

September 5, 2017

MEMORANDUM

To: Civil Rights, Utilities, Economic Development and Arts
From: Peter Lindsay, Council Central Staff
Subject: Council Bill (CB) 119050 -- Proposed 2018-2020 Retail Water Rates

EXECUTIVE SUMMARY

On September 12, the Civil Rights, Utilities, Economic Development & Arts Committee (CRUEDA) will consider action on the Executive's proposed new water rates. This memo outlines Seattle Public Utilities (SPU's) proposal to increase retail water rates and collect \$5 million more in annual retail water rate revenue beginning in 2018.

New water rate revenue would fund increased costs of providing basic services, increased cash financing of capital projects, moderate the impacts of future rate hikes (also known as "rate smoothing"), and comply with adopted financial policies. Increases to water rates would be reflected in customer water bills beginning in January 2018; and charges would continue to be based on (a) the size of water meters and (b) the amount of water consumed.

If the legislation is passed as proposed, the median¹ single-family residential bill would be \$1.72 higher in 2018 than in 2017 and rate increases would average 4.6 percent per year over the three-year rate period. Effects of the increase on general service customers such as businesses and multi-family residences would vary. For example, a convenience store's bill is estimated to increase up to 3.7 percent per year, with monthly bills about \$2.85 higher in 2018 than in 2017, whereas a small office building is estimated to increase up to 3.1 percent per year, with monthly bills about \$8.00 higher in 2018 than in 2017.

RATE AND BILL IMPACTS

Table 1 shows "typical" monthly bill impacts and water rates should Council approve the proposed legislation.

¹ Median, or as SPU describes "typical," residential, single-family customer water bill rates are based on a 5 CCF (hundred cubic feet) monthly consumption pattern averaged over the course of 12-months. 1 CCF is equivalent to 748 gallons.

Table 1: 2018 to 2020 Water Rates and Bill Impacts Summary

	2017 Test Year	2018 Proposed	2019 Proposed	2020 Proposed
Revenue Requirement	\$185,740,521	\$260,031,319	\$212,163,763	\$220,040,448
Average Rate Increase	2.7%	3.0%	3.5%	4.0%
Typical Monthly Bills				
Residential (see note)	\$41.13	\$42.75	\$44.66	\$46.79
General Service – Convenience Store	\$99.80	\$102.65	\$105.90	\$109.85
General Service – Office Building	\$322.00	\$330.00	\$339.00	\$350.00

Note: Typical single-family water consumption is 5 CCF.

ANALYSIS

2018-2023 Strategic Business Plan Update

The CRUEDA Committee is currently considering adopting SPU’s 2018 to 2023 Strategic Business Plan Update (the Plan Update) via [Resolution 31760](#). The Plan Update guides investments and projects rates for all SPU lines of business including water, drainage, wastewater and solid waste. To moderate the projected increases described in the Plan Update, SPU proposes to set water rates to meet rate increase targets (rate smoothing) instead of specific financial policy targets². If Council should pass CB 119050, water rate revenues in 2018 and 2019 would exceed all financial policy targets; in 2020 debt-service coverage would become the binding financial constraint and revenues would be sufficient to meet this financial policy.³

The next table demonstrates the differences in the proposed water rates for the 2018 to 2020 rate period between the Plan Update (as proposed) and SPU’s 2018 to 2020 Water Rate Study.

² Council passed [Resolution 30742](#) in 2005 establishing the current water system financial policies that determine the level at which water rates shall be set given forecasted costs, demand, and the scale of CIP spending.

³ The Customer Review Panel—SPU’s stakeholder committee empaneled to provide input in the Plan Update process—recommended SPU propose water rates with rate smoothing to help minimize rate volatility.

Table 2: Plan Update vs. Proposed Rate Study

Water Rates	2018	2019	2020
Plan Update	3.5%	4.1%	5.2%
Proposed Rate Study	3.0%	3.5%	4.0%
Difference	(0.5%)	(0.6%)	(1.2%)

In sum, SPU's proposed water rates are lower in all three years of the rate period compared to the corresponding rates included in the Plan Update. Council has discussed including smaller water rate increases in SPU's proposed Plan Update and endorsing a lower combined annual average rate increase than initially proposed by SPU. The Plan Update is still under review by the CRUEDA Committee and may further impact elements of SPU's water rate proposal.

Projected Revenues and Lower Debt Service

SPU's proposed 2018-2020 water rate increases are lower than water rate increases proposed in the Plan Update due to higher wholesale water revenues. The difference is the product of a change in the wholesale revenue assumptions that were not prepared in time for inclusion in SPU's Plan Update. Table 3 describes the differences in wholesale water revenue assumptions between the Plan Update and the 2018-2020 Water Rate Study.

Table 3: Comparison of Wholesale Revenue Assumptions—2018 to 2020 Water Rate Study to the Plan Update

	2018	2019	2020
2018 to 2022 Water Rate Study	\$67.4M	\$57.3M	\$58.8M
Plan Update	\$63.1M	\$52.6M	\$53.7M
Difference	\$4.3M	\$4.6M	\$5.1M

Wholesale water revenues are a model input for determining retail rates; and higher wholesale revenues help offset retail revenue requirements.

