

Seattle Public Utilities Customer Review Panel

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

June __, 2014

Mayor Edward B. Murray
The City of Seattle
600 Fourth Avenue
P.O. Box 94749
Seattle, WA 98124-4749

Dear Mayor Murray:

As members of the Seattle Public Utilities Customer Review Panel, we are pleased to convey our strong endorsement of SPU's 2015-2020 Strategic Business Plan ("Plan") and specifically, the "Recommended Path" outlined in the Plan. We believe that the Recommended Path represents a responsible and important investment in infrastructure and services provided by Seattle Public Utilities, benefitting both current and future generations of customers.

The Strategic Business Planning Process

SPU has conducted an impressive and thorough process to develop the Plan. The Utility's leadership team has been fully involved in the effort from beginning to end. Hundreds of SPU employees participated at various stages of the Plan's development. An extensive public outreach process successfully engaged many residents and businesses throughout the community. The process was also supported by Council and City Budget Office staff, who were at the table with us throughout the process. Councilmembers Godden and Bagshaw each attended a Panel meeting, and the City Council's SPU and Neighborhoods Committee received briefings over the last several months.

Our role in this effort, per Council Resolution 31429, has been advisory. The Panel has met 27 times since April 2013, deliberating with and advising the Utility's executive team. The Utility has been highly responsive to our many questions and ideas, and we commend their knowledge, commitment and initiative. We have sought to provide a *customer perspective* to the Utility's work on the Plan. Our nine members have a broad range of experience and views. Two of our members have worked for years as public utility professionals. The remaining seven members have experience ranging from construction management, small business, finance, environmental economics, medicine, facilities management, and managing nonprofit agencies providing programs for low-income communities and youth.

The Value of a Strategic Business Plan

SPU is a large organization that supports vast, critically important infrastructure systems. The issues the Utility faces are highly complex. The combination of four lines of business – water, drainage, sewer and solid waste -- into a single department also appears to be highly unusual amongst public utility organizations nationally, contributing to the challenge of developing the Plan.

In our view, the Plan represents a planning and policy tool of significant value different from that provided by either typical six-year capital improvement plans or a two-year budget process. This is the first time the Utility has completed a comprehensive strategic *business plan* that ties proposed actions to the budget and rates. The Plan is a critical self-examination by the Utility of its organizational, service delivery and infrastructure issues. The Plan:

- Improves transparency of SPU's operations, illuminating the "drivers" behind rate increases: regulatory requirements; projects underway; inflation; central services costs; labor, pension and benefit costs rising faster than inflation; and declining demand.
- Incorporates findings from an independent study of potential SPU efficiencies—the first such comprehensive study by the Utility.
- Provides important predictability for customers as to where rates will go over the next 6 years.
- Is a powerful accountability tool, in that the Utility has committed to deliver specific projects within a defined rate path.
- Includes specific, achievable goals and milestones, and addresses each line of business both individually *and* in an integrated manner so as to manage the overall rate impacts for customers.

We applaud the City's leadership for directing the Utility to undertake this planning effort.

Recommended Path

The Plan recommends, and the Panel endorses, the Plan's "Recommended Path" for 2015-2020 that will result in an annual average rate increase of 4.6% across all four lines of business combined. As stated at the outset of this letter, we believe the Recommended Path is a responsible investment in the infrastructure and services provided by Seattle Public Utilities for both current and future generations of customers. The Recommended Path will address specific gaps in current operations and is an important commitment to the future of Seattle.

The foundation for the Plan is a "Baseline" study: a forecast of the costs to support current service levels (both operating and capital), under current operational practices, while also meeting new regulatory requirements. The Baseline includes over 90% of the projected costs to ratepayers in the 2015-2020 planning period under the Recommended Path. It is a critical piece of analysis incorporating both technical and policy assumptions. The Baseline projects year-to-year rate increases of 4.6% over the planning period. From there, the Utility engaged in an exploration of ways to reduce the projected growth of rates by challenging assumptions and identifying programmatic reductions and efficiencies in current operations – resulting in a reduced rate path requiring approximately 4.1% in average annual rate increases. But stopping at that point leaves significant service and operational challenges unanswered: the Recommended Path incorporates a set of investments targeted to address compelling challenges and results in a final projected rate path with average annual rate increases of 4.6%.

