

Activities of the Southeast Michigan Consortium for Water Quality

March 2005

Prepared by SEMCOG, the Southeast Michigan Council of Governments, on behalf of the Southeast Michigan Consortium for Water Quality. For further information, including additional copies of this report, contact SEMCOG Information Services at 313-961-4266.

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Introduction

Purpose

The Southeast Michigan Consortium for Water Quality was formed in 2001 at the urging of the Honorable John Feikens, Judge, United States District Court. In a background paper discussing the Consortium, Judge Feikens wrote, “it became prudent to construct a process which would be a complement to the oversight judicial responsibility I have. I wanted to create a continuing forum that would include, on a voluntary basis, those with an interest and role in the protection of the region's water quality. I wanted a process that could be proactive about solving problems collaboratively before anyone felt the need to resort to litigation.” Judge Feikens has also indicated he is willing to use the Consortium to help resolve issues taken to litigation.

The purpose of this report is to describe the ongoing activities of the Consortium. For each issue on the agenda of the Consortium, areas of progress are summarized and action steps (completed or in need of completion) are described.

Even with progress in many areas, much more remains to be done. The challenges faced by the Southeast Michigan region result from a combination of factors including:

- A desire to minimize costs and keep water and sewer rates as low as possible,
- A seemingly conflicting desire to assure that the level of investment in physical infrastructure is sufficient to maintain quality, reliable service and meet current and emerging regulatory requirements,
- A large, incrementally developed, complex water and sewer system that transcends the political boundaries of over 100 communities – the Detroit Water and Sewerage Department (DWSD),
- More than 100 other smaller water or sewer systems in Southeast Michigan,
- Periodic proposals (written and unwritten) for transforming the current system of governance of the DWSD system,
- The desire of some to control growth and development by limiting access to water and sewer service, and
- Maintaining and maximizing use of existing infrastructure while meeting demand for service in growing areas.

Each of these factors complicates the ability of the Consortium and any other existing entity to resolve issues. Nonetheless, they represent the context in which the Consortium operates and must navigate as it seeks to synthesize, confront, and resolve issues on a voluntary basis.

This report concludes with an identification of activities the Consortium will pursue in the coming year.

Policies guiding Consortium activities

In its first year, the Consortium had wide-ranging discussions on numerous issues. These discussions frequently included visitors from other parts of the state and country. After contemplating the many water quality challenges faced by the region enumerated in these presentations, the need to focus on key issues became apparent. As a result, the Consortium zeroed in on three policies to guide its activities.

The first policy calls for consistency in rate-making policy, true cost, and disclosure. It states, “A common policy basis should be developed for guiding rate setting for both the regional and local components of the system. A part of that policy basis should be full disclosure to the billed customer regarding which components of the bill are being charged by various entities. Finally, rates should reflect the true costs associated with providing the service.”

A second policy seeks implementation of best practices and efficiency. It states, “incentives that promote conservation, best management practices, and water quality protection should be included in rate structures. This includes incentives for land use designs demonstrated to reduce cost of service/protect water quality. Further, rate structures should be designed to promote maximizing the use of infrastructure already in place. Finally, treatment providers should collaborate to identify service areas and assure consistency between their plans and community master plans and ordinances.”

The final policy of the Consortium concerns the preservation of home rule. It states, “programs designed to achieve the above policies should not impinge upon home rule, and local authorities must continue to establish retail customer rates.”

All the activities of the Consortium described in the remainder of this report are, in one way or another, connected to pursuit of these policies.

In early 2003, the Consortium formed several working teams, including one focused on rates, another focused on infrastructure coordination, another on operational and management efficiency, and finally, a team on best management practices. These teams provide the Consortium with irreplaceable expertise and provide stakeholders an opportunity to actively engage in problem identification and resolution.

Progress to Date

Disclosure

Disclosure in DWSD's rate-setting process

Early dialogue on disclosure focused on the process of rate setting used by the Detroit Water and Sewerage Department (DWSD). While new rates are instituted on July 1st of each year, the actual process of rate-setting begins almost 10 months earlier.

After deliberating with the Consortium Rate Policy Team on this process for a number of months, DWSD agreed to a series of customer meetings and information sharing earlier in the process. This began in the fall of 2004. In addition to early scheduling of meeting dates and notice to customers, the subject matter for each of three meetings was pre-determined. This included both the type of information and the level of detail that would be disclosed on various matters related to development of rates for the upcoming year.

As of this writing, four meetings have been held. The latest was designed for elected officials and was held on January 13, 2005. Each meeting concludes with the collection of an evaluation form participants are encouraged to complete. Part of the purpose of this evaluation form is to honor the Consortium's commitment to seek continued improvements to the process using experience gained in this rate cycle. Indeed, several ideas for improving the process have been identified and are incorporated later in this report as a first step toward assuring they are implemented.

