



June 7, 2011

David S. Hasson, Ph.D.
Finance Director
Portland Water Bureau
City of Portland
1120 SW 5th Avenue, Room 600
Portland, OR 97204

Re: Final Report: Sewer/Stormwater/Water Rate Approval Process

Dear Mr. Hasson:

Red Oak Consulting, the management consulting practice of ARCADIS/Malcolm Pirnie, is pleased to provide the attached final report for the Sewer/Stormwater/Water Utility Rate Approval Process project.

The report addresses “Best Practices” regarding the approval process for setting municipal sewer, stormwater, and water utility budgets and rates. The information in the report was derived from a telephone survey of 10 major North American public utilities as well as research into the Portland Water Bureau’s rate setting practices.

We appreciate this opportunity to work with the Portland Water Bureau. If you have any questions, please don’t hesitate to contact me.

Very truly yours,

RED OAK CONSULTING
The Management Consulting Practice of ARCADIS

A handwritten signature in blue ink that reads "Richard D. Giardina".

Richard D. Giardina, CPA
Senior Vice President/Project Director

Portland Water Bureau

1120 SW 5th Avenue, Room 600 • Portland, OR 97204-1926

Sewer/Stormwater/Water Rate Approval Process

June 2011

Report Prepared By:



100 Fillmore Street, Suite 200
Denver, CO 80206
303-316-6500

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- A. FY2012 City Budget
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1. Introduction

Red Oak, the management consulting practice of ARCADIS/Malcolm Pirnie, was retained by the City of Portland Water Bureau (Water Bureau) and Bureau of Environmental Services (BES) to conduct a survey of utilities within North America to identify “Best Practices” regarding the approval process for setting municipal sewer, stormwater, and water utility budgets and rates. The purpose of this survey was to compare these Best Practices with the practices currently used by the City of Portland (City) and develop recommendations for changes to the City’s rate setting approval practices where applicable.

1.1. Background

The Water Bureau and the BES are the City’s two principal enterprise fund utilities. The Water Bureau provides high-quality water to enhance public health and safety, and contribute to the economic viability and livability of the Portland metropolitan region. The BES protects and enhances the health and livability of the City by managing the collection and transmission of wastewater and stormwater.

The Portland Utility Review Board (PURB) is a nine-member board created by the City Council to advise the Council, on behalf of and for the benefit of the citizens of Portland, on water, wastewater, stormwater, and solid waste financial plans and rates. The PURB is composed of citizens appointed by the Mayor and confirmed by the Council to represent Portland’s three major geographic areas, commercial and industrial interests, small businesses, and general public concerns. The PURB advises the Council on the establishment of fair and equitable rates, consistent with customer needs, legal mandates, existing public policies, operational requirements, and the long-term financial stability and viability of the utilities.

As part of its review of the proposed fiscal year (FY) 2010-2011¹ budget for both the Water Bureau and BES, the PURB made several recommendations to the Council that centered on the PURB’s concern with the current system for setting water, wastewater, and stormwater rates and especially with the adequacy of system “checks and balances”. The PURB has expressed concern regarding the lack of transparency in the current rate approval process and believes that the general public has the same concern. Furthermore,

¹ The City’s fiscal year begins on July 1 of each year; “FY 2010-2011” and “FY2011” refer to the same 12-month period ending June 30, 2011.

there is a perception that the resulting process allows for non-core utility service delivery items to be included in the Water Bureau and BES budgets and the resulting rates.

PURB recommended that a consultant be retained to review and make recommendations regarding Best Practices for the approval process of setting utility rates at other similar utilities nationally and internationally. Consequently, the Council included a budget note in its approved FY2011 budget which directed BES and the Water Bureau to procure such services.

1.2. Study Objectives

The following tasks were included as part of the study:

- Review and identify Best Practices for the approval process for setting municipal sewer, stormwater, and water revenue requirements and rates.
- Compare these Best Practices with the practices currently used by the City.
- Develop recommendations for changes to the City's rate setting approval practices where applicable.

It is important to note that the focus of the study was on the rate approval process itself, not the rate setting methodologies nor the actual revenue requirements, rate levels, or rate structures.

The following tasks were completed with assistance from City staff and members of the PURB:

- Completed a survey of North American cities to determine national or international Best Practices for utility rate setting approval processes and provide detailed documentation to the City. This was accomplished by locating and interviewing the administrators of representative utilities in North America regarding their rate setting approval process.
- Documented the existing rate setting approval process for water, stormwater and wastewater utilities currently used by the City. Particular attention was paid to Portland's unique form of city government and the roles of elected officials as well as senior bureau managers.
- Identified Best Practices among peer North American utilities and recommended adaptations of those practices that would fit with Portland's form of city government and which could be efficiently and effectively implemented by the City.
- Completed a preliminary study report with tentative recommendations to be distributed to the Council, the Water Bureau, BES, the City of Portland Auditor's Office, and the PURB.

