



Staff Report

DATE: June 28, 2017

TO: Mayor, Vice-Mayor, and Councilmembers

FROM: Mike Futrell, City Manager
Brian Schumacker, Water Quality Control Plant Superintendent

SUBJECT: REPORT REGARDING A RESOLUTION ESTABLISHING SEWER SERVICE RATES FOR FISCAL YEARS 2017-18 THROUGH 2021-22, AMENDING THE MASTER FEE SCHEDULE TO INCLUDE THE SEWER SERVICE RATES, ADOPTING THE REPORT OF ANNUAL SEWER RENTAL AND CHARGES FOR FISCAL YEAR 2017-18, AND ESTABLISHING MAXIMUM NOT TO EXCEED RATES FOR FISCAL YEARS 2018-19 THROUGH 2021-22.

RECOMMENDATION

It is recommended that the City Council conduct a public hearing, tabulate formal written protests and if less than half of parcel owners protest, adopt a resolution establishing sewer service rates for Fiscal Year (FY) 2017-18, amending the master fee schedule to include said rates, adopting the Report of Annual Sewer Rental and Charges for FY 2017-18, and establishing Maximum not to Exceed Rates for FY's 2018-19 through 2021-22.

I. BACKGROUND/DISCUSSION

The sewage collection and treatment system operates 24 hours per day, seven days per week, and processes up to 62 million gallons per day (MGD) of wastewater. This wastewater is conveyed through a network of over 165 miles of underground sewer lines and thirteen sanitary sewage pump stations in South San Francisco to the Water Quality Control Plant (WQCP). This infrastructure serves 12,593 residential and 1,594 commercial connections.

Once the wastewater is fully treated at the WQCP, it is discharged into San Francisco Bay. The treatment process is complex and is, understandably, heavily regulated by local, state and federal regulators. Regulatory Agencies are charged with protecting the health and safety of humans, animals, plants, and the overall environment. The discharge requirements for the WQCP to put treated wastewater into San Francisco Bay are governed by the San Francisco Bay Regional Water Quality Control Board and defined in Order No. R2-2014-0012, National Pollution Discharge Elimination System (NPDES) No. CA 0038130 adopted on April 9, 2014.

These discharge requirements have been made consistently more stringent since the passage of

the Clean Water Act in 1972, requiring adequate plant upgrades to meet new state and federal mandates. The most recent mandate requires additional plant upgrades and necessitates the reexamination of user sewer rates to fund the mandated changes.

Plant Upgrade History and Compliance Sequence

The WQCP has reliably served the communities of South San Francisco and San Bruno since going online in February, 1952. South San Francisco owns 79 percent and San Bruno owns 21 percent of the plant's infrastructure. The sewer program has 52 professional, full-time staff with an annual operations and maintenance budget of \$24,973,790. South San Francisco and San Bruno share the annual operation and maintenance costs respective of flow and loadings contributions from each city.

Between 1952 and 2005, the WQCP has undergone six upgrade, expansion and improvement projects required by the State Water Resources Control Board (SWRCB) to comply with mandated NPDES permit requirements. The most comprehensive of these improvements was completed in 2000.

This major plant upgrade provided increased treatment capacities to all unit processes while replacing outdated processes. Modifications were also done to improve the treatment plant's reliability. Major additions to the plant included:

- A second headworks (Headworks No. 2)
- A new influent pumping station
- Four new primary clarifiers
- Two new aeration basins
- One new secondary clarifier
- A new Return Activated Sludge/Waste Activated Sludge pumping station
- Two new chlorine contact basins
- Two new anaerobic digesters, and
- A new sludge dewatering facility

Outcomes of these modifications to the plant in 2000 included increasing the capacity of the effluent pumping station, converting the former Digester No. 3 to a sludge storage tank, rerouting of digester sludge piping, upgrades to the existing secondary clarifiers, and conversion of the gravity thickener to a dissolved air flotation thickener (DAFT) system. Moreover, in 2005, a seven million gallon storage pond was constructed to comply with SWRCB restrictions concerning the use of a wet weather nearshore discharge point.

