December 9, 2010 Finance Committee Information
6:00 PM in the OWASA Boardroom

AGENDA ITEM

- **DRAFT STATEMENT OF STRATEGIC ISSUES AND POLICIES, DRAFT PLANNING ASSUMPTIONS AND BACKGROUND INFORMATION DOCUMENT AND FISCAL YEAR 2012 DRAFT BUDGET CALENDAR**

BACKGROUND

- OWASA's *Financial Management Policy* requires a review by Staff, the Finance Committee and Board of Directors of the strategic issues, policies, and economic assumptions that are expected to impact the preparation of budgets (Operations and Maintenance and Capital Improvements Program) and rates.

- The identification of these key issues is intended to guide the Board and staff in the preparation of the annual budgets.

- The planning assumptions and background information reflect both internal and external constraints that define various financial and operating parameters within which OWASA must operate.

- The budget calendar includes the proposed dates of Board and Committee meetings at which budget matters are to be discussed and lists the dates by which major budget tasks are to be completed.

- The attached documents have been prepared by staff and will be discussed with the Finance Committee at its meeting on December 9, 2010.

ACTION NEEDED

- Provide guidance to the Finance Committee and staff as appropriate on the strategic issues and planning assumptions for Fiscal Year 2012.

December 9, 2010

ORANGE WATER AND SEWER AUTHORITY

A public, non-profit agency providing water, sewer and reclaimed water services to the Carrboro-Chapel Hill community.

MEMORANDUM

TO: Board of Directors

THROUGH: Ed Kerwin

FROM: Stephen Winters, CPA

DATE: December 3, 2010

SUBJECT: *Draft Summary of Strategic Issues, Draft Planning Assumptions and Background Information*, and *Fiscal Year 2012 Draft Budget Calendar*

As part of the annual budgeting process, OWASA's *Financial Management Policy* requires a review by Staff, the Finance Committee and the Board of Directors of the strategic issues, policies, and economic assumptions that are expected to impact the preparation of budgets (Operations and Maintenance and Capital Improvements Program) and rates. The preparation of an annual budget calendar is also a key component of OWASA's annual budgeting and rate setting process.

The attached documents have been prepared by staff and will be discussed with the Finance Committee at its meeting just prior to the Board Meeting on December 9, 2010.

The identification of critical and strategic issues is intended to guide staff and the Board of Directors in the preparation of the annual budget and capital improvement plan, as well as set the stage for long-term comprehensive financial planning.

The planning assumptions and background information reflect primarily the legal, regulatory and contractual constraints to which we are obligated, and also provide various economic and operational assumptions.

The budget calendar includes the proposed dates of Board and Committee meetings at which budget matters are to be discussed and the dates by which major budget tasks are to be completed.

Staff looks forward to working with the Finance Committee and the Board of Directors to develop our annual budgets.



Stephen Winters, CPA
Director of Finance and Customer Service

Attachments: *Draft Summary of Strategic Issues*
Draft Planning Assumptions and Planning Background Document
Fiscal Year 2012 Draft Budget Calendar

ATTACHMENT 1

Fiscal Year 2012 Budget Preparation
Draft Summary of Strategic Issues and Policies

According to OWASA's *Financial Management Document (March 26, 2009),* the *Statement of Strategic Issues and Policies* "shall identify the major issues, policies, and concerns that should be addressed in the upcoming annual budget and capital improvements deliberations."

OWASA must maintain an operating and maintenance budget and capital improvements budget that continue to ensure high quality and reliable services to our customers while minimizing any necessary rate increase to limit the impacts of such rate increase on our customer base .

Specific budgetary factors include:

1. Drinking water and reclaimed water sales in FY 2012 are expected to be approximately 6.1 - 6.3 and 0.7 - 0.8 MGD, respectively.

2. System growth is expected to remain well below historical levels; further contributing to a decline in expected revenue.

