Water and Westwater Enterprise Fund — Rate-Freeze Scenario/Rate-Tier Removal Analysis

Fiscal Impact of July 7, 2026, Proposal to Freeze Rates and Eliminate Tiers

Prepared for July 7, 2026, City Council meeting · Five-year forecast through FY2030-31

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Executive Summary

On July 7, 2026, the City Council will consider suspending the tiered water rate structure and freezing water rates at their 7/1/2025 levels. This analysis models the five-year fiscal consequences of that action and compares it to two alternatives: continuing the currently adopted rate schedule (the baseline) and adopting the rate freeze **together with** the cost-side reforms recommended by the Enterprise Fund Oversight Committee (EFOC).

The central finding is straightforward. Freezing Water rates and removing the rate-tiers ***in isolation*** leaves frozen revenue to be overtaken by steadily rising costs. **The fund's operating margin collapses to a deficit by FY2028-29, and reserves fall from roughly $2.4 million today into a deficit of about -$0.1 million by FY2030-31** — below the City's 25% reserve policy floor and continue into the red. This is the same pattern of revenue reduction that drove the Water Operating Fund to a negative balance in FY2023-24 and forced the emergency rate study and steep rate increases of 2024.

Rate relief is not the problem — doing it alone is. **When the freeze is paired with the EFOC's recommended cost-allocation reforms, the attorney-fee refund, and the shift of the Syserco energy loan to the General Fund, the fund remains healthy** — above the reserve policy in every year of the forecast. The reforms supply the savings that make the revenue reduction sustainable.

Taken together, the changes recommended here move both the Water and Sewer enterprise plans toward **Proposition 218 and Proposition 26 compliance** with how central-government costs are allocated to the funds. They also provide sufficient revenue for the infrastructure repair the systems require, and they keep rates stable for the next several years — until there is enough time-tracking data to build a new, defensible Cost Allocation Plan and, on that foundation, a properly grounded new rate study.

One caveat is the unknown condition of the old clay sewer pipes. We have miles of pipe, and the replacement cost is high. The currently projected reserve in the Wastewater Enterprise Fund is large but still may not be high enough, once the city produces the Sewer Study.

If the proposed changes are adopted the city would have the added advantage of being able to present a plan compliant with the Grand Jury recommendation to restore $5.5MM to the Enterprise funds. The plan outlined here would total $5.5MM returned to rate payers over 6 years in addition to the savings rate payers realize from paying the lowest tier an having near-term rate increases suspended.