Regulators continue to require more treatment process improvements. During the reissuance of the plant's current NPDES permit in 2014, the SWRCB ordered the implementation of a collection system/treatment plant capital improvement program. The improvements are documented in the South San Francisco/San Bruno WQCP Facility Plan Update. The bulk of these improvements are required to reduce primary and secondary effluent blending occurrences by increasing the plant's secondary treatment capacity from 30 MGD to 40 MGD.

In order to meet these mandates, new reliability and treatment plant improvement projects are required. Additionally, there are requirements to rehabilitate aging infrastructure through repairs and enhancements. Design engineers forecast approximately \$83 million dollars' worth of infrastructure investments needed over the next five-year rate plan. The following are the engineering estimates for project outlays:

- Sanitary sewer rehabilitation (\$12 million)
- Completion of the Pump Station No. 4 redundant force main (\$3.5 million)
- WQCP Digester and Wet Weather Improvements Projects (\$50.4 million)
- Plant and pump station equipment recoating project (\$6 million)
- Sea-level rise approach to protect WQCP infrastructure (\$2.6 million)
- WQCP equipment replacement and maintenance projects (\$8.4 million)

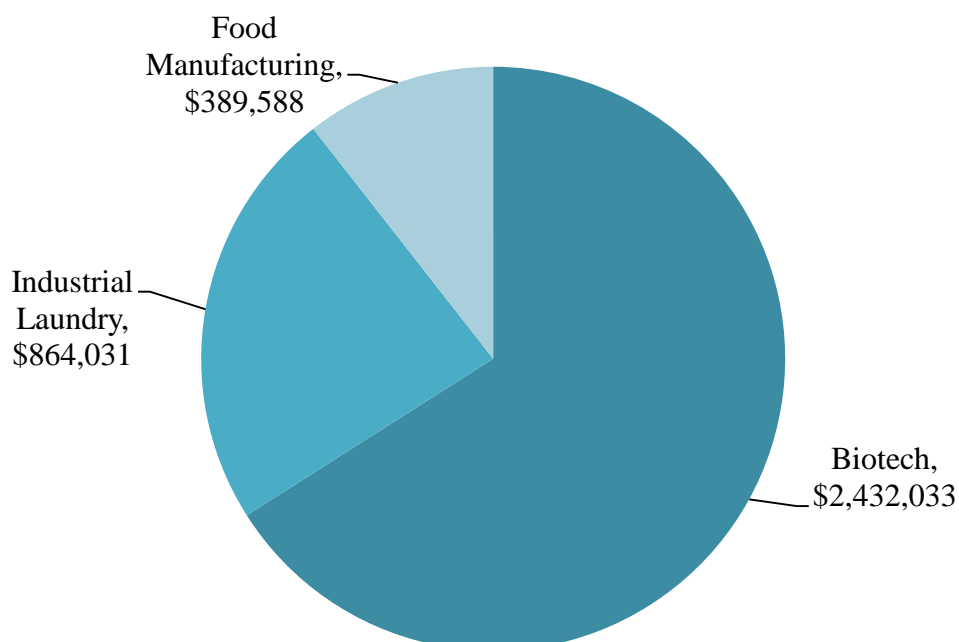
Overview of Sewer Rate Fees

The sewer collection, conveyance and treatment system is funded entirely through an enterprise fund, with revenue coming from commercial and residential users. Additionally, revenue is received from new developments which pay a connection fee.

The total paid by commercial/industrial users in FY 2016-17 is \$10,257,097. There are 1,594 commercial/industrial rate payers, which pay roughly 52 percent of total sewer fees. The average commercial property pays **\$536** per month while residential users pay **\$49** per month.

