

October 14, 2021

To: Calvin M. Hawkins, Chair
Prince George's County Council

From: Lavinia A. Baxter, Senior Legislative and Budget Policy Analyst 
Office of Audits and Investigations
J. Kenneth Battle, Jr., Committee Director, TIEE *JKB*

THRU: Robert Williams, Council Administrator
Prince George's County Council

Subject: Work session Overview: FY 2023 WSSC Water Spending Control Limits

Purpose: To provide relevant data necessary for County Councilmembers to discuss and support recommendations on the FY 2023 spending control limits for WSSC Water.

Each year, the spending affordability process focuses debate, analysis, and evaluation on balancing affordability considerations against the provision of resources necessary to serve existing customers (including infrastructure replacement/rehabilitation), meet environmental mandates, and maintain operating and capital budgets and debt service at prudent and sustainable.

Table 1: WSSC Water Base Case Spending Control Limits – FY 2023

Spending Control Limits	Base FY 2023 Proposed	FY 2022 Approved	Change From FY 2022 Approved	FY 2023 Staff Recommendation
Rate Increase	9.0%	5.9%	3.1%	7.0%
New Debt	\$430,093,000	\$409,922,000	\$17,958,00	\$430,093,000
Debt Service	\$328,423,000	\$309,045,000	\$4,522,000	\$328,423,000
Total W/S Operating Expense	\$879,912,000	\$842,299,000	\$17,948,00	\$863,282,000

Table 2: Customer Bill Impact Initial Base Case

Residential Customer Impact	Quarterly Bill Increase at Base Case	% Increase at Base Case	Quarterly Bill Increase at Council Rec.	% Bill Increase at Staff Recommendation
Proposed Rate Increase		9.0%		7.0%
Impact at 100 Gallons per day	\$13.72	9.0%	\$10.67	7.0%
Impact at 165 Gallons per day	\$21.66	9.0%	\$16.88	7.0%
Impact at 500 Gallons per day	\$79.99	9.0%	\$62.22	7.0%

Notable Assumptions 9% Base Case:

- Meet financial metrics to maintain AAA Bond rating. These measures are critical to demonstrate a strong financial position to assure financial sustainability during periods of economic stress. This long-term plan has been revised to address rating agency concerns.
- Full funding of WSSC Water’s FY 2023 – FY 2028 Capital Improvement Program;
- Marker for compensation adjustment funding equal to 4.3% in FY 2023 and 4.5% in the out years as WSSC Water is in labor negotiations. Note that due to the impact of pandemic on revenues and NO FEDERAL AID, WSSC Water employees received no COLAs or Merit increases in FY 21 or FY 22. (As in the past, salary enhancements may be reduced or eliminated from the Proposed FY 2023 budget to reflect County plans);
- \$10 million of FY 23 operating expense reductions to fund critical new costs for the Piscataway BioEnergy Facility, lead and copper regulations and tank painting as well as to improve financial metrics.
- All Other Category increase of 2.1%; 2.0% in outer years
- Sewer Use Charges in FY 2022 are reduced by \$11 million to rebaseline projections;
- Reconstruction Debt Service Offset (REDO) is assumed at \$4 million in FY 2023, a reduction from FY 2022 at \$6.0 million, with further reductions assumed through FY 2024 where the surplus funds are expected to be fully exhausted;
- No use of fund balance in FY 2023 or in the outer years to build up reserves in response to rating agency concerns.
- In FY 2023 and the outer years, no funds were identified in the Unspecified Reductions or Additional and Reinstated Programs. If rate is lowered, reductions will be necessary.

Also included in this year’s proposed budget is an increase of 9% to the Ready to Serve Charge (RTS) which includes the Account Maintenance Fee and the Infrastructure Investment Fee. These fixed fees have remained unchanged since 2017.

