BOARD OF DIRECTORS
METROPOLITAN DOMESTIC WATER IMPROVEMENT DISTRICT
PIMA COUNTY, ARIZONA

March 30, 2015

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

MINUTES

Board Members Present:	Bryan Foulk, Vice-Chair Jim Doyle, Member Helen Ireland, Member Dan M. Offret, Member
Board Members Not Present:	Judy Scrivener, Chair
District Staff:	Joseph Olsen, General Manager Diane Bracken, Chief Financial Officer Charlie Maish, District Engineer Tullie Noltin, Recorder Steve Shepard, Utility Superintendent Warren Tenney, Assistant General Manager

Study Session

I. Call to Order and Roll Call

Bryan Foulk, Vice Chair of the Board of Directors of the Metropolitan Domestic Water Improvement District (District), called the Board Study Session to order at 5:30 p.m. Jim Doyle, Bryan Foulk, Helen Ireland, and Dan Offret were present. Judy Scrivener was not present.

II. General Comments from the Public

There were no comments by the public.

III. Discussion of Enhancement of Revenue Stability through Adjustment of Rates & Fees and Consideration to Schedule a Public Hearing

Mr. Olsen said over the past year, the Finance Oversight Committee (FOC) and Board of Directors have had numerous discussions about the need to address three areas of financial issues: water resource stability, revenue stability, and financial cycle stability. Last year's revenue adjustment included the first phase of adjusting for water resource stability, by increasing the Water Resource Utilization Fee (WRUF) from 20 cents to 40 cents per thousand gallons. Subsequent phases are projected 10 cent increases in Fiscal Years 2017, 2018, and 2019 for Board consideration to move the District forward with projects such as the Central Arizona Project (CAP) Recharge, Recovery, and Delivery System. This year, the goal is to address both financial cycle stability and revenue stability. The FOC discussed those initiatives as well as the proposed adjustments to four fees to bring them back in line to cost of service methodology along with the Fiscal Year 2016 proposed budget.

Historically, the financial plan and budget were planned to take effect on July 1 at the beginning of the fiscal year. A few months later, the Board would discuss a proposed revenue or rate adjustment based on analysis of the financial plan, which would go into effect in November or December. That created a challenge because revenue adjustments were approved that were not in the financial plan. Financial best practices recommend switching the timing and identify the requirements before discussing, approving, and integrating revenue adjustments into the financial plan. The goal this year is to follow that plan, with all discussions occurring through May and Board consideration in June, with the intent to use this cycle for future years. The FOC discussed the proposed financial cycle and concurred with the approach.

The primary focus for revenue stability is balancing the fixed/variable revenue and costs. Metro Water customer bills derive revenue from two sources: fixed revenue, which is the Water Availability Rate, and variable revenue, which is based on water consumption. A truly revenue balanced entity would have 100% of fixed costs, or items that must be paid regardless of how much water is used, coming from fixed revenue. The District currently captures around 69% of fixed revenue to meet fixed requirements. The remaining 31% of fixed requirements are met by variable revenue based on how much water is used. If water demands decrease, there is less revenue and it becomes a challenge to cover fixed costs. That is exactly what is facing Metro Water today. In Metro Main, 2013 was the lowest demand year on record, 2014 was 4% less than 2013, and the trend continues. Some form of adjustment is required to make sure revenue stability is accomplished.

Over the past couple years, the District has been making positive steps with incremental increases in the Water Availability Rate to bring in more fixed revenue. Staff spent a lot of time looking at numerous revenue models to identify the best rate structure. Staff was able to find one that achieves 83% of fixed cost recovery by a couple of simple adjustments in the fixed and variable revenues. A substantial increase (from $22.00 to $27.00) in the Water Availability Rate for standard 5/8 inch meters is proposed while at the same time, decreasing the water consumption charges for the first tier from $2.00 to 99 cents. For the average customer in Metro Main and Hub, the increase would be 80 cents. It also puts the District in a significantly more revenue stable position to ensure a sustainable path, addressing the needs of the infrastructure and maintain reliability.

Achieving 100% fixed cost recovery is not possible because of the inverted tier structure. At the higher tiers, the District generates a large amount of revenue that is more than the actual cost to pump, treat, and deliver the water. This structure promotes conservation and looking at demands, it is having the desired effect.

