



NEWPORT BEACH

City Council Staff Report

November 14, 2023
Agenda Item No. 23

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

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TITLE: Resolution Nos. 2023-74 and 2023-75: Conduct a Public Hearing and Consider Water and Sewer Rate Adjustments

ABSTRACT:

The City Council conducted a Study Session on August 22, 2023, and approved the 2023 Water and Sewer Rate Studies on September 26, 2023. The completed studies analyze the cost of services, revenues and reserves, and recommend increases to the water and sewer rates. Increases are needed to fund the increased costs to purchase and pump water, to operate the system, and to fund the increased Capital Improvement Program to rehabilitate and maintain the City of Newport Beach's (City) water and sewer infrastructure for the long term. Staff has sent notices to all affected property owners and customers per state law. The City Council is asked to conduct a public hearing, tabulate the results of protests received, and if a majority protest is not received, approve the five-year water and sewer rate increase effective January 1, 2024.

RECOMMENDATIONS:

- a) Conduct a public hearing to accept comments on the proposed water rates and at the conclusion of the hearing close the 45-day notice period;
- b) Determine this action is exempt from the California Environmental Quality Act (CEQA) pursuant to Sections 15060(c)(2) and 15060(c)(3) of the CEQA Guidelines because this action will not result in a physical change to the environment, directly or indirectly;
- c) Direct the City Clerk to tabulate the results of the protests received from property owners and customers and announce the findings;
- d) Adopt Resolution No. 2023-74, *A Resolution of the City Council of the City of Newport Beach, California, Establishing Water Rates and Charges Effective January 1, 2024, and Four Years of Phased In Increases Thereto*; and
- e) Adopt Resolution No. 2023-75, *A Resolution of the City Council of the City of Newport Beach, California, Establishing Sewer Rates and Charges Effective January 1, 2024, and Four Years of Phased In Increases Thereto*.

DISCUSSION:

Executive Summary:

- Both the Water and Wastewater Enterprise Funds operate at a structural deficit, drawing down on net working capital reserves to fund the current Capital Improvement Programs.
- Increased replacement and rehabilitation of the water and sewer system pipes and components (the Capital Improvement Program) are needed and are estimated to cost \$45 million over the next five years.
- Current and future inflationary costs are affecting the Capital Improvement Program as well as all operational costs for materials, supplies, labor and electricity. The cost of pumping groundwater and purchasing imported water continues to increase.
- New comprehensive Water and Sewer Rate Studies have been completed, reviewed by the Finance Committee, and approved by the City Council.
- Water and sewer rate increases are recommended to properly sustain the water and sewer system, with regular increases each year for five years.
- The average rate increase for the first year is approximately \$4.77/month for water and \$2.20/month for sewer services, per household.
- The City Council is asked to conduct a public hearing and to approve the new, 5-year rate schedule.

If approved, water and sewer rate adjustments will commence on January 1, 2024, and will adjust annually on January 1 of each subsequent year. The total amount of a customer’s bill will depend on the amount of water consumed. Based on the typical single-family residential customer consuming 10 HCF per month with a 5/8” metered connection, the bills will increase as noted below:

	Current	2024	2025	2026	2027	2028
Single Family Residential						
Monthly Typical Bill (5/8” meter and 10 HCF)						
Water	\$63.92	\$68.69	\$74.19	\$80.19	\$86.19	\$92.19
<i>\$ Increase</i>		\$4.77	\$5.50	\$6.00	\$6.00	\$6.00
Sewer	\$13.65	\$15.85	\$18.35	\$21.35	\$24.85	\$28.35
<i>\$ Increase</i>		\$2.20	\$2.50	\$3.00	\$3.50	\$3.50

On August 22, 2023, the City Council held a study session to review the water and sewer rate studies and the proposed rates. On September 26, the City Council approved the rate studies, authorized the public noticing, and set a date of November 14 for the public hearing. In accordance with Proposition 218, local agencies are required to provide a 45-day notice period whereby property owners may submit in writing a protest objecting to the proposed water rates. At the conclusion of the notice period, the City is required to conduct a public hearing and tabulate the protests received. In the absence of a majority of property owners objecting to the rate, the City Council may adjust the rate and/or structure. The 45-day period will conclude at the end of the November 14, 2023 public hearing.

