

CITY COUNCIL AGENDA ITEM
CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	Authorize the City Manager to Approve a Services Contract Amendment with EES Consulting for SPU Feasibility Analysis
DEPARTMENT:	Public Works
PRESENTED BY:	Mark Relph, Public Works Director

PROBLEM/ISSUE STATEMENT:

Staff is requesting Council consideration and approval of a contract amendment with EES Consulting in the amount of \$95,490 for the Engineering and Financial Feasibility Analysis of the Seattle potable water system within the City of Shoreline.

At the direction of City Council, staff has been negotiating with the City of Seattle (through Seattle Public Utilities – SPU) for the acquisition of the potable water system within the City of Shoreline. The negotiations have progressed where a tentative sale price with terms and conditions is likely to be achieved.

This contract amendment would allow the City to progress to the next phase of the process and allow for a more detailed analysis of the sale price and confirm how sale price would fit with all of the other costs associated with operating and maintaining such a utility. This analysis would ultimately test the total cost against two objectives set by Council:

1. To acquire the system at a price that, when added to 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.
2. Reinvest back into the system more aggressively with operations and maintenance (O&M) and a capital improvement plan (CIP).

FINANCIAL IMPACT:

This contract amendment has been divided into three phases:

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| <u>Phase 1</u> | Development of a financial model and preliminary analysis with a draft operations plan (\$33,540) |
| <u>Phase 2</u> | Engineering analysis for which the results supply the data for completing the financial analysis(\$49,150); and; |
| <u>Phase 3</u> | Water supply analysis to be used for the wholesale water contract with SPU (\$12,800). |

In 2010 the City entered into a contract with EES to provide assistance in determining the feasibility of acquiring the SPU system. This contract totaled \$27,000. This amendment totals \$95,490, bringing the total authorized contract to \$122,490.


Per the City's purchasing policies the City Manager has waived the requirement that these services be obtained through a Request for Proposal (RFP) process because of the prior work EES did on the initial analysis that is the basis of the additional scope of work requested in this amendment.

The second phase of this contract would not be implemented until sufficient negotiation progress with the tentative sale price has been achieved with Seattle. The third phase would be implemented depending upon the conclusions of the second phase – the engineering analysis. Depending upon the outcome of the data and analysis, it is possible that we will not expend the full contract.

Adequate funds exist for this contract and have been budgeted within the Public Works Department, Administration – professional services.

RECOMMENDATION

Staff recommends that Council authorize the City Manager to execute a contract amendment with ESS Consulting in the amount of \$95,490, which results in a total authorized contract amount of \$122,490 for the Engineering and Financial Feasibility Analysis of the Seattle potable water system within the City of Shoreline.

Approved By: City Manager  City Attorney _____

BACKGROUND

The Council was briefed on the status of the Seattle water system negotiations on April 18th, 2011. A copy of the staff report may be found at <http://cosweb.ci.shoreline.wa.us/uploads/attachments/cck/Council/Staffreports/2011/stafreport041811-7b.pdf>, which provides an update on the status of the negotiations as well as a discussion explaining the reasons to consider such an acquisition, the parameters that would suggest a successful acquisition, and the extent of a public participation process.

City Council has established the acquisition of the SPU water system within the City of Shoreline as one of their Council Goals. As such, the City has developed a web page dedicated to this issue: *Council Goal #7: Acquire the SPU Water System*. A link to this page may be found at <http://shorelinewa.gov/index.aspx?page=762>. This page provides some background to the issue along with a set of frequently asked questions (FAQs) to help keep the public informed as this issue evolves over time.

EES Consulting is the firm the City has used during the preliminary negotiations with Seattle as we explored the details of the appraisal methodologies specifically applied to the SPU system, the budget development for all costs and revenues, plus financial models to test assumptions and alternatives. All of this effort has provided staff a high degree of confidence in understanding the complexity of such an acquisition and whether or not this effort can ultimately meet the Council's established financial objectives.

Once the City and Seattle reach a tentative agreement to a sale price along with any terms or conditions, the City would need to complete an engineering and financial feasibility analysis. Some models have been developed to date to help test what might be a reasonable sale price, but this contract would confirm those original assumptions, perform an engineering and financial analysis of the acquisition and develop a draft business or operating plan for the utility.

