

CITY COUNCIL AGENDA ITEM
CITY OF SHORELINE, WASHINGTON

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| <p>AGENDA TITLE: Update to Council Goal #7 – Acquire SPU Water System DEPARTMENT: Public Works PRESENTED BY: Mark Relph, Public Works Director</p> |
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PROBLEM/ISSUE STATEMENT:

City Council Goal #7 is stated as the acquisition of the Seattle Public Utilities (SPU) potable water system in the City of Shoreline. In November of 2011, the City of Seattle and the City of Shoreline announced a tentative agreement in principle to the sale of the water system assets at a price of \$25 million in the year 2020. This staff report will provide a summary of the next steps in the process.

FINANCIAL IMPACT:

There is no immediate impact to Shoreline residents. However, if the acquisition is to proceed, the financial mechanism to purchase the system would be a Revenue Bond issued at the time of acquisition and paid for only by the utility rate payers within the SPU service area. Citizens who receive their water service from the Shoreline Water District are not financially affected by this decision. Repayment of the Revenue Bond, or debt service, would be incorporated within a rate structure approved by City Council.

RECOMMENDATION

No action is required. This is intended as an update and for Council discussion.

Approved By: City Manager - *JU* City Attorney - *IS*

INTRODUCTION

The goal to acquire the SPU water system within the City of Shoreline has been a specific Council goal since at least 2009; however, the issue has been discussed perhaps as far back as the time of the City's incorporation. The central issues have been no direct citizen representation on issues such as rates and service since the utility is owned and operated by Seattle, and the decisions that affect infrastructure improvements. The Council's goal with the acquisition has been to address such concerns, but within a rate structure that would be equal to or less than the SPU forecasted rate structure over a reasonable time period. This report is intended to provide a brief review of the progress that lead to the announcement with the sale and to review the next steps in the process.

BACKGROUND

The SPU water system is located approximately west of I-5 (see attachment A) and serves roughly two thirds of the City. The water system within Shoreline is a distribution system. It includes water storage tanks and pump stations, but does not include a watershed or water treatment. There are larger transmission lines that pass through the City, providing treated water supply to larger wholesale customers (e.g. Shoreline Water District, Olympic View Water & Sanitation District) and south to the Seattle distribution systems. With the SPU system in Shoreline being solely a distribution system, the costs and responsibilities are more narrowly focused and less substantial had it included the water supply.

The infrastructure itself varies in age from the 1930s to present day with a large phase of construction in the 1950's through the 1960's, as this area developed into an unincorporated suburb of King County. While the pipelines are perhaps moderate in age, the question that many have raised is whether or not the level of maintenance performed over that time has been adequate, and if the investment in capital improvement programs (CIP) has met the demands of redevelopment and fire protection. This has been one of the central issues staff has discussed with SPU during the past several months as the City negotiated for the acquisition.

On April 18, 2011, staff presented to City Council an update on the negotiations with SPU, including:

1. The reasons for acquiring the system;
2. What are the parameters to decide if the acquisition would be successful; and
3. The extent of the public participation process.

A copy of the full staff report may be found at:

<http://cosweb.ci.shoreline.wa.us/uploads/attachments/cck/Council/Staffreports/2011/stafreport041811-7b.pdf>

This staff report will discuss in more detail the next steps in the process and the citizen participation process. A brief summary of the first two issues of the April 18, 2011 presentation is found within Attachment B.

DISCUSSION

With the announcement of the tentative agreement in principle for the purchase of the water system assets, the City will now begin a more detailed engineering and financial analysis for creating a City water utility. This “due diligence” phase will be completed by the firm EES Consulting. The team assembled has considerable experience in the financial analysis of utilities and has added two key engineering personnel tasked with the development of an operations and maintenance plan for the water utility. A copy of their biographies is found in Attachment C.

On May 23, 2011, the City Council approved a contract with EES Consulting for this next phase, in anticipation of the City reaching an agreement for the sale of the assets with SPU. The detailed staff report explaining the contract and this “due diligence” may be found on the City’s website at:

<http://cosweb.ci.shoreline.wa.us/uploads/attachments/cck/Council/Staffreports/2011/staffreport052311-8a.pdf>.

