimated the expected rate of customer growth. In addition, the recent State mandated water conservation efforts were unforeseen when the Rate Study was developed, thus significantly impacting commercial and industrial revenue, since commercial and industrial sewer billing calculations are based on water usage.

Table 1	
Revenues - FY 2015/16	Amount
Actuals	\$ 52,392,031
2014 Study Estimates	\$ 55,470,681
Variance – Favorable / (Unfavorable)	(\$ 3,078,650)

The expenditures for the Sewer Fund, as reflected in Table 2 (below), were compared to the Rate Study estimate (excluding capital improvement projects). Actual expenditures for 2015/16 fiscal year are \$12,403,127 less than those estimated in the Rate Study.

Table 2	
Expenditures - FY 2015/16	Amount
Operating and Debt Service Actuals	\$ 40,163,829
2014 Study Estimates	\$ 52,566,956
Variance – Unfavorable / (Favorable)	(\$ 12,403,127)

The majority of the \$12,403,127 variance from budgeted expenditures is due to attrition and staff vacancies that occurred during the year along with actual debt service expenditures being

significantly lower than projected. These positions have since been filled or are currently in the recruitment stage. The expenditure savings offsets the decrease in revenue.

The debt service expenditures were \$9.96 million lower than expected as a result of the impact of the GASB 68 credit related to estimated future pension obligations. The 2015 sewer bond interest and the year-end interest accrual were not budgeted since the bonds were not issued prior to the budget being prepared. The combination of the \$10 Million in accrued interest expenditures, not budgeted, offset by \$19 Million in capitalized interest make up for the reduction in the debt service expenditures. Depending on the specific bond covenants, capitalized interest is restricted for approved bond funded projects or debt service.

Fiscal Years 2016/17 to 2018/19 – Projected Revenue and Expenditures

For the fiscal years 2016/17 through 2018/19, the projected revenues have decreased from the 2014 Rate Study since updating the revenue model with actuals for 2015/16. This is partly due to a slower than expected residential and commercial customer growth. Customer growth is dependent on economic conditions. Therefore, better than expected economic conditions over the next two fiscal years will likely increase projected revenues. Additionally, mandatory water conservation implemented in the State of California has decreased commercial/industrial revenue which was unforeseen at the time of the 2014 Rate Study. It is believed that an improvement in drought conditions along with easing of water restrictions could result in an increase of commercial/industrial revenue. Staff is tracking on an on-going basis both economic and water conservation as they relate to the Sewer Fund financials.

Based on first quarter actuals in fiscal year 2016/17, annual revenues are projected to be \$57,370,874. This is \$1.7 Million or 2.9% lower than the Rate Study estimate. In comparison to the Rate Study, projected revenue for fiscal years 2017/18 and 2018/19 do not keep pace with the Rate Study estimates. Table 3 (below) shows the Rate Study projected totals for revenues through fiscal year 2018/19.

Table 3			
	FY 2016/17	FY 2017/18	FY 2018/19
Projected Revenues	\$ 57,370,874	\$ 64,618,608	\$ 70,637,732
2014 Rate Study Revenues	\$ 59,111,977	\$ 66,286,034	\$ 72,459,717
Variance – (Unfavorable) / Favorable	(\$ 1,741,103)	(\$ 1,667,426)	(\$ 1,821,985)

Table 4 (below) shows the Rate Study projected totals for expenditures through fiscal year 2018/19. The Rate Study originally projected \$53,945,625 in expenditures for 2016/17. Based on the first quarter of activity in fiscal year 2016/17, expenditures are projected to be \$59,743,495. For the fiscal year 2017/18, the total projected expenditures have decreased slightly, less than 1%, in comparison to the Rate Study. The fiscal year 2018/19 increase of \$2.6 Million is due to the increase in projected debt service costs.

