City of Sebastopol

Proposed Water and Sewer Rates
Fiscal Years 2012 - 13 through 2015 - 16

February 20, 2012

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Introduction

The City of Sebastopol owns and operates municipal water and sewer systems and provides potable water and sewer service to all properties within the City.

These systems are intended to be self-funding, i.e. the costs of operating these systems are borne by the customers of the system. In order to secure this funding, the City imposes user fees on its customers. Each customer's water usage is measured through the placement of water metering devices at each customer location in the City. The customer is billed for their water usage and their sewer bill is calculated based on that water usage as well. Since water and sewer usage is not the same as water usage includes water that does not eventually flow into the sewer system, the sewer rates are based on a formula that assumes winter water usage periods as that is the time of year that water and sewer flows most closely mirror one another.

In the fall of 2002, the City prepared a rate study for both the water and sewer systems. That study found that, with respect to the Water Fund, customer rates were not sufficient to cover operating expenses. Likewise, the study found that sewer revenues were not sufficient to support the cost of operating the system. A significant difference between the two systems is that the water system is entirely self-contained, i.e., the City does not need to nor does it contract with any other municipal or private water providing utilities. On the other hand, the City only owns and maintains the sewer collection and distribution system and contracts with the City of Santa Rosa for the treatment of its sewage. This introduces a variable into the costs of the sewer system of which the City has very limited control. In November of 2008, the City approved increases to both the water and sewer rates. These rates were increased without the benefit of required Proposition 218 majority protest vote process. Therefore, the current analysis relates proposed rates back to the rates included in the 2002 - 2006 rate study.

The City does not have the wherewithal, nor would it be a prudent exercise at this point in time, to explore sewage treatment options other than the City of Santa Rosa. The City has invested significant funds to provide the connection to the Santa Rosa treatment facility, has sufficient capacity assigned to it at the treatment facility to accommodate growth assumed by the City's General Plan and does not have sufficient funding to plan, design, construct and operate its own treatment facility.

A significant shortcoming of the 2002 study was the omission of the routine need to fund the replacement of aging facilities. The study did provide an amount for depreciation of the system assets, however, it appears to have been significantly lower that it should have been. In this analysis, staff has provided the costs to replace our aging systems in 2011 dollars and divided that by the expected life span of the facilities. While this generates a comprehensible amount needed to be funded each year for system replacement, the acknowledged flaw in our current analysis is that it essentially assumes the system is new and we know that not to be the case. As you will note, the proposed rates of increase are very significant and to adjust the replacement costs to more accurately reflect the age of the system could cause these already large increases to skyrocket. It's staff's view that getting the rates to a point where the funds are returned to a sustainable level with significant allocations for system replacement will be a significant improvement and that once the operational aspects of the system are corrected, the City can look at this replacement formula in greater detail in the future.

Finally, with respect to the 2002 report, a significant amount of effort appeared directed at comparing the City's rates to other cities and special districts in the County. While that information is interesting, in staff's view it is not significant and that our rates, first and foremost, should be set to pay for our systems' costs. It may be useful to compare our costs to other entities, however, every system is different and comparisons are rarely apples to apples.

This report will review the history of both the water and sewer funds going back to Fiscal Year 2006 - 07 and project system revenues and expenditures for both funds. A number of funding scenarios will be presented as options along with staff's preferred scenario. Any increase in the rates would be subject to a Proposition 218 majority protest vote of the electors of the City.

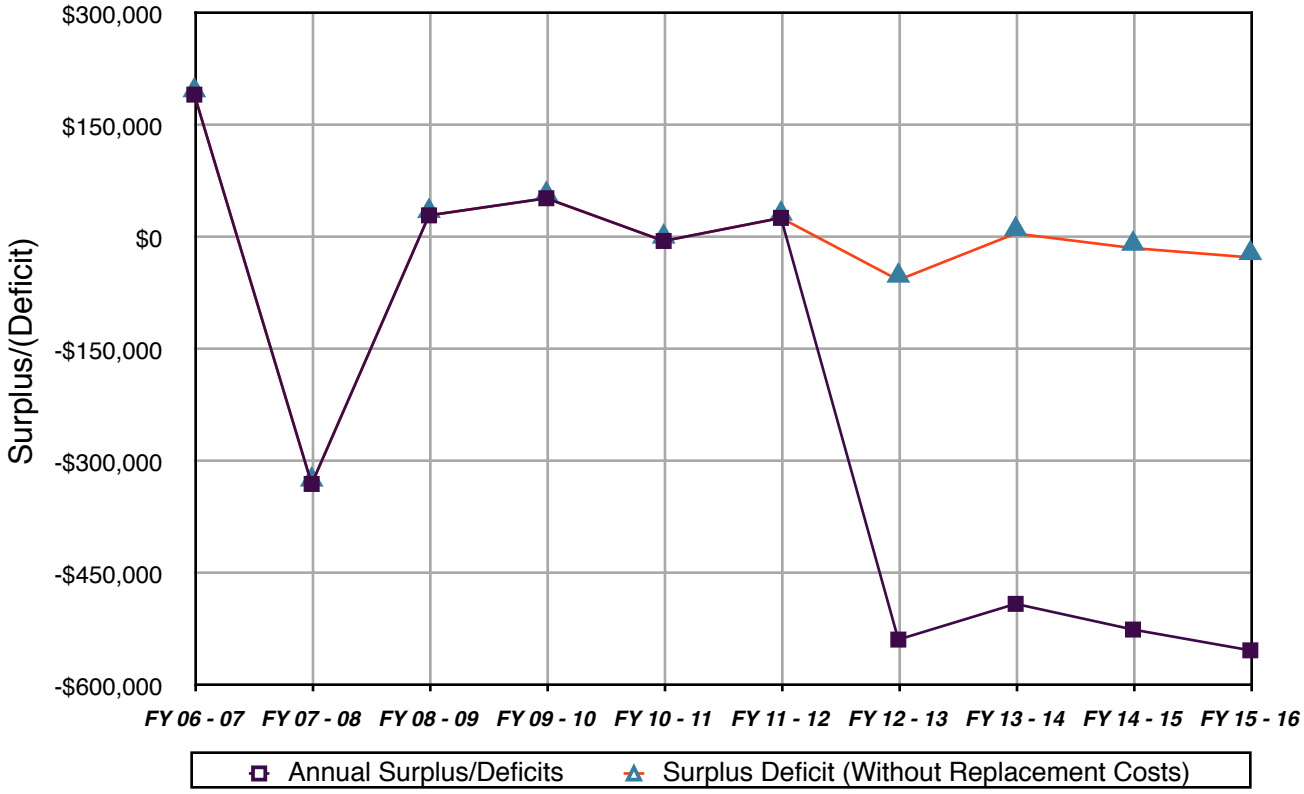
While the issue of not running annual deficits in these funds is important, equally important is the need to maintain significant and stable fund balances. While it might be appropriate to maintain reserves in the area of 10% to 15% in general operating funds, these two funds, while providing for operating expenses, are also significantly more capital heavy than typical operating funds. In either fund, it could only take one incident of equipment failure to substantially deplete the fund balance. The City should strive, at a minimum, to maintain fund balances of at least 25% of budgeted expenditures and seek to increase those balances when possible.

