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

**DRAFT MINUTES**

**Wednesday, March 2, 2016 - 12:30 p.m.**

**MEMBERS PRESENT:** Sheila Bowen, John Lynch (Chair), Armando Membrila, Mark Taylor (Vice-Chair)

**OTHERS PRESENT:** Jennifer C. Coyle (RWRD), Keith Dommer (FRMD), Jackson Jenkins (RWRD), Patrick McGee (FRMD), Jody Watkins (RWRD)

### A. Call to Order/Roll Call

Jody Watkins (RWRAC Program Coordinator) took roll call. A quorum was present.
John Lynch (Chair) called the meeting to order at 12:38 p.m.

### B. Pledge of Allegiance

### C. Safety Share

Jackson Jenkins, Director, Regional Wastewater Reclamation Department (RWRD), discussed the importance of personal care, preventive maintenance, diagnostic and annual check-ups. Pima County conducts numerous health and wellness events. Reminding staff and others that usually there are warning signs that you should not disregard and should have diagnosed, don't procrastinate.

### D. Call to the Audience

None

### E. Approval of Minutes

Meeting Minutes for February 10, 2016
ACTION: Mark Taylor (Chair) made a motion to approve minutes. Mr. Lynch seconded. Sheila Bowen abstained. Approved unanimously.

### F. Discussion/Action

**1) Requested Information from the February 10, 2016, RWRAC Financial Sub-Committee**

- **a. Difference between ROMP principal-only payments and early payment of $38M debt recommendations**
- **b. Annual cost of delaying early payment of $38M of debt**

(Audio 3:40) Keith Dommer, Finance and Risk Management Director, discussed the County being firm on a fairly short and equal distribution of principal throughout the payback period and as a predictable consistent way to manage debt. The County has been unwilling to vary from that in terms of back loading principal on the end of debt to save cash flows now, which has an effect to increase interest cost due to more principal outstanding for a longer period of time. Although there would be "temporary" cash flow savings, it would be at an additional interest costs. Earlier in the Regional Optimization Master Plan (ROMP) program, the County did allow a one-time ROMP issue (2010), the first 3 years of the repayment schedule were interest only. Mainly due to RWRD being cash poor at the time and none of the ROMP rate increases had gone into effect; therefore, none of the debt service ratios that would have allowed the County to issue the debt would have been met. Due to the cash flow extreme need and to meet the debt service ratio and the Financial Plan was not in place to pay the debt that was preferred. This is the only time that the County has paid “interest only” toward any debt.

John Lynch, (Chair) asked what was the monetary impact of the overall payment schedule for those three years. Mr. Dommer will obtain the answer and get back to the Committee. Mr. Lynch had raised the question at a previous meeting whether deferring any type of payments on the $38 million dollars as a means of mitigating the impact on the rate payers. The only scenarios discussed previously were 1) moving the $38 million dollars to a payment schedule to fifteen years or 2) not doing it. None of the scenarios showed the impact if the payments were deferred for a year, two or three years if interest only was being paid. Since the County paid interest only during the ROMP for the first three years, the Committee is interested in the implications if the same scenario should occur. Sheila Bowen asked if an early payment of $38 million dollars would be towards the senior debt and would it be bonds or ROMP debt. Mr. Dommer clarified that the debt was for all ROMP debt and the payment would be towards junior debt. Mr. Jackson stated that the only pre-2010 ROMP project was the Plant Interconnect ($33-$35 million project), which was part of the $720 million dollar ROMP estimate. Payment would be towards 2004/2007 WIFA bonds and ROMP. Junior debt is both junior (net operating revenues + unrestricted cash balance) and senior debt (net operating revenues), so early payment would help both the debt ratios. Discussion ensued.

