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## MEMORANDUM

Date: January 11, 2021

To: Ben Noble, Director, City Budget Office

From: Mami Hara, General Manager & CEO, Seattle Public Utilities

Subject: Proposed 2021-2026 Strategic Business Plan Rate Path and current SPU Financial Status

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### **Executive Summary**

This memo highlights the proposed rate path as part of the Seattle Public Utilities' (SPU) proposed 2021-2026 Strategic Business Plan and describes the utility's current financial status as we look to implement the plan. The proposed rate path averages 4.2% over the six-year term and is a 20% decrease from the prior adopted rate path. In addition to operations and maintenance, these rates fund capital projects - many of which are required under federal and state regulations - taxes, and other obligations. Overall, there are no substantial changes to the Utility's operations and capital program.

SPU is in sound financial shape and all of SPU's funds are financially strong, despite COVID-19 related financial stressors, allowing for SPU to support current and emerging needs. The proposed rates path includes significant reductions in SPU's annual costs. These cost containment and savings efforts help the Utility meet financial policy goals while preserving rate revenues that can be used to prevent rate volatility and smooth future rates. At the same time, SPU strives to enhance affordability and has developed several customer programs that offer significant support.

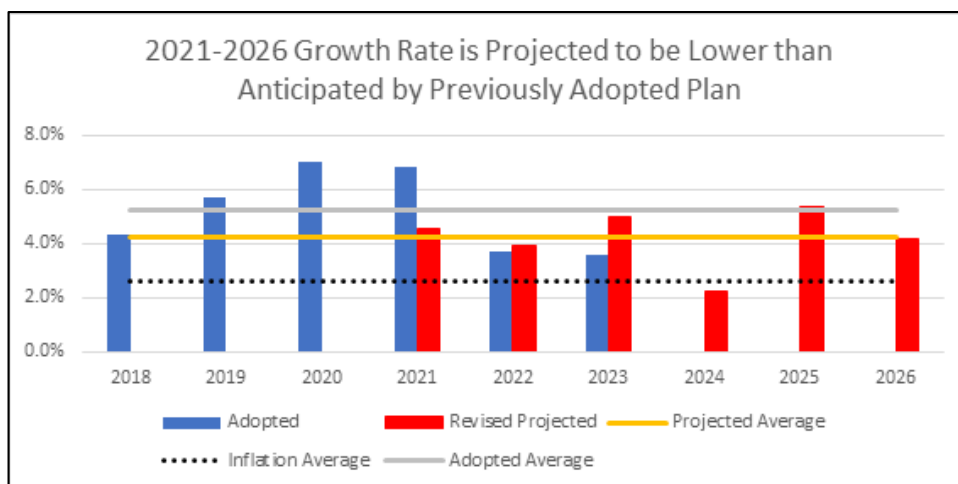
### **Strategic Business Plan Rate Path**

Seattle Public Utilities is proposing the new 2021-2026 Strategic Business Plan (SBP) to guide essential service delivery and a comprehensive business strategy for our three lines of business: drinking water, drainage and wastewater, and solid waste. The plan looks forward to the next six years (2021-2026) and provides a predictable three-year rate path to be adopted by City Council and projections for the subsequent three years.

	Rate Path			Rate Forecast			Average
	2021	2022	2023	2024	2025	2026	
Water	0.0%	2.7%	4.7%	3.6%	4.2%	5.5%	<b>3.4%</b>
Sewer	7.3%	3.1%	5.9%	0.5%	7.8%	3.6%	<b>4.7%</b>
Drainage	7.4%	8.6%	7.2%	3.9%	6.5%	6.7%	<b>6.7%</b>
Solid Waste	2.9%	2.9%	2.2%	2.3%	2.1%	2.1%	<b>2.4%</b>
<b>Combined</b>	<b>4.5%</b>	<b>3.9%</b>	<b>5.0%</b>	<b>2.2%</b>	<b>5.4%</b>	<b>4.2%</b>	<b>4.2%</b>

SPU deferred introducing the 2021-2026 SBP from 2020 until 2021 because of COVID and the pandemic impacts to the local and regional economies. SPU anticipates formally introducing the SBP in early 2021. For more information, please see the Timing Information in Appendix A.

