

Seattle Public Utilities Customer Review Panel

c/o B. Medford, Seattle Public Utilities
P.O. Box 34018, Seattle WA 98124-4018

June 1, 2017

Council President Bruce A. Harrell
and Members, Seattle City Council
The City of Seattle
600 Fourth Avenue
Second Floor
Seattle, WA 98124-4749

RE: 2018-2023 Update to Seattle Public Utilities Strategic Business Plan

Dear Council President Harrell and Members of the City Council:

As members of the Seattle Public Utilities Customer Review Panel, we convey our overall support for the Seattle Public Utilities 2018-2023 Strategic Business Plan (“Plan”) as submitted to you by the Mayor, with some exceptions and concerns as stated in this letter.

Summary of Recommendations

Our recommendations are summarized below:

- The strategic planning work at Seattle Public Utilities (“SPU” or “the Utility”) is important and should be continued.
- We are concerned about the increase in the rate path, which includes significant rate spikes in 2019 and 2020, and about the overall affordability implications for both residents and commercial ratepayers. In response, we recommend:
 - Vigilant oversight of the CSO Ship Canal Water Quality Project—the largest capital project ever undertaken by SPU—to keep it on time and on budget.
 - Careful analysis of the cost impact of City-wide initiatives before they are approved. Related to this, there should be more transparency about the full costs of infrastructure required by City ballot measures.
 - Smoothing of water rates as recommended in the Plan and also adjust upward 2018 drainage and wastewater rates in order to moderate combined rate increases in the six-year planning period.
 - Providing transparent information on utility bills about the level of City and state utility taxes, by line of business, and how the City applies these revenues.
 - Indexing utility tax collections to a fixed amount, rather than grow at the same fast rate that utility revenues are increasing.

- Continuing the current Utility Discount Program, while increasing the City's focus on ways to create savings for all ratepayers rather than simply shift costs between different groups of ratepayers.
- Expanding the use of system development /connection charges for new customers to increase collection of revenues from new development rather than general rates.
- Expanding efforts to develop and track comprehensive cost comparison data for all of SPU's lines of business. SPU should also increase its analysis of rate impacts on small businesses.
- In the context of ongoing significant rate increases, it is particularly important the Utility deepen its commitment to find, implement and track new efficiencies and new savings.
- Repair and replacement of aging infrastructure is a priority and should be funded at the levels proposed in the Plan. The Utility is challenged to balance this goal with the goal of rate affordability. Therefore, we support the initiative to replace water pipe infrastructure that would not otherwise be replaced except for Move Seattle street reconstruction, as it will reduce the disruption to residents, commuters and businesses resulting from repeatedly digging up streets. However, our concern about rate increases leads us to recommend against taking advantage of this same opportunity for the deeper sewer pipes since there are "trenchless" construction methods that are not as disruptive.
- "Transforming the workforce" is an important focus area for the Utility. We would like to see more information and emphasis regarding specific programs/action items the Utility plans to implement here over the next 6 years.
- The Utility should be given the opportunity to meet the rate commitments in this Plan. We recommend that any new investments required of SPU coming from the new City initiatives around resiliency and climate change (or other new mandates) should be timed to occur with the 2020 Plan update, rather than in the next three years.
- We believe ratepayer input into the strategic planning process through the Panel and Community Advisory Committees is important and could be enhanced. We recommend that the Panel be reconvened at least twice a year to discuss with the Utility how Strategic Plan work is progressing.

Introduction

The Plan is the first update to the original Strategic Business Plan adopted in 2014 for the 2015-2020 period ("2015 Plan"). SPU has completed two years of work under the 2015 Plan. The Utility is on track with most of the action plans in the 2015 Plan and to date rates have stayed within the recommended rate path, although several action plans had to be deferred in order to meet this commitment. Unfortunately, the rate path is increasing notably going forward.

The Panel believes the strategic planning process provides a very important longitudinal look at rates and planned operations and capital expenditures supporting this billion-dollar-a-year public operation. The process supports several objectives: predictability for ratepayers; accountability of the Utility; and ensuring that the City continues to make progress in repairing, replacing and maintaining our aging

sewer and water infrastructure while meeting new federal and state regulatory requirements. *We thank the Council and Mayor for your continuing support of this strategic planning effort.*

We are very pleased to see the Utility's focus on meeting the 2015 Plan commitments. The Plan makes transparent the cost drivers within the Utility and provides real accountability for delivering services and specific capital improvements. Utility leadership tell us that the 2015 Plan is used every day and is helping to shape positive cultural change in the Department.

