



DWSD BUDGET REVIEW

BOWC Finance Committee

3/9/2016

Next week, we will request the BOWC approve \$115 million and \$266 million Water and Sewer budgets for FY 2017; we anticipate rates well below 4%



DWSD Preliminary 2-Year Budget Proposal

| | WATER | | SEWER | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | 2017 | 2018 | 2017 | 2018 |
| Sales Revenue | | | | |
| Retail Domestic MCF Charges | \$ 69,059,865 | \$ 67,823,461 | \$ 262,101,914 | \$ 274,882,935 |
| Retail Fixed Charges | 27,928,397 | 28,812,890 | 12,495,669 | 12,933,574 |
| Fee's & Penalties | 4,750,000 | 4,750,000 | 5,000,000 | 5,000,000 |
| Ownership Equity | 20,700,000 | 20,700,000 | 5,516,000 | 5,516,000 |
| Less: Bad Debet & NSF's | (12,261,123) | (12,449,029) | (29,061,230) | (28,882,197) |
| Net Sales Revenue | \$ 110,177,138 | \$ 109,637,322 | \$ 256,052,354 | \$ 269,450,312 |
| Controllable Operations & Maintenance | | | | |
| Personnel | 13,033,985 | 13,451,333 | 19,550,977 | 20,176,999 |
| Contracted Services | 15,074,618 | 15,074,618 | 17,543,802 | 17,543,802 |
| Utilities | 73,378 | 73,378 | 1,341,971 | 1,346,351 |
| Fringes, Taxes & Other Overhead | 7,917,204 | 7,917,204 | 5,787,231 | 5,787,231 |
| Total O&M Charges | \$ 36,099,185 | \$ 36,516,533 | \$ 44,223,982 | \$ 44,854,383 |
| Contribution Margin | \$ 74,077,953 | \$ 73,120,789 | \$ 211,828,372 | \$ 224,595,929 |
| Wholesale O&M Allocation | | | | |
| Monthly Wholesale O&M Charges | 15,831,543 | 16,464,805 | 51,836,900 | 53,910,376 |
| Retail Allocation | 4,969,467 | 5,168,246 | 10,209,270 | 10,698,861 |
| Other CTA Allocation | 2,323,176 | 3,170,614 | 6,788,722 | 10,768,746 |
| Total Operating Expenses | \$ 23,124,186 | \$ 24,803,664 | \$ 68,834,892 | \$ 75,377,983 |
| Operating Surplus/(Deficit) | \$ 50,953,767 | \$ 48,317,125 | \$ 142,993,481 | \$ 149,217,946 |
| Non-Operating Expense / (Income) | | | | |
| Debt Payments | 45,195,714 | 45,182,224 | 121,809,319 | 123,265,760 |
| Lease Payments | 2,529,884 | 2,529,884 | 11,950,476 | 11,950,475 |
| WRAP Deposits | 604,809 | 605,235 | 1,321,541 | 1,350,308 |
| ER&R | 713,792 | 713,792 | 1,024,493 | 1,024,493 |
| B-Note Payment | 706,644 | 706,644 | 7,206,431 | 7,206,431 |
| Budget Stabilization Deposits | 2,327,026 | 2,327,026 | 2,352,133 | 2,352,133 |
| Total Non-Operating Expenses | \$ 52,077,869 | \$ 52,064,805 | \$ 145,664,393 | \$ 147,149,600 |
| Deposits to Improvement & Extension | \$ (1,124,102) | \$ (3,747,680) | \$ (2,670,912) | \$ 2,068,346 |
| Minimum Rate Increase | 1.10% | 3.70% | 0.96% | -0.71% |
| Additional I&E Deposit | \$ 2,000,000 | \$ 2,000,000 | \$ 7,000,000 | \$ 7,000,000 |
| Required Incremental Rate | 2.06% | 2.07% | 2.55% | 2.43% |
| Maximum Rate Increase | 3.17% | 5.77% | 3.50% | 1.73% |

Budget Highlights

- ▶ FY 2017 rates likely to be less than 4% for both Water & Sewer
 - Despite falling volume, max water rate increase projected at 3.2% FY 2017
 - Sewer volumes expected to improve; max rate less than 3.5% for FY 2017
- ▶ Rate increases include additional deposits into the I&E fund
 - Creates some cushion in the budget
 - Helps DWSD begin to rebuild credit rating
- ▶ Budget figures are predicated on strong collections – data is pointing in the right direction
- ▶ No lease money used to support rates

Several major assumptions underpin our budget



Major Assumptions

| Metric | Water | Sewer |
|---------------------------|-------------------|-------------------|
| Volume | 3,034,000 (↓8.0%) | 2,800,000 (↓7.5%) |
| One Year Collection Rate | 90% (↑ 5%) | |
| Bad Debt Expense | \$12,200,000 | \$29,000,000 |
| Default System Allocation | 40% | 60% |
| Headcount | 482 (↑ 57 heads) | |
| Employee Compensation | 4% | 4% |

