



Memorandum

CITY OF MERCER ISLAND, FINANCE DEPARTMENT

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Date: October 5, 2020
To: Utility Board
From: LaJuan Tuttle, Deputy Finance Director
Re: October 2020 Utility Board Meeting – Sewer Rate

At the October 14th Utility Board meeting the Utility Board is being asked to make a Sewer 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 as 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 Sewer Utility is presented in the table below. There are no significant changes to the level of operation and maintenance of the sewer system proposed.

Description	2019	2020	2021	2022	Percent Change	
	Actual	Forecast	Budget	Budget	20-21	21-22
Operating Expenditures						
Budgeted						
Salary & Benefits	\$ 1,059,902	\$ 1,255,127	\$ 1,282,391	\$ 1,343,912	2.2%	4.8%
King County Sewer Treatment	4,797,727	4,828,462	5,083,506	5,312,086	5.3%	4.5%
Supplies	93,426	92,630	69,030	78,030	-25.5%	13.0%
Contractual Services	135,977	252,130	200,180	229,180	-20.6%	14.5%
Internal Service Charges	122,328	131,365	188,509	190,185	43.5%	0.9%
Insurance	63,993	66,649	54,000	56,900	-19.0%	5.4%
Debt Service	1,036,539	1,337,720	1,047,070	1,256,361	-21.7%	20.0%
City Administration/Overhead	137,983	154,254	241,192	245,858	56.4%	1.9%
Other Services and Charges	544,602	543,365	364,520	374,245	-32.9%	2.7%
Total Operating Expenditures	\$ 7,992,477	\$ 8,661,702	\$ 8,530,398	\$ 9,086,757	-1.5%	6.5%

Some highlights from the operating budget:

- The combined total for **salary and benefit** costs are increasing 2.2% as compared to the 2020 budget. The increase results in part 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 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 GIS (geographic information system) support. The total dollar impact to the Sewer Utility for the two new positions is \$86,519 in 2021 and \$88,575 in 2022 which represents 25% of the full cost for 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 20.6% lower in 2021 as compared to the 2020 budget. The decrease reflects the anticipated savings in contract services by bringing Closed Circuit Television (CCTV) video pipe and manhole inspections in-house. Increases in contract services in 2022 reflect staff's proposal to conduct a comprehensive Rate Study after the meter replacement project is complete (\$25,500).
- **King County Sewer Treatment** services are projected to increase 5.30% in 2021 as compared to the 2020 budget and 4.5% in 2022. 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 preliminary sewer rates include the issuance of \$2.5 million in additional debt in 2022 to fund the SCADA project planned for 2021-2022. The new debt will result in additional annual debt payment estimated at \$220,505 beginning in 2022.
- **City Administration** costs are the Sewer 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 Sewer 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 sewer rate increases for 2021-2026.

Sewer Utility Capital Program 2021-2022		
Description	2021	2022
Emergency Sewer Repairs	300,000	300,000
Pump Station R&R Improvements	200,000	
Easement, Access Codes and Standards Review	150,000	150,000
Comprehensive Pipeline R&R Program	500,000	500,000
Sewer System Generator Replacement	150,000	150,000
Pump Station Accessibility Improvements	100,000	100,000
SCADA System Replacement (Sewer)	675,000	975,000
Street & Other Sewer Projects	155,000	51,000
Project Management - Sewer Utility	141,759	146,651
SEWER UTILITY TOTAL	\$ 2,371,759	\$ 2,372,651

Sewer Rate Proposal

A sewer 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 4.0% for 2021-2026.

