MINUTES OF THE
SPECIAL MEETING OF THE
BOARD OF DIRECTORS
OTAY WATER DISTRICT
May 19, 2015

1. The meeting was called to order by President Lopez at 3:04 p.m.

2. ROLL CALL

Directors Present:	Croucher, Lopez, Robak, Smith and Thompson
Directors Absent:	None
Staff Present:	General Manager Mark Watton, General Counsel Daniel Shinoff, 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 Croucher, seconded by Director Smith and carried with the following vote:

Ayes:	Directors Croucher, Lopez, Robak, Smith 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.

<u>WORKSHOP</u>

6. REVIEW THE DISTRICT'S FISCAL YEAR 2015-2016 OPERATING AND CAPITAL BUDGET AND PROVIDE DIRECTION TO STAFF AS TO WHICH

CONSERVATION LEVEL SHOULD BE ASSUMED FOR THE BUDGET WHICH WILL BE AVAILABLE FOR ADOPTION AT THE JUNE 3, 2015 REGULAR BOARD MEETING

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

- Reviewing the FY 2015 - 2018 Strategic Plan
- Presenting for approval an $89.1 million Operating Budget
- Presenting for approval a $11.1 million CIP Budget
- Review options for water rate increases at various conservation levels to be effective January 1, 2016
    - Water Conservation Between 8% and 16%
    - Review Recommended Rate Increases

Chief Financial Officer Beachem introduced Mr. Gary London of the London Group and indicated that he will be providing an overview of the economic outlook for San Diego County for 2015 and beyond. Mr. London worked with staff to develop the growth projections for the development of the District's budget.

Mr. London presented the employment rate from January 2002 to January 2015 and indicated that the employment level in 2015 is looking very good nationally. He stated that the unemployment rate is also looking good, as well as, in terms of underemployment. Income growth is finally on an upswing and the economy is strong at the moment as was predicted last year. Growth is being experienced across most sectors, with a year-to-year increase in employment of approximately 2%, which is healthy. He stated that the unemployment rate in 2015 is 5.4% and that the unemployment rate has been steadily going down over the last five (5) years which is also a reflection of the overall health of the economy.

He reviewed job growth in San Diego from December 2013 to December 2014. He indicated that the County added 31,000 jobs which is a 2.3% decrease from the last two years and before that the County had a 4% decrease. He noted that this is growth to the positive, but it is not the robust makeup growth that the County had in the first years coming out of the recession. He stated in terms of a demographic overview, the District's service area is growing at a substantially robust pace than the San Diego County region as a whole. The household count is a little higher than the County and the Hispanic and Asian populations are greater in the District's service area than in the overall region. He stated the median age of the population and education in the District's service area is about the same as the County, however, the average and median household income is higher than the County as a whole (see attached copy of Mr. London's presentation). He stated this paints a positive picture going forward.

Mr. London stated that from a real estate perspective, total sales is about the same as in the last five or so years. The average median price of resale homes have been going up, but the prices are not yet at the peak that the County experienced in the period between 2006 and 2007. He stated from his experience since the late 1970's, in every succeeding cycle, the peak of home values has always gone higher than the high in the previous cycle. He indicated that home prices are not yet at their peak, but predicts that they are going to get there before this current growth period ends. He stated that he felt that we are close. He noted the April average home price was about $464,000 compared to the year before which was $434,000 (up 6.8%). He stated that the County will continue to see an increase in home values as it is assumed interest rates will increase in the next year, which is encouraging people to purchase homes or refinance their loans now. He indicated that there are a lot of factors in our economy that suggests that pricing will continue to go up, not the least of which is the continuing diminishing supply of available developable property in all areas of the County, but within the District's service area.

He stated with regard to the commercial market, particularly in office and retail, commercial construction is increasing significantly in 2014. Not so much in the District's service area, but within the University Towne Center and Sorrento Valley areas. He stated, however, that a substantial increase is not expected as there has not been that much demand in the commercial sector as there has been in the residential sector.

Mr. London indicated that residential foreclosures have declined significantly and this area of the market is in a relatively healthy condition. The foreclosure crisis is long past. He stated that permitting for residential construction is a little less than last year and that the prior year was a little less as well. He noted that on 100 residential units (40 single family and 60 condominium) are scheduled to be built in the remaining months of fiscal year 2015 and 550 units (150 single family, 250 condominiums and 150 apartments [including senior homes]) are expected to be built in fiscal year 2016. He stated that these predictions are based on discussions with the city, developers, and SANDAG. He felt that we are in about the 5th inning now in the economic recovery.

Director Croucher stepped off the dias at 3:23 p.m.

