



"Providing Life's Essential Services"

Utility Advisory Committee Meeting Highlights – January 30, 2008

Committee Members present:

Deena Monteiro, Michael Napoli, Sharon Schilling, Allan Schroeder, Sarah Velasquez, Arthur Reker

Committee Member absent:

John McCubbin

Staff present:

Lon Martin, John Watkins, May Albiani, Sarah Rubin, Ric Hutchinson, Bill O'Brien, Pat Tierce, Mai Vang, Eric Schwartz, Robert Gedert, Robert Weakley

1. Recap of Action Items

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

Chair Sharon Schilling asked for an overview of the 5-year rate plan adopted by Council verses the 5-year rate plan recommended by the previous Utility Advisory Commission. Lon stated Council adopted the recommended rate plan with one exception to the Solid Waste rates. The Commission included \$3.63 in the Solid Waste rate plan to pay for increased services for median island street tree trimming. The City Manager recommended removing this cost from the Solid Waste rate and Council agreed. Consultant Ric Hutchinson reported it was pulled out of the current rate model. Lon noted starting September 2007 additional funding for increased services for median island street tree trimming is gone from the rate model.

Chair Schilling inquired about Community Sanitation Division (CSD) being included in the rate model. Lon advised the CSD rates were not included in the Proposition 218 process and review of the current rate is not a task for this Committee. The primary focus is on the three divisions (Solid Waste, Water, Wastewater) and due to deadlines for budget recommendations, the UAC can investigate and make recommendations on CSD at a later date.

Chair Schilling asked about the possibility of merging CSD it into Solid Waste if we wish to; do we need to wait to 2009? Lon replied the City Manager has given staff the go-ahead to analyze and develop a merge plan.

Chair Schilling said she wanted CSD in the final UAC report if the members agreed. Lon Martin informed staff will place it on the action item report to place in the final UAC report and at a future meeting the UAC will reconsider if they want it to go into the final report.

Lon Martin explained how the 45-day reserve came to fruition and referred to past UAC meeting notes. Lon advised the minimum rule of thumb recommendation is:

- 1) no less than 5 to 15 percent of operating revenues, or
- 2) no less than one to two months of operating expenditures – (GFOA recommendations) consistent with City policy.

Lon reported that the City Finance Department follows the Government Financial Officers Association (GFOA) as a guidance tool so the City's policy mimics the GFOA and provided excerpts from the 2006 PowerPoint presentation.

Committee member Allan Schroeder said he was looking for a financial model to show where there are concerns and how the 45 days would cover them. Lon Martin replied that the reserve amounts were developed at the policy level and that a formal reserve model has not been developed.

Committee member Allan Schroeder questioned if trash was not picked up for two weeks, would the reserves hold out; and asked is that why the Solid Waste Division has the lowest reserve compared to Water Division which expenses and revenues are based on water sales? Staff responded that the Solid Waste Division was less capital intensive and has a consistent revenue metric providing reliable cash flow allowing for a lower reserve. Water has a higher capital demand and a volatile cash flow requiring a higher reserve.

Committee member Allan Schroeder asked could the reserve go down to 30 days; once the City gets over the hump?

Committee member Allan Schroeder stated that could be a recommendation of the UAC to develop a risk analysis model.

Committee member Sarah Velasquez observed the increase in fuel has been a concern so it may be just as easy to plan on using the current reserve recommendations.

Committee member Allan Schroeder said he would not want to limit the risk analysis to Solid Waste but across all the utilities.

Chair Sharon Schilling stated in regards to the fuel surcharge agreement; she could not find who developed the formula or calculates the amount of the surcharge. Staff reported the City Manager developed the surcharge formula and directed Solid Waste to do the calculation, confirming Mr. Caglia does not do the calculation.

Chair Sharon Schilling reported the City Manager wants the utility businesses to operate under a higher financial risk and the previous UAC felt it was not good.

Lon addressed the Committee's inquiry regarding overtime. Overtime in Solid Waste does not have a net effect on expenses, overtime is paid for by the cost savings incurred from vacancies.

Bill O'Brien, Assistant Director – Solid Waste, explained the laborious recruitment process for Solid Waste drivers. Noting the division begins with 100 applicants finding only 20 qualified because it is a specialized job compared to long-haul drivers.

