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## MEMORANDUM

FY 2021 Budget/Charge Planning  
Executive Summary

December 17, 2019

To: Nicolette Bateson

From: Bart Foster

This memorandum has been prepared to summarize observations based on our review of the preliminary GLWA budget plan for FY 2021. Via our review we have updated our comprehensive five-year financial forecasts, and those updated forecasts have been used to prepare the budget summary exhibits presented nearby. This commentary focusses on the budget plan for FY 2021, in support of the proposed Water and Sewer charges that will be presented next month.

### Executive Summary of Preliminary FY 2021 Budget / Charge Adjustments

- The average FY 2021 “System” Charge Adjustment for each System is below 4%
  - *Water = 3.8%, Sewer = 3.7%*
  - *Impacts on the on the overall Suburban Wholesale and Detroit Customer Classes, and on individual Member Partners, will be determined via the Cost of Service Study and presented next month.*
- The FY 2021 financial plan embraces GLWA’s commitment to stable and increasing “bottom line” contributions to the Improvement and Extension (“I&E”) Fund(s) and the accompanying debt service coverage ratios.
- The “drivers” for the charge increases are somewhat different between Water and Sewer, as illustrated below

	<u>Water</u>	<u>Sewer</u>	<u>Combined</u>
<u>Charge Increase Drivers - %</u>			
Revenue Requirement Increase	1.1%	3.0%	2.2%
Negative Sales Revenue Variance	1.4%	0.0%	0.6%
Negative Investment Income Variance	<u>1.3%</u>	<u>0.7%</u>	<u>0.9%</u>
Total	<b>3.8%</b>	<b>3.7%</b>	<b>3.7%</b>

- *The Water charge adjustment is designed to support a moderate increase in overall revenue requirements, and to address negative baseline revenue budgets associated with both sales and investment income.*
- *The Sewer revenue requirement increase is a bit larger, but the baseline Sewer revenues do not have to overcome negative sales revenue budget to the entirely fixed nature of the Sewer charges. Sewer charges must also accommodate lower forecasted investment income.*
- The Operation and Maintenance Expense (“O&M”) Budget reflects detailed review and recognition of 3 full years of GLWA experience.

	<u>FY 2020</u>	<u>FY 2021</u>	<u>Variance</u>	<u>% Variance</u>
<u>O&amp;M Expense - \$ millions</u>				
Water	131.5	137.1	5.6	4.3%
Sewer	<u>187.1</u>	<u>184.9</u>	<u>(2.1)</u>	-1.1%
Combined	318.5	322.1	3.5	1.1%

- *Overall increase from FY 2020 budget is 1.1%*
- *Water / Sewer impacts reflect actual experience and specific budget programs.*
- The debt service amounts in the total Revenue Requirement BUDGETs reflect natural changes in the existing principal and interest schedules, but do not reflect any issuance of new revenue bonds during FY 2021.
- The debt service amounts in the total Revenue Requirement BUDGETs also reflect anticipated savings with the planned refunding transactions in late FY 2020. \* See I&E Deposit commentary below.
  - *Projected Water savings = \$4.8 million*
  - *Projected Sewer savings = \$7.0 million*
- The FY 2021 budget amounts associated with Master Bond Ordinance (“MBO”) requirements are largely fixed and the same as the FY 2020 amounts.
  - *Legacy Pension Reimbursement, Lease Payment, WRAP Fund contribution*
- Amounts not required to fund O&M, debt service, and MBO requirements represent to “bottom line” contributions to the I&E Fund (and operating reserves). These amounts support the measure of debt service coverage.
  - *The Water “bottom line” amounts are stable compared to FY 2020*

- *The Sewer “bottom line” amounts reflect significant improvement compared to FY 2020, and are now more closely aligned with the Water figures*
  - *\* To the extent that actual refinancing results vary from those assumed above, it is our understanding that GLWA intends to adjust the I&E deposits accordingly, without impacting the overall BUDGET or Charge Adjustments*
- The following schedule provides additional perspective on key indices for GLWA budget plans since FY 2017