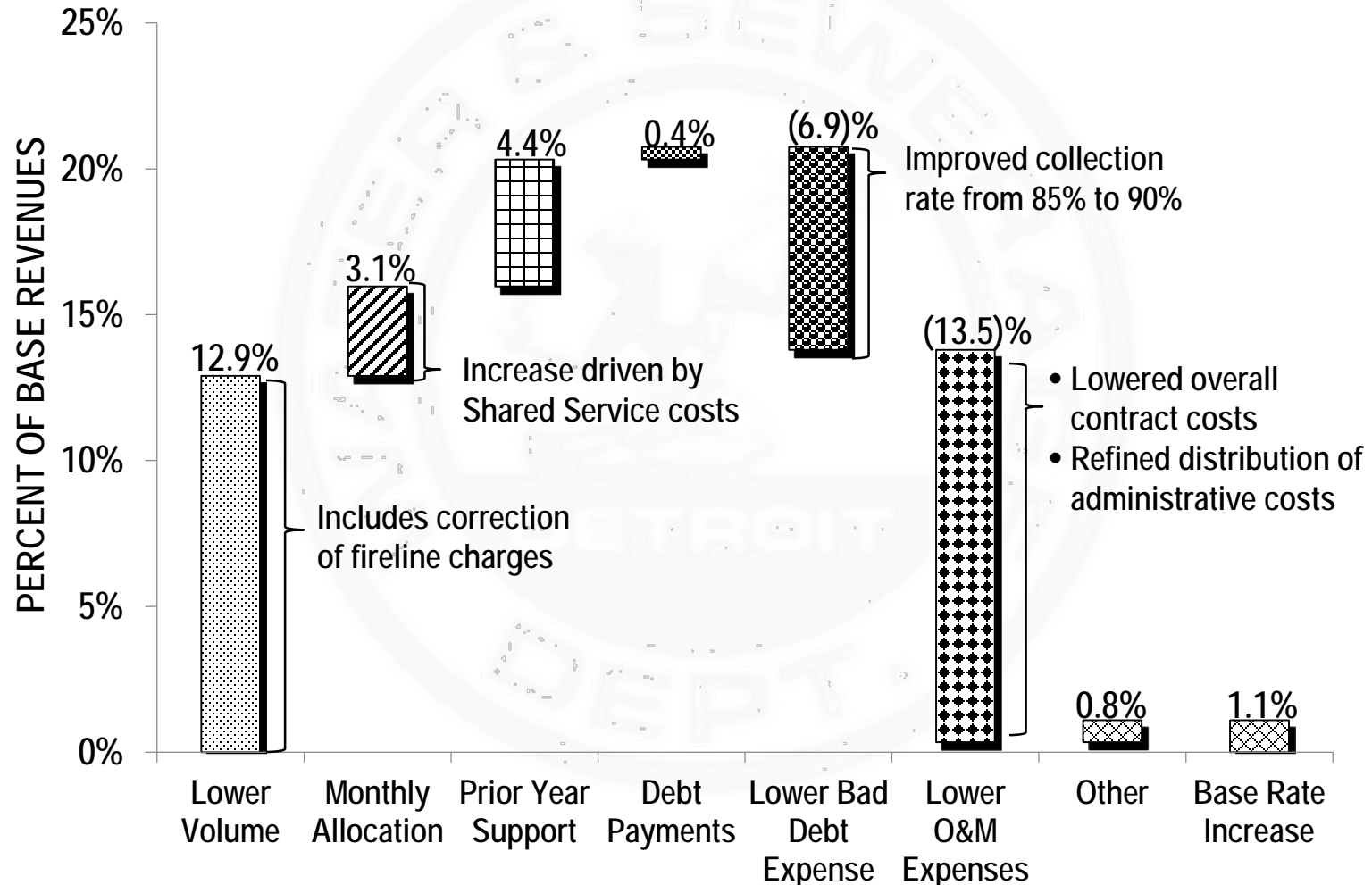
Other Assumptions

- ▶ Lease payments deposited to I&E funds; no support of rates
- ▶ GLWA allocated expenses reduce by \$9 million to reflect more appropriate allocation of Administrative & General costs
- ▶ Reduction in hospitalization assumption to 10% of salaries to reflect elimination of sewer treatment plant workers in DWSD employee pool (down from 21%)
- ▶ Zero net impact of shared services agreement true-up

Lower water bad debt and O&M expenses offset lower volumes, bifurcation inefficiency, and the elimination of prior year water rate support