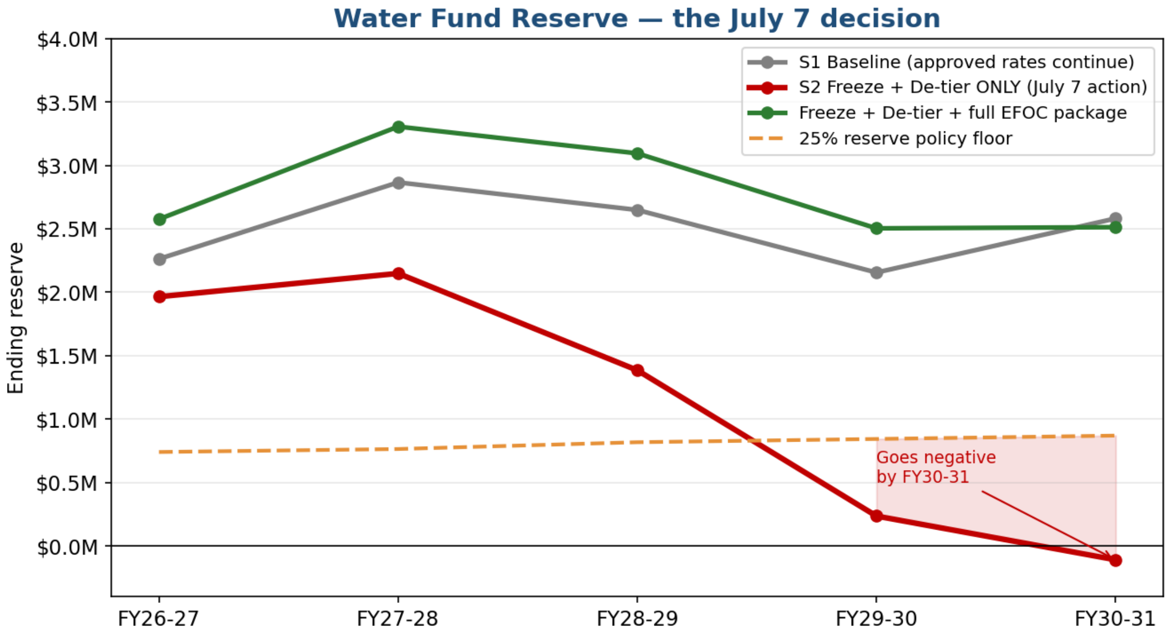

Figure 1. Water fund reserve under the three paths. The July 7 action alone (red) falls below the 25% policy floor; paired with the full EFOC package (green) it stays healthy.

Purpose and Background

The City of Sebastopol operates its water system as an enterprise fund, meaning water rates cover the cost of running, maintaining, and rebuilding the system. In 2024, following a period in which the water fund's reserves were drawn down to a deficit, the **Council commissioned a rate study and adopted a multi-year schedule of rate increases to rebuild reserves and fund a substantial capital program.**

The Enterprise Fund Oversight Committee (EFOC) is the City's citizen oversight body for water and wastewater operations. The EFOC has recommended eliminating the tiered volumetric rate structure (which the City Attorney has identified as legally vulnerable under Proposition 218) and freezing rate increases — but only as one part of a larger package that also:

- Reforms how central-government overhead is charged to the enterprise funds. 30% of administrative overhead would be allotted to the Enterprise Funds with 15% of identified departmental budgets attributed to Water and 15% of identified departmental budgets attributed to Sewer.
- Refunds $350,354 in attorney's fees the Committee contends were improperly charged. $130,867 would be restored to Water Fund. $219,487 would be restored to Sewer Fund.
- General Fund repays Water Fund for previous Syserco Lease Payments of $843,965 over four years.
- Shifts responsibility for future Water Fund Syserco energy lease payments to the General Fund.
- “Forgiveness” of $1,200,000 “loan” from General Fund to Sewer Fund.

The action placed before the Council on July 7, 2026, adopts revenue reduction without the accompanying cost-side reforms. This analysis below quantifies what that distinction means for the water fund's solvency over the next five years.

The staff recommendation is to fix volumetric rates at $5.22. This $5.22 rate is used throughout the analysis below.

Staff Recommendations to Council for rate freezes for Water customers

Fixed Monthly Charges

Meter Size	*7/1/2025 (Will Remain In Effect)*	*7/1/2026 (suspended)*
5/8"x3/4" & ¾"	$70.39	73.21
1"	$116.43	$121.09
1.5"	$231.50	$240.76
2"	$369.59	$384.38
3"	$806.86	$839.14
4"	$1,451.28	$1,509.34

Volumetric Rates ($/1,000 gallons)

Customer Class	*7/1/2025*	*7/1/2026*
Residential 0-7,000 Gallons	$5.22	$5.22
Residential 7,000-16,000 Gallons	$6.65	$5.22
Residential >16,000 Gallons	$9.26	$5.22
Commercial	$5.74	$5.22
Irrigation	$10.32	$5.22

Source: 7/6/2026 Council Staff Report

Data Sources

Every figure in this analysis is drawn from the City's own adopted documents. No external or estimated data is used except where explicitly noted as an assumption.

- **FY2026-27 Proposed Budget** (Agenda Item 8, Council packet of June 2, 2026). Used for the Water Operating Fund 500, Water Capital Fund 501, and Connection Fund 502 financial schedules; department operating budgets; debt service detail; and the Cost Allocation Plan department detail (object 4996 / G&A Allocation 4998).
- **2024 Water and Wastewater Rate Study** (Raftelis, draft dated May 15, 2024). Used for billed water volumes by customer class and tier (Table 5-5), account/meter counts (Table 3-3), and the fixed- and volume-charge revenue methodology (Tables 4-1 and 4-2).
- **Approved 2024-2028 Water and Sewer Rate Schedule** (Exhibit A). Used for the adopted fixed (bi-monthly) and volumetric rates by meter size and customer class, including the tier rates and the 7/1/2025 lowest-tier rate of $5.22/kgal used for the de-tiered scenario.
- **Capital Improvement Program — Global Summary** (Funding Sources for CIP Projects). Used for the water capital program and its funding sources by year through FY2030-31.

