

Detroit Water and Sewerage Department



Customer Rates Meeting Water Supply System Meeting #4 – Proposed FY 2015-16 Schedule of Charges

February 24, 2015

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The 5 Takeaways

1. No Budget Increase = Promise kept
2. It's the Sales! Lower usage = Revenue Shortfall
 - ✓ *WE have been too optimistic! Since WE launched our collaborative planning process in 2008, in conjunction with OUR new contracting process, WE have consistently overestimated water sales.*
3. Average Unit Cost **must** be increased to eliminate Revenue Shortfall - will vary by community to match actual sales.
4. DWSD optimization efforts have absorbed the revenue shortfalls...until now.
 - ✓ *Little progress is being made on lessening the borrowing needed for CIP funding.*
5. Your communities and elected officials may feel misled, and WE take the hit for it, but we can't clear up this confusion alone ... help us to get the right message out: Problem recognized...Problem fixed.



Today's Agenda

- Executive Summary Messages
- Responses to Questions from Last Week
- Next Steps

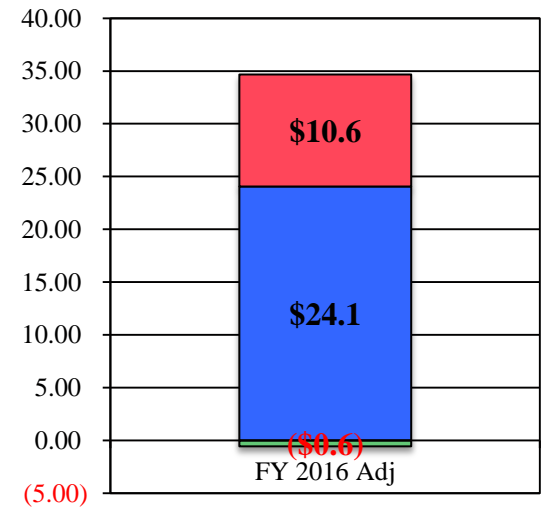
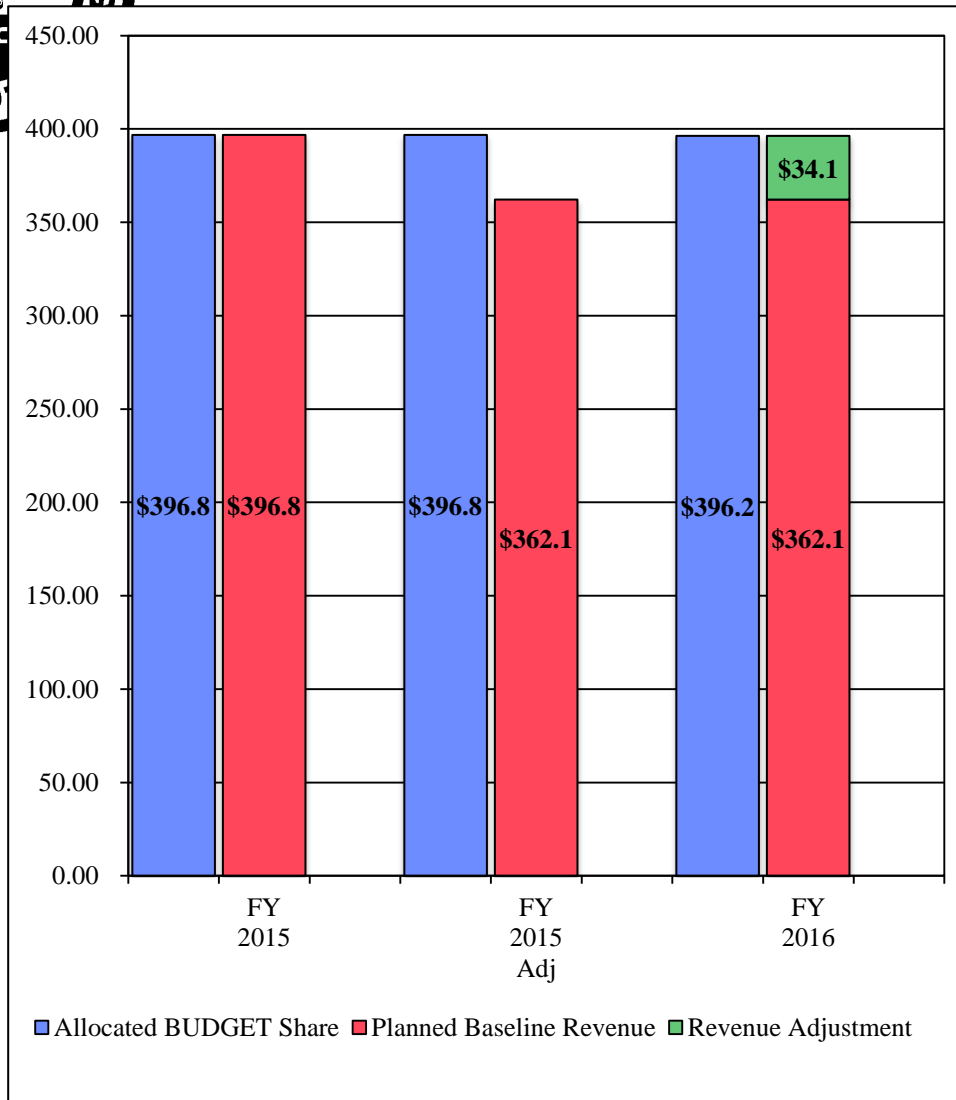


