



## **Mid-Cycle 2012 Operating Budget**

The EID Board of Directors adopted the current mid-cycle operating budget during the November 14, 2011, regularly scheduled Board meeting.

Estimated revenues and expenses and other relevant information pertaining to the budget are contained in the following agenda item summary that was prepared for the November 14 meeting.

EL DORADO IRRIGATION DISTRICT

**Agenda Item Summary**

**Board Meeting Date:** November 14, 2011

**Date Prepared:** October 25, 2011

**Prepared by:** John Frankhouser and Mark Price

**Agenda Title:** Action

**Subject:** Consideration of the 2012 Mid-Cycle Operating Budget

**Approvals (initial):**

**Preparer** \_\_\_\_\_

**Division Head** \_\_\_\_\_

**Department Head** \_\_\_\_\_

**Finance Manager** \_\_\_\_\_

**General Manager** \_\_\_\_\_

**EL DORADO IRRIGATION DISTRICT**

**Subject:** Consideration of update to the 2012 Mid-Cycle Operating Budget

**Previous Board Action:**

March 20, 2000:	The Board adopted a multi-year operating budget process.
December 13, 2010:	The Board adopted the 2011-2012 operating budget.
October 24, 2011:	The Board held a 2012 mid-cycle operating budget workshop.

**Board Policies and Administrative Regulations:**

**BP 3010:** It is the responsibility of the General Manager to inform the Board about financial operations of the District so the Board can make informed decisions and fully discharge its legal responsibilities in a fiscally sound manner. The Board shall adopt a two-year operating budget and may modify it prior to the end of the year.

**AR 3011:** It is the responsibility of the General Manager to develop the budget based on the priorities and needs of the District and its customers. The budget and any budget modification shall:

1. include, but not be limited to, operating expenses, debt, construction, and reserve funds;
2. meet all legal requirements;
3. support the District's mission;
4. maintain prudent levels of reserves in water, wastewater, hydroelectric, and recreation to fund contingencies that meet the District's debt service requirements;
5. allow the District to meet its financial obligations, including bond covenants;
6. be consistent with a financial plan that guides the District in satisfying its multi-year commitments; and
7. encourage public participation through required disclosures and public hearings.

Responsibility for overseeing the budget development process is assigned to the Director of Finance. Once the annual budget is prepared, the Board shall act on it.

**Summary of Issues:**

In accordance with Board policy, the Board adopts a two-year budget and conducts a mid-cycle review to determine any changes that may be needed in the second year of the cycle. This cycle continues to reflect the slowdown in the economy. Projected 2011 yearend expenditures are expected to be slightly lower than the adopted budget. Staff was given the direction, in developing the 2012 mid-cycle revision, to keep the 2012 operating expense budget flat to the 2011 adopted budget and similarly match projected 2011 year end expenditures. The resulting revision ends up reducing the previously adopted second year of the 2011-2012 biennial budget by approximately \$1.1 million.

In early 2010 the Board adopted a series of rate increases for the water, wastewater, and recycled water utilities for 2010 through 2014. Additionally the Board directed staff to conduct a cost of service study for the utilities. The Board has received updates on this study throughout 2011. The final results of that study, presented to the Board at its meeting on October 11, 2011, were discussed at two public workshops on October 24<sup>th</sup> and October 26<sup>th</sup>. The results of that study are incorporated into the 2012 revenue projections in this proposed budget.

Challenges staff had in developing the 2012 operating budget revision, while keeping it flat, were many. Wage and benefit concessions bargained for with the Employees' Association for 2010 and 2011 will now expire, increasing these costs. In 2012 a 1% cost of living increase goes into effect and the District will resume paying part of the employees' Public Employees' Retirement System (PERS) contribution. Finally, a moratorium on merit-based wage increases for individual employees will expire on November 1, 2012.

Another significant employee related expense staff needed to absorb in the 2012 proposed budget is a 3.5% increase to the employer's PERS contribution. This additional percentage increase is related to market losses incurred by PERS over the past few years which employers are required to make up.