Methodology and Key Assumptions

The water enterprise is modeled on a consolidated basis, combining the operating fund (500), the capital fund (501), and the connection-fee fund (502), because these three funds together represent the working capital available to the water system. The consolidated beginning reserve at the start of FY2026-27 is **$2,359,173**. The FY2026-27 projection reconciles to the reported ending working capital in the adopted budget.

Rate revenue is built up from principles established in the most recent water rate study and reconciled to the adopted FY 26-27 budget. Billed volumes from the rate study are multiplied by the published rates to derive volume revenue by class; fixed (service-charge) revenue is derived as the residual needed to tie to each customer class's adopted budget line. The FY2026-27 build-up ties to the adopted usage revenue of **$3,452,233** to the dollar. Expenditures include operating costs, the Cost Allocation Plan charge, existing and Well 4 debt service, routine capital, and the full capital improvement program as a direct charge against reserves.

The following assumptions apply uniformly across all scenarios unless a scenario explicitly changes them:

Assumption	Value / basis
Operating expense growth	4.0% per year
Cost Allocation Plan growth	3.5% per year
Adopted rate path (baseline)	As approved through 7/1/2028; +3%/yr thereafter
De-tier flat rate	$5.22/kgal (7/1/2025 lowest tier)
Reserve policy target	25% of operating expenditure (ex-CIP)
Consolidated beginning reserve	$2,359,173 (funds 500 + 501 + 502)

Note — Well 4 replacement loan. *Well 4 is a critical water-supply source scheduled for replacement within the capital program. The forecast assumes the City finances the replacement with a $2.6 million loan drawn in FY2027-28. The assumed source is the State Water Resources Control Board's Drinking Water State Revolving Fund (DWSRF), which provides below-market financing for municipal water projects, at an assumed 2% interest rate amortized over a 30-year term — producing level debt service of approximately $116,000 per year beginning FY2028-29. Because the loan both funds the project and is repaid from water rates, its proceeds are a one-time financing source and do not, by themselves, improve the fund's recurring operating position.*

Scenario 1 — Baseline (Adopted Rates Continue)

The baseline case for the Water Fund assumes the Council makes no change: the adopted rate schedule remains in effect, and the cost allocation and capital plan proceed as budgeted. Under this path the water fund stays comfortably above its 25% reserve policy throughout the forecast, ending FY2030-31 at approximately $2.58 million. The baseline is the yardstick against which the July 7 proposal should be measured.

Water fund — Baseline	FY26-27	FY27-28	FY28-29	FY29-30	FY30-31
Ending reserve	$2.26M	$2.87M	$2.65M	$2.16M	$2.58M
Over / (under) 25% target	+$1.52M	+$2.10M	+$1.83M	+$1.31M	+$1.71M

Scenario 2 — The Action Before Council (Freeze + De-tier Only)

Scenario 2 models the action on the July 7 agenda exactly as proposed:

- Freeze all water rates at their 7/1/2025 levels and eliminate the rate-tiers by charging all residential use at the flat lowest-tier rate of $5.22/kgal — with **no other changes**.
- Cost allocation, debt, and the capital program remain as budgeted. Usage revenue is frozen at **$3,154,424**, while the adopted plan would have grown it to nearly $3.93 million.

With revenue being held flat and costs continuing to rise, the fund's operating position deteriorates every year. Operating revenue stays near $3.26 million while operating expenditures climb from about $2.96 million to roughly $3.48 million. The operating margin collapses from about **+$297,000 in FY2026-27 to a deficit of roughly -$220,000 by FY2030-31** — the fund stops covering its own recurring costs.

