

Independent Rates Oversight Committee (IROC)

February 19, 2013

MINUTES

1. **Roll call**

Chairwoman Welch called to order the regular meeting of the IROC at 9:03 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; and Tom Zeleny, Deputy City Attorney.

2. **Non-Agenda public comment**

None.

3. **Approval of Draft Minutes of January 22, 2013**

ACTION: Chairwoman Welch asked for a motion to approve the minutes as submitted. Member Peugh moved, and Member Hollingworth seconded. Motion passed 7 (in favor)-0 (opposed).

4. **Chair updates** – *Chairwoman Welch*

- Scheduled meeting with Mayor Filner Friday, February 22 at 2:00 p.m. Member Peugh has also reached out to Donna Frye, who may be in attendance. Will be looking to solicit a point of contact for IROC with the Mayor’s office to regularly interface with.
- Presentation of the FY2012 Annual Report to Natural Resources & Culture Committee (NR&C) on February 27. The Public Utilities Department will also be in attendance to respond.
- Announced that Noam Glick and Michael Ross have both resigned from IROC due to work commitments. They were much appreciated while serving on the Committee. There are two (2) vacancies, and this will be discussed on Friday’s meeting with the Mayor. She asked if IROC members have any recommendations of potential members, to please notify her.

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- She asked all subcommittees to finalize their portions in their respective March meetings so it can be brought to the full IROC in March. It can then be presented to NR&C on April 17, to meet the requirement as outlined in the new Charter.
- Subcommittees have discussed recommendations for the 2014 Performance Audit to be performed by the Office of the City Auditor (OCA). These will be fine tuned in the March meetings, to discuss with the OCA. She asked that any topics and/or key questions be identified so the OCA can properly evaluate the suggestions.

5. City Staff updates

Stan Griffith, Assistant Public Utilities Director, mentioned on January 26, the California Water Environment Association, San Diego Section, presented the City of San Diego a Collections System of the Year award for systems that are over 500 miles. This is a great accomplishment and also allows us to compete with other State agencies for the System Award for large systems. Updates are as follows:

- Terrell Powell, Water Utility Supervisor: 8 sewer spills this year vs. 9 this time last year. He noted the volume of spills is down, and the miles of pipe cleaned are about the same.
- Stan Medina, Deputy Director of Water Operations: 12 fire hydrant knock-overs year to date vs. 11 the same time last year. There have been 27 water main breaks vs. 20 this time last year.

This past Friday there were 4 breaks in a 24 hour period and 1 large break the following day in Pt. Loma at Nimitz Blvd. This was a 16 inch water main installed in 1943 (70 years ago). He noted Harbor Drive, “Second Pipeline” is in the process of being replaced and should break ground in April. There was some damage to several homes and vehicles. Water was restored the following early morning.

Member Peugh indicated he would like to know how long it took before the water was secured. Mr. Medina stated he believes approximately 3a.m., but he will get back to him on the duration of time.

Member Hollingworth asked about the onramp to I-8 at Rosecrans partial closure. Mr. Medina indicated this was a 12” PVC break at this location. This was newly installed and still under warranty; the contractor will be billed for all repairs and damage. Member Hollingworth commented within a very small area, there has been a series of main breaks. He asked if there could be a construction defect involved. Director Bailey indicated there are coming meetings to start an assessment, beginning today. He will provide updates to IROC.

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Member Kubota recommends if possible, the Department provide pictorials of these events to give the public a visual of the needs of the Department.

Director Bailey commented he would like the Department to provide an annual financial item to IROC presenting the basic understandings of the financial obligations, terms, and also an opportunity to address any questions.

6. Mayor and Council Staff Comments

No one was present to comment. Chairwoman Welch indicated when she meets with the Mayor's Office she will try to identify a point of contact from their staff, to interface with more regularly.

7. Public Utilities Financial Presentation

Lee Ann Jones-Santos, the Deputy Director of Finance & IT, along with Scott Clark, Principal Accountant of the Office of the City Comptrollers, and Tom Haynes, Program Manager of Finance & IT Budget Section were present to provide an overview of the financial statements which include information related to cash balances, unrestricted net assets, debt coverage ratios, Capital Improvement Program (CIP) what was proposed in the last Rate Case and future projections, and estimated revenue from the last Rate Case.

Ms. Jones-Santos referred listed and described the 3 primary financial statements: Statement of Net Assets (snapshot of the utility on the last day of the fiscal year), Statement of Revenues, Expenses, and Changes in Fund Net Assets (depicts the operating results of the utility over the fiscal year), and the Statement of Cash Flows, explaining how the financial statements link together and how they must balance. She noted the Water and Wastewater funds are separate enterprise funds and cannot be combined.