The Proposed SBP calls for a substantially lower six-year rate path compared with projections from the last adopted 2018-2023 Strategic Business Plan. The proposed 2021-2026 rate path is a 20% decrease from the prior path -- specifically, from 5.2% to an overall annual rate increase of 4.2%, for the average six-year projection, as reflected in the below chart:



### Seattle Public Utilities’ Fiscal Health

Currently, SPU is in a good financial position and all of SPU’s funds are financially strong, in spite of the COVID-19 situation, which means that SPU is in an ideal position to support current and emerging needs. The tables below illustrate SPU’s forecast of 2020 year-end financial results, given current operations, revenues, and expenses through October. They indicate that SPU will meet or exceed its financial policies at year-end, and also show how SPU will meet its financial policies through 2026. Note especially SPU’s strong cash position.

### Financial Policies for All Funds

### Water Fund

(\$ in millions)	Target	2020	2021	2022	2023	2024	2025	2026
Debt Service Coverage	1.70x	1.90	1.73	1.70	1.70	1.89	1.75	1.70
Net Income	>\$0	\$39.7	\$33.5	\$33.1	\$35.4	\$40.4	\$32.9	\$34.1
Cash-to-CIP	>20%	53%	38%	40%	25%	28%	24%	27%
Cash Balance	\$34M in 2021, +\$1M/year	\$127.8	\$90.0	\$75.0	\$75.0	\$75.0	\$75.0	\$75.0
RSF Withdrawals*		\$0	\$0	\$0	\$0	\$0	\$0	\$0
Bond Issues		\$0	\$100.6	\$71.5	\$91.2	\$98.6	\$151.9	\$0
Debt Service		\$84.1	\$85.7	\$88.5	\$92.3	\$88.2	\$93.8	\$99.3
Consumption (ccf, mil)		26.5	26.4	26.4	26.3	26.2	26.0	25.9

\* Note: RSF is the Rate Stabilization Fund.

### Drainage and Wastewater Fund

(\$ in millions)	Target	2020	2021	2022	2023	2024	2025	2026
Debt Service Coverage	1.50x	2.89	2.00	2.01	1.91	1.72	1.56	1.55
Net Income	>\$0	\$42.0	\$48.0	\$57.4	\$60.8	\$57.7	\$48.6	\$40.6
Cash-to-CIP	25%	38%	53%	51%	43%	39%	25%	25%
Cash Balance	\$100M	\$186.8	\$140.4	\$97.7	\$98.7	\$101.6	\$110.3	\$112.9
Bond Issues		\$0	\$87.1	\$54.5	\$74.5	\$96.4	\$116.2	\$128.1
Debt Service		\$66.5	\$70.7	\$73.9	\$77.9	\$84.8	\$92.4	\$104.0
Consumption (ccf, mil)		20.7	21.2	21.2	21.2	21.2	21.2	21.2

### Solid Waste Fund

(\$ in millions)	Target	2020	2021	2022	2023	2024	2025	2026
Debt Service Coverage	1.50x	4.40	1.72	1.65	1.68	1.59	1.70	1.51
Net Income	>\$0	\$15.2	\$3.4	\$1.6	\$1.2	\$0	\$1.7	\$0
Cash-to-CIP	Greater of \$3.7M or 10% CIP	100%	100%	100%	100%	100%	100%	100%
Cash Balance	\$23M	\$84.2	\$58.5	\$40.2	\$40.0	\$48.1	\$58.6	\$67.4
RSF Withdrawals*		\$0	\$0	\$0	\$0	\$0	\$0	\$1.1
Debt Service		\$15.4	\$15.4	\$15.4	\$15.4	\$15.4	\$15.4	\$15.4

\* Note: RSF is the Rate Stabilization Fund.

Both Water and Drainage and Wastewater will be issuing debt multiple times over the course of the SBP period. The rating agencies (Standard & Poors and Moodys) actively monitor each fund’s financial performance and have expressed concern over the levels of liquidity. In an effort to prevent a downgrade that would result in higher interest rates and upon the advice of our financial advisor, the funds have internally adopted higher cash balances.

SPU takes a fiscally balanced approach to its financial policies and reserves. By maintaining sufficient reserves, SPU is better able to weather fluctuations in revenues and expenses and navigate financial uncertainty. These prudent practices protect our asset investments and benefit customers through the avoidance of extraordinary rate increases and volatility.

### **Delinquencies Due to COVID-19 and Customer Assistance**

The COVID-19 pandemic has impacted economies around the world, including Seattle. As a result, utilities are facing increasing ratepayer delinquencies and having to put forth additional financial support to help people weather this period, typically through the use of utility discount programs. To plan for and mitigate these occurrences, SPU monitors customer payment status on a monthly basis. For 2020, SPU has seen increases in its delinquencies (those accounts 90 days or more past due) as compared to its 2019 accounts receivable. It is important to compare these delinquencies to their associated revenues to show the nominal financial impact they are actually having on SPU cash flow.

