



STAFF REPORT

TO: Standing Advisory Committee
FROM: John Erwin/Jeff Tissier
DATE: 27 November 2012
SUBJECT: Review of TMWA's financial position in regard to the implementation of second phase of rate adjustment (scheduled to go into effect in February, 2013) approved by the Board in January, 2012

FINDINGS

At its January 18, 2012 meeting the Board approved and adopted rate adjustments to be 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 was implemented by staff in February 2012. The Board anticipated that in late 2012 and late 2013 a review of TMWA's finances would occur to decide whether the timing or implementation of Phase 2 or Phase 3 rates remain appropriate to achieve the intended effect based on the Authority's financial position at that time.

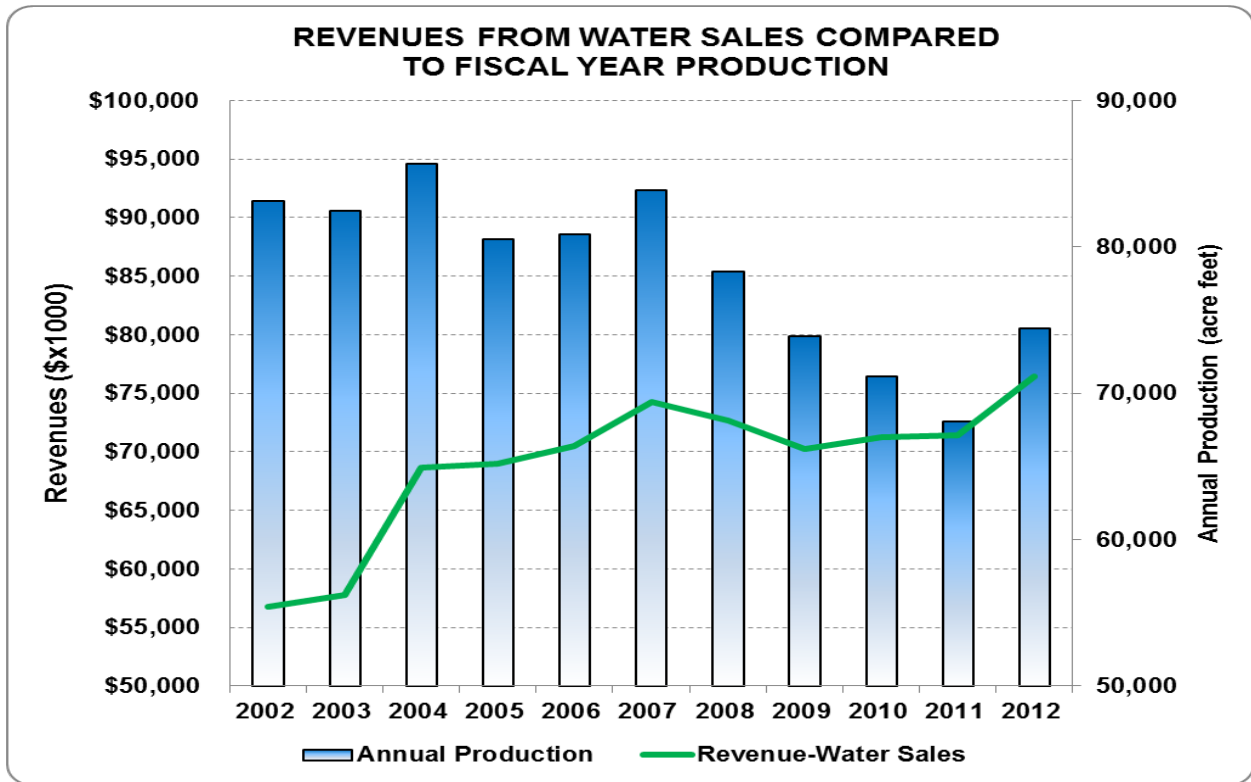
A review of FY2012 water sales and revenues determined the following:

- FY2012 total water production was 9.4% greater than FY2011.
- Precipitation data for 1974 to 2012 indicates:
 - Spring 2012 is 9th driest spring with the 2nd fewest number of precipitation days
 - 2012 is warmer than 90% of the years in the time horizon
 - 2010 and 2011 represent typical precipitation patterns
- FY2012 revenues from all sources (water sales, hydroelectric generation, investment income, and other charges/rents) of \$84.1 million exceeded FY2011 revenues of \$78.6 million by \$5.5 million.
 - FY2012 hydroelectric generation sales were approximately \$0.5 million over FY2011.
 - Monthly customer rates, adjusted in February 2012, added approximately \$0.85 million to FY2012 revenues.

