



SUPPLEMENTAL

COUNCIL AGENDA:03/23/04
ITEM: 3.9

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: SEE BELOW

DATE: March 23, 2004

Approved

Date

3/23/04

COUNCIL DISTRICT: City-wide
SNI AREA: N/A

SUPPLEMENTAL

SUBJECT: UPDATE ON FUNDING ALTERNATIVES FOR THE CUSP PROJECT, AN INTEGRATED UTILITY BILLING, CUSTOMER SERVICE AND PERFORMANCE MONITORING SYSTEM

BACKGROUND

On March 10, 2004, staff presented an update on the CUSP project, an integrated utility billing, customer service and performance monitoring system, to the Making Government Work Better (MGWB) Committee. Included with the presentation was an ROI analysis that included a funding plan that would expand the City's commercial paper (CP) program to fund the project related costs. The MGWB Committee requested that staff also review and analyze two additional funding options in lieu of external borrowing; 1) use existing balances that may be available in the respective utility funds, and 2) borrow available balances from other funds. Staff computed the net present value of each option. Based on the analysis, the commercial paper program option would yield the lowest cost to the City with a net present value benefit of approximately \$1.36 million compared to borrowing project costs from other City funds. This supplemental memorandum provides the requested analysis.

ANALYSIS

Although the Council previously directed staff to proceed with the request for proposal process for CUSP, given the current budget challenges, staff reviewed additional alternative solutions to be considered by the MGWB Committee. Based on the risks and costs associated with each option, the MGWB Committee directed staff to move forward and present two options to council; 1) proceed with CUSP, an off the shelf, licensed software solution with on-going technology support from the City's Information Technology Department; or 2) Contract with an outsource vendor for the CUSP system who would provide support for CUSP system. It should be noted that the outsource option would be a contractual arrangement between the City and a

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third party vendor over a two year period. The City would not own the CUSP project. In reviewing funding options, the Outsource option would not qualify for the commercial paper program described below due to the inability to capitalize and finance a system that the City would not ultimately own. The estimated total costs to implement the first option, through the "go-live" date are \$7.8 million. Go-live cost components include the following implementation and stabilization costs, which are to be expended over an eighteen-month implementation period once an implementation vendor has been chosen:

- Software;
- Hardware;
- Implementation vendor travel and related expenses;
- Initial software licensing;
- Dedicated city staff, lease space; and
- Project management and coordination.

As a means to fund the implementation costs for the CUSP project, staff has considered three alternatives as directed by the MGWB Committee. The table below lists each funding alternative, average annual project costs and opportunity benefits for each alternative, and the net present value of these components over a ten-year period. Discussion relative to each alternative considered is presented immediately following the table.

CUSP Project Funding Alternatives

Funding Alternative	Average Annual Project Payment ⁽¹⁾	Average Annual Opportunity Benefits ⁽²⁾	Net Present Value – Total Cost to City
Use of Commercial Paper Program	\$932,165	\$346,466	\$(4,854,789)
Use of existing balances in respective utility funds ⁽³⁾	N/A	N/A	N/A
Borrow available balances from other funds	\$940,263	\$200,145	\$(6,195,639)

(1) Average annual payments are calculated over a 10-year payback period for each option (principal, interest and borrowing costs), amortized from the first year the respective option would go live. Assumes the annual operating revenues for each utility service receiving benefit would fund the amortized repayment amounts.

(2) Average annual opportunity benefits include the continued ability to earn interest on funds remaining in City Investment Pool.

(3) Based on a pro-rata distribution of project costs, existing funds are insufficient to fund the required go-live costs for the CUSP project.

It should be noted that the average annual payment is one-half of one percent (0.5%) of total annual revenues of \$170 million generated by the four City utility services benefiting from the project. The impact on future rates has not been calculated. The model assumes that the annual payments would begin in fiscal year 2006-07 (the first year following implementation.)

