



Austin Water Utility

Joint Committee on AWU Financial Plan

April 4, 2012

Presentation Outline

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 - Decision points
 - Volumetric rate spread between block 1 and 5
- Revenue Stability Reserve Fund
 - Decision points
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 - Financial policy highlights
- Financial Metrics
 - Decision points
 - Targets
 - Financial policies
- Settle Up / Decoupling
 - LA Option
 - Decoupling description and example

Volumetric Rates

New Rate Design Options

- Option 15
 - Hybrid of Option #2
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$2.40, and blocks 3-5 at \$10.25
 - Reduces volatility slightly
- Option 16
 - Variation of Option #15
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$3.00, block 3 at \$6.00, and blocks 4-5 at \$12.50
 - Reduces volatility slightly

New Rate Design Options

- Option 17
 - Eliminate current revenue stability fee
 - Increase blocks 1 and 2 to recover revenue lost from revenue stability fee, no changes to blocks 3-5
 - Increases volatility significantly
- Option 18
 - \$46 M reserve fund target at 20% of total revenue and 163 days of O&M, with a 5 year goal to achieve target
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$3.00, block 3 at \$6.00, and blocks 4-5 at \$12.50
 - Reduces volatility slightly

New Rate Design Options

- Option 19
 - \$26 M reserve fund target at 11% of total revenue and 90 days of O&M, with a 5 year goal to achieve target
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$3.00, block 3 at \$6.00, and blocks 4-5 at \$12.50
 - Reduces volatility slightly
- Option 20
 - New rate block consumption levels based on Karen Keese's general recommendations on block design
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$2.63, block 3 at \$6.00, and blocks 4-5 at \$8.00
 - Maintain large dollar spread between blocks 1 & 5
 - \$46 M reserve fund target at 20% of total revenue and 163 days of O&M, with a 5 year goal to achieve target
 - Increases volatility significantly

New Rate Design Options

- Option 21
 - New rate block consumption levels based on Karen Keese’s general recommendations on block design
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$2.63, block 3 at \$6.00, and blocks 4-5 at \$8.00
 - Maintain large dollar spread between blocks 1 & 5
 - \$46 M reserve fund target at 20% of total revenue and 163 days of O&M, with a 5 year goal to achieve target
 - Increases volatility more than current rates but less than Option 20
- Option 22
 - Rate blocks reduced to 4 blocks with bottom 10% in block 1, average annual customer in block 2, block 3 up to the top 10%, and block 4 for the top 10%
 - New tiered fixed fee with block 1 at \$1.00, block 2 at \$3.00, block 3 at \$6.00, and blocks 4-5 at \$12.50
 - \$46 M reserve fund target at 20% of total revenue and 163 days of O&M, with a 5 year goal to achieve target
 - Increased volatility from current rates

Volumetric Rate Spread

- Volumetric rate spread between blocks 1 & 5
 - Current: \$11.02 spread (\$1.17 to \$12.19)
- Future volumetric rate spread illustration
 - Assumed 5% rate increase per year for 10 years
 - Future volumetric rates illustrations
 - All blocks increase at same percent per block per year
 - All blocks increase at same dollar amount per block per year
 - Blocks 1 & 2 increase at a higher percent than other blocks

Volumetric Rate Spread Illustration

- Assumptions: 5% rate increase per year, current volume rate spread between blocks 1 & 5 is \$11.02
 - All rate blocks increase at same percent per block per year
 - Rate spread between blocks 1 and 5 increases from \$11.02 to \$17.97 or 63% by 2022
 - All blocks increase at same dollar amount per block per year
 - Rate spread between blocks 1 and 5 remains the same at \$11.02 by 2022
 - Blocks 1 & 2 increase at a higher percent than other blocks
 - Rate spread between blocks 1 and 5 decreases from \$11.02 to \$9.94 or -10% by 2022

