



**City of Seattle**  
**Seattle City Council**

**MEMORANDUM**

Date: February 23, 2012

To: Monica Martinez Simmons, City Clerk

*HARD COPY:* City Hall, Third Floor, Main Reception

*ELECTRONIC COPY:* [clerkfiling@seattle.gov](mailto:clerkfiling@seattle.gov)

From: Susana Serna, Council Central Staff  
 (Dan Nolte, Council Staff)

Re: Request to Create Clerk File – Response to 2012 Council Statement of Legislative Intent

Title of Clerk File: Seattle Public Utilities (SPU) Department’s Response to 2012 Statement of Legislative Intent (SLI) No. 13-1-A-1: Review of SPU financial policies.

Please cross-reference: Resolution No. 31361 (2012 SLI Adoption Resolution)  
 Ordinance No. 123758 (2012 Budget Adoption Ordinance)  
 Clerk File No. 311810 (City Council Changes to the 2012 Proposed Budget and the 2012-2017 Proposed Capital Improvement Program)

Please create a Clerk File for the *SPU* response, and related documents to 2012 Council SLI No. 13-1-A-1.

I am attaching hard and electronic copies of all materials related to this SLI.

Clerk File Table of Contents:

Item	Title	File Name
1	SLI 13-1-A-1_SPU Response_Financial Policies FINAL	SLI 13-1-A-1 Response Memo.docx
2	2012 Statement of Legislative Intent 13-1-A-1	SLI 13-1-A-1.docx



Seattle Public Utilities  
Response to 2012 Seattle City Council  
Statement of Legislative Intent, No. 13-1-A-1

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*Review of SPU Financial Policies*

**January 31, 2012**

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## I. Executive Summary

This report responds to Seattle City Council's (Council) request for a review of Seattle Public Utilities' (SPU) financial policies, with an emphasis on drainage and wastewater policies. The SLI requested that this report specifically include:

1. A summary of financial policies for SPU's Funds and an explanation of why each policy target was selected.
2. A comparison of SPU financial policies and bond ratings to those of other comparable utilities and Seattle City Light, and
3. An evaluation of the Drainage and Wastewater Fund cash-financed CIP policy that considers a change from a 25 percent to a 20 percent cash-financed CIP contribution.

In response to these requirements:

**Section II (Financial Policy Overview)** provides a contextual basis for financial policies, including policy objectives, metrics, and implementation considerations.

**Section III (Financial Policy Comparisons)** provides comparisons of SPU enterprise fund policies with comparable jurisdictions. This section also provides a comparative overview between SPU enterprise funds which provides valuable context for the fund specific reviews that follow.

**Section IV (Water Fund Review), Section V (Drainage and Wastewater Fund Review), and Section VI (Solid Waste Fund Review)** discuss each fund's financial policies, looking both at the origins of their adopted targets and at historical and projected performance against these targets. The Drainage and Wastewater Fund review also includes a more detailed analysis of the impacts of lowering its cash-financed CIP contribution from 25 percent to 20 percent.

Financial policies serve one or more key functions:

- *Providing Financial Certainty.* One of the most basic purposes of financial policies is to ensure the utility can meet its financial obligations and maintain a strong credit rating (and thus preserve access to a low-cost borrowing);
- *Ensuring Rate Stability.* If a utility is subject to significant, unpredictable swings in revenues or costs, policies can be established to minimize any resulting impact on rates;
- *Managing Long-Term Debt.* For a utility with a significant capital program, financial policies provide an opportunity to establish how the costs of capital investments will be shared among current and future ratepayers, and how debt service costs will be managed within the context of overall operational expenses.

## Section I: Executive Summary

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### **Jurisdictional Comparisons**

Included in this report is a comparative review of the financial policies of 15 water, sewer and stormwater utilities (including SPU utilities). To summarize findings:

- Most jurisdictions have targets for debt service coverage (DSC). Seattle's Drainage and Wastewater Fund (DWF) and Water Fund (WF) DSC targets are more conservative than most peer utilities.
- Very few jurisdictions have policies defining desired levels for cash-financing of the CIP. However, based on available debt ratios, nearly all jurisdictions are funding significant portions of their capital program with cash.
- Only Seattle's DWF has a policy target for debt-to-assets ratio. However, DWF and WF have actual debt ratios that are high relative to most of their peers
- Rate stabilization funds are not a common mechanism among peer utilities, perhaps because many maintain fairly high liquidity in their operating funds.
- Seattle's DWF and WF operating cash balance targets are generally very modest relative to peer utilities. However, SPU utilities have access to a large consolidated City cash pool, an option that may not be available to certain other jurisdictions.

It is difficult to find truly comparable Solid Waste utilities due to wide variances in business models and financing mechanisms. Therefore, only a cursory presentation of Solid Waste comparisons is included.

### **SPU Fund Policies**

While the stated policies for SPU's three enterprise funds are very similar, their performance against these targets has varied considerably. This variance stems from considerable differences in the size and growth patterns of their respective capital programs and their associated reliance on debt financing. These differences also influence their respective binding constraints, or the financial policy requiring the highest amount of revenue recovery and to which rates are set.

- The WF has had the largest sustained capital program, with debt outstanding about twice that of DWF and 20 times the amount of the Solid Waste Fund (SWF). A growing debt service load relative to water service revenues led to a switch in its binding constraint from cash-financed CIP to debt-service coverage with the 2012-2014 rate cycle.
- DWF capital spending has increased considerably over the past ten to fifteen years. This growing capital program influenced the development of the broadest and most conservative mix of financial policy targets focused on debt management among the three enterprise funds. Cash-financed CIP has (and continues to be) the binding constraint for DWF.
- The SWF is much more infrastructure-limited than the other SPU lines of business with relatively low capital spending and debt. Operational policies such as net income or operating cash have historically been the binding constraints when setting solid waste rates.

### Changes to DWF Cash-financed CIP Policy

In response to this request, SPU evaluated the impacts for 2013-2017 of three levels of average cash financing: 25 percent (current), 22 percent (reduced) and 20 percent. The 22 percent scenario represents the lowest average contribution during the analysis period that will allow DWF to meet all financial targets.

Relative to status quo (25 percent cash financing):

- A 20 percent average cash financing reduces rates and bills throughout the analysis period, but also drives a reduction in financial performance, with the fund not meeting net income, debt-to-assets and debt service coverage targets at various points.
- A 22 percent average cash financing initially reduces rates and bills. However, by the latter part of the period, rates must be raised in order to meet the debt-to-asset target and end the period higher than if the current policy were maintained. This scenario also represents a **temporary** reduction in cash financing as levels must increase to 25 percent or higher from 2017 forward to maintain a debt-to-asset ratio below 70 percent.
- Both reduced cash-financing scenarios increase annual debt service and debt outstanding relative to the current policy.

SPU recommends no changes to the current 25 percent cash-financed CIP policy. Reductions in cash financing, while decreasing rates, also erode financial performance and increase debt outstanding. When adopting DWF financial policies in 2003, Council and SPU shared a broad consensus on the benefits of a robust financial policy mix to manage the debt associated with DWF's rapidly growing capital program. Council not only supported SPU's proposed 25 percent cash-financing option, the highest of those analyzed, but also recommended and adopted a 70 percent cap on the debt-to-asset ratio to "reinforce debt control", a policy reviewed by SPU but not included in its final policy proposal.

According to the City's Debt Manager, rating agencies are impressed when issuers can stick by their stated financial policies. Relaxing those policies raises significant concern, particularly if viewed as a means to provide short-term rate relief. The 25 percent limitation results in a fairly modest cash contribution to capital and therefore, significant financial leverage. Reducing this cap could be interpreted as a means of simply deferring the need to raise rates or cut costs.

Although the DWF's bond ratings are not currently at risk of a downgrade, the City's Financial Advisor has indicated that this policy change could put downward pressure on the fund's ratings. The utility's debt ratio has risen significantly over the last decade and is already significantly above the median for similarly rated utilities. Any reduction in the amount of the CIP that is financed from cash will create more pressure on this ratio. Given continuing market concerns about credit quality, a ratings downgrade would have very significant long-term financial consequences for the DWF and its customers.

## II. Financial Policy Overview

### II.A. Policy Metrics

Financial policies may provide general operating guidance that impacts performance (i.e. maintain equipment in good operating conditions) or highly specific financial targets which measure performance against industry standard metrics, such as net income or debt service coverage. This report focuses on the latter. Table 1 describes common industry metrics used to measure utility financial performance and which form the basis for SPU's utility funds' financial policy targets.

**Table 1**  
**Description of Financial Policy Metrics**

<b>Metrics</b>	<b>Objective</b>	<b>Importance</b>
Net Income	-Financial certainty	Measure of the sustainability of an enterprise over time. Signals to rating agencies the City's commitment to establishing fees that cover costs.
Year-End Cash Balance	-Financial certainty -Rate stability	Ensures that an enterprise has sufficient cash to meet near-term operating needs and absorb some unexpected changes to revenues and expenditures.
Variable Rate Debt	-Financial certainty -Rate stability	Balances the advantages of lower interest costs with the risk of unexpected interest rate increases.
Rate Stabilization Fund	-Financial certainty -Rate stability	Provides a cushion to protect utilities from short-term revenue shortfalls caused by fluctuations in consumption.
Debt Service Coverage	-Financial certainty -Debt management	A higher coverage ratio means more "excess" revenue is available after making debt payments. This reduces financial risk and provides more flexibility to respond to unexpected needs or revenue shortfalls. Rating agencies particularly emphasize this metric.
Debt-to-Asset Ratio	-Financial certainty -Debt management	An indicator of reliance on debt for infrastructure financing. A high ratio suggests less flexibility, as a greater portion of each year's revenues is used to repay debt.
Cash-financed CIP	-Debt management	Helps to prevent a rapid increase in debt levels and to limit an escalation in the debt-to-assets ratio. If implemented as an average, may be used to smooth rate increases when CIP spending is uneven from year to year.

## Section II: Financial Policy Overview

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### II.B. Financial Policy Implementation Considerations

There is not one universal metric for measuring financial performance. As noted in Table I, each metric addresses a different (or different set) of policy objectives. Each utility establishes a mix of financial policies that best suits its individual requirements. Different mixes may achieve similar objectives. The City's Financial Advisor noted the following factors that influence an entity's choice of financial policies:

- *Management to policies.* Utilities take different approaches in how they manage financial policies:
  - Active management of rates and expenses to ensure that policies are met.
  - Use of conservative planning assumptions to provide a significant cushion against negative variances.
  - Setting rates to target meeting financial policy goals and managing the achievement of these goals from an expense standpoint while considering a revenue solution only in extreme situations, even if this means that financial policy targets won't be met.

Financial policies managed in the manner noted in the last two bullets need to be more robust than those where utilities actively adjust rates and costs to ensure financial policy targets are always met.

- *Rate cycles.* Shorter rate cycles (i.e. annual revisions) allow ongoing adjustment to rates if there are financial performance shortfalls in a given year. Longer rate cycles (more typical of SPU utilities) require management of performance over time. More stringent policies provide a cushion when rates cannot be raised to address underperformance.
- *Capital plan size.* More stringent financial policies are particularly important in limiting debt buildup for jurisdictions with large ongoing capital programs.
- *Debt management considerations:* A package of financial policies is particularly important in providing an overall framework for debt management. For example, even with formal cash-financing policies, a utility may end up not meeting legal coverage requirements in the absence of other policy mechanisms that allow for an increase in revenues **before** a critical level of debt relative to revenues is reached. Heavy dependence on debt can eventually limit future options to issue debt due to additional bonds test requirements<sup>1</sup>.

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<sup>1</sup> Prior to issuing new revenue bonds, the issuer must show that the new debt will not dilute the returns to existing bond holders. The additional bonds requirement test is a metric which demonstrates that prior year's revenues (or in some cases future revenues) are more than sufficient to pay debt service on BOTH existing and new bonds.

### III. Financial Policy Comparisons

#### III.A. Interjurisdictional Comparisons

The Council SLI requests a comparison of SPU financial policies to those of comparable utilities with similar bond ratings. This section provides a description of the utilities surveyed, rating agency considerations, and finally comparisons of each financial policy target by jurisdiction. Some general conclusions on these comparisons:

- Most jurisdictions have targets for debt service coverage. Seattle’s DWF and WF DSC targets are higher than most peer utilities.
- Very few jurisdictions have policies defining desired levels for cash-financing of the CIP. However, based on available debt ratios, nearly all jurisdictions are funding significant portions of their capital program with cash.
- Only Seattle’s DWF has a policy target for debt-to-assets ratio. However, DWF and WF have actual debt ratios that are generally very high levels relative to their peers
- Rate stabilization funds are not a common mechanism among peer utilities, perhaps because many maintain fairly high liquidity in their operating funds.
- Seattle’s DWF and WF operating cash balance targets are generally very modest relative to peer utilities. However, SPU utilities have access to a large consolidated City cash pool, an option that may not be available to certain other jurisdictions.

#### Utilities Surveyed

This section compares the financial policies of the water, sewer, stormwater and solid waste utilities listed in Table 2<sup>2</sup>. All of the utilities selected have high bond ratings of AA or higher.

**Table 2**  
**Public Utilities Included in Financial Policy Comparisons**

Water	Sewer/ Storm (1)	Stormwater	Solid Waste
Seattle	Seattle	Des Moines (IA)	Seattle
District of Columbia (2)	Louisville & Jefferson County	Miami Dade County	Tacoma
Portland	Portland	Fort Worth	
Phoenix	Tacoma		
Cincinnati	Honolulu		
Denver			
San Antonio			

**Notes:**

- 1) All of these utilities, except Honolulu, bill separately for stormwater. Honolulu also manages stormwater services but no separate charge is apparent.
- 2) Combined Water/Sewer Utility. Referred to as “DC Water & Sewer” in charts.

<sup>2</sup> A brief discussion of solid waste utilities is included this section with comparisons found in Appendix A.

## Section III: Financial Policy Comparisons

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### Water, Sewer, and Stormwater Utilities

A fairly large pool of comparable sewer and water utilities with high credit ratings exist. These utilities tend to provide comparable services, have similar municipal governance structures and are generally relatively stable.

The bonds of most dedicated stormwater utilities are backed by a general obligation pledge or assessment fee revenue and are therefore not comparable to Seattle. The three stormwater utilities included in this comparison issue bonds backed solely by revenues derived from stormwater fees. However, these are relatively young utilities that have not issued a significant amount of debt, and consequently, have not yet developed a full set of financial policies.

