

Attachment 2b



STAFF REPORT

Meeting Date: June 21, 2016
To: Honorable Mayor & City Council
From: Trish Rhay, Assistant Director of Public Works Services
Michelle Tse, Planning and Research Analyst *MT*
Subject: b. Proposal to Suspend Water Penalty Surcharge Assessments
Attachments: 1. Los Angeles Times article dated April 27, 2016

INTRODUCTION

The Public Works Liaison Committee supports the recommendation to suspend the penalty surcharges and is in favor of developing a longer-term, more sustainable fee/fine structure program which promotes water use efficiency and discourages excessive water use. Staff intends to return with various policies and programs for the City Council's consideration within the next three months.

On May 18, 2016, the State Water Resources Control Board ("State Water Board") extended its emergency water conservation regulations through the end of January 2017. Additionally, the State Water Board adopted a new approach that replaces the prior percentage reduction-based water conservation standard (in which the City is currently at 32%) with a water supply deficit conservation target based on a supply and demand analysis or a "stress test".

For context, the State Water Board originally adopted a Drought Emergency Regulation in May 2015 which included a statewide 25% reduction in potable urban water through February 2016. Under the former declaration, the City (as a water supplier) was mandated to reduce water usage by 32% compared to Year 2013 levels. Under the new State Water Board conservation regulations, the self-certified conservation target is to be based on each water supplier ensuring a three year water supply under drought conditions and further based on each agency's specific circumstances. Discussion regarding the recommended self-certification target to the State Water Board is separately agendaized for the City Council's consideration at its June 21, 2016 Study Session.

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During the past year, staff has been working closely with the Public Works Commission, its Conservation Subcommittee, and the Public Works Liaisons to develop policies and programs to achieve the State's initial mandate for the City to reduce its water use by 32% compared to Year 2013 levels. One of the programs currently in place is the penalty surcharges, which are assessed in instances of excess water use where users fail to meet conservation targets. In response to the most recent policy changes issued by the State Water Board, it is recommended that the City suspend the penalty surcharge assessments and that efforts be focused on developing a long-term, more sustainable City program that promotes water use efficiency as well as a fine structure with penalties imposed to discourage excessive water use.

DISCUSSION

The following is a timeline of the State Water Board regulations and how the City has responded accordingly in order to adhere to the conservation regulations.

Table 1: Timeline of State Water Board and City Conservation Regulations

Date	Event
July 14, 2014	State Water Board issues emergency regulations for voluntary water conservation efforts
September 2, 2014	City Council declares Stage B (10%) emergency regulations are in effect.
April 1, 2015	Governor declares first ever state-wide mandatory water use reductions of 25% from June 2015 through February 2016.
May 5, 2015	State Water Board adopted emergency water use regulations in response to Governor's declaration; City mandated to reduce water use by 32% (originally 36%).
May 5, 2015	City Council declares Stage D (30%) emergency regulations are in effect.
June 30, 2015	City Council approves resolution to implement penalty surcharge assessments for excessive water use with advance notification given prior to penalty surcharge assessments beginning in November 2015
November 2015	Penalty surcharges begin appearing on water utility bills.
February 2, 2016	State Water Board extends drought declaration through October 2016.
March 1, 2016	City Council approves modification of penalty surcharge multipliers due to updated risk cost information..
May 18, 2016:	State Water Board extends drought declaration through January 2017 and requires self-certified conservation target.
June 22, 2016	Deadline for water suppliers (City) to submit self-certified conservation target to State Water Board. Target goes into effect retroactively to June 1, 2016.

Staff has been in continuing discussions with the Conservation Subcommittee of the Public Works Commission (Chair Aronberg and Vice Chair Wolfe) to evaluate the City's policies and conservation programs, including the penalty surcharge. In addition to restricting certain water uses that are mandated by State Water Board regulations, the City also implemented penalty surcharge assessments for water users that failed to meet conservation targets. All water customers were given an initial conservation target to reduce their usage 30% compared to 2013 levels.

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The purpose of the penalty surcharge was to change behavior and to incentivize high water users to reduce their water consumption. The penalty structure framework was developed to account for the City's potential drought-related costs. The following three potential risk costs originally identified:

1. City Costs – Accelerated Conservation Measures:

If the City fails to meet the State-ordered conservation goal of 32%, State regulators may require the City to accelerate the current 10-year conservation strategy that is outlined in the Water Enterprise Plan and require such programs to be implemented over Year 1, rather than Years 2-10 as outlined in the Water Enterprise Plan.

