Homer City Hall
491 E. Pioneer Avenue
Homer, Alaska 99603
www.cityofhomer-ak.gov

City of Homer
Agenda

City Council Worksession
Tuesday, May 18, 2021 at 5:00 PM
City Hall Cowles Council Chambers via Zoom Webinar
Dial: (669) 900 6833 or (253) 215 8782 or Toll Free (888) 788 0099 or (877) 853 5247
Webinar ID: 965 8631 4135 Password: 792566

CALL TO ORDER, 5:00 P.M.

AGENDA APPROVAL (Only those matters on the noticed agenda may be considered, pursuant to City Council's Operating Manual, pg. 6)

DISCUSSION TOPIC(S)

a. Memorandum 21-078 from Public Works Director re: Water/Sewer Financial Polices

- Memo from Shawn Koorn, *Discussion of the Development of the City's Financial/Rate Setting Policies* [for water & sewer utilities]
- Pages from 2019 Audit (provided by Mayor)

COMMENTS OF THE AUDIENCE (3 minutes)

ADJOURNMENT

Next Regular Meeting is Monday, May 24, 2021, at 6:00 p.m. Committee of the Whole at 5:00 p.m. All meetings are scheduled to be held in the City Hall Cowles Council Chambers located at 491 E. Pioneer Avenue, Homer, Alaska.

City of Homer
www.cityofhomer-ak.gov

Public Works
3575 Heath Street
Homer, AK 99603
publicworks@cityofhomer-ak.gov
(p) 907- 235-3170
(f) 907-235-3145

Memorandum 21-078

TO: Mayor and Homer City Council

THROUGH: Rob Dumouchel, City Manager

FROM: Janette Keiser, PE, Director of Public Works

DATE: May 14, 2021

SUBJECT: Work Session – Water/Sewer Financial Policies

The City commissioned HDR Engineers to help diagnose issues related to financial policies and practices related to the City's water and sewer utilities. The purpose of the May 18 work session is to engage Council in a discussion about financial policies for the water and sewer utilities, whose deliberation and input will guide further work.

The work session will be structured as follows:

A. Presentation by Shawn Koorn, an economist and financial analyst with expertise in addressing the complex world of utility finance. Themes of his presentation are presented in his attached memorandum.

B. Q & A between Council and Mr. Koorn

C. Identify specific issues, which need further investigation. (Staff will not be asking for specific authorizations at this time, but will return to Council with recommendations for follow-up legislation later.)

Attachment:

a. Memo from Shawn Koorn, *Discussion of the Development of the City's Financial/Rate Setting Policies* [for water & sewer utilities]

City of Homer Water and Sewer
Discussion of the Development of the City's Financial/Rate Setting Policies

Introduction

Financial policies are an important tool for maintaining a financially healthy utility while also maintaining required and/or mandated measures. The Government Finance Officers Association (GFOA), bond rating agencies, and other industry organizations (e.g. the American Water Works Association (AWWA), the Water Environment Federation (WEF), etc.) recommend written financial/rate setting policies to provide clear policy direction and guidance.

The establishment of written financial policies is intended to:

- Institutionalize sound financial practices
- Clarify strategic intent
- Define boundaries
- Support bond ratings
- Promote long range strategic thinking
- Manage risk
- Adhere to established best practices

To be effective, the policies must be written and, if possible, adopted by the governing body; policies should furthermore be well understood by management to enable consistent and accurate application throughout the financial planning and rate setting process.

Standard & Poor's (S&P), Fitch and Moody's Rating Agencies each have unique methodologies for determining a utility's bond rating. These rating methodologies contain quantitative measures which are largely financial, as well as qualitative measures that assess a spectrum of qualities such as management and governance. A qualitative measure common to each of the rating agency's review methodologies is the presence and strength of financial policies. Generally, a strong set of written financial policies demonstrates to the rating agencies a well-managed utility which uses policies to help guide the utility in a business-like and apolitical manner.

In addition to supporting the need for written financial policies, the bond rating agencies also provide survey information (medians) on the specific financial metrics for various rated utilities (i.e. "AAA", "AA" etc.). S&P does not explicitly state their target measure for different rating levels, but rather refers to what they consider strong or good, which may be interpreted as leaning more towards being "AAA" or "AA" rating, respectively.

At the current time, the City has various documents and information that outline some of the basic financial policies and approaches to setting water and sewer rates. However, there does not appear to be a single, stand alone, document that summarizes the City's water and sewer rate setting policies and approaches.

Financial Policy Goals and Objectives

The goals of the City's financial policies are to:

1. Maintain sufficient revenues for operating and capital needs,
2. Maintain sufficient reserves, and,
3. Provide rate stability. Notwithstanding (1) and (2) above, rates will be set to provide rate/revenue stability and avoid major periodic increases.

A detailed set of financial policies have been drafted to provide guidance and consistency in utility financial planning and rate setting decision-making for the City Council and management team.

Objective of this Discussion Paper

The purpose of this paper is to outline the City's various policies and approaches into a more comprehensive financial framework and to establish clear financial targets based on a review of industry data and City documents. For example, in establishing a policy on minimum reserve levels, this framework provides recommendations that take into consideration the typical or median reserve levels for a "AAA" versus a "AA" rated utility. By providing this level of understanding, the City Council can make more informed decisions in establishing the financial targets contained within the financial policies.

Review and Discussion of the City's Financial/Rate Setting Policies

The following discussion provides the specific policy being proposed and then provides a brief discussion of the need for the policy, and if appropriate, the financial metrics used by the rating agencies.

1. Reserve Funds

Reserve funds shall be established for the City to properly account for the City's funds, but to also provide adequate reserve levels to address the different types of funding requirements of the City. The City's reserve policies shall be as follows:

1.1 Operating Reserve – The City's operating reserve is an unrestricted reserve. The minimum operating reserve shall be established at 90 Days of annual O&M expenses (approximately 25% of O&M for both Water and Sewer Funds).

