

**CITY OF SAN ANTONIO
INTERDEPARTMENTAL CORRESPONDENCE
CITY MANAGER'S OFFICE**

TO: Mayor & City Council
FROM: Ben Gorzell, Chief Financial Officer
COPIES: Troy Elliott, Deputy Chief Financial Officer, Finance; Rogelio Pena, Assistant City Attorney
SUBJECT: Report on Proposed Adjustments to SAWS Rates
DATE: November 9, 2016

SUMMARY & RECOMMENDATIONS:

On November 19, 2015, City Council approved a 2016 Rate Plan for the San Antonio Water System (SAWS). The plan provided for pre-approved rate increase caps in the total bill of 7.5% for 2016 and 7.9% for 2017. These rate adjustment percentages are based on the impact to the average residential customer bill. SAWS is proposing a 6.8% increase for 2017, below what has already been approved. The SAWS Board is scheduled to vote to approve the 2017 Budget and the proposed rate adjustment of 6.8% on December 13th.

Based upon the Ordinance approved on November 19, 2015, establishing the not-to-exceed rate increase amount, no City Council action is required. City Staff conducted a comprehensive review and has determined that the proposed rate adjustment of 6.8% is reasonable and recommends the following considerations:

- ⇒ SAWS should closely monitor the progress associated with the Vista Ridge Project and the integration pipeline construction;
- ⇒ SAWS should continue to conduct outreach in an effort to provide additional assistance to customers receiving the affordability discount whose water usage is in residential blocks four through eight;
- ⇒ SAWS should continue to monitor customer assistance programs in relation to rate increases implemented in the future and should continue to expand program outreach;
- ⇒ SAWS should continue to monitor key customer service metrics and continue to focus on making improvements to its customer service business processes to include potential technology enhancements;
- ⇒ SAWS should continue to evaluate and focus on reducing water loss within its system;
- ⇒ SAWS should continue to provide quarterly written progress reports relating to its Sanitary Sewer Overflow (SSO) program which outlines performance of the program to include operational statistics such as miles of lines cleaned and televised and financial information; and,
- ⇒ SAWS should resume briefings to City Council or the Transportation, Technology, and Utilities Committee every other month; agenda to be managed by the City and should be focused on financial performance and key policy issues such as water supply projects to include Vista Ridge and Desalination, SSO Program, customer service improvements, drought management plan, and conservation initiatives.

BACKGROUND:

The Public Utilities Staff (“Staff”) of the Finance Department conducted a comprehensive review of the proposed rate adjustment for 2017 and the proposed rate plan for 2017 through 2021. Staff was involved in the process as SAWS was developing its revenue requirements and rate models for the 2017 Budget and updated 5-Year Plan. The review included areas such as the Economic/Rate Model; Key Financial Targets; Revenue Requirements; Proposed Capital Plan; Operations and Maintenance Budget; Financing Plan; Affordability Programs; Credit Considerations and others. The following sections offer a more detailed description of the analysis.