Table 4			
	FY 2016/17	FY 2017/18	FY 2018/19
Projected Expenditures	\$ 59,743,495	\$ 64,566,270	\$ 70,858,136
2014 Rate Study Expenditures	\$ 53,945,625	\$ 64,840,505	\$ 68,248,956
Variance – Unfavorable / (Favorable)	\$ 5,797,870	(\$ 274,235)	\$ 2,609,180

Major Items Unanticipated in the 2014 Rate Study

1. Development and implementation of a Sewer Enterprise Fund Reserve Policy – The City Council adopted the Sewer Fund Reserve Policy at their November 15, 2016 meeting. The policy guides the operations and financial decision making of the Wastewater Division, helps secure its fiscal strength, allows for required capital infrastructure investment and improves the Fund's credit ratings from bond rating agencies.
2. Interfund Loan Payment Plan – Sewer Fund reimbursement projections have been incorporated consistent with the approved City Council loan repayment strategy implemented to eliminate interfund loans.
3. Heavy Equipment Replacement – a fund has been set aside to pay for the replacement of mobile heavy equipment as the fleet ages and has reached its expected service life. Heavy equipment is not included in the General Service motor pool replacement program.
 - a. Minimum target level is 25% of the projected five-year rolling replacement schedule of Heavy Equipment for the Wastewater Division, is currently estimated at approximately \$340,000 annually to replace equipment over the next 10 year period.
 - b. This Reserve may be used to fund capital purchases of fleet equipment on an as needed basis approved by the City Council. Heavy equipment includes large CNG vacuators used to clean sewer lines, sewer line video inspection vans, dump trucks and excavation equipment.
4. SEIU Contract provisions - the recently approved SEIU contract includes completion of a Wastewater Salary Survey, salary adjustments tied to the City BFI, one-time per employee contribution of \$750 along with other provisions. The Sewer Fund budget increase is estimated at approximately \$500,000-\$650,000 annually.

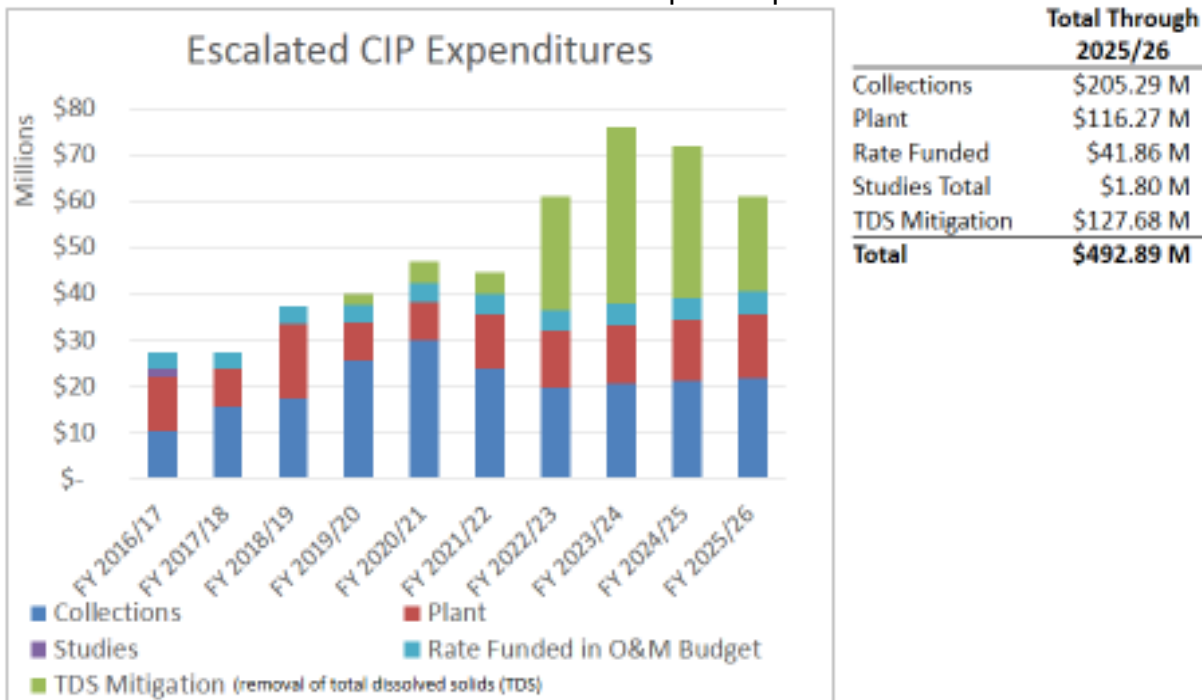
Consequences for Deferring or Eliminating Capital Projects

