

September 15, 2023

MEMORANDUM

To: Transportation and Seattle Public Utilities Committee
From: Brian Goodnight, Analyst
Subject: CB 120657: 2024–2026 Water Rates

On September 19, 2023, the Transportation and Seattle Public Utilities Committee will continue its consideration of [Council Bill \(CB\) 120657](#) that would revise Seattle Public Utilities' (SPU's) retail water rates for 2024 through 2026. SPU provided a [presentation](#) on the proposed bill at the committee's September 5, 2023, meeting. This memorandum provides background information on prior Council actions and the structure of water rates, describes the proposed rate increases and compares them against the rates adopted in the 2021–2026 Strategic Business Plan, and summarizes the impact to customers.

Background

Prior Council Actions

SPU operates three distinct utilities: Drainage and Wastewater, Solid Waste, and Water. The Council typically considers rate-setting legislation for one of the utilities each year, with rates being set for a three-year period. Due to the pandemic and its economic impacts, however, the Executive did not propose an increase to water rates in 2020 for the 2021 calendar year. To return to the customary rate-setting cycle, in 2021 the Executive proposed a two-year water rates package covering calendar years 2022 and 2023. The Council approved those rates in September 2021, via [Ordinance 126434](#).

In addition to rate-setting legislation, every three years the Council also considers an update to SPU's Strategic Business Plan (SBP). The Council most recently adopted an SBP in May 2021, via [Resolution 32000](#), covering 2021–2026. The SBP contained a new mission and vision for SPU, identified the department's focus areas, described its long-term goals and short-term strategies, and specified a three-year rate path (2021 to 2023) and a three-year rate forecast (2024 to 2026) for all three of SPU's distinct utilities.

Water Rate Structure

SPU manages and operates a water system that supplies drinking water to customers inside and outside of the city boundaries. The department derives revenue to support the water system through a few primary sources: retail water rates charged to commercial, residential, and fire system customers; wholesale contracts with nearby cities and water districts¹; and other

¹ Wholesale customers typically own and operate separate water delivery systems and assets, but still rely on SPU to provide maintenance, oversight, and investment in the regional water supply system.

miscellaneous non-rate revenues². In 2022, as presented by SPU staff at the committee's September 5 meeting, retail customers provided approximately 76 percent of revenues, wholesale customers provided about 20 percent, and miscellaneous non-rate revenues accounted for the remaining four percent. These revenues are all managed within the department's enterprise Water Fund, and the revenues generated on an annual basis from these sources must be sufficient to cover the costs of the water system and to meet established financial targets.

For the retail water rates, which are the subject of CB 120657, SPU uses a complex cost allocation process to distribute costs amongst different customer classes, which are groups of similar customers in terms of demand patterns and the cost to provide services. The four customer classes are:

- Residential – This class includes single-family homes and duplexes and represents about 88 percent of all SPU retail water accounts and approximately 38 percent of annual retail water usage. Residential customers are charged two types of charges: a “base service charge” that is based on the size of their water meter, and a commodity charge that is based on the amount of water consumed. Residential commodity charges are seasonal, with a uniform, lower rate in the off-peak season (September 16 – May 15) and tiered, higher rates in the peak season (May 16 – September 15). Tiering rates in the peak season is intended to provide a disincentive for excessive summer water usage.
- General Service – This includes commercial, governmental, and industrial customers, as well as multi-family residential structures. The class represents about 11 percent of all retail water accounts, but accounts for approximately 61 percent of annual retail water usage. Similar to the Residential class, General Service customers are charged a base service charge and a commodity charge that varies seasonally. Unlike the Residential class, however, the General Service commodity rates do not have tiers; rather, there is a uniform rate for off-peak and a uniform rate for peak season.
- Private Fire – This class contains separately-metered connections for fire-protection sprinkler systems installed on customer property and, combined with the Public Fire class, makes up less than one percent of retail water accounts. Customers pay a monthly base service charge based on meter size, which includes a monthly usage allowance for testing and system operations. The charges for these services are in addition to their Residential or General Service charges.
- Public Fire – This class includes governmental agencies that are responsible for providing public fire protection, such as fire hydrants. Customers are charged a flat annual fee that is determined by the size of the water main attached to the hydrant and the jurisdiction where the hydrant is located.

² Non-rate revenue includes things such as capital contributions and fees, interest income, rentals, and charges for miscellaneous services.

Retail water rates are also influenced by anticipated customer demand and expected enrollment in the City’s Utility Discount Program (UDP), which provides qualifying low-income customers with a 50 percent discount on their bills. Additional detailed information on the cost allocation model and rate structures for the various customer classes can be found in [Exhibit A to the Summary and Fiscal Note](#), which is SPU’s 2024–2026 Water Rate Study.

Proposed 2024–2026 Rates and SBP Comparison

The proposed water rate increases for 2024–2026 are shown in Table 1, alongside the previously approved rates for 2022–2023 and the endorsed rate increases from the SBP.