The largest commercial users are shown below in Table 1, along with annual payments:

Table 1: Major Commercial User Groups



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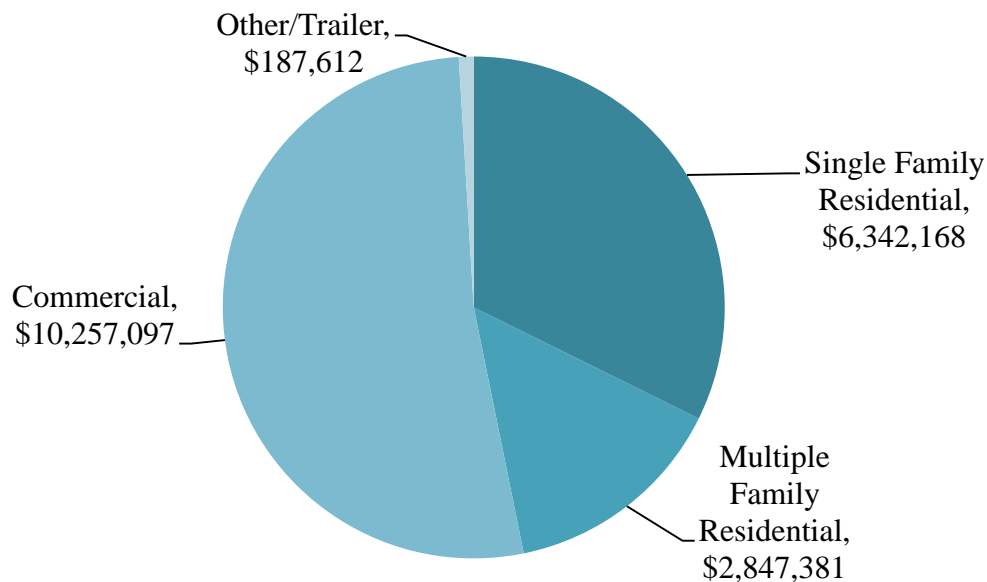
There are 16,490 residential users, broken down as follows:

- Single Family Homes - 10,811
- Multi-Family Units - 5,323
- Mobile Homes – 356

Residential users paid roughly 48 percent of total sewer fees, with a single family resident paying \$49 per month in FY 2016-17. The total paid by residential users in FY 2016-17 is \$9,377,161. Sewer fees for multi-family units, also referred to as rental units, are paid by the commercial property owner, or landlord, through assessed property taxes.

The breakdown of sewer fee revenue by source is shown in Table 2:

Table 2: Revenue Source by Number and Type



South San Francisco residential users currently pay one of the lowest sewer fees per month in San Mateo County as shown below.

Hillsborough	\$ 194
Burlingame Hills Sewer Management District	\$ 133
Crystal Springs County Sanitation District	\$ 113
Millbrae	\$ 105
San Carlos	\$ 93
San Bruno	\$ 88
West Bay Sewer District (Menlo Park)	\$ 86
Montara Sanitary District	\$ 83
Emerald Lake Heights Sewer District	\$ 81
Redwood City	\$ 75

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Pacifica	\$ 75
Belmont	\$ 67
Half Moon Bay	\$ 67
Brisbane	\$ 61
Foster City	\$ 57
Burlingame	\$ 55
San Mateo	\$ 54
South San Francisco	\$ 49
Daly City (NSMCSD)	\$ 48
East Palo Alto Sanitary District	\$ 48
Bayshore Sanitary District	\$ 40

In order to finance the mandated infrastructure improvement projects, the sewer rates must increase over the next five years. The first three years of the rate plan are critical to ensure that the sewer fund has sufficient money available to fund state mandated improvement projects and the ability to maintain capital reserves, required by debt service providers.

Proposition 218 Requirements

The process for sewer user fee rate setting is specifically dictated by the California State Constitution, with language added through Proposition 218, which was passed by the voters of California in 1996. The Proposition 218 process requires notice to all parcel owners of any proposed sewer user rate change by mail 45 days in advance of the public hearing of the governing body. The parcel owners have a right to issue a written protest notice. If more than half of the parcel owners submit a written protest notice, then a city council cannot vote on the resolution establishing sewer rates. There are 14,187 parcel owners in South San Francisco. As of June 15, 2017, there were 164 written protest notices received by the City Clerk.

