



Special Audit Committee Meeting
Monday, March 15, 2021 at 8:00 a.m.
www.glwater.org

Join by Microsoft Teams
Dial-In: 313-771-3116 Conference ID: 868 434 344#
[**GLWA Audit Committee Meeting**](#)

AGENDA

1. CALL TO ORDER
2. ROLL CALL
3. APPROVAL OF AGENDA
4. APPROVAL OF MINUTES
5. PUBLIC PARTICIPATION
6. OLD BUSINESS
 - A. Discussion Draft: FY 2022 & FY 2023 Biennial Budget and Five-Year Plan and Proposed FY 2022 Water and Sewer Service Charges (Page 2)
7. NEW BUSINESS
8. REPORTS
9. COMMUNICATIONS
10. LOOK AHEAD
 - A. Next Audit Committee Meeting: March 26, 2021 at 8:00 a.m.
11. OTHER MATTERS
12. ADJOURNMENT



Financial Services Audit Committee Communication

Date: March 15, 2021

To: Great Lakes Water Authority Audit Committee

From: Nicolette Bateson, CPA
Chief Financial Officer & Treasurer

Re: Proposed FY 2022 & FY 2023 Biennial Budget and FY 2022 Charges

Background: In accordance with service agreements with the Great Lakes Water Authority (GLWA) member partners, the budget and charges for the next fiscal year are presented in January each year. To accommodate that schedule, the upcoming year's budget is presented to the Audit Committee within the context of the biennial budget and five-year financial plan as well as a ten-year forecast in December. Subsequently, the Audit Committee conducts a review of the budget and related analysis in January.

At the December 18, 2020 Audit Committee meeting, a discussion draft of the FY 2022 & FY 2023 Biennial Budget and Five-Year Plan was presented. This draft focused on a) overall strategy of key budget elements including system-wide service charges and b) proposed operating group budgets.

On January 15, 2021, staff provided additional analysis and a summary budget document to close open issues given that the budget is prepared in the second quarter of the fiscal year. The updates were made within line items of the discussion draft budget (which did not change the total proposed operations and maintenance (O&M) portion of the budget). A continuation of that budget review was scheduled for a special meeting of the Audit Committee on January 22, 2021. On January 27, 2021, the Board of Directors received a presentation related to the FY 2022 & FY 2023 Biennial Budget and Five-Year Plan and FY 2022 Charges.

On February 24, 2021, public hearings were held by the Board of Directors related to the proposed budget and related charges. After the public hearings were completed, the Board was asked to consider adoption of the proposed budget and charges. The Board voted to refer the budget and charges back to the Audit Committee to review a Board Member's request asking for the GLWA Administration to reconsider the proposed water system O&M budget and opportunities for reduction of that budget (and related charges).

On March 8, 2021, the Audit Committee met to review the GLWA Administration's response to a Board member request to reduce the water system budget and related charges. The Administration presented a proposal to reduce the FY 2022 budget with a) \$2.2 million decrease to the FY 2022 water system O&M expenses and a corresponding impact on charges, b) \$1 million in sewer system O&M budget decrease with an offsetting increase to



Financial Services Audit Committee Communication

the Improvement & Extension Fund contribution, and c) with the details of this action to be executed by the Chief Executive Officer or her designee. It should also be noted that outstanding Member Partner water contract matters are likely to reduce the FY 2022 revenues by \$1 million. Combined with the \$3.2 million reduction in the water O&M budget proposed, this equates to a \$4.2 million reduction for the water system. The feedback from the Audit Committee was that they would like to see further reduction in the water system O&M budget of \$5.5 million and a further reduction of the 2% systemwide water charge from the new proposal of 1.3% to something less. In addition, the Audit Committee would like to see any spillover of O&M reductions to the sewer system budget as a result of cuts to the administrative and centralized budgets to move the proposed 0% sewer system adjustment to a rollback of sewer charges. Finally, the GLWA Administration was asked to review the staffing plan.

