



**WATER AND WASTEWATER COMMISSION RECOMMENDATION  
20170809-E1**

Date: August 9, 2017

Subject: Budget Committee Report

Motioned By:

Seconded By:

**Recommendation**

**Description of Recommendation to Council**

*See Attached Report*

**Rationale:**

The Committee appreciates the opportunity to provide a report to the full Commission. However in the future, we strongly appeal to City Management to adopt a more collaborative approach to providing draft initial proposed budget documents to the Committee (by mid-June), including proposed rates, to provide sufficient time for the Committee to perform a thorough and responsible review on behalf of the rate payers.

**Vote**

For:

Against:

Abstain:

Absent:

Attest:

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## Water & Wastewater Commission 2017 Budget Committee

*Report to Commission at August 9, 2017 Meeting*

***The Committee appreciates the opportunity to provide a report to the full Commission. However in the future, we strongly appeal to City Management to adopt a more collaborative approach to providing draft initial proposed budget documents to the Committee (by mid-June), including proposed rates, to provide sufficient time for the Committee to perform a thorough and responsible review on behalf of the ratepayers.***

### Report Highlights

- **No increase in user rates;**
- Implementation of lower fixed fee charges for multi-family and commercial customers with fire demand meters;
- Utility continues to sell 66% of residential consumption below cost;
- Reduced debt service requirements by \$166M and debt service coverage costs by \$141.1M over seven years due to impact fee (CRF) application to debt defeasance for a total reduction in revenue requirements of **\$307.1M**; and
- Utility maintains stabilized financial outlook from all three rating agencies for 2<sup>nd</sup> consecutive year.

### Background

#### 1. Budget Committee Members & Meetings

- The Budget Committee included Commissioners Mickey Fishbeck Maia (Chair), Susan Turrieta (Vice-Chair), Melissa Blanding, Travis Michel, and Mia Parton.
- The Committee met May 17, 2017, July 10, 2017, and July 26, 2017 to review the proposed Austin Water budget and rates for FY2018.
- The Committee scheduled, but did not meet on June 7, 2017 and June 19, 2017, due to a lack of a quorum.
- In response to the Budget Committee's protests during last year's budget review, Staff has been more responsive in providing budget information in a timely manner. However, it remains Management's position that the proposed budget will not be made available in a timely manner, nor will proposed rates be available for Committee review and analysis in future years. This year the proposed budget will not be available until after the Budget Committee concludes its work for timely submission to the Commission as a whole.
- Staff announced that no rates would be increased during FY2018. Thus there was no need for the Budget Committee to perform an analysis of proposed rate and bill changes. However, rates will change during FY2019 responsive to Austin Water's ongoing cost of service study, including the proposed Impartial Hearing Examiner process. If Management continues to withhold public information on specific rate changes as it has in the past, the Budget Committee will not be able to advise the

City Council and public about the impact of those changes, nor will it be able to recommend possible adjustments if the Committee considers them warranted.

## 2. Matters Considered by Budget Committee

- City Financial Forecast and Economic Outlook (presented to City Council on April 19, 2017)
  - Includes the implementation of a new, revenue-neutral Community Charge for the Customer Assistance Program (CAP)
  - The wastewater volumetric rates will be reduced for CAP customers (in a similar manner as CAP water rate structures)
  - Growth, Inflation and Service Demand Assumptions used by Staff to develop the FY2018 Budget
  - Additional Staff (15 FTEs) will be added in FY2018, with increases of 20 FTEs/year thereafter to respond to growth demands. Accordingly personnel costs will increase by approximately \$1.5M in FY2018, and by approximately \$2.5M per year thereafter.
  - Significant changes between FY2017 and forecast FY2018 (Some of these line items will change with the final proposed FY2018 budget, which is released too late for the Budget Committee to review.)
    - \$4.9M increase in personnel costs, including new personnel
    - \$0.6M increase in fleet services costs
    - \$0.3M increase in CTM costs
    - \$4.6M increase related to O&M cost inflation
    - \$1.0M increase in billing costs
    - \$2.95M increase in Transfer to the General Fund
    - \$0.4M increase in Economic Development Fund Transfer
    - \$5.0M increase to cure backlog of street cut patches
    - \$0.3M decrease for Market Adjustment
    - \$0.75M decrease related to completion of existing GO debt service
    - \$4.0M decrease in debt service costs
    - \$18.8M increase in CIP transfers
    - \$5.6M increase in capital recovery fee (CRF) debt defeasance

