M E M O R A N D U M

EUGENE WATER & ELECTRIC BOARD

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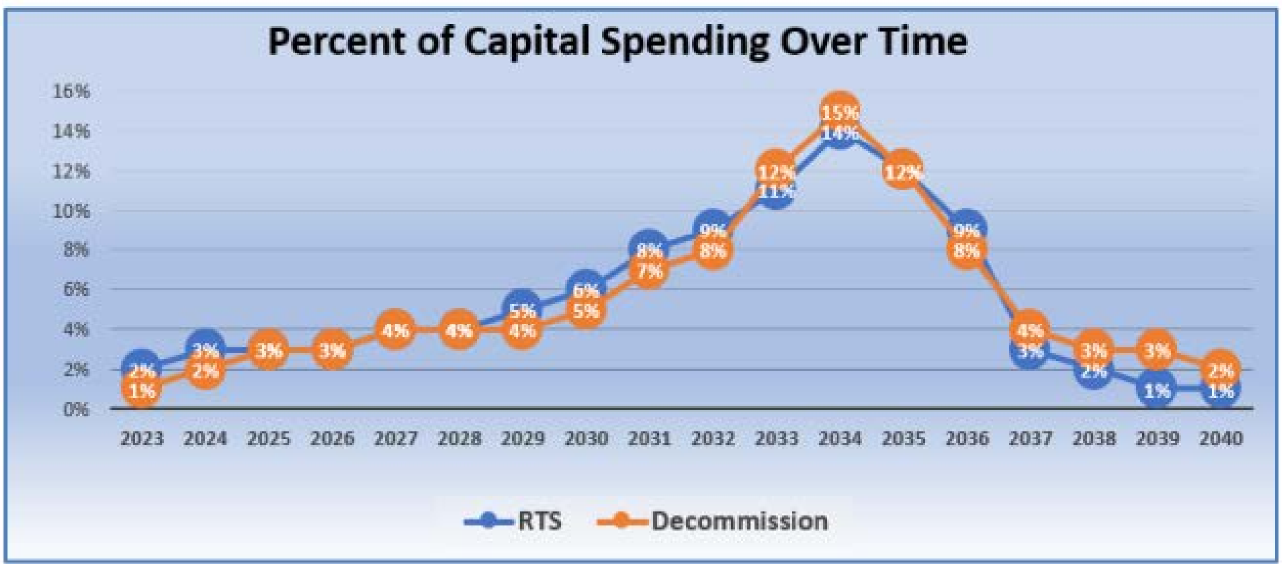
TO:	Commissioners Carlson, Barofsky, McRae, Schlossberg, and Brown
FROM:	Deborah Hart, Chief Financial Officer; TiaMarie Harwood, Financial Services Manager; Aaron Balmer, Fiscal Services Supervisor
DATE:	March 29, 2023
SUBJECT:	Leaburg Prefunding / Funding Options
OBJECTIVE:	Information/Discussion

Issue

There may be several funding options supporting EWEB's Record of Decision to decommission the Leaburg Hydroelectric Project, which will require significant expense in the coming decades. The timing and tempo of decommissioning efforts are anticipated to peak in the mid-2030s as referenced in the following chart.



Source: Leaburg Canal TBL & Strategic Assessment

Background

Funding large projects can entail variations in the type of proceeds used, with traditional funding methods including rates, reserves, grants, and debt. Rates are the ultimate funding mechanism, as reserves originate, and debt is serviced, through the rate-making process.

Prudent financial practice dictates the use of debt financing only in those cases where public policy, ratepayer equity, and economic efficiency favor the use of debt over current financial resources. Debt service payments match the useful life of the asset and can be structured to mirror the stream of benefits from the infrastructure being funded.

Current financial resources include reserves and rates. In the rate-making process, EWEB employs the following rate-making principles:

- *Sufficiency* is the principle that EWEB rates are sufficient to meet the reasonable ongoing costs of utility operations
- *Affordability* is the principle that EWEB makes all reasonable efforts to make rates affordable for its community owners
- *Efficiency* is the principle that EWEB will send efficient price signals to allow customers to make sustainable, long-term investments to either increase or decrease demand without unfavorably impacting other customers
- *Cost basis* is the principle that EWEB will establish rates as a function of costs
- *Equity* is the principle that EWEB will charge customers nondiscriminatory prices and customers receiving like services will be treated equally
- *Gradualism* is the principle that EWEB rate stability is maintained and, to the extent feasible, rates do not unnecessarily vary year to year

Also of note, EWEB policy permits the use of regulatory accounting which allows for revenues and expenses to be charged to future periods to match the time periods when the revenue and expenses are included in rates. Revenues and expenses that are recorded using regulatory accounting may be treated as other assets, liabilities, deferred inflows, or deferred outflows, depending on the nature of the revenue or expense. Board approval, either by resolution or by inclusion in the annual budget, is required prior to using regulatory accounting. The primary benefit is that it better matches revenues with related costs and can mitigate impacts on the debt service coverage metric in a year where decommissioning costs peak. It does not impact funding.