Mr. Foulk asked what percentage is considered the most stable position. Mr. Olsen said tier 2 will also be reduced from $2.70 to $2.66 but the other three tiers will have no adjustment or increase slightly. The proposed adjustment continues to promote the conservation message. The District is taking the lead in the region, taking steps to acquire such a large portion of fixed costs while other entities have the desire to do so but are still working through the realities of educating the public and navigating governing bodies. Mr. Olsen said there is no absolute answer but based on fixed versus variable costs, 83% is the appropriate balance at this juncture. Another provider in the region created a bar chart depicting all local utilities' monthly base charges and Metro Water was already pretty far to the right, meaning we are taking the lead in proactively capturing fixed costs. Achieving 83% puts the District in a good position if demands continue to plummet. For example, if the District captures 83% and demands drop by 10 percent in one year we would only have to cut 1.7% of the fixed budget, whereas if the District stayed at the current 69%, a budget cut of 3.1% would be needed.

Mr. Olsen said the FOC had a healthy discussion regarding fixed/variable. One point of clarification was to break out water consumption into fixed and variable, so it is clear to the customer what they are paying for the Water Availability Rate versus consumption charges.

Ms. Bracken said separating out fixed and variable costs is something that has always been done in private industry. The District is doing this to identify the break-even point rather than to define profit. Expenses and revenue vary every year so the amount of fixed versus variable is going to vary as well. Even if the District captured 100% in one year, it would be short lived. Fixed and variable costs were determined by taking each team's budget and going through each line item to identify discretionary, non-discretionary, and mixed costs, and allocating them out accordingly. Expenses included in the 2016 requested budget are 52% fixed and 48% variable. Revenue is also separated into fixed and variable, such as the Water Availability Rate and the RTA fee. If the District does nothing, 35% of planned revenue is fixed and 65% is variable. If we move forward with the requested adjustments to gain a stronger position, fixed revenue would go up to 40.5% and variable revenue would decrease to 59.5% resulting in the 83% coverage Mr. Olsen explained.

Ms. Bracken said one of the questions the FOC asked was what percentage of customers are in each of the tiers. Customers with 5/8 inch meters in Metro Main are broken out as follows: 17.2% are in tier 1, 39.5% are in tier 2, 28.7% are in tier 3, 10.7% are in tier 4, and 1.9% are in tier 5. Ms. Bracken also looked at Metro Hub because they have different consumption habits: 5.83% are in tier 1, 17.19% are in tier 2, 19.75% are in tier 3, 18.44% are in tier 4, and 38.79% are in tier 5.

Ms. Bracken said another question was asked about how much of the revenue is considered fixed versus variable for metered water sales. With no changes, $5,431,008 is fixed water sales, and variable is $9,374.872. If the District moves forward with proposed adjustments, fixed meter water sales would equal $6,665,328 and variable would be $8,762,513.

Ms. Olsen said the goal is to obtain revenue stability rather than to generate additional revenue. The FOC voted 8-0 to recommend the proposed adjustment for fixed/variable for Board consideration. The adjustments for Metro Main and Metro Hub have been discussed but staff is also proposing bringing into alignment the rates at Metro Southwest – E&T and Metro Southwest – Diablo Village. Metro Southwest – Lazy B is not mentioned because their Water Availability Rate is already at $30.00. There is a proposed insert for each service area to explain the prosed rate adjustments. Each of the proposed adjustments result in changes of less than a dollar for the average customer.

Ms. Ireland asked what costs go down when people use less water. Mr. Olsen said primarily energy, the costs related to conveying the water through the system, and chlorination. There is also the water resource itself, or the water resource credit. Ms. Ireland noted discretionary costs are necessarily considered variable and whether people use less or more does not seem to have a large impact on the cost of running a water company. Mr. Olsen said it is important to note whether capacity is reached. Years ago, when demand was much higher, water systems were stressed by the high demand and the infrastructure needed improving the serve the additional demand through greater storage, additional wells, and upsizing mains. Under the tier structure, if demands go up, adding new infrastructure is not as critical as continuing to maintain the existing aging infrastructure under a CIP. The unit cost of water is pretty much the same whether 1,000 gallons or 10,000 gallons are used, as long as demands do not reach the point where the system is overtaxed.