He stated the District's service area represents the most affordable of new developments and the region is looked upon as highly affordable and as high quality. He stated, however, that we are past our most affordable period and developments will get more and more unaffordable and buyers somehow will still be able to put the resources together to purchase a home as they wish to live in the region.

Director Smith inquired what would occur to the real estate market and the economy in general if a moratorium on building was instituted due to water restrictions. Mr. London indicted that it would bid up the pricing of housing. Building outside the range of water restrictions could occur in small numbers, but likely it would just delay development until the restrictions are reduced. He stated, however, that he did not see a drought based water moratorium as being very helpful. He indicated that he felt that perhaps, ultimately, saner minds would prevail on this issue. He indicated that he looks upon the water issue as an economic issue and not a resource issue and feels that the market is elastic with respect to increases in water pricing. Water prices go up because availability is limited or the agencies are forced by the larger water authorities to limit water to some extent. The translation is not a moratorium, but higher prices and conservation. A moratorium in building would not do anything but bid up the pricing of housing.

Director Croucher returned to the dias at 3:27 p.m.

Director Thompson inquired if residential prices remained about where they are now for Eastern Chula Vista, have the developers indicated that there is ample profitability in those projects moving forward at the same rate as he (Mr. London) has projected. Or would he assume into his model a certain pricing increase over the next several years. Mr. London indicated that they do assume a price increase because there is a perpetual balance between supply and demand. There is elasticity in the pricing because we cannot possibly supply enough housing.

Director Robak indicated that some believe that we are on a precipice with regard to the economy and any change of consequence by the Federal Government regarding interest rates would self-implode the economy. He inquired what Mr. London's view is on how fragile the economy may or may not be. Mr. London indicated he believes that is why the Federal Government is being very careful with interest rates. He stated that though we are at historically low rates by every measure, there is reticence to increase interest rates in the near term. They want to wait to see how strong the economic recovery is. He felt, however, there is no doubt that we are in a fairly strong recovery. We are in our sixth (6th) year in the recovery period, which is past the five (5) year recovery mark and he felt we have already adjusted.

In response to any inquiry from President Lopez, Mr. London indicated that he felt the numbers he has presented with regard to development are accurate. He stated that his projections have been right in the short term and they will be no less right this time.

Chief of Information Technology Geoff Stevens provided a presentation on the District's 2015-2018 Strategic Plan. He stated that in 2015 the District implemented key systems as a foundation (i.e., SCADA, GIS-centric Work Order System, and the Emergency Procedures for the Management of Disasters). In FY 2016, staff will be focused on process improvements through the use of systems and data to run the business. The District's success will come directly from the work order, SCADA and financial systems. In 2017 and 2018 the District will be evolving to fine tune the measurement metrics and focus on unit costing; determining what costs can be eliminated/combined to drive costs down and improve efficiency. This is the whole key to the Strategic Plan. He presented slides indicating the District's *Mission* (what the District will do), *Vision* (how the District will do it), *Statement of Values* and *Key Challenges* (see attached copy of staffs' presentation). He also presented slides stating the objectives and performance measures for each of the District's division's (Administration and Information Technology, Engineering, Operations and Finance) noting, again, the focus on streamlining and process improvements.

He stated the next steps in the Strategic Plan is to:

- Utilize SCADA and Work Management for Better Metrics
- Continue the Focus on Long-term Asset Management
- Begin Developing System Derived Measures of Unit Costing
- Add more Complete Trending Data on Performance Measures in the Extra Net

In response to an inquiry from Director Robak, Chief of Information Technology Stevens stated that the District's business is to provide high quality water/sewer service in a cost effective and efficient manner. The best way for the District to respond to the drought is to increase its efficiency and be able to adapt and change processes quickly and efficiently. He indicated a good example of that in the Strategic Plan is the objectives for customer service and the ability to target specific audiences. Staff would look in the District's GIS and billing system to identify the high and low use customers and use tools, identified through the strategic planning process, to communicate with customers to encourage conservation to accomplish the drought business objective of conservation, if that is the District's objective right now. He indicated that the District's basic tools will not change and that is what the Strategic Plan does; fine tune the direction of the District to do its business objectives.

General Manager Watton indicated that the board is aware of the State Governor's mandate to reduce water consumption to 20% below 2013 usage as discussed at the recent board workshop on the drought. The State Board approved the Governor's regulations on May 5, 2015 and implementation of the mandates go into effect on June 1, 2015. The focus now is determining what will happen in upcoming years. The State Board did consider and approve working groups to meet and discuss over the next 270 days if the conservation mandate needs to be extended and what is next. He indicated that the budget presented today uses a reasonable approach to manage the 20% reduced consumption and many of the member agencies will be using the same strategy, that staff will be presenting today, in putting together their budgets.

