



Alternative Rate Structure Analysis

Philadelphia Water Department

STAKEHOLDER MEETING 3 – September 10, 2019



Agenda

- Welcome & Meeting No. 2 Recap
- Meeting Overview
- Focus Topic No. 3 – Rider for Pension Expenses
- Reflection & Discussion
- Wrap-up



Welcome

- Alternative Rate Structure Analysis Background
- Meeting No. 2 Recap
- Development Service Committee Feedback
- Today's Topic: Rider for pension-related expenses

Written comment deadline extended to September 20th.



Meeting Agenda Potential Pension Rider

- Technical Presentation
 - Rate Rider Background
 - Pensions Trends
 - PWD Pension Expenses
 - Example Pension / OPEB Riders
 - Applicability to PWD & Factors for Consideration
 - Alternative Approaches & Recommended Alternative
- Reflection & Discussion

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Focus Topic No. 3: Potential Pension Rider



Tiered Assistance Program (TAP) Rate Rider

- Adopted with FY 2019 – FY 2020 Rate Determination
- Recovers revenue loss associated with the TAP discounts
- Applied as a water and sewer quantity surcharge (\$ per Mcf)
- Allows for:
 - Annual reconciliation and surcharge rate updates
 - More accurate and timely cost recovery
- Addresses concerns:
 - Difficult to predict enrollment levels
 - Uncertain revenue loss
 - Potential under/over-recovery of costs

What other expenses would benefit from a similar recovery approach?

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Reason to Consider a Rider Approach

	PENSIONS
• Ability (of the utility) to control the expense	✓
• Volatility of the expense	✓
• Difficulty in accurately predicting the expense	✓
• Contribution to overall variance (projected versus actual)	✓

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National Industry Trends

According to Moody's Investor Services, **the nation's unfunded public pension liabilities tops \$4.4 trillion.**

This is comparable to ASCE's \$4.5 trillion estimate of what the nation needs to fix it's failing infrastructure by 2025.



ASCE = American Society of Civil Engineers

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National Industry Trends

Pension issues can affect credit ratings

- Chicago
 - Dropped to Junk Bond status in 2015
 - Annual contributions will increase from \$1 billion in 2018 to \$2.1 billion in 2023
 - Raising property taxes and utility bills
- Detroit and Stockton bankruptcies
 - Pension obligations still exist
- Illinois and New Jersey

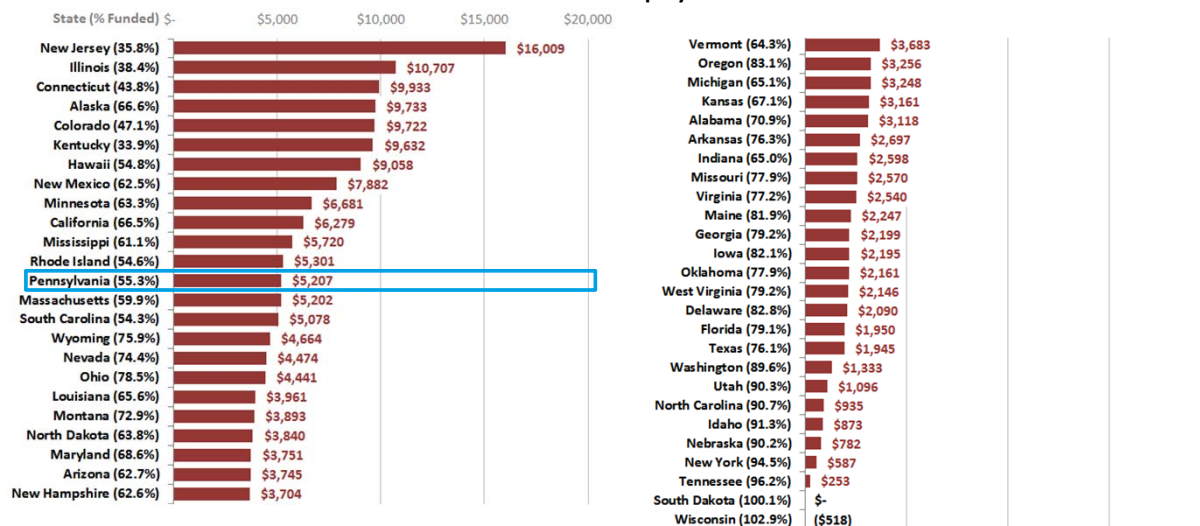
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National Industry Trends

2018 Cost of Unfunded State Government Employee Pension Liabilities Per State Resident



Source: Bloomberg (October 12, 2018, 2017 Data), 2017 U.S. Census Bureau Population Estimates

