

Sound Financial Practices for Sound Utilities

October 2018

*Moving from a cycle of financial inadequacy to a
cycle of sufficiency through implementation of
sound financial practices*



HISTORICAL EXPERIENCE

Setting the stage for the future

Transition Costs



NEW ISSUE

STANDARD & POOR'S: AAA
AMBAC Indemnity Insured

In the opinion of Bond Counsel, interest on the 1986C Bonds is exempt from all present Federal income taxes under existing statutes, regulations and court decisions. See "Tax Exemption" herein. See also "Pending Federal Tax Legislation" herein.

\$40,840,000

Oklahoma City Municipal Improvement Authority
(Oklahoma City, Oklahoma)

WATER AND SEWER SYSTEM REVENUE BONDS, SERIES 1986C

Dated: August 1, 1986 **Due: July 1, as shown below**

Deferred Interest Bonds dated August 31, 1986

Interest on the 1986C Bonds (except interest payable at maturity and interest on the Deferred Interest Bonds) is payable commencing January 1, 1987 and each January 1 and July 1 thereafter by check or draft mailed to the registered address of the Bondholder. Principal of the 1986C Bonds (and interest due at maturity) is payable to the registered owner thereof upon presentation and surrender at the corporate trust office of The Liberty National Bank and Trust Company of Oklahoma City, Oklahoma City, Oklahoma (the "Trustee"). The interest on the Deferred Interest Bonds will be payable only upon redemption or at maturity of such Deferred Interest Bonds. The 1986C Bonds are issuable only as fully registered bonds in the denominations of \$5,000 maturity amount or any integral multiple thereof. The 1986C Bonds are subject to redemption prior to maturity as more fully described herein.

\$18,080,000 Oklahoma City Municipal Improvement Authority
Water and Sewer System Revenue Bonds, Series 1986C
(Current Interest Bonds)

Principal Amount	Maturity	Interest Rates	Principal Amount	Maturity	Interest Rates
\$ 765,000	July 1, 1987	4.75%	\$1,225,000	July 1, 1995	6.80%
810,000	July 1, 1988	5.25%	1,305,000	July 1, 1996	6.90%
850,000	July 1, 1989	5.75%	1,395,000	July 1, 1997	7.00%
895,000	July 1, 1990	6.00%	1,495,000	July 1, 1998	7.10%
950,000	July 1, 1991	6.20%	1,600,000	July 1, 1999	7.15%
1,010,000	July 1, 1992	6.40%	1,715,000	July 1, 2000	7.20%
1,080,000	July 1, 1993	6.60%	1,840,000	July 1, 2001	7.20%
1,145,000	July 1, 1994	6.70%			

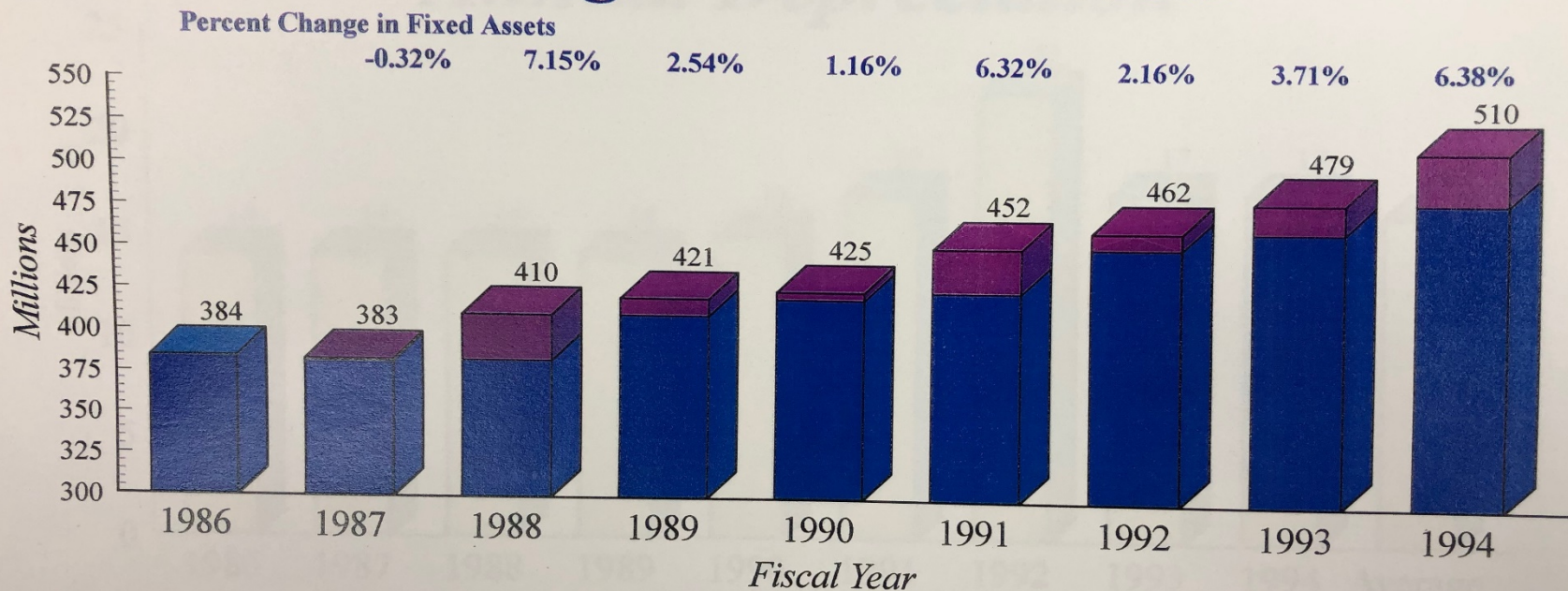
\$22,760,000
(Deferred Interest Bonds)

Face Amount of Bond (Par Value)	Accreted Value on Maturity Date	Maturity Date	Interest Rates
\$2,693,814.97	\$10,195,000	July 1, 2004	7.60300%
2,483,840.19	10,195,000	July 1, 2005	7.63900%
2,309,731.76	10,195,000	July 1, 2006	7.62700%
2,126,447.79	10,195,000	July 1, 2007	7.66600%
1,976,086.40	10,195,000	July 1, 2008	7.65700%
1,816,589.82	10,195,000	July 1, 2009	7.69800%
1,687,910.43	10,195,000	July 1, 2010	7.68900%
1,549,232.18	10,195,000	July 1, 2011	7.73200%
1,438,553.13	10,195,000	July 1, 2012	7.72500%
1,318,814.40	10,195,000	July 1, 2013	7.76800%
1,224,008.94	10,195,000	July 1, 2014	7.76200%
1,110,107.27	10,195,000	July 1, 2015	7.83955%
1,024,862.72	10,195,000	July 1, 2016	7.85000%

