"Baseline Elevator Speech:" Why Are SPU's Rates Going Up?
--SPU Customer Panel Perspective--

Seattle Public Utilities (SPU) provides City residents with safe **drinking water**; operates the City **drainage** system(which collects run-off from the streets, driveways, roofs and parking lots); the **sewer** conveyance system; and oversees operation of the **garbage** system—recycling, yard waste, and disposal (services primarily provided by private firms under contract with the City).

SPU is now developing a "**Strategic Business Plan**" that will identify service levels, needed investments, and rates for the **2015-2020** Period. The Strategic Business Plan will be submitted to the City Council this June. As members of a nine-member Customer Review Panel, we have been tasked with advising SPU in the development of the Plan.

So, what's in store for rates? Based on information the Panel has received from SPU over the last several months, *baseline rates*– defined as the rates projected to be required to support current service levels, current methods of operation and meet known regulatory requirements-- will be going up each year by about ***4.6% per year*** between 2015 and 2020. While this rate is well below the 7% average annual increases of the last decade, it's still well higher than forecast rate of general inflation (2.5-2.6%). It's important to understand the reasons for the yearly increases.

This document describes what we understand to be the key drivers in SPU's projected baseline rates. The baseline is foundational to building the Strategic Business Plan, but not the whole picture. The Utility will also identify efficiencies and programmatic reductions to reduce rates and investments to address service gaps.

What's the Current Situation?

SPU is the second largest department in the City of Seattle, in terms of the number of employees and budget. SPU's 2014 budget for all lines of business is approximately $925M, including both operations & maintenance (O&M) and capital spending. There are about 1400 Full Time Equivalent employees in SPU in the 2014 budget—their salaries and benefits account for only about 16% of total budgeted expenditures.

Current SPU operations are impressive in a number of respects:

- We enjoy some of the best quality drinking water in the nation. To protect the source of this water, the City owns hundreds of thousands of forested acreage in the Cascade foothills.
- Our customers have steadily reduced their rate of water consumption. Population in the City and adjacent service grew by 15% in the last 20 years, but we now consume less total water in total than we did in 1959. This trend is expected to continue (and also affects demand for sewer service, which is tied to water consumption).
- The City has one of the highest recycling rates in the country – nearly 56% (by weight) in 2012 for *all* customers. Our *single family residential* customers have the highest recycling rate in the country at 71%.
- SPU is pioneering new "green" approaches to treating street stormwater run-off.
- Our City sewer and water systems are highly reliable.
- The City partners with others to clean-up contaminated sites to be sure costs are shared appropriately.

However, The City's water, sewer, drainage and garbage systems have been in service a long time:

- City water pipes are, on average, 67 years old.
- City sewer and stormwater pipes are, on average, 85 years old.

- The City's garbage transfer station (where garbage and recyclables come to be transferred for processing/disposal) serving the north half of the City is 47 years old (and will be rebuilt in the the next few years; the south transfer station was rebuilt and reopened in 2013 after 47 years in use).

Rates went up a lot in the last decade. Customer bills went up 7% *a year* on average between 2004 and 2014, primarily due to federal regulatory requirements and replacement of major infrastructure. For example:

- City water reservoirs have been covered with lids to protect drinking water safety.
- A new water treatment plant was required for the Cedar River (one of the City's 2 main water sources).
- The 47-year old garbage transfer station in South Seattle was replaced.
- King County built a new sewage treatment plant in Southeast Snohomish County (the "Brightwater Plant") and Seattle, like all other customers of the County's regional sewage treatment system, must pay its share of that project.
- Other repair and replacement of aging systems.
- Declining demand for service: the downside of success in water conservation is additional rate pressure on water, sewer and solid waste rates--as costs of operation go up and the units of service purchased decline, rates must increase to recover costs.

Looking ahead to 2015-2020: What are the rate pressures?

To address regulatory requirements and maintain our current levels of service, rates will be going up—but by much less than in the last decade. The projected *average annual* baseline rate increase for SPU's four lines of business is *4.6% per year* over the six year period from 2015 through 2020.

