METROPOLITAN DOMESTIC WATER IMPROVEMENT DISTRICT
FINANCE OVERSIGHT COMMITTEE

Metropolitan Domestic Water Improvement District
**** Board Conference Room ****
6265 N. La Cañada Drive
Tucson, AZ 85704

November 9, 2016

MINUTES

Board Members Present:	Reb Guillot, Chair Lee Harbers, Vice Chair Robert Shonka, Member Lee Mayes, Member Danny Sargent, Member
Board Members Not Present:	Barbara Gelband, Member Tom Ruppenthal, Member
District Staff:	Joseph Olsen, General Manager Sheila Bowen, District Engineer / Deputy General Manager Diane Bracken, Chief Financial Officer Steve Shepard, Utility Superintendent Mike Block, Water Resources Manager Tullie Noltin, Clerk of the Board Theo Fedele, Recorder

I. Call to Order and Roll Call

Mr. Guillot called the Metropolitan Domestic Water Improvement District Finance Oversight Committee (Committee, FOC) meeting to order at 4:00 p.m. Mr. Guillot, Mr. Harbers, Mr. Shonka, Mr. Mayes, and Mr. Sargent were present. Ms. Gelband and Mr. Ruppenthal were not present.

II. Call to the Public

There were no comments by the public.

Mr. Olsen introduced Theo Fedele as the new Executive Assistant and Board Recorder. Mr. Olsen thanked Sheila Bowen for her ten years of service on the Finance Oversight Committee (FOC). Ms. Bowen has resigned her position on the FOC and has accepted the position as the Deputy General Manager and District Engineer with the District. Charlie Maish retires on November 16, 2016 and the District thanks Mr. Maish for his over 20 years of service.

The past three years there have been three FOC meetings each year. One in January for the mid-year budget review and any proposed changes; one in March to discuss upcoming rates, revenue projections, and the proposed budget; and one meeting, like today's, to share information on activities in the District. At the last FOC meeting in March, an update on the Central Arizona Project Recharge, Recovery, and Delivery System (CAP RRDS) and the Inter-Active Management Area (Inter-AMA) Firming efforts were requested.

III. Approval of Minutes – March 21, 2016 Meeting

Mr. Harbers made a motion to accept the minutes as presented. Mr. Shonka seconded the motion. Motion passed unanimously.

IV. Chief Financial Officer's Update on the District's Financial Position

Ms. Bracken stated that she would go over the general information about the District's audit, funding and investment information, and the Fitch Rating review. For the audit, the independent auditors are hired to verify and validate data. This information is used by businesses, financial institutions, customers, rating agencies, and the District so it is important to present this information in an accurate, useful format. For the audit process, the standard unqualified audit report is regarded as a clean bill of health. The first page of the audit report is a letter from the auditor and is made up of three paragraphs. The first paragraph is the introduction paragraph which clarifies the responsibility of management, the second paragraph is the scope paragraph which describes the nature of the audit and the scope of work, and the final paragraph is the opinion paragraph which states the opinions and conclusions of the auditors. An unqualified opinion can only be expressed when an independent auditor has found nothing of substance or value with any errors in it and the auditor has formed an opinion in accordance with Generally Accepted Accounting Principles (GAAP). The financial staff is responsible for preparation and fair presentation of the financial statement in accordance with GAAP including design, implementation, and maintenance of internal controls used to ensure all statements are free of material misstatements. The Chief Financial Officer (CFO) is responsible for discussion and analysis of the financial statements which can be found in the Management Discussion and Analysis section of the Comprehensive Annual Financial Report (CAFR) on pages 4 through 13.

