Utility Rates and Charges Assessment Report

Purpose
The purpose of the Utility Rates and Charges Assessment is to present information to help the City Council understand costs of utility service and what impacts these costs might have on economic development. Additionally, this report provides a regional comparison of rates and charges from twenty (20) utility providers. The comparison demonstrates the significant variability in the cost of utility service. Lastly, the assessment presents future policy considerations and how they might relate to economic development.

Utility Rates and Charges Language
Paying for utilities is typically done using a combination of rates and charges. Understanding the vocabulary of utility rates and charges is often difficult and confusing because of similar terms with different meanings, reader unfamiliarity, and cryptic industry jargon. The following provides an introduction to some common terms and their definitions to be used in this report.

Rates
Rates include reoccurring, time-based and commodity usage charges for the utility service provided; i.e., water usage.

Usage Rate. This is the commodity price usually expressed as cost per unit per time ($/unit/time).

Ready to Serve. This a fixed monthly charge for being connected to the system and is expressed as dollars per month ($/month). This is sometimes called a meter charge.

Flat Rate. This a fixed price for utility service and is expressed as dollars per time ($/time).

Charges
Charges are one time fees paid for connections, equipment installation (e.g. water meters), and reimbursement for installed infrastructure.

System Development Charge (SDC). SDCs are one-time charges paid by customers when they apply for a new water or sewer connection (or an increase in the size of an existing connection). SDC's are also known as connection charges, general facility

charges, capacity charges, tap fees, and facility charges. The SDC is the one charge that has the most potential to impact economic development. The SDC can be substantial as it is applied to all new or increased capacity connections.

Installation Charge. This charge pays for installation of equipment such as service lines and meters. These charges are also called connection fees, connection charges, meter installation, equipment fees, etc.

Latecomer Charge. This charge pays for infrastructure installed by others. This charge is also known as a payback charge.

Two other important terms to understand are Customer Classification and Cost of Service Allocation. Utility customers are typically divided into Customer Classifications based on their usage type. The common classifications are: residential, commercial, and industrial. Rates and charges are allocated to each class based on the cost to provide service to them. Allocating costs base on type of service is called Cost of Service Allocation and is fundamental to creating utility rates and charges.

Application of Rates and Charges

The purpose of having rates and charges is to generate revenue to pay for utility operating expenses and capital improvement costs. There are many possible combinations of rates and charges to meet revenue needs; however, finding the right mix for a particular utility depends on its financial policies and the desires of its governing body. The allocation of costs and charges is largely a policy decision with the major driver being equity based on actual cost of service to each customer class. Allocating rates and charges also addresses the impacts new customers have on system capacity. The following describes the common ways rates and charges are applied and allocated to generate revenues.

<u>Rates</u>

The rate component of the utility revenues is usually directed at paying operating expenses. If any is left over then it can be applied to future capital improvement projects that are related to renewal and replacement of existing utility facilities. The key policy questions are:

- How to define rate structures for individual Customer Classifications (cost allocation)?
- How much capital improvement funds should collected using rates?
- Should utility infrastructure depreciation be funded and if so, how much?

<u>Charges</u>

The charge component of utility revenues typically centers on the System Development Charges (SDCs) or Connection Charges. SDCs provide revenue to utilities from new user hook ups to recover costs of existing and future capacity enhancing capital improvements. New customers' use of the existing water or sewer system infrastructure reduces existing capacity and may also lead to the need for construction of new facilities. SDCs provide the means of balancing the cost requirements for new (growth-

related) utility infrastructure between existing customers and new customers. From the economic development perspective keeping this charge as low as possible reduces costs for developers and therefore may make the City more competitive for future development and private investment. However, the tradeoff of this rates and charges methodology would be to push capacity costs into the rates.

A common way SDCs are used is to shelter existing utility customers from the financial impacts of growth; in other words, "growth pays for growth." While this may work from an economic perspective, unfortunately in the case of construction of new facilities, the burden of paying for new facilities falls mainly on the existing ratepayers in the near term as new customers join the utility gradually over the life of those new facilities. Therefore, considering SDCs as a "buy-in" to the utility system may be better way to think of SDCs.

Some key policy questions regarding System Development Charges are:

- Should SDCs be charged (there is no requirement to charge them)?
- How much of the capital program should be paid for by SDCs?
- What methodology should be used to calculate SDCs?

Rates and Charges Comparison

Comparing rates and charges from other water and sewer utilities provides some idea of the variability in rates and charges and suggests some policy differences between providers. To show this, staff gathered rates and charges information from twenty (20) water and sewer utility provides in the surrounding area.

The following comparison includes two (2) water and sewer customer classes: a residential customer class based on a ¾" water meter, and a commercial customer classed based on 1-1/2" water meter. There are three (3) comparisons for each customer class:

1) Water Rates, which compares the commodity costs for within each class (see Figures 1 & 2)
2) Connection Charges, which compares water and sewer connection charges (i.e. SDCs) for each class (see Figures 3 & 4)
3) New Service Costs, which compares the cost to establish a new service for each class (see Figures 5 & 6).

All three of the comparisons show a high degree of variability between utility providers. An explanation for this is that each utility is responding to unique circumstances driven by their financial polices and fiscal conditions. For example, the City of Kent has very high water SDCs, while Seattle Public Utilities (SPU) has much lower charges (see Figures 3 & 4).

The City of Kent has recently made large investments to improve system capacity and develop new water supplies. As result, Kent is likely putting the burden on new connections to pay for the recent improvements. Kent may also have a strong "growth pays for growth" policy which also support high SDCs. SPU on the other hand is a

mature water system and does not need to make substantial capacity improvements. Therefore, SPU is does not to seek a large portion of its revenues from new connections.

Comparing commercial water SDCs for North City Water District (Shoreline) and SPU (Shoreline) shows North City with a much higher SDC than SPU - $21,800 and $3,508 respectively (see Figure 4). The residential water is also higher for North City (see Figure 3). This inequity could be having some economic impact within the City with developers choosing to develop in the SPU service area rather than in North City Water District.