Robert Weakley reported they balanced the routes in FY07 and overtime averages only three hours per week, per driver. Robert Gedert advised in FY03 and FY04 overtime was flagged as obsessive, and staff addressed it by developing a plan.

Lon referred to the meeting packet items that provided the history of the Department's need for rate increases and the factors contributing to financial stress along with the environment in which the Department was operating.

Item 2A, the Utility Rate Study Analysis for FY07, was discussed.

Item 2C, Contingency Plan for FY 2007 Budget; assumed there would be no rate increases in FY07 with implications in reduced levels of service to customers and City exposure to potential health and safety violations.

Item 2B, was a briefing on the bond debt coverage test for Water and Solid Waste Divisions alerting the City Manager to the risk to the bond debt coverage test due to a flat revenue and expenditure plan complicated by unforeseen expenditures.

Public Utilities incurred \$20 million in the pass-through costs (fuel, energy, chemical costs, internal service providers) with no rate increases. This included major renegotiation with labor unions.

Lon explained how close the City came to bond debt violation and how the Department went to Council with a budget relying heavily on reserves. Lon reported the Solid Waste Division still, to this day, is not covering their cost on the residential side. Consultant Ric Hutchinson illustrated how the Division is building their way back into the black.

The Committee inquired why from 2003 to 2007 the Department did not take a rate increase proposal to City Council. Lon reported the UAC was created by the Mayor and Council to determine if rate increases were necessary and, if so, how much of an increase. Then the UAC would make recommendations to the City Council.

Chair Schilling opined some of the UAC recommendations were ignored. She explained how the 2006 Commissioners personally talked to their individual Council members regarding staff recommendations that did not make it passed the City Manager.

Lon reported staff went to City Council with two plans: the UAC recommendation and the Mayor's recommendation. City Council's action resulted in splitting the difference. Lon concluded staff was able to tell their story (need for rate increases) through the 2006 Commission. Sharon Schilling reported the 2006 Commission asked a lot of difficult questions and that is how they found out as much as they did.

Lon noted the financial stress started in 2003 and ran to the breaking point in 2006. He encouraged the UAC to read the materials provided.

2. Solid Waste Rate Model Presentation – Rick Hutchinson, R3 Consulting Group

Consultant Ric Hutchinson explained rate setting factors are similar to a "three legged stool."

- 1) Bond coverage requirements
- 2) Reserve balances
- 3) Maintaining Proposition 218 requirements

Ric Hutchinson built the rate models based on current conditions and overtime balanced the three key components for the financial plan. He explained that many of the costs included in the model are directives from the City.

Mr. Hutchinson reported as they proposed some rate increases to implement the “three legged stool” financial plan. There are a few changes from the previous model to this year’s model. Primarily the moving out of capital projects, which does not reduce the need for rate adjustments. If you reduce the current adopted rate adjustment now, it will increase future rate adjustments causing some customers to pay more. Over the entire rate model time period spanning several fiscal years, you see the ratepayer paying \$10 more if we use the scenario with a lower rate for FY09.

Committee member Deena Monterio noted despite the spike in rates, both scenarios used reserves.

Committee member Sarah Velasquez observed the spike in FY09 and FY10 drops off in FY11 as the debt goes down and capital projects are moved out.

Committee member Allan Schroeder asked how is the equipment replacement schedule determined and incorporated into the model. Staff answered that each vehicle is depreciated and that Divisions pay into a replacement fund annual anticipating replacement needs.

Lon explained in regards to the Landfill Closure, it is more effective to pay cash instead of bonding it.

Committee member Michael Napoli inquired about the \$4 million capital costs for the Landfill. Pat Tierce, Solid Waste’s Financial Officer, replied the split is half commercial and half residential. Landfill capital was pushed out.

Staff reported the development of the Hazardous Household Waste facility is being shifted to the County, but the Department will still have to pay for that service. Funding is kept in the budget to pay for the tipping fees and to pay for ongoing fuel charges. There is \$2.3 million left as of FY09. Staff noted they eliminated the Biosolid Project from the rate model.

