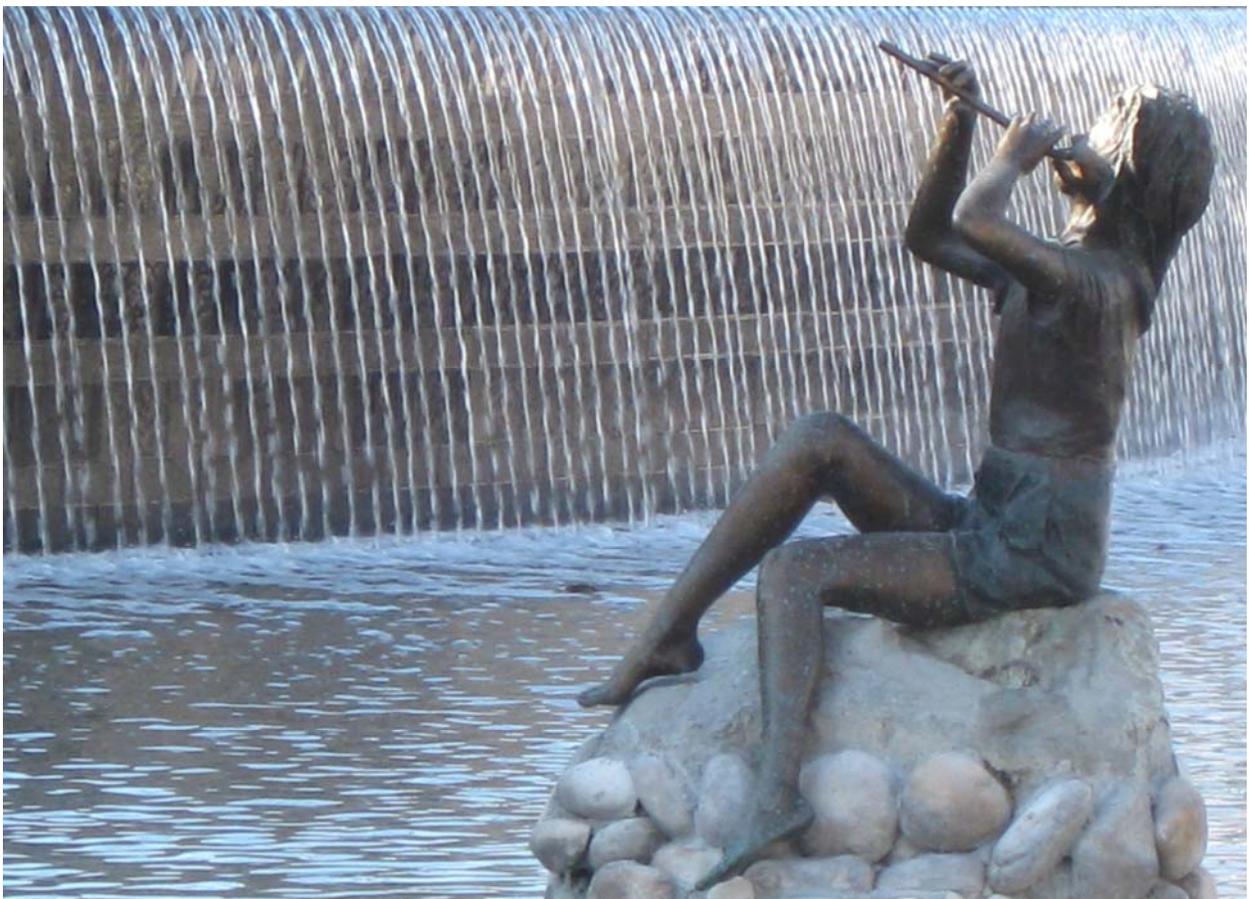




2009/10 & 2010/11 Utility Rate Analysis

Water and Sewer Rate Recommendations



Utility Section
Public Works Department
February 3, 2009

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EXECUTIVE SUMMARY

This utility rate analysis was performed to support the FY 2009/10 and FY 2010/11 water and sewer rate recommendations presented to the City Council on February 3, 2009.

Water Rate Recommendations

- Increase residential rates by 9% annually for the next two years. For Fiscal Year (FY) 2009/10, this increases the average bimonthly cost for a single-family residence from \$58.05 to \$63.19, an increase of \$2.57 per month. For FY 2010/11, the average bimonthly cost increases from \$63.19 to \$68.97, an increase of \$2.89 per month. The average usage for single-family residential is 23 hundred cubic feet (hcf).
- Increase the rate for Ed Levin Park from \$1.02 to \$1.66/hcf for FY 2009/10, and from \$1.66/hcf to \$1.94/hcf for FY 2010/11 to match San Francisco Public Utilities Commission's (SFPUC) wholesale water rate.
- Set rates for City accounts equal to the average wholesale water rate (\$1.60/hcf for FY09/10, and \$1.81/hcf for FY10/11).
- Increase all other rates by 9% annually in FY 2009/10 and FY 2010/11.

Recycled Water Rate Recommendation

- Increase recycled water rates by 9% annually for the next two years. This would maintain recycled water irrigation rates at 80% of the potable irrigation rate and recycled water industrial rates at 50% of the potable water industrial rate in order to create incentive for recycled water use.

Sewer Rate Recommendations

- Increase single-family residential rates by 9% annually for the next two years. For FY 2009/10, this would increase the bimonthly cost for single-family residences from \$59.70 to \$65.08, an increase of \$2.69 per month. For FY 2010/11, the bimonthly cost would increase from \$65.08 to \$70.94, an increase of \$2.93 per month.
- Make proportional rate increases for other residential and non-residential customers based on the flow and strength of discharge in accordance with the U.S. Environmental Protection Agency Sewer Revenue Program model.

INTRODUCTION

It is the City's fiscal policy that all utility enterprise funds will be operated in a manner similar to private enterprise. This means that fees and user charges are to be set for each utility fund at a level that fully supports the total short-term and long-term direct and indirect costs of utility operation, including depreciation of infrastructure assets, overhead charges, and banking of reserves for unanticipated expenses and current and future capital improvement projects.

Utility Long Term and Short Term Financial Needs

The City has completed evaluations and developed plans that define the water and sewer utility financial needs. Among these are:

- **Utility Master Plans** – establishes facility improvements and additions to meet current and future demands (2004 Sewer System Master Plan, 2002 Water System Master Plan, and 2001 Storm Drain Master Plan).
- **2002 Water System Seismic Improvements Evaluation** – identifies retrofits needed to protect the distribution system “backbone” from failure due to earthquake ground movement. The 2006 Water System Seismic Improvements Strategic Plan identified and prioritized specific seismic improvement projects.
- **2002 Utility Depreciation Study** – establishes facility retrofit/replacement schedule based on useful life of utility infrastructure.
- **2003 Financial Utility Master Plan (FUMP)** – serves as the long-term planning document defining objectives and best management practices for comprehensive rate setting.

