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**SUBJECT:** Fiscal Year 2021-22 Wastewater Rate Study Findings  
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## **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) 2019-20. Based on the prior study findings, annual rate increases of 2.5 percent were recommended for the five-year period FY 2021-22 through FY 2025-26. However, in response to affordability concerns brought on by the COVID-19 pandemic, the City has not raised rates since July 1, 2019.<sup>1</sup>

This memorandum presents the findings of the FY 2021-22 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 memorandum 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 FY 2018-19 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 (FY 2021-22 through FY 2030-31, 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.

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<sup>1</sup> City of McMinnville Resolution 2019-08.

- Capital Transfers - Annual capital improvement projects funded by rates and reserves.

In addition, annual requirements include operating contingencies equal to 120 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 expenses for FY 2019-20 and FY 2020-21, and budgeted expenses for FY 2021-22. 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 3-6 percent, based on projected inflation, system growth, and historical trends. Specific escalation factors used are:
  - Salaries & Wages - 5.5% (FY 2022-23); 4% in subsequent years
  - Benefits - 6%
  - Materials and Services - 4%
  - Insurance & Utilities - 5%
- Interest earnings accrue at an average annual rate of 1.0%.
- Average annual SDC revenue = \$325,000.
- Capital costs escalate at an average annual rate of 4%.

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

- Pretreatment or lab FY 2021-22
- Operator II FY 2022-23
- Facility maintenance FY 2024-25
- Pretreatment or lab FY 2025-26
- Operator II FY 2027-28

## **Operation and Maintenance Costs**

Table 1 shows actual O&M costs for the wastewater system for FY 2019-20 and FY 2020-21, as well as estimated costs for the budget year (FY 2021-22).

**Table 1**

Wastewater Financial Plan  
*Operations and Maintenance Costs*

Item	Actual	Actual	Budget
	2019-20	2020-21	2021-22
Personnel Services	\$2,044,366	\$2,192,813	\$2,311,191
Material & Services	1,394,563	1,437,388	1,709,264
Other Expenditures			
Franchise Fees	541,666	522,027	524,835
Transfers (General Fund)	378,648	405,363	415,573
Capital Outlay	168,100	60,643	127,826
<b>Total O&amp;M Costs</b>	<b>\$4,527,343</b>	<b>\$4,618,234</b>	<b>\$5,088,689</b>

Projections of O&M costs are shown in Attachment 1 and include general cost escalation discussed previously.

## Capital Improvement Plan

The 10-year CIP is summarized in **Table 2**. The total projected improvement costs are about \$75.0 million, including inflation. The first half of the plan includes about two-thirds of the anticipated spending driven by the administration building improvements, next generation autothermal thermophilic aerobic digestion (ATAD), and ongoing system rehabilitation. The City plans to update the wastewater facility plan over the next couple of years which is likely to result in identification of improvements at the end of the planning period. The current CIP includes potential expenditures of \$10-\$15 million in FY 2030-31 pending completion of the updated plan.

**Table 2**

Wastewater Financial Plan  
*Summary of Capital Projects (FY2019/20 - FY2028/29)*

Item	Total
<b>Collection System</b>	
Buildout Rehabilitation	\$13,727,659
3ml Ln Bridge Force Main	75,000
<b>WRF - Liquids</b>	
Administration Building <sup>1</sup>	12,984,192
Pre-Screening Structure/ Diversion Structure	3,442,084
<b>WRF - Solids</b>	
Next Generation ATAD	21,078,656
Dewatering Process (Equipment and Building)	1,423,312
Odor Control	540,800
Facility Plan Projects (TBD)	14,233,118
<b>Investigation and Consultant Services</b>	
Model / master plan updates	1,452,400
<b>Equipment Replacement</b>	
Miscellaneous Treatment and Pump Stations	6,179,625
<b>TOTAL</b>	<b>\$75,136,845</b>

<sup>1</sup>Total estimated costs (includes some funding from other city funds).

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 \$5.6 million (\$56 million total) over the study period.
- A portion of the administrative building will be funded by other City departments through a loan from the wastewater fund.
- The remainder of CIP funding will come from interest earnings and capital reserves (which as of July 1, 2021, were about \$36.1 million).

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 shows the projections of revenues and requirements from rates by major expense component for the current year and first five years of the financial forecast. Projected ending fund balances for the wastewater fund (Fund 75) are also shown.

