

TO: MAYOR AND CITY COUNCIL
FROM: RONALD JOHNSON, CITY ADMINISTRATOR
SUBJECT: 2016 UTILITY RATES (AMENDED MEMO)
DATE: APRIL 19, 2016

BACKGROUND

Representative(s) from Ehlers & Associates will be at the City Council meeting to present their recommendations for the 2016 utility rates and answer any Council questions. A copy of the Executive Summary is included in the packet.

They are recommending the following increases:

Water – 5%
Sanitary Sewer – 5%
Storm Sewer – 2%

Council is being requested to call for a public hearing to consider utility rate adjustments to be held on May 17th, 2016 at 6:30 p.m.

RECOMMENDED COUNCIL ACTION

Staff respectfully requests a motion receiving the Utility Rate Study and calling for a public hearing to consider utility rate adjustments to be held on May 17th, 2016 at 6:30 p.m.

Attachments:
Executive Summary

TO: MAYOR AND CITY COUNCIL
FROM: RONALD JOHNSON, CITY ADMINISTRATOR
SUBJECT: 2016 UTILITY RATES
DATE: April 13, 2016

BACKGROUND

Representative(s) from Ehlers & Associates will be at the City Council meeting to present their recommendations for the 2016 utility rates and answer any Council questions. A copy of the Executive Summary is included in the packet.

They are recommending the following increases:

Water – 5%
Sanitary Sewer – 5%
Storm Sewer – 2%

Council is being requested to approve the 2016 utility rates effective with the May 1, 2016 billing for April 2016 usage. The required resolution will be presented for adoption at the May 3, 2016 Council meeting.

RECOMMENDED COUNCIL ACTION

Staff respectfully requests a motion receiving the Executive Summary and approving the 2016 utility rates effective May 1, 2016 for April 2016 usage.

Attachments:
Executive Summary

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

**Executive Summary
April 19, 2016**

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 2016 and beyond. The City’s utility enterprise funds continue to be managed well and are in good financial health. This year’s update takes into account significant changes to anticipated future capital improvement projects.

Future utility upgrades within the street reconstruction program are planned for every other year. In the next five years, the City also has plans for several water projects. It is expected that after the final phases of the street reconstruction program are finished there will be minimal capital costs associated with sustaining the utility infrastructure and operations.

At this time the City has identified the need to increase utility rates for 2016 in order to build sufficient revenues to pay for the upcoming projects and maintain operating reserves. Long term rate increases will depend greatly on future utility improvements and the rate of growth within the community. Toward this end, the City will need to continue reviewing capital and financial conditions regularly.

Growth

How quickly the City grows will impact the utility revenues and fees collected, as well as capital requirements. While the City is already seeing some new business with the addition of a local brewery, growth estimates remain conservative. Assumptions regarding growth and future development were held consistent with prior year’s rate studies. The chart below reflects the number of future connections assumed in the study.

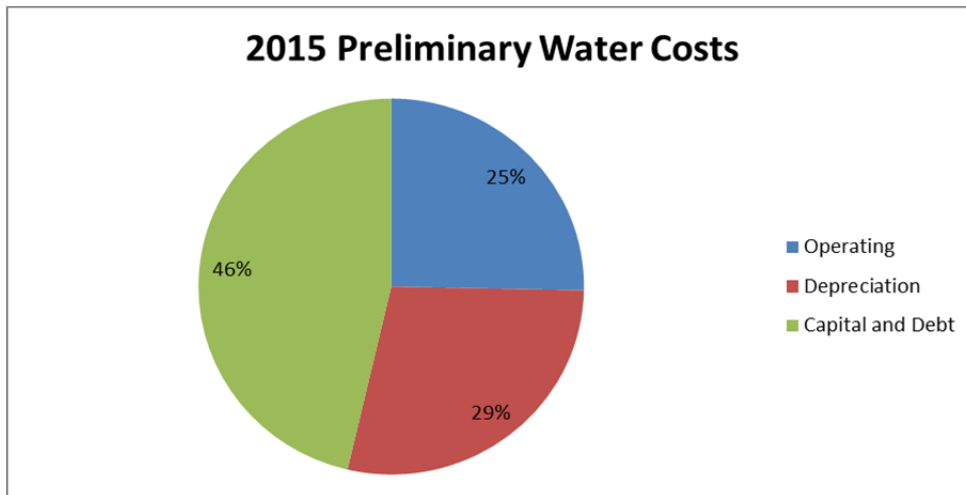
	2017	2018	2019	2020	2021
Residential	5	5	5	5	5
Commercial	3	3	3	3	3



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.

