

# Section 4: Financial Management

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### Financial Overview

This limited financial program review for the Plan Update focuses on the following:

- **An overview of the Utility's projected expenses and revenues**
- **Rate Path**
- **Financial Policies**
- **Financial Performance Expectations**

### Expenses

The Bothell Storm and Surface Water Utility funds most of the Utility's day-to-day storm and surface water activities as well as projects that support the built and natural storm and surface water systems. In addition to paying for operations and projects, the Utility pays back the cost of loans and bonds that are used to finance projects not appropriately funded by cash.

Like other City utilities, Storm and Surface Water pays excise tax.

In addition to paying for operations and projects, the Utility funds replacement of worn-out storm infrastructure. These funds are tracked as depreciation expenses and are currently added back into the Utility's year-end cash balance if they are not used to replace depreciated infrastructure.

### Revenues

**Rates:** The primary source of funds for the Utility come from rate payers, who pay an annual fee based on the extent that their property is developed. These revenues first go to annual operating expenses, taxes and debt repayment. Any rate revenues that exceed these annual expenses are available to fund projects. In 2019, the Utility collected \$5,380,995 in rate revenue. By 2021, based on assumed rate increases and growth, rate revenues are expected to be about \$5.34 million.

**Capital Facilities Charges:** In addition to rate revenue, the Utility collects stormwater capital facilities charges for new development to connect to the Utility storm drain system. Capital facilities charges are one-time revenues that are highly dependent on the market activity that affects development. These one-time revenues must be used only to fund capital projects that typically add system capacity necessary to accommodate growth and correct deficiencies.

Two facilities charges were established in 2011 – a citywide charge and a Downtown sub-basin charge. These charges fund a stormwater capital improvement fund. In 2019, the Utility collected \$381,146 in citywide charges and \$205,861 in Downtown sub-basin charges.

**Loans and Bonds:** When necessary to provide cash for large projects and to be fair to current and future rate payers, the Utility accesses loans or seeks revenue bond funds to finance projects. The cost of projects financed through these sources is then repaid by the Utility over time through its debt repayment expense. The Public Works Trust Fund administered by the State Public Works Board has been a past source of project financing for the Utility.

**Grants:** Grants are sought by the Utility to the extent practical to partially fund projects and programs. These grants may come from federal or state agencies such as the Environmental Protection Agency, Federal Emergency Management Agency, or State Department of Ecology (Ecology). The Utility also accesses grants from county districts like the King Conservation District and King County Flood Control District. In 2019, the Utility received \$118,673 in grant funds from Ecology and FEMA for local programs. It received \$32,176 from the King County Flood District.

**Other:** A small amount of funding is collected each year by the Utility for permits and fees. In 2019, this amounted to \$18,559. The City also received legal judgement and settlement funds in the amount of \$729,044.

## Rate Path

**1995-2007:** Beginning on January 1, 1995, the Utility imposed charges on all developed property in the city based on the extent that the property is covered by impervious surface. Since 1995, the rates have been subject to annual review by the City to assure that the revenue they generate is adequate to meet the Utility's needs. For the first 11 years, rates increased moderately.

**2008-2013:** In 2008, a significant (42%) rate increase was enacted to allow the Utility to meet new requirements under the federal Clean Water Act NPDES program. Rates were steady from 2008 until 2011, when a thorough rate analysis was performed. The 2011 rate analysis included development of a rate model that looked at operations and capital needs through 2018. The analysis recommended substantial increases in 2012 (15%) and 2013 (13.74%). Rates were raised by 8% in 2012 and 15% in 2013.

Addition of capital facilities charges in 2012 offset some of the need to use rate revenues to fund the Utility's capital needs. Since 2013, the Utility has only experienced periodic moderate increases as needed to remain solvent.

Two significant changes that reduced the projected need for rate increases include:

- *Billing Corrections:* In 2013, Utility staff reviewed impervious surface calculations for all customer bills and corrected inaccuracies for some properties. This is now conducted annually to ensure properties are calculated as development changes.
- *Elimination of Credits for Maintenance:* In 2014, the Utility eliminated reductions against rate charges for non-single family properties that maintain their stormwater detention facilities.

