



MEMO TO CITY COUNCIL

Request to Include Topic on the City Council Workshop Agenda

From: Laurelei McVey, Public Works **Meeting Date:** July 11, 2023
Presenter: Laurelei McVey, Public Works **Estimated Time:** 15 minutes
Topic: Cost of Service Study and Proposed FY24 Water and Sewer Fees

Recommended Council Action:

No official action required. The Department plans to hold a public hearing on the proposed rate increase in August 2023.

Background:

The Public Works Department has concluded efforts to complete a comprehensive cost of service study for both utilities (water and wastewater). The City worked with FCS Group, a financial consultant experienced in conducting such studies with municipalities all over the Northwest, as well as consulting with the City's Finance Department.

The purpose of the study was to analyze and make recommendations around the City's Water and Wastewater Utility Rates and Fees. The scope of the study included the following:

- Revenue requirements for both utilities
- Cost to deliver services to customers for both utilities
- Recommendations around rate structure and updated fees
- Assessment Fee calculation: Methodology and Updated Charges
- Three opinion papers (development of customer classes, enterprise fund split, future replacement funding)

The above outcomes were evaluated through the lens of several guiding principles that helped inform the study results. The recommendations would:

- Result in legally defensible rates/fees based on Idaho Statutes
- Adhere to City Financial policies and procedures
- Assume no debt financing options
- Minimize impacts to customers in terms of rate changes
- Treat each utility as a separate entity in terms of finances
- Align with industry best practices
- Recover costs equitably and provide maximum revenue stability

Study Results and Recommendations:

General findings confirmed that Meridian is in healthy shape from an Enterprise Fund perspective.

The City also shared with FCS the intent to eventually separate each utility into its own fund (Water Fund & Sewer Fund) and FCS agreed that is an industry best practice. The study approached all analysis under that assumption.

The Utility Assessment fees were recommended to be updated and implemented as soon as possible to ensure maximum legal defensibility. The updated assessment fees were presented and adopted by City Council in October 2022 (effective 11/1/22).

Meridian's utility rates are legally defensible and financially sound with no further adjustments in calculation methodology; however, the City could move some of these initiatives forward to better represent true costs of service to various customer types in the future, if they chose. The recommendations listed below are just that, recommendations not requirements.

Assessment Fees Findings and Study Recommendations:

Connection fees (also commonly known as hookup fees and assessment fees) are an important mechanism to capture an equitable share of cost from development for water and wastewater system infrastructure. There is defined case law in Idaho that prescribes a methodology to accomplish this. This report applied that methodology to both utilities and calculated an updated fee to apply based on system value.

Water Assessment Fee:

- The updated Water connection fee was calculated to be \$1,514 per ERU, a reduction from the previous fee of \$1,972.

Wastewater Assessment Fee:

- The updated Wastewater connection fee was calculated to be \$5,411 per ERU, an increase from the previous fee of \$3,884.

It was recommended that these fees be updated as soon as possible. These fees were updated in November 2022. It is also recommended that the City revisit these fees on a 3-year basis or anytime there are significant changes to the components that affect system value in the calculation.

Water Utility Rate Findings and Study Recommendations:

Findings:

- Base/Usage Rate Design: Some costs are incurred by the utility no matter the volume of water produced (base rate). Other costs are variable depending on the amount of water produced (use rate). Currently, not all costs that could be placed on the base rate are included in this portion of the rate. This structure does give the customer more control over their billed amount; however, it does not capture the true cost of providing service. Additionally, moving a higher portion of the rate to a fixed charge (where appropriate) also aids in greater revenue stability going forward.

- Customer Cost Allocation: Analysis suggests the residential customer class is subsidizing the other classes, to some degree on the water utility side. Some interclass adjustments could be warranted. This recommendation would create various rates for various customer classes, increasing the complexity of Meridian's rate structures. It should be noted that the creation of customer classes may not be feasible with the City's current billing software platform.
- Meter Size: In order to capture the difference in cost to supply customers of different meter size, a meter size-based rate schedule could also be introduced. However, this recommendation may not be feasible with the City's current billing software platform.