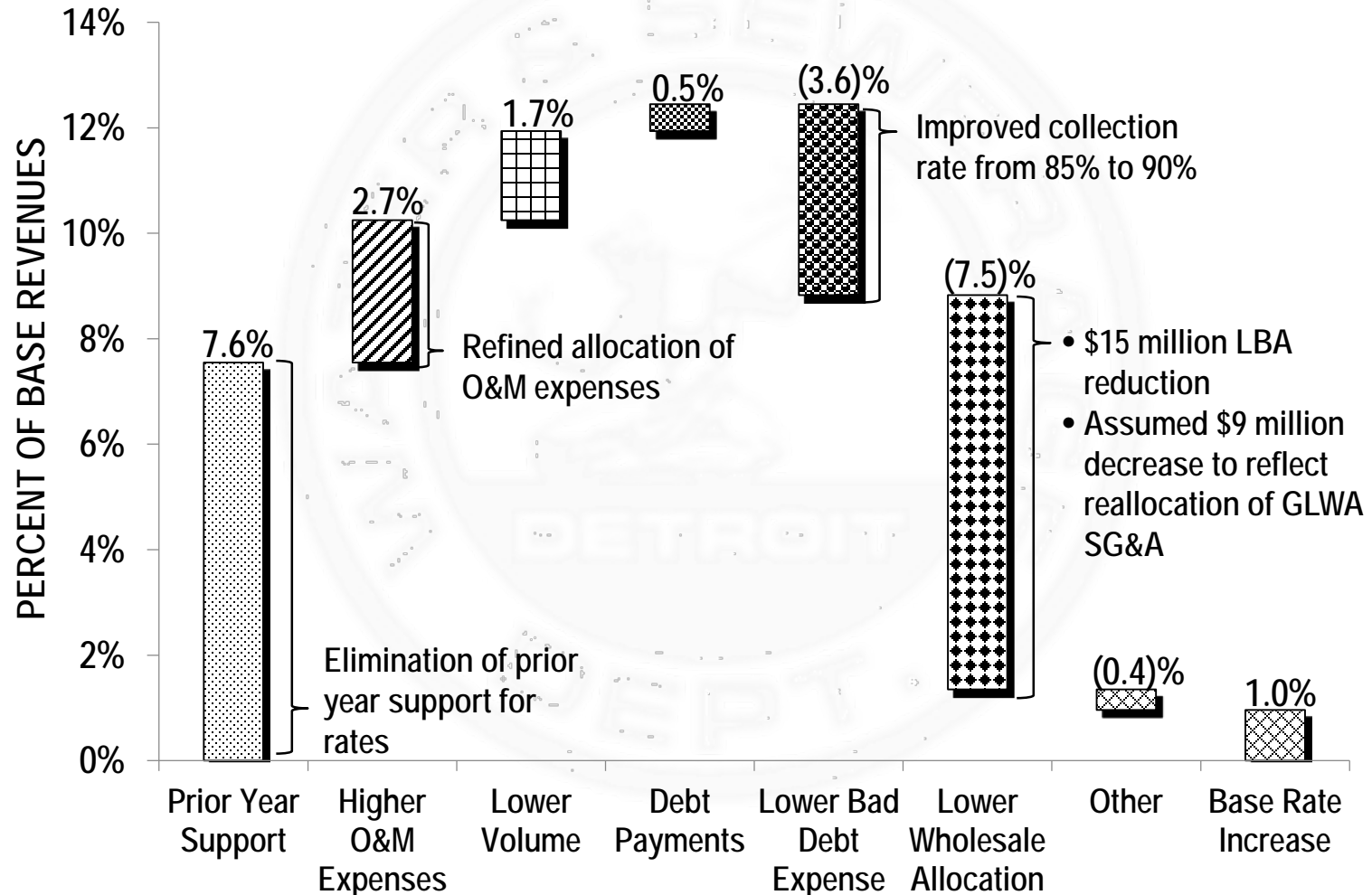
Water FY 2016 to FY 2017 Rate Walk



For sewer, lower bad debt and wholesale allocation offset lower volumes, higher O&M expenses, and the elimination of prior year sewer rate support



