



City and Borough of Sitka

100 Lincoln Street • Sitka, Alaska 99835

MEMORANDUM

To: Mayor Hunter and Assembly Members
Keith Brady, Municipal Administrator

From: Jay Sweeney, Chief Finance and Administrative Officer, Melissa Haley, Controller,
Michael Harmon, Public Works Director

Date: 5 June 2018

Subject: Approval of Ordinance 2018-27 FY2019 Rate increase for Wastewater

As is the case with other enterprise funds, the Wastewater Fund needs significant levels of capital investment in order to avoid catastrophic failures similar to the one we saw earlier this year when the Thomsen Lift station failed. Both the underground infrastructure as well as the wastewater treatment plant are overdue for very significant repairs. The wastewater treatment plant and much of the underground infrastructure, funded by grants, were put into service in the early to mid-1980's, meaning that this critical infrastructure is nearing the 40-year mark. Thus it is the need for investment in infrastructure that drives the rate increases, rather than just operations (though operational expenses have also increased faster than the rate of inflation). Unfortunately, for decades, the rates charged were structured to cover the cost of operations, not to set aside any significant amount of funding for future infrastructure replacement. Now that we are facing the need to make critical repairs to our infrastructure with no available grant support, we find ourselves in a situation in which we have very little capital available to invest in our infrastructure and must rely on debt to finance the necessary infrastructure repairs. The rates that we propose for FY2019 and forward are structured to slightly increase the amount of working capital available in the fund in order to be able to fund some investments in infrastructure from working capital, but in no way eliminate the need to continue using debt to finance key infrastructure repairs.

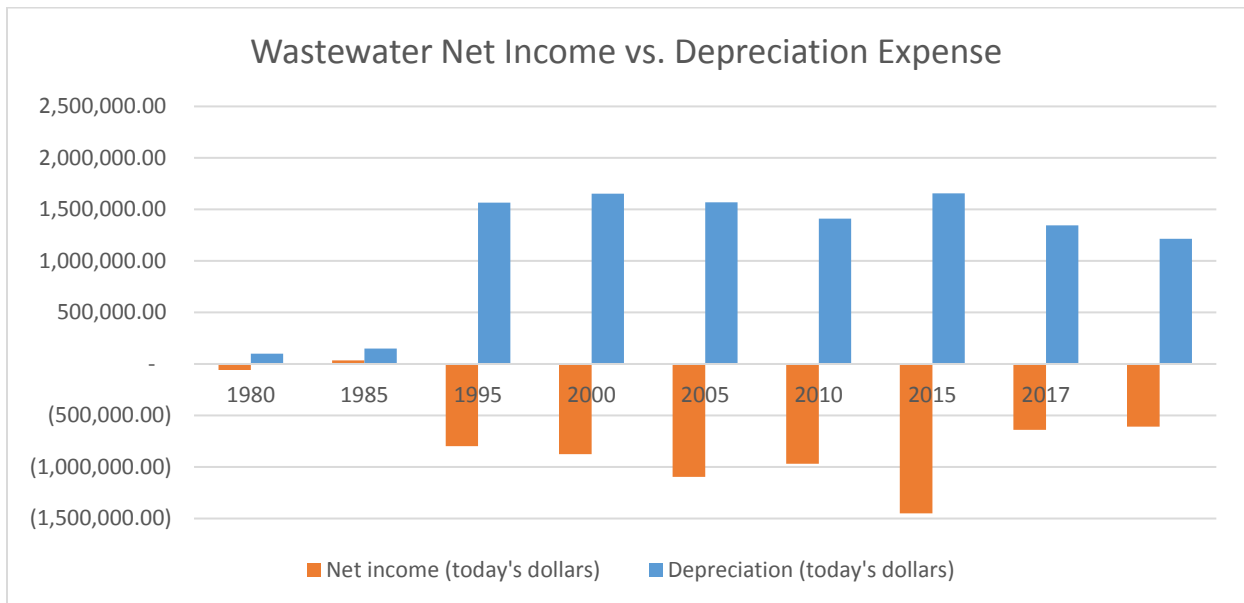
The primary goals for the Wastewater Fund during the next year are to:

- Identify critical repairs to wastewater treatment plant for the longevity of the facility, health and safety of staff, and determine how the project will be funded.
- Continue to identify infrastructure that is most at risk of failure and plan for needed improvements.