In summary, the vast majority of feedback on the working sessions has been that the meetings have been positive and helpful. These meetings have also prompted additional questions as more information is disclosed. At the same time, new questions are being raised as more information is disclosed. Many of these questions have been posed on the meeting evaluation forms and can be used to ascertain what other information would be helpful to customers.

(Note: Between drafting and finalizing this report, the Rate Policy Team and DWSD agreed on a number of additions to further improve the process. These additions were based on several proposed improvements in the following sections. Table 1 incorporates these improvements. They will be included in the customer outreach meeting during the FY 06-07 rate-setting process.)

Disclosure in local revenue collection

In addition to disclosing information about the DWSD rate-setting process, it was decided that more information was needed on revenue collection to recover costs associated with running the local portion of the system(s). The first step in that process was a region-wide study conducted on behalf of the Consortium modeled after one completed in Oakland County by the Drain Commissioner.

A wide range of information on water and sewer revenue was collected from over 140 communities in Southeast Michigan. Key findings and conclusions of this report conducted by Plante & Moran follow:

- A wide range of methods are used to collect revenues for water and sewer service – including rates, fees, and property taxes. Communities follow varying fiscal policies (capital financing strategies, level of reserves, methods to “true-up” actual costs, etc.) when establishing rates.
- There is no uniform methodology used to establish water and sewer rates in Southeast Michigan. Some communities use the ‘utility method’ for establishing rates, others use the ‘cash method,’ and still others use some combination of methods.

- About half of the communities surveyed use at least one funding mechanism in addition to usage charges. A fixed quarterly fee is the most common.
- User rates do not necessarily reflect the actual cost customers are paying for water and sewer services. Therefore, simply comparing user charges between communities can lead to erroneous conclusions.
- Periodic (annual) collection of revenue data would be useful for:
 - Tracking trends in costs,
 - Tracking how much is being invested in water and sewer systems,
 - Anticipating and preparing for changes in the cost of providing water and sewer service, and
 - Comparative purposes and disclosure (help separate fact from fiction).

Disclosure through billing

Another aspect of achieving the Consortium’s policy of disclosure relates to the manner in which customers are routinely billed for services. At a minimum, customers of DWSD pay for services from at least two providers – the local community and the DWSD. In some cases, there are an additional one or two intermediary service organizations.

This multi-layered service structure is usually not apparent in bills received by customers. In order to more fully disclose what service is being paid for, and to whom, the Consortium developed a model billing template which is shown in Table 2. A committee representative of customer communities has been asked to refine this general template and propose a process for implementing it.

Disclosure tailored to local officials

On a parallel path to the Consortium’s pursuit of disclosure, a committee of DWSD customer communities partnered to develop a generic, easy-to-understand description of the sewer rate-setting process, referred to as “Rates 101.” That document and presentation is available to customer communities upon request. The format for giving the presentation usually includes a representative of DWSD and one or more customer communities.

A draft of the presentation was shared with the Rate Policy Team for review and comment. The Rate Policy Team endorsed the presentation and acknowledged it as yet another part of the process for improving disclosure with customer communities. A companion summary describing water rate development is being prepared.

Summary of actions on disclosure in rate-setting process

In summary, the following has occurred:

- A series of customer meetings was scheduled in advance with the specific subject matter identified (agenda) as well as the extent of information that would be available and when. (Feedback from customer communities on the meeting process employed in Fall 2004 has been very favorable.) A study was completed that identifies the revenue collection mechanisms being employed by over 100 communities.
- Agreement by a DWSD customer committee to develop a protocol for periodic surveys on revenue collection and to assess the policy basis for various revenue collection practices
- A template for billing was designed that discloses what types of service are provided, which organization is providing them, and how each organization is charging for these services.

- A presentation on rate setting designed for local officials was developed by customers and is ready for application. A second presentation is being prepared that provides more depth and details for parties desiring more information.

Other helpful steps have been identified.

- The rate-setting process employed in the current cycle must be improved using a combination of feedback from the meetings and lessons learned by the Rate Policy Team as it deliberated on a number of substantive issues. Subsequent sections describe detailed improvements.
- More detail will be collected on the rationale (policy basis) for revenue collection at the local level by a DWSD customer committee to ascertain the degree to which revenue collection is sufficient to cover the “true cost of service” for all service providers in the region.
- The public’s understanding of who they are paying and how much must be improved. A prime opportunity is through refinement of bills.

DWSD Rate-Setting Policy

Subsequent to formation of the Consortium, a report was released by the Oakland County Drain Commissioner (prepared by Raftelis Inc.) raising several concerns and issues related to different components of DWSD’s rates. The Rate Policy Team spent numerous meetings discussing different aspects of the Oakland County report and DWSD’s responses (Appendix A). A summary of the Consortium’s deliberations on each of the points raised up until the preparation of this progress report is also in Appendix A.

