



Oceano Community Services District

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Date: March 12, 2025

To: Board of Directors

From: Peter Brown, General Manager

Subject: **Agenda Item #7(A):** Purpose and Need of Water and Sewer Rates (Rates 101)

Recommendation

It is recommended that the Oceano Community Services District Board Receive a presentation from HDR Engineering the key components of the 2025 Sewer and Water Rate Studies.

Discussion

Sewer Rates –

A sewer rate study is an essential tool for public agencies and elected officials responsible for managing a sewer conveyance utility. By providing a thorough analysis of the utility's financial needs, capital/labor costs projects, service demands, and rate structures, a sewer rate study ensures that the utility can continue to provide reliable, sustainable, and equitable services to the community. It helps to align revenue generation with operational expenses, compliance requirements, and future infrastructure improvements. In the case of OCSD, the last sewer rate study was conducted in 2009, with the last set of rate adjustments taking place between 2010 and 2015. While rate payers have not experienced sewer cost increases since 2015 and the District has been operating the system effectively for the last decade, the District has foregone regular assessments and any substantial capital investments in sewer infrastructure for the last ten years, resulting in a backlog of CIP projects which are currently unfunded. This staff report outlines the key reasons a sewer rate study is crucial and the value it brings to both the utility and the community it serves. Professional consultant services are recommended for rate studies – ensure compliance with Proposition 218 regulations, and well as other state law requirements for developing and justifying cost-based rate increases for water and sewer services within the District.

OCSD's public sewer system is a vital part of critical infrastructure, ensuring that wastewater is safely transported from homes, businesses, and other facilities to the South San Luis Obispo County Sewer Sanitary District (SSLOCS D) treatment plant, thus preventing public health risks and environmental damage. Effective sewer system management relies on sound financial planning to ensure that sufficient funds are available to operate, maintain, and upgrade the system. A sewer rate study serves as a comprehensive financial and operational assessment that supports the development of fair and sustainable sewer rates. The study is not only valuable for meeting day-to-day financial requirements but also for addressing long-term needs, regulatory requirements, and equity considerations within the community.



Key Reasons for Conducting a Sewer Rate Study:

- 1. Financial Sustainability:** Sewer utilities are capital-intensive, requiring significant investment in infrastructure, maintenance, and compliance with environmental regulations. A sewer rate study evaluates the utility's revenue needs and helps determine the appropriate rate structure to meet these needs. It considers both operating expenses, such as labor, energy costs, and maintenance, as well as capital expenses for infrastructure repair and expansion. Proper rate-setting ensures that the utility remains financially solvent without overburdening customers.
- 2. Regulatory Compliance:** Public sewer systems are subject to local, state, and federal regulations. These regulations include water quality standards, reporting requirements, and limits/reporting on sewer system overflows (SSOs). A sewer rate study helps ensure that the utility has adequate resources to meet these regulatory demands, which may involve substantial capital expenditures or operational changes. By identifying current and future regulatory obligations, a sewer rate study helps align financial strategies with compliance requirements.
- 3. Equitable and Transparent Rate Setting:** One of the most critical aspects of a sewer rate study is its ability to establish fair and equitable rates for all customers, especially in a community like Oceano. Different user categories (residential, commercial, industrial) may have different levels of demand on the system, which should be reflected in the rates they pay. The study ensures that rates are aligned with the actual cost of service delivery, preventing cross-subsidization where some customer groups pay more than their fair share. Additionally, the study provides transparency, allowing staff, consultants and elected officials to explain and justify rate increases to constituents based on data-driven insights.
- 4. Long-Term Planning and Infrastructure Investment:** Sewer systems require ongoing maintenance, upgrades, and expansions to address population growth, aging infrastructure, and environmental concerns. A sewer rate study helps identify the funding needed for capital projects, such as replacing old pipes, expanding capacity, or upgrading lift stations. The study supports long-term planning by projecting future capital and operational needs, allowing the utility to plan for infrastructure improvements without disrupting services or accumulating unsustainable debt.
- 5. Enhanced Decision-Making for Elected Officials:** Elected officials have a responsibility to make informed decisions that balance the needs of the sewer utility with the interests of the community. A sewer rate study provides the data and analysis required for effective decision-making. By understanding the financial status of the utility, the cost of providing service, and the potential impact of rate changes, officials can make more informed policy decisions, ensuring that rate adjustments are necessary, fair, and in the best interest of the public. As required by State Law and the Proposition 218 process, OCSD can only charge rates equal to the present and future cost of service, but not above that.



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- 6. Public Trust and Community Support:** Transparency and engagement are critical when it comes to changes in public utility rates. A well-conducted sewer rate study helps foster public trust by providing clear, data-supported justifications for rate adjustments. When the public understands the reasoning behind rate changes—such as infrastructure upgrades, regulatory compliance, deferred maintenance, aging lift station, or cost increases, they are more likely to support those decisions, or at least not oppose them. Moreover, involving the community in the rate-setting process can help address concerns and ensure that the rates do not disproportionately affect vulnerable or low-income populations.

A sewer rate study is a critical tool for public agencies and elected officials to ensure the long-term financial health, operational efficiency, and fairness of a sewer conveyance utility. By conducting a comprehensive analysis of financial needs, service costs, and rate structures, a sewer rate study supports sustainable rate-setting, helps meet regulatory obligations, and ensures that the utility is able to serve the community effectively. It fosters transparency, strengthens public trust, and aids in sound decision-making by providing data-driven insights. Ultimately, conducting a sewer rate study is not just a financial necessity but a fundamental responsibility for those managing public sewer utilities.

Water Rates –

The rationale for sewer rate studies outlined in detail above, equally applies to water rates for District residents and business owners. OCSD’s last rate study for our municipal water system was conducted and completed in 2019. The Board adopted a set of five-year water rates to meet the District’s need at that time. The existing rates are set to expire on June 30, 2025, and with increasing capital costs, construction escalations, a CIP of 31 construction projects that are yet completed, rising labor and materials costs, there is no doubt that a new Water Rate Study is needed for the District.

