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WestRock Mill Closure Impacts to Tacoma Water

Presented by Scott Dewhirst and Jodi Collins to the Public Utility Board on September 13, 2023

Scenarios Presented

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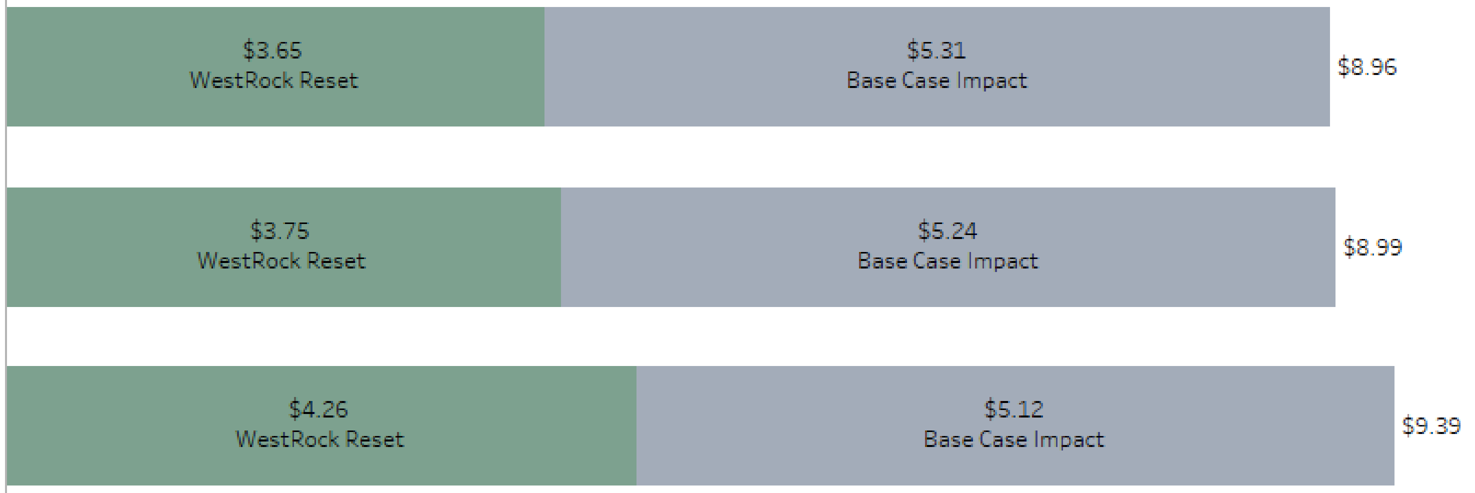
We shared the following scenarios with the Public Utility Board on August 23

2024-2026 Projected Average Monthly Bill Impact by Scenario

Scenario	2024	2025	2026
One-Time Rate Increase (8% in 2024)	$49.20	$50.92	$52.70
Gradual Rate Increases (5% in 2024, 1.5% in 2025, 1.5% in 2026)	$47.83	$50.23	$52.74
Rate Increases Starting in 2025 (4.5% in 2025, 4.5% in 2026)	$45.55	$49.20	$53.13



In all three scenarios, the customer credit for BCAP will be increased to offset the full impact of the rate increase related to the WestRock Reset to support our most vulnerable customers

Waiting until 2025 to adjust rates results in higher average bills for customers

Average bills include approved rate adjustment of 4% for 2024 and projected adjustments of 3.5% each year 2025 & 2026

Long-Range Financial Planning

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We have three reserve funds that help us manage potential risks, meet working capital needs, and support stable rate adjustments for our customers. The Water Rate and Financial Policy defines minimum levels for each of our reserve funds.

Fund	Requirement	Purpose
Operating (Current Fund)	60 Days Budgeted Operating Expenses	• Day-to-day operation and maintenance of our system • Industry best practice to provide flexibility to manage risk • Manage seasonal revenue fluctuations • Meet working capital needs
Capital Reserve	1% Original Cost Plant-in-Service	• Must be used for Capital expenditures • Industry best practice to mitigate risk and provide financial stability • Deposits to this fund include one-time revenues such as land or timber sales
System Development Charge (SDC)	$2M	• Must be used for Capital Expenditures, generally growth-related • Mitigate risk, provide financial stability, support stable rate adjustments • Deposits to this fund include connection fees related to development
Rate Stabilization Account (RSA)	Included in SDC Fund Balance No Requirement for Minimum Balance	• SDC Fund includes deferred revenues from Wholesale connection charges collected in 2005/2006, referred to as the Rate Stabilization Account (RSA) • RSA is included as part of reserves liquidity, but is intended to be used to boost debt service coverage during times of borrowing or reserve spend-down

The SDC Capital RSA is not a traditional RSF and is not used to manage fluctuations in water sales operating revenue, revenue is recognized to boost debt service coverage and is not planned to be replenished when gone

