



UTILITY BOARD STAFF REPORT

Item 3
October 8, 2024
Regular Business

AGENDA ITEM INFORMATION

TITLE:	2025 Water Rate Discussion/Recommendation	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input checked="" type="checkbox"/> Motion <input type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Accept the proposed Water Utility rate for FY 2025.	

STAFF:	Ben Schumacher, Financial Analyst Matt Mornick, Finance Director
COUNCIL LIAISON:	Jake Jacobson
EXHIBITS:	1. None

SUMMARY

BACKGROUND

As part of the 2025-2026 biennial budget process, staff seeks a recommendation from the Utility Board regarding the Water Utility rate adjustment for the upcoming fiscal year. Staff recommends an 8% increase to the Water Utility rates for 2025 as proposed in the smoothed rate model.

The operating and capital budgets presented in this memo were released to the Public and City Council on September 26, 2024 and figures from the current biennium include budget amendments through May 21, 2024. The Utility Board’s recommended rate adjustment for water service will directly inform the final 2025-2026 biennial budget, scheduled for City Council adoption on December 3, 2024.

2025-2026 OPERATING BUDGET

The operating budget for the Water Utility is presented in Table 1.

Operating Expenditures <i>(\$ in thousands)</i>	2023	2024	2025	2026	Percent Change	
	Actual	Budget	Budget	Budget	24-25	25-26
Salary & Benefits	\$2,637	\$2,133	\$2,318	\$2,451	8.7%	5.7%
Water Purchased for Resale	2,134	2,147	2,255	2,335	5.1%	3.5%
Other Services and Charges	3,987	3,699	3,615	3,779	-2.3%	4.5%
Debt Service	107	134	2,427	2,430	1715.6%	0.1%
Total	\$8,865	\$8,112	\$10,615	\$10,995	30.9%	3.6%

Table 1

Highlights from the Water Utility operating budget include:

- The combined total for salary and benefit costs in 2025 are increasing 8.7% as compared to the 2024 budget. The 2025 operating budget contains a portion of one additional support position in 2025 currently proposed as a Support Services Technician. The cost-of-living adjustments (COLA) is 4.2% for

2025. The increase is also due, in part, to the City Council having adopted a new Compensation Plan (see [AB 6491](#)) in June of 2024 with a new classification system and established salary schedule for non-represented employees, who make up approximately half of the City's workforce (99 of 207 employees).

- Water Purchases from Seattle Public Utilities (SPU) are projected to increase 5.1% in 2025 when compared to the 2024 budget. Note that SPU sets a higher rate for the period of Peak usage (May 15-Sept 15) than for non-peak period usage (Sept 16-May 14).
- In 2024, debt service payments are for limited tax general obligation (LTGO) bonds issued in 2011 for the First Hill Booster Pump Station upgrade and water system improvements projects.
- New debt service payments come online in 2025. The first ties to the public works trust fund loan for the booster chlorination system project, with an initial principal and interest payment of \$201,320 in 2025.

On September 3, 2024, the City Council approved a bond ordinance for second reading to issue a not-to-exceed amount of \$28 million (M) in LTGO bonds to finance and refinance capital improvements for the water utility (see [AB 6528](#)). Staff estimates issuance of new debt would result in additional annual debt payment estimated at \$2.7 M, beginning in 2025.

- Other Services and Charges include all other costs of operations including supplies, insurance, and City administration costs. Administration costs include the Water Fund's share of administrative support provided by the City Attorney's Office, City Manager's Office, Finance, and Human Resources staff.

On May 21, 2024, the City Council adopted a new overhead cost allocation model (see [AB 6475](#)) was implemented citywide to allocate indirect or internal services for each allocable City program, external service, operating department, and/ or fund, including the Water Utility.

SUMMARY CAPITAL REINVESTMENT PROJECTS

Planned capital reinvestments in 2025 and 2026 are outlined below in Table 2. Systemwide water distribution components – such as main transmission lines, water reservoirs, and pressure reducing valve stations, among others – are simultaneously reaching the end of their useful life.

Capital investment costs are the primary driver of the proposed water rate increase as the water distribution system enters a period of significant reinvestment. The numbers presented below include projects that staff deemed necessary to accelerate and spend down bond proceeds within the three-year eligibility window to effectively spend these resources and meet federal obligations for tax-exempt Bonds.