Discussion

A combination of approaches may be used to fund decommissioning of Leaburg, be it prefunding to generate current resources, or borrowing to secure funds and repay costs over time. Each mechanism has both pluses and minuses and they are not mutually exclusive. The Board could employ multiple tactics to fund the Leaburg Hydroelectric Project.

<u>Prefunding</u>

Two primary ways to generate current financial resources to prefund Leaburg include:

1. Flat fee per account (residence, business)
2. Rate increase tied to consumption

With decommissioning costs projected to slowly ramp up over the next decade, increasing rates or initiating a fee to build reserves and cover costs early in the decommissioning plan begins the cost recovery in advance of construction and helps to mitigate the need for larger action down the road. Building reserves also presents the opportunity to generate interest income. The interest rate environment for the past 15 years has been historically low, and while EWEB reserves have generated investment returns, EWEB's investment policy prioritizes safety and liquidity over return/yield. The rising interest rate environment is presenting an opportunity for returns higher than experienced in years, while still maintaining safety and liquidity needs.

Dedicating a revenue stream for a project of this magnitude is not required; however, it provides increased transparency for future reporting and clarity in billing and rate-making conversations.

Cost recovery in the form of a rate or fee could be implemented at any time. Additionally, the amount of the rate or fee could be modified over time to promote gradualism. Starting earlier provides a longer time period and allows for a gradual approach. Delaying provides more certainty around the timing and direction of the project. Generating $2 million a year in prefunding would require a per-customer fee of approximately $1.75 or a 1% rate increase.

Funding considerations using rates or fees include the following advantages and disadvantages:

- \+ Responsible, begin addressing the obligation
- \+ Increases financial flexibility
- \+ Preserves future borrowing capacity
- \+ The fee has a clear start/stop
- – Intergenerational equity
- – Opportunity cost

Debt/Borrowing

While the Electric Utility has a strong credit rating and the ability to borrow, borrowing pressures the Debt Service Coverage (DSC) metric. Bond covenants require EWEB to maintain DSC levels greater than or equal to 1.00x. The Board target is 1.75x - 2.00x. This provision helps insure current and future bondholders are paid and long-term financial stability is maintained. As the targeted metric becomes pressured, either with increasing debt service levels or increasing expenses, rate increases will be required, not only to cover current operational costs but to maintain the 1.75x coverage of revenue available to service debt.

EWEB Financial Policy considers debt an appropriate funding option for capital projects. However, the decommissioning plan is not going to create an operational asset, so the principle of matching the stream of benefits with the project funding does not hold. The use of debt would likely require a modification to our financial policy.

Debt funding would closely align with the pace of spending on the project and likely require multiple issuances over the period of the decommissioning. The cost would be borne by ratepayers over a longer period of time, and after decommissioning.

Considerations for debt include the following advantages and disadvantages:

- \+ Fiscal practicality
- \+ Funding security
- \+ Reduce pressure on rate trajectory
- – Financial policy complexity
- – Additional financial leverage
- – Intergenerational equity

Grants

Potential for grant funding to decommission dams through federal funding from the Inflation Reduction Act (IRA) and Infrastructure Investment and Jobs Act (IIJA) as well as any other state or non-governmental organization opportunity is of interest to staff. At this time, grant opportunities are uncertain and may align more with returning the site to a pre-construction state. EWEB has contracted with a consulting firm, Baker Tilly, to best understand and pursue any grant opportunities that may align with utility goals.

Metrics

Metrics provide an indication of financial performance and help decision-makers assess financial condition. Various metrics bring insight into managing affordability and debt levels and are affected by increases in rates/fees and debt differently, as noted below.

Increases to rates/fees	Increases to debt
↑ Average bill as % of MHI	↑ Average bill as % of MHI
↑ Rate of return	↔ Rate of return
↔ Debt to NBV	↑ Debt to NBV
↔ Debt Service Coverage ratio (timing dependent)	↓ Debt Service Coverage ratio

Recommendation and Requested Board Action

Management is seeking Board feedback on funding for Leaburg to including in the draft Long-Term Financial Plan, which will be presented in July.