METROPOLITAN DOMESTIC WATER IMPROVEMENT DISTRICT
FINANCE OVERSIGHT COMMITTEE

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

January 27, 2014

MINUTES

Committee Members Present:	Reb Guillot, Chair Jennifer Dussor, Vice Chair Sheila Bowen, Member Lee Harbers, Member Lee Mayes, Member Tom Ruppenthal, Member
District Staff Present:	Mark R. Stratton, General Manger Diane Bracken, Chief Financial Officer Tullie Noltin, Recorder Warren Tenney, Assistant General Manager

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. Ms. Dussor, Mr. Guillot, Mr. Harbers, Mr. Mayes, and Mr. Ruppenthal were present. Ms. Bowen arrived at 4:08 p.m.

II. Approval of Minutes – October 21, 2013 Meeting

Ms. Dussor made a motion to approve the minutes. Mr. Mayes seconded the motion. Motion passed unanimously.

III. Status of Capital Improvement Projects and County Road Projects

Mr. Stratton gave the update in Mr. Maish's absence.

Riverside Well has been completed and is operational now. In the early stages, there were entrained air issues and production had to be throttled down to reduced output until things stabilized. The well output is now being gradually increased and monitored. The District has encountered similar issues with other deep wells in the past.

The Hub 1A well near Fruchthendler Elementary School is near completion. There had been delays on the electrical installation due to sub-contractor issues.

Staff is working through some issues on Orange Grove Road, where it appears part of our waterline still needs to be relocated. The City of Tucson contractor will perform the work since we do not have one available at this time.

There was a leak on Magee Road between La Canada and Shannon as a result of the County roadwork. The District received a letter from the Department of Transportation Director that they will be filing a claim. The District responded to the letter today, stating it was the County's contractor who caused the damage. The District is confident in its analysis that the damage occurred during construction by the County's contractor.

District infrastructure on Magee Road from La Canada to Oracle was relocated some time ago. Tucson Water is currently replacing their lines in that area and it should not impact the District.

Mr. Ruppenthal asked what causes air to be introduced into lines. Mr. Stratton said air is introduced by the aquifer itself. Analysis has shown that because the upper surface of the aquifer contains air, it takes awhile to bleed through the system. The air is not due to cavitations.

Mr. Ruppenthal also wondered how the District determines whether to use our own contractor or another's. There is often a fine line between using our own contractor or another's. When a new line is going in, it is generally best to hire an outside consultant to do the work because it involves easement acquisitions and varying jurisdictions.

Ms. Bowen arrived at 4:08 p.m.

IV. Mid-Year Review of Fiscal Year 2013-14

Mr. Stratton introduced the new Chief Financial Officer, Diane Bracken.

Ms. Bracken said the spreadsheet format for the midyear review is a little different from the past. There is now a budget column and a six month total with a straight line comparison. Metered sales are $802,891 above on a straight line basis, mostly due to the rate increase. System development fees are up by $150,000. Connection fees and the Water Resource Fee are also over budget. Overall, the District is $1.1 million ahead of budget on a straight line projection for the year. On expenditures, not a lot stands out as extremely high or low. Legal fees are higher due to the litigation with Pima County and AECOM. Salaries and benefits are under budget, partly because of a vacant position not filled after retirement. Historically, not all well maintenance has been completed annually but this year the District is on schedule to complete all well maintenance. Total Consultant/Contract Services are under budget by $104,000. General operating expenses are slightly over budget, with a large portion in increased liability insurance premiums.

Mr. Harbers asked if the overage in legal fees will be ongoing. Mr. Stratton said yes. The trial date has been set for the AECOM case and depositions are under way. There will be additional legal fees until the case is settled or goes through the courts. Ms. Dussor pointed out those fees are not recoverable and Mr. Stratton confirmed. Mr. Ruppenthal asked for a brief synopsis of the Pima County/AECOM history. Mr. Stratton explained the issue is tied with events that occurred in design and the requirements that affected the approval process. The County approved plans that ended up with the District installing $1 million worth of additional infrastructure that was not necessary. Pima County did win on summary judgment, which is a decision the District disagrees with. The design consultant for the County, AECOM, was acting as the County's agent that is the defendant in the trial later this spring.

Ms. Bracken resumed reviewing the Midyear Review spreadsheet. The District is $301,000 under budget on operating expenses. On the Total Debt Service section, it is noted that this line appears behind budget but a payment scheduled for January 2nd puts us back on track. The Debt Service Reserve is behind because the investment fund lost a little. The District will continue to fund that to build it back up to the balance we are required to hold. The Contingency for Sick/Vacation Payout will dwindle as others retire in the near future. In total, the operating budget is in pretty good shape.

There is not much change in Capital Equipment. At the last Board meeting, an additional arsenic treatment vessel was approved for Diablo Village Well No. 1.

The addition of a Reliability Centered Maintenance (RCM) Program training and pilot study at a cost of $41,000 is being recommended to improve overall maintenance and asset management. Ms. Dussor asked if RCM training will be provided in house for staff, so they can carry forward the knowledge. Ms. Bracken spoke with the individual who requested the RCM, and it is her understanding they analyze the District's data and provide a week long training program for up to 16 of our staff. Mr. Guillot said he is familiar with similar RCM programs for periodic scheduled maintenance and asked if this might change the projected figures. Ms. Bracken said the old way was to maintain things on a regular basis but the new way takes data analysis and identifies equipment that requires more or less maintenance, so the goal is to maintain more efficiently. Mr. Stratton said the RCM concept was generated out of the aerospace industry and expanded to utility operations. It has been around for quite some time.

Mr. Stratton noted on the revenue side, metered sales are fairly high on a straight line budget but July and August are high use months. Right now we are in the lowest use months, so will see that change and by the end of June, it should be balanced to what we forecasted last year; which is historically proven.

