



"Providing Life's Essential Services"

Utility Advisory Committee Meeting Highlights – February 20, 2008

Committee Members present:

John McCubbin, Michael Napoli, Sharon Schilling, Allan Schroeder, Sarah Velasquez, Arthur Reker

Committee Member absent:

Deena Monteiro

Staff present:

Lon Martin, John Watkins, Cindy Williams, May Albiani, Sarah Rubin, Garth Gaddy, Henry McLaughlin, Tom Pavletic/Consultant, David Bogdanov/JSA

1. Recap of Action Items

Lon Martin, Assistant Director, reviewed the Action Item list.

2. Water Division Rate Model Presentation – Tom Pavletic, Municipal Financial Services

Lon Martin presented a briefing on Water Division's operation. In summary: over the past 20 years, Fresno utility rate increases have been unplanned and reactive. From 1996-2000, no rate adjustments; then in 2001 it seemed that capital projects were needed for the Water Division and in 2005 the City lost the in-lieu fee system due to a lawsuit. The last three to four years there was a financial shift in General Fund needs resulting in fees like the Hydrant Maintenance Program. The beginning of the financial crunch for the Water Division was in 2005 and in 2006 the financial crisis was addressed. In 2006, a Contingency Plan was implemented to resolve potential bond debt coverage violation. Bond debt test violation is not something that can be fixed month by month, it is a rolling average which creates a need for a rate adjustment or expenditure reductions.

Consultant Tom Pavletic presented a PowerPoint evaluating the water rates. Mr. Pavletic reported this model projecting five years out looking at the rates is not really what financial planning is. That is a separate exercise from rate development. The Water Division is a water enterprise and one sliver of the financial planning for a business that actually exists into perpetuity that the Water Division is expected to go on forever so think of the financial planning model as the backdrop and the water enterprise as a corporation. Most of the assets have over 60 years of a useful life.

The set of adopted rate increases was adopted under the scenario on slide 5. Above the zero line are revenues and below are expenditures. The ending fund balance is in the smaller boxes along the zero line. Staff did not present to City Council the best plan; but a good plan that would minimize the impact to customers and provide the financial backing

necessary for the Division. At the time, it was the debt service coverage that needed to be addressed. The debt coverage test drove the rate increases. Over several years reserves were used reducing fund balances. The rate adjustments worked out by the 2006 UAC after stewing over the information and three criteria (expenditures, reasonable fund balance, and meeting coverage).

The comparison from PowerPoint slide 5 to slide 6 updated the debt service and bond sales; however, the one thing that did not change much was the revenue projection. Growth in the City and water sales revenue was estimated but was close to reality. Rate increases and weather conspired to lower sales. As the prices go up the sales go down. Remaining projections in the model are from the City in FY08 and FY09 budgets.

Lon stated there was some purposeful implementation not to run the Water Division with that low of a reserve or fund balance; staff altered the way they ran their business to ensure bond coverage.

Target balance - Tom's opinion: The coverage test is not running the rates in the future.

You use an anchor project to size the bonds, and then you bid the project but do not know exactly how much revenue from bonds will be needed.

Lon reported the Water Division compiled several projects around the anchor project for the bond sale and possibly consolidate in 2009 with the Wastewater Division for leverage. The Meter Retrofit Project is planned for 2009. When you plan out over the long-run, you can see you will have to slowly rebuild the system.

The update vs. projection (slide 7) reports in years 2007-2011 not much has changed; some expenditures land in different years than originally assumed.

Committee member John McCubbin questioned the merits maintenance vs. replacement and whether the replacement program is proactive. Henry McLaughlin, Water Division's Management Analyst referred to meeting packet item 2, page 2 noting the major capital over next three years including replacement wells. Lon Martin reported staff tracks where water main failures occur and this helps to develop the budget based on where staff finds consist repairs to determine where replacement to the water mains are warranted.

Committee Member Sarah Velasquez stated she was trying to reconcile the capital expenditures. To clarify her inquiry, staff will provide the detail breakdown of the capital budget to the UAC and this was noted as an action item.

Consultant Pavletic reported when you secure a bond, you don't know what you will be getting from the market. Capital spending can be volatile and then you have three years to spend it.

Tom conducted an analysis beyond the Proposition 218 time period, evaluating how rates may be affected if the September 1, 2008, adopted rate is changed. The scenarios look beyond the planning period ensuring fund balance, bond debt coverage and capital spending. In scenario #1 is the Proposition 218 scenario.

Tom Pavletic defined "working capital" as any business that has money coming in and going out with the classical prudent reserves of 45-60 days in operating expenditures. And, what is used for the target balance is 60 days in operating expenditures.

Facilitator Sarah Rubin asked committee members for initial reactions to the presentation.

Committee member McCubbin stated he understands the urgency to get rates stabilized; however, for clarity it would be better to separate out the pay-as-you-go from bonded expenditures. Lon Martin responded we can provide that information. Currently the Department is two years into the five-year rate plan that has been established by Proposition 218. The rate models are based on a rolling five-year period pushing out the modeling analysis to FY15.

In response to Committee member McCubbin's comment about the residential metering having a significant impact on revenues, Lon reported we need to take our best estimate at this time and run that revenue projection out. Lon explained the objective when Fresno changes from a flat to a metered rate, there should be no change in revenues. Staff hopes the revenue needs are already established within the current rate structure. Consultant Tom Pavletic advised the size of projections of the revenue balance between residential and commercial customers is the same with or without meters; what changes is the rate to produce that revenue. Garth Gaddy, Water Manager, added the cycle at which the rate revenue comes in will change, the bulk of the residential rate revenue will come during the summer, after the meters are installed.

