

**CITY OF NAPERVILLE
MEMORANDUM**

DATE: November 21, 2017

TO: Mayor and City Council

FROM: Douglas Krieger, City Manager

SUBJECT: CY2018 Proposed Budget Workshop #3 – Water Rate Scenarios

PURPOSE

The City engaged a rate consultant, Municipal & Financial Services Group (MFSG), to perform a five-year rate study for the Water Utility. The study's goals included 1) revenues covering operating expenses and building required 30-day cash reserves by 2021, 2) increasing capital funding to replace and rehabilitate aging infrastructure for system integrity and reliability and 3) implementing a graduated phosphorus surcharge and allocating the Electric loan repayment to fund required improvements at Springbrook Water Reclamation Center.

A City Council workshop was held on February 27 on the topic, and a new rate schedule was formally approved and went into effect on May 1, 2017.

Earlier this fall, discrepancies were noted in cash balances and forecasts of water purchases that were being considered for the utility's 2018 budget. Examination of these discrepancies identified three distinct errors that created the differences between actual performance and that anticipated by the rate study: leakage was not accounted for in the rate model, connection fee revenue was double counted and a difference in projected versus audited cash balances was discovered.

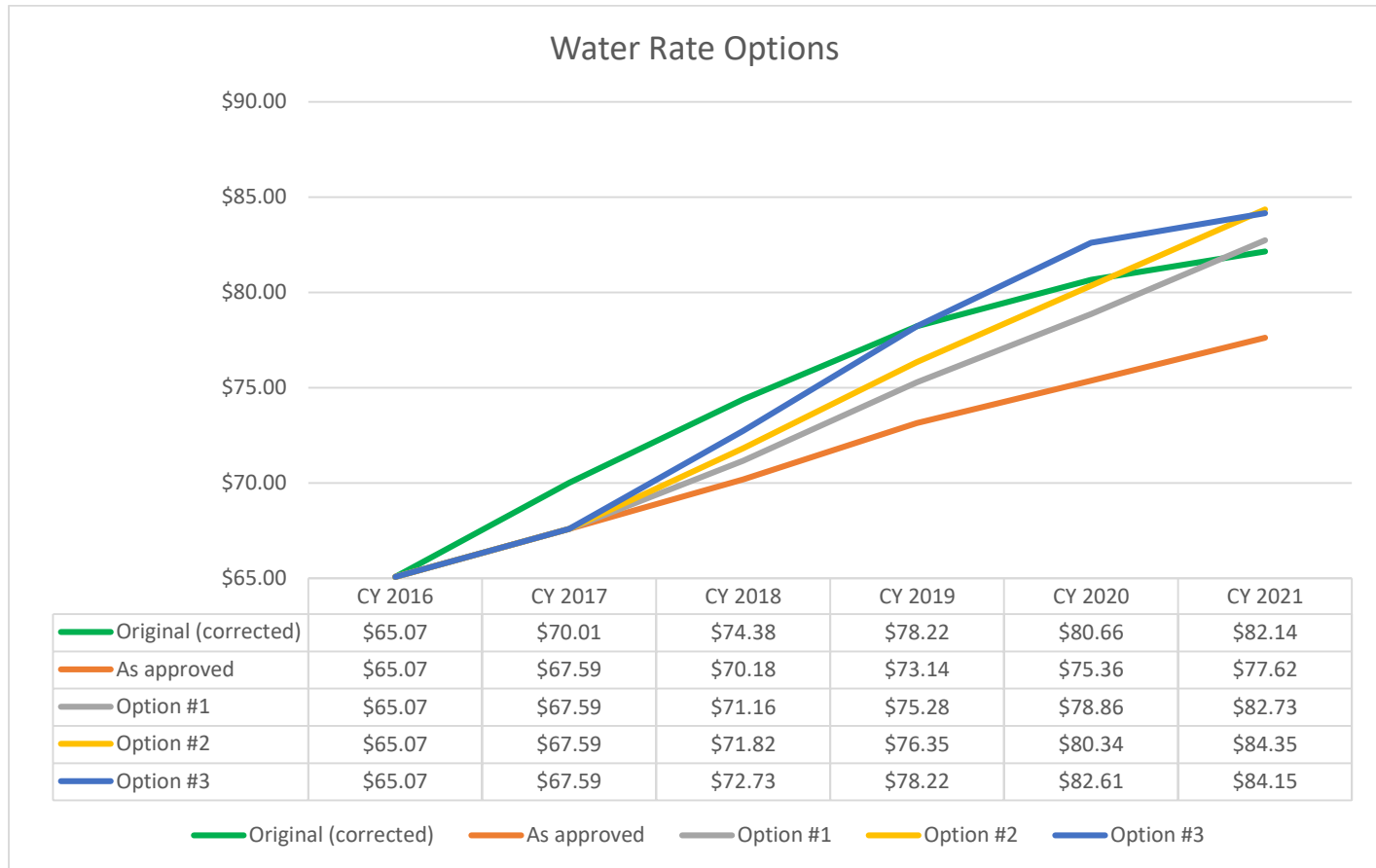
DISCUSSION

In reviewing potential solutions to remedy this error, staff has developed three options for City Council consideration. (For reference, two additional scenarios are presented to guide Council in decision making; these contextual scenarios are noted as such.) In each of these scenarios, revenues exceed expenditures in all years, with the use of the Electric loan repayment subsidizing operational expenses in the near term. All scenarios remain on target to achieve funding 50% (\$25 million) of the required phosphorus improvements at Springbrook by 2025.

Scenario variability is focused on the length of time it takes to restore the Water Utility's unrestricted cash reserve and enter an operating cash positive state, defined as the Water Utility's ability to not have to utilize the Electric loan repayment to subsidize general operations. The three options reflect three different paths to realigning the rate study with its original goals.

- **Original (Corrected):** This scenario is presented for context and reflects the rates that should have been implemented in May 2017 if the rate model errors were not present. This scenario meets the original goals of the rate study.
