SEATTLE CITY COUNCIL
CENTRAL STAFF

DRAFT M E M O R A N D U M

Date:	March 31, 2017
To:	Civil Rights, Utilities, Economic Development and Arts Committee
From:	Peter Lindsay, Council Central Staff
Subject:	Seattle Public Utilities – Strategic Business Plan Update

Introduction

This memo summarizes Seattle Public Utilities' (SPU's) Strategic Business Plan update process and describes the rate path options presented to the Customer Review Panel (CRP) as it deliberates on critical issues facing the utility. Although the update process is not complete, the CRP is currently evaluating three rate path options as a framework for prioritizing future expenditures and evaluating potential savings. The utility is facing a number of external challenges to meeting its core service goals and overcoming those challenges may require additional investments in infrastructure, service and staff. SPU's four lines of business provide basic services that effect every resident in Seattle and the SBP update process establishes new business initiatives, policies and investments that directly impact all rate payers.

SPU's Strategic Business Plan: Goals, Structure And Governance

SPU has begun updating its six-year Strategic Business Plan (SBP). The SBP and required SBP updates follow a strategic planning process that was established in Resolution 31429 (the resolution) to achieve the following goals:

a) Set a transparent and integrated direction for all of SPU's lines of business;
b) Reflect customer values in the utility's decision making;
c) Provide rate predictability for utility customers; and
d) Deliver best value for the rate payer.

The resolution prescribed a specific process for developing the SBP, including developing a six-year rate path for water, drainage, wastewater and solid waste; and the resolution establishes that SPU will update the SBP on a three-year cycle. Based on the three-year cycle formalized in Resolution 31534, SPU will update the SBP by the end of 2017 and then do so again in 2020. Plan updates, including the effort currently underway, are to identify and recommend priority reductions and additions to current utility expenditures including:

- Potential efficiencies for the provision of existing services;
- Identifying low-priority existing services that may be reduced or eliminated; and
- Evaluating new investments to respond to future needs such as climate change and growth.

SPU is currently engaged with a nine-member Customer Review Panel (CRP) composed of four Council appointees and five Mayoral appointees tasked with considering new policies and business initiatives proposed by SPU. The CRP began meeting in October 2016 and meets twice a month to deliberate on current policies and new initiatives that will influence SPU's future investments; the last meeting was on March 22. The CRP will submit a letter of recommendation to the Council prior to SPU's SBP update proposal, explaining the critical issues from the perspective of the panel and endorsing certain policy changes, changes in utility operations and new investments.

The process for developing the plan is envisioned as collaborative with input and engagement from the CRP (comprised of commercial, residential and institutional stakeholders), SPU customers, SPU staff, the Mayor's Office, and the City Council.

SPU Proposed Options Summary

SPU is working with the CRP to develop a proposed 2017 update to the SBP for transmittal to the Council in May 2017. The CRP is currently evaluating three discrete options and Table 1 describes the 6-year rate path implications for these three options.

Table 1: Three Potential SBP Rate Options

	2018	2019	2020	2021	2022	2023	AVERAGE
Option 1: 5.6% - Low Risk	2.7%	9.8%	9.9%	3.4%	4.4%	3.5%	**5.6%**
Option 2: 5.4% - Medium Risk	2.7%	8.4%	8.6%	5.0%	4.2%	3.4%	**5.4%**
Option 3: 5.3% - High Risk	2.7%	8.5%	8.6%	4.4%	3.5%	4.0%	**5.3%**

In the context of each option, risk is defined as the prospect that lower levels of investment may translate into decreased levels of service for some programs or risk increased emergency expenditures for failing infrastructure. For instance, reduced expenditures on sewer cleaning could result in more sewer backups and overflow, damage to infrastructure and increased spending on emergency repairs. Thus, the high risk and medium risk options include programmatic cuts, reductions in capital spending and changes in operations that reduce the average annual rate increase, but incur ever increasing risk to assets and service delivery in comparison to the low risk option.

Notes:

1. **5.6% Low Risk Option** -- Low risk option results in a 5.6 percent average annual increase across all lines of business for the period 2018 to 2023 reflecting adoption of all 13 Action Plans and all expenditure reductions proposed by SPU.
2. **5.4% Medium Risk Option** – Medium risk option results in a 5.4 percent average annual increase across all lines of business for the period 2018 to 2023. As compared to OPTION 1: Low Risk, it reduces spending on the City's rodent control contracts and reduces capital expenditures on betterments and opportunity improvements related to Move Seattle.

3. **5.3% High Risk Option**—High risk option results in a 5.3 percent average annual increase across all lines of business for the period 2018 to 2023. This option incorporates reductions discussed in OPTION 2: Medium Risk as well as reductions to sewer cleaning and water opportunity projects that support transportation initiatives. It also assumes lower risk reserves and a continuation of billing-in-advance practice for solid waste services.

It is important to note that SPU's lowest risk rate option (the 5.6% option described in Table 1) when combined with actual adopted rates extrapolated over the currently endorsed business planning period—2015 to 2020—results in an annual average rate increase of 5.8 percent during the six-year SBP period (2015 to 2020) as compared to the 4.6 percent average annual rate increase over the same period in the currently adopted SBP. Table 2 summarizes the difference between the average annual rates initially adopted in the 2014 SBP and the cumulative effect of SPU's Option 1: Low Risk currently under consideration.

