

22 July 2011

Project Memorandum

To: Lance Newkirk, Public Works Director
From: Thomas Keown
Reviewed By: Gary Bourne (BHC), Katy Isaksen (KIA)
Project: City of Bainbridge Island
Utility Business Advisor
Subject: Response to UAC Questions of UBA Presentation

BACKGROUND

The Utility Business Advisor (UBA) consulting team, led by Tom Keown, P.E. (formerly of GHD Inc., now with Kennedy/Jenks Consultants) along with Katy Isaksen (Katy Isaksen & Associates) and Gary Bourne (BHC Consultants), presented preliminary findings of the water utility study to a joint meeting of the City Council and Utilities Advisory Committee (UAC) on May 18, 2011. The City Council asked the UAC to review the findings and prepare a recommendation for the Council. In order to facilitate the review, a meeting is scheduled between the consultant team and the UAC for the team to provide more detail, discuss questions and the UAC to provide input before the consultant team finalizes the report. Based on information discussed at the UAC meeting, the consultant will prepare the final report and plan to present it to the City Council at another joint meeting to be scheduled.

In order to prepare for the consultant team meeting, the UAC developed their questions. Two files transmitted the questions, dated 6/3/2011: UAC Questions for GHD RE-UBA Report-2.pdf and Peters 6-1-2011 questions for utility advisers.doc.

RESPONSE

The preliminary findings were presented in a higher level overview on May 18, 2011 in order to focus on comparing the water utility options for the City Council's consideration and to fit within the time constraints of the meeting. The consultant team does have more detailed analyses to support the water utility comparison and would like to share this with the UAC at the planned meeting (July 26). This written response to the questions is a preview and in addition to the detailed information to be presented and discussed at the UAC meeting.

David Ward

1. Re: number of FTE's in optimized COBI solution and KPUD – The consultant team will be providing a detailed description of the FTE's (by function and number) included in the alternatives. Briefly, the resulting difference is based on two primary factors. First, approximately one of the two FTE difference is a result of what activities COBI

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completes “in house” compared to outsourcing. The following services are provided by COBI internally and are generally outsourced at KPUD:

- Engineering
- GIS
- Survey
- Construction Services
- Legal

Second, during the May 18th, 2011 presentation where the allocations for Number of Connections/FTE and Mile of Pipe/FTE were discussed you will notice that KPUD scored very well. KPUD does a very good job of providing service with as few employees as possible. However, for the COBI optimized solution, a total of 4 FTEs were used to match the FTE average range of other water utility providers. After further discussion and evaluation with staff, it may be possible to lower the FTE count. This discussion and evaluation effort is beyond the scope of this effort.

2. Re: a business/financial model for the optimized solution – Yes, the consultant team has developed spreadsheets to support the comparison of alternatives. These are sophisticated enough to compare the dollar impacts of each alternative and will be included in our UAC discussion and final report.
3. Re: optimized solution operating cost and FTE's – The breakdown of operating costs will be addressed by the consultant team at the UAC meeting.

Randal Samstag

1. Re: expand on conclusion that the existing water rates could be reduced by 34% - The revenue requirements to be supported by monthly rates were 34% less than the estimated revenue from the existing rates. The city has reduced expenses in recent years and an adjustment to the rates is a logical next step. Prior to 2010, the city had an annual escalator on the rates to keep up with cost escalation and construction increases. The detail will be shown and discussed at the UAC meeting and in the final report.
2. Re: a value of the system of less than \$2.5 million, what would be optimum level of reserves –The consultant's analysis identified a conservative level of target minimum reserves to be used in the comparison between alternatives. This will be discussed at the meeting:
 - a. Cash flow reserve, 3 months operating expense, \$310,000
 - b. Debt reserve, 1 year debt repayment, \$0
 - c. Emergency reserve, 2.5% of fixed assets on \$17.4M, \$435,000
 - d. Rate stability reserve, 10% of water sales at \$2.35M, \$235,000
3. Re: what level of capital expenditure did the 34% reduced rate include – 2.5% of fixed assets or \$435,000 to be funded by rates on an annual basis is included.

