PIMA COUNTY
WASTEWATER RECLAMATION

REGIONAL WASTEWATER RECLAMATION ADVISORY COMMITTEE (RWRAC)
FINANCIAL SUB-COMMITTEE MEETING
Public Works Building
201 N. Stone Avenue – 7th Floor Conference Room

Wednesday, February 10, 2016
8:30 a.m.

Members Present:
John Lynch, Mark Stratton, Mark Taylor

Others:
Jennifer C. Coyle (RWRD), Keith Dommer (FRMD), Jackson Jenkins (RWRD), Patrick McGee (FRMD), Lorraine Simon (RWRD), Amber Smith (RWRAC), Jody Watkins (RWRD)

A. Call to Order/Roll Call

Jody Watkins, RWRAC Program Coordinator, took roll call.
John Lynch, Chair, called the meeting to order. Meeting began at 8:35 a.m.

B. Pledge of Allegiance

C. Safety Share – Mark Stratton said there is more traffic and pedestrians with the Gem Show in town. Everyone needs to be more aware and patient and look out for pedestrians and increased traffic. Jackson Jenkins, RWRD Director, said it is important to keep in mind 40-degree temperature swings with morning lows and afternoon highs.

Call to the Audience
Amber Smith, RWRAC member, spoke about the frustrations that occurred at last RWRAC meeting. She is excited to hear what new information unfolds today at the Financial Sub-Committee meeting.

Approval of Minutes
Meeting Minutes for January 6, 2016
Mark Taylor, RWRAC Chair, had changes to the meeting minutes. He stated that the amount of meeting minutes be cut back to 3-4 pages. Mr. Stratton added a summary would suffice to include discussion was held and the motions. Mr. Lynch suggested, to include the time stamp of important items on the recording for members who would want to hear more detail.

- Page three, third paragraph. Change the minutes to reflect Ms. Bowen provided a briefing on what happened at the CIP Sub-Committee meeting.
- Eliminate % symbol when referring to the Debt Service Ratio (DSR).
- Page five has if the bond ratio dips below 1.2-1.3. It should just read dips below 1.3.
- Page five and page nine seem to tie into each other. It could be the placement of content.
- There was duplication of the conversation and table.
- Page 8 – $500 million is incorrect. Should be $500,000.
- Page 15, Action: The amount of the rate increase is not provided. Include the amount, at 7%, and the specifics.
- Page 15, Action: Elaborate with more specifics on the motion for a rate study. Motion passed unanimously.
- When a motion passes, include ‘motion passed unanimously’.
- Page 15, Call to the Audience – Amber Smith’s comments on a fixed rate increase.

Mr. Stratton made a motion to approve. Mr. Taylor seconded. Motion passed unanimously. Meeting minutes were approved with corrections.

D. Discussion/Action

1) Review Finance & Risk Management Department Memorandum Summarizing Updated Financial Information

Mr. Lynch referenced in the January 28, 2016 memo, the word ‘default’, should be non-compliance of the established goal of the 1.3 DSR, per the May 21, 2013 letter from the RWRAC. Additionally, the word healthy should be defined. There was a high level of conservatism established with the 1.3 DSR. There needs to be a balance that is equitable for the rate payers and to meet the needs of the Department to pay off debt and assure a well-operated and financially-stable utility.

There was a discussion the desired ratio of 1.2 required by the bond rating agencies. Mr. Taylor referenced the January 19, 2016 memo stating that the County strives to maintain a 1.3 DSR for a favorable bond rating. Mr. Lynch added the Fitch rating agency did not downgrade the bond rating even though the DSR was at 1.28 and a rate increase did not occur last year. This runs counter to what was stated in the memo. His concern was there are contradictions to what is being said and what is actually happening.

Mr. Dommer explained the default ratio is calculated differently than the bond ratio. Financial health, defined by the bond rating agencies, is 1.3 DSR. When the DSR dips below 1.3, it is an indicator of worsening financial health, Pima County has been willing to raise rates when necessary to stay out of default. The rating agencies look at all debt, including Senior Debt and Junior Debt. This affects the Department’s ability to borrow and the associated cost.

Mr. Taylor commented that revenue is being counted twice with the new calculation to determine if bonds are in default. This is troublesome because the 1.3 bond covenant is met, however in reality there is not enough revenue to pay off all the debt. He referenced the January 19, 2016 memo, in FY 2019, the bond rating agencies DSR falls to 0.97. He questioned why the Senior Debt and Junior Debt DSRs fall well within the recommended range of 1.2 or higher. Senior Debt = Net Revenue / Senior Debt. The Senior Debt gets paid first and has voter approval. There is a contractual obligation to the lender to meet the DSR requirement, which is currently 4.96 and rising as the debt gets paid off. Junior Debt = Net Revenue + Unrestricted Cash / Senior Debt + Junior Debt. The Junior Debt gets paid after Senior Debt and is not voter approved. There is a contractual obligation to the lender to meet the DSR requirement, which is currently 2.73 and is dropping as new debt gets added. Mr. Stratton added new debt is assumed to be obligation bonds as opposed to revenue bonds.