Mr. Dommer discussed the revised debt ratio sheet (see individual handout and page 19-20 in the “draft” 2016 Financial Plan). Mr. Taylor questioned if the $38 million was prepaid, how much is the long term savings and would it make the junior or senior debt ratios worse? Mr. Dommer responded that $7.5 million would be saved in interest, which would be spread over the time the prepayment was made until the final principal payment. Delay of prepayment would lower the interest saved by $1.5 million a year. Mr. Dommer confirmed the Debt Service Ratios would still be met for a couple of years if the prepayment was made with no rate increases; however, the cash immediately is taken off the top (effective immediately) of the Junior Debt Ratio and only one year of principal comes off the bottom (over time), which would decrease the debt service ratio. Discussion on Debt Service Ratios for Bond Rating Agencies, Senior Debt and Junior Debt with and without rate increases. (See chart on bottom of page 20 “draft” 2016 Financial Plan) The first chart shows the Debt Service Ratios assuming rate increases and $38 million prepayment. The second chart assumes no rate increases/no prepayment and utilize the $38 million cash for other expenses. Mr. Dommer will clarify the two charts on page 20, as to whether the Senior Debt was added in the denominator to the Junior Debt in item #3 and the calculations in both charts.

Mr. Taylor stated that these charts are mutually exclusive and the Committee will need to make a decision on prepaying the $38 million and potentially have a rate increase. He questioned if the $38 million was prepaid and there was no rate increase, will the preferred Junior Debt Service Ratio be met. Ms. Bowen inquired if an early payment is made to pay off debt, what is that effect to the debt ratio without a rate increase? Additionally, if the prepayment is delayed, how much of a rate increase will be needed and for how long and what is the financial impact? Armando Membrila asked, what is the impact if the Committee recommends a rate increase higher than what the Board of Supervisors will approve? These questions are answered below.

(Audio 21:30) Mr. Dommer discussed the Rate Change Option Summary (see spreadsheet), which includes the current year (2015-2016) through the next four years (2019-2020). There are three Options and the County Recommended Option in the Financial Plan. These options relay Junior Debt Ratios only, as the Senior Debt Ratios are currently high and improve as the Senior Debt is being paid off quickly. The Rating Agency Ratio (1.3 preferred, as an indicator of good financial health) is included in each table. Option #1 – No rate increase and $38 million prepayment. Option #2 – No rate increase and no prepayment. Option #3 – 7% rate increase and $38 million prepayment. County Recommended Option 4% rate increase and $38 million prepayment.

*Option #1 – No rate increase and $38 million prepayment.* No rate increase needed until 2018-2019. The Junior Default Ratio drops below 1.2. Mr. Dommer emphasized that it was not good to manage the finances on the brink of going into default. The rate increase needed in 2018-2019 would be 14% and an additional 3% the following year (2019-2020) for a total of **17%**, in order to be back in good financial health. The Rating Agency Ratio would decline and the County’s ability to issue debt at favorable interest rates would plummet. Certificates Of Participation (COPs) would be excluded. The Rating Agency Ratio is a combination of both Junior and Senior debt.

*Option #2 – No rate increase and no prepayment.* Mr. Dommer explained that this option would cost the tax payers an additional $7.5 million dollars due to additional interest and will have to be recovered in rate increases in the future. If we are managing on the brink of the Junior Default Ratio, no rate increase needed until 2019/2020. However, in order to get back to good financial health, a **22%** rate increase would be needed in 2019/2020. Mr. Taylor mentioned that the Rating Agency Ratio declines as well. Mr. Dommer confirmed that revenues are staying the same and additional debt service payments due to not prepaying the $38 million.

*Option #3 – 7% rate increase and $38 million prepayment.* Originally the Committee had voted on a 7% rate increase to include the $38 million prepayment to maintain the target 1.3 debt ratio. The 7% rate increase would be needed in 2016/2017. In order to maintain the 1.3 debt ratio, an additional three 3% increases in 2017-2018, 2018-2019 and 2020 would also be needed for a total of **16%** rate increase overall. Option #3 will cost less to tax payers overall as increase in user fees is inevitable. (Note: Table does not include the three 3% rate increase in the Junior Default Ratio totals, only the initial 7% rate increase.)