We are pleased that the projected rate path is well under the 7% average annual increases of the last decade. That said, we recognize that the 4.6% average annual rate increase represents a rate of increase above the expected growth in household income for most in our community. Affordability of utility services has been a recurrent theme at our meetings since we first convened. Our concerns about the affordability of utility service prompt us to offer some additional observations and recommendations below under the section captioned "*Affordability Challenges.*"

Efficiencies & Programmatic Reductions

Both the Panel and the Utility were very focused on finding ways to reduce the increase in rates over the six-year planning period. In the Panel's view, a credible effort at implementing efficiencies is a prerequisite to proposing significant cost increases, and we feel the Utility has met this test. We have reviewed and support the suite of proposals for efficiencies and programmatic reductions offered by the Utility. The efficiency proposals reflect the recommendations from HDR, an independent consulting firm, and a thorough and thoughtful response to the HDR report by the Utility. The commitments outlined in the Plan should generate significant and measurable reductions in SPU's Baseline costs.

The efficiencies outlined the Plan are an important starting point. That said, the search for efficiencies needs to become an integral part of the culture of the SPU organization. It should be an ongoing priority to find additional efficiencies -- and implement a tracking system to document savings achieved. Benchmarking with other comparable utilities should be part of this effort. We encourage SPU to produce an annual "report card" on efficiencies, showing the magnitude and source of savings, benchmarking costs to industry standards, and identifying future potential savings opportunities.

The Utility has proposed to meet many of its efficiency targets through a "zero-net FTE" pledge. This reflects a commitment to capture savings from many of the proposed investments in the Plan and should not impact overall service levels. We applaud Director Ray Hoffman's creative approach, and his willingness to be held accountable to this target; we encourage the City to give him latitude to choose how he meets this goal.

One of the major efficiency recommendations from HDR was for SPU to realign its organizational structure. We strongly support Director Hoffman's decision to pursue this recommendation. SPU's current structure is complex by necessity but is also overly confusing. A realignment offers the opportunity both to increase accountability and streamline decision-making to help deliver the targeted efficiencies and improvements. Related to this, we would note a silver lining associated with an aging workforce: retirements offer an opportunity to simplify the overall organizational structure.

We also emphasize the importance of rigorous management of the Utility's capital project delivery program as a means of becoming more efficient. Director Hoffman has recently launched an impressive initiative in this regard. We believe it is extremely important to continue to focus on improving SPU's delivery of capital projects.

Strategic Business Plan Focus Areas

The Plan identifies four "Focus Areas:"

- "Improving how we work to deliver consistent, high quality services"
- "Protecting your health and our environment"
- "Enhancing our services by improving employee skills"
- "Making it easier to get help and find answers"

Placing these Focus Areas at the forefront of the Utility's attention in the next six years will improve organizational efficiency and the quality of service delivery. . The Focus Areas are based on an analysis

of the Utility's current operations and were developed with input from the entire Department—important to securing the needed buy-in to move forward.

The Utility has proposed specific investments, or “Action Plans,” to address identified gaps within each Focus Area. The Panel has reviewed information about each of these Action Plans and has offered feedback to the Utility about scaling some back, increasing others, and incorporating some into the Baseline. The Utility responded to several of our suggestions in shaping its final proposal.

We believe the “Action Plan” investments will add value exceeding their cost, in terms of improved operational effectiveness and efficiency. The Panel endorses the proposed “Action Plans,” which combined will cost about \$52 million in operating expense and \$116.5 million in capital improvement dollars over the six-year planning period. In total, these investments raise the annual average rate increase from about 4.1% to 4.6% -- a 0.5% increase per year. We offer below some additional comments about these Focus Areas and some key investments:

(note: Sections below will be re-ordered to match presentation in plan)

- **Focus Area: “Improving how we work to deliver consistent, high quality services” (62% of new operating investments; 93.5% of new capital investments)**

Sewer Pipe Inspection, Cleaning and Repair. This is the most costly of the proposed Action Plans, calling for accelerating the rate of sewer inspection and rehabilitation. The Panel strongly supports this effort, together with a related Action Plan to increase the rate of sewer pipe cleaning. The City's sewer pipes are on average over 85 years old. As they age, we can expect to see increased costs associated with repair and replacement: it will be critical to keep pace with this aging system to avoid higher costs of major system failures in the future.

