



# MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

*Rely on us.*

TO: Commissioners Brown, Mital, Helgeson, Manning and Simpson  
FROM: Cathy Bloom, Finance Manager; Sue Fahey, Fiscal Services Supervisor;  
Harvey Hall, Deborah Hart & Edward Yan, Senior Financial Analysts  
DATE: July 15, 2014  
SUBJECT: Long-Term Financial Plan Update and 2015 Budget Assumptions  
OBJECTIVE: Direction on 2015 Budget Assumptions

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## **Issue**

Board Policy SD6 requires that staff prepare balanced budgets for the Electric and Water Utilities on an annual basis and that the Board approves those budgets by the end of the calendar year. Each summer the Board provides direction to staff on the assumptions used to develop the following year's budget.

## **Background**

In recent years both the Electric and Water Utilities have experienced financial challenges, albeit very different ones. Water consumption did not rebound as quickly as anticipated after the recession resulting in lower than projected revenues to support the high fixed cost nature of the business. Water Utility reserve levels and working cash were extremely low which was compounded by aging infrastructure replacement needs. While Electric loads remained comparatively stable, wholesale power prices plummeted. Power sales revenue budgets which had been used to support operations declined over \$40 million in the last five years as a result of that wholesale price reduction and less resources available from the Bonneville Power Administration. Accordingly, the Electric Utility struggled to balance budgets and meet Board targets for debt service coverage. In June 2013, faced with the potential of over \$20 million in 2014 operations and maintenance (O&M) budget reductions to meet Board financial targets, the Board approved financial policies that align with an "A" bond rating for the Electric Utility versus the prior ones that aligned with a "AA" bond rating. Shortly after that, the Electric Utility's bond rating was reduced to "A" by rating agencies.

In developing the 2013 and 2014 budgets, EWEB reduced over 70 positions and \$7.7 million O&M dollars to increase the financial stability of both Utilities. In addition, capital budgets were reduced or deferred by \$60 million and \$20 million in 2013 and 2014, respectively. These reductions were made using a priority-based budgeting approach aligned with EWEB's overarching strategy "*To Deliver Value for Generations.*"

## **Discussion**

Over the last several months, management and staff have considered the Board's feedback from strategic planning meetings to develop the long term financial plans (LTFP) and budget assumptions. The Strategic Plan approved by the Board included three cornerstone concepts to prepare EWEB for

the future: Be Flexible and Resilient, Enhance Customer Value, and Focus on People – both Customers and Employees. The plan also discusses trade-offs that are often required in order to achieve EWEB’s core mission to enhance our community’s vitality by providing water and electric services consistent with the values of our customer-owners. In assessing those trade-offs, Commissioners indicated that the Electric Utility should improve average bill competitiveness and in order to accomplish that, a slight reduction in Electric reliability would be acceptable given EWEB’s current extremely high reliability. The Water Utility primary trade off was to reduce risk by securing an alternative water source (AWS) and also reducing the average bill competitiveness given the fact that EWEB’s average residential water bill is in the bottom quartile of its comparators. Additional information on bill competitiveness will be provided at the meeting. Management believes that the assumptions used to develop the LTFP address those trade-offs.

### Overarching Forecast Assumptions

The assumptions used in creating forecasts and budgets greatly influence the results. The following assumptions have been used in developing the current forecasts and are anticipated to be used in creating the 2015 budget.

#### Both Utilities

- 2.5% non-labor CPI increase as per the US Bureau Labor and Statistics, Portland/Salem 10 year average
- Labor/Benefits increases:
  - 2.4% salary escalation based on an average of the Portland/Salem CPI for All Urban Consumers (CPI-U) and Wages (CPI-W)
  - PERS increase – 3 percentage points on July 1, 2015, 5 percentage points on July 1, 2017; 3 percentage points on July 1, 2019, 2021, and 2023
    - \$45 million payment to reduce PERS unfunded actuarial liability in 2017 which results in projected total O&M savings of over \$2.5 million starting in 2018
  - Health insurance increase – 15% in 2015, 10% in subsequent years
  - Priority Based Budgeting Related O&M Net Change – Electric: \$1.5 million increase; Water: \$500,000 increase
    - Major items include:
      - Information technology major project assistance - \$800,000
      - Harvest Wind warranty extension - \$300,000
      - Regulatory Increases (NERC/Oregon Department of Energy) - \$125,000
      - System upgrades (Interagency radio system/Customer texting services for outage management) - \$150,000
  - Net 3.0 FTE increase
    - Additions include Electric Distribution Tech, Water Meter Mechanic, Security Systems Coordinator, Work Asset Management Coordinator and Customer Service Specialists
    - Most positions were funded through reorganizations or other budget reductions
- Rate changes effective February

