PIMA COUNTY
WASTEWATER RECLAMATION

REGIONAL WASTEWATER RECLAMATION ADVISORY COMMITTEE (RWRAC) MEETING
Water and Energy Sustainability Center
2955 W. Calle Agua Nueva - Radon Conference Room

MINUTES
March 17, 2016

Members Present: Bill Katzel (via phone), Rob Kulakofsky, John Lynch, Matt Matthewson, Armando Membrila, Amber Smith, Mark Stratton, Mark Taylor, Ann Marie Wolf

Others Present: Keith Bagwell (Supervisor Elias' office), Marla Berry (RWRD), Jennifer C. Coyle (RWRD), Keith Dommer (FRMD), Jackson Jenkins (RWRD), Patrick McGee (FRMD), Jeff Prevatt (RWRD), Timothy Thomure (City of Tucson Water Dept.), Lilian Von Rago (RWRD), Ricky Wascher (RWRD), Jody Watkins (RWRD), Eric Wieduwilt (RWRD)

A. Call to Order / Roll Call
Mark Taylor (Chair) called the meeting to order. The meeting began at 8:05 a.m.
Jody Watkins, RWRAC Program Coordinator, took roll call. A quorum was present.

B. Pledge of Allegiance

C. Call to the Audience
None

D. Safety Share
Amber Smith stated that she raises goats and recently helped deliver three baby goats. It is very important that someone should be present when your animals are giving birth in case there are any problems. She stated that one of the baby goats was delivered fine; however, two other goats were breech and the mother needed help. All three of the baby goats are okay; however, that may not have been the case if she wasn't present to help with the delivery.

E. Approval of Minutes
Meeting Minutes for February 18, 2016
ACTION: Rob Kulakofsky motioned to approve the minutes. Ann Marie Wolf seconded. Motion passed unanimously.

F. Citizens' Water Advisory Committee (CWAC) Update – Meeting Report and Tucson Water Activities
(CWAC Meeting Minutes/Audio are posted at: http://www.tucsonaz.gov/water/cwac)

At the last CWAC meeting (March 2, 2016), the Committee is proposing a one-time 7% increase for water rates next year. They are currently reviewing the cost allocation adjustments. The Committee reviews a five-year period for future rate increases in which additional rate increases will be needed.

G. Discussion/Action
1. Director's Update (15 minutes) – Jackson Jenkins, Director, Wastewater Reclamation Department (RWRD), introduced Keith Bagwell from Supervisor Elias' office.

Condolences as one of our employees, Chester Allen, passed away.

Mr. Jenkins discussed the Tony Davis article regarding the effluent in the river. The Metro Water Company (MWC) and the Bureau of Reclamation (BOR) want to take some of their water that they are entitled to, out of the river at Tres Rios and send it through the CMIV canal system to farms and to achieve 100% credit from the Arizona Department of Water Resources (ADWR). The discharge into the Santa Cruz River is considered banished recharge and the owners of the effluent only receive a 50% credit for what recharges in our management area. They would now get 100% credit for the farming criteria, which requires the BOR to conduct an environmental analysis. There will be less water in the river and potentially less trees and loss of habitat. Mr. Jenkins stated that the High Plains Constructive Recharge Project along the river may be affected if the effluent is removed from Ina Road at Tres Rios, as the water may not reach the high plains. Currently, the County receives 100% constructive recharge credit for this project. Mr. Jenkins stated that this has brought up questions and discussions. RWRD will be meeting with ADWR to discuss options. One of the key solutions is to get the BOR 100% recharge credit in the river. John Lynch inquired what percentage of effluent would be diverted. Mr. Jenkins replied MWC/BOR mentioned 2,000 acre feet; however, it could be as high as 7,000 acre feet, which would be significant. Mark Stratton stated on the legislator side of ADWR there are two irrigation districts in the Phoenix Active Management Area (AMA) that are the problems. Water providers in the AMA don't want irrigation districts to receive the same benefit as the BOR. Discussion ensued.

Mr. Jenkins stated RWRD has a total of 468 budgeted positions, which will be reduced by seven for Fiscal Year 2016/2017. Currently, there are 30 vacancies. Over the next five years, 35% of our organization is eligible for retirement either being age 65 or having 80 points in the retirement system. The average age of our current workforce for the entire Wastewater staff is 49.98 / 50 years old. The average County experience of those staff is between eleven and eleven and a half years.