Analysis: The GLWA Administration has carefully considered the Audit Committee's further requests. While anything is possible, it does not come without costs. The GLWA Administration has been and continues to be focused on quality and cost controls. In some instances, we do need to spend money to save money. In a heavy infrastructure service sector, evaluating system integrity and reliability is a high priority. In other instances, the GLWA Administration is asked to initiate or improve programs. All of these have long-term implications. For that reason, the attached presentation has been prepared to better understand the FY 2022 budget and charge discussions as it relates to the long-term financial plan.

After compiling and reviewing the attached presentation, the GLWA Administration would like to revise its prior proposal given the benefit of time to consider the long-term implications of the prior recommendations.

Proposed Action: Audit Committee recommends that the Board of Directors adopts the FY 2022 and FY 2023 Biennial Budget and related proposed FY 2023 Schedule of Charges with a revision as follows: a) \$2.2 million decrease to the FY 2022 water system O&M expenses and a corresponding increase to the Water Improvement & Extension Fund contribution, b) \$1 million in sewer system O&M budget decrease with an offsetting increase to the Sewer Improvement & Extension fund contribution, and c) with the details of this action to be executed by the Chief Executive Officer or her designee.

Great Lakes Water Authority

*Budget & Financial Plan Alignment
FY 2022 thru FY 2026
& Long-term Forecast thru FY 2031*



Key Takeaways – Annual Budget Alignment

- *Annual budget discussion are intended to align with long-term forecasts presented to stakeholders*
- Initiatives, directives and policies have budget impacts
- Affordability and sustainability objectives are achieved, or derailed, through short-term actions
- Requests to decrease the FY 2022 O&M budget derail the above objectives as demonstrated by the long-term financial forecast included in this presentation
- The goal of this presentation is to provide context to the FY 2022 and FY 2023 biennial budget discussions in light of financial risks

Financial Plan: Stakeholders & Expectations

- Public -> Water Quality, Environmental Stewardship, Affordability
- Member Partners -> Stability in charges
- Bondholders -> Official statements, debt burden, and financial performance
- Regulatory -> Sufficiency of resources to address unforeseen needs, asset management commitment, permit requirements
- Vendors -> Contracted projects executed according to agreed-upon schedule
- Team Members -> Funding availability to reward performance
- Potential Team Members -> Competitive compensation to recruit and retain talent

Not Forgetting Where We Have Been

- Game changing era – 2011 to 2012
- Forecasted increases of 8% to 9% in 2012
- Decades of federal court oversight ending in 2013
- City's Chapter 9 Impacts
- Uncertainty of the ability to obtain financing for needed capital improvements
- System needs delays
- Start-up Entity
- Now, projects and initiatives that were part of regional discussion to form an authority now taking flight

Quick Facts – FY 2022 Proposed Charges

- The overall, originally proposed *Water System Charge Adjustment* is 2.0%
 - For the average Suburban Wholesale Water class as a whole, the proposed charge adjustment is an *increase* of approximately 2.4%
 - For DWSD the charge adjustment, after the ownership benefit, is a *reduction* of 3.2%
- The *effective revenue increase from water system charges could be reduced down to 1.7%* should pending model contract negotiations with Grosse Pointe Park and Dearborn get finalized
- The budget reduction being suggested* would lower the overall Water System Charge Adjustment to 0.5%

* \$5.5 million in total O&M of which \$4 million is allocable to the water system

Fact Check – What is the history of DWSD / GLWA Water Charge Adjustments

- The average annual increase in water charges to Suburban Wholesale Member Partners was:
 - DWSD era: 7.1% from FY 2004 through FY 2016 (Budget 4.1%)*
 - GLWA era: 1.7% from FY 2017 through FY 2022 (proposed) (Budget 1.2%)*
 - Since 2004: 5.3% from FY 2004 through FY 2022 (proposed) (Budget 3.1%)*
- This metric reflects a combination of changes in a) materially declining sales volume and b) revenue requirements