Mr. Olsen said the FOC discussed four different fees that staff has proposed to adjust. As in previous discussions, the adjustments are not about generating additional revenue as much as bringing them into alignment and capturing the cost of service. The intent is to ensure each fee is self-sustaining and not subsidized by other revenue.

The water service connection fee is comprised of three related fees. First, is the cost of the meter itself and the installation and administrative costs. Second, is the system development fee, which is an equity buy-in to the capacity that previous ratepayer investment has made, such as reservoir storage and the infrastructure required. Third, is the renewable water resource fee, so that the water flowing through that meter pays towards harnessing renewable water resources for the District. These fees were last adjusted in July 2006. In the past, these fees were roughly indexed to what other entities in the region were collecting. The District is now proposing an American Water Works Association (AWWA) methodology from *M-1 Principles of Water Rates and Charges* to identify actual system capacity to determine the appropriate system development fee. Mr. Olsen passed out a handout showing the various meter sizes and proposed fees versus current fees. The fees are pretty close on standard 5/8 inch meters but are farther apart on larger meters. Meter equivalencies are factored in based on the capacity the meter is able to provide. While the District was using similar equivalency methodology, over the years, different methodologies became practice. The proposed revenue is negative $14,000 and that is due to the irregular equivalencies used in the past. Under certain scenarios, multi-family developments with large meters were charged an additional $819 per unit. AWWA methodology does not do that, so one could argue that using the equivalencies and also charging per unit could be considered double charging. Projecting development is a roll of the dice. Discussions with the FOC members revealed the District connection fees are low compared to those in other regions. The FOC voted 8-0 to follow this method.

Mr. Offret asked where the old charges came from. Mr. Olsen said there are some theories but staff is uncertain. One guess is that $819 was the system development fee at the time. AWWA standards say the charges should be based on the capacity rather than the number of units. Mr. Tenney said the unit cost that was added for multi-family went all way back to 1994 to a concept Herb Johnson was pushing but in the 2000’s there was a change where the District was moving away from the AWWA method on some of the larger meters to help balance the budget.

Mr. Offret asked how many other entities are using AWWA methodology. Mr. Olsen said others in this region use it. Ms. Bracken said according to AWWA, there are two basic choices. The District chose a system to buy into existing infrastructure. The other option would have customers buying into system needs for the future but in order to do that, a solid CIP is needed. Mr. Foulk said the other method would be easier in a region where water is drawn from a lake or river.

Mr. Olsen explained private fire service lines are unmetered lines in standby mode ready to provide fire flow capacity for fire suppression needs. These lines are commonly found in commercial, multi-floor buildings, assisted living facilities, and less frequently in single family homes. The fee is indexed on Tucson Water methodology and is associated with the capacity held in reserve. This fee was last adjusted in 2010. As staff reviewed this fee, it was discovered to only go up to a 6 inch diameter. The District has 8 inch fire service lines that were not being charged, precluding us from capturing the cost of service provided. Tucson Water has incremented up their monthly service charges since 2010. Staff is proposing similar adjustments and the addition of charges for 8 inch fire service lines. The methodology includes equivalencies. Other providers have similar fees. Ms. Bracken said there are 44 lines that were not being billed that are now set up for billing. If approved, this fee is projected to generate $34,000-$35,000 next year, in addition to what is generated now. The FOC discussions clarified this fee is paid by the customer not by the fire district. The FOC voted 8-0 to forward this adjustment for consideration by the Board.

Ms. Ireland asked if the fire service line fee will be talked about at the public information meeting. Mr. Olsen said if the Board concurs, an information meeting and public hearing can be held with a focus on fixed/variable and the proposed fee adjustments. The goal is to show customers the District is not just asking them to help with revenue stability for under a dollar per month, but also that we are taking steps to capture cost of service so that they are not subsidizing other services.