WSSC Water team shared Recent Bond Rating Review Comments:

- Three rating agencies maintained the AAA ratings.
- **Fitch changed the Rating Outlook from Stable to Negative** noting a sharp weakening in fiscal 2020 financial performance that is expected to be followed by a relatively slow and uncertain near-term recovery
- Fitch Ratings noted that, fiscal year **2020 leverage**, defined as net adjusted debt to adjusted funds available for debt service **escalated to 11.1 times up from 8.4 times**, driven primarily by pandemic related pressures and additional debt to address capital needs
- **Rating Agency comments on Factors that could lead to a downgrade:**
 - **“should revenue pressures persist longer-term. Leverage sustained at or above 10 times will likely result in negative rating action” (Fitch)**
 - **“Failure to raise rates to support operations and debt needs, leading to declines in reserves and liquidity” (Moody’s)**
 - **“If management is unable to effectuate necessary rate increases or contain costs which results in a reduction in reserves or failure to meet sum sufficient coverage, we will lower the rating one of more notches (S&P)**

Bi-County Meeting Participants Representing WSSC Water and Prince George’s County Included:

WSSC Water:

Joseph Beach, Deputy General Manager

Patricia Colihan, CFO

Letitia Carolina-Powell, Budget Division Manager

Brian Halloran, Capital Budget Section Manager

Julie Pohutsky, Operating Budget Section Manager

Prince George’s County:

Kenneth Battle, TIEE Committee Director

Lavinia Baxter, Senior Legislative Budget and Policy Analyst

Jared McCarthy, DCAO

Linda Turner, Senior Advisor to the DCAO

Wadson Pericles, OMB Budget Analyst III

Background

WSSC Water’s spending control limits process was established in April 1994 via a resolution by both Prince George’s and Montgomery County Councils, with the goal of both Councils agreeing on certain budgetary limits by November 1 of each year. Noted below are key objectives regarding the spending affordability guidelines (SAG) process.

1. Process is based on a multi-year planning model. A strategy to stabilize annual rate increases over time and holding customer fee supported debt service below 40% of the operating budget,
2. Process consists of four (4) spending limits:
 - Maximum Average Rate Increase (The maximum average rate increase limit covers volumetric water/sewage charges only. WSSC Water’s fixed fees includes the Infrastructure Renewal Fee and the Account Maintenance Fee).
 - Debt Service
 - New Debt
 - Total Water and Sewer Operating Expenses

3. The process provides direction to WSSC Water as to what to request but does not create a ceiling (or floor) as to what the Councils may jointly approve at a later date. State law defines the annual WSSC Water Proposed Budget as the “default” budget, should the Montgomery and Prince George’s County Councils cannot agree on changes. Therefore, the limits are an important first step to define proposed budget parameters that are acceptable to both Councils.

4. The Bi-County process allows for debates to focus on the impacts of the average rate increase for the coming year as well as implications for the out years. The other limits are then adjusted to take into account the impact of the rate decision.

Schedule

- Bi County Working Group Sessions (virtual): September 8th and September 21st, 2021
- Committee of the Whole Review: October 14th, 2021
- Council Action: TBD

The goal of the spending control limits process is for the Montgomery and Prince George’s County Councils to come to an agreement by **November 1** of each year so that the WSSC Water can build the approved limits into its Operating Budget Draft, which is released by January 15 each year. WSSC Water must transmit an Operating Budget to both counties by **March 1** of each year.

Spending Control Limits History

The following chart presents the rate increase limits recommended and agreed upon by both Councils (unless otherwise noted) since FY 1996 and the actual budget rate approved for each fiscal year.

As shown in Table 3 below, WSSC Water rate increases have varied from 0% to as high as 9% over the past two decades. Specifically, over the past ten years the average rate increase is 5.2%. The cumulative increase over this period is 51.75%. It was noted by the working committee that the cumulative residential customer bill increases since 2000 are lower than other utilities in the region. WSSC Water also stressed that consumption has been flat and recently is declining causing pressure on rates which differs from the county property tax revenues that increase with increases to the assessable base as well as the tax rate increases.

