

CITY COUNCIL STUDY SESSION

Utilities Department Proposed 2019-2020 Budget and Rates.

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Utilities Department

DIRECTION NEEDED FROM COUNCIL**DIRECTION**

Staff is seeking feedback and direction regarding the Utilities Department proposed budget and rates for 2019-2020.

RECOMMENDATION

N/A

BACKGROUND & ANALYSIS

The Utilities Department operates as a business enterprise within the City structure. The Utilities Department does not receive tax revenues for utility services and relies primarily on rates to fund operations and capital programs. Utility revenues do not generally grow without rate increases, and there is limited potential to increase revenues from population or economic growth.

Utilities is a capital-intensive industry. The City of Bellevue owns, operates, and maintains over \$3.5 billion of utility infrastructure assets, with over 1,600 miles of pipeline to provide clean and safe drinking water; safely convey wastewater away from homes and businesses; and safely manage storm and surface water runoff to protect property and the environment. Most of this infrastructure is past midlife. As infrastructure ages, it becomes less reliable and more failures occur. As a result, the cost to operate, maintain, rehabilitate, and replace infrastructure increases.

Key Council Adopted Financial Policies Guiding Budget Development

The 2019-2020 Utilities Department proposed budget and rates implement Council adopted financial policies and are based on the full costs of providing utility services. The Waterworks Utility Financial Policies were first adopted by Council in 1995 and updated in subsequent budgets. Key financial policies affecting the budget and rates development process are summarized below:

Rate Levels. Rates should be set at a level sufficient to cover current and future expenses, maintain reserves consistent with Utility financial policies and the long-term financial plans, and to pass through wholesale cost increases directly to Utility customers. Changes in rate levels should be gradual and uniform to the extent that costs can be forecasted.

Reserves. Each Utility shall maintain a reserve to protect the solvency of the funds. Additionally, to provide rate stabilization, reserves will be managed to target levels. The reserve policy was updated in 1997-1998 to stipulate all unanticipated reserves (ending fund balances) greater than planned levels will be transferred to the infrastructure Renewal and Replacement (R&R) Account in a manner

consistent with the long-range Utility financial plan.

Capital Investment/Reinvestment. Investment in capital infrastructure and/or deposit of funds in an R&R Account are to be made to ensure that current and future customers pay an equitable amount for the long-term integrity of utility systems. The R&R Account will accumulate high levels of funds in advance of major expenses. These funds will provide rate stabilization over the long-term when used for this purpose and shall not be used for rate relief.

Rigorous Budget Review Process

Fiscal stewardship is an essential element of Utilities' budget development. The 2019-2020 proposed budget and rates were developed with an eye towards delivering reliable, high-quality services to customers, maintaining long-term financial sustainability, responsibly maintaining and replacing aged infrastructure assets, and ensuring competitive rates for the ratepayer.

The budget before Council has been through a rigorous process with multiple layers of review to ensure these objectives are met. This includes budget review and scrutiny by the Department leadership, the City's Leadership Team, and City Manager's Office.

Additionally, the proposed Utilities Department budget and rates have been thoroughly reviewed by the Environmental Services Commission (ESC). Utilities is the only department in the City whose operating and capital budgets are reviewed by a board or commission.

Environmental Services Commission Recommendation

The ESC advises City Council on water, wastewater, storm and surface water, and solid waste utility programs in the areas of planning, budgeting, ratemaking, CIP financing, contracts, and policies. Review of the Utilities Department operating and capital budgets are within the ESC's purview. The Commission is comprised of seven members who reside within the Bellevue Utilities Department's service area.

The Utilities Department proposed budget has been reviewed in detail by the ESC over 10 meetings. Additionally, the ESC took a tour of the major Utilities CIP projects and received public input on the capital investment program through an online open house. The ESC also held a public hearing on the proposed budget and rates on October 4. The ESC's budget review culminates in a budget and rates recommendation to City Council.

The ESC unanimously recommends the proposed budget and rates, and the letter of support is provided in Attachment C. The ESC Chair will be present at the November 13 Council meeting to present the Commission's recommendation.

