



Independent Rates Oversight Committee (IROC)
 March 11, 2013
 Special IROC Meeting Minutes

1. Roll Call

Chairwoman Welch called to order the special meeting of the IROC at 10:07 a.m. Monica Foster conducted roll 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 |

Department representatives: Roger Bailey, Director; Tom Crane, Assistant Director; and Tom Zeleny, Deputy City Attorney

2. Non-Agenda Public Comment:

None.

3. Discussion of the Public Utilities Department Cost of Service Study (COSS)

Director Bailey gave a brief overview. He indicated this will give us the opportunity to review different scenarios, costs, raw water supply and impacts of potential future County Water Authority (CWA) rate increases, as well as Capital Improvement Program (CIP) project costs.

Lee Ann Jones-Santos, Deputy Director of Finance Information & Technology, introduced Alberto Morales and Brian Jewett of Black & Veatch (B&V); and Jeanne Cole, Rates & Finance Program Manager, Guann Hwang, Deputy Director of Engineering & Program Management, and Darren Greenhalgh, Deputy Director of Public Works, Engineering.

She reviewed the agenda for the meeting noting there were some written questions received ahead of time from IROC members, and these would be addressed in detail at the conclusion of the presentation.

Mr. Jewett reviewed a presentation that was presented to members at the February 19 IROC meeting, noting a few updated and additional slides. He reminded members the

current area of focus for the COSS is related to revenue requirements, and that the cost allocation, and rate design features of the COSS will be addressed in a future meeting.

Mr. Jewett briefly listed major milestones that have affected rates within the City, and reminded members that there are always game changers such as the Waiver and Indirect Potable Reuse that can change the cost structures. He added they are focusing on the next 2 years for this rate case, with the idea there could possibly be another COSS in a few years. Aside from recapping information presented at the last full IROC meeting, he highlighted the following areas and changes:

- He noted that for the Water benchmark of 1% replacement mileage, this mileage may change in the future, after the needs analysis is fully vetted by the Department. The Wastewater side is comfortable with the current projections.
- Water purchase assumptions are a large factor of the O&M expenses, he noted as of now it is anticipated a 5%-9% pass through from CWA, if the increases are absorbed, a number of COSS items will be affected related to reserve funds and debt coverage ratios. He added the City is reducing its reliance on CWA water, however the cost of CWA is increasing.
- He reviewed the Water and Wastewater Account & Flow growth charts were revised from the original handouts last meeting. He pointed out that for Wastewater a return factor for residential and non-residential wastewater flow has been incorporated into the model. (*Handouts provided.*)
- He indicated changes to slides 20 and 21. For Projected Water/Wastewater CIP Budget for FY14 and FY15 was now assuming an \$80M CIP after discussions with Department staff to come down to a more reasonable amount from an execution standpoint. He noted the Department is still analyzing the CIP, and it is likely for FY16-18 numbers may change.

Member Peugh asked if the CIP is designed to accommodate the City's capacity to issuing and manage contracts as opposed to the need for pipe replacements. Mr. Jewett indicated it is based on what is executable over the next couple of years, as the outer years are still being refined to identify the needs. Ms. Jones-Santos added there also needs to be a ramp-up going forward. Director Bailey indicated it all needs to balance, and that the Department is willing to consider reasonable suggestions and scenarios, but need to consider Council's willingness to accept a more aggressive replacement schedule.

Member Peugh commented the EPA indicates that utilities should ramp up the infrastructure replacement to approximately 2% a year by the year 2030. He suggests the Department focus on where we need to be in 20 years, so in turn, the COSS should describe what rate decisions in these next 2 years will best prepare us.

Mr. Jewett compared scenarios for FY14-18 revenues and revenue requirements for Water showing what the order of magnitude would be, for not including future CWA

increases vs. including a future 5% increase or a 9% increase, as reserves would be drawn down with cash while financing the CIP. Vice Chair Billings added that the baseline is not passing through the actual cost of water increases already absorbing from prior years. Mr. Jewett concurred.