#### **A/R Delinquencies (90+ days past due)**

<b>(\$ in Actuals)</b>	<b>October 2019</b>	<b>October 2020</b>	<b>Percent Change</b>	<b>As a % 2020 Revenue</b>
<b>Water Fund</b>	\$1,629,961	\$3,522,149	118%	1.2%
<b>Drainage/Wastewater</b>	\$762,015	\$2,529,354	232%	0.6%
<b>Solid Waste</b>	\$238,854	\$614,058	157%	0.3%

Enhancing ratepayer affordability is a primary goal for SPU, and we have several programs available to ratepayers that offer significant support during this difficult time. SPU provides a 50% credit on all qualifying customer bills as part of its Utility Discount Program (UDP). Recent modifications have expanded outreach to include an auto-enroll program, which was extended through the end of 2020. SPU also supports an Emergency Assistance Program that has been modified to provide relief for up to 50% of the bill two times per year instead of one, for qualifying individuals. The success of these programs can be measured through increased enrollment of 5,402 customers in 2020. Appendix B includes a comprehensive list of all of SPU’s affordability programs, including additional statistics on the UDP. Strong cash balances in the three Funds enable SPU to withstand this delayed cash flow through the end of the year.

### **Cost Containment Efforts and Savings**

The 2018-2023 Strategic Business Plan adopted a six-year rate path of 5.2%. Since that time, SPU has reduced annual costs in meaningful ways that have reduced costs in the short-term and long-term. Cost containment and savings efforts help the Utility meet financial policy goals and help preserve rate revenues that can be used to smooth future rates. Examples of our recent cost containment efforts and savings include:

- **Water Infrastructure Finance and Innovation Act Funding (WIFIA):** The Utility applied and was awarded a grant from the Federal government under the WIFIA program that offered low-interest rate financing for the Ship Canal Water Quality Project. This effort saved approximately \$66 million.
- **Washington State Revolving Fund (SRF).** The Drainage and Wastewater Fund secured a \$25M state revolving fund loan at a reduced interest rate, leading to estimated savings of \$6.4M over the life of the loan. SPU is in the process of securing additional low interest loans from the state.
- **Solid Waste Contracting:** The Utility worked to negotiate new Solid Waste contracts that provide garbage, yard waste, and recycling services. As a result, this effort saved the Utility \$5 million annually.
- **Planned underspending on operations and capital projects:** Since 2018, the Utility has been underspending on operations and CIP. For example, the Utility held more positions vacant than initially planned, a 4% projection compared to an annual average of 10%, providing vacancy savings. No new positions were added for 2021. Additionally, the CIP has been spending at slower rates than initially planned. After examining assumed capital spending in forecasts compared to actuals for the last several years, SPU reduced its financial accomplishment assumption for rate forecasts from 97.5% to 85%, which is a common industry benchmark, for most projects. SPU also coordinates with other City departments to achieve efficiencies where possible; for example, reducing costs of digging up and replacing streets to install pipes by collaborating with SDOT for timing (such as the Seattle and Waterfront projects). The underspending is the result of these and other drivers but has generated savings that affect both the short- and long-term. As a result, the Utility has been able to build up healthy cash balances that could be used to maintain a lower rate growth in the new Strategic Business Plan.
- **Implementing the Affordability and Accountability framework:** As part of the Utility effort to better partner operating and financial performance, the Utility developed and is implementing the Affordability and Accountability framework – a series of projects in each division to seek better efficiencies for the work we conduct as well as being accountable to the results.