Long-Term Cost Factors

- San Francisco Public Utilities Commission (SFPUC) is initiating a \$4.3 billion water system improvement program to replace and seismically upgrade aging distribution infrastructure. Milpitas' share will be approximately \$100 million payable over 30 years.
- Santa Clara Valley Water District (SCVWD) is planning its Infrastructure Reliability Program. Costs have not yet been estimated, but will be significant.
- The San Jose/Santa Clara Water Pollution Control Plan (WPCP) is completing a master plan to reconstruct its facility at a cost of \$1 - 2 billion. Milpitas' share will be approximately \$100 million payable over 30 years.
- The City's 2006 Water System Seismic Improvements Strategic Plan identified “backbone” improvement and mitigation projects necessary to protect the system integrity at a cost of approximately \$3 million per year for the next five years or longer.

Public Notification

Article XIII(D) of the California State Constitution, also known as Proposition 218, requires that the City notify property owners prior to adopting property-related fees (including water and sewer rates) and allows property owners an opportunity to submit written protests to the proposed rates. The City must mail a notice to every property owner receiving water and/or sewer service from the City showing the proposed rates and the time, date, and place for the public hearing protest (no earlier than 45 days after the notice is mailed). The City may not adopt new rates if more than half of the property owners submit protests. The notification schedule includes these steps:

- **January 22** – Public hearing notice published in the Milpitas Post notifying the community of the introduction of the water and sewer rate ordinances.
- **February 3** – Council will hear first reading of ordinances setting water, recycled water, and sewer rates. Staff will request direction to mail the Proposition 218 brochure.
- **March 20** – This date is 45 days prior to the public protest hearing and the last date to mail the Proposition 218 brochure.
- **May 5** – Public protest hearing and adoption of rate ordinances. Staff will recommend that the City Council adopt ordinances setting water, recycled water, and sewer rates if there has not been a majority protest.
- **June 4** – The proposed water, recycled water and sewer rates for FY 2009/10 are effective thirty (30) days after adoption by City Council. These rates apply to services received on or after this date. Utility bills issued on or around August 24, 2009 will reflect the FY 2009/10 rates.
- **April 19, 2010** – The proposed water, recycled water and sewer rates for FY 2010/11 are effective and apply to services received on or after this date. Utility bills issued on or around July 5, 2010 will reflect the FY 2010/11 rates.

WATER RATE ANALYSIS AND RECOMMENDATION

The water rate analysis is performed by starting with the actual July 1, 2008 water fund balance and estimating revenues and expenses to project an expected fund balance at the beginning of FY 2009/10. Estimated FY 2009/10 expenses are deducted from this balance to determine needed revenues. The unit rates within the water rate structure are then adjusted to yield the needed revenues. This process is repeated for FY 2010/11 to develop recommendations for this second year, and for the subsequent three years to forecast long-term trends. As with all predictive models, the accuracy of the fund balance projection depends upon the accuracy of the cost and revenue estimates and upon the validity of assumptions about future growth and consumption. The forecasted results are most reliable in the short-term of one year or so, and should be considered progressively less reliable as the projection is extended out to five years.

In addition to the primary Water Fund, the family of funds includes the Water Line Extension Fund and Water Infrastructure Fund to help pay for CIP and future infrastructure improvements. The Water Line Extension Fund is funded by water connection fees, while the Water Infrastructure Fund is funded by transfers from the Water Fund. A breakdown of these fund balances is shown in Exhibit W-3.

The FUMP sets parameters for estimating rates and expenses including the following:

- Maintain 1st-tier residential rate at no less than the average of wholesale rates (October 1995 Council policy).
- Transfer up to \$2 million annually from the Water Fund into the Water Infrastructure Fund for future capital projects.
- Target a \$4 million minimum reserve in the Water Fund. The recommended rate does not fully achieve this goal, but the combined total of the family of water funds does maintain a balance over \$4 million.

Recommended Rate Increase

- Increase residential rates by 9% annually for the next two years. For FY 2009/10, this increases the average bimonthly cost for a Milpitas single-family residence from \$58.05 to \$63.19, an increase of \$2.57 per month. For FY 2010/11, the average bimonthly cost would increase from \$63.19 to \$68.97, an increase of \$2.89 per month. The average single family usage is 23 hcf.
- Increase the rate for Ed Levin Park from \$1.02 to \$1.66/hcf for FY 2009/10, and from \$1.66 to \$1.94/hcf for FY 2010/11 to match SFPUC's wholesale water rate.
- Set rates for City accounts equal to the average wholesale water rate (\$1.60/hcf for FY 2009/10, and \$1.81/hcf for FY 2010/11).
- Increase all other rates by 9% for FY 2009/10, and again by 9% for FY 2010/11.

- The impact on the average single family residence using 23 hcf every two months will be to increase the monthly cost from the current \$29.03 per month to \$31.60 in FY 2009/10 and \$34.49 in FY 2010/11.
- The increase is projected to increase revenues from meter sales from the current \$14.5 million to \$15.8 million in FY 2009/10 and \$17.3 million in FY 2010/11.

Projected Water Fund Balance (Exhibits W-2 and W-3)

- Beginning Water Fund balance is projected to be \$2.21 million on July 1, 2009¹.
- The Water Fund balance will maintain at \$2.21 million on June 30, 2010, and increase to \$2.60 million on June 30, 2011.

Projected FY 2009/10 and FY 2010/11 Revenues (Exhibit W-1)

- \$16.8 million and \$18.3 million.

Projected FY 2009/10 and FY2010/11 Expenditures (Exhibits W-1 and W-4)

- Total: \$16.8 million and \$17.9 million in FY 2009/10 and FY 2010/11, respectively:
 - Wholesale water purchases:
 - SFPUC: \$5.7 million and \$6.8 million².
 - SCVWD: \$2.6 million and \$2.8 million³.
 - City CIP:
 - CIP projects: \$2 million and \$1.7 million⁴.
 - Infrastructure fund: \$1 million and \$1 million⁵.
 - City operations: \$3.6 million and \$3.7 million^{6,7}.
 - City overhead: \$1.8 and \$1.9 million⁶.

Basis for Cost Assumptions and Findings

- SFPUC projects wholesale rate increases of 16% for FY 2009/10 (from \$1.43/hcf to \$1.66/hcf) and 17% for FY 2010/11 (from \$1.66/hcf to \$1.94/hcf).
- SCVWD projects wholesale rate increases of 8% for FY 2009/10 (from \$1.42/hcf to \$1.54/hcf) and 8% for FY 2010/11 (from \$1.54/hcf to \$1.66/hcf).
- Water sales will be 4.5 million hcf for FY 2009/10 and 4.6 million hcf for FY 2010/11. This assumes an increase in water sales for 1st-tier residential in FY 2010/11 of 35,573 hcf to account for 300 new multi-family residential units. No increase in water sales for 2nd-tier residential, irrigation, commercial, industrial and institutional use is assumed.
- The City's CIP will expand to include several seismic projects, but will defer non-critical projects until an adequate fund balance is achieved.

¹ City of Milpitas Finance Dept projection.

² Email communication from BAWSCA staff of discussion with SFPUC staff dated 12/12/08.

³ Email communication from SCVWD dated April 2008.

⁴ City of Milpitas 2009-2014 CIP draft 1-6-09.

⁵ Council policy.