He indicated the future direction of the Governor and the State Board on the drought is unknown at this time. He asked the District's legal counsel to provide the board a memo regarding this fact. He stated what is known is that an agency must be in a water supply shortage (Water Code Section 350, Emergency Storage) in order to shut off meters. He stated this is very difficult to do if there are no findings of a water supply shortage. He indicated that he felt that we were not at the point of restricting growth at this time and there may be some legal challenges to the mandates.

Chief Financial Officer Beachem indicated that conservation is a big challenge in the District's budget this year. He stated that the District's residential customers have already achieved a 26% reduction in their water use historically. He presented water use projections for FY 2016 based on conservation levels of 0%, 8%, 10%, 12%, 16% and 20%. He stated that staff will continue its outreach to encourage customers to cut back their usage, however, with the prior water use cutbacks that customers have already achieved, it will make it pretty difficult to acquire additional savings. He indicated that the mandated conservation period starts on June 1, 2015 through the end of February 2016 (270 days). He noted in the months of November 2015 through February 2016, the fall and winter months, it would be very difficult for customers to reduce their water use by an additional 20% as much of the winter use is indoor. It is more realistic that customers could achieve a 10% reduction in their water use during these months. Thus, if the District's residential customers are to achieve an overall savings of 20%, they would need to achieve savings greater than 20% or 25% in June, July, August and September 2015 and 20% in October 2015. This may be achieved as water usage during these months is mainly outdoor where the additional savings could possibly be attained. However, because of the very short lead time before the conservation period begins, he indicated that it is felt that the more realistic savings that can be attained by customers is 6% in June, 11% in July, 15% in August, 19% in October, 13% in November and 10% in December, January and February.

Director Smith inquired what occurs following the nine (9) month period. Chief Financial Officer Beachem indicated that it is not certain what customers will do, but staff will taper back to more normal usage. Staff is projecting that residential customers will continue to cut their water use 12% over the remaining three (3) months in the fiscal year. It was discussed that once customers remove their lawns or change it out for water conserving plants, the water savings achieved through these changes will continue. Following fiscal year 2016, staff is projecting annual water conservation of 6% which takes into account growth. Staff indicated that at the end of this fiscal year, the positive or negative cash flows would be rolled into the next fiscal year. Staff indicated that sales were slightly above budget because the weather was warm and dry during the winter months. In April, the weather cooled and sales have slowed to budget projections.

Director Smith also inquired if there were any issues with the State Board with the District proposing a budget that indicates 12% in water savings. General Manager Watton indicated that he did have concerns, however, he found that most of the other agencies are projecting similar savings in their budget and stated that it was a defendable approach.

Chief Financial Officer Beachem indicated that staff had developed the water rates based on water conservation of 12%. However, staff did run the numbers for various levels of water conservation (20%, 16%, 10%, 8% and 0%) to determine what rate increases would occur at each of these levels. He stated at a conservation level of 12%, the proposed rate increase would be 5.4%. The debt coverage ratio would drop below target (150%) to 141.1% and reserves will be drawn down as well. He stated that the District will not drop below its bond covenant unless conservation is achieved above 17.2%, which staff believes is a very high number to achieve.

In response to an inquiry from Director Thompson, Chief Financial Officer Beachem explained that the District looks at two Debt Coverage Ratios; with growth and without growth. One of the ratios includes capacity fees (growth revenues) and it cannot drop below 125% and the ratio that does not include capacity fees cannot drop below 100%. He stated the District's target is 150% which excludes growth. He stated the concept is if growth were to cease, the District needs to always be in a position that it will not violate its bond covenant. He stated this is a common target used by other agencies as well.

He stated that none of the proposed 5.4% rate increase is due to cost increases from the District's operations. He indicated that 4.99% of the rate increase is due to water wholesale cost increases from San Diego County Water Authority (CWA), 0.32% is due to increases from the City of San Diego, and 0.27% is due to increases from San Diego Gas & Electric (SDG&E). The District's costs represents -0.18% of the rate increase.

The District was able to reduce its costs through:

- Reducing its water loss from 5% to 4%
- Reducing personnel from 140 to 138 FTE
- Reducing Administrative Expenses and Material Expenses despite increases for conservation efforts and for leak detection

Director Robak indicated that he also felt that the District's customers may not be able to achieve a 20% reduction in their water consumption. He asked how staff came up with 12% as the achievable savings. Chief Financial Officer Beachem indicated that staff took into account the lead time to achieve the savings goal; how much time it would take to get the 20% water savings. He indicated that it is a very subjective question. Staff feels that 12% was the most reasonable savings that the District's customers could achieve based on the numbers and information.

