

---

# Round Hill Rate Study Update

---

Today - Introduction of Issues

Next Meeting – Capital Project Scenarios

March 15, 2023

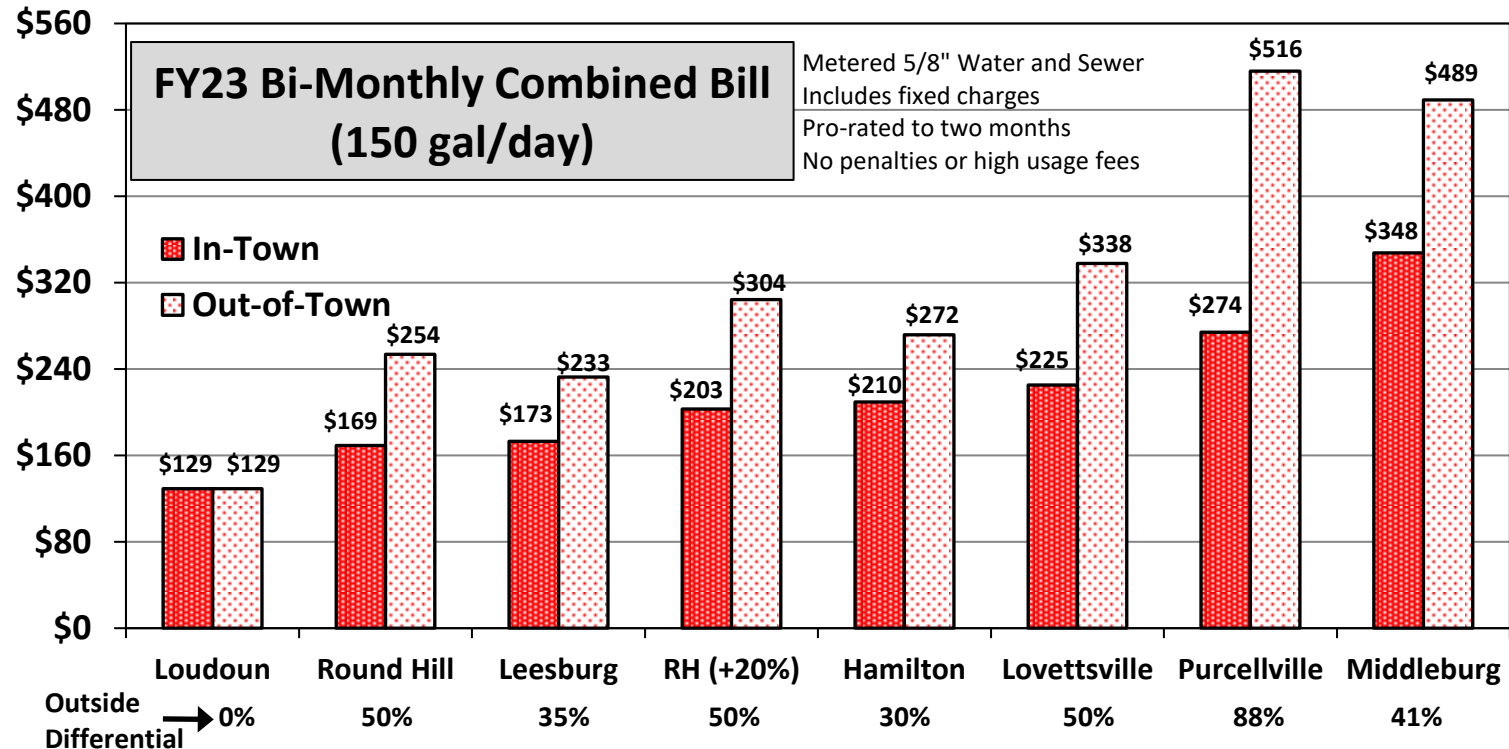
# Rate Study Summary

- Last rate study was 2 years ago in 2021
- Several developments since 2021
  - Housing growth again exceeded 'Fast growth' scenario (+105 in 2 years)
  - New CIP projects and significant growth in construction cost estimates
  - Growth in operating costs that exceeds prior projections
- Financial Model updated with FY22 Audit, current FY23 Draft Budget, and projected CIP expenses
  - Significant rate increases necessary to execute expanded capital plan

Today's discussion is an introduction to issues affecting Round Hill utility rates, and an outline of possible scenarios