In addition to comparing water and sewer rates, Staff is also providing a regional comparison of stormwater rate (see Figure 7). The Figure shows how the annual cost for a single family residence for the City of Shoreline compares with other jurisdictions in the Puget Sound. Figure 7 also shows how stormwater rates have increased from 2008 to 2014. The City of Shoreline has had one of the smallest rate increases during the period between 2008 and 2014. The City of Seattle has the highest stormwater rate and the greatest rate increase of the sample group. The City of Shoreline has nearly identical stormwater rates as the Cities of Edmonds, Bothell, Kent and Renton.

Unlike water and sewer rates which are typically capacity driven, stormwater rates have major drivers other than capacity such as meeting Stormwater NPDES Permit requirements and flood management. Additionally, the type of stormwater conveyance system can also impact the rates. Simple storm systems consisting mainly of ditches are generally less expensive to operate and maintain relative to closed conduct systems in major urban areas. Consequently, stormwater rates vary depending on how communities structure their stormwater programs and what kind of conveyance system they have.

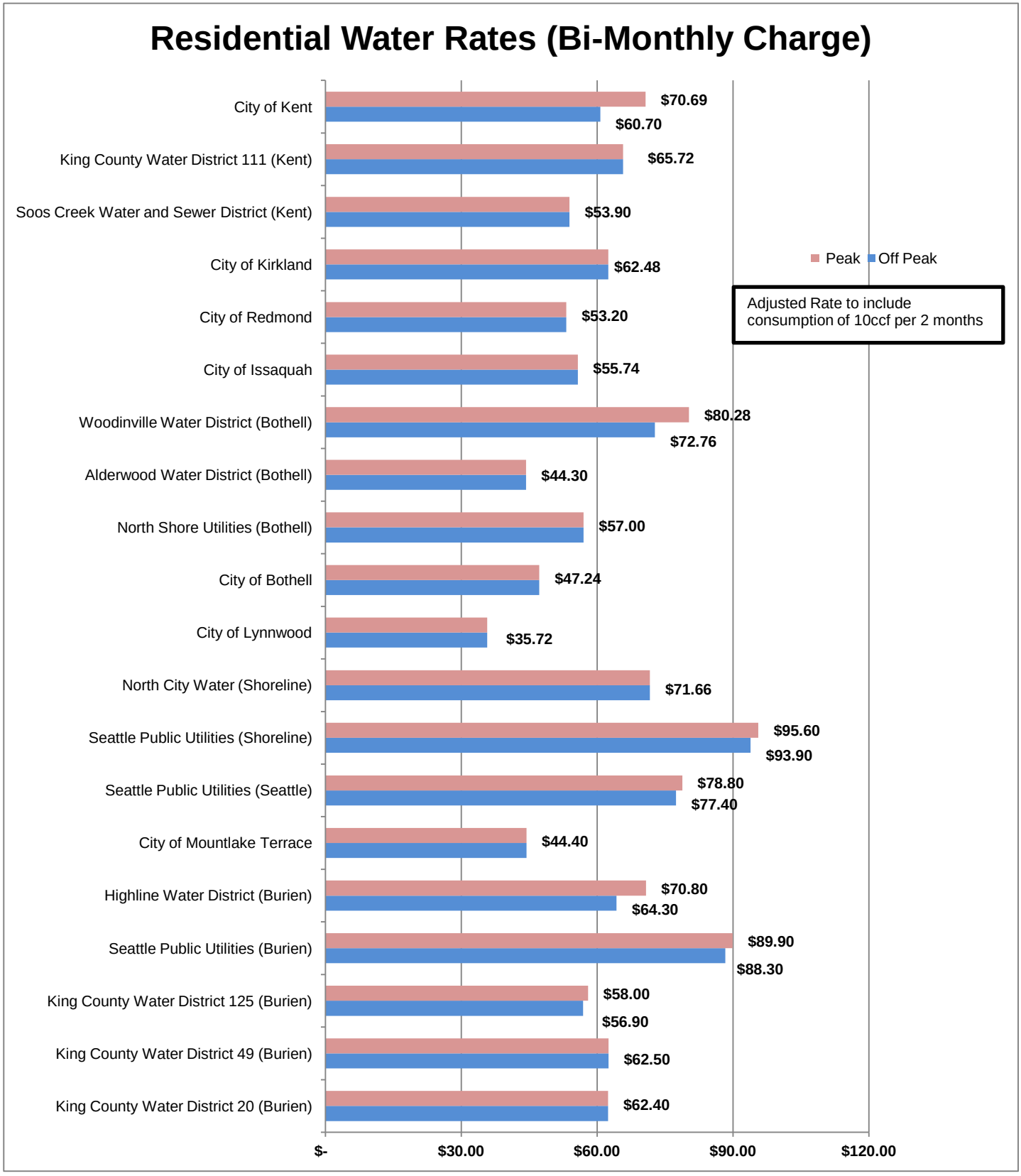


FIGURE 1 - Bi-Monthly Residential Water Rate (Peak and Off Peak)

