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: **Finance Committee**
John Young (Chair)
Terri Buckner
Gordon Merklein
Will Raymond
Amy Witsil
Alan Rimer (*ex-officio*)

THROUGH: Ed Kerwin

FROM: Stephen Winters, CPA

DATE: March 22, 2013

SUBJECT: Finance Committee Meeting – March 28, 2013

The Finance Committee will meet on Thursday, March 28, 2013, at 5:30 p.m. in the First Floor Conference Room adjacent to the Council Chambers at the Chapel Hill Town Hall. The agenda will be:

- Staff will provide an update on the status of the Fiscal Year (FY) 2014 budget and rate adjustment analysis, and the process used for developing the draft budget.

  Committee Action Requested: Review and discuss information.

Stephen Winters, CPA
Director of Finance and Customer Service

cc: Board of Directors
Ed Kerwin
Bob Epting

Purpose

The purpose of the meeting is to provide the Finance Committee with:

- An update on staff's development of the draft operating budget for Fiscal Year (FY) 2014 and the approach we have taken to prepare it.
- A summary of the next steps in budget development process.
- An overview of the expenditures included in the draft FY 2014 operating budget and comparisons with historical and forecasted results.

The information that follows does not include projections of revenues. Revenue projections are developed as part of working with our consultants to update our 15-year financial plan and will be included in the next iteration of the budget.

The Committee and Board of Directors will discuss these topics again in April and May as necessary in order to be prepared to hold public hearings on May 23, 2013 and make final budget and rates decisions in June.

Budget and rate adjustment status

Staff has developed drafts of the FY 2014 operating budget, the 5-year capital improvements program (CIP), and the capital equipment budget. On March 21, we began incorporating this data into our 15-year financial planning model along with water and sewer demand projections and other information critical to determining whether there is a need to adjust the rates we charge for services, if and when to issue additional debt to fund capital improvements, etc. At the time of this writing, we have not progressed far enough in the process to come to a preliminary conclusion about the need for a rate adjustment. However, as you will see from the information presented below, the preliminary FY 2014 budgets are favorable when compared to the information projected for FY 2014 that was included in last year's financial plan. At the Finance Committee and Board meetings on March 28, we expect to be able to discuss our preliminary findings regarding a rate adjustment.

Highlights of the preliminary budget

Highlights of the current draft FY 2014 budget include the following.

- The operating budget is:
  - Slightly less than the adopted FY 2013 budget,
  - 1% greater than the most recent FY 2013 forecast, and
  - 3.7% less than the FY 2014 budget projection that was assumed in last year's financial plan.
- The CIP budget totals, capital equipment expenditures and debt service are closely aligned with the totals assumed for FY 2014 in last year's financial plan.

Expenditures in the draft FY 2014 budget are summarized below.

Category	Amount (in thousands)
Operating Expenses	$19,503
Capital Improvements Program	15,900
Capital Equipment Expenditures	500
Debt Service on Outstanding Bonds	7,900
Total	$43,803

Approach to developing the FY 2014 budget

We have drafted the FY 2014 budget based on "normal operating conditions" without contingencies. This increases our risk of exceeding the budget if we incur higher than normal costs from, for example, chemical price increases, more instances of equipment failures, etc. However, OWASA has taken deliberate actions over the last several years to improve its financial condition and these efforts have been successful. Our improved financial condition has enhanced our ability to manage the finances of the organization with a leaner budget.

In December 2009, Fitch Ratings downgraded OWASA's bond ratings due to our debt service coverage and liquidity (reserves) levels. Beginning in FY 2009, OWASA began rebuilding its reserves and improving its operating margins and as the Board has seen in our quarterly financial reports, our goals for reserves, debt service coverage and other critical financial indicators set forth in our financial management policy are being met. The combination of having a Board-adopted financial management policy, following the plan identified in the policy, and improving our financial condition has resulted in "double-A" bond ratings from each of the three major ratings agencies. Our customers benefit from high bond ratings through lower interest costs, avoidance of the need to purchase bond insurance or to set aside debt-related reserves, and increased flexibility in meeting borrowing needs.

