Utilities 2013-2018 Financial Forecasts
Water, Wastewater, and Storm & Surface Water Funds

The early outlook forecast is based on a status quo budget and does not include any new programs. Since all Utility functions are supported by rates, the forecasts include funding for operations, asset replacements (e.g., vehicles), capital investment programs (CIP), and the long-term Replacement and Renewal (R&R) requirements.

The overarching goal for this early forecast was to limit projected rate increases for all three funds to levels previously shared with Council despite increasing costs and a decrease in rate based revenues, especially in the Water Utility. This goal has been accomplished for all three Utility Funds through cost containment measures undertaken in 2011 and going forward in the operations and capital programs.

As part of the 2013-2014 Budget development process, Utilities management will continue to look for opportunities for cost containment from efficiencies gained through process improvements, as well as a review of the array of services provided and service levels.

Key Challenges:

Wholesale Costs:

Approximately 50 % of water rate revenues and 70% of the wastewater rate revenues support costs relate to the purchase of water from the Cascade Water Alliance, and to payments to King County for wastewater treatment, respectively. Rate increases are needed to fund cost increases for these functions. To ensure sufficient funding to maintain the integrity of utility operations and capital programs, Council-adopted policy directs that rate increases necessary to fund wholesale costs be passed through to the customer so as to not degrade operations or the CIP.

Impact of Aging Infrastructure on both Operating and Capital Programs:

The Utilities' infrastructure is aging and most of the systems are well past their mid-life. As a result, the drinking water, wastewater, and storm and surface water systems are experiencing more failures and increasing costs for damage claims and unanticipated system repairs. To minimize costs and optimize the integrity of the systems, Utilities has developed a strategic asset management plan that prioritizes asset replacements based on criticality to achieving service level goals and also identifies the most cost-effective capital improvement, operations, and maintenance strategies. These planning efforts coupled with effective maintenance programs are designed to extend infrastructure life and minimize life-cycle costs. These actions are integral to the funding strategies designed to smooth rate increases and provide intergenerational equity. In implementing cost containment measures, Utilities' staff are mindful to not jeopardize the operation or the integrity of the systems.

Regulatory Requirements including National Pollutant Discharge Elimination System (NPDES):
Regulatory requirements on Utilities programs are increasing and may necessitate rate increases:
Ecology plans on issuing a new NPDES Municipal Stormwater Permit in 2012 that will build on the current permit and add new costs. Based on draft permit language, new conditions will be phased in over the 5-year permit term beginning in August 2013, with full new permit costs roughly estimated at $500,000 per year.

Regulatory and environmental permit fees are increasing across-the-board and utility monitoring requirements are becoming more stringent; for example, the drinking water program operating permit fees are expected to increase from approximately $9,000 to $40,000 per year by 2014 as mandatory disinfection by-products sampling begins in 2012.

Decrease in Water Demand and Corresponding Impact on Water Service Revenues:
Water demands have been decreasing over the past several years; this trend also has affected other water utilities in the region and across the country. There are three primary factors contributing to decreasing water demand: (1) long-term conservation efforts; (2) two consecutive years (2010 and 2011) with cooler summer weather and lower sales; and (3) impacts of the economic recession. The combination of these factors has reduced water reserves to unacceptably low levels despite cost containment efforts to date. Projected rate increases coupled with cost containment efforts will restore reserves to target levels by 2018.

A one-time cost adjustment is also being included in water rates. This adjustment reflects the cumulative effects to date of the current wholesale water supply contract with Cascade Water Alliance. The Cascade contract is fixed in the short term and therefore does not fluctuate with retail water sales. As such, in periods of low water sales, revenues decrease but wholesale supply costs do not. Since the Water Fund is experiencing declining water sales, this adjustment attributes a greater portion of the required retail rate increase to Cascade costs.

Water rate revenue projections have been revised downward from previous estimates to better reflect historical results. Wastewater revenue projections, which have not shown reductions similar to those experienced in Water, were also adjusted downward to recognize the linkage between water and sewer volumes.

