



June 8, 2010

2:00 – 3:40 pm

Forecasting in Uncertain Times

Moderator: **Mickie Pearsall**
Milwaukee Metropolitan Sewerage District

Speakers: **Susan Parker**
City of Rochester Public Utilities

Steven Kreklow
County of Milwaukee

James M. Hurley
DC Government



Presented by: Susan Parker
City of Rochester Public Utilities, MN



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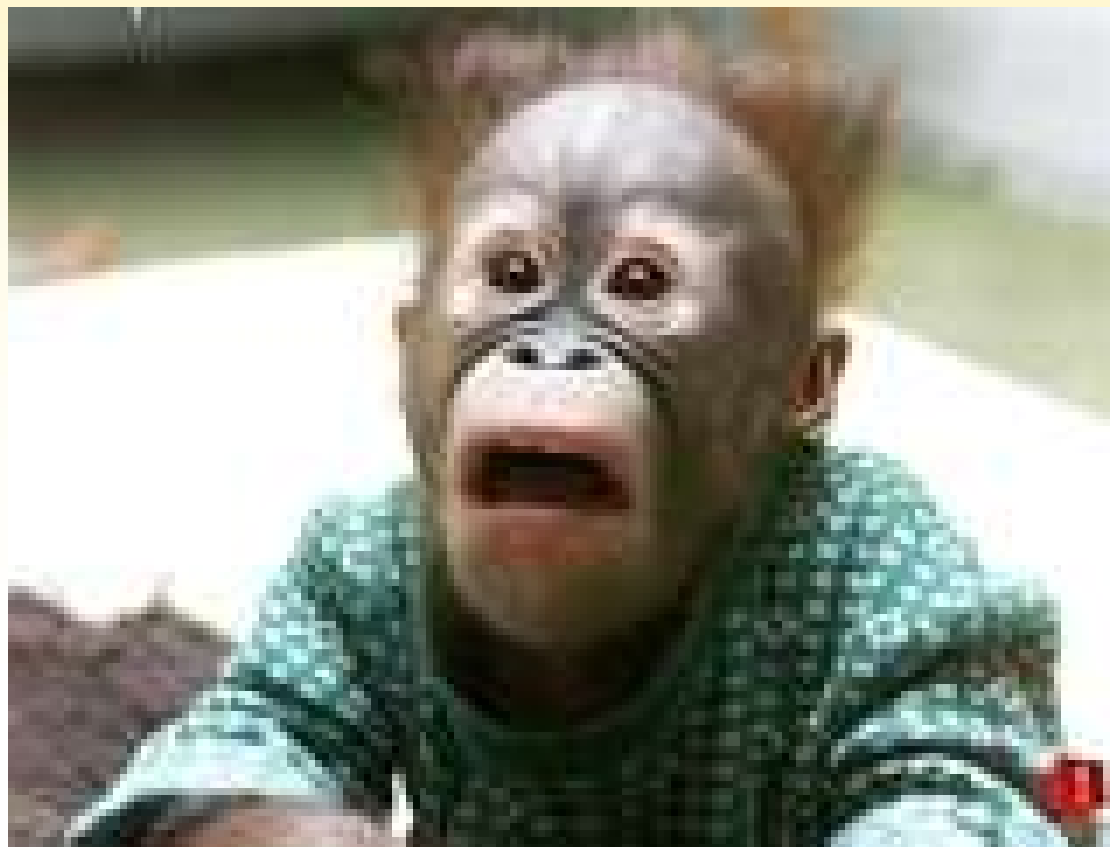


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VISION: We will set the standard for service.

CORE VALUES: Safety • Integrity • Service • Stewardship • Accountability • Skill

Why Use Scenario Planning



To avoid looking like this!

What is Scenario Planning?

- Scenario planning is a type of strategic planning specifically designed to deal with major, uncertain shifts in the our business environment
- It is not about predicting the future; instead it helps you plan for what is possible and plausible
- The challenge comes in determining how to respond or “deal” with each scenario
- Purpose is to imagine scenarios and determine actions before you are in the heat of the battle

Why and When to Use Scenario Planning

Why?

1. Managers are better able to understand the drivers of the business and its impact
2. Decision-makers are able to recognize the scenario in its early stages with pre-determined actions
3. Provides greater agility in decision making
4. Reinforces risk management over risk avoidance

Why and When to Use Scenario Planning

When?

1. When a great deal of uncertainty is present in your business drivers or environment
2. When you need to be able to respond quickly once a scenario is being realized
3. When you cannot afford to overlook a serious business risk; scenario planning is designed to deal with major, uncertain shifts in the business environment

About Rochester & RPU

- Rochester is located about 75 miles south of Minneapolis/St Paul
- Rochester is the third largest city in Minnesota with an estimated population of 101,000
- RPU is the largest community owned utility in Minnesota
- Governance – Utility Board and Council
- RPU serves approximately 49,000 customers
- Two largest customers comprise 19% of our revenue base; Mayo Clinic and IBM
- Retail revenue mix is about 30/70 between residential and commercial base
- RPU participates in the wholesale electric market

Impact of Economic Downturn

- As the 2009 budget and rates were being approved the financial market was collapsing
- Rochester growth of 1.5% to 2% halted
- The largest employer, Mayo Clinic, announced immediate operating budget cuts and no capital investments
- Other employers began to announce layoffs
- Wholesale electric market became almost non-existent

