

MADISON WATER UTILITY

MANAGEMENT'S DISCUSSION AND ANALYSIS December 31, 2016 and 2015

GENERAL INFORMATION ABOUT MADISON WATER UTILITY

Madison recognized the need for a central water supply early in its history. The common council of the City of Madison (municipality) directed its waterworks committee to establish the Madison Waterworks on September 5, 1881. Financing was obtained and contracts let in spring of 1882. Pumping commenced on December 7, 1882. Early management was vested in the common council through its committee, and on March 2, 1884, general management was transferred to a Board of Water Commissioners. The Madison Waterworks achieved department status in the early 1960's and, at that time, became the Madison Water Utility (utility) under a General Manager leadership with a Water Utility Board that continues today.

The utility has always been a groundwater system in spite of being surrounded by lakes. The utility currently has 22 deep wells with a capacity of 68 million gallons per day. In common with other Wisconsin water utilities, the Public Service Commission of Wisconsin (PSCW) regulates the utility in matters of rates, rules and levels of service.

2016 FINANCIAL HIGHLIGHTS

- > Total revenues increased \$6.0 million or 20.5% from 2015 to 2016, while pumpage decreased 1.2%. In September 2015, the utility implemented a rate increase which increased revenue.
 - > Income before capital contributions and transfers increased \$4.8 million or 139.6% from the prior year. The increase was due to the \$6.0 million increase in revenue and higher depreciation, non-operating expense and operation & maintenance expense.
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2015 FINANCIAL HIGHLIGHTS

- > Total revenues decreased \$.4 million or 1.2% from 2014 to 2015, which is a smaller decrease than the utility's decrease (-5.69%) in pumping during 2015.
- > Income before capital contributions and transfers decreased \$1.3 million or 26.7% from the prior year. The decrease was due to the \$400,000 decrease in revenue and higher depreciation, non-operating expense and operation & maintenance expense.

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RATES

The utility was granted a 31% rate increase by the PSCW, which became fully effective September 29, 2015. The utility is currently ranked thirty-sixth for residential rates out of 78 rates for utilities classified as AB (over 4,000 customers) in Wisconsin.

UTILITY FINANCIAL ANALYSIS

The Statement of Net Position includes all of the utility's assets and liabilities and provides information about the nature and amount of investments in resources and the obligations to creditors. This statement provides the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of the utility.

A summary of the utility's Statements of Net Position is presented in Table 1 as of December 31:

Table 1

Condensed Statements of Net Position
(000's)

	<u>2016</u>	<u>2015</u>	<u>Restated 2014</u>
Current and Other Assets	\$ 62,207	\$ 59,727	\$ 38,610
Capital Assets	<u>266,711</u>	<u>244,982</u>	<u>227,395</u>
Total Assets	<u>328,918</u>	<u>304,709</u>	<u>266,005</u>
Deferred Outflows of Resources	<u>6,888</u>	<u>3,098</u>	<u>1,959</u>
Current Liabilities	15,643	14,879	14,657
Long-term Debt Outstanding	180,840	166,490	131,000
Long-term Liabilities	<u>16,561</u>	<u>13,819</u>	<u>12,243</u>
Total Liabilities	<u>213,044</u>	<u>195,188</u>	<u>157,900</u>
Deferred Inflows of Resources	<u>1,864</u>		
Net Investment in Capital Assets	106,282	98,847	99,646
Restricted	7,964	8,369	7,251
Unrestricted	<u>6,652</u>	<u>5,403</u>	<u>3,167</u>
Total Net Position	<u>\$ 120,898</u>	<u>\$ 112,619</u>	<u>\$ 110,064</u>

Total assets combined with deferred outflows of resources increased \$28.0 million and total liabilities with deferred inflows of resources increased \$19.7 million, resulting in an increase in net position of \$8.3 million from 2015. In 2015, total assets combined with deferred outflows of resources increased \$39.8 million and total liabilities increased \$37.3 million, resulting in an increase in net position of \$2.5 million.

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UTILITY FINANCIAL ANALYSIS (cont.)