Mr. Jenkins indicated that Richard Miranda, previously the City Manager and Chief of Police, has joined Pima County Wastewater as the new Program Manager Senior and will be overseeing Security.

Mr. Taylor stated that Barbee Hanson is not renewing her term as a Member. He indicated that the Committee would like to invite both Ms. Hanson and Kendall Kroesen (previous Member) to the next RWRAC meeting to acknowledge them for their dedication and hard work. A plaque will be created for each of them.

NOTE: Agenda Items #2 and #3 were taken out of order.

2. **RWRAC Financial Sub-Committee Meeting Report & Update** (40 minutes) – John Lynch/Sub-Committee Members (RWRAC Financial Sub-Committee Minutes and Audio are posted at: www.pima.gov/wastewaterreclamation

Mr. Lynch reminded everyone that at the last RWRAC meeting there was some discussion about the proposed pre-payment of the $38 million dollar existing debt. The Finance Sub-Committee (FSC) had a lot of questions regarding the pros and cons and spent a fair amount of time having Keith Dommer, Director, Finance and Risk Management Department (FRMD), go through various scenarios. The Committee discussed various options 1) prepay $38 million dollars; 2) extend payment over the fifteen-year term; or 3) extend the pre-payment out for 1, 2, or 3 years.

Mr. Dommer referred to Handout #1. The line graph shows the prepayment of $38 million dollars. A savings of one million dollars on the debt service payment would occur the first year (2017) and around five million dollars annually. Overall, a savings of $7.5 million dollars in interest. The graph on the bottom shows the debt service payments that would be avoided if the $38 million dollars was prepaid. If the $38 million dollars is not prepaid, it will affect future rate increases by an additional 5%. If the prepayment is delayed by a year, only six million dollars would be saved versus the $7.5 million dollars in interest.

Mr. Dommer referred to Handout #2. Option #1 illustrates prepaying the $38 million dollars, which could delay a rate increase until 2021. Option #2 illustrates no prepayment and relying on existing cash and no rate increase. Mr. Dommer stated that we are "managing" to not go into default on our Junior debt rather than staying financially healthy. The yellow highlighted bars are the rate increases necessary to bring the Department back to financial health. In Option #1 with a $38 million prepayment, the first rate increase would need to be 18% to get back to financial health. Option #2 with no prepayment, the first rate increase would need to be 26%. If we do not prepay the $38 million dollars and don't increase rates until the Department is about to be placed into a receivership, it will take a cumulative 34.97% rate increase to get back to financial health versus a cumulative 30% increase with Option #1.

Mr. Lynch requested that Mr. Dommer explain the nuances between the Rating Service Ratios versus the Bond Covenant Ratios. Mr. Dommer referred to Handout #1 from the FSC packet. There are three Debt Service Ratios that have been reviewed by the FSC. 1) Rating Agencies; 2) Senior Debt Holders; and 3) Junior Debt Holders.

The Debt Service Ratio for the Rating Agencies is Net Revenue, which is generated by operating the system less operating expenses. The Rating Agencies want the number to be large enough to cover all of the Junior and Senior debt. There are two levels of debt. Senior debt was issued pre 2009 and the holders of that debt have a claim to the system and its resources above the holders of the Junior debt that was issued in 2009 and later. Rating Agencies prefer a 1 to 3 ratio of Net Revenue over the total of Debt Service Payments to cover some non-operating costs and to help build a reserve for unforeseen events or emergencies. Also, it's a good indicator to rely on for good financial health. The Senior Bond Covenants require Net Revenue over the Senior Debt Service only and set revenues to generate a ratio of at least 1.2. This is the default indicator; if this does not happen the courts could order the Department to set rates at levels to keep that ratio higher or we could be placed into trustee-ship. The Junior Bond Covenants require Net Revenue and allows any Unrestricted Cash to be included to maintain a 1.2 ratio. Mr. Lynch stated that on the Rating Agencies Debt Ratio it states "preferred" not required as the 1.2 Debt Ratio is for both the Senior and Junior Debt. It's desirable to obtain optimal bond rates at 1.3 or preferably a little above to assure optimal interest rates, but there's no legal requirements that mandate it. Mr. Taylor stated that the Rating Agencies also review the amount of cash on hand, propensity to get rate increases when needed and rate studies. Mr. Dommer reiterated that 1.3 is a strong indictor and one of the strongest factors that the Rating Agencies review. Many of the other factors support whether that's maintainable in the future. Rating Agencies will allow a controlled, planned and reasonable way to intend to use and spend down some cash to a reasonable level even if the 1.3 ratio temporarily drops below. There is no guarantee that it will not affect their ratings. Ann Marie Wolf inquired why it would be dangerous to use the Senior and Junior Debt Ratios to evaluate the health of the Department. Mr. Dommer replied that the closer the Department gets to the 1.2, the greater the risk of something unforeseen happening that causes some financial trouble then all of a sudden it's below 1.2 and there are now significant problems. By managing your risk using the Rating Agency Ratio of 1.3, there is a cushion to protect against risk. This would have implications on the financial health of the Department, less able to issue debt and obtaining new debt would cost the Department more in interest.