Operating and Capital Reserves

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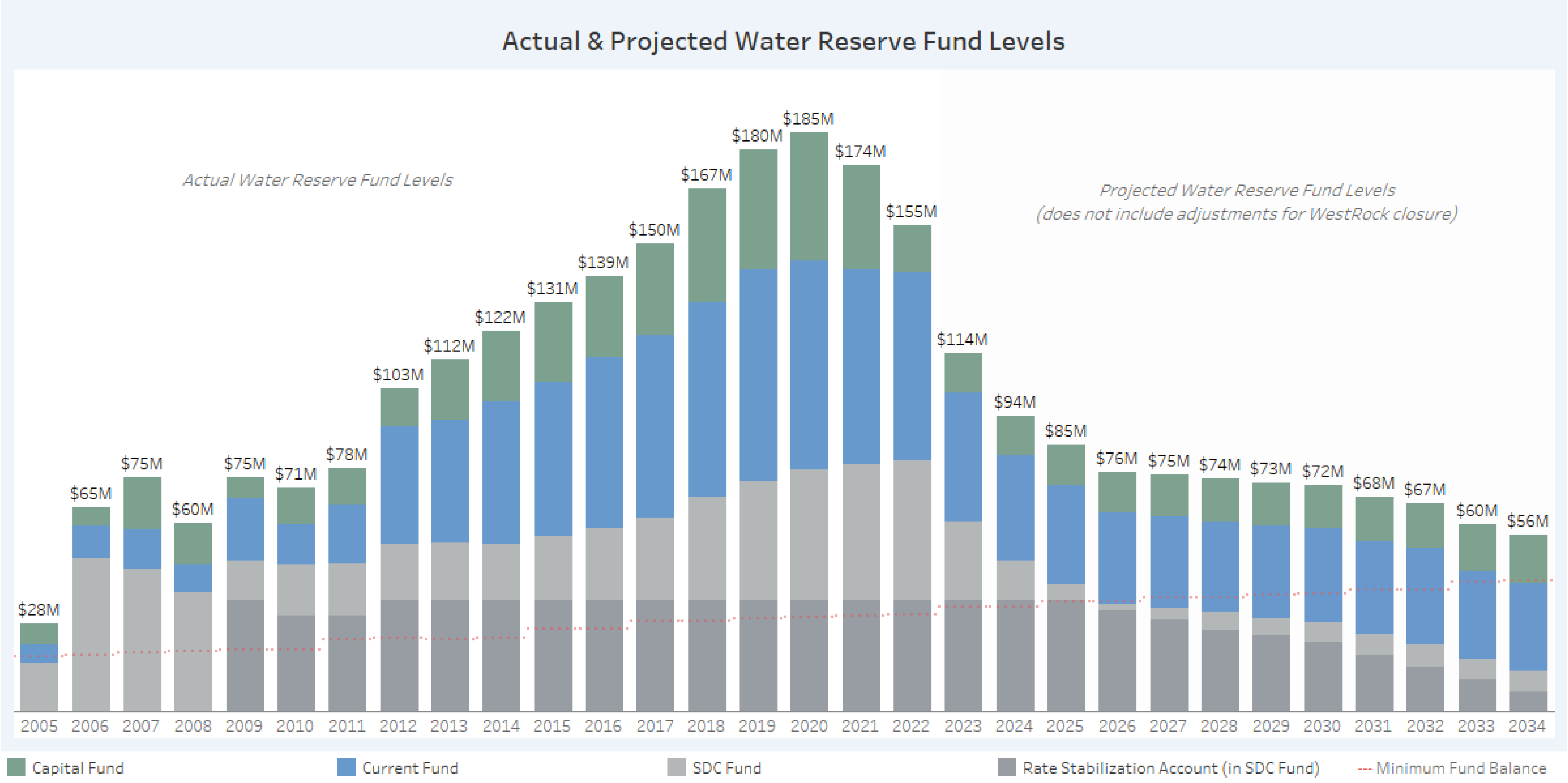
Nearly $70 million reserves being spent between 2020 and 2023, with continued spend included in the Base Case LRFP



Operating and Capital Reserves

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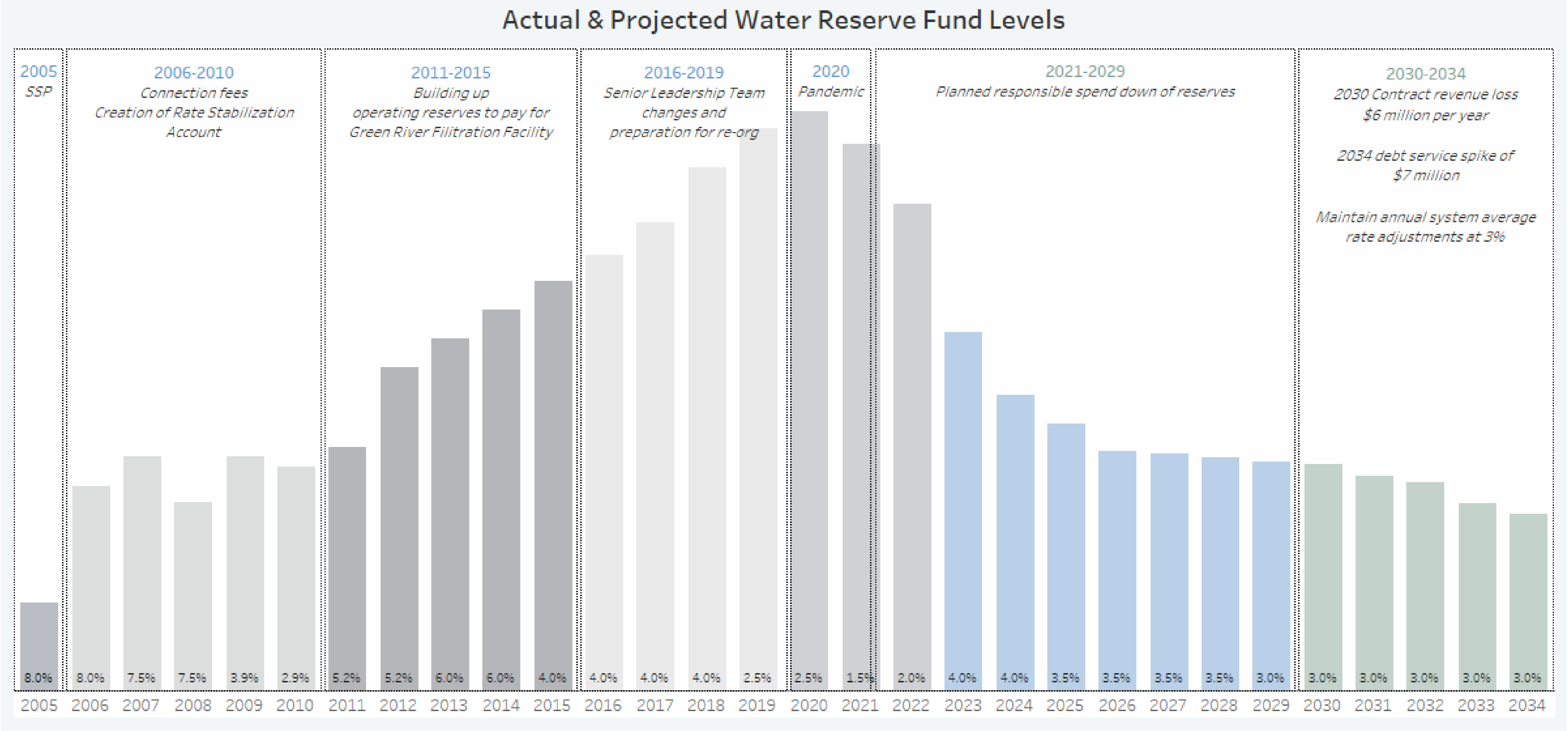
Reserves built from one-time revenues, used over the planning period supports gradual rate increases through 2034



% above represent actual and projected annual system average rate adjustments.