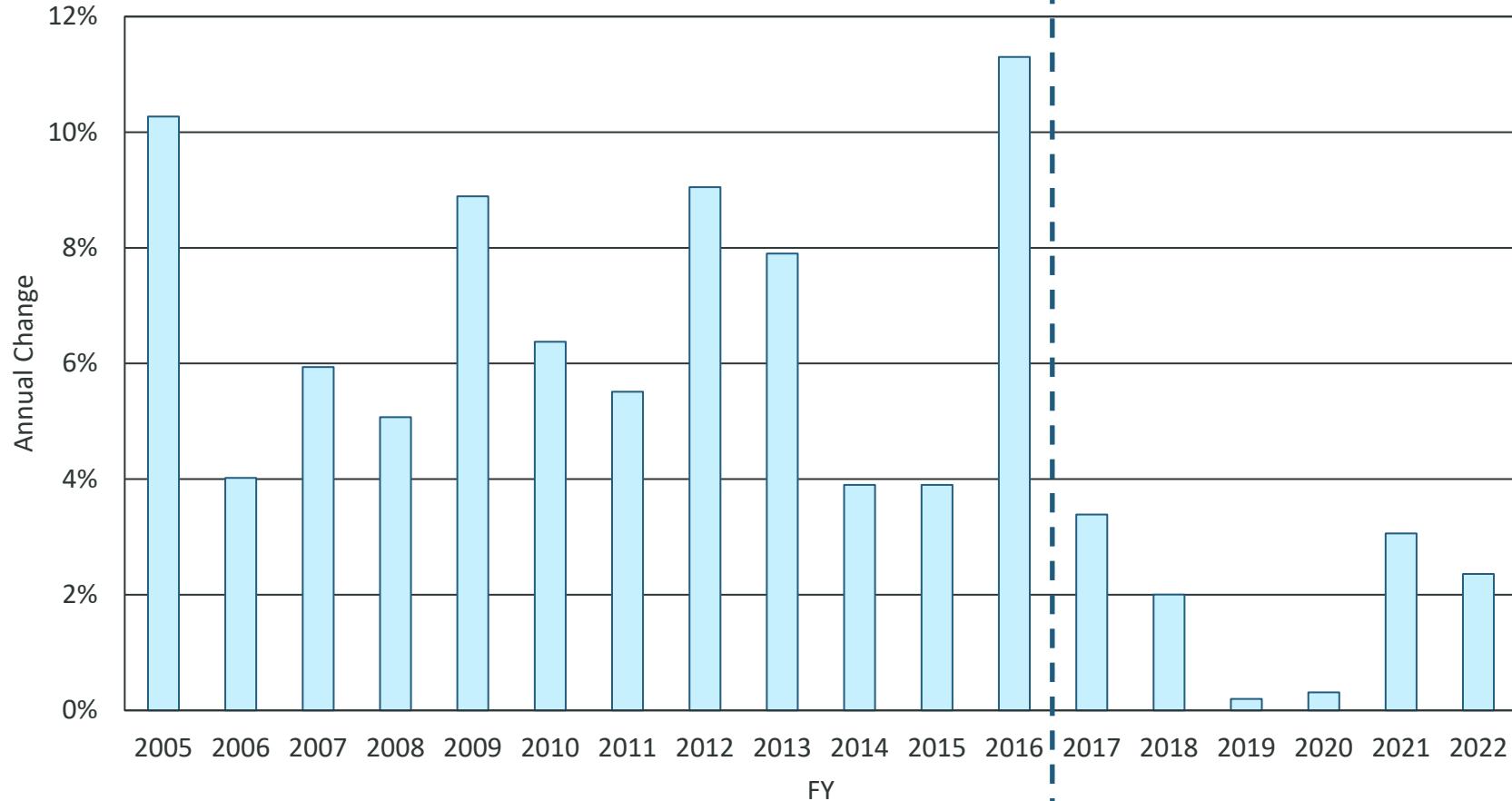
Relative Changes in Water Charge Fundamentals

