



STAFF REPORT TO THE CITY COUNCIL

DATE: May 28, 2024

TO: Mayor and Members of the City Council

VIA: Dante Hall, City Manager

SUBMITTED BY: Mike Roberts, Public Works Director/City Engineer
Edwin Gato, Finance Director

SUBJECT: FY 23/24 Sewer Fund Financial Analysis and Recommendations for
FY 25/26 Rate Adjustments

RECOMMENDED ACTION:

The City Council receive a presentation on the FY 23/24 Sewer Fund financial model run including the recommendation to proceed with a Proposition 218 process in Spring 2025 to increase rates in FY 25/26.

BACKGROUND:

City's Sewer System

The City owns and operates the sewer collection system which consists of approximately 62 miles of gravity sewer mains including 1,660 manholes, six lift stations, 4.5 miles of force mains, and is connected to 7,000 private laterals from 8,300 parcels. The collection system service area includes all 26,000 residents of Hercules and conveys approximately 1.7 million gallons per day of wastewater to the Pinole-Hercules Water Control Plant, which is located at the bottom of Tennant Avenue in Pinole. The two Cities own 50/50 equal interests in the Plant which is managed by the City of Pinole. Expenditures for operational costs are determined from a pro rata share of flow and capital improvements costs are split 50/50. The treated effluent is then pumped through a force main which is considered to be part of the Plant infrastructure to the deep-water outfall in Rodeo, which is managed by the Rodeo Sanitation District. Costs for this facility are shared based upon flow contribution as outlined in the 3-party agreement.

City's Sewer System Financial Model

Willdan Financial Services was previously selected to assess the health of the sewer fund and presented their initial study and recommendations to City Council in March 2021. For

this work they developed a financial model, which is built on an Excel platform. This provides a flexible tool which can be used to model different financial scenarios in real time, such as significant funding changes being contemplated or annual model updates to confirm the health of the Sewer Fund. Use of this model allowed for the FY 23/24 analysis to be performed in a cost-effective manner.

Data used to populate the model includes Operation & Maintenance (O&M) costs, the 5-Year Capital Improvement Program (CIP) for both the sewer collection system and Water Pollution Control Plant, existing rate revenue, growth projections and associated impact fee and rate revenues, and debt service. The model also establishes an O&M reserve equivalent to 180 days, a Capital Reserve not less than \$1M, and a Debt Service Reserve of \$1,600,000. This Debt Service Reserve amount is equal to the annual debt payment to the Water Resources Control Board for the low-interest loan to upgrade the Pinole-Hercules Wastewater Treatment Plant. Having a Debt Service Reserve is a requirement of the loan, as well as maintaining a debt service coverage ratio of operating revenues being 1.20 times annual debt service.

Willdan's 2021 financial model indicated that if (1) no rate increases were implemented and (2) the Upper Sycamore Trunk Main project was not needed, then the financial metrics would all be satisfied until FY 23/24 when the debt service ratio would fall below 1.20. Flow monitoring was installed in the Winter of FY 22/23 to determine if the Upper Sycamore Trunk Main project was needed; however, it did not rain so a determination could not be made. The flow monitoring was subsequently installed this last winter and it was determined the \$6M project was not needed and the FY 23/24 financial model could then be completed incorporating this information.

City Sewer Rates

Sewer rates, which are collected twice a year through the County tax roll, have not increased since 2014. Current rates are:

Single Family Homes, Townhomes, Condominiums	\$625.80 per year
Apartments	\$427.16 per year
Commercial/Industrial	\$3.87/1,000 cubic feet of water consumption

City Sewer Operations Staffing Levels

Approximately a decade ago the Public Works Department's staffing levels were reduced by 40% and the Maintenance & Operations Division is now in the process of strategically rebuilding to sustainable levels and implementing succession planning. Currently the Division consists of a Superintendent, Supervisor, and 6 Maintenance Workers that oversee streets, facilities, lighting & landscaping, stormwater, and sewer. The sewer collection system is an essential facility that is highly regulated. Compliance is achieved by following the recommendations and mandates of the City's Sanitary Sewer Management Plan, which is periodically updated and subject to audit by the Regional Water Quality Control Board. In the closely related field of stormwater, requirements are ratcheting up under the new MRP 3.0 permit which includes inventorying all of the City's stormwater piping for asset management and tracking the associated maintenance costs,