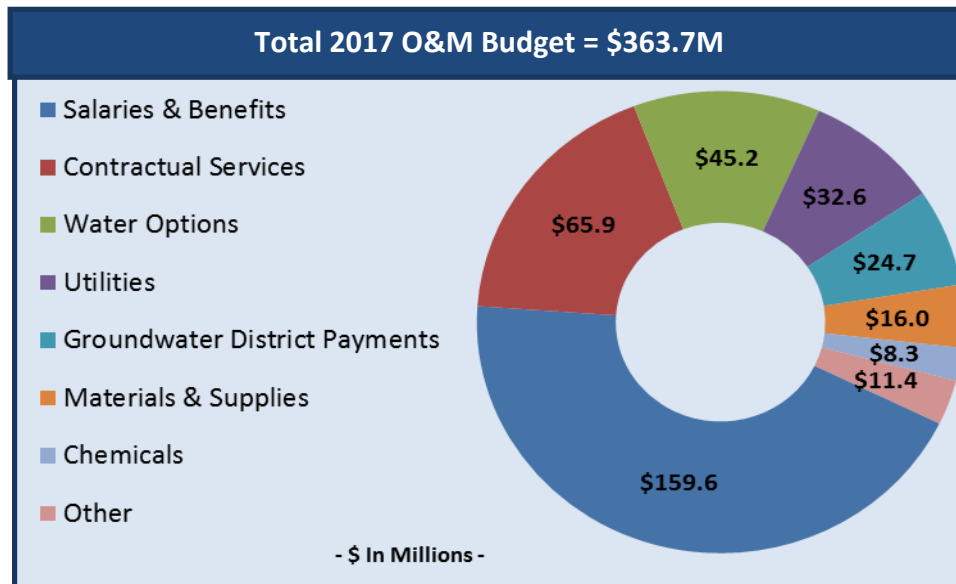
Proposed Rate Adjustments

On November 19, 2015, City Council approved an Ordinance authorizing adjustments to SAWS rates and an updated rate structure as a result of a comprehensive cost of service study. The Ordinance approved system-wide rate adjustments which resulted in a 7.5% rate increase for the average residential customer that took effect on January 1, 2016. In addition, the Ordinance approved a Rate Plan going forward that included a system-wide increase in rates not-to-exceed 7.9% for the average residential customer to be effective January 1, 2017, as well as additional adjustments to the water supply fee rates through 2020. SAWS is proposing a system-wide rate increase of 6.8% for the average residential customer, with no structural changes, to be effective January 1, 2017. This proposed adjustment is 1.1% below the not-to-exceed amount of 7.9%. SAWS will bring any future rate increases for Water Delivery and Wastewater to City Council for approval prior to implementation. In addition, the Ordinance approved in 2015 authorized certain special services fees to be increased by the annual adjustment in the Consumer Price Index (CPI) going forward, the proposed budget assumes a 0.88% annual CPI adjustment to those SAWS special services fees.

The 2016 Plan also provided for rate increase caps, solely for the Water Supply core business, for 2018 through 2020. This was done to support financial closure for the Vista Ridge Project.

Operations & Maintenance (O&M) Budget

The total O&M budget is \$363.7 million for 2017. After capitalization of \$38.9 million in costs that support and will be charged to the capital budget, the proposed O&M budget is \$324.8 million. This represents an \$11.2 million or 3.6% increase from last fiscal year’s budget of \$313.7 million. The following graphic reflects the major categories of the O&M Budget before capitalization.



The following are highlights from the review of the proposed O&M Budget for 2017:

- ⇒ Of the total O&M Budget, \$159.6 million, or 44% is for salaries and benefits;
- ⇒ Another \$192.7 million, or 53% is in major categories to include contractual professional services, electric utility charges, water options, groundwater district payments, maintenance and materials, and chemicals;
- ⇒ Remaining \$11.4 million, or 3%, is comprised of the various remaining line items such as fuel and lubricants, software and hardware maintenance, legal services, communications equipment, small tools and others;
- ⇒ Includes the addition of 42 positions (39 Full-Time Equivalent positions or FTEs), the majority of which are being added to continue to improve SAWS levels of customer service, and of which the funding for 19 of these positions is being redirected from other resources within the O&M budget;
- ⇒ Compensation increases for 2017 are reflected in performance pay which is based on a budget pool of 4.0% of salaries; and includes the implementation of a \$14 living wage; and,
- ⇒ Includes costs to support benefits programs to include active healthcare, retiree healthcare and pension benefits; SAWS has implemented a number of changes to manage benefit costs; Examples include additional cost sharing with retirees, increased deductibles and out-of-pocket maximums, the implementation of a Spousal Surcharge of \$100/month for spouses who elect SAWS health coverage but have other access to coverage, and the conversion of a PPO Plus Plan to an EPO Plus Plan deleting out-of-network coverage.