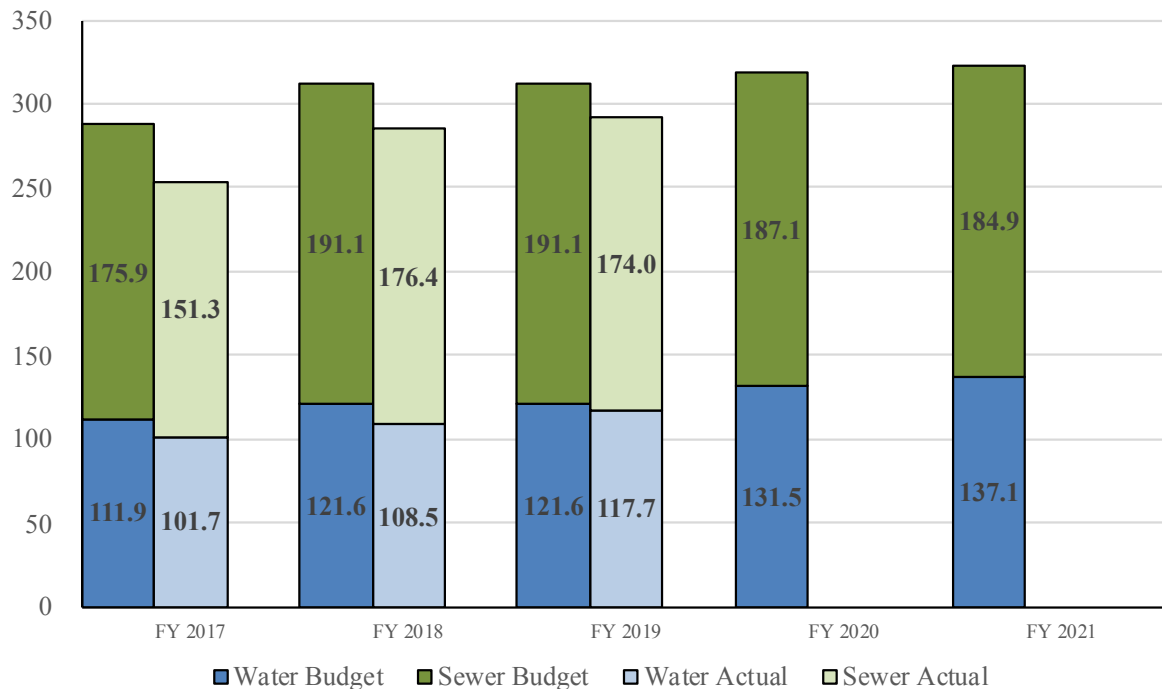
	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
<b><u>Water</u></b>					
Annual Change in Budgeted Revenue Req't (a)	4.0%	-0.9%	1.0%	2.5%	1.1%
<b><u>Annual Average Charge Increase</u></b>					
Total Regional System, Including Detroit Customer Class	4.5%	1.9%	1.6%	0.6%	3.8%
<b><u>(a) Revenue Requirement Budget Indices</u></b>					
O&M Budget Adjustment (b)	4.0%	8.7%	0.0%	8.2%	4.3%
Budgeted Deposit to I&E Fund - \$ millions	23.8	32.8	39.1	30.1	30.1
Budgeted Deposit to All Reserve Funds - \$ millions	23.8	34.6	39.1	34.1	31.0
Regional System Debt Service Coverage	1.34	1.48	1.52	1.47	1.44
<b><u>Sewer</u></b>					
Annual Change in Budgeted Revenue Req't (a)	4.0%	0.3%	1.0%	2.2%	3.0%
<b><u>Annual Average Charge Increase</u></b>					
Total Regional System, Including Detroit Customer Class	8.3%	-0.7%	0.1%	0.8%	3.7%
<b><u>(a) Revenue Requirement Budget Indices</u></b>					
O&M Budget Adjustment (b)	4.0%	8.7%	0.0%	-2.1%	-1.1%
Budgeted Deposit to I&E Fund - \$ millions	14.1	11.9	12.2	25.5	55.0
Budgeted Deposit to All Reserve Funds - \$ millions	14.1	14.5	12.2	25.5	55.0
Regional System Debt Service Coverage	1.25	1.27	1.25	1.31	1.48
<b><u>Combined Water and Sewer</u></b>					
Annual Change in Budgeted Revenue Req't (a)	4.0%	-0.2%	1.0%	2.3%	2.2%
<b><u>Annual Average Charge Increase</u></b>					
Total Regional System, Including Detroit Customer Class	6.7%	0.3%	0.7%	0.7%	3.8%
<b><u>(a) Revenue Requirement Budget Indices</u></b>					
O&M Budget Adjustment (b)	4.0%	8.7%	0.0%	1.9%	1.1%
Budgeted Deposit to I&E Fund - \$ millions	37.9	44.7	51.3	55.6	85.1
Budgeted Deposit to All Reserve Funds - \$ millions	37.9	49.1	51.3	59.6	85.9
Regional System Debt Service Coverage	1.29	1.35	1.35	1.37	1.46

(b) FY 2018 Budget reflects reassignment of \$10 million per system from minor capital expense to O&M expense.

