

**CITY OF BAINBRIDGE ISLAND
MEMORANDUM**

TO: City Council

FROM: Utility Advisory Committee

DATE: March 7, 2019

SUBJECT: Recommendation Regarding Revision to Water and Sewer Rates

Beginning in March 2018, the City undertook a study of the rates and fees charged by its water and sewer utilities. The City retained a financial consultant, who worked with the staff and Utility Advisory Committee (“UAC”) to evaluate the finances of the utilities and, if necessary, to make recommendations to adjust the rates. The consultant has prepared a report, dated March 7, 2019, detailing the analysis and recommendations. The UAC recommends adoption of the revised rates contained therein.

I. Background of Rate Study

It is standard practice for utility systems to conduct studies of their rates, charges, and fees at periodic intervals to ensure they provide adequate revenue for the utilities, and to insure the rates, charges, and fees are in conformance with state law.

Such studies are frequently conducted following a utility’s completion of periodic comprehensive system plans. COBI completed updates to its Sewer System Plan in 2015 and its Water System Plan in 2016-7. In both utilities, it had been many years since previous System Plans had been adopted.

It had also been many years since the City’s utility rates, charges, and fees had been evaluated and reconsidered. The City last performed a study to update rates in 2009, but never implemented its recommendations. (This was apparently due to the financial challenges experienced by the City during the recession.) As

such, the current rate and fee structure has been in existence for a very long time without review. Therefore, in August 2017, the UAC recommended that a rate study be conducted, and the City Council agreed and authorized the current study.

This rate study actually includes an evaluation of six different City utility rates and fees. They are:

1. Winslow water system rates
2. Rockaway Beach water system rates
3. Winslow sewer system rates
4. South Island sewer system rates
5. System participation fees (SPFs) for both water systems
6. SPFs for both sewer systems

In March 2018, the City hired a consultant, Financial Consulting Solutions Group, to evaluate the utilities' rates and make recommendations to City management, the UAC, and ultimately the City Council.

The consultant developed preliminary recommendations which were first presented to the UAC on July 11, 2018. Thereafter, the consultant met with the UAC at 13 additional meetings. The meetings involved comprehensive discussions of the consultant's findings, consideration of financial policies applicable to the utilities, and evaluation of multiple alternatives for implementing adjustments to the rates.

In the fall of 2018, the consultant and UAC completed analysis of the SPFs, and on November 14, 2018, the UAC formally recommended approval of the consultant's recommendations to modify the SPFs (listed above as items 5 and 6). The City Council approved the modifications on December 11, 2018.

Thereafter, the UAC continued its discussions with the consultant and staff regarding the rates charged in the Winslow water and sewer systems, the Rockaway Beach water system, and the South Island Sewer System (listed above as items 1 through 4).

When considering the appropriateness of utility rates, many factors are considered:

1. Revenue requirements of the systems;
2. Projected capital improvements;
3. Cost to serve each class of customer (e.g., single family residential, multi-family residential, commercial, irrigation); These costs usually vary among the classes because operating and capital expenses typically are not equitably allocated to each.
4. Allocation of charges to a minimum level of service (the “base rate”) as opposed to a customer’s actual usage of water or sewer (“consumption rate”);
5. Impact on customers for each separate utility and for the combined users of water and sewer (most, but not all, Winslow residents are served by both water and sewer utilities).

II. Summary of Financial Condition of Utilities

Before discussing the rates, short comments on the financial condition of the four utility systems will provide some context. In general, the City’s four separate water and sewer systems are financially sound. However, each is different. Below is a summary of each:

1. Winslow Water System (2598 customers).

The water system has low rates in comparison to other water utilities, and significant reserves (\$7,600,000). It has no debt. Planned CIP projects totaling \$9,200,000 over the next 6 years, most notably for replacement of the high school storage tanks, will draw down most of the reserves. Therefore, it is projected that a modest rate increase and limited issuance of bonded debt will be necessary to cover increased costs and ensure maintenance of an adequate reserve.

2. Rockaway Beach Water System (70 customers).

Although this water system is physically separate from Winslow's water system, its operations are fully integrated with it.

Rockaway Beach customers pay slightly higher rates than Winslow customers, a vestige of the late 1990's transfer of the system to the City.

3. Winslow Sewer System (2114 customers).

The Winslow sewer system has relatively higher rates in comparison to other local sewer utilities, primarily driven by past expensive upgrades to the Winslow Wastewater Treatment Plant and other projects (such as the reconstruction of an Eagle Harbor beach main). The system has current reserves of \$6,600,000. The 6-year CIP projected at \$9,800,000 includes, among other projects, expensive reconstruction and renovation of pump stations, and thus it is expected that a bond issue will be issued in 2021.