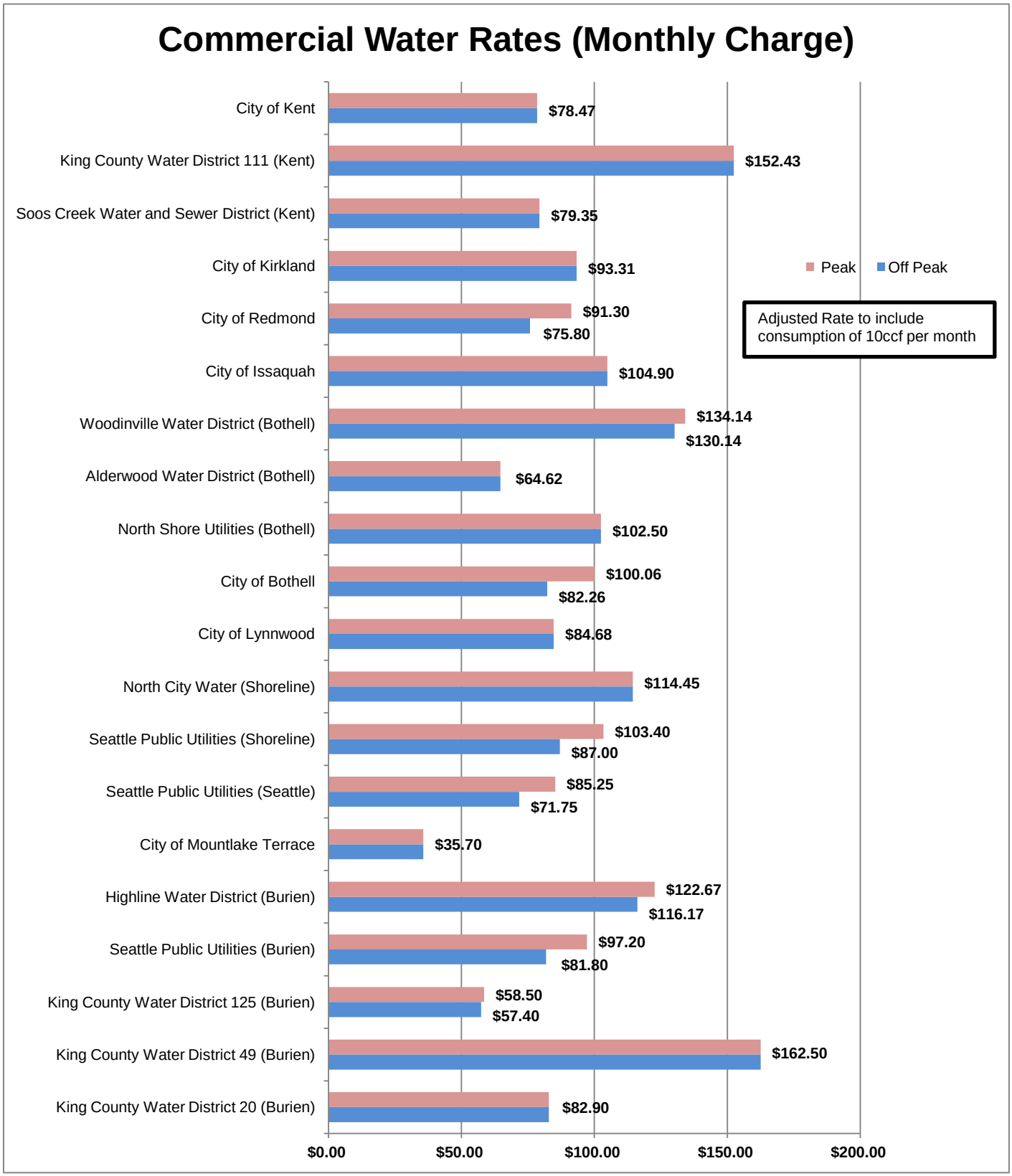
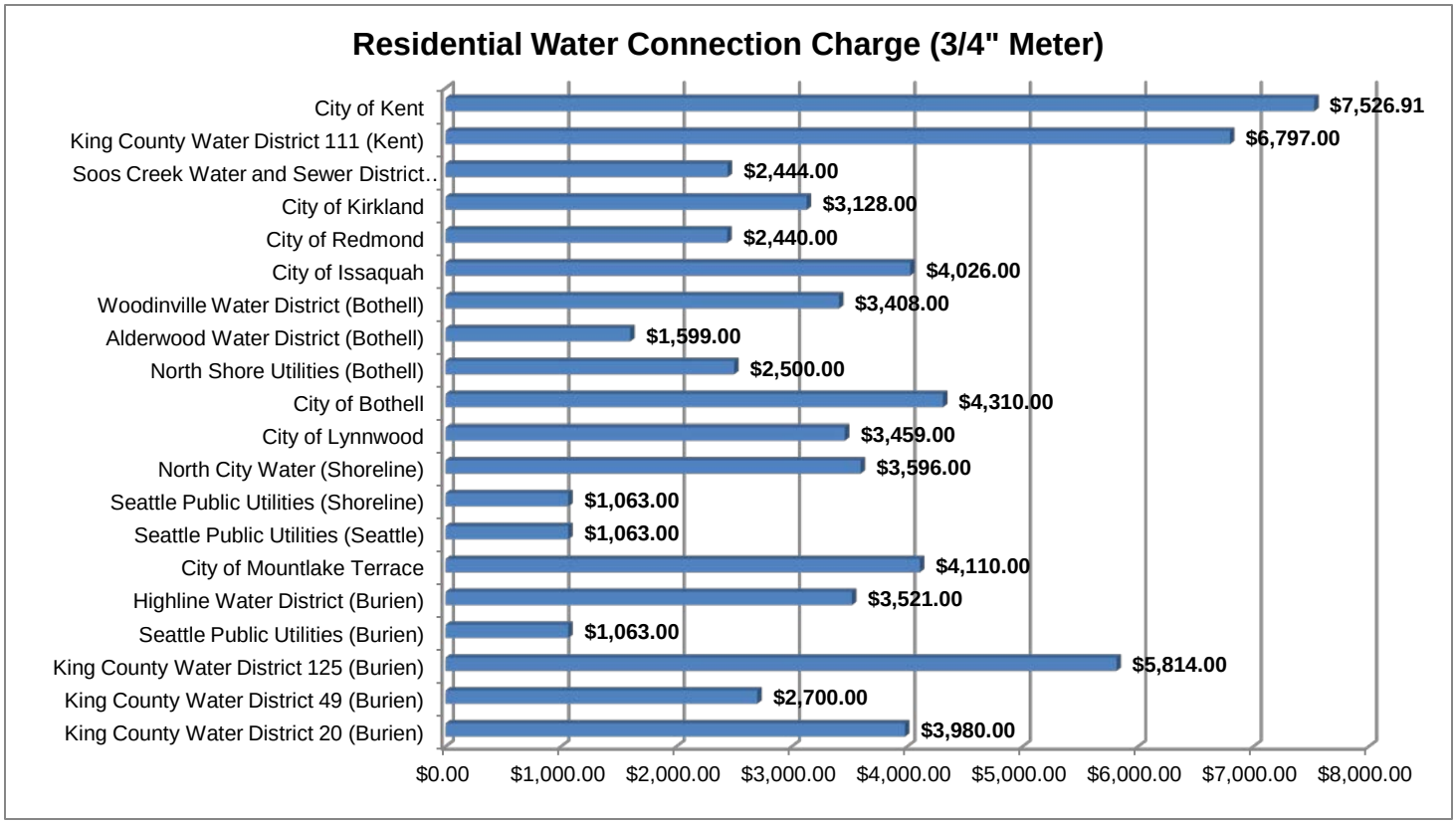
