CORRECTED

MINUTES OF THE BOARD OF DIRECTORS
ZONE 7
ALAMEDA COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT

SPECIAL BOARD MEETING

October 1, 2014

President Greci called the meeting to order at 5:20 p.m. The following were present:

DIRECTORS:	JOHN GRECI SARAH PALMER DICK QUIGLEY ANGELA RAMIREZ HOLMES BILL STEVENS
DIRECTORS ABSENT:	DIRECTORS FIGUERS, MCGRAIL
ZONE 7 STAFF:	JILL DUERIG, GENERAL MANAGER TAMARA BAPTISTA, FINANCE MANAGER JAVIA GREEN, STAFF ANALYST RHETT ALZONA, SENIOR ENGINEER, FACILITIES ENGINEERING JUDY RECTOR, BOARD SECRETARY
COUNSEL:	DAVID ALADJEM, DOWNEY BRAND

Item 1 - Call Meeting to Order

President Greci called the meeting to order at 5:20 p.m.

Item 2 - Pledge of Allegiance

President Greci led a salute to the flag.

Item 3 – Citizens Forum - none.

Director Stevens arrived at 5:25 p.m.

Item 4 - Draft FY 15/16 Capital Improvement Program

General Manager Duerig reminded the Board that they usually review the Capital Improvement Program (CIP) at the same time as the water rates. The CIP is now reviewed every other year but was delayed due to new financial software and the drought.

JaVia Green, Staff Analyst, told the Board that staff had met with the Retailers and the Finance Committee on the CIP methodology. The CIP provides a ten-year plan for the Water System and a five-year plan for Flood Protection. The CIP provides a baseline for Zone 7's budget so the first year of the CIP is used as a basis for the following year's budget. Ms. Green had a presentation which showed the Water System CIP Actual Expenses vs. CIP Planned Expenses. Ms. Green showed the Board before-and-after slides for several projects that have been completed under the CIP. Then Ms. Green and Rhett Alzona, Senior Engineer for Facilities Engineering, reviewed the CIP and related funding.

Ms. Green explained funding scenarios for Fund 120, including the possibility of debt financing, and Fund 130, including connection fees showing some rebound in growth. Without a ramp-up in connection fee revenue, there could be problems in FY 2018-19 so staff will closely monitor the cash flow. The Flood Protection CIP for five years is composed of two funds, Fund 200 and Fund 210.

Staff was looking to the Board for direction on projects, deferrals and debt financing and will finalize the draft CIP and bring it to the Board for possible adoption on October 15, 2014.

Director Ramirez Holmes clarified that the methodology came to the Finance Committee, but they did not see the project list and she questioned why this list didn't come to the committee. Ms. Duerig said there was a procedure for prioritizing this year that staff wanted to have vetted first. The direction sought for this meeting is how staff drafts and selects those projects and whether we are on track. This is a first reading and the CIP does not need to be adopted October 15th. If the Board would prefer to defer this, a CIP could be adopted at the time of the budget.

Director Ramirez Holmes asked Mr. Alzona about new projects and staffing needs. Mr. Alzona said it is going to vary but he estimated that 10-15 projects could be done by the current engineering staff or more if consultants were included. Staff tries to be aggressive to keep up with projects and get the most out of a year.

Director Palmer made a suggestion that the spreadsheet be sorted by year in order of implementation which will help in judging various different budget years. Director Quigley said that if the Board had a historical track back five or six years it might be meaningful, too, and would show how the board had been proactive previously.

Director Stevens said Zone 7 has always saved money for large projects like the Altamont Treatment Plant under a pay-as-you-go philosophy. Ms. Duerig agreed but said that the Finance Committee would also like staff to come back with a "white paper" on what debt financing means, advantages and disadvantages, and timing. Director Stevens said that the projects recommended are acceptable to him and he is comfortable finalizing the CIP at the next board meeting on October 15th.