The prior rate study can serve as the backbone of the analysis but will need significant updates in order to assess the future five years of fiscal need. For example, Lopez Lake costs, State Water and even groundwater may become more expensive to deliver over the coming five-year period as a result of legal requirements, court orders, habitat conservation, and resiliency projects such as Delta Conveyance. In the case of Lopez water, given the ongoing lawsuit against San Luis Obispo County for the operation of the dam, there is potential the future studies, capital upgrades, fish passage assessments, habitat restoration, etc. which will all create escalating costs that will be passed along to Zone 3 partners, and in turn, local rate payers. In the case of State Water, costs may be increasing for normal operations, and at the same time, cost savings may be realized as a result of the County and its Subcontractors making sales of excess/stored water as was done this year. HDR Engineering is in a good position to assist the District in updating our Water Rates with an independent assessment of future needs, while relying heavily on the prior rate study to achieve economy of scale, reduce fiscal impacts, and save in consultant costs.

Other Agency Involvement



Oceano Community Services District

Board of Directors Meeting

N/A

Financial Considerations

The Board adopted \$30,000 in the current year's Sewer Fund to prepare the wastewater rate study. Sewer Fund reserves are estimated to be \$1,124,298 at the end of the fiscal year. Water fund reserves are estimated to be \$2,328,978 and will be drawn down to \$2,313,978 since in February 2025, the Board approved the contract for HDR Engineering to assist staff in updating the Water Rate Study for an amount not to exceed \$15,000.

Results

Considering the necessary revenues and rate structure to operate the wastewater and water system is important to promote a safe, healthy, and well-governed District.

Attachments:

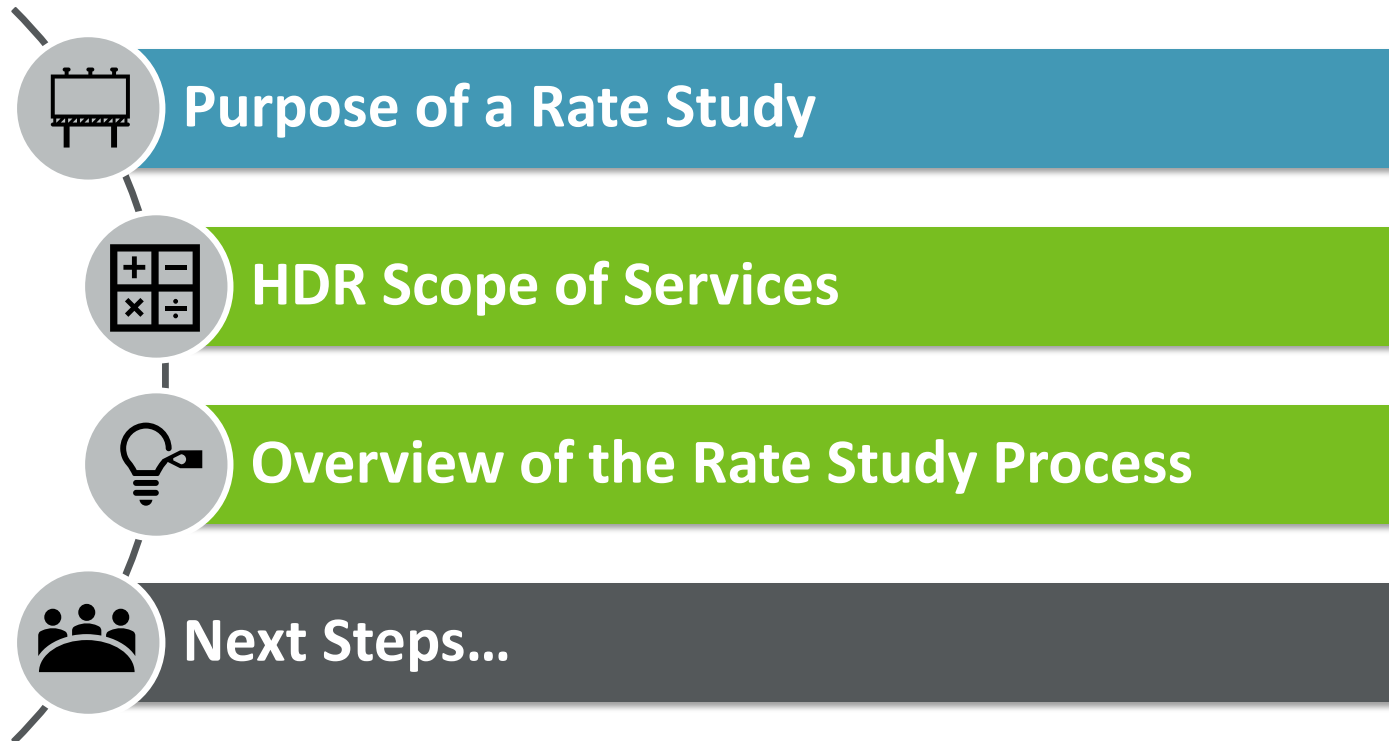
1. Sewer and Water Rate Study 101 Presentation by HDR Engineering, Inc.

