

**MINUTES OF THE
SPECIAL BOARD OF DIRECTORS MEETING OF THE
OTAY WATER DISTRICT
May 21, 2009**

1. The meeting was called to order by President Croucher at 10:02 a.m.

2. PLEDGE OF ALLEGIANCE

3. ROLL CALL

Directors Present: Bonilla, Breitfelder, Croucher, Lopez and Robak

Directors Absent: None

Staff Present: General Manager Mark Watton, Asst. GM Administration and Finance German Alvarez, Asst. GM Engineering and Water Operations Manny Magana, General Counsel Yuri Calderon, Chief of Information Technology Geoff Stevens, Chief Financial Officer Joe Beachem, Chief of Engineering Rod Posada, Chief of Operations Pedro Porras, Chief of Administrative Services Rom Sarno, Communications Officer Armando Buelna, District Secretary Susan Cruz and others per attached list.

4. APPROVAL OF AGENDA

A motion was made by Director Breitfelder, seconded by Director Lopez and carried with the following vote:

Ayes:	Directors Bonilla, Breitfelder, Croucher, Lopez, and Robak
Noes:	None
Abstain:	None
Absent:	None

to approve the agenda.

5. PUBLIC PARTICIPATION – OPPORTUNITY FOR MEMBERS OF THE PUBLIC TO SPEAK TO THE BOARD ON ANY SUBJECT MATTER WITHIN THE BOARD'S JURISDICTION BUT NOT AN ITEM ON TODAY'S AGENDA

No one wished to be heard.

WORKSHOP

6. ADOPT RESOLUTION NO. 4136, APPROVING THE FISCAL YEAR 2009-2010 OPERATING AND CAPITAL BUDGETS; APPROVE FUND TRANSFERS FOR POTABLE, RECYCLED, AND SEWER; AND OBTAIN APPROVAL OF THE PROPOSITION 218 NOTICES AND DIRECT STAFF TO PROCEED WITH THE

PROPOSITION 218 HEARING FOR THE RECOMMENDED RATE INCREASES (BEACHEM)

Chief Financial Officer Joe Beachem indicated that staff would be providing a presentation discussing and recommending approval of the Fiscal Year 2010 Operating Budget of \$75.7 million, the Capital Improvement Program Budget (CIP) of \$37.2 million, and approval of fund transfers to keep the District's reserves at or above target levels. In addition, staff is recommending approval of the Proposition 218 Notice process along with any minor modifications that the General Manager may see fit. These recommendations are supported by a 19.9% rate increase proposal for recycled customers, and a 7.2% rate increase for sewer customers. For clarification, Chief Financial Officer Beachem indicated that staff is recommending approval of the District's budget, not the proposed rate increases. Staff will present for the board's consideration in August 2009 approval of the rate increases following the Proposition 218 process. Chief Financial Officer Beachem indicated if the Board approves the rate increase in August, implementation of the new rates will occur on September 1, 2009. In addition, he indicated that the sewer rate increase will be implemented on January 1, 2010.

Chief Financial Officer Beachem indicated that MWD and CWA have both raised their rates substantially because of the state water shortage and the cost of the infrastructure that they are implementing. He reported that approximately 49% of the District's budget goes towards purchasing water. A chart that categorized the distribution of District funds was provided to the Board. Chief Financial Officer Beachem indicated that the chart displays a two-year view and includes the two large rate increases that CWA is expected to implement in the next two years. He stated that the District also has a debt issuance that staff is looking into. He indicated that over the next two years, approximately 61% of revenues from the rate increase will be going straight to CWA to pay for the higher cost of water.

Chief Financial Officer Beachem discussed debt coverage for the District. He indicated in 2007, the District was able to obtain a rating upgrade from an A+ to an AA-. He stated that the District's goal was to maintain its debt coverage ratio (excluding growth money) above 125 with a target of 150. In 2008, with the goal of keep rates low, in consultation with the District's financial consultant Ms. Suzanne Harrell, the District moved its debt coverage ratio down to the minimum of what we considered a strong level and subsequent to this change, in September 2008, S&P gave the District a rating upgrade.