Table 3: Historical Rate Increases

Fiscal Year	Rate Increase		Fiscal Year	Rate Increase	
	Approved Limit***	Actual Increase		Approved Limit ***	Actual Increase
1996	3.0%	3.0%	2009	9.7%	8.0%
1997	3.0%	3.0%	2010	9.5%	9.0%
1998	3.0%	2.9%	2011	8.0%	8.5%
1999	2.0%	0.0%	2012	8.0%	8.5%
2000	1.5%	0.0%	2013	8.5%	7.5%
2001	0.0%	0.0%	2014	7.5%	7.25%
2002	2.0%	0.0%	2015	6.0%	5.5%
2003	0.0%	0.0%	2016*	2.1%	1.0%

2004	0.0%	0.0%		2017*	3.5%	3.0%
2005	3.0%	3.0%		2018	3.5%	3.5%
2006	2.5%	2.5%		2019	4.0%	4.5%
2007	3.0%	3.0%		2020	5.0%	5.0%
2008	5.3%	6.5%		2021	7.0%	6.0%
				2022	6.6%	5.9%

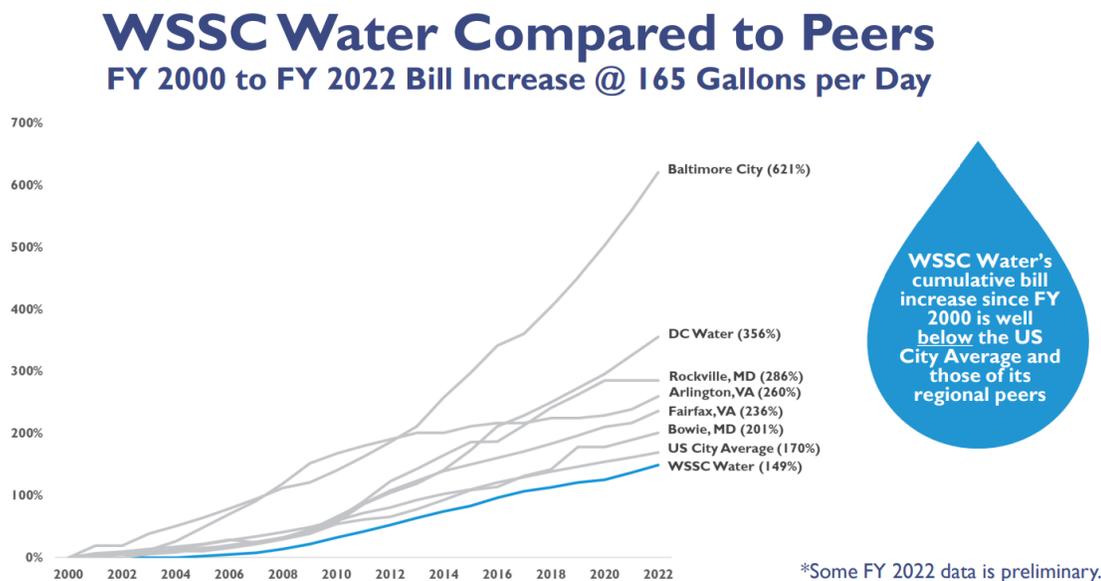
*The actual bill impact in FY 2016 and 2017 was 6.0% and 6.5% respectively, due to recalibration of the Account Maintenance Fee and the implementation of the Infrastructure Investment Fee.