**Reduction in Revenue:** The City currently bills the City Street Fund in order to bill the Washington State Department of Transportation (WSDOT) for their impacts on the City related to the pollution, congestion, and maintenance from limited access highways including I-405 and portions of SR522. In 2019, Bill 5505 amended RCW 90.03.525 which gives local municipalities the ability to charge stormwater fees to WSDOT for state highway stormwater impacts.

Amendments to the RCW in the Bill included:

- Funding must be used directly for state highway runoff impacts.
- The City must develop a plan for each calendar year of expenditures and have this approved by WSDOT by December 31<sup>st</sup> of the prior year.
- The City must provide a progress report for the charges from the previous year and no charges will be paid until the plan and report have been submitted and approved by WSDOT.

State highways contribute a significant amount of increased runoff to our stormwater system, which contributes to our costs for basin planning, drainage facility construction and maintenance, spill response, staffing and equipment needs, and state/federal program requirements to reduce and eliminate pollution under the Clean Water Act.

These amendments require an additional level of work and reporting which must be approved, and delay payment of stormwater fees to the following year which impact City budget and the ability to complete necessary work in a timely manner. WSDOT has still not approved costs from the plan submitted in 2019 because they would like to see more proof to show direct impacts from the limited access highways.

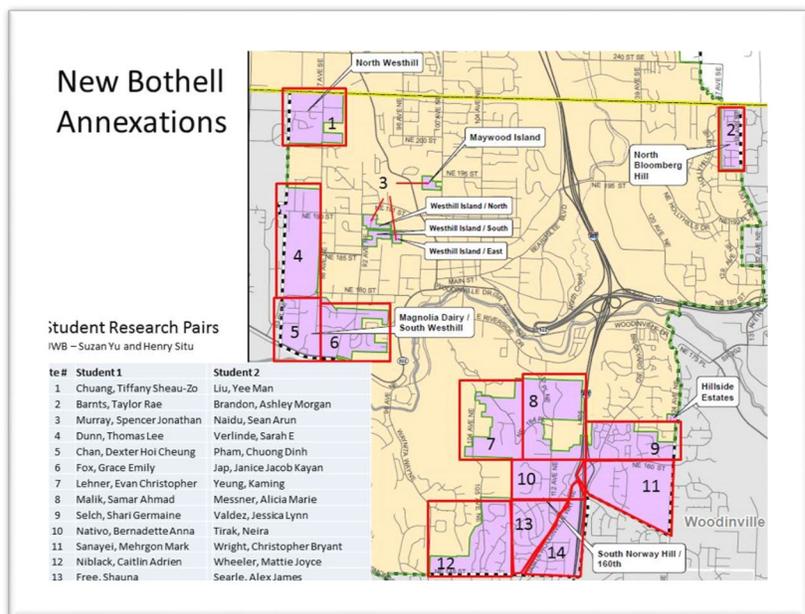
Staff are reviewing these impacts by drainage basin to determine whether this should continue in the future. The Utility received \$184,583 from WSDOT and \$465,830 from the City Street Fund in 2019.

### WSDOT Analysis

As part of the City’s overall stormwater management program, the City collects approximately \$190,000 per year in stormwater fees from WSDOT to specifically mitigate runoff from state highways I-405, SR 522, and SR 527 where WSDOT infrastructure drains to the City’s storm drain system. Evaluating the impacts and potential mitigation of this WSDOT drainage is outside of the scope of the Master Plan update. Therefore, the City is conducting a separate assessment of the impact of WSDOT runoff on stormwater assets and evaluating potential mitigation needs and opportunities. This work will include estimating the general share of WSDOT stormwater runoff contribution to the city’s receiving waters, identifying potential impacts to the City’s assets, and evaluating and mapping potential opportunities for mitigation in each Bothell watershed that receives runoff from state highways.

**Annexation:** On February 28, 2014, Bothell annexed 1,005 acres from unincorporated King County. The annexations increased the service area of the Utility and increased the rate revenues by about \$400,000 per year for the Utility.