Discussion: An operating reserve is the most basic of reserves; it holds the funds used to meet the utility's day-to-day expenses. Generally, an operating reserve is an unrestricted fund and the target minimum balance is set at a level to assure liquidity is sufficient to pay liabilities as they are due for payment. A common measure for a target balance is a function of the number of days of O&M expenses, excluding depreciation, which is reflective of the lead/lag of revenues and expenses. In the case of the City, 90 days of O&M as a minimum operating reserve level would be approximately equal to $600,000 for water and $480,000 for sewer.

At the present time, the City does not appear to have a current target for Water and Sewer operating reserve funds. The balance of the Water Reserve Fund is reported at $2.84 M and the Sewer Reserve Fund at $ 2.07 M as of 3/31/20. These reserve funds appear to serve functions beyond that of a typical operating reserve to support capital projects and act as a Bond Reserve and Rate Stabilization Reserve described in Sections 1.3 and 1.4.

1.2 Capital Reserve – The City currently has two different capital reserves for the water and sewer utilities. The first is the Homer Accelerated Water and Sewer Program (HAWSP). HAWSP is funded through a portion of the voter approved sales tax and assessments levied on benefited properties. The second is the Capital Asset Repair and Maintenance Allowance (CARMA). CARMA is funded annually through a rate surcharge equal to 15% of water and sewer costs and collected through the water and sewer rates. In general, HAWSP is intended to provide seed money to support expanded access to the City water and sewer system while CARMA is intended to support improvements, repairs, and replacements of the City's existing infrastructure, and may also be used for Capital Contingencies or Infrastructure Replacement. CARMA and HAWSP funds may be used jointly to fund a project where applicable.

1.2.1 Homer Accelerated Water and Sewer Program (HAWSP) – Voters in the City of

Homer established the HAWSP fund to improve the Health and Welfare of the community by funding capital improvements to the City's water and sewer system. The HAWSP is funded by a voter approved dedicated sales tax, and assessments levied on benefited properties. (See HCC 9.16.010(b).) Specifically, the HAWSP Fund is built from a levy of ¾ of a percent on the retail sales tax. This tax was established by voters and can only be modified through another ballot measure. The key objectives of the HAWSP fund are as follows:

- Provide for water/sewer improvements without placing a heavy financial burden on individual property owners. (Resolution 99-53.)
- Increase the number of users to the system(s), thereby increasing revenues to the Water and Sewer Enterprise Funds. (Resolution 99-53.)
- Promote construction of additional improvements to the City water and sewer systems. (See Ordinance 99-14(S)(A).)
- Protect public health. (2016 HAWSP Policy Manual.)

The HAWSP is generally intended to provide "Seed Money" for major projects (projects that exceed $1.1 million) but is not intended to be the primary source of funding. The target HAWSP fund value is to be maintained at $2 million as specified in the draft HAWSP policy manual. The HAWSP fund may additionally be used to pay off HAWSP-project debt, subject to City Council approval, and may furthermore be used in conjunction with CARMA for project funding, especially where an element of the project involves extension of service, expansion of capacity, or promotion of public health.

Discussion: The HAWSP fund has a relatively narrow focus and should be thought of as a supplemental reserve to accelerate capital projects as defined above. While the HAWSP fund does not appear to provide a rate-adjustment mechanism for the City Council to balance future capital needs. Adjustments can be accomplished by augmenting HAWSP funding with funding from CARMA and the general reserve, both of which offer the City adjustment mechanisms to meet the overall planned capital needs.

1.2.2 Capital Asset Repair and Maintenance Allowance (CARMA) – The CARMA reserve was established to fund improvements, repairs, and replacements to the City's existing water and sewer systems. CARMA is currently is funded annually through a rate surcharge equal to 15% of water and sewer costs and collected through the water and sewer rates. The level of CARMA funding can be adjusted by the City Council. "The amount of the CARMA funds shall be established by City Council in the biennial budget based on the projected maintenance and repair needs of the City." (Ordinance 19-35(S)(A)).

The intent of the City of Homer Water and Sewer CARMA Fund is "for appropriation and expenditure for equipment replacement, fleet replacement, engineering or planning services, major maintenance of city facilities, or any other purpose as identified and recommended by the City Manager and authorized by the City Council…and to extend the life and use of taxpayer funded assets, facilities and infrastructure." (See Ordinance 19-35(S)(A)). The City Council established similar CARMA accounts across multiple City programs and departments within the General Fund. The Water and Sewer Utilities - which operate independently - use CARMA Funds for improvements, repairs, and replacements to the City's existing water and sewer systems. CARMA Funds may

additionally be used for capital contingencies or infrastructure replacement and can be used in conjunction with HAWSP to jointly fund a project.

Discussion: CARMA provides a mechanism through which funding levels can be adjusted to meet anticipated capital repair and replacement needs. Funding adjustments should be determined in consideration of capital needs and in conjunction with the rate setting process. Capital needs should be determined annually through an appropriate planning process (such as an asset management plan and CIP) to enable accurate forecasting. As discussed in Policy #2, a prudent practice is the develop an annual level of capital replacement funding through current rate levels. CARMA essentially provides that annual funding for ongoing renewal and replacement needs. An important concept is that if annual funds are not used in the current year, these funds are placed in reserves and can be utilized in future years where renewal and replacement needs are greater than annual CARMA funding levels. In this way, the City is continually replacing and improving the water and sewer systems on an annual basis.

1.3 Bond Reserve – A bond reserve fund is a restricted reserve. A bond reserve fund shall be established, as required and in accordance with bond covenants. The minimum fund balance of the bond reserve shall be equal to bond reserve requirements set by bond covenants.

