**Meeting: Budget Work Session** 

**Date: August 21, 2008** 

# GARLAND POWER AND LIGHT SUPPORTS AND TRANSFERS

#### **ISSUE**

The transfer of funds from Garland Power and Light (GP&L) to support the services provided through the City's General Fund has arguably been one of the most difficult, and at times controversial, financial policy decisions faced by Garland City Councils. The desire to keep property tax rates as low as possible, and yet provide quality city services, has had to be balanced with providing a competitive rate for electric service for GP&L's customers and insuring the long-term financial health of the city-owned utility. This policy report attempts to provide a balanced financial analysis of GP&L's support of the City's General Fund.

#### **OPTIONS**

For informational purposes only.

#### RECOMMENDATION

For informational purposes only.

#### **COUNCIL GOAL**

Financially Stable Government.

#### **BACKGROUND**

GP&L's support of other City funds and operations is accomplished primarily through a Return on Investment (ROI) transfer to the General Fund along with electrical power and other services provided at a discounted rate or at no charge. GP&L also pays General and Administrative (G&A) and Support Service charges to the General Fund and Support Service Funds on the same basis as other City departments.

#### Return on Investment (ROI)

GP&L, as a city-owned utility, transfers funds each year to the General Fund based on a Return on Investment (ROI) methodology. The ROI methodology applies a percentage rate to the three-year moving average of the Electric Utility's revenue to arrive at the annual transfer amount. The three-year moving average consists of revenues from the three most recently completed fiscal years. The current percentage rate for the ROI transfer is 7.4% and yields a transfer of \$18,168,500 in the Proposed Budget for FY 2008-09.

With implementation of the ROI methodology in 2007-08, subsidies borne on behalf of the General Fund through the allocation of internal expenditures for Support Services and Self Insurance were eliminated. Also eliminated were Charges In-Lieu of Property Tax and Charges In-Lieu of Franchise Fees which had historically been the basis for annual transfers. The ROI methodology has several advantages in that it more clearly reflects amounts being transferred from the Electric Utility to the General Fund, allows the Council to better control the amount being transferred between the funds, adds stability in the General Fund by eliminating mid-year shortfalls due to volatile weather patterns, and adds stability in both funds by eliminating dramatic year-to-year variances. The ROI rate of 7.4% for GP&L also compares favorably to 14.0% used by the City of San Antonio's City Public Service and 9.1% used by the City of Austin's Austin Energy.

## Return on Investment (ROI)

Revenue	RO Rate	Transfer Amount
Three-Year Moving Average	7.4%	\$18,168,500

## Services Provided to Other City Funds

GP&L provides electrical power to most of the City's facilities. With the exception of Water and Wastewater operations, service is provided at a per kWh intra-city rate of .002 cents plus the TMPA fuel factor. Currently, the intra-city rate is .02194 cents per kWh. The total benefit of the intra-city rate to other City funds is approximately \$3.0 million. In addition, GP&L provides the majority of funding for street light maintenance which is valued at approximately \$2.2 million a year. As a City department, GP&L also assists with set-up for the Christmas on the Square event and, in the past, has been a sponsor of the Star Spangled Fourth event. A total listing of indirect supports provided by GP&L is shown below:

#### **Services Provided to Other City Funds**

(1)	Intra-City Rate	\$ 3,032,800
(2)	Street Light Maintenance	2,174,200
(3)	Ball Park Lighting	61,500
(4)	Tree Trimming	50,000
(5)	Christmas on the Square	39,000
	Total Services Provided	\$ 5,357,500

In addition to supporting internal City operations, GP&L provides approximately \$60,000 of community support and sponsorships to various groups and events each year.

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## Total Support of the General Fund

Combined, GP&L provides approximately \$23.5 million in support to General Fund operations through the ROI transfer and indirect supports such as the intra-city electric rate. The \$23.5 million equates to 8.4% of GP&L's projected revenue for FY 2008-09. The annual ROI transfer alone represents approximately 13.7% of the General Fund's total annual revenue and is the third largest funding source behind property taxes and sales tax revenue.

# **Total GP&L Support of General Fund**

Return on Investment	\$ 18,168,500
Services Provided to Other City Funds	5,357,500
Total Support to Other Funds	\$ 23,526,000

## Subsidy Portion of GP&L Support

If GP&L were an investor-owned utility (IOU) it would make payments to the City of Garland in the form of property taxes and franchise fees. It is estimated that GP&L would pay \$1.6 million in city property taxes and \$4.7 million in franchise fees for a total of \$6.3 million annually. The difference between current supports of \$23.5 million and the \$6.3 million that GP&L would pay as an IOU is typically considered the amount of subsidization and is estimated to be \$17.2 million.

## Calculation of GP&L Subsidy

Total Support of General Fund	\$ 23,526,000
Payments by GP&L as IOU	(6,318,000)
Net Subsidy	\$ 17,208,000

## Tax-Exempt Benefit to GP&L

While providing approximately \$23.5 million in annual support to the City's General Fund, GP&L enjoys substantial benefits from the City's tax-exempt status that would not be available to an IOU. The benefits include being excluded from city, school, and county property taxes, State of Texas franchise tax, and PUC Assessment Fees. The utility also benefits from being able to issue tax-exempt debt, which carries lower borrowing costs and the utility has no requirement to return a dividend to stockholders.

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With assistance from Deloitte & Touche, the City's outside auditors, an annual value of approximately \$19.8 million was placed on these benefits. For purposes of this analysis, the advertising expense that an IOU would typically have has been ignored.

