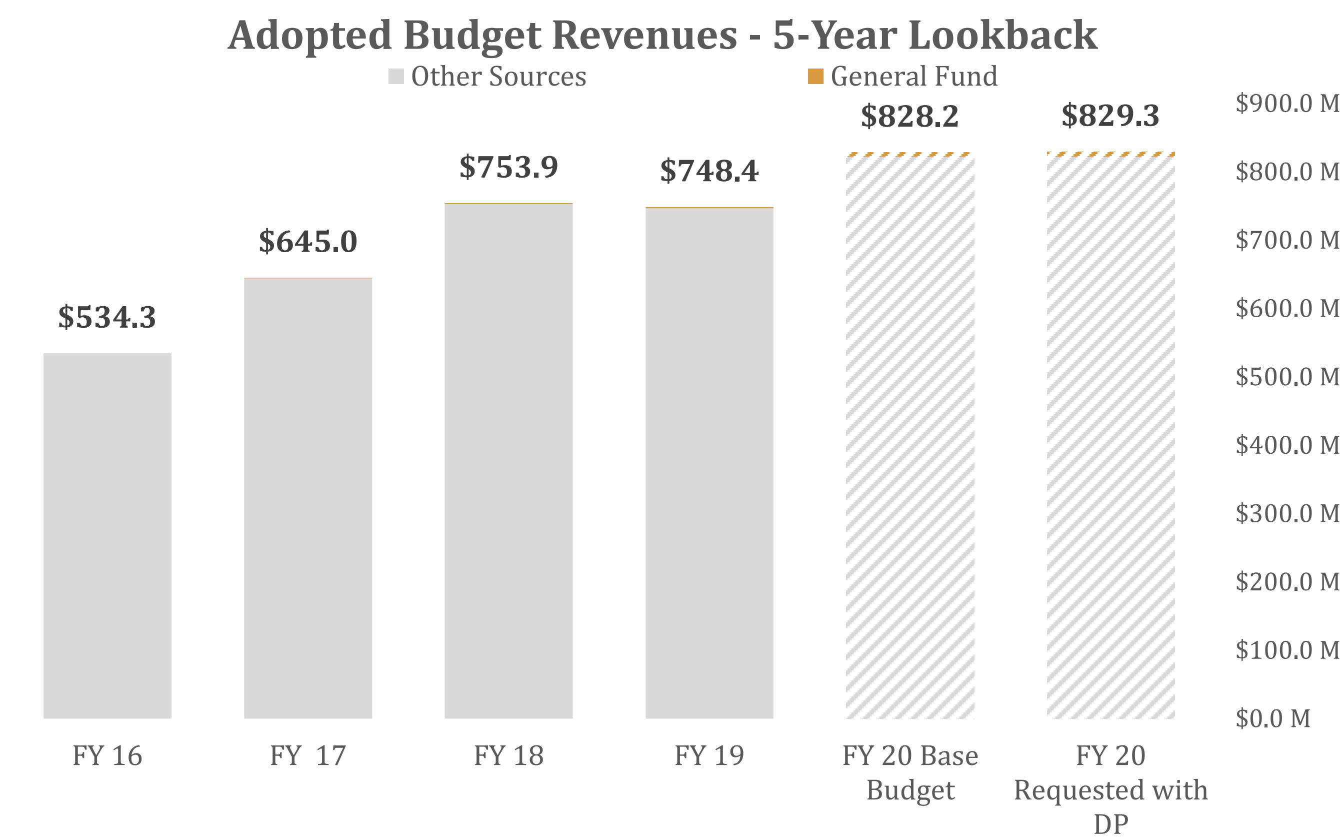
City Budget Office

Portland Water Bureau

Analysis by Yung Ouyang



567.5 FTE	577.6 FTE	588.6 FTE	615.7 FTE	616.3 FTE	616.3 FTE

INTRODUCTION

Portland Water Bureau's (PWB) Requested Budget includes $108.6 million in operating expenses and $181.8 million for capital expenses for FY 2019-20, totaling $290.5 million. This is a 22% increase from the FY 2018-19 Adopted Budget of $237.6 million. The operating budget alone is increasing by $7.4 million, or 7.3%. The change in total FTE between the FY 2018-19 Adopted Budget and FY 2019-20 Requested Budget is minimal, at 0.55 FTE, compared to the FY 2018-19 Adopted Budget's total FTE count of 615.70.

