



LEHIGH COUNTY AUTHORITY

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2019 BUDGET – EXECUTIVE SUMMARY

Submitted by: Liesel M. Gross, Chief Executive Officer
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Around mid-year each year, Lehigh County Authority (LCA) enters into a planning cycle in which we look forward and evaluate our financial, operational, capital and organizational needs for the year(s) ahead. In 2018, LCA revised the planning cycle to more closely match our financial evaluation process for rates and capital funding. While this shift may have limited impact on the 2019 budget as presented, it is an important part of the organization’s evolution in which we place additional focus on long-range planning and financial forecasting. The updated planning schedule will commence in 2019 as follows:

Winter	Five-Year Capital Plan (2020-2024) developed and presented Five-year capital financing and rate projections developed
Spring	Five-Year Capital Plan finalized and adopted
Summer	Preliminary Budget developed and presented (using “year 1” of the Five-Year Capital Plan)
Fall	Budget finalized and adopted Next year’s rates finalized and adopted Develop conceptual project plans for inclusion in the next Five-Year Capital Plan

This revised planning cycle is not groundbreaking in any way, but serves to place the focus on planning, financial forecasting and development of longer-term rate projections for all customers. This is critical for LCA as we continue to move forward with capital intensive system upgrades that are required to meet environmental, regulatory and service-level requirements of the communities we serve in Lehigh and Northampton counties.

The 2019 Budget is presented as the first step in implementing this important shift for our organization. The sections below describe key challenges for each of the operating funds LCA manages, and the summary on the last page of this executive summary illustrates the positive overall organizational performance we expect in the year ahead.

Suburban Water Division

Over the past 10 years, and more noticeably in the past 5 years, expenses in LCA’s Suburban Water Division have increased sharply. These expenses are due to rising operational costs across the board, but focused in the following areas:

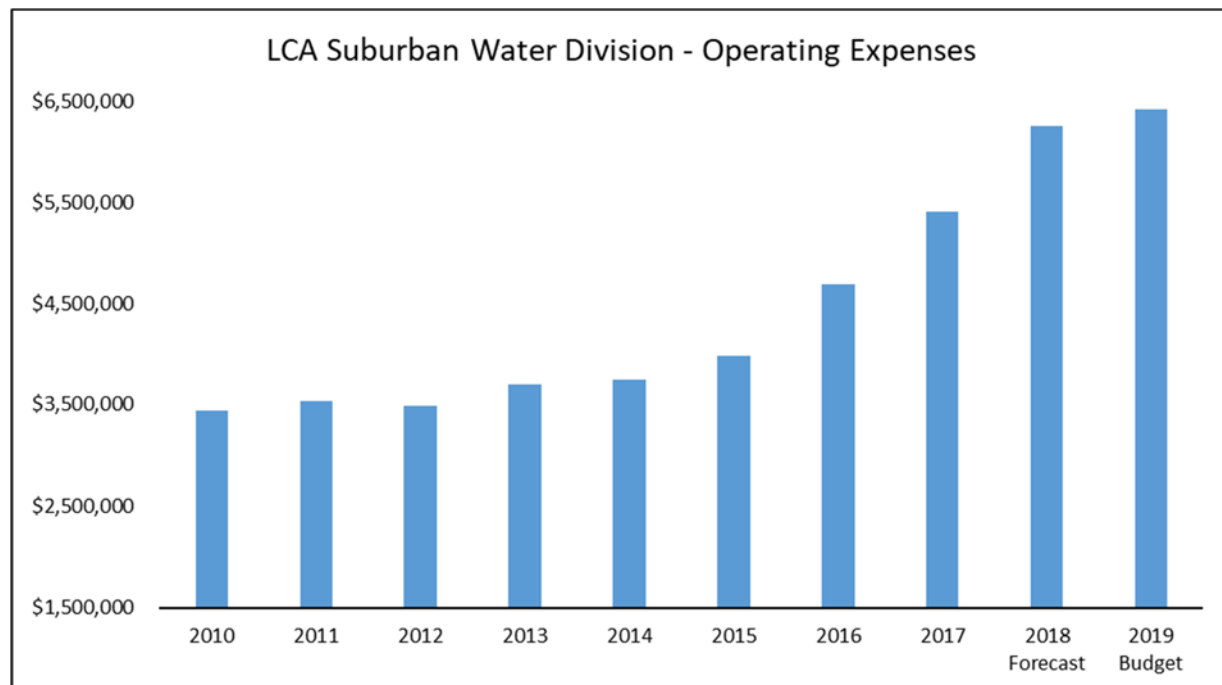
Payroll & Benefits – Significant staffing expense increases driven by additional employees required to maintain aging water infrastructure, salary adjustments to maintain market competitiveness, and sharply increasing health benefits expenses. This impacts both operational costs as well as general overhead expenses that are allocated to each operating unit.