Decision Points

- Volumetric Rates Goals
 - Increase current \$11 variance between blocks 1 & 5
 - Maintain current \$11 variance between blocks 1 & 5
 - Decrease current \$11 variance between blocks 1 & 5
- Financial policies
 - How to set volumetric rates to achieve goal
 - Same percentage per block
 - Same dollar per block
 - Higher dollar for blocks 1-2 versus other blocks

Revenue Stability Reserve Fund

Revenue Stability Reserve Fund

- Decision Points
 - Appropriate funding target
 - Percentage of total revenue
 - Set dollar amount
 - Funding mechanisms
 - Revenue stability fee
 - Current ending balances
 - Volumetric rates
 - Funding timelines
 - To reach target levels
 - To replenish once funds are used
 - Use of funds
 - Restricted or unrestricted

Reserve Fund Levels

Revenue Stability Reserve Fund Level Comparison

<u>Reserve Fund Level</u>	<u>Percent of Water Total Revenue \$ 234,000,000</u>	<u>Number of Water Days O&M \$ 105,000,000</u>	<u>Volumetric Rate to Achieve Goal in 5 Years</u>
\$20,000,000	8.5%	70	\$0.09
\$25,000,000	10.7%	87	\$0.11
\$30,000,000	12.8%	104	\$0.14
\$35,000,000	15.0%	122	\$0.16
\$40,000,000	17.1%	139	\$0.18
\$45,000,000	19.2%	156	\$0.20
\$50,000,000	21.4%	174	\$0.23

Reserve Fund – Funding Mechanisms

- Possible funding mechanisms
 - Revenue stability fee – volumetric charge
 - Current ending balances – reduce to fund reserve
 - Transfer of higher than budgeted revenue
- When fund level is reached
 - Eliminate fee
 - Reduce fee to lowest level that would maintain percentage of total revenue as they grow

Reserve Fund – Uses of Funds

- Possible uses of reserve funds
 - Covered by specific financial policies
 - Revenue losses
 - Above certain dollar or percentage levels
 - Operations and Maintenance
 - Unanticipated or extraordinary circumstances
 - Rate Stabilization
 - To smooth out increases in rates

Questions and Discussion?

Financial Metrics

Financial Metrics

- Decision Points
 - Debt Service Coverage targets
 - Minimum in bond covenant
 - Financial policy levels
 - Cash Balances
 - Number of days of O& M expense
 - CIP Funding
 - Debt vs. cash funding targets
 - Timelines
 - Timelines to meet financial metric goals

Financial Metrics

- Debt Service Coverage (DSC)
 - Description: the ratio of the amount of net cash flow available compared to annual principal and interest on debt
 - Calculation:
Total Revenue minus Operations & Maintenance costs divided by total debt service (revenue bonds)
 - Bond covenant levels
 - Bond covenants require a 1.25x DSC
 - Financial policy levels
 - City financial policies require a minimum of 1.50x DSC
 - Rating agency benchmarks
 - Midrange to strong AA rated utilities should be between 1.50x and 2.0x

Financial Metrics

- Cash Balances
 - Amount of cash in relation to the number of days of operations and maintenance it could cover
 - Financial policy levels
 - City financial policies require a minimum of 45 days of O&M
 - Targets in 2012 forecast
 - AWU has targeted between 75 and 100 days O&M in their financial forecast last year
 - AWU will continue to target increased cash balances in 2012 forecast
 - Rating Agency benchmarks
 - Midrange to strong utilities should have between 6 months to a year of cash

Financial Metrics

- Capital Improvement Program (CIP) Funding
 - Cash funding levels of CIP
 - Amount of cash used to fund CIP projects as compared to using debt
 - Financial policy levels
 - City policies recommend a minimum of 20% cash funding of capital spending
 - Rating agency benchmarks
 - Midrange to strong utilities should fund between 20% to 50% of their capital spending in cash

Financial Metrics

- Timelines
 - Improving financial metrics would be transitioned over several years to reduce rate impacts
 - Number of years to reach financial metric goal could vary depending on the financial metric

Questions & Discussion?

