Tacoma Water

Preliminary Long-Range Financial Plan

Financial Policy Discussion
AGENDA

1  Budget and Rate Timeline

2  Long-Range Financial Plan Update
   • Coverage and Liquidity
   • Expense Budget and Revenue Requirement
   • Debt Management and Capital Funding Strategy

3  Potential Changes to our process and the Water Rate and Financial Policy
   • Cost of Service Analysis
   • Rate Design
   • Debt Service Coverage Policy
   • SDC Fees and Funds
   • Market-Based Wholesale Rates

4  Next Steps
Budget and Rate Timeline
2019/2020 Budget and Rate Timeline

- 2/7 Rates & Financial Planning Workshop
- 4/25 Draft LRFP
- 5/23 Power & Water: Budgets Preview
- 6/13 Public Outreach Planning Meeting
- 7/25 Revenue Requirement & Rate Design
- 9/12 Water & Rail: PUB Study Session
- 10/10 PUB Hearing
- 10/16 Joint Study Session
- 10/24 PUB Adoption
- 10/31 GPFC
- 11/20 Council 2nd Reading
- 11/13 Council 1st Reading
- 1/1 Rates Effective

We are here.
Our long-range plan has helped us ensure financial stability and sustainably.
Actual and Projected Rate Increases

This forecast is subject to change, and is dependent upon actual financial performance in future years.

Projected rate adjustments of 2.5% annually for 2019 – 2026
## Financial Metrics

**Tacoma Water Achieved**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tbody>
<tr>
<td>Total Liquidity</td>
<td>$112.4</td>
<td>$119.5</td>
<td>$130.9</td>
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<tr>
<td><strong>Target (millions)</strong></td>
<td>&gt;$25.6</td>
<td>&gt;$25.6</td>
<td>&gt;$27.2</td>
<td>&gt;$27.2</td>
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<tr>
<td>Senior Debt Coverage Ratio</td>
<td>1.72x</td>
<td>2.14x</td>
<td>2.33x</td>
<td>2.18x</td>
<td>2.19x</td>
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<td><strong>(Target: &gt;1.5x)</strong></td>
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<tr>
<td>All In Debt Coverage Ratio</td>
<td>1.23x</td>
<td>1.30x</td>
<td>1.36x</td>
<td>1.18x</td>
<td>1.23x</td>
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<tr>
<td><strong>(Target: &gt;1.25x)</strong></td>
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1 Based on unaudited financial results

### Moody’s S&P Investment Grade

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<th>Grade</th>
<th>Moody’s</th>
<th>S&amp;P</th>
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<td>Baa3</td>
<td>BBB-</td>
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### Non-Investment Grade Speculative

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<th>Grade</th>
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<td>C</td>
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</table>
Long-Range Financial Plan Update

Debt Service Coverage Ratio

- Sr. Debt Coverage - Requirement (1.50x)
- Sr. Debt Coverage - Achieved/Projected
- All-In Debt Coverage - Requirement (1.25x)
- All-In Debt Coverage - Achieved/Projected
- Bond Covenant Minimum (1.25x)
## Long-Range Financial Plan Update

### Debt Service Coverage Calculations: Net Revenue Divided by Total Debt Service

<table>
<thead>
<tr>
<th><strong>Senior Lien Coverage Ratio</strong></th>
<th><strong>All In Coverage Ratio</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>+ Operating Income</td>
<td>+ Operating Income</td>
</tr>
<tr>
<td>+ Non-operating Income</td>
<td>+ Non-operating Income</td>
</tr>
<tr>
<td>+ SDC Retail Revenues</td>
<td>+ SDC Retail Revenues</td>
</tr>
<tr>
<td>+ Transfers from SDC Rate Stabilization Account</td>
<td>Not included</td>
</tr>
<tr>
<td>- Operating and Maintenance Expenses</td>
<td>- Operating and Maintenance Expenses</td>
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<tr>
<td>- Tacoma Share RWSS Bonds (RWSS CRO)</td>
<td>Included in Total Debt Service</td>
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<tr>
<td>- State Utility Tax and Franchise Fees</td>
<td>- State Utility Tax and Franchise Fees</td>
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<td><strong>Not Included</strong></td>
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<tr>
<td>= Net Revenue</td>
<td>= Net Revenue</td>
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<tr>
<td>Divided by Total Debt Service</td>
<td>Divided by Total Debt Service</td>
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<tr>
<td>+ Tacoma Water Parity Bonds</td>
<td>+ Tacoma Water Parity Bonds</td>
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<tr>
<td><strong>Not Included</strong></td>
<td>+ PWTF and DWSRF Loans</td>
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<tr>
<td>Included as Operating Expense</td>
<td>+ Tacoma Share RWSS Bonds</td>
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</table>
## Long-Range Financial Plan Update