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4. Re: what level of capital reserve – see above response.
5. Re: did the 34% reduction include an accelerated reduction in the existing capital reserve? – Yes, at \$435,000 per year as system replacement funding from rates, a total of \$2,175,000 would be available over the five years, 2011-2015. With \$3,797,080 in capital improvements identified for the same period, the additional \$1,622,000 would be funded by drawing down reserves. More details will be presented and discussed at the UAC meeting.
6. Re: did the 34% reduction assume an intertie negotiation and is the reservoir necessary? – No, this was not included in this calculation. However, this alternative is available and would likely result in further savings to the City.
7. Re: impacts on other utilities – This will be addressed at the UAC meeting.
8. Re: issues involved in transferring capital to KPUD – All alternatives in the preliminary findings were silent on the use of reserves for a fair comparison. The \$5 per month from KPUD's proposal is in lieu of transferring reserves to fund the capital. The team will be showing another set of alternatives at the UAC meeting where reserves are assigned.
9. Re: same questions for the 45% optimized scenario – Are similar as mentioned above. These will be provided and discussed at the UAC meeting.

Andrew W. Maron

1. Re: FTE guidelines or ranges – The selected entities that were presented at the initial findings presentation were chosen based on each purveyor's water utility (only) data which included:
 - Staffing levels
 - Size of the utility
 - Type of sourceThe initial survey results will be shown at the UAC meeting to show which entities were excluded to illustrate this further.
2. Re: norms for capital expenditures on an annual basis – Every municipal utility sets its own capital expenditure policy based on the system needs, age of infrastructure and identified capital projects from the water system plan.
3. Re: optimum number of customers for water systems – The team is not aware of any available data that suggests an optimum number of customers. Generally, each system is designed to serve the needs of the customers based on geographical area, population, etc. The team's understanding is KPUD can accommodate the COBI system by absorbing some of the effort within the existing staffing levels, therefore we believe it

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is reasonable that COBI could accommodate additional customers by absorbing some of the effort within their existing staffing levels.

4. Re: if KPUD was contracted to manage the system, would city water FTE's disappear – 5 FTEs would need to be eliminated. 1.0 FTEs would need to be redistributed to the storm/sewer utility and 0.5 FTE to the general fund. Please note, KPUD indicates that they would need to hire 2 additional FTEs. This will be discussed in further detail at the UAC meeting.
5. Re: is \$1000 per customer a fair value & what about reserves – The baseline for this value was our conversations with both KPUD and WWSC. They stated that this value was based on their recent practice. KPUD noted that they would not pay more than this amount. WWSC noted that they may pay more based on the financial status of the water utility under consideration to be purchased. This estimated market value did not include the approximate \$4-5M cash reserves in COBI's water utility fund after the interfund loan is repaid. Legal issues concerning the ownership and status of any reserves are outside the scope of the consultant team's work and would need to be separately addressed by the City Attorney.

Dan Mallove

1. Re: Valuing the Water Utility – Please see answer to Andy Maron's Question #5.
2. Re: City Staff Input. – All three entities (COBI, KPUD, WWSC) were initially provided the same list of questions which included requests for information. The consultant team then held separate meetings (with no other entity present) to review the questions and ensure that our interpretations and assumptions of each entity's response were correct and accurate before going forward with presenting the team's initial findings. The monthly rates were provided by KPUD and WWSC and the consultant estimated rate impacts for the COBI alternatives based on the analysis. The data showed that the City had been reducing costs and an adjustment to the rates appeared to be the next step necessary. The team will have the detail supporting this for discussion at the UAC meeting as described above. Industry standards/benchmarks include:
 - American Water Works Association Manual of Water Supply Standards
 - Washington State Department of Health Engineering Design and Operations Standards,
 - AWC 2010 Utility Rate Survey Results for Water
 - Consultant Monthly Residential Water Rate Comparison
 - Consultant Team FTE Survey Results
3. Re: Progressive Preventative Maintenance – When benchmarking COBI compared to the other entities (KPUD and WWSC) it became apparent that COBI staff provides a

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higher level of preventative maintenance inspections and resulting corrections before equipment fails. KPUD and WWSC generally perform “reactive” maintenance, or rather corrections, after their equipment fails. The cross-connection control program as currently undertaken by COBI focuses on the “last device” within a building as directed in the Uniform Building Code (UBC). However, both KPUD and WWSC’s cross-connection programs comply with WAC 246-290, so their authority ends at the customer’s meter. This is known as premise isolation. So, the normalization of FTEs showed the COBI water utility only providing premise isolation. Since the UBC still requires “last device” inspections this additional activity and cost (estimated at 0.2 FTE, or \$15,000) could be attributed to the COBI Building Department or could be provided by KPUD/WWSC at an additional cost to COBI.