Operating Expenses: Overview of our Costs

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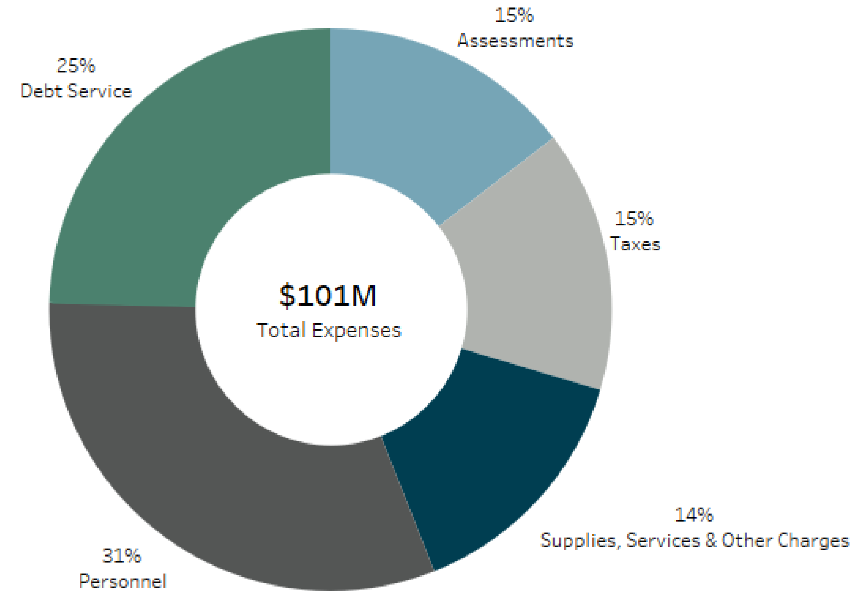
Over half of actual operating expenses in 2022 was committed to external obligations



Personnel	$31,789,328
Debt Service	$24,859,392
Taxes	$15,255,617
Assessments	$14,704,486
Supplies, Services & Other Charges	$14,551,614
Grand Total	$101,160,438

- **The amount of water we sell does not directly translate to the amount of costs we have to pay**
- **Approximately 95% of our expenses are fixed in the short term**
- **About 55%, or $54.8 million of our operating expenses are to pay for external obligations including debt service, taxes, and internal assessments**
- **When we are looking for cost efficiencies, we have to consider other categories**

Supplies, Services, and Other Charges

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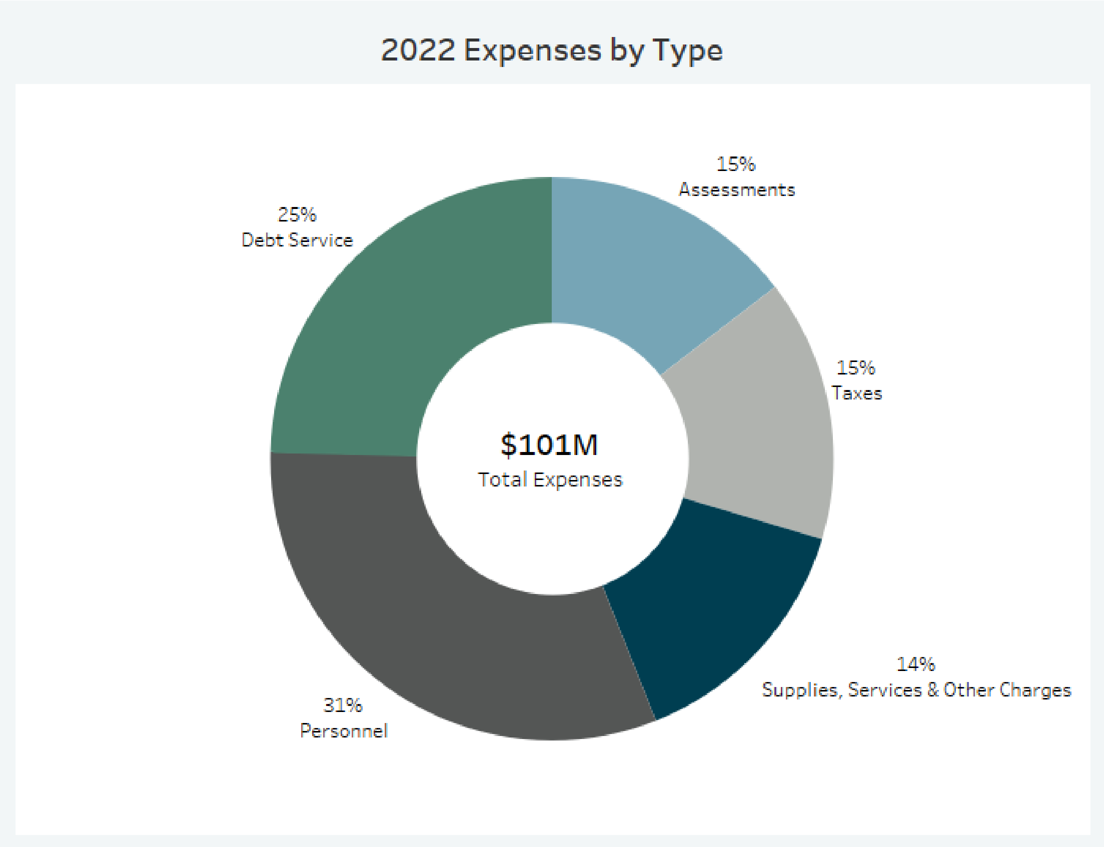
This category made up only about 14% of our total operating expense in 2022

- (39%) Additional external obligations are reflected in this category including:
  - Tacoma Share of RWSS Debt Service: $3.8 million
  - Building Rent: $743,898
  - Insurance: $1.2 million
- (40%) This category also includes commodities and other necessities such as:
  - Fleet Expenses: $2.5 million
  - Electricity & Other Utilities: $1.7 million
  - Financial, Banking, & Audit Fees: $567,489
  - GRFF Treatment Chemicals: $1 million
- (21%) The remaining $3.1 million includes all of the other expenses that are needed to operate the Utility such as: Operating, Repair, & Maintenance Supplies, Professional & Legal Services, Computer & Technology Support, Software & Licensing, Employee Training & Development



