Summary of Rates & Finance Subcommittee October 6, 2022, Meeting
For MWPAAC General Meeting October 26, 2022

1. Capital Program Cash-Funding Policy Discussion

Andres Bas Moore, Financial Planning & Analysis Coordinator, Wastewater Treatment Division (WTD) and Devin ViBarnes, Rates, Capital, & Debt Management Interim Unit Supervisor, WTD

Mr. Bas Moore made a presentation to attendees via screen-share. He spoke from a slide deck that was distributed to the MWPAAC members via email prior to the meeting. Readers should consult this slide deck, titled "MWPAAC RF WTD Cash Funding Policy Alternatives 2022.10.06.pdf". For more in-depth information about the policy alternatives evaluated, please also review the document called "Cash Funding Policy Review for 2024 Sewer Rate Setting.pdf" – this was also sent to MWPAAC members via email well in advance of the meeting.

Mr. Bas Moore was the primary presenter, with occasional remarks by Kamuron Gurol, WTD Director, and Devin ViBarnes. There were many questions and comments from attendees throughout the presentation. Several MWPAAC members expressed concerns about WTD's proposed policy change. This topic is already scheduled to return to Rates & Finance Subcommittee in November, where WTD staff can address those concerns and provide requested information.

Below is a record of some of the clarifications, concerns and requests for more information.

Clarifications about content:

- Clarification from WTD that any reduction in CIP cash funding now will necessarily result in more debt being issued, which will increase long term costs due to interest expense. (no free lunch)
- Clarification from WTD that the debt-to-asset ratio, which currently stands at around 96%, would continue to decrease with WTD's preferred cash funding method (funding original cost depreciation). With the current method (cash-funding 40% of annual CIP amount, 10-year averaged), it would trend toward a 60% debt-to-asset ratio. A reduction to cash-funding 30% of CIP would lead toward a 70% debt-to-asset ratio. The preferred method would likely lead toward to a debt-to-asset ratio of between 60% - 70%. The point is that all methods continue to draw down the magnitude of "leverage" that rating agencies frequently reference.
- Clarification from WTD about the meaning original cost vs. replacement cost depreciation.

Concerns:

- Concern that original cost has little to do with the replacement cost of an asset. Using replacement cost (inflating original cost to replacement cost using an inflation index, e.g.), while causing higher cash funding and higher rates, would get us closer to truly funding asset management, and reducing debt load and total expenses over time.

Requests for more information:

- Request to see the tables comparing the policy alternatives extend at least 20–30 years since that is the common term for debt.
- Request to see a longer-term comparison between the current policy and the 100% R&R option (which would reduce volatility). Comment that "making a connection between capital funding policy and the class of capital need has the potential to promote the cost-of-service concerns that were mentioned."

The next R&F meeting will be held on November 3, 2022. Please attend this teleconference meeting.

<u>Questions?</u>

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