



**TO:** Elizabeth Pauli, City Manager  
**FROM:** Jackie Flowers, Director of Utilities, Tacoma Public Utilities  
**COPY:** Government Performance and Finance Committee (GPFC)  
**PRESENTER:** Sean Senescall, Tacoma Water, Finance and Analytics Manager  
 Lyna Vo, Tacoma Water, Utilities Economist  
**SUBJECT:** Tacoma Water Wholesale Rates, System Development Charge, and Fixed Fees  
**DATE:** August 20, 2019

**PRESENTATION TYPE:**  
 Informational Briefing

**SUMMARY**

Tacoma Water requests a recommendation from the GPFC for wholesale rate adjustments effective January 1, 2020; System Development Charge adjustments effective January 1, 2020; and Fixed Fees adjustments effective each January 1<sup>st</sup> starting in 2020 through 2024.

**WHOLESALE RATE ADJUSTMENT**

**BACKGROUND:**

Tacoma Water serves 15 wholesale customers in the region. We have contractually obligated about 18 million gallons per day (MGD) of supply to the wholesale class, but only 2.5 MGD are consumed annually. In 2018, the wholesale class generated approximately \$3.1 million in revenue, or 4% of total revenue, and 2.5 MGD of demand, or 5% of total demand.

**ISSUE:**

Wholesale revenue and demand have been declining while ongoing costs to maintain our supply obligation remain. Tacoma Water seeks to increase net revenue and balance supply obligation by proposing wholesale pricing and policy changes.

- **Rate design** would increase the fixed rate while decreasing the variable rate;
- **Market pricing** would require a take-or-pay agreement, pricing water against a wholesale customer’s own source of supply or a competitor’s rate for a limited duration; and
- **Reverse capacity amortization** would allow wholesale customers to reduce their contracted capacity if they opt out of taking water.

Collectively, the new rate structure and contract features are designed to increase net revenue for the benefit of our customers, which includes retail customers. This will ultimately keep our rates lower and attempt to solve equity issues within the wholesale class and beyond.

**ALTERNATIVES:**

An alternative would be taking no action and the current rate structure would remain intact.

**FISCAL IMPACT:**

Without changes to our wholesale pricing and policy, we could experience a potential opportunity loss of up to \$3.6 million annually.



## SYSTEM DEVELOPMENT CHARGE ADJUSTMENT

### BACKGROUND:

Tacoma Water assesses System Development Charges (SDCs) for water service connections. It is a one-time charge for connection to the water system, service upgrade that requires a larger meter, or existing service for larger meters that exceeds usage thresholds. The SDC is typically charged to new development, commercial and wholesale customers. From 2014 – 2018, the average annual SDC revenue was \$2.9 million.

### ISSUE:

This charge was last updated in 2004. Since this time, changes have occurred to our system capacity, plant assets, capital projects, debt, and demand. Refreshing the charge to reflect these changes will provide us with an updated schedule with the goal of ensuring generational equity within our water system.

### ALTERNATIVES:

An alternative would be taking no action and the current charge structure would remain intact.

### FISCAL IMPACT:

Since we are requesting a reduction to this charge, we could see a decline in SDC revenue. However, Tacoma Water is a cost of service utility and this reduction aligns with our core ratemaking principles.

## FIXED FEES ADJUSTMENT

### BACKGROUND:

Tacoma Water assesses fixed charges for water service installations, commonly known as fixed fees. This is a one-time charge for water service installations in schools, shopping centers, restaurants, residential homes, and apartments. In circumstances where fixed fees are not adequate to cover the actual costs, charges are based upon actual costs, which are commonly referred to as Time & Materials (T&M). From June 2017 – May 2019, fixed fees and T&M generated approximately \$2.0 million in revenue.

### ISSUE:

This charge was last updated in 2009. Since this time, our cost of service has become misaligned with our fixed fees. From June 2017 – May 2019, we under collected approximately \$385,000 in fixed fees. Refreshing the charge to reflect current costs will allow us to align our fees with actual expenses, reduce staff time, and shorten the time of quote delivery to our customers.