2. Current Approval Process

The City is organized under a mayor-commissioner form of government. This is a relatively unique government type under which the Mayor appoints each Council member as the Commissioner-in-Charge of multiple bureaus or departments. The Mayor also serves in this capacity for several bureaus. The Commissioner-in-Charge functions as the chief executive officer of each bureau and oversees the day-to-day operations, sets policy, has hiring and retention authority, etc.

The City's current rate approval process is consistent with its commissioner-based form of government. Specifically, each bureau is responsible for preparing a "Requested Budget" under the leadership of its administrator and Commissioner-in-Charge. In addition to being subject to the City's budget process, BES and the Water Bureau each execute their own rate approval process. Both the budget and rate approval process are managed by their respective bureaus with direct input from the bureau's Commissioner-in-Charge.

2.1. Budget Review and Approval Process

The City budget process includes the preparation of four sequential documents:

1. Requested Budget
2. Proposed Budget
3. Approved Budget
4. Adopted Budget

These documents are prepared in three key phases as noted below:

1. Requested Budget Development
2. Requested Budget Review
3. Budget Approval and Adoption

Figure 2-1: City Budget Process presents a general interpretation of the timeline for the City budget process.

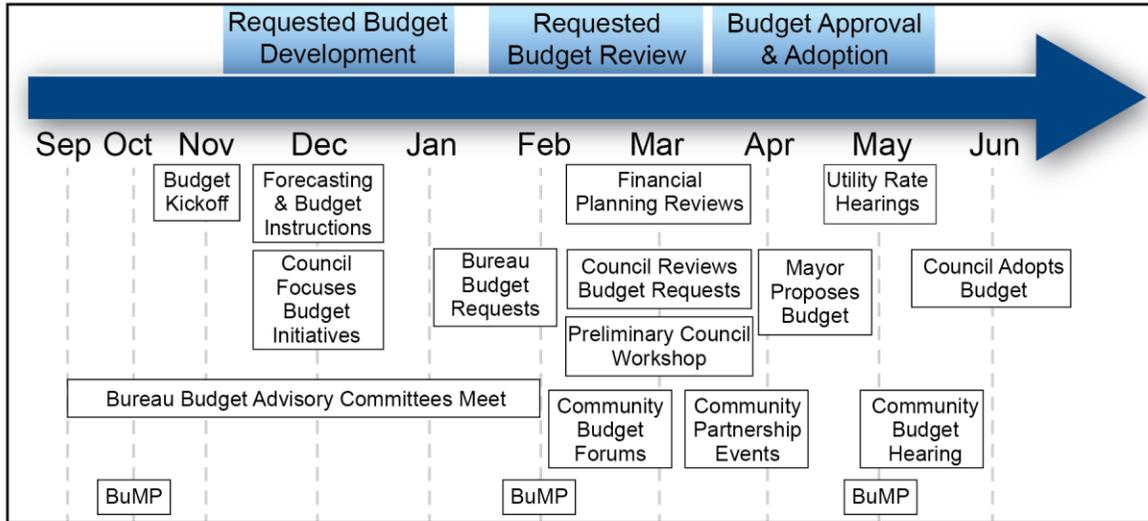


Figure 2-1: City Budget Process

2.1.1. Requested Budget Development

Each bureau prepares a Requested Budget based on its plans for the upcoming fiscal year. The process includes public participation by each bureau’s Budget Advisory Committee, which are composed of citizen’s that represent specific public interests, as well as members of the PURB. The process normally starts in the fall prior to the fiscal year (which has a July to June cycle) for which the budget is being requested.² The Requested Budgets are submitted to the Office of Management & Finance in late January for review (by way of example, see Attachment A for the specific schedule for the FY2012 budget).

2.1.2. Requested Budget Review

During the late winter and early spring, the Council and Mayor review each bureau’s Requested Budget. This review includes a public process through Community Budget Forums and Community Partnership Events. The Council holds these public workshops to review the Requested Budget for each bureau in order to determine public priorities for City spending.

Typically the Mayor works with each bureau’s Commissioner-in-Charge to revise the Requested Budget to meet the overall City goals. This process begins in March and ends

² Attachment A presents information obtained by Red Oak Consulting from the City’s web site. This information presents important budget events and dates as well as the proposed dates for the Budget Advisory Committee meeting schedules.

in late April. In mid to late March an informal workshop is conducted with the Council, during which the Council is given the opportunity to review the draft budget, ask questions, and provide input. This is the staff's first opportunity to make an informal presentation to Council regarding the upcoming budget process. This is an open meeting and Council does not take any action. The workshop is followed by meetings in which the Mayor and respective Commissioners review the Requested Budgets for each utility. These meetings are not public meetings.

2.1.3. Budget Approval and Adoption

In late March to late April, the Mayor releases "Proposed Budget Decisions" that form the basis for the "Mayor's Proposed Budget". These Proposed Budget Decisions provide direction to each bureau regarding how to revise their respective Requested Budgets to support the forthcoming Mayor's Proposed Budget.