*County Recommended Option - 4% rate increase and $38 million prepayment.* Mr. Dommer explained this option is a more measured, planned spend down of the cash balance. The amount of unrestricted cash ($100 million) is not being utilized well. County could utilize some of the cash and delay rate increases, keeping a target of 1.2 debt ratio versus 1.3 and still maintaining a higher Junior Default Ratio. If the County re-evaluates “temporarily” and have a short-term goal below 1.3 and keep a measured, controlled, predictable and plan to slowly spend down cash along with three 4% rate increases (2017-2019) it would be more acceptable. This is a safe, fair and rational alternative and would look better overall. The only difference in the County Recommended Option and Option #1 is the rate increases (0% versus 4%) The $38 million prepayment would be paid in 2017. (Note: Table does include the three 4% rate increases in the Junior Default Ratio totals, initial 4% and two additional 4% for a total of **12%** overall.)

Mr. Lynch asked, what happens beyond the 2019-2020 Fiscal Year of the County recommended option? Mr. Dommer stated that it would be less meaningful to project a few more years versus to project out to 2024/2025 as the repayment of ROMP is declining. The Committee has requested a review (table) of a longer duration and whether additional increases would be needed after 2019-2020. Mr. Dommer explained that rate increases would continue to be necessary due to the $38 million prepayment would no longer help the ratio by 2020-2021. The County would go back to maintaining the 1.3 Debt Service Ratio and all three Options including the County Recommended Option would need the same increases. It would be slightly smaller if the County maintained the 1.2 Debt Service Ratio. Currently, these tables are for a short term goal to go below a 1.3 as reasonable and prepay the $38 million. Mr. Membrila mentioned that once the table is extended out to 2023, it may look like to the public that rates could be reduced. Mr. Dommer stated that ROMP isn’t completed until 2023 and once we get passed the next seven years of repayment and if no changes or major events happen, then it’s possible that the rates could be reduced. Ms. Bowen stated, if the County paid the $38 million early prepayment, it would save $7.5 million overall. How much rate revenue would have to be generated? Mr. Dommer will create a schedule that shows no prepayment ($38 million) for the Committee, which could reduce rates now; however, future rate payers would have to pay more including the $7.5 million. Mr. Lynch reminded everyone that the Committee is reviewing the needs of the Department over a ten year span; therefore, would like to see what the implications are for future rates. The Committee has recommended that the Department go out for a Rate Study which will provide many insights. Ms. Bowen inquired if there is an alternative versus paying the $38 million all in one year? Mr. Dommer replied that prepaying the $38 million over several years would not be noticeable savings. Discussion ensued regarding Option 1 and Option 2. (Audio 43:15)

Mr. Taylor stated, the difference between Option 1 and Option 2 is the prepayment of the $38 million. The Rating Agency Ratio is better if the prepayment is made. The prepayment would push out the need for an immediate rate increase. Mr. Dommer confirmed that the rate increases would be lower 14% and 3% (2018/2019 & 2019/2020) versus 22% (2019/2020), if the prepayment is made.

Mr. Taylor mentioned the County Recommended Option shows the ratio for the Rating Ratio Agency is going to be lower for a few years regardless. Do you think the rating agencies are going to lower the County’s rating due to this? Mr. Dommer stated, if we show that the County realizes the ratio is lower than preferred; however, we are able to predict and measure in a slow and controlled way that our intent after spending the cash down to a reasonable level, the County plans on going back to the 1.3 preferred ratio. Mr. Dommer thinks that the Rating Agencies would take that into consideration; however, there is no guarantee.

Mr. Membrila asked if the $38 million dollars is paid early, what happens if an emergency arises. Mr. Jenkins responded that the Department has $20 million emergency reserve and that there are other reserves that could be slated in another direction if need be.