### ALTERNATIVES:

An alternative would be taking no action and the current charge structure would remain intact.

### FISCAL IMPACT:

Since we are attempting to achieve full cost recovery, we anticipate a revenue increase of approximately \$200,000 annually. Otherwise, fixed fees are subsidized in order to achieve our cost recovery of fixed fees.

## RECOMMENDATION

Tacoma Water requests a recommendation from the GPMC for wholesale rate adjustments effective January 1, 2020; System Development Charge adjustments effective January 1, 2020; and Fixed Fee adjustments effective each January 1<sup>st</sup> starting in 2020 through 2024.

**APPENDIX:** The chart below highlights background, issue information, alternatives, and fiscal impacts of these recommended adjustments.

	<b>Wholesale Rate Adjustment</b>	<b>System Development Charge Adjustment</b>	<b>Fixed Charge Adjustment</b>
<b>Background</b>	Tacoma Water serves about 15 wholesale customers in the region. We have obligated about 18 million gallons per day (MGD) of supply to the wholesale class, but only 2.5 MGD are consumed annually. In 2018, the wholesale class generated approximately \$3.1 million in revenue, or 4% of total revenue, and 2.5 MGD of demand, or 5% of total demand.	Tacoma Water assesses SDCs for water service connections. It is a one-time charge for connection to the water system, service upgrade that requires a larger meter, or existing service for larger meters that exceeds usage thresholds. The SDC is typically charged for new development, commercial and wholesale customers. From 2014 – 2018, the average annual SDC revenue was \$2.9 million.	Tacoma Water assesses fixed charges for water service installations, commonly known as fixed fees. This is a one-time charge for water service installations in schools, shopping centers, restaurants, residential homes, and apartments. In circumstances where fixed fees are not adequate to cover the actual costs, charges are based upon actual costs, which are commonly referred to as Time & Materials (T&M). From June 2017 – May 2019, fixed fees and T&M generated approximately \$2.0 million in revenue.
<b>Issue</b>	<p>Wholesale revenue and demand have been declining while ongoing costs to maintain our supply obligation remain. Tacoma Water seeks to increase net revenue and balance supply obligation by proposing wholesale pricing and policy changes.</p> <ul style="list-style-type: none"> <li>• <b>Rate design</b> would increase the fixed rate while decreasing the variable rate;</li> <li>• <b>Market pricing</b> would require a take-or-pay agreement, pricing water against a wholesale customer’s own source of supply or a competitor’s rate for a limited duration; and</li> <li>• <b>Reverse capacity amortization</b> would allow wholesale customers to reduce their contracted capacity if they opt out of taking water.</li> </ul> <p>Collectively, the new rate structure and contract features are designed to increase net revenue for the benefit of our customers, which includes retail customers. This will ultimately keep our rates lower and attempt to solve equity issues within the wholesale class and beyond.</p>	This charge was last updated in 2004. Since this time, changes have occurred to our system capacity, plant assets, capital projects, debt, and demand. Refreshing the charge to reflect these changes will provide us with an updated schedule with the goal of ensuring generational equity within our water system.	This charge was last updated in 2009. Since this time, our cost of service has become misaligned with our fixed fees. From June 2017 – May 2019, we under collected approximately \$385,000 in fixed fees. Refreshing the charge to reflect current costs will allow us to align our fees with actual expenses, reduce staff time, and shorten the time of quote delivery to our customers.
<b>Alternatives</b>	An alternative would be taking no action and the current rate structure would remain intact.	An alternative would be taking no action and the current charge structure would remain intact.	An alternative would be taking no action and the current charge structure would remain intact.
<b>Fiscal Impact</b>	Without changes to our wholesale pricing and policy, we could experience a potential opportunity loss of up to \$3.6 million annually.	Since we are requesting a reduction to this charge, we could see a decline in SDC revenue. However, Tacoma Water is cost of service utility and this reduction aligns with our core ratemaking principles.	Since we are attempting to achieve full cost recovery, we anticipate a revenue increase of approximately \$200,000 annually. Otherwise, fixed fees are subsidized in order to achieve our cost recovery of fixed fees.