



## MEMORANDUM

Date: September 28, 2021

To: Water Utility Board

From: Krishna Kumar, General Manager

Subject: Submission of 2022 Rate Case to the Public Service Commission of Wisconsin (PSCW)

## RECOMMENDATION

- 1) Authorize the General Manager to file, on behalf of the Utility, a conventional rate case with the PSCW for the test year 2022 that includes accelerated depreciation of water mains (Expense Depreciation) and a means tested Customer Assistance Program (CAP)
- 2) Authorize the General Manager and Finance Manager of the Utility and interested Water Utility Board members to provide individual testimonials to the PSCW

## BACKGROUND

Madison Water Utility (the Utility)'s last rate case was filed on July 1, 2019 and approved by the PSCW on June 22, 2020. The new rates were implemented on July 2, 2020. The Utility is in the process of filing a new conventional rate case with the PSCW (# 3280-WR-116.) The Utility applied for and was approved to extend the submission date for this rate case to December 1, 2021.

The Utility plans to incorporate three seemingly disparate components – expense depreciation, rate design, and affordability goals – into its 2022 Rate Case. These three components 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 2022-27 calls for \$61.5 million in capital investments by way of infrastructure renewal. In the past, the Utility issued revenue bonds to primarily fund its capital projects. However, currently, the Utility has an outstanding total debt obligation of \$245M and an annual debt service payment of \$18.5M for 2021, which is higher than 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', which the PSCW has so far allowed for three other jurisdictions (Janesville, Marshfield and Fort Atkinson). Expense depreciation is a means to **cash finance** replacement of water mains. The PSCW will generally allow 1.3% depreciation on the original cost of existing water mains. The Utility plans to seek PSCW approval to

generate an additional \$5M of depreciation. This will preempt the Utility from incurring more debt in the next several years thereby strengthening its short and long-term financial position.

The Utility plans to request that 55% of the charges relating to the expense depreciation be collected as a separate non-volumetric charge (Infrastructure Renewal Charge). The 55% threshold was chosen to keep the overall percentage of the fixed portion of the water bill to be less than 50%. The entire \$5M of expense depreciation will 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 4.9% on the value of utility assets) provides enough debt coverage. However, in the Utility’s last rate case, the PSCW determined that a ‘cash adder’ of \$6.9M was needed, in addition to depreciation expense and return on investment, to provide debt coverage.

Long-range Financial Plan

The Utility has retained the independent contractor services of Trilogy Consulting, LLC, (Trilogy) to assist with the development of the Utility’s long- range financial plan. 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 developed three long-range financial options as listed in Table – 1 below. In past cases where the PSCW approved expense depreciation, the utilities have been required to spend the entire amount on water main replacements and are not allowed to use the funds for debt service. Therefore, the PSCW may agree that the \$5.0 million expense depreciation should not be considered as available to provide debt coverage. In that case, a cash adder of at least \$7.3M would be appropriate as shown under Option – 3. These three options will be discussed in detail during the presentation at the Board meeting.

<b>Table – 1</b>			
<b>Alternative Options Considered</b>			
	<b>Option 1</b>	<b>Option 2</b>	<b>Option 3</b>
	No Expense Depreciation with \$7.4M Cash Adder	Expense Depreciation with \$2.6M Cash Adder	Expense Depreciation with \$7.3M Cash Adder
Normal Depreciation Expense	\$6.3M	\$6.3M	\$6.3M
Expense Depreciation		\$5.0M	\$5.0M
Return on Investment	\$10.9M	\$10.8M	\$10.8M
Cash Adder	\$7.4M	\$2.6M	\$7.3M
<b>Revenues Available for Debt Service &amp; Capital Projects</b>	<b>\$24.6M</b>	<b>\$24.7M</b>	<b>\$29.4M</b>
Available for Debt Service	\$18.3M	\$18.3M	\$18.3M
<b>Available for Capital Projects</b>	<b>\$6.3M</b>	<b>\$6.4M</b>	<b>\$11.1M</b>

## Customer Assistance Program

Understandably, the expense depreciation approach will result in higher water rates to our customers. To meet the Utility's long-standing commitment to ensure safe drinking water is accessible and affordable for all its customers, the Utility plans to seek PSCW's approval for introducing a means tested Customer Assistance Program (CAP) as part of its current rate case. The PSCW has not approved a CAP program to date.

The proposed CAP will apply income standards set by the Federal Department of Housing & Urban Development (FDHUD). Table – 2 below summarizes the major components of the proposed CAP.

<b>Table – 2 Means Tested Customer Assistance Program</b>			
<b>Area Median Income (AMI) Criteria</b>	<b>“Extremely Low- Income” (≤ 30% AMI)</b>	<b>“Very Low-Income” (&gt; 30% AMI but ≤ 50% AMI)</b>	<b>Total</b>
Eligible Annual Income Threshold (for 3-person household)	≤ \$27,900	≤ \$46,400	
Estimated # of Households Benefited	2,530	3,010	5,540
Monthly Bill Offset Amount	\$12	\$8	
Annual Bill Offset Amount	\$144	\$96	
<b>Estimated Annual Utility Program Cost</b>	<b>\$364,320</b>	<b>\$288,960</b>	<b>\$653,280</b>

Under the proposed CAP, households at or below 30% of AMI will receive a monthly bill offset of **\$12** on their water bill and households at or below 50% of AMI will receive a monthly bill offset of **\$8** on their water bill. The approximate annual cost of the CAP to the Utility at full participation is \$653,280.