Table 2

**Condensed Statements of Revenues,
Expenses and Changes in Net Position
(000's)**

	Year Ended December 31,		
	2016	2015	Restated 2014
Operating Revenues	\$ 34,588	\$ 28,381	\$ 28,658
Other Operating Revenues	964	1,132	1,208
Total Revenues	35,552	29,513	29,866
Operation & Maintenance Expense	15,373	15,250	15,107
Depreciation Expense	6,328	5,776	5,621
Nonoperating Expense	5,623	5,054	4,451
Total Expenses	27,324	26,080	25,179
Income before Capital Contributions and Transfers	8,228	3,434	4,687
Capital Contributions	5,789	2,311	858
Transfers, net	(5,738)	(5,910)	(5,577)
Change in Net Position	8,279	(165)	(32)
Beginning Net Position	112,619	110,064	110,096
Cumulative effect of change in accounting principle	-	2,720	-
Ending Net Position	\$ 120,898	\$ 112,619	\$ 110,064

The utility's total revenues increased \$6.0 million or 20.5% from 2015 to 2016. Although pumping decreased slightly (1.49%), the utility added 448 new customers in 2016. In addition, the utility implemented a rate increase on September 29, 2015. This increase was in effect for all of 2016. Total revenues decreased \$0.4 million or 1.2% in 2015 from 2014, which is a smaller decrease than the utility's decrease (-5.69%) in pumping during 2015.

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UTILITY FINANCIAL ANALYSIS (cont.)

Table 3

Operating Revenues and Expenses (000's)

	Year Ended December 31,		
	2016	2015	Restated 2014
OPERATING REVENUES			
Unmetered Sales	\$ 175	\$ 91	\$ 110
Metered Sales			
Residential	12,377	11,168	11,607
Commercial	11,534	9,395	9,421
Industrial	1,060	960	1,098
Public authority	4,502	2,848	2,603
Sales for resale	262	333	355
Total Metered Sales	29,735	24,704	25,084
Private Fire Protection	585	424	372
Public Fire Protection	4,094	3,162	3,092
Total Sales of Water	34,589	28,381	28,658
Customer Late Payment Penalties	176	163	221
Miscellaneous	100	91	55
Rents from water property	214	383	410
Other	473	495	522
Total Operating Revenues	35,552	29,513	29,866
OPERATING EXPENSES			
Source of Supply	75	53	124
Pumping	3,584	3,422	3,748
Water Treatment	742	744	732
Transmission and Distribution	5,460	6,180	5,841
Customer Accounts	847	735	854
Administrative and General	4,188	3,633	3,778
Total Operation and Maintenance	14,896	14,767	15,077
Depreciation	6,328	5,776	5,621
Taxes	477	483	30
Total Operating Expenses	21,701	21,026	20,728
Operating Income	\$ 13,851	\$ 8,487	\$ 9,138

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UTILITY FINANCIAL ANALYSIS (cont.)

Revenues

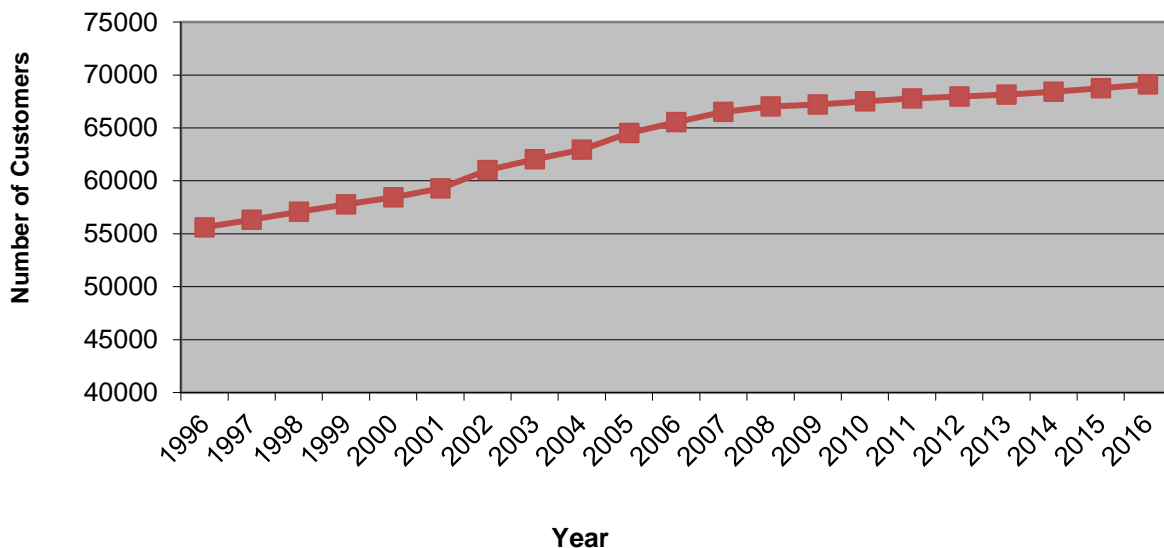
Total revenues were \$35.5 million in 2016, compared with \$29.5 million in 2015, an increase of \$6.0 million or 20.5%. Although pumping decreased slightly (1.49%), the utility added 448 new customers in 2016, the highest number of new customers added since 2007 (536). In addition, the utility implemented a rate increase on September 29, 2015. This increase was in effect for all of 2016.