SPU is has completed major investment hurdles for the solid waste and water systems. However, recent federal regulations to protect water quality in streams, lakes and Puget Sound present costly challenges for our sewer and drainage systems. The good news is that SPU successfully negotiated with federal regulators to allow a balance between drainage and sewerage investments that is less expensive than other alternatives. That said, a major investment will still be needed in order to comply. And, other regulatory requirements now under consideration by state and federal regulators could require additional investments.

Aside from regulatory challenges, the City must continue to repair, rehabilitate or replace aging pipes in the sewer and water systems. Intrusion of tree roots into sewer lines, cracked and misaligned joints are continuing problems. City water mains also experience significant build-ups of iron deposits that can affect water quality. Much of these systems are well over 50 years old: it's far less expensive to strategically repair, rehabilitate or replace pipes than to wait for them to fail. In terms of drainage issues, chronic flooding in some City neighborhoods is being addressed at a very slow pace— at current funding levels, solutions are decades away.

Some of the major drivers for rate increases are:

- **Ongoing regulatory requirements.**
    - The City must generate funds to pay its share of federal "Superfund" settlements related to toxic materials in the Duwamish River and in Lake Union near Gas Works Park.
    - When we have heavy rains, raw sewage spills from the City drainage system directly into Lake Washington and Puget Sound—because the system was not designed or built to address the growth that we have seen in the City over the last many decades. Last year, these rain events resulted in an

estimated 37 million gallons of raw sewage spills. Portions of our sewage systems must be re-designed and re-built to stop this from happening and meet federal clean water regulations.

- State permits require the City to improve the quality of stormwater runoff by installing and maintaining filtration systems along roadways, implementing “Green” projects (such as rain gardens that capture and naturally treat run-off), and increasing street sweeping to reduce the amount of contaminated roadway sediments that would otherwise end up in our creeks, lakes and Sound. SPU will be required to significantly ramp up its spending in this area.

  The combined cost of these ongoing regulatory requirements accounts for about 20-25% of the total annual average cost of doing business.

- **Planned Investments in our systems to maintain and improve service levels.**

  - In the next two to three years, SPU will complete the replacement of the North Transfer Station. This project is expected to cost roughly $58 million.

  - The City seeks to double the number of eligible low-income households that are signed up for rate assistance by 2018. Only about 14% of total estimated number of eligible households now participate in the program. Currently, about $7 million in credits are paid to participants each year: these costs are shifted to other SPU customers. Assuming the sign-up target is met by 2020, this cost shift will increase average customer rates by 0.22%.

  - The City Council has set a target of 60% by 2015 and 70% by 2022 for overall recycling and waste reduction (by weight) for our solid waste operations. SPU will be implementing programs to help move towards this target. The estimated cost of meeting targets between now and 2020 is about $1.0 to $1.7 million a year.

  - Utilities are a capital intensive business. Simply to support current levels of service, there will be ongoing capital investments in facilities. In 2014, 24% of SPU’s expenditures go to pay for capital improvements (cash and debt service payments). This percentage will increase slightly to an estimated 2020 total of 24.5% of spending.

- **The increasing cost of doing business.**

  - SPU’s operations are getting more expensive. O&M costs are currently about 31% of total costs, and are the biggest share of the baseline rate increase between now and 2020 (43% of the total *increase* is attributable to O&M). By far the largest part of the O&M increase is in the cost of labor.
    - Salaries are increasing on average 1% more than inflation each year.
    - The cost of health care for SPU employees will continue to rise at rates faster than inflation (about 7% per year).
    - Pension costs are also rising faster than inflation (the city contribution rate will increase from 14.3% of employee salary to 16.3% over the 2015-2020 period).
    - The baseline includes 12.5 new employees.
    - SPU purchases many overhead services from other City departments (such as information technology and vehicles). The cost of these services is expected to rise between 4% and 12% per year over the 2015-2020 period.

- Utility taxes add 11.5% to 15.54% to each bill.

- Overall, about 31% of the Utility's 2014 budget goes to third-party service contract providers (for sewage treatment, garbage disposal, recycling, composting of yard waste). This cost share is expected to *decrease* slightly to 30% by 2020—a welcome change from the previous decade. The single largest contract is with King County, to pay for sewage treatment services.