A common theme during the Rate Policy Team deliberations on these issues was that any changes contemplated to the rate structure needed to be considered on a holistic basis. Therefore, with one exception, the team did not make any specific proposals on any individual issues. The process was to provide a forum for openly discussing different points of view with the goal of reaching agreement on how to move forward.

This section includes a brief description of various components of the rate structure that were delved into by the Rate Policy Team. A brief summary of discussion by topic is followed by a course of action by topic. **Courses of action were developed by using the Consortium policies as a basis for synthesizing various points of view culled from a review of both the Oakland County report and DWSD’s response, as well as discussions of the Rate Policy Team and comments raised during the previously described customer outreach meetings.**

Maximum debt financing

In preparing its annual budget, DWSD must determine that part of the Capital Improvement Program (CIP) that it will finance through borrowing. This is referred to as debt service coverage.

For the sewer side of the system, DWSD’s debt service coverage must be in compliance with the maximum debt financing provisions of the rate settlement agreement formulated under the jurisdiction of the federal court. The maximum debt financing provision of the 1978 rate settlement agreement states:

Detroit shall obtain capital funds for the expansion, renewal and reconstruction of common use or solely suburban use major capital assets or improvements from the issuance of revenue bonds, to the maximum extent possible together with maximum use of coverage monies generated thereby.

While there are some differing interpretations of this language, debt service coverage policies are recognized as the primary factor in determining the level of debt accrued over time.

The higher the debt service coverage level, the lower the amount of the capital improvement program that is financed through debt. This results in higher rates in a given year. The lower the debt service coverage level, the more the CIP is financed through debt. Because more expenses are distributed over a period of years, lower debt service coverage results in lower rates in a given year.

This impacts the degree to which current users or future users pay for capital improvements. Lower debt service coverage spreads more of the cost to future users and lower rates, at least initially. Lower debt service coverage also requires incurring more expense to pay interest on borrowing, more current borrowing, and as a result, potentially higher rates in the long-term.

In addition to maximum debt financing, the rate-settlement agreement (affecting only sewer rates) provides for the application of an annual “look back” so that customer community charges can be adjusted (up or down) to reflect actual expenses.

The Rate Policy Team discussed how maximum debt financing is one part of the overall strategy to cover debt service. DWSD determines compliance with the rate settlement agreement provisions on maximum debt financing in the context of all debt service coverage. Information on debt service coverage for the last four years was discussed.

It was stated that DWSD’s policy of 140 percent debt service coverage, when coupled with the look-back provisions in the rate settlement agreement, provides a comfort level for bonding agencies that results in lower borrowing costs. Other views on the proper interpretation of the maximum debt financing provisions of the rate settlement agreement were extensively debated, including an argument that such debt service coverage practically out of compliance with the rate settlement language that capital improvements be funded through revenue bonds “to the maximum extent possible together with maximum use of coverage monies generated thereby.”

Maximum debt financing/summary of actions

- The culmination of the Rate Policy Team discussion was correspondence (August 18, 2004) to the DWSD Board of Commissioners and the DWSD Director requesting their consideration of a debt service coverage of around 130 percent. This would help maintain favorable interest rates on bonds and allow for financing a greater portion of the CIP with debt. Furthermore, recognizing that a fixed level for debt service coverage does not provide DWSD with necessary flexibility, the team requested establishing the level of debt service coverage be an element of the annual rate-setting process and be determined within the bounds of some predetermined criteria (that had not been developed by the team).
- On October 27th, the Board of Water Commissioners adopted a resolution establishing policy on debt service coverage. That resolution is in Appendix B.
- While some members have expressed a concern that the new board policy, as written, could allow for very high levels of debt service coverage, the coverage ratio in the current rate cycle is approximately 130 percent.
- The concern that the policy could result in a high level of debt service coverage in the future is addressed by this restatement of the Consortium’s desired intent for a debt service coverage level of “around” 130 percent. Experience with a coverage level of about 130 percent should be used to assess both the desirability and feasibility of a lower coverage policy.

- In addition, the annual determination for debt service coverage will be coupled with the process of earlier disclosure that is now underway. This earlier disclosure provides the opportunity for explaining and discussing the rationale for the proposed debt service coverage level in a given rate cycle.

Charges from the City of Detroit

In the course of its day-to-day operations, DWSD requires specific services be performed by other departments of the City of Detroit. DWSD is invoiced by the City of Detroit for these services and treats them as an expense in the rate development process. The 1978 rate settlement agreement places limitations on these charges by describing types of activities undertaken by the City of Detroit which they can include.