3. The existing seasonal and increasing block rate fee structures will remain in place for FY 2012. Data from our experience with the current block rate structure is influenced by unusual factors such as the 2008 drought. More time is necessary in order to accumulate "clean customer experience data" before we consider any potential changes to the current structure. During FY 2011, we plan to continue our efforts to analyze customer data which may lead us to decide to conduct a rate study in FY 2012.

4. Results of studies conducted at the wastewater treatment plant (WWTP) have allowed us to reduce planned CIP expenditures over the 15-year planning period and have also identified potential reductions in WWTP operating expenses, primarily resulting from reduced chemical usage.

5. Although general inflation remains low, prices for specific products vital to the treatment of water and wastewater have proven to be extremely volatile. Chemical costs stabilized in FY 2010 but price volatility remains a concern.

6. Our 15-year financial planning model is based on achieving the goals established in our *Financial Management Policy*. Currently, the model projects the need to increase rates by 8.75% as of October 1, 2011. However, financial results for FY 2010 and for the first quarter of FY 2011 were better than expected which may provide the opportunity to recommend lower rate increases than originally anticipated. We remain committed to achieving the *Financial Management Policy* goals.

7. Continued focus on reducing costs and improving efficiency is critical to minimizing any necessary rate increase. Our challenge is to continue to reduce costs where possible while maintaining the ability to deliver high quality, reliable water, wastewater and reclaimed water services.

8. OWASA has recently developed a draft plan for the sustainable, long-term management of its forest lands. The primary objectives of the plan are to protect water quality, enhance forest conditions for wildlife and improve and restore the overall quality of OWASA woodlands through a long-range program of managing our forest resources in accordance with sound, science-based silvicultural practices. Another primary objective of this plan is to ensure that adequate revenues are generated through the sustainable harvesting of timber resources so that OWASA's forest management objectives can be met while ensuring that revenues equal or exceed the costs associated with implementing the program.

9. OWASA is currently participating with other Triangle Area entities in the Jordan Lake Partnership. The goal of the Partnership is to coordinate planning for further development of the Jordan Lake water supply. OWASA's principle objectives are to maintain our existing water supply storage allocation and to obtain formal commitments that assure the permanent and cost-effective access to that allocation. If we are unable to access our Jordan Lake allocation for any reason, the future costs of providing an equivalent level of water supply reliability will be substantially higher than estimated in our 2010 Long-Range Water Supply Plan.

10. To help ensure that our employee classifications, compensation and benefits are appropriate and in-line with market conditions, we periodically conduct a study to benchmark our practices. If a study takes place in FY 2012, its results may have an impact on our overall human resources cost.

11. As of October 2010, we have 15 vacant positions, 11 of which are unfunded in the FY 2011 Budget. In planning for the FY 2012 Budget, we will conduct an assessment to determine whether we need to reinstate any of our unfunded vacant positions.

Meeting the financial management objectives set forth in OWASA's *Financial Management Policy* requires OWASA to continue to focus on core, mission-critical services; greater operational efficiency; accurate and sustainable asset management and capital improvement priorities; and opportunities for further permanent reductions in operating expenditures.

ATTACHMENT 2

FISCAL YEAR 2012 BUDGET PREPARATIONDRAFT PLANNING ASSUMPTIONS AND BACKGROUND INFORMATION DOCUMENT

OWASA's *Financial Management Policy* (FMP) states that staff, the Finance Committee and the Board of Directors shall review the "economic assumptions that are expected to impact the preparation of budgets (O&M and CIP) and rates." Included in this document are the major assumptions and governing constraints upon which the Annual Budget for FY 2012 and the 15-year financial plan will be based.

The planning assumptions summarized in this draft *Planning Assumptions and Background Information Document* are derived from the following categories of influence and obligation.

- Legal and Regulatory
- Intergovernmental
- Bond Order
- Organizational
- Economic

Legal/Regulatory Assumptions

Federal, State, Local and Judicial

- OWASA must adopt a balanced budget in accordance with the *Local Government Budget and Fiscal Control Act* (N.C. General Statute 159).

