

Power Up Your Financial Policies, Jillian Jurczyk, Manager, Utility Financial Solutions, LLC

Utilities face the challenge of balancing customer rate impacts by maintaining reliability and planning for infrastructure upgrades. Financial decision-makers play a crucial role in this task by determining revenue needs and other key targets to ensure long-term stability. Learn to assess your utility's financial status, identify improvement areas, and minimize the effect of rate changes on customers. The presentation will include case examples for meeting revenue requirements and provide guidelines to simplify tough financial decisions.



Power Up Your Financial Policies

Jillian Jurczyk, Manager
Utility Financial Solutions, LLC

Thursday, August 1st, 2024
Breakout Session #3: 2:00 – 3:00PM



Overview

- Assess your utility's financial status
 - Tools for assessing financial health
- Identify improvement areas
 - Three key financial targets!
- Minimize the effect of rate changes on customers
 - Implement policies and action to improve or maintain financial health



Utility Financial Solutions, LLC

- International consulting firm providing cost of service and financial plans and services to utilities across the country, Canada, Guam and the Caribbean
- Instructors for cost of service and financial planning for APPA, speakers for organizations across the country, including AWWA.
- Hometown Connections preferred vendor

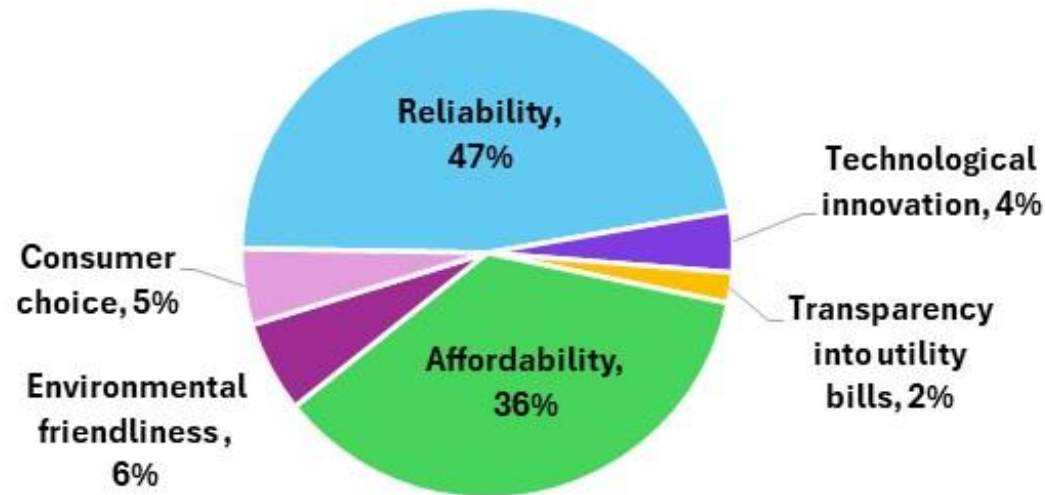


True or False?

Price is the number one concern among electric end users.



American's Top Energy Priorities



False!

Reliability is the number one concern

“Reliability is job #1 and we (the electric utility) are expected to make it work”

-APPA President & CEO, Scott Corwin,
FMEA Annual Meeting 2024



Reliability vs. Price

64% - Outages cause "really significant problems" for their households

55% - Would pay their utility more if outages could be kept to under four hours

45% - Would pay their utility \$10, \$20 or \$40 per month more if power outages could be kept under four hours

Up to 42% would not accept a two-day outage even if they were paid as much as \$1,000 for it

