2012-2014 Wholesale Rate Proposal
Explanation of rate drivers

This information is meant to supplement the rate study summary that was distributed directly to all wholesale water customers and also provided at several Operating Board meetings. That summary detailed the inputs to the rate study and walked through the intermediate steps as regional costs were developed, resulting rates were calculated, and so on.

This paper provides more context to the changes in rates and rate drivers. Please note that the rates below are the average annual rate. In other words, they are the weighted average of peak, off-peak, and growth charge if applicable.

Table 1
2012 Rate Drivers

Rate Drivers	2011*	2012	Effect on Rates
Regional Cost**	$ 71,260,360	$ 70,956,896	-0.4%
True Up Balance	$ -	$ 5,738,000	8.1%
Revenue Requirement	$ 71,260,360	$ 76,696,908	7.6%
Demand, ccf	46,499,897	42,087,473	10.5%
Average F&P rate if no growth charge subsidy/ccf* **	**$ 1.54**	**$ 1.82**	**18.1%**
Expiration of growth charge subsidy	$ (0.13)	$ -	10.5%
Average of base F&P rate/ccf* **	**$ 1.41**	**$ 1.82**	**28.6%**

* From 2009-2011 rate study

** Non-block portion, 2011 shown as-if '82s were F&P to allow comparison

*** Weighted average rate over entire year, includes peak, non-peak, and growth charge if applicable

Costs

Projected Regional Costs for 2012 are actually lower than 2011 costs from the rate study, lowering the increase needed in 2012.

As a review of costs under the F&P contracts:

- Regional costs are only based on the regional assets and regional O&M in the contract exhibits. Wholesale rates are not affected by changes in spending in areas such as human resources, information technology, finance, etc.
- Asset costs are recovered on a utility basis, which means that they are not included until an asset is in service. Because only a small portion of regional CIP projects are projected to be completed/ in service during 2012-2014, the effect of a delay of CIP on wholesale rates is minimal.
- O&M costs are current year costs for activities that support that support regional assets.

To show the relative contributors of costs, below is the breakdown of wholesale rates by cost pool.

	2012		2013		2014	
Rates per CCF	Off-Peak	Peak	Off-Peak	Peak	Off-Peak	Peak
Existing Supply	$1.04	$1.54	$1.04	$1.54	$1.04	$1.55
Existing Transmission	$0.46	$0.69	$0.47	$0.69	$0.47	$0.69
New Supply	$0.02	$0.02	$0.02	$0.03	$0.02	$0.03
New Transmission	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00

Growth Charge

The expiration of the growth charge is responsible for a 10.5% increase in the base rate.

The 2011 effective rate experienced by each customer depends on their mix of water demand

Commodity rates for wholesale customers include peak rates, off-peak rates, and until 12/31/2011, growth charges. Each customer has a unique mix of demand under each rate and therefore their overall average rate over the course of a year will be unique. Below is an illustration using 2010 demand at 2011 rates. Again, the average rate is the weighted average of peak, off-peak, and growth charges.

Table 2
Hypothetical Average Rate
(calculated by applying 2011 rates to 2010 demand)

	2011 Average Rate	Base Rate Revenue	Growth Charge Revenue
	($/ccf)	($)	($)
Duvall	1.89	318,714	105,394
WD 119	1.86	162,393	52,901
Bothell	1.76	924,681	200,912
Woodinville	1.73	2,579,405	507,587
Cedar River	1.72	1,141,344	232,787
Renton	1.71	102,555	-
Coal Creek	1.69	719,547	100,771
Soos Creek	1.59	2,631,616	351,157
Mercer Island	1.56	1,336,577	-
Olympic View	1.47	532,640	-
WD 90	1.47	636,213	-
Highline	1.47	3,143,996	-
WD 20	1.45	1,799,118	-
WD 45	1.44	144,471	-
WD 125	1.43	735,583	-
Shoreline	1.41	1,091,467	-
WD 49	1.40	778,418	-
Total		18,778,737	1,551,509