A cost containment plan developed and implemented in 2011 identified almost $4.8 million in cost reductions for the Water utility is the primary reason water rate projections have been limited to those shown in the previous forecast from 2010. Other actions currently underway include a study of rate design alternatives to improve revenue stability, ongoing cost containment analyses in conjunction with the 2013-14 budget process, and a continued emphasis on process improvements focusing on further efficiencies.

Personnel, Taxes and Other Operating Costs:
Consistent with the City’s General Fund forecast, in all three Utility funds, Personnel and associated benefit costs are a significant rate driver. These costs are increasing in large part

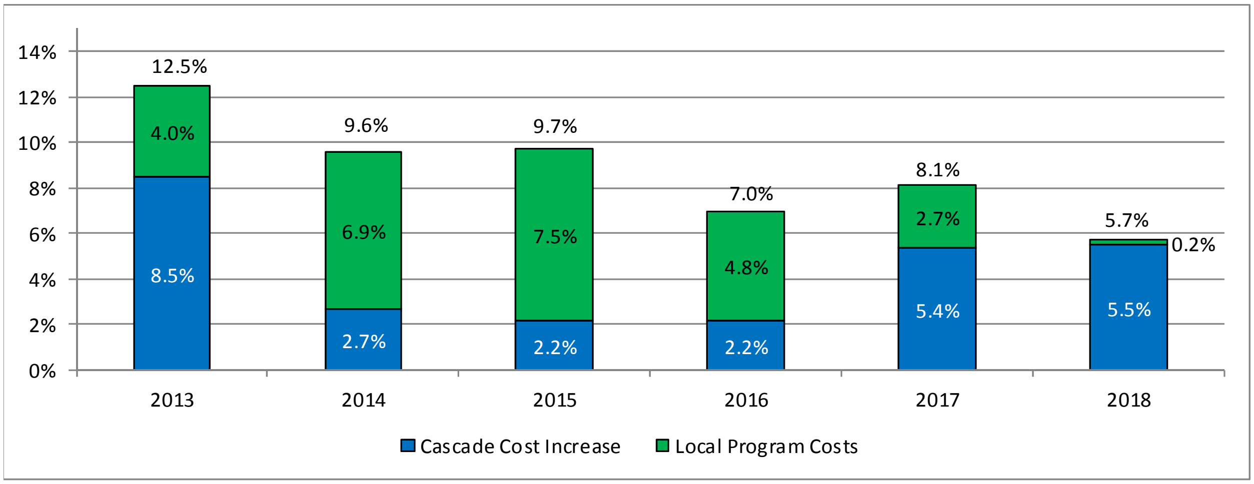
due to increases in medical costs and other benefits, which are not in Utilities' direct control. State taxes are another rate driver for all three funds, although with a somewhat lesser impact on rates. Other Operating Costs, before planned reductions, are projected to increase from 2012 levels at less than the general rate of inflation due to the cost containment efforts.

The following section provides a brief review of each Utility fund forecast and key rate drivers.

WATER UTILITY FUND

2013 - 2018 Early Outlook Rate Forecast

PROJECTED RATE INCREASES



Impact to Monthly Bill for a Typical Residential Customer

	2013	2014	2015	2016	2017	2018
Prior Year Bill	$44.87	$50.48	$55.32	$60.69	$64.94	$70.20
Increase:						
Wholesale	3.81	1.36	1.22	1.34	3.51	3.86
Local	1.79	3.48	4.15	2.91	1.75	0.14
Total	5.61	4.85	5.37	4.25	5.26	4.00
Projected Bill	$50.48	$55.32	$60.69	$64.94	$70.20	$74.20

Key Rate Drivers

- **Wholesale Costs**

  Cascade projects cost increases to Bellevue averaging 4.1% per year for 2013 through 2016, primarily due to purchased water costs. The forecast also assumes 8% annual cost increases for 2017 and 2018, primarily due to the uncertainty of future water demands and the potential need to build future water facilities.

- **Capital Program**

  The capital program continues to ramp up AC watermain replacement from 1.5 miles in 2008 to 5 miles per year by 2018, consistent with the asset management strategy. Also included in the 2011-2017 CIP Program are a number of growth-related capital projects, including increased area-specific water reservoir storage and water supply despite region-wide reductions in water sales, and mandated WSDOT utility relocations. The other capital rate driver will be construction inflationary costs. These will require rate increases averaging about 2.7% per year.

