

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

August 24, 2009

**** Board Room ****

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

MINUTES

Board Members Present:

Jim Doyle, Chair
James Tripp, Vice Chair
Bryan Foulk, Member
Reb Guillot, Member
Dan M. Offret, Member

District Staff:

Mark Stratton, General Manager
Warren Tenney, Clerk of the Board
Tullie Noltin, Recorder

Regular Session

I. Call to Order and Roll Call

Jim Doyle, Chair of the Board of Directors of the Metropolitan Domestic Water Improvement District (District), called the Board Meeting to order at 5:30 p.m. Jim Doyle, James Tripp, Bryan Foulk, Reb Guillot, and Dan M. Offret were present.

II. General Comments from the Public

There were no comments from the public.

III. Discussion of Possible Rate Structure Adjustments

Mr. Stratton, General Manager, explained the staff report outlines rate structure concepts rather than a specific recommendation. The District's financial position can be discussed in greater detail as the discussions unfold. The intent of this Study Session is to get feedback and direction from the Board.

Val Little, Director of the Water Conservation Alliance of Southern Arizona (Water CASA), was present to show a PowerPoint presentation on her research. She gathered information on indoor and outdoor usage, single-family users, and multi-family users. She also utilized research by other utilities on residential and commercial structures. Ms. Little said a dramatic change in usage coincided with the economic downturn, beginning last winter. She has seen an unprecedented drop off in demand, which is in part due to foreclosures, the doubling of

households, an increase in vacant houses, and widespread job loss all over the country. Rate structures developed in the past have suddenly become less appropriate given the new paradigm. Many utilities are adding various fees and assessments. The effects are disproportionate; a 5% drop in usage can result in a 15-20% loss in revenue. High water users have the most elastic demand, and when their usage changes drastically it throws the revenue stream off. She sees a universal recession within water utilities, and there is a need to find more stability. One utility in Nevada added a "Reliability Surcharge", the City of Phoenix started collecting an "Environmental Charge" in addition to their commodity charges, Albuquerque instituted a "Strategy Implementation Fixed Monthly Charge", and a Los Angeles utility began a "Pass-through Adjustment Factor". A National Resources Defense Council (NRDC) article recommends water utilities should decouple sales from revenue and stop relying on water sales to ensure fiscal stability. This is a new way of looking at water rates.

Mr. Stratton confirmed actual usage data was provided to Ms. Little by the District. Ms. Little added the persons per household factors were borrowed from the U.S. Census. There was some question on the exact definition of "multi-family user" but it was generally agreed, the term describes complexes larger than a duplex or triplex. Ms. Little also used data from last year's multi-family study. Mr. Stratton said there must also be a distinction between those with separate irrigation meters, and those without. Mr. Stratton explained multi-family complexes can have meters in various number and size, depending on what was requested when service was established.

Ms. Little said over the past few years multi-family usage has steadily increased, whereas single-family usage has seen a sharp downturn in high-use months. She was able to determine the average Gallons Per Capita per Day (GPCD) for the multi-family complexes within the District. Ms. Little was able to pinpoint the average indoor water usage of a multi-family user, by looking at six complexes that have separate indoor and outdoor irrigation meters. Warren Tenney, Assistant General Manager, said some multi-family complexes may be using more water indoors if they have older, less efficient plumbing. Larger multi-family complexes have not put as much effort, if any, toward conservation as do single-family users. Ms. Little estimated the lowest-use months would represent average levels for indoor single-family use because that would generally be the time of year when there is less outdoor watering. Ms. Little said she was surprised to find the lowest usage occurred between December and February only about half the time. She used the Golden Heritage neighborhood as an example where there are individually metered townhomes, with a separately metered irrigation system for all common areas. Their indoor use is in line with the average but outdoor water use is well above average, which has a great impact their total GPCD.

Mr. Stratton said through other utilities' and Ms. Little's data, and conversations with other professionals, he hopes to recommend for Board adoption a more stable rate structure that is not threatened by demand or conservation efforts. When high end users conserve, substantial revenue is lost. He was looking at a rate structure that has the base rate collect the needed revenue for fixed operational costs.

