



City of Cannon Falls Water, Sewer, and Storm Water Rate Analysis

**Executive Summary
December 3, 2013**

Introduction

The City of Cannon Falls has requested Ehlers to complete an updated utility rate analysis to review water, sewer, and storm water rates for 2014 and beyond.

The water, sewer, and storm water utilities have established rates that are adequate to meet operating expenses. In addition, the water and sewer funds are financially healthy and have established solid cash reserves. The storm water fund was established in 2009 and has made great strides over the last couple of years to build cash reserves. The City recently refunded the 2006A and 2006B PIR bonds in 2012 and also issued debt in 2013 to pay for the East Side Project I, including utility upgrades. Future utility upgrades within the street reconstruction program are planned for every other year. In the long term, the City also has plans for a potential new water tower and several sewer projects. The City has identified the need to increase utility rates to build additional reserves in advance of these projects.

In conjunction with current economic conditions, assumptions regarding growth and future development were scaled back. The chart below reflects the number of future connections assumed in the study.

	2013	2014	2015	2016	2017
Residential	0	2	5	10	15
Commercial	0	3	3	4	4

Projected developer fees have also been scaled back to reflect the slower growth projections. This shifts the burden to pay for the existing debt service to user rates rather than developer fees.

Water Utility

The City of Cannon Falls owns and operates the water utility that serves its residents and businesses. The utility’s financial activity is accounted for in the City’s Water Fund. By looking at the fund as a whole, we can see key features of the utility operations.

Operating costs are the single biggest expense of the water utility, followed closely by capital and debt expenditures. As a rule, utilities are capital intensive operations. Operating costs account for 53% of the total utility expenses. Capital costs and principal and interest on outstanding debt issued to finance capital projects accounts for 47%.

In 2012, the City of Cannon Falls refunded their 2006A & 2006B P.I.R. Fund Bonds with the 2012B G.O. Revenue debt. Water utility upgrades in conjunction with the 2013 east side reconstruction project were financed as part of the 2013A G.O. Bond.

The City has consistently increased water rates on an annual basis. Ehlers is recommending the City continue this trend in 2014 and annually thereafter. This will allow the City to collect adequate revenues and to provide for operating expenses, debt obligations and future scheduled capital improvements.

Proposed Water Rates

This report proposes, for the City Council’s consideration, a simple rate increase for 2014 in order to generate sufficient revenues to operate the utility, make annual debt payments, and pay for capital projects.

This report proposes a 4% rate increase for flat rates and usage rates for 2014. This is less than our previous reports, which had recommended 10% rate increases. Dry summers resulted in higher than expected revenues for 2011 and 2012. Rate increases are still necessary in order to provide cash flow for operations, future capital and future debt for needed improvements. This rate increase takes these factors into account and also compensates for the slower growth projections due to the sluggish economy. We are recommending a 4% annual rate increases for 2014 and beyond.

The chart below shows the existing water rate for 2013 and the proposed rates for 2014 and beyond. An average residential property consumes 800 cubic feet per month. This type of property would see an increase of \$1.04 increase in their monthly water bill. The average commercial property using only 2,600 cubic feet per month would receive a modest \$2.91 increase in their monthly bill. The chart below shows the proposed rates for 2014 through 2017.

Monthly Water Rates	Existing	Proposed			
	2013	2014	2015	2016	2017
Annual Rate Increase		4%	4%	4%	4%
Base Rate (All Users)	\$ 5.25	\$ 5.46	\$ 5.68	\$ 5.91	\$ 6.14
Residential Users					
100-300 cu. Ft.	\$ 2.22	\$ 2.31	\$ 2.41	\$ 2.50	\$ 2.60
400-900 cu. Ft.	2.77	2.88	3.00	3.12	3.24
1,000-6,000 cu. Ft.	3.46	3.60	3.74	3.89	4.05
+6,000 cu. Ft.	5.18	5.39	5.60	5.83	6.06
Commercial Users					
100-800 cu. Ft.	\$ 2.22	\$ 2.31	\$ 2.41	\$ 2.50	\$ 2.60
900-2,800 cu. Ft.	2.77	2.88	3.00	3.12	3.24
2,900-7,500 cu. Ft.	3.46	3.60	3.74	3.89	4.05
+7,500 cu. Ft.	5.18	5.39	5.60	5.83	6.06
Irrigation Accounts					
All Usage	\$ 5.18	\$ 5.39	\$ 5.60	\$ 5.83	\$ 6.06

