MINUTES OF THE
SPECIAL MEETING OF THE
BOARD OF DIRECTORS
OTAY WATER DISTRICT
May 14, 2013

1. The meeting was called to order by President Lopez at 3:12 p.m.

2. ROLL CALL

   Directors Present: Croucher, Gonzalez, Lopez, Robak and Thompson

   Directors Absent: None

   Staff Present: General Manager Mark Watton, Attorney Richard Romero, Asst. GM German Alvarez, Chief of Information Technology Geoff Stevens, Chief Financial Officer Joe Beachem, Chief of Engineering Rod Posada, Chief of Administration Rom Sarno, Chief of Operations Pedro Porras, District Secretary Susan Cruz and others per attached list.

3. PLEDGE OF ALLEGIANCE

4. APPROVAL OF AGENDA

   A motion was made by Director Thompson, seconded by Director Croucher and carried with the following vote:

   Ayes: Directors Croucher, Gonzalez, Lopez, Robak and Thompson
   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. 4210 TO APPROVE THE FISCAL YEAR 2013-2014 OPERATING AND CAPITAL BUDGET; APPROVE FUND TRANSFERS FOR POTABLE, RECYCLED, AND SEWER; APPROVE TEMPORARY REDUCTION IN THE RESERVE LEVEL OF REPLACEMENT FUNDS; ADOPT THE SALARY SCHEDULE; OBTAIN APPROVAL OF THE DRAFT PROPOSITION 218 RATE INCREASE NOTICES AND DIRECT STAFF TO MAIL THE NOTICES

Chief Financial Officer Beachem reviewed the objectives of the workshop which included:

- Review the FY 2014 Strategic Plan
- Present for approval an $86.1 million Operating Budget
- Present for approval a $13.8 million CIP Budget
- Request approval to include in the budget, rate increases beginning with the January 2014 billing
    - Water: 7.5%
    - Sewer: 7.9%
- Obtain direction to prepare and send 5-year Proposition 218 notices of water and sewer rate increases
- Request approval of the annual fund transfers
- Approve a temporary reduction in the potable replacement fund (setting balance below target budget, but above minimum) to avoid short term external borrowing

Chief Financial Officer Beachem indicated that staff has also looked at another alternative for rates which is presented as “Option B” in staffs’ report. Also included with the materials is a presentation for Option B along with Proposition 218 notices for both Option A and Option B. Staff will be presenting Option A and at the end of the presentation will discuss Option B.

Chief of Information Technology Geoff Stevens provided a presentation on the District’s Strategic Plan and what has been accomplished over the last 10 years. He stated that the District developed the first version of the District’s Strategic Plan in 2002. Since that time, 350 objectives have been identified in the plan and over 250 have been completed which has included the implementation of the Automated Meter Reading (AMR) program, the EDEN financial and billing system, a comprehensive Cathodic Protection program, etc. The strategic planning process is repeated in three (3) year increments and follows the same process:

1. Develop a three (3) year Strategic Plan based on the District’s vision, mission and strategies
2. Execution/implementation of the plan
3. Determining the success through measuring performance

4. Communicate findings of the performance measures
5. Based on performance, take corrective action if required

He reviewed new objectives that will be included in the Fiscal Year 2014 Strategic Plan:

- Define expenditures or projects that would require a cost/benefit analysis (identify projects that the District will place focus on)
- Replace the SCADA and Work Order systems over the next 12 to 24 months
- Enhance security processes and planning
- Implement the recommendation within the Integrated Water Resources Plan
- Complete the Waste Water Management Plan
- Improve measurement of project performance

He stated that the approval of the budget will allow staff to execute the Strategic Plan and initiate the planning for the Fiscal Year 2015 to 2017 Strategic Plan.

Director Robak inquired, with regard to the improvement of process performance, what process the District utilizes to assess the success of the implementation of new hardware/software. Chief of Information Technology Stevens indicated that when an objective is identified, staff also must identify a measurement plan that specifies exactly what is to be accomplished and when it is to be accomplished. By having specificity in the measurement, the District can measure the success of an objective.

Chief Financial Officer Beachem reviewed the process to develop the District's budget. He stated the Strategic Plan is where the process begins and it is what drives where the District will be focusing its efforts. With Strategic Plan as a guide, all items are input into the 6-year rate model which includes the 6-year CIP Budget, Operating budget, MWD and CWA rates, beginning year balances, the various assumptions for interest rates, inflation, growth and sales, and the District's targets for debt coverage and reserve levels. From the input, the District generates an Operating and CIP Budget and the water and sewer rates to support the budgets.

