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

SPECIAL MEETING
August 26, 2015

The following were present:

DIRECTORS:	SANDS FIGUERS JOHN GRECI JIM McGRAIL SARAH PALMER RICHARD QUIGLEY ANGELA RAMIREZ HOLMES BILL STEVENS
DIRECTORS ABSENT:	
ZONE 7 STAFF:	JILL DUERIG, GENERAL MANAGER KURT ARENDS, ASSISTANT GENERAL MANAGER, ENGINEERING OSBORN SOLITEI, ASSISTANT GENERAL MANAGER, FINANCE LINDA VAN BUSKIRK, ACTING BOARD SECRETARY
COUNSEL:	DAVID ALADJEM, DOWNEY BRAND

Item 1 - Call Meeting to Order

President Palmer called the regular meeting to order at 4:00 p.m.

Item 2 - Pledge of Allegiance

President Palmer led a salute to the flag.

Item 3 – Citizens Forum – None.

Item 4 – Cost of Service Study

Osborn Solitei, Assistant General Manager, Finance discussed some preliminary numbers before introducing Raftelis Financial Consultants, Inc. The drought creates a lot of financial impact. In FY 15-16 Zone 7 has already seen a 35 percent conservation rate. The budget anticipated 20 percent. In that case Zone 7 had a budget of around $33,000,000 with a 20 percent conservation rate and used around $8,000,000 to balance the budget of reserves. With the 35 percent conservation level, the agency anticipates receiving around $27,000,000 from water sales. The cost of services study should accomplish two things: To make sure the agency can stabilize its financials by making sure that the reserves that it is now using will be recovered, and also to anticipate as we go forward during the drought that at least 20 percent of conservation will be built in already. If, for example, there is no rate adjustment, Zone 7 anticipates as much as an additional $6,000,000 this year to be used from reserves and the Water Enterprise fund will end up with around $1,000,000 of reserves left. The agency as a whole also has entered into or has obligations or commitments – debt – of approximately $467,000,000 incurred by others on behalf of Zone 7. The biggest fraction is the South Bay Aqueduct which is around $346,000,000 for improvements and enlargement. Other State Water Project capital indebtedness is approximately $94,000,000, Cawelo is approximately $26,000,000, and Semitropic is around $1,000,000. This shows there are already a lot of commitments on the agency's operating budget to pay for debt, so when compounded with a loss in revenues related to approximately 20 to 35 percent of anticipated conservation, then the agency's budget is really being hit very hard.

Mr. Solitei introduced Sanjay Gaur from Raftelis Financial Consultants, Inc. (RFC) to present the cost of service study workshop.

Mr. Gaur stressed that these are tentative numbers. RFC and Zone 7 are still working on a number of different inputs and factors. The drought has created uncertainty and RFC is trying to develop a better understanding of what the future holds, especially with sales. This is the first cut at this. The data will change as better information is made available.

Mr. Gaur then gave a detailed presentation on assumptions of Zone 7's cash flow analysis, current financial position of the operating fund and the wholesale water enterprise. The second part of the presentation discussed rate design and rate structures, and looking at different options associated with wholesale rates. Comments and questions from the Board and public were discussed and questions were answered.

President Palmer asked for feedback from the retailers and public.

John Archer with Dublin San Ramon Services District (DSRSD) said that DSRSD has been included in all the discussions so far about fixed and variable costs and model assumptions. Staff has been working well with retailer staff. DSRSD's rate is developed as a pass through, so one thing he asked staff is that as we develop even a blended rate we come up with something that can pass through, not having fixed charges on top of our fixed charges. DSRSD's rate is at a fixed and variable component, with 30 percent being fixed. He asked that Zone 7 not make it too complicated, remembering that the retailers have to pass it through on a bill to customers and that is an impact on people who are paying for this.