Rate Study Background:

Every few years, as the current rate schedules expire, a separate financial plan and rate studies are necessary to evaluate the water and sewer rates and to determine the charge for customers. Rate studies were previously completed in 2017 for sewer and in 2019 for water. These studies represent a best practice for determining utility rates that are fair, equitable and reflective of the demand placed on the systems by the customers. The City retained Black & Veatch Corporation to conduct the studies and assess the City's water and sewer rate structures. The goal was to ensure that the City's plans for critical infrastructure maintenance and for funding capital improvement projects with cash are in alignment with the proposed rates.

On May 11, 2023, and July 26, 2023, the Finance Committee reviewed the water and sewer rate financial analysis of both funds. This included the reserve policy, the continued reinvestment needs for infrastructure replacement through the Capital Improvement Program, inflationary cost increases, and preparation for future droughts. Briefly discussed were typical steps and decision points for evaluating rates and rate structures. Staff recommended, and the Finance Committee concurred, with maintaining a similar and simplified, easy-to-understand rate structure and moving fixed and variable rates to better match actual costs. The City Council studied and approved the various items as noted above on August 22, 2023, and September 26, 2023.

The rate studies have been constructed with a financial plan that corrects the structural deficit and sufficiently funds operations, capital and reserves. Each fund has a reserve policy/target, which considers the various types of risk the utility faces. The reserve policies are similar to the previous policies; however, they better articulate the types and uses of the reserves. In general, even with the rates increasing, reserve calculations are below target. The rates ramp up over the years, attempting to reach the target values by the fifth year (the amount is similar to the existing policy).

Reserve Policy for the Water Enterprise Fund:

- **O&M Reserve** – to cover day-to-day expenses and maintain sufficient funds to cover operating cash flows, periods of lower-than-expected water sales, or unforeseen cost.
 - > 33% of operating expenses (or 4 months of expenses)
- **Capital Reserve** – to cover a portion of upcoming annual capital expenditures, smooth out the amount of capital infusion needed each year, and help mitigate unexpected capital costs.
 - > 75% of 5-year average CIP
- **Rate Stabilization Reserve** – to absorb lower-than-expected revenue due to short-term decreases in water sales in order to avoid large swings in rates charged to customers over time.
 - > 30% of water use reduction (approximately \$3 million)

Reserve Policy for the Sewer Enterprise Fund:

- **O&M Reserve** – to cover day-to-day expenses and maintain sufficient funds to cover operating cash flows, periods of lower-than-expected sewer sales, or unforeseen cost increases.
 - > 25% of operating expenses (or 3 months of expenses)
- **Capital Reserve** – to cover a portion of upcoming annual capital expenditures, smooth out the amount of capital infusion needed each year, and help mitigate unexpected capital costs.
 - > 100% of 5-year average CIP

Understanding the fees, the water and sewer bill:

Water and sewer users are billed for two components: the size of the meter, known as the fixed charge (or standby/ready-to-serve charge), and the commodity or water usage charge. Most users are billed every two months via a Municipal Services Statement. This statement also includes charges for the City's recycling program and the Fire Medics program for those who are subscribed. Some users receive a monthly bill, and the future goal is to transition to monthly billing.

The rate studies looked at each of these charges, including their proportionality and recommended structured rate levels consistent with industry standard, in order to fairly and equitably recover the cost of providing water and sewer to the City's customers. The Finance Committee concurred with the goal of moving fixed and variable rates to better match actual costs. In order to accomplish this, most of the rate increases are reflected in the fixed meter charges as compared to the commodity charges. This approach better aligns with actual fixed expenditures, enhances the stability of the Enterprise Funds, and continues to maintain affordability and water conservation goals.

Water System:

The Utilities Department oversees the water system to provide safe and reliable water for drinking, irrigation and fire protection to Newport Beach residents, businesses and visitors. These essential services are accomplished through a strategic combination of dedicated in-house licensed staff operators (on-call 24 hours a day) and highly qualified contractors. Behind the scenes, the department is responsible for all water purchases/production, treatment, disinfection, water quality testing, regulatory compliance, field customer service, and emergency response. The water system is supported by the Public Works Department for the Capital Improvement Program projects and the Finance Department for utility billing and customer service. The system includes approximately 300 miles of water pipelines, 200 million gallons of water storage, 26,000 service connections (water meters), 17 water booster pumps, 42 pressure-reducing stations, 2,700 fire hydrants, 8,100 water valves, 12 interconnects and four groundwater wells.