Additional commentary on these executive summary observations follows.

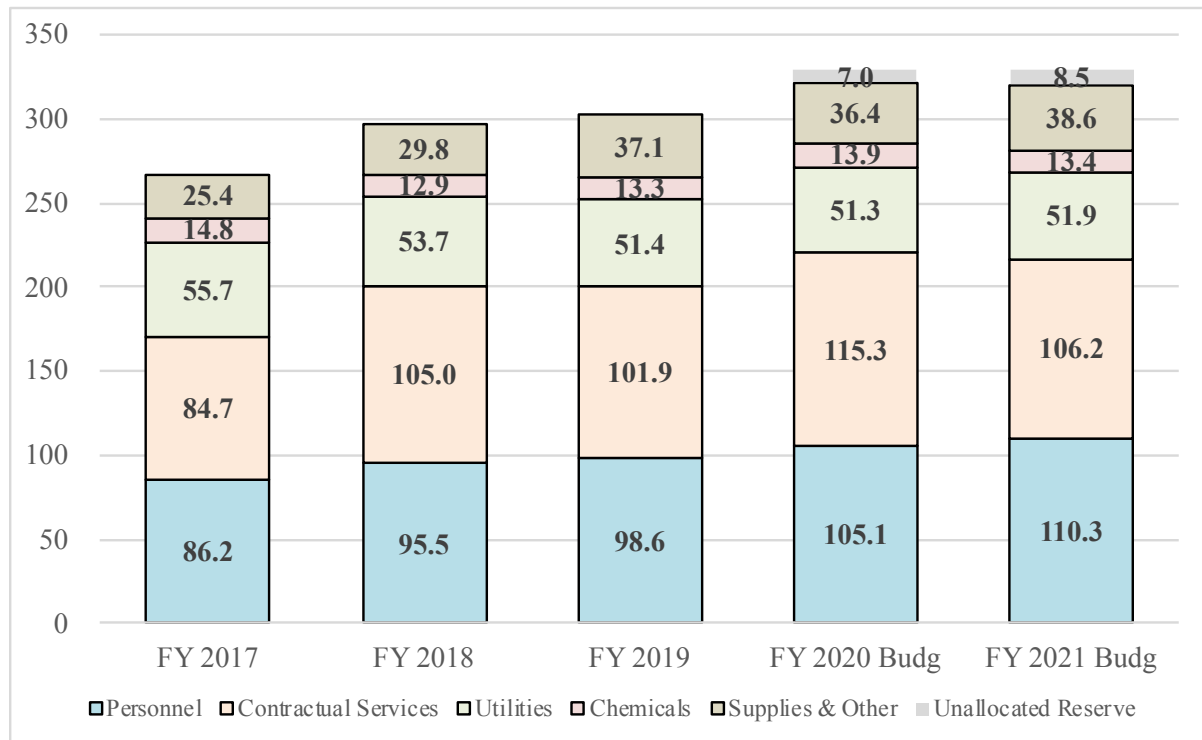
### Operation and Maintenance Expense Budget

The chart below summarizes overall budgeted O&M expense (in \$ millions) for FYs 2017 through FY 2021 (preliminary) and compares actual reported figures for FYs 2017 through 2019. The FY 2021 O&M budget reflects detailed review and recognition of 3 full years of GLWA experience.



	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Water Budget	111.9	121.6	121.6	131.5	137.1
Sewer Budget	<u>175.9</u>	<u>191.1</u>	<u>191.1</u>	<u>187.1</u>	<u>184.9</u>
Total Budget	287.7	312.6	312.6	318.5	322.1
Water Actual	101.7	108.5	117.7		
Sewer Actual	<u>151.3</u>	<u>176.4</u>	<u>174.0</u>		
Total Actual	253.0	284.9	291.7		
Water Variance	(10.1)	(13.0)	(3.8)		
Sewer Variance	<u>(24.5)</u>	<u>(14.7)</u>	<u>(17.1)</u>		
Total Variance	(34.7)	(27.7)	(20.9)		
Water % Variance	-9.1%	-10.7%	-3.2%		
Sewer % Variance	-14.0%	-7.7%	-8.9%		
Total % Variance	-12.1%	-8.9%	-6.7%		

Additional perspective on the O&M Budget is provided by examining the major cost types included in the budget. (Figures in \$ millions)



