

Independent Rates Oversight Committee (IROC)

March 18, 2013

MINUTES

1. Roll call

Chairwoman Welch called to order the regular meeting of the IROC at 9:04 a.m. Monica Foster conducted roll call, and a quorum was declared. Attendance is reflected below:

Members:	Present	Absent
Gail Welch, Chair	X	
Don Billings, Vice Chair	X	
Christopher Dull	X	
Andy Hollingworth	X	
Jeff Justus		X
Jack Kubota	X	
Jim Peugh	X	
Irene Stallard-Rodriguez	X	
Todd Webster	X	
Ex-Officio Members:		
Luis Natividad, Metro JPA		X
Ken Williams, City 10	X	

City representatives present: Roger Bailey, Director of Public Utilities, Tom Crane, Assistant Director

2. Non-Agenda public comment

None.

3. Approval of Draft Minutes of February 19, 2013

ACTION: Chairwoman Welch asked for a motion to approve the minutes as submitted. Vice Chair Billings noted to correct: Page 8, 2nd bullet near end, “Director Billings” should be changed to “Director Bailey”. Member Kubota noted to correct page 7, paragraph 5, “not that the MAC...” should be changed and read “now that the MAC...” Vice Chair Billings moved to approve with said corrections, Member Peugh seconded. Motion passed 6 (in favor) - 2 (abstained, Dull, Webster) - 0 (opposed).

4. Chair updates – Chairwoman Welch

- Chairwoman Welch, along with Vice Chairman Billings and Member Hollingworth, presented the FY2012 IROC Annual Report to Natural Resources & Culture Committee (NR&C) on February 27. Councilmember Emerald welcomed review and recommendations on the Advanced Water Purification Demonstration project. Councilmember Sherman expressed concern with the growth of unrestricted cash and investment levels. Member Hollingworth also expressed concerns on this issue during the meeting. Director Bailey addressed this concern, and Member Billings pointed out contributors to the financial results indicating his confidence with the levels being satisfactorily explained. Councilmember Alvarez asked IROC to work on this issue.

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Chairwoman Welch is having the Department present today on the cash and investments, and also has added Item 10 to today's agenda to respond back to Councilmember Alvarez.

- Met with Mayor Filner on March 7. In attendance were Vice Chair Billings, Members Stallard-Rodriguez, Peugh, and Kubota. Mayor Filner welcomed hearing that IROC was willing to take a position on important items. Items pointed out were concerns on infrastructure, outreach, and being able to review the Cost of Service Study. Also brought to his attention was IROC has 3 vacancies come May. Mayor Filner indicated it is in process. There is a follow-up meeting on April 10 with the Mayor on the items mentioned, indicating the Department's response. The IROC Chair and Vice Chair positions are coming up on 1 year. These positions are eligible to be renewed for 1 additional year. There will be a vote next meeting, for nominations, she added that she is planning on re-running for Chair.
- FY2014 IROC Work-plan on today's agenda is docketed on the NR&C agenda on April 17, where she will present.

5. City Staff updates

- Director Bailey: He met with Councilmember Sherman after IROC's presentation at the last NR&C Committee. He indicated that he felt Councilmember Sherman was satisfied with the information provided. Today's presentation should address IROC's concerns that were raised at NR&C.
- Terrell Powell, Water Utility Supervisor: Noted there have been 2 spills since last month bringing a total of 13 year to date vs. 14 last year. The cause of the 2 mentioned spills: 1 was related to a contract related spill, and 1 was due to heavy roots.

Member Hollingworth asked for information on the power outage last year. Director Bailey indicated last week, City Council formally approved a settlement agreement with the Regional Board of approximately \$1.2M. He added this item still must go to the Regional Board for action.

- Stan Medina, Deputy Director of Water Operations: Calendar year to date, there have been 15 fire hydrant knock-overs vs. 20 last year. There have been 30 water main breaks vs. 22 last year same time. He noted the most recent significant break was at 14th Street at F Street, again. The Mayor approved ORION to replace the 16" 102 year old pipe. Vice Chair asked when this particular segment was scheduled for replacement. Stan Griffith, Assistant Director, indicated it was scheduled for 2015. Director Bailey indicated an item was taken to NR&C recently regarding the Condition Assessment, including the water distribution, transmission, and collection systems. He noted that his

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information will be presented to IROC next meeting. Member Kubota suggests members go to sites when large pipes are being replaced to get a hands-on look at the work for a valuable understanding.

6. Mayor and Council Staff Comments

None.