Looking ahead to the next six years, the Utility faces a number of challenges, and responding to these challenges is going to cost more. The rate path in the updated Plan projects a combined overall 5.5% annual average increase in SPU's rates. This is up from the 4.6% combined annual average increase in the 2015 Plan. If the Plan is implemented as proposed, ratepayers will have seen a cumulative combined utility rate increase of 40.2% in the ten years between 2013 and 2023. This far outstrips inflation and growth in wages for the average household. Affordability is a significant focus of our comments in this letter.

Panel Process

The nine-member Customer Review Panel is advisory to the Council, Mayor and Utility, per Council Resolution 31694. Four of our members served on the original Panel created in 2013, and four of the new members have served or continue to serve on various Community Advisory Committees for the Utility.

The newly convened Panel has met 15 times since September 2016. Senior Utility staff as well as Council and Budget Office staff participated throughout our deliberations. We commend the Utility staff for their very high quality analytical work provided to us throughout this effort, and for their commitment to being responsive and transparent. The presentation and analysis of the "baseline" (the cost over the planning period of providing the same level of service and meeting firm regulatory requirements) was particularly excellent.

We are very appreciative of the perspective and insights provided throughout the process by Council and Budget Office staff; their contributions were a very positive addition to our deliberations.

We also are grateful for the opportunity Panel leadership had to discuss the Plan with the Mayor in April, and to meet twice with the Council's Civil Rights, Utilities, Economic Development and Arts Committee since February of this year.

Overview of Plan

The Plan is an update to the 2015 Plan: the last three years of the 2015 Plan (2018-2020) overlap with the first three years of this Plan. It is important to note that the 2015 Plan incorporates an average annual rate increase of 5.0% per year for the 2018-2020 time period -- well higher than the 2015 Plan

overall average annual rate increases of 4.6% per year. Costs in the 2015 Plan were essentially back-loaded to the last three years, and those years are the starting point for the new Plan.

The Plan continues with the same four focus areas as the 2015 Plan: protecting public health and the environment; operational excellence; transforming the workforce; and improving customer service. The new Plan looks forward through the lens of an updated assessment of the Utility's strengths and weaknesses, informed by input from employees, customers and Utility leaders.

As with the 2015 Plan, over ninety-five percent of the Utility's work, and its revenues, are applied to meet "baseline" needs. The baseline is defined as actions and programs necessary to ensure the Utility continues to deliver the same level of service to a growing population while also meeting firm regulatory requirements.

The Plan adds "action plans" to the baseline in order to address gaps identified in the assessment of strengths and weaknesses. The Panel spent considerable time reviewing the proposed action plans, as well as some potential reductions to the baseline. Action plans launched in the 2015 Plan are now incorporated into the baseline.

One new approach the Utility is proposing in the Plan is to exclude any specific efficiency goals (no action items or dollar targets) but rather, adopt a policy and practice of looking for efficiencies. We discuss this below.

Utility staff tell us that when they began their work, the estimated cost of baseline and proposed action plans would have resulted in an overall rate path with 6.8% average annual cost increases. Staff scrubbed over \$171 M out of that initial draft. We commend their focus on the importance of prioritizing work and looking for savings in order to keep costs down.

Recommended Rate Path and Affordability Concerns

While we endorse the Plan, we are concerned about the cost increases for ratepayers. Affordability and concern about rate increases were recurring themes of our discussion over these last eight months – as they were when the Panel was convened three years ago. We are glad to hear it is also a priority for the Council and Mayor.

Most of the rate pressure on the Utility in the next six years is the result of three things: (1) the need to address aging sewer and water infrastructure; (2) the need to comply with federal environmental regulations; and (3) costs associated with the Move Seattle transportation ballot measure.

