CITY OF RAPID CITY

Financial and Rate Setting Policies for the Water and Water Reclamation Utilities
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Financial/Rate Setting Policies for the Water and Water Reclamation Utility

The City of Rapid City’s water and water reclamation utilities financial planning and rate setting process is guided by financial and rate setting policies. These policies are arranged into the major policy categories of reserve funds, debt issuance and debt management, balanced operating budget, capital asset policies and procedures, and establishing rates and fees. Provided below are the details of the financial and rate setting policies for the water and water reclamation utilities.

1. Reserve Funds

Reserve funds shall be established for the utilities to properly account for the City’s water and water reclamation funds but to also provide adequate reserve levels to address the different types of funding requirements of both the water and water reclamation utility. The reserve fund will be a separate fund for each utility and will reflect the target minimum reserves for the following components:

1.1 Operating Reserve – The minimum operating reserve shall be established at 55 Days or 15% of annual O&M expenses for each utility.

1.2 Capital Reserve – The City shall strive to maintain a capital reserve balance equal to 1-year of annual depreciation expense.

1.3 Rate Stabilization Reserve – A rate stabilization reserve shall be established and maintained at a level equal to approximately 10% of the annual rate revenue derived from each utility. These funds are unrestricted but their use shall be limited to mitigating large or unanticipated rate impacts, or emergency/catastrophe situations.

In addition to unrestricted reserves, the City may require other restricted reserve funds. These reserve funds are for specific purposes or a requirement imposed on the City. These funds are:

1.4 Pactola O&M Reserve – As part of the agreement with the Bureau of Reclamation, the City will reserve $1.0 million annually for maintenance of Pactola Reservoir.

1.5 Bond Reserve – A bond reserve fund is a restricted reserve. A bond reserve fund shall be established, as required and in accordance with bond covenants. The minimum fund balance of the bond reserve shall be equal to bond reserve requirements set by bond covenants.

1.6 Cost Recovery Fee Reserve – Cost Recovery Fees (CRFs) are derived from new customers connecting to the City’s water and water reclamation systems or existing customers expanding their capacity requirements. The revenues derived from these fees shall be designated for capital construction and, as required, expansion of capacity for each utility. Revenue derived from CRFs shall not be used to fund on-going O&M expenditures for the water or water reclamation utility. No minimum reserve is designated for this reserve.
When a reserve fund falls below the designated policy minimum, the City’s water and water reclamation management teams shall inform the City Council. City staff will then work with the City Council to take appropriate action to address any shortfalls. A reserve fund which falls below the minimum reserve level, on its own, shall not trigger the need for a rate adjustment in the short-term (e.g., 1-2 consecutive years).

2. Debt Issuance and Debt Management

The City, during the course of normal operations, may issue long-term debt to fund certain water and water reclamation utility capital projects. The establishment of City policies related to debt issuance and debt management are intended to minimize the overall long-term costs of the City and utilize long-term debt to the benefit of the City’s water and water reclamation utility customers. Provided below are the City’s debt issuance and debt management policies for the water and water reclamation utilities.

2.1 Funding of Annual Renewal and Replacement Capital Projects – The City’s water and water reclamation utilities will provide adequate annual rate funding to prudently fund the water and water reclamation utilities annual renewal and replacement capital projects. Given adequate funding from rates, as a matter of policy, the City will not issue long-term debt to fund water and water reclamation utility annual renewal and replacement capital projects. The minimum annual funding from rates shall be at least equal to or greater than the water and water reclamation utilities annual depreciation expense.

2.2 Long-Term Debt as a Funding Mechanism – The City will consider the use of long-term debt to fund significant non-reoccurring capital projects of the water and water reclamation utilities. The City’s policy objective in issuing long-term debt is to minimize the financial and rate impacts of significant non-reoccurring capital projects for the utilities.

2.3 Types of Long-Term Debt – To minimize the overall costs of debt, the City shall strive, at all times, to utilize the lowest and best available cost option for issuing debt for the water and water reclamation utilities.