- FY2012 earned, but unbilled, water sales revenues are approximately \$1.2 million greater than FY 2011.
- The unexpectedly warm and dry condition during the winter and spring of 2011/2012 resulted in approximately \$3.3 million in additional water sales revenue.¹

DISCUSSION

At its October 2012 meeting, SAC discussed the findings of TMWA staff analysis of daily precipitation data for the years 1974-2012 and temperature data for the years 1973 to 2012. The analysis compared Spring 2012 weather patterns with prior springs to determine if Spring 2012 was an extreme event. Results indicate that was indeed the case. The following graphic compares fiscal year water production to revenues from water sales since FY2002; a 6,400 acre foot increase in water production FY2012 over FY2011 occurred as a result of the weather.

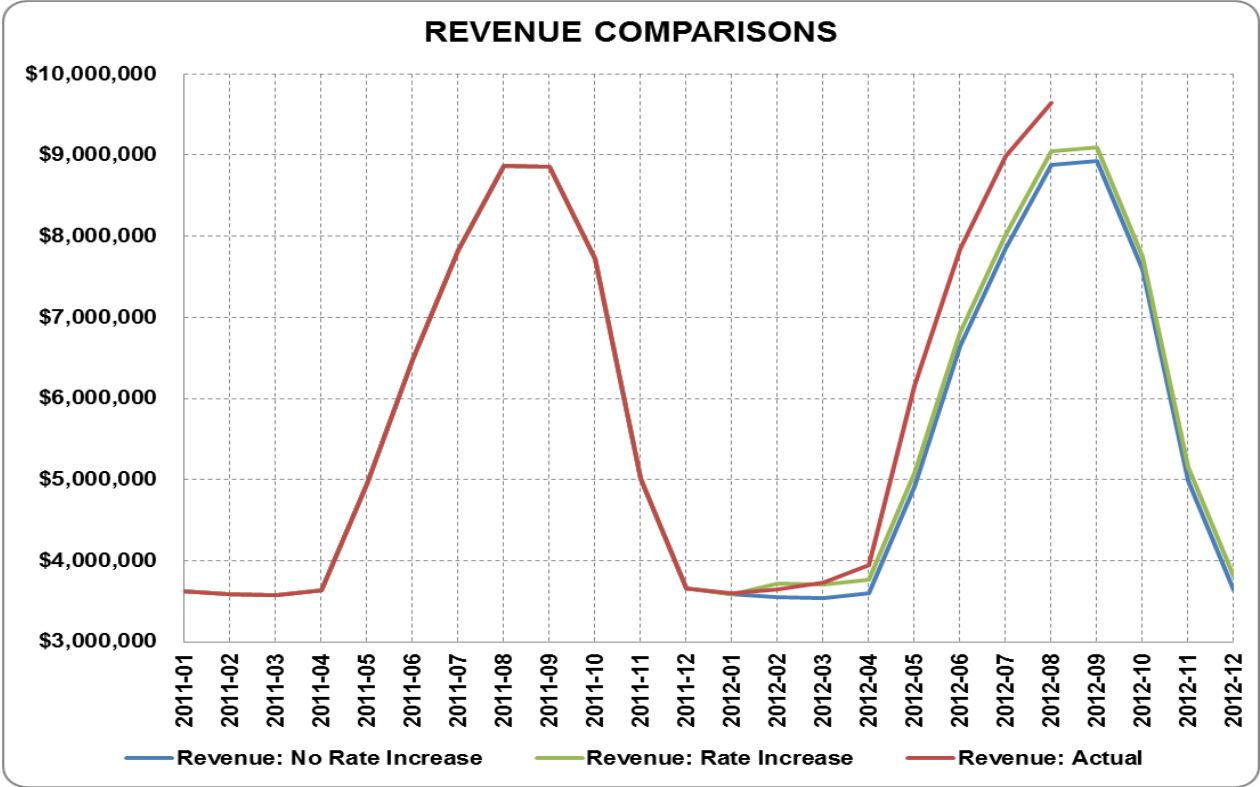


The above graphic’s green line illustrates the direct effect water consumption has on revenues and how both consumption *and* revenue can vary significantly as a function of the weather. In fact FY2012 water production was 9.4 percent higher than FY2011 water production.

The following graphic further explains the effect of weather on water sales by separating the various differences in revenues when comparing retail/residential revenues: (a) without adjusting

