

**To the Mayor and Members of the City Council****August 13, 2019**

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SUBJECT: WATER DEPARTMENT FY2020 REVENUE REQUIREMENTS

Each year the Water Department completes cost of service studies for Retail and Wholesale customer classes for both water and sewer services. Those studies are used to determine the rates that will be recommended to the City Council. The purpose of this Informal Report is to outline the process and topics addressed in the 2020 rate setting process and to provide the projected change in water and sewer revenue requirements.

Retail Water and Sewer Rate Process

Retail rates paid by Fort Worth residents and businesses are based on the Department's cost of service, which is established as part of the annual budget process using industry standards. Once the cost of service is determined, the preliminary rates and specific topics that might affect the rate structure are presented to the Department's informal Water and Sewer Retail Rate Structure Stakeholder Group for input and feedback. This group is comprised of customers representing the various retail customer classes, which include residential, commercial, industrial, irrigation and super users. The group is charged with ensuring equity among customer classes and providing input into how costs are allocated within rate structures.

Water Department staff met with the Stakeholder Group on May 20, June 3, June 17, and June 24 to present budget drivers and costs, trends in water and wastewater usage over the last decade, and preliminary 2020 rates for both water and sewer service for all customer classes. Staff requested feedback on specific issues impacting revenue recovery and rate structure. These topics included the fixed versus variable revenue recovery stability plan for retail sewer service, integration of the Super User class into the Industrial class, and full cost of service revenue recovery for all retail classes.

Budget Drivers

The FY2020 budget is increasing by 3.5% over the FY2019 Adopted Budget. The FY2020 increase is driven primarily by the City Council-adopted capital improvement plan, which requires increases to both debt service and pay-go cash financing. Other major increases include implementation of the new City Council-approved pension reform plan and the City Manager's proposed pay for performance compensation plan. Other increases include personnel costs to fund new positions to address growth and complexity in the system and new regulatory requirements, additional contractual services for sewer treatment and biosolids management provided by third party vendors, costs to comply with the newly adopted Utility Cut Policy, and additional funding for vehicle and facility repair and maintenance.

Cost of Service Process and Rates

As part of the cost of service study, staff prepares the budget for the ensuing fiscal year and determines the cost responsibility and revenue requirements to recover the costs of providing service to each of the six water customer classes. Staff also reviews volume usage by class and makes adjustments based on both recent and long-term trends. This process provides cost of service rates.

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Since the inception of a tiered rate structure for the Irrigation customer class beginning in 2008, its volumetric rates were tied to the rates of the upper tiers of the Residential customer class. However, different water usage patterns of the two classes created difficulty in maintaining each class at its cost of service. After in-depth discussion with the Stakeholder Group in 2016, the group recommended untying the Irrigation volumetric rates from the Residential rates beginning in 2017, enabling each class to stand alone relative to its cost of service. The recommended 2020 rates make significant progress towards closing this gap.

The Super User class was established in 2006 for customers using more than 30 million cubic feet of water each year through a single meter and with constant level usage and very little peaking each month. However, upon review of water usage trends since 2006, the class behaves very similarly to the Industrial class. The planned integration of the Super User class back into the Industrial class has been phased in successfully over a five-year period and will be eliminated in 2020.

Fixed vs. Variable Revenue Recovery Stability Plan

The 2020 rates continue the multi-year implementation of increased cost recovery from fixed service charges for sewer service to improve revenue recovery stability. This reduces the Utility's dependence on more volatile, volume sales-based revenues. Begun in FY2014 for Water charges, the revenue derived from fixed charges was increased from a ratio of 17% fixed and 83% variable to a 30%/70% ratio, which was achieved in 2018 and remains in place. Begun in FY2015, the revenues for Sewer service are increasing from a ratio of 12% fixed and 88% variable to a 20-25% fixed component. The 2020 recommended sewer rates continue the plan to reach the desired 20-25% fixed component of sewer revenue. This shift to receiving more revenue from fixed rather than variable income sources results in the monthly service fee becoming a greater portion of the monthly bill. Moving to a higher percentage of fixed revenue recovery is a utility industry trend that lessens dependence on weather conditions and improves stability in revenue collection and cash flow. This issue was reviewed with the customer Stakeholder Group, which continues to support the plan.

Wholesale Water and Sewer Rate Process

Wholesale rates paid by the Department's 32 water customer cities and 23 sewer customer cities are based on cost of service studies performed on a three-year rotation using consultant services, alternating water and sewer, with Department staff completing the study the alternate years. The process and methodology are established within the Uniform Wholesale Contracts for water and sewer services. Studies are based on test year expenditure data, adjusting for known and measurable changes. Volumes used to calculate the rate change are based on prior year actual use. Results of the cost of service studies and preliminary rates are presented to the Wholesale Water and Wastewater Advisory Committees, comprised of representatives of each of the customer cities. Staff met with the Cost of Service Subcommittee of the Wholesale Advisory Committees on May 14 and June 27, and met with the full Wholesale Advisory Committees on June 5 to present the preliminary FY2020 wholesale water and sewer rates. Final rates were provided to the members of the Wholesale Advisory Committees on July 12.

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Based on the cost of service studies and the input received from the Stakeholder Group for retail rates, staff recommends the following adjustments in system wide revenue requirements for Retail Water and Sewer service:

Retail Water: + 1.98%
Retail Sewer: + 2.93%

Based on the prescribed cost of service rate methodology established in the Uniform Wholesale Contracts with our Wholesale customers and input from the Wholesale Advisory Committees, the following adjustments in system wide revenue requirements are required for Wholesale Water and Sewer rates:

Wholesale Water: -10.56%
Wholesale Sewer: - 3.53%

Additional detailed information about the recommended FY2020 rates may be provided, as desired. Should you have any questions about the retail or wholesale rate processes, please contact Chris Harder, Water Director, at 817-392-5020.

David Cooke
City Manager