Item 2b

STAFF REPORT

Meeting Date:	March 1, 2016
To:	Honorable Mayor & City Council
From:	Trish Rhay, Assistant Director of Public Works Services, Infrastructure & Field Operations
	Caitlin Sims, Senior Management Analyst CS
Subject:	b. Penalty Surcharge Framework
Attachments:	1. Resolution 15-R-13045

INTRODUCTION

At its May 5, 2015, Formal Meeting, the City Council approved Resolution 15-R-13037, declaring a Stage D (30%) water use reduction. Stage D allows the City Council to assess a penalty surcharge on water usage in excess of the 70% baseline. At its June 30, 2015, meeting, the City Council adopted Resolution 15-R-13045, which established the penalty surcharge framework. All single-family and multi-family customers not in Tier 1 and all commercial customers are required to reduce their water usage to 70% of their 2013 usage or be subject to penalty surcharges. The penalty surcharge was applied to bills in early November 2015.

The purpose of the penalty surcharge is to change behavior and to incentivize high water users to reduce their consumption and, to the extent that this is not achieved, to cover the City's potential drought-related costs. As such, staff worked with HF&H Consultants LLC ("HF&H"), with input from the Public Works Commission's Conservation Subcommittee, to develop a penalty surcharge framework based on the City's potential risk costs from the State Water Resources Control Board ("State Water Board") and Metropolitan Water District of Southern California ("MWD") if it does not meet its conservation mandates.

Staff now has a better understanding of what the City's risk costs could be from the State Water Board and MWD and, based on this updated information, staff worked with HF&H and the Public Works Commission's Conservation Subcommittee to revise the penalty surcharge. The Public Works Commission and staff are recommending that the penalty surcharge multipliers be reduced, as further described in this report.

DISCUSSION

Under the existing framework, all commercial customers as well as single-family and multi-family customers not in Tier 1 are required to reduce their water usage to 70% of their 2013 usage or be subject to penalty surcharges. The penalty framework relates to

the City's risk costs if the City's water users fail to meet the City's conservation mandates as established by the State Water Board and MWD.

The penalty surcharge framework is currently designed to account for three potential risk costs as identified by staff:

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 Resources Control Board ("State Water Board") Fines:
   The State Board can fine water providers a penalty of $10,000 per day for not meeting the 32% conservation target. The potential $1,000,000 fine assumes that the State Board will begin to impose fines if the City fails to achieve compliance with the conservation target within a reasonable period. In the initial calculation, the projected risk cost for fines from the State Water Board was based on an assumption that the City could be subject to fines of up to $10,000 per day for 100 days.

3) Metropolitan Water District of Southern California ("MWD") Costs:
   MWD required each of its member agencies to reduce water consumption 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. Based on 2014 water use data, if the City fails to reduce consumption, it is projected that 1,291 acre feet of water purchased from MWD will be assessed at the Tier 2 rate. In order for the City to avoid paying the higher MWD Tier 2 rate, the City would need to reduce MWD water use by 12% compared to 2013 water usage.

To allocate these risk costs across the City's customers and develop multipliers, assumptions were made about the City's overall average water conservation based on the best information available at that time. Staff initially estimated that approximately 50% of customers would reduce water use by 30% compared to 2013 usage, approximately 25% of customers would reduce water use by 15%, and approximately 25% of customers would not reduce their water use. This equated to a City-wide average water use reduction of 18.8%. Over the months since the State's conservation order became effective, the City has averaged a reduction of approximately 19%, which is consistent with the initial assumptions.

The City now has a better understanding of the City's potential risk costs from the State Water Board and MWD and anticipates that the potential risk costs will be lower than previously projected. The City initially projected that it could be subject to the maximum daily penalty of $10,000 per day from the State Water Board. Based on the State Board's practice over the last several months and conversations with State regulators, the City is not likely to be subject to these maximum daily penalties; State regulators have suggested that the maximum penalties are likely to be levied only against agencies that are not making sufficient efforts to meet their conservation targets. The City also revised its assumptions about how much water it may have to purchase at the higher MWD Tier 2 rate and allocated only the difference between the higher MWD Tier 2 rate and the Tier 1 rate as a potential risk cost, rather than allocating the entire MWD Tier 2

rate. In addition, the State Water Board has extended the Emergency Water Conservation Regulation and drought regulations through October 2016.

In keeping with the effort to base the penalty surcharge on actual potential risk costs, staff, HF&H, and the Public Works Commission's Conservation Subcommittee have revised the future risk costs as follows:

Risk Costs	Potential Costs	Future Potential Costs
City Costs – Accelerated Conservation Measures	$1,763,708	$1,763,708
State Water Board Fines	$1,000,000	$600,000
MWD Costs	$3,821,897	$1,928,628
TOTAL	$6,585,605	$4,292,336

The revised potential costs for the State Water Board fines assume that the City could be subject to fines of up to $2,500 per day for the period that runs from March 1, 2016, to October 31, 2016. The revised potential risk costs from MWD reflect the assumption that the City will purchase less water at the higher Tier 2 rates than was originally projected and a modified methodology in which only the difference between the MWD Tier 2 rates and the Tier 1 rates (rather than the entire MWD Tier 2 rate) be allocated as a potential risk cost.

