Analysis By: Ryan Kinsella

PORTLAND WATER BUREAU

All Funds Budget Summary	Adopted FY 2013-14	Request Base FY 2014-15	Decision Pkgs FY 2014-15	Request Total FY 2014-15	Percent Change
Resources					
Budgeted Beginning Fund Balar	$233,886,685	$150,499,726	$0	$150,499,726	-35.7%
Charges for Services	139,407,766	148,392,945	(1,349,780)	147,043,165	5.5%
Intergovernmental Revenues	666,000	526,000	0	526,000	-21.0%
Interagency Revenue	3,201,050	3,049,700	0	3,049,700	-4.7%
Fund Transfers - Revenue	221,253,375	206,841,239	(14,152,890)	192,688,349	-12.9%
Bond and Note Proceeds	0	133,572,890	(14,152,890)	119,420,000	NA
Miscellaneous Sources	5,344,115	5,780,200	0	5,780,200	8.2%
Total Resources	**$603,758,991**	**$648,662,700**	**($29,655,560)**	**$619,007,140**	**2.5%**
Expenditures					
Personnel Services	$61,769,827	$62,670,883	($1,675,330)	$60,995,553	-1.3%
External Materials and Services	23,592,899	24,620,288	(561,935)	24,058,353	2.0%
Internal Materials and Services	19,844,784	19,340,756	(179,090)	19,161,666	-3.4%
Capital Outlay	98,715,853	85,755,700	(13,086,315)	72,669,385	-26.4%
Debt Service	51,036,055	57,004,679	0	57,004,679	11.7%
Fund Transfers - Expense	226,677,164	212,204,448	(14,152,890)	198,051,558	-12.6%
Contingency	85,997,797	76,085,608	(2,122,934)	73,962,674	-14.0%
Unappropriated Fund Balance	36,124,612	110,980,338	2,122,934	113,103,272	213.1%
Total Requirements	**$603,758,991**	**$648,662,700**	**($29,655,560)**	**$619,007,140**	**2.5%**
Total Bureau FTE	**577.35**	**577.35**	**(11.00)**	**566.35**	**-1.9%**

Percent Change is the change from FY 2013-14 Adopted Budget to FY 2014-15 Total Requested Budget.

Key Issues

FY 2014-15 Budget and Rates. The Portland Water Bureau's FY 2014-15 Requested Budget results in the typical residential customer (5 CCF/month) seeing a rate increase of $1.93 per month for a total typical monthly bill of $29.54. Following the direction of their Commissioner-in-Charge, the bureau reduced its planned operating budget by $1.4 million in addition to reducing the planned capital budget by $14.1 million in FY 2014-15. This amounts to a retail rate increase of 7.0% compared to current year rates.

For context, outlined below are the forecasted rate increases as projected at the time of the requested budget submission. The bottom line of the table is the projected typical residential monthly bill based upon usage of 5 CCF/month.

The table also identifies the factors that drive rate increases, and specifically, budget and forecast adjustments that impacted FY 2014-15 proposed rates.

TABLE 1: Water Retail Rates Forecast	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19
Escalation Factors	3.2%	3.3%	2.1%	2.7%	
Capital Program	**17.8%**	**11.2%**	**7.6%**	**4.2%**	
Rate Stabilization Account	-8.1%	-0.9%	-2.5%	0.9%	
Lower Retail Demand	1.5%	0.8%			
2013 Bond Refunding	-0.3%	-0.3%			
Wholesale Revenue			1.8%	0.2%	
FY 2013-14 Adopted Rate Forecast	14.1%	14.1%	9.0%	8.0%	7.2%
Forecast Adjustments					
FY 2012-13 CIP Underspending	-1.0%				
FY 2012-13 Operating Savings	-1.5%				
Updated CIP	-1.6%	-2.1%			0.3%
Updated Bond Rate to 5.25%	-0.8%				
Updated Non-Rate Revenue Projections	-0.1%				
Inflation Update (October)	-1.1%	0.8%	0.1%	0.8%	0.1%
Interest Earning Rate Update		-0.1%	-0.1%		
Wholesale Updates	0.2%	-1.4%	1.4%	0.7%	
	8.2%	11.3%	10.4%	9.5%	7.6%
Budget Adjustments					
Operating Reduction	-0.8%				
General Fund Overhead	-0.2%				
Interagency Updates	-0.2%				
Requested Retail Rate	7.0%	11.3%	10.4%	9.5%	7.6%
Projected Typical Residential Bill (5 ccf)	$29.54	$32.88	$36.30	$39.75	$42.78