Discussion: Bond reserves are restricted funds that are generally required by bond covenants. The reserve balance, when required is set in the bond documents and is often equal to one year of debt service. For this particular reserve, the specific minimum balance is specified by each specific issuance.

1.4 Rate Stabilization Reserve – A rate stabilization reserve shall be established and maintained at a level equal to approximately 10% of the annual rate revenue derived from the water and sewer utility. These funds are unrestricted but their use shall be limited to mitigating large or unanticipated rate impacts, or emergency/catastrophe situations.

Discussion: A rate stabilization reserve can used to help mitigate the need for large rate adjustments, but it can also function as a form of an emergency reserve. In that sense, this reserve can serve in a duel roll. While these are a form of unrestricted reserves, their use should be limited and clear direction developed for when and how these funds should be used. Generally, rate stabilization funds are to be used to mitigate short term rate impact such as economic or drought-driven revenue shortfalls. Using the assumed 10% of rate revenues as the level of the rate stabilization reserve, the water utility would be $240,000 and the sewer would be $195,000.

When a reserve fund falls below the designated policy minimum, the City's management team shall inform the City Council. The Council will take appropriate action to address any shortfalls. A reserve fund which falls below the minimum reserve level, on its own, shall not trigger the need for a rate adjustment.

Discussion of the Overall Reserve Policy – In considering the financial targets for this policy it is important to understand that the rating agencies do not look at specific funds within the utility, rather, they look at the purpose and whether the funds are unrestricted or restricted. One exception to this is the Rate Stabilization Reserve, where a proper and well-defined usage of the

fund can be a benefit for the utility's rating since this is a level of funding over and above basic funding levels. Table 1 shows each rating agency's desired level of cash reserves for an AAA/Aaa or AA/Aa rated utility.

Table 1
Days of Cash on Hand

Rating Agency	AAA/Aaa	AA/Aa
Standard & Poor's Ratings Services[1]	Greater than 150 days	90 to 150 days
Fitch Ratings (of Working Capital)[2]	Greater than 365 days	180 to 365 days
Moody's Investors Service[3]	Greater than 250 days	150 to 250 days

Each of the rating agencies may define "days cash" or "cash on hand" in slightly different ways, but each is intended to demonstrate that the utility has a strong cash position. That is, sufficient reserves to meet all short-term liabilities while also capable of handling the variability of seasonal cash flows. Finally, the reserve levels still have cash flow sufficiency to handle unexpected events. More specifically, the definitions for these financial metrics are as follows:

Standard and Poor's Ratings Service

Days Cash, *all unrestricted cash and equivalents plus any reserves that are designated but ultimately available for any lawful purpose including long-term investments divided by 1/365th of operating expenditures.*

Fitch Ratings

Measure was described as "Days cash and days of working capital"

- ***Days Cash on Hand.*** *Current unrestricted cash and investments plus any restricted cash and investments (if available for general system purposes), divided by operating expenditures minus depreciation, and divided by 365.*
- ***Days of Working Capital.*** *Current unrestricted assets plus any restricted cash and investments (if available for general system purposes), minus current liabilities payable from unrestricted assets, divided by operating expenditures minus depreciation, divided by 365.*

Moody's Investors Service

[1] Standard & Poor's Ratings Services McGraw Hill Financial, "*U.S. Public Finance Waterworks, Sanitary Sewer, and Drainage Utility System: Rating Methodology and Assumptions*", P. 26, Table 18, January 19, 2016

[2] Fitch Ratings, "*U.S. Water and Sewer Revenue Bond Rating Criteria*", P. 6, Attributes: Financial Profile (Table), September 3, 2015

[3] Moody's Investors Service, "*Rating Methodology: US municipal Utility Revenue Debt*", Page 12, Exhibit 7, December 15, 2014

***Days Cash on Hand**, cash and cash equivalent that is both unrestricted and liquid, excluding cash held in a debt service reserve fund unspent bond proceeds or cash restricted for capital times 365 divided by operations and maintenance expense expressed in days.*

Provided below in Table 2 is a simple summary of each rating agency's desired level of cash reserves.

Table 2
Determination of the City's Days of Cash on Hand
Using the Proposed Financial Policies

Rating Agency	Fund Balances Included in Calculation	City's Current Days of Cash on Hand	AA/Aa Target
S&P Ratings Services	Operating Reserve Capital Reserve Rate Stabilization Reserve	XX days	90 to 150 days
Fitch Ratings (Days of Cash)	Same as S&P + Bond Reserve	XX days	180 to 365 days
Moody's Investors Service	Operating Reserve + Rate Stabilization Reserve	XX days	150 to 250 days

The City currently has approximately $XX in unrestricted reserves. This is composed of approximately $XX in operating reserves, $XX in HAWSP reserves, and $XX in rate CARMA reserves. This equates to approximately XX days of cash on hand.

2. Debt Issuance and Debt Management

The City, during the course of normal operations, may issue long-term debt to fund certain capital projects. The establishment of policies related to debt issuance and debt management are intended to minimize the overall long-term costs of the City and utilize long-term debt to the benefit of the City's customers. Provided below are the debt issuance and debt management policies.

2.1 Funding of Annual Renewal and Replacement Capital Projects – The City will provide adequate annual rate funding to properly and adequately fund the City's annual renewal and replacement capital projects. Given adequate funding from rates, as a matter of policy, the City will not issue long-term debt to fund annual renewal and replacement capital projects. The minimum annual funding from rates shall be at least equal to or greater than the City's annual depreciation expense. The annual funding of CARMA is an example of annual renewal and replacement funding approach than can be used annually for infrastructure betterments and replacement.

