SUMMARY NOTES OF THE FINANCE COMMITTEE
ZONE 7 BOARD OF DIRECTORS

September 8, 2014
3:30 p.m.

Directors present:	Sandy Figuers Angela Ramirez Holmes Sarah Palmer
Staff present:	Jill Duerig, General Manager Tamara Baptista, Finance Manager JaVia Green, Staff Analyst Judy Rector, Board Secretary

Director Figuers called the meeting to order at 3:30 p.m.

1. Public Comment – None

2. Proposed 2015 Municipal & Industrial Water Connection Fee

JaVia Green, Staff Analyst in Finance, updated the Finance Committee members regarding the Municipal & Industrial (M&I) Connection Fee Program. The basic fee is updated annually based on inflation, with periodic, detailed reviews. The next periodic review will be in 2016. Staff recommends adjusting the current fees this year to keep pace with inflation. Staff recommends that the item be brought to the full board at the October board meeting for adoption.

The directors discussed the item and asked questions. If the Engineering News Record Construction Cost Index (ENR CCI) goes down, the connection fee will be lower. All three directors recommended that the item go to the full board for adoption.

3. Water Rates

General Manager Jill Duerig introduced Sandra Sato, a contract employee with Urban Futures. She will be working for Assistant General Manager Tom Hughes, overseeing Administration, including Finance, Accounting and Employee Services.

Tamara Baptista, Finance Manager, presented this item as a continuation of the water rate discussion from the Finance Committee meeting on August 28. Staff members met with the retailers on September 4. The retailers stated that they want to see Zone 7 increases in line with the Consumer Price Index (CPI) increases but did recognize that Zone 7 faces revenue shortfalls with the 2014 drought and may need a water rate increase that is higher simply to keep up with inflation. Staff told the retailers that they are looking at water rates, models and options and one option is the 12% increase under discussion. This option meets revenue requirements and stabilizes reserves. Two components that go into the development of water rates are projected revenue and estimated cost of service.

Staff discussed two options for treated water. One was a 12% water rate increase for 2015 and 3% CPI for 2016, which stabilizes reserves and is a long-term plan for replenishing reserves. Option 2, based on input from the retailers, is a 3% CPI for two years for 2015-16 along with a 9% drought recovery surcharge (which is temporary) for 2015 and 2016. For the first year, 2015, Zone 7 would have 3% CPI and 9% temporary drought recovery surcharge on top of the 3% and the same for the second year, 2016.

The retailers stated that if Zone 7 was going to have a large water rate increase, they would support a drought recovery surcharge rather than a large water rate increase to recover the loss of revenue due to the drought. Director Ramirez Holmes said the retailers don't want the drought recovery tied into water rates.

Ms. Baptista asked for direction from the Finance Committee before moving forward on the water rates. Reserves are taken into consideration so there are two questions: 1) how much of the reserves to use; and (2) how long do you want to take to replenish the reserves?

Director Ramirez Holmes asked for dollar amounts for Operating Reserves and the AMP and the revenue gap created by reduced sales. She suggested discussing a hiatus for the AMP ramp-up instead of the high fees, which might help resolve the high rate increases. She urged being creative in how Zone 7 uses money. She questioned having a two-year drought recovery surcharge assuming the drought is a one-year event. Ms. Baptista said staff could come back with a baseline to show the shortfall.

Director Figuers asked what is the average number for reserves, what is the time period to replenish reserves and how long will it take to replenish them to a comfortable level? He suggested asking the full board to define the term "minimum reserves." The issue of water consumption after the drought was discussed and lower water consumption due to conservation habits developed by customers.

The directors discussed the options presented by staff and the use and replenishment of reserves including shifting money from one reserve to another or reducing the operating reserve. Director Ramirez Holmes said she feels there are options to explore, be more creative than just raising rates, and lay options out to the board. She also feels the minimum amounts in reserves cover what could occur, she would not vote for either option presented by staff, and would like to see new options. She wants to see how much Zone 7 is short for 2015-16, how much is projected to be short for 2016-17, figure out how not to be at the maximum and use more of the reserves, plus consider not bumping up the AMP for two years. Director Palmer wants to see the baseline.

