

Ins and Outs of Utility Financial Planning

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UTILITY FINANCIAL PLANNING CONSIDERATIONS FROM A MUNICIPAL PERSPECTIVE

FINANCIAL PLANNING FOR UTILITY FUNDS

- *Financial planning is always important but even more so in these times*
 - Inflation is at an all time high and hitting operational costs.
 - Construction costs are way up causing some CIP costs to now be DOUBLED and TRIPLED in price.
 - Delayed maintenance gives short term financial relief but not reinvesting in your infrastructure may cause public health and safety concerns, compliance issues resulting in higher costs.
 - Long term debt financing must be well thought out with a balance of cash versus debt, timing of when to sell debt and how much will be needed. ***This process does not happen quickly and shouldn't!***
 - Infrastructure grants are becoming available but are very competitive and application must be well planned.

FINANCIAL PLANNING FOR UTILITY FUNDS

- *Why is a rate study important for a City/Town Manager, Utility Director, Finance Professionals and Citizens?*
 - City/Town Manager- As the CEO of the organization, they are responsible for the financial sustainability of the municipality for all funds, including utility funds such as water, sewer, sanitation, etc. We will be focusing on water and sewer in today's presentation.
 - Utility Director – The Utility Director is responsible for treatment and distribution of water and collection and treatment of wastewater in a compliant and safe manner, through operations and infrastructure maintenance.
 - Tell the Manager and Finance Professionals what operational and capital resources are necessary.
 - Provide the revenue and expenditure information needed for the rate study to the finance professionals.

FINANCIAL PLANNING FOR UTILITY FUNDS

- *Why is a rate study important for a City/Town Manager, Utility Director, Finance Professionals and Citizens?*
 - Finance Professionals- Works with Utility Director in completing a rate study either internally or with an outside rate consultant to determine:
 - Long term debt financing (if needed);
 - Revenue increases and timing needed to fund the various components of the systems;
 - Revenue and debt will be further discussed by Kevin Burnett and Michael Vasquez;
 - Responsible for following Arizona State Statutes on publishing and posting dates and presenting (or their consultant if outside) results to Town/City Council in conjunction with the utility director to clearly show what is needed and why it is needed in an easily understandable format.

FINANCIAL PLANNING FOR UTILITY FUNDS

- *Why is a rate study important for a City/Town Manager, Utility Director, Finance Professionals and Citizens?*
 - Governing Body – Review the results of the utility study, hear from stakeholders or users of the system, determine the objectives they want the City/Town to achieve in the rate study such as conservation, revenue enhancement etc. and finally determine if they are going to increase the rates and if so how much and who pays (i.e. residential vs commercial, etc.)
 - Users of the system (Citizens) – Understand why the rates are increasing and how it impacts their individual bills.

FINANCIAL BASICS FOR PUBLIC UTILITY SYSTEMS

RATE STUDY COMPONENTS

- Financial Plan

- What amount of revenue do we need?

- Cost-of-Service

- Who (which customers) are incurring the costs?

- Rate Design

- How are we recovering the revenue?



FINANCIAL PLAN GOALS

- Meet Annual Expenses
 - Operations and Maintenance
 - Capital
 - Debt Service
- Fund and Maintain Reserves
 - Cash/Working Capital
 - Contingency Reserves
 - Rate Stabilization
 - Asset Maintenance
 - Debt Service
- Debt Service Coverage
 - Legal Requirement



**HOW DO WE GET
THERE?**

SOURCES OF INCOME

- User Rate Revenues
 - Monthly Water & Wastewater Rates
 - Miscellaneous Service Charges
- Impact / Capacity Fees
 - Capital-Related Charges
 - Applied to New Development
- Existing Reserve Funds



EXPENDITURES

- Operating Expenses
 - Personnel Costs
 - Day-to-Day Costs of Providing Service
- Debt Service
 - Parity Debt
 - Subordinate Debt
 - Coverage Requirements
- Other Expenditures
 - Transfers (General Fund, PILOT, etc.)
 - Reserves (Operating, Capital, etc.)