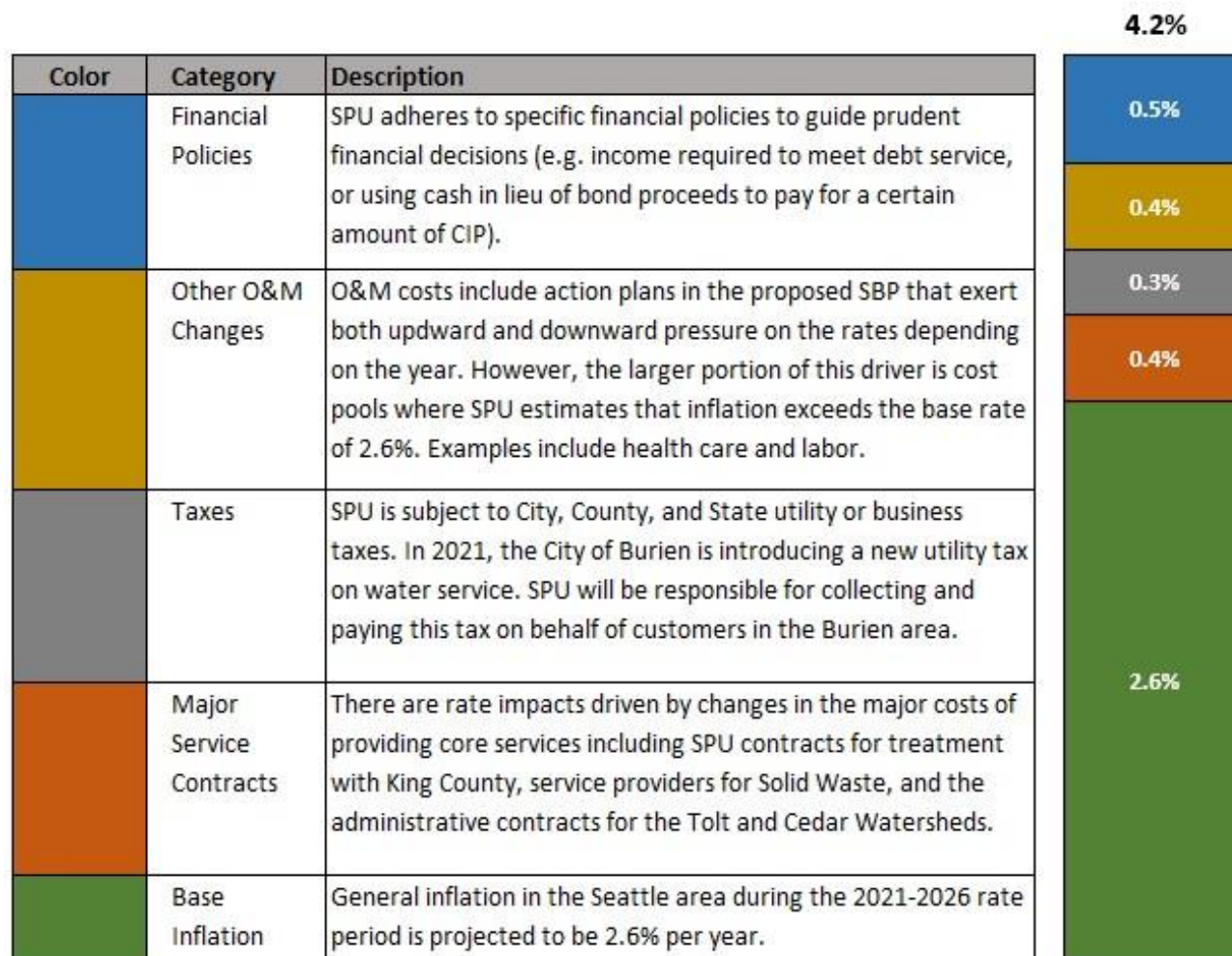
### Proposed SBP Rate Path Summary

SPU uses a combination of direct rates revenues (bills charged to customers) and revenues from other funding sources to meet SPU’s total revenue requirement, which is the revenue required to cover Operations and Maintenance (O&M) and Capital Improvement Program (CIP) expenses together with any additional revenues required to meet SPU’s financial policy requirements.

Generally, rate increases are the result of covering base inflation and increases in CIP costs (usually due to debt service costs) and may be smaller or greater than the actual change in the rates revenue requirement. This SBP assumes increases in costs due to capital project planning (and associated debt service costs) as well as costs associated with increases in the Utility Discount Program participation.

As discussed in the previous section, the 2021-2026 SBP includes an average annual combined rate growth of 4.2% per year. This is significantly lower than the 5.2% rate that was included in the 2018-2023 SBP. The table below summarizes the components of the proposed rate.