Director Figuers asked Mr. Archer how his district is handling 30% plus drops in water use, as the same thing that is happening to DSRSD is happening to Zone 7. Mr. Archer said that several years back DSRSD instituted drought rates. Those charges have been in place and they have worked very well. They were ahead of the game by having the drought rates in place that could be implemented quickly. Mr. Archer said he does like the idea of having specific sunsets on any drought surcharges. DSRSD's rates are set so that they coincide with Zone 7's and they will increase on January 1, 2016, so if we push it off we are going to have the same challenge others will end up having, a double notice going out.

Leonard Olive, City of Pleasanton, said that Pleasanton is currently going through a study much like this, although they are approximately eight months into the process. They are trying to be quite thorough as they develop and model different variables. He said Pleasanton is unique as it is the only retailer that does not or has not been passing 100% of Zone 7's rate through. On average Pleasanton passes through a little less than 90% and that factor was developed based in part on the amount of groundwater that is pumped annually. He said the rate design that is in front of council right now is in the Prop 218 stage. Rates may be heard at the October 6th council meeting, although the schedule may be flexible. In their new rate design, they will be passing 100% through to the customers.

Mr. Gaur added clarification by saying they are not suggesting any kind of inclining tiers on the wholesale side, they are just suggesting two components: One is a uniform rate for amount of water purchased and the other is a fixed component. The fixed component would be comprised of two elements: One is based on a 5-year historical rolling average of how much water is used, and the other one would be how much water you use during the summer time, or peak use. There will be no inclining tiers.

Mr. Olive reiterated that he thinks we are on the same page as we have the same concerns. He added that in the new rate proposal the City of Pleasanton will have a drought pricing add-on that only the council can invoke and then withdraw depending upon water conditions. Their drought surcharge began in 2014. It was volatile at first, but has proven to be effective, so they are doing the same thing this year. Pleasanton's water sales are also down for the month of July, finishing at roughly 47 to 48 percent reduction. August may not be quite as robust, but is expected to be at least 45% conservation reduction. Mr. Olive summarized by echoing John Archer at DSRSD's comments that we are here to work together. He liked the comment about raising rates to make up the shortfall, but suggested also taking a look at the other side, where can we save a little bit? The water purchase savings should be incorporated in the cost of service going forward. We get it. We are in the same position as Zone 7 is.

Helen Ling, Water Resources Division Manager at City of Livermore, Zone 7's smallest retailer, said they serve a portion of the city of Livermore and Cal Water-Livermore District serves the other 2/3 of Livermore. Livermore appreciates the opportunity to work closely with staff and with Raftelis to provide input on Zone 7's cost of service study. She said we are all in this together. The drought has really changed the conditions that we all operate under as water providers. Back in May when the San Juan Capistrano ruling came and the tiered rates were challenged, Livermore looked at moving forward with a rate study to see how defensible its tiers are, and whether they should be looking at a different rate structure, etc. As time has gone on its customers, just as the other valley retailers, are saving twice the state-required conservation standard. As the state adopts more and more laws and regulations that are changing how people are using water, we are not going to be back to what we used to know as normal, even after the drought is over. That is what Livermore is predicting. They are updating their water master plan and as part of that they are also going to be revisiting their rates. Fortunately, similar to DSRSD, when Livermore last adopted water rates they also adopted conservation rates. She reiterated that the City of Livermore appreciates working with staff. She said it has been really helpful for Livermore to be involved and to be able to make comments.

Alfred Exner, a Pleasanton resident, commented that he is glad we are having the workshop but was expecting more people to be involved. He proposed Zone 7 actually sit down at tables with the public. He would like to see, as Director Greci touched on, a serious look at costs. He said when talking about revenue vs. cost, the public needs to see that. He said a couple of months ago he pointed out that Zone 7 was eating into its reserves and the costs seemed to be out of alignment. The recommendation of a 3-year rate is a nice thing in what we call normal times, but may be unrealistic given we have no idea what next month is going to be like, let alone three years from now. He is looking forward to the public hearings and would like to see a lot of granularity on the cost side.

Ken Bradley said that what he saw this evening was pretty graphs, but the data might be somewhat fictional. Zone 7 has the responsibility of managing the entire system and without good data he doesn't know how the agency can do that. He seconded everything the last speaker said. He did pose a question: Two years ago Zone 7 created a reserve fund for its reserve fund and he was one of those who spoke against it that night. He is wondering which reserve funds we are now talking about when we are talking about deficits.