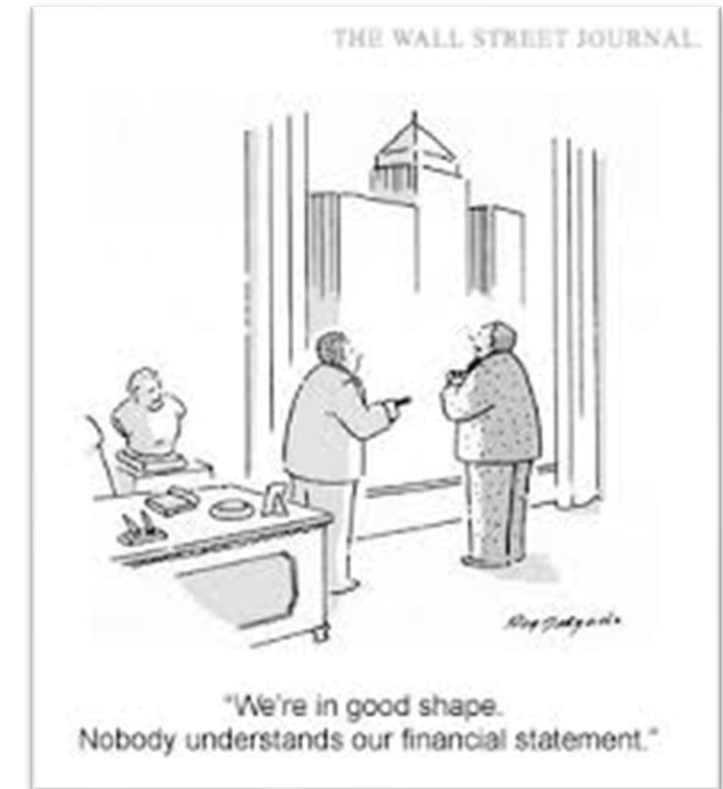
Sponsored jointly by Build Energy America and Potomac Communications Group of Washington, D.C.,
conducted by YouGov Definitive Insights of Portland, Ore. – 500 adults surveyed.



This is an Education Opportunity!

We haven't had a rate increase in XX years 😊

- Board/Council avoids rate adjustments
- Operating at a loss
- Spending down cash
- Foregoing capital investment
- System aging
- Have to borrow for regular capital
- Need major improvements
- We want to be the lowest cost provider....



All of these point to a lack of financial policies.



#1 Goal is Financial Stability

Pay Bills + System Reliability = Provide Service



Financial Policies

- **Written guidance** on core financial areas adopted by the legislative body
- **Clarity** to be understood by staff and decision makers
- **Consistency** as staff and elected officials change
- Helps your managers make **consistent and reliable decisions**





Enterprise Funds:

Revenues should meet financial requirements,
including reinvestment for reliability



Reasons for Changes in Financial Risk

- Increasing Costs
 - Inflation
 - Power costs
 - System growth
 - Aging system
 - Insurance
 - Pension/Labor costs
- Decreasing Sales
 - General economy
 - Large customer leaves system
 - Large sector of business from one type of customer



Tools for Assessing Financial Health

- Overview of basic indicators to determine overall financial health
- Concepts we talk about are what we repeatedly see working in the industry – there are exceptions to everything in this presentation
- Being out of the “range”, doesn’t necessarily mean you have a problem!
- Methodical review the same any size of utility
- Review can apply to other utility types

How’s your
Financial
Health?



Where Do I Find the Information?

- ▶ All you need is:
 - ▶ Income Statement
 - ▶ Balance Sheet
 - ▶ Cash Flow Statement



Most of the time a pretty accurate picture of financial health can be determined after a quick review



Metric #1 – Rate of Return

Should public power have a rate of return?

- Adequate rate of return on investment to help ensure current customers are paying their fair share of the use of the infrastructure and not deferring the charge to future generations
 - Fund Interest expense
 - Fund inflationary increase on historical investment of system



Determination of Optimal Operating Income (ROR)

- Operating Income divided by Net Book Value (Rate of Return %)
- Do for all utilities = upward pressure on electric when not healthy

Description	Current Year	Formula
Operating Income	\$ 1,536,000	A
Net Book Value (NBV)	36,000,000	B
ROR %	4.3%	A / B

Typically, 4-6% for municipals



Metric #2 - Cash Reserves

- Customers and governing body may not understand why utilities need to maintain reserves
- **Having a formal policy can help!**
 - List methodology and show calculations in policy for ease of update in the future
 - Periodic reviews of cash levels and rate adjustments
- **Action** - Identify time-period to restore cash reserve if falls below minimum cash levels
 - **Cash restored through issuance of debt, rate adjustments, reduced expenses in 5 years**
- Future management, Boards and Councils, will continue to maintain adequate reserve levels