Committee member Michael Napoli said the FY10 increase leaves a gap. Lon referred to the handout saying it highlighted the larger O&M expenditures and capital projects, the smaller items that accumulated are not stated on the handout. Ric Hutchinson added there is \$1 million for trucks, drivers and growth on the commercial side; same as residential.

In response to Chair Sharon Schilling, Solid Waste receives a Federal LNG rebate of \$400,000 and it is in the model. Noting Solid Waste uses grants from the Air Control Board to retrofit trucks. Robert Weakley reported California LNG fueling plants are being built, and that Solid Waste currently pays shipping charges for fuel from out-of-state deliveries, and expects LNG costs to come down in the future.

Staff explained when we talk about the Proposition 218 balance, residential has to pay for its expenses, this cannot be subsidized by the commercial side. Residential is still pulling from reserves and the Division’s objective is to break even as much as possible. If allowed to continue, residential will begin to consume commercial reserves creating a subsidization, which is illegal. It is important that Solid Waste keeps their residential expenditures covered with residential revenue.

Committee member Doreen Monterio announced her opinion had changed, rates are going to be lower in the long run for the rate payer because you are spiking early on and pulling rates down.

Committee member Allan Schroeder said he could agree with that if there is an investment in return; but was confused by a higher reserve. Ric Hutchinson responded there is a compounding effect with the rates allowing for higher reserve.

Committee member Allan Schroeder estimated so if it is out-of-pocket from the rate payer's prospective, that means the rate payer is paying more if the lower rate is implemented now. Ric Hutchinson, responded if you compare the two rate scenarios over the modeling time frame the rate model with the lower rate for FY09 will cost the customers \$10 more a year.

Robert Weakley responded to Committee member Schroeder, saying he was looking at it as business model and not a government model; government cannot make a profit.

Facilitator Sarah Rubin summarized for the Committee the two rate increase scenarios and asked to hear where the Committee members were currently leaning towards.

Chair Sharon Schilling responded scenario #2; 16.7%; commented the health of the City is important.

Lon explained the decision before the UAC is to make a recommendation for FY09 but it sets the stage for FY12. Committee member Deena Monterio asked are we just to approve and recommend for FY09 or all the years? Facilitator Sarah Rubin advised whatever changes we do now will have implications for future years. The objective here is to make a recommendation for FY09, but that can't be effectively made without knowing future impacts.

Committee member Allan Schroeder said in response to the upper limit of the adopted rates, the percentage can change, it can only go lower.

Committee member Deana Monterio advised she was leaning toward the 12% recommendation because if she can save money for the rate payers, she will do it. She added 12% is a very big chunk to swallow because the Proposition 218 process has set the limits until FY12 when a new Proposition 218 hearing can be conducted.

Committee member Sarah Velasquez asked how close do you want to cut it; the goal is to set a fair base so the Division can do their job and at the same time not gouge the consumer and concluded by saying she was more supportive of the 16% like Chair Schilling.

Committee member Michael Napoli said he did not recall being mandated to recommend a rate increase and said he was still off the chart and would only support a 3% Consumer Price Index adjustment.

Committee member Art Reker stated he supported the 16%. He commented the past 2006 UAC had provided a great service, and as a businessman he knows what reserves are all about. He supports the City building up the best reserves they can, knowing they will be used. And, if you cut it too close, you are doing a great disservice to the citizens of the community.

Committee member Allan Schroeder said the City gained reserve balances in FY06 and in FY07, by receiving a refund from the County \$16 million. He asked what was the number of days for the reserves in the FY09? Ric Hutchinson answered close to 60-75 days, and FY11 or FY12 the Division's reserves drop to 45 days. Committee member Schroeder asked what type of capital projects do we have outside of FY11? Mr. Hutchinson responded capital projects such as Landfill, trucks, containers are built into the model every year. What is not built into the model is the unknown EPA requirements that Lon talked about.

Committee member Allan Schroeder said he agreed with what Committee member Napoli said, but, given the two scenarios he recommended the 12%, if there is nothing else that Proposition 218 can do.

