

June 5, 1996

Introduced By:

Miller, Gossett,
Derdowski,
von Reichbauer, Sims,
Phillips

June 24, 1996 clerk

Proposed No.:

96-449

ORDINANCE NO. **12353**

AN ORDINANCE determining the monetary requirements for the disposal of sewage for the fiscal year beginning January 1, 1997 and ending December 31, 1997; setting the sewer rate for the fiscal year beginning January 1, 1997 and ending December 31, 1997; confirming a sewer rate for the fiscal year beginning January 1, 1998 and ending December 31, 1998; and setting a goal for sewer rate stability for the fiscal year beginning January 1, 1999 and ending December 31, 1999 and repealing and replacing Ordinance No. 11377, Section 1, as amended and K.C.C. 4.90.010.

BE IT ORDAINED BY THE COUNCIL OF KING COUNTY:

SECTION 1. MONETARY REQUIREMENTS FOR THE DISPOSAL OF SEWAGE; ESTABLISHMENT OF THE SEWER RATE FOR THE FISCAL YEAR BEGINNING JANUARY 1, 1997 AND ENDING DECEMBER 31, 1997. The council hereby determines the monetary requirements for the disposal of sewage as follows:

Administration, operating, maintenance repair and replace (net of other income):

\$57,784,000.

Establishment and maintenance of necessary working capital reserves: \$3,809,890.

Requirements of revenue bond resolutions (not included in above items and net of interest income): \$92,073,250.

TOTAL: \$153,667,140.

SECTION 2. Ordinance No.11377, Section 1, as amended and K.C.C. 4.90.010 is each hereby repealed and replaced with the following:

A. Having determined the monetary requirements for the disposal of sewage, the council also hereby adopts a 1997 sewer rate of \$19.10. Prior to July 1, 1996, a copy of

1 this ordinance shall be delivered to each agency having an agreement for sewage disposal
2 with King County.

3 SECTION 3. SEWER RATE FOR 1998. The Council hereby confirms a sewer
4 rate of \$19.10 for 1998 and establishes a Rate Reserve Fund of \$11,483,000 for the 1997
5 fiscal year to be carried over into the 1998 fiscal year.

6 SECTION 4. SEWER RATE FOR 1999. The Council establishes a goal for sewer
7 rate stability through the end of fiscal year 1999 based upon continuing efficiencies,
8 merger savings and electrical power savings achieved through a negotiated agreement with
9 Puget Power. The Executive shall deposit electrical power savings estimated at \$377,000
10 in 1996; \$387,000 in 1997; and at least \$450,000 in 1998 into the Rate Reserve Fund to
11 offset some or all of the user fee adjustments which might be needed in estimating the
12 1999 sewer rate.

13 INTRODUCED AND READ for the first time this 20th day of
14 May, 1996

15 PASSED by a vote of 13 to 0 this 24th day of June
16 1996.

17 KING COUNTY COUNCIL
18 KING COUNTY, WASHINGTON

19 Jan Hague
20 Chair

21 ATTEST:

22 Gerald A. Peterson
23 Clerk of the Council

24 APPROVED this 28th day of June, 1996

25 Ray Lode
26 King County Executive

27 Attachments: Water Quality Fund: 1996-2000 Financial Forecast

Submitted by:

Gary Locke King County Executive

Prepared by the following:

| | |
|----------------|---|
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EXECUTIVE SUMMARY

The major near-term challenge for the Water Quality Program is to provide some stability to ratepayers after several years of large annual increases while continuing to optimize the new secondary treatment process at the West Point treatment plant and to complete the current capital program.

The longer-term focus within this planning horizon is the selection of a preferred system configuration that will provide the additional capacity needed to meet projected growth in the next century and comply with regulatory mandates with regard to environmental standards. The selected configuration will determine needed capital expenditures beyond 1998 when most of the projects that comprise the current Comprehensive Plan are expected to be completed. Although an alternative is not expected to be adopted until mid-1997, the capital expenditures presented in this Forecast are based upon estimates for the Regional Wastewater Services Plan (RWSP) configuration currently designated as Service Strategy 1.

1997 and 1998 Sewer Rate Proposal

As a key element of this Forecast, the Executive is proposing that the monthly sewer rate be maintained at the current level of \$19.10 in both 1997 and 1998. Historically, sewer rates have been established for a single year only.

Under this proposal, the sewer rate for 1997 would actually be somewhat higher than the minimum needed to provide for the monetary requirements of the program. The option of reducing the rate in 1997 was not considered prudent, however, since a lower rate would not be sustainable and would just have to be followed by an increase to above \$19.10 in 1998. Instead, the Executive has committed to depositing moneys in excess of the minimum target balance of \$5 million accumulated in 1997 into a rate stabilization reserve. The target amount for this rate stabilization reserve is \$11.5 million and that will be dedicated to the funding of capital expenditures in 1998. By means of this mechanism, the Executive expects to be able to provide ratepayers a period of 3 years of rate stability (1996-98), a welcome respite after the large annual increases that have been needed to fund the West Point project.

