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MEMORANDUM

Proposed FY 2023 Water and Sewer Charges **UPDATED** December 29, 2021

To: Sue Coffey, Nicolette Bateson

From: Bart Foster

This memorandum is intended to introduce our recommended proposed Water and Sewer Charges for FY 2023. Herewith we provide an executive summary of our recommendations. We have prepared and provided additional material under separate cover which supports the analyses summarized in this document.

Executive Summary

1. Proposed FY 2023 Water and Sewer Charges reflect a simplified approach that does not require preparation of a FY 2023 Cost of Service Study.
   - *Supported by uniformity in units of service related to the upcoming Water Contract Alignment Process (CAP) and continuation of the FY 2022 Sewer SHAREs.*
   - *Cost of service analyses will still be completed to support ongoing review and initiatives.*
2. Proposed FY 2023 Water Charges reflect:
   - *Budgeted Revenue Requirement increase of **3.5%**;*
   - *System Charge Adjustment equal to a **3.7%** increase;*
     - ✓ *Uniform Charge Increase of **3.4%** for almost all Member Partners;*
     - ✓ *Uniform Charge Increase of **2.6%** for Non Master Metered Member Partners;*
     - ✓ *Slightly higher "net" increase for Detroit and Flint after recognizing specific contract requirements and credits.*
3. Proposed FY 2023 Sewer Charges reflect:
   - *Budgeted Revenue Requirement increase of **2.5%**;*
   - *System Charge Adjustment equal to a **3.7%** increase;*
     - ✓ *Uniform Charge Increase of **4.5%** for suburban wholesale Member Partners relate to Highland Park Bad Debt;*
     - ✓ *Increase to Detroit is **2.5%***

<u>Proposed FY 2023 Water Charges</u>

Budgeted Revenue Requirements and System Charge Adjustment:

- We are proposing a ***System Charge Adjustment*** of a 3.7% increase. As shown in the table below, this adjustment is the product of:
    - *3.5% to address a $12.0 million revenue requirement increase;*
    - *Approximately 0.2% to reflect a decrease in budgeted water sales volumes, creating a $0.5 million negative sales revenue forecast. (See Line 17)*

Revenue Requirement and Charge Adjustment Summary

		(1)	(2)	(3)	(4)
		Approved FY 2022	Recommended FY 2023	Variance	% Variance
		$	$	$	
	Revenues				
1	Revenues from Charges	342,808,200	354,946,100	12,137,900	**3.5%**
2	Other Operating Revenue	175,000	175,000	0	0.0%
3	Non-Operating Revenue	1,047,300	950,500	(96,800)	-9.2%
4	Total Revenues	344,030,500	356,071,600	12,041,100	3.5%
	Revenue Requirements				
5	Operations & Maintenance (O&M) Expense	143,933,800	144,847,700	913,900	0.6%
6	General Retirement System Legacy Pension	6,048,000	6,048,000	0	0.0%
7	Debt Service - Regional System Allocation	135,481,000	150,337,100	14,856,100	11.0%
8	General Retirement System Accelerated Pension	6,268,300	6,268,300	0	0.0%
9	WRAP Contribution	1,705,500	1,770,500	65,000	3.8%
10	Lease Payment	22,500,000	22,500,000	0	0.0%
11	Deposit to Improvement & Extension (I&E) Fund	28,093,900	24,300,000	(3,793,900)	-13.5%
12	Total Revenue Requirements	344,030,500	356,071,600	12,041,100	3.5%
	Charge Adjustment Summary				
13	Adjustment Index		**3.50%**		
14	Baseline Revenue		342,296,100		
15	Change in Annual Revenue Requirement			12,041,100	3.5%
16	Change Attributable to Non-Charge Revenue			96,800	0.0%
17	Change Attributable to Sales Revenue / Bad Debt			512,100	0.1%
18	System Charge Adjustment			12,650,000	**3.7%**

Totals may not foot due to rounding.

- The budgeted revenue variance is lower than that presented earlier in the charge planning process, including at the November 16 Charge Rollout meeting on proposed Units of Service. Subsequent to that meeting, we have:
    - *Made some minor adjustments to projected sales volumes for specific Member Partners based on review of specific data;*
    - *Adjusted the presumed decline in base month water sales from 2.5% annually to 1.0% annually, which is more indicative of recent activity - so the adjustment factor applied to the 3-year average base month sales is 98% instead of 95%.*
    - *This reduces the "negative budgeted revenue variance" from approximately $2.0 million to approximately $0.5 million and puts less pressure on the FY 2023 charges.*
- As a result, the proposed System Charge Adjustment is lower than what was indicated in originally presented material.

Specific Member Partner Charge Proposals:
As presented at the November 16 Charge Rollout meeting, there is only one Member Partner (St. Clair County DTE) whose contracted max day and peak hour demands will change for FY 2023. All Member Partners will have the opportunity to change their contracted demands during the re-opener process during 2022, and to impact their charges for FY 2024. We believe this dynamic supports a simplified approach to the proposed FY 2023 Water Charges, similar to what has been employed in recent years, to support the stability objectives embraced by the GLWA Charge Methodologies. Our recommended charges have been developed by:

- Using the FY 2022 Cost of Service Study as an appropriate mechanism to allocate the FY 2023 Revenue Requirements to Cost Pools, for purposes of establishing the allocation of Revenue Requirements to "Mod" customers introduced below.
- Treating St. Clair County DTE as a "Mod" customer and compute their proposed charges based on their specific demands.
    - *This will result in a significant charge increase for this Member Partner.*
- Treating the Non Master Metered Member Partners (Detroit, Dearborn, Highland Park) uniformly as a group of "Mod" customers and uniformly adjust their allocated wholesale revenue requirement.
    - *After adjusting for the "Mod" above, this results in a **3.1%** uniform increase in the "wholesale" revenue requirement for this "Mod" class.*
    - *This approach continues recent charge calculations that allow the max day and peak hour demands to vary with variances in average day volumes year over year. The change in average volumes for these Member Partners from FY 2022 to FY 2023 is relatively uniform and we believe treating this group as a class is reasonable and embraces the simplified approach introduced herein.*
- Treating ALL other Member Partners as members of the "No Mod" customer class and uniformly adjust their allocated wholesale revenue requirement.
    - *After adjusting for the "Mods" above, this results in a **3.7%** uniform increase in the "wholesale" revenue requirement for this "No Mod" class.*
- Apply the required contractual adjustments to the allocated wholesale revenue requirements.
    - *Since the Detroit Ownership Benefit and the KWA debt service credit are fixed[1], the uniform charge adjustment for all members of the "No Mod" customer class is **3.4%**.*
    - *Proposed charge adjustments to Detroit and Flint (expressed on a "gross" pre credit basis) after reflecting contractual adjustments are **3.1%** and **3.5%**, respectively.*

[1] There is a minor reduction in the budgeted KWA debt service credit, which has the effect of moderately reducing the amount allocated to all other Member Partners.

<u>Proposed FY 2023 Sewer Charges</u>

Budgeted Revenue Requirements and System Charge Adjustment:

- We are proposing a ***System Charge Adjustment*** of a 3.7% increase. As shown in the table below, this adjustment is the product of:
  - *2.5% to address a $11.9 million revenue requirement increase;*
  - *Approximately 1.2% to reflect inclusion of one year's worth of revenue requirements allocable to Highland Park as a bad debt expense allowance. (See Line 17). No such amounts were included in the approved FY 2022 Budget and Charges.*

Revenue Requirement and Charge Adjustment Summary

		(1)	(2)	(3)	(4)
		Approved FY 2022 $	Recommended FY 2023 $	Variance $	% Variance
	Revenues				
1	Revenues from Charges	474,005,900	485,760,000	11,754,100	**2.5%**
2	Other Operating Revenue	400,000	400,000	0	0.0%
3	Non-Operating Revenue	1,023,300	1,154,900	131,600	12.9%
4	Total Revenues	475,429,200	487,314,900	11,885,700	2.5%
	Revenue Requirements				
5	Operations & Maintenance (O&M) Expense	181,299,800	187,052,600	5,752,800	3.2%
6	General Retirement System Legacy Pension	10,824,000	10,824,000	0	0.0%
7	Debt Service - Regional System Allocation	207,209,500	205,638,100	(1,571,400)	-0.8%
8	General Retirement System Accelerated Pension	11,620,700	11,620,700	0	0.0%
9	WRAP Contribution	2,358,300	2,423,800	65,500	2.8%
10	Lease Payment	27,500,000	27,500,000	0	0.0%
11	Deposit to Improvement & Extension (I&E) Fund	34,616,900	42,255,700	7,638,800	22.1%
12	Total Revenue Requirements	475,429,200	487,314,900	11,885,700	2.5%
	Charge Adjustment Summary				
13	Adjustment Index		**2.50%**		
14	Baseline Revenue		468,644,700		
15	Change in Annual Revenue Requirement			11,885,700	2.5%
16	Change Attributable to Non-Charge Revenue			(131,600)	0.0%
17	Change Attributable to Sales Revenue / Bad Debt			5,486,700	1.2%
18	System Charge Adjustment			17,240,800	**3.7%**

Totals may not foot due to rounding.

- As a result, the proposed System Charge Adjustment is higher than what was indicated in originally presented material.

Specific Member Partner Charge Proposals:

As presented at the November 16 Charge Rollout meeting, the existing SHAREs established for the FY 2022 Charges will remain in effect for FY 2023 and FY 2024. Revenues collected via the SHAREs process account for almost 97% of the revenues generated from charges, with Industrial Specific charges and contractual charges to OMID making up the remainder. We believe this dynamic supports a simplified approach to the proposed FY 2023 Sewer Charges to support the stability objectives embraced by the GLWA Charge Methodologies. Our recommended charges have been developed by:

- Increase the "wholesale revenue requirements from charges" for ALL charge categories by 2.5% to align with the overall budgeted revenue requirement increase.
    - *This will effectively increase the Sewer Charges for ALL Member Partners (prior to adjustments related to the Agreements) by **2.5%**.*
- Allocate responsibility for the $5.4 million expected bad debt expense allowance associated with Highland Park to Member Partners in the Suburban Wholesale customer class and compute a FY 2023 "surcharge" associated with this amount[2].
    - *This will effectively result in uniform charge increase of **4.5%** for members of this customer class.*
- Apply the required contractual adjustments related to the Detroit Ownership Benefit and the OMID Specific revenue requirements.
    - *Since the Detroit Ownership Benefit is fixed, the charge adjustment for Detroit is **2.6%** expressed on a "gross" pre-credit basis (Compared to the 2.5% budgeted revenue requirement increase).*
- Compute specific Industrial Waste Control and Industrial Surcharge rates for FY 2023 that align with the overall 2.5% increase in budgeted revenue requirements.

We believe that the simplified approaches recommended above are consistent with the goals and objectives set forth in the "One Water Charge Initiatives" that were (most recently) presented at the November 16 Charge Rollout meeting. We are prepared to prepare and provide specific Member Partner charge calculation sheets that embrace and follow these approaches.

We are prepared to present this material and to discuss this matter further at your convenience.

[2] We have provided commentary and analysis regarding specific details on the Highland Park bad debt expense and the impact on Sewer Charges under separate cover.