

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

TO: Erik Walsh, City Manager
FROM: Ben Gorzell, Chief Financial Officer
COPIES: Mayor and City Council; Troy Elliott, Deputy Chief Financial Officer, Finance;
Rogelio Pena, Assistant City Attorney
SUBJECT: Pre-approved SAWS Rate Adjustments for 2020
DATE: October 31, 2019

EXECUTIVE SUMMARY

On November 19, 2015, City Council approved rate adjustments for the San Antonio Water System (SAWS) that included adjustments to water delivery, wastewater and the water supply core business units for 2016 and pre-approved rate caps for 2017. In addition, City Council approved a rate plan (rate caps) for 2018 through 2020 solely for the water supply core business which were necessary to support “financial closure” on the Vista Ridge Project. Table I below reflects the approved rate plan. The rate adjustment percentages are based on the impact to the average residential customer (assumes a monthly consumption of 7,092 gallons of water and 5,668 gallons of wastewater).

Table I

SAWS 2015 Rate Plan - With Pre-Approvals for 2017 and WS for 2018-2020					
	2016	2017	2018	2019	2020
	Actual	Plan	Plan	Plan	Plan
Water Supply Fee	1.8%	3.2%	1.3%	4.5%	9.9%
Water Delivery & Wastewater	5.7%	4.7%	4.9%	4.2%	3.8%
Total	7.5%	7.9%	6.2%	8.7%	13.7%
Pre-Approval					

The pre-approved rates as outlined in Table I above were subject to a review by the Public Utilities Office. If the Public Utilities Office agrees with SAWS’ request and the request does not exceed the pre-approved rate caps, the rates will go into effect automatically on January 1st of each respective calendar year without further City Council action. While no further City Council action will be required, if the rate adjustment in any respective calendar year is within the pre-approved amounts, representatives of SAWS and City staff will brief the City Council prior to the implementation of any such rate adjustment. Since 2015, SAWS has implemented rates at or below the rate plan and has not exceeded the pre-approved caps in any year.

Table II below reflects the actual implemented rate adjustments as compared to the pre-approved rate plan and the proposed adjustment for 2020. The rate plan was developed with the assumption that SAWS would take the maximum pre-approved Water Supply Fee change each year, in other words, it recognized the cumulative effect of rates compounding each year. It also

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was developed based on conditions known in 2015 and the project and costs have evolved over time. As reflected in the table, SAWS implemented an actual rate lower than the pre-approved rates under each year of the plan. Additionally, if the cumulative impact of the rate plan was applied, the 2020 adjustment could have been 15.9% rather than 9.9% assuming underlying Vista Ridge costs would support the increase.

Table II

SAWS 2015 Water Supply Fee (WSF) Rate Plan Compared to Actuals					
	2016	2017	2018	2019	2020
2015 Plan - WSF	1.8%	3.2%	1.3%	4.5%	9.9%
Actuals w/ 2020 Proposed - WSF	1.8%	1.3%	0.9%	0.8%	9.9%
WSF Results % Reduction	0.0%	-1.9%	-0.4%	-3.7%	0.0%
<i>Pre-Approval</i>					

The table below reflects the cumulative bill impact to the average residential customer over the pre-approved rate plan period from 2016 through the proposed 2020 adjustment. The actual bill from 2016 of \$55.65 would increase to a proposed \$72.38. This is \$6.40 less than the pre-approved rate plan, an 11.5% reduction.