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Use of Commercial Paper Program

Staff has reviewed an alternative to expand the use of the Commercial Paper program to include the go-live costs of the CUSP project. Under the Commercial Paper alternative, the City would issue commercial paper notes as cash expenditures are paid for project implementation costs over an estimated eighteen-month period. The repayment, including interest and borrowing costs, would be amortized over a ten-year period, beginning in fiscal year 2006-07 (when the CUSP system would “go-live” and becomes available for use).

Using the Commercial Paper program to fund CUSP project costs allows the City to maintain existing cash reserves necessary to fund existing operations, while prolonging the City’s ability to invest unexpended funds during the term of the payback period. As presented in the table above, the Commercial Paper program results in the most economic benefit for the City at the lowest cost to the City, from a net present value perspective (results in a savings of nearly \$1 million compared to borrowing up-front from internal City funds).

Use of Existing Balances in Respective Utility Funds

Staff has reviewed required project cost-sharing levels for the four utility funds that will receive direct benefits as a result of implementing CUSP:

<u>Fund</u>	<u>Share of Project Cost</u>
<i>Integrated Waste Management Fund (Fund 423)</i>	<i>\$ 4,400,000</i>
<i>Water Utility Fund (Fund 515)</i>	<i>\$ 960,000</i>
<i>Storm Sewer Operating Fund (Fund 446)</i>	<i>\$ 825,000</i>
<i>Sewer Service and Use Charge Fund (Fund 541)</i>	<i>\$ 1,615,000</i>

The pro-rata share of project costs for each utility fund is based on: 1) the number of annual bills sent to customers for each utility service; and 2) the amount of annual operating revenue generated by each utility fund.

After analyzing the respective utility fund’s projected budget “statements of sources and uses of funds” (including projected rate increases), the initial analysis indicates that funding may be available in the Water Utility and Sewer Service and Use Charge Funds while the levels of unrestricted fund balance available in the Integrated Waste Management and Storm Sewer Operating Funds are not sufficient to cover their pro-rata share of the CUSP project estimated costs.

Based on a pro-rata distribution of project costs, existing funds are insufficient to fund the required go-live costs for the CUSP project. Therefore, it would be necessary to borrow from available fund balances in other City funds.

Borrow From Other Funds

Staff continues to review the feasibility of borrowing cash resources available in other City funds to pay for the implementation costs of the CUSP project. Staff has identified the Sewer Treatment Connection Fee Fund (Fund 539) as a possible alternative to facilitate a loan for the CUSP implementation costs. The loan payback period would commence during fiscal year 2006-07, when it is anticipated that the CUSP project will go live. Payback periods and payment schedules would be established for each borrowing fund consistent with the levels of resources

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estimated to be available over the term of the loan. Loan payments would include interest commensurate with the amount earned by the City's Investment Pool.

Regardless of the amount loaned from another fund to cover the cost of the CUSP project, paying for the project using the borrowing alternative results in a \$7.8 million outlay of funds during the first two years of the project. Unlike the Commercial Paper funding option, expending all project-related funds from existing City cash balances results in lost opportunities for the City to invest the unexpended funds at a higher rate than the borrowing rate in the commercial paper program.

CONCLUSIONS

In conclusion, based on the net present value calculations for each option, the City would be better off to utilize the expanded commercial paper program to fund the CUSP project costs. Staff estimates that the net benefit to the City for the commercial paper program compared to borrowing internally from other City funds would be approximately \$1.36 million. This net benefit is due to lower borrowing costs for the commercial paper program and increased interest earnings resulting from investing the City's cash on hand in the City pool. Additionally, in reviewing fund balance in other funds, staff was unable to identify a fund that has sufficient available balances or that does not have sufficient funds available to commit over a ten year period. Therefore, if Council directs staff to move forward with procuring the licensed CUSP solution, staff recommends expanding the City's commercial paper program to fund the project.

COORDINATION

This memorandum has been coordinated with the Departments of Environmental Services, Information Technology and Finance and the Offices of the City Attorney, Budget and City Manager.


SCOTT P. JOHNSON
Director, Finance Department