Joe Ledbetter, Livermore resident, said he doesn't have a good way of telling whether or not the costs are reasonable. He did a quick back of the envelope calculation and said it looks like this district is spending about $2,000 per acre foot per year, and translated to per capita it is about $200. Is this reasonable? He suggested that the Board may want to compare numbers from other districts across the state. He also commented that it is hard to fathom that the cost to the district for the first thousand acre feet equals the cost to the district for the last thousand acre feet it provides. He said something is missing there and it seems that if you promulgate the average rates without looking at marginal costs, that's a big fallacy and perpetrating that is just going to make those who consume the least pay the most.

Carl Hickorelli, a resident of Pleasanton and wildlife biologist, said he is upset about what is happening. He would like to know what Zone 7 is going to do if we really have an El Nino. Interesting things are happening in Alaska. They just had a blue-green algae bloom from Nome all the way down to Monterey, so something is happening. We have some climatologic change. He wants to know what Zone 7 is doing to capture that water and to have an adequate supply of water for its customers. He is concerned over the amount of new construction in Pleasanton and the effects on wildlife in the area. As a past ecology instructor, he is familiar with the concept of care and capacity of the environment. He says excess building will supersede the care and capacity of our environment and that causes reverse damage. He said he hopes the agency tells the public what it is doing for the future because we have to have some kind of infrastructure in place. He doesn't know if that is the Chain of Lakes or Zone 7's desalination plant, but whatever it is, there should be some way to capture water and retain that water for emergencies like now.

Mer Cromer, a resident of Pleasanton, has been coming to the meetings because he is not in favor of the rate increase. He said is does not make a lot of sense when the more we conserve the more we have to pay. He mentioned that the timing is not right, knowing that we will probably have an El Nino coming in and suggested holding off on the rate increase until next year after the rains. He said property values in Pleasanton have been impacted because residents must cut back on watering and lawns look despicable. If rates are increased, people are going to use even less water and Zone 7's deficit could grow tremendously, even more than what it is now. That's going to be a problem. He said he agrees with the comments that Director Greci made. He urged the agency to show the public what it has done to reduce costs, especially if it is raising rates.

Ms. Duerig said that Zone 7 will take the comments received tonight and consider them while continuing to work with staff from the retailers and our consultant. A presentation in September will be the next step. The Water Resources Committee needs to get together with us and talk through some possible project deferrals to see how that would impact the water resource factors.

Director Greci said it is extremely important that we take aggressive action to ensure the numbers balance as it is imperative we act now. He is against using reserves. If this is presented to the public Zone 7 should also present what the agency is going to cut back on. Infrastructure is imperative, but cut out any gingerbread. The agency should review expenses and cut back on certain projects. Use common sense.

Director Stevens said that he likes what he saw and heard. He likes the change in the rate structure and is all for it, especially since the agency is way behind the times. The agency knows it must increase rates temporarily because of the drought. Zone 7 has been cutting costs for years in anticipation of this because of the fact that we saw these rates coming up and so we're probably at a point where the only thing we can really cut is our capital improvement projects. He said he is very encouraged by this presentation and would like to proceed. When it comes down to numbers, he is sure the retailers and Zone 7 staff can work out what is best for everybody.

Director Ramirez Holmes commented that the numbers have to get in line. There are some items that we need to make sure we are tracking as we are looking at the numbers so that everything is adequate. For example, there are two amounts that were considered in the FY15-16 budget but were not included in the numbers here. One is that $3,000,000 is expected from the state. It has been awarded as a grant for some of our drought work and it hasn't arrived yet. Secondly, Funds 110 (20%) and 130 (80%) Zone 7 will receive a $4,800,000 credit back from the state. It also would be great if we could see a report in terms of the close of June 30 as we are expecting some surplus. Those are numbers that we don't have yet, so it is difficult to talk conceptual without that information. What does 17% mean? What does 3% mean in terms of someone's bill, in terms of what we are doing as an agency? Conceptually it sounds great, but it is difficult to not be able to crunch real numbers. We need to make sure that all of the numbers match to what the board was given. Does this include, for example, the 3% increase that we've already approved for 2016? What are the reserve numbers that are necessary for the agency? Director Ramirez Holmes wants the consultant to be able to explain why the agency's budget has gone up so much in the last few years. When she first became a board member the budget was $80,000,000. Now we are at $120,000,000. She would like to see clarification and a bigger discussion about these numbers. She suggested that a Finance Committee meeting be scheduled.