	Actual			Budget		FY 2021 Budg vs		FY 2021 Budg vs	
	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2019	FY 2020 B	FY 2019	FY 2020 B
Personnel	86.2	95.5	98.6	105.1	110.3	11.7	5.2	11.9%	5.0%
Contractual Services	84.7	105.0	101.9	115.3	106.2	4.3	(9.2)	4.2%	-7.9%
Utilities	55.7	53.7	51.4	51.3	51.9	0.5	0.6	1.1%	1.2%
Chemicals	14.8	12.9	13.3	13.9	13.4	0.1	(0.5)	1.1%	-3.4%
Supplies & Other	25.4	29.8	37.1	36.4	38.6	1.5	2.2	4.1%	6.1%
Subtotal	266.7	296.9	302.3	322.0	320.5	18.2	(1.6)	6.0%	-0.5%
Unallocated Reserve	0.0	0.0	0.0	7.0	8.5	8.5	1.5	NA	22.2%
Gross Total	266.7	296.9	302.3	329.0	329.0	26.7	(0.0)	8.8%	0.0%
Capital Program Allocation	(2.1)	(1.7)	(3.4)	(5.4)	(3.5)	(0.1)	1.9	3.4%	-35.4%
Shared Services	(11.7)	(9.9)	(7.1)	(5.0)	(3.4)	3.7	1.6	-52.2%	-32.1%
Operation and Maintenance Expense	252.9	285.3	291.7	318.5	322.1	30.3	3.5	10.4%	1.1%

Personnel Costs reflect the largest area of budget increase, reflective of the continual ramp up towards fulfilling the staffing plan and of the underlying prices of salaries and fringe benefits. Contractual services reflect a budget reduction for FY 2020. Commodity costs associated with chemicals and utilities are remarkably stable. The unallocated reserve reflects a fairly conservative allowance for unanticipated expenditures. We note that the total “gross” FY 2021 O&M budget is actually the same as the FY 2020 budget. Lower offsets related to the capital program allocation and shared services result in the overall 1.1% increase on a net basis.

### Water Revenue Requirement BUDGET

The table below compares the preliminary FY 2021 budgeted Water revenue requirements with the original (used for charge development) FY 2020 budget. *(Figures in \$ millions)*

	(1)	(2)	(3)	(4)
	Baseline FY 2020 BUDGET	Preliminary FY 2021 BUDGET	Variance	% Variance
<b><u>Baseline Establishment</u></b>				
1	Baseline FY 2020 Revenue Requirement Budget	339.7	339.7	
2	Revenue Requirement Index		1.1%	
3	Budgeted FY 2021 Revenue Requirement [1]*(1+[2])	339.7	343.4	3.7 1.1%
4	less: Forecasted Investment Income	(9.1)	(4.9)	4.2 -46.6%
5	Revenues Required from Charges [3] + [4]	330.6	338.5	8.0 2.4%
6	Revenues Under Existing Charges	<u>330.6</u>	<u>326.1</u>	(4.5) -1.4%
7	Revenues Required from Charge Increases [5] - [6]		12.5	
8	Projected Average Charge Increase [7] / [6]		3.8%	
<b><u>Revenue Requirement Specifics</u></b>				
9	Operation and Maintenance Budget	131.5	137.1	5.6 4.3%
10	Legacy Pension Reimbursement - Operating	6.0	6.0	0.0 0.0%
11	Debt Service (a)	137.6	138.8	1.2 0.9%
12	Transfer to Pension Obligation Payment Fund	6.3	6.3	0.0 0.0%
13	Transfer to WRAP Fund	1.7	1.7	(0.0) -0.8%
14	Lease Payment - Transfer to Detroit Local I&E	22.5	22.5	0.0 0.0%
15	Operating Reserve Requirement	<u>4.0</u>	<u>0.9</u>	(3.1) -78.0%
16	Subtotal Rev Req'ts [9] thru [15]	309.5	313.3	3.8 1.2%
17	Balance = Transfer to GLWA Regional I&E [3] - [16]	<b>30.1</b>	<b>30.1</b>	<b>(0.0)</b> -0.1%
18	Regional Debt Service Coverage Ratio	1.47	1.44	
<b><u>(a) Debt Service Specifics</u></b>				
19	Existing Revenue Bonds	135.8	139.9	4.1 3.0%
20	Forecasted Revenue Bonds	0.0	0.0	0.0 0.0%
21	Existing SRF Loans	1.8	2.6	0.9 48.5%
22	Forecasted SRF Loans	<u>0.0</u>	<u>1.0</u>	1.0 0.0%
23	Subtotal	137.6	143.6	6.0 4.4%
24	less: Forecasted Refinancing Savings	<u>0.0</u>	(4.8)	(4.8) 0.0%
25	Budgeted Debt Service	137.6	138.8	1.2 0.9%

This provides more detailed comparisons of the observations expressed in the Executive Summary. Note the debt service specifics in footnote (c). The FY 2021 principal and interest requirements on existing revenue bonds reflects a natural increase compared to FY 2020. In addition, the amounts required for existing and forecasted SRF loans is naturally increasing as GLWA's participation in DWRF funding of water projects increases. As a result, the overall budgeted debt service for FY 2021 is an increase over FY 2020 despite the recognition of forecasted refinancing savings. This has negative implications on the budgeted FY 2021 "bottom line" contribution for the Water Fund.