Ms. Harrell further indicated that as growth declines, conservation increases, and water sales are less certain, the rating agencies look for districts to achieve more than the minimum 125 debt coverage ratio from net operating income. She indicated that growth revenues are no longer being considered to support the difference between the Districts' debt payment and its minimum coverage ratio.

Chief Financial Officer Beachem indicated that if the District had an additional 4.1% drop in water sales above what has been projected, it would still allow the

District to maintain a debt coverage ratio of 125%, but the District feels that 140 debt coverage ratio would be a strong financial position to start with.

Director Breitfelder inquired about the consequences of maintaining a debt coverage ratio at 100%. Chief Financial Officer Beachem indicated that the District would expect to see a rating down-grade. He noted that the District will need to issue debt this year and another \$52 million in three years. If the District does not maintain an appropriate debt ratio, there would be a much higher cost to its customers for financing infrastructure. He indicated that it is in the customers' best interest for the District to maintain its debt coverage at an appropriate level. In addition, there would be significant impacts if the District does not meet its bond convenience. He indicated if the District starts strong in 2010 with a 19.9% rate increase, the debt coverage ratio would increase to 208%. In 2011, when the District's debt payments for the debt issue would be in full effect, the District's ratio would drop to 140%. He indicated that the District knows its goals and has good planning tools to project its debt coverage ratio to maintain a strong financial position. He stated that staff has conducted a variance analysis in order to react to challenges to the plan. The District would be able to review the District's financial status during the 2011 budget cycle and may also implement drought pricing if necessary. Staff presented a slide showing the debt coverage ratio starting at 208% in 2010, dropping to 140.9% in 2011 and moving back up to the District target ratio of 150% in 2013.

Chief Financial Officer Beachem reviewed the financing requirements for the District's capital improvement projects. He stated that the District would need to issue \$41 million in debt later in the year with most of the issuance going toward the betterment of the District's potable systems, a portion towards replacement of potable systems, and a smaller portion towards the expansion of reclaimed water systems. He noted that three years from now, the District estimates that it will need to issue another \$54.4 million in debt. He stated that maintaining the District's debt coverage ratio and credit rating is very key for Otay.

He also discussed the District's reserve policy. He indicated that another aspect of budgeting is assuring that the District meets its target reserve levels. He presented a chart showing the total reserves at the end of 2010 of \$89.9 million following the debt issuance. In addition, he indicated that reserve funds will be drawn down during fiscal years 2010 to 2012 as they are used to fund CIP projects.

He reported that the District's 2009 water sales have reduced by approximately 5.8% due to customers conserving water. In 2010, staff is projecting a 4.8% decrease and another 2% in 2011 and 2012. He indicated that although water sales have reduced, customers conserving water helps the District avoid the County Water Authority's (CWA) penalty for exceeding its water allocation. He indicated that the District's water reclamation system have also helped the District avoid CWA penalty fees. He stated that the District's investment in reclamation systems has been beneficial as it has very little risk of incurring CWA penalty fees.

Chief Financial Officer Beachem indicated that the District hired a firm (Rea & Parker) to conduct a survey of the District's single-family residential customers to determine the conservation level that is expected to be achieved in 2009. He stated that the information gathered from the survey (take shorter showers, reduce landscape watering, etc.) was a significant factor which helped determine the 19.9% rate increase. He stated that the rate increase will cover the District's ability to issue a \$41 million debt and strengthen the District's debt coverage ratio to the 140% level in 2011. He reported that the District will be the 7th lowest water cost/provider agency in San Diego County.

He indicated that the District engaged PBS&J to update the District's rate study with regard to the tiers and rates. He indicated that the study monitored changes in water usage and water consumption habits by customers, and how these changes might affect the District's tiers. It was noted that historically residential customers' average high summer usage was 26 units. Today, that usage has dropped to 22 units. To be consistent with the methodology of the rate structure, staff is recommending that the District adjust the residential tiers based on this new usage.