- **Aging infrastructure.** SPU's water pipes are on average 70 years old. SPU's sewer pipes are on average 80 years old. Ramping up expenditures on assessment, repair and replacement of these two systems was a major focus for us in the 2015 Plan. *It is critical to maintain that focus moving forward.* The Plan, as proposed, does so.
- **Federal Mandates.** The biggest cost challenge in the near term is the CSO Ship Canal Water Quality Project. The project is required as part of a negotiated federal consent decree. The consent decree was being finalized when the 2015 Plan was adopted; since then, the timeline

for the project has been accelerated. The project is the largest capital project ever undertaken by the Utility. It is further complicated by the need to coordinate the construction and funding with King County. The combined total project cost to SPU and King County is currently estimated at between \$338M and \$550M. SPU will pay up to 65% of the cost. A significant cost overrun in this project could significantly increase rates: *we urge vigilant oversight of this project by the Utility and City with the goals of keeping it on time and on budget.*

As part of the CSO consent decree, a variety of green stormwater infrastructure projects also will be implemented by SPU. We note that when the Clean Water Act was originally passed in the 1970's the federal government was committed to paying most of the cost of local compliance with the new law: since the 1980s, there has been a gradual reduction to the current situation of no federal grant funding for this mandate.

- **Move Seattle.** The Move Seattle ballot measure (proposed after the 2015 Plan was approved), did not include funding for any of the Utility capital work associated with the proposed street projects. The Move Seattle costs are contributing notably to the rate spikes we see in 2019 and 2020. Specifically, \$152M is included in the baseline for necessary pipe relocations, and an additional \$49M in “opportunity” projects (relocating some shallower water pipes now, ahead of schedule, rather than rip up streets twice) is funded as an action plan.

How do SPU's rates compare to other utilities?

In our 14th meeting, SPU staff shared an assessment of rates as compared to other large utilities.¹ It indicates that other large urban utilities are also seeing significant cost pressures from aging systems and federal regulatory requirements. Based on the information provided to us, there are some unique and positive things about SPU's situation as compared to other major cities, including:

- A remarkably low average rate of water consumption per household compared to other major cities; a very strong water conservation response by city ratepayers has allowed SPU to avoid hundreds of millions in capital costs for new water supply.
- SPU has one of, if not the most generous low income rate discount program as compared to other utilities surveyed—both in terms of the level of discount and the amount of money applied to support this program.
- Extremely high quality water, sourced from a municipally-owned watershed.
- A very high rate of recycling.
- Reliable infrastructure that delivers uninterrupted service to SPU's customers.

The staff presentation notes the difficulty of developing an “apples-to-apples” comparison of utility costs: utilities provide different services and use different funding structures. Utilities are in varying stages of implementing response to federal Clean Water Act mandates. That said, Seattle's drainage and wastewater fees are among the highest of other cities surveyed. While water and sewer bills are in the middle of the pack for those cities, when combined with drainage and wastewater charges, Seattle's

¹ Cities surveyed by SPU staff included New York, Everett, Atlanta, Boston, Tacoma, Baltimore, Milwaukee, San Francisco, Portland, Atlanta and Seattle.

rates are the second highest of all those surveyed. However, other cities with much lower rates have yet to complete some of the major investments required by the Clean Water Act. We were not provided with any cost comparisons for solid waste because the business models of surveyed cities are so disparate.

While we are confident that ratepayers are getting high quality service from SPU, and we appreciate the City's pro-active stance on environmental and social issues, *it is time to focus more attention on ways to control the growth in rates. We offer six recommendations in this regard.*

- **Consider cost impacts of City initiatives**

We urge that the City carefully analyze the cost impact of City initiatives before approving them. Two new City initiatives were announced just in the time we have been meeting: the resiliency initiative, and the parental leave initiative. While we offer no opinion on the merits of these new efforts, we would note that they create uncertainty: the Utility does not know how much any of these will cost in the years ahead, or the impact on rates. When unexpected costs are placed on SPU, the Utility is placed in the awkward position of either exceeding the recommended rate path or deferring or eliminating promised services and programs.

The most obvious example of our concern relates to the Move Seattle initiative. It was known in advance that this initiative would impose significant costs on SPU. As noted above, no funding was included in the ballot initiative for those costs. The Move Seattle costs are contributing notably to the rate spikes we see in 2019 and 2020. *In the future, we believe there should be more transparency about the full costs of these types of proposals. Voters should understand the full impact of what they are being asked to approve. We have encouraged the Utility to track the full costs associated with Move Seattle and to report to the Council on these.*

Other examples of internal City mandates that have had unanticipated impacts on the Strategic Plan include:

- Centralization of Information Technology
- City office space initiatives
- Plans to centralize Human Resource functions within the City
- The Green Fleet initiative.