The bureau's request for $1.1 million in one-time General Fund resources for historic preservation work at Mount Tabor is the bureau's only decision package. City Council approved a resolution in 2015 to spend at least $4.0 million over four years for the project; Council has in the past three years allocated $2.9 million in General Fund discretionary resources and FY 2019-20 marks the final year of that agreement. Due to limited available General Fund resources for competing allocations, equity concerns, and the potential for continued ongoing costs associated with prior Council agreements related to Mt. Tabor historic preservation work, CBO does not recommend allocating General Fund discretionary resources to this effort this year. Instead, CBO recommends that Council revisit the optimal funding level and source associated with this work.

BASE BUDGET KEY ISSUES

Rate Forecast and Affordability

The Portland Water Bureau has requested a retail rate of increase of 7.4%. This amounts to a bill increase of approximately $2.90 per month or $8.70 per quarter for the typical single-family household. Combined with the Bureau of Environmental Services' requested rate of increase of 3.00%, the typical single-family household would experience a 4.53% increase or $5.11 per month for a total combined monthly bill of $117.90 or $353.70 quarterly in FY 2019-20.

PWB's FY 2019-20 rate of increase of 7.4% is the same as the rate projected in the bureau's financial plan submitted during last year's budget season. While the higher retail rate increase of 8.7% in FY 2018-19 was driven primarily by the addition of the filtration project and decision packages, most of the increase in FY 2019-20 is to maintain current service levels, some of which are associated with additional costs associated with new policies pertaining to non-represented classifications (see section on Changes to the Operating Budget and New Costs for Non-Represented Classifications below). PWB projects a 7.4% rate of increase over the next four years, as illustrated in the table below.

	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24
FY 2020-24 Plan	7.4%	7.4%	7.4%	7.4%	7.4%
FY 2019-23 Plan	7.4%	7.4%	7.4%	7.4%	

To achieve parity with the rate forecast analysis in BES's budget review, CBO used the consumer price index (CPI-U) and BES's Key Performance Measure (KPM) "typical household bill as a percentage of median household income" to analyze both the Water Bureau's portion of the bill and the combined utility bill. The consumer price index (CPI-U) forecasted by Moody's for next year and ongoing is 2.5% which is approximately 4.9% less than PWB's 7.4% rate of increase in FY 2019-20 and the subsequent four years. Together with BES's 3.0% rate of increase over the next three years and 3.1% in the last two years of the forecast, the combined typical single-family household bill is expected to increase by 20% between FY 2019-20 and FY 2023-24 compared to 11% if the bill increased at the same rate as inflation. This means that the typical single-family household will pay approximately $71 more for its quarterly combined utility bill ($283 annually) in FY 2023-24, compared to only $37 more quarterly (and $149 annually) if the bill increased by the forecasted CPI-U.

PWB states that the federal guidance on water bill affordability ranges from 1.0% to 3.5% of median household income (MHI), with 2.0% as the most commonly cited affordability measure. With the rate increase of 7.4% in FY 2019-20, the typical monthly water bill would represent 0.8% of the monthly MHI, compared to 0.7% in FY 2018-19. Thus, the measure is showing an increase for PWB's portion of the bill relative to median household income growth. When combined with BES's portion of the bill, the utility bill is approximately 2.2% of median household income in Portland in FY 2019-20.

Among other financial assistance programs, the bureau offers low-income discounts to qualifying families in two tiers based on income thresholds. It notes that with the 7.4% increase in retail rates in FY 2019-20, the monthly bill to qualified Tier 1 low-income residential customers receiving a 50% discount will increase by $1.46, while the monthly bill to qualified Tier 2 low-income customers receiving an 80% discount will increase by $0.60 a month.