Mr. Lynch reiterated that the unrestricted cash is not included in the Department's reserves ($90 million) for emergencies and other operational needs. Mr. Dommer reminded the Committee that utilizing the reserves must have very specific triggering events. Mr. Lynch stated that on previous presentations at the Capital Improvement Program (CIP) Sub-Committee and the FSC meetings, that staff is managing the assets at a very high level and they're anticipating through their inspection program and through their maintenance schedules what the needs of the Department are and keeping the system at a very high level of operation. The risk factor has been addressed and mitigated. Mr. Jenkins confirmed that the risk factor is minimal. Discussion ensued.

Mr. Lynch stated that the FSC and the RWRAC had endorsed the idea of the Department undertaking a Rate Study. The FSC asked for a presentation at their next meeting (April 15, 2016) on any modifications, including Tom Burke's edits and the final "Scope of Work".

Discussion on the Fitch Ratings reports. <u>See Handouts from FSC meeting #5A, #5B-1, #5B-2 and #5C</u>.

<u>Mr. Dommer referred to Handout #3</u>. The graph shows the Senior debt (red) in relation to the rest of the Department's debt. The graph indicates that the Senior debt will be paid off in 2024. The CIP (green) has the majority of debt, which is fairly new debt. Incurring new debt for current Continuing Capital Maintenance (blue) needs. One reason to issue debt is due to the expenditure limitation report. Certificate of Participation (COPs) may not be available to the Department for future use.

Mr. Lynch indicated that the level of conservatism goes up once we get beyond five years as it is a best guess estimate after the five year window. Mr. Dommer replied that the County forecasts capital needs, cash needs and revenue expenditures for five years, beyond that there is significantly more uncertainty and risk.

Mr. Lynch confirmed that the FSC did not take formal action on the pre-payment of the $38 million, but it was unanimous (4 of 5 Members attended), they agreed that the $38 million pre-payment looked to be the most reasonable.

<u>Mr. Dommer referred back to Handout #2</u>. Option #3 and Option #4 were discussed. The Financial Plan is going to be written to support Option #4. Mr. Dommer strongly recommends the prepayment of the $38 million. Option #3 and Option #4 manage the Department's finances based on the Debt Service Ratio, which is a better indicator of financial health.

In Option #3, a 7% rate increase would be needed this year and an additional series of 3% increases to maintain the Rating Agency Ratio at or close to 1.3. Option #4 attempts to manage the Department's financial health using the Debt Service Ratio at 1.2 for a short period. A series of 4% increases would be needed. The County Administrator is in support of Option #4 and suggested that the first three 4% rate increases go into effect January 2017, 2018, 2019. Utilizing the excess unrestricted cash to pay down debt should not affect the Department's bond ratings with the Rating Agencies. Mr. Dommer stated that if the three 4% increases were approved at once, that would give the Rating Agencies greater comfort and reduce the risk of being downgraded. Discussion ensued.

Mr. Dommer stated that he was cautious to forecast going past 2023; however, in 2024 the debt starts to drop down significantly due to the final ROMP payment and the ratios returning to normal or above. In these next couple of years the debt service typical payment should be cut in half from a high of near $100 million down to a fairly flat $40 or $50 million.