⁶ City of Milpitas FY2008/09 budget, projected to increase 3% annually thereafter.

⁷ Includes partial funding for the operation of the storm drain collection system and management of the urban runoff program.

- "Lost revenue" transfer from the Recycled Water Fund to the Water Fund is \$836,679 in FY 2009/10, and \$893,726 in FY 2010/11. "Lost revenue" represents the loss of potable water sales due to recycled water sales. Transfers from the Recycled Water Fund to the Water Fund are made in order to keep potable water operations level and whole.

PROPOSED WATER RATES

For metered water service, staff recommends the following rates for FY 2009/10 and FY 2010/11:

Bimonthly Quantity Charges

Categories	Current	FY 2009/10	FY 2010/11
Residential (per dwelling unit):			
1-20 hcf	\$1.49	\$1.62	\$1.77
21+ hcf	\$3.13	\$3.41	\$3.72
Commercial, Industrial, & Institutional	\$3.40	\$3.71	\$4.04
Potable Irrigation	\$3.89	\$4.24	\$4.62
Santa Clara County (Ed Levin Park)	\$1.02	\$1.66	\$1.94
City of Milpitas Accounts	\$1.12	\$1.60	\$1.81

1 hcf = One Hundred Cubic Feet = 748 Gallons

Bimonthly Fixed Meter Charges:

(Similar Increases for Other Meter Sizes)

Categories	Current	FY 2009/10	FY 2010/11
5/8" Residential Meter	\$18.86	\$20.56	\$22.41
5/8" Non-Residential Meter	\$19.90	\$21.69	\$23.64
2" Residential Fire Meter	\$30.16	\$32.87	\$35.83
2" Non-Residential Fire Meter	\$31.90	\$34.77	\$37.90

EXHIBIT W-1: WATER REVENUES & EXPENDITURES
FY 2009/10 & 2010/11

	09/10 Projected	10/11 Projected
BEGINNING BALANCE - July 1	\$2,212,022	\$2,210,513
REVENUES:		
Interest	\$66,361	\$66,315
Water Service Agreements (Meter Sales)	\$24,720	\$25,462
Metered Water Sales:		
Construction Water	\$15,828,119	\$17,273,732
Operating Transfer from Recycled Water	\$37,080	\$38,192
	\$836,679	\$893,726
Total Revenues	\$16,792,959	\$18,297,427
REVENUES + BEGINNING BALANCE	\$19,004,981	\$20,507,940
EXPENSES:		
City CIP		
FY 2009/10 and FY 2010/11	\$2,000,000	\$1,700,000
Infrastructure	<u>\$1,000,000</u>	<u>\$1,000,000</u>
Subtotal: CIP	\$3,000,000	\$2,700,000
Overhead	\$1,834,302	\$1,889,331
Operations		
Personnel Services	\$2,055,711	\$2,117,382
Services & Supplies	\$1,394,046	\$1,435,868
Capital Outlay	<u>\$140,000</u>	<u>\$140,000</u>
Subtotal: Operations	\$3,589,757	\$3,693,250
Wholesale		
SFPUC	\$5,737,438	\$6,774,216
SCVWD	<u>\$2,632,971</u>	<u>\$2,848,676</u>
Subtotal: Wholesale	\$8,370,409	\$9,622,892
Total Expenses	\$16,794,468	\$17,905,473
ENDING BALANCE - June 30	\$2,210,513	\$2,602,467

Exhibit W-2 Projected Water Fund Balances (Fund 400)

The solid upper line shows the year end water fund balances for FY 2009/10 through FY 2013/14, assuming annual 9% increases and expenditures as described above. For comparison, the dashed lower line shows the fund balance with the same expenditures and no rate increases.

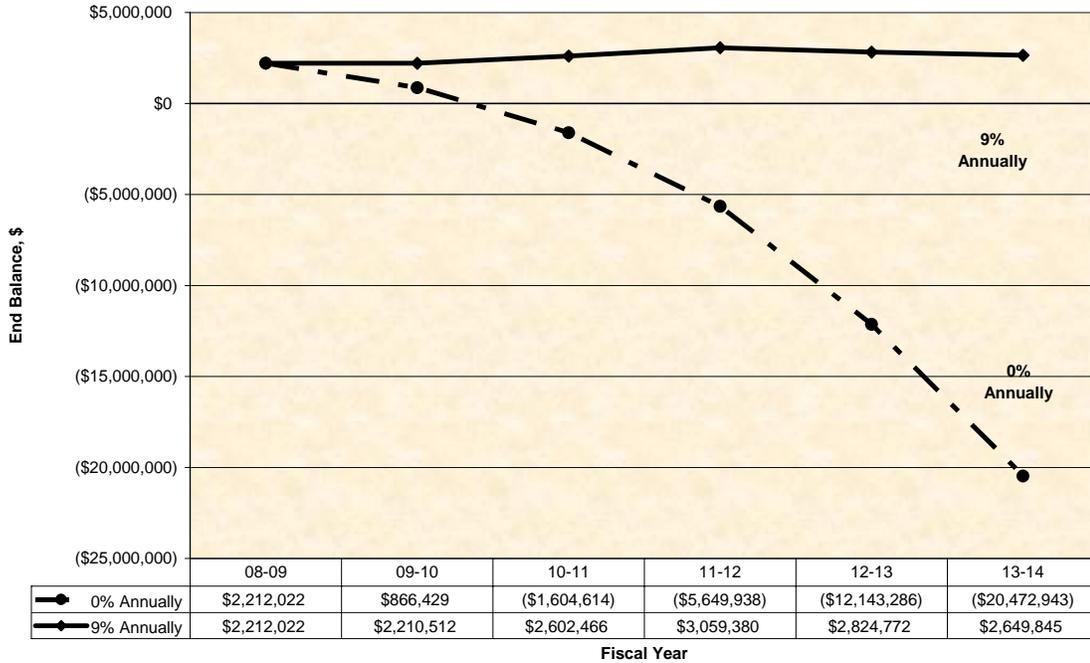


Exhibit W-3 Family of Water Funds

The stacked bar chart shows the water fund balances for all three water funds assuming annual 9% increases and expenditures as described above.

