



MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Helgeson, Brown, Mital, Simpson and Carlson
FROM: Sue Fahey, Chief Financial Officer; Deborah Hart, Fiscal Services Supervisor;
Jerry Reller and Nate Schultz, Senior Financial Analysts
DATE: September 27, 2017
SUBJECT: 2018 Draft Budgets and Long-Term Financial Plans (LTFP) Update
OBJECTIVE: Direction on 2018 Budget and Price Changes

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 (LTFP), which help ensure that the budgets approved provide longer term financial stability for both utilities. Staff has prepared draft 2018 budgets and updated 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 3rd meeting, staff will develop budget and price proposals for consideration at the November 7th Board meeting, and approval at the December 5th meeting.

Background

Over the last several years, both the Electric and Water Utilities have faced financial challenges. Those challenges have been managed by reducing and restructuring debt, designing prices that increase fixed cost recovery, strategically reducing O&M and capital costs, and prudently using reserves to strengthen financial metrics.

In 2017 an Affordability Initiative was launched in order to increase the value of EWEB's products and services, and to better align sustainable spending levels to what our customer-owners expect. The initiative includes controlling costs through efficiencies while aligning the Utilities to focus work on those things most important. As part of the initiative, O&M costs were strategically reduced, and both the Electric and Water Utilities used reserves to reduce debt by \$35 million and \$11 million, respectively. This work directly supports Phase I of the Strategic Plan to enhance customer confidence.

Financial savings initiatives over the last several years are summarized in Attachment 1.

Discussion

At the July 11, 2017 meeting, the Board directed staff to prepare the draft 2018 budgets based on the assumptions presented. Since July, the following assumptions have changed.

- Projected increase of \$560,000 for health insurance has been removed. EWEB's 2018 premiums will not increase.
- Projected wage escalation increased from 2.4% to 3.5%, or approximately \$500,000, based on updated Bureau of Labor statistics
- Expense for the move from the headquarters building to Roosevelt Operations Center has been reduced by \$1.8 million to \$750,000
- Electric Utility's conservation budget increased by \$250,000 over last year which is \$650,000 over projections in July
- BPA increase in July estimated to be \$4.2 million. Based on updates from BPA, impacts are now expected to be \$2.7 million, inclusive of the effects of the spill injunction

Staff has incorporated direction from the Strategic Plan into the draft 2018 budgets. The budgets include investments in water and electric infrastructure, emergency response and resiliency, conservation and energy efficiency, and education grants. The capital budgets and plans include funds dedicated to building emergency preparedness and resiliency. Next year the water utility will begin substantial work on the emergency water supply system and also begin the first phases of the multi-year base level reservoir replacement and upgrade project. Resiliency projects on our generating assets includes seismic upgrades at Leaburg dam and the Carmen-Smith substation. In 2018 work on the automated response to ShakeAlert, the earthquake early warning system signal, will be completed. Projects to replace aging infrastructure and create more resilient paths of transmission, such as the Holden Creek substation in 2018 and future work at the Thurston and Currin substations, are also included in the plan. The Electric O&M budget includes an additional \$250,000 for customer conservation incentives. Additionally, a new department has been added for emergency preparedness, resiliency, and business continuity work.

The following assumptions have been used to develop the budgets and LTFFP:

Both Utilities

- 2% non-labor CPI increase
- Labor/Benefit Increases:
 - 3.5% wage escalation
 - PERS increase –7 percentage points in 2019 and then 5 percentage points in 2021, 2023 and 2025
 - Health insurance increase – 0% in 2018, and then 10% in subsequent years
- Financial Initiative Adjustments
 - Electric total ongoing savings \$9.4 million reductions in 2018
 - \$6.2 million O&M
 - \$3.2 million debt service
 - Water total ongoing savings \$2.1 million reductions in 2018
 - \$1.5 million O&M
 - \$600,000 debt service
- Education grants approximately \$500,000

Electric

- Retail load approximately the same as 2017 budget – 2.4 million MWh and relatively flat in the out years
- \$1 million reduction in contingency
- 2018 contribution margin risk tolerance of \$2.7 million which represents 90% generation, 2.1% load reduction or 40% wholesale price reduction
 - Similar contribution margin risk tolerance through 2022, expected conditions 2023-2027
- \$22 melder mid-market price curve increasing to \$33 in 2027
- \$1.4 million contribution margin reduction due to increased Snake and Columbia River dam spills for fish migration
- Partial year Carmen-Smith generation outages in 2018, 2019, and 2021 respectively
- Bond issuance: \$36 million in 2021; and \$17 million in 2024, primarily for funding capital work on Carmen-Smith
- No 2018 overall average price change

Water

- Consumption: 7.8 million KGAL
 - 200,000 KGAL greater than 2017 budget
 - 8 year average, 8.1 million KGAL
- Return of 3% 2014 price increase dedicated to AWS
- Contribution margin risk tolerance of \$750 thousand
 - Represents the difference between budgeted consumption and the 8 year average
 - 100 thousand KGAL represents approximately \$250 thousand
- Bond issuance: \$40 million in 2026 for Willamette Treatment Plant

