



Water Services Department’s Financial Plan Update and Water Allowance Adjustment

This report provides the Transportation, Infrastructure and Planning Subcommittee with an update on the Water Services Department’s financial plans for Fiscal Years 2023-28 and proposed changes to the water allowance. Additionally, it addresses the need for capital improvement investments imposed by further shortages on the Colorado River and the impacts of continuing high inflation on operating, maintenance, and construction costs.

THIS ITEM IS FOR INFORMATION AND DISCUSSION.

Summary

The Water Services and Finance Departments have prepared the five-year financial plans for both the City's water and wastewater utilities. The plans reflect the financial requirements needed to operate and maintain the water and wastewater utilities. The financial requirements include funding the Capital Improvement Plan (CIP), which allows for rehabilitation and/or replacement of critical infrastructure. A portion of that CIP will be used to fund the City’s first Advanced Water Purification (AWP) Facility, that will be the first facility to take treated wastewater and apply advanced purification methods to meet or exceed potable water standards.

The City Council has taken the necessary actions to meet the needs of a rapidly growing city, maintain the infrastructure for existing residents, and meet federal standards for safe drinking water and wastewater effluent.

Ongoing and upcoming plans include:

- Delivery of necessary resources for Water and Wastewater to continue to operate efficiently and effectively;
- Maintaining rates that assure safe and reliable water services delivery and provide affordability for water and wastewater customers;
- Restoring and upgrading the Cave Creek Water Reclamation Plant (CCWRP) to augment the City’s water resources by taking the region’s generated wastewater and treating it to potable water standards; and

- Continuing to encourage water conservation efforts with outreach and education.

The following sections outline the financial requirements for proposed water and wastewater rates, and allowance adjustment to assure the water and wastewater utility meet its current debt obligations as well as its forecasted Operations & Maintenance (O&M) and CIP expenditures.

Inflation and Other Impacts to O&M Budgets

The Water Services Department (WSD) has experienced substantial increases in cost of supplies and materials due to inflation over the past year-and-a-half. During that time, Phoenix has experienced the highest inflation of any metropolitan area in the country. For FY19 to FY24 the department has experienced various cost increases, including:

- Chemicals - 136 percent increase for Water and 51 percent for Wastewater;
- Electricity - 12 percent increase for Water and 17 percent for Wastewater;
- Raw Water - 35 percent increase; and
- Personnel - 38 percent increase for Water and 16 percent for Wastewater.

Additional financial pressure is expected if inflation continues and as a result of the City of Phoenix class and compensation study that will be finalized in 2023. The proposed financial plan includes costs associated with further labor increases over the next two years.

Colorado River Water Shortages and AWP

Water Services is also looking ahead for ways to provide safe, clean, drinking water in response to the current and unpredictable drought. Water scarcity is driving the need for “new” water sources and turning wastewater into potable water is a way to provide a sustainable source of water.

As a way to minimize the impact of the continued shortage occurring on the Colorado River, Water Services is preparing for significant treatment upgrades to the currently offline CCWRP to augment the existing water resources portfolio. The City believes AWP facilities will play a large role in offsetting some of the future losses of surface water supplies. Upgrading the CCWRP is the first step in the City’s overall AWP plan.

O&M and CIP Budgets

Given the impact of increased costs due to inflation and the impacts of the Colorado River shortage, the Water and Wastewater O&M and CIP budgets were carefully developed to minimize costs in the current fiscal year while upholding the Department’s mission to provide safe and reliable drinking water and wastewater

services that meet or exceed regulatory requirements.

As submitted to the Transportation, Infrastructure, and Planning Subcommittee on November 16, 2022, the approved FY 23 and proposed FY 24 through 28 CIPs for water and wastewater are \$1.86 billion and \$1.69 billion respectively. The capital programs are a reflection of the necessary infrastructure improvements needed, based upon ongoing condition assessments and prioritization of both utilities to ensure safe, reliable water/wastewater service.