Chief Financial Officer Beachem reported that there is a significant increase in sewer rates due to regulatory requirements that District's prepare a Sewer System Management Plan that involves inspecting sewer pipes by way of CCTV to ensure that they are well maintained. This requirement has added a significant cost (16.6% increase) to the District's sewer expenses each year. Chief Financial Officer Beachem discussed options to cover the 16.6% increase and indicated that staff is proposing that sewer rates be increased 7.2% over the next six years. He indicated that revenues and expenses would balance out at the end of the six-year period. Staff is also recommending a draw on the sewer general fund reserves, which will equal over \$1.3 million dollars over the six-year time period. At the proposed 7.2% rate increase, the District is placed in 7th lowest cost sewer service provider throughout the region compared to 8th last year.

Chief of Information Technology Geoff Stevens indicated that the District's daily operating expenses were not a factor to the proposed rate increases. He stated that the District had approximately 166 employees in FY 2000, and continues to remain at 166 employees in FY 2009. A graph was presented to the Board that compared Otay's staffing history and projections. He indicated that in the early 80's and 90's an engineering study was prepared that looked at a progressive rate of employees per customer. He stated that in 2002, the Otay Information System was presented to the Board with the intention to increase efficiency. He reported that the District's customer rate of growth increased from 23,000 accounts to approximately 46,000 accounts as of FY 2009. He indicated that the increased amount of work is being performed with the same level of staffing.

Geoff Stevens stated that there are three factors that have helped the District perform more efficiently: 1) Strategic Planning; 2) Advanced Technology; and 3) Best Management Practices. He indicated that the District will hold a workshop in September to provide a progress report on the strategic plan and

performance measures. He stated that the transparency of the strategic plan is the major factor in improving efficiency because it helps significantly with the communication and understanding of the District's goals and how important it is to execute the strategic plan. He reported that In FY 2000, there were about 230 accounts per employee. As of FY 2009, the District has approximately 295 accounts per employee. That is a 15%-20% increase in the District's objective measure of efficiency. Mr. Stevens stated that the collaboration between Board members and District staff has allowed the District to establish a set of policies, practices and procedures that drives towards efficiency.

Chief of Engineering Rod Posada provided a presentation on the District's Capital Improvement Program for FY 2010. He indicated that due to the economy, the District projects its EDU sales at 263 for the next year and in FY 2011 it will decrease to 236. A recovery is expected in FY 2012 with EDU sales at 413. He indicated that the District's CIP Budget was based on the anticipation that growth projections will remain flat and that the budget includes expansion, betterment, and replacement projects. The budget also includes increases in the price of materials and labor based on the regional as well as national standards of ENR and CWA. Several graphs were provided that displayed the costs of materials which concluded that prices will remain flat or will increase for lumber, steel, paving asphalt, etc. Also, included in the District's CIP budget were the Integrated Resources Master Plan, Water Resources Master Plan, Sewer System Management Plan, Sub-Area Master Plan, Urban Water Management Plan, and the District's Strategic Plan. It was discussed that in FY 2010, staff expected to request approximately \$27 million dollars for the CIP budget. The budget was revised to request up to \$37.3 million dollars because of unspent monies in FY 2009 for the 36-Inch Pipeline project. Staff will be requesting that the unspent monies be transferred to FY 2010. It was indicated that the six year CIP increased from \$170.4 million to \$222.4 million and includes \$158.1 million for supply projects identified in the 2006 Integrated Water Resources Plan, \$10.4 million for Renewal & Replacement Projects, \$1.2 million for the development of the Multiple Species Conservation Plan and Management of the San Miguel Habitat, \$21.1 million for Strategic Plan elements, and \$31.6 million for other initiatives that include capital purchases, reservoirs, pipelines, etc. Of the \$37.3 million proposed for FY 2010, 40% of the monies will be expended on the 36-inch pipeline project. A slide was presented which indicated the projects that the remaining FY 2010 CIP budget will be expended.

Since it is projected that growth will remain at zero for several years, Director Breitfelder asked District staff to justify their request for additional money for the CIP budget.

