



## Staff Report

---

**File #:** 16-221

**Version:** 1

**Date:** 10/10/2016

**Item #:**

---

**TO:** Mayor and City Council

**THROUGH:** Steve Powers, City Manager

**FROM:** Peter Fernandez, PE, Public Works Director

**SUBJECT:**

Proposed Fees and Charges for Utility Service Rates (Water, Wastewater, and Stormwater)

Ward(s): All Wards

Councilor(s): All Councilors

Neighborhood(s): All Neighborhoods

**ISSUE:**

Shall City Council adopt Resolution No. 2016-46, with exhibit, establishing fees and charges for utility service rates (water, wastewater, and stormwater) effective January 1, 2017, and January 1, 2018?

**RECOMMENDATION:**

Adopt Resolution No. 2016-46 with exhibit, establishing fees and charges for utility service rates (water, wastewater and stormwater) effective January 1, 2017, and January 1, 2018.

**SUMMARY AND BACKGROUND:**

Council has a practice of reviewing and adopting utility rates every other year. This process begins with the Water/Wastewater Task Force reviewing proposed changes to the utility's financial policies and practices, and rates. The Task Force's recommendations are considered by the Public Works Director and then forwarded to Council for review and adoption.

Council has been using a cost of service model to set utility rates for many years. Salem provides utility services to customers in several classifications both inside and outside of its city limits. Under a cost of service methodology, the costs to provide treated drinking water, remove and treat wastewater, and collect and convey stormwater are assigned to the appropriate groups of customers in proportion to the services provided. The most recent Cost of Service Analysis (COSA) was adopted in 2012 and reflects standard industry technical approaches as well as Salem's policy framework. The 2012 COSA provides the foundation for the proposed utility rates to be effective in

2017 and 2018.

Over the past decade, the Water/Wastewater Task Force and City Council have been supportive of appropriately funding the needs of the utility. Council has adopted the minimum rate increases necessary to operate and maintain the systems, complete important capital projects, and maintain financial stability. As a result of careful financial planning and annual rate adjustments, the City has been able to make the required investments and navigate economic challenges without rate spikes. The Utility Fund is now financially stable, even as the overall trend in water consumption locally, and nationally, continues to decline.

The 2016 Water/Wastewater Task Force met bi-weekly from June 30<sup>th</sup> to September 8<sup>th</sup> to review policy issues and financial projections. They conducted detailed and thoughtful deliberations on twelve policy items and received information reports on five additional developing issues. The Task Force unanimously recommended the following revenue slope adjustments:

Revenue Slope	1/1/2017	1/1/2018
Water	2.0%	3.0%
Wastewater	2.5%	3.0%
Stormwater	3.0%	3.0%

The Task Force also recommended two policy changes that are reflected in the rate proposal. First, they recommended an increase in the percentage of water system costs that are recovered through fixed charges. Second, they recommended an increase in the monthly backflow fee to \$1.50 from \$1.25, to achieve full program cost recovery, from customers with a backflow device.

A third policy change regarding a reduction in irrigation rates was widely discussed and debated and ultimately not recommended by the Task Force. A change in irrigation rates is not reflected in the rate proposal.

## FACTS AND FINDINGS:

- 1. Financial Planning Goals.** Long-term financial planning involves projection of customer growth and usage, system requirements, and revenue. It is integral to the rate-setting process. Revenue slope recommendations are developed by weighing operational and capital needs against the policy objective to minimize and smooth rate increases for customers. A more detailed analysis of modeling assumptions, trends, and requirements is in Attachment 1 - 2016 Financial Analysis and FY 2017 and 2018 Rate Proposal.

Financial planning 2017 and 2018 continues to reflect operating on a cash basis without any anticipated borrowing for capital projects. The strategy outlined in the Water and Sewer Fund Financial Policy (City Council Policy C-14) is to minimize the proposed rate increase while maintaining the financial health of the Utility and adequately funding debt service, operations and maintenance, capital investment, and reserves. The proposed increases for 2017 and

2018 meet these goals.