### Solid Waste Utilities

Due to considerable differences in business models and financing mechanisms, it is difficult to find comparable solid waste utilities which hold at least a AA credit rating, as is the case with SPU's Solid Waste Fund (SWF). Due to the lack of true comparables, Solid Waste Utilities are not included in this section. However, Table A-1 in Appendix A provides some limited comparisons.

Solid Waste business models vary in terms of both who provides service and the type of service provided. Services may be provided by public entities, private entities or a mix of the two. Rates cover varying types of service, from incinerator only, to managing landfill risk to a mix of owning and/or contracting out parts of the collection/transport process. SPU falls into this latter category. It owns transfer stations but not landfills and contracts out for collection and transport to the transfer station but manages its own rail transfer to the landfill.

These differences extend to financing mechanisms as well. It is not uncommon for utilities that have received a high AA rating from rating agencies to rely more heavily on property tax revenues than rate revenues in paying for solid waste services, as shown in Table A-1 of Appendix A.

### **Rating Agency Considerations**

According to the City's Financial Advisor, rating agencies rate a utility system's bonds based on their long-term expectation of the strength of the revenue stream. The revenue stream will be determined by future utility rate decisions made by the governing body, and rating agencies will look at financial policies as the framework for guiding these future policy decisions. Without financial policies or with financial policies that are constantly in flux (or frequently reviewed and adjusted), rating agencies lose the predictive framework regarding how rates will be established by the governing body going forward.

In determining ratings, rating agencies focus on actual financial performance. Financial targets provide some idea of a utility's commitment to certain performance levels but are meaningless in the absence of acceptable levels of actual performance. Moreover, financial performance is only one part of the evaluative criteria used by rating agencies in determining bond ratings. Agencies consider a number of factors including:

- the strength of the local economy,
- the legal security provided to bondholders,

## Section III: Financial Policy Comparisons

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- risk factors that could produce sharp swings in revenues or costs,
- financial factors such as debt service coverage, level of outstanding debt, and rate levels compared to surrounding utilities,
- management capability and performance, and
- willingness of elected officials to raise rates when needed.

There is no simple formula used by rating agencies to determine utility bond ratings and no direct link between a specific performance level (e.g., debt service coverage greater than 2.0x) and a specific rating (e.g., Aa1, AA+). For this reason, it is not unusual to see different utilities with the same rating but quite different performance on individual financial targets.

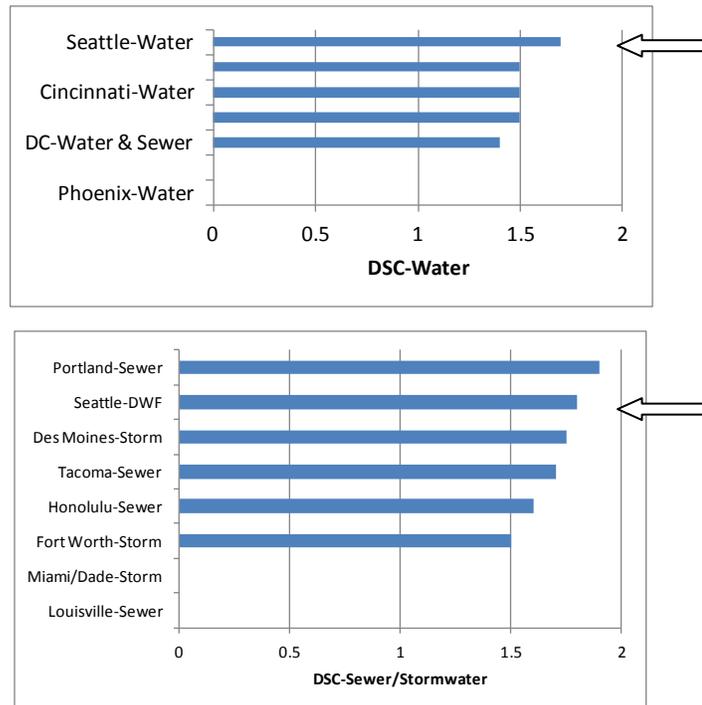
### **Comparisons by Target**

All comparisons in this section are based on a survey conducted by the City's Financial Advisor. Table A-2 in Appendix A provides a complete comparison of all financial policy data gathered for the utilities listed in Table 2. The following discussion focuses on comparisons of policies for individual metrics.

#### Debt service coverage

Debt service coverage seems to be the financial ratio most frequently cited by rating agencies. Most agencies surveyed have debt service coverage policy targets. The two stormwater utilities that do not have policy targets are relatively young and have not yet issued significant amounts of debt. Seattle's DWF and WF coverage targets are among the highest of the utilities surveyed.

**Figure 1<sup>3</sup>**  
**Comparative DSC Policy Targets**

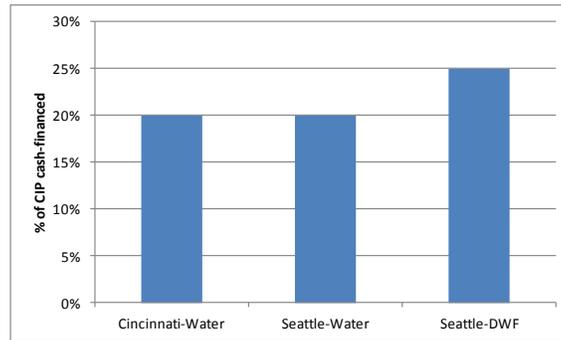


Cash-financed CIP

Five utilities have cash-financed CIP policies, with two of these being DWF and the WF. Figure 2 shows the three utilities with similar metrics (percent capital spending). Not included in the figure are Portland Water and Washington DC Water and Sewer. Portland expresses its target in terms of a Construction Fund Reserve (lesser of \$5 million or 50 percent of debt-funded CIP). WDC’s policy is to use any excess cash to fund capital projects.

<sup>3</sup> The absence of a bar for a utility indicates that there is no policy target (or comparable metric) for that jurisdiction.

**Figure 2**  
**Comparative Capital Cash-Financing Policy Targets**



The absence of a cash financing target is not indicative of a utility’s actual capital financing practices. Seattle WF and DWF are among the most highly leveraged among their peer utilities, as further discussed under “Debt Statistics” later in this section.

### Rate Stabilization Fund

Four utilities utilize Rate Stabilization Funds. Only three of these have balance requirements: Seattle Water (\$9M); Portland Sewer (approx 8 percent operating expense); and Portland Water (\$2M). Rate stabilization funds provide a reserve to offset revenue shortage typically caused by fluctuating consumption. As discuss below, many of the utilities surveyed have significant operating cash targets which can also be used to address revenue shortfalls.

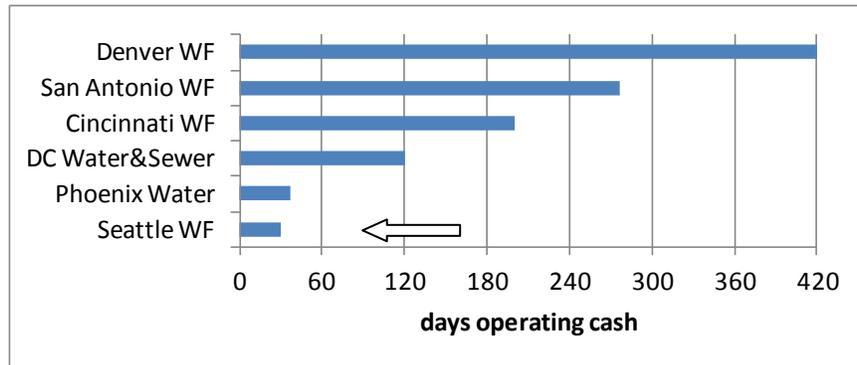
### Operating Cash

All but three of the utilities surveyed have an operating cash target. San Antonio Water and Denver Water do not have formal targets but appear to hold high operating cash balances (see Figure 3). No information was available for the Miami Dade County Stormwater Utility.

Most utilities express targets in terms of days of operating expense or operating and maintenance expense. Figures 3 and 4 compare the cash policies of Water and Sewer/Stormwater utilities, using metrics that can be converted to days operating cash for comparability. Cash policies that cannot be stated in days of operating cash (i.e. flat dollar amounts) are annotated below each table. While the targets may not be directly comparable due to differences in how operating expense is defined, they provide an idea of how utilities compare in relative terms.

## Section III: Financial Policy Comparisons

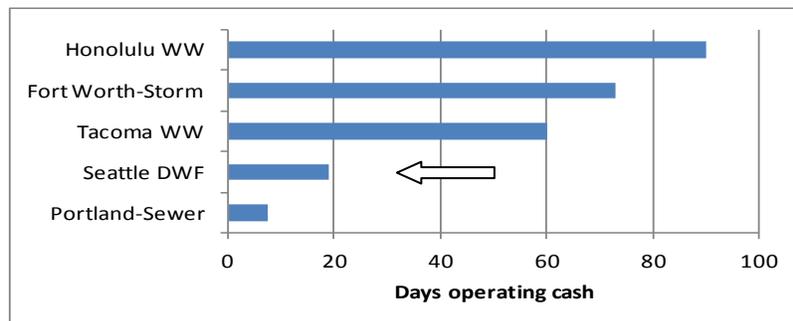
**Figure 3**  
**Comparative Operating Cash Policy Targets-Water**



**Table Notes:**

- 1) Denver and San Antonio have no stated policy. Data above reflects actual cash on hand at the end of FYE 2009 and 2010 respectively.
- 2) Phoenix operating days calculated assuming policy of 10 percent of operating expenditures.
- 3) Not in table: Portland (\$15M min)

**Figure 4**  
**Comparative Operating Cash Policy Targets-Sewer/Stormwater**



**Table Notes:**

- 1) Fort Worth Storm's operating days are calculated assuming policy of 20 percent of operating expenditures.
- 2) The Seattle DWF target is 30 days wastewater treatment expense. The data above assumes treatment expense accounts for 62 percent of non-tax operating expense (2010).
- 3) Portland Sewer's operating days calculated assuming policy of 2 percent of operating expenditures (8 percent goes to their RSF).
- 3) Not in table: Louisville Storm (\$25M min); Des Moines storm (\$5M or 30 percent annual revenues) Miami Dade Storm (no data).

SPU utilities' operating cash targets are modest relative to peer utilities. Looking at the operating cash policy alone is somewhat misleading. Both DWF and the WF also have access to the City's consolidated cash pool for short term operating cash shortages. In addition, both utilities split

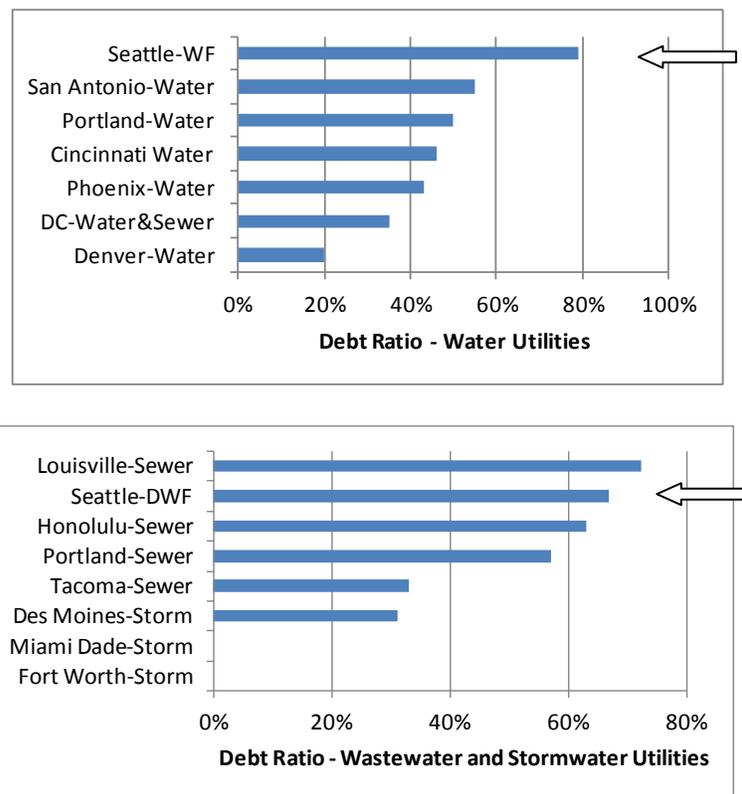
## Section III: Financial Policy Comparisons

excess year-end cash between two policy targets: operating cash and cash-financed CIP. Consequently, excess year-end cash would be much higher than the operating cash targeted levels in the absence of, or reduced cash-financing of the CIP.

### Debt Statistics

As discussed above, cash-financed CIP targets are not an indicator of how much cash a utility actually uses to finance its capital program. Debt ratios provide an alternative method to evaluate how highly leveraged a utility is. Figure 5 compares the Moody's Debt Ratios<sup>4</sup> for the utilities surveyed. Based on this data, it appears that Seattle's DWF and WF are among the most highly leveraged of their peer group.

**Figure 5  
Comparative Debt Ratios**



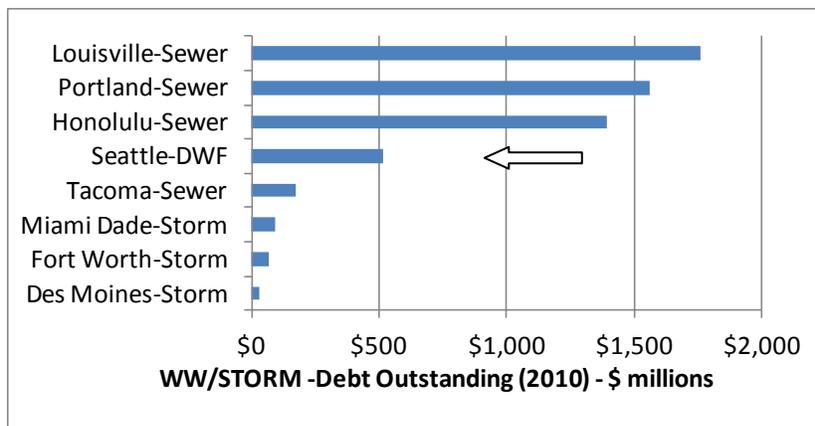
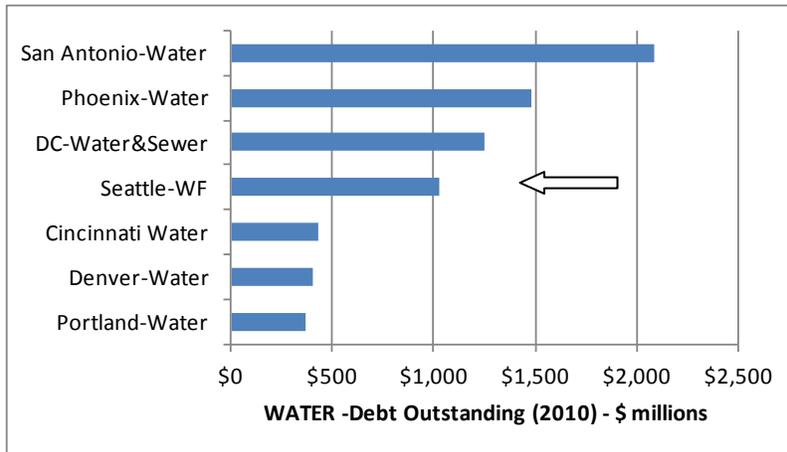
While Seattle's DWF and WF debt ratios are among the highest in the group, their actual debt outstanding falls in the middle of their peer groups. This indicates that utilities with comparable or larger capital programs are making significant cash investments in infrastructure funding, not only on a percentage basis but on a dollar basis as well. As noted previously, the dedicated stormwater

<sup>4</sup> Moody's Debt Ratio = Net Funded Debt (Total Current and Non-Current Debt, minus Debt Service and Debt Service Reserve Funds) divided by the sum of Net Working Capital and Net Fixed Assets.