Ms. Bowen inquired as to the deadline for the Committee to make a recommendation in order for the Board of Supervisors to approve for a January 2017 rate increase with either Option #3 or the County Recommended Option? Mr. Jenkins stated that the absolute last day for the Board to approve, after the sixty day public comment period (Public Meeting needed in September), would be November 15, 2016 Board meeting. The increase would take effect thirty days after the Board of Supervisors approved. (Audio 49:40)

Mr. Taylor inquired, what is the urgency for the Finance Sub-Committee to recommend with the Financial Plan in order to maintain a timeline? The Financial Plan will be completed by FRMD and submitted to the Board in early April. Mr. Dommer, stated that historically the Financial Plan is tied to the budget, but it doesn’t have to be. FRMD is adding a supplemental budget package that includes a 2% rate increase in the budget with the Financial Plan and a 4% to become effective in January 2017 (Rate Users bill). Ideally it would be nice if the full RWRAC and Financial Sub-Committee are on the same page as FRMD and that the Board would have the recommendation together. Does the Board have to approve the financial plan with the increase now? No, since the 4% increase would not take effect until January 2017, the recommendation can go to the Board mid-summer to late summer (which is preferred) or after the elections. The Financial Plan is a report to the Board; therefore, the sixty day notice is not necessary. The sixty day public notice must occur before the new budget is adopted for any rate increases. Budget hearings begin in April.

Mr. Lynch indicated that he requested that Agenda #5 be added to the Agenda for a *“Potential vote on Recommendation to Full RWRAC on Rate Increase”*; however, given so much informative materials from FRMD, the Committee has decided to refrain until after the next regular RWRAC meeting (March 17, 2016) and potentially vote at the next Financial Sub-Committee meeting. Mr. Taylor stated, it would be better if the RWRAC goes in together with FRMD on the Financial Plan and budget recommendations, this would be the optimal way. The Committee does not need to make a decision immediately and can wait closer to summer to make a recommendation. Mr. Dommer does not believe that the County Administrator plans on moving forward on the Financial Plan without the Committee’s recommendation. The Committee has requested that Mr. Dommer continue to update any changes to the “draft” Financial Plan and present it at the next regular RWRAC meeting. The Committee would have time to read and understand the plan before a vote is made. Mr. Dommer explained that the Committee is not approving the Financial Plan, but recommending the County Recommended Option for the three 4% rate increases to be incorporated in the Financial Plan packet.

Mr. Lynch is comfortable with the information and would like to see the information expanded out to 2024. Ms. Bowen, Mr. Lynch, Mr. Membrila and Mr. Taylor agreed that the County approach is a good approach and are in favor of recommending the County Recommendation Option. (Audio 1:05:34)

Skip to Agenda #3) (Audio 1:12:42)

**2) Requested Financial Information from the February 18, 2016 RWRAC Meeting**

**a. Review of various Key Rating Drivers (i.e. Debt Service Coverage, High Liquidity, Debt and Capital Costs, Economy)**

(Audio 2:07) Mr. Dommer explained the handouts on *Fitch Ratings* (Gutierrez), *Fitch Rating Agency Questions/Outlines for GO COPS HURF* rating meetings, *Standard & Poor’s Rating Agency Questions/Outlines for GO COPS HURF* rating meetings, *Fitch Rating update for Pima County’s Sewer Revenue Bonds*.

Based on the questions, the rating agency makes a determination of bond rating. Mr. Dommer explained how the information was obtained at the meetings which included notes, conference calls, schedules and completed questionnaires they submit to Fitch. The Agency usually provides topics that are going to be discussed ahead of time, so that the County can be prepared. The County gets to review the report and comment if there were any discrepancies and corrections needed. No other changes or wording can be revised, only corrections. Chuck Huckelberry, Pima County Administrator, a Financial Advisor and Mr. Dommer are on the conference call along with numerous people from the rate agency. Attorneys are on the phone at times. The ratio is a prime factor; however, there are other factors to be included. Since these are sewer revenue obligations, the rating agency is concerned about net revenues of operating the sewer system and what is pledged in payments. They want to know if the County is generating enough net revenue and how likely is that revenue to continue in the future that would be adequate to pay off the debt.

(Audio 2:18:42) Mr. Jenkins wanted to clarify that previously he stated that he had put a memo out “not to support a rate increase this year”, which was mainly due to the new information that was provided regarding the debt service ratio and that it is a risk during an election year. However, he wanted to clarify that he is fine with the mid-year recommendation of a rate increase and the Board to vote on it later in the year to approve for January 2017. He does not recommend that the Committee submit their recommendation too early.