Mr. Dommer reiterated that if the ROMP debt had a 40 year re-payment schedule rather than the current 15 year re-payment schedule, it would have cost the rate payers an extra $350 million in extra interest costs. Discussion ensued. The Committee agreed that although no rate increases are preferred, Option #4 is a conservative option and seems best overall. Note: The Financial Plan will not recommend how to capture the additional 4%, the Rate Study will help figure out what's the best way for the Department, whether it's 4% on fees, 4% on commercial, increase connection fees, operating revenues, etc.

The Department is an enterprise and should operate as a standalone, organization without envisioning the rest of Pima County as a safety net. To measure financial health means that the Department generates enough revenue consistently into the future, to cover all of the costs and a cushion for unforeseen events. The Department has a fairly stable revenue base for a variety of factors. Working costs are staying controlled, managed and efficient through history and having reliable revenues, manageable expenses, and assets for unforeseen events.

One of the goals the Committee is hoping for with the Rate Study is distinguishing whether the allocation between the volumetric charges and the fix charges and the rate schedule currently are appropriate or whether that should be weighted differently. Additionally, whether the formulation the Department came up with in 2012 are appropriate or whether tweaking that formulation is necessary. Economic development projects are not part of the Rate Study as the Board of Supervisors decide where they will be funded, such as the Aerospace Corridor.

Mr. Jenkins reiterated that every year the Department prepares the Operations and Maintenance budget with a zero based budget. The numbers are sufficient to maintain the Department's infrastructure with high integrity. The current fiscal year is just over $84 million and the Department submitted basically the same amount for next year although there will be a 7% increase in the electrical rate due to an increase from Tucson Electric Power Company (TEP) and cost for a new expansion. The last rate increase was July, 2013. The amount of water usage is decreasing due to consumers being more conservative.

The Committee would like to know how other jurisdictions handle economic development projects that impact infrastructure costs to a Department. Who or how should they be paid for? Are there means to fund economic development projects versus the rate payers and if so, what are the options? Mr. Jenkins requested that the Finance Sub-Committee create language that could be discussed at the next meeting and could be included in the "Scope of Work" in the Rate Study. The Rate Study will take six months from July 1, 2016 – December 31, 2016. The Committee will be updated throughout the process and it is anticipated the recommendation will be given to the Board of Supervisors in early spring for implementation July 1, 2017.

Questions arose regarding rate increases and rate structure. Discussion ensued. The Committee would like to see a new Option #5 that shows the rate increase effective in July, 2017 and what the new debt ratio will be. Prepaying debt with accumulated cash to keep rates lower on the existing users was discussed, such as it was with ROMP. Prepaying the $38 million lowers the rate increase to 4% versus waiting until 2018, which would be a 5% rate increase.

3. 2016 Financial Plan (40 minutes) – Keith Dommer, Director, Finance and Risk Management Department

<u>Mr. Dommer referred to the Financial Plan</u>. There are sections on revenues, expenses, cash balances, debt payments, and ratios. All of the sections are very consistent with the prior Financial Plan other than the company graphs that have been updated. The ratio section has been significantly modified to talk about the additional Rating Agency Ratios. The conclusions and summary have not been fully updated and will include the Committee's recommendations or comments. There is information in the Appendices on how to calculate ratios to scenarios, rate increase versus no rate increase.

At the next FSC meeting, Mr. Dommer will have the updated County administrators recommendations section. The sub-Committee can discuss and supplement if needed and it will be brought back to the full Committee to vote on the final recommendation.

4. Financial Update (10 minutes) – Patrick McGee, Division Manager, Finance and Risk Management Department RWRD Fiscal Year 2015/16 Budget

Mr. McGee stated that there are no major changes, the Department is still staying on budget, $84.4 million for Operations and Maintenance. The only place below budget is in revenue, which is down $13 million. Majority of that revenue is the lack of getting rate increases last year, which were included in the budget. If the rate increases hadn't been included in the budget, the revenue would be down approximately $8 million ($3 million in connection fees).

H. Future Agenda Items
Mt. Lemmon Updates (May 2016 meeting)

I. Call to the Audience
None

J. Adjournment
Ann Marie Wolf made the motion to adjourn the meeting, Rob Kulakofsky seconded.
Meeting adjourned at 10:07 a.m.

NEXT REGULAR MEETING DATE:
May 19, 2016