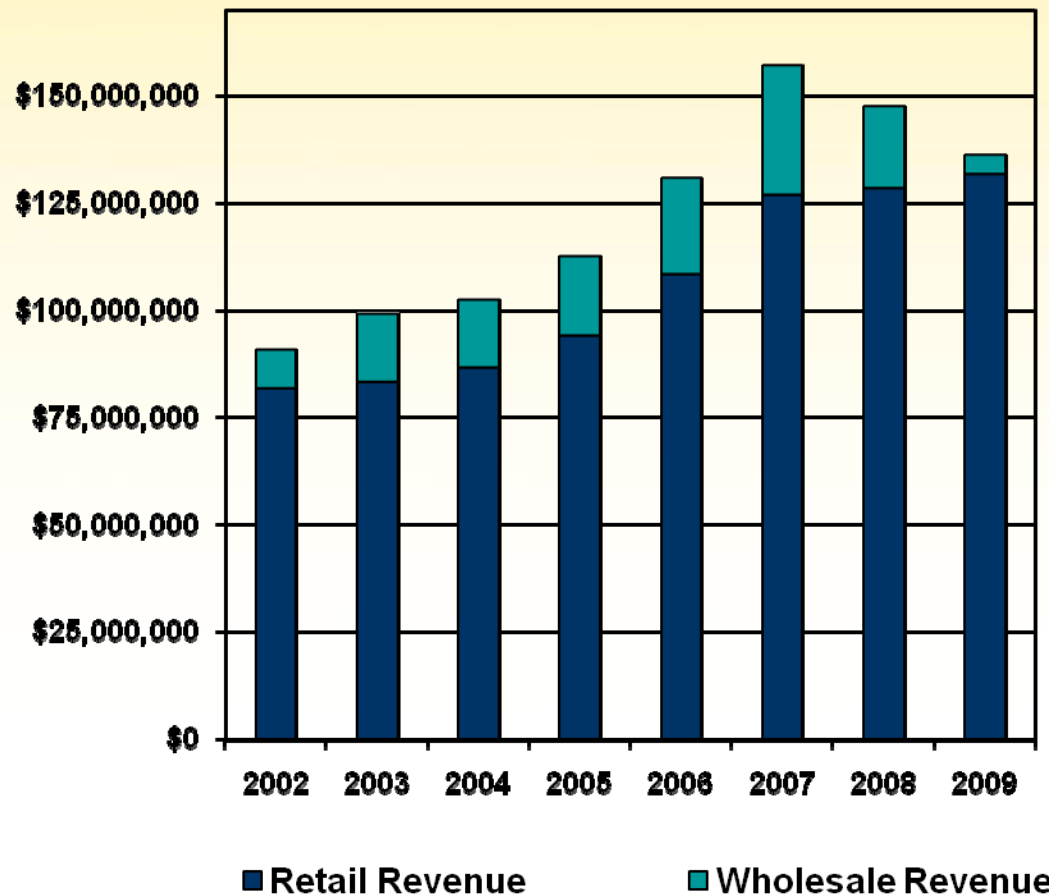
Our Political Environment

- Citizens testified against increases in property taxes
- City Council approval of the 2009 rate increase was difficult
- Deficits in the State budget were passed along to cities and counties through decreases in aid
- Legislation to reduce energy sales by 1.5% of KWhs sales per year
- Labor concessions were already being discussed

Uncertainty of Major Business Drivers

- Wholesale provider rate increases
- Retail revenue market
 - Commercial customers reducing production
 - No new investment in business community
 - Housing growth was almost non-existent
 - Foreclosures at all time high
- Wholesale market revenue
 - MISO market
 - Revenues decreased from high of \$30 million in 2007 to \$4.5 million in 2009



Retail & Wholesale Revenue Trend



Wholesale revenue as a percent of total:

2009 – 3.3%
2008 – 13.0%
2007 – 19.1%
2006 – 17.2%
2005 – 16.4%
2004 – 15.5%
2003 – 15.8%
2002 – 9.7%

The Situation

Driver	Impact
Move from budgeted 4.7% rate increase to 0% rate increase	\$5.6 Million
 Revenue decrease in Wholesale and Retail Markets	\$6.2 Million
 Power Supply Expense Increase	\$3.6 Million
Bottom Line: Budget Case was off by 8% due to unforeseen economic and political conditions.	<u>\$15.4 Million</u>

Process

Six Steps:

1. Determine change drivers
2. Determine what we call “stake in the ground”
3. Define 3 – 5 scenarios with magnitude of each driver
4. Determine key actions in each scenario to maintain “stake”
5. Prioritize activities
6. Develop consistent communication plan and monitor

Process

1. Determine change drivers:

- Revenue drivers
- Expense drivers
- Debt impacts
- Cash reserve targets

2. Determine what we call the “stake in the ground”

- No rate increase to our customers

Process

3. Define 3 to 5 scenarios with magnitude of change of each driver

- Budget case (\$5 million reduction)
 - \$5 million in reductions in achieved plus \$1 million in 2010
 - Sales into wholesale market are at 50% of budget
 - No change in gas turbine sales
 - Rate increase from wholesale provider at only 4%
- Likely case (additional \$3 - \$4.5 million)
 - \$4 million in reductions achieved
 - Sales into wholesale market are at 25% of budget
 - Rate increase from wholesale provider at 6%
- Worst case (total reduction of \$15 million)
 - \$3 million in reductions achieved with \$3 million increase in 2010
 - Reduction in wholesales to 10% of budget
 - Rate increase from wholesale provider at 8%

Process

4 and 5. Determine key actions by scenario and prioritize:

Stake in the ground = 0% rate increase

- Budget case (\$5 million total reduction target)
 - \$2.9 million reduction in capital and major maintenance
 - \$1.36 million reduction in operating budgets
 - \$1.0 million challenge to staff for reductions
- Likely case (Additional \$3 - \$4.5 million reduction)
 - \$3.5 million in financing of long-term assets
 - \$300k - \$400K furlough program
- Worst case (total reduction of \$15 million from 09 budget)
 - \$1 million further reduction in capital and major maintenance
 - Remove all temporary and contract labor
 - Reduction in labor costs (10%) by \$1.4 million
 - Implement Energy Adjustment charge
 - Rate Increase

Best, Likely & Worst Case

(Change - Better / (Worse) from 2009 Budget Cycle

	Budget		Scenario 1 - Best		Scenario 2 - Likely		Scenario 3 - Worst	
	2009	2010	2009	2010	2009	2010	2009	2010
Assumptions			\$4M budget reductions and \$1.0M challenge are achieved. \$1M in 2010. SLP 50% of Budget. No change in CCGT. 4% SMMPA rate increase in 2010		\$4M budget reductions are achieved. SLP 25% of Budget. No change in CCGT. 4% SMMPA rate increase in 2010		\$3M in budget reductions, \$3M increase in 2010. SLP 10% of Budget. CCGT 50% of budget. 4% SMMPA rate increase in 2010	
Retail Gross Margin	39,812	42,853	(\$339)	(\$5,800)	(\$2,390)	(\$9,288)	(\$4,317)	(\$13,303)
Wholesale Gross Margin	\$8,949	\$9,720	(\$4,520)	(\$5,484)	(\$4,642)	(\$3,427)	(\$4,701)	(\$5,468)
Salaries & Benefits	\$19,458	\$20,522	\$500	\$500	\$579	\$134	\$500	(\$500)
Other Operating Expenses	\$10,641	\$10,622	\$1,660	\$660	\$322	\$498	\$660	(\$660)
Major Maintenance	\$2,253	\$3,094	\$758	\$0	\$608	\$158	\$0	\$0
Non-Bonded Capital Projects	\$8,422	\$6,744	\$2,208	\$0	\$1,607	\$914	\$1,832	(\$1,832)
Total Controllable Costs	\$40,773	\$40,982	\$5,126	\$1,160	\$3,116	\$1,704	\$2,992	(\$2,992)
Nonoperating Expenses			\$2,296	\$654	\$2,296	\$654	\$2,296	\$654
Other Increases/(Reductions) to Cash Debt Proceeds, net of debt service			\$0	\$0	\$0	\$0	\$0	\$0
Power Supply Adjustment								
Impact on Cash Target			\$2,563	(\$6,906)	(\$1,620)	(\$11,977)	(\$6,026)	(\$27,135)
Cash Forecast before Rate Increase	\$29,500	\$35,320	\$32,063	\$28,414	\$27,880	\$23,343	\$23,474	\$8,185
Proposed % Rate Increase			n/a	0%	n/a	0.0%	n/a	0%
Proposed \$ Rate Increase				\$0		\$0		\$0
Cash Forecast after Rate Increase	\$29,500	\$35,320	\$32,063	\$28,414	\$27,880	\$23,343	\$23,474	\$8,185
Cash Target per Board Policy	\$32,600	\$35,000	\$32,600	\$35,000	\$32,600	\$35,000	\$32,600	\$35,000
Forecast Above (Below) Target	(\$3,100)	\$320	(\$537)	(\$6,586)	(\$4,720)	(\$11,657)	(\$9,126)	(\$26,815)
Projected Cash % of Board Policy			98%	81%	86%	67%	72%	23%