2. State Water Board Fines:

The State Board can fine water providers a penalty for not meeting its conservation target.

3. Metropolitan Water District of Southern California (“MWD”) Costs:

MWD required each of its member agencies to reduce water purchases by 15% compared to its 2014 water purchases starting July 1, 2015. Water purchases in excess of the reduction target will be assessed at the MWD Tier 2 rate of \$2,960 per acre-foot.

Additionally, an appeals process for the penalty surcharges was established to address circumstances that may prevent water customers from conserving and/or to recognize instances in which water customers were already conserving to the best of their ability. The appeals process consisted of two levels: Level 1 entailed staff review based on pre-determined criteria while the Level 2 review required a Public Works Commissioner to serve as the Hearing Officer.

The penalty surcharges appear to have achieved what they were intended to do, which was to encourage significant conservation and trigger water customers to contact City staff for assistance with such efforts. Furthermore, the penalty surcharge was initially designed to be a short-term program to promote conservation during the drought period and was initially anticipated to last for a few months. As the State Water Board continued to extend the drought declaration, it became apparent that the penalty surcharge program was no longer sustainable given the high level of administrative support required. The program has been experiencing backlog due to the continued receipt of appeal applications. Additionally, given the recent policy changes set forth by the State Water Board and the City's ability to self-certify its own conservation target, there is reduced likelihood of State Water Board fines. In addition, MWD has eliminated the requirement that member agencies reduce their water purchases by 15% compared to 2014 water purchases, so the City will not be subject to any MWD Tier 2 charges. However there will continue to be a need for targeted conservation programs.

For these reasons previously stated and the recent May 18, 2016, State Water Board regulations that allow the City to calculate a self-certified conservation target, the Conservation Subcommittee recommends suspending the penalty surcharges developing a long-term program that includes policies and programs to promote water conservation as the norm. In addition, a fee/fine structure would be imposed on excessive water users, similar to the program established by the Los Angeles Department of Water and Power. For reference, a copy of the *Los Angeles Times* article

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regarding this program is included as Attachment 1. The Conservation Subcommittee recommends that this will be a more effective long-term approach. The Conservation Subcommittee discussed this item with the Public Works Commission at its June 2, 2016 meeting, and the Commission unanimously agreed with the Subcommittee's recommendation. It was expressed during the Commission meeting that if the penalty surcharges were suspended, it is imperative that minimally a fine structure be developed within three months to ensure the City continues its positive trajectory towards complying with the City's State-mandated goal to reduce water usage 20% by 2020 (as mandated in SBx7-7).

At its June 7, 2016 meeting, the Public Works Liaison Committee (Vice Mayor Krasne and Councilmember Gold) expressed support for the recommendation to suspend the penalty surcharges but also voiced concerns about confusion from the public with the frequent changes to water rates and the imposition of penalty surcharges. They felt that any additional changes would create more confusion from members of the public. The Liaisons stressed that if the City Council suspends the penalty surcharge, the public must be clearly informed that the penalty surcharge suspension would only be an interim change while the City develops a fee/fine program for excessive water users.

The following is the recommended and projected timeline for next steps related to the water conservation policies and programs:

Table 2: Projected Timeline for Implementation

Date	Anticipated Milestone
June 21, 2016	City Council to consider suspending the penalty surcharge
July 14, 2016	Public Works Commission meeting discussion to reduce the City's Stage D emergency conservation declaration
July 19, 2016	City Council meeting to consider reducing the City's Stage D (30%) emergency conservation declaration
August 11, 2016	Public Works Commission meeting to discuss programs, policies, and a fine structure for excessive water users
August 15, 2016	Public Works Liaison Committee meeting to discuss Commission recommendation
August 25, 2016	City Council meeting to consider programs and ordinance amendments to establish policies and a fine/fees structure for excessive water users (Introduction of Ordinance)
September 6, 2016	Second reading of Ordinance
October 7, 2016	Ordinance effective date

It is important to note that staff is also concurrently working with the Public Works Commission to develop a new water rate structure; there will likely be instances in which the timeline for the conservation program implementation and the introduction of the water rate structure could overlap. For instance, at this time, staff anticipates that the new water rates structure will initially be presented to the Public Works Commission in August 2015, which is the anticipated effective date for the conservation programs, policies and the fine/fee structure. Staff anticipates the new water rate structure will be presented to the City Council for consideration later this year.