Capital and debt are currently the biggest expense of the water utility. As a rule, utilities are capital intensive operations. The following chart shows the proportion of operating costs to capital and debt service, with capital and debt accounting for 46% of the 2015 Water Fund costs.



The City has consistently increased water rates on an annual basis. Ehlers is recommending the City continue this trend through 2019. This will allow the City to collect adequate revenues 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 5% rate increase for flat rates and usage rates for 2016. This is consistent with last year's report. Rate increases are still necessary in order to provide cash flow for operations, future capital and debt service requirements. This rate increase takes these factors into consideration and also compensates for the conservative growth projections.

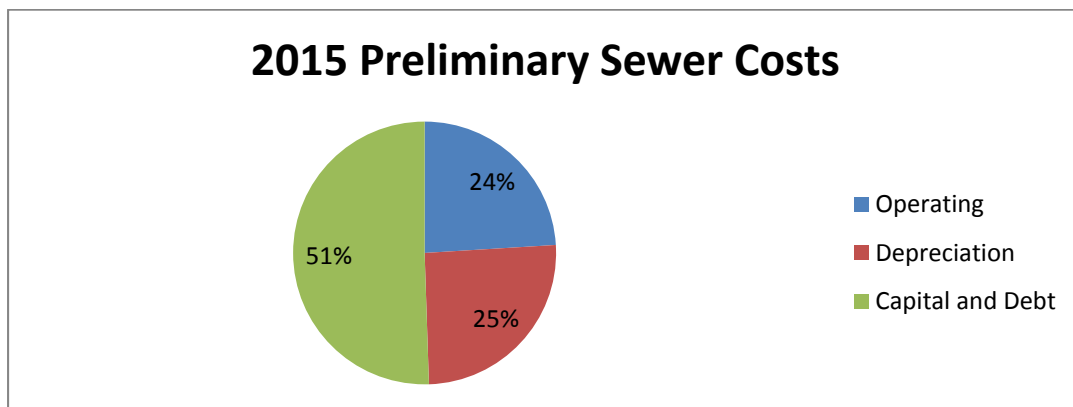
An average residential property consumes 800 cubic feet of water per month. With a 5% rate increase in 2016, this type of property would see an increase of \$1.41 in their monthly water bill. The average commercial property using only 2,600 cubic feet per month would receive a modest \$3.99 increase in their monthly bill. The chart on the following page shows the current water rate and the proposed rates for 2016 through 2020.

Monthly Water Rates	Existing	Proposed				
	2015	2016	2017	2018	2019	2020
Annual Rate Increase		5.0%	5.0%	5.0%	5.0%	0.0%
Base Rate (All Users)	\$ 5.74	\$ 6.03	\$ 6.33	\$ 6.64	\$ 6.98	\$ 6.98
Residential Users						
100-300 cu. Ft.	\$ 2.43	\$ 2.55	\$ 2.68	\$ 2.81	\$ 2.95	\$ 2.95
400-900 cu. Ft.	3.03	3.18	3.34	3.51	3.68	3.68
1,000-6,000 cu. Ft.	3.78	3.97	4.17	4.38	4.59	4.59
+6,000 cu. Ft.	5.66	5.94	6.24	6.55	6.88	6.88
Commercial Users						
100-800 cu. Ft.	\$ 2.43	\$ 2.55	\$ 2.68	\$ 2.81	\$ 2.95	\$ 2.95
900-2,800 cu. Ft.	3.03	3.18	3.34	3.51	3.68	3.68
2,900-7,500 cu. Ft.	3.78	3.97	4.17	4.38	4.59	4.59
+7,500 cu. Ft.	5.66	5.94	6.24	6.55	6.88	6.88
Irrigation Accounts						
All Usage	\$ 5.66	\$ 5.94	\$ 6.24	\$ 6.55	\$ 6.88	\$ 6.88

Sanitary Sewer Utility

The City is responsible for maintaining the utility system of collecting and treating wastewater from its residents and businesses. The utility's financial activity is accounted for in the City's Sanitary Sewer Fund. As with the Water Fund, the Sanitary Sewer Fund currently carries a large amount of capital and debt expense.