#### Tax-Exempt Benefit to GP&L

Annual Benefits of Tax-Exemption	Est. Amount
City, School and County Property Taxes	\$ 5,931,000
City Franchise Fees	4,671,000
Federal Income Tax	1,358,000
State Franchise Tax	833,000
PUC Assessment Fees	377,000
Tax-Exempt Debt v Taxable Debt Service	2,623,000
Foregone Annual Dividends	4,029,000
Total Benefit of Tax-Exempt Status	\$19,822,000

#### General and Administrative Charges

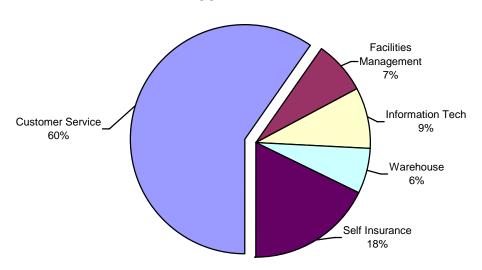
The Electric Utility, like all other City enterprise funds, reimburses the General Fund for a portion of the cost related to administrative support. Administrative support includes the services provided by Financial Services, Budget, Purchasing, Human Resources, Internal Audit, and the City Attorney's Office, as well as others. All City proprietary funds are assessed a G&A charge equivalent to 13.25% of each fund's salary and benefit costs in order to recapture a portion of the costs associated with these services. In the FY 2008-09 Proposed Budget, G&A charges to the Electric Utility are \$3.0 million.

# Support Service Charges

Support Service Departments are those that provide services to other City departments and then recover their expenditures through an allocation of costs to user departments. Those areas recovering their cost through annual allocations include Customer Service, Facilities Management, Information Technology, Warehouse, and Self Insurance. Other Support Services not included as part of the allocation are Group Health Insurance, Fleet Services and Long-Term Disability. These funds recoup their costs through rates or direct charges to user departments rather than through the Allocation Plan.

The allocation methodologies for each of the Support Services determine how costs are distributed. The allocation method for each Support Service is unique and typically involves a combination of multiple factors. For example, expenditures in the Information Technology (IT) Fund are broken down by division or type of service provided. The cost of each service is then allocated to other City funds based on a methodology that best fits the particular type of work being performed.

In the FY 2008-09 Proposed Budget, total allocated Support Service charges to the Electric Utility are \$9.5 million. Of this amount, \$5.7 million (60%) is for the Customer Service Department which is within the managerial control and oversight of GP&L.



**GP&L Support Service Allocation** 

#### **CONSIDERATION**

#### Impact of GP&L Subsidies to Residential Utility Customers

Below is an analysis of how GP&L financial subsidies impact the average residential customer:

- (1) Subsidies borne by GP&L are approximately \$17.2 million a year, which equates to approximately .0083 cents per kWh.
- (2) Assuming subsidies are spread equally across kWh usage and assuming the average residential usage is 1,300 kWh per month (15,600 kWh per year), the subsidies would amount to \$129.50 per year for the average residential GP&L customer.
- (3) Approximately 15% of Garland is served by other power providers and, as a result, these residents and businesses do not bear any portion of the \$17.2 million in subsidies. The disproportionate share of subsidies borne by ratepayers serviced by GP&L would be 15% of the \$17.2 million or \$2.6 million. For the average homeowner on GP&L this amount equates to \$19.42 a year or \$1.62 a month.

### **Disproportionate Share of Subsidy**

Total GP&L Subsidy	\$ 17,208,000
Disproportionate Share Borne by GP&L Ratepayers (15%) Disproportionate Share Per kWh	2,581,200 .00125
Average Homeowner – 15,600 kWh per year	\$ 19.42

- (4) If property taxes were increased to eliminate the GP&L subsidies, a tax rate increase of 16 cents would be required. The impact of the 16-cent tax rate increase would be \$188.68 a year for a home valued at \$128,182, which is the average value of homestead properties in Garland.
- (5) To reduce the General Fund budget by \$17.2 million would require the elimination of approximately 25% of the employee work force or the equivalent of eliminating the Parks and Recreation, Library, Code Compliance, Building Inspections, and Community Relations Departments.
- (6) As noted above, if \$17.2 million is paid as subsidies through GP&L, the cost to the average GP&L residential customer is \$129.50 a year. If the same \$17.2 million is paid through property taxes instead, it would cost the average homeowner \$188.68 or \$59.19 (45%) more per year.

## **Support Paid as Subsidy v. Property Tax**

	As GP&L Subsidy	As Property Tax	Differ
Amount of Subsidy (in millions)	\$ 17.2	\$ 17.2	
Annual Amount Paid by Homeowner	130	189	\$ 59

This would indicate that there is an advantage to the average residential homeowner – even those serviced GP&L – for the \$17.2 million to be funded as subsidies rather than through property taxes. The advantage is due to the fact that homestead properties represent approximately 42% of the tax base while consuming an estimated 34% of GP&L's kWh usage.

## It is important to note several observations regarding these calculations:

- (a) Funding the \$17.2 million through GP&L subsidies, rather than property taxes, has the effect of shifting a portion of the cost from residential homeowners to commercial businesses and those entities and individuals that do not pay property taxes, such as not-for-profit organizations and renters.
- (b) Property taxes are deductible from Federal income tax for those individuals that itemize their deductions, whereas utility payments are not. Assuming a 15% tax rate the net benefit of funding the \$17.2 million as subsidies would be reduced from \$59.19 a year to \$50.31 for the average homeowner.
- (c) The calculations noted above are based on averages. The advantage to any specific individual homeowner is dependent on their actual electric usage and the assessed property value of their residence. There could be situations where it is more costly to a specific homeowner for the subsidies to be funded through GP&L.

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