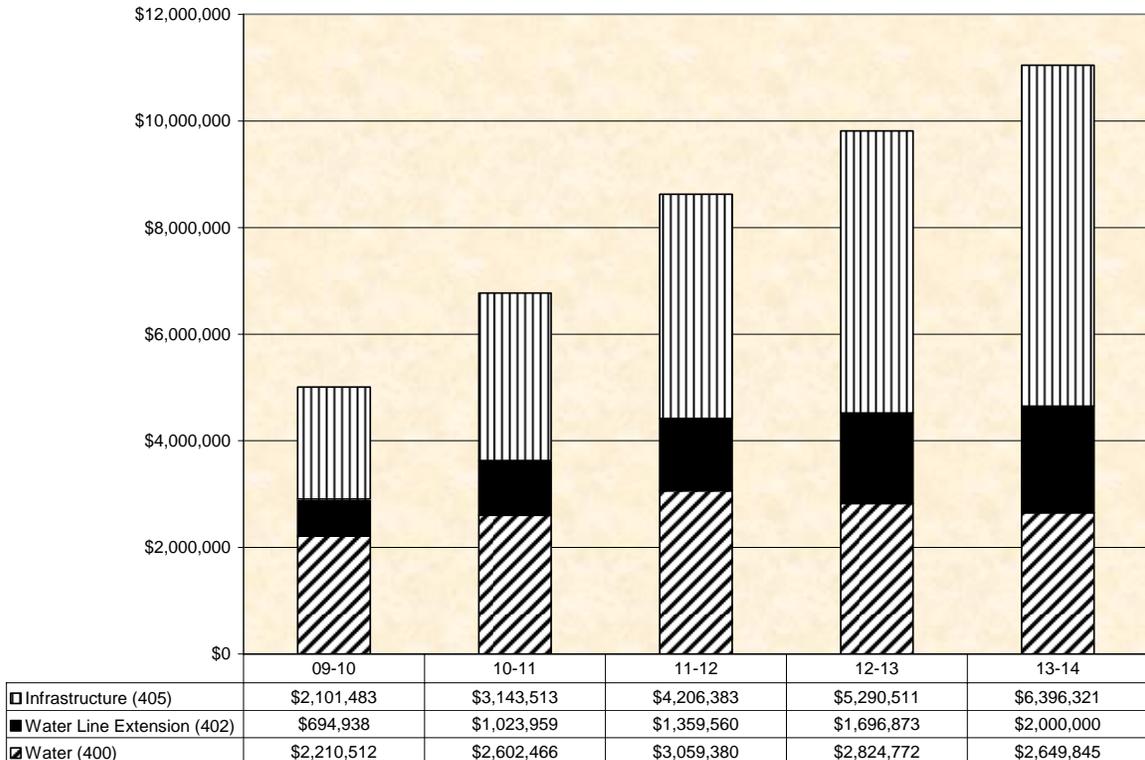
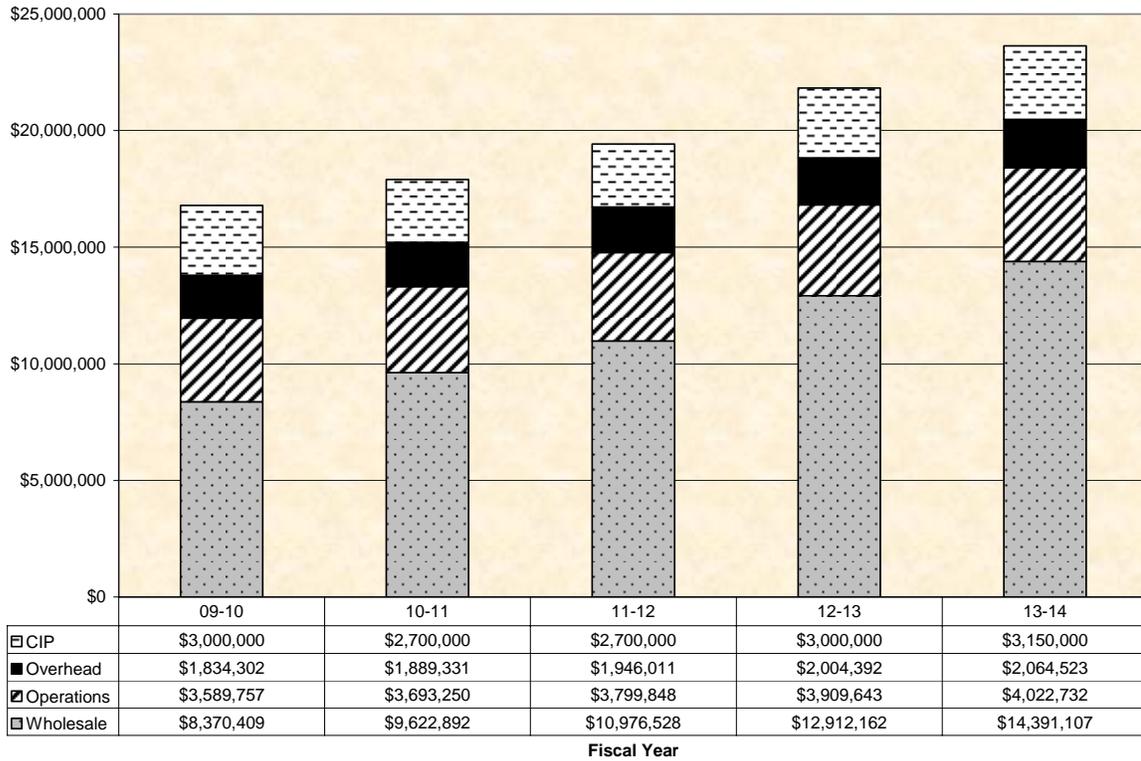


Exhibit W-4 Water Expenditures

The stacked bar chart shows the projected expenditures from the water fund. Expenditures for the CIP include transfers into the CIP and Infrastructure Fund for City water improvement projects.



RECYCLED WATER RATE ANALYSIS AND RECOMMENDATION

The recycled water rate analysis sets the recycled water irrigation rate at 80% of that for potable irrigation and set the industrial use at 50% of the potable industrial rate, then checks the fund balance to ensure that this provides sufficient revenues for expected expenses. The FUMP guidelines specific to recycled water are:

- Establish rates that are lower than potable water rates to encourage recycled water use and decrease dependence on potable water.
- In accordance with Regional Water Quality Control Board guidelines, encourage water conservation and recycled water diversion to reduce treated wastewater discharges to the South San Francisco Bay.
- Maintain a \$300,000 minimum reserve in the Recycled Water Fund.

Recommendation Rate Increase

- Increase recycled water rates by 9% annually for the next two years. This would maintain recycled water irrigation rates at 80% of the potable irrigation rate and recycled water industrial rates at 50% of the potable water industrial rate in order to create incentive for recycled water use.

Recycled Water Fund Balances (Exhibit R-2)

- Beginning Recycled Water Fund balance is \$1.48 million as of July 1, 2009⁸.
- The Recycled Water Fund balance will decrease from \$1.48 million on July 1, 2009 to \$1.14 million on June 30, 2010, and decrease to \$1.11 million on June 30, 2011.

Estimated Revenues (Exhibit R-1)

- \$1.51 million and \$1.62 million for FY 2009/10 and 2010/11, respectively⁹.

Estimated Expenditures

- Total expenditures are:
 - Wholesale recycled water purchases: \$351,786 and \$385,566 in FY 2009/10 and FY 2010/11, respectively.
 - City CIP: \$325,000 and \$25,000 in FY 2009/10 and FY 2010/11, respectively.
 - Lost Revenue Transfer: \$836,679 in FY 2009/10 and \$893,726 in FY 2010/11.

Cost Basis and Assumptions

- Assume recycled water purchases of 372,852 hcf in FY 2009/10 and in 2010/11.

⁸ City of Milpitas Finance Dept projection.

