

Utility Rates 201

Developing Acceptable Ratios and Goals

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Public Utility = Enterprise Fund?

- 💧 Enterprise funds by definition are businesses.
- 💧 Much easier to apply business model than general purpose governments.
- 💧 Strong business practices yield:
 - 💧 Insulation from politics
 - 💧 Justifiable rates and fees
 - 💧 Improved credit ratings

Sound Business Applications Related to Rate Setting

- ◆ Establishment of policies and objectives to describe a systematic and comprehensive approach to financial planning, and development and implementation of policy and related decisions that guide the organization in providing the best and most economical services to current and future customers.
- ◆ Long-term financial planning
 - ◆ Operations and maintenance
 - ◆ Capital Improvements Plans
 - ◆ Modeling

Policy Framework Goals

- Provide sufficient financial resources and ability to fund continued operation, maintenance and construction of high quality services and facilities.
 - Equitable
 - Economical
 - Meets demand of present without compromising the ability to meet future needs

Policy Framework Objectives

- ◆ Long-range financial planning and management that enables:
 - ◆ Full compliance with all legal requirements
 - ◆ Set rates fees and charges that generally reflect cost of service
 - ◆ Manage credit ratings for favorable cost of debt
 - ◆ Maintain appropriate risk management program
 - ◆ Establish context in which debt will be issued
 - ◆ Enhance Revenue stability
 - ◆ Minimize uncertainty in revenue, capital and expense forecasts
 - ◆ Minimize rate shock through programmed implantation
 - ◆ Maintain competitive rates

General Policies

- Commit to as reasonable revenue and expenditure estimates as possible.
 - Smooths out peaks and valleys in budget variance
 - Stabilizes long-term planning
- Pay operating expenses with operating revenues.
 - Don't plan to use nonrecurring revenues
 - Put non-operating revenues in the CIP kitty

General Policies (Cont.)

💧 Establish reserves

- 💧 Working capital reserve (rainy day fund)
sufficient to:

- 💧 Offset significant downturns in revenue streams
and hedge against revenue instability

- 💧 Provides cash flow

- 💧 Measurable in number of days or ratios

General Policies (Cont.)

💧 Just in time reserves

- 💧 Capital Reserve

- 💧 Research & Development

- 💧 Asset maintenance

💧 Establish amount of cash funding of the CIP (Pay-As-You-Go)

Specific Measurements

💧 Liquidity ratios

- 💧 Liquidity – current ratio, etc.

- 💧 Operating revenues in receivables =
receivables divided by operating revenues
divided by 365 days

- 💧 Days of cash on hand = unrestricted cash
divided by operating expenses divided by 365
days

Liquidity Ratios (Cont.)

- Operating ratio = operating expenses divided by total operating revenues
- Net take-down = net revenue divided by gross revenue

Debt Measurements - bolster credit ratings, minimize borrowing costs, preserve access to credit

- 💧 Debt service ratio = net operating revenue divided by annual debt service
 - 💧 Min. per bond order generally 1.2 and 1.1 (bonded and total debt, respectively)
 - 💧 Set higher but be realistic
- 💧 Debt service safety margin – net revenues less debt payments divided by gross revenue

Debt Measurements (Cont.)

- 💧 Debt ratio = debt divided by net fixed assets and working capital
- 💧 Debt service as percentage of revenues
- 💧 Annual debt per customer
- 💧 Outstanding debt to net fixed assets

Other Ratios

- Age of plant = accumulated depreciation divided by annual depreciation
 - Indicates level at which maintenance is being deferred
- Resources
 - GFOA
 - AWWA
 - Rating Agencies
 - Your old accounting text books

Summary

- Applying a strategic business model approach to financial planning and reporting provides:
 - Greater long-term stability
 - Fewer surprises
 - Enhanced credit worthiness
 - Sustainable future



Questions?