

Background Report

National City provides wastewater service to approximately 17,000 customers within the incorporated area of the City of National City. It owns and operates approximately 100 miles of pipeline, 2,000 manholes, and 2 lift stations/force mains.

The City is responsible for collecting and conveying wastewater flows originating within the City to the City of San Diego's Point Loma Treatment Plant for treatment and disposal. The City's primary goals are operating the sewerage system safely and efficiently while meeting the needs of their customers.

To meet these goals, the City undertakes routine cleaning, inspections, and repairs and rehabilitates its facilities as needed. The wastewater system operates in an area subject to strict regulatory oversight by Federal and State agencies such as the U.S. Environmental Protection Agency (USEPA) and the California State Water Resources Control Board (SWRCB). The City must comply with a multitude of laws including, but not limited to, State Wastewater Discharge Requirements (WDRs). Complying with these regulations and resulting mandates contributes to a large share of the cost burden on the City's system.

The City of National City is one of thirteen participating agencies (PAs) who send their wastewater to the City of San Diego Metropolitan Sewage Treatment System (Metro) for treatment and disposal. Along with the other PA's, the City entered into the Regional Disposal Agreement with San Diego in 1998. Due to positive financial negotiations with San Diego since that time and especially the establishment of the "Administrative Protocol on Allocation of Operating Reserves and Debt Service Coverage" during FY 2010 the City has enjoyed stable annual billings for the last 8 years from the City of San Diego. However, in 2015 the City of San Diego initiated a multi-billion dollar public works project entitled the Pure Water Program which will provide the double benefit of "secondary equivalency" to San Diego's wastewater customers including National City as well as a significant new potable water supply for the City of San Diego.

In September 2016, the City of San Diego provided the PAs with a range of annual costs from FY 2016 through FY 2022 for Phase I of the Pure Water Program. These annual cost increases began with FY 2018 (current fiscal year) and are the basis for establishing the San Diego portion of the revenue requirement developed by this Study.

The City of National City customers enjoy some of the lowest sewer service charges in the Metro System. The City last adjusted sewer service charges through a 2003 Rate Study and rates were last increased in FY 2006. FY 2018 charge is 38% lower than the average Metro PA rate of \$50.82 per month. However, the City's increased internal CIP requirements and the costs associated with the Pure Water Program require that the City adjust their sewer rates for the next five years at an average of 9.8% per year.

The City's sewer utility was evaluated on a "stand-alone" basis. That is, no subsidies between the utility or other City funds occur. By viewing the utility on a stand-alone basis, the need to

adequately fund both operations and maintenance (O&M) and capital infrastructure (CIP) must be balanced against the rate impacts on utility customers.