### Section III: Financial Policy Comparisons

utilities are relatively young and hold a limited amount of debt relative to their peers at this point in time.

**Figure 6**  
**Comparative Debt Outstanding (nominal dollars, in millions)**



## Section III: Financial Policy Comparisons

### III.B. Intra-SPU Comparisons

Prior to the 1990s financial policies were affirmed or modified in a resolution prior to each rate study for all funds. After 1992, rate studies included policy guidelines but no legislation was enacted until 2003 for DWF, 2004 for Solid Waste and 2005 for Water. Table 3 presents the current adopted financial policies for each fund.

**Table 3**  
**Adopted Financial Policies by Fund**

<b>Metric</b>	<b>WF</b>	<b>DWF</b>	<b>SWF</b>
Net Income	Generally positive	Generally positive	Generally positive
YE cash	One-month operating expense; \$6.4 (2010)	One-month treatment expense; \$9.3 (2010)	20 days contract expense; \$4.8 (2010)
Cash-financed CIP	20 percent over rate period; >= 15 percent annually	25 percent 4-yr rolling avg.	Greater of \$2.5 million (in 2003 dollars) or 10 percent
Debt Service Coverage	1.7x	1.8x	1.7X
Debt-to-Asset Ratio	NA	<70 percent	NA
Variable Rate Debt	<15 percent	<15 percent	<15 percent
RSF	\$9 million	NA	NA

The stated policies for SPU's three enterprise funds are very similar. However, there has been considerable variance in actual performance against targets (discussed further by Fund in Sections IV, V, and VI). This variance largely stems from considerable differences in the size and growth patterns of the three funds' capital programs and their associated reliance on debt financing.

The **Water Fund** has the highest historic levels of capital spending, largely due to multi-generational investments in water treatment, regional capacity, and reservoir covering. In the first part of the 2000's, the WF's pending levels were twice those of DWF and 20 times those of the SWF. WF spending has declined considerably since its apex in the late 1990's and is expected to grow only moderately during the next six years in real terms. However, high levels of debt financing of a large capital program over a number of years have made debt management a necessity when setting rates.

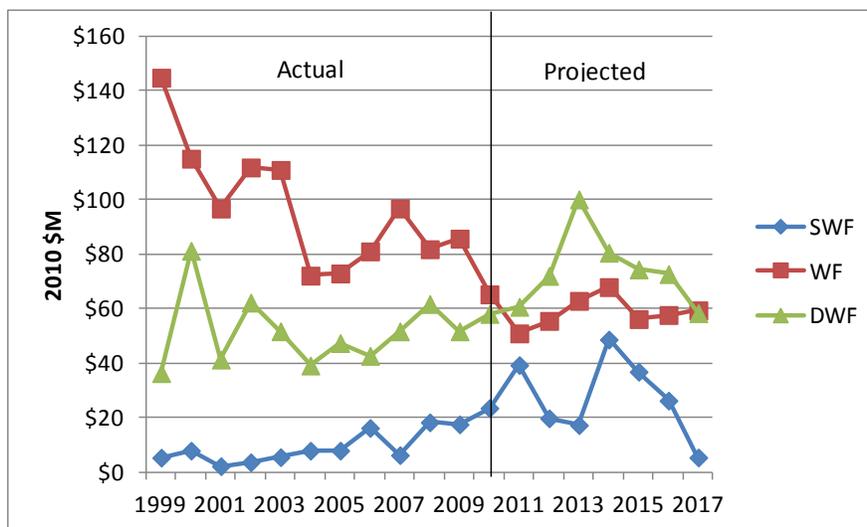
The **Drainage and Wastewater Fund** was not formed until 1989 and therefore does not carry the historical debt burden of the WF. However, capital spending took a big leap at the beginning of the

## Section III: Financial Policy Comparisons

last decade, continued to grow steadily until present and is projected to grow considerably during the next six years due to regulatory requirements. Although very debt reliant in its early years, DWF's cash-financing policy adopted in 2003 has helped it to control levels of outstanding debt without running into coverage problems, as has happened with the WF. However, continued control of growing debt will remain a priority as CIP spending grows more rapidly in upcoming years.

The Solid Waste line of business is much more infrastructure-limited than water, wastewater, and drainage. As result, the **Solid Waste Fund** spends much less on its capital program, with operational expenditures a greater area of focus. Increases to SWF capital spending are driven by specific limited initiatives rather than meeting sustained infrastructure requirements. While spending levels have increased significantly since the mid-2000's and will sustain this growth through the middle of this decade, spending will drop off dramatically once the implementation of the Solid Waste Facilities Master Plan is complete, including new transfer stations.

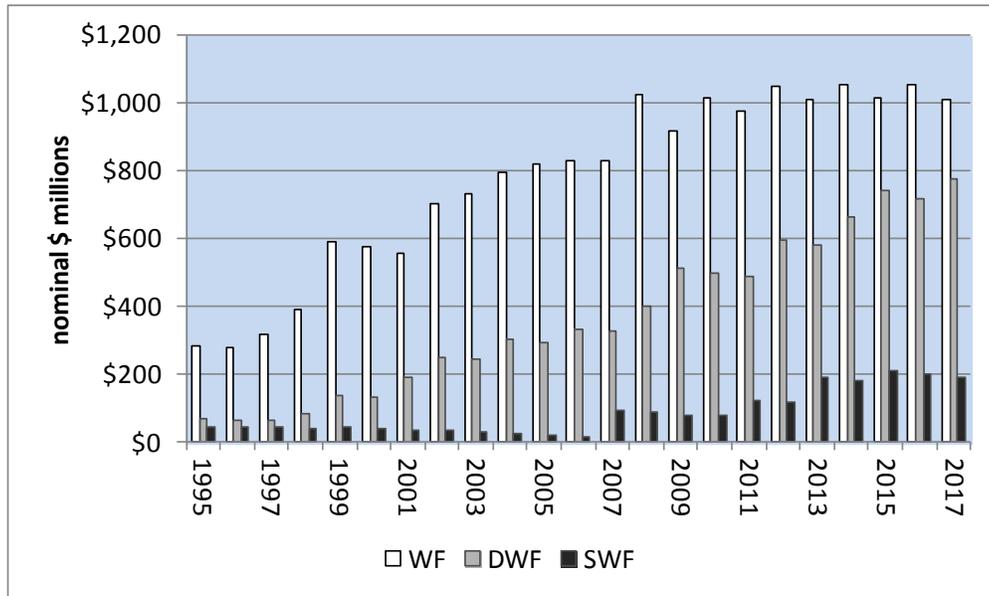
**Figure 7**  
**Historical and Projected CIP Spending by Fund (2010 dollars, in millions)**



	Average Annual Spending (\$2010)		
	1999-2005	2006-2011	2012-2017
<b>WF</b>	\$103.6	\$77.0	\$60.0
<b>DWF</b>	\$51.4	\$54.5	\$76.4
<b>SWF</b>	\$5.8	\$20.2	\$25.7

Figure 8 shows the impact on debt outstanding of past capital spending and financing choices for each fund.

**Figure 8**  
**Debt Outstanding by Fund (2001-2010; nominal dollars, in millions)**



Although each fund has adopted several targets, only one target (the binding constraint) drives rate setting in any given year. This target has typically been cash-financed CIP for DWF and the Water Fund and operating cash or net income for Solid Waste. However, the binding constraint can change as debt exceeds certain levels relative to revenue and assets. This is the case for the Water Fund (DSC now binding) and would be the case for DWF by 2015 if the cash-financed target were reduced (debt-to-asset ratio would become binding). These situations highlight the importance that a mix of targets plays in overall debt management, as also discussed in Section II.

**Seattle City Light Financial Policies**

The next sections of this report describe how the financial policies of each of the three SPU enterprise funds have evolved over time. Likewise, SCL’s policies have developed over time to address the specific conditions of its business, a very different business from Water, Drainage and Wastewater and Solid Waste. Table 4 presents SCL’s principal adopted financial policy targets.

**Table 4**  
**Seattle City Light Adopted Financial Policies**

Metric	Target
DSC	1.8x
Cash-financed CIP	40 percent avg. over 6-yr capital plan
RSF	\$100 million
YE cash balance	N/A

## Section III: Financial Policy Comparisons

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Adopted in 2010, the SCL financial policy targets specified in Table 4 were designed to specifically mitigate the utility's exposure to net wholesale revenue. While this exposure had always been an issue for SCL, a combination of low energy prices as a result of the recession and a below normal snowpack prompted the utility, Council and the Mayor to work together to develop this new approach to addressing this risk.

The new policies included two major policy revisions that went hand in hand:

- a reduction in the policy coverage target from 2.0x to 1.8x, and
- the creation of a \$100 million rate stabilization account (RSA) to protect against volatility the utility experiences due to exposure to the wholesale power market.

The RSA has an automatic replenishment feature that institutes a rate surcharge if net wholesale revenue falls below the forecasted level. As a result the utility has less net exposure to its most significant source of ongoing volatility. The 2.0x coverage level was set, in part, to address this volatility. Thus, by establishing the RSA, the utility could reduce the targeted level of coverage without impacting the overall risk position of the utility.

## IV. Water Fund Review

Table 5 presents the Water Fund’s adopted financial policies. Table B-1 in Appendix B provides a more detailed summary of the most significant legislative and/or policy changes in the past 20 years. This section presents an overview of historical and projected capital spending. A policy-by-policy review follows which describes the basis for each policy and tracks historical and projected financial performance. It is important to note that Water Fund used financial policy targets as *planning* targets. Rates are set to meet these targets, but the fund may not actually achieve all policy targets in a given year. Although targets may not always be met, higher planning targets create a cushion for unanticipated financial results that could put the fund at risk of not meeting legal requirements, such as debt service coverage covenants.

All financial projections assume 2011 Water System Plan spending levels. Table C-1 in Appendix C documents spending assumptions.

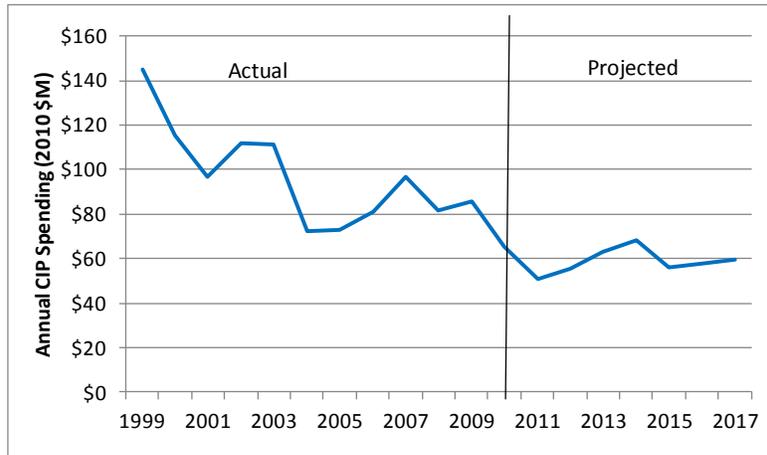
**Table 5  
Water Fund Adopted Financial Policies**

Policy Metric	Target/Guidance
<b>Debt Service Coverage</b>	1.7x on a planning basis for first lien debt
<b>Cash to CIP</b>	No less than 20 percent over the rate proposal period. No less than 15 percent in any given year.
<b>Year-End Cash</b>	One twelfth of operating expenditures
<b>Net Income</b>	Generally positive
<b>Revenue Stabilization Sub fund</b>	Balance of \$9M maintained with exceptions
<b>Variable Rate Debt</b>	Not exceed 15 percent of total outstanding debt
<b>Facility Maintenance</b>	Maintain assets in sound working condition.
<b>Eligibility for Debt Financing</b>	Certain criteria must be met for debt financing.

### IV.1 Capital Spending

Sustained high capital spending levels, combined with a policy of almost-exclusive debt financing between 1990 and the early 2000’s, have shaped the evolution of the Water Fund’s financial performance. Spending peaked in the latter part of this same period due to construction of water treatment plants on both the Cedar and Tolt sources, progress on reservoir covering, and construction of a second Tolt pipeline to meet the region’s growing water needs. Although spending slowed considerably in the ensuing years, management of this existing debt burden will continue to shape performance against policy targets and associated rate impacts.

**Figure 9**  
**Water Fund Capital Spending (2010 dollars, in millions)**



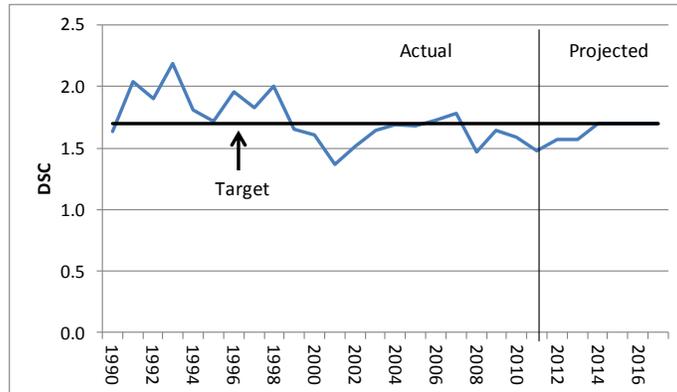
## IV.2 Debt Service Coverage

The 1.7x coverage target was originally established as a guideline in 2000 as part of an overall financial policy framework (see Cash-financed CIP below). This target was intended to slow the growth of rates without jeopardizing the utility’s financial integrity. Actual debt service coverage in the years immediately prior to this policy change exceeded 2.0x.