Chief of Engineering Posada stated that growth will come back at some point and that the District must still prepare for that growth by working on its CIP projects that are identified in the District's Water Resources Master Plan. He indicated that when developers start building again, the District should have facilities in place to provide services to these new customers. He stated that the District will need to build these facilities and it is best to build facilities now rather than later when labor and materials will be more expensive. In addition, the District is

seeking new water resources/supplies and it would be a problem if the District did not build the infrastructure for the new water supplies.

In response to a question from Director Breitfelder, Chief of Engineering Posada stated that the District currently has the opportunity to build the necessary facilities because the cost of materials is down. It was indicated that in 2 or 3 years when the economy picks up, the price of materials will pick up too. Director Breitfelder thanked District staff and expressed his appreciation for the investments they've recommended for future supply. He stated that it would be a great benefit for the public in the future.

Accounting Manager Rita Bell provided a presentation of the District's Operating Budget, which included the process and the highlights of the budget. It was indicated that the District's budget process is aligned with the rate model where items similar to growth and projections are considered and the budgeting methodology may be updated. She stated that the challenges in FY 2010 are the increase of water costs and the uncertainty of sales. The District is focusing on new water supplies, its financial strength, reserve levels, debt that will need to be issued, and maintaining the District's rates in line with other agencies. It was indicated that the District does have some unprecedented changes such as reduction and the set values for property taxes in FY 2010, and the potential State Tax Grab under the Prop 1A law. It was discussed that the District's actual growth for FY 08 and projection for FY 09 indicates that potable sales growth has been low at approximately 1% or ½ %, and is projecting about 2% for FY 2010. She stated that the District's recycled sales have increased in FY 09, which helped the District stay above its pay limit with its contract with the City of San Diego. She indicated that charges from the MWD and CWA were included in the District's budget as a 100% pass-thru of fixed costs to rate payers. Fixed fees are set to not exceed 28% to meet the requirements of BMP 11. To off-set the pass-thru charges is the decrease of the District's system fee. Accounting Manager Bell also indicated that the District's controlled cost actually went down by \$793,100. A chart was provided to show changes in the District's expenditures, which displayed the CIP funding and potable water cost increasing along with fixed cost. She indicated that there was a decrease in expenditures for materials, maintenance, power, recycled water purchases, and a major decrease in the District's administrative expenses. It was indicated that the District's average rate increase for two years (FY 09 and proposed for FY 10) is estimated to be an approximately 16.3%. The District has not been notified of the official price increase from the City of San Diego, but it is felt that it is reasonable to estimate a price increase using the District's 2003 contract with the City and inflating that by the CPI from 2003 to present day and that figure would be approximately \$445 an AF (or a \$95 increase). She indicated that staff is presenting a balanced budget that meets the needs of its customers. She indicated that the proposed budget is supported by a 19.9% rate increase for potable and recycled to be implemented on September 1, 2009 and a 7.2% sewer rate increase to be effective January 1, 2010. Both are subject to Proposition 218 hearings prior to approval.

Chief Financial Officer Beachem stated that staffs' recommendation is that the Board adopt the resolution and approve the CIP and Operating Budget, approve the transfers, and also direct staff to proceed with the Proposition 218 hearing notices in order to move forward with public hearings on rates.

Director Jamie Bonilla thanked staff for their detailed presentation. He indicated that Director Lopez and he believe that the District's proposed budget is one of the most detailed budgets that staff has presented. He indicated that many factors were considered to develop the budget, such as the financial situation, drought issues, penalties, over projections, etc. Director Bonilla stated that the District's Strategic Plan was also very instrumental in developing the proposed budget because it provided a transparency of everything that was going on with the District over the years. It allows the District to make more intelligent decisions because they can be made based on facts from historical information. Director Bonilla indicated that the District could only do so much with improving efficiency and that the proposed rate increase was due to external factors, such as, the rate increase from MWD and CWA. Director Bonilla stated that he believes that the detailed presentation would provide an answer to any questions regarding the proposed budget. He congratulated District staff, including all Board members who have always worked together from early 2000 to present for the benefit of the District and its customers. He stated that the District and its Board members had the foresight and ability to prepare ahead for the future, and he believes that is the reason why the Otoy Water District is in a much better position than most local agencies.

