

Independent Rates Oversight Committee (IROC)

June 24, 2013

MINUTES

1. **Roll call**

Chairwoman Welch called to order the special Workshop of the IROC at 8:45 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, Ann Sasaki, Assistant Director

2. **Non-Agenda public comment**

None.

3. **Update regarding the June 17 IROC Meeting Public Comment: Relocation and Removal of Construction Meters in San Carlos**

Stan Medina, Deputy Director, presented in response for the Department regarding construction meters located within the San Carlos community. He highlighted 3 areas that some meters have been relocated. He noted that 2 of the 3 areas each with 1 meter, have been temporarily placed on Federal Boulevard near I-94 and I-805 until another site is available. The third area in mention located near the I-125 freeway behind Fresh & Easy, has 2 meters, - one of which is still active. He indicated once the future site desired is in working order, the active meter will be removed and located in the Mission Gorge/Princess View Drive area and should occur sometime next week.

Chairwoman Welch asked for an assessment of how this will relieve the issues raised at the last IROC meeting. Mr. Medina indicated that the issues will go away completely, and will not impact other residential areas. He added the City, Sempra, and their subcontractor Beta are always actively looking for other locations, and other inland resources. Vice Chairperson Billings suggested asking SDG&E to mitigate somehow, in a way that is visible to the impacted residence. Mr. Medina indicated that Sempra agreed to re-surface the streets once the project was complete. He stated he paid a site visit recently and the streets show no sign of damage.

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Member Webster asked in regard to the cost of the water, are there other costs involved? Mr. Medina indicated there are standard fees paid per meter. Director Bailey added outside the standard fees the City has relative to construction, there are no additional fees charged. However, this is an area to discuss whether or not the Department can do this, or if Council approval is needed to charge fees that are outside the existing fees.

4. Cost of Service Study (COSS) Rate Design Presentation

Lee Ann Jones-Santos, Deputy Director of Finance, presented along with Brian Jewett and Ann Bui from Black & Veatch. She indicated next steps are to provide this presentation to NR&C on July 10, with a goal of having the Use of Funds, Water Based Budget Billing, and Recycled Water Pricing Study to Council on July 30.

Member Hollingworth asked Ms. Jones-Santos when the Wastewater Cost of Service Study (COSS) would be available. She indicated the tables behind the Water COSS but are not proposing any changes to the rates for the Wastewater side. The updated tables will be provided in the near future.

Mr. Jewett reviewed the key elements for financial viability, cash flow, adequate reserve levels, and debt service coverage. He noted the city is conserving water, however the cost of water purchased from County Water Authority continues to rise, and the net aggregate effect to the water fund has been increasing costs. He added that absorbing the CWA increases has had a negative effect on the debt service coverage ratio, and are barely meeting the aggregate minimum requirement of 1.0 in 2014. Wastewater increases are not recommended for the next 2 years, there is adequate coverage ratio, but a trend of the decline. He mentioned the suggested aggregate target is 1.25 as the rating agencies like to see a cushion.

He indicated recommended is a revenue adjustment next year of 7.25% of which 5% is to capture some of the past CWA absorption as well as another 2.25% for the anticipated CY2014 increases. Also, recommending for FY15 is a 7.50% revenue adjustment.

He then explained what the cost of service entails and reviewed detailed draft graphs outlining cost allocation, showing cost functions and cost causative parameters. Costs are adjusted accordingly by demand, and components are broken down into major functions. He explained in detail the logistics behind cost allocation. He noted when doing a COSS it is important to make sure the current revenue is collected from customer classes is close to the revenue recovered for customer classes doing the new COSS.

Next, Ms. Bui described in detail, the three Single Family Residential (SFR) options: 1) keep existing structure, existing of 3 tiers; 2) increasing pricing differential between tiers; and 3) adding a 4th tier, which recognizes low-end conservative users, and increases pricing differential. She also described the Non-Residential rate structure options being: 1) keep existing structure with a uniform rate; or 2) develop 3-tiered rate structure. She indicated the Multi-family, Commercial and Industrial remain the same, and no change for wastewater rates. Ms. Bui added all three options for SFR with respect to the rates

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proposed will accomplish 100% revenue recovery and essentially 100% by the different customer classes.

Member Hollingworth asked how much water consumption is enough, because the cost structure of the water agencies is not reduced, so customers are using less and charged more. Ms. Bui commented that San Diego is a very desirable area, therefore population will continue to grow as well as business. Conservation is very important for reliability and independence. She reminded him that there are fixed recovery costs, not only consumption costs. Director Bailey indicated the fundamental issue behind conservation is supply, and we still have a limited supply of water, and the goal is to supply the community with a reliable, dependable source of water and conservation is a necessary approach.

Ms. Bui illustrated examples of how the typical bill changes in accordance with the comparison of given alternatives. She displayed examples of low use, medium use, and higher use, under the 4-tier option. Last, she explained that these alternatives are explained to the public in a way that can be understood easily.