4. South Island Sewer (225 customers).

This stand-alone sewer system utilizes the City's collection system with treatment of effluent provided by Sewer District #7 (pursuant to a contract with the City). The customers' sewer rates do not currently include the cost of planned capital upgrades to the system, a vestige of the 2000's construction of the system.

The consultant's analysis of the systems revealed that the costs to serve certain classes of customers did not match the rates charged for those same classes. This finding is not surprising as it has been many years – perhaps decades – since a cost-of-service adjustment was implemented. In fact, reviewing costs-of-service allocation is precisely why periodic rate studies are conducted by utilities.

III. Analysis by UAC of Water and Sewer Rates

With the above summary in mind, the consultant, staff, and UAC concluded that a relatively modest increase in revenue was needed for each utility, but that adjustments in greater or lesser percentages were needed in specific classes of customers.

1. Winslow water system.

- a. The system should increase revenue by approximately \$50,000 each year over the next 5 years to keep abreast of rising costs. To partially fund this goal, a modest (2.0%) aggregate rate increase per year is necessary. This additional revenue will not fully fund capital needs. Modest use of future debt is recommended considering the long-term useful life of the assets.
- b. Capital and operational costs indicate that rates for single family customers should be increased greater than the 2% aggregate, and rates for multi-family, commercial, and irrigation customers should be decreased. Rather than immediately making such an increase or decrease, the UAC recommends that adjustment of rates between classes of customers be phased in over 3 years, and thereafter the rates be increased by 2% across the board.

2. Rockaway Beach water system.

- a. The conclusions discussed directly above apply similarly to the Rockaway Beach system. It is noteworthy that all of Rockaway Beach's customers are in the single-family residential class.
- b. Continuing to charge slightly higher rates than Winslow's is no longer justified, and therefore the rates should be adjusted to be the same as Winslow.

3. Winslow sewer system.

- a. The system should increase revenue by approximately \$130,000 each year over the next 5 years. This additional revenue will mean that an aggregate rate increase of 2.0% per year is necessary.
- b. The utility is forecast to continue paying down significant debt (in excess of \$1,000,000 annually) while planning to implement a major capital improvement program. Recognizing the impact on rate payers, the proposal combines a strategy of modest rate increases with future debt. Overall, the proposal will provide for the financial requirements of the utility, while moderating rate increases and achieving a net reduction in indebtedness.
- c. Capital and operational costs indicate that rates for single family and multi-family customers should be decreased rather than increased by 2% per year, and rates for non-residential customers should be increased greater than 2% per year. Rather than immediately making such increase or decrease, the UAC recommends that adjustment of rates between classes of customers be phased in over 3 years, and thereafter the rates be increased by 2% across the board.

4. South Island sewer system.

- a. The conclusions discussed directly above apply similarly to the South Island sewer system.
- b. Current rates do not recover costs needed for capital reinvestment in the city's collection system. Accordingly, the rates are being increased to include those costs.

IV. Policy Considerations

During the 13 meetings the UAC devoted to this topic, the consultant, staff, and UAC discussed many policies for the utilities, and how their implementation would impact the classes of water and sewer customers.

The most Important of the policy considerations discussed were the following:

1. Capital Project Funding.

All utilities must continually reinvest in their facilities by construction of capital projects. Should this reinvestment be funded by rates (paid by current ratepayers), bond issues (paid by future ratepayers), or a combination of both?

The UAC answered this by concluding that the systems should employ a combination of both, that is through accumulation of rate-generated reserves and issuance of bonded debt for projects with long-term useful lives.

2. Adjustment of Rates Among Classes.

As mentioned, it is very common that a rate study reveals that certain classes of customers are paying more or less than the infrastructure and operational costs necessary to serve the classes. How should the inevitable adjustments in rates among classes of customers be implemented?

The UAC answered this by concluding that adjustments of rates among classes should be phased in over three years to allow for better financial planning for customers.

3. Base Versus Volume Charges.

The water and sewer utilities have a wide variety of users, particularly within the commercial class. Some have small impacts on the systems, such as professional offices, while others are major users of water and sewer, such as restaurants. Still others, like churches, have large fire flow requirements yet only intermittent usage. How should the rates for these non-residential customers be established to fairly pay for the cost of infrastructure and service?

The UAC considered establishing additional classes of commercial customers to segregate costs accordingly, but was hesitant because of the increase in administration necessary to do so. Rather, the UAC decided to primarily increase rates for usage of water/sewer (known as the "volume charge") rather than increasing the base charge for a service connection. This method more fairly allocates the costs to those customers using larger volumes of water and sewer.

V. Conclusion

The UAC recommends approval of the water and sewer rates contained in the consultant's report dated March 7, 2019.

APPROVED BY THE UTILITY ADVISORY COMMITTEE ON MARCH 7, 2019



Jeff Kanter and Andrew Maron, Co-Chairs

Charles Averill, Steven Johnson, Ted Jones, Nancy Nolan, Emily Sato