1. Non-compliance with Federal and State regulations.
 - a. The City of Riverside's treatment plant and collection system are operated under regulatory permits that require systematic and planned maintenance, repair and replacement of systems.
 - b. Failure to do so could result in a regulatory action against the City of Riverside.
2. Increase in sewer overflows and/or treatment water quality violations.
 - a. High risk of sewer overflows from manholes and broken pipelines. These sewer overflows can be large in volume and flow into the storm drain stream and to the Santa Ana River.
 - b. Regulatory enforcement and fines could be levied against the City of Riverside.
3. Reactive emergency repair
 - a. The City of Riverside typically pays a premium for emergency repairs that could otherwise be bid for competitive pricing.
4. Negative public impact on City brand
 - a. As a result of sewer overflows and/or water quality violations at the treatment plant, the City brand could have a negative impact on public perception.

Capital Improvement Program

The total capital improvement plan (CIP) as displayed in Chart 1 (below) is identified in the 2008 Integrated Master Plan for Wastewater Collection and Treatment Facilities (Master Plan) that is funded by the adopted five year Sewer Rate Plan through fiscal year 2018/19. As the chart shows, beyond fiscal year 2018/19, sewer rate adjustments will need to be assessed in order to fund the approximate \$500 Million in CIP expenditures through fiscal year 2025/26. Evaluation of the required infrastructure investment and associated five year financial plan for the fiscal years 2019/20 to 2023/24 is discussed below in the “Master Plan Project to Update CIP and Financial Plan” report section.

Chart 1 – 2008 Master Plan Capital Improvement Plan



1. Replace Pipelines and Pump Stations

The City owns, operates and maintains approximately 800 miles of sewer pipeline and nineteen sewer pump stations. The 2008 Master Plan determined that approximately 50% of the sewer pipelines were installed before 1966, more than 50 years ago, with the 1950's and 1960's having the greatest number of sewer pipelines installed. These older pipelines are primarily made of vitrified clay pipe (VCP) and typically have a service life of approximately sixty to eighty years.

Of the City's nineteen sewer pump stations, ten pump stations or 52% need to be rehabilitated over the next ten years. Sewer pump stations are installed at low points in the sewer collection system and function to pump wastewater up and over high areas. They are high risk systems for sewer spills because they are located at low points and the pump stations are necessary to keep wastewater flowing to the treatment plant.

Approximately \$200 million of collection system pipelines and sewer pumps stations have been identified in the Bond funded CIP. There is significant investment that is needed over the next ten to twenty year period in order to replace aging collection pipelines.

2. Repair Sewer Laterals

In 2008, the City took ownership for maintenance and repair of approximately 400 miles of residential sewer lateral lines from the property line to connection to the City's main sewer system (usually located in the street). Since 2008, the financial obligation has been steadily increasing and for FY 2016-17 is estimated at \$450,000.

3. Rehabilitate Treatment Systems

Approximately \$116 million of Bond funded CIP has been identified to rehabilitate existing treatment systems. These are systems not addressed in the current Phase 1 Rehabilitation and Expansion project. This is mainly due to additional planning and design that is necessary and they had not yet reached their expected service life.