Study Recommendations:

- Consider moving appropriate costs to the base portion of rate
- Consider 4 customer classes (Residential, Non-Residential, Builder, Sprinkler)
- Consider moving to a Meter Size base rate

Wastewater Utility Rate Findings and Study Recommendations:

Findings:

- Base/Usage Rate Design: Some costs are incurred by the utility no matter the volume of wastewater discharged. Other costs are variable depending on use. Currently, not all costs that could be placed on the base rate are included in this portion of the rate.
- Customer Cost Allocation: This is somewhat less complex than water rate design as all classes are treated in a similar fashion due to the functions of service being common to all customers. This eliminates the necessity of a more complex fee system; however, different classes of customers could be created if desired. It should be noted that the creation of customer classes may not be feasible with the City's current billing software platform.

Study Recommendations:

- Consider moving appropriate costs to base portion of rate
- Consider 3 customer classes (Residential, Non-Residential, Builder)

Additional Study Issue Papers:

The final portion of the Rate Study includes three "Issue Papers" that addressed topics of interest that the City was seeking professional input on.

The three topics included:

- "Customer Class and Rate Structure Alternatives": This paper explored rate setting philosophies and drivers that the City may want to explore in the future to adapt to the changing needs of the utilities and customers such as base versus usage and customer classes.

- “Enterprise Fund Separation”: This paper reviewed the pros and cons of separating the Enterprise fund and discussed industry best practices.
- “System Reinvestment Funding”: This paper focused on how to approach financing the replacement of aging infrastructure and recommendations specific to Meridian’s system characteristics.

Study Recommendations:

- Consider adopting a more complex customer class rate structure to better capture true costs of service. This is not a requirement, but is a best practice to ensure true cost of service is considered.
- Consider separating the Enterprise Fund into two self-sustaining utility funds. This is not a requirement, but is a best practice to ensure true cost of service is considered.
- Because the City’s utility systems are relatively new, significant current reinvestment into or building savings for future system replacement is not warranted at this time. The City should continue to monitor and evaluate this.

City of Meridian Utility Cost of Service Implementation Plan:

Based on the study recommendations, the Public Works Department in conjunction with the Finance Department recommend the following implementation plan.

2022 (COMPLETED)

- Update and implement assessment fees as soon as possible **(COMPLETED- Nov 1, 2022)**
- Annual utility rate adjustments- 2% **(COMPLETED- June 15, 2022)**

2023

- Annual utility rate adjustments, as needed

2024

- Sunset of EPA Fee (September 30, 2024)
- Consider implementing base/usage rate adjustments
- Consider creation of customer classes and meter size base rates
- Annual utility rate adjustments, as needed

2025

- Enterprise Fund Split
- Evaluate and update assessment fees
- Annual utility rate adjustments, as needed

2026

- Annual utility rate adjustments, as needed

2027

- Annual utility rate adjustments, as needed

2028

- Update Cost of Service Study
- Evaluate and update assessment fees
- Annual utility rate adjustments, as needed