Within a few weeks or less of providing the Proposed Budget Decisions, the Mayor releases the Proposed Budget document. Subsequent to this release, the Council conducts its Utility Rate Review (see Section 2.2.1), after which the Council holds its first public hearing to approve the budget in mid-May. The final public hearing to approve the budget is scheduled for the end of May.

2.2. Rate Review and Approval Processes

For both BES and the Water Bureau, the rate approval process is an integral part of the budget approval process. As each bureau develops its respective budget, it simultaneously develops utility rates that support the requested expenditures. In this way, the levels of expenditures in the budgets determine the rate adjustments required. This process can be iterative; alternative rates are developed to support various budget levels and priorities. Those alternative rate scenarios are considered during the budget review process.

2.2.1. Bureau Role

Both the Water Bureau and BES begin their respective rate approval process at the beginning of their budget development by reviewing the previous year's five-year financial plan with their respective Budget Advisory Committees and the PURB in the fall. Throughout the development of the Requested Budget, and during the Council's review process, staff from each bureau continuously calculate the rate impacts of the latest budget(s) with the guidance provided by its Commissioner-in-Charge and directed by the Mayor and/or the full Council. Information from those rate impact calculations is then used during the budget review process.

Rate projections are developed based on the best available information during the budget review process. The formal Rate Review process is started in late April when the bureaus use the Mayor's Proposed Budget Decisions to prepare their formal documents for the

proposed utility rates. The Council conducts its first public hearing in May; within a few weeks (or less) of when the Proposed Budget document is released. This hearing is the one at which public testimony is taken and the PURB presents its final recommendations to the Council. The second and final public hearing is conducted one week later (also in May) and does not include any public testimony. The new rates become effective no sooner than 30 days after Council approval at the second rate hearing, almost always on July 1. Technical adjustments to proposed rates may occur at any time during the budget approval process.

2.2.2. PURB Role

The PURB's involvement in the Rate Approval Process in principle begins with its review of the respective bureaus' five-year financial plans in the winter, although the PURB has not always undertaken the opportunity to perform this review. More recently, the process has also included the PURB's participation in each bureau's Budget Advisory Committee. At any time during the budget review process, the Water Bureau and BES may brief the subcommittees of the PURB on the development of the Requested Budget. Recently, the members of the PURB subcommittees have also participated in the Council budget review workshops for their associated bureau. This allows the PURB members to give feedback directly to the Council as it considers each bureau's Requested Budget.

The PURB members also testify at the Utility Rate Review meetings. This allows the PURB to provide direct feedback to the Council.

2.2.3. Challenges for the Rate Approval Process

Because the current rate approval process is integrated with the budget approval process, members of the PURB find it difficult to influence the adopted rates for the Water Bureau and BES. Specifically, the rates for each bureau depend primarily on the Mayor's Proposed Budget.

Under this form of government the Commissioner-in-Charge has the ability to unilaterally influence the ultimate determination of the annual budget and rates for his/her bureau. For example, the PURB and other citizens typically have approximately three weeks from the time the Proposed Budget is released for review and acted upon. However, the process is such that last minute additions or changes in the budget as proposed by the Mayor or Council are not subject to the same level of review or transparency. Also, mid-year changes in expenditures may occur with a lesser level of public or Council review. This may occur within the established process of mid-year adjustments (three times per year, called "BuMP" adjustments), which are formally approved by Council, or sometimes by redirected spending that may be the result of staff or Commissioner-in-Charge decisions. It is important to note that these mid-year budget adjustment opportunities have not historically included the involvement of the PURB, despite occurring at public hearings. The public and the PURB have commented that this

redirected spending and the less visible BuMP adjustments create the perception that non-core business expenditures can circumvent the review process. This dynamic is possible, in part, because the Commissioner-in-charge has both a lead executive role in the development of the budget (although the exercising of this role may vary considerably) and is also a member of the legislative branch (i.e. the Council) which approves the budget that is being developed. Thus, the Commissioner-in-charge has a role in both the executive and legislative branches of the governmental process. Increased involvement of the PURB in this part of the process would address the gap in public transparency inherent in the current approach.

Further, the PURB feels that the process of developing the Proposed Budget from the Requested Budget is not transparent enough. PURB members claim that the commissioners and Mayor make political compromises outside of the public process during their individual meetings. This has led some members of the community to question the relevance of certain expenditures by the Water Bureau and BES and a recent audit by the City Auditor's Office addressed this topic³.

³ *Spending Utility Ratepayer Money: Not always linked to services, decision process inconsistent*, March 2011, Office of the City Auditor.

3. Survey Findings

A telephone survey of peer water, wastewater, and stormwater utilities in North America was conducted as a means of identifying Best Practices with respect to utility rate approval processes. A list of questions was developed concerning the governmental and legal aspects of each participant's process for reviewing and approving utility rates. The survey deliberately avoided questions related to how the rates were developed from a technical perspective.