The formal policies adopted in 2005 maintained the 1.7x target. The utility considered raising the target to 2.0x as a means to check the debt-to-asset ratio which reached 70 percent in 2002 and was projected to exceed 79 percent in 2007. The lower coverage target was instead maintained to achieve a more moderate rate path, with the expectation that the new policies (including increases to cash-financed CIP) would bring the debt-to-asset ratio down below 70 percent by 2013. A significant downturn in water consumption later in the decade, combined with a 2008 conversion of variable to fixed rate debt, caused coverage to become binding with the 2012-2014 rate study.

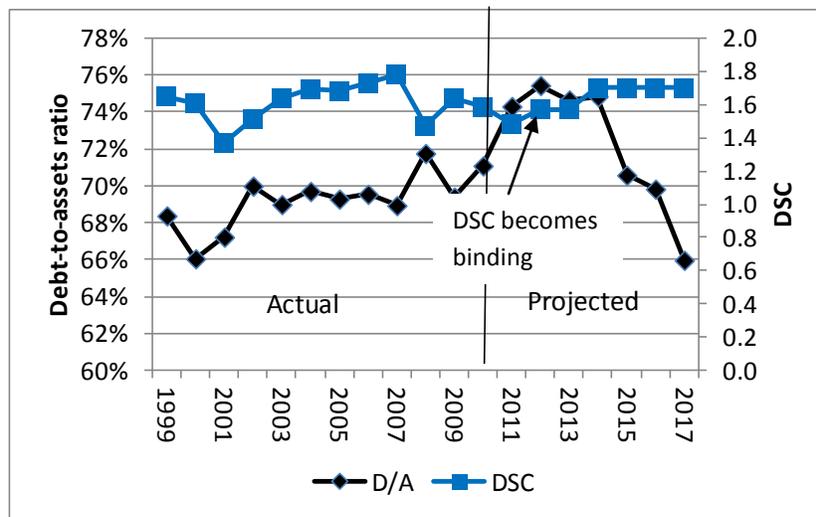
Figure 9 presents historical and projected Water Fund debt service coverage. The Fund is projected to achieve the 1.7x target from 2012 through the balance of the planning period.

**Figure 10**  
**Water Fund Actual and Projected Debt Service Coverage**



Although the Water Fund does not have an official debt-to-assets policy target<sup>5</sup>, it is instructive to note the impact on this ratio of the increased cash required once DSC becomes binding (see Figure 11). In the absence of unanticipated shortfalls, excess cash will be used to provide additional cash financing of the CIP, resulting in a nearly immediate and significant decline in the debt-to-asset ratio. This provides yet another example of the inter-relationship between debt management financial policies.

**Figure 11**  
**Water Fund Debt-to-Assets Ratio and Debt Service Coverage**



### IV.3 Cash-financed CIP

Prior to 2002, the official policy of the Water Fund was to use as much debt as possible to finance CIP. This policy had its origins in a 1989 legislative-executive utility policy review. This review was

<sup>5</sup> Prior rate study guidelines (1995-1996) did specify that the ratio not exceed 70 percent.

## Section IV: Water Fund Review

undertaken in reaction to significant utility rate increases between 1980 and 1988, uncertainty regarding the level of financial performance required to maintain bond ratings, and questions concerning intergenerational equity. Water Fund financial policies adopted in 1990 encouraged 100 percent debt financing. However, this policy was intended to be a temporary measure until the Water System Plan (WSP) CIP projections were completed. The increases in spending required to implement the WSP were expected to be temporary as well.

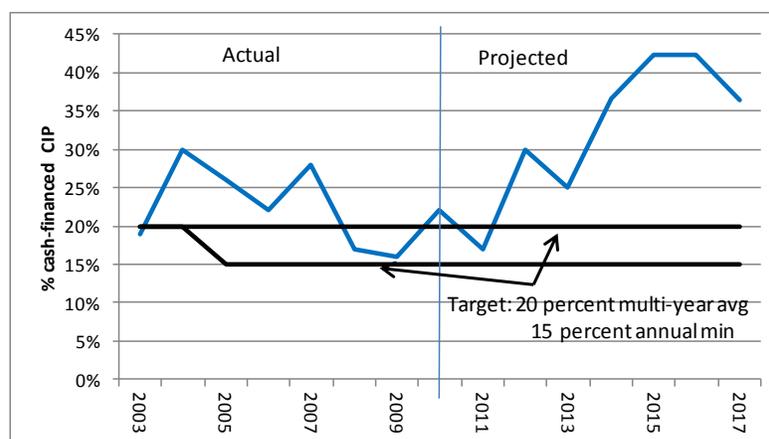
As early as 1993, SPU financial advisors expressed concern over the water system's level of debt. The 2002 rate study introduced an informal guideline of 20 percent cash financing (six-year average). However, since rates are generally set for two to three year periods, rate increases to meet this target could be shown in the out years but not implemented in the rate setting period. Formal financial policies, adopted in 2005 via Resolution 30742, re-defined the 20 percent as the average across the rate setting period, with a minimum of 15 percent financing in a given year to provide rate-setting flexibility in years with higher CIP spending.

Documentation does not specifically address why a 20 percent target was selected. However, it is reasonable to assume that this was considered to be an acceptable trade-off between rate increases and slowing debt growth.

The Water Fund has generally met its cash-financed CIP guidelines, which has been the binding-constraint in setting rates over the past several years. Projections for cash-financed CIP from 2012 forward significantly exceed the policy target as debt service coverage becomes binding and revenues must be increased to meet coverage target requirements.

Figure 12 presents historical and projected performance of the cash-financed CIP target.

**Figure 12**  
**Water Fund Actual and Projected Cash-financed CIP**



## Section IV: Water Fund Review

### IV.4 Rate Stabilization Fund

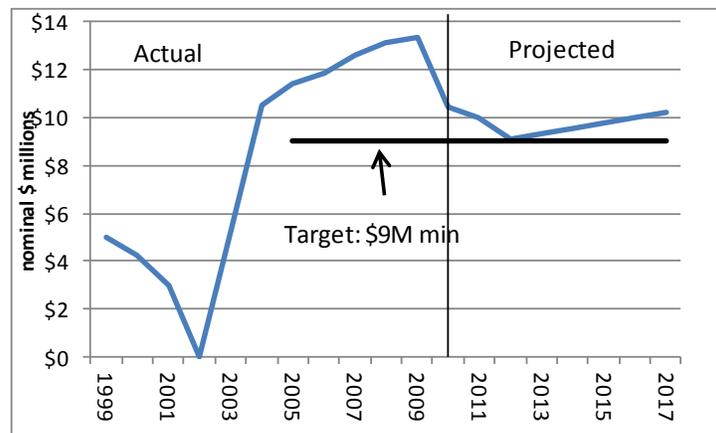
SPU established a Water Rate Stabilization Fund (RSF) in 1993. Until the adoption of a formal policy in 2005, the RSF was used to amortize unexpected or windfall revenues over several years. Revenue instability spurred by changes in demand in the late 1990s resulted in increased long-term debt (insufficient revenues for cash financing of the CIP) and reduced service levels.

To address these issues, Ordinance 120875 (2002) required that mandatory deposits be made to the RSF of \$2.5 million per year, plus excess revenues, with rates specifically set to provide these additional revenues. This action allowed the Water Fund to intentionally set aside for a “rainy day” and make withdrawals to meet financial needs in poor revenue years. The 2005 formal policy established a \$9 million RSF Fund balance and stipulated requirements to be met in the event balances fell below the minimum. Since 2002, withdrawals from the RSF must be approved by ordinance.

In addition to providing funds to preserve revenue stability, the RSF also helps to maintain financial policy targets as withdrawals from the RSF are included in net income and thus also in revenues available for debt service coverage.

Figure 13 presents historical and projected RSF balances.

**Figure 13**  
**Water Fund Actual and Projected Rate Stabilization Fund Balance (nominal dollars, in millions)**



### IV.5 Operating Cash

Beginning in the mid-1990s, the WF’s formal operating cash policy target was to have a net zero balance over the year. When operating cash was negative, current obligations were paid with cash from the consolidated cash pool, and the Water Fund paid interest to the cash pool on its negative cash balance.

In practice, the WF set year-end operating cash targets at the nominal level of one month’s operations and maintenance expenditures. This “practical” target acknowledged the importance placed on operating cash balances by the financial community and provided a small hedge against

## Section IV: Water Fund Review

unexpected circumstances. At that time bond rating agencies were resistant to considering the consolidated cash pool as a liquidity strength.<sup>6</sup>

A “net zero balance over the year” target was impractical on other fronts as well. Water’s revenues are seasonal, with the largest monthly revenues received between August and October. Where possible, water system expenses (such as debt service expenses) are structured to coincide with the arrival of seasonal revenues. It is not possible to exactly match the revenue and expense streams, so operating cash balances are substantially negative for most of the year.

In light of the considerations noted above, the 2005 financial policies included a formal target equal to the planning target in use of one-twelfth of annual operating expense. As noted in the jurisdictional comparisons in Section III, this is quite a modest balance target relative to peer utilities. However, the WF still has access to the City cash pool in the event that its operating cash balances are insufficient to cover expenditures, an option that may not be generally available to other utilities.

**Figure 14**  
**Water Fund Actual and Projected Operating Cash (nominal dollars, in millions)**

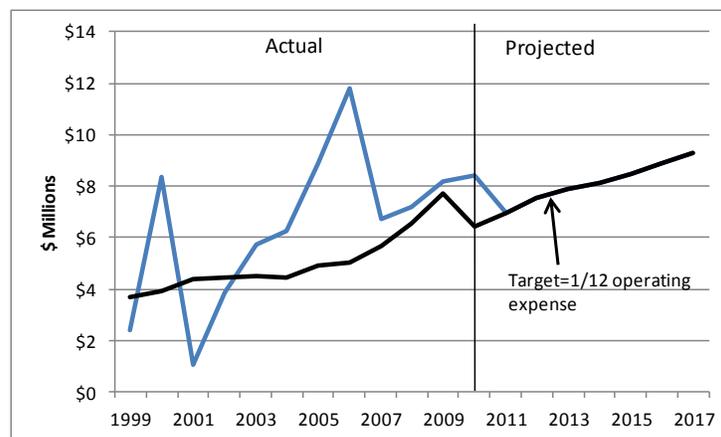


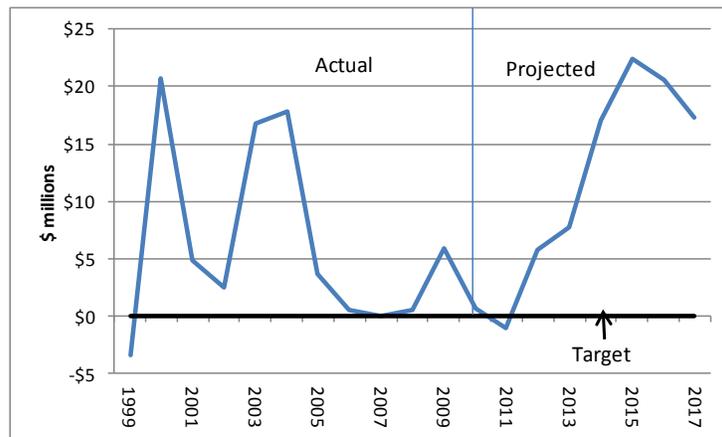
Figure 14 assumes the one-twelfth operating expense target in all years. The Water Fund exceeded this target in all but two years since 1999. However, when allocating year-end excess cash between its two cash targets (cash balance and cash-financed CIP), the utility has typically sought to achieve the cash balance target, to the detriment of the cash-financing target in some instances.

<sup>6</sup> Rating agencies do focus on a utility’s stand-alone liquidity and how it compares to that of its peers across the country. It is one of the metrics analysts use at the outset to stack one utility against others in order to determine an appropriate rating. As a secondary step, they also take other factors into account such as whether the utility has access to any outside sources of liquidity. The City has been very successful in convincing rating analysts that the consolidated cash pool provides a liquidity backstop sufficient to help compensate for the less than standard internal liquidity that the City’s utilities maintain.

**IV.6 Net Income**

Historic WF net income has generally been healthy. In the latter part of the last decade, net income levels hovered at the positive level due to declining service revenues, the reduction in hydrant revenues associated with the Lane suit, and a change in SPU accounting policy to expense more of its capital expenditures. SPU projects significant increases in net income during the next five years as rates are set to generate the higher revenues required to meet the WF debt service coverage policy target.

**Figure 15**  
**Water Fund Actual and Projected Net Income (nominal dollars, in millions)**



**IV.7 Variable Rate Debt**

The WF first instituted a 15 percent cap on variable rate debt in the 1995-96 Water Rate Study. Increases to variable interest rates divert cash from cash balances or cash contributions to the CIP in order to fund debt service. At the same time, increased interest on construction fund balances serves as at least a partial hedge against debt service increases. The 15 percent cap on outstanding variable rate debt keeps the likely financial impact of rising interest rates within the range that can be hedged or accommodated through these mechanisms.

The WF issued two sets of variable bonds, the 1995s (\$45 million) and the 2002s (\$66 million). These bonds were remarketed weekly. The fund benefited from interest rate savings on these bonds until the financial market collapse in 2008 when SPU was no longer able to find buyers for all the bonds. They were refunded into fixed rate bonds in November 2008. This refunding resulted in higher annual debt service and was one of the factors leading to debt service coverage becoming binding with the 2012-14 rate study.

## V. Drainage and Wastewater Fund Review

Table 6 presents the Drainage and Wastewater Fund financial policies adopted via Resolution 30612 in 2003. Table A-2 in Appendix A summarizes the evolution of DWF financial policies during the past 20 years. Relevant aspects of this evolution are discussed further in this section.

All financial projections assume latest spending projections as of early January 2012. Table C-2 in Appendix C documents spending assumptions by year.