As state above, the water and sewer funds are self-contained enterprise funds. Should these funds fall into a deficit condition, the City would need to either utilize other available funding sources or reduce services within the funds. The latter option is very difficult to accomplish as the demands of the systems are predictable and regular.

WATER FUND

The Water Operations Fund operated at a deficit in Fiscal Year 2007 - 08 ($329,403) and in Fiscal Year 2010 - 11 ($3,978). It is projected to operate at a slight surplus in the current fiscal year, then at significant deficits in the future as system replacement costs are included. Figure 1 depicts the annual fund balances from 2007 through 2016 assuming the current rate structure.

Figure 1 - Projected Surplus/Deficit



The graph clearly demonstrates that the current rate structure is not sustainable in terms of providing the ability for the City to systematically plan for the replacement of its facilities. In fact, the current rate structure will not support the basic operations costs. When considered in the light of the current year starting balance of -$369,944, the problem becomes quite clear. There are three principal reasons for the current negative fund balance; 1) diminishing revenues, 2) escalating operational costs and 3) the need to undertake replacement projects without having the fee structure include those costs. Figure 2 shows the annual drop in starting balances under the current structure both with and without replacement costs. While the drop is far less precipitous under the scenario without replacement costs, the balances never move back in a positive direction and the deterioration of fund balance starts to accelerate in FY 15 -16 and thereafter.

In terms of diminishing revenues, the amount of water sales have been steadily declining. Figure 2 below shows the actual water sales by customer classification as well as per capita sales per day.

Figure 2 - Projected Starting Cash Balances (Current Rate Structure)

