



TO: Board of Directors
THRU: Mark Foree, General Manager
FROM: John Erwin/Jeff Tissier
DATE: December 6, 2013
SUBJECT: **Review of TMWA's financial position and possible action in regard to implementation of the Phase 3 rate adjustment previously adopted by the Board in January, 2012**

RECOMMENDATION

With Phase 2 rate adjustments scheduled for implementation February 2014, Staff and TMWA's Standing Advisory Committee ("SAC") recommend the Board delay implementation of previously adopted Phase 3 rates from February 2014 to February 2015.

Outside of delaying the Phase 3 rate adjustment no other action is required by the Board at this time. However, should the Board desire, instead, to change or modify its previously-adopted rate adjustments, it would trigger the requirements for conducting additional public workshops otherwise applicable to new rate adjustment proposals.

DISCUSSION

In 2011, SAC recommended the Board implement Phase 1 rates beginning February 2012 and implement Phases 2 and 3 according to schedule subject to annual review of TMWA financial performance. At its January 18, 2012 meeting the Board approved and adopted such adjustments to be effective and implemented as follows:

- i) Phase 1 Rates - commencing for the first billing cycle for February 2012;
- ii) Phase 2 Rates - commencing for the first billing cycle for February 2013;
- iii) Phase 3 Rates - commencing for the first billing cycle for February 2014.

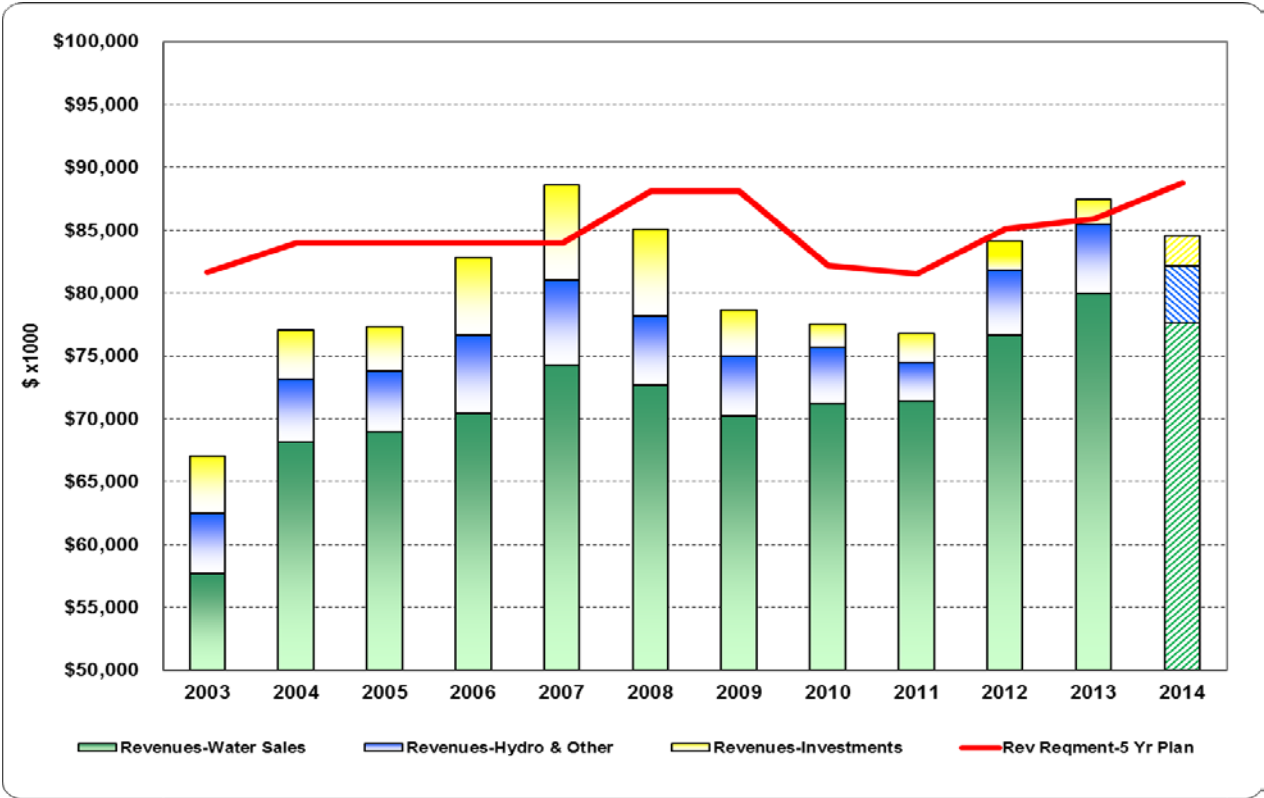
Phase 1 rates were implemented in February 2012.

At its December 2012, SAC again recommended implementation of Phase 2 rates beginning February 2013. At its December 12, 2012 meeting the Board "delayed implementation of the previously approved second phase rate adjustment until the first billing cycle in February, 2014,"

such that both the Phase 2 and Phase 3 adjustments would commence the first billing cycle in February 2014 [December 12, 2012 Minutes]. Phase 2 rates will be implemented effective the first billing cycle in February 2014.