LONG TERM FINANCIAL PLANNING

IMPACTING FORCES



RECENT PROBLEM AREAS

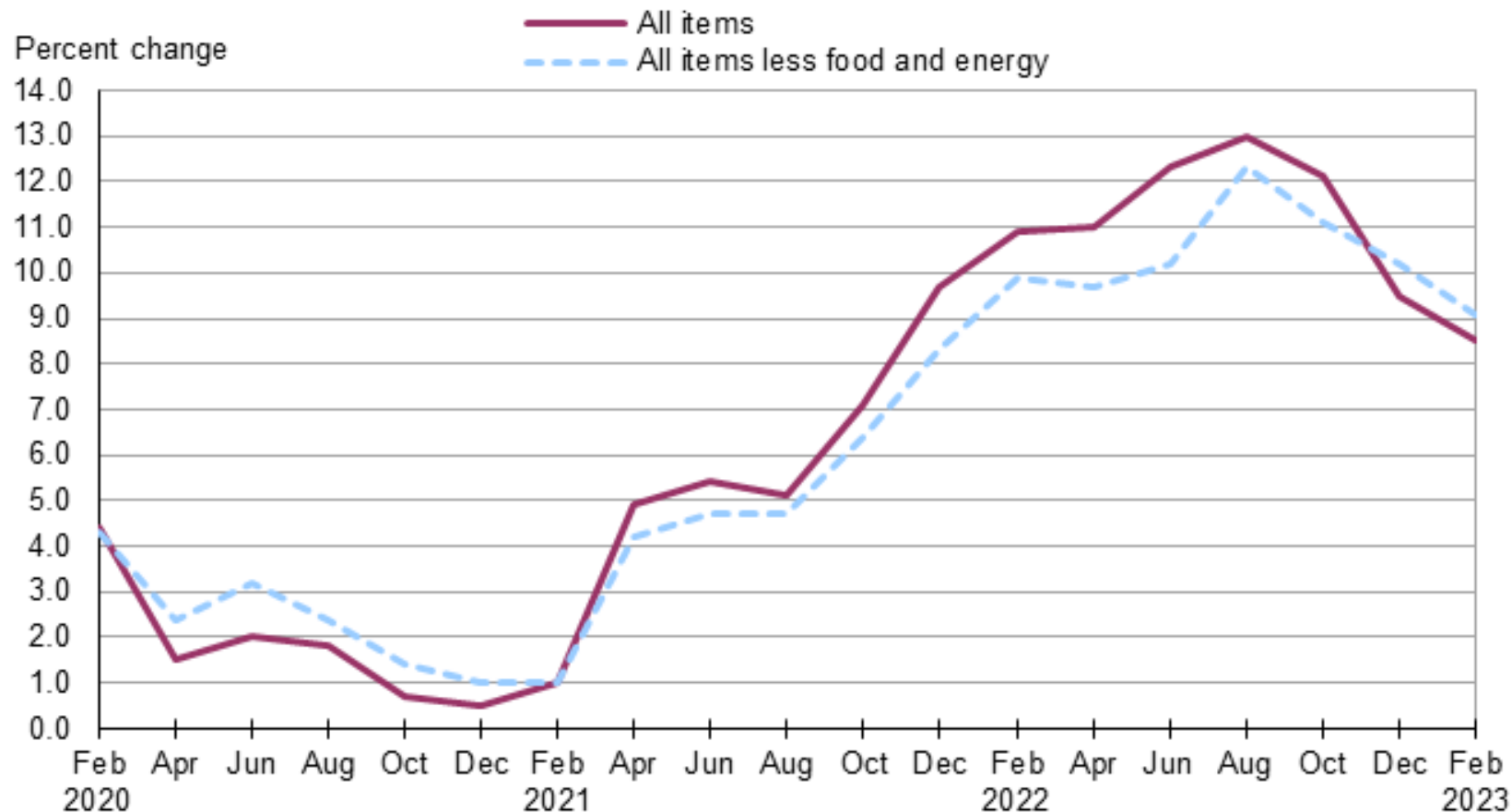
Planners are Faced With:

- Uncertain Growth Trends
- Fluctuating Revenues
- Increasing O&M Costs
- Declining Household Usage
- Equity (new users vs. existing, service area)
- Low Tolerance for Rate Increases



CONSUMER PRICE INDEX

Chart 1. Over-the-year percent change in CPI-U, Phoenix-Mesa-Scottsdale, AZ, February 2020–February 2023



Source: U.S. Bureau of Labor Statistics.

LONG TERM PLANNING

- Establish Long-Term Facility Needs
 - Capital Costs Drive Financial Planning
 - 5 – 10 Year Forecast is Essential
 - 10 – 20 Years Becoming More Common
- Iterative Process to Evaluate Alternatives
 - Management Policies & Decisions
 - Match Funding Sources & Uses
- Manage
 - Cashflow
 - Reserves
 - Debt Service Coverage



Revenues Drive Capital

- Revenues
- Less Operating Expenses
- Less Debt Service
- Less Capital Costs
- Equals Bottom Line Balance
Surplus or Deficit (For Capital)

PAYGO VERSUS DEBT FUNDING

- PAYGO

- Use or build up of cash to fund capital
- May be cheaper compared to borrowing costs

- Debt Funded

- Funding through borrowed funds (issuance of bonds)
- May be more expensive over time
- Provides greater generational equity for capital

FINANCIAL PLAN GOALS REVISITED

- Meet Annual Expenses
 - Utilities are operated like a business
 - May be periods of expenses exceeding revenue
- Fund and Maintain Reserves
 - Cash/working capital (60-90 days water, 45-60 days sewer)
 - Contingency reserves (25% of O&M)
 - Rate stabilization (X% of annual revenue)
 - Asset maintenance/capital reserve (2% of fixed assets)
 - Debt service (one year of debt service)
- Debt Service Coverage
 - Legal requirement
 - Self imposed target

CAPITAL FUNDING

CAPITAL FUNDING SOURCES – INTERNAL

- User Rate Revenues
- Impact / Capacity Fees & Other Charges
- Existing Reserve Funds



