City of Bonney Lake
Executive Department

Memo

To: Mayor and Council

From: Don Morrison, City Administrator

Date: September 13, 2017 (Updated from May 8th)

Re: **Water and Sewer Rate Adjustment**

I have reviewed the current 2017 operating budgets for the water and sewer operating funds through August or 66% of the year (see attached), and find the following:

1. To date, water operating revenues are covering operating expenses plus debt service payments, leaving some funding (+/- 4% of budget) to contribute to the CIP program. This is only the case because staff have been frugal and expenditures are trending below appropriations. Note: The City currently receives more water revenue from non-city customers than it does from City customers. A rate increase is needed to fund the CIP. Many of the CIP projects have been deferred or reduced to lessen the impact on rates.

2. To date, sewer operating revenues are running slightly (3%) above budget estimates. Sewer revenues are sufficient to cover operating expenses, but when you add debt service payments (bonds, PWTF Loans), the fund is running slightly in the red. A rate increase is needed to cover operating expenses, debt services, and fund a reasonable CIP. Think of it this way: You're making enough money to cover your daily expenses and make your mortgage payment, but you don't have quite enough left to make your car payment.

Staff, working with FCSG and RH2, have scaled back and deferred the originally recommended water/sewer capital improvement plan to the point where the scaled back/deferred project version can be funded with annual rate increases of 4% per year through 2022. However, an estimated $1.4-1.5 million dollars would need to be issued in utility bonds in 2021 to complete the remaining projects unless projected SDC or operating revenues exceed estimates over the next few years.

Needed water projects that have been either scaled back or deferred further into the future to accommodate a lower rate increase include:

- Interlake Island/Inlet Lake Bed Crossing Water Main Replacement - $250K
- 192nd Water Main Replacement - $500K
- 12" Water Main Replacement - Myers Road - To City Limits - $543K
- 16" Water Main Replacement- BPA Alignment - $1.5M
- Cedar View Water Main Replacement Program - $1.46M
- 16" Replacement - Summer Buckley Highway - $870K
- Wholesale 800 to 748 Zones Connection - $500K

The proposed sewer rate increase would be sufficient to fund the needed sewer capital improvement projects that have been recommended as part of the sewer comprehensive plan. However, if the recent Cedarview sewer project as envisioned by RH2 were to be included, an additional ½% would need to be added to the rate increase (i.e. from 4% per year to 4.5% per year increase).

From May 8th Memo:

I have reviewed the past history of the water and sewer funds, and compiled a number of documents that help show where we have been and where we need to go to assure the financial viability of the utility enterprises.

I have come to a number of conclusions based on my findings. These are my own thoughts and do not necessarily represent the opinions of the finance or public works departments. Some of my key findings and conclusions include:

1. System Development Charges (SDCs) generated a significant amount of the utility's capital revenue, especially in pre-recession times. However, the last two years collections have been among the lowest of the past 14 years, and this trend is not likely to change. Thus, there needs to be more reliance on rate generated capital funding.

2. Bonney Lake is becoming built-out. The supply of available building lots have dwindled from 700+ lots to 100+. With the environmental and development cost challenges in Eastown, it is not anticipated that the supply of residential building lots will increase much. The notable exception will be the future development of the residential portion of the former WSU forest. However, there is no current project planned for the site, as Tarragon chose not to renew their option on the property. Multi-family and commercial development will generate some continued SDC funding, but nowhere like the City experienced in pre-recession times. Knowledgeable officials understood that the day was coming when SDC revenue would wain and rates would need to be increased to fund most of the capital program. That day is now here.

3. For 2015-2016 utility rate revenue was sufficient to cover operating costs and debt service. However, from 2017 forward existing rate revenue will not be sufficient to cover operating costs plus debt service. In the water fund, this includes the many Public Works Trust Fund Loans (PWTFL) and the new public works center (PWC) bond payments. In the sewer fund, this includes PWTFL (mostly for the wastewater treatment plant (WWTP) upgrade) and the sewer share of the new PWC.

4. Capital spending needs are as great as ever. 2016 and 2017 capital spending far outstrips incoming SDC revenues, greatly drawing down on retained earnings (the enterprise fund term for fund balance). The revenue gap will need to be made up through rate increases.

5. In 2012 water rates were reduced to offset increases in sewer rates. This contributed to the current rate increase urgency in the water fund. Officials have a fiduciary responsibility to maintain the integrity of the utility system to assure a safe and reliable utility operation. It is not in the long term public interest to play politics with rates. Utility enterprises are not to be operated that way.

6. Immediate and continued rate increases are needed in both water and sewer because:

    A. The City needs to be able to make the debt payments that have been incurred to date for the improvements to the systems.

    B. The City needs to enhance operations by adding an increased preventive maintenance component to both the water and sewer operations.

    C. The City needs to continue to invest in capital improvements to keep the system functional as identified in the comprehensive plan and the WA Department of Health (DOH) review.

7. The City retained RH2, which thoroughly understands our utility systems, to develop comprehensive plans that meet the City's needs for both operations and capital improvements. The proposed CIP is based on years of understanding and expertise with our specific system. Some of those projects could possibly be moved around to temporarily affect revenue demands, but in the end will need to be funded.

8. The City retained the Financial Consulting Services Group (FCSG), the most knowledgeable rate and SDC consultants in the Northwest, to evaluate our cost of operations, capital and other needs, and recommend a series of rate adjustments that would both maintain the financial viability of the utilities as well as fund needed capital improvements. FCSG works with lots of city councils and understands the fiscal and political constraints councils work under. This was taken into account when they reviewed needed rate adjustments as well as the comp plan CIP list. For example, FCSG used only 8% of annual operating expenses (current budget policy) to figure the needed operating reserve amount, when the DOH and AWWA recommend 25%.

9. If SDC charges are reduced, there needs to be a corresponding increase in rates above what FCSG recommended. To reduce SDC charges and not add another increment to the rates would be robbing Peter but not paying Paul.