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2022 actual expenses

Personnel

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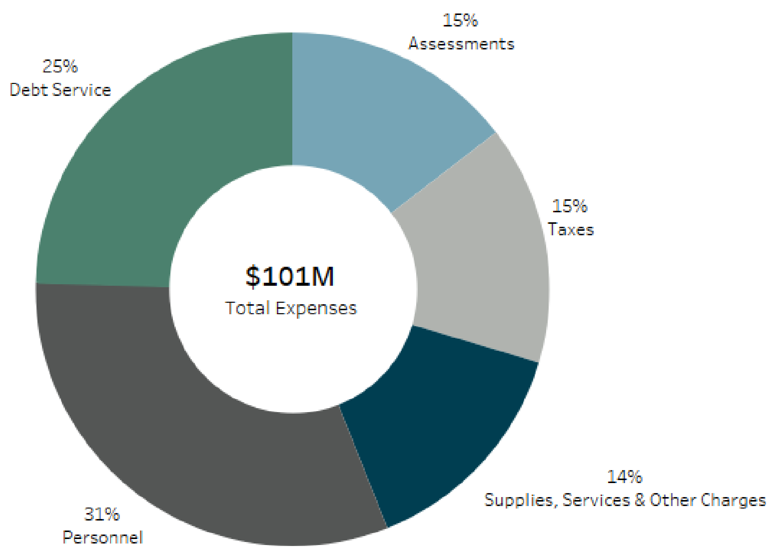
The remaining 31% of our total operating expenses in 2022 was for personnel that care for the system

The Cost



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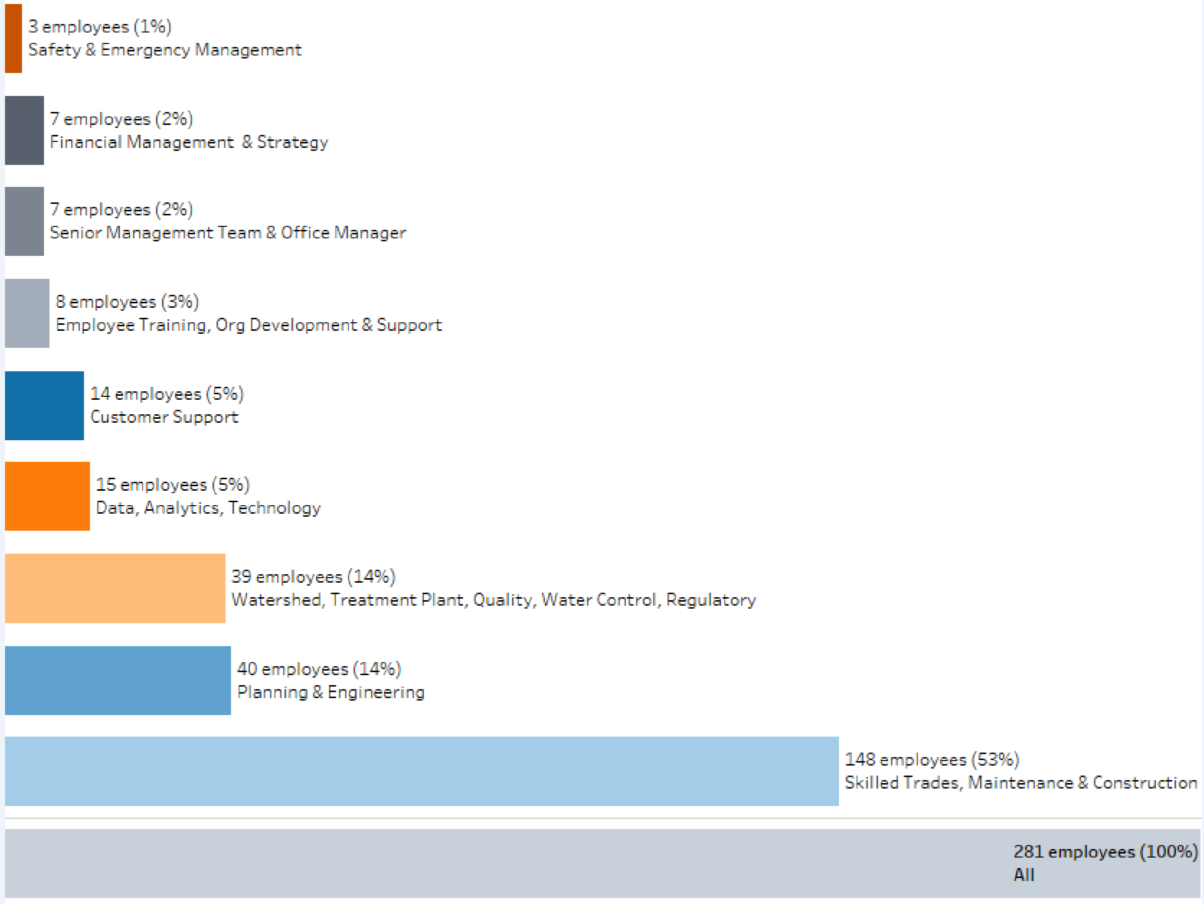
The Work



