



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 and Edward Yan, Senior Financial Analysts
DATE: September 29, 2014
SUBJECT: 2015 Draft Budget and Long-Term Financial Plans Update
OBJECTIVE: Direction on 2015 Budget and Revenue Requirements/Rates

Issue

Board Policy SD6 requires that staff prepare balanced budgets for the Electric and Water Utilities on an annual basis and that the Board approve those budgets 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 balanced 2015 budgets and updated the long-term financial plans for the Board's consideration. The draft O&M expense budgets determine the revenue requirements needed to fund operations. Using those revenue requirements, staff included embedded rate change assumptions in the draft budgets to prepare a balanced budget. Based on Board direction provided at the October 7th meeting, staff will develop budgets, revenue requirements and final rate proposals for consideration at the November 4th Board meeting.

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 that had been used to support operations have declined about \$40 to 60 million in the last five to seven 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 an additional \$20 million in 2014 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 downgraded 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."

At the July 22, 2014 meeting, the Board directed staff to prepare a draft 2015 budget based on the following assumptions:

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% wage escalation based on an average of the Portland/Salem CPI for All Urban Consumers (CPI-U) and Wages (CPI-W)
 - Health insurance increase – 15%
- Priority Based Budgeting O&M Net Change – Electric: \$1.5 million increase, Water: \$400,000 increase
 - Material items include:
 - Information technology major project assistance - \$800,000
 - Harvest Wind warranty extension - \$300,000
 - Utility costs - \$200,000
 - Regulatory Increases (NERC/Oregon Department of Energy) - \$125,000
 - System upgrades (Interagency radio system/Customer texting services for outage management) - \$150,000
 - Water System Planning and Modeling - \$100,000
 - 1 FTE increase, net
- Reduction in capital expenses from "business as usual"

Electric

- Retail load approximately the same as 2014 budget – 2.5 million MWh
- 90% generation
- \$33/MWh melded mid-market price curve

Water

- Consumption: 7.7 million kgals; 300,000 kgals higher than 2014 due to unrealized sensitivity to prior rate changes

Discussion

The following items represent the more significant changes to the July assumptions:

Both Utilities

- Higher capital labor and overhead costs resulting in lower O&M (\$1.5 million Electric, \$1.1 million Water)

- Alignment of employee benefits with wages resulting in more benefit costs shifting to water than anticipated (\$1 million shift from Electric to Water)

Electric

- Western Generation Agency, Bonneville Power Administration and interest revenue higher than previously anticipated - \$1 million
- Contingency increase of \$1 million to 1% of O&M budget

Revenue Requirements Rate Assumptions and Outcomes

Electric

For the Electric Utility, options for meeting revenue requirements include: (1) an overall average 1% February rate change and (2) no rate change. With the assumptions in the long-term financial plan (LTFP), \$1.7 million of additional on-going revenue or cost reductions would be required to meet the Board's debt service coverage financial target in 2017-2021 using a 1% average rate change or increase in revenue requirements. With no rate change, \$2 million would be required. Whether the Board approves 0% or 1%, we have a significant challenge in front of us.

Provided for your information is the 1% average rate change with a 20% drop in the forward price curve for wholesale power revenue. In that scenario, the debt service coverage gap is \$4.7 million. This scenario demonstrates how significant the wholesale power market is for EWEB and our customers.

The Electric long-term financial plan revenue requirements rate option outcomes are provided in **Attachment 1**.

Water

The Water Utility revenue requirements are calculated using a smoothing strategy and result in a 4.92% overall average rate increase for 2015. Based on the Board's strategic planning work and direction provided at the July 22nd meeting, major Alternate Water Source capital construction work is scheduled to start in 2019, and the LTFP assumes building reserves to reduce future bond issuances.

The Water long-term financial plan 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% overall average February 2015 Electric rate change and a 4.92% overall average February 2015 Water rate change.

Requested Board Action

Management is not requesting Board action at the October 7th meeting; however, staff is requesting that the Board provide clear direction on budget assumptions as well as the rates to support the revenue requirements included in the draft budget. At the November 4th Board meeting, Management will present the budget and rate proposals which are scheduled to be approved at the December 2nd meeting.

Attachment 1– Summary of Electric LTFP Revenue Requirements Rate Assumptions and Outcomes

Attachment 2 – Summary of Water LTFP Revenue Requirements Rate Assumptions and Outcomes

