



TPU Rate and Financial Policies and Strategic Directives Update

City of Tacoma | Tacoma Public Utilities

Government Performance and Finance Committee

June 7, 2022



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TPU Strategic Directives

➔ Provide Strategic Direction of the Public Utility Board

Strategic Directives (SD's)

- SD-1: Equity & Inclusion
- SD-2: Financial Sustainability
- SD-3: Rates
- SD-4: Stakeholder Engagement
- SD-5: Environmental Leadership
- SD-6: Innovation
- SD-7: Reliability and Resiliency
- SD-8: Telecom
- SD-9: Economic Development
- SD-10: Government Relations
- SD-11: Decarb/Electric Vehicles
- SD-12: Employee Relations
- SD-13: Customer Service
- SD-14: Resource Planning

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TPU Strategic Directives



- Rate and Financial Policies are aligned with SD's
- Particular ties to Financial Sustainability (SD2) and Rates (SD3)
- ✓ SD2 - Providing safe and reliable utility services over the long term by maintaining sustainable budget, financial, and asset management practices.
- ✓ SD3 - Producing revenue sufficient to meet objectives; rates are to be adequate, fair, just, and reasonable. *(Includes Gradualism)*

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Tacoma Water: Purpose and Guiding Objectives



Purpose

The Water Rate and Financial Policy gives direction to planning decisions and helps ensure that the Tacoma Water provides an adequate supply of safe, clean water to all customers efficiently, reliably, and at the lowest possible cost consistent with prudent utility management.


Guiding Objectives

- a. Water Rates Should Ensure Adequate Supply.
- b. Water Rates Should Be As Low As Is Responsible.
- c. Water Rates Shall Be Fair.
- d. Water Rates Should Be Stable and Understandable.
- e. Water Rates Should Be the Product of Customer Involvement.

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Tacoma Water: Policy Summary




Revenue Requirement	Cost-Based	Stable Rates	Financial Metrics	Rate Adjustments	Affordability
<ul style="list-style-type: none"> Regular reviews with full study every two years Study includes projected revenue, expenses and capital improvements 	<ul style="list-style-type: none"> Cost-of-Service Study determines the cost of serving each customer class Allocates class responsibility for projected expenses of the system 	<ul style="list-style-type: none"> Water Rates Should Be As Low As Is Responsible Water Rates Should Be Stable and Understandable To the extent possible, apply gradualism in rate adjustments 	<ul style="list-style-type: none"> 60 days of current budgeted expenditures Capital: \$2M minimum in SDC Fund and 1% of original plant in Capital Reserve Senior Debt Service Coverage above 1.50x All In Debt Service Coverage above 1.25x 	<ul style="list-style-type: none"> Sufficient to meet Tacoma Water budgets Revenue collected to maintain financial sufficiency Short and long-run rate impacts presented Minimize long-run costs to rate-payer 	<ul style="list-style-type: none"> Special consideration for low-income senior and/or disabled customers

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Tacoma Water: Reviewing and Testing our Policy



Our review shows the current Water Rate and Financial Policy is sound.

Quantitative Review	Qualitative Review
<ul style="list-style-type: none"> In 2020, we developed a risk reserve analysis model, providing rigor behind our recommended reserve levels* Staff will conduct annual updates to incorporate actual results and updated forecasts to retest policy sufficiency Based on our modeling, we have sufficient balances in our Operating and Capital Funds to absorb modeled risks and planned spend-down over the next 10 years We recommend maintaining our current policy levels for minimum reserve requirements <p>* Our work with the risk reserve analysis model is discussed in more detail in our Tacoma Water Long-Range Financial Plan (LRFP)</p>	<ul style="list-style-type: none"> In 2018, we enhanced our policy addressing the needs of low-income customers In 2020, the COVID pandemic highlighted other areas of continued focus that warrant potential policy additions The positive financial impact of our commitment to gradual rate adjustments is substantiated in our LRFP published in 2021 Equity, affordability, and climate change are addressed in the PUB Strategic Directives (SDs), Council Strategic Priorities, and emphasized in Tacoma Water but not explicitly stated in our policy We recommend highlighting long-term financial planning, gradualism, equity, affordability, and climate change in our policy as areas of focus

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Tacoma Water: Recommended Changes



We have recommended updates to modernize existing language and highlight important areas of focus.