Basis for Rate Proposal

Several factors have contributed to the program's ability to maintain the sewer rate at a level that in 1998 is \$3.10 lower than that projected a year ago in the 1995-2000 Financial Forecast. These are as follows:

1. Efficiency Savings

First, the evidence from running secondary treatment at West Point since mid-1995 indicates that the plant can be run more efficiently than had been assumed in the consultants' cost estimates used as the basis for recent budget planning. Together with

WATER QUALITY PROGRAM SUMMARY

(\$s in Thousands)

| | 1995 Actual | 1996 Projected | 1997 Proposed | 1998 Proposed |
|--------------------------------|------------------|-------------------|------------------|------------------|
| Revenues: | | | | |
| Customers (000s) | 667.80 | 669.10 | 670.40 | 677.10 |
| Monthly Rate | \$17.95 | \$19.10 | \$19.10 | \$19.10 |
| Customer Charges | \$143,883 | \$153,358 | \$153,644 | \$155,180 |
| Other Operating Income: | | | | |
| Capacity Charge | 3,614 | 3,750 | 4,250 | 4,750 |
| City of Seattle CC Charge | 792 | 656 | 904 | 938 |
| Hazardous Waste Fees | 1,986 | 2,515 | 2,411 | 2,750 |
| Industrial Surcharge Fees | 2,789 | 2,900 | 3,200 | 3,400 |
| Septic Tank Disposal Fees | 1,456 | 1,600 | 1,744 | 1,800 |
| Sale of By-Products | 600 | 300 | 293 | 300 |
| Contracts & Grants | 488 | 920 | 513 | 550 |
| Misc. Operating Income | 586 | 565 | 639 | 264 |
| Subtotal | 12,311 | 13,206 | 13,954 | 14,752 |
| Interest Income | 9,814 | 6,560 | 6,398 | 5,754 |
| Capital Funds: | | | | |
| Capital Grants & Loans | 37,247 | 35,207 | 22,907 | 17,560 |
| Proceeds from Bond Sales | 90,000 | 0 | 50,000 | 65,000 |
| Short-Term Borrowing (net) | (50,000) | 100,000 | 0 | 30,000 |
| Other Capital Revenues | 0 | 4,151 | 6,292 | 4,377 |
| TOTAL PROGRAM REVENUE | \$243,255 | \$312,482 | \$253,195 | \$292,623 |
| Expenditures: | | | | |
| Operating Expense | 58,663 | 70,990 | 71,738 | 72,441 |
| Capital Expenditures | 163,247 | 152,758 | 111,801 | 136,267 |
| Debt Service -- Bonds | 75,171 | 76,637 | 78,777 | 82,649 |
| Other Financing Costs | 2,918 | 8,664 | 9,951 | 11,751 |
| TOTAL EXPENDITURES | \$299,999 | \$309,049 | \$272,267 | \$303,108 |
| Reserves & Adjustments | (1,213) | (159) | (616) | (37) |
| BALANCE FORWARD | \$90,854 | \$32,897 | \$36,171 | \$16,483 |
| BALANCE END OF YEAR | \$32,897 | \$36,171 | \$16,483 | \$5,961 |
| DEBT SERVICE COVERAGE | 1.43 | 1.33 | 1.30 | 1.25 |

further savings that are expected to be generated by the continuing integration of the Water Quality program into the County government and the pending merger with Surface Water Management, this favorable experience has caused staff to scale back earlier projections of operating expenses. This has allowed a rate saving in 1998 of approximately 90 cents.

2. Reduced Capital Expenditures

Second, capital expenditures during the 4-year period from 1995 through 1998 are projected to be substantially lower than shown in the 1995-2000 Financial Forecast. Allowing for an associated delay in the receipt of some capital grant revenues, this has allowed a reduction in the 1998 rate of approximately \$1.50. Note that one significant factor behind this decline in projected capital spending is the use of a 90% capital accomplishment rate assumption for rate-setting purposes.

3. Financing Strategy

Staff proposes relying somewhat more heavily on short-term debt to provide on-going funding for the capital program as a means of providing improved asset-liability management. This is considered prudent since it would provide a better maturity matching of the program's assets and liabilities and thereby help to reduce its exposure to interest rate movements. This change in funding strategy lowers the targeted 1998 sewer rate by approximately 50 cents.

4. Customer Growth

Lastly, a further 20 cent decline in the rate needed to finance the program in 1998 is due to an assumed increase in the customer base as the pace of local economic activity is projected to pick up over the next few years with the announced rebound of hiring at Boeing.