With the City reaching a tentative agreement, EES has been authorized to begin the work. Over the course of the next seven to eight months, EES will be completing four key tasks:

1. Performing a preliminary engineering due diligence on the distribution and general plant water system
2. Completing a financial analysis and feasibility study
3. Developing a Business or Operating Plan
4. Providing an overview and study of water supply options in the region

A summary of the four tasks includes:

Engineering Analysis

An important component of preparing for the purchase of the water system is performing preliminary engineering due diligence on the distribution and general plant water system included in the proposed sale of Seattle’s assets within the City of Shoreline. The City must be satisfied that the assets reflected on Seattle’s books are in existence and in good working condition. In addition, the City will need to review SPU’s planned capital improvement plans, identify additional capital improvements, general operation and maintenance (O&M) spending needed on the system, and estimating separation costs of the two systems.

The engineering analysis report will outline the status of the current system, proposed capital and operational improvements, a proposed capital and O&M budget, and identification of separation issues and potential costs.

The Financial Analysis

The purpose of the economic and financial analysis would be to develop detailed information that can be used to make a decision on how to proceed. The focus of this financial feasibility study will be a forecast of retail user rates under various scenarios. As such, a 10 to 20-year forecast of retail rates under each option will be developed.

There are numerous responsibilities associated with operating a water utility. The functions of the City generally fall under the categories of engineering and operations, finance and administration, customer service, and human resources. In general, the financial analysis will include cost projections for SPU rates contained in the current SPU water rate study for the years 2012-2014. Forecasts will continue under the SPU utility through 2019 to establish the starting point of a separate Shoreline water utility for the year 2020. Projections for the initial 10-year period will be developed to look at long-term impacts as well as first year impacts of the new utility.

The financial analysis will test the purchase price along with the other operating costs against the forecasted SPU rates. A retail rate forecast would be developed based on information from the engineering analysis.

The financial analysis will be a report to describe the responsibilities associated with providing water service to the City, and to present a preliminary plan for meeting those responsibilities. In addition, the plan will provide a financial comparison between projected SPU water rates and City of Shoreline water rates.

Business Plan

The Business Plan is intended to use information from the engineering and financial analysis and identify the steps necessary to move the process from acquisition to implementation.

Water Supply Analysis

Adequate and competitively-priced water supply is one of the most important aspects of this utility acquisition. Currently, Shoreline customers receive water costs based on Seattle's retail rate. In the future, the City would pay the wholesale rate for water. This analysis would include a review of the water supply situation in the region and provide an overview of water supply options, including those costs that may be unique to other existing SPU wholesale customers and how that might affect the City's wholesale contract.

The City and SPU will now begin the drafting of a formal agreement, and it is anticipated to be presented to the public and eventually City Council by late spring. This agreement will be coordinated with the City's engineering and financial analysis.

This agreement is anticipated to address such issues as the final contract price, the level of system maintenance until the City would take ownership, how the wholesale

water contract would be addressed, any services the City may still contract with SPU after ownership (permanently and/or temporarily), separation of the two systems and so on.

STAKEHOLDER OUTREACH

The City is committed to an extensive public process, which will occur over the next eight months. Sharing the details and soliciting input on the level of water service problems, the CIP, maintenance, rates, and expectations on customer service will be important to determine if a proposed budget will meet the public expectations and ultimately the financial parameters established by Council.

The City has assembled a Steering Committee whose task is to review and comment on the engineering and financial analysis prepared by EES Consulting. This Committee has been appointed by the City Manager and will meet approximately every three weeks beginning in late January. A tentative list of Committee members is included as Attachment D. Attachment E is a copy of the Committee's charter.

The Steering Committee will be facilitated by Milenko Matanovic of the Pomegranate Center, whose motto, "bringing people together to build better communities," has been very successful for many communities trying to use collaboration to address complex issues. The Pomegranate Center is a non-profit organization and has been used in the past by the City of Shoreline for the development of the Sunset School Master Plan. More information about the Pomegranate Center may be found at: www.pomegranate.org.

Coordinated with the Steering Committee will be other types of opportunities for public participation, and they are likely to include:

- Attending neighborhood, business, and civic group meetings;
- Providing open houses and workshops;
- Distributing information to neighborhood newsletters, *Currents*, the cable channel, direct mailers to the affected rate payers as well as all the citizens of Shoreline; and
- Conducting formal public hearings.

