



DEPARTMENT OF PUBLIC WORKS

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November 16, 2012

To: Mayor Kelli Linville
City Council

Fr: Ted Carlson, Public Works Director

Cc: John Carter, Finance Director

Re: Utility Rates - Responses to Council Questions

During the staff presentation on November 5, 2012, and in subsequent correspondence, several Councilmembers have submitted questions and asked for additional information related to the rate studies. This memo is intended to address these questions and provide additional information prior to the Public Hearing on Monday, November 19.

Question – What is the difference between reserves proposed in the rate studies, based on 45 or 60 day operating cost, and City policy?

Council expressed concern that the rate study is proposing to change the existing Council policies related to required reserve levels. The rate study was prepared using the City's Financial Management Guidelines and is consistent with City policy on reserves, however FSCG used a different approach and terminology to arrive at a comparable total dollar amount.

City policies for designated reserves are based on the Council policy contained in the 2010 Financial Management Guidelines adopted by Resolution #2010-17. As stated in the Guidelines the City's goal is to be sufficiently strong financially to:

- Sustain essential services
- Withstand local and regional economic impacts
- Ensure the timely payment of all fiscal impacts
- Provide resources adequate to pay for unanticipated emergencies
- Meet all debt covenants
- Maintain Financial benchmarks.

In the context of the Guidelines the minimum designated reserve is an absolute minimum. ***“When a fund reserve falls below its minimum standard, the Mayor shall be required to present to the Council within 60 days, a Financial Plan that will restore the fund reserve balance to the minimum standard within the shortest period feasible or in no case longer than three Budget years.” (Fin. Mgmt. Guidelines., pp. 9)***

Designated reserves are specifically set aside to ensure the basic financial security of the utility. Designated reserves in enterprise utility funds (Water, Sewer, Storm and Surface Water) are intended for the following purposes:

- Bond requirements and credit rating
- Emergencies - City is self-insured and needs funds on hand to account for risks or damage caused by the utility
- Catastrophic failures
- Unanticipated capital expenditures -- acquisitions, developments, regulatory changes

For the enterprise utility funds (Water, Sewer, and Storm and Surface Water) both minimum designated reserves and target designated reserves are set. Minimum designated reserves are the basic requirement but may not be sufficient to meet the City's overall long-term financial goals. Target designated reserves are intended to meet the long-term goals of the City as outlined in the guidelines.

As stated in the financial management guidelines designated reserves shall be:

1. Target: 5% of current year budgeted Operating Expenditures plus 10% of its total budgeted five year capital plan
AND
2. Minimum: 5% of current year budgeted Operating Expenditures plus highest annual debt service (D/S) payment plus \$1 million in water and sewer; plus \$400k in storm and surface water.

The rate studies conducted by FCSG consider the reserve requirements set by the Council. The revenue requirements in the modeling are based on meeting the designated reserve targets (dollar amount) by the end of the study period. While the FCSG terminology and percentages vary from the total dollar amounts for the designated reserves, they are comparable to City target reserves in the long-term. The table below compares the City Council designated reserve targets and minimums with the modeling approach used by FCSG.

WATER	2013 Draft Budget	2013 Minimum*	2013 Target*	2013 FCSG	2018 FCSG
RESERVE - DESIGNATED	\$ 2,314,571				
5% Operating Budget		\$ 1,018,087	\$ 1,018,087		
\$1M Capital		\$ 1,000,000			
10% of 5-year Capital	\$ -		\$ 5,303,169		
Operating - 30:60 Days	\$ -			\$ 1,673,568	\$ 3,347,136
Capital Fund (1%)				\$ 1,700,000	\$ 1,700,000
RESERVE - DEBT	\$ 1,866,752	\$ 1,866,752	\$ 1,866,752	\$ 1,866,752	\$ 1,866,752
TOTAL	\$ 4,181,323	\$ 3,884,839	\$ 8,188,008	\$ 5,240,320	\$ 6,913,888
SEWER	2013 Draft Budget	2013 Minimum*	2013 Target*	2013 FCSG	2018 FCSG
RESERVE - DESIGNATED	\$ 3,377,072				
5% Operating Budget		\$ 949,722	\$ 949,722		
\$1M - Capital		\$ 1,000,000			
10% of 5-year Capital			\$ 6,910,000		
Operating - 30:60 Days				\$ 1,561,187	\$ 3,122,373
Capital Fund (1%)				\$ 1,500,000	\$ 1,500,000
RESERVE - DEBT	\$ 4,451,812	\$ 4,451,812	\$ 4,451,812	\$ 4,451,812	\$ 4,451,812
TOTAL	\$ 7,828,884	\$ 6,401,534	\$ 12,311,534	\$ 7,512,999	\$ 9,074,185
SSW	2013 Draft Budget	2013 Minimum*	2013 Target*	2013 FCSG	2018 FCSG
RESERVE - DESIGNATED	\$ 495,000				
5% Operating Budget		\$ 284,564	\$ 284,564		
\$400K Capital		\$ 400,000			
10% of 5-year Capital			\$ 834,634		
Operating - 45 Days				\$ 701,664	\$ 701,664
Capital Fund (1%)				\$ 450,000	\$ 450,000
RESERVE - DEBT	\$ -	\$ -	\$ -	\$ -	\$ -
TOTAL	\$ 495,000	\$ 684,564	\$ 1,119,198	\$ 1,151,664	\$ 1,151,664