2022 actual expenses and FTE's

System Growth/Complexity Requires Personnel to Protect

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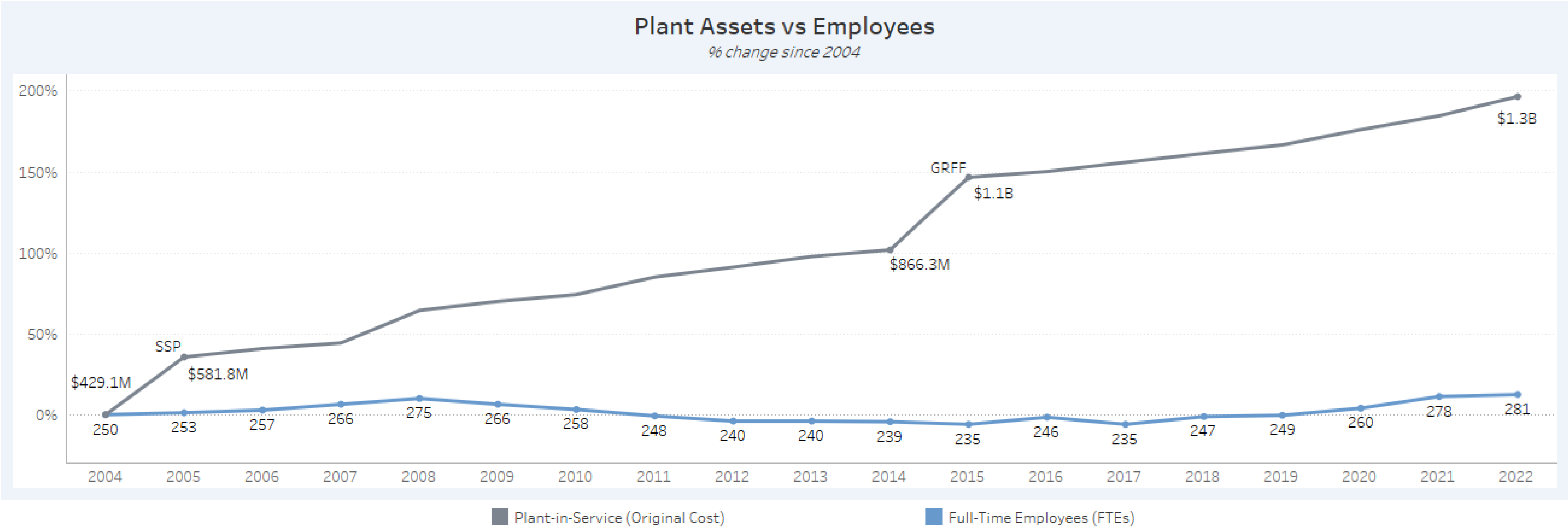

- **We have added a second supply system and a filtration facility in addition to new distribution facilities and other fixed assets, original cost assets in service has grown 197% since 2004**
- **In addition to increasing size and complexity of our system, we have added new capabilities including financial stewardship, asset management, and ArcGIS**
- **During this time, the number of employees that care for the system, ensure water quality, comply with regulatory mandates, support our customers, and responsibly provide financial, project, asset and data management has only grown 12% and the infrastructure cost per employee rose from $1.7 million to $4.5 million**

Capital and O&M Projects: Review Underway

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Additional Operational Updates at PUB Study Sessions or Board Meetings

System Changes

- This loss of demand will require major changes and reconfiguration of our system
- Staff are analyzing what improvements may be needed due to the loss of nearly 1/3 of our average day demand
- We are also evaluating capital and operational projects that are already planned or budgeted to determine the need for, the priority of, and the sizing/capacity of those projects given the major change in system demand

Long-Term Planning is Working and Supports Customers

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We have been recognized for our long-term planning, management & operational practices, and support from PUB/Council

2022 S&P Bond Ratings Upgrade to AA+

Independent third-party analysis

- "Consistently healthy financial performance that continues to meet or exceed financial targets, including robust liquidity and strong debt service coverage";
- "A history of implementing necessary rate increases to maintain a robust financial profile";
- "Governance factors that are highlighted by its credit-supportive financial and management policies"

Washington State Department of Health Sanitary Surveys

Conducted every 3-5 years as an inspection/review of our entire distribution system and filtration facility

- Distribution System Report August 2023: "In general, your facilities were in very good to excellent condition and your operations and management practices appear to be effective and appropriate."
- Green River Filtration Facility Survey Report August 2022: "The GRFF appears to be in exceptionally good shape, and we did not observe any deficiencies or regulatory exceedances. I also did not note any issues of concern with the diversion facilities or the portions of the watershed that we visited."

Appendix

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Table for Operating and Capital Reserves

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Reserves have been spent down between 2020 and 2023, with continued spend included in the Base Case LRFP

	Operating Reserve Spend-down		Capital Reserve Spend-down		SDC Fund Spend-down*		Total Reserve Spend-down	
Year	Year-end Balance	Change	Year-end Balance	Change	Year-end Balance	Change	Year-end Balance	Change
2019	67,999,772	-	38,261,216	-	73,294,466	-	179,555,454	-
2020	66,638,225	(1,361,547)	41,220,865	2,959,649	77,260,182	3,965,716	185,119,272	5,563,818
2021	62,483,012	(4,155,213)	33,158,861	(8,062,004)	78,768,250	1,508,068	174,410,123	(10,709,149)
2022	60,380,368	(2,102,644)	14,964,836	(18,194,025)	80,044,102	1,275,852	155,389,306	(19,020,817)
2023	41,417,712	(18,962,656)	12,420,837	(2,543,999)	60,429,476	(19,614,626)	114,268,025	(41,121,281)
2024	33,699,369	(7,718,343)	12,401,758	(19,079)	48,178,965	(12,250,511)	94,280,092	(19,987,933)
2025	31,701,367	(1,998,002)	12,875,775	474,017	40,577,980	(7,600,985)	85,155,122	(9,124,970)
2026	29,019,985	(2,681,382)	13,153,080	277,305	34,259,409	(6,318,571)	76,432,474	(8,722,648)
2027	28,965,513	(54,472)	13,334,177	181,097	33,180,128	(1,079,281)	75,479,818	(952,656)
2028	29,084,607	119,094	13,521,046	186,869	31,554,344	(1,625,784)	74,159,997	(1,319,821)
2029	29,411,576	326,969	13,715,483	194,437	29,786,684	(1,767,660)	72,913,743	(1,246,254)
2030	29,883,489	471,913	13,938,984	223,501	28,382,494	(1,404,190)	72,204,967	(708,776)
2031	29,599,572	(283,917)	14,270,175	331,191	24,481,988	(3,900,506)	68,351,735	(3,853,232)
2032	30,875,030	1,275,458	14,545,171	274,996	21,128,313	(3,353,675)	66,548,514	(1,803,221)
2033	28,367,818	(2,507,212)	14,906,806	361,635	16,513,088	(4,615,225)	59,787,712	(6,760,802)
2034	27,935,041	(432,777)	15,176,279	269,473	13,134,385	(3,378,703)	56,245,705	(3,542,007)

This plan does not include impacts from revenue loss due to WestRock closure

Operating and Capital Reserve Spend-down

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Reserves have been spent down between 2020 and 2023, with projections to be near policy levels by 2026

- Nearly $30 million of our reserves were spent down in 2021-2022, with another $41 million projected to be spent in 2023
- 2023-2024 spending is projected to be very close to budgeted appropriation
- About $40 million additional reserve spend is included in the 2022 Long-Range Financial Plan Base Case in 2024-2026, bringing levels closer to policy minimums while maintaining gradual rate adjustments and planning for contract revenue loss in 2030 and debt service spikes in 2034
- This plan also includes recognition and spend of $29.5 million from the SDC Capital Rate Stabilization Account (RSA) between 2026 and 2034 when we plan to begin issuing revenue bonds to finance our biennial capital budgets
- Use of reserves supports stable annual rate increases of 3% 2029-2034
- If we spend additional reserves earlier, we will need to issue bonds earlier, incur more debt service, and build up again to manage through 2030's