Director Croucher indicated that decisions are being made before they are being evaluated and there is a lot of confusion and questions regarding the mandates and potential penalties. He indicated that he felt that the agencies need to continue to work together, legislatively as well, to come up with what is fair. He stated that we need to continue to think outside the box.

Director Smith commented that none of the rate increase is due to the District's internal operations and the District will be using some of its reserves to moderate the rate increase. He suggested that the District could provide a 2% increase (about the rate of inflation) for internal operations and utilize less reserves. He indicated that he wished to suggest another option to work the numbers. If a 2% increase is provided for the District's operations, then less reserves would be utilized and the overall increase would then be about 5.6%. He also indicated that he felt it would be hard to explain that last year the District required a 5.8% increase and this year the increase is 5.4%. He indicated that he understood that the District has reduced its costs and that is the reason the increase is lower, but from a perception stand point, it is difficult for the public to understand.

Finance Manager Kevin Koeppen presented on the District's Bond Covenant. He stated the Debt Coverage Ratio is a key part of the District's budgeting process. It is a key financial ratio that the District uses to evaluate its ability to meet it debt obligations and one factor that the rating agencies use to rate the District's bonds. He indicated that the District has a Debt Covenant to set rates sufficient to yield a debt coverage ratio of 125% (including growth revenues) and 100% (excluding growth revenues). Staff believes, based on the District's rate setting history, liquidity, and current cash position, that the short term impact of any non-compliance in the Debt Covenant would have little adverse impact if the District's rate setting process was reasonable and there was a plan to achieve compliance in the following year. He stated that the potential adverse impact to the District in not complying with the covenant is the District would be required to provide additional disclosures and increase communications to impacted parties. Additionally, the Rating Agencies would likely place the District on "watch" status which would result in annual rating reviews. Currently, the District's rating review is every two (2) years. The impact of multi-year non-compliance with the District's Debt Covenant, the bond insurer or bondholders could require the District to increase it rates to reach compliance. This would require the District to hire a rate consultant and, if needed, require a 218 notice to raise rates. Further, the rating agencies would likely downgrade the District's credit rating. Currently, the District has an "AA" rating with Standards & Poor's and an "AA-" rating with Fitch. Staff feels an overall financial risk and impact to the District of a downgrade is limited at this time as the budget presented today maintains the District's debt coverage ratio above the covenant level.

In response to an inquiry from Director Smith, Chief Financial Officer Beachem indicated that it was not a good idea to let the District's Debt Coverage Ratio drop below the Bond Covenant as the District has an implicit agreement with its bond holders. There are companies who may do that as they do not need to borrow for 10 years or so. However, the problem would be in the prospectus, the document utilized to market the bonds. Even if the District has a current rating of "AA-," if the District had dropped to a "A" rating over the last five (5) years, it will not attract purchasers as they will look at the rating and conclude that the agency is not that stable which would discourage them from buying the agency's bonds. It will also impact the District's ability to get good interest rates in future debt issuances.

Chief Financial Officer Beachem reviewed some of the budget highlights and reviewed the rate model and staff's process to develop the District's budget. He stated that, this year, the rate model includes the Governor's conservation mandates. The District is also looking to rebuild the District's Debt Coverage Ratio to 151% by 2018 and in every year, fund the operating budget ($89.1 million) and the capital budget ($11.1 million). This year, the District is utilizing reserves to offset the rate increase and the reserves are being maintained above the minimum level.

Each year staff rebalances the reserves in accordance with the District's Reserve Policy and propose the following inter-fund transfers (for a total of $12.6 million):

- Potable:
  - General Fund to Replacement - $2.4 million
  - Designated Expansion to Replacement - $3.5 million
  - Designated Betterment to Replacement - $2.1 million
  - Designated New Water Supply to Replacement - $0.7 million

- Recycled:
  - General Fund to Designated Expansion - $2.2 million

- Sewer:
  - Designated Expansion to Betterment - $0.2 million
  - General Fund to Replacement - $1.6 million

Staff is also proposing the net operating revenue transfers as follows (for a total of $10.61 million):

- Potable:
  - to Replacement Reserve - $2.4 million
  - to Sewer Replacement Reserve - $1.2 million
  - to OPEB Trust Fund - $0.9 million

- Recycled:
  - to Expansion Reserve - $2.7 million
  - to Betterment Reserve - $1.9 million
  - to Replacement Reserve - $0.31 million
  - to OPEB Trust Fund – $0.06
  - to New Supply Fund - $0.04

- Sewer:
  - to Betterment Reserve - $0.46 million

- to Replacement Reserve - $0.6 million
- to OPEB Trust Fund - $0.03 million

Chief Financial Officer Beachem indicated that staff had projected in last Fiscal Year's (FY) six-year budget projections a water rate increase of 4.7% in FY 2016. Staff is now proposing a slightly higher increase of 5.4% for FY 2016, which includes 12% water conservation by the District's customers. He noted that the proposed rate increase would allow for the Debt Coverage Ratio to rebound to target levels over time.

