

MEMORANDUM

DATE: September 1, 2017
TO: William Stowe, CEO and General Manager
FROM: Peggy Freese, CFO
SUBJECT: Preliminary 2018 Water Rates

Board action on rate setting takes place at the October board meeting. Our wholesale contracts require a six-month notice for rate increases, thus action in October is required in order for rates to become effective on April 1. Since development of the 2018 budget is going on concurrently, a preliminary discussion with the Finance and Audit Committee in September is necessary to enable staff to factor rate increases into the budget.

One factor to consider in setting rates is the Cost of Service Study (COS). Staff reviewed the 2016 COS with the Finance and Audit Committee meeting at their July meeting. As noted at that meeting, both costs and consumption increased. The impact of the consumption increase outweighed the increase in costs resulting in a decrease in the cost per 1,000 gallons in most service areas. Total costs increased 1% in 2016. There are two components to total cost: operating and maintenance costs which increased 0.2% and capital replacement costs which increased 2.9%. In the three-year period from 2013 to 2016, O&M cost increases averaged 5% per year. Capital replacement cost increases averaged 3% over the same period.

In the 2016 COS, overall costs exceeded revenue by 3%. That was a significant improvement from 2014 and 2015 where costs exceeded revenue by 19% and 17% respectively. Rate increases of 7% in 2015 and 10% in 2016 are the reason for the improvement.

Many line items in our operating budget can generally be expected to increase annually—labor rates, chemical prices, and energy costs to name a few. On the capital side, the aging of our assets creates an ongoing and increasing need for spending on capital projects even though we have a long history of substantial reinvestment in our infrastructure.

Attached is a chart that shows three percentages of rate increases across our service areas. Columns two and three show the actual 2015 and 2016 Cost per 1,000 gallons from the COS for those years. The fourth column shows an estimated 2017 COS per 1,000 gallons. This is projected based on increases in operating and maintenance costs over the last five years. Column five is the current rate, effective April 1, 2017.

There are three sections, showing rate increases of 5%, 7% and 10%. In each of the increase sections, there are three columns. Column one is the new rate, column two is the amount of the increase and column three is the difference between the increased rate and the projected 2017 COS amount.

Comparing columns 4 and 5 indicates that 2017 rates are mostly in line with 2017 COS projections. We want to maintain this rather than having rates lag behind COS. Considering the recent trend increases in O & M and capital costs, we feel a 7% increase for most service areas would be appropriate. In some service areas, rates will continue to be higher than the COS, which is our intent. These areas have significant capital needs beyond what would normally be funded through their rates.

We believe there are two rates that should have an increase other than 7%. Those are the wholesale With Storage rate and the PCRWD #1 service area. We recommend a 5% increase in the With Storage rate. Beginning in 2015, this rate has been above the COS amount. A 5% increase will still leave the rate above cost, but by a smaller amount. When PCRWD #1 became a full service customer in 2013, we set their rate at the same level it had been under their independent operation. Their actual COS has been less than this rate thus we have accumulated a capital fund balance for this service area. When PCRWD #1 dissolved earlier this year, they transferred their remaining fund balance to DMWW. We are making several water system improvements in 2017 in this area. After these improvements, we do not anticipate additional improvements will be needed for several years. Their rate will remain above their COS amount, accumulating funds for future needs.

We do not recommend any increase in water availability charges. Our last increase in water availability charges was in 2011, but we want to continue to have our rates be primarily volume based.

As a reminder, although we have engaged Raftelis Financial Consultants (RFC) to review our Cost of Service methodology, any changes that might result from their work would be used in our rate recommendations for 2019 and beyond. The Board approved our selection of RFC in February. To kick off the project, RFC met with several of our wholesale customers to solicit their opinions on our Cost of Service study. RFC has completed an initial review of our 2016 Cost of Service report and the underlying calculations. We are working with RFC to review their initial observations and identify next steps. Any changes to our COS process or our rate structure would require a substantial amount of time to design and implement. As we continue to work with RFC over the next several months, we will be able to provide the more detailed updates about the project.