Ms. Duerig agreed that Director Ramirez Holmes is right in terms of what the consultant has agreed to do for the amount of money we've approved, so we can't go off scope very easily, but we can certainly work at getting more information to the Board and staff. The focus of this study is Funds 100 and 120 which are funded by water rates.

Director Ramirez Holmes noted that the numbers have to be accurate in order to have an accurate picture of the cost of service study. President Palmer added that if you can footnote a trail in terms of how we got from there to here showing how the numbers changed, that would be useful.

Director Quigley said in hearing some of his Board colleagues' comments and the comments from our retailers and the public (he thanked them all for coming) and having been on this board since 2004, 11 years or more, he urges staff to throw in a paragraph or two about what Zone 7 did after the 2009 financial crash when Lehman Brothers went under and the agency held meetings and was desperate to tighten its belt, and in fact did so for several years. Zone 7 eliminated positions, gave golden handshakes, deferred projects and really tightened its belt, saving millions. Those figures are in the annual reports on Zone 7's website dating back 10 years. There are some statements in those annual reports about cost savings. The thing this board does is keep costs for the public on track and reasonable. Some of those statements on how much the agency has saved over the years are really important for public consumption. They are needed in this rate report because we really squeeze the sponge a lot and there is not much fat. The retailers have been through those discussions, but the public may not be fully aware of the extensive actions already taken. Director Quigley encouraged our consultant to work with staff on a paragraph that tells the cost containment and deferrals that the agency has done at least since 2009, but it goes back to 2004 and 2005. Ms. Duerig agreed on that point. She shared that in 2007 the agency had a 99% ready-to-bid Altamont Treatment Plant that would have cost Zone 7 almost $200,000,000. It was decided to defer that project because of the slower growth and pulling that project at that point probably saved this agency from financial ruin. It was a great choice on the part of the Board. Unfortunately, what it meant was had that plant come online as it was planned by late 2009/2010, the ultrafiltration plant would have been phased out. Our costs for maintaining the UF plant have skyrocketed by trying to keep an obsolete plant online as we decide where we are going to go. Some of the staff decisions were, as Director Quigley said, the soft hiring freeze and a huge reduction in staff – it was 20% at one point – but one or two have been hired back as needs have dictated. Zone 7 also had a lot of contract labor for SCADA, telemetry and other things where the agency decided we could do it cheaper in-house and it has in fact worked out very well for us. There are many things the agency has done that have been significant. Ms. Duerig suggested that adding some slides that capture what Mr. Solitei went over in the beginning of this discussion would be a great idea. She further suggested adding a slide or two that talks about the cost savings that are ongoing for the agency.