- OWASA's primary source of income is through customer rates and fees. The OWASA Board has sole authority to set and revise rates, fees and other charges for our services. Our rates, fees and charges are not subject to supervision or regulation by any bureau, board, commission or other agency of the State or by any political subdivision (N.C. General Statute 162A-9).

- Rates, fees and charges shall be set so that our revenues, together with any other available funds, shall be sufficient at all times to pay (1) the cost of maintaining, repairing and operating the water and sewer systems including reserves for such purposes, and (2) all of the principal and interest on bonds issued by OWASA.

- Fees shall be made applicable throughout the service area, but fees and charges may vary by customer class when discernable cost factors can be attributed to the varying classes.

Intergovernmental

Agreements of Sale and Purchase with the University of North Carolina at Chapel Hill (UNC) and the Towns of Chapel Hill and Carrboro state:

- OWASA shall charge reasonable rates, based on cost of service, to all classes of users, serving all users within each class impartially and without unjust discrimination, with no differential in rates based on the location of a customer.

- OWASA shall operate the water and sewer system at the lowest rates possible consistent with its obligation to provide proper and efficient service.

- OWASA will furnish, for as long as UNC shall desire, water, meeting acceptable purity standards, in such quantity as may be required to meet UNC's needs.

- UNC will purchase all its water requirements from OWASA, unless OWASA is unable to supply sufficient water.

- UNC will be provided, now and hereafter, reliable and adequate sewer services to meet its needs.

- If five-year cumulative rate revisions exceed 20%, then UNC may request that a rate study be prepared by a qualified consultant and its results shared.

- OWASA agrees to meet the reasonable water and sewer needs of Carrboro and Chapel Hill.

- Chapel Hill, Carrboro and Orange County have adopted local water conservation ordinances as recommended by OWASA. The requirements of those ordinances have short and long-term demand and revenue implications.

Bond Order

- Interest earnings on any debt service reserve fund may be included in the debt service ratio calculation.

- OWASA shall not provide free service, and shall charge all users including public bodies based on established rates, except for water used in fire protection, street-washing, and the flushing and testing of water lines.

- While the FMP reflects a targeted 2.0 debt service coverage ratio, the Bond Order requires a minimum ratio of 1.2.

- Rate adjustments shall be made as often as necessary to ensure that annual gross receipts will be sufficient to provide for the payment of current expenses and proposed debt service in each subsequent year. Failure in this requirement could preclude the issuance of new debt until the requirement is met.

Organizational Assumptions

Mission Statement - OWASA's mission, values and departmental goals and objectives will be reflected in the budgeting process.

Financial Goals and Objectives

- The FMP specifies that the working capital reserve balance be at least equal to the greater of four months of the Operations & Maintenance Budget or 20% of the total estimated cost of capital improvements projects identified for the succeeding three years.

- The FMP stipulates that OWASA maintain a debt service coverage ratio of 2.0.

- For developing our CIP, we assume an annual construction cost escalation factor of 5%. This escalation factor is reviewed periodically.

- The FMP stipulates cash funding of at least 30% for capital improvements. We will use 100% equity funding for the FY 2012 CIP.

- The most recent projection for potable water sales for FY 2012 is 6.1 - 6.3 MGD. Reclaimed water sales are currently projected to be 0.7 - 0.8 MGD.

- The FY 2011 financial planning model assumed the following rate adjustments for the next three years:

Year	Projected Water and Sewer Rate Adjustments
FY 2012	8.75%
FY 2013	7.00%
FY 2014	6.00%

Demand and Growth Projections

FY 2012 revenue projections for potable water and new connections are affected most significantly by the following factors:

- Potable water sales will continue to remain near current levels in FY 2012 and beyond. We anticipate customer conservation patterns to continue and UNC is expected to marginally increase its use of reclaimed water (RCW).

- Current and near term development trends do not indicate any significant rebound of development activity in our service area in FY 2012.