Table 2: Comparison of Endorsed Strategic Business Plan Rate Path to Update Strategic Business Plan 2015 to 2020

	2015	2016	2017	2018	2019	2020	AVERAGE
(A) SBP*	Projected 2.7%	Projected 5.0%	Projected 4.7%	Projected 4.2%	Projected 5.5%	Projected 5.2%	4.6%
(B) Adopted Rates and Option 1: Low Risk**	Adopted 2.9 %	Adopted 4.1%	Adopted 5.3%	Option 1: Low Risk 2.7%	Option 1: Low Risk 9.8%	Option 1: Low Risk 9.9%	5.8%
Above SBP (Below SBP) (A-B)	(0.2%)	.9%	(0.6%)	1.5%	(4.3%)	(4.7%)	(1.2%)

***Combined Weighted Average** across all lines of business – Water Drainage Wastewater and Solid Waste
** Reflects combination of **rates adopted through 2017 and SPU's low risk option (see Table 2)** currently under deliberation by the CRP.

Based on SPU's low risk option presented to the CRP, the proposed rates for the next three years would be substantially higher—about 78 percent higher in 2019 and 90 percent higher in 2020—than rates assumed in the 2014 adopted rate path. Based on the proposed low risk option, the average bill would increase $5.56 in 2018, $18.46 in 2019 and $20.38 in 2020. The substantial increase in rates for 2019 and 2020 is largely driven by the concentration of capital spending on projects like the Ship Canal Water Quality project, Move Seattle related infrastructure improvements and new operational facilities for Drainage and Wastewater line of business.

Each of the discrete options described in Table 1 has been presented to the CRP in one or more bi-monthly meetings as a means of framing the overall business plan policy discussion. Although each option is defined by specific investments, the CRP is not limited to an "either or" choice; the panel could select one of the options or none of them depending on a) the issues

CRP members feel are a priority, b) the kind of feedback provided through the public outreach process and c) input from the City Council and Mayor's Office. Finally, SPU is not obligated to submit a proposal that follows the panel's recommendations. Ultimately, SPU may propose a set of investments and representative rate path completely different than the options described above.

Rate Pressures

SPU prides itself on working to deliver environmentally sensitive, high-quality and best-value utility services for its customers. Yet the utility will be challenged in the coming years to sustain those values in the face of external pressures like climate change, a constraining regulatory environment, active private and public development and macroeconomic factors. Below are a few of the salient rate pressures SPU has identified as part of the SBP update process.

- In 2015, the Port of Seattle formed its own drainage and wastewater utility. Per RCW 53.08 port districts may form and manage their own drainage and wastewater utilities. The port was the second largest SPU customer responsible for about $4 million in annual revenue to the Drainage and Wastewater Fund (DWF).
- Implementation of prescriptive measures under the federal Consent Decree namely the Ship Canal Water Quality Project and other combined sewer overflow (CSO) projects. The Ship Canal Project is SPU's largest capital project to date representing about 24.7% of the six-year Drainage and Wastewater Fund CIP. Moving capital project spending earlier than anticipated in the original business plan means that spending on DWF projects peaks in 2019 and 2020.
- Passage of Move Seattle levy. Additional spending related to transportation improvements impacting SPU infrastructure such as Move Seattle corridor projects the offer the opportunity to improve aging utility infrastructure. SPU anticipates spending $247 million over six year on levy-related project. According to SPU, the impact of Move Seattle is much larger than pervious levies due to the scale of transportation investments and the timing of projects.
- Staffing resources and unmet efficiency goals: SPU anticipated efficiencies of $30 million from 2015 to 2020 as part of the 2014 endorsed SBP and has not been able to fully realize position savings anticipated in the SBP. Increased staffing for the Ship Canal Water Quality project, NCIS and other programs has resulted in higher than anticipated staffing levels.
- Technical assumptions – A number of financial inputs are incorporated into the utility's baseline or business as usual assumptions influencing rates. Interest on debt service payments, King County wastewater treatment rates, health care inflation, retirement costs and allocations to other City departments generally run higher than inflation and can drive increases in baseline rates despite no change in the utilities operations.

In addition to the macro-level pressures influencing SPU's rates, the utility anticipates spending about $55 million per year over the 6-year rate path on new strategic O&M and capital initiatives known as Action Plans. To help offset spending on new initiatives, SPU has identified $105 million in additional savings from 2018 to 2023 on capital projects such as culvert rehabilitation, pump station rehabilitation and other operational efficiencies. Council is currently considering an amendment to the WM disposal contract that, if approved, results in $8 million in savings on its long-haul waste disposal contract from 2017 to 2023.

Next Steps

Representatives from the CRP will be meeting with members of the Civil Rights, Utilities, Economic Development and Arts (CRUEDA) Committee on March 31. The CRP continues to meet and discuss the rate pressures articulated by SPU staff and possible alternatives to SPU's proposed rate path options. SPU anticipates sending an updated business plan to the CRUEDA Committee sometime in May 2017. Retail and wholesale water rates legislation will follow SPU's SBP update proposal sometime in June and August 2017 respectively.

cc: Seattle City Councilmembers
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