Constraints on operating revenues related to the continued economic difficulties of California and specifically El Dorado County are also ongoing. The District's expected property tax revenues are now estimated to be about \$1.1 million less for the 2012 budget year versus the amount originally projected eighteen months ago. Despite hydroelectric revenues for 2011 projected to be about \$11.5 million (\$3.5 million more than originally budgeted) this source of revenue will be budgeted at \$8.0 million in 2012 which reflects a revenue estimate for a "normal" water year.

The District does continue to have benefit from the weak financial market. In 2011, the rate on the District's variable rate debt obligations (VRDO), which reset weekly, has ranged between 0.04% and 0.32%. For 2012, the budgeted rate for this debt has been estimated, on an annual basis, to be at 2.5%.

At the October 24, 2011 budget workshop, staff presented a revised 2012 operating budget of \$42.970 million, slightly higher than the 2011 adopted budget by \$0.190 million or 0.4% and lower than the 2012 adopted budget by about \$1.054 million or 2.40%.

### **Staff Analysis/Evaluation:**

In anticipation of each two-year budget cycle and mid-cycle review, staff prepares projected operating revenues and expenses for Board consideration. At the beginning of the budget review, Finance staff provides department heads and division managers with actual operating costs for the past two years through the most recent month of the current year, along with projections to the current year's end. Based on past and current expenditures, operational commitments for the coming year, workload indicators and budget goals, staff develops proposed budgets for the upcoming year.

### **Analysis of revenue projections for fiscal years 2012**

The revised revenue projections for 2012 are slightly higher than those originally adopted in December 2010 for the 2011-2012 biennial budget. The increase in water sales and services projected within the Cost of Service Study are offset by the reduced property tax collections.

**Table 1: Revenue Projections for 2011 and 2012 (in millions of dollars)**

	<b>2011 Adopted Budget (12/13/2010)</b>	<b>2011 Revised Projections</b>	<b>2012 Adopted Budget (12/13/2010)</b>	<b>2012 Revised Proposed Budget</b>
Water sales and services <sup>(1)</sup>	\$ 21.800	\$ 20.060	\$ 22.577	23.932
Wastewater sales and Services <sup>(2)</sup>	19.661	19.600	20.362	20.362
Recycled water sales	0.756	0.900	0.781	0.781
Hydropower sales	8.000	11.500	8.000	8.000
Wholesale contract- Placerville	0.423	0.425	0.432	0.432
Investment income	0.902	0.750	0.850	0.850
FCCs	2.000	1.400	3.000	3.000
Debt surcharges	1.979	2.180	1.979	1.979
Property tax	10.400	9.500	10.452	9.300
Other income	2.005	2.285	2.007	2.006
Recreation	1.050	1.050	1.039	1.039
FEMA reimbursement	0.170	0.170	0.250	0.250
<b>Total revenues</b>	<b>\$ 69.146</b>	<b>\$ 69.820</b>	<b>\$ 71.729</b>	<b>\$ 71.931</b>

<sup>(1)</sup> 2012 projections include the 5% rate increases previously adopted and a Cost of Service Study additional 6% increase.

<sup>(2)</sup> 2012 projections include the 5% previously adopted rate increase.

### **Analysis of 2012 proposed operating budget:**

Table 2 identifies budget expense by department. The previous 2012 adopted budget was established using an inflation factor of 3% on top of the 2011 adopted budget. As illustrated in Table 2, the 2012 revised proposed budget for operating expenses is \$1.054 million less than the previous 2012 adopted budget and almost identical to that of the 2011 adopted budget .

Table 3 identifies budget expense by type. The 2012 revised proposed budget projects higher wage and benefit costs when compared to the revised projections for 2011. These, as previously mentioned, are due to wage and benefit concessions bargained for with the Employees' Association for 2010 and 2011 that expire at the end of 2011 thereby increasing these costs. In 2012 a 1% cost of living increase goes into effect and the District will resume paying half of the employees' Public Employees' Retirement System (PERS) contribution. Additionally the moratorium on merit-based wage increases for individual employees expires on November 1, 2012.

Material and supplies expense is almost identical to the projection for the 2011 year end expenses although 2012 includes an increase in the contingency expense of \$0.300 million. Finally, there is an increase in the 2012 revised proposed budget for capitalized labor (which is charged to capital assets under construction at the District) of approximately \$1.100 million over the projected 2011 year end results. This amount, though, is only \$0.300 million higher than the original 2012 adopted budget.