4. Re: operational costs – The team will have the detail supporting this for discussion at the UAC meeting as described previously.

Arlene Buetow

1. Re: municipal code changes – The municipal code will need to be reviewed for any changes approved by the City Council and implemented by the administration. This is a normal course of business by the administration and Council.
2. Re: assessment of lane case – The consultant team understands there would be no net change regarding the financial impact of the Lane case to the City regardless of which alternative is chosen. Further analysis of the Lane case and other case law is outside the consultant team’s scope of work and should be referred to the City Attorney.
3. Re: excess water rights and valuation – The consultant team made no determination on whether excess water rights were available. Since the team did not establish the availability of water this was not part of the valuation. The team did ask KPUD and WWSC what the value of excess water rights might be. They did not offer the team an estimate due to the complicated variables of appropriating water rights. However one mentioned that water rights would be considered to be additional only after accommodating planned build out. A complete discussion of water rights and future value should include the assistance of legal advice obtained through the City Attorney.
4. Re: control level of service – The summary chart shows green for no change, and yellow or red when there is a change in the existing level of control that the City has. In the case of management options, the City would be in a position to negotiate the level of service terms with the developer/contractor. In the case of transfer/own, COBI will no longer have control over setting the level of service, so it was expressed as a “con”. Also please see the consultant team’s answer to Don Mallove’s Question #3.
5. Re: control over capital projects – The summary chart shows green for no change, and yellow or red when there is a change in the existing level of control that COBI has. In

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the case of the management options, COBI could negotiate with the developer/contractor the level of service. And in the case of transfer/own, COBI would no longer have direct control over scheduling, design and financing of water-only capital projects. This could impact the efficiency and effectiveness of COBI to initiate and complete projects that meet the goals of the city. Of course COBI would still have control in the case of joint projects with another jurisdiction or utility, but a higher degree of collaboration would be required. In addition, our experience indicates meeting schedules are delayed when you need to coordinate a meeting with different entities to discuss approvals/project needs as compared to holding a meeting with staff from one entity.

6. Re: control over land use/growth – It is true that COBI has control over land use and growth in their responsibilities separate from the water utility. In addition, however, utilities have used indirect methods of impacting growth by setting and scheduling capital improvements. These boxes were colored to indicate that from a policy perspective COBI may be reducing their options to influence the process in the case of management or ownership transfer.
7. Re: control over water resource planning – These boxes were colored to indicate that from a policy perspective COBI may be reducing their options to directly influence the water resource planning process in the case of management or ownership transfer. If divestiture of the water utility occurs, then COBI would not be in as strong a position to fund water resource research efforts. COBI staff would no longer be involved in the day-to-day monitoring of the aquifers, so any immediate issues would not be known to the city unless the information is communicated by other parties. COBI would no longer have any significant wells in their control, so would not be able to directly or immediately respond to issues with the aquifer. This is a topic that will likely need further research and legal opinions as the City should not abdicate its statutory responsibility to perform water resource planning. This could result in redundant efforts.
8. Re: water rate comparisons – the consultant team will have two sets of scenarios at the UAC meeting with the rate components built up for each alternative. It is important to note that use of reserves and rates are tied together and need to be compared using consistent assumptions for a fair comparison. The scenario shown in the joint meeting did not specify the use of reserves for any of the options. A second scenario has been developed that makes consistent assumptions about the use of reserves and the resulting rate impacts.
9. Re: water utility valuation – Please see answer to Andy Maron’s Question #5