HintonBurdick, the District's independent auditor, is responsible for expressing an opinion on these financial statements based upon their audit, which was conducted in accordance with Government Auditing Standards. Auditing standards require the audit to be planned and performed so they can obtain reasonable assurance about whether the financial statements are free from material misstatements. This includes assessing risks by reviewing internal controls, evaluating accounting policies and procedures, reviewing the reasonableness of significant accounting assumptions and estimates made by District Management, and evaluating the overall presentation of financial statements. HintonBurdick's opinion stated that the financial statements presented fairly, in all material respects, the respective financial position of the business-type activities of Metropolitan Domestic Water Improvement District as of June 30, 2016. As of June 30, 2016, the District has improved the total net position by $6.9 million dollars in Fiscal Year 2016, with assets increasing by $1.3 million dollars and liabilities decreasing by $5.6 million dollars. Unrestricted cash increased by $3 million dollars and the value of the water recharge credits increased by $893,581 for a book value of $5,475,048. The revenue sources remained consistent between Fiscal Year 2015 and Fiscal Year 2016. Expense distributions were also consistent with only a 1% increase in other operating expenses and a 1% decrease in Salaries and Benefits. Revenue from operations increased by $1 million dollars and the total Operating Expenses in Fiscal Year 2016 were $46,364 lower than they were in Fiscal Year 2015. At the end of the fiscal year, the District's senior debt service coverage ratio was 1.83 compared to 1.64 last fiscal year. The cost quote to complete the audit was $19,500 and the actual cost was $16,000, saving the District $3,500 which was largely attributed to staff's ability to prepare and organize all of the information.Mr. Olsen stated that with the hundreds of transactions processed per month HindonBurdick found no material findings and no items were approved without the appropriate internal controls which is a testament to the professionalism of Ms. Bracken and her team. HintonBurdick also provided guidance points and observations beyond the audit and financial aspects to allow the District to enhance processes in areas such as information technology. It is a great partnership with the auditor, not just to have the financial analysis, but also additional information that they are able to provide. Ms. Bracken stated that in accordance with the District's bond resolution, the debt service reserve account was established in lieu of surety bond insurance. The District was required to establish and maintain a balance equivalent to one year of debt service payments totaling $4,636,079 and the last contributions in this fund were in March 2014. Although these funds are restricted they are still District dollars which allows the CFO to make investment decisions. In the last year, the stock market has taken a few dips and rebounds. The District had secured investments in accordance with the Arizona Revised Statutes (ARS) which is predominantly in the bond market so when the bond market fluctuates the gains received on the bonds are just paper gains and as soon as the market goes down, the gains are lost. Active cash investment allows the District to capitalize on the gains. The bonds that are purchased have a sellout option so if the market spikes the bonds can be sold to physically capitalize on the gains and then the bonds can be repurchased usually at a better price within a week or two taking advantage of market fluctuation. This account exceeded the allowable balance by $415,755.81 at the end of the fiscal year. The Bank of New

York Mellon swept $344,671.06 out of this account leaving $71,000 balance for the market fluctuation. Since the District does not have any bonds that are callable, those dollars will be used toward the debt service payment in the current fiscal year reducing the cash needs by $344,671.06. Mr. Olsen stated that Ms. Bracken is very humble but she did something phenomenal and this is the first time it has been done in the District. With the active funds management, Ms. Bracken has essentially generated $344,671.06 which is equivalent to a one time rate increase. These long term interest option investments provide a revenue resource at no risk to the District.

Ms. Bracken stated that on October 11, 2016, the Fitch Rating Agency issued a press release affirming the AA- rating on the senior bond lien, and the A+ bond ratings on the subordinate lien bonds. Comments made by the Fitch Rating Agency included an increase in the number of days cash on hand from 348 to 462 days. The District's debt leverage, which was previously noted as high, has moderated and debt ratios continue to decline after peaking in 2011. Debt has rapidly amortized providing capacity for future debt relating to the CAP RRDS project. Fitch Ratings continued to state that recent rate adjustments have resulted in the District's fixed base rate now providing a significant 61% of the average monthly residential bill, up from 50% in the prior review. Fitch Rating views the high percentage of fixed rates favorably as it provides stability to the District's revenue. Mr. Olsen said that Fitch mentioned revenue stability multiple times. In the last two years, the District has moved to 90% fixed cost recovery and Fitch highlighted that as a significant improvement and a stabilizing influence.