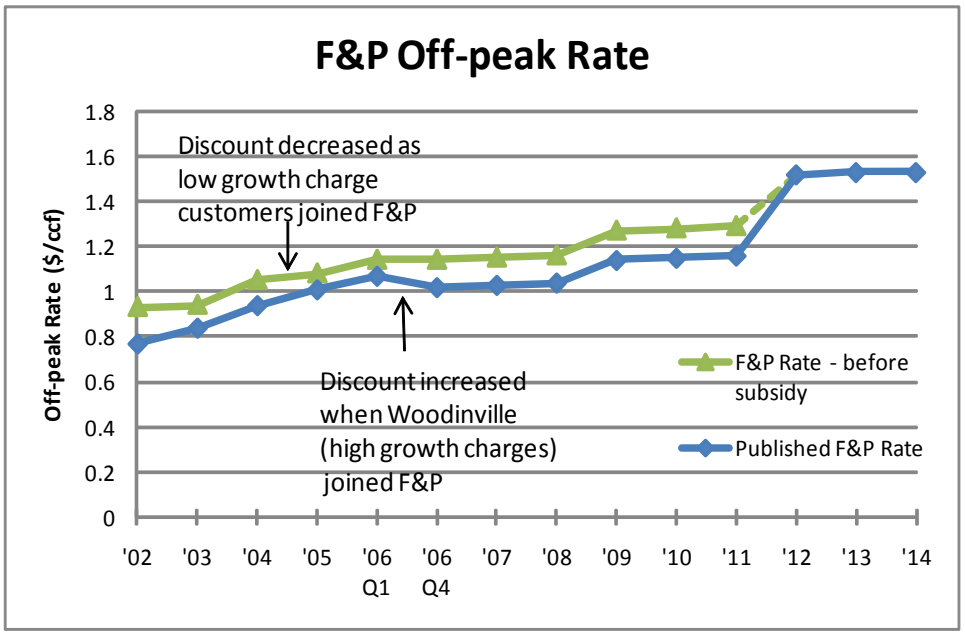
Using 2011 rates, the highest average rate (Duvall) is 35% higher than the lowest (WD 49). Seven out of the top eight have high average rates due to their growth charges; Renton has a high average rate because of the relatively high peak season use.

The Growth Charge has been subsidizing the base rate

The table above shows the growth charge revenues that have been used to subsidize the base rates for all other Full and Partial customers. Although it was called the "growth charge," it had nothing to do with growth; under the F&Ps, growth pays for growth via facilities charges. The temporary creation of the growth charge was intended to mimic the New Water rates under the 1982 contract and remove the changing rate structure from the decision to sign the F&P contracts.

> IV.E.12.d Transition Growth Surcharge.
>
> A transition growth surcharge of $0.60 per CCF shall be applied to the rates of Water Utility for delivery of water in excess of the old water allowance of the 1982 Water Purveyor Contract for the Transition Period. The revenue from this surcharge shall be used to discount the base rates of the holders of Full and Partial Requirements Contracts by not more than $0.16 per CCF. In the event that the revenues generated by the surcharge exceed those required to fund the discount, Seattle may keep the difference.

The subsidy can be seen in the chart below showing the difference between the unsubsidized rate and the actual base rate. The subsidy has never exceeded $0.16/ccf.

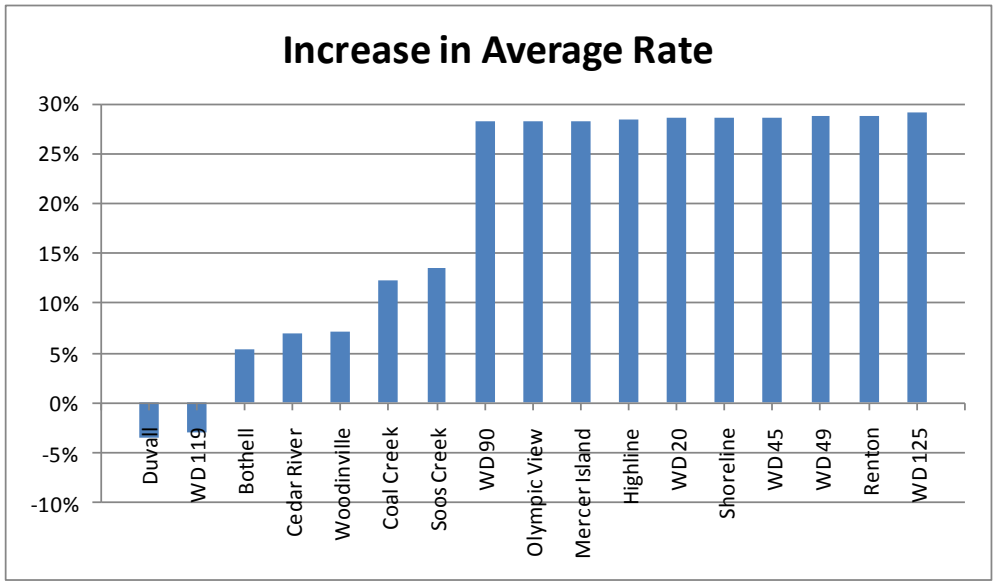


The effective rate <u>increase</u> experienced by each customer depends on their mix of water demand

For customers who have not paid growth charges, their effective increase is the 29% shown in the bottom row in Table 1. At the other extreme, Duvall and WD 119 paid such a high percentage of growth charges that they will experience a rate decrease.