Long-term Financial Plan Price Assumptions and Outcomes

Electric

The Electric Utility LTFP indicates no overall average price change is needed in 2018. This is the fourth year in a row that the revenue requirement does not include a general price increase. In October 2016 when the Board reviewed the LTFP, the plan indicated a 2018 price increase of 2.5% resulting from the BPA pass through. Through debt reduction and financial initiatives, the BPA increase is modeled to be absorbed by EWEB with no price change to our customer-owners. In order to maintain current Board targets for financial metrics, a total of \$4.8 million savings identified in the workforce transition process in 2018 and 2019 will have to be realized. The Electric LTFP outcomes are summarized in Attachment 2.

Water

The Water Utility LTFP includes a 3% return to customer-owners in 2018 and models 0% change in price until 2026. In order to maintain that trajectory, beginning in 2024, the utility would need to draw down cash reserves. In 2026 the LTFP has modelled \$40 million in bond funding for the Willamette Treatment Plant, should the Board decide to move forward at that time. This maintains Board targets for financial metrics through the duration of the financial plan. However, in the out years of the plan the revenue requirement will need to increase 10%, for several years in a row, in order to fund

additional debt service payments from the 2026 bond. The 2016 LTFP projected 2.6% increases for all years throughout the plan. The Water LTFP outcomes are summarized Attachment 3.

Recommendation

Management recommends that the Board direct staff to prepare the 2018 proposed budgets using the assumptions set forth in this document, a 0% overall average February 2018 Electric price change and a 3% overall average February 2018 Water price reduction.

Requested Board Action

Management is not requesting Board action at the October 3rd 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 7th Board meeting, Management will present the budget and price change proposals which are scheduled to be approved at the December 5th meeting.

Attachment 1 - Financial Savings Initiatives 2013 - 2017

Attachment 2 - Summary of Electric LTFP Price Assumptions and Outcomes

Attachment 3 - Summary of Water LTFP Price Assumptions and Outcomes

Attachment 4 - Median Household Income (MHI) %

Financial Savings Initiatives 2013-2017

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 and reserves
- Financial initiative adjustments: Electric Utility - \$2.6 million and Water Utility - \$337,000 in ongoing reductions

2017

- \$5.8 million savings from EWEB Workforce Transition Initiative
- Additional \$1.8 million of O&M savings
- Electric Utility defeased \$35 million in debt, saving \$3.2 million in debt service for 2018
- Water Utility paid \$11 million to the Electric Utility for reducing intercompany debt for an overall \$600,000 savings in debt service

Summary of Electric LTFP Price Assumptions and Outcomes

(\$000's)	Target	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Reserves and Cash	\$71,720	\$134,800	\$136,500	\$122,200	\$127,500	\$127,000	\$127,400	\$126,000	\$123,300	\$127,000	\$137,500
Debt Service Coverage Ratio	1.75	2.68	1.91	1.90	1.87	1.60	1.61	1.58	1.46	1.81	2.34
Days Cash	>150 Days	247	260	232	230	215	208	197	186	192	214
Average price impact resulting from change in revenue requirement*		0.00%	0.00%	2.50%	2.00%	3.75%	2.00%	2.50%	2.75%	2.50%	0.00%
Workforce transition reductions		\$0	\$2,400	\$3,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Additional O&M improvements to support Board Targets		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Total Cumulative O&M improvements		\$0	\$2,400	\$5,400	\$5,400	\$5,400	\$5,400	\$5,400	\$5,400	\$5,400	\$5,400
DSC Ratio with O&M Improvements		2.68	2.05	2.23	2.25	1.91	1.92	1.92	1.79	2.14	2.69

Key Assumptions

- Retail load approximately the same as 2017 budget – 2.4 million MWh and relatively flat in the out years
- \$1 million reduction in contingency
- 2018 Contribution margin risk tolerance of \$2.7 million which represents 90% generation, 2.1% load reduction or 40% wholesale price reduction
 - Similar contribution margin risk tolerance through 2022, expected conditions 2023-2027
- \$22 melded mid-market price curve increasing to \$33 in 2027
- Partial year Carmen-Smith generation outages in 2018, 2019, and 2021 respectively
- \$1.4 million contribution margin reduction due to increased Snake and Columbia River dam spills for fish migration
- Bond issuance: \$36 million in 2021; and \$17 million in 2024, primarily for funding capital work on Carmen-Smith
- 2% non-labor CPI increase
- Labor/Benefit Increases:
 - 3.5% salary escalation
 - PERS increase –7 percentage points in 2019 and then 5 percentage points in 2021, 2023 and 2025
 - Health insurance increase – 0% in 2018, and then 10% in subsequent year