	FY 2004 - FY 2016 (12 yrs)		FY 2016 - FY 2022 (6 yrs)		FY 2004 - FY 2022 (18 yrs)		<i><- Numerator</i>
	<u>Cumulative</u>	<u>Avg Annual</u>	<u>Cumulative</u>	<u>Avg Annual</u>	<u>Cumulative</u>	<u>Avg Annual</u>	
Change in Revenue Requirement	62.2%	4.1%	7.3%	1.2%	74.0%	3.1%	<i><- Numerator</i>
Change in Wholesale Sales Volume	-28.9%	-2.8%	-3.0%	-0.5%	-31.0%	-2.0%	<i><- Denominator</i>
Change in Unit Cost	128.1%	7.1%	10.6%	1.7%	152.3%	5.3% **	<i><- "Charge Increase"</i>

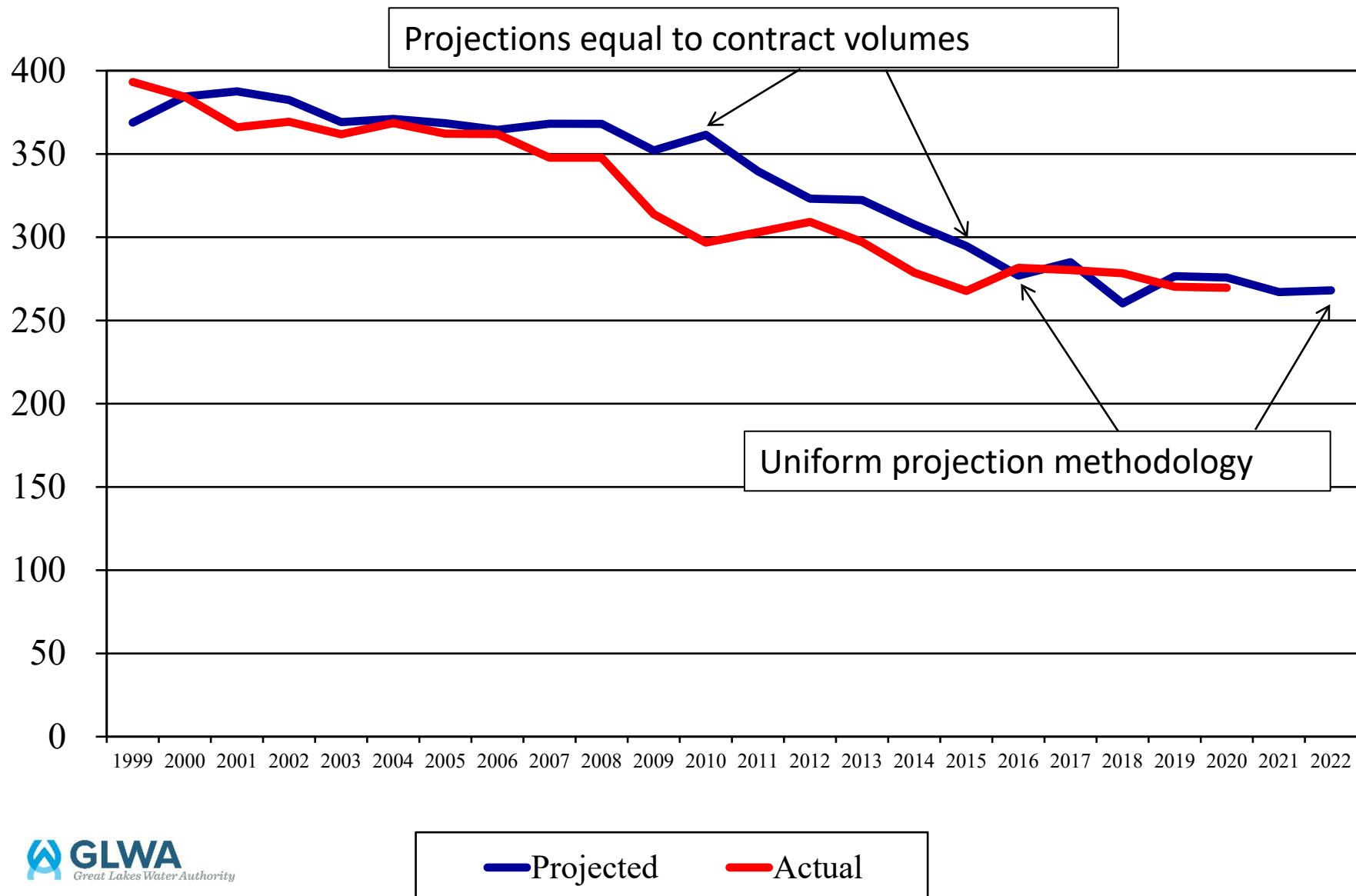
* Suburban Wholesale Only - Excludes Detroit

