

EUGENE WATER & ELECTRIC BOARD
BOARD PLANNING RETREAT
PHOENIX INN—PHOENIX ROOM
AUGUST 17, 2006

Commissioners present: Mel Menegat, John Simpson, and Ron Farmer. Commissioner Patrick Lanning arrived toward the end of the meeting, and President Sandra Bishop was excused.

Others present: Randy Berggren, Jim Origliosso, Jim Wiley, Tom Buckhouse, Debra Smith, Roseanna McArthur, Dick Helgeson, Dick Varner, Dean Ahlsten, Mel Damewood, Patty Boyle, Krista Hince of the EWEB staff; commissioner-elect John Brown; Kim Young and Ruth Atcherson, City of Eugene minutes recorders.

Vice President Menegat convened the Board Planning Retreat for the Eugene Water & Electric Board (EWEB) at 8 a.m. Those present introduced themselves to commissioner-elect John Brown.

AGENDA CHECK

Vice President Menegat reviewed the agenda and determined Commissioners had no changes to suggest.

STRATEGIC PLANNING—RATE STRATEGY

Assistant to the General Manager Debra Smith noted the tie between the rate strategies introduced to the Board at its August 15 meeting to the planning session, in particular in regard to the water utility. She said that staff hoped to make rate setting and rate positions the focus of the Board's 2007 Governance work to help guide staff in the future. She indicated there was a timing issue related to the capital needs of the water utility.

Speaking to water rates, General Manager Randy Berggren said that for the first time since the beginning of his tenure EWEB had a comprehensive ten-year view of its water funding requirements. He said the Board frequently talked with staff about rate comparability and he believed EWEB was in a better position in terms of that issue with water than with electric because of the number of issues that impact electric rates. A diverse and comprehensive set of values was incorporated into electric rates. In addition, there was pressure on the electric capital because of increased materials costs. EWEB's rate competitive position had eroded significantly as EWEB was now in the top third among regional utilities. He believed that EWEB needed to establish policies related to the tradeoffs that must be made to maintain rate competitiveness in the electric utility. Mr. Berggren thought the same would be true of the water utility, and he believed having a policy position would be a very useful tool for the board. The challenge would be the steps that followed the establishment of that position.

Commissioner Farmer expressed support for rate comparisons in general as he believed they helped quantify the dynamic tension between rates and service. He wanted to ensure that the Board considered the rate targets it set on a time horizon. Commissioner Farmer said that the public needed to be educated about rates and the Board's goals and strategies so that when facing rate increases they knew what the Board was thinking about.

Vice President Menegat expressed an interest in seeing information about the utilities EWEB was tracking in regard to the programs and goals encompassed in their rates.

Commissioner Simpson indicated it would be useful for him to have trend data when seeing rate information from other utilities. He also suggested that the Board receive a break down of EWEB rates so it could consider the cost of the value added programs and their impact on rates. He wanted to quantify the value of the product by breaking out its component parts.

Commissioner Farmer said there would always be a tension between such things as price and reliability, for example, but ideally, EWEB would strive to deliver the highest reliability at the lowest cost, and not strive to be average.

WATER CAPITAL PLAN

Water Engineering Manager Mel Damewood provided a PowerPoint presentation on the *Water Capital Plan*. The presentation included identification of water project drivers and emerging issues, an overview of the proposed water utility projects, a summary of the 2007 five-year Capital Improvement Program with the associated uncertainties and unknowns, and a summary of the risks associated with project deferment. He noted the total projected estimate for the CIP of \$70,615,000. Commissioners asked questions clarifying the information presented.

Vice President Menegat called for a brief break.

LONG-TERM CAPITAL PLAN

Senior Financial/Rate Analyst Patty Boyle provided a PowerPoint presentation on the *Long-Term Capital Plan*. The presentation included a historic perspective of the water utility regarding rates and consumption and the basic assumptions behind the plan. Commissioners asked questions clarifying the information presented.

