2018-2023 Rate Path Options

First Presentation to the Customer Review Panel
January 25, 2016
Purpose of this Presentation

Provide a first look at SPU’s rate path options for 2018-2023

1. Financial overview reminders and big drivers
2. Unveil the rate path options and main components: baseline; savings; action plans
3. Understand the baseline and financial assumptions
4. Savings overview
5. Action plan overview
6. Options to reduce rates
Reminder: Rates Growing at Slower Pace

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Annual Growth</th>
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<tbody>
<tr>
<td>2004</td>
<td>4%</td>
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<tr>
<td>2005</td>
<td>4%</td>
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<td>2006</td>
<td>2%</td>
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<tr>
<td>2007</td>
<td>2%</td>
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<tr>
<td>2008</td>
<td>6%</td>
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<td>2009</td>
<td>14%</td>
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<tr>
<td>2010</td>
<td>8%</td>
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<tr>
<td>2011</td>
<td>6%</td>
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<tr>
<td>2012</td>
<td>4%</td>
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<td>2013</td>
<td>4%</td>
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<td>2015</td>
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<td>2016</td>
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<td>2018</td>
<td>4%</td>
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<tr>
<td>2019</td>
<td>4%</td>
</tr>
<tr>
<td>2020</td>
<td>4%</td>
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Average Annual Growth:
- 2004-2014: 6.8%
- 2015-2020: 4.6%

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

Plan Update: 6-year endorsed rate path TBD
What Happened in 2015-2016?

• Lost major drainage customer, the Port of Seattle, resulting in $4M less in revenue per year.

• Faced new cost pressures, such as:
  • Moved up Ship Canal project to meet regulatory requirement timelines.
  • New requirements for privacy controls and payment card industry changes.
  • Costs to operate our new billing and customer information system were higher than planned.
How Did We Manage to Stay Within Endorsed Rates?

- Deferred capital projects and curbed operations and maintenance spending.
- Higher than planned water revenue due to hot summers.
- Lower than expected interest rates on debt service.
- Secured a few large low-interest-rate loans.
Rate Driver: Infrastructure Investments

Total CIP
(1995-2023)

- Solid Waste
- Water
- Drainage/Wastewater

Costs in thousands:
- Tolt Treatment
- Cedar Treatment
- Reservoir Covering
- North Transfer Station
- South Transfer Station
- Morse Lake Pump Plant
- Tolt Slide
- CSO Plan

Years: 1995 to 2023
Rate Driver: Infrastructure Investments

- Regulatory requirements increasing and shifting in from later years.
- Completion of the Facilities Master Plan (2015-2020 action plan) resulted in identification of significant deficiencies that are larger than planned and needed earlier than anticipated.
- Utility work to support transportation projects are large and more concentrated in the first few years.
Rate Driver: Operations and Maintenance Costs (O&M)

- Under-estimated costs of operating the new assets coming on line, especially in drainage and wastewater:
  - Gaining experience with new technologies and real time controls.
- Expanded regulatory requirements.
## Rate Driver: Staffing Resources

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<thead>
<tr>
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<tr>
<td></td>
<td>SBP</td>
<td>Updated</td>
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<tr>
<td>Needs</td>
<td>67</td>
<td>72</td>
</tr>
<tr>
<td>Reallocations/Efficiencies</td>
<td>(49)</td>
<td>(33)</td>
</tr>
<tr>
<td>Budget Adds</td>
<td>18</td>
<td>39</td>
</tr>
<tr>
<td>Budget Reductions</td>
<td>(5)</td>
<td>0</td>
</tr>
<tr>
<td><strong>Cumulative Totals</strong></td>
<td><strong>13</strong></td>
<td><strong>39</strong></td>
</tr>
</tbody>
</table>

### What Was Different than the 2015-2020 Plan?
- Ship Canal (7)
- Customer billing and information system (6)
- Privacy, payment card industry, internal controls, public disclosure (4)
- Clean City program (2)
- Did not realize all planned efficiencies
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### 2018-2023 Rate Path Options and Rate Math

