

December 8, 2014

CITY OF NEWARK
Delaware

TO: Mayor and Council

FROM: Carol S. Houck, City Manager

SUBJECT: Black and Veatch – 2011 Water Rate Study

As we continue to consider the 2015 Operating Budget and more specifically the recommended 7.2% water rate increase, it has become necessary to share with you additional information. Having not been personally involved in this effort following the letting of the RFP 2011, and in consideration of the concerns and criticisms raised about the 2011 study's exclusion of cost of service calculations, I thought it would be appropriate to reach out to Black and Veatch to gain a better understanding of the reasoning behind decisions made.

Finance Director Lou Vitola and I recently met with Prabha Kumar, the Director of Management Consulting for Black and Veatch, and the prime representative that worked with Newark on the in 2011 study. We advised her of the history of the actual increases since the first year of the study and inquired about the fact that the study didn't include cost of service, customer classes, tiered rates or other common rate evaluations. Ms. Kumar shared that in fact a more robust look at our water rate design was originally anticipated but the scope of the study was limited to the completion of the financial picture. Additional documentation was provided that was prepared on our behalf, but never publically presented to the entire Council. I am unaware if it was discussed or shared in some other fashion and have attached a copy of the presentation for your reference. We do know a meeting was held with a smaller group of Council and then Finance Director and City Manager in July of 2011 that served to provide preliminary findings from the financial scope. It should be noted that the water rate study was following on the heels of the electric rate study which had already impacted our rate payers.

Apparently the preliminary findings of the rate study's financial phase resulted in our representatives noting the following:

- The existing two class structure was simple
- Any potential change based on detailed cost of service would adversely cause some cost shifting
- Rate tiers could cause some potential revenue decrease
- A fixed charge could impose a burden on low income customers
- A desire to assess the impact of increased electric rates before taking on the water side
- Desire for Newark rates to stay competitive
- That Newark had the lowest inside vs. outside differential among neighboring communities (I am are not aware if this is still the case)

Ultimately the decision was made to leave the rate design as is and to implement an across the board increase for both inside and outside customers over multiple years.

Going forward, and with this additional insight we are more committed to the 2015 water rate increase as not implementing it could further burden decisions a year from now if we commit to a new study, as will the impact of not having kept to the 2011 recommended annual increases.

As you are aware, comments have been made that suggested Black and Veatch should not be considered to perform an update to the 2011 study. However, it is now clear that the firm had identified our options appropriately and that decisions were made with an eye towards reducing the burden on our rate payers. The most cost effective way to update the 2011 study with new guidelines and smart meter measurement and verification results would be to engage Black and Veatch. While it is our thought that an update should include at least inside and outside differentials and fire protection fees, we would suggest that an educational workshop on the mechanics of rate studies could be helpful prior to August 2015. It is likely that the concerns related to a full cost of service rate study, that guided the decisions of our predecessors, will continue to be concerns next year as well.


I hope I have adequately shared background related to the 2011 study to assist with your decision making. Please let me know if you have any additional questions.

**BUILDING
WORLD
DIFFERENCE**

25 July 2011


**City of Newark, Delaware
Water Rate Study**

David Jagt, Project Manager
Prabha Kumar, Director

 **BLACK & VEATCH**
Building a world of difference.

Agenda

- Rate Design Policy Considerations
- Goals of the Rate Study
- Rate Study Process
- Revenue Requirements Overview

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**NOTE: THIS PRESENTATION WAS
NEVER PUBLICALLY DELIVERED**

Rate Design Policy Considerations

- Customer Classification
- Fixed Charges
- Conservation Efforts
- Inside/Outside City Differential



