



WATER AND WASTEWATER COMMISSION RECOMMENDATION 20180214-E1

Date: February 14, 2018

Subject: Budget Committee Report on Austin Water Cost of Service Study and Proposed
Retail Water and Sewer Rate Decreases

Motioned By:

Seconded By:

Recommendation

See Attached Report

Description of Recommendation to Council

See Attached Report

Rationale:

Austin Water faced considerable financial challenges during the recent drought. The Utility's customers both secured the water resource through their conservation efforts and endured steep rate increases needed to offset drought-related revenue losses. Because of sacrifices by our customers, efforts by Austin Water Staff and citizen volunteers, and Council policy support, Austin Water has now been found to be in sound financial condition with enhanced budgetary safeguards in place for the future. Now that financial security has been restored, the Utility can re-prioritize affordability for its customers. The Water and Wastewater Budget Committee recommends that the Council adopt the retail rate decreases proposed by AW Staff for the remainder of FY2018, and supports the Utility's intentions to keep rates stable through FY2020. Moreover, the Budget Committee supports the recommendation by AW Staff and the Cost of Service Study Public Involvement Committee (PIC) to discontinue efforts for an Independent Hearing Examiner process due to its high projected costs (approximately \$1.2 million) and the one-year delay it would cause in lowering customer rates. The Budget Committee also advises the Council that the full-cost-recovery impact fees (capital recovery fees) that were adopted by Council in 2014 are the primary reason that the Utility is now able to lower its debt service costs sufficiently to offer lower rates to its customers, and recommends that Council continue to support full-cost fees with limited fee waivers in order to continue to enhance affordability for existing customers.

Vote

For:

Against:

Abstain:

Absent:

Attest: Liaison

REPORT OF THE BUDGET COMMITTEE TO THE WATER AND WASTEWATER COMMISSION

Austin Water Cost of Service Study And Proposed Retail Rate Reductions

The Budget Committee of the Water and Wastewater Commission met on February 8, 2018 to review:

- the results of the Water and Wastewater Cost of Service Study conducted by Austin Water (AW);
- the recommendations of the Public Involvement Committee (PIC) for retail customers (in concert with AW) related to that study; and
- the recommendations (especially regarding affordability of water/sewer service for all customers) of NewGen Strategies & Solutions, a firm engaged by Austin Water to act as a rate advocate for residential customers.

The purpose of this document is to make recommendations to the Water and Wastewater Commission as a whole so that the Commission can advise the City Council on proposed water and sewer rate decreases and related matters.

We commend and thank Austin Water Staff, other City Staff and consultants, and members of the retail PIC and wholesale WIC (Wholesale Involvement Committee) for their many months of demanding work in developing a cost of service study designed to result in fair cost-based rates for all customers.

The following are our observations and recommendations:

1. The Budget Committee recommends that AW re-orient Utility priorities as recommended by NewGen Strategies & Solutions in their report “Austin Water Rate Review: Report by the Residential Rate Advocate” (October 2017, page 8).

New Gen suggests improving financial metrics should no longer be the highest priority of AW at the cost of affordability. Instead, it is prudent at this point for AW to refocus on affordability.

2. All rates should be based on the cost of providing service.
3. All data and processes used in calculating cost of service should be available to the public. A potential Independent Hearings Examiner (IHE) process should not be necessary for transparency and input for the public.
4. AW should discontinue establishing an IHE process.

5. It is recommended that all retail water and wastewater rates be lowered immediately as shown in AW's rate and budget adjustments proposed to the Budget Committee on February 8, 2018. (See "2017-18 RCA Fee Schedule Amendment.pdf", attached.)
6. The Budget Committee recommends that all retail rates adopted immediately for FY2018 remain unchanged in FY2019.
7. The Budget Committee also supports AW Staff's intention to leave rates for all retail customer classes unchanged in FY2020.
8. Revenue from full cost Capital Recovery Fees (Impact Fees) have made it financially possible to lower rates immediately due to reductions in debt service costs. The Budget Committee recommends that Capital Recovery Fees remain at full cost levels in future years, with minimal waivers in order to protect that revenue stream.
9. Ammonia surcharges should be based on cost of service and should not be negotiated.
10. Two types of financial metric measures play into costs: Formal City financial policies, and AW financial metric goals (which are greater than City official policies). NewGen found that AW metric goals are more than adequate to achieve the highest bond ratings, and thus should not be increased beyond current levels since customers will not receive the benefit of better financing terms by paying for excessive metric goals.
11. Various financial metrics are significant drivers for rate increases. Accordingly, the Budget Committee recommends that no rates be increased directly due to AW Staff increasing financial metric goals included in Austin Water's FY 2017 budget, as set forth in the NewGen report:

1.71 Debt Service Times Coverage
216 Days of Cash on Hand
35.8% Cash Funding of CIP

12. Moreover, official City Financial policies for the same metrics should not be revised upward to any measure higher than the level needed to achieve the highest grade possible from S&P Ratings Services or other similar agency relied upon by AW for rating for bond purchases. According to NewGen, those levels are currently:

1.60 Debt Service Times Coverage (as calculated by S&P) which is roughly equivalent to 1.85 times coverage as calculated by Fitch and Moody's and in Austin Water's budget.

150 Days of Cash, with \$75 million in cash on hand

CIP funded with cash should be based on the useful lives of funded facilities.

13. Calculation of financial metrics by AW should use the same methodologies as the ratings services used by AW.

14. The Budget Committee supports the "Joint Recommendation to the Austin City Council" from AW and PIC members, with the following exceptions:

Item 14 – We do not recommend unchanged Wholesale rates, but rather recommend wholesale rates based on their identified cost of service.

Item 21 – The meaning of this recommendation is unclear as written. Based on explanations by AW staff, the Budget Committee included item 15 below which we think addresses the PIC's concerns.

15. AW should include current financial metric measurements, including unrestricted and restricted reserve balances, in AW's monthly financial reports.

**AUSTIN WATER
2018 COST OF SERVICE
STUDY AND PROPOSAL TO CHANGE
BASE WATER AND WASTEWATER
RATES**

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**BEFORE THE AUSTIN
CITY COUNCIL**

JOINT RECOMMENDATION TO THE AUSTIN CITY COUNCIL

This Joint Recommendation to the Austin City Council (“Recommendation”) is entered into by Austin Water, Residential Rate Advisor, Austin Apartment Association, Austin Water Low Income Customers, Building Owners and Managers Association of Austin, Cypress Semiconductor, Greater Austin Chamber of Commerce, Karyn Keese – Residential Customer Representative, Marcia Stokes – Multifamily Representative, NXP Semiconductors, Samsung Austin Semiconductor, and the University of Texas and through their duly authorized representatives (collectively, the “Signatories”). The Signatories agree that a negotiated resolution of this matter on the basis set forth in this Recommendation and related tariffs is in the public interest, provides just and reasonable rates, and will conserve resources and eliminate controversy. Accordingly, the Signatories request approval of this Recommendation by the Austin City Council (“City Council”). In addition, the Signatories request the City Council issue a rate ordinance and approval of the tariffs applicable to retail customers throughout Austin Water’s service area consistent with this Recommendation.

I. BACKGROUND

1. Austin Water is a municipally owned utility providing water, wastewater and reclaimed water service to the City of Austin and surrounding areas. Austin Water is owned and operated by the City of Austin.
2. In 2016, Austin Water engaged Raftelis Financial Consultants, Inc. to conduct a comprehensive cost of service study of Austin Water’s water and wastewater operations.

The final Water and Wastewater Cost of Service Study (“Cost of Service Study”) was issued on November 13, 2017.

3. Under the Cost of Service Study, the adjusted fiscal year 2018 retail water revenue requirement was \$291,053,795. This revenue requirement is \$14,620,394 or 4.8% less than the revenue that would be generated by current retail base rates.
4. Under the Cost of Service Study, the adjusted fiscal year 2018 retail wastewater revenue requirement was \$255,809,834. This revenue requirement is \$11,112,383 or 4.2% less than the revenue that would be generated by current retail base rates.
5. Based upon the results of the Cost of Service Study, Austin Water initially proposed to reduce its base rates by \$14,632,076. Subsequently, Austin Water revised the cost of service to update certain consumption figures and to remove base rate costs associated with ammonia mitigation. The revised cost of service study resulted in a \$25,780,410 or 4.5% reduction in retail base rates.
6. To ensure transparency and effective customer input, Austin Water utilized a public involvement process for the cost of service study. The public involvement process included the creation of the PIC (“Public Involvement Committee”) and the WIC (“Wholesale Involvement Committee”). These groups consisted of stakeholder representatives from all customer classes. Austin Water also engaged the services of an independent residential rate advisor to represent the interests of residential customers.
7. Between September 27, 2016 and May 23, 2017, Austin Water conducted 13 meetings of the PIC and 12 meetings of the WIC to discuss all aspects of the rate review process.
8. Between November, 2017 and January 2018, Austin Water met with PIC and WIC members to discuss the rate proposal.

