

REVISED



THE CITY OF SAN DIEGO

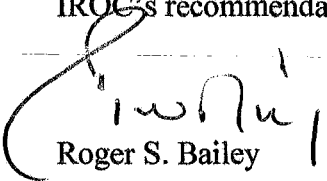
MEMORANDUM

DATE: January 30, 2013
TO: Independent Rates Oversight Committee (IROC)
FROM: Roger Bailey, Director of Public Utilities
SUBJECT: FY2012 IROC Annual Report

On December 21, 2012, IROC issued its FY2012 Annual Report which included 15 Key Recommendations.

We agree with 7 recommendations, partially agree with 6 recommendations, and do not agree with 2 recommendations. We have prepared responses to each of the recommendations (see attached). We will update IROC periodically to keep you informed of our progress towards implementation.

I would like to express my gratitude on behalf of the Public Utilities Department for your insightful and wide ranging recommendations. Staff will continue to evaluate and consider all of IROC's recommendations for implementation.


Roger S. Bailey

Attachment: Public Utilities Department Response to the FY 2012 IROC Annual Report

cc: Honorable Mayor and City Council
Independent Budget Analyst
Jay Goldstone, Chief Operating Officer
Tom Zeleny, Deputy City Attorney

Public Utilities Department Response to the FY2012 IROC Annual Report

The complete FY2012 IROC Annual Report can be found on the City's website at:

<http://www.sandiego.gov/mwwd/general/commissions.shtml>

The following is a summary of IROC's 15 Key FY2012 Recommendations followed by staff responses.

IROC recommends that:

1. No further water rate increases or sewer rate increases to be adopted - either retail or pass-through - until the current rate structure can be recalibrated through the cost of service study currently underway; including IROC's review of the revenue, expenditures, and sales volume assumptions underlying the study.

Department's Response:

The Department agrees with this recommendation.

The Department will continue to provide presentations including detailed five-year revenue and expenditure information and the various assumptions in the Cost of Service Rate Model.

2. The Department should contract with SAP to develop a software patch for the SAP system to fix a critical missing element for management control and reporting concerning project-to-date "budgets versus expenditures/encumbrances."

Department's Response:

The Department does not agree with this recommendation.

This issue was also addressed in the CIP Audit. The data is available and City staff is working on the report creation. The City is expected to have this report in production by the end of March 2013.

3. IROC should be given access to the Excel model underlying the upcoming cost of service study and that it also receives quarterly internal cash flow forecast model reports being generated internally within the Department. IROC further recommends that the model and related cash flow forecasts be submitted to IROC and the Council prior to any proposed rate increase as justification for the increase.

Department's Response:

The Department partially agrees with this recommendation.

The Department will provide hard copies of the data relating to all revenue and expenditure detail, including the various assumptions incorporated in the Cost of Service Study Rate Model. The five-year cash flow projections will be provided as part of this information. These cash flow projections will be the same information utilized in the rate model. We will work with the new administration in determining the supporting documentation needed to accompany any Cost of Service Study updates.

- 4. The 2013 Cost of Service Study (COSS) cash flow forecast model should be structured to provide for a direct comparison of forecasted cash and investment levels to future actuals as reported in the Comprehensive Annual Financial Report.**

Department's Response:

The Department partially agrees with this recommendation.

The annual reconciliation between the Cost of Service Study assumptions for revenue and expenses will provide the necessary information to explain any material changes in the cash balance. This reconciliation will be presented to IROC in the third quarter of the following fiscal year after the completion of the Comprehensive Annual Financial Report. The investment levels are monitored and maintained by the City Treasurer's Department. This request is outside of the normal Cost of Service Study development and standard practices.

- 5. An annual variance analysis and reconciliation be done between Comprehensive Annual Financial Report (CAFR) results to the COSS forecast to determine the extent to which actual results are on target with forecast and the cause of any variances.**

Department's Response:

The Department partially agrees with this recommendation.

The model will incorporate projected revenue and expenditure information to determine the net revenue requirement for both the water and wastewater systems. Although the model is developed on a cash basis, it incorporates and relies on elements that are in the CAFR. Typically, once the COSS has been finalized for both systems, the Department's Rates and Finance Section will compare projected revenue and expenditure information to actuals on an annual basis based on supplemental financial information provided by the Comptroller's Office. This will include a detailed comparative analysis of revenues, O&M expenditures, CIP expenditures and debt service. This reconciliation will be presented to IROC in the third quarter of the following fiscal year after the completion of the Comprehensive Annual Financial Report.

- 6. The NR&C Committee request the Independent Budget Analyst to verify that the \$15M transfer from DRES to the Rate Stabilization Fund was made as represented, and report its findings to IROC. IROC also recommends that the Department prepare updated Water Fund Debt coverage ratio projections for review by IROC which both**

includes and excludes the \$15M transfer to the Rate Stabilization Fund to verify that the debt coverage ratio was in danger of falling to 1.10.