V. <u>Presentation and Discussion on the Central Arizona Project Recharge, Recovery, and Delivery System</u>

Mr. Olsen stated that in 2012 the FOC approved the Water Resource Utilization Fee (WRUF or Fee) to fund projects that utilize the District's water resources or to put those resources to use. Originally the fee was ten cents per 1,000 gallons and has subsequently been adjusted three times to the present 50 cents per 1,000 gallons in 2016. One project that is projected to utilize the funds from this fee is the CAP RRDS project because the aquifer below Metro Main is dropping at a rate of two feet per year and has been for the past 20 years. While not an urgent emergency today, it is a long term concern. The District presently recharges a majority of its renewable CAP allocation at the Avra Valley Recharge Project (AVRP) and groundwater savings facilities (GSF). That water is about 13 miles away from where it is needed so the CAP RRDS will include drilling recovery wells near where the water is being stored, conveying that water to a booster forebay station, and pumping the water to the Herb Johnson Reservoir to be blended with groundwater. The District is moving forward with the design and land acquisition activities for the project. The 22 acres for the booster and forebay site have been purchased and the District is also moving forward with various easement acquisitions and cultural surveys.

Oro Valley and Marana also store a portion of their CAP allocation near where the wells are planned to be drilled resulting in a potential partnership with these water providers. Entities such as Tucson Water and Flowing Wells were very supportive of this initiative but were not able to be infrastructure partners due to funding or timing issues and instead these entities will be wheeling partners in the future. Both Oro Valley and Marana have joined with the District on planning for an Intergovernmental Agreement (IGA) to partner in this project. Having these entities partner on the infrastructure, which is roughly a $36 million investment, drops the cost to the District to approximately $20-22 million. The final costs are unknown but there is potential to save almost a full year of revenue saving the rate payers a substantial amount of money. An additional benefit of this partnership is the delivery of roughly 10,000 acre-feet (AF) per year of renewable water resources, which enhances the regional aquifer levels. By mid-spring the IGA will be considered by all respective governing bodies and by the summer of 2017 the initial design process can move forward. The current schematics are based on a route study that provided various options and validations for the 13 mile delivery pipeline. The more detailed design efforts will begin in the next calendar year and continue for approximately three years to ensure proper design for the three wells, booster forebay, treatment such as chlorination, balancing of the pumps and boosters to deliver to the various service areas, and the 13 mile alignment of the pipe which includes crossing the railroad, I-10, and the CAP canal. Construction would then last roughly three years so the goal would be to complete the project by 2023.

Mr. Harbers asked if the CAP RRDS is a District project. Mr. Olsen stated that the District has worked with Marana, Oro Valley, and legal counsel to come up with the right governance documents. All the infrastructure and land will be owned by the District with Marana and Oro Valley paying the equivalent proportional share of capital infrastructure which will guarantee capacity in the pipeline. The initial fee target for the WRUF was 70 cents per 1,000 gallons and it is currently at 50 cents but due to the partnerships with Oro Valley and Marana the final amount is likely to be less than the anticipated 70 cents per 1000 gallons.

Mr. Harbers asked if there is a sunset date on the IGA. Mr. Olsen stated the sunset date is 50 years because this is a long range project to invest in and guarantee the flow of water resources. All parties involved wanted to ensure the governance framework was solid enough to ensure it survives 50 years.

Mr. Guillot asked if the 10,000 AF per year will be set as the maximum number or if it has a potential to be expanded. Mr. Olsen stated the pipeline is not planned to be oversized and is based on what each entity viewed as their long-term need. This project is a pressing need that will be the top capital initiative for the next six years because if the aquifer declines at the current rate of two feet per year in six years it will be 12 feet lower and the goal of this project is to bring the aquifer into alignment and halt decline.

Mr. Harbers asked about the status of the land acquisition and right of way easement acquisitions. Mr. Olsen stated it is an ongoing process and that time has been built into the schedule. Some parcels have been acquired and Tierra Right of Way Services, the District's consultant, has been collecting the pertinent data for the private parcels as well as the larger block parcels. The goal is to have the easements completed by next year to then move into design. The real property actions and the design activities are funded from the WRUF so the District does not need to take any debt until the construction period begins which is a significant savings to District ratepayers.