Water and Wastewater Rate Study

Introduction to Rate Setting

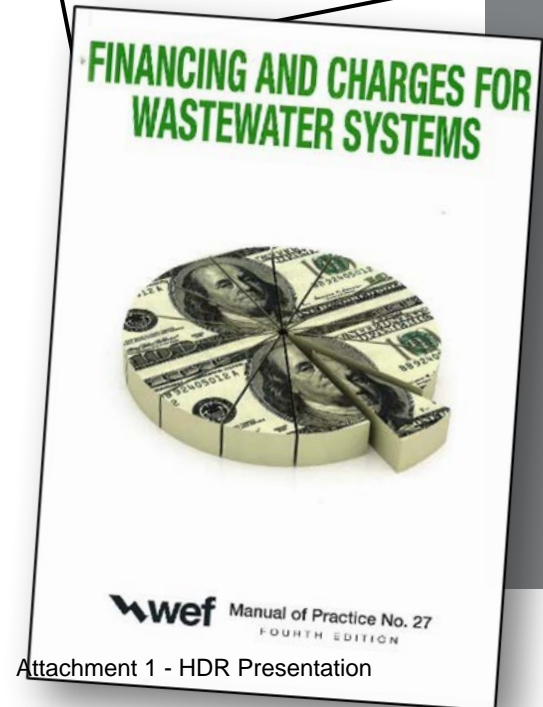
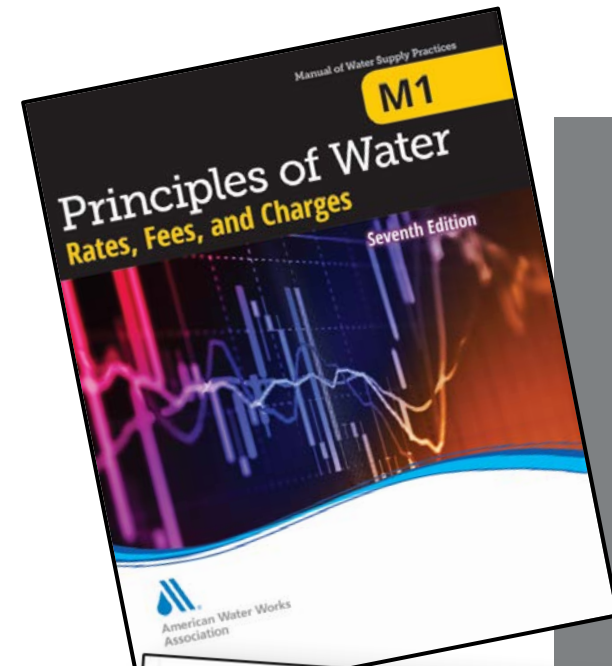
February 12, 2025