At the conclusion of the Steering Committee's review, the Committee will make a recommendation to the City Manager as to whether or not to proceed with the acquisition along with their supporting observations and conclusions. The City Manager will use this information, along with other staff input and public comment in her recommendation to City Council. This is anticipated to be complete by late spring or early summer 2012.

The City Manager's recommendation will include whether or not to proceed with the acquisition and if so, a recommendation on the specifics of the agreement between the City of Seattle and the City of Shoreline. If the City Council decides to move forward with the acquisition, then the Council would have to approve the agreement and forward to the City of Seattle. Approval by Seattle City Council would then allow the Shoreline

City Council to set the ballot language sometime this summer for a vote of the entire City in November 2012. If Shoreline voters approve the acquisition, then the City would move to the last phase of the project – the detailed development of a transition plan to move the utility from the City of Seattle to the City of Shoreline.

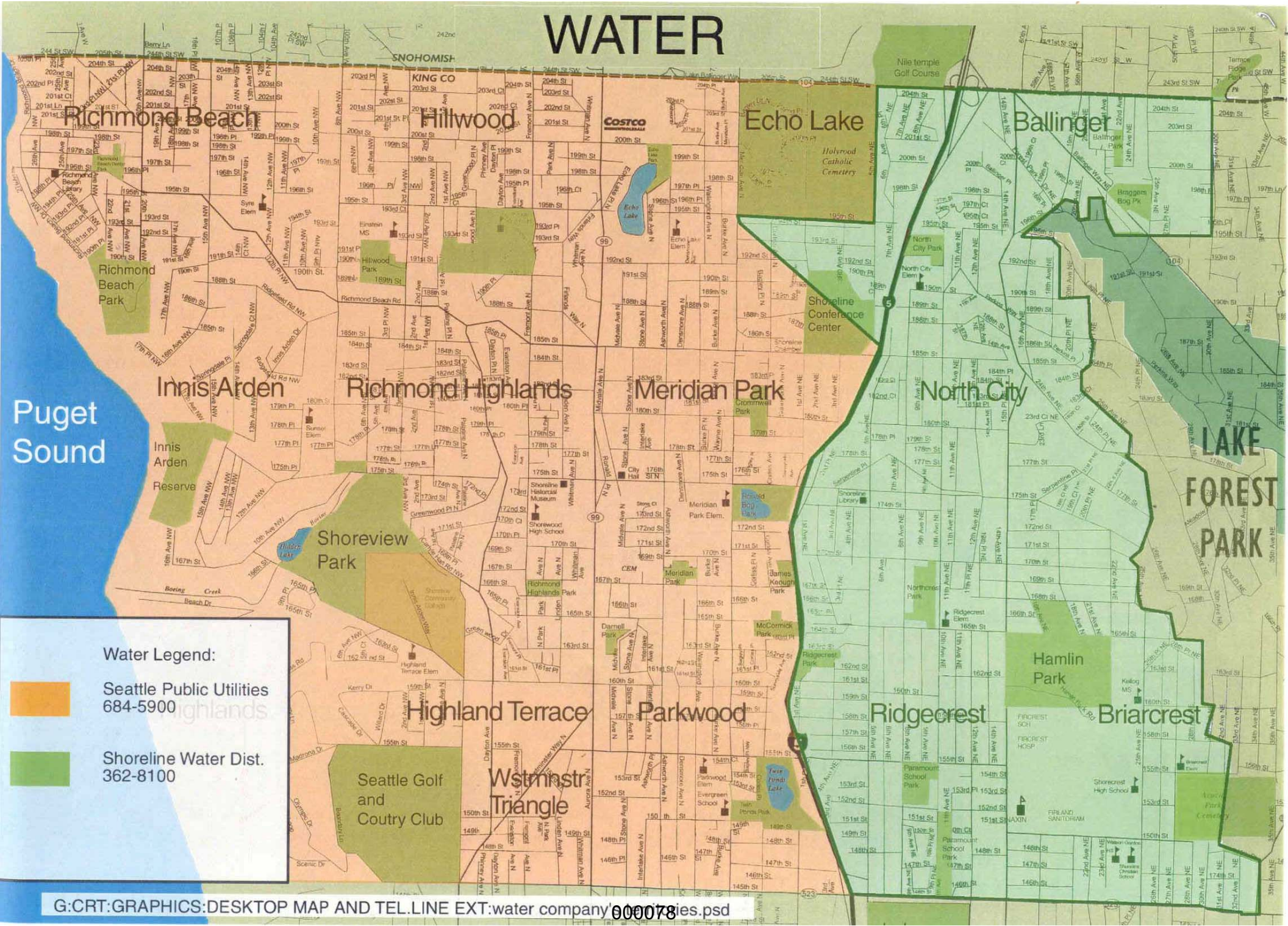
RECOMMENDATION

No action is required. This is intended as an update and for Council discussion.

ATTACHMENTS

- Attachment A – SPU Water Service Area within the City of Shoreline
- Attachment B – Summary of the April 18, 2011 Council presentation
- Attachment C – EES Consulting Team Bios
- Attachment D – Tentative List of Steering Committee Members
- Attachment E – Steering Committee Charter.

WATER



Water Legend:

- Seattle Public Utilities
684-5900
- Shoreline Water Dist.
362-8100

ATTACHMENT B – Summary of the April 18, 2011 Council presentation:

1. Reasons for Acquiring the SPU System:

A. Long-term Strategic Interests

In 2009, the City Council adopted a **Community Vision Statement** and a series of **Framework Goals** through a diverse and extensive public process of community meetings and open houses. The resulting Framework Goals provide the overall policy foundation for the Comprehensive Plan and support the City Council's vision. Acquisition of the SPU system would be a significant step towards achieving the intent of Framework Goals #2 and #14:

FG 2: Provide high quality public services, utilities, and infrastructure that accommodate anticipated levels of growth, protect public health and safety, and enhance the quality of life.

FG 14: Designate specific areas for high density development, especially along major transportation corridors.

