



City of Las Cruces®

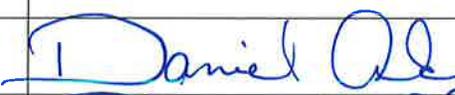
PEOPLE HELPING PEOPLE

COUNCIL WORK SESSION SUMMARY ROUTING SLIP

Meeting Date March 28, 2016

TITLE: REVISED UTILITY RATE SETTING PROCESS.

- Are there attachments to the Council Work Session Summary? Yes No
- Will there be a Video Presentation for this item? Yes No
- Will there be a PowerPoint Presentation for this item? Yes No
- If "yes", will a copy of the PowerPoint Presentation be included on the Council Work Session Agenda? Yes No

DEPARTMENT / ORGANIZATION	SIGNATURE	PHONE NO.	DATE
Drafter/Staff Contact		x3636	3/18/16
Department Director		x3524	3/18/16
Other			
Assistant City Manager/CAO (if applicable)			
Assistant City Manager/COO (if applicable)			3/21/16
<i>for</i> City Manager			3/21/16



Council Work Session Summary

Meeting Date: March 28, 2016

TITLE: REVISED UTILITY RATE SETTING PROCESS.

PURPOSE(S) OF DISCUSSION:

- Inform/Update
- Direction/Guidance
- Legislative Development/Policy

BACKGROUND / KEY ISSUES / CONTRIBUTING FACTORS:

Las Cruces Utilities ("LCU") staff researched and developed a streamlined and standardized utility rate setting process based on comments received from former members of the Ratepayers Advisory Committee ("RAC"). On February 11, 2016, LCU staff presented Utilities Resolution 15-16-LCU016, a revised utility rate setting process, to the Las Cruces Utilities Board of Commissioners ("Board") who approved it 6-0.

The approved rate setting process outlines the following defined steps: (1) establishing the need for a rate review; (2) selecting a consultant through a Request for Proposal process; (3) performing a rate review study; (4) securing public input and feedback from a City created Utility Customer Advisory Group ("UCAG"); (5) presenting feedback results to the LCU Board; (6) LCU Board providing direction to the consultant; (7) consultant submitting final report containing rate adjustment recommendations to the LCU Board; and (8) submitting LCU Board's rate adjustment recommendations to the City Council. Process step number (3) listed above provides for LCU staff compiling financial criteria to enable the consultant to prepare a draft report for public review.

The financial criteria information includes: (a) wages and benefits; (b) operating expenses; (c) operating fund reserve; (d) administrative transfers; (e) equipment reserve fund transfers and fund balances; (f) capital fund transfers and funds balances; (g) debt services; and (h) rate design.

The LCU Board By-Laws currently authorize the LCU Board "To set City utility rates for the Las Cruces Utilities based on an industry accepted methodology recommended by Las Cruces Utilities staff." The above referenced rate setting process will incorporate industry accepted methodologies but the By-Laws will have to be amended by the City Council, to provide for the City Council

(Continue on additional sheets as required)

approving any new utility rate adjustment recommendations, which was the direction provided by the City Council at the November 24, 2014, Work Session.

This revised utility rate review will replace the current adversarial quasi-judicial method modeled after the New Mexico Public Regulation Commission process, in which LCU and the RAC each had their own attorneys and consultants. LCU staff and Board recommend the simplified administrative rate review process to be adopted by City Council.

SUPPORT INFORMATION:

1. Attachment "A", LCU Board Approved Resolution No. 15-16-LCU016 with associated Exhibits.

LAS CRUCES UTILITIES BOARD RESOLUTION NO. 15-16-LCU016

A RESOLUTION RECOMMENDING TO CITY COUNCIL TO ADOPT A NEW UTILITY RATE SETTING PROCESS.