Table III

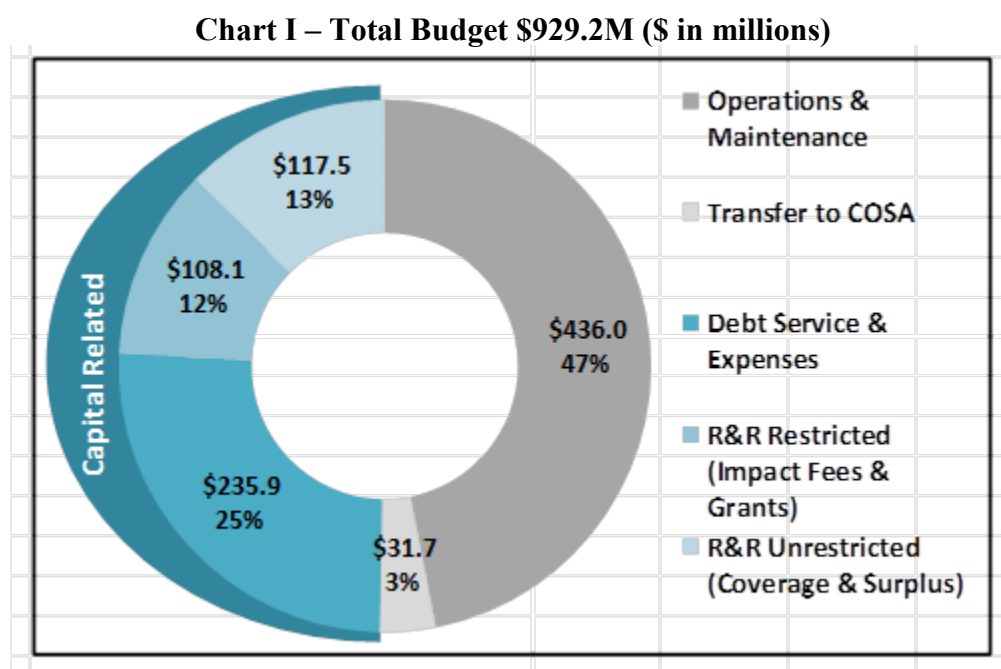
SAWS 2015 Rate Plan Compared to Actuals - Cumulative Bill Impact					
	2016	2020	\$ Change	% Change	
2015 Rate Plan	\$ 55.65	\$ 78.78	\$ 23.13	41.6%	
Actuals/2020 Proposed	\$ 55.65	\$ 72.38	\$ 16.73	30.1%	
Savings		\$ 6.40		11.5%	

On November 5, 2019, the SAWS Board will consider approval of the 2020 SAWS Budget and associated water supply fee rate adjustment which will result in rates less than the maximum water supply fee rates pre-approved in 2015 by the City Council for 2020.

There are no proposed changes to the water delivery or wastewater rates for 2020. The rate adjustment for the water supply fee when applied in conjunction with water delivery and wastewater rates generates an increase of 9.9% to the total bill for the average SAWS residential customer. As a result of the water supply fee rate change, a 19.2% rate adjustment is proposed for recycled water service, which is consistent with SAWS policy to change recycled water rates based on the average impact of water delivery and water supply rate adjustments on the average residential customer for potable water service.

Staff Review and Rate Drivers

The Public Utilities Division of the Finance Department (“City Staff”) conducted a review of the proposed rate adjustments for 2020. The review focused on the capital improvements plan, operations and maintenance (O&M) expenses, the multi-year financial plan model, affordability and other items. The driver for the rate adjustment in 2020 is the Vista Ridge water supply project, which is on schedule to start delivery of 50,000 acre-feet (AF) annually by April 2020. The chart below illustrates SAWS FY 2020 Total Budget by major category.



Operations & Maintenance Expenses

As illustrated in Table IV below, SAWS projected O&M expenses for 2020 are \$436 million (after capitalization), up \$85.6 million or 24.4% over the 2019 expenses. This is almost entirely driven by the Vista Ridge water coming online in April of 2020, representing a projected increased expense of \$80.7 million which is included in the contractual services line item. This will grow to a projected \$106.8 million for a full 12-month period. Non-Vista Ridge O&M expenses only increase by a projected \$4.9 million or 1.4%.

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Table IV

SAWS Operations and Maintenance Expenses				
O&M Category (\$ in thousands)	2017 Actual	2018 Actual	2019 Budget	2020 Budget
O&M Before Capitalized Cost				
Salaries & Fringe Benefits	\$ 149,874	\$ 157,374	\$ 162,683	\$ 167,672
Contractual Services	168,350	171,032	181,764	262,857
Materials and Supplies	23,159	23,485	23,779	24,974
Other Charges	9,156	9,956	11,624	11,979
O&M Before Capitalized Cost Total	\$ 350,539	\$ 361,847	\$ 379,850	\$ 467,482
Capitalized Cost	(32,219)	(31,612)	(29,403)	(31,500)
Total O&M	\$ 318,320	\$ 330,235	\$ 350,447	\$ 435,982

Total salaries and fringe benefit costs for 2020 are estimated at \$167.7 million, or 35.9% of gross O&M costs, and reflect a 3.1% increase from prior year budget. The increase is a result of projected performance pay adjustments (3%), medical insurance costs and the addition of 11 net positions, shown on Table V below.