Sewer Utility

The Sewer Fund is still paying for the 2001 PFA loans, plus has planned utility upgrades in conjunction with the street reconstruction program. It is anticipated the City will need to issue debt on the odd years to pay for projects. Thus, Ehlers is proposing increases in sewer fees of 10% per year for 2014 through 2016. However, for 2017 and beyond, we are projecting only inflationary increases of 5% per year. These rates are consistent with previous year's reports.

The chart below shows the recommended sewer rates for 2014 and beyond.

Monthly Sewer Rates	Existing	Proposed			
	2013	2014	2015	2016	2017
Annual Rate Increase		10%	10%	10%	5%
Residential Users					
Minimum Charge	\$ 22.17	\$ 24.38	\$ 26.82	\$ 29.50	\$ 30.98
(Includes 400 cu. Ft.)					
Consumption Rate	7.74	8.51	9.37	10.30	10.82
Commercial Users					
Minimum Charge	\$ 31.91	\$ 35.10	\$ 38.61	\$ 42.47	\$ 44.60
(Includes 400 cu. Ft.)					
Consumption Rate	7.74	8.51	9.37	10.30	10.82

Storm Water Utility

The storm water utility was first established in 2009. Prior to that, storm water costs were paid for out of the General Fund. This fund has made steady increases in cash and fund balance through 2012. The storm water projects completed as part of the 2013 street projects are included in the study. Currently, residential rates are a fixed amount of \$2.42 per home. Commercial properties are calculated individually based on the amount of impervious surface. Ehlers is recommending only inflationary rate increases of 2% per year in order to make current bond payments, plus build reserves for future capital projects. This is less than prior year projections of 10% as revenues have increased and expenditures have stabilized.

The rate chart below shows the recommended storm water rates through 2017.

Monthly Storm Water Rates	Existing	Proposed			
	2013	2014	2015	2016	2017
Annual Rate Increase		2%	2%	2%	2%
Residential Users					
Fixed Charge	\$ 2.42	\$ 2.47	\$ 2.52	\$ 2.57	\$ 2.62
Commercial Users					
Calculated individually	Contact City Finance Staff for details				

Putting It All Together: The Utility Bill

From a customer’s perspective, they receive one bill for water, sewer, and storm water and are concerned about the total amount. The increases to each of the utility rates provides for a consistent and equitable approach each year, thus avoiding high spikes in rates or “sticker shock”. The following chart shows a sample utility bill for average residential customers consuming 800 cubic feet per month using the rates proposed above.

Monthly Bill	Existing	Proposed			
	2013	2014	2015	2016	2017
Water	\$ 25.77	\$ 26.81	\$ 27.88	\$ 28.99	\$ 30.15
Sewer	53.13	58.44	64.28	70.71	74.24
Storm Water	2.42	2.47	2.52	2.57	2.62
Total Bill	\$ 81.32	\$ 87.72	\$ 94.68	\$ 102.27	\$ 107.01
\$ Increase		\$ 6.40	\$ 6.96	\$ 7.59	\$ 4.74