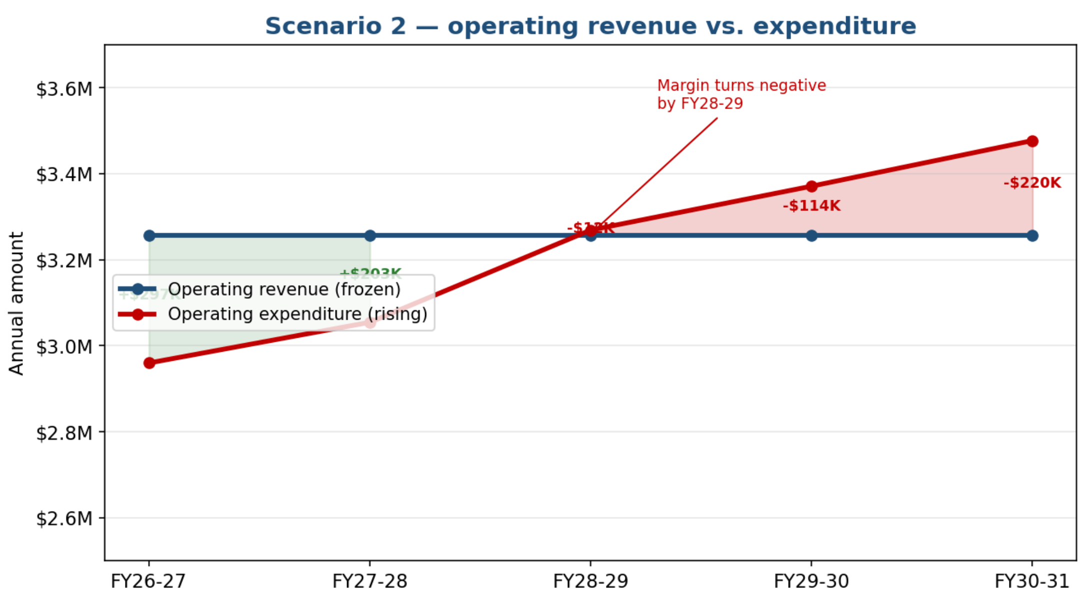

Figure 2. Scenario 2 operating revenue (frozen) versus operating expenditure (rising). The operating margin shrinks each year and turns negative by FY2028-29.

Figure 2 shows operating revenues and expenditure only. It excludes the one-time $2.6 million Well 4 replacement loan proceeds and the multi-year capital improvement program (both financing / capital items), so that the fund's recurring operating position is shown on its own terms.

Compounding the operating squeeze, the fund must still carry its capital program. The combined effect draws reserves down steadily — from $2.36 million into a deficit of about -$0.11 million by FY2030-31 — falling below the 25% policy floor in FY2029-30 and into outright deficit the next year. Over the three years FY2028-29 through FY2030-31 the fund loses roughly **$2.4 million**, more than its entire balance, and on this trajectory is effectively depleted within the forecast window itself.

Water fund — Scenario 2	FY26-27	FY27-28	FY28-29	FY29-30	FY30-31
Ending reserve	$1.96M	$2.15M	$1.38M	$0.23M	**($0.11M)**
Over / (under) 25% target	+$1.22M	+$1.38M	+$0.57M	($0.61M)	($0.98M)

This Is How the FY2023-24 Deficit Happened

The danger is not hypothetical. The Water Operating Fund reserve fell to **negative $188,000 in FY2023-24** — the very crisis that forced the City to commission the 2024 rate study and adopt sharp rate increases to rebuild**. Reducing revenue now, without reducing costs, points the fund down the same slope.**