Table 1. Comparison of Proposed Water Rates vs SBP

	2021	2022	2023	2024	2025	2026	6-Year Avg
Adopted Rates	0.0%	2.6%	3.6%				2.0%
Proposed Rates				2.0%	2.0%	2.0%	
<i>Adopted SBP</i>	<i>0.0%</i>	<i>2.7%</i>	<i>4.7%</i>	<i>3.6%</i>	<i>4.2%</i>	<i>5.5%</i>	<i>3.4%</i>

As shown in Table 1, the proposed water rate increases are significantly lower for all three years than the rate increases endorsed in the SBP. Because of this and the lower rates previously approved for 2022 and 2023, the overall six-year average is also lower than the average anticipated in the SBP.

According to SPU, the primary driver for these proposed lower rate increases is reduced spending on both operating and capital expenses. In terms of operating expenses, the department spent approximately \$57 million less during the first three years of the SBP period primarily due to labor and supply disruptions associated with the pandemic.³ SPU anticipates that its operating expenses will continue to be below those assumed in the adopted SBP, with expenses predicted to be about \$7 million below the SBP estimates annually.

Capital expenses for the first three years of the SBP period were also below projections by approximately \$81 million. This reduced spending lowered the need to borrow, leading to lower debt service costs. Additionally, SPU was able to take advantage of favorable interest rates by refinancing existing debt to lower rates resulting in debt service savings of approximately \$1.5 million per year.

³ Although the SBP was adopted in May 2021, many of the underlying assumptions for the SBP and its projections were created in advance of the pandemic.

Rate Smoothing

Similar to many other City departments and funds, the Council has established financial policies for the management and operation of the water system. The policies address elements such as the amount of debt service coverage required, the percentage of capital program costs that must be funded with cash, and the minimum cash balance to be kept on-hand.⁴ Typically, retail water rates are set to generate a sufficient amount of revenue to meet the system's revenue needs and to satisfy all of the financial policies. With the rates proposed in CB 120657, however, SPU is not simply meeting the revenue requirement and financial policies, but has recommended rate increases with the intention of smoothing rates over a longer time horizon. Rate smoothing works by increasing rates above the minimum amount required earlier in a rate cycle which allows future rates to be lower than they would otherwise need to be. The approach is used to reduce rate volatility and have a more balanced trajectory of increases. The Council has endorsed rate smoothing in the past, most recently for Drainage and Wastewater rates in 2018 via [Ordinance 125443](#).

In this instance, approval of the proposed rate increases would generate excess revenue for SPU during the three-year period which would be used in two ways: to maintain a cash balance that exceeds financial targets, and to increase cash financing of the capital program. With regard to the cash balance, SPU's long-term planning goal is to maintain 120 days of operating expenses in the Water Fund, which for 2024 would be approximately \$67 million. The proposed rate package would maintain a cash balance of \$110 million in 2024 and the same amount for the remaining two years.

The excess revenue would also be used to increase cash financing of the capital program by approximately \$31.5 million over the three years. Increasing cash financing for capital projects directly reduces the need to borrow funds and incur debt service costs, thereby reducing total project costs. Although the amount of cash financing could be increased even more by drawing down the cash balance, SPU believes that using additional cash in the near term could negatively impact future rate periods. SPU expects that by the end of the decade capital spending could increase at a pace that would necessitate rapid increases in rates if sufficient cash is not kept on-hand to buffer the impacts.

In the near term, the proposed water rates would increase SPU revenues by almost \$4.4 million in 2024 (relative to 2023), \$4.8 million in 2025 (relative to 2024), and \$5.0 million in 2026 (relative to 2025). Due to the City's imposition of a utility tax on retail water revenue, the City's General Fund is estimated to receive additional revenue of approximately \$679,000 in 2024, \$753,000 in 2025, and \$781,000 in 2026, as a result of the proposed increases.

⁴ Council most recently updated the policies in March 2005, via [Resolution 30742](#).

Customer Impact

Table 2 shows the impact of the proposed water rate increases on the monthly bills for a median residential customer, 90-unit apartment building, and for a typical small store, such as a convenience store. The table shows the expected monthly bills for those typical customers and provides the dollar and percentage increases from the previous year. Please note that although the annual percentage increases in Table 2 come close to matching the overall proposed rate increases shown in Table 1, the annual increases do not match exactly. The rate increases in Table 1 show the average increase for all customer types and tiers, but do not represent the specific increase that every customer will experience.

Table 2. Monthly Impact of Proposed Rate Increases to Customers

	2023	2024	2025	2026
Residential ^a	\$48.66	\$48.66	\$49.66	\$50.71
<i>\$ change from prior year</i>	--	\$0.00	\$1.00	\$1.05
<i>% change from prior year</i>	--	0.0%	2.1%	2.1%
90-Unit Apartment Building ^b	\$1,368.00	\$1,423.00	\$1,450.00	\$1,478.00
<i>\$ change from prior year</i>	--	\$55.00	\$27.00	\$28.00
<i>% change from prior year</i>	--	4.0%	1.9%	1.9%
Convenience Store ^c	\$113.70	\$119.10	\$122.05	\$125.10
<i>\$ change from prior year</i>	--	\$5.40	\$2.95	\$3.05
<i>% change from prior year</i>	--	4.8%	2.5%	2.5%

a – Based on monthly water consumption of 5 CCF (“hundred cubic feet”; 1 CCF = 748 gallons), and a ¾” meter size

b – Based on monthly water consumption of 195 CCF, and a 3” meter size

c – Based on monthly water consumption of 15 CCF, and a 1” meter size

cc: Esther Handy, Director
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