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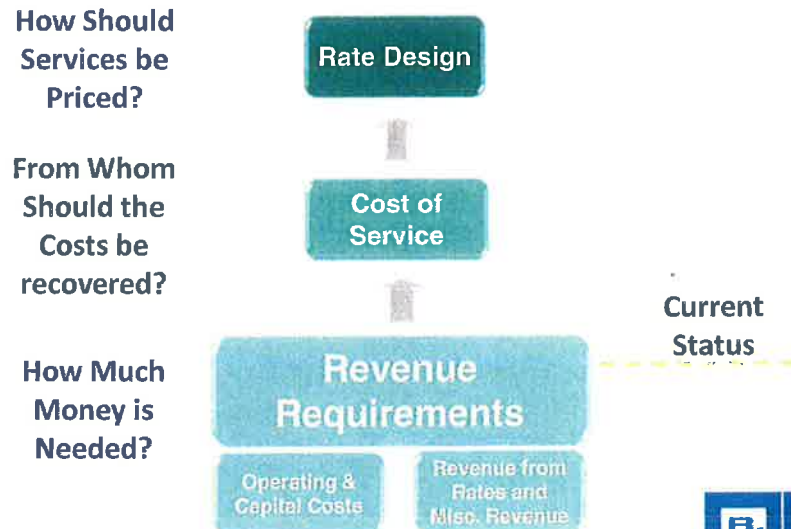
Goals of the Rate Study

1. Fair and equitable rates to all classes of customers
2. Revenue adequacy to meet the water utility's operating and capital costs and a fair margin
3. Competitive rates for all customers
4. Encourage water conservation
5. Support economic development within the City
6. Recover more fixed costs with fixed charges and reduce volatility in usage revenues



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Building Blocks of a Rate Study



Financial Plan: Approach

- **Revenue Projections**
 - Forecast increase in customer accounts and billed volume
 - Forecast revenues under current rates
- **Revenue Requirement Projections**
 - Project revenue requirements
 - Operation and Maintenance Expense
 - Capital Costs
 - Capital Project Expenditures
 - Debt Service
 - Operating Margin
 - Build and Maintain Operating Reserves

Five Year Study Period (2012 – 2016)



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Financial Plan: Approach

- **Cash Flow Projections**
 - Develop a five-year financial forecast
 - Determine overall revenue adjustments needed



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Financial Plan: Preliminary Findings

- **Preliminary draft forecast indicates the need for a 12% to 20% revenue increase in FY 2012 and additional subsequent significant increases.**

Reasons for revenue increases:

- Increasing capital requirements
- Increasing operating costs
- Establishing operating reserves

**2011 RATE STUDY
WAS CONCLUDED
HERE.**



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Questions and Comments?



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Rate Design Policy Considerations Customer Classification

- **Current Customer Classification**
 - Recognizes customer ownership (Inside and Outside Customers)
- **Options for Consideration**
 - Additional classification to reflect level of service (ie. Residential, Commercial, and Industrial)
- **Potential Benefits**
 - Enhance equity of cost recovery
 - Provide flexibility to adjust conservation rate block for each customer class
 - Provide ability to balance conservation goals with economic development goals
- **Potential Impacts**
 - Additional effort to designate customers into classes
 - Billing system programming changes
 - Customer education



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Rate Design Policy Considerations Fixed Charges

- **Current Rate Structure**
 - Primarily a variable (volume based) charge
- **Options for Consideration**
 - Billing Service Charge
 - Meter Service Charge
 - Private Fire Protection (Fire Line) Charge
- **Potential Benefits**
 - Enhance equity of cost recovery
 - Improve revenue stability
- **Potential Impacts**
 - Reduces the ability of lower income customers to decrease total water bill
 - Reduces conservation impact



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Rate Design Policy Considerations Conservation Efforts

- **Current Rate Structure**
 - Two-tier variable rate structure
 - Two customer classes reflecting customer ownership
- **Options for Consideration**
 - Public Education Program
 - Monthly Billing
 - Additional Rate Tier(s)
- **Potential Benefits**
 - Meet state conservation requirements
 - Monthly billing provides low income customers with lower bills
- **Potential Impacts**
 - Billing system programming changes
 - Potential to impact economic development
 - Potential impact to revenue generation



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Rate Design Policy Considerations Inside/Outside City Differential

- **Current Rate Structure**

- Two-tier variable rate structure
 - Two customer classes reflecting customer ownership

- **Options for Consideration**

- Align rate differential with cost of service
 - Benchmark rate differential of peer utilities

- **Potential Benefits**

- Provides utility owners (City and Inside City customers) with reasonable return
 - Enhances equity of cost recovery

- **Potential Impacts**

- Potential for resistance and challenges