Mr. Dommer responded, Senior Debt is fine because there is so little of it. The Junior Debt is fine because cash is being added. The bond rating is less than one because there is not enough being generated in revenue to cover all of the Department costs, and as a result excess cash is being used up. Mr. Taylor stated the bond ratios are fine for the contractual debt. Yet, the Department could get to a position where there is not enough money to pay off debt. As a Committee, our job is to see to it that the Department does not get into that position. Decisions should not be based on the equations, which only tell part of the story.

Mr. Dommer explained that not setting rates to meet the 1.2 DSR requirement for either Senior Debt or Junior Debt is non-compliance with the rate covenants and also a potential default situation. There is no pledged assets or immediate due and payable clause for revenue debt. Having a default situation can trigger one of two actions. The person holding the debt can compel the judicial system to direct the County to set rates. The second is that the debt holder can place the Wastewater Department in receivership and control is taken away from the BOS and the Department, and given to a trustee. The trustee will then set the rates.

He continued, the Bond Rating Agency Ratio = Net Revenue / Senior Debt + Junior Debt. The bond rating agencies focus on recurring predictable revenue and operating results. Not on unrestricted cash or one-time connection fees. Mr. Jenkins added there are several factors the bond rating agency considers. How the Department / County is perceived in the marketplace; the sewer bill and how much of a burden it is as a percentage of income to local residents; and the BOS willingness to raise rates when necessary. The Department is not borrowing to the extent it did during the ROMP. Mr. Dommer added, the bond rating agencies analyzed that the Department is in the top of the tier for rates in comparison to income levels. Mr. Taylor expressed, since there are also subjective factors involved with bond ratings, the question becomes how conservative does the Committee need to be with decisions to maintain the financial stability of the Department?

Mr. Lynch said, as long at the bond rating ratio stays between 1.2-1.3, the Department would be above the contractual ratios for Junior and Senior Debt. The 1.3 ratio is the desirable goal. Mr. Taylor asked, how low can the Department’s DSR go to maintain financial stability and a healthy utility? Mr. Dommer responded the Department should hover between 1.2-1.3 DSR. If the rating dropped only one notch, this would have a slight impact on the interest rates charged since not much is being borrowed currently. He cautioned there could be unforeseen circumstances the Department might encounter that could cause some financial instability and that it is important to have a rainy day fund.

Mr. Lynch stated, it is only not optimal if the Department sells additional bonds in the future. This may have an impact on rate payers. Mr. Dommer stated, the Committee can come up with its own ratio that would take into account net revenues, how much debt is being paid, CIP budget, and the amount of a financial cushion needed. The goal is 1.3 DSR for optimal financial health, not a requirement. This would demonstrate that the Department is operating responsibly in setting rates that balance the needs of the users and bond holders. The DSR should never fall below 1.2. A question had been asked at the prior RWRAC meeting on January 21, 2016, what changed? What changed was the amount of money being borrowed, $720 million forecasted, was significantly higher during the Regional Optimization Master Plan (ROMP) than currently, $40 million. Due to the higher amount of money that was being borrowed the 1.3 DSR was much more critical during the ROMP.

Mr. Jenkins stated that even if the DSR is maintained at 1.3, negative impacts could still cause the rating agencies to downgrade the rating. The Department's rates are below the national average currently per the National Association of Clean Water Agencies. Mr. Dommer expressed, basing long-term financial decisions solely on the ratios would be bad. A short-term goal could be if the Department wanted to use some excess cash to delay raising rates.

Mr. Lynch recalled, at the January 21, 2016 RWRAC meeting, Mr. Burke had stated in the first three years of ROMP, the Department's cash position was increasing at $20 million a year. Then it started dropping, why? Mr. Burke's response was, interest only payments were being made during the first three years of ROMP. The Department could prepay the $38 million in Senior Debt. However, if the Senior Debt was not prepaid, there would be an additional $7.5 million incurred in interest payments. This was looked upon as a negative. Mr. Lynch asked, why is this negative, when the interest only payments during the first three years of ROMP, which were considerable amounts of money, were not? Interest is being paid on those three years of deferred principal payments at an additional cost to the rate payers. Mr. Dommer replied, it could have been because the ROMP debt was issued with a 15-year payback period, with more of the principal payment being loaded on the back end of the term. This is an important consideration for the Committee, if using excess cash to delay raising rates has a cost impact associated with it. In this case, the cost is $7.5 million. Is it worth paying $7.5 million to delay a rate increase for an additional year? He will do some additional research to answer Mr. Lynch's question.

Mr. Taylor added he would hate to make a recommendation to the BOS for no rate increase and cost the utility an additional $7.5 million. This is not a good financial decision. In Mr. Burke's memo of January 19, 2016, if there was no rate increase for FY 2017 the bond rating drops to 1.15 or 1.13. Mr. Dommer replied, it's possible to have a DSR of 1.15 for one year without having the bond rating drop. The ratio effects Senior and Junior Debt for the Department only. The bond rating agency could delay downgrading the bonds due to the Department's $110 million in excess cash, coupled with a plan to use $38 million to pay off debt.