State of Oklahoma, Oklahoma County, Oklahoma, The City of Oklahoma

Celebrate Past Team Accomplishments

Water & Wastewater Utilities Change in Fixed Assets



Fixed asset amount is net of depreciation

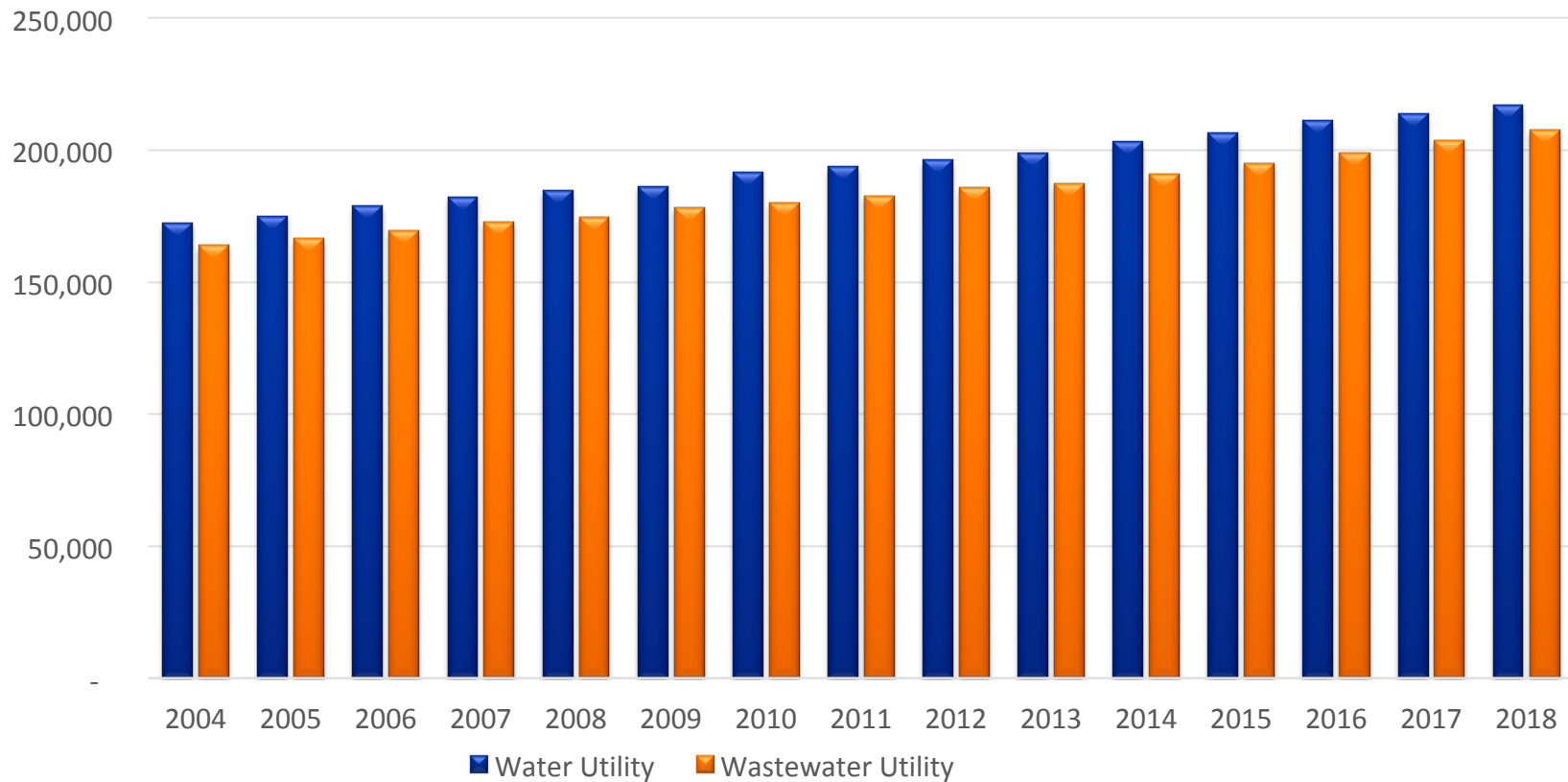
FY 1986 amount is ending balance

Source: Comprehensive Annual Financial Report

Utility Long-term Financial Goals -1995

- Incrementalism
 - Adjust rates annually in approximately equal increments, avoiding rate shock
 - Pace capital and operating plan implementation in “bite-size” portions we can readily afford and achieve
- Solvency
 - Maintain adequate cash reserves/adjust balances as we grow
 - 90 days working capital minimum
 - Debt service reserves - Fund all debt service accounts in-full and on-time
- Credit Management
 - Maintain/enhance S&P (AA-) and Moody’s (Aa) bond ratings
 - Revenue bonds coverage target minimum raise from 1.5 to 2.0 times annual debt requirement
 - Fund 40% of capital plan from net revenues and 60% from debt
- Strategic Pricing – Focus on improving revenue productivity from fixed charges above 5%
 - Add wastewater base charge
 - Add monthly private fire service fee
 - Add account origination/transfer fee
 - Stop charging for shut-offs since they often just add bad debt
- Wholesale Service Strategy
 - Develop and implement strategy to become regional water and wastewater provider
 - Standard service plan options
 - Standard contract form
 - Standard pricing by service plan