The Board of Commissioners for the City of Las Cruces Utilities, on behalf of the City of Las Cruces, is informed that:

WHEREAS, Las Cruces Utilities staff has been researching and developing a streamlined and standardized utility rate setting process; and

WHEREAS, the revised rate setting process outlines the following defined steps:

- (1.) establishing the need for a rate review;
- (2.) selecting a consultant through a Request for Proposal process;
- (3.) performing a rate review study;
- (4.) securing public input and feedback from a City created Utility Customer

Advisory group ("UCAG");

- (5.) presenting feedback results to the Las Cruces Utilities Board ("LCU Board");
- (6.) LCU Board providing direction to the consultant;
- (7.) consultant submitting final report containing rate adjustment

recommendations to the LCU Board; and

(8.) submitting LCU Board's rate adjustment recommendations to the City Council; and

WHEREAS, process Step No. 3 provides for LCU staff compiling financial criteria to enable the consultant to prepare a draft report for public review; and

WHEREAS, the financial criteria includes information on (a) wages and benefits; (b) operating expenses; (c) operating fund reserve; (d) administrative transfers; (e)

equipment reserve fund transfers and fund balances; (f) capital fund transfers and funds balances; (g) debt service; and (h) rate design; and

WHEREAS, the LCU Board By-Laws currently authorize the LCU Board "to set City utility rates based on an industry accepted methodology by Las Cruces Utilities staff"; and

WHEREAS, the new utility rate setting process will incorporate industry accepted methodologies but the By-Laws will have to be amended by the City Council, to provide for the City Council approving any new utility rate adjustment recommendations, which was the direction provided by the City Council at the November 24, 2014, work session; and

WHEREAS, Las Cruces Utilities staff recommends the simplified administrative rate review process to be adopted by City Council.

NOW, THEREFORE, be it resolved by the Board of Commissioners for the City of Las Cruces Utilities, on behalf of the City of Las Cruces:

(I)

THAT the new utility rate setting process be recommended to City Council for adoption.

(II)

THAT Utilities staff is hereby authorized to do all deeds necessary in the accomplishment of the herein above.

DONE AND APPROVED this 11th day of February 2016.

APPROVED:

By Bill M. Sorg
Board Chair

ATTEST:

[Signature]
Secretary

Moved by Johnson

Seconded by Pedroza

APPROVED AS TO FORM:

[Signature]
Sr. Assistant City Attorney

VOTE:

Chair Sorg: Aye
Vice-Chair Little: Aye
Commissioner Baumgarn: Aye
Commissioner Carmichael: Aye
Commissioner Ericson: Absent
Commissioner Johnson: Aye
Commissioner Pedroza: Aye



Las Cruces Utilities

Rate Setting Process

January 2016

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Glossary

- **2/12th:** A target minimum balance for a fund's expenditure level for a 2 month period.
- **Adjustment:** Known and measurable changes of the audited Fiscal Year data for the purposes of setting rates in a rate review.
- **Capital Improvement Projects:** Engineering and construction services for major new and/or rehabilitation projects on the utility's system and infrastructure.
- **Comprehensive Annual Financial Report (CAFR):** Governmental financial statements comprising the financial report of the City of Las Cruces that adhere to the Governmental Accounting Standards Board.
- **Equipment Replacement Reserve:** Fund to purchase replacement vehicles, trailers, and major equipment used to maintain and operate each respective utility operation.
- **Fiscal Year:** A 12-month period that begins on July 1 and ends on June 30.
- **Funds:** A group of related accounts that are used to record, administer and control categorization of revenue, expenditures, and resources for specific activities within each utility operation.
- **Rate Revenue:** All revenues collected through approved tariff charges or utility connection charges.
- **Rate Riders:** Las Cruces Utilities (LCU) Board approved mechanisms to recover or refund interim unexpected/unplanned costs or changes in costs.
- **Request for Proposal (RFP):** A proposal made by the City of Las Cruces inviting bids from possible suppliers of products or services, which follow the City's Procurement Code.
- **Test Year:** Audited data for a Fiscal Year as presented in the City's end of Fiscal Year Comprehensive Annual Financial Report.
- **Transfers:** Amounts designated to fund capital improvement projects, equipment replacement reserve, or intergovernmental transfers to the General Fund to fund Department's utilization of City-wide common administrative resources.