Mr. Dommer advised the Committee the plan was to have the Department operate on a pay-as-you-go basis with cash on hand, or utilizing 2-3 year COPs, for CIP projects. If the Department's excess cash was used up, the pay-as-you-go option would not be available for the CIP maintenance. If COPs are not available, there is an option to use Junior Debt. All state governments are subject to expenditure limitations. Debt proceeds are being used to fund spending capacity of the Department. The County can ask the voters to increase the expenditure limitation.

Mr. Jenkins responded, his preference is to go toward a flat fixed fee option. The industry trend is more toward fixed costs since water usage is decreasing everywhere. This will make four years the Department has gone without a rate increase with declining revenues. With no rate increase for this year, then the amount of a needed increase in future years will be higher.

2) Potential Rate Study

a. Timeline

Jennifer C. Coyle, Special Assistant to the Director, provided a Rate Study Project Timeline. At the January RWRAC meeting there was discussion to look at a potential rate study and a timeline. For FY 2017, the bidding process could start in April or May 2016. The selection process for a firm to conduct the study could begin in June 2016. Given this timeline, the rate study would begin in July 2016. It is anticipated the rate study will be a six-month process. The draft Scope of Work will be presented to the full RWRAC at the February 18, 2016 meeting to receive their feedback and input. Once that is complete, the three-month procurement bid process can begin in March 2016. Beginning in January 2017 the rate study will be reviewed. Public meetings are scheduled for February and March 2017. Following the public meetings, the BOS review is slated to occur in April and May 2017. Implementation of the rate study would happen on July 1, 2017.

b. Scope of Work

Mr. Jenkins explained that approximately $80,000 - $100,000 has been set aside for the rate study in FY 2016/17. The Department will hire a third party firm to focus on user fees, with a fixed and variable component. Additionally, high-strength users, 2012 connection fees, and the Department's cost of doing business will be reviewed. Once the FY 2016/17 budget is approved by BOS, the Department will get a bid request for a rate study in July 2016. The chosen firm will do interim presentations to Financial Sub-Committee and RWRAC.

3) Review Various Rate Setting Workbooks

Making a decision today would be premature. Instead the Financial Sub-Committee will explain what was discussed today at the February 18, 2016 RWRAC meeting. The discussion will include the rate study, DSRs and the risks associated, and the available options. There is no urgency for a decision now.

a. Exercises Utilizing Various Options

Mr. Dommer stated the Financial Plan will likely recommend a 7% rate increase with an alternative to delay a rate increase for one year. The implications of not having a rate increase will be included and presented to the BOS. The full RWRAC would need to approve the Financial Plan. The Financial Plan will go to the County Administrator, who will share it with the BOS with a recommendation. A preliminary draft of the Financial Plan will be completed by February 24, 2016.

b. Assessment of Alternatives

With no rate increase for this fiscal year, FY 2016/17, the bond ratio drops to below 1.2. Instead Mr. Jenkins will recommend a rate study be completed and to defer a rate increase until next fiscal year, FY 2017/18.

c. Implications

What happens if the Department spends down the $38 million in excess cash to prepay debt? Mr. Dommer responded the impact would be on the Department's future ability to generate net revenues. His recommendation is to pay off the debt early to avoid additional interest costs. This won't have a major impact on the bond rating, because the debt service isn't enough to affect the DSR in the future. The Financial Sub-Committee will recommend the option to use excess cash to prepay debt. A request was made for Mr. Dommer to provide information on how much a one-year delay in the debt prepayment will cost the Department.

4) Amendments to or Rescinding of the May 21, 2013, Letter in Support of the 2013 Financial Plan

No reason to change. The emphasis is to meet the target goal of 1.3 DSR.

5) Potential Vote on Recommendation to Full RWRAC on Rate Increase

Action: Mr. Taylor made a motion to defer the vote for a 7% rate increase to the full RWRAC, until the Committee has had a chance to understand the implications of the new information presented. Mr. Stratton seconded.

E. Call to the Audience

Ms. Smith stated a lot was said about credibility at the RWRAC meeting on January 21, 2016. There was a lot of new information that was presented at that meeting. There was a discussion of how a 7% rate increase will impact the constituents. It is important to explore other options to see what this increase will look like. The fee study will take care of the County's need to be fiscally sound and also look at the needs of our constituents. In her discussions with BOS members they have indicated that they will not support a rate increase for FY 2016/17.

F. Future Items

RWRAC – Review of what was discussed at the Financial Sub-Committee meeting.
RWRAC – Discuss Financial Plan. Mr. Lynch suggested a short handout be provided that highlights Senior Debt, Junior Debt, and bond rating.
RWRAC – Ordinance Revision for the BOS Hearing on April 17.
RWRAC – Mt. Lemmon

Financial Sub-Committee – Review Financial Plan

G. Adjournment

Mr. Stratton made a motion to adjourn. Mr. Taylor seconded. Meeting adjourned at 11:00 a.m.

NEXT REGULAR MEETING DATE*: TBD*

Jody Watkins to send a Doodle Poll for next meeting date.