



MAYOR & COUNCIL MEMORANDUM

September 25, 2024

Subject: Overview of Tucson Water's Five-Year Financial Plan and Proposal of FY 2025 through FY 2027 Adjustment of Water Supply Fee and Commercial and Industrial Water Rate Schedule (City Wide and Outside City)

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Issue – Time is reserved in Study Session for staff to update Mayor and Council on the proposed Tucson Water financial plan and proposed adjustment to the water supply fee and commercial and industrial volumetric rates.

City Manager's Office Recommendation – Staff will present an overview of Tucson Water's updated five-year financial plan ahead of Mayor and Council's consideration of a Notice of Intent to adjust the Water Supply Fee, along with the proposed increase to Commercial and Industrial volumetric rates during this evening's Regular Session.

Present Considerations – Tucson Water reviews and updates its five-year financial plan annually to ensure the utility meets its revenue requirements. On September 11, the Mayor and Council approved the updated FY25-29 financial plan including an adjustment to the Water Supply Fee and an increase to the Commercial and Industrial volumetric rates to align with the previously approved 5.5% rate increases.

Tucson Water's Five-Year Financial Plan Overview

Tucson Water's updated FY25-FY29 Financial Plan (Attachment A) provides an overview of Water's projected revenues, operating, capital, and debt service requirements. The recommended Plan will allow Tucson Water to meet its financial obligations, maintain regulatory compliance, and ensure public health and safety.

In January 2023, the Mayor and Council approved a 5.5% revenue increase for FY24-FY27. Following this, in October 2023, they adjusted the commercial and industrial summer surcharge, applying the rate change only for FY24. The recommended plan extends these commercial and industrial rate adjustments to FY25-FY27, aligning them with initially approved 5.5% annual increases. The revenue forecast has been updated to reflect recent consumption trends and includes removing consumption charges of isolated system accounts. It also accounts for a one-time funding source for the sale of these isolated systems. Residential and duplex/triplex block rate revenue have been adjusted to recognize continued conservation by shifting more volume to lower blocks.

Expenditures have been forecasted from the FY25 adopted budget, with personnel costs expected to increase by 3% annually, and commodities and supplies by 1% annually. Additionally, CAP rates have been updated based on firm and provisional rates adopted by the Central Arizona Water Conservation District Board on June 4, 2024, with a 10% escalation and full allocation for CY26-CY29. The recommended plan includes the Water Supply Fee (previously the CAP and Water Supply surcharge) to be increased from \$1.00 per ccf to \$1.25 per ccf in FY25 and again in FY28 to \$1.50 per ccf to keep pace with the projected increased CAP costs.

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The Capital Improvement Program (CIP) is a projection of Tucson Water’s capital funding requirements for planned capital projects from Fiscal Year 2025 through Fiscal Year 2029. The purpose of the CIP is to document planned Tucson Water projects and help integrate work with other local agency planning efforts. The CIP covers several critical projects including the Northwest Wellhead, Old Vail reservoir and booster station, Tres Rios Reclaimed Water project, upgrades to CAVSARP Facilities Phases I-III, AMI Phases 1& 2, and the Randolph PFAS Treatment Plant.

Debt service has been updated to reflect the recent WIFA loans and a planned \$75 million revenue obligation debt issuance this fall. The city remains committed to flattening the debt service curve to ease the pressure on future rate increases.

Water Supply Fee

In January 2023, the Water Supply Fee (formerly CAP Surcharge) was adjusted from \$0.70 to \$1.00. As part of Tucson Water’s annual financial plan update, CAP cost projections have been updated based on new rates published by the Central Arizona Water Conservation District on June 4, 2024. Staff has included an additional 10% escalation to these rates due to current volatility in CAP rates due to evolving river and drought conditions. Based on this updated forecast, annual CAP costs are projected to outpace projected revenues recovered through the Water Supply Fee. The projection of CAP costs versus revenues is as outlined:

Annual CAP Cost versus Water Supply Fee Revenue Projection

Fiscal Year	Projected Cost	Keep Water Supply Fee at \$1.00	
		Revenue @ @1.00/Ccf	Annual Net (Deficit)/Surplus
FY25	\$ 40,733,958	\$ 35,351,094	\$ (5,382,864)
FY26	\$ 45,348,070	\$ 35,503,857	\$ (9,844,213)
FY27	\$ 48,376,081	\$ 35,647,568	\$ (12,728,513)
FY28	\$ 49,817,991	\$ 35,833,551	\$ (13,984,440)
FY29	\$ 52,125,047	\$ 36,020,797	\$ (16,104,250)
FY30	\$ 54,360,007	\$ 36,209,316	\$ (18,150,691)
			\$ (76,194,971)

To keep pace with escalating costs, the recommended financial plan includes the Water Supply Fee to be increased from \$1.00 per ccf to \$1.25 per ccf in FY25 and again in FY28 to \$1.50 per ccf. The projected annual revenue associated with these increases compared to the CAP cost is as outlined:

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Annual CAP Cost versus Water Supply Fee Revenue Projection with Rate Increases

Fiscal Year	Projected Cost	Increase Water Supply Fee in Mid FY25 to \$1.25 and FY28 to \$1.50	
		Revenue @ \$1.25 & \$1.50	Annual Net (Deficit)/Surplus
FY25	\$ 40,733,958	\$ 39,769,981	\$ (963,977)
FY26	\$ 45,348,070	\$ 44,379,822	\$ (968,248)
FY27	\$ 48,376,081	\$ 44,559,460	\$ (3,816,621)
FY28	\$ 49,817,991	\$ 53,750,327	\$ 3,932,336
FY29	\$ 52,125,047	\$ 54,031,196	\$ 1,906,149
FY30	\$ 54,360,007	\$ 54,313,974	\$ (46,033)
			\$ 43,606

The above cost projections are based on Tucson Water ordering its full 144,191 AF allocation of CAP water.

Commercial & Industrial Rates

During 2023, the Mayor and Council also asked Tucson Water staff to develop a recommendation for rate-based adjustments for the Commercial and Industrial classes that could serve to further encourage conservation within this rate class. Based on staff’s analysis and proposal, Mayor and Council formally adopted an adjustment to commercial and industrial rates that changed the definition of winter and summer periods. The winter period was adjusted from 6 to 3 months to calculate the winter average that is used as the consumption threshold for surcharges during the summer period. For commercial and industrial customers with greater seasonal variability in their water use, this change subjects a greater portion of their increased summer consumption to summer surcharges, thus encouraging customers to conserve during summer months.

This change was developed to be revenue neutral meaning that, in the year implemented (FY24), the change would not generate revenue above and beyond what was outlined in the FY23-FY27 financial plan and the approved 5.5% increase for that year. For this reason, recognizing that the change would subject more consumption to the summer surcharges and generate additional revenue, the base rate for both classes was adjusted to go into effect in March FY24. The base rate adjustment for Commercial and Industrial customers was adopted by Mayor and Council for FY24 only.

As part of the financial plan update, the Commercial and Industrial rate changes that were adopted by Mayor and Council have been incorporated into the plan. At the time of adoption only the FY24 volumetric rate for these classes was adopted. Tucson Water staff now recommend that the Commercial and Industrial rates should be adjusted for FY25-FY27 based on the previously approved annual increases for all rate classes. These changes will help ensure that Commercial and Industrial rates are recovering their allocated share of costs over the FY25-FY27 period the same as the other rate classes who already had their rates increased on July 1, 2024, and will see additional increases each year through FY27 as approved by Mayor and Council in January 2023.

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Legal Considerations – The attached rate schedule to be considered in connection with the proposed water rate increases conforms to the requirements of State law.

Respectfully submitted,



Timothy M. Thomure, P.E., ENV SP
City Manager

TT/JK/sma

Attachment(s): A – Tucson Water Five-Year Financial Plan