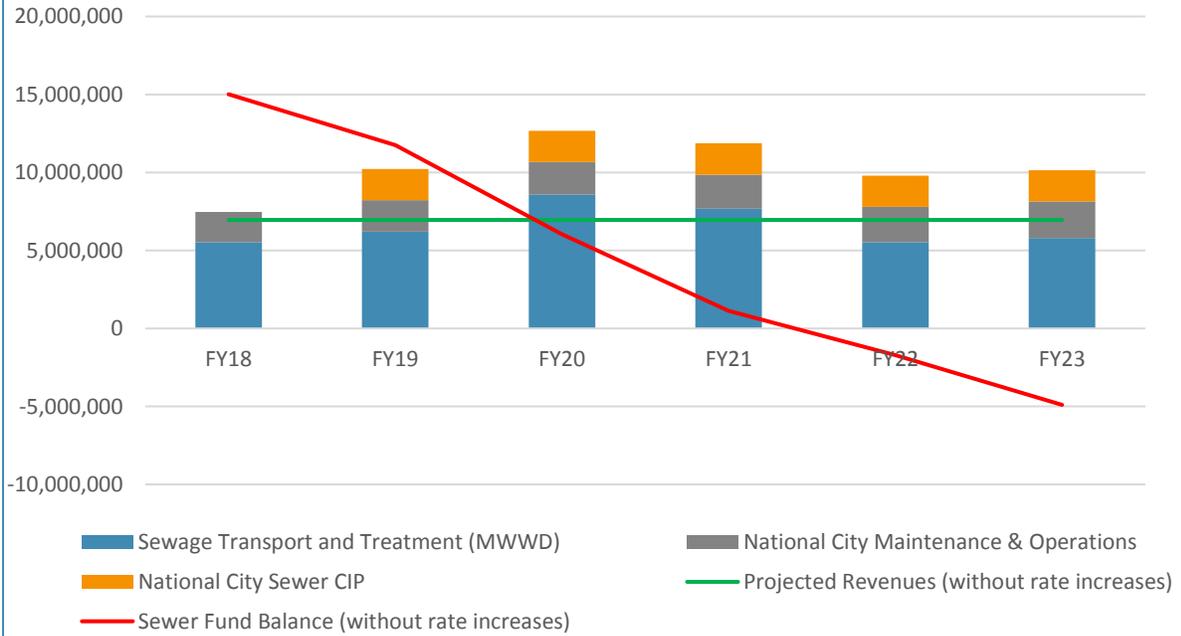
A comprehensive process was used to review the City's rates and projected expenses. Background information on capital needs was available through the CIP Needs Assessment, which was presented at the City Council Meeting of February 28, 2017.

The revenue requirement analysis revealed that several significant financial changes have occurred since the City's 2003 rate study and subsequently adopted sewer user rates. The significant changes are:

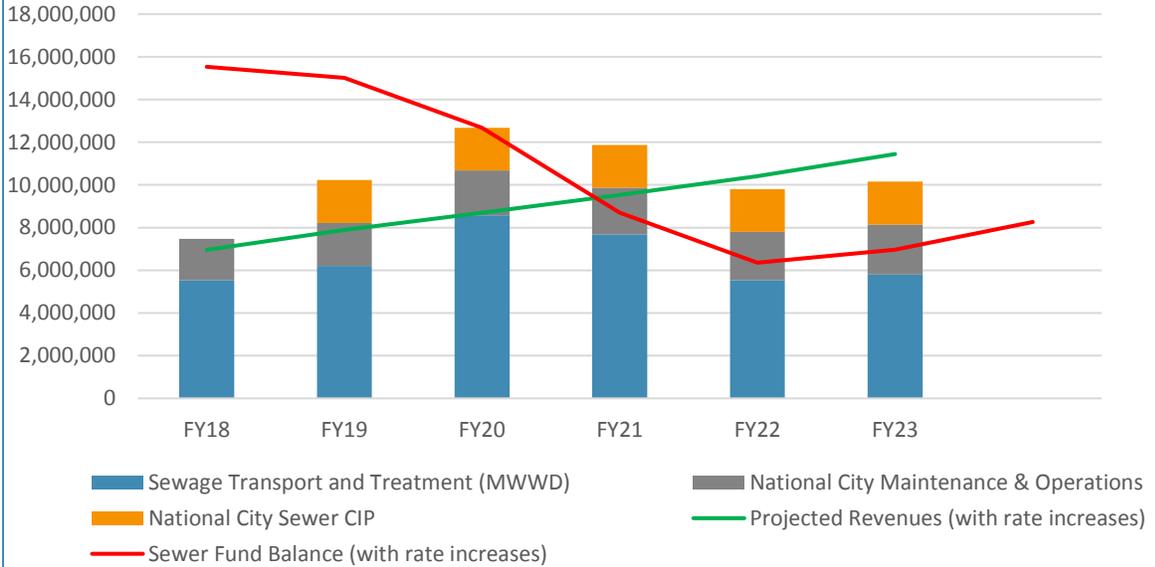
1. The Wastewater Master Plan contains an annual capital requirement of \$2 million for capital projects for the next 9 years.
2. The planning phase of the City of San Diego's Pure Water Program have begun and during FYE 2018 to FYE 2023 additional Metro costs are anticipated for Phase 1 of this program. City of San Diego staff has identified the increased funding level for the participating agencies from the 2010 adopted Protocol level of \$65 million to \$128 million per year over the next four-years. The City's portion of this budget is currently 7.4%. National City's increased funding level for the Pure Water Program is included in this rate case.