Every drop matters. Every customer counts.

Maintenance Services – As the Suburban water systems have aged, preventive maintenance has become a higher priority for LCA and aggressive work is required to complete system-wide programs such as valve exercising and hydrant maintenance.

Technology – LCA has invested heavily in technology over the past 3 years to enhance capabilities of the organization to track maintenance activities, record critical asset data, generate mobile applications for our field staff to access data remotely, and more. While these upgrades are necessary for efficient operation in the future, implementation of updated technology requires upfront investment of resources to achieve the goals of the program.

The graph below shows the 10-year operating expense trend in the LCA Suburban Water Division, which illustrates the increasing cost exposure associated with operating and maintaining our systems.



To address these increasing costs, a water rate study was conducted in 2017 and updated in 2018 with current and projected expenses over the next five years. The 2019 Budget includes a 5 percent increase in water rates, with future increases required over the next several years to keep pace with anticipated cost increases.

Suburban Wastewater Division

LCA's Suburban Wastewater Division is unique because most of the service we provide is regional in nature, and our primary customers are the municipalities we serve. LCA provides direct sewer service to only 2,500 residential and commercial properties in smaller outlying communities.

Through the service arrangements LCA has with the municipal customers we serve, and our small direct customer base, LCA has worked hard to incorporate financing for capital improvements into the rates so that the need to borrow for these improvements is limited. As a result, the system carries a low debt load and has generated additional reserves each year in the past.

In 2019, LCA expects to draw on these reserves for key projects to address wastewater treatment plants that require intensive repairs and maintenance, and to continue the important work of repairing systems to prevent sanitary sewer overflows throughout our service area.

While the 2019 Budget process has revealed no major challenges for the Suburban Wastewater Division, it is important to note that significant investment will continue to be made in fostering the partnership among all Western Lehigh communities. These municipalities have been working together for more than a decade to develop programs to repair and replace aging sewer systems, reduce wet-weather peak flows in the system, and eliminate sanitary sewer overflows. Work planned for 2019 includes:

- Flow monitoring and modeling work to update current and future sewer flow projections
- Initial design work for a \$13 million interceptor upgrade to address overflow concerns in the Trexlertown area of our Western Lehigh service area
- Completion of the Park Pump Station refurbishment project to reinstate full pumping capacity at this critical regional facility
- And much more!

As we continue this work, we will need to also work with other communities including the City of Allentown and its sewer signatories to find ways to expand system capacity for the future needs of the region to address both peak flows and economic development.

City Division (Water & Wastewater)

In 2018, LCA celebrated the fifth anniversary of the landmark lease arrangement with the City of Allentown for its water and sewer systems. Five years ago, LCA entered into a 50-year lease agreement to operate the City's systems for a \$220 million upfront payment and an ongoing \$500,000 per year payment to the City. LCA believes that the entire region will be best served by a single organization that can manage financial, environmental and operational resources through a public, non-profit business model. We believe water and sewer services are essential for our community to thrive, and LCA is happy to meet this important need.

In the short time since 2013, LCA has learned a lot about how the City water and sewer systems operate and the large investments that are needed to maintain, repair and replace the systems so that residents can continue to receive high quality, reliable services that protect public health and the environment. These needs place considerable strain on the financial condition of the City Division, in addition to the large debt burden incurred to address the City's financial requirements in the lease. Several key factors are considered within the 2019 Budget:

Customer Rates – City ratepayers will see an overall rate increase of 5.1 percent in 2019 as a result of the rate adjustment factors included in the lease.

Debt Service – In October 2018, LCA completed the refinancing of the 2013C bonds that were due for payment this year. As a result, higher debt service levels must be covered through operational revenues.

Funding for Capital Improvements – In 2013, LCA borrowed \$32 million to provide an initial block of funding for capital improvements for the leased systems in Allentown. This funding was exhausted during the first five years of the lease. As a result, capital improvements in 2019 are reduced from prior levels and will remain lower until financial sustainability is achieved.

In 2018, LCA completed a study to develop a new financial model and to evaluate the financial viability of the City Division. Key recommendations of the financial study included:

1. **Revenue Sufficiency** – Implementation of higher monthly billing rates that are included in the Lease Agreement will generate in excess of \$4 million additional net revenue to support the financial viability of the lease.

STATUS: While the LCA Board of Directors approved the change to monthly billing in May 2018, the proposed 2019 Budget is presented without this additional revenue pending additional good-faith efforts to negotiate with the City of Allentown regarding this measure and other options that may be available to increase revenues or otherwise improve financial viability of the lease. However, monthly billing will likely be implemented in January 2019 and an amended budget may be presented at that time.