One of the intended outcomes of accumulating reserves and improving our financial condition is to be better prepared for contingencies that can adversely affect the organization and the customers we serve. Without adequate reserves, we might not be able to react timely and effectively to situations such as a critical asset failure, significant and sudden decrease in water demand, or the effects of a natural disaster. Having adequate reserves also helps us reduce the risk of needing to suddenly increase rates to address unbudgeted expenditures.

Budget preparation efforts to date

Our draft budget is based on the needs of the organization and our continued commitment to provide high value for our customers. We began the process of developing the FY 2014 budget in December 2012. We completed budget request worksheets for each department, compiled the information, performed various analyses, and held budget request review meetings. Through this process, we refined the draft budget and identified about $200,000 of operating budget requests that could be deferred if needed in order to achieve a desired rate adjustment outcome. Although these proposed expenditures have been requested based on needs, we do not believe there will be significant adverse impacts on near-term operations or service to our customers if they are deferred.

Comparative data

Tables 1 and 2 show how the draft FY 2014 budget compares to other relevant data.

Table 1

	FY12 Actual	FY13 Budget	FY13 Forecast	FY14 Budget projected in last year's financial plan	Draft FY14 Budget
	(in thousands)				
Operating Exp.	$19,043	$19,552	$19,307	$20,246	$19,503
CIP	10,507	11,076	8,370	14,700	15,900
Capital Equip.	595	225	225	400	500
Total	$30,145	$30,853	$27,902	$35,346	$35,903

Table 2

	Draft FY14 Budget vs. FY12 Actual	Draft FY14 Budget vs. FY13 Budget	Draft FY14 Budget vs. FY13 Forecast	Draft FY14 Budget vs. FY14 Budget projected in last year's financial plan
		(percent change)		
Operating Exp.	2.4%	(0.3)%	1.0%	(3.7)%
CIP	51.3	43.6	90.0	8.2
Capital Equip.	(16.0)	122.2	122.2	25.0
Total	19.1	16.4	28.7	1.6

Tables 3 and 4 show how the key expenditure categories in the draft FY 2014 operating budget compare to FY 2011 and FY 2012 actuals as well as our updated forecast for FY 2013.

Table 3

Operating Budget	FY12 Actual	FY13 Budget	FY13 Forecast	Draft FY14 Budget
		(in thousands)		
Salaries and Wages	$6,963	$7,255	$7,127	$7,162
Benefits and Taxes	2,909	2,988	2,871	3,174
Utilities	1,802	1,916	1,953	1,922
Materials and Supplies	2,817	2,550	2,579	2,710
Maintenance	2,714	2,990	2,954	2,769
Professional Services	1,419	1,430	1,388	1,299
Communications	122	140	141	157
Education and Development	111	132	120	132
Miscellaneous	186	151	174	178
Total	$19,043	$19,552	$19,307	$19,503

Table 4

Operating Budget	Draft FY14 Budget vs. FY11 Actual	Draft FY14 Budget vs. FY12 Actual	Draft FY14 Budget vs. FY13 Forecast
	(percent change)		
Salaries and Wages	5.3%	2.8%	0.5%
Benefits and Taxes	12.6	9.1	10.6
Utilities	5.3	6.7	(1.6)
Materials and Supplies	16.1	(3.8)	5.1
Maintenance	(2.4)	2.0	(6.3)
Professional Services	18.6	(8.5)	(6.4)
Communications	25.4	29.0	11.8
Education and Development	28.6	18.9	10.1
Miscellaneous	37.9	(6.8)	1.4
Total	7.9	2.4	1.0

The draft of the FY 2014 operating budget of $19.5 million includes the following assumptions:

- The volumes of water, reclaimed water, and wastewater treated will remain essentially the same as in FY 2013.
- 1.5% vacancy allowance – in recent years, we have budgeted for our positions to be 100% filled for the entire budget year. In the current draft of the FY 2014 budget, we have reduced the overall personnel budget by 1.5%, or approximately $140,000, to allow for position vacancies.
- 15% increase in health insurance. However, we just learned that our actual health insurance increase will be 6.4% which will be reflected in the next iteration of the budget. The net cost increase will be about 80,000.
- 4.7% increase in electricity costs – an approximate increase in costs of $65,000.
- 2.5% placeholder for merit and cost of labor increases. The Board will make a decision on merit and cost of labor adjustments in late summer or early fall; this is just a budget placeholder.
- $40,000 placeholder for converting employee Service Pay (or longevity pay) to regular compensation. Staff plans to submit a proposal for consideration by the Board in follow-up to the recent Employee Classification and Compensation Study which recommended that we consider eliminating Service Pay since it is inconsistent with a performance based system.
- No allowance for increasing the amount of employer contributions to the employee 457 retirement plan. The Employee Classification and Compensation consultants also recommended that we consider enhancing this benefit. We project that we will contribute $225,000 to the plan under the current arrangement. Staff plans to submit a proposal for modifying the 457 plan to the Board for consideration.
- Costs related to obtaining easements – $55,000 for survey work, attorney fees and compensation to property owners for an initial phase of easement acquisitions in areas where there are old sewer lines without easements.
- $66,000 for our proportionate share of the costs of a regional water system interconnection modeling study that will be done through the Jordan Lake Partnership project.
- $29,000 increase in state unemployment tax due to State legislative action.
- Retiree insurance benefits costs for three of the ten employees eligible for retirement in FY 2014.
- Three part-time lake staff.
- $24,000 increase in vehicle maintenance costs for license tags due to State legislative action.
- Elimination of chemical costs of about $30,000 as a result of a CIP project at the Heritage Hills pump station.

Draft 5-year Capital Improvements Program budget

The draft FY 2014-2018 CIP Budget totals are closely aligned with the totals included in last year's financial plan for these same years. Differences from last year's budget include an increase in FY 2014 to reflect FY 2013 funds that will not be expended and therefore carried over to the coming fiscal year, as well as the addition of several smaller projects identified by operations and maintenance staff.

This draft 5-year CIP reflects significant investment at the Mason Farm Wastewater Treatment Plant (WWTP) to cover and treat the air emanating from ten of the 16 aeration basins and to achieve substantial increases in the energy efficiency and effectiveness of the plant's biological treatment process by converting the coarse-bubble aeration system to a fine-bubble system and converting the existing jet-mixing pumps to mechanical (rotating) vertical mixers. A contract has been awarded for this project and it is scheduled for completion by December 2014 in order for us to meet our odor control obligations to the Town of Chapel Hill (per the Town Council's Special Use Permit requirements).

The draft CIP also has been informed by OWASA's evolving asset management program and related condition assessment efforts. Initial efforts have been focused on improved management (including identification of future

capital needs) of our vertical (above-ground) assets. The asset management effort has provided important information and we expect that as we achieve a comprehensive asset management portfolio of both our above- and below-ground infrastructure, our capital plans will be better informed than at any point in our history.

More than 75% of the draft FY 2014 CIP budget is dedicated to a number of large projects for which contracts have already been awarded (WWTP Odor Control/Aeration System Improvements, Heritage Hills Sewer Force Main Replacement, Friday Center Sewer Interceptor Replacement, Cameron Avenue Water Main Replacement, etc.). As a result, there will be less non-committed funding in FY 2014 than is typically available.

Despite an uncertain future, we believe that the proposed levels of investment presented in this CIP leaves OWASA well-positioned to maintain customer service levels and remain the sustainable, responsible and environmentally focused organization that the community expects.

Table 5 summarizes planned expenditures of the five-year CIP by major functional areas.