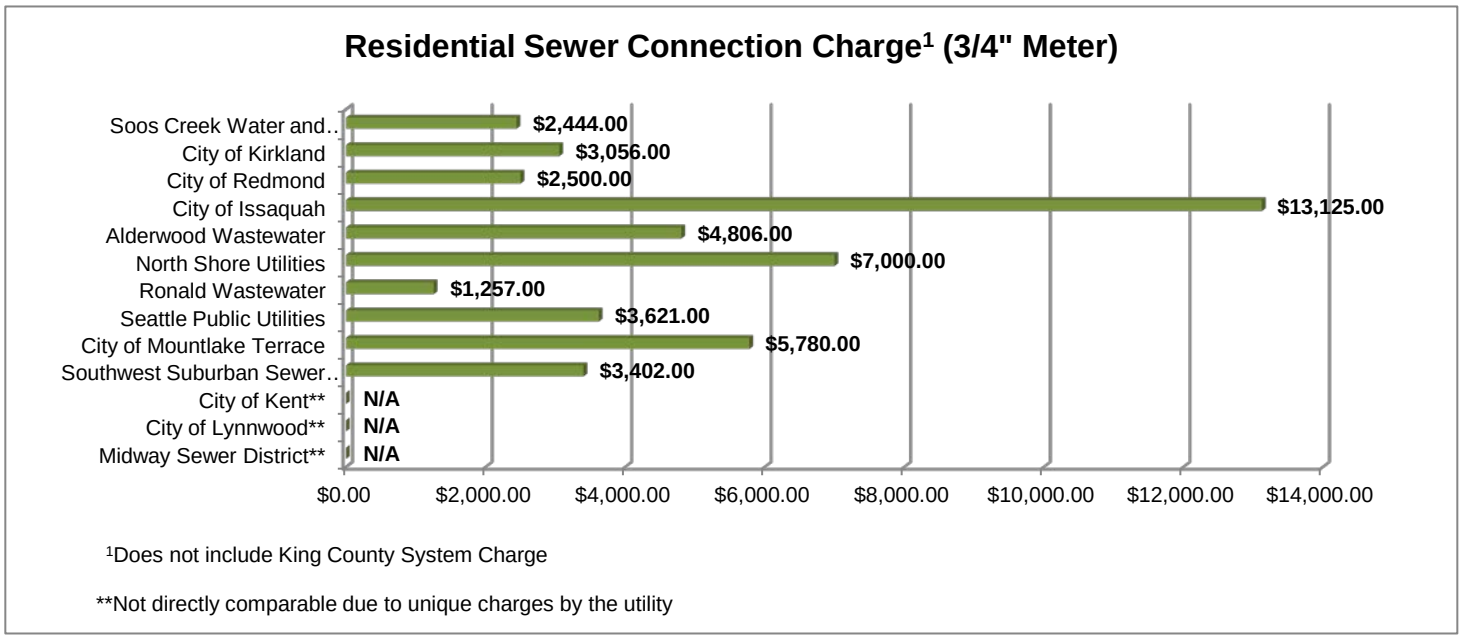