- **Re-open the adopted drainage and wastewater rates to further smooth rates in 2019 and 2020**

The Move Seattle project and CSO Ship Canal Water Quality Project create particular pressure on rates in 2019 and 2020, despite work of Utility leaders to shift timing of other projects where possible. *We strongly support the Utility's proposal to smooth water rates in order to mitigate these rate spikes in 2019 and 2020.*

However, that still leaves wastewater rates increasing at over 12% per year in 2019 and 2020, and drainage rates increasing between 14.2% and 15.9% respectively in those same years. The combined rate increase for all four lines of business in 2020 would be 9.5%. *We urge the City to take additional steps to reduce the rate increases in 2019 and 2020 by re-opening the adopted wastewater rate plan. As*

shown in Table 1, increasing the 2018 sewer rate by 3% will allow significantly smoothing of the combined rate path: the maximum overall rate increase in 2020 would drop from 9.5% to 8.3%.

Table 1: Combined SPU rate path with water rate smoothing, and with drainage and wastewater rate smoothing

	2018	2019	2020	2021	2022	2023	2018-2023 average
With water rate smoothing alone	3.2%	8.2%	9.5%	4.1%	3.7%	4.2%	5.5%
With addition of wastewater rate smoothing in 2018	4.7%	6.3%	8.3%	5.8%	3.7%	4.5%	5.5%

- **Provide transparency on utility taxes and limit their increase**

We repeat a concern and recommendation raised by the Panel three years ago: City utility taxes on garbage, water, drainage and wastewater are quite high compared to other cities in the state. They add an average of 15% to SPU’s customer bills. We understand that utility taxes are a major source of revenue for the City’s General Fund. However, this is completely opaque to the ratepayer. Nowhere on the bi-monthly SPU bills is the City utility tax rates noted, nor is how much of the bill is attributable to these taxes noted, nor how these revenues are used by the City. *We recommend that the bills transparently present all this information.*

The Panel also again recommends that the City consider indexing its utility tax collections – perhaps tied to reflect the consumer price index and population growth, rather than grow at the rate of SPU rate increases. At present, the more SPU rates increase, the more City Utility tax revenues increase.

- **Focus on ways to reduce costs overall rather than just shift costs between groups of ratepayers**

We are impressed that enrollment in the Utility Discount Program (UDP) has more than doubled since 2014. We strongly support this program in its current structure. It is a great help to those that qualify, and we understand tens of thousands more households in the City and greater service area potentially qualify under the program’s existing terms. We applaud efforts to get qualified households enrolled. As noted, this is the most generous such program of major utilities surveyed, in terms of both the level of subsidy and the amount of utility revenues applied to support it. The success of the UDP comes with a price tag for other ratepayers. *We urge continuation of the current UDP program, but caution that cost shifting between groups of ratepayers should not be the City’s primary response to the overall need to control the growth in utility rates.*

- **Expand use of system development fees and connection charges as a means of generating new revenue for the Utility and reducing pressure on utility rates**

As the Customer Review Panel urged three years ago, *the City should implement expanded revenue streams for the Utility through expanded use of system development fees and connection charges.* This action item was included in the 2015 Plan but failed to gain traction. Most cities depend on such charges to help fund system improvements needed to accommodate growth and in turn, keep utility rates more affordable to existing customers. Seattle is growing quickly—as a quick count of

construction cranes will readily confirm. Yet SPU's drainage and wastewater utilities have neither any connection charges nor any system development fees in place. SPU does have a water connection charge, but this contributes less than 0.4% of water revenues -- and the charge does not fully recover the cost of connections. Overall, the City lags far behind other cities in our region in asking new development to contribute to these costs. *We endorse the premise that growth should pay for growth and believe such charges can be structured in a manner that does not significantly impact the goal of housing affordability.*

- **Track Seattle's costs as compared to other utilities**

Based on the interesting comparative cost survey information provided by staff, we think it would be helpful for SPU to expand these efforts and develop and track comprehensive cost comparison data for all of SPU's lines of business.

