Seattle Public Utilities and
Section 4 of the Association of Sewer and Water Districts

Capacity Charge Allocation Recommendations Final Report
June 25, 2013

In 2009, The King County Regional Water Quality Committee (RWQC) created the Financial Policy Work Group (FPWG) in 2009 for the purpose of reviewing the King County Wastewater Treatment Division's financial policies. A major focus of this effort was to examine "whether the requirement that new customers pay certain new and existing treatment costs achieves the principle that “growth pays for growth”.

During the effort, work group members identified significant differences of opinion about certain cost allocations. As a result, two papers were prepared. This paper represents the analysis and recommendations of two work group members: Seattle Public Utilities (SPU) and Section 4 of the Association of Sewer and Water Districts (Districts) on three issues related to the capacity charge. Seattle and the Sewer and Water Districts represent 65% of the customer base for King County Wastewater Treatment Division.

The other five work group members (King County Executive, King County Council staff, City of Bellevue, Suburban Cities Association (now Sound Cities Association, and two members of the Metropolitan Water Pollution Abatement Advisory Committee) do not agree with all statements presented in this paper. The opinions and recommendations of those five work group members are in a separate report.

<u>Background</u>

At the outset of the FPWG meetings that began in late 2009, the City of Seattle and Sewer Districts were of the opinion that the capacity charge should be substantially higher to accurately reflect the growth-pays-for-growth policies in the Regional Wastewater Services Plan (RWSP). SPU analysis indicates that the charge should be $90 per month (in 2008 dollars) based on King County estimates. Seattle had previously identified over fifteen different allocation procedures that appeared to conflict with the growth-pays-for-growth policies.

The FPWG discussions focused on just seven of the original set of questioned procedures. A few of the others were partially settled, some others were deferred since their impacts were relatively small, and others were combined into the seven issues further discussed by the

FPWG. The seven remaining issues, in combination, were still sufficient to produce a substantial increase in the capacity charge above its current level.

Recommendations

Seattle and the Districts recommend that three primary issues be the focus of discussion at this time. In doing so, Seattle and the Districts believe that the capacity change can more accurately reflect growth-pay-for-growth policies while acknowledging the discomfort of having a much higher capacity charge,. The four issues being set aside for now include: i) allocation of existing excess capacity used by new customers to defer other facility investments for them, ii) shared allocation of facilities not otherwise explicitly defined, as called for by FP-15, iii) inclusion of certain facilities with excess capacity not currently allocated to new customers, and iv) formalized procedures to ensure future capacity charge calculation consistent with current intent. All of these issues are presented in detail in Attachment A to this report.

In the spirit of trying to move forward, Seattle and the districts are making alternative recommendations on specific allocation procedures for the following three categories of costs:

a) costs of excess capacity of existing infrastructure (Issue #2 cited in the FPWG report),
b) new RWSP shared conveyance project cost shares (Issue #7 cited in the FPWG report), and
c) 2003-30 debt service on pre-2003 RWSP project expenditures (Issue #5 cited in the FPWG report).

Based on these three issues, and King County estimates of capacity charge impacts, the recommendations in this report would increase the capacity charge by $15 (in 2008 dollars) instead of the $45 increase (in 2008 dollars) that was estimated to be associated with the full original set of issues discussed.

The recommendations by Seattle and the Districts on the first two issues listed above are based on the same concept: existing and new customers should pay for facilities in proportion to their use. This recommendation is consistent with policy direction of the RWSP. The cost shares that result from these recommendations are more proportionate to the shares of facilities' capacities that will be needed for new and existing customers' projected wastewater flows in 2030 ("flow shares").

a) **<u>Issue 2: Costs of excess capacity of existing infrastructure</u>**: For excess capacity in existing infrastructure (completed before 2003), SPU and the Districts are of the opinion that all capacity above existing customers' use is excess. A corresponding share of 2003-30 costs should be allocated to new customers, whether or not the excess capacity is used by 2030. The current method allocates a share of costs associated with infrastructure built before 2003 to new customers based on the projection of new customers' 2030 flow. All responsibility for excess capacity after 2030 is assigned to existing customers. In addition, existing customers have already paid past debt service which is over 90% of the total cost.

SPU's analysis shows that the current method undervalues the portion that should be allocated to new customers as compared to their share of flows through those facilities. The excess capacity was designed and built to accommodate growth regardless of when or if it materializes. Basing the allocation only on new customer projected flows in 2030 results in a significant amount of the cost of excess capacity that was intended for new customers to be allocated to existing customers.

In contrast, the result of the recommendation by Seattle and the Districts is to allocate costs between existing and 2003-30 new customers in proportion to their flow shares, as shown in Table 1.

Table 1
Allocation of Costs of <u>Existing Excess Capacity</u>:
Cost Shares of Current Approach versus Seattle and the Districts Recommended Approach

Current Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**59%**	**11%**	**41%**
Cost Allocation Share	**95%**	**3%**	**5%**
Cost Allocation in $m	$1,313	$43	$74
Seattle and the Districts Recommended Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**59%**	**11%**	**41%**
Cost Allocation Share	**83%**	**15%**	**17%**
Cost Allocation in $m	$1,153	$203	$234
Difference in $m	**($ 160)**	**($160)**	**($ 160)**

b) **<u>Issue 7. New RWSP shared conveyance project cost shares</u>**: Similarly, SPU and the Districts are of the opinion that the cost shares for new conveyance facilities that will serve both new and existing customers should be proportional to flow shares for the total cost of the project. That means 2003-30 allocations to existing customers reflecting their flow share and to new customers reflecting the difference between each facility's total capacity and existing customers' flow share.

In addition, the post 2030 cost of those facilities will be borne disproportionately by existing customers because RCW and contract requirements limit cost recovery options for that period. Taking this into account, the result of the recommendation by Seattle and the Districts is again to allocate total projected costs between existing and 2003-30 new customers in proportion to their flow shares, as shown both in Table 2 and in Figure 1b.