VI. Presentation and Discussion on the Intergovernmental Agreement with the City of Phoenix for Inter-AMA Firming of Central Arizona Project Water

Mr. Block stated that he would explain a few key items before outlining the collaborative partnership with the City of Phoenix. Active Management Areas (AMA) refers to the five areas in the State of Arizona where there had been significant pumpage resulting in ground level declines. The State created a groundwater management code to manage the groundwater pumpage in those areas. Phoenix and Tucson each have an AMA and have come up with a way to collaborative leverage CAP supplies. The Colorado River could potentially enter a declared shortage in 2018. This will primarily affect the Arizona Water Bank who is storing excess CAP water as well as a portion of the agricultural water going to farms. Municipal and industrial subcontractors such as the City of Tucson and the District have been storing excess CAP at recharge projects for the future called self-firming. The City of Tucson has three recharge projects and the District has the AVRP. The City of Phoenix primarily utilizes their CAP water directly, where the water comes through the canal and goes into a water treatment plant. The City of Phoenix is not fully utilizing their CAP supply because growth has not been as fast as projected. Phoenix does not have a way to store that water to be able to get access to it quickly because they do not have a recharge, recovery, and delivery system. The District collaboratively worked with the City of Phoenix to come up with a way to share water. Phoenix would first store a portion of their excess supply here in the Tucson recharge facilities and Phoenix would acquire long term storage credits. During a shortage, Phoenix would exchange their long term storage credits for a portion of the District's CAP water allocation that would then be diverted to Phoenix's treatment plant instead of having it come all the way down to Tucson. The benefits with this program is that the operational costs and capital investments are paid for by the storing entity. The City of Phoenix benefits because they do not have to build the costly recharge systems. Both Phoenix and Tucson have an added savings benefit from lower energy charges in CAP rates when there is a water shortage because the water does not have to come all the way down to Tucson.

In October 2014, the District and the City of Phoenix approved the first IGA as a pilot test program with only 150 AF. This had never been done before in the State so this was to test the process with the state agencies, the Arizona Department of Water Resources (ADWR) and CAP. In 2016, 1,500

AF will be stored and a two year extension was recently approved for 3,500 AF annually. The City of Phoenix may be interested in investing infrastructure and expanding AVRP in the future since presently the facility is operationally doing 7,000 AF annually but the permit for the facility is for 11,000 AF. On the cost side, reimbursing the District for the operations and maintenance cost in 2015 with 150 AF is a little over $2,800. This year's reimbursement for the operations and maintenance cost is $25,000. The new agreement for 3,500 AF annually also includes the capital costs resulting in over $100,000 annually reimbursed to the District.

Mr. Olsen stated that this has been a collaborative effort in the works for many years and Mr. Block deserves an enormous amount of credit. A significant amount of behind the scenes discussions with the City of Phoenix, ADWR, CAP and the Bureau of Reclamation was needed to get the program where it is today. Tucson Water and the District have each partnered with the City of Phoenix. This project has attracted statewide attention as well as the interest of the White House who called this "an innovative water management solution" to weather the looming shortage on the Colorado River System. CAP is moving forward with a system use agreement to facilitate Inter-AMA implementation. The District will continue to stand beside larger entities with an equal voice to help to secure and beneficially influence the statewide policies.

VII. Clerk of the Board Updates; Future Meetings

The next Finance Oversight Committee meeting is scheduled for January 24, 2017. The intended topics on that agenda are election of new FOC officers for 2017 and a review of the mid-year budget before it is reviewed by the Board of Directors in February.

Mr. Olsen asked for suggestions for topics of interest where staff could then provide more background and detail at a future meeting.

Mr. Sargent asked for more information and an update on the Supervisory Control and Data Acquisition (SCADA) System.

Mr. Olsen stated that he had an opportunity to speak at the Alliance for Water Efficiency conference in Phoenix about revenue stability with roughly 100 directors, managers, and financial leads of various water entities across Arizona. There Mr. Olsen shared the District's revenue stability journey and arrived at a ten step process that other entities could mimic to reach revenue stability. Feedback was positive with many of the entities in attendance wanting to mirror the District's methods. The ten steps can be shared with the FOC at a future meeting.

Mr. Guillot requested information on effluent reuse at a future meeting.

VIII. Call to the Public

There were no comments from the public.

IX. Adjournment

The meeting adjourned at 4:58 p.m.

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Reb Guillot, Chair
Finance Oversight Committee