Assessing Financial Condition

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Session Objectives

- Understand where your water system is right now, or has been in the past, financially

- Learn some standard measures that you should be concerned with and what funders (and the LGC) will be looking at

Whiteboard Video: Financial Benchmarking

http://www.waterrf.org/Pages/Projects.aspx?PID=4366

Can You Sleep at Night?

- Is your utility (public enterprise) self sufficient? — Operating Ratio
- Can your utility meet its short term obligations? — Quick Ratio
- If your customers stop paying their bills, how long can you maintain operations? — Days Cash on Hand
- Are you able to cover your debt service after paying for your day to day operations? — Debt Service Coverage Ratio
- How much of your utility's expected life has already run out (and how much is left)? — Asset Depreciation

Where Do We Get Started?

- Local governments: Audited Financial Statements!

(I know, I know, it's still morning...)

- Non-governments: balance sheets, shareholder reports, annual reports, etc.

A Tale of Two Systems

Helen, GA

- Service Population: 1,313
- Number of Connections: 505
- MHI in 2011: $30,972
- Percent Poverty: 23%

Woodbine, GA

- Service Population: 1,508
- Number of Connections: 580
- MHI in 2011: $29,891
- Percent Poverty: 27%

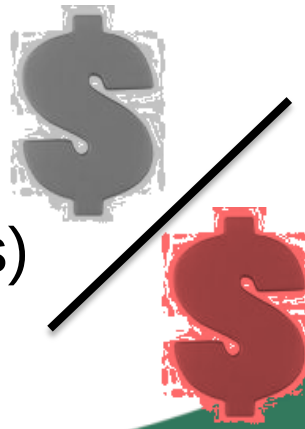
Operating Ratio

$$= \frac{Operating\ Revenues}{Operating\ Expenses}$$

Natural Benchmark: > 1.0

A measure of self sufficiency.

The revenue you get from daily operations, divided by the expenditures or expenses you make to keep operations running (see next slides)



Note: sometimes operating ratio is inverted

This Funny Thing Called Depreciation

- This is an accounting solution to the problem of things getting old

- You have a “cost” every year of your infrastructure wearing out, a percentage of its value

T'mayto, Tahmahto: Operating Ratio

- You may wish to include depreciation in your operating ratio
  - Operating revenues divided by operating expenses including depreciation and the provision for bad debts.

- National Association of Clean Water Agencies
  - Operating revenues divided by operating expenditures (excludes depreciation).

A Tale of Two Systems

Helen, GA

- Operating Revenue (1): $709,972
- Operating Expenses (2) (including depreciation): $671,333
- **Operating Ratio: 1.06**

Woodbine, GA

- Operating Revenue (1): $444,231
- Operating Expenses (2) (including depreciation): $511,448
- **Operating Ratio: 0.87**

A Tale of Two Systems

Helen, GA

- Operating Revenue (1): $709,972
- Operating Expenses (2-3) (excluding depreciation): $459,082
- **Operating Ratio: 1.55**

Woodbine, GA

- Operating Revenue (1): $444,231
- Operating Expenses (2-3) (excluding depreciation): $368,985
- **Operating Ratio: 1.20**

Debt Service Coverage Ratio

$$= \frac{Operating\ Revenues - \ Operating\ Expenditures\ (excludes\ depreciation)}{Principal + Interest\ Payments\ on\ Long\ Term\ Debt}$$

Natural Benchmark: > 1

A measure of the ability to pay debt service with operating revenue: Operating revenue left over after daily operation expenditures, divided by debt service

Funders typically set targets for utilities that exceed 1.0 by a substantial amount, and prefer to see much higher ratios.

A Tale of Two Systems

Helen, GA

- Operating Revenue (1): $709,972
- Operating Expenses (2-3) (excluding depreciation): $459,082
- P & I (4): $190,633
- **Debt Service Coverage Ratio: 1.32**

Woodbine, GA

- Operating Revenue (1): $444,231
- Operating Expenses (2-3) (excluding depreciation): $368,985
- P & I (4): $84,783
- **Debt Service Coverage Ratio: 0.89**

Quick Ratio

$$= \frac{Quick\ Assets\ (unrestricted, excluding\ Inventories\ and\ Prepaid\ Items)}{Current\ Liabilities}$$

Natural Benchmark: >1

Accepted Benchmark: > 2

A measure of short-term liquidity: ability to pay your current bills

A Tale of Two Systems

Helen, GA

- Current Unrestricted Assets (5): $634,407
- Current Liabilities (6): $898,474
- **Quick Ratio: 0.71**

Woodbine, GA

- Current Unrestricted Assets (5): $326,000
- Current Liabilities (6): $108,390
- **Quick Ratio: 3.01**

Days Cash on Hand

$$= \frac{Unrestricted\ cash\ and\ cash\ equivalents \times 365}{Operating\ Expenses - Depreciation}$$

Benchmark? At the very least, enough to last a billing cycle or when you expect a substantial inflow of cash

A measure of the ability of the utility to weather a significant temporary reduction in revenue to continue paying for daily operations

A Tale of Two Systems

Helen, GA

- Unrestricted cash & cash equivalents (7): $568,061
- Operating Expenses (2-3) (excluding depreciation): $459,082
- **Days Cash on Hand: 452**

Woodbine, GA

- Unrestricted cash & cash equivalents (7): $284,130
- Operating Expenses (2-3) (excluding depreciation): $368,985
- **Days Cash on Hand: 281**

Asset Depreciation*

$$= \frac{Accumulated\ Depreciation}{Gross\ Plant\ and\ Equipment}$$

Benchmark? Don't get close to 1.0

A measure of how much of your total assets have already depreciated. As you approach 1.0, your system is near the end of its expected life.

*Caveat – This indicator is only as good as your depreciation schedule and even then historic pricing is likely to distort the results.

A Tale of Two Systems

Helen, GA

- Accumulated depreciation (8): $2,670,974
- Total Capital Assets (9): $7,480,208
- **Asset Depreciation: 36%**

Woodbine, GA

- Accumulated depreciation (8): $2,514,933
- Total Capital Assets (9): $6,246,472
- **Asset Depreciation: 40%**

Transfers to the General Fund

- Generally, your water system should not be subsidizing the tax base and vice versa
- However, if you receive services from the local government, it is appropriate for you to pay for them (partial time of town manager, attorney, payroll services, public works to re-pave roads, etc.)
- PILOTS

Why Care About This?

- Setting rates and financial planning: as you think about the future needs of your system, you have to know where you are starting from
- Monitor system's financial performance to detect any negative trends (long-term)
- Funders care about these ratios → lower interest rates
- Accountable to your customers

Debt Ratios

FitchRatings Public Finance

Appendix F: 2013 Medians Relative to Rating Category

	Rating Category			
	AAA	AA	A	All Credits
Total Outstanding Long-Term Debt Per Customer ($)[a]	1,213	1,828	1,951	1,650
Total Outstanding Long-Term Debt Per Capita ($)[a]	352	492	521	460
Projected Debt Per Customer Year Five ($)[a]	1,583	2,117	2,354	2,024
Three-Year Historical Average All-In ADS Coverage (x)[a]	2.3	2.0	1.4	2.0
All-In ADS Coverage (x)[a]	2.7	1.9	1.5	2.0
Operating Margin (%)	37	39	45	39
Days Cash on Hand[a]	427	418	285	417
Days of Working Capital[a]	430	390	250	373
Quick Ratio	3.4	3.0	2.6	3.1

Soooooo....

- Once we figure out where we are, how do we know where we are going?

- How do we estimate the future costs and revenues?