9. At the conclusion of a series of meetings, the Signatories reached an agreement in principal in late January, 2018.
10. The Signatories believe that a negotiated resolution of this matter is desirable and in the public interest because (a) the result is reasonable under the circumstances, (b) it will conserve the public's and the Signatories' resources, (c) will result in early implementation of a rate decrease to all customer classes, (d) will result in all classes paying cost based rates and (e) will eliminate controversy.

II. SETTLEMENT PROVISIONS

The Signatories have reached agreement on the issues as set out below and agree that the City Council should adopt a rate ordinance consistent with this Recommendation.

11. **Application of Recommendation:** The terms of this Recommendation apply to retail rates charged by Austin Water to customers throughout its service area. This Recommendation has no impact on wholesale rates.
12. **Effective Date:** The provisions of this Recommendation shall become effective no later than June, 2018 unless stated otherwise below.
13. **Revenue Requirement:** The Signatories agree that base rates (i.e. fixed and volumetric rates) should be reduced by \$25,780,410 effective no later than June, 2018.
14. **Cost Allocation/Revenue Spread:** In order to ensure cost based rates, the Signatories agree that the \$25,780,410 retail base rate reduction is to be allocated in approximately the following manner:
 - \$5,021,032 to the Residential class;
 - \$1,147,366 to the Residential – CAP class;
 - \$6,868,436 to the Multifamily class;
 - \$9,640,118 to the Commercial class;
 - \$3,103,458 to the Large Volume class; and
 - No change in wholesale class rates.

15. **Cost of Service Rates:** Austin Water agrees to develop retail water and wastewater rates based on the cost of service methodologies recommended during the 2017 Cost of Service Rate Study and implemented within the new cost of service rate model.
16. **Impartial Hearing Examiner Process:** The Signatories agree that the current year Impartial Hearing Examiner Process should be cancelled.
17. **Future Rate Increases:** Austin Water agrees to not increase retail base rates in fiscal year 2019. Austin Water projects no increase in retail base rates in fiscal year 2020.
18. **Customer Assistance Program (“CAP”) Enhancements:** Austin Water agrees to waive CAP customers from being required to pay drought rates. In addition, Austin Water agrees to develop and implement a faucet/toilet repair or replacement program for CAP customers in fiscal year 2019. Austin Water will work with Neighborhood Housing and Community Development Department to determine whether they can assist in implementing this program.
19. **Ammonia Surcharge:** Austin Water will implement an ammonia surcharge for certain customers in November 2018 as part of the fiscal year 2019 budget. Prior to implementing the surcharge, Austin Water will meet with effected customers to discuss costs, rates and other processes.
20. **Financial Policies:** Austin Water agrees to make no fiscal year 2019 changes to its financial policies. Austin Water agrees to create a process that provides for stakeholder input before proposing future changes to its financial policies to City Council. Austin Water agrees to procure services of a Residential Rate Advocate to represent the residential customers during any stakeholder process related to a proposed change in financial policies regarding debt coverage, days cash on hand, and cash financing of

capital projects.

21. **Financial Reporting:** Austin Water agrees to provide future reports of reserve fund data and targets collectively.
22. **Large Volume Customers:** Austin Water agrees to meet annually with Large Volume customer representatives to discuss consumption projections, peaking factors, and other data.
23. **Financial Forecast:** Austin Water agrees to meet annually with customer representatives to discuss Austin Water's Financial Forecast.
24. **Affordability Measures:** Austin Water agrees to conduct a comprehensive affordability benchmarking study as described and approved by City Council resolution on February 1, 2018.
25. **Future Cost of Service Study:** Austin Water will conduct a cost of service rate study and PIC process no later than 2024.
26. **City Audit:** The Office of the City Auditor will complete a special project addressing meter reading, billing, complaint processes and tiered rate impacts on high bills in fiscal year 2018.
27. **Budget Committee Update:** Austin Water agrees to provide updates on the progress of this Recommendation and its terms to the Budget Committee of the Water and Wastewater Committee as appropriate.
28. **Support of Recommendation:** The parties agree to support the terms of the proposal before the Austin City Council and to not seek, fund, or support an appeal of this rate review before any oversight body including the Public Utility Commission of Texas.