While recognizing the strides that PWB has made in its adjustments to its financial assistance programs, CBO recommends that the bureau also revisit its efforts and standards to measure affordability. In a 2013 study conducted for the American Water Works Association, the Water Environment Federation, and the U.S. Conference of Mayors, Stratus Consulting noted that median household income can be a highly misleading indicator of a community's ability to pay for several reasons, including bearing little relationship to poverty or other measures of economic need, not capturing impacts across diverse populations, not accounting for the historical and future trends of a community's economic condition, and not capturing impacts to landlords and public housing agencies.[1]

	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24
Maintain Current Service Level	4.7%	3.1%	4.3%	2.9%	3.9%
Fund Balances Surplus	-0.4%				
Wholesale & Other Revenues Updates	-0.2%	-0.2%	-0.1%	-0.2%	-0.2%
Operating Budget Adds	0.8%				
Filtration	2.2%	2.2%	2.2%	2.2%	2.2%
Capital Program	2.0%	3.6%	2.2%	1.9%	1.4%
Rate Stabilization Fund (RSA)	-1.7%	-1.3%	-1.2%	0.6%	0.1%
Rate Increase	**7.4%**	**7.4%**	**7.4%**	**7.4%**	**7.4%**

[1] Stratus Consulting, Affordability Assessment Tool for Federal Water Mandates. 2013. Available at: https://www.awwa.org/Portals/0/AWWA/ETS/Resources/AffordabilityAssessmentTool.pdf, pp. 4&5.

Rate increases are driven by many factors. As indicated in the table above, Filtration and other capital projects in the bureau's portfolio are often the biggest rate drivers in the forecast. Further, escalation factors like personnel costs and material and utility costs will increase rates by 4.7% in FY 2019-20 and between 2.9% to 4.3% in the other years of the forecast. Thus, the costs to simply maintain current service levels, which consist of personnel as well as O&M costs, will exceed CPI-U. PWB plans to issue revenue bonds on average every 12 months through FY 2027-28. About $144 million in revenue bonds are next scheduled for sale in August 2019. Proceeds totaling $542 million will be used to fund capital costs in the five-year period. Debt service for the bonds are primarily financed through rate increases.

PWB will contribute to its Rate Stabilization Account (RSA) to smooth rate increases in FY 2019-20 through FY 2025-26. The projected year-end balance in FY 2019-20 of the Rate Stabilization Account is approximately $65.1 million. PWB plans to increase the account to approximately $89.9 million by the end of the forecasted period. The bureau will continue to increase the account until FY 2026-27 when it begins to draw down funds to mitigate rate increases from the filtration project.

Changes to the Operating Budget and New Costs for Non-Represented Classifications

PWB's requested operating budget is forecasted at $108.6 million which is a $7.4 million or a 7.3% increase compared to the FY 2018-19 Adopted Budget. The requested budget includes one decision package, totaling approximately $1.1 million in General Fund requested resources. Other increases are due largely to inflationary increases that includes COLA, salary step increases, employee pension and health costs, and additional salary costs resulting from the City's implementation of new non-represented classifications and pay equity adjustments.

The City engaged in a multi-year effort to transform itself into a more competitive employer, resulting in the creation of many new non-represented classifications and the reclassification of many employees into these new classifications. One effect is increases in the top salaries of many classifications so that many employees who were formerly at the top of their salary range are now no longer so and are eligible for further merit increases. Preliminary estimates of the effect on PWB are about $350,000 if all the affected employees receive a 4.1% merit increase. In addition, beginning in January of 2019, the City increased the salaries of many non-represented employees to comply with an Oregon State mandate to achieve equity in compensation for employees with the same qualifications doing the same type of work. An estimate of the cost impact to PWB of these "pay equity" adjustments is at least an additional $300,000 per year.

In response, the bureau has noted that it has budgeted conservatively by assuming that all non-represented employees will receive the full 4.1% merit increase. It has also stated that it will be following the Bureau of Human Resources (BHR) guidelines for employee performance reviews.