Out of 12 agencies that were sent letter invitations, 10 agencies (representing eight states/provinces) agreed to participate:

- Austin Water Utility, Texas (“Austin”)
- Boston Water & Sewer Commission, Massachusetts (“Boston”)
- City of Calgary Water Services, Alberta, Canada (“Calgary”)
- Charlotte-Mecklenburg Utilities, North Carolina (“Charlotte-Mecklenburg”)
- Denver Water, Colorado (“Denver”)
- El Paso Water Utilities, Texas (“El Paso”)
- City of Phoenix Water Services Department, Arizona (“Phoenix”)
- San Antonio Water System, Texas (“San Antonio”)
- San Francisco Public Utilities Commission, California (“San Francisco”)
- Seattle Public Utilities, Washington (“Seattle”)

Each of the 10 agencies were contacted by telephone and surveyed based on the questions presented in Attachment B. The telephone surveys lasted between 30 and 50 minutes, depending on the availability of the staff and the lengths of their responses. A high level summary of survey results has been provided as Attachment C.

All of the agencies surveyed provide water and wastewater utility services with the exception of Denver, which provides water utility service exclusively. Calgary, El Paso, San Francisco, and Seattle also administer a stormwater program/utility. All of the agencies surveyed are funded exclusively through rates, charges, or fees. None of the agencies receive any revenue from property taxes or transfers from the general fund(s) of the cities and/or counties they serve. San Antonio Water System collects stormwater fees on behalf of the City of San Antonio, which administers its own stormwater program/utility.

3.1. Governance

All of the agencies surveyed as part of this study are public utilities governed either by a city council or board of commissioners/directors/trustees. For those agencies governed by a board, the board members are appointed by the mayor and/or city council. The city mayor appoints their utility commissioners for Denver, Boston, and San Francisco; however, the appointment is subject to city council approval in Boston and San Francisco. Board members are appointed by the city council at El Paso and San Antonio, with the exception of the mayor, who, in both cities, is also on the board and elected at-large. None of the agencies surveyed share the City of Portland’s unique Mayor-Commissioner form of government in which each commissioner is responsible for at least one bureau and the Mayor has limited powers and roles beyond those of the other commissioners. San Francisco and Charlotte serve both their county and their city(s), while Denver, Austin, San Antonio and Seattle serve many, but not all, county customers. Table 3-1 presents the agencies surveyed by type of governing body.

**Table 3-1
Governing Body**

City Council	Board of Directors / Commissioners / Trustees
Austin	Boston
Calgary	Denver
Charlotte	El Paso
Phoenix	San Antonio
Seattle	San Francisco

3.2. Survey City Approval Process

The rate approval process for all of the agencies surveyed, including the Portland’s Water Bureau and BES, share the same basic elements. Rate setting flows from each agency’s revenue requirements: operating budget, capital projects, and debt service requirements. However, one “organizational” difference does exist: nine of the ten agencies surveyed have a combined water and sewer utility (Denver being the only city with “separated” responsibilities). It seems intuitive that since these utility services are billed on the same utility bill (the customer writes a single check), the coordination of the rate approval process would result in efficiencies in communication, public input, acceptance, etc. that might otherwise be difficult to achieve when the two separate departments, or in this case the Water Bureau and BES, independently prepare and carry forward their rate proposals.

Our experience would indicate that the rate approval process is certainly not the reason water and wastewater functions are combined under a single agency/department. The drivers for such a consolidation likely stem from planning and operational considerations with rate approval a second or third tier benefit/consideration.

For the majority of the agencies surveyed, new rates are approved on an annual basis. The exceptions are Calgary which adopts three-year rate schedules, Seattle which sets their rates for two to three years at a time, and San Francisco and Phoenix which set rates for up to five years at a time. All of these agencies review and adopt their budgets annually, with exception of San Francisco which adopts its budget biennially.

Development of the agency's operating budget is often regarded as the first step in the rate approval process. The length of time from the start of the budgeting process to the implementation of rates varies from six to seven months (Austin, Boston, Charlotte-Mecklenburg, and El Paso) to 11-12 months (Denver, San Antonio, Seattle, Calgary, and Phoenix). Portland's process generally takes about nine months, although it varies somewhat by bureau. Unsurprisingly, it was observed that utilities with a longer approval process (in terms of timeline) included a more elaborate rate approval process, including review committees, public participation, and legal requirements such as noticing.

For all utilities, the initial development of an annual operating budget is an institutionalized process conducted by in-house staff. On the other hand, cost-of-service analyses and/or rate design are sometimes conducted in-house and sometimes with the assistance of external rate consultants. Seattle completes all of its rate-related analyses internally, as does Portland for both water and wastewater rates. Denver conducts its own cost-of-service and rate design analyses, but has an external/wholesale customer committee (which includes rate consultants) that actively participates in the rate-setting process. Some utilities, such as Boston and San Antonio, periodically retain consultants to update their rate structures; but for the subsequent years they use in-house resources to update the models. Finally, utilities such as San Francisco and Charlotte-Mecklenburg routinely use a rate consultant during their rate development and approval process.