Table 5

Project Category	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
	(in thousands)				
Raw Water Supply Sources	$217	$63	$20	$195	$775
Raw Water Transmission		23			
Water Treatment Facilities	779	722	29	2,144	2,251
Finished Water Pumping	60				
Water Transmission and Distribution	2,146	3,057	5,544	4,745	4,984
Wastewater Collection Lines	3,494	4,081	3,448	6,580	3,264
Wastewater Pump Stations	322	604	1,982	476	548
Wastewater Treatment and Disposal	8,636	1,461	2,691	4,076	4,588
Central Office and Operations	336	218		390	410
Total	$15,990	$10,229	$13,714	$18,606	$16,820

Draft capital equipment budget

Table 6 is a summary of the current draft of the capital equipment budget for FY 2014:

Table 6

Equipment	Department	Current Request	Notes
Phone system	IT	$70,000	Support for current system ends in FY14.
Network storage	IT	55,000	Support for current unit expires in FY13.
Tape library	IT	6,000	Support for current unit expires in FY14.
Server	IT	10,000	Support for current unit expires in FY14.
Security camera system at Wastewater Plant	IT	30,000	Current system already past end of support.
Ortho phosphate analyzer	Water Plant	12,000	Optimizes feeding of phosphate.
Valve operator	Distribution	31,000	Essential for valve maintenance program.
Utility body truck	Distribution	66,000	Replaces 15-year old vehicle with high

Equipment	Department	Current Request	Notes
			maintenance costs.
Nitrate analyzer	Wastewater Plant	20,000	Improve accuracy of control data collection.
Pump station wet well mixer	Wastewater Plant	20,000	Helps control grease, keep wet well clean, reduce pump failures, and prevent overflows.
Power monitoring system	Wastewater Plant	50,000	Enables monitoring of electrical power use for key process units and facilitates load management.
Flow meters	Wastewater Plant	25,000	Flow metering at key locations.
Boom hoist	Wastewater Plant	10,000	Replacement for current equipment that is undersized and at end of useful life.
Pole camera	Collections	17,000	Will improve efficiencies by enabling easement maintenance crew to perform their own inspections rather than calling the TV crew off of another job.
HACH Water & Wastewater Information Management System	Water and Wastewater Plants	68,000	Centralized, uniform data management and reporting system for both plants.
Equipment Contingency		10,000	
Total		500,000	

Budget process next steps

The following steps are planned towards achieving our objectives of conducting the scheduled public hearings on the budget and rates on May 23, 2013 and presenting a final budget and proposed rate schedule for Board of Directors approval at Board meeting on June 13:

1. Staff will perform further review and analyses of the initial financial plan developed with our rate consultants on March 21 and 22.
2. Provide a brief summary of the March 28 Finance Committee meeting to the Board at its meeting later that same evening.
3. Staff will incorporate feedback from the March 28 Finance Committee and Board of Directors meetings into the draft budget, CIP, financial plan, and associated rate recommendations.
4. Staff will present a draft of the FY 2014 budget, CIP and rate adjustment recommendation to the Finance Committee and Board of Directors in late April.
5. Staff will incorporate feedback from the Finance Committee and Board of Directors into drafts of the budget, etc.
6. Staff will present a revised draft of the FY 2014 budget, CIP and rate adjustment recommendation to the Finance Committee and Board of Directors in early May.
7. Staff will prepare revised drafts of the FY 2014 budget, CIP and rate adjustment recommendation for presentation at the May 23 public hearings.
8. Board will receive and consider comments from customers and other stakeholders on May 23.
9. After considering public input, the Board of Directors will discuss and provide guidance to staff on the final draft FY 2014 budget, CIP and rate adjustment.
10. Staff will finalize the FY 2014 budget, CIP and rate adjustment recommendation and present it for adoption by the Board of Directors at its meeting on June 13, 2013.

Action requested

Review the draft FY 2014 budget information and provide feedback.