



600 NE Grand Ave.  
Portland, OR 97232-2736

## Council work session agenda

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Tuesday, December 14, 2021

2:00 PM

<https://us06web.zoom.us/j/86003416363>

(Webinar ID: 86003416363) or

669-900-6833

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### Best Practices in Public Utilities - Expert Panel & Discussion

Please note: To limit the spread of COVID-19, Metro Regional Center is now closed to the public.

This meeting will be held electronically. You can join the meeting on your computer or other device by using this link: <https://us06web.zoom.us/j/86003416363> (Webinar ID: 86003416363) or 877-853-5257 (toll free)

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**1. Introductions**

**2. Presentation**

Overview of Public Utility Fee Setting Process

[21-5637](#)

Attachments: [Fee Setting Principles](#)  
[Glossary](#)

**3. Panelist Discussion**

**4. Council Q/A**

**5. Wrap-Up and Next Steps**

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ការគោរពសិទ្ធិពលរដ្ឋរបស់ ។ សំរាប់ព័ត៌មានអំពីកម្មវិធីសិទ្ធិពលរដ្ឋរបស់ Metro ឬដើម្បីទទួលបានកម្មប័ណ្ណរើសអើងសូមចូលទស្សនាគេហទំព័រ [www.oregonmetro.gov/civilrights](http://www.oregonmetro.gov/civilrights)។  
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# UTILITY FEE SETTING

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## I.A. OVERVIEW

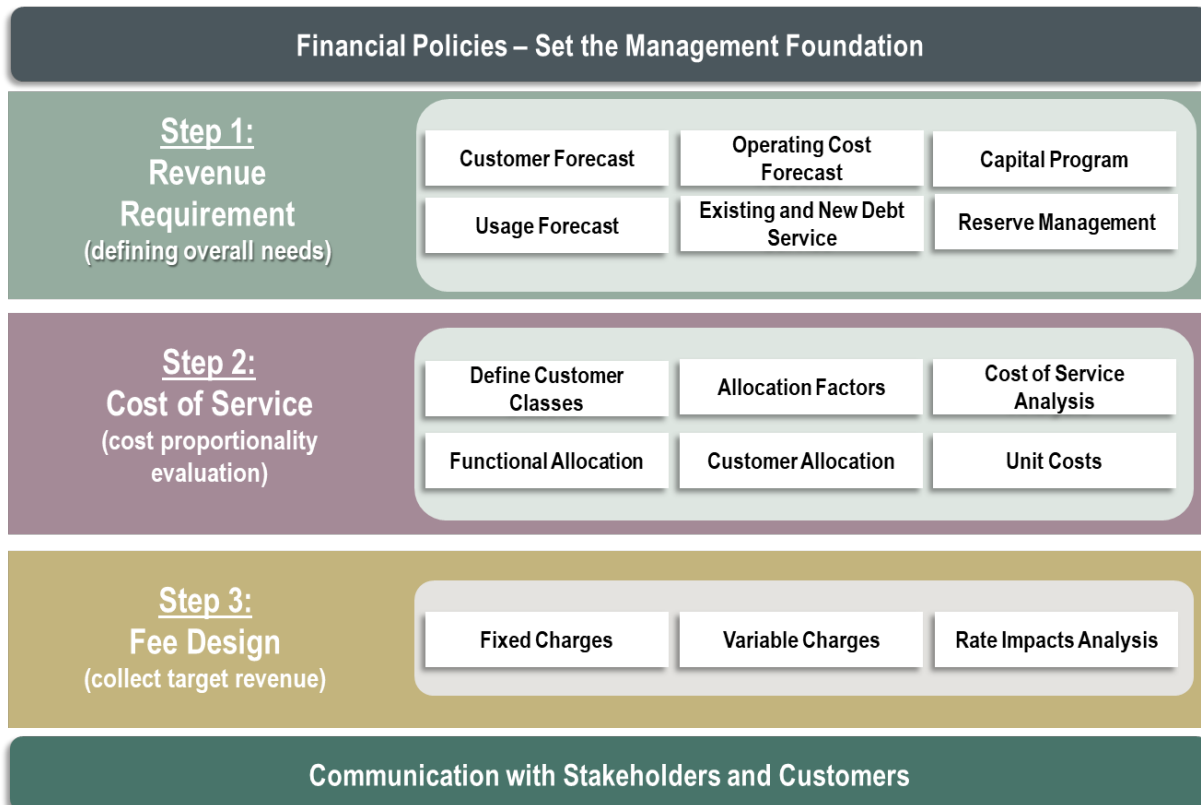
The methods used to establish utility fees are based on principles that are generally accepted and widely followed throughout the industry. These principles are designed to produce fees that recover the costs of the utility by setting the appropriate level of revenue to be collected from fee payers and utilizing the established fee structure to collect those revenues.

