



MEMORANDUM

PREPARED FOR: Mike Bisset, Community Development Director

PREPARED BY: Deb Galardi, Galardi Rothstein Group

SUBJECT: FY2019-20 Wastewater Rate Study Findings

DATE: June 5, 2020

Introduction

The City of McMinnville (the City) has a long-standing practice of reviewing wastewater rates every two years and implementing rate increases to keep pace with cost escalation and system investment needs. The last rate analysis was conducted in Fiscal Year (FY) 2017-18. Based on the prior study findings, the City Council adopted rate increases of 2.8 percent for FY2018-19 and FY2019-20. However, prior to the implementation of the FY2019-20 increase, the City Council adopted a five (5) percent wastewater franchise fee, effective July 1, 2019. As a result, the sewer rates were increased by an additional five percent (Resolution 2019-08), bringing the total July 1, 2019 rate increase to 7.8 percent.

This memorandum presents the findings of the FY2019-20 rate analysis for the wastewater system. The financial analysis provides the framework from which to estimate future rate changes needed to support continued implementation of the wastewater system Capital Improvement Plan (CIP), and to fund ongoing operations, maintenance and capital replacement costs. The rate increases identified in this analysis are assumed to be applied across-the-board to the City's current wastewater rate structure. The rate structure was developed in 2015 as a result of a comprehensive rate equity review. The recommendations from the equity review were phased in over multiple years, with the final changes reflected in the FY2018-19 rates.

Financial Plan Development

The building blocks of the financial analysis are the projections of costs or "revenue requirements" that the wastewater system will incur during the 10-year planning period, and the revenues, under existing rates, projected during the same period.

Revenue Requirements

The primary components of revenue requirements are:

- Operation and maintenance (O&M) costs – Ongoing personnel and other costs associated with system operation and routine facility maintenance, and equipment replacement costs.
- Capital Transfers - Annual capital improvement projects funded by rates and reserves.

In addition, annual requirements include operating contingencies equal to 45 days of O&M (personnel and materials and services) costs. However, 100 percent of annual contingencies are assumed to be unspent and roll forward to subsequent year beginning balances.

Assumptions

Revenue requirements were projected based on data provided by the City, including actual results for FY2017/18 and FY2018/19, and budgeted expenses for FY 2019/20; future year projections are based on assumptions related to customer growth, inflation, and other factors, as well as the specific phasing of the wastewater system CIP.

The following general assumptions were used in developing the wastewater system financial plan:

- Customer growth will occur at an average rate of 0.4 percent annually.
- Operation and maintenance costs will escalate at annual rates of 2-6 percent, based on projected inflation and system growth, and historical trends. Specific escalation factors used are:
 - Salaries & Wages – 3%
 - Benefits – 6%
 - Materials and Services – 4%
 - Insurance & Utilities – 5%
- Interest earnings accrue at an annual average rate of 1.5%.
- Average annual SDC revenue = \$325,000.
- Capital costs escalate at an average annual rate of 3 percent.

Beyond the base escalation factors for salaries and benefits for existing personnel, the financial forecast includes the following additional staff positions:

- Operator II FY2020-21
- Facility Maintenance FY2022-23
- Pretreatment or Lab FY2023-24
- Operator II FY2025-26

Capital Improvement Plan

The 10-year CIP is summarized in **Table 1**. The total projected improvement costs are about \$65.8 million, including inflation. The first six years of the CIP include Water Reclamation Facility (WRF) liquids improvements, as well as a new one million gallon (mg) storage tank and mixer for solids. The final years of the plan are focused on WRF solids improvements, most notably dewatering process improvements. Ongoing improvements include collection system rehabilitation and equipment replacement.