Minimum Cash

- Policy should identify **minimum** cash reserve level
 - Cash should be allowed to be above the minimum level
 - Cash reserves will fluctuate over time depending on age of assets and capital improvement program
- Most Common Policy: Number of Days of O&M
 - 90–120+ Days
 - Higher bond rating 200+



Determination of Minimum Cash: At Least 5 Factors to Consider



Five Risk Factors to Consider	% Risk Range to Allocate	Influenced By:
O&M Expenses (Less Power Costs and Depreciation)	12-25%	Billing Cycle - timing of expenses VS Receipts
Power Costs	10-25%	Max Month converted to working capital days
Historical Investment in Assets	1-3%	Age of System, Likelihood of ice, wind, other
Annual Debt Payment	50-100%	Timing of Debt Payments
Total Five-Year Capital Plan	20%	1/5 of five-year plan - funds beginning of season
Total of These Five Items		\$X,XXX,XXX MINIMUM Recommendation



Minimum Cash Reserve Policy

Five Risk Factors to Consider	% Risk Range to Allocate	MINIMUM Reserves
O&M Expenses (Less Power Costs and Depreciation)	12.3%	\$2,958,904
Power Costs	15.6%	5,675,082
Historical Investment in Assets	2.0%	3,311,700
Annual Debt Payment	80.4%	505,879
Total Five-Year Capital Plan	20.0%	1,800,000
Total of These Five Items		\$14,251,565



Simplification of Policy

Once the methodology is established – simplify policy for number of days of O&M

Policy Simplification	
Annual Expense	\$ 24,000,000
Power Supply	36,356,174
Total Expenses	\$ 60,356,174
Minimum Cash Reserve	\$ 14,251,556
Factor (\$60.4M/\$14.3M)	4.23
Days Cash on Hand (365/4.23)	86.0



Minimum Reserve Policy

Five Risk Factors to Consider	% Risk Range to Allocate	MINIMUM Reserves
O&M Expenses (Less power costs and depreciation)	12.3%	\$2,958,904
Power costs	15.6%	5,675,082
Historical investment in assets	2.0%	3,311,700
Annual debt payment	80.4% ^{100%}	505,879
Total five-year capital plan	20.0%	1,800,000
Large Customer Risk	40.0%	850,000
Total of these five items		\$14,250,565



Add other line items unique to your utility



Metric #3 - Debt Coverage Ratio (DCR)

- Identifies cash generated by operations above the debt service payment
- Debt coverage ratios mandated by covenants and established in bond ordinances
- Know your requirements and calculate with the yearly budget process



DCR General Calculation

- **Cash generated by operations divided by debt service**
- Typical formula:
 - Net Income, add back depreciation expense (non cash), plus interest expense
 - Divided by Debt Service Payment
- Typical requirements are 1.25X



Build in Safety Factor

- When setting rates a safety factor must be built into the coverage ratio for planning purposes
 - Electric sales dependent on weather
 - Power supply prices fluctuate
 - Unexpected expense can occur
 - Unexpected Transfers to city

Bond Covenant Requirement	Safety Factor	Minimum Target Level for Planning Purposes
1.10	0.20	1.30
1.20	0.20	1.40
1.25	0.20	1.45

- Potentially causes the utility to fall below coverage requirements
- Safety factor of 0.2 is typically added to Bond Coverage requirement



PILOT and Debt Coverage Ratio

Actual Ordinance	Financial Planning	Item
\$ 268,986	\$ 268,986	Net income (PILOT Included in O&M)
1,256,890	1,256,890	Depreciation
789,465	789,465	Interest Expense
1,058,932	-	PILOT Payment
\$ 3,374,273	\$ 2,315,341	Cash flow from operations
1,986,543	1,986,543	Debt Payment
1.70	1.17	Debt Coverage Ratio

1.25 In Ordinance

Meeting stated ordinance, but not for financial planning purposes.
 Could you really forgo paying the City??





