

DRAFT “Baseline Elevator Speech:” Why Are SPU’s Rates Going Up?¹
--SPU Customer Panel Perspective--

Seattle Public Utilities (SPU) provides City residents with safe **drinking water**; operates the City **drainage** system (which collects run-off from the streets, driveways, roofs and parking lots), and the **sewer** conveyance system; and oversees operation of the **garbage** system—recycling, yard waste, and disposal (services primarily carried out by private firms under contract with the City).

SPU is now developing a “**Strategic Business Plan**” that will identify service levels, needed investments, and rates for the **2015-2020** Period. The Strategic Business Plan will be submitted to the City Council this June. As members of a nine-member Customer Review Panel, we have been tasked with advising SPU in the development of the Plan.

So, what’s in store for rates? While the final details are not yet known, based on information the Panel has received from SPU over the last several months, *baseline rates* will be going up each year, but at a much slower rate than experienced in the last 10 years. It’s important to understand the reasons for the yearly increases.

This document describes what we, the Customer Review Panel, understand to be the key drivers in *SPU’s projected baseline rates*—defined as the rates projected to be required to support current service levels, current methods of operation and meet known regulatory requirements. The baseline is just the *beginning of the work*: from here, we will look at efficiencies that could reduce rates and other investments to address service gaps.

What’s the Current Situation?

The City utilities are *publicly owned*, and fully paid for by those who use these systems: residents and businesses in Seattle. (The City also supplies water to retail and wholesale customers in many surrounding communities—those communities pay about 31% of the total revenues needed to fund the City water system).

SPU is the **second** largest department in the City of Seattle, in terms of the number of **employees(?)** (and **budget?**). SPU’s 2014 spending on all lines of business will be approximately **\$750M**, including both operations & maintenance (O&M) and capital spending. There are **1400** Full Time Equivalent employees in SPU in the 2014 budget—their salaries and benefits account for only about **16%** of total budgeted expenditures.

Current SPU operations are impressive in a number of respects:

- We enjoy some of the best quality drinking water in the nation. To protect the source of this water, the City owns hundreds of thousands of forested acreage in the Cascade foothills.
- Our customers have steadily reduced their rate of water consumption. Despite the population in the City and our adjacent service area growing **___%** in the last **___** years, we now consume less total water than we did in **_____**. This trend is expected to continue (and also affects demand for sewer service, which is tied to water consumption).
- We have one of the highest recycling rates in the Country – nearly 56% (by **volume**) in 2012 for *all* customers. Our *single family residential* customers have the highest recycling rate in the country at 71%.
- SPU is pioneering new “green” approaches to treating street run-off.
- Our City sewer and water systems are highly reliable. The City partners with others to clean-up contaminated sites to be sure costs are shared appropriately.

¹ This revised draft was developed by Noel and Karen; SPU has provided the numbers data; highlighted text indicates info that has not yet been confirmed. Baseline numbers are still under development. This document is still a **draft**.

However, The City's water, sewer, drainage and garbage systems have been in service a long time:

- City water pipes are, on average, 67 years old.
- City sewer and stormwater pipes are, on average, 85 years old.
- The City's garbage transfer station serving the north half of the City is 47 years old (and will be rebuilt in the next few years. The south transfer station was rebuilt after 49 years in use and reopened in 2013).

Rates went up a lot in the last decade. Customer bills went up 7% a year on average between 2004 and 2014, primarily due to federal regulatory requirements and replacement of major infrastructure. For example:

- City water reservoirs have been covered with lids to protect drinking water safety.
- A new water treatment plant was required for the Cedar River (one of the City's 2 main water sources).
- The 47-year old garbage transfer in South Seattle was replaced.
- King County built a new sewage treatment plant in East Snohomish County (the "Brightwater Plant") and Seattle, like all other customers of the County's regional sewage treatment system, must pay its share of that project.
- Other repair and replacement of aging systems.
- Declining demand for service: the downside of success in water conservation is additional rate pressure on both water and sewer rates--as costs of operation go up and the units of water/sewer service purchased decline, rates must increase to recover costs.

Looking ahead to the next 6 years: What are the rate pressures?

SPU is past the major investment hurdles for the garbage and water systems. However, recent federal regulations to protect water quality in streams, lakes and Puget Sound present costly challenges for our sewer and drainage systems. The good news is that SPU successfully negotiated with federal regulators to allow a balance between drainage and sewerage investments that is less expensive than other potential alternatives. That said, a major financial investment will still be needed in order to comply. And, there are other regulatory requirements now under consideration by state and federal regulators that could require a lot of additional investment.

Aside from regulatory challenges, the City will continue to face the need to repair, rehabilitate or replace aging pipes in the systems. Intrusion of tree roots into sewer lines, cracks, misaligned joints are continuing problems of an aging system. City water mains also experience significant build-ups of iron deposits that can affect water quality. Much of these systems are well over 50 years old: it's far less expensive to strategically repair, rehabilitate or replace pipes than to wait for them to fail. In terms of drainage issues, chronic surface water flooding in some City neighborhoods is being addressed at a very slow pace— at current funding levels, solutions are decades away.