Rate Setting Process

1. Establish the requirement for a rate review:
 - a. Request submitted by LCU staff based on industry accepted methodology
 - b. LCU Board concurrence
2. Select Consultant:
 - a. Identify Budget
 - b. RFP, follow established City Procurement Code
 - c. LCU Board selects consultant
3. Perform rate review study:
 - a. LCU staff compiles financial data
 - b. Consultant produces draft report
 - c. Draft report presentation to LCU Board, Utility Customer Advisory Group (UCAG), and public
4. Public input and feedback:
 - a. UCAG coordinates and hosts customer input meetings to gather commentary and feedback
5. Results presented to LCU Board:
 - a. LCU, UCAG, public, and other interested customers
6. Develop comments/recommendations:
 - a. Summary of feedback from all parties is forwarded to LCU Board
 - b. LCU Board provides direction to consultant
7. Final Report:
 - a. Consultant incorporates comments/recommendations based on LCU Board direction
 - b. LCU Board approves, disapproves, or modifies Report
 - c. LCU Board accepts Report and approves Resolution recommending rate adjustments to the City Council
8. Rate decision:
 - a. City Council approves new utility rate adjustment recommendations
 - b. City Council does not approve – remands back to LCU Board with strategic guidance

Financial Criteria

Criteria – Wages and Benefits:

1. **Purpose:** To establish utility rates to recover wages, salaries, benefits, and payroll tax expenses in a test period review year without incurring a deficit.
2. **Justification:** City Council authorizes increases in wages and benefits for all City employees. LCU personnel are on the same pay scale as all other City employees and LCU must cover this increase.
3. **Calculation:** Standardized Human Resources calculation based on hourly wage rates.
4. **Example:** Past years experienced an increase of 1.5% for the union contracts, a merit, and longevity increase for some City personnel. For example, Fiscal Year 2015 had increases in wages that amounted to:

	<u>FY15</u>	<u>FY16</u>	<u>% increase</u>
Gas	\$2,356,211	\$2,565,646	8.88%
Water	\$1,727,877	\$1,779,468	2.98%
Wastewater	\$1,790,252	\$1,875,240	4.75%
Solid Waste	\$1,582,370	\$1,704,854	7.74%

Criteria – Operating Expenses:

1. **Purpose:** To establish utility rates to recover on-going and recurring expenses to ensure a safe, reliable, and regulatory compliant operation of the utility.
2. **Justification:** LCU is an enterprise fund that must recover all operation and maintenance expenses through rates, in addition to equipment and capital funds, and Landfill Closure costs.
3. **Calculation:** Based on the most recent audited CAFR.
4. **Example:** Infrastructure repairs and maintenance expenses, materials, equipment, supplies, training, pumping and treatment expenses, and internal transfers, etc.

Criteria – Operating Fund Reserve:

1. **Purpose:** Achieve the targeted minimum fund balance that reasonably covers expenditures for 2 months out of a year (2/12th) or 16.67%.
2. **Justification:** To ensure fund balance coverage is consistent with City budget requirements, which covers operational emergencies.
3. **Calculation:** Fund ending balance / (total expenditures - transfers - non-cash expenses).
4. **Example:** Water Operating Fund: \$1,321,163 / (\$14,845,122 - \$1,233,999) = 9.71%. The fund balance is below the target minimum balance of 16.67%.

Criteria – Administrative Transfer:

1. **Purpose:** Intergovernmental transfer(s) to the General Fund to fund the Department's utilization of City-wide common administrative resources.
2. **Justification:** The Utilities Department is a part of the City organization and relies on administrative support from IT, Human Resources, Risk Management, Legal, and Facilities Management.
3. **Calculation:** Executive budgetary action agreed upon by Budget, Finance, Department Directors, and the City Manager.
4. **Example:** Gas FY2015 Administrative Transfer \$641,405 (5.70% of operational expenditures).