Piecing the Targets Together



Financial Projection

Base Case – No Rate Increase

Fiscal Year	Projected Rate Adjustments	Adjusted Operating Income	Target Operating Income	Projected Cash Balances	Recommended Minimum Cash	Debt Coverage Ratio	Target Debt Coverage Ratio
Year 1	0.00%	\$ (1,034,980)	\$10,273,763	\$ 35,313,396	\$ 40,304,223	2.34	1.40
Year 2	0.00%	(2,704,765)	10,398,330	29,549,231	41,239,701	2.14	1.40
Year 3	0.00%	(5,541,229)	10,522,897	20,701,100	42,175,179	1.78	1.40
Year 4	0.00%	(8,483,988)	10,647,464	7,246,116	43,110,657	1.42	1.40
Year 5	0.00%	(12,343,175)	10,887,198	(7,718,630)	44,395,205	1.13	1.40



Financial Projection Debt Coverage

Fiscal Year	Projected Rate Adjustments	Adjusted Operating Income	Target Operating Income	Projected Cash Balances	Recommended Minimum Cash	Debt Coverage Ratio	Target Debt Coverage Ratio
Year 1	0.00%	\$ (1,034,980)	\$10,273,763	\$ 35,313,396	\$ 40,304,223	2.34	1.40
Year 2	0.00%	(2,704,765)	10,398,330	29,549,231	41,239,701	2.14	1.40
Year 3	0.00%	(5,541,229)	10,522,897	20,701,100	42,175,179	1.78	1.40
Year 4	0.00%	(8,483,988)	10,647,464	7,246,116	43,110,657	1.42	1.40
Year 5	1.50%	(10,379,999)	10,887,198	(5,755,455)	44,395,205	1.43	1.40



Financial Projection

Operating Income Adjustments

Fiscal Year	Projected Rate Adjustments	Adjusted Operating Income	Target Operating Income	Projected Cash Balances	Recommended Minimum Cash	Debt Coverage Ratio	Target Debt Coverage Ratio
Year 1	9.50%	\$10,917,349	\$10,273,763	\$ 47,265,726	\$ 40,304,223	3.86	1.40
Year 2	1.00%	10,736,993	10,398,330	55,331,769	41,239,701	3.88	1.40
Year 3	2.00%	10,860,388	10,522,897	63,723,187	42,175,179	3.94	1.40
Year 4	1.50%	10,319,407	10,647,464	70,469,815	43,110,657	3.93	1.40
Year 5	2.50%	10,379,244	10,887,198	80,282,259	44,395,205	4.88	1.40



Financial Projection

Minimum Cash Reserve Target

Fiscal Year	Projected Rate Adjustments	Adjusted Operating Income	Target Operating Income	Projected Cash Balances	Recommended Minimum Cash	Debt Coverage Ratio	Target Debt Coverage Ratio
Year 1	4.00%	\$ 3,997,579	\$10,273,763	\$ 40,345,956	\$ 40,304,223	2.98	1.40
Year 2	1.00%	3,689,427	10,398,330	41,139,540	41,239,701	2.97	1.40
Year 3	2.00%	3,603,893	10,522,897	41,813,217	42,175,179	2.98	1.40
Year 4	3.50%	3,639,925	10,647,464	43,168,289	43,110,657	3.26	1.40
Year 5	0.90%	3,216,620	10,887,198	44,930,808	44,395,205	3.66	1.40



Financial Projection Recommended Rate Track

Fiscal Year	Projected Rate Adjustments	Adjusted Operating Income	Target Operating Income	Projected Cash Balances	Recommended Minimum Cash	Debt Coverage Ratio	Target Debt Coverage Ratio
Year 1	2.80%	\$ 3,997,579	\$10,273,763	\$ 40,140,956	\$ 40,304,223	2.98	1.40
Year 2	2.80%	6,064,412	10,398,330	43,514,526	41,239,701	3.27	1.40
Year 3	2.80%	7,144,652	10,522,897	47,806,147	42,175,179	3.43	1.40
Year 4	2.80%	8,353,199	10,647,464	52,069,264	43,110,657	3.62	1.40
Year 5	2.80%	8,788,985	10,887,198	59,693,430	44,395,205	4.55	1.40