## Electric

- Retail load approximately the same as 2014 budget – 2.5 million mWh
- 90% generation
- \$36 melded mid-market price curve increasing to \$58 in 2024
- Use of reserves to pay off Harvest Wind note in 2015
- Partial year Carmen-Smith generation outages in 2017 and 2023
- Reduction in capital expenses from “business as usual”
- BPA rate increases of 6% in October of odd-numbered years which represents approximately a 2.5% rate impact to EWEB customers.
  - BPA rate increases are assumed to be incorporated into February rate proposals
- Bond issuances of \$15 million and \$53.5 million in 2017 and 2022, respectively

## Water

- Consumption: 7.7 million kgals; 300,000 kgals higher than 2014 due to unrealized assumed sensitivity to prior rate changes
- AWS major work begins in 2018
- Bond issuances of \$19 million in 2016; \$58 million in 2018; and \$21 million in 2021

## **Long-term Financial Plan Rate Assumptions and Outcomes**

### Electric

For the Electric Utility, both 1.5% and 0% February 2015 rate change scenarios are presented along with the resulting projected financial metrics and change in reserves.

- Scenario 1 includes selective strategic capital work which is approximately 25% less than “business as usual” and assumes a 1.5% overall average rate change in 2015 and 2.5% to 5% rate increases in the out years of the LTFP.
- Scenario 2 also assumes a 2015 1.5% overall average rate increase and the same expense assumptions as Scenario 1. Rate increases in the out years; however, have been reduced in order to make progress towards bringing EWEB’s average bill closer to the middle of our comparator utilities and range from 2.25% to 3.5%. Based on LTFP assumptions, in order to maintain the Board target for debt service coverage, approximately \$2 million of reductions would need to occur by 2017.
- Scenario 3 focuses on minimizing rate increases in the short term and further reduces capital work over the LTFP by \$35 million and assumes a 0% rate increase in 2015, 1.5% rate increases in 2016-2018 with rate increases in the out years ranging from 3% to 6.5%. In order to meet board metrics, \$14 million of O&M reductions would be required by 2018. The Electric LTFP outcomes are included in Attachment 1.

### Water

Water Utility scenarios include a 6.3% and a 5.2% February 2015 rate increase. Scenario 1 assumes a 6.3% overall average rate increase in 2015 and includes the financial impact of AWS construction beginning in 2018 with completion in 2020. Scenario 2 assumes a 5.2% 2015 overall average rate increase with the financial impact of AWS construction spread over 4 years beginning in 2018 with completion in 2021. Both options maintain Board targets for financial metrics for the length of the financial plan. The Water LTFP outcomes are included in Attachment 2.

## **Recommendation**

Management recommends that the Board direct staff to prepare the 2015 budget using the assumptions set forth in this document, a 1.5% February 2015 overall average Electric rate increase and the Selective Strategic Capital Plan which is approximately a 25% reduction from “business as usual”. For the Water Utility, management recommends that the Board direct staff to use a 5.2% February 2015 overall average Water rate increase.

## **Requested Board Action**

Staff is not requesting Board action at the July 22<sup>nd</sup> meeting; however, staff is requesting that the Board provide clear direction on the assumptions to be used in developing the 2015 budget.

Attachment 1 – Summary of Electric LTFP Rate Assumptions and Outcomes

Attachment 2 – Summary of Water LTFP Rate Assumptions and Outcomes

# Attachment 1 – Summary of Electric LTFP Rate Assumptions and Outcomes

(Dollars in \$000's)

Scenario	2015 Assumptions		Current Target	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						CS outage						CS outage	
1	Adjusted Present Model - Selective Strategic CIP	Reserves & Cash	\$48,420 - \$58,920	\$102,578	\$108,111	\$84,511	\$97,211	\$107,711	\$116,111	\$130,911	\$153,211	\$179,811	\$213,911
		Operating Reserve Change		\$12,000	\$6,700	\$13,300	\$12,700	\$10,500	\$8,400	\$14,800	\$22,300	\$26,600	\$34,100
		Days Cash	90	147	147	135	148	159	165	181	208	235	272
		DSC	1.75 - 2.0	2.06	1.94	1.93	1.92	2.00	1.99	2.17	2.68	3.00	3.37
2	Long-Term Transformation: Lower/Smoothen rates - Selective Strategic CIP	Reserves & Cash	\$48,420 - \$58,920	\$102,378	\$105,711	\$75,411	\$82,611	\$84,811	\$85,211	\$88,011	\$92,411	\$100,011	\$109,111
		Operating Reserve Change		\$11,800	\$4,500	\$6,600	\$7,200	\$2,200	\$400	\$2,800	\$4,400	\$7,600	\$9,100
		Days Cash	90	147	143	121	126	125	121	122	126	131	139
		DSC	1.75 - 2.0	2.05	1.85	1.67	1.71	1.69	1.69	1.72	1.98	2.16	2.27
		Incremental O&M Cuts to support 1.75 DSC			\$2,000								
		Cumulative O&M Cuts to support 1.75 DSC			\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
3	Near Term Rate Priority: 0% 2015 rate - Responsive CIP	Reserves & Cash	\$48,420 - \$58,920	\$99,096	\$95,756	\$58,056	\$58,956	\$52,556	\$49,166	\$48,966	\$52,101	\$53,031	\$68,951
		Operating Reserve Change		\$10,300	\$800	-\$700	-\$2,600	-\$6,400	-\$3,200	-\$500	\$6,100	\$11,300	\$18,500
		Days Cash	90	140	126	91	89	78	69	67	70	69	87
		DSC	1.75 - 2.0	1.86	1.53	1.27	1.21	1.30	1.37	1.47	1.93	2.18	2.48
		Incremental O&M Cuts to support 1.75 DSC		\$5,500	\$6,400	\$2,200							
		Cumulative O&M Cuts to support 1.75 DSC		\$5,500	\$11,900	\$14,100	\$14,100	\$14,100	\$14,100	\$14,100	\$14,100	\$14,100	\$14,100