Table V

Position Changes	
Aqua Vista Operations	6
AMI Support	4
Chemists	2
Affordability Specialists	2
Custodial Staff	2
Environmental Lab Analyst	1
Eliminated Positions	(6)
Total Changes	11
Total SAWS Positions 2020 Budget	1,890

Vista Ridge

In October 2014, The City Council adopted an Ordinance, approving the execution of a Water Transmission and Purchase Agreement (WTPA) between the City, acting by and through SAWS, and Vista Ridge LLC to provide up to 50,000 AF of potable water per year for an initial period of 30 years. The water provided through the Vista Ridge Pipeline Project represents a significant diversification of SAWS' water resources. If delivered at the maximum amount, it will account for approximately 20% of the SAWS' current annual usage. Under the terms of the agreement, SAWS only pays for water (up to 50,000 AF) delivered to the Aqua Vista Station, minimizing project risk to SAWS. In 2015, the City Council approved a series of increases to the water supply fee through 2020 to support the acquisition of new water supplies, including water

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supplied from this project. The status of the project is on schedule for water delivery by April 2020. The 9.9% rate adjustment is projected to generate \$82 million annually primarily to cover the projected cost of \$80.7 million for the 50,000 AF of water to be delivered in April, and other expenses.

The first year operating and maintenance costs of the project are listed in Table VI. Specifically, a total of \$80.7 million is budgeted to make contractually required payments for water transmitted via the Vista Ridge pipeline, to provide for the operation and maintenance of the pipeline, to support the operation of the new Agua Vista Station, which will receive and treat Vista Ridge water for transmission into the SAWS distribution system, and to provide for the added utility expenses associated with the pipeline and the Agua Vista Station.

Table VI

Vista Ridge Pipeline Water Delivery Costs - 1st Yr. O&M	
Component Description (\$ in Millions)	Cost
Vista Ridge Water Payment (\$1,606 per AF)	\$ 61.0
Vista Ridge Ops. & Maint. Payment (\$204.55 per AF)	7.8
Vista Ridge Utility Costs	8.0
Agua Vista Station Chemical Cost & Utility Costs	3.9
Total	\$ 80.7

In May 2016, SAWS exercised its contractual right to fix the Capital and Raw Groundwater Unit Price under the Agreement. This action served to lock in the price of the water component of SAWS annual payment requirement at \$1,606 per acre-foot for the entire 30-year term of the WTPA, compared to \$1,959 in the original projection.

Capital Improvements Program

SAWS capital plan has increased significantly over the past several years. As illustrated in Chart II below, the 5-year CIP projected for years 2015 through 2019 totaled \$1.5 billion averaging \$300 million per year. The current 5-year CIP for years 2020 through 2024 totals \$2.6 billion averaging \$500 million per year. The increase is due in large part to the increase in costs related to the EPA Consent Decree. This is illustrated in the Wastewater core business unit's \$1.5 billion 5-year CIP projection which represents 60% of the total CIP. Other key drivers for this increase include: the Water Resource Integration Project (WRIP) which expands capacity to integrate water sources from the H2Oaks Center into the system and the implementation of technology improvements through Advanced Metering Infrastructure. In addition, the Water Delivery core business unit includes \$798 million for main replacements, storage tanks, well pumps, and system upgrades. The growing capital plan will drive the need for rate adjustments going forward. Table VII below illustrates the total capital costs by core business unit over the next five years.