Notice the Power of Small Yearly Increases



Financial Projection

Base Case – No Rate Increase

Fiscal Year	Projected Rate Adjustments	Adjusted Operating Income	Target Operating Income	Projected Cash Balances	Recommended Minimum Cash	Debt Coverage Ratio	Target Debt Coverage Ratio
Year 1	0.00%	\$ (1,034,980)	\$10,273,763	\$ 35,313,396	\$ 40,304,223	2.34	1.40
Year 2	0.00%	(2,704,765)	10,398,330	29,549,231	41,239,701	2.14	1.40
Year 3	0.00%	(5,541,229)	10,522,897	20,701,100	42,175,179	1.78	1.40
Year 4	0.00%	(8,483,988)	10,647,464	7,246,116	43,110,657	1.42	1.40
Year 5	0.00%	(12,343,175)	10,887,198	(7,718,630)	44,395,205	1.13	1.40



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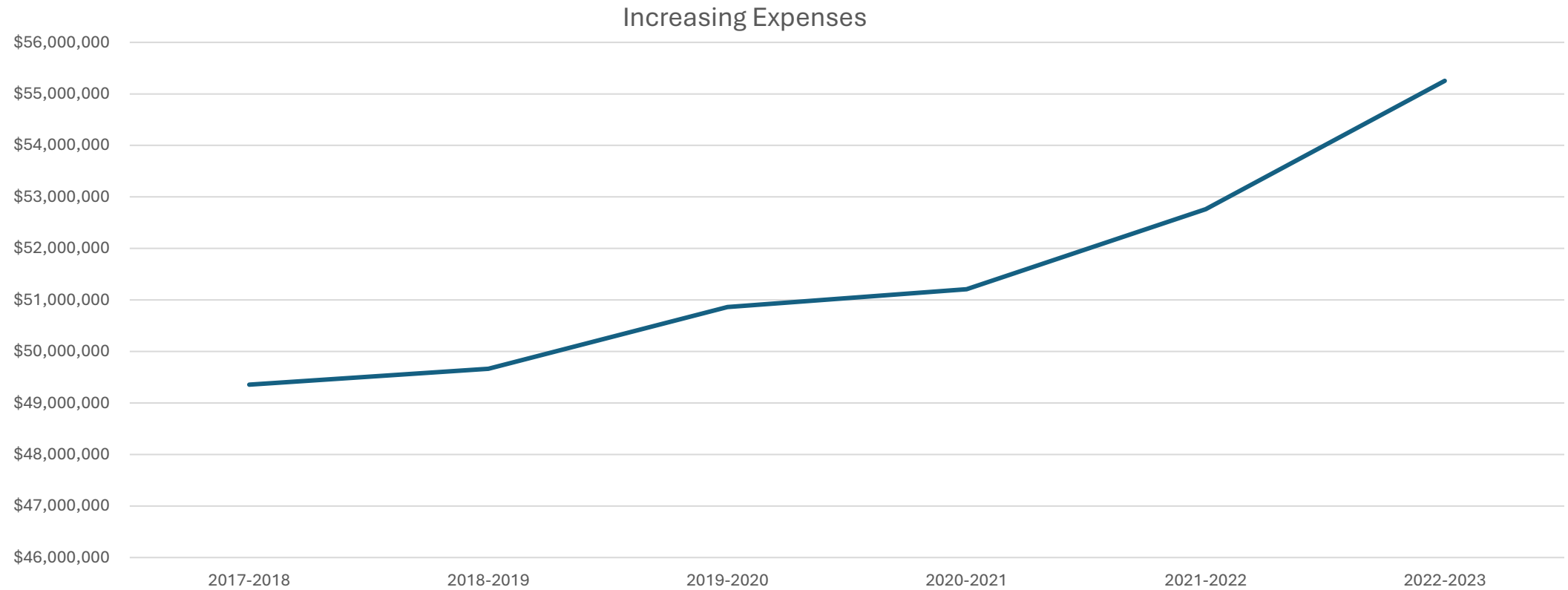