Criteria – Equipment Reserve Fund Transfers and Fund Balance:

1. **Purpose:** To fund current year rolling stock expenditures through funding transfers from respective Operating Funds to maintain an adequate reserve to mitigate the impact of expenditures based on LCU Replacement Schedule as approved by the LCU Board. The utility commits to maintain the industry average life of rolling stock.
2. **Justification:** Each operating utility's revenue stream funds the equipment reserve to ensure timely replacement of its equipment and vehicle stock in order to reliably operate and maintain each respective utility's system and service standards.
3. **Calculation:** (Current vehicle depreciation + ½ year of depreciation for new vehicles + cost of new vehicles needed to be purchased in the upcoming year) x current price index factor.
4. **Example:** Wastewater: $(\$101,030 + \$64,056 + \$768,674) \times 1.02 = \$952,435$. For FY2015, the Wastewater Equipment Reserve Fund should have a minimum fund balance of \$952,435.

Solid Waste – Collections Vehicles:

1. **Purpose:** To fund current year collections vehicles and major equipment replacement expenditures through fund transfers from the Solid Waste Operating Fund to maintain an adequate reserve to mitigate the impact of expenditures based on LCU Solid Waste Replacement Schedule. The utility commits to maintain the industry average life of this rolling stock.
2. **Justification:** Solid Waste revenue stream funds the equipment reserve fund to ensure timely replacement of its collections equipment and vehicle stock in order to reliably operate and maintain Solid Waste service standards.
3. **Calculation:** [Current vehicle depreciation + ½ year of depreciation for new vehicles + (actual new vehicles costs / average life)] x current price index factor.
4. **Example:** $[\$707,364 + \$68,333 + (\$1,500,000 / 8.5 \text{ years})] \times 1.02 = \$971,210.94$. For FY2015, the Solid Waste Equipment Reserve Fund would set a minimum fund balance of \$971,210.94.

Solid Waste – Light Duty Vehicles:

1. **Purpose:** Maintain the ability to fund recurring rehabilitation of light duty vehicle expenses and maintain an adequate reserve to fund planned expenditures based on LCU Solid Waste Replacement Schedule as approved by the LCU Board. The utility commits to maintain the industry average life of this rolling stock.
2. **Justification:** The capital fund will be used for the purchase of light duty rolling stock.
3. **Calculation:** (Current vehicle depreciation + ½ year of depreciation for new vehicles + new vehicle cost) x current price index factor.
4. **Example:** $(\$100,000 + \$7,083 + \$85,000) \times 1.02 = \$195,924.66$. For FY2015, the Solid Waste Capital Fund would set a minimum fund balance of \$195,924.66.

Criteria – Capital Fund Transfers and Fund Balance:

1. **Purpose:** Maintain the ability to fund recurring rehabilitation expenses and maintain adequate reserve to fund impact of expenditures.
 2. **Justification:** The capital fund funds the Capital Improvement Plan adopted by the City.
 3. **Calculation:** Highest actual expense in a 5 year range - a minimum fund balance based on the average of 5 year actual recurring rehabilitation expenses.
 4. **Example:** Highest actual Water expense in a 5 year range: \$2,682,625
5 year average of actual recurring rehabilitation expenses for Water: - \$1,716,358
\$ 966,267
- the minimum fund balance is \$966,267. FY2015 the Water Capital Fund Balance was \$397,594.

Criteria – Debt Service:

1. **Purpose:** Maintain the ability to fund non-discretionary, non-recurring rehabilitation projects; new regulatory requirements; replacement of plant and facilities that do not reach their useful life; system expansion to existing or new service areas not paid by impact fees; and modernization of plant and infrastructure to integrate technological improvements. The ultimate level of borrowing will be determined pursuant to the Utilities Board recommendation and City Council authorization.
2. **Justification:** 1.4 debt service coverage is the recommended minimum by Moody's Bond Rating. However, LCU highly recommends maintaining a 1.6 debt service coverage.
3. **Calculation:** (utility service charges – operating expenses) / (debt service principal + debt service interest).
4. **Example:** Debt service to fund WWTF Primary Clarifier and Water Quality Laboratory Rehabilitation are non-recurring rehabilitation projects. Projects associated with NMDOT are non-discretionary projects.

Solid Waste:

1. **Purpose:** Solid Waste collection vehicles are the essential and major assets in this utility's operation.
2. **Justification:** Light duty vehicles and non-collections equipment will be primarily funded through rate revenue. Collections vehicles and major equipment will be treated as capital and funded through operating fund transfers and debt may be considered during the annual budget review and the rate setting test period review.