The Sanitary 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 every other year starting in 2016 to help pay for street reconstruction projects. The following chart shows the proportion of operating costs to capital and debt service, with capital and debt accounting for over half of the 2015 Sanitary Sewer Fund costs.



In favor of level annual rate increases, we recommend the City continue to consistently increase sewer rates on an annual basis through 2019.

Proposed Sewer Rates

This report proposes, for the City Council’s consideration, a 5% rate increase for flat rates and usage rates for 2016. This is consistent with last year’s report. Rate increases are still necessary in order to provide cash flow for operations, future capital and debt service requirements. This rate increase takes these factors into consideration and also compensates for the conservative growth projections.

An average residential property consumes 800 cubic feet of water per month. With a 5% rate increase in 2016, this type of property would see an increase of \$3.07 in their monthly sewer bill. The average commercial property using 2,600 cubic feet of water per month would receive an increase of \$11.67 in their monthly bill. The chart below shows the current water rate and the proposed rates for 2016 through 2020.

Monthly Sewer Rates	Existing	Proposed				
	2015	2016	2017	2018	2019	2020
Annual Rate Increase		5.0%	5.0%	5.0%	5.0%	0.0%
Residential Users						
Minimum Charge (Includes 400 cu. Ft.)	\$ 25.60	\$ 26.88	\$ 28.22	\$ 29.63	\$ 31.12	\$ 31.12
Consumption Rate	8.94	9.38	9.85	10.34	10.86	10.86
Commercial Users						
Minimum Charge (Includes 400 cu. Ft.)	\$ 36.86	\$ 38.70	\$ 40.63	\$ 42.66	\$ 44.80	\$ 44.80
Consumption Rate	8.94	9.38	9.85	10.34	10.86	10.86

Storm Sewer Utility

The Storm Sewer utility was established in 2009 and has made great strides over the last couple of years to build cash reserves. This will allow for capital improvement projects associated with the street reconstruction program to be paid from cash on hand during the next few years. Currently, residential rates are a fixed amount of \$2.52 per home. Commercial properties are calculated individually based on the amount of impervious surface.

Ehlers is recommending only an inflationary rate increase of 2% for 2016. This is consistent with last year’s report. However, annual rate increases will need to be incrementally larger in future years in order to keep the cash reserve at target levels and fund future capital improvement projects.

The rate chart below shows the recommended storm sewer rates through 2020.

Monthly Storm Sewer Rates	Existing 2015	Proposed				
		2016	2017	2018	2019	2020
Annual Rate Increase		2.00%	2.00%	2.25%	2.25%	2.25%
Residential Users						
Fixed Charge	\$ 2.52	\$ 2.57	\$ 2.62	\$ 2.68	\$ 2.74	\$ 2.80
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 sewer 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 of water per month using the rates proposed above.

Monthly Bill	Existing 2015	Proposed				
		2016	2017	2018	2019	2020
Water	\$ 28.18	\$ 29.59	\$ 31.07	\$ 32.62	\$ 34.25	\$ 34.25
Sanitary Sewer	61.34	64.41	67.63	71.01	74.56	74.56
Storm Sewer	2.52	2.57	2.62	2.68	2.74	2.80
Total Bill	\$ 92.04	\$ 96.57	\$101.32	\$106.31	\$111.55	\$111.61
\$ Increase		\$ 4.53	\$ 4.75	\$ 4.99	\$ 5.24	\$ 0.06