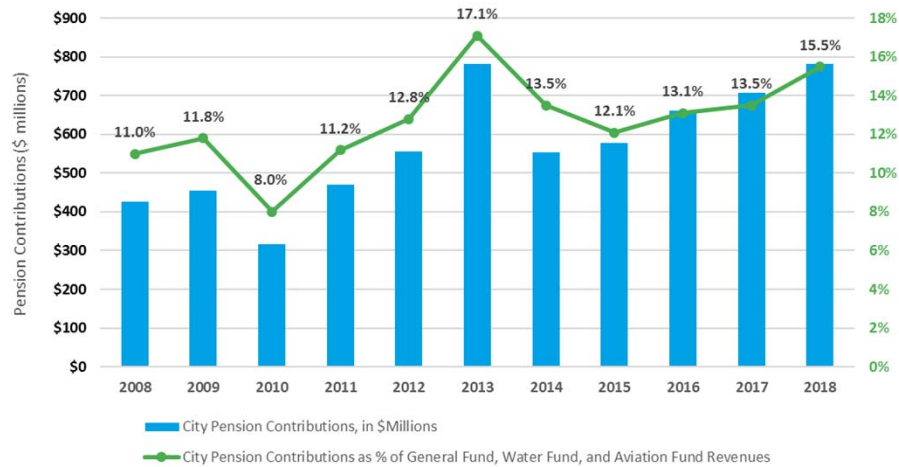
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City Contributions to the Philadelphia Pension Fund, FY 08 - 18

City has committed to making higher contributions to the pension fund



Source: 2019 The Pew Charitable Trust

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Annual Employee Contributions to Pension Fund, FY 08-18

Active employee contributions are increasing as well



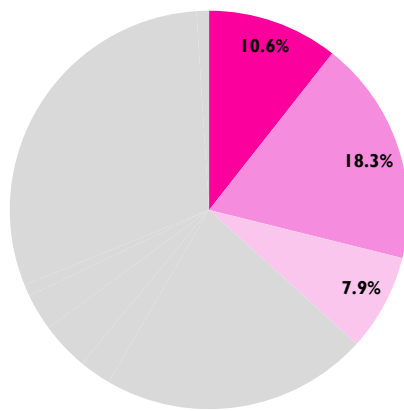
Source: 2019 The Pew Charitable Trust

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PWD Pension Costs – FY 2018 Expense Summary



EXPENSE CATEGORY	FY18 FINAL (\$000s)
10.6% - Pension Costs	76,957
18.3% - Personal Services	132,309
7.9% - Other Employee Benefits	56,889
Workforce Costs	266,154
21.7% Services	156,997
2.6% Electricity and Gas	18,858
3.9% Materials, Equipment & Supplies	28,306
3.0% Chemicals	21,771
0.9% Indemnities	6,779
30.1% Capital Program - Debt Service Payments	218,483
1.0% General Fund Reimbursement	7,319
TOTAL	724,667

Pensions costs make up roughly 10% of annual obligations



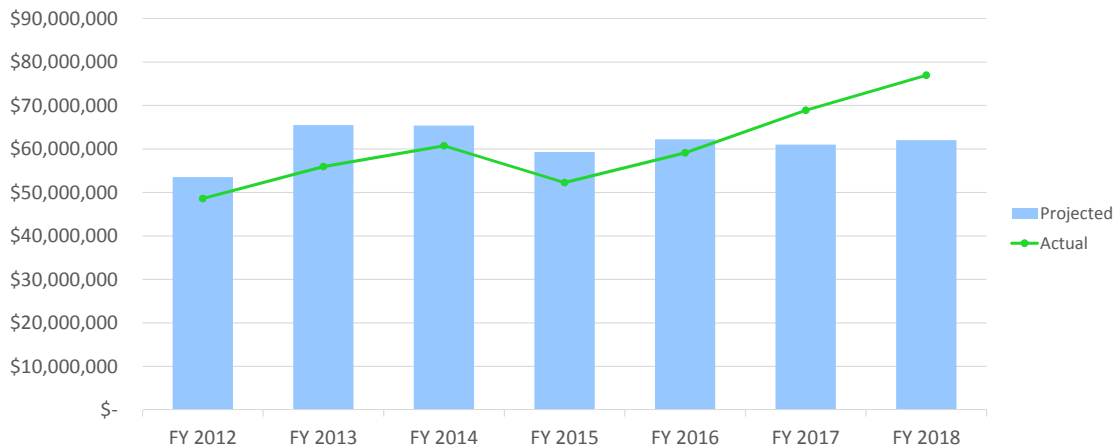
PWD Pension Costs – Background

- Pension expenses have nearly doubled over the last 7-8 years
- Increases in pensions costs are generally due to:
 - Required increase in contributions
 - Funding must be from operating revenues (per City policy change)
 - Increased staffing levels
- Other factors influencing pension costs:
 - Overall performance of the City's pension plan
 - Actuarial calculations determine pension liabilities and are conducted by an outside firm
 - Increasing staffing levels compared to the rest of the City influence PWD's proportion of pension contributions