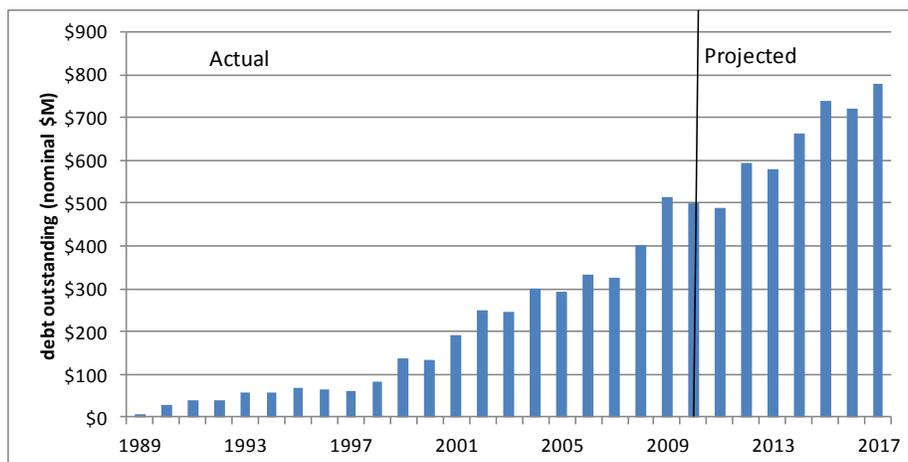
**Table 6**  
**Drainage and Wastewater Fund Adopted Financial Policies**

<b>Policy Metric</b>	<b>Target/Guidance</b>
<b>Debt Service Coverage</b>	1.8x
<b>Cash to CIP</b>	25 percent minimum cash financing (4-year rolling average)
<b>Year-End Cash</b>	Year-end balance of one month wastewater treatment expense
<b>Net Income</b>	Generally positive
<b>Facility Maintenance</b>	Seek to maintain capital assets in sound working condition
<b>Variable Rate Debt</b>	Limited to 15 percent of total debt
<b>Debt-to-Assets</b>	<70 percent

The 1989 joint legislative-executive Utility Policy Review strongly influenced the shape of the early financial policies for the newly formed Drainage and Wastewater Utility, much as it did those of the Water Fund. As with Water, DWF financial policies adopted in Resolutions 28087 (1989) and 28554 (1992) provided only that fund balances in excess of working capital be directed towards cash financing of the capital program.

Growth in the DWF capital program beginning in the late 1990s, and associated increases in debt outstanding, spurred the 2003 review of the fund's financial policies and adoption of more conservative debt management policies. Debt management will continue to be a focus of DWF financial policies in light of continued increases in CIP spending and outstanding debt.

**Figure 16**  
**DWF Debt Outstanding 1989-2017 (nominal dollars, in millions)**



**V.1 Capital Program**

Significant investments in the drainage and wastewater system by the City did not begin until the late 1990s. Indeed, prior to 1993, the DWF financed the majority of its capital related expenses on a pay-as-you-go basis within its operating expenses. Federal and environmental regulations associated with the Clean Water Act, Endangered Species Act, maintenance of the City’s National Pollutant Discharge Elimination System (NPDES) permit, and the National Oceanic and Atmospheric Administration (NOAA) Fisheries listings have driven significant increases in capital spending since the late 1990’s. Even more dramatic growth is projected for the 2012-2017 capital plan for continued implementation of Combined Sewer Overflow (CSO) requirements, already a major driver of CIP spending during the past several years.

Table 7 presents the change in average annual CIP spending since 2000 and the associated impact on debt outstanding and annual debt service obligations.

**Table 7**  
**DWF Actual and Projected Capital Spending and Debt Statistics**

	<b>2000-2005</b>	<b>2006-2011</b>	<b>2012-2017 (Projected)</b>
Avg. Annual CIP (2010 dollars, in millions)	\$44.9	\$53.6	\$84.2
Debt outstanding end of period (nominal dollars, in millions)	\$294.9	\$487.5	\$778.2
Annual debt service end of period (nominal dollars, in millions)	\$21.2	\$37.3	\$61.7

## Section V: Drainage and Wastewater Fund Review

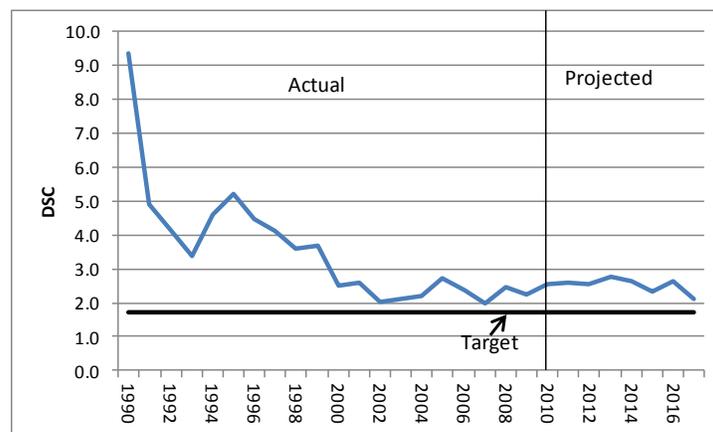
### V.2 Debt Service Coverage

Debt service coverage is a measure of the security of a utility's lenders. It represents the times annual debt service obligations could be paid with the annual revenues remaining after annual operations costs have been paid. DWF's debt service coverage target was raised from 1.5x to 1.7x in 2003 to ensure that revenue or cost fluctuations would not drive the actual coverage rate below the legal covenant ratio of 1.25.<sup>7</sup>

Through the mid-1990s when the Fund carried a relatively small amount of debt, actual coverage remained high. DSC began a steady descent beginning in the mid-1990s with the growth in the capital program and high levels of debt financing. By 2003, the margin between debt levels and net revenues was such that, at the then-planning margin of 1.5x, a drought with water restrictions would have reduced wastewater volumes and revenues, and thus would have driven debt service coverage down to a 1.28 to 1.30 range. The 2003 review noted that a further shift of less than \$ 1 million dollars would have driven coverage below the "legal" coverage level.

Although capital spending has steadily increased, the fund has comfortably met the higher 1.7x target since its adoption due to the fact that cash-financed CIP, and not DSC, has been the binding constraint in setting rates.

**Figure 17**  
**DWF Actual and Projected Debt Service Coverage**



### V.3 Cash-financed CIP

This ratio measures the percentage of the annual capital program paid from current revenues. Using current revenue to fund the capital program reduces borrowing. However, annual revenues

<sup>7</sup> Actual coverage below 1.25 constitutes a default on the bonds. In addition, it would result in the inability to issue new debt as the fund would be unable to meet the additional bonds requirement test. Prior to issuing new revenue bonds, the issuer must show that the new debt will not dilute the returns to existing bond holders. The additional bonds requirement test is a metric which demonstrates that prior year's revenues (or in some cases future revenues) are more than sufficient to pay debt service on **both** existing and new bonds.

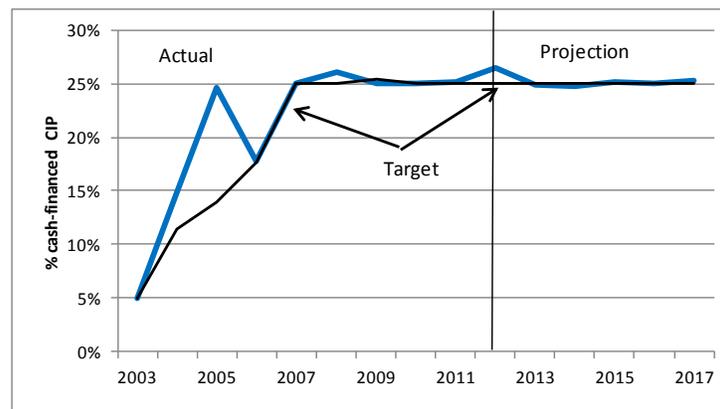
## Section V: Drainage and Wastewater Fund Review

used to finance infrastructure are one of the most flexible resources to deal with unexpected circumstances.

Between 1989 and 2003, the DWF policy (and also that of the WF) was to put “excess cash balances” after funding working capital towards the CIP. The 2003 policy review evaluated alternative cash financing levels (15 percent, 20 percent, and 25 percent) in response to the mounting debt levels discussed earlier in this section. While the lower targets evaluated would have maintained the coverage target and helped to prevent a rapid buildup of debt levels, SPU ultimately recommended (and Council adopted) a 25 percent financing level to slow growth in the debt-to-assets ratios. The 2003 study predicted that at 25 percent cash financing, the debt-to-asset ratio would rise from 48 percent in 2002 to 66 percent by 2013. This prediction has roughly played out with debt-to-assets currently projected to reach 66 percent in 2012. A further discussion of the impact of cash financing on the debt-to-asset ratio and debt levels follows in Section V.8.

Figure 18 presents actual and projected performance against the 25 percent CIP financing target. Resolution 30612 provided for a gradual ramp up to the 25 percent target level between 2004 and 2007 to mitigate the rate impact of the revised policy. As noted in the chart below, actual financing levels have consistently met or exceeded stated targets.

**Figure 18**  
**DWF Actual and Projected Cash-financed CIP**



### V.4 Debt-to-Assets Ratio

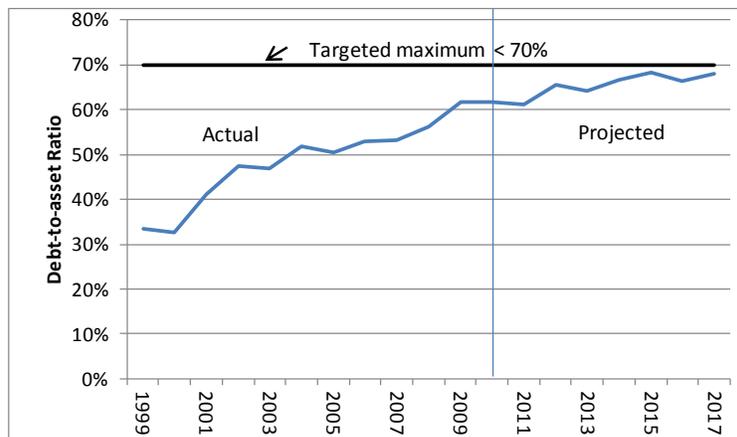
The debt-to-assets ratio measures the amount of infrastructure a utility purchased with borrowed money. High debt-to-asset ratios generally mean that a larger portion of annual revenues are being used to pay debt service, making it harder to respond to unexpected circumstances.

SPU considered setting the debt-to-assets ratio at no higher than 60 percent as part of the 2003 policy review, particularly in the event that a cash-financing target of less than 25 percent were implemented. However, a formal policy was not proposed. Council Staff ultimately proposed (and Council adopted) a policy target for debt-to-assets of less than 70 percent, noting that a maximum target would reinforce the goal of debt control. Seventy percent was selected as a reasonable level that would not be bind in the short-term and have no immediate impact on rates.

## Section V: Drainage and Wastewater Fund Review

Figure 19 characterizes the rise in the DWF debt-to-asset ratio since 1990. As with the DSC ratio, increased capital spending and associated debt have pushed the ratio up considerably since the mid-1990s. With projected sharp increases during the next 6 years in capital spending for CSO Plan implementation, SPU expects the debt-to-assets ratio to approach, but not to exceed the target during the planning period, assuming current cash financing policy targets are met.

**Figure 19**  
**DWF Actual and Projected Debt-to-Assets Ratio**

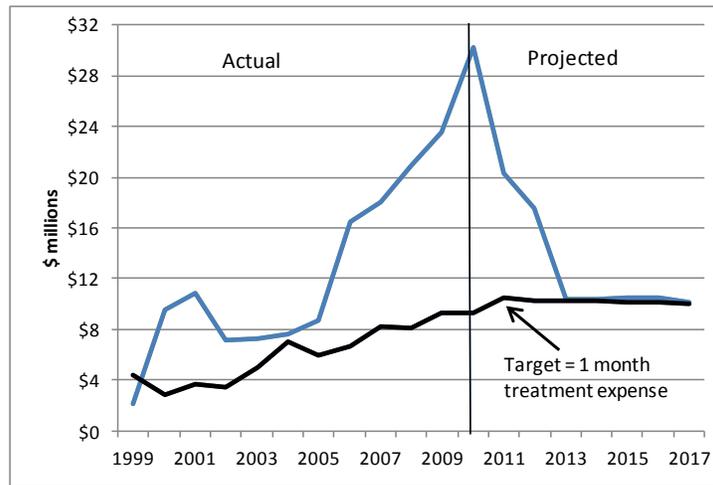


### V.5 Cash Balances

Unrestricted cash balances are the cash in the bank that can be used to respond to unexpected situations, and are a utility's most flexible financial resource. Cash balances are generally created by saving annual rate revenues.

Until 2003, the Fund set rates to maintain a cash balance equal to at least 45 days of operating expenses, which was noted to be a generally accepted industry standard in the 1993 policy review. During the 1993 rate study, a detailed cash analysis determined that the Fund has fairly predictable and stable cash flow patterns throughout the year, with the exception of the monthly payment to King County for treatment expenses. Thus the target was reduced from 45 days to one month wastewater treatment expense. Figure 20 presents actual and projected DWF year-end cash balances.

**Figure 20**  
**DWF Actual and Projected Year-end Cash Balance (nominal dollars, in millions)**



Yearend cash has historically exceeded target, with a significant increase in balances since 2006. Between 2006 and 2010, actual cash financing of the CIP was on target in percentage terms, but less than the levels built into rates in dollar terms due to CIP under spending. The utility held onto the resultant excess cash rather than invest a higher percentage into the capital program for a number of reasons, including:

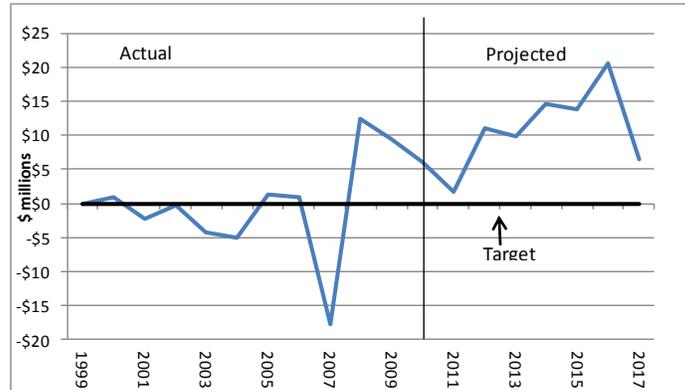
- uncertainties regarding the impact of a 2006 accounting policy change to expense certain categories of capital projects that had been previously debt financed and to treat these as operating expense (and thus finance with operating cash) moving forward,
- uncertainty regarding future claims payouts associated with flood and sewer-backup caused by large storm events,
- the decision by Council to not increase drainage rates in 2010, as originally expected, and
- uncertainty regarding the O&M impacts associated with SPU’s Consent Decree requirements, estimated, until recently, at over \$16 million per year, beginning in 2012.<sup>8</sup>

<sup>8</sup>These O&M estimates have been significantly revised downwards as a result of recent discussions with the Department of Ecology.