# Current (FY23) Rate Comparison

## FY23 Bi-Monthly Combined Bill (150 gal/day)

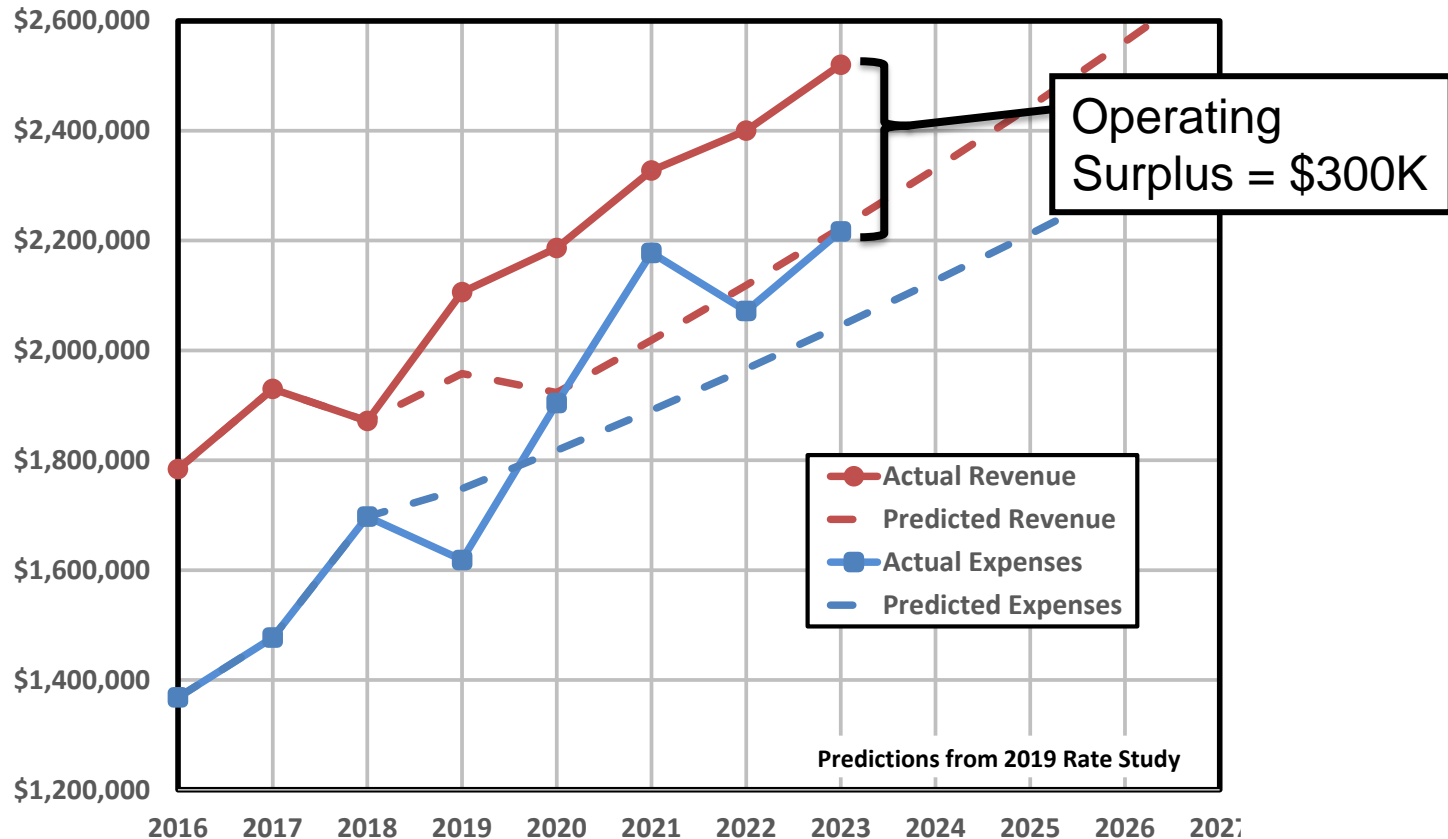


- Round Hill currently has lowest utility rates of the Loudoun towns
  - Even if rates increased 20%, would still be lower than all other towns except Leesburg

