



# MEMORANDUM

EUGENE WATER & ELECTRIC BOARD



TO: Commissioners Simpson, Helgeson, Manning, Mital and Brown  
FROM: Sue Fahey, Chief Financial Officer; Deborah Hart, Fiscal Services Supervisor;  
Jerry Reller, Nate Schultz and Sheila Crawford, Senior Financial Analysts  
DATE: September 23, 2016  
SUBJECT: 2017 Draft Budget and Long-Term Financial Plan (LTFP) Update Assumptions  
OBJECTIVE: Direction on 2017 Budget and Price Changes

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## Issue

Board Policy SD6 and Oregon Statutes require that staff annually prepare balanced budgets for the Electric and Water Utilities for Board approval by the end of the preceding calendar year. The foundation of the Operations & Maintenance (O&M) budgets is the Electric and Water Utilities' long-term financial plans, which help ensure that the budgets approved provide longer term financial stability for both utilities. Staff has prepared draft 2017 budgets and updated long-term financial plans (LTFP) for the Board's consideration. The draft O&M budgets include embedded price assumptions to support revenue requirements. Based on Board direction provided at the October 4<sup>th</sup> meeting, staff will develop budgets and price proposals for consideration at the November 1st Board meeting.

## Background

Over the last several years, both the Electric and Water Utilities have faced financial challenges. Those challenges have been managed by strategically reducing O&M and capital costs, designing prices that increase fixed cost recovery, reducing and restructuring debt, and prudently using reserves to strengthen financial metrics. In 2016 the electric utility refunded \$115 million in bonds at a lower interest rate resulting in a cash flow savings of \$19 million and defeased \$28 million in additional debt primarily using proceeds from the sale of Smith Creek. The water utility also realized savings of \$5.6 million from refunding bonds. Financial savings initiatives over the last several years are summarized in Attachment 1.

At the July 19, 2016 meeting, the Board directed staff to prepare the draft 2017 budgets based on the assumptions presented. Since July, certain assumptions have changed resulting in increased savings such as health insurance which decreased from a 5% increase to 2.2%, and additional savings of \$1 million in O&M resulting from the recent reorganization. The following assumptions have been used to develop the budget and LTFP:

## Both Utilities

- 1% non-labor CPI increase
- Labor/Benefit Increases:
  - 2.4% salary escalation
  - PERS increase – 7 percentage points above current rates on July 1, 2017, 7 percentage points in 2019, 5 percentage points in 2021, and 3 percentage points in July 2023 and 2025
  - Health insurance increase – 2.2% in 2017, 8% in 2018 and then 10% in subsequent years
- Financial Initiative Adjustments
  - Electric: \$2.6 million ongoing O&M reductions in 2017
  - Water: \$337 thousand ongoing O&M reductions in 2017

### Electric:

- Retail load approximately the same as 2016 budget – 2.5 million MWh and relatively flat in the out years
- Contribution margin risk tolerance of \$3.2 million which represents 90% generation, 2.6% load reduction or 49% wholesale price reduction
  - Similar contribution margin risk tolerance through 2021, expected conditions 2022-2026
- New large customer load of \$660 thousand in 2017 increasing to \$4.7 million by 2026
- \$25 melder mid-market price curve increasing to \$37 in 2026
- Debt service restructuring with the 2016 bond defeasance and refunding
  - \$47 million savings from refinancing and defeasance combined
- Partial year Carmen-Smith generation outages in 2017, 2018, and 2021 respectively
- Bond issuance: \$67 million in 2019; \$19 million in 2022; and \$13 million in 2025, for funding capital work on Carmen-Smith

### Water:

- Consumption: 7.6 million kgal, approximately the same as the 2016 budget, remaining relatively flat in the out years
- Alternative Water Source (AWS) work begins in 2019
- Bond issuance: \$31 million in 2018; and \$24 million in 2021
- \$850 thousand in additional O&M costs beginning in 2022 to operate AWS

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

### Electric

The Electric Utility LTFP indicates no overall average price change is needed in 2017. This is the third year in a row that the revenue requirement does not include a general price increase. In October 2015 when the board reviewed the LTFP, the plan indicated a 2017 price increase of 3.5%. Through debt reduction and restructuring, and financial initiatives, the projected overall average increase has been eliminated. The Electric LTFP outcomes are summarized in Attachment 2, along with scenarios representing an additional 2.5% load variance in 2017.

