M E M O R A N D U M

EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Simpson, Brown, Helgeson, Manning and Mital

FROM: Roger Gray, General Manager; Debra Smith, Assistant General Manager;
Cathy Bloom, Finance Manager; Sue Fahey, Fiscal Services Supervisor;
Adam Rue, Senior Financial Analyst; Harvey Hall, Principal Project Manager

DATE: March 13, 2013

SUBJECT: Electric Utility Financial Strategies Update

Issue

On March 5th we provided you an update in regard to the work we are doing to help stabilize the financial health of the organization. The financial health is measured based on shortfalls (i.e., gaps) which are reflected in the long-term financial plan. These gaps represent projections of financial metrics that fall short of the financial targets in the Board's Financial Policies. Below is an update regarding the work we are performing in regard to the strategies for the Electric Utility.

Background

Attached is the information provided at the March 5th Board meeting regarding the long-term financial plan (LTFP) updated based on changes in power prices and generation. This LTFP is considered the baseline in which we are recommending changes to close the financial gaps.

To eliminate the 2014 projected operating shortfall, achieve a 2.0 debt service coverage (DSC) per Board Policy and maintain the current LTFP's 2014 3% base rate increase (note: the LTFP 2014 assumption for base rate increase is 3% and 0.25% for Carmen-Smith or a total of 3.25%), it would require: 1) reducing expenses by $20 million, 2) reducing debt service costs by $10 million, 3) increasing rates by 20%, or 4) some combination thereof. There are four primary"dials" that Management and the Board can use to balance EWEB's financial metrics – (1) service levels, (2) DSC, (3) rate changes and (4) risk.

Discussion

Over the last several months in an effort to close the financial gap Management has been working on Financial Initiatives which include capital reductions, deferral of bond issuances, operating and maintenance reductions, and asset sales. At the March 5th Board meeting we introduced a conceptual model with these primary dials so that the Board could develop a better understanding of how these different initiatives "flow through" to EWEB financial outcomes. For example, we saw how reductions in O&M have a different impact than reductions in capital and that one-time revenues (e.g. from asset sales) are different than year-over-year revenues (e.g. revenues from rate increases). Below is a table that provides options to close the financial gap that displays the impacts on the "dials" mentioned above.

Electric Long Term Financial Plan Scenarios	Board Decision "Dials"			
Scenario	Approximate Rate Increase*	Debt Service Coverage/Implied Bond Rating	Capital/O&M Service Level Reductions (excluding debt deferrment)	Operational Related Risk
1. Business as usual	20%	2.00/AA	No additional dollar reductions.	No service/customer impacts relative to status quo
2. Base rate increase of 3%; maintain 2.0 Debt Service Coverage	3%	2.00/AA	~$20 million/Very large FTE impact	Serious and immediate service and customer impacts.
3. Balanced Option A	5%	1.75/A	~$9 million/ Up to 20 FTE impact	Moderate and some delayed service/customer impacts.
4. Balanced Option B	7%	1.75/A	~$6.5 million/Up to 10 FTE	Minor to moderate service/customer impacts.
* Includes 3% base rate assumption				

Attached are summaries of the financial initiatives that Management has been working on as well as the LTFP metrics for scenarios #3 and #4.

At the March 19th Board meeting, Management will be prepared to disucss these and potentially other scenarios as well as the impacts in more detail.

Recommendation

Management recommends Scenario #3 – Balanced Option A to help close the financial gap and set the direction for 2014 Budget development.

Requested Board Action

Management is not requesting approval of a 2014 budget. However, Management is requesting clear indication and feedback from the Board regarding direction so that we can continue to develop definitive proposals. Management recommends that the Board either signal general approval of Scenario #3 or a clear alternative. Again Scenario 3 – Balanced Option A provides direction for 1) Board financial policies for financial metric targets, 2) Long term financial plans and budget development and 3) Deferral of bond issuance. If approved, Board policies would be revised for future Board action and staff would begin incorporating the option into the long term financial plans and budget development process.

Electric Long Term Financial Plan Assumptions/Results
October 2012 with Updated Sales Revenue and Power Costs

February 2013

Retail Revenue Assumptions

- 2.4 million MWH's retail sales for 2014, with no material load growth in subsequent years.
- Projected rate increases as follows:

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Base Rate Increase	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
BPA		2.5%		2.5%		2.5%		2.5%	
Carmen Smith Debt	0.25%	0.75%	1.0%	0.75%	0.50%				
Total	**3.25%**	**6.25%**	**4.0%**	**6.25%**	**3.5%**	**5.5%**	**3.0%**	**5.5%**	**3.0%**

- Addition to (reduction from) reserves:

(in millions)	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Change in Reserve Balance	($3.7)	($4.2)	($6.8)	$0.4	$7.1	$10.8	$22.0	$21.2	$28.2

Power and Wholesale Sales Assumptions

- Assumes ***90% generation*** in all years and:
  - Includes 2013 BPA power cost increase of $7.1 million, or 10%
  - Forward price curve (see below)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Melded Mid Mkt	$32.72	$35.82	$38.53	$41.00	$44.55	$47.07	$50.54	$53.95	$57.99

*** Prices based on ICE forward price curve through 2020 and escalated for 2021&2022 based on prior two year's rate of increase**

Operations and Maintenance Assumptions

Non-Labor (O&M)

- Non-labor escalation is 2.1% annually as per US Bureau of Labor Statistics Portland-Salem 10 year average
- Advanced Meter Infrastructure (AMI) cost savings from Business Case included beginning in 2016 of $1.5 – 2.5 million annually

Labor/Benefits

- Salary escalation of 2.1% annually
- Health Insurance increases of 15.6% in 2014 (due to use of reserves in 2013) and 8.6% annually in subsequent years
- PERS increase of 2.5 percentage points in July 2013 and related $85 Million Debt Issuance at the end for 2013, with related reduction in PERS costs in 2014.
- No additional FTE

Capital and Debt Related

- Capital expenditures as per Capital Improvement Plan.
- Bonds issued for Carmen Smith of $40 million in 2014 and $55 million in 2016.
- Bonds issued for AMI of $16 million and Type II work of $15 million in 2015.