New Topic

Settle Up / Decoupling

Los Angeles Water Revenue Adjustment

- Recovers any prior year shortage in revenue due to variation in water sales
- Adjustment factor per 1,000 gallons added to all water consumption until revenue shortfall recovered
- Limit on adjustment unless financial required
- Excludes:
 - Reclaimed water service
 - Public sponsored irrigation, recreational, agricultural, horticultural, floricultural, community gardens, and youth sports

LA Option – 2010 Water Revenue Shortfall Example

(\$ in Millions)	Water Revenue 2010 Budget	Water Revenue 2010 Actual	Revenue Shortfall	Percent Shortfall
Residential	\$ 85.8	\$ 66.8	\$ (19.0)	-22.1%
Multifamily	\$ 35.9	\$ 34.1	\$ (1.8)	-5.0%
Commercial	\$ 61.6	\$ 47.4	\$ (14.2)	-23.1%
Large Volume	\$ 12.9	\$ 10.8	\$ (2.1)	-16.3%
Wholesale	\$ 9.9	\$ 8.9	\$ (1.0)	-10.1%
Total	\$ 206.1	\$ 168.0	\$ (38.1)	-18.5%

LA Option – 2010 Water Revenue Shortfall Example – Option #1

(\$ in Millions)	2011				
	2010 Revenue Shortfall	2011 Budget Volumes (in 1,000 Gals.)	Adjustment by Total Shortfall \$/1,000 Gals.	2011 Revenue Adjustment	Additional Percent Increase
Residential	\$ (19.0)	18,451,969	\$ 0.82	\$ 15.2	16.7%
Multifamily	\$ (1.8)	9,165,148	\$ 0.82	\$ 7.5	19.7%
Commercial	\$ (14.2)	12,875,668	\$ 0.82	\$ 10.6	17.0%
Large Volume	\$ (2.1)	2,763,019	\$ 0.82	\$ 2.3	18.7%
Wholesale	\$ (1.0)	3,142,779	\$ 0.82	\$ 2.6	24.4%
Total	\$ (38.1)	46,398,583		\$ 38.1	

FY 2011 Water Rate Increase 5.4%

Water Revenue Adjustment Based on Total Shortfall and Total Volumes

LA Option – 2010 Water Revenue Shortfall Example – Option #2

(\$ in Millions)	2011				
	2010 Revenue Shortfall	2011 Budget Volumes (in 1,000 Gals.)	Adjustment by Class Shortfall \$/1,000 Gals.	2011 Revenue Adjustment	Additional Percent Increase
Residential	\$ (19.0)	18,451,969	\$ 1.03	\$ 19.0	20.83%
Multifamily	\$ (1.8)	9,165,148	\$ 0.20	\$ 1.8	4.73%
Commercial	\$ (14.2)	12,875,668	\$ 1.10	\$ 14.2	22.76%
Large Volume	\$ (2.1)	2,763,019	\$ 0.76	\$ 2.1	17.07%
Wholesale	\$ (1.0)	3,142,779	\$ 0.32	\$ 1.0	9.40%
Total	\$ (38.1)	46,398,583		\$ 38.1	

FY 2011 Water Rate Increase 5.4%

Water Revenue Adjustment Based on Class Shortfall and Class Volumes

LA Option Pros and Cons

- Pros
 - Recovers revenue shortfalls in following year
 - Easy mechanism to increase rates when needed
 - Adjustment is removed when shortfall recovered
- Cons
 - Volatile solution to volatility problem
 - Possibly high rate adjustments on top of regular rate increases
 - Multiple year shortfalls would increase revenue adjustment
 - If there are maximum limits on the adjustment, then revenue would not be recovered or it would take longer to recover
 - Does not take into account expense savings and cash or reserve balances in adjustment
 - Complex for customers to understand
 - More difficult for customers to budget for water bills

Decoupling Description

- An adjustable price mechanism that breaks the link between the amount of energy sold and the actual revenue collected by the utility.
- Decoupling is used primarily to eliminate incentives that utilities have to increase profits by increasing sales, and the corresponding disincentives that they have to avoid reductions in sales.
- Primarily an investor owned electric and gas rate regulation method.
- Rather than holding prices constant between electric or gas rate cases, decoupling adjusts prices periodically, even as frequently as each billing cycle, to reflect differences between budgeted units and actual sold units, as necessary to collect their required revenue.