3.3. Governing Body Review

Among the agencies surveyed, the governing body is typically responsible for approving proposed operating budgets and rate increases, with the exception of Boston, Charlotte-Mecklenburg, San Antonio, and San Francisco. At Charlotte-Mecklenburg, the City Manager has the authority to set rates although the council is actively involved in the review and public process. Boston and San Antonio boards (appointed) approve the budget while their city councils approve rates. In San Francisco, the commission (appointed) approves the budget and rates; however, rates must be confirmed by the city's Board of Supervisors. El Paso is the only agency that has both a board and a city council and gives full discretion for budget and rates approval to the board; however the issuance of debt must be approved by the council.

The governing bodies of most agencies play an active role in the development of the operating budget. The governing bodies of Austin and San Antonio both have

subcommittees that work closely with utility managers. The City Council of Calgary provides written direction to the Water Services Department for budget priorities.

There were no instances of individual members of governing bodies having the authority to unilaterally change the budget. In some cases, (such as in Seattle and San Antonio) the governing body did have the authority to amend the budget after the standard approval process, but we found that this authority was never exercised.

Generally, all capital projects and budget items are required by internal policy (or state law) to be related to the provision of utility services. Capital projects for all of the agencies are set based on multi-year capital improvement programs. Several agencies evaluate the plans annually in order to accelerate or decelerate certain project schedules to meet strategic goals such as service reliability or affordability. Adjusting the timing of capital projects is a common way of controlling rate adjustments/increases. Strategic decisions regarding debt-financing of capital projects (versus cash financing) is also a common approach to managing the need for rate adjustments.

3.4. Public Participation and Transparency

While public participation in the rate setting process was ubiquitous among survey participants, the extent of formalized public involvement in the process was varied. Being public agencies, all survey participants have some means for the public to request information and provide comments regarding the agency's operations. In all cases, rate adjustments are presented at public meetings before adoption. All of the agencies except Boston and Calgary have some form of citizens' advisory committee that works with utility managers on a variety of matters (including rates). The advisory committee at San Antonio is currently inactive, but the agency has an aggressive public affairs department that actively meets with stakeholder groups during the rate approval process. Citizens' advisory committees are generally composed of appointed citizens, industry representatives, and a variety of special interest stakeholder groups.

None of the citizens' advisory committees play a material role in the initial development of the operating budgets of the agencies surveyed; rather, they help formulate budget priorities and they serve as third party reviewers of expenditure decisions. For example, the Austin Water and Wastewater Commission is an advisory board comprised of citizens that are appointed by City Council. This Committee is primarily focused in the areas of planning and service levels, but also includes a budget subcommittee.

The majority of agencies only seek the feedback of the advisory committee after a preliminary rate proposal has been developed by internal staff. None of the advisory committees have any binding authority in terms of the rate approval process; however, agencies such as San Francisco have an ordinance that requires the meetings at specified intervals. All agencies make a genuine effort to reach a minimal level of acceptance and a

maximum level of understanding. Agencies see the citizens' advisory committees as an opportunity to both give and receive constructive feedback to and from all stakeholders, not simply a required formality.

3.5. Legal Requirements

Each agency surveyed maintains, at a minimum, a small amount of documentation concerning the rate approval process; the majority of this documentation, however, is not legally binding. The range in the formality of the documentation is wide, but rate approval documentation typically includes a schedule of the major milestones, responsible parties, and specifications for deliverables.

Regarding the legal environment for agencies, noticing requirements are an important aspect of the rate approval process for Denver, Boston, and San Francisco. For example, Denver has an internal requirement of providing a specified amount of time between the approval and implementation of new rates (90 days for outside-city customers and 30 days for all other customers). Boston has a similar requirement of three weeks between the approval and adoption of its rates. San Francisco is subject to California's Proposition 218 which requires ratepayers to be notified 45 days prior to public hearings to adopt new rates. During that time, ratepayers have the opportunity to reject the rate increase by majority protest. This same law also requires that rates be proportional to the cost of providing service (hence all budget line items must be tied directly to the provision of service).

The survey found that legal counsels (internal or external) do not play an active role during the rate approval process, unless their legal opinion is requested.

4. Best Practices

The following identifies Best Practices in the budget and rate approval processes resulting from the survey. These Best Practices were distilled from (1) what survey participants thought were the strengths of their process and (2) Red Oak’s perspective given the information provided by the participants and within the context of our own professional experience.