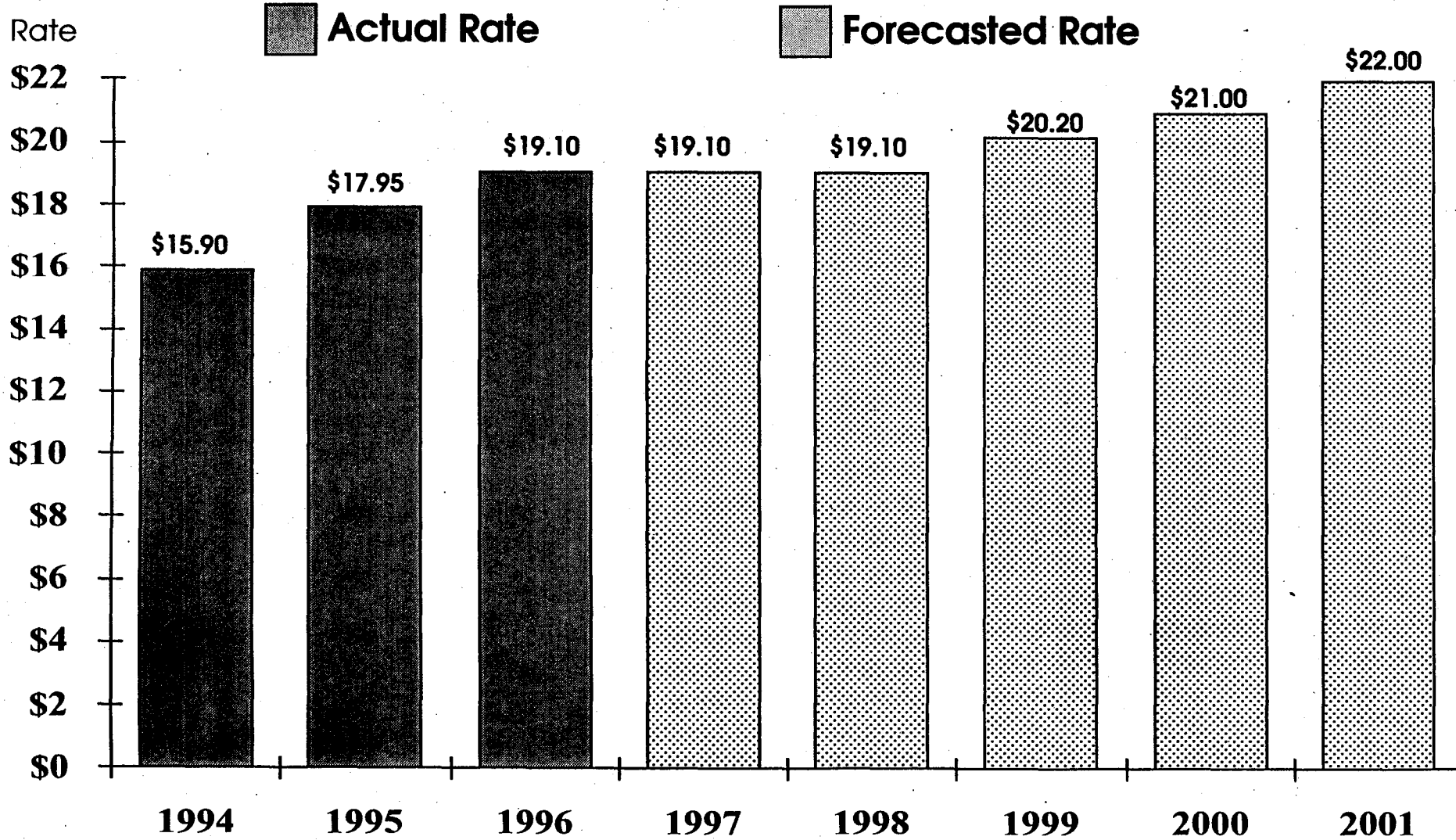
Future Rates

The projected sewer rates for the balance of the Forecast period are shown in the chart on the following page. It shows that rates are expected to increase by roughly \$1 each year to a level of \$22.00 by 2001.

It must be noted, however, that the need for these increases is largely based on the assumed ramp-up of the capital expenditures associated with the system configuration selected under the RWSP. Any lowering or delay of such costs would act to moderate the rates needed for the period 1999-2001. Similarly, these increases could be mitigated if financial markets allow the refunding of the system's existing debt at lower interest rates.

King County Sewer Rate

1994 - 2001 Actual and Forecast



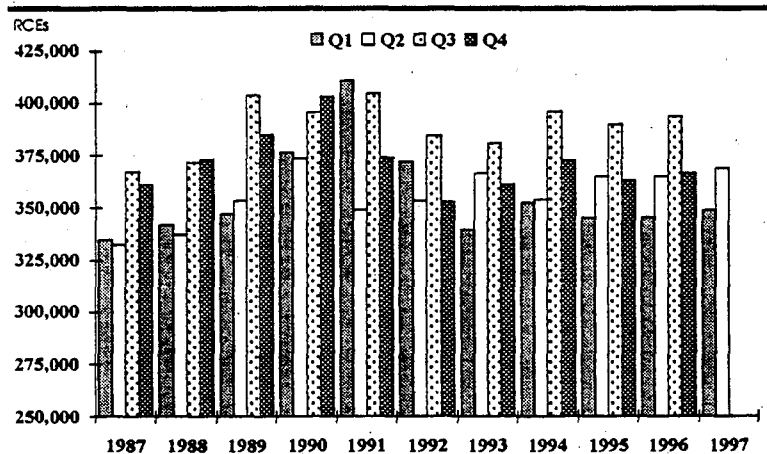
PLANNING ASSUMPTIONS: REVENUE

Residential Customers and Residential Customer Equivalents (RCEs)

Sewer system billings to the Component Agencies are based on the number of single-family households (residential customers) and on the water consumption of other users such as factories, offices, and apartment complexes. Specifically, the billings for customers other than single-family households are based on a four-quarter average of water consumption and the single family rate is levied for each 750 cubic feet of usage. Each such 750 cubic feet unit of water consumption therefore comprises one RCE.

