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July 21, 2021

Re: Alternative Scenarios for Sewer Rate Study

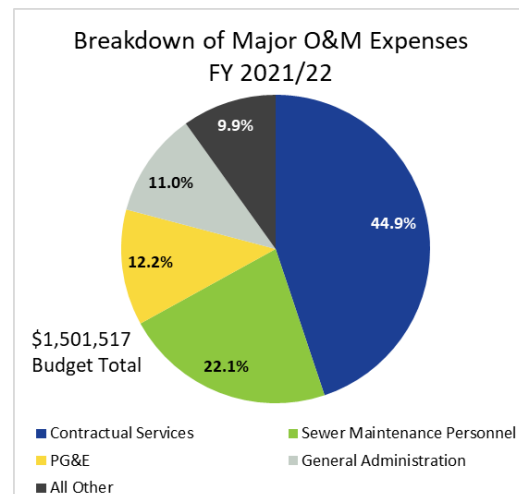
David,

At the City Council presentation on the proposed sewer rates on June 21, there were two areas where the Council wanted some additional information. This first item was wanting to understand what level of City administrative costs were included in the proposed budget. The second information request was to look at the impact of smaller rate increases than the proposed rates. This memo provides this background information.

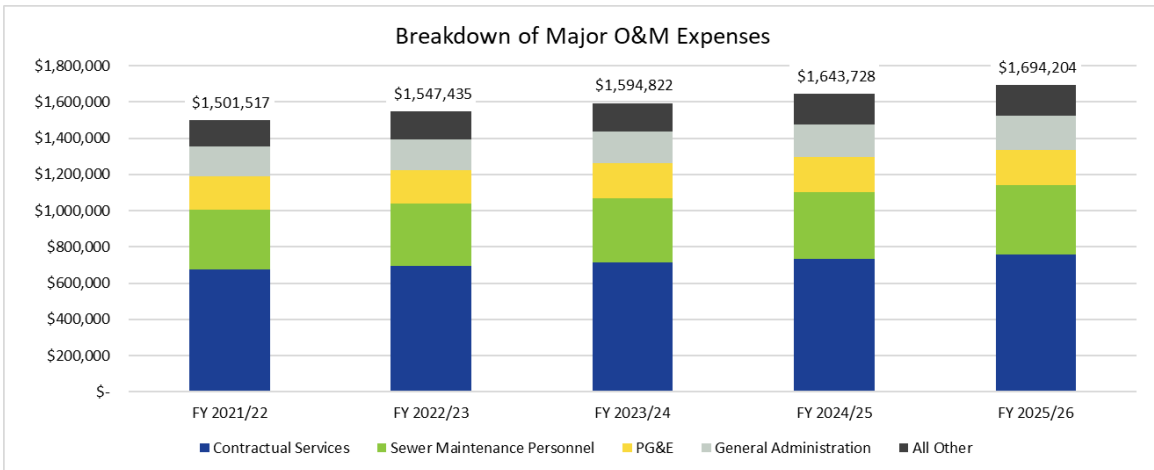
CITY ADMINISTRATIVE COSTS AS A SHARE OF THE TOTAL OPERATING EXPENSES

The City sewer operating expenses are summarized into 5 major categories of expenses:

- Contractual Services – 44.9%
- Sewer Maintenance Personnel – 22.1%
- PG&E – 12.2%
- General Administration – 11%
- All Other – 9.9%



For FY 21/22, the City administrative costs to be recovered from sewer rates were approximately 11 percent of the total operating expenses. The projected operating expenses for the next five years are also shown. The City administrative costs are expected to stay relatively the same going forward.