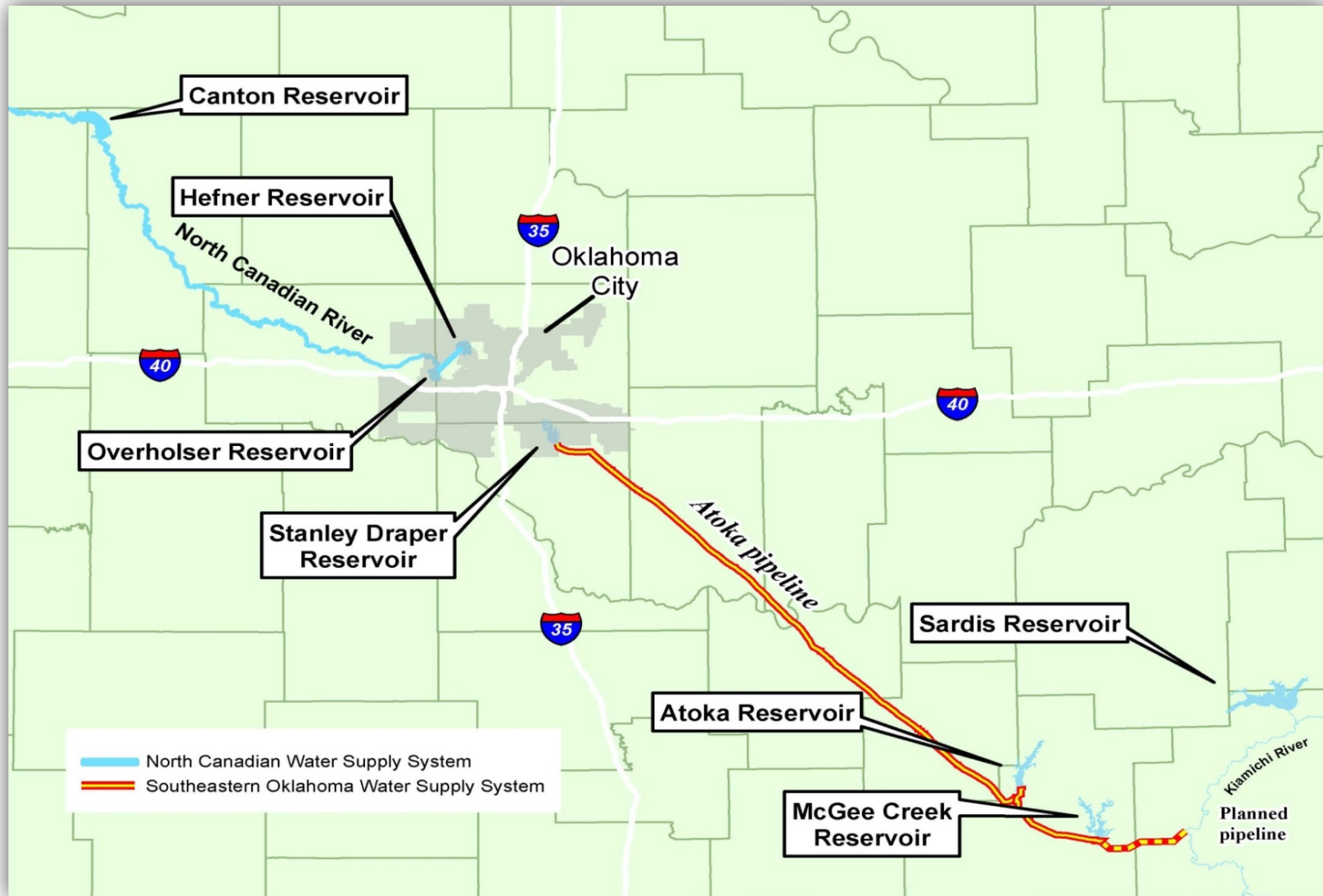
Customer Growth Consumes System Capacity