A. Water Rates Should Ensure Adequate Supply

- Objective: Operationalize equity and call out climate change.
- Proposed Language: *“Climate change and equity will be incorporated when planning for investments and improvements to the water system.”*

B. Water Rates Should Be As Low As Is Responsible

- Objective: Emphasize focus on affordability for customers.
- Proposed Language: *“As rate adjustment proposals are developed, we will monitor the affordability of our rates and assess ways to mitigate impacts to our customers.”*

C. Water Rates Shall Be Fair

- Objective: Expand the current language to include equity and assistance programs.
- Proposed Language: *“C. Water Rates Shall Be Fair [and Equitable]”*
- Proposed Language: *“2. An embedded cost-of-service study will determine the cost of serving each customer class, allocation of class responsibility for the projected expenses, and proposed rates sufficient to equitably recover projected expenses.”*
- Proposed Language: *“15. Inter-class revenue requirements adjustments significantly in excess of the system average may be allocated proportionately to the remaining customer classes. Subsequent increases for the subsidized class will be set equitably and appropriately until cost-of-service rates are reestablished.”*
- Proposed Language: *“16. The needs of low-income, senior, and disabled water customers will be considered when establishing rate/s/levels, providing bill assistance, developing and implementing customer programs, and offering financial education.”*

Tacoma Water: Recommended Changes



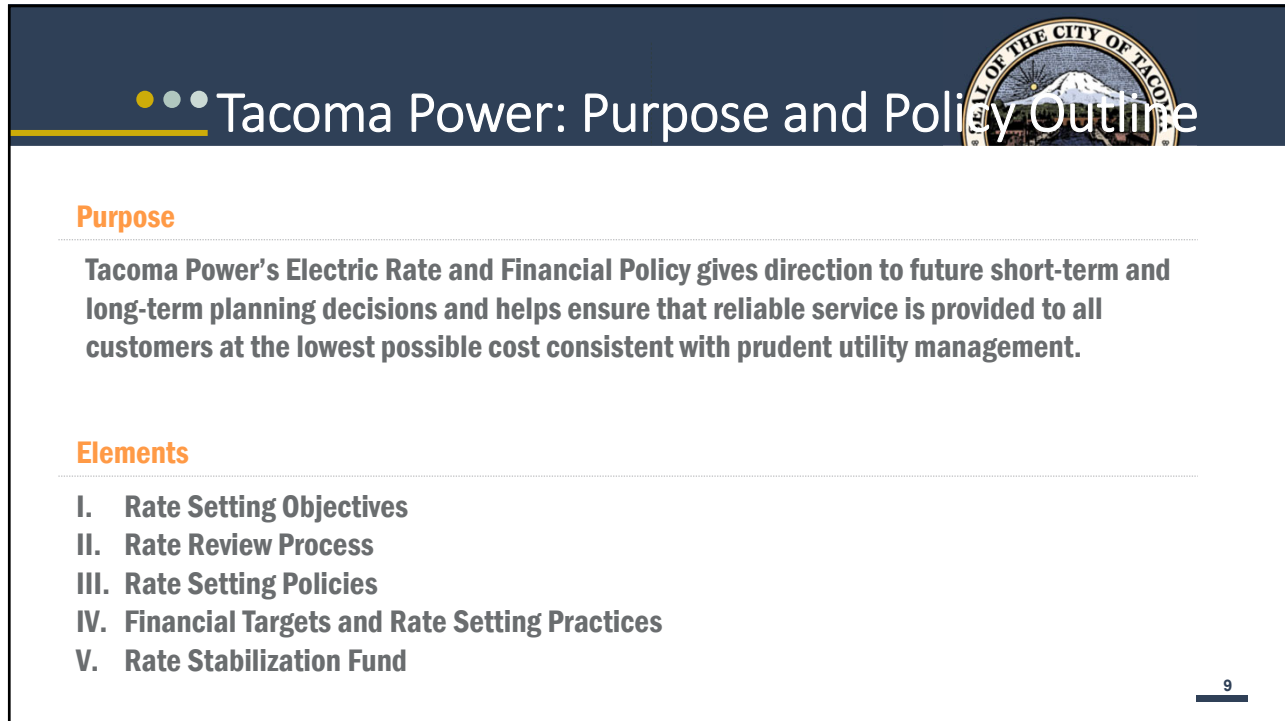
We have recommended updates to modernize existing language and highlight important areas of focus.

D. Water Rates Should Be Stable and Understandable

- Objective: Emphasize objective on gradual rate adjustments through long-term financial planning.
- Proposed Language: *“D. Water Rates Should Be Stable and Understandable- [Based on Long-Term Financial Planning and Adjusted Gradually]”*

E. Water Rates Should Be the Product of Customer Involvement

- Objective: Expand the current language to include equity
- Proposed Language: *“3. Tacoma Water will gather citizen input and provide equitable access to information about its rate-making process. Any proposal to be discussed will be made available as far in advance of its public hearing as is practical.”*
- Proposed Language: *“6. The Utility staff will respond to requests from the Neighborhood Councils and other local organizations to the Community and Media Services section of the Utility and provide speakers to disseminate equitable access to information on water rates, rate policy or rate assistance programs.”*