# Affordability Index

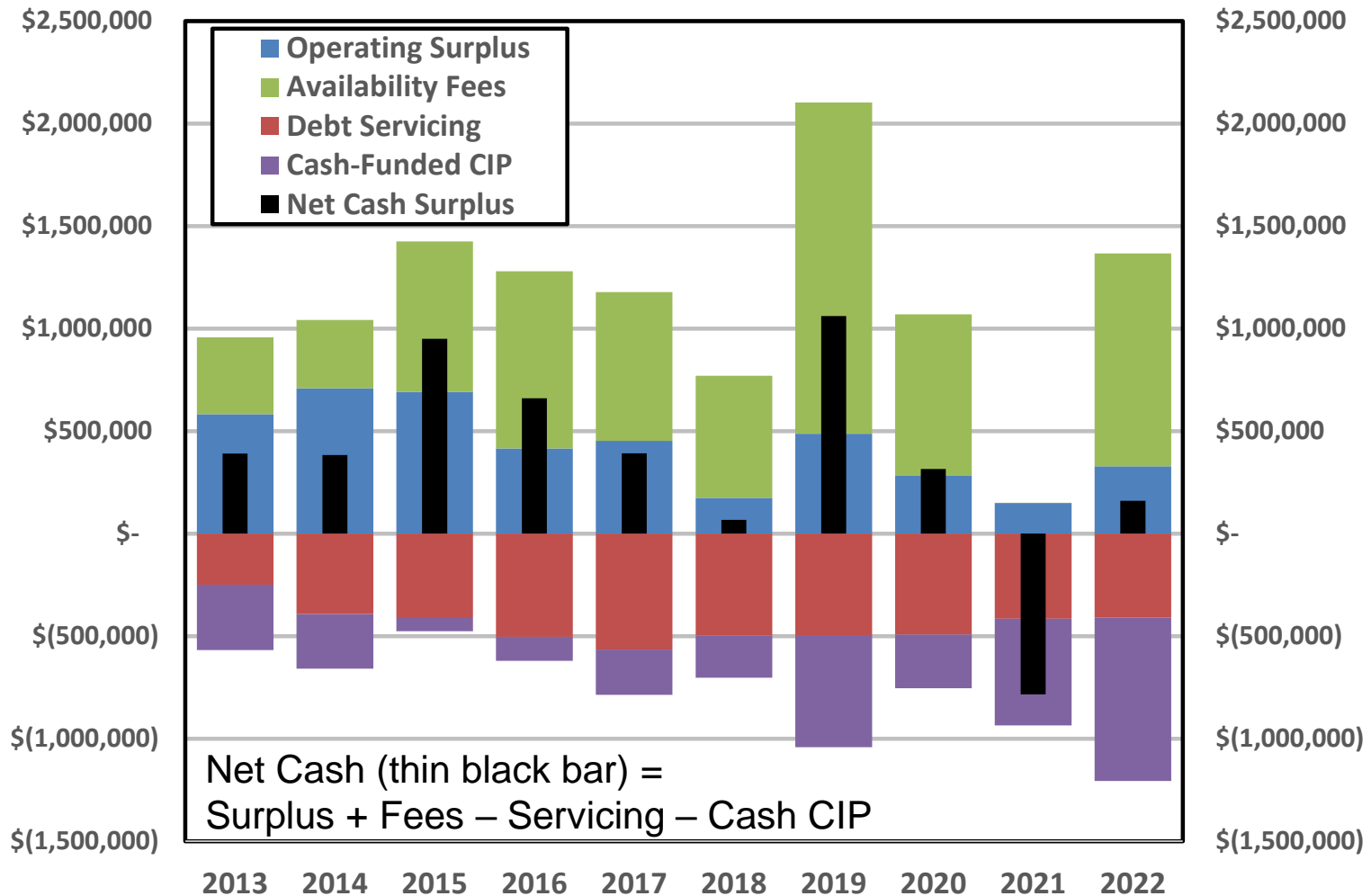
- Round Hill Median Household Income (MHI) = \$96K per Census Bureau
- Affordability Index (AI) = (annual utility bills)/(median household income)
- Typical standard of affordability for public utilities:
  - 2% for water service
  - 4.5% for combined water+sewer service
- Round Hill In-Town Affordability Index = 1.1% (combined) (\$1,015 per year)
- Out-of-Town Affordability Index = 1.6% (combined) (\$1,522 per year)
- Round Hill does not qualify for most state and federal grants because our median household income is high
  - Current rates would be assessed as affordable

# Operating Revenue v. Expenses



- Faster buildout than expected and Covid led to higher operating revenues
- Operating expenses increased 8% per year (vs. 3% per year expected)
- $(\text{Operating Revenue}) - (\text{Operating Expenses}) = (\text{Operating Surplus})$