Question: Water Calculations

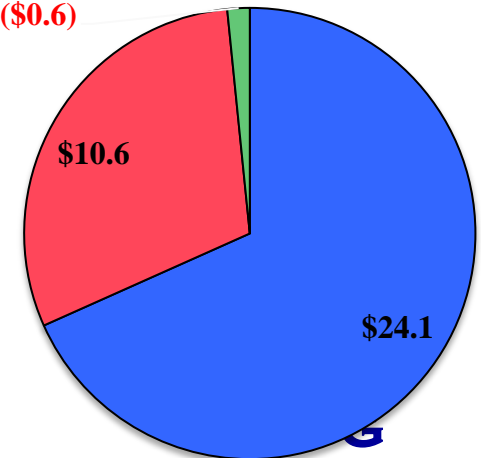
- Can the calculation be simplified to depict the total costs required and overall costs/units of service compared with last year?
- Can DWSD delineate the the 3 principal drivers of the revenue adjustments being proposed
 - ✓ *We believe the material we're distributing today is responsive to these questions.*



SYSTEM Illustration of Revenue Adjustments for FY 2015-16



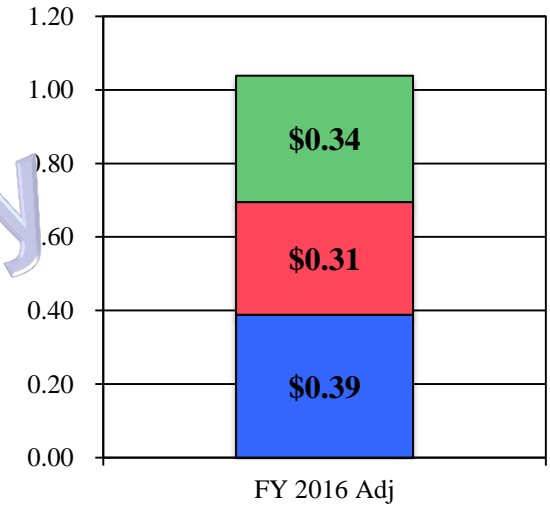
