



## Financial Services Audit Committee Communication

**Date:** January 5, 2018

**To:** Great Lakes Water Authority Audit Committee

**From:** Nicolette N. Bateson, CPA, Chief Financial Officer/Treasurer

**Re:** Discussion Draft: FY 2019 & FY 2020 Biennial Budget  
and Five-Year Plan (FY 2019 thru FY 2022)

**Background:** The annual financial planning cycle has three key workstreams that are highly interdependent: 1) preparing a budget and financial plan, 2) preparing a capital improvement plan, and 3) developing customer charges. Contractual commitments to customers to provide a notification of proposed charges defines a key target date that falls in late January. This year that date is January 25, 2018.

The status of each key workstream is below.

1. **Budget & Financial Plan:** Discussion draft presented today for Audit Committee review. Similar (but condensed) material will be presented to the entire GLWA Board at a regular meeting next Wednesday, January 10, 2017 and to the customer community next week at an annual “Charges Rollout #3 - Budget” meeting on Thursday, January 11, 2017. Staff considers the substance of the budget to be largely complete as a “proposed” budget, pending any material requests from stakeholders and the impact of the other two workstreams.
2. **Capital Improvement Plan (CIP):** This is in process. Last month, a sewer system CIP presentation was given to the Board CIP Committee and to customers at an annual “Charges Rollout #2 – CIP” meeting. The focus in January is on the water system CIP. For purposes of the budget and financial plan, estimates have been utilized which we believe to be appropriate proxies for the final CIP based on what we know to date.
3. **Charges:** This week the GLWA proposed budget and financial plan was “handed off” to The Foster Group (TFG) to begin analysis that will result in proposed charges by the end

of the month. TFG is presenting a status report on charge development considerations at today's meeting.

**Analysis:** Headline news for our organization: for the first time as a new entity, we now have twelve months of actual from our first full year of operations which ended June 30, 2017. This data provides a springboard for better understanding and benchmarking the budget for the current and future years. Due to the expanded need to present FY 2017 through FY 2018, we have utilized 11 x 17 worksheets which are in an accompanying file. The more extensive five-year plan document will be compiled over the next few weeks.

Noteworthy items and topics for discussion as we proceed with the review of the materials today include the following.

1. **Proposed Overall Budget Adjustment:** Keeping within the 4% commitment, a 2% increase is proposed for FY 2019. Subsequent years are proposed at 4% driven by capital needs, investment in technology, and targeted maintenance projects.

Achieving 2% was not easy. The operating units were initially asked to review their expenses (and revenue opportunities) with a goal of a 0% increase. Two areas that are newer, System Planning and Information Technology, also had the highest level of increase in budgetary requests as they have been asked to establish new programs and initiatives. Both areas, in addition to many other GLWA areas, scaled back staffing and other requests to achieve the more realistic 2%. More information on the affected areas is attached. Please note that the enclosed personnel worksheet is being updated because of the budget reductions (the cells are highlighted in gray). A new worksheet will be presented at the Audit Committee meeting

2. **Likely Deferral of Borrowing until FY 2020:** Based on cumulative optimization savings, timing of capital project phases, and current cash balances, it appears that GLWA will be able to not need to issue new bonds (other maximizing than State or Drinking Water Revolving Fund Loans) for two entire fiscal years. That is a historic departure from prior financial trends. It should be noted however, that we continue to monitor refunding opportunities as well as the borrowing needs for DWSD. Those circumstances could cause a shift in the plan but likely a lower level of borrowing.
3. **Continuous Improvement in Cost Allocation:** In December 2017, the Audit Committee received a presentation that indicates that the nature of centralized and administrative services would result in an increase to water operations. We suggest that it is premature to shift the entire six to seven percent in one year as the data set is limited to one year. Instead we have a proposed a budget with a three-year phasing of that

amount with the cost allocation being updated and revisited on an annual basis. This approach also aligns with the Charges Stability Initiatives presented to stakeholders earlier this year.

4. **Policy Considerations:** With the maturing of our financial operations, we can now focus on financial policies that are supportable by data and analysis. One key area is defining a target for net position (largely cash less payables) in the a) Improvement & Extension Funds (I&E) and b) Construction Bond Funds. A demonstration of the following policies is presented in the budget worksheet.

***Policy proposal for Improvement & Extension Funds: Net Position sufficient to fund the five-year capital plan commitments with a minimum ending balance equal to 1.75 times subsequent year needs but no less than \$50 million.***

The intent of the 1.75 is to ensure that the entity does not count on utilizing funds from current year charges which may not be realizable or align with cash flow needs (reduces risk) while maintaining a minimal balance. A minimum of \$50 million may be low based on the five-year plan, however we do not have a history (due to our short existence) of actual to support a higher minimum. It is also recommended that any policy that we establish should be revisited bi-annually to evaluate its effectiveness. As we review the five-year plan, the significance of applying this policy and the use of I&E to lower borrowing will be highlighted.

***Policy proposal for Construction Bond Funds: A Net Position no lower than six months of subsequent twelve months projected spend calculated on a rolling monthly basis.***

The intent of the policy is to introduce discipline to proactively manage GLWA's borrowing needs. With regular cash flow forecasting for capital projects (a new model is being rolled out this month), the need for capital will be evident in advance of six months. Six months was selected for the policy, however, to ensure that parties consider the time to prepare for a transaction as well as to be prepared to execute a transaction at the right time. Further, this will prevent over-borrowing (reduce debt service) and optimize the planned use of I&E Funds.

5. **Assumptions and Estimates:** The preparation of this plan is dependent on our best knowledge at the time and our ability to control the outcome of those items (the less control we have, the more conservative the estimate). Assumptions and estimates include the following.

- a. Status quo in shared services with DWSD with one potential exception (increase in analytical lab testing provided by GLWA).
  - b. DWSD budget and CIP development are underway. There are no known impacts to GLWA.
  - c. No change in the budget related to ongoing implementation matters (including water sales to GLWA by DWSD, operational and capital responsibility for certain 24-inch mains in the City of Detroit, finalization of debt allocation, treatment of partial lease payment advanced, and any other related matters).
  - d. No change in operating or capital investment responsibility for the Northeast Pump Station although an alternative operating agreement is being explored.
6. **Operations & Maintenance Budget by Area and Group Analysis:** The Financial Planning & Analysis Team has drafted an 11 +/- page analytical review of the “Operations & Maintenance Budget by Area and Groups” worksheet. That document is presently being reviewed internally and will be distributed on Monday, January 8, 2018 with materials for the Board meeting next week. It is anticipated that the Audit Committee meeting on Friday, January 19, 2018 will serve as a venue to address budget and financial plan questions and requests.

**Proposed Action:** Receive and file report.