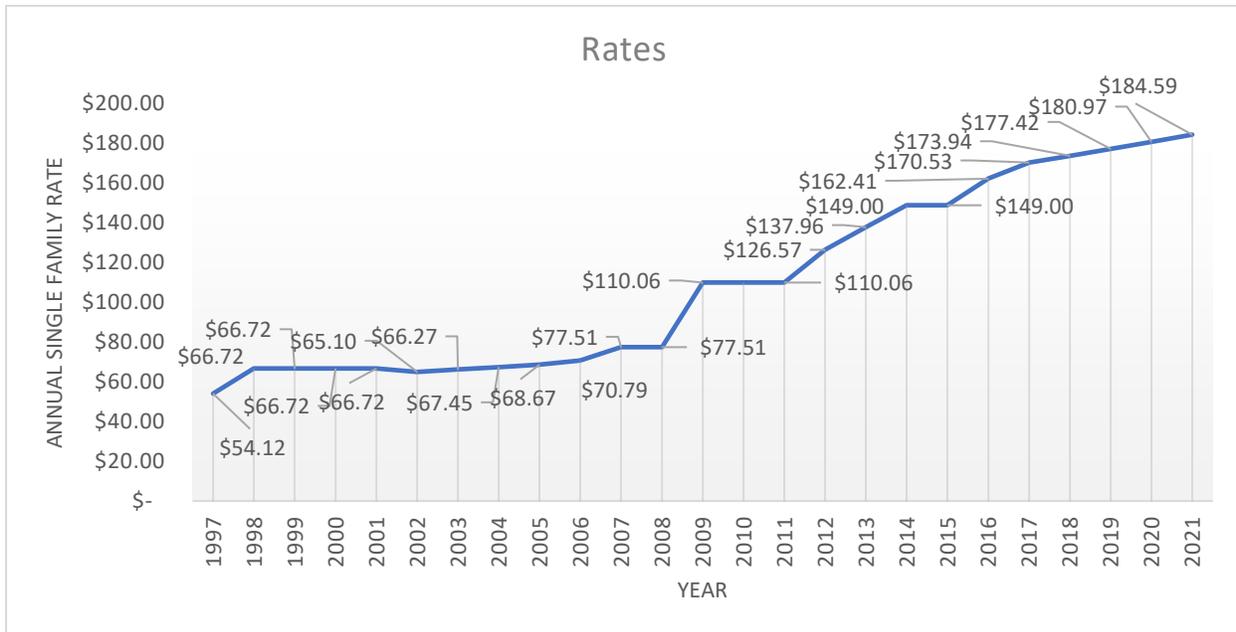
Internal review by Utility staff before and after the annexations indicate that the effects of the annexations were rate-neutral if no significant capital spending is needed in the annexed areas.



**Projected Rates 2021 – 2025:** The Utility is projecting an increase in rates for 2021. The projected rates assume that the Utility’s rate base will increase to compensate for additional internal charges. No annexations or other significant rate base additions are assumed in the rate projections. A full rate study is needed in 2021 to determine whether funding is sufficient to remain solvent into the future.

Other assumptions in the projected rate path for 2021-2025 might include:

- Salary costs increases
- Personnel benefits costs
- Service costs
- Operations costs for equipment and supplies
- Operations costs to accommodate system expansion



Class	Impervious Surface %	2020 Rate
Residential	N/A	\$180.03 per acre/year
Very Light	>0% to <10%	\$180.03 per acre/year
Light	10% to <20%	\$419.97 per acre/year
Moderate	20% to <45%	\$871.14 per acre/year
Moderate Heavy	45% to <65%	\$1,682.46 per acre/year
Heavy	65% to <85%	\$2,132.31 per acre/year
Very Heavy	85% to 100%	\$2,795.39 per acre/year
City Streets	N/A	Set in accordance with RCW <a href="#">90.03.525</a>
State Highways	N/A	Set in accordance with RCW <a href="#">90.03.525</a>
Undeveloped	0%	Exempt

## Financial Policies

The Utility's rates are controlled by fiscal policies that identify its financial needs. These policies help the Utility establish funding levels and manage uncertainty in cash flow, project costs, and potential revenue shortfalls.