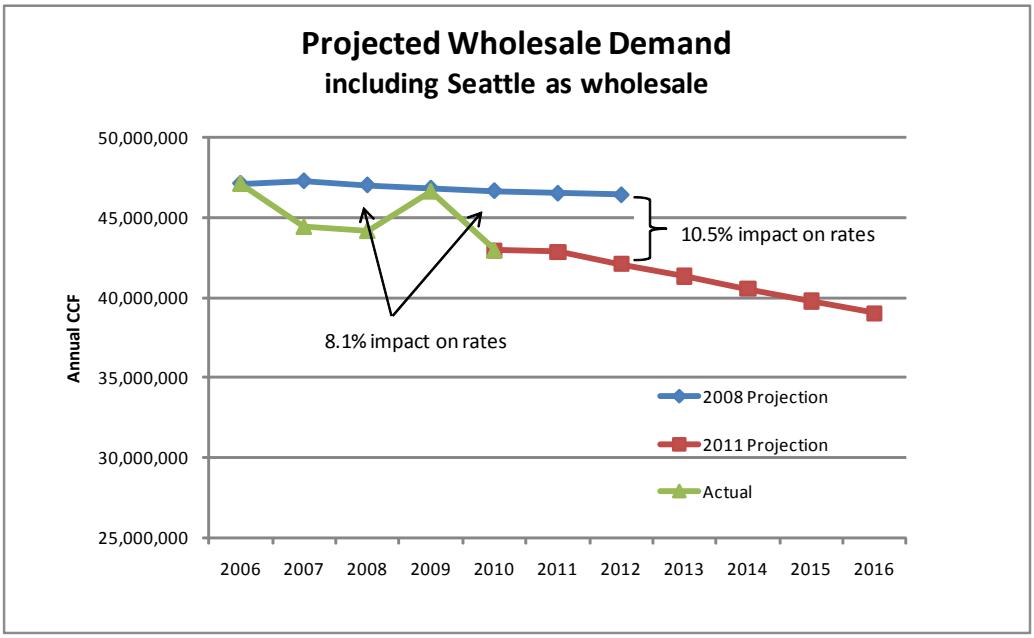
Table 3
Hypothetical REGIONAL Average Rate Increase – not including subregional
(calculated by applying proposed 2012 rates to 2010 demand)

	2012 Average Rate ($/ccf)	Base Revenue ($)	Rate Increase (%)
Duvall	1.83	409,623	-3%
WD 119	1.81	208,911	-3%
Bothell	1.85	1,186,817	5%
Cedar River	1.84	1,470,618	7%
Woodinville	1.86	3,310,288	7%
Coal Creek	1.90	921,674	12%
Soos Creek	1.81	3,385,993	14%
WD 90	1.88	815,452	28%
Olympic View	1.89	683,415	28%
Mercer Island	2.00	1,715,144	28%
Highline	1.88	4,037,928	28%
WD 20	1.87	2,312,473	29%
Shoreline	1.82	1,403,567	29%
WD 45	1.85	185,832	29%
WD 49	1.80	1,001,831	29%
Renton	2.20	132,031	29%
WD 125	1.85	949,265	29%
Total		24,130,860	