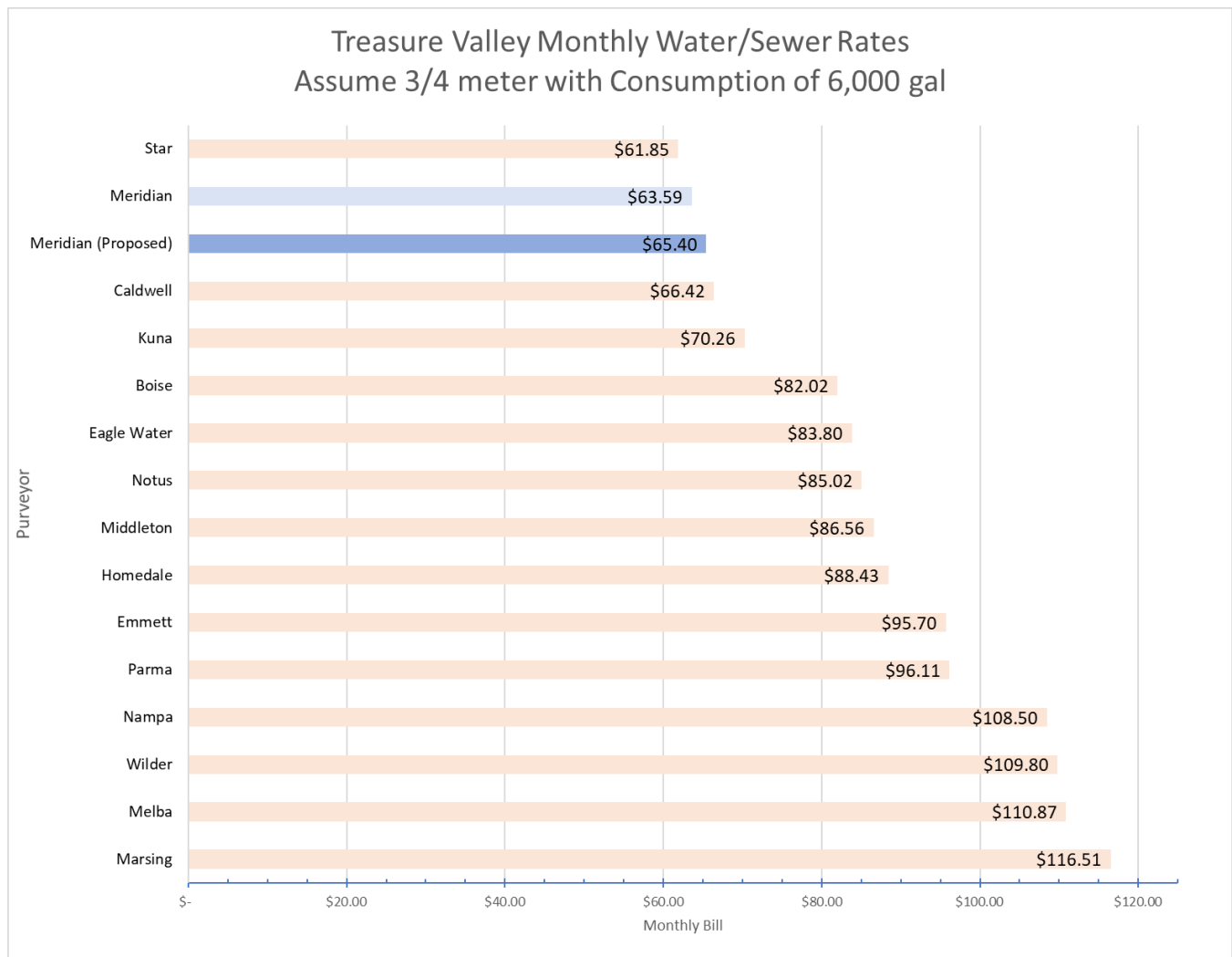
FY2024 Recommended Rate Adjustments:

In order to keep up with the rise in the ongoing operational and personnel costs, a rate increase of 3% is recommended by Public Works and the Finance Department for FY2024 (effective October 1, 2023).

A 3% increase to both the water and sewer rates would result in approximately a \$1.91/month increase to the average customer's monthly bill.

Additional future rate increases are likely needed, but these increases will be modeled, analyzed, and brought to City Council annually.

Due to Meridian's continued conservative and detailed financial planning, the City maintains some of the lowest utility rates in the Treasure Valley. The following table compares current neighboring utility rates. Additionally, it should be noted that several of the cities listed below are planning to implement additional rate increases in October that are not reflected in this table.



The Public Works Department, in alignment with the City's Finance Department, plans to conduct the appropriate public hearings in the summer of 2023 to include the proposed 3% rate increase recommendation.

Questions related to this topic should be directed to Laurelei McVey, Public Works, lmcvey@meridiancity.org, 208-985-1259.