Mr. Jewett reminded IROC that the City re-entered the bond market in 2009, and it is critical for the City to maintain those good ratings. He noted there are covenants in each existing installment agreement and SRF loan agreement, and if violated, technical default or full default could occur, making future bonding more expensive. Vice Chair Billings commented that IROC would not support a rate case that could possibly risk a default. Ms. Jones-Santos indicated the goal is to show a variety of scenarios to see what it would look like, so the figures for O&M, CIP, and Revenues are draft for this purpose. Director Bailey concurred with Vice Chair Billings; the Department has an obligation and will be very actively engaged with the policy makers.

Mr. Jewett pointed out the Water debt service coverage, giving examples of the order of magnitude with absorbing the CWA pass-throughs. Director Bailey reemphasized bringing this to the public's attention that absorbing the rate increase costs this time around is not an option. He added there is difficult work ahead, and if costs were absorbed it would be seriously problematic for the Department. His goal is to capture issues in a factual way. Member Hollingworth concurred, however the financial planning seems to be a concern of his.

Last, Mr. Jewett reviewed the items excluded from this COSS, and would need to be incorporated in a few years. Those listed were the cost of desalination, secondary treatment at Pt. Loma, AMI costs beyond those authorized, Indirect Potable Reuse, feasibility analysis of water allocation budgets, recycled water pricing study, and Water allocation budget structure.

Ms. Jones-Santos asked Guann Hwang, Deputy Director, to respond to a question submitted by Member Kubota related to a possible study of the cost of the fire protection component of a public water system. Mr. Hwang indicated the Department has performed analysis and field data collection in the past, and have identified the weakest points in terms of the water pressure for fire protection. When projects are performed, that portion of the study is incorporated. They are dealt with project by project. Member Kubota stressed the importance of the public understanding that their water bill includes the fire hydrants, which is a tremendous cost. Mr. Hwang agreed with Mr. Kubota.

Member Peugh asked if customers are charged for fire service water costs by the size of their meter, if so has an analysis been performed to determine the fairness. Mr. Jewett indicated that is a rate design question, and there will be an opportunity to cover this in the next step of cost allocation. However, he indicated that water systems are designed to handle peak-flow as well as to ensure adequate flow in the case of a fire emergency. He

added this is a critical cost based component, and the public fire protection cost become part of the fixed meter charge in most cases, and therefore are allocated based on the meter size, and yes, the allocation of cost will be analyzed. Director Bailey suggested looking at nationwide practices, and asked B&V to look at alternatives available for consideration.

Next, Ms. Jones-Santos distributed written responses to a list of questions submitted by Member Hollingworth in advance. Member Hollingworth commented that his three main concerns after reviewing the COSS. They include: (1) the beginning cash balance is substantially lower than the ending cash balance reflected on the CAFR; (2) the total Water and Wastewater CIP program is approximately 35% more than what the Department has actually been able to expend in the past 4 years, so what is operationally being done different to make this feasible, if not feasible what would the money be used for; and (3) the maintenance of the 80%-20% debt to ratepayer funding ratio for the CIP program, and how this ties in with the maintenance of the debt service coverage ratio.

Ms. Jones-Santos replied:

(1) She noted these are draft tables at this time, and pointed out there was an error on the beginning cash balance, and have since corrected this, as well as included in the response back. She added that restricted cash is not included due to legal requirements regarding the bond covenant; it must be set aside, and used for the last principle payment.

(2) While evaluating expenditures and revenues, there are a variety of scenarios such as a ramp-up period. She also added to keep in mind that the CIP expenditures cannot be averaged, as the CIP projects are very unique. She described past years experience, and add that going forward, Finance and Engineering are working together to make sure targets are met. Also, the CIP program has implemented the MAC contract which will assist with streamlining the award of contracts. Lastly, if needed, there will be more frequent COSS's to recalibrate revenues and expenditures. Director Bailey added that execution of projects is relevant, and the MAC contract will help in this area.

