



Memorandum

CITY OF MERCER ISLAND, FINANCE DEPARTMENT

9611 S.E. 36th St. • Mercer Island, WA 98040-3732
www.mercerisland.gov

Date: October 9, 2020
To: Utility Board
From: LaJuan Tuttle, Deputy Finance Director
Re: October 2020 Utility Board Meeting – Water Rate

At the October 14th Utility Board meeting the Utility Board is being asked to make a Water Utility rate recommendation for the 2021-2022 Biennial Budget. The operating and capital budgets presented in this memo have been incorporated into the City Manager's Preliminary Budget Document, which was delivered to the City Council on October 1st. Changes to the proposed budget and rate proposals may result as further refinements are incorporated or when Council reviews the Preliminary Budget on October 13, 2020 (Operating Budget) and October 20, 2020 (Capital Budget).

2021-2022 Preliminary Operating Budget

The proposed operating budget for the Water Utility is status quo, in that there are no significant changes planned to the level of operation and maintenance of the Water system.

| Description | 2019 | 2020 | 2021 | 2022 | Percent Change | |
|-------------------------------------|---------------------|---------------------|---------------------|---------------------|----------------|--------------|
| | Actual | Forecast | Budget | Budget | 20-21 | 21-22 |
| Operating Expenditures | | | | | | |
| Budgeted | | | | | | |
| Salary & Benefits | \$ 1,284,188 | \$ 1,411,215 | \$ 1,390,816 | \$ 1,458,519 | -1.4% | 4.9% |
| Water Purchased for Resale | 1,922,076 | 2,110,162 | 2,300,000 | 2,415,000 | 9.0% | 5.0% |
| Supplies | 210,160 | 207,230 | 200,430 | 200,430 | -3.3% | 0.0% |
| Contractual Services | 181,088 | 500,795 | 297,795 | 351,795 | -40.5% | 18.1% |
| Internal Service Charges | 179,383 | 188,420 | 185,329 | 186,569 | -1.6% | 0.7% |
| Insurance | 124,077 | 129,551 | 148,300 | 155,640 | 14.5% | 4.9% |
| Debt Service | 108,195 | 107,150 | 109,875 | 415,958 | 2.5% | 278.6% |
| City Administration/Overhead | 176,732 | 196,059 | 245,616 | 250,261 | 25.3% | 1.9% |
| Other Services and Charges | 574,305 | 532,586 | 561,255 | 585,480 | 5.4% | 4.3% |
| Total Operating Expenditures | \$ 4,760,203 | \$ 5,383,168 | \$ 5,439,416 | \$ 6,019,652 | 1.0% | 10.7% |

Some highlights from the operating budget:

- The combined total for **salary and benefit** costs are decreasing 1.4% as compared to the 2020 budget. The decrease results from changes to the percentage splits in how staff are budgeted across operating funds. The salaries budget includes two new positions, a Public Works Deputy Director and a Cityworks 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 two new positions is \$86,519 in 2021 and \$88,575 in 2022 which represents 25% of the full cost of each position. Other impacts include a cost of living adjustment (COLA) of 1.71% in 2021 and estimated at 1.98% in 2022.

- **Contractual services** are forecasted to be 40.5% lower in 2021 as compared to the 2020 budget. The decrease reflects removal of one-time maintenance costs to “catch up” on deferred maintenance in 2019-2020 for utilities valve exercising/operations, asphalt repair, and hydrant maintenance contracts (\$91,000 decrease from 2020 to 2021). Increases in contract services in 2022 reflect the staff proposal that a comprehensive Water Rate Study be conducted after the meter replacement project is complete (\$25,500).
- **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 2020. 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 40% 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 preliminary Water rates include the issuance of \$3.5 million in additional debt in 2022 to fund the SCADA and Meter Replacement projects planned for 2021-2022. The new debt will result in additional annual debt payment estimated at \$308,708 beginning in 2022.
- **City Administration** costs are 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 variable basis allocation model is used to determine the Water Utility’s proportionate share of these internal service functions.