Decoupling Description

- Once the revenue requirements are determined, decoupling adjusts prices to maintain the allowed revenue requirement.
- Any change in consumption associated with weather, conservation or other causes, will result in an inverse change in prices.
- Some electric utilities use a monthly adjustment, but most use an annual adjustment to prices.
- Decoupling only looks at revenue changes from budget and adjusts rates accordingly.

City Budget Process

- City Council annually reviews budget of AWU
- All changes in actual revenue in current year and changes to revenue projections for future years are included in budget process review
- All changes in actual costs in current year and changes to cost projections for future years are included in the budget process review.
- Rates for the budget year are adjusted accordingly based on revenue and cost projections.
- City budget process for AWU rates results in the same annual adjustment to revenue as decoupling

FY 2010 Decoupling Example

- Assumptions
 - 2010 water revenue under wet weather extremes and \$38M in revenue less than projections
 - Quarterly decoupling adjustments based on actual 2010 revenue and projected consumption
 - Decoupling adjustment to recover previous quarter revenue loss based on budgeted consumption
 - Subsequent quarter losses would compound decoupling adjustment in the next quarter

FY 2010 Decoupling Example

	2010 Qrt 1 <u>Oct-Dec</u>	2010 Qrt 2 <u>Jan-Mar</u>	2010 Qrt 3 <u>Apr-Jun</u>	2010 Qrt 4 <u>Jul-Sep</u>	2011 Qrt 1 <u>Oct-Dec</u>	2011 Qrt 2 <u>Jan-Mar</u>
Actual Revenue Loss	\$ (12.0)	\$ (8.1)	\$ (6.9)	\$ (11.0)	\$ (1.9)	\$ (0.9)
Settle Up Rate / 1,000 gals.		\$ 1.27	\$ 0.91	\$ 0.55	\$ 1.06	\$ 0.29
Projected Settle Up Revenue		\$ 12.0	\$ 10.3	\$ 8.2	\$ 12.1	\$ 2.7
Actual Settle Up Revenue		\$ 9.8	\$ 9.0	\$ 7.1	\$ 11.3	\$ 2.5
Settle Up Status	\$ (12.0)	\$ (10.3)	\$ (8.2)	\$ (12.1)	\$ (2.7)	\$ (1.1)

Settle Up Rate: The rate per 1,000 gallons that would be charged the following quarter to recover the previous quarter's revenue loss. If additional revenue losses occur, the following quarter's rate is adjusted to make up the cumulative revenue loss in the quarter.

Settle Up Status: Provides the cumulative revenue loss after implementation of settle up rate. If settle up rate recovers the previous quarters revenue loss, the status would be positive. If the settle up rate does not recover the previous quarters revenue loss, the status would be negative.

Decoupling Concerns

- Electric and gas utility rate mechanism
- Designed more for investor owned electric or gas utilities
- Annual decoupling adjustment would be similar to our budget process
- Monthly or quarterly decoupling rate adjustments would change bills more often in addition to current rate adjustments
- Might not be accepted by our customers or would impact bills adversely
- Charter requires public hearing for any rate increase
- Utilities risk of reduced revenues is eliminated but shifted to consumers
- More emphasis on revenue and cost projections outside of the normal budget time frame
- Multiple quarters of revenue losses would compound and extend any rate adjustment
- Customers would find decoupling difficult to understand other than it adjusts their rates more frequently

Questions & Discussion?