Audit Results

Tacoma Public Utilities
Public Utility Board Presentation

May 18, 2018
May 18, 2018

To the Chair and Members of the Public Utility Board
Tacoma Public Utilities - Power, Water, and Rail Divisions

Dear Board Members:

Thank you again for your engagement of Moss Adams LLP. We are pleased to present to you the results of our audits of the Utilities’ financial statements for the year ended December 31, 2017.

The accompanying report, intended solely for the use of the Board and management, presents important information regarding the Utilities’ financial statements that we believe will be of interest to you.

We conducted our audits with the objectivity and independence you expect. We received the full support and assistance from the Utilities’ personnel. We are pleased to serve and be associated with the Utilities, and we look forward to our continued relationship.

Sincerely,

Olga A. Darlington
Moss Adams LLP
Auditor’s Report on the Financial Statements

Unmodified Opinions

- Financial statements are presented fairly and in accordance with US GAAP – following pronouncements promulgated by the Governmental Accounting Standards Board (GASB)
- Tacoma Public Utilities - Power, Water, and Rail Divisions – reports issued April 18 and 20, 2018

Audit and report on internal control and compliance over financial reporting in accordance with Government Auditing Standards

- No material weaknesses in internal control
Our Responsibility Under Auditing Standards

1. To express our opinion on whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, and conform to US GAAP. However, our audit does not relieve you or management of your responsibilities.

2. To perform an audit in accordance with generally accepted auditing standards issued by the AICPA and Government Auditing Standards issued by the Comptroller General of the United States and design the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement.

3. To consider internal control over financial reporting as a basis for designing audit procedures but not for the purpose of expressing an opinion on its effectiveness or to provide assurance concerning such internal control.

4. To communicate findings that, in our judgment, are relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.
Area of Audit Emphasis

Internal Control Environment

- Cash receipts/revenues, cash disbursements/payables, payroll, power trading, treasury, financial close and reporting;
- General computer controls, IT environment

Treasury

- Coordination with SAO testing of cash and investment balances for existence, valuation, restrictions; evaluation of fair value

Management Estimates

- Allowance for doubtful accounts
- Unbilled revenues
- Depreciable lives and estimated residual value of plant
- Accrued liability for injuries and damages
- Actuarial valuations for pension and OPEB amounts
- Environmental liabilities
Area of Audit Emphasis, continued

Capital Assets

- Consideration of capitalization policies, as well as testing of work orders for additions, retirements, overhead application, capitalized interest, depreciation

Net Pension Liability

- Recognition of share of the liability for employees’ future pension obligations as part of the Tacoma Employees Retirement System (TERS);
- Employer liability and related deferred inflows/outflows including selections of new hires from the census and contributions made by the Utilities to TERS

Debt Activity

- New debt issued and defeased in Power Fund; debt repayments, arbitrage liability, capitalized interest, discounts and premiums, compliance with covenants
Required Audit Communications

Planned Scope and Timing of Audit

• The planned scope and timing of the audit was communicated through our communication letter to those charged with governance dated December 7, 2017, and was included in the engagement letter dated October 31, 2017.

Significant Accounting Policies

• See notes to the financial statements

Accounting Estimates

• Note 2 discloses the Utilities’ significant accounting policies:
• Allowance for doubtful accounts
• Unbilled revenues
• Depreciable lives and estimated residual value of plant
• Actuarial valuations for pension and OPEB amounts
• Environmental liabilities
Required Audit Communications, continued

Consultation with Other Accountants
- None noted

Disagreements with Management
- No disagreements or difficulties in performing the audit

Potential Effect of Any Significant Risks and Exposures
- The Utilities are subject to potential legal proceedings and claims that arise in the ordinary course of business.
Audit Adjustments and Passed Audit Adjustments

**Audit Adjustments**
- None

**Passed Audit Adjustments**
- One passed audit adjustment:
  - Water Fund – to reduce beginning net position and record accumulated depreciation in the amount of $1,208,381 for uncapitalized IDC assets from 2014 – 2016 and unrecognized depreciation.
New Accounting Standards

GASB 75 - OPEB
• Addresses accounting and financial reporting issues related to other postemployment benefit plans.
• Effective for 2018 financial statements

GASB 83 – Asset Retirement Obligations
• Addresses accounting and financial reporting for certain asset retirement obligations.
• Effective for 2019 financial statements

GASB 87 - Leases
• Addresses accounting and financial reporting for leases recognizing that leases are financings of the right to use an underlying asset.
• Effective for 2020 financial statements
The audit progressed on time and in an orderly fashion; requested schedules and draft financial statements were received on a timely basis.

All Utilities personnel across all departments were courteous, responsive, and fulfilled all of our requests in a timely manner.