⁹ City of Milpitas FY 2008/09 budget, projected to increase 9% in FY 2009/10 and FY 2010/11

- The South Bay Water Recycling Program (SBWRP) projects wholesale rate increases of 10% in FY 2009/10 (from \$0.86/hcf to \$0.94/hcf) and 10% in FY 2010/11 (from \$0.94/hcf to \$1.03/hcf).
- SBWRP will reimburse a portion of the City's operational expenses for needed maintenance of the distribution system under an SBWRP O&M agreement. However, since the reimbursement amount is unknown at this time, this offsetting revenue has been omitted from the projection. Past reimbursements have ranged from \$20,000 to \$77,500 per year.
- "Lost revenue" due to recycled water sales replacing potable water sales is estimated to be \$836,679 in FY 2009/10 and \$893,726 in FY 2010/11. This revenue is transferred from the Recycled Water Fund to the Water Fund to keep the Water Fund "whole" (retain the same level of funding to meet water operating expenses) and is calculated by applying the potable margin (retail rate less wholesale cost) to the usage of the former potable water customers.

PROPOSED RECYCLED WATER RATES

For metered recycled water service, staff recommends the following increases:

BIMONTHLY QUANTITY CHARGES

Categories	Current	FY 2009/10	FY 2010/11
Recycled Industrial Process Use	\$1.70	\$1.86	\$2.02
Recycled Sanitary (Dual Plumbing)	\$1.70	\$1.86	\$2.02
Recycled Irrigation (Formerly Wells)	\$0.68	\$0.75	\$0.81
Recycled Irrigation (Agricultural)	\$0.32	\$0.34	\$0.37
Recycled Irrigation (All Others)	\$3.11	\$3.39	\$3.70
City of Milpitas Recycled Accounts	\$0.61	\$0.94	\$1.03

1 hcf = One Hundred Cubic Feet = 748 Gallons

BIMONTHLY FIXED METER CHARGES:

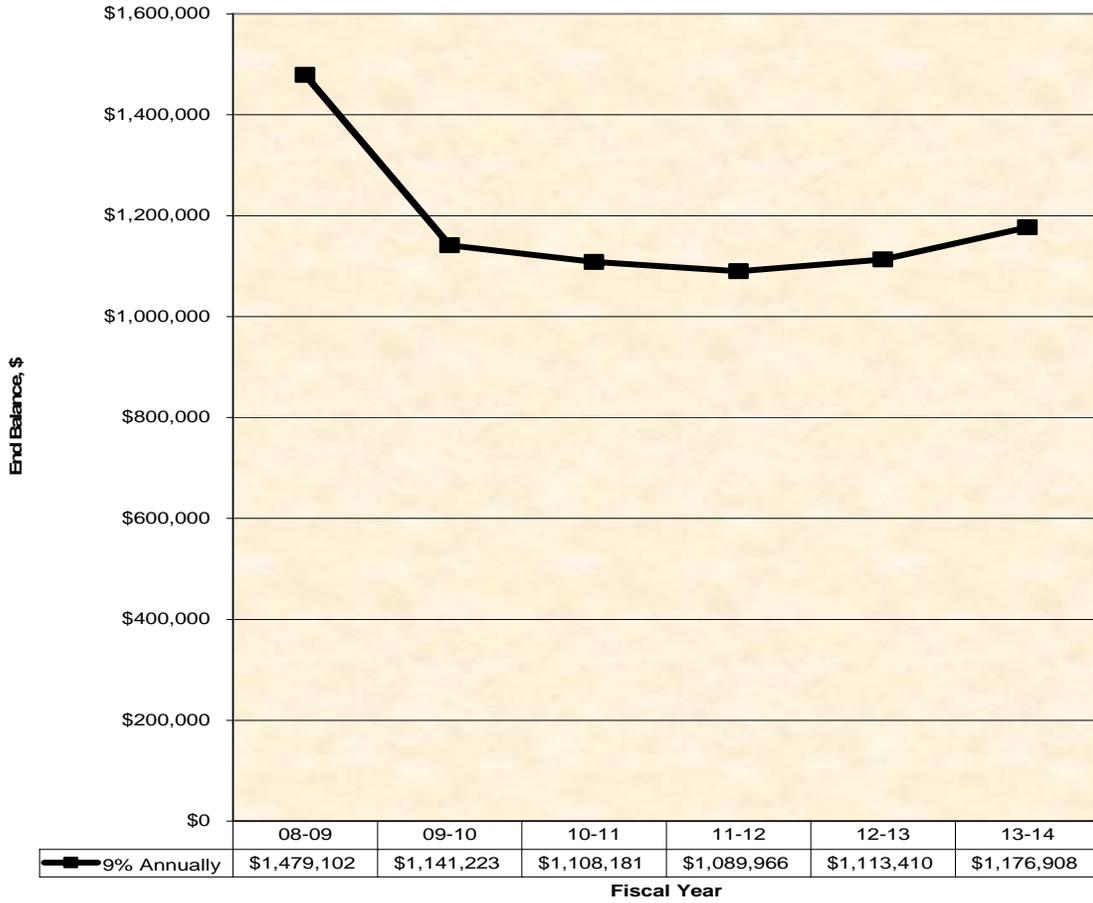
Categories	Current	FY 2009/10	FY 2010/11
Recycled Irrigation (Formerly Wells and Agricultural)	\$60.00	\$60.00	\$60.00
5/8" Meter (All Others)	\$19.90	\$21.69	\$23.64

EXHIBIT R-1: RECYCLED WATER REVENUES & EXPENDITURES
FY 2009/10 & 2010/11

	09/10 Projected	10/11 Projected
BEGINNING BALANCE - July 1	\$1,479,102	\$1,141,222
REVENUES:		
Interest	\$44,373	\$34,237
Metered Recycled Water Sales	<u>\$1,467,270</u>	<u>\$1,583,152</u>
Total Revenues	\$1,511,643	\$1,617,389
REVENUES + BEGINNING BALANCE	\$2,990,745	\$2,758,611
EXPENSES:		
CIP	\$325,000	\$25,000
Overhead	\$172,343	\$177,513
Operations		
Personnel Services	\$148,547	\$153,003
Services & Supplies	<u>\$15,168</u>	<u>\$15,623</u>
Subtotal: Operations	\$163,715	\$168,626
Operating Transfer to Water Fund	\$836,679	\$893,726
Wholesale	<u>\$351,786</u>	<u>\$385,566</u>
Total Expenses	\$1,849,523	\$1,650,431
ENDING BALANCE - June 30	\$1,141,222	\$1,108,180

Exhibit R-2 Projected Recycled Water Fund Balances (Fund 406)

The line represents the year-end recycled water fund balances for the five-year period from FY 2009/10 through FY 2013/14, assuming annual 9% increases and expenditures as described above.



SEWER RATE ANALYSIS AND RECOMMENDATION

As in past years, staff prepared the Sewer Revenue Program recommendations in accordance with the U.S. Environmental Protection Agency guidelines for cost allocation. These require that the City set sewer services charges in proportion to the benefits received by the customers. Benefits are defined as flow volume and strength of the waste as measured by biochemical oxygen demand, suspended solids, and ammonia. Rates are based on an allocation of sewer service cost among these four parameters. Thus, there is an intrinsic relationship for charges among users; change of any single rate due to changes in parameter flow or strength results in reallocation of costs to other users' rates.