Table 2
Allocation of Costs of <u>New RWSP Conveyance</u>:
Cost Shares of Current Approach versus Seattle and the Districts Recommended Approach

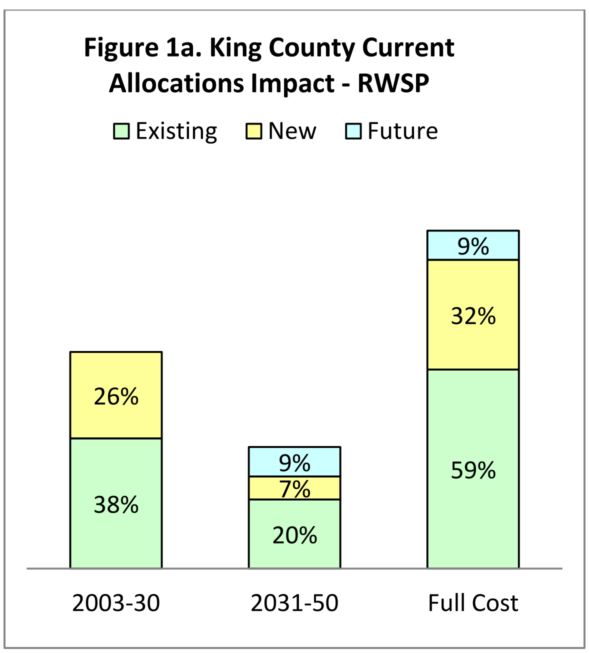
Current Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**36%**	**37%**	**64%**
Cost Allocation Share	**59%**	**32%**	**41%**
Cost Allocation in $m	$408	$224	$285
Seattle and the Districts Recommended Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**36%**	**37%**	**64%**
Cost Allocation Share	**44%**	**47%**	**56%**
Cost Allocation in $m	$306	$326	$387
Difference in $m	**($ 102)**	**($102)**	**($ 102)**

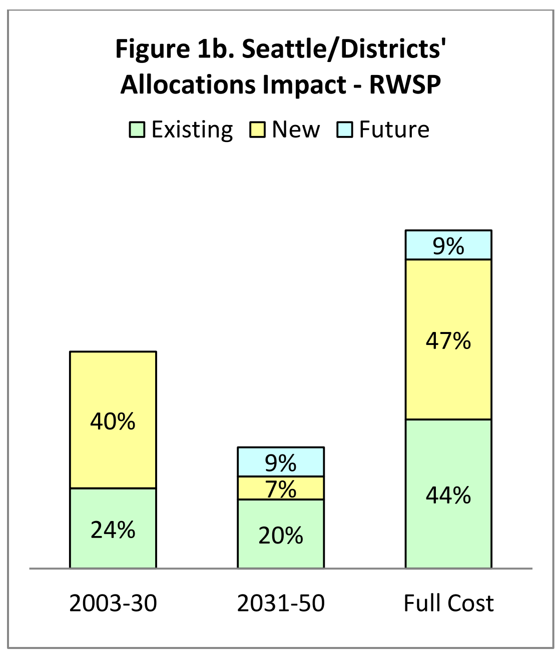
Tables 1 and 2 show the existing and new customers' flow shares in the facilities covered by Issues 2 and 7, along with the change in the allocated cost shares in moving from the current allocation approach to the one recommended by Seattle and the Districts. Both highlight how the proposed adjustments in these recommendations more closely align the allocation of costs with flow shares. The increase in capacity charge resulting from the recommended alternative approaches on these two issues would be about $11 in 2008 dollars, based on King County estimates. The total cost shift involved would be over $260 million.

The flow shares, facilities list and cost projection information used in these tables was developed as part of the 2008 wastewater rate process and provided by King County. The summary calculations presented in the tables were also reviewed by King County staff.

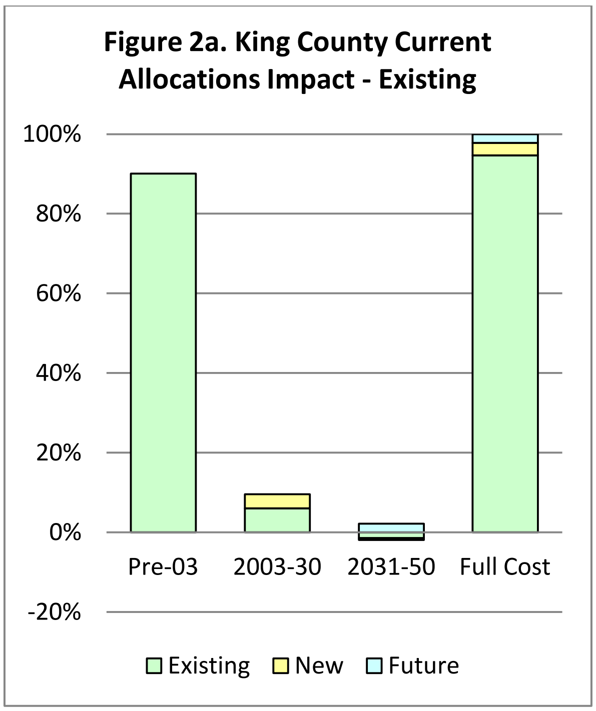
Graphic comparisons provide another perspective on these issues. Comparisons of the current approach and the approach recommended by Seattle and the Districts for existing excess capacity (Issue 2) and for new RWSP conveyance projects (Issue 7) are also illustrated in the figures below.