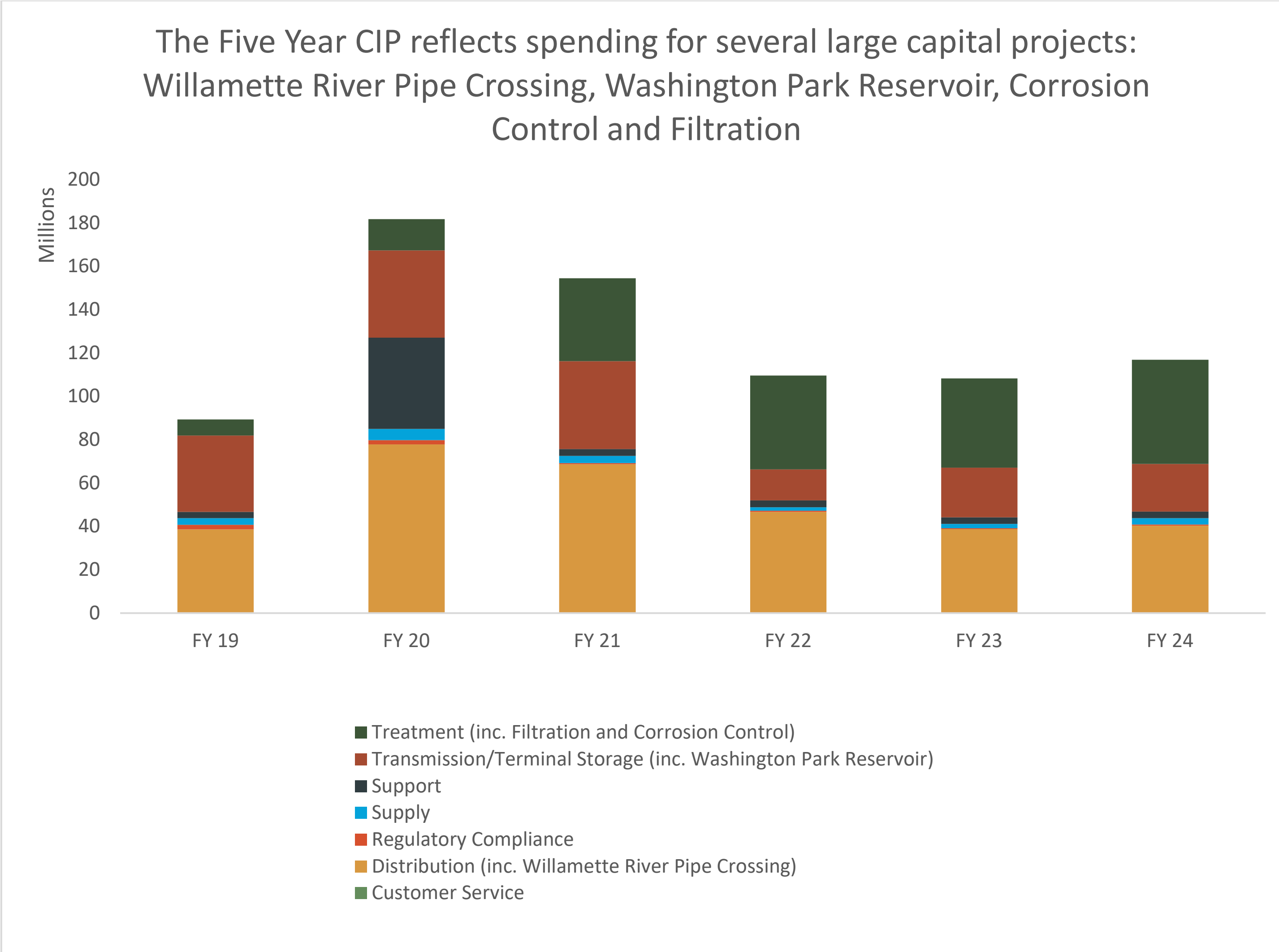
Specifically, PWB has stated that actual merit increases will be based on individual performance reviews and recommended merit increases by the employee's supervisor/manager using BHR's performance management system and merit calculation tool. The bureau believes that it is following the City's guidelines to budget conservatively by including the 4.1% merit increase across the board for all non-represented employees.