President Palmer said that although there is a lot of talk about less water use so our treatment costs should be down, her understanding is that generally speaking, when you have a period of drought, the dissolved and suspended solids go up and treatment costs per unit go up as well. Ms. Duerig agreed that is quite true. In fact, Zone 7's unit treatment costs today are probably doubled the unit cost of pre-drought and that is because the water quality coming into the plants is so bad. As you are getting less runoff from snowmelt, as you are getting fewer releases from the reservoirs, the water is not as clean. As it is conveyed through the Delta, it picks up a lot of solids and other contaminants. Even though the Department of Water Resources has built a rock barrier to try to minimize the salt water intrusion, a lot of other degradation is still seen. A recent article said that the USGS thinks some of the algal growth we are seeing this summer is related to that, and when we have algal growth we have to add powdered carbon which increases costs enormously. Part of that is an outgrowth of having deferred the ozone project over and over again. President Palmer added it is more of a taste and odor problem. Ms. Duerig agreed it is right now for the most part, but again, some of the newer algae that we are seeing – Microcystis – has the potential to release some unpalatable side effects that are best treated with ozone. Due to the drought, we are seeing the decline in source water quality and have to use much more chemicals to make it potable. It is right to say the agency's chemical costs have certainly not gone down. Manning a plant 24/7, whether you are putting 10 MGD through it or 40 MGD, means that our labor costs to operate the plants are not going down. Our maintenance costs are going up because of some of the deferred projects. As Director Quigley suggested, we can add that to the discussion for this cost study and it will frame the discussion much better. President Palmer agreed that would be valuable because that is real. Director McGrail echoed that and added our fixed costs are our fixed costs. He suggested to Raftelis that although he realizes Raftelis is limited to do a certain task, he would like to see some education of the public while we investigate this and before we make a decision so that we have something as a basis on which we are making that decision. He believes a lot of the public does not realize what the fixed costs are and for them to see that we have cut back and saved and yet our costs are rising – that has got to be part of the equation.

Director Figuers said that, believe it or not, this is the fourth crisis in water to hit the valley. The first was in the mid-1950s with major floods in 1954 and 1955, coupled with the major dropping of the groundwater basin. That situation is what triggered the founding of Zone 7 and getting bonds in upwards of $20,000,000 in 1950 dollars. The second was Proposition 13: It took all of the agency's funding and basically threw it out the window, and many water districts were close to being financially insolvent. They wouldn't be able to pay State Water Project costs until the state did some stuff and we recovered from that. The third was the first major drought in late '80s/early '90s and that was actually worse than this one. That was a 6-year drought and the only reason it wasn't longer than that was that we had one year with a miracle March. That triggered a bunch of reserves to be established, increasing water rates. We got through that and now we are in the fourth, but the Zone has come through it all and we are going to come through this one. Zone 7 produces very good quality water and that is what we are going to continue to do. Situations like this happen every now and then. The big difference here is we keep using this term "drought" and "conservation" as if it's a temporary thing. When you say people are using less water because of a drought, there is an implication that when the drought is over usage is going to come back, which is what happened with the '90s drought. It is entirely possible that may not occur this time, or the increase won't be as large, but that could be offset by bringing more people into the valley. Director Figuers concluded with saying he doesn't know how to name that permanent loss outside of the jaded term "the new normal" but this study needs to somehow take that possibility into account also.

President Palmer thanked everyone in the audience for coming in. There will be more to come on this topic.

<u>Item 5 – Consider Response to the 2014/15 Alameda County Grand Jury Final Report</u>

David Aladjem, General Counsel, introduced the proposed response to the June 2015 Grand Jury Report. An earlier version of a response was circulated in last week's Board package, but after receiving comments from a Director, President Palmer decided to continue this item and the letter was modified. Mr. Aladjem invited comments from the Board and direction.

Director Figuers said the letter is extremely well-written. Director Stevens liked the first version better, but this version is fine. Director Quigley did not have a problem with the first version but this one is fine also. President Palmer said that substantively this version is very much the same as the first, the latter being a bit "preachy" so the Board modified it while still maintaining our message.

Director Figuers moved for approval of the resolution authorizing the President of the Board to provide the required Grand Jury response, and Director Quigley seconded the motion which was passed by a roll call vote of 5-2, with Directors Ramirez Holmes and McGrail voting no.

Resolution No. 15-84	Authorized the President of the Board to Provide Required Grand Jury Response

<u>Item 6 – Verbal Reports</u>

Ms. Duerig announced that staff is working on a Flood Open House event. Staff will try to schedule this during Flood Awareness week which is the third week in October. As the details develop, staff will be reaching out to the cities and others to see who wants to participate. We have a lot of great ideas and are eager to make this happen.

<u>Item 7 – Closed Session</u>

None.

<u>Item 8 – Adjournment</u>

The meeting was adjourned at 5:48 p.m.