Ms. Boyle distributed and reviewed two scenarios for the long-range plan, *Scenario 1 – Rate Funded Capital*, and *Scenario 1 – Mix of Rates and Bonds to Fund Capital*. She asked the Board how it felt about the idea of going out for bonds, if it liked the idea of a fully funded capital plan, if it preferred a single major rate increase, or to do nothing at all, which would still require a rate increase of five percent for regular operations and maintenance. She asked if the Board had another direction it would like to see the utility go so staff could begin to build the 2007 budget and begin to refine the model.

Responding to a question from Commissioner Farmer, Ms. Boyle confirmed that staff could run a new model showing what could be raised using a 2.5 percent ratio and 6 percent to leverage against. She anticipated that the debt service coverage would be a constraint. Commissioner Farmer explained that he wanted to have O&M dollars come from operations, but if the utility was building long-term infrastructure he believed that should be funded through long-term debt. Mr. Varner said that if the utility reached 2010 and \$9 to \$10 million were being spent annually on capital, he would not want to borrow that amount. He would want to borrow for a build-up or a “hump,” not annual borrowing that required interest payments. Commissioner Farmer agreed, but indicated he wanted to know what was available before the utility reached that point.

Commissioner Farmer suggested that staff run a second projection and pick as a target a mid-point in the utility’s comparables. Ms. Boyle shared slides showing rate projections for the two scenarios for five and ten years. Under both scenarios and not accounting for rate changes in the comparable utilities, the projections indicated that EWEB would be in the middle of the comparables in five years; the figures were higher over a ten-year period.

Commissioner Farmer questioned the services and programs offered by the comparables and how they really compared to EWEB. Ms. Boyle said that they were comparables in regard to geography. She agreed that more information would be useful. Mr. Damewood indicated that staff had some information about the other utilities, such as Medford, which had a well system and no filter plant, keeping its costs low, and which was aggressive in regard to regional sales to leverage its system capacity. Power Resources Division Director Dick Helgeson observed that Medford’s water utility was not restricted from selling outside the city’s corporate limits.

Referring to EWEB’s systems development charge (SDC), Fiscal Services Supervisor Dick Varner noted that revenues from the current SDC would cover the utility’s cash flow needs for SDC-funded projects for the first five years of projections. Another SDC review was scheduled to occur in 2008 or 2009 to realign the SDC with the capital plan, and at that time the SDC was likely to be increased.

Commissioner Simpson noted his preference for a “pay as you go” approach. He thought a 25 percent rate increase would be quite shocking to ratepayers and he would like to spread it out over two years with even rate changes. He supported building the utility’s reserves. He agreed with Mr. Varner’s position on debt funding for long-term infrastructure.

The Board and staff discussed the risk of deferment. Mr. Damewood said that staff had attempted to defer \$3 million from the first three years of the capital plan, and after making those adjustments projects begin to shift around with zero gain. If deferment was to be a part of the utility’s strategy, he recommended the Board and staff begin to discuss specific deferments and the associated risks and planning criteria.

Mr. Varner asked the Board if staff should go back to the drawing board, or if it was going in the right direction. Mr. Berggren indicated his interest in having a more thorough discussion with Mr. Damewood about the risk of deferment to increase his understanding. While the risks may be great, he did not assume that EWEB could not take any risks. Mr. Damewood said that the dollars were not in place for the deferments that EWEB could take risks on, such as the work associated with Hayden Bridge not paid for by SDCs. He said that the secondary source was another needed big ticket item that there was risk around. General Manager Randy Berggren questioned how EWEB could quantify its second source risk given that it had gone 100 years without one.

Commissioner Farmer thought Mr. Berggren's points well taken. He acknowledged that the Board had new information but he was uncomfortable with the rate increases proposed under either scenario, given the ten-year capital planning that occurred last year. He requested a risk ranking be done of each project so that if EWEB had to defer a project out of rate considerations, the Board knew which was most important. Ms. Boyle said that the current residential average bill was \$14.91, and the projections would increase that by about \$4 monthly. She said staff would produce the requesting ranking using current dollars.

Mr. Berggren said that this was the first time the Board had taken a ten-year view of the capital plan relative to the financial outlook, and he did not think the Board was sufficiently well grounded in the planning criteria, as that had been a staff-driven view. He advocated for a policy discussion about the implications of the criteria and the risks associated with deferment of projects such as the secondary source.