As the rate model is developed, staff assures that District objectives are met. Some of the objectives include:

- Increasing the debt coverage ratio to the 150% target level
- Funding the $86.1 million Operating Budget
- Funding the $13.8 million Capital Budget
- Maintaining all reserves at target level
- Assuring that all are accomplished in accordance with the District's Reserve Policy
- Keep District's rates as low as possible

He stated that staff is also requesting approval of the proposed fund transfers:

- Potable:
  - Replacement to Designated Betterment - $540,000
  - Replacement to Designated Expansion - $357,000

- Sewer:
  - General Fund to Designated Betterment - $774,000

- Potable to Sewer:
  - Potable Replacement to Designated Sewer Expansion - $40,000
  - Potable Replacement to Designated Sewer Betterment - $221,000
  - Potable Replacement to Sewer Replacement - $267,000

From the Operating Budget, staff is proposing transfers to the following reserve funds:

- From Potable ($3,418,000) and Recycled ($10,000) transferring a total of $3,428,000 to the Expansion Reserve
- From Recycled transferring $125,000 to the Betterment Reserve
- From Recycled transferring $4,230,000 to the Replacement Reserve
- From Potable transferring $152,800 to the Sewer General Fund
- From Potable ($1,913,100), Recycled ($66,900) and Sewer ($61,400) transferring a total of $1,242,900 to the OPEB Trust Fund
- From Potable transferring $1,913,100 to the Potable General Fund

Chief Financial Officer Beachem indicated that staff had projected in last Fiscal Year's (FY) six-year budget projections, water rate increases that are pretty close to this year's projection for FY's 2014 and 2015. However, the increases projected for FY's 2016 through 2017 is about 10% higher from last FY's projections; 2.9% versus today's projection of 7.5% in 2016 and 2.8% versus today's projection of 7.5% in 2017. This is mainly due to the estimated increase of water cost from CWA for supplies from the Carlsbad desalination project starting in 2016. Staff is proposing a smooth rate increase of 7.5% in FY's 2014 through 2017. This will also allow the District to meet its debt coverage ratio target in 2017 of 150% and above.

He indicated with sewer, the projected six-year budget projections for sewer last FY is the same as projected for this FY. The projected rate increases for sewer from FY 2014 through 2019 is 7.9%. In response to an inquiry from Director Robak, Chief Financial Officer Beachem indicated that the rate increase is due to a rate increase from the City of San Diego's Metro Commission and the District's needs for operating expenses. He stated that last year the District projected where it needed to be to assure reserves are on target to fund the sewer CIP and this year there is nothing different in staffs' projections. Thus, staff is proposing a 7.9% increase this FY as projected last FY.

The District’s Debt Coverage Ratio in FY 2013 is projected to be 138%. This is a fairly low number. Standards & Poor’s is reviewing the District’s rating for the refinancing of the 2004 Certificates of Participation and had reaffirmed the District’s “AA” rating. However, they moved the District from the “Strong” category to the “Good” category and placed the District on their negative watch list. If the District’s rates do not support a debt coverage that is higher, they will likely downgrade the District’s rating as Fitch had done a year ago (AA-).

Chief Financial Officer Beachem indicated that the lower debt coverage ratio is a result of 30% decrease in water sales. He stated that the District’s water sales have leveled off and it is expected that the District’s debt coverage ratio will increase to the 150% target level. He noted that the District’s debt coverage ratio without growth (capacity fees paid by development) is the ratio that staff wishes to keep above 150%. When the District matures, it will need to be able to support a strong financial position without growth revenues.

Director Thompson inquired when the District would need to issue debt again. Chief Financial Officer Beachem indicated that it is likely a few years beyond 2020. It depends on growth. If growth is as strong as projected six years from now, it may be many years from then that the District would need to issue debt. The District’s rate model does not go out that far, but it is projected that the District will be in a strong position in six years.

Chief Financial Officer Beachem indicated that 95% of the District’s proposed rate increase is a result of the District’s suppliers (CWA, MWD, City and County of San Diego and SDG&E) rate increases. Five percent of the increase is due to the District’s internal needs to increase the District’s debt coverage ratio and maintain its reserve funds.

