City of Cuyahoga Falls

Office of the Service Director

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December 15, 2010

RE: Water Rate Increase

Dear Council Members:

I'd like to take this opportunity to provide some additional details pertinent to the Water Department budget and our proposed rate increase.

Community Comparison per 1000 cubic feet

As you know from past discussions we continue to provide water at the lowest cost levels in the surrounding area. The impending increases still keep us the lowest in the area. The City proposes to raise the water rate by 15% in 2011, 10% in 2012, and 10% in 2013. The average customer uses approximately 1,000 cubic feet per month, therefore the impact would be as follows:

2011 increase $17.95/1000 cu ft to $20.64 or $2.69 per mo/$32.28 per year
2012 increase $20.64/1000 cu ft to $22.70 or $2.06 per mo/$24.72 per year
2013 increase $22.70/1000 cu ft to $24.97 or $2.27 per mo/$27.24 per year

Applying the three year rate increase proposal to the community comparison chart we still fare below the other communities.

City	Water	Rate Increases	2010	2011	2012	2013
Cuyahoga Falls	$17.95	15%, 10%, 10%	$17.95	$20.64	$22.70	$24.97
Akron	$23.40	8%, 8%	$23.40	$25.27	$27.29	
Hudson	$26.46		$26.46			
Silver Lake	$33.20		$33.20			
Munroe Falls	$42.80		$42.80			
Stow	$32.60		$32.60			
Kent	$24.70		$24.70			
Tallmadge	$40.81		$40.81			
Green	$38.52		$38.52			
Barberton	$39.49	1.5%	39.49	$40.08		

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Certainly we don't want to raise rates just to match the other communities. However, while we pride ourselves on having the lowest water rates with this comparison, it also begs the question, is our water rate too low? After thorough analysis and forecasting on our needs over the next three years, we find the answer to be yes, our rates are too low. Furthermore, with an increase in 2011 and 2012 (based on community rate plans), we still remain the lowest for comparison purposes at today's rates. These communities may increase their rates in the next three years.

EPA recommendation:
Report provided by J. Robert Henn, Environmental Specialist II
Division of Drinking and Ground Waters
July 26, 2010

In this July 2010 report the EPA also questions that our rates are too low based on the benchmarks the EPA has established.

According to a report provided by the EPA the following was explained;

> *"For community water systems, it is recommended that that system's water rates fall somewhere between 1.3% and 3.1% of the median household income (MHI) of the system's service area based on an average use of 7,756 gallons per month. The City's rates are currently below the statistical percentage of the MHI. It is highly recommended that the rates be re-evaluated annually and increased as necessary in order for the City to be fiscally responsible so future improvements can be completed in a timely manner."*

The Cuyahoga Falls 2009 MHI was $47,383. Using the benchmarks provided by the EPA our rate and even our proposed rates do not meet the EPA thresholds.

$17.95(12 months)/$47,383= .45% of MHI vs. the recommended minimum of 1.3%
$20.64(12 months)/$47,383= .52% of MHI
$22.70(12 months)/$47,383= .57% of MHI
$24.97(12 months)/$47,383= .63% of MHI

While we realize we are not meeting the 1.3% recommendation, we find it is important to make an effort to follow the EPA recommendation and gradually work toward the benchmarks provided. To achieve the 1.3% recommendation, an average household would increase from $17.95/mo to $51.33/month, which is not reasonable. We have chosen a three-year approach to step closer to industry benchmarks and based on the future needs of the fund.

Can't AMR Safeguard Against Rate Increases
As we discussed early on with the AMR project was the importance of getting accurate reads from our meters. The preliminary data from the AMR project is indicating a greater capture of meter flow.

In 2009 January through October, 2041.5 Million Gallons of water were distributed from the Water Treatment Plant. Revenue for those 10 months = $3,634,127. In 2010 January through October, 1904.27 Million Gallons were distributed. Revenues = $3,672,727.

Flow/production levels are down by approximately 7% in 2010 from 2009, however revenues for the same 10 months are slightly higher. Efficient, accurate water meters can be attributed to increased revenues associated with the AMR project. For comparison purposes, if 2010 had the same production level as 2009 (at 2041.5 million gallons), revenues for 2010 would have averaged near $3,938,05 for the same 10 months. All in all, in 2009 the City averaged $1,780/ million gallon and in 2010 averaged $1,929/million gallon, all while still installing meters in 2010.

In sum, although 7% less water was produced in 2010, our revenues increased. We are encouraged by these statistics, however AMR alone cannot support the total needs of the Water system.

3-year Capital Improvements

One of the most important reasons to consider raising rates is to safeguard our necessary capital program. The City is extremely proud of our aggressive maintenance program and capital investment schedule. However maintaining our aging infrastructure (some 200 miles of lines) coupled with a proactive maintenance schedule to keep the system as efficient as possible, requires increased funds to support our short and long term plans. Below please find annual investments that are critical, but costly to the water departments operations:

- Miscellaneous water line repair and replacement as needed or driven by emergency
- Maintain well-balanced maintenance plan
- Lateral waterline replacement with major road reconstructions (to avoid patchwork and potentially re-opening a new roadway)
- Valves must be exercised and replaced routinely; this is the most critical part to a "shut down" with a water main break
- Upgrading undersized lines
- Maintaining adequate inventory to meet annual and emergency driven needs
- Keep all high service pumps at the Water Treatment Plant fully operational
- Conduct routine water tank inspections
- Upgrade vehicles and equipment as necessary

As with every municipality our infrastructure continues to age. Engineering standards design lines to have a 50 year life span. However, it is not uncommon in our city and others that some lines last well over 50 years. In a recent review of our infrastructure age, our records indicate that 67% of our water lines are 50 years or older. This goes hand in hand with our city build out, when there was a housing boom in the 1950s after WWII.