Since 2004, the number of customers has grown 1.7% per year

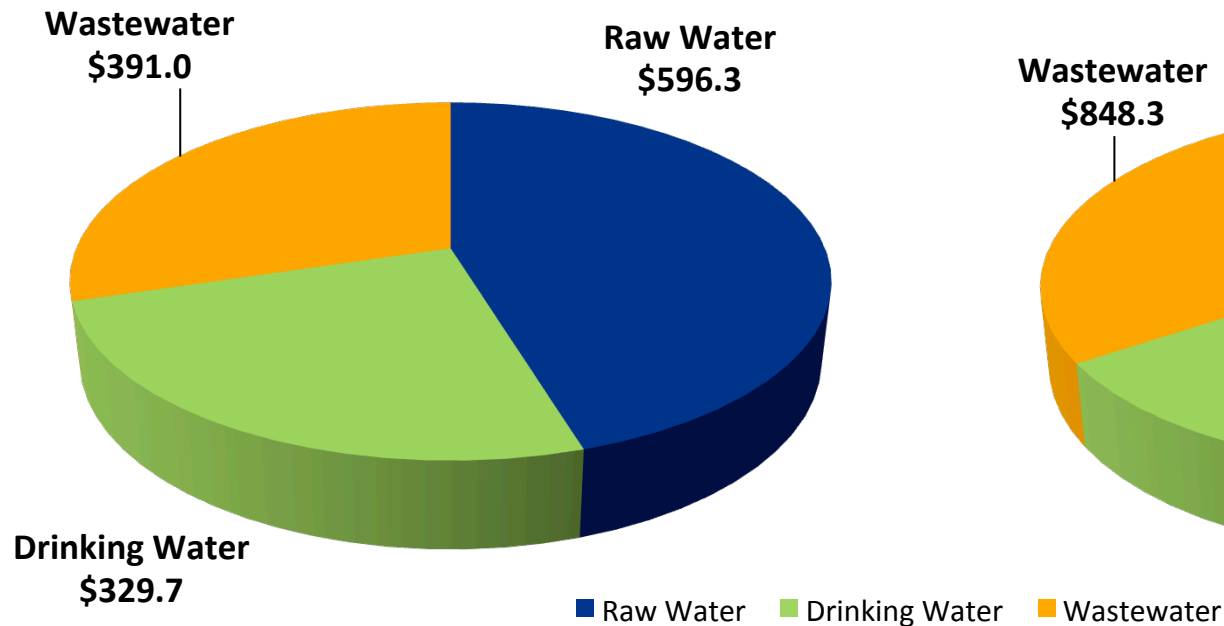
NEXT CHALLENGE

OKC Water Supply System

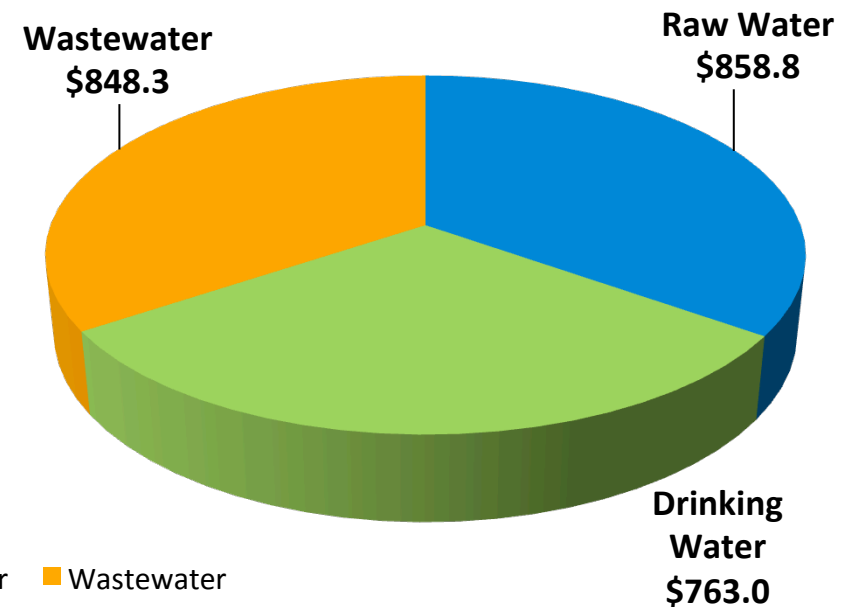


OKC Capital Plan Summary

5 Year CIP \$1.3 Billion

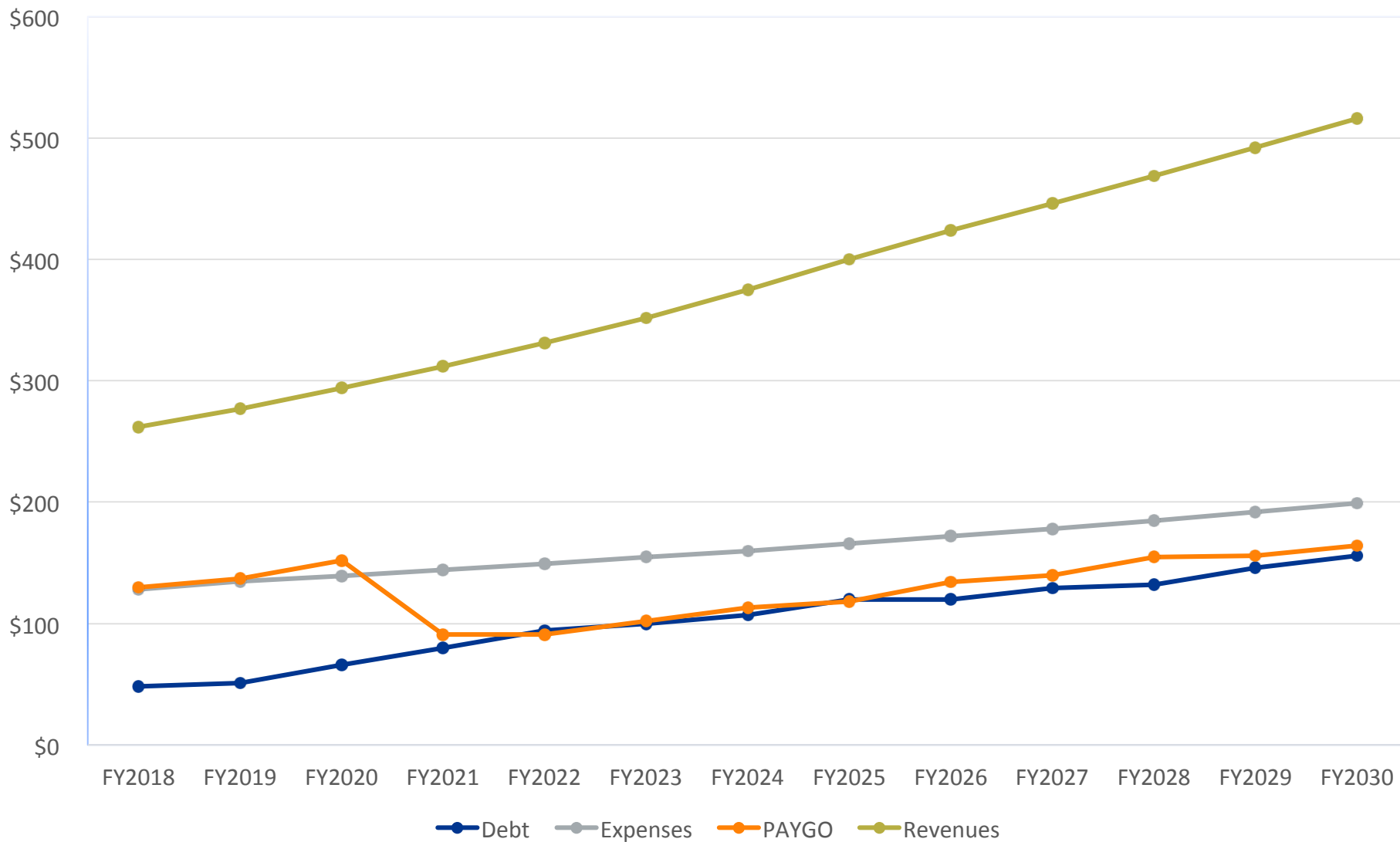


10-Year CIP \$2.5 billion



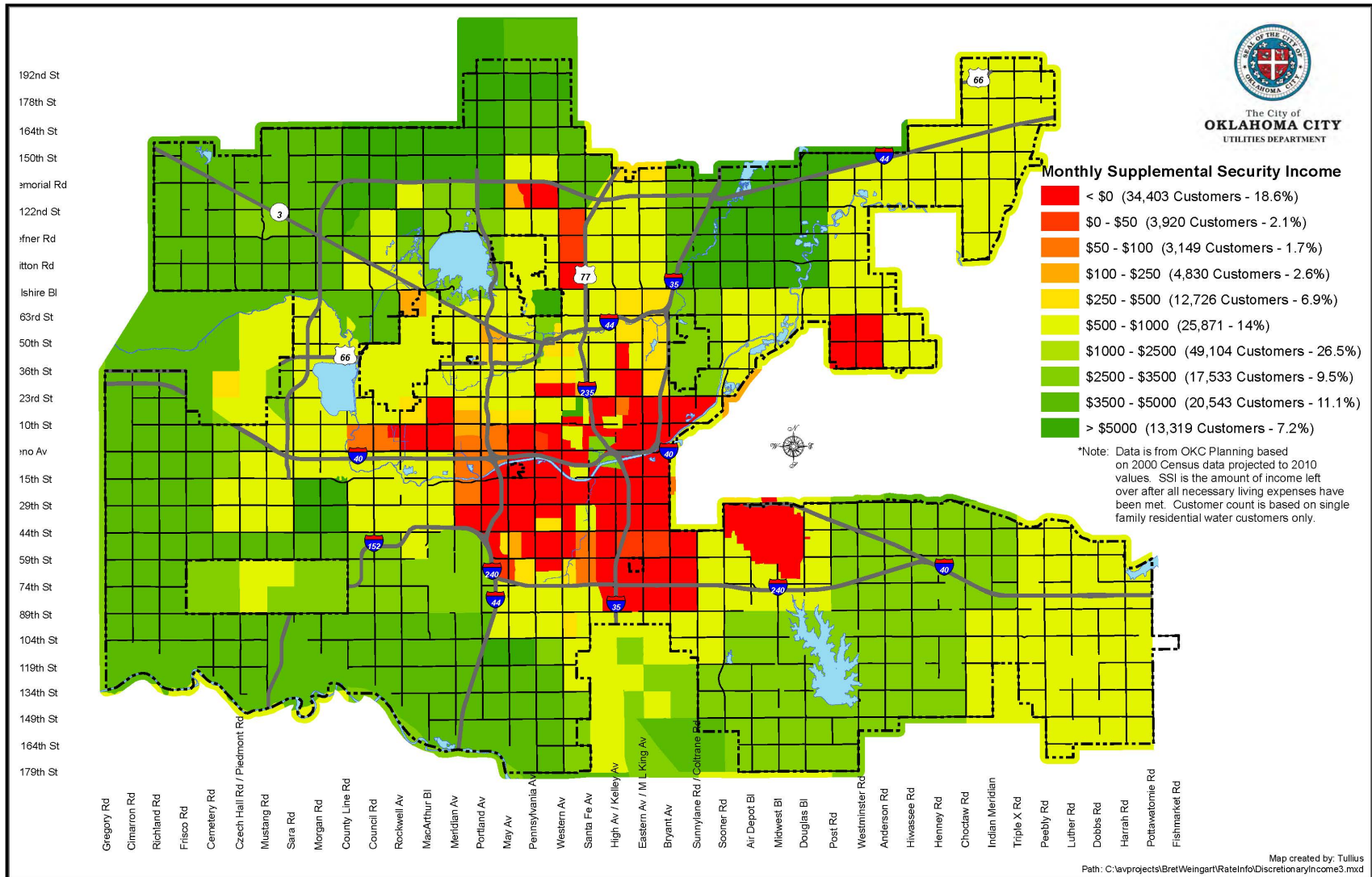
*Capital Expenditures averaged \$97mil/yr last 10 years;
Will average \$250m / yr next 10 years*

