June 22, 2021

Subject: Public Hearing: Amending Tucson Code to Implement a Differential Rate Structure for Tucson Water customers Located in Unincorporated Pima County (Outside City) (Continued from June 8, 2021 Meeting)

**Issue** – Continuation of the June 8, 2021, public hearing concerning the proposed implementation of a differential rate structure for Tucson Water customers located in unincorporated Pima County.

**City Manager’s Recommendation** – Following the close of today’s public hearing the Mayor and Council are respectfully requested to consider the attached revised schedule of FY 21-22 differential rate options (Attachment A), and to also consider adoption of the attached ordinance. If adopted, differential rates for Tucson Water customers located in unincorporated Pima County will take effect on or after August 1, 2021.

**Background** – This item is the continuation of a public hearing held on June 8. The Communication and materials for the June 8 meeting are available on the Mayor and Council meeting notice and agenda website (tinyurl.com/COT-MC-060821, Item #8).

Mayor and Council directed staff to return today with additional analysis of rate options #1, #4, #6, and #7, to include projected revenues, impacts to typical water bills, and a comparison of the rate options to differential rates charged by other water providers. Additionally, Mayor and Council directed staff to describe how differential rate revenues could be used by Tucson Water to support and/or expand its current programs in the following areas:

- Expanding the Low-Income and other Customer Assistance Programs
- Enhancing water resources management
- Improving infrastructure reliability

After today’s public hearing, the Mayor and Council may enact a differential rate structure that is equal to or less than the 50% maximum recommended with the Notice of Intention, or they may choose not to implement a differential rate structure.

**Summary of Differential Rate Options** – As requested by Mayor and Council, Table 1 below shows differential rate options #1, #4, #6, and #7 for the single-family residential (SFR) customer class, which is Tucson Water’s largest class with approximately 90% of customer accounts across the entire service area. This class represents 95% of the customer base among customers located in unincorporated Pima County.
The SFR rate structure consists of three basic components: a fixed monthly service charge based upon meter size; a volumetric usage charge based on a four-tiered, inclining-block structure; and miscellaneous fees. The SFR volumetric rate blocks established in FY 2016 are as follows, and would not be affected by the proposed differential rate options:

- Tier 1 = 0-7 Ccf
- Tier 2 = 8-15 Ccf
- Tier 3 = 16-30 Ccf
- Tier 4 = >30 Ccf

Options #1 and #4 are flat percentage increases of 10% and 40%, respectively, across all rates and fees. Options #6 and #7 each feature a base percentage increase for the monthly base rate, first volumetric tier (0–7 Ccf), Central Arizona Project (CAP) Fee, and Conservation Fee, in addition to escalating percentage increases in the inclining block rate structure.

### Table 1. Focused rate options for consideration

<table>
<thead>
<tr>
<th>Single Family Residential</th>
<th>Current Rate FY 21 &amp; FY 22</th>
<th>Option 1</th>
<th>Option 4</th>
<th>Option 6</th>
<th>Option 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly Base Rate (5/8&quot;)</td>
<td>$16.33</td>
<td>Flat 10%</td>
<td>Flat 40%</td>
<td>5% Differential Rate on Base plus Escalating Tiers (T1-5%, T2-10%, T3-15%, T4-20%)</td>
<td>10% Differential Rate on Base plus Escalating Tiers (T1-10%, T2-20%, T3-30%, T4-40%)</td>
</tr>
<tr>
<td>1 – 7 Ccf</td>
<td>$2.07</td>
<td>10%</td>
<td>$2.28</td>
<td>$2.90</td>
<td>$2.17</td>
</tr>
<tr>
<td>8 – 15 Ccf</td>
<td>$3.82</td>
<td>10%</td>
<td>$4.20</td>
<td>$5.35</td>
<td>$4.20</td>
</tr>
<tr>
<td>16 – 30 Ccf</td>
<td>$8.39</td>
<td>10%</td>
<td>$9.23</td>
<td>$11.75</td>
<td>$9.65</td>
</tr>
<tr>
<td>Over 30 Ccf</td>
<td>$12.93</td>
<td>10%</td>
<td>$14.22</td>
<td>$18.10</td>
<td>$15.52</td>
</tr>
<tr>
<td>CAP Fee</td>
<td>$0.70</td>
<td>10%</td>
<td>$0.77</td>
<td>$0.98</td>
<td>$0.74</td>
</tr>
<tr>
<td>Conservation Fee</td>
<td>$0.10</td>
<td>10%</td>
<td>$0.11</td>
<td>$0.14</td>
<td>$0.11</td>
</tr>
</tbody>
</table>