CAPITAL FUNDING SOURCES – EXTERNAL

- Debt Instruments
 - Bonds (Short, Mid and Long-Term Debt)
 - Bank Loans (Short to Mid-Term Debt)
- Government Programs
 - Grants
 - Low-Interest Loans
- Private Party Contributions
 - Developers
 - Business /Community Partners



EXTERNAL FUNDING – DEBT

GENERAL OBLIGATION (GO) BONDS

- Secured by property taxes and the municipal district's "full faith and credit"
 - Debt service is repaid by a property tax levy on all properties within the municipal district (e.g., City, Town, County, CFD, etc.)
- Requires voter approval
- Higher credit rating – lower interest rates
- Debt limit as a percent of net assessed valuation
 - 6% limit: general purpose projects
 - 20% limit: water, sewer, lighting, acquisition of land for parks/preserves, and public safety, law enforcement, fire/emergency, street/transportation facilities
- Term does not exceed useful life of the project, facility or equipment



EXTERNAL FUNDING – DEBT

REVENUE BONDS/OBLIGATIONS

- Voter approval required for Revenue Bonds
- Voter approval NOT required for Revenue Obligations
- Typically secured by certain revenues of the particular enterprise issuing debt (i.e., water and/or sewer revenues)
 - Alternatively, many Arizona issuers also issue debt secured by excise taxes, the proceeds of which are used to fund enterprise projects
- Typically structured to provide aggregate level annual debt service
- Term does not exceed useful life of the project, facility or equipment

STATE REVOLVING FUND - WIFA

■ Benefits of SRF Loans

- Very Low Interest Rates
- Typically allows lower debt service coverage ratios/requirements
- No Payments Until Project Completion
- State Agency Helpfulness
- Lower overall closing costs
- Possibility of Principal Loan Forgiveness (dependent upon Municipality)

■ Drawbacks of SRF Loans

- Short Term
- Higher Hurdles (Davis Bacon Requirements)
- Inflexible Compared to Bonds
 - ✓ Equal Annual Payments
 - ✓ No Capitalized Interest

BOND ISSUANCE PROCESS

Assemble Financing Team

- ✓ Utility Staff
- ✓ Financial Advisor
- ✓ Bond Counsel
- ✓ Underwriter
- ✓ Feasibility Consultant



DEBT ISSUANCE GOALS

HIGHEST POSSIBLE CREDIT RATINGS

- Higher Ratings + Lower Interest Rates
- Lower Interest Rates = Lower Interest Expense
- Lower Interest Expense = Lower User Rates



DEBT & CREDIT RATINGS

- “REPORT CARD”
 - Likelihood of Repayment of Principal and Interest (Risk Factor)
 - Impacts Interest Rate Paid on Bonds
- Rating Agencies (Municipal Bonds)
 - Moody’s
 - Standard & Poor’s (S&P)
 - Fitch Ratings
- Ratings also a Source of Pride



CREDIT RATINGS

LONG-TERM CREDIT RATING SCALE						RISK	GRADE
Moody's INVESTORS SERVICE		S&P Global Ratings		FitchRatings			
Aaa		AAA		AAA		Highest Quality	Investment
Aa	1	AA	+	AA	+	Highest Quality	
	2						
	3		-		-		
A	1	A	+	A	+	Highest Quality	
	2						
	3		-		-		
Baa	1	BBB	+	BBB	+	Highest Quality	
	2						
	3		-		-		
Ba, B		BB, B		BB, B		Speculative	Junk
Caa, Ca		CCC, CC, C		CCC, CC, C		Highly Speculative	
C		D		D		Default	

FUNDING – IIJA

INFRASTRUCTURE INVESTMENT AND JOBS ACT

- Contains a Utility Element
- \$55 billion of the next 5 years
- Money will go to the States
- Administered through the State Revolving Fund (SRF) programs
- 49% of the money must be used for disadvantaged communities
 - Grants
 - Principal forgiveness



FUNDING – IRA

INFLATION REDUCTION ACT

- \$369 billion towards climate and energy investments
- Who Benefits?
 - Local agencies
 - Disadvantaged communities (DACs) / low-income communities
 - Public Works
- Projects:
 - ✓ HVAC
 - ✓ Building Automation Systems (BAS)
 - ✓ Plumbing
 - ✓ Solar & Backup Generators
 - ✓ Pumps & Boilers (water, sewer, recycled water, pools, etc.)
 - ✓ Water Meter Upgrades

FUNDING – FED AGENCIES

DEPARTMENT OF AGRICULTURE – RURAL DEVELOPMENT (RD)

- Combination Loans / Grants
- Very Low Interest Rates
- Up to 40 Year Loan Terms
- Municipalities < 10,000 People
- Unable to secure other cost-effective funding



Committed to the future of rural communities.

WHAT ABOUT THE EPA?

ENVIRONMENTAL PROTECTION AGENCY

- Historically, No Funding Directly to Utility Systems
- Provides Money to State Agencies for SRF Programs
- Each State Manages its own SRF Program
- Each State has its own Application Process
- Qualifying projects **MUST** be consistent with SDWA Initiatives



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