** The 50 Largest Cities “Utility Rate Index” published by Black & Veatch is 5.8% during this period

History of Average Suburban Wholesale Water Charge Adjustments

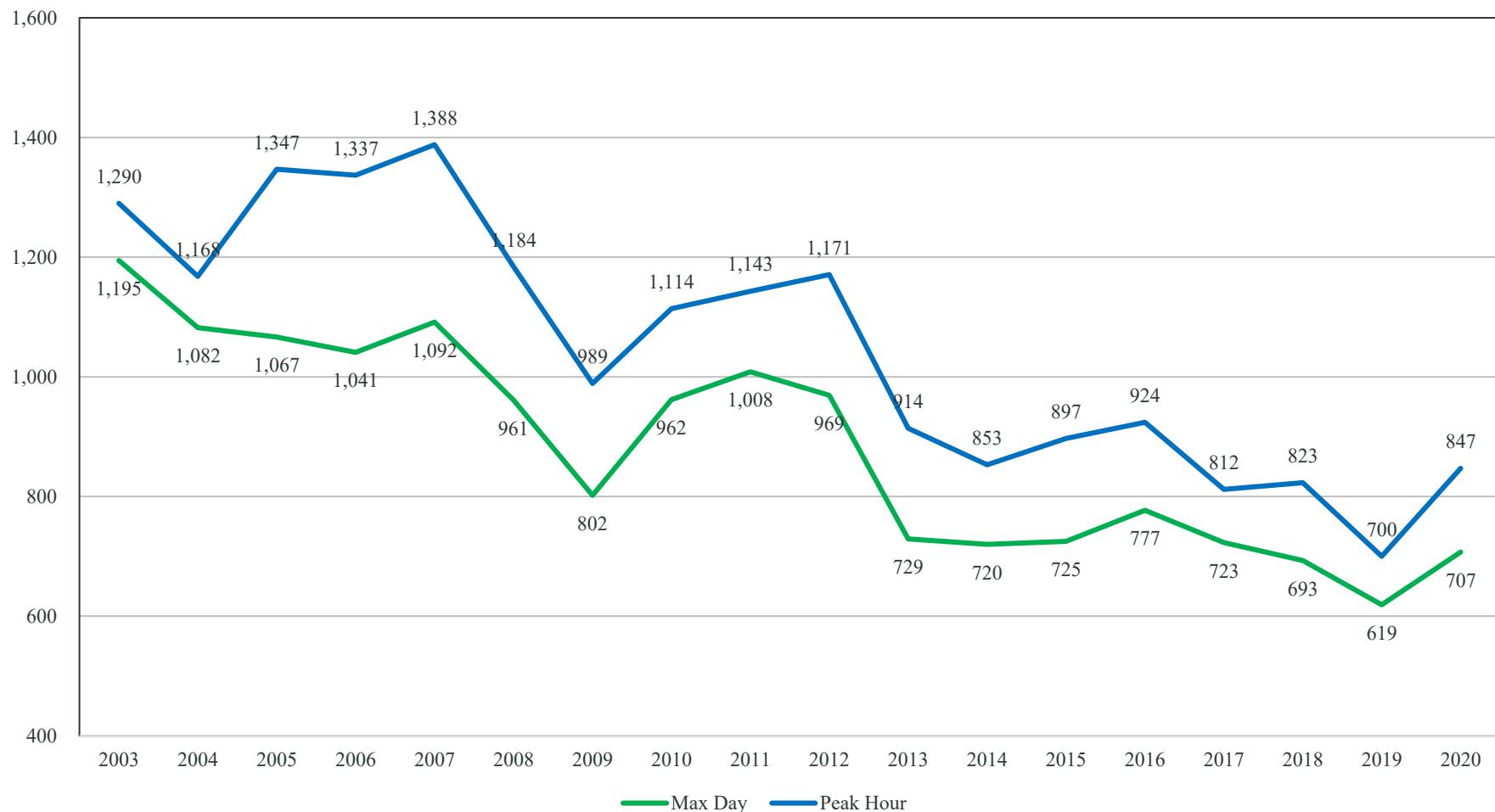


Annual Suburban Wholesale Water Sales * (mgd)



Reported Water Production Observations

Millions of gallons per day (mgd)



Forecast Sensitivity Analysis

- We've prepared an executive summary forecast analysis to evaluate the sensitivity on key financial and sustainability metrics of various assumptions and approaches towards budget and charge decisions
- As shown on the following slide, the metrics are not favorable under the latest Water plan being considered
- We can illustrate alternative scenarios as needed
- Addressing an improved, but fragile financial outlook if investment in utility does not proceed in alignment with the financial plan's steady and controlled pace

Budget Cut Request – Long-term Impact

- GLWA's long-term forecast objectives are designed to achieve affordability and sustainability through decreased debt and managed operating risks.
- GLWA's Management consistently provides forecasts to achieve those objectives with lean assumption metrics: revenue increase at 3%, operations and maintenance (O&M) expense increase at 2%, and lower borrowings to reduce heavy debt burden.
- Reducing the FY 2022 O&M expense and the charge revenues by \$5.5 million is not a one-time reduction. The simple cumulative effect is \$55 million over the next ten years – which creates a material gap in achieving charge stability as well as the objectives stated above. For this reason, we cannot view FY 2022 by itself – decisions we make today impact future generations.
- The financial management principle that has been consistently communicated to stakeholders has been that the O&M budget will not be exceeded – and any positive financial results will increase Improvement and Extension Fund (I&E).
- The current budget discussion is contra to the established approach which has been in effect since 2012 - and a contributor to the 4% promise that pre-dated GLWA – and the improved credit ratings that GLWA has earned.