Revenues Vs Financing Requirements

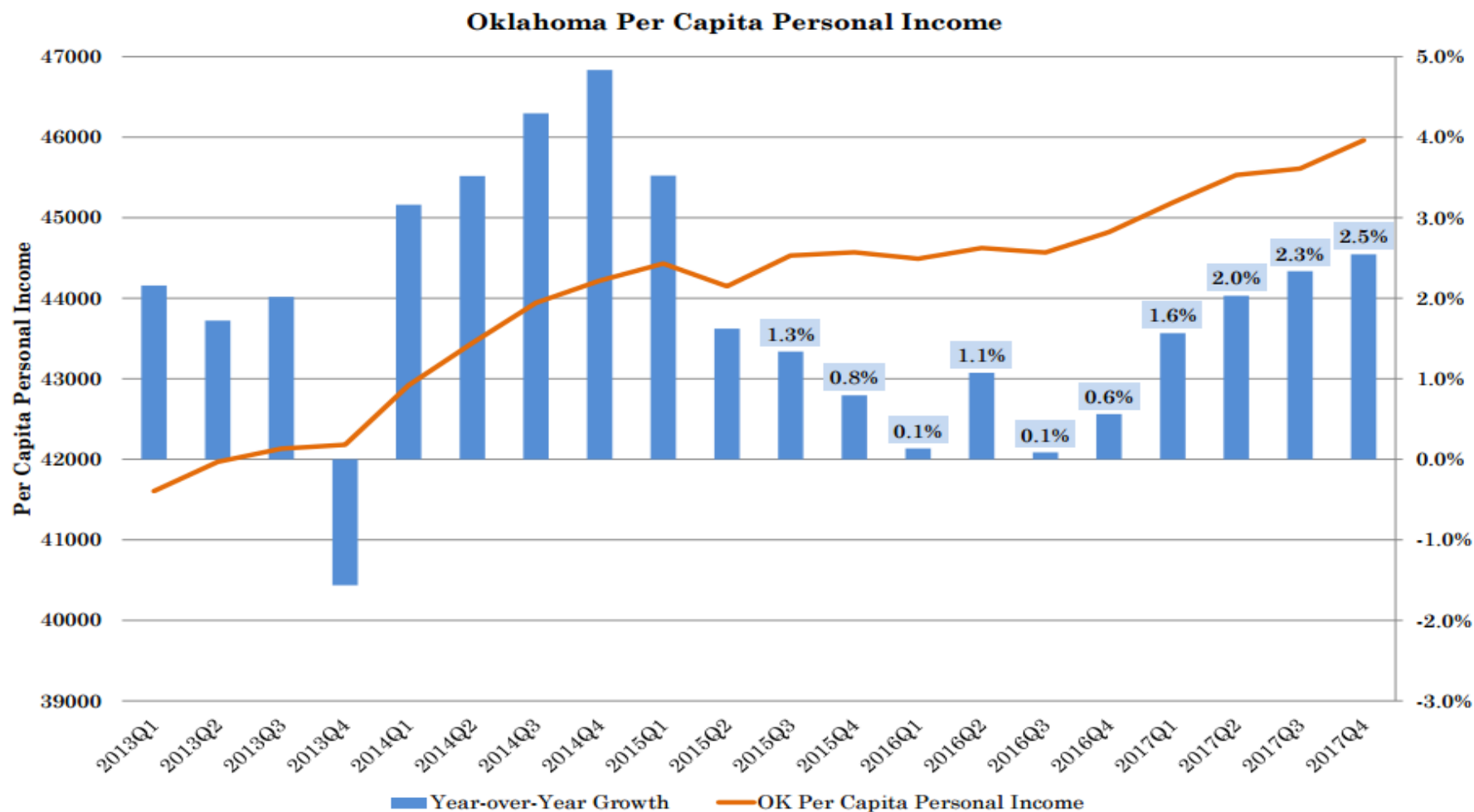


CUSTOMER FINANCIAL METRICS

Financial Capacity of Customers



OKC Per Capita Personal Income



Source: "2016 Greater Oklahoma City Economic Forecast". Greater Oklahoma City Chamber. Prepared by Russell Evans, Steven C. Agee Economic Research and Policy Institute – Oklahoma City University.

UPDATE FINANCIAL STRATEGY

Pricing and Financing Strategies

- Alternative outcomes from pricing methodologies:
 - Revenue productivity from traditional cost-of-service (COS) studies
 - Gas, electric, cable, cell phone utility revenue reliability examples
 - Wholesale pricing based on capacity requirements rather than use
- Leveraging strategies
 - Equity Position
 - PAYGO strategy to sustain equity position
 - Debt loading
 - Debt repayment metrics
 - Coverage goals
 - Total debt service coverage
 - Fixed charge coverage
- Reserve Policies
 - Revenue bond requirements
 - State Revolving Fund zero reserve
- Contributed capital strategies
 - Plat requirements
 - System development charges
- Political realities