Process

6. Develop communication plan and monitor

- Communicate plan and results to stakeholders
- Monitor results against forecast and budget
- Be prepared to move from one scenario to another

Our Success Story

- Began early and identified worst case drivers
- No rate increase for the electric customers despite a 4% wholesale power increase or \$3.6 million
- Successfully reduced budget shortfall of about \$11.4 million without compromising reliability, safety or financial stability
- Maintained cash reserves within specified range
- Maintained debt service coverage of 2.5
- Engaged our employees
- Communicated the scenarios with employees and stakeholders

Keys to Success

- Begin early and be prepared to move quickly
- Engage the right experts
- It is not an exact science; be flexible
- Engage everyone to participate - \$1 million challenge
- Communication to stakeholders
 - Community
 - Employees
 - Rating Agencies
- Integrity during the process is important for success



Forecasting in Uncertain Times

2010 GFOA Conference

Presented by: Steven Kreklow
County of Milwaukee, WI





Uncertain Times in Milwaukee County

Challenges to Effective Strategic Financial Planning:

- ✦ Stubborn Structural Deficit
- ✦ Impacts of the Economic Downturn
- ✦ Challenging Political Environment
- ✦ Credibility Gap
- ✦ Budget Reduction Fatigue



Stubborn Structural Deficit

- ✦ Model of Fiscal Health and Stability through the 90's.
- ✦ Structural Deficit Developed 2000-02
- ✦ Deficit Drivers:
 - ✦ Unfunded Pension Liability
 - ✦ Employee/Retiree Health Care
 - ✦ Flat/Declining Federal and State Revenues
- ✦ Early Actions Made the Deficit Worse



Economic Downturn: Impacts of the Great Recession

- ✦ Unfunded Pension Liability Increased from \$300 million to \$400 million.
- ✦ 10% Decline in Sales Tax Collection – What's the new base?
- ✦ Major Declines in real estate transfer fees, earnings on investments and other revenues.



Political Environment

- ✦ Low Levels of Trust
- ✦ High Levels of Partisanship and Interest Group Involvement
- ✦ Intense Public Scrutiny – Watchdog Media



Credibility Gap

- ✦ Difficult to Accept Change
- ✦ Multiple Review of County Finances
 - ✦ Reality (Gloom and Doom) Tour
 - ✦ Greater Milwaukee Committee
 - ✦ Governor's Task Force
 - ✦ Public Policy Forum

Goal of the Forecasting Process: Acceptance...Understanding...Consensus



Resisting Reality

Denial



Anger



Bargaining



Depression



Acceptance



Process Does Matter

- ✦ Flexible, Easy-to-Use Software - Municast
- ✦ Broad Participation in Work Group
- ✦ Painstaking Review of Data and Assumptions
- ✦ Consensus Based Baseline Scenario
- ✦ What-if? Capabilities for Policy Analysis



“Policy-Neutral” Structural Deficit

- ✦ Assumed Continuation of Status Quo
- ✦ Data-driven Revenue/Expense Forecast
- ✦ Budget Balanced Annually with One-Time Fixes
- ✦ Measure Impact of Policy Changes Using “What-If?” Capabilities



Acknowledged the Good, the Bad and the Ugly

- ✦ Highlighted the Positive and Reasons for Optimism
- ✦ Identified Impact of Decisions that Worsened the Gap
- ✦ Didn't Sugarcoat the Magnitude of the Problem



Key Lessons Learned

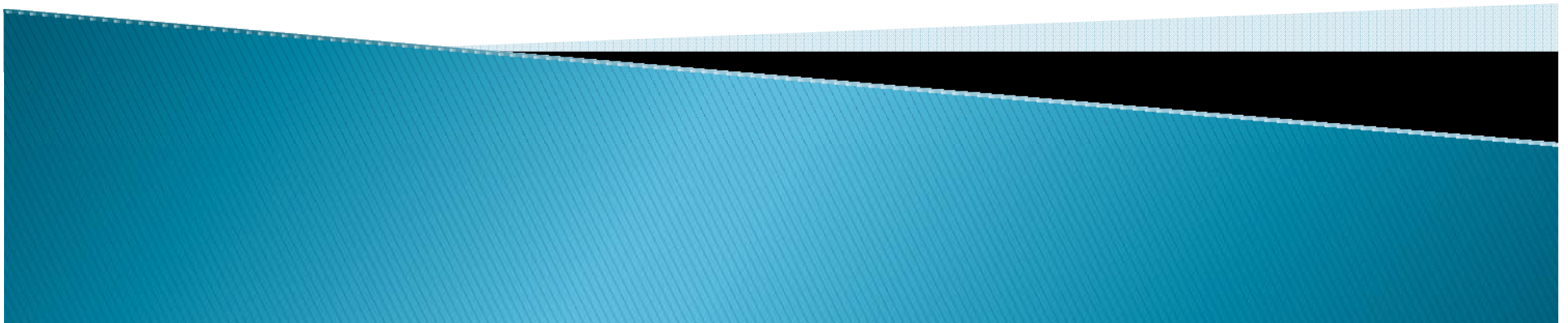
1. Developing a forecast that is *used* requires **consensus**.
2. **Transparency** is critical and requires more time.
3. De-politicize the forecast by making it **policy neutral**.
4. Use the process to build **relationships** and enhance credibility.

