



Memorandum

CITY OF MERCER ISLAND, FINANCE DEPARTMENT

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Date: October 13, 2022

To: Utility Board

From: Ben Schumacher, Financial Analyst

Re: Utility Board Meeting – Water Rates

The preliminary 2023-2024 operating and capital budgets were released to the Public and City Council on September 28, 2022. As part of the biennial budget development process, staff seeks a recommendation from the Utility Board regarding the Water Utility rate adjustment for the upcoming two years, based on rate modeling work completed over the past three months. The Utility Board’s recommended water rate adjustment will directly inform the final 2023-2024 biennial budget, scheduled for City Council adoption December 6, 2022.

2023-2024 Operating Budget

The operating budget for the Water Utility presented in the table below.

Description (\$ in thousands)	2021	2022	2023	2024	Percent Change	
	Actual	Forecast	Budget	Budget	22-23	23-24
Budgeted Operating Expenditures						
Salary & Benefits	\$1,357	\$1,653	\$1,728	\$1,853	4.6%	7.2%
Water Purchased for Resale	2,223	2,239	2,351	2,468	5.0%	5.0%
Other Services and Charges	1,446	1,755	1,674	1,773	-4.6%	5.9%
Debt Service	109	107	1,577	1,582	1370.4%	0.3%
Total Operating Expenditures	\$5,134	\$5,754	\$7,330	\$7,676	27.4%	4.7%

Some highlights from the preliminary budget:

- The combined total for **salary and benefit** costs in 2023 are increasing 4.6% as compared to the 2022 budget. The increase is a result of the current pace of inflation which has led to atypically high cost-of-living adjustments (COLA), per the City’s collective bargaining agreements. The COLA increase is 6.0% for 2023 and 6.0% is estimated for the 2024 budget.
- The salaries & benefits budget includes two new positions, a **Utilities Engineer** limited term position, primarily meant as a hire ahead for an expected retirement in the 2023-2024 biennium, and a **Capital Project Inspector** which will work across all three utilities and some general government projects. Existing staffing of the Water Utility includes seven Public Works team members dedicated to the operation and maintenance of the water system, as well as administrative oversight, utility billing and customer service, utility inspections of private development, and GIS (geographic information system) support. The total dollar impact to the Water Utility for the two new positions is \$180,647 in 2023 and \$191,828 in 2024 which represents 100% of the Utilities Engineer and 25% of the CIP Inspector.

- **Water Purchases** from Seattle Public Utilities (SPU) are projected to increase 5.0% in 2023 as compared to the 2022 budget and 5.0% in 2024. Note that SPU sets a higher rate for the period of Peak usage (May 15-Sept 15) than for the period of non-peak usage (Sept 16-May 15). The cost of water purchases makes up about 32% of all Water Utility operating expenses.
- Existing **debt service** costs are related to repayment of the debt issued in 2011 on the First Hill Booster Pump Station upgrade and water system improvements projects. The Water rate model includes the proposed issuance of \$19.1 million in additional debt in 2023 to fund water capital improvement projects (tentatively the meter replacement project, water reservoir improvements, asbestos cement main replacement, and pressure reducing valve station replacements) planned for 2023 and 2024. Issuance of new debt would result in additional annual debt payment estimated at \$1.47 million, beginning in 2023.

Given State law requirements, projects must be completed within 3 years of the respective date of debt issuance. Staff has observed material delays with the ongoing Pandemic and is relying on available fund balance through the design phase of qualifying projects. Staff would initiate the debt issuance process once projects are through the design phase and poised to begin construction, ensuring projects can be completed within the required timeframe.
- **Other Services and Charges** include all other costs of operations including supplies, contract services, insurance, and City administration costs. The latter includes the Water Fund’s share of administrative support provided by the City Attorney’s Office, City Manager’s Office, Finance, and Human Resources staff. An overhead cost allocation model is used to determine the Water Utility’s proportionate share of these internal services.