To address regulatory requirements and maintain our current levels of service, rates will be going up—but by much less than in the last decade. The projected *average annual* baseline rate increase is 4.6% per year over the six year period from 2015 through 2020. Some of the major drivers for rate increases are:

- **Ongoing regulatory requirements.**
 - The City must find funds to pay its share of a federal "Superfund" settlement related to toxic materials in the Duwamish River and its share of a toxic sediment site in Lake Union near Gas Works Park.

- When we have heavy rains, raw sewage spills from the City drainage system directly into Lake Washington and Puget Sound—because the system was not designed or built to address the growth that we have seen in the City over the last many decades. Last year, these rain events resulted in an estimated 37 million gallons of raw sewage spills. Portions of our sewage systems must be re-designed and re-built to stop this from happening and meet federal clean water regulations.
- State permits require the City to improve the quality of stormwater runoff by installing and maintaining filtration systems along roadways, implementing “Green” projects (such as rain gardens that capture and naturally treat run-off), and increasing street sweeping to reduce the amount of contaminated roadway sediments that would otherwise end up in our creeks, lakes and Sound. SPU will be required to significantly ramp up its spending in this area.

The combined cost of these ongoing regulatory requirements accounts for about 20-25% of the total annual average cost of doing business.

- **Planned Investments in our systems to maintain and improve service levels.**

- In the next six years, SPU will complete the replacement of the North Transfer Station (where garbage and recyclables come to be transferred for processing/disposal). This project is expected to cost roughly \$58 million.
- The City seeks to double the number of eligible low-income households that are signed up for rate assistance. Only about 14% of total estimated number of eligible households now participate in the program. Currently, about \$7 million in credits are paid to participants each year; these costs are reallocated amongst all other SPU customers (increasing rates for those other SPU customers by about XX% a year in 2020, assuming the sign-up target is met).
- The City has a goal of 60% recycling (by weight) by 2015 and 70% by 2022. While investments of several million dollars will need to be made, SPU expects to see lower overall costs due to the savings on garbage collection and disposal.
- Utilities are a capital intensive business. Simply to support current levels of service, there will be ongoing capital investments in facilities. In 2014, 24% of SPU's expenditures go to pay for capital improvements (cash and debt service payments). This percentage will increase each year in the baseline, to an estimated 2020 total of % of total spending. About % of this increase is due to projected increased interest rates over the period.

- **The increasing cost of doing business.**

- SPU's operations are getting more expensive. O&M costs are currently about 31% of total costs, and are the biggest share of the baseline rate increase between now and 2020 (43% of the total increase is attributable to O&M). By far the largest part of the O&M increase is in the cost of labor.
 - Salaries are increasing on average 1% more than inflation each year.
 - The cost of health care for SPU employees will continue to rise at rates faster than inflation (about 7% per year)
 - Pension costs are also rising faster than inflation (X% per year).
 - The baseline includes 20 new employees.

- SPU purchases many overhead services from other City departments (such as information technology and vehicles). The cost of these services is expected to rise between **X and 11%** per year.
 - City utility taxes (added to bills at rates ranging from 11.5% to 15.54%) will contribute to growing customer bills.
 - Overall, about 31% of the Utility’s 2014 budget goes to third-party service contract providers (King County sewage treatment, garbage disposal, recycling, composting of yard waste); this is expected to increase to a total cost share of % by 2020, a growth rate **less than (CONFIRM)** general inflation over the period—a welcome change from the previous decade. The single largest such contract is with King County, to pay for sewage treatment services.
- **Declining Demand**
 - Despite population growth and a rebounding economy, demand for water and sewer service is projected to continue to *decline* slightly. The total tonnage of garbage disposed of is also expected to decline. Drainage demand (based the number of parcels of property) is expected to be flat. The amount of **total rate revenue** the utility requires is growing **4.2%** per year on average; the decline in demand means the **customer rates** charged must increase by *more* than that—**4.6%** per year on average.

What does it all mean?

There are many factors contributing to increased SPU rates, both external and internal to SPU’s operations. Based on SPU’s current projections—still under review-- the cost of doing business at *current service levels* and *complying with regulatory mandates* will result in average annual rate increases of **about 4.6% per year over the 2015-2020 period**. This is well below the rate increases of the last decade, but still considerably higher than projected general inflation over the period (**2.5-2.6%/year**).

As work continues to complete the Strategic Business Plan, the challenge is to find opportunities to become more efficient and reduce the cost of doing business where possible—while still meeting customers’ expectations that SPU maintain and improve service levels today and plan for the next generation of customers.

The following charts depict the major **cost drivers** behind the currently projected *baseline rate increases* for all of SPU’s “lines of business:” water, drainage and wastewater, and solid waste.

(INSERT COMBINED RIVERS CHART)

Notes: “**O &M**” = Operations and Maintenance costs—employees, equipment, payroll, administration, etc.; “**Taxes**” = City utility taxes; “**Cap Fin**” = Capital Financing-- costs of borrowing (principal and interest) to pay for capital assets.

(insert detailed breakout of cost increase)