MEMORANDUM

Date: September 22, 2021

To: The Honorable Chair and Members
Pima County Board of Supervisors

From: C.H. Huckelberry
County Administrator

Re: City of Tucson Differential Water Rates Cost-of-Service Study

As you are aware, the City of Tucson Mayor and Council adopted an ordinance on June 22, 2021 directing staff to establish a differential water rate for Tucson Water customers located in the unincorporated County with an effective date of December 1, 2021. On August 10, 2021 Mayor and Council adopted Resolution 23379 providing a notice of intent to implement a minimum differential rate for customers in the unincorporated County of 10 percent, and up to 40 percent for single-family tiered rate of use over 3,000 cubic feet/month. The resolution also sets a public hearing for the rate increase on October 19, 2021.

On June 15, 2021, Principal Assistant City Attorney Chris Avery generated a legal analysis indicating that the Mayor and Council adoption of a differential water rate for the unincorporated County could only be legitimized by a cost-of-service study in order to comply with the Arizona Supreme Court ruling in Jung v. City of Phoenix, A.R.S. § 9-511.01(D) and -511.01(E), and Tucson Code § 27-32. Additionally, Mr. Avery stated that the study needs to demonstrate that at least a portion of the rate is supported by an increased cost. This statement is consistent with the analyses conducted by the County Attorney’s Office, which you have reviewed and publicly released following waiving attorney-client privilege.

The City has since contracted with Raftels Financial Consultants, Inc. for a cost-of-service study which was provided in two phases, the second of which was sent to the Citizen’s Water Advisory Committee on September 15, 2021 (attached).

A review of this study indicates that the City, through their consultant, has failed to demonstrate an increased cost to providing service in the unincorporated County since they have only selected factors in the analysis that support their case and ignored others that do not. Factors included in the cost-of-service analysis are customer meter and class data, system peaking data (maximum usage by hour and month), and distribution lines (inch-miles of 8” diameter and smaller pipes). While these factors could be considered legitimate, assumptions and calculations were not provided for validation, including elements such as isolating distribution and metering infrastructure costs which are paid by property owners through the development process. The same applies to how operations and maintenance costs were allocated to inside City and unincorporated residents. Using self-serving targeted factors and questionable assumptions, the study reports an approximately five percent greater cost-based differential for the unincorporated County.
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The cost-of-service study also incorrectly allocates 100 percent of the Utility Tax to inside City customers stating, "...this tax is only assessed to customers living within city limits." However, City tax does appear on unincorporated resident bills.

Additional factors not considered in the cost-of-service analysis include:
- Using consumption as the basis for splitting all costs between inside and outside customers when some of these costs such as director’s office, billing, metering, financial and engineering are unit costs not related to volume consumed;
- City sales tax and groundwater protection fee applied to Tucson Water bills, benefiting solely the City of Tucson;
- Disproportionate payment of Central Arizona Water Conservation District taxes by unincorporated residents thereby subsidizing Central Arizona Project water for City customers;
- Costs of treating and conveying water containing contaminants such as PFAS and 1,4 Dioxane within City limits subsidized by unincorporated County customers;
- Reclaimed water use in the City of Tucson subsidized by unincorporated County customers; and
- Evaluation of average customer elevation data due to the significant costs associated with moving water from the Avra Valley, SAVSARP and CAVSARP well fields to the east side of the City of Tucson.

A review of these combined factors would likely demonstrate that unincorporated County water service costs less than City of Tucson and that unincorporated customers are already significantly subsidizing City residents at existing rates.

The Raftelis study goes on to calculate a utility-basis with a differential rate of return. However, the consultant acknowledged at the September 16, 2021 Citizen’s Water Advisory Committee (CWAC) Financial Subcommittee Meeting that the only real “finding” of the analysis is a five percent differential and that further selection of an outside City differential is strictly a policy decision left to Mayor and Council based on the artificial “returns” they wish to receive.

This rate setting methodology, inferring a rate of return, assumes differences between owners and non-owners. As explained in Assistant County Administrator Yves Khawam’s attached letters to the CWAC, this distinction is tenuous at best in terms of how Mayor and Council has selected to allocate Tucson Water’s risk and debt and does not meet the criteria set by the American Water Works Association for developing fair and equitable rates.

Additionally, the City has further corrupted the concept of utility-basis and equity ownership by including other municipalities, the Tohono O’odham nation, the Pascua Yaqui Tribe and Tucson Unified School District within the “ownership” group, even though these entities have no more ownership stake in the utility than the remainder of the unincorporated County. This clearly demonstrates the discriminatory approach used by the City, which politically intermingles owners and non-owners thereby invalidating the utility-based approach altogether and rendering any rate of return projections meaningless.
In summary, the City cost-of-service study finds that an artificial five percent differential exists in certain areas of the unincorporated County through solely selecting factors that assist in making this case and ignoring factors that would potentially negate and even reverse this differential. Furthermore, the City proposed utility-basis fee differential cannot legitimately be applied from the standpoint of overall validity based both on the manner that the Tucson Water Enterprise is managed and by having corrupted the concept of ownership through including an array of entities unrelated to the Tucson municipality within the same ownership class.

The City cost-of-service study does not stand up to scrutiny and provides no legitimate basis for a differential fee to be applied to unincorporated County residents. As stated in the July 28, 2021 County Attorney analysis regarding legal options available to challenge the differential rate, the County has standing and capacity to sue the City on its own behalf or it may join a class of unincorporated customers. The City Council did not follow statutory procedures in adopting the differential rate ordinance on June 22, 2021 and has yet to demonstrate a basis for a fee differential through a valid cost-of-service study.

CHH/mp

Attachments
A. Undated phase 2 of 2 Raftelis Consultants cost-of-service study (sent to CWAC on 09/15/21)
B. Correspondence between the County and CWAC related to cost-of-service study

c: Honorable Mayor and Council Members, City of Tucson
Chair and Members, Citizen’s Water Advisory Committee
Jan Lesher, Chief Deputy County Administrator
Carmine DeBonis, Jr., Deputy County Administrator for Public Works
Yves Khawam, PhD, Assistant County Administrator for Public Works