The rate study process generally used by public utilities is comprised of three key analyses:

- **Revenue Requirement.** This analysis identifies the total revenue requirement to fully fund the utility on a standalone basis, considering operating and maintenance expenditures, capital funding needs, and fiscal policy objectives.
- **Cost of Service.** This analysis distributes costs to customer classes based on their proportional demands on and use of the system.
- **Fee Design.** This analysis includes the development of a fee restructure that generates sufficient revenue to meet each system's revenue requirement forecast, and to address the utility's pricing objectives.

**Exhibit 1.1** illustrates the entire rate study process.

**Exhibit 1.1**  
**Overview of Fee Study Process**



## I.B. FINANCIAL POLICIES

The basic framework for evaluating utility revenue needs is founded on a set of financial policies. These policies, which can address a variety of topics including cash management, capital funding strategy, financial performance, and cost proportionality, are intended to promote long-term financial viability and achieve other goals for the utility.

### I.B.1. Utility Reserves

Reserves are a key component of any utility financial strategy, as they provide the flexibility to manage variations in costs and revenues that could otherwise have an adverse impact on customers. Financial reserves can be designed to manage month-to-month variation in cash flow, mitigate financial disruptions resulting from unanticipated events (e.g., natural disaster), and as a tool to smooth annual adjustments to fees. The amount and uses of financial reserves can vary by utility and may account for the unique cost and debt obligations, customer usage patterns, climate, and other factors specific to each utility.

Reserves should fluctuate above and below targets, and such experience does not reflect on the quality of budgeting or management. In fact, if a reserve remains static for extended periods of time without use, this may indicate that it is not set appropriately, or is unnecessary. Utility reserves are intended to absorb fluctuation in revenues or expenditures without abrupt fee impacts. As reserve levels vary, a policy structure can define the mechanisms for regulating those levels and returning them to intended targets.

### I.B.2. Debt Management

Debt issuance is a valuable tool for a utility to finance certain costs, as it allows an agency to spread a relatively large capital project cost over several years. Debt repayment structures can be quite flexible (e.g. deferred principal repayment), allowing a utility to “shape” its cost structure and facilitate a stable progression of moderate fee adjustments. When developing its capital funding strategy, utilities must weigh the pros and cons of issuing debt to pay for a project. Too much debt issuance may limit the ability to manage fees. However, excessive aversion to issuing debt can also create problems, shifting the burden of funding capital investment to existing customers. It is prudent to consider policies related to debt management as part of a broader utility financial policy structure. Common debt management policies may include the level of acceptable outstanding debt, debt repayment terms, bond coverage and total debt coverage targets.

## I.C. REVENUE REQUIREMENT

A revenue requirement analysis forms the basis for a long-range financial plan and multi-year fee management strategy for a utility. A revenue requirement enables a utility to set fee increases which fully recover the total cost of operating the utility: capital improvement and replacement, operations, maintenance, administration, fiscal policy attainment, cash reserve management, and debt repayment. Linking fee levels to a financial plan such as this helps to enable not only sound financial performance, but also establishes a clear and defensible relationship between the fees imposed on utility customers and the costs incurred to provide the service.

A revenue requirement analysis establishes the total annual financial obligations of the utility by bringing together the following core elements:

- **Fiscal Policy Analysis.** Identifies formal and informal fiscal policies to ensure that current policies are maintained, including reserve levels and debt service coverage.
- **Capital Funding Plan.** Defines a strategy for funding the capital improvement program, including an analysis of available resources from fee revenues, debt financing, and any special resources that may be readily available (e.g., grants, outside contributions, etc.).
- **Operating Forecast.** Identifies future annual non-capital costs associated with the operation, maintenance, and administration of the system.
- **Sufficiency Testing.** Evaluates the sufficiency of revenues in meeting all financial obligations, including any coverage requirements associated with long-term debt.
- **Strategy Development.** Designs a forward-looking strategy for adjusting fees to fully fund all financial obligations on a periodic or annual basis over the planning period.

## I.D. COST-OF-SERVICE ANALYSIS (COSA)

The purpose of a cost-of-service analysis is to provide a rational basis for distributing the full costs of each utility service to each class of customers in proportion to the demands they place on the system. Detailed cost allocations, along with appropriate customer class designations, help to sharpen the degree of alignment that can be achieved in the resulting fee structure design. The key analytical steps of the cost-of-service analysis are as follows:

- **Customer Class Designation.** Identifies the customer classes that will be evaluated as part of the study. Existing as well as new or revised customer classes or class definitions may be considered. It is appropriate to group customers that exhibit similar usage characteristics and service requirements. Customer classes can be unique to a type of utility (e.g., solid waste, water, natural gas) as well as utility services (e.g., retail, wholesale)
- **Functional Cost Allocation.** Apportions the annual revenue requirement (e.g., operating expenses, annual debt service, use/funding of financial reserves) to the major functions of the service.
- **Cost Classification.** Establishes a rational relationship between functions (activities) and costs. For example, the cost of disposing waste at an area landfill is determined by the tonnage sent to the landfill. An allocation of these disposal costs to a particular customer class would be based on the tons generated by that customer class. Customer and operational statistics are developed to allocate the cost of service to customers classes.
- **Cost Allocation.** Allocates the costs from the functional cost allocation to different customer classes based on their unique demands for each service as defined through the cost classification process. The results identify shifts in cost recovery by customer class from that experienced under the existing rate structure.

## I.E. FEE DESIGN

### I.E.1. Overview

Fee design is the third and final technical step in utility fee setting. The first two technical steps (identifying the total rate revenue needs and determining the proportional distribution of those revenue needs to the utility's customer classes of service) provide the revenue targets for fee design. The principal objective of fee design is to implement fee structures that collect the appropriate level

of revenue and that are reasonably aligned with cost of service. In addition to this objective, utilities also consider other objectives in the fee design step including revenue stability, conservation, transparency, simplicity, and efficiency.

No one fee structure will work well for every utility nor will one fee structure work equally well for all customer classes within a single utility. Assessing fixed fees to utility customers can provide a stable and sustainable revenue source to support utility services. Usage (variable) fees can be aligned to the utility's costs that change in response to higher or lower demands by customers. Variable fees can help promote cost proportionality between customers and are used by utilities to promote conservation — customers can lower their monthly bill by reducing usage. Because utilities oftentimes use fee design as a pricing signal to their customers, it is critical that fees are understandable and transparent to customers and stakeholders.

## I.F. COMMUNICATION WITH STAKEHOLDERS AND CUSTOMERS

The utility fee setting process relies on an open and involved process for informing and educating stakeholders and customers. Utilities need to clearly define the cost basis for proposed fees imposed on customers by linking the financial requirements to costs. Workshops with elected officials provide a forum to present preliminary fee recommendations and gain feedback. Some public agencies leverage utility advisory committees to discuss, review, and vet fee recommendations. Proposed fees and fee adjustments can be communicated to customers using billing flyers, open houses, bill calculators, and social media. Customer outreach can also include information related to utility bill assistance, links to formal utility fee studies, and scheduled public hearings.

# GLOSSARY

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Primary sources include:

- » Metro Fee Schedules
- » Principles of Public Utility Rates. Bonbright, Danielson and Kamerschen.
- » Principles of Water Rates, Fees, and Charges, Sixth Edition. American Water Works Association.
- » Solid Waste Association of North America
- » Solid Waste Rate Setting and Financing Guide published by the American Public Works Association.

Term	Definition
Bond Covenants	Terms of obligation incurred as conditions of the issuance of bonds.
Bonded Debt	Indebtedness represented by outstanding bonds.
Capital Expenditures	Expenditures that result in the acquisition, construction and/or addition of fixed assets.
Capital Improvement Program	A multiyear plan for capital expenditure spending to meet the regulatory, renewal, replacements, and expansion needs of a utility. It sets forth each project or other contemplated expenditure in which the utility is to have a part and specifies the full resources estimated to be available to finance the projected expenditures.
Cash Basis	The basis of accounting under which revenues are recorded when cash is received, and expenditures are recorded when cash is disbursed.
Community Enhancement Fee	Fee collected by Metro on every ton of garbage at all public and private disposal sites in greater Portland. Pays for grants to enhance the communities that host and are directly impacted by transfer stations.
Cost Allocation	The procedure for classifying or assigning the annual costs of service to appropriate cost components for subsequent distribution to respective customer classes.
Cost-of-Service Analysis (COSA)	The process of determining the cost of providing utility service to each of the defined customer classifications. This analysis distributes the utility's revenue requirements by functional and customer allocations based on the annual usage, demand, and customer-related costs for which each class of service is responsible.
Customer Classification	The grouping of customers into homogeneous groups or classes. Typically, utility customers may be classified as residential, commercial, and industrial for rate making and other purposes. For specific utilities, there may be a breakdown of these general classes into more specific groups. For example, residential solid waste customers may be further itemized by collection service (e.g., recycling, yard waste, and refuse).
Debt Service	The amounts of money necessary to pay interest and principal requirements for a given series of years.
Debt Service Coverage Ratio	A financial metric associated with bonded indebtedness reflecting the ratio of the actual or projected net revenue available for debt service to annual debt-service payments. Net revenue is generally defined as total recurring operating revenue less recurring operation and maintenance expense. Debt service coverage is generally expressed as a percentage of current-year debt service, and is a requirement included in the bond indentures associated with revenue bonds.
Direct Cost	Those types of costs, which can be obviously and directly associated with a particular type of utility service (e.g., solid waste driver wages, disposal costs).
Enterprise Fund	Mechanisms used by local governments for activities that can be financed and operated like private business. An enterprise fund is a common mechanism for the financial management of public utilities.
Full Cost Accounting	How goods and services should be priced to reflect their true costs, which may include environmental and social costs.