**3) 2016 Financial Plan**

Mr. Dommer briefed the Committee on the Financial Plan handout. (Audio 1:12:42)

Mr. Jenkins requested clarification on the first paragraph (page 11) regarding the “debt service is expected to remain relatively flat…..no additional debt”, whereas the bottom of page 3 states “an additional $30 million to $35 million of capital improvements are anticipated to be needed annually”.

Mr. Dommer replied that historically, part of the financial plan has been for the maintenance of the Capital Improvement Program (CIP) to be self-funded through cash and operations. CIP cannot be funded directly through cash due to the County’s expenditure limitation. It is typically funded with short-term debt (i.e. Certificates Of Participation (COPs)), and the goal is to still have COPs available. The County issues bonds by mortgaging downtown buildings and provide those proceeds to Wastewater. The debt is not included as Wastewater’s debt as the goal is to still have a relatively short COPs funded three years CIP rotation that is roughly equivalent of paying in cash. Mr. Jenkins responded that once ROMP is paid off, the Department could get to zero debt and the collateral could be the Wastewater Treatment plant, such as Agua Nueva. Mr. Dommer explained the people who purchased COPs don't actually want the assets, they want the County to continue to pay on its debt.

Mr. Taylor referred to Figure #1 on the Financial Plan, the Capital Project Costs show $30-$40 million annually through 2020 and probably beyond. Figure #4 is projecting out $30-$40 million dollars additional debt each year through 2020. Figure #5 is extended through 2028, which gives an unrealistic expectation. Mr. Dommer responded that as certified Accountants, they are prohibited on making opinions on future forecast. Mr. Lynch asked if an additional Figure can be added and the wording could state "based on historic information and moving forward, we don't see the historic trend changing much"? Mr. Dommer can present what the known actual debt service payments are and what the effect of the ROMP has and is tapering off. He can add an additional chart to show what additional expected costs might be and what the plan for the future is once the ROMP debt is paid off. The last payment on the ROMP debt is 2028.

Mr. Dommer discussed the 2016 Financial Plan in more detail, which included the "*Summary and Recommendations*" based on the projected revenues, projected expenses and projected Capital Improvement Program for the current fiscal year and for the next four fiscal years through Fiscal Year 2019-20. The "*Key Assumptions*" in which FRMD, RWRD and the RWRAC developed. The major assumptions include a relatively slow growth in the customer base, an increase in user fees and in connection fees at the rate of population growth, a declining volume usage rate factor based on a 5-year average, a capital program of $199 million, additional sewer revenue debt of $150 million, and the issuance of an additional $20 million of County COPs to be used for the Wastewater CIP. The "*Capital Improvement Program*", Figure #1 shows Prior Year Projects including ROMP of $694 million and Current and Future Projects of $199 million. "*Revenues*" from the wastewater system are generated from two major sources: sewer user fees and sewer connection fees. "*Total Revenues*" for Fiscal Year 2015 decreased overall from the prior Fiscal Year due to reduced volume usage, despite the increase in population growth. Fiscal Year 2016 revenues, are also expected to decrease by about one and a half percent from $174 million to $171.4 million. The "*Operating and Maintenance Expenses*" are currently $83.9 million for 2015/2016; however, not yet determined, a possible 2% increase in operating costs for 2016-2017 would increase this amount to $84.4 million. The Department's *"Debt Financing*" has $608.9 million outstanding of sewer revenue debt. The County plans to issue another $20 million of COPs later this fiscal year and an additional $150 million of new sewer revenue obligations in the next four years. "*Debt Service Payments*" are expected to continue to increase in the next few years even though the annual level of projects is declining. "*Cash Reserves and Cash Balances*" – the Department's Enterprise Fund has unrestricted cash and several types of restricted and designated cash accounts to meet the various debt covenants as well as to maintain an emergency fund to enable the County to handle unexpected events.

Mr. Jenkins mentioned that we need to get away from ROMP as capital expenditures will continue past 2028, even though the repayment for ROMP will be completed. The Committee agreed that they have an obligation of five and ten years and would prefer the graph to display information through 2026. (Figure #5) Continuing the information through 2028, gives everyone a false hope that there is no additional capital expenses. A request to add a line stating that "in the capital expenditures the Department has incurred, the major portion of which was ROMP for these years", as other capital projects were included.