For example, the plant headworks, dewatering, activated sludge and sand filtration treatment systems. The largest potential treatment project that has been identified is a TDS (salt) removal project to address regulatory standards for discharge to the Santa Ana River. This project would install an advanced reverse osmosis treatment system at the treatment plant to remove dissolved salts from the water.

Master Plan Project to Update CIP and Financial Plan

The Public Works Department is in the process of awarding a contract for a consulting firm to update the 2008 Integrated Master Plan for Wastewater Collection and Treatment Facilities (Master Plan). The goal of the project is to reevaluate the Master Plan and to develop sewer rate and financing alternatives for the next five year planning cycle for fiscal years 2019/20 through 2023/24. The project is expected to commence in January 2017 and will be completed by the summer of 2018. The department will then present the Master Plan to the City Council for their consideration.

Community Service District Agreements

Wastewater from the Jurupa, Rubidoux, and Edgemont Community Services Districts are treated by the City of Riverside pursuant to terms of Regional Wastewater Treatment Agreements. On a monthly basis, each of the community service districts are billed by the City for the operating cost to treat the wastewater.

However, the Regional Wastewater Treatment Agreements did not outline the shared cost for the City's CIP expenses related to rehabilitation/replacement of treatment systems at the plant. To address these CIP shared costs, the City has entered into settlement agreements with the Jurupa Community Services District (\$15 Million) and Edgemont Community Services District (\$1.75 Million). The City of Riverside is currently in legal proceedings with the Rubidoux Community Service District regarding their treatment plant CIP shared cost.

The total settlement funding of \$16.75 million has been included in the Sewer Enterprise Fund financial planning and Reserve Fund that was adopted by the City Council on November 15, 2016. There are some restrictions on how this funding can be used, specifically they cannot be used towards debt service or rate stabilization.

Fiscal Impact - Sewer Service Rates

An analysis was completed in order to explore the impact of adjusting sewer rates through 2018/19.

Scenario 1: Reduce rates by 1.5% over the last two years of the 5-year rate plan - 3% in total

Customer Impact: Single Family Residence is estimated at \$14.16 annually, or \$1.18 per month, in fiscal year 2017/18.

Negative impact:

1. Decrease in revenue estimated at \$2.6 Million
2. Unfund \$40 Million of pipeline and lift station improvements through 2025/26
3. Shift \$40 Million to meet bond debt coverage and maintain reserve levels
4. Higher risk of sewer overflows and regulatory action

Scenario 2: Reduce rates by 4.25% over the last two years of the 5-year rate plan - 8.5% in total

Customer Impact: Single Family Residence is estimated at \$39.60 annually, or \$3.30 per month, in fiscal year 2017/18.

Negative impact:

1. Decrease in revenue estimated at \$7.3 Million
2. Eliminates the ability to meet bond debt coverage in 2018/19
3. Eliminates the ability to maintain reserve levels
4. Unfund \$107 Million of pipeline, lift station improvements, and rehabilitation of treatment plant systems through 2025/26
5. Higher risk of sewer overflows and regulatory action

Considering the information above, staff is recommending that the sewer rates, which have been previously approved by City Council through FY 2018/19, are appropriate and necessary to cover expected operating expenses, required CIP investment along with maintaining debt coverage requirements and Revenue Bond rating. In addition, there are future operating costs not included in this analysis that factor into this recommendation. These include: new equipment coming on line at the wastewater treatment plant, the expected SEIU MOU Wastewater Salary Survey costs and increasing City sewer lateral repair costs.

FISCAL IMPACT:

There is no General Fund fiscal impact associated with this update. There is no Sewer Fund fiscal impact should the adopted Sewer Service Charge Rates remain unchanged. Staff estimates that a reduction in sewer service charge rates of 3.0% or 8.5% would result in a reduced Sewer Fund revenue, respectively, of approximately \$2.6 Million and \$7.3 Million.

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Attachment: Presentation