Director Figuers asked for public comments. Matt Morrison, Pleasanton, said he feels it is important to have separate, designated reserves and the public can see who is paying for what.

Darren Greenwood, City of Livermore, feels that Zone 7 can sharpen its pencil more when using reserves.

Bert Michalczyk, DSRSD, said he supports the AMP to maintain assets. The better approach is Option 2 in order to focus on rates for core services and a surcharge for the drought; if the base rate is wrong, it can be changed. He sees the concepts as drought surcharge versus replenishing reserves.

The Finance Committee's recommendation to staff is to develop more options. Director Ramirez Holmes noted that the reserve policy needs to be reviewed but in terms of making up for the lack of water sales, not using the drought surcharge to replenish them. Director Figuers said the directors need a range so they can see what is happening.

Director Ramirez Holmes left the meeting early due to a previous commitment.

4. Draft FY 15/16 Capital Improvement Program Development Methodology

JaVia Green said the CIP is developed every other year and when staff comes to the Finance Committee, it is a list of projects and cash flow but staff has not explained how the list of projects is developed, the CIP prioritization methodology. The CIP Prioritization Committee is made up of staff from several sections (Integrated Planning, Finance, Operations, Maintenance and Engineering) that are responsible for coming up with a list of projects to recommend to the General Manager and retailers to maintain Zone 7's water and flood control systems for the duration of the CIP period. As part of the CIP, they look at water supply needs, the facilities needed to deliver water, and create water supply portfolios.

She discussed the funding strategy for the CIP with investments such as expanding capacity, taste and odor at the treatment plant, and treating for Chromium 6 but Zone 7 has a pay-as-you-go funding policy to minimize borrowing. With pay-as-you-go funding, sometimes projects have to be deferred until Zone 7 has the cash to pay for those projects. Risks such as inflation can be incurred because those projects are more expensive to do in the future. When using connection fees or impact fees, there has to be a rational nexus between the fee and the cost.

One of the advantages of debt financing is that Zone 7 most likely has a favorable credit rating. Also the rating agencies look favorably upon the fact that Zone 7 has an asset in banked water at Cawelo and Semitropic. Interest rates are low and can be used to Zone 7's advantage, which helps with inflation. Financing helps smooth out rate increases and reserve levels, spreads the cost over the life of the asset, and can be appropriate for big-ticket items.

Fieldman, Rolapp & Associates is a financial consultant that put together Zone 7's reserve policy and works on the long term financial plan for Zone 7. As part of the agenda item, the directors reviewed a study that Fieldman Rolapp did for another water district that used pay-as-you-go financing and compared pay-as-you-go versus debt financing. Staff asked the Committee if they were interested in having Fieldman Rolapp do a plan for Zone 7 comparing the two types of financing.

Director Palmer asked why Zone 7 needs the study. Ms. Duerig said there are a lot of projects that should be done and there are liability issues so perhaps it is time to revisit the financing policy. Director Figuers commented that Director Ramirez Holmes left notes on the item saying that what is needed is the money variation on both pay-as-you-go and debt financing options. Maintaining current infrastructure and expansion for 30-40 years is also important. Director Palmer said we need to decide if we need an ISA or increase debt. We can change things as a board and use staff to give the directors advice, but do we need this study?

Ms. Duerig said if the directors are open to a discussion, with staff, Ms. Sato and retailers' input, staff could come back with a proposal. Staff would need to know the comfort level of the directors and if they would be open to the concept of debt financing, and if Fieldman Rolapp is needed to explain it and make a proposal. Ms. Green said that part of the CIP analysis is to know whether debt financing is an option for the project schedule. Director Figuers said he would like to hear a discussion on the types of long-term financing. Director Palmer said it would probably be a combination of pay-as-you-go/debt financing for some projects because of deferral issues.

The Committee's recommendation is to have staff look at the concept of pay-as-you-go and debt financing because some can't be deferred and big ticket items can't be pay-as-you-go due to the cost involved.

5. Verbal Reports - none.

6. Adjournment

Since there were no further issues or comments, the meeting was adjourned at 5:05 p.m.