In addition to the Sewer Fund, the City uses the Treatment Plant Fund and Sewer Infrastructure Fund to help pay for WPCP and City CIP, as well as future infrastructure improvements. The Treatment Plant Fund is funded by sewer connection and treatment plant fees, while the Sewer Infrastructure is funded by transfers from the Sewer Fund. A breakdown of these funds is shown in Exhibit S-3.

As is the case with the water analysis, the sewer analysis is guided by objectives and principles established by the FUMP, including:

- Goal of transferring of up to \$2 million annually from the Sewer Fund to the Sewer Infrastructure Fund. However, it was found that such a transfer would deplete the Sewer Fund within two years, so no transfer is assumed in FY 2009/10 and FY 2010/11.
- Maintain a \$3 million minimum reserve in the Sewer Fund. It was not possible to maintain this goal for the Sewer Fund, but it is possible to hold the total value of the family of sewer funds, including the Treatment Plant Fund and Sewer Infrastructure Fund, above the target.

Rate Recommendations

- Increase single-family residential rates by 9% annually for the next two years. For FY 2009/10, this would increase the bimonthly cost for single-family residences from \$59.70 to \$65.08, an increase of \$2.69 per month. For FY 2010/11, the bimonthly cost would increase from \$65.08 to \$70.94, an increase of \$2.93 per month.
- Make proportional rate increases for other residential and non-residential customers based on flow and strength of discharge.

Fund Balances

- Beginning Fund Balance is \$2.57 million on July 1, 2009¹⁰.
- The Sewer Fund balance will decrease from \$2.57 million on July 1, 2009 to \$2.33 million on June 30, 2010, and will decrease to \$1.39 million on June 30, 2011.

¹⁰ City of Milpitas Finance Dept projection.

Projected Revenue Breakdown

Revenue is estimated at \$15 million and \$12 million for FY 2009/10 and 2010/11, respectively¹¹. A revenue breakdown is shown in Exhibit S-1.

Projected Cost Breakdown

The City has planned for the following expenditures in FY 2009/10 and 2010/11, respectively, from the Sewer Fund:

- Sewer Treatment at WPCP¹²:
 - \$4.6 million and \$5 million for WPCP O&M.
 - \$5.1 million and \$2.4 million for WPCP CIP.
- City O&M: \$2.9 million and \$3 million.^{13,14}
- City overhead: \$1.8 and \$1.9 million.¹³
- City CIP: \$150,000 and \$85,000.¹⁵

Cost Basis and Assumptions

- WPCP O&M costs increased 19%, from \$3.6 million in FY 2007/08 to \$4.3 million in FY 2008/09. O&M costs are projected to increase to \$4.3 million in FY 2009/10 and \$5.0 million in FY 2010/11.
- WPCP CIP costs significantly increased from \$600,000 in FY 2007/08 to \$4 million in FY 2008/09. In the following year, CIP costs are projected to increase to \$5.1 million in FY 2009/10, but will approximately be cut in half to \$2.4 million in FY 2010/11. Capital costs have large changes when compared year-to-year.
- The sewer fund has insufficient balance to pay the City's share of the WPCP capital program. Therefore, \$3 million will be used from the Treatment Plant Fund in FY 2009/10 to help pay for WPCP CIP costs.
- No increase in sewage discharge is assumed (approximately 8 million gallons per day).

¹¹ City of Milpitas Finance Dept, Actual revenue through 12/31/08, projected to increase 9% annually.

¹² City of San Jose, FY08/09 budget allocation, April 2008.

¹³ City of Milpitas, FY 08/09 budget, projected to increase 3% annually.

¹⁴ Includes partial funding for the operation of the storm drain collection system and management of the urban runoff program.

¹⁵ Draft 2009-2014 CIP, 12/6/08.

PROPOSED SEWER RATES

Staff recommends the following rates:

BIMONTHLY QUANTITY CHARGES

Categories	Current	FY 2009/10	FY 2010/11
Single-family residential	\$59.70	\$65.08	\$70.94
Multi-family residential	\$43.14	\$46.49	\$50.68
Mobile Home	\$26.88	\$28.73	\$31.18
Commercial categories	\$2.20 - \$3.93	\$2.35 - \$4.11	\$2.52 - \$4.52
Industrial categories ¹⁶	\$1.22 - \$5.43	\$0.97 - \$6.52	\$0.72 - \$7.61
Institutional categories	\$2.29 - \$2.91	\$2.49 - \$2.94	\$2.68 - \$3.20

One unit of wastewater is 100 cubic feet, or 748 gallons.

BIMONTHLY FIXED CHARGES:

Category	Current	FY 2009/10	FY 2010/11
Non-residential	\$10.08	\$10.99	\$11.98

By an agreement with the City of San Jose, future wastewater from the North McCarthy Blvd area located in San Jose can be discharged through the Milpitas system to the WPCP for treatment. To date, San Jose has not planned development in this area. However, if it should, the established rate is increased from \$459.00 to \$492.00 bimonthly (based on the Consumer Price Index) for discharges up to 75,000 gallons per day (maximum flow). An excess flow charge of \$100 for each 1,000 gallons per day in excess of the Maximum Flow or part thereof is also applicable.

Proposed rates for commercial, industrial and institutional customers are shown in Exhibit S-5.

¹⁶ Some industrial customers will have their sewer charges adjusted based on their Sewer Flow Adjustment Agreement.

Exhibit S-1: SEWER REVENUES & EXPENDITURES
FY 2009/10 & 2010/11

	09/10 Projected	10/11 Projected
BEGINNING BALANCE - July 1	\$2,569,876	\$2,329,303
REVENUES:		
Close Main Pump Station CIP 6103	\$1,000,000	\$0
Transfer from Treatment Plant Fund	\$3,000,000	\$0
Interest	\$150,000	\$120,000
Use charges + Flat fee	<u>\$10,876,368</u>	<u>\$11,914,966</u>
Total Revenues	\$15,026,368	\$12,034,966
REVENUES + BEGINNING BALANCE	\$17,596,244	\$14,364,269
EXPENSES:		
City CIP		
City FY2009/10 and FY 2010/11	\$150,000	\$85,000
Main Pump Station Sewer Bond	<u>\$686,793</u>	<u>\$689,468</u>
Subtotal: CIP	\$836,793	\$774,468
Overhead	\$1,821,635	\$1,876,284
Operations	\$2,857,678	\$2,961,338
SJ/SC WPCP O & M cost	\$4,646,491	\$4,993,347
SJ/SC WPCP CIP cost	<u>\$5,104,344</u>	<u>\$2,370,740</u>
Total Expenses	\$15,266,941	\$12,976,177
ENDING BALANCE - June 30	\$2,329,303	\$1,388,092

Exhibit S-2 Projected Sewer Fund Balances (Fund 450)

The solid upper line represents the year end sewer fund balances for the five-year period from FY 2009/10 through FY 2013/14, assuming annual 9% increases and expenditures as described above. For comparison, the dashed lower line shows the fund balance with the same expenditures and no rate increases.