### Sewer Revenue Requirement BUDGET

Here's the same comparison for the preliminary FY 2021 Sewer revenue requirement budget with the original (used for charge development) FY 2020 budget. *(Figures in \$ millions)*

	(1)	(2)	(3)	(4)
	Baseline FY 2020 BUDGET	Preliminary FY 2021 BUDGET	Variance	% Variance
<b><u>Baseline Establishment</u></b>				
1	Baseline FY 2020 Revenue Requirement Budget	480.6	480.6	
2	Revenue Requirement Index		3.0%	
3	Budgeted FY 2021 Revenue Requirement [1]*(1+[2])	480.6	495.0	14.4 3.0%
4	less: Forecasted Investment Income	(8.7)	(5.6)	3.1 -35.7%
5	Revenues Required from Charges [3] + [4]	471.9	489.4	17.5 3.7%
6	Revenues Under Existing Charges	471.9	471.9	0.0 0.0%
7	Revenues Required from Charge Increases [5] - [6]		17.5	
8	Projected Average Charge Increase [7] / [6]		3.7%	
<b><u>Revenue Requirement Specifics</u></b>				
9	Operation and Maintenance Budget	187.1	184.9	(2.1) -1.1%
10	Legacy Pension Reimbursement - Operating	10.8	10.8	0.0 0.0%
11	Debt Service (a)	215.7	202.7	(13.0) -6.0%
12	Transfer to Pension Obligation Payment Fund	11.6	11.6	0.0 0.0%
13	Transfer to WRAP Fund	2.4	2.5	0.1 2.5%
14	Lease Payment - Transfer to Detroit Local I&E	27.5	27.5	0.0 0.0%
15	Operating Reserve Requirement	0.0	0.0	0.0 0.0%
16	Subtotal Rev Req'ts [9] thru [15]	455.1	440.1	(15.1) -3.3%
17	Balance = Transfer to GLWA Regional I&E [3] - [16]	25.5	55.0	29.5 115.8%
18	Regional Debt Service Coverage Ratio	1.31	1.48	
<b><u>(a) Debt Service Specifics</u></b>				
19	Existing Revenue Bonds	161.0	155.7	(5.3) -3.3%
20	Forecasted Revenue Bonds	1.8	0.0	(1.8) -100.0%
21	Existing SRF Loans	52.9	53.6	0.7 1.3%
22	Forecasted SRF Loans	0.0	0.4	0.4 0.0%
23	Subtotal	215.7	209.7	(6.0) -2.8%
24	less: Forecasted Refinancing Savings	0.0	(7.0)	(7.0) 0.0%
25	Budgeted Debt Service	215.7	202.7	(13.0) -6.0%

Again, note the debt service specifics in footnote (c). Contrary to Water, the FY 2021 principal and interest requirements on existing revenue bonds reflects a natural **decrease** compared to FY 2020. In addition, the projected revenue bond issue included in the FY 2020 budget has been delayed to FY 2022 in the updated forecast, in part due to enhanced utilization of the SRF loan process and in part due to natural delays in the CIP. As a result, the overall budgeted debt service for FY 2021 reflected a decrease **even before** the recognition of forecasted refinancing savings. The resulting budgeted debt service savings has **positive** implications on the budgeted FY 2021 “bottom line” contribution for the Sewer Fund, and produces a more consistent budgeted contribution – and resulting debt service coverage ratio - from both Funds.

We continue diligent review on all of the budget parameters included in the preliminary submittal. We are preparing additional analysis and commentary to provide to the GLWA management team, the Board of Directors, and ultimately to Member Partners as part of the FY 2021 Charge Rollout process in early January.

In addition, we are utilizing this information in our preparation of the FY 2021 Cost of Service Study and the accompanying proposed wholesale service charges for FY 2021. Those proposed charges are scheduled to be delivered to the Board of Directors on January 22, 2020 and formally presented to Member Partners at the final FY 2021 Charge Rollout meeting on January 23, 2020.

We are prepared to discuss this matter at your convenience.