Cash Balances and Financing Capital Improvements

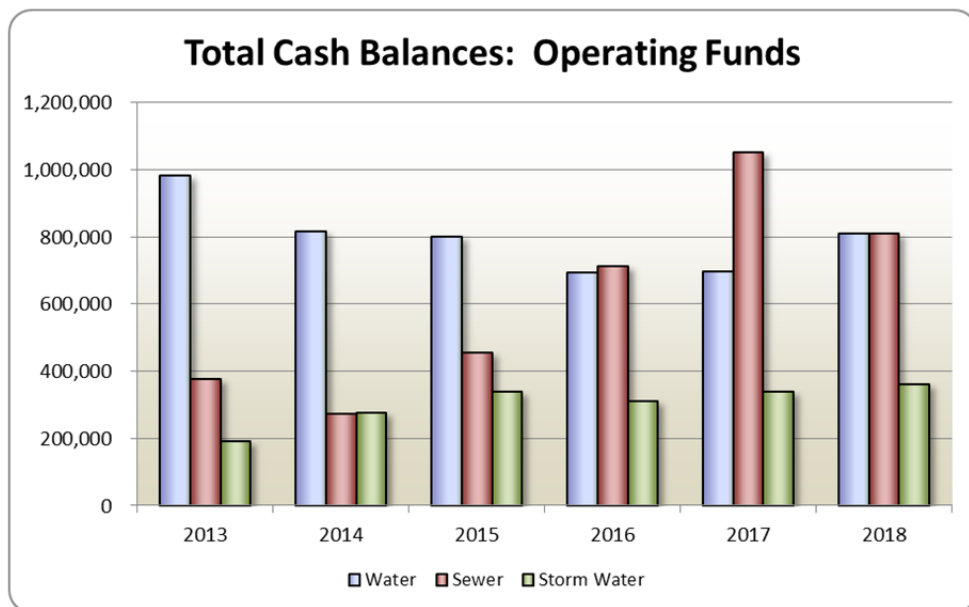
Water, Sewer, and Storm Water Capital Improvements

The capital improvement plans for the water and sewer funds are attached in Exhibit A.

The City is planning to upgrade existing utility infrastructure every other year in conjunction with the street reconstruction program. There is also the possibility of a new water tower, depending on future development and a water treatment plant, if mandated by the State of Minnesota.

Target Cash Reserves – Water, Sewer, and Storm Water Funds

The proposed rates impose the lowest rate increases that will still leave the City's utility systems in good financial health. The projected cash balances for the funds, a measure of financial health, are shown in following graph.



Proposed rates were designed to approximate a targeted cash balance equal to 50% of the current year's operating expense, plus 100% of next year's debt payments. For the Water Fund, the cash balances are very close to the target. However, the Sewer Fund continues to close in on this targeted amount each year. We are estimating this will happen around 2021. Projections for the Storm Water Fund are at or above target. However, we expect the targeted balance to increase as this fund continues to take on its share of current and future debt.

The proposed rates will provide sufficient revenue to pay routine operating expenses, pay for capital improvements to upgrade and expand the system, and provide prudent cash balances. Adequate cash balances allow the City to:

- Survive changing circumstances in the economy and the weather without rapidly increasing rates;
- Use cash to pay for a portion of capital improvements and reduce the frequency of borrowing.