Tacoma Power: Purpose and Policy Outline

Purpose

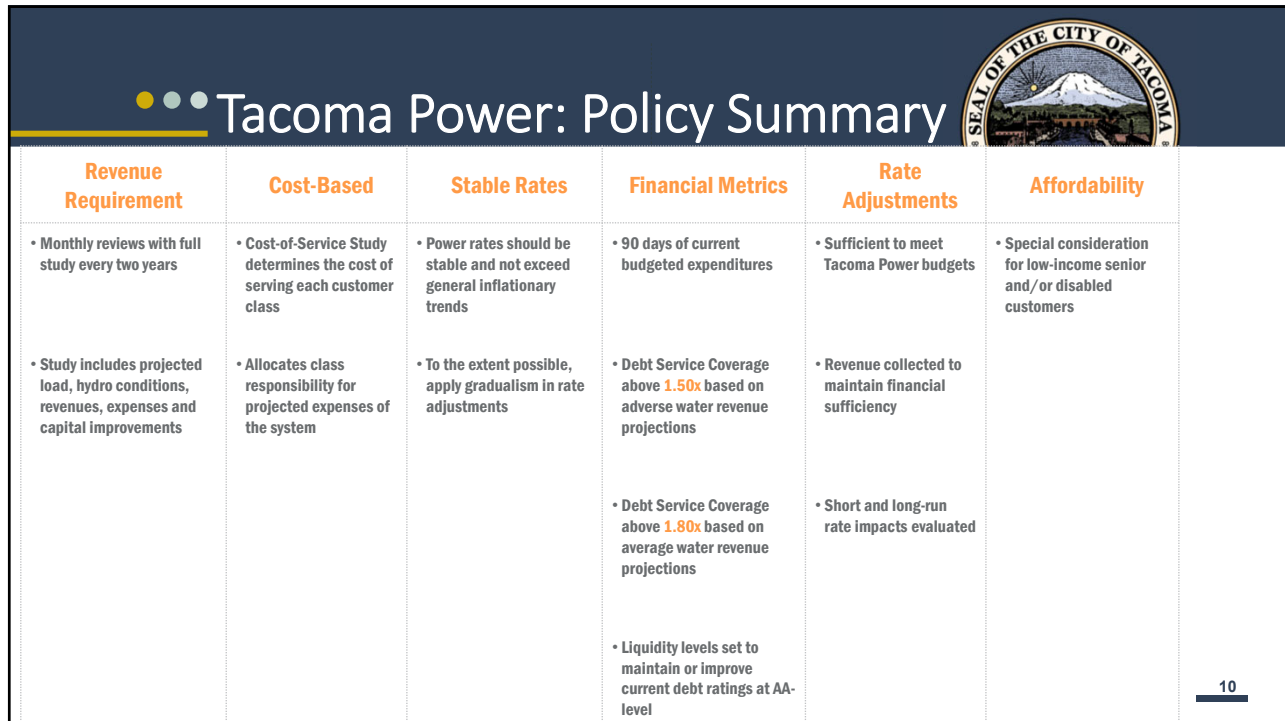
Tacoma Power’s Electric Rate and Financial Policy gives direction to future short-term and long-term planning decisions and helps ensure that reliable service is provided to all customers at the lowest possible cost consistent with prudent utility management.

Elements

- I. Rate Setting Objectives
- II. Rate Review Process
- III. Rate Setting Policies
- IV. Financial Targets and Rate Setting Practices
- V. Rate Stabilization Fund

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Tacoma Power: Policy Summary

Revenue Requirement	Cost-Based	Stable Rates	Financial Metrics	Rate Adjustments	Affordability
<ul style="list-style-type: none"> Monthly reviews with full study every two years Study includes projected load, hydro conditions, revenues, expenses and capital improvements 	<ul style="list-style-type: none"> Cost-of-Service Study determines the cost of serving each customer class Allocates class responsibility for projected expenses of the system 	<ul style="list-style-type: none"> Power rates should be stable and not exceed general inflationary trends To the extent possible, apply gradualism in rate adjustments 	<ul style="list-style-type: none"> 90 days of current budgeted expenditures Debt Service Coverage above 1.50x based on adverse water revenue projections Debt Service Coverage above 1.80x based on average water revenue projections Liquidity levels set to maintain or improve current debt ratings at AA-level 	<ul style="list-style-type: none"> Sufficient to meet Tacoma Power budgets Revenue collected to maintain financial sufficiency Short and long-run rate impacts evaluated 	<ul style="list-style-type: none"> Special consideration for low-income senior and/or disabled customers

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Tacoma Power: Reviewing and Testing our Policy



Quantitative Review

- In 2010, we funded a Rate Stabilization Fund* (RSF) to stabilize rates and maintain AA-rated utility metrics.
- Staff conducts annual updates to incorporate actual results and updated forecasts to retest the sufficiency of the RSF balance.
- Based on our modeling, we do not need to change our policies around liquidity or the Rate Stabilization Fund balance.