Transparency in Budgeting

The Revenue Side

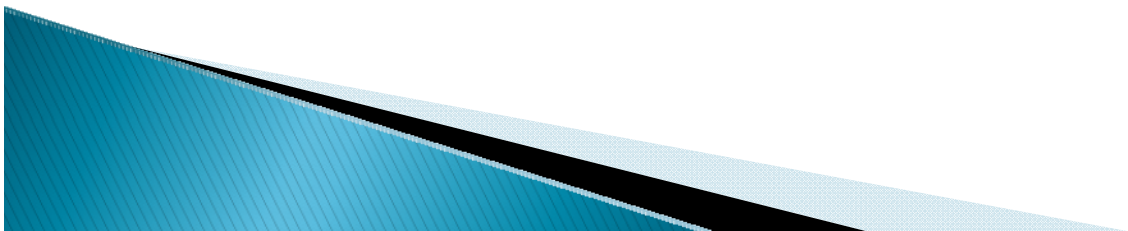
By Dr. James M. Hurley

GFOA Conference – June 8, 2010



Stress On Public Budgeting

- ▶ Great Recession and Declining Revenues
- ▶ Hidden Problems and Structural Deficits Revealed
- ▶ Limitations of Existing Revenue Systems
- ▶ Rethinking Revenue Plans



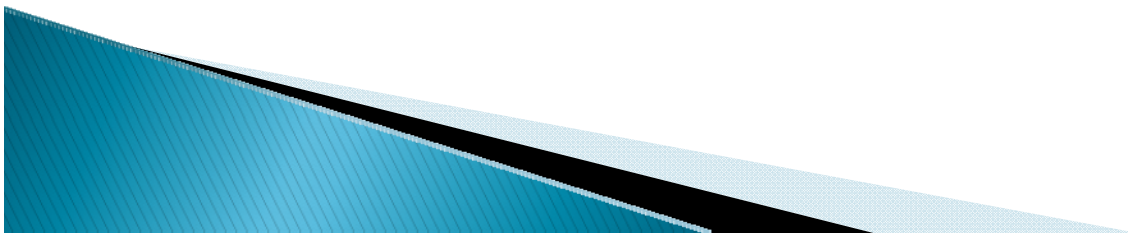
State and Local Governments

- ▶ States Continue to Face the Impact of the Great Recession
- ▶ State Tax Collections Have Declined for 4 Consecutive Quarterly (largest – 10.9% , 16.4%, and 11.6%)
- ▶ Pension Plans Operating Under a Deficit of at least \$ 1 Trillion.



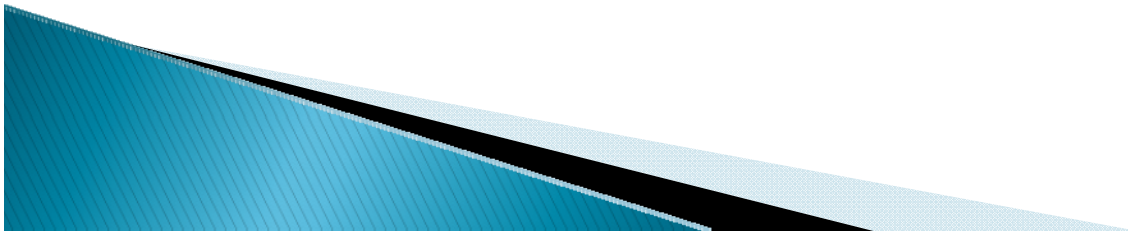
Medicaid Growth

- ▶ FY 2009 Spending was \$ 335 Billion (an increase of 7.8% over previous year).
- ▶ Enrollment Grew by 5.4% in FY 2009 and will Grow another 6.6% in FY 2010.



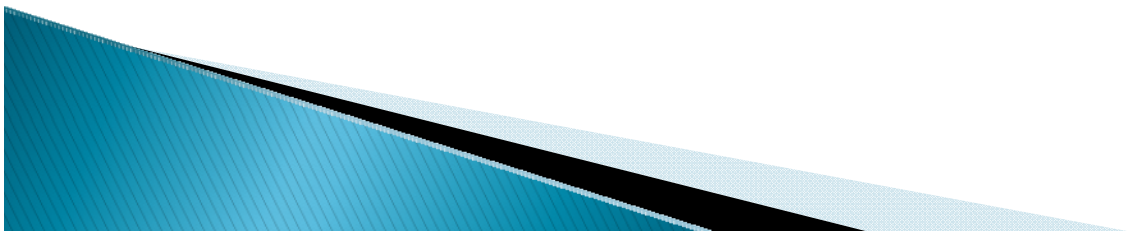
Local Governments

- ▶ Budget Shortfalls Worse than Anticipated
- ▶ Financial Crisis has had a Massive Impact on Operations
- ▶ Many Face Trouble Borrowing Through Traditional Means



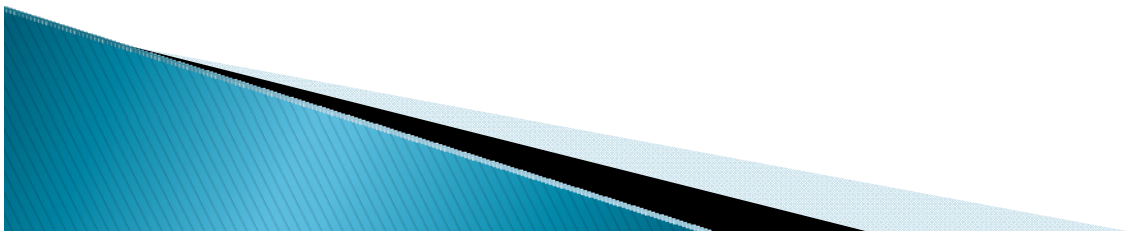
Revenue Systems

- ▶ Revenue Governed by Growth in Economic Activity and Not Service Levels
- ▶ Service Level Demands Can Increase or Remain the Same as Revenues Decrease
- ▶ Need to Reexamine Revenue Options and Move to More Sustainable Systems



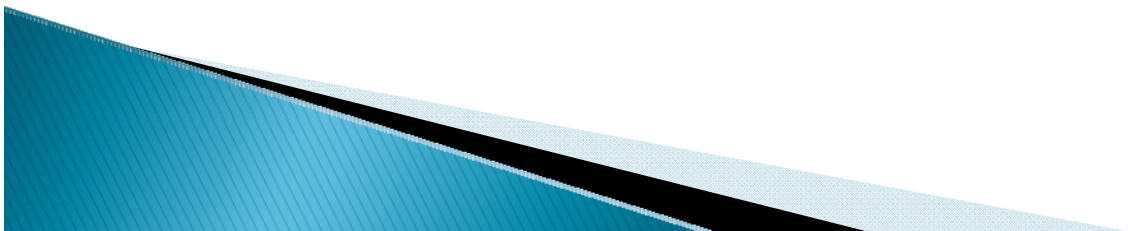
Public Budgeting

- ▶ “Who Gets What and Who Pays For It”
- ▶ “A budget is a series of goals with price tags.”
- ▶ “A budget reflects citizens’ preferences for different forms and levels of taxation, as well as the ability of some groups of taxpayers to shift the tax burden to others.”