Water Utility Capital Program Budget 2025-2026			
<i>(\$ in thousands)</i>			
Project ID	Description	2025	2026
90.40.0001	Emergency Water System Repairs	\$200	\$207
90.40.0002	Water System Components Replacement	50	52
90.40.0003	Modeling & Fire Flow Analysis	40	41
90.40.0004	Street Related Water System Improvements	150	156
90.40.0005	2024 PRV Station Construction	2,500	
90.40.0007	2025 WSI: Greenbrier Loop	400	
90.40.0008	WS Regulatory Compliance Plans	225	233
90.40.0009	Reservoir Security Improvements	50	156
90.40.0010	Water System Instrumentation	75	78
90.40.0011	First Hill VFD Replacement	50	270
90.40.0012	First Hill Generator Replacement	640	570
90.40.0013	2025 AC Main Replacement	1,067	4,633
90.40.0014	2026 Water System Improvements	117	516
90.40.0015	2026 PRV Station Replacements	395	2,100
90.40.0016	2026 AC Main Replacement		596
90.40.0017	2027 Water System Improvements		513
90.40.0018	2027 PRV Station Replacements		410
90.40.0031	2024 Water System Imp Construction	4,820	
90.40.0032	City Transmission Line Replacement	1,870	3,740
Water Utility CIP Total		\$12,649	\$14,271

Table 2

WATER RATE PROPOSAL

The 2025 Water rate proposal is based on the 2025-2026 operating budget, the 2025-2030 Capital Improvement Program (CIP), and the corresponding debt financing needs. Staff recommends an 8.0% increase to the water utility rates for 2025 as proposed in the smoothed rate model.

This year-over-year smoothed rate model is predicated on leveraging outside funding for investments that cost more than \$2.5 M each and have a useful life greater than 20 years. Debt financing spreads costs incurred in a relatively short period over the useful life of updated infrastructure, thereby avoiding spikes in annual rate adjustments year-over-year while generations of rate payers who benefit from these investments help pay down the associated costs.

The proposed rate adjustment for FY 2025 ensures that the Water Fund has adequate resources to complete the critical capital project work detailed below and into the future, as well as meet long-established fiscal policy guidelines.

These include an operating reserve target of 90 days of operating and maintenance costs, and a capital reserve target of 1.0% of capital assets. The 8.0% rate increase in FY 2025 enables the fund to achieve its target for both established guidelines, as detailed in Tables 3 & 4 below.

Revenue Requirement	2024	2025	2026	2027	2028	2029	2030
Pre Rate Revenues							
Revenues							
Rate Revenues Under Existing Rates	\$ 11,663,490	\$ 11,663,490	\$ 11,663,490	\$ 11,663,490	\$ 11,663,490	\$ 11,663,490	\$ 11,663,490
Non-Rate Revenues	<u>702,178</u>	<u>78,504</u>	<u>66,903</u>	<u>50,295</u>	<u>78,912</u>	<u>79,713</u>	<u>80,633</u>
Total Revenues	\$ 12,365,668	\$ 11,741,994	\$ 11,730,393	\$ 11,713,785	\$ 11,742,402	\$ 11,743,203	\$ 11,744,123
Expenses							
Cash Operating Expenses	\$ 6,290,356	\$ 7,083,043	\$ 7,383,651	\$ 7,671,184	\$ 7,941,331	\$ 8,255,370	\$ 8,583,332
Existing Debt Service	98,045	2,422,066	2,428,037	2,428,255	2,420,972	2,421,439	2,419,157
New Debt Service	-	-	-	<u>2,778,279</u>	<u>2,778,279</u>	<u>2,778,279</u>	<u>3,115,040</u>
Total Expenses	\$ 6,388,401	\$ 9,505,108	\$ 9,811,688	\$ 12,877,717	\$ 13,140,582	\$ 13,455,088	\$ 14,117,529
Net Surplus (Deficiency)	\$ 5,977,268	\$ 2,236,886	\$ 1,918,705	\$ (1,163,932)	\$ (1,398,181)	\$ (1,711,885)	\$ (2,373,406)
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	\$ 11,663,490	\$ 12,596,569	\$ 13,604,295	\$ 14,692,638	\$ 15,868,049	\$ 17,137,493	\$ 18,508,493
Additional Taxes from Rate Increase	-	<u>46,925</u>	<u>97,603</u>	<u>152,336</u>	<u>211,447</u>	<u>275,288</u>	<u>344,235</u>
Net Cash Flow After Rate Increase	\$ 5,977,268	\$ 3,123,041	\$ 3,761,907	\$ 1,712,880	\$ 2,594,932	\$ 3,486,831	\$ 4,127,361
Sample Residential Bill	\$ 71.26	\$ 76.96	\$ 83.11	\$ 89.76	\$ 96.94	\$ 104.70	\$ 113.07
Monthly Increase (\$)		\$ 5.70	\$ 6.16	\$ 6.65	\$ 7.18	\$ 7.76	\$ 8.38

