

Monthly Strategic Topic

February 19, 2008



CHELAN COUNTY



Topics for this Month

1. Integrated utility philosophy
 - a. Discussion of philosophies

2. Cost of service study/rate-setting process
 - a. Overview of process
 - b. Discussion of policies and objectives



Requested Action from Board

1. Integrated utility philosophy
 - ❑ Guidance on funding options
2. Cost of service study/rate-setting process
 - ❑ Guidance on Board policies and objectives



Topic #1: Integrated Utility Philosophy

Options for utilizing reserves (if they exist)

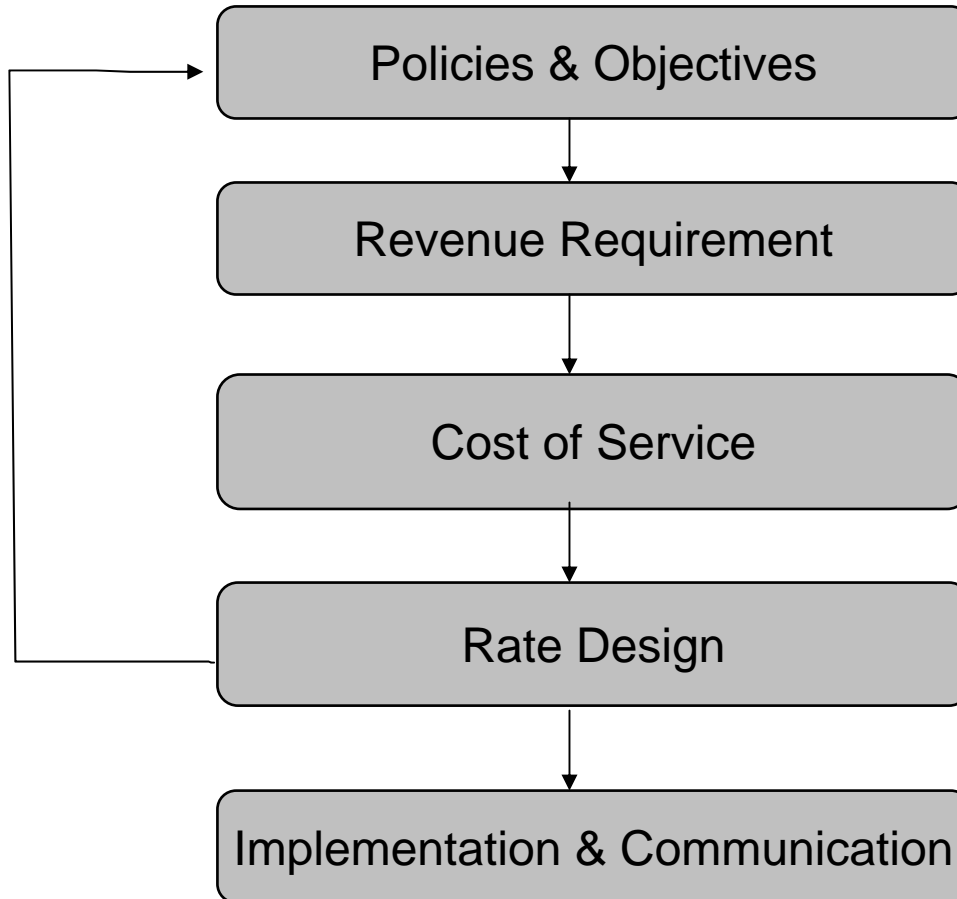
1. Loans for capital projects
 - Market-based interest rates
 - Low interest rates
 - No interest
2. Cash infusions for capital projects
3. Loans or cash infusions for ongoing O&M
4. Loans or cash infusions for existing debt service



Topic #2: Cost of service study/rate-setting process

1. Overview of process
2. Discussion of policies and objectives

Overview of Rate-Setting Process





Rate-Setting Process Overview

1. Policies and Objectives Established
2. Revenue Requirement Identified
3. Cost of Service Performed
4. Rates Designed
5. Implement and communicate rate decisions



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Policies and Objectives

1. Strategic planning guidance and policies
2. Load forecasting
3. Financial planning and targets
4. Capital and O&M budgets
5. Funding mechanisms - debt, rates, etc.



Rate-Setting Process Overview

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What is “revenue requirement”

Compares the rate base revenues and cost to determine the revenue adjustment required while incorporating various financial planning targets and objectives.

Why determine a revenue requirement?

- Identification of revenue needs to provide services
- Establish base requirement for rate structure



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What is “cost of service”

A method to equitably allocate the revenue requirement of the utility between the classes of service and systems.

(e.g. residential, commercial, etc.) (e.g. water, electric, etc.)

Why perform a cost of service?

- Many costs are not accounted for by customer class
- Many costs are incurred for joint benefit, others are direct
- Class usage patterns vary



Cost of Service – Analytical Steps

1. Functionalization – costs arranged by major function (production, transmission, distribution, etc)
2. Classification – of functionalized cost to cost components (commodity, delivery, customer)
3. Allocation – assignment of classified costs to customer classes using allocation techniques and methodologies



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What is “rate design”

The process of taking the cost of service results and applying any relevant policies, goals or objectives to the actual rates or rate components.

Why initiate a rate design?

- To ensure alignment with various policies and objectives
- To incorporate external requirements



Common Rate Design Objectives

- Easy to understand and administer
- Fair, equitable and non-discriminatory
- Provide stable and predictable revenue
- Promote efficient use of resource
- Incorporates utility objectives



Action items

- Acknowledge the team
- Establish the policies and objectives
- Select the time period for study
- Develop revenue requirements
- Develop cost of service study/analysis
- Design rates
- Implement and communicate decisions



The Team

- Board of Commissioners
 - Set policies and objectives with a long-term view
- Executive Management
 - Apply policies and objectives to the process
- Rates Committee
 - Finance, Utility Engineering, Customer Service, Utility Services Business Office, Energy Resource Planning, IT
 - Develop required analyses

Establish policies and objectives

Review and re-affirm strategic financial guidance:

- Target a combined positive Change in Net Assets (bottom line) by 2011
- Target an overall operating ratio of 80%-100% by 2011
- Limit the potential surcharge to 14% under unusual circumstances (10% probability of this outcome or worse in any year)
- Target a minimum debt coverage of 1.25 under unusual circumstances (10% probability of this outcome or worse in any year)
- The Water and Wastewater Systems should move toward combined system “postage stamp rates” to reduce costs



Establish policies and objectives

Further discussion for today:

- Funding guidelines as an integrated utility
- Magnitude of the gaps between cost of service and current rates may vary widely by customer class – approach to close the gaps?
- Level of public participation in each step of process
- Level of consultant review in each step of process



Select time period for study

- Base period to include 2009-2011 forecast
- Multi-year analysis to be revisited annually



Review for next steps

- Acknowledge the team
- Establish the policies and objectives
- Select the time period for study
- Develop revenue requirements
- Develop cost of service study/analysis
- Design rates
- Implement and communicate decisions



Questions?