**V.6 Net Income**

A requirement of ‘generally positive net income’ is a contingency against forecast errors and uncertainties in the revenue stream. The Fund has maintained positive net income with the exception of 2001 through 2004 and 2007 in which reported losses were primarily driven by large non-cash, non-operating expenses.<sup>9</sup>

**Figure 21**  
**DWF Actual and Projected Net Income (nominal dollars, in millions)**



**V.7 Variable Rate Debt**

A limit on variable rate debt is designed to balance the benefits and risks associated with variable- and fixed rate debt. The 15 percent maximum variable debt target level was selected to be consistent with the targets for the WF and SCL. At the time the 2003 policy was adopted, DWF had no variable rate debt and has not issued any since that time.

**V.8 Implications of Revision of Cash-financed CIP from 25 to 20 percent**

The Council SLI requested an evaluation of the DWF cash-to-CIP policy, considering a change from a 25 percent to a 20 percent cash contribution level. Specific information requested included: revenue requirement savings, the rate path through 2017, long term implications for debt outstanding, and any associated risks of such a change.

<sup>9</sup> The 2001 loss was primarily attributable to the transfer of contributed assets to the Ronald Wastewater District, at no cost. Beginning in 2001, GASB 33 required that such transfers flow through the income statement as an expense. A significant increase in non-current environmental liabilities related to the Duwamish and Gasworks Superfund sites was the primary driver of the 2003 and 2004 losses. Prior to 2005, DWF reported the annual change in total projected environmental remediation costs as a non-operating expense. Beginning in 2005, SPU began to defer these expenses over a five-year period, reducing the substantial fluctuations in net income caused by immediately expensing these costs. The 2007 loss was related to the expensing of historical CIP projects as part of the accounting policy change described in Section V.5.

## Section V: Drainage and Wastewater Fund Review

In response to this request, SPU evaluated the impacts for 2013-2017 of three levels of average cash financing: 25 percent (current), 22 percent (reduced) and 20 percent. The 22 percent scenario represents the lowest average contribution level during the analysis period that will allow DWF to still meet all financial targets on a planning level. All options assumed the latest financial data available as of early January 2012, including the capital spending levels noted in Section V.1. A summary of analysis results is followed by additional detail on revenue requirement and capital financing impacts.

### Summary Findings

Relative to status quo (25 percent cash financing):

- 20 percent average cash financing reduces rates and bills throughout the analysis period but also drives a reduction in financial performance, with the fund not meeting net income, debt-to-assets and DSC targets at various points
- 22 percent average cash financing initially reduces rates and bills. However, by the latter part of the period, rates must be raised to meet the debt-to-asset target and end the period higher than if the current policy were maintained. This scenario also represents a **temporary** reduction in cash financing as levels must increase to 25 percent or higher from 2017 forward to maintain a debt-to-asset ratio below 70 percent.
- Both reduced cash-financing scenarios increase annual debt service and debt outstanding relative to the current policy.

**Table 8**  
**2017 Debt Service and Debt Outstanding (nominal dollars, in millions)**  
**Alternative Financing Scenario**

Scenario	2017	Variance with 25 percent
<b>Debt Service (Annual)</b>		
25 percent	\$61.7	
22 percent	\$62.7	\$1.0
20 percent	\$63.5	\$1.8
<b>Debt Outstanding</b>		
25 percent	\$778.2	
22 percent	\$786.6	\$8.4
20 percent	\$811.1	\$32.9

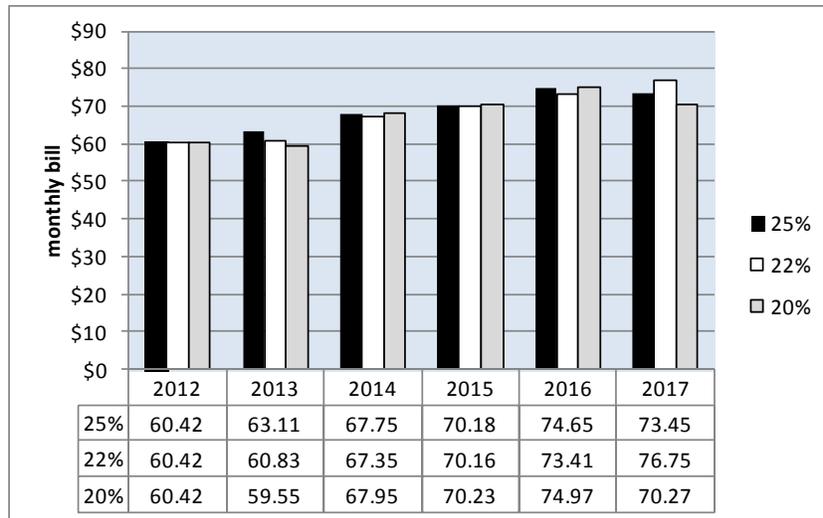
Lower annual cash financing increases the size of each bond issue, leading to a greater annual debt service payment and higher debt outstanding. Relative to 25 percent cash financing, the annual debt service payment increases by \$1.0 million per year assuming 22 percent cash financing and

## Section V: Drainage and Wastewater Fund Review

\$1.8 million per year assuming 20 percent. The impacts on debt outstanding are more pronounced, with an increase of \$8.4 million under the 22 percent scenario and \$32.9 million under the 20 percent scenario over a five year period.

Figure 22 depicts projected typical monthly single family residential (SFR) combined drainage and wastewater bills under each scenario.

**Figure 22**  
**Drainage/Wastewater Combined Monthly Bill (Single Family Residential)**



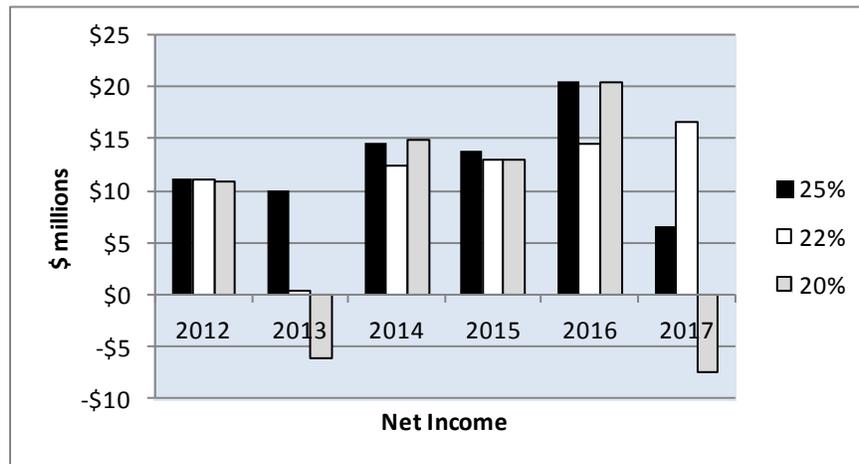
The 22 percent bill ends the period \$3.18 higher per month than the 25 percent bill, but averages \$0.13 less across the period. This is due to lower initial increases associated with lower cash financing followed by higher increases to meet the debt-to-assets target later in the period. The 20 percent bill is consistently below the other two scenarios across the period. Although the bill fluctuates, it averages about \$1.23 per month less than the 25 percent bill across the period.

Bills are lower under a 20 percent scenario because, unlike the other scenarios, rates under the 20% cash-financing scenario are not set to meet all financial policy targets. It is simply not possible to finance at this level **and** meet all financial targets on a planning level. Planning rates to meet policy targets provides a cushion for unanticipated fluctuations in costs or revenues. Setting rates to miss targets increases financial risk and leaves no cushion for unexpected shortfalls.

Figures 23, 24, and 25 present net income, debt-to-assets ratio, and DSC under the three scenarios.

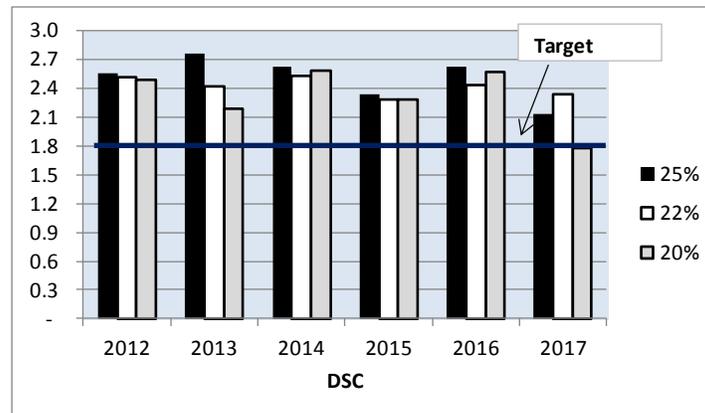
## Section V: Drainage and Wastewater Fund Review

**Figure 23**  
**Net Income under Alternative Financing Scenarios (nominal dollars, in millions)**



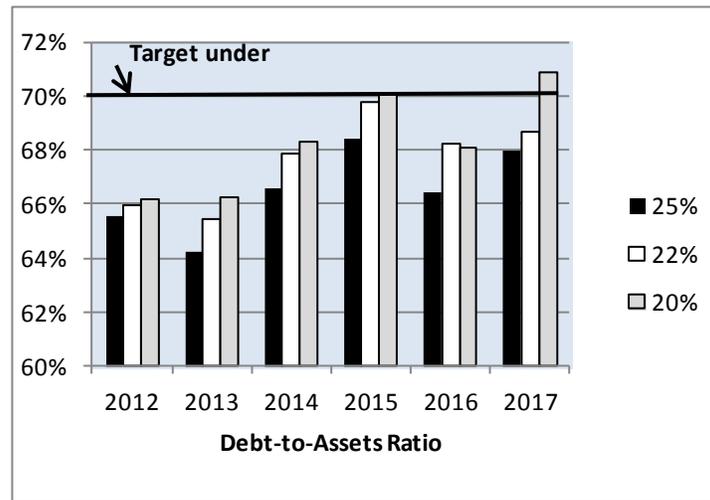
Under the 25 percent scenario, net income comfortably exceeds the target in all year. At 22 percent the target is met in all years although near \$0 in 2013 when cash financing is reduced considerably. At 20 percent the net income target is met in three of the five years evaluated.

**Figure 24**  
**Debt Service Coverage under Alternative Financing Scenarios**



All scenarios exceed 2.0x coverage across the period **except** in 2017 under the 20 percent scenario when DSC drops just below the 1.8x targeted level. In their ratings of the 2009 DWF revenue bonds, both Moody's and S&P highlighted DWF's consistently high coverage levels in excess of 2.0x.

**Figure 25**  
**Debt-to-Assets Ratio under Alternative Financing Scenarios**



At 25 percent, DWF’s debt-to-asset ratio remains comfortably under the maximum throughout the analysis period. At 22 percent, debt-to-assets becomes binding in 2015 and would exceed the targeted maximum that year if rates were not raised accordingly. At 20 percent, the fund exceeds the target maximum in 2015 and 2017.

**Rate and Revenue Impacts**

Relative to current practice, a 20 percent financing scenario saves \$14.5 million annually on the revenue requirement by 2017. In line with the discussion on bills, this savings is due to consistently lower cash financing of the CIP. Conversely, by 2017 the revenue requirement at 22 percent exceeds that of the 25 percent scenario by \$12.5 million due to a combination of higher debt service and increased cash required to meet the debt-to-asset fund target (see Capital Financing Impacts below). Table 9 presents the projected revenue requirements and rate paths under each scenario.

## Section V: Drainage and Wastewater Fund Review

**Table 9**  
**Projected DWF Revenue Requirement and Rate Path under Alternative Cash Financing**  
**(nominal dollars, in millions)**

	2012	2013	2014	2015	2016	2017
<b>DWF Revenue Requirement</b>						
25%	\$285.5	\$297.6	\$312.9	\$319.6	\$335.5	\$327.1
22%	\$285.5	\$287.0	\$311.3	\$319.7	\$329.8	\$339.6
20%	\$285.5	\$279.7	\$314.5	\$319.9	\$336.7	\$312.5
<b>Drainage Rate Increase</b>						
25%	11.8%	7.6%	16.1%	6.4%	9.2%	0.7%
22%	11.8%	3.5%	19.7%	6.7%	7.8%	10.6%
20%	11.8%	2.0%	19.2%	6.8%	12.6%	-3.8%
<b>Wastewater Rate Increase</b>						
25%	3.9%	2.7%	2.2%	1.7%	4.4%	-3.3%
22%	3.9%	-0.9%	5.4%	2.5%	2.4%	0.1%
20%	3.9%	-3.4%	10.5%	0.1%	4.2%	-6.9%

### Capital Financing Impacts

Under both the 22 percent and 20 percent scenarios, annual debt service is higher and cash financing is (obviously) lower than the 25 percent scenario. The higher revenue requirement associated with the 22 percent scenario stems from two factors:

- higher annual debt service (+\$1million) due to higher debt financing, and
- a significant increase in cash financing requirements in 2017 in order to not exceed the debt-to-assets target

Although debt service is consistently higher under the 22 percent option throughout the analysis period, the total revenue requirement is lower through 2016 as lower annual cash contributions more than offset the higher debt service. This is true even in 2015 when debt-to-assets becomes binding under this scenario, although a higher cash-financing contribution (24 percent) is required than in prior years. Everything changes in 2017 when annual cash financing must rise to 34 percent so the fund does not exceed its debt-to-assets cap. In contrast, under the 25 percent contribution scenario, only a 20 percent contribution is required in 2017. This is the level of annual financing required to achieve the 25 percent four-year average target which is the binding constraint under this scenario.

At 20 percent, lower cash contributions consistently more than offset increased debt service, resulting in a lower revenue requirement. However, this lower revenue requirement is only possible because rates are not set to meet other financial performance targets, as is the case with the 22 percent scenario. Consequently, targets for debt-to-assets ratio, net income and debt service coverage are missed at various points throughout the 2013-2017 analysis period.

Table 10 presents the annual capital financing impacts under both analysis scenarios.