Accelerating Projects to Mitigate Chronic Flooding in South Park, Broadview and elsewhere. The severity of recurrent flooding in City neighborhoods is not an acceptable level of service. We support action to correct these problems sooner than Baseline levels of funding will allow.

Facilities Management. Several key maintenance facilities used by SPU staff are well over 50 years old and are in poor condition. These need to be rehabilitated, and a management plan and capital needs assessment developed, so that SPU can be ready to serve its customers over the next 50 years.

Information Technology (IT). The Plan includes sizeable investments in IT systems. We support these because we view them as necessary to getting critical information to management and employees in order to better manage the Department. We appreciate management's cautious approach to how IT projects are implemented in order to control costs and secure desired benefits.

Forward-Thinking Planning. We commend the Utility's focus on planning for the future. There are several planning initiatives in the Plan, for example, that deal with climate change and seismic issues. Proactive planning is important to allow SPU to shape its future, rather than being shaped by it.

- **Focus Area: “Protecting your health and our environment” (16%¹ of new operating investments; 5% of new capital investments)**

The City of Seattle has a strong commitment to the environment. It is one of the things residents value most highly about living here. The Utility’s existing programs in this area are extensive--and many of them are required by federal and state regulators. Federal regulations impacting SPU operations have been getting much more stringent in recent years, particularly for the drainage and wastewater lines of business: complying with these regulations is a major cost driver for the Utility and is a central focus of SPU’s activities. The major regulatory requirement (included in the Baseline) driving investment in 2015-2020 is the consent decree with Environmental Protection Agency requiring SPU to increase the capacity of its combined sewer systems in order to reduce incidents when heavy rains result in raw sewage spills into our lakes and the Sound.

Carbon Neutrality. The Panel encourages SPU to pursue efficiencies in its use of vehicles in order to reduce carbon emissions, but we are skeptical of proposed City policies that would require SPU to invest heavily to reduce SPU’s carbon emissions, given the unacknowledged contribution of SPU’s forested watersheds to carbon neutrality calculations, and our concerns about affordability.

Street Sweeping. We also are strongly supportive of expanding street sweeping programs as a low cost-high impact way to reduce pollutants flowing into the City water bodies. The Panel hopes that the Environmental Protection Agency will accept this very cost effective tactic as a component strategy of the Combined Sewer Overflow consent decree.

- **Focus Area: “Enhancing our services by improving employee skills” (17% of new operations investments)**

This Focus Area is the Panel’s top priority. We strongly believe that the quality of SPU’s employees determines the quality of service provided, as well as the ability to innovate and respond to changing circumstances. HDR emphasized to us that SPU has high quality employees. We certainly found this to be true in our work with the Department’s leadership staff over the last many months: they are a dedicated team focused on high performance. But there are serious challenges ahead in terms of an aging workforce, and major issues in current human resources systems that need to be addressed. We urge your support for the proposed Action Plans that strengthen the Utility’s workforce because we believe that success here is necessary to help reduce future rate increases. We appreciate that these Action Plans may require some complex union negotiations. We offer the following observations:

- SPU employee surveys conducted in 2012 identified a desire for greater accountability and greater efficiency in the organization: the Action Plans address this directly.
- By 2020, approximately 62% of the SPU workforce will be eligible to retire: succession planning and developing a pipeline of talent must be a priority.
- Existing human resource systems in the Department have major gaps and require an overhaul and updating. A strong supervisor training program is something we see as being particularly important to pursue. Again, the proposed Action Plans will target these areas.

¹ Percentages in these captions are rounded to the nearest .5%.

- SPU is part of the larger City organization and has limited ability to affect important cost and process rules related to its employees (for example, “step” increases, pensions, and sick-leave pay).
- Employee injury and re-injury rates are high and are expensive to the Utility. Employee safety should be a priority. We encourage the Utility to be aggressive in addressing this problem. We commend efforts to reduce injuries and get employees back to work sooner in jobs where re-injury risks are reduced.
- If due to injuries or age an employee cannot perform the required skills for his/her job, the Utility needs to consider ways to assign employees to alternative jobs where they can perform the required skills.
- Promoting internal mobility for employees is a practice that can reap benefits over time.
- We support initiatives to increase field and office productivity.
- We also encourage the Utility to consider “multi-skill job classifications,” where appropriate, as a means to achieve efficiencies.