Community Engagement

In addition to the CIP online open house, numerous ESC meetings, and the public hearing conducted by the ESC on the proposed Utilities Department budget and rates, the Department conducted several outreach efforts on the proposed budget and rates with the Bellevue community. This included

presentations and discussions with neighborhood leaders, the Bellevue Chamber of Commerce, and the Building Owners Management Association.

Key Budget Components

The key cost drivers for the proposed 2019-2020 budget are budget increases to fund wholesale costs, infrastructure funding for current capital investment programs and future renewal and replacement needs, local operating costs, and financial obligations such as taxes and interfund payments for internal support services.

Wholesale Costs

The single-largest cost center for the Utilities Department is wholesale costs. Wholesale costs include payments to the Cascade Water Alliance for the cost of purchasing water supply and regional capital facility charges and payments to King County Metro for wastewater treatment. Consistent with Council adopted financial policies, the proposed budget fully funds wholesale cost increases, thereby ensuring funding for local programs are not degraded. Wholesale costs represent approximately 37 percent of the total budget for the Utilities Department, or \$116 million for the 2019-2020 biennium.

Local Costs

Capital Investment Program (CIP): Aside from wholesale costs, the next largest cost driver for the Utilities Department is the CIP and the cost to renew and replace infrastructure, representing approximately 30 percent of the total budget for Utilities Department, or \$95 million for the 2019-2020 biennium.

The City's utility infrastructure is aging, and increased maintenance and capital investments are inevitable. The future capital program will focus largely on renewal and replacement of this aging infrastructure. Over the 2019-2025 planning period, the City's investment in the proposed Utilities CIP totals \$225 million. The proposed CIP is developed in close coordination with other Departments, such as Transportation, to leverage cost efficiencies and minimize disruption to the community during construction.

The following table provides a summary of projected CIP expenditures by year and driver for the 7-year CIP period. See Attachment B for additional detail on the 2019-2025 proposed Utilities CIP.

Table 1: 2019-2025 CIP Expenditures by Driver (\$000's)

Driver	2019	2020	2021	2022	2023	2024	2025	Total
Aging Infrastructure	\$32,161	\$25,305	\$24,428	\$23,214	\$22,345	\$21,951	\$24,078	\$173,482
Environmental Preservation	8,540	480	697	1,461	3,122	2,341	1,902	18,543
Capacity for Growth	8,083	285	541	551	271	276	271	10,278
Service Enhancement	19,725	3,000	--	--	--	--	--	22,725
Total	\$68,509	\$29,070	\$25,666	\$25,226	\$25,738	\$24,568	\$26,251	\$225,028

Major areas of capital investment over the 2019-2025 planning period include:

- **Aging infrastructure:** \$173.5 million, or 77 percent of the total CIP, is proposed to address aging infrastructure needs.
 - \$125.2 million is proposed to address aging water infrastructure needs. Major projects include \$79.2 million for small diameter water main replacements and \$18.5 million for water pump station rehabilitation or replacement. The water utility is in active system replacement and the majority of water utility CIP expenditures will be used to support replacement of existing aging infrastructure. During 2019 and 2020 water rates are not sufficient to fully fund the water utility CIP and R&R reserves are used to subsidize the Water CIP in these years.
 - \$35.3 million is proposed to address aging sewer infrastructure needs. Major projects include \$11.5 million for sewer system pipeline repairs, \$14.5 million for sewer system pipeline replacements, and \$7.8 million for sewer pump station improvements. The sewer utility is in the early stages of systematic asset replacement.
 - \$12.9 million is proposed to address aging storm infrastructure needs. Major projects include \$10.5 million for storm system conveyance repairs and replacement. In the storm utility, the focus continues to be on enhanced condition assessment to better determine future asset replacement needs.

- **Environmental preservation:** \$18.5 million, or 8 percent of the total CIP, is proposed for environmental preservation. Significant investments include funding for storm flood control (\$5.8 million) and lower Coal Creek flood hazard reduction (\$6.1 million).