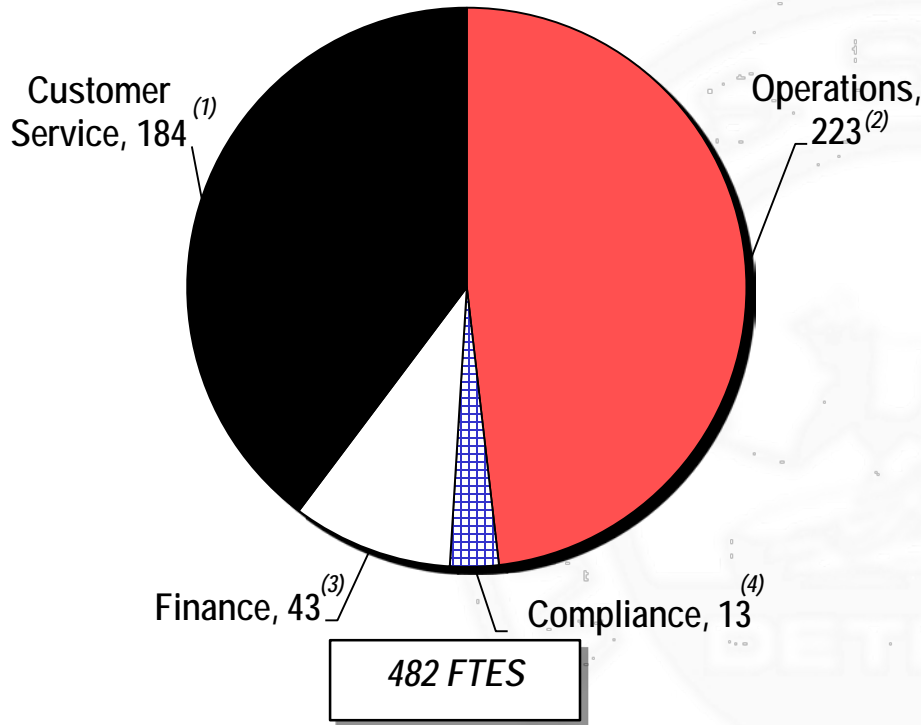
Sewer FY 2016 to FY 2017 Rate Walk



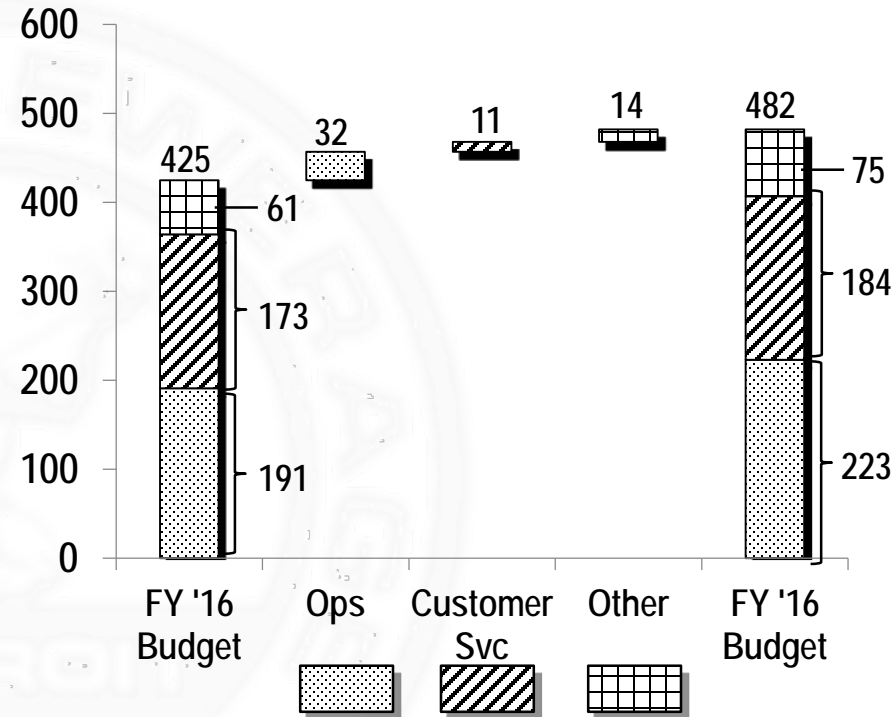
As we strive to improve customer service and clear a backlog of 40,000 work orders, we project 482 FTEs for FY 17, a 13% increase over FY 16



Projected 2017 Headcount



DWSD FY '16 vs. FY '17 Headcount



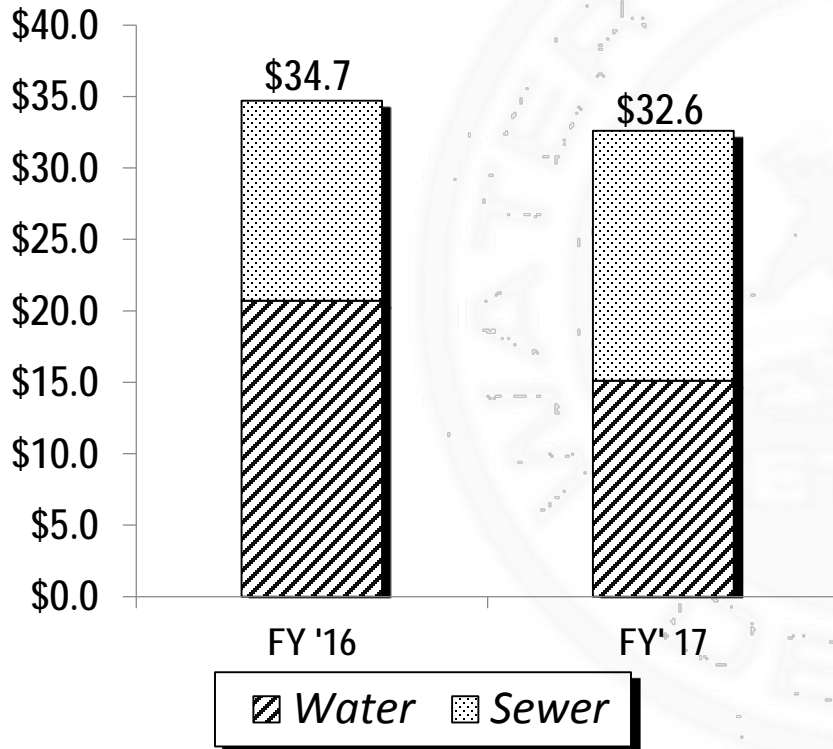
- ▶ New customer service initiatives including WRAP and Drainage as well as delinquency management (shut-offs, illegal checks, etc.) likely to flood customer service centers as well as call center
- ▶ 48,000 open service orders includes 8,000 "fatal" orders
 - Includes residential lawn and pavement repair
 - Inhibiting full billing of customers

(1) Customer service includes Service Centers, Billing & Collection, Meter Operations, and Fleet
 (2) Operations includes Field Services and Field Engineering
 (3) Finance includes Budget, Accounting, Purchasing, & Material Management
 (4) Compliance includes Legal, Public Relations, and Information Technology

FY '17 contract spending represents a \$2 million or 6% decrease over FY '16; reduction in interagency billing allows increase in service initiatives



DWSD FY '16 vs. FY '17 Contract Spending



Contract Summary

Major Contract Subtractions

- ▶ Detroit Interagency billing reduced by \$7.1 million
 - Reflects smaller DWSD; lower allocations as a result
 - Several allocations for which DWSD is self contained have been removed
- ▶ EMA contracts expires June 30th (~\$1 million) – no intention to renew
- ▶ 75% (\$2.1 million) of Green Infrastructure moved to CIP; eligible for SRF loans