**DES MOINES WATER WORKS
PROPOSED 2018 RATE INCREASES**

	(1)	(2)	(3)	(4)	(5)	5% Increase			7% Increase			10% Increase		
	# of Accts	2015 COS	2016 COS	Est 17 COS	2017 Rate	5% Increase	Inc Amt	Rate/COS Diff	7% Increase	Inc Amt	Rate/COS Diff	10% Increase	Inc Amt	Rate/COS Diff
Des Moines Inside	67,300													
Residential (Step 1)		4.04	3.90	4.13	4.11	4.32	0.21	0.19	4.40	0.29	0.27	4.52	0.41	0.39
Commercial (Step 2)		2.71	2.58	2.74	2.76	2.90	0.14	0.16	2.95	0.19	0.21	3.04	0.28	0.30
Industrial (Step 3)		2.06	1.98	2.12	2.12	2.23	0.11	0.11	2.27	0.15	0.15	2.33	0.21	0.21
Wholesale	47													
Purchased Capacity		1.81	1.72	1.84	1.85	1.94	0.09	0.10	1.98	0.13	0.14	2.04	0.19	0.20
With Storage		3.56	3.49	3.67	3.84	4.03	0.19	0.36	4.11	0.27	0.44	4.22	0.38	0.55
Des Moines Outside	1,200													
Residential (Step 1)		4.34	4.37	4.70	4.47	4.69	0.22	(0.01)	4.78	0.31	0.08	4.92	0.45	0.22
Commercial (Step 2)		3.09	2.92	3.09	3.36	3.53	0.17	0.44	3.60	0.24	0.51	3.70	0.34	0.61
Industrial (Step 3)		2.27	2.08	2.20	2.40	2.52	0.12	0.32	2.57	0.17	0.37	2.64	0.24	0.44
Polk County	7,000													
Residential (Step 1)		6.64	6.00	6.08	8.10	8.51	0.41	2.43	8.67	0.57	2.59	8.91	0.81	2.83
Commercial (Step 2)		3.64	3.34	3.47	4.96	5.21	0.25	1.74	5.31	0.35	1.84	5.46	0.50	1.99
Industrial (Step 3)		3.15	3.04	3.22	3.87	4.06	0.19	0.84	4.14	0.27	0.92	4.26	0.39	1.04
Pleasant Hill	3,100													
Residential (Step 1)		6.61	6.09	6.37	7.54	7.92	0.38	1.55	8.07	0.53	1.70	8.29	0.75	1.92
Commercial (Step 2)		5.83	5.57	5.87	6.36	6.68	0.32	0.81	6.81	0.45	0.94	7.00	0.64	1.13
Windsor Heights	2,100													
Residential (Step 1)		3.84	3.80	3.99	4.19	4.40	0.21	0.41	4.48	0.29	0.49	4.61	0.42	0.62
PCRWD #1	464													
Residential (Step 1)		4.54	3.29	3.36	4.00	4.00	-	0.64	4.00	-	0.64	4.00	-	0.64
Berwick	220													
Residential (Step 1)		3.74	4.02	4.24	4.00	4.20	0.20	(0.04)	4.28	0.28	0.04	4.40	0.40	0.16
Runnells	182													
Water		5.66	5.15	5.18	7.15	7.51	0.36	2.33	7.65	0.50	2.47	7.87	0.72	2.69
Waste Water		6.71	8.23	9.91	7.76	8.15	0.39	(1.76)	8.30	0.54	(1.61)	8.54	0.78	(1.37)
Alleman	156													
Residential (Step 1)		9.18	8.23	8.80	8.34	8.76	0.42	(0.04)	8.92	0.58	0.12	9.17	0.83	0.37
Cumming	141													
Residential (Step 1)		5.33	4.06	4.71	7.03	7.38	0.35	2.67	7.52	0.49	2.81	7.73	0.70	3.02
Warren County	79													
Step 1		12.21	12.52	13.21	15.17	15.93	0.76	2.72	16.23	1.06	3.02	16.69	1.52	3.48
Step 2		10.32	10.42	10.99	11.14	11.70	0.56	0.71	11.92	0.78	0.93	12.25	1.11	1.26