Table 1

City of McMinnville

Wastewater Financial Plan

Summary of Capital Projects (FY2019/20 - FY2028/29)

Item	Total
Collection System	
Buildout Rehabilitation	\$ 13,993,000
3ml Ln Bridge Force Main	1,390,000
Water Reclamation Facility - Liquids	
Headworks -Grit system expansion	2,785,563
Tertiary Treatment - Filtration system expansion	4,201,875
Administration Building	3,512,492
Water Reclamation Facility - Solids	
New 1 MG Storage Tank and Mixer	5,987,219
Dewatering Process (Equipment and Building)	9,205,000
Dryer	16,100,000
Dry Biosolids Storage	1,190,000
Odor Control	410,000
Investigation and Consultant Services	
Model / master plan updates	600,000
Equipment Replacement	
Miscellaneous Treatment and Pump Stations	1,354,625
Miscellaneous Treatment and Pump Stations	5,100,000
TOTAL	\$ 65,829,774

The following key assumptions were made with respect to capital funding:

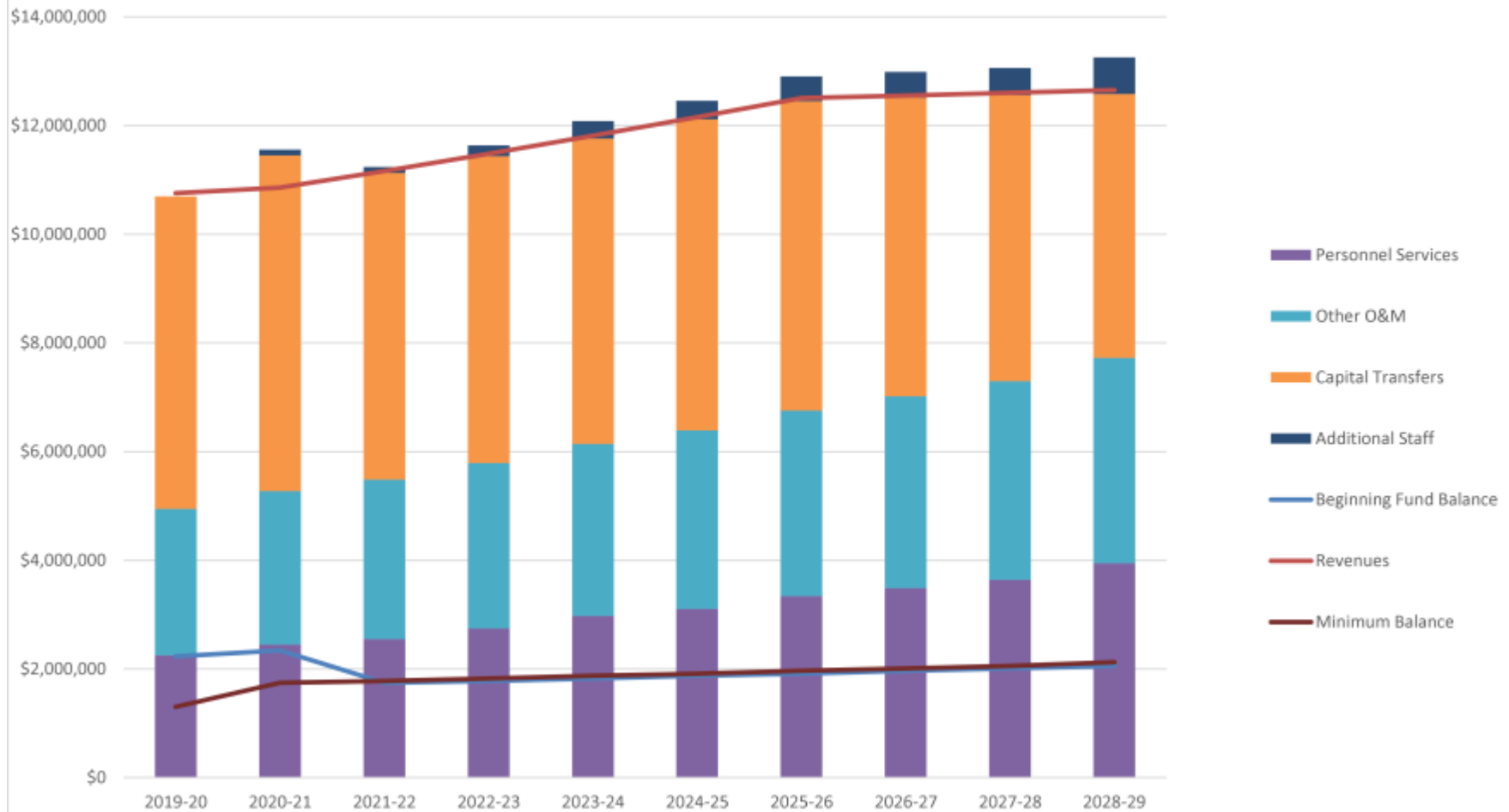
- The City will spend available system development charge (SDC) revenues on eligible capital projects, estimated to total about \$3.3 million through the study period.
- Annual revenue from rates available for capital expenditures will average about \$5.5 million (\$56 million total) over the study period.
- The remainder of CIP funding will come from interest earnings and capital reserves.

