

# IBA Review of the Public Utilities Department FY 2023-2027 Five-Year Financial Outlook

City Council

Item 202

December 13, 2021



Office of the Independent Budget Analyst



## Background

- Third PUD Outlook
  - First was about 3 years ago
  - PUD Outlook is intended *“to guide long-range planning and serve as the framework for the development of the next year’s Proposed Budget for the Water and Sewer Enterprise Funds”* (Council Policy 000-02: Budget Policies)
- Providing highlights of our review (IBA Report 21-29)
  - Our report provides additional information, context, analysis and issues for Council to consider.

## Expenditure Projections

- The PUD Outlook projects expenditures of approximately \$2.2 billion in FY 2023 for water and wastewater expenditures.
- Pure Water is a continued driver.

<b>Summary of Public Utilities FY 2023-2027 Five-Year Financial Outlook Expenditures</b> <i>(in millions)</i>						
	<b>FY 2022 Adopted</b>	<b>FY 2023 Projection</b>	<b>FY 2024 Projection</b>	<b>FY 2025 Projection</b>	<b>FY 2026 Projection</b>	<b>FY 2027 Projection</b>
Water Fund	\$ 1,084.5	\$ 1,109.7	\$ 1,092.6	\$ 1,012.9	\$ 1,001.5	\$ 1,024.8
Wastewater Funds	717.2	1,066.4	686.3	616.1	605.6	594.8
<b>COMBINED</b>	<b>\$ 1,801.7</b>	<b>\$ 2,176.1</b>	<b>\$ 1,778.9</b>	<b>\$ 1,629.0</b>	<b>\$ 1,607.1</b>	<b>\$ 1,619.6</b>

## Rate Increases

<b>Summary of PUD Outlook Water and Sewer Rate Increases FY 2023-2027</b>						
	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>	<b>FY 2026</b>	<b>FY 2027</b>
Water	3.0%	6.9%	6.3%	6.4%	6.4%	6.9%
Sewer	5.0%	4.0%	4.0%	3.0%	5.0%	3.0%

- Wastewater – Recent wastewater COS study (approved Sept 2021) are reflected in the Outlook (FY 2022 - FY 2025).
- Water
  - Water COS study planned for CY 2021 delayed to CY 2022 due to Patz litigation.
  - Most recent water COS study and rate case was approved by Council in Nov 2015 and there were no water rate increases in CY 2020-21.
  - CY 2022 passthrough water rate increase of 3.0%; 0.75% included in proposed rates due to delays.

## COS Study and Oversight

- BA hired Stantec, a consulting firm with expertise in rate development and evaluation, to conduct independent review of water and wastewater COS study.
- Stantec issued its [Independent Review of the Wastewater Financial Plan, Cost of Service, and Rate Study](#) in May 2021.
  - Our report, Attachment 1 includes summary of findings as well as important areas identified by Stantec that should be addressed in the next wastewater COS study.
- Stantec and our office reviewed the PUD Outlook and are identifying areas for further research and evaluation in preparation for the upcoming water COS study (anticipated in CY 2022).

# Key Areas for Evaluating the PUD Outlook, Financial Plan and COS

Primary Elements of the Outlook	Key Data, Inputs, and Assumptions for Evaluation
<p><b>Revenues</b></p>	<ul style="list-style-type: none"> <li>– Water demands (and account growth)</li> <li>– Water sales</li> <li>– Non-rate revenues</li> </ul>
<p><b>Operations and Maintenance Expenditures</b></p>	<ul style="list-style-type: none"> <li>– Water purchases</li> <li>– Baseline operations budget</li> <li>– Staffing levels, augmentation, and salary adjustments</li> <li>– Critical operating expenditures for upcoming new programs</li> </ul>
<p><b>Capital Improvement Program (CIP)</b></p>	<ul style="list-style-type: none"> <li>– Pure Water Phase 1</li> <li>– Baseline CIP (Ongoing investments in infrastructure)</li> <li>– CIP funding and use of debt</li> <li>– Historical CIP execution</li> <li>– Cost escalation</li> </ul>
<p><b>Financial Policies and Rate Stabilization</b></p>	<ul style="list-style-type: none"> <li>– Debt service coverage ratio (DSCR)</li> <li>– Reserve targets</li> <li>– Financial key performance indicators (KPIs)</li> <li>– Affordability</li> </ul>

## Revenues

- Water demand assumptions
  - The forecast of water sales increases due to population growth, but also accounts for ongoing conservation. The City's 2021 [Urban Water Management Plan](#) estimates about a 7.6% reduction in usage due to conservation by 2045.
  - Conservation efforts reduce PUD's need to purchase water from outside sources, but a significant portion of operating expenditures for the water system are fixed costs, which generally do not change.
- Given the combined impacts to rate revenues and water purchase costs, water demand projections are an important component of the financial plan and will be evaluated by Stantec to fully understand the impact of changes on the financial outlook.

## Operations and Maintenance

- Water purchase assumptions
  - City currently imports 85-90% of its water supply; Pure Water will provide about 50% of drinking water when it comes online in FY 2035.
  - The largest single expenditure for PUD in the Outlook and the largest nonpersonnel expense for the City is the purchase of water from CWA.
  - CWA-related risks
    - Potential change in rate structure and range of CWA rate increases for purchased water is not clear, especially given decreases in demand will occur.
    - CWA projects on the horizon, like the Regional Conveyance System (RCS) could be very costly to City ratepayers.



## Conclusion

- The Pure Water Program continues to be a significant component of the PUD Outlook, and progress made on Phase 1 is very positive for the City.
- Compared to last year's Outlook, PUD's sewer system is in a relatively better position due to rate increases approved by Council in Sept 2021 (go into effect Jan 1, 2022.)
- This PUD Outlook provides an initial basis for expenditure and revenue forecasts for the upcoming water COS study, although the ongoing litigation requires that the City be flexible in its approach to future water rates.
- There are a variety of financial challenges and risks that could impact the projections contained in the PUD Outlook and future years.

## Conclusion

- Challenges and risk (but are not limited to):
  - Unknown resolution of litigation related to tiered rate structure for water.
  - Additional delays in water rate increase adoption, further raising the level of increases needed to meet funding needs.
  - Potential range of CWA rate increases for purchased water, especially given decreases in demand occur as Pure Water and similar regional projects come online.
  - Potential impacts if the CWA's proposed RCS goes forward.
  - CIP funding strategies, including the use of cash, debt, capacity fees, and grants, to mitigate potential large rate increases while monitoring the level of fixed debt service costs and revenue needs to meet long-term DSCR requirements.
  - Ongoing maintenance and replacement of infrastructure assets to reduce likelihood of failure and prevent expensive emergency repairs, such as the recent water main breaks which flooded I-5 and caused related negative impacts.
  - Delays implementing AMI and lack of clarity regarding costs.

## Conclusion

- Stantec's review of the upcoming water COS study will be particularly helpful given the financial challenges and risks noted above.
- Our office is continuing to work with Stantec to assist Council, IROC, and the public by conducting an in-depth review of the water COS study and proposed water rate increases.
- In the meantime, the Environment Committee may want to consider requesting regular updates and/or briefings on Pure Water and other high-profile projects and areas of interest.

# Questions