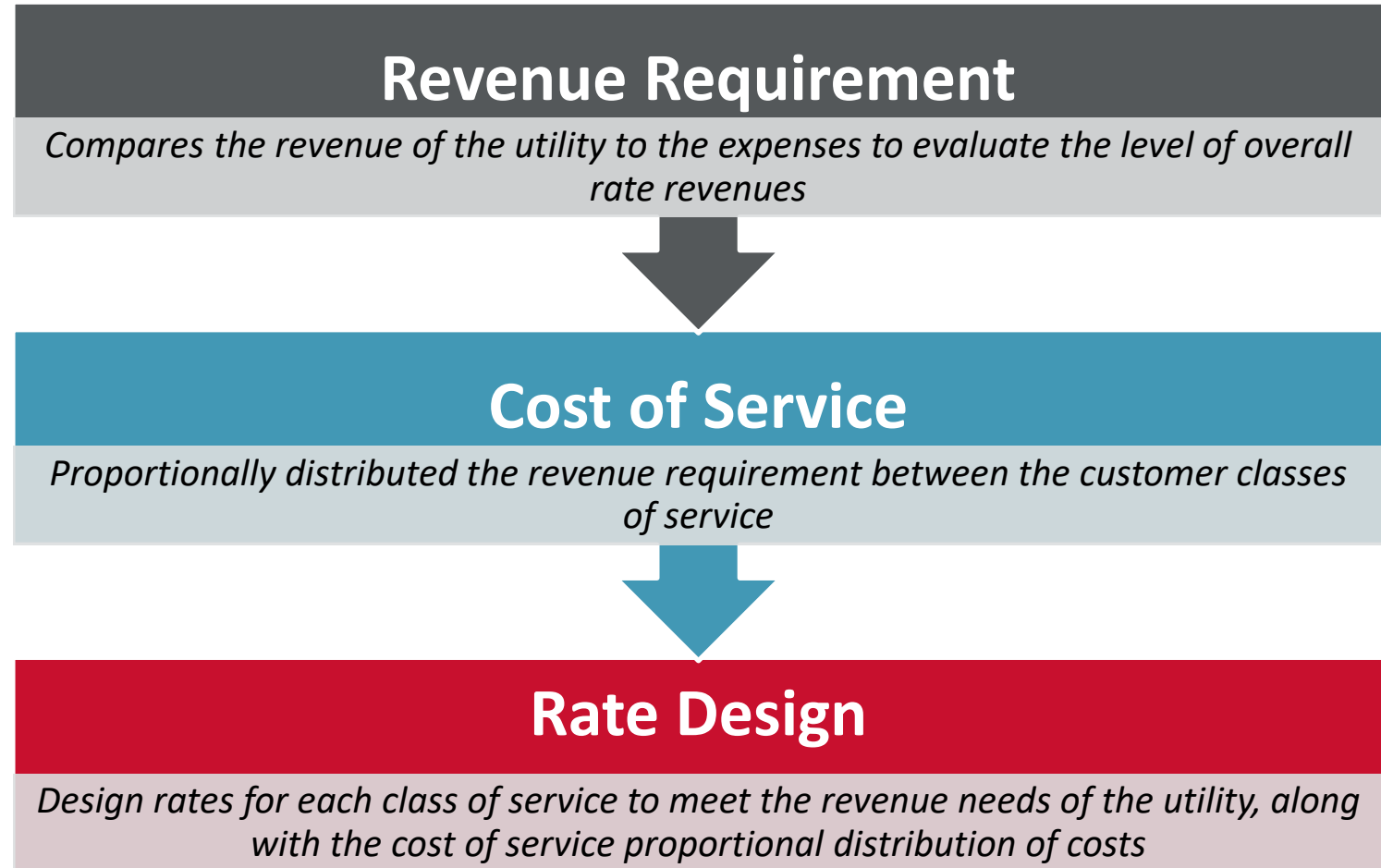


Purpose of the Study

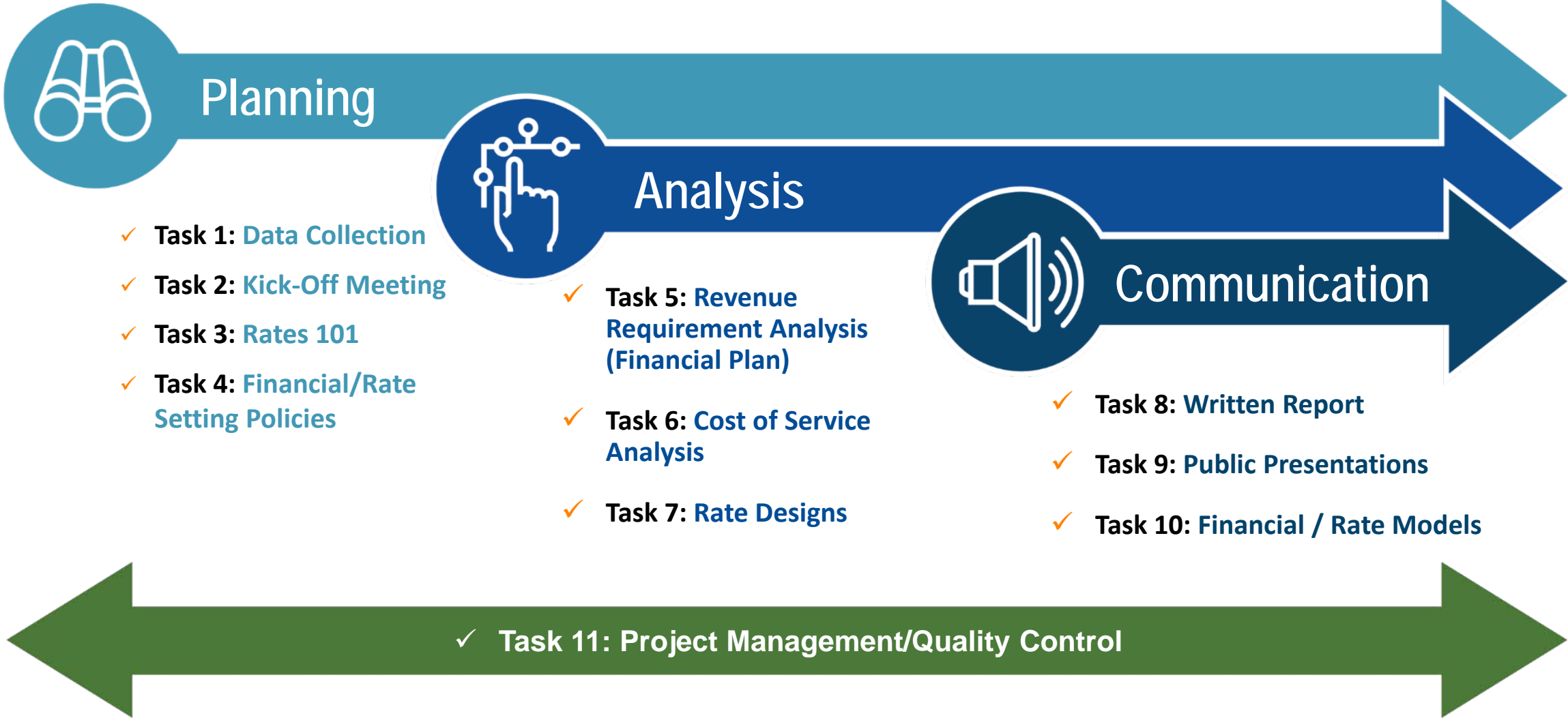
- Provide sufficient revenue to operate and maintain the District's water and wastewater utilities
 - Annual O&M expenses
 - Capital improvement needs
- Develop proportional and cost-based rates
 - Meet the requirements of Proposition 218
- Reflect prudent financial planning criteria
 - Maintain target debt service coverage (DSC) ratio
 - Prudent level of rate funding for capital projects
 - Meet minimum reserve balances
- Develop the study using generally accepted methodologies tailored to the District's system and customer characteristics



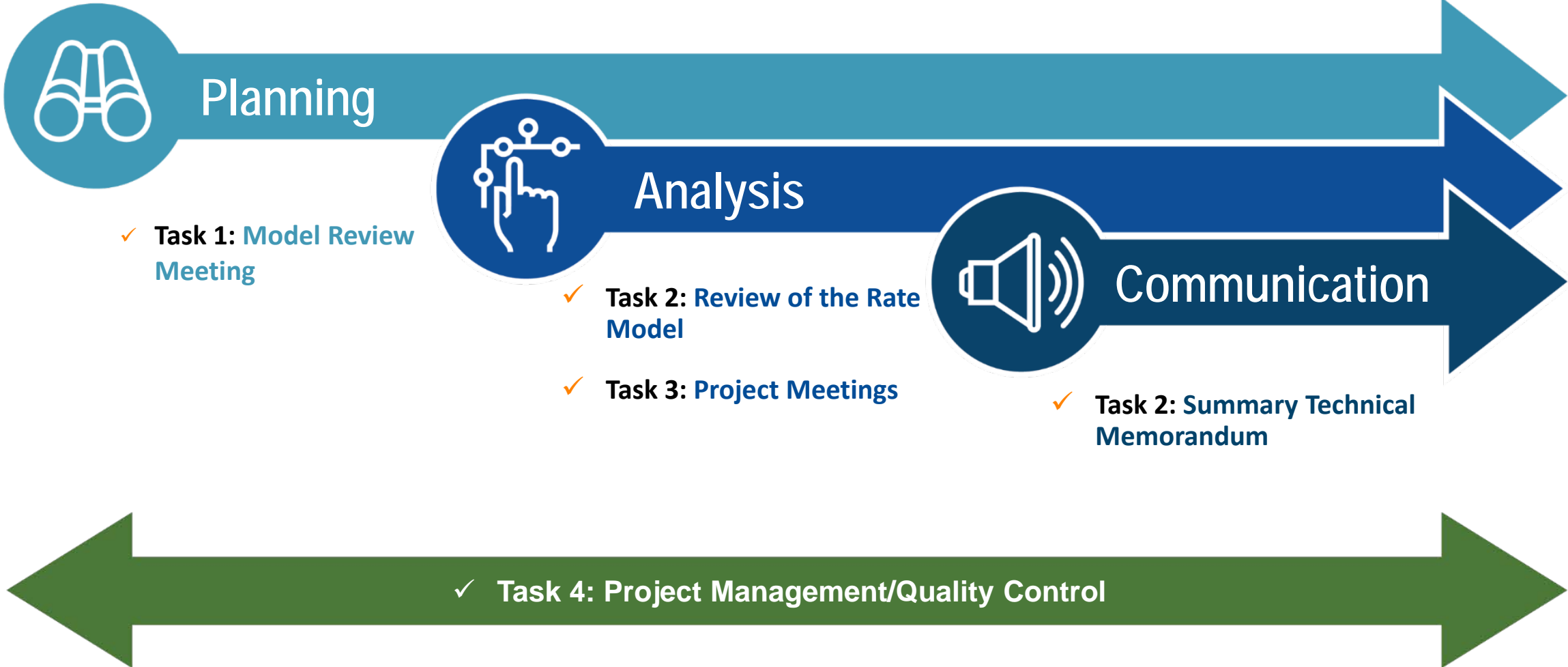
Establishing Cost-Based Wastewater Rates



