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MEMORANDUM

GLWA Sewer Capital Cost Allocation August 17, 2022

To: Nicolette Bateson

From: Bart Foster

You have asked for analysis and commentary regarding how capital costs related to specific Sewage Disposal System capital improvements are assigned to customers in the Sewer Charge Methodology. My understanding is that the specific question at hand is whether the costs of certain contracts being considered for approval should appropriately be considered as "common to all" – given that the capital improvements the contracts are designed to deliver may in whole or in part be related to Combined Sewer Overflow ("CSO") facilities.

Executive Summary

The simple answer is that no decision regarding the ultimate cost allocation related to ANY Wastewater CIP project has been formally made. In the current approved CIP the cost allocation field for the projects being considered is populated with a to be determined designation. In fact, ALL Wastewater CIP projects are populated in the same "TBD" manner. As noted in the Finance Chapter of the approved CIP:

> "The Wastewater projects are currently all assigned as "To Be Determined" (TBD) pending discussion of Master Plan strategies and alignment with the Authority's service agreements with Wastewater customers and the associated Wastewater Charge Methodology."

The specific designation of cost allocation of individual CIP projects depends on the outcome of ongoing discussions in various forums, including the Sewer Charges Work Group. The goal of those discussions is to resolve the cost allocation approach on ALL Sewer CIP projects in a timely manner that supports developments of the next SHAREs for implementation in the FY 2025 Sewer Charges – since the FY 2024 charges will keep in place the existing SHAREs and will not be impacted by any cost allocation decisions on CIP projects. That would indicate a decision deadline of approximately October 2023.

Having said that, my understanding of the GLWA interpretation of the existing agreements is that the CSO 83/17 Cost Pool is limited to "***new*** wet weather facilities being constructed to alleviate or to be constructed to alleviate combined sewer overflows" at the time the original 1999 Rate Settlement Agreement was entered. As such improvements to facilities that existed at the time should be assigned to the conveyance (or WRRF) cost pools. Based on an initial

review of the scope of the projects in question, that interpretation would place them entirely in the Conveyance Cost Pool.

Further Discussion

At the risk of complicating what seems to be a simple question, I feel compelled to provide some background and perspective, some of which was presented at last October's Charge Rollout Meeting regarding the CIPs. I've repeated the content from that presentation and freshened it to address potential application for the FY 2024 Sewer Charges.

The discussion is designed to convey an understanding of both ***when*** and **how** individual capital investments impact charges. A brief summary of how the existing GLWA Sewer Charge Methodology allocates capital revenue requirements follows.

When do CIP projects impact Charges?

- The primary capital revenue requirements in annual cost of service studies are debt service and deposits to the I&E Fund.
    - *Debt Service is currently 80% to 90% of this total.*
- These amounts are proportionally allocated to "Cost Pools" based on the most recently audited capital asset inventory
    - *The FY 2024 debt service will be assigned to Cost Pools in proportion to the 6/30/2022 asset data, including any spending to date on active CIP projects (CWIP).*
- This approach recognizes that:
    - *The majority of annual debt service is related to outstanding bonds issued to finance existing assets. Only a very small amount of projected debt service for a budget / charge fiscal year is related to financing new CIP expenditures.*
    - *The CIP is dynamic by nature, as it is a planning document. The spending plan must be flexible to address emerging priorities.*
- No projected CIP expenditures will impact the FY 2024 Cost of Service Study or Charges.
    - *The "Cost Allocation" field for each CIP project will impact **future** cost of service studies and charges once project expenditures impact future year-end asset data.*
- Sewer SHAREs are fixed for the FY 2024 Sewer Charges
    - *Next cost allocation update will be for the FY 2025 SHAREs and Charges based on 6/30/2023 asset data.*

How do CIP projects impact Charges?

- The "Cost Allocation" field of the CIPs is in the process of being refined
- Historically, many projects carried a "common to all" (CTA) category. This originally was designed to primarily identify which projects were:
    - *"Detroit Only" for local Water and Sewer*
    - *"OMID Only" for Sewer*
- All other projects were CTA
    - *Over time, CTA connotated "not CSO" on Sewer*
- Now that the GLWA CIP does not contain any Detroit only nor OMID only projects:

  - *CTA categorization is meaningless;*
  - *ALL projects are CTA – they are just allocated to Cost Pools in a manner that supports the wholesale cost of service methodologies*
- Cost Allocation field should be populated in a manner that supports the methodologies
- As part of the development of the FY 2022 SHAREs the FY 2019 Asset Data was used to allocate assets into the 3 Sewer Cost Pools noted below.
  - *WRRF*
  - *Conveyance*
  - *CSO 83/17*

The point of all of this on the question at hand is that the capital revenue requirements in the existing Sewer charges are based on asset data from FY 2019 – and the FY 2024 charges will be based on the same allocation factors due to the maintenance of the FY 2022 SHAREs. The next opportunity to reflect new asset data into the allocation methodology will be for the scheduled update effective with the FY 2025 SHAREs and Sewer Charges. And the costs of the projects at hand will only impact those charges to the extent that expenditures are made through June 30, 2023.

Notwithstanding that, the question at hand needs to be addressed, as the capital improvements will eventually impact specific Sewer Charges under the existing methodologies. Subsequent to the development of the FY 2022 SHAREs, the Sewer Charges Work Group – via a sub work group known as the "Think Tank" - met on several occasions in an attempt to specifically assign each Sewer CIP project into one of the three cost pools. I participated in the deliberations of that Think Tank.

Part of the challenges at hand are the nature of the individual projects in the CIP. The existing contracts (and Rate Settlement Agreements) discretely identify specific facilities that are assigned to the CSO 83/17 Cost Pool. While some of the individual projects in the CIP are clearly targeted towards improvements to those specific facilities, others are more complex, and designed to result in strategic operation of the overall Regional System. Further, there was a realization that the Regional System will likely be faced with similar and even more complex investment needs in the near future, including projects that may either: (a) directly benefit specific Member Partners; (b) represent an investment required by a specific Member Partner but that requires GLWA participation; and (c) a combination of both scenarios.

Ultimately, the work group could not come to a consensus. In fact the list of projects that were under debate as truly "TBD" with regard to Cost Pool assignment began to grow rather than shrink. There were also suggestions that either: (a) additional Cost Pools may need to be developed in order to "precisely" assign cost responsibility to Member Partners; or (b) a compromise solution needed to be found. The Think Tank has not met in several months and the task remains.

I am prepared to discuss this matter at your convenience.