Note: Orange highlight represents metric is close to target. Red highlight represents metric is below target.

	Rate Schedule	Rate Increase Assumptions										Compounded 10 Yr Total	
		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024		
1	Adjusted Present Model	General Rate Increase	1.50%	1.75%	4.25%	0.00%	4.00%	0.50%	4.50%	2.50%	2.50%	2.50%	26.64%
		BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
		Carmen/Smith Debt			0.25%					1.00%			1.25%
		<b>TOTAL RATE CHANGE</b>	<b>1.50%</b>	<b>4.25%</b>	<b>4.50%</b>	<b>2.50%</b>	<b>4.00%</b>	<b>3.00%</b>	<b>4.50%</b>	<b>6.00%</b>	<b>2.50%</b>	<b>5.00%</b>	<b>44.74%</b>
2	Long-Term Transformation	General Rate Increase	1.50%	0.50%	2.00%	0.75%	2.50%	1.00%	2.50%	0.00%	2.50%	0.00%	14.02%
		BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
		Carmen/Smith Debt			0.25%					1.00%			1.25%
		<b>TOTAL RATE CHANGE</b>	<b>1.50%</b>	<b>3.00%</b>	<b>2.25%</b>	<b>3.25%</b>	<b>2.50%</b>	<b>3.50%</b>	<b>2.50%</b>	<b>3.50%</b>	<b>2.50%</b>	<b>2.50%</b>	<b>30.51%</b>
3	Near-Term Rate Priority	General Rate Increase	0.00%	1.50%	1.50%	1.50%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	24.86%
		BPA Increase		0.00%		0.00%		2.50%		2.50%		2.50%	7.69%
		Carmen/Smith Debt			0.00%					1.00%			1.00%
		<b>TOTAL RATE CHANGE</b>	<b>0.00%</b>	<b>1.50%</b>	<b>1.50%</b>	<b>1.50%</b>	<b>3.00%</b>	<b>5.50%</b>	<b>3.00%</b>	<b>6.50%</b>	<b>3.00%</b>	<b>5.50%</b>	<b>35.45%</b>

## Attachment 2 – Summary of Water LTFP Rate Assumptions and Outcomes (\$000s omitted)

		Targets	<u>FY2015</u>	<u>FY2016</u>	<u>FY2017</u>	<u>FY2018</u>	<u>FY2019</u>	<u>FY2020</u>	<u>FY2021</u>	<u>FY2022</u>	<u>FY2023</u>	<u>FY2024</u>	cummulative totals	
#1	<b>Present Model</b> - Current course on capital construction, AWS construction spread over 3 years	Rate Adjustment		6.30%	6.30%	6.30%	6.30%	6.30%	6.30%	2.80%	2.80%	2.80%	2.80%	61%
		Debt Service Coverage Target 2.00-2.50	2.00-2.50	3.00	2.79	2.76	2.30	2.05	2.14	2.11	2.12	2.16	2.33	
		Cash Balance Diff from Target (\$1000s)	\$3400	\$5,004	\$6,660	\$10,648	\$10,554	\$4,515	\$85	\$717	\$1,408	\$132	\$50	
		Borrowing assumptions			\$19,500		\$75,500			\$4,700				\$99,700
		Days Cash on Hand	90	233	259	347	342	200	103	119	136	110	108	
#2	<b>Selective Strategic Capital Work</b> - Overall 10% decrease in Capital, AWS construction spread over 4 years	Rate Adjustment		5.20%	5.20%	5.20%	5.20%	5.20%	5.20%	5.20%	5.20%	5.20%	1.30%	60%
		Debt Service Coverage Target 2.00-2.50	2.00-2.50	2.95	2.70	2.60	2.25	2.04	2.11	2.04	2.04	2.16	2.29	
		Cash Balance Diff from Target (\$1000s)	\$3400	\$5,103	\$7,234	\$11,055	\$10,825	\$6,596	\$3,667	\$115	\$751	\$1,096	\$2,061	
		Borrowing assumptions			\$19,000		\$57,800			\$21,500				\$98,300
		Days Cash on Hand	90	245	277	355	345	240	170	95	109	111	125	