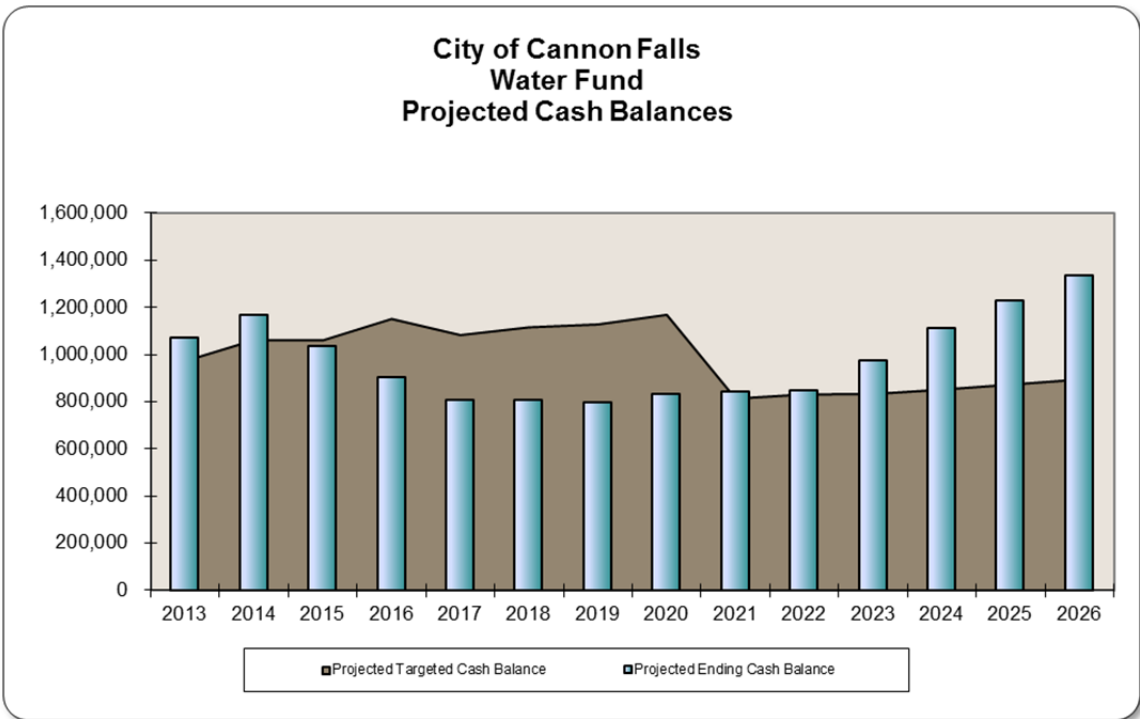
Financing Capital Improvements

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

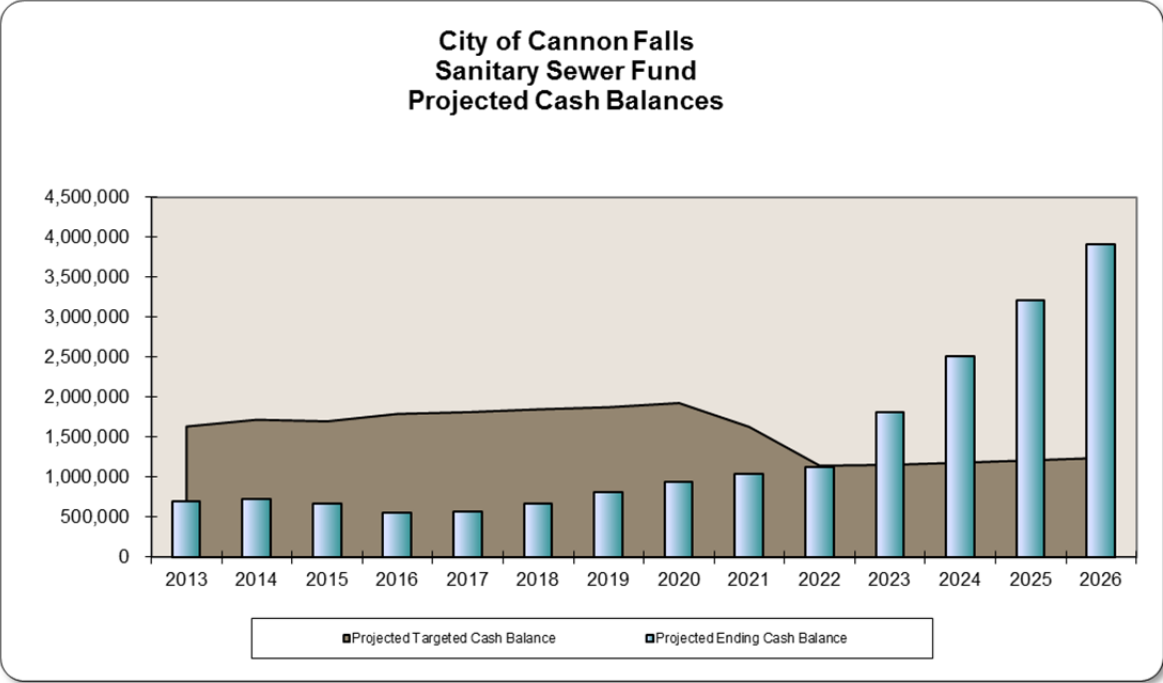
The City is planning to upgrade existing utility infrastructure every other year, from 2016 through 2022, in conjunction with the street reconstruction program. There are also plans for water tower cleaning, capital equipment purchases and other utility upgrades. However, it is anticipated that after the current street reconstruction program is completed in 2022 there will be minimal capital improvement costs going forward. The City will need to maintain adequate cash flow for any unpredictable expenses and continue reviewing capital requirements regularly in order to adjust utility rates accordingly.