Noted below are several factors that result in rate changes:

- **Escalation Factors**. To provide the same level of service, escalation factors require a rate increase of 3.2% in FY 2014-15. These escalation factors include a melded inflation (materials and other utility cost increases) in addition to increases in personnel costs (PERS and health costs), and lower interest earnings.
- **Capital programs.** The bureau's capital plan continues to be the primary driver of rate increases through FY 2018-19 (a topic that is discussed at length below). The bureau uses its rate stabilization account to mitigate significant fluctuations in rates due to planned capital spending. For example, planning that its FY2014-15 capital program would impact rates by a 17.8% increase, the bureau will use funding from its rate stabilization account, lessening the required rate increase.
- **Bond rate assumptions.** The bureau plans to issue $119.4 million in first-lien revenue bonds in August 2014. The City's Debt Manager provides bureaus with estimated interest rates for future planned issuances, and per internal policy, advised the bureau to plan for 6.0% interest rates prior to budget development. Based on current market conditions, the Debt Manager lowered the

expected interest rates to 5.25%, lessening the impact on the FY 2014-15 retail water rate. Depending upon rates at the time of issuance, this bond interest rate may again change.

- **Wholesale contracts.** The bureau does not project significant changes to wholesale contract revenues, except for in FY 2016-17, when the bureau has planned for an additional increase of 1.8% impact to retail rates when the City of Tigard's contract terminates.

Since the beginning of the budget process, the bureau adjusted rates in its FY 2014-15 Forecasted Rate Increase; these adjustments are reflected in the "Forecast Adjustments" and "Budget Adjustments" subsections.

As noted in prior CBO analyses, CBO recommends that current operating and capital budget decisions be considered in the context of future rate requirements, as several rate drivers span multiple years, particularly CIP requirements.

Before discussing the requested budget and CIP, the following discussion provides a framework for showing how capital needs impact bureau finances, given that the bureau's CIP continues to be a primary driver of forecasted rate increases. Specifically, this review discusses the bureau's capital needs in the context of aging infrastructure and the financing mechanisms to pay for these ongoing requirements. Finally, CBO outlines how Council provides direction on bureau capital planning, including recommendations on when Council's direction will have the most direct impact on future rates.

Aging Infrastructure

The Portland Water Bureau has an asset management program that aims to avoid a situation where extensive portions of the water system are considered "very poor" assets. Portland's situation is not dissimilar to cities across the county. The American Society of Civil Engineers and the Environmental Protection Agency both find that significant portions of the water system's infrastructure for many jurisdictions are in need of replacement.

This aging infrastructure results from periods of large system expansion, (e.g., the postwar era of the 1950s), during which large "cohorts" of assets are built. If installed in uniform conditions, and being built with similar materials and within a certain period, these assets will require replacement around the same time. However varying environmental conditions, like high street traffic, soil type, corrosivity, manufacturing and construction variances lead to failures at different times.

The Water Bureau's asset management program addresses the aging infrastructure issue by planning maintenance and replacement with the aim of minimizing both risk and costs. The Asset Management program manages the need to reinvest in large cohorts by creating detailed estimates of asset life and weighing risks, cost efficiency and service levels.

For example, the bureau's Asset Management Plan forecasts main replacement for the next 200 years, and for the most part, the plan calls for a relatively stable rate of replacement. The next 20-30 years are an exception to this stable investment, as the oldest cast iron near the end of their useful lives. (For further details, please see "Asset Management Planning at the Portland Water Bureau", June 2013).

For illustrative purposes, the table below illustrates the design life of water system's major components, as outlined the by the American Water Works Association.

TABLE 2: Design life of drinking water systems	
Water System Components	**Design Life**
Reservoirs and dams	50-80
Treatment plants—concrete structure	60-70
Treatment plants—mechanical and electrical	15-25
Trunk mains	65-95
Pumping stations—concrete structures	60-70
Pumping stations—mechanical and electrical	25
Distribution	60-95

In Portland, with relative benign conditions, the bureau expects much longer economic lives. However, as evidenced by this table, water system components are likely to span multiple generations of ratepayers, some of whom will not be responsible for the costs of replacing major system assets.

To the degree that lesser investments are made towards current needs, the burden of addressing aging infrastructure (and corresponding rate increases) is deferred to future generations. As the American Water Works Association notes, "although the financial cost of upgrading or replacing the infrastructure is daunting, the cost of ignoring it could be catastrophic." Currently the Asset Management group estimates that 14% of assets are in poor to very poor condition, representing $1 billion of needed investment. Of those assets with the highest risk (10 in total), all are being addressed in the current capital plan.