**Table 2: 2011 Adopted Budget, 2011 Year End Projections, 2012 Adopted Budget and 2012 Revised Proposed Budget by Department (in millions of dollars)**

<b>Departments</b>	<b>2011 Adopted Budget (12/13/2010)</b>	<b>2011 Revised Projections</b>	<b>2012 Adopted Budget (12/13/2010)</b>	<b>2012 Revised Proposed Budget</b>
Office of the General Manager	\$ 2.328	\$ 2.026	\$ 2.398	\$ 2.586
Communications /Community Relations	0.569	0.529	0.586	0.539
Finance	7.428	7.023	7.651	7.469
Human Resources	2.272	2.117	2.340	2.199
Information Technology	2.307	2.364	2.376	2.445
Engineering				
-Engineering Administration Division	0.242	0.180	0.249	0.197
-Records Management Division	0.508	0.524	0.523	0.518
-Water/Hydro Engineering Division	0.086	0.166	0.089	0.108
-Wastewater/Recycled Engineering Division	0.240	0.172	0.247	0.184
-Drafting Services Division	0.312	0.363	0.321	0.340
-Construction Inspection Division	0.032	0.154	0.033	0.024
-Environmental Compliance/Water Policy Division	1.182	1.002	1.217	1.149
Operations				
-Administration	0.370	0.334	0.381	0.368
-Water Operations	9.927	9.511	10.226	9.308
-Wastewater Operations	8.893	9.342	9.160	8.854
-Recycled Water Operations	0.448	0.533	0.462	0.574
-Hydroelectric Operations	3.235	3.685	3.332	3.575
-Recreation Operations	1.073	1.109	1.105	1.205
<b>Subtotal</b>	<b>41.452</b>	<b>41.134</b>	<b>42.696</b>	<b>41.642</b>
Letter of credit fee	1.328	1.328	1.328	1.328
<b>Total</b>	<b>\$ 42.780</b>	<b>\$ 42.462</b>	<b>\$ 44.024</b>	<b>\$ 42.970</b>

**Table 3: 2011 Adopted Budget, 2011 Year End Projections, 2012 Adopted Budget and Proposed 2012 Revised Operating Budget by Expense Type (in millions of dollars)**

Type	2011 Adopted Budget (12/13/2010)	2011 Revised Projections	2012 Adopted Budget (12/13/2010)	2012 Revised Proposed Budget
Salaries	\$ 17.296	\$ 16.923	\$ 17.815	\$ 17.528
Benefits	9.912	9.729	10.209	10.814
Materials and Services				
-Operating Supplies	3.645	3.865	3.755	3.633
-Chemicals	1.382	1.025	1.424	1.096
-Administration	3.074	2.857	3.166	2.988
-Utilities	3.816	3.893	3.931	3.726
-Professional Services	3.030	2.871	3.121	2.915
-Repair Services	0.918	0.871	0.945	0.724
-Insurance	0.844	0.759	0.869	0.786
-Operating Capital Outlay	0.208	0.173	0.214	0.115
-Contingency	0.200	0.200	0.206	0.500
Grants	(0.171)	(0.035)	(0.176)	(0.100)
CIP and Development Reimbursement Labor Offsets	(2.702)	(1.997)	(2.783)	(3.083)
<b>Subtotal</b>	<b>41.452</b>	<b>41.134</b>	<b>42.696</b>	<b>41.642</b>
Letter of credit fee	1.328	1.328	1.328	1.328
<b>Total</b>	<b>\$ 42.780</b>	<b>\$ 42.462</b>	<b>\$ 44.024</b>	<b>\$ 42.970</b>

**Debt service coverage:**

The Installment Purchase Agreements associated with the District’s debt issuances require the District—to the fullest extent permitted by law—to fix, prescribe, and collect rates and charges so that revenues exceed operating expenditures, including debt payments, by 1.25x. The District may make adjustments from time to time in its rates and charges, but cannot reduce those rates and charges unless the District’s net revenues from reduced rates and charges will at all times be sufficient to meet the debt service coverage of 1.25x.