She then presented the FY2012 ending balances, and provided a breakdown of the unrestricted Net Assets for Water and Wastewater. She noted that the Department plans on funding the CIP program with cash on hand. She showed the projected capital expenditure preview for FY2013-2016. She reminded all that the CIP program is on-going.

Member Billings asked if there is a Federal Consent Decree. Tom Zeleny, Deputy City Attorney, stated the Decree has an expiration date of July 1, 2013 assuming all projects are complete – then the mandate goes away. Mr. Zeleny indicated he believes we are on track.

Ex-Officio Member Natividad asked if there is a policy on the amount of reserves. Ms. Jones-Santos stated for the operating reserve, it is a number of days, and for Water and Wastewater it was ramped up to 70 days for each fund. There is a CIP fund of \$5M as well as appropriated reserve at \$3.5M per fund at the Director's discretion, a rate

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stabilization reserve at \$20.3M-\$21.5M. This has been presented to IROC, and she can present again by request.

Ms. Jones-Santos described Debt Service Coverage Ratios; she noted the key is that it is an annual calculation required by a bond covenant. The Comptroller's Office prepares on an annual basis, whereas the Department prepares projections throughout the fiscal year. This was provided to the Finance Subcommittee today. She then explained the debt coverage ratio calculation and the difference between Aggregate and Senior debt coverage ratios. She also described the calculation which is defined by the Master Installment Purchase Agreement (MIPA). Again, the ratios are prepared annually by the Office of the City Comptroller. The Department prepares projected debt service ratios on an on-going basis.

Member Hollingworth observed and indicated he is concerned that if too much cash is collected in the past year and draw down, this could impair future debt coverage ratios in the future. She stated that the receipt of the grant proceeds and the ability to record that in the debt coverage ratio (DCR) was taken advantage of, and were able to set funds aside for FY14. This is why the Department does on-going projections for debt coverage ratios to evaluate alternative scenarios. She indicated the use of the Rate Stabilization Reserve was established to be used to maintain a consistent DCR, and deposits reduce your current year revenue.

Ms. Jones-Santos reviewed the Water DCRs for FY2011-2014 (audited figures for FY2011, FY2012 and projected figures for FY13 and FY14). She noted the aggregate debt of 1.02 for FY2014 appears thin; however, the Department is conservative with projections.

She gave a brief overview of the Water and Wastewater Funds for FY2008-2011 CIP as proposed in the 2007 Rate Case, as well provided graphic charts of what was proposed. She noted that CIP execution was initially delayed but still met all regulatory requirements and more than was proposed. Ms. Jones-Santos then listed the number of miles of Water pipelines replaced.

Ms. Jones-Santos then reviewed the Water CIP expenditures for the Rate Case vs. Actual as well as the CIP execution for Actual FY2008-2013 as of December 2012. She stated this was just the projects incorporated in the Cost of Service plan, not including unplanned projects.

Member Hollingworth commented that an issue is that the rates were increased to build a set of projects in the 2006 Rate Case, and some are still in process. Meanwhile, others were added substantially increasing the program scope. He asked when the 2006 projects will be built. Ms. Jones-Santos indicated many have been built. She suggested reviewing

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the Taxpayers/Lockdown table showing all of the detailed information, as well as what unplanned projects have been added to the program. Member Hollingworth added that the rate payers deserve to have the entire scope for 2006 completed in a timely manner. Director Bailey concurred that the presented Cost of Service schedule of 2006 needs to be completed, which most of the projects have, and still working toward this goal; however, the City has a very complex and old system that must be managed as needed, at the same time complying with all regulations.

Ex-Officio Member Williams enquired about the diagram on slide 38. He asked if only less than half of the money borrowed was spent during a 4 year period. Ms. Jones-Santos indicated yes, due to many CIPs coming under budget, projects were executed in the timeframe required. In addition, additional projects were added. Also, the EPA Consent Decree requirements were completed and/or ongoing with anticipation of completion by the expiration date, and more miles were completed at a cost less than projected.

Director Bailey asked the IROC to keep in mind that a schedule of cost and a construction schedule are two different things and do not generally align. Ms. Jones-Santos added funds need to be available as we approach entering into the projects. Also, the CIP streamlining should help with shortening the timeframe.

Last, Ms. Jones-Santos reviewed graphs and explained how Water and Wastewater CIP components were funded. She then gave a comparison of Water and Wastewater revenues from the rate increase from the Cost of Service Study versus the calculated revenue received from those rates. She pointed out there is currently a review of funds taking place with Macias & Gini, and the charts outlined in the handouts are DRAFT.

8. Cost of Service Study (Assumptions and Revenue Requirements) – First Draft

Brian Jewett of Black & Veatch introduced team members Ann Bui and Alberto Morales, to give an overview of the Water and Wastewater Cost of Service Study. Mr. Jewett indicated that the focus in this meeting is to discuss the Revenue Requirements: assumptions, constraints, and scenarios.