4.1. Governmental Review

This report makes no attempt to define Best Practices regarding the governance structures of municipal governments and their associated utilities. That being said, five of the 10 agencies surveyed are governed by an appointed versus elected body. While there is little if any definitive research on the effectiveness of one form compared to another⁴; it is interesting to note that the Mullin research does make the following observation:

“When water district officials are directly elected, candidates’ positions on water rates might well be the most salient issue in the election. The incentives to respond to residents’ preferences are much stronger for elected officials. Finally, the transmission of constituent preferences to a special district board is simply more direct with an elected board; adding an appointing authority introduces friction that may produce bias in outcomes.” (Mullin, Megan, page 135)

Certainly this observation lends support to a conclusion that elected bodies are more responsive “...to resident’s preferences...” regarding water rates. One might also interpret this observation as supporting, at best anecdotally, the position that elected bodies seek to satisfy constituent preferences to a greater degree than appointed ones. Continuing with this line of reasoning, it could be concluded that appointed bodies are less focused on short-term voter/resident preferences, and have a longer-term vision regarding the stewardship and the business operation of, in this case the utility, than their elected peers.

Regardless of governance structure, the survey did reveal some Best Practices regarding the communication culture between utility managers and the governing body. We found

⁴ Research on this topic (not specifically on point) by Megan Mullin of Temple University, focused on the governance structure, i.e., special districts compared to general purpose local governments, and with regard to the water rate structures and in particular, increasing or inclining block pricing. (Mullin, Megan, *The Conditional Effect of Specialized Governance on Public Policy*, American Journal of Political Science, Vol. 52, No. 1, January 2008, Pp. 125-141)

that, in addition to the importance of defined annual reviews and workshops, most agencies found considerable benefits in the ongoing communications between managers and governing bodies.

Open communications between agency managers and the governing bodies in advance of formal meetings (as appropriate) contributes to agenda development, gauging political acceptance, and identifying budgetary concerns early in the process. For example, while San Francisco is the only utility to adopt its budget biennially, the utility manager meets with the commission every two weeks to brief them on developments. As such, the outcome of the proposed budget cycle rarely holds a surprise. In no case did we find an agency that gave the authority to a single board or city council member to unilaterally modify the budget; either during the budget development process or during the fiscal year as the budget is “executed”. For example, it is not unusual for budget modifications to occur during the year. However, it is customary, even a Best Practice, that material budget changes are subject to a formal, documented and public process and that “re-directed” expenditures are consistent with the primary mission of the utility.

4.2. Public Outreach and Involvement

The majority of the agencies surveyed have some form of citizens’ advisory committee to represent the interests of the major stakeholder groups. Those agencies with such committees all agreed that their participation, while clearly an investment of staff resources, ultimately makes the rate approval process go more smoothly. By involving the public and stakeholder groups early in the rate approval process, agencies can avoid or mitigate contentious public hearings, negative press reports, and diminished political will, while improving transparency, anticipating questions from other stakeholders, promoting civil discourse, and gauging public acceptance. The need to mitigate things such as “contentious public hearings” obviously depends on the environment surrounding the individual agency; agencies that otherwise receive little or no interest from the public may not see the value in both investing resources for more public participation and taking the risk that such participation would invite unnecessary scrutiny. It remains our opinion that public participation during the budget process and during the development of utility rates is a Best Practice. The purpose of this participation is to provide a “second set of eyes” to the governing body, whose job is to represent the public. The form of this participation may range from the formation of a special public advisory committee to full disclosure through readily-accessible media like the agency’s website. The agency should provide *pro-active* disclosure of proposed expenditures, including accurate and helpful line-item descriptions, and with attention given to changes to spending from the previous fiscal year or to the initially approved budget.

4.3. Use of Funds

All of the agencies surveyed are funded exclusively through their utility rates and fees (save for the occasional grant), which are designed to recover the cost of providing utility services. These agencies adhere to commonly held cost-of-service principles which generally require that “the rate in question captures the cost causal relationship of *the service provided*⁵.” While some governing bodies are authorized to exercise discretion in defining which expenditures are relevant to providing utility services, the active participation of citizens’ advisory committees and other forms of public involvement is effective in discouraging the inclusion of budgetary line items that are unrelated to the delivery of core services.

4.4. Rate Adoption Frequency

It is difficult to prescribe a universal ‘best practice’ for the frequency of rate adoption. Frequent rate adoption has its costs: the initiation of the rate approval process, the formal and informal meetings, public noticing, etc. While those agencies surveyed with multiple-year rate adoption practices attest to the advantages of establishing higher level multi-year financial plans, it can be challenging (if not impossible) to produce accurate long-term (five-year) financial and demand forecasts. Therefore, the costs of frequent rate adoption must be weighed against the importance of accurate and up-to-date rates. At a minimum, a utility with a long range approach should continuously monitor its costs and have a mechanism for over-riding the adopted rates schedule when required.

4.5. Formal Process Documentation

Although formal documentation of the rate approval process was uncommon among the agencies surveyed, those agencies with adopted requirements indicated its clear usefulness. Provided that the requirements are limited to high-level guidelines (such as deadlines for presenting draft budgets to specific committees), such institutionalization of the rate adoption process confers several advantages by:

- Managing the expectations of all stakeholders;
- serving as a resource to existing and incoming staff (a form of knowledge management);
- adding transparency by showing at what points the public can get involved (where applicable); and/or
- establishing accountability for execution of the process.