Proposition 218 specifically prohibits setting rates which are not proportional to the users actual use and benefit of the service. For example, commercial rates cannot be set higher so that residential users pay less. Each class of user must pay fees proportional to the actual benefit to the user, not skewed higher or lower based upon political or other considerations. The City's independent financial consultant, Bartle Wells, has reviewed the sewer rate structure and has found that residential and commercial/industrial are paying their appropriate allocation of the sewer fees.

In accordance with the requirements of Proposition 218, on April 28, 2017, the City mailed written notices to all parcel owners in South San Francisco. The mailed written notice identified: the amount of the proposed rate increase FY's 2017-18 through 2021-22; the basis on which the proposed rate was calculated; the reason for the rate increase; and the date, time, and location of the public hearing on the proposed fee or charge. In addition to setting the public hearing for June 28, 2017, the mailed notices informed property owners of a public information meeting on May 16, 2017.

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Prior to mailing out the written notice, the City held a study session where the proposed rate plan was presented to the City Council. The sewer rate plan conceptually approved by City Council at the March 22, 2017 City Council meeting included five years of necessary increases as follows:

- FY 2017-18, 15 percent increase, single unit \$56.33 per month, Multi-unit \$50.67 per month
- FY 2018-19, not to exceed 10 percent increase, single unit \$62 per month, multi-unit \$55.83 per month
- FY 2019-20, not to exceed 5 percent increase, single unit \$65.08 per month, multi-unit \$58.58 per month
- FY 2020-21, not to exceed 5 percent increase, single unit \$68.33 per month, multi-unit \$61.50 per month
- FY 2021-22, not to exceed 5 percent increase, single unit \$71.75 per month, multi-unit \$64.58 per month

The commercial rates have a minimum rate tied to the signal unit rate. In addition, commercial rates are calculated based on water usage, a calculation of total suspended solids (TSS) and biological oxygen demand (BOD). The calculations for each commercial strength type will also be increased according to the percentages provided in the written notice.

Public Information Meeting

On May 16, 2017, staff held a public information meeting about the proposed sewer rate increases. Staff counted 35 people present. From the open forum there were several common themes that emerged:

- Frustration with the Proposition 218 process
- Burden of the rate increases on low income residents
- A perception of residents paying more sewer fees than commercial/industrial users

Limited Income Assistance Program

At the May 16, 2017, public meeting, a resident asked if South San Francisco could implement an assistance program for residents with limited income. Subsequent research showed this suggestion had merit, and staff is recommending City Council implement an assistance program for residents with limited income. Because South San Francisco sewer fees are collected through property tax payments, it is not possible to individually reduce a resident's property tax prior to billing; however, the City can establish a rebate program for qualified residents, rebating the cost of the fee increase. Staff recommends a rebate of up to \$60 for the first year, with results and participation reported to City Council, and adjustments to the rebate in subsequent years to meet the goal of providing meaningful assistance to limited income residents.

Revised Five Year Rate Plan

A cautious approach to rate-making was followed. The proposed five-year rate plan that was mailed to all property owners, and is described above, accounted for all potential risks to revenue which may occur over the next five years; this would make it absolutely certain that the City has the finances to build the mandated improvements.

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The valuable public input received since announcing the proposed rate plan, plus additional work with third party financial consultants, resulted in staff preparing and proposing a leaner rate plan. The rates in this revised plan are lower than those originally noticed to parcel owners in April 2017. The leaner plan is less cautious, and thus has more risk to the City, but is less onerous on residents and businesses in South San Francisco. However, there are risks associated with this minimalist rate plan structure, including:

- Unforeseen, additional state mandated treatment process improvements
- Higher interests rates for financing mandated capital improvement projects
- Escalating construction costs
- Economic downturn or recession

Any one of the above risks could result in higher than forecasted costs and/or lower revenue, requiring a return to City Council and another Proposition 218 process to make up any financing deficit. Of particular concern is the interest rate the City must pay for bonds needed to finance construction. The State Revolving Loan Fund has a favorable interest rate of 1.7 percent and is our desired financing vehicle; however, access to the Loan Fund is a competitive process and there is no guarantee that the City would receive these funds. Plus, the Loan Fund has not been adequately funded in the State Budget, and thus may not have the funds to lend. If pushed to the private market, the City may pay interest in excess of 4 percent, adding significant cost.