- **As approved:** This scenario is presented for context and reflects the rates that were actually implemented in May 2017.
- **Option 1:** This option is the most conservative and takes the longest for the utility to both be operating cash positive and return to an operating cash positive state.
- **Option 2:** This option takes a "middle of the road" approach to being cash positive/restoring cash reserves.
- **Option 3:** The most aggressive option, this scenario has the shortest timeframe to meet the original financial targets outlined in the rate study goals.

	Original (corrected)	As approved	Option #1	Option #2	Option #3
Operating Cash Positive	2019	N/A	2020	2020	2019
Cash Reserves Met	2022	N/A	>2022	>2022	2022



RECOMMENDATION

In reviewing the rate study errors, status of the IEPA permit for phosphorus improvements at Springbrook, consideration of the impact on utility customers and previous rate studies, staff recommends implementing Option #2 rates for 2018 and 2019 with a report to the City Council in the third quarter of 2019 to discuss the rates for 2020 and 2021.

The previously approved monthly increases for an average household in 2018 and 2019 were \$2.59 and \$2.96, respectively. The increases in Option #2 are \$4.23 and \$4.53, respectively. An average customer will be paying \$38.52 more per year in 2019 than the originally approved rate model.

Staff is recommending Option #2 for the following reasons:

- Option #2 puts the utility on track to achieving a sustainable financial operating model in a reasonable amount of time.
- Option #2 balances the need for increased revenues with the expectations and concerns of our customers.

- While the proposal does utilize the loan repayment from the Electric Utility in the short term, this strategy is used to help smooth in rate increase across the next five years. The \$14 million loaned to the Electric Utility in 2014 was rate revenue generated by the Water Utility.
- The City still does not have an IEPA permit, which means that the utility still has 11 years to complete the phosphorus improvements at Springbrook.
- Utility revenues can be volatile and are extraordinarily dependent on the weather. A wet or dry summer can change the revenue requirements for upcoming years. Given the additional time on the IEPA permit and the variability in revenues, staff recommends that the rates are only approved for a two-year period, with a report to City Council in third quarter of 2019 to discuss increases for 2020 and 2021. As with other City budgets and funds, there is greater clarity in the next two years than there is in the out years.