2.4 Bond Covenants – The City, at all times, shall adhere to and meet any bond covenants put forth by bonds issued by the City for the water and water reclamation utilities. Bond covenants are legal obligations placed upon the City. If the City is not in compliance with bond covenants, the City’s water and water reclamation utilities management team shall inform the City Council and appropriate action (e.g., rate adjustments) will be taken.

2.5 Debt Service Coverage Ratio – At all times, the City’s water and water reclamation utilities shall meet the minimum debt service coverage (DSC) requirements associated with their bond covenants. For financial planning and rate setting purposes, the City shall target a minimum DSC of 1.25 times annual debt service on all outstanding debt.

2.6 Accounting and Reporting Standards – The City’s water and water reclamation utilities will comply with all applicable accounting and reporting standards.
3. **Balanced Operating Budget**

3.1 **Self-Supporting** – The water and water reclamation utilities shall be self-supporting, where revenues fully fund normal operating and capital expenditures of the respective utility.

3.2 **Adequate Funding to Preserve System Assets** – The City’s water and water reclamation assets shall be properly operated and maintained to provide for a long life. Annual operating expenditures will be budgeted and funded at a level that promotes the efficient operation of and preservation of assets through the asset’s useful life.

3.3 **Evaluation and Monitoring of Cost** – Costs will be monitored to ensure the water and water reclamation utilities is operated in a cost effective and economically prudent manner.

3.4 **Positive Annual Net Income** – The City’s water and water reclamation utilities shall plan for annual net income (total revenue less O&M, taxes, debt service and capital projects funded from rates) greater than or equal to zero (positive balance of funds).

3.5 **Strive for Rate Stability** – The City’s water and water reclamation utilities rates should be stable over time while generating sufficient revenue. As a part of the annual budgeting process, the City’s water and water reclamation utilities shall review the rates to confirm the adequacy of the current rates.

3.6 **Disposition of “One-Time” Revenue** – In instances of large one-time revenues (e.g. legal settlement), if not specifically earmarked, the funds will be transferred to an appropriate reserve(s) (operating, capital, or rate stabilization).

3.7 **Alternative Funding/Revenue Diversification** – To minimize overall rates, the City’s water and water reclamation utilities should explore alternative revenue sources such as grants and direct developer contributions.

4. **Capital Asset Policies and Procedures**

4.1 **Purpose** – To provide guidelines to ensure adequate stewardship over City resources through control and accountability of capital assets, and to collect and maintain complete and accurate capital asset information for the water and water reclamation utilities.

4.2 **Definitions** – The City’s water and water reclamation utilities assets shall be properly operated and maintained to provide for the long-term. Annual operating expenditures will be budgeted and funded at a level that promotes the efficient operation of and preservation of assets through the asset’s useful life.

4.2.1 “Assets” - All land, buildings, improvements, and equipment purchased, donated, constructed, or acquired by the City water and water reclamation utilities.

4.2.2 “Capital Assets” – Land of any value; improvements to buildings valued at a minimum of $15,000, their furnishings, fixtures, and furniture; equipment, machinery, vehicles, and tools, with a value of $5,000 or more and having a useful life exceeding one year from the date of acquisition.

4.2.3 “Control”- Being in charge of, and having the authority to manage the asset. Having the custodial responsibility of the asset that includes, but is not limited...
to the caring, keeping, safekeeping and protecting the asset.

4.2.4 “Inventory” – The process of physically confirming the existence and location of capital assets.

4.3 Capitalization Threshold – All land of any value, improvements to building valued at a minimum of $15,000, their furnishings, fixtures, and furniture; equipment, machinery, vehicles, and tool assets with a cost of $5,000 or more will be capitalized and considered assets for purposes of marking and identification, record keeping and tracking.

4.4 Improvement/Repair/Maintenance Expenses – Routine repair and maintenance costs will be expensed as they are incurred and will not be capitalized. Major repairs will be capitalized if they result in betterments/improvements. To the extent that a project replaces the “old” part of a capital asset, outlays will not be capitalized, and to the extent that the project is betterment/improvement, outlays will be capitalized.