Ex-officio Member Williams asked for an explanation of the 3 options from a qualitative description standpoint, and pros and cons. Ms Bui indicated for example, that Option 1 would be equivalent to an “across the board” increase; an example of Options 2 and 3 would be like an additional step to increase the City’s message with respect to conservation.

Vice Chairman Billings commented that customers need to understand that conserving water is very important, and what is in it for them is to avoid purchase of more expensive water, and so more can be invested in infrastructure. Ms. Bui concurred.

Member Hollingworth asked in regard to the proposed revenue adjustment of 7.25% for Water, he suggested an option that the Wastewater portion be reduced. Ms. Bui indicated her concern with this is that there are a number of very large Wastewater upcoming projects. Member Hollingworth suggested that before this is brought forward to Council, that Wastewater reduction option be examined. Director Bailey indicated this can be looked into; however, reminded IROC that the Department will come back in 2 years and assess Desal and IPR, and must be mindful that there are 2 upcoming significant costly projects.

5. Recycled Water Pricing Study

Rita Bell, Finance Manager of the Otay Water District (Otay), commented that late this past Thursday Otay received the Recycled Pricing Study and it is currently under review. She indicated Otay is the largest Recycle Distribution System in the county, and that in 2003 contracted with the City of San Diego (City) to purchase water from the South Bay Water Reclamation Plant. A transmission main, pump station, and reservoir were built, with the City not having any infrastructure to convey water. Since, the City has been using Otay facilities against objection, and is past the point to settle this matter.

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Ms. Bell added that this Pricing Study explains that the Optimized Distribution System was built in North City serving retail customers and will be expanded. She indicated the Otay does not benefit nor use this system, and therefore should not pay for distribution costs. She suggests a proper cost of service study in Prop. 26 would consider this fact. Should the City implement this COSS, the effective wholesale rate for Otay would be costly, when it can purchase potable water from CWA for much less. Ms. Bell indicated the City should have a retail rate that is more in line with other retail customers with industrial standard rate setting. She added that without a wholesale rate, this study is not fair or equitable. With limited time to review, Otay will put all comprehensive comments into a Report and have delivered to City staff.

Karen Keese, representing the Metro/JPA Commission, gave brief background information indicating they are 36% of the Metro Wastewater system, and receive 36% of the recycled water revenue. She stated adequate time was not given to review this, and asked that this not go forward to City Council, and for the City to consider giving them a sufficient amount of time to properly vet the study.

Lee Ann Jones-Santos, Deputy Director of Finance, Sudhir Pardiwala of Raftelis Financial Consultants, Inc., and City staff Jeanne Cole, Program Manager and Dave Stallman, Supervising Management Analyst were present. Mr. Pardiwala reviewed the Recycled Water Pricing Study. He gave a brief background of the historical context, noting that with the Federal court order in 1995, the City complied with orders by 1998 and constructed the North City Treatment Plant (30 mgd capacity) and then the South Bay Treatment Plant (15 mgd capacity). He then displayed map graphs of the current North and South distribution systems.

Mr. Pardiwala noted some observations such that the City has been charging \$0.80 cents per HCF of recycled water, with a small period of time charging \$1.34 then reduced to incentivize the sale of recycled water; the potable water system has benefited from the expansion of the recycled water system; recycled water is part of the City's long range water resources plan; and the cost is apportioned to water, wastewater, and recycled water users. He indicated that in agreement, until the optimized system is paid off, wastewater will continue to bear some of the cost of treatment, etc.

He then reviewed the Revenue Requirements, indicating that the Metro system, as well as the recycled water system, is a unitary system now. Costs incurred at North City distribution system and South Bay has been consolidated into one basic utility to determine the cost of service. He noted that the rebate from MET is set to expire in 2023, and the rebate from CWA is set to expire in 2032, which is a significant source of revenue.

Mr. Pardiwala then discussed the Rate Calculation. All costs should be shared proportionately by irrigation, industrial, and wholesale customers based on peak demands. He noted it was found that wholesale customers have the highest peaking demands than the retail customers, which is unusual.

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He then outlined other agencies recycled water rate charges (75%-90% of the potable water rate), and the City's current water rates (20% of the potable irrigation rate). The recommended rate is 56% of the potable irrigation rate, he then showed graphs showing the proposed commodity rate for recycled water from the current \$0.80/HCF to \$2.24 for the next 4 years (56% of the current irrigation rate). Also being recommended is that meter charges be updated to reflect the cost of providing service, based on the size of the meter.

Mr. Billings asked if there is a rational basis to consider establishing a wholesale rate?

Mr. Pardiwala indicated the whole system is unitary, and all costs are combined in order to determine the rate calculated. He indicated in the industry of the profession, it is possible to look at certain customer's lower peaking factors to see if a lower rate can be assigned to those. In our case as indicated, this is not an option. Ms. Cole added, using the average monthly usage information, illustrated on page 26 of the Report shows that the wholesale peaking factor was greater than the retail.