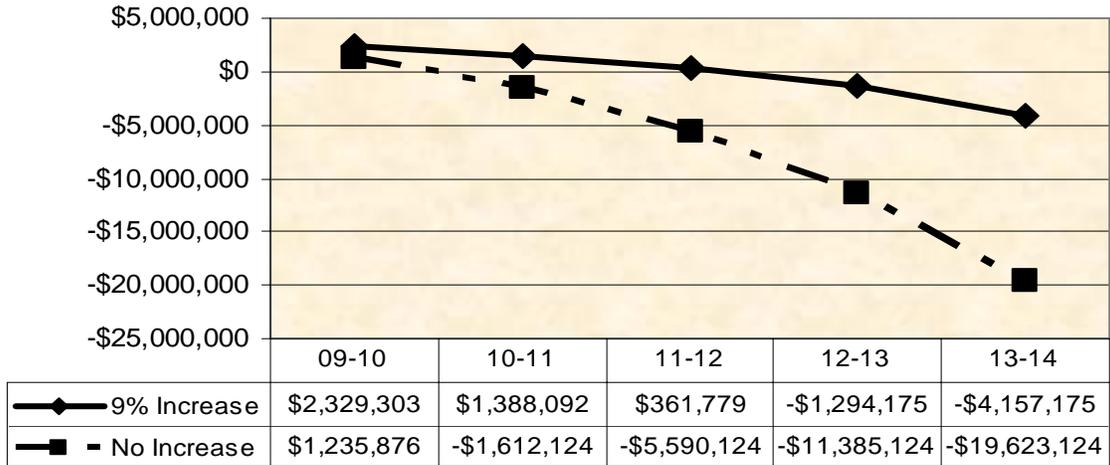


Exhibit S-3 Family of Sewer Funds

The stacked bar chart shows the year end sewer fund balances for all three sewer funds assuming annual 9% increases and expenditures as described above.

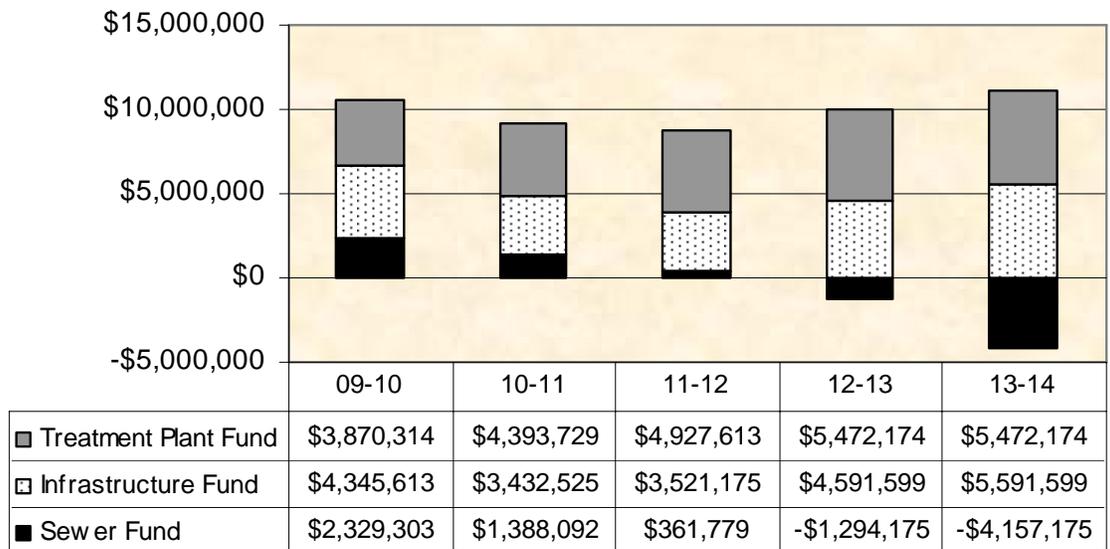
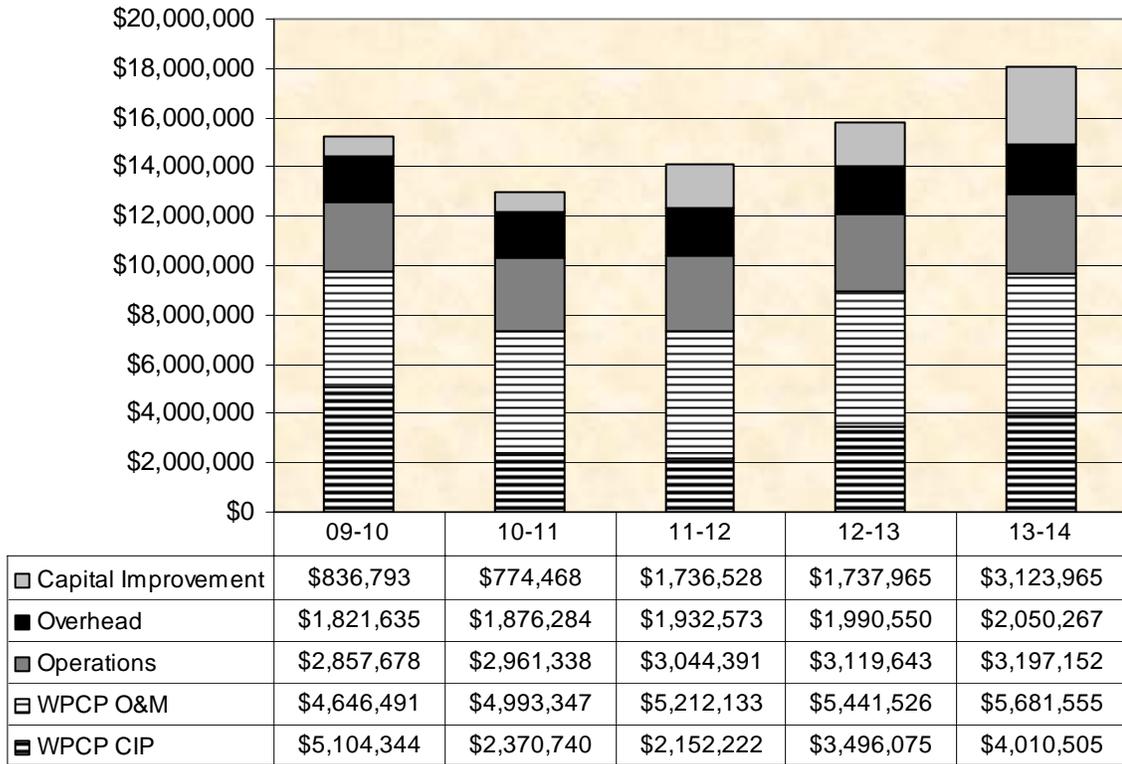


Exhibit S-4 Sewer Expenditures

The stacked bar chart shows the projected expenditures from the sewer fund. Expenditures for the CIP include transfers into the CIP and Infrastructure Fund for City sewer improvement projects and debt service for the Main Sewer Pump Station bonds.