Investing in the long-term needs of the Water Bureau assets, while challenging in light of pressures to limit rate increases, is an important component of running a utility. Moreover, the discussion of aging infrastructure is a reminder that, for the foreseeable future, the bureau will need to continue to prioritize highest risk assets in its CIP.

Capital Financing

The bureau plans for the replacement of infrastructure in the Five-Year Financial Plan by outlining the financing requirements for the bureau's immediate capital needs. As Table 1: Water Retail Rates Forecast illustrates, capital needs are the most significant driver of future rate increases. The following discussion answers several questions about financing capital needs, including:

- Why are additional ongoing rate increases included in the Five-Year Financial Plan?
- Why is additional debt required, in contrast to waiting for the maturity of prior debt?
- How can Council provide the most effective direction in prioritizing capital needs?

Currently three resources are used to finance the bureau's capital needs: (1) cash, (2) debt, (3) and capital revenues. The bureau estimates that 40% of the FY 2014-19 CIP will be funded through current resources, whereas approximately 60% will be funded through bond proceeds. Table 3: Capital Financing (below)

outlines forecasted capital requirements (including both direct and indirect capital costs) and the type of resources used to finance the capital plan. The bureau currently projects that 25% to 30% of the 45.8% rate increase over the five years is due to capital needs.

TABLE 3: Capital Financing (millions)	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	Total	
Forecasted Capital Spending	$110,607	$83,916	$97,520	$118,413	$84,074	$494,530	
Capital Financing							*% of Total*
Capital Revenues	$6,885	$7,437	$7,917	$8,504	$9,013	$39,757	**8.0%**
Debt	$77,458	$48,749	$57,552	$76,089	$38,351	$298,198	**60.3%**
Cash	$26,264	$27,730	$32,051	$33,820	$36,710	$156,575	**31.7%**

Cash. Cash available to finance capital expenditures comes from three primary sources: water sales revenues (retail and wholesale), surplus fund balance (from underspending or additional revenues) and interest on fund balances. Approximately 45% of water sales revenues go towards operations, 20% towards cash financing capital and 35% towards debt service (that pays for capital). The table below summarizes the forecasted water sales revenues and how these revenues will be used to fund operations and capital expenditures.

TABLE 4: Water Sales (millions)	FY 2014-15	FY 2015-16	FY 2 016-17	FY 2017-18	FY 2018-19	Total
Revenues						
Retail	125,718	138,903	153,349	167,917	180,678	766,564
Wholesale	16,563	18,605	16,117	16,402	16,796	84,484
Ground Water/Outside-City	594	743	727	811	816	3,689
Total	$142,875	$158,251	$170,193	$185,130	$198,290	$854,737
Requirements						
Operation and Maintenance	66,746	77,251	77,492	86,680	91,676	399,845
Capital	26,239	27,700	32,021	33,790	36,680	156,430
Debt Service (Capital)	49,890	53,300	60,680	64,658	69,934	298,462
Total	$142,875	$158,251	$170,193	$185,128	$198,290	$854,737

Revenues exceed operating and debt services expenses so that the bureau meets its debt coverage ratios as agreed upon by Council in bond covenants. For FY 2012-13, the bureau achieved a ratio of 2.62 on first lien bonds, and 1.94 on combined first and second lien bonds stabilized net revenues. (Please see the CBO Review of FY 2013-14 Water Bureau's requested budget for further discussion on debt coverage ratios.) These net revenues after debt service payments are used for utility license fees (ULFs) and the capital program. The amount of net revenues after debt service payments for FY 2014-15 is expected to be $37.4 million, of which approximately $6.1 million will cover ULFs and $26.2 million will provide for capital projects (see line 3, "Capital" of Table 4 for forecasted amounts of cash financing of capital).

Debt. Approximately 60% of the capital plan will be financed through debt by the issuance of first and second lien water revenue bonds. The proceeds from the bonds are used to pay for approximately 2 years of capital requirements. The repayment of these bonds are typically financed over a 25-year period. Because debt service becomes an ongoing expense over the next 25 years, a corresponding rate increase is required.

The bureau plans to issue $119.4 million in revenue bonds in August 2014, followed by issuances of approximately $120-150 million every two years to finance the capital program. As a result, debt service will increase from $45.7 million in FY 2013-14 to an estimated $70.9 million in FY 2018-19. Currently, the annual debt service to water sales ratio is about 34%. The bureau projects this ratio to remain at this level in the next five years based upon forecasted water sale revenues and planned bond sales.