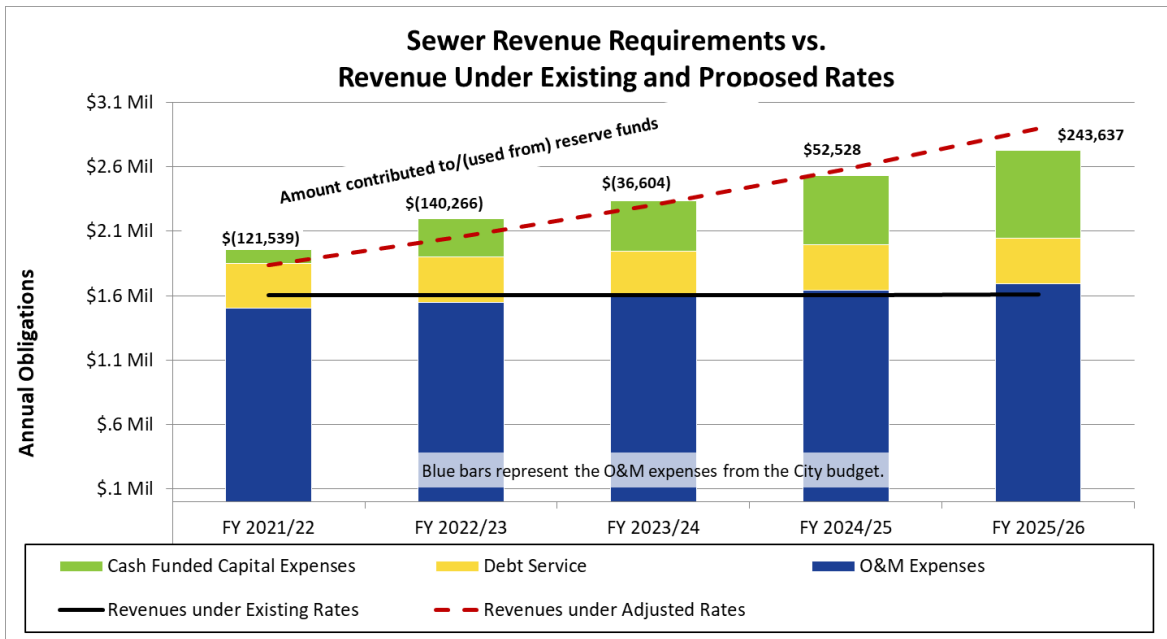
THE IMPACT OF SMALL SEWER RATE INCREASES

The rationale behind the proposed rates is summarized here, followed by a discussion of the impacts of two lower rate increase scenarios.

The proposed rates presented in the rate study and shown in the proposition 218 notice sent to customers includes increases to the revenue requirement (amount needed to recover expenses less non-rate revenue) of,

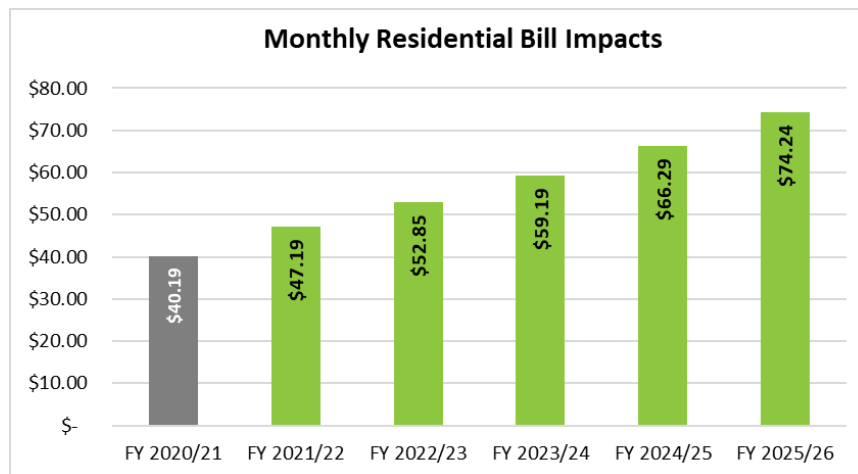
- 15% in FY 2021/22
- 12% in FY 2022/23
- 12% in FY 2023/23
- 12% in FY 2023/24
- 12% in FY 2024/25