Target Cash Reserves

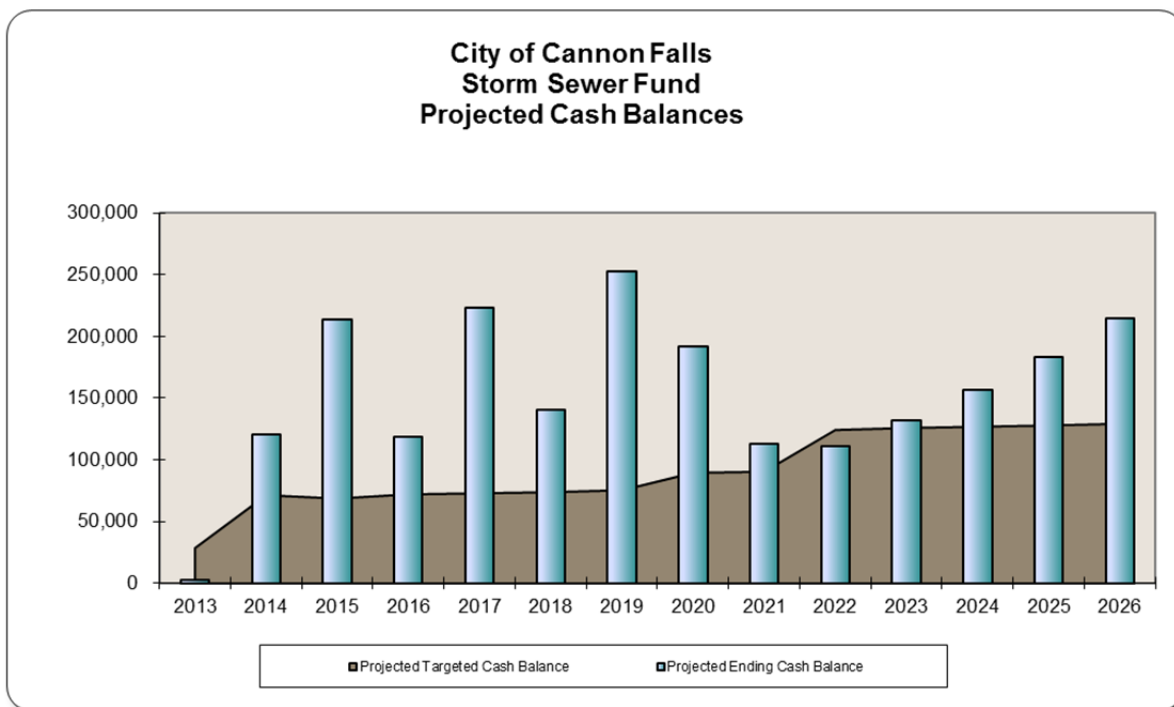
The proposed rates impose the lowest rate increases that will still leave the City’s utility systems in good financial health and were designed to approximate a targeted cash balance equal to 50% of the current year’s operating expense, plus 100% of current year’s depreciation expense and next year’s debt payments. The projected cash balances for the funds, a measure of financial health, are shown on the following page.