**Highlights of Bill Effects** – Each of the differential rate options would result in some level of bill increase for all customers in the unincorporated County. Options #1 and #4 would result in a flat, across-the-board increase of all water bill components. Options #6 and #7 would shift a greater proportion of the rate increase for any given customer toward the higher volumetric rate blocks, potentially increasing the conservation incentive for customers using more than the in-City average of 7 Ccf per month.

The projected effect of each differential rate option upon a sample of SFR customers is shown in Table 2.
Table 2. Residential bill examples (Options #1, #4, #6, and #7)

<table>
<thead>
<tr>
<th>Water Bill</th>
<th># Ccfs</th>
<th>Current</th>
<th>Flat 10%</th>
<th>Flat 40%</th>
<th>5% Differential Rate on Base plus Escalating Tiers (T1-5%, T2-10%, T3-15%, T4-20%)</th>
<th>10% Differential Rate on Base plus Escalating Tiers (T1-10%, T2-20%, T3-30%, T4-40%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>4</td>
<td>$27.81</td>
<td>$30.59</td>
<td>$38.93</td>
<td>$29.20</td>
<td>$30.59</td>
</tr>
<tr>
<td>Inside City Average</td>
<td>7</td>
<td>$36.42</td>
<td>$40.06</td>
<td>$50.99</td>
<td>$38.24</td>
<td>$40.06</td>
</tr>
<tr>
<td>Outside City Average</td>
<td>10</td>
<td>$50.28</td>
<td>$55.31</td>
<td>$70.39</td>
<td>$53.37</td>
<td>$56.45</td>
</tr>
<tr>
<td>High</td>
<td>45</td>
<td>$417.18</td>
<td>$458.90</td>
<td>$584.05</td>
<td>$481.24</td>
<td>$545.31</td>
</tr>
</tbody>
</table>

Financial Considerations – New annual revenues anticipated from the implementation of differential water rates would depend on the rate adjustment applied to customers located in unincorporated Pima County. A summary of revenue estimates based on the rate options presented today to Mayor and Council appears in Table 3.

Table 3. Focused revenue estimates

<table>
<thead>
<tr>
<th>Revenue Projections</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Option 1</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Flat 10%</td>
</tr>
<tr>
<td>$ 6,340,000</td>
</tr>
</tbody>
</table>

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Mayor and Council directed staff to describe how differential rate revenues could be used by Tucson Water to support and/or expand specific current programs. Staff proposals for potential uses of additional revenues include:

1. Expand the Low-Income and other Customer Assistance Programs, including:
   - One-time debt forgiveness for those financially impacted by COVID-19
   - Expansion of the low-income program
   - Development of an Emergency / Special Hardship Relief Program

2. Enhance water resources management by:
   - Expanding recharge capabilities
   - Providing additional funding for GSI/Stormwater capture
   - Acquiring and developing additional renewable water supplies

3. Improve infrastructure reliability through investments in:
   - Addressing system-wide leakage and water loss
   - Rehabilitating aging infrastructure
   - Improving system reliability

**Additional Information as Requested:** In response to stakeholder input gathered prior to and during the June 8 public hearing, Mayor and Council have requested that staff provide additional information related to the proposed implementation of a differential rate structure:

**Cost-of-Service analysis:** The process of determining which portion of water sales revenues will be borne by each rate class is known as a cost-of-service (COS) allocation. During a full rate-setting process, Tucson Water develops COS models in conjunction with its rate consultants, which are then reviewed by CWAC and the City Manager’s Office before being presented to Mayor and Council.