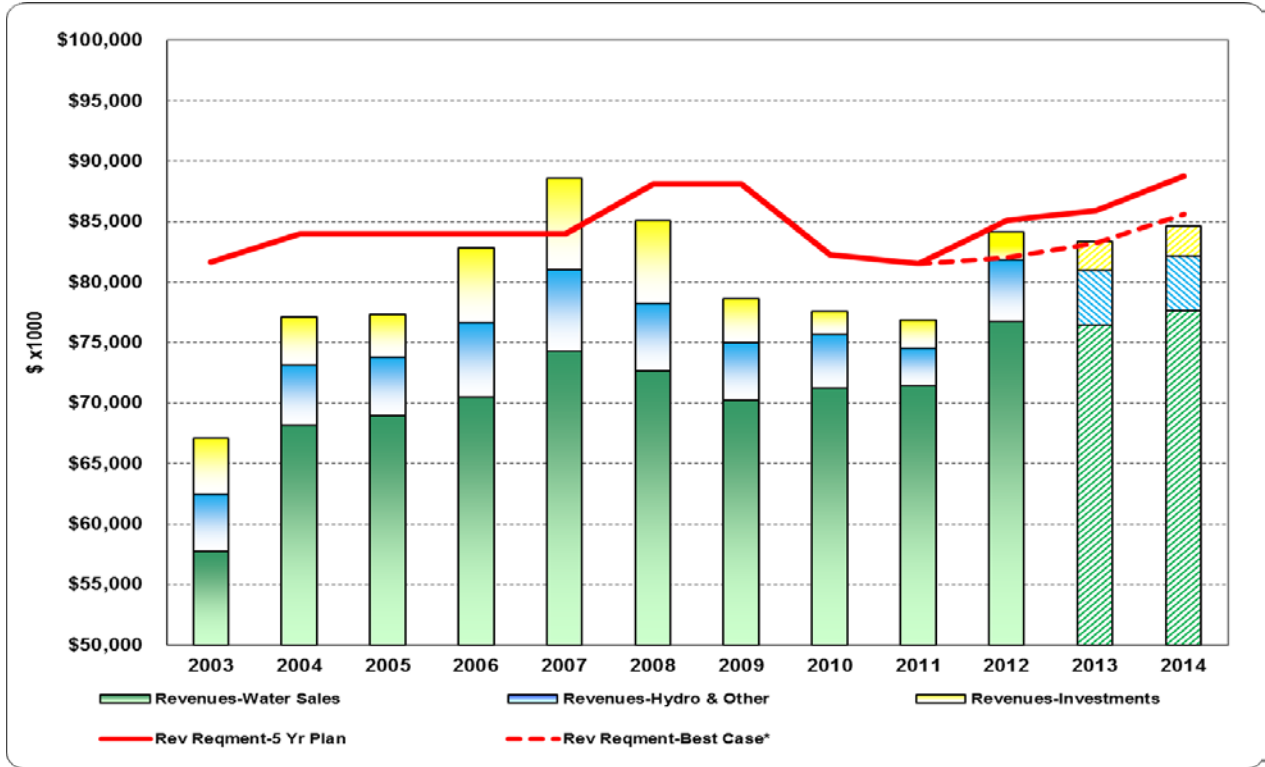
¹ About \$2.8 million of the \$3.3 million is estimated from April to June 2012 billings, the balance of about \$0.5 million is from the fall and winter of 2011 billings.

monthly customer charges (blue line); (b) adjusting monthly customer charges (green line); and (c) the estimated revenues from the change in volume of water sold between the spring months of 2011 to 2012 (red line).



The estimated revenues resulting from the difference in volume of water sold in the spring months (April through June) between 2011 and 2012 is approximately \$2.8 million. When combined with additional water sales revenues (estimated to be \$0.5 million) that occurred in the fall and winter, the combined effect of these warmer conditions produced approximately \$3.3 million in additional revenues above those added by the approximately \$0.850 million from adjusting the monthly customer charges in February 2012.

The final graphic, below, shows all revenue sources by fiscal year when compared to the annual revenue requirement (or cost to service). Due to the weather effects and extra hydroelectric generation (approximately \$0.5 million during the fiscal year), FY2012 revenues almost equaled the projected revenue requirement for FY2014. Projected Phase 1 revenues from water sales were \$74.015 million; actual FY2012 revenues were \$76.5 million. Projected water sales revenues from Phase 2 rate adjustments are expected to be \$76.3 million. Because 2012 weather represented an extreme event, it is unlikely water-sale revenues will remain at their elevated Spring 2012 levels.



Debt Retirement and Restructuring

Despite an overall operating costs reduction of over \$7.3 million (18%) in the past 3 years, TMWA is still experiencing upward operating-cost pressure and expects this trend to continue—particularly with activities related to electrical pumping. Revenues are also impacted by declining investment income due to diminished cash balances and lower, recession-level rates of return on maturing investments. Additional factors are potentially-downward trends in local and national customer usage patterns, and minimal-to-no expected growth in services in the near future. All of these conditions will continue to challenge TMWA’s financial performance and potentially limit the organization’s debt management opportunities. Given that TMWA has gone to extreme lengths to control operating expenses, debt management remains a key area for controlling future cost-of-service to produce water. To preserve its ability to access low-cost capital, TMWA must continue to maintain or strengthen its senior lien debt coverage ratio in a manner satisfactory to the credit rating agencies and capital markets. TMWA has established certain financial metrics to be achieved consistent with credit rating and bond market expectations. Credit rating agencies are concerned about TMWA’s responsibility to protect its creditors.