‘Tone at the Top’ and attitude from management was one of helpfulness and openness in response to audit requests and discussion points.
THANK YOU
TACOMA WATER
2019 - 2020
BUDGET PREVIEW

Scott Dewhirst, Superintendent
May 23, 2018
TODAY’S DISCUSSION

• State of the Utility
• Strategy
• Budget Drivers
• Base Case Rate Scenario
• Budget & Rate Impacts
• Next Steps
STATE OF THE UTILITY: DEMAND

* Excludes demand from RWSS partners.
STATE OF THE UTILITY: INCREASING COSTS
STATE OF THE UTILITY: CAPITAL SPENDING

Renewal & Replacement vs New Capital (%)

Capital Expenses (in $ millions)

- Renewal & Replacement ($)
- New Capital ($)
- Projected Spending
- Renewal & Replacement (%)
- New Capital (%)

* 2018 reflects spending through Q1
** 2019/2020 budgeted projections are preliminary
STATE OF THE UTILITY: RATE PRESSURE & RELIEF

Asset Management
Declining Residential & Commercial Demands
All Hazards Risk Mitigation
Regulation

Current State
Potential

Asset Management
New Large Volume Customer
Increased Wholesale Revenue

Potential

Increased Wholesale Revenue
New Large Volume Customer

Asset Management
Declining Residential & Commercial Demands
All Hazards Risk Mitigation
Regulation

Current State

Asset Management
VISION: Growing trust through extraordinary service

Mission: Providing clean, reliable water now and in the future.
STRATEGY: 2018 STRATEGIC THEMES

- EUM Assessment
- SWOT
- Org. Feedback

- Community understanding & support
- Workforce development
- Operational innovation
- Operational optimization
STRATEGY: COMMUNITY UNDERSTANDING & SUPPORT

Areas of Improvement

- Identification of New Revenue Opportunities
- Communication of our Long-Range Financial Decisions
- Promoting our Value Proposition to Stakeholders
- Lack of External Communication (TPU, GG, SIGs)
- Maintaining low & stable rates in a “payment challenged” community

Strategic Theme
STRATEGY: WORKFORCE DEVELOPMENT

Areas of Improvement

- Inconsistent Hiring Philosophy & Processes
- Identification & Development of Future Leaders
- Current Classification Structure Hinders Recruitment & Retention
- Lack of Bench Strength
- Area-wide Labor Environment

Strategic Theme

Workforce Development
STRATEGY: OPERATIONAL INNOVATION

Areas of Improvement

- Lack of Data Maturity (architecture & analytics)
- Workforce Connect
- Cross-utility Technology Coordination
- AMI
- Lack of Technology Integration

Strategic Theme

Operational Innovation
STRATEGY: OPERATIONAL OPTIMIZATION

Areas of Improvement

- Lack of Documented Processes, Policies, and Procedures
- Lack of Data-Driven Decision Making (KPIs, Levels of Service)
- “Siloed” Org Structure (communication, change management)
- Project Management Immaturity (standardization, reporting, tracking)
- Lack of Safety Prioritization

Operational Optimization

Strategic Theme
### BUDGET DRIVERS

<table>
<thead>
<tr>
<th>Financial Modeling Scenario</th>
<th>Description</th>
<th>Rate Pressure &amp; Relief</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019/2020 Base Case</td>
<td>Expected customer growth, base CIP, base O&amp;M</td>
<td></td>
</tr>
<tr>
<td>High Customer Growth</td>
<td>Assumes account growth with historical modeling</td>
<td></td>
</tr>
<tr>
<td>New Large Volume Customer</td>
<td>Assume additional large volume customer with demand similar to Niagara</td>
<td></td>
</tr>
<tr>
<td>Increased Wholesale Revenue</td>
<td>Expanded wholesale sales through market-based and traditional wholesale agreements, assumes additional $1.2M per year additional revenue</td>
<td></td>
</tr>
<tr>
<td>High Case CIP</td>
<td>Includes high range capital mitigation from the Vulnerability Assessment, assumes additional capital of $128M over the next 10 years</td>
<td></td>
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<tr>
<td>Pulp Mill Shutdown</td>
<td>Models 2019 closure, assumes loss of $6M per year</td>
<td></td>
</tr>
<tr>
<td>AWSP Finalization</td>
<td>Fish Passage, Howard Hanson Dam Biological Assessment, assumes additional capital of $2.6M in 2020</td>
<td></td>
</tr>
</tbody>
</table>
BASE CASE RATE SCENARIO

Rate Increases & Coverage Tests

- Rate Adjustment
- Sr. Debt Coverage - Requirement
- Sr. Debt Coverage - Achieved
- All-In Debt Coverage - Requirement
- All-In Debt Coverage - Achieved
BUDGET & RATE IMPACTS

Systemwide Average Rate Increase Spread

2019 2020 2021 2022 2023 2024 2025 2026 2027 2028 2029 2030 2031 2032 2033 2034
The monthly average residential bill assumes water consumption of 7 CCF per month. The years 2019 - 2022 assume an annual rate increase of 2.5%.
NEXT STEPS

• June 13th
  – Public Outreach Planning

• July 25th
  – Revenue Requirement
  – Rate Design

• September 12th
  – TPU Board Study Session Budget Presentation

• October 16th
  – Joint Council/PUB Study Session Presentation

• October 24th
  – Public Utility Board approval of preliminary budget
TACOMA POWER
2019 - 2020
BUDGET PREVIEW