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Table 3 is the projected timeline for the water rate structure development process:

Table 3: Projected Time for New Water Rate Structure Development

Date	Milestone
Summer 2016	Community outreach regarding water rates
Mid-July 2016	Anticipated completion of the Water Fund financial and operational audit
August 11, 2016	Presentation of Water Fund audit and preliminary water rate structure to Public Works Commission
August 25, 2016	Presentation of Water Fund audit and preliminary water rate structure to City Council
July – August 2016	Incorporate comments from Commission and City Council into new water rate structure analysis
September 8, 2016	Presentation of new rate structure to Public Works Commission
September 20, 2016	Presentation of new water rate structure to City Council
September 26, 2016	45-day legal noticing period regarding proposed water rate structure
November 15, 2016	First public hearing
December 6, 2016	Second public hearing
Early January 2017	Water rate structure goes into effect (30 days after second hearing)

At the Liaison Committee meeting on June 7, 2016, the Liaisons expressed concerns that while the conservation programs and policies are under development, staff should have clear public messaging to minimize the confusion between the penalty surcharges, the development of excessive water fees and fines, and the water rates. Based on these comments, staff will implement a communications plan to minimize the confusion. This would include development of a “Frequently Asked Questions” document to address questions surrounding the City’s conservation program, penalty surcharges, and water rates. The document will be available at locations throughout the City and online. This information could also be included as a utility billing insert and on the City’s website.

FISCAL IMPACT

As part of the evaluation process, staff conducted a fiscal analysis regarding the Water Fund. Given the reduced water use, revenues in the water fund have decreased. Additionally, expenditures increased as a result from the Water Enterprise Plan. As such, Finance estimates that the Water Fund will have a net loss of approximately \$3.5M by the end of FY15/16. Penalty surcharges collected through the end of the fiscal year are estimated to be \$5.3M, which could potentially offset the fund’s losses and/or be used to cover conservation programs, of which over \$1.4M has been budgeted towards the conservation program during FY15/16. In addition to the existing programs already budgeted, staff anticipates spending an additional \$420,000 between now through early 2017 for conservation program support and outreach.

With penalty surcharges included, 2015-16 bond coverage ratio is 1.98, which is close to the historical level of 2.0+ coverage. Bond coverage is projected to dip to 1.51 in 2016-17 without the surcharges. However with a plan in place to adopt a new rate structure to allow for conservation and the cost of the Water Enterprise Plan (“WEP”), this temporary lowering of the coverage ratio should not be a significant issue. Should the implementation of a new rate structure be delayed, this would result in a larger projected

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net loss and require additional reductions in costs in order to meet bond coverage covenants. Though staff initially planned to introduce a new rate structure in time to implement by November, the completion of a Water Fund financial and operational audit, as directed by the City Council, has extended the timeframe such that the new rate structure is likely to be introduced in late Fall 2016 for City Council's consideration. If approved, the rate structure could be in place by early 2017.

The projected 2016-17 net loss of \$4.1 million will be offset by 1) any revenues from the new penalty program being developed (no revenues from that program are assumed in the analysis below); and 2) the issuance of bonded debt to cover the portion of the Capital Improvement Project ("CIP") program related to the WEP. For example, of the \$8.7 million shown in the CIP program below, \$2.9 million is directly related to the groundwater development portion of the WEP. Once bonds are issued to pay for this and other WEP projects, much of the \$7 million deficit in the Capital Replacement Reserve (seen in Table 1 below) will be covered.

Note that the Water Fund balance is not projected to be in a deficit position overall at any point. The deficit in the Capital Replacement Reserve of the Water Fund is covered by the \$17.6 million Designated Operating Reserve in the Water Fund. This means the Designated Operating Reserve (set at the policy level of 50% of operating revenues in the Water Fund) would be temporarily funding the WEP projects until bond issuance in the spring/summer of 2017. This temporary self-funding by the Water Fund should not be an issue and is in line with the recommendation of the Finance Task Force that studied this issue last fall.