Attachment 1

2015 Electric Long Term Financial Plan Summary
Assumptions and Outcomes (\$000's omitted)

Scenario	2015 Assumptions		Current Target	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				CS outage				CS outage					
1	Long-Term Transformation: Budget 1% 2015 Rate change	Reserves & Cash	\$58,420 - \$68,920	\$99,911	\$104,011	\$73,511	\$80,111	\$81,711	\$82,111	\$85,711	\$92,111	\$103,711	\$119,711
		Operating Reserve Change		\$10,800	\$4,100	\$6,400	\$6,600	\$1,600	\$400	\$3,600	\$6,400	\$11,600	\$16,000
		Days Cash	90	153	147	125	130	129	124	127	135	147	167
		DSC	1.75	2.13	1.85	1.68	1.70	1.68	1.71	1.76	2.07	2.35	2.59
			Incremental O&M Cuts to support 1.75 DSC	\$1,700									
			Cumulative O&M Cuts to support 1.75 DSC	\$1,700	\$1,700	\$1,700	\$1,700	\$1,700	\$1,700	\$1,700	\$1,700	\$1,700	
2	Scenario 1 with 20% Price Decrease	Reserves & Cash	\$58,420 - \$68,920	\$96,211	\$98,411	\$64,911	\$66,711	\$62,511	\$57,211	\$55,311	\$55,911	\$62,511	\$72,811
		Operating Reserve Change		\$9,800	\$2,200	\$3,400	\$1,800	-\$4,200	-\$5,300	-\$1,900	\$600	\$6,600	\$10,300
		Days Cash	90	149	141	112	110	100	88	83	83	90	103
		DSC	1.75	2.09	1.77	1.56	1.52	1.47	1.49	1.56	1.85	2.13	2.33
			Incremental O&M Cuts to support 1.75 DSC	\$4,700									
			Cumulative O&M Cuts to support 1.75 DSC	\$4,700	\$6,100	\$7,500	\$7,500	\$7,500	\$7,500	\$7,500	\$7,500	\$7,500	
3	Long-Term Transformation: Budget 0% 2015 Rate change, 3.25% In 2017	Reserves & Cash	\$58,420 - \$68,920	\$98,111	\$100,411	\$69,611	\$76,111	\$77,711	\$78,111	\$81,711	\$88,111	\$99,611	\$115,611
		Operating Reserve Change		\$9,000	\$2,300	\$6,100	\$6,500	\$1,600	\$400	\$3,600	\$6,400	\$11,500	\$16,000
		Days Cash	90	150	141	118	124	122	118	121	129	142	161
		DSC	1.75 - 2.0	2.06	1.78	1.67	1.69	1.68	1.71	1.76	2.07	2.35	2.59
			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	

Scenario	Assumptions	Rate Schedule	Revenue Requirement Rate Assumptions										Compounded 10 Yr Total
			2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	
1	Long-Term Transformation: 1% in 2015	General Rate Increase	1.00%	0.50%	2.00%	0.75%	2.50%	1.00%	2.50%	0.00%	2.50%	0.00%	13.46%
		BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
		Carmen/Smith Debt			0.25%					1.00%			1.25%
		Average Rate Change	1.00%	3.00%	2.25%	3.25%	2.50%	3.50%	2.50%	3.50%	2.50%	2.50%	29.86%
2	Long-Term Transformation: 1% in 2015 - 20% Price Decrease	General Rate Increase	1.00%	0.50%	2.00%	0.75%	2.50%	1.00%	2.50%	0.00%	2.50%	0.00%	13.46%
		BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
		Carmen/Smith Debt			0.25%					1.00%			1.25%
		Average Rate Change	1.00%	3.00%	2.25%	3.25%	2.50%	3.50%	2.50%	3.50%	2.50%	2.50%	29.86%
3	Long-Term Transformation: 0% in 2015 and 3.25% in 2017	General Rate Increase	0.00%	0.50%	3.00%	0.75%	2.50%	1.00%	2.50%	0.00%	2.50%	0.00%	13.43%
		BPA Increase		2.50%		2.50%		2.50%		2.50%		2.50%	13.14%
		Carmen/Smith Debt			0.25%					1.00%			1.25%
		Average Rate Change	0.00%	3.00%	3.25%	3.25%	2.50%	3.50%	2.50%	3.50%	2.50%	2.50%	29.84%

Power and Wholesale Sales Assumptions

- 90% generation in all years
- 2.5 million MWh sales for 2015 - no material change over 2014
- Forward Price Curve of \$33/MWh in 2015 and \$57 in 2024
- Partial year Carmen-Smith outages in 2017 and 2022
- Includes payoff of Harvest Wind obligation in 2015 and \$37M payment to PERS UAL in 2017

Summary of Water LTFP Revenue Requirements Rate Assumptions and Outcomes (000s omitted)
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Assumption	<u>Current Target</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	
4.92% Average rate change	Reserves & Cash	\$7,900 - \$11,400	\$10,026	\$9,827	\$8,047	\$9,101	\$10,380	\$10,399	\$10,668	\$ 10,568	\$ 9,867	\$ 9,364
	Operating Reserve Change		\$1,052	-\$199	-\$1,780	\$1,054	\$1,279	\$19	\$269	-\$100	-\$701	-\$503
	AWS Reserve change		\$1,000	\$1,000	\$1,000	\$1,000	-\$5,000					
	DSC	2.00-2.50	2.96	2.87	2.68	2.73	2.39	2.14	2.10	2.00	2.05	2.19
	February Overall Average Revenue Requirement Rate Action		4.92%	4.92%	4.92%	4.92%	3.9%	3.9%	3.9%	3.9%	2.1%	2.1%

Major Assumptions

- Consumption: 7.7 million kgals; 300,000 kgals higher than 2014 due to unrealized assumed sensitivity to prior rate changes
- 2.5% non-labor CPI increase as per the US Bureau Labor and Statistics, Portland/Salem 10 year average
- 2015 Priority based budgeting on-going changes carried forward
- AWS construction work begins in 2019
- Labor/Benefits:
 - 2.4% wage escalation based on an average of the Portland/Salem CPI for All Urban Consumers (CPI-U) and Wages (CPI-W)
 - Health insurance increase – 15% in 2015, 10% in the out years
 - \$8 million payment to reduce PERS unfunded actuarial liability in 2017. Reduced O&M PERS costs starting in 2018