FIGURE 2 - Monthly Commercial Water Rate (Peak and Off Peak)

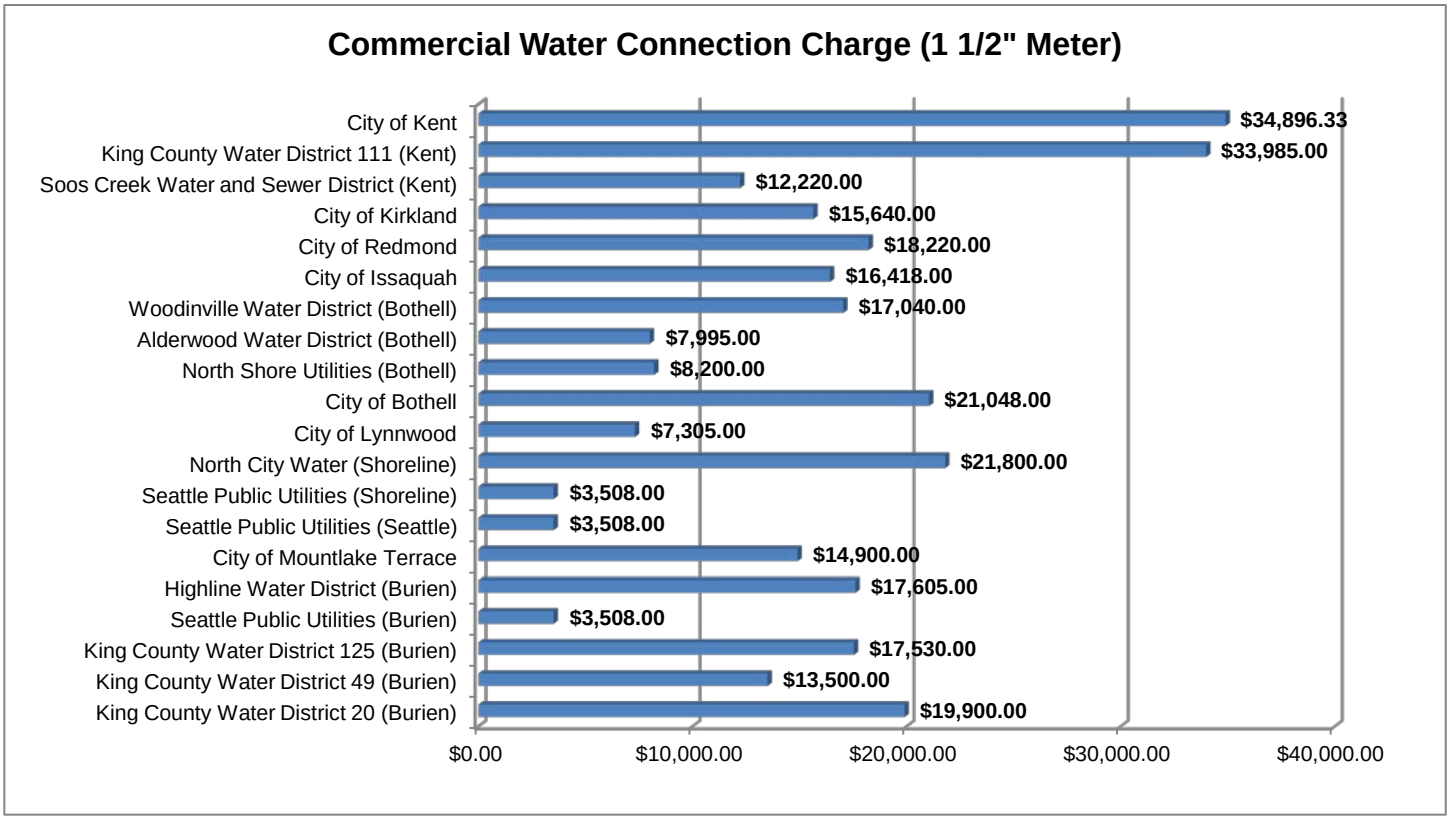




[1]Does not include King County System Charge

**Not directly comparable due to unique charges by the utility

FIGURE 3 - Residential Water and Sewer Connecting Charge Comparison



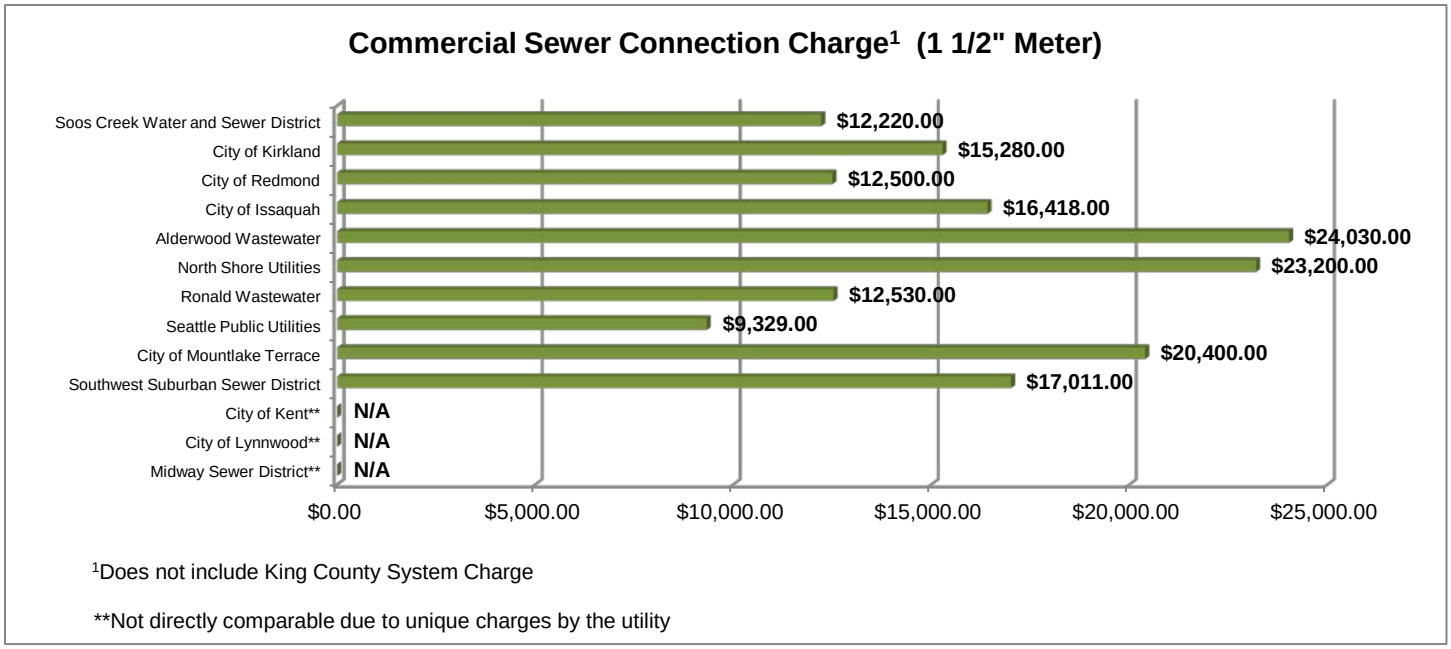


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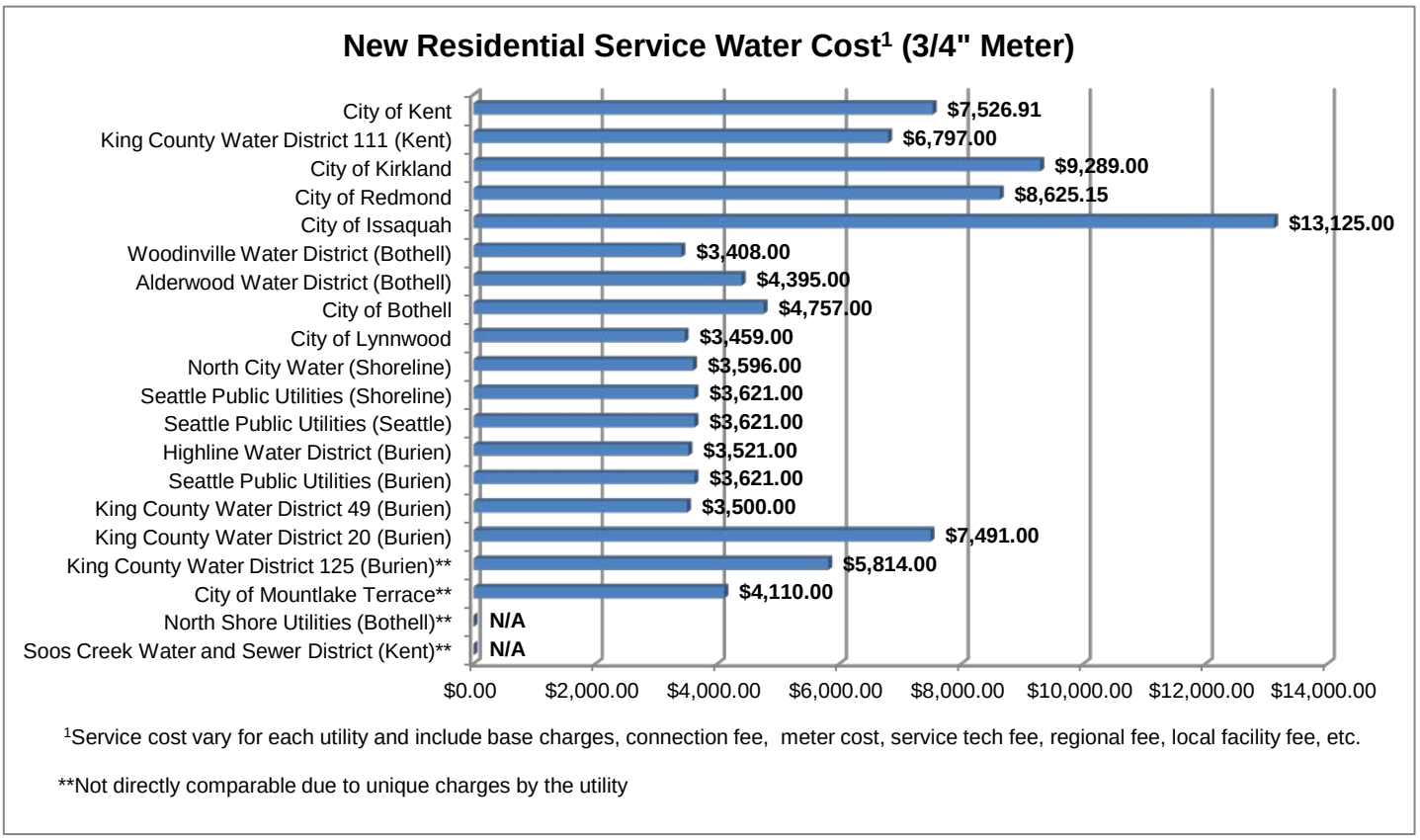