Department's Response:

The Department partially agrees with this recommendation.

At the December 2012 IROC Finance Subcommittee meeting, the general ledger was provided to validate the transfer of funds from DRES to the Rate Stabilization Reserve. The Department will provide updated Water Fund Debt coverage ratio projections for fiscal year 2014 and additional projections will be provided with the draft calculations from the active Cost of Service Study.

- 7. The Department work with IROC's I&O Subcommittee to develop appropriate CIP reporting to facilitate IROC's timely completion of quarterly CIP schedule and expenditures reviews.**

Department's Response:

The Department agrees with this recommendation.

The Department will work with the I&O Subcommittee to enhance the current IROC CIP reporting so that it meets both the IROC and I&O Subcommittee needs. Our goal is to provide a comprehensive report of the CIP program at the project level. The report will show each project's cost and schedule, and include a list of critical projects mandated by the regulatory agencies, high profile projects under construction such as Lindberg Field and Harbor Drive pipeline replacement, and projects with large project costs.

At the December 10, 2012 and January 14, 2013 I&O Subcommittee meetings, the Department in cooperation with Public Works staff presented our recommendation to change the CIP project schedules from a Gantt chart format to an Excel spreadsheet format. The spreadsheet format will include the baseline and current schedule dates for the critical activities and their variances. This new schedule reporting format will allow the committee members to quickly identify projects that are behind schedule and/or exceeding planned expenditures. With the consent of the I&O Subcommittee on the final format of the spreadsheet, the Department will present it to the full committee for review.

The Department will continue to work with both the IROC and I&O Subcommittee to improve the reporting of our CIP program.

- 8. The Department provides results of their condition assessment review for the Asbestos Cement (AC) replacement program, as well as possibilities for alternative cost-savings measures.**

Department's Response:

The Department agrees with the recommendation.

AC pipelines make up two-thirds of the total pipelines in the City's distribution system with 2,100 plus miles out of the 3,200 plus total pipeline miles. The AC pipelines were installed from the 1930's to the 1980's, range in size from 2 inches to as large as 20 inches, and are scattered throughout San Diego. The AC Program is divided into two phases: a short (Phase I) and long term plan (Phase II) that will address inventory, condition assessment, and replacement needs that will help establish a comprehensive AC pipeline asset management system. Phase I will address approximately 80 miles of the most critical AC pipelines based on a criteria matrix, and Phase II will address the 2,000 plus remaining miles of AC pipelines.

Phase II will be a consultant based effort and will address condition assessment, risk analysis, statistical modeling/prioritization, replacement rates, and financial analysis. The Department is in the process of procuring a qualified consultant specialized in AC pipeline assessment and expects to kick off the Phase II Program before the end of FY 2013. Phase II findings are expected to be completed by the second quarter of FY 2015.

Complete results of the AC pipeline condition assessment program will be presented to IROC upon completion of Phase II Program; progress reports will be provided as necessary. Alternative methods for construction, including lining the pipes, are currently being examined by the Department in conjunction with the Public Works Department, and will be further studied in Phase II by our selected consultant; these findings will be presented to IROC when available.

9. **The Department provides an update on the Automated Metering Infrastructure (AMI) Project deployment process and suggests that the project move at a more rapid pace and includes more classes of consumers.**

Department's Response:

The Department partially agrees with this recommendation.

The Department will provide regular updates on the status of the AMI project. A contract for the selected vendor to provide and install the AMI system was approved by the City Council in November 2012. Implementation of the system should begin in the next 60 days and be completed by the end of the calendar year, December 31, 2013. This initial targeted implementation of approximately 11,000 service locations includes customers in all customer classes. Since this is a pilot, the project will prove out the benefits and impacts of AMI in our system as well as provide the necessary data to support future decisions regarding broader use of this technology.

10. The Department provides an Advanced Water Purification Demonstration Project presentation to IROC, specifically detailing their outreach to the various community leaders, and their engagement with them to help promote the project outreach and awareness efforts.

Department's Response:

The Department agrees with this recommendation.

The Department will continue to foster existing relationships with stakeholders and seek new avenues for assistance in the promotion of the Water Purification Demonstration Project.

Public outreach and education objectives were identified early on in the planning stages and fully detailed in a communication plan. Key stakeholders were identified through a variety of ways: City Councilmembers, Water Reliability Coalition members and by reviewing lists of stakeholders interviewed during the Water Reuse Study.

It was concluded that the most effective way to achieve the goal of informing San Diego residents about the water purification process was through focusing communication efforts on community leaders and stakeholder groups or organizations. Key audiences for the outreach program included local business, environmental, civic, and community leaders from all areas in the City of San Diego, including multicultural communities; members of community planning groups and neighborhood councils; elected officials at all levels of government; media representatives; special interest groups such as seniors, the health community, science students, and religious leaders; Public Utilities Department staff; and water agencies throughout the county.

