Tacoma Water
Rate & Financial Policy and
Financial Outlook Update

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Today’s Discussion

1. Strategy
2. State of the Utility
3. Rate & Financial Policy
4. Budget Drivers
5. Base Case Rate Scenario
6. Budget & Rate Impacts
7. Next Steps
Strategy

- **Implementation is Underway**
- **Guiding Light in Uncertain Times**
- **Customer and Internal Focus**
- **Reinforced by Recent Events**
• **Delivery of Water:** Delivery of total water to the system continues to track with 2019

• **Projections:** We are continuing to project increased residential demand and decreased commercial demand during the Stay Home, Stay Healthy mandate followed by a recession

• **Monitoring:** Total billed demand and revenue for March and April above budget and we continue to monitor billed demand and revenue
State of the Utility: COVID-19 Impacts

**Increased Expenses**
- Initial teleworking expenses
- Social distancing implementation
- Customer assistance program
- Suspension of late fees and shut offs

**Balancing Efforts**
- Financial management
- Expense prioritization
- Operational efficiencies
- Strategic alignment

**Decreased Expenses**
- Hiring
- Meetings, travel & trainings
- Suspension of intern program
- Delaying projects
State of the Utility: Demand & Costs

- Operating costs continue to rise despite stable demand

The blue line represents average day demand for water in million gallons per day from 1985 - 2019. The grey line represents annual operating expense in millions from 1985 - 2019.

Source: Tacoma Water Annual Financial Reports
State of the Utility: Capital Spending

- Environmental Leadership
- Innovation
- Stakeholder Engagement
- Rates
- Financial Sustainability
- Equity & Inclusion
State of the Utility: Rate Pressure & Relief

- Pipeline 1 Pressurization
- Advanced Metering
- Large Customer Loss
- All Hazards (primarily seismic)
- Investment in Technology
- Water System Acquisitions
- Customer Account Growth
- Pandemic (with local impact)
- Decreased Demand (per account)
- Increased Wholesale Demand
- Employee Retention & Engagement
- Asset Management
- Project Management
- Process Documentation

Higher Cost→

Higher Rate Pressure

Higher Rate Relief←
Rate & Financial Policy

Revenue Requirement
• Regular reviews with full study every two years
• Study includes projected revenue, expenses and capital improvements

Cost-Based Rates
• An embedded cost-of-service study will determine the cost of serving each customer class and allocation to recover projected expenses

Stable Rates
• Water rates should be as low as is responsible
• Water rates should be stable and understandable
• To the extent possible, apply gradualism in rate adjustments

Financial Metrics
• 60 days of current budgeted expenditures
• Capital: $2M minimum in SDC Fund and 1% of original plant in Capital Reserve
• Debt Service Coverage: Senior above 1.5x and All In above 1.25x

Rate Adjustments
• Sufficient to meet Tacoma Water budgets and maintain financial sufficiency
• Minimize long-run costs to rate-payer
• Short and long-run rate impacts presented

Low-Income
• Special consideration for low-income senior and/or disabled customers

Environmental Stewardship
• Maintain the quality of the environment and preserve sensitive ecosystems at the source of supply
## Rate & Financial Policy

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Requirement</td>
<td>• In development and based on budget</td>
</tr>
<tr>
<td>Cost-Based Rates</td>
<td>• Based on the previous Cost of Service Analysis</td>
</tr>
<tr>
<td>Stable Rates</td>
<td>• Preserve gradualism and long-term rate stability</td>
</tr>
<tr>
<td>Financial Metrics</td>
<td>• Apply risk model analysis to support recommendation for reserve level requirements&lt;br&gt;• Rating agency response for water utility: essential business with rate-setting ability and relatively inelastic demand</td>
</tr>
<tr>
<td>Rate Adjustments</td>
<td>• Preserve long-term financial sustainability</td>
</tr>
<tr>
<td>Low-Income</td>
<td>• Increase support for low-income senior and/or disabled customers</td>
</tr>
<tr>
<td>Environmental Stewardship</td>
<td>• Continue commitment to the health of our environment</td>
</tr>
</tbody>
</table>
Budget Drivers

<table>
<thead>
<tr>
<th>Least Control</th>
<th>Limited Control</th>
<th>Most Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Assessments</td>
<td>• Debt service</td>
<td>• Strategic initiatives</td>
</tr>
<tr>
<td>• Taxes</td>
<td>• Capital Investment Plan (CIP)</td>
<td>• FTE count</td>
</tr>
<tr>
<td>• Personnel benefits</td>
<td>• Wholesale Water Sales</td>
<td>• Workforce Development</td>
</tr>
<tr>
<td>• Cost of commodities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scenario</td>
<td>Description</td>
<td>Positive or Negative Impact on Rates</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
<td>--------------------------------------</td>
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<tr>
<td>2021/22 Base Case</td>
<td>Expected customer growth, base CIP (with low-case Pipeline 1 Project), base O&amp;M</td>
<td></td>
</tr>
<tr>
<td>2021/22 Alternate Base Case</td>
<td>Assumes no rate adjustment in 2021</td>
<td></td>
</tr>
<tr>
<td>New Large Volume Customer</td>
<td>Assumes additional 2 million gallons per day beginning in 2022, doubling Large Volume revenue assumptions</td>
<td></td>
</tr>
<tr>
<td>High Customer Growth</td>
<td>Assumes account growth with historical modeling</td>
<td></td>
</tr>
<tr>
<td>Increased Wholesale Revenue</td>
<td>Expanded wholesale sales through market-based and traditional wholesale agreements, assumes additional $1.2 million per year additional revenue</td>
<td></td>
</tr>
<tr>
<td>Pulp Mill Shutdown with High Case CIP</td>
<td>Assumes 5-extension is executed in 2020 and Mill shuts down in July 2021 and high case Pipeline 1 project</td>
<td></td>
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<tr>
<td>Pulp Mill Shutdown</td>
<td>Assumes 5-extension is executed in 2020 and Mill shuts down in July 2021</td>
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<tr>
<td>High Case CIP</td>
<td>Assumes Pipeline 1 project at high end of projection with $150 million over 20 years</td>
<td></td>
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<tr>
<td>Prolonged Recession after Pandemic</td>
<td>We are continuing to monitor the environment and will be model additional scenarios as needed</td>
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</table>
Base Case Rate Scenario (Recommended)