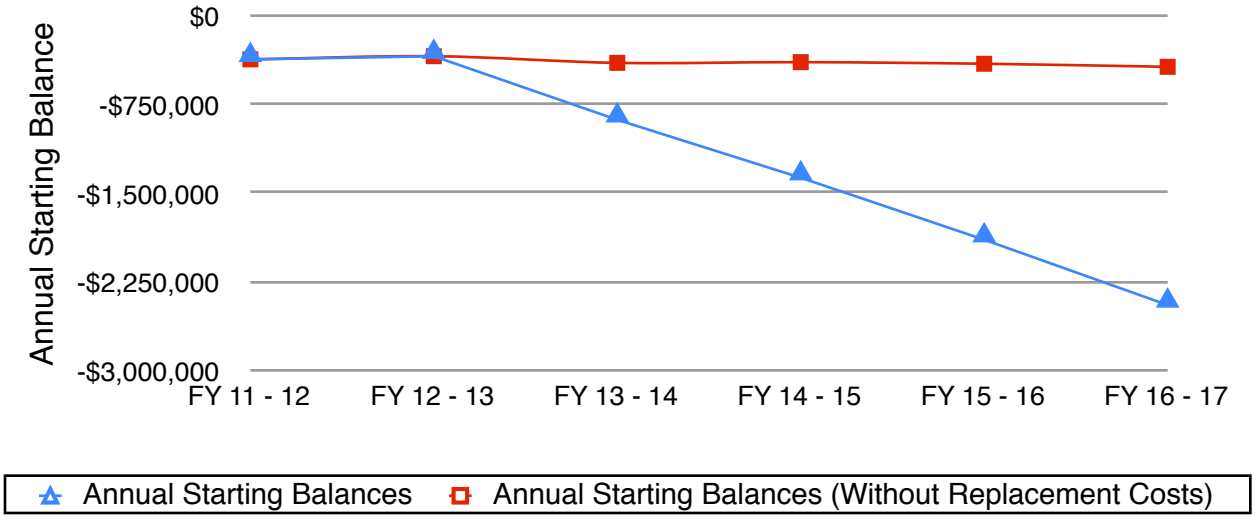


Figure 3a - Water Sales By Users

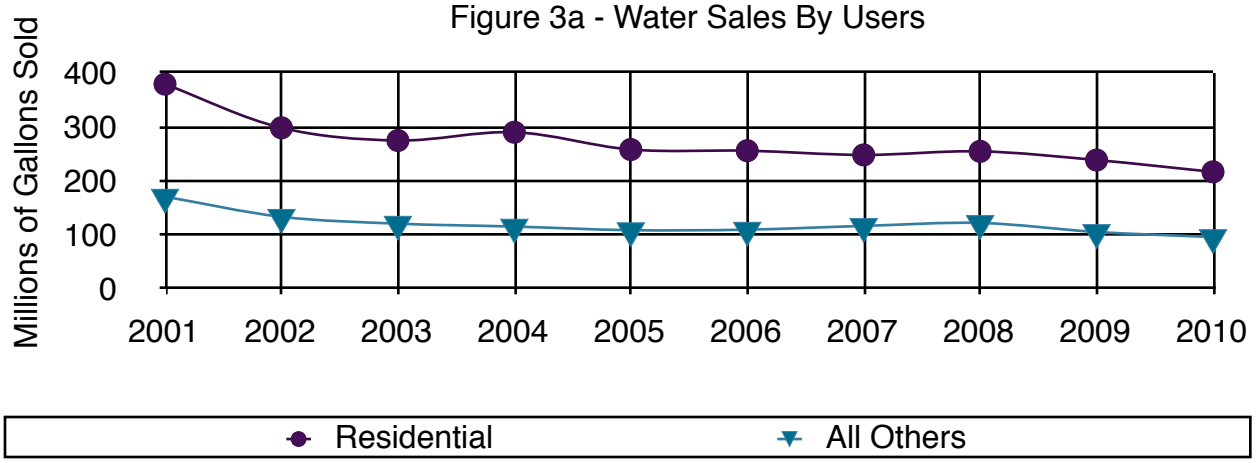
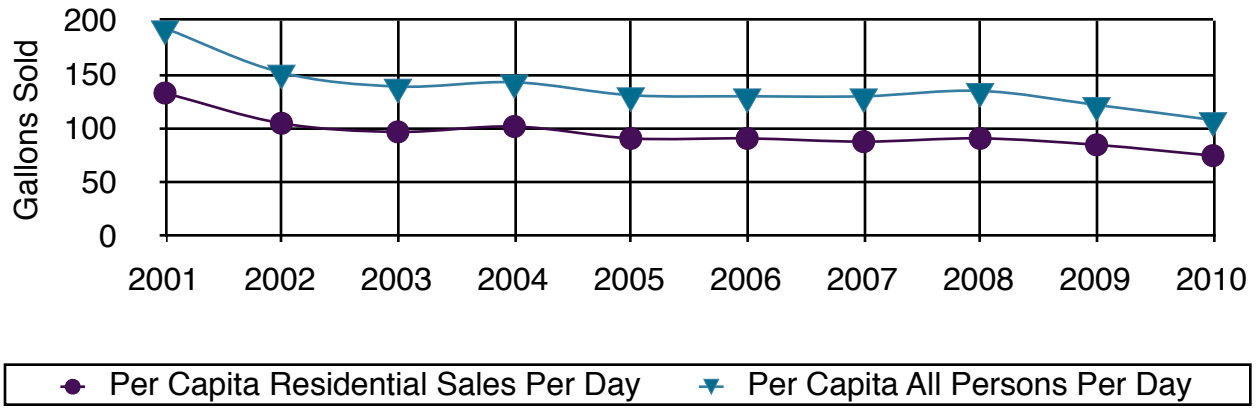


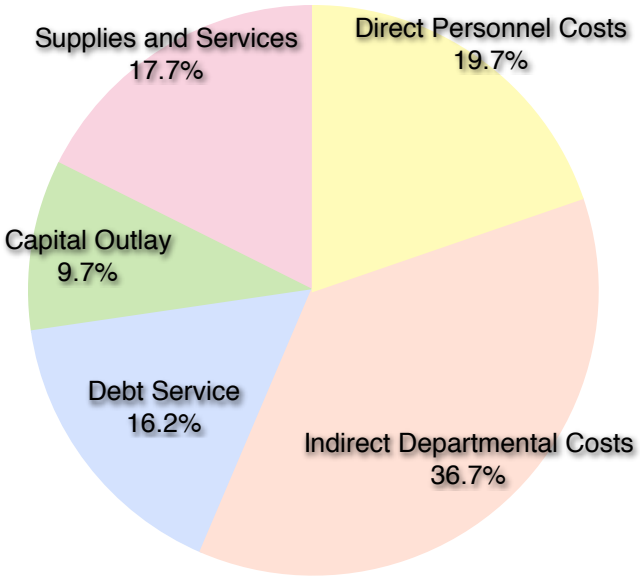
Figure 3a - Water Sales Per Capita



Figures 1 and 2 clearly demonstrate that the City's current water rate fee structure is not only not sufficient to meet current needs, it provides no ability whatsoever to react to problems or unforeseen circumstances. Figures 3a and 3b clearly shows that there is no apparent or looming uptick in sales that would offset the increasing operating costs. Ignoring, for a moment, the need to fund ongoing replacement costs, the data leads to only three possible conclusions in terms of the fiscal stability of the water fund. Conclusion 1 is that to maintain rates as they currently exist, expenditures need to be drastically reduced. Conclusion 2 is that fees need to be adjusted upward in realization of current fiscal status and costs. Conclusion 3 is a blended approach of Conclusions 1 and 2.

In the approved Fiscal Year 2011 - 12 budget, the water operations fund had an approved expenditure budget of $1,173,049. Figure 4 shows how that budget is broken down by categories.

Figure 4 - Water Expenditures



The direct personnel costs include 2.4 full time equivalent employees. That level of staffing for a system with 193,547 lineal feet (36.7 miles), multiple pump stations, wells, fire hydrants, two major reservoirs and assorted other devices should hardly be considered extraneous. The indirect departmental costs reflects those costs that the City's various departments incur in managing the water system, including most notably the costs to administer the utility billing portion of the operation. The debt service is a fixed cost that is not changeable in any meaningful way, the capital outlay is quite low which is a main part of the problem and supplies and services are the basic materials needed to keep the system operational. There does not appear to be any way to significantly reduce the costs of the system with the exception of reducing the indirect departmental costs. They total $440,948 in the current fiscal year, so eliminating all of that and imposing those costs on the City's general fund, would basically bring the fund balance back to near $0.

It is staff's view that the fund's basic issue was a significantly flawed prior rate study and revenues not keeping pace with expenditures. From Fiscal Year 2006 - 07 to the current fiscal year, expenditures have increased by roughly 4% per year, while revenues have increased by 0.4%.

If there is agreement that cost containment is not the problem or a driving force for the fund's fiscal difficulties, then the City is left with Conclusion 2 as the way in which this problem needs to be solved. To move forward with a rate increase, the City would need to identify its goals in terms of both solvency for the fund and its ability to maintain and upgrade the system.