- **Capacity for Growth:** \$10.3 million, or 5 percent of the total CIP, is proposed to address Utilities' capacity to meet growth in the City. Significant projects include the Midlakes Pump Station improvements (\$3.4M) and construction of a new water inlet station (\$2.3 million).

- **Maintain and enhance customer service:** The proposed budget includes two investments to be funded within existing resources within the water and sewer utilities and will not have an impact on rates.
 - **Service enhancement:** The proposed budget includes \$14.7 million to complete implementation of a new Advanced Metering Infrastructure (AMI) system, which will provide customers near real-time access to water consumption information and allow for early leak detection.
 - **Address operational facility deficiencies:** Utilities needs an additional maintenance facility in the North End of Bellevue to better serve our customers and improve emergency response. The current operations and maintenance facilities are operating at or near capacity and will not meet Utilities operational needs to service the community in the future. The proposed budget includes \$8 million for this investment.

Long-Range Infrastructure Renewal and Replacement (R&R) Planning: The estimated replacement value for water, sewer, and stormwater infrastructure in the City of Bellevue is approximately \$3.5 billion. In 1995, in recognition of the enormity of this future cost, City Council established the Utilities Capital Facilities Renewal & Replacement (R&R) Account. The purpose of the R&R Account is two-fold: (1) achieve customer equity where each generation of ratepayers that use the utility systems pay their fair share of system costs, and (2) create a “savings account” to help smooth peaks in future infrastructure expenditures.

The long-range infrastructure funding plan is premised on building rate capacity to provide sustainable investment in capital infrastructure. This rate capacity is the main funding source for Utilities capital needs. The R&R Account balance serves as a supplemental source of capital funding when needed.

Bellevue Utilities is better prepared than most utilities to meet increasing infrastructure resource requirements due to the R&R Account and the use of long-term infrastructure financial planning to accumulate funds necessary to replace Utilities infrastructure as it ages. This allows Utilities to amortize major pending liabilities over a long-time span, and simultaneously maintain current service levels, keep rate increases gradual and predictable, and maintain intergenerational equity. The following table summarizes the projected balance of the R&R Account by year by utility.

Table 2: R&R Account Ending Fund Balance (\$000's)

	2019	2020	2021	2022	2023	2024	2025
Water	\$27,311	\$23,327	\$25,129	\$30,892	\$39,045	\$49,023	\$59,002
Sewer	69,535	80,229	93,138	106,899	122,003	138,974	157,144
Storm	59,863	70,538	82,366	95,283	108,384	122,559	138,242
Total	\$156,709	\$174,094	\$200,633	\$233,074	\$269,432	\$310,556	\$354,388

Lean Operating Budget: Operating costs include personnel, supplies, and professional service expenses that are necessary to carry out the daily functions of the Department. This cost category represents about 18 percent of the Utilities Department budget, or \$56.8 million for the 2019-2020 biennium. The portion of rate increase attributable to local operating costs is within 1 percent for the combined utility bill.

The proposed budget includes minimal new programs. Local operational cost increases remain below inflationary levels. The only increase in staffing proposed is an increase of 0.25 full time equivalent (FTE) to address increased workload demands in customer service. The budget also includes temporary staffing to implement the AMI system. The following table summarizes the proposed new FTEs and limited term employees (LTEs) included in the 2019-2020 proposed budget.

Table 3: Proposed New FTEs and LTEs

Position	FTEs	LTEs
Billing Account Representative	0.25	--
AMI - Implementation Support	--	6.00
AMI - Meter Reader	--	2.00
Maintenance Worker (expires at end of 2018)	--	(1.00)
Total Change	0.25	7.00

Taxes and Internal Service Provider Payments: Taxes and interfund payments represent approximately 15 percent of the total budget for the Utilities Department, or approximately \$48.4 million for the 2019-2020 biennium. The amount of taxes is based on the amount of revenue collected and the tax rates assessed by the State and cities. No changes to the State and city tax rates are assumed in the proposed budget except for a new utility tax on water and sewer services in the City of Medina. The cost for the new utility tax in Medina will only be passed onto customers in Medina. Interfund payments represent costs that Utilities pays to the General Fund for support services. The portion of the rate increase attributable to taxes and interfund payments is less than 1 percent for the combined utility bill.