There are four main expenditure categories of the water enterprise that are important to providing water service: Purchasing/Pumping Water, Operations, Replacement and Customer Service. The cost to purchase and pump water includes the direct cost for the rights to pump groundwater and to buy imported surface water. The Operations category includes day-to-day operations and maintenance and is comprised of salaries, contract maintenance, repair materials, permits, outside agency fees, electricity, and professional services. Replacement includes the annual capital replacement or rehabilitation of aging infrastructure and recommended improvements per the Water Master Plan. Over \$40 million in total annual capital improvements are planned over the next five years. Customer Service includes meter reading, invoicing, customer service, administration, and internal service charges.

Water rates, as shown in the table below and in the report, are proposed to be adjusted proportionally and increased each year for the next five years. The average residential customer, who uses approximately 10 billing units (7,480 gallons per month), is expected to see a \$4.77 per month increase starting in 2024. This was the previously approved rate originally scheduled in 2019. In the following years, the monthly rate will increase monthly by \$5.50 in 2025, \$6.00 in 2026, \$6.00 in 2027 and \$6.00 in 2028. A billing unit is 100 cubic feet (one HCF) or 748 gallons.

Proposed 5-year (Potable) Water Rates:

	Current	<i>Approved</i>	<i>New</i>	<i>New</i>	<i>New</i>	<i>New</i>
Effective Date		1/1/2024	1/1/2025	1/1/2026	1/1/2027	1/1/2028
Fixed Service Charges (\$/Month)						
Meter Size						
5/8", 3/4"	25.22	27.09	31.59	36.59	41.59	46.59
1"	39.09	41.99	50.07	58.30	66.53	74.75
1-1/2"	73.69	79.15	96.29	112.59	128.88	145.16
2"	115.23	123.76	151.74	177.74	203.71	229.65
3"	305.61	328.23	405.92	476.32	546.65	616.89
4"	523.69	562.45	697.06	818.33	939.47	1,060.46
6"	1,112.15	1,194.45	1,482.68	1,741.22	1,999.48	2,257.39
8"	1,942.91	2,086.69	2,591.80	3,044.12	3,495.95	3,947.18
Usage Charge (\$/HCF)						
Water Usage	3.87	4.16	4.26	4.36	4.46	4.56

Fire Service Water Rates:

The City's water system also has approximately 460 fire service customer connections. These are typically the large, red, above-ground pipes and valves seen in front of businesses or in parking lots. This pressurized water is supplied on a standby basis to provide additional fire-fighting water if needed by the property beyond the fire hydrant. The fire service water rates recover the proportional cost to provide fire protection capacity, metering and billing. As seen in the table below, especially for the larger meter sizes, rates have been increased and adjusted to be compliant with industry "proportionality" standards, ensuring compliance with Proposition 218. Simply put, the larger the pipe connection, the larger the burden on the system to meet peak demands.

Most fire services do not use water regularly. However, if water is used through the fire service, the standard commodity potable water rate is used. Fire service water rates are shown below:

Proposed 5-year Fire Protection Service Water Rates:

	Current	<i>Approved</i>	<i>New</i>	<i>New</i>	<i>New</i>	<i>New</i>
Effective Date		1/1/2024	1/1/2025	1/1/2026	1/1/2027	1/1/2028
Fire Service Charge (\$/Monthly)						
Meter Size						
1"	13.14	14.12	8.96	9.59	10.18	10.75
1-1/2"	13.72	14.74	10.15	10.86	11.55	12.23
2"	14.72	15.81	12.21	13.06	13.92	14.77
2-1/2"	16.23	17.44	15.31	16.36	17.48	18.60
3"	18.31	19.67	19.59	20.94	22.43	23.91
4"	24.52	26.34	32.33	34.53	37.10	39.68
6"	46.75	50.21	78.03	83.29	89.75	96.25
8"	85.13	91.43	156.85	167.41	180.56	193.84
10"	142.84	153.42	275.42	293.93	317.16	340.62