He reviewed items that are helping to keep rates down:

- Salary and benefit costs net of $180,700 due to:
    - Reduction in staffing levels (5 positions) saving $519,900
- Materials and Maintenance decrease of $264,100
- Reduction in 6-year CIP of $9.3 million (projects have been delayed due to a slowdown/decrease in development)
- No new water debt issuances in 6-year timeframe

He indicated the following items are putting an upward pressure on rates:

- Water cost increase of $3,262,700 million
- Carlsbad Desalination increases the rate from 7.3% to 7.5% in FY 2014 (with more significant increases in future years)
- Administrative costs increase of $277,700

Chief Financial Officer Beachem indicated that staff had presented to the board in March 2013 the findings of the Rate Study for water and sewer. The board had directed staff to incorporate the water and sewer rate structure changes into the budget based on the Cost of Service Study, Best Management Practices and Industry Standards. The changes have been incorporated into the proposed budget for FY 2014.

He stated that with the proposed water rate increase for FY 2014, the District would rank as the eighth (8th) lowest cost water provider with an average residential bill of $77.84 for customers utilizing an average of 14 units of water a month. The District's goal is to remain under the mid-point among the local water agencies.

He indicated with regard to the proposed sewer rate increase of 7.9% in each of the next six (6) years, the typical residential customer will see a $6.20 increase per month where $3.34 of the increase is due to the findings of the Cost of Service Study and $2.86 is due to the 7.9% rate increase. With the proposed increases in FY 2014, the District will be the sixth (6th) lowest cost sewer service provider with an average residential bill of $42.35 for customers who use an average of 14 units of water a month. Again, the District's goal is to remain under the mid-point among the local sewer providers.

He stated in 2015, it is projected that the District will need to borrow to fund the sewer CIP. It is proposed that the District borrow the needed $10.2 million from the State Revolving Funds. This is a low cost and low interest rate (1.7% for 20 years) debt with no issuance cost other than internal costs (staff time). The sewer budget will be reimbursed in FY 2014 for funds borrowed by the potable budget last FY and reserves are all on target.

Chief Financial Officer Beachem introduced Mr. Alan Nevin of the London Group who had worked with staff to develop the growth projections for the development of the District's budget. He stated that Mr. Nevin will be presenting an economic overview for San Diego County. Mr. Nevin indicated that this year he included a demographic profile for the County. He stated that demography sets the path, in terms of utility usage, for future years. He indicated that the United States has changed pretty dramatically in the last 50 years. The birth rate has dropped by half and the average age of the population is moving upward. The composition of households is changing. Households are getting smaller, the population is getting married later (from an average of 23 to 24 years old to 28 years old) and having less children (from two [2] to three [3] children to having only one [1] child). He stated that only one (1) in every seven (7) households in the County is composed of a mother, father and two (2) children. Twenty-five percent of all the households in the County are only one (1) person. He stated that SANDAG projects that household size will average 3.3 persons. He stated all these changes are indicative of the demography of the County.

In the mid-2000's the County was producing 9,000 single-family homes a year with very little Townhomes. Today, we are producing 2,000 single-family homes a year (a drop of approximately 80%) and the production of condominium units is virtually non-existent. He stated that the District's service area is dramatically different from the rest of San Diego County. He stated that the majority of the County is built out and much of the County's construction in the northern area is mainly high density (30 to 50 units an acre; 3 to 4 story buildings) and the supply of single family homes is very meager. He stated the preponderance of available land for development is within the District's service area. There will be a rapid change in 2015 when Villages 8 and 9 in Otay Ranch and Millenium's 3,000 units are constructed. There will be, however, a large difference between today and the mid-2000's. In the mid-2000's the majority of residential construction was single family homes. Today, 25 to 30 units are being constructed per acre. He stated in the next decade there will be very little single family homes being constructed, thus, there will be reduced water use in the new developments as there will be a decline in homes with landscaping. There will also be a decline in commercial development in the District's service area. Water needs will be declining on a per unit basis, however, three will be more units to service. Thus, there will be a balance.

Director Robak inquired on Mr. Niven's thoughts with regard to SANDAG's projection that the size of households will drop to 3.3 persons; if this was the realistic household size. Mr. Niven indicated that he felt that there would likely be 2.9 to 3 persons per household.

Director Thompson asked if there has been any analysis of how immigration reform would impact the County's population. Mr. Niven indicated in the last 30 years, the size of the population for persons who were not born in the United States has doubled from 12% to 25%. However, the birth rates for the Hispanic and Asian populations have dropped dramatically in the last 30 years. The birth rates are now almost the same as non-Hispanic/White population. He indicated that the Asian birth rates have even dropped to below the non-Hispanic/White population. He stated that he did not see any changes to these profiles in the future.

The board thanked Mr. Niven for his presentation and insights.