Expenses

Operation and maintenance expenses totaled \$14.9 million in 2016, compared to \$14.8 million in 2015, an increase of \$100,000 or 1.0%. In 2016, the utility changed their method of accounting for service lateral rehook expenses in relation to main replacements. These expenses are now being capitalized with the cost of the main replacement. This resulted in \$700,000 of capitalized rehook expenses in 2016. Depreciation expense increased \$552,000 or 9.6% to \$6.3 million in 2016 from 5.8 million in 2015. Interest and amortization expense was \$5.9 million in 2016, compared with \$5.2 million in 2015, an increase of \$700,000 or 13.5%.

Chart 1

Customer Growth 1996 - 2016



In 2016, the utility received 630 new applications for service, compared with 604, 529 and 478 new applications received in 2015, 2014 and 2013, respectively. 2016, 2015 and 2014 continued the first increase in consecutive years since a record number of new applications (1,442) was received in 2002, following 1,405 new applications in 2001.

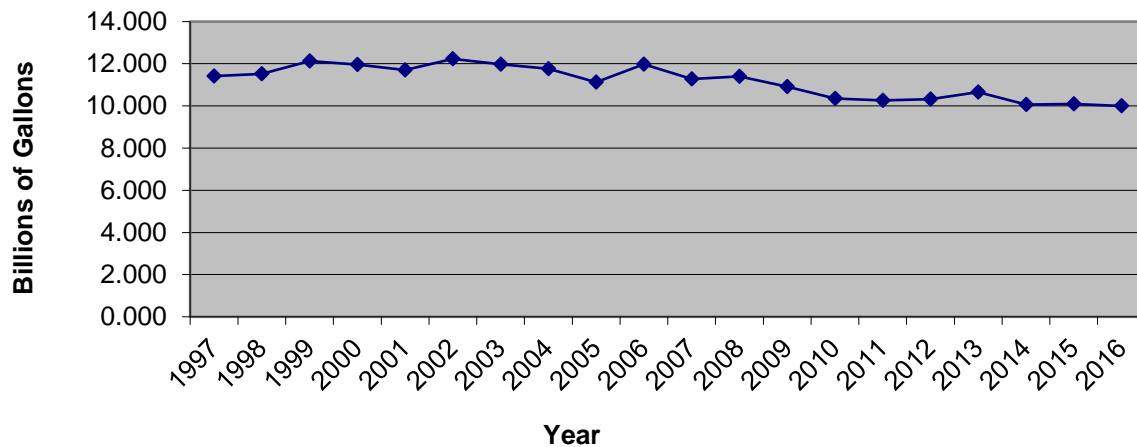
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UTILITY FINANCIAL ANALYSIS (cont.)

Chart 2

Pumpage 1996 - 2016



Pumping for the year decreased slightly (1.49%) from 9.997 billion gallons in 2015 to 9.848 billion gallons in 2016, due to moderate weather conditions and continued water conservation efforts by customers.

CAPITAL EXPENDITURES

The utility added a net \$21.7 million of plant in 2016. Of this amount, approximately \$5,789,000 was contributed by developers and contractors, and received by special assessment.

Capital projects paid for by the utility in 2016 included \$9.35 million for new and replacement water mains, \$2.6 million for Lakeview Reservoir reconstruction, \$9.4 million for the Operations Center Building Remodel, \$944,000 for miscellaneous pumping station work and our meter program.