Facilitator Sarah Rubin advised the UAC is seeking consensus on all key issues. Consensus is defined as 5 of the 7 UAC members. Taking a consensus-based approach to decision making does not mean that 100 percent support will be required to move forward with recommendations. It does mean that every effort will be made to reach consensus, and that opposing points of view will be presented and explained if consensus cannot be reached. Consensus can include situations where participants either "step aside from" or "agree not to oppose" recommendations. "Minority" views will be included in meeting summaries.

Committee member Michael Napoli stated with the way the information is presented thus far, he was not comfortable with moving to the 12%. He opined he has not seen the detail financial information leaving \$5 million of expenditures unexplained. He would need the break down of FY06 budget to get an idea. He opined the Solid Waste Division is run well, tight administratively and can understand rate increases are not necessary. In regard to Committee member Art Reker's comment, the City needing reserves, he believes households need reserves as well. At this point, he does not have the information to get him to move to the 12%. He stated he was not concerned with low income discounts; but all citizens. Stating this is hyperinflation, if everyone does this, it needs to be justified. There are pieces of the pie that need to be addressed.

Committee member Sarah Velasquez questioned, historically the City has run with no increases and is doing the make up now? Lon responded yes.

Lon Martin referred to a graph illustration starting with the negative balance and bumping into the positive; saying the Department is trying to balance ourselves right at the zero level.

Committee member Allan Schroeder asked can the UAC see a scenario that reflects a 3% rate increase in FY09. Lon responded, the City would be in violation of Proposition 218 at 3%. Committee Schroeder asked what is the penalty to be in violation of Proposition 218. Consultant Ric Hutchinson advised if Proposition 218 was challenged in the Courts, the City would have to refund all the rates to the rate payers (commercial side) and live on what reserves there are until the City could redo the rates.

Committee member Allan Schroeder asked if the Committee could see a 3% scenario. (This was noted as an action item.)

Lon Martin explained it was a legal and moral issue and the City can legally go no lower than 12%. As a body you can recommend less, but legally and ethically this is the prudent range that staff can offer between 12% and 16%.

Lon clarified the discussion was based on a rolling five-year period. The urgent part that the UAC would be recommending to City Council is the FY09 recommendation since staff is building the budget.

Council approved the 16% and staff acknowledges we can legally and ethically go as low as 12% and we are asking the UAC to ratify a recommendation within that range.

Facilitator Sarah Rubin lead round two in consensus building.

Chair Sharon Schilling advised she did not have a range, she was at 16%, saying do it now, get it over with and then let it level out. She finished by saying she could not live with anything lower.

Committee member Deena Monterio stated 12% is enough.

Lon clarified, the City Council will take the UAC's recommendation very seriously.

Committee member Allan Schroeder said he was at 12% but still wants to see the 3% model.

Committee member Sarah Velasquez said she only sees increased costs and is somewhere in the middle but willing to move to the right (16%) because this is a well-run operation.

Committee member Deena Monterio said she understands what happened in the past but wants to help the rate payer and give them a balance.

Michael Napoli said 3% will be a minority opinion, but would be well-suited to him.

Committee member Deena Monterio questioned as an advisory committee, don't we have a problem with it being a split opinion? Committee member Sarah Velasquez added she would like to see consensus.

Lon Martin estimated maybe we couch it in this position, instead of spitting it into fractures. State it as 12% gets us legally where we need to go, we had consensus for the 12%.

Committee member Art Reker said he is in the favor of the 16%, rate payers are better off under that scenario.

Chair Sharon Schilling asked what frills would you have at 16%. Lon Martin said compound the money early on and use it over time.

Committee member Allan Schroeder said he does not like using today's rate payers' money to pay for future growth. He added fuel surcharges concerns him.

Robert Weakley advised a second contractor has made an inquiry regarding renegotiating his fuel surcharge agreement.

Committee member Art Reker said he will go with the majority.

Committee member Deena Monterio said she can go 14%.

Committee member Allan Schroeder said he cannot go above the 12%.

Chair Sharon Schilling noted the Committee was split and should return to this discussion at a future meeting.

Committee member Michael Napoli opined he knows the Division is properly run and the infrastructure shows extreme financial discipline; in his opinion that money does not need to be added.

3. Unfinished and New Business

The Committee agreed to add a March 5 meeting to their schedule. They also agreed to hold the March 13 meeting in the Fresno City Hall Chamber.

Meeting adjourned.