Mr. Dommer continued with "*Cash Reserves and Cash* Balances" regarding Emergency Reserve Fund, Operating Reserve Fund, Debt Service Reserve Fund, Bond Proceeds and Use of Unrestricted Cash Balances. The *"Debt Service Ratio*" – Net Operating Revenue to Debt Service. Once operational expenses are paid, the remaining revenue is known as "net operating revenue" (total revenues less the O&M expenses) must still be sufficient to meet the required debt service payments and required reserves, and to have a sufficient margin necessary to enable the County to maintain favorable bond ratings. "*Expenditure Limitation*" has restrictions (Article IX, Section 20, of the Arizona Constitution) that the County is not able to use available cash to fund capital improvements on a pay-as-you-go basis. The "*Bond Ratings*", in December 2015, Fitch Ratings reaffirmed the County's rating for its sewer revenue debt. Senior Debt received a rating of AA and the Junior Debt received AA-. "*Recommended Rate Increases*" will be needed in order to maintain the debt service ratio of 130 percent by Fiscal Year 2019-2020, in which the County will need to increase net operating revenues by approximately $22.3 million. Mr. Lynch stated that it is important that another paragraph be written to the Recommended Rate Increases (page 15), that explains why 130% is desirable and include the RWRAC's statement from 2012/2013 of maintaining that goal. The Committee wants to make sure that it is understood that the minimum debt service ratio is 1.2; however the full Committee strives to maintain the 1.3, which is preferred. Discussion ensued regarding if "senior" and "junior" debt should be added in the "Bond Ratings" (page 15). Mr. Dommer mentioned that it was notified within the Financial Plan in Appendix F. Additionally, he expressed concern if the Department should manage their financial plan based on the Junior Debt Ratio and would not recommend it. The Committee requested the Appendix show that the Committee recommends and has a goal for the 1.3 ratio; however, they can modify it for a short-term period relative to the best interest of the rate payer. The bond covenants need to be mentioned in the Appendix as well.

Mr. Dommer will update the information on the "draft" Financial Plan from the input of today's meeting and present it at the next RWRAC meeting to include bringing the debt ratios up.

Lastly, "*Advisory Committee Recommendation*" will be added to this section once they have made a formal recommendation. A separate letter of recommendation from the full Committee will be attached. Also the title in the Financial Plan may state "*Advisory Committee Plan*" versus "*Recommendation*". Page 16, change the word "several" to "numerous".

### 4) Finance and Risk Management, and County Administration's comments on the Rate Study

(Audio 1:50:00) The Rate Study Proposal was provided to the RWRAC and the Financial Sub-Committee and voted on by both at their January meetings. This is providing an update, any changes to the scope of the Rate Study.

Email from Tom Burke, Deputy County Administrator to Mr. Jenkins. Mr. Burke wanted to make sure that Finance was more involved and that the Rate Study includes FRMD. (See two-page handout.)

The Department is revising the Rate Study Proposal to accommodate Mr. Burke's recommendations and will be moving forward. Mr. Jenkins stated that the scope needs to be collaborative. The Rate Study needs to adhere to Pima County's policies. Discussion ensued.

Jennifer C. Coyle, Special Assistant to the Director, RWRD, stated that changes are being updated for the Rate Study "Scope of Work" and will be submitted to Procurement next week. Ms. Coyle will email a copy to the Financial Sub-Committee for review and comments.

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

Deferred to next Financial Sub-Committee meeting as the Committee is not ready to vote at this time.

## G. Call to the Audience

None

## H. Future Agenda Items

Ten Year Projections (Keith)
2016 Financial Plan Updates (Keith)
Review and Question on Requested Financial Information from Fitch Ratings, Standard & Poor's Ratings
Potential Vote on Recommendation to Full RWRAC on Rate Increase

## I. Adjournment

Mr. Membrila made a motion to adjourn. Mrs. Bowen seconded. Meeting adjourned at 3:03 p.m.

***<u>NEXT REGULAR MEETING DATE</u>***: *TBA*