# Net Cash Flow Past 10 Years



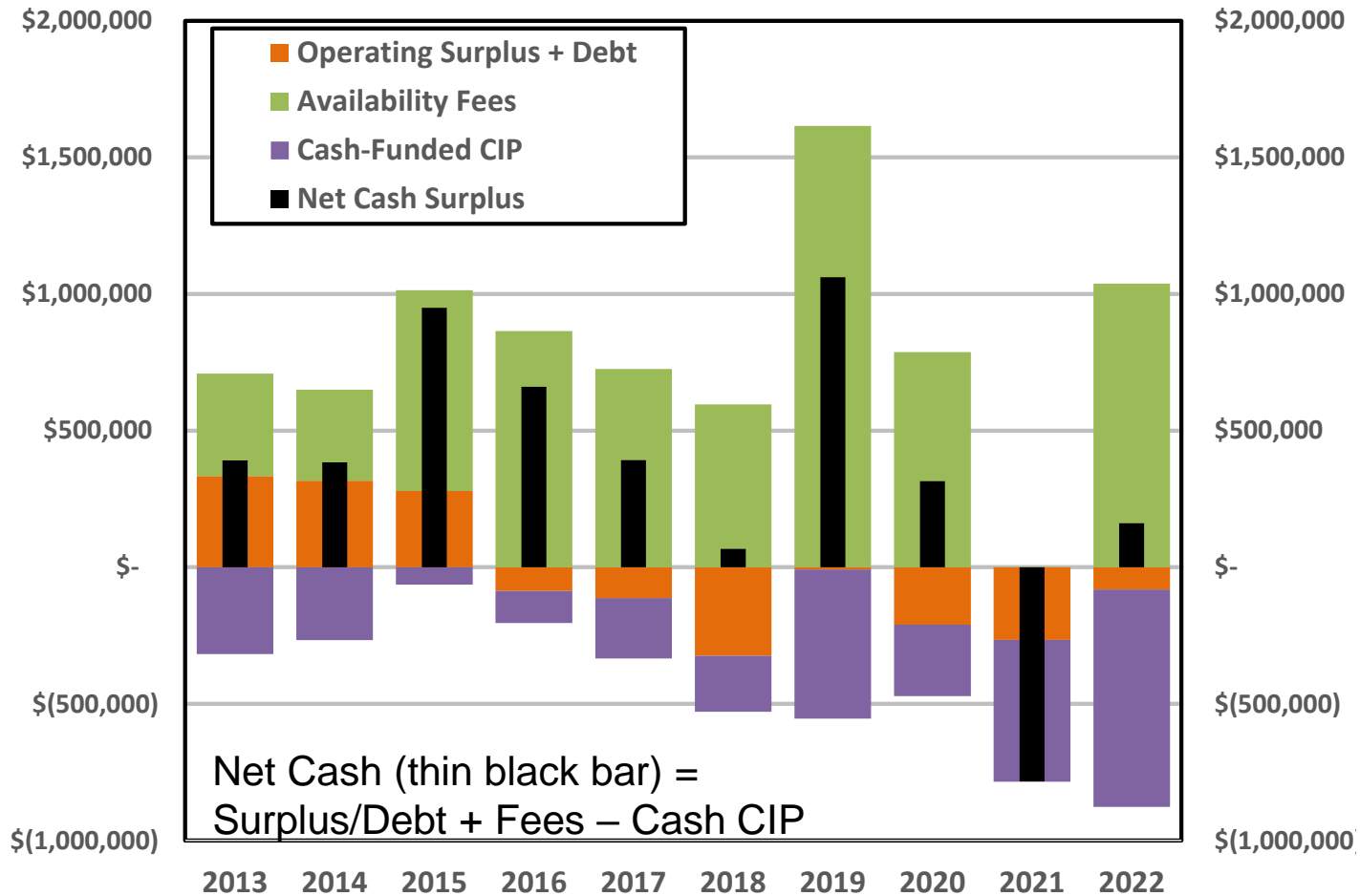
- (Operating Surplus + Availability Fees) balance (Debt Servicing + Cash-Funded CIP)

---

# Debt Servicing as Operating Expense

- Debt servicing is a non-operating expense
  - Availability fees offset debt servicing (and debt-funded CIP)
  - User fees offset operating expenses and cash-funded CIP
- Without incoming availability fees, debt servicing (and hence CIP) act like operating expenses for the Utility Fund
  - Debt servicing is mandatory and cannot be delayed like CIP projects
- Operating surplus must now be enough to repay debt