He explained with regard to the projected sewer rate increase, that the District had a large decrease in cost from the District's sewer processing provider and there were decreases in labor charges to sewer and, thus, the District is not proposing any rate increases for sewer services. He noted that there is, however, a $1.30/month system fee increase that was implemented in 2013 due to findings of the Cost of Service Study (COSS). The COSS found that the fixed charges were not covering the full fixed cost for sewer services and the board had voted in 2013 to phase in the increase to the fee in three phases. This is the last of the three phases for the increase.

He noted items in the Operating Budget that were holding down rates which included:

- Lower variable water rate increase from CWA/MWD than anticipated (1.9% projected CY16 vs. 10.1% budgeted; this is offset by the new Reliability Fixed charge of $1 million
- Reduction in 6-year CIP of $7.4 million
- Reduced water loss from 5% to 4% savings of $432,000
- Reduced FTE from 140 to 138
- Administrative costs decrease of $31,400
- Materials & Maintenance costs decrease of $7,000

He reviewed in detail the items that are putting an upward pressure on the District's rates:

- Water sales reduction of 12% (in volume from 2013 sales)
- Fixed CWA Cost increase of $1 million
- City of San Diego recycled "take or pay" increase of $104,300
- Power cost increase of $274,400
- 2016 Salary and benefit cost net increase of $463,000 while reducing by 2 FTE (does not include the FY2015 COLA)

He indicated with regard to the sewer budget that the:

- Reduction in anticipated rate increase reflects reduced service providers rates and lower labor charges to operations

- Typical residential customer will see a $1.30 monthly increase and no other rate increases are anticipated in the six year budget projections
- $13.9 million CIP over six years
- Final payment by Potable to Sewer for a prior loan
- Reserves are on target

Chief of Engineering Rod Posada presented the District's projected six (6) year CIP from 2016 to 2021. He stated that staff utilized Mr. London's and the developers' projections to develop the District's growth projections which is presented in slide number 38 of staffs' report (see attached copy of presentation). He indicated that 149 units of Single-Family homes, 297 condominiums and 150 apartment units are projected in FY 2016. There will also be approximately $35 million in commercial development.

He indicated the development of the CIP budget for FY 2016 was based on the following guidelines:

- Growth would remain relatively flat in FY 2016
- New developments will have a greater proportion of multi-family dwellings versus single-family dwellings
- In preparing the budgets for the individual CIP projects, the Engineering Department used current construction and bidding data to adjust costs for each project
- Reprioritized projects based on District's planning documents and Water Supply Assessment and Verification reports

He stated in the development of the CIP budget for FY 2016, staff reprioritized projects based on the District's planning documents, Water Supply Assessment reports and Developer requests and estimates the CIP Budget requirement for FY 2016 is $11.1 million. The six-year CIP Budget total for FY's 2016 to 2021 is $96.2 million. He indicated that Director Smith inquired why there was a big difference between last year's forecast for FY 2016 ($23.4 million) and this year's forecast for FY 2016 ($11.1 million). He explained that the District had reprioritized two projects; the Desalination Project and the 870-2 Pump Station. He stated that it was expected that the Desalination Project would be in the design phase and the 870-2 Pump Station would be in construction in FY 2016 with an approximate cost of $11 million. He also explained that the difference in the six-year CIP total expenditure projections between last year of $103.6 million and today's projection of $96.2 million is mostly due to the moratorium for recycled water projects and a reduction of $3 million in sewer projects.

He presented the high profile CIP projects which included:

- Campo Road Sewer Replacement, $5.1 million
- Otay Mesa Desalination Conveyance and Disinfection System, $26.8 million
- 870-2 Pump Station Replacement, $15.2 million

- Sewer System Rehabilitation, $4.6 million
- Reservoir Improvements, $11.3 million

for a total expenditure of $63.0 million.

He indicated of the $96.2 million projects in the CIP Budget, $56.3 million is designated for capital facility projects (including developer reimbursement projects), $35.9 million for replacement/renewal projects and $4 million for capital purchases. In response to an inquiry from Director Smith, Chief Financial Officer Joe Beachem indicated that it is approximately 2/10 to 3/10 of a percent and that assumes that there is some borrowing between funds.