However, this practice will have an effect on the bureau's operating budget and planned retail rate increase for FY 2019-20. PWB's five-year forecast assumes that in the first year (FY 2019-20), all eligible non-represented employees would receive the merit increase, while years two and three (FY 2020-21 and FY 2021-22) assume percentages of the incremental increase of the prior year. The last two years of the forecast assume the impact of the increased compensation ranges will not result in material impacts as many non-represented employees would reach the new top of the salary range within the first three years of the forecast. The bureau's assumptions in this regard are tied to expectations of when employees' salaries would once again reach the top of their class. PWB notes, though, that despite the full-budgeting of the 4.1% merit increase in FY 2019-20, with the bureau implementing BHR's new guidelines for employee performance reviews and merit increases, not all non-represented employees eligible for a merit increase will actually receive one, resulting in savings that will be realized in the bureau's ending fund balance.

Current Five-Year Capital Improvement Plan (CIP)

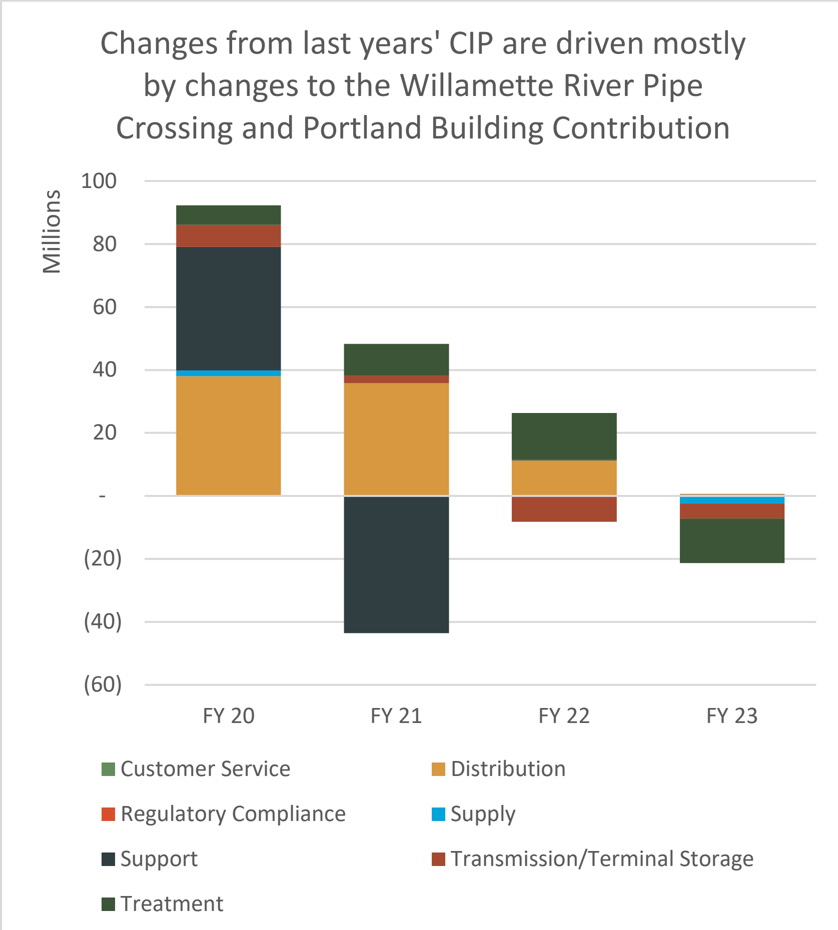
The bureau's Requested Budget includes $671.2 million in capital expenditures over the next five years. This capital plan includes several large projects driven by federal and state drinking water regulations, improving the resilience of the water system, and replacing assets that are at the end of their useful life.