Capital Improvements Plan

Capital requirements are a significant driver in the development of rates as funding is derived from the issuance of additional debt and equity contributions, both of which impact cash flows on an annual basis. Equity contributions include both cash funding from the Renewal and Replacement Fund and impact fees. Staff's review of the capital plan focused on the first 5 years (FY2017 through FY2021). SAWS' five year capital plan is projected at \$1.64 billion and includes \$216.8 million for Water Resource development, \$924.8 million for Wastewater projects, and \$488.5 million for Water Delivery projects. For 2017, the capital budget of \$367.5 million is being driven primarily by Wastewater projects related to the Consent Decree as discussed in more detail below and the Vista Ridge integration pipeline. Further details are provided as follows:

- ⇒ \$178.8 million in Wastewater projects with 72.9% of this amount going towards mains replacement, 11.3% for governmental projects, 6.3% for collection facilities, 3.6% for treatment facilities and 5.9% for other projects;
- ⇒ \$75.1 million in Water Delivery projects with 34.5% of this for governmental projects, 29.2% for production facilities, 15.5% for main replacements, 12.5% going towards new mains, and 8.3% for other projects; and,
- ⇒ \$113.5 million in Water Supply & Recycled Water projects with 98.5% of this amount being dedicated to the Vista Ridge Integration Project, 1.2% for the Regional Carrizo Water Supply Project, and 0.3% for Recycled Water and other projects.

Sanitary Sewer Overflow Reduction Program (SSORP)

In 2013, SAWS entered into a Consent Decree under which it agreed to implement and perform several programs and initiatives over a ten year period from 2013 to 2023 to reduce the number of Sanitary Sewer Overflows (SSOs). Over this ten year period, the projected cost is estimated to be \$1.092 billion comprised of \$252 million in operating costs and \$840 million in capital costs.

From 2013 to July of 2016, SAWS has expended \$118.3 million in operating costs and has committed \$247.6 million in capital projects in the SSORP. Operating costs are higher in the earlier years of the program due to efforts such as line cleaning, televising of lines, and inspections. Capital investment will become larger as SAWS proceeds through the ten year program with the start of this increased investment level beginning in 2017. SAWS submits quarterly reports to the City documenting its efforts under the SSORP, tracking progress, and measuring results of the program. SAWS must also submit a report to the Environmental Protection Agency (EPA) annually. SAWS' website – <http://www.saws.org/infrastructure/epa/download.cfm> contains reports relating to this program. Based upon the quarterly reports, SAWS is on track with the SSORP goals for the various programs, however, due to the significant rainfall in 2015 and early 2016, the trend for SSOs will be higher as compared to 2014.

Non-Revenue Water

Non-revenue Water is water that SAWS produces but receives no revenue for. Non-revenue water consists of three components: authorized water loss – firefighting and line flushing; apparent water loss – erroneous meter reads or faulty meters; and, real water loss – physical loss of water from the distribution system, including leaks in pipes and valves, theft, line breaks and customer service adjustments. Real water loss within a utilities distribution system remains a challenge for most water utilities. SAWS has a water distribution system made up of almost 7,000 miles of distribution mains, pumps, and storage tanks. Non-revenue water made up 16.8% (38,829 Acre Feet or AF) of all water produced by SAWS in 2015. Of this amount; it is estimated that 1.6% (3,698 AF) was authorized water loss, 2.6% (6,009 AF) was apparent water loss, and 12.6% (29,122 AF) was real water loss.

