



# Memorandum

## CITY OF MERCER ISLAND, FINANCE DEPARTMENT

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**Date:** November 17, 2021  
**To:** Utility Board  
**From:** LaJuan Tuttle, Deputy Finance Director  
**Re:** Utility Board Meeting – Water Rates

As part of the mid-biennial budget process, staff seeks a recommendation from the Utility Board regarding the annual Water Utility rate update based on the 2021-2022 adopted budget. The operating and capital budgets presented in this memo were adopted by the City Council on December 1, 2020.

### 2021-2022 Operating Budget

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

Description (\$ in thousands)	2019	2020	2021	2022	Percent Change	
	Actual	Forecast	Budget	Budget	20-21	21-22
<b>Budgeted Operating Expenditures</b>						
Salary & Benefits	\$1,284	\$1,411	\$1,561	\$1,653	10.6%	5.9%
Water Purchased for Resale	1,922	2,110	2,300	2,415	9.0%	5.0%
Other Services and Charges	1,446	1,755	1,674	1,773	-4.6%	5.9%
Debt Service	108	107	110	416	2.5%	278.6%
<b>Total Operating Expenditures</b>	<b>\$4,760</b>	<b>\$5,383</b>	<b>\$5,644</b>	<b>\$6,257</b>	<b>4.9%</b>	<b>10.8%</b>

Some highlights from the operating budget:

- The combined total for **salary and benefit** costs are increasing 5.9% as compared to the 2021 budget. The increase results from changes to the percentage splits in how staff are budgeted across operating funds. The salaries budget includes three new positions, a Public Works Deputy Director, a Sustainability Program Analyst and an Asset Management Coordinator position, in addition to existing staffing. 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 three new positions is \$111,341 in 2021 and \$114,050 in 2022 which represents 25% of the full cost of each position. Cost of living adjustments (COLA) were estimated at 1.98% for the 2022 budget, actual COLA increases for 2022 are estimated at 2.97%.
- Water Purchases** from Seattle Public Utilities (SPU) are projected to increase 9.0% in 2021 as compared to the 2020 budget and 5.0% in 2022. 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 38% 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 \$3.5 million in additional debt in 2022 to fund water capital

improvement projects (tentatively the water SCADA project, meter replacement project, or the booster chlorination station) planned for 2022. Issuance of new debt would result in additional annual debt payment estimated at \$308,708, beginning in 2022. Given State law requirements, projects would need to be completed within 3 years of the respective date of debt issuance. Staff has observed material delays with the ongoing Pandemic and are inclined to rely on available fund balance through the design phase of these 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. 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. A variable basis allocation overhead model is used to determine the Water Utility’s proportionate share of these internal services.

**Summary Capital Reinvestment Projects**

Planned capital reinvestment work in 2021 and 2022 is shown in the table below. Capital investment costs are the primary driver of the proposed water rate increases for 2021-2026.

Water Utility Capital Program 2021-2022		
Description	2021	2022
Emergency Water System Repairs	150,000	150,000
Booster Chlorination Station	995,000	2,510,000
SCADA System Replacement (Water)	675,000	975,000
Water Reservoir Improvements	375,000	1,735,000
Madrona Crest East Addition Water System Improvements	350,000	2,448,000
Water System Improvements - 60th Ave SE	0	229,000
Water System Improvements 82nd Ave SE	1,087,000	
Water System Components (valves, air vac, blow off)	35,000	35,000
Water Model Updates / Fire Flow Analysis	15,000	50,000
RRA, ERP Updates and Water System Plan Updates	200,000	100,000
Meter Replacement Implementation	2,050,000	2,050,000
Reservoir Generator Replacement	240,000	120,000
Solutions for Water System Deficiencies	120,000	
Project Management, Street & Other Water Improvements	580,921	452,237
<b>Water Utility Total</b>	<b>\$ 6,872,921</b>	<b>\$ 10,854,237</b>

## Water Rate Proposal

The 2022 rate proposal is based on the operating budget, six-year Capital Plan, and debt financing needs. The rate model proposes a smoothed rate increase of 5.25% for 2021-2026. No significant changes have been made to the capital or operating budget that would necessitate an update to the water rate model. **As such, staff recommends a 5.25% increase to the water utility rates for 2022 as proposed in the 2021-2026 smoothed rate model.**

