



Staff Report

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Date: 7/25/2022

Item #: 4.a.

TO: Mayor and City Council
THROUGH: Kristin Retherford, Interim 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

Result Area(s): Good Governance; Safe Community; Safe, Reliable, and Efficient Infrastructure

SUMMARY:

Council has had a long-standing commitment to provide adequate funding for the City's water, wastewater, and stormwater systems (collectively referred to as the Utility) to meet the current, growing, and changing needs of our community, and to comply with state and federal regulations. Council has adopted the rate increases necessary to operate and maintain the systems, complete important capital projects, and preserve the financial health and stability of the Utility. To continue this commitment, the recommended revenue slope increases for each system are:

- Water 5.0 percent in 2023 and 2024,
- Wastewater 5.0 percent in 2023 and 2024, and
- Stormwater 5.0 percent in 2023 and 2024.

As part of the rate proposal, Council will also consider fee adjustments for other revenue including backflow monitoring, septage, leachate, and domestic sludge as well as continued funding for the Emergency Utility Assistance Program. All proposed changes were reviewed and recommended by the Water/Wastewater Task Force (Task Force).

ISSUE:

Shall Council adopt Resolution No. 2022-43, (Attachment 1) with exhibit (Attachment 2), establishing fees and charges for utility service rates (water, wastewater, and stormwater) effective January 1, 2023, and January 1, 2024, and approve the allocation of up to \$300,000 of Utility revenue annually beginning in 2023 for the Emergency Utility Assistance Program?

RECOMMENDATION:

Adopt Resolution No. 2022-43 with exhibit, establishing fees and charges for utility service rates (water, wastewater, and stormwater) effective January 1, 2023, and January 1, 2024, and approve the allocation of up to \$300,000 of Utility revenue annually beginning in 2023 for the Emergency Utility Assistance Program.

FACTS AND FINDINGS:

The Public Works Department operates a large and complex water, wastewater, and stormwater utility. Department staff are committed to operating the Utility in a manner that is reliable and protects the health, safety, and welfare of the community. Responsible stewardship of the Utility's physical and financial assets is the top priority. As a result of careful financial planning and small annual revenue slope adjustments for many years, the City has been able to make the required investments, navigate economic challenges and emergencies, and address emerging operational needs without urgent or excessive rate increases. The Utility Fund (Fund 310) remains financially sound; however, inflationary pressures require greater increases over the next two years to preserve capacity for capital investments and maintain adequate reserves in both the short-term and long-term. The following sections of this staff report provide detailed information on the need for the recommended revenue slope.

1. Water/Wastewater Task Force Review and Recommendation

The Water/Wastewater Task Force was first convened in the early-1990s to review the Utility's finances and staff-developed rate recommendations. Following reviewing the information, the Task Force recommends a rate proposal to the Public Works Director, who typically forwards it to the City Council for adoption. The Task Force is made up of representatives from the City Council and the Utility's customers. The 2022 membership includes:

- Four City Councilors;
- A Marion County Commissioner;
- Representatives from City of Keizer and City of Turner;
- A representative of Suburban East Salem Water District;
- Representatives from Salem Chamber of Commerce and SEDCOR; and
- Two members at-large.

For the current rate process, the Task Force met four times between April and June 2022, to consider the revenue slope of 5.0 percent in 2023 and 3.50 percent in 2024. This preliminary staff recommendation was considered the lowest possible rate increase to meet projected Utility requirements over the next two years, including current inflationary pressures. However, the Task Force was concerned that the initial rate proposal did not provide longer term financial stability as

evidenced by the decline in unrestricted fund balance over the initial 5-year planning period, and a continued decline in projected days of cash in fund balance over a 10-year planning period. Specifically, unrestricted fund balance was projected to be less than \$1 million in FY 2026 (compared to \$10 million in FY 2023), and projected total days of cash decreased from an estimated 259 in FY 2023 to 157 in FY 2029. As discussed below, days of cash is a standard bond-rating criteria, and the smaller revenue slope places the Utility at the low end of this measurement for the next ten years. Acknowledging concerns with the original proposal, the Task Force requested two additional scenarios be evaluated:

- 5.5 percent in 2023 and 3.5 percent in 2024
- 5.0 percent in 2023 and 5.0 percent in 2024

After deliberation, the Task Force recommended 5.0 percent in 2023 and 5.0 percent in 2024. Adoption of this recommendation allows the City of Salem to move toward the center of the bond-rating metric at 191 days of cash within five years and to maintain a more stable financial condition for the Utility over the next ten years.

2. Financial Health Measured by Days of Cash in Fund Balance

During this rate-setting cycle, a new metric was introduced as a standardized measure of financial health: days of cash in the Utility Fund at the end of the fiscal year. The City of Salem Utility received a rating of Aa2 from Moody's when the utility revenue bonds were issued in 2020. This rating recognizes, in part, that a utility maintains between 150 and 250 days of cash in fund balance. Days of cash includes all debt, rate stabilization, and capital and operating reserves. Historically, the Utility's required debt reserve was a significant component of annual cash reserves. However, as the existing debt reaches maturity, a new metric is needed to make sure that total cash balances are maintained at levels consistent with industry benchmarks. The required debt reserve decreases from \$19 million in FY 2023 to \$4 million in FY 2027.

One of the key reasons for the recommended revenue slope increase of 5.0 percent for two years, rather than the historical 3.0 percent, is the need to maintain adequate cash reserves. The updated Utility financial model indicates that under a long-term 3.0 percent scenario, the days of cash decline from an anticipated 307 days at the end of FY 2021-22, to just 138 days within five years, and to zero by FY 2033. Should the City need to issue utility revenue bonds within the next few years, the Aa2 bond rating could be in jeopardy and would result in either a greater interest rate or require a more significant rate increase to support a future bond sale.

Based on the proposed revenue slope of 5.0 percent in 2023 and 5.0 percent in 2024, the estimated days of cash declines from the current 307 days but remains at approximately 190 days through FY 2029 before increasing more substantially in future years. This provides a significantly improved and more stable financial outlook for both the short and long-term.

3. Estimated Impacts on Customer Bills

Sample bills for all customer classes and service areas are contained in Attachment 4. The median

residential customer account in Salem uses 8 ccf of water, and the average wastewater base is 5.5 ccf. These are used in the example below for a typical single-family residential customer account with a 3/4-inch meter. A typical account with these characteristics will experience an anticipated increase of \$4.69 and \$4.88 per month in 2023 and 2024, respectively.

Single Family	Month Use (ccf)	Current 1/1/2022	Proposed 1/1/2023	Proposed 1/1/2024	% Change 2022 to 2023	% Change 2023 to 2024
Water	8.0	\$33.67	\$35.40	\$37.06	5.1%	4.7%
Wastewater	5.5	36.93	38.83	40.88	5.1%	5.3%
Stormwater		18.92	19.76	20.70	4.4%	4.8%
Subtotal		\$89.52	\$93.99	\$98.64		
Franchise Fee		4.48	4.70	4.93		
Total Utility Bill		\$94.00	\$98.68	\$103.57	5.0%	4.9%
Dollar Change			\$4.69	\$4.88		