**Note: No agreement was reached in fiscal years 2002, 2006, 2009, 2010, 2011, 2012, and 2014.

*** Note: The Approved Limits shown reflects Prince George’s County recommendations only.

- FY 2018: A 3.5% rate limit was approved by both Councils for FY 2018 and the FY 2018 budget was approved with this rate increase assumption.
- FY 2019: The two Councils did not agree on a rate increase limit. The Prince George’s Council approved a 4.0% rate increase while the Montgomery Council supported a 5.0% rate increase. The WSSC Water budget was transmitted with a 4.5% rate increase, which was ultimately supported by both Councils.
- FY 2020: The two Councils agreed on a rate increase limit of 5.0% and the FY 2020 budget was approved with this rate increase assumption.
- *FY 2021: The two Councils agreed on a rate increase limit of 7.0%. This limit was reduced to 6.0% due to the impact of the COVID-19 crisis on the community. The FY 2021 budget was approved with this rate increase assumption*

Figure 1: How Does WSSC Compare with it its Peers?



The above graph on page 20 of the FY 2023 Spending Affordability Meeting 1 (dated Sept. 8, 2021) shows the rate of cumulative bill increases among regional peer utilities over the past 20 years for various water utilities in the region, as well as the US City average. WSSC Water's residential customer bill increases since 2000 have increased 149%; the lowest of the regional utilities, as well as, lower than the US City average. The WSSC Water 149% bill increase since 2000 equates to about a 4.2% annual increase over that 22-year period.

COVID 19 Impact on Water Revenues and Usage

Per capita water usage in the WSSC Water service regions is down by nearly 7% since 2011 and overall water production is expected to remain flat over the financial forecast period. While water conservation is good from an environmental standpoint, it means that WSSC Water's dominant revenue source (over 80% of its revenues) has been stagnant, putting more emphasis on rates to address increases in debt service in recent years for ongoing infrastructure needs. Therefore, WSSC Water continues to face significant fiscal challenges with rate increase needs being potentially higher than inflation.

WSSC Water projects a continued revenue shortfall primarily due to the effects of COVID-19 in FY 2022. The utility has implemented a proactive savings plan to offset revenue losses, as follows:

- FY 2020: \$61.1 million (actual net expenses \$57 million below budget)
FY 2021: \$72.7 million; and (actual net expenses \$105 million below budget)
- FY 2022: \$19.8 million planned reductions

Revenue:

- Pre-pandemic delinquent accounts of \$37 million grew to approximately \$64 million as of June 30, 2021
- Reserve for delinquent accounts was increased by \$29 million in FY 2021 and totaled \$41 million as of June 30, 2021
- Two savings plans effectively offset revenue shortfalls requiring no draw or renewal of the Line of Credit established in May 2020

Figure 2: FY 21 Past Due Account

Past Due Accounts/Amounts (as of 8/23/21) High-Level

Past Due Accounts*

of accounts 30 days past the bill date



FY22 Target: 77,000 past due accounts

Past Due Amount*

\$ of accounts (millions) 30 days past the bill date



FY22 Target: \$37.7 Million past due

Customer Affordability Program (CAP)

Over the course of the pandemic, WSSC Water has enhanced its customer affordability program to help those who are facing tough financial times. Measures include, expanding payment plans to more customers, waiving late fees, and suspending service turnoffs, which began on March 12, 2020. While the Commission took this position early on during the pandemic even before the Governor’s directive. WSSC Water resumed shutoffs much later than other utilities.

On August 1st, the Commission resumed shutoffs to Commercial/government accounts and on September 13 to residential customers. Also, in September Commissioners voted to further enhance the affordability program by reducing turn-on fees for CAP customers to \$67 (down from the \$135 combined turn-on fee); introducing a payment plan incentive that waives the late fees for customer who complete payment plans; and permanently waiving late fees for CAP customers.

CAP Budget Impacts on WSSC accounts

FY 2022 CAP Projection = 18,352 participants (18% increase over FY 2021)

- Anticipated cost impact = \$1,871,904
- Already funded at \$2,100,000

FY 2023 CAP Projection = 22,022 participants

- CAP participants = 22,022 (20% over FY 2022)
- Anticipated cost impact = \$2,200,000
- Current approved funding = \$2,200,000

Long Range Planning Ready to Serve Charge (RTS) at 9%

As part of their long-range financial plan, the Commission is proposing that the 9% rate increase apply to the volumetric and ready to serve charge.

