

1 **City of Homer Water and Sewer**
2 **Water and Sewer Utility**
3 **Financial/Rate Setting Policies**
4 **Resolution 23-048(S)(A)**

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7 **Introduction**

8 Financial policies are an important tool for maintaining a financially healthy and sustainable
9 utilities while also maintaining required and/or mandated measures. The Government Finance
10 Officers Association (GFOA), bond rating agencies, and other industry organizations (e.g., the
11 American Water Works Association (AWWA), the Water Environment Federation (WEF))
12 recommend written financial/rate setting policies to provide clear policy direction and guidance.

13
14 The establishment of written financial policies is intended to:

- 15 • Institutionalize sound financial practices
16 • Clarify strategic intent
17 • Define boundaries
18 • Promote long range strategic thinking
19 • Manage risk
20 • Adhere to established best practices

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22 **Financial Policy Goals and Objectives**

23 The goals of the City’s financial policies are to:

- 24 1. Maintain sufficient revenues for operating and capital needs,
25 2. Maintain sufficient reserves, and,
26 3. Provide rate stability. Notwithstanding (1) and (2) above, rates will be set to provide
27 rate/revenue stability and avoid major periodic increases.

28 A detailed set of financial policies have been adopted to establish consistency in utility financial
29 planning and rate setting decision-making for the City Council and City management team.

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31 This framework provides recommendations that take into consideration the typical or median
32 reserve levels for a “AAA” versus a “AA” rated utility. This framework will also enable the City
33 Council to make more informed decisions in establishing the financial targets contained within
34 the financial policies.

Review and Discussion of the City's Financial/Rate Setting Policies

The Utility Financial Plan will take into consideration the following financial policies. The financial planning period will be for a minimum of five years to determine overall trends and impacts to reserves and rates over a long-term horizon. The Utility Financial Plan is an integral component of the City's approach to effectively managing the utilities at a sustainable level to support the service levels of the community.

1. Reserve Funds

Reserve funds shall be established for the City to properly account for the City's funds, but to also provide adequate reserve levels to address the different types of funding requirements of the City. The City's reserve policies shall be as follows:

1.1 Operating Reserve – The City's operating reserve is an unrestricted reserve. The minimum operating reserve shall be established at 90 Days of annual O&M expenses (approximately 25% of annual O&M for both the Water and Sewer Funds) as outlined in Exhibits 4 and 6 in the Utility Financial Planning models for water and sewer.

1.2 Capital Reserve – The City currently has two different capital reserves for the water and sewer utilities. The first is the Homer Accelerated Water and Sewer Program (HAWSP). HAWSP is funded through a portion of the voter approved sales tax and assessments levied on benefited properties. The second is the Capital Asset Repair and Maintenance Allowance (CARMA) Fund. CARMA is funded annually through a rate surcharge equal to 15% of water and sewer costs and collected through the water and sewer rates.

In general, HAWSP is intended to provide seed money to support expanded access to the City water and sewer system while CARMA is intended to support improvements, repairs, and replacements of the City's existing infrastructure, and may also be used for Capital Contingencies or Infrastructure Replacement. CARMA and HAWSP funds may be used jointly to fund a project where applicable. The development of the projection of CARMA and HAWSP funds is provided in Exhibits 8 and 9 respectively of the Utility Financial Plan.

1.2.1 Homer Accelerated Water and Sewer Program (HAWSP) – HAWSP will not be incorporated into this financial policy, as HAWSP has its own dedicated policy manual.

1.2.2 Capital Asset Repair and Maintenance Allowance (CARMA) Fund – The CARMA reserve was established to fund improvements, repairs, and replacements to the City's existing water and sewer systems. The level of CARMA funding can be adjusted by the City Council. "The amount of the CARMA funds shall be established by City Council in the biennial budget based on the projected maintenance and repair needs of the City." (Ordinance 19-35(S)(A)). CARMA is funded annually through a rate surcharge equal to 15% of budgeted water and sewer costs and collected through the water and sewer rates. Balance minimums and maximums are as follows: Water CARMA - minimum of \$500,000 and a maximum of \$1,500,000; Sewer CARMA - minimum of \$500,000 and a

maximum of \$1,500,000. Additionally, the CARMA accounts may be supplemented by transfers from the Utility Operations Fund Balance (with Council appropriation).

The intent of the City of Homer Water and Sewer CARMA Fund is “for appropriation and expenditure for equipment replacement, fleet replacement, engineering or planning services, major maintenance of city facilities, or any other purpose as identified and recommended by the City Manager and authorized by the City Council...and to extend the life and use of taxpayer funded assets, facilities and infrastructure.” (See Ordinance 19-35(S)(A)). The Water and Sewer Utilities - which operate independently - use CARMA Funds for improvements, repairs, and replacements to the City’s existing water and sewer systems. CARMA Funds may additionally be used for capital contingencies or infrastructure replacement and can be used in conjunction with HAWSP to jointly fund a project.

2. Balanced Operating Budget

2.1 Self-Supporting – The water and sewer utility shall be self-supporting, where current revenue fully funds current operating expenditures on an annual basis.

2.2 Adequate Funding to Preserve System Assets – The City’s assets shall be properly operated and maintained to provide for a long life. Annual operating expenditures will be budgeted and funded at a level that promotes the efficient operation of and preservation of assets through the asset’s useful life.