Ms. Duerig said there are options: 1) if the Board is wants to bring forward the CIP with the water rates at the October 15th board meeting or 2) if the Board is comfortable bringing forward the projects, staff will put it together in a CIP that could be adopted October 15th. Decisions about debt financing are probably a couple of years off and the CIP is a plan plus no project goes forward without Board approval unless it is very small, so there are lots of "exit ramps" if the Board feels things are moving too quickly or the choice is not to do debt financing.

President Greci asked for public comments.

Dan McIntyre, City of Livermore, said Livermore supports the idea of debt financing and feels it is a way to equitably spread the cost of the infrastructure to all users over time. The Asset Management Program (AMP) includes a healthy allowance for system-wide improvements that the board adopted in 2011 and some of the projects that were accelerated this year to address the drought were already factored into the AMP, even though not originally identified by name, and there was an allowance provided by the AMP. Increasing the transfers over the next three years looks like double counting because Zone 7 has already collected money for unexpected projects which came up and then reimbursed the fund. The funds have already been collected for system-wide improvements and the AMP could fund projects through cash on hand and debt financing. There are 28,000 future connections so debt financing would insure that those future users participate and share in the cost of those proposed projects in the CIP budget. He recommends not super funding the AMP, stick to the plan from 2011, and fund the transfers as originally adopted.

Daniel Smith, City of Pleasanton, said Pleasanton also supports debt financing and there is a frustration on their part regarding the CIP program for the next 10 years. He knows the retailers want to have a partnership and they would like to meet with Zone 7 and take a look at the CIP projects and more back-up information on those projects.

John Archer, DSRSD, said his comments echo theirs in that they support debt financing. A presentation on the impact on water rates with debt financing and pay-as-you-go should be looked at by the board as they do have different impacts and there is a cost to borrowing money. DSRSD is concerned about the impact of all these projects over time. He would like to see a blended version of pay-as-you-go and debt financing.

President Greci said we are banking on new connection fees for money but they may not be what is estimated. He is concerned about where the water is going to come from to supply the connection fees if they are used. Zone 7's system is old, we have new government regulations for contaminants such as Chromium 6 which are non-discretionary costs so no choice but to spend the money and they are expensive. To meet reliability along with water quality, it is imperative that we spend money to meet those requirements. The word "defer" is critical in our management plan from now on and we should put off what we can. Maintenance is the key to reliability because our facilities are old and we need to go with new technologies but there is a price for it, and we don't have a choice when it comes to quality. The number one thing is to give our residents quality water. Where are we going to be with new State mandates for groundwater protection when our groundwater runs out and we are not getting water from the State? This could be catastrophic for us. He suggested closing the door on permits, getting more water, getting more storage and feeling confident in the needs for potential growth in this valley and take care of the people who are already here.

Director Ramirez Holmes wants time for retailers and staff to work together and make comments to help with the board's decisions. She thinks it should go to committee but more importantly is to have a solid discussion with retailers and not sure two weeks before the next board meeting allows for that. She wants a thorough process and to take time to do it right. She wants a project list by year and the 10 year plan showing input, transfers, fund balances.

Director Stevens asked if the CIP should be delayed until a special meeting in November.

Director Palmer said she hears the retailers concerns about funding and continuing to build up reserves, setting reserves lower or using debt financing, but it doesn't change the adoption of the plan and some projects should not be deferred as they have been in the past. She would like to see the CIP go forward but organized in terms of years so she can make a better judgement. She is in favor of going forward October 15th.

Ms. Duerig confirmed that the board wants staff to meet with retailers in the next two weeks and come back with the CIP on October 15th.