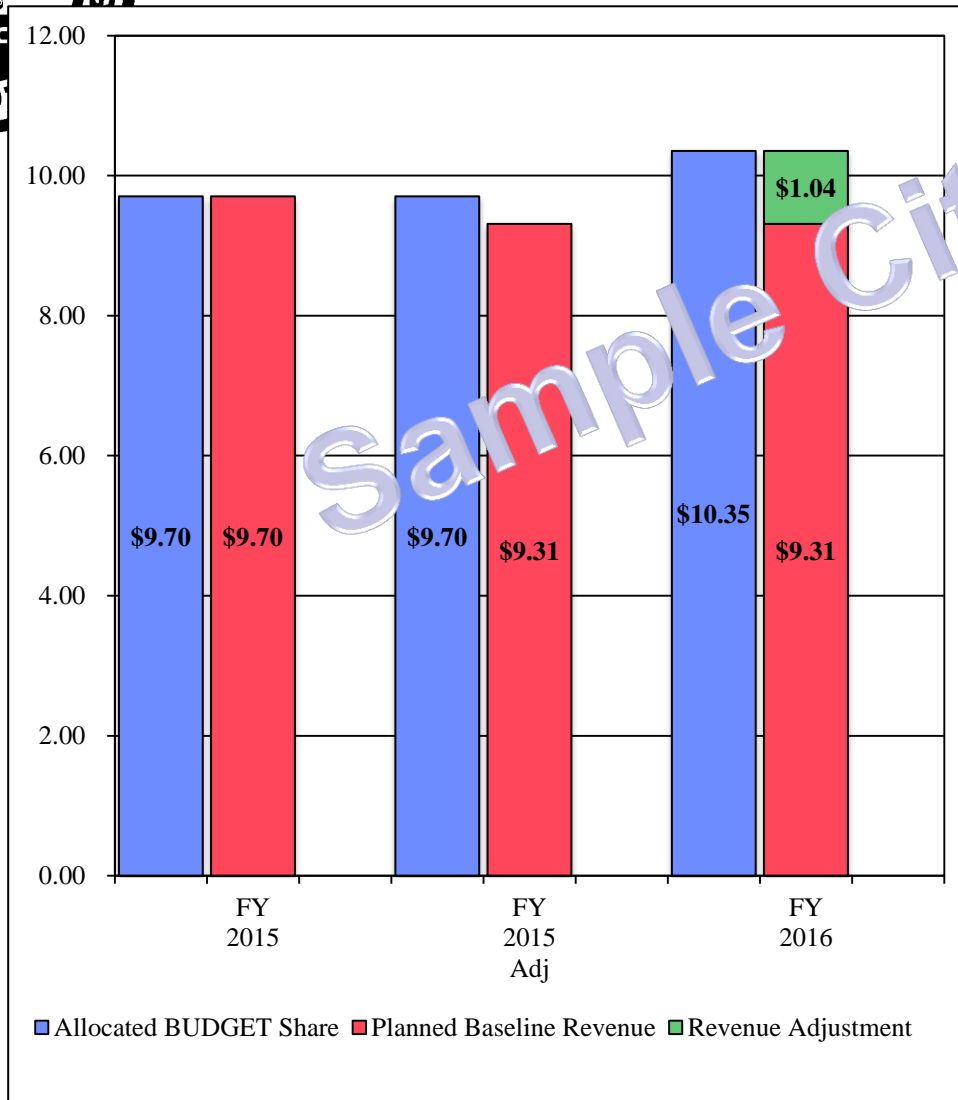
■ Sales Adjustment ■ Flint Shortfall
■ Cost of Svc Allo
((\$0.6))



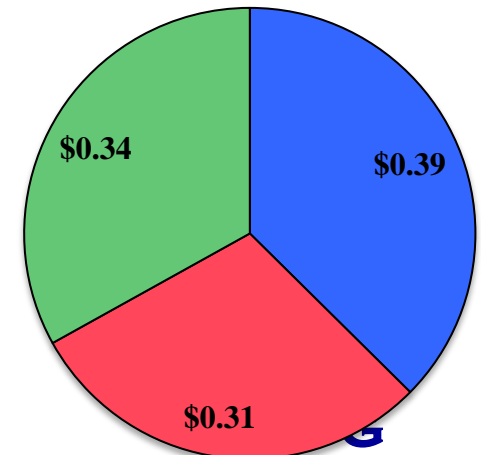
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Sample Illustration of Revenue Adjustments for FY 2015-16



■ Sales Adjustment ■ Flint Shortfall
■ Cost of Svc Allo



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Question: Contract Volumes

Why aren't contract volumes being used for rate setting?