<table>
<thead>
<tr>
<th>Description</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td><strong>Starting Point (September 2016)</strong></td>
<td>6.8%</td>
</tr>
<tr>
<td>• Scrubbed base &amp; assumptions</td>
<td></td>
</tr>
<tr>
<td>• Prioritized &amp; removed investments</td>
<td></td>
</tr>
<tr>
<td>• Expenditure reductions of $171M</td>
<td></td>
</tr>
<tr>
<td><strong>Current baseline operations</strong></td>
<td>5.2%</td>
</tr>
<tr>
<td><strong>Plus action plan investments</strong></td>
<td>0.7%</td>
</tr>
<tr>
<td><strong>Minus additional savings</strong></td>
<td>(0.3%)</td>
</tr>
<tr>
<td><strong>Option A: Average Annual Rate Increase</strong></td>
<td>5.6%</td>
</tr>
<tr>
<td><strong>Option B: Medium Risk</strong></td>
<td>5.4%</td>
</tr>
<tr>
<td><strong>Option C: Higher Risk</strong></td>
<td>5.3%</td>
</tr>
</tbody>
</table>
Year-by-Year of the 5.6% & Comparison with Last Time

2015-2020 Strategic Business Plan versus 2015-2023 Actuals & Projections

- **2015-2020 Strategic Business Plan**
- **2015-2023 Actuals and Projections**

- **2015-17 SBP Rates**
  - 2015: 4.1%
  - 2016: 4.2%
  - 2017: 4.2%

- **2018-20 Projected SBP Rates**
  - 2018: 5.0%

- **2018-20 Updated SBP Rates**
  - 2019: 7.5%

- **2021-23 Updated SBP Rates**
  - 2021: 7.5%
  - 2022: 3.8%
  - 2023: 3.8%

Seattle Public Utilities
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Baseline Rates Overview

Baseline Definition:
• Baseline rates are the future cost of “business as usual.”

Why we calculate a baseline:
• The baseline is our starting point for rate discussions.

Why are baseline rates higher than inflation?
• See the next slide for components of the baseline rate
Baseline Rates Overview

Baseline = 5.2%

- Operations & Maintenance (O&M), 1.70%
- Capital Financing, 0.84%
- All Other, 0.26%
- Seattle Inflation, 2.40%
- Taxes, 0.39%
- O&M inflation, 0.61%
- Large Contracts Inflation, 0.56%
- O&M increments, 0.15%

Components of the 1.70% increase in operations above general inflation
Baseline Rates Overview: 0.15% Operations Increments

$20M regulations and recycling programs. Examples:
  • Duwamish monitoring
  • New pet waste and diaper composting program

$10M Operating new assets. Examples:
  • Staffing to operate, monitor and control new assets
  • Green storm water infrastructure maintenance
Baseline Rates Overview

Baseline = 5.2%

- Operations & Maintenance (O&M), 1.70%
- Capital Financing, 0.84%
- All Other, 0.26%
- Seattle Inflation, 2.40%

2018-2023 Baseline CIP = $1.5B

$ in millions

- Regulatory, $695
- Pipe replacement, Flooding, Culverts, etc., $506
- Infrastructure Related to Transportation, $184
- Facilities & Other, $86
- Technology, $66

Seattle Public Utilities
Baseline Rates Overview: 0.84% Capital Increments

- $356M shifting the Ship Canal Project in to meet the consent decree.
- $120M increase in interagency projects
## Baseline Rate Path

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Water</td>
<td>1.6%</td>
<td>5.6%</td>
<td>5.6%</td>
<td>4.0%</td>
<td>5.9%</td>
<td>5.3%</td>
<td>4.7%</td>
</tr>
<tr>
<td>Wastewater</td>
<td>1.2%</td>
<td>9.3%</td>
<td>8.3%</td>
<td>4.5%</td>
<td>5.4%</td>
<td>2.5%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Drainage</td>
<td>7.9%</td>
<td>14.9%</td>
<td>11.6%</td>
<td>10.8%</td>
<td>2.8%</td>
<td>5.0%</td>
<td>8.8%</td>
</tr>
<tr>
<td>Solid Waste</td>
<td>3.1%</td>
<td>3.3%</td>
<td>2.9%</td>
<td>4.2%</td>
<td>4.3%</td>
<td>2.8%</td>
<td>3.4%</td>
</tr>
<tr>
<td><strong>Combined</strong></td>
<td><strong>2.8%</strong></td>
<td><strong>7.8%</strong></td>
<td><strong>6.9%</strong></td>
<td><strong>5.5%</strong></td>
<td><strong>4.8%</strong></td>
<td><strong>3.7%</strong></td>
<td><strong>5.2%</strong></td>
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</tbody>
</table>

