



# 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 – Sewer Rate Update

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 Sewer Utility rate adjustment for the upcoming two years, based on rate modeling work completed over the past three months. The Utility Board’s recommended sewer 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 Sewer Utility is presented in the table below.

Description (\$ in thousands)	2021	2022	2023	2024	Percent Change	
	Actual	Forecast	Budget	Budget	22-23	23-24
<b>Budgeted Operating Expenditures</b>						
Salary & Benefits	\$1,132	\$1,385	\$1,460	\$1,567	5.4%	7.4%
King County Sewer Treatment	4,928	5,217	5,518	5,836	5.8%	5.8%
Debt Service	1,037	1,036	1,034	1,032	-0.2%	-0.2%
Other Services and Charges	1,090	1,234	1,350	1,373	9.4%	1.6%
<b>Total Operating Expenditures</b>	<b>\$8,187</b>	<b>\$8,872</b>	<b>\$9,363</b>	<b>\$9,808</b>	<b>1.0%</b>	<b>6.9%</b>

Some highlights from the preliminary budget:

- The combined total for **salary and benefit** costs in 2023 are increasing 5.4% 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 in 2023 is 6.0% and is estimated at 6.0% for the 2024 budget.
- The capital budget includes one new position, a **Capital Project Inspector** which will work across all three utilities and some general government projects. Existing staff in the Sewer Utility includes six Public Works team members dedicated to the operation and maintenance of the sewer system, as well as administrative oversight, utility billing and customer service, utility inspections of private development, and geographic information system (GIS) support. The total dollar impact to the Sewer Utility for utility’s portion of the Capital Project Inspector is \$33,144 in 2023 and \$35,252 in 2024 which represents 25% of the position.
- **King County Sewer Treatment** services are authorized by King County to increase 5.76% in 2023. Increases are passed through to sewer customers and are identified separately on a customer’s utility bill.

- Existing **debt service** costs are related to repayment of the debt on the Sewer Lake Line project and include a Public Works Trust Fund Loan and LTGO bonds. The sewer rate model assumes no new debt will need to be issued for capital projects in 2023-2024.
- **Other Services and Charges** include all other costs of operations including supplies, contract services, insurance, and City administration costs. The latter includes the Sewer 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 Sewer Utility’s proportionate share of these internal service functions.

### 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 sewer rate increases for 2023-2028.

Sewer Utility Capital Program 2023-2024 (\$ in thousands)			
Project ID	Description	2023	2024
SU0100	Emergency Sewer System Repairs	\$300	\$300
SU0103	Easement, Access, Codes, and Standards Review	150	150
SU0108	Comprehensive Pipeline R&R Program	1,000	1,000
SU0109	Sewer System Generator Replacement	200	200
SU0113	SCADA System Replacement (Sewer)	1,500	500
SU0114	Sewer System Components	50	50
SU0115	Sewer Pipe Replacements & Upsizing	600	
SU0117	Pump Station Rehabilitation & Replacement Assessment	300	300
SU0127	Backyard Sewer System Improvement Program	130	120
SU0128	Pump Station Rehabilitation & Replacement Improvements	150	950
<b>Sewer Utility CIP Total</b>		<b>\$4,380</b>	<b>\$3,570</b>

## Sewer 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 proposed for the 2023-2024 biennium includes a smoothed rate increase of 4.5% for 2023-2028. **Staff recommends a 4.5% increase to the sewer 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
<b>Pre Rate Revenues</b>							
<b>Revenues</b>							
Rate Revenues Under Existing Rates	\$ 5,665,500	\$ 5,665,500	\$ 5,665,500	\$ 5,665,500	\$ 5,665,500	\$ 5,665,500	\$ 5,665,500
Non-Rate Revenues	<u>5,224,128</u>	<u>5,521,413</u>	<u>5,839,272</u>	<u>6,175,142</u>	<u>6,531,123</u>	<u>6,907,233</u>	<u>7,529,028</u>
<b>Total Revenues</b>	<b>\$ 10,889,628</b>	<b>\$ 11,186,913</b>	<b>\$ 11,504,772</b>	<b>\$ 11,840,642</b>	<b>\$ 12,196,623</b>	<b>\$ 12,572,733</b>	<b>\$ 13,194,528</b>
<b>Expenses</b>							
Cash Operating Expenses	\$ 7,870,013	\$ 8,295,280	\$ 8,732,369	\$ 9,145,227	\$ 9,580,484	\$ 10,038,208	\$ 10,744,483
Existing Debt Service	1,035,856	1,034,242	1,031,829	1,028,615	1,029,601	623,618	626,625
New Debt Service	-	-	-	284,831	284,831	846,794	846,794
System Reinvestment Funding	<u>1,600,000</u>	<u>1,700,000</u>	<u>1,800,000</u>	<u>1,900,000</u>	<u>2,000,000</u>	<u>2,000,000</u>	<u>2,000,000</u>
<b>Total Expenses</b>	<b>\$ 10,505,870</b>	<b>\$ 11,029,522</b>	<b>\$ 11,564,198</b>	<b>\$ 12,358,672</b>	<b>\$ 12,894,916</b>	<b>\$ 13,508,619</b>	<b>\$ 14,217,902</b>
<b>Net Surplus (Deficiency)</b>	<b>\$ 383,759</b>	<b>\$ 157,391</b>	<b>\$ (59,425)</b>	<b>\$ (518,030)</b>	<b>\$ (698,293)</b>	<b>\$ (935,887)</b>	<b>\$ (1,023,374)</b>
<b>Annual Rate Increase</b>		<b>4.50%</b>	<b>4.50%</b>	<b>4.50%</b>	<b>4.50%</b>	<b>4.50%</b>	<b>4.50%</b>
<b>Cumulative Rate Increase</b>		<b>4.50%</b>	<b>9.20%</b>	<b>14.12%</b>	<b>19.25%</b>	<b>24.62%</b>	<b>30.23%</b>
<b>Post Rate Revenues</b>							
Revenues After Rate Increases	\$ 5,665,500	\$ 5,920,448	\$ 6,186,868	\$ 6,465,277	\$ 6,756,214	\$ 7,060,244	\$ 7,377,955
Additional Taxes from Rate Increase	<u>-</u>	<u>9,821</u>	<u>20,083</u>	<u>30,807</u>	<u>42,014</u>	<u>53,726</u>	<u>65,964</u>
<b>Net Cash Flow After Rate Increase</b>	<b>\$ 383,759</b>	<b>\$ 402,518</b>	<b>\$ 441,859</b>	<b>\$ 250,939</b>	<b>\$ 350,407</b>	<b>\$ 405,132</b>	<b>\$ 623,117</b>
Sample Residential Bill (3/4" Meter, x 12 ccf)	<b>\$ 161.21</b>	\$169.71	\$178.66	\$188.08	\$198.02	\$208.48	\$223.73
Bi-Monthly Increase (\$)		\$8.50	\$8.95	\$9.42	\$9.94	\$10.46	\$15.25