Revenue Requirement	2020	2021	2022	2023	2024	2025	2026
<b>Revenues</b>							
Rate Revenues Under Existing Rates	\$ 8,272,471	\$ 8,272,471	\$ 8,272,471	\$ 8,272,471	\$ 8,272,471	\$ 8,272,471	\$ 8,272,471
Non-Rate Revenues	94,913	84,781	66,590	44,532	29,029	29,947	37,893
<b>Total Revenues</b>	<b>\$ 8,367,384</b>	<b>\$ 8,357,252</b>	<b>\$ 8,339,061</b>	<b>\$ 8,317,003</b>	<b>\$ 8,301,500</b>	<b>\$ 8,302,418</b>	<b>\$ 8,310,364</b>
<b>Expenses</b>							
Cash Operating Expenses	\$ 3,197,783	\$ 3,081,773	\$ 3,178,762	\$ 3,257,831	\$ 3,361,547	\$ 3,470,062	\$ 3,583,431
Purchased Water	2,190,480	2,300,004	2,415,004	2,535,755	2,662,542	2,795,669	2,935,453
Existing Debt Service	107,150	109,875	107,250	109,531	111,631	108,550	110,150
New Debt Service	-	-	308,708	308,708	308,708	308,708	308,708
Rate Funded Capital	2,300,000	2,750,000	3,000,000	3,250,000	3,500,000	3,700,000	3,900,000
<b>Total Expenses</b>	<b>\$ 7,795,414</b>	<b>\$ 8,241,652</b>	<b>\$ 9,009,724</b>	<b>\$ 9,461,824</b>	<b>\$ 9,944,428</b>	<b>\$ 10,382,989</b>	<b>\$ 10,837,742</b>
<b>Net Surplus (Deficiency)</b>	<b>\$ 571,971</b>	<b>\$ 115,600</b>	<b>\$ (670,662)</b>	<b>\$ (1,144,821)</b>	<b>\$ (1,642,928)</b>	<b>\$ (2,080,570)</b>	<b>\$ (2,527,378)</b>
Additions to Meet Coverage	-	-	-	-	-	-	-
<b>Total Surplus (Deficiency)</b>	<b>\$ 571,971</b>	<b>\$ 115,600</b>	<b>\$ (670,662)</b>	<b>\$ (1,144,821)</b>	<b>\$ (1,642,928)</b>	<b>\$ (2,080,570)</b>	<b>\$ (2,527,378)</b>
<b>% of Rate Revenue</b>	<b>0.00%</b>	<b>0.00%</b>	<b>8.11%</b>	<b>13.84%</b>	<b>19.86%</b>	<b>25.15%</b>	<b>30.55%</b>
<b>Annual Rate Adjustment</b>	<b>0.00%</b>	<b>5.25%</b>	<b>5.25%</b>	<b>5.25%</b>	<b>5.25%</b>	<b>5.25%</b>	<b>5.25%</b>
<b>Cumulative Annual Rate Adjustment</b>	<b>0.00%</b>	<b>5.25%</b>	<b>10.78%</b>	<b>16.59%</b>	<b>22.71%</b>	<b>29.15%</b>	<b>35.94%</b>
Rate Revenues After Rate Increase	\$ 8,272,471	\$ 8,706,776	\$ 9,163,881	\$ 9,644,985	\$ 10,151,347	\$ 10,684,293	\$ 11,245,218
Additional Taxes from Rate Increase	\$ -	\$ 58,333	\$ 119,728	\$ 145,425	\$ 199,077	\$ 255,545	\$ 314,979
<b>Net Cash Flow After Rate Increase</b>	<b>\$ 571,971</b>	<b>\$ 491,572</b>	<b>\$ 101,020</b>	<b>\$ 82,268</b>	<b>\$ 36,871</b>	<b>\$ 75,706</b>	<b>\$ 130,391</b>
Coverage After Rate Increases	n/a	n/a	11.39	12.15	12.82	13.58	14.41
Average Residential Bi-Monthly Bill (14 ccf usage)	\$ 110.29	\$ 116.08	\$ 122.17	\$ 128.59	\$ 135.34	\$ 142.44	\$ 149.92
\$ Bi-Monthly Difference		5.79	6.09	6.41	6.75	7.11	7.48