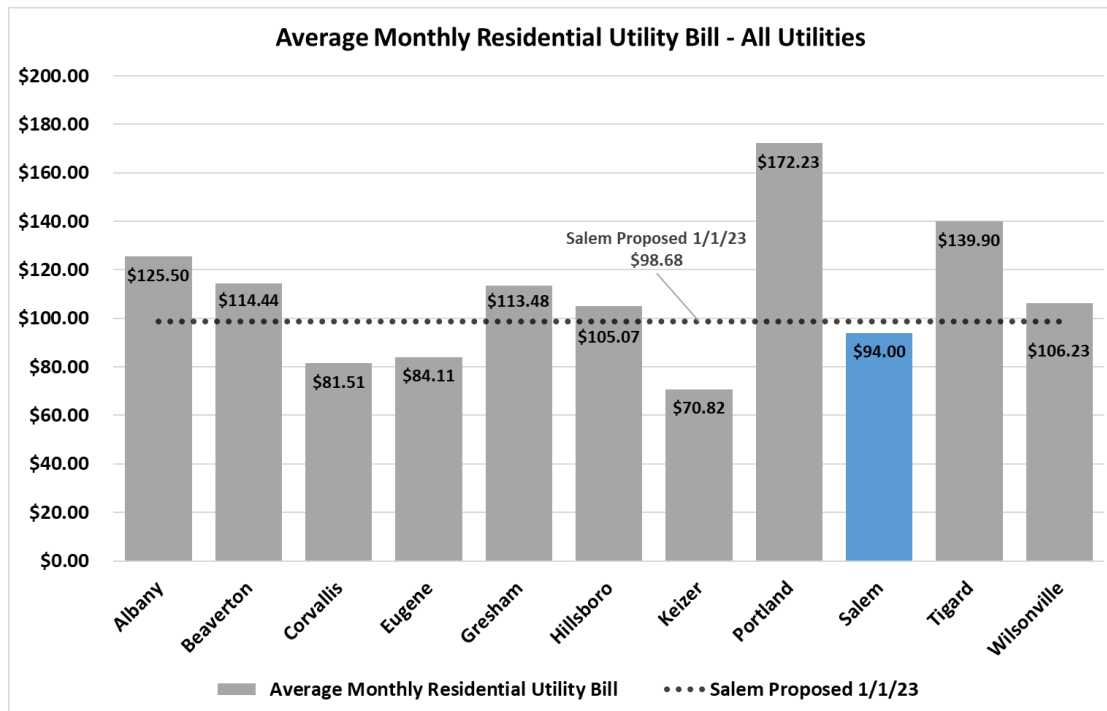
Water consumption varies by season, and when averaged over a 12-month period, monthly water consumption for single-family accounts in Salem is distributed as follows:

- 3 percent of accounts use 3 ccf or less
- 21 percent of accounts use 4 to 7 ccf
- 51 percent of accounts use 8 to 16 ccf
- 25 percent of accounts use more than 17 ccf

The total monthly City of Salem utility bill for a typical residential customer shown above represents 2.0 percent of Salem's monthly median household income. Customers with financial needs may qualify for assistance programs described in Attachment 3.

4. Comparison to Other Cities

Salem has historically been in the middle or lower than the group of cities providing similar utility services. Total bills shown for the cities below are based on rates in effect in June 2022. Salem's proposed rate increase would take effect January 1, 2023, and many of the identified cities will be considering a rate proposal in the coming months. With the proposed rate increases, Salem is anticipated to continue to remain ranked eighth of the eleven standard comparator cities.



5. Cost of Service Analysis (COSA) - 2022 Technical Update

Salem provides utility services to customers in many customer classifications and service areas, inside and outside of its city limits. Salem's utility rates are based on a cost-of-service model under which the costs to provide treated drinking water, remove and treat wastewater, and collect, treat, and convey stormwater are assigned to the appropriate groups of customers in proportion to the services they receive. Assumptions are made about anticipated water consumption, wastewater volumes, and impervious surfaces creating stormwater runoff to estimate the unit demand for each service type. Rates are set to recover the cost of these service units and are then charged to customer accounts based on the actual level of services received.

A technical update of the COSA has been prepared for 2022, and results are described in more detail in Attachment 5. This update reflects foundational practices noted in Table 1 of the 2022 COSA Technical Update as well as current usage characteristics for customer classes, service areas, and system components. It does not implement any new policies or policy changes. More information on specific impacts to customers by area or classification maybe found in the technical update.