**Revenue Requirements:** The Utility recommends rates to the City Council to assure that it remains self-sufficient. Its expenditures are controlled through the City's biennial budget, which currently covers 2019-2020. Revenue requirements are generally recommended by Utility staff to assure that the Utility maintains an adequate cash balance to cover its ongoing and project expenses. The Utility also assures that it has cash reserved to address fluctuations in customer bill payment, emergencies, unforeseen costs and long-term asset replacement needs. In 2019, the Utility's reserves totaled about \$1.4 million.

**Rates:** Each year, the Utility is obligated to present information to the City Council so that it may review the charges for sufficiency.

Bothell Municipal Code 18.10.110 D: Annual Review of Schedule. The city council will review the surface water management service charges annually to ensure the long-term fiscal viability of the program and to guarantee that debt covenants are met. The program shall use equitable and efficient methods to determine service charges.

The last rate review by City Council was on October 15, 2019. A three percent increase to the prior rates was recommended at that time.

**Reserves:** The following fiscal policies relating to reserves are included in the City's Capital Facilities Program and Comprehensive Financial Management Policies.

**Operating Reserve:** The Utility reserves cash to meet the short-term payment needs such as payroll. Because the Utility currently collects its primary revenues from rates through Snohomish and King County property tax billings, there is a considerable lag in receipt of these rate revenues throughout the year. To cover its cash operating needs, the Utility maintains a reserve of 120 days or 32 percent of annual budgeted operating expenditures. In 2019 this amounted to \$1,405,149.

**Capital Emergency Reserve:** The capital fund includes the balances from two accounts, the capital contingency reserve and the capital reserve. A capital emergency reserve is an amount of cash set aside for emergencies, should a piece of equipment or a portion of the Utility's infrastructure fail unexpectedly. The Capital Emergency Reserve is set at two percent of the value of the Utility's infrastructure and was \$349,722 in 2019.

**Capital Reserve:** In addition to the capital emergency reserve, the capital reserve is intended to provide an extra buffer for capital project cost overruns. For the Utility, the minimum target capital reserve fund balance is set at 10% of the two-year average capital cost (average between current year and the following year). In 2019, the capital reserve was \$321,500.

**Projects Funding:** The Utility has operated on a combination of debt financing and cash to fund projects. Most small to medium Utility projects have been paid through cash that the Utility has on hand from rates and grants.

For all other projects anticipated by the Utility in 2021-2025, this Plan uses a pay-as-you-go approach that pays for projects with cash and grants. Cash for these projects generally comes from rate revenues and anticipated facilities charges. Projects that rely on facilities charges and/or grants will not proceed if these charges or grants are not received.

**Asset Replacement:** The Utility funds the replacement of aging system facilities by establishing an annual expense for depreciation. Through 2019, the depreciation expense has been added back into the Utility as cash balance at the end of the year. This approach assumes that the projects completed by the Utility have contributed an amount at least equal to the annual depreciation towards the lifecycle value of the Utility's assets.

**Debt Coverage:** The City owns, operates and maintains a Combined Utility System (water, sewer, storm and surface water). The coverage requirement will be a function of the combined rate revenue compared with combined operating expenses and annual revenue bond debt service. Bond covenants typically establish a minimum debt coverage ratio as a means of protecting an agency against the risk of nonpayment. Bond payment and interest in 2019 was paid \$866,241 with additional trust fund payments totaling \$47,109. For any future bond issues, it is assumed that the stormwater utility would be required to meet the 1:25 revenue bond coverage ratio.

### Projected Financial Performance for 2021-2025

By the end of 2020 the Utility should have enough cash to cover its reserves after funding projects, their annual portion of the City Hall lease at \$253,894, and setting aside an accumulated asset replacement fund of \$1,271,548.

For 2021 through 2022, the Utility is expected to continue to generate sufficient revenues to cover its ongoing expenses, debt payments, and reserves. However, if rates are not increased in the next two years, by the end of 2024, the Utility will have a negative unrestricted fund balance. This leaves little to no unrestricted cash to deal with the following:

- Uncertainty in the cost associated with new NPDES regulations to be issued in 2024
- Variability in Project costs
- Unforeseen flood or other emergency events

If these or other unforeseen events occur, the Utility would need to consider reducing other expenses, delaying projects, or recommending additional rate increases. For this reason, it is recommended that the City complete the full rate analysis in 2021 to remain solvent.