## Typical Monthly Residential Bill

<table>
<thead>
<tr>
<th>Residential Bill</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
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<tbody>
<tr>
<td>Water</td>
<td>41.79</td>
<td>44.14</td>
<td>46.62</td>
<td>48.50</td>
<td>51.37</td>
<td>54.10</td>
</tr>
<tr>
<td>Wastewater</td>
<td>56.24</td>
<td>61.47</td>
<td>66.57</td>
<td>69.57</td>
<td>73.32</td>
<td>75.16</td>
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<tr>
<td>Drainage</td>
<td>38.90</td>
<td>44.70</td>
<td>49.87</td>
<td>55.27</td>
<td>56.80</td>
<td>59.65</td>
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<tr>
<td>Solid Waste</td>
<td>48.78</td>
<td>50.46</td>
<td>51.97</td>
<td>54.28</td>
<td>56.70</td>
<td>58.37</td>
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<tr>
<td><strong>Combined</strong></td>
<td><strong>185.71</strong></td>
<td><strong>200.78</strong></td>
<td><strong>215.03</strong></td>
<td><strong>227.62</strong></td>
<td><strong>238.20</strong></td>
<td><strong>247.28</strong></td>
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</tbody>
</table>

**Change** 5.65 15.07 14.26 12.59 10.58 9.08
Why is the Rate Path Spiky in 2018-2020?

- Rates are adopted through 2018 in Drainage and Wastewater and set too low.
- SPU is using extra cash to stay within rates in 2018; this is unsustainable for another 6-year period.

Drainage and Wastewater

<table>
<thead>
<tr>
<th>($s in millions)</th>
<th>2016</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>Expense</td>
<td>$367</td>
<td>$392</td>
<td>$440</td>
<td>$492</td>
<td>$542</td>
<td>$548</td>
<td>$572</td>
<td>$594</td>
</tr>
<tr>
<td>Revenue</td>
<td>$372</td>
<td>$396</td>
<td>$408</td>
<td>$469</td>
<td>$537</td>
<td>$551</td>
<td>$572</td>
<td>$597</td>
</tr>
<tr>
<td>Shortfall</td>
<td>$5</td>
<td>$4</td>
<td>($32)</td>
<td>($22)</td>
<td>($6)</td>
<td>$3</td>
<td>$0</td>
<td>$3</td>
</tr>
</tbody>
</table>

Wastewater

- 3.6% 5.4% 1.2% 9.3% 8.3% 4.5% 5.4% 2.5%

Drainage

- 9.9% 10.9% 7.9% 14.9% 11.6% 10.8% 2.8% 5.0%

NOTE: Negatives = use of cash
What Would It Take to Get to a 4.6% Baseline?

An estimated $228M expenditure reductions in 2018-2023 across all lines of business:

- $71M capital reductions or deferrals.
- $157M operations and maintenance reductions – equivalent to about 200 positions.
- Only 27% of all O&M is not fixed (Ex. contracts & taxes)
- 67% of the non-fixed spending is labor.
Next Time on Baseline Rates

- Detailed review of operations increments
- Detailed review of capital expenditures
- Detailed review of financial policies
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Savings Overview

$105 million in additional savings between 2018-2023:

• $82M in capital projects and programs:
  • Shifting out some investments in culverts, pump stations, localized flooding, and reservoirs; and
  • Permanent decrease in the Tolt Slide project due to finding a significantly less expensive solution.

