

**MINUTES OF A SPECIAL MEETING OF THE  
BOARD OF DIRECTORS OF THE  
OTAY WATER DISTRICT  
November 18, 2015**

1. The meeting was called to order by President Lopez at 3:46 p.m.

2. ROLL CALL

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

Directors Absent: None

Staff Present: General Manager Mark Watton (arrived at 3:49 p.m.), General Counsel Dan Shinoff, Asst. GM German Alvarez, Chief Financial Officer Joe Beachem, Chief of Water Operations Pedro Porras, Chief of Engineering Rod Posada, Assistant Chief of Administration and IT Services Adolfo Segura, Assistant Chief of Water Operations Jose Martinez, District Secretary Susan Cruz and others per attached list.

3. PLEDGE OF ALLEGIANCE

4. APPROVAL OF AGENDA

A motion was made by Director Thompson, and seconded by Director Croucher 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.

WORKSHOP

6. DISCUSSION OF CONSERVATION'S IMPACT ON REVENUES AND THE CITY OF SAN DIEGO'S PROPOSED RECYCLED WATER RATE INCREASE; PRESENTATION OF A NUMBER OF FINANCIAL CONSIDERATIONS WITH REGARD TO THE CURRENT BUDGET IMPACT AND FUTURE RATE

## INCREASES; AND REQUEST FOR THE BOARD CONSIDERATION AND DIRECTION

Chief Financial Officer Joe Beachem indicated that this workshop is scheduled today to discuss two issues that will significantly impact the District's budget: 1) the City of San Diego's vote to increase reclaimed water rates; and 2) the District's customer water conservation rate which is much higher than anticipated.

He presented the District's customers actual conservation level from July to October which is 26.24%. He stated that staff is projecting conservation through the end of the year will be 25.7%. He noted that the State's mandated conservation for the District is 20%. Mr. Beachem stated that the conservation level wherein the District would begin to violate its bond covenant is 17.2%. The District had budgeted a conservation level of 12% and as much as the District hoped that there would be a rebound in water sales, at this point staff is projecting a smaller rebound than anticipated. He noted that for every 1% of potable conservation, the net budget impact is \$102,000 and the total net budget impact of 1% recycled conservation is \$34,000.

In response to a question from Director Robak, Chief Financial Officer Beachem indicated that potable conservation is 10% higher than what was budgeted, and stated that he did not have the figure for recycled water. He noted that the State Governor has extended the water conservation mandate through October 2016.

Chief Financial Officer Beachem indicated with regard to recycled water, the City of San Diego has voted to increase their recycled water rate to the Otay WD 116.25% effective January 1, 2016. He stated that the fiscal impacts from customer conservation and the rate increase from the City of San Diego is approximately \$2,390,000 (please reference slide 4 of the attached powerpoint presentation for a breakdown of the \$2,390,000).

Mr. Beachem reviewed in detail how the additional expense of \$2,390,000 will impact the District's debt coverage ratio and bond covenants. He also reviewed costs that staff has identified that can be avoided and some revenue that will be greater than anticipated to help mitigate the increased costs and reduced revenues. He indicated, however, that these cost savings will not fully mitigate the impact of the increased recycled water cost and reduced revenues due to mandated conservation.

He noted that conservation and the recycled water rate increase from the City of San Diego will have an ongoing impact to the District's budget and the sooner the District can implement a rate increase, the smoother the impact is to the District's rates and the more connected the increase is to the City's actions and the Governor's mandate.

Chief Financial Officer Beachem reviewed the different rate increase options and indicated that a rate increase of 8.6% would only pass through the City of San

Diego's recycled water rate increase and would give the District low protection from violating its bond covenants. Implementing a 9.9% rate increase would put the District back, or very close to budget, and give moderate protection. Staff recommends implementing a rate increase to be effective March 1, 2016.

General Counsel Daniel Shinoff indicated that violating bond covenants can result in serious implications for the District.

Director Smith inquired if the District could increase its recycled water rate from 85% of the potable rate to 90-95%. Mr. Beachem stated that the District has a recycled water agreement with CWA that restricts the District from going above 85%. If the District were to do so, it would lose future credits equal to the amount of extra revenues gained from increasing the District's recycled water rates. Director Smith indicated that customers will inquire why potable rates are impacted by an increase to recycled water rates. General Manager Watton indicated that, per Proposition 218, the City of San Diego's recycled rate increase cannot be placed fully on recycled customers. He indicated that water is water, whether it is recycled or potable. The cost of water is discounted by 15% for recycled water.

Director Croucher suggested that staff approach CWA to see if there is a possibility of amending the District's agreement as it would help alleviate the unanticipated rate increase from the City of San Diego.

Director Smith commended staff for identifying budget savings and the deferral of costs outlined on the last page of the staff report.

In response to questions and comments from several members of the board, Chief Financial Officer Beachem stated that deferring or eliminating Capital Improvement Projects do not affect the District's debt coverage calculation as those expenditures do not become revenues, they would just remain in reserves.

General Manager Watton added that staff developed the Capital Budget as a 6-year plan. Many of the projects are maintenance (the extension of the life) of existing facilities. If these projects were to be deferred, it would work temporarily, however, the District is just postponing the Capital Investment for maintenance to another time in the future. Thus, those projects would really not go away, they accumulate until they are scheduled and completed sometime in the future. Chief Financial Officer Beachem further indicated that if the District had a significant sized capital project that could be permanently deleted, then it may provide enough reserves to possibly pay-off some debt, which would have an immediate impact on the District's debt coverage ratio. Otherwise, a year-to-year shift in the CIP projects would not provide a positive impact to the debt coverage ratio.