Chief of Engineering Rod Posada presented the District's projected six (6) year CIP from 2014 to 2019. He stated that staff utilized Mr. Nevin's and the developers' projections to develop the District's growth projections which is presented in slide number 27 of staffs' report (see attached copy of presentation). He indicated that Single-Family homes (200 units), condominiums (200 units) and apartment units (900) are the majority of the developments projected in FY 2014. There will also be approximately $46 million in commercial development mainly in the Otay Mesa area with some in the City of Chula Vista. He indicated that growth, thus, will remain relatively flat in FY 2014.

He stated that in the development of the six-year CIP budget last year, staff had projected that the CIP Budget requirements for FY 2014 was $19.2 million. In the development of the CIP budget for FY 2014 this year, staff reprioritized projects based on recent requests for water availability letters, Water Supply Assessment reports, and the District's Water Resource Master Plan, and projects that the CIP Budget requirement for FY 2014 is $13.8 million. The six-year CIP Budget total for FY's 2014 to 2019 is $107.1 million. Of the $107.1 million, $63.4 million is designated for Capital Facilities Projects, $32.73 million for Replacement/Renewal Projects and approximately $11 million for Developer Reimbursements and Capital Purchases. He presented the high profile CIP projects which included:

- Potable Water Projects:
  - Otay Mesa Desalination Conveyance and Disinfection System, $28.4 million
  - 870-2 Pump Station Replacement, $12 million
  - Reservoir Improvement, $7 million

- Sewer Projects:
  - Sewer System Rehabilitation, $5.7 million
  - Campo Road Sewer Replacement, $5.5 million

Accounting Manager Rita Bell presented the details of the FY 2014 Operating Budget. She indicated the District's water sales projections for FY 2014 are based on the prior year sales (April 2012 through March 2013) which have been affected by price elasticity, conservation, economy and weather patterns. She stated that from FY 2009 to FY 2010, the District had a large decline in water sales which is attributed to the historically large rate increase implemented in FY 2009. The rate increase was a pass-through from the increases implemented by the District's water suppliers. She stated that since FY 2009, water sales have leveled off.

She reviewed the Cost of Service Study recommendations for water that have been incorporated into the FY 2014 budget by board direction:

- Adjust the monthly fixed fee due to the updated meter equivalencies to match AWWA Standards
- Adjust tier and break points based on current usage patterns for Commercial and Recycled customers
- Create a Recycled Commercial Rate
  - The District does not yet have a customer under this category, however, such a customer is anticipated in the next five (5) years
  - The rate is set at 85% of the Commercial Rate
- Updated the Fire Service Fee to reflect the true Cost of Service

She stated the District's potable sales have increased by $5.3 million. A large portion of the increase in revenue is due to last year's rate increase and a change in the sales volume and $2.1 million is due to the proposed FY 2014 rate increase. It was indicated that the potable water volume is expected to increase 0.2% based on growth projections. She stated when the District sets its rates, no more than 30% of the water revenue will be collected through fixed fees to comply with Best Management Practice 1.4. This is an industry standard.

She indicated that recycled sales revenues will increase $637,700 or 8.3%. She shared that the increase in revenues is due to the rate increase implemented last fiscal year and the resetting of the meter equivalency fee. She stated that recycled customers tend to have larger meters and, thus, they need to contribute more towards the maintenance of the system for the water capacity they require. A smaller portion of the recycled revenue increase is due to the increase in the recycled water sales volume of 23,600 units or 1.3% and the remaining $173,000 is due to the proposed rate increase that is built into the FY 2014 budget.

Accounting Manager Bell reviewed the Cost of Service of Study recommendations for sewer that have been incorporated into the budget as the board's direction:

- Adjust monthly fixed fees based on meter equivalency to match AWWA for all customer types
    - This will make water and sewer consistent as the water meter is utilized to measure sewer use
- Single-Family Residential:
    - Same monthly fixed fee for ¾" and 1" meters as the same volume is flowing through to the sewer
    - Phase-in the Cost of Service increase:
        - Year 1 – Implement Usage Fee increase
        - Year 2 – Implement Fixed Fee increase
        - Year 3 – Implement repayment of the phase-in increase (repayment of the first year delay)
- Multi-Residential: Charge system fee based on meter size instead of per dwelling unit
- Commercial:
    - Eliminate ASU calculation and instead base fixed fee on meter size
    - Update the strength factors to State Water Resources Control Board (SWRCB) standards
- Churches and Schools: Change the methodology to match commercial customers

She indicated that the overall sewer revenue increase based on the proposed rate increase of 7.9% and the implementation of the recommended changes of the Cost of Service Study, sewer revenues will increase $146,400 or 5.7%. The increase is not for the full 7.9% in the first year as the Fixed Fee increase will not be implemented until year two (2).