Summary Capital Reinvestment Projects

Planned capital reinvestment work in 2021 and 2022 is shown in the table below. A summary of projects for the six-year plan covering 2021-2026 is included as appendix A. 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 |
| 60 Ave SE, btw SE 27 and SE 32, and 62 Ave Water System Improv. | | 229,000 |
| 82nd Ave SE, N of SE 24th St Water System Improv - Construction | 1,087,000 | |
| Water System Components (valve, air vac, blow off, and etc.) | 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 - Consultant Services | 120,000 | |
| Street & Other Water Improvements | 395,250 | 260,500 |
| Project Management - Water Utility | 186,096 | 192,192 |
| WATER UTILITY TOTAL | \$ 6,873,346 | \$ 10,854,692 |

Water Rate Proposal

A water rate proposal will be presented by the City's consultant, FCS Group, for the Utility Board's consideration. The rate proposal is based on the preliminary operating budget, six-year Capital Plan, and debt financing needs. The rate model proposes a smoothed rate increase of 5.25% for 2021-2026.

| Revenue Requirement | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
|--|---------------------|---------------------|---------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Revenues | | | | | | | |
| 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 |
| Total Revenues | \$ 8,367,384 | \$ 8,357,252 | \$ 8,339,061 | \$ 8,317,003 | \$ 8,301,500 | \$ 8,302,418 | \$ 8,310,364 |
| Expenses | | | | | | | |
| 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 |
| Total Expenses | \$ 7,795,414 | \$ 8,241,652 | \$ 9,009,724 | \$ 9,461,824 | \$ 9,944,428 | \$ 10,382,989 | \$ 10,837,742 |
| Net Surplus (Deficiency) | \$ 571,971 | \$ 115,600 | \$ (670,662) | \$ (1,144,821) | \$ (1,642,928) | \$ (2,080,570) | \$ (2,527,378) |
| Additions to Meet Coverage | - | - | - | - | - | - | - |
| Total Surplus (Deficiency) | \$ 571,971 | \$ 115,600 | \$ (670,662) | \$ (1,144,821) | \$ (1,642,928) | \$ (2,080,570) | \$ (2,527,378) |
| % of Rate Revenue | 0.00% | 0.00% | 8.11% | 13.84% | 19.86% | 25.15% | 30.55% |
| Annual Rate Adjustment | 0.00% | 5.25% | 5.25% | 5.25% | 5.25% | 5.25% | 5.25% |
| Cumulative Annual Rate Adjustment | 0.00% | 5.25% | 10.78% | 16.59% | 22.71% | 29.15% | 35.94% |
| 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 |
| Net Cash Flow After Rate Increase | \$ 571,971 | \$ 491,572 | \$ 101,020 | \$ 82,268 | \$ 36,871 | \$ 75,706 | \$ 130,391 |
| 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 |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| OPERATING FUND | | | | | | | |
| Beginning Balance | \$ 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) |
| Ending Balance | \$ 788,495 | \$ 759,889 | \$ 783,804 | \$ 803,301 | \$ 828,875 | \$ 855,632 | \$ 883,586 |
| 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 |
| CAPITAL | | | | | | | |
| Beginning Balance | \$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 | \$17,492,698 | \$15,734,557 | \$15,431,902 | \$ 7,423,225 | \$ 4,501,704 | \$ 4,897,441 | \$ 6,713,305 |
| less: Capital Expenditures | (5,028,318) | (6,879,760) | (11,321,448) | (6,432,818) | (3,353,212) | (2,186,573) | (2,921,073) |
| Ending Working Capital Balance | \$12,464,380 | \$ 8,854,797 | \$ 4,110,454 | \$ 990,407 | \$ 1,148,492 | \$ 2,710,868 | \$ 3,792,232 |
| Minimum Target Balance | \$ 402,957 | \$ 471,754 | \$ 584,969 | \$ 649,297 | \$ 682,829 | \$ 704,695 | \$ 733,906 |
| COMBINED BEGINNING FUND BALANCE | \$15,279,222 | \$13,252,875 | \$ 9,614,687 | \$ 4,894,258 | \$ 1,793,708 | \$ 1,977,367 | \$ 3,566,500 |
| COMBINED ENDING FUND BALANCE | \$13,252,875 | \$ 9,614,687 | \$ 4,894,258 | \$ 1,793,708 | \$ 1,977,367 | \$ 3,566,500 | \$ 4,675,817 |

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 and representatives from FCS group will be available at the Utility Board meeting to answer questions regarding the proposed operating and capital budgets, as well as the proposed 2021-2022 water utility rate increases.

The 2021 Water Utility rate resolution is on the Council planning schedule for review and adoption on November 17, 2020.