Demand

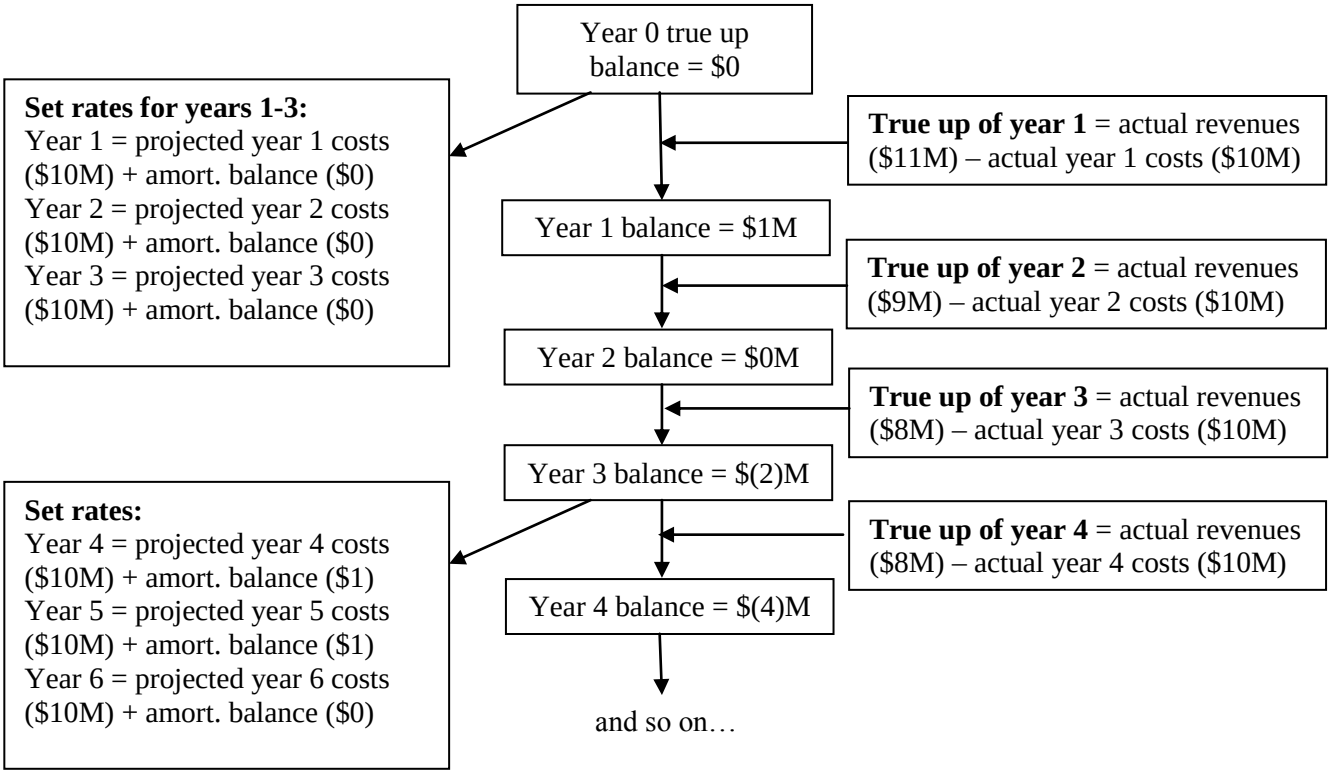
The 2009-2011 rate study was completed towards the end of 2007, and assumed demand would decline an average of a quarter of a percent per year from 2006 to 2012. Actual average demand from 2006 to 2010 dropped by over 2% per year, in spite of the 3.0 MGD increased demand in 2009 from the CWA Supplemental Block, which is priced at F&P rates.



Background on the mechanics of the true up/rate setting processes

Below is an illustration of the interplay between the true up balance and rates. Numbers are examples only, and costs were held at a constant $10M to make the math easier to trace from year to year. Since costs are fixed, the only factor affecting the true up balance below is demand. In reality, costs would also change, affecting the true up balance.

In the first rate study below, there is no true up balance included in rates. In the next rate study, the true up balance is amortized over years 4 and 5. Please notice that the actual true up balance is only affected by the actual revenues and actual costs in the right hand column of boxes.



Demand over 2009- 2011 has created a true up deficit

This unexpectedly low demand has created a significant true up deficit projected to be $9.4M by the end of 2011. The contracts stipulate that this be collected over the next rate study period, adding 8.1% to the rate increase. Below is the relevant contract language with emphasis added.

> IV.I. Truing Actual Costs and Actual Revenues
>
> A mechanism for reconciling revenue targets for the various cost pools and the actual revenues received during each year shall be implemented by Seattle as follows:
>
> 1. For each previously identified class of customers in each cost pool, Seattle shall maintain a running balance of the excess or deficit of actual rate revenues collected less actual expenses incurred. Each balance shall earn simple interest at the rate of Seattle's Average Cost of Debt. At the end of each year, each balance shall be adjusted to reflect the operating results of that year. The statement of these balances shall be reviewed and approved by an external auditor.
>
> 2. FC balances shall be carried forward as set forth in Section IV.E.7.
>
> 3**. Each wholesale rate study shall adjust rates to eliminate the cost pool balances.** ERU fees shall be based on the costs of increments in supply and transmission capacity, and shall not be adjusted to reflect surpluses or deficits in FC revenues.

Demand after 2011 requires a step change in rates

Rates in 2012 also require an increase to catch up to regional demand that is 10.5% lower than the projection for 2011. This rate study assumes a 1.9% average drop in demand over 2011 to 2016.

Benchmarking

Each year, the Bay Area Water Supply and Conservation Agency issues a rate comparison of various wholesale rates in Western states. Even after the rate increase, Seattle remains lower than many other 2011 wholesale rates.