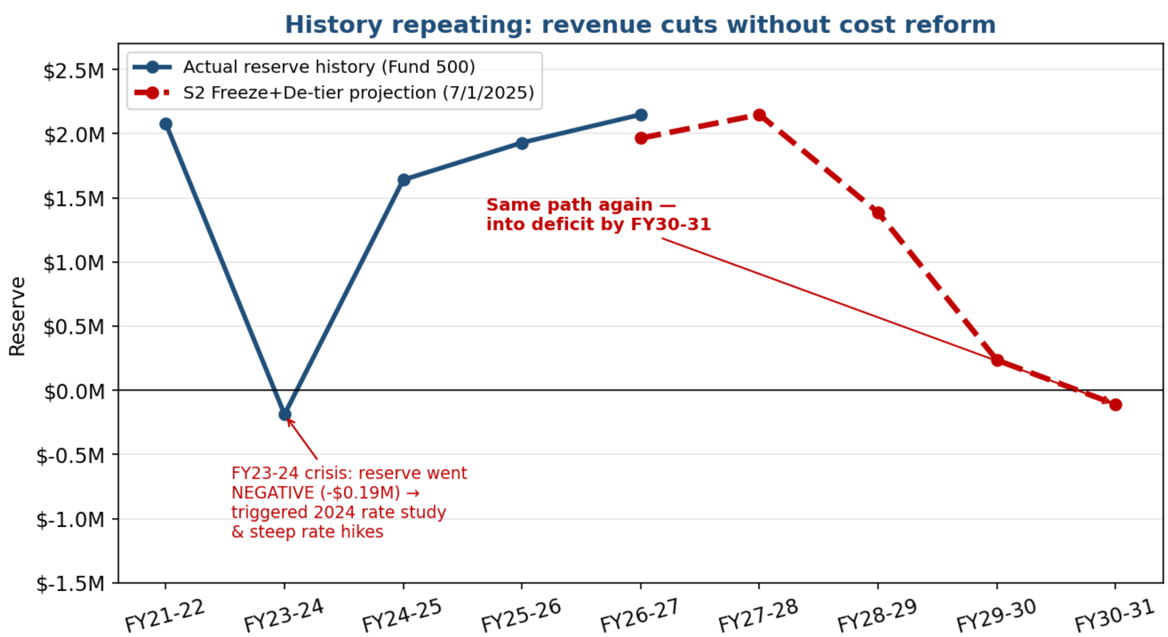

Figure 3. The reserve history (blue) shows the FY2023-24 crash to a negative balance that triggered the 2024 rate increases. Scenario 2 (red) retraces the same downward path.

The EFOC's Full Recommendation — the Responsible Alternative

The EFOC did not recommend freezing rates and eliminating tiers as a standalone act of revenue reduction. It recommended that step only in conjunction with cost-side measures that bring the enterprise funds toward Proposition 218 compliance and recover money owed to ratepayers:

1. **Reject the FY2026-27 Cost Allocation Plan and reform it toward Prop 218 compliance**:
   - Remove City Council time from the enterprise funds — no allocation to water or sewer.
   - Reduce the City Manager allocation to 30% of that department's budget. (15% to each fund)
   - Reduce the Finance / Administration allocation to 30% of that department's budget. (15% to each fund)
   - Cap in-house legal at $12,500 per enterprise fund (historically, charges never exceeded this).
   - Move the engineering contract into Contracted Services (~$100,000 per fund) rather than carrying it as overhead.
2. **Refund $354,000 of improperly charged attorney's fees** to the enterprise funds.
3. **Shift the Syserco energy-project loan to the General Fund**. The City's no-bid decision to partner with Syserco Energy Solutions left water ratepayers paying as much as twice what comparable water systems pay. Under this action the General Fund assumes responsibility for that decision — taking over the $168,593 annual loan payment and repaying the water enterprise $843,965 for prior loan payments already made from water rates.
4. **Institute time tracking** to build a defensible, cost-of-service Cost Allocation Plan (meet Prop 26 requirements) before any new rate study is commissioned.

The cost-allocation reform is modest in its impact on the General Fund but decisive for the enterprise funds. The chart below shows the water fund's share of the four central departments the reform touches: City Council overhead is removed entirely, and the City Manager and Finance charges are cut to a defensible 15%-of-budget basis to each fund.