For the Water Fund, the cash balance is currently very close to the target. However, consistent annual increases will be needed to maintain cash reserves in the near term.



The Sewer Fund continues to close in on its target amount each year. We are estimating that with annual rate increases over the next few years the Sewer Fund will hit target around year 2022.



The Storm Sewer Fund cash balance currently exceeds the target. However, combined with steady incremental annual rate increases, this will allow the City to minimize reliance on bonding and avoid sudden large rate increases in the future.

Summary

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.

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 sewer for 2016.
 - a. Water Fund – 5%
 - b. Sanitary Sewer Fund –5%
 - c. Storm Sewer 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 municipal advisor, consider when and how much debt to incur in any given year.

Exhibit A – Capital Improvement Projects by Fund

City of Cannon Falls

Water System Capital Improvement Plan

Project	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
R&R N. Booster Generator												
Radio Telemetry System												
North Reservoir				30,000								
Upgrade East Booster					50,000							
Water Treatment Facility												
Street Reconstruction Projects		653,000		160,000		232,000		310,000				
Pickup Truck (50%)	20,000		20,000									
Water Tower Clean			50,000	50,000	50,000	50,000	50,000	50,000				
Future Year Placeholder									150,000	150,000	150,000	150,000
Total	20,000	653,000	70,000	240,000	100,000	282,000	50,000	360,000	150,000	150,000	150,000	150,000
Total Inflated CIP Expense	20,000	653,000	72,100	254,616	109,273	317,393	57,964	429,859	184,481	190,016	195,716	201,587
Inflation Rate			3%	3%	3%	3%	3%	3%	3%	3%	3%	3%

Sanitary Sewer System Capital Improvement Plan

Project	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Sewer River Crossing												
Sludge Dryer												
Two New Clarifiers												
Increase Size of Fine Screen								100,000				
Oxidation Ditch												
Replace Portable Generator												
Street Reconstruction Projects		611,000		120,000		260,000		480,000				
Pickup Truck (50%)	20,000		20,000									
Future Year Placeholder									125,000	125,000	125,000	125,000
Total	20,000	611,000	20,000	120,000	-	260,000	-	580,000	125,000	125,000	125,000	125,000
Total Inflated CIP Expense	20,000	611,000	20,600	127,308	-	292,632	-	692,550	153,734	158,346	163,097	167,990
Inflation Rate			3%	3%	3%	3%	3%	3%	3%	3%	3%	3%

Storm Sewer System Capital Improvement Plan

Project	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
318th St./CSAH 24 storm work												
4th & Mill St. storm						40,000						
Amsbury pond improvements												
Interchange storm share												
Equipment - Sweeper							160,000					
Street Reconstruction Projects		198,000		180,000		340,000		400,000				
Future Year Placeholder									50,000	50,000	50,000	50,000
Total	-	198,000	-	180,000	-	380,000	160,000	400,000	50,000	50,000	50,000	50,000
Total Inflated CIP Expense	-	198,000	-	190,962	-	427,693	185,484	477,621	61,494	63,339	65,239	67,196
Inflation Rate			3%	3%	3%	3%	3%	3%	3%	3%	3%	3%

