



2012-2014 WATER RATE ISSUES

Seattle Public Utilities and Neighborhoods (SPUN) Committee July 26, 2011

PROPOSED REVENUES, SERVICES, BILLS, AND RATES.

- **Rate Revenues.** The proposal includes new water rates for 2012, 2013 and 2014.
 - o Seattle Public Utilities (SPU) proposes to collect \$35 million more in retail rate revenue in 2014 than was planned for 2011, as shown below:

<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
\$154M	\$160M	\$173M	\$189M

- **Drivers of the Increase.** Although no new categories of services are proposed, the need for additional revenue and increased rates is attributable to the following factors:
 - o **Expenses.** Proposed rates include increases (for inflation, COLA, etc) to continue base services, and up to \$1.1M/year of new operations and maintenance (O&M) costs for expansion of certain services.
 - o **Financial policies.** Proposed rates meet Water Fund financial policies, which resulted in a \$11.5M increase to meet the debt service coverage (DSC) policy. This DSC-related increase is largely due to SPU’s 2008 refinancing of its variable rate debt after submittal of the last rate proposal. The refinancing added \$93M to the amount used to calculate DSC.
 - o **Revenue shortfalls.** Revenues are down due to the recession and lower water use by customers, requiring rates (the charge per unit of water) to increase to cover water system costs.
 - o **Workforce.** The proposal would neither increase or decrease SPU’s current workforce.
- **Bills.** Bills are what customers pay based largely on how much water they use and the size of their water meter.
 - o Effects of the proposed rates on typical monthly bills for a sample of customers are:

	2011	2012	'11-'12 diff \$	'11-'12 diff %	2013	'12-'13 diff \$	'12-'13 diff %	2014	'12-'13 diff \$	'12-'13 diff %
Single family	\$31.70	\$34.12	\$2.41	7.6%	\$36.79	\$2.68	7.9%	\$39.71	\$2.91	7.9%
Convenience store	\$92.81	\$102.86	\$10.06	10.8%	\$114.12	\$11.26	10.9%	\$126.60	\$12.48	10.9%
Apartment building	\$253	\$282	\$30	11.8%	\$316	\$33	11.7%	\$353	\$37	11.7%
Downtown hotel	\$2,823	\$3,137	\$314	11.1%	\$3,489	\$351	11.2%	\$3,879	\$390	11.2%

- o The 2011 single-family bill shown above assumes 5.5 ccf of water use. SPU has reduced its estimate of typical single family usage to 5 ccf for 2012 through 2014. If 5.5 ccf were used for all years, typical bill increases would be \$2.68 in 2012, \$2.98 in 2013 and \$3.25 in 2014.
- **Retail Rates.** A rate is the charge for each unit of service, contrasted with a bill, which is what a customer pays based on how much service they use.

- o Retail rates allocate costs to four classes of customers: residential, general service (businesses, apartments, etc), private fire and public fire. Most costs are assigned to residential and general service customers. The rate structure for those two customer classes is similar, with:
 - A base charge that varies by meter size and is charged even when no water is used,
 - A charge for each unit of water (called a commodity charge) that includes:
 - Non-peak season charges that are the same for residential and general service customers, and
 - Peak summer season charges that include a single general service rate, and a three-tiered residential rate designed to discourage excessive landscape watering, with the second-tier equal to the general service peak season rate.

These rate components are proposed to increase at different rates. For the base charge, a 0% per year increase is proposed for the larger meters, with charges for smaller meters increasing from 1% to 2% per year. For the commodity charge, off-peak, general service peak, and residential second-tier peak charges would increase around 12% per year. Residential first-tier peak rates would increase about 10% per year and third-tier rates would have no increase.

- o When all the components of the rate for different customer groups are blended together, the average systemwide rate would increase 9.3% in 2012, 9.5% in 2013 and 9.6% in 2014.
- **Wholesale Rates.** Distribution of costs to wholesale customers is governed by contract and wholesale rate increases are lower than retail increases. For example, rates for most wholesale customers would increase by about 18% over the three-year rate period.

POTENTIAL ISSUES. The rate proposal incorporates many services that have been endorsed by past Council action. However to promote equitable rates and cost-effective services, the Committee could consider the following issues:

Issue 1. Base services.

- A. SPU-proposed cuts:** Does Council agree with SPU’s choices of base O&M activities that are cut or reduced in the rate proposal?
- C. Mismatch between rates and proposed budget:** Are assumptions for base costs such as health care, COLAs, non-labor inflation, retirement and Central City costs higher in the rate proposal than in the proposed 2012 budget? If so, should rates be reduced to reflect the lower budget costs?
- D. Further cuts - specific:** Should specific non-essential services be cut or reduced?
- E. Further cuts - general:** In addition to the SPU-proposed cuts, should top-down reductions in base services be explored? For example, should direction be given to reduce costs by X% or \$Y,

perhaps targeting recently added services or specific categories of spending such as contracts?