**The 4.2% Rate Path is Mostly Driven by Inflation and Factors Outside of SPU Control**



**Factors Impacting Rates**

SPU has been working to flatten rate increases over time. While a consistent growth in rates is expected due to inflationary factors, SPU’s growth in costs to provide services for the 2021-2026 period is projected to be lower than in the 2018-2023 period. Factors lowering the growth in the cost of services include:

- Using cash balances to smooth rate changes
- Negotiating lower solid waste contract rates
- Reducing the cost of borrowing money
- Improving capital investment planning to better reflect experience

At the same time, there are also factors that are increasing costs at a faster pace and offsetting cost savings. These include:

- Higher than expected increases in King County wastewater treatment charges to cities
- Funding for large capital projects required for state and federal regulatory compliance
- Targeted funding increases to address deferred maintenance of aging capital assets
- Increased commitment to keep pollutants out of our natural waters
- Rise of delinquencies and the enhancement of affordability assistance programs

### **Major CIP Projects for Regulatory Compliance**

Each fund is subject to regulatory requirements from the City, State, and/or Federal government including consent decrees. These regulations require the Utility to invest in significant capital improvements to mitigate potentially hazardous contamination to the State's natural resources. Major CIP projects for compliance include:

- The Ship Canal Water Quality Project (Drainage and Wastewater Fund 2021-2026, Costs: \$375M):  
This is a joint project between SPU and King County to design and construct a storage tunnel to capture Combined Sewer Overflows for 5 SPU outfalls and two King County outfalls.
- Green Stormwater Infrastructure (Drainage and Wastewater Fund 2021-2026, Costs: \$131M):  
This program includes several projects and will achieve the water quality goals identified in Seattle's Plan to Protect Seattle's Waterways.
- South Park Water Quality Facility (Drainage and Wastewater Fund 2021-2026, Costs: \$93M):  
Utility work in the South Park neighborhood includes a pump station, a Water Quality Facility, and developing drainage conveyance improvements.
- Historic Landfill Remediation: (Solid Waste Fund 2021-2026, Costs: \$12M):  
This program funds compliance activities related to the Midway landfill closure project as required under the Consent Decree with the State Department of Ecology.

Please see Appendix C for additional information on major CIP projects by fund. Also, worth noting, the Water Fund is currently transitioning from a period of regulatory capital improvement to a new phase of asset rehabilitation and seismic improvements. The Water Fund continues to have regulatory capital programs for fish passage and improvements to dam safety.

### **Potential Issues Under Consideration**

At this point, SPU anticipates the following issues that could affect either the timeline for the SBP or the SBP directly:

- The Rate Path: The pandemic continues to affect the local and regional economy for both residential and commercial customers. The SBP includes lower than anticipated rate growth, but growth, nonetheless. As noted in this memorandum, the rate path is one percentage point (or 20%) lower than the previously projected rate path. SPU will continue to look for efficiencies to support affordable rates in 2021 and beyond.