We commend the Utility for its transparency regarding workforce challenges, and strongly support its request for funding for improving workforce systems and practices.

- **Focus Area: “Making it easier to get help and find answers” (5% of new operating investments; 2% of capital investments)**

Improving SPU’s Website. The Plan includes a modest investment to upgrade the SPU website. This is the first point of contact for many customers. We strongly support this Action Plan.

Service Equity. The Utility’s efforts in the area of race and social justice are commendable and we support the Action Plan that will expand upon this work.

Coordination of Outreach. We encourage City departments to consider how they can coordinate outreach to various communities to reduce both the expense to the City and the commitment of time it takes for customers to participate.

Affordability Challenges

With this Plan, SPU's rates will increase over 30% between now and 2020.² The rate of increase is well higher than inflation and higher than we would like; however, we believe the Plan includes important investments in critical basic infrastructure and services and we support it. If we don’t make these investments now, the problems will not go away and will cost more to resolve later. Beyond the planning period, we are convinced that aging systems and an evolving regulatory environment mean customers can expect continuing SPU rate increases but that these will be mitigated by the investments and initiatives outlined in the Plan.

At the same time, City Light rates are projected to go up a similar amount over the next six years. And there are several other initiatives under discussion or recently implemented that will also drive up the cost of living in the City during this period. In other words, SPU’s rates are just one part of an overall picture of increasing affordability challenges in Seattle. We encourage the Mayor and City Council to

² While the average annual rate increase is 4.6% across all lines of business, each year the percentage increase is applied to a larger base cost, so as compounded, total rates will increase over 30%.

consider the larger context of this affordability challenge. There must be a continual effort to balance our collective desire for strong City services and our equivalent desire to keep Seattle affordable to households of all income levels, with a positive climate for businesses that employ our residents.

We expect the Utility's continued focus on efficiencies, and on keeping pace with the demands of an aging infrastructure, will be the major ways SPU can act to keep rates affordable over time. We offer the following additional comments and recommendations with respect to this difficult issue:

First, we acknowledge that affordability is a concept that can be difficult to measure and is somewhat subjective. And, it is best measured in context. None of the Panel members would advocate for low quality, unreliable utility services in lieu of the safe, high quality, reliable services we now receive from SPU.

Second, we support expanding participation in the low income rate assistance program, which provides rate discounts of 50% to qualified households, while noting that this program expansion will correspondingly increase the cost of utility services for customers not participating in the program.

Third, it is important to recognize that several of the major cost drivers that the Utility is experiencing are not within its control. The largest uncontrollable cost item is regulatory requirements: while the state and federal government are responsible for most of these, there are also some city-imposed requirements. Overall labor costs—including salary, pension and benefits costs—are determined to a large extent by a combination of City policy decisions, market forces and demographic reality, and are currently growing at rates well above inflation (but fortunately represent only about 16% of SPU's annual budget). The Utility is required to purchase administrative services from City departments (for example fleet and Information Technology) and the costs of these services are also projected to rise at rates well above inflation. We hope other parts of the City organization will be asked to pursue planning efforts similar to the SPU Strategic Business Planning effort, in order to secure greater efficiencies elsewhere in the City.

Fourth, the City has chosen to raise a significant portion of its General Fund revenues through taxes on utility services. These taxes are calculated as a percentage add-on to customer bills. Seattle's utility tax rates on SPU operations are at least 50% higher than the median rate imposed by all other cities in Washington State, according to a 2012 survey by the Association of Washington Cities. The highest Seattle utility tax rate in place currently is on water, at 15.54%. In 2012, Seattle collected \$73.6 million from SPU's customers to support General Fund programs (police, fire, human services, etc.). We acknowledge the importance of this revenue source to the General Fund and the importance of General Fund programs. We know alternate sources of revenue would need to be found to replace a loss of utility tax revenues. However, we encourage the City to consider whether there are options to reduce reliance on this regressive tax on basic necessities. For example, if the City gradually scaled back utility tax rates over the next six years to the rates in place in 2004, it would be a major improvement in affordability. Alternately, perhaps the growth of utility tax revenues could be capped at the general rate of inflation. At a minimum, we encourage the City to increase transparency on utility bills so that customers understand this is an add-on to their bills that supports general City operations.