*Our plans to use the Rate Stabilization Fund is discussed in more detail in our [Tacoma Power Long-Range Financial Plan](#) (LRFP).

Qualitative Review

- In 2018, we enhanced our policy addressing the needs of low-income customers and formalized our Long-Range Financial Plan with a long-term view on gradual rate adjustments
- Equity, affordability, and climate change are addressed in the PUB Strategic Directives (SDs), Council Strategic Priorities, but were not explicitly stated in Tacoma Power's policy
- We recommend highlighting long-term financial planning, gradualism, equity, affordability, and climate change in our policy

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Tacoma Power: Recommended Changes



We recommend updates to modernize existing language and highlight important areas of focus.

I. A. Serving Customer Needs in a Competitive Electric Industry

- Objective: Operationalize equity
- Proposed Language: *"Tacoma Power's financial planning and rate-setting process aims to deliver to all households safe, reliable, and affordable electric services and provide equitable access to information."*

I. G. Low Income Customers

- Objective: Emphasize our focus on affordability for customers.
- Proposed Language: *"As rate adjustments are made, we will monitor the affordability of our rates and assess ways to mitigate impact on customers."*
- Objective: Expand current language to include customer programs.
- Proposed Language: *"The needs of low-income, senior, and disabled electric customers will be considered when establishing rate[s] levels, providing bill assistance, developing and implementing customer programs and offering financial education."*

I. D. Review of Major Commitments

- Objective: Call out climate change
- Proposed Language: *"Tacoma Power will plan for, and consider ways of mitigating, the impacts of climate change on our electric system in an affordable manner."*

I. J. Rate Stability

- Objective: Emphasize our objective on gradual rate adjustments through long-term financial planning.
- Proposed Language: *"To the extent possible, rate adjustments should be stable and consistent level across years, adjusted gradually through long-term financial planning, and not exceed general inflationary trends."*

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Tacoma Rail: Purpose and Guiding Objectives



Purpose

The Tacoma Rail Rate Policy provides for rates adequate to ensure the operation, maintenance, and construction of the Department’s railway system while providing safe, cost effective, and reliable service to customers within Tacoma Rail’s service area.

Guiding Objectives

Rail rates should:

- A. Be cost based and adequate to recover costs
- B. Be stable
- C. Ensure sufficient resource planning and acquisition for reliable service while being as competitive as possible
- D. Have a customer involvement and review process

Tacoma Rail: Policy Summary



Revenue Requirement	Cost-Based	Stable Rates	Financial Metrics	Rate Adjustments
<ul style="list-style-type: none"> • Rates reviewed every two years at a minimum • Full revenue requirement study performed every two years 	<ul style="list-style-type: none"> • Utilize an average embedded cost-of-service methodology • Allocates rate class responsibility for projected expenses of the system • Fuel surcharges shall be based on actual costs over an established threshold 	<ul style="list-style-type: none"> • To the extent possible, rate adjustments will not exceed general inflationary trends • The term of debt financing will not be longer than the useful life of the capital project 	<ul style="list-style-type: none"> • Minimum cash balance of 60 days of current budgeted expenditures • The limit of debt to total assets shall be set up to a maximum of 40% • Debt service coverage ratio shall be at least 1.5x 	<ul style="list-style-type: none"> • Rates based on best estimates of rail volume • Rates will be designed to meet the changing needs of the customer • Rate classes may be established by blending customers • The character and volume of service is used to apportion costs, developing rates, and tariff revisions

Tacoma Rail: Recommended Changes



We recommend updates to modernize existing language and highlight important areas of focus.

B. Rail rates should be stable.

- Objective: Establish a Volume Investment Fund
- Proposed Language: Rates will be based on best estimates of rail volume. *Operating revenue surpluses due to unanticipated rail volume growth may be applied to the Volume Investment Fund, a subfund of Tacoma Rail's enterprise fund. To establish a balance to the fund, an initial \$500,000 will be transferred to the subfund when created.*

C. Rail rates should ensure sufficient resource planning and acquisition for reliable service while being as competitive as possible.

- Objective: Establish a Volume Investment Fund
- Proposed Language: *Tacoma Rail maintains a Volume Investment Fund, a subfund of Tacoma Rail's enterprise fund, that provides revenue requirement flexibility during times of unanticipated economic downturns or capital spending that may be used to offset the necessity of rate increases. Use of the fund will be limited to:*
 - Workforce stability to ensure adequate staffing retention for service reliability and resiliency for when rail volumes rebound after a downturn.*
 - Locomotive upgrades to sustain Tacoma Rail's environmental leadership goals.*
 - Timely acquisition, replacement and upgrade of infrastructure and capital assets.*
 - Grant or debt matching opportunities.*



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