Wastewater Rate Study Scope of Services



Water Rate Study Assistance Scope of Services



Revenue Requirement Analysis

Overview of the Revenue Requirement

Compares utility revenues to expenses

- Determines the level of revenue (rate) adjustment necessary

Uses prudent financial planning criteria

- Maintaining sufficient target ending reserve balances
- Meeting required debt service coverage (DSC) ratio

Reviews a specific time period

- 2- to 5-year rate setting period
- 10-year planning period

Utility is analyzed on a “stand-alone basis”

- No transfer of funds from other District funds
- Rates need to support operations and capital

Utilizes the “cash basis” methodology

- Generally accepted method for municipal utilities

Summary of the Revenue Requirement

Determines system overall revenue adjustment

Includes capital funding analysis

Includes growth and inflation assumptions

Reflect consumption/volume assumptions

Revenue Requirement – Policy Considerations

Meeting Financial Policies

- Debt service coverage ratio
- Target ending reserve balances
- Use of long-term debt

Prudent Funding of Annual Renewal and Replacement

- Annual depreciation expense
- Future replacement needs
- Asset management plan

Long-Term Financial Sustainability

Levels of Service

- Impacts of growth
- Projection of future O&M
- Additional programs/practices
- Capital infrastructure needs

Volume/consumption assumptions for Revenue Projections

- Revenue stability
- Customer growth

Cost of Service Analysis

Overview of the Cost of Service

What is cost of service?

- Analysis to proportional distribute the revenue requirement to the customer classes of service

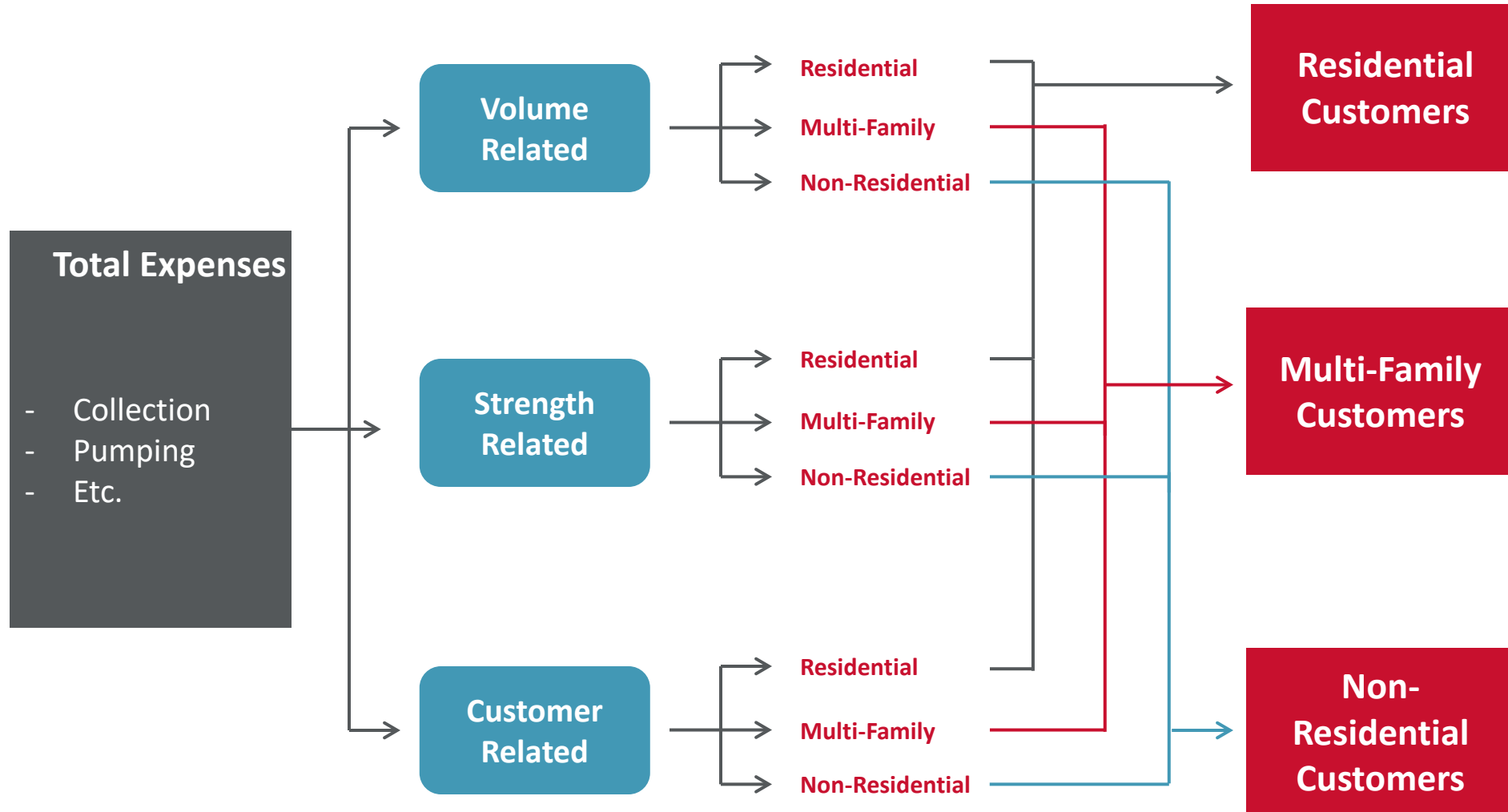
Why cost of service

- Generally accepted as “fair and equitable”
- Avoids interclass subsidies
- Revenues reflect costs
- Meets the intent of Proposition 218