⁵ Water Rates, Fees and the Legal Environment, Second Edition, C.W. Corssmit et al., American Water Works Association. Emphasis added.

5. Recommendations

Based on our findings of Best Practices among participating agencies and our professional judgment, Red Oak has developed the following recommendations for the City of Portland’s rate approval process for both the Water Bureau and BES.

5.1. Public Outreach and Involvement

Recommendation: In order to maintain the desired transparency of the budget/rate process and to create an opportunity for “third party” review, the City should formally modify the process to require PURB review and input regarding all material⁶ changes to the budget. This would include establishing a reasonable timeframe for proposing changes to the budget and the review of these changes by PURB.

The PURB has the ability to provide input during the development of the annual budget for both the Water Bureau and the BES through its representation on the respective Budget Advisory Committees. While the existence of the PURB itself is consistent with Best Practices regarding public participation, its function appears to end prematurely during the rate approval process. Specifically, the PURB is involved very early in the process but is no longer part of the process when certain budgetary items are considered by the Commissioner-in-Charge and/or Mayor; a point in the process where the PURB is particularly concerned.

We did not identify any instances where an individual member of a governing body (such as a Commissioner-in-Charge) could unilaterally amend a final budget; this finding also extends to changes or modifications to the budget that might take place during the course of the year. In addition, based on our own professional judgment we find that such a practice is not consistent with the Best Practices exhibited by the survey agencies.

Also, we did find instances where a governing body could and in fact did, amend a budget after the normal approval process. These amendments rarely increase the total spending level as initially approved; they typically result in the re-direction of funds from one core-utility activity to another. As previously noted, most agencies must adhere to a formal, public process to make material changes to approved budgets. While we offer no opinion on whether or not such authority (to modify approved budgets) should exist, we do recommend that if it does exist it should be counter-balanced with a proportionate amount of transparency surrounding how this authority is exercised. In order to reduce

⁶ A percentage and/or dollar threshold could be established wherein the PURB review would be required.

public criticism over these late-entry budget items, it is recommended that the PURB, at a minimum, be made aware of any such items and be given sufficient time to prepare comments to the Council regarding their approval. This may require keeping the PURB involved for the duration of the budget approval process and setting deadlines for when new (un-reviewed) expenditures can be added to the budget. As noted in the recommendation at the start of this section, consideration should be given to a more formal process that “requires” PURB review (not approval) for all material changes to the budget.

5.2. Formal Process Requirements Documentation

Recommendation: Codify/document the formal rate approval process to identify roles and opportunities for public/PURB input.

Based on the information provided by the Water Bureau and BES staff, execution of their respective rate approval processes are not problematic due lack of guidance in the form of formal documentation. Nevertheless, codifying the rate approval process would have the benefit of clearly identifying the roles of bureau management, the Commissioner-in-Charge, the Mayor, the City Council, and the PURB in both the budget process and the rate approval process. The goal should be to formalize the rate approval process such that a maximum amount of flexibility is conferred while defining levels of oversight for budgeting and rate-setting that are consistent with the public’s interest. This will lead to a more formal structure of oversight by the full City Council. The very act of formalizing the process will bring to light any weaknesses of the current process and obligate public approval of the process to be used on a going-forward basis.

Attachment A

Important Budget Events and Dates

Budget Calendar FY 2011-12

December 8, 2010	General Fund financial forecast presentation at City Council.
January 31, 2011	City Bureaus, Council Offices, and Portland Development Commission submit their Requested Budgets, Capital Improvement Plans, and Five-year Financial Plans to Financial Planning.
February 24, 2011	Public Forum on Requested Budget: David Douglas High School, 1001 SE 135 th (Community Fair: 6:00-6:30 pm, Public Forum: 6:30-8:30 pm)
March 1, 2011	Public Forum on Requested Budget: Wilson High School, 1151 SW Vermont (Community Fair: 6:00-6:30 pm, Public Forum: 6:30-8:30 pm)
March 7, 2011	Financial Planning analysis on Requested Budget due to Council.
March 14-18, 2011 April 4-8, 2011	Bureaus and Portland Development Commission present their Requested Budgets to City Council.
April 29, 2011	Mayor releases Proposed Budget decisions.
May 17, 2011	Proposed Budget document released.
May 18, 2011	Mayor presents Proposed Budget to City Council.
May 18 & 25, 2011	Utility Rate Review – first and second reading at City Council.
May 19, 2011	Approved Budget Public Hearing (includes Portland Development Commission). Location TBD
May 25, 2011	City Council votes on the Approved Budget and Portland Development Commission budget.
June 15, 2011	Tax Supervising & Conservation Commission holds public hearing on the Approved Budget.
June 16, 2011	City Council votes to adopt Budget.