The Rate Policy Team worked with DWSD and the City of Detroit to gather information in order to better understand how direct charges are calculated, and what they include. The team received detailed information from the City of Detroit, as well as an explanation of how the City of Detroit's updated accounting system works. That included a discussion of how indirect costs from city departments are allocated to DWSD, using a "Full Cost Allocation Plan." This Full Cost Allocation Plan was developed for the City of Detroit by the firm of Maximus. The city is henceforth implementing the system developed by Maximus.

DWSD stated its commitment to continuing to share additional information with customers on these charges from the City of Detroit.

Charges from the City of Detroit/summary of actions

- DWSD has clearly articulated its commitment to continuing to share additional information on these charges with customers. Disclosure on these charges early in the annual rate-setting process is how that commitment will be achieved.
- Consistent with Consortium's policy on disclosure, a background memorandum summarizing how direct charges are calculated will be prepared. This will be tailored for elected officials of customer communities. It will also include a description of how the Full Cost Allocation Plan can be accessed for those desiring more detailed information on these charges in any given year.

Payments for indirect benefits

The City of Detroit also provides a range of services to DWSD for which there is no invoice or direct billing. These costs are recovered by DWSD at a fixed amount set in the 1978 rate settlement agreement. The settlement agreement provides that increases in this category be limited to five percent.

While the Rate Policy Team has not had any detailed discussion of these charges, compliance with the Rate Settlement Agreement has been acknowledged. Still, the Oakland County report recommends that annual increases for direct charges be based on the consumer price index instead of the five percent stipulated in the rate settlement agreement.

Payments for indirect benefits/summary of actions

It is agreed that the preference is that changes to these charges be based on some index instead of a fixed percentage. The team will complete an examination of the merits of different indexing alternatives and a change to the fixed five percent increase.

Unaccounted for water

Water loss (or unaccounted for water) is the difference between the reported amount of water produced at all of the production facilities and the reported amount sold. Some unaccounted for water is inevitable due to water line breaks, leaking pipes, and unmetered uses such as firefighting.

In general, discussion of unaccounted for water often entail whether estimates for unaccounted for water are reasonably accurate, how costs should be allocated, and whether the amount of unaccounted for water being experienced is in the “acceptable” range.

In discussing this issue, all parties recognized that there are many opportunities for improved data collection and evaluation. DWSD reiterated its commitment to developing rates that reflect the best available verifiable information. In the past year much was learned about unaccounted for water as a result of preparing a master water plan and the phasing in of a master metering program.

There is recognition that a number of ongoing and planned DWSD activities will provide considerable additional information on calculations of unaccounted for water in future years.

Unaccounted for water/summary of actions

- In proposing the water rates for fiscal year 2005-2006, DWSD modified the total anticipated unaccounted for water percentage to 17.5 percent in a manner consistent with the Oakland County report. That was higher than the actual reported figure for fiscal year 2003-2004, which was 16.8 percent.
- DWSD has initiated a professional services contract designed to gather necessary information to further quantify unaccounted for water.
- Discussions on how to estimate unaccounted for water should continue based on results of the previously referenced contract. These discussions should include customer committees.
- In the meantime, the figure for unaccounted for water used to calculate rates should be determined on an annual basis and disclosed as early as possible in the rate-setting process.

Depreciation expense

Concern was raised in the Oakland County report that depreciation expenses were overstated. The possibility of refining assumptions used in projecting depreciation expenses was stated.

Discussion of this issue resulted in the following clarifications:

- DWSD assumes that a portion (20 percent for the current rate analysis) of the construction work in progress (CWIP) will become plant in service (PIS) assets during the year and will be added to the depreciable asset base.
- A fixed asset inventory, begun in 2002, has resulted in a better understanding of the asset base used to calculate depreciation expenses.
- The useful life of short-lived assets has been revaluated and adjusted (e.g., the useful life of computers was adjusted from seven years to three years).

Depreciation expense/summary of actions

- DWSD developed a new fixed asset system and refined some assumptions used in the projection of expenses. These changes are consistent with concerns raised in the Oakland County report.

- Given the limited time allotted to discussing this issue, it is possible that other suggested revisions might arise once there has been enough time for the new system to be understood. The door to that opportunity is open.
- In the interim, projected depreciation expenses, their impact on rates, and supporting rationale will be disclosed to customers as early as is feasible in the rate-setting process.

Operational and maintenance expenses

A large portion of the annual system costs (roughly half) are associated with operations and maintenance. These expenses include day-to-day operations of all system facilities plus routine maintenance and repair.

Concern was raised in the Oakland County report about the large differences between budgeted and actual O & M expenses. The processes for estimating O & M expenses and for the differences were presented and discussed. Many questions have been answered. New ones have arisen. Others are expected each year as a result of the following:

- Pressure to minimize rate increases and customer recognition that O & M expenses represent a major component of charges.
- An increased level of disclosure on expense-related information (as a result of the Consortium's efforts).
- The combination of both factors can be expected to result in more, rather than less questions, at least in the foreseeable future.