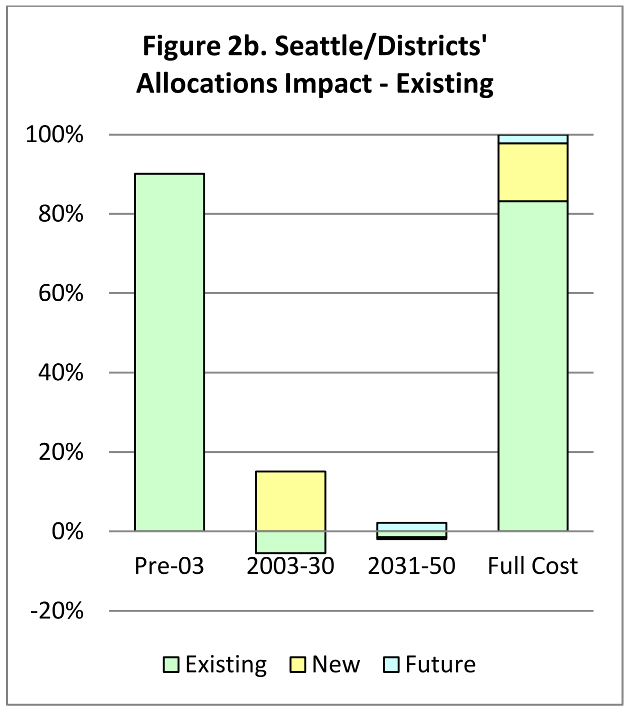
Figures 1a and 1b show how much of the substantial post-2030 debt service on new conveyance projects will be allocated to existing customers, given the provisions of existing statutes and contracts. This influences the full cost shares for RWSP conveyance projects that will ultimately be borne by existing versus new customers. For Seattle and the Districts' recommendation, Figure 1b shows that new customers will pay slightly more than existing customers (44% existing versus 47% new), which is almost proportional to the two groups' projected flow shares of these facilities (36% existing versus 37% new), as shown in Table 2. Seattle and the Districts are of the opinion that this would address a major cost imbalance in the current procedure, as shown in Figure 1a.





Figures 2a and 2b show how much of the past debt service on pre-2003 facilities has already been allocated to existing customers. The excess capacity allocation to new customers in the 2003-30 period is the procedure by which those customers can be charged for their proportionate share of facility use. For Seattle and the Districts' recommendation, Figure 2b shows that existing customers will still pay significantly more than new customers (83% existing versus 15% new), but these shares are proportional to the two groups' projected flow shares of these facilities (59% existing versus 11% new), as shown in Table 1. Seattle and the Districts are of the opinion that this would again address a major cost imbalance in the current procedure, which is shown in Figure 2a.

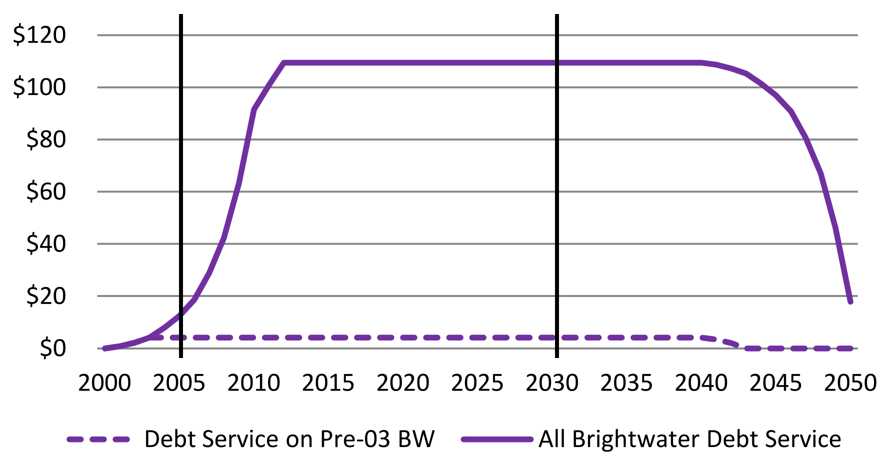




c) **<u>Issue 5: 2003-30 debt service on pre-2003 RWSP project expenditures</u>**. The third issue for which Seattle and the Districts have an alternative recommendation is related to paying 2003-30 debt service on pre-2003 expenditures on RWSP facilities for new customers, largely Brightwater. Seattle and the Districts understand that until 2000 the law did not allow the capacity charge to be high enough to recover full costs for new customers, and that once the law did change, it was too late to include those pre-2003 debt service costs in the capacity charge before 2003. However, RWSP policy documents starting in 1998 consistently stated that these costs were intended to be paid by new customers. Further, because the 2003-30 rates are set to recover debt service related to both pre-and post-2003 RWSP expenditures, SPU and the Districts are of the opinion that this debt service can and should be allocated to new customers to the extent they are associated with projects for new customers. Seattle and the Districts recommend that the 2003-30 debt service expense for these facilities should be allocated to new customers in the same proportion as the debt service on post-2003 expenditures associated with those same projects.

Figure 3 shows the schedule of debt service on Brightwater construction, with the portion below the dotted line reflecting the portion associated with pre-2003 spending. This figure illustrates that some debt service expense on this new customer facility was incurred and allocated to existing customers prior to the 2003-30 rate period, and a large share will be incurred and shared by existing customers after the rate period. However, only the debt service that occurs during the period 2003-30 is included in the capacity charge calculation, and SPU and the Districts are of the opinion that all of it should be allocated consistently.

Figure 3. Schedule for Brightwater Debt Service, 2000-2050



The increase in capacity charge resulting from the alternative approach recommended by Seattle and the Districts on this issue is about $4 in 2008 dollars, according to King County estimates.

In addition to cost allocations, the other FPWG report addresses the possibility of extending the capacity charge calculation period by ten years to 2040. Seattle and the Districts identified several important data issues that would need to be explored before such a proposal could be considered, and also examined the probable implications of a change which include a likely shift of costs from new to existing customers.