The largest investment in the capital plan continues to be in the Distribution Program. It makes up 41% or $271.9 million of the five-year CIP. The Willamette River Pipe Crossing is approximately 29%, or $78.7 million, of the Distribution Program's five-year budget. Other projects in this program include repair, replacement, and rehabilitation of pump stations, tanks, and distribution mains. The Transmission and Terminal Storage Program represents 21% or $140.0 million of the bureau's five-year CIP. Approximately $101 million or 72% is for the construction of a seismically resilient water storage reservoir at Washington Park. Furthermore, the Treatment Program is $185.3 million or 28% of the five-year total CIP. Of this, $167.0 million is for the filtration plant and $17.8 million for corrosion control improvements. The combined total for both projects is approximately $520 million, the majority of which will be reflected in future capital improvement plans.



Compared to last year's Five-Year CIP, several changes resulted in an increase of $75 million (a 13% increase). A majority of this increase is the result of the Filtration plant and the Willamette River Pipe Crossing projects. A comparison of the four common years of the two CIPs (FY 2019-20 through FY 2022-23) shows an $85.7 million increase in spending in the Distribution program mostly due to additional costs for the Willamette River Pipe Crossing project, and a $17.1 million increase in spending for the Treatment Program (i.e. Filtration). Together there was an approximately $8 million reduction in the Regulatory Compliance, Supply, Support, and Transmission/Terminal Storage Programs. Another notable change concerns the bureau's contribution to the Portland Building reconstruction project in the Support program. In the FY 2018-19 Adopted Budget, PWB planned to spend $43.5 million for its share of project costs in FY 2020-21; the amount has now been reduced to $38.8 million, with the timeline moved up to FY 2019-20.

The Requested Budget includes 13 projects that are new to the capital plan with estimated costs of $11 million over the next five years and almost $16 million in total new project costs. Ten new projects totaling $4.2 million for FY 2019-20 are for improvements in the distribution system.



However, the new projects only make up 1.6% of the 5-year total. In contrast, about 25% of the costs over the next five years is due to the Filtration project, while 12% of the costs are from the Willamette River Pipe Crossing project. Moreover, costs associated with the Portland Building Contribution consist of 6% of the 5-year plan, while work on the Washington Park reservoir make up 15% of the 5-year total. Roughly 33% of the costs for Filtration would occur in the next five years, and 49% of the costs of the work at Washington Park is expected to be realized over the same time period. PWB expects to expend 89% of the Willamette River Pipe Crossing project's total costs over the next five years, but the contribution for the Portland Building will be completely paid for in FY 2019-20.

New Projects by Program in the FY 2019-20 Capital Improvement Plan

Program	Project	FY 19-20	5 Year Total	Total Project Cost	Confidence
Distribution	Sunnyside North Reconstruction	154,000	154,000	1,077,000	Moderate
Distribution	Greenleaf Tank 3	30,000	1,310,000	3,095,000	Low
Distribution	IA - N Rivergate Blvd Bridge Transport	490,000	490,000	650,000	Low
Distribution	IA - SW Capitol Hwy fr Garden Home Rd S	1,772,500	1,772,500	2,300,000	Low
Distribution	NE Morris St from 123rd Ave to 127th Ave	365,000	365,000	450,000	Low
Distribution	NE Skidmore from 23rd to 27th Aves	410,000	415,000	465,000	Low
Distribution	SE 1st Ave from Oak to Market	120,000	4,336,000	4,336,000	Low
Distribution	SE Holgate Blvd I-205 Bridge Main Rehab	334,000	461,000	543,000	Low
Distribution	SW Troy St from 25th Ave to 28th Ave	364,000	367,000	409,000	Low
Distribution	Wash Park PS 2 Transformer Replacement	188,000	188,000	1,000,000	Low
Supply	Groundwater PS Roof Replacement	80,000	718,000	728,000	Low
Support	Mt. Tabor Interpretive Project	292,000	298,000	470,000	Low
Treatment	Headworks Screenhouse 3 Roof Replacement	125,000	125,000	370,000	Low
	Total	**4,724,500**	**10,999,500**	**15,893,000**	

Several capital projects included in last year's five-year CIP have been completed. These include improvements at the Greenleaf Pump Station, work with BES at NE Wheeler, transformer and other electrical replacements at the Groundwater Pump Station, road repair in the Bull Run Watershed, and inspections of Conduit 2. In total, those projects were estimated to cost $5.7 million over fiscal years 2018-23 in the FY 2018-19 Adopted Budget.