Water Forecast Sensitivity Analysis

Exec. Sum. Forecast Sensitivity Analysis			FY 2022 O&M Budg Reduction	4.0	Apply Savings to Charges (1) or I&E (2)	I	Bond Interest Rate	4.25%	<--- Key Assumptions		
Water Supply System - \$ millions			Future O&M Index	2.0%	Avg Annual CIP + Cap Outlay (less: SRF)	160.0	Bond Term	30			
			Future Revenue Req't Index	3.0%	Minimum Capital Funds Balance	90.0	Bond Issue Costs as % of Proceeds	6.0%			
Metric Calculations	Metric Target	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	Min A	Min AA	Min AAA								2030
Operating Margin											2031
23 Depreciation Expense			130.7	126.0	128.9	133.3	133.2	95.1	96.0	96.3	94.8
24 Total Operating Expenses			263.3	260.2	270.3	277.5	280.2	245.1	249.0	252.4	254.0
25 Operating Margin			71.0	75.1	69.0	72.0	79.8	125.7	132.9	141.0	151.2
26 Operating Margin %	25%	40%	50%	21.2%	22.4%	20.3%	20.6%	22.2%	33.9%	34.8%	35.8%
Regional Revenue Allocation											
27 O&M			39.8%	41.6%	43.3%	42.8%	40.7%	40.3%	39.8%	39.3%	38.9%
28 Debt Service	40%	33%	25%	38.2%	40.8%	39.8%	40.5%	42.4%	43.2%	43.9%	44.1%
29 Non-Operating Expense			9.0%	9.0%	8.9%	8.7%	7.7%	7.7%	7.4%	7.2%	6.9%
30 Capital Financing			13.0%	8.5%	8.0%	7.9%	9.3%	8.9%	8.8%	9.4%	9.6%
31 Total			100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Debt Service Coverage											
32 Net Revenue - Local System (a)			42.0	42.0	42.4	43.4	45.5	45.6	45.6	45.6	45.6
33 Total Net Revenues			251.5	238.5	235.5	243.9	260.0	268.2	276.9	286.5	295.2
34 Debt Service Coverage	1.25	1.70	2.00	1.49	1.33	1.32	1.31	1.30	1.29	1.30	1.30
35 Sr. Lien Debt Service Coverage	1.50	2.00	2.25	2.06	1.93	1.89	1.90	1.92	1.87	1.83	1.80
Debt to Operating Revenue											
36 Outstanding Debt Balance			2,492.8	2,422.1	2,349.1	2,266.8	2,173.9	2,077.1	1,976.0	1,871.5	1,762.9
37 Additional Principal			0.0	0.0	108.5	240.6	371.0	497.8	618.6	734.5	845.5
38 Estimated Premium/Discount			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
39 Outstanding Indebtedness			2,492.8	2,422.1	2,349.1	2,375.2	2,414.5	2,448.1	2,473.9	2,490.1	2,497.5
40 Debt to Operating Revenue	7.0	4.0	2.0	5.84	5.83	5.59	5.48	5.41	5.33	5.24	5.13