Summary

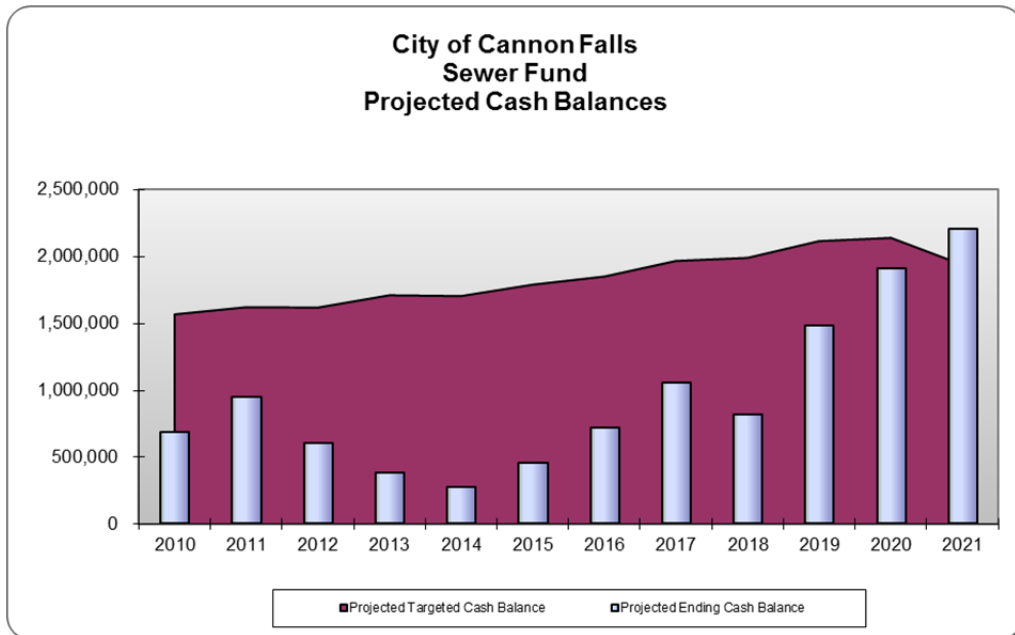
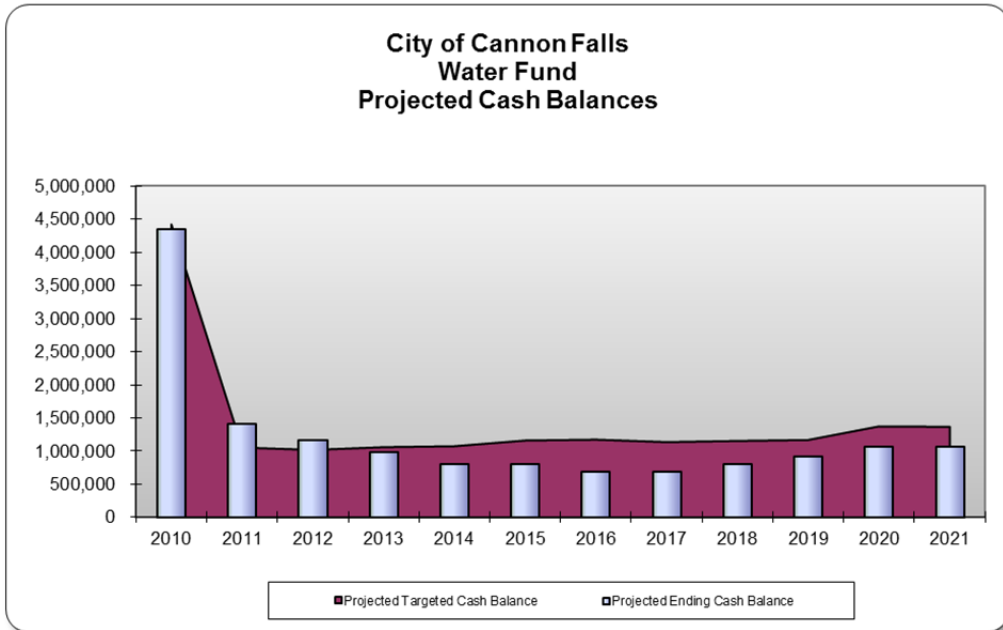
Ehlers is recommending a dual-pronged approach to maintain the financial health of the City's utilities.

1. Consider the proposed changes in the rates for water, sewer, and storm water for 2012.
 - a. Water Fund – 4%
 - b. Sewer Fund – 10%
 - c. Storm Water Fund – 2%
2. Consider annual updates to the utility rate study to ensure continued financial health of the funds.

The study assumes the City will finance major utility improvements in order to keep cash balances relatively steady from year to year. This study is not a debt plan. In practice, the City staff will continue to use the rate study's financing plan as a guide and, in consultation with its financial advisor, consider when and how much debt to incur in any given year.

Exhibit A – Operating Fund Projections

Below are charts which show how closely the actual and projected cash balances for each fund are to their respective targeted balances.