Criteria – Rate Design

1. Rate design shall reflect the appropriate level of fixed and variable costs in the recovery of revenue requirement.
2. Rate design is an acceptable means to recover the cost of conservation measures or legislative mandates.

Ancillary Components to Rate Setting

1. **Consultant Selection:**
 - a. Include UCAG and LCU staff in the two evaluator positions within the Procurement process. UCAG will review and have input on the RFP.
 - b. The RFP will address impartiality concerns for consultants used in prior rate reviews. The RFP will address peer review of LCU's rate review request.
 - c. An alternate, peer review could be done by an independent entity, such as the NMSU Center for Public Utilities, at additional expense.
2. **Process Sequence:**
 - a. The rate review process will have an iterative process for LCU Board to evaluate and recommend documented solutions to Council. LCU Board can repeat outlined steps until satisfied with the Final Report.
 - b. Council makes the decision to approve or remand the Board's recommendation. LCU staff will present the Final Report to Council. LCU Board and UCAG are not allowed to appear before Council to voice their respective positions.
 - c. Submitted and remand loop between Council and LCU Board is a potential reality as is the case with the current process.
3. **Ad-Hoc Committee:**
 - a. The UCAG can be established so that the appointments are valid for a series of rate reviews.
4. **Rate Setting Methodology:**
 - a. LCU will utilize industry accepted methodologies, for example the "AWWA M1 Principles Water Rates, Fees, and Charges," guidelines for water utilities.
 - b. Appropriate training regarding different rate setting options can be provided to the LCU Board before the next rate review.
 - c. The training would not affect the rate review process itself.
5. **Procurement Process:**
 - a. This process is approved by Council Ordinance and is used for all Procurement of Professional Services.
 - b. UCAG can be part of the Procurement process, as there are two evaluator positions.
 - c. Staff recommends this process to be used for the selection of the rate review process consultant.
6. **Rate Riders:**
 - a. Utility Rate Riders recover or refund interim unexpected/unplanned costs or changes in costs.
 - b. Updates or revisions to the riders will be approved by the LCU Board.
7. **Council Voting:**
 - a. LCU Board Members who are also Councillors would abstain from participating and voting as Council Members

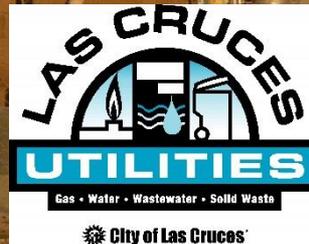


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Las Cruces Utilities Revised Rate Setting Process