This spending plan does not include impacts from revenue loss due to WestRock closure

Operating and Capital Reserves: 2005-2010

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Reserves accumulated primarily from one-time SDC revenues that were deferred to be used for coverage ratios

- The Second Supply Project went live in 2005, at that time we had less than $6 million in the operating fund for working capital and only $28 million total reserves
- Between 2006 and 2010, regional water purveyors, including Tacoma Water, forecasted 'hockey stick' demand growth and we collected nearly $40 million in the SDC Fund from contracts that included Wholesale connection charges
- This SDC revenue was deferred until the interties were operational, then we would be able to provide service and earn or 'recognize' the revenue
- Rather than recognize this cash as revenue, in 2009 we moved it into another account within the SDC Fund (the Rate Stabilization Account) to recognize and spend as needed to boost our debt service coverage ratio
- At that time, we planned to issue revenue bonds each biennium to pay for most of our capital budget and we were concerned that we would have to raise rates to ensure we were meeting policies and covenants for coverage

Operating and Capital Reserves: 2011-2015

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Building reserves to address increased capital requirements, favorable financing, and lower than expected costs

- There were a number of regulatory requirements that required intensive capital investments during this time, including covering our reservoirs and filtering our surface water
- In order to avoid large rate spikes as we built the McMillin Reservoir and the Green River Filtration Facility (GRFF), we gradually increased rates between 2011 and 2015 to fund the capital expenditures as well as the additional O&M increases related to the operation of the new GRFF
- We had originally anticipated that we would also need higher rate increases in 2015-2016, however bids came in much lower than anticipated and we completed these projects significantly under budget
- We also saved a significant amount of money for financing costs, in addition to issuing taxable Build America Bonds with favorable interest rates, we also received a number of low interest loans with interest rates between 0.5% and 1.5%

Operating and Capital Reserves: 2016 & Beyond

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Responsibly spending down reserves

- In 2016, we had more bond funds available than we had expected due to the awards of low interest loans and we did not spend the capital reserves as quickly as we had planned
- In addition, between 2016 and 2020 Water was in a period of transition as we had several long-tenured senior leaders retire, delayed decision-making in filling these positions, and as new leadership arrived, we completed plans for a reorganization and on top of that, we had the pandemic
- This transition and delay in decisions and direction for staff, as well as impacts from the pandemic, meant that we were not spending our budgets as quickly as planned
- These savings, including budget variance, added to our reserve balances and we updated our long-range financial plan to include those reserves as funding sources for capital and operating expenses to keep rates as low as is responsible
- Between 2021-2034, we have a plan to use a combination of reserves, debt, and rate revenue to fund the utility and keep rate increases gradual for our customers

This spending plan does not include impacts from revenue loss due to WestRock closure

Table for WestRock Revenue Loss

Year	Revenue at Existing Rates	Rate Adjustment*	Additional Revenue*	Projected Revenue Before Shut-down	Projected Revenue After Shut-down	Total Lost Revenue
2023	$ 7,314,878	4.0%	$ 292,595	$ 7,607,473	$ 6,931,926	$ 675,547
2024	7,607,473	4.0%	304,299	7,911,772	2,688,526	5,223,246
2025	7,911,772	3.5%	276,912	8,188,684	-	8,188,684
2026	8,188,684	3.5%	286,604	8,475,288	-	8,475,288
2027	8,475,288	3.5%	296,635	8,771,923	-	8,771,923
2028	8,771,923	3.5%	307,017	9,078,940	-	9,078,940
2029	9,078,940	3.0%	272,368	9,351,309	-	9,351,309
2030	9,351,309	3.0%	280,539	9,631,848	-	9,631,848
2031	9,631,848	3.0%	288,955	9,920,803	-	9,920,803
2032	9,920,803	3.0%	297,624	10,218,427	-	10,218,427
2033	10,218,427	3.0%	306,553	10,524,980	-	10,524,980
2034	10,524,980	3.0%	315,749	10,840,730	-	10,840,730
Total				$ 110,522,177	$ 9,620,452	$ 100,901,725