Capital Revenues. The bureau also collects capital revenues via system development charges, new services/mains, IA revenues and asset sales. New services account for approximately 40% of capital revenues, but do not contribute toward general system repair and replacement.

Alternatives. As alternatives to financing capital through new debt, the bureau could either (1) only issue new debt after retiring debt service on outstanding bonds, (2) cash finance a greater portion of new capital through current rate revenues.

1. **Wait for prior bond maturity.** At the end of FY 2013-14, the bureau will have outstanding bonds that total $566.4 million. The next planned maturity is October 2020 (2006 Series B Refunding, $44.0 million). Per the direction of the Debt and Treasury Office, the bureau may refund bonds in order to reduce financing costs; however, currently the bureau plans to continue debt service on the five outstanding bonds, the first of which is set to mature in 2033. At that point, a series of 25-year bonds are scheduled for maturity that were originally issued in 2008 in order to pay for LT2-related project costs and other projects in the capital plan. To fund its current CIP, the bureau will need to issue additional bonds on top of its current debt requirements.

2. **Cash finance a greater portion of new capital through current rate revenues.** Financing a greater portion of the bureau's capital program through increased revenue collection would require significant rate increases. For example, approximately a 50% rate increase would provide for an ongoing capital program of about $65 million a year. The table below highlights the difference between forecasted water sales and planned expenses.

Table 5: Cash Finance Requirements (in millions)	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19
Water Sale Revenues	142,875	158,251	170,193	185,128	198,290
Expenses					
Noncapital Expenses*	116,636	130,551	138,172	151,338	161,610
Planned Capital	110,607	83,916	97,520	118,413	84,074
	227,243	214,467	235,692	269,751	245,684
Difference	84,368	56,216	65,499	84,623	47,394

* Includes General Overhead, utility license fees, and pension obligation bonds less other system resources. Assumes no new debt service beginning in FY 2015-16. To note: depending upon the changes to the capital plan, forecasted expenses may vary.

Though funding the capital program through current revenues avoids the costs of bond financing, using debt equitably distributes costs across generations of rate-payers who use the infrastructure. This concept, known as intergenerational equity, allows users to pay over a period that often matches the usable life of the asset. The alternative, cash financing of projects, will place greater financial burden on ratepayers today.

CBO does not recommend any changes to current capital financing methods. Rather, it is the task of bureau financial planners and the City's Debt and Treasury Office to strategize how to most efficiently use debt, aiming to balance the critical needs of the capital plan with financing costs and minimizing rate increases.

In the following discussion CBO outlines key decisions points in the capital approval process and recommends where Council can provide the most effective direction.

Capital Approval Process

By adopting the bureau's FY 2014-15 budget, Council would approve both operating and capital expenses as budgeted in the first year of the CIP, totaling $96.7 million. Although included as part of its requested budget, Council is not approving all five years of the bureau's CIP, totaling $392.2 million. Due to interconnectedness of the capital budget, however, approval of the first year of the CIP implicitly approves aspects of the 5-year CIP.

As such, Council provides the most effective direction when large projects and capital programs are first introduced in the CIP. Providing direction prior to project spending avoids the possibility of sunk costs and having to re-approve projects during approval of bond issuances or project contracts. Therefore it is critical that Council understand what would be approved in this year's capital budget and how these decisions will impact future budgets.

In addition to ongoing capital programs, included in the CIP's first year are several new projects, which also have planned spending over the next few fiscal years. (For example the first year of the FY 2014-15 CIP includes SW Nevada and Macadam Mains project, Tabor Pump Station Improvements, and several terminal reservoir projects.) For larger projects, first year cost are likely small amounts, relative to the

annual capital budget and relative to the project total. Projects without any prior spending can be eliminated or delayed without negative financial impacts.

Through the planning and design phases of projects, it becomes increasingly difficult for Council to change direction on projects without incurring sunk costs. Notably, some projects may be delayed with minimal financial risk, but only if there are no contract provisions that result in penalties, stable economic conditions, no increasing regulatory requirements and if already-completed work will be useable at a later date. For example, the first 2 years budgeted amount of the Willamette River Pipe Crossing was almost $800,000; the requested FY 2014-15 project budget is $2,6000,000, or a bit more that 2.5%, of the bureau's $96.7 million budget; however, the total project costs $56.1 million, or 14% of the bureau's Five-Year CIP of $392.2 million.