Based on these considerations and preliminary calculations, Seattle and the Districts strongly recommend against extending the rate calculation period, but remain willing to participate in further exploration of this and other ideas for addressing transition from the current RWSP rate period (2003-2030) to its eventual successor period (post 2030).

Conclusion

The alternative recommendations on the seven issues discussed at the FPWG and the other issues raised previously but not resolved related to implementing growth-pays-for-growth policies, reflect a significant potential impact to the capacity charge. By focusing on the three primary cost allocation recommendations in this report, the capacity charge would increase by $15 in 2008 dollars, but would distribute costs in better proportion to flow shares for both existing and new customers. This magnitude of increase also reflects consideration for rate stability and housing affordability.

Further, since the difference of opinion on these allocation procedures arises in part due to ambiguity in FP-15, Seattle and the Districts are also recommending that RWSP FP-15 be revised to eliminate the ambiguity that results in different procedural interpretations.

Finally, regarding the issue of extending the capacity charge allocation period beyond 2030, the set of questions identified in this report should be carefully analyzed and resolved before considering whether or not an extension should be made. Therefore, Seattle and the Districts strongly recommend against extending the rate calculation period at this time.

Attachment A
City of Seattle and the Districts Recommendations on FPWG Issues

Background

At the outset of the meetings that began in late 2009, the City of Seattle and the Sewer Districts (Seattle and the Districts) were of the opinion that the capacity charge should be substantially higher to accurately reflect the growth-pays-for-growth policies in the Regional Wastewater Services Plan (RWSP) and in Financial Policy 15 (FP-15). SPU analysis indicates that the charge should be $90 per month (in 2008 dollars) based on King County estimates. Seattle had previously identified over fifteen different allocation procedures that appeared to conflict to varying degrees with those policies.

FPWG discussions focused on seven of the original set of questioned procedures. A few of the others were combined into overarching issues; some were at least partially resolved; and some others were deferred for later consideration. Several of the more significant additional issues are noted at the end of this section.

The seven issues, as numbered in FPWG discussions, are:

1. formalized procedures to ensure future capacity charge calculation consistent with current intent,
2. costs of excess capacity of existing infrastructure,
3. shared allocation of costs of facilities not explicitly addressed by FP-15,
4. costs of existing excess capacity used by new customers to defer other facility investments for new customers,
5. debt service incurred during the 2003-30 rate calculation period on pre-2003 expenditures for RWSP projects,
6. inclusion of certain facilities with excess capacity not currently allocated to new customers, and
7. new RWSP shared conveyance project cost shares.

Basis for Recommendations

Seattle and the Districts recommend that three primary issues be the focus of discussion at this time. In doing so, Seattle and the Districts believe that the capacity change can more accurately reflect growth-pay-for-growth policies while acknowledging the discomfort of having a much higher capacity charge. This leaves four secondary issues and the other issues noted above to discuss at a later time.

The three primary issues are numbers 2, 5 and 7 from the FPWG list above:

- costs of excess capacity of existing infrastructure (issue #2)
- debt service incurred during the 2003-30 rate calculation period on pre-2003 expenditures for RWSP projects (issue #5), and
- new RWSP shared conveyance project cost shares (issue #7).

The four secondary issues are numbers 1, 3, 4 and 6 from the FPWG discussion list above:

- formalized procedures to ensure future capacity charge calculation consistent with current intent (issue #1),
- shared allocation of costs of facilities not explicitly addressed by FP-15 (issue #3)
- costs of existing excess capacity used by new customers to defer other facility investments for new customers (issue #4),
- inclusion of certain facilities with excess capacity not currently allocated to new customers (issue #6).

Adoption of the Seattle and the Districts recommendations on the three primary issues, based on the King County estimates of capacity charge impacts for these issues, would increase the capacity charge by about $15 in 2008 dollars above its current level.

City of Seattle and the Districts' Recommendations on Three Primary Issues

The recommendations by Seattle and the Districts on the issues listed above are based on the growth-pays-for-growth policy, reflecting the concept that existing and new customers should pay for facilities in proportion to the shares of the facilities' flow or capacity they will require ("flow shares").

Issue 2. Allocation of the cost of excess capacity in facilities completed prior to 2003

Seattle and the Districts recommend that all capacity above existing customers' use is excess and a corresponding share of 2003-30 costs should be allocated to new customers, whether or not it is projected to be used by 2030. The current method allocates a share of costs associated with excess capacity to new customers based on the County's projection of new customers' 2030 flow. That method undervalues the portion that should be allocated to new customers because the excess capacity was designed and built to accommodate growth regardless of when it is projected to materialize. Basing the allocation only on new customer projected flows in 2030 results, therefore, in a significant amount of the cost of excess capacity that was intended for new customers being allocated to existing customers.

The result of the recommendation by Seattle and the Districts' is to allocate costs between existing and 2003-30 new customers in proportion to their flow shares. Any excess capacity that may never be utilized is effectively split proportionately between these customer groups if allocation shares are assigned as Seattle and the Districts recommend they should be.

Table 1 shows the difference in cost allocations between the current approach and the alternative approach recommended by Seattle and the Districts for existing excess capacity. It also shows the existing and new customers' respective flow shares in these facilities, along with the change in the allocated cost shares in moving from the current approach to the one recommended by Seattle and the Districts.