Committee member Allan Schroeder stated it was a good presentation and questioned the adopted rate that was proposed and adopted by the previous UAC and Council and if there are no changes made, then why did we go 18%, 18%, 0%, 0%, 0%? Lon answered we had such a large capital need as illustrated on slide 5, the past UAC looked at five scenarios and the debt coverage and capital programs drove the rate adjustments.

Committee member Schroeder asked why the City bills every two months instead of monthly? Staff advised because there is a \$400,000 additional expense for once a month billing costs. Councilmember Duncan proposed a monthly billing cycle, but Council did not adopt his proposal.

Committee member Art Reker asked what is the rationale for scenario #2? Consultant Tom Pavletic explained the analysis started with 23% rate increase for September 1, 2008 and started dialing down the rate increase and quickly found fund balance problems. Also creating the need for large increases in the future.

Committee member Reker asked how do other communities make the transition when they went to meters? Staff reported, HDR's (the water meter consultant) findings show a 20% reduction in water usage in the first year. There is fluctuation over a period of time and fluctuates back to 10% reduction over the long term. It was noted residential customers will be affected by the meter program; commercial water users are already on a meter system.

Committee member Michael Napoli asked what is the penalty for not installing meters. Lon responded saying there are two issues: The City would be in violation of the Central Valley Project (CVP) contract which provides the annual 60,000 acre feet of San Joaquin water supply. This water supply represents about 40% of the water used by Fresno each year. The CVP water is a critical component to the City's water supply and is more reliable than the City's Kings River entitlements for which the City has no storage rights. Another significant issue related to CVP contract renewal is its link to the City County MOU which stipulates that the City of Fresno must renew the CVP Contract. Failure to comply with the CVP contract could nullify the General Plan. California legislature adopted AB 514,

overriding local meter prohibitions and requiring Fresno and other CVP contractors to install water meters and bill all services a metered rate by 2013.

The Fresno Irrigation District (FID) water supply will be used by customers by 2022 so what we don't use now is recharged. A Cooperative Agreement with FID for Kings River water supply was entered into in 1968. In the next 18 years that water will be coming into the City of Fresno for direct treatment and distribution. Lon explained it is a water resource management decision to treat the water directly for drinking or recharging the water supply. The water supply cross over in year 2022 is to off-set ground water pumping and to fulfill the General Plan requirement; if it is not there, there could be a moratorium on development.

Committee member Michael Napoli asked how the different water usages Kings River differ from the CVP? The CVP water supply is the highest reliability of our water supplies. The FID water supply is only available March through September on a good year. FID water supply is primarily used for recharge.

Kings River water will supply the Southeast SWTF in the future. The City's water supply infrastructure is aging while there is new growth in Southeast Fresno, creating a need for substantial water infrastructure investments.

The Southeast SWTF may take water from both sources but depends on the year and rain. The CVP water supply is targeted for consumption while the FID water supply is used for recharge.

Water conservation is how we regulate droughts.

In regard to establishing a residential metered rate, once we know how much water is being used by residential customers we can do the equity analysis. Lon said his gut feeling is there may be a difference possibly required adjustments.

Lon advised compared to other areas of the state, we don't have a lot of losses in our system (leaks). For example, desert communities are where you have sandy soils which can hide leaks for many years.

Year 2011 we go from a flat rate to a meter rate holding revenue steady.

Consultant Tom Pavletic reported he looked at the 22% percent rate and dialed it down 21%, 20% and fund balance goes negative. So when he got to 19%, below 20%, there was nothing he could do to meet the three criteria. If you go too low your fund balance goes negative. It was the revenue criteria that he focused on, not the rates.

Lon Martin responded to Chair Schilling saying other City departments do pay for their water use at City parks and on median islands; some are flat rate but most parks are on meters.

In response to Committee member Velasquez, Consultant Tom Pavletic stated he worked with the City of Woodland on their meter program as well as other cities going into and coming out of water meter transition.

Tom concurred with Lon that there will be a 20% savings on water usage from customers as a result of metering. Tom added he is seeing long term water conservation resulting from installation of new appliances such as washers and toilets; saying once they go in, you don't see much of a relaps.

Lon responded to Committee member Reker that Fresno and Sacramento are some of the last larger communities to implement a residential meter program, saying state legislation trumped the City Charter.

Chair Sharon Schilling asked if the gap in water consumption could be captured through recycled water. Lon advised new development is addressing this with “purple pipe” dedicated to recycled water for irrigation and we will see more of this in the future.

Chair Schilling asked if farmers are paying full price or do they get a discount for water usage? Lon responded some farmers near the City receive additional surface water to offset groundwater pumping and to recharge the aquifer.

Facilitator Sarah Rubin asked, given what you heard tonight, are you okay with going forward with the rate that was adopted?

Member

John McCubbin	Yes
Allan Schroeder	Yes
Art Reker	Yes
Michael Napoli	No
Sarah Velasquez	Yes
Sharon Schilling	Yes

Facilitator Sarah Rubin advised there was a consensus to endorse the current water rate recommended by the previous UAC and adopted by Council.

Committee member John McCubbin asked to see capital expenditures broken down into “pay as you go” and bonded to be an action item.

Committee member John McCubbin asked where the late fee fines collected go. Staff responded they go to the division’s enterprise fund, approximately \$4,000 a year, and we will get the spreadsheet to you.

Meeting Adjourned.