Capital projects paid for by the utility in 2015 included \$12.4 million for new and replacement water mains, \$3.1 million for Lakeview Reservoir reconstruction, \$2.2 million for Unit Well 7 reconstruction, \$2.8 million for the Operations Center Building Remodel, \$1.9 million for Unit Well # 31 well drilling, design and construction, \$1.1 million to upgrade Booster Station 115, \$980,000 for miscellaneous pumping station work and our meter program.

Please refer to the notes to the financial statements for further details of the utility's capital assets.

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CAPITAL BORROWING

The previous policy of the utility had been to maintain depreciation and net revenues such that depreciation funds could be used for capital projects, and net income could be used for debt retirement. Due to the increased level of planned capital spending, the utility has looked to fund the vast majority of its capital budget needs through the sale of revenue bonds. The utility borrowed \$38.2 million in 2016, \$41.6 million in 2015, \$24.3 million in 2013, \$21.1 million in 2012, \$19.4 million in 2011, and \$13.2 million in 2010. The 2016 borrowing included \$23.8 million to fund 2016 and 2017 capital projects and \$14.6 million to advance refund 2007 revenue bonds. The utility plans a sale of revenue bonds in late 2017 to fund its 2017 & 2018 capital budget. The utility has stepped up its borrowing patterns in the last eleven years by going to the markets almost annually. Management envisions a continuation of active borrowing for the next several years.

ECONOMIC FACTORS AND FUTURE BUDGET ISSUES

Madison has a unique status in terms of economic stability, being the state capital and home to the University of Wisconsin – Madison and its 43,000 students, versus the national economy. However, even as the utility's largest customer, the University of Wisconsin – Madison, is nearing the end of fulfilling its growth plans requiring additional water from the utility. While customer growth has slowed, the utility added a net 30.2 miles of water main in the last three years as its service area has grown. Growth entails the need for additional infrastructure while meeting the challenge of upkeep of current infrastructure. Management believes that future rate increases will ensure that the utility is well prepared to handle these challenges. While rates are expected to increase over time, management expects utility rates will remain near the statewide median average.

In 2012, the utility began implementing an Advanced Metering Infrastructure called *Project H₂O*, to retrofit all existing water meters with a device that allows the automated collection of meter readings via a fixed network system. This allows customers to closely monitor and control their own water use and thereby conserve water, reducing system demands. The utility is able to implement water conservation rates, monitor the system for leaks, evaluate and optimize system operation, and improve customer service. The total cost of the project was \$13.9 million. *Project H₂O* became operational at the end of 2013. In addition, effective September 2014, the utility converted its semiannual metered accounts to monthly, which helps customers in budgeting for a lower monthly billing.

UTILITY CONTACT INFORMATION

This financial report is designed to provide customers and creditors with a general overview of the utility's finances and to demonstrate the utility's accountability for the funds it receives. Anyone having questions regarding this report or desiring additional information may contact Robin G Piper, Chief Administrative Officer, Madison Water Utility, 119 East Olin Avenue, Madison, Wisconsin 53713 or by phone at (608) 266-4656 or e-mail at rpiper@madisonwater.org.



FUND BALANCE REPORT

May 23, 2017

	<u>Balance Dec 31 2016</u>	<u>Balance Dec 31 2015</u>
Reserves required by Bond Ordinance		
Operation and Maintenance Fund		
Reserve Account (Minimum \$150,000)	\$ 150,000.00	\$ 150,000.00
Special Redemption Fund		
Interest and Principal Account	\$ 9,675,922.00	\$ 11,102,023.51
Reserve Account (Minimum \$16,466,237.51)	\$ 16,928,248.52	\$ 15,076,463.68
Depreciation Fund ⁽¹⁾ (\$750,000 required by Bond Ordinance)	\$ 750,000.00	\$ 750,000.00
Construction Fund	\$ 19,867,697.19	\$ 17,378,694.51
Assessment Revolving Fund	\$ 998,036.41	\$ 575,481.34
Unrestricted Funds		
PILOT Fund	\$ (957,854.00)	\$ 0.00
Cash Flow Fund	\$ 692,010.07	\$ 420,908.84
Debt to City of Madison		
Short Term Loan from City	\$ 2,295,000.00	\$ 3,060,000.00

⁽¹⁾Transfer of funds to Construction Fund approved as needed.

Reporting special fund balances as specified in 1978 Waterworks Bond Ordinance.

Refer any questions to Robin Piper, Chief Administrative Officer, at (608) 266-4656.