- **Declining Demand**

Despite population growth and a rebounding economy, demand for water and sewer service is projected to continue to *decline* slightly. The total tonnage of garbage disposed of is also expected to decline. Drainage demand (based the number of parcels of property) is expected to be flat. While this reflects success in the City's conservation programs, it has a downside for rates. The amount of **total rate revenue** the utility requires is growing 4.1% per year on average: declining demand ***adds 0.3%*** to that rate, as relatively fixed costs are spread over a smaller base.

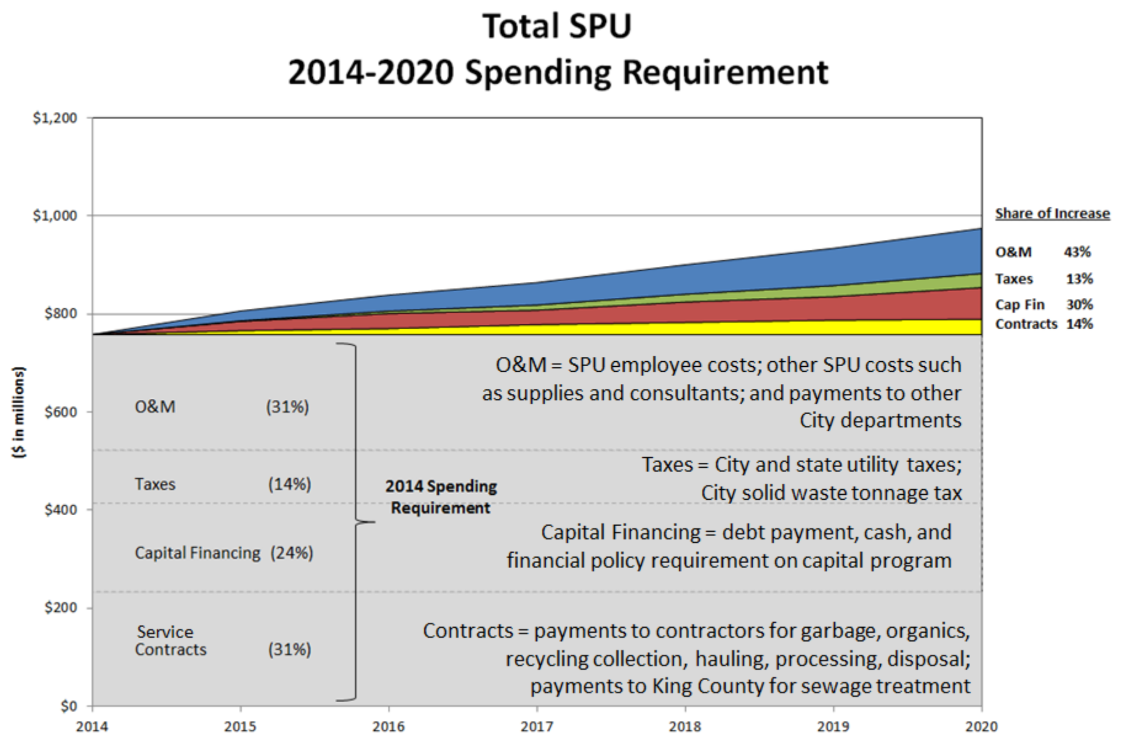
What does it all mean?

There are many factors contributing to increased SPU rates, both external and internal to SPU's operations. Based on SPU's current projections, the cost of doing business at *current service levels* and *complying with regulatory mandates* will result in average annual rate increases of **about 4.6% per year over the 2015-2020 period**. This is well below the rate increases of the last decade, but still considerably higher than projected general inflation over the period (2.5-2.6%/year).

As work continues to complete the Strategic Business Plan, the challenge is to find opportunities to become more efficient and reduce the cost of doing business where possible—while still meeting customers' expectations that SPU maintain and improve service levels today and plan for the next generation of customers.

The following charts depict the major **cost drivers** behind the currently projected *baseline rate increases* for *all* of SPU's "lines of business:" water, drainage and wastewater, and solid waste.

2015-2020 Projected SPU Baseline Cost Increases, All Lines of Business



Preliminary baseline – average annual rate increase across all SPU lines of business of 4.6%

Notes: "**O &M**" = Operations and Maintenance costs—employees, equipment, payroll, administration, etc.; "**Taxes**" = City utility taxes; "**Cap Fin**" = Capital Financing-- costs of borrowing (principal and interest) to pay for capital assets.