41 Free Cash as a % of Depreciation	65%	105%	145%	52.7%	50.5%	48.5%	47.4%	44.9%	62.8%	62.6%	64.5%
42 Net Position	-	250	500	(96.4)	(109.3)	(122.6)	(136.5)	(145.2)	(110.3)	(70.1)	(22.4)
43 Debt / Asset Ratio	1.00	0.90	0.75	1.05	0.99	0.96	0.96	0.98	0.97	0.97	0.96

Standards

Red: Below minimum A-rated criteria (GLWA is AA- with 1 rating agency; the others are A category)

Yellow: Between A and AA rated criteria

Green: AA to AAA

Reminder: \$0 Revenue Bonds Available

- For both the water and sewer system, all capital programs are funded 100% by I&E except for SRF projects
- 44% of GLWA's investment balance is I&E Funds which will be materially reduced over the next two to three years as outlined in the long-term financial plan
- The majority of the remaining funds available are designated or restricted in some way

Account Purpose		Value Market	Allocation %	Cost Yield at	Market Yield at	Duration
Improvement & Extension	\$	417,891,130	43.5%	1.19%	0.13%	1.102 Years
Debt Service	\$	169,829,238	17.7%	0.18%	0.10%	0.159 Years
Receiving Funds (includes lockbox account)	\$	163,936,351	17.0%	0.02%	0.02%	0.003 Years
Extraordinary Repair & Replacement Funds	\$	72,135,164	7.5%	1.21%	0.12%	0.829 Years
Operating & Maintenance	\$	49,903,027	5.2%	0.05%	0.05%	0.003 Years
Pension Obligation Funds	\$	21,510,992	2.2%	0.05%	0.05%	0.012 Years
Retainage	\$	19,362,400	2.0%	0.03%	0.03%	0.003 Years
Debt Reserves	\$	19,020,101	2.0%	1.51%	0.14%	1.186 Years
WRAP Funds	\$	11,496,823	1.2%	0.05%	0.04%	0.011 Years
Budget Stabilization Funds	\$	7,589,851	0.8%	1.33%	0.14%	0.767 Years
Construction	\$	5,247,033	0.5%	0.10%	0.10%	0.003 Years
Flint Security Deposit Account	\$	3,813,910	0.4%	0.10%	0.10%	0.003 Years
Total	\$	961,736,022	100.0%	0.69%	0.10%	0.600 Years

Where do we go from here?

1. Long-term Financial Plan
 - A. A failure to plan is a plan to fail
 - Now have multiple years of history to support
 - B. Achieving alignment
2. Current Budget and Charges Proposal
 - A. Administration's revised proposal given the time to consider the impact on the long-term financial plan