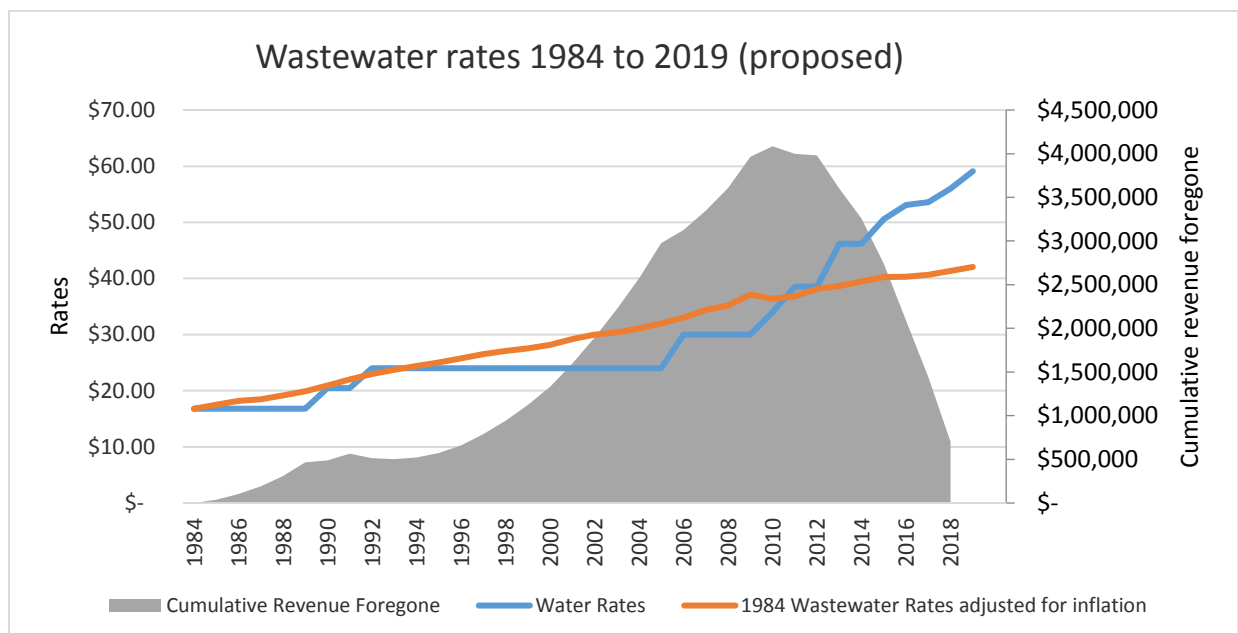
Below is an example demonstrating the total increased cost of a scenario which could be applicable to an average family in Sitka:

Example of typical household service	Total additional cost (proposed rate increase)
Wastewater monthly service fee	\$3.08
Total cost	\$3.08
<i>Average monthly recurring cost</i>	<i>\$3.08</i>

As is illustrated in the following chart, in the past, wastewater rates (similar to other utility rates) have been structured so that general operations are covered by the revenue generated, but not much has been set aside for future infrastructure needs (as can be roughly estimated by using the rate of depreciation). In order to be truly setting aside an amount that would bring the fund closer to generating enough working capital to replace aging assets, the net income (which includes depreciation expense) would need to be positive. In addition, some assets are allowed to stay in use beyond their usable life, thus, in many cases, using annual depreciation expense as a goal for asset replacement may be understating the true need.