Table 4 shows that the projected debt service coverage for 2011 and also the revised projected budget for 2012 will meet requirements. For 2012 the debt service reflected in the 2012 Revised Proposed Budget is reduced by \$2.000 million reflecting the prepayment the District will make in late 2011 to an irrevocable trust as authorized by the Board at its October 24th meeting. A similar payment to another irrevocable trust is expected to be made in late 2012 for its 2013 debt owing as reflected in Table 6 showing the 2012-2016 Five-Year Forecast.

**Table 4: Debt service coverage for 2011 and 2012 (in millions of dollars)**

	<b>2011 Adopted Budget (12/13/2010)</b>	<b>2011 Revised Projections</b>	<b>2012 Adopted Budget (12/13/2010)</b>	<b>2012 Revised Proposed Budget</b>
Estimated revenues	\$ 69.146	\$ 69.820	\$ 71.729	\$ 71.931
Estimated operating expenses	(42.780)	(42.462)	(44.024)	(42.970)
Net revenues	26.366	27.358	27.705	28.961
State loans (preexisting)	1.079	1.079	1.079	1.079
Available net revenues	\$ 25.287	\$ 26.279	\$ 26.626	\$ 27.882
Debt service (1)	20.305	19.660	21.023	18.993
Debt service ratio	1.25	1.34	1.27	1.47
Internal (1.0) debt service ratio	1.15	1.27	1.13	1.31

(1) Debt service for 2012 reflects a 2.5% rate of interest on the VRDO debt and a \$2.00 million payment from an irrevocable trust for the 2004A debt.

Beginning with the first Certificate of Participation bond sale in 2003, the District has included FCC revenue in meeting its debt coverage requirements. As reflected in Table 5, the District exceeded the 1.25x coverage requirement for every year except for FY 2004, when the State of California took local property tax revenues to help meet the State’s debt, and FY 2009. However, if the District had not received any FCCs during those years, the coverage test would not have been met—except for FY 2006, when the District received approximately \$8.0 million in reimbursements from the Federal Emergency Management Agency and in 2010 with extensive cost cutting to operating expense and the new power generation contract with PG&E. For 2011, the District again is projected to exceed the 1.25x test without FCC revenue.

One of the initiatives the Board implemented in February 2010 was a new, internal debt service 1.0x test. This test is identical to the bond test of 1.25x except it excludes FCCs from the calculation. Following the Cost of Service Study staff is now recommending two different coverage amounts to ensure revenues are in place to meet the required bond covenants and to produce additional resources to be used for pay for smaller needed District construction projects. The recommendation is a coverage of 1.5x with FCC revenue and a 1.25x coverage without including FCC revenue. By creating budgets that meet these tests, the District increases its ability to meet all of its obligations for a given year, including operating expenses and debt payments, and producing resources to reduce the reliance on bond financing for all construction projects.



**Table 5: Debt service coverage FY2003-2010 (in millions of dollars)**

Fiscal Year	Net Revenues	Debt service	Coverage	FCCs	Coverage if FCCs excluded
2003	\$13.044	\$7.414	1.76	\$12.775	0.04
2004	10.312	11.435	0.90	9.835	0.04
2005	18.578	11.624	1.60	15.884	0.23
2006	36.284	15.561	2.33	11.470	1.59
2007	27.349	15.276	1.79	15.237	0.79
2008	25.919	17.792	1.46	11.453	0.81
2009	12.125	14.755	.082	1.099	0.75
2010	22.224	16.133	1.38	.577	1.34

**Five-Year Forecast**

Beginning with the 2011 budget process staff now presents its five-year financial forecast with the budget. This forecast is regularly prepared and updated and is included as part of the budget process. The forecast, used mainly for management purposes and for inclusion into bond documents that are prepared from time to time, is updated throughout the year as financial results are reported. Table 6 reflects staff's current five-year forecast for the District.