The District also receives revenues from other sources which includes:

- Capacity Fee Revenues will increase $136,600 due to an increase in projects funded by capacity fees
- Betterment Fee Revenues will increase $60,800 due to an increase in projects funded by betterment fees
- The Grant Revenue of $20,000 will be eliminated, but will be offset by decreases in the Conservation budget
- There will be no significant change in Property Tax revenues
- Miscellaneous Revenues will decrease $68,000 due to the completion of the AMR meter replacement project. When the project is complete, the District will no longer have scrap metal to sell.

She stated that the District's water cost is increasing $3,262,700 or 7.8%. She reviewed the reasons for the water cost increases which included:

- Variable Cost Increase:
  - Potable costs increase of $2,476.700 or 8.1% due to the District's water suppliers (CWA and MWD) increasing their rates
  - Recycle costs increase of $95,500 or 6.3% due to the "Take or Pay Contractual" agreement with City of San Diego and the volume increase of recycled water use (there is no recycled rate increase from the City this fiscal year)
- Fixed Cost Increase:
  - Potable costs increase of $690,500 or 7.1% due to a rate increase from the District's water suppliers (CWA and MWD)
  - There is no change in the recycled water costs

She indicated that sewer costs will increase $49,100 or 3.9% in FY 2014. The primary reasons for the increase is the City of San Diego's Metro Commission will increase their cost to the District $13,700 and the Spring Valley Sanitation District's will increase their cost $35,400 to the District.

Accounting Manager Bell indicated the one of the largest increase in FY 2014 is power cost. Power cost from SDG&E is estimated to increase $325,300 or 13.7%. The reasons for the increase include:

- Water demand increase of 0.2% for potable and 1.4% for recycled
- SDG&E is anticipating up to four (4) separate 2.5% rate increases due to their rate case, increase in natural gas prices, shutdown of San Onofre, and transmission rate increases

To offset the energy cost increases, the District has implemented energy savings programs which have been successful. The District will continue to operate at non-peak and semi-peak rates.

Director Robak inquired, as the District's customers are buying less water, is it also causing sewer revenues to decrease because sewer is based on water use. Chief Financial Officer Beachem indicated that that was correct.

In response to another inquiry from Director Robak, General Manager Watton indicated that part of the issue with regulated utilities, in this case SDG&E, their rate of return is approximately 11% on invested capital. If you try to find an investment with the same return, it would be very hard to find and is the reason SDG&E is getting a lot of criticism.

Chief of Engineering Posada indicated that meter sales projections are based on discussions with developers and the information provided is compare to the plans that developers have submitted for new developments. Staff also references Mr. Allen Nevins economic forecasts.

Chief of Administration Rom Sarno reviewed the staffing changes. He indicated that each year the Senior Team members conduct an analysis of staff workload requirements and existing vacancies. Based on the review, five (5) vacant positions were deleted reducing the fulltime equivalent (FTE)/headcount from 148 to 143 in FY 2014. He stated that the District has reduced the number of staff members from 174.75 in 2007 to 143 in 2014; a reduction of 31.75 employees or 18.2%. The cumulative cost savings from the reduction in staffing is approximately $14,181,300 from 2007 to 2014. From an efficiency standpoint, the customer to employee ratio has increased from 301 customers serviced per employee in 2007 to 380 customers serviced per employee in 2014 or an increase of 26.1%.

He indicated that salaries and benefits have decreased $180,700 or 1%. The items increasing salary and benefits include:

- Increase in in-range adjustments per the MOU of $129,300 (no COLA increase)
- Increase in Operating budget caused by a decrease in CIP charges of $445,200
- Increase in health insurance costs of $121,500

Offsetting the increases in salaries and benefits are a:

- Decrease in the staffing level of ($519,900)
- Decrease in Vacation/Sick/Holiday, Social Security and other labor related costs due to the elimination of staffing of ($190,600)
- Decrease in Pay for Performance of ($105,000)
- Decrease in Overtime of ($58,800)

Staff is also requesting that the board approve the salary schedule which is attached as Exhibit 2 to staffs' report.

In response to an inquiry from Director Croucher, Accounting Manager Bell indicated that cost savings realized by outsourcing workload is netted against the cost saved by eliminating positions. She stated that the numbers presented do reflect this net savings.