Other Items of Note

- **Rate Design & Connection Charges**

We encourage the City to undertake a broad review of rate design for each of SPU's lines of business. While this is not within the scope of our mission, rate design issues came up several times in our deliberations. Successful conservation efforts have resulted in declining demand for SPU's services, contributing to the increase in rates. Virtually all of SPU's revenues are recouped from volumetric charges – despite many costs of operation being fixed. Thus, even if SPU's cost of doing business doesn't change, as demand goes down rates must go up. The issues here can be very complex, but it seems appropriate to consider whether adjustments in rate design structures are advisable.

One action we think is appropriate to pursue now is greater use of connection charges to pay for some system expansion costs. The Plan includes a proposal to institute connection charges for sewer service and increase connection charges for water service. This "growth-pays-for-growth" tool is common practice in the industry and we think it should be implemented more broadly by SPU. There are several approaches to implementation and use of revenues collected. More work must be done to select a specific path here.

- **Every-other-week Garbage Collection**

A majority of the Panel agree it is not appropriate to implement every-other-week garbage collection at this time. However, the City could reconsider this concept at the next renewal of the hauler contracts. If the decision is made to pursue the program, it must be proven that the reduction in collection service is worth the cost. It will be critical to fund a serious public education outreach and to address equity issues, given results of the pilot program.

- **Tracking Delivery on the Commitments of the Strategic Plan**

The Strategic Business Plan calls for the investment of millions of dollars to improve service and address gaps. It is important for the Utility to focus on the results of these expenditures and report the outcomes. Progress in implementing programs and capital projects, cost savings, and efficiencies achieved should be documented and shared with the Mayor, Council and the public at least annually. The City should hold the Utility's leadership accountable as appropriate for delivering on the commitments in this Plan. Periodic employee surveys should be a part of this effort as well.

Accurate and comprehensive data collection and reporting here can help communicate the value of SPU's services to the public and also help target actions in the next Strategic Business Plan Update. We support a 3-year cycle for updating the six-year Plan.

The Panel is very invested in the success of this Plan. For this reason, the Panel offers to reconvene in a year to review the Utility's progress and to offer our comments to you on this important work. We also encourage the Utility to engage the three existing Citizen Advisory Committees in the work of overseeing implementation of the Plan.

- **Acknowledgements**

We wish to thank Director Ray Hoffman and his entire team, as well as our facilitator, Karen Reed, for their excellent work in supporting us over the last sixteen months. The Utility's approach throughout

Mayor Edward B. Murray

June __, 2014

Page 9 of 9

this effort has been extremely collaborative and it has been a pleasure to work with them. We also thank Council, Mayor and Budget Office staff for their support of this effort.

In closing, the Strategic Business Plan represents an enormous investment of the Utility's time. Implementing this Plan will result in a stronger and more efficient Utility, benefitting the residents and businesses in Seattle. The Plan should serve as a catalyst for the organizational change that will be necessary to accomplish the aggressive goals outlined—helping to get everyone on the same page and providing a framework for measuring accomplishments. That said, the challenges ahead should not be underestimated. There are corporate culture challenges to be addressed here—becoming a more performance driven organization, focusing on efficiencies and service outcomes. Successful implementation will require ongoing support from the Mayor and Council.

We are pleased to have had a role in the development of SPU's Strategic Business Plan, and we thank you for this opportunity. We encourage your support for the Plan and the Recommended Path. We would be pleased to meet with you to discuss our recommendations.

Sincerely,

Members of the Seattle Public Utilities Customer Review Panel

Noel Miller
Panel Chair

Carl Pierce
Panel Vice-Chair

Suzie Burke

Dave Gault

Dave Layton

Laura Lippman

Bruce Lorig

Tara Luckie

Walter Reese

cc: Seattle City Council
Director Ray Hoffman, SPU