7. City 10 – County Water Authority Updates, Ken Williams

- The next Metropolitan Water District (MWD) rate increase is scheduled for January 1. It is currently scheduled at 5% which is the 2nd year of a 2-year plan that was passed last year. Largest driver was the “wheeling” (transportation) rate. This is for the IID water transported from the Colorado River to CWA.
- MET lawsuit was filed by the County Water Authority on the basis of the high wheeling costs. The lawsuit is at the motions and discovery stage, and the trial date is targeted for November.
- CWA's Cost of Service Study (COSS) is underway and one outcome will be the amount each agency will pay for the Desal project. There will be a series of meetings and a target date of completion is June 2014.
- The San Vicente Dam raise is almost complete and targeted for the Fall of 2013. This will increase the storage capacity from 90,000 ac/ft to 240,000 ac/ft. The water to fill this dam needs to be purchased as well, which is costly.
- The water outlook for this year is considered a “dry” year. The level is 60%-75% of normal at the Colorado River, and northern California. The added storage levels of water remain good in San Diego and MET, so there will not be a strong impact to supply at this time.

8. Comprehensive Annual Financial Report (CAFR) Balances – Cash and Investments

Chairwoman Welch indicated that this presentation was scheduled in response to Councilmember Alvarez’ comments at the NR&C meeting mentioned earlier.

Lee Ann Jones-Santos, Deputy Director of Finance, along with Jeanne Cole, Program Manager for Rates and Finance, presented a summary of the Cash and Investments and Unrestricted Net Assets from the CAFR, and explanation of its components. Ms. Jones-Santos reviewed the components within are the Reserves, Continuing Appropriations, and Encumbrances. She reviewed the Statement of Net Assets from FY12 CAFR prepared by the Office of the City Comptroller, outlining the Cash and Investment and Unrestricted Net Asset line items to be addressed in the presentation.

Ms. Jones-Santos proceeded through several slides which outlined the summary of the FY2012 ending balances for Water and Wastewater, as well as a breakdown (reserves, continuing appropriations, encumbrances, and undesignated) of the cash and investments and unrestricted net assets for both funds as of FY2012, explaining the components. She noted as a priority, the Department is currently in the process of evaluating the continuing appropriations for both funds with Public Works Engineering. Also, shown was a table of projected capital program expenditures for Water and Wastewater as of February 19,

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2013, currently actively working on with Black & Veatch and Public Works Engineering. Director Bailey pointed out the importance of the provided breakdown of the projected schedule costs for FY2013-FY2016.

Next, Ms. Jones-Santos reviewed how the current cash on hand is drawn down for both Water and Wastewater funds. She explained the illustrations for each fund beginning with projections for FY2012 through FY2015 showing the use of Bonds, Grants/SRF, and cash, keeping in mind that the appropriate level of cash will be evaluated to best practices, legal and financial obligations and Rating Agency expectations.

Vice Chair Billings clarified that as the cash is used, this benefits the rate payers going forward because it reduces the amount needed to be collected going forward. Member Hollingworth disagreed, and indicated that fundamentally this should ramp up and then ramp down to a lower level, in his experience.

Director Bailey indicated the Department will be performing a Condition Assessment, which will bring more clarity to the issue. He reiterated that this system is vast, and over 100 years old, and will be never ending – as pipes will continue to need replacing. Member Hollingworth noted he is particularly interested in having control of construction programs, because as an aggregate they put an increasing burden on tax payers. Ms. Jones-Santos indicated that with the continued oversight with the Infrastructure & Operations Subcommittee, and presented project schedules and expenditures will help.

Ex-officio Member Williams asked, in regard to the 80%-20% guideline, if tracking is performed in a given year, as to what the actual percentages are each year. Director Bailey indicated he has requested a look at the CIP program since the last COSS period (2006), what projects have been completed, the total cost, how much money has been borrowed, and how much cash has been used, and this will determine the actual percentage split. He repeated this program is ongoing, and adjustments need to be made along the way.

Ex-officio Member Williams suggested, in regard to the 80%-20% split, a year by year look at what the split has been, or projected to be. Vice Chair Billings added to also look at all cash collected in the Rate Case. Ms. Jones-Santos noted that using a longer period of time would be most beneficial. Director Bailey indicated that the Draft Use of Funds Audit should be back soon. Member Hollingworth asked Director Bailey if he can make a commitment to IROC that an annual reconciliation will be done. Director Bailey concurred. Member Hollingworth also asked for a commitment as a safeguard, is that the Department shares with IROC and the NR&C the internal quarterly cash flow analysis.

9. Use of Cash and Debt Coverage Ratios

Lee Ann Jones-Santos indicated this presentation is to provide technical information on the draw-down of the cash and debt funds, as described in the previous presentation (Item 7). She showed duplicate information for the CIP component for Water and Wastewater Branches, which is still being reviewed with Black & Veatch.