Mr. Tenney said Mike Land, Chief Financial Officer, looked at various base rate scenarios. Mr. Stratton said the District's base rate is currently about 40-45% of fixed operating costs. It was

agreed there would be tremendous rate shock if the District adopted a base rate equal to 100% of fixed costs, which would translate to about \$35.00 per month. He explained indoor usage is considered essential to human health, whereas outdoor usage is considered a lifestyle choice. One of the goals is to maintain costs for the average user. Those using no water would see a substantial increase if the base rates were adjusted. Mr. Stratton mentioned instead of the term "base rate" it might be more appropriate to use "water service availability" to highlight the fact that the rate covers costs of making water available, whether water is actually used or not. He thinks it may be appropriate to start with 60% of fixed costs, and gradually increase it over time. When Mr. Land returns from vacation, he will be able to gather more specific information on what each approach would mean for total revenues.

Mr. Guillot said he would like to know how a change to the rate structure would affect customers using under 1000 gallons per month. Mr. Foulk said it would be great if the base rate covered fixed costs, but he is concerned about elderly customers on a fixed income. Mr. Stratton agreed there must be a balance. He suggested there could be heavier increases on the higher tiers to protect the lower end and promote conservation.

There was a discussion comparing tier sizes of other utilities in the region, which varies greatly. Mr. Stratton said he has had discussions with Jeff Biggs of Tucson Water on this issue. Tucson Water is interested in the outcome of Metro Water's efforts. Mr. Stratton said when looking at increasing the upper tiers, thus promoting conservation, the effect on revenues is somewhat uncertain. Mr. Guillot remembered the initial rate shock in the Metro-Hub service area. Customers used less water for a few months but then usage returned to normal.

Mr. Foulk said his instinct says the District needs to raise base rates, but he does not want to have the most expensive rates. Mr. Stratton reiterated the District could gradually move towards a fixed cost structure over time. When Mr. Land returns he will be exploring the longer term financial plan, considering the bond-debt ratios as well. The District must look at rate increases that will bring the bond-debt ratios back to where they should be since the reduction in revenues. The first set of bonds will be finalized in 2019. Financial Advisor Mark Reader is looking into ways to pay for future costs without an impact on existing users today.

Mr. Stratton said because there is no uniformity in meter sizes at multi-family complexes, a per-unit base or water service availability rate might be more appropriate. Mr. Stratton said then water consumption could be calculated using two tiers. Mr. Land has started a spreadsheet comparing what multi-family users currently pay versus what they might pay under this scenario. Mr. Doyle asked whether use of larger meters for multi-family complexes puts too much strain on the system. Mr. Stratton said no. Mr. Foulk believes if the multi-family tiers have too large a cost increase between the first and second tiers, the users will not be happy. Mr. Tenney explained most multi-family users would generally fall within the lower tier and the highest usage per unit is 7,000 gallons. Mr. Tenney said the multi-family users are increasingly using more water. Ms. Little added the complexes within the District seem more interested in lowering rates than improving their own efficiency. Mr. Stratton found a number of other utilities in other states who are charging per-unit base rates. In 1995 Board Member Herb Johnson advocated a similar per-unit concept.

Mr. Stratton asked the Board whether they would like to continue moving forward with the analysis. Mr. Tripp asked if it would be expensive to launch a campaign to educate the public and get their feedback. Mr. Stratton said there are time constraints, and suggested it might be better to focus on a standard rate increase now, and introduce the idea of a rate structure adjustment to the public in the spring. He wants to be sure there is ample time to address all questions. Mr. Foulk said he would be interested in seeing the exact figures staff comes up with. Mr. Tenney added that staff intends to propose that the District pursue a 4% increase whether or not the Board moves to change the rate structure at this time.

Mr. Foulk stated if one can apply an actual revenue ratio to multi-family rates, it will make more sense to them. He believes it should be set in stone. Mr. Offret is worried that multi-family users will balk if their rates are changed to per unit, while single-family users are still charged per gallon. He feels the current structure is more defensible. Ms. Little said she stumbled upon a consistency between revenue percentages and water use percentages. For instance, single-family uses 65% of usage, and they account for 65% of total revenues and this trend continues with other customer classes. The numbers did not vary by more than 3 or 4% in each class.