Accounting Manager Rita Bell presented the details of the FY 2016 Operating Budget and the how the budget was developed. She indicated that the District's water sales projections for FY 2016 are based on FY 2013 actual sales less 12%. She stated that staff also developed the growth rates based on projections by The London Group and the Engineering Department. She stated that the District strives to maintain its water and sewer rate positions relative to other agencies in the region and would normally be providing charts showing how the District's rates compare to other water and sewer agencies in the region. However, the agencies, at this time, are deciding what their strategies will be in order to comply with the Governor's mandate. Staff will bring the charts back to the board once the information is received from the other agencies.

She indicated that projected potable water sales of 11,704,000 units for FY 2016 is the lowest sales projection since 2011. Water sales are expected to decrease 1,012,300 units (or 8.6%) in the FY 2015 to FY 2016 budget projections. The reduced water sales decreases the District's water sales revenues by $2.3 million (or 3.2%). The impact to the typical single-family residential customer utilizing 14 units of water per month is an increase from $81.67 to $85.69 per month.

Accounting Manager Bell indicated that staff left recycled water sales the same in FY 2016 as last year. The projected recycled water sales volume is 1,723,100 units. Recycled sales revenues will increase $284,600 (or 3.2%). A portion of the increased revenue for recycled water sales, $117,400, is attributed to the FY2015 rate increase and volume changes and $167,200 is due to the assumed rate increase for FY 2016.

She also reviewed the sewer sales revenues and indicated that sewer revenues will increase $198,000 (6.6%) in FY 2016 due to the January 1, 2015 rate increase and system fee phase-in (of $1.30) from the prior year's budget. She indicated that in FY2016 budget staff had determined a:

- $3.5 million decrease in the 6-year sewer CIP
- $2.4 million decrease in operating expenses over the 6-year rate model
- $0.3 interest expense savings

These savings have resulted in no rate increase for sewer services over the six year rate model, except for the system fee increase for residential customers, and the District has avoided the need for a $3.8 million debt issuance.

The District receives revenues from other sources which include:

- Property Tax Revenues will increase $135,100 (4.4%)
- Betterment Fee Revenues will decrease $301,800 (100%) due to the expiration of betterment fee revenues (betterment fees are being shifted to water rates); this is revenue neutral
- Capacity Fee Revenues will decrease $15,800 (1.4%) due to a decrease in developer activity

She stated that the District's water cost is decreasing $1,179,000 or 2.6%. She reviewed the reasons for the water cost decreases which included:

- Variable Cost Increase:
    - Potable cost decrease of $2,189,400 or 6.3% (purchasing less potable water)
    - Recycle costs will not change
- Fixed Cost Increase:
    - Potable costs increase of $1,010,400 or 9.2% due to a rate increase from the District's water suppliers (CWA and MWD); $950,000 of the increase is due to their new reliability charge
    - There is no change in the recycled water costs
- Take or Pay
    - Contractual agreement (with City of San Diego) is causing a recycled cost increase of $104,300 or 18.5%

She indicated that sewer costs will decrease $475,900 or 17.5% in FY 2016 due to an O&M cost decrease of $205,000 from the City of San Diego Metro Commission. The Spring Valley Sanitation District's O&M charges will also decrease $93,200 and all other costs (primarily labor and benefits) will decrease $177,700 in FY 2016. This is primarily due to improvements made by the District's Operations department.

Accounting Manager Bell stated that power cost from SDG&E is estimated to increase $274,400,100 or 9.7%. The reasons for the increase include:

- Water demand decrease of 8.9% for potable and no change for recycled
- SDG&E had indicated last year that there would be four (4) separate 2.5% rate increases in FY 2015. They actually increased their rate 22.4% over the period. The District had budgeted 10% of the increase and will need to raise rates to catch up. The District, thus, has gone over budget on its power costs due to the larger than anticipated rate increase from SDG&E.

In response to an inquiry from Director Robak, General Manager Watton indicated that staff had reviewed the possibility of implementing solar energy for the District. However, the leased terms and the cost of the power did not provide the savings that would make it cost effective for the District at that time. Today, the lease terms and the cost of solar power is different and the District believes that it is time to look at solar power again and determine if it could provide power cost savings. The District has a solar vendor reviewing the District's power needs and they should be submitting a proposal to the District soon.

Director Croucher indicated that the District should include in its outreach materials, that the District had received a 22.4% rate increase from SDG&E over the last year. He stated that it is important for the District's customers to know what is impacting their water rates.

General Manager Watton indicated that SDG&E was proposing last year to change their on-peak and off-peak hours which would have drastically increased the District's rates even more as the District utilizes the off-peak hours to pump water into its reservoirs and move water around its service area.