Implementation of a means tested CAP 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 as delayed investment in needed infrastructure replacement will ultimately cost all customer classes more money in the long run.

### Levels of Participation

The biggest challenge with any CAP rollout is the actual level of participation by eligible households accomplished over a period of time. It will take time and effort on the part of the Utility to reach meaningful levels of participation by eligible households. Clearly without a significant level of participation, the program will not meet its stated goals. With this challenge in mind, staff is committed to accomplishing three goals:

- 1) Exploring effective ways to increase the level of participation
- 2) Reducing both the administrative burden (on the eligible applicant) and the administrative cost (on the Utility)
- 3) Reporting annually on the actual levels of participation in the program, if and when implemented, as well as the nature of both the administrative burden and cost

The Utility staff has been in consultations with the City of Madison Community Development Authority (CDA) staff to explore ways to benefit from CDA’s vetting process so as to reduce the administrative burden on eligible households. Staff is confident that a streamlined process can be finalized by the time of the actual implementation of the CAP.

A survey of other jurisdictions in the US which have implemented similar CAPs show a wide range of income criteria as shown in Table – 3 below.

<b>Table – 3 / Annual Income Limits (for a 3-person household)</b>			
<b>Jurisdiction</b>	<b>Amount in \$</b>	<b>Jurisdiction</b>	<b>Amount in \$</b>
Atlanta	25,000	Marin Water	100,400
California Water Service	43,920	New York	32,940
Camden County, NJ	10,000	Portland	43,860
Detroit	43,920	Raleigh	38,548
District of Columbia	60,698 – 113,400	Seattle	57,680 – 65,920

Potential Madison Municipal Services Customer Assistance Program (MMS-CAP)

The City of Madison currently bills for five utility services in one combined monthly bill administered by the Madison Water Utility (Water, Sewer, Stormwater, Urban Forestry, and Landfill). The average current monthly municipal services bill amounts to approximately **\$100** a month. If the PSCW is to approve the Water Utility’s CAP, the City of Madison may consider implementing a similar CAP across the other four utilities as well and will adopt similar income and bill assistance levels.

The proposed levels of bill assistance will result in the municipal services bill amounting to approximately **3%** (from 4.3% currently) of the family income for the ‘Extremely Low-Income’ households and **2%** (from the current 2.6%) of the family income for the ‘Low-Income’ households. The program elements of a potential MMS-CAP are shown in Table – 4 below.

<b>Table – 4 Potential Madison Municipal Services – Customer Assistance Program (MMS-CAP)</b>			
<b>Area Median Income (AMI) Criteria</b>	<b>Extremely Low-Income (≤ 30% AMI)</b>	<b>Very Low-Income (&gt; 30% AMI but ≤ 50% AMI)</b>	<b>Total</b>
Eligible Annual Income Threshold	≤ \$27,900	≤ \$46,400	
Estimated # of Households Benefited	2,530	3,010	5,540
Monthly Water Utility Bill Offset Amount	\$12	\$8	
Monthly Other Municipal Services Bill Offset Amount	\$18	\$12	
Total Monthly Bill Offset Amount	\$30	\$20	
Municipal Services Bill as % of Income	3%	2%	
Annual Bill Offset Amount	\$360	\$240	
<b>Potential Estimated Annual MMS-CAP Program Cost</b>	<b>\$910,800</b>	<b>\$722,400</b>	<b>\$1,633,200</b>

## Average Residential Customer Water Rate Impacts

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

<b>Table – 5 Average Residential Customer Impacts</b>				
	Current Rates	Option – 1	Option – 2	Option – 3
		No Expense Depreciation with \$7.4M Cash Adder	\$5M Expense Depreciation with \$2.6M Cash Adder	\$5M Expense Depreciation with \$7.3M Cash Adder
General Service Charge	\$13.80	\$14.75	\$13.49	\$14.54
Volumetric Rate – First 3,000 gallons	\$11.19	\$12.30	\$11.52	\$12.45
Next 1,000 gallons	\$4.93	\$5.43	\$5.13	\$5.55
Infrastructure Renewal Charge		\$0.0	\$2.19	\$2.40
<b>Average Residential Monthly Bill</b>	<b>\$29.92</b>	<b>\$32.48</b>	<b>\$32.33</b>	<b>\$34.94</b>
Change in Monthly Bill		\$2.56	\$2.41	\$5.02
Net Change in Monthly Bill with \$12 Bill Offset		(\$9.44)	(\$9.59)	(\$6.98)
Net Change in Monthly Bill with \$8 Bill Offset		(\$5.44)	(\$5.59)	(\$2.98)

### Recommended Option

Trilogy and the Utility staff recommend Option – 3 to be included in the 2022 Rate Case.

### 2022 Rate Case Milestones

- September 21, 2021 –Common Council for introduction
- September 28, 2021 – Water Board for consideration
- October 11, 2021 – City Finance Committee for consideration
- October 19, 2021 – Common Council for approval
- December 1, 2021 – Submission of Rate Case to the PSCW
- Late 2022 – PSCW Decision
- January 1, 2023 – Effective date of new rates

### **ATTACHMENTS**

1. Common Council Draft Resolution # 67459