Policies have been put in place by the Director to hold the line on operating expenses. For perspective on budgeted expenses, the total operating budget for FY 2006 is one percent higher than the FY 2003 budget. For perspective on expenses incurred, actual operating expenses for FY 2004 were effectively the same as FY 2002 levels.

Operations and maintenance/summary of actions

Improvements to the already improved process for rolling out rates in 2005/2006 will be made.

- A part of the first customer meeting will include a review of relevant information used to project expenses. This will include a comparison of actual and projected expenses for previous periods.
- This will also include a discussion of factors expected to affect rates in the upcoming year, the DWSD Director's expectations of senior management, and supporting rationale for those expectations.

Rate of return

Because of the risks and responsibilities associated with ownership of a water system, the Utility Basis of Ratemaking provides for establishing a return on rate base. This issue was discussed in response to concern expressed in the Oakland County report that the rate of return being utilized was too high.

There are a number of alternatives available for determining the rate of return. The Utility Basis for Rates only requires the rate of return on rate base be "reasonable." Thus, a broad range of practices would be considered acceptable when applying the reasonableness test. In fact, the team reviewed a recently completed survey of peer utilities (conducted by Raftelis) and concluded that the practice used by DWSD is within the range of practices used by comparable utilities.

The broad range of possible applications that meet the reasonableness test results in some year-to-year uncertainty by customers.

Rate of return/summary of actions

- The utility basis for rate-making stipulates that the rate of return on rate base be “reasonable.” However, that does not preclude a utility from developing and self-imposing criteria it would utilize in determining the rate of return. While some flexibility might be lost, more certainty to customers would be gained. And, disclosure would be enhanced because the policies/criteria for establishing rate of return would be apparent.

Therefore, the Consortium will strive to develop **mutually acceptable** criteria that would guide the annual determination of rate of return.

Demand factors

Maximum daily usage and peak hour usage (demand factors) have a major impact on water rates. Many changes were recently made to these demand factors as a result of data now available from a new water metering program partly designed to aid in rate setting. Nonetheless, interpretation of the data collected, as well as the most suitable procedure for applying demand factors in calculating rates, have been the subject of extensive discussion in other customer forums.

Demand factors/summary of actions

- DWSD has committed to considering changes in the use of demand factors to calculate rates. A DWSD-sponsored Water Rates Workgroup of customer communities has been charged with identifying and evaluating alternatives to the current methodology. The expectation is that agreed-upon changes will be in place prior to the next rate season.
- The Consortium requests that demand factors be applied to setting rates in a manner that, as closely as possible, reflects the true cost of providing maximum daily and peak hour service to any particular community.
- Prior to finalizing any refinements to demand factors, all water customers will be invited to a special forum to learn about the proposed refinements, the rationale for refinements, and the anticipated impact on rates.

Financing Infrastructure Improvements

SEMCOG estimates the region’s sewer infrastructure needs to be between \$14 billion and \$26 billion, not including the costs of financing. Comprehensive estimates for water needs are not available but are likely to be of a similar magnitude. Recognizing the challenges posed by these massive costs, the Consortium dedicates significant effort toward achieving two outcomes – reducing costs and assuring that levels of investment are adequate to meet the regions needs. This section summarizes the Consortium’s efforts aimed at achieving those outcomes.

Accelerating sewer infrastructure investment using the sewer loan program
In response to the identified sewer improvement needs, the Michigan Legislature authorized a ballot Proposal to add \$1 billion to the existing sewer low-interest loan program. Michigan voters overwhelmingly approved that ballot proposal.

At the same time, both state and local governments are experiencing an almost unprecedented level of fiscal stress. That fiscal stress has made it very difficult for communities to take on new debt it must

repay, even if the rate of interest is favorable. Moreover, open market interest rates are at relatively low levels. This diminishes some of the advantage normally provided by a governmental low-interest loan program.

Representatives of the Consortium presented the State of Michigan with several suggestions geared toward increasing the level of participation in the low-interest loan program. That request and the state's response is in Appendix C.

Accelerating sewer infrastructure investment using the sewer loan program/summary of action

- The State of Michigan lowered interest rates to 1-5/8 percent for loans in FY04,
- MDEQ and SEMCOG are working on a legislative initiative to make planning costs eligible as part of the loan program,
- MDEQ committed to developing improvements to its Web site to help streamline the application process,
- MDEQ has clarified that there is no 30 percent cap on loans if sufficient funding is available in a given year,
- MDEQ committed to expanding eligibility to include more types of sewer rehabilitation projects,
- The state has made clear their willingness to considering other suggestions from the Consortium.