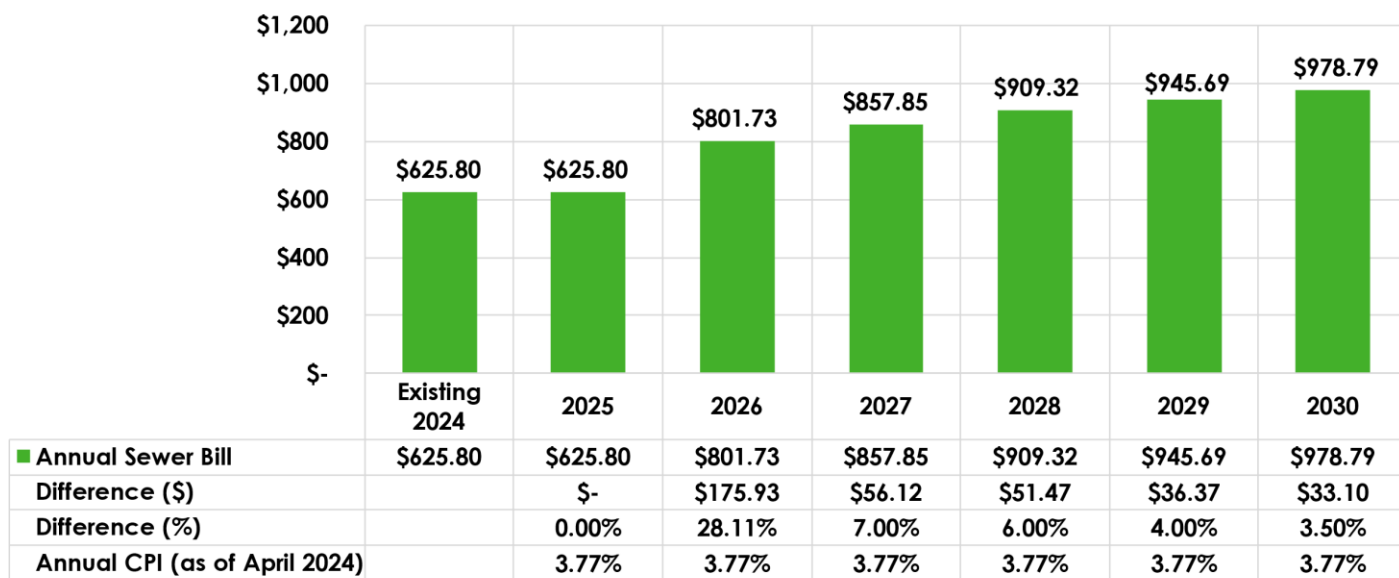
which is an unfunded mandate. As discussed in more detail under the Analysis section, staff is recommending the addition of a Sewer and Storm Drain Supervisor.

ANALYSIS:

The 2023/24 model run indicates significant rate increases are needed to meet future financial obligations, as would be expected from not having a rate increase since 2014, including adjustments for inflation. The debt service ratio requirement of 1.20 is the most urgent to address, with other contributing factors being the rising cost of equipment, materials, personnel, and reserve fund requirements. The Sewer fund is required by the bond covenant to maintain a debt service coverage ratio of at least 1.20. The cost to pay for 70% of a Supervisor position, which is being recommended by staff, is also included in the model run (discussed in greater detail below).

The recommended rate increases for a Single-Family Residence over 5 years is shown below to provide a general idea of the increases proposed, while the rate increases for other categories are detailed in Att #1.

5-Year Annual Bill Path

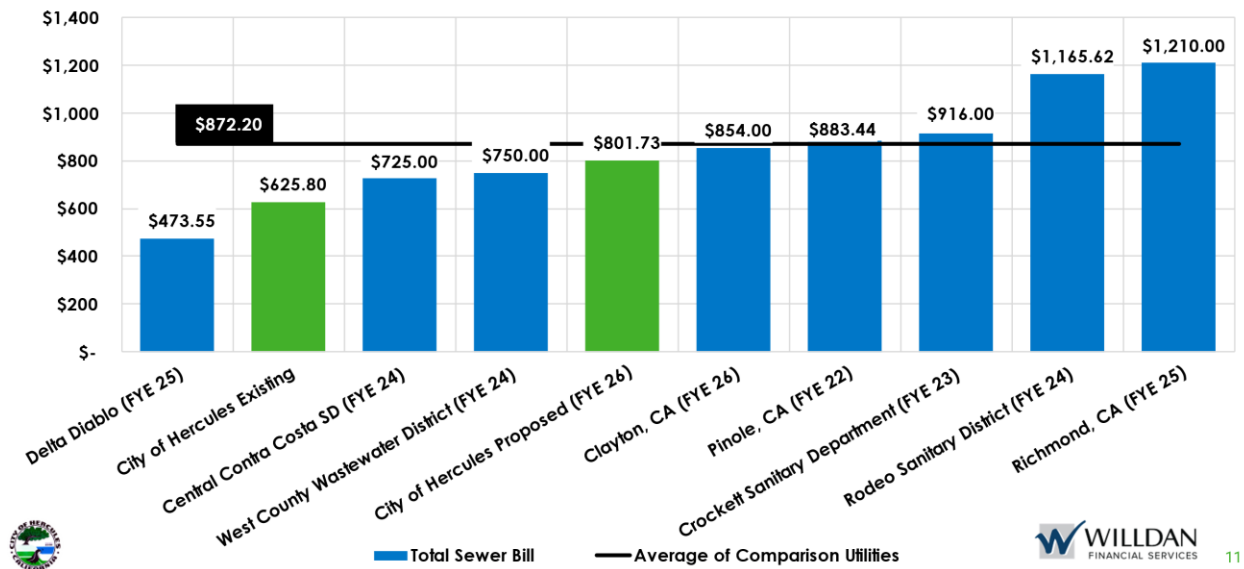


■ Annual Sewer Bill



The increase would become effective in FY 25/26 since a Proposition 218 process would be required, which could occur in Spring 2025. This rate increase would place Hercules mid-range in comparison to comparable sewer utility providers in Contra Costa County.

Annual Neighboring Utility Comparison



It is also being recommended that condominiums and townhomes be combined into the multi-family rate with apartments, since they typically have 2-3 bedrooms, while single family residences have 3-4 bedrooms. Additionally, it is recommended a new category for senior living be established given the lower effluent rates that they generate.

Lastly, staff is recommending funding 70% of a Supervisor position be funded to oversee the City's sewer system while the remaining 30% would be funded out of Gas Tax to oversee the City's storm drain system for the transportation network. Establishing the Sewer and Storm Drain Supervisor Position would implement Council's draft Strategic Planning Goals of addressing staff capacity, developing a succession plan, and funding facilities assessment and maintenance. Should the Council wish to pursue this option, staff can provide additional justification for the position next fiscal year, ahead of the proposed rate increase.

FISCAL IMPACT:

There is no fiscal impact associated with this staff report.

ATTACHMENTS:

1. Presentation