Tacoma Water Operating Fund
Base Case 2021/2022
Alternate Rate Scenario

Rate Increases & Coverage Tests
Alternate Base Case 2021/2022

[Graph showing rate adjustments and coverage ratios over the years 2019 to 2034.]
Alternate Rate Scenario

Tacoma Water Operating Fund
Alternate Base Case 2021/2022
Budget & Rate Impacts

Range of System Average Rate Adjustments

- Equity & Inclusion
- Rates
- Financial Sustainability
- Stakeholder Engagement
- Innovation
- Environmental Leadership

Base Case (Recommended) vs Alternate Base Case

- 2020: 2.0%
- 2021: 3.5%
- 2022: 2.5%
- 2023: 2.5%
- 2024: 2.5%
- 2025 to 2034: 4.0%
Budget & Rate Impact: Affordability

Comparing Tacoma Water’s Annual Rate Adjustments with the CPI for Water, Sewer, and Trash (CPI-WST)

- Equity & Inclusion
- Environmental Leadership
- Innovation
- Stakeholder Engagement
- Rates
- Financial Sustainability

Budget & Rate Impact: Affordability

A Plan for Equity and Inclusion: Monitoring the Income Burden of an Average Water Bill

Family of Four: Rate Adjustments Remain Affordable

Two Person Household Age 65 and Older: Rate Adjustments are Becoming a Burden

In 2018, the median household income (MHI) for the Tacoma Water service area was $71,543 and the average water bill was 0.7% of MHI. % of Burden on Income: Annual Water Bill / Annual Poverty Threshold. 2019 Poverty Threshold Source: US Census Bureau. The 2020-2030 poverty thresholds are projected using a 5 year rolling median increase.
Average Monthly Bill for a Residential Single Family Customer Inside the City of Tacoma

<table>
<thead>
<tr>
<th>Year</th>
<th>Bill ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>$32.77</td>
</tr>
<tr>
<td>2016</td>
<td>$35.50</td>
</tr>
<tr>
<td>2017</td>
<td>$36.96</td>
</tr>
<tr>
<td>2018</td>
<td>$38.49</td>
</tr>
<tr>
<td>2019</td>
<td>$39.51</td>
</tr>
<tr>
<td>2020</td>
<td>$40.58</td>
</tr>
<tr>
<td>2021</td>
<td>$41.60</td>
</tr>
<tr>
<td>2022</td>
<td>$42.64</td>
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</tbody>
</table>

An average monthly bill for a residential single family customer inside the City of Tacoma is calculated using an assumption of 6 CCF in winter months and 9 CCF in summer months.
Next Steps

- **APR 22**: Water Budget Preview
  - PUB Meeting

- **MAY 13**: Water Rate & Financial Policy
  - PUB Meeting

- **JUL 22**: Water LRFP & Rate Recommendation
  - PUB Study Session

- **SEP 23**: TPU Budget Presentation
  - PUB Study Session

- **OCT 13**: Review of Preliminary Biennial Budget & Rates
  - PUB/City Council Joint Study Session

- **OCT 28**: Consideration of Preliminary Biennial Budget & Rates
  - PUB Meeting
## State of the Utility: COVID-19

### Rating Agency Responses to COVID-19: Public Utilities

<table>
<thead>
<tr>
<th>Agency</th>
<th>Summary</th>
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</table>
| Moody’s | **No action taken on the sector associated with COVID-19**  
- Public power, and water and sewer sectors: less affected, at least in the short run  
- The essentiality of their service and rate-setting ability help to mitigate coronavirus-related risks, although parent governments could expose them to credit deterioration  
- The regulated utility sector is well positioned to withstand the crisis due to supportive cost recovery tools, stable residential customer demand and resilient financial profile. The only financial risk is associated with financial volatility due to dependence on external capital for liquidity |
| S&P | **No action taken on the sector associated with COVID-19**  
- Public power and electric co-ops require persistent operations. The greatest risk is that virus contagion interrupts operations due to sick or furloughed employees. Increased residential electricity usage could potentially mitigate declines in industrial customer demand  
- Water and wastewater are essential services with fairly inelastic demand. Operational risks due to sick employees is offset by increased automation.  
- Wastewater treatment technology and methods are effective against all known pathogens |
| Fitch | **On March 27th Fitch affirmed its stable outlook on the sector**  
- Enterprises are protected given their quasi-monopolistic characteristics, long useful lives, both restricted and unrestricted reserves, balance sheet flexibility and discretion over capital expenditures  
- Contracted assets especially in the energy space have counterparty risk. Historically there has been stability of utility counterparties |