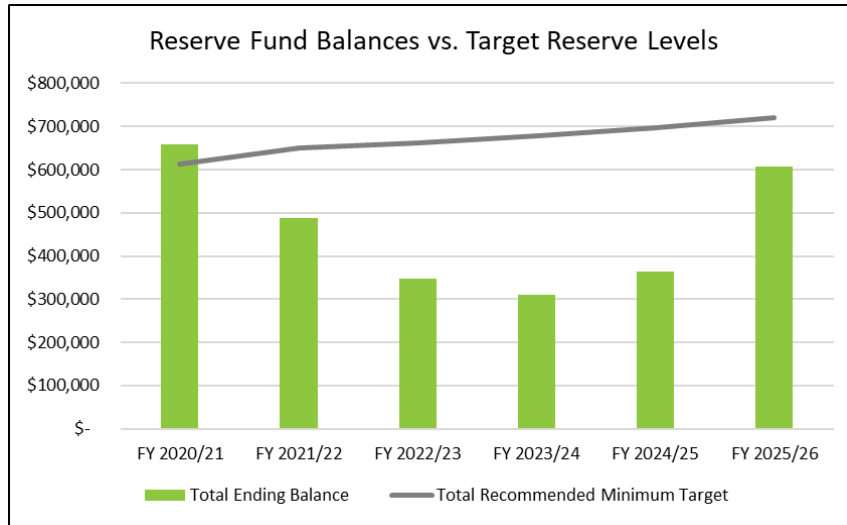
These rate increases are needed to recover not only operation and maintenance expenses, but also current debt obligations, necessary capital improvement projects, and to start to build up reserves necessary for the long term financial viability of the enterprise. From the chart below, the red dotted line represents the proposed rates vs. the total expenses by category. The amount contributed, or used from, reserve funds is noted above each fiscal year. Even under the proposed rates, the City will draw down reserves for three years to mitigate the needed rate increase. Under these rates, the City will not hit the reserve target requirements until FY 2026/27 as the reserve funds will be drawn down until FY 2024/25. Once a surplus begins, the City will begin to replenish the reserve funds to the set target reserve funds.



For single family residential customers, there will be an increase to monthly bills. These rates are based on the cost of service analysis, which allocates expenses to customer class to comply with State requirements in Proposition 218.

Under the annual proposed increases, the City is expected to draw reserve funds below target levels to fund the capital improvement projects. The year following the proposition 218 period, the City will have finally met the target reserve fund levels.