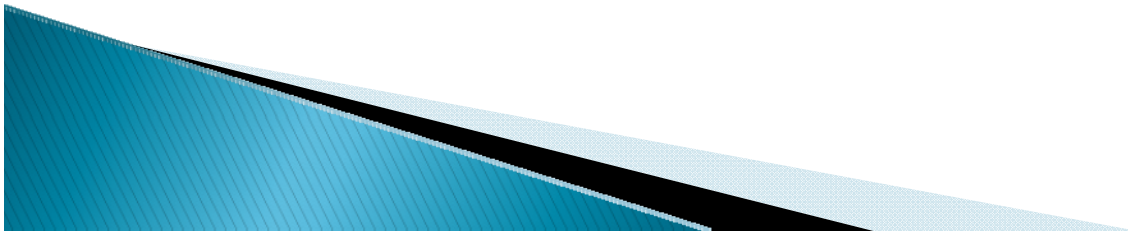
Transparency in Budgeting

- ▶ Openness and Honesty
- ▶ Easy to Understand Formats
- ▶ Communications with Stakeholders
- ▶ Accountability to Citizens



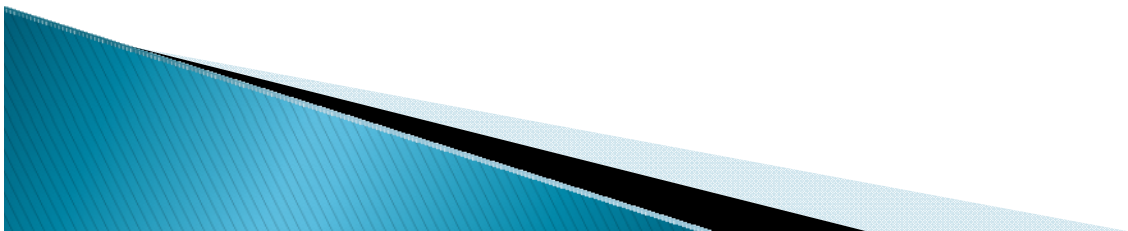
Revenue Side of the Budget

- ▶ How Money is Raised is as Important as How it is Spent
- ▶ Citizens Should Know More About Who Is Paying for Public Services and How Much They Pay



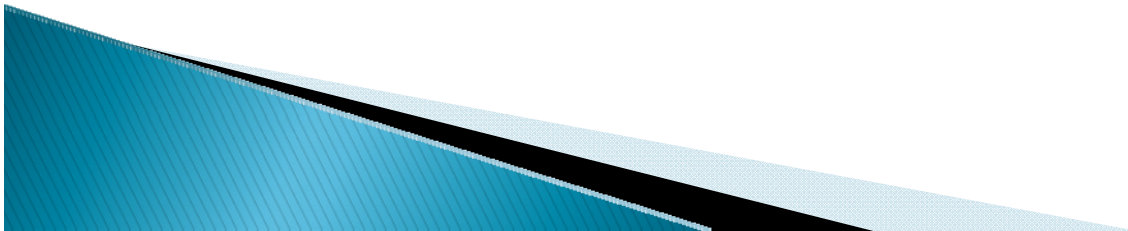
Changes in Revenue Presentations

- ▶ Move Beyond Just Forecasting Revenue by Sources
- ▶ Focus on Revenue Per Household
- ▶ Link Dollars Collected to Benefits Received



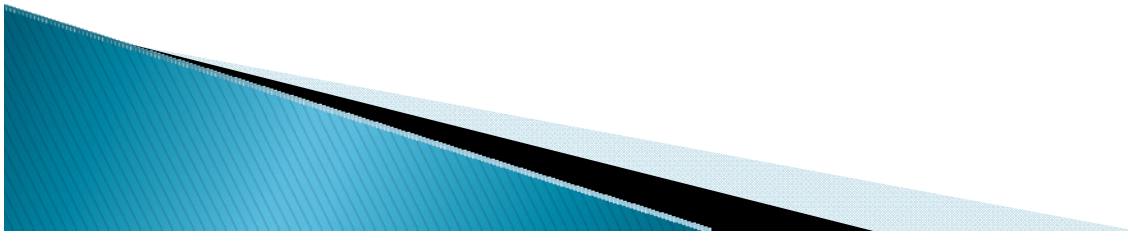
More Attention On Several Areas

- ▶ Present Fiscal Incidence Analysis
- ▶ Examine Tax Expenditures
- ▶ Explain Fund Balances



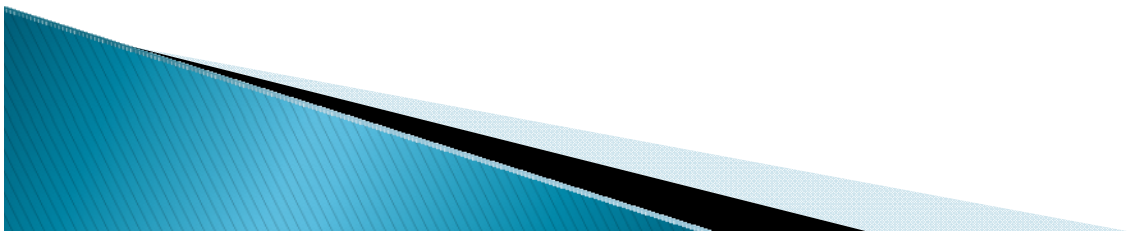
More Attention on Several Areas

- ▶ Indicate Underlying Assumptions Regarding Revenue Forecast
- ▶ Disclose Tax Gap



Fiscal Incidence Analysis

- ▶ Amount a Household Pays in Taxes and Fees Compared to Amount the Household Receives in Government Benefits
- ▶ Amount Each Household Pays for Public Services and the Actual Cost of Providing Those Services



Incidence Analysis

- ▶ Distribution of the Tax Burden Among Income Groups
- ▶ Distribution of Government Spending Benefits
- ▶ Net Outcome: Burden Compared to Benefits