* City of Bellingham Financial Guidelines, August 2010

As shown in the table, with the exception of the Storm and Surface Water Utility, designated reserves are at the City **minimum** levels. The proposed rate increase in Storm and Surface Water will bring the designated reserve in line with the minimum reserve. The proposed rate structure will bring the designated reserves closer to the Council established **targets** over the next six years. Note that the FCSG recommended total reserve is greater than the City minimum but comparable to the City target.

By using a different reserve calculation in the financial modeling, the FCSG study justifies the Council policy on the total target designated reserve requirement. However, the modeling suggests a need to consider the approach to establishing the reserve levels. For example, the current policy looks at 5 years of future capital projects. Designated reserves based on the 5-year future plan, may be skewed higher than needed in years with high dollar construction (such as the Post Point Treatment Plant project). Using a percentage of total booked asset value would normalize the reserve target over a longer historic period, be easier to calculate and not subject to short-term variations in construction cost.

Also, it may be appropriate to reconsider the target reserve criteria in storm and surface water as additional capital projects move forward and new debt service is acquired. A target in Storm and Surface Water comparable to Water and Sewer may be worth considering.

Operating at minimum designated reserve levels leaves very few options for addressing unanticipated expenses. In recent years, we have had to reduce annual main replacement spending by several hundred thousand dollars to address, failures in the diversion pipeline, water quality issues at Marietta Reservoir, and a major water main break under I-5. These are "routine" emergencies, larger emergencies would be much more challenging. Without adequate reserves, these expenditures can have a major impact on our ability to reinvest in the system.

Overall, reserve levels have a relatively minor impact on the overall rates. For example, using a minimum capital reserve of \$1 million and an operating reserve of 10% has no impact on the rates in the first two years and a 1% reduction in years 2016 and 2017.

Question – What is the cost impact of adding an annual capital project or acquisition expense of \$350,000 to the water fund for Lake Whatcom?

An additional \$350k for capital increases the revenue requirement at least an additional 2.5% annually over the six-year period. Minimum reserve requirements would also increase.

Question –How does the rate structure provide for capital replacement of existing and future infrastructure?

The rate structure incorporates an annual funding level for infrastructure replacement based on 50% percent of annual depreciation at the end of the study period. This is a generally accepted practice in the utility industry for establishing a replacement funding benchmark. Use of system development charges are generally limited to capital expansion and upgrade of the system and not used to replace existing infrastructure. In reality, many projects have components of expansion, upgrade and replacement, and are funded through a combination of rates and system development charges (i.e. Wastewater Treatment Plant).

Question – Can current Autopay customers move now to a monthly billing?

Staff strongly supports the eventual move towards a monthly billing system. Customers currently using the autopay option can choose voluntarily to pay in advance for service by a fixed amount and pay the balance when the actual bill is sent. Customers desiring to do this should contact the Finance Department. The City-wide shift to mandatory monthly billing requires additional effort and careful planning, as it will require a fundamental change in operations and additional staff.

Question – What is the long-term plan for utility rate planning?

Utility planning looks at long-term planning, 20-year + planning, 6-year capital project schedules, and 2 year budgets. The rate study falls in the 6-year capital project schedule. If the revenue model and assumptions in the study are correct another comprehensive rate study will be needed in 2018. One of the risks associated with moving to a metered water utility system is the possibility that the revenue generated from metered consumption will be less than required as people use less water. Checks on the predicted and actual revenue will be conducted annually. If intermediate adjustments are needed, staff will provide recommendations concurrently with the budgeting process.