Exhibit B – Projected Cash Flows by Fund

City of Cannon Falls Utility Rate Study

Water Fund	Actual	Preliminary	Budget	Projected									
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Proposed Rate Increase (%)		5.00%	5.00%	5.00%	5.00%	5.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Operating Revenues	707,799	719,316	760,608	843,968	887,810	934,030	937,949	941,867	945,786	949,705	953,623	957,542	961,461
Operating and Maintenance Expense	319,882	314,268	375,500	386,765	398,368	410,319	422,629	435,307	448,367	461,818	475,672	489,942	504,641
Net Before Debt Service	387,917	405,048	385,108	457,203	489,442	523,711	515,320	506,560	497,419	487,887	477,951	467,600	456,820
Existing Debt Service (P&I)	453,256	555,427	550,913	548,441	463,574	465,861	460,647	460,064	86,338	85,155	67,012	65,575	66,022
Projected Debt Service (P&I)	0	0	0	54,700	54,700	68,521	68,521	91,906	91,906	91,906	91,906	91,906	91,906
Total Debt Service	453,256	555,427	550,913	603,140	518,274	534,382	529,168	551,970	178,244	177,061	158,917	157,480	157,927
Net Revenues	(65,339)	(150,380)	(165,806)	(145,937)	(28,832)	(10,671)	(13,848)	(45,410)	319,175	310,826	319,034	310,120	298,893
Interest Income	5,573	5,133	10,334	9,014	8,079	8,053	9,927	12,495	14,741	16,933	19,505	22,166	24,588
Special Assessments	68,263	49,441	44,000	130,994	123,158	116,252	115,681	115,681	115,682	824	0	0	0
Other Non Operating Revenues/(Expenses)	(7,300)	(15,475)	(20,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)
Net Annual Cash Flow	1,197	(111,281)	(131,947)	(21,405)	86,931	98,159	96,285	67,292	434,123	313,108	323,064	316,811	308,006
Capital Projects	(80,720)	(20,000)	(653,000)	(72,100)	(254,616)	(109,273)	(317,393)	(57,964)	(429,859)	(184,481)	(190,016)	(195,716)	(201,587)
Bond Proceeds	0	0	653,000	0	165,000	0	260,000	0	0	0	0	0	0
Net Cash Flow after Capital Projects	(79,523)	(131,281)	(131,947)	(93,505)	(2,685)	(11,114)	38,891	9,328	4,265	128,626	133,049	121,095	106,418
Ending Cash Balance	1,164,672	1,033,391	901,445	807,940	805,255	794,141	833,033	842,361	846,626	975,252	1,108,301	1,229,395	1,335,814
Targeted Working Capital	1,061,195	1,060,038	1,150,890	1,082,456	1,115,490	1,127,710	1,168,467	813,237	831,103	832,581	851,353	872,617	894,058
Over/(Under) Target Working Capital	103,477	(26,647)	(249,445)	(274,516)	(310,235)	(333,568)	(335,434)	29,124	15,523	142,672	256,947	356,778	441,756

Sanitary Sewer Fund	Actual	Preliminary	Budget	Projected									
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Proposed Rate Increase (%)		5.00%	5.00%	5.00%	5.00%	5.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Operating Revenues	1,279,346	1,373,574	1,381,058	1,500,269	1,581,998	1,668,251	1,677,494	1,686,737	1,695,979	1,705,222	1,714,465	1,723,708	1,732,951
Operating and Maintenance Expense	492,958	471,300	534,850	550,896	567,422	584,445	601,978	620,038	638,639	657,798	677,532	697,858	718,794
Net Before Debt Service	786,388	902,274	846,208	949,374	1,014,575	1,083,806	1,075,515	1,066,699	1,057,341	1,047,424	1,036,933	1,025,850	1,014,157
Existing Debt Service (P&I)	872,062	970,536	965,888	964,934	964,363	964,653	966,659	966,360	641,648	99,264	81,968	80,234	79,886
Projected Debt Service (P&I)	0	0	0	51,098	51,098	61,568	61,568	87,651	87,651	119,131	119,131	119,131	119,131
Total Debt Service	872,062	970,536	965,888	1,016,032	1,015,461	1,026,221	1,028,227	1,054,011	729,299	218,394	201,099	199,365	199,016
Net Revenues	(85,674)	(68,262)	(119,680)	(66,658)	(885)	57,584	47,288	12,687	328,042	829,030	835,834	826,485	815,141
Interest Income	4,248	4,149	6,632	5,600	5,718	6,609	10,060	14,081	18,282	22,552	36,213	50,178	64,139
Special Assessments	54,943	40,909	36,300	109,028	101,993	95,219	94,648	94,648	94,649	674	0	0	0
Other Non Operating Revenues/(Expenses)	(9,953)	(15,475)	(25,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)	(15,475)
Net Annual Cash Flow	(36,436)	(38,679)	(102,223)	32,494	91,352	143,938	136,522	105,942	425,497	836,781	856,573	861,188	863,805
Capital Projects	(24,214)	(20,000)	(611,000)	(20,600)	(127,308)	0	(292,632)	0	(692,550)	(153,734)	(158,346)	(163,097)	(167,990)
Bond Proceeds	0	0	610,000	0	125,000	0	290,000	0	350,000	0	0	0	0
Net Cash Flow after Capital Projects	(60,650)	(58,679)	(103,223)	11,894	89,044	143,938	133,890	105,942	82,947	683,047	698,226	698,091	695,816
Ending Cash Balance	721,854	663,175	559,951	571,846	660,889	804,827	938,716	1,044,658	1,127,605	1,810,652	2,508,878	3,206,969	3,902,785
Targeted Working Capital	1,720,733	1,700,406	1,793,457	1,816,208	1,850,992	1,877,740	1,929,010	1,630,548	1,146,681	1,157,234	1,184,184	1,213,379	1,243,810
Over/(Under) Target Working Capital	(998,879)	(1,037,231)	(1,233,506)	(1,244,362)	(1,190,103)	(1,072,913)	(990,294)	(585,890)	(19,076)	653,418	1,324,694	1,993,590	2,658,975