Long-Term Financial Planning Metrics

Summary Report

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
Rate Adjustments & Coverage										
Rate Adjustment (W)	6.31%	6.15%	6.02%	6.26%	6.50%	6.50%	6.50%	4.00%	4.00%	3.13%
Rate Adjustment (WW)	4.83%	4.35%	4.22%	4.25%	4.31%	4.40%	4.26%	4.32%	4.40%	4.45%
Working Capital Days	246	90	90	90	90	90	90	90	90	90
Revenue Bond Coverage	3.26	2.83	2.45	2.23	2.29	2.15	2.04	2.18	2.12	2.22
All in Coverage	2.81	2.43	2.12	1.96	2.00	2.03	1.95	2.11	2.07	2.15
Fixed Charge Coverage	1.62	1.41	1.23	1.12	1.14	1.06	1.01	1.07	1.05	1.10
Water CIP										
Renewal and Replacement	43,650	37,890	17,740	17,520	23,680	42,430	43,710	44,830	32,790	25,740
Transmission and Distribution	17,140	11,050	3,490	2,440	2,510	28,140	20,420	14,510	34,800	8,190
Sys Imp for Growth and Expansion	230,370	178,990	208,200	152,710	168,570	53,010	56,470	25,040	97,500	112,910
Asset Management	530	1,100	1,120	1,160	1,200	2,470	5,710	4,570	4,030	3,460
Total Water CIP	291,690	229,030	230,550	173,830	195,960	126,050	126,310	88,950	169,120	150,300
Wastewater CIP										
Renewal and Replacement	32,590	41,590	44,420	26,160	28,510	31,830	32,940	33,790	33,470	34,470
Interceptors	16,870	7,210	5,640	5,220	-	-	5,070	19,610	20,400	-
Wastewater Treatment Expansion	22,290	60,140	10,920	24,370	29,890	36,950	39,010	43,570	34,060	90,510
Sys Imp for Growth and Expansion	3,180	7,930	4,500	12,180	3,000	8,620	1,900	1,960	2,020	5,550
Asset Management	6,900	8,470	8,740	8,990	8,960	9,240	16,170	16,670	10,100	8,670
Total Wastewater CIP	81,830	125,340	74,220	76,920	70,360	86,640	95,090	115,600	100,050	139,200
Total CIP										
Total Water and Wastewater CIP	373,520	354,370	304,770	250,750	266,320	212,690	221,400	204,550	269,170	289,500
Financing										
Amount Funded with Pay-Go	145,355	150,519	91,211	92,055	102,727	112,613	117,048	133,568	138,991	153,584
Amount Funded with Debt	228,165	203,851	213,559	158,695	163,593	100,077	104,352	70,982	130,179	135,916
Total Amount Financed	373,520	354,370	304,770	250,750	266,320	212,690	221,400	204,550	269,170	289,500
Ratios										
Operating Margin Ratio	51.18%	52.51%	53.45%	54.51%	55.65%	56.82%	57.98%	58.91%	59.50%	60.03%
Debt Payoff Ratio	50.65%	42.86%	43.85%	50.97%	41.42%	46.39%	51.84%	49.78%	54.97%	51.27%

OKC Commercial Paper Program

- Municipal Utilities usually finance capital via bonds and net revenues
- Laws usually require governments to have cash on hand or a contract in place to provide the funds at the time of project awards
- Borrowing all the money up-front (prior or at construction contract award) causes high interest costs (negative arbitrage) during construction
- Utilities can avoid this high interest cost during the construction phase by incurring debt incrementally as construction claims are paid
- Commercial Paper (CP) Programs are used to put in place the capability to borrow funds incrementally
- The current CP borrowing rate is about 1.7%
- Bond Buyer Revenue Bond Index is about 4.4%
- For each year between award and completion of a project, a utility can save about \$230,000 in negative arbitrage by using CP / \$10 million in projects, anticipate saving over \$30 million in next 10 years
- OKC has a \$200 million CP borrowing capacity and usually converts outstanding temporary borrowings to permanent financings when they reach about \$100 million
- Anticipate raising CP program capacity to \$350 million soon

Distribution of Debt Responsibility Options

- Many municipal utilities are financially combined (cross-collateralized)
- Each utility has unique (variable) capital needs over time
- Needs often fail to align with individual utility borrowing capacity
- Debt distributed based on use of proceeds option (traditional)
 - Consequences of traditional approach on expenses / rates
 - Customer / political reactions as capital plan is implemented
- Debt distributed based on net fixed assets of each utility option
 - “Holding company” financing model works well for combined utilities
 - Customer pays burden of financing regardless of option
 - Rates for each utility are more stable, (less rate shock) over time
 - Enables cross-collateralized utility to manage debt with less rate stress
 - Should one of the utilities have a bigger retail / wholesale customer base than the other, its share of the debt responsibility grows commensurately with asset growth
 - Spreads debt cost more fairly between inside and outside city customers
 - Accommodates combined debt management, commercial paper borrowing program approach much better

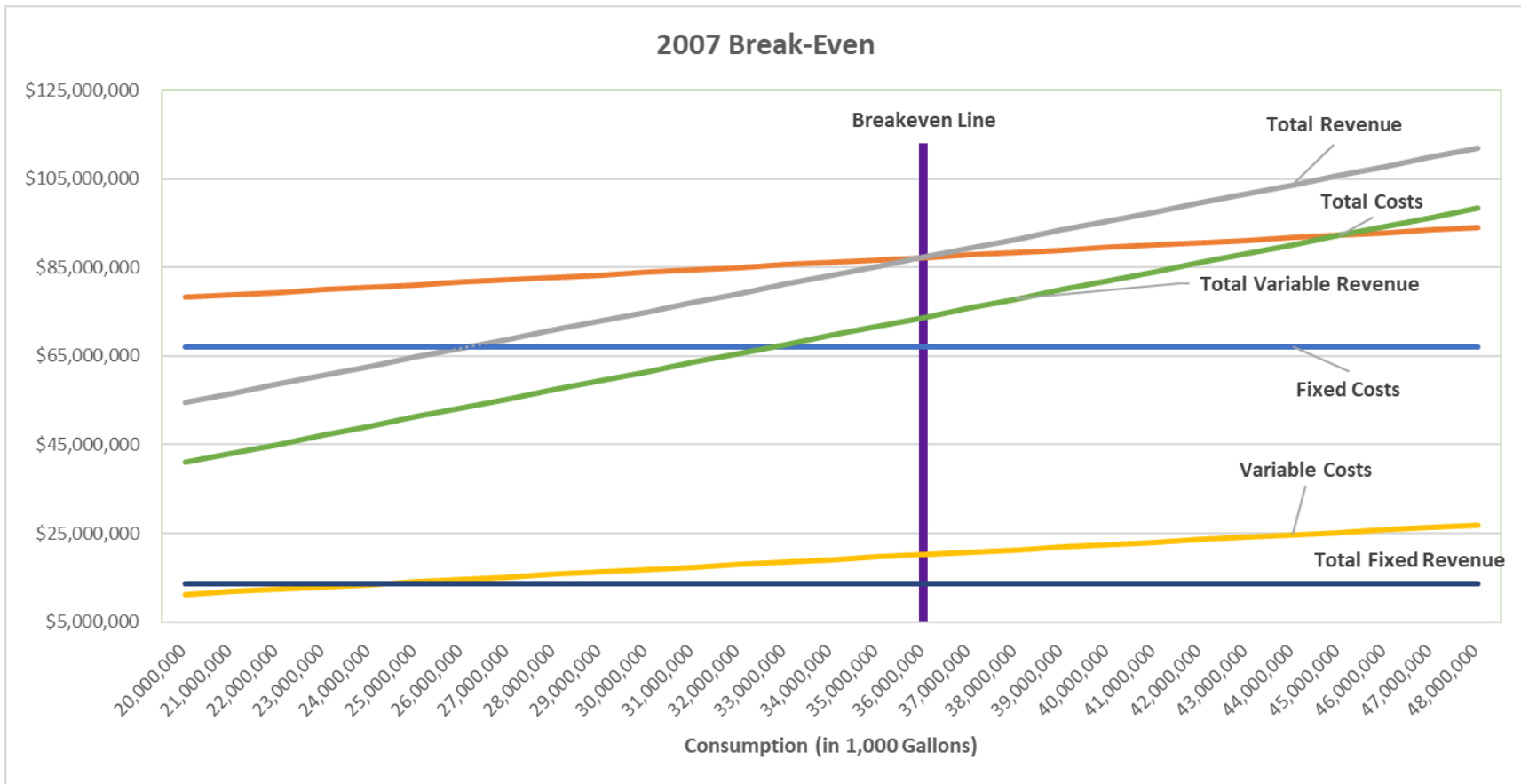
Relationship Between Pricing & Financial Health