FIGURE 4 - Commercial Water and Sewer Connecting Charge Comparison



[1]Service cost vary for each utility and include base charges, connection fee, meter cost, service tech fee, regional fee, local facility fee, etc.

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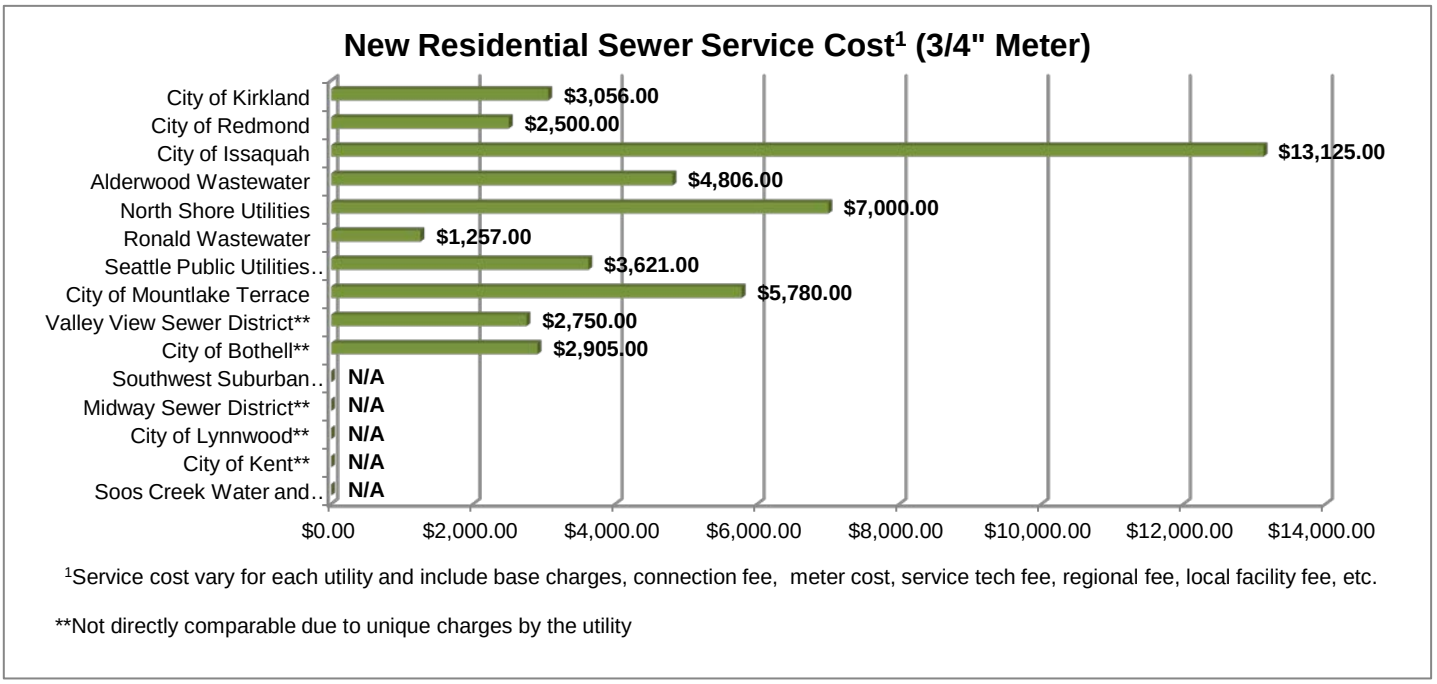

[1]Service cost vary for each utility and include base charges, connection fee, meter cost, service tech fee, regional fee, local facility fee, etc.