# Net Cash Flow Past 10 Years (restated)

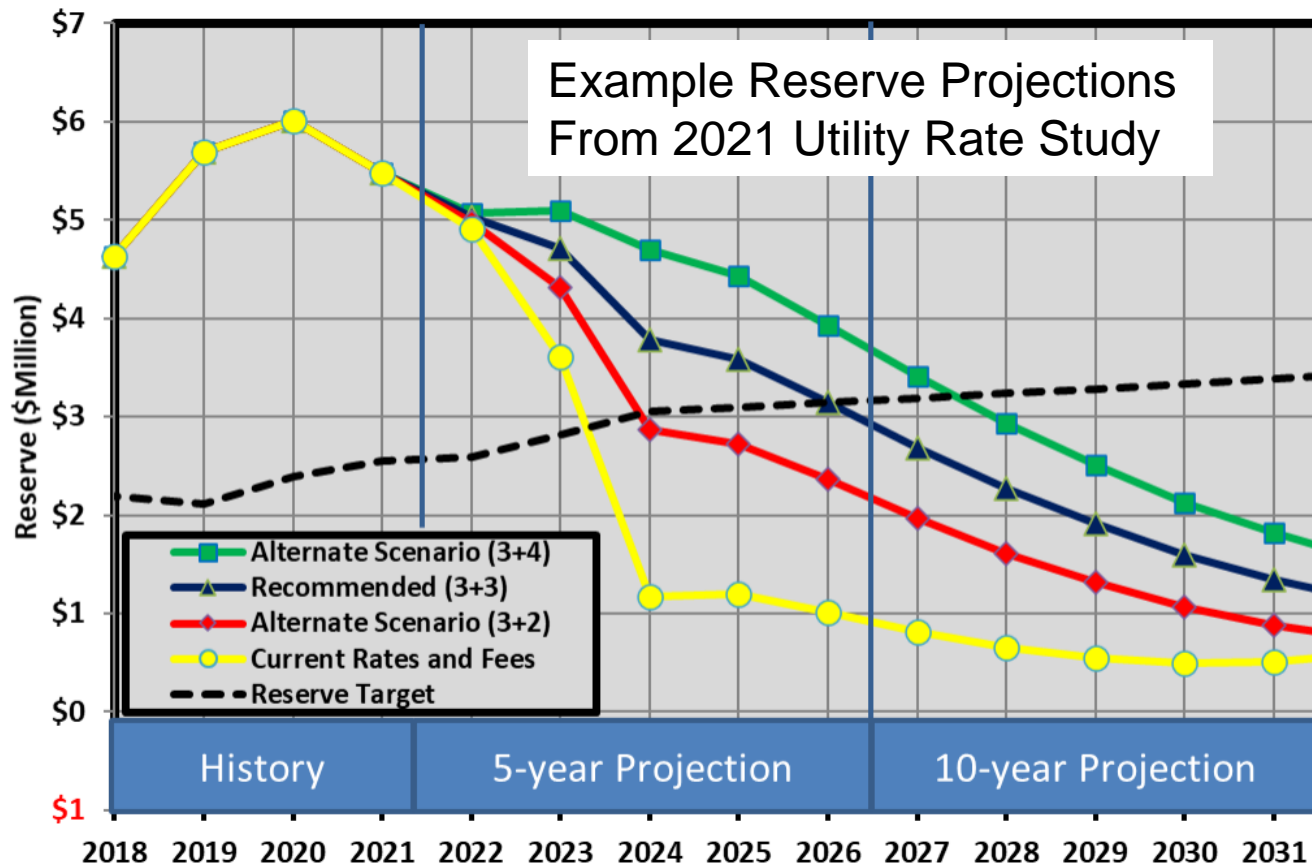


- Operating Surplus + Debt Servicing has been negative since 2015
- Reserves have been maintained due to availability fees



# Why Cash Matters

- Rates are set in order to maintain adequate operating reserves
  - Town fiscal policy sets required reserve level at 12 months of operating expenses
  - Current approach is to set rates to maintain reserve levels for next 5 years



# Cash Flow Pressure Next 10 Years

- Availability Fees are disappearing – system is near build out
  - Fewer than 100 remaining connections (out of 1950) – mostly infill
  - Past 10 years: \$7M collected
  - Next 10 years: \$2.5M predicted
  - Future CIP (and debt servicing) must come from operating surpluses
  
- CIP Expenses projected to be significantly increased
  - Past 10 years: **\$3.3M CIP** expenses
  