Recycled Water System Rates:

The City provides recycled (non-potable) water to irrigate parks, certain landscaping, center medians, and golf courses encompassing 3% of the City's total water use. The City purchases recycled water from the Orange County Water District through a project known as Green Acres Project. The recycled water rates recover the direct costs to purchase the recycled water as well as the proportional costs with regards to capacity, metering and billing. Proportionality standards also apply to these recycled meters and in this case, the fixed rates are adjusted and reduced. Certain users also have exclusive pump stations to increase the flow and pressure of the water to meet watering needs. Those users are charged the direct charges associated with the pump stations. In general, recycled water remains less expensive than potable water. Recycled water rates are shown below:

Proposed 5-year Recycled Water Rates:

	Current	<i>Approved</i>	<i>New</i>	<i>New</i>	<i>New</i>	<i>New</i>
Effective Date		1/1/2024	1/1/2025	1/1/2026	1/1/2027	1/1/2028
Fixed Service Charges (\$/Month)						
Meter Size						
1"	18.41	19.78	21.85	23.06	24.16	25.25
1-1/2"	32.35	34.75	39.84	42.10	44.15	46.16
2"	49.09	52.73	61.43	64.95	68.13	71.25
3"	125.81	135.12	160.38	169.69	178.05	186.25
4"	213.68	229.50	273.72	289.66	303.96	317.97
6"	450.80	484.16	579.56	613.40	643.72	673.42
8"	785.55	843.69	1,011.34	1,070.43	1,123.38	1,175.23
Usage Charge (\$/HCF)						
RW Usage	2.21	2.29	2.66	2.74	2.82	2.91
Pump Charge	0.67	0.72	0.50	0.52	0.55	0.57

Sewer (Wastewater) System:

The Utilities Department oversees the operation of the City’s sanitary sewer system. Hidden below the ground, a properly functioning system provides a crucial service to Newport Beach residents, businesses and visitors, and protects the environment. This essential service is also accomplished through a strategic combination of in-house, licensed, staff operators (on-call 24 hours a day) and highly qualified contractors. Behind the scenes, the department is responsible for cleaning, pumping and repairs of the collection system. Sanitary sewer flows are collected from homes and businesses in Newport Beach and transported through more than 25,000 laterals, 200 miles of gravity sewer mains, and five miles of pressurized force sewer mains by way of 21 pump (lift) stations to the Orange County Sanitation District. The sewer system is supported by the Public Works Department for the Capital Improvement Program projects and the Finance Department for utility billing and customer service.

There are four main expenditure categories of the sewer (wastewater) enterprise that are important to providing sewer service: Cleaning Operations, Pump Station Operations, Repairs/Capital Replacement, and Customer Service. Cleaning Operations include the cost to regularly clean and video tape sewer lines. The public may be familiar with the department’s large, yellow vacuum trucks. Pump Station Operations includes the day-to-day operation, inspection and repairs of the City’s 21 pump stations that lift and pump wastewater from low-lying areas. Repairs include the scheduled and unscheduled dig out spot repairs of the underground pipelines and laterals. Capital Replacement includes the larger-scale replacement and rehabilitation of pipelines and pump stations as recommended per the Wastewater Master Plan. More than \$5 million in total annual capital improvements are planned over the next five years. Customer Service includes meter reading, invoicing, customer service, administration and internal service charges.

Sewer rates as shown in the table below and in the report are proposed to be adjusted proportionally and increased each year for the next five years. The average residential customer, who uses approximately 10 billing units (7,480 gallons per month), is expected to see a \$2.20 per month increase starting in 2024. In the following years, the monthly rate will increase by \$2.50 in 2025, \$3.00 in 2026, \$3.50 in 2027 and \$3.50 in 2028. A billing unit is 100 cubic feet (or 1 HCF) or 748 gallons.