GASB	The Governmental Accounting Standards Board, an independent body responsible for setting accounting standards.
General Fund	Mechanism used by local governments to account for all financial resources except those required to be accounted for in another fund.
Indirect Costs	Those types of costs that are shared among different types of operations and are not as readily linked to a particular type of service (e.g., building rent, agency overhead, management salaries).
Minimum Fee	Fixed charge assessed to customers that deliver up to 360 pounds of municipal solid waste at Metro transfer stations.
Non-Operating Revenues	Includes revenue not usually directly related to the provision of utility service; may include tax revenues, gains or losses from the sale of property, rental of nonoperating property, interest income, and other items.
Operating Revenues	Generally, includes the sales of utility service to general customers and other services directly related to the provision of utility service; revenue from sales that are usually provided under standard fee schedules or by contractual arrangements.
Price Elasticity of Demand	Measures the responsiveness of use to price changes; measures the sensitivity of utility service use relative to changes in the price of the service, after controlling for the influence of other factors that can also alter demand, such as income and weather.
Fee Design	The process of developing a fee restructure that generates sufficient revenue to meet each system's revenue requirement forecast and addresses the agency's pricing objectives. The types and priority of pricing objectives vary by utility and can include (among other objectives) cost-based fees, revenue sufficiency, predictability, efficient use of utility services, understandability, and feasibility.
Fee-Making Process	The process of developing and establishing utility fees. The process is comprised of four phases: (1) determination of revenue requirements; (2) allocation of revenue requirements to appropriate cost components; (3) distribution of the costs of service for each cost component to customer classes; and (4) development and design of a schedule of fees applicable to each class that recovers the allocated cost of service. This fee-making process is generally used throughout the industry although specific steps may vary based on the type of utility as well as local and state regulatory processes governing utility fees.
Organics	Solid wastes containing carbon compounds that are capable of being biologically degraded, including paper, food residuals, wood wastes, yard debris and plant wastes but not metals and glass or plastic.
Regional System Fee	Fee collected by Metro on every ton of garbage at all public and private disposal sites in greater Portland. The fee pays for education programs and garbage cleanup on public lands.
Revenue Bond	A bond payable solely from net or gross nontax revenues derived from tolls, charges, or rents paid by users of the facility constructed with the proceeds of the bond issue.
Revenue Requirements	The total annual operation and maintenance expense and capital-related costs incurred in meeting various aspects of providing utility service. Cash-needs revenue requirements include operation and maintenance expenses, debt-service costs, cash-financed capital improvements, reserve fund requirements, taxes, and consideration of debt-service coverage requirements. Utility-basis revenue requirements include operation and maintenance expenses, depreciation expense, taxes, and return on rate base.
Solid Waste	Any garbage, refuse, sludge, and other discarded material, including solid, liquid, semisolid, or contained gaseous material, resulting from residential habitation; industrial, commercial, mining, and agricultural operations; and community activities. This definition may vary under diverse local, state, provincial and national laws. Municipal solid waste is solid waste other than hazardous wastes comprised of commercial, household, and institutional wastes.
Transfer Station	Facility that receives and consolidates solid waste or recyclable materials from municipal or commercial collection trucks and self-haulers' vehicles and loads the solid waste onto tractor trailers, railcars or barges for long-haul transport to a distant disposal facility.
Test Year	The annualized period for which costs are to be analyzed and fees established. A cost-of-service analysis is often performed on a test year of the revenue requirement.
Tonnage Fee	Disposal fee collected by Metro on garbage received at Metro-owned transfer stations. The charge covers the cost of moving materials from transfer stations to recycling and composting facilities, or to landfills.



Unit Cost	The cost of producing a unit of a product or service. An example would be the cost of receiving, consolidating, transporting, and disposing of a ton of municipal solid waste.
User Fees	The monthly, bimonthly, quarterly, or unit fees made to the users of service through the general fee structures of the utility for the utility's share of the cost of providing service. Typically, these fees can include both a fixed component and a variable or volume-based fee applied to use.
Wholesale Service Customers	Service in which utility service is sold to a customer at one or more major points of delivery for resale within the wholesale customer's service area.
Working Capital	Cash, materials, supplies, and other similar current assets necessary in the operation of the enterprise. It is usually measured by the excess of current assets over the current liabilities, or sometimes as a percentage of annual operation and maintenance expense levels.