Table 4: Customer Impact – Ready to Serve Charge – 9% for Customers at 55 gpd

Quarterly Bill	FY 2022 Approved	FY 2023 (9.0 Volumetric & RTS)
Volumetric Charges	\$213.04	\$232.18
Ready-to-Serve Charges	28.00	30.52
Total Quarterly Bill	241.04	262.70
FY 23 Quarterly Bill Increase		21.66

CAP participants will not be impacted by the 9.0% increase to RTS.

Table 5: CAP Customer Impacts – If the percentage increase does not apply to the fixed fees, a 9.9% increase to the volumetric is needed

Quarterly Bill	FY 2022 Approved	FY 2023 (9.0% Volumetric & RTS)	FY 2023 (9.9% Volumetric)
Volumetric Charges	\$213.04	\$232.18	\$234.14
Ready-to-Serve Charges	0	0	0
Total Quarterly Bill	213.04	19.14	234.14
FY Quarterly Bill Increase		19.14	21.10

Cost Savings Implemented - Capital Improvement Program (CIP)

Through FY 2022, projects were reduced or deferred by nearly \$272 million, for FY 2023, CIP and Information Only combined spending was within guidelines as submitted.

In the Proposed FY 2023 – FY 2028 CIP, the Water Main Reconstruction Program goal has increased to 37 miles but remains below the 55 miles per year asset management program target. Additionally, the Potomac Submerged Channel Intake project remains deferred to the beyond 6 years period. Additional cost saving opportunities may be challenging given the prior years' reductions and considering that the majority of the deferrable capital projects are located in Prince George's County. In any case, reductions in capital projects have a relatively small impact on the operating budget. For instance, to reduce the proposed rate increase by 1.0%, \$283.1 million in reductions or deferrals to the capital budget would be required. The expenditures in FY 2023 from the Proposed CIP are \$736.0 million. This is comprised of the following:

CIP Projects	\$484.0 million
Information Only	\$252.0 million

CIP/Capital Savings:

- Water Main Reconstruction program at 31 miles remains below asset management target of 55 miles
- Increase PAYGO from \$31 million in FY 2021 to \$80 million in FY 2027 to better manage debt service ratios
- Implement level principal payments beginning in FY 2025
- Strategic Sourcing Teams and operating departments have identified \$54 million in capital cost savings/avoidance since 2013

Cost Savings - Operational Savings in Progress

- Group insurance plan revision savings of \$5.7 million since FY 2017
- Supply Management Transformation has identified \$26.1 million in operating cost savings/avoidance since 2013
- Reduced overtime expenses of \$7.9 million since FY 2017
- \$26.1 million in energy conservation savings since FY 2004
- \$19.8 million FY 22 savings plans to offset COVID-19 impacts
- 45 frozen positions
- Prestressed Concrete Cylinder Pipe Condition Assessment
 - \$24.0 million invested to date in acoustic fiber optic monitoring (AFO)
 - \$90.0 million in savings from 45 averted failures
- Capital Savings
 - Water main reconstruction program goal of replacing 37 miles in FY 2023 remains below target level of 55 miles
- Maintain AAA Bond Rating based on a 9% rate increase
 - Increase PAYGO to \$31 million in FY 2023 from \$27.6 million in FY 2022

Multi-Year Context/Financial Forecast

While the spending control limits review is an annual process, the Bi-County Working Group takes a multi-year look at trends. The outer year estimates help the staff to identify issues that could arise in future years. For instance, rate increases in the first-year help to improve WSSC Water's fiscal position in future years by increasing WSSC Water's base revenues. Conversely, deferring rate increases to future years, or using one-time revenue to reduce the amount of the rate increase in the first year, results in increased challenges since the revenue base is lower in future years.