Our Capital Waterline Replacements for the next three years are as follows:

	Total Project Cost	Construction	Engineering	Length (ft)
2012				
Front Street Waterline	$ 250,000	$230,000	$20,000	1,600
2013				
Maitland Avenue Waterline	$ 350,000	$325,000	$25,000	2,211
Graham Road Waterline	$1,200,000	$1,100,000	$100,000	6,000
2014				
Loomis Avenue Waterline (6")	$ 530,000	$490,000	$40,000	3,920
Loomis Avenue Waterline (10")	$ 370,000	$344,000	$26,000	2,600

Although, Issue I monies will be applied for all projects, we still think these are crucial projects with or without funding.

Department is keeping costs down

The Administration has been working closely with the Water Department in an effort to keep costs down, while maintaining a high level of service. We think it is important to tighten our belts before we asked for any rate increases.

In coordination with AFSCME, the Water Treatment Plant Operators participated in a pilot program this summer, adjusting shifts and schedules to operate with five operators (as opposed to the staffed 7) in light of a workers comp leave and abrupt resignation. With cooperation and team-work, no overtime was endured during this time. In participating in this pilot, it has been established that six operators can effectively operate the plant, therefore not backfilling one operator position. Furthermore, cross training among the maintenance mechanics and operators at the Plant has enhanced overall operations and personnel functions to the department's benefit.

More recently, City Council approved a reorganization on the managerial level, eliminating the Assistant Superintendent (GR32), Water Utilities Maintenance Supervisor (GR28), and Storm Water Administrator (GR25), in turn creating a Supervisor of Water Distribution and a Supervisor of Sewer Collections (GRs28). This was an actual savings of approximately $107,000 for wages only.

In addition, we have not backfilled positions in the Water department. In fact, we are down seven (7) positions from our authorized staffing level of 35 personnel. Admittedly, we are at crucial staffing levels and we can not go down any further. We currently have five (5) employees eligible for retirement. These positions, upon evaluation, will probably need to be backfilled to continue our service level.

Fund Balance

The Water Fund is classified as an Enterprise Fund and should therefore be run as a business. Some of the Water Fund's revenue is weather dependent (i.e. additional revenues generated from watering of lawns and gardens in a dry season). Therefore, we need to plan for unforeseen contingencies. Contingencies to hedge against wet or dry years, to be able to handle wild price

fluctuations for chemicals at the treatment plant, and extraordinary water main breaks in a given year.

Speaking of chemicals, caustic soda is a perfect example. The City's treatment plant uses 161 tons on an annual basis. In 2008 we paid approximately $370 per dry ton. In 2009, due to high demand in China, the prices were $1,150 per dry ton. This price change in a one year time period caused the City to spend an additional $125,000 for just one of the chemicals at the treatment plant.

All this begs the question: how much is enough reserve, and how much is too much? A good rule of thumb is to use the benchmarks available from the various credit rating agencies. In a recent publication, Fitch Ratings provided a median Days Cash on Hand for AA-rated water agencies of 266 days. The formula is calculated as follows: $ Ending Fund Balance / ($ Annual O&M Expenses / 365). Fitch's AA rating is equivalent to our Aa2 rating with Moody's. At the end of 2009 our Days Cash on Hand was 87.70 or approximately 33 percent of what industry standards say it should be. The proposed rate increase legislation moves the City in the right direction of investing in our aging infrastructure, maintaining adequate reserves for unforeseen contingencies, without mortgaging the future by issuing an extraordinary amount of long-term debt.

Another benchmark that is used in the industry by the American Water Works Association is the Return on Assets. This ratio can be calculated after the completion of the City's CAFR. For the City of Cuyahoga Falls the calculation is Net Income divided by Net Assets resulting in a negative (.80%). The benchmark is 2.6%. For the City to meet this threshold for 2009, our net income would have needed to be approximately $767,000 higher than it was. Obviously a rate increase would bring us closer to that number, thus protecting our reserves.

Finally, the Ohio EPA produced a 2009 Water Rate Survey which listed 493 water districts throughout the State of Ohio with their 2009 water rates annualized. Of the 493 district rates listed, 465 have higher rates than the City of Cuyahoga Falls. This certainly is a good thing as a rate payer, however it also shows that we are at the extreme low end of rates within the State of Ohio. The average annualized rates in Ohio for 2009 was $484.00. In Cuyahoga Falls, our rate annualized was $223.00, or 46% of the average rate. This legislation provides for rate increases in the next three years. It will take our $223.00 annualized rate to $310.30 annualized. It would put us at 64% of the $484.00 annualized rate.

We have also attacked this problem from the expense side of the ledger. To increase fund balance (i.e. reserves) one can attack the problem from the expense side or from the revenue side (in the form of rate increases). The administration has attacked the expense side of the ledger, however we are at the point where expenses have very little left to attack. We are getting to the point where a fully functioning water system cannot be properly maintained with anymore significant expense cuts. To illustrate this point, "personal service" costs (i.e. payroll) has been controlled. In 2006 the Water Fund's Personal Services was $1,651,573. If one were to assume a two percent raise each year, the 2010 costs would have been $1,787,715. The revised 2010 Personal Services is $1,428,911 and the requested 2011 budget for this line item is $1,479,627.

This is a ten percent decrease from 2006 actual. Expenses have been controlled as much as they can, unfortunately now is the time to increase rates in order to maintain reasonable reserves.

Upon your review please call me with any questions or concerns, or if you need any additional information prior to Monday's discussion.

Sincerely,

Valerie Wax Carr
Director of Public Service

Cc: Mayor
Senior Cabinet
Water Superintendent