- Historical Budget Figures
- Capital Improvement Program (CIP), including debt service and cash transfers related to CIP spending and the proposed CIP spending plan
- Status of Austin Water with bond rating agencies (All 3 agencies provided a stable outlook in 2017, the 2<sup>nd</sup> year of stable outlook since 2015)
- Existing and Projected Debt Service, including 2017 bond refinancing savings and proposed increasing debt service coverage ratios
- Projections of CRF revenues, waivers and application to bond defeasances
- Continued growth of cash reserves and Revenue Stability Reserves
- The possibility of budgeting for reclaimed water within the Water Utility rather than a stand-alone reclaimed water utility, and the possibility of including reclaimed water capital improvements in the next impact fee update
- Proposed program for arrearage management whereby defaulting customer pays full current bill, then AW takes one-half of payment to pay arrearage and reduces “rates” for current service to an amount which would produce remaining half of current bill payment. This unique customer-specific rate adjustment would be performed so that the City would not be considered to be making an illegal payment of the customer’s bill.
- Proposed future CAP programs
  - CAP benefits for multifamily customers
  - AW sends money to agencies which give money to customers in arrears to pay their bills. This would be another mechanism for the City to not be seen as making an illegal payment of customer’s bill.
- Management set financial benchmark targets responsive to the ongoing cost of service process:
  - Operating reserve targets were set to 245 days of operating cash (water and wastewater) plus 120 days from the water Revenue Stability Reserve, for a total of 365 days of water cash reserves and 245 days of wastewater cash reserves;
  - Debt service coverage target was set at 1.85; and
  - Percent of CIP equity financing target was set at a maximum of 50%. (The equity financing % is forecasted to increase from 37% in FY 2017 to 47% in FY 2022).

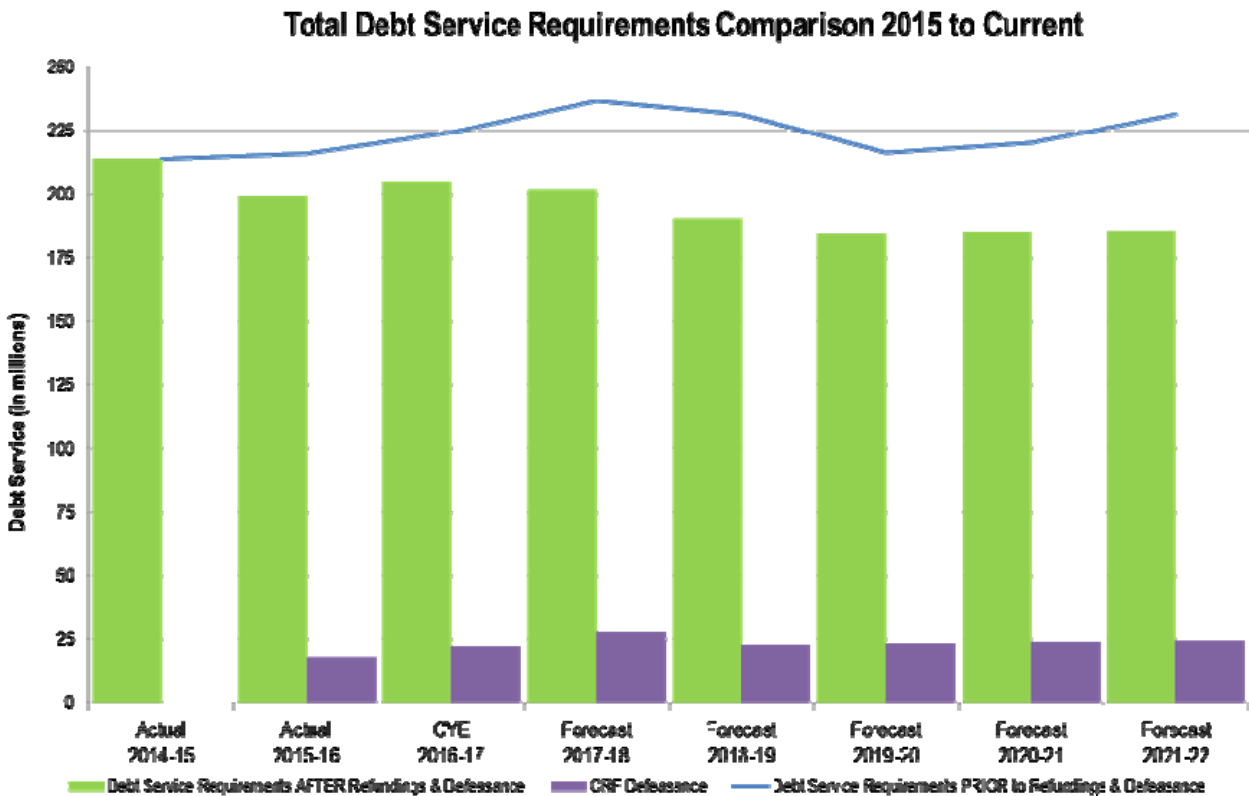
### 3. Water & Wastewater Budget and Rates