Discussion: Adequate annual rate funding for renewal and replacement capital projects has two key benefits to the City. First, it helps to maintain the City's facilities and avoid deferrals of capital projects. The other major benefit is that appropriate capital funding from rates provides a stronger debt service coverage ratio which provides a positive signal to the bond rating agencies. The use of annual depreciation expense as a target

for minimum annual funding reflects the current infrastructure in the City's system, but it does not reflect the full replacement cost of those assets. Hence, the "equal to or greater than" portion of this policy is intended to reflect the issue of replacement cost funding.

Rating Agencies view capital funding through rates (i.e. renewal and replacement funding from rates) as important for the overall health of the system. Fitch views declining annual depreciation as an indication that the Utility is not keeping up with renewal and replacement. Moody's considers fully funding depreciation an indication that the Utility is adequately conducting renewal and replacement of aging infrastructure. Table 3 provides Fitch and Moody's specific measures for adequate funding for capital.

Table 3
Level of Rate Funding for Renewal and Replacement Capital Funding

Rating Agency	AAA/Aaa	AA/Aa
S&P Ratings Services	None	None
Fitch Ratings[4]	Free cash relative to depreciation equal to 100% or greater	Free cash relative to deprecation equal to approximately 85%
Moody's Investors Service[5]	Net Fixed Assets/Annual Depreciation Greater than 75 Years	Net Fixed Assets/Annual Depreciation 25 to 75 Years

As can be seen, Fitch and Moody's each use annual depreciation expense to assess the adequacy of annual funding.

2.2 Long-Term Debt as a Funding Mechanism – The City can consider the use of long-term debt to fund significant non-reoccurring capital projects. The policy objective when issuing long-term debt is to minimize the financial and rate impacts of significant non-reoccurring capital projects.

Discussion: The intent of this policy is to signal a prudent use of long-term debt and avoidance of, or reliance upon, long-term debt for funding annual renewal and replacement activities. In that respect, this policy is a companion to Policy 2.1. Other considerations for the use of long-term debt include, but are not limited to:

- *Current interest rates (costs)*
- *Current amount of the utility's outstanding debt levels*
- *Consistency with the City's debt policy and overall debt level*

An important concept is the avoidance of an over-reliance upon debt. To assess this, the rating agencies use certain variations of debt/equity ratios. More specifically, the rating agencies may consider the measure of debt to capitalization or debt to operating revenue. These measures are a measure of leverage, rather than just the City's ability

[4] *Fitch Ratings, P. 6, Attributes: Financial Profile (Table)*
[5] *Moody's Investors Service, P. 9 Exhibit 6*

to pay. It is possible for a utility to have a high debt service coverage ratio, but be highly leveraged. Table 5 shows Standard & Poor's and Moody's measure of the extent the utility is leveraged.

Table 4
Rating Agency Debt Leverage Measures

Rating Agency	AAA/Aaa	AA/Aa
S&P Ratings Services[6]	Up-to 20% Debt to Capitalization	20% to 35% Debt to Capitalization
Fitch Ratings	None	None
Moody's Investors Service[7]	Less than 2.0 Debt to Operating Revenue	2.0 to 4.0 Debt to Operating Revenue

The S&P approach is the more common measure and likely more easily understood by the City Council and the Public. Given that, the City's policy has been written to encourage a debt/equity ratio which is less than XX%.

2.3 Types of Long-Term Debt – To minimize the overall costs of debt, the City shall strive, at all times, to utilize the lowest and best available cost option for issuing debt.

Discussion: This policy is a logical perspective about the cost of debt and the City's desire to maintain low costs of operation and funding of capital.

2.4 Bond Covenants – The City, at all times, shall adhere to and meet any bond covenants put forth by bonds issued by the City. Bond covenants are legal obligations placed upon the City. If the City is not in compliance with bond covenants, the City's management team shall inform the City Council and appropriate action will be taken.

Discussion: This policy is not necessary since bond covenants are legal requirements associated with the issuance of debt and the City is legally obligated to meet the bond covenants or face a technical default on the bonds.

2.5 Debt Service Coverage Ratio – At all times, the City shall meet the minimum debt service coverage (DSC) requirements associated with bond covenants. For financial planning and rate setting purposes, the City shall target a minimum DSC of 1.50 times annual debt service on all outstanding debt.

Discussion: A debt service coverage (DSC) ratio is a financial measure of the City's ability to repay the debt. The rate covenants typically require a minimum DSC of 1.25 or 1.30 on the outstanding bonds. Subordinate debt (e.g. SRF loans, etc.) typically require only a 1.00 DSC. While those are the minimum required DSC, the City should plan around a higher DSC to ensure meeting the bond covenants. Given that, a utility will establish a DSC for planning purposes which is higher than the minimums.

Ratings Agencies view debt service coverage, or similar calculation, as a critical measure. Fitch specifically speaks of conducting stress tests where there is either a

[6] *Standard & Poor's Ratings Services, P. 28, Table 21*
[7] *Moody's Ratings Service, P. 12, Exhibit 7*

drought or a key industrial customer leaves the area and views the impact to the DSC. Having a 1.0 indicates the utility has no more funds after paying debt service which would leave no room for unexpected events such as sudden economic downturn or even a drought. Table 5 provides an overview of the rating agency's targeted debt service coverage ratio, or a relatively comparable ratio, for AAA/Aaa and AA/Aa rated utilities.

Table 5
Debt Service Coverage Ratio

Rating Agency	AAA/Aaa	AA/Aa
S&P Ratings Services (All-in Ratio)[8]	Equal to or Greater than 1.6	1.4 to 1.6
Fitch Ratings[9]	Equal to or Greater than 2.0	1.5 to 2.0
Moody's Investors Service[10]	Equal to or Greater than 2.0	1.7 to 2.0

2.6 Accounting and Reporting Standards – The City will comply with all applicable accounting and reporting standards.

Discussion: This policy is a very common sense policy, but it is also typically a part of the bond covenants.