In the next two years and in preparing for the 2015-2016 budget staff will do the following:

- Compare predicted vs. actual revenues –affected by growth, actual consumption etc.
- Compare estimated vs. actual project costs
- Plan (possibly implement monthly billing)
- Evaluate source control and conservation methods (note that some high strength or high volume users may be motivated to reduce demand to reduce their utility bill)
- Collect data from a wider range of metered residential users

In the first quarter of 2013, staff will prepare recommendations for adjustments to the System Developments Charges for Council consideration early in the second quarter. As part of the process, staff will meet with building industry representatives for input and will consider options for economic development through credits or incentives. A Council work session late in the 1st quarter of 2013 may be appropriate.

Question – How can meters be used to promote conservation and can a single family user be billed for sewer consumption based on volume?

Tiered water rates are often used to promote conservation. In many cases utilities include a minimal fixed amount (i.e. 3ccf) of water in the base charge and then charge higher rates at higher consumption levels (i.e. at 6 ccf, 10 ccf etc.) Some utilities include seasonal adjustment for flat rate single family sewer customers.

The installation of meters will assist in developing the data set necessary to rationally apply a tiered rate structure based on consumption. However, it may take several years to collect sufficient data from the Bellingham area to accomplish this. Without this historic data, the proposed rate structure uses a base charge with zero consumption followed by a consumption charge for each hundred cubic feet (ccf) of water used.

The metering of all city customers will roughly coincide with the end of the rate study period. It is assumed that the next rate study will have sufficient data to consider a conservation based rate structures using tiered, block and seasonal rates.

Question –Why is the irrigation volume rate constant?

The rate study is based on a cost of service analysis. As demand from dedicated irrigation meters has significantly dropped, the percentage of revenue and the corresponding cost of service has also dropped. Accordingly, the volume rate in the rate study report was held constant to reflect this reduction in cost of service over the 6-year period.

In the draft ordinances staff proposes to increase the dedicated irrigation services volume rate by approximately 2% annually. The increase is less than the 6-8% increase for other customers, thereby reflecting the lower cost of service, but increases the cost of irrigation for conservation purposes.

Question – Why abandon the high vs. low volume rates in lieu of the untreated water rate?

Historically the untreated high and low volume rate was used primarily by the Georgia Pacific facility. The infrastructure is in place to provide the water, but a user consuming a comparable amount of water is unlikely to come forward in the near future. Nor is it likely that a high volume user would be willing to pay the high base charge (5x the comparable commercial user for treated water) needed to offset the low volume charge currently in the code. The proposed rates charge 80% of the base meter charge and 80% of the volume rates based on the non-residential rates to encourage use of this untreated water rather than treated water.

Question – How many units are in the example below and how would individual meters change the cost?

Apartment Building - 29,000 imp. sf (1" Meter, Monthly Usage: 25 ccf)	2012	2013	2014	2015	2016	2017	2018
Water Bill	\$82.70	\$88.60	\$93.80	\$99.26	\$106.72	\$113.03	\$119.57
Watershed Surcharge	21.00	21.63	21.98	22.35	23.26	23.92	24.59
Total Water Bill	\$103.70	\$110.23	\$115.78	\$121.61	\$129.98	\$136.95	\$144.16
Sewer Bill	92.56	103.50	114.29	122.07	131.78	140.26	146.35
Stormwater	67.57	81.76	86.67	91.87	97.38	103.22	106.32
Total Water/Sewer/Stormwater Bill	\$263.83	\$295.49	\$316.74	\$335.55	\$359.14	\$380.43	\$396.83
Change From Prior Year		\$31.66	\$21.25	\$18.81	\$23.59	\$21.29	\$16.40
% Change From Prior Year		12.0%	7.2%	5.9%	7.0%	5.9%	4.3%

This example is based on an assumed 4 unit building with a single 1-inch master meter and no irrigation meter. Assuming each unit is separately metered with a 5/8 x 3/4 inch meter, the 2013 monthly bill based on 25 ccf would be as follows:

Water (4 x \$13.10/meter*25ccf*\$1.58/ccf)	= \$91.9
Watershed (4*\$12/meter)	= \$48.00
Sewer (4*\$33.97/month)	= \$135.88
Stormwater (29,000sqft*\$0.00281/sqft)	= \$81.76
Total	= \$398.14

In addition, at the time of connection the separate, individually metered units would pay approximately \$3,963/ea. (total of \$15,852) for water system development fees versus \$9,908 for a single master meter. (based on 2012 charges plus 3%)

Comments on Lake Whatcom Watershed surcharge

A few structural changes related to metered vs. unmetered accounts are appropriate and are proposed in the redline ordinances. Council policy on how revenues are spent, capital project needs, schedule and property acquisitions are separate from the rate increases proposed. It is recommended that a Council work session be conducted early in 2013 to discuss issues related to the watershed surcharge.