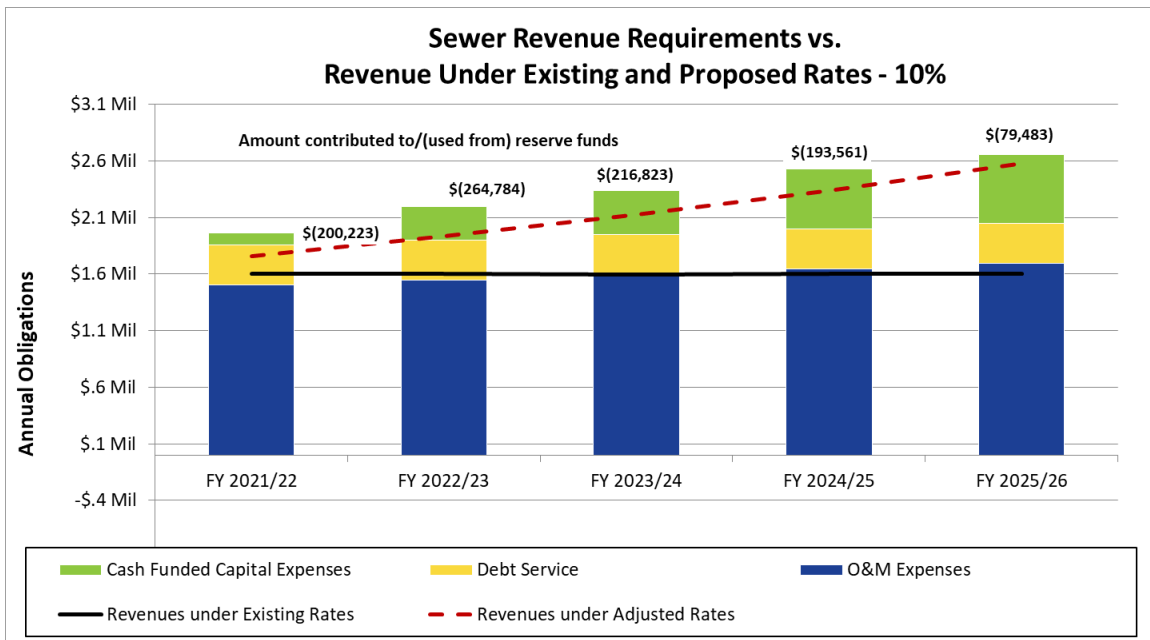




ALTERNATIVE RATE STRUCTURE – 10% ANNUAL SFR RATE INCREASE

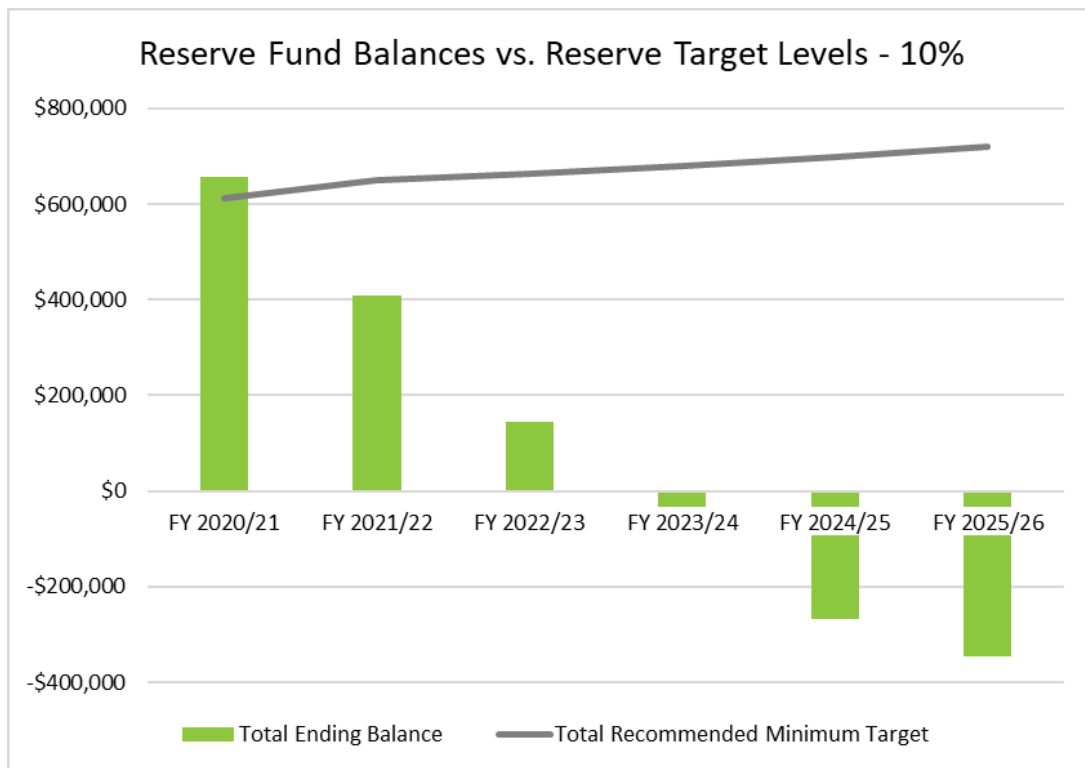
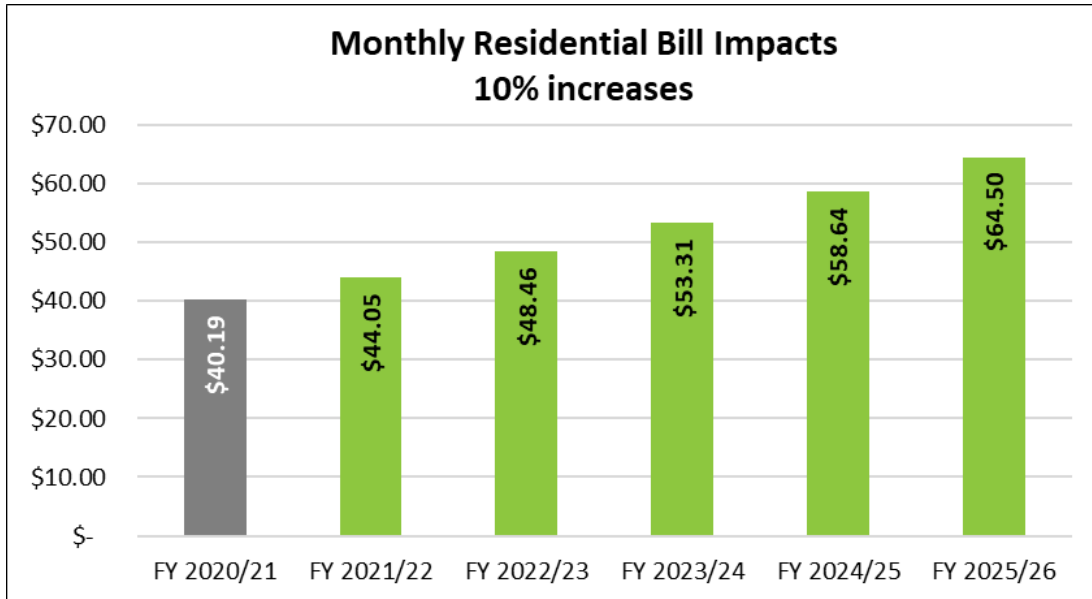
An alternative rate structure that City staff has requested includes increasing the SFR user charge ten percent annually.