Issue 2: New O&M Expenses

- A. Deferred maintenance (BIP 101):** Should funding be increased up to \$363k/year for deferred maintenance? Deferred maintenance funding was increased as part of the 2009-2011 rates, but SPU decided to cut most of that activity when revenue shortfalls occurred. If this has been a low SPU priority, can it be reduced or delayed for this rate period as well?
- B. Watermain condition assessment (BIP 102):** Since SPU has successfully used other methods to assess watermain conditions up to now, can this up to \$150k/year pilot project be delayed until the next rate period?
- C. Shared Fund fuel costs (BIP 106):** Is the \$256k/year that was added for fuel cost increases based on unduly high gas price assumptions? Would more recent gas price projections or CBO budget assumptions be lower?
- D. Morse Lake Temporary Pumping Plant (BIP 302):** Is an added \$260k/year needed for Morse Lake channel dredging and temporary pump maintenance? Periodic dredging has always been part of reservoir operations and recent rate studies did not request new money to do this long-standing task. Should these costs be part of base service costs?

Issue 3: Capital Program

- A. Morse Lake Long-Term Pump Project:** Rates assumed the more expensive of two project alternatives. Should the less expensive alternative be assumed or should rates split the difference?
- B. Accomplishment rate** Is an 85% accomplishment rate realistic? Water Fund CIP spending was 105% in 2008, 77% in 2009, and 67% in 2010.
- C. Shared cost projects** Does the rate proposal overestimate the pace or size of large projects (such as road or light rail projects) controlled by other departments or agencies?
- D. Other capital projects** Is it essential to pursue all capital projects at the proposed scope and schedule? Could some projects be reduced or delayed, perhaps delaying or reducing the new bond issuance and the debt service coverage associated with it?

Issue 4: Demand/Financial

- A. Demand projections:** Does Council agree with SPU’s projected continuing decrease in water demand? Should CBO and SPU economic assumptions that drive demand (i.e. employment growth) be the same, instead of SPU’s employment growth assumptions being 50% lower?
- B. CIP cash contribution:** Should the extra revenue collected to meet the DSC policy be used to increase the cash contribution to the capital program as proposed by SPU, or for some other purpose such as increasing RSF balances?
- C. Tap fees** Does Council agree with SPU’s level of projected tap fees, which is based on the proposal’s assumption that very low levels of new development will continue?

Issue 5: Utility tax rate. Should City utility tax rates be the same for water, drainage, wastewater, and solid waste? City utility taxes are 15.54% for water and 12% or 11.5% for the other SPU services.

ITEMS FOR COMMITTEE ATTENTION.

The following actions and assumptions in the rate proposal should be considered in Committee deliberations, but do not necessarily represent issues that warrant a Council action to change proposed rates. These items include:

General Subfund (GSF) Impacts of Rate Reductions. The proposed 2012 budget will assume added GSF revenues from utility taxes generated by higher rates. If rate increases are reduced by Council, utility taxes to the GSF also will be reduced. For every 1% reduction in the water revenue requirement, 2012 GSF revenues would be decreased \$250,000.

Revenue Stabilization Fund (RSF). The RSF is designed to be tapped in the case of substantial revenue shortfalls due to droughts and other extraordinary events. Although SPU analysis suggests that a higher minimum RSF balance may be needed during a moderate drought, it proposes to maintain the minimum \$9 million balance during this rate period, supplemented by interest deposits totaling \$298,000 over the three-year rate period.

Other Budget Issue Paper (BIP)-Added Costs. The rate proposal incorporates new O&M costs that will be added to the proposed 2012 budget but are not identified as issues in this paper. Shared Fleet Reductions (BIP 100) reduces SPU fleet costs by about \$11,000 per year. CCSS Purge and Archive (BIP 300) would add \$200,000 for 2012 only to add an archiving and purge capability to the billing system, allowing the system to run faster and customer service representatives to provide faster service. Hatchery decommissioning (BIP 301) adds up to \$225,000 per year for removing the temporary hatchery and restoring habitat as required by King County permits.

Rate Design and Smoothing. SPU's rate proposal maintains the same rate design (method for allocating costs among customers) as in the last rate study. SPU also chose to submit rate increases that are fairly evenly distributed across the three-year period. Other options for the increases could have front-loaded the rate increase (with first year increases of as much as 18%) or back-loaded increases (with 2014 increases of as much as 14%).

Workforce Succession. SPU proposes to hire no new Water Pipe Worker apprentices until late 2012 because jobs may not be available at the end of the 2-year training period due to revenue constraints and a reduced Water Fund work load. In contrast, the Drainage and Wastewater Fund work load is expanding and up to 13 apprentices are planned to be hired in early 2012.

Workforce Efficiencies. The rate proposal includes the \$500,000 in cuts to address the span of control concerns in 2011-2012 Green Sheet 4-1-A-1. Although SPU is pursuing the other workforce efficiencies (including multi-skill job classes) addressed in their response to 2011-2012 Statement of Legislative Intent (SLI) 12-1-A-1, savings from those actions were not included in the rate proposal because of the long lead time to implement new approaches.

Affordability and Low-income Assistance. With the rate increase, typical residential bills would represent less than 1 percent of the state median household income. Despite recent expansion of eligibility for 50% low-income rate discounts, the rate proposal assumes that enrollment of eligible customers will remain relatively low. SPU says that they assumed an enrollment of about 4,700 (out of over 16,000 enrolled for City Light and SPU programs combined) but that low number needs confirmation. Those low-income customers not receiving rate discounts will have the most difficulty paying increased rates.