Ms. Boyle asked to what extent the Board believed funding was needed for capital, and if she should build a budget with a ten-percent rate increase. Mr. Berggren believed the question was hard to answer at this point.

Vice President Menegat believed the projects proposed were necessary for reliable water, and the need would not go away. He did not support deferment. He supported the 25 percent rate increase shown in Scenario 2 and believed he could defend it to his constituents given the small size of the increase and the fact it leveled off.

Commissioner Farmer agreed with Mr. Berggren, saying that it would be irresponsible for the Board to build its budget based on the projections without a policy discussion about the criteria. He suggested the Board build a budget based on what was needed for 2007, and to have the policy discussion required over the next year. The Board had a brief discussion of what was meant by "what was needed" for 2007 and if it represented the first year of what was presented. Mr. Berggren indicated that staff was fairly confident about the first five years of the plan. Mr. Berggren suggested that given staff's confidence in the 2007 numbers, it prepare projections that included some debt issuance for those near-term projects and a ten percent rate increase. He reiterated his remarks about the need for a Board policy discussion.

Responding to a request from Commissioner Farmer, Mr. Damewood indicated that staff could break out the soft and hard costs for each project.

ELECTRIC CAPITAL PLAN

Systems Engineering & Substation Reliability Manager Dean Ahlsten provided a PowerPoint presentation on the *Electric Capital Plan*. Commissioners asked questions clarifying the information presented.

Mr. Berggren emphasized the financial pressure on the five-year plan created by regulatory changes and rising construction costs, changing the amount available for the reserves. Regulations, particularly on the generation side, were escalating, draining funds that could otherwise be used to address aging infrastructure needs. Attempts to address those regulatory requirements at the legislature in concert with other Oregon utilities had not met with success.

Commissioner Simpson called for a future Board discussion about the risk list. Mr. Berggren agreed.

The board recessed for lunch and reconvened at 12:43 p.m.

ELECTRIC LONG-TERM FINANCIAL PLAN

Mr. Varner provided a PowerPoint presentation on the *Electric Long-Term Financial Plan*. He noted that the reserve funds were doing well and it appeared they would meet target for 2007. He said in 2010 and 2011, according to forecasts, the targets were going to be exceeded. This was intended to offset construction costs for the Carmen-Smith facility. He added that targets should remain flexible.

Commissioner Farmer observed that there was a dip in the debt service. Mr. Varner responded that EWEB should come up with a plan for this in the next year or two and possibly sell to the rating agencies prior to reaching that point. He thought there were potential ways to mitigate the downturn in debt service coverage.

Mr. Varner stated that the current target was based on 20 percent of the Carmen-Smith facility capital. He reiterated that the draft license application had been submitted and the final application would be submitted to the Federal Energy Regulatory Commission (FERC) in November. He said this would provide a better picture of the capital needs, what the outage might be, and its subsequent impacts to revenue during the time of construction.

Mr. Varner related that the auditors agreed with Commissioner Farmer's recommendation that EWEB have a working cash reserve greater than 30 days of operation. He said the Board may want to consider whether EWEB should change the target to 45 days.

Regarding the power reserve fund, Mr. Varner stated that it was based on “one bad year of hydro.” He said it sought to have enough money to weather a truly bad year without immediately having to engage a rate action.

Mr. Varner reported that a small provision in the final rate proposal from the Bonneville Power Administration (BPA) would allow the BPA on very short notice to increase rates. He thought EWEB may want to decide whether the utility should “follow them immediately” or to have some money set aside for such a scenario. He added that this scenario would likely arise from a “bad hydro year,” a year in which EWEB would most likely have to tap its own reserves. He wondered if the Board would want to up the power reserve target to provide some breathing room to respond to a BPA Cost Recovery Adjustment Clause (CRAC).

Additionally the post-retirement medical benefits would affect both utilities. Mr. Varner said he and Assistant Treasurer Cathy Bloom would likely make a recommendation in the fall to take the money that EWEB had set aside over the last few years and buy down the Public Employee Retirement System (PERS) liability. He stated that a discussion had been scheduled for an agenda in October on the Government Accounting Standards Board (GASB) Statement 45, which issued a requirement that EWEB recognize on its books unfunded liabilities for post-retirement benefits. He was uncertain of its impact at this point. He predicted that staff would recommend that EWEB fund it on its current books in order to avoid building up a big liability.