3. Balanced Operating Budget

3.1 Self-Supporting – The water and sewer utility shall be self-supporting, where current revenue fully funds current operating and capital expenditures on an annual basis.

Discussion: The City currently separates the revenues and expenses between the water and sewer utilities. This allows for the City to review the funding needs for each utility on a stand-alone basis where water revenues fund water expenses and sewer revenues fund sewer expenses. Avoidance of subsidies between the water and sewer utility should be a goal of the City.

3.2 Adequate Funding to Preserve System Assets – The City's assets shall be properly operated and maintained to provide for a long life. Annual operating expenditures will be budgeted and funded at a level that promotes the efficient operation of and preservation of assets through the asset's useful life.

Discussion: This policy is a companion to Policy 2.1 and is intended to provide adequate funding to support the operation and maintenance of each system.

3.3 Evaluation and Monitoring of Cost – Costs will be monitored monthly to ensure the utility is operated in a cost effective and economically prudent manner.

Discussion: This policy is a companion to Policy 2.6 and is intended to demonstrate the City's commitment to managing the utility in a cost-effective and prudent manner.

[8] *Standard & Poor's Ratings Services, P. 24, Table 17*
[9] *Fitch Ratings, P. 6 Attributes: Financial Profile (Table)*
[10] *Moody's Investors Service, P. 12, Exhibit 7*

3.4 Positive Annual Net Income – The City shall plan for annual net income (total revenue less O&M, taxes or transfers, debt service, and capital projects funded from rates) greater than or equal to zero (positive balance of funds).

Discussion: This policy is a companion to Policies 3.1 and 3.2 and is intended to provide a simple financial test to demonstrate positive cash-flow for the systems.

3.5 Strive for Rate Stability – The City's rates should be stable over time while generating sufficient revenue. As a part of the annual budgeting process, the City shall review the rates to confirm the adequacy of the current rates.

Discussion: Revenue stability can be viewed from two perspectives; from the City's perspective and from the customer's perspective. In this case, the focus is on stable revenue from the City's perspective.

3.6 Disposition of "One-Time" Revenue – In instances of large one-time revenues (e.g. legal settlement), if not specifically earmarked, the funds will be transferred to an appropriate reserve(s) (operating, capital or rate stabilization).

Discussion: The City Council should provide clear direction to management on the use of proceeds from a large "one-time" source of revenue.

3.7 Alternative Funding/Revenue Diversification – To minimize overall rates, the City should explore alternative revenue sources such as grants and direct developer contributions.

Discussion: This policy is a companion to the policies to minimize overall costs of the utility.

4. Establishing Rates and Fees

The City shall establish rates utilizing industry recognized "generally accepted" rate setting methodologies. This will provide the City with consistency in their ratemaking process, while also establishing rates which are legally defendable. The City's policies on establishing the water and sewer rates and fees, and the general methodologies to be utilized, are as follows:

4.1 Revenue Requirement Analysis

The revenue requirement analysis provides a projection of the City's revenues and expenditures for a defined time period. The revenue requirement analysis shall provide the City Council with the information and cost-basis to determine the size and timing of any proposed rate adjustments. The City's revenue requirement analysis methodology shall consider the following:

4.1.1 The revenue requirement analysis will be developed for a projected five-year time period.

4.1.2 Revenue requirements will be established using the "cash basis" methodology. The "cash basis" methodology includes O&M expenses, taxes/transfer payments, debt service (P+I) and capital improvements (renewal and replacement) funded from rates. The revenue requirements may include a component for change in working capital/rate stabilization funds to manage reserve balances and mitigate rate impacts.

4.1.3 Costs shared across utilities shall be allocated to each utility based an equitable

allocation method. These may include, but not be limited to, labor ratios, number of customers, revenues, usage etc. The allocation method should be whichever method most equitably allocates the specific cost.

4.1.4 Any wholesale increases imposed upon the City by a water supplier or wastewater treatment agency will be reviewed for financial/rate impacts.

4.1.5 The City's revenue requirement analysis shall fully incorporate the City's reserve, debt and budgeting policies.

Discussion: Revenue requirements projects the City's revenues and expenses (operating and capital) to determine the overall level of rate adjustments needed.

4.2 Cost of Service Analysis

A cost of service analysis provides an equitable method to allocate the City's water and sewer revenue requirements to the customers utilizing the service. The City's cost of service analysis for the water utility shall use generally accepted cost of service methodologies as defined by the American Water Works Association (AWWA) and the analysis developed for the City's sewer utility shall use cost of service methodologies as defined by the Water Environment Federation (WEF). The City's water and sewer cost of service shall be developed to provide an equitable allocation of costs by taking into consideration a customer group's (e.g. residential, commercial) facility requirements and usage characteristics. The City's specific cost of service policies are as follows:

4.2.1 The cost of service shall be developed for a projected one-year time period or the period over which rates will be set, utilizing the revenue requirements as developed in 4.1.

4.2.2 The cost of service analysis shall be designed and developed to consider the unique and specific circumstances of the City's water and sewer system.

4.2.3 The City shall allocate costs to customer class of service based upon facility requirements and usage characteristics.

4.2.4 When necessary, the City may phase-in the cost of service results to transition to fully-cost based rates.

Discussion: A cost of service equitably allocates the City's water and sewer revenue requirements to the various customer classes of service. The City's recent rate study provides a similar approach to reviewing the differences in serving the various types of water and sewer customers served.

4.3 Rate Design Analysis

The development of cost-based rate designs concludes the City's rate setting process. The development of rate designs utilizes the results from the revenue requirement and cost of service analysis to establish the target level of revenues for each customer class of service (rate schedule). The City's rate design analysis is primarily focused on the structure of the rates. The City's rate design analysis policies are as follows:

4.3.1 The City shall utilize the results of the revenue requirement analysis and cost of service analysis in the development of final proposed rate designs.