Item 5 - Water Rates for 2015 & 2016

Ms. Baptista said the 2015 and 2016 water rates were discussed at two Finance Committee meetings and staff met twice with retailers. Ms. Baptista explained the makeup of water rates with a slide presentation on water rate components: revenue, cost of service and reserves. Expenses are estimated to be $31.8 million for FY 14/15 and $32.6 million for FY 15/16 with AMP transfers for both years. Financial Consultant Sandra Sato reviewed the CIP and recommended a change to the reserve allocation methodology which sets both the operating reserve and the emergency reserve to the maximum reserve levels. The remaining balance of the fund is then allocated to the rate stabilization reserve. For FY 14/15, the Board approved 100% use of the drought contingency reserve so in all models that balance is zero for FY 16/17. The reason for Ms. Sato's recommendation is to get a higher credit rating for future debt financing because credit agencies like to see higher reserves.

Three calculations were presented to the Board. In all three calculations, graphs showed the impact of that calculation on the emergency reserve, drought contingency reserve, operating reserve and rate stabilization reserve. There was a brief presentation on advantages to maintaining reserves.

The next steps for the board are to provide direction to staff regarding considering the reserve allocation method and which water rate calculation to bring forward to the October 15th board meeting.

The board members were given a copy of a letter from Dublin San Ramon Services District and Director Palmer noted that one of the suggestions was to look at a pool of reserves as opposed to the individual reserves. She said that at the 3% calculation, Zone 7 still had some healthy reserves so she did not see the need to go to 7%.

Director Ramirez Holmes asked several questions and expressed concerns about reserves and the reserve policy not being followed. ~~She suggested that the reserve policy may need to be revised and she is concerned that the policy has been bypassed.~~ She said if the current reserve policy is not adequate, we should revisit, but is concerned that the existing policy has been bypassed. She also noted that the retailers suggest Zone 7 follow the AMP policy and last year the AMP was overfunded.

Director Stevens discussed his concerns regarding the drought continuing and if there is water, filling up reservoirs including groundwater and lakes. He does not have confidence that there will be water next year so he suggests planning for the worst-case scenario. He recommended the 7% increase for both years.

Ms. Duerig said that the ramp-up for the AMP increases by about $1 million each of these years (rule-of-thumb is that every $400,000 of increased expense is equivalent to a 1% increase). With the 3% for the CPI, the 1.5% for the increase set aside for the AMP ramp up and the 2.5% increase cost for water, the 7%-7% option will keep Zone 7's reserves neutral. Staff is asking for direction from the board.

Director Palmer asked if, for example, there is a 3% increase, does that stop the board from doing a temporary drought surcharge to make it up? Ms. Duerig said it would have to be adopted in time to be in place by January 1 because of the way the contracts with the retailers are written. One of the recommendations the retailers made is that as we consider our Urban Water Management Plan update next year, we consider adding a drought surcharge stage. Director Ramirez Holmes said all three directors in the Finance Committee agreed they did not want an automatic trigger but agreed that it would be part of the Urban Water Management Plan. Director Palmer agreed with Director Ramirez Holmes but Ms. Duerig pointed out that the Urban Water Management Plan would likely not be adopted any sooner than December 2015 so it will not apply next year.

President Greci discussed the effect of unexpected expenses and preventative maintenance budgeting, and then asked for public comments on the water rates.

Dan McIntyre, City of Livermore, contributed his personal comments and said Zone 7 should adhere closely to existing policies without any major deviations and recommends that a new run of the model for Option 3 be done with changes: the AMP policy should be implemented as designed and approved in 2011 but in the absence of unusual circumstances such as the recession, the planned ramp-up of the AMP should continue as scheduled and, for that reason, he does not support Option 2, reducing the transfer to the AMP. He also recommended that the Board adhere closely to the reserve policies. He says the operating policy seems prudent and reasonable and no changes are needed. The drought contingency reserve and the rate stabilization reserves are related and serve to smooth out choppy cash flows. He suggested adding the two reserves together to meet the minimum reserve requirement for those two funds combined; add the two numbers from Option 3 together, see if they exceed the combined minimum numbers, and those funds are good. The sticking point is the emergency reserve which is mildly at variance with the board-adopted policy which says, "Zone 7 will strive to maintain a target balance equal to 2% of capital assets of the water enterprise system." The board does have discretion to vary this amount from 1% to 3%. Option 3 proposes to increase this reserve from 2% to 3% which drives some of the rate increase. He requested that the board adhere to the 2% figure. He encouraged the board to consider some of these ideas and re-run the Option 3 model to see what the numbers are, and he would support whatever number the calculations show.