Major Contract Additions

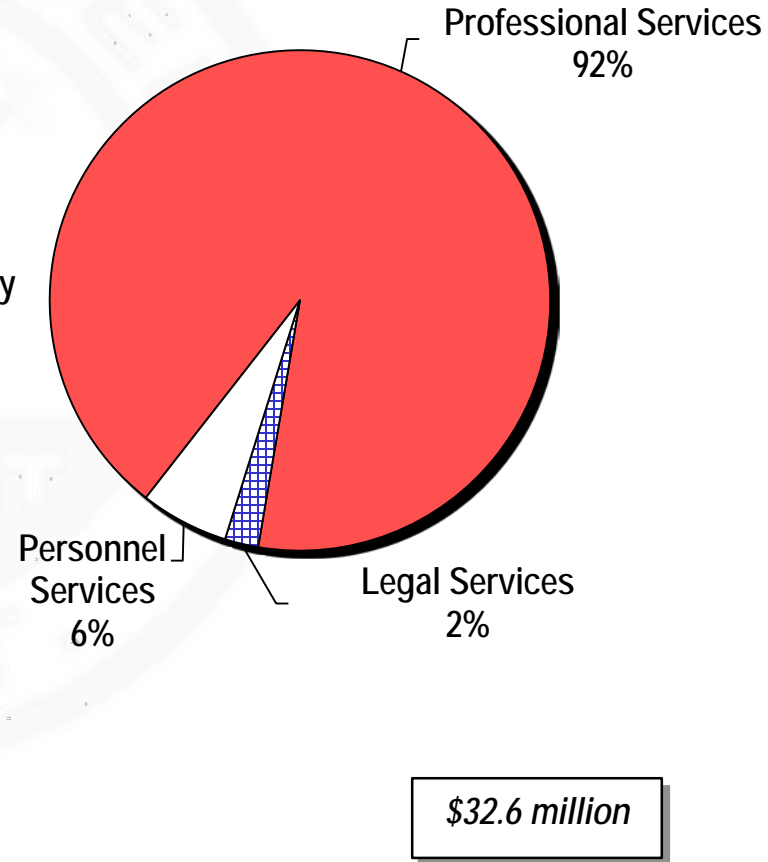
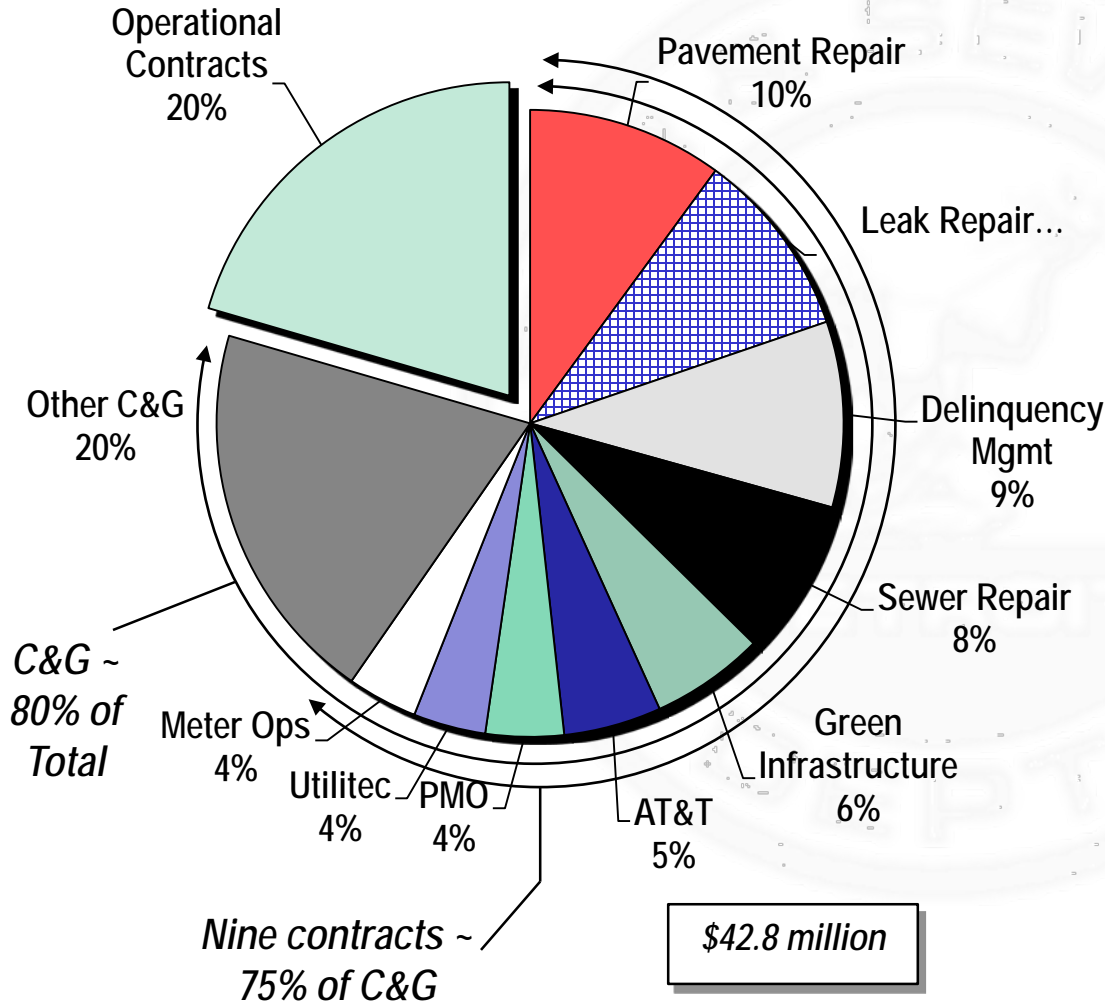
- ▶ Increase delinquency management to be on par with FY '16 spending (↑ \$3 million)
- ▶ Outsourcing printing to Utilitec (\$1.8 million) – note, self funded as it includes labor and all printing fees

80% of operating contract funding is driven by C&G; nine contracts drive 75% of C&G spending most of which is for professional services