As in prior plans, the City anticipates continuing to fund the CIP on a pay-as-you-go basis, with no debt financing.

Projected Revenue and Rates

Figure 1 (next page) shows the projections of revenues, Wastewater Fund balance, and requirements from rates by major expense component, through FY2028-29.

Figure 1 - Projected Revenues, Fund Balance and Requirements from Rates



In FY2019-20, revenue from existing (July 1, 2019) rates is estimated to be about \$10.7 million. This estimate is based on the City's existing rate schedule and the current billing units (accounts and estimated billed water volumes) by customer class reported by McMinnville Water and Light's billing system. The number of accounts in the billing system for FY2019-20 is approximately 11,000. As the system grows, wastewater sales revenues at existing rates are projected to be slightly below \$11.0 million by FY2025-26, assuming continued modest customer growth and stable industrial revenue.

Rate Increases

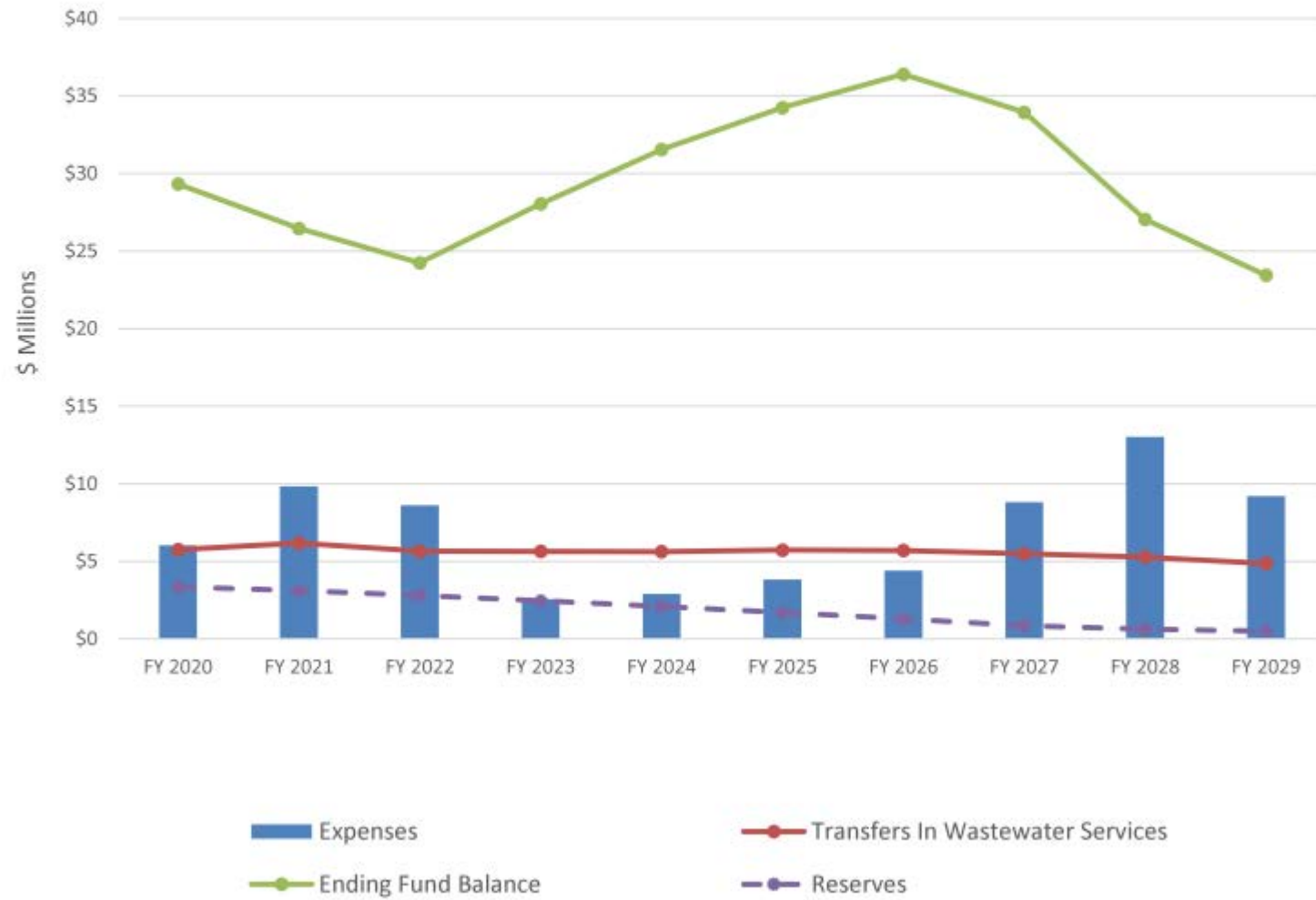
In order to fund the projected revenue requirements shown in Figure 1, and to maintain cash reserves consistent with past practices, projected annual rate increases are as follows:

- FY2020-21 – 0 percent
- FY2021-22 through FY2025-26 = 2.5 percent

Given the 7.8 percent rate increase implemented July 1, 2019 and the planned deferral of some CIP expenditures to later years of the plan, the City has flexibility to go without a rate increase in the next fiscal year (FY2020-21). However, it is recommended that inflationary-level increases resume in subsequent years to keep pace with general cost inflation, and to build extra capacity in the rates to fund the needed capital improvements that are more significant in the second half of the plan. In subsequent years, the City may be able to forego additional rate increases in one or more years again, depending on actual cost and revenue growth, and the results of the next facility plan update (anticipated within a couple of years).

Figure 2 shows projected CIP costs, reserves, and ending fund balances for the City's Capital Projects Fund. Reserves include required balances associated with the City's Public Employee Retirement System (PERS) obligations (which decrease over the planning period), as well as a minimum \$0.5 million capital reserve. Based on the projected CIP phasing and wastewater fund transfers, the Capital Projects Fund balance is projected to fluctuate throughout the plan, ending slightly (\$5 million) lower than the current level.

Figure 2 - Projected Capital Costs and Reserves



Rates

Table 2 provides the City's existing rate schedule and recommended rates for FY2020-21 (no increase) and FY2021-22 (including 2.5 percent increase). Rates are based on a fixed monthly charge (assessed per equivalent dwelling unit) and volume rate applied to billable water volumes (winter water use for all residential and some commercial customers). Industrial customers are charged based on their strength class based on wastewater sampling data.

Table 2

City of McMinnville
Wastewater System Plan
Rate Schedule

	FY 2019-20	FY 2020-21	FY2021-22
Customer Charge (\$/month)			
Residential	\$22.38	\$22.38	\$22.94
Residential Flat	\$64.86	\$64.86	\$66.48
Commercial	\$22.38	\$22.38	\$22.94
Industrial	\$22.38	\$22.38	\$22.94
Volume Charge (\$/ccf)			
Residential	\$6.07	\$6.07	\$6.22
Commercial	\$7.51	\$7.51	\$7.70
Industrial Low	\$6.24	\$6.24	\$6.39
Industrial Medium	\$7.52	\$7.52	\$7.71
Industrial High	\$9.70	\$9.70	\$9.95
Industrial Very High	\$11.42	\$11.42	\$11.71
Industrial Super High	\$14.43	\$14.43	\$14.79

Conclusions

The financial analysis is based on available information on revenue, expenditures, customer accounts, and water use as of December 2019. There will usually be differences between assumed and actual conditions because events and circumstances frequently do not occur as expected, and those differences may be significant. Among the variables that could impact future rate increases are changes in customer growth, and economic and other factors impacting water consumption patterns.

Furthermore, any changes to capital improvement funding or other key assumptions would likely necessitate changes to the recommended rate increases. Therefore, it is important that the City continue to update the financial plan every two years and revise as needed.