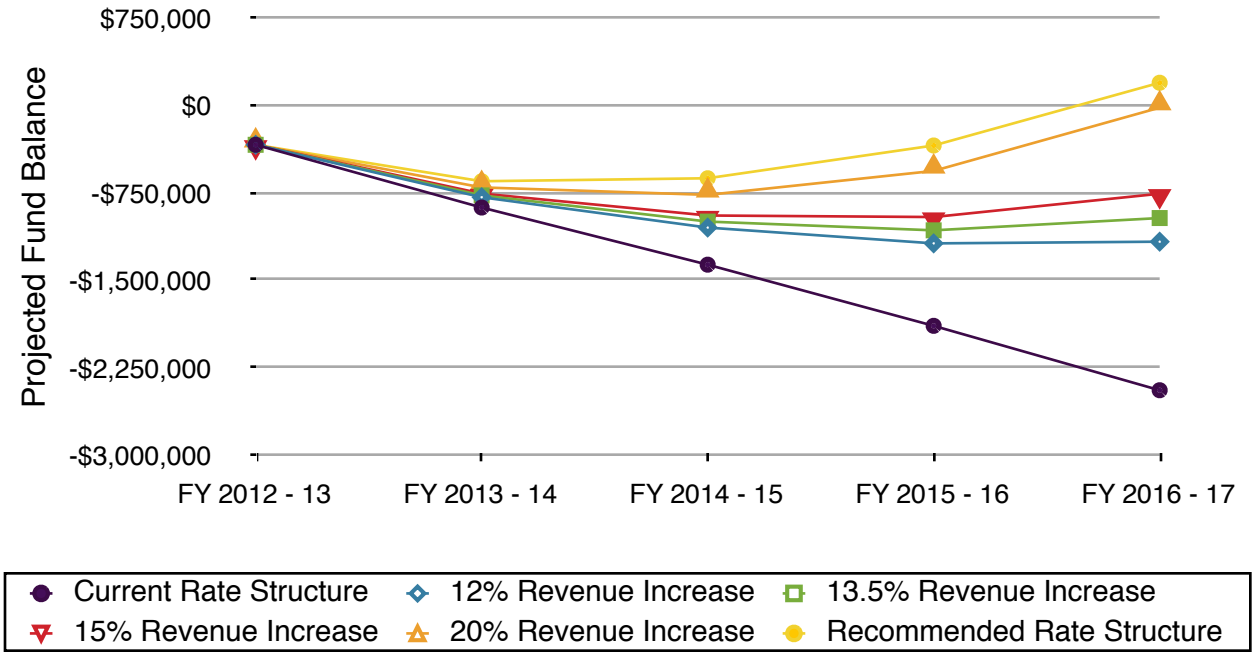
Staff has developed a number of scenarios for increases. These scenarios all assume that the City would start to fully fund its system replacement needs. The scenarios are provided in detail

in Appendix A of this document. It will be difficult to dig the water fund out of the hole it finds itself in over a short period of time like two years. This fee analysis looks at the next four fiscal years. There are six rate scenarios provided for your consideration:

Current Rate Structure
Revenue Increase of 12%
Revenue Increase of 13.5%
Revenue Increase of 15%
Revenue Increase of 20%
Recommended Rate Structure

Figure 5 below shows the changes in the annual starting cash balance under each of these scenarios.

Figure 5 - Projected Starting Cash Balances (Various Rate Scenarios)



As the chart indicates, only the recommended rate results in the fund balance being above $0 after four years. The annual 20% revenue increase nearly brings the fund back to $0, while the others fall far short. The recommended rate scenario also has the benefit of reducing the level of increase through the four years thus bringing the fund closer to being able to have revenues track more consistently with expenditures plus inflation beyond the timeframe of this fee study. It would be expected with the recommended rate, and to a lesser extent the 20% revenue increase, that future rates could then be tied more directly to actual expenditures, including the funding of replacement costs. The other four scenarios still leave a significant deficit that would undoubtedly result in continued high rate increases in subsequent years. They would also not in any way provide the fund with the ability to react to unplanned or unforeseen circumstances.

On the face of it, the recommended scenario or the 20% revenue increase scenario appear to be significant increases, and indeed, they are. A fundamental question that the City must consider is whether to present to the ratepayers a rate structure that returns the water fund to a sustainable fiscal level and provide the resources needed to operate and maintain the system

that will also provide the ability for a future rate scheme that is based on reasonable cost and revenue projections or present a rate scenario that continues to fail to adequately provide for the future well-being and reliability of the system. It's abundantly clear that the current rate structure will ultimately lead to a failed water system or will eventually demand significant service reductions on all other City services.

Staff recognizes that the level of increases discussed in this report will present hardships to the system's customers, particularly those with low or fixed incomes. It's also important to note that previous rate schemes basically resulted in artificially low rates due to the lack of recognition of the need to fund system replacement needs. The tables below provides a summary of the rate impacts on system customers under the various rate scenarios. The typical residential account uses approximately 1.2 hundred cubic feet (HCF) of water per month.

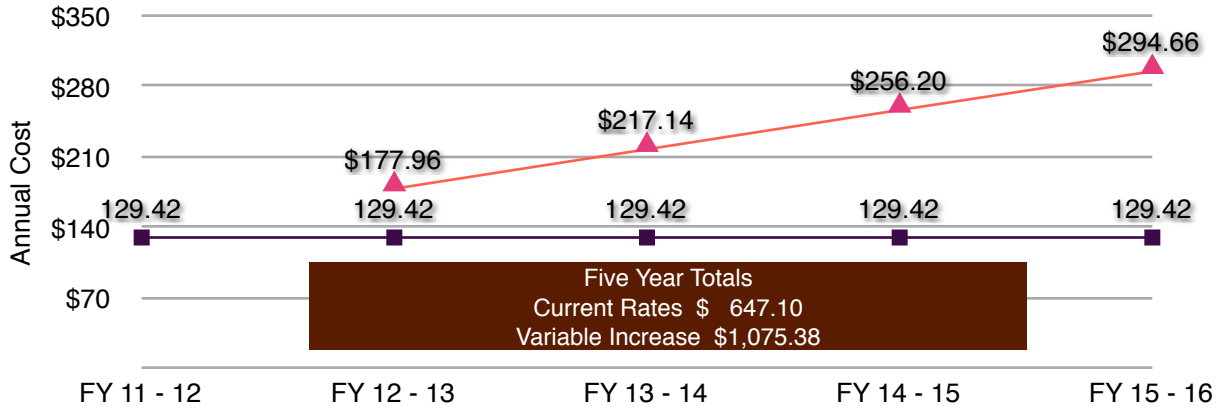
Bi-Monthly Water Rate Minimums (Recommended Rate Structure)					
Meter SIze	FY 2005/06 Rate	Proposed 2012/13 Rate	Proposed 2013/14 Rate	Proposed 2014/15 Rate	Proposed 2015/16 Rate
5/8" x 3/4"	$21.57	$29.66	$36.19	$42.70	$49.11
1"	$36.04	$49.55	$60.45	$71.33	$82.03
1.5"	$71.76	$98.68	$120.39	$142.06	$163.37
2"	$114.90	$157.99	$192.75	$227.44	$261.56
3"	$251.59	$345.94	$422.05	$498.02	$572.72
4"	$359.34	$494.09	$602.79	$711.29	$817.99

In addition to the bi-monthly minimums shown above, the City imposes usage charges on those users who exceed 100 cubic feet of water usage bi-monthly. The table below depicts the recommended increases to that usage rate.