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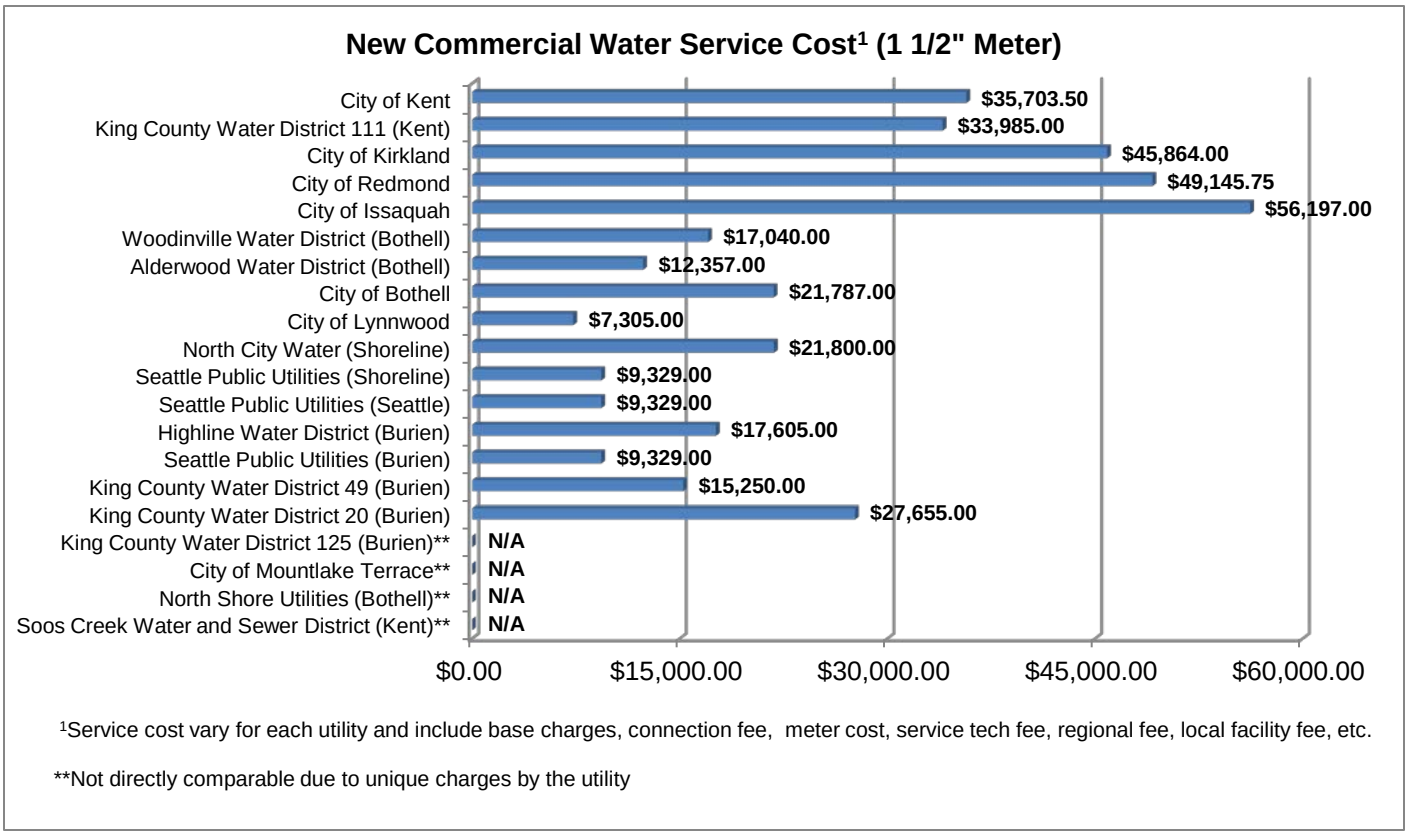
FIGURE 5 - New Residential Water and Sewer Service Cost



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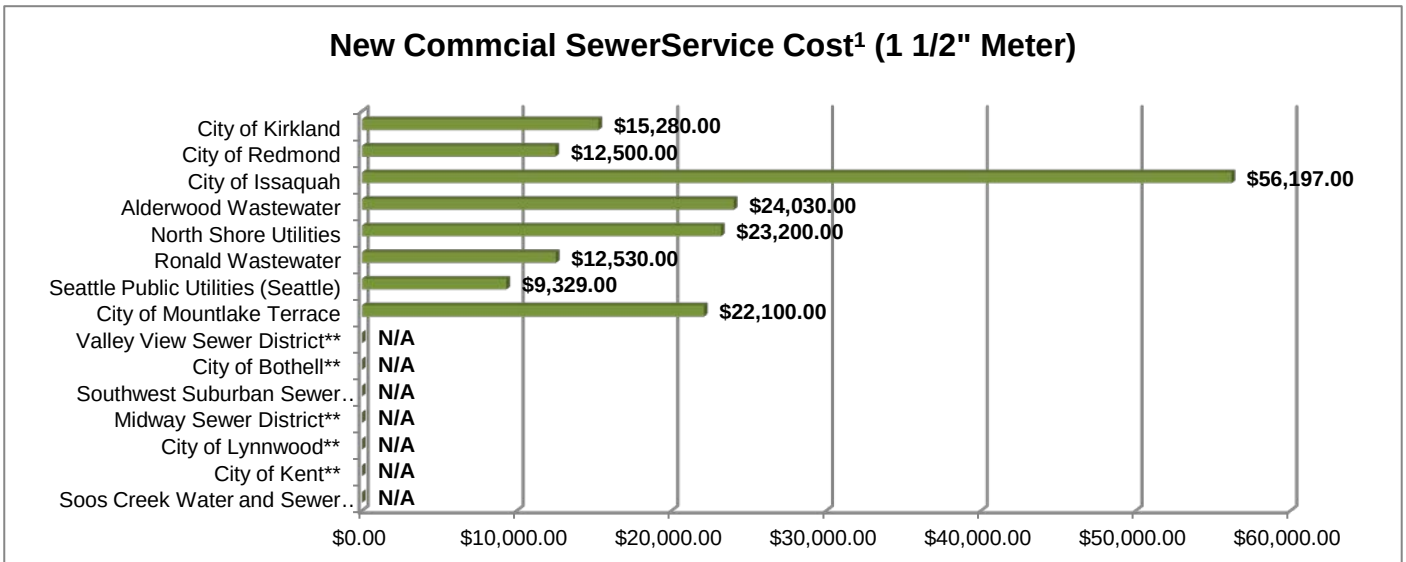

[1]Service cost vary for each utility and include base charges, connection fee, meter cost, service tech fee, regional fee, local facility fee, etc.