Table 1 Allocation of Costs of <u>Existing Excess Capacity</u>: Cost Shares of Current Approach versus Seattle and the Districts Recommended Approach			
Current Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**59%**	**11%**	**41%**
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Cost Allocation in $m	$1,313	$43	$74
Seattle and the Districts Recommended Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
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Cost Allocation Share	**83%**	**15%**	**17%**
Cost Allocation in $m	$1,153	$203	$234
Difference in $m	**($ 160)**	**($160)**	**($ 160)**

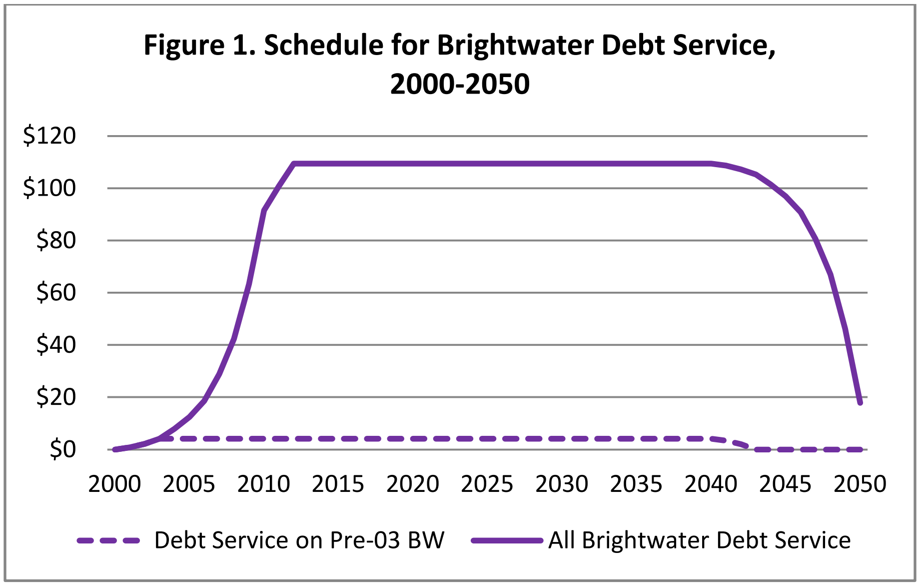
The upper section of Table 1 shows that under the current approach, existing customers' allocated share will total 95%, compared to their 59% share of projected flow in these facilities. By contrast, 2003-30 new customers allocated cost share would be just 3%, compared to their 11% flow share. The lower section of Table 1 shows that under the approach recommended by Seattle and the Districts, existing customers' allocated cost share would be 83% and 2003-30 new customers' allocated cost share would be 15%, which cost shares are in proportion to the two groups' respective flow shares.

The estimated difference in the capacity charge between the recommended approach by Seattle and the Districts and the current method would be about $6-$7 per month.

Issue 5. Allocation of 2003-30 debt service associated with expenditures made prior to 2003 on RWSP projects

The second issue for which Seattle and the Districts make an alternative recommendation is related to paying 2003-30 debt service on pre-2003 expenditures on RWSP facilities built for new customers, largely Brightwater. Seattle and the Districts understand that until 2001 the law did not allow the capacity charge to be high enough to recover full costs for new customers, and that once the law did change, it was too late to include those costs in the capacity charges calculated and assessed prior to 2003. However, debt service related to those expenditures being paid now and in the future can and should be recovered through the capacity charge to the extent that they are associated with projects for new customers. This has been consistently noted in RWSP documents since even before the rate period. Thus, Seattle and the Districts recommend that 2003-30 debt service expense should be allocated to new customers in the same proportion, whether it reflects pre- or post-2003 expenditures on those projects.

Figure 1 shows the schedule of debt service on Brightwater construction. While this illustrates that some debt service expense was incurred prior to the 2003-30 rate period and a large share will be incurred after the rate period, only the debt service that occurs during the period 2003-30 is included in the 2003-30 rate calculation, and it should all be allocated consistently.



The estimated difference in the capacity charge between the approach recommended by Seattle and the Districts and the current method would be about $4 per month.

Issue 7. Allocation of the 2003-30 debt service on shared facilities constructed between 2003 and 2030

The recommendation by Seattle and the Districts is that the 2003-30 debt service costs for shared new conveyance projects should be allocated to new customers in proportions reflecting the difference between total capacity and existing customers' projected flow. The underlying concept supporting this recommendation is the same as for Issue 2: if 2003-30 costs are allocated between existing and 2003-30 new customers as recommended by Seattle and the Districts, the two groups' cost responsibilities will be proportional to their flow share of the facilities. This is consistent with how costs are allocated for new RWSP conveyance projects defined as being for existing customers only. For those projects all of the 2003-30 costs are allocated to existing customers whether or not they will have unused capacity in 2030.

Table 2 is similar in form to Table 1. It summarizes results that are also shown graphically in **Figure 2**, indicating in dollar terms the difference in overall cost allocations for new conveyance excess capacity under the current approach versus the approach recommended by Seattle and the Districts. It highlights again how Seattle and the Districts' recommended adjustments much more closely align the allocation of costs with flow shares.