NOTABLE CHANGES

Bureau Strategic Planning

PWB is in the process of developing its Five-Year Strategic Business Plan, which involves an overhaul of the bureau's performance measures. Thus, the bureau is keeping its existing measures for FY 2019-20. CBO notes that for four of the current measures the bureau has already met or exceeded the targets for FY 2019-20. In response, PWB notes that it plans to review all existing performance measures including its targets, during the summer of 2019 and expects to update them in time for the next budget process.

The bureau states that it is changing the organization to be able to deliver the strategies in the plan. PWB has not waited for a final document to be drafted, but instead, staff has been implementing changes in behavior, culture, and process since the inception of the strategic planning process. The bureau believes that its Strategic Business Plan is a unique risk-based process and as such, it is different from any process it has embarked upon before.

DIRECTIONS TO DEVELOP

Mount Tabor Historic Preservation

$1,115,000, 0.00 FTE

Direction Language

On July 15, 2015, City Council approved resolution No. 37146 making financial obligations and other commitments for work at Mount Tabor. The resolution included a provision that the City shall allocate at least $4.0 million over the next four years to the maintenance, repair and preservation work identified in the 2009 Mount Tabor Reservoirs Historic Structures Report. The resolution did not specify the funding source. Because the reservoirs are no longer part of the water system, these funds are being requested from the General Fund and not included as part of the water rate increase.

CBO Analysis

The Water Bureau requested and received $750,000 in FY 2016-17, $1,020,000 in FY 2017-18, and $1,115,000 in General Fund resources to fund the first three years of activities to fulfill this obligation. The request for FY 2019-20 of $1,115,000 is the remaining amount of the $4.0 million commitment. As of the writing of this analysis, PWB, along with representatives from the Mt. Tabor Neighborhood Association (MTNA), is working to prioritize the final increment of work at the site in FY 2019-20. In January 2019, bureau staff, along with members of the MTNA, presented to City Council progress on work at the site, including completed subprojects and work in progress.

There are several unresolved issues as to the full scope of the work to be completed at the site and who will be financially responsible for those costs. In FY 2016-17, the Water Bureau updated the original 2009 Historic Structures Report (HSR) and budget-level cost estimates for the list of project components to account for inflation and to add project design and management costs that were not included in the initial construction estimates in the 2009 HSR. These initial estimates indicate that total preservation costs could amount to more than $12.0 million if all recommended work in the 2009 HSR were completed. Roughly 80% of those costs are to repair and replace lighting and to replace the lining of two reservoirs. Resolution No. 37146 requires the Council to consider an additional $1.5 million at some time in the future for the lighting work. The HSR report included replacement of the linings of the reservoirs, especially Reservoirs 1 and 6 because of leaking, with Reservoir 1 in the most need of repair. It has a concrete lining that needs repair and has no underdrain system to monitor how much it leaks. Installing new liners in Reservoir 1 and 6 would cost several million dollars per reservoir. PWB has stated that the concrete lining will be repaired with the approved budget from FY 2018-19 and that a contract is underway to do this work.

In addition, the bureau will incur ongoing costs to maintain the facilities. While some of that work will be done in the normal course of draining, cleaning, and filling the reservoirs as agreed to in the land use agreement, other work would require additional costs to the Water Bureau.