By the time Council appropriates the most significant portions, approximately $20 million, of the Willamette River Pipe Crossing project in FY 2016-17, it is planned that the bureau will have spent $8.4 million towards this project. As discussed in the Capital section of this review, the bureau has requested budget appropriation for several projects that are new or in the planning and design phases.

Though reductions to new projects and ongoing capital programs are possible, it is not expected that Council would reduce or eliminate the budget for a partially completed project. For example, having invested approximately $56.5 million through FY 2013-14 in the Kelly Butte Reservoir, changing the project (delay, scale back or stop) now would result in significant losses and possible non-compliance with debt coverage covenants.

In effect, as amounts are appropriated towards larger projects during the first year of the CIP, the opportunity to change direction, without risk of negative financial consequences, becomes limited.

Approval Steps. In addition to the budget process, Council is given three opportunities to impact capital planning through official action, all of which commonly occur during each fiscal year. The table below outlines what is being authorized as a result of each of these different Council actions:

Council Action	What is being authorized?
1. Adopt Budget Each year Council adopts bureau's budget, which includes a Five-year Capital Plan	**Budget for first year CIP only** Adopting the budget appropriates resources and capital expenditures for only the first year of the current Five-year Capital Plan. (City Financial Policy 2.03). City policy directs that any changes to operation and maintenance costs, due to new capital projects, should be included in the bureau's ongoing budget.
2. Adopt Rate Prior to budget adoption, Council approves any changes to utility-rates through ordinance after conducting a rate hearing.	**Changes to rates based on first year CIP requirements** Adopting rates allows the bureau to charge customers an amount that is forecasted to provide sufficient revenue requirements as planned in the bureau's budget.
3. Approve Capital-related Contracts Throughout the fiscal year, Council approves contracts (and contract amendment) for work on projects.	**Not to exceed contract amount for services on projects included in Five-year CIP** Funding for portions of the contract is available through current appropriation; however, for projects that span multiple years, Council will need to appropriate funds to spend up to contracted amounts when adopting capital budgets in subsequent years.
4. Approve Debt Issuance Council approves the bureau to sell bonds, typically every two years.	**Bond issuance for first (and second) year requirements of Five-year CIP** Bond revenues provide financing for one to two years of capital requirements. This may include funding for only portions of projects, the remainder of which, will be financed through future issuances. Council should be aware of projects included in the second year of the capital plan, but appropriation for these projects will not have been officially approved by Council. Bonds are issued with the assumption that rate increases, cuts or changes to debt coverage ratios are expected in order to meet debt service requirements.

CBO Recommendations: The most effective and cost efficient point for Council to weigh-in on a project is when the project is first included in the Five-Year CIP. Therefore, CBO recommends that special attention is given to any new projects or those in early phases during the budget process. Bureaus should use this opportunity to make a business case for the project; CBO should emphasize these projects in the budget review; budget advisory committees should be briefed and given opportunities to offer feedback; and Council should exercise its authority to appropriate capital budgets, particularly in regard to new projects.