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Council Member Barry Peters

1. Re: budgetary policies– The consultant’s analysis identified a conservative level of target minimum reserves to be used in the comparison between alternatives. The team did not examine the City’s budgetary policies related to reserves as this was beyond the scope and would be a policy matter for the City to decide. The typical reserve values used in our analysis will be discussed at the UAC meeting. Also see Samstag Question #2.
2. Re: Operating efficiencies - These interfund loans earn interest for the water utility so there is no loss to the utility or ratepayers. The billing related activities of the storm and sewer fund would be impacted by 0.25 FTEs (approximately \$20,000), assuming no optimizing efforts of the sewer and storm billing functions were undertaken. Operationally, there will be a net reduction of 2 FTEs water utility field staff. This reduction in force will not likely impact the efficiency and effectiveness of City storm and sewer field activities on “routine” days, but going forward would limit management’s options to address sewer or storm field issues during peak load activities (e.g. emergencies) or when these staff are out of the office (ie vacations, sick leave, training, etc.). Going forward, the City would need to address mitigation strategies to overcome the staffing issue if a transfer of ownership were to occur. Actions to consider would be to purchase additional equipment to assist with emergency repairs that would replace the labor deficit; work with the community to develop an acceptable lower level of emergency response capability, etc. Finally, the total potential impact on the sewer fund and general fund will be discussed at the UAC meeting.
3. Re: Expanded scenario - It would require the willingness on the behalf of another water utility purveyor to express an interest to become part of the COBI water system. The consultant team is not aware of any interested water utilities. The team believes that KPUD would be willing to meet and discuss the possibility of transferring the North Bainbridge Water System, but they have not formally expressed an interest in transferring/selling this system.
4. Re: Joint utility operations - Yes, there are definite possibilities as this new legislation eliminates previous legal barriers for municipalities to form a joint utility. However, these joint utility operation agreements require all parties to negotiate, so currently there is no known benefit or detriment to COBI’s water utility until each interested party came to the table to discuss how the agreement might work.

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5. Re: franchise fee - The range stated appears to be reasonable, although that can be changed at any time. AWC provides a biennial survey of utility taxes and fees but does not list franchise fees. The analysis includes the assumption provided by KPUD that a franchise fee could be accommodated, estimated the same as the 6% city utility tax rate. For a fair comparison, this same 6% was added to the WWSC rates. The details will be provided and discussed at the UAC meeting. This brings up an issue of inequity that currently the city water utility customers are the only water customers paying the city utility tax.
6. Re: Water right valuation - The team did ask KPUD and WWSC what the value of excess water rights might be. They did not offer the team an estimate due to the complicated variables of appropriating water rights but did mention that "excess" would be considered at build-out.
7. Re: Explain drawbacks - Please see the answer to Arlene Buetow's Question #8 and #5 respectively.
8. Re: WWSC scenario - WWSC does appear to have less of an immediate economic benefit to COBI's ratepayers. The scope of this effort was to provide a fair comparison among alternatives to support a robust policy discussion among the Council, not to provide recommendations.
9. Re: Water rate structure - This analysis did not consider the rate structure details, other than to note that each alternative includes a base rate and increasing volume tiers that would affect each individual customer differently. In order to make a fair comparison, a typical residential customer using 1000 cubic feet of water in a month was compared. The question of weighting revenue between base and volume rates would be part of a rate study and not included in the scope of this effort. It is important to recognize that the 34% rate adjustment could be accommodated by decreasing each element of the rate structure by the same percentage, assuming the customers use the same volume of water, but a rate study would specifically evaluate whether other adjustments would be recommended.
10. Re: Water usage request - This question has been called to the attention of staff.
11. Re: Use of interties - Interties are often an effective tool in balancing the needs of water system demand and an aquifer. An intertie can also provide a second source of supply in the case of an emergency. The consultant team encourages the City to engage with

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KPUD to explore this option as there is a high degree of certainty that this will result in a successful outcome.

12. Re: 2009 debt service expense - The amount was the 2009 final payment of LTGO bonds issued in 1995. There is no existing debt for the water utility.
13. Re: define "tax savings" - The reference to "tax savings" may be referring to the last slide in the preliminary presentation. The terms savings, impact, reduction, etc. all depend on the point of view being described at the time. An overview of the taxes follows: the budget is prepared with an assumption of the state taxes and city utility taxes that are estimated based on revenue to be collected. The water rates presumably have been set to reflect the fact that the water utility will pay state and city utility taxes. If the water rate were to be reduced (by say 30%), then the utility would receive less revenue and pay less in taxes to the state and city (another 4% savings). The budget items for state and city utility tax would be reduced and the total reduction would be 34% savings. On the other hand, this reduction in city utility taxes would have a negative impact on the general fund – there would be less utility tax revenue from the reduced water rates. The COBI water rates include state and city utility taxes. Contrary to KPUD and WWSC which set water rates without these items included, and add appropriate taxes on the bill.