- **Personnel Costs**

  Projected personnel costs will require rate increases of about 1.4% per year in 2013 and 2014, and about 0.8% per year thereafter, largely due to increases in medical and other benefits. This is consistent with projections for other City departments. The forecast assumes no new FTEs for operations during this forecast period.

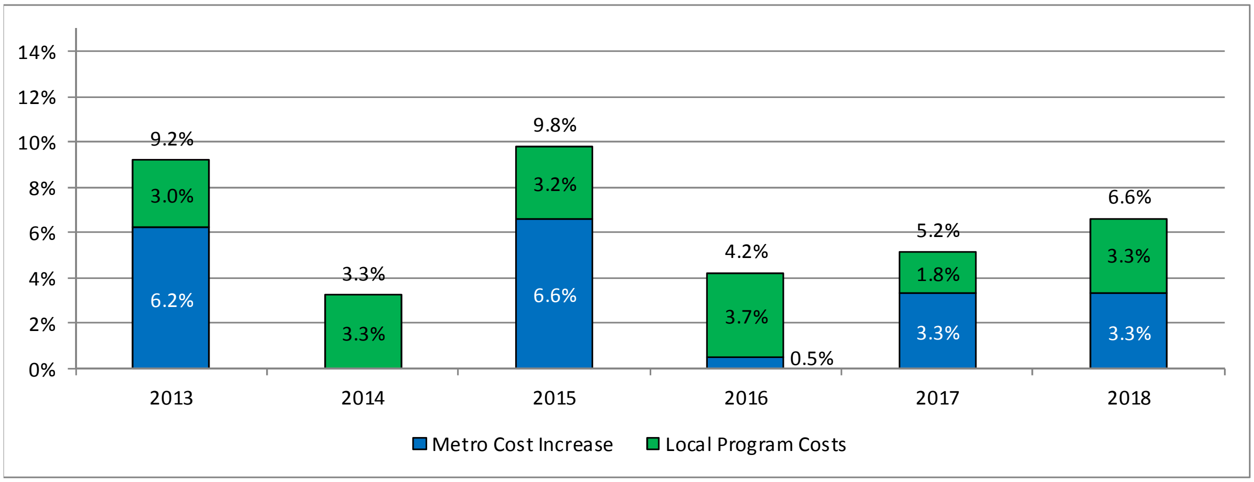
- **Other Operating Costs**

  Interfund payments to other City departments will require rate increases averaging about 0.3% per year. State taxes will require rate increases averaging about 0.4% per year due to increased rate revenues. Other operating costs are increasing at a rate significantly below inflation (CPI).

WASTEWATER UTILITY FUND

2013 - 2018 Early Outlook Rate Forecast

PROJECTED RATE INCREASES



Impact to Monthly Bill for a Typical Residential Customer

	2013	2014	2015	2016	2017	2018
Prior Year Bill	$60.39	$65.94	$68.09	$74.78	$77.95	$81.97
Increase:						
Wholesale	3.76	0.00	4.52	0.39	2.60	2.71
Local	1.79	2.15	2.17	2.78	1.42	2.73
Total	5.55	2.15	6.69	3.17	4.02	5.44
Projected Bill	$65.94	$68.09	$74.78	$77.95	$81.97	$87.41

Key Rate Drivers

- **Wholesale Costs**
  King County/Metro projects cost increases to Bellevue averaging 3.3% per year, primarily due to ongoing debt service and operating costs from the Brightwater treatment plant and operating costs related to compliance requirements associated with the Combined Sewer Overflow (CSO) program.

- **Capital Program**
  The capital program includes an increase for repair of significant sewer pipe defects, beginning in 2014 and ongoing, consistent with the asset management strategy of extending the useful life of pipes as long as it is cost effective to do so. The program also includes a number of growth-related capital projects including sewer lines under street improvements in the BelRed Corridor, and mandated WSDOT utility relocations. Capital costs, including transfers to the R&R account, will require rate increases averaging about 2.0% per year.