Stakeholders were engaged through various activities including a speaker's bureau, informational materials (including those for multicultural audiences), community leader interviews, AWP Facility tours, community event involvement, research surveys, social media, videos, and a dedicated website.

Outreach efforts officially began in March 2010, and since that time, the City has conducted 132 presentations, hosted informational booths at 42 community events, and hosted 3,244 visitors to the AWP Facility as of December 2012.

To gauge the progress of the outreach program, public opinion research polling was conducted in 2004, 2011, and 2012. Analysis of the data found a steady increase in residents favoring the use of water purification to diversify the City's water supply.

The Demonstration Project received recognition for their outreach efforts in 2011 by winning the WaterReuse Association Public Education Program of the Year award.

11. The Department fix the call center operational problems with respect to call center times and billing inconsistencies, as identified by IROC members, as soon as possible and report back to IROC.

Department's Response:

The Department agrees with this recommendation.

The customer experience and customer service is very important to the Department. The Department has been working to improve both the wait time for customers calling the customer service call center and the information contained in customer bills. The Department will continue to update IROC members quarterly on the progress of these efforts. It should be noted that the "billing inconsistencies" identified by IROC members are specific to the clarity of information contained within the bill and labeling/messaging to convey the purpose or reason for off-cycle or exception bills to enhance customer understanding and avoid confusion. The calculations of customer fees and charges included in customer bills have and continue to be performed accurately within the customer information and billing system.

12. The Department develops a policy for future temporary large water use projects that requires as a condition of obtaining a permit, a plan to mitigate these issues prior to project commencement.

Department's Response:

The Department agrees with this recommendation.

The Department agrees that a policy should be developed to address water usage during construction of large projects. We will evaluate the feasibility of updating the City's Water Design Guide to stipulate this policy with the following considerations:

If a project outside the City limits is requesting temporary water service from the Department for construction water, the project owner should address or subsequently amend its environmental document to include water delivery (potable or recycled) from the City similar to any development project occurring within the City. Impacts under CEQA will include, noise, traffic, water availability, community impacts, community input, etc. The environmental document will be submitted to the Development Services Department for review. Once the environmental document has been approved by the City, the temporary water service can be granted and the project owner will pay all applicable fees.

The water use for projects within the City limits is currently addressed during the discretionary and/or ministerial approval process administered by the City. As a part of the requirements, the project's environmental document will analyze and document impacts to noise, traffic, water availability, community impacts, community input, etc. The project's environmental document is reviewed by Development Services Department and ultimately approved by the City Council. In addition, if required, the project's water study will further

address pressure, flow, and velocity issues as well as construction phasing and temporary water facilities (pipelines, pump stations, etc.) issues. The water study is approved by the Public Utilities Department.

13. The Department presents Managed Competition project options to IROC at a future meeting.

Department's Response:

The Department partially agrees with this recommendation.

At this time the Mayor has directed that all managed competition projects be suspended until directed otherwise. The Department will provide updates on any policy changes regarding managed competition.

14. The Department reports back to IROC with an evaluation of the cost effectiveness of expanding the purple pipe to specific Commercial and Industrial users.

Department's Response:

The Department does not agree with this recommendation.

An evaluation was conducted as part of the 2010 Recycled Water Master Plan Update (Plan) and Recycled Water Study. The researchers performed a market assessment to identify potential new customers of non-potable recycled water. The assessment showed that potential new customers are disbursed across the City's service area. Realizing that the infrastructure requirements to serve all potential customers is estimated to be \$430 million, the City chose to focus on recycled water distribution expansion concepts in areas with high occurrences of potential customers.

The high cost of system expansion shifted the non-potable focus to infill customers only. These infill customers are close to existing distribution system infrastructure, so that capital improvements required to serve them are relatively low cost. Future infill demand is estimated at 7 million gallons a day (mgd) and would increase recycled water city-wide demands from 11 to 18 mgd.

The Plan was accepted by City Council on July 17, 2012 (R307584). The current market expansion strategy is to continue to connect infill customers, and build small pipeline extensions to connect sites within close proximity of the existing recycled water distribution system.

15. The Department reports back to IROC on the Bid to Goal program status and the Bid to Goal replacement program.

Department's Response:

The Department agrees with this recommendation.

The Department will report to IROC at the conclusion of the two Programs which were effective during FY 2010 and 2011. Final awards to employees are expected in February and final projects funded by the Employee Efficiency Incentive Reserve (EEIR) must be approved within 12 months of the final audit, anticipated to be March 2014. Any funds remaining will be transferred to the respective DRES accounts. The Department is actively engaged in developing Recognition and Rewards Program concepts to be presented to the City administration at the Mayor's request.