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

Presentation to Libraries, Utilities and Center Committee

March 20, 2012

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SLI No. 13-1-A-1 Requested:

- **Financial policy summary by fund, including explanation of target choices**
- **Jurisdictional comparison of financial policies and bond ratings**
- **Evaluation of change in the Drainage and Wastewater Fund (DWF) cash-financed CIP policy from 25 to 20 percent.**

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Today's Discussion:

- Financial policy objectives and implementation considerations
- Jurisdictional comparison highlights
- Overview of SPU financial performance drivers
- Evaluation of alternative DWF cash-financed CIP scenarios,

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Financial Policy Objectives & Implementation Considerations

Financial policy objectives and related policy measures:

Objectives

- ➢ **Provide financial certainty**
- ➢ **Maintain long term financial health**

Related Policies

- Net Income
- Year-end cash
- Variable rate debt
- Rate stabilization fund
- Debt service coverage
- Debt-to-asset ratio

- ➢ **Ensure rate stability**

- Year-end cash
- Variable rate debt
- Cash-financed CIP

- ➢ **Manage long-term debt**

- Debt service coverage
- Debt-to-asset ratio
- Cash-financed CIP

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Implementation considerations:

➢ Management to meeting financial policies

- Annual rate and expense adjustments allow for more modest targets
- More robust planning targets important with longer rate cycles

➢ Capital plan size

- Large multi-year capital programs require greater focus on financial policies that limit debt build-up

➢ Debt management considerations

- ***Package*** of policies important to control debt buildup
- Heavy debt dependence may limit future options to issue debt

Rating agency considerations:

➢ Financial policies provide predictive framework

Signals to rating agencies how governing bodies intend to manage the long term revenue stream

➢ Actual financial performance vs. targets

Actual performance (against targets) is one of various criteria used to determine ratings

➢ Other criteria also important to ratings

- Willingness of elected officials to raise rates
- Strength of local economy
- Risk factors producing sharp revenue/cost swings
- Level of debt outstanding
- Rate levels
- Strength of management

Jurisdictional Comparisons

Jurisdictional survey summary conclusions:

- **Liquidity-related policies**

  SPU requires lower operating cash than peers but has access to large City cash pool.

- **Debt-management related polices**

  SPU debt-related policies are among the most stringent, but the WF and DWF carry much higher levels of debt as a percentage of assets than peers.

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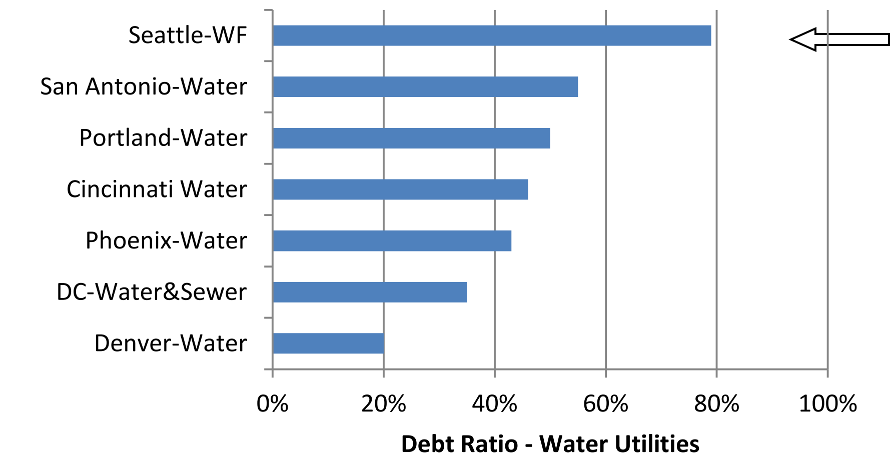
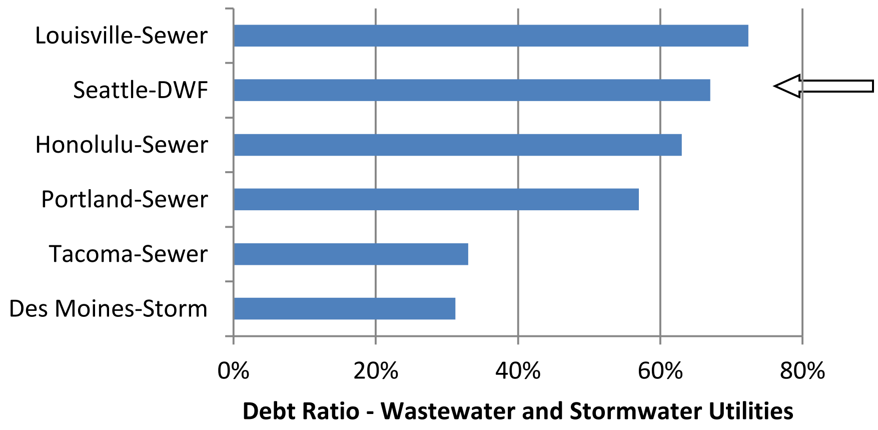
Comparison of actual debt ratios (Moody's):





