

MEMORANDUM

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DATE: February 6, 2020

TO: Environmental Services Commission

FROM: Lucy Liu, Assistant Director – Resource Management and Customer Service Division
Jolie Liu, Fiscal Manager

SUBJECT: Utilities Finances Overview

Action Required at this Time

Staff is not proposing any changes to the Waterworks Utility Financial Policies. No action by the Commission is required at this time. This is an informational briefing.

Fiscal Impact

None.

Policy Issues

The Waterworks Utility Financial Policies guide the development of the Utilities Department operating and capital budgets and rates, and its management of reserves.

Background

On February 6, staff will provide a foundational overview of Utilities finances to help prepare the Commission for upcoming discussions and review of the proposed 2021-2022 Utilities budget. At this meeting, staff will review with the Commission:

- Sources of utility revenues
- Uses of utility revenues
- Financial policies guiding Utilities budget development, rate setting, and reserves management
- How utility rates are set

Rates Are Utilities' Primary Source of Revenues

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. As a result, rate increases are necessary to generate sufficient revenues to keep pace with increasing business costs.

Uses of Utility Revenues

Over half of the Utilities Department's revenues are used to pay external financial obligations. The remaining revenues fund capital infrastructure investments and local operational costs. These cost categories are described below.

- **External Financial Obligations:** Over half of the Utilities Department's operating costs represent legal and contractual financial obligations, including wholesale cost payments for water supply and wastewater treatment, tax payments to the State and cities in Bellevue Utilities' service area, and support service charges from the General Fund. Wholesale costs, representing about 37% of the 2019-2020 Utilities budget, is the largest cost driver for the Department. Taxes and support service costs represent about 15% of the 2019-2020 Utilities budget.
- **Capital Infrastructure Investments:** Outside of wholesale costs, the next largest cost driver for the Utilities Department is the capital investment program and the cost to renew and replace infrastructure in the future, representing about 30% of the 2019-2020 Utilities budget. Utilities infrastructure has a replacement value of over \$3.5 billion and most of the systems are past their mid-life. As infrastructure ages, it becomes less reliable and more failures occur. As a result, the cost to operate, maintain, rehabilitate, and replace infrastructure increases.
- **Local Operational Costs:** Approximately 18% of the 2019-2020 Utilities budget pays for local operations. This includes the cost to operate and maintain the utility systems; provide customer service, billing, engineering system planning, and development services functions; meet regulatory requirements; and maintain the vehicle fleet and technology systems that support utility operations.

Waterworks Utility Financial Policies Guide Budget Development

The City's Waterworks Utility Financial Policies (Attachment A) relate to rate-making, funding and management of operating reserves and capital planning, and serve as the foundation for building each biennial budget and for the ongoing management of the existing budget. These policies were established with the goals of financial stewardship, self-sufficient funding, and comprehensive planning.

The Waterworks Utility Financial Policies were first adopted by City Council in 1995 and updated in subsequent budgets. The key financial policies affecting the budget and rates development process are summarized below.

- **Rates and Rate Levels:** Below are the key financial policies that guide utility rate-setting:
 - Plan for long term investment in infrastructure.
 - Accumulate funds in advance of major expenses.
 - Maintain existing levels of service by renewing and replacing systems.
 - Keep rate increases gradual and uniform to the extent costs can be forecasted.
 - Maintain equity – each generation of ratepayers that use the utility systems should pay their fair share of costs.
 - Use debt sparingly and maintain financial flexibility.
 - Pass wholesale cost increases through to customers so that local programs are not degraded by regional cost increases.
- **Reserves:** Each Utility shall maintain an operating reserve to protect the solvency of the funds. Additionally, to provide rate stabilization, reserves will be managed to target levels. The reserve policy also stipulates 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 their 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.

Utility Rates are Guided by Council-Adopted Financial Policies

The above-referenced financial policies guide the development of utility rates. During the biennial budget process, the Environmental Services Commission reviews the proposed Utilities budget and rates in detail and makes a recommendation to City Council. The Council reviews and adopts rates every two years, as part of the City's overall budget process. Utilities rates are set as low as possible, while still allowing the Utilities Department to accomplish ongoing operations, maintenance, repairs, long-term renewal and replacements, system improvements, and its general business.

Competitive Utility Rates

Bellevue's utility rates are competitive with neighboring jurisdictions. With the Council-adopted financial policy to proactively plan and prepare for infrastructure replacement and renewal, Bellevue's rates will continue to be competitive in the future. See Attachment B for a comparison of sample monthly bills for selected types of Utility customers.

Attachments:

- Attachment A – Waterworks Utility Financial Policies
- Attachment B – 2019 Combined Monthly Bill Comparison