

Memo

To: Mayor McConnell and Assembly Members
From: Jay Sweeney, CFAO
Date: June 9, 2014
Re: Tracking of Utility Rate Increases to Utility Master Plans

Mayor McConnell and Assembly members,

As you have proposed water and wastewater user fee increases before you for consideration, I thought it would be helpful to review how these fee increases relate to the approved master plans for water and wastewater treatment.

The proposed fee increases are being greeted by the public with somewhat of an element of surprise. The master plans, which were approved by the Assembly, laid out a series of annual fee increases for water and wastewater, however, and the fee increases being proposed for FY15 are right in line with the overall goals of the respective master plans. Thus, there may be some element of forgetting the goals and conclusions of the master plans associated with this surprise.

Water Master Plan

In the City and Borough of Sitka Municipal Water System Master Plan (MWMP), approved in May, 2009, it was noted (Executive Summary, page 6) that “...**user fees have not increased since July, 2002, and (were at the time) significantly lower than other communities in Alaska**”. The MWMP recommended that the monthly base rate per unit be increased by roughly 14% per year for a period of 7 years, from FY09 through FY15, with the base rate rising from \$16.00 to \$35.12 in FY15 (Executive Summary, page 6). The current rate increase would raise the monthly base rate per unit to \$35.42, slightly ahead of the planned rate for FY15.

The MWMP went on to discuss, in Chapter 8, the importance of raising user fees to increase working capital. Within the Fiscal Policy Framework in the MWMP (Chapter 8, pages 1-2), the Plan stated “...**the purpose of maintaining a working capital balance is to provide sufficient cash flow to meet daily operating expenses....this study incorporates a minimum balance in the operating account equal to 30 to 45 days of annual operating and maintenance expense sustained from rate revenue**”. The Plan further stated that, in addition to working capital, “...**a capital contingency is similar to a working capital balance, but is used for capital purposes. Consistent with industry practice, this study incorporates a target (capital contingency) balance of 1% of water system fixed assets, ranging from about \$100,000 to \$270,000 a year**”. Finally, the Plan addressed accumulation of cash for system reinvestment by stating “...**this study introduces a system of reinvestment funding to annually fund from rates an amount equal to annual depreciation rates**”.

In Table 1 in the Technical Appendix, Financial Spreadsheet Model, the MWMP showed total working capital rising to \$1,540,656 by the end of FY14, with user fee increases implemented annually as

recommended. This goal has not been achieved, unfortunately, despite the series of implemented rate increases. The reason for the goal not being achieved has been higher than anticipated rate funded system reinvestment (replacing worn out infrastructure).

The following were target goals for FY14 and projections for actual results:

Total Revenue Projected Per Plan, FY14:	\$1,753,319
Total Estimated Actual Revenue, FY14:	\$1,763,000
Total Cash Outlays Projected Per Plan, FY14:	\$1,794,772
Total Estimated Actual Outlays, FY14:	\$1,548,000
Total Working Capital Per Plan, FY14:	\$1,540,656
Total Estimated Working Capital, FY14:	\$ 157,000

Given the above data, it is clear that it not the inability to achieved planned revenues, not the inability to control costs, which is the reason for the inability to achieve planned levels of working capital. Instead, it is that expenditures for system reinvestments (replacements of infrastructure) that have exceeded planned levels. These reinvestments were absolutely essential and are indicative of an infrastructure in worse shape than previously thought.

The MWMP further went on to recommend “**...following the implementation of the proposed rate strategy, future year rate increases....(will) correspond with annual inflationary levels**” (Executive Summary, page 6).

Given the fact that the water Fund has not been able to achieve its planned level of working capital despite 6 years of rate increases, it is highly likely that (1) a water rate increase will be necessary annually, and (2) the water Fund will need to continue with rate increases above the rate of inflation for some time after FY15.

Wastewater Master Plan

In the City and Borough of Sitka Municipal Sanitary Sewer Master Plan (MSSMP) was approved in October, 2012. The MSSMP recommended that the monthly base rate per unit be increased by roughly 9.5% per year for a period of 6 years, from FY13 through FY18, and then by 6.5% per year for another 4 years, from FY19 through FY22, with the base rate rising from \$38.53 to \$85.44 in FY22 (Rate Schedule, page 29). The current rate increase would raise the monthly base rate per unit to \$50.59, the planned rate for FY15.

The MSSMP set forth fiscal policies which, if adopted, would meet certain key goals. These included:

- “**providing sufficient cash flow (working capital) to meet daily operating expenses.....allowing the Wastewater Fund to maintain a minimum balance equal to 30 to 45 days of operations and maintenance expenditures (about 8% to 12%) which are sustained from rate revenues**” (Fiscal Policies: Working Capital, Page 18);
- “**providing a source of funding for emergency repairs (other than catastrophic events), unanticipated capital expenditures, and project cost overruns...maintaining a minimum balance in the capital account equal to 1% to 2% of the original cost of system fixed assets**” (Fiscal Policies: Capital Contingency, Page 19); and,
- “**providing for ongoing system integrity through reinvestment in the system...annually funded from rates in an amount equal to annual depreciation expense – phased in over 10 years**” (Fiscal Policies: System Reinvestment Funding, Page 20).

In The Revenue Requirement Table (Page 28), the MSSMP showed total working capital needed to fund capital projects and system reinvestment through FY2022. The data was presented in such a way

as to show an annual cash flow deficit if rate increases were not enacted. This cash flow deficiency was shown to be (\$2,530,136) at the end of FY22, again if rate increases were not enacted.

Financial results through FY14 have been achieved and the plan is being executed as envisioned.

The following were target goals for FY14 and projections for actual results:

Total Revenue Projected Per Plan, FY14:	\$2,446,000
Total Estimated Actual Revenue, FY14:	\$2,628,000
Total Cash Outlays Projected Per Plan, FY14:	\$3,886,180
Total Estimated Actual Outlays, FY14:	\$2,695,000
Total Estimated Working Capital, FY14:	\$5,510,000
Total Estimated Undesignated Working Capital	\$2,012,000
Total Estimated Designated Working Capital	\$3,498,000
(Note: MSSMP did not forecast working capital)	

User Fees need to be raised in FY15, as recommended by the MSSMP, but for a different reason than in the Water Fund. As previously noted, the Water Fund has not achieved the fiscal goals of the MWMP, despite six years of user fee increases, due to higher than anticipated system reinvestment. The Wastewater Fund is achieving plan goals, but it is only entering the third year of the plan. If the Wastewater Treatment Fund continues to meet plan goals for several more years, lower annual fee increases could possibly be considered in the future. For example, the shift from annual fee increases of 9.5% to 6.5% could be made earlier than planned (currently in FY19). It is imperative, however, as advocated for the Water Fund, that user fees be increased every year and that we not use positive results as a reason to discontinue the plan, thus falling back into an eventual fiscal crisis.