6. Proposed Fee Adjustments for Other Revenue (Non-rate Revenue)

As part of the COSA update and financial review, other revenue sources are reviewed and evaluated. Revenue sources set by market rates are reviewed and proposed for adjustment to ensure they are in line with competitors offering the same service. Fees set to recover costs are evaluated for adjustment to achieve full cost recovery.

a. Hauled Waste

The City of Salem accepts four types of waste hauled to either the Waste Processing Facility on Airway Drive SE or directly to the Willow Lake Water Pollution Control Facility. Three of these are the subject of proposed fee adjustments during this rate setting cycle:

- i. *Leachate from Coffin Butte Landfill* is a result of the waste degradation process and is formed when rainwater infiltrates through the degrading waste, picking up contaminants as it forms a putrid liquid byproduct.
- ii. *Septage* includes any liquid or solid material removed from septic tanks, cesspools, portable toilets, and similar systems that receive domestic sewage.
- iii. *Domestic sludge* is a semi-solid slurry byproduct of the City of Aurora's sewage treatment process and is one of two types of waste that are currently hauled to and accepted directly at the Willow Lake Water Pollution Control Facility.
- iv. *Fat, oils, and grease (FOG)* is a food waste that supports wastewater treatment plant operations. No fee adjustment is recommended at this time.

Fees for the acceptance and treatment of leachate, septage, and domestic sludge were last adopted in 2012, 2016, and 2018, respectively. Increases in the cost of labor and materials to operate the treatment facilities warrant an adjustment in processing fees for these services provided to the community. A regional market analysis indicates the City of Salem will remain competitive with incremental increases in hauled waste fees over the next two years. The proposed rate resolution and financial forecast include these fee increases as recommended by the Task Force.

Type of

Hauled Waste	Fee Per Gallon		
	<u>Current 2022</u>	<u>Proposed 2023</u>	<u>Proposed 2024</u>
Leachate	\$0.03	\$0.035	\$0.04
Septage	\$0.12	\$0.13	\$0.14
Domestic Sludge	\$0.06	\$0.07	\$0.08

If volumes remain constant, the proposed fee increases will generate an additional \$190,000 per year of other revenue from the treatment of leachate, septage, and domestic sludge.

b. Backflow Device Monitoring

The City of Salem is required by state law to manage a program to protect the drinking water system from potential sources of contamination and has operated a program since 1982. *Oregon Administrative Rules 333-061-070* and *Salem Revised Code 72.150* require a backflow

prevention assembly be installed on water services that have the potential to contaminate the City's water system, including homes or businesses with possible hazards such as irrigation systems or specific onsite processes identified by rule or code. The property owner is responsible for the installation, maintenance, annual testing to ensure proper function, repair, and replacement of each backflow assembly. The City of Salem is required to maintain proof of compliance.

In 2012, City Council adopted a Backflow Prevention Fee to recover the cost of the compliance program from the 30 percent of accounts with backflow assemblies rather than all water customers. With inflationary pressures, backflow revenue in FY 2022 covered approximately 75 percent program costs. The rate proposal reflects an increase in the monthly fee to \$2.25 from \$1.50 on January 1, 2023, to return to full cost recovery for this program. Revenue is anticipated to increase approximately \$125,000.

7. Emergency Utility Assistance

For many years, the Emergency Utility Assistance program was funded solely with private donations and provided customers in need with \$150 in financial assistance in a calendar year. In 2016, the Water/Wastewater Task Force recognized demand exceeded donations and recommended a match of up to \$10,000 in Utility revenue. In April 2020, Council approved a one-time allocation of \$500,000 of Utility revenue and increased the assistance level to \$500 per customer/account per calendar year. This limit expires December 31, 2022, unless extended. Reinstatement of this program is on this Council agenda as #22-321.