- Municipal utilities are “owned” by the customers / citizens
- Operate in the best interest of the owners / each owner
- How does this express itself in the financial factors of a utility?
 - Affordability – no more customer “financial sacrifice” than necessary
 - Stable pricing, lower fluctuations from bill-to-bill, easy to estimate/pay
 - Maximize the benefits received per dollar charged
 - Avoid pulling more funds than necessary from each owner
 - Achieve breakeven by class with least negative economic impact
 - Reliable service (utility resourced to meet customer needs)
 - Annual / monthly receipts vs cost to serve primary measure
 - Fixed vs variable relevant only for consumption above fixed cost to serve
- Utilities must find sweet spot
 - Services provided reliably
 - Revenues adequate to meet all financial responsibilities
 - Breakeven occurs in every weather/service condition
- What pricing strategy will achieve / maintain financial health?

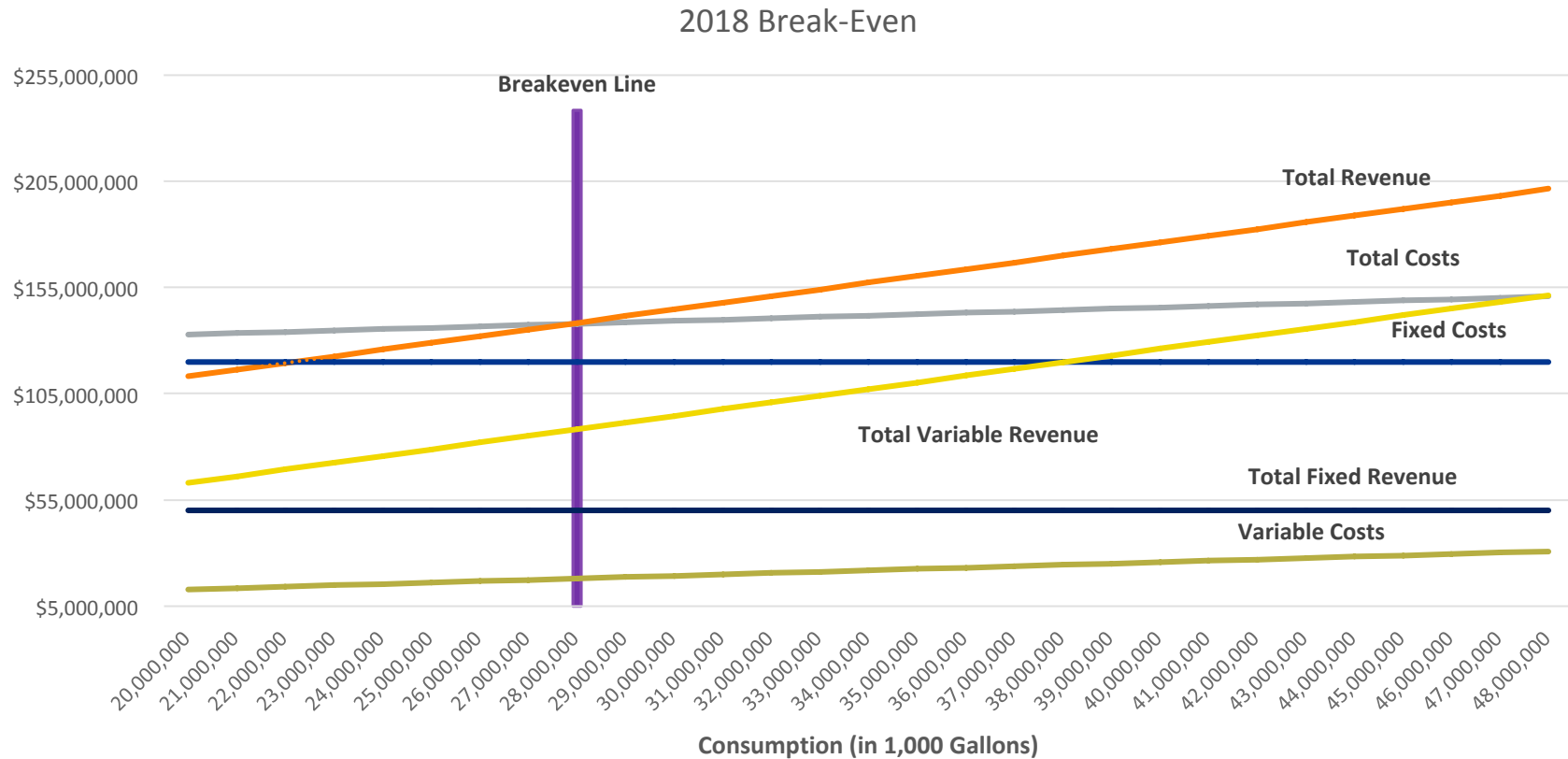
Relationship Between Pricing & Cost

- Utilities have many recurring costs that can be considered fixed:
 - Personnel salaries, benefits, insurance, retirement
 - Insurance
 - Pay-as-you-go / net revenue contributions to capital projects
 - Debt service
 - Taxes/Transfers
- COS industry guidelines/practices favor (biased towards) allocating far more recurring costs to variable charges (consumption) than to fixed charges due to tradition rather than achieving/maintaining financial health
- Annual consumption may vary 10-30 percent based on weather/use
- Higher revenue variability leads to financial health protection mechanisms like larger reserve policies, lower bond ratings, higher borrowing costs, capital project delays, bigger rate increases, etc
- “Parking” cash and delaying capital projects have negative economic effects (owners pay a risk premium for higher pricing variability)
- Traditional COS allocation biases have negative financial health consequences that can be overcome with financial logic
- Rebalancing relationship between pricing and cost allocation objectives is warranted to improve revenue reliability/financial health
- Rebalancing lessens risk premiums, causing lower economic extraction from the owners, given equivalent service level (customer bills are lower over long term)