4.3.2 Rates shall be designed to collect the overall target level of revenues for each customer class of service.

4.3.3 The City's rate designs shall be reflective of the City Council's rate design goals and objectives, while also being reflective of the greater public purpose (e.g., economic development, conservation, etc.).

4.3.4 The City shall take into consideration both fixed and variable costs in the development of final proposed rates. The average unit costs calculated within the cost of service analysis provides the cost-information related to fixed and variable costs.

4.3.4 Bill comparisons shall be developed for all proposed rate designs to illustrate the general impacts to customers across a range of consumption.

4.3.5 In establishing the final water and sewer rates, the City's Council may take into consideration neighboring utility rates, but not to the financial detriment of the City.

Discussion: The final analytical step of a comprehensive rate study is the design of water and sewer rates. This policy and the sub-policies are intended to develop proposed rate designs which are based upon the findings, conclusions and recommendations from the revenue requirement and cost of service analysis.

4.4 Other Rate Setting Considerations

Provided below are other policies related to the City's rate setting process.

4.4.1 At a minimum, the City shall conduct a comprehensive rate study every five (5) years to update assumptions and determine financial sustainability.

Discussion: This is a common industry best practice. Gaining an independent outside expert opinion and developing a well documented rate study is a significant document during the bond ratings process.

City of Homer, Alaska

Governmental Funds
Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit)

	Major Funds						
Year Ended December 31, 2019	General	Utility Special Revenue	City Facilities Capital Project	Gas Line Capital Project	HART Roads Capital Project	Nonmajor Funds	Total Governmental Funds
Revenues							
Property taxes	$ 3,651,365	-	-	-	-	29,630	3,680,995
Sales and use taxes	6,398,988	1,583,087	-	-	1,503,204	838,504	10,323,783
Permits and licenses	41,152	-	-	-	-	-	41,152
Intergovernmental	916,369	640,158	429,230	-	-	103,914	2,089,671
Charges for services	2,205,197	3,946,563	-	-	-	-	6,151,760
Special assessments	-	426,218	-	1,047,965	-	67,251	1,541,434
Investment income	188,592	105,161	134,690	46,396	180,137	212,744	867,720
Fines and forfeitures	28,798	-	-	-	-	-	28,798
Donations	-	-	-	-	-	5,362	5,362
Other	-	100,011	-	-	-	(4,536)	95,475
Total Revenues	13,430,461	6,801,198	563,920	1,094,361	1,683,341	1,252,869	24,826,150
Expenditures							
Current:							
General government	3,201,579	-	-	-	115,085	58,063	3,374,727
Public safety	4,359,655	-	-	-	-	-	4,359,655
Public works	2,557,981	-	-	-	-	-	2,557,981
Library	873,440	-	-	-	-	-	873,440
Airport	196,901	-	-	-	-	-	196,901
Community services	94,000	-	-	-	-	-	94,000
Water	-	2,090,696	-	-	-	-	2,090,696
Sewer	-	1,522,675	-	-	-	-	1,522,675
Debt service:							
Principal	-	881,066	-	536,819	-	28,045	1,445,930
Interest	-	149,933	-	145,339	-	103,041	398,313
Capital outlay	-	1,019,555	3,984,541	-	20,126	712,146	5,736,368
Total Expenditures	11,283,556	5,663,925	3,984,541	682,158	135,211	901,295	22,650,686
Excess of Revenues Over (Under) Expenditures	2,146,905	1,137,273	(3,420,621)	412,203	1,548,130	351,574	2,175,464
Other Financing Sources (Uses)							
Issuance of bonds	-	-	4,804,048	-	-	-	4,804,048
Transfers in	1,671,930	779,535	572,277	-	-	1,075,744	4,099,486
Transfers out	(922,329)	-	-	-	(1,680,431)	(1,599,790)	(4,202,550)
Net Other Financing Sources (Uses)	749,601	779,535	5,376,325	-	(1,680,431)	(524,046)	4,700,984
Special Item - construction of gas pipeline on behalf of third parties	-	-	-	(100,729)	-	-	(100,729)
Net Change in Fund Balances	2,896,506	1,916,808	1,955,704	311,474	(132,301)	(172,472)	6,775,719
Beginning Fund Balances (Deficit)	7,155,081	4,114,638	1,764,118	(932,007)	6,039,671	5,246,206	23,387,707
Ending Fund Balances (Deficit)	$ 10,051,587	6,031,446	3,719,822	(620,533)	5,907,370	5,073,734	30,163,426

See accompanying notes to basic financial statements.

4. Interfund Balances and Transfers

A schedule of interfund balances and transfers for the year ended December 31, 2019 follows:

Transfers

From General Fund to:	
Utility Special Revenue Fund	$ 779,535
Nonmajor governmental funds	142,794
From HART Roads Capital Project Fund to:	
General Fund	1,671,930
City Facilities Capital Project Fund	8,501
From nonmajor governmental funds to:	
City Facilities Capital Project Fund	563,776
Internal Service Fund	103,986
Nonmajor Governmental Funds	932,950
From Port of Homer Enterprise Fund to nonmajor governmental funds	922
Total Transfers to Other Funds	$ 4,203,472

Interfund transfers are routinely recorded throughout the year. In 2019, transfers from the general fund are to fund capital depreciation reserves and operating subsidies. Transfers from nonmajor governmental funds to the General Fund were to pay off debt and to other nonmajor funds were for the police station capital project. At December 31, 2019, an interfund balance of $25,355 was owed from the Gas Line Capital Project Fund to the General Fund. At December 31, 2019, an interfund balance of $377,225 was owed from the nonmajor governmental funds for capital projects to the General Fund.