## Water

The Water Utility LTFP includes a 3.05% annual price change over the next ten years. This maintains Board targets for financial metrics through the duration of the Financial Plan. The 2015 LTFP projected 3.6% increases for all years throughout the plan. Scenarios were run based on changes in consumption. A 5% increase or decrease in consumption, approximately 400 thousand kgal, represents \$800 thousand in revenue. This would yield an overall 0.5% change in price. The Water LTFP outcomes are summarized Attachment 3.

## **Recommendation**

Management recommends that the Board direct staff to prepare the 2017 budget using the assumptions set forth in this document, a 0% overall average February 2017 Electric price change and a 3.05% overall average February 2017 Water price change. Based on the analysis of consumption and the results of the cost of service analysis (COSA), in November, staff will bring for Board consideration, an additional scenario for each utility.

## **Requested Board Action**

Management is not requesting Board action at the October 4th meeting; however, staff is requesting that the Board provide direction on the assumptions as well as the prices to support the revenue requirements included in the draft budget. At the November 1<sup>st</sup> Board meeting, Management will present the budget and price change proposals which are scheduled to be approved at the December 6<sup>th</sup> meeting.

Attachment 1 - Financial Savings Initiatives 2012 - 2016

Attachment 2 -Summary of Electric LTFP Price Assumptions and Outcomes

Attachment 3 -Summary of Water LTFP Price Assumptions and Outcomes

# Attachment 1

## Financial Savings Initiatives 2012-2016

### 2012

- Electric utility introduced a rate stabilization fund to formally handle swings in revenue and expense due to natural fluctuation in hydro conditions

### 2013

- Reduction measures :
  - ~ Position reductions - Over 50 FTE
  - ~ O&M reductions - \$7.5 million; Capital spending deferral \$60 million
- Established a centralized contingency account to be used for unanticipated expenses, revenue shifts and emergency needs
- The budget assumed hydro generation based on 90% of average stream flow. Unsustainable reserve draws to balance budget eliminated
- Began ongoing water price design changes, relying more on basic charge and less on volumetric charge
- Began completing budget-based power market hedging earlier in the year
- Implemented priority based budgeting

### 2014

- Reduction measures :
  - ~ Position reductions - 20 FTE
  - ~ O&M reductions - \$3.6 million; Capital spending deferral or elimination \$20 million
- Board approved financial policies to align Electric Utility with a single “A” rated utility
- Established a designated fund for future Alternative Water Supply (AWS) project
- Began ongoing Electric price design changes
- Implemented department budget monitoring

### 2015

- \$28.8 million Harvest Wind debt extinguished through strategic use of reserves
- Water Utility established rate stabilization fund
- Financial initiative adjustments - Electric Utility \$2.5 million in ongoing savings, Water Utility \$380 thousand in ongoing savings

### 2016

- Electric Utility realized savings of \$19 million from refunding bonds at lower interest rates
- Water Utility realized savings of \$5.6 million from refunding bonds at lower interest rates
- Electric Utility defeased \$28 million in additional debt using proceeds from Smith Creek.
- Financial initiative adjustments: Electric Utility - \$2.6 million and Water Utility - \$337 thousand in ongoing reductions