**Exhibit S-5 Proposed Sewer Rates for Commercial,
Industrial and Institutional Customers**

Name	Yearly Flow (hcf)	Rate per hcf Current	Rate per hcf FY 2009/10	Rate per hcf FY 2010/11
COMMERCIAL				
Motels and Hotels (Y) (76)	114,593	\$2.39	\$2.53	\$2.72
General Office (J) (61)	84,803	\$2.39	\$2.54	\$2.74
City of Milpitas (Z2) (77)	3,150	\$2.26	\$2.54	\$2.74
Service Stations (S) (73)	4,631	\$2.41	\$2.67	\$2.89
Eat/Drink Establishments (O) (66)	249,513	\$3.93	\$4.11	\$4.52
Personal Services, Laundrys (P) (67)	35,972	\$2.20	\$2.35	\$2.52
INDUSTRIAL				
Jefferson Smurfit - 32.77% (R) (69)	3,773	\$1.89	\$2.65	\$3.40
T. Marzetti Co. – 72% (N) (65)	14,322	\$5.43	\$6.52	\$7.61
Prudential Overall Supply (U) (75)	16,289	\$2.81	\$3.08	\$3.35
Loral-Fairchild (E1) (53) – 85.2% Lockheed Martin	26,957	\$2.22	\$2.18	\$2.15
Siemens Water Tech (D) (51) – 100% (previously US filters)	67,445	\$2.33	\$2.36	\$2.39
Lucky Pure Water – 87.13% (I1) (62)	1,100	\$1.34	\$1.93	\$2.51
DS W (87) (moved to Arrowhead site (50))	16,749	\$1.22	\$0.97	\$0.72
Milpitas Materials – 0.8% (M) (64)	44	\$2.50	\$2.75	\$3.00
Union Pacific Railroad (J2) (83)	203	\$3.08	\$3.16	\$3.24
Headway Tech. (E9) (84)	370,769	\$2.61	\$2.65	\$2.68
Electrical/Electronics (E) (52)	311,052	\$2.35	\$2.50	\$2.64
Machinery Manufacture (L) (63)	6,401	\$3.09	\$3.31	\$3.52
Linear Technology (E3) (55)	70,682	\$1.97	\$2.15	\$2.32
Seagate Technology 77% (E8) (82)	47,959	\$2.60	\$2.44	\$2.29
Peripheral Storage – S86	2,022	\$2.35	\$3.37	\$4.39
INSTITUTIONAL				
Schools/Colleges (I) (74)	38,213	\$2.91	\$2.94	\$3.20
Convalescent Hosp/Daycare (Q) (68)	12,399	\$2.34	\$2.49	\$2.68
Elmwood Rehabilitation – 100% (G) (60)	134,475	\$2.29	\$2.65	\$2.86

**Per their Sewer Flow Adjustment Agreements, the following industrial customers are subject to sewer charge adjustments based on their sewer volumes:

- Jefferson Smurfit
- T. Marzetti Co.
- Loral-Fairchild
- Lucky Pure Water
- Milpitas Materials
- Seagate Technology

CONCLUSION

The rate analysis for water and sewer services shows that the City needs to raise its rates at least 9% per year for the next two years to generate sufficient revenue for the City's short- and long-term needs. This rate of increase will maintain positive fund balances, at least in the near term, but will not fully meet all Council goals of operating reserve targets and growth of the infrastructure funds for future aging infrastructure replacement.

The City has not raised utility rates since August 2006, while wholesale water and sewer treatment costs increased substantially over this period. Wholesale water and sewer treatment costs are the largest component of the City's costs and are beyond the City's ability to control. The agencies providing water and sewer treatment services are all planning further substantial investment into their infrastructure in the near term, and will pass these costs to their retail customers and tributary agencies. Therefore, it is important that the City prepare for these substantial cost increases by planning to structure rates to accommodate the pass-through costs.

Wholesale water costs are increasing at a much faster rate than the City's retail rates and will exceed the first tier residential rate if the City does not raise water rates at least 9% per year for the next two years. This would directly conflict with Council policy not to sell water for less than its purchase price. In future years, the first tier rate will likely need to be increased at even more aggressive rates to keep pace with the wholesale rate. SFPUC is anticipated to increase their wholesale rate by 16% in FY 2009/10, followed by an increase of 17% in FY 2010/11. SFPUC recently received approval to begin construction on their \$4.3 billion Water System Improvement Program, which will enhance their water system's reliability after a major seismic event. The City's share in the cost is approximately \$100 million. SCVWD is anticipated to increase their wholesale rate by 8% in FY 2009/10, followed by an increase of 8% in FY 2010/11. SCVWD long-term cost projections have not yet incorporated the substantial costs of its planned Infrastructure Seismic Reliability Program.

Sewer treatment costs are also poised to begin a rapid ascent. As part of its Master Plan, the WPCP has conceptually estimated \$1 to \$2 billion in improvements for the upgrade of this 50-year old facility. The City's share in the cost would be approximately \$100 million over the next 30 years. Depending on the actual magnitude and schedule of the WPCP capital improvements, either the WPCP or the City may need to obtain alternate funding, such as from bonds, to level the impact of WPCP improvements on future rates.

At this time, Milpitas water and sewer rates remain comparable to those of surrounding agencies as shown in the following exhibits. All surrounding local agencies are under similar pressure to accommodate the rapidly increasing wholesale water and sewer treatment costs and so are expected to need to implement similar increases in the next five years.

Exhibit C-1 Bimonthly Utility Charge Comparison (Single-Family Residents)*

City	Service Provider	Water	Sewer	Total
Santa Clara	+	\$53.02	\$25.52	\$78.54
Fremont	W2, S3	\$65.00	\$43.20	\$108.20
Sunnyvale		\$56.77	\$52.04	\$108.81
S.J. (Muni)	+S4	\$62.48	\$54.18	\$116.66
Mountain View		\$71.63	\$46.10	\$117.73
MILPITAS (current)	+	\$58.05	\$59.70	\$117.82
Cupertino	+W2, S2	\$83.23	\$42.00	\$125.23
MILPITAS (09/10)	+	\$63.19	\$65.08	\$128.27
Campbell	+W1, S1	\$83.23	\$46.70	\$129.93
S.J. (Water Co.)	+S4	\$83.23	\$54.18	\$137.41
MILPITAS (10/11)	+	\$68.97	\$70.94	\$139.91
Palo Alto		\$111.76	\$46.96	\$158.72
San Mateo	W3	\$84.81	\$103.73	\$188.54

NOTE: Costs based on average single-family consumption of 23 HCF water.

+ Tributary to the San Jose/Santa Clara Water Pollution Control Plant

* Utility Service provided by the indicated city unless it is noted as part of one of the following special districts:

WATER SERVICE:

- W1 San Jose Water Company
- W2 Alameda County Water District
- W3 California Water Service Company

SEWER SERVICE:

- S1 West Valley Sanitation District
- S2 Cupertino Sanitary District
- S3 Union Sanitary District
- S4 City of San Jose

Exhibit C-2

Utility Charge Comparison

This graph compares the current rates for average residential customers in surrounding agencies with Milpitas's current rate, showing that Milpitas remains within the mid-range of the scale. The graph also shows where Milpitas's proposed rates would fall in FY 2009/10 and 2010/11; however, a direct comparison is not possible at this time. The surrounding agencies are expected to raise their rates in the next two years, but these data are not yet available for comparison.