Interfund Loan

In 2011, the City underwent an extensive energy audit with the goal of identifying areas for energy savings and efficiencies. Numerous minor upgrades or repairs were conducted in this effort. Most of these costs were funded by fund balances set aside in the prior year along with grant funds. The City approved and recorded an interfund loan from the Energy Revolving Loan Capital Project Fund to the Port of Homer Enterprise Fund in the amount of $29,294 to fund a portion of the Port related upgrades. The Port will repay the loan in $3,291 annual installments over nine years. The loan had a balance of $6,255 as of December 31, 2019.

In 2018, the General Fund loaned $300,000 to the Port of Homer Enterprise Fund in order to purchase land from the Alaska Mental Health Trust Authority. The loan is due in annual payment of $30,000 plus interest at 3% per year payable over ten years. At December 31, 2019 the outstanding balance was $161,122.

7. Fund Balances

Fund balances, reported for the major funds and the nonmajor funds in the aggregate on the governmental funds balance sheet are subject to the following constraints:

	General	Utility Special Revenue	City Facilities	Gas Line Capital Project	HART Roads Capital Project	Nonmajor Funds	Totals
Nonspendable:							
Inventory	$ 27,691	405,258	-	-	-	-	432,949
Prepaid items	168,902	20,968	-	-	-	-	189,870
Interfund loans	161,122	-	-	-	-	-	161,122
Total nonspendable	357,715	426,226	-	-	-	-	783,941
Restricted:							
Roads and trails	-	-	-	-	5,907,370	1,468,762	7,376,132
Special service district	-	-	-	-	-	70,140	70,140
Police station construction	-	-	1,652,452	-	-	-	1,652,452
Total Restricted	-	-	1,652,452	-	5,907,370	1,538,902	9,098,724
Committed:							
Police station debt service and construction	-	-	593,137	-	-	616,883	1,210,020
Assigned:							
Library	-	-	-	-	-	173,497	173,497
Public safety	-	-	-	-	-	44,990	44,990
Community schools	-	-	-	-	-	270	270
Sustainability	-	-	-	-	-	15,544	15,544
Water and sewer	-	5,605,220	-	-	-	-	5,605,220
PERS benefits	171,314	-	-	-	-	27,901	199,215
Capital and land	-	-	1,474,233	-	-	3,021,718	5,784,999
Total assigned	171,314	5,605,220	1,474,233	-	-	3,283,920	10,534,687
Unassigned (deficit)	9,522,558	-	-	(620,533)	-	(365,971)	8,536,054
Total Fund Balances	$ 10,051,587	6,031,446	3,719,822	(620,533)	5,907,370	5,073,734	30,163,426

Exhibit D-2

City of Homer, Alaska

200 - Utility Special Revenue Fund
Schedule of Revenues, Expenditures, and
Changes in Fund Balance - Budget and Actual

Year Ended December 31, 2019	Budget Original	Budget Final	Actual GAAP Basis	Budget to GAAP Difference	Actual Budget Basis	Variance with Final Budget
Revenues						
Sales taxes	$ 1,338,809	1,338,809	1,583,087	-	1,583,087	244,278
Intergovernmental	-	-	640,158	(66,929)	573,229	573,229
Charges for services	3,729,021	3,737,312	3,946,563	-	3,946,563	209,251
Water and sewer special assessments	-	-	426,218	-	426,218	426,218
Investment income	9,294	1,003	105,161	-	105,161	104,158
Other	-	-	100,011	-	100,011	100,011
Total Revenues	5,077,124	5,077,124	6,801,198	(66,929)	6,734,269	1,657,145
Expenditures						
Water	2,114,194	2,151,694	2,090,696	(38,101)	2,052,595	99,099
Sewer	1,533,942	1,531,442	1,522,675	(28,828)	1,493,847	37,595
Debt service:						
Principal	868,835	868,835	881,066	-	881,066	(12,231)
Interest	172,665	172,665	149,933	-	149,933	22,732
Total debt service	1,041,500	1,041,500	1,030,999	-	1,030,999	10,501
Capital outlay	-	-	1,019,555	-	1,019,555	(1,019,555)
Total Expenditures	4,689,636	4,724,636	5,663,925	(66,929)	5,596,996	(872,360)
Excess of Revenues Over (Under) Expenditures	387,488	352,488	1,137,273	-	1,137,273	784,785
Other Financing Sources (Uses)						
Transfers in	73,779	-	779,535	-	779,535	779,535
Transfers out	(33,398)	(199,035)	-	-	-	199,035
Net Change in Fund Balance	$ 427,869	153,453	1,916,808	-	1,916,808	1,763,355
Fund Balance, beginning			4,114,638			
Fund Balance, ending			$ 6,031,446			

See accompanying notes to required supplementary information.

Exhibit H-1

City of Homer, Alaska

Utility Special Revenue Fund
Combining Balance Sheet

December 31, 2019	Utility Operations 200	HAWSP Debt Service 205	Utility Capital Projects 215	Utility Reserves 256	Total Utility Fund
Assets					
Cash and investments	$ 164,016	1,946,924	(1,937,315)	4,729,813	4,903,438
Receivables					
Accounts	196,875	-	-	-	196,875
Sales taxes	-	228,826	-	-	228,826
Assessments	-	3,393,907	-	-	3,393,907
State and Federal grants and loans	-	-	442,433	-	442,433
Total Receivables	196,875	3,622,733	442,433	-	4,262,041
Inventory	405,258	-	-	-	405,258
Prepaid	20,968	-	-	-	20,968
Total Assets	$ 787,117	5,569,657	(1,494,882)	4,729,813	9,591,705
Liabilities					
Accounts payable	$ 55,094	-	3,420	49,423	107,937
Accrued payroll and related liabilities	15,962	-	-	-	15,962
Customer deposits	42,453	-	-	-	42,453
Total Liabilities	113,509	-	3,420	49,423	166,352
Deferred Inflows of Resources					
Deferred assessments	-	3,393,907	-	-	3,393,907
Total Liabilities and Deferred Inflows of Resources	113,509	3,393,907	3,420	49,423	3,560,259
Fund Balances (Deficits)					
Nonspendable - inventory and prepaid	426,226	-	-	-	426,226
Assigned - water and sewer	247,382	2,175,750	(1,498,302)	4,680,390	5,605,220
Total Fund Balances (Deficits)	673,608	2,175,750	(1,498,302)	4,680,390	6,031,446
Total Liabilities, Deferred Inflows of Resources and Fund Balances (Deficits)	$ 787,117	5,569,657	(1,494,882)	4,729,813	9,591,705