**Table 10**  
**Capital Financing under Alternative Cash Financing Options**

	2012	2013	2014	2015	2016	2017
<b>Debt Service (\$M)</b>						
25%	\$37.3	\$45.7	\$48.5	\$52.6	\$59.4	\$61.7
22%	\$37.3	\$46.4	\$49.2	\$53.5	\$60.7	\$62.7
20%	\$37.3	\$46.8	\$49.6	\$53.9	\$60.8	\$63.5
<b>Cash Financing</b>						
25%-4 yr. Avg	26%	25%	25%	25%	25%	25%
22%-4 yr Avg	26%	22%	21%	22%	20%	25%
20%-4 yr Avg	26%	20%	20%	20%	20%	21%
25%-Annual	30%	21%	25%	25%	29%	20%
22%-Annual	30%	13%	22%	24%	22%	34%
20%-Annual	30%	7%	24%	24%	29%	3%

**Conclusions**

A reduction to a 20 percent cash financing level is not possible without missing DWF’s adopted debt-to-asset and net income targets. A lower cash contribution than 25 percent is feasible in the short-term. No additional risks are associated with this scenario if debt management is addressed by continuing to set rates to achieve all other financial targets. However, as discussed in this section, within five years these lower contributions will result in both higher rates AND greater debt. Consequently, there is not a strong argument for pursuing this option either.

When adopting DWF financial policies in 2003, Council and SPU shared a broad consensus on the benefits of a robust financial policy mix to manage the debt associated with DWF’s rapidly growing capital program. Council not only supported SPU’s proposed 25 percent cash-financing option, the highest of those analyzed, but also recommended and adopted a 70 percent cap on the debt-to-asset ratio to “reinforce debt control”, a policy reviewed by SPU but not included in its final policy proposal.

According to the City’s Debt Manager, rating agencies are impressed when issuers can stick by their stated financial policies. Relaxing those policies raises significant concern, particularly if viewed as a means to provide short-term rate relief. The 25 percent limitation results in a fairly modest cash contribution to capital and therefore, significant financial leverage. Reducing this cap could be interpreted as a means of simply deferring the need to raise rates or cut costs.

Although the DWF’s bond ratings are not currently at risk of a downgrade, the City’s Financial Advisor has indicated that this policy change could put downward pressure on them. The utility’s debt ratio has risen significantly over the last decade and is already significantly above the median for similarly rated utilities. Any reduction in the amount of the CIP that is financed from cash will create more pressure on this ratio. Given continuing market concerns about credit quality, a ratings downgrade would have very significant long-term financial consequences for the DWF and its customers.

## VI. Solid Waste Fund Review

Table 11 presents the Solid Waste Fund's adopted financial policies. Table A-3 in the Appendix A provides a more detailed summary of the most significant legislation and/or policy changes in the past 20 years for the Solid Waste Fund. All financial projections assume adopted O&M and CIP spending levels. Table C-3 in Appendix C documents spending assumptions by year.

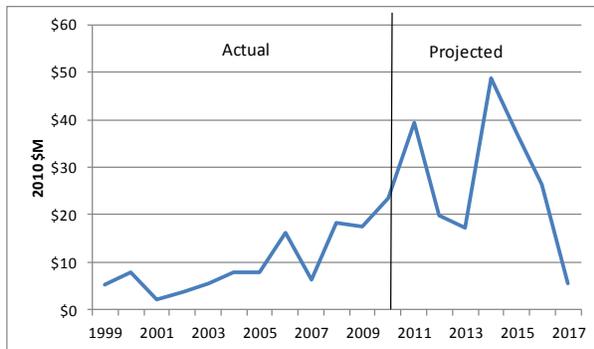
**Table 11**  
**Solid Waste Fund Financial Policy Legislative Benchmarks**

<b>Policy Metric</b>	<b>Target/Guidance</b>
<b>Debt Service Coverage</b>	1.7x on a planning basis for first lien debt
<b>Cash to CIP</b>	The greater of \$2.5million (in 2003 dollars) or 10 percent of the CIP
<b>Operating Cash</b>	Twenty days of collection and disposal contract payments
<b>Net Income</b>	Generally positive on a planning basis
<b>Variable Rate Debt</b>	Should not exceed 15 percent of total outstanding debt

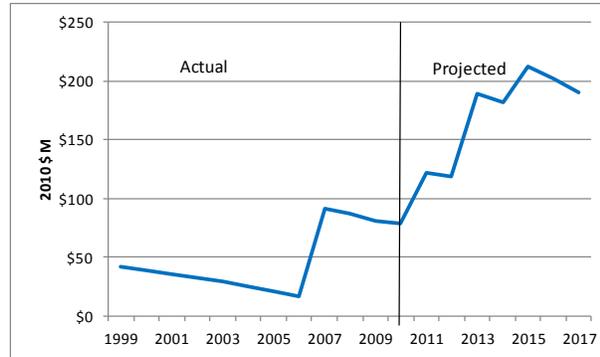
### VI.1. Capital Spending

Debt management has not historically been a significant factor underlying the Solid Waste Fund's financial policies. Unlike the other SPU lines of business, solid waste infrastructure is limited. Rather than issuing debt to fund ongoing capital infrastructure needs, Solid Waste has issued debt to fund large one-time multi-year capital requirements, most notably the Midway and Kent landfill closures (bonds issued in the late 1980's) and implementation of the Solid Waste Facilities Master Plan (bonds issued in 2007, 2011 and projected issues for 2013 and 2015) which includes rebuilding two transfer stations.

**Figure 26**  
**Solid Waste Fund Actual and Projected**  
**Capital Spending (2010 \$M)**



**Figure 27**  
**Solid Waste Fund Actual and Projected**  
**Debt Outstanding (nominal dollars, in millions)**



SWF historical financial performance has typically exceeded policy targets by a very comfortable margin. Due to its limited capital requirements, financial targets related to ongoing operating performance, such as net income and operating cash, have historically been binding. This will continue to be the case during the next several years although increased capital spending and associated debt will reduce financial performance somewhat.

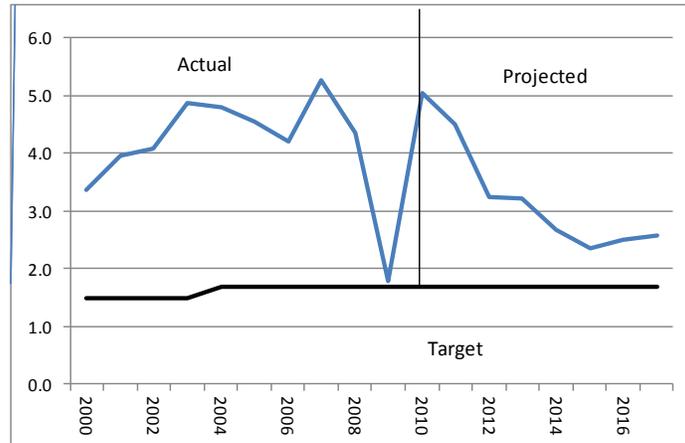
**VI.2. Debt Service Coverage**

The SWF established a 1.7x formal policy target in 2004 to be consistent with the WF. An informal policy target of 1.5x had been used until that time with the exception of the 1992-1994 rate period when rates were set to meet the 1.35x legal requirement.<sup>10</sup> Due to its limited debt outstanding, SWF actual coverage has historically tracked well above the 1.7x target. While an ample margin over the target is expected for the next several years, DSC is projected to decline until the completion of the Solid Waste Master Plan Implementation and then begin to rise again.

Figure 28 presents historical and projected SWF performance against its DSC target.

<sup>10</sup> The SWF received about \$10M in 1990 as a result of its withdrawal from the King County disposal system. Financial policies adopted for the 1992-94 rate period were set to keep rates low by drawing down this cash (deposited into a Rate Stabilization account) just enough each year to meet the legal DSC requirement, while intentionally running negative net income.

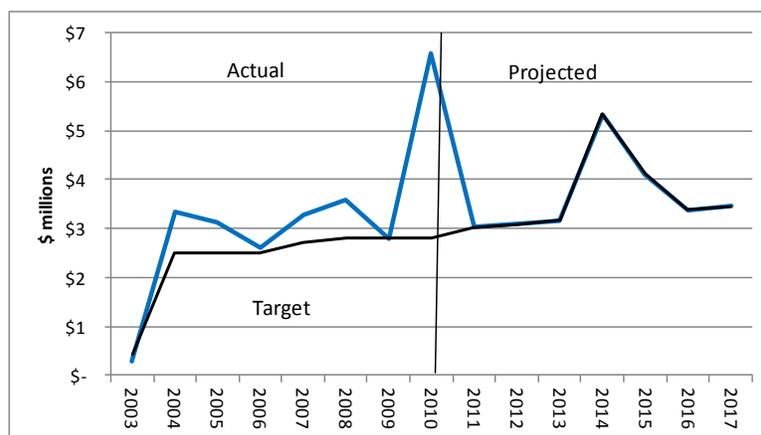
**Figure 28**  
**Solid Waste Fund Actual and Projected Debt Service Coverage**



**VI.3. Cash-financed CIP**

Resolution 30695 (2004) established a formal policy target of a \$2.5 million annual cash financing minimum, expressed in 2003 dollars. A flat target was adopted to avoid rate spikes associated with uneven CIP spending. However, in recognition of the debt impacts of the significant increase in capital costs associated with Solid Waste Facilities Plan implementation, the 2009-2010 rate study refined this target to an informal guideline of the greater of \$2.5 million in 2003 dollars or 10 percent of annual CIP spending. The formal policy was not modified as capital spending is expected to decline significantly after completion of the transfer stations.

**Figure 29**  
**Solid Waste Fund Actual and Projected Cash-financed CIP**



**VI.4 Net Income**

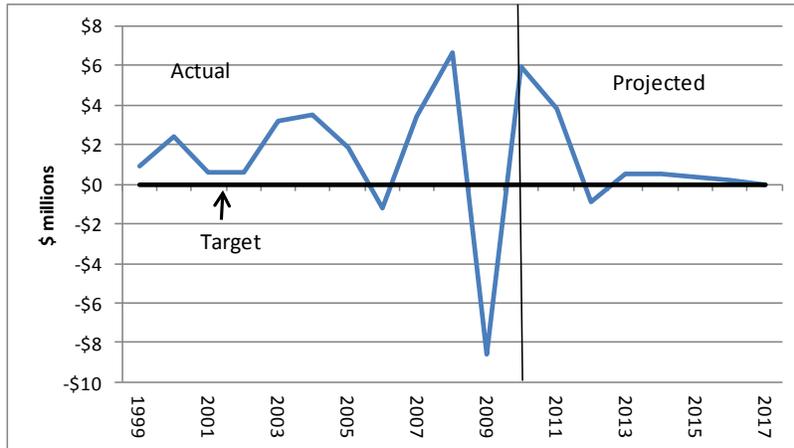
The SWF has typically met its generally positive net income target. Net income will become the binding constraint beginning with the 2013-14 rate study due to a significant increase in expense

## Section V: Solid Waste Fund Review

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associated with depreciation on new transfer station assets and environmental liabilities related to the South Park landfill site. As a result, rates will be set to just meet positive net income in the foreseeable future.

**Figure 30**  
**Solid Waste Fund Actual and Projected Net Income (nominal dollars, in millions)**

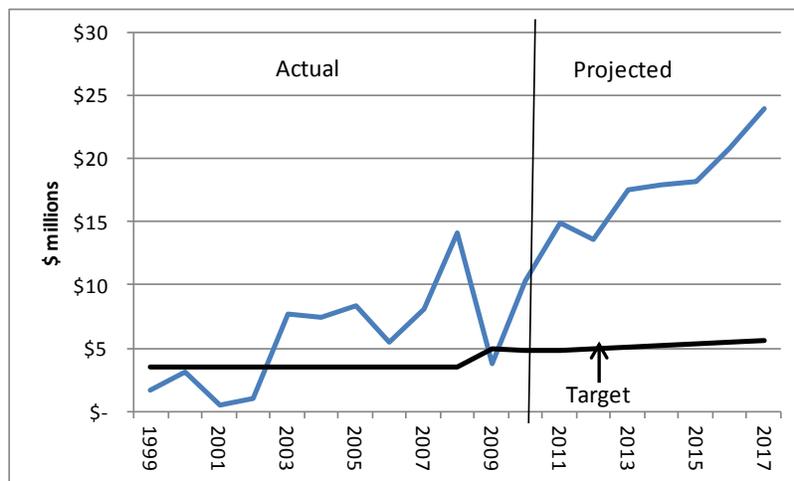


**VI.5 Operating Cash**

Resolution 30695(2004) changed the operating cash balance target from a flat dollar amount to 20 days of contract costs. The Utility had recently taken over commercial collection, and expenses had risen. The change was made so that the target would increase along with the largest component of Solid Waste cost obligation.

While the SWF has generally performed well against its cash target since 2003, it is projected to significantly outstrip the target in the foreseeable future. The increase in expense driving the net income binding constraint noted in Section VI.4 is non-cash expense. Therefore, the rates set to produce a minimally positive net income will also recover higher revenues than actual cash expense.

**Figure 31**  
**Solid Waste Fund Actual and Projected Operating Cash (nominal dollars, in millions)**



## Appendix A-Jurisdictional Comparisons

**Table A-1 – Solid Waste Utility Comparisons (2009)<sup>11</sup>**

	<b>Seattle Solid Waste (Aa3/AA)</b>	<b>Tacoma Solid Waste (A2/AA/A+)</b>
<b>Debt Service Coverage Requirement(s)</b>	1.70x coverage on fixed-rate LT Parity Bond DS.	1.70x coverage.
<b>Capital Expenditures</b>	Formal policy: minimum CIP cash contribution of \$2.5 million (2003 dollars); internal target : greater of \$2.5 million or 10 percent of annual CIP	Minimum of 20 percent of capital financed with current revenues.
<b>Rate Stabilization Account</b>	N/A	N/A
<b>Cash Requirement</b>	Cash balance requirement of 20 days contract payments.	Minimum of 60 days of operating cash.
<b>Other</b>	Solid waste rates set to achieve generally positive net income.	

<b>Solid Waste Enterprise</b>	<b>Rating</b>	<b>Bond Security</b>
Prince George County (MD) Solid Waste Mgmt System	Aa3	Gross pledge of system revenues (property taxes comprise 74 percent)
Solid Waste Authority of Palm Beach County	Aa3	Net revenues of disposal operations (property taxes comprise 58 percent)
Lincoln Solid Waste Mgmt (NE)	Aa3	Net revenue pledge with City Appropriation backstop to provide 1.10x coverage.
Montgomery County (MD) Solid Waste Enterprise	Aa3	Service payments from Montgomery County (property taxes comprise approx. 63 percent of system revenues)
Monroe County Solid Waste Mgmt (IN)	Aa3	Special Ad Valorem Property Tax
Atlanta Solid Waste Mgmt Auth.	Aa3	General Obligation (ULT)
Solid Waste Authority of Central Ohio	Aa1	General Obligation, Limited Tax

<sup>11</sup> Data gathered by the City's Financial Advisor.