Mr. Olsen talked about two inspection fees being recommended for adjustment. The first one comes into play when a developer constructs a subdivision or modifies the distribution system. A construction inspector must ensure it is constructed to standards and specifications. Currently, inspection fees are 2.5% of the total water infrastructure costs are for the project and staff is not proposing to change that. Some of the smaller projects do not generate enough through the 2.5% fee to capture the cost of the inspector's time. The proposal is to establish a two hour minimum to account for those smaller jobs. The other inspection fee is the backflow inspection fee. Backflow devices prevent chemicals and contaminants from reversing flow and entering the system from the private side. Any new backflow device must be inspected to ensure it is properly installed. The backflow inspection fee is proposed to go from $25.00 to $95.00 to reflect the actual time. This fee has not been adjusted in over 20 years. If approved, it will not generate a significant amount of revenue, only around $2,000 next fiscal year, but it will bring costs into alignment with revenue. The FOC voted 8-0 to forward these proposed adjustments to the Board.

Mr. Foulk asked if there are any new proposals requiring certain backflow standards for residential customers. Mr. Olsen said there had been proposed legislation requiring the use of certified plumbers for backflow inspections but he was not aware of anything that would impact residential customers. Mr. Tenney had not heard of anything either. Mr. Foulk asked about irrigation meters. Mr. Olsen said standalone irrigation meters do require backflow devices. After initial installation, the customer is responsible for annual inspections.

Mr. Olsen went over plan review fees. Similar to the discussion on inspection fees, when a developer plans a subdivision or modification to the system, before construction, the developer must submit plans so the engineering staff can hydraulically model the system to ensure it meets all standards, specifications, and requirements. It takes staff a good deal of time to review all plans before construction. The last time these fees were adjusted was about 20 years ago, and the costs to review plans have increased since. To come up with an accurate accounting of cost of service, staff looked at the actual hours and classifications associated with reviewing the plans, the number of pages to review, and the differences for a first submittal versus a resubmittal. If approved, this is projected to generate only around $2,000-$3,000 but that is proportionally related to how many plans actually come in. The District is not expected to receive a large number of plans but however many come in, the cost of service can be captured. Other utilities in the region charge a cost of service type review fee. Some are reviewed in-house and some are outsourced but the fees capture the costs. The FOC voted 8-0 to forward this proposed adjustment to the Board as well.

Mr. Foulk said many of these fees have not been reviewed in a long time. He asked if the District is scheduling a review of fees more frequently. Mr. Olsen said many entities get into a cycle where they review fees every couple of years. As we move forward, staff is looking for any large items that would require the fees to be adjusted. Staff will review fees periodically and bring it to the Board only if an adjustment was recommended. Ms. Bracken talked about how some of the calculations depend on infrastructure, capacity, and the CIP. Staff will recognize changes that will impact certain fees when other changes occur. Mr. Foulk added there are sometimes economic bumps that make a difference in some fees more than others. Mr. Olsen said staff have discussed prioritizing the review of fees and it was these four at this time. It requires a substantial amount of staff effort to analyze and review each fee.

Mr. Olsen said if the Board concurs with moving forward with the discussion, staff will send inserts to customers notifying them of two public meetings: an information meeting on Wednesday, May 13, 2015 and a public hearing to consider the revenue adjustments on Monday, May 18, 2015. The information meeting will be similar to last year, in that it is not just related to adjustments to fixed/variable revenue and fees but is a more casual setting for general questions about the District. The public hearing is an official Board meeting specifically for acting upon the proposed adjustments. The regular Board meeting is scheduled for Monday, May 11, 2015.

Ms. Ireland pointed out the Water Availability Rate at Metro Southwest - E&T is increasing from $15.00 to $22.00. She asked if it is fair those customers do not pay as much as the others. Mr. Olsen said the goal was to try to keep the change for the average customer in each service area under a one dollar increase. The priority is not bringing in more revenue but bringing revenue stability. In Metro Main, Metro Hub, and Metro Southwest - Diablo Village, the proposed increase is from $22.00 to $27.00. In Metro Southwest - E&T, there is still a balancing and at less than a dollar for the average customer. It is a step in the right direction.

Mr. Olsen said Metro Main and Metro Hub have five tiers, or rate blocks. The proposed changes also bring Metro Southwest - Diablo Village and E&T to five tiers. Ms. Ireland asked if Metro Southwest - Lazy B has just one tier. Ms. Bracken confirmed Lazy B has one tier at $3.90 per thousand gallons.