- With two exceptions, discussed below, Staff is proposing no net changes in rates for FY2018. However, there will be a change in the manner in which the rates are presented. A “Community Benefit Charge”, which funds lower rates for CAP customers (CAP = Customer Assistance Program), will be discretely noted on customers’ bills at the rate of \$0.15 per 1,000 gallons of water. Current FY2017 retail volumetric rates will be adjusted downward by \$0.15 such that all customers will pay the same amount in their volumetric rates in FY2018 as they do in FY2017. Wholesale customer rates will remain unchanged from the current FY2017 rates.
- There is one group of customers which will have lower bills for the same amount of water in the coming year. There are approximately 600 multifamily customers or commercial customers with compound fire demand meters. For these customers, the minimum charge is currently based on the larger compound meter size that is not generally used unless there were a fire. This results in an extremely high fixed charges for these customers. Following customer complaints and analysis by Staff, Staff has determined that this system produces inequitable rates compared to other similar customers, and has recommended that those minimum charges be based on the smaller meter size which provides sufficient capacity for daily domestic use for these customers. These changes to fire demand meter customer charges will be implemented on August 1, 2017, prior to the beginning of FY 2018.
- The breakeven point for cost of service for non-CAP residential customers is projected to be 9,200 gallons in FY2018, which is unchanged from FY 2017. Non-CAP customers using less than 9,200 gallons of water will pay less than full cost and will be subsidized by higher-use customers.
- Roughly two-thirds of residential gallons will be sold below cost in FY 2018 with proposed rates. (In FY 2017, approximately 66% of residential gallons have been sold below cost.)
- For retail customers, the Revenue Stability Reserve Fund Surcharge will remain at \$0.19 per 1,000 gallons in FY2018. This coming fiscal year will be the final build-up year for this fund, and the Surcharge will be reduced in FY2019 and in following years to an amount that is needed to keep up with cost inflation only.
- Drought rates (\$1.00 per 1,000 gallons in Stage 3 and \$3.00 per 1,000 gallons in Stage 4) are unchanged in the proposed budget. (The Joint Committee had requested during the past two years that the \$3.00 charge at Stage 4 be reconsidered for CAP customers, but Staff has not considered a change in that rate yet.)
- As for FY2017, proposed rates for FY2018 deviate from Joint Committee/Staff recommendations for FY2016:
  - The Joint Committee had adopted Staff recommendations that fixed revenues increase from 22.5% to 25%. That was not put in place for FY2016, and AW Staff again recommends that fixed revenue sources remain at 22.5% of revenues for FY2018.

- The Joint Committee had also adopted Staff recommendations to increase Tier 2 of non-CAP residential rates to full cost in FY2017. AW recommends that Tier 2 remain at FY2017 levels in the coming year, which is not yet at full cost.

#### 4. Use of Capital Recovery Fees (Impact Fees) for Debt Defeasance

In FY 2016, Austin Water began using collected Capital Recovery Fees (CRFs) to defease or pay off existing growth related debt. In January 2014, the Capital Recovery Fees were updated to the maximum allowable level allowed by State law. This large increase in the Capital Recovery Fees has resulted in significantly more revenue from new development. The use of these fees for debt defeasance is a critical part of Austin Water’s debt management strategies. To date, Austin Water has used \$39.4 million of CRF revenue to reduce future debt service requirements by \$43.3 million. Austin Water expects to use \$123 million of CRF revenue during the 5 year forecast period to defease additional debt.



Because of CRF-funded defeasances, along with other defeasances and refundings, debt service as a percentage of total budget requirements is expected to be reduced from 42.5% in FY2015, 37.6% in FY2016, and 35.6% in FY2017 to 29.5% by FY2020.

Over \$39M in CRFs have been used for defeasances since January 2014 when the current full-cost CRFs were adopted. Another \$123M in CRF-related defeasances are expected in the five-year period of FY2018-FY2022. Those defeasances (totaling \$162M) will result in debt service savings of \$166M, including avoided interest payments. In addition, at the targeted 1.85 debt service coverage, this use of CRFs

would result in \$141.1M less coverage costs in customers rates, for an overall impact of \$307.1M in avoided costs by FY2022.

#### 5. Budget Committee Comments – Update on Concerns Expressed in 2016

The Budget Committee recommended in their 2016 report that Staff review and analyze several areas of Committee concern. The following comments reflect Committee response to Staff's study/action since last year's report:

- “Magnitude of rate increases as impacted by “Other Requirements” & “Transfers Out” (charges from other Departments to Austin Water for support services). The Committee recommends that Austin Water examine other alternatives for these services to reduce costs.”
  - Economic Development funds Transfers have been increasing annually for three years during a fund development period. These costs are expected to level off in future years according to Staff.
- “The Committee continues to have concerns regarding the magnitude of increases from Austin Energy for meter reading and billing. The Committee supports the executive agreement with Austin Energy to review the customer care allocation methodology to ensure costs and allocation among all departments are reasonable and fair.”
  - Staff reports that an allocation study by AE is being conducted, but will not be implemented until FY 2019.
  - AE is, for the first time, performing a “true-up” calculation using actual costs. This has resulted in a reduction in costs for FY2017 of \$1.7M.
- “Reconsideration of Stage 4 Drought Rates as applied to CAP Customers, as recommended in the Budget Committee report of August, 2015.”
  - Staff has not studied this issue during the past year.
- “Further consideration of budget structure relative to the reclaimed water system and recovery of reclaimed water costs, in particular consideration of including reclaimed water as a component of the water utility in the budget, rather than being operated as a stand-alone utility.”
  - Staff reports that they have decided to retain reclaimed water as a separate utility, but will only subsidize this utility from Water Utility funds and not from Wastewater Utility funds. The Committee supports Staff's decision to discontinue “subsidies” from the wastewater utility. However, the Committee continues to have concerns that the function of reclaimed water as a water source benefitting ALL water customers is not reflected in the budget structure and may subject Austin Water to rate challenges related to the so-called “subsidy” of this source of water. In reality, the willingness of some customers to use reclaimed water instead of potable water made available

for existing users and new development potable water supplies that might not have otherwise been available during the drought.

- “Further consideration of including reclaimed water capital improvements in the next impact fee update.”
  - Staff has reported that they do not intend to include reclaimed water capital improvements in the water capital recovery fee program when it is updated.
- “Although there have been some improvements in AW presentation documents, Budget documents continue to mis-use the term “rate increase” instead of the more accurate term “rate revenue increase”. This misleads the public because it suggests that a typical monthly bill, particularly a monthly residential bill, will be at the magnitude of the Staff’s reported “rate increase”. In fact, typical residential bills tend to be considerably higher than the mislabeled “rate increase” in budget presentations and documents. This discrepancy has been highlighted by Water and Wastewater Commissioners for at least five years, and was also consistently noted by the Joint Committee. Although AW Staff has acknowledged the concerns and changed some of their presentation documents, Budget Office documents continue to use the misleading labels.”
  - Although there has been some improvement in the use of the term “rate increase”, it is still widely misused. There have been numerous statements that rates will not increase during a number of coming budget years. Reference, for example, the City Financial Forecast used the term “combined rate increase” in Austin Water’s “Combined Operating Budget Fund Summary” to indicate needed overall revenue increases beyond that provided by growth. That table shows 0% rate increases for three of the next five years. Except for FY2018, that perception is incorrect. Although the amount of funding provided by rate revenues may not be expected to increase beyond what would be generated by utility growth in future years, rates for various customer classes, and by various residential rate tiers, are expected to change starting in FY2019. Statements about no rate increases in future years is misleading to the customers.
- “Staff continues to use varying volumes of water and sewer service for historical residential bill comparisons, making it difficult to determine bill changes for a consistent amount of service. This manner of presenting information has been used tactically in the past to misrepresent large bill increases (presenting a residential bill increase of approximately 3% when the real increase for a constant amount of service was approximately 23%). Transparency in presenting customer bill impacts remains a concern.”
  - Since no rate changes are proposed for FY2018, the Committee has no comment on this concern at this time.
- “In an effort to minimize average residential bill impacts, AW did not fully implement recommendations of the Joint Committee related to fixed charges and raising Tier 2 rates to full cost of service. The Committee supports AW’s continued efforts to implement those recommendations as soon as is reasonable.”



- Staff is not making any proposed rate changes for FY2018.

6. The Budget Committee recommends further review and analysis on the following:

- The Committee recommends continued analysis by staff to limit costs related to Other Requirements and Transfers Out.
- The Committee supports staff action related to AE Cost Allocation review and annual AE Cost Allocation true-up.
- The Committee continues to recommend reconsideration of Stage 4 drought rates for CAP customers so that a policy, as warranted, is in place should the Utility find itself in drought conditions in the future.
- With regard to inclusion of reclaimed water facilities in the impact fee update, the Committee continues to recommend that reclaimed water, as well as other future water supply facilities, be considered water sources that benefit all water customers, not just those customers which are directly using reclaimed water or other new types of water supply facilities. In particular, the need to expand capacity due to growth is benefitted by the development of reclaimed water facilities which “free up” potable water supplies, and accordingly growth should be required to pay for reclaimed facilities as well as conventional water supply facilities.
- The Committee continues to recommend that references to “rate increases” in budget documents and public discourse be discontinued and replaced with more transparent and accurate terminology.
- The Committee continues to recommend that bill comparisons presented in future years are inclusive of all fees/rates, as well as apples-to-apples usage amounts.
- The Committee continues to support raising Tier 2 rates to full cost of service as soon as reasonable, subject to consideration of any recommendation from Staff to do otherwise.