In FY 2021-22, revenue from existing rates is estimated to be about \$10.5 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 FY 2021-22 is approximately 11,300. As the system grows, wastewater sales revenues at existing rates are projected to be slightly above \$11.0 million by FY 2025-26, assuming continued modest customer growth and stable industrial revenue.<sup>2</sup>

### **Rate Increases**

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

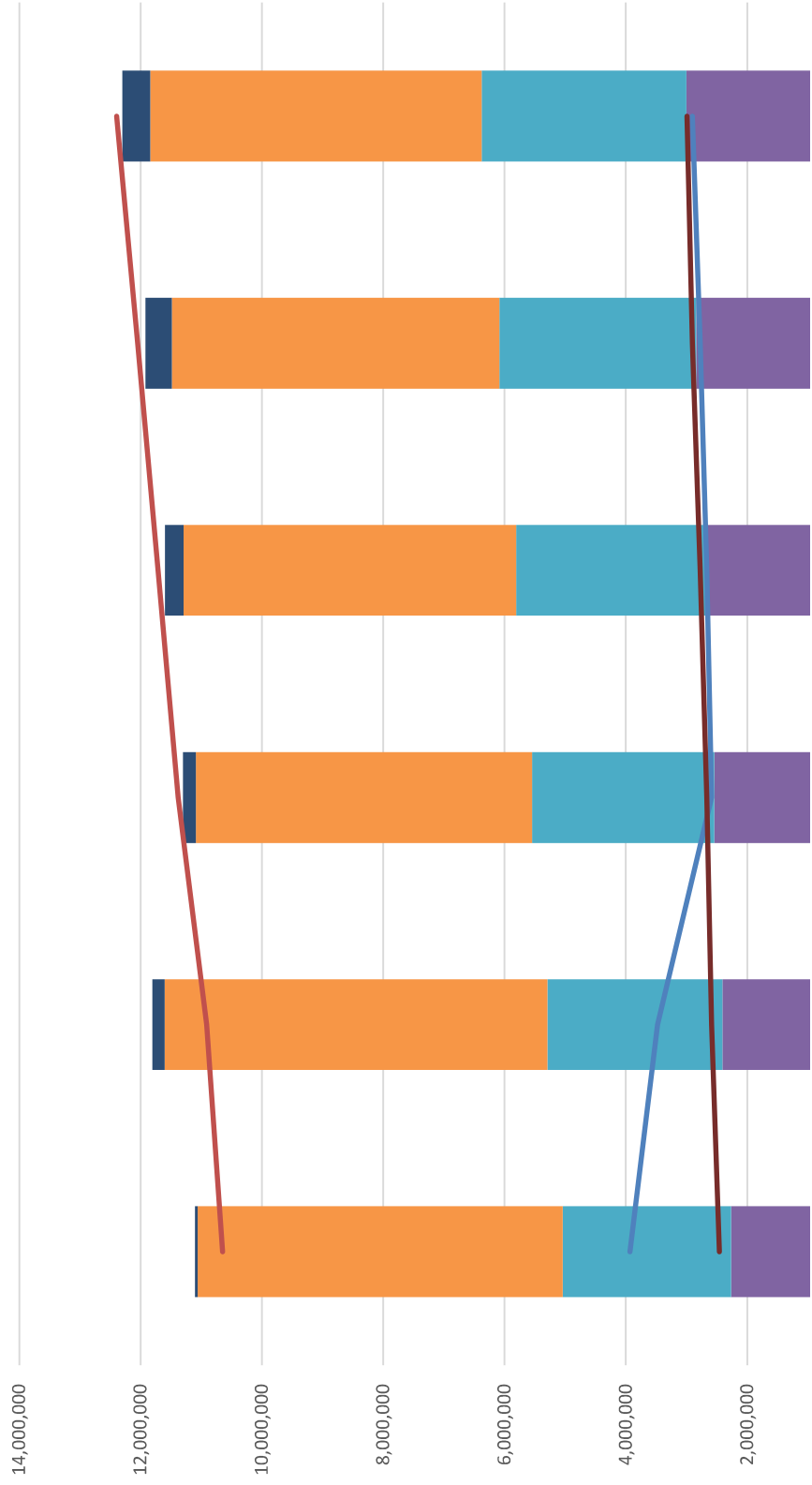
- FY 2021-22 and FY 2022-23: no rate increases
- Beginning July 1, 2023 (FY 2023-24) and annually thereafter: 2.5 percent rate increases

The current analysis indicates that the City has flexibility to continue without a rate increase through FY 2022-23, due to both: (1) higher than projected water sales and customer growth, and (2) an overall reduction in projected capital and O&M expenses, compared to the prior plan. Updated expenses are projected to be about \$17 million lower over the FY 2020-21 to FY 2028-29 period (the common years of the two plans). In the short-run O&M "savings" resulted from deferred increases in staffing positions and reduced routine capital and vehicle replacements. More significantly, while the current CIP is higher in the first five years, it is about \$13 million lower overall compared to the prior plan.