Director Ramirez Holmes said she knows Darren Greenwood from the City of Livermore had concerns with the additional money given to AMP last year. She clarified that Mr. McIntyre is not in favor of the $3.3 million more put into AMP for 2014-15. Mr. McIntyre agreed that the AMP should be implemented as approved but without increasing the emergency reserve. Director Ramirez Holmes said that would be Option 2.

John Archer, DSRSD, summarized the detailed DSRSD letter and said DSRSD supports multi-year rate setting. Concerns about coming back each year might be avoided if a longer term than two years was implemented, perhaps five or six years. Discussions about the asset replacement fund could be included. DSRSD supports a rate increase with a drought surcharge as long as it has a sunset date at a specific time or occurrence. That could be used to have base rates stay as base rates and not inflated so maybe it would be an alternative; if the drought continues, that rate would stay in place and not be built into rates as the 7% might be. He encouraged the board to set their rates based on the established reserve policies. DSRSD also supports a CPI and maybe some type of a drought surcharge.

Dan Martin, City of Pleasanton, said that Pleasanton supports a policy based on an annual CPI increase. When there are projections beyond the CPI, that is when they hope to see an explanation of why that is necessary and currently they do not see that. There have been discussions about potential costs and the uncertainties for next year. The idea that rates need to be raised ahead of those uncertainties is not something that Pleasanton supports. Pleasanton cannot support an increase that is permanent with drivers that may be temporary. The sequence of events leading to the initiation of the AMP was based on the repair and replacement of existing facilities that have a fixed life span that have to be replaced preferably ahead of their critical failure point. All of the retailers were in agreement with Zone 7 on categorizing and determining the triggers and funding requirements but at the last minute the discussion changed from repair and replacement projects and turned to talking about completely discretionary system-wide improvements that were dumped into the AMP program at the last minute. All of the retailers went on record saying that this was not what they had been talking about, not agreed to, and the impact of throwing the system-wide improvements on top of repair and replacement had a dramatic impact on the AMP funding requirements.

Ms. Duerig said that discretionary costs include upgrades. A big driver with the difference was the ozone project which was seen as very expensive but because there was a pay-as-you-go philosophy, AMP transfers was the mechanism to save for it. In terms of water rates, what we adopted two years ago was based on the AMP ramp up. Zone 7's rates have not been adjusted regardless of the budget and our current proposal is only based on that approved ramp up. It doesn't recover reserves and there is no double counting. Each step of the ramp up, until you get to the last step, is not setting aside what the AMP and the system-wide improvement piece of it recommended so each year it has been underfunded instead of overfunded.

Director Stevens asked if the board was locked into two years so if they vote for 7%, is the second year locked in also at 7%? Ms. Duerig said the board is not locked into anything but could be if they don't take further action. It could be revisited next year or the board could decide to do just a one-year rate increase because of the drought. But all the retailers and staff agree that a multiple year rate adoption is preferable.

Director Palmer asked about a base plus a surcharge to be sunsetted after one or two years. Ms. Duerig replied that because staff is not recommending any depletion of reserves, staff is saying they feel that these costs are solid and part is due to the ramp up that has already been adopted. The CPI is 3%, another 2-1/2 % is because we are increasing a $1 million set aside each year which equals 5-1/2% that is a given because of the policies the board has adopted even before any discussion about changes in reserves. The speculative and debatable part is whether costs will increase next year, whether revenues will decrease, whether water will be available and how expensive it will be.

Director Stevens recommended going ahead and passing the 7% water rate for two years and revisiting the AMP and reserves later.