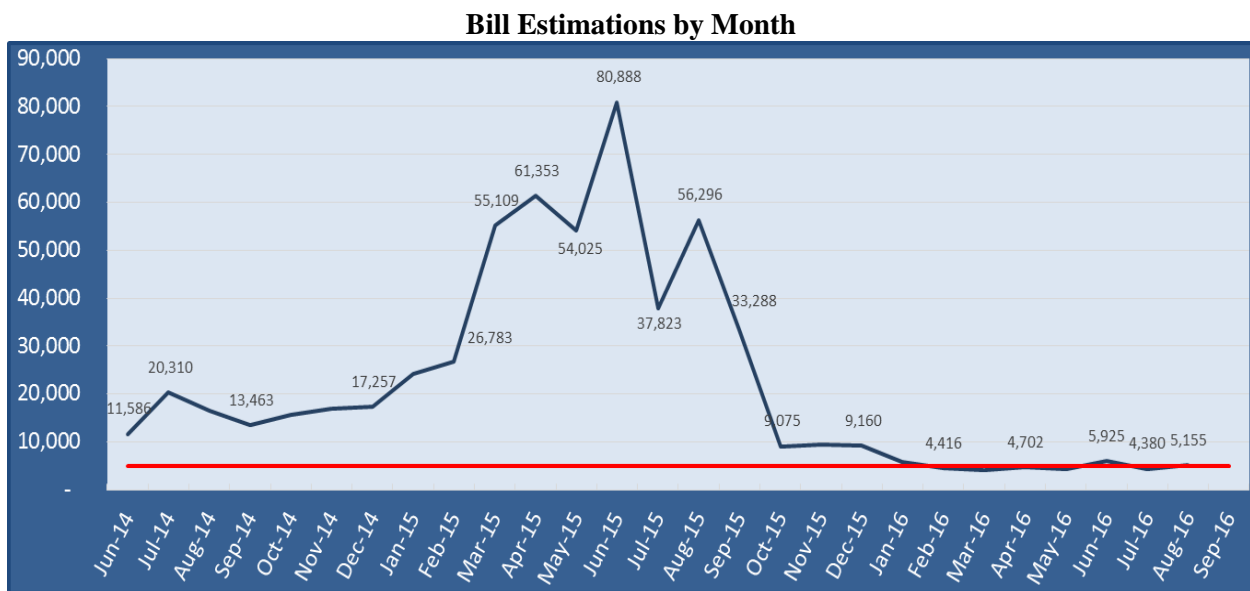
Over the past several years, SAWS has made changes to begin to address the issue of real water loss. It has installed meters at its production facilities to more accurately account for the water that is produced and has also been replacing older or low performing customer meters to get a more accurate accounting of water used by customers. In 2016, SAWS added new positions for a leak detection and repair crew to also focus on reducing the real water loss.

In 2017, SAWS is proposing to spend \$14 million dollars to address the issue of non-revenue water. Of this total amount \$6.1 million will be for point leak repairs, \$4.5 million will be used for outside contract work for other leak repairs, \$2.0 million will be for meter replacements, \$1.2 million will be for leak detection and valve replacements, and \$0.2 million will be for water systems optimization. Recently, SAWS began utilizing new technologies to better determine the location of leaks in order to isolate repairs and save costs. Examples of these new technologies include: the “Smart Ball” inline leak

detection system that will roll through a pipe listening for sounds and detecting leaks within 6 inches of the actual location; in-line acoustic leak and gas pocket detection using tethered and untethered tools; structural pipe wall inspections using electromagnetic technologies to identify areas of corrosion; robotic platforms; and others.

Customer Service Improvements

In 2015, SAWS experienced issues with some customers receiving high water bills as a result of meter estimations. On October 1, 2015, SAWS briefed City Council on the issues that contributed to these high bills and SAWS’ proposed an action plan to address billing errors. SAWS took steps to address these issues such as increased staffing support, meeting with community groups, creating a dedicated phone line and an e-mail address for reporting concerns, and “Rapid Response” sessions. The graph below depicts meter estimation progress as SAWS moves toward a goal of 99% of all meters read, as illustrated by the red line, the blue line represents the actual monthly bill estimations. The industry standard for meter reads is 95% of meters read, while best-in-class is 98% to 99%.



The proposed budget continues to include additional initiatives designed to improve the customer service function in the two main areas: meter reading and customer call answer times. SAWS is focusing on key metrics to gauge progress in these areas. For meter reading, SAWS will be targeting a goal of 99% of all meters read as illustrated above. For customer call times, SAWS will be targeting a service level goal of having 70% of all calls answered within 45 seconds. SAWS has not yet achieved that level, but progress is being made. In order to address these issues the proposed FY17 budget provides for the funding of an additional 36 positions (33 FTEs) in the following departments: Call Center – 13; Reading Review – 6; Billing/Account Review – 6; Quality Assurance – 4; and, Meter Reading – 7. In addition, the 2017 Budget provides for \$400,000 in funding to support additional contractual services for Advanced Metering Infrastructure consultant and a Customer Interaction System, and \$339 thousand in funding for temporary employees to work in the Call Center during peak times.