Fund Balance	2020	2021	2022	2023	2024	2025	2026
<b>OPERATING FUND</b>							
<b>Beginning Balance</b>	\$ 1,412,783	\$ 788,495	\$ 759,889	\$ 783,804	\$ 803,301	\$ 828,875	\$ 855,632
plus: Net Cash Flow after Rate Increase	571,971	491,572	101,020	82,268	36,871	75,706	130,391
less: Transfer of Surplus to Capital Fund	(1,196,259)	(520,177)	(77,105)	(62,771)	(11,297)	(48,949)	(102,437)
<b>Ending Balance</b>	<b>\$ 788,495</b>	<b>\$ 759,889</b>	<b>\$ 783,804</b>	<b>\$ 803,301</b>	<b>\$ 828,875</b>	<b>\$ 855,632</b>	<b>\$ 883,586</b>
O&M Target Balance	\$ 788,495	\$ 759,889	\$ 783,804	\$ 803,301	\$ 828,875	\$ 855,632	\$ 883,586
Days	90	90	90	90	90	90	90
<b>CAPITAL</b>							
<b>Beginning Balance</b>	\$13,866,439	\$12,464,380	\$ 8,854,797	\$ 4,110,454	\$ 990,407	\$ 1,148,492	\$ 2,710,868
plus: Rate Funded Capital	2,300,000	2,750,000	3,000,000	3,250,000	3,500,000	3,700,000	3,900,000
plus: Transfers from Operating Fund	1,196,259	520,177	77,105	62,771	11,297	48,949	102,437
plus: General Facilities Charge Revenue	130,000	-	-	-	-	-	-
plus: Net Debt Proceeds Available for Projects	-	-	3,500,000	-	-	-	-
plus: Interest Earnings	-	-	-	-	-	-	-
Total Funding Sources	<b>\$17,492,698</b>	<b>\$15,734,557</b>	<b>\$15,431,902</b>	<b>\$ 7,423,225</b>	<b>\$ 4,501,704</b>	<b>\$ 4,897,441</b>	<b>\$ 6,713,305</b>
less: Capital Expenditures	(5,028,318)	(6,879,760)	(11,321,448)	(6,432,818)	(3,353,212)	(2,186,573)	(2,921,073)
<b>Ending Working Capital Balance</b>	<b>\$12,464,380</b>	<b>\$ 8,854,797</b>	<b>\$ 4,110,454</b>	<b>\$ 990,407</b>	<b>\$ 1,148,492</b>	<b>\$ 2,710,868</b>	<b>\$ 3,792,232</b>
Minimum Target Balance	\$ 402,957	\$ 471,754	\$ 584,969	\$ 649,297	\$ 682,829	\$ 704,695	\$ 733,906
<b>COMBINED BEGINNING FUND BALANCE</b>	<b>\$15,279,222</b>	<b>\$13,252,875</b>	<b>\$ 9,614,687</b>	<b>\$ 4,894,258</b>	<b>\$ 1,793,708</b>	<b>\$ 1,977,367</b>	<b>\$ 3,566,500</b>
<b>COMBINED ENDING FUND BALANCE</b>	<b>\$13,252,875</b>	<b>\$ 9,614,687</b>	<b>\$ 4,894,258</b>	<b>\$ 1,793,708</b>	<b>\$ 1,977,367</b>	<b>\$ 3,566,500</b>	<b>\$ 4,675,817</b>

A summary table comparing the proposed rates from the most recent rate model updates (2018-2020) as compared to the current rate recommendation is presented below.

Rate Update	2019	2020	2021	2022	2023	2024	2025	2026
2018 Rate Update	5.30%	5.30%	5.30%	5.30%				
2019-2020 Rate Update	6.50%	6.50%	6.50%	6.50%	6.50%	6.50%		
2021-2022 Rate Proposal			5.25%	5.25%	5.25%	5.25%	5.25%	5.25%

Staff will be available at the Utility Board meeting to answer questions regarding the proposed operating and capital budgets, as well as the proposed 2022 water utility rate increases.

The 2022 Water Utility rate resolution is on the Council planning schedule for review and adoption on December 7, 2021.