Mr. Offret made a motion to schedule a public hearing on May 18, 2015 at 6:00 p.m. for the purpose of discussing and possibly adopting an adjustment to the District's water rates, water service connection fees, private fire service line monthly fee, inspection fees, and plan review fees, as described in this report and discussed at this meeting. Ms. Ireland seconded the motion. Motion passed unanimously.

Mr. Olsen said staff will move forward with getting the inserts out to provide adequate public notification for those meetings.

Mr. Offret asked when the final insert will be sent. Mr. Tenney said the inserts will go out with April bills with at least two weeks' notice before the meetings.

IV. Discussion of Requested Budget for Fiscal Year 2016

Mr. Olsen said this is an opportunity for the Board to express any concerns or recommendations for staff to take a further look at the financial plan. Two separate financial plans were created, one based on approval of the proposed adjustments and another without any adjustments. The financial plan is not approved until the June meeting but if staff waited until the June meeting and the Board had substantial changes, there would not be enough time to have subsequent meetings.

The priority-driven budget process began with last year's financial plan. The process was much more inclusive this year and team managers and key staff were present for the meetings. That really opened the door to a lot of enhanced efficiencies, ideas, and clarifications. There is now a positive budgetary culture within the organization. Staff has not waited for the budget cycle to share ideas and come up with ways to spend more efficiently. Through that budgetary culture, the District has realized a savings of about $1 million in the operating budget this fiscal year.

The operating budget is $125,000 less than the current fiscal year budget, which is almost unheard of but this is a direct proportional to the success of the process and staff partnering.

Mr. Olsen said on page 38 of the requested budget, items 1-18 were the approved and funded items in the current budget. Last year a comment was made that it would be interesting to see if the priorities were realized or if they changed. Items 1-18 have all either been accomplished or are in the final phases of being accomplished. That was about $400,000 in prioritized items. Priorities 19-38, also about $400,000, were not funded and were later determined to be either not needed, redundant, or rolled into the operating budget. One of the best examples is the Board room audio. The audio system was priced for full replacement and upgrade for a cost of $30,000. Staff took a snapshot of current requirements and the greatest need is to be able to record and document public meetings. Staff was able to purchase a small handheld audio recording device at a cost of $150 to satisfy current and pressing needs. Staff are looking at ways to work around items that are not funded. Last year, about $400,000 in requests were funded and another $400,000 was not funded. This year, with more dialogue, the requests received were vetted and validated before they came to the meeting. Every request was valid and all of them are funded in the proposed budget at a total of $381,000.

Mr. Olsen went over the CIP list. There are two lines on the list. The first line is the baseline budget if none of the proposed adjustments are approved. If they are approved, the second funding line shows an additional six or seven projects for a total CIP of $1.2 million. The only real difference in the two budgets is how much of the CIP gets accomplished. This is a 250% increase from the current CIP this fiscal year and allows investment in lot of initiatives, such as well capacity replacement at Oracle Jaynes, main replacements in older neighborhoods, moving into phase one of enhancing storage capacity at Metro Hub. If the District is able to head off some of the short term emergencies, it frees the resources to focus on long term initiatives.

Ms. Bracken said staff prepared two budgets, one without the rate adjustment changes and one with all rates and fee changes approved. Without any changes, the revenue plan for operations totals $17,949,578 with operating expenses totaling $17,333,551. With all proposed adjustments, the total planned operating revenue would be $18,557,276 and operating expenses would remain the same. The changes would generate an additional $607,698 and the plan is to apply $601,525 of operating revenue towards capital in the requested budget. Revenue projections include a consumption decline of 2.4% if the fixed/variable rate plan is not changed. If the Board moves forward with the fixed/variable rate adjustment, the assumption in the requested budget is a decline of 1.4% which will be a more stable revenue source. The requested budget does include spending down some of the accumulated cash and fund balance.

Ms. Bracken said with the existing debt service, the District is required to maintain debt service coverage of 120%. The current budget with no adjustments has 145% and the proposed budget with adjustments has 156%. Mr. Offret asked if the debt service ratio has been projected out a few years. Ms. Bracken said the ratio is projected to be within the limit for a few years before it would dip down. She would like to get the coverage ratio up before the District goes out for any loans for the CAP Recharge, Recovery, and Delivery System because the higher the ratio is the year before, the better rates we will get.