Table 1: Analysis of Water Fund		
	2015-16	2016-17
Revenues & Transfers In	\$33.9	\$38.4 ¹
Expenses & Debt Service	-31.8	-33.8
Capital Improvement Program	<u>-5.6</u>	<u>-8.7</u>
Net Loss	<u>\$ -3.5</u>	<u>\$ -4.1</u>
Penalty Surcharges	\$ 5.3	\$ 0.0 ²
Bond Coverage	1.98	1.51
Designated Operating Reserve	\$15.3	\$17.6
Capital Replacement Reserve	\$-0.5	\$-7.0 ³

¹ Assumes new rate structure in place by January 2017

² Assumes existing penalty surcharge program ends June 2016

³ First round of bond issuance would fund Water Enterprise Plan portion of capital program

RECOMMENDATION

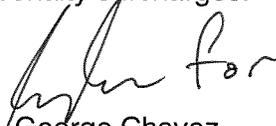
Staff recommends the City Council adopt a resolution to suspend the penalty surcharge assessments while staff develops a fine/fees structure for City Council's consideration. The proposed structure will be presented to the City Council within three months, and the intent is that the penalty surcharges will be repealed when a fine/fees structure has been adopted.

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For the City Council's consideration, a Resolution to suspend the penalty surcharges is agendized for the June 21, 2016 Formal Session meeting. If approved by the City Council, water bills issued after that date will not include the penalty surcharges.



