What is the Purpose of this Presentation?

Provides an opportunity to increase understanding of SPU’s rate setting process, specifically around:

• Rates and forecasting

• Technical assumptions in the rates

But first, a brief summary of what we discussed last time
From last time: rates growing at slower pace

The Plan is projected to create more predictable, lower rate increases than during the previous 10-year period.
From last time: Strategic Business Plan Rate Path of 4.6% is Back-loaded

Strategic Business Plan Update: 6-year rate path TBD
From last time: Many operating & maintenance costs are non-discretionary

2016 O&M Spending Plan: $788M

- Non-labor - $58M
- Salaries - $112M
- Fringe - $44M
- City Central Costs - $33M
- Debt Service - $155M
- Taxes - $112M
- Contracts - $274M
From last time: lots of financial policies

- **Net Income**
  - Pay Bills!
  - CIP - Cash vs. Debt Financing
  - Down Payment

- **Debt Service Coverage**
  - Income vs. Debt

- **Year-End Cash Balance**
  - Piggy Bank

Seattle Public Utilities
From last time: strong financial policies lead to high bond ratings

<table>
<thead>
<tr>
<th>Category</th>
<th>Standard &amp;Poors</th>
<th>Moody's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prime Maximum Safety</td>
<td>AAA</td>
<td>Aaa</td>
</tr>
<tr>
<td><strong>High Grade High Quality</strong></td>
<td><strong>AA+ Water, DWF</strong></td>
<td><strong>Aa1 Water, DWF</strong></td>
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<tr>
<td></td>
<td><strong>AA Solid Waste</strong></td>
<td><strong>Aa2</strong></td>
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<tr>
<td></td>
<td><strong>AA-</strong></td>
<td><strong>Aa3 Solid Waste</strong></td>
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<tr>
<td>Upper Medium Grade</td>
<td>A+</td>
<td>A1</td>
</tr>
<tr>
<td></td>
<td>A</td>
<td>A2</td>
</tr>
<tr>
<td></td>
<td>A-</td>
<td>A3</td>
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<tr>
<td>Lower Medium Grade</td>
<td>BBB+</td>
<td>Baa1</td>
</tr>
<tr>
<td></td>
<td>BBB</td>
<td>Baa2</td>
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<tr>
<td></td>
<td>BBB-</td>
<td>Baa3</td>
</tr>
<tr>
<td>Non Investment Grade</td>
<td>BB+</td>
<td>Ba1</td>
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</tbody>
</table>
Forecasts and the Rates Process: Starting with Spending
(example from 2016 water rate study)

“How much will we spend?”

$314M

- Bond Proceeds
- Cash-to-CIP
- Taxes
- Debt Service
- Other O&M

* Required revenue lower than total budget due to use of bond proceeds
Forecasts and the Rates Process: Costs Covered with Current Revenues and Cash
(example from 2016 water rate study)

“How much will we spend?”
$314M

“How much revenue do we need to pay O&M and meet financial policies?”
$275M*

* Required revenue lower than total budget due to use of bond proceeds
Forecasts and the Rates Process: Setting Rate Levels
(example from 2016 water rate study)

“How much will we spend?”
$314M

“How much revenue do we need to pay O&M and meet financial policies?”
$275M*

“Additional Revenue to meet financial targets”
Taxes
Debt Service
Other O&M

“What rates will produce the needed revenue?”
$275M

Retail Rates
Wholesale Rates
Non-Rates Revenue

* Required revenue lower than total budget due to use of bond proceeds
Forecasts and the Strategic Business Plan

- The Strategic Business Plan is like three rate studies rolled into one.
- The Strategic Business Plan projects costs and services over six years instead of the three years projected during the individual rate studies.
- The Strategic Business Plan projects average rates for all customer classes, not rates by each customer class.
- The further out we go, the more uncertainty and financial risk there is.
Technical assumptions in 2018-2023 baseline rates

1. Definition of baseline rates, and why we calculate a baseline

2. Inflation assumptions

3. Demand

4. Other
Baseline Rates

• **Definition**: *Baseline rates are the rates necessary in 2018-2023 to maintain current service levels and meet firm regulatory requirements*

• **Why we calculate a baseline**: The baseline is our starting point for rate discussions. We will review with you the technical assumptions and policy decisions embedded in the baseline.