- ✓ *The contract volumes do not reflect current reality, resulting in both revenue shortfalls and inequity issues among communities*
- ✓ *Given the downward trend in per usage in the service area (and nationally), annual review of volumes will be critical moving forward both for planning and for pricing.*

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Question: Average Sales Volumes

Why don't we use more historical data than a 2-year average?

- ✓ *If we went further back, it would skew the average towards higher usage – something that we definitely don't see in the sales trend of the past five years or being consistent with national trends.*



Question: Revenue Shortfall

Was the water budget increased to cover the revenue shortfall?

- ✓ No. *The water budget actually reflects a small decrease from FY 2014-15. The proposed revenue adjustments are designed to prevent additional revenue shortfalls from occurring again next year.*



Question: Revenue Shortfall

You indicated that part of the revenue adjustment was to make up prior shortfalls but it doesn't appear that any "catch up" has been included in the rate calculation?

- ✓ *The proposed rates do not seek to make up prior shortfalls, but rather to prevent future revenue shortfalls from occurring.*



Question: Revenue Shortfall

DWSD knew the sales decline was occurring. What specific cost reductions in FY 2014-15 were made to address the shortfall?

- ✓ *The department has been able to absorb the revenue shortfall through optimization cost savings, timing and scope reductions in contractual services, and a delay in achieving revenue financed capital reserves.*



Question: Revenue Shortfall

DWSD knew the sales decline was occurring. What cost reductions in FY 2014-15 were made to address the shortfall?

✓ *While reduced expenses continue to occur in a variety of areas across the system, in response to the early indication of revenue shortfall the three most significant adjustments are:*

- accelerated optimization;
- deferred contract initiation (ERP, etc.) and;
- anticipation that net resources will not meet the budgeted objective

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Question: Revenue Shortfall

How does the decline in sales compare to similar declines in gas and electric utilities?

✓ *A good question worthy of ongoing discussion . . .*



Question: Revenue Shortfall

What is the continuing impact of conservation (and reduced sales volumes) on fixed costs?

- ✓ *In the short term, the fixed cost produces a higher "unit cost" of service.*
- ✓ *In the mid to long term, more effective investments in capital improvements can be made to match the new demands.*
- ✓ *In addition, improved operating results directly impact creditworthiness which lowers the costs of borrowing.*



Question: "Surplus Revenue"

What happens if sales exceed expectations and produce a revenue surplus?

✓ *This is a policy decision to consider, but **ALL** revenues stay in the System. To the extent that "extra" revenues occur, options include:*

- Accelerate the revenue financed capital program;
- Rate stabilization; and/or
- Improve financial ratios to achieve lower borrowing costs.



Question: "Surplus Revenue"

If a revenue surplus occurs, can the excess funds be returned to the customers that generated the excess – this seems like an equitable solution vs. returning the funds to the entire system?

- ✓ *With future rate schedules based on actual sales volumes, customers that generate "excess" revenues will receive lower future revenue adjustments.*



Question: Fixed Charges

Since 90% of the cost profile is fixed, why not recover 90% (instead of 60%) of the revenue through fixed charges?

- ✓ *Increasing the fixed charge component to that extent would send a price signal that is inconsistent with the strategic objective to continue to focus on demand management.*



Question: Lease Payment

How will the cost of the lease payment be made up, will capital projects be cut?

- ✓ *No. Capital projects for the Water System will not be impacted by the Lease Payment*
- ✓ *The Lease payment is simply a "first call" on revenues to finance capital projects for the Detroit retail system.*
- ✓ *Common to all capital projects will continue to be financed by revenue transfers and by bond proceeds.*



Question: Lease Payment

There is \$76.8 million less for System Revenue Finance Capital due to the Lease Payment. How do you make up that cost?