It has been one of the City's expressed goals for acquiring the system to gain local control for our citizens in the decisions that allow for a more aggressive investment strategy, thereby facilitating more effectively the redevelopment of corridors such as Aurora Avenue N. The timely and strategic installation of utilities is perhaps one of the greatest inducements any city can perform to encourage redevelopment, which for the City of Shoreline, is key in growing and diversifying the City's tax base. This direct control of the CIP would also allow a more direct opportunity to address fire protection issues the City and the Fire Department have identified throughout the SPU system.

B. Representation

Direct control of the utility by the City perhaps has its most significant meaning when it comes to the decision of rates. Currently, those Shoreline citizens that are within the SPU system have no say in the rates, including the current 14% surcharge for Shoreline residents simply because they are outside the City of Seattle.

C. Construction Coordination

Another reason to acquire the SPU is to allow the City to better plan and manage construction activity within the public rights-of-way. Currently, the City has to rely upon working relationships to facilitate City goals, but the City cannot require certain actions or improvements.

D. Operational Efficiencies

One of the key responsibilities of owning any utility is providing adequate operation and maintenance (O&M) that allows for long-term, efficient use of the system.

Properly performed, the investment of O&M provides for a longer service life and a more reasonable and stable rate structure over time.

E. Staff Expertise

One of the issues to consider is the City's experience with utilities. The City's Surface Water Utility has a very similar set of responsibilities. The City has clearly demonstrated effective management and service of the Surface Water Utility since its inception in 1996.

In April, 2011, staff discussed the two key management positions essential in moving the acquisition forward to create a successful City utility: the Public Works Director and the Administrative Services Director. Since then, Debbie Tarry has become the Assistant City Manager. Her involvement and expertise will still be part of the process. However, the new Administrative Services Director, Robert Hartwig, will also bring another list of extensive experience with utilities and will certainly add to the process.

2. Parameters for Successful Acquisition:

In establishing Council goal #7, the City Council set some specific parameters. The first and most significant would be:

To acquire the system at a price that when added to the other costs to operate and maintain the system, would fall within a rate structure equal to or less than what SPU would forecast over a reasonable period of time.