Current Five-Year Capital Improvement Plan

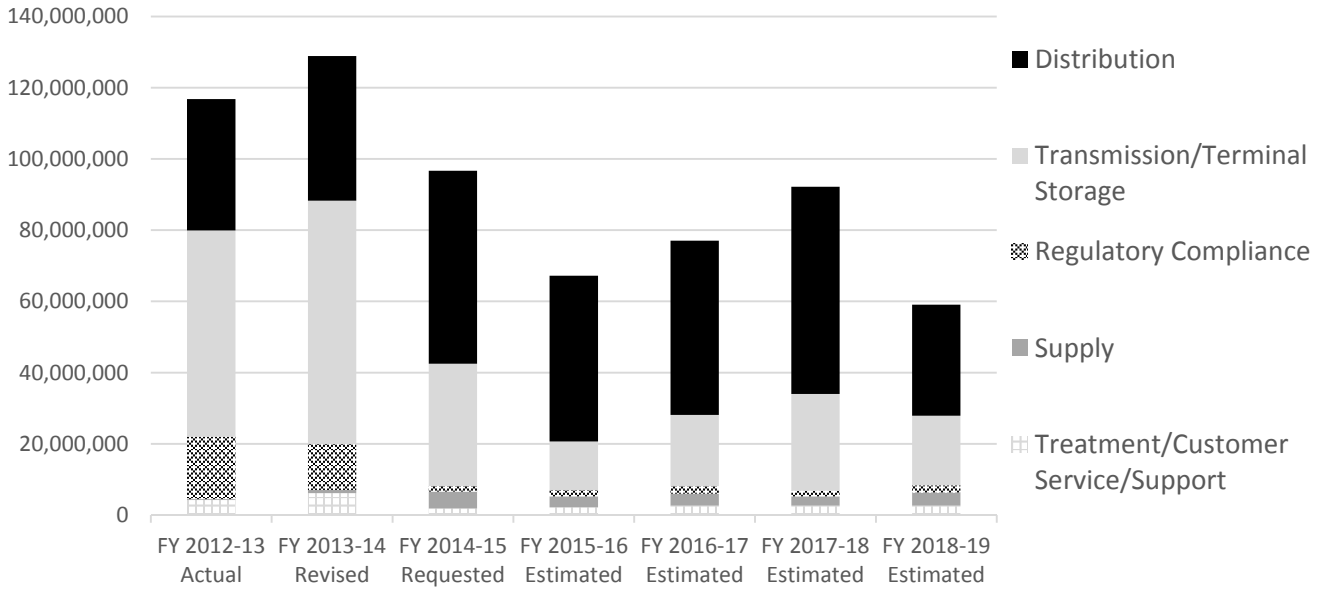
The bureau's Capital Improvement Plan (CIP) currently includes $392.3 million in projects over the next five years, including $96.7 million in FY 2014-15. Two projects greater than $500,000 are new to the CIP, both of which will have budget expenses in FY 2014-15: (1) SW Nevada and Macadam Mains project (FY 2014-15 budget of $382,000, total project cost of $690,000), and (2) Tabor Pump Station Improvements

(FY 2014-15 budget of $400,000 total project cost of $550,000). As part of the bureau's decision package, the bureau removed $14.1 million from the first year of the FY 2014-19 CIP. Reductions include the following:

- $8 million reduced from the planned conduit work, allowing for additional planning before moving forward with these replacement projects
- $2 million reduced from the Habitat Conservation Plan, aligning budgeted amounts with more accurate cost estimates
- $0.5 million reduced from meter replacements.

For broad context of how capital spending has changed, the chart below shows prior year actual and estimated future year expenditures.

Chart 1: Capital Expenditures - FY 2012-13 Actual through FY 2018-19 Estimated



The chart illustrates two key points of the bureau's planned capital spending:

- Current year costs for transmission/terminal storage projects are relatively high due to LT2 – related projects, which include Kelly Butte Reservoir, Powell Butte Reservoir 2, Washington Park Reservoir and Mt Tabor-Division projects. Total costs of these projects are $280 million.
- Distribution program costs will become proportionally greater in future years, as the FY 2014-19 CIP shifts investments to the pipes, pump stations, storage tanks and valves that make-up the City's water distribution system – the bureau's primary "aging infrastructure." The Distribution program's five-year capital costs are expected to be $239.1 million including the $56 million Willamette River Pipe Crossing project. Over the next five years, 61% of capital spending will be in Distribution.

Significant changes have been made to the CIP since the bureau submitted its FY 2013-14 Requested Budget last year. Comparing the four common years of the FY 2013-18 CIP to the FY 2014-19 CIP, the bureau has made a number of adjustments, as outlined in the table below:

TABLE 6: Changes in CIP FY 2013-14 to FY 2014-15

	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	4-Year Total
Customer Service	0	(190,000)	(440,000)	(440,000)	(1,070,000)
Distribution	205,110	7,447,678	(93,138)	125,662	7,685,312
Regulatory Compliance	(2,519,000)	(7,530,000)	(270,000)	(440,000)	(10,759,000)
Supply	34,000	140,000	130,000	100,000	404,000
Support	53,000	80,000	100,000	100,000	333,000
Transmission/Terminal Storage	(12,323,000)	(8,820,000)	(4,300,000)	(3,790,000)	(29,233,000)
Total	**($14,549,890)**	**($8,872,322)**	**($4,873,138)**	**($4,344,338)**	**($32,639,688)**

As evidenced in the table, significant reductions were made to the transmission and terminal storage program budget, totaling $29.3 million, and $10.8 million total, from the Regulatory Compliance capital budget. The bureau realigned some of the resources to the Distribution program, signaling an increased priority of this infrastructure.

