

November 14, 2016

CITY COUNCIL STUDY SESSION ITEM

SUBJECT

Utilities Department Proposed 2017-2018 Budget and Rates

STAFF CONTACTS

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Utilities Department

POLICY ISSUES

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.

DIRECTION NEEDED FROM COUNCIL

ACTION

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DIRECTION

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INFORMATION ONLY

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This is a follow-up to Utilities budget overview on October 24, 2016 (see **Attachment A** for the Council agenda memorandum). Staff is seeking feedback and direction regarding the Utilities Department proposed budget and rates for 2017-2018.

BACKGROUND/ANALYSIS

SUMMARY

The 2017-2018 Utilities Department proposed budget and rates were developed with an eye towards delivering high quality utility services to customers, maintaining long-term financial sustainability, responsibly maintaining and replacing aged infrastructure assets, and ensuring competitive rates for the rate-payer. Consistent with those objectives, Utilities' proposed rate increases of 4% per year in 2017-2018 will enable Utilities to continue providing high quality services to our customers while maintaining long-term financial sustainability and rate predictability.

ENVIRONMENTAL SERVICES' COMMISSION (ESC) RECOMMENDATION

The Utilities Department proposed budget has been reviewed in detail by the Environmental Services Commission (ESC) over the course of the year. The Commission has held 10 meetings regarding the budget, including holding a public hearing on the proposed budget and rates on October 20, 2016. In addition, the Commission was briefed regarding public input received through the on-line capital investment program (CIP) open house and took a Utilities CIP tour in July. The Commission made a recommendation in support of the proposed budget and rates on November 3, 2016, and the letter of support is provided in **Attachment B**. The ESC Chair will be present at the November 14, 2016 Council meeting to present the Commission's recommendation.

POLICIES

The 2017-2018 Utilities Department proposed budget and rates are a consequence of longer-term financial forecasts that, according to Council-approved financial policies, are based on the full costs of providing utility services now and in the future. 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 changes in rate levels should be gradual and uniform.
- *Wholesale Pass-Through.* Wholesale costs are to be fully funded and passed through directly to Utility customers.
- *Use of Savings/One-Time Revenues.* Savings or one-time revenues are not used to fund on-going cost increases or buy down rates in the short term. One-time revenues are reserved for one-time expenses or to build the capital facilities Renewal and Replacement (R&R) funding capacity.
- *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 their fair share of the cost to replace utility systems.

HIGH QUALITY SERVICES FOR CUSTOMERS

The Utilities Department has a strong local and national reputation of providing high quality drinking water, sewer, and storm utility services to its customers. Nationally, Utilities has been awarded the most prestigious Sustainability award by the Association of Metropolitan Water Agencies (AMWA). Utilities has also been accredited by the American Public Works Association (APWA) for the past 12 years. Year after year, Utilities' performance metrics are a testament to the high quality services we provide. Unplanned water service interruptions have been sustained at under 5 breaks per 100 miles¹, despite an aging water system with a high composition of asbestos cement (AC) water mains. Annual wastewater overflows have been held to under 4 overflows per 100 miles², also despite an aging sewer system with significant challenges such as submerged lake lines. The proposed 2017-2018 budget provides funding to allow Utilities to continue its commitment of providing high quality services to our customers.

LONG-TERM FINANCIAL SUSTAINABILITY

Utilities in the region and across the country are struggling to meet the increasing demands of aging water, sewer, and storm systems. Many utilities have become steeped in debt and are experiencing 10-20% rate increases for multiple years as they struggle to renew and replace their aged underground infrastructure. In contrast, Bellevue Utilities is significantly better prepared than most utilities to meet increasing infrastructure resource requirements due to the Renewal & Replacement Account and the use of long-term infrastructure financial planning to accumulate funds necessary to replace Utilities

1 Five breaks per 100 miles is a historical benchmark that was established by the City of Bellevue, based on the history of water main breaks from 2000 through 2010. National rates for water main breaks are 4-6 times higher than Bellevue's rates.

2 Four overflows per 100 miles was established as a performance threshold by the Environmental Protection Agency (EPA) and the Washington State Department of Ecology (Ecology) in the City of Seattle's Consent Decree for Sewage Overflows in 2013.

infrastructure as it ages. Utilities's proactive, long-range planning allows for the amortization of major asset replacement needs over a long time span, while maintaining current service levels, keeping rate increases gradual and uniform, and ensuring that each generation of customers pay their fair share of system costs. Long-term financial sustainability is the foundation for Utilities' proposed 2017-2018 budget and rates. The proposed rates do not hold the promise of lower rate increases in the near-term at the expense of higher rate increases in the long-term. Rather, the proposed budget and rates have been established with the goal of having sufficient resources to manage the Utilities' infrastructure both now and in the future.