**2. Debt Service Requirements.** Since 2004, Salem's rate proposals have been framed by debt requirements, both as a result of large capital investments and the national financial challenges of 2008. Utility revenue bond agreements require Salem to maintain net revenue (annual revenues less expenditures) equal to 1.25 times the annual debt services payments (the coverage ratio). Salem has taken several steps to improve the Utility's financial position and the parity debt coverage ratio:

- Bonds backed by the full faith and credit of the City's General Fund were issued in 2009;
- Utility revenue bonds were refunded ("refinanced") in 2012 to take advantage of lower interest rates; and,
- In 2017, prepayment of a Business Oregon loan for \$5.1 million will result in a net present value savings of \$2.1 million.

As a result of these actions, stabilization of revenue, and declining future debt service, the coverage ratios are projected to improve from 2.44 to 5.44 during the next five years. Debt service in FY 2016-17 is \$25.7 million (31.5 percent of utility rate revenue) and decreases to \$13.6 million (14.8 percent of utility rate revenue) over the same period. Opportunities to refund the 2009 full faith and credit debt and to prepay the 2012 revenue bonds will be evaluated over the next two years for any cost saving opportunities.

**3. Capital Investment.** As debt service declines, increases in capital investment are possible within the revenue slope. In FY 2016-17 \$13.7 million is budgeted for capital projects, and the amount increases to \$20.5 million by FY 2021-22. With an asset value at nearly \$4 billion, assuming assets last an average of 100 years, an investment of \$40 million is required annually to replace aging infrastructure. As debt is retired, prepaid, or refunded, additional investment in capital will be analyzed and programmed to the extent available within the planned revenue slope.

**4. Operations and Maintenance.** Public Works Department staff continue to identify operational efficiencies and savings in areas that are controllable; however, many expenses are fixed, regardless of how much water is consumed or how much wastewater is treated. The Utility is tightly managed and cost saving opportunities are continually evaluated. FY 2015-16 operating expenditures were 1.6 percent greater than FY 2014-15.

**5. Reserves.** Reserve levels are set based on debt requirements and best management practices. In FY 2016-17, Salem will maintain \$8.2 million in debt reserves or one year of payments for debt backed by the City's General Fund. No debt reserves are required for the \$12.8 million parity debt service associated with the 2012 revenue bonds. Consistent with best management practices, a 120-day operating reserve of \$20.5 million is maintained. The operating reserve includes rate stabilization reserves that can be used in lieu of an urgent rate increase in years where net revenues are insufficient to meet coverage requirements.

**6. Rate Structure.** The 2012 Cost of Service Analysis established a new rate policy framework that reflected the goal of enhancing revenue stability as water consumption continues to decline both locally and nationally. This policy increased the proportion of water system costs recovered from fixed charges to approximately 15 percent by 2016. The proposed rates in 2017 and 2018 include another shift to fixed charges. Rates reflect a phased increase over the next two years to achieve 20 percent of water revenue from fixed charges by 2018. No other changes in the rate structure are proposed in 2017 or 2018. The phased implementation of the stormwater utility was completed in 2016.

**7. Estimated Impacts on Customer Bills.** Units of water and wastewater are measured in hundred cubic feet (ccf). One ccf is equal to 748 gallons. A typical single family residential customer using only 3 ccf of water and 2 ccf of wastewater will see a monthly increase of \$2.20 in 2017 and \$2.65 in 2018. A residential customer using 8 ccf of water and 6 ccf of wastewater will see an increase of \$2.43 in 2017 and \$3.02 in 2018. A residential customer using 24 ccf of water and 10 ccf of wastewater will see an increase of \$2.41 in 2017 and \$3.31 in 2018. Users of larger amounts of water experience less of a rate increase in their bill because the fixed cost of delivery of the larger volumes is less than the cost of delivery for smaller-volume users. These amounts vary as a result of volume differences and the shift in cost recovery from volume to fixed charges in over the next two years. The total utility bill for a typical customer in Salem represents about 2.12 percent of median household income.

Sample bills are contained in Attachment 2 for all customer classes and services areas.

Alicia Blalock  
Administration Division Manager

Attachments:

1. 2016 Assumptions
2. Sample Bills
3. Resolution 2016-46
4. Resolution 2016-46 Exhibit
5. Written Testimony

09/27/2016