Despite these positive developments, we note that incurring debt on loans for sewer improvement projects is extraordinarily difficult when funding for the provision of basic services is being scaled back. Furthermore, repeated efforts to increase federal support have been rebuked. In fact, the very limited federal support that is available is usually reduced early in the budget proposal cycle.

We also note that the desire to minimize rates contributes to the difficulty for project proponents.

Efficiency through improved planning

As indicated, sewer-related costs for the region are already very large. Additional costs that result from inefficient planning need to be avoided. SEMCOG's Water Quality Management Plan and the Consortium promote use of infrastructure already in place and assurance that of local plans and ordinances are consistent with those of service providers.

In discussing this issue, a limitation in the current permitting process was identified. Specifically, when reviewing sewer permit applications, state rules do not require MDEQ to assure those applications are consistent with the plans of the local government.

Efficiency through improved planning/summary of action

- The Consortium requested that MDEQ revise state rules to require local government affirmation that a proposed sewer permit is consistent with its plans and ordinances. MDEQ agrees but is awaiting advice from the Attorney General's office on the possible impact of such a change based on a recent court decision involving a private wastewater treatment facility to serve a condominium project in Isabella County.

Enabling use of fees to support services that provide water quality protection
While some of the current financial difficulties facing state and local government in Michigan are related to the sluggish economy, many problems of government financing are structural and will not be resolved

by an improved economy. One of those structural issues results from a Michigan Supreme Court decision (*Bolt v. City of Lansing*) on government's ability to use fees to support the provision of any number of expected, essential services.

The court in *Bolt* established a three-part test for distinguishing a valid user fee from a tax:

1. The fee must serve a *regulatory purpose* rather than a revenue-raising purpose.
2. A user fee must be *proportionate to the necessary costs* of the service.
3. A user fee must be *voluntary* – property owners must be able to refuse or limit their use of the commodity or service.

This, and subsequent court decisions, have far-reaching implications for both state and local governments. While the *Bolt* case dealt with a fee imposed by a local government for a sewer project, the fee versus tax test laid out by the *Bolt* court has been applied in a number of cases beyond water and sewer fees at both the state and local level. The result of the *Bolt* decision has been a lack of necessary certainty and predictability with regard to using fees as a mechanism to fund the provision of essential governmental services.

This has far-reaching implications with respect to local government's ability to finance a number of water quality protection projects. A working team with extensive experience in municipal finance is preparing a report summarizing the case, the implications of subsequent court decisions, and suggestions for consideration by the Michigan Legislature.

Enabling use of fees to support services that provide water quality protection/Summary of actions

- The report on *Bolt* and its impact was completed in February 2005,
- The report will be used by the Consortium, SEMCOG, and other interested parties as a starting point for discussions with the Michigan Legislature on options for addressing the current climate of uncertainty.

Reducing costs with regulatory flexibility

Much of the extensive infrastructure improvement cost is for projects to address sanitary sewer overflows. And, regulatory decisions on proposed corrective actions have a major impact on the cost of any particular project. Recognizing the importance of both implementing corrective action programs and the need to minimize costs whenever possible, the Consortium engaged in this issue.

The Consortium discussed concerns with MDEQ regarding their newly issued policy guidance on Sanitary Sewer Overflow corrections. And, the Consortium helped organize and took part in a number of discussions on a specific project in Oakland County.

Reducing costs with regulatory flexibility/summary of actions

- Several clarifications were added to MDEQ's SSO policy (Appendix D).
- MDEQ and Oakland County reached agreement on a corrective action program that will protect water quality at a fraction of the originally anticipated costs.

Reducing costs with operational efficiencies

As previously noted, operation and management costs account for about half of water and sewer rates. Therefore, operational costs have a major impact on rates.

While there are more than 50 publicly owned wastewater treatment plants in Southeast Michigan, 80 percent of the wastewater treatment capacity in the region is provided by two facilities – DWSD and the Wayne County-Downriver system. Both of these treatment facilities have recently instituted programs to identify and implement operational improvements that will result in cost efficiencies.

As previously indicated, every effort must be made to reduce costs. Otherwise, proposed increases in revenues will be difficult to justify and support. Clearly, reductions in operational expenses associated with running these larger facilities represents a major opportunity for cutting costs. Major steps have been (are being) taken to reduce operational costs at these large facilities. The Consortium is facilitating a discussion of steps taken and being contemplated. Among other things, successes and failures can be shared with other providers in Southeast Michigan.

Reducing costs with operational efficiencies/summary of actions

DWSD:

Improvements in operational efficiencies have resulted in a total operation and maintenance savings of approximately \$68 million for a variety of actions implemented since 2002. Some of the actions taken to achieve this include:

- Staff reductions,
- Redistribution of staff and work assignments,
- Reduction in overtime,
- Reduction in outsourcing to private contractors,
- Consolidation of maintenance facilities, and
- Establishing and implementing performance measures for all divisions.

