



UTILITIES COMMITTEE
SEPTEMBER 8, 2017
4:00 P.M.
COUNCIL CHAMBERS

1. **AFRICAN CLAWED FROG – COLLEGE STORM FACILITY UPDATE**
DOUG CHRISTENSON
(VERBAL – PRESENTATION)

2. **2018-2019 WATER RATE RECOMMENDATION**
TROY WOO, FINANCE DIRECTOR
(STAFF REPORT ATTACHED)



UTILITIES COMMITTEE
September 8, 2017

SUBJECT: Review Water rate increases for 2018 and 2019

RECOMMENDATION: The 2018 Proposed Budget assumes a three (3.0) percent Water service rate increase.

STAFF CONTACT: Scott Spence, City Manager *SS*
Troy Woo, Finance Director *TW*

ORIGINATED BY: Troy Woo, Finance Department

ATTACHMENTS:

FISCAL NOTE:

PRIOR REVIEW: First Review.

BACKGROUND:

The City Council adopted Ordinance No. 1402 establishing the current water rate schedule. 2017 is the final year of the adopted rate schedule. The next scheduled update of the water comprehensive plan will begin in 2018 and is expected to be a two-year project. Based on City Council guidance provided during the 2017 Budget process, staff is developing a two-year rate recommendation until the comprehensive plan can be updated and contemplate a long-term rate schedule. This short-term model uses an average cost methodology rather than a more detailed line-by-line item analysis that is typically performed in a full Comprehensive Plan update.

The current rate schedule (2013-2017) was developed based upon the following fiscal policies:

- Operating reserve level of 60-90 days
- Capital reserve equal to 1.0 percent of the existing plant asset valuation
- Debt to equity ratio not to exceed of 50.0 percent
- Growth escalator of 1.25 percent

- A capital improvement plan that is limited to essential projects (other capital projects are deferred)
- Maintain current rate structure, low-income discounts, and outside City multiplier

The 2018-2019 rate model maintains the same policies.

A combination of a recovering economy and a conservative approach to financial planning has resulted in the improvement to the financial condition of the Water Fund. Stronger than expected growth, delayed General Fund indirect cost plan implementation, slower than planned capital project construction, and two fewer debt issuances than planned for in the comprehensive plan have had positive impacts to the utility's fund balance. These results will give the utility more flexibility and less of a financial burden on the ratepayers.

Significant assumptions of the staff developed 2018-2019 water rate model include:

- Historic increases for operational and maintenance expenses including labor
- No debt issuance required
- \$12 million two-year capital improvement program (2018-2019)
- Average development levels rather than recent higher levels
- Maintains fireflow utility tax despite State Legislative fix to the Lane v. City of City court ruling
- 2018 implementation of the City General Fund indirect cost plan
- No consideration for the proposed septic to sewer conversion program

The proposed water financial model includes a three (3.0) percent inflationary increase. A three percent increase maintains the cost recovery approach for operations and maintenance and maintains the historic capital improvement program funding level. Analysis shows that aforementioned recent financial conditions have resulted in an increase to reserves during the current rate schedule. This provides an option for zero percent increases for 2018 and 2019 without creating significant setback or harm to the overall financial condition of the water utility. The annual capital improvement contribution could be lowered to allow a larger portion of the rate revenues to fund operations and maintenance, while the proposed 2018 and 2019 capital improvements be funded with one-time reserves.

There are sound reasons supporting both approaches. Support for continuing inflationary rate increases includes:

1. Steady and consistent rate increases can provide a higher probability for debt avoidance. Funding for the capital improvement program is the primary reason for the rate increases within the current water rate schedule. The current comprehensive plan projected three separate revenue bond issues to fund the capital improvement program. Higher than projected water sales and general facility charges and slower than expected expenditures has allowed for a pay as you go approach, so two of the projected debt financings were unnecessary. Funding the capital improvement program projects with cash can save significant interest expense. In 2013, the Water

Fund issued \$6,894,873 of Revenue Bonds. The scheduled interest to be paid by the Water Fund over the 20-year repayment period is \$3,150,324.

2. Planning can be easier for both utility customers and the utility if rate increases are more consistent and predictable. The current comprehensive plan provided level rate increases as opposed to fluctuating rate increases that were projected for cashflow purposes. In addition, consistent rate increases can avoid potential higher “catch-up” rate increases and maintain the gains of the compounding impact of consistent rate increases, which in the long-term keeps future rate increases lower.

Support to suspend rate increases until a full rate analysis is performed as part of the next water comprehensive plan update includes:

1. The City Council has placed a higher priority on affordable housing through development standards, building codes, development fees, and award of community development block grants. The cost of a basic need like water is a consideration of affordable housing. A two-year suspension of water rate increases could provide short-term financial relief for distressed households.
2. The City’s Wastewater and Stormwater rates have approved increases scheduled through 2019. The LOTT Board recently approved a 2018 rate increase. A temporary suspension water rate increases will help lessen the cumulative effect of utility rate increases.

A 3.0 percent increase to the 2018 residential water service charge is equal to \$0.95 per month (900 cubic feet). The following table illustrates the impact of a 3.0 percent increase for 2018 and 2019:

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Base Rate	\$ 14.28	\$ 15.21	\$ 15.67	\$ 16.14
Consumption	<u>15.50</u>	<u>16.51</u>	<u>17.01</u>	<u>17.52</u>
Total Monthly Charges	\$ 29.78	\$ 31.72	\$ 32.68	\$ 33.66

It is recommended that the Water General Facility Charge (GFC) continue to be increased 6.0 percent or by the Engineering News Record Construction Cost Index (ENR CCI), whichever is higher until the GFC reaches the comprehensive plan calculated level.

The Water Comprehensive Plan Update is expected to be completed by the end of 2019 and is expected to fully address the utility needs for the years 2020 through 2028.

City staff presented the same proposal to the Finance and Economic Development Committee on September 6. It is expected that the final recommendations will be discussed

with the full City Council at a Worksession in September or during the October 2018 Budget Workshop, so the rate recommendation can be incorporated into the proposed 2018 Budget. The public process will occur through the 2018 Budget public hearings that are scheduled for November and December.

ADVANTAGES:

1. Inflationary rate adjustments will help address future capital needs and the growing costs to produce and deliver quality water.
2. Any rate increase imposed in 2018 and 2019 will help lessen the expected future rate increase impacts.
3. Maintaining inflationary rate increases provides customers consistent and predictable rate increases for planning purposes.

DISADVANTAGES:

1. Deferring needed capital improvements or maintenance and ignoring operational and maintenance costs can occur when rates are kept artificially low. This can send the wrong message to customers, but staff does not believe this is the case during the next two-year period.
2. Using reserves to fund the 2018-2019 capital improvement program, reduces the water utility's financial flexibility to address emergencies, unexpected changes, and opportunities.