Ms. Dussor pointed out that she recently received a new meter but it took her a couple of billing cycles to realize and respond by adjusting her habits. The new meters record more efficiently. She asked if, with the number of new meters being installed, that effect has been taken into account. Mr. Stratton said yes, the Hub service area has all been changed out and Metro Main meters are replaced in a normal ten year time frame.

Mr. Guillot asked if there are any other soft spots besides metered sales that we need to watch in this budget year. Ms. Bracken said the budget is pretty solid and the District should end up under budget.

Mr. Stratton explained new connections are always at the mercy of the development community but the District has seen more development lately, not just in Metro Southwest but also in Metro Main. Mr. Ruppenthal asked how much the connection fees run. Mr. Stratton said for 5/8" residential service, a new connection totals about $2,200. The District's costs are fairly close to Oro Valley and Marana's.

Mr. Guillot said he feels comfortable with the Mid-Year Budget Review as presented.

Ms. Dussor said she supports the RCM funding because it provides in house training and will have a positive impact on future maintenance.

Mr. Harbers said he does not feel qualified to offer strong opinion as a new member but what he has seen appears legitimate.

Mr. Mayes thinks we should stay the course and not change things while water sales are fluid.

Mr. Ruppenthal supports moving forward. He likes to see the modernization of asset management. This is used in all types of industry and is the way to go.

Mr. Guillot said the consensus seems to be in favor of proceeding with RCM. The proposed budget brought up by staff every year is always clear, with a lot to work with.

Ms. Bracken said she has started working on analysis of the personnel benefits following a similar schedule. She would like to see debt service shown with principle and interest rather than a lump sum.

Mr. Tenney noted the memo covers important dates in the budget process and the next FOC meeting will be held on April 21, 2014.

V. <u>Financial Scenario for CAP Recharge, Recovery & Delivery System</u>

Mr. Tenney said financing the CAP Recharge, Recovery, & Delivery System has been discussed with the Board. The District's long term goal of bringing CAP water into the service area involves recharging the CAP allocation at AVRP, recovering the recharged water, building a delivery system to move it from AVRP to our service area, and blending the water at the Herb Johnson Reservoir. The major cost is in the delivery system and booster station. The line must go past I-10, the railroad, and the Santa Cruz River. The District will need to make certain we have recovery wells with the capacity to pump the amount of water we need. After some analysis by HDR, the District is looking at how to finance the project with the least impact to our customers.

Mark Reader, the District Underwriter, helped put together a financial scenario. Ms. Bracken has also come up with some information that helps the District move forward. FOC members received Mr. Reader's presentation from the Board meeting and a few spreadsheets.

Ms. Bracken explained the Proposed Debt Service Schedule and Future Proposed Rates spreadsheets. Certain assumptions had to be made and the calculations are based on an interest-only loan from WIFA. The 2009 refinance of the 1999 bonds will end in fiscal year 2019-2020, which opens up a little capacity to take on additional debt service. The proposed interest-only debt is an estimate based on a five year construction draw-down. In fiscal year 2019-2020, both the Hub Water note and the 2002 subordinate bonds will be ending but the 2013 subordinate debt payments will increase as principal is applied. In fiscal year 2023-2024, as construction comes to an end, the District would start paying full principle of the proposed debt, as the 2013 refinance of the 2002 senior bonds comes to an end. Debt coverage ratios need to be kept at the required levels and Ms. Bracken pointed out how the timing plays into that. The proposed Water Resources Utilization Fee increases are based on current proposed designs and land acquisitions. Annual increases to operating expenditures are factored in.

Mr. Stratton referred to a graph in Mr. Reader's presentation which shows how the current debt structure drops off over time. The goal is to minimize any potential rate increases to customers for this specific infrastructure. The large scope of this project means $35 million is needed for construction and design. The downside is that we cannot do this as quickly as we would like. The proposed construction draw schedule shows up to $8 million per year for five years, which is significant but falls in line historically with what we have been able to accomplish.

Mr. Ruppenthal asked about the required balances and debt ratios and Ms. Bracken said those are being considered. Mr. Ruppenthal asked how certain staff is about a WIFA approval. Mr. Tenney said the District has a positive working relationship with WIFA and staff is very confident we would be able to obtain another loan. Mr. Stratton said staff has already had conversations specifically about this project with WIFA. There are a few unknowns, such as the impact of Davis-Bacon wage requirements. Once those factors can be determined, the District can decide whether to go to the open market or WIFA.

Ms. Bowen asked about the assumptions of no growth and no decline in consumption. Ms. Bracken said growth hopefully will exceed decline but there is no way to know, so for this exercise they are both assumed flat. Mr. Stratton said there has been roughly a 2% decline in water consumption and any growth that occurs will compensate for the water loss. We hope we have hit the bottom of decline but there are no strong indicators of change.

Mr. Tenney pointed out another positive is that having increases to the Water Resources Utilization Fee, rather than other types of rate increases, is a clear message to customers on how the District is funding this project. The proposed 70 cents is less than Oro Valley's similar current fee of 95 cents. Ms. Bracken said the fee would pay for the interest expense on the debt. Once the principle is added and the District starts paying full debt, the fee will not cover 100%.

VI. Call to the Public

Mr. Stratton said he is retiring and March 5, 2014 would be his last day. He appreciates the time and effort of the FOC committee and extended his gratitude for their recommendations over the years. The Board respects the FOC and takes their opinions as customers very seriously. Mr. Guillot thanked Mr. Stratton for all he has done.

Ms. Dussor said she will be leaving the District sometime in the next three to four months. Mr. Guillot said the FOC will be sorry to see her leave.

VII. Adjournment

The meeting adjourned at 4:59 p.m.

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Finance Oversight Committee