• $23M in operations and maintenance that support various initiatives but with little programmatic impact.
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Highlights of Action Plans: Operations & Maintenance

6-year action plan operating costs = $15M or about $3M annually

- Water Modeling, $0.8
- Side Sewer, $0.9
- Data Management Support, $1.8
- Water Distribution, $3.2
- Apprentices, $1.5
- Sewer Repair, $1.3
- Transportation Project Support, $2.5
- Security, $3.0
Highlights of Action Plans: Capital

6-year action plan capital project costs = $318M

- Transportation Opportunity Projects, $115.7
- Sanitary Sewer Capacity, $34.9
- Facilities and other, $123.6
- Sewer Rehab, $25.9
- Pump Stations, $18.1
Next Time on Action Plans

Detailed information on each Action Plan:

- What outcome will this action achieve?
- What problem does it solve?
- What are the costs and benefits?
- Description of activities already in the baseline.
- Implementation plan, budget and timeline.
- Alternatives considered.
- Possible race and social justice implications.
- Plan to evaluate success or progress of this action.
Option A Rate Path: Baseline – Savings + Action Plans

Option A: Six-Year Annual Average = 5.6%
## Option A Rate Path: Baseline – Savings + Action Plans

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<tbody>
<tr>
<td>Water</td>
<td>1.4%</td>
<td>5.9%</td>
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<td>5.6%</td>
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<td>5.9%</td>
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<td>4.3%</td>
<td>2.8%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Combined</td>
<td>2.7%</td>
<td>9.8%</td>
<td>9.9%</td>
<td>3.4%</td>
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<tbody>
<tr>
<td>Water</td>
<td>41.70</td>
<td>44.17</td>
<td>46.74</td>
<td>49.42</td>
<td>52.27</td>
<td>55.21</td>
<td>5.56</td>
</tr>
<tr>
<td>Wastewater</td>
<td>56.24</td>
<td>64.45</td>
<td>73.99</td>
<td>74.88</td>
<td>77.35</td>
<td>78.59</td>
<td>18.46</td>
</tr>
<tr>
<td>Drainage</td>
<td>38.90</td>
<td>45.00</td>
<td>51.76</td>
<td>53.94</td>
<td>56.67</td>
<td>59.66</td>
<td>20.38</td>
</tr>
<tr>
<td>Solid Waste</td>
<td>48.78</td>
<td>50.46</td>
<td>51.97</td>
<td>54.28</td>
<td>56.70</td>
<td>58.37</td>
<td>8.05</td>
</tr>
<tr>
<td>Combined</td>
<td>185.62</td>
<td>204.08</td>
<td>224.46</td>
<td>232.51</td>
<td>242.99</td>
<td>251.82</td>
<td>8.84</td>
</tr>
</tbody>
</table>
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Option B Rate Path: Medium Risk

Option B: Six-Year Annual Average = 5.4%
Option B Rate Path: Medium Risk

- Meet environmental objectives by evaluating the 70% recycling goal to determine if an alternative approach might be similarly effective.

- Reduction in culvert program, delaying projects.

- Decrease investment in rodent control.
Option B Rate Path: Medium Risk

- Eliminate Move Seattle opportunity projects for Drainage and Wastewater.
- Remove a placeholder for storm water regulatory compliance.
Option C Rate Path: Higher Risk

Option C: Six-Year Annual Average = 5.3%
Option C Rate Path: Higher Risk

- Decrease the level of sewer cleaning.
- Eliminate SPU’s contribution to Green Seattle Partnership.
- Reduce the level of risk reserves.
- Continue billing in advance for Solid Waste bills.
Option C Rate Path: Higher Risk

- Decrease investment in sanitary sewer capacity.
- Reduce Move Seattle opportunity projects for Water.
- Assume lower Solid Waste contract inflation.
Next Time on Rate Path Options:

Detailed information on each reduction, including:

• Description of the cost reduction
• Impacts or risks of cost reduction
• Ways to mitigate these risks
• Possible race and social justice implications
Next:

- January 31st
  - Answer questions from this session
  - Baseline details
  - Financial policy details

- February 22nd
  - Action Plan details
  - If time permits, details on reduction options, otherwise in March
QUESTIONS?