## Summary of Electric LTFP Price Assumptions and Outcomes

<b>90% Hydro 2017-2021, 100% 2022-2026. \$3.2M CM Risk Tolerance</b>											
		2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Reserves and Cash	\$69,820	\$130,625	\$126,826	\$134,737	\$138,979	\$142,942	\$149,114	\$152,946	\$155,584	\$157,972	\$168,114
Debt Service Coverage Ratio	1.75	2.29	2.07	2.09	2.01	1.94	2.03	1.67	1.66	1.60	1.93
Days Cash		220	223	247	252	246	240	239	232	232	249
Average Rev Requirement Change		0.00%	2.50%	2.75%	3.25%	1.50%	2.50%	3.50%	2.50%	2.00%	3.00%
O&M improvements to support 1.75 DSC		\$0	\$0	\$0	\$0	\$0	\$0	\$1,800	\$0	\$1,400	\$0
Total O&M improvements to support 1.75 DSC		\$0	\$0	\$0	\$0	\$0	\$0	\$1,800	\$1,800	\$3,200	\$3,200
DSC Ratio with O&M Improvements		2.29	2.07	2.09	2.01	1.94	2.03	1.75	1.75	1.75	2.07

<b>Revenue Requirement Rate Assumptions</b>											Compounded
Rate Schedule	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	10 Yr Total
General Rate Increase			2.00%		1.50%		2.00%		2.00%		7.71%
Carmen/Smith Debt			0.75%	0.75%			1.50%			0.50%	3.54%
BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
<b>Avg Rev Requirement Change</b>	<b>0.00%</b>	<b>2.50%</b>	<b>2.75%</b>	<b>3.25%</b>	<b>1.50%</b>	<b>2.50%</b>	<b>3.50%</b>	<b>2.50%</b>	<b>2.00%</b>	<b>3.00%</b>	<b>26.09%</b>

<b>2.5% Load Reduction in 2017, 90% Hydro 2017-2021, 100% 2022-2026. \$6.3M CM Risk Tolerance</b>											
		2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Reserves and Cash	\$69,820	\$127,925	\$124,126	\$132,037	\$136,279	\$140,242	\$146,414	\$150,246	\$152,884	\$155,272	\$165,414
Debt Service Coverage Ratio	1.75	2.14	2.07	2.09	2.01	1.94	2.03	1.67	1.66	1.60	1.93
Days Cash		216	218	242	247	241	236	235	228	229	245
Average Rev Requirement Change		0.00%	2.50%	2.75%	3.25%	1.50%	2.50%	3.50%	2.50%	2.00%	3.00%
O&M improvements to support 1.75 DSC		\$0	\$0	\$0	\$0	\$0	\$0	\$1,800	\$0	\$1,400	\$0
Total O&M improvements to support 1.75 DSC		\$0	\$0	\$0	\$0	\$0	\$0	\$1,800	\$1,800	\$3,200	\$3,200
DSC Ratio with O&M Improvements		2.14	2.07	2.09	2.01	1.94	2.03	1.75	1.75	1.75	2.07

<b>Revenue Requirement Rate Assumptions</b>											Compounded
Rate Schedule	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	10 Yr Total
General Rate Increase			2.00%		1.50%		2.00%		2.00%		7.71%
Carmen/Smith Debt			0.75%	0.75%			1.50%			0.50%	3.54%
BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
<b>Avg Rev Requirement Change</b>	<b>0.00%</b>	<b>2.50%</b>	<b>2.75%</b>	<b>3.25%</b>	<b>1.50%</b>	<b>2.50%</b>	<b>3.50%</b>	<b>2.50%</b>	<b>2.00%</b>	<b>3.00%</b>	<b>26.09%</b>

2.5% Load Increase in 2017, 90% Hydro 2017-2021, 100% 2022-2026. \$174K CM Risk Tolerance											
		2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Reserves and Cash	\$69,820	\$134,025	\$130,226	\$138,137	\$142,379	\$146,342	\$152,514	\$156,346	\$158,984	\$161,372	\$171,514
Debt Service Coverage Ratio	1.75	2.48	2.07	2.09	2.01	1.94	2.03	1.67	1.66	1.60	1.93
Days Cash		225	229	253	258	252	245	244	237	238	254
Average Rev Requirement Change		0.00%	2.50%	2.75%	3.25%	1.50%	2.50%	3.50%	2.50%	2.00%	3.00%
O&M improvements to support 1.75 DSC		\$0	\$0	\$0	\$0	\$0	\$0	\$1,800	\$0	\$1,400	\$0
Total O&M improvements to support 1.75 DSC		\$0	\$0	\$0	\$0	\$0	\$0	\$1,800	\$1,800	\$3,200	\$3,200
DSC Ratio with O&M Improvements		2.48	2.07	2.09	2.01	1.94	2.03	1.75	1.75	1.75	2.07