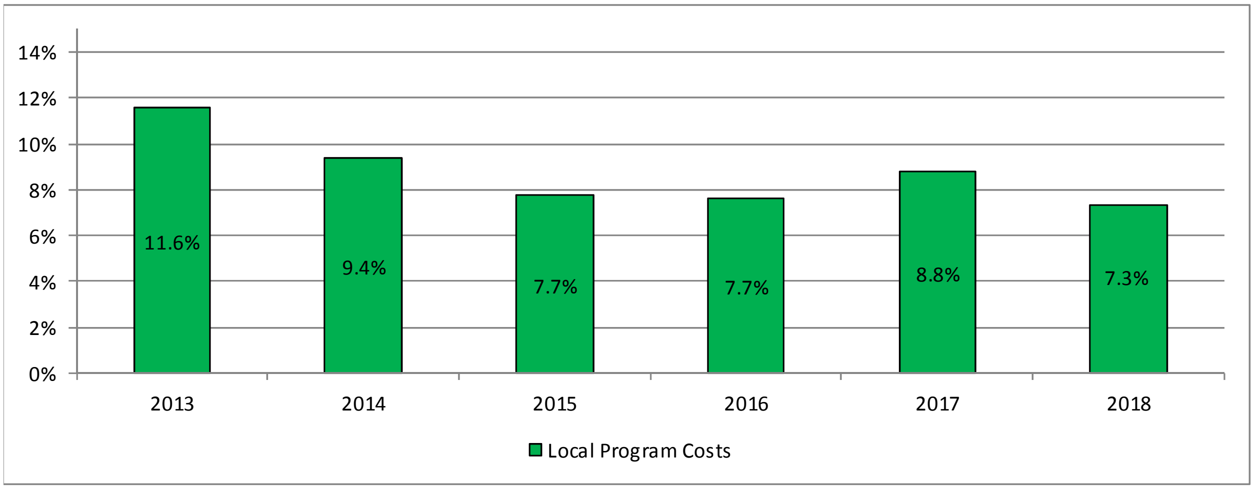
- **Personnel Costs**
  Projected personnel costs will require rate increases of about 0.8% per year in 2013 and 2014, and about 0.4% per year thereafter, largely due to increases in medical and other benefits. This is consistent with projections for other City departments. The forecast assumes no new FTEs for operations during this forecast period.

- **Other Operating Costs**
  Interfund payments to other City departments will require rate increases averaging about 0.2% per year. Other O&M costs will also require rate increases averaging 0.2% per year. State taxes will require rate increases averaging about 0.1% per year due to increased rate revenues. Other operating costs are increasing at a rate significantly below inflation (CPI).

STORM AND SURFACE WATER UTILITY FUND

2013 - 2018 Early Outlook Rate Forecast

PROJECTED RATE INCREASES



Impact to Monthly Bill for a Typical Residential Customer

	2013	2014	2015	2016	2017	2018
Prior Year Bill	$18.26	$20.37	$22.28	$24.01	$25.85	$28.12
Increase	2.11	1.91	1.73	1.84	2.27	2.06
Projected Bill	$20.37	$22.28	$24.01	$25.85	$28.12	$30.18

Key Rate Drivers

- **Capital Program**

  The capital program includes significant work to open and restore streams in the BelRed Corridor as that area redevelops, as part of the Mobility and Infrastructure Initiative, which requires an annual 1.5% rate increase through 2018. Other ongoing storm capital projects are for infrastructure repair, including the Coal Creek Parkway culvert replacement, flood control, and environmental preservation. Capital costs, including transfers to the R&R account, will require rate increases averaging about 6.0% per year.

- **Personnel Costs**

  Projected personnel costs will require rate increases of about 2.2% per year in 2013 and 2014, and about 1.3% per year thereafter, largely due to increases in medical and other benefits. This is consistent with projections for other City departments. The forecast assumes no new FTEs for operations during this forecast period.

- **Other Operating Costs**

  The Storm utility will fund half of street sweeping operations starting in 2012; this has a one-time rate impact of 1.1%. Interfund payments to other City departments will require rate increases averaging about 0.5% per year. Other O&M costs will also require rate increases averaging 0.4% per year. State taxes will require rate increases averaging about 0.2% per year due to increased rate revenues. Other operating costs are increasing at a rate significantly below inflation (CPI).