Mr. Varner said a new PERS Actuarial Study would be completed circa January 1, 2007. He surmised from preliminary information that the funded status would not be good and EWEB might be looking at a small PERS rate increase. As a result, he had already built into the assumptions to be used for 2007 that rates would increase.

Mr. Varner reported that the retiree lawsuit was still pending and staff predicted there may be some progress in the spring. He thought, depending in how it went, it could cause a dramatic shift in funding levels for the post-retirement medical benefits.

Mr. Varner averred, regarding debt service coverage, that the construction year in combination with a bad water year could cause EWEB to be in violation of its covenants. He preferred not to cut it close. He said staff had begun to brainstorm on what could be done to help debt service coverage for the electric utility and came up with the following:

- The current plan, which entailed the electric utility borrowing all of the money and to the water utility paying their 14 percent share for the Roosevelt Boulevard building site;
- A plan in which the electric utility would borrow the money for its share, the water utility would borrow money for its share and each would take their own obligations onto their books.

In response to a question from Assistant to the General Manager Debra Smith, Mr. Varner stated that water had always paid 14 percent of the operations building costs. He said no analysis had been conducted and likely it was a policy discussion the Board should engage in.

Treasurer Jim Origliosso said a recommendation would have to be based on a study and the information such a study would gather.

Commissioner Farmer asked what the 14 percent had been based upon. Mr. Varner replied that it was a combination of staffing, revenues, and planned investments.

Mr. Varner reported that currently EWEB intended to borrow 80 percent of the cost of Carmen-Smith construction and 100 percent of the cost of the Roosevelt Boulevard building site. He noted that financing more of this out of rates would help the debt service position.

Additionally Mr. Varner pointed out that the Board could designate a certain amount of revenue for a certain future purpose. He noted that under the Finance Accounting Standards Board (FASB) Statement 71 there was a capability to defer the revenue to a future year.

In response to a question from Commissioner Farmer, Mr. Varner affirmed that it would become a restricted reserve account.

Mr. Varner stated that a proposal would come before the Board at the September 5 meeting for a BPA "pass through" in the amount of a two percent decrease in rates. It did not appear that the BPA was going to impose a CRAC on the basic rates announced in June.

Mr. Varner reported that should the Hynix contract be put into place as currently written, EWEB would realize approximately \$3 million more in revenue. He thought it would be enough money to offset a rate increase in spring, 2007.

In closing, Mr. Varner emphasized that all of the numbers were based on sub-par rainfall years. He said if EWEB experienced good water years it would provide a much greater level of flexibility.

2007 BUDGET ASSUMPTIONS AND RATE IMPACTS

Ms. Boyle reported that staff were creating and reviewing departmental budgets. She reviewed the timeline for the budget planning process, which would culminate in presentation of the draft budget at the fall Budget Retreat, to be held in October. It was slated to be published on November 8 and the public hearings were scheduled for November 21 and December 5.

In response to a question from Commissioner Farmer, Ms. Smith stated that staff intended to push for the hearings to bring out customer comments on rate actions as well as on the budget.

Ms. Boyle stated that labor costs were expected to increase by 3.3 percent, with a 4 percent increase to the International Brotherhood of Electrical Workers (IBEW) and 2.5 percent to general labor. She said staff was being encouraged to keep non-labor operating and management costs at 3.5 percent, though there would be some exceptions such as petroleum-based products.

Mr. Varner noted that FERC fees were going to double.

Mr. Varner said on the electric side of the budget, staff intended to show a draft that indicated the Hynix revenue offsetting a rate increase in the spring and that brought in \$10 million for building the reserves. He stated that the water utility draft budget was planned to include a 10 percent rate increase, an assumption of borrowing for capital, and \$400,000 to \$500,000 allocated to building the reserve fund.

OTHER INFORMATION REQUESTS AND WRAP UP

Mr. Berggren stressed that if there was additional information above what had been discussed at the retreat that Board members should contact Ms. Boyle, Mr. Varner, Ms. Smith, or himself.

Vice President Menegat adjourned the retreat at 1:26 p.m.

Assistant Secretary

President