

Water/Sewer Service – Making sense of the dollars & cents!

City of Homer
September 28, 2020

Why are we talking about this now?

- It's time to set water/sewer rates.
- The process of setting rates means we have to talk about:
 - How we collect revenue,
 - How much money we need, and
 - How we spend it.
- The conversation is messy because:
 - It's complicated,
 - There's a lot of history, and
 - Systems evolve over time

Overview –

- How we got to where we are
- Recommendations from American Water Works Association (AWWA)
- Our Current Reality
- Recommended Action Plan
- Decisions Council needs to make
- Steps Staff needs to take

Generally Accepted Rate-Setting Methodology includes 3 elements –

- Analyzing revenue requirements –compile the costs of operating the system as well as capital needs and compare to existing rates.
- Analyzing costs of service – ascertain whether it costs more to deliver service to different classes of customers
- Analyzing rate structure – establish rates that meet the utility's goals

Analyzing Revenue Requirements – Two Generally Accepted Approaches

Approach No. 1 – Cash Needs Approach.

- Most often used by government-owned utilities
- Objective – collect money to cover cash needs for a given time period

Approach No. 2 – Utility Basis Approach.

- Most often used by regulated or investor-owned utilities
- Objective – provide a rate-of-return for investors

Two Ways to Analyze Revenue Requirements

Cash Needs Approach

- O & M expenses
- Taxes or transfer payments
- Debt-service payments
- Contributions to specified reserves
- Cost of capital expenditures that are not debt financed
- Depreciation is not included.

Utility-Basis Approach

- O & M expenses
- Taxes or transfer payments
- Depreciation Expense
- A “fair return” on rate base investment

The Biggest Difference –

Cash-Needs Approach

- Capital projects are funded by
 - debt-service
 - capital expenditures within the rates.

Utility-Basis Approach

- Capital projects are funded by
 - depreciation expense
 - rate of return base

A Light Bulb goes on –

- Homer had been charging “depreciation expenses” through the tariff.
- Former Finance Director observed this was wrong approach because the HAWSP Fund and grants had been used to construct water lines and major acquisitions, not the tariff.
- She concluded Homer’s utility was a “Special Revenue Fund”, where rates had been designed to pay the costs of O&M, but not depreciation or capital improvements.

Homer acknowledged Cash-Needs Approach

- Former Finance Director recommended Homer:
 - Change the name of its water/sewer utility to “Special Revenue Fund”
 - Establish a “depreciation reserve” to fund capital improvements, through the tariff, in addition to the HAWSP Fund
- City Council adopted the recommendations in Resolution 10-91 on December 13, 2010.

Ambiguity ensued!

- HAWSP Fund, or grants, had been used for capital improvements, but there was also a “depreciation reserve” account..
- Language of ballot measure establishing HAWSP Fund is broad.
- The meaning of the word “depreciation” used in Homer’s context is different than what is used by Generally Accepted Accounting Standards.
- Rate Setting Committees included 15% “reserve” in the tariff; interpretations differ about how it should be managed.

AWWA Recommends –

- Repairs to existing equipment to serve existing customers should be shared by existing customers.
- Costs to expand capacity to new customers should be shared by those customers.

Our Current Reality –

- Grants are less available now to pay for capital needs.
- Homer has considerable deferred maintenance needs.
- The public wants lower rates.

How to get there – in accordance with AWWA best practices

- Words matter – adopt common vernacular and definitions
- Maintenance matters – identify the costs needed to keep systems in state of good repair for existing customers
- The future matters – identify the costs needed to provide for reasonable increases to capacity
- Fairness matters – charge repairs needed to serve existing customers to existing customers and projects needed to serve future customers to future customers
- Rates matter – make rates affordable

Our Action Plan Needs To –

- Employ sensible planning
 - Asset Management Plan
 - Vulnerability Assessment
 - Capital Improvement Plan
 - HAWSP Policy Manual
- Maintain transparency
- Fund repairs needed to bring system into state of good repair.
- Conform accounting methodologies as necessary.

Decisions for Council –

Can we agree to change the term “Water/Sewer Depreciation Reserve” to “Water/Sewer Capital Reserve?”

Recommendation:

YES!

Decisions for Council –

How should the Water/Sewer Capital Reserve be funded?

- Provide for a minimum transfer of \$200,000 - \$500,000 in accordance with Resolution 11-061(A)(S)?
- Provide for a maximum capital reserve fund balance, in accordance with Resolutions 91-25 and 91-26?
- Continue to use the 15% element of the current tariff?
- Use some other method?

Recommendation:

Maintain a minimum level of capital reserves, which will enable the systems to be maintained in state of good repair.

Decisions for Council –

How should we distinguish between the application of the Water/Sewer Capital Reserves and the HAWSP Fund?

Recommendation –

- Capital Reserves – repair/replace existing facilities serving existing customers
- HSWSP – expand facilities to serve new or future customer

Actions for Staff –

- Employ management practices that comport with policies
- Develop planning documentation
- Provide progress reports as part of budget cycle
- Coordinate rate setting schedule with budget cycle