Table 3

Fund Balance	2024	2025	2026	2027	2028	2029	2030
Operating Reserve							
Beginning Balance	\$ 16,755,134	\$ 1,551,047	\$ 1,746,504	\$ 1,832,197	\$ 1,915,591	\$ 1,995,699	\$ 2,087,708
plus: Net Cash Flow after Rate Increase	5,977,268	3,123,041	3,761,907	1,712,880	2,594,932	3,486,831	4,127,361
less: Transfer of Surplus to Capital Fund	<u>(21,181,355)</u>	<u>(2,927,584)</u>	<u>(3,676,214)</u>	<u>(1,629,485)</u>	<u>(2,514,824)</u>	<u>(3,394,821)</u>	<u>(4,030,752)</u>
Ending Balance	\$ 1,551,047	\$ 1,746,504	\$ 1,832,197	\$ 1,915,591	\$ 1,995,699	\$ 2,087,708	\$ 2,184,317
<i>Actual Days of O&M</i>	<i>90 days</i>	<i>90 days</i>	<i>90 days</i>	<i>90 days</i>	<i>90 days</i>	<i>90 days</i>	<i>90 days</i>
Capital Reserve							
Beginning Balance	\$ 471,754	\$ 22,190,620	\$ 12,911,408	\$ 1,904,559	\$ 13,536,203	\$ 7,058,512	\$ 1,615,371
plus: System Reinvestment Funding	-	-	-	-	-	-	-
plus: Transfers from Operating Fund	21,181,355	2,927,584	3,676,214	1,629,485	2,514,824	3,394,821	4,030,752
plus: New LTGO Proceeds	28,576,427	-	-	-	-	-	-
plus: Revenue Bond Proceeds	-	-	-	33,000,000	-	-	4,000,000
plus: Interest Earnings	<u>18,870</u>	<u>665,719</u>	<u>258,228</u>	<u>19,046</u>	<u>135,362</u>	<u>70,585</u>	<u>16,154</u>
Total Funding Sources	\$ 50,248,406	\$ 25,783,923	\$ 16,845,851	\$ 36,553,090	\$ 16,186,389	\$ 10,523,919	\$ 9,662,277
less: Capital Expenditures	<u>(28,057,786)</u>	<u>(12,872,514)</u>	<u>(14,941,292)</u>	<u>(23,016,887)</u>	<u>(9,127,876)</u>	<u>(8,908,548)</u>	<u>(7,898,255)</u>
Ending Capital Fund Balance	\$ 22,190,620	\$ 12,911,408	\$ 1,904,559	\$ 13,536,203	\$ 7,058,512	\$ 1,615,371	\$ 1,764,023
<i>Minimum Target Balance</i>	<i>\$ 651,221</i>	<i>\$ 779,946</i>	<i>\$ 929,359</i>	<i>\$ 1,159,528</i>	<i>\$ 1,250,807</i>	<i>\$ 1,339,892</i>	<i>\$ 1,418,875</i>
Combined Beginning Balance	\$ 17,226,888	\$ 23,741,667	\$ 14,657,912	\$ 3,736,755	\$ 15,451,794	\$ 9,054,211	\$ 3,703,079
Combined Ending Balance	\$ 23,741,667	\$ 14,657,912	\$ 3,736,755	\$ 15,451,794	\$ 9,054,211	\$ 3,703,079	\$ 3,948,340

Table 4

Table 5 provides a summary comparing proposed rates from the most recent rate model updates (2020-2023) as compared to the current rate recommendation that is presented in the bottom row.

Description	2023	2024	2025	2026	2027	2028	2029	2030
2020 Rate Update	6.50%	6.50%						
2021-2022 Rate Update	5.25%	5.25%	5.25%	5.25%				
2023-2024 Rate Update	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%		
2025-2026 Rate Proposal			8.00%	8.00%	8.00%	8.00%	8.00%	8.00%

Table 5

SCHEDULED WATER UTILITY BOND ISSUANCE

The current Water Utility rate proposal assumes a portion of the scheduled capital projects will rely on outside funding to offset the more than \$74.7 M in escalated capital spending between 2025-2030. Table 4 includes the projected LTGO debt issuance that amounts to \$28.5 M in 2024, \$33 M in 2027, and \$4 M in 2030.

For modeling purposes, timing when to seek outside funding is based on when qualifying infrastructure improvements are scheduled in the six-year capital improvement program (CIP). In practice, staff closely manage cash-flow needs for capital projects as they unfold with the requirement to spend down bond proceeds within three years of receipt.