Revenue Requirement	2020	2021	2022	2023	2024	2025	2026
Revenues							
Rate Revenues Under Existing Rates	\$ 5,238,081	\$ 5,238,081	\$ 5,238,081	\$ 5,238,081	\$ 5,238,081	\$ 5,238,081	\$ 5,238,081
King County Metro Revenue	4,813,463	5,030,539	5,257,191	5,797,752	5,797,752	6,392,582	6,392,582
Non-Rate Revenues	30,608	26,809	25,049	35,970	21,506	17,445	11,458
Total Revenues	\$10,082,152	\$10,295,429	\$10,520,321	\$11,071,803	\$11,057,339	\$11,648,108	\$11,642,121
Expenses							
Cash Operating Expenses	\$ 2,496,133	\$ 2,408,651	\$ 2,502,106	\$ 2,579,631	\$ 2,665,750	\$ 2,755,819	\$ 2,849,812
King County Treatment Costs	4,864,583	5,083,506	5,312,086	5,857,246	5,857,246	6,457,136	6,457,136
Existing Debt Service	1,042,284	1,047,070	1,035,856	1,034,242	1,031,829	1,028,615	1,029,601
New Debt Service	-	-	220,505	220,505	220,505	485,112	485,112
Rate Funded Capital	1,400,000	1,500,000	1,600,000	1,700,000	1,800,000	1,900,000	2,000,000
Total Expenses	\$ 9,803,000	\$10,039,226	\$10,670,554	\$11,391,625	\$11,575,330	\$12,626,682	\$12,821,661
Net Surplus (Deficiency)	\$ 279,152	\$ 256,202	\$ (150,233)	\$ (319,821)	\$ (517,990)	\$ (978,574)	\$ (1,179,541)
Additions to Meet Coverage	-	-	-	-	-	-	-
Total Surplus (Deficiency)	\$ 279,152	\$ 256,202	\$ (150,233)	\$ (319,821)	\$ (517,990)	\$ (978,574)	\$ (1,179,541)
% of Rate Revenue	0.00%	0.00%	2.87%	6.11%	9.89%	18.68%	22.52%
Annual Rate Adjustment	0.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Cumulative Annual Rate Adjustment	0.00%	4.00%	8.16%	12.49%	16.99%	21.67%	26.53%
Rate Revenues After Rate Increase	\$ 5,238,081	\$ 5,447,604	\$ 5,665,508	\$ 5,892,129	\$ 6,127,814	\$ 6,372,926	\$ 6,627,844
Additional Taxes from Rate Increase	-	\$ 25,478	\$ 51,976	\$ 61,194	\$ 83,245	\$ 106,178	\$ 130,028
Net Cash Flow After Rate Increase	\$ 279,152	\$ 440,247	\$ 225,219	\$ 273,033	\$ 288,498	\$ 50,093	\$ 80,194
Coverage After Rate Increases	n/a	n/a	13.98	14.64	15.15	7.14	7.41
Local Average Residential Bi-Monthly Bill (10 ccf winter usage)	\$ 90.26	\$ 93.87	\$ 97.63	\$ 101.53	\$ 105.59	\$ 109.82	\$ 114.21
\$ Bi-Monthly Difference (Local)		3.61	3.75	3.91	4.06	4.22	4.39
King County Metro Residential Bi-Monthly Bill	\$ 90.66	\$ 94.74	\$ 99.00	\$ 109.16	\$ 109.16	\$ 120.34	\$ 120.34
\$ Bi-Monthly Difference (Metro)		4.08	4.26	10.16	-	11.18	-
Total Residential Bi-Monthly Bill (10 ccf winter usage)	\$ 180.92	\$ 188.61	\$ 196.63	\$ 210.69	\$ 214.75	\$ 230.16	\$ 234.55
\$ Bi-Monthly Difference (Total)		7.69	8.01	14.07	4.06	15.40	4.39

Fund Balance	2020	2021	2022	2023	2024	2025	2026
OPERATING FUND							
Beginning Balance	\$ 651,231	\$ 205,162	\$ 197,971	\$ 205,653	\$ 212,024	\$ 219,103	\$ 226,506
plus: Net Cash Flow after Rate Increase	279,152	440,247	225,219	273,033	288,498	50,093	80,194
less: Transfer of Surplus to Capital Fund	(725,222)	(447,437)	(217,538)	(266,661)	(281,419)	(42,690)	(72,468)
Ending Balance	\$ 205,162	\$ 197,971	\$ 205,653	\$ 212,024	\$ 219,103	\$ 226,506	\$ 234,231
CAPITAL							
Beginning Balance	\$ 5,366,058	\$ 5,052,243	\$ 4,707,440	\$ 6,663,463	\$ 3,764,277	\$ 2,944,939	\$ 1,475,502
plus: Rate Funded Capital	1,400,000	1,500,000	1,600,000	1,700,000	1,800,000	1,900,000	2,000,000
plus: Transfers from Operating Fund	725,222	447,437	217,538	266,661	281,419	42,690	72,468
plus: General Facilities Charge Revenue	17,925	-	-	-	-	-	-
plus: Net Debt Proceeds Available for Projects	-	-	2,500,000	-	-	3,000,000	-
plus: Interest Earnings	-	-	-	-	-	-	-
Total Funding Sources	\$ 7,509,205	\$ 6,999,680	\$ 9,024,978	\$ 8,630,124	\$ 5,845,696	\$ 7,887,629	\$ 3,547,970
less: Capital Expenditures	(2,456,962)	(2,292,240)	(2,361,514)	(4,865,848)	(2,900,757)	(6,412,127)	(1,790,305)
Ending Working Capital Balance	\$ 5,052,243	\$ 4,707,440	\$ 6,663,463	\$ 3,764,277	\$ 2,944,939	\$ 1,475,502	\$ 1,757,665
Minimum Target Balance	\$ 1,050,670	\$ 1,096,515	\$ 1,143,745	\$ 1,241,062	\$ 1,299,077	\$ 1,427,320	\$ 1,463,126
COMBINED BEGINNING FUND BALANCE	\$ 6,017,289	\$ 5,257,404	\$ 4,905,412	\$ 6,869,116	\$ 3,976,301	\$ 3,164,041	\$ 1,702,008
COMBINED ENDING FUND BALANCE	\$ 5,257,404	\$ 4,905,412	\$ 6,869,116	\$ 3,976,301	\$ 3,164,041	\$ 1,702,008	\$ 1,991,896

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	7.80%	7.80%	7.80%	7.80%				
2019-2020 Rate Update	7.70%	7.70%	7.70%	7.70%	7.70%	7.70%		
2021-2022 Rate Proposal			4.00%	4.00%	4.00%	4.00%	4.00%	4.00%

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 sewer utility rate increases.

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