While the number of residential customers typically exhibits steady growth, the RCEs actually declined quite markedly during the period 1991-1993 (see chart). Although it is difficult to quantify the importance of each factor, this decline in RCEs was considered to be attributable to a combination of drought conditions, reduced activity levels at many local companies -- especially those that are relatively heavy water users -- and the continuing introduction of cost-saving water conservation devices.

King County Commercial RCEs (1987 - 1997)



Another factor that may have contributed to the decline was a change made in Metro's billing methodology in 1993 that effectively shifted more of the system costs to these large users from households (the previous 900 cubic feet standard used for residential equivalency was revised to the current 750 cubic feet standard described above).

Although water consumption continued to decline slightly during 1995, the Forecast is based on an assumption that RCEs will once again start to exhibit some consistent growth during the second half of 1996 as local economic conditions improve, paced by the announced pickup in production and employment at Boeing. Economists project the region's population to grow by 1.9% and 2.3% respectively in 1996 and 1997.

Specifically, RCEs are projected to post year-over-year increases of 1% during the second half of 1996 and in 1997. This assumption is lower than population growth due to the expected impacts of water conservation.

This anticipated rebound in RCEs will be supplemented by continuing growth in the number of residential customers. Specifically, consistent with recent experience, the Forecast assumes that the number of suburban residential customers will continue to grow by 1% annually during this time period. Based on these assumptions, total residential customers and RCEs of 669,100 and 670,400 are projected for 1996 and 1997 respectively. This compares to the estimate of 662,300 that was used for both of these years in the 1996 Financial Forecast.

Beyond 1997, total residential customers and RCEs are expected to continue to grow by 1.0% annually over the period 1998-2001 as local economic conditions continue to improve.

Capacity Charge

Pending the development of a revised methodology for the calculation of the capacity charge that incorporates the recommendations of the recent county audit, the projection of revenues is based on the assumption that the levy is maintained at its current level of \$7.00 per month.

This rate is lower than the \$10.50 maximum rate permitted under state law. Even if the revised methodology supports the setting of the capacity charge at this higher level, the adoption of a \$10.50 rate by the Council would not have a substantial near-term revenue impact since it would only be applied to new hookups. The majority of revenues would still come from existing accounts billed at the current \$7.00 rate.

Capital Grants

No significant new capital grants beyond those already identified in the 1996 Budget are anticipated during the Forecast period. By the same token, however, the Forecast does not incorporate the possibility that certain grant receipts may be jeopardized as a result of recent unfavorable county audit findings.

OPERATING PROGRAM

The projected expense levels during the entire period are significantly lower than those that had been assumed in previous Forecasts. This is basically due to two factors.

First, the evidence from operating the West Point plant at secondary treatment over the past six months has now provided clear evidence that the previous consultant-generated cost estimates were overly conservative. This very favorable experience has allowed the expenditure projections for such key cost items as electricity, chemicals, and biosolids recycling to be scaled back considerably. Specifically, expenses in 1996 are now expected to total \$3.2 million less than the Budget appropriation of \$74.2 million, a reduction of more than 4%.

Second, further savings in operating expenses are also expected to be generated over the next few years by the continuing integration of the Water Quality program into the County government. In particular, the pending merger with Surface Water Management will allow various duplicated functions to be streamlined. Such savings are expected to total approximately \$4.0 million annually by 1998.

Together, these reductions in operating expenses, which are assumed to carry through into succeeding years, are a very important factor behind the program's ability to avoid a sewer rate increase for both 1997 and 1998.

Looking further ahead to the last three years of the Forecast period, the operating expenses of the Water Quality program are projected to simply keep pace with the assumed underlying inflation in resource costs. This projection therefore reflects an assumption that any significant new program initiatives that are contemplated during this timeframe will either have to be driven directly by cost efficiencies or be accommodated by savings and workload reprioritizations in other cost areas. In particular, it should be noted that no operating expenses associated with the new facilities identified by the RWSP are expected to be incurred during the Forecast period. Capital expenditures for RWSP are shown on the following page.