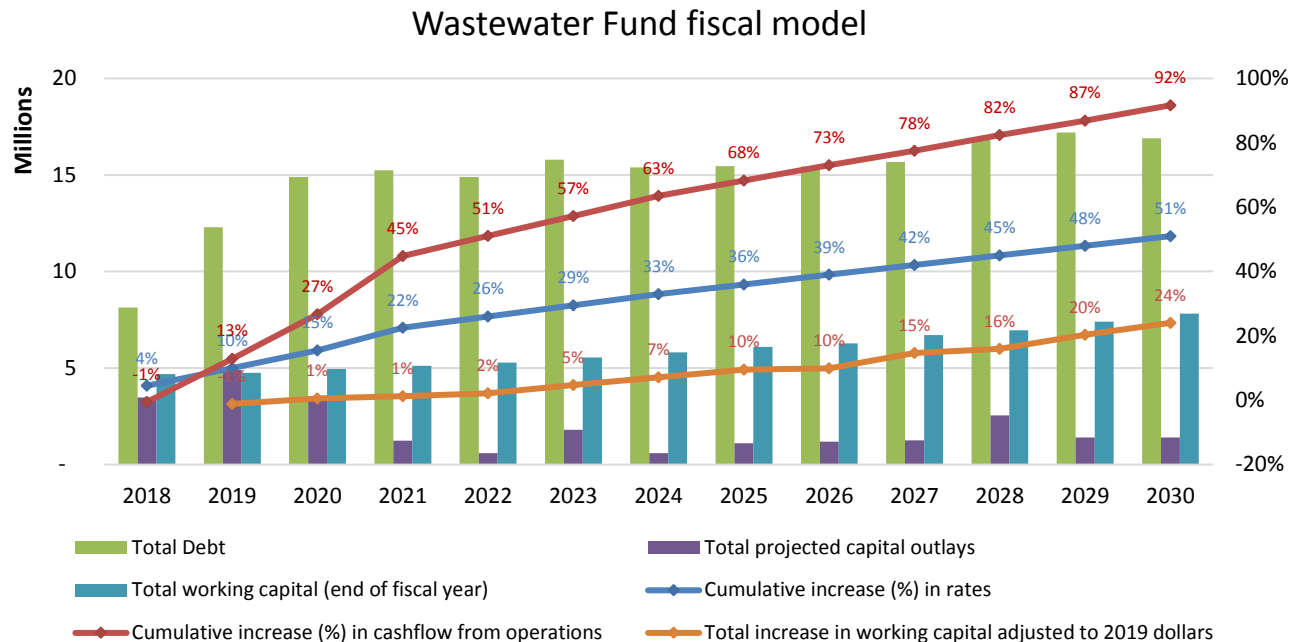


Due to the rapidly ageing infrastructure and the minimal working capital available, current rates are higher now than if the rates at the time the wastewater treatment plan went online had been adjusted for inflation. Yet at the same time, net income still is not covering depreciation expense, meaning that we are still not setting aside significant funds for future capital investment and will continue to rely significantly on debt into the future.



As the chart above demonstrates, there was a significant period of time (1992-2005) where rates were not raised, even by the rate of inflation. Had those increases been made, the more recent and steeper increases likely could have been lessened, though given the ageing of the infrastructure it is likely that rates would still need to be adjusted beyond where the 1984 rates adjusted for inflation would have been as those initial rates only covered operations, not future capital needs.). Finally, by not increasing rates (in some cases for longer than a decade), services actually become cheaper (due to inflation) and unrealistic expectations are set.

Below is the graphical presentation of the fiscal model that staff used to determine the rates necessary today to ensure the future viability of the fund:



As the chart above shows, future rate increases are necessary to maintain our current infrastructure and also to ensure that debt levels remain fairly steady.

As we have mentioned before, the fiscal models which guide our rates are ever-evolving and generally take a “middle-of-the-road” approach. It is important to note that the April 2018 facility assessment report for the treatment plant identifies an additional \$3-million not currently programed in the rate model. This will not impact the FY2019 rates, but will put more pressure on higher rates in the future. Costs related to this project will remain fluid until the design details are complete and we ultimately receive bids for the work.

Category	Service Type	Monthly Price increase	Notes
Residential	Residential/Dwelling unit	\$3.08	
Commercial	Commercial (General)	\$3.08	
Commercial	Restaurant , bar, lounge, snack bar	\$6.08	20 seats
Commercial	Bed and Breakfast	\$4.93	4 rooms
Commercial	Barber/beauty shop	\$8.62	3 stations
Commercial	Bowling alley	\$15.40	4 lane
Commercial	Church	\$6.16	100 seats

Commercial	Office space-over 10 employees	\$3.70	
Commercial	Hospital	\$40.04	15-bed hospital
Commercial	Meat market	\$12.32	
Commercial	Supermarket/grocery store	\$27.72	
Commercial	Rest home	\$15.40	20 beds
Commercial	Hotel/Motel	\$104.72	100 rooms
Commercial	Dorm/Boarding house	\$21.56	20 rooms
Commercial	RV park	\$21.56	20 spaces
Commercial	Launderette (Laundromat)	\$64.68	20 wet machines
Commercial	Commercial Laundry	\$27.72	1 wet machine
Commercial	Schools, college, day care	\$9.24	50 students enrolled
Commercial	Theater	\$9.24	100 seats
Commercial	Car Wash	\$9.24	1 stall
Metered	General metered	\$3.25	per 1000 metered gallons
Connection Fee	Sewer connection fee	\$20.00	