Chris Robinson, Superintendent
May 23, 2018
AGENDA

- Expenses are Increasing
- Revenues are Declining
- Strategic Solutions
- Long-Range Financial Plan
- Next Steps
Expenses are Increasing

**OPERATING EXPENSES**

- Purchased Power: $127 M (32%)
- Generation: $32 M (8%)
- Transmission & Distribution: $50 M (13%)
- Administrative & General: $49 M (12%)
- Other Expenses: $19 M (5%)
- Taxes: $41 M (10%)
- Debt Service: $77 M (20%)

**POWER SUPPLY EXPENSE**

- BPA Power & Transmission: $187 M (47%)
- Owned Power Supply: $139 M (35%)
- Other: $69 M (18%)

* Source: 2016 Production Unit Cost Report (FERC)
Total Expenses are Increasing

Average Annual Increase: 3.0%
Purchased Power & Transmission

Average Annual Increase for 2011 – 2017: 3.0%

Average Annual Increase for 2018 – 2022: 3.7%
Owned Generation

Average Annual Increase: 8.0%
Taxes

Average Annual Increase: 5.2%
Average Annual Increase: 3.9%
Capital Expenses

Average Biennial Increase: 7.4%
2017 REVENUE COMPONENTS

$341 M 76%
$57 M 13%
$27 M 6%
$22 M 5%

Retail Sales
Wholesale Sales
Click!
Other
Wholesale Prices Decline

Average Annual Decrease: 5.5%
Wholesale Percent of Total Revenue
Market Drivers

HENRY HUB NATURAL GAS PRICES

WESTERN STATES RENEWABLE PRODUCTION

Source: US Energy Information Administration
Retail Demand

Average Annual Increase for 2006 – 2017: 0.4%

Average Annual Decrease for 2018 – 2022: 0.8%
Most Costs are Fixed in the Short-term

Cost per MWh Served (Total Expense/Total MWh Billed)

Average Annual Increase: 5.3%
Tacoma Power Strategy

OUR FOCUS
EMPLOYEES
CUSTOMERS
FINANCES
ENVIRONMENT

COMMUNITY VALUE FIRST

TOP PRIORITIES NOW
Put Safety 100% First | Support Click! Network | Leadership Development
Listen to our Community Leaders | Participate in New Market Opportunities
Managing Expenses

Implement Asset Management Roadmap

Stand-up Construction Project PMO

Prioritize O&M Cost Saving Initiatives

Create Utility Analytics Strategy
Managing Revenue Challenges

- Review Policies & Procedures that Impact Economic Development
- Create Economic Incentive Alternatives
- Underground Electric Facilities
- Pursue New Wholesale Products & Services
- Develop Transportation Electrification Proposals
How are we developing our budget?

**Capital**
- Business Cases
- Risk Analysis
- Capital Steering Committee Review
- Project Presentations
- Preliminary Recommendation
- Final Approval

**FTE**
- FTE Requests
- Work Plan Review
- Preliminary Recommendation
- Final Approval

**Other O&M**
- Budget Requests
- Justification Review
- Preliminary Recommendation
- Final Approval
Preliminary Budget Information

**PRELIMINARY CAPITAL REQUEST**

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<th>Category</th>
<th>Request (M)</th>
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<td>Technology</td>
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<tr>
<td>Natural Resource Requirements</td>
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<tr>
<td>Conservation Portfolio</td>
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<tr>
<td>Advanced Metering Infrastructure</td>
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<td>Aging Infrastructure Upgrades</td>
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<tr>
<td>Additions &amp; Replacements</td>
<td>$80</td>
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<tr>
<td>Total</td>
<td>$180</td>
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</table>

**PRELIMINARY FTE REQUEST**

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<thead>
<tr>
<th>Category</th>
<th>Request</th>
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<tbody>
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<td>AMI</td>
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<tr>
<td>Digital Modernization</td>
<td>10</td>
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<tr>
<td>Environmental Projects</td>
<td>6</td>
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<tr>
<td>Wholesale Market Opportunities</td>
<td>4</td>
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<tr>
<td>Operational Efficiencies</td>
<td>8</td>
</tr>
<tr>
<td>Utility Operations</td>
<td>17</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>49</strong></td>
</tr>
</tbody>
</table>

2019-2020 Projected
Budget & Revenue Requirement Decoupled

Preliminary Revenue Requirement: $746.5 Million
Separate from budget, based on historical spend, inflation, and new projects

Objectives:
- Minimize the rate increase
- Reduce the revenue requirement to actual spend projection
Projected Rate Increases: 2019-2020

Additional shading in future years represents uncertainty associated with revenues and expenses, mostly due to potential for adverse or critical water conditions.
NEXT STEPS

Budget Development
  ▪ Capital program
  ▪ O & M

June 27th
  ▪ Study Session: Cost of Service Review

September 26th
  ▪ Study Session: Budget Presentation

October 9th
  ▪ Joint Council/PUB Study Session Presentation

October 24th
  ▪ Public Utility Board approval of preliminary budget