Economic/Rate Model

SAWS uses a comprehensive Cash Flow Model (“Model”) to develop financial forecasts of revenues, operations and maintenance expense, capital expenditures, capital financing including cash and debt financing, and rate requirements. The Model incorporates 20-year financial forecasts and requirements by each core business unit – Water Delivery, Wastewater, Water Supply, and Chilled Water.

The structure of the Model, which includes the calculation of the flow of funds and rate adjustment requirements, is based on the enabling Ordinance of SAWS. In addition to requirements under the Ordinance, SAWS leadership team has developed key financial targets and policies that are designed to assist SAWS in maintaining a strong financial position, attaining its long-term financial goals, meeting the capital and maintenance requirements of the four core business units, and maintaining a strong credit rating. Credit ratings are an important factor due to the level of projected capital funding required and the impact on the overall cost of borrowing.

The model fully integrates the District Special Project (DSP), the former Bexar Met, in order to meet the requirements of state law on January 1, 2017; where the DSP and SAWS System’s will be fully consolidated and will achieve rate parity.

The analysis of the rate model indicates that the current rate request will maintain or slightly improve key SAWS financial measures during the next several years. With the large capital program SAWS has planned over the next several years, strong financial measures will be essential to ensure the lowest possible financing costs along with adequate debt capacity. The proposed rate model also plans for all obligations in the flow of funds (outlined in SAWS bond ordinances) to be met as required. The model includes conservative assumptions that should allow SAWS actual rate requirements for 2018 to 2021 to be less than those included in the updated “2017 Rate Plan”. Some of the key conservative assumptions include variables such as:

- ⇒ Assumes no sale of water from the Vista Ridge Project to third parties;
- ⇒ Issuance of all debt utilized to fund the Capital Improvement Program at the Senior Lien level and the related debt service fund requirements;
- ⇒ Issuance of debt occurs on January 1 of each year; and,
- ⇒ Assumes no savings from future debt re-financings.

Customer Bill Impact

The rate adjustments as proposed by SAWS will have a combined effect of an overall increase of 6.8% in system-wide revenues for Wastewater, Water Delivery and Water Supply Fee rates. If the proposed budget and rate increase is approved by SAWS Board, the average residential customer using 7,092 gallons would pay \$59.44 per month, an increase of \$3.79 per month from the existing rate structure. The proposed increase would become effective January 1, 2017. For examples of the impact of the proposed rate increases on the residential and general class customers at various usages, please see Appendix A. As noted above DSP customers will now be fully integrated into the SAWS rate structure. As such, most former DSP residential customers’ water rates will increase for the first time since 2010 with the average increase exceeding the 6.8% average of other SAWS residential customers. All former DSP commercial class customers will see a decrease in rates for usage other than irrigation.

Affordability Program Update

The Affordability Discount Program (ADP) is projected to increase by 26% from \$2.7 million to \$3.4 million in 2017. The ADP is a discount taken off each monthly bill and it is available for those customers who have income at or below 125% of Federal Poverty guidelines. Attachment B summarizes the yearly changes in the sliding scale from 2016 to 2017.

For those SAWS customers receiving an ADP discount, staff reviewed where their usage would fall within the new proposed eight block water rate structure. Based upon this review, approximately 42% would fall in blocks 4 through 8. Staff recommends that SAWS perform additional outreach to these customers to assist in determining why usage is in the upper blocks and, if possible, assist in lowering their usage into the lower blocks. If needed, SAWS should also consider providing additional assistance to ADP customers in the upper blocks if usage cannot be lowered given that SAWS tiered rate structure results in more significant cost increases to customers in the upper blocks.