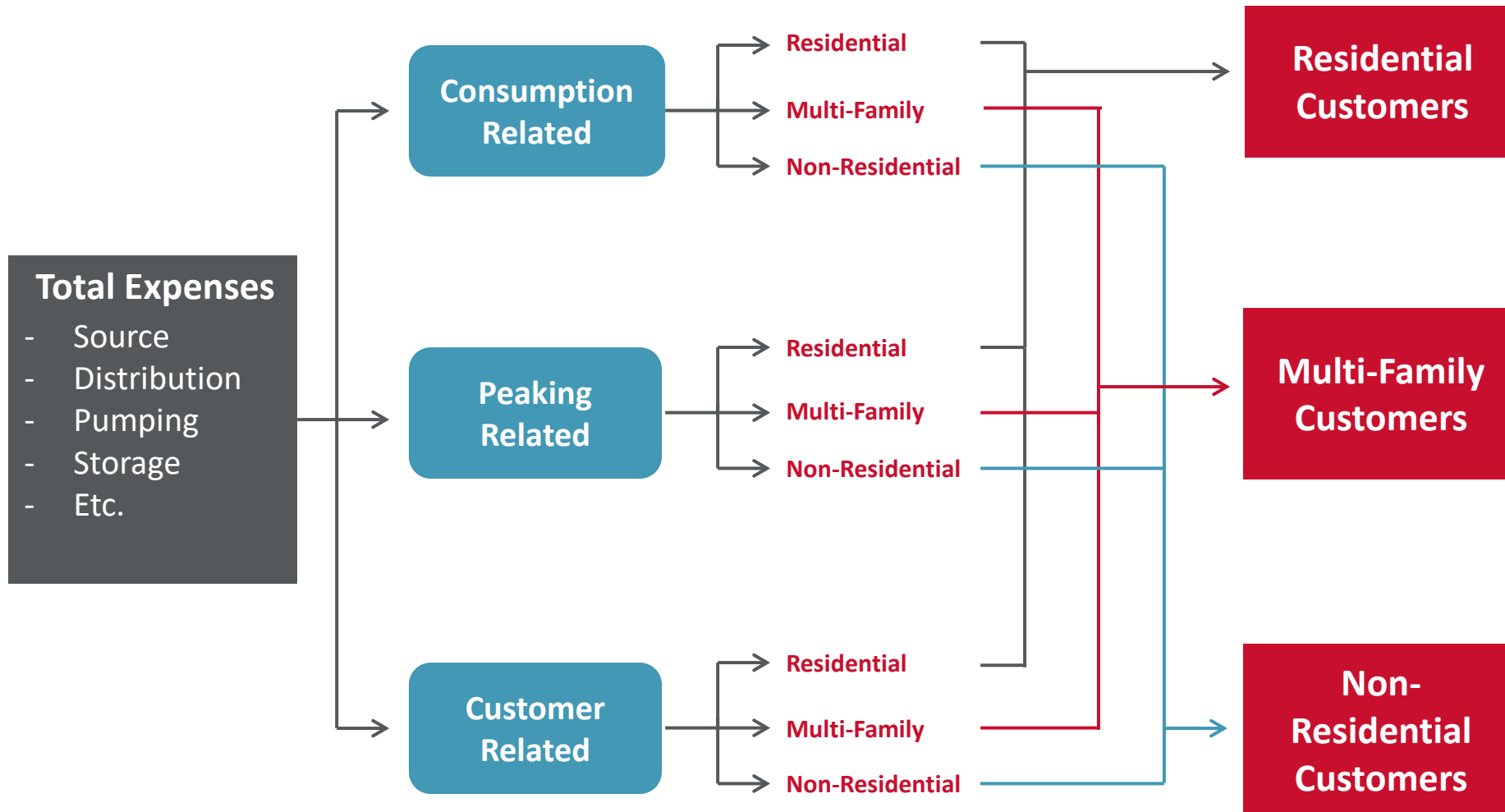
Objectives of Cost of Service

- Determine if subsidies exist
- Develop average unit costs

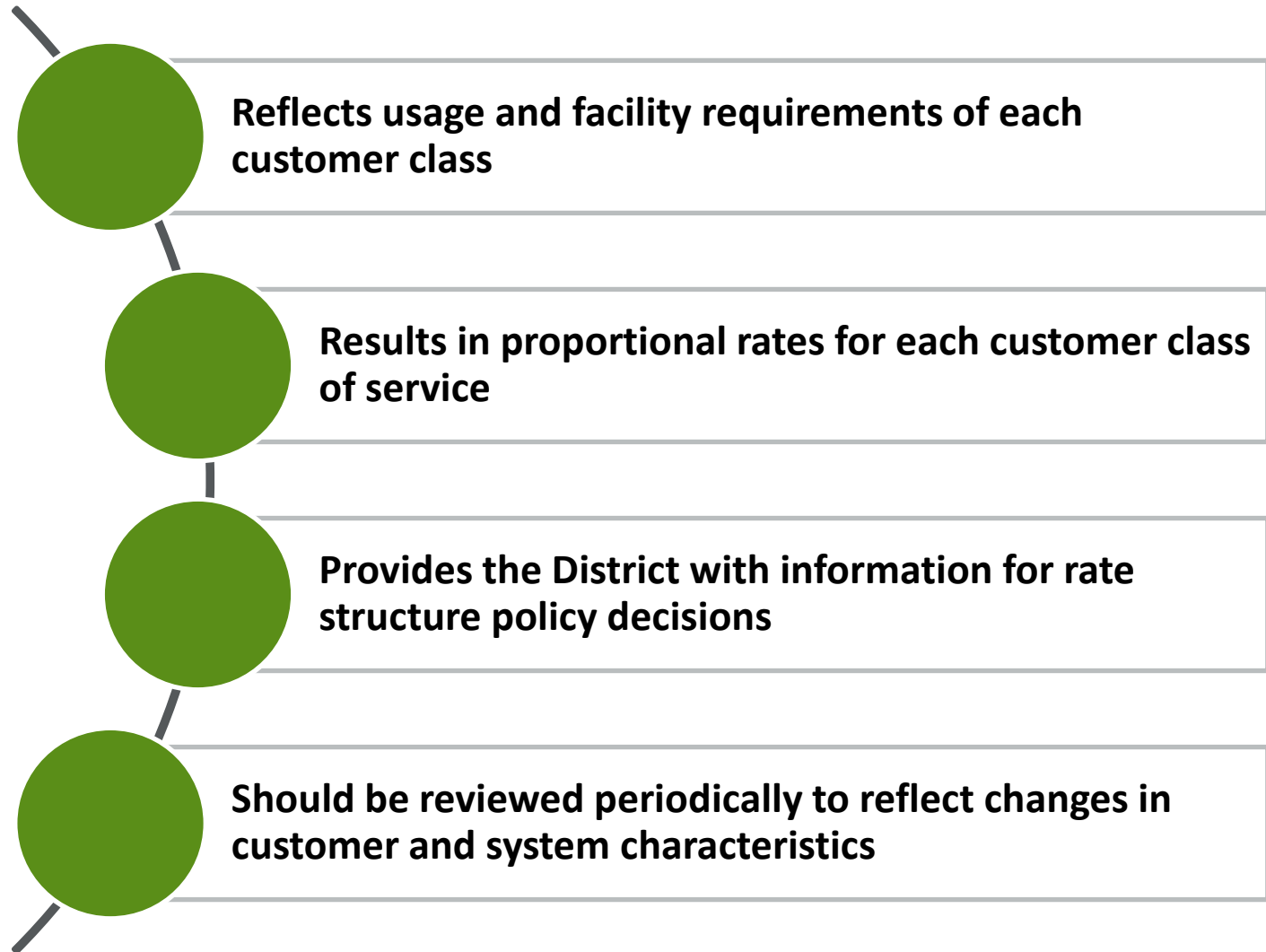
Generic Wastewater Cost of Service Methodology