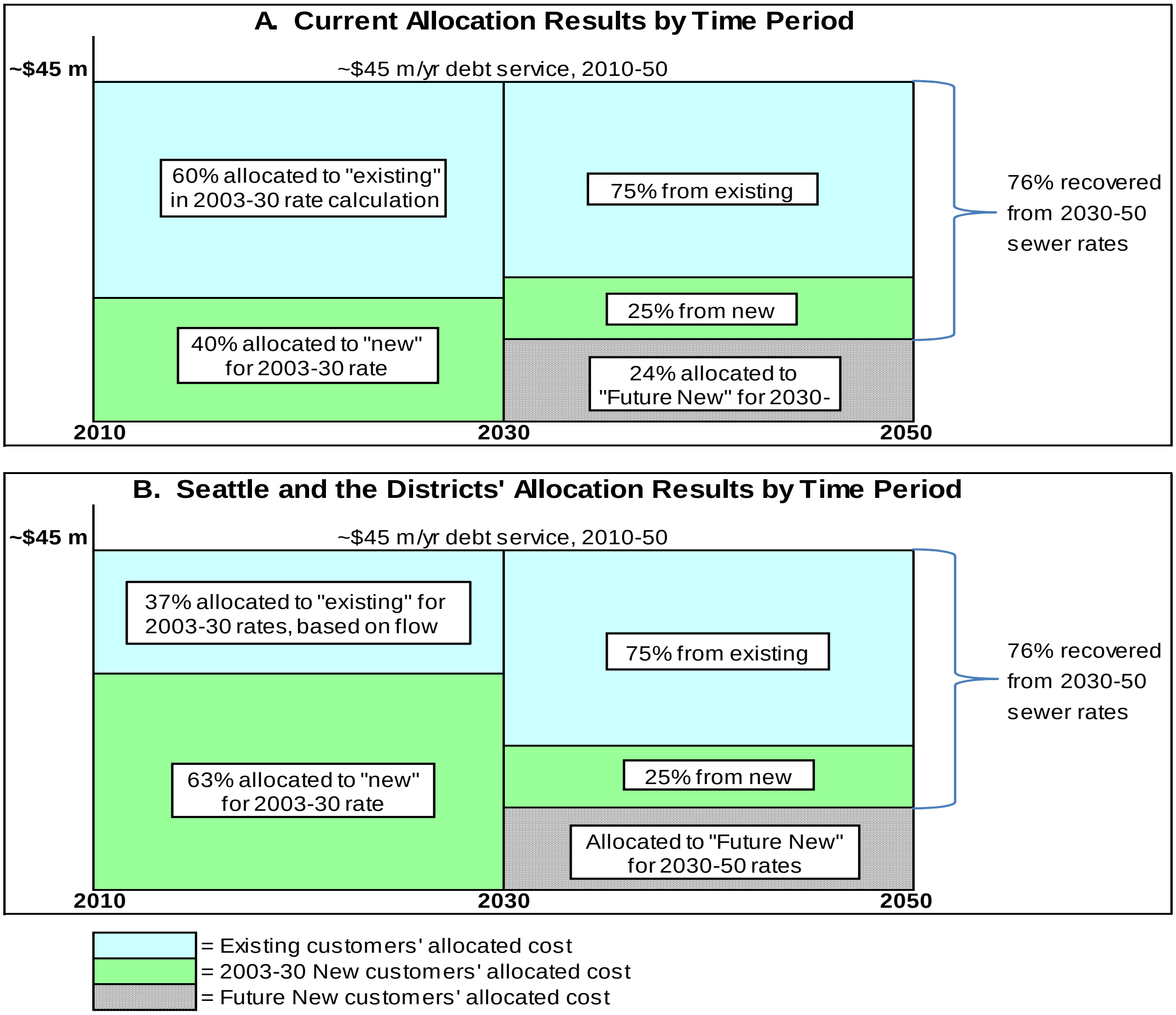
Table 2 Allocation of Costs of New RWSP Conveyance: Cost Shares of Current Approach versus Seattle and the Districts Recommended Approach			
Current Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**36%**	**37%**	**64%**
Cost Allocation Share	**59%**	**32%**	**41%**
Cost Allocation in $m	$408	$224	$285
Seattle and the Districts Recommended Approach			
	Existing Customers	**2003-30 New Customers**	**All New Customers**
Flow Share	**36%**	**37%**	**64%**
Cost Allocation Share	**44%**	**47%**	**56%**
Cost Allocation in $m	$306	$326	$387
Difference in $m	**($ 102)**	**($102)**	**($ 102)**

The upper section of Table 2 shows that under the current allocation approach the costs allocated to existing customers total 59%, compared to their 36% flow share of the facilities' capacity. By contrast, the costs allocated to 2003-30 new customers total 32%, compared to their 37% flow share of the facilities' capacity. These overall cost shares reflect both the direct allocation of 2003-30 costs and the projected - and predictable - allocation of post-2030 costs to these customers. The far right column of Table 2 reports the flow share and cost allocation share of all new customers, pre- and post-2030. It indicates that their combined 41% of cost allocations will be well below their 64% flow share of the facilities' capacity. Thus, in the current approach, existing customers pay a share of costs much higher than their flow share of the facilities, while the new customers pay a share that is lower than their flow share.

By contrast, the lower section of Table 2 shows that under the approach recommended by Seattle and the Districts the costs allocated to existing customers total 44%, compared to their 36% flow share of the facilities' capacity. The costs allocated to new customers total 47%, compared to their 37% flow share of the facilities' capacity. In other words, both existing and new customers would pay shares of costs that are more proportional to their projected overall flow shares of these facilities. When all new customers are combined, as shown in the right-hand column of the lower section of Table 2, their combined 56% share of cost allocations under Seattle and the Districts' recommended approach is still lower than their 64% share of projected flows, but it is substantially closer than under the current allocation approach.

Figure 2 below provides a graphic illustration of the allocation splits by period, under both the current approach and the alternative approach recommended by Seattle and the Districts. Figure 2 shows that much of the substantial post-2030 debt service on these new conveyance projects will be allocated to existing customers. The post-2030 allocation shown is a best case for existing customers; the existing customers' cost share would be even higher if the current capacity charge were eliminated in the future, since they would then pay 75% of a higher amount post-2030.

Figure 2. Comparative Cost Allocation Results for RWSP Shared-Use Conveyance Projects, Based on Projected Flow Shares



<u>**2003-30 Allocations of RWSP Projects' Costs**</u>

* The Current method allocates 37% of the 2003-30 debt service on new facilities to 2003-30 new customers, 36% to existing customers, and splits the remaining 27% between existing (85%) and 2003-30 new (15%) customers. The resulting 2003-30 shares are: **existing - 60%, new - 40%.**
* Seattle and the Districts would allocate the 2003-30 debt service on the portion of new facilities not serving existing customers to new customers. The 2003-30 shares are: **existing - 37%, new - 63%.**

<u>**Post-2030 Allocations of RWSP Projects' Costs**</u>

* Post-2030 allocations of these projects costs are determined by RCW and contract terms, and will be the same under either the current method or the Seattle/sewer district alternative.
* The post-2030 share that can be allocated to Future New is limited by contract and RCW 35.58.570.
* The remainder of 2030-50 costs for these facilities will be folded into rates; that will mean a 75/25 split between existing and 2003-30 new customers' based on their projected RCE shares.