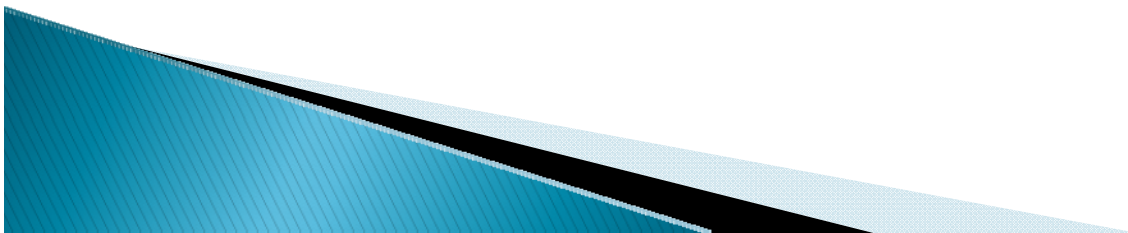
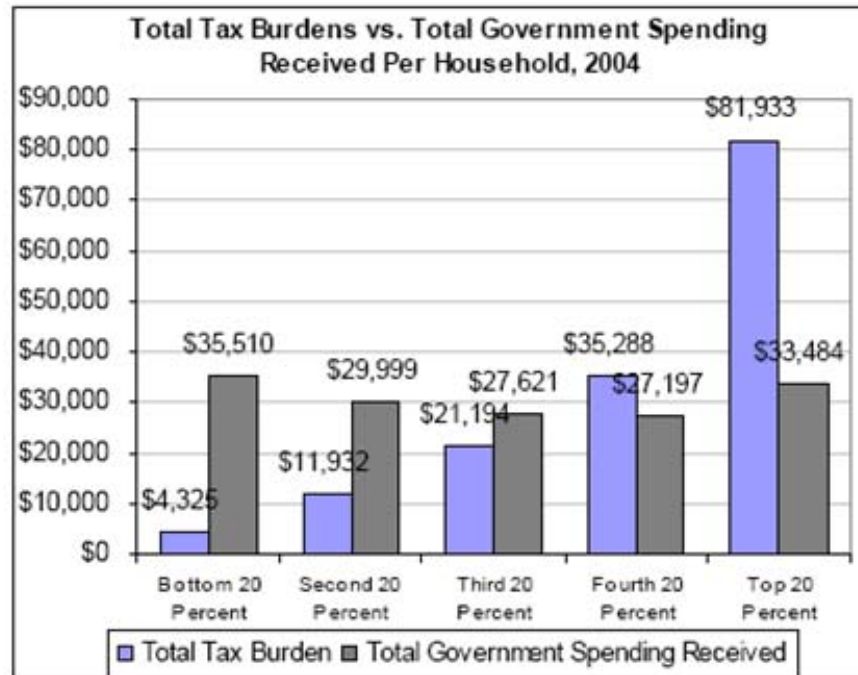


Figure 7. Total Tax Burdens Per Households Compared to Government Spending Received Per Household, Calendar Year 2004



Source: Tax Foundation

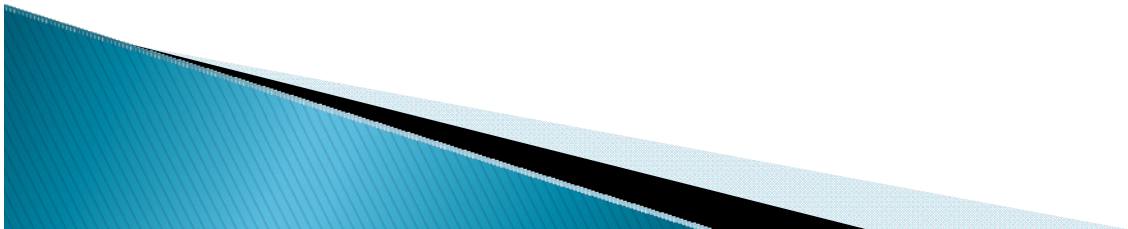
Table 8. Total Tax Burden Per Household Compared to Government Spending Received Per Household, With and Without Public Goods, Calendar Year 2004

	Quintiles of Household Cash Money Income, Calendar Year 2004				
	Bottom 20 Percent	Second 20 Percent	Third 20 Percent	Fourth 20 Percent	Top 20 Percent
Total Tax Burden	\$4,325	\$11,932	\$21,194	\$35,288	\$81,933
Total Government Spending Received	\$35,510	\$29,999	\$27,621	\$27,197	\$33,484
Excluding Public Goods	\$27,361	\$21,849	\$19,471	\$19,047	\$25,335

Source: Tax Foundation

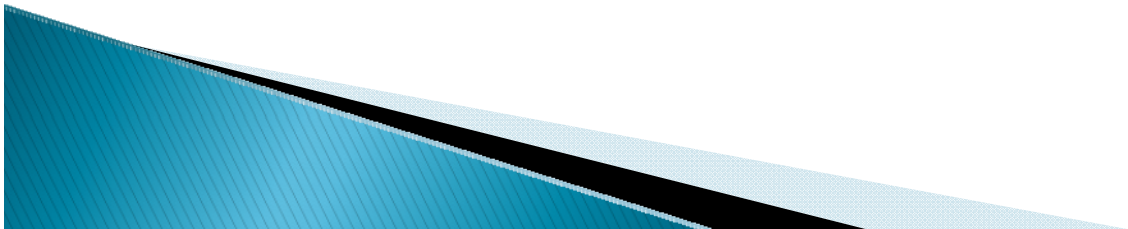
Tax Expenditures

- ▶ Tax Expenditures are Revenue Losses Attributable to Tax Law Provisions
- ▶ Tax Law is Being Used to Promote Social Goals without Incurring Direct Expenditures



Tax Expenditures

- ▶ Tax Expenditures Tend to be Off the Radar
- ▶ Like Entitlement Programs They Often have Built in Escalation Factors
- ▶ At the Federal Level They Were Worth More than \$ 1 Trillion to Recipients Last Year



State and Local Tax Expenditures

- ▶ Need for Public Review and Approval on Regular Basis
- ▶ Breakdown of Who Benefits and Value of Benefits
- ▶ Legislation should Required Periodic Reauthorization of Tax Expenditures

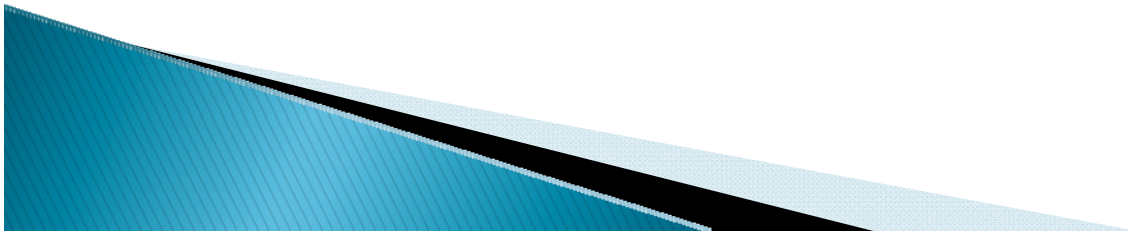


Table 4-22 (continued)
District of Columbia Tax Expenditure Estimates for FY2010-2013