In addition to higher wholesale water revenues, warmer than average summer conditions have resulted in increased city-wide water consumption. As a result of these two factors, SPU is currently in a favorable cash position compared to financial projections assumed in the Plan Update and proposes to use extra cash to increase cash financing of capital and lower projected debt obligations.

Revenue Stabilization Fund

Ordinance 119050 seeks Council approval to use SPU’s water Revenue Stabilization Fund (RSF) to fund capital programs and reduce the retail revenue requirement. SPU’s financial policies require that⁴ the RSF reserve a minimum of \$9 million to help offset revenue losses during droughts. With Council approval, RSF balances above \$9 million can be used to fund the capital projects or meet financial policies. See Table 4 for a summary of the anticipated RSF balances, interest, and withdrawals from 2018 to 2020.

Table 4: 2018 to 2020 RSF Assumptions in the Water Rate Proposal (in millions)

	2018 Proposed	2019 Proposed	2020 Proposed
(A) Beginning RSF Cash Balance	\$33.1	\$30.4	\$15.9
(B) Earned Interest	\$0.3	\$0.3	\$0.2
(C) Withdrawal to support revenue requirement	-\$1.8	\$0	-\$1.2
(D) Withdrawal to support capital financing	-\$3.5	-\$14.8	\$0
(E) Cascade Water Alliance Deposit	N/A	N/A	N/A
Ending RSF Cash Balances (Sum of A through E)	\$30.4	\$15.9	\$14.9
Difference: Ending Cash Balance - Constraint (\$9M) ^{Note}	\$21.4	\$6.9	\$5.9

Note: The “difference” between SPU’s proposal and current RSF financial constraint is the “Ending RSF Cash Balance” summation less the \$9 million policy constraint. This number represents the amount of capacity available to SPU to reduce the retail revenue requirement and support capital financing at the end of the year.

SPU proposes spending \$3 million--\$1.8 million in 2018 and \$1.2 million in 2020--of RSF funds over the three-year rate period to decrease the revenue required from rates. To reduce future debt obligations, SPU plans to spend about \$18 million of RSF funds to cash finance the Water Fund capital program. Both proposals are policies intended to reduce SPU’s exposure to long-term debt and short-term rate increases. According to SPU, the RSF will still be \$5.9 million above the minimum threshold balance at the end of 2020.

⁴ [Ordinance 121761](#) requires SPU maintain a minimum of \$9 million in the RSF except when withdrawals below this level are needed to offset shortfalls in metered water sales revenues or to meet financial policy requirements.

Increased O&M and Capital Expenses

Compared to expenditures described in the 2016-2017 Water Rate Study, SPU anticipates spending \$21.7 million more on operations and maintenance (O&M) expenses over the three-year period to pay for higher labor costs, utility taxes, city cost allocations and emergent programs identified in the Plan Update. New initiatives identified in the Plan Update include enhanced security monitoring of the municipal watershed, increased maintenance on water distribution systems and an expanded apprenticeship program.

During the three-year rate period, SPU anticipates spending \$335 million on water utility Capital Improvement Program (CIP) projects with increased activity for water distribution system improvements, Move Seattle utility relocations, and SPU's project to stabilize the Tolt Pipeline in a potential slide area. SPU anticipates spending \$46.3 million more on Water Fund CIP projects over the three-year rate period compared to the 2017 to 2022 Adopted CIP. Support for increased CIP spending comes from a combined \$17.8 million withdrawal from the Revenue Stabilization Fund, a one-time \$7 million withdrawal of operating cash in 2018, \$12 million in Cascade Water Alliance payments and additional debt issuance.

Demand: Water Consumption and Base Meter Charges

SPU's 2018 to 2020 rate study takes two demand driven factors into consideration: water consumption and customer base, typically measured in the number of residential and commercial water meters. Demand for water is not a revenue requirement driver, but it can increase or decrease rates depending on how consumption patterns and the number of retail customers comport with projections. SPU anticipates flat to slightly lower retail water consumption over the three-year rate period with consumption varying from 26.5 million CCF to 26.8 million CCF.⁵ Consumption levels above these estimates would result in favorable financial conditions for the utility similar to the past few rate studies; consumption levels below estimates would result in increased rate pressure. SPU's forecast model does anticipate a slight short-term increase of 0.5 percent in the number of retail meters due to city-wide development.

NEXT STEPS

Further discussion and possible vote on Ordinance 119050 is scheduled for the September 12, 2017 Civil Rights, Utilities, Economic Development and Arts Committee. New rates would become effective January 1, 2018.

cc: Kirstan Arestad, Central Staff Director
Dan Eder, Central Staff Deputy Director

⁵ CCF or 100 cubic feet of water, is a standard unit of measurement used in the water industry to approximate consumption and bill customers. 5 CCF is equal to 500 cubic feet of water.