Based on these revised potential risk costs, the Public Works Commission recommends that the penalty surcharge multipliers be revised as follows:

Less than 30% Conservation		Less than 12% Conservation	
For excess usage above 70% baseline, the **penalty-only** multiplier is:		For excess usage above the 88% baseline, the **penalty-only** multiplier is:	
Current	Proposed	Current	Proposed
0.59 times the Base Rate	0.25 times the Base Rate	Additional 3.08 (Cumulative 3.67 times the Base Rate)	Additional 1.60 (Cumulative 1.85 times the Base Rate)

The example below shows what the bill impact would be to a single-family residential customer that uses 140 units of water in a two-month billing period and has not conserved from its 2013 usage:

Charge	With Current Multipliers	With Proposed Multipliers	Change	
			$ Reduction	% Reduction
Water Meter Charge	$75.16	$75.16	0	n/a
Water Usage Charge	$1,112.15	$1,112.15	0	n/a
Level 1 Penalty	$295.21	$125.09	$170.12	57.6%
Level 2 Penalty	$869.30	$451.58	$417.72	48.1%
Total	$2,351.82	$1,763.98	$587.84	25.0%

Penalty surcharges have been used to pay fines from the State Water Board and to accelerate the City's water conservation programs beyond those that were budgeted in FY 2015-16, in an effort to achieve its water conservation targets. For example, the City has supplemented its rebate programs for turf removal and water efficient devices. In

October 2015, the State Water Board fined the City $61,000 for not meeting its 32% reduction mandate from June 1, 2015, to September 30, 2015. The State Water Board may also take enforcement action against the City for non-compliance from November 1, 2015, to present. In addition, while the City has not incurred any MWD Tier 2 costs to date, these costs will be assessed based on water purchases for an entire year.

FISCAL IMPACT

The City has updated the risk cost estimates for the period from March1, 2016, to October 31, 2016, to be $4,292,336. The funding collected will be used to pay potential fines from the State Water Board, potential MWD Tier 2 rates, and for the accelerated implementation of the City's water conservation programs.

RECOMMENDATION

Staff recommends that the City Council reduce the penalty surcharge multipliers contained in Resolution 15-R-13045. Should the City Council move forward with the recommendation, a resolution is agendized for the March 1, 2016, Formal Session. The new penalty surcharge would be implemented immediately after the March 1, 2016 meeting.

Don Rhoads	George Chavez
Finance Approval	Approved By

Attachment 1

RESOLUTION NO. 15-R-13045

RESOLUTION OF THE COUNCIL OF THE CITY OF BEVERLY HILLS ESTABLISHING A PENALTY SURCHARGE FOR WATER USAGE CONTRARY TO THE PROVISIONS OF THE STAGE D WATER CONSERVATION MEASURES

RECITALS

WHEREAS, during calendar year 2014, the Governor declared a drought in the State of California and the State Water Resources Control Board enacted emergency water conservation measures. As a result, the City of Beverly Hills declared the Stage B shortage, which is currently in effect, mandating a 10% reduction in potable water use.

WHEREAS, in April 2015, the Governor issued an Executive Order directing the State Water Board to impose restrictions to achieve an aggregate statewide 25% reduction in potable urban water use through February 2016. As a result, the State Water Board released a preliminary framework, outlining reduction targets from 8% to 36% for each water supplier, with Beverly Hills having a reduction target of 36%. Upon additional review of information submitted by the City of Beverly Hills, the State Water Board reduced the reduction target to 32%.

WHEREAS, on May 5, 2015, the City Council adopted its resolution No. 15-R-13037 declaring and implementing Stage D water conservation measures pursuant to Beverly Hills Municipal Code Section 9-4-304 and authorizing a penalty surcharge for water usage contrary to the provisions of the Stage D water conservation measures.

WHEREAS, pursuant to Beverly Hills Municipal Code Section 9-4-302, the City Council desires to establish a penalty surcharge for water usage contrary to the provisions of the Stage D water conservation measures.

NOW THEREFORE, the City Council of the City of Beverly Hills does hereby resolve as follows:

Section 1. The City Council hereby establishes a penalty surcharge for water usage contrary to the provisions of Stage D as follows:

a. For a customer who reduces water use by less than thirty percent (30%) of the amount in the baseline period, the penalty surcharge is 1.59 times the basic water rate for water usage in excess of seventy percent (70%) of the amount in the baseline period.

b. For a customer who reduces water use by less than twelve percent (12%) of the amount in the baseline period, the penalty surcharge is an additional 3.08 times the basic water rate for water usage in excess of eighty-eight percent (88%) of the amount in

the baseline period (for a cumulative 4.67 times the basic water rate for water usage in excess of eighty-eight percent (88%) of the amount in the baseline period).

c. The baseline period shall be the days in the 2013 calendar year against which water use is compared for those same days in the current year (for example, the baseline period is July 1, 2013 through August 31, 2013 for determining the amount water use reduction for July 1, 2015 through August 31, 2015).

d. The penalty surcharge established by this section shall be effective October 15, 2015.

Section 2. In accordance with Beverly Hills Municipal Code Section 9-4-303, the City Council hereby directs the City Clerk to publish this Resolution within 10 days of its adoption at least once in a newspaper of general circulation within the city and to post this Resolution in at least three (3) public places and continue to post this Resolution until such time as the restrictions set forth herein are repealed by resolution of the City Council.

Section 3. The City Clerk shall certify to the adoption of this resolution and shall cause this resolution and his certification to be entered in the Book of Resolutions of the Council of the City.

Adopted: June 30, 2015

JULIAN A. GOLD, M.D.
Mayor of the City of Beverly Hills, California

ATTEST:

(SEAL)

BYRON POPE
City Clerk

APPROVED AS TO FORM:

LAURENCE S. WIENER
City Attorney

APPROVED AS TO CONTENT:

GEORGE CHAVEZ
Director of Public Works Services