Wayne County:

- Wayne County and the customer communities formed a Joint Management Committee (JMC) in 2000. The JMC oversees plant operations and acts on recommendations from various subcommittees (legal, technical, and financial).
- In 2002, Wayne County, in conjunction with the JMC, began the Comprehensive Assessment and Master Plan Project (CAMPP).
- CAMPP identified a potential cost reduction of around 30 percent, based on a review of best of class facilities. Closing this gap represents approximately \$9 million in potential annual savings.
- Currently, implementation of CAMPP recommendations has resulted in annual cost reductions of approximately \$1.5 million. About half of these savings come from staff reductions. (Staffing has been reduced from 133 in 2000 to a currently level of 89, with additional reductions expected by 2008.)

General:

- Information and experience on various performance measures needs to be shared. That will be the basis for discussing the desirability and usefulness of having some shared performance measures.

Reducing costs with best management practices

Sewer collection system best management practices (BMPs) are intended to reduce cost through improvements to system operation and identification of maintenance needs before becoming a critical problem. Implementation of best management practices can benefit both large and small collection systems.

Reducing costs with best management practices/summary of actions

The Consortium is completing a list of recommended BMPs for collection system operators to consider when establishing operation and maintenance programs. Next, a strategy for disseminating the recommended BMPs to collection system operators will be developed and implemented.

Evaluations of alternative water service

There are three studies underway designed to estimate the costs and feasibility of providing water service independent of DWSD. One involves 23 communities or some subset of those communities in Oakland County, Macomb County, and a small section of Wayne County. Another involves communities in northern Oakland County and Genesee County, and the third involves four Grosse Pointes communities. Consortium policies focus on both minimizing cost and using existing infrastructure to the maximum extent possible. Thus, the outcome of these studies has major implications for Southeast Michigan and, therefore, is of critical interest to the Consortium.

Evaluations of alternative water service/summary of action

- Thus far, action has been limited to receiving a presentations on the status of the studies. When sufficient information from the studies is developed, the Infrastructure Team will discuss and summarize the implications on the region.

Agenda for 2005

While progress has been made in several areas, much work remains. This section summarizes the substantive issues on the Consortium's agenda for 2005. Each of these items emanates from the work described earlier in this report.

Establish criteria to guide decisions on Rate of Return: By June 2005, the **Rate Policy Team** will propose policy criteria to use in determining the annual Rate of Return.

Finalize and implement schedule for rollout of FY06-07 rates: The Rate Policy Team will work to revise the schedule of meetings and specific information to be presented. That will be finalized by May 2005 followed by notice to all customer communities.

Finalize template for billing: Recommendations from the DWSD customer community committee will be considered on a billing template that provides a greater degree of disclosure. The Consortium will solicit support from as many service providers as possible for using some form of the template. This will be addressed by the end of summer 2005.

Report on policy rationale for revenue collection at local level: Findings of the DWSD customer community committee will be considered. It will be used to develop a policy basis for revenue collection that reflects true (actual) cost of service. By the end of 2005, the Consortium will consider those policies as well as mechanisms to assure that they are applied by as many service providers as possible.

Elected official summary of charges from the City of Detroit: A brief summary of how these charges are calculated will be prepared and made available to elected officials (and/or will be added to the rates 101 presentation).

Revise procedure for assessing payment for indirect benefits: The team will complete an examination of the merits of different indexing alternatives and a change to the fixed 5 percent increase. This will be done by August 2005.

Seek legislation authorizing use of SRF funds to support project planning: SEMCOG will collaborate with MDEQ in drafting legislative language and seeking support for passage. Language will be developed by February 2005.

Consider policy on unaccounted for water charges: Results of the contractor work should serve as the basis for assessing the appropriateness of changes to estimating and allocating charges for water loss (unaccounted for water). In the mean time, the framework for projections used in FY05-06 should continue.

Pursue legislation that assures fees are a feasible alternative for recovering cost of services: The report on issues arising from the *Bolt* case and possible remedies was completed in February 2005. Informational meetings will be scheduled with legislators.

Assure that demand factor charges reflect true cost of service: The DWSD-sponsored Water Rate Workgroup is working with DWSD to revise the demand factor methodology. The Consortium will seek to assure the changes are consistent with the true cost of service policy. This will be completed prior to developing rates for FY 05-06.

Evaluate feasibility of some shared performance measures: After learning about steps taken to achieve operational efficiencies from more service providers, the merits of some common performance measures will be considered.

Support MDEQ rule change to assure sewer permits are consistent with local plans: Pending feedback from the Michigan Attorney General, proposed language to achieve this goal will be crafted. The Consortium will support MDEQ efforts to revise their rules. Because of the time it takes to adopt administrative rules, this is expected to continue into 2006.