*2022 LRFP Base Case

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Bill Comparison

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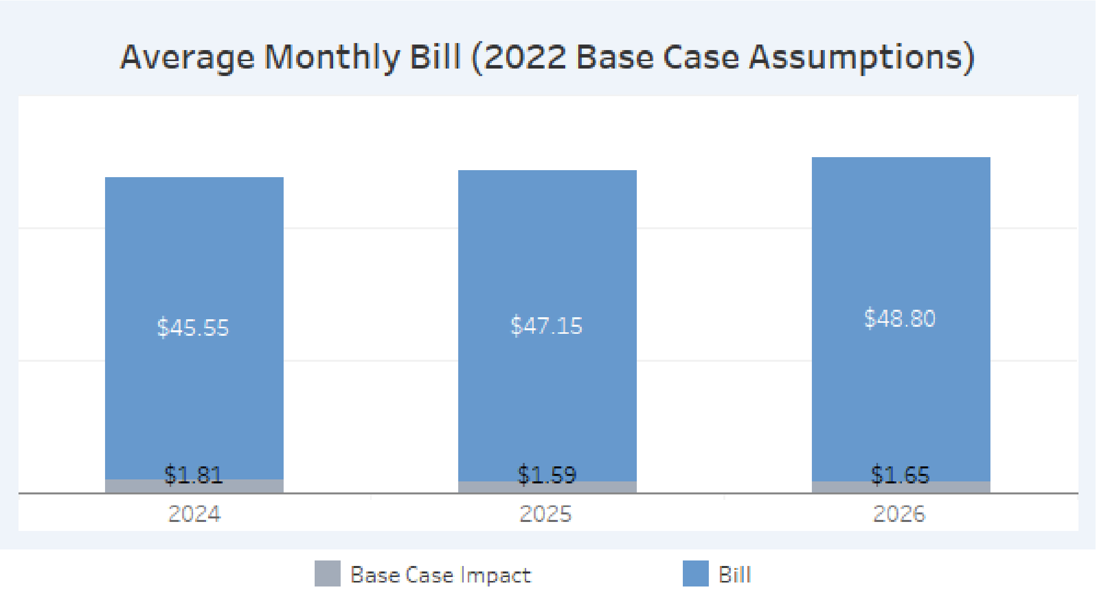
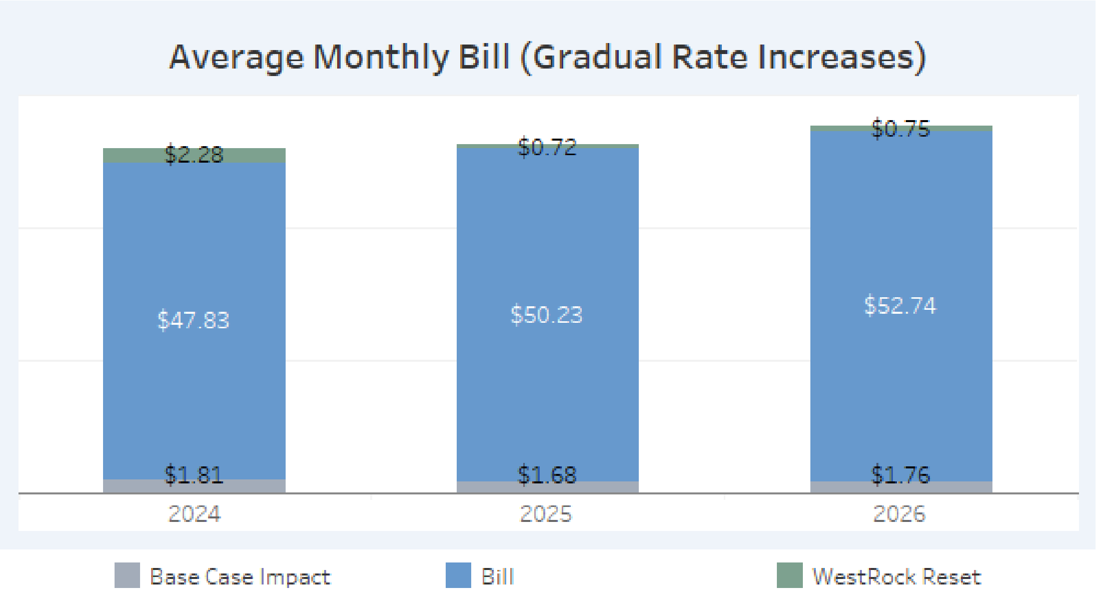
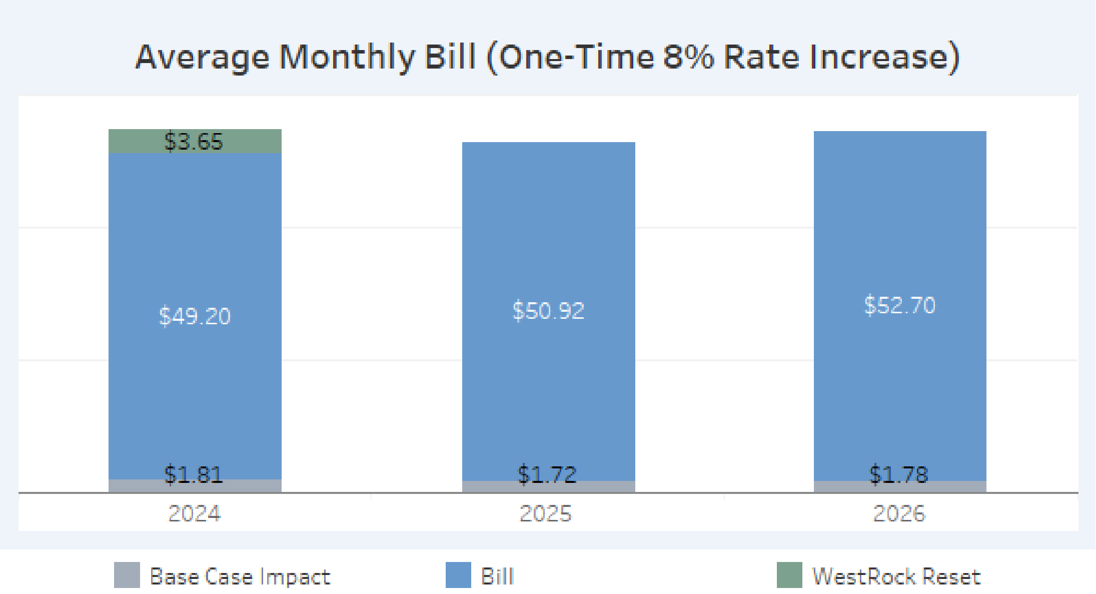
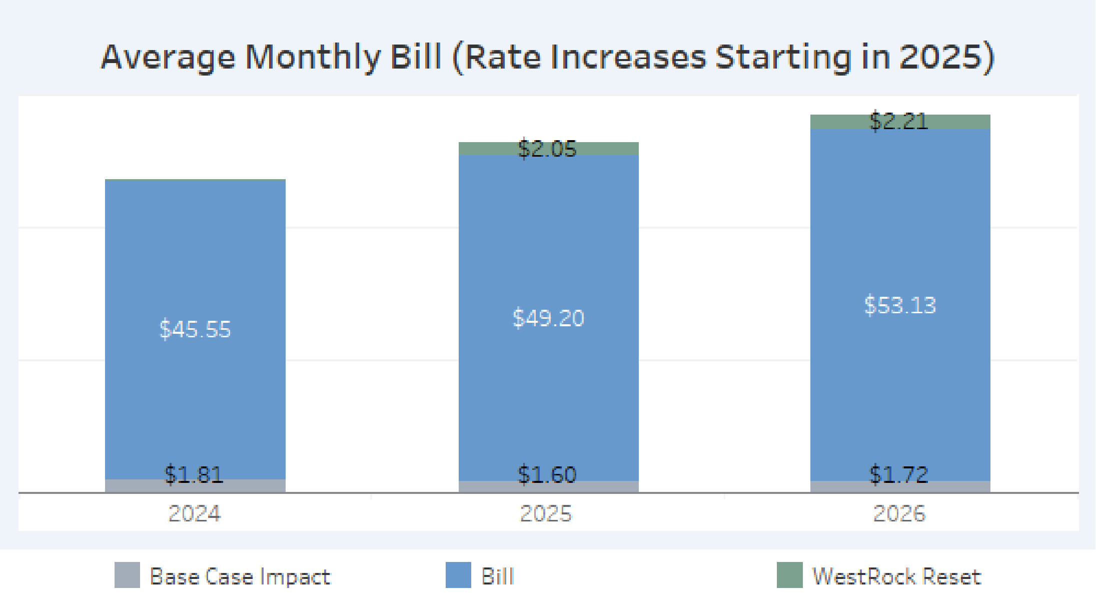