Director Thompson inquired what is the percentage change to total compensation cost per employee in comparison to total labor cost. Staff indicated that they would bring this figure back to the board. Director Thompson observed that at some point the District will have more retirees in the system versus active employees and inquired how this impacts the District's total labor cost with regard to pension cost. General Manager Watton indicated that the PERS cost is an actuarial calculation that is done periodically. The largest impact is how PERS is calculating their return. Staff will review these numbers and provide the board the information. He stated that the advice the District receives from PERS is pretty reliable and the District's pension is pretty well funded.

Chief of Operations Pedro Porras reviewed changes in the District's materials and maintenance costs and indicated that the District has decreased it materials and maintenance cost $264,100 or 10.6%. He stated the decrease is due to:

- Decrease in infrastructure equipment and supplies of $87,500 or 14.9%
- Decrease in fuel and oil of $72,100 or 19.6%
  - The decrease has been consistent since 2006 and is attributable to the use of SR-125 and the District's use of more fuel efficient vehicles.
- Decrease in meter and materials of $53,100 or 28.2%
  - With the completion of the AMR retrofit project, the District will not need to purchase additional meters. However, in three (3) to five (5) years the District will need to start replacing the batteries of the automated meters.
- Decrease in chemicals of $47,900 or 10.1%
  - Due to the improvements to the District's treatment plant, the treatment process requires less chemicals. A lesser amount of chemicals are also being utilized on the recycled system.
- Offset by increase in District-wide contracted services of $24,100 or 5.5%
  - The District no longer employs an in-house welder. The District instead hires a welder on a case-by-case basis when the services are required which has increased contracted services costs.

Accounting Manager Bell indicated that the overall administrative expenses increased $277,700 or 5.8%. She reviewed the reasons for the increase:

- Increase in services of $180,000. These increases, however, are all one-time increases and include:
  - Increase of $100,000 is related to a Water Conservation Program
  - Increase of $60,000 is related to the cost to prepare a Water and Sewer Capacity Fee Study

  - Increase of $35,000 is related to the cost to prepare a Condition Assessment Study for the Otay river Potable Water Trestle
- Increase in bank fees of $73,700 related to customer credit card payments. As the cost of water increases, the fees to process larger bill payments also increases. It was noted by accepting credit card bill payments, the District has reduced its bad debt expense as more customers are paying on time.
- Increase in Property Liability Insurance of $35,200 related to the increase in the number of facilities and property to be insured.
- Increase in General Office Expense primarily due to postage for Proposition 218 noticing of $24,600.

Director Robak inquired what the $100,000 increase for a water conservation program is related to. General Manager Watton indicated that at this point it is a place holder as the District develops other options/programs to encourage water conservation.

Director Thompson inquired with regard to customers utilizing credit cards to pay their bills if the District has not considered charging customers the credit card processing fee. Chief Financial Officer Beachem indicated that the District receives a discount if the District's customers do not pay the credit card payment fee. There is also a cost/benefit to providing the additional payment option as the District also avoids the cost to process check payments. Staff will review the cost/benefit to receiving bill payment through credit card payments and provide the information to the board.

Director Croucher inquired with regard to the increase in services of $180,300 that the items noted which are contributing to increased costs do not add up to $180,300. Accounting Manager Bell indicated that staff has only presented those items which have the largest impact to Administrative costs. She stated that there is a large list of items impacting Administrative costs which net to $180,300.

Director Croucher also inquired if the Proposition 218 notices could be included with the mailing of customer bills. Chief Financial Officer Beachem indicated that the notices could be included with customer bills. However, because of the size of the notices, it would increase postage. There is also a timing issue as bills are mailed in various batches over a month based on when the customers' meters are read. It was noted that a notice must be mailed physically to customers and staff had also considered mailing a postcard advising customers that the rate notice is available on the District's website or to contact the District for a copy. It was indicated that Helix Water District had forwarded postcards and found that it was more costly and time consuming as a large number of their customers asked that the notice be forwarded to them.

Accounting Manager Bell reviewed those items which are reducing Administrative costs which included:

- Decrease of $54,300 in Regulatory Agency Fees
  - Decrease in Election Fees for the Registrar of Voters of $36,000 as there will be no elections for a director in FY 2014.
  - Decrease in Department of Public Health fees of $21,000 as they are reducing the number of required site visits which reduces their fees.
- Decrease in conservation incentives for MF/HOA cash for water smart plants and residential smart landscape of $21,000.
- Decrease in technology hardware and software of $26,100.
- Decrease in Bad Debt Expense of $23,300 as customers have more options to pay their water bills, such as by credit card.