In the early months of the pandemic, customers received approximately \$8,000 per month in total assistance. More recently, the distributions have grown to \$18,000-\$25,000 per month. Available funds are anticipated to be depleted in spring 2023. The increase in funding distribution is partially driven by growing community awareness of this and other assistance programs. The current \$500 limit per customer/account is appreciated by customers and the non-profit partners who qualify them. The Task Force endorsed the staff recommendation to provide up to \$300,000 of Utility funding annually for the Emergency Utility Assistance Program and to retain the \$500 limit on assistance per customer/account per calendar year. The proposed utility rates and financial plan on which they are based assumes this level of funding will be provided.

Applicants for Emergency Utility Assistance are qualified through St. Vincent DePaul, the Salvation Army, and Mid-Willamette Valley Community Action Agency (MWVCAA). Additional information on recipients of assistance is contained in Attachment 3

8. Public Outreach and Responses

All Water/Wastewater Task Force meetings were noticed to the public. Following the Task Force recommendation, the City's website was updated with materials including how to access financial assistance programs, a utility bill estimator, and information about the proposed rate increases.

Over 50,750 postcards were mailed directly to retail customers in all service areas notifying them of the public hearing on proposed utility rates. The postcard contained information about the proposed

rate increase including the URL for the Utilities webpage, an email address to request an account analysis, and information on how to submit testimony to the City Recorder or provide virtual testimony during the hearing.

BACKGROUND:

Financial Planning Goals

Long-term financial planning is integral to the Utility's success and focuses on adequately investing in the systems through managing capital construction, properly funding operations and maintenance, maintaining sufficient reserves and debt coverage, and balancing these needs with the practice of smaller, predictable annual rate increases rather than periodic rate spikes. For the past decade, Salem has adopted the smallest revenue slope increases necessary to achieve these financial goals and comply with requirements of [Council Policy C-14](#) <https://www.cityofsalem.net/home/showpublisheddocument/1540/637793306901000000>, the Utility Fund Financial Policy. The financial plan indicates the proposed revenue slope meets the thresholds in the policy as follows:

- Debt reserves are maintained to meet bond declarations
 - ✓ The debt reserve for FY 2023 is \$19.1 million
- A minimum 120-day operating reserve is maintained
 - ✓ The operating reserve for FY 2023 is \$25.7 million
- Net revenues will exceed debt service requirements
 - ✓ In FY 2023, net revenue will be 2.02 times debt service

A decade ago, when debt service requirements represented 30 percent of total utility revenue, financial analysis focused heavily on debt coverage ratios. Current debt obligations decline in the future as the 2012 Refunding is retired in FY 2025 and the 2017 Refunding is retired in FY 2027. Previous financial plans provided for an increase in pay-as-you-go capital investment as debt retired and contemplated development of a capital reserve in the future for large projects. When the algal toxin event occurred in 2018, however, a new \$60 million bond was required for the Utility to fund the new ozone treatment facility.

The financial planning focus continues to be on funding capacity for capital investment at a rate that supports the integrity of the assets. Although capital investment continues to increase during the planning horizon, inflationary pressures prevent a full one-for-one increase in capital investment in the near term until debt is retired. The proposed revenue slope responsibly addresses the financial needs of the Utility now during an inflationary period rather than pushing greater increases to future generations of ratepayers.

Public Works Department staff continue to identify operational efficiencies and savings in areas that are controllable; however, the majority of each system's expenses are fixed, regardless of how much water is consumed, wastewater is treated, or stormwater is conveyed. In FY 2022, operating expenditures increased approximately 5.1 percent over the prior year. Future year operating

expenditures are expected to increase at between 5.0 and 9.5 percent per year for the next few years. If current inflationary pressures of 7 to 8 percent continue and impact future labor rates, projected operating expenditures will increase, adversely impacting the Utility's financial position and potentially resulting in reduced capacity for capital project investment or other program support.

Alicia Blalock
Administration Division Manager

Attachments:

1. Resolution 2022-43
2. Exhibit 1 to Resolution 2022-43
3. Participation in Utility Assistance Programs
4. Sample Bills
5. Cost of Service Analysis - 2022 Technical Update
6. Public Comment as of 7/11/2022