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FIGURE 6 - New Commercial Water and Sewer Service Cost

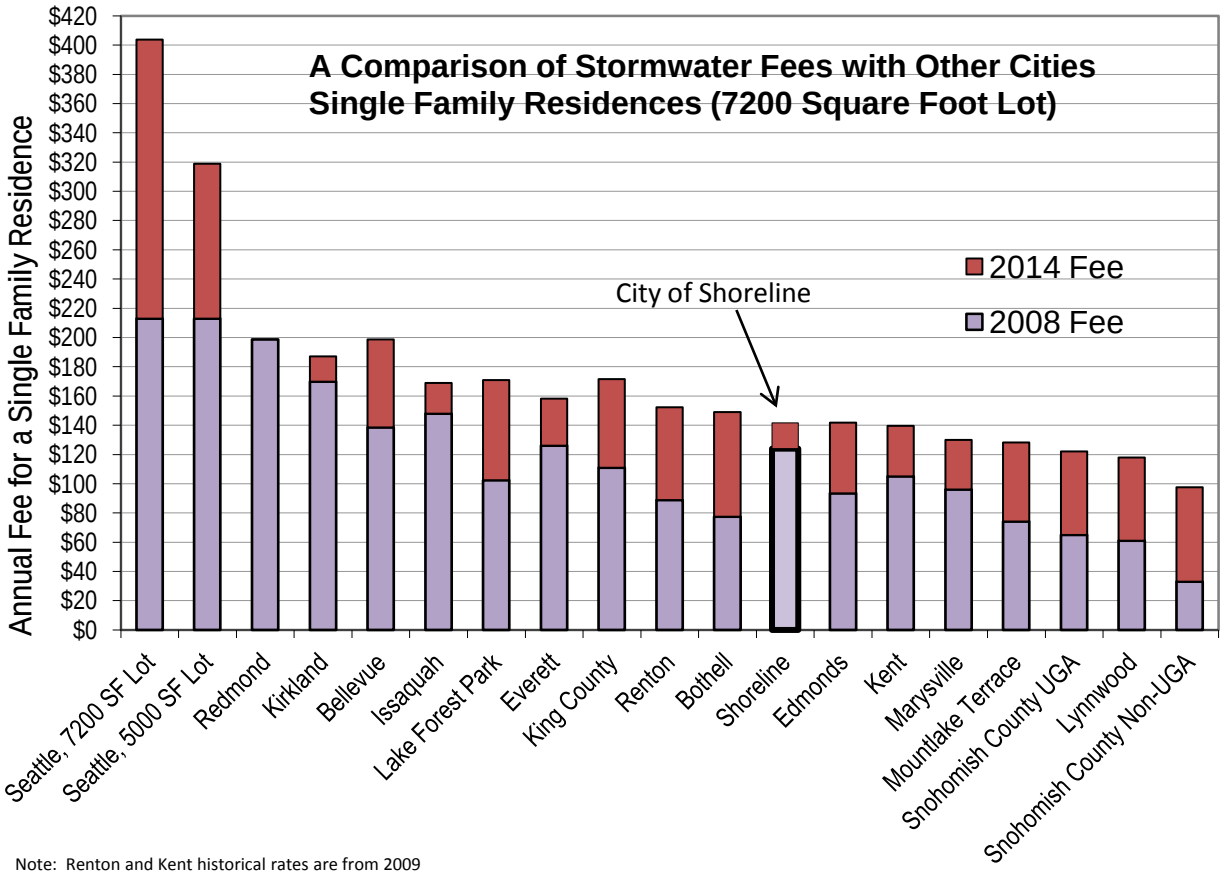

FIGURE 7 - Regional Comparison of Stormwater Fees and Rate Increases.

Future Policy Issues

Some future policy issues regarding utility rates and charges are as follows:

- Financial policies should be used to guide the allocation of utility costs between rates and charges and among customer classes. The policy issues facing the City Council when utilities are unified with City operations include:
    - Defining rate structures for individual customer classes to promote equity.
    - Deciding how much of the funds from new connections should contribute to system improvements while balancing economic development needs.
    - Deciding how much capital improvement money should be collected using rates.
- North City Water District connection charges and commercial water rates are higher than SPU in the City of Shoreline. A future policy issue will be how to equalize rates and charges throughout the City. Leveling these utility costs should provide a benefit to economic development in the City.

- Developing utility rates and charges requires detailed analysis of operation expenses and capital improvement needs. The City Council needs to define the financial planning objectives for the future utilities including stable revenue sources, debt coverage limits, and maintaining adequate reserves.

Conclusions

Future utility unification will provide the City Council an opportunity to create utility rates and charges which best reflect community values and the City's goals. However, there will be tradeoffs in four general areas when the Council weighs the policies that will affect these utility rates and charges. They are:

1) Keeping rates affordable for City residents. The City Council's past decisions regarding stormwater rates reflect their understanding of keeping utility rates at reasonable and affordable levels. The City's single family stormwater utility rate has had one of the smallest increases since 2008 when compared to other stormwater utilities in the region.
2) Maintaining adequate revenues to support utility operations and capital needs.
3) Balancing current utility rate inequities within the City.
4) Promoting economic development through minimized SDCs without overburdening existing rate payers.

The City Council's policy making process will be aided by detailed rate comparisons, such as the one contained in this report, and careful analysis of actual utility costs. The Council will then be able to work through various policy options and consider the tradeoffs of each before deciding on the right mix of utility policies for the City.