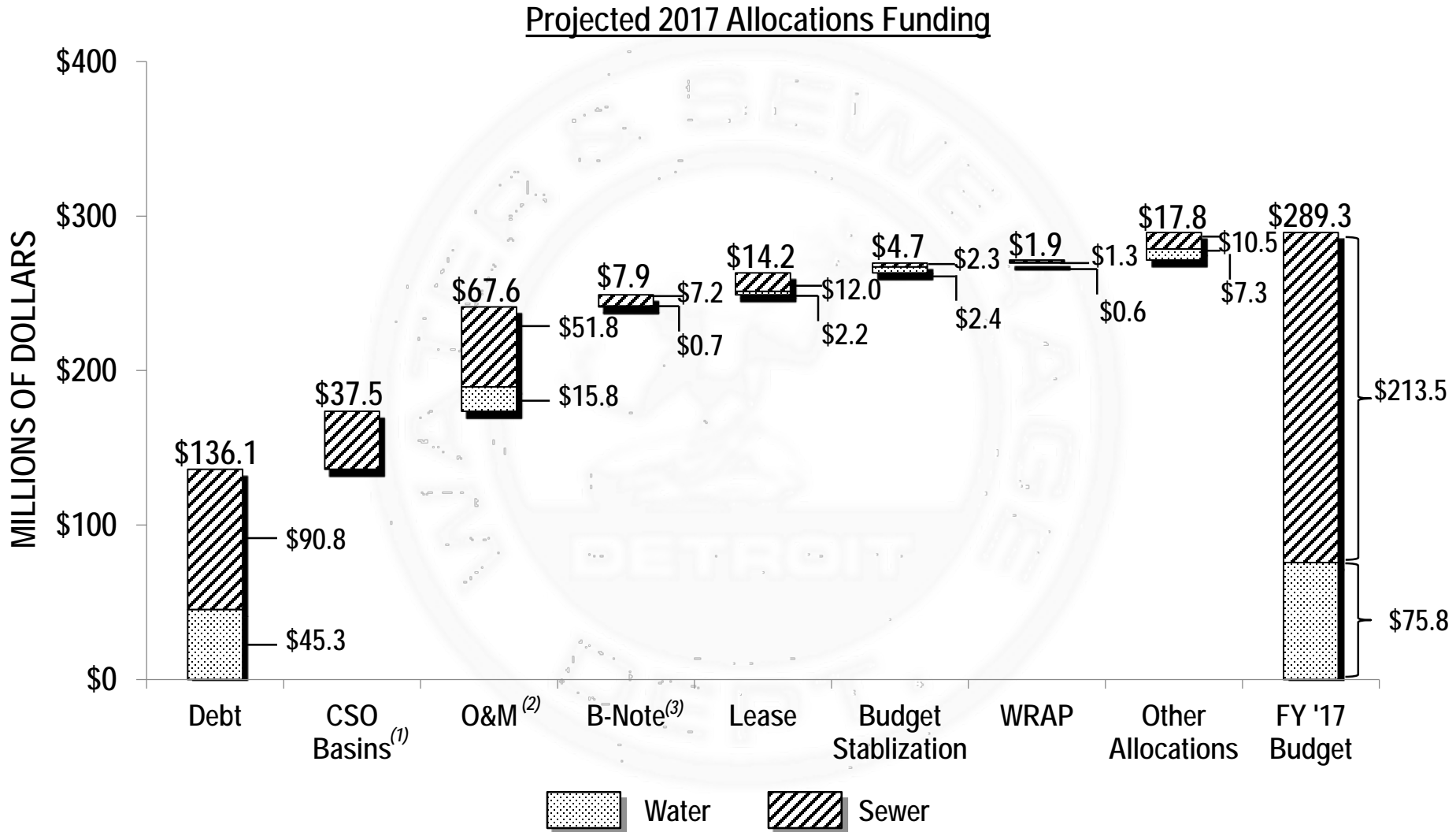


Projected 2017 Contract Spending

Projected 2017 C&G Contract Spending



Our budget includes \$76 million and \$228 million for GLWA water and sewer allocations, respectively; most of this represents debt service



(1) CSO Basins is Sewer only and include \$31.5 million of Detroit specific debt

(2) O&M costs include approximately \$8.8 million of shared service costs. Also note that \$10 million of Sewer O&M is in dispute with GLWA

(3) Includes non-operating portion of Pension allocation

Several headwinds pose a threat to the FY '17 and '18 budgets; we have a “Plan B” if we cannot meet revenue and expense requirements



DWSD Budget Headwinds

| Risk Characteristics | Volume Declines Accelerate | Collection Rates Don't Meet Expectations | DWSD / GLWA Cannot Settle on Appropriate Allocation |
|----------------------|---|--|--|
| Probability | <ul style="list-style-type: none"> • Low-Medium | <ul style="list-style-type: none"> • Medium | <ul style="list-style-type: none"> • Medium-High |
| Impact | <ul style="list-style-type: none"> • Every 1% decline in volume reduces revenues an additional \$3 million | <ul style="list-style-type: none"> • 5% decrease in collection rate increases sewer bad debt allowance by \$10 million and water bad debt expense \$7 million | <ul style="list-style-type: none"> • Maintaining current methodology will increase allocated expenses by \$9 million vis-à-vis budgeted amounts |
| Mitigating Factors | <ul style="list-style-type: none"> • More cost allocated to Sewer; higher fixed price to customers | <ul style="list-style-type: none"> • Moving name to accounts in April • Increased shut-off spending • WRAP has launched | <ul style="list-style-type: none"> • Entering dispute resolution process |

What Is Plan B?