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Next, she reviewed a chart illustrating outstanding debt, and what has been done in terms of refinancing. She pointed out that all old debt has been refinanced, leaving the 2009 A and B issuances, and 2010 A, for Wastewater. The first availability for refinancing these (Call Dates), were listed. She noted per the City Debt Policy, a refunding will only be considered if it meets at least a 3% aggregate net present value savings (4% for advance refunding). She showed the savings for both Water and Wastewater, as well as the outstanding principal. She added with a very aggressive debt management program, that the Department is doing best as possible to pay the best and most current rate possible.

Ms. Jones-Santos gave a brief description of the debt coverage ratio (DCR), different types of DCR's being Senior Debt Coverage Ratio (first right to repayment), and Aggregate Debt Coverage Ratio. She briefly reviewed the Master Installment Purchase Agreement (MIPA) which is the document showing how the DCR should be calculated, noting that it is vetted through the Disclosure Council and approved by City Council. She noted that the Department prepares the projections, however the annual calculation is prepared by the City Comptroller's Office.

She provided and reviewed in detail, a reference sheet titled Net System Revenues available for Debt Service which illustrated notes that tied line items back to the CAFR. She walked through each line item describing each. This included Total Operating Revenues, Operating Expenses (not including depreciation expense from the CAFR Statement of Revenues), Other Charges, and Debt Service Coverage – Parity Obligations.

She then provided Water and Wastewater Debt Coverage Ratios for FY2011-FY2014. She noted if the last Water refunding rating agency comments is reviewed, she reminded IROC that the Department is known to be conservative, and usually do come in higher than projected.

10. Proposal to send a letter to the Natural Resources & Culture Committee (NR&C) responding to questions that were raised during IROC's Annual Report presentation at the February 27, 2013 NR&C meeting

Chairwoman Welch asked for comments. Member Hollingworth referred a draft copy of an edited version of the Draft letter to NR&C provided in the packet. He indicated this is a complicated issue, and he suggested there are many factual errors in the proposed letter therefore, he then proposed an amended draft. He also provided a Press Release as a sample, of how the Federal Reserve deals with policy disagreements. He referred to the last paragraph in the handout, and suggested that going forward, when IROC has recommendations, that this same format is used, due to each member having different constituencies, which indicates who and why each member votes.

Mr. Hollingworth then pointed out what he feels are factual errors in the proposed draft letter. He read the last paragraph, and referred to his outlined comments:

- It was determined that the Black & Veatch projection provided to IROC, each year the projected cash level was low due to different errors and issues. Vice

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Chair Billings disagreed, due to the detailed discussions about the breakdown, amounts set aside according to City reserve policy, set aside amounts for contracts, encumbrances, and a schedule of coming CIP investments. Member Hollingworth disagreed with Vice Chair Billings' comments.

- Member Hollingworth expressed concern about the cash levels in both the 2011 and 2012 Annual Reports and therefore cannot “remain satisfied” about the current cash levels.
- In regard to the statement that the “level of funds are appropriate given the existing debt covenant requirements”, he does not recall speaking about debt covenant requirements. Vice Chair Billings indicated he is willing to strike this.
- Suggested adopting the same type of language and format as illustrated by his distributed Federal Reserve Press Release, on a go-forward basis. Vice Chair Billings disagreed with this comment, pointing out that changing the format of the way voting is shown in the minutes is irrelevant to this item.

ACTION: Member Hollingworth made a motion to use the Federal Reserve's format method of communicating policy recommendations, in the basis of equity as shown in the example distributed on a go-forward basis as well as the proposed letter for this item. Member Webster seconded the motion with the stipulation of more discussion on this subject, and perhaps a separate future agenda item. Motion failed 2 (in favor) – 6 (opposed). Member Hollingworth requested a roll-call vote for the record:
In favor: Members Hollingworth and Webster; Opposed: Members Welch, Billings, Dull, Kubota, Peugh, Stallard-Rodriguez; and Absent: Member Justus.

Member Peugh commented about the second paragraph of the proposed letter in relation to the level of investments being appropriate, and suggested modifying this sentence. He and Vice Chair Billings compromised by suggesting altering the paragraph to read: During the report discussion, Councilmember Sherman asked about Water and Wastewater cash and investment levels, as reflected in the FY2012 CAFR, and raised the question of whether the current level of “cash and investments” is appropriate. Chairwoman Welch concurred.