Staff forecast the Water Fund balance will require the additional funding from the planned \$28.5 M issuance this year to remain positive through year-end. This issuance will provide critical funding support for the water utility, including the following projects:

- **Pressure Reducing Valve (PRV) Station Replacements** (90.40.0005, 90.40.0015) is an ongoing program to systematically replace PRV stations throughout the island. Most stations are below the City's current operational standards. There is a total of 85 PRV stations in the City's water distribution system. In general, the life span of a new PRV station is around 50 to 60 years, with routine maintenance.

The initial design phase of the project is nearing completion in Q3 2024. Total project costs are estimated at \$4.9 M through 2025-2026.

- **Water System Improvements** (90.40.0017, 90.40.0031) aims to Install over 6,500 linear feet of new 8-Inch ductile iron water main at six different locations on the northern portion of Mercer Island. Water services and fire hydrants in these areas will also be replaced. Total project costs are estimated at \$5.3 M through 2025-2026.
- **Asbestos Cement (AC) Water Main Replacements** (90.40.0013,90.40.0016) is recently instated ongoing program to systematically replace antiquated AC water mains with ductile iron water mains. The replacement program reduces the potential for catastrophic system failure, unexpected service disruptions, and large damage claims to the City.

Staggered capital reinvestment for aging water mains is being accelerated as AC water main ruptures have notably increased relative to prior years. Over the 2025-2030 CIP planning period, total project costs are estimated at \$17.3 M.

- **City Transmission Line Replacement** (90.40.0032) involves the realignment of approximately 5,000 feet of the City's 24-inch transmission line. The existing transmission line alignment traverses' steep slopes, which has raised concerns necessitating the transmission line realignment to more stable terrain. This project is the most recent addition to the City's proposed Capital Improvement Plan and represents a substantial, unforeseen funding need. Total project costs are estimated at \$18.7 M from 2025-2027.

Staff will return to the City Council on October 1, 2024 to discuss potential alternatives for this transmission pipe and the potential transfer of ownership from Seattle Public Utilities to the City, including a projected range of potential costs. Given the anticipated range of costs, future Bond sales or outside funding may be required for this project.

MECHANICS OF A BOND ISSUANCE

When issuing bonds for significant infrastructure related projects, it is commonplace for utility systems to issue debt as revenue bonds. The City also has the option to issue debt as limited tax general obligation (LTGO). Staff recommends the latter option. By issuing an LTGO bond, the debt would still be secured and paid for by the revenues of the utility system, but it would also have the backing of the City’s full faith and LTGO credit, and other legally available sources, such as utility revenues.

The City’s general obligation rating by Moody’s is currently at Aaa, which is the highest rating category and was affirmed in February 2024. By issuing LTGO Bonds, the City can take advantage of its LTGO credit rating which results in more competitive borrowing rates and use the water utility system’s revenue to repay the debt. Table 6 outlines the City’s current debt service.

Limited Tax General Obligation Bonds	Date Incurred	Final Maturity	Initial Debt Amount	Amount Outstanding as of 12/31/23
2011 LTGO Bonds, First Hill Water Improvements	03/23/11	12/01/30	\$1,500,000	\$655,000
2017 LTGO Refunding Bonds, Sewer Lake Line	08/17/17	12/01/29	6,205,000	3,450,000
Other Non-Voted General Obligation Debt				
2005 Sewer Lake Line, PWTF Loan	01/31/05	07/01/26	\$6,650,000	\$1,208,273
2013 LTGO Refunding Bonds, CCMV Construction	02/06/13	12/01/23	\$1,140,000	\$0
2015 Capital Financed Fire Mini Pumper	06/01/15	06/01/24	\$341,295	\$41,721
2018 Capital Financed Enforcer Pumper	04/19/18	04/09/27	\$732,778	\$354,268
2023 Booster Chlorination System, PWTF Loan	03/01/23	06/01/43	\$3,284,770	\$3,284,770

Table 6

Issuing utility bonds as LTGO does impact the City’s LTGO debt capacity. This could be an issue for municipalities with a considerable amount of general obligation debt outstanding, but this is not the case for Mercer Island. As prescribed by State statutes and the City’s Financial Management Policies, based on 1.5% of the City’s 2024 assessed valuation of \$20.3 billion, the City’s remaining available debt capacity is \$295 million.

CONCLUSION

Staff will be available at the Utility Board meeting to answer questions regarding the proposed 2025 Water Utility rate increases.

The 2025 Water Utility rate adjustment is on the City Council planning schedule for review and adoption on December 3, 2024 as part of the City’s annual Master Fee Schedule update. Staff will return during the 2025-2026 mid-biennial budget process with new information to inform potential annual rate adjustments for fiscal year 2026 and beyond.

RECOMMENDED ACTION

Accept the proposed Water Utility rate for FY 2025.