The largest component of the City of National City's revenue requirement is the costs associated with transportation, treatment and disposal of the City's wastewater by the Metro facilities. A summary of the projected City collection system O&M, CIP and Metro expenses, compared to current and proposed sewer rates, are included in the City's rate case and summarized in the charts below.

Sewer Service Fund Revenue Projections vs Expenses Without Rate Increases (FY 2018 - FY 2023)



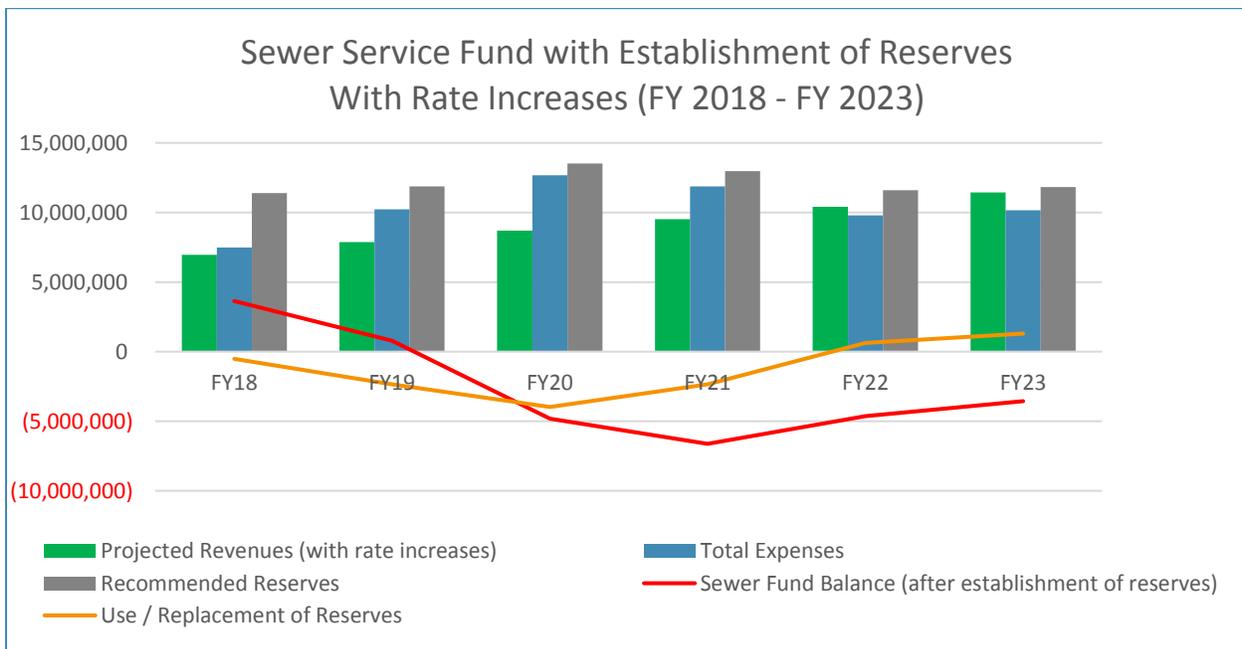
Sewer Service Fund Revenue Projections vs Expenses With Rate Increases (FY 2018 - FY 2023)



Based on cost of service and projected revenue requirements, the City proposes new sewer service charges. The following table shows the proposed sewer charges for FY 2019 through FY 2023 and compares them to existing charges:

User Class	Current	2019	2020	2021	2022	2023
Residential: \$ Per Month						
Single Family	\$ 32.08	\$ 35.23	\$ 38.68	\$ 42.47	\$ 46.61	\$ 51.18
Multi-family/Condo	\$ 25.00	\$ 27.48	\$ 30.17	\$ 33.13	\$ 36.36	\$ 39.92
Mobile Homes	\$ 19.50	\$ 21.49	\$ 23.60	\$ 25.91	\$ 28.43	\$ 31.22
Non-Residential: \$ Per HCF						
Commercial - Low	\$ 3.03	\$ 3.61	\$ 3.97	\$ 4.35	\$ 4.78	\$ 5.25
Commercial - Medium Low	\$ 3.12	\$ 3.89	\$ 4.33	\$ 4.73	\$ 5.13	\$ 5.66
Commercial - Medium	\$ 4.09	\$ 4.69	\$ 5.37	\$ 5.76	\$ 6.13	\$ 6.80
Commercial - Medium High	\$ 4.90	\$ 5.48	\$ 6.40	\$ 6.80	\$ 7.12	\$ 7.95
Commercial - High	\$ 6.12	\$ 6.82	\$ 8.14	\$ 8.55	\$ 8.79	\$ 9.88

The City should also establish a definitive reserve policy to protect the financial integrity of our sewer enterprise fund. City staff proposes a reserve policy that meets industry standard guidelines in establishing formal reserve policies as well as the City’s needs for financial stability and potential exposures to external forces which could require unplanned O&M or capital expenditures. The establishment of this reserve has been integrated into the projected revenue requirements for the rate case. The following chart presents a financial picture of the Sewer Enterprise Fund over the next five fiscal years based on the inclusion of proposed sewer rate increases (revenues), total expenses, and operational and capital reserves.



Long Range Financial Plan: Establishment & Use of Reserves Table

5	Total Revenue	\$ 6,957,939.32	\$ 7,881,478.71	\$ 8,696,609.30	\$ 9,521,184.34	\$10,409,369.16	\$ 11,443,792.61
12	Total Expenses	\$ 7,473,749.71	\$ 10,221,478.71	\$ 12,671,609.30	\$ 11,866,184.34	\$ 9,794,369.16	\$ 10,148,792.61
13	Fund Balance Prior to Reserves	\$15,014,450.61	\$ 12,674,450.61	\$ 8,699,450.61	\$ 6,354,450.61	\$ 6,969,450.61	\$ 8,264,450.61
14	Reserve Targets:						
15	Operations/Cash Flow	\$ 3,736,874.86	\$ 4,110,739.36	\$ 5,335,804.65	\$ 4,933,092.17	\$ 3,897,184.58	\$ 4,074,396.31
16	Metro Cash Flow	\$ 4,400,000.00	\$ 4,400,000.00	\$ 4,400,000.00	\$ 4,400,000.00	\$ 4,400,000.00	\$ 4,400,000.00
17	Emergency/Nat. Disaster	\$ 1,245,624.95	\$ 1,370,246.45	\$ 1,778,601.55	\$ 1,644,364.06	\$ 1,299,061.53	\$ 1,358,132.10
18	Capital Expansion Reserve	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00
19	Capital Replacement Reserve	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00
20	Total Recommended Reserves	\$ 11,382,499.81	\$ 11,880,985.81	\$ 13,514,406.20	\$ 12,977,456.23	\$ 11,596,246.11	\$ 11,832,528.41
21	Fund Balance Over/(Under) Target	\$ 3,631,950.80	\$ 793,464.80	\$ (4,814,955.59)	\$ (6,623,005.62)	\$ (4,626,795.50)	\$ (3,568,077.80)
22	(Use)/Replacement of Reserves	\$ (515,810.39)	\$ (2,340,000.00)	\$ (3,975,000.00)	\$ (2,345,000.00)	\$ 615,000.00	\$ 1,295,000.00

Footnote: (Use)/Replacement of Reserves – A negative value indicates use of reserves required to offset total expenses. A positive value indicates replenishment of reserves based on revenues exceeding expenses.

The following chart represents a monthly sewer rate comparison for PA's before and after the FY 2019 proposed rate increase. With the rate increase for FY 2019, National City would still have the lowest sewer rate among all cities in San Diego County.