Related to this, *we would urge SPU focus more attention and analysis of the impact of rates on commercial customers, which contribute 46.5% of the Utility's retail revenue.* Small businesses may be particularly hard hit by the rate hikes in this Plan --and there is no rate discount program for them.

Efficiencies & Programmatic Reductions

As stated above, we commend the Utility for its scrub of the initial rate path which estimated 6.8% average annual rate increases over the 2018-2023 period. A second round of internal review by SPU further reduced baseline costs. Proposed action plans initially would have added 0.7% to the baseline, for a total 5.6% average annual rate increases. After multiple discussions with the Panel, the Utility scaled back several of the proposed action plans and deferred others, to result in the current proposed 5.5% average annual rate increases in the Plan.

Staff explained to us that they were unable for a number of reasons to meet the savings targets in the 2015 Plan. For example, the Utility was unable to convert as many employee positions to different jobs as had been hoped. Also, several of the initially proposed efficiency items were deferred--often due to lack of staffing or resources, or central service delivery changes/directives within the City.

In the current proposed Plan, the Utility is not identifying any dollar targets for future savings or efficiencies, or any specific future cost savings items. Rather, the Utility is committing to look for such savings and efficiencies. *While most of the Panel members are willing to see how this new approach plays out, some of us would prefer to see specific dollar targets for efficiencies in the Plan. We all agree is important that the Utility get better at projecting and calculating efficiencies. In the future, we would like to see more information about SPU's success of implementing and tracking new efficiencies and savings: this is a critical piece of the effort to bend down the future cost curve.*

We also note that the benefits of, and efficiencies resulting from, some Action Plans are not consistently well quantified, although the costs have been quantified. There could be greater savings than projected. *The Utility should make a greater effort to do this analysis with respect to each Action Plan, perhaps through metrics developed as part of Strategic Plan implementation.*

Focus Areas and Proposed Gap Action Plans

We support continuing with the four focus areas that were in the 2015 Plan, as proposed. These focus areas are appropriate for prioritizing the Utility's work. The action plans recommended by the Utility generally track the updated assessment of the Utility's strengths and weaknesses. *The Panel endorses the action plans included in the Plan, with the comments and caveats noted below.*

- **Environment & Public Health**

We concur with SPU's recommendation to defer diaper and pet waste composting at this time. We hope that less expensive means of reaching the 70% target recycling goal can be found.

Panel members have a range of reactions to the Expanded Green Stormwater Infrastructure Initiative. Most of us support proceeding with it: we see it as an investment in being able to implement lower cost approaches to federal regulatory requirements on controlling water contaminants. Some of us believe that there is not yet enough evidence to support the project funding proposed in the out-years of the Plan (\$20M) and would prefer that funding be eliminated or treated as a placeholder pending review of initial research and planning work. We all agree that the work of the next few years to develop pilot proposals here should be carefully examined as part of the next strategic plan update in three years.

- **Operational Excellence**

We note that the vast majority of new action plans are in this area. *One of our priorities as a Panel is that the Utility stay on a reasonable pace to repair and replace aging infrastructure.* SPU staff tells us that the recommended investments in the Plan will place the Utility in a significantly better place by 2023 in terms of infrastructure condition. This is an important reason for our support for the Plan.

- **Transforming the Workforce**

There is one action plan in this focus area: an expansion of the apprenticeship program; we support this. Additionally, given the importance of a skilled and engaged workforce to the success of the Plan, *we would like to see more information and emphasis regarding specific programs/action items the Utility plans to implement over the next 6 years in this focus area.* People can be the largest asset or largest liability in any organization. For example, the Utility is proposing a significant capital investment in reconfiguring employee work stations, in part to facilitate a more collaborative work environment. To get the benefit of this investment, management practice and programs must support collaboration and teamwork throughout the organization. Additionally, we would be interested in understanding whether SPU experiences any significant hiring challenges due to local economic conditions.

- **Customer Experience**

There is one Initiative in this focus area: opportunity projects to replace water pipe infrastructure that would not otherwise be replaced except for Move Seattle street reconstruction. As noted, *we support this initiative because it will reduce the disruption to residents, commuters and businesses resulting from repeatedly digging up streets. However, our concern about rate increases leads us to recommend against taking advantage of this same opportunity for the deeper sewer pipes as there are "trenchless" construction methods that are not as disruptive.*

Other Issues

- **Public Outreach**

The Utility engaged in a robust, multi-lingual outreach effort to get customer input on the potential planning priorities, with focus on reaching under-served communities. We applaud the Utility's effort to try to gauge customer priorities on expenditure of existing dollars--rather than just how to spend *new* dollars. We were however disappointed with the level of engagement by local businesses in the outreach and would encourage more focus on getting business customer input in the future.