The FY 2023, **original base case forecast**, developed by WSSC Water staff, assumed a 8.0% rate increase with additional increases as follows: 8.0% in FY 2024; 7% in FY 2025; 6.5% in FY 2026; 6.0% in FY 2027; and 6.0% increase in FY 2028.

In response to Rating Agency comments, WSSC Water developed a FY 2023 **revised base case** subsequent to the Bi-County Working Groups second meeting on September 21, 2021. The revised base case assumes 9.0% rate increase in FY 2023; 8.5% in FY 2024; 6.0% in FY 2025; 4.0% in FY 2026, FY 2027 and FY 2028.

At the second meeting, staff requested a 7.0% scenario. This third scenario assumes 7.0% in FY 2023; 8.5% in FY 2024; 6.0% in FY 2025; 4.0% in FY 2026, FY 2027 and FY 2028.

In order to maintain adequate liquidity, fund balance reserves and AAA bond rating, the 7.0% scenario requires \$16 million in operating reductions in FY23 which would impact service levels:

- Accommodate its existing debt and debt service projections for its FY 2023 – FY 2028 Proposed CIP
- Maintain debt service coverage at Target: 1.1 to 1.25
- Maintain debt service as a percentage of Expenditures at Target: <40%
- Attain Days Operating Reserves on Hand at Target: 120-150
- Ending Fund Balance as a %age of Operating Revenue at Target: 15%

FY 2023 Spending Control Limits Staff Requested Scenario 7.0% Rate Increase

For the upcoming budget, WSSC Water staff prepared a staff requested spending control limit scenario for review and comment by County staff, as summarized in Table 5 below:

Table 6: WSSC Water Staff Requested Scenario Spending Control Limits at 7.0% – FY 2023

Spending Control Limits	FY 2022 Approved Budget	Staff Requested Scenario FY 2023 Proposed	Change From FY 2022 Approved
Rate Increase	5.9%	7.0%	1.1%
New Debt	\$409,704,000	\$430,093,000	\$20,389,000
Debt Service	\$309,045,000	\$328,423,000	\$19,378,000
Total W/S Operating Expense	\$842,299,000	\$862,912,000	\$20,613,000

The staff requested scenario at 7.0% assumes the following:

- Debt Service and PAYGO as required to fully fund the Capital Improvement Program
- The debt service at both 7.0% and 9.0% is \$328.4 million
- Compensation marker equal to an increase of 4.3% in FY 2023 and 4.5% in each of the out years; same as last year’s forecast
- Inflationary increase of current programs of 2.1% in FY 2023 and 2.0% in each of the out years; same as last year’s forecast
- An increase of \$1.2 million in Regional Sewage Disposal costs in FY 2023
- Reconstruction Debt Service Offset (REDO) is assumed at \$4.0 million in FY 2023 a decrease of \$2.0 million from FY 2022 Approved Budget, with additional declines planned for FY 2024 and with zero assumed beyond FY 2025
- \$16 million reduction in FY23 growing to \$20.7 million in FY28

The elements of the staff requested scenario base case funding gap are shown in Table 6 below.

Table 7: Contribution to the FY 2023 Staff Requested Scenario Rate Increase

Factors Contributing to the FY 2023	Change from FY 2022 (\$, millions)	% Impact on Rate
Staff Requested Rate Increase		
Change in Revenues		
Water & Sewer Charges (rebaseline sewer)	(10,131)	1.3
Miscellaneous Fees	647	-0.1
Interest Income	0	0.0
Uncollectable	(6,000)	0.8
Other Transfers & Credits	(2,000)	0.3
Change in Expenses		
Debt Service	19,378	2.5
Regional Sewage Disposal	1,183	0.2
Heat, Light and Power	740	0.1
Maintenance and Operating	6,107	0.8
Unspecified Reductions	(15,630)	0.7
Salaries and Wages Increases	5,774	-2.1
PAYGO	3,431	0.4
Ready-to-Serve Growth	141	0.0
Additional Cash Balance Reserve	16,189	2.1
Total Base Case Rate Increase Assumption		7.0%

Changes in Revenue

Overall changes in the revenue is assumed to be down by \$17.5 million (equivalent to 2.3% rate increase). This a result mostly of resetting of expected revenue in FY 2023 and beyond (-\$10.8 million) and an increase in uncollectable bills (\$6.0 million).