City of Homer, Alaska

Utility Special Revenue Fund
Schedule of Revenues, Expenditures, and
Changes in Fund Balance - Budget and Actual

Year Ended December 31, 2019	Budget	Actual	Variance
Revenues			
Sales taxes	1,338,809	$ 1,583,087	$ 244,278
Intergovernmental	-	640,158	640,158
Other	-	100,011	100,011
Charges for services:			
Water charges and connection fees	2,015,298	2,190,568	175,270
Sewer charges and connection fees	1,722,014	1,755,995	33,981
Total charges for services	3,737,312	3,946,563	209,251
Water and sewer special assessments	-	426,218	426,218
Investment income	1,003	105,161	104,158
Total Revenues	5,077,124	6,801,198	1,724,074
Expenditures			
Water:			
Administration	630,904	643,808	(12,904)
Treatment plant	634,642	588,673	45,969
Water system testing	27,400	21,194	6,206
Pumping stations	97,020	88,521	8,499
Distribution system	303,476	305,560	(2,084)
Water reservoir	29,047	22,003	7,044
Water meters	239,972	224,953	15,019
Water hydrants	189,233	195,984	(6,751)
Total water	2,151,694	2,090,696	60,998
Sewer:			
Administration	402,246	393,377	8,869
Sewer plant operations	673,034	693,445	(20,411)
Sewer system testing	14,500	9,235	5,265
Sewer lift stations	199,213	194,147	5,066
Collection system	242,449	232,471	9,978
Total Sewer	1,531,442	1,522,675	8,767
Debt service:			
Principal	868,835	881,066	(12,231)
Interest	172,665	149,933	22,732
Total debt service	1,041,500	1,030,999	10,501
Capital outlay	-	1,019,555	(1,019,555)
Total Expenditures	4,724,636	5,663,925	(939,289)
Excess of Revenues Over (Under) Expenditures	352,488	1,137,273	784,785
Other Financing Sources (Uses)			
Transfers in	-	779,535	779,535
Transfers out	(199,035)	-	199,035
Net Change in Fund Balance	153,453	1,916,808	$ 1,763,355
Fund Balance, beginning		4,114,638	
Fund Balance, ending		$ 6,031,446	

City of Homer, Alaska

Utility Special Revenue Fund
Combining Schedule of Revenues, Expenditures, and Changes in Fund Balances (Deficits)

Year Ended December 31, 2019	Utility Operations 200	HAWSP Debt Service 205	Utility Capital Projects 215	Utility Reserves 256	Total Utility Fund
Revenues					
Sales taxes	$ -	1,583,087	-	-	1,583,087
Intergovernmental	66,929	-	573,229	-	640,158
Other	-	100,011	-	-	100,011
Charges for services:					
Water charges and connection fees	2,190,568	-	-	-	2,190,568
Sewer charges and connection fees	1,755,995	-	-	-	1,755,995
Total charges for services	3,946,563	-	-	-	3,946,563
Water and sewer special assessments	-	426,218	-	-	426,218
Investment income	105,161	-	-	-	105,161
Total Revenues	4,118,653	2,109,316	573,229	-	6,801,198
Expenditures					
Water:					
Administration	499,951	143,857	-	-	643,808
Treatment plant	588,673	-	-	-	588,673
Water system testing	21,194	-	-	-	21,194
Pumping stations	88,521	-	-	-	88,521
Distribution system	305,560	-	-	-	305,560
Water reservoir	22,003	-	-	-	22,003
Water meters	224,953	-	-	-	224,953
Water hydrants	195,984	-	-	-	195,984
Total water	1,946,839	143,857	-	-	2,090,696
Sewer:					
Administration	393,377	-	-	-	393,377
Sewer plant operations	693,445	-	-	-	693,445
Sewer system testing	9,235	-	-	-	9,235
Sewer lift stations	194,147	-	-	-	194,147
Collection system	232,471	-	-	-	232,471
Total Sewer	1,522,675	-	-	-	1,522,675
Debt service:					
Principal	-	881,066	-	-	881,066
Interest	1,233	148,700	-	-	149,933
Total debt service	1,233	1,029,766	-	-	1,030,999
Capital outlay	-	-	822,345	197,210	1,019,555
Total Expenditures	3,470,747	1,173,623	822,345	197,210	5,663,925
Excess of Revenues Over (Under) Expenditures	647,906	935,693	(249,116)	(197,210)	1,137,273
Other Financing Sources (Uses)					
Transfers in	-	3,989,047	-	(3,209,512)	779,535
Transfers out	(3,300,117)	-	(27,106)	3,327,223	-
Net Change in Fund Balances	(2,652,211)	4,924,740	(276,222)	(79,499)	1,916,808
Fund Balances (Deficits), beginning	3,325,819	(2,748,990)	(1,222,080)	4,759,889	4,114,638
Fund Balances (Deficits), ending	673,608	2,175,750	(1,498,302)	4,680,390	6,031,446