### Debt Service Coverage Calculations: 2016 Calculation

<table>
<thead>
<tr>
<th></th>
<th>Senior Lien Coverage</th>
<th>All In Coverage</th>
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<tbody>
<tr>
<td>+ Operating Income</td>
<td>$85,107</td>
<td>$85,107</td>
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<tr>
<td>+ Non-operating Income</td>
<td>+ 3,723</td>
<td>+ 3,723</td>
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<tr>
<td>+ SDC Retail Revenues</td>
<td>+ 2,424</td>
<td>+ 2,424</td>
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<tr>
<td>+ Transfers from SDC Rate Stabilization Account</td>
<td>+ 0</td>
<td>NA</td>
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<tr>
<td>- Operating and Maintenance Expenses</td>
<td>- 43,460</td>
<td>- 43,460</td>
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<tr>
<td>- Tacoma Share RWSS Bonds (RWSS CRO)</td>
<td>- 3,260</td>
<td>NA</td>
</tr>
<tr>
<td>- State Utility Tax and Franchise Fees</td>
<td>- 4,639</td>
<td>- 4,639</td>
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<tr>
<td>- City of Tacoma Gross Earnings Tax</td>
<td>NA</td>
<td>- 6,753</td>
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<tr>
<td><strong>= Net Revenue</strong></td>
<td><strong>$39,895</strong></td>
<td><strong>$36,402</strong></td>
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<tr>
<td>+ Tacoma Water Parity Bonds</td>
<td>$18,297</td>
<td>$18,297</td>
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<td>+ PWTF and DWSRF Loans</td>
<td>NA</td>
<td>+ 9,043</td>
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<tr>
<td>+ Tacoma Share RWSS Bonds</td>
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<td>+ 3,260</td>
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<td><strong>Divided by Total Debt Service</strong></td>
<td><strong>$18,297</strong></td>
<td><strong>$30,600</strong></td>
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<tr>
<td><strong>Debt Service Coverage Ratio</strong></td>
<td><strong>2.18x</strong></td>
<td><strong>1.19x</strong></td>
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</table>
Long-Range Financial Plan Update

Total Liquidity

Measures: Actual and projected annual liquidity.

Policy Minimums:
- System Development Charge Fund: $2,000,000
- Capital Reserve: 1% of original cost of plant-in-service
- Operating Fund: 60 days of current budgeted expenditures
Long-Range Financial Plan Update

Operating Cash on Hand

Measures: Days of cash on hand to meet current budgeted operating expenditures

Policy Minimum: 60 Days.
Long-Range Financial Plan Update

SDC Fund

Forecast to be $1.3M/year
Based on growth

SDC Revenues

- Retail SDC payments
- Wholesale SDC time payments

SDC Fund

- May be used for capital purposes only
- Minimum balance of $2 million
- Fund Balance primarily Wholesale in 2006
  - No new projected

Balance at 12/31/17
$61.6 M

Reimburse Capital Project Expenditures

- Appropriated with Biennial Budget
- Mid-Biennium Adjustment

Based on growth
Long-Range Financial Plan Update

Capital Reserve Fund

- Operating Fund Transfers or Surplus
  - Budgeted Appropriation
  - Unbudgeted surplus or one-time payments

- Balance at 12/31/17
  - $29.2 M

- May be used for capital purposes only
- Minimum balance of 1% of plant-in-service

- Reimburse Capital Project Expenditures
  - Appropriated with Biennial Budget
  - Mid-Biennium Adjustment

- Long-Ranger Financial Plan Update
  - CWA contract payments phase down in 2030, done in 2042
  - Timber and land sales
    - “One time”
Expense Budget and Revenue Requirement

We are preserving the connection with our budget.

Rate and Financial Policy: Rates will be sufficient to meet Tacoma Water Budgets.
Historical Spending Trends for Personnel

Expense Budget and Revenue Requirement

* 2019/2020 projected expenses are in initial stages of review.
Expense Budget and Revenue Requirement

Historical Spending Trends for Other O&M

* 2019/2020 projected expenses are in initial stages of review.
Expense Budget and Revenue Requirement

Revenue Requirement Analysis

**O&M Expense Forecast**
*Apply decision-making tools
*Historical cost review, strategic initiatives, forecast assessments and labor assumptions

**Capital Expense Forecast**
*Business Case Evaluations (BCEs)
*Funding assumptions apply existing bond funds, then reasonable reserve spend down

**Non-Rate Revenue**
*Project miscellaneous fees and charges

**Rate Revenue Forecast**
*10-year projection under existing rates using updated Demand Forecast

**O&M and Capital Expense Budget Proposal**

**Non-Rate Revenue Budget Proposal**

**Forecast revenue at existing rates**

**2019/2020 Revenue Requirement**
Revenue Requirement Analysis

Our Rate Adjustments are lower because we are spending down our Operating Reserves.
Debt Management and Capital Funding Strategy
No new revenue bonds projected until 2027.
Absent a really large upward movement of US Treasury securities, we are unable to refinance our Series 2009 and 2010 Build America Bonds for savings or breakeven.
In June 2023, RWSS Series 2013 are callable, with expected savings between 2023-2032.

