Date: December 19, 2017

To: Allan Warman & Colleen Johnson, Portland Utility Board Co-Chairs

CC: Portland Utility Board members
Melissa Merrell & Shannon Fairchild, City Budget Office

From: Director Michael Jordan, Bureau of Environmental Services
Director Michael Stuhr, Portland Water Bureau

RE: Response to PUB Co-Chairs requested Information for Bureau FY 2018-19 Budgets

Introduction

The following memo is in response to the PUB Co-Chairs letter dated December 4th, 2017.

In the letter you requested that the bureaus identify and prioritize decision package requests within specified categories prior to December 19. It is our belief and understanding that the information provided in advance of and presented at the December 5 and December 19 meetings responds to that request. In that same letter, the PUB Board Co-Chairs' requested analysis by the January 9th PUB meeting of budget requests (i.e. reductions) that would be required to limit ongoing combined rate increases of 4% and 3%. Significant capital and operating reductions would be required to achieve these rate targets. These reductions would increase the risk of the bureaus not meeting their minimum service obligations and transfer costs to future ratepayers. We believe the substantial cuts would be inconsistent with the budget guidance of the Mayor and Commissioner Fish and previous PUB input.

Background

Over the past several months, the Bureau of Environmental Services and Portland Water Bureau have engaged in a budget development process that is responsive to the budget guidance provided by Mayor Wheeler and Commissioner Nick Fish. Commissioner Fish directed the bureaus to limit any combined rate increase impact to below 5%. Mayor Wheeler encouraged bureaus to prioritize requests to have direct and measurable impact on "..maintaining the City's critical infrastructure…and continuing to pursue innovation and strengthening our resiliency posture." Commissioner Fish directed the bureaus to prioritize "..our commitment to running the bureaus efficiently, economically, and equitably, with a continued focus on strengthening our infrastructure and supporting our workforce."

In addition, Commissioner Fish noted that the proposed budgets should dedicate the necessary resources for full implementation of the bureaus' strategic plans and optimize financial assistance programs to lessen the impact of utility costs on low-income customers. In preparing the proposed budget for the PUB's consideration, the bureaus have prioritized program realignments, additions and reductions in accordance with this guidance.

Discussion

The bureaus appreciate that rate-setting is complex. We rely on asset management and financial best practices, public input, and our strategic plans to identify priority areas for investment. Further, we aim to continuously improve our ability to accurately forecast long-term costs and risks, and to minimize rate impacts over the long-term.

The bureaus believe that the proposed preliminary budgets under review by the PUB Board are responsive to the Mayor's and Commissioner's budget guidance. They also represent the optimal mix of capital reinvestment, regulatory compliance, ongoing operational needs and investment in strategic goals that benefit ratepayers over the long-term. We look forward to discussing this further at the December 19 meeting.

To be responsive to the request to review options to limit combined ongoing rate increases to 4% and 3%, below is an example of the typical monthly combined bill and three pathways to limit the combined rate increase to 4% and 3% compared to a 5% combined rate increase.

Typical Monthly Combined BES and Water Bill

	FY17-18	5% combined rate increase	4% combined rate increase	3% combined rate increase
BES	$71.86			
Water	$36.11			
	$107.97	$113.37	$112.29	$111.21
			($1.08)	($2.16)

Pathway #1 – Limit and Reduce CIP Investments

Required ongoing CIP reduction (between both bureaus) to meet:

- 4% target (instead of 5%) – at least $75 million combined annually (~30% of combined 5-year CIP)
- 3% target (instead of 5%) – at least $120+ million combined annually (~50% of combined 5-year CIP)

Reducing the CIP at these levels would require that multiple projects be stopped, delayed or reprioritized, resulting in increased regulatory risk and non-compliance, increased risk of system failure, degradation of the environment and public health, and increased costs for operations and maintenance (O&M) and emergency system repairs. The corresponding effect of CIP reductions is increased rate pressure and system risk in future years. The bureaus' current CIP strategies aim to improve service delivery and reduce long-term O&M and system risk by investing in prioritized asset replacement and repair. It should be noted that savings in the first year of the reduction is limited due to financing obligations and the cost of stopping ongoing projects.

Pathway #2 – Limit and Reduce Operating Programs and Staffing

Required <u>ongoing</u> O&M reductions each year (between both bureaus) to meet:

- 4% target (instead of 5%) – $4.5 million in the first year (equivalent of approximately 36 FTE reduction)
- 3% target (instead of 5%) – $10.3 million in the first year (equivalent of approximately 82 FTE reduction)

To affect the desired rate impact the bureaus would need to target O&M and staff reductions that do not unduly impact critical service delivery. This would mean decreases in areas such as customer service and assistance, community involvement, permit compliance monitoring, as well as support services that aim to improve efficiency, innovation, and transparency. Ongoing operating limits at these levels will impact critical service delivery. The bureaus' strategic plans and priorities aim to maintain and improve upon these service areas rather than reduce them overtime.

Pathway #3 – Modify Financial Planning/Forecast Assumptions

City policy and financial best practices encourage reasonable and conservative estimates regarding assumptions such as future revenue growth, debt costs, inflation, cash balances, earnings and other financial considerations. This best practice aims to avoid sudden and unexpected shocks to the financial system due to unpredictable economic and demographic changes. Bureaus could use more aggressive assumptions in the rate and forecast models as a method to reduce forecast rate requirements. It is unlikely that this strategy alone would be sufficient to reduce rates more than incrementally. Further, this strategy transfers the risk and costs of unexpected economic outcomes to be borne by future ratepayers, reducing the targeted rate stability.

Conclusion

We respectfully request PUB clarify it's expectations for this process, including the level of detail to evaluate significant rate reductions.

We appreciate the due diligence and input provided throughout the year by the Portland Utility Board, and we look forward to participating fully throughout the budget deliberation process.

<u>Attachments:</u>

Mayor Ted Wheeler FY 2018-19 Budget Guidance

Commissioner Nick Fish FY 2018-19 Budget Guidance

PUB Co-Chairs' letter - Requested Information for Bureau FY 2018-19 Budgets