General Manager Watton stated that staff will review the Capital Budget for the next fiscal year and look into the possibility of deferring CIP projects, as well as, other alternatives that may help avoid increasing the District's water rates.

Director Croucher stepped off the dias at 4:31 p.m.

In response to comments from General Manager Watton, Director Smith stated that it is important to understand that there may be additional costs associated with the City of San Diego's recent action that are not included in staffs' presentation at this time. Chief Financial Officer Joe Beachem also added that it is anticipated the El Niño storms will impact the District's budget.

Director Croucher returned to the dias at 4:34 p.m.

Assistant General Manager German Alvarez clarified that the District's 9.9% proposed water rate increase includes the City of San Diego's unitary increase.

Director Thompson inquired if staff has considered a hiring freeze to assist with the budget. General Manager Watton stated that the District has downsized over the years by not filling vacant positions. He indicated that there will be two staff members who will be retiring (one in December 2015 and one in February 2016) and the District does not plan on filling their positions. In the last 7-8 years, when a vacancy occurs, the District reviews the position and determines if its duties can be automated or distributed without impacting the workload of other staff members in order to economize and increase efficiency.

Director Thompson recommended that staff defer hiring new staff members until the District has a better handle on the impacts of the City of San Diego's rate increase and conservation. If it is necessary to hire new employees, he recommended that staff members provide a justification to the board.

In response to comments from Director Smith and Croucher, General Manager Watton stated that he will have staff discuss the format of the District's water rate increase notices. It was discussed that the notices should include detailed information on how the 9.9% water rate increase will be distributed and that it should also include a comparison chart of where the District stands in comparison to other agencies with regard to water rates. Mr. Watton also stated that he will have staff draft a document that provides information on what the District has done over the years to offset water rate increases (i.e. reduction of fleet and personnel, etc.). Director Thompson suggested the document should be added to the District's website for customers to access. Director Croucher also suggested that staff provide information concerning MWD's illegal rates, the outcome of the County Water Authority's (CWA) litigation with MWD regarding their illegal rate structure, and that CWA is in the process of trying to get those funds back.

Assistant General Manager Alvarez provided additional information with regard to the downsizing of personnel. He indicated that this year the District has eliminated the following positions: Chief Information Officer, Assistant Buyer, Network Analyst, and a Customer Service Manager. This was made possible

through automation, restructuring the organization and handling workflow differently.

Director Thompson further commented on the different rate alternatives provided in staffs' presentation and stated that he would prefer the 9.9% rate increase to be implemented now for reasons cited by staff. He stated that it would coincide with the City of San Diego's rate increase and would also protect the District's bond covenant.

In response to a question from Director Smith, Chief Financial Officer Beachem indicated that with the implementation of a 9.9% rate increase, the District would have 25.7% conservation level built into the budget. In the next year, the conservation level will increase to 1%, then 2% the year after. Director Smith stated that he is comfortable with the proposed 9.9% rate increase as it would allow the District to collect the appropriate revenues to cover unknown impacts, such as, El Niño and landscape modifications by customers who want to conserve water.

Director Croucher discussed the contract between the District and the City of San Diego with regard to the District's treatment facility and inquired when the contract will expire. Finance Manager Bell indicated that the contract expires at the end of 2026. General Manager Watton commented that the City is dependent on the District's facility for storage and noted that any water that is delivered from the District's reservoir is treated. The City of San Diego also utilizes the District' conveyance system to deliver water to its customers. It is felt that the City of San Diego owes the District for a portion of the O&M costs associated with the District's facilities that they utilize. General Manager Watton indicated that staff plans to work with the City of San Diego's staff to negotiate contract terms that would respond to the issues impacting both agencies. General Manager Watton recommended that the board discuss this matter further in closed session with legal counsel.

At the request of President Lopez, District Secretary Susan Cruz made a note to schedule a Special Board Meeting in December 2016 to further discuss the contract between the District and the City of San Diego.

In response to a question from Director Croucher, Finance Manager Bell indicated that the Take-or-Pay Agreement with the City of San Diego requires the District to take 4604 AF of recycled water in calendar year 2015. The District has budgeted to take 2900 AF in calendar 2015 and is currently behind in its sales. However, General Manager Watton commented that developer projects are starting up again in the City of Chula Vista, which means there will be a need for recycled water for grading.

Director Thompson requested that staff perform a thorough review of potential recycled water customers. General Manager Watton shared that the District had a pilot program for Home Owners Associations (HOAs) to convert their community landscapes to utilize recycled water. Mr. Watton stated that staff will

look into the feasibility of offering this program again to potential recycled water customers.

Director Croucher requested that staff also inform customers of the District's limitation in providing tiered rates due to restrictions within Proposition 218.

In response to a question from Director Thompson, Chief Financial Officer Beachem stated that board members will be able to review and further discuss the language in the rate increase notices at the Special Board Meeting in December 2016. Director Thompson suggested that if the board required a follow-up discussion on the rate increase notices, an Ad Hoc Committee could be scheduled to follow the Special Board meeting.

President Lopez stated he will consider implementing an Ad Hoc Committee to review and discuss the language in the rate increase notices. He then requested that the Special Board Meeting be scheduled in the second week of December.

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

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

to approve a rate increase of 9.9% and that the District form an Optimization Ad Hoc Committee.

## 7. ADJOURNMENT

With no further business to come before the Board, President Lopez adjourned the meeting at 5:28 p.m.

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President

ATTEST:

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District Secretary