Also in June 2023, Series 2013 will be eligible to be refunded - with the bulk of the savings in 2041-2043.

We could also choose to refund and create levelized debt service and fill in the trough between 2024-2032.
Debt Management and Capital Funding Strategy

Historical Trends on Capital Spending

* 2019/2020 projected expenses are still in initial stages of review.
Debt Management and Capital Funding Strategy

Capital Funding Strategy

[Bar chart showing use of remaining bond funds, transfers from capital reserve fund, transfers from SDC fund, transfers from the current fund, and new debt funding from 2017 to 2026.]

Millions

$25
$20
$15
$10
$5
$-


Use of Remaining Bond Funds
Transfers from Capital Reserve Fund
Transfers from SDC Fund
Transfers from the Current Fund
New Debt Funding
Total CIP
Water Rate & Financial Policy
Cost of Service Analysis (COSA)

Proposal to defer COSA (only Revenue Requirement for 2019-2020):

• Our current practice has been to conduct COSAs every 2 years along with the budgeting cycle.

• Our financial policy says that, “An embedded cost-of-service study will determine the cost of serving each customer class, allocation of class responsibility for the projected expenses, and proposed rates sufficient to recover projected expenses.” However, the policy does not implicitly state that this must be performed every 2 years.

• We will continue to perform demand forecasting and rate-design with the budget cycle.

• We propose this change because there are no significant shifts in plant functionality for the 19/20 biennium and rates currently charged for each for each class of customer will be set to reflect the cost of supplying service to that class.

• Many water utilities perform COSAs every 4-6 years.
There are a few proposed structural changes to Rate-Design for 2019-2020:

Public Fire Protection

• The recovery of unpaid historical costs from Outside City Customers will be achieved by this summer.

• The rate-design will include retiring “Historical Service Component” for outside city customers effective January 1, 2019.

• The rate-design will include recovering public fire protection costs from general rate, and remove “Hydrant Service Fee” as a separate line item on bill.

Irrigation

• We will continue transitioning to a rate structure that will ultimately consist of only volumetric rates for irrigation customers until fully implemented in 2022.
Debt Service Coverage Policy

Proposal to change the minimum requirement or the addition of language that will allow us to achieve a lower metric during times when we are strategically spending down reserves.

- Our financial policy says that, “Senior Debt Service Coverage will be maintained above 150%, exceeding Tacoma Water’s bond covenant requirement of 125%. All In Debt Service Coverage will be maintained above 125%.”
- We aren’t projecting to meet our policy goal for All In Coverage over the next several biennia, this is primarily due to our intentional spend down of reserves as well as the significant amount of low interest loan debt that we will be paying over this time period.
- We will be proposing language to allow for flexibility and give us the ability to view our coverage and liquidity goals holistically. The working draft states:

  “When operating/current fund balance exceeds the policy minimums, application of these reserve funds when previously planned and budgeted may be considered as revenue for the computation of the all-in debt service coverage calculation up to the budgeted amount to be applied.”
System Development Charge and Fund Structure

In the next year, we will review SDC cost basis, policy supports, and fund structure. This includes:

• Conducting a full analysis on our current SDC structure and fees.
• Assessing opportunities to simplify by combining the SDC and Capital Reserve Funds into one Capital Fund.
Market-Based Wholesale Rates

We are currently underway with a strategic initiative regarding wholesale pricing and policy revisions.

• Some goals related to this initiative include:
  • Analyzing changes such as the ready-to-serve, system development, and volumetric charges.
  • Creating recommendations such as a turn on/off policy and operating board alternatives.
• We are currently drafting an RFP for analysis of the wholesale market.
• We have and continue to meet with wholesalers to discuss market-based pricing.
• We met with SPU to learn about their wholesale program and operating board.
• We will continue discussions with the Board regarding wholesale opportunities outside of the budget and rate process.
Next Steps
Long-Range Financial Plan Update

Actual and Projected Rate Increases

This forecast is subject to change, and is dependent upon actual financial performance in future years.

Projected rate adjustments of 2.5% annually for 2019 – 2026
### Upcoming Discussions

<table>
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<tr>
<th>PUB Meeting Date</th>
<th>Topic(s)</th>
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<tr>
<td>May 9&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Power and Water Financial Policy Discussions</td>
</tr>
<tr>
<td>May 23&lt;sup&gt;rd&lt;/sup&gt;</td>
<td>Power and Water Budget Preview Presentations</td>
</tr>
<tr>
<td>July 25&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Revenue Requirement and Rate-Design Proposals</td>
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<tr>
<td>September 12&lt;sup&gt;th&lt;/sup&gt;</td>
<td>TPU Board Study Session Budget Presentation</td>
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<tr>
<td>October 9&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Joint Council/PUB Study Session Presentation</td>
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<td>October 24&lt;sup&gt;th&lt;/sup&gt;</td>
<td>Public Utility Board approval of preliminary budget</td>
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