Evaluate the regional impacts of water customers opting for a separate system(s): Preliminary results of studies evaluating the feasibility of alternative water supply systems are being completed. Once enough information is available, the Consortium will assess the regional ramifications of these proposals. This will be ongoing in 2005.

Table 1:
 DWSD Rates Rollout Process for FY06-07
 As of March 22, 2005

| | |
|---|---|
| Preliminary meeting with water customers (late-May) | Explanation of the methodology that will be used to establish demand factors, as developed by the DWSD customer work group. |
| Meeting #1 (early-October) | Preliminary Prior Year Actuals |
| | Presentation of FY 2006-2007 CIP, with detailed project descriptions |
| | Preliminary units of service data – (water peaking factors, sewer flows, etc.) <ul style="list-style-type: none"> - Flow analysis and projections - Preliminary water peaking factors - Sewer flows from GDRSS, etc. - Unaccounted for water update |
| | Preliminary O&M budget forecasts <ul style="list-style-type: none"> - Director’s expectations of projected O&M expenses, including factors expected to affect rates and rationale for those expectations |
| | Preliminary operating and capital financing plans & revenue requirement levels, including: <ul style="list-style-type: none"> - Anticipated debt service coverage for coming rate cycle and supporting rationale - Information on direct and indirect charges from the City of Detroit - “System” rate increases |
| Meeting #2 (mid-November) | Preliminary prior year actuals <ul style="list-style-type: none"> - Comparison of actual and projected O&M expenses for previous periods |
| | Preliminary cost allocations to customer communities & supporting key elements, including (for water) <ul style="list-style-type: none"> - Projected depreciation expense, supporting rationale, and impact on rates - Discussion of the policies/criteria used to develop proposed rate of return |
| | Preliminary “system” look-back adjustment – sewer |
| | Customer comments on preliminary units of service & revenue requirements (including flow volumes, peaking factors, CIPs, O&M budgets, overall revenue requirement levels) |

| | |
|------------------------------------|--|
| Meeting #3 (early/mid-December) | “Final” prior year actuals - with comparisons |
| | Final operating budget, CIP, & financing plan "final" operating budget for purposes of rate design – modifications may be made during continuing internal review |
| | Final peaking factor calculations – incorporating any customer information. |
| | Recommended water and sewer rates to customer communities |
| | Recommended look-back adjustments to customer communities |
| Meeting #4 (early-January) | Presentation of rate proposals to technical and administrative leaders of customer communities |
| Late January | BOWC public hearing |
| Mid-February | City Council public hearing |
| March 1 st | Rates approved |

Table 2:
Draft Illustrative
Water and Sewer Bill

| | Fixed Service Charges | Usage Charges | | | Total Charge | Percent Of Total |
|------------------------|-----------------------|------------------|--------------------------|-----------------|------------------|------------------|
| | | Thousand Gallons | Cost Per Thousand Gallon | Amount | | |
| Water | | | | | | |
| Water Supplier | | 18 | \$ 0.93 | \$ 16.74 | \$ 16.74 | 34% |
| Wholesale Delivery | \$ 3.75 | 18 | \$ 0.35 | 6.30 | 10.05 | 21% |
| Retail Delivery | 10.50 | 18 | \$ 0.63 | 11.34 | 21.84 | 45% |
| Total | \$ 14.25 | 18 | \$ 1.91 | \$ 34.38 | \$ 48.63 | |
| Sewer | | | | | | |
| Treatment & Disposal | | 18 | \$ 1.13 | \$ 20.34 | \$ 20.34 | 39% |
| Wholesale Collection | \$ 4.24 | 18 | 0.42 | 7.56 | 11.80 | 23% |
| Retail Collection | 6.00 | 18 | 0.74 | 13.32 | 19.32 | 38% |
| Total | \$ 10.24 | 18 | | \$ 41.22 | \$ 51.46 | |
| Pay this amount | | | | | \$ 100.09 | |

| Gallons used during this billing period | Gallons used during previous billing period | Gallons used during this billing period last year |
|---|---|---|
| 18,000 | 16,560 | 18,920 |

Water Quality Tip: Use fertilizer low in phosphorus, select a slow release fertilizer where at least half of the nitrogen is water soluble. Keep fertilizer away from lakes, streams, and storm drains. Sweep excess fertilizer back onto your lawn. **Always follow the application directions on the label.**

Note to Water Quality Consortium

Purpose: Water and sewer bills represent an opportunity to achieve a certain level of disclosure. In this example, the recipient receives information on how much of the bill is for water, how much is for sewer, how much is for local service, and how much is for regional service. Also shown is water used in a commonly understood unit (gallons), along with a comparison of usage to the previous billing period and the same billing period in an earlier year.

Source: SEMCOG