Upcoming Council Actions in FY 2014-15. Although the CIP includes only two new projects, significant portions of continuing projects move into the construction phase. As such, Council should anticipate hearing ordinances to approve contracts for the following projects in FY 2014-15:

Project	Project Total
Fulton Pump Station Improvements	$15.0 million
Raymond Tank Supply Improvements	$880,000
SW Nevada and Macadam	$690,000
Road 10 Milepost 0.6-1.8 (Bull Run)	$930,000
Road 1008 Paving (Bull Run)	$720,000
Groundwater Electrical Supply Improvements	$2.2 million
Tabor Pump Station Improvements	$550,000
Tabor Reservoir Adjustments	$3.9 million

Of these contracts, the Fulton Pump Station Improvement project will be the largest. This pump station replacement addresses the risk of a major outage due to possible failure in the current pump station, and prior bureau studies have identified this project as critical. Through FY 2012-13, the bureau has spent $2.6 million in the planning and design phases in addition to $450,000 budgeted in the current fiscal year. The total project cost is estimated at $15.0 million and expected to be completed in FY 2016-17.

In addition to these contracts, the bureau is preparing an owner's representative contract for Willamette River Pipe Crossing project. The winning bidder will provide the bureau with technical expertise on developing the RFP for design-bid-build process and provide quality assurance throughout the duration of this project. The Willamette River Pipe Crossing has an estimated total cost of $57 million. The bureau has budgeted $460,000 for this project in FY 2013-14 and $2.6 million in FY 2014-15, with major expenditures beginning in FY 2016-17 when the bureau has capacity for new construction projects.

Correspondingly, Council should also anticipate a bond sale of approximately $120 million in August 2014 that will provide funding for the FY 2014-15 CIP and portions of the FY 2015-16 CIP.

Access to Bureau's Finance Details

Like most utility providers across the country, there continues to be increased scrutiny of rates and demand for greater transparency of utility providers' budgets. CBO finds that the Portland Water Bureau provides sufficient access to bureau finances and related information, but that the public would benefit if other bureaus provided a similar degree of transparency.

For example, included in the bureau's requested budget to the City Budget Office are extensive details on several aspects of the budget --- details that are uncommon compared to the details provided by other bureaus. Specifically, the bureau's requested budget includes the following supplementary materials:

- *Professional Services*: listing of all professional service contracts that are budgeted in FY 2014-15, including details on which program the contract supports, funding source and amount, in addition to a short explanation of the business need for the contract.
- *Training and Travel*: listing of all budgeted training and travel for FY 2014-15, including the name of the training, details of organizations in the bureau that will benefit from the training/travel, number of employees, days of training, location and breakdown of costs of training versus travel.
- *Equipment*: listing of all major equipment expenses budgeted in FY 2014-15, including the type of equipment, details of which organization uses the equipment, five-year budget for equipment and additional bureau comments, such as the replacement cycle of the equipment.

These details, CBO finds, exemplify the bureau's aim to disclose decisions and finances to the public and City Council. In addition, the Portland Water Bureau publishes a Capital Improvement Plan Annual Report that provides detailed updates of all capital projects and Monthly Financial Reports that provide the status of current year spending.

Updates on Prior Year Significant Issues

Lastly, CBO reminds Council of two significant issues that continue from prior years:

- **Pending Litigation** - In December 2011, Citizens for Water Accountability, Trust and Reform filed a lawsuit against the City, declaring that the City improperly spent millions of dollars of utility ratepayer monies on projects that are unrelated to the utilities. The first summary judgment was heard in February 2014; the bureau's financial plans assume no financial impact from the ruling.
- **Decreasing water sales.** Past CBO analyses have noted the impact on water sales due to decreasing consumption. Fluctuations in sales reflect both short term and long term causes. Whereas seasonal trends in weather are the most common short-term factor, efficiencies from plumbing code revisions and consumer conservation efforts have caused a steady decline in water demand. Since FY 2004-05, actual water demand has been less than forecasted, leading the bureau to incorporate the impact of this trend into revenue projections. Whereas the bureau

forecasted 27.0 million CCF (100 cubic feet of water) in FY 2012-13, actual sales were closer to 25.6 million CCF. The bureau forecasts that demand will stabilize around 25.75 million CCF, and for this year, the bureau forecasts 26.5 million CCF. To mitigate the potential revenue shortfall, the bureau has asked managers to reduce operating spending by 2.5%. As actual demand continues to be less than planned, the bureau is likely to maintain a similar underspending policy in FY 2014-15.