Summary Capital Reinvestment Projects

Planned capital reinvestment work in 2023 and 2024 is shown in the table below. Capital investment costs are the primary driver of the proposed water rate increases for 2023-2028.

Water Utility Capital Program 2023-2024 (\$ in thousands)				
Project ID	Description	2023	2024	
WU0100	Emergency Water System Repairs	\$150	\$150	
WU0102	SCADA System Replacement (Water)	75		
WU0103	Water Reservoir Improvements	2,805	2,750	
WU0112	Water System Components Replacement	50	50	
WU0115	Water Modeling and Fire Flow Analysis	15	50	
WU0117	Meter Replacement Implementation	3,253		
WU0120	First Hill Generator Replacement	400	400	
WU0128	Reservoir Pump Replacement	540	540	
WU0130	2023 Water System Improvements (First Hill, NMW, SE 37th Pl, SE 41st-42nd Pl)	4,684		
WU0131	2024 Water System Improvements (8600 Block SE 47th & SE 59th)	373	2,082	
WU0135	2024 AC Main Replacement (Gallagher Hill Rd, Greenbrier and SE 40th)	479	2,680	
WU0136	2025 AC Main Replacement (Upper Mercerwood)		1,040	
WU0140	Pressure Reducing Valve Station Replacements	395	2,025	
WU0141	Street Related Water System Improvements	150	150	
WU0142	Emergency Well #2 Site Evaluation		50	
Water Utility CIP Total		\$13,369	\$11,967	

Water Rate Proposal

The 2023 rate proposal is based on the 2023-2024 operating budget, the 2023-2028 Capital Plan, and the corresponding debt financing needs. The rate model proposes a smoothed rate increase of 8.0% for 2023-2028. **Staff recommends an 8.0% increase to the water utility rates for 2023 as proposed in the 2023-2028 smoothed rate model.** Staff will return during the 2023-2024 mid-biennial budget process with new information as it becomes available to inform potential rate adjustments for fiscal year 2024.

Revenue Requirement	2022	2023	2024	2025	2026	2027	2028
Pre Rate Revenues							
Revenues							
Rate Revenues Under Existing Rates	\$ 9,999,563	\$ 9,999,563	\$ 9,999,563	\$ 9,999,563	\$ 9,999,563	\$ 9,999,563	\$ 9,999,563
Non-Rate Revenues	43,405	38,365	37,252	37,606	37,207	37,682	38,041
Total Revenues	\$10,042,968	\$10,037,928	\$10,036,815	\$10,037,169	\$10,036,770	\$10,037,245	\$10,037,604
Expenses							
Cash Operating Expenses	\$ 5,824,937	\$ 6,190,414	\$ 6,464,270	\$ 6,680,811	\$ 6,911,568	\$ 7,151,734	\$ 7,401,718
Existing Debt Service	107,250	109,531	111,631	108,550	110,150	111,550	107,750
New Debt Service	-	1,470,342	1,470,342	2,093,890	2,093,890	2,563,476	2,563,476
System Reinvestment Funding	3,000,000	3,250,000	3,500,000	3,700,000	3,900,000	3,900,000	3,900,000
Total Expenses	\$ 8,932,187	\$11,020,287	\$11,546,243	\$12,583,251	\$13,015,609	\$13,726,760	\$13,972,944
Net Surplus (Deficiency)	\$ 1,110,781	\$ (982,359)	\$ (1,509,428)	\$ (2,546,083)	\$ (2,978,838)	\$ (3,689,515)	\$ (3,935,341)
Annual Rate Increase		8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Cumulative Rate Increase		8.00%	16.64%	25.97%	36.05%	46.93%	58.69%
Post Rate Revenues							
Revenues After Rate Increases	\$ 9,999,563	\$10,799,528	\$11,663,490	\$12,596,570	\$13,604,295	\$14,692,639	\$15,868,050
Additional Taxes from Rate Increase	-	40,230	83,679	130,603	181,282	236,015	295,126
Net Cash Flow After Rate Increase	\$ 1,110,781	\$ (222,625)	\$ 70,820	\$ (79,679)	\$ 444,612	\$ 767,546	\$ 1,638,020
Sample Residential Bill (3/4" Meter, x 14 ccf)	\$122.15	\$131.92	\$142.48	\$153.87	\$166.18	\$179.48	\$193.84
Bi-Monthly Increase (\$)		\$9.77	\$10.55	\$11.40	\$12.31	\$13.29	\$14.36