<u>**Total Cost Allocations for RWSP Projects**</u>

* The combined 2003-30 and post-2030 allocations under the <u>Current method</u> total to a **59% share for existing** customers and a **32% share for 2003-30 new customers**. Combined allocations under the <u>Seattle/Districts method</u> total to a **44% share for existing customers** and a **47% share for 2003-30 new customers**.

The estimated difference in the capacity charge between the approach recommended by Seattle and the Districts and the current method would be about $5 per month in 2008 dollars.

Seattle and the Districts' Recommendations on Four Secondary Issues

Seattle and the Districts are in agreement with the other FPWG members on parts of the four secondary issues. Specifically, Issue 1 has been resolved, and Issues 3 and 6 have been partially resolved.

Issue 1. The modeling approach for assigning to growth customers their defined share of the cost of excess capacity in existing facilities

Staff review has determined that the current model does not "double-allocate" existing excess capacity, as previously thought. The broader modeling issue raised by Seattle and the Districts boils down to adopting formalized procedures to ensure future capacity charge calculation is consistent with current intent.

The finding on double-allocation resulted from "hands-on" review of the model, which had not previously been available. Seattle and the Districts recommend ongoing review capacity, to improve the transparency of the rate calculation process, and provide customers with sufficient detailed information and advance forums that they can participate in an informed way and ensure that their rates are being calculated in conformance with their understanding and expectations based on existing policies.

Issue 3. Allocation of the costs of existing excess capacity not currently allocated to growth customers

a. **Facilities with excess capacity not projected to serve growth.** Seattle and the Districts understand the basis for the current approach. However, its application is based on judgment as to whether growth - including infill growth expected to occur throughout the service area - will occur in specific areas with excess capacity. FP-15 does not appear to make this distinction. Seattle and the Districts recommend that this issue be examined further.

b. **Conveyance pipes with excess capacity formerly lacking cost estimates.** Seattle and the Districts agree with the county's method for estimating costs of these facilities for subsequent cost allocation. Once that cost basis has been calculated, Seattle and the Districts believe the costs associated with excess capacity in those facilities should be allocated as Seattle and the Districts recommend for other facilities with excess capacity (see Issue 2 discussion), rather than as they are in the current approach.

c. **Excess capacity created by construction of Brightwater conveyance facilities.** Seattle and the Districts agree that excess capacity in existing pump stations or conveyance lines created by the development of new customer facilities such as Brightwater should be allocated to existing customers. However, excess capacity in these pump stations or conveyance lines unrelated to the development of new facilities should not be allocated to existing customers as they are in the current approach.

Issue 4. Allocation of the costs of existing facilities temporarily used by growth customers

This issue relates to excess capacity of existing facilities used by new customers to defer other facility investments for new customers. FP-15 does not specify when excess capacity is to be defined - 2003, 2030, or year-by-year. The current approach assumes 2030 for most facilities, although more existing capacity is excess as of 2003, some of which is used by new customers during the period 2003-30 to their substantial financial benefit.

Seattle and the Districts recommend the allocation of costs between existing and new customers on a year-by-year basis for all existing facilities where there is some excess capacity before 2030 that is used by new customers. This will reflect some value of the actual use of those facilities by new customers. In the instances where this alternative recommendation has been followed in the current approach, calculations show that it assigns a fairly low cost for the use of existing customers' facilities by new customers, relative to the benefit the new customers receive by deferring facilities that would otherwise be required to serve them.

This is a relatively minor issue in dollar terms. The estimated difference in the capacity charge between the recommendation by Seattle and the Districts and the current approach would be about $2 per month in 2008 dollars.

Issue 6. Allocation of the costs of projects not explicitly or otherwise addressed by FP-15

FP-15 states that any costs not otherwise explicitly allocated by its provisions shall be paid by existing and new customers in the sewer rate, which translates to proportionally shared allocations. The City of Seattle originally identified a list of specific RWSP projects that appeared to fall outside the specific allocation directives of FP-15, but that had not been allocated on a shared basis by the current method. The County has revised its allocations of some of these general projects to reflect this provision of FP-15. For about half, in dollar terms, of the original list of projects that did not appear to be covered by any other clause of FP-15, it has retained the approach of assigning the costs entirely to existing customers.

Seattle and the Districts recommend that all projects not explicitly allocated by the provisions of FP-15 be allocated in proportional shares (approximately 85%/15%) to existing and new customers. In particular, projects not otherwise assigned that provide general benefit to all customers should be allocated on a shared basis.

This is a minor issue, which the county has addressed in part. The estimated difference in the capacity charge between the recommendation of Seattle and the Districts and the current approach would be less than $2 per month in 2008 dollars.

Remaining Allocation Issues Not Addressed in FPWG Discussions

To provide further context for the recommendations made by Seattle and the Districts' there are a number of other allocation issues that have not been resolved but that are not included here. These include costs associated with the following:

- Existing Renton 1987 upgrade's excess capacity for growth
- Existing West Point 1987 expansion's excess capacity for growth
- RWSP projected Renton re-rating - capital cost share
- RWSP projected Renton 2030 upgrade for growth
- RWSP projected Asset Management that should be shared by existing and new customers

Seattle and the Districts' Recommendation on the Rate Calculation Period

Seattle and the Districts recognize the value in looking ahead to anticipate the transition from the current rate calculation period (2003-2030) to its eventual successor period (post 2030). However, we strongly recommend against a ten-year extension to the 2003-30 rate and capacity charge calculation period that is currently defined in FP-15.