Water Fund Contribution as a percentage of MMO has increased from 5.6% in FY 2010 to 10% in FY 2018



Prior Projections vs. Actual Pension Expenses



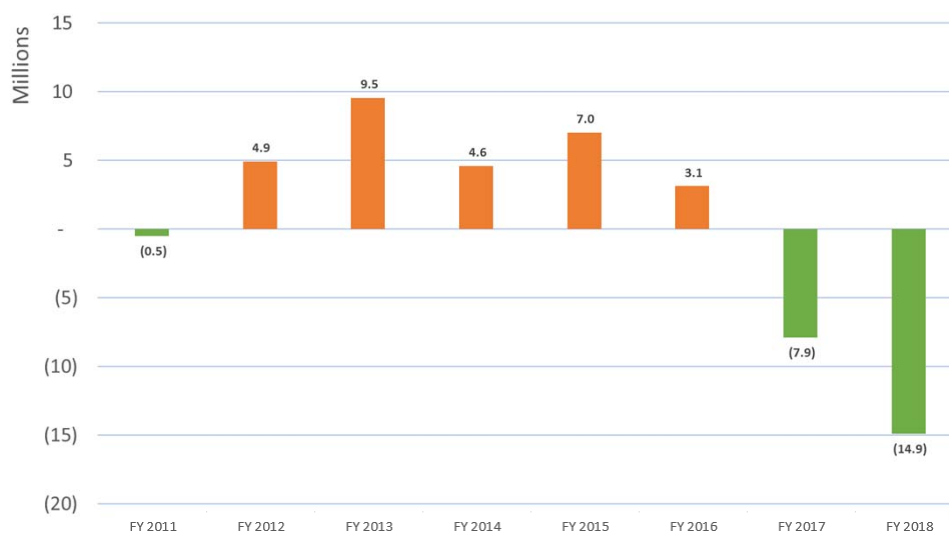
Note: Prior projections are based on prior rate determinations

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Variance – Projected versus Actual Pension Expenses



FY 2017 and FY 2018 variances reflect the change in funding policy, which occurred following the Rate Board determination.

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Projected PWD Pension Expenses and Personnel Count

Projections	FY 19	FY 20	FY 21	FY 22	FY 23	FY 24
Pension Expenses (\$ millions)	\$ 79.0	\$ 81.6	\$ 83.2	\$ 84.6	\$ 86.1	\$ 87.8
Personnel Count	2,508	2,559	2,571	2,582	2,582	2,582

The above figures are estimates and intended for discussion purposes only.

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What are others doing?

- Pension and Other Post-Employment Benefits (OPEB) related rider mechanism are more common in the electric and natural gas industry / some water industry examples
- Electric and gas utilities face similar challenges related to pensions:
 - Continue to recovery costs via annual operating revenue needs without eroding reserves
 - Address market fluctuations / volatility in pension plan performance
 - Meet applicable indenture requirements

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Pension and OPEB Related Riders - Examples

Utility	Type	Rider Mechanism(s)	Expenses Recovered	Reconciliation Frequency	Charge Component
National Grid	Electric	Pension Adjustment Factor (PAF)	Uncapitalized Pension and OPEB expenses	Annual	\$ Per kWh
Eversource Energy	Electric	PAF	Uncapitalized Pension and PBOP expenses	Annual	\$ per kWh
PGW	Gas	OPEB Surcharge	OPEB Expenses	Annual	\$ per Mcf
Cal Water	Water	Pension Surcharge Healthcare Surcharge	1) Uncapitalized pension expenses 2) Healthcare expenses	Annual	\$ per CCF

OPEB = Other Post Employment Benefits
PBOP = Post-Retirement Benefits Other than Pensions

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Applicability to PWD

- Pension costs are expected to increase from \$79 million in FY 2019 to \$88 million in FY 2024
- Under/over-performance of pension related expenses:
 - Have a material impact on fund balances
 - May effect PWD's ability to meet Bond Ordinance and Rate Board covenants

Recovery via a rider mechanism:

- Provides agility to more accurately reflect actual experience
- Addresses costs recovered via rates in a more timely and transparent fashion

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Factors for Consideration

- Example riders all utilize consumption-based charges (i.e., \$/kWh, \$/Mcf, etc.) as part of their respective recovery mechanisms
- For the Department, Pension costs are a personnel-related O&M expense:
 - Under cost-of-service principles all cost components and customers receive an allocation of pension related costs
 - Pension costs are currently recovered via all rates and charges