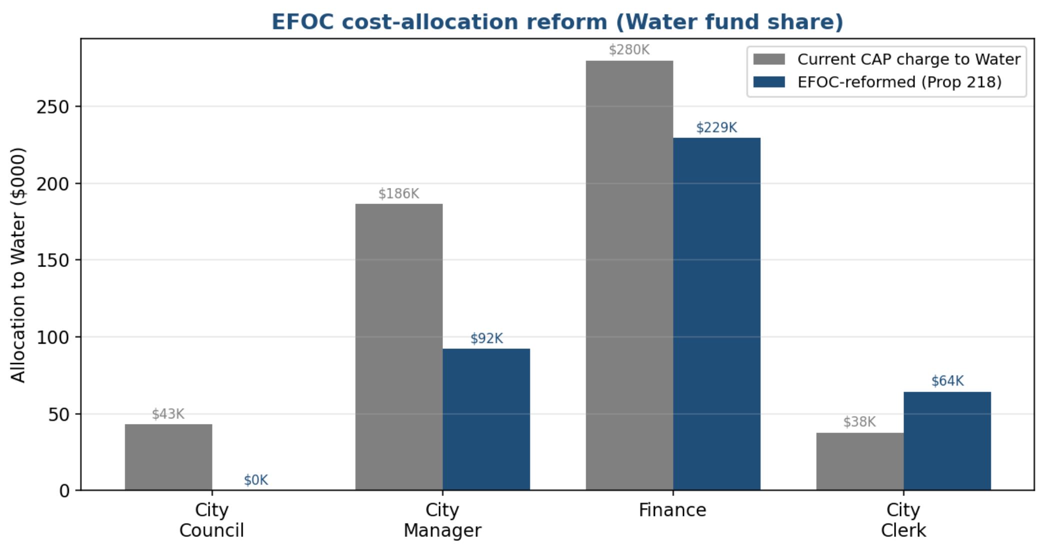

Figure 4. The EFOC cost-allocation reform (water fund share). Council overhead is eliminated; City Manager and Finance charges are reduced to a Prop 218-defensible level.

With these reforms, the $354,000 attorney fee refund, and the Syserco loan shift are layered onto the same rate freeze and de-tiering, the picture reverses. The savings offset the revenue reduction, and the water fund remains **above its 25% reserve policy in every year**, ending FY2030-31 around $2.51 million — comparable to the baseline. In other words, **the City can give ratepayers the rate relief the EFOC seeks and still keep the fund solvent — but only if the freeze travels with the cost reforms.**

Ending reserve comparison	FY26-27	FY27-28	FY28-29	FY29-30	FY30-31
S1 Baseline	$2.26M	$2.87M	$2.65M	$2.16M	$2.58M
S2 Freeze + de-tier ONLY	$1.96M	$2.15M	$1.38M	$0.23M	**($0.11M)**
Freeze + de-tier + full EFOC package	$2.58M	$3.31M	$3.09M	$2.50M	**$2.51M**

Proposition 218 and Legal-Risk Context

The EFOC's package is framed as a good-faith move toward Proposition 218 compliance. Proposition 218 requires that enterprise-fund rates reflect the actual cost of providing service; charges that shift general-government overhead onto ratepayers, or tiered rates not tied to cost of service, are legally exposed. The City Attorney has identified the tiered structure as vulnerable, which is itself a reason to suspend the rate-tiers.

The Committee's position is that the cost-allocation reform shifts roughly **$421,000** of overhead back to the General Fund and reduces enterprise reserves by only about **$804,593 by FY 2030.**

— a small price to move toward compliance and reduce the City's litigation exposure, particularly with a Grand Jury matter outstanding.

The Grand Jury directed the city to restore $5.5 million in overpayments to the Enterprise Funds to help pay for neglected infrastructure repairs. **Over about 5 years the changes recommended restore the total amount of the overpayments. This provides the city with a compelling response to the Grand Jury findings.**

The EFOC further cautions against commissioning a new rate study now: a study built on the current, non-compliant cost allocation would be premature and wasteful and should wait until time-tracking data supports a defensible allocation plan, the Grand Jury matter is resolved, and the Sewer Master Plan is in hand.

The relevance to July 7 is direct: adopting the revenue reduction alone does nothing to cure the underlying Prop 218 exposure on the cost side, while removing the revenue the fund needs to carry its capital obligations.

The Wastewater Fund — the Same Freeze, a Different Result

The same analysis was applied to the wastewater (sewer) enterprise fund, using its own budget schedules (Funds 510, 511, and 512), the adopted sewer rate schedule, and a parallel cost-allocation reform. One structural difference drives a very different outcome: the wastewater fund's adopted rate path rises roughly 9% per year through 7/1/2028 — far steeper than water's.

Because those approved increases substantially over-collect, the wastewater fund is on track to accumulate very large reserves — about **$6.5 million by FY2030-31** under the baseline, roughly six times its 25% policy target. Freezing all sewer rates at their FY2026-27 levels does *not* threaten the fund: even fully frozen, reserves keep growing, ending near **$3.6 million** and staying comfortably above policy in every year of the forecast.