At present, however, indicators show, with the exception of the interest rate challenge, that the risks are low enough to justify a less cautious approach to rate setting. The lower rate plan detailed below should fund currently mandated projects while maintaining sufficient reserves required by debt service providers. Given the current economic and regulatory conditions, staff proposes the following amended rate plan for residential and commercial users (see Attachment 2):

- FY 2017-18, 13 percent increase, single unit \$55.33 per month, Multi-unit \$49.67 per month, a **\$6.33 per month increase** compared to current rates
- FY 2018-19, not to exceed 10 percent increase, single unit \$60.83 per month, multi-unit \$54.58 per month, **\$5.50 per month increase** compared to FY 2017-18
- FY 2019-20, not to exceed 2 percent increase, single unit \$62.08 per month, multi-unit \$55.67 per month, **\$1.25 per month increase** compared to FY 2018-19
- FY 2020-21, not to exceed 2 percent increase, single unit \$63.33 per month, multi-unit \$56.83 per month, **\$1.25 per month increase** compared to FY 2019-20
- FY 2021-22, not to exceed 2 percent increase, single unit \$64.58 per month, multi-unit \$57.92 per month, **\$1.25 per month increase** compared to FY 2020-21

Note that the referenced rates for FY 2018-19 through FY 2021-22 are the maximum rates possible. Staff will return to City Council each year to review finances and recommend a specific

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rate for the upcoming year, which could be lower than the maximum allowed if actual sewer fund finances are more positive than anticipated.

Contingent upon the 13 percent rate increase approval for FY 2017-18, South San Francisco users will still pay one of the lowest sewer fees in San Mateo County as shown below.

Hillsborough	\$ 234.42
Burlingame Hills Sewer Management District	\$ 132.92
Crystal Springs County Sanitation District	\$ 112.50
Emerald Lake Heights Sewer District	\$ 106.67
Millbrae	\$ 104.36
San Carlos	\$ 97.93
San Bruno	\$ 92.02
West Bay Sewer District (Menlo Park)	\$ 89.33
Pacifica	\$ 84.53
Montara Sanitary District	\$ 83.46
Redwood City	\$ 76.68
San Mateo	\$ 73.86
Belmont	\$ 72.45
Half Moon Bay	\$ 67.16
Foster City	\$ 65.27
Brisbane	\$ 61.00
South San Francisco	\$ 55.33
Burlingame	\$ 54.98
Daly City (NSMCSD)	\$ 48.12
East Palo Alto Sanitary District	\$ 47.92
Bayshore Sanitary District	\$ 40.42

Proposition 218 precludes the City from increasing sewer rates if a majority of all property owners (not a majority of those turning in protests) submit formal written protests against the proposed rate increase prior to the public hearing. At the close of the public hearing on June 28, 2017, if there is not a majority (more than half of the City's 14,187 property owners) protest against the proposed fees, the City Council may approve a resolution containing the revised five-year schedule of charges set forth above. If City Council does not support the proposed five-year rate schedule, City Council can act on a resolution maintaining the current rate schedule from FY 2016-17.

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Procedures for Public Hearing

At the public hearing on June 28, 2017, the City Council will:

1. Open the public hearing
2. Hear and review Staff's presentation
3. Take public testimony
4. Close the public hearing
5. Tabulate the written protests; and
6. If no majority protest received, vote on the proposed sewer rate increases

II. FISCAL IMPACT

The proposed FY 2017-18 rate plan results in anticipated revenue of \$22,147,395 should it be approved.

III. CONCLUSION

Staff has updated the estimated cost of improvements to the City's sewer system after taking into consideration ongoing operational costs, new State requirements in the current NPDES permit, and new CIP projects. Based on this evaluation and an estimate of Sewer Fund revenues, staff recommends that Council approve a new five-year rate plan for FY 2017-18 through FY 2021-22.

Attachments:

1. Sewer Rate Plan Presentation
2. Revised Sewer Rate Plan FY 2017-18 through FY 2021-22