TMWA’s unrestricted cash balance is not an element of its debt coverage ratios (DSC). Only ongoing operating revenues and investment income count toward the coverage ratio since developer fee collections are virtually non-existent. Although unrestricted cash balances are not a part of the DSC calculations, these balances have been a key element in preserving TMWA’s credit ratings since they currently demonstrate strong liquidity. A significant, unexpected decline in unrestricted cash reserves can have serious ramifications in the future.

A build-up of unrestricted cash balances, such as that experienced this past FY2012, enhances TMWA’s future ability to improve its financial position and redeem outstanding commercial paper. All revenues generated in excess of expenses are part of the long-term plan to produce the significant savings for TMWA anticipated in the planned debt restructuring, scheduled to begin in 2015 through 2017.

Rate Revisions

The following table compares, by class, the cost to serve a customer class and the projected revenues from each rate adjustment phase to FY2011 and FY2012 actuals.

| | Cost of Service | FY11 Actual Revenues | Projected Phase 1 Revenues | FY12 Actual Revenues | Delta | Projected Phase 2 Revenues | Projected Phase 3 Revenues |
|----------------------|-----------------|----------------------|----------------------------|----------------------|-----------|----------------------------|----------------------------|
| | | | | | d-c | | |
| | ----a---- | ----b---- | ----c---- | ----d---- | ----e---- | ----f---- | ----g---- |
| Flat residential | \$7,263 | \$6,560 | \$6,738 | \$6,007 | (\$731) | \$7,218 | \$7,569 |
| Flat Multi-family | 4,789 | 5,051 | 4,968 | 4,919 | (49) | 4,968 | 4,968 |
| Meter residential | 39,955 | 34,668 | 36,393 | 38,429 | 2,035 | 37,625 | 38,389 |
| Metered Multi-family | 3,310 | 2,969 | 3,027 | 3,187 | 160 | 3,090 | 3,129 |
| Commercial | 11,642 | 10,214 | 10,445 | 10,509 | 64 | 10,854 | 10,932 |
| Irrigation | 9,007 | 7,725 | 8,068 | 8,802 | 733 | 8,130 | 8,168 |
| Private fire | 1,375 | 1,282 | 1,338 | 1,362 | 24 | 1,351 | 1,373 |
| Sun Valley GID | 1,162 | 980 | 1,012 | 1,028 | 16 | 1,036 | 1,063 |
| County Whsl | 2,100 | 1,958 | 2,027 | 2,445 | 418 | 2,060 | 2,090 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| Totals | \$80,602 | \$71,408 | \$74,015 | \$76,687 | \$2,672 | \$76,332 | \$77,680 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== |

Current average monthly bills for ¾ inch residential services compared to Phase 2 and 3 rate monthly averages are shown in the next table.

| | Current Averages | Proposed Year 2 | Proposed Year 3 |
|--|------------------|-----------------|-----------------|
| ¾" 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 |
| ¾" 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 |

FY2013 Revenue and Expense Expectations

First quarter FY2013 revenues are approximately \$2.7 million over budget and expenses for the same period are approximately \$0.3 million over budget, for a net of \$2.4 million revenues-over-expenses thus far in FY2013. Projected revenues for FY2013 are based on historic revenues driven by typical spring weather patterns.

With the unexpected FY2012 revenues coupled with the additional revenues generated in the first quarter of FY2013, TMWA has an opportunity to delay the Board adopted Phases 2 and 3 rate adjustments by at least a year. Pursuant to SAC and Board direction, an annual revenue of TMWA financial performance each fall allows TMWA to assess its financial future and make adjustments, or not, to customer water rates. Given that current financial performance far exceeded expectations, it is not unreasonable to consider delaying implementation of the Phase 2 and 3 rate adjustments to 2014 rather than 2013, giving TMWA another year to analyze its finances and the timing of rate adjustments.

So long as the amount of the previously-adopted rate adjustment is not modified, the Board may delay the implementation date of the adopted rate adjustment consistent with the Board's action in February 2012 without triggering the requirements for conducting additional public workshops otherwise applicable to new rate increases.

SUMMARY

Staff's rate adjustment proposals were based on the projected costs summarized in TMWA's 2012-2016 Funding Plan. As of this writing, that plan is still active. Despite the positive growth in FY2012 and first quarter FY2013 revenues, over the planning period the potential exists to have a gap of approximately \$5 million between estimated future revenues and expenses—even after the February 2012 rate adjustments. 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 rate adjustments along with TMWA's continued diligence in managing operating expenses are designed to collect sufficient revenues to cover projected expenses through FY2014 and maintain TMWA's financial integrity in preparation for potentially significant debt management opportunities beginning in 2015 and extending through 2017.