Other adjustments such as REDO are also down (-\$2.0 million).

Debt Service and PAYGO

Debt service cost is up \$19.4 million (equivalent to a 2.5% rate increase).

The staff requested scenario assumes an increase in PAYGO of \$3.4 million. (equivalent to a 0.4% rate increase).

Regional Sewage Disposal

Regional Sewage Disposal expenses (based on actual WSSC Water sewage flows to the Blue Plains Wastewater Treatment Plant) are up \$1.2 million (0.2% rate increase).

Heat, Light and Power

Heat, Light and Power costs are expected to increase by \$740,000 (0.1% rate increase).

Other Expenditures

\$16 million unspecified reductions to operating to be identified

The Maintenance and Operating category is inflated by 2% in the base case (equivalent to 0.8 % rate impact).

Compensation Adjustment marker equal to a FY 23 increase of 4.3% (\$5.8 million) to cover adjustments is to be determined through labor negotiations. (equivalent to a 0.7% rate increase). Historically, the Councils have supported WSSC Water compensation levels comparable to County Government compensation adjustments.

Fund Balance and “Days Operating Reserve on Hand”

WSSC Water has fund balance in excess of its target (beyond its 15% policy reserve level). Its fund balance projection at the end of FY 2022 is \$163.2 million, while its 15% working reserve is about \$123.4 million, leaving \$39.8 million in excess reserves.

WSSC Water staff continues to support a 120 to 150 Days Operating Reserves-on-Hand as an appropriate target to allow WSSC Water to handle a major event causing a temporary loss in revenue generation. The staff requested scenario puts WSSC Water Days of Operating Reserves-on-Hand at 122 which meets the target with the operating expense reduction.

Residential Bill Impact under the Revised Base Case Scenario

The monthly impact of the staff requested scenario rate increase on the average residential account using 165-gallons per day is \$5.63 per month (a 7.0% increase from the current average bill). The quarterly bill for a customer using 165 gallons per day would go from \$241.04 to \$257.92, a \$16.88 increase.

Table 8: Customer Bill Impact Staff Requested Scenario Case

Residential Customer Impact	Quarterly Bill Base Case	% Base Case	Quarterly Bill Staff Request	% Bill Council Rec.
Proposed Rate Increase	9.0%		7.0%	
Impact at 100 Gallons per day	\$166.20	9.0%	\$163.15	7.0%
Impact at 165 Gallons per day	\$262.70	9.0%	\$257.92	7.0%
Impact at 500 Gallons per day	\$968.78	9.0%	\$951.01	7.0%

Staff Recommendation

The impacts from COVID-19 have had unprecedented impact on WSSC Water and they have not received any federal financial assistance. The spending control limits process requires balancing WSSC Water revenue estimates and expenditures with what are reasonable rate increases to assume in the coming year. It should be kept in mind that the spending control limits approved by both Councils create a ceiling for the WSSC Proposed Budget, not a final budget.

Council Staff recommends the following:

- 7.0% rate increase in FY 2023
- The same level of new debt and debt service as provided in the Revised Base Case.
- Assume \$863,282,000 in Total Water and Sewer Operating Expenses.
- Fixed fees increase at the same rate as volumetric fees

Spending Control Limits	Council Staff Recommendation FY 2023
Rate Increase	7.0%
New Debt	\$430,093,000
Debt Service	\$328,423,000
Total Water and Sewer Operating Expenses	\$863,282,000