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Pension Rider – Alternative Approaches

Approach	Option	Advantages	Disadvantages
Water / Sewer Quantity Surcharge	<u>All</u> pension expenses	<ul style="list-style-type: none"> • Simple surcharge / reconciliation calculations • Similar to TAP Rider • Allows for annual reconciliation of revenues and expenses 	<ul style="list-style-type: none"> • Less than ideal cost recovery as costs only recovered from water and sewer • Overburdens water and sewer quantity charges • Stormwater customers would not contribute
	<u>Only under/over-performance of</u> pension expenses	<ul style="list-style-type: none"> • “Base level” pension costs remain in each rate • Limits the number of rates and charges impacted • Simple surcharge / reconciliation calculations • Similar to TAP Rider • Allows for annual reconciliation of expenses 	<ul style="list-style-type: none"> • Less than ideal cost recovery as costs only recovered from water and sewer • Overburdens water and sewer quantity charges • Stormwater customers would not contribute to surcharge or benefit from credit

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Pension Rider – Alternative Approaches

Approach	Option	Advantages	Disadvantages
Percentage Cost Adjustment	Cost-based adjustment for each rate (percent basis)	<ul style="list-style-type: none"> Allows for adjustment to all rates to be adjusted to better align with actual experience 	<ul style="list-style-type: none"> Requires adjustment to all rates and may require more complex calculations and documentation
Per Bill Surcharge	<u>All</u> pension expenses	<ul style="list-style-type: none"> Retains a nexus in that each type of utility service contributes to recovery of pension costs Reconciliation more feasible compared to a surcharge on all fees 	<ul style="list-style-type: none"> Not directly tied to <u>current</u> base rate recovery approach Might result in a significant cost per bill (i.e., \$/bill or \$/meter size)
	<u>Only under/over-performance of</u> pension expenses	<ul style="list-style-type: none"> “Base level” pension costs remain in each rate Retains a nexus in that each type of utility service contributes to recovery of pension costs Lower surcharge compared to recovering all costs per bill Could be reset with a base rate proceeding 	<ul style="list-style-type: none"> Not directly tied to base rate recovery Might result in a significant cost per bill (i.e., \$/bill or \$/meter size)

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Pension Rider Recommended Alternative

- A per bill surcharge/surcredit for under/over performance only
- Keeps a portion of pension expenses within the base rates
- Surcharge/surcredit retains a nexus by being distributed to all utility service types
- Reset with a base rate proceeding
- Allows for simplified reconciliation

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Summary

- Pension make up nearly 10% of Department operating expenses
- The Department does not have direct control over this expense
- The Department's contributions are expected to further increase and will be influenced by market fluctuations / pension plan performance
- A rider mechanism would:
 - Aid in managing costs recovered by rates
 - Allow for more timely adjustments

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Reflection & Discussion

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Reflection

- Purpose: capture all points of views about the questions, concerns, and suggestions related to each alternative
 1. Give everyone a chance to participate
 2. Efficiently collect feedback
- Use the note-taking handout to capture initial thoughts

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Large Group Discussion

1. Question
2. Concerns
3. Suggestions

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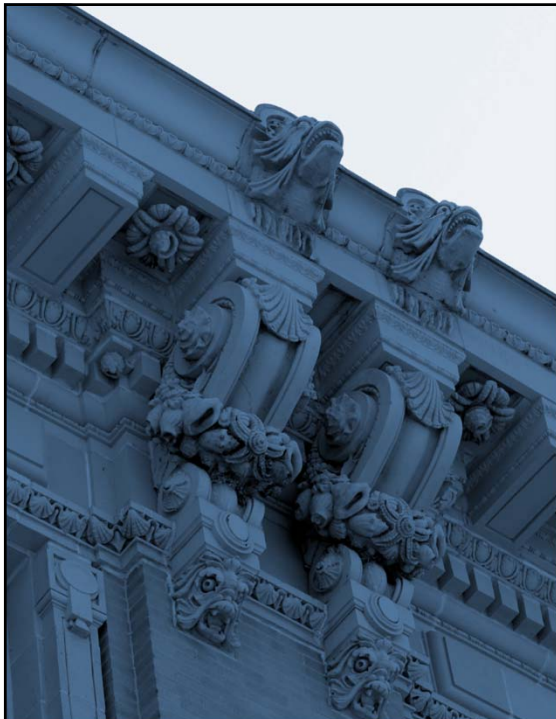


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Wrap Up



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What's Next?

- **Today:** Complete evaluation form
- **By September 20th:** Please submit comments to:
Danae Mobley: danae.mobley@phila.gov

Reminder: All meeting materials and written comments will be treated as public information and posted to the Rate Board website.

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