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<sup>2</sup> The financial plan considers a reduction in production at one of the City's largest industrial customers (Organic Valley) in FY 2021-22; however, wastewater flows are assumed to return to return to pre-2022 levels by FY 2023-24.

Figure 1 -- Forecast Rate Revenue, Requirements and Wastewater Fund Balances

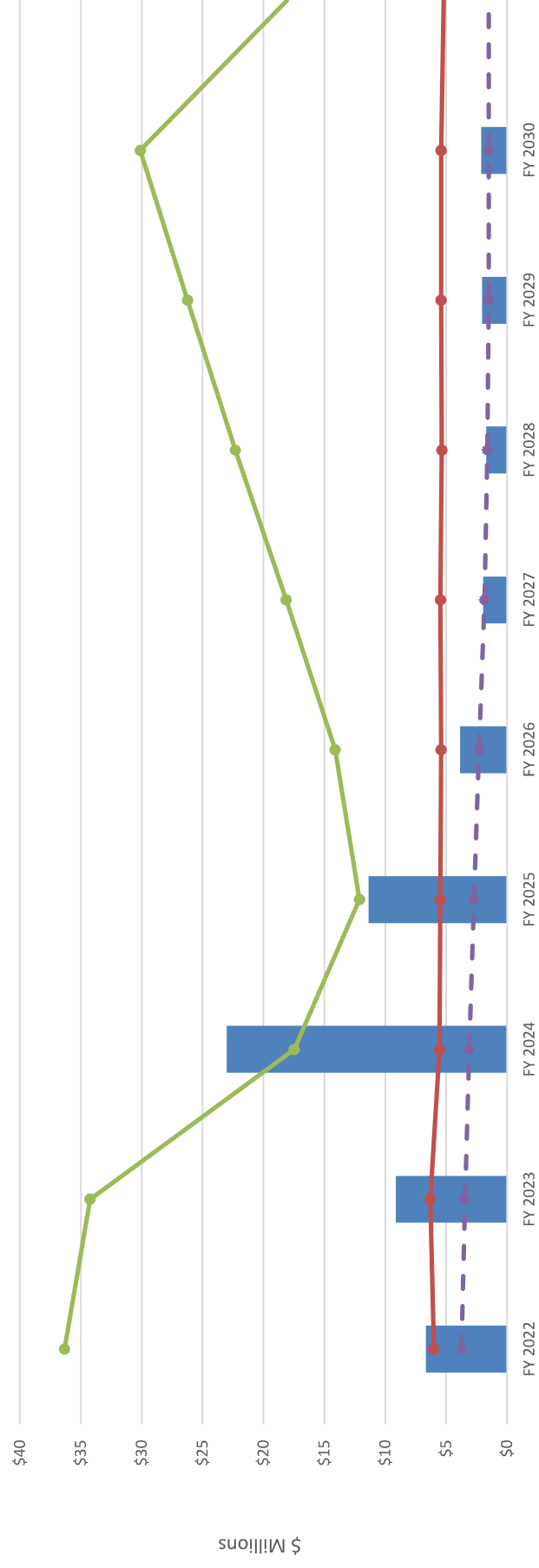


It is recommended that annual inflationary-level increases resume in FY 2023-24 years to keep pace with general cost inflation, and to maintain capacity in the rates to fund future capital improvements. Future rate increases should be further evaluated in the context of continued expense and revenue growth, and the results of the upcoming facility plan update.

**Figure 2** shows projected CIP costs, designated reserves, and ending fund balances for the City's capital projects fund (Fund 77) over the planning period. 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 \$1.5 million capital contingency.

Based on the projected CIP phasing and wastewater fund transfers, the capital projects fund balance is projected to fluctuate significantly throughout the plan. While the projected fund balance at the end of the plan is \$20 million lower than current levels, it is within the range historically maintained by the City, and at a level sufficient to provide flexibility for cash funding large capital projects. However, rate increases and capital reserve targets should be considered further following refinement of the administrative building cost estimate and funding contributions from other City departments, and completion of the wastewater facilities plan update which will result in an updated long-term CIP.

Figure 2 - Projected Capital Costs and Reserves



## Rates

**Table 2** provides the City's existing rate schedule and recommended rates for FY 2022-23 (no increase) and FY 2023-24 (including a 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 which is determined for each customer from wastewater sampling data.

**Table 2**  
City of McMinnville  
Wastewater System Plan  
Rate Schedule

	FY 2021-22	FY 2022-23	FY2023-24
<b>Customer Charge (\$/month)</b>			
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
<b>Volume Charge (\$/ccf)</b>			
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 2021. 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.