Revenue Requirement Rate Assumptions											Compounded
Rate Schedule	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	10 Yr Total
General Rate Increase			2.00%		1.50%		2.00%		2.00%		7.71%
Carmen/Smith Debt			0.75%	0.75%			1.50%			0.50%	3.54%
BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
Avg Rev Requirement Change	0.00%	2.50%	2.75%	3.25%	1.50%	2.50%	3.50%	2.50%	2.00%	3.00%	26.09%

- Retail load approximately the same as 2016 budget – 2.5 million MWh. Actuals for 2015 were 2.4 million MWh.
- Contribution margin risk tolerance of \$3.2 million
  - Similar contribution margin risk tolerance through 2021, expected conditions 2022-2026
- New large customer load of \$660 thousand in 2017 increasing to \$4.7 million in 2026
- \$25 melded mid-market price curve increasing to \$37 in 2026
- Debt service restructuring with 2016 bond defeasance and refunding
- Partial year Carmen-Smith generation outages in 2017, 2018, and 2021 respectively.
- Bond issuance: \$67 million in 2019; \$19 million in 2022; and \$13 million in 2025, for funding capital work on Carmen-Smith.
- 1% non-labor CPI increase
- Labor/Benefit Increases:
  - 2.4% salary escalation.
  - PERS increase – 7 percentage points above current rates on July1, 2017, 7 percentage points in 2019, 5 percentage points in 2021, and 3 percentage points in 2023 and 2025.
  - Health insurance increase – 2.2% in 2017, 8% in 2018 and then 10% in subsequent years.

### Attachment 3

#### Summary of Water LTFP Price Assumptions and Outcomes (000's omitted)

	<b>Current Target</b>	<b><u>2017</u></b>	<b><u>2018</u></b>	<b><u>2019</u></b>	<b><u>2020</u></b>	<b><u>2021</u></b>	<b><u>2022</u></b>	<b><u>2023</u></b>	<b><u>2024</u></b>	<b><u>2025</u></b>	<b><u>2026</u></b>
Reserves & Cash	\$11,680	\$24,212	\$26,981	\$32,117	\$19,959	\$17,748	\$18,986	\$17,144	\$16,585	\$15,458	\$12,997
AWS Reserve Balance <sup>1</sup>		\$6,237	\$7,270	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
DSC	2.00-2.50	3.42	2.96	2.66	2.76	2.50	2.23	2.51	2.56	2.63	2.73
Feb Price Action <sup>2</sup>		3.05%	3.05%	3.05%	3.05%	3.05%	3.05%	3.05%	3.05%	3.05%	3.05%

Note 1: AWS reserve balances subject to change based on board approved transfers each spring

#### Major Assumptions

- Consumption: 7.6 million kgal, approximately the same as the 2016 budget. Actuals for 2015 were 8.2 million kgals.
- AWS work begins in 2019.
- Bond issuance: \$31 million in 2018; and \$24 million in 2021.
- \$850 thousand in additional O&M costs beginning 2022 to operate AWS.
- 1% non-labor CPI increase
- Labor/Benefit Increases:
  - 2.4% salary escalation
  - PERS increase – 7 percentage points above current rates on July 1, 2017, 7 percentage points in 2019, 5 percentage points in 2021, and 3 percentage points in 2023 and 2025.
  - Health insurance increase – 2.2 % in 2017, 8% in 2018 and then 10% in subsequent years.
- \$1.2 million reduction in cash reserve balance by end of plan.