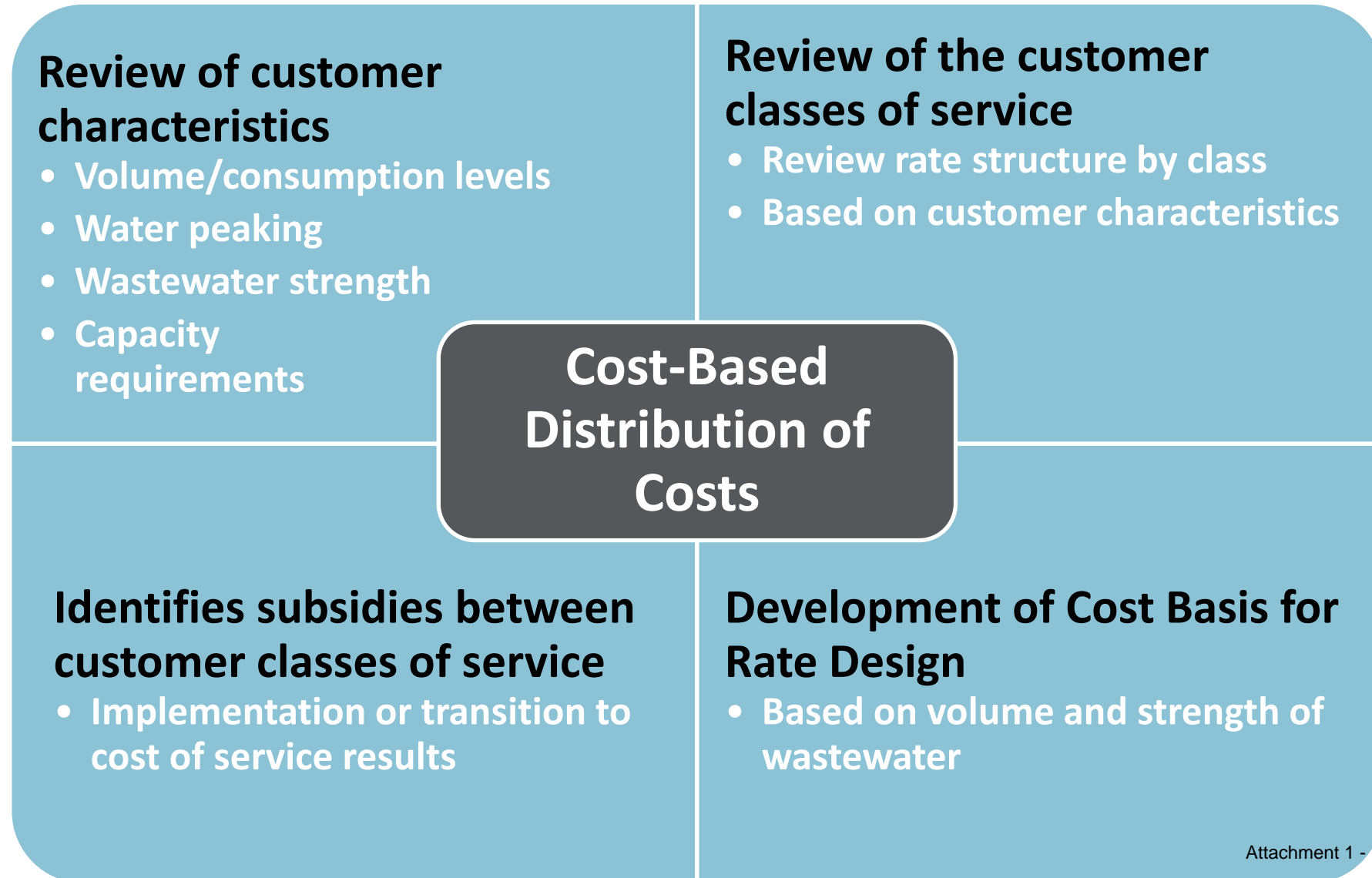
Generic Water Cost of Service Methodology