RESPONSIBLE MANAGEMENT OF INFRASTRUCTURE ASSETS

The City's utility infrastructure is aging and increased maintenance and capital investments are inevitable. The proposed budget and rates for local operations and capital improvements will enable Utilities to responsibly maintain and replace aged assets, thereby avoiding an increase in system failures and a degradation of service to customers. The proposed capital improvement program (CIP) expenditures over the 2017-2023 planning period include:

- ***Aging Infrastructure:*** \$159.6 million, or 72% of the total CIP, is proposed to replace aged pipes, reservoirs, and pump stations. Examples of projects include:
 - AC Water Main Replacement: Approximately 35 miles of older AC water main will be replaced. The largest project will involve replacement of approximately 2 miles of AC water main on West Lake Sammamish Parkway, which was found to have between 50-75% degradation in 2015. Replacement of the water main on West Lake Sammamish Parkway will prevent a potentially catastrophic failure, such as the one which occurred in 2011.
 - NE 8th Street Culvert Replacement at Kelsey Creek: The existing culvert on NE 8th Street at Kelsey Creek was identified to have significant deficiencies that could risk a road collapse if left in disrepair. This project will replace the existing culvert with a new bridge structure that will also meet current standards for fish passage.
- ***Environmental Preservation:*** \$27.8 million, or 13% of the total CIP is proposed for environmental preservation and flood protection projects. Projects in this category will prevent flooding at NE 21st and Valley Creek, on Factoria Blvd, in Downtown at NE 8th St and 100th Ave NE, and in the Newport Shores neighborhood. Over 37% of the funds for these projects will be recouped through the King County Flood Control District.
- ***Capacity for Growth:*** \$10.1 million, or 5% of the total CIP, will increase the capacity of the water/sewer/stormwater systems to accommodate growth. Examples projects include a new water inlet station and installation of new water pipelines to supply more water to the downtown and Bel-Red areas.
- ***Customer Service Enhancement:*** \$23.1 million, or 10% of the total CIP, will support implementation of a new Advanced Metering Infrastructure (AMI) system. The AMI system will enable customers to access drinking water consumption information real-time through their computer or mobile device. In addition, AMI will enable real-time notification of leaks on customer premises, promote conservation activities, and enhance water system modeling. This project will be fully funded with existing resources and will not require an increase to rates.

CERTAINTY AND PREDICTABILITY OF UTILITY RATES

Rates are the primary source of revenue for Utilities' services, accounting for 93% of the department's funding. The Utilities Department proposed rates for 2017-2022 (see Table 1) were developed using Council's policies as the foundation with the goals of achieving both predictability and certainty in rate increases. One-time expenditures in the 2017-2018 budget will be funded using extraordinary revenues from 2015. This has enabled Utilities to propose rate increases of 4% in both 2017 and 2018.

Table 1: 2017-2022 Combined Water, Sewer, Storm Utility Rates Forecast

	2017	2018	2019	2020	2021	2022
Early Outlook	5.7%	4.9%	5.8%	3.9%	4.3%	4.1%
Proposed	4.0%	4.0%	4.3%	2.7%	3.5%	3.4%

In all years, the proposed rate increases are lower than the levels anticipated in the Early Outlook forecast.

Table 2 summarizes the combined water, sewer, and storm and surface water utility rate drivers for 2017 and 2018.

Table 2: Combined Utility Bill Rate Drivers

Category	2017	2018
Wholesale Rate Driver	1.8%	0.7%
Local Rate Drivers		
CIP and R&R	1.4%	2.1%
Taxes / Interfunds	0.1%	0.7%
Operations	0.2%	0.5%
Issaquah assumption	<u>0.5%</u>	<u>0.0%</u>
Total Local Rate Drivers	2.2%	3.3%
Total Increase	4.0%	4.0%

The monthly utility bill for the typical single-family residential customer for water, sewer, and storm and surface water services is \$156.74 in 2016. With the above proposed rate increases, the total monthly bill for the typical single-family resident would increase by 4.0% or \$6.30 in 2017 and 4.0% or \$6.51 in 2018. Even with a cash funded capital investment program of \$220 million and a robust funding strategy for future infrastructure renewal and replacement, Bellevue's utility rates are competitive with neighboring jurisdictions. In addition, Bellevue's rates will be even more competitive in the future as other jurisdictions move into active replacement cycles. See **Attachment C** for a rate comparison with neighboring jurisdictions.

ALTERNATIVES

N/A

RECOMMENDATION

N/A

ATTACHMENTS

A - October 24, 2016 Council Agenda Memo on Utilities 2017-2018 Rates & Budget

B - ESC Recommendation Letter

C - Combined and Individual Utility (Water, Sewer, and Storm & Surface Water) Monthly Bill Comparison