

MEMORANDUM

Date: September 24, 2024

To: Mayor Satya Rhodes-Conway
Common Council
Finance Committee
Water Utility Board

From: January Vang, Finance & Administration Manager
Krishna Kumar, General Manager

Subject: Submission of 2025 Rate Case, including proposed modifications to MadCAP, to the Public Service Commission of Wisconsin (PSCW)

RECOMMENDATION

- 1) Authorize the General Manager to file a conventional rate case with the PSCW for the test year 2025 that includes accelerated depreciation of water mains (Expense Depreciation) and modification to the MadCAP (Madison Customer Affordability Program).
- 2) Authorize the General Manager and Finance & Administration Manager to provide testimonials to the PSCW.

BACKGROUND

Madison Water Utility (Utility)'s last rate case was approved by the PSCW on December 29, 2022. The new rates were implemented on March 1, 2023. The Utility is required to file a new conventional rate case with the PSCW by the end of 2024 (# 3280-WR-117). For the new rate case, the Utility will continue to incorporate three seemingly disparate components – expense depreciation, rate design, and affordability goals, which collectively form the core of the Utility's strategic water affordability plan.

Expense Depreciation

The Utility's 6-year Capital Improvement Program (CIP) for FY 2024-29 calls for \$139.5M in capital investments by way of infrastructure renewal. In the past, the Utility issued revenue bonds primarily to fund its capital projects. Currently, the Utility has an outstanding debt of \$166M and a projected annual debt service payment of \$18.9M for 2025, which is almost as much as the Utility's current Operations and Maintenance Expenditures. The Utility desires to limit further borrowing given the current debt load.

An alternative method of capital project financing is through 'expense depreciation'. Expense depreciation is a means to *cash finance* replacement of water mains. The PSCW will generally allow 1.3% depreciation expense on the original cost of existing water mains, which amounts to

\$2.0M per year. The PSCW would also like the utilities to replace water mains up to 1% of the total feet existing water mains per year, which in our case translates to \$12.5M per year. To reduce the gap, PSCW allowed the Utility to generate an additional \$5M of depreciation in the 2022 rate case. The Utility is seeking PSCW approval for expense depreciation of \$10M in the 2025 rate case, which would be sufficient to replace water mains up to 0.8% of the total feet of existing water mains per year. This will preempt the Utility from incurring more debt in the next several years thereby strengthening its short and long-term financial position.

The entire \$10M of expense depreciation, if approved, is required to be separately tracked and solely dedicated to funding water main replacement projects.

Cash Adder

At a minimum, the Utility’s revenues must be enough to cover operation and maintenance expenses (O&M), payment in lieu of taxes (PILOT), and debt service, including a margin to ensure that the Utility can pay debt service even if revenues or expenses fluctuate. The Utility’s existing bond covenants require the Utility to have revenues available to pay debt service of at least 1.25 times the annual debt service (also known as debt coverage). The additional margin may be used to cash fund capital improvements if not needed to pay debt service.

For most utilities, the amount that the PSCW allows them to collect for depreciation expense and the standard return on investment (currently 6.2% on the value of utility assets) provides enough debt coverage. However, in the Utility’s 2022 rate case, the PSCW determined that a ‘cash adder’ of \$6.5M was needed, in addition to depreciation expense and return on investment, to provide debt coverage.

The PSCW also agreed that the expense depreciation should not be considered as available to provide debt coverage. In that case, a cash adder of at least \$8.3M would be appropriate to be included in the 2025 Rate Case. Please see Table – 1 below.

Table – 1 Recommended Expense Depreciation and Cash Adder Request for Test Year 2025	
Item	Amount
Normal Depreciation Expense	\$7.2M
Expense Depreciation	\$10.0M
Return on Investment	\$15.0M
Cash Adder	\$8.3M
Revenues Available for Debt Service & Capital Projects	\$40.5M
Available for Debt Service	\$18.9M
Available for Capital Projects	\$21.6M

Madison Customer Assistance Program (MadCAP)

As part of the 2022 rate case, PSCW approved the Madison Municipal Services Customer Assistance Program (MadCAP) on a 2-year pilot basis. MadCAP is a means tested customer affordability program that offers eligible customers rebates on their municipal services bills, with the Water Utility portion of the rebate being funded by ratepayers. Implementation of a means tested affordability program is both prudent and reasonable to accomplish the Utility's twin objectives of increased water rates to make needed investments in the Utility's infrastructure and making drinking water accessible and affordable to all its customers. Delayed investment in needed infrastructure replacement will ultimately cost all customer classes more money in the long run.

MadCAP can help reduce municipal services costs for low-income residents. It offers monthly bill credits to low-income customers. Eligible households can receive a monthly bill credit of \$20 or \$30 (based on income.) The average current monthly municipal services bill amounts to approximately \$100. MadCAP was introduced on March 1, 2023. The participation data for the first 16.5 months is shown on Table – 2.

Table – 2 / MadCAP Participation Data (as of July 15, 2024)				
Applications	Area Mean Income <30%	Area Mean Income >30% and <50%	Total (#)	Total (%)
Received	294	188	482	100%
Approved	209	119	328	68%
Not Approved	85	69	154	32%
Approved – Homeowners	126	84	210	64%
Renters	83	35	118	36%

Barriers to Entry Experienced

The Utility estimates approximately 8,258 households within the City of Madison who are potentially eligible for MadCAP. As shown in Table – 2, 328 households or 4.0% of the estimated eligible households enrolled in the program within the first 16.5 months of program launch. Out of the 482 applications received, nearly one-third of all applications were denied for various reasons as indicated in Table – 3.