Water Allowance

In 1990, the Water Services Department substantially changed the water rate structure. The new rate structure contained an allocation of water for each customer in the monthly base service charge. This rate feature is referred to as an allowance. These levels have remained the same since 1990, when they were enacted. However, since implementation of the allowance in 1990, there has been a significant decline in average water use per household. In the early 1990s, 21 percent of monthly household bills had consumption levels within the allowance. As a result of water conservation, 31 percent of all household bills now have consumption levels within the existing allowance.

The proposed change will better align the water allowance levels with the current average water usage and have a larger portion of the water usage under the volumetric (actual use) rate. In addition, the proposed change would lower the levels so that the ratio of water average consumption to the allowance levels matches those set in 1990, effectively accounting for successful water conservation efforts. This realignment would change the levels to 8 units in the summer months and 5 units in the non-summer months from the current levels of 10 units in the summer months and 6 units in the non-summer months. Lowering the allowance levels to 5 and 8 would result in 22 percent of all single-family bills falling below the allowance annually. In the past five years, the number of customers who use less than the current allowance has ranged from 21 percent to 40 percent each month, depending on the season. With the new levels, it will be between 15 percent and 31 percent.

A larger portion of a customer's water usage under the volumetric (actual use) rate and not the flat base charge (allowance) will generate a stronger water usage signal to our customers. The expectation is that a better understanding of usage will encourage people to use less water, helping the City reach its conservation goals.

The WSD feels that these new levels strike a balance between water conservation and affordability. Having a portion of a customer's water usage included in the low monthly

base rate allows some conscientious water customers to receive water service at a low rate, making our utility one of the most affordable in the nation.

We anticipate that the change in the monthly allowance will increase water revenue by approximately \$17M, if water usage remains the same. The changes to the monthly water allowance will be included as an integral part of the Water Services Financial Plan.

Water and Wastewater Financial Plan

The financial plans forecast inflationary adjustments that are necessary to support future O&M costs. The plans also address the ongoing impacts of the Colorado River shortage by investing in the conversion of the CCWRP to an AWP Treatment Facility thereby augmenting Phoenix’s potable water supplies. In addition, the plans incorporate projected bond debt for near-term CIP investment.

Based on Water Services projected O&M and CIP needs, the Finance Department has developed a financial plan to determine the forecasted revenue requirements. Information on operating costs and capital needs were examined and forecasted, to determine required bond issuance amounts and timing to determine future rate revenue requirements.

The forecasted water rate revenue increases, as compared to the last financial forecast, are summarized in the table below.

Water Rate Revenue Increase

<u>Calendar Year of increase</u>	<u>Previous Financial Plan</u>	<u>Proposed Rate Revenue Increase</u>
2023	3.5%	6.5%
2024	Not Forecasted	6.5%
2025	Not Forecasted	13%
2026	Not Forecasted	5%
2027	Not Forecasted	5%
2028	Not Forecasted	5%

Wastewater Rate Revenue Increase

<u>Calendar Year of increase</u>	<u>Previous Financial Plan</u>	<u>Proposed Rate Revenue Increase</u>
2023	0%	6.5%
2024	Not Forecasted	6.5%

2025	Not Forecasted	7%
2026	Not Forecasted	9%
2027	Not Forecasted	9%
2028	Not Forecasted	9%

Concurrence/Previous Council Action

On January 26, 2023, the Citizens' Water/Wastewater Rate Advisory Committee (WWRAC) recommended:

- Water rate revenue increases of 6.5 percent effective Oct. 2023, 6.5 percent effective March 2024, and 13 percent effective March 2025; by a vote of 9-0.
- Wastewater rate revenue increases of 6.5 percent effective Oct. 2023, 6.5 percent effective March 2024, and 7 percent effective March 2025, by a vote of 9-0.
- Decrease the current water allowance from 600 cubic feet (6 units) per month to 500 (5 units) from Oct. to May and from 1000 (10 units) to 800 (8 units) from June to Sept., by a vote of 9-0.

Responsible Department

This item is submitted by Deputy City Manager Karen Peters and the Water Services Department.