• **What are the next steps in rate setting**: The next steps are reviewing potential savings and Action Plan investments.
Technical assumptions in 2018-2023 baseline rates: Inflation assumptions are similar to 2015-2020

<table>
<thead>
<tr>
<th>Topic</th>
<th>Assumptions in 2015-2020 SBP</th>
<th>Assumptions in 2018-2023 draft rate path</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heath care inflation</td>
<td>7%/year</td>
<td>6.4% in 2018; 6.0% thereafter</td>
</tr>
<tr>
<td>Workers comp inflation</td>
<td>3%/year</td>
<td>3%/year</td>
</tr>
<tr>
<td>Salary inflation</td>
<td>1.6% in 2015; 2.2% in 2016; 2.5% thereafter</td>
<td>2.75% in 2018; 2.4% thereafter</td>
</tr>
<tr>
<td>Retirement costs</td>
<td>City contribution of 15.3% in 2015-16; 16.3% in 2017-2020</td>
<td>15.5% in 2018; 16.0% thereafter</td>
</tr>
<tr>
<td>Professional services inflation</td>
<td>3%/year</td>
<td>3%/year</td>
</tr>
<tr>
<td>Charges from other City departments:</td>
<td>Year 1/Year 2 of biennium:</td>
<td>Year 1/Year 2 of biennium:</td>
</tr>
<tr>
<td>- General allocations</td>
<td>8%/4%</td>
<td>6%/6%</td>
</tr>
<tr>
<td>- Finance &amp; Administrative Services</td>
<td>8%/5%</td>
<td>6%/6%</td>
</tr>
<tr>
<td>- Seattle IT allocation</td>
<td>12%/5%</td>
<td>6%/6%</td>
</tr>
<tr>
<td>- Seattle IT billed</td>
<td>12%/7%</td>
<td>6%/6%</td>
</tr>
<tr>
<td>- Fleets – allocation</td>
<td>11%/7%</td>
<td>11%/7%</td>
</tr>
<tr>
<td>- Fleets - fuel</td>
<td>11%/7%</td>
<td>11%/7%</td>
</tr>
<tr>
<td>- Fleets – maintenance</td>
<td>11%/4%</td>
<td>11%/4%</td>
</tr>
<tr>
<td>Other O&amp;M inflation</td>
<td>2% per year</td>
<td>Generally 2%/year</td>
</tr>
</tbody>
</table>
Technical assumptions in 2018-2023 baseline rates: Inflation assumptions on large contracts

Drainage and Wastewater large contract is King County’s rate for sewer treatment; inflation assumption based on County projections. 2017 costs total $161.7 million.

Solid Waste large contracts are the collection, hauling, and disposal contracts for garbage, recycling, and organics. Actual payments depend on a consumer price index, a labor cost index, and fuel costs. 2017 costs total $111.0 million.

<table>
<thead>
<tr>
<th>Fund</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drainage and Wastewater</td>
<td>5.2%</td>
<td>0.0%</td>
<td>6.4%</td>
<td>0.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Solid Waste</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>
Technical assumptions in 2018-2023 baseline rates: Demand relatively constant

- Water and wastewater reset slightly higher in 2018; decline minimally thereafter

- Drainage demand constant

- Solid Waste increasing tons as population increases
  - Organics and recycling increases are leading to declining garbage can sizes
Consumption and Population


* Forecasts are Preliminary Draft
The Impacts of Conservation

Categories with high conservation achievements

Typical pre-conservation monthly
2,980 gallons, $82.02

Toilets
$54.50/month

Showers
$27.52/month

Conservation has saved $46/month for a typical residential customer

Typical post-conservation monthly
950 gallons, $35.87

Showers - $18.30
$9.22 savings

Toilets - $17.57
$36.93 savings

Monthly bill is combined water and sewer
Technical assumptions in 2018-2023 baseline rates:

Other

• Bond interest rates set per advice of City’s financial advisor
  o In Water Fund, assume 4.75% interest rate in 2017 and 5.0% thereafter
  o In Drainage and Wastewater Fund, assume 5.0% interest rate through 2023

• Assume 100% accomplishment rate for capital program
What to remember

1. 6-year rate path in SBP is divided into two 3-year chunks, with greater uncertainty and financial risk in the final 3 years

2. Lots of technical assumptions impacting rates and financial risk

3. Customer Panel will be asked to offer their comments on all of this in the new year
QUESTIONS?