Usage Charges Per HCF (Recommended Rate Structure)					
Usage Classification	FY 2005/06 Rate	Proposed 2012/13 Rate	Proposed 2013/14 Rate	Proposed 2014/15 Rate	Proposed 2015/16 Rate
From 1HCF to 30 HCF	$1.33	$1.83	$2.23	$2.63	$3.03
Above 30 HCF	$1.40	$1.93	$2.35	$2.78	$3.20

The annual costs to rate payers will obviously see significant increases under the recommended rate structure. Figure 6 below depicts the annual costs to the typical residential customer for the recommended rate structure.

Figure 6 - Typical Residential Customer



The recommended rate structure represents a total increase of 66% over 5 years.

Any rate increase is a painful exercise and staff would much prefer to be bringing forward a rate scenario that is far more modest. Unfortunately, the issue of funding what is truly a routine function which is the well planned replacement of aging infrastructure has often been sacrificed in the past in an effort to avoid larger rate increases. This is true in many cities, Sebastopol not excepted, and is not limited to the water fund. A city can only push those expenses out for so long before they start to have to address them in emergency or crisis situations. Once a system starts to show regular failures, it is often too late for the owner/operator to deal with those failures through their normal fiscal means. They usually mean paying higher costs for emergency repairs, financing of what should have been routine operating expenses and potential costs associated with system failures such as environmental damage, legal fees and other consultant costs.

In the case of our water system, we will have to ask our ratepayers to bite the bullet at some point. It is staff's view that if we ask that question now, the risk of significant, unplanned costs will be somewhat mitigated. They can never be eliminated as infrastructure starts to deteriorate as soon as it is constructed, and like a new car, different parts deteriorate at different rates. Planning to address that deterioration in our rate structure now should help to avoid significant rate increases going out much farther into the future.

Lastly, this recommended rate structure is based on an increase to the usage rates. Most cities base their rate schedules on sliding scales of costs for actual usage. This provides the individual rate payer with some ability to limit the amount of additional costs they incur through changes in usage patterns. Many cities will significantly inflate the costs for high volume users to encourage conservation. The recommended rate structure will maintain the City's long provided opportunity for rate payers to have some control of their costs. The alternative to the rates based on usage factors is to increase the base rate significantly across all rate payers. This tends to deemphasize conservation as a valued goal and also significantly limits the individual rate payers ability to control their costs. The City Council has routinely sought to encourage conservation measures and the recommended rate structure recognizes that long held goal.

WATER CAPITAL FUNDS

The City has what would be considered three water related capital funds. The largest of these funds is called the Water Capital Fund and is funded through fees payable as a result of building permits. The City Council has previously adopted resolutions establishing water system connection fees for all new development. The purpose of these fees is to enable the City to develop a funding source that will enable it to increase the capacity of its system when those needs arise.

The second capital fund is the Water Annexation Fund. As the name implies, whenever a property or properties are annexed into the City and are connected to the City's water distribution system, a fee is charged to enable the costs of those connections to be borne by the properties subject to the annexation and not the ratepayers in general.

Lastly, the City has a fund entitled the Well 4 Litigation Fund which was funded by the proceeds of a legal issue that the City successfully litigated with respect to Well Number 4.

Combined, these accounts have a combined balance of $541,484, broken down as follows:

Water Capital Fund	-	$414,625
Water Annexation Fund	-	$ 9,273
Well 4 Litigation Fund	-	$117,586

The approved Fiscal Year 2011 - 12 budget will significantly draw down the Water Capital Fund through the Well 6 Water Blending/Water Zone Connection Project.

It is acknowledged by staff that the Water Capital Fund and the Water Annexation Fund are due for a review as to whether the current rate structures are adequate. That analysis is not part of this review and will be brought forward as an independent item in the future. Please note that these two fees are not subject to Proposition 218.

SEWER FUND

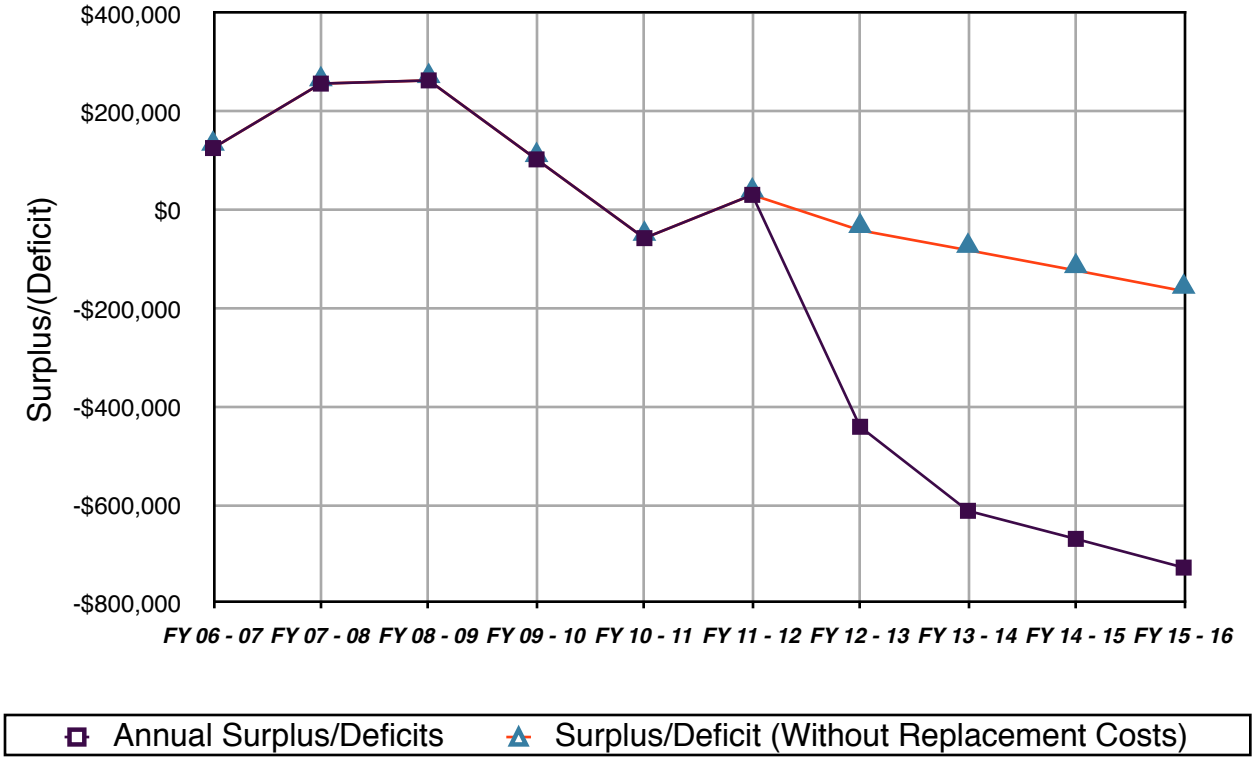
The City operates a sewer collection system. The City does not operate a sewage treatment system. To treat its sewage, the City contracts with the City of Santa Rosa. The City has constructed a force main that transmits the City's sewage to the Santa Rosa sewage treatment facility on Llano Road.