#	Name	Program Area	Year Enacted	D.C. Code Section	Revenue Forgone (\$ in thousands)			
					FY 2010	FY 2011	FY 2012	FY 2013
PROPERTY TAX								
Exemptions (cont)								
150	Federal government property	General law	1942	§ 47-1002(1)	\$629,330	\$629,330	\$629,959	\$630,589
151	Hospital buildings	Health	1942	§ 47-1002(9)	\$14,434	\$14,434	\$14,448	\$14,463
152	Homestead exemption	Housing	1978	§ 47-850	\$40,833	\$41,241	\$41,654	\$42,070
153	Historic property	Housing	1974	§ 47-842 - § 47-844	\$336	\$311	\$299	\$302
154	Multi-family and single-family rental and cooperative housing for low- and moderate-income persons	Housing	1978	§ 47-1002(20)	\$15,539	\$15,694	\$15,851	\$16,010
155	Qualifying lower-income homeownership households and cooperative housing associations	Housing	1983	§ 47-3503	\$1,295	\$1,308	\$1,321	\$1,334
156	Nonprofit housing associations	Housing	1983	§ 47-3505	\$9,064	\$9,155	\$9,246	\$9,339
157	Resident management corporations	Housing	1992	§ 47-1002(24)	\$0	\$0	\$0	\$0
158	Embassies, chanceries, and associated properties of foreign governments	International affairs	1942	§ 47-1002(3)	\$34,032	\$34,032	\$34,086	\$34,100
159	Correctional Treatment Facility	Public safety	1997	§ 47-1002(25)	\$784	\$784	\$784	\$784
160	Art galleries	Social policy	1942	§ 47-1002(6)	\$2,362	\$2,362	\$2,365	\$2,409
161	Churches, synagogues, and mosques	Social policy	1942	§ 47-1002(12)	\$56,324	\$56,324	\$56,360	\$56,437
162	Cemeteries	Social policy	1942	§ 47-1002(12)	\$4,573	\$4,573	\$4,578	\$4,582
163	Properties of charitable organizations	Social policy	1942	§ 47-1002(6)	\$13,531	\$13,531	\$13,545	\$13,558
164	Headquarters buildings of tax-exempt organizations	Tax administration and equity	1942	§ 47-1002(17)	included in #163	included in #163	included in #163	included in #163
165	Grounds belonging to tax-exempt organizations	Tax administration and equity	1942	§ 47-1002(16)	included in #163	included in #163	included in #163	included in #163
166	Properties owned by the Washington Metropolitan Area Transit Authority	Transportation	1966	§ 9-1107.01	\$6,626	\$6,626	\$6,633	\$6,639
Credits								
167	First-time homebuyer credit for D.C. government employees	Employment	2000	§ 42-2506	\$351	\$363	\$419	\$413
168	Credit for senior citizens and persons with disabilities	Housing	1996	§ 47-863	\$5,781	\$5,784	\$5,842	\$5,900
169	Assessment increase cap	Housing	2001	§ 47-864	\$151,059	\$151,135	\$152,646	\$154,173
170	Condominium and cooperative trash collection	Natural resources and environment	1990	§ 47-672 (condominiums) and § 47-673 (cooperatives)	\$4,882	\$4,931	\$5,029	\$5,130
171	Brownfield revitalization cleanup	Natural resources and environment	2001	§ 6-637.01	\$0	\$0	\$0	\$0

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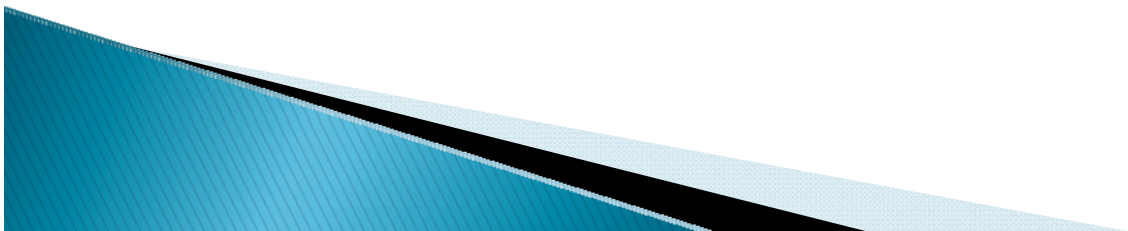
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District of Columbia Tax Expenditure Estimates for FY2010-2013