Ms. Bui pointed out many factors that have occurred over the past 5 years that were not anticipated in the last rate case, but do form the basis for the current rate case going forward. Mr. Jewett gave a 5 year overview of the O&M escalation factors based on the City's 5-year financial outlook of October, 2012, and CIP assumptions.

Mr. Jewett reviewed project prioritization. He noted the City needs to complete all mandated projects; examine annual water and wastewater prioritization lists based on Council Policy and Department sub-criteria, especially health and safety, mandates, constructions and grant/loan funded projects; and public safety and operational aspects of main breaks and sewer spills, as well as reduce the unaccounted for water. He then described the water replacement mileage of using the typical 1% guideline of replacement per year, over FY09 through FY18.

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Vice Chair Billings asked why it is typical to use 1% when this would not be feasible. Ms. Bui indicated this is a guideline, as there are others area of the country in which the life of pipes could be significantly longer. She added when the Condition Assessment results are complete, she realizes the asset life on certain lines may be shorter that suspected and longer on others and there will be adjustments. Replacement is an ongoing program, not a project and there are goals the Department would like to achieve over time.

Member Peugh commented in prior discussions, he asked what the CIP would be based on, and believed there would be a fairly sophisticated look at the system needs. He indicated using a 1% guideline does not seem efficient for the City's needs. He expected more analysis would go into the projection. Ms. Bui indicated again that the Department is undergoing a Condition Assessment currently, and until then there must be a target.

Director Bailey suggested an alternative may be using a 30 miles per year, or less than 30 years, then in comparison see what the impact would be to the rate projections. The results could be brought back to IROC, and discussed with the Mayor and Council. Vice Billings asked if the costs of not replacing in an optimal way be included, as well as the costs associated with additional maintenance, etc.

Vice Chair Billings indicated he would like to start with an optimized investment program, taking into account the internal and external costs of not doing enough that an optimization study indicates we should be doing, rather than making unrealistic assumptions. Mr. Hollingworth suggested having a baseline forecast, as well as an aggressive CIP Program scenario. Member Peugh added the needs of the system should come first.

Mr. Jewett then reviewed the much more aggressive Wastewater mileage replacement chart. Member Peugh commented in his view, the Water side should be more aggressive, based on the reports. Mr. Jewett added there are more mandates on the wastewater side, which is a factor to the aggressive schedule.

He then briefly reviewed water purchase assumptions, as well as reviewed the FY08-FY12 water purchases by acre-feet and cost. Vice Chair Billings asked as water rates rise, at what point can we factor in the cost to the rate payers. Ms. Bui indicated that the more difficult factor is whether or not to make the increase in that purchased water cost, revenue neutral. Currently, in the COSS any increase is revenue neutral and will show a scenario of impact in the detailed report.

Director Bailey suggested an alternative of having a scenario in which the actual adjustment on wholesale water supply is factored into the rates, showing what the additional revenue requirement would be for the cost of service. This will give the rate payers an understanding of what the rates would be if it is not revenue neutral. Member Hollingworth concurred. Member Peugh asked if the affordability issue will be studied. Mr. Jewett stated yes they will.

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Mr. Jewett then reviewed the customer account and usage growth for water and wastewater for FY2014-2018. He noted we projected the first two years to be conservative and gradually increase the percentage going forward.

Member Justus asked for clarification as to why, on the Water and Wastewater charts slides 12 and 13, it shows projected percentage amounts in FY2016-2018 for Wastewater, but shows zero for Water. He asked if these should correlate. Director Bailey indicated most of the discretionary use of water does not go into the sewer system, much is irrigation purposes. However, this should be followed up on. Ms. Bui concurred.

Mr. Jewett then reviewed Financing Assumptions on the Capital side. He listed there is no anticipation for Grant money received over the forecast period; the guideline of 80% Bonds 20% Cash Financing continues; and are listing only the signed agreements for the SRF loans. Member Peugh asked if the 80/20% guidelines have had long term analysis showing this will allow us to most economically maintain our system over a period of multiple decades. Ms. Bui stated this is the City's guideline at this time. Member Peugh would like to see modeling done occasionally, with the declining water supply, looking ahead.

Mr. Jewett listed and reviewed the main components of the Revenue Requirements being Revenue, Operating Budget, Capital Program, Reserves, and Financing Sources. Member Hollingworth questioned the Capital Improvement Program, indicating it appeared very aggressive for what could be accomplished. James Nagelvoort, Assistant Director, elaborated on the need to ramp up. Member Hollingworth suggested looking at the CIP schedule of timing moving forward, expressing his concerns with the execution. Ms. Bui indicated this can be delved into going forward, and recognizes this is a major element and cost.