- ▶ Pare merit increases as necessary
- ▶ Limit non-critical IT and other contract spending
- ▶ Stagger hiring of incremental headcount

For FY 2017 and FY 2018 we have budgeted \$9 million per year in I&E between the water and sewer funds to mitigate downside budget risks



- ▶ **Provides additional flexibility in the event of accelerated declines in volume, increase in unforeseen expenditures, or lower collections**
- ▶ **Protects DWSD in the event of unfavorable dispute resolution**
- ▶ **Allows for more cash availability for System Revenue Finance Capital, decreasing funding need**
- ▶ **Begins to build DWSD credit rating; reducing reliance on GLWA and providing debt issuance flexibility**
- ▶ **The Goal: 200 days cash on hand by FY 2021**

Next steps...



- ▶ 3/10: Presentation to City Council
- ▶ 3/16: Approval by BOWC
- ▶ 3/23: Approval by FRC
- ▶ 3/23: Submission to GLWA
- ▶ April: Presentation of Financial Strategy
- ▶ May: Introduction and Approval of Rates by Customer Class



APPENDIX – QUESTIONS FROM CITY COUNCIL



- 1. The Detroit Water and Sewerage Department bifurcated from the Great Lakes Water Authority on January 1, 2016. The FY 2017 DWSD budget is pending approval by the Board of Water Commissioners (BOWC) and is expected in early March 2016. Please provide us with the final BOWC approved budget**
 - To be provided after 3/8/2016 BOWC Finance Committee Meeting
- 2. How much bad debt expenses are appropriated in the DWSD FY 2017 Budget? What is the total amount of delinquent accounts receivable due from Detroit water and sewerage customers as of January 31, 2016? Have collections improved in the last year?**
 - We have appropriated \$9 million in bad debt expense to the water fund and \$29 million in bad debt expense to the sewer fund for FY2017. Collections within one year is currently between 88% and 90% of billings, up from 85% assumed for FY2016.
- 3. What is the amount of debt service charges included in the DWSD FY 2017 budget? How much of the annual \$50 million Lease revenue due to DWSD is being applied to pay debt service in the FY 2017 budget?**
 - Water and sewer debt service approximate \$46 million and \$122 million, respectively. The latter includes approximately \$31.5 million for CSO Basins. Our intent is to not use any lease dollars for debt service in FY2017.
- 4. City of Detroit residents pay the highest rates for sewerage disposal in the region. How is the City's 40.04% of "Common-to-all" share determined (per the attachment "FY 17 Cost of Service Study and Service Charge Recommendations", dated January 26, 2016- Table 5 of the "Sewer Tables")? What is being done to bring these rates down?**
 - The 40.4% is Detroit's proportion of gross sewer volume (called "flow" which equals sanitary flow + infiltration & inflow + wet weather inflow) vis-à-vis other regions. There is a minor adjustment made for the dilutive impact of wet weather inflow. We have challenged the allocation methodology used by the Authority as it allocates a significant amount of fixed costs on a variable basis and for which Detroit gets no incremental benefit. While costs associated with the plants call for a greater study, we believe the administrative and general expense portion can be handled immediately and have budgeted \$7 million in lower costs in anticipation of resolving this issue.



- 5. Please explain the 83/17% split between the City (83% of costs) and suburbs (17% of costs) regarding the costs for the Combined Sewer Overflow (CSO) systems? What is being done to reduce this burden on the City?**
 - The 83/17% split is the result of extensive rate settlement talks between the suburbs and the City approximately a decade ago. Simply put, suburban communities agreed to pickup 17% of the basins' construction and operating costs given that Detroit's building of the basins allowed them to continue to send their flow to the sewerage system. There is fairly minimal technical data which supports the 83/17% split. DWSD executive staff has asked for a technical review of the 83/17% split by the Technical Advisory Committee of the Customer Outreach Group (DWSD is represented in the Technical Advisory Committee by Palencia Mobley). We anticipate a study will start sometime in FY2017 and will likely take in upwards of a year. Rate relief on this topic will likely take two to three years.
- 6. How does DWSD ensure the quality of the drinking water? What measures are taken to inspect the drinking water for contaminants such as lead and other hazardous materials? Where are these costs in the FY 2017 budget?**
 - By law, Detroit is required to test samples of water from residents for lead and other contaminants. Currently, DWSD has a shared service agreement with GLWA to test samples at the GLWA laboratories.
- 7. What is being done to reduce the amount of unbilled water lost in the system due to leakage and other causes? What is Detroit's share of these costs?**
 - DWSD has dedicated \$9.5 million for local leak detection and repair. To aid the effort, we have budgeted an additional 20 heads in the Field Services and Field Engineering groups. GLWA has similar efforts. The incremental costs associated with broader system leaks are accounted for as a common to all expense and allocated in line with the normal methodology. Detroit is charged approximately 12% of these costs.
- 8. Has the charges for the Bankruptcy settlement debt (e.g., VEBAs, POCs, Swaps) been determined and allocated between GLWA/DWSD? If so what are the annual cost for the settlement debt in the FY17 budget for GLWA/DWSD?**
 - All charges for the bankruptcy settlement are included in the Operating Pension and B-Note line items, the latter of which includes OPEB. The annual costs appropriated to these amounts totals \$48.3 million annually of which roughly \$20 million is allocated to DWSD