Based on these factors, staff expects average daily potable water demand in FY 2012 to be approximately 6.1 - 6.3 MGD (compared to the current FY 2011 estimate of 6.1 MGD). We expect that new service connection activity in FY 2012 will be only slightly above FY 2011.

Economic Assumptions

- Real gross domestic product (the output of goods and services produced by labor and property located in the United States) increased at an annual rate of 2 percent in the third quarter of 2010. The increase in real GDP in the third quarter primarily reflected a smaller decrease in net exports, an acceleration in inventory investment, and a pickup in consumer spending for services. Although these contributions were partly offset by a downturn in residential housing and a slowdown in business investment in equipment and software, this may indicate a slowly improving economy.

- The CPI-U increased 1.1 percent for the 12-month period ending in September 2010. The index for all items less food and energy increased 0.8 percent over the same period.

- The energy index rose 3.8 percent for the 12-month period ending in September 2010. The index for energy commodities rose 5.8 percent, with the gasoline index increasing 5.1 percent. The index for fuel oil rose 11.8 percent. The electricity index increased 1.1 percent while the index for natural gas rose 3.1 percent.

- We expect an increase in the employer contribution to the Local Government Employee Retirement System of .53 points to approximately 7%.

- Proposals for renewing property, liability and health insurance coverage are not yet available but an increase in health coverage premiums is probable.

- Key interest rates are at historical lows, resulting in expectations for return on investment in FY 2011 of 1.0% or less.

ATTACHMENT 3

ORANGE WATER AND SEWER AUTHORITY
FISCAL YEAR 2011 DRAFT BUDGET CALENDAR

December 6, 2010	Distribute templates for the preparation of operating and maintenance appropriations, Capital Equipment Request Forms and Departmental Budget Narratives.
December 9, 2010	**Board of Directors Meeting** – presentation of draft *Strategic Issues and Policies* and *Financial Planning Assumptions and Background Information Document*, and presentation of draft *Budget Calendar for FY 2012*.
December 31, 2010	Submission of Capital Equipment Request Forms, Budget Narratives and Departmental Operations and Maintenance Budget Requests to Budget Officer.
January 24 – 28, 2011	Departmental budget request and cost containment review with the Executive Director, Director of Finance and Customer Service and Budget Officer.
January 27, 2011	**Finance Committee** – review 2nd quarter financial report and discussion of strategic issues, planning assumptions and budget process calendar.
January 27, 2011	**Board of Directors Meeting** – presentation of 2nd quarter financial report and report by Finance Committee on refinement of strategic issues, planning assumptions and budget process calendar.
February 24, 2011	**Finance Committee** – discussion of *Draft Preliminary Annual Budget* and staff recommendation of rate adjustment.
March 24, 2011	**Board of Directors and Finance Committee Meetings** – discussion of *Draft Preliminary Annual Budget* and staff recommendation of rate adjustment.
April 22, 2011	Deliver *Draft Preliminary Annual Budget* to the Board of Directors.
April 28, 2011	**Board of Directors Meeting** – adoption of the *Preliminary Annual Budget*.
May 6, 2011	Deliver *First Draft Final Annual Budget* and *Draft Schedule of Rates, Fees and Charges* to the Board of Directors.
May 12, 2011	**Board of Directors Meeting** – presentation of the *First Draft Final Annual Budget* and *Draft Schedule of Rates, Fees and Charges*.
May 26, 2011	**Board of Directors Meeting** – Public Hearing on the *Draft Final Annual Budget, Capital Improvements Budget* and Public Hearing on the proposed adjustments to rates, fees, and charges.
June 3, 2011	Deliver *Annual Budget* to the Board of Directors.
June 9, 2011	**Board of Directors Meeting** – adoption of *FY 2012 Annual Budget* and adoption of *Schedule of Rates, Fees and Other Charges*.
June 30, 2011 (On or About)	Distribution of *FY 2012 Annual Budget*.