4.5 Additions – The City may acquire property by purchase, construction, donation, or lease.

4.6 Deletions – Asset deletion will be required for all assets as the result of sale of the asset, scrapping, lost or stolen items, or involuntary conversion (fire, flood, etc.).

4.7 Disposal – Disposal of capital assets may occur only after being declared surplus. This may include sale, disposal, conversion, or another means.

5. Establishing Rates and Fees

The water and water reclamation utilities shall establish rates utilizing industry recognized “generally accepted” rate setting methodologies. This will provide the City with consistency in their ratemaking process, while also establishing rates which are legally defendable. The City’s policies on establishing the water and water reclamation rates and fees, and the general methodologies to be utilized, are as follows:

5.1 Revenue Requirement Analysis

The revenue requirement analysis provides a projection of the City’s revenues and expenditures for a defined time period. The revenue requirement analysis shall provide the City’s City Council with the information and cost-basis to determine the size and timing of any proposed rate adjustments. The City’s revenue requirement analysis methodology shall consider the following:

5.1.1 The revenue requirement analysis will be developed for a projected five-year, or longer, time period.

5.1.2 Revenue requirements will be established using the “cash basis” methodology. The “cash basis” methodology includes O&M expenses, taxes/transfer payments, debt service (P+I) and capital improvements (renewal and replacement) funded from rates. The revenue requirements may include a component for change in working capital/rate stabilization funds to manage reserve balances and mitigate rate impacts.

5.1.3 Costs shared across utilities shall be allocated to each utility based on an equitable allocation method. These may include, but not be limited to, labor ratios, number of customers, revenues, usage etc. The allocation method should be whichever method most equitably allocates the specific cost.
5.1.4 The City’s revenue requirement analysis shall fully incorporate the City’s reserve, debt and budgeting policies.

5.2 Cost of Service Analysis

A cost of service analysis provides an equitable method to allocate the City’s water and water reclamation utilities revenue requirements to the customers utilizing the service. The City’s cost of service analysis for the water utility shall use generally accepted cost of service methodologies as defined by the American Water Works Association (AWWA) and the analysis developed for the City’s water reclamation utility shall use cost of service methodologies as defined by the Water Environment Federation (WEF). The City’s water and water reclamation utilities cost of service shall be developed to provide an equitable allocation of costs by taking into consideration a customer group’s (e.g., residential, commercial) facility requirements and usage characteristics. The City’s specific cost of service policies are as follows:

5.2.1 The cost of service shall be developed for a projected one-year time period or the period over which rates will be set, utilizing the revenue requirements as developed in 5.1.

5.2.2 The cost of service analysis shall be designed and developed to consider the unique and specific circumstances of the City’s water and water reclamation systems.

5.2.3 The City shall allocate costs to customer classes of service based upon each customer class’s facility requirements and usage characteristics of the water and water reclamation utilities.

5.2.4 When necessary, the City may phase-in the cost of service results to transition to fully-cost based rates.

5.3 Rate Design Analysis

The development of cost-based rate designs concludes the City’s rate setting process. The development of rate designs utilizes the results from the revenue requirement and cost of service analysis to establish the target level of revenues for each customer class of service (rate schedule) of the water and water reclamation utilities. The City’s rate design analysis is primarily focused on the structure of the rates of each of the utilities. The City’s rate design analysis policies are as follows:

5.3.1 The City shall utilize the results of the revenue requirement analysis and cost of service analysis in the development of final proposed rate designs.

5.3.2 Rates shall be designed to collect the overall target level of revenues for each customer class of service.

5.3.3 Collection of billing data provides information for rate design analysis. The City should collect billing data to provide necessary information in the rate design process and to assure accurate revenue recovery. It is important for the City to track billed units and revenue by class, by month, and by year. The billing data collected should be formulated into the City’s current rate structure. Revenues at present rates should be easily calculated based on the billing data collected and the City’s current rate structure. The collection of billing data ensures the rate structure currently in place is collecting the appropriate amount of
revenues.

1. Collection of Billing Data – Billing data is important for rate study purposes and to account for the current rate structure and revenues being collected.

2. The collection of billing data provides the ability to reconcile with water and water reclamation utilities production data and to track losses.