29. **Effect of Joint Recommendation:** A Signatory's agreement to entry of a rate ordinance of the City Council consistent with this Recommendation should not be regarded as an agreement to the appropriateness or correctness of any assumptions, methodology, or legal or regulatory principle that may have been employed in reaching this Recommendation. Except as otherwise noted above, the Signatories acknowledge and agree that the provisions of this Recommendation have been entered into as a matter of compromise and are not intended to create a precedent for resolving such issues in any future matter and are not binding or precedential on any Signatory or its representatives in any other matter before the City of Austin, Public Utility Commission, or any court, tribunal, or similar authority. The Signatories agree that their request that the City Council adopt a rate ordinance consistent with the Recommendation is the result of negotiation, and is not intended to have precedential value with respect to any particular principle, treatment, or methodology that may underlie the Recommendation.
30. **Severability:** The Signatories agree that the terms and conditions herein are interdependent and not severable, and no Signatory shall be bound by any portion of this Recommendation outside the context of the Recommendation as a whole. If the City Council does not accept this Recommendation as presented, or issues a rate ordinance inconsistent with any term or provision of this Recommendation, the Signatories agree that any Signatory adversely affected by that modification or inconsistency has the right to withdraw its consent from this Recommendation, thereby becoming released from all commitments and obligations, and to proceed to exercise all rights available under law.
31. **Statements:** The Signatories agree that neither oral nor written statements made during the course of the settlement negotiations, nor the terms of this Recommendation may be

used as an admission or concession of any sort or as evidence in any matter. This obligation shall continue and be enforceable, even if this Recommendation is terminated.

32. **Entire Recommendation:** This Recommendation contains the entire understanding and agreement of the Signatories, supersedes all other written and oral exchanges, or negotiations among them or their representatives with respect to the subjects contained herein; and neither this Recommendation, nor any of the terms of this Recommendation, may be altered, amended, waived, terminated, or modified, except by a writing properly executed by the Signatories.
33. **Execution:** Each signing representative warrants that he or she is duly authorized to sign this Recommendation on behalf of the Signatory he or she represents. Facsimile and PDF copies of signatures are valid for purposes of evidencing execution. The Signatories may sign individual signature pages to facilitate the circulation and filing of the original of this Recommendation.

AGREED:

AUSTIN WATER

Greg Meszaros

**RESIDENTIAL CUSTOMER
REPRESENTATIVE**

Karyn Keese

RESIDENTIAL RATE ADVISOR

David Yanke / Grant Rabon


AUSTIN APARTMENT ASSOCIATION

Kristan Arrona

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**AUSTIN WATER LOW INCOME
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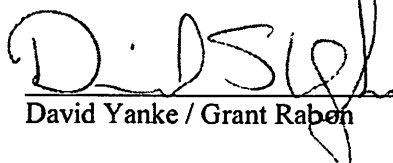
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Tina Cannon

SAMSUNG AUSTIN SEMICONDUCTOR

Jeff Smith

THE UNIVERSITY OF TEXAS

Leonard Friesenhahn

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Stephan Shepard

CYPRESS SEMICONDUCTOR

Ron Rogerson

NXP SEMICONDUCTORS

Todd Davey

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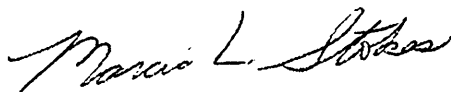
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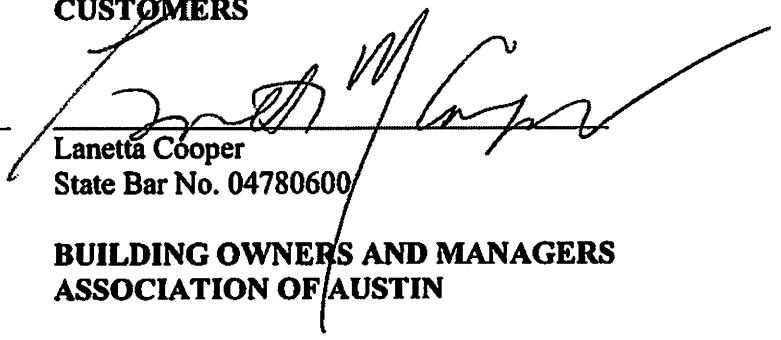
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