Table - 3 / Basis for Denial of MadCAP Applications			
	Basis	Denials (#)	Denials (%)
1	Declined to participate in conservation	55	36%
2	Annual Renewal Not Done	41	27%
3	Income - too high or no documentation	37	24%
4	No account/service not in name	12	8%
5	Account Inactive (Moved or Deceased)	8	5%
6	Incomplete application	1	>1%
	Total	154	100%

The relatively large number of denials (**36% or nearly 1/3rd**), as shown on Table – 2, indicate that the program, as currently structured, poses significant barriers to entry for potential applicants. **60%, or nearly 2/3rd** of the denials was due to two reasons – either declining to participate in the Utility’s conservation program or due to challenges posed in meeting the current qualifying income limits.

A critical measure of success for MadCAP is a significant level of participation by eligible households. Without such participation, the program will not meet its stated goals. To ease the barriers to entry into the program and to reduce both the administrative burden (on the eligible applicant) and the administrative cost (on the Utility), the Utility has taken or is taking the following measures:

- 1) Introduced a modified application process for any household with less than 4 persons who has a municipal services bill in their name and is currently a FoodShare (WI-SNAP) member to receive MadCAP benefits at \$20 per month since they meet the current MadCAP income thresholds as shown on Table - 4. Such households will have to confirm the possession of valid FoodShare Eligibility Card (WI QUEST Card) and are not required to provide additional income documentation.

This is an approach well-researched by leading water affordability scholar Manny Teodoro, professor at the University of Wisconsin-Madison, and implemented by JXN (Jackson) Water, Mississippi. Professor Teodoro characterizes this novel approach as an “...interim measure by a local water utility (that) bridges a gap until national policy changes to allow SNAP benefits to be used to pay water bills – something that would really help with water affordability.”¹ According to Professor Teodoro, linking MadCAP eligibility to FoodShare participation helps low-income Utility customers receive help in paying their municipal services bill with very low administrative burden. FoodShare members need not complete lengthy forms to qualify for the lower rates, and they won’t have to provide extensive income documentation.

- 2) Collaborating with the WI Department of Health Services (DHS) to
 - a. Send mailings to FoodShare members living within the City of Madison inviting them to participate in the program.
 - b. Explore if it is allowable for DHS to share FoodShare eligibility status data with the Utility, as well as what a process would look like for safely transmitting the data to the Utility with the goal of qualifying FoodShare members for MadCAP automatically. According to Professor Teodoro, “It’s a magnificently simple affordability strategy that’s easy on customer and utility alike. That kind of seamless, frictionless process maintains citizens’ dignity, and is the gold standard of good public administration.”
- 3) Seek PSCW approval for modification to MadCAP in the 2025 rate case to streamline the income verification process by:
 - a. Matching or exceeding the qualifying income levels to that of the FoodShare limits.
 - b. Combining the existing two income thresholds (30% AMI and 50% AMI) into one group with a uniform monthly credit of \$30 (with Utility’s share at \$12) as shown in Table – 4.

¹ Jackson Action - *A pricing strategy for safe, sustainable, affordable water*
(<https://mannyteodoro.com/?p=4433>)

Table 4 - MadCAP (Current and Proposed) and FoodShare Income Limits				
Household Size	MadCAP (Existing)		FoodShare Limit	MadCAP - Proposed (\$30)
	30% AMI (\$30)	50% AMI (\$20)		
1	25,700	42,750	29,160	42,750
2	29,350	48,850	39,456	48,850
3	33,000	54,950	49,728	54,950
4	36,650	61,050	60,000	61,050
5	39,600	65,950	70,296	70,296
6	42,550	70,850	80,568	80,568
7	45,450	75,750	90,840	90,840
8	50,560	80,600	101,136	101,136
9			111,432	111,432
10+			121,728	121,728

- 4) Seek PSCW approval to modify the need to participate in the Utility’s conservation program from a pre-enrollment condition to a post-enrollment follow up by the Utility, which would include providing water audit kits and detailed instructions for taking advantage of the services provided by Project Home and Focus on Energy²

Average Residential Customer Water Rate Impacts

As is evident from Table – 5 below, households making at or under 50% of the area mean income will see a reduction in their monthly water bills if the proposed Customer Assistance Program is authorized by the PSCW and subsequently implemented by the Utility.

Table 5 - Average Residential Customer Water Rate Impacts		
	Current Rates	\$10.M Expense Depreciation with \$8.3M Cash Adder
General Service Charge	\$14.00	\$15.20
Volumetric Rate – First 3,000 gallons	\$13.80	\$17.19
Next 1,000 gallons	\$6.10	\$7.75
Average Residential Monthly Bill	\$33.90	\$40.14
Change in Monthly Bill		\$6.24
Net Change in Monthly Bill with \$12 Bill Offset		(\$5.76)

² Focus on Energy provides among other things an Online Home Assessment Tool

Recommended Proposal to be included in the 2025 Rate Case to the PSCW

The Utility retained Trilogy Consulting, LLC, (Trilogy) to assist with the development of the Utility's long range financial plan and the 2025 Rate Case proposal. Trilogy has critically examined the Utility's water consumption trends, cash flows, operating and maintenance expenses, infrastructure needs, debt burden, operating and capital ratios and reserves, etc., and assisted Utility staff in developing this proposal. Trilogy and the Utility staff recommend this proposal to be included in the 2025 Rate Case. Trilogy will be making a presentation at the board meeting to go over the proposal.

LEGISLATIVE PATH:

09/24/24 – Common Council (Introduction)
09/25/24 – Water Utility Board
09/30/24 – Finance Committee
10/08/24 – Common Council (Final Approval)

ATTACHMENTS:

1. Common Council Draft Resolution File #85165
2. 2025 Rate Case Presentation