Layering on the same cost-allocation reform (rejecting the FY2026-27 plan for a reformed charge of $609,596 versus the budgeted $836,947, or $580,480 with Council removed) and the wastewater share of the attorney-fee refund ($219,487) only widens the cushion. Unlike water, the wastewater freeze needs no offsetting savings to remain solvent.

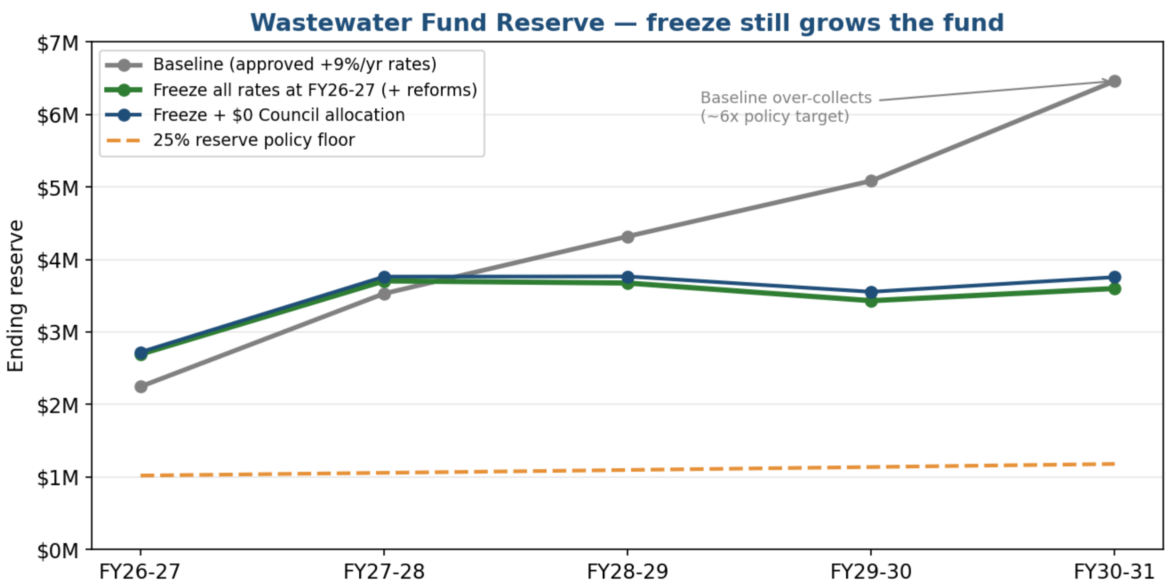

Figure 5. Wastewater fund reserve. Even a full rate freeze (green) leaves the fund growing and far above the 25% policy floor; the baseline (gray) over-collects toward roughly six times the target.

Wastewater fund	FY26-27	FY27-28	FY28-29	FY29-30	FY30-31
Baseline (approved +9%/yr)	$2.25M	$3.53M	$4.32M	$5.08M	$6.46M
Freeze all rates + reforms	$2.69M	$3.70M	$3.67M	$3.43M	$3.60M
Freeze + $0 Council allocation	$2.72M	$3.76M	$3.76M	$3.55M	$3.75M

The concern for Wastewater Fund is therefore the reverse of the Water Fund. There is no depletion risk from a freeze; if anything, the current plan returns money to ratepayers while still leaving reserves well-funded for the capital program.

The current plan has $5.1MM in capital projects included. However, one caveat is the clay sewer pipe. The city owns 30 miles of gravity sewer mains. Since clay was the primary material used through the 1960s and 70s, we can assume most are clay pipes. The EFOC committee reported to council that the pipes are getting stormwater infiltration leading to increased pumping and treatment costs. Clay has a life expectancy of 30 -60 years so much of a 1960s era system is past that. **Replacement of the entire 30 miles depends on materials used but likely ranges from $16MM to $40MM.** The sewer master plan when complete will give a better picture of cost and what the pace of repair needs to be.