The City charges fees for those properties that are connected to the sewage collection system and these fees are intended to pay the costs to both operate and maintain the collection system and the costs of treatment at the City of Santa Rosa's treatment plant.

Sewer rates for the individual residential user are based on their actual water usage during the winter months. The reason for winter calculation is this is when the relationship between actual water usage and the amount of water that is sent it to the sewage collection system mostly closely mirror one another.

The current rate structure is projected to provide a small surplus of $31,038 in Fiscal Year 2011 - 12. The rate structure, like the water fund, does not provide for adequate funding of system replacement. When those costs are included, it becomes clear that the sewer fund will not be able to sustain a positive fund balance and will result in significant deficits at its current rate. Figure 7 below demonstrates the projected annual fund balances with and without replacement costs at the current rate structure.

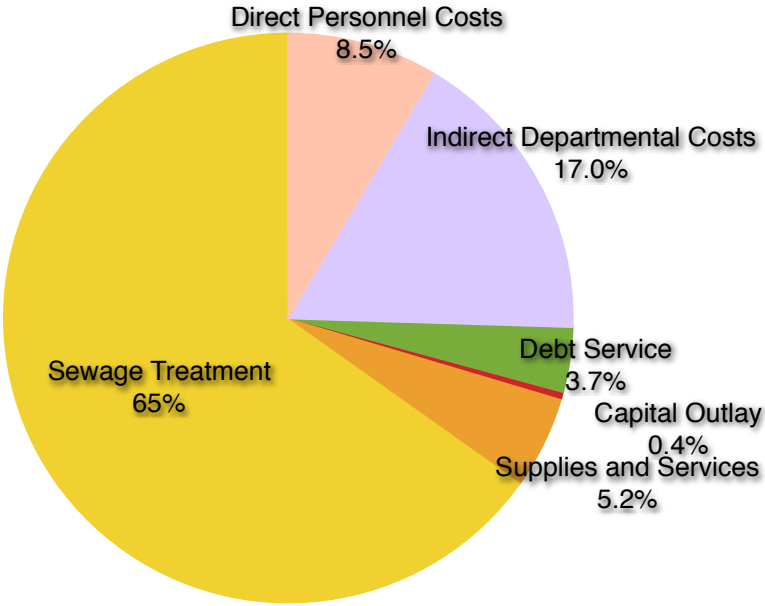
Figure 7 - Projected Surplus/Deficit



As Figure 8 indicates, the current rate structure results in annual deficits without replacement costs factored in, though at significantly smaller deficits than with replacement costs included. The projected starting fund balance for Fiscal Year 2012 - 13 is $101,073. Within two years without the replacement costs included, the fund will be experiencing a negative fund balance. In order to continue to maintain the system, an alternate funding source would need to be identified, costs will need to be reduced or or the rate structure will need to adjusted upward.

Like the water fund, the City operates a very lean sewage system and there are not significant savings to be found within the fund. Figure 8 depicts the cost allocation breakdown with the sewer fund in the current fiscal year. As the chart clearly demonstrates, sewage treatment makes up nearly two-thirds of the total fund expenses, making cost reductions very difficult. The costs of sewage treatment are broken into two categories. First, the cost of actually treating the amount of sewage flow that is generated in the city. The second portion is for the City's share of debt service for the cost of the treatment facility. The debt service amount is based on the amount of treatment capacity that the City has reserved at the treatment plant. The amount of capacity the City has is greater than the amount of flow that it is currently sending to the plant. The "excess" capacity is there to ensure that the City will have sufficient treatment capacity in the future to handle future growth in the City. This "excess" capacity can be considered an asset in that it does provide assurance that future development or redevelopment plans the City may have will have adequate sewage treatment capacity to utilize. It also can be considered an asset that could be sold to other contractors at the treatment facility that have a need for additional capacity. At present, it does not appear that any of the current contractors are running short of sewage capacity or are concerned that they may run short in the future. This lack of demand renders the asset to likely be of little value. Until it appears that there is any demand for additional capacity and the willingness of a contractor to take on additional debt service, it seems unlikely that the City could see its treatment related debt service reduced.