Sean Karafin, San Diego County Tax Association (SDCTA), commented that the SDCTA has concern still about the levels of cash being appropriate. He indicated the use of funds audit has not come out yet, as it has been pushed back. He cautioned the Committee of making a claim that the levels are appropriate when the study is not complete. Director Bailey replied that the use of funds audit currently being conducted and is in draft form, however, the question of the levels being appropriate, this Audit does not address this.

Member Stallard-Rodriguez expressed her disagreement with the mid sentence of paragraph 3 of the proposed letter, beginning with, “On the basis of our review and analysis, IROC remains satisfied...” She indicated she is not comfortable and would like to revise this portion. With input from Ex-officio Williams, Vice Chair Billings, and Member Stallard-Rodriguez, Chairwoman Welch proposed the language to read, “On the

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basis of the information provided, IROC is satisfied that the current cash levels in the Water and Wastewater funds as reflected in the FY12 CAFR, appear reasonable given the existing debt service ratios, the City Reserve Policy, and projected near-term future cash needs for Capital Improvement Projects”.

ACTION: Vice Chair Billings moved to send the letter as revised in response to IROC member comments, based on Chairwoman Welch’s revised language. Member Peugh seconded the motion. Motion passed 6 (in favor) – 2 (opposed). Member Hollingworth requested a roll-call vote for the record: In favor: Members Welch, Billings, Dull, Kubota, Peugh, Webster; Opposed: Members Hollingworth and Stallard-Rodriguez; and Absent: Member Justus.

11. Adoption of the FY2014 IROC Annual Work-plan

Chairwoman Welch commented that all subcommittees worked diligently on their respective components. She pointed out and reviewed the latest collective edits to the Annual Work-plan showing broken out subcommittee areas of focus, and expanded details represented in Appendix A. She indicated her intention to present to NR&C on April 17. She then asked for comments and/or edits:

Member Peugh pointed out a few minor format edits, as well as bullet 2, page 2 of Appendix A, needed to be revised to match bullet 2, Item III, page 2 of the main document. Chairwoman Welch concurred.

Member Stallard-Rodriguez pointed out in Item IV, bullet 2 of page 2, “...public education” was agreed to be changed to “...public information”. Also, page 3 of Appendix A, bullet 2, same change needed several times. Chairwoman Welch concurred.

Member Dull pointed out on page 1, Item II, bullet 3, concerned with the verbiage, and suggests rather than stating “conduct cost/benefit analysis...” use something similar to “recommend and oversee City staff in the City 10’s evaluation of new water supplies...” Also, similar to page 2, Item II, bullet 5, suggests using “recommend and oversee City staff working with the San Diego County Water Authority (SDCWA) staff and City 10 to evaluate the SDCWA’s water sales volume and cost structure.” since IROC does not “oversee” those entities, it is more appropriate to have City staff work with them. He added also to be consistent with this new language on bullet 3 of page 1 of Appendix A as well, noting to change the word “desalinization” to “desalination”. Chairwoman Welch concurred.

Director Bailey added that when goals are set, to be mindful that the Department, IROC, as well as other agencies, do not have direct access to the comprehensive data set that other agencies may have. Member Dull agreed.

ACTION: Chairwoman Welch asked for a motion. Member Peugh moved to approve IROC’s FY14 Annual Work-plan with said corrections to be presented to NR&C in April. Member Dull seconded. Motion passed 8-0.

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12. **Public Utilities 2nd Quarterly Capital Improvements Program Report of FY2013**

This item was tabled for the next IROC meeting, due to time constraints.

13. **Subcommittee Reports:**

a. **Finance – Andy Hollingworth**

b. **Infrastructure and Operations – Jim Peugh**

c. **Outreach and Communications – Irene Stallard-Rodriguez**

This item was not heard due to time constraints.

14. **Metro/JPA Report out – Gail Welch**

This item was not heard, due to time constraints.

15. **IROC’s recommendations for FY2014 Performance Audits to be performed by the Office of the City Auditor**

This item was tabled to the next IROC meeting due to time constraints.

16. **Proposed Agenda items for next IROC meeting**

- Public Utilities 2nd Quarterly Capital Improvements Program Report of FY2013
- IROC’s recommendations for FY2014 Performance Audits to be performed by the Office of the City Auditor

17. **IROC Member’s Comments**

Member Stallard-Rodriguez asked for an update on an article recently published about a customer who had received a \$3,007 water bill due to a mis-read, and asked for information on the City’s safeguards in place for potential mis-reads. Director Bailey stated a follow-up and a presentation will be provided at the Public Outreach meeting next month.

This meeting was adjourned at 12:25 p.m.

Minutes submitted by: Monica Foster