In prior rate-setting processes, CWAC and Tucson Water staff have agreed that the COS allocation approach endorsed by the American Water Works Association should be the “baseline” for setting customer-class revenue targets. In previous years, CWAC has also recommended two adjustments to the baseline COS: a pro-rata redistribution of Tucson Unified School District peak demand costs, and a reallocation of reclaimed water costs.

Previous COS analyses have been done on the entire Tucson Water system, accounting for systemwide components such as customer-class data and peak-demand expectations. The utility does not break down COS allocations by Ward or by ZIP Code, and a typical COS analysis does not provide the granularity to examine specific geographical areas or elevation zones.
Supreme Court has held that a cost-of-service analysis is not required to support a differential rate – a City is entitled to a return-on-investment from service to outsiders.

If the Mayor and Council desire that a specific COS analysis be performed to compare customers inside the City to those in unincorporated Pima County, the utility will work with its rate consultants to produce such an analysis. Staff expects this process would take at least six months to complete.

**Analysis of delinquent Tucson Water accounts:** Mayor and Council previously requested a breakdown of Tucson Water accounts in delinquent status or on a payment plan, in relation to location inside or outside of the City. This analysis is included with this Communication as Attachment B.

**Additional legal considerations:** Specific challenges to the legality of the proposed differential rate structure were raised during the June 8 public hearing. These are addressed in the attached memorandum from the City Attorney’s Office (Attachment C).

**COVID-related debt cancellation:** There are approximately 3,000 accounts on payment plans that were established by customers that self-reported being negatively affected by the COVID-19 pandemic. The amount outstanding is around $2.5 million and represents water, wastewater, and garbage/recycling services.

**Tucson is not the regional water provider:** Tucson Water is not the sole regional water provider, and its water service obligations outside the City’s jurisdiction are limited to contracts and infill. In a December 10, 2007, memo to Tucson Water (refer to Attachment G in the June 8 public meeting materials), the City Attorney’s Office indicated that “the City is not a public service corporation and has no obligation to provide persons in unincorporated areas with water, and need not treat new and existing customers in those areas under the same policies.”

**CAP allocation does not constitute an agreement to serve outside jurisdiction:** The City’s CAP Subcontract does not obligate Tucson Water to provide service to specific areas outside of the City’s jurisdiction. As noted in a December 11, 2007, memo to Tucson Water (refer to Attachment H in the June 8 public meeting materials), the Department’s legal counsel established that the City’s CAP Subcontract and the CAP allocation process do not obligate the City to provide water service to any particular area within the City’s 50-year service area filed with the Central Arizona Water Conservation District.

**Additional staff responses:** Throughout the public hearing process, Mayor and Council have provided staff with questions and requests for additional information about the proposed implementation of a differential rate structure. Collected staff responses are included here for Mayor and Council reference as Attachment D.
Legal Consideration – Adoption of the attached ordinance by the Mayor and Council following tonight’s public hearing is required to establish a new rate structure effective on or after August 1, 2021.

Consistency with Plan Tucson – The proposed differential rate schedules are consistent with the voter approved goals outlined in Plan Tucson related to the Social Environment policies associated with Governance & Participation (G1-12); the Natural Environment policies associated with Energy & Climate Readiness (including EC8-9), Green Infrastructure (including GI1-6), and Water Resources (including WR1-11); and the Built Environment policies associated with Public Infrastructure, Facilities, & Cost of Development (including PI1-2 & 5-6).

Respectfully submitted,

[Signature]

Timothy M. Thomure, PE, ENV SP
Interim Assistant City Manager

TT/kl
John Kmiec, Interim Director, Tucson Water

Attachments:  Attachment A - Tucson Water Proposed Differential Rates for Unincorporated Pima County Customers
Attachment B - Status Report on Utility Billing
Attachment C - Memorandum to Water Department Dated June 15, 2021
Attachment D - Staff Responses to Mayor & Council Inquiries Re: Differential Rate Proposal, June 8 and June 22, 2021 Ordinance