Figure 8 - Sewer Expenditures

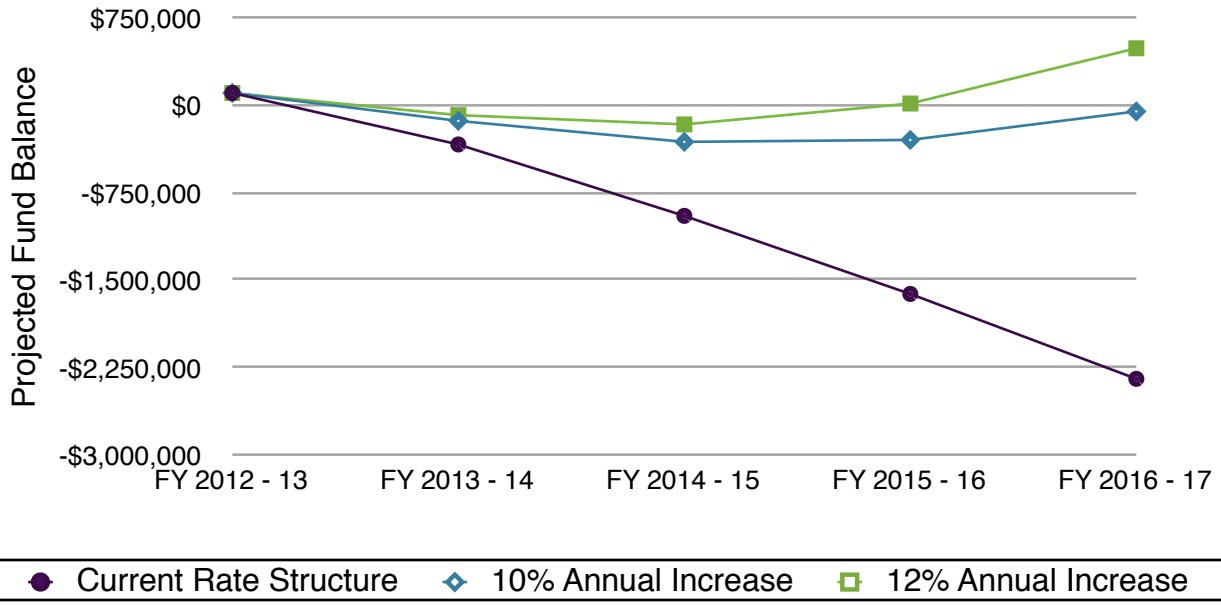


In terms of direct personnel costs, only 1.8 full time equivalent employees are budgeted to the sewer fund. The indirect departmental costs take into account all of the costs that are associated with staffing and building usage related to the sewer fund and the other cost categories are very minor. Like the water fund, it appears that there is not significant savings to be garnered by reducing costs in the sewer fund. This conclusion then leads to the need to adjust the rate structure.

Unfortunately, staff has come to the same conclusion with respect to the sewer rates that it came to regarding the water rates. The former rate analysis, which was done in combination with the water rate analysis was significantly flawed in a number of ways. Principally, it did not account for the significant replacement costs that the sewer fund needs to assume.

Staff has developed two rate increase scenarios for review in addition to the current rate structure. Those scenarios contemplate a 10% revenue increase and a 12% revenue increase. Figure 9 demonstrates the projected fund cash balances under each of these scenarios.

Figure 9



As Figure 9 indicates, an annual 10% revenue increase brings the fund back to almost balanced by the end of the rate study period. A 12% revenue increase results in a fund balance of $484,504 at the end of the period with a reserve balance of 17%. It's projected that the 12% revenue increase would enable future rates beyond the study period to more closely mirror normal inflation, thus not requiring double digit increases farther out in the future. The recommended rate structure is the one resulting in 12% revenue gains. The impact on rate payers are provided on the following table:

Bi-Monthly Sewer Rate Minimums (Recommended Rate Structure)					
Meter SIze	FY 2005/06 Rate	Proposed 2012/13 Rate	Proposed 2013/14 Rate	Proposed 2014/15 Rate	Proposed 2015/16 Rate
5/8" x 3/4"	$43.84	$62.06	$69.51	$77.85	$87.19
1"	$73.13	$98.63	$110.47	$123.72	$138.57
1.5"	$145.84	$185.44	$207.69	$232.62	$260.53
2"	$233.47	$291.44	$326.41	$365.58	$409.45
3"	$511.09	$627.24	$702.51	$786.81	$881.23
4"	$730.07	$892.12	$999.17	$1,119.08	$1,253.36

In addition to the bi-monthly minimums, the city charges a usage charge for those users whose water use exceeds 1 HCF on a bi-monthly basis. The recommended rate structure for the usage charges is shown in the following table.

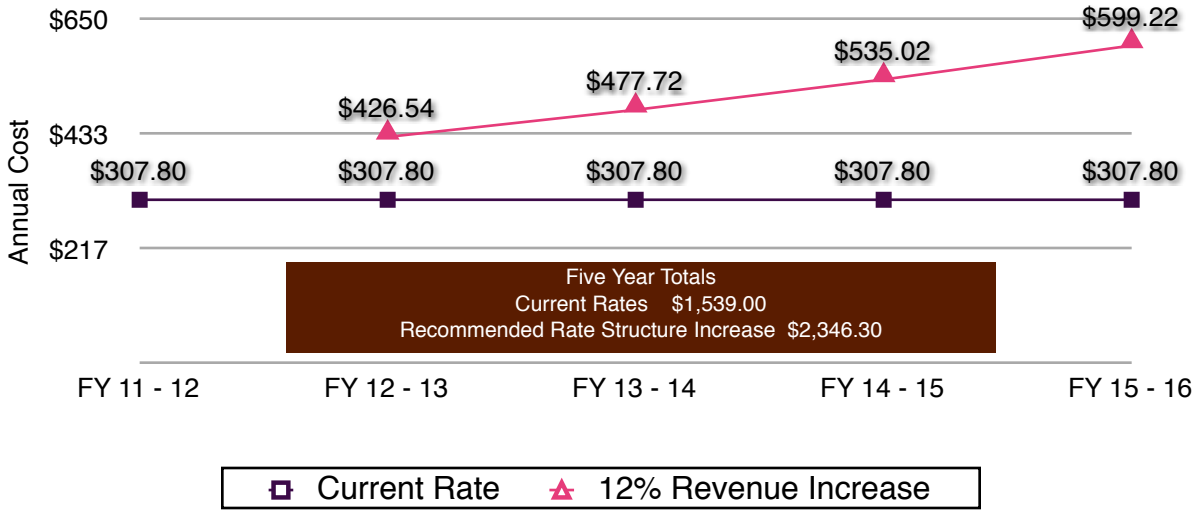
Sewer Usage Categories (Recommended Rate Structure)					
Type of User	FY 2005/06 Rate	Proposed 2012/13 Charge per HCF	Proposed 2013/14 Charge per HCF	Proposed 2014/15 Charge per HCF	Proposed 2015/16 Charge per HCF
Residential	$3.89	$4.70	$5.26	$5.90	$6.60
Dining Facility (Take Out)	$4.36	$5.28	$5.91	$6.62	$7.42
Dining Facility (On Premise)	$5.41	$6.54	$7.32	$8.20	$9.19
All Other (Up to 50,000 cubic feet)	$3.89	$4.70	$5.26	$5.90	$6.60
All Other (Over 50,000 cubic feet)	$3.23	$3.91	$4.38	$4.90	$5.49

The sewer rate contains a fixed rate for all users regardless of usage. The table below indicates the rate as of FY 2005/06 and the recommended rate adjustment.

Bi Monthly Fixed Rate for Sewer Service (Recommended Rate Structure)					
	FY 2005/06 Rate	Proposed 2012/13 Rate	Proposed 2013/14 Rate	Proposed 2014/15 Rate	Proposed 2015/16 Rate
Fixed Rate	$7.46	$9.03	$10.11	$11.32	$12.68

Figures 10 depicts the annual costs to rate payers for the recommended rate structure and the current rate structure.