- ✓ *This variance is not entirely related to the Lease Payment. It also reflects the lower revenue profile.*
- ✓ *The \$76.8 million figure cited in the question reflects the TOTAL System variance for Water and Sewer from the FY 2014-15 Budget.*



Question: Lease Payment (continued)

- ✓ *The Water System portion of the Lease Payment is \$22.5 million. This amount does not result in less revenue financed capital, but rather a "first call" on revenue financed capital for Detroit retail capital projects.*
- ✓ *Capital projects for the "Common-to-All" portion of the System will continue to be financed by remaining revenue transfers (after the lease payment) and by bond proceeds.*
- ✓ *In effect, the Lease Payment arguably slows the transition away from debt to finance System "Common-to-All" capital projects.*

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Question: Lease Payment

Does Detroit Retail pay a portion of the lease?

- ✓ *Yes. Approximately \$14.4 million of the total \$50 million Lease Payment is allocated to the Detroit Retail class.*
- ✓ *The revenue requirement allocated to the Detroit Retail class includes a proportional share of the Lease Payment which is defined in the MOU as "common-to-all" revenue requirement.*



Question: Rate Calculations

Will FY 2016-17 consist of wholesale rates only?

- ✓ *The rate schedules approved by the BOWC have only been "wholesale rates" since Judge Cox's order took effect for FY 2013-14 rates. The BOWC approves Detroit retail class's SHARE of the BUDGET, not the individual retail rates for Detroit, which are subject to City Council approval.*
- ✓ *DWSD wholesale rate schedules are not subject to review by the Detroit City Council*



Question: Rate Calculations

Would it be possible for DWSD to share the rate calculations for the other wholesale customers to provide a better frame of reference on our rate adjustment?

- ✓ *Calculations of the proposed wholesale water monthly and unit charge schedules for each customer are delineated in detail in the February 11, 2015 "Proposed FY 2015-16 Water and Sewer Rates" memorandum.*



Question: Rate Calculations

"Rate Comparisons" continued

- ✓ *In conversations with our customers in recent years we've become keenly aware that there is a wide spectrum of how DWSD wholesale charges impact local rates.*



Question: Rate Calculations

What is the detailed breakdown of suburban vs. retail costs?

✓ *From Table 6 of 2/11 memorandum:*

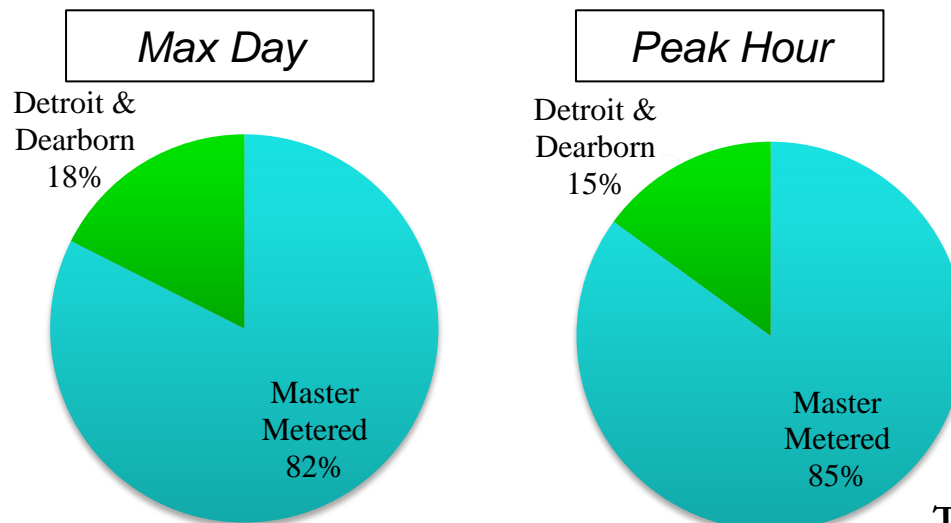
	(1)	(2)	(3)	(4)	(5)
	Suburban <u>Wholesale</u>	City of Detroit		<u>Total Detroit</u>	<u>Total</u>
		<u>"Wholesale"</u>	<u>Retail</u>		
Net Operating Expenses	100,941,300	14,061,900	49,732,100	63,794,000	164,735,300
Net Capital Requirements	179,962,100	20,704,100	30,843,100	51,547,200	231,509,300
Subtotal	280,903,400	34,766,000	80,575,200	115,341,200	396,244,600
Capital Adjustment	20,700,000	(20,700,000)	0	(20,700,000)	0
Total Req'd from Rates	301,603,400	14,066,000	80,575,200	94,641,200	396,244,600



Question: Rate Calculations

What is the detailed breakdown of max day and peak hour allocation for the unmetered customers?