2. **Debt Management** – Current debt service schedules for the lease extend generally to the end of LCA’s current term of existence, which expires in 2049. Restructuring of the lease debt may be beneficial in the future if LCA’s term is extended, but will add cost to the overall system due to increased interest / financing expense.

STATUS: This item is on hold pending discussion with the Lehigh County Board of Commissioners about an extension to LCA’s term of existence.

3. **Capital Improvements** – Updated projections call for \$1.3 billion or more in system improvements through the end of the lease in 2063, and proper prioritization and phasing of this work will be critical to achieving both operational and financial targets.

STATUS: Ongoing. Estimated project categories and costs outlined in the study include:

Intake/Springs	\$ 39,245,000
Water Treatment Plant	\$ 113,430,000
Storage and Pumping	\$ 78,429,000
Water Distribution	\$ 289,798,000
Other	\$ 92,574,000
Total Water System Projects	\$ 613,476,000
Wastewater Treatment Plant	\$ 514,589,000
Collection System	\$ 162,573,000
Other	\$ 39,142,000
Total Wastewater System Projects	\$ 716,304,000
Grand Total	\$ 1,329,780,000

Ultimately, while LCA faces significant financial challenges in the City Division, we believe the lease continues to be a good deal for Allentown and its citizens. Vital water and sewer services are being provided by a local non-profit organization that holds the customers’ needs above all else. Every penny collected from customers will be returned to the community via system improvements and high quality, reliable services. In 2019, LCA will continue to operate the Allentown systems with the level of care and integrity that our customers deserve.

2019 BUDGET – SUMMARY OF EXPECTED RESULTS

The sections above describe the breadth of issues that were evaluated and discussed through the development of the 2019 Budget. The summary below shows that the 2019 Budget is presented with positive cash flows, meeting debt service requirements, and providing alternative funding for capital improvements that limits the borrowing required to pay for these investments. In 2019, we also see positive movement toward our target for operational cash balances, which supports overall financial sustainability of the organization.

Budget Overview	Suburban Water	Suburban Wastewater	City Division	Total
Operating, Non-Operating & Other Revenue	\$10,876,588	\$15,806,873	\$38,692,198	\$65,375,659
Operating Expenses (net of depreciation)	\$6,423,554	\$12,029,493	\$18,270,913	\$36,723,960
Net Revenues Available for Debt Service	\$4,453,034	\$3,777,380	\$20,421,285	\$28,651,699
Debt Service	\$3,191,702	\$684,476	\$14,956,576	\$18,832,754
Debt Service Coverage Ratio (indenture based)	1.40	5.52	1.37	1.52

Capital Budget Overview	Suburban Water	Suburban Wastewater	City Division	Total
Capital Expenses	\$10,210,540	\$9,619,500	\$4,845,000	\$24,675,040
Funding from 2019 Revenue & Operating Reserves	\$2,743,000	\$3,326,000	\$2,710,000	\$8,779,000
Funding from Existing Project Reserves	\$896,690	6,293,500	\$2,135,000	\$9,325,190
Funding from Prior Borrowing	\$6,570,850	-	-	\$6,570,850
Funding from New Borrowing	-	-	-	-
Year-End Project Reserve Balance	\$1,740,011	\$1,139,670	\$2,669,949	\$5,549,630

Total Cash Flow	Suburban Water	Suburban Wastewater	City Division	Total
Beginning Operations Cash Balance (2018 forecast)	\$4,854,240	\$6,072,409	\$1,281,159	\$12,207,808
2019 Surplus	\$518,332	\$2,266,904	\$4,762,423	\$7,547,659
Provided From (To) Capital	(\$2,000,000)	(\$2,500,000)	(\$500,000)	(\$5,000,000)
Ending Operations Cash Balance	\$3,372,572	\$5,839,313	\$5,543,582	\$14,755,467
Operating Days Cash on Hand	192	177	111	147
Project Reserve Balance	\$1,740,011	\$1,139,670	\$2,669,949	\$5,549,630
Other Reserves & Investments (includes restricted)	\$7,031,358	\$4,363,390	\$47,551,272	\$58,946,020
Ending Total Fund Balance - 2019 Budget	\$12,143,941	\$11,342,373	\$55,764,803	\$79,251,117

The 2019 budget as presented offers a positive outlook in terms of meeting or improving upon key financial benchmarks such as debt service coverage ratio and operating days cash on hand, and illustrates revenue sufficiency for key operational programs, debt service and allowing for current-year funding for some capital improvements. Existing project reserves are available to fully fund the 2019 capital program. However, the year(s) ahead will also bring challenges as rates continue to rise to meet escalating expenses. Capital project financing in the City Division is also severely limited by current revenue challenges, and the LCA team will continue working toward resolution to those concerns via negotiation and, if needed, other legal approaches with the City of Allentown.