Kathy Narum, Pleasanton City Council, wanted to appeal to the board for moderation due to the drought. Pleasanton did their part to conserve water 25% citywide and constituents had compelling and undisputable reasons to conserve. If residents have good and reliable information, they will do the right thing. She does not feel there is enough information and the cities all have questions. Perhaps there is a justification for the 7% increase in the interest of keeping Zone 7 financially stable. She asked the board to step back, work with the retailers and city staff and make sure that they understand and that there is a justification and either come up with the surcharge that sunsets and can be explained to residents or do Option 2 tied to the CPI rather than an arbitrary 7%. They need the credibility to continue to get the constituents to conserve and to ask them to keep conserving and accept a 7% increase hurts that credibility.

Georgean Vonheeder-Leopold spoke on behalf of DSRSD and thought the retailers were more together on the recommendations but there are slight differences so she agrees that maybe we need to take a step back and look at the numbers. She said DSRSD can support the 3% and favors the multi-year. Perhaps Zone 7 needs to look at their issues with the reserve policy. DSRSD has had stable reserve policies for several years and they stick to them which is why they are in the financial shape they are in plus they were pay-as-you-go but when you have $50 million projects, you can't expect current residents to pay for them when they are going to last 50 years. She didn't expect to see a problem with the AMP and DSRSD is in favor of keeping it the way it is. DSRSD is in favor of looking at a surcharge that would sunset because you have to recover the extra costs because of the drought but it needs to sunset and cannot be rolled into the water rates, become permanent and compounded. In conclusion she also thinks there needs to be more conversations and information before making a decision and the recommendation from staff covers all of the contingencies.

President Greci summarized that there is a strong need for interaction with the retailers. Over the years he has seen an increase in the cooperative effort between everyone and it is a good working relationship that Zone 7 wants to continue to improve. He encouraged staff to continue that increased interaction with our retailers before making a recommendation for rates at the next board meeting.

Ms. Duerig said it sounds like Option 1 can be eliminated. Director Ramirez Holmes said bring back Options 2 and 3 especially since two directors were absent and not able to weigh in on the two options. This gives the retailers time to learn more about some of the things they suggested for information and number crunching and we may be able to make a more informed decision.

Director Palmer said we should look at the 3+3 with a drought surcharge on top that sunsets. Director Palmer said a base for recurring or permanent costs (maybe 3%) with a surcharge on top that sunsets for drought-related factors is something that could be a third option to consider as reasonable and necessary to keep Zone 7 financially whole.

Director Ramirez Holmes wanted to make sure we are utilizing the reserve policy and the board is the one making the decision if we are re-allocating the amounts for reserves. ~~to exceed the 2%.~~

Item 6 - Preliminary Untreated Water Rate for 2015

Ms. Baptista said staff is recommending $130 per acre-foot for CY 2015 which is an 18% increase over CY 2014 and CY 2013. The untreated water rate is a pass-through of the cost of importing water, supplemental water purchases and untreated water administration. Ms. Baptista showed a graph with the untreated water rate history.

Staff's recommendation was to ask the board to provide direction to staff.

Director Ramirez Holmes asked why there was an 18% increase in cost? Ms. Baptista said staff looks at their water supply operations plan for 2015 and different water sources coming into the Zone 7 service area based on Semitropic and Cawelo recovery for untreated and treated water which influences the increase. Ms. Duerig added that the cost of Semitropic and Cawelo pump back water has increased because of the regulation regarding treatment for arsenic. Water cannot be pumped back into the canal without paying for the treatment for arsenic.

The direction from the board was to proceed with the recommendation for the 18% increase.

Item 7 - Verbal Reports - none.

The Board went into closed session at 8:10 p.m.

Item 8 - Closed Session

(a) Conference with Legal Counsel - Significant exposure to litigation pursuant to Gov't Code Section 54956.9(d) (2): 1 case

Item 9 - Open Session and Report Out of Closed Session

The Board came out of Closed Session at 8:24 p.m. and President Greci reported there were no reportable actions taken in closed session.

Item 10 - Adjournment

The meeting was adjourned at 8:25 p.m.