The ADP is in addition to the following programs which provide assistance to qualified customers who need help paying their SAWS bill: Project Agua – Payment Assistance, Senior Citizen Billing Program and the Disability Billing program. SAWS total budget for all affordability programs is projected to increase by 30% from \$3.0 million to \$3.9 million in 2017.

FISCAL IMPACT:

The City receives 2.7% of gross revenues from SAWS. If the new rates become effective January 1, 2017, additional revenue of approximately \$784,500 will be generated for the nine months in FY2017. On an annual basis, City payment would increase by approximately \$1,046,000.

The City's utility expenses would also increase for the remainder of the current fiscal year in the amount of approximately \$199,700. On an annual basis, the City's utility expenses will increase by approximately \$268,650 beginning in FY2017. The net impact to the City will be \$584,500 in FY2017 and \$777,350 on an annual basis.

Appendix A: Monthly Bill Impact Residential and General Class

Monthly Bill Impact Residential Class

Gallons in Block	Water Usage (Gallons)*	Existing Rates (2016)	Proposed Rates (2016)	% Change
1	1,500	\$ 23.15	\$ 24.75	6.9%
2	3,000	\$ 31.51	\$ 33.68	6.9%
3	5,000	\$ 45.07	\$ 48.12	6.8%
4	7,092	\$ 55.65	\$ 59.44	6.8%
5	8,500	\$ 62.27	\$ 66.56	6.9%
6	11,000	\$ 74.93	\$ 80.21	7.0%
7	16,000	\$ 104.44	\$ 111.96	7.2%
8	22,000	\$ 150.67	\$ 161.69	7.3%

- Includes Water Delivery, Water Supply Fee and Wastewater for ICL rates (Inside City Limits) – does not include EAA & TCEQ pass-through fees
- Amount of sewage usage equals water usage in blocks 1-3; Blocks 4-8 have a sewer usage of the projected Average Winter Consumption of 5,668 gallons

Monthly Bill Impact General Class

	% of Base	Gallons	Existing Rates (2016)	Proposed Rates (2016)	% Change
50,000 gallons 1" meter	100%	50,000	\$ 372.40	\$ 397.40	6.7%
	125%	62,500	\$ 462.38	\$ 493.39	6.7%
	175%	87,500	\$ 670.31	\$ 715.48	6.7%
200,000 gallons 2" meter	100%	200,000	\$ 1,449.78	\$ 1,546.77	6.7%
	125%	250,000	\$ 1,809.68	\$ 1,930.72	6.7%
	175%	350,000	\$ 2,641.38	\$ 2,819.02	6.7%
500,000 gallons 4" meter	100%	500,000	\$ 3,694.71	\$ 3,942.52	6.7%
	125%	625,000	\$ 4,594.46	\$ 4,902.39	6.7%
	175%	875,000	\$ 6,673.71	\$ 7,123.14	6.7%

- Includes Water Delivery, Water Supply Fee and Wastewater for ICL rates – does not include EAA & TCEQ pass-through fees

Appendix B: Affordability Scale

	Income at or below 50% of Poverty	Income at or below 75% of Poverty	Income at or below 100% of Poverty	Income at or below 125% of Poverty
Water & Sewer				
2016 Discount	\$ 18.00	\$ 12.60	\$ 8.25	\$ 6.55
2017 Increase	\$ 3.40	\$ 1.70	\$ 0.55	\$ 0.44
2017 Discount	\$ 21.40	\$ 14.30	\$ 8.80	\$ 6.99
Water Only				
2016 Discount	\$ 8.00	\$ 5.61	\$ 4.00	\$ 3.73
2017 Increase	\$ 1.32	\$ 0.65	\$ 0.32	\$ -
2017 Discount	\$ 9.32	\$ 6.26	\$ 4.32	\$ 3.73
Sewer Only				
2016 Discount	\$ 10.00	\$ 7.00	\$ 4.25	\$ 3.63
2017 Increase	\$ 2.08	\$ 1.04	\$ 0.24	\$ -
2017 Discount	\$ 12.08	\$ 8.04	\$ 4.49	\$ 3.63