Chart II – Prior 5-Year CIP Comparison

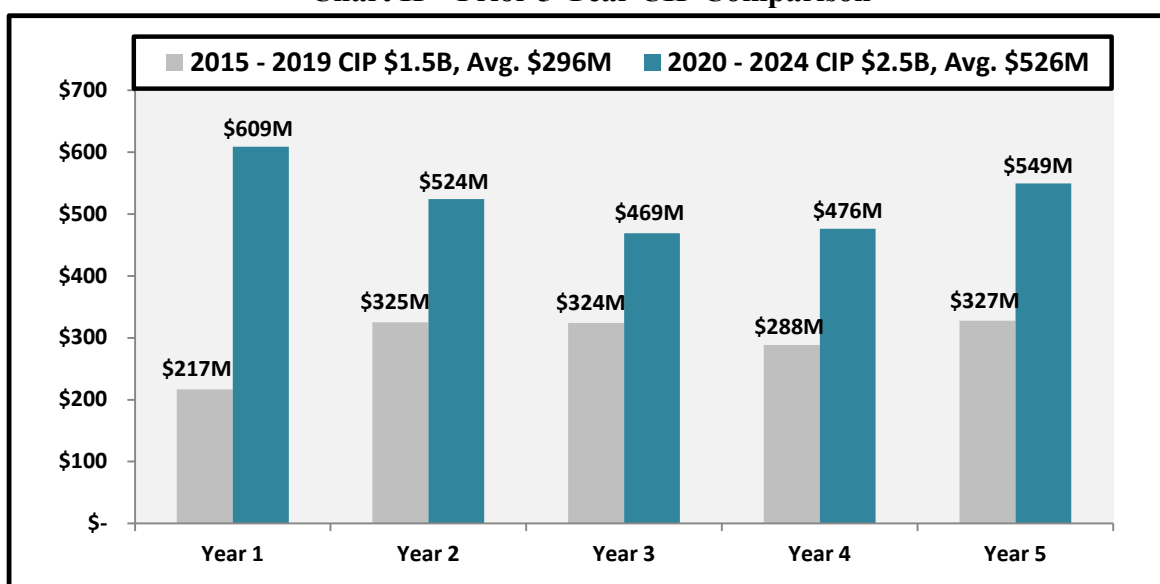


Table VII

Five-Year Capital Improvements Plan by Business Unit						
Business Unit	2020	2021	2022	2023	2024	5-Yr Total
Water Delivery	\$ 94,770,086	\$ 144,525,275	\$ 160,238,637	\$ 174,182,779	\$ 224,539,412	\$ 798,256,189
Wastewater	412,676,097	318,910,824	268,099,742	237,796,061	282,976,746	1,520,459,470
Water Resources	98,371,381	59,571,647	34,979,118	56,998,487	34,530,765	284,451,398
Recycled Water	1,802,980	964,749	5,656,870	6,981,593	7,170,780	22,576,972
Chilled Water	1,255,800	125,000	125,000	125,000	125,000	1,755,800
Total	\$ 608,876,344	\$ 524,097,495	\$ 469,099,367	\$ 476,083,920	\$ 549,342,703	\$ 2,627,499,829

The CIP for 2020 totals \$609 million, of which wastewater projects total \$413 million, or 68%, and represent the largest single year investment in SAWS wastewater infrastructure primarily related to the EPA Consent Decree. The vast majority of the 2020 Wastewater program focuses on the rehabilitation and replacement of wastewater mains identified through the SAWS Sanitary Sewer Overflow Reduction Program (SSORP) for the Consent Decree. The single largest SSORP project in 2020 is the W-6 sewer main project along Highway 90 to S.W. Military Drive at \$218 million. The project involves replacing the existing sewer infrastructure that currently runs through Lackland Air Force Base. Other key drivers for the 2020 CIP plan include: \$93.4 million in Water Resources for phase 2 of the WRIP, which completes the pump station and pipeline infrastructure necessary to expand the WRIP's water delivery capacity from the current 45 million gallons per day (MGD) to 75 MGD; and, \$94.8 million in Water Delivery for production facilities upgrades, replacements and expansion as well as water main replacements.

Multi-Year Financial Plan

SAWS utilizes a multi-year financial model that projects all system sources and uses of funds as well as rate requirements. The table below reflects the rate projections over the next five years.

Table VIII

SAWS Current Projected 5-Year Rate Plan					
	2020	2021	2022	2023	2024
	Proposed	Plan	Plan	Plan	Plan
Water Supply Fee	9.9%	0.0%	0.8%	0.2%	0.3%
Water Delivery & Wastewater	0.0%	0.0%	4.6%	5.0%	6.3%
Total	9.9%	0.0%	5.4%	5.2%	6.6%

The impact of the Vista Ridge project on financial metrics is illustrated in Table IX below. As expected, the liquidity metric “Days Cash on Hand” (DCH) is impacted going from a projected 479 DCH in 2019 down to 378 DCH in 2020 with a partial year of the Vista Ridge project, then down to 295 DCH in 2021 with a full year of the project. This reduction in DCH does not represent a significant decrease in the amount of cash on hand by SAWS but rather reflects the significant increase in SAWS operations and maintenance expenses due to the Vista Ridge project becoming operational. This puts the DCH slightly below the SAWS Board target of 300+ DCH.