**City of Cannon Falls
Storm Sewer Fund
Projected Cash Balances**

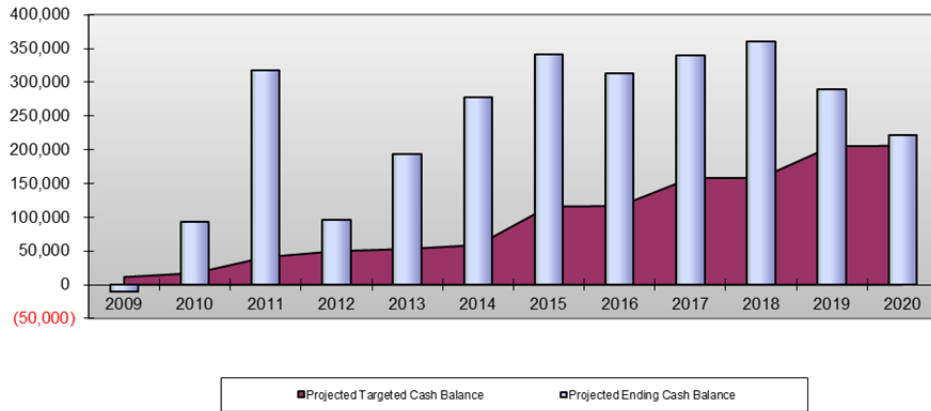


Exhibit B – Capital Improvement Projects by Fund

City of Cannon Falls										
Water System Capital Improvement Plan										
Project	2013	2014	2015	2016	2017	2018	2019	2020	2021	
R&R N. Booster Generator			26,000							
Radio Telemetry System	32,000									
Replace North Reservoir or Industrial Park Tower								1,400,000		
Upgrade East Booster				90,000						
Water Treatment Facility										3,000,000
Street Reconstruction Projects	305,000		572,760		286,380		278,640			-
Pickup Truck (50%)	20,000	20,000								
Water Tower Clean		75,450	75,450							
Total	357,000	95,450	674,210	90,000	286,380	-	278,640	1,400,000	3,000,000	
Total Inflated CIP Expense	357,000	98,314	715,269	98,345	322,323	-	332,711	1,721,823	3,800,310	
Inflation Rate	0%	3%	3%	3%	3%	3%	3%	3%	3%	3%

City of Cannon Falls										
Sanitary Sewer System Capital Improvement Plan										
Project	2013	2014	2015	2016	2017	2018	2019	2020	2021	
Sewer River Crossing				400,000						
Sludge Dryer					600,000					
Two New Clarifiers						500,000				
Increase Size of Fine Screen							100,000			
Oxidation Ditch										800,000
Replace Portable Generator			28,000							
Street Reconstruction Projects	660,000		518,700		251,628		527,700			168,480
Pickup Truck (50%)	20,000	20,000								
Other										
Total	680,000	20,000	546,700	400,000	851,628	500,000	627,700	-	968,480	
Total Inflated CIP Expense	680,000	20,600	579,994	437,091	958,515	579,637	749,507	-	1,226,841	
Inflation Rate	0%	3%	3%	3%	3%	3%	3%	3%	3%	3%

City of Cannon Falls
Storm Sewer System Capital Improvement Plan

Project	2013	2014	2015	2016	2017	2018	2019	2020	2021
318th St./CSAH 24 storm				75,000					
4th & Mill St. storm								40,000	
Amsbury pond improvements		13,500							
Interchange storm share									106,000
Equipment - Sweeper									160,000
Street Reconstruction Projects	132,000		604,200		404,700		478,800		
Total	132,000	13,500	604,200	75,000	404,700	-	478,800	40,000	266,000
Total Inflated CIP Expense	132,000	13,905	640,996	81,955	455,493	-	571,712	49,195	336,961
Inflation Rate	0%	3%	3%	3%	3%	3%	3%	3%	3%