The work group on several occasions raised the possibility of extending the capacity charge and rate calculation period from its current 2003-30 to include ten additional years. The discussions were general, and were not supported by either thorough staff analysis or review of detailed information by the work group members.

Several significant questions were identified in FPWG discussions regarding this idea that have not been examined, analyzed, or resolved to a sufficient degree to support a recommendation to extend the rate calculations period. In particular, the idea appears likely, based on current information, to shift growth facility costs from new to existing customers, while also further extending the period before any current subsidies of growth would potentially be repaid by new customers capacity charge payments.

Key unresolved issues include several related to inadequate supporting information and several related to the risk of anticipated financial burdens on existing customers :

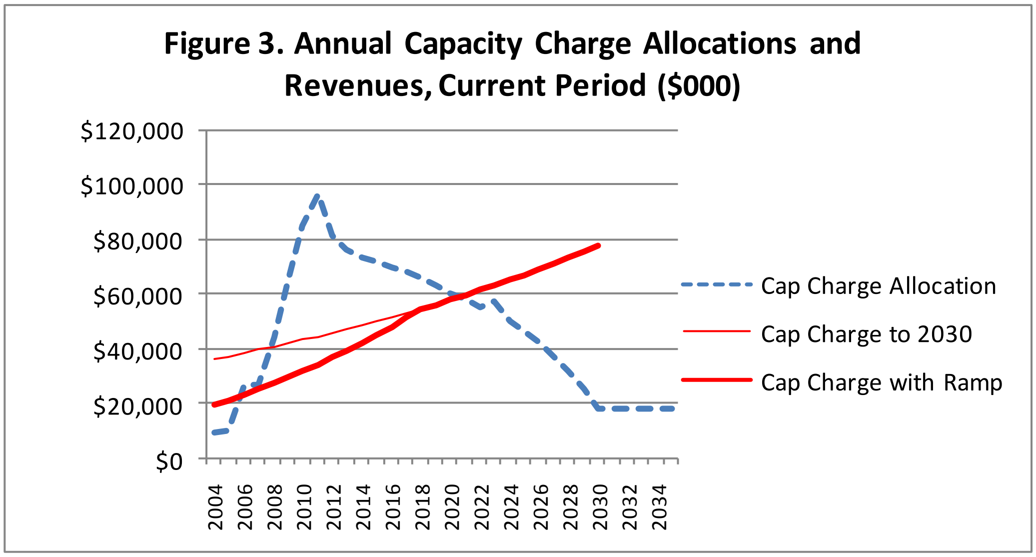
Lack of adequate consistent information

- Quality of new facility cost information beyond 2030
- Quality of flow information beyond 2030
- Quality of RCE information beyond 2030

Risk of increased cost burden on existing customers

- Likely inconsistency of an extension with "growth-pays-for-growth"
- Probable deferral of payback to existing customers for near-term subsidy of growth
- Potential RCW-based exclusion of post-2030 Brightwater cost allocation to growth
- Probable political impediments to maintaining future capacity charges sufficient to provide repayment to existing customers

The first set of issues reflect the uncertainty in estimating facility plans, costs, flows and RCEs for a period not analyzed or reviewed as part of the RWSP. The second set of issues reflect some of the other risks inherent in further extending the pattern of new customers' allocated costs versus capacity charge revenues. A high-level review of the King County 2003-30 cost allocations underlying the 2008 capacity charge calculations confirmed the pattern shown in **Figure 3** below. Annual capacity charge cost allocations will exceed capacity revenues until around 2020 and fall below them thereafter. This requires a near-term subsidy of growth by existing customers until 2020 that is assumed to be balanced by repayment in the later years of the period.



If an extension of the rate period included projected annual capacity charge revenue requirements that remain below currently projected capacity charge revenues beyond 2030, as shown by the dotted line in Figure 3, that extension would translate to an artificially lowered capacity charge throughout the entire period. That in turn would increase the under-recovery of new customers' costs through 2020, further increasing the amount that existing customers would be required to subsidize

This would also pose other significant financial risks to existing customers, as noted in the bullets listed above. Thus, while an extension appears very likely to shift costs from new customers to existing customers in the 2012-30 period, it is highly uncertain whether any added revenues from the post-2030 portion of the capacity charge projections would actually be realized or returned to existing customers as is currently assumed in the calculations.

Based on these unresolved issues, and independent of decisions on the 2003-30 capacity charge cost allocation issues discussed above, Seattle and the Districts strongly recommend that the rate calculation period should remain 2003-30. It may be worthwhile to revisit the rate calculation period in much more careful detail at a later date.

Conclusions

Cost Allocation. The three primary cost allocation recommendations that Seattle and the Districts are making would more fully reflect growth-pays-for-growth policies. Adoption of these three recommendations would raise the capacity charge by $15 in 2008 dollars, and would distribute costs in better proportion to flow shares for both existing and new customers.

The alternative recommendations on the remaining four issues discussed at the FPWG and the other issues raised previously but not resolved, would also reflect existing policies and produce outcomes consistent with growth-pays-for-growth, but would raise the capacity charge further. The same is true for the remaining issues listed above.

Finally, since the difference of opinion on these allocation procedures arises, in part, due to ambiguity in FP-15, Seattle and the Districts also recommend that FP-15 be clarified to eliminate the ambiguity that results in different procedural interpretations.

Rate Calculation Period. Seattle and the Districts strongly recommend that the current rate calculation period be maintained. There is insufficient information to support a change while complying with the principle of growth-pays-for-growth. Further, the information that is available suggests that with a ten-year extension of the period, current subsidies of growth by existing customers would be increased.