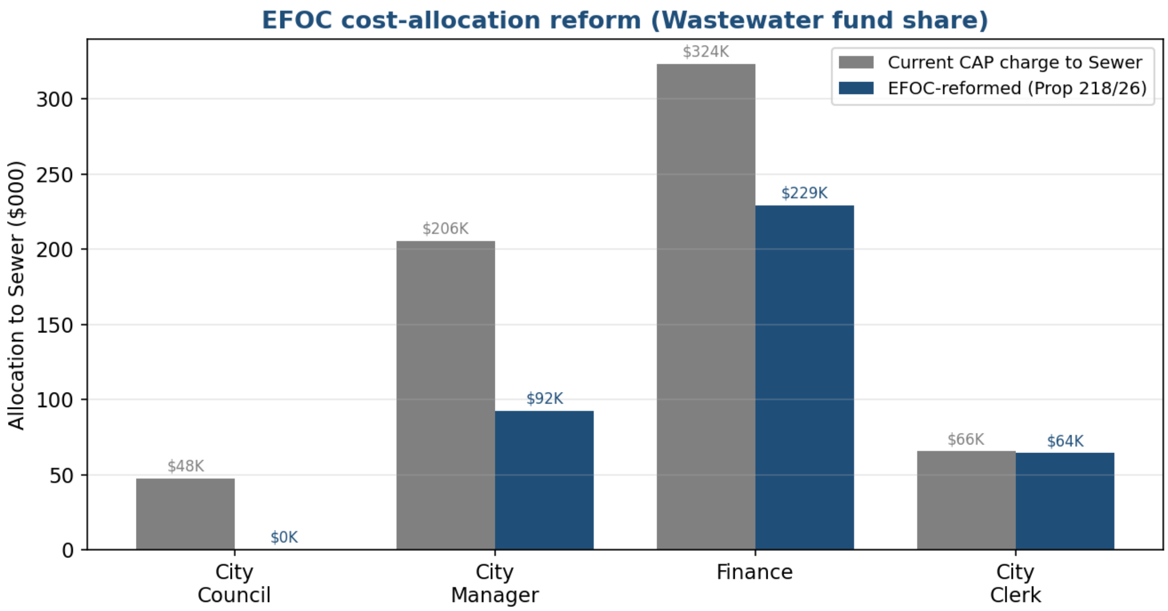

Figure 6. The same cost-allocation reform applied to the wastewater fund. As with water, City Council overhead is removed, and the City Manager and Finance charges are cut to a Prop 218/26-defensible level.

Conclusion and Recommendation

Freezing water and wastewater rates and eliminating the rate-tiers is legitimate and, for the tiers, legally advisable objective — and it is welcome opportunity to return misallocated funds to ratepayers by eliminating rate tiers and freezing planned rate increases. Rate payers will get substantial savings in their water and sewer charges over the next couple of years.

But the modeling is clear that the revenue reduction **cannot responsibly be adopted on its own**. Standing alone, it recreates the exact conditions — a collapsing operating margin and a depleting reserve — that produced the FY2023-24 crisis and the rate shock that followed. **The City still faces a substantial capital program; it cannot simply cut revenue and leave the cost side untouched**.

The fiscally and legally prudent path is the EFOC's full package of recommendations:

- Suspend the tiers and freeze the increases,
- At the same time reform, the Cost Allocation Plan toward Prop 218 compliance,
- Refund the improperly charged attorney's fees,
- Direct charge legal and Engineering contract expense
- Move the Syserco loan payments to the General Fund.
- Repay the Water Fund $843,965 of prior Syserco loan payments over 4 years from the General Fund.
- Forgive the General Funds $1,200,000 “loan” to the Sewer Fund.

That combination delivers rate relief while keeping the water and wastewater funds above their reserve policy throughout the forecast. **Adopting the freeze without those companion measures is half of the recommendation that creates the risk.**

Taken together, the changes recommended here move both the Water and Sewer enterprise plans toward **Proposition 218 and Proposition 26 compliance** with how central-government costs are allocated to the funds. They also provide sufficient revenue for the infrastructure repair the systems require, and they keep rates stable for the next several years — until there is enough time-tracking data to build a new, defensible Cost Allocation Plan and, on that foundation, a properly grounded new rate study

If all recommendations are enacted, these actions show a good faith and responsible response to the Grand Jury findings and recommendations.

Prepared from the City's FY2026-27 Proposed Budget, the 2024 Raftelis Rate Study, the adopted 2024-2028 rate schedule, and the CIP Global Summary. All reserve figures are model outputs reconciled to the adopted budget; a companion Excel workbook contains the full scenario detail and formulas.