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January 28, 2014

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RE: Proposed Rate Increase

Dear Mr. Christopher:

On behalf of the Madison Water Utility, I am writing in response to your letter to the Water Utility's Board dated August 27, 2013, regarding the above-referenced subject matter.

In 2012, the water portion of the Madison Municipal Services bill for a residential customer averaged an annual \$221.10 or \$18.425 per month. A 22% rate increase would raise such bill by \$48.60 over the course of a year or \$4.05 per month. If approved, the rate increase likely would be distributed among water use (currently \$2.81 per 1,000 gallons), meter charge (currently \$4.50 per month) and the public fire protection fee (currently \$1.50 per month).

Madison Water Utility's last rate increase of 9% was applied for on October 6, 2010, and approved by the Public Service Commission of Wisconsin on May 3, 2011. Prorated billing over the Utility's six-month billing cycle began on August 1, 2011, and the rate increase became fully effective on January 1, 2012. In order to have a balanced 2014 Operating Budget, the Utility needs a 22% revenue increase over 2013, beginning in August 2014. Aside from the financial necessity, the reason for filing a rate increase application in the near future is the long lead time from application to fully effective increase.

Part of the reason for Madison Water Utility's delaying its rate increase application from 2012, was due to the results noted on page one of your letter, along with the Utility wanting to be farther along in its implementation of the Advanced Metering Infrastructure/Project H₂O, which it completed at the end of 2013. Any rate increase is ultimately determined by the Public Service Commission of Wisconsin.

As part of its previous rate case, Madison Water Utility stipulated with Clean Wisconsin that seasonal rates would be included in its next rate case application, not specifically in 2013. However, per the stipulation, seasonal rates would not be developed until after the Utility completes implementation of its Advanced Metering Infrastructure/Project H₂O and converts its billing frequency from semiannual to monthly, expected to start in mid 2014. The additional data collected will allow both the Utility and the Public Service Commission of Wisconsin to determine usage patterns for residential customers. This data will help establish steps or blocks of usage for the implementation of conservation rates in the future.

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Madison Water Utility is not selling its bonds at a 12.3% rate of return. The Utility issues revenue bonds upon which it pays interest to bondholder investors. The Utility's series 2013 revenue bonds were issued at a true interest cost to the Utility of 3.52%.

In 2011, Madison Water Utility provided a total of \$242,580 in rebates to its customers for their replacement of higher water usage toilets. In 2012, due to fewer replacements occurring following 2011, the Utility provided \$152,988 in toilet rebates and in 2013, the Utility rebated a total of \$221,107 toward customers' purchase of efficient water usage toilets.

As noted in its 2014 Operating Budget Request, on December 18, 2013, Madison Water Utility issued \$24.3 million in revenue bonds, a small part of which took into account the nine months of capital expenditures following its reported 2013 capital expenditures to-date as of March 31, 2013. The bond proceeds will also fund a majority of the Utility's 2014 Capital Budget. Generally, the Utility borrows in advance according to its financial plan, so that it knows funding is available for budgeted expenditures.

Madison Water Utility's PILOT payment to the City of Madison is a major expense for the Utility and its rate payers. In 2012, the Utility's PILOT payment was \$5,017,460 or 15.5% of its total operating expenditures; in 2013, PILOT is expected to be \$5,368,242 (16%) and in 2014, budgeted PILOT is \$5,919,256 or 16.9% of total budgeted operating expenditures. Water Utility staff, the Water Utility Board and City officials have discussed and are monitoring the Utility's growing PILOT expense.

In its communication to the Madison Water Utility Board dated June 20, 2013, the Utility's independent auditor only identified internal control over financial reporting or the preparation of year-end financial statements as a material weakness. However, this is consistent with the City of Madison's internal control over financial reporting as a whole.

Madison Water Utility is not borrowing from the City of Madison in its 2014 Operating Budget Request. The Utility has not borrowed from the City since 2010. The Operating Budget only includes the repayment of funds borrowed. In 2012, the Utility paid \$62,271 interest to the City on funds borrowed.

Providing clean, quality drinking water and water for fire protection is a capital intensive endeavor, much greater than other utilities such as electricity, natural gas, cable TV (including internet and telephone), or cell phone. Madison Water Utility's rates are currently below the 2012 state median average of \$24.07 per month for Class AB Utilities as measured by the Public Service Commission of Wisconsin.

Long-term, like other water utilities in Wisconsin and across the U.S., Madison Water Utility faces flat to declining revenues, aging infrastructure, new regulations and increasing costs. Please be assured that Madison Water Utility always has and will continue to strike a balance between reliable service and reasonable customer costs.

Thank you and your client, Dolores Kester, for your letter.

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Sincerely,

MADISON WATER UTILITY

Michael L. Krentz, CPA
Financial Manager

cc: Mayor Paul R. Soglin (via e-mail)
Common Council Members (via e-mail)
Water Utility Board Members (via e-mail)
Thomas O. Heikkinen (via e-mail)
Dolores Kester (via e-mail)