Ms. Bell commented that Otay does not use the North City distribution system, so the flaw in the peaking is that if you are not using the distribution system and was built to upsize to allow peaks, costs cannot be applied if you are not using it. Mr. Pardiwala indicated peaking is not considered as a differentiator of rates. The overall cost of the recycled water system is spread amongst the use that is occurring in the system.

Member Peugh asked why the two Plants are not analyzed independently. Mr. Pardiwala reiterated that the way the whole recycled water system came about, to meet the requirements of the wastewater system, as well as the placement of the plants. Further, as a matter of policy, if they were to be independent, sales at North City would be jeopardized and Grant condition requirements would not be met. He added that Otay has signed an agreement that they would pay the same rate as the City's customers. Rita Bell commented that Otay also has a take or pay agreement with the City on top of the rate. Ms. Jones-Santos added that compared to other agencies in the region, the City's proposed rate is still lower.

Director Bailey indicated the goal is to present to NR&C on July 10 as a recommendation, and would like this to be an action item. Member Hollingworth recommended, due to opposition, it be moved forward without recommendation.

Karen Keese commented that NR&C meets before the next Metro TAC meeting, and feels this may have a detrimental effect on the sales of recycled water. She asked for more time to review the Report. Member Hollingworth suggested NR&C move the item to the following meeting in order to give adequate time for vetting the Report. Director Bailey explained that in order to meet the schedule for the CWA rate adjustment in January, this is desired to present to the full Council by the end of July, as Council is dark in August.

ACTION: Vice Chairman moved to have staff come back at the next full IROC meeting to discuss the nexus between treating this as unitary vs. non-unitary, and the impact on the

demand for the recycled water product if we were to revisit this and look at the potential for wholesale vs. retail rates. Member Hollingworth seconded. Motion passed 6-0.

6. Water Budget Based Billing

Marsi Steirer, Deputy Director, Luis Generoso, Water Resources Manager, and Kyrsten Burr-Rosenthal, Senior Management Analyst, were present to review the Consultant Report. Mr. Generoso briefly reviewed the timeline, noting that staff will present this to NR&C in July. He indicated the Report has three sections, one to evaluate water based billing for all customer classes; two is to identify any hurdles to implementation; and third, to identify any water conservation programs that will compliment water budget based billing.

Mr. Generoso then reviewed the Phase I results, and indicated that Red Oak made the following findings/highlights:

- Recommended methodologies to develop budgets which varied by customer class;
- The billing system must be upgraded to handle all proposed methodologies and calculations;
- Customers should be billed on a monthly basis and dedication of significant staff resources are required;
- Variance process is very important to assure water budget accuracy and dedication of significant staff resources are required;
- Water budgets can be a useful drought management tool to achieve targeted usage reductions as necessary; and
- The City's existing water conservation programs should be enhanced, in order for customers to meet their budgets.

He then listed other considerations as well.

Ms. Burr-Rosenthal explained the cost estimates for water budgets for all customer classes, as well as the irrigation only customers. She noted that the costs estimates are derived from the findings and recommendations in the Phase I Report. The largest expenses are things such as billing system enhancements, migration to monthly billing, the variance program, and the initial development of water budgets.

She indicated that staff recommends looking more closely at water budgets for the Irrigation customer class. The benefits to this recommendation include a minimal cost and complexity to implement, significant water use in proportion to a relatively small number of accounts, and will allow for implementation of tiered rate structure for irrigation, with those exceeding water budgets paying a higher rate.

Recommended next steps are to go forward with Phase II – rate modeling for Irrigation accounts, followed by a decision point at conclusion of Phase II (which will be brought to IROC as well as City Council). Should that policy decision be to move forward, then project would continue to Phase III – implementation of water budgets for Irrigation accounts. She added that this is only for potable water.

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Member Peugh asked why the Irrigation class would have to go to monthly billing. Ms. Burr-Rosenthal this was a strong recommendation from the consultant; receiving consumption data only every 60 days can make it difficult for a customer to monitor whether they are staying within their water budget – more frequent feedback on consumption should be provided.

Vice Chairman Billings noted he is opposed to using water based budgets for residential customers. He believes if this is looking at Irrigation only, and moving toward a possibility of introducing tiered rates to the Irrigation class, this is positive and another tool for conservation, etc.

ACTION: Vice Chairman Billings moved to accept the Water Budget Based Billing Phase I Report prepared by Red Oak, and recommended that the Mayor direct staff to complete a modified Phase II scope of work for the study to model a Water Based Budget rate structure for the Irrigation customer class. Member Kubota seconded. Motion passed 5-0-1 (abstained – Hollingworth).

ACTION: Member Peugh moved to urge City Council not to move forward with Water Based Budgeting for Residential. Vice Chairman Billings seconded. Motion passed 5-0-1 (abstained – Hollingworth).

7. **IROC Member's Comments**

None.

This meeting was adjourned at 12:10 p.m.

Minutes submitted by: Monica Foster