Summary of the Cost of Service

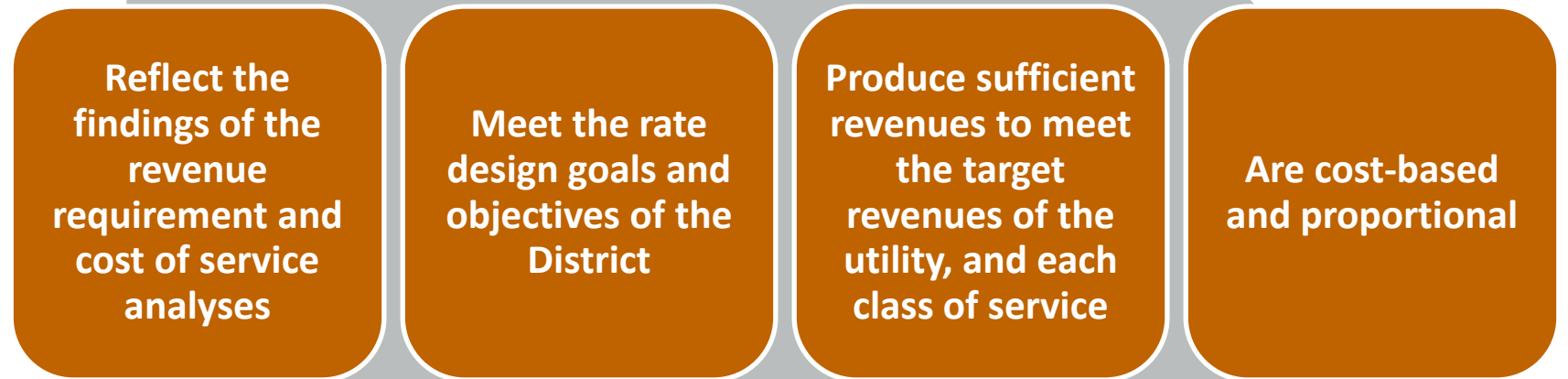


Cost of Service – Policy Considerations



Rate Design Analysis

Overview of the Rate Design



Typical Rate Setting Goals and Objectives

Revenue Sufficiency and Stability

Easy to Understand (customer)

Easy to Administer (District)

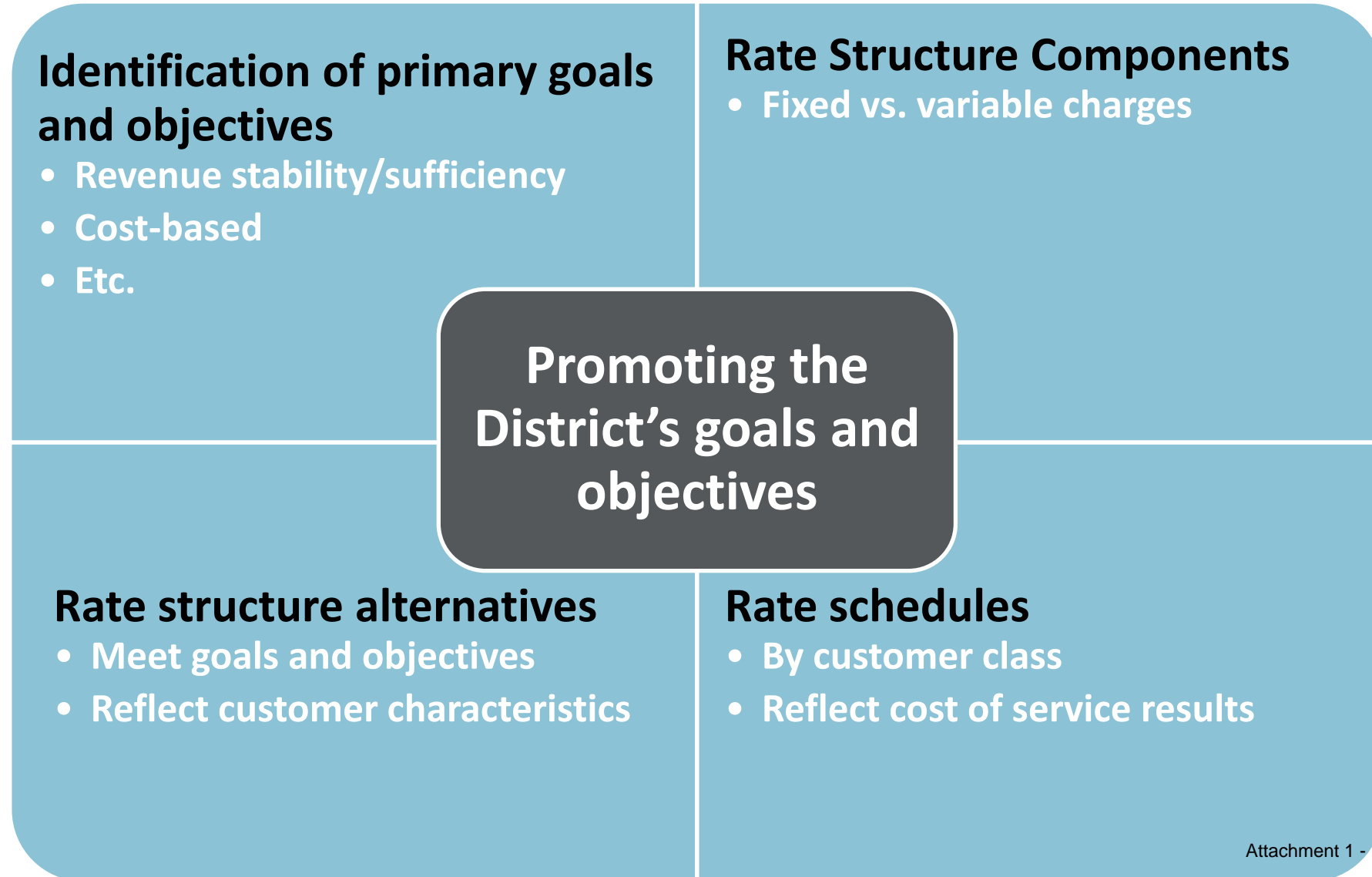
Affordability

Efficient Use of the Resource

Equitable and Non-discriminating (cost-based)

Legally Defendable

Rate Design – Policy Considerations



Next Steps

- Receive Board feedback and input
- Develop draft wastewater technical analyses/review water technical analysis
- Review results with District staff
- Review draft final results with Board
- Revise analyses based on feedback and finalize technical analyses
- Implement proposed wastewater rates through Proposition 218 process



Questions?



Rate Structure Terms Defined

Structure vs. Level

Rate structure is how the customer is charged

Rate level is how much revenue is collected

Fixed Charges

Not based on usage

Often varies by meter size

May include multiple "fixed" charges

Variable Charges

Based on water consumption or wastewater volume / flow

Commonly charged per CCF or kGal

Utility Cost Structure

