

Internal Monitoring Report

Policy #: O-2D Affordability

Monitoring Frequency: Annual

Date: July 27, 2021

Policy Language:

Madison Water Utility customers will pay an affordable rate for water, including the financing of necessary replacement of water distribution plant and improvements to water treatment.

With a goal of maintaining affordable water rates and funding necessary improvements to the water supply system, Madison Water Utility shall:

1. Maintain its water rates between the 25th and 75th percentile for Class AB utilities (those serving 4,000 customers or more) in Wisconsin.
2. Apply for a necessary rate increase (subject to the adopted City of Madison Budget) that does not exceed an annualized rate of 9% per year. "Annualized rate increase" is defined as the increase beginning from the time when the last rate increase was fully effective to the estimated date the applied-for rate increase is anticipated to become fully effective, apportioned annually.
3. Generate its authorized return on rate base consumption (defined as per F-23 of the Utility's Annual Report to the PSCW). This sets a reasonable return on investment as determined by an outside party, the PSCW. The allowable return on investment is comparable to that of other publically and privately owned utilities in Wisconsin. By maximizing this return, the utility will have revenue necessary and reasonable for reinvestment in system improvements, and operations and maintenance expenses.
4. Prepare to file a rate case every two years.

General Manager's interpretation and its justification:

1. "Water rates" in this context means the average residential customer bill. To make a like-kind comparison, a quarterly billing frequency is used across the board and consumption is assumed to be 12,000 gallons per quarter, which is one of the amounts used by the Public Service Commission of Wisconsin for bill comparisons and is close to the average quarterly use by Madison residential customers. Nonresidential water rates cannot be compared on an "apples-to-apples" basis due to differences in meter sizes, water uses, and rate structures. The Public Service Commission of Wisconsin sets all class rates based on cost-of-service for a particular class (residential, multifamily, commercial, industrial and public authority).
2. An annualized rate increase not to exceed 9% means the increase is 9% or less beginning from the date when the last rate increase became fully effective, to the estimated date the applied-for rate increase is anticipated to become fully effective, apportioned annually (subject to the adopted City of Madison Operating Budget).

3. Return on rate base is computed on page F-23 of the Madison Water Utility Annual Report to the Public Service Commission of Wisconsin. Madison Water Utility has a return on rate base authorized by the Public Service Commission of Wisconsin.
4. "Prepare to file a rate case" means completing a simplified or conventional rate increase application at least once every two years. If a rate increase is not justified then the Water Utility Board will be informed through this report.

Data directly addressing the General Manager's interpretation:

1. *Maintain its water rates between the 25th and 75th percentile for Class AB utilities (those serving 4,000 customers or more) in Wisconsin.*

Madison's average residential customer water bill (if billed quarterly) with a usage of 12,000 gallons is \$89.76. As shown in the attached comparison, Madison Water Utility is ranked at the 76th percentile, minimally outside the desired 75th percentile.

2. *Apply for a necessary rate increase (subject to the adopted City of Madison Budget) that does not exceed an annualized rate of 9% per year...*

Madison Water Utility's last rate case was implemented on July 2, 2020. The authorized revenue increase was 8.9%.

Madison Water Utility is in the process of filing a new rate case with the PSC by August 1, 2021. The revenue increase is not expected to exceed an annualized rate of 9%.

3. *Generate its authorized return on rate base consumption....*

MWU has an authorized rate of return of 4.9% from the Public Service Commission of Wisconsin (PSC) per rate order 3280-WR-115 dated June 22, 2020. The return on rate base for the year ending December 31, 2020 was 6.63%. An application to increase rates will be filed by August 1, 2021.

PSC's Calculation of Rate of Return:

$$\text{Rate of Return} = \frac{\text{Operating Revenue} - \text{Operating Expense} - \text{Depreciation} - \text{Taxes}}{\text{Average Net Utility Financed Investment in Utility Plant}}$$

2020 Actual Computation of Rate of Return:

$$\frac{\$44,929,868 - \$16,254,706 - \$6,241,783 - \$7,727,020}{\$220,770,403} = 6.63\%$$

The PSC authorized rate of return (ROR) is designed to recover operational costs with additional dollars for reserve. If a utility does not meet the authorized ROR, it usually

means that the actual revenues are too low or the actual expenses are too high when compared to the approved rate structure. The PSC approved a 4.9% ROR for MWU in the last rate case with a \$6.9 million cash adder to be used for funding debt service. When taken together, MWU's ROR should be 8.0% and we realized 6.63%.

4. *Prepare to file a rate case every two years.*

Current water rates went into effect on July 2, 2020. Madison Water Utility is preparing to file another rate case by August 1, 2021.

Attachments:

1. Residential Bill Comparison