Council Work Session

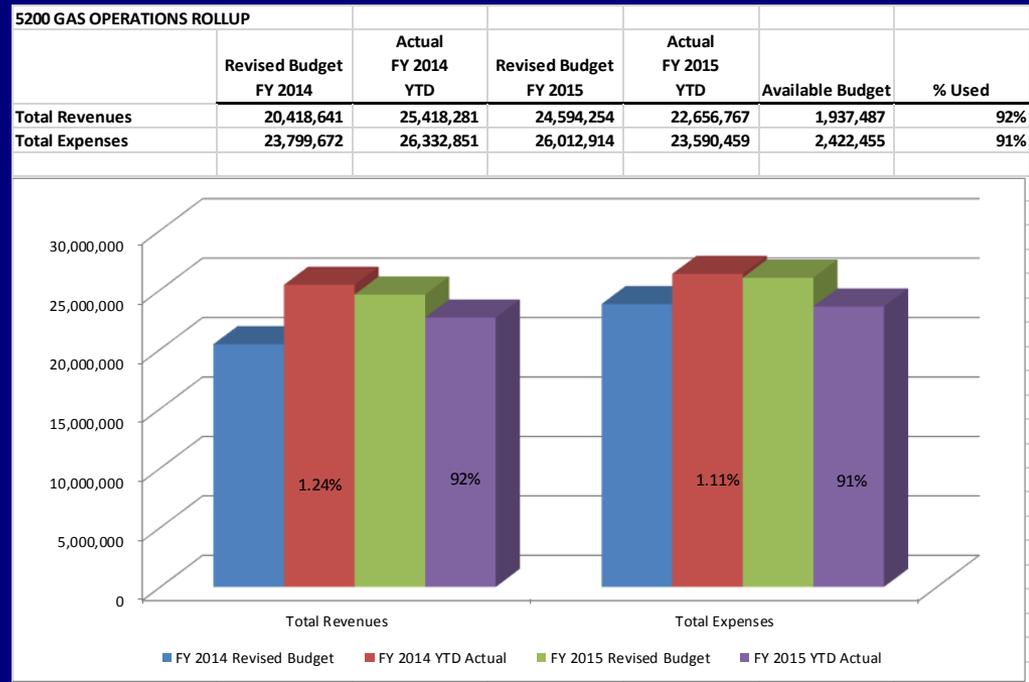
March 28, 2016



City of Las Cruces

Topics of discussion

- Background - Current rate setting process
- Proposed rate setting process
 - Process steps
 - Financial criteria
 - Ancillary components



Current Rate Setting Process

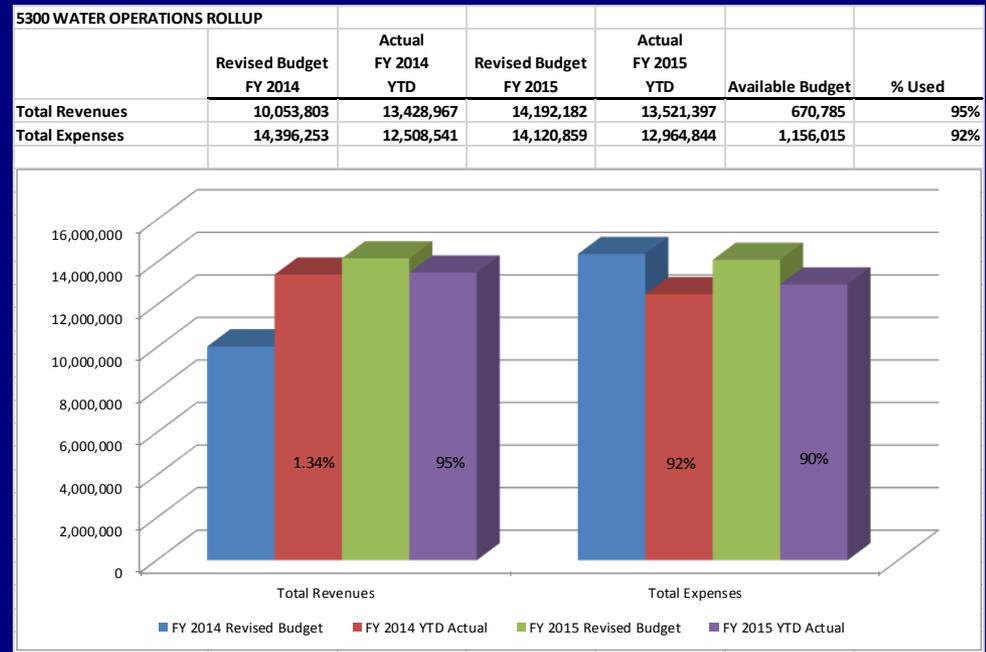
- ❑ Quasi Judicial process
- ❑ Utility develops and files a rate case before the Utility Board
- ❑ Ratepayer Advisory Committee (RAC) responds to the filed rate case
 - ❑ RAC is appointed by Mayor with advice and consent of Council
 - ❑ Members are ratepayers themselves
- ❑ Represent residential and small commercial customers
- ❑ Other large commercial or industrial customers may intervene in the case

Current Rate Setting Process..(cont.)