Figure 10 - Typical Residential Customer



The recommended rate structure represents a total increase of 52% over 5 years.

The recommended rate structure assumes that the sewer fund will be able to start the process of regular replacement of the distribution system. The City would need to move forward with a lesser rate increase to bring the fund into some level of sustainability even if replacement costs were not included. It is staff's view that to leave the replacement costs out of the equation will only exacerbate the eventual problem the City will face and it will likely cost more in the future as the chances of being forced to make emergency repairs on a more frequent basis instead of a regular and planned system of replacements and upgrades.

SEWER CAPITAL FUNDS

The City has four sewer related capital funds. They are the Sewer Capital Fund, Wastewater Impact Fee Fund, Sewer Annexation Fund and Techite Settlement Fund. The Sewer Capital Fund is funded through system connection fees that are collected with the issuance of building permits. The Wastewater Impact Fee Fund is funded from fees collected for construction or annexation of new residential structures. The Annexation Fund is based on funds collected from properties annexed into the City which need to be connected to the City's sewer collection system. The Techite Settlement Fund is the result of a lawsuit settlement related to the construction of past sewer improvements in the City.

Combined, these funds have a projected year end balance of $727,942, broken down as follows:

Sewer Capital Fund	-	$115,140
Wastewater Impact Fee Fund	-	$124,974
Sewer Annexation Fund	-	$ 10,223
Techite Settlement Fund	-	$477,605

It is acknowledged by staff that the Sewer Capital Fund, Wastewater Impact Fee Fund and the Sewer Annexation Fund are due for a review as to whether the current rate structures are adequate. That analysis is not part of this review and will be brought forward as an independent item in the future. Please note that these three fees are not subject to Proposition 218.

SUMMARY AND RECOMMENDATIONS

The City's water and sewer funds are on unsustainable fiscal paths. This is not a new or recent occurrence. In the 2002 - 2006 rate study, in the cover letter dated August 21, 2002, the consultants stated, "Water rates do not support expenses. Annual shortfalls in FY 02-03 will total $145,836. This means that depreciation will not be funded and other expenses such as capital outlay would need to be curtailed. We do not recommend this. Depreciation should be funded annually in order to keep the water utility in a strong position to pay for needed repairs and replacements as needed. The depreciation schedule is based on an extended life of facilities and may even be understated."

Unfortunately, it appears that the depreciation costs were understated. That understatement led to the water fund continuing to struggle financially despite the increases that were made in the 2002 - 2006 time period. Rates have not been adjusted since 2006 and the combination of underfunding capital replacement costs, revenue stagnation/reductions and normal inflation have placed the fund under significant strain.

Staff recognizes that these increases will be painful for all and particularly difficult for low and fixed income ratepayers. Nevertheless, staff is convinced that the ultimate costs to continue to underfund our rehabilitation and replacement needs as well as not maintain our operating revenues in a manner commensurate with operating expenditures will ultimately cost the rate payers far more. The recommended rate structure will not solve all of our issues but it should place the funds back on a far more solid fiscal footing and enable the City to start to tackle its long terms capital issues.

This rate plan would return the water fund to a positive fund cash balance of approximately $130,000 (7.9% of expenditures) in Fiscal Year 2015 - 16. It includes funding of $481,585 in FY 2012 - 13 for replacement efforts and escalates that amount by 2% per year thereafter. Staff acknowledges that these rate increases could be significantly reduced by not funding the replacement costs, however, in an aging system with a declining population, that is a substantial risk to take and staff does not recommend that such a risk be made.

With respect to the sewer fund, the FY 2002 - 2006 rate plan likewise acknowledged that sewer rates did not support expenses. That study also acknowledged that the Sewer Capital Fund was propping up the Sewer Fund, thus reducing the ability of the City to fund capital needs. That study continued that support and the end result was a rate structure insufficient to meet the operating system needs and a significant diminution of the sewer capital fund. The study states, "Without these transfers, rates would have to increase more than projected." Whenever capital funds are used to offset operating costs, both the operating fund and the capital fund will eventually find themselves in significant difficulties. That is exactly the case that the Sewer Fund and Sewer Capital Fund find themselves in now.

Staff recommends that the ratepayers be presented with a rate proposal that increases revenues above current levels by 12% each year from FY 2012 - 13 to FY 2015 - 16.

As stated several times in this report, staff recognizes the significant increased costs that these proposed rates will cause. Unfortunately, these costs are going to be unavoidable at some point. The City does not have viable options to get out of the water production and distribution business without the incurring of what would likely be cost prohibitive capital costs to connect to another water system. While that has not been analyzed, the lack of a nearby connection and

the fact that combined water and sewer rates in the closest City, Santa Rosa were roughly 37% higher than in Sebastopol in 2010, leads to the conclusion that even with the rates proposed, Sebastopol rates would be on a par and possibly still less than Santa Rosa rates.

On the sewer front, the reality is that the City has no other option than the one it currently uses with respect to sewage treatment. Even if one were to assume that the acquisition, construction and operational costs of a new treatment facility were within the realm of possibility, it is very unlikely that a new treatment facility could be permitted when one exists so close by and has more than sufficient capacity to meet the city's and, indeed, the region's short and long term sewer treatment demands.

With these conclusions, the question for the City and its ratepayers is whether it wants to make the necessary corrections to the funding of its water and sewer systems now and place those funds on a sustainable path going forward. This does not mean that after this four year rate plan expires that rates would then freeze at that point. In order to keep these funds solvent, the adjustment of rates to match both normal inflation and inevitable unforeseen circumstances will be needed. It is staff's view that the risk to both the water and sewer system as well as all other city operations is too great to not view the fiscal condition of these funds with completely open eyes and lay before the ratepayers the full picture with a complete explanation of the capital replacement issues.

APPENDICES

Water Fund Rate Scenarios
Water Capital Fund
Water Annexation Fund
Well 4 Litigation Fund
Water Fund Summaries
Water Capital Needs - System Replacement Schedule

Sewer Rate Scenarios
Sewer Capital Fund
Wastewater Impact Fee Fund
Sewer Annexation Fund
Techite Settlement Fund
Sewer Fund Summaries
Sewer Capital Needs - System Replacement Schedule

2002 - 2006 Rate Study