- 9. Have the cost of services the City of Detroit provides to GLWA and DWSD such as DRMS, new ERP, asset inventory (Asset Works), accounts payable, payroll, workers compensation, etc. been determined and included in the FY 2016 and FY 2017 budgets? If so how much are GLWA and DWSD paying to the City in FY 2016 and FY 2017? Where are these costs in the FY 2017 DWSD budget?**
 - Services provided by the City to DWSD are allocated to DWSD and included in the appropriate cost center as an interagency contracts (627000 series of objects). Any costs charged to DWSD for which GLWA receives a benefit will be recovered from GLWA via the shared services agreement. Note, the new ERP will not be allocated to GLWA as GLWA has opted for an alternative ERP solution.
- 10. Please provide us with copies of the Shared Services Agreements between DWSD and GLWA that have been approved by the BOWC. What are the revenues included in the FY 2017 DWSD budget for shared services provided to GLWA? What are the appropriations for GLWA provided shared services included in the FY 2017 DWSD budget?**
 - Copies to be provided post meeting with the BOWC. DWSD has budgeted approximately \$4.4 million in revenue from GLWA while appropriating \$8.8 in charges from GLWA. The difference is primarily IT costs.
- 11. Please provide us with the Agreement on methodology for allocating pension funding and investment expenses to GLWA/DWSD**
 - Clarification needed – Agreement on methodology between GRS and combined DWSD/GLWA organization (Amanda Van Dusen) or agreement between DWSD and GLWA on amount allocated from GRS. The latter has not yet been agreed to and will be included in a forthcoming MOU.
- 12. Are there any other major agreements between DWSD and GLWA with significant financial implications for the City? If so, what are the agreements and what are their implications?**
 - DWSD is currently negotiating a MOU which will memorialize the initial distribution of cash and potentially redefine the allocation of Administrative & General expenses to DWSD, both of which could have a substantial impact on rates. The MOU will also address the allocation of Pension / OPEB allocation between DWSD and GLWA as well as the allocation of existing debt service



- 13. How much has DWSD budgeted in FY 2017 for its pension contribution to the General Retirement System, and is DWSD current on making its pension contributions to the General Retirement System?**
 - DWSD is current on its payments to GRS and has budgeted approximately \$14.4 million for payment in FY 2017. This EXCLUDES additional payments to GLWA as part of DWSD's common to all allocation.
- 14. Is DWSD using the new ERP/HR (Ulltipro) solution the City of Detroit's Office of the CFO/Department of Innovation and Technology are currently undertaking? If so, what is DWSD's cost share of the new system? What is included in the FY 2017 DWSD budget for the City's DOIT (Department of Information Technology) service costs?**
 - DWSD will be on new ERP / HR systems. Cost associated with the system have yet to be provided to DWSD, as such, we have used previous billings from DOIT to estimate DWSD's FY2017 costs. Based on the allocation methodology used by the City (number of users), we estimate the total costs associated with DOIT to approximate \$600,000 per year.
- 15. Is DWSD responsible for fire hydrant maintenance in the City? If so what is the budget in the FY 2017? Will the Fire Department be billed for these costs? If so how much is expected to be billed to the Fire Department for FY 2017?**
 - Follow up needed from Palencia / Gary.
- 16. Is the afford ability of water and sewerage services for City of Detroit residents, who cannot reasonably afford the rising rates, part of the mission, responsibility, or vision of either DWSD or GLWA? Please explain. No reference to the report of the Blue Ribbon Panel on Afford ability would be necessary or helpful.**
 - DWSD Executive Management deems the affordability of water and sewer rates as core to our mission. As outlined in previous documents, we are guided by three principles: Affordability, Accessibility, and Accountability. To this end, we have examined a refinement of cost allocation between sewer and water, focused on reducing bad debt expense, pushed GLWA on system cost allocation, introduced the WRAP, and are seeking to refine drainage charges all within the construct of current State laws. Further, we are working vigorously to develop and implement an inclining block rate structure and are seeking grants for internal resident infrastructure which, given our analysis of DWSD customers, will likely provide rate relief for lower income residents.



- 17. How much is included in the FY 2017 DWSD budget for the Water Residential Assistance Program (WRAP) for Detroit residents? Where is this in the budget??**
 - DWSD's FY2017 budget includes \$1.9 million for WRAP (\$0.6 for Water and \$1.3 for Sewer). This will be included in Non-O&M Expenditures.
- 18. What are the available federal and state revenue sources for DWSD? What are the amounts of federal and state revenue included in the FY 2017 DWSD budget?**
 - Currently, no revenues from the State of Michigan or Federal Government are included in the DWSD budget. While there are State run loans with some principle forgiveness (i.e., for Green Infrastructure), grants are fairly limited (e.g., SAW grants). Any such of the currently available grants would be included in DWSD's CIP. DWSD is investigating multiple sources to determine our ability to develop special, non-CIP programs eligible for grants.
- 19. What is DWSD's "ownership benefit" that is a factor in its cost share as a "hybrid" wholesale customer for GLWA services?**
 - DWSD's ownership benefit for water is \$20.7 million and \$5.516 million for sewer. These amounts are used to reduce the revenue requirement on a dollar for dollar basis and reflect a continuation of the recognition that the citizens of Detroit own the water / sewer systems. Note, the sewer ownership benefit is substantially lower than water given the selling of several major sewer assets to other communities
- 20. Will Judge Cox's 2012 order governing which DWSD contracts must come before City Council be modified? What would be the justification after the bifurcation date (January 1, 2016) to not submit the DWSD contracts to City Council for approval?**
 - Judge Cox's orders were amended to allow for the reintegration of DWSD upon agreement between the Mayor and the BOWC that the City is prepared to handle such reintegration. Given the substantial amount of change in the City, we do not anticipate this reintegration happening in the near future. Approval levels have not been modified under Judge Cox's orders. As such, certain contracts above the delegation of authority as laid out by the court will continue to require Council (and FRC) approval. Requiring approvals below this amount given the numerous changes occurring in the City would decrease the alacrity in which DWSD can effectively operate.