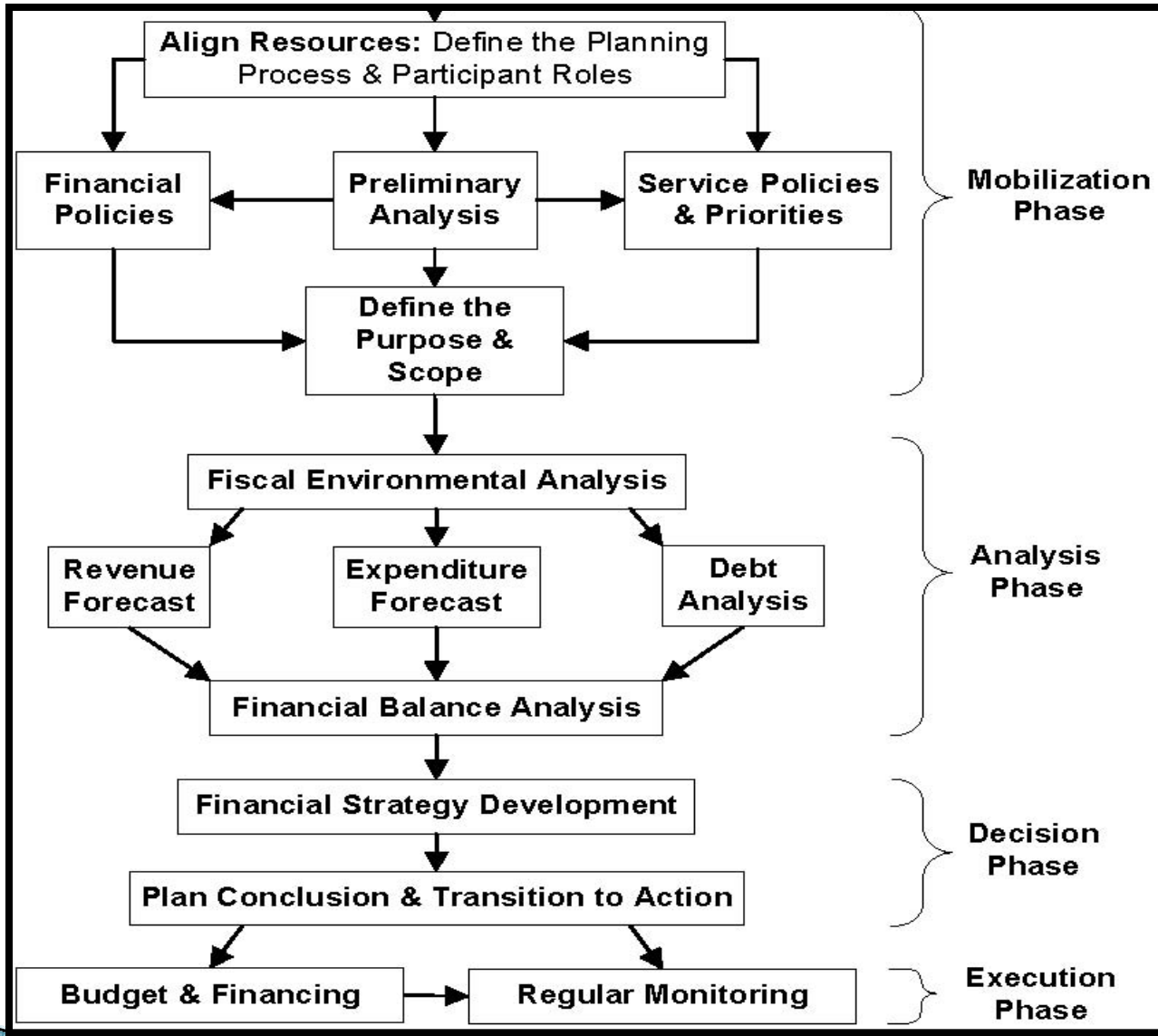
#	Name	Program Area	Year Enacted	Section of Internal Revenue Code	Revenue Forgone (\$ in thousands)			
					FY 2010	FY 2011	FY 2012	FY 2013
INCOME TAX								
Federal Exclusions								
1	Exclusion of interest on state and local "private-activity" bonds issued to support airport, dock and similar facilities	Economic development	1968	103, 141, 142, and 146	\$1,711	\$1,711	\$1,711	\$1,906
2	Credit union income	Economic development	1951	501(C)(14)	\$817	\$868	\$919	\$919
3	Magazine, paperback, and record returns	Economic development	1978	458	too small	too small	too small	too small
4	Cash accounting, other than agriculture	Economic development	1916	446 and 448	\$966	\$996	\$1,085	\$1,085
5	Structured settlement accounts	Economic development	1962	104(A)(2) and 130	too small	too small	too small	too small
6	Exclusion of step-up basis of capital gains at death	Economic development	1921	1001, 1002, 1014, 1015, 1023, 1040, 1221, 1222	\$20,616	\$25,466	\$30,641	\$32,965
7	Earnings of certain environmental settlement funds	Economic development	2005	468B	too small	too small	too small	too small
8	Imputed interest rules	Economic development	1964	163(e), 483, 1274, and 1274A	\$395	\$493	\$493	\$592
9	Exclusion of interest on state and local "private-activity" bonds issued to support education	Education	1966	144,150,145,501(C)(3)	\$4,938	\$5,133	\$5,378	\$5,378
10	Exclusion of interest on savings bonds redeemed to finance educational expenditures**	Education	1968	135	\$23	\$23	\$23	\$23
11	Exclusion of scholarship and fellowship income	Education	1954	117	\$1,170	\$1,232	\$1,294	\$1,356
12	Employer-provided educational assistance	Education	1978	127	\$554	\$554	sunset	sunset
13	Coverdell education savings accounts	Education	1998	530	\$115	\$115	\$230	\$230
14	Qualified tuition programs	Education	1997	529	\$576	\$691	\$922	\$1,268
15	Discharge of certain student loan debt	Education	1964	108(f), 20 U.S.C. 1087ee(a)(5) and 42 U.S.C. 2541-1(g)(3)	\$115	\$115	\$115	\$115
16	Spread on acquisition of stock	Employment	1961	422 and 423	-\$218	-\$218	-\$317	-\$407
17	Cafeteria plan benefits	Employment	1974	125	\$25,547	\$28,215	\$30,479	\$32,823
18	Employer-paid meals and lodging (other than military)	Employment	1916	119 and 132(e)(2)	\$808	\$889	\$889	\$933
19	Employee stock ownership plan	Employment	1974	133, 401(a)(2)(B), 404(a)(9), 404(k), 415(c)(6), 1042, 4975(e)(7), 4978, and 4979A	\$966	\$1,017	\$1,017	\$1,068
20	Employee awards	Employment	1966	74(c) and 274(j)	\$162	\$162	\$162	\$162
21	Voluntary employees' beneficiary associations	Employment	1928	419, 419A, 501(a), 501(c)(9), 4976	\$1,536	\$1,698	\$1,858	\$1,858

(Continued on next page)

Long-Term Financial Planning

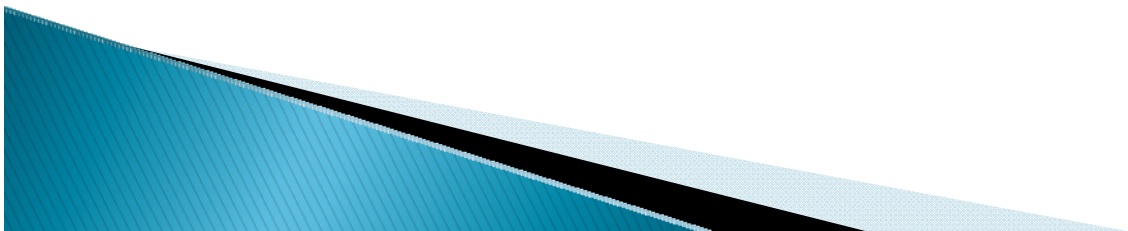
- ▶ A Process for Aligning Financial Capacity with Long-term Service Objectives
- ▶ Should Promote Strategic Thinking
- ▶ Should Produce Clear Strategies for Achieving Long-term Sustainability





Analysis Phase Should Include

- ▶ Fiscal Incidence
- ▶ Tax Expenditures
- ▶ Fund Balance
- ▶ Forecast Assumptions
- ▶ Tax Gap



Implications For Stakeholders

- ▶ Elected Leaders Need Better Information For Better Decision Making
- ▶ Citizens Need to Have A Full Understanding of the Impact of Budget Proposals
- ▶ Investors and Rating Agency Need Additional Insight Regarding Revenue Capacity