3. The collection of billing data provides the City the ability to track revenue billed against total budget revenues.

4. Billing data should be collected by rate structure and customer class
   - Number of meters, by size, by class
   - Amount of water billed, by block, by class
   - Amount of sewer flows, by class

5.3.4 The City’s rate designs shall be reflective of the City Council’s rate design goals and objectives, while also being reflective of the greater public purpose (e.g., revenue stability, conservation, etc.).

5.3.5 The City shall take into consideration both fixed and variable costs in the development of final proposed rates for the water and water reclamation utilities. The average unit costs calculated within the cost of service analysis provides the cost-information related to fixed and variable costs.

5.3.6 Bill comparisons shall be developed for all proposed rate designs to illustrate the general impacts to customers across a range of consumption for both the water and water reclamation utilities.

5.3.7 In establishing the final water and water reclamation utilities rates, the City’s City Council may take into consideration neighboring utility rate comparisons, but not to the financial detriment of the City.

5.4 Cost Recovery Fee Analysis

Cost recovery Fees are related to new customers connecting to the water and/or water reclamation systems. A cost recovery fee is intended to provide equity between existing customers and new customers connecting to the City’s water and water reclamation systems. To develop cost-based cost recovery fees, the City’s policies are as follow:

5.4.1 The City shall establish CRFs to be compliant with any State or legal requirements.

5.4.2 The City shall use generally accepted general facility charge (system development charge) methodologies, as described by the AWWA and WEF to determine cost-based CRFs.

5.4.3 The CRFs shall consider the City’s specific facilities of the water and water reclamation utilities and any unique situations in the calculation of the cost-based water and water reclamation CRFs.

5.4.4 The final adopted CRFs shall be established taking into consideration the cost-based levels of the fees and the City Council’s policy or philosophy as it relates to the sharing of growth-related costs between existing rate payers and new customers connecting to the water and water reclamation systems. At no time shall the City Council establish or adopt fees greater than the calculated cost-
5.4.5 CRF revenues will not be used to pay for O&M expenses. CRFs will be used for pay for growth-related capital improvements, or pay for replacement capital projects for the water and water reclamation utilities (i.e. existing “buy-in” component facilities).

5.4.6 CRF revenues will not be used to fund annual debt service payments.

5.4.7 CRFs shall be annually adjusted to reflect cost changes. The City shall use the Engineering News Record Construction Cost Index (ENR CCI) or other appropriate cost index to annually adjust the City’s water and water reclamation utilities CRFs.

5.4.8 The City will evaluate their water and water reclamation utilities CRF studies when comprehensive system (master) plans are completed to capture changes in planning assumptions, infrastructure and capital financing.

5.5 Miscellaneous Fees Analysis

Service fees and charges for special services for both the water and water reclamation utilities shall be updated periodically, to keep charges reasonably equal to the cost of such services (meter installation, turn on/turn off fees, new account setup charges, etc.). To develop cost based miscellaneous fees, the City’s policies are as follow:

5.5.1 The miscellaneous fee shall consider the City’s specific water and water reclamation special services and any unique situations in the calculation of the cost-based water and water reclamation utilities miscellaneous fees.

5.5.2 These miscellaneous fees shall be reviewed annually, and as appropriate, adjustments made to reflect inflation and avoid major periodic increases. Fees shall be adjusted annually by the Municipal Price Index as developed by American City and County.

5.5.3 The City shall use generally accepted costing practices and methodologies for calculation of miscellaneous fees.

5.6 Other Rate Setting Considerations

Provided below are other policies related to the City’s rate setting process.

5.6.1 Annually, City staff will update the rate model to compare to prior projections for a review of each utility’s financial status.

5.6.2 Annually, City staff will present the financial status of each utility to the City Council.

5.6.3 At a minimum, the City shall conduct a comprehensive rate study for the water and water reclamation utilities once every five (5) years to update assumptions and determine financial sustainability.

5.6.4 If a rate study is not completed within the five-year period, rates shall be adjusted by the Municipal Price Index as developed by American City and County to account for inflationary impacts to the cost of providing service.