MWPAAC Rates & Finance Subcommittee

May 4, 2023 Meeting Summary

Agenda:

1. Welcome & Introductions, Andy Baker, Rates & Finance Subcommittee Chair

   8:30 (5 min)

2. Depreciation and Cash Funding Approach, Devin ViBarnes, Rates, Capital, & Debt Management Manager, WTD Staff

   8:35 (60min)

   Devin ViBarnes presented details regarding the approach WTD uses for forecasting depreciation and the implications it has for WTD's cash funding approach.

   WTD relies on the accounting determination of Booked Asset Useful Life and the original cost of the value to compute annual depreciation on existing assets. When compared to the 'best estimate of real lives' developed by WTD's Asset Management team, this, in most cases, results in a shorter useful life. As a result, the annual depreciation amount for an individual asset will be higher at first, but as it nears the end of its real useful life it will in most cases already be fully depreciated, and will not be part of the annual depreciation amount used in rate forecasting. Using a useful life determination that differs from the accounting basis requires a formal exception from the County's central finance department. Staff confirmed that fully depreciated assets that are still in service are excluded from the cash funding target.

   For future assets, WTD makes an average assumption of 40 years useful life for all future capital spending. As a result, 1/40th of the planned CIP in each year is added to that year's forecasted annual depreciation target, cumulative for each year in the forecast. WTD excludes land in the planned CIP from this calculation. WTD forecasts spending $263 million on land costs between 2024 and 2033.

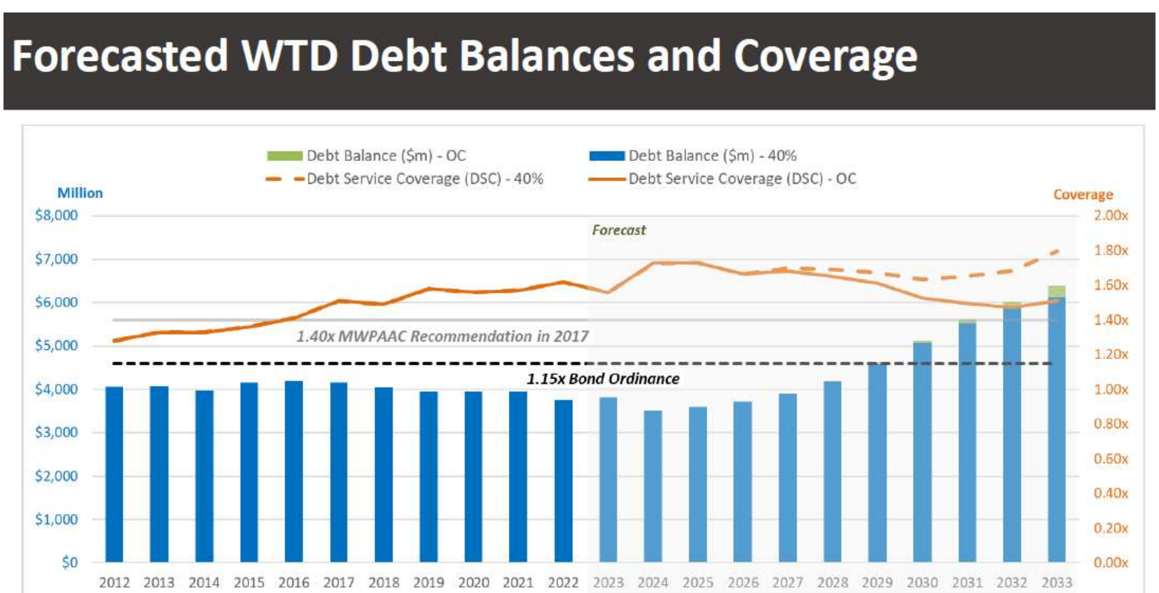
   As with the prior practice of targeting 40% cash funding, the cash target established through the depreciation forecast is planned to be met over the 10-year term, rather than being a requirement in every year. This is a tool to allow smoothing of rate increases over the forecast period. Under the 40% cash funding practice, this was a necessary tool to avoid a single year of high capital spending creating a spike in the targeted cash spending in that year. MWPAAC members observed that under a depreciation approach to the target, this additional smoothing results in falling behind relative to depreciation over the course of the forecast period.

Cash-Funding Calculations	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Forecasted Depreciation	$183.41	$190.07	$197.69	$203.91	$214.72	$229.36	$248.77	$269.49	$276.34	$295.41
Proposed Cash Funding	$190.09	$198.65	$200.75	$218.79	$228.96	$236.17	$232.45	$241.30	$252.24	$287.43
Surplus / (Deficit)	**$6.68**	**$8.58**	**$3.06**	**$14.88**	**$14.24**	**$6.81**	**($16.32)**	**($28.19)**	**($24.10)**	**($7.98)**

Devin presented that WTD continues to use a 1.40x debt service coverage (DSC) ratio as a secondary rate-setting requirement for the rate proposals. Maria Coe observed that, given the rising use of debt, this may well become the primary limiting constraint.

Devin presented a comparison of the outcomes within the 10-year forecast period under the original cost depreciation approach to establishing a cash funding target. These are consistent with the outcomes presented in the March 7 briefing, summarized below:

Metric	Original Cost Depreciation	40% Cash Funding
Monthly Sewer Rate in 2033	$97.63	$110.14
10-year Avg Cash Funding	33.9%	40.0%
Debt Service Coverage	1.51x	1.80x
Debt to Asset Ratio	74%	71%
Debt to Operating Ratio	5.3x	4.6x



MWPAAC member feedback:

Regarding volatility – if capital spending needs increase dramatically, the original cost depreciation approach to setting a cash target would allow WTD to keep rates lower by keeping the cash target lower. What does that situation look like beyond the 10-year horizon? When does the bill come due for this policy trade-off?

Our biggest concern is with the sustainability of the systems. We hear directly the concerns about affordability from our ratepayers, but there is a massive system that must be sustained. We want to see from WTD that the full cost of reinvesting in this system is being planned for so that rate surprises can be avoided.

The policy choices being made today will have a lasting impact. Currently there's some flexibility to make choices about cash funding approaches, minimum coverage targets, and rate smoothing. However, we need to be able to see a longer term view so that we can see the impact of these choices, otherwise we will be caught with no choice but to spike rates to catch up.

WTD cannot provide a longer-term financial view at this time but is aware of MWPAAC's request and is working to develop a method to model a longer term view in order to respond.