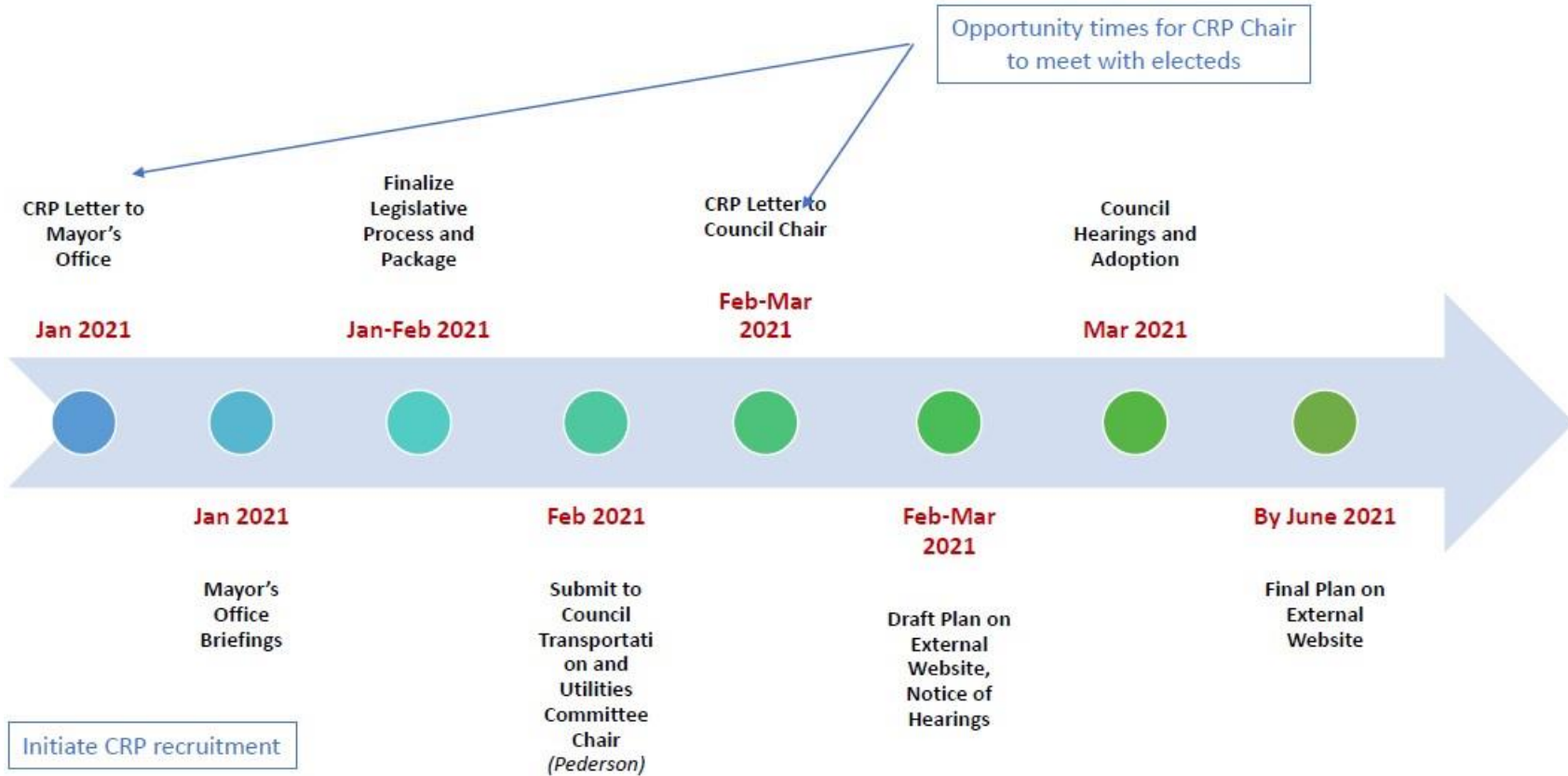
- *Impacts to the General Fund:* In addition to deferring introduction of the SBP, SPU deferred the development of the Water Rate Study from 2020 to 2021. Consequently, SPU will need to update the projections for how much the General Fund would have to pay SPU for water hydrant maintenance. When the Water Rate Study is proposed in 2021, it may result in an increase in the General Fund obligation to maintain water hydrants.
- *Possible Fiscal Strain on SPU:* As the pandemic continues to affect the local and State economy, this pressure may grow in 2021 and beyond. If the fiscal pressure increases, the City may consider raising tax rates to cover shortfalls and SPU would have to absorb those increases.