Under this scenario, the City will be able to fund Operation and maintenance expenses and most of the current debt service payments, but will not be able to pay for the pay as you go capital projects and there will be no contributions to reserve funds for the next two years.. Even with 10% increases, the City will not be able to contribute to reserve funds to meet target levels.



For single family residential customers, there will be an increase to monthly bills. It's notable to mention the cost of service analysis performed in the rates calculated in FY 2021/22, which allocates expenses to relative customer class to comply with State requirements in Proposition 218.

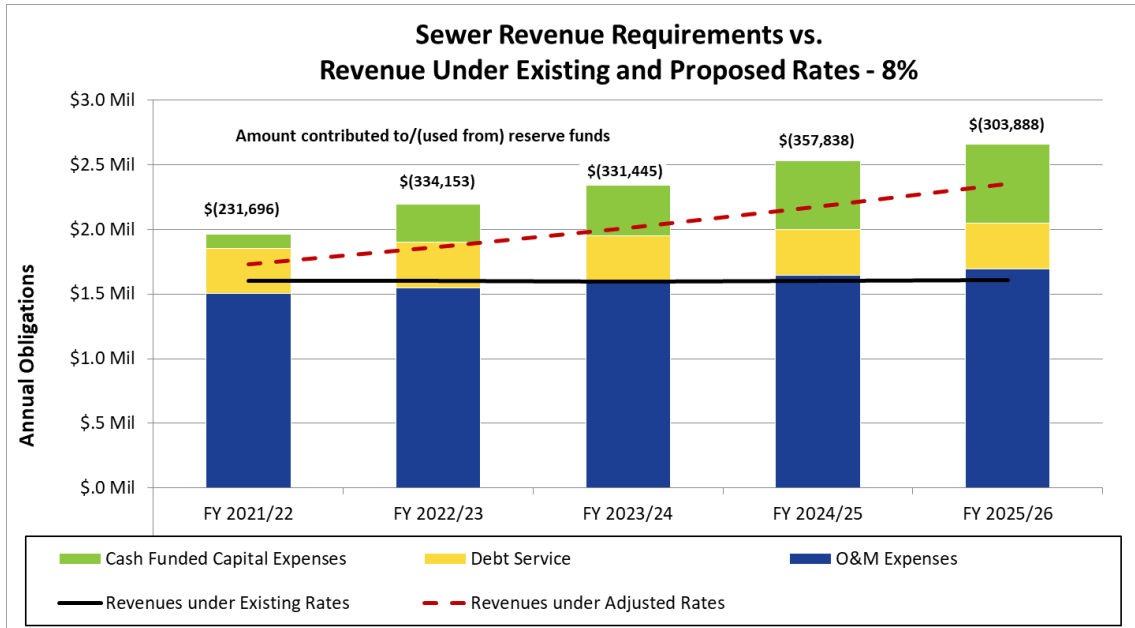
Under the annual 10% increases, the City is expected to fully draw reserve funds negative starting in FY 2023/24 if the City moved forward with the pay as you go capital projects.



ALTERNATIVE RATE STRUCTURE – 8% ANNUAL

A second alternative rate structure that City staff has requested includes increasing the SFR user charge eight percent per year.

With annual 8% increases to the SFR user charges, the City can pay for O&M expenses, most of the current debt service payments, but will not have funding for the capital improvement projects. The City will not be able to contribute to reserve funds to meet target levels.



For single family residential customers, there will be an increase to monthly bills. It's notable to mention the cost of service analysis performed in the rates calculated in FY 2021/22, which allocates expenses to relative customer class to comply with State requirements in Proposition 218.

Under the annual 8% increases, if the City did the proposed capital improvements, the City would deplete reserve funds in three years.