Accounting Manager Bell indicated that the proposed FY 2014 Operation Budget is $86.1 million which includes both water and sewer. Staff is also proposing the consolidation of Improvement Districts (IDs) which will be included in the Proposition 218 Notices. Staff is recommending that ID 25 be consolidated into ID 20 and ID 19 into ID 22.

She stated in compliance with Proposition 218, staff is proposing a five-year rate increase notice and public hearing and is requesting:

- Authorization to pass-through rate increases from the District's wholesale providers; CWA, MWD, City and County of San Diego and SDG&E.
- That the board authorizes a 10% maximum increase for internal operational requirements.

Accounting Manager Bell also presented the approximate number of notices to be mailed to each customer type (reference slide number 65 in attached presentation) and noted that the notices will be mailed to both tenants and owners of properties. Thus, more notices will be mailed than the number of District accounts.

She stated in conclusion, staff is presenting a balanced budget which supports the District's Strategic Plan and the water and sewer needs of its customers. Staff is proposing two options (Option A and B) for the proposed water rate increase and a 7.9% sewer rate increase to support the FY 2014 budget. She indicated that Chief Financial Officer Beachem will review, at the close of staff's presentation, proposed Option B. Staff is also proposing that the board approve the detachment and annexation of the two ID's as presented earlier.

Chief Financial Officer Beachem presented the two water rate increase options. He indicated that Option A provides for a rate increase of 7.5% for four (4) years (FY's 2014 through 2017) and Option B provides for a rate increase of 6.4% for two (2) years (FY's 2014 through 2015) and 10.6% in FY 2016 and 5.3% in FY 2017. He stated that Option B does not avoid a spike in rates that is caused by the Carlsbad Desalination Project. He indicated that the delay in the revenue stream of Option B also results in short term external borrowing of $2.6 million for about 2.5 years. This is required to avoid the District Replacement Fund Reserve from going below its minimum target level as identified by the District's Reserve Policy. Also, at the end of the Rate Model six-year time period, the District will have slightly less reserves of approximately $3.1 million and a resulting delay in the return of the Replacement Reserve to target of approximately 1.5 years. He indicated that the debt coverage ratio is slightly lower under Option B compared to Option A.

Chief Financial Officer Beachem indicated that he does want to emphasize that both options are financially responsible. He stated, because of his fiscal conservative nature, he believes Option A places the District in a slightly better position to address any rate spikes. If the District's wholesalers were to miss their estimated rate increases, the District would be in a slightly better position to address the higher increase.

He reviewed the benefits and drawbacks of both options. He indicated with regard to:

Option A:

- Benefits:
    - Smooth rate without a rate spike
    - Financially better position to respond to CWA's Carlsbad Desalination Project cost
    - Strengthens the District's financial position more rapidly
- Drawbacks:
    - Slightly higher rate increases than Option B in the years other than the year of the rate spike (10.6% in 2016)

Option B:

- Benefits:
    - Slightly lower rate increases in the years surrounding the rate spike
- Drawbacks:
    - Requires short term external borrowing
    - More vulnerable to unknown factors regarding Carlsbad Desalination costs
    - Slightly lower financial strength, lower reserves and debt coverage ratio, and a delay in returning to the target level for the replacement reserve

Staff is requesting that the board adopt Resolution No. 4210 to approve the:

- FY 2014 Operating and CIP Budget
- Listing of Job Classifications and Salary Schedule
- Approve the fund transfers
- Approve a temporary reduction of the potable replacement fund level below target, but above the minimum
- Direct staff to prepare and send Proposition 218 notices of public hearing with proposed rate changes to customers

In response to an inquiry from Director Croucher, Chief Financial Officer Beachem indicated that that would fall under a pass-through. If the City of San Diego Metro Commission were to have a significant rate increase, it would not impact the District because the Proposition 218 Notices that staff is proposing to mail to customers indicate that the District would pass through rate increases or decreases imposed from its suppliers. Director Croucher noted that there are other issues beyond the District's control such as the Bay Delta pumping issues and the secondary conveyance of water from the southeast. Chief Financial Officer Beachem agreed that there are a number of unknowns which also include the City of San Diego's reclaimed water rate, CWA's allocation of the cost of the Carlsbad Desalination Project, etc. He stated that the cost increases would be a pass-through as per the proposed Proposition 218 Notices. They are certainly big unknowns and may cause the District to have higher rates.