*You don't need to be a
financial wizard to see it!*



Increasing Expenses = Increase Rates*



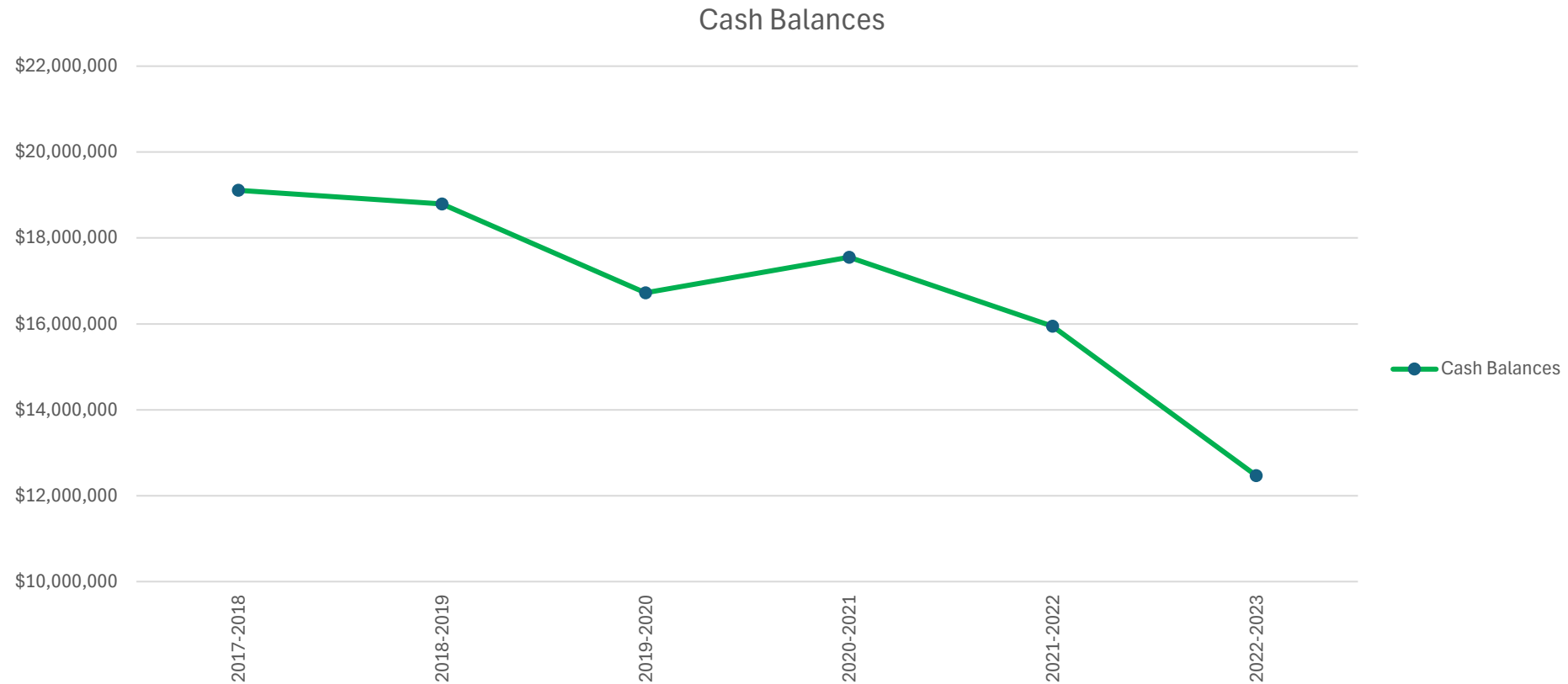
* All other things being equal



Operating Income Down = Increase Rates*



If Cash is going Down = Increased Rates*



Other Policies that Help Financial Stability



- Power Cost Adjustment

- An approved mechanism to pass on fluctuations in monthly power supply costs to customers.
- Can be in the form of a credit or a charge.



- Capital Improvement Program (at least 5 years)

- Line Extension Policy

- Identifying the benefit a new customer brings to the system (contribution margin) and what the utility should contribute towards new growth.
- Goal is to bring on new customers without harming existing ratepayers.



- Adopting a Multi-Year Rate Design



Key Takeaways

Power Up Your Financial Policies

- Shared Goal = Reliability
- Reliability depends on financial stability – three metrics
 - Do I have a positive operating income?
 - Do I have adequate cash reserves?
 - Am I meeting debt coverage?
- Tools: Financial statements, approved policies with action, trend graphs
- Commit to a long-term rate adjustment plan to create financial health and stability