Decision Package Analysis & Recommendations

Budget Reduction and Realignment, WA_01, ($15,502,670), (11.00) FTE

Following the direction of the Commissioner-in-Charge, the bureau developed a budget request that reduced its operating budget by $1.4 million, in addition to reducing the planned capital budget by $14.1 million in FY 2014-15. This amounts to a requested rate increase of 7.0% compared to current year rates. To achieve the $1.4 million in operating savings, the bureau submitted one decision package that includes reductions and realignments across 17 of the bureau's 22 Water Programs. This reduction eliminates 11 positions, of which 4 positions are expected to be filled at the end of FY 2013-14.

The bureau has consistently reduced its operating budget over the past five years in order to limit the rate increases, essentially cutting across all programs. The bureau highlights this fact in its Requested Budget, noting that from FY 2008-09 through FY 2014-15, the bureau will have eliminated 91 positions, or approximately 14% of its employees. Moving forward, the bureau may be less able to "thin the soup", but rather, cuts to the operating budget will require the elimination of programs or finding savings through operational efficiencies.

CBO recommends that Council accept the bureau's proposed operating reductions, totaling $1.4 million which can be summarized as either (1) realignment of budgeted amounts to reflect prior year actual spending and eliminating unnecessary budget items, (2) reductions in training and travel, or (3) reductions that may result in minor service impacts, including small reductions to overtime and contingencies.

Discussed below are reductions that warrant Council's notice; however, CBO does not recommend any changes:

- Reduction of $28,000 in overtime costs for employees who diagnose and repair frozen pipes and respond to "emergency shut-offs" at the request of customers in cases of frozen pipes.
- Reduction of $132,227 in costs associated with research and analysis on the Columbia South Shore Well Field. This will have no immediate on bureau services; however, it is in the long-term interest of the bureau to best understand the capacity of aquifers and best site for future wells.
- Realignment of $50,000 to professional services for condition assessment, bringing the total budget to $100,000. As noted in the "Aging Infrastructure" discussion, Asset Management estimates. To most effectively manage assets, condition assessments are still needed for high consequence infrastructure, including mains, conduits, pump stations, tanks and critical valves.

The requested realignment covers a portion of needed condition assessments; however, the bureau estimates that investing $500,000 per year would be the optimal amount. CBO supports this realignment, but given the context of aging infrastructure, CBO also notes that funds for conditions assessments may be required in future years.

The bureau's requested budget and decision package, and corresponding requested rate increase of 7.0%, do not factor the impact on the bureau's budget of Council decisions (e.g., changes to General Fund Overhead or bureau-to-bureau IA amounts) or any changes in the COLA or CPI forecasts. To mitigate any cost increases, the bureau will need to (1) increase rates, slightly, (2) find additional ongoing reductions, or (3) bridge the increased overhead costs with contingency and then either increase rates or make reductions in the FY 2015-16 budget.

CBO also recommends the proposed capital reductions, totaling $14.1 million. For further discussion of this recommendation, see "Current Five-Year Capital Improvement Plan" in the Key Issues (above). In summary, these reductions consist of (1) deferring $8 million in planned conduit work, allowing for additional planning before moving forward with these replacement projects, (2) reducing $2 million from the Habitat Conservation Plan, aligning budgeted amounts with more accurate cost estimates, and (3) deferring $4 million in other projects in the Transmission and Treatment program.

CBO Recommendation: ($15,502,670), (11.00) FTE

City of Portland

Decision Package Recommendations

(Includes Contingency and Ending Balance)

	Bureau Priority	Bureau Requested FTE	Bureau Requested Gen Fund Ongoing	Bureau Requested Gen Fund 1-Time	Bureau Requested Other Revenues	Bureau Requested Total Expenses	CBO Analyst Recommendations FTE	CBO Analyst Recommendations Gen Fund Ongoing	CBO Analyst Recommendations Gen Fund 1-Time	CBO Analyst Recommendations Other Revenues	CBO Analyst Recommendations Total Expenses
Portland Water Bureau											
Reductions											
WA_01 - Budget Reduction and Realignment	01	(11.00)	0	0	(29,655,560)	(29,655,560)	(11.00)	0	0	(29,655,560)	(29,655,560)
Total Reductions		*(11.00)*	*0*	*0*	*(29,655,560)*	*(29,655,560)*	*(11.00)*	*0*	*0*	*(29,655,560)*	*(29,655,560)*
Total Portland Water Bureau		**(11.00)**	**0**	**0**	**(29,655,560)**	**(29,655,560)**	**(11.00)**	**0**	**0**	**(29,655,560)**	**(29,655,560)**