**Appendix A: Strategic Business Plan Timeline**

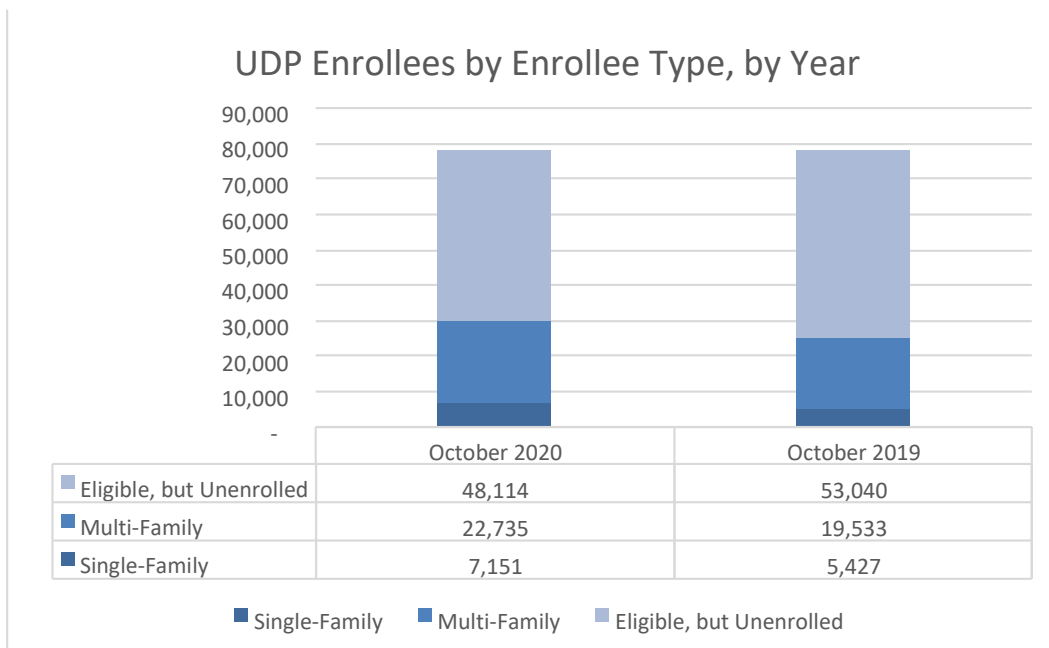
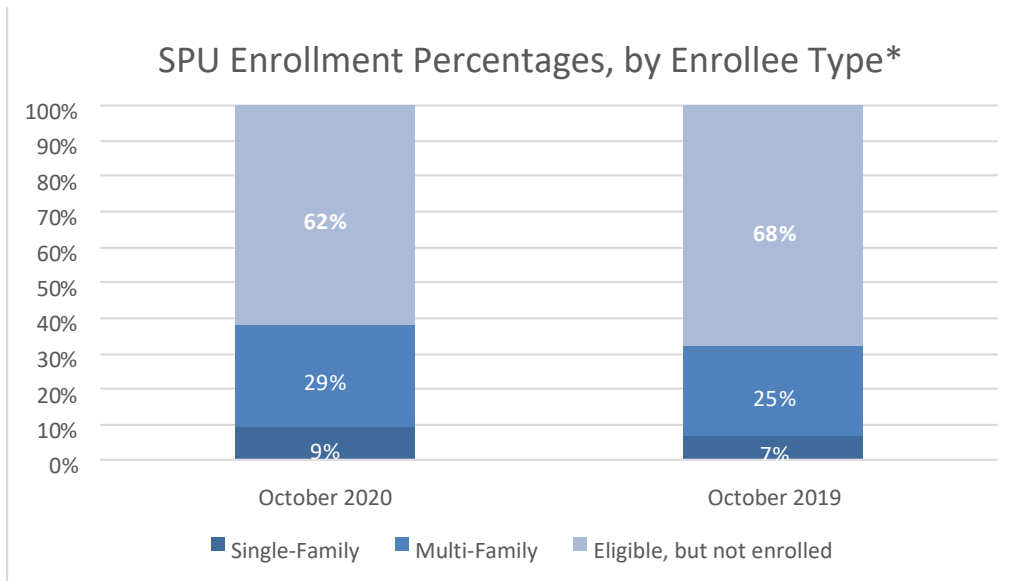
Includes Key Dates for Input from the Utility’s Customer Review Panel (CRP)





**Appendix B: SPU Utility Discount Program Facts and Figures**

Through the Utility Discount Program (UDP), SPU provides assistance to nearly 30,000 customers, which is equivalent to 38% of the 78,000 estimated eligible customers.



- In 2020, the average Single-Family utility discount averages \$102.75 per month, while the Multi-Family discount averages \$57.
- In 2019, the UDP provided a total of \$16.6 million in credits to customers. In 2020, the program is anticipated to provide over \$19.0 million in credits.

The following table catalogues all of SPU's forms of customer assistance.

### SPU Customer Assistance Catalogue

Program	Benefit	Frequency	Eligibility
Emergency Assistance Program (EAP)	Credit of 100% of the bill balance, up to \$448 in 2020.  <i>Pending Change: SPU has received Council authority to receive customer donations to provide additional assistance (up to \$200) to eligible customers. Program is estimated to begin in November 2020.</i>	Once per year (twice per year if household has minor children).	<ul style="list-style-type: none"> <li>Income at 80% of State Median Household Income.</li> <li>Single Family Household only.</li> <li>If renting, must have a SPU or SCL bill in tenant's name.</li> </ul>
Utility Discount Program (UDP)	50% discount (off actual consumption for Single Family Households, and off typical consumption for Multi-Family Households.) Single family household receive the credit directly on their bill, and Multi-Family Households see the discount reflected on their SCL account.	Every bill while enrolled in the program.	<ul style="list-style-type: none"> <li>Income at 70% of State Median Household Income.</li> </ul>
Fast Track Enrollment Pilot	Allows customers to enroll in UDP program with significantly less paperwork, by asking enrollees to self-attest their income eligibility.	Pilot going through December 31, 2020.	Customers must receive a fast track form as part of the pilot project. Not available to all customers at this time.
UDP Shut-off Pilot	Gives customers enrolled in the UDP program an extra week to reach out about emergency assistance before a shut-off. Increased communication from SPU for these groups.	Ongoing.	Customer must be enrolled in UDP program and be facing a shut-off.
Leak Adjustment Policy (Effective May 25, 2020)	Water and sewer bill adjusted at 100% above normal consumption for all customers, <b>except</b> 50% sewer above normal consumption for commercial customers for indoor leaks.	One adjustment per calendar year.	Outdoor and indoor leaks.
Payment Plans – SEE COVID POLICY FOR CURRENT BENEFIT	Allows payment plan for current or outstanding debt. Requires a down payment of 25% for current balance, and 50% for past-due. The term is up to 60 days.	As needed.	All bills.