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

(\$000's)	Target	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Reserves & Cash	\$11,680	\$27,500	\$31,200	\$33,600	\$34,600	\$35,800	\$35,900	\$35,700	\$32,600	\$27,400	\$19,500
AWS Reserve Balance		\$5,300	\$4,300	\$3,300	\$2,300	\$1,300	\$300	\$0	\$0	\$0	\$0
DSC	2.00-2.50	3.98	3.97	4.01	3.90	3.65	4.16	3.82	3.65	2.99	2.30
Days Cash	>150 Days	720	805	832	844	820	752	715	620	519	398
Average price impact resulting from change in revenue requirement		-3.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	3.00%	3.00%

Key Assumptions

- Consumption: 7.8 million KGAL
 - 200,000 KGAL greater than 2017 budget
 - 8 year average, 8.1 million KGAL
- Return of 3% 2014 price increase dedicated to AWS
- Contribution margin risk tolerance of \$750 thousand
- 2% non-labor CPI increase
- Labor/Benefit Increases:
 - 3.5% salary escalation
 - PERS increase –7 percentage points in 2019 and then 5 percentage points in 2021, 2023 and 2025
 - Health insurance increase – 0% in 2018, and then 10% in subsequent years
- Bond issuance: \$40 million in 2026 for Willamette Treatment Plant

Median Household Income (MHI) %

Background

The Board has requested staff provide bill affordability information. To prepare this information, *Assessment of Affordability of Residential Rates* (Glenn Barnes and Shadi Eskaf; Environmental Finance Center at the University of North Carolina, Chapel Hill; 2016) was used.

The approach uses the local community’s median household income (MHI) and is based on the following data:

1. Current monthly water and electric bill at average residential consumption per month.
2. Annual bills at same level of use.
3. Median Household Income in 2015 for Eugene, OR.

Currently, there is no national standard for what affordable percent (%) of MHI value is or is not. When using this assessment, consideration must be given to financial sustainability of the utility as a whole in addition to affordability of price. Setting artificially low prices may produce financial constraints to reinvesting in the system and eventually harm public health through poor product quality and service.

To address the limited income customer-owner bill impact, EWEB has maintained a customer care program for many years that provides assistance for bill payment and weatherization programs.

Included below are the combined average water and electric bill for residential customers (water is 7 KGAL and electric is 1050 kWh) in Eugene, Portland, Everett, Vancouver, Tacoma, and Seattle. This average is annualized and compared as a percentage of MHI.

The percent of MHI for EWEB has risen slightly over last year, from 4.0% to 4.06%. This is due to a fall in household income. Should the Board approve the management recommendation of no overall average change to electric and a return of the rate action associated with AWS for water, EWEB’s new percent of MHI would be 4.03%.

<u>Eugene, Oregon Consumption & MHI</u>	<u>Current Prices</u>
Monthly water & electric bills at overall average residential consumption/month	\$145.80
Overall average residential water consumption: 7 KGAL; electric consumption: 1050 kWh	
Annual bills at same level of use	\$1,750
Median Household Income in 2015 for Eugene, OR	\$43,101
Water & Electric % MHI	4.06%
<u>Portland, Oregon Consumption & MHI</u>	<u>Current Prices</u>
Monthly water & electric bills at overall average residential consumption/month	\$174.09
Overall average residential water consumption: 7 KGAL; electric consumption: 1050 kWh	
Annual bills at same level of use	\$2,089
Median Household Income in 2015 for Portland, OR	\$55,003
Water & Electric % MHI	3.80%

<u>Vancouver, Washington Consumption & MHI</u>	<u>Current Prices</u>
Monthly water & electric bills at overall average residential consumption/month	\$124.92
Overall average residential water consumption: 7 KGAL; electric consumption: 1050 kWh	
Annual bills at same level of use	\$1,499
Median Household Income in 2015 for Vancouver, WA	\$50,626
Water & Electric % MHI	2.96%
<u>Tacoma, Washington Consumption & MHI</u>	<u>Current Prices</u>
Monthly water & electric bills at overall average residential consumption/month	\$133.16
Overall average residential water consumption: 7 KGAL; electric consumption: 1050 kWh	
Annual bills at same level of use	\$1,598
Median Household Income in 2015 for Tacoma, WA	\$52,042
Water & Electric % MHI	3.07%
<u>Seattle, Washington Consumption & MHI</u>	<u>Current Prices</u>
Monthly water & electric bills at overall average residential consumption/month	\$182.81
Overall average residential water consumption: 7 KGAL; electric consumption: 1050 kWh	
Annual bills at same level of use	\$2,194
Median Household Income in 2015 for Seattle, WA	\$70,594
Water & Electric % MHI	3.11%
<u>Everett, Washington Consumption & MHI</u>	<u>Current Prices</u>
Monthly water & electric bills at overall average residential consumption/month	\$147.58
Overall average residential water consumption: 7 KGAL; electric consumption: 1050 kWh	\$1,771
Annual bills at same level of use	\$49,578
Median Household Income in 2015 for Everett, WA	3.57%
Water & Electric % MHI	

References: Assessment of Affordability of Residential Rates (Glenn Barnes and Shadi Eskaf; Environmental Finance Center at the University of North Carolina, Chapel Hill; 2016)