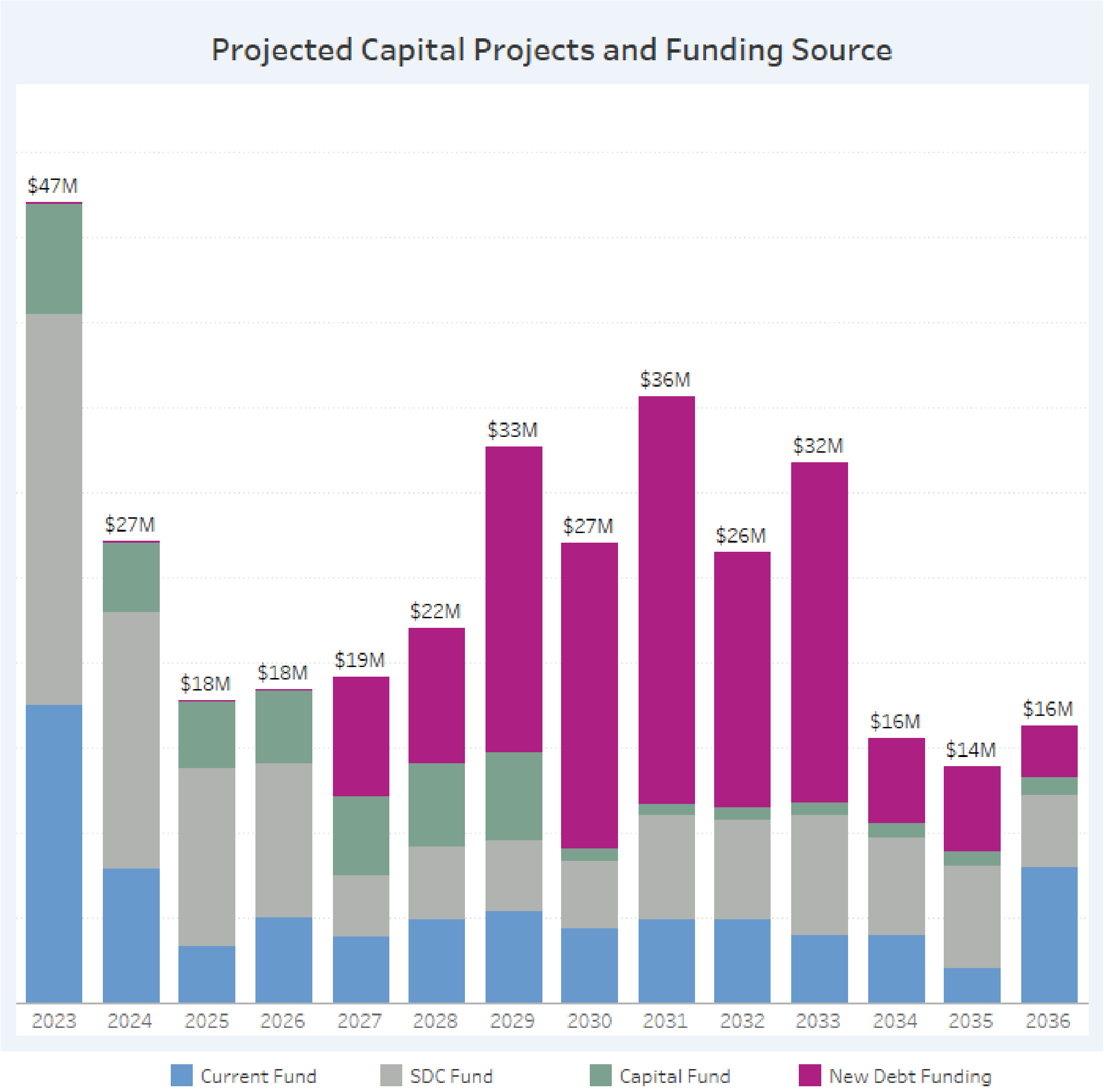






Capital Expenses: Funding

- In the current Long-Range Financial Plan we anticipate a revenue bond issue in 2026 to partially fund the biennial budget for 2027-2028
- At that time, reserves have been spent and we expect to borrow each biennium to fund our capital plans
- This also means increases in debt service expenses and potential constraints related to coverage requirements
- If we use reserves earlier, we need to borrow earlier and debt service expenses increase



Infrastructure and Employees

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Plant Assets vs Employees

% change since 2004

	Budgeted FTEs	Actual FTEs	Δ in Actual FTEs Since 2004	Plant-in-Service	Δ in Assets Since 2004	Infrastructure per FTE
2004	252	250	0%	$429,132,593	0%	$1,716,530
2005	263	253	1%	$581,791,345	36%	$2,299,571
2006	262	257	3%	$604,236,187	41%	$2,351,114
2007	283	266	6%	$619,239,712	44%	$2,327,969
2008	283	275	10%	$705,571,558	64%	$2,565,715
2009	290	266	6%	$729,441,103	70%	$2,742,260
2010	288	258	3%	$747,509,259	74%	$2,897,323
2011	262	248	-1%	$793,903,858	85%	$3,201,225
2012	262	240	-4%	$820,187,184	91%	$3,417,447
2013	247	240	-4%	$848,502,779	98%	$3,535,428
2014	248	239	-4%	$866,279,607	102%	$3,624,601
2015	256	235	-6%	$1,058,533,815	147%	$4,504,399
2016	256	246	-2%	$1,073,997,566	150%	$4,365,844
2017	272	235	-6%	$1,098,436,212	156%	$4,674,197
2018	274	247	-1%	$1,122,191,727	162%	$4,543,286
2019	288	249	0%	$1,144,604,458	167%	$4,596,805
2020	289	260	4%	$1,184,997,878	176%	$4,557,684
2021	301	278	11%	$1,221,697,392	185%	$4,394,595
2022	309	281	12%	$1,272,776,387	197%	$4,529,453