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SPU Financial Performance Drivers

Policy overview:

- Current policies adopted in 2003 for DWF, 2004 for SWF and 2005 for the WF
- Stated policies of three funds are very similar
- Size and growth of the Funds capital programs and related debt reliance have driven:
  - variances in actual performance against targets
  - policy used as binding constraint in rate setting

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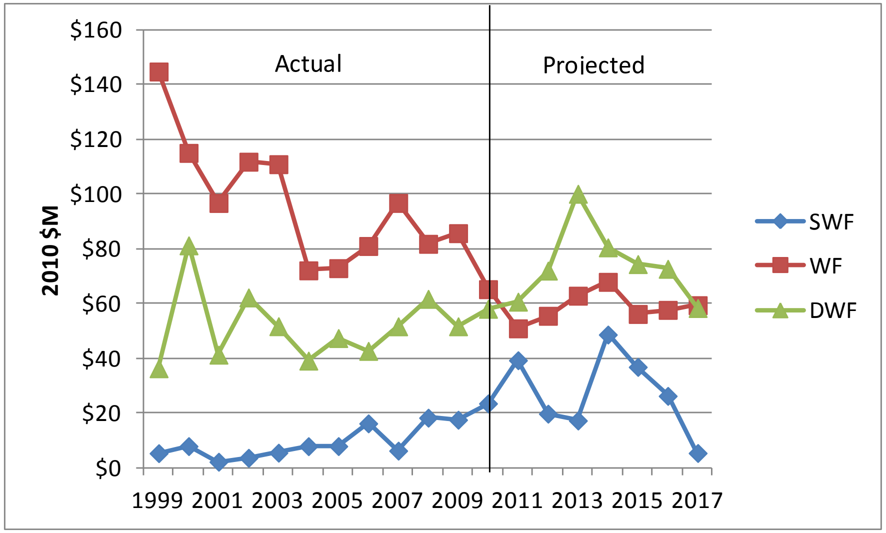
SPU capital spending by fund:

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



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

- WF has highest historic levels of capital spending
- Gradual historic growth (in real terms) in DWF CIP with rapid escalation projected during near term planning period
- SWF more infrastructure limited with temporary growth in CIP to meet specific initiatives (such as master plan implementation)

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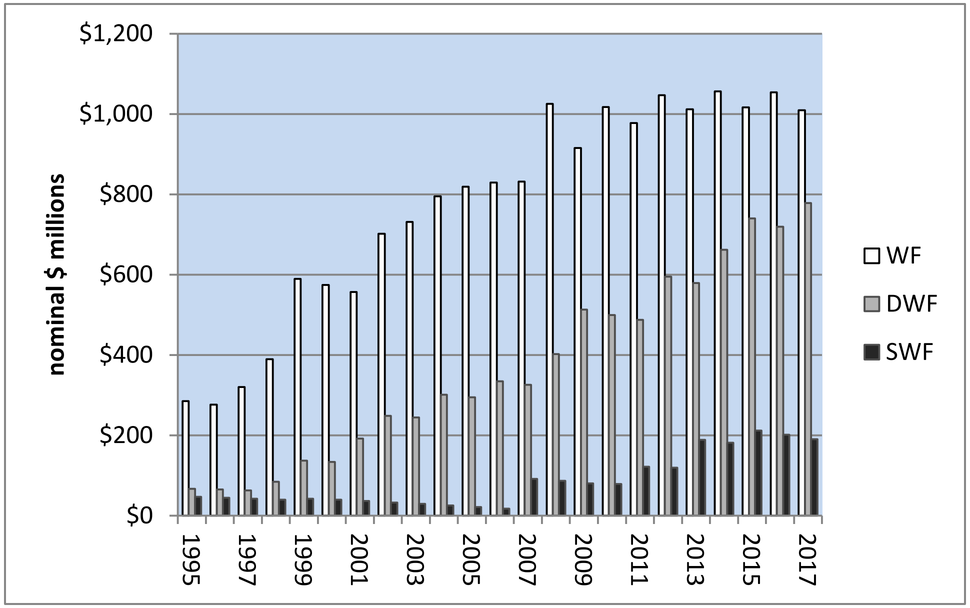
SPU fund debt reliance and rate-setting impact:

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



- **WF:** High debt + high spending led to much higher cash financing (average of 31% in 2012-2014 rate period) to meet debt service coverage binding constraint.
- **DWF:** Conservative financial debt management policies have helped to control debt despite growth in CIP spending. Cash to CIP remains binding constraint.
- **SWF:** Less reliant on debt than other SPU funds due to limited infrastructure needs.