Director Lopez agreed with Director Bonilla's statements and indicated that the District's Strategic Planning was the highlight because it put into perspective the District's goals and achievements. He indicated that the pass-thru of MWD and CWA fees to ratepayers was a major factor in the District's proposed rate increase, which was unavoidable. He stated that District staff and Board members worked hard to develop a reasonable rate increase while at the same time working within the District's Strategic Plan.

Director Mark Robak agreed that the proposed budget was very detailed and thanked District staff and the Committee members involved with the development of the budget. He believes that the District's budget workshop also assisted in the development of the proposed budget. He inquired about the District's zero-based budget process, and asked if that is how the District's budget is constructed. Chief Financial Officer Beachem indicated that that was correct.

Director Mark Robak inquired if adjustments to the proposed budget were made based on a process that involved thoroughly reviewing and justifying the budget. Chief Financial Officer Beachem indicated that that was also correct.

Director Mark Robak further inquired about slide 21 of the presentation, which notes that public and commercial customers indicated that they did not expect to make any cuts in their consumption, if the information was a result of the District's survey of public and commercial customers. Chief Financial Officer Beachem indicated that, yes, businesses had indicated that much of their use is

internal business consumption and they have already made changes to their use. They have limited ability to change their business water needs and did not expect to make further cuts in their usage.

Director Mark Robak inquired if some of those businesses included Southwestern College, Cuyamaca College, or also landscaping businesses that do not plan to make cuts. Chief Financial Officer Beachem indicated that the District separates irrigation water from potable water. He stated that there may be some minor potable irrigation, but for the most part irrigation is on irrigation meters. He indicated that for clarification, Rea and Parker conducted a survey of the District's residential customers and District staff conducted the commercial surveys.

Director Mark Robak inquired about the source of the information on slide 22 concerning the breakdown of where water is utilized in Single-Family homes. Accounting Manager Bell indicated the District's consultant, Mr. Carl Nettleton, works with homeowners associations and landscape companies had provided the information and the chart, according to the District's Conservation Manager William Granger, is pretty universal.

Director Mark Robak inquired if the tier changes on Page 28 of the presentation were strictly tiers, not including drought pricing. Chief Financial Officer Beachem stated that was correct; it is strictly tiers.

Director Mark Robak inquired how much of the proposed increase for sewer (7.2%) is attributed to the Metro Commission rate increase and what is causing the majority of the increase. Accounting Manager Bell indicated that much of the increase can be attributed to the development of the Sewer System Management Plan (SSMP) required by the state and the televising (CCTV) of the sewer facilities. The CCTV cost of \$260,000 is included in the operating budget. The increase will also include the additional labor costs associated with this project.

Chief of Engineering Posada indicated that the District has a five-year program and every year the District has to comply with a specific guidance. He stated that the District has monies allocated for the next five years to complete all required activities such as the CCTV program. He indicated that the CCTV program will take up to five years to complete the entire system. In addition, there is also reporting requirements and fixing of District facilities.

General Manager Watton indicated that a continuing reporting requirement enforced by the Regional Board was implemented due to sewer spills. He stated that the District's SSMP will help maintain its sewer systems and avoid penalty fines from sewer spills.

Director Mark Robak inquired about the significant increase in the District's budget in the next several years. Chief of Engineering Posada indicated that in FY 2012-2013, the District will have a large expenditures related to a desalination project. In addition, the District has a project that involves the intertie between the northern and southern districts. He indicated that the intertie project is

important because it would enable the District to provide services to the southern area in case of an emergency. Assistant General Manager Magana indicated that detailed back-up data for the projects are available for review.

Director Breitfelder indicated that the District is continuing with its preventative maintenance program and researching new water resources. He stated that without the public's long-term investment in recycled water, the District's rate-payers would experience even more inconvenience and expense than what they are today with the water shortage situation. He stated that technology and strategic planning along with astute guidance and disciplined facilities maintenance is providing dividends. Director Breitfelder stated that he has a lot of confidence in the proposed budget.

