

**STAFF REPORT**  
December 10, 2018

**Topic:** Proposed sewer rate increase for 2020 and 2021

**Discussion:**

In September, DPW presented the findings of a sewer rate study and recommended that the sewer rate be increased by 9.5% per year for each of the next three years. The proposed rate increase was based on maintaining a balance of \$3.5 million in undesignated reserve, supporting an annual CIP of \$1.5 million and supporting an annual operating budget which is being impacted by both decreased water sales and inflation. The Water Department over the last 20 years has experienced an annual decrease of 1.5% in water sales. The majority of the Sanitary Sewer Fund's revenue is based on water consumption. Inflation the last two years has been at least 2% per year which affects wages, benefits and material costs. If no other changes were made to the sewer program, and the same level of operations are maintained, an annual increase of 3.5% rate is needed to just offset declining water usage and rising inflation.

The Council approved a 9.5% increase starting in February 2019. Council requested additional information on whether financing a portion of the CIP would help reduce future sewer rate increases by spreading out payments for infrastructure improvement projects. A question was also asked whether reducing the reserve fund would help offset the sewer rate increase.

The recommended reserve fund balance is \$3.5 million. This amount ensures that the fund has 50% of the annual operating and maintenance budget for any emergencies that arise with our system and a reserve for potential emergencies that may arise with the Winnepesaukee River Basin Program's system. Rochester, Concord, and Dover have a similar reserve fund structure where reserves are maintained for items such as expenses, debt service and rate stabilization. Rochester maintained a \$3M reserve in 2017. Concord targets their reserve at 25% of operations, 25% of debt service and 10% for rate stabilization. Dover contributes \$500,000 annually to their reserve fund.

Decreasing the reserve fund would initially result in lower rate increases as the reserve fund is drawn down to pay for expenses that exceed revenue. Eventually the available fund balance would be exhausted and the result will be a larger rate increase to fund annual expenses. For example, the proposed rate increase was 9.5% for the next three years resulting in a total rate increase of 31%. If the reserve fund was decreased to \$2 million, the rate increase would be 4% for three years and then 9% in year four, resulting in an overall rate increase of 34%.

The Sanitary Sewer Fund can use financing to spread payments over the life of a project thus lowering annual CIP expenses for those projects. Bonding is appropriate when the life of the capital improvement project exceeds the life of the bond. Approximately half of the Sanitary Sewer Fund's annual Capital Improvement Plan over the next three years consists of this type of infrastructure improvement projects. The other half of the plan includes items that are not appropriate for bonding such as upgrades or improvements with a lower lifespan (pumps and grinders), and programs that do not have a direct impact on the life of a system such as the cleaning and inspecting sewer lines.

Bonding can provide needed capital while managing rates. Two roadway improvement projects slated for FY20 and FY21 are Court Street Phase 2 and the Union Avenue, Main St. to Gilford Ave. project.

Approximately 4,500 feet of sewer will be replaced in conjunction with these roadway improvement projects. These sewer replacement projects are appropriate for financing and will be included in a bond request for \$750,000 in FY20 and another \$750,000 bond in FY21. Therefore, approximately half of the CIP for these two years will be financed if the bonds are approved.

The impact of funding the two projects with bonds reduces the proposed rate increase of 9.5% in 2020 and 2021 to 5.5% in 2020 and 2021. The average bill would increase \$28 per year for the next two years compared to \$40 under the 9.5% scenario.

Public Works anticipates that the Sewer Fund's capital improvement program will be \$1.5 million per year for the foreseeable future.

When the anticipated capital improvement plan is at consistent levels for an extended period of time, bonding will eventually result in higher rate increases in order to pay the bond's principal and interest versus just the cost of the project (the principal).

Bonding will result in reduced rates in the near term, however, since the plan is to fund the CIP at \$1.5 million annually moving forward, bonding will result in higher rate increases later. Financing projects should be used strategically to level future rate increases.

Based on the amount and type of sewer infrastructure work associated with the Court Street Phase 2 and Union Avenue projects, and the desire to manage sewer rate increases in the near-term, it is recommended that financing for these projects be pursued. It is also recommended that the reserve balance be maintained at \$3.5M. A rate increase of 5.5% in 2020 and 2021 is recommended to support the CIP and reserve fund.

**Staff Recommendation:** Public Works recommends that the City Council:

Approve the conceptual sewer rate increases to occur in FY 2020 and 2021 enabling Public Works to draft the proposed changes to the Sanitary Sewer ordinances in the City Code and for the City residents to prepare for budget increases in the future.

**Fiscal Impact:**

The impact of the proposed increase on the average residential bill would be \$28 each year until 2021. This is a 9.5% increase in 2019 and a 5.5% increase in 2020 and 2021, and includes an increase to both the usage charge and the annual fixed charge.

By 2021, charges based on metered water consumption would be \$5.79 per hundred cubic feet and a fixed yearly fee of \$41.44 per unit per quarter. For non-metered, flat rate (sewer-only) accounts, the increase would be a 9.5% increase in 2019 and a 5.5% increase in 2020 and 2021.

Council previously approved a 9.5% sewer rate increase for 2019 for both metered and non-metered, flat rate (sewer only) accounts.

**This report submitted by:** Krista Larsen, Assistant Director of Public Works