

CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:

Pass the ordinance amending Title 8 (Public Utilities) Chapter 2 (Municipal Water and Sewer) Article C (Water and Sewer Rates, Connection Charges) of the Naperville Municipal Code

DEPARTMENT: Water Utilities

SUBMITTED BY: Darrell Blenniss, Director

BACKGROUND:

Serving more than 43,500 customers and a population of more than 145,000, the Naperville Water Utilities (“Utilities”) provides high quality, reliable, and critical services to the community. Detailed financial planning, including annual budget development and periodic rate studies, is essential to provide continuity of services and sustainable capital investment.

The last Utilities rate study was conducted in 2017 to help plan for financial needs through 2021, with the City Council approving rate increases that went into effect in May 2017. Amended rates were enacted in January 2018 to address discrepancies in the study discovered as part of the 2018 budget process. Increases across various customer classes were effective January 1 of 2019, 2020, and 2021, and bill impacts varied between 1.8% and 5.8%.

The cash balance for the Utilities was approximately \$24.4 million at the end of 2020 and in line with City policy. With the Utilities now in the final year of the 2017 study, staff contracted with Carollo FMG to determine an appropriate financial plan through 2026 and a rate schedule for the next three years.

The 2021 rate study involved the creation of a revenue sufficiency model, a cost-of-service evaluation, expanded capital improvement plan, and a review of the existing rate design, with all components evaluated to determine their sufficiency in meeting policy goals. Anticipated cash balances at the end of the three-year rate period with the recommended rates/charges are \$36.5 million.

DISCUSSION:

Study Goals

The following four goals were incorporated into preparing the 2021 rate study:

Ensure revenues received appropriately cover the costs of operating and maintaining the water and wastewater systems

To ensure the City’s financial principles are met, the new rate structure should have revenues covering the cost of operating and maintaining the utilities. The new rate structure will also take declining water usage, a nationwide conservation trend, into consideration.

Evaluate cost-of-service equity between customer classes

Each user class should pay their proportional share of system costs.

Evaluate rate design

The rate design should be relevant to meeting the Utilities' various needs.

Address the long-term issues raised in the 2020/2021 Water Utilities asset evaluations

Prior to the 2021 rate study, Utilities staff engaged consultants in 2020 and 2021 to examine the condition of the water distribution and water supply systems, as well as Springbrook Water Reclamation Center, and provide five, ten, and 20-year capital improvement plan recommendations. The results were divided among the utilities major business groups: Wastewater Collections & Pumping, Water Supply/Distribution, and Wastewater Treatment (Springbrook) and found that additional investment is needed in the Water Supply/Distribution and Wastewater Treatment groups to maintain service levels and regulatory compliance moving forward.

Study Recommendations

Through the 2021 rate study, the Water Utilities developed the following four recommendations in alignment with the above goals as well as in compliance with the City's financial policies and principles and maintaining competitiveness in the residential and commercial space.

1. Approve staff recommended rate increases in alignment with cost-of-service equity

Carollo prepared a five-year revenue model as well as a three-year rate schedule. The attached schedule of rates and charges will provide sufficient revenues in the study years to address anticipated operating expenses and the staff recommended capital program.

Under the proposed rates and scenarios described, the average residential combined water/wastewater customer (750 cubic ft/month use) will see a 4.7% increase each year in 2022 through 2024. The average commercial combined water/wastewater customer (2,000 cubic ft/month use and 2" meter size) will see a 4.2% increase in 2022, 4.5% in 2023, and 4.6% in 2024.

A thorough examination using American Water Works Association approved methodologies determined that no cost-of-service adjustments between customer classes are required at this time.

2. Increase yearly capital investment to staff recommended \$27M per year to incorporate annual watermain replacement program expansion over the next five years

The 2020 asset evaluation, coupled with data-driven evaluations of service level trends, including an uptick in watermain breaks, led the Water Utilities to examine what an enhanced capital improvement plan would look like for the utilities. Multiple scenarios were developed, all of which consider the additional funding needed for improvements to

meet the regulatory compliance program at Springbrook and the current level of capital support for the successful Wastewater Collections & Pumping programs.

The major difference between the scenarios comes with the amount of expanded watermain replacement. Over the past decade, the utility has fallen behind in the recommended standard of 1% of system replacement per year. To begin to address this backlog, staff recommends a \$27 million annual Capital Improvement Program that provides an additional 3.2 miles of watermain replacement per year. Of the scenarios proposed, this was the mid-level option that balanced out forward movement with concern for customer impacts. Additional replacements would be determined by age, risk, and coordination with road resurfacing projects to minimize customer impacts.

3. Advance generational equity through support of a blended pay-as-you-go/financing model for expanded capital program

Staff evaluated several financing models that incorporate rate structure as well as financing to further generational equity, which is the concept that all of those who will utilize a capital asset over a longer timespan contribute to the cost of that long-term asset. The revenue model developed and recommended by staff using a blended pay-as-you-go (rates) and financing plan, which ultimately keeps rates and charges lower for the customer.

This approach requires \$10 million a year in financing. The City has a strong financial position due to its financial principles and AAA bond rating, and the Water Utilities has a low existing debt position.

Financing does not necessarily mean assuming more debt through bonding; staff remains committed to seeking federal/state funding and grants to reduce borrowing potential as well as examining leveraging existing cash balances and reserves.

4. Approve addition of a water capital charge

Staff recommends introduction of a new water capital charge as part of the study's rate design. This monthly flat charge, similar to the existing phosphorus charge for wastewater customers, will be based on meter size and dedicated to fund water capital projects. This charge will provide a transparent and reliable revenue stream to support the assets that deliver water that is independent of usage variables such as weather and water conservation trends. In its first year, the rate study estimates just over \$800K will be collected through the charge.

Public Outreach

In late summer, staff met with representatives from the Naperville Area Homeowners Confederation, the Naperville Area Chamber of Commerce, and Naperville Development Partnership to review the concepts behind the rate study and anticipated bill impacts. These groups understood the goals of the study and the above recommendations. Staff also met with several of the largest customers in both Utilities.

On Sept. 23, the PUAB reviewed staff's requests and proposed rate structure and unanimously approved staff's recommendation.

Following ordinance approval, the Water Utilities will work with the Communications Division to appropriately communicate rate changes to customers, including through the *Connected* resident newsletter included with utility bill mailings and the City's website.

FISCAL IMPACT

Under the proposed rates and scenarios described, the average residential combined water/wastewater customer (750 cubic ft/month use) will see a 4.7% increase each year in 2022 through 2024. The average commercial combined water/wastewater customer (2,000 cubic ft/month use and 2" meter size) will see a 4.2% increase in 2022, 4.5% in 2023, and 4.6% in 2024.