President Croucher stated that he is very impressed with the fact that the District's preventative maintenance program has decreased its cost of repairs. It shows the savings and the reliability of the District's systems and he is happy to see that the District is continuing its focus in this direction. He stated that the District's investment in its waste facility and the generation of electric power from methane gas from the adjacent landfill is important as it shows that Otay is contributing regionally. President Croucher also stated that he is glad to see that the District's increased rates are aligned with CWA. He inquired with regard to the reduction in personnel that the District is utilizing contractors and he was interested in seeing the personnel count if contractors were included in the count. He asked if staff can provide a report to one of the District committee's regarding this information.

A motion was made by Director Bonilla, seconded by Director Breitfelder and carried unanimously with the following vote:

Ayes:	Directors Bonilla, Breitfelder, Croucher, Lopez, and Robak
Noes:	None
Abstain:	None
Absent:	None

to adopt Resolution No. 4136, approving the Fiscal Year 2009-2010 Operating and Capital Budgets, approve fund transfers for potable, recycled, and sewer; and approve the Proposition 218 Notices and direct staff to proceed with the Proposition 218 hearing for the proposed rate Increases.

7. APPROVE A FIVE-YEAR RATE INCREASE AND FIVE-YEAR PASS-THROUGH OF WHOLESALER COST INCREASES

Chief Financial Officer Beachem indicated that the Board had directed staff to develop a plan for a 5-year pass-thru of wholesaler costs and a 5-year plan to increase District cost that would not require an annual Proposition 218 process. He indicated that staff worked closely with General Counsel to create the 5-year plan, and that it is presently being refined and updated before notices are mailed. He stated that the 5-year plan would allow the District to respond quickly to

wholesaler costs due to changes in the economy. He indicated that the plan includes a pass-thru from wholesalers and a 10% annual increase by the District. He indicated that the 5-year plan would protect the District from being challenged annually. Chief Financial Officer Beachem indicated that the wholesalers for water are MWD, CWA, and City of San Diego and that the wholesalers for sewer are the County and City of San Diego.

General Counsel Yuri Calderon indicated that a legal opinion letter on the 5-year pass-thru plan was provided to board members. He commended Attorney Aerobel Banuelos who assisted in the revisions of the Proposition 218 notices due to amendments to legislation. He indicated that the revised notice allow the District to build in inflation factors and pass through the District's actual wholesaler costs.

Director Mark Robak inquired if the 5-year plan would allow board members to request, at any time, updates on the pass-thru and rate increases. General Counsel Calderon stated yes, that it would.

Director Larry Breitfelder inquired if the 5-year plan precludes ratepayers from protesting increases in rates and just allow pass-thrus. General Manager Watton indicated that District customers would be notified of increases prior to implementation so that they may have an opportunity to communicate any concerns they have with the District.

Chief Financial Officer Beachem indicated that a number of agencies have implemented a similar plan, and have indicated that state law clearly authorizes pass-thrus.

Director Mark Robak inquired if the 5-year plan would allow the District to implement rate increases quicker. Director Jamie Bonilla inquired if the District could raise rates as early as 30 days after notifying customers. Staff indicated that a public hearing must be held, per state law, to inform the public of the District's rate increases. The District is required to notify its customers 45 days prior to holding the public hearing. Staff stated that the 5-year plan does not allow customers to protest once the Board has adopted the rate increase, unless 25,000 customers register a protest against the rate increase.

General Counsel Yuri Calderon stated that the 5-year plan does not preclude customer protest from occurring as long as the majority of customers weigh in. He indicated state law gives the District more flexibility in identifying what the rate increase is for and by disclosing the exact rate increase amount. The District can pass through inflation cost to customers, as well as pass-thrus.

Chief Financial Officer Beachem indicated that the 5-year plan will change the way the District notifies customers of rate increases, but that the Board will continue to consider implementation of the increases.

A motion was made by Director Bonilla, seconded by Director Breitfelder and carried with the following vote:

Ayes: Directors Bonilla, Breitfelder, Croucher, Lopez and Robak
Noes: None
Abstain: None
Absent: None

to approve staffs' recommendation.

8. ADJOURNMENT

With no further business to come before the Board, President Croucher adjourned the meeting at 11:52 p.m.

President

ATTEST:

District Secretary