- ❑ Utility Board hears the case and makes a decision:
 - ❑ Contested hearing
 - ❑ Settlement among the parties
- ❑ Any party, including the Utility, can appeal the decision to the City Council;
- ❑ If there is an appeal, City Council hears the appeal
 - ❑ May concur with the LCU Board decision
 - ❑ May not concur with the decision, in which case they remand back to LCU Board for reconsideration

Proposed Rate Setting Process

- ❑ Substitute Quasi Judicial process by a Legislative process
- ❑ Maintain industry accepted rate making methodology
- ❑ Maintain ratepayer input and participation process – Utility Customer Advisory Group (UCAG)
- ❑ Defined process steps
- ❑ Defined financial criteria for rate setting



Rate Setting Process Steps

1. Establish requirement for a rate review
 - ❑ Request by LCU
 - ❑ LCU Board concurrence
2. Select Consultant
 - ❑ Identify budget
 - ❑ RFP – City procurement process
 - ❑ LCU Board selects consultant
3. Perform rate review study
 - ❑ LCU staff compiles financial data
 - ❑ Consultant produces Draft Report
 - ❑ Draft Report presented to LCU Board, UCAG, public
4. Public input and feedback
 - ❑ UCAG coordinates and hosts customer input meetings

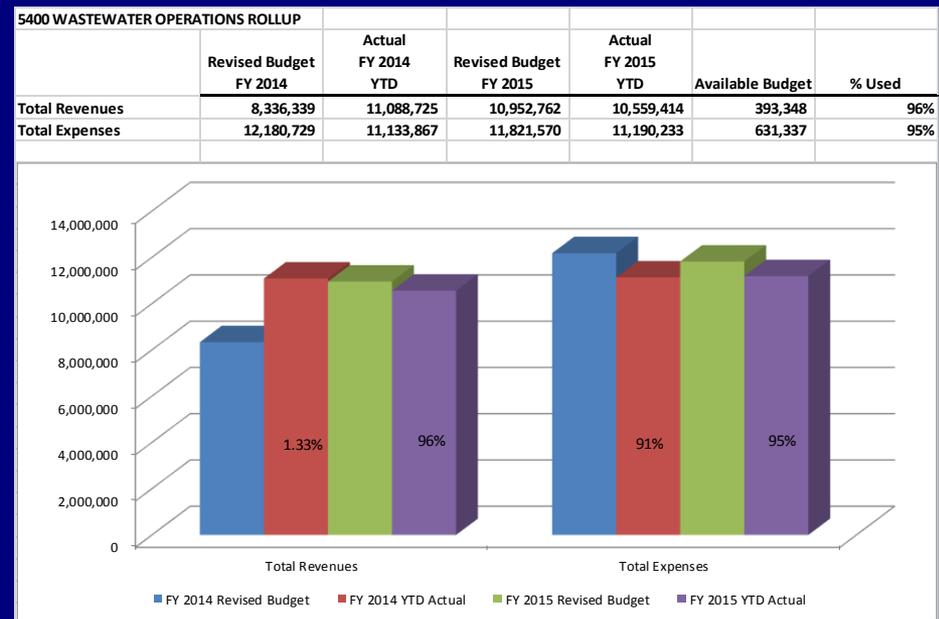
Rate Setting Process Steps...(cont.)

5. Results presented to LCU Board

- ❑ LCU, UCAG, public, and other interested customers

6. Develop comments /recommendations

- ❑ Summary of all feedback from all parties forwarded to LCU Board
- ❑ LCU Board provides direction to consultant



Rate Setting Process Steps...(cont.)

7. Develop recommended Final Report

- ❑ Consultant incorporates comments / recommendations based on LCU Board direction
- ❑ LCU Board approve, disapproves, or modifies Report
- ❑ LCU Board approves Resolution recommending rate adjustments to City Council

8. Rate Decision - Council adoption

- ❑ Council approves rate adjustment recommendations
- ❑ Council does not approve – remands back to LCU Board with strategic guidance

Financial Criteria for Rate Setting

- ❑ Wages and Benefits
 - ❑ Maintain appropriate funding for personnel expenses as determined by City Council
- ❑ Operating Expenses
 - ❑ Appropriate funding for utility operation and maintenance expenses
- ❑ Operating Fund Reserve
 - ❑ Maintain 2/12 of operating expenses in fund balance
- ❑ Administrative Transfers
 - ❑ Fund governmental transfers
- ❑ Equipment Reserve Fund Transfers and Fund Balance
 - ❑ Maintain sufficient funds for vehicle replacements
- ❑ Capital Fund Transfers and Fund Balance
 - ❑ Appropriate funding of system rehabilitation expenses