Finally, as part of the Mount Tabor land use review that the City Council approved in August 2015, the City is required, within five years of approval, to develop an interpretive program related to the Mount Tabor Reservoirs Historic District. The resolution does not include a monetary commitment for these activities, and they are not part of the initial $4.0 million allocation for preservation work. PWB has included the project in its Five-Year Capital Improvement Plan, with a low-confidence total project cost of $470,000 and $292,000 of that total budgeted in FY 2019-20.

Council committed to these historic improvements via Resolution No. 37146 and the Tabor land use approval, which has been the basis for CBO recommended funding levels over the past three years. However, CBO notes that the Council may revisit this commitment given current Citywide needs and priorities and available resources. Due to limited available resources, CBO is only recommending General Fund discretionary funding for allocations that will clearly and directly result in reduced negative financial or legal consequences for the City. CBO also is recommending Council consider prioritizing funding for proposals which have demonstrated evidence to meaningfully advance key citywide goals, with an emphasis on increasing the equitable delivery of City services to historically underserved populations. This allocation does not meet that criteria. Although this is a Council commitment, it can be revisited and amended by the current Council. In the past, portions of the Tabor Reservoir Preservation Project have been funded from the capital set-aside. While components of the Mt. Tabor preservation work would repair or replace current infrastructure, none of these components have a high likelihood or risk of failure. As such, compared to the other critical infrastructure projects that are ranked in the capital set-aside process, the Tabor Preservation project is a lower priority. Moreover, when using these funds for the Mt. Tabor project, other projects with much greater health and safety risks go unfunded.

As an alternative to this option, the bureau should determine whether water rate funds can be used for some of these improvements. CBO recommends that the Water Bureau develop a list of projects from the HSR that have not been completed. Once this list has been developed, then the bureau should work with the City Attorney's Office to determine which of these projects are related to the provision of water and/or directly the responsibility of the Water Bureau as the owner of the assets. Having culled the list to this subset, the bureau should then develop estimated project costs and provide Council with the option to move forward with funding these parts using water rates. Any costs that could be funded with water rates would lessen the amount that is needed to be funded with General Fund resources.

CBO Recommendation: $0 | 0.00 FTE

SUMMARY OF REQUESTS AND RECOMMENDATIONS

Below is a summary of the Portland Water Bureau's total budget.

	Adopted FY 2018-19	Request Base (A)	Bureau Decision Packages (B)	CBO Recommended Adjustments (C)	Total Recommended Revised (A+B+C)
Resources					
Budgeted Beginning Fund Balance	$ 216,044,496	$165,434,285	$ -	$ -	$165,434,285
Charges for Services	193,905,167	206,801,916	-	-	$206,801,916
Intergovernmental Revenues	526,000	526,000	-	-	$ 526,000
Interagency Revenue	3,530,117	3,840,560	-	-	$ 3,840,560
Fund Transfers - Revenue	236,765,709	299,244,394	1,115,000	(1,115,000)	$299,244,394
Bond and Note	91,680,000	144,385,000	-	-	$144,385,000
Miscellaneous	5,920,767	7,957,210	-	-	$ 7,957,210
Total Resources	**$748,372,256**	**$828,189,365**	**$1,115,000**	**($1,115,000)**	**$828,189,365**
Requirements					
Personnel Services	$ 76,484,076	$ 82,736,872	$ -	$ -	$ 82,736,872
External Materials and Services	44,750,910	43,176,176	1,115,000	(1,115,000)	$ 43,176,176
Internal Materials and Services	22,087,015	22,713,499	-	-	$ 22,713,499
Capital Outlay	96,916,025	143,393,803	-	-	$143,393,803
Bond Expenses	62,557,700	66,835,876	-	-	$ 66,835,876
Fund Transfers - Expense	240,846,679	299,134,134	-	-	$299,134,134
Debt Service Reserves	36,218,013	39,957,011			$ 39,957,011
Contingency	104,234,691	109,056,389	-	-	$109,056,389
Unappropriated Fund Balance	64,277,147	21,185,605	-	-	$ 21,185,605
Total Requirements	**$748,372,256**	**$828,189,365**	**$1,115,000**	**($1,115,000)**	**$828,189,365**