



KING COUNTY AUDITOR'S OFFICE

DECEMBER 1, 2022

Follow-up on Wastewater Capacity Charge: Unclear Whether Growth is Paying for Growth

Since the last follow-up report, the Wastewater Treatment Division (WTD) has hired a consultant to evaluate the existing capacity charge model and begin developing a simpler alternative, making progress toward a capacity charge that is less susceptible to error while being more transparent, verifiable, and equitable. A simpler approach creates the opportunity to easily verify that growth costs are paid by growth revenues, and WTD plans to have its methodology independently verified every six years moving forward. As part of the consultant's new methodology, WTD now fully allocates existing excess capacity to growth costs and potentially avoids creating conflicts in financial policy goals. The consultant also found that the amount of the capacity charge calculated by the current model is very sensitive to the discount rate WTD uses in its estimates of costs and revenues, making it even more important that WTD obtain explicit authorization if it continues to use a rate greater than inflation.

Of the seven audit recommendations:

 <div>0 DONE</div>	 <div>6 PROGRESS</div>	 <div>1 OPEN</div>
Fully implemented Auditor will no longer monitor.	Partially implemented Auditor will continue to monitor.	Remain unresolved Auditor will continue to monitor.

Please see details below for implementation status of each recommendation.

Recommendation 1

PROGRESS



The Wastewater Treatment Division, working with its component agencies, should develop an approach to determining the capacity charge that leads to a simpler and more transparent model, and propose for consideration by the Regional Water Quality Committee and the County Council any changes to the financial policies necessary to implement such an approach.

STATUS UPDATE: WTD has completed initial discussions with its component agencies about revising the approach to calculating the capacity charge. With input from the Metropolitan Water Pollution Abatement Advisory Committee (MWPAAC), WTD hired a consultant to develop a new model approach that is simpler and reflects current industry standards. WTD and its consultant have briefed MWPAAC at a high level on the direction of the changes in a series of meetings in 2021. WTD is continuing to work on developing a new method and expects to be able to implement these changes when a new agreement is reached with component agencies.

WHAT REMAINS: In order to fully implement the recommendation, once WTD develops a simpler and more transparent model, it should communicate to the King County Council and the Regional Water Quality Committee any changes to code necessary to implement the new approach.

Recommendation 2

PROGRESS



The Wastewater Treatment Division should have an independent party review the validity of the model's methodology and calculations on a regularly scheduled basis.

STATUS UPDATE: WTD hired a consultant to review the validity of the existing model's methodology. Once the new model referenced in Recommendation 1 has been implemented, WTD plans to have an independent review of the new methodology every six years.

WHAT REMAINS: In order to fully implement the recommendation, WTD should have the validity of the new model independently reviewed every six years, as planned.

Recommendation 3

PROGRESS



The Wastewater Treatment Division should ensure that the approach developed in Recommendation 1 allows a reviewer to verify the extent to which growth costs equal growth revenues based on values estimated independently of the model.

STATUS UPDATE: WTD is working with its consultant to revise and simplify the methodology for determining growth costs and growth revenues, which will be easier to verify. Implementing their proposed methodology will require revisions to code and policies.

WHAT REMAINS: In order to fully implement the recommendation, once WTD has finalized its new methodology, it should communicate to the County Council and the Regional Water Quality Committee any necessary changes to financial policies or code, along with the changes to implement Recommendation 1.

Recommendation 4

OPEN



The Wastewater Treatment Division should either stop discounting growth costs and revenues in the capacity charge model by more than the inflation rate or propose that the King County Council modify the financial policies to explicitly authorize such a practice, consistent with state law.

STATUS UPDATE: The key finding by the consultants WTD hired to evaluate the validity of the capacity charge model was that “the calculation is very sensitive to the discount rate.” For example, the consultants found that doubling the discount rate did not simply double the capacity charge, but rather resulted in a capacity charge that was five times higher (\$13.55 with a 3 percent rate close to historic inflation, but \$67.25 with the 6 percent rate used by WTD). WTD stated that the County Council authorized its continued use of a 6 percent discount rate in Motion 16041.

In Motion 16041, the County Council adopted revised comprehensive financial management policies for the County. Although these policies discussed using discount rates for cost-benefit analyses in general, they did not explicitly authorize the practice of using a discount rate greater than the inflation rate when calculating growth costs and revenues. The only reference to using discount rates for rate-setting purposes is as an example of using permissible alternative rates to account for future uncertainty. However, accounting for future uncertainty was not the purpose WTD gave for its use of its discount rate in the capacity charge model. In response to the audit, WTD instead stated that its use of the discount rate “recognizes the cost to existing customers of carrying the costs of creating new capacity, in addition to the effects of inflation, thus helping ensure growth is paying a fair share.” Furthermore, the financial policies limit use of such alternative rates to those “accompanied by clear and documented assumptions for the alternative rate,” but WTD has not provided any documentation for why it chose to use a 6 percent rate.

Recommendation 5

PROGRESS



The Wastewater Treatment Division should continue developing a new methodology that fully estimates how much existing excess capacity should be allocated to growth costs.

STATUS UPDATE: The new methodology being developed by WTD’s consultant for calculating the capacity charge fully allocates existing excess capacity to growth costs.

WHAT REMAINS: In order to fully implement the recommendation, WTD should propose changes to code and financial policies that would allow it to implement a new methodology for calculating the capacity charge that fully estimates how much existing excess capacity should be allocated to growth costs.

Recommendation 6

PROGRESS



The Wastewater Treatment Division should propose to the King County Council, as part of the proposal in Recommendation 1, a way to resolve conflicts between other financial policies and KCC 28.86.160(C)(3)(FP-15)(3)(d), which mandates that each new customer pay an equal share.

STATUS UPDATE: The methodology developed by WTD's consultant potentially removes the conflicts between the policy that growth pays for growth and the policy that each customer should pay an equal share of growth costs.

WHAT REMAINS: In order to fully implement the recommendation, WTD should propose changes to code and financial policies that would allow it to implement a new methodology for calculating the capacity charge that does not create a conflict between financial policy goals.

Recommendation 7

PROGRESS



The Wastewater Treatment Division should propose to the King County Council, as part of the proposal in Recommendation 1, a way to resolve the ambiguities in KCC 28.86.160(C)(3)(FP-15)(3)(g), which allocates growth-related capital costs.

STATUS UPDATE: WTD states that the language in subsection KCC 28.86.160(C)(3)(FP-15)(3)(g) would be revisited when developing a proposal to implement the new methodology developed by WTD's consultant.

WHAT REMAINS: In order to fully implement the recommendation, WTD should resolve the ambiguities in the financial policies as part of its proposal to implement its new methodology for calculating the capacity charge.

Peter Heineccius conducted this review. If you have any questions or would like more information, please contact the King County Auditor's Office at KCAO@KingCounty.gov or 206-477-1033.