See Attachment A for additional detail on the 2019-2020 proposed Utilities operating budget.

Utility Rates

The following table summarizes the rate adjustments in 2019 and 2020 that are necessary to support the Utility Department’s proposed budget as well as forecasted annual rate adjustments for the period 2021 to 2024. The projected rates for 2019-2024 were developed using Council’s policies as the foundation with the goals of achieving both predictable and gradual rate increases. One-time expenditures in the 2019-2020 budget will be funded using extraordinary revenues from 2017. This has enabled Utilities to propose rate increases of 4 percent in 2019 and 3.8 percent in 2020. The proposed 2019-2020 rates are lower than those presented in the Early Outlook forecast in March and reflect updated utility cost projections.

Table 4: Proposed and Projected Utility Rate Increases 2019-2024

	Water Utility	Sewer Utility	Storm Utility	Combined Utility
2019 Proposed	3.7%	3.9%	5.4%	4.0%
2020 Proposed	5.0%	2.3%	5.4%	3.8%
<i>2021 Projected</i>	<i>4.6%</i>	<i>5.2%</i>	<i>5.3%</i>	<i>5.0%</i>
<i>2022 Projected</i>	<i>4.6%</i>	<i>2.5%</i>	<i>5.1%</i>	<i>3.7%</i>
<i>2023 Projected</i>	<i>4.7%</i>	<i>3.9%</i>	<i>5.1%</i>	<i>4.4%</i>
<i>2024 Projected</i>	<i>4.6%</i>	<i>4.0%</i>	<i>4.8%</i>	<i>4.4%</i>

Total Rate Impact to Customer

The monthly utility bill for the typical single-family residential customer for water, sewer, and storm and surface water services is \$169.55 in 2018. With the above proposed rate increases, the total monthly bill for the typical single-family resident would increase by 4 percent or \$6.85 in 2019 and 3.8 percent or \$6.68 in 2020. The following table summarizes the combined water, sewer, and storm and surface water utility bill drivers for 2019-2020.

Table 5: Typical Residential Combined Water, Sewer, & Storm Utility Monthly Bill Rate Drivers

	2019 Bill		2020 Bill	
Prior Year Monthly Bill	\$169.55		\$176.40	
Wholesale Costs	1.4%	\$ 2.35	0.8%	\$ 1.33
Local				
CIP/R&R	1.0%	\$ 1.62	1.8%	\$ 3.22
Taxes and Interfunds	0.6%	1.03	0.5%	0.83
Operations	<u>1.0%</u>	<u>1.85</u>	<u>0.7%</u>	<u>1.30</u>
Total Local	2.6%	\$ 4.50	3.0%	\$ 5.35
Total Increase	4.0%	\$ 6.85	3.8%	\$ 6.68
New Monthly Bill		\$176.40		\$183.08

Even with these rate increases, Bellevue’s utility rates are competitive with neighboring jurisdictions. See Attachment D for a bill comparison with neighboring jurisdictions. Given Bellevue’s long-range financial policies and proactive infrastructure funding plan, our rates will be even more competitive in the future.

POLICY & FISCAL IMPACTS

In accordance with Council-adopted financial policies, utility rate increases are needed to maintain, operate, and invest in utility infrastructure to ensure reliable service delivery to water, sewer, and storm and surface water customers.

OPTIONS

N/A

ATTACHMENTS & AVAILABLE DOCUMENTS

- A. Utilities Proposed 2019-2020 Operating Budget
- B. Utilities Proposed 2019-2025 CIP Budget
- C. ESC 2019-2020 Budget and Rates Recommendation to Council
- D. Utility Bill Comparison

AVAILABLE IN COUNCIL LIBRARY

N/A