  - 2021 rate study assumed **\$9.6M CIP** 2021-2026 CIP funded partially by \$6M in new debt
    - \$3.3M Southern Tank, \$2.5M ESTP, \$1M Utility Bldg, \$0.6M Well D, \$2.2M Other
    - Current rates were set to meet that assumed level of CIP spending
  
  - FY22-27 Draft CIP (January 18, 2023) presented this cycle showed **\$13.4M CIP**
    - Increased: \$4.2M Southern Tank, \$3.3M ESTP, \$1.2M Utility Bldg, \$0.8M Well D
    - New: \$0.9M Tertiary Filters, \$0.6M Stoneleigh Tank, \$0.5M Valve replacements
  
  - Working with Town Administrator on Reduced CIP Option (**\$12M CIP** Target)
    - Temporary delay of Southern Tank, Indefinite delay of several other projects
    - Projected new debt increases from \$6M to \$8M

# Cash Flow Pressure (Continued)

- Other Factors Than Increased CIP Construction costs
  - Inflation has increased significantly in past 12 months
    - 2019 Rate Study assumed 3% annual increases
    - Actual Operating costs increased 8% per year over last 7 years
    - Suggest 5% annual increases to track future inflation until costs stabilize
  - Borrowing costs have also increased (4-6% interest rates anticipated)
    - Current debt: \$3.75M with \$400K/year servicing, will be retired in 2034
    - \$8M in new debt assumed, if in 20-year loans:
      - 4% interest rate -> \$588K per year additional servicing
      - 5% interest rate -> \$641K per year additional servicing
      - 6% interest rate -> \$698K per year additional servicing
  - \$6M of new borrowing at 3% interest was built into current rates (+\$404K/year)
  - \$8M of new borrowing at 6% interest would require +\$698K/year
    - Need to raise user rates 12% just to cover increased debt servicing projection
    - \$2.5M Revenues x 12% rate increase = \$300K/year to service debt

# Water Rate vs. Sewer Rate

- Previous discussion assumed equal increases to water and sewer rates
  - Current rates are \$7.39 Water and \$11.09 Sewer
  - Water rate = 1.5x Sewer rate, so bills are 40% water/60% sewer
- There are not separate water and sewer funds within our books
  - Distinction is to set fair rates for water-only and sewer-only users
  - ~1745 combined users, ~73 water only users, ~13 sewer only users
- Because most of new CIP are water-only projects, most of the necessary increases are from water-only
  - Instead of 40% water/60% sewer, should be closer to 50%/50% now
- Extreme example: 25% combined rate increase (+55% water, +5% sewer)
  - 1745 users see +25%, 73 users see +55%, 13 users see +5%
  - Would be seen as very unfair to the 73 water-only users
  - Suggest reducing rate-shock on water-only users by either keeping current 40/60 split or only going to 45/55 split instead of 50/50

---

# The Good News

- There is good news
  
- Round Hill has significant debt capacity available
  - Borrowing \$8M will still keep Town well below policy limits on debt
  - Current policy is to finance up to 75% of CIP
    - Should try to finance all major projects, even up to \$10M
  
- Round Hill has low rates currently relative to peers
  - Approximately same as Leesburg, well below other Towns
  - 30% rate increase would only surpass Leesburg and Hamilton
  
- Round Hill has solid reserve levels
  - Can phase in increases over several years if delay some projects

# Potential Rate Scenarios

- Depend on final CIP, interest rate, inflation assumptions
  - Still finalizing revised CIP project list with staff
  
- Full CIP (\$13.4M), Step Increase
  - 30% - 5% - 5% - 5% - 5% - 5%
  
- Full CIP (\$13.4M), Phased Increase
  - 15% - 15% - 10% - 10% - 5% - 5%
  
- Reduced CIP (\$12M), Step Increase
  - 24% - 5% - 5% - 5% - 5% - 5%
  
- Reduced CIP (\$12M), Phased Increase
  - 13% - 13% - 8% - 8% - 5% - 5%

**Examples only**

**Updated and  
detailed scenarios  
to be presented at  
next meeting**

---

# Next Steps

- Refine CIP project list
  - Timing and status of major projects
    - Delay Southern Tank?
    - Delay ESTP?
    - Delay/replan Office Building?
    - Delay/replan 2<sup>nd</sup> Stoneleigh Tank?
  
- Discuss detailed CIP and rate scenarios at next Council meeting
  - Focus on major projects, but many smaller projects can add up
  
- Council sets direction on acceptable rate plan and CIP
  
- Staff/Mayor prepare Rate Study report for Council approval