Debt Service Ratio

	Policy Target	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Proposed LTFP Debt Service Coverage	2.00 – 2.50	1.39	1.36	1.27	1.42	1.57	1.66	1.83	1.96	2.13

Electric Long Term Financial Plan Results

Scenarios 3 and 4

March 2013

Scenario #3 - Balanced Option A	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Rate Increases	5.00%	5.50%	5.25%	5.50%	5.25%	5.50%	3.00%	5.50%	3.00%
Change in Reserves	5,900	7,200	7,100	12,700	17,900	22,400	33,200	38,200	36,000
Debt Service Coverage	1.77	1.78	1.67	1.84	2.01	2.07	2.25	2.42	2.61

Scenario #4 - Balanced Option B	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Rate Increases	7.00%	5.50%	5.25%	5.50%	5.25%	5.50%	3.00%	5.50%	3.00%
Change in Reserves	5,800	8,400	8,600	14,300	19,900	24,300	35,300	40,500	38,400
Debt Service Coverage	1.76	1.83	1.72	1.89	2.07	2.12	2.31	2.48	2.68

Summary of Financial Initiatives - Scenario #3 Balanced Option A

Initiative #	Initiative Item	Description	2014 LTFP Changes
	Capital Improvement Plan Reductions (Deferrals)		
1	Type 1 - Rate Funded	$3.7M Reduction	-
2	Type 2	$1.6 Reduction	-
3	Type 3	CS 2014 $40M & PERS $85M Canceled	6,200,000
		Capital Initiatives Total	6,200,000
4	O&M Reductions/Revenue Enhancements (On-Going)		
	Lower Risk		1,200,000
	Higher Risk		2,500,000
		Total Non-Labor O&M/Revenue	3,700,000
	Asset Sales (On-Going/One Time)		
5	Property Sales	$5,000,000 in anticipated sales 2013-15	-
6	Generation Asset Sales	$10,000,000 in potential net asset sales 2014-15	-
7	Other Electric Asset Sales		-
		Total Asset Sales	-
		Inititiative Total	$ 9,900,000
		Target to get to a 1.75 Debt Service Ratio	$ 11,800,000
		Savings Amount Over <Under>	$ (1,900,000)
		See NOTE below: 2 % Additional Rate Increase ($1.1M Per %)	$ 2,200,000

Notes:

The 2% Rate Increase would be in addition to the already planned 3.0% Electric Rate increase

2014 Service Level Changes	
Capital Improvement Plan Reductions (Deferrals)	
Type 1 - Rate Funded	$3,700,000
Type 2	$1,600,000
Total Capital Reductions (Defferals)	$5,300,000
O&M Reductions/Revenue Enhancements (On-Going)	
Lower Risk	$1,200,000
Higher Risk	$2,500,000
Total O&M Reductions/Revenue (On-Going)	$3,700,000
Total Service Level Changes	$9,000,000

Summary of Financial Initiatives - Scenario #4 Balanced Option B

Summary of Financial Initiatives - Scenario #4 Balanced Option B			
Initiative #	Initiative Item	Description	2014 LTFP Changes
	Capital Improvement Plan Reductions (Deferrals)		
1	Type 1 - Rate Funded	$3.7M Reduction	-
2	Type 2	$1.6 Reduction	-
3	Type 3	CS 2014 $40M & PERS $85M Canceled	6,200,000
		Capital Initiatives Total	6,200,000
4	O&M Reductions/Revenue Enhancements (On-Going)		
	Lower Risk		1,200,000
	Higher Risk		-
		Total Non-Labor O&M/Revenue	1,200,000
	Asset Sales (On-Going/One Time)		
5	Property Sales	$5,000,000 in anticipated sales 2013-15	-
6	Generation Asset Sales	$10,000,000 in potential net asset sales 2014-15	-
7	Other Electric Asset Sales		-
		Total Asset Sales	-
		Inititiative Total	$ 7,400,000
		Target to get to a 1.75 Debt Service Ratio	$ 11,800,000
		Savings Amount Over <Under>	$ (4,400,000)
		See NOTE below: 4 % Additional Rate Increase ($1.1M Per %)	$ 4,400,000

Notes:

4% Rate Increase would be in addition to the already planned 3.0% Electric Rate increase

2014 Service Level Changes	
Capital Improvement Plan Reductions (Deferrals)	
Type 1 - Rate Funded	$3,700,000
Type 2	$1,600,000
Total Capital Reductions (Defferals)	$5,300,000
O&M Reductions/Revenue Enhancements (On-Going)	
Lower Risk	$1,200,000
Higher Risk	
Total O&M Reductions/Revenue (On-Going)	$1,200,000
Total Service Level Changes	$6,500,000