Additionally, effective October 1, 2019, the City Council increased the City’s transfer from SAWS from 2.7% to 4.0% of Gross Revenues. This change was made as part of the adoption of the FY 2020 City Budget. After consultation with SAWS, it was determined that the increased transfer from SAWS could be made from accumulated cash reserves without an impact to SAWS rates for two or more years. SAWS will evaluate the need to recover the costs associated with this increased transfer to the City in the future beyond FY 2021. A detailed memo on the increase in the SAWS transfer was provided to the Mayor and City Council on August 29, 2019.

In addition, SAWS debt service coverage metric covering total bonded debt is impacted moving from 1.95x projected in 2019 down to 1.72x in 2020 with a partial year of the project, then down to 1.59x with a full year of the project. This puts this debt service metric below the SAWS board target of 1.75x coverage. As reported by SAWS, these metrics represent the amounts calculated in SAWS financial model. Based on conservative assumptions included in the model, SAWS has historically outperformed these projections. SAWS anticipates maintaining levels at or near SAWS’ target levels throughout the projection period and beyond.

SAWS maintains the following rating agency senior lien debt ratings: Fitch AA+, Moody’s Aa1, and S&P AA+. Maintaining these positive ratings is critical to SAWS given the capital intensive nature of operating a utility. Recent rating agency reports cite the large capital needs and

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associated leverage as driving the need for future rate increases in an effort to manage key performance metrics. The following summarize some challenges cited by each agency:

- Fitch – substantial capital needs and leverage levels higher than category medians over the long term could pressure ratings;
- Moody's – large capital plan and significant debt, rate increases required to maintain strong metrics, erratic weather could pose operational challenges; and,
- S&P – moving through most capital-intensive period in history.

Table IX

SAWS Key Financial Metrics							
Metric	Target	2019	2020	2021	2022	2023	2024
Total Debt Coverage	1.75x	1.95x	1.72x	1.59x	1.64x	1.65x	1.66x
Days Cash on Hand	300+	479	378	295	254	253	266

Recycled Water

SAWS is proposing an adjustment to recycled water rates that is consistent with prior year rate plans to move recycled water closer to cost recovery by increasing recycled water rates at the same percentage increase as potable water rates. As such, the recycled water rates will increase by 19.2% in 2020.

Miscellaneous Service Fees

On November 19, 2015, City Council approved Ordinance No. 2015-11-19-0956 that allows the annual adjustment of miscellaneous service fees based on the annual change in the U.S. Consumer Price Index. SAWS proposed 2020 budget includes these adjustments.

Affordability

SAWS is proposing to increase the amount of funding for the Affordability Discount Program by \$600K going from \$5.9 million in the 2019 budget to \$6.5 million projected for 2020, a 10% increase. The budget has increased 85% since 2016. In addition, the number of customers that have been able to participate in the program has continued to increase; going from 20,663 customers in 2016 to 31,679 customers in 2019, a 53% increase.

Rates Advisory Committee

Every 5 years, SAWS conducts a comprehensive cost of service and rate design study. The last study was completed in 2015 and resulted in a new rate structure that took effect in January of 2016. In 2019, SAWS began the process again. The process includes the establishment of a Rates Advisory Committee (RAC) that is comprised of a diverse cross section of customers to review current water and wastewater rates and other SAWS fees. The purpose of the committee is to make recommendations regarding future rate structures. The RAC has conducted two meetings

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over the past two months and will be an integral part of the current cost of service and rate design study.

Financial Impact

As approved in the FY 2020 City Budget process, the City receives 4% of gross revenues from SAWS. If the new rates become effective January 1, 2020, additional revenue of approximately \$2.5 million will be generated in the City's FY 2020. On an annual basis, the City payment would increase by approximately \$3.3 million in FY 2021. The City's utility expenses would also increase for FY 2020 in the amount of approximately \$545K. On an annual basis, the City's utility expenses will increase by approximately \$702K in FY 2021. Based upon the City Council pre-approved rate plan, the additional revenue was already included in the City's FY 2020 Adopted Budget. As such, there is no update needed to the City's FY 2020 Adopted Budget for the proposed increases.