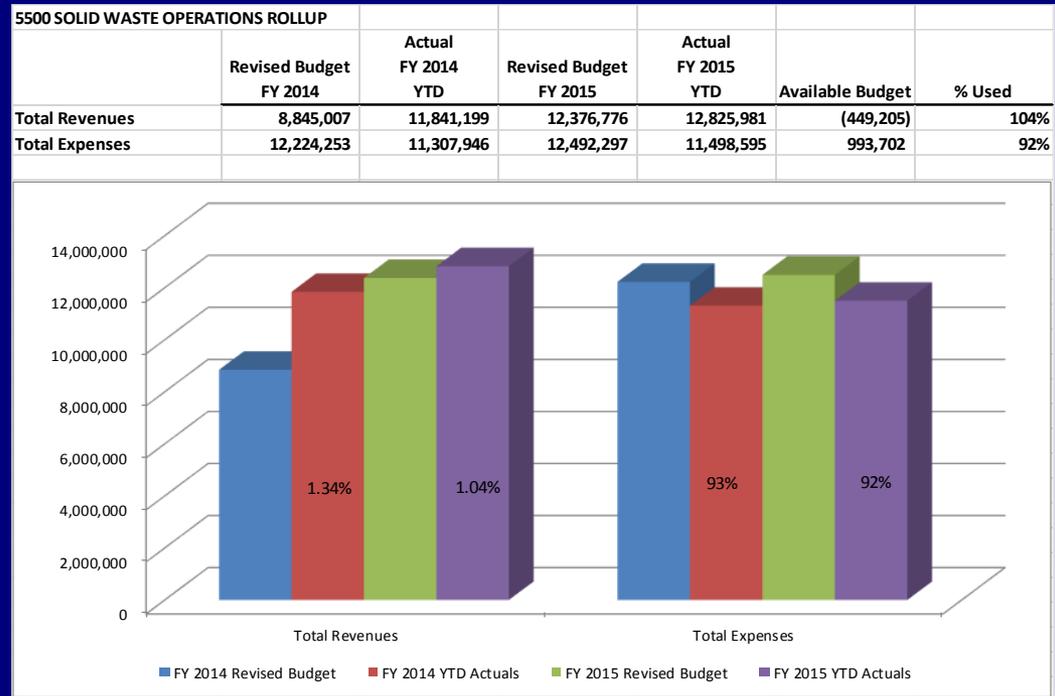
Financial Criteria....(cont.)

□ Debt Service

- Adequate debt service coverage in order to maintain current Utility bond rating

□ Rate Design

- Ensure that rates are designed to reflect appropriate level of fixed and variable costs
- Rate design used as a conservation tool and related cost recovery



Ancillary Components in the Rate Setting Process

1. Consultant Selection via the City Procurement Rules
2. Rate review process may have several iterations
3. Ad-Hoc Committee – Utility Customer Advisory Group in place for series of rate reviews
4. Defined industry accepted Rate Setting Methodology and training
5. Procurement Process to select consultant with UCAG participation
6. Rate Riders
7. Council voting

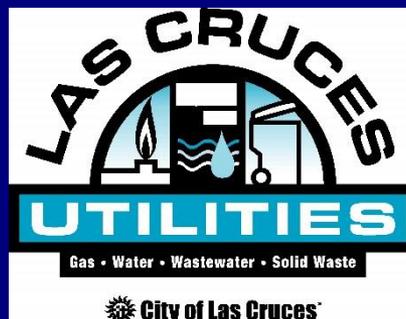
Summary

- ❑ Legislative process rather than Quasi-Judicial
- ❑ Maintain industry rate making methodology
- ❑ Defined financial criteria will maintain integrity of enterprise funds
- ❑ Final decision by the City Council
- ❑ More expedited and lower cost process

Next steps

- ❑ Incorporate Council input and recommendations
- ❑ Present a Council Resolution adopting the revised Rate Setting Process
- ❑ Revise LCU Board By-Laws to reflect the new Process

Questions?



Appendix

LCU Rate Setting Process Diagram