WATER QUALITY CAPITAL FINANCIAL PLAN

| (\$s In Thousands) | Actuals 1987-94 | 1995 Actual | 1996 Plan | 1997 Plan | 1998 Plan | 1999 Plan | 2000 Plan | 2001 Plan | 1997 Forecast Thru 2001 | 1996 Forecast Thru 2000 | Change |
|---------------------------------|----------------------------|------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|--|--|-----------------|
| Alki Stormweather/Transfer | 35,088 | 23,510 | 30,338 | 18,760 | 13,152 | 5,152 | 0 | 0 | 126,000 | 126,000 | (0) |
| North Creek Connection | 562 | 3,965 | 4,710 | 11,892 | 22,253 | 30 | 0 | 0 | 43,412 | 41,978 | 1,434 |
| Renton Enlargement III | 60,585 | 50,681 | 43,661 | 21,850 | 25,325 | 24,365 | 9,680 | 0 | 236,147 | 236,147 | 0 |
| University Regulator | 16,147 | 95 | 709 | 1,690 | 833 | 0 | 0 | 0 | 19,474 | 19,642 | (168) |
| West Point | 485,667 | 51,896 | 38,261 | 7,604 | 10,065 | 0 | 0 | 0 | 593,493 | 604,063 | (10,570) |
| Denny Way CSO | 276 | 5,347 | 2,541 | 5,238 | 5,731 | 5,080 | 8,365 | 35,171 | 67,749 | 120,000 | (52,251) |
| Other Secondary/CSO Projects | 109,243 | 667 | 854 | 279 | 1,516 | 0 | 0 | 0 | 112,559 | 112,395 | 164 |
| Capital Assets Management | 20,257 | 6,781 | 5,612 | 6,802 | 11,346 | 11,545 | 11,042 | 13,983 | 87,367 | 66,536 | 20,831 |
| Biosolids Management Plan | 4,922 | 375 | 4,907 | 4,374 | 429 | 476 | 968 | 1,006 | 17,457 | 10,034 | 7,423 |
| Facilities Improvements | 19,990 | 10,442 | 23,411 | 19,467 | 18,648 | 16,922 | 27,941 | 15,523 | 152,344 | 130,066 | 22,278 |
| Transmission Improvements | 10,422 | 5,123 | 11,617 | 11,249 | 7,529 | 6,938 | 7,449 | 7,482 | 67,807 | 63,665 | 4,142 |
| South Interceptor | 6,780 | 4,365 | 1,731 | 1,779 | 16,589 | 14,017 | 0 | 0 | 45,261 | 43,949 | 1,312 |
| RWSP | 0 | 0 | 1,379 | 13,239 | 17,993 | 43,991 | 45,753 | 40,410 | 162,765 | 229,698 | (66,933) |
| Total Capital Program | 769,939 | 163,247 | 169,732 | 124,223 | 151,408 | 128,516 | 111,198 | 113,575 | 1,731,836 | 1,804,173 | (72,337) |
| Prior Years Carryover | | | | | | 14,845 | 14,845 | 14,845 | | | |
| Accomplishment Assumption (90%) | | | (16,973) | (12,422) | (15,141) | | | | | | |
| Total Financial Plan | 769,939 | 163,247 | 152,758 | 111,800 | 136,267 | 143,361 | 126,043 | 128,420 | | | |

PLANNING ASSUMPTIONS: EXPENSES**Inflation**

Despite some isolated cautionary signals such as the recent strength of commodity prices, there does not seem to be any compelling reason to believe that inflation will accelerate significantly from the very subdued pace experienced over the past few years. Accordingly, the 1996-2001 Financial Forecast is therefore based on an assumed annual inflation rate, as measured by the CPI, of 3.0%. This replaces the 3.5% rate that was assumed in the cash flow presented in the previous 1995-2000 Financial Forecast.

For 1997 rate-setting purposes, this inflation rate is used as the basis for cost-of-living adjustments (COLAs) and for adjusting the costs of all non-salary line items in the 1996 Budget that do not warrant separate price projections. Beyond 1997, other sources of operating revenues are also assumed to increase broadly in line with this inflation rate.

Salaries

Salary expense is assumed to increase in line with inflation. Under existing pay practices, this would be sufficient to cover COLAs, which are calculated as 80% of appropriate year-over-year inflation measures, as well as some limited merit and longevity increases.

Medical Benefits

Mounting evidence suggests that the rapid rise in healthcare benefit costs seen during the late-1980s and early-1990s has now largely run its course. For planning purposes, there no longer seems to be any persuasive reason to expect that medical benefit costs will continue to outpace general inflation. The Forecast embodies this assumption.

Electricity

Projections of electricity rates for 1996 and 1997 were obtained directly from Seattle City Light and Puget Power. City Light expects to raise rates by 7.4% in March, while Puget Power does not anticipate the need for any rate increase in October due to the cost savings expected from their pending merger with Washington Energy Co. Beyond 1997, electricity prices are assumed to outpace inflation by 75 basis points annually.

Chemicals

Chemicals are typically purchased at fixed prices under long-term contracts. Information regarding projected price changes for new contracts expected to commence during 1997 was obtained from discussions with manufacturers and suppliers.

Service Area Growth

An important expense driver is the growth in the volumes handled at the treatment plants since this directly influences expenditures for many items, notably chemicals, electricity, and biosolids recycling. In line with recent experience, the 1997 rate proposal assumes growth of 1.0% and 1.5% for the northern and southern service areas respectively.

CAPITAL PROGRAM

The period 1996-2001 will be highlighted by the completion of the current projects that comprise the fourth stage of the Comprehensive Plan and the expected commencement of various new projects associated with the RWSP. While the preferred configuration for the RWSP has yet to be selected, the amounts included for planning purposes are based on current estimates for Service Strategy 1.

The schedules for some of the major capital projects, notably the Denny Way CSO project and the RWSP projects, have been pushed back significantly from those shown in the 1995-2000 Financial Forecast and in the 1996 Budget. Together with the \$11 million that has been pulled out of the contingency for the West Point project as it nears completion, such deferrals have resulted in a considerable decline in lifetime costs. Specifically, after adjusting for the addition of another year to the forecast period, total lifetime costs for the program through 2000 have actually declined by \$186 million.

The lowering of the estimated expenditures for the West Point project and the delay in other key projects -- notably the Denny Way project, the Southern Interceptor, and the RWSP -- have been key factors allowing the program to avoid any rate increase for 1998. Although partially offset by slower grant receipts, the \$114 million overall decline in total project expenditures identified for the key 1995-1998 period has provided rate relief on the order of \$1.00 by reducing the need for borrowing.