- ✓ *See Table 4a of 2/11 memorandum*
- ✓ *Same demand assumptions for "non-master metered" customers as FY 2014-15*





Question: Communication Strategies

How can DWSD help customers communicate and clarify that the 4% increase in the MOU is related to budget and the FY 2015-16 revenue adjustments are specific to customer cost allocations?

- ✓ *This presentation, and all of the materials we've prepared during the roll-out process, are designed to assist in that messaging. DWSD is also available to provide assistance at local meetings.*

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Question: Communication Strategies

Customers expected a 4% RATE increase. They don't understand budget increase vs. rate increase. What are your additional plans to clear up the confusion?

- ✓ *DWSD continues to rollout new materials to explain the rate adjustments. The materials presented at the February 24, 2015 meeting provide additional information at the individual customer level.*



Question: Communication Strategies

Customers expected a 4% RATE increase. They don't understand budget increase vs. rate increase. What are your additional plans to clear up the confusion?

- ✓ *DWSD cannot control the reallocation of cost of service due to contract changes, nor can DWSD control the decline in customer usage.*
- ✓ *What DWSD can control in the short term is operating costs - which are decreasing slightly for FY 2015-16. This was the genesis for the 4% commitment.*
 - No more than a 4% increase in revenue requirements (BUDGET).
- ✓ *DWSD needs Community technical representatives to assist in this effort*

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Question: Communication Strategies

You need to start the conversation with community finance directors. What is your plan?

- ✓ *This should be OUR plan – with DWSD supplementing or assisting the local technical representatives as requested.*
- ✓ *The wholesale customer outreach program maintains an extensive database. Additional efforts are underway to reach out to local units to provide additional information.*



Question: Conservative Budgeting

Is DWSD too conservative in budgeting?

- ✓ *The FY 2015-16 budget is a baseline budget for "as is" DWSD and does not reflect standing up new organization(s) while running the existing organization.*
- ✓ *The budget is based on a set of assumptions, many of which are reasonably predictable. To the extent that unforeseen circumstances arise, it is management's recommendation that alternatives would be developed within the parameters of the existing budget.*



Question: Contract Employees

Are charges for contractors who are filling in for FTEs included in salaries/wages?

- ✓ *For purposes of the FY 2016 Budget, these "transitional services contract" resources are included in contractual services, as a non-personnel item. It is envisioned that these resources will phase into future personnel budgets where it is cost-effective.*



Question: Storage Strategy

Has there been consideration of a macro vision for storage that shifts emphasis from micro/community level to region as a whole that benefits everyone?

- ✓ *This challenge is being addressed in the Water Master Plan Update. The consolidation of communities into NOCWA is an example of this type of macro vision coming to life.*



Question: Highland Park

Why is Highland Park rolled in as a system wide cost?

✓ *It isn't. We have not allocated any water costs to Highland Park, nor included any Highland Park bad debt as a Budget item allocated to any customers.*



Next Steps



Financial Plan Review Process

- ~~January 22, 2015 Customer Rate Rollout: Preliminary FY 2015-16 BUDGET~~
- ~~February 11, 2015 BOWC Workshop on Preliminary Proposed FY 2015-16 Rates~~
- ~~February 17, 2015 Finance Committee Review of Preliminary Proposed FY 2015-16 Rates~~
- ~~February 17, 2015 Combined TAC / GLWA / Steering Committee Meeting~~
- February 24, 2015 Customer Rate Rollout: Proposed FY 2015-16 Rates and Charges
- February 25, 2015 BOWC Public Hearing on Proposed FY 2015-16 Rates and Charges
 - ✓ *Continues on March 4 and March 11*
- March 3, 2015 Finance Committee Review of Proposed FY 2015-16 Rates
- March 11, 2015 BOWC Special Meeting and Proposed Approval of FY 2016 BUDGET, CIP, and Rates