Attachment B

City of Portland Survey Questions

Governance

1. How would you describe your role at [Insert Utility]?
2. How would you describe the governance structure for your agency? For example, are you governed by a City Council or a separately appointed board of directors?
3. Are the members of your governing board elected or appointed?
4. Are there any unique circumstances about the governance of your utility that I have not asked about?

Rate Process

5. We are very interested in all the steps you go through to have your rates adopted. Can you briefly identify the major steps and timelines for your rate approval process?
6. How do you receive guidance from your governing body to prepare your budget?
7. We are interested in both when things happen and who is responsible for them. For example, we would like to know how the budget process relates to the rate approval process, and how your citizens are involved in the process. When does your rate approval process begin?
8. Is this process documented in a formal ordinance, mission statement or any written guidance?
9. Who has the specific authority to set rates for:
 - a. Water
 - b. Wastewater,
 - c. Stormwater?
10. What roles do the following play in the rate approval process?
 - a. Staff
 - b. Elected Officials
 - c. Citizens
 - d. Legal Counsel
 - e. Boards or other independent bodies that have a formal role in the rate approval processes
11. What other key dates do you have for your rate approval process?

Public Participation

12. What opportunities does the public have to participate in the rate approval process?
13. Are there any unique aspects of your agency's policy-making process that affects the public's participation in the rate approval process?

14. What is the role of industry groups or special interest groups (for example, low-income advocates) in the rate approval process?

Other Questions

15. Are you funded in part by property taxes or any transfers from the general fund?
16. Is your agency a party to any agreements that impose any requirements on the rate approval process? For example, wholesale service agreements?
17. How large of a role do state and/or federal regulations play in your rate approval process?
18. When was the last time you implemented a rate increase?
19. Is the rate approval process codified in any agency ordinance?

Summary Questions

20. What in your opinion are the aspects of your rate approval process that seem to work the most smoothly from a staff perspective?
21. What in your opinion are the aspects of your rate approval process that seem to work the most smoothly from a governing body perspective?
22. What in your opinion are the aspects of your rate approval process that seem to work the least well from a staff perspective? Please be as specific as possible.
23. What in your opinion are the aspects of your rate approval process that seem to work the least well from a governing body perspective? Please be as specific as possible.
24. Has the public raised concerns regarding your rate approval process?
25. Is there anything else related to your rate approval processes that I have not asked about and which might be helpful in determining best practices for water-sewer-stormwater rate approval processes?

Attachment C Summary of Survey Results

Agency	Services Provided	Form of Governance	Months for Rate Approval Process (approx.)	Years of Rates Approved at Once	Governing Body Role in Developing Budget	Approves Budget	Approves Rates	Public Advisory Committee
Austin Water Utility (Austin, TX)	Water, Sewer	City Council	7	1	Council subcommittee reviews budget	City Council	City Council	Yes
Boston Water & Sewer Commission (Boston, MA)	Water, Sewer	3 Commissioners appointed by Mayor; approved by City Council	6	1	Commissioners review at high level, Council has no role	Board	City Council	No
City of Calgary Water Services (Calgary, AB Canada)	Water, Sewer, Stormwater	City Council	10	3	Council provides written direction for priorities	City Council	City Council	No
Charlotte-Mecklenburg Utilities (Charlotte, NC)	Water, Sewer	City Council	7	1	Council provides guidance through City Manager and can insert items related to utility services	City Council	City Manager	Yes
Denver Water (Denver, CO)	Water	Board of Commissioners appointed by Mayor	11	1	Board reviews budget and advises	Board	Board	Yes
El Paso Water Utilities (El Paso, TX)	Water, Sewer	Public Service Board appointed by City Council; Mayor also on Board	7	1	Board reviews all capital projects over \$1M	Board	Board	Yes
City of Phoenix Water Services Department (Phoenix, AZ)	Water, Sewer, Stormwater	City Council	8	1	City Manager & staff works with Council to develop budget	City Council	City Council	Yes
City of Portland Water Bureau and Department of Environmental Services (Portland, OR)	Water, Sewer, Stormwater	City Council made up of Commissioners that are "in-Charge" of individual Bureaus	6	1	Council represented by Commissioner-in-Charge in budget process	City Council	City Council	Yes
San Antonio Water System (San Antonio, TX)	Water, Sewer	Board of Trustees appointed by City Council; Mayor a Trustee	11	1	Board subcommittee reviews budget and Board can make amendments to budget	Board	City Council	Yes (For rate structure change, not standing)
San Francisco Public Utilities Commission (San Francisco, CA)	Water, Sewer, Stormwater	Board of Commissioners; appointed by Mayor and overseen by Board of Supervisors (veto power)	7	5	General Manager routinely confers with Commission (biweekly)	Board of Commissioners	Board of Commissioners	Yes (multiple committees)
Seattle Public Utilities (Seattle, WA)	Water, Sewer, Stormwater	City Council	12	2-3	Council has consulting role, can direct staff to insert items related to utility services	City Council	City Council	Yes