Accomplishment Rate Assumption

Projections of annual capital expenditures have been even further reduced for rate-setting purposes since the program's long-term financing will be based on the assumption that only 90% of planned spending will actually be achieved in each year. (The resultant expenditure shortfalls in the period 1996-1998 are in turn assumed to be made up during the last three years of the Forecast period to ensure consistency with lifetime cost estimates.) This explains why in the preceding page the WPC Financial Plan identifies expenditure shortfalls for 1996 - 1998 under Accomplished Assumptions (90%) with the offset made up under the prior year's carryover during 1999 - 2001.

The basis for this reduced accomplishment rate assumption is that unanticipated factors such as bid protests and permit delays have historically caused annual capital expenditures to fall short of the projections used during the rate-setting process. This assumption is even lower than the 95% assumption used for the setting of the 1995 and 1996 sewer rates since such underspending has become more pronounced during the past two years.

The use of this 90% assumption permits approximately a 50 cent lowering of the 1998 sewer rate.

A significant factor behind the program's ability to maintain stable sewer rates through 1998 is the willingness to place somewhat greater reliance on short-term borrowing as a semi-permanent source of financing for the capital program. Specifically, outstanding short-term debt is planned to be increased to \$130 million in 1998 from the current level of \$65 million.

At such a level, short-term borrowing would be equal to approximately 11% of projected outstanding long-term debt in 1998. An increase to this ratio is considered prudent since it will contribute to a better maturity matching of assets and liabilities and thereby help to reduce the program's overall exposure to interest rate movements.

Operationally, \$35 million of this increased short-term debt will take the form of additional near-term borrowing that has been authorized under the existing 3-year Commercial Paper (CP) program. The remaining \$30 million projected to be needed in early 1998, however, is likely to be raised by means of the separate sale of 1-year Bond Anticipation Notes (BANs) until it can be integrated with the current CP debt into an expanded short-term borrowing program in 1999.

Beyond 1998, the Forecast assumes that short-term borrowing will be increased incrementally in line with management's goal of maintaining the ratio of such debt to outstanding long-term obligations in a range of somewhere between 10 and 12%. This target is lower than the 15% limitation proposed in the Water Quality Financial Policies because management also considers it important to reserve some unused short-term borrowing capacity as a safeguard to cover any unforeseen constraints on long-term debt issuance or other funding needs.

Even with this increased reliance on short-term borrowing, the Forecast still projects the need to issue \$115 million of long-term (40-year) bonds through 1998 in order to provide continued funding for the Water Quality capital program. It is assumed that such debt will again take the form of Limited Tax General Obligation (LTGO) bonds that are payable from sewer revenues. The use of LTGO bonds helps reduce sewer rates since the interest costs are between 15 to 25 basis points lower than on traditional sewer revenue bonds and there is no requirement to contribute a portion of the proceeds into a reserve fund.

Given that the County's non-voted general obligation debt capacity is limited, however, the Financial Forecast assumes renewed reliance on traditional sewer revenue bonds for the long-term debt issues needed after 1998. Depending on financial market conditions, however, LTGO bonds may very well also be utilized to refund outstanding revenue bonds during the coming year. As such, the critical policy choice between these instruments will need to be revisited annually in the context of the competing demands for use of the County's available debt capacity.

Interest Rate Assumptions

The interest rates on future long-term LTGO and revenue bond issues are assumed to be 6.50% and 6.75% respectively. These rates are approximately 25-50 basis points higher than current market levels, a cushion that is considered prudent for planning purposes to allow for some potential deterioration in financial market conditions.

The interest cost of commercial paper and other forms of short-term borrowing is assumed to be 4.50% (inclusive of remarketing and liquidity support fees) while the yield on new investments is assumed to average 4.75%.

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WATER QUALITY PROGRAM CASH FLOW