Director Thompson indicated that he would like to see a timely communication to the Board of the outcome of the solar review. He stated that there may be some timing issues in the District installing or not installing solar and anything that would make the District less dependent on an energy provider is worthwhile exploring as energy is a large expense in the District's budget.

Director Croucher suggested, with regard to the State Water Board's action, that if the District is receiving complaint letters from its customers, it would be helpful to share those with the State Water Board. They hear the representatives from the different agencies share their customer complaints, but hearing it from our customers directly would have more impact.

Assistant Chief of Administration and Information Technology Adolfo Segura 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, two (2) vacant positions were deleted reducing the fulltime equivalent (FTE)/headcount from 140 to 138 in FY 2016. He stated that the District has reduced the number of staff members from 174.75 in 2007 to 138 in 2016; a reduction of 36.75 employees or 21%. The cumulative cost savings from the reduction in staffing is approximately $23,935,600 from 2007 to 2016. From an efficiency standpoint, the customer to employee ratio has increased from 301 customers serviced per employee in 2007 to 396 customers serviced per employee in 2016 or an increase of 31.5%.

He indicated that salaries and benefits have increased $463,000. The items increasing salary and benefits include:

- Increase in salaries for negotiated COLA and performance based increase of $203,200 or 3.3%
- Increase in pension costs of $280,000 or 8%
- Increase for staff advancements of $137,000 or 1.3%
- Increase in health costs of $228,600 or 4.9%
- Increase in other benefits such as Social Security and Medicare of $65,300 or 2.2%

Offsetting the increases in salaries and benefits are a:

- Decrease in the staffing level of ($106,700) or -1%
- Decrease in temporary position of ($98,500) or -0.9%
- Decrease in allocation to work orders ($50,800) or -2.1%
- Decrease in overtime, vacancy factor, vacation/sick, and workers compensation of ($153,100) or -1.2%
- Decrease in OPEB, offset by employee contributions (on track with 2013 actuarial valuation) of ($42,000) or -2.9%

Director Robak commented that the District is constantly improving its employee to customer ratio and inquired if staff has compared the District's ratio with other agencies. Chief of Information Technology Stevens indicated that the District has done that comparison. The last time staff had done the comparison with the District's neighboring agencies, the District was doing better than its neighboring agencies. Staff indicated that there is not an AWWA threshold as AWWA utilizes much larger agencies and, thus, it is difficult to do a true comparison. Staff set the target for comparison based on the District's budget.

Director Thompson noted that there was a significant increase in pension cost, an 8% increase, which was not taken into consideration. The increase is very high and he understands that the District does not control this increase. Healthcare costs had a little less increase, however, the increases are significantly above the rate of inflation. He indicated that he felt that one of the things the District needs to do is to keep its total salary and benefits close to inflation. He indicated that he understand that the District does not have much control over these increases, but he would like to encourage staff to continue to look at those areas that we do control and figure out how to keep costs to a minimum.

The board recessed at 5:23 p.m. and reconvened at 5:33 p.m.

Assistant Chief of Operation Jose Martinez presented on the District's materials and maintenance costs. He stated that despite inflation and investment in the leak detection program, the District's materials and maintenance costs have gone down. He noted the reasons for the overall decrease of ($7000) or -0.2%:

- Decrease in the Metro O & M of ($205,300) or -20.1%
- Decrease in the Spring Valley Sewer of ($93,200) or -33.9%

- Decrease in the unit cost of Fuel and Oil of ($53,700) or -17.6%

The above decreases were offset by the following increases:

- Increase in Contracted Services of $107,200 or 18.2%
- Increase in Safety Equipment by $83,100 or 188%
- Increase in Other Materials & Supplies by $58,700 44.5%
- Increase in Infrastructure Equipment & Supplies of $96,300 or 18.3%

He noted that because of the District's investment in equipment and technology and continually enhancing its business processes, it has been able to reduce its fuel consumption by 36%, the number of vehicles (pool and construction) and equipment (generators, backhoes, vactor trucks, etc.) has gone down 17%, and recycled water DEH charges for inspection fees was reduced from $40,900 to $8,000 (or 80%) over the last ten (10) years. He also shared that the District has been able to reduce its water loss through its "Leak Detection and Repair Program" from 5.8% in FY 2011 to 3.2% (45% decrease) in FY 2015, which is much below the national average of 15%.