2.3 Evaluation and Monitoring of Cost – Costs will be monitored monthly to ensure the utility is operated in a cost effective and economically prudent manner and reported to the City Council on a quarterly basis.

2.4 Positive Annual Net Income – The City shall plan for annual net income (total revenue less O&M, taxes or transfers, debt service, and capital projects funded from rates) greater than or equal to zero (positive balance of funds).

2.5 Strive for Rate Stability – The City’s rates should be stable over time while generating sufficient revenue. As a part of the annual budgeting process, the City shall review the rates to confirm the adequacy of the current rates.

2.6 Disposition of “One-Time” Revenue – In instances of large one-time revenues (e.g., legal settlement), if not specifically earmarked, the funds will be transferred to an appropriate reserve(s) (operating, capital, or rate stabilization).

2.7 Alternative Funding/Revenue Diversification – To minimize overall rates, the City should explore alternative revenue sources such as grants and direct developer contributions.

2.8 Fund Balance – the Fund Balance is an accumulation of fiscal year net activity (revenues over expenditures). The Utility Operating Fund Balance is used when purchasing inventory items. These items will be expensed (pulled out of inventory) when utilized. It may also be used to replenish the CARMA accounts or “buy down” rates.

3. Establishing Rates and Fees

The City shall establish rates utilizing industry recognized “generally accepted” rate setting methodologies. This will provide the City with consistency in their ratemaking process, while also

establishing rates which are legally defensible. The City's policies on establishing the water and sewer rates and fees, and the general methodologies to be utilized, are as follows:

3.1 Revenue Requirement Analysis

The revenue requirement analysis provides a projection of the City's revenues and expenditures for a defined time period. The revenue requirement analysis shall provide the City Council with the information and cost-basis to determine the size and timing of any proposed rate adjustments. The City's revenue requirement analysis methodology shall consider the following:

- 3.1.1 The revenue requirement (financial plan) analysis will be developed from the current year's budget, as part of the budget process.
- 3.1.2 Revenue requirements will be established using the "cash basis" methodology. The "cash basis" methodology includes O&M expenses, and taxes/transfer payments. The revenue requirements may include a component for change in working capital/rate stabilization funds to manage reserve balances and mitigate rate impacts.
- 3.1.3 Costs shared across utilities shall be allocated to each utility based an equitable allocation method. These may include, but not be limited to, labor ratios, number of customers, revenues, usage etc. The allocation method should be whichever method most equitably allocates the specific cost.
- 3.1.4 Any wholesale increases imposed upon the City by a water supplier or wastewater treatment agency will be reviewed for financial/rate impacts.
- 3.1.5 The City's revenue requirement analysis shall fully incorporate the City's reserve and budgeting policies.
- 3.1.6 The City's goal is to project revenue requirements for a minimum of five years into the future.

3.2 Cost of Service Analysis

A cost of service analysis provides an equitable method to allocate the City's water and sewer revenue requirements to the customers utilizing the service. The City's cost of service analysis for the water utility shall use generally accepted cost of service methodologies as defined by the American Water Works Association (AWWA) and the analysis developed for the City's sewer utility shall use cost of service methodologies as defined by the Water Environment Federation (WEF). The City's water and sewer cost of service shall be developed to provide an equitable allocation of costs by taking into consideration a customer group's (e.g. residential, commercial) facility requirements and usage characteristics. The City's specific cost of service policies are as follows:

- 3.2.1 The cost of service shall be developed for a projected one-year time period or the period over which rates will be set, utilizing the revenue requirements as developed in 4.1.
- 3.2.2 The cost of service analysis shall be designed and developed to consider the unique and specific circumstances of the City's water and sewer system.
- 3.2.3 The City shall allocate costs to customer class of service based upon facility requirements and usage characteristics.
- 3.2.4 When necessary, the City may phase-in the cost of service results to transition

to fully-cost based rates.

3.3 Rate Design Analysis

The development of cost-based rate designs concludes the City's rate setting process. The development of rate designs utilizes the results from the revenue requirement and cost of service analysis to establish the target level of revenues for each customer class of service (rate schedule). The City's rate design analysis is primarily focused on the structure of the rates. The City's rate design analysis policies are as follows:

3.3.1 The City shall utilize the results of the revenue requirement analysis and cost of service analysis in the development of final proposed rate designs.

3.3.2 Rates shall be designed to collect the overall target level of revenues for each customer class of service.

3.3.3 The City's rate designs shall be reflective of the City Council's rate design goals and objectives, while also being reflective of the greater public purpose (e.g., economic development, conservation, etc.).

3.3.4 The City shall take into consideration both fixed and variable costs in the development of final proposed rates. The average unit costs calculated within the cost of service analysis provides the cost-information related to fixed and variable costs.

3.3.4 Bill comparisons shall be developed for all proposed rate designs to illustrate the general impacts to customers across a range of consumption.

3.3.5 In establishing the final water and sewer rates, the City's Council may take into consideration neighboring utility rates, but not to the financial detriment of the City.

3.4 Other Rate Setting Considerations

Provided below are other policies related to the City's rate setting process.

3.4.1 At a minimum, the City shall conduct a comprehensive rate study every five (5) years to update assumptions and determine financial sustainability.