This specific requirement has set the parameters for the City in the negotiations with SPU. If this is achieved, then the Council goal would be met and those citizens affected would have a unique opportunity to control their long-term future. If those parameters cannot be met, then the service would continue under the franchise agreement with SPU.

Another parameter the Council established was the development of a budget that reasonably accounted for the costs to own and operate a utility. This work would occur over two phases: the first during the negotiation phase to test the reasonableness of the purchase price, and the second as a more detailed review and confirmation of the costs once and if the two parties reach some level of a tentative agreement on the purchase price. Included in the proposed utility budget are such costs as:

- A proposed revenue stream for the utility based largely on historical data and rate projections from SPU
- Debt service for the purchase price
- The purchase of "wholesale" water by contract from SPU
- Operating and Maintenance costs

- Separation costs between Shoreline and Seattle
- Capital Improvement Program (CIP)

Another parameter established by state law for a utility of this nature is the requirement that all revenues collected for the utility be spent for purposes of operating and maintaining the utility. A utility is expected to operate much like a private business, in that the resources collected (utility fees/rates) have to pay for all the costs of the utility without any tax subsidy. As such, the financial operations of the utility are accounted for as an Enterprise Fund. The utility itself is charged its share – of which there has to be specific criteria subject to auditing standards to determine the appropriate amount – of overhead such as accounting and legal services, human resources, facility costs, etc.

ATTACHMENT C – EES Consulting team

Anne Falcon, Manager of Economics and Rates

Anne Falcon's primary responsibility with EES Consulting includes providing project management and technical support for all types of economic studies. Ms. Falcon has managed projects concerning cost of service and rate analyses, financial planning and regulatory proceedings for electric, water, wastewater, and natural gas utilities. Her area of expertise includes restructuring, strategic planning, forecasting, unbundled cost-of-service studies, optimization research and specialized statistical studies.

Through her research and analysis of the current state of the industry, she has assisted many California and Northwest clients in preparing for the changes that are taking place. Ms. Falcon's work with utilities has included developing unbundled rates, average embedded and marginal cost-of-service studies, analysis of stranded costs, development of customer choice and conservation programs, market-based and green rate designs.

Ms. Falcon, who has a graduate degree from Stanford in operation research, also provides technical assistance for EES Consulting's clients by applying modeling techniques for our client needs. This includes modeling in the following areas: dispatch modeling, least-cost planning, load forecasting, demand-side management studies, and cost of service studies. She assisted in developing optimization models in utility dispatch and resource planning.

Gail Tabone, Consultant

Ms. Tabone has applied her skills in integrated resource planning, resource evaluation, load forecasting, economic feasibility studies, cost of service analysis, conservation planning, and surveys in the many work products related to financial and power supply planning. A strong educational background combined with years of experience in the utility industry provide her with the skills to assess the needs of the client, to develop an approach to meet the need, provide the expertise necessary to conduct the economic analysis, and to make recommendations on future actions.

Kelly Tarp, Project Manager

Kelly Tarp specializes in the areas of project management, cost of service, rate analysis and financial studies. Ms. Tarp has more than six years experience as a consultant in the energy industry, completing a variety of technical assessments for electric and gas utilities, government agencies, and supporting energy organizations with a focus on distributed generation and renewable energy. In addition, Ms. Tarp has performed a variety of financial studies, including cost of service and rate analyses for electric, water, and wastewater utilities; valuation studies; and financial analyses. Since joining EES Consulting, Ms. Tarp has performed the analytical and technical work on a long-range financial and rate impact analysis for a \$500 million water project. Duties include developing detailed cost allocation models, evaluating and comparing project alternatives, projecting costs under different financing options, and allocating projected costs to individual participants. Ms. Tarp has a degree in mechanical engineering.

David Sherman

Mr. Sherman retired from Tacoma Water in 2010, where he served as the Water Supply Manager for the last 17 years of his 32-year career at Tacoma. Mr. Sherman was responsible for the engineering design, construction, inspection, operation and maintenance of Tacoma Water's supply infrastructure including transmission mains, tanks and reservoirs, wells, structures, pump stations, pressure reducing stations, and communications systems. Mr. Sherman also administered the water rights for the system, and was responsible for emergency response planning and coordination for Tacoma Water. In addition, Mr. Sherman was responsible for the operation and maintenance of the water transmission system and management of seasonal water storage for the Regional Water Supply System, a partnership formed by Tacoma and three other large water systems. Subsequent to retirement, Mr. Sherman has provided consulting expertise to Tacoma Water on several ongoing projects.