Proposed 5-year Sewer Rates

	Current	<i>New</i>	<i>New</i>	<i>New</i>	<i>New</i>	<i>New</i>
Effective Date		1/1/2024	1/1/2025	1/1/2026	1/1/2027	1/1/2028
Fixed Service Charges (\$/Month)						
Meter Size						
5/8", 3/4", 1"	8.55	10.55	12.85	15.65	18.95	22.25
1-1/2"	9.41	15.83	19.28	23.47	28.43	33.38
2"	12.83	21.11	25.71	31.30	37.90	44.51
3"	14.54	26.38	32.14	39.12	47.38	55.63
4"	17.11	31.66	38.56	46.95	56.85	66.76
6"	19.25	36.94	44.99	54.77	66.33	77.89
8"	21.39	42.22	51.42	62.60	75.81	89.01
Usage Charge (\$/HCF)						
Sewer Usage	0.51	0.53	0.55	0.57	0.59	0.61

Approximately 600 Newport Beach properties receive sewer service from the City, but are supplied water by Mesa Water District or Irvine Ranch Water District. For those properties, the City does not have immediate access to their water use for billing purposes. The best practice is to estimate an average based on the meter size, as explained in the official report. Hence, these users only receive a flat fee. As noted and approved by the City Council on July 25, 2023, these properties, for the second year in a row, will be billed through the property tax roll.

Proposed 5-year Sewer Only Customer Rates

	Current	<i>Approved</i>	<i>New</i>	<i>New</i>	<i>New</i>	<i>New</i>
Effective Date		1/1/2024	1/1/2025	1/1/2026	1/1/2027	1/1/2028
Sewer Only Customers, Fixed Service Charge, (no Use Charge) (\$/Monthly)						
Meter Size						
5/8", 3/4"	13.10	15.86	18.36	21.35	24.85	28.36
1"	15.34	18.51	21.11	24.20	27.80	31.41
1-1/2"	46.14	53.99	58.88	64.52	70.91	77.30
2"	47.54	59.27	65.31	72.34	80.39	88.43
3"	122.10	137.68	147.63	158.83	171.29	183.74
4"	216.25	238.35	253.06	269.27	286.97	304.67
6"	381.07	413.21	435.48	459.51	485.26	511.00
8"	383.21	418.49	441.91	467.33	494.74	522.12
10"	389.20	423.77	448.33	475.15	504.21	533.25

Proposition 218 Procedures

Under State Proposition 218 requirements, the rates cannot be increased if a majority of the property owners submit valid written protests to the City Clerk by the close of the 45-day notice and protest period. At the conclusion of the public hearing, the City Clerk shall complete the tabulation of all written protests received, including those received during the public hearing, and shall report the results to the City Council. The City Clerk may advise the City Council of the absence of a majority protest without determining the validity of all protests. Notices were also sent to all water customers who may not be property-owning customers and the City Council may consider their protests; however, they will not be counted as part of the requirement. Only one protest is allowed per property parcel. At this point, if a majority of property owners do not submit a valid written protest, the City Council could vote to adopt the new rates and structure.

If the rates are approved via the attached resolutions, the proposed water and sewer rates would become effective on January 1, 2024, and for every year thereafter with the final scheduled adjustments occurring January 1, 2028.

FISCAL IMPACT:

The adopted budget includes sufficient funding for completion of the studies and the public noticing. The cost of the studies is approximately \$100,000 and the cost of the public noticing (Proposition 218 mailed notice) was approximately \$15,000. As currently budgeted, the Water Enterprise Fund and Wastewater Enterprise funds are now operating at a structural deficit, drawing down on net working capital reserves.

If the proposed rate increases are approved, rates would be adjusted and generally increase each year for five years, starting in January 2024. The rate increases will fund the necessary Capital Improvement Program, the increased inflationary cost of maintenance and operations, the cost to purchase and pump water, and stabilizing the enterprise funds.

ENVIRONMENTAL REVIEW:

Staff recommends the City Council find this action is not subject to the California Environmental Quality Act (CEQA) pursuant to Sections 15060(c)(2) (the activity will not result in a direct or reasonably foreseeable indirect physical change in the environment) and 15060(c)(3) (the activity is not a project as defined in Section 15378) of the CEQA Guidelines, California Code of Regulations, Title 14, Chapter 3, because it has no potential for resulting in physical change to the environment, directly or indirectly.

NOTICING:

The agenda item has been noticed according to the Brown Act (72 hours in advance of the meeting at which the City Council considers the item).

ATTACHMENTS:

Attachment A – Resolution No. 2023-74, Establishing Water Rates
Attachment B – Resolution No. 2023-75, Establishing Sewer Rates