Payment Arrangements	Allows payment plan of up to three years. No down payment required.	As needed.	Only available upon receipt of an unexpected, higher than normal bill (e.g. back-billing.)
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**COVID-Specific Policies**

<b>Program</b>	<b>Benefit</b>	<b>Frequency</b>	<b>Eligibility</b>
Suspension of Shut-Offs	Will not shut-off customers (residential or commercial) through the end of the year.	Through 2020	All customers (with special review for Top Customers.)
Waiver of interest on delinquent accounts	Customers with delinquent accounts will not be charged interest on past due balances, per the emergency legislation from the Mayor’s Office.	Through 2020	All customers.
Flexible Payment Plans – Residential	Do not require down payment for payment plan, even with past-due balance. Term is up to 120 days. Payment plans can be renewed, and (soon) completed online.	Through 2020	Residential customers.
Flexible Payment Plans – Small Business	Reach out proactively to set up payment plans. Do not require down payment.	Through 2020	Small businesses.

Fund	Program Area	Description	Major CIP Projects	2021-2026 Projection
Drainage and Wastewater	Combined Sewer Overflows	This program consists of projects that are mandated by State and Federal regulations to control combined sewer overflows into the City's receiving waters.	Ship Canal Water Quality Project Future CSO Projects	\$375M \$65M
	Flooding, Sewer Backup, and Landslides	This program prevents and reduces flooding and sewer backups in order to protect public health, safety, and property.	South Park Pump Station, Water Quality Facility, and conveyance improvements Sanitary Sewer Overflow Capacity	\$93M \$52M
	Protection of Beneficial Uses	This program improves the drainage system to reduce the harmful effects of stormwater runoff on creeks and receiving water bodies and preserve the storm water conveyance function of our creeks through stream culvert repair and rehabilitation.	Green Stormwater Infrastructure Creek Culvert Replacement Project	\$131M \$46M
	Rehabilitation	This program repairs, rehabilitates, or replaces existing drainage and wastewater assets to maintain or improve the current functionality level of the system.	Pipe Renewal Program Pump Station and Force Main Improvements	\$193M \$48M
	Sediments	The Sediments program provides funding for studies and analysis for cleanup of contaminated sediment sites in which the City is a participant, for engineering design and construction of actual cleanup of contaminated sites, and for liability allocation negotiations.	Sediment Remediation	\$50M
	Shared Projects	This program includes individual capital projects that benefit multiple Lines of Business (LOB) (e.g. the Water LOB and the Drainage and Wastewater LOB) and which costs are "shared," or paid for by more than one utility fund.	Transportation-Related Projects	\$80M
	Technology	The Technology CIP provides departmentwide technology investments to address SPU's strategic, business, and City-wide priorities. Project costs are shared by more than one utility fund.	Technology	\$27M

Appendix C: 2021 – 2026 Major CIP Investments

Fund	Program Area	Description	Major CIP Projects	2021-2026 Projection
<b>Water Fund</b>	Distribution	This program rehabilitates and improves water mains and appurtenances, water storage tanks, pump stations, and other facilities that are part of the system that distributes treated water.	Watermain Rehabilitation	\$113M
	Transmission	This program rehabilitates and improves large transmission pipelines that bring untreated water to - and convey treated water from - the treatment facilities.	Seismic System Improvements	\$48M
	Water Quality and Treatment	This program constructs, rehabilitates, or improves water treatment facilities, and covers the remaining open water reservoirs.	Bitter Lake Reservoir Covering	\$45M
			Lake Forest Reservoir Covering	\$10M
	Shared Projects	This program includes individual capital projects that benefit multiple Lines of Business (LOB) (e.g. the Water LOB and the Drainage and Wastewater LOB) and which costs are "shared," or paid for by more than one utility fund.	Transportation-Related Projects	\$119M
Technology	The Technology CIP provides departmentwide technology investments to address SPU's strategic, business, and City-wide priorities. Project costs are shared by more than one utility fund.	Technology	\$25M	
<b>Solid Waste Fund</b>	New Facilities	This program includes the planning, design, and construction of new facilities to enhance solid waste operations.	South Transfer Station Phase II	\$36M
			South Park Development	\$17M