Storm Sewer Fund	Actual	Preliminary	Budget	Projected									
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Proposed Rate Increase (%)		2.00%	2.00%	2.00%	2.25%	2.25%	2.25%	2.50%	2.50%	2.50%	2.75%	2.75%	2.75%
Operating Revenues	147,072	146,702	149,883	153,132	156,835	160,626	164,509	168,897	173,401	178,022	183,212	188,551	194,052
Operating and Maintenance Expense	8,072	10,327	10,950	11,279	11,617	11,965	12,324	12,694	13,075	13,467	13,871	14,287	14,716
Net Before Debt Service	139,000	136,375	138,933	141,853	145,218	148,661	152,184	156,203	160,326	164,555	169,341	174,263	179,336
Existing Debt Service (P&I)	(1,077)	42,639	38,696	38,560	38,454	38,333	38,792	29,291	29,113	28,948	29,331	29,110	28,880
Projected Interfund Loan Payments (P&I)	0	0	0	0	0	0	0	22,485	22,485	55,314	55,314	55,314	55,314
Total Debt Service	(1,077)	42,639	38,696	38,560	38,454	38,333	38,792	51,776	51,598	84,261	84,644	84,424	84,194
Net Revenues	140,077	93,737	100,237	103,293	106,764	110,329	113,392	104,427	108,728	80,294	84,697	89,839	95,142
Interest Income	169	76	2,140	1,184	2,228	1,409	3,158	2,872	1,982	2,227	2,648	2,648	3,128
Special Assessments	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Non Operating Revenues/(Expenses)	0	0	0	0	0	0	0	0	0	0	0	0	0
Net Annual Cash Flow	140,246	93,813	102,377	104,477	108,992	111,737	116,550	107,299	110,710	82,521	87,345	92,487	98,270
Capital Projects	(23,017)	0	(198,000)	0	(190,962)	0	(427,693)	(185,484)	(477,621)	(61,494)	(63,339)	(65,239)	(67,196)
Bond Proceeds	0	0	0	0	0	0	250,000	0	365,000	0	0	0	0
Net Cash Flow after Capital Projects	117,229	93,813	(95,623)	104,477	(81,970)	111,737	(61,144)	(78,185)	(1,910)	21,028	24,006	27,249	31,074
Ending Cash Balance	120,178	213,991	118,367	222,844	140,875	252,612	191,469	113,283	111,373	132,401	156,407	183,656	214,730
Targeted Working Capital	71,313	68,681	72,035	72,933	73,846	75,371	89,452	90,405	124,232	125,814	126,830	127,871	129,182
Over/(Under) Target Working Capital	48,865	145,310	46,332	149,911	67,029	177,241	102,016	22,879	(12,860)	6,586	29,577	55,785	85,548