TMWA’s certified audit for FY13 was completed in November 2013 and the results did not change from the initial October 2013 Board presentation.

The following graphic shows all revenue sources by fiscal year when compared to the annual revenue requirement (or cost of service). Due to the weather effects and extra hydrogeneration, TMWA met the total projected revenue requirement in FY13. Prior to that, FY07 was the only time in TMWA’s history that the revenue requirement was met. All other years TMWA has operated in a deficit situation, either spending its cash reserves or issuing debt.



Although revenues were higher in FY12 and FY13, it was the result of unusually warm spring weather patterns. Water sales can vary significantly as a function of the weather. FY12 water production (74,495 acre feet) was 9.39 percent higher than FY11 water production (68,098 acre feet); FY13 water production (76,714 acre feet) was 2.98 percent higher than FY12 water production. Water sales corresponding to FY11, FY12 and FY13 were \$71.4M, \$76.5M, and \$79.9M, respectively.

The projected rate and revenue requirements for all three phases of the rate adjustments are based on 2011 usage which more closely match the median and mean growing conditions of longer term historic weather conditions. FY14 projected revenues from water sales remain below the FY14 revenue requirement (refer to Item No. 7 on Agenda discussing first quarter results of FY14). Phase 2 rate adjustments scheduled to go into effect in February of 2014 will offset a portion of the projected revenue deficit.

The implementation of the scheduled Phase 2 (3.4%) and Phase 3 (2.1%) rate adjustments, in combination with active cost control activities by staff, continue to close the revenue-to-expense gap. Current average monthly bills for 3/4 inch residential services compared to monthly averages after Phase 2 and 3 rate adjustments are shown in the next table.

	Current Averages	Phase 2 Scheduled Feb 2014	Phase 3 Scheduled Feb 2014
3/4" Metered Rate Single Family Residence			
1 Average Monthly Bill	\$41.64	\$43.06	\$43.94
2 Delta Prior Year Avg Monthly Bill		\$1.42	\$0.88
3 Percent Delta Prior Year Avg Monthly Bill		3.41%	2.04%
4 Average Daily Cost	\$1.37	\$1.41	\$1.44
5 Delta Prior Year Avg Daily Cost	\$0.05	\$0.04	\$0.03
3/4" Flat Rate Single Family Residence			
6 Average Monthly Bill	\$94.10	\$100.63	\$105.06
7 Delta Prior Year Avg Monthly Bill		\$6.53	\$4.43
8 Percent Delta Prior Year Avg Monthly Bill		6.94%	4.40%
9 Average Daily Cost	\$3.09	\$3.31	\$3.45
10 Delta Prior Year Avg Daily Cost	\$0.25	\$0.22	\$0.14

At its December 4, 2013 meeting, SAC discussed the final FY13 and for Q1-FY14 financial results. SAC discussion centered on implementing or delaying Phase 3 rate adjustments as much as a year. SAC conclusions on the matter are summarized as follows:

- The Phase 3 rate adjustments are part of the long-term plan to achieve substantial debt reduction within the next few years.
- TMWA continues to play “catch-up” in closing the gap between its revenues and annual revenue requirement. Extra cash in any year can be used to buy-down debt to reduce the annual revenue requirement thereby closing the gap sooner rather-than-later.
- The unexpected weather in 2013 should not be considered a trend away from historic weather patterns.
- The extra cash derived from unexpected revenues is a one-time event, and to use the proceeds to delay rate adjustments rather than buy-down debt may result in the need for higher rate increases in the future.

- The Phase 3 rate adjustments, which apply to the monthly customer charge, are reasonable with minimal impact on customers' rates.

The decision of the SAC members was to implement Phase 3 rate adjustments in February 2015 subject to review of TMWA's finances in Fall 2014.

SUMMARY

Staff's rate adjustment proposals were based on the projected costs summarized in TMWA's 2012-2016 Funding Plan; that plan is still active. While approaching the first of several major refinancing/debt restructuring opportunities, it is critical TWMA continue to rigorously monitor its financial performance and maintain its flexibility to adapt as its performance changes. The proposed Phase 2 and Phase 3 rate adjustments along with TMWA's continued diligence in managing operating expenses are designed to collect sufficient revenues to cover projected expenses through FY14 and maintain TMWA's financial integrity in preparation for potentially significant debt management opportunities beginning in 2015 and extending through 2017.

A build-up of unrestricted cash balances such as that experienced in FY12 and FY13 enhances TMWA's ability to improve its financial position by redeeming outstanding commercial paper or restructuring fixed-rate debt. TMWA has preserved a great deal of financial flexibility to assist with a long-term plan to reap significant savings with an anticipated planned debt restructuring program scheduled to begin in the 2015/2016 timeframe.

Staff, with SAC concurrence, finds a one year delay of Phase 3 rates is a prudent course of action based on healthy FY12 and FY13 financial performance, minimal impact to existing cash should FY14 revenues be less than FY13, time to assess Phase 2 rate effects on revenues, and TMWA remaining on the path to achieve its long-term financial goals as planned.