



# INTEROFFICE MEMO

EUGENE WATER & ELECTRIC BOARD  
Corporate Services Division

*Rely on us.*

TO: Commissioners Farmer, Brown, Cassidy, Cunningham, and Ernst

FROM: Jim Origliosso

November 10, 2009

RE: Financial Policy Review

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## Issue

Anticipated draws from reserves in future years will impact the debt service coverage ratio which is used by outside agencies to determine the creditworthiness of the Electric Utility. The anticipated reduction in debt service coverage ratio would remain above the legal minimums required by bond covenant, but would not meet the higher standard currently contained in existing financial policy.

## Background

The Board has 13 separate financial policies which guide staff in making proposals of a financial nature. The policies are contained in Strategic Direction #6 (SD#6) which is attached. Rather than review all of the policies, this discussion focuses on how the one of the policies is being applied in an attempt to resolve an actual financial issue.

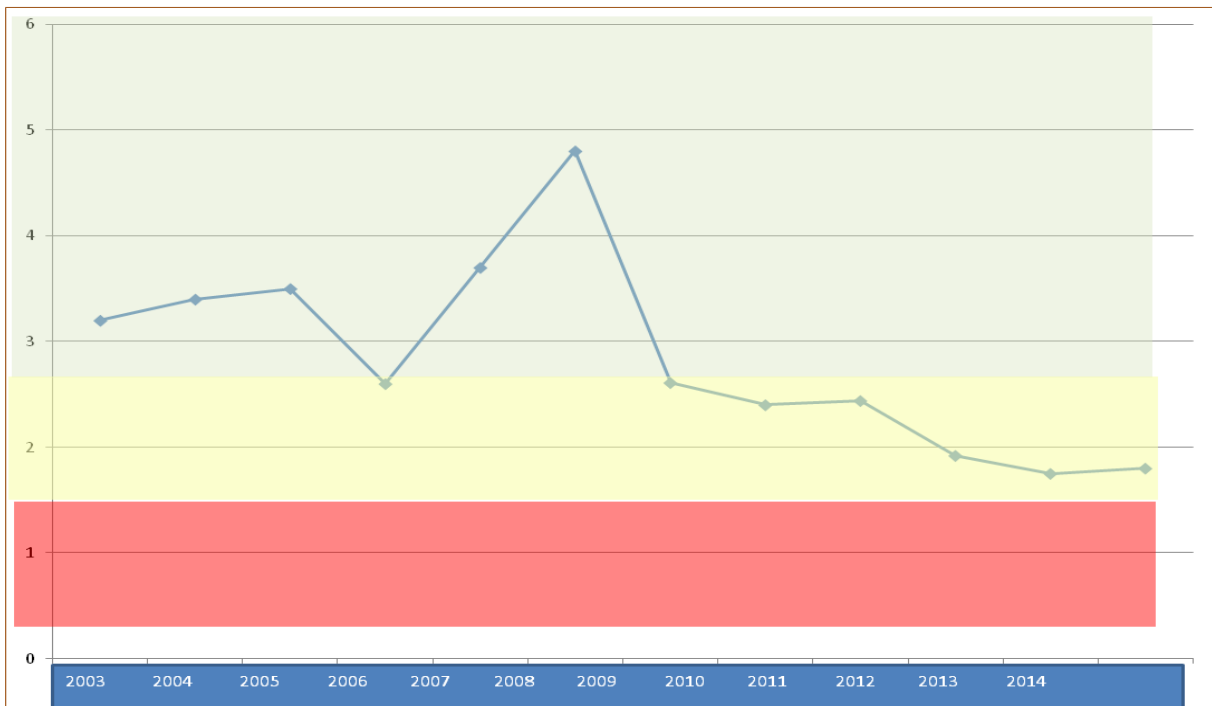
In prior deliberations of the Electric Utility's long-term financial picture, a strategy has emerged that involves spending down accumulated cash reserves to replace revenues that will be foregone as a result of an extended outage of the Carmen Smith Project. Part of this strategy was implemented in 2006 with the deferral of \$20 million of revenue which was set aside in a Carmen Smith Equity Reserve for the purpose of reducing the amount that would ultimately need to be borrowed to complete relicensing improvements. The revenue was to be recognized during the periods that the money was to be spent on the project which is to begin in 2010 and extend through 2012.

Beginning in 2012, however Carmen-Smith power generation is expected to be interrupted for portions of the ensuing three years as fish passage and generation facilities are constructed. This is expected to have a \$20 million to \$30 million revenue impact. In informal discussions of the issue this has been described as the financial "hole" that needs to be filled. In order to prepare for this phase, \$13 million was earmarked (but not revenue deferred) in the Power Operating Reserve during 2008.

In its Rate Sufficiency Policy, the Board states "Rates and charges will be adequate to provide revenues sufficient to maintain a high degree of financial soundness over and above requirements for compliance with existing bond covenants." The explanatory comments go on to state that financial soundness will be measured with several yardsticks, the most important of which is a statistic called "debt service coverage ratio". To demonstrate above average financial soundness, EWEB has the goal of achieving debt service coverage of at least 2.5. What this means is that net revenue (all revenues less operating expenses) in any given year is sufficient to pay debt service 2.5 times.

Historically, EWEB has had little difficulty achieving this goal. However with the expected loss of

Carmen-Smith revenues during the construction period, projections indicate coverage dropping to about 1.8 times by 2013-14 and then recovering to over 2.0 times after that. Historical and projected debt service coverage is shown on the graph below.



Analysis

The economic downturn has resulted in constraints on credit and more conservative evaluations of creditworthiness. A good credit rating in these times has turned out to be a highly valuable asset. Allowing debt service coverage to fall below the stated Board policy standard could have implications for EWEB’s bond rating and subsequent effects on borrowing costs, availability of capital, and a myriad of other business transactions. While EWEB could decide to relax its self-imposed standard for a few years and that might not result a credit rating down-grade, such an outcome cannot be precisely determined. The impacts of any such down-grade however, could be costly and long lasting.

While credit ratings are not formula driven, the debt service coverage ratio is. The following actions would have these effects on the calculation:

- \$1 million increase in revenue has a .04 increase in coverage
- \$1 million decrease in operation and maintenance cost has a .04 increase in coverage
- \$1 million decrease in debt service has a .09 increase in coverage
- \$12.5 million decrease in debt is a \$1 million decrease in debt service

Alternatives

Given that any single one of these actions has by itself a modest impact on the calculation, a multi-pronged approach to preserving debt service coverage over the next several years has a greater likelihood of success. This would look like proposals over the coming months and years that do a

combination of the following:

- Constrain operations and maintenance expenses
- Defer surplus revenues into periods of lower projected debt service coverage as opportunities arise
- Obtain greater certainty on Carmen Smith impacts (costs and schedule)
- Review aging infrastructure requirements and determine if additional rate revenues for ongoing capital needs is warranted
- Constrain new debt and restructure existing debt to improve debt service coverage

There are no specific recommendations at this time. I expect to discuss this further at the November 17 Board meeting. In the meantime please direct questions and comments to me at 685-7335 or [jim.origliosso@eweb.org](mailto:jim.origliosso@eweb.org)