Accounting Manager Bell reviewed the District's Administrative Costs and indicated that the District's overall administrative costs decreased $31,400 or -0.6%. The decreases in costs included:

- Decrease in legal expense of ($160,000)
- Decrease in insurance of ($45,000)
- Decrease in equipment of ($27,300)
- Decrease in fees of ($25,700)
- Decrease in overhead allocation of ($19,900)

Increases in Administrative Costs included:

- Increase in Outside Services of $150,000 for conservation outreach efforts
- Increase in Leak Detection of $107,500 (one-time cost)

She stated that staff is presenting for the board's consideration a budget that estimates a 12% conservation level with a potable budget of $76,667,400, a recycled budget of $9,117,900 and a sewer budget of $3,303,300 for a total budget of $89,088,600. The budget is supported by a 5.4% average rate increase for water and only a system fee increase for sewer residential customers.

The presented budget also supports the water and sewer needs of the District's customers and the Strategic Plan. Staff indicated that the recommended 12% water conservation level would allow for up to 17% conservation and the FY 2016 budget will be presented for the board's consideration at the June 3, 2015 regular board meeting.

Director Croucher inquired if there is room in the budget if the board should wish to explore pilot projects, such as, ideas to respond to conservation. General Manager Watton indicated that staff has not budgeted funds for that general category. He stated that if the initiative required a few thousand dollars, it can probably be funded into the customer communications budget. However, if there is a project that requires much more funding, staff would need to present the project to the board as a discreet item to be added to the budget at that time. He noted that the budget would show a negative ending balance which would go into the next year's budget.

Director Thompson inquired with regard to the proposed rate increase, why the increase is front loaded (rate increase of 5.4% for FY's 2016 to 2018; and rate increases of 3.8% for FY's 2019 to 2021) versus equalizing the increases over the six (6) year budget rate model. Chief Financial Officer Beachem indicated that the estimated 12% reduction in sales is significant and in order for the District to maintain its debt coverage ratio, rates need to be high enough to maintain the ratio. Staff indicated that they did try to normalize the rates, however, the proposed six-year rate model was the closest they could get to equalized increases over the period. Following three years of 5.4% increases, the District needs to drop the rate significantly to reduce the revenue inflow to where it should be by that point in time. Staff additionally noted that some of the conservation accomplished by the District customers will continue as once a customer takes measures to increase conservation (ie., Xeriscape their landscape, install a new irrigation timer, buy new water efficient appliances, etc.) that impacts their future water use permanently. Staff is estimating that half of the water use savings will come back, but some will be permanent. Staff utilized historical data from previous water use cutbacks to develop the estimates, but staff can modify this assumption. It was noted that this is reviewed each year and staff can make modifications if the actual is different from staff's estimates.

Chief Financial Officer Beachem indicated that if 12% savings is compared with 10% or even 8% savings, the rate does not change too significantly and the level of conservation wherein the bond covenant is violated does not change that significantly as well. With regard to high levels of conservation, staff feels that it is very unlikely that customers can reach those levels of conservation. Staff expects that they will not be absolutely accurate on the conservation level, but feels that 12% is a reasonable estimate of the conservation that customers can achieve.

Director Thompson indicated that he felt that proposing a rate increase for master metered customers and the tier structure for these customers did not make sense to him. He stated that he will likely state this concern again when the District performs its next rate study.

In response to an inquiry from Director Smith, Chief Financial Officer Beachem indicated that the District will be drawing down the reserves by $12.2 million with the 12% conservation level. He stated at the peak, approximately three (3) to (4) years out, the District will be below reserve target by about $5.2 million, but in six (6) years the District will be back on target. Director Smith indicated that he felt that it would be difficult to explain to the District's customers that it is reducing its rate increase during the drought and he would prefer not to draw down the District's reserves. He would like to propose a 5.8% increase for FY 2016 with the intent to lessen the draw on reserves.

Director Croucher stated that he felt that now, during the drought, is the time to draw on reserves. He stated he supported the budget as it is presented. Director Thompson indicated that there are reasonable assumptions in staff's recommendations and the board could look at a larger rate increase next year if staff is off on some of its assumptions. He stated that his customers always discuss with him staff salaries and rate increases. He stated that he supported the proposed 5.4% increase as opposed to something higher with the understanding that the reserve levels would be adequate.

Chief Financial Officer Beachem indicated, in response to an inquiry from Director Robak, that the other local agencies are still trying to determine what conservation level they will propose and, thus, are not ready to provide their rates. Staff will bring back to the board the rate comparison chart for all the agencies as soon as they can.

President Lopez thanked staff for the good work they have done on the budget. He indicated that it was well done and well presented. General Manager Watton indicated that staff will bring the budget back to the June 3, 2015 board meeting for consideration by the board.

7. ADJOURNMENT

With no further business to come before the Board, President Lopez adjourned the meeting at 6:08 p.m.

____
President

ATTEST:

____
District Secretary