Director Croucher requested a list of possible issues that could have a large impact to the District's cost, such as, the CWA vs. MWD lawsuit, Colorado River Water and Bay Delta, etc. This would be helpful to Directors to make them aware of possible issues. Chief Financial Officer Beachem indicated that in the official statement of the bond documents, staff highlighted areas that can be of risk to the District. He stated that staff might include that information in the budget documents. Director Croucher thanked staff for the good work on the budget.

Director Robak inquired when staff felt the District will start seeing the costs from the Carlsbad Desalination Project. Chief Financial Officer Beachem indicated that the costs are estimated to hit in 2016 or 2017. It was discussed that Option A includes the anticipated costs from the Carlsbad Desalination Project, Option B, does not. Staff believes the rate setting for the Carlsbad Desalination Plant will be set likely next year. Director Robak inquired what the cost differential was between the proposed FY 2014 rate increase of 7.5% in Option A and the 6.4% increase in Option B. Chief Financial Officer Beachem indicated that he did not have the dollar value, but the overall difference is about 10%. He referenced the presentation for Option B (attachment M to staffs' report) and indicated that it provides the difference in total revenue collected between Option A and B in FY 2014. Staff could provide the overall difference in revenue following today's meeting.

Director Robak indicated that he felt that Option A was the prudent option. He indicated that the District needs to make it clear to its customers the reasons for the increases and the implications of the Carlsbad Desalination Project and that Option A puts the District in a stronger financial position and avoids a rate spike.

Director Thompson indicated that he believes that the District should implement Option A because of the reasons indicated by staff. He stated that he would like to see a hybrid between Option A and B as in FY's 2018 and 2019 the projected rate increase is 2.3% (both years) in Option A and 3.3% (both years) in Option B. He stated that he would like to see more of a blend over the six years as in the last two years of the model the increase is very small versus 7.5% in Option A in FYs 2014 through 2017. He stated he really doesn't like double digit increases and that he would like to see a blending of the increases. Chief Financial Officer Beachem indicated in the third year of the six years, the Carlsbad Desalination Project costs will be hitting fully. To maintain the District's operational debt ratio, 7.5% increases are needed in FY's 2014 through 2017. This will assure that the ratio does not drop below the District's target level of 150%. Chief Financial Officer Beachem referenced slide number 17 of staffs' presentation which graphically presents the District's ratio from 2014 to 2017 with the 7.5% rate increases incorporated (see attached copy of presentation). He noted that double digit increases would be required in Option B if the District wished to avoid borrowing. In response to an inquiry from Director Gonzalez, Chief Financial Officer Beachem indicated that in Option B the District would borrow in FY 2017.

General Manager Watton responded to another inquiry from Director Thompson and indicated that there are no changes to the Capital Program which would put any infrastructure at risk or delay maintenance. Staff reviewed the projects and determined which projects need to be constructed or could be delayed based upon need. Director Thompson further inquired what percentage of the District's assets has utilized replacement reserves and do we ever determine on an annual basis how much we need to maintain all the District's infrastructure long term. Chief of Engineering Posada indicated that staff does a cathodic protection evaluation every year and based on the evaluation, determines which pipelines and reservoirs need to be replaced or require maintenance. General Manager Watton further indicated that the District does not have one comprehensive plan, however, staff will be completing its Asset Management System which will maintain such information for the District's assets/infrastructure.

The board complimented staff on their work on the budget and indicated that they were very pleased with the knowledge and experience of the District's staff. Director Robak noted with regard to the "Notice of Public Hearing" that it should include information indicating that a portion of the increase is due to the cost of CWA's Carlsbad Desalination Project. He stated that he felt that information provided on the sewer rate increase was very helpful and that the increase is due to rate increases from the City of San Diego's Metro Commission, the District's sewer processing service supplier. He also suggested that the District include information on what customers can do to help conserve water and provide information about the District's programs and website, and the Water Conservation Garden.

Director Robak inquired when the hearing will be held. Chief Financial Officer Beachem indicated that the Notices are scheduled to be forwarded in approximately two (2) months and the hearing will be held at the September board meeting.

A motion was made by Director Robak, seconded by Director Croucher and carried with the following vote:

Ayes: Directors Croucher, Gonzalez, Lopez, Robak and Thompson
Noes: None
Abstain: None
Absent: None

to approve the FY 2014 Operating and Capital Budget utilizing Option A; approve the fund transfers for potable, recycled and sewer; approve temporary reduction in the reserve level of replacement funds; adopt the salary schedule; approve the draft Proposition 218 Rate Increase Notices and direct staff to mail the notices.

7. ADJOURNMENT

With no further business to come before the Board, President Lopez adjourned the meeting at 5:55 p.m.

____
President

ATTEST:

____
District Secretary