## Appendix A – Jurisdictional Comparisons

**Table A-2 – Water, Sewer, and Stormwater Comparisons**

Utility (Bond Rating) (1)	DEBT SERVICE COVERAGE	CASH-FINANCED CAPITAL	RATE STABILIZATION ACCOUNT	CASH REQUIREMENT
<b>WATER UTILITIES</b>				
Seattle Water (Aa1/AA+)	1.70x	20 percent per rate period; minimum 15 percent per year	Minimum balance requirement of \$9.0 mil.	Minimum year-end cash balance of 30 days of current year operating expense.
Portland Water (Aaa/NR/NR)	1.9x	Construction cash reserve = lesser of \$5.0 million or 50 percent annual debt-financed CIP.	Minimum balance requirement of \$2.0 million (2)	Minimum fiscal year-end operating cash reserve requirement of \$15.0 million.
Phoenix Water (Aa2/AAA/NR)	N/A	N/A	N/A	Internal target of maintaining 10 percent of operating expenditures as an operating balance.
Cincinnati Water (Aaa/AAA/NR)	1.50x	Minimum of 20 percent of capital needs financed with cash.	N/A	Minimum of 200 days cash on hand in total reserves. Working capital reserve equal to 15 percent of prior year operating expense.
Denver Board of Water Commissioners (Aa1/AAA/AAA)	1.50x for planning purposes	N/A	N/A	No policy stated but held 420 days of cash on hand as of the end of fiscal year 2009.
San Antonio Water (Aa1/AA/AA+)	N/A	N/A	N/A	No policy stated but held 277 days of cash on hand as of the end of fiscal year 2010.
DC Water & Sewer Authority (Aa2/AA/AA)	1.40x	Any excess operating reserve amounts are to be used for capital financing or repayment of higher- cost debt. Whenever possible, the least costly capital financing is be used for capital projects.	No minimum balance requirement.	Minimum cash reserve of 120 days of operating expenses less District's stormwater revenues, but not less than a cash balance of \$125.5 million.

## Appendix A – Jurisdictional Comparisons

Utility (Bond Rating) (1)	DEBT SERVICE COVERAGE	CASH-FINANCED CAPITAL	RATE STABILIZATION ACCOUNT	CASH REQUIREMENT
<b>SEWER &amp; STORMWATER UTILITIES (COMBINED)</b>				
Seattle Drainage & Wastewater (Aa1/AA+)	1.80x	Minimum of 25 percent (4 yr. rolling avg)	N/A	Minimum year-end cash balance of 30 days wastewater treatment expense.
Portland Sewer (Aa2/AA/NR)	1.50x	N/A	Combined ending fund balances within the operating fund and rate stabilization fund must be 10 percent of each year's operating expenses plus any required debt service reserves. (3)	Combined ending fund balances within the operating fund and rate stabilization fund must be 10 percent of each year's operating expenses plus any required debt service reserves. (3)
Tacoma Sewer (Aa2/AA+/AA+)	1.70x	N/A	N/A	Minimum cash reserve of 60 days of operating expense.
Honolulu Wastewater (Aa2/AA/AA)	1.60x	N/A	N/A	Minimum operating reserve equal to 90 days of operating and maintenance costs.
Louisville & Jefferson Co. Metrop. Sewer District (Aa3/AA/AA-)	N/A	N/A	N/A	Maintain \$25 million in unrestricted cash
<b>STORMWATER (ONLY) UTILITIES</b>				
Fort Worth Drainage (NR/AA+/AA+)	1.50x for planning purposes	N/A	N/A	Operating reserve maintained at 20 percent of the current year's budgeted appropriation for operation and maintenance.
Des Moines Stormwater Utility (Aa2/AA+/NR)	1.75x to 2.00x	N/A	N/A	Maintain unrestricted liquidity balance of approx. \$5 million or 30 percent of utility's annual revenue collection.
Miami-Dade County Stormwater Utility (Aa2/NR/AA-) (4)	N/A	N/A	N/A	N/A

## Appendix A – Jurisdictional Comparisons

Utility (Bond Rating) (1)	DEBT SERVICE COVERAGE	CASH-FINANCED CAPITAL	RATE STABILIZATION ACCOUNT	CASH REQUIREMENT
<b>OTHER SEATTLE UTILITIES</b>				
Seattle City Light (Aa2/AA-)	1.80x	40 percent on average over 6-yr capital plan	\$100 million balance used to offset volatility in net wholesale revenue	None
Seattle Solid Waste (Aa3/AA)	1.70x	Minimum \$2.5 million (2003 \$)	N/A	Cash balance requirement of 20 days contract payments.

### Table Notes:

(1) Rating – First Lien (Moody's/S&P/Fitch)

(2) Minimum Rate Stabilization Account balance also serves as an available usable reserve such as a "rainy day" fund.

(3) The Bureau (Portland) uses transfers between the Sewer System Operating Fund and Sewer System Rate Stabilization Fund to smooth rate increases over the financial planning period. Per S&P, the Bureau maintains a policy of retaining 2 percent of Operating Expenses in Operating Reserve and 8 percent in Rate Stabilization Fund.

(4) No financial policies stated for Miami-Dade Stormwater Utility. Per Moody's stormwater fees are set at a level sufficient to pay debt service, cover operating costs, provide for pay-go funding (\$9.3 million in FY09) and maintain reserves without general fund support.

## Appendix B-Legislative Evolution of SPU Fund Financial Policy Targets

**Table B-1 – Water Fund**

Target	1990 (Res 28152)	1995-96 Rate Study Guidelines	2002 (Ord 120875)	2005 (Res 30742)
<b>Debt Service Coverage</b>	1.7x on a planning basis	1.7x  1.25 percent on second lien debt	N/A	1.7x on a planning basis for first lien debt
<b>Cash to CIP</b>	Finance as much as possible from debt, considering: 1. Rate implications 2. Excess balances used for CIP 3. Level of CIP debt financing sustainable in long run 4. Debt financing not appropriate for all projects	Minimum of 20 percent over 4 years	N/A	No less than 20 percent over the rate proposal period. No less than 15 percent in any given year.
<b>Year-End Cash</b>	None	Net zero balance. Negative months supported by consolidated cash.	N/A	One twelfth of operating expenditures
<b>Net Income</b>	Positive on a planning basis	Positive	N/A	Generally positive
<b>Revenue Stabilization Sub fund</b>	None	Deposits are from higher than planned net revenues.	Mandatory deposits to the RSF of \$2.5M/year, plus excess revenues.	Balance of \$9M shall be maintained with exceptions.
<b>Variable Rate Debt</b>	None	15 percent of total debt	N/A	Should not exceed 15 percent of total outstanding debt.
<b>Debt-Equity</b>	None	No higher than 70 percent	N/A	None
<b>Facility Maintenance</b>	Maintain assets in sound working condition.	None	N/A	Maintain assets in sound working condition.
<b>Eligibility for Debt Financing</b>	None	None	N/A	Certain criteria must be met for debt financing.

## Appendix B – Legislative Evolution of SPU Fund Financial Policy Targets

**Table B-2 – Drainage and Wastewater Fund**

Target	April 1989 (Res 27973)	October 1989 (Res 28087)	1992 (Res 28554)	2003 (Res 30612)
<b>Debt Service Coverage</b>	1.5x average annual debt service requirements	1.5x average annual debt service requirements	1.5x average annual debt service requirements	1.8x average annual debt service requirements
<b>Cash to CIP</b>	As a long-term goal, the utility should seek a 1:1 ratio for long-lived improvements (50/50 long-term debt/equity).	Fund balances in excess of working capital shall be contributed to the CIP. The allocation of capital costs over time should be fair.	Fund balances in excess of working capital shall be contributed to the CIP. The allocation of capital costs over time should be fair.	Minimum 25 percent of CIP should be funded with cash on an annual basis by 2007. After 2007, the minimum 25 percent is calculated on a 4-year rolling average.
<b>Year-End Cash</b>	None	Cash balance equal to 45 days of working capital (informal policy)	Cash balance equal to 45 days of working capital (informal policy)	Year-end balance of one month wastewater treatment expense.
<b>Net Income</b>	Positive	Generally Positive	Generally Positive	Generally Positive
<b>Facility Maintenance</b>	None	Seek to maintain capital assets in sound working condition.	Seek to maintain capital assets in sound working condition.	Seek to maintain capital assets in sound working condition.
<b>Revenue Stabilization Sub fund</b>	None	None	None	None
<b>Eligibility for debt financing</b>	None	None	None	None
<b>Variable Rate Debt</b>	None	None	None	Limited to 15 percent of total debt.
<b>Debt-to-Assets</b>	None	None	None	<70 percent

## Appendix B – Legislative Evolution of SPU Fund Financial Policy Targets

**Table B-3 – Solid Waste Fund**

Target	1992 (Res 28532) for 1992-94 Rate Study	1999 Rate Study Guidelines	2004 (Res 30695)	2009-10 Rate Study Guidelines
<b>Debt Service Coverage</b>	1.35x (Legal requirement) during rate period	1.5x	1.7x on a planning basis for first lien debt	1.7x on a planning basis for first lien debt
<b>Cash to CIP</b>		Minimum of 50 percent cash financing in any 6 yr period	Minimum of \$2.5 million (in constant \$2003), unless there is a compelling reason to do otherwise.  Each rate proposal will make a recommendation whether to finance more in the period.	The greater of \$2.5M (in \$2003) or 10 percent of the CIP.
<b>Operating Cash</b>	“Composite Cash” (Revenues plus RSF)- \$5M by the end of the rate period (1994).	\$3.5M	Twenty days of collection and disposal contract payments	Twenty days of collection and disposal contract payments
<b>Net Income</b>	None	Positive	Generally positive on a planning basis	Generally positive on a planning basis
<b>Facility Maintenance</b>	None	None	Utility should seek to maintain assets in sound working condition.	
<b>Debt Structure</b>	None	None	Level nominal debt service.	
<b>Variable Rate Debt</b>	None	None	Should not exceed 15 percent of total outstanding debt.	Should not exceed 15 percent of total outstanding debt.

## Appendix C – Spending Assumptions – Financial Projections (in nominal dollars, thousands)

**Table C-1 – Water Fund Spending Assumptions**

	2012	2013	2014	2015	2016	2017
O&M	\$218,318	\$229,522	\$237,002	\$243,023	\$251,568	\$265,761
CIP -85%	\$59,973	\$54,896	\$55,651	\$54,107	\$56,931	\$60,081
CIP-100%	\$70,557	\$64,583	\$65,472	\$63,655	\$66,978	\$70,684

**Notes:**

- 1) O&M: 2011 Water System Plan assumptions, in nominal dollars.
- 2) CIP: Water System Plan assumptions (nominal dollars). Modeling assumes 85% accomplishment rate.

**Table C-2 – Drainage and Wastewater Fund Spending Assumptions**

	2012	2013	2014	2015	2016	2017
O&M-Total	\$206,233	\$209,085	\$212,040	\$214,898	\$217,959	\$221,046
<i>Treatment</i>	\$123,638	\$123,167	\$122,692	\$121,978	\$121,265	\$120,545
<i>Non-treatment</i>	\$82,595	\$85,918	\$89,348	\$92,919	\$96,694	\$100,501
CIP -90 percent	\$75,848	\$107,499	\$88,215	\$83,146	\$82,847	\$67,860
CIP-100 percent	\$84,275	\$119,443	\$98,017	\$92,385	\$92,052	\$75,400

**Notes:**

- 1) Branch O&M (non-treatment): 2012=Adopted Budget; 2013+ = 2012 inflated at 4 percent annually. Treatment O&M per SPU modeling estimates at 1/5/2012
- 2) CIP: Spending projections at 1/5/2012. Modeling assumes 90 percent accomplishment rate.

**Table C-3 – Solid Waste Fund Spending Assumptions**

	2012	2013	2014	2015	2016	2017
O&M-Total	\$137,332	\$141,049	\$144,909	\$149,000	\$153,313	\$160,385
<i>Contract</i>	\$90,779	\$92,633	\$94,557	\$96,634	\$98,852	\$103,746
<i>Branch O&amp;M</i>	\$46,553	\$48,415	\$50,352	\$52,366	\$54,461	\$56,639
CIP -90%	\$16,599	\$16,279	\$47,649	\$36,837	\$26,724	\$5,466
CIP-100%	\$18,443	\$18,088	\$52,944	\$40,930	\$29,693	\$6,073

**Notes:**

- 1) Branch O&M: 2012=Adopted Budget; 2013+ = 2012 inflated at 4% annually (branch spending only). Treatment per early January 2012 Solid Waste Fund modeling estimates.
- 2) CIP: 2012-2017 Adopted CIP.

2012 Seattle City Council Statement of Legislative Intent

Approved

Tab	Action	Option	Version
13	1	A	1

**Budget Action Title:** Review of SPU financial policies.

**Councilmembers:** Conlin; Harrell; O'Brien

**Staff Analyst:** Meg Moorehead

**Budget Committee Vote:**

Date	Result	SB	BH	SC	TR	JG	NL	RC	TB	MO
11/08/2011	Pass 9-	Y	Y	Y	Y	Y	Y	Y	Y	Y

**Statement of Legislative Intent:**

The Council requests that Seattle Public Utilities (SPU) submit a report that reviews its financial policies, with an emphasis on drainage and wastewater policies including the policy for the cash contribution to the capital improvement program (CIP). The report should include:

- 1) A summary of financial policies for SPU's Funds and an explanation of why each policy target was selected.
- 2) A comparison of SPU financial policies and bond ratings to those of other comparable utilities and Seattle City Light.
- 3) An evaluation of the Drainage and Wastewater Fund cash-to-CIP policy that considers a change from a 25% CIP cash contribution to a 20% cash contribution. The evaluation should show any revenue requirement savings, the rate path through 2017 if a 20% cash-to-CIP policy were adopted and the long-term implications for debt outstanding. It also should explain any financial risks associated with such a change.

**Responsible Council Committee(s):** Seattle Public Utilities & Neighborhoods

**Date Due to Council:** January 31, 2012