Fund Balance	2022	2023	2024	2025	2026	2027	2028
Operating Reserve							
Beginning Balance	\$ 5,762,177	\$ 1,872,958	\$ 1,650,333	\$ 1,721,153	\$ 1,641,474	\$ 1,736,426	\$ 1,808,141
plus: Net Cash Flow after Rate Increase	1,110,781	(222,625)	70,820	(79,679)	444,612	767,546	1,638,020
less: Transfer of Surplus to Capital Fund	(5,000,000)	-	-	-	(349,660)	(695,831)	(1,562,884)
Ending Balance	\$ 1,872,958	\$ 1,650,333	\$ 1,721,153	\$ 1,641,474	\$ 1,736,426	\$ 1,808,141	\$ 1,883,277
<i>Actual Days of O&M</i>	<i>117 days</i>	<i>97 days</i>	<i>97 days</i>	<i>89 days</i>	<i>90 days</i>	<i>90 days</i>	<i>90 days</i>
Capital Reserve							
Beginning Balance	\$10,024,654	\$ 6,240,578	\$13,921,201	\$ 867,812	\$ 2,554,160	\$ 978,660	\$ 1,557,176
plus: System Reinvestment Funding	3,000,000	3,250,000	3,500,000	3,700,000	3,900,000	3,900,000	3,900,000
plus: Transfers from Operating Fund	5,000,000	-	-	-	349,660	695,831	1,562,884
plus: LTGO Proceeds	-	19,100,000	-	8,100,000	-	6,100,000	-
plus: Interest Earnings	25,062	31,203	69,606	4,339	12,771	4,893	7,786
Total Funding Sources	\$18,049,716	\$28,621,780	\$17,490,807	\$12,672,151	\$ 6,816,591	\$11,679,384	\$ 7,027,846
less: Capital Expenditures	(11,809,138)	(14,700,580)	(16,622,995)	(10,117,991)	(5,837,931)	(10,122,208)	(5,749,235)
Ending Capital Fund Balance	\$ 6,240,578	\$13,921,201	\$ 867,812	\$ 2,554,160	\$ 978,660	\$ 1,557,176	\$ 1,278,611
<i>Minimum Target Balance</i>	<i>\$ 475,035</i>	<i>\$ 622,041</i>	<i>\$ 788,271</i>	<i>\$ 889,451</i>	<i>\$ 947,830</i>	<i>\$ 1,049,052</i>	<i>\$ 1,106,544</i>
Combined Beginning Balance	\$15,786,831	\$ 8,113,536	\$15,571,534	\$ 2,588,965	\$ 4,195,634	\$ 2,715,086	\$ 3,365,317
Combined Ending Balance	\$ 8,113,536	\$15,571,534	\$ 2,588,965	\$ 4,195,634	\$ 2,715,086	\$ 3,365,317	\$ 3,161,888

A summary table comparing the proposed rates from the most recent rate model updates (2020-2022) as compared to the current rate recommendation is presented below.

Description	2021	2022	2023	2024	2025	2026	2027	2028
2020 Rate Update	6.50%	6.50%	6.50%	6.50%				
2021-2022 Rate Update	5.25%	5.25%	5.25%	5.25%	5.25%	5.25%		
2023-2024 Rate Proposal			8.00%	8.00%	8.00%	8.00%	8.00%	8.00%

Staff will be available at the Utility Board meeting to answer questions regarding the proposed operating and capital budgets, as well as the proposed 2023 water utility rate increases.

The 2023 Water Utility rate resolution is on the City Council planning schedule for review and adoption on November 15, 2022.