| (\$s in Thousands) | 1995 | 1996 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | Totals |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-----------|
| | Actual | Adopted | Projected | Proposed | | | | | 1996-2001 |
| CUSTOMER EQUIVALENTS RATE | 667.80 \$17.95 | 662.30 \$19.10 | 669.10 \$19.10 | 670.40 \$19.10 | 677.10 \$19.10 | 683.88 \$20.20 | 690.71 \$21.00 | 697.62 \$22.00 | |
| OPERATING REVENUE: | | | | | | | | | |
| Customer Charges | 143,883 | 151,799 | 153,358 | 153,644 | 155,180 | 165,741 | 174,060 | 184,172 | 986,154 |
| Investment Income | 9,814 | 9,033 | 6,560 | 6,398 | 5,754 | 7,549 | 7,145 | 8,338 | 41,745 |
| Capacity Charge | 3,614 | 3,000 | 3,750 | 4,250 | 4,750 | 5,250 | 5,750 | 6,250 | 30,000 |
| City of Seattle CC Benefit | 792 | 656 | 656 | 904 | 938 | 1,063 | 1,188 | 1,313 | 6,059 |
| Other Income | 7,905 | 9,112 | 8,800 | 8,800 | 9,064 | 9,336 | 9,616 | 9,904 | 55,520 |
| TOTAL OPERATING REVENUES | 166,008 | 173,600 | 173,124 | 173,995 | 175,686 | 188,939 | 197,758 | 209,976 | 1,119,479 |
| OPERATING EXPENSE | (58,663) | (74,218) | (70,990) | (71,738) | (72,441) | (74,667) | (76,961) | (79,327) | (446,123) |
| DEBT SERVICE REQUIREMENT | (75,171) | (79,385) | (76,637) | (78,777) | (82,649) | (91,420) | (96,696) | (104,469) | (530,648) |
| DEBT SERVICE COVERAGE RATIO | 1.43 | 1.25 | 1.33 | 1.30 | 1.25 | 1.25 | 1.25 | 1.25 | |
| OPERATING RESERVE | (161) | (535) | (159) | (616) | (37) | (35) | (111) | (115) | (1,074) |
| SUBORDINATED DEBT SERVICE | (875) | (7,463) | (8,164) | (8,951) | (10,301) | (10,301) | (11,651) | (11,651) | (61,019) |
| BALANCE ON OPERATIONS | 31,138 | 11,999 | 17,174 | 13,913 | 10,258 | 12,517 | 12,338 | 14,415 | 80,615 |
| <u>FUNDS AVAILABLE FOR CAPITAL</u> | | | | | | | | | |
| BEGINNING FUND BALANCE | 90,854 | 81,218 | 32,898 | 36,172 | 5,000 | 5,961 | 4,953 | 4,939 | |
| REVENUES: | | | | | | | | | |
| Bond Proceeds | 90,000 | 50,000 | 0 | 50,000 | 65,000 | 97,427 | 70,607 | 102,847 | 385,882 |
| Short Term Borrowing (net) | (50,000) | 0 | 100,000 | 0 | 30,000 | 0 | 30,000 | 0 | 160,000 |
| Grants | 37,247 | 29,845 | 35,207 | 22,907 | 17,560 | 32,265 | 12,500 | 12,500 | 132,939 |
| Other | 0 | 4,151 | 4,151 | 6,292 | 4,377 | 9,413 | 7,450 | 8,554 | 40,238 |
| Balance on Operations | 31,138 | 11,999 | 17,174 | 13,913 | 10,258 | 12,517 | 12,338 | 14,415 | 80,615 |
| TOTAL REVENUES | 108,385 | 95,995 | 156,532 | 93,112 | 127,195 | 151,622 | 132,896 | 138,316 | 799,673 |
| CAPITAL EXPENDITURES | (163,247) | (168,162) | (152,758) | (111,801) | (136,267) | (143,361) | (126,043) | (128,420) | (798,650) |
| DEBT ISSUANCE COSTS | (2,043) | (1,325) | (500) | (1,000) | (1,450) | (1,949) | (1,562) | (2,057) | (8,518) |
| ADJUSTMENTS | (1,052) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| BOND RESERVE CONTRIBUTION | 0 | 0 | 0 | 0 | 0 | (7,321) | (5,305) | (7,728) | (20,354) |
| 1997 - 1998 RATE FUND RESERVE | | | | (11,483) | 11,483 | | | | 0 |
| ENDING FUND BALANCE | 32,898 | 7,726 | 36,172 | 5,000 | 5,961 | 4,953 | 4,939 | 5,050 | |

FINANCING OPTIONS FOR RATE REDUCTION

The projected \$19.10 sewer rate for 1997 and 1998 already incorporates the reductions in operating expenses made possible by the consolidation as well as various other programmatic initiatives undertaken by management in recent years. Furthermore, the consolidation has also yielded benefits on the financing front since the Water Quality program's ability to utilize LTGO bonds has allowed significant savings in debt service costs associated with the funding of the capital program. As a result of these combined savings and other favorable external developments, the 1998 rate is nearly \$4.00 lower than that projected in the final Metro budget issued prior to the merger.

While already substantially reduced, however, there are still some strategies that could be used to produce a lower sewer rate for 1997 and 1998. Two that are frequently suggested are the further lowering of the assumed accomplishment rate for capital expenditures and the greater use of short-term borrowing. The merits of these options are discussed below.

1. Reduction of Capital Expenditure Accomplishment Rate Assumption

One option would be to further reduce the assumed rate of capital expenditure accomplishment below the 90% assumption used as the basis for the current proposal. For example, use of an 85% assumption would permit a reduction of almost another 25 cents in the 1997 and 1998 monthly sewer rates.

Such a proposal might be supported by the fact that the actual accomplishment rate has averaged just 83% over the past five years and has actually been below 80% in 1994 and 1995. In spite of this recent pattern of increasing under performance, however, it does not seem prudent to reduce the accomplishment rate assumption below 90% since it seems likely that this recent average will be exceeded over the next few years. The West Point project is fast nearing completion and the resolution of various contractor disputes should allow work on the Alki and Renton projects to progress quite rapidly.

Note that the assumption of a lower rate of capital expenditure accomplishment would not formally require the Water Quality program to reduce planned construction activity or defer any projects. This assumption is simply used to reduce the amount of long-term bonds to be issued, thereby lowering the sewer rate. Once a lower rate is adopted or targeted, long-term debt issuance would be effectively constrained. The Agency could still rely on additional short-term borrowing beyond that already anticipated, however, if the assumed accomplishment rate proves incorrect and the program were to achieve its planned expenditures. As such, use of a lower accomplishment assumption would not result in any actual disruption to the Water Quality capital program.