Reaching Breakeven 2007



Reaching Breakeven 2018 – Pricing Strategy



Utility Long-term Financial Goals - 2018

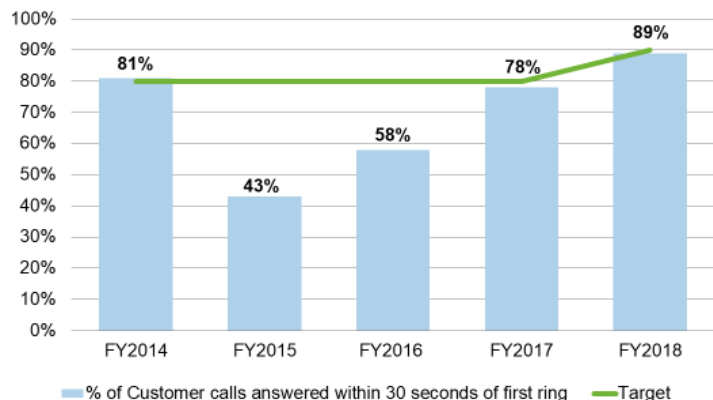
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 - Adjust rates annually in approximately equal increments, avoiding rate shock
 - Paces capital and operating plan implementations in “bite-size” portions we can readily afford and achieve
- Solvency
 - Maintain adequate cash reserves
 - 90 days working capital minimum
 - Debt service reserves - Fund all debt service accounts in-full and on-time
- Credit Management
 - Maintain S&P (AAA) and Moody’s (Aaa) highest available stable bond ratings
 - Revenue bonds coverage target minimum 2.0x
 - Fixed charge coverage ratio target 1.0x
 - Debt payoff ratio (bonds paid off at half-life/15 yrs)
 - Fund 40% of capital plan from net revenues and 60% from debt
- Strategic Pricing –continue growing fixed charges to meet annual debt service requirements (35% today)
- Innovative Wholesale Contract Pricing
 - Wholesale service pricing – 73% of annual revenues from fixed fees
- Large Manufacturing Uniform Rate = 5 million gallons or more per month, excluding irrigation and peak to average ratio of 1.25 or less
- Wholesale Raw Water Sales
- Treated Wastewater Reuse Sales – 8% of wastewater treated annually

Close to the Customer

- The book, In Search of EXCELLENCE, Lessons from America's Best-Run Companies, Chapter 6
- “In observing the excellent companies, and specifically the way they interact with customers, what we found most striking was the consistent presence of obsession. This characteristically occurred as a seemingly unjustifiable overcommitment to some form of quality, reliability, or service...they do seem to us more driven by their direct orientation to their customers than by technology or by a desire to be the low-cost producer... Service, quality, reliability are strategies aimed at loyalty and long-term revenue stream growth (and maintenance).”
- How can municipal utilities use this concept to achieve such loyalty and revenue stream growth / reliability to fulfill their missions of providing excellent water and wastewater service?

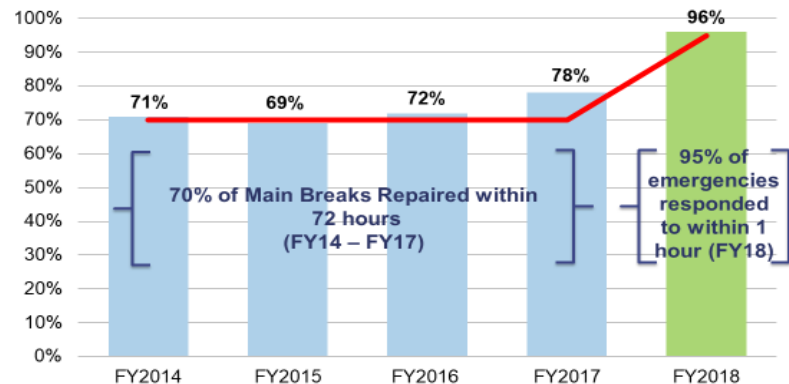
Keeping Close to the Customer

Customer Service 90% of calls answered within 30 seconds



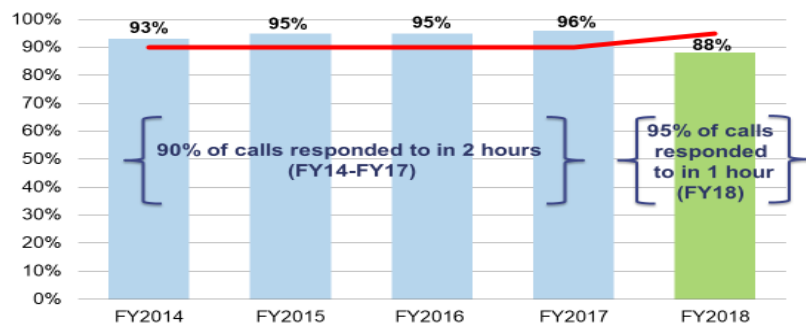
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Water 95% of emergencies (main/service line breaks) responded to within 1 hour



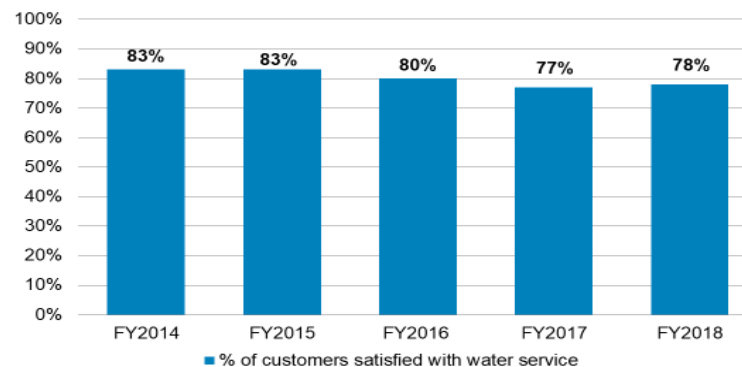
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Wastewater 95% of overflow/backups calls responded to within 1 hour



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Citizen Survey % satisfaction with water service



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Presentation Themes

- Shared values, shared responsibilities (100%/ZERO)
- Long-term perspective, respect past contributions, establishes minimum pattern for projecting future possibilities
- Transparency, create regular buy-in opportunities
- Make incremental improvements every year
- Establish strong financial goals that generate consensus
- Clarify accountability for financial planning/solvency management vs financial operations
- Debt management, debt/equity, coverage ratios, reserve policies, commercial paper programs, private activity bond challenges
- Evolutionary ratemaking that supports financial goals
- Tie specific fee components to specific financial objectives where possible