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DWF Cash-financed CIP Policy Review

Overview of DWF Cash-to-CIP policy review:

Historical context

- Prior to 2003, "excess cash" contributed to CIP
- Three contribution levels (15, 20, and 25 percent) evaluated in 2003 to address mounting debt. Council adopted the 25 percent level recommended by SPU.
- Council staff proposed, and Council adopted, a maximum debt-to-asset ratio to further reinforce the goal of debt control.

Scenarios evaluated in 2012 review

- 25 percent (current)
- 22 percent - represents the lowest average contribution during the analysis period that allows DWF to <u>meet all financial targets</u>.
- 20 percent (SLI requested)

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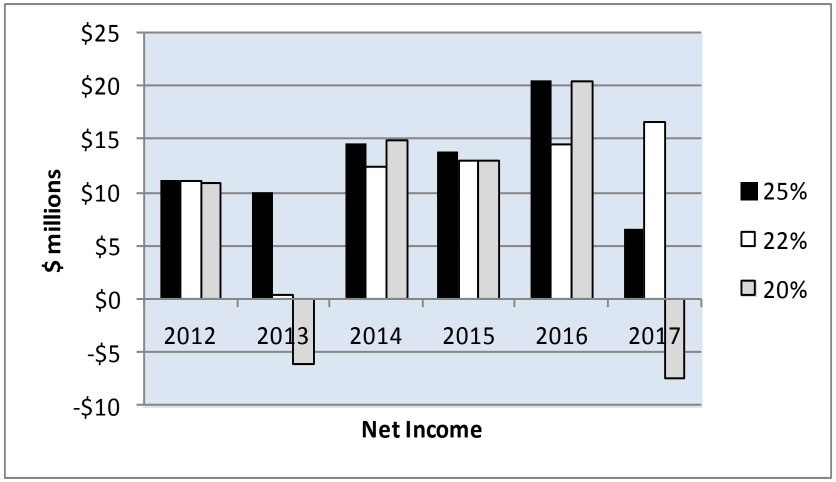
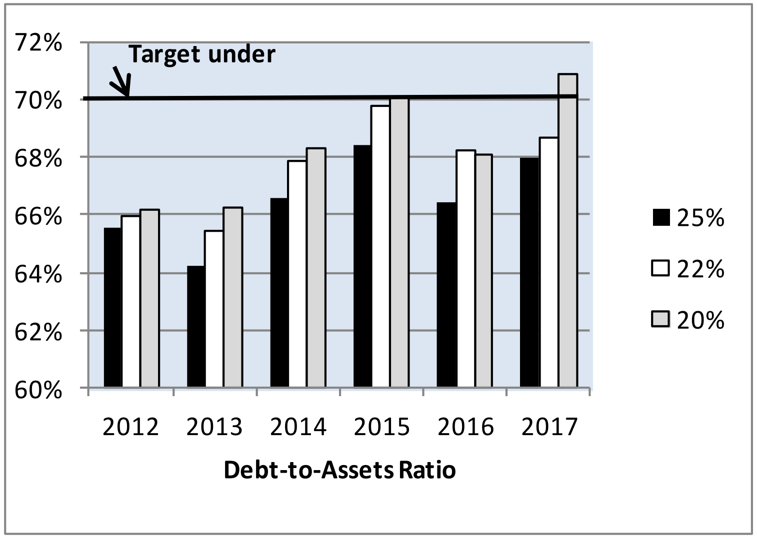
Impacts on financial performance, debt, and bills:





* DSC is just missed in 2017 under a 20% policy as well.

	2017	Variance with 25 percent
Debt Service (annual; $ millions)		
25 percent	$61.7	
22 percent	$62.7	+$1.0
20 percent	$63.5	+$1.8
Debt Outstanding ($ millions)		
25 percent	$778.2	
22 percent	$786.6	+$8.4
20 percent	$811.1	+$32.9
Drainage/Wastewater Bill (monthly SFR)		
25 percent	$73.45	
22 percent	$76.75	+$3.30
20 percent	$70.27	-$3.18

*Under 22% policy, bill increases significantly in 2017 as debt-to-assets becomes binding constraint. Prior to this, bills under this scenario are equivalent or below 25% scenario bills.

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Wrap-up:

- **Impacts of a 20 percent cash contribution policy:**
  - Financial performance: must SET RATES to miss targets in 3 of 5 years
  - Debt: significant increase
  - Bills: Modest reduction (-4%) in SFR bill by 2017
- **Impacts of a 22 percent cash contribution policy:**
  - Financial performance: hits all targets
  - Debt: increase
  - Bills: Modest increase (+4%) in SFR bill by 2017, although some bill savings in earlier period before growth in debt drives rates higher to meet debt-to-asset
- **Other considerations/risks**
  - Relaxing financial policies to provide short-term rate relief can raise concerns within rating agencies.
  - The WF and DWF debt loads are already high relative to peer utilities
  - A policy change could put downward pressure on fund ratings and have significant long-term consequences given market concerns about credit quality.

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