Fund Balance	2022	2023	2024	2025	2026	2027	2028
<b>Operating Reserve</b>							
Beginning Balance	\$ 2,676,392	\$ 646,850	\$ 681,804	\$ 718,536	\$ 753,313	\$ 789,969	\$ 828,511
plus: Net Cash Flow after Rate Increase	383,759	402,518	441,859	250,939	350,407	405,132	623,117
less: Transfer of Surplus to Capital Fund	<u>(2,413,301)</u>	<u>(367,564)</u>	<u>(405,127)</u>	<u>(216,162)</u>	<u>(313,751)</u>	<u>(366,589)</u>	<u>(564,104)</u>
<b>Ending Balance</b>	<b>\$ 646,850</b>	<b>\$ 681,804</b>	<b>\$ 718,536</b>	<b>\$ 753,313</b>	<b>\$ 789,969</b>	<b>\$ 828,511</b>	<b>\$ 887,524</b>
<i>Actual Days of O&amp;M</i>	<i>30 days</i>	<i>30 days</i>	<i>30 days</i>	<i>30 days</i>	<i>30 days</i>	<i>30 days</i>	<i>30 days</i>
<b>Capital Reserve</b>							
Beginning Balance	\$ 2,596,515	\$ 4,186,086	\$ 1,888,522	\$ 642,008	\$ 2,399,513	\$ 771,771	\$ 4,619,409
plus: System Reinvestment Funding	1,600,000	1,700,000	1,800,000	1,900,000	2,000,000	2,000,000	2,000,000
plus: Transfers from Operating Fund	2,413,301	367,564	405,127	216,162	313,751	366,589	564,104
plus: LTGO Proceeds	-	-	-	3,700,000	-	7,300,000	-
plus: Interest Earnings	<u>6,491</u>	<u>20,930</u>	<u>9,443</u>	<u>3,210</u>	<u>11,998</u>	<u>3,859</u>	<u>23,097</u>
<b>Total Funding Sources</b>	<b>\$ 6,616,307</b>	<b>\$ 6,274,580</b>	<b>\$ 4,103,091</b>	<b>\$ 6,461,380</b>	<b>\$ 4,725,261</b>	<b>\$ 10,442,220</b>	<b>\$ 7,206,610</b>
less: Capital Expenditures	<u>(2,430,221)</u>	<u>(4,386,059)</u>	<u>(3,461,083)</u>	<u>(4,061,868)</u>	<u>(3,953,490)</u>	<u>(5,822,811)</u>	<u>(6,108,555)</u>
<b>Ending Capital Fund Balance</b>	<b>\$ 4,186,086</b>	<b>\$ 1,888,522</b>	<b>\$ 642,008</b>	<b>\$ 2,399,513</b>	<b>\$ 771,771</b>	<b>\$ 4,619,409</b>	<b>\$ 1,098,055</b>
<i>Minimum Target Balance</i>	<i>\$ 534,889</i>	<i>\$ 578,749</i>	<i>\$ 613,360</i>	<i>\$ 653,979</i>	<i>\$ 693,514</i>	<i>\$ 751,742</i>	<i>\$ 812,827</i>
<b>Combined Beginning Balance</b>	<b>\$ 5,272,907</b>	<b>\$ 4,832,936</b>	<b>\$ 2,570,326</b>	<b>\$ 1,360,544</b>	<b>\$ 3,152,826</b>	<b>\$ 1,561,741</b>	<b>\$ 5,447,920</b>
<b>Combined Ending Balance</b>	<b>\$ 4,832,936</b>	<b>\$ 2,570,326</b>	<b>\$ 1,360,544</b>	<b>\$ 3,152,826</b>	<b>\$ 1,561,741</b>	<b>\$ 5,447,920</b>	<b>\$ 1,985,579</b>

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

Description	2021	2022	2023	2024	2025	2026	2027	2028
2020 Rate Update	7.70%	7.70%	7.70%	7.70%				
2021-2022 Rate Update	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%		
2023-2024 Rate Proposal			4.50%	4.50%	4.50%	4.50%	4.50%	4.50%

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 sewer utility rate increases.

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