Board Meeting 04/25/16

Revenue Model

LEHIGH COUNTY AUTHORITY

What are we trying to Achieve?

- Long-term
  - Financial Stability
  - Financial Sustainability
  - Stability of Rates
- What does that mean?
  - Change in net position Not <0
  - Cash Flows not <0
  - Compliance with all Indenture Requirements
  - Lower levels of debt

What are we trying to Achieve?

- It also means that we:
  - Have operations revenue fund
    - All O & M expenses
    - Capex Spending
    - Debt service – both Interest & Principal
  - Have NO borrowing for
    - O & M
    - Debt service
    - Capex spending required by regulations and planned system maintenance through our asset management program

What are we trying to Achieve?

- It also means that:
  - Borrowing is limited to:
    - New Revenue generating opportunities
    - Unplanned events

How do we get there?

- Recover full costs of the Authority
- Reduce costs
  - O & M Costs
  - Project costs
  - Costs of capital
    - Interest expense
- Start working on the reduction on debt

Where are we?

- Running negative changes in net position – expenses exceed revenues
  - Suburban Water - Budgeted change in net position is negative
  - Suburban WW – negative in last two years and negative 3 out of the last four years

Where are we?

- Running negative cash flows – cash out exceeds cash in
  - Suburban Water – budget for 2016 is negative, we were slightly positive for 2015
  - Suburban WW – budget for 2106 is negative
- High levels of debt with high interest expense

Where are we?

Suburban Water	Net Rev/Exp	Net Cash Flow
2012	130	810
2013	527	1,818
2014	1,146	1,528
2015	1,297	76
2016	(96)	(1,071)

Suburban WW	Net Rev/Exp	Net Cash Flow
2012	996	(1,548)
2013	(1,169)	3,196
2014	1,143	3,481
2015	(942)	624
2016	(327)	(953)

The Full Cost Model of Revenue

- Concepts
  - Considers the effects of all costs and expenses
  - Considers the effect of all major cash flows
    - O & M
    - Debt related
    - Project related (Capex)
    - Meets the Financial Criteria
      - Net position change not <0
      - Cash Flow not<0
      - Avoids constant use of debt

The Full Cost Model of Revenue

- Calculation

Total Operating Expenses (including Depreciation

Add: Non-Operating expenses

Less: Non-Operating fees – tapping & connection fees

Add: Interest expenses

Add: Capital Reserve

Add: Cash reserve

= TOTAL REVENUE POOL

The Full Cost Model of Revenue

	Sub Water	Sub WW
Budget Revenue	8,787	16,045
Model Revenue	9,806	16,381
Increase $	1,019	336
Increase %	11.6%	2.1%
Net Position		
Budget	(96)	(327)
Model	684	0
Cash flow		
Budget	(1,071)	(953)
Model	191	939

The Full Cost Model of Revenue

	Sub Water	Sub WW
Is Change in Net Position >0		
Budget	NO	NO
Model	YES	YES
Is Cash Flow >0		
Budget	NO	NO
Model	YES	YES
DSCR		
Budget	1.56	2.25
Model	2.06	3.44

Fundamental Issues With Model

- Works on the Suburban side of the business where we can control the revenue rates
- Not so good on the City side of the business where we are limited in rate controls. Have not really incorporated City into this model discussion

Things to Watch For

- Spikes in Principal Repayment create rate fluctuation issues – have to be normalized. This requires looking at repayments over a period of time.
- Same thing with respect to Capex spending

So What Do We Do?

- Adopt the model for the Suburban business
- Maximize other revenues for both City and Suburban
  - Tapping fees
  - Connection fees
  - CCRC
- Initiate a water rate study to work the revenue requirements down through the customer chain

So What Do We Do?

- Revamp the capital planning process
  - Shorten the time frame to 5 years
  - Focus on drivers of capital projects
  - Focus on the projects with higher probability of completion to be incorporated into rates
- As add-on to Revenue Model, adopt the policy of borrowing only for unplanned major issues and new revenue generating opportunities

So What Do We Do?

- Adopt the new statement format as the format for reviewing status of changes in net position and cash flows (have seen this for January and February)
- Resolve City Revenue issues
- Incorporate all into the 2017 Budget, especially the use of the revenue model for determining budgeted revenue pool

Concluding Thoughts

- We have a great opportunity to clearly manage our revenue to enhance our net position and cash flows
- Doing that will allow this Authority to have the funding necessary to successfully operate in a quality manner and to maintain and enhance the system to be the water and wastewater service our customers expect for a long time