2. Use of Additional Short-Term Financing

Another option would be to rely even more heavily on short-term debt to fund the capital program. Full utilization of the short-term debt capacity defined in the Water Quality Financial Policies would permit approximately \$170 million of such debt by 1998 rather

than the proposed \$130 million. Issuance of this additional \$40 million could lower the 1998 sewer rate by approximately 25 cents.

Management would not endorse such a recommendation, however, since retention of some unused short-term borrowing capacity provides a vital element of financial flexibility in the event that adverse events limit the ability to raise long-term debt or generate additional funding needs.

The key reason for preserving such a significant volume of unused short-term debt capacity is that the RCE projections that underpin the Forecast are still subject to a significant degree of uncertainty. Specifically, it is estimated that approximately \$40 million of additional short-term borrowing would be needed to offset the adverse financial impact of a 1% shortfall in total residential customers and RCEs relative to the level shown in this Forecast. To put this potential need in context, the program faced just such a situation in 1993 when the drop-off in RCEs caused a sharp decline in revenues and forced the issuance of \$50 million of BANs in lieu of additional parity bonds.

Furthermore, preservation of some unused short-term borrowing capacity could be important if capital expenditures exceed the accomplishment rate assumption used for rate-setting purposes.

Management therefore believes that it is prudent to retain this flexibility by planning to borrow less than the full 15 percent limit. In addition, since investible funds on hand during 1998 average approximately \$130 million, the rationale for short-term borrowing beyond this level as a tool for asset-liability management appears to weaken.

3. Rate Reduction in 1997

During the review of the rates for 1997, a reduction in the current rate of \$19.10 to \$18.55 was considered as achievable due to the savings previously mentioned. However, in subsequent years annual increases would be necessary, i.e., the reduction in rates could not be sustained and would result in larger increases in the later years. Further, the Financial Policies proposed for adoption this year include consideration of a multi-year rate. The savings in 1996 and 1997 provide the opportunity to implement this policy over a three year period (1996 - 1998) if these savings are reserved to "buy down" rates in 1998. Therefore, the option of reducing rates in 1997 was rejected in favor of accomplishing rate stabilization over a three year period.

WATER QUALITY FUND 1996-2001 FINANCIAL FORECAST

KING COUNTY
Department of Natural Resources
Water Pollution Control Division

INTRODUCTION

This document presents a multi-year financial plan and cash flow forecast for the period from 1996 through 2001 as required by the Water Quality Program Financial Policies. It is intended that this Forecast will be used by the Metropolitan King County Council (the Council) as the basis for policy decisions including the setting of the 1997 sewer rate and the preparation of the annual budget.

POLICY REVIEW

The 1997 sewer rate proposal is predicated upon the adoption of certain revisions to the existing Water Quality Program Financial Policies that govern key elements of the Forecast.

Appendix A

SEWER RATE AND CASH FLOW EXPLANATION

This report is prepared to satisfy the mandate of the Water Quality Program Financial Policies that a detailed explanation be prepared in support of proposed sewer rates.

The proposed monthly sewer rate of \$19.10 for 1997 and 1998 and the projected rates for the balance of the Forecast period are generated by a detailed cash flow model. This model incorporates the key economic and financial assumptions as well as the specific projections relating to future revenues and expenditures described in this Forecast.

In accordance with the Financial Policies, the Water Quality program must set the monthly sewer rate at a level that is expected to, at a minimum, generate sufficient current revenues to meet all annual operating and maintenance expenditures and to provide 1.25 times coverage for the annual debt service payments due on outstanding bonds. This standard, which must be satisfied in each year, precludes the "averaging" of revenues for the purpose of setting a multi-year rate. In this Forecast, the minimum rate that can satisfy the Executive's desire to maintain stability for the next two years is therefore that which will provide such 1.25 coverage in 1998. An inevitable corollary, however, is that the proposed rate for 1997 will actually provide a higher coverage ratio of 1.30.

More specifically, the proposed rate of \$19.10 is actually determined by the projected monetary requirements for 1998. Operating expenses are projected to total \$72.4 million and debt service requirements for the year are expected to rise to \$82.6 million as the Water Quality program plans to issue \$115 million of additional bonds through 1998 to fund capital expenditures. Because of the pledge to maintain a minimum 1.25 coverage ratio against the debt service payments, these projections result in the need to generate operating revenues totaling \$175.7 million in 1998 ($=72.4 + (82.6 * 1.25)$).

Given that interest earnings (\$5.8 million) and the proceeds from the various other revenue sources described earlier are projected to generate a total of \$20.5 million, the program therefore needs to set its monthly sewer rate at a level that generates \$155.2 million. Spreading this amount across the projected 1998 customer base of 677,100 RCEs produces a rate of approximately \$19.10 ($=155.2 * 1,000 / 12 / 677.1$).

As such, the sewer rate is comprised of two major elements, namely operating costs and debt service payments. For 1998, approximately 37 percent is attributable to operating expense (net of operating revenues) and 63 percent is needed to meet debt service coverage requirements (net of interest earnings).

Options for the 1997-98 Sewer Rate

As required by the Water Quality Financial Policies, staff has analyzed the viability and impact of certain alternative options for reducing the 1997-98 sewer rate. Discussion of such options is presented within the main Forecast document. (See "Financing Options for Rate Reduction".)