(3) Director Bailey added the 80%-20% split is a guideline. He reiterated the importance of rather than borrowing more money, utilize the cash on hand. He indicated this is the approach that needs to be taken. Member Hollingworth stressed the importance of staying on schedule. Ms. Jones-Santos indicated the Department has worked hard with IROC to provide detailed schedules on the CIP projects along with timings, and this will continue to be reported out. She added due to exhausting bond proceeds, cash is being drawn down for the CIP program. Director Bailey suggested providing examples on how the debt coverage ratio is calculated, to give a better understanding. He also added it is very important to have a financing plan for the CIP moving forward.

Vice Chair Billings asked if COSS scenarios and separate sensitivity analysis can be developed to see the impacts/risk of what is excluded, such as desalination, Bay Delta fix, etc. and if we are being realistic about how much of our own infrastructure investment we can make. Director Bailey indicated the guide and principal is the COSS will cover at least a recommendation for 2 years, with a 5 year horizon, but we must consider some policies are not set, Indirect Potable Reuse (IPR) for example so there is no schedule of cost or construction activities from a policy standpoint. However, scenarios can be developed for potential planning ahead, as most of these costs come further out.

Member Peugh expressed that He would like a range of scenarios, each with different assumptions about IPR, DPR, Bay Delta fix, IID collapse, going to full secondary treatment, drought, etc. Also, suggested the Department should identify and avoid COSS alternatives that could make it difficult to get to where we need to be in 20 years for all the likely ensembles of assumptions.

Director Bailey indicated the Department is looking at the long term horizon as well, and as for the recommendation to the Mayor and Council soon, this COSS does not include IPR, Desalination, or the Bay Delta fix; however internally these discussions are welcome and he is committed to developing scenarios regarding those things that may happen, that are very consequential. Member Hollingworth asked B&V to include policy options to potentially smooth down a rate increase in 2014, such as changes to the CIP program, adding bond funding, etc. Director Bailey assured that different scenarios would be run, and will bring back to IROC. He added he is planning to meet with Mayor Filner in April to speak about these items.

Director Bailey asked Mr. Hwang to describe the process of how the CIP compares to the Master Plan and other documents that assists with developing a CIP Program. Guann Hwang, Deputy Director of Engineering & Program Management, gave a brief explanation and indicated they are in the process of updating the prioritization list, which is done on an annual basis, and will bring the update to IROC next month, showing the status of each project.

Director Bailey suggested taking the 2010 Master Plan, see where we are relative to implementation, and compare to the current CIP for differences. Member Peugh added we need to choose COSS alternatives that will have the highest likelihood of getting us to where we need to be further out, perhaps 20 years for the most likely ensembles of those assumptions. Member Hollingworth suggested IROC drafting an advisory letter to the NR&C discussing these policy issues regarding the need to maintain the infrastructure, feasibility of rate increases, also how the Department designs a rate structure. Director Bailey indicated updated information and a prioritization list with implementation of this will be provided at the next Infrastructure & Operations Subcommittee, and then to IROC.

Chairwoman Welch asked what the next steps are in regard to the scenarios to address IROC's comments. Director Bailey indicated after reviewing the 2010 Master Plan and comparing it to the CIP, determining any differences, and have the COSS include any unconstrained areas, the Department will present to IROC next month. Vice Chair Billings asked when IROC would have an opportunity to discuss the rate structure. Mr. Jewett indicated cost allocation has begun in a parallel track with revenue requirements; it may be up to 6 weeks for draft information.

Vice Chair Billings noted he would like to see how costs are allocated between the fixed and variable charges, as well as tiers and the extent that they can be steepened to encourage conservation, and the possibilities of extending tiering to other rate payer classes, as well as budget based structure. Member Hollingworth requested considering the feasibility of using more bond financing than that of the earlier years.

4. IROC Member's Comments

None.

The meeting was adjourned at 12:00 noon.

Minutes taken by: Monica Foster, IROC Support