Mr. Guillot said it would eventually be a benefit to the District to institute a base rate to cover fixed costs, and a variable rate to cover variable costs, even if it starts very low and is stretched out over several years. Mr. Offret agreed the goal of covering fixed costs is logical, but he questioned whether the District has ever had difficulty covering fixed costs in the past. Mr. Stratton explained many professional journals are talking about rate stability and paying per thousand gallons might not be the most financially sound method. Economic changes must be considered to achieve a steady revenue stream, rather than fluctuating up and down based on unforeseen water usage. Years ago when rates were first instituted, many utilities charged flat rates, which provided for fixed costs.

Mr. Offret suggested the District might take the opportunity to implement a pilot program with the water utility it is in the process of purchasing. Mr. Stratton said a pilot program could work in that particular area because their base rates are already higher. He thinks Mr. Offret's idea of a pilot program is a good one.

Mr. Stratton said it looks like the District is not ready to unveil a rate structure change for the October rate hearing due to the complexity involved. The upcoming rate increase could approach 8% depending on the analysis of the bond debt ratio needs. Mr. Offret asked if the increase is a direct result of the decline in revenues. Mr. Stratton confirmed the District's revenues were down \$1,800,000 last year. Mr. Tenney suggested several increase scenarios could be presented to the Board. Mr. Offret asked if the only answer is a rate increase. Mr. Stratton said Mr. Reader believes there could be up to \$1,000,000 savings achieved through refinancing existing debt without extending the dates for payoff. However, the District must ensure debt coverage is maintained.

Mr. Guillot asked how much a 4% increase translates to in dollars for the average user. Mr. Stratton said it would be about \$1.45 per month. Mr. Guillot also wondered if the waterline relocation project monies would be spent as fast as the related revenues are collected. Mr. Stratton said the money will be withdrawn within five months, and the loan payments are

payable monthly. Mr. Stratton concluded there is a fair amount of work to be done to continue analyzing the rate structure.

IV. General Manager's Report

Mr. Stratton said last week's meeting with Gary Hayes, Director of the Regional Transportation Authority (RTA), went well. They agreed to monitor the situation, and if the public develops a higher interest they will resume discussions. Mr. Stratton expressed if there are any future relocation fees assessed to the District's customers, he will give consideration to avoiding the use of the RTA name. Mr. Offret expressed a desire to see any future fees included in bond elections. Mr. Stratton mentioned comparisons have recently been made on local talk radio between RTA cost inefficiencies and the Arizona Department of Transportation's success with the I-10 project.

Mr. Stratton will meet with Michael McNulty, Legal Counsel, and a couple of multi-family complex representatives tomorrow, August 25, 2009.

The next Board of Directors meeting will be held on Monday, September 14, 2009. Mr. Tenney said the call for a public hearing will be on the agenda. Rate hearings are usually held in October.

Mr. Stratton gave an update on the Northeast Reservoir Booster Station (NERBS). He has placed Chris Hill, Deputy General Manager, in charge of the facility repair. Charlie Maish, District Engineer, will be in charge of any related design. Steve Shepard, Assistant Utility Superintendent, will coordinate the operation side. Frank Gallego, Electrical Instrumentation Supervisor, will oversee the electrical issues. Mr. Offret asked if staff will be refitting the shutoff valve. Mr. Hill explained staff is going to modify the door so that water can escape at ground level. Mr. Stratton added the power shuts off immediately when water is present. The insurance company will issue the first check soon, and a purchase order will be completed to order replacement parts. Staff will meet with Kelly Electric on August 28, 2009. Replacement parts may have a six-month lead time from order to delivery.

V. Adjournment

Mr. Tripp made a motion to adjourn. The meeting adjourned at 6:57 p.m.

Jim Doyle, Chair of the Board

Warren Tenney, Clerk of the Board