**Table 6: 2012-2016 Five-Year Forecast (in millions of dollars)**

	<u>Projected 2012</u>	<u>Projected 2013</u>	<u>Projected 2014</u>	<u>Projected 2015</u>	<u>Projected 2016</u>
Cash balance - January 1	\$ 91.3	\$ 74.7	\$ 129.9	\$ 124.8	\$ 120.4
Total Debt Proceeds <sup>1</sup>	-	60.0	-	-	-
Total revenues	71.9	75.7	79.7	84.2	86.9
Total maintenance and operation costs	43.0	43.8	44.7	45.5	46.4
Net revenues	28.9	31.9	35.0	38.7	40.5
Pre-existing state obligations	1.1	1.1	1.1	1.1	1.1
Net revenues available after preexisting obligations	27.8	30.8	33.9	37.6	39.4
Senior debt service <sup>4</sup>	19.0	22.1	25.2	28.7	28.7
total CIP <sup>2</sup>	17.4	13.5	13.8	13.3	11.2
OPEB - one time partial funding <sup>3</sup>	6.0	-	-	-	-
Future year debt payment <sup>4</sup>	2.0	-	-	-	-
Cash balance - December 31	\$ 74.7	\$ 129.9	\$ 124.8	\$ 120.4	\$ 119.9
Senior debt service coverage	1.46	1.39	1.35	1.31	1.37
Alternative senior debt coverage					
Total FCCs in revenue above \$\$\$ of FCCs removed from calculation	3.0	3.0	3.0	5.0	5.0
Potential senior debt coverage	1.31	1.26	1.23	1.14	1.20

<sup>1</sup> Potential \$60 million bond sale (78.61% water / 21.39% wastewater)

<sup>2</sup> Represents 80% of the adopted 2012-2016 CIP plan expenditures

<sup>3</sup> Projected partial funding of OPEB liability

<sup>4</sup> Potential prepayment on 2004A COP's in 2012 and 2013 of \$2 million in each year

## **Conclusion**

The 2012 operating budget process presents a number of challenging financial issues because of ongoing economic conditions. Like all of EID's two-year budgets, staff approached this mid-cycle process first and foremost with the priority of maintaining a reliable level of service to customers that protects public health and safety, and the environment. Staff believes this objective will be achieved under the revised proposed 2012 operating budget. Staff also believes that if projected revenues are met and staff can meet the budget expectations, then there will be enough net revenue in 2012 to meet and exceed the 1.25x coverage requirements in the District's bond covenants and enough revenue, excluding FCCs, to exceed the existing internal 1.0x coverage test.

### **Board Decision/Options:**

Option 1: Adopt the El Dorado Irrigation District 2012 mid-cycle operating budget of \$42.970 million.

Option 2: Take other action as directed by the Board.

Option 3: Take no action.

### **Staff/General Manager Recommendation**

Option 1

### **Supporting Documents Attached:**

Appendix 1: Cash Flow Projection for 2012

Appendix 2: Total District Summary of Materials and Services by Account

Appendix 3: Office of the General Manager Materials and Services by Account

Appendix 4: Human Resources Materials and Services by Account

Appendix 5: Communications/Community Relations Materials and Services by Account

Appendix 6: Finance Materials and Services by Account

Appendix 7: Information Technology Materials and Services by Account

Appendix 8: Engineering Materials and Services by Account

Appendix 9: Water Operations Materials and Services by Account

Appendix 10: Wastewater Operations Materials and Services by Account

Appendix 11: Recycled Water Operations Materials and Services by Account

Appendix 12: Hydroelectric Operations Materials and Services by Account

Appendix 13: Recreation Materials and Services by Account

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**Appendix 1: Cash Flow Projections for 2012 (in millions of dollars)**

	<b>2010</b>	<b>Projected 2011</b>	<b>Projected 3/31/2012</b>	<b>Projected 6/30/2012</b>	<b>Projected 9/30/2012</b>	<b>Projected 12/31/2012</b>	<b>Total Projected 2012</b>
Beginning cash balance	\$122.5	\$102.49	\$91.27	\$78.00	\$76.36	\$72.56	\$91.27
Total revenues	74.24	69.82	15.61	20.41	15.61	20.30	71.93
Operating expenses	43.68	42.46	10.74	10.74	10.74	10.75	42.97
Debt payments	19.78	20.74	13.80	.97	4.33	.97	20.07
CIP expenditures	30.79	15.84	4.34	4.34	4.34	4.38	17.40
OPEB – one time partial funding				6.00			6.00
Future year debt payment		2.00				2.00	2.00
Ending cash balance	\$102.49	\$91.27	\$78.00	\$76.36	\$72.56	\$74.76	\$74.76
Debt service coverage ratio	1.58	1.34					1.46