Don Rhoads
Approved By

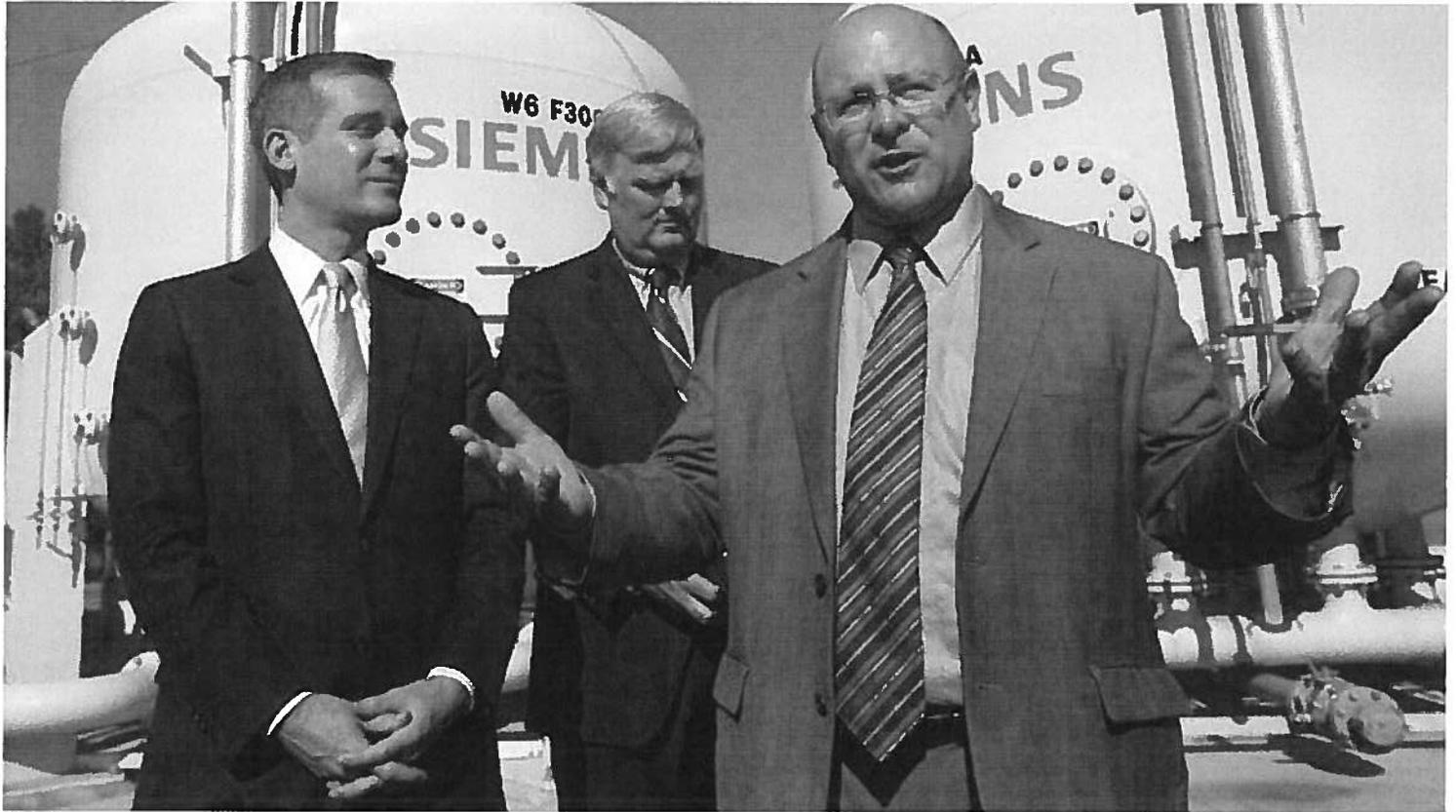


George Chavez
Approved By

Attachment 1

LOCAL / L.A. Now

L.A.'s water wasters will soon face heavier fines and audits



L.A. Mayor Eric Garcetti, left, and the DWP's head of operations, Marty Adams, right, discuss the city's response to the drought at the Tujunga Spreading Grounds in Arleta in 2014. Garcetti signed new water-saving measures this week. (Al Seib / Los Angeles Times)



By **Matt Stevens** · Contact Reporter

APRIL 27, 2016, 6:06 PM

As regulators mull softening the state's drought restrictions amid outcry from some Northern California water districts, water wasters in Los Angeles will soon face stiffer fines and water audits under a plan approved this week by Mayor Eric Garcetti.

Under the city's amended water conservation plan, which will take effect Tuesday, the Department of Water and Power will be able to fine residents between \$1,000 and \$40,000 a month for what it deems "unreasonable use" of water when the city is in an elevated phase of its emergency drought plan.

Currently, the department can fine only customers who violate a specific provision of the city's water ordinance, such as watering at the wrong time of day or using a hose to wash down a driveway. The fines are relatively

small, ranging from \$100 to \$300 while the city is in any phase of its conservation plan. Under the new proposal, fines for those types of violations will increase to as much as \$1,200.

The customers who find themselves chronically in the highest water-use tier will also be subject to a water-use analysis by the DWP, in which utility staff members will need to be given access to a customer's property.

Staff members will then prepare a conservation plan that spells out ways to reduce water waste, as well as the reasonable amount of use for the specific property. Failure to meet any of the requirements of the plan could result in a penalty.

DWP officials have said the first fines are not likely to appear until the middle of the summer. All the money generated by the fines would go back into the utility's conservation programs, they said.

In a statement, Marty Adams, the DWP's senior assistant general manager in charge of the water system, said the changes will "improve our ability to respond to ongoing drought conditions by reaching out to and working with our customers on the higher end of the water use spectrum."

"These changes address our city's highest users to ensure that we keep our momentum going during this historic drought," Garcetti added in the statement from his office.

City officials became alarmed last fall when a report from the Center for Investigative Reporting disclosed that a Bel-Air homeowner had used 11.8 million gallons of water in a single year, even as the state battled a record drought. They called on the DWP to figure out how to combat such profligate water use and the utility unveiled its plan in March.

Garcetti's decision to sign off on the tougher rules comes the same week that officials at the East Bay Municipal Water District in Northern California decided to suspend the agency's "Excessive Water Use Penalty Ordinance," citing "a wet winter that restored reservoirs to healthy levels." The water agency had gained acclaim from some corners of the water world for publicly identifying some of the heavy users it fined under the ordinance.

Some water districts have publicly called on the State Water Resources Control Board to significantly soften California's drought restrictions in response to improved hydrology. Water board staff members could publish a draft of proposed modifications as early as next week.

Garcetti's office also announced that he signed an ordinance that updates the city's Green Building Code. Effective June 6, the updates will require that new buildings, additions or alterations valued at more than \$200,000 incorporate a variety of water conservation measures that have the effect of cutting indoor water use by 20%.

For more on the California drought and water, follow me on Twitter: @ByMattStevens