- **West Point Treatment Plant**

King County's cost of repairing the West Point Treatment Plant will hopefully be covered by County insurance policies. If not, there will be further rate increases. It is a reminder that even with the best planning and effort by SPU, unanticipated events can disrupt the recommended rate path.

- **Rate Design**

The Utility's rates are almost entirely based on volumetric charges, whereas most of its costs are fixed. While we appreciate that this may increase the "conservation" signal in the case of water and solid waste, we encourage the City to explore whether an increase in fixed rate recovery should be adopted, and re-examine the current tiered rate structure. A shift along these lines more accurately reflects the Utility's cost structures and can increase revenue stability.

A citizen committee (on which two of us participated) was convened last year to look at SPU's rate design. To us, it makes more sense to examine rate design now that this Plan has been completed.

Another rate issue we note is that apparently the Solid Waste Division rates still subsidizes "self-haulers." It is not clear to us that what policy outcome is supported by this approach.

- **Homelessness Response**

It is important that the City respond to the growing problem of garbage on City streets, parks and greenspaces, which many associate with our growing homeless population. It is also important that the City continue to ensure that solid waste ratepayers are not charged for those efforts which are and should continue to be a General Fund expense.

- **Long Term Challenges for the Utility**

Seismic resiliency and climate change are important challenges for SPU and we are glad the City is proactive on these matters. However, we encourage City to *plan within the Strategic Plan's three year update calendar on these matters*, rather than impose additional mandates that will unexpectedly drive up the rate path in between Plan updates.

- **Tracking Implementation of the Strategic Plan**

The Utility has been dedicated in implementing the 2015 Plan, and we expect they will similarly be committed to carrying out the updated Plan. It is important that their success, and challenges, be tracked over time by the Council and Mayor. In this regard, we have three final recommendations.

- First, *we urge that the three-year update cycle to the Strategic Plan be continued.*
- Second, we believe that *ratepayer input in to the process, through the Panel, is important and could be enhanced if the Panel were reconvened at least twice a year to hear from the Utility how Strategic Plan work is progressing. All Panel members are willing to serve in this extended capacity.* We believe it will increase our understanding of the Utility's operations and challenges and our ability to provide helpful advice and input in the next iteration of the Plan. This could also provide some consistency in oversight, as Council committee membership and Executive office staffing changes over time. This change would also mean SPU's process more closely mirrors the approach taken with respect to City Light's strategic plan oversight. SPU's Community Advisory Committees should also remain engaged in Strategic Plan oversight.
- Third, regardless of whether our mission is amended, we would ask that, at the next convening of the Panel, the Utility share with us at the outset what progress has been made on the various issues outlined in this letter

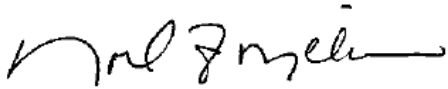
We thank the Council for your continued support of the Panel and the Strategic Business Planning Process. Pro-active, strategic oversight of the Utility is part of the commitment we believe the City should have to ensure the Utility can keep its promise to ratepayers. We thank the Utility leadership and staff for their open and thoughtful engagement with us and their tireless work to respond to our many questions over the past eight months. Our City is very well served by their dedication and expertise.

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We would be pleased to discuss our findings and recommendations with the Council and we thank you for your consideration of this letter.

Sincerely,

Members of the Seattle Public Utilities Customer Review Panel



Noel Miller
Panel Chair



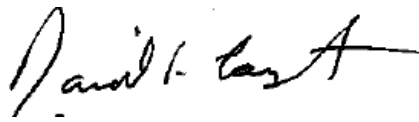
Laura Lippman
Panel Vice-Chair



Suzie Burke



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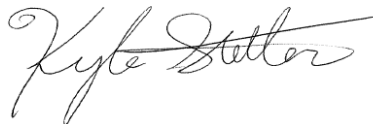
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