Director Bailey asked to keep in mind to look at the needs of the operation, and be cautious to not set the schedule based upon the current capacity to do the work, but also the needs of the system. The execution should be improved, now that the MAC contracts are in place. He asked if adjustments alternative to the current schedule are requested, this can be looked at.

Mr. Jewett also shared a chart outlining FY2014-FY2018 Water revenues & revenue requirements not assuming County Water Authority increases, as well as Wastewater. Member Hollingworth asked him to recheck the numbers listed for Water. He added he would like to have a Special meeting to review the Cost of Service Study in detail, and this would be included. Ms. Jones-Santos, Deputy Director, indicated the reserves and current encumbrances were backed-out which could be the difference, but this can be discussed in the meeting.

Mr. Jewett pointed out the Debt Financing constraints, as well as reviewed Water and Wastewater debt service coverage for FY2014-FY18.

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Last, Mr. Jewett listed what was excluded from the Cost of Service Study. This included: cost of desalination, secondary treatment at Pt. Loma, AMI costs beyond those authorized by R-307885, IPR, Recycled water pricing study, and water allocation budget structure.

Member Hollingworth indicated he would like to hold a special Joint Finance/Infrastructure & Operations Subcommittee Meeting soon to go over the more detailed assumptions. After discussion, it was decided a meeting would be scheduled in the next few weeks.

Director Bailey indicated the follow-up items he understood include: looking at an alternative replacement schedule in terms of quantities, which can affect cost; rate recommendation that assume the pass-through is not revenue neutral; and clarification of the zero % growth.

Ex-officio Williams commented the Cost of Service Study is a great opportunity to take many of the Department issues, and gain some agreement as to what the issues are and what some approaches can be. He commended the Department and Black & Veatch for bringing the valuable detailed information.

Vice Chairman Billings noted one other item he would like to explore would be the financing guideline of 80% Bonds 20% Cash Financing. Member Hollingworth recommended the members prepare and forward any questions they have, as well as members or members of the audience may have, and submit them so Black & Veatch can prepare a response.

Chairwoman Welch thanked the Department for presenting the overview and background of the Cost of Service Study, as well as Black & Veatch's hard work.

9. Subcommittee Reports:

a. Finance – Andy Hollingworth

- Discussed the \$15M transfer from the Dedicated Reserve & Efficiency Savings to the Rate Stabilization Fund. The subcommittee came to a decision to support the transfer. He added he would recommend this message be relayed to the NR&C, if the members agree. Vice Chairman Billings and Chairwoman Welch concurred.
- Reviewed the Public Utilities Department responses to the Finance section of IROC's Annual Report. There were concerns about their response, about whether or not the investments should be included in their cash position. Also there was a disagreement concerning the Purple Pipe. Chairwoman Welch indicated she was looking for a follow-up on the Department's Recycled Study and to identify who those infill customers were, and what the Department's plan would be to move forward with them. Director Bailey commented he spoke to Chairwoman Welch and the Department is committed to make sure the infill opportunities will be looked at.

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b. Infrastructure and Operations – Jim Peugh

- Discussed the Limnology Study, pointing out potential vulnerabilities in the study.
- Discussed thoughts for future audits.
- Brief on the Waiver readiness

c. Outreach and Communications – Irene Stallard-Rodriguez

- Discussed the importance of the full IROC to conduct tours of the Public Utilities Department facilities. She noted since there are members that have resigned recently, it would be favorable to wait until the positions are filled.
- Discussed the FY2014 Work-plan, and developed a format for the subcommittees to use.
- Update from Brent Eidson, including some Cost of Service information.

10. Metro/JPA Report out – Gail Welch

None.

11. Proposed Agenda items for next IROC meeting

- All Subcommittees finalize their portions of the FY2014 Work-plan, keeping it to 1 page.
- All Subcommittees finalize recommendations for the Performance Audits.
- Potential overview from the MWD and their operations and cost drivers.
- The 2nd Quarter Capital Improvement Program Report.
- Long Range Water Resource Plan
- Potential Water Purification Demonstration Project Update. (April)
- Pt. Loma Permit Modification to secondary treatment. (April)
- FY2014 Public Utilities proposed budget. (April)

12. IROC Member's Comments

Member Hollingworth asked in regard to the Proposed Budget, will IROC have a chance to review the budget before it goes forward to the Budget and Finance Committee to make comments. Director Bailey suggested during the meeting with the Mayor this coming Friday, perhaps this process can be discussed and determined if IROC may view the budget before or after the Budget and Finance Committee.

Chairwoman Welch adjourned the meeting 12:00 p.m.

Minutes submitted by: Monica Foster