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 in 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 and identify additional capital improvements and general O&M spending needed on the system.

Separation of the two water utility systems will have to be discussed with SPU staff and any major issues will need to be identified. Based on the planned separation of the two systems, separation costs will have to be estimated.

The objectives of the proposed engineering analysis or due diligence review are to determine that:

- Major assets listed do, in fact, exist as per the drawings and documents describing the sale.
- Assets appear to be in good working order.
- Assets appear to be in compliance with applicable laws and practices pertaining to safety and system integrity.
- Assets appear to comply with accepted utility practice.
- Assets are sufficient to meet present demands.
- Engineering and construction projects to meet normally expected system load growth and maintenance are evident.

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 the various scenarios. As such, a 10 to 20 year forecast of retail rates under each option would 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. The following table summarizes the main responsibilities contained under the four categories and the costs of such would be included in the analysis:

Engineering and Operations Tasks	Finance and Administration Tasks
<ul style="list-style-type: none"> • Acquire and manage water supply • Operate distribution facilities • Repair & maintain distribution facilities • Plan for new load and facilities • Install distribution facilities • Install and maintain meters • Equipment & supply management 	<ul style="list-style-type: none"> • Accounting • Billing of customers and collections • Maintenance of information systems • Purchasing • Financial analysis for rates, financing • Contract administration • Risk management
Customer Service Tasks	Human Resources Tasks
<ul style="list-style-type: none"> • Customer service and interface • Conservation/other programs • Marketing & business development • Public & community information • Meter reading • Collections • Large & government accounts 	<ul style="list-style-type: none"> • Employee payroll and benefits • Administration of hiring • Labor relations • Training programs

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 and would include:

- Collection and review of data.
- Given the sales price, separations costs and issuance costs, determine size of bond issue, determine a financing plan, and estimate likely annual financing costs for existing facilities and anticipated new facilities over the next 10 to 30 years.
- Development of a model for pro-forma financial analysis comparing revenues and costs, cash flow, debt service coverage and other relevant financial indicators through time.
- Determine the revenue requirement and ultimate rates to consumers. This analysis will include the following components:
 - Water supply costs will be based on wholesale rate projections provided by SPU
 - O&M costs will be based on any actual O&M costs provided by Seattle and the O&M cost estimate developed during the engineering task.
 - Administrative and general (A&G) costs will be based on City estimates along with benchmarking studies for similarly-sized municipal systems.
 - Taxes will be estimated as applicable, including applicable property taxes, income taxes, in-lieu of franchise fee and/or in-lieu of property tax.
 - Capital improvements financed with rate revenues will be based on historic and projected future capital plans provided by Seattle and proposed capital expenditures from the engineering analysis.
- Rate sensitivity analyses showing impact of changes on different financial indicators.

The financial analysis will be a report describing the responsibilities associated with providing water service to the City and provide 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. This plan would in part address the following issues:

- Provide an initial engineering due diligence and understanding of the assets to be purchased, including a review of pump stations, water tanks, stand pipes, pressure reducing stations or other major facilities, plus separation costs and alternatives.
- Prepare a detailed estimate of the operations and maintenance costs of the utility and implementation strategies that could be considered over time.
- Identify actions the City must complete prior to the initial operation date and for long-term operation of the system.

- Provide details of the business plan to entities providing financing for the acquisition.
- Demonstrate the City's ability to operate the system.
- Identify key positions and staffing needs by organizational structure and responsibility.

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.

Summary

While the Council has included acquisition of the SPU system in the City of Shoreline on their list of goals and priorities, without this information and analysis, they cannot make an informed decision of whether to continue to move forward.

This analysis will help yield a staff recommendation, which at this point, one has not been developed. Through each of the phases the analysis and data will be shared with the Council and public.

RECOMMENDATION

Staff recommends that Council authorize the City Manager to execute a contract amendment with ESS Consulting in the amount of \$95,490, which results in a total authorized contract amount of \$122,490 for the Engineering and Financial Feasibility Analysis of the Seattle potable water system within the City of Shoreline.