Mr. Foulk asked if there is any indication from other water utilities that water use habits change after balancing fixed/variable revenue. Ms. Bracken said it would help to stabilize the revenue and it is not necessarily going to impact consumption habits. The District is ahead of the pack on getting to a higher level of coverage on fixed costs, so the results are not yet known. Mr. Olsen said regardless of the rate structure, the conservation activities and continual declines in usage are seen as “passive conservation” as opposed to reducing as a response to rate changes.

Ms. Bracken said over the past year, management and staff have implemented many process improvements in the past budget and spending patterns, and focused on taking care of business, resulting in $1 million in savings that can now be allocated towards priorities in the requested budget.

The WRUF has been part of the monthly bill since March 2013 to be used for development, design, and construction of projects to utilize the District’s renewable water supply. Fiscal Year 2016 requested budget includes spending $2 million of restricted funds for land needed for the CAP Recharge, Recovery, and Delivery System in accordance with the timeline presented to the FOC on July 28, 2014 and approved by the Board on August 11, 2014.

Key assumptions driving the budgeted revenue category have been described in the memos and descriptions associated with the requested budget. With the priority-driven budget process in place, resources are being allocated towards District priorities. Total operating expenditures requested in Fiscal Year 2016 are $125,092 lower than the operating expenditures of the prior year. The requested budget includes a 2% cost of living allowance and a 2% merit adjustment midyear for eligible employees. According to an article published March 5, 2015 in Forbes magazine titled *Interest Rate Forecast 2015-2016*, the goal of the federal government is to tighten interest rates to force the consumer price index excluding food and energy up by 2% annually. Budgeted wages and benefits also included projected increases to health and dental insurance of 15%.

Budgeted legal fees have been reduced. The budget for outside electrical contracted work has been reduced with the District now being fully staffed. Issuance costs will no longer be part of the requested expenditures with the implementation of GASB 65 which means a large decline in expenditures.

This request includes an additional $60,000 for principle payment of the Riverside Well WIFA loan of 2007. The process of applying extra principle continues, the District should be able to pay off this 20 year loan in five years or less, saving over $100,000 in interest payments.

The contingency for sick and vacation payout includes anticipated retirees and an additional 15% of vested sick liability. Capital projects are planned for Metro Main, Metro Hub, and Metro Southwest. Metro Southwest has a balanced operating and maintenance budget and with requested adjustment would be self-supporting for planned capital projects in that area.

When fringe benefits and overhead rates were previously implemented, it was discussed that this would be reviewed each year as part of the financial process. The last page in the requested budget book shows the updated rates based on the 2016 requested budget. The prior rate was 218.38 and with the 2016 requested budget, it is 223.22.

Mr. Foulk asked if the 15% estimated increase on health insurance is from staff or the insurance broker. Ms. Bracken said it is only a projection from the broker and is likely to change month to month. Mr. Olsen said last year the estimated 50% came in closer to the mid-30% level. The largest adjustment is behind us, when the District had to become Affordable Care Act complaint.

Mr. Foulk asked if the retirement and sick pay is fully funded and saved. Ms. Bracken said this is the first year funds are being set aside in addition to anticipated retirees. There were some anticipated retirees that did not retire, so there were funds set aside. When the calculation was done for the next year, those funds were subtracted and new accruals were calculated in to the balance, plus 15% of the other balance. Mr. Foulk is glad to see the District setting the funds aside. Ms. Bracken is covering the vested sick pay first, then anticipated retirees, then plans to focus on setting side some of the vacation pay. Mr. Foulk asked when it will be 100% funded. Ms. Bracken said that is unknown because it will vary year to year with each budget. This year the District had the capacity to request some additional funds.

Mr. Olsen said the FOC expressed appreciation of staff efforts and the completeness of the materials. The FOC moved unanimously to recommend this proposed budget to the Board, which will not be considered for adoption until June. Mr. Olsen will provide updates as the process moves forward. The public rate hearing will occur before adoption of the budget.

V. General Comments from the Public

Mr. Foulk thanked staff and the FOC for their work. The District is starting to take care of things that were missed in the past and he appreciates the work. The Board's job is easier because of the concise ground work.

VI. Adjournment.

The meeting adjourned at 6:44 p.m.

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Judy Scrivener, Chair of the Board

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Warren Tenney, Clerk of the Board