John Kirner

John Kirner is retired from Tacoma Water, where he served as the Water Superintendent of the Tacoma Department of Public Utilities. His previous professional experience includes work for the Boatbuilding Company in Tacoma, Washington, as an associate program manager for the construction of two hazardous waste burning incineration ships. Mr. Kirner also worked for the Washington Department of Social and Health Services, Water Supply Program in administration of the State of Washington's Water Supply Program. He has a Bachelor's degree in Civil engineering from Tufts University, a Master of Science and Engineering from the University of Michigan at Ann Arbor and a Master of Business Administration from University of Puget Sound. Mr. Kirner has been a member of the American Water Works Association for more than 20 years and has served on the National Water Utility Council, an industry group concerned with regulatory and legislative affairs affecting water utilities.

ATTACHMENT D – Tentative Steering Committee Members

1. Jim Abbott
2. Gretchen Atkinson
3. Joe Bozick
4. Mark Bunje
5. Bill Clements
6. Kevin Grossman
7. David Harris
8. Marcia Harris
9. Bruce Hosford
10. Joseph Irons
11. Jeff King
12. Lee Michaelis
13. William Montero
14. Edie Loyer Nelson
15. Les Nelson
16. Rick O'Leary
17. Larry Owens
18. Sis Polin
19. Johanna Polit
20. Diane Pottinger
21. Bob Ransom
22. Kyle Roquet
23. Jesse Sycuro
24. Dan Thwing
25. Mark Torrance

SEATTLE PUBLIC UTILITY WATER SYSTEM ACQUISITION STEERING COMMITTEE

The citizen steering committee will assist City staff in validating the final feasibility and technical review process required to be completed prior to the City Manager making a final Seattle Public Utility water system acquisition recommendation to the City Council. Steering committee members are appointed by the Shoreline City Manager and will make recommendations to the City Manager.

Problem Statement

City Council Goal No. 7 is the acquisition of the Seattle Public Utility water system in Shoreline. In order to develop a final acquisition recommendation to the City Council staff must complete a final feasibility analysis and financial plan.

Desired Outcome

The Steering Committee will provide a recommendation to the City Manager on whether the City should proceed with the acquisition of the Seattle Public Utility water system acquisition in Shoreline.

Project Steps

1. *Establish the Steering Committee (November 2011):* The recommended committee size is 12 to 15 Shoreline residents and/or business owners. The committee should include representatives from major stakeholder groups along with some positions that are at-large from the community.
2. *Review of Financial Feasibility Analysis and System Operation and Maintenance Plan (December 2011 – June 2012)*
3. *Recommendation to the City Manager (July 2012):* The committee needs to complete its review and deliberation by June 2012 in order to provide a final recommendation to the City Manager by early July 2012. The City Manager will include the Committee's recommendation in her final recommendation to the City Council. The Council will need to determine, based on recommendations from the City Manager, the timing of a public vote on the SPU acquisition.
4. *Election Strategy and Campaigns (If Council chooses to pursue a public vote based on a recommendation from the City Manager):* At this phase the election strategy and campaign is turned over to citizen volunteers. Under Public Disclosure Commission rules, City involvement is limited to drafting the ballot title and providing factual information to the electorate. In general, at least four to five months lead-time is needed for a good citizen campaign. As with any election, a strong core of active volunteers is needed to raise funds and run the campaign.

Communication

Throughout the process the City Manager will be briefed by staff and the Committee to ensure that the work of the committee is focused on this charter. A communications plan will also be developed to inform the public, neighborhood councils, citizen groups and stakeholders about the process and how to provide input.

Roles and Responsibilities

The City Manager will appoint the members of the Committee. The City Manager will set the charter and parameters for the committee and receive the final recommendations on acquisition of the SPU water system in Shoreline. The committee will receive input from staff, consultants, public survey results, and provide recommendations to the Manager. Staff will provide all necessary information to the committee to support their decision making process, manage consultants and surveys, and ensure good communications to and from the public during this process.