



**STANDING ADVISORY COMMITTEE WORKSHOP
MINUTES
November 1, 2011**

The Standing Advisory Committee met at Truckee Meadows Water Authority in the Independence Room, 1355 Capital Blvd., Reno, Nevada. Chairman Vorreyer called the meeting to order at 3:05 p.m.

Chairman Vorreyer welcomed Mike Pagni, Legal Counsel, and John Bonow and Brian Thomas, Public Financial Management (PFM), TMWA's financial advisors.

1. ROLL CALL

Members Present: Ernest Buchner, Colin Hayes, Neil McGuire, Jeannie Redinger*, Fred Schmidt, Ron Turner and Greg Vorreyer

Alternates Present: Harry Culbert (voting), Mike Heffner, Jim Smith*, and Paul Rose*

Staff Present: John Erwin, Mark Foree, Kim Mazeres, Lora Richards, Jeff Tissier, Scott Estes, Shawn Stoddard, and Mike Pagni, Legal Counsel

2. PUBLIC COMMENT

There was no public comment.

3. APPROVAL OF THE AGENDA

**Upon motion duly made and seconded, and carried by
unanimous consent of the members present, the Committee
approved the agenda.**

4. APPROVAL OF THE MINUTES OF THE OCTOBER 4, 2011 MEETINGS

**Upon motion duly made and seconded, and carried by
unanimous consent of the members present, the Committee
approved the minutes of October 4, 2011.**

**5. STATUS REPORT ON THE MERGER OF THE WASHOE COUNTY DEPARTMENT
OF WATER RESOURCES WATER UTILITY FUNCTIONS INTO TMWA,
INCLUDING A 5-YEAR FINANCIAL UPDATE AND REVENUE SUFFICIENCY
REPORT**

General Manager Mark Foree said that there is nothing new to report at this time. The Washoe County Bond Bank Ordinance, which will ultimately help the merger in terms of refinancing the

Washoe County Department of Water Resources (DWR) publicly-issued debt with more favorable terms, is going to be on the November 8, 2011 agenda of the Board of County Commissioners.

6. PRESENTATION OF STAFF'S PROPOSAL WITH REGARD TO POTENTIAL RATE ADJUSTMENT, INCLUDING BACK-UP DOCUMENTATION, REVIEW AND DISCUSSION

Mr. Tissier introduced John Bonow, who had been TMWA's financial advisor since 2001. Due to Mr. Bonow's recent promotion to CEO of PFM, his duties are transitioning to Brian Thomas. Mr. Tissier invited Mr. Thomas to introduce himself and tell the Committee about his background. Mr. Thomas said he had served in the public sector for almost 30 years before joining PFM as a Managing Director in the Los Angeles office in February, 2011. For the last 10 ½ years, Mr. Thomas was Chief Financial Officer and Assistant General Manager for the Metropolitan Water District of Southern California, the nation's largest supplier of treated drinking water. He was responsible for all financial functions including treasury and debt management, water rates and charges, water rights and negotiating water transfers. At PFM, Mr. Thomas will primarily focus on western water and wastewater utilities helping with everything from rates and charges to financing restructuring. Mr. Thomas has a Bachelor of Science in Biology and a Bachelor of Science in Economics from California State Polytechnic University, Pomona. He also has a Master's degree and a Ph.D. in Economics from the University of California, Riverside.

Mr. Tissier stated the basis for the proposal that Mr. Erwin will present had been developed from the five-year (FY 2012-2016) financial forecast.

Mr. Erwin presented the rate proposal, beginning with the following graphs:

FY2001 – FY2011 Water Production vs. Sales

Even with the rate increases in 2009 and 2010, revenues have not increased. Water production was at its highest in 2007 and water production in years since has declined annually. With decreased water production, comes decreased water revenues. Decreased production is due partially to weather and partially to the economic conditions that exist in the region. In answer to a question as to how much of the decline can be attributed to conservation, staff replied that the same conservation programs have been in effect since 2001 with the exception of changing water days from two to three days a week, which had minimal or no impact on consumption. The weather has been trending toward cooler spring months since 2007 and cooler weather in April, May and June can result in an estimated decrease of between \$1.5 million to \$2.5 million in water sales. Studies throughout the water industry have shown that weather and economics play a greater role in demand than conservation or price.

FY2002 – FY2011 Operating Revenues, Investment Income and Grants

Total income from all sources has decreased from a high in 2007. The decrease again is due to the economic climate. In 2009, the annual revenue projection was anticipated to get close to \$77 million which is the same revenue target with this current rate increase.

Operating Expenses

There has been an 18 percent decrease in operating expenses in the past two years from a high of approximately \$40.2 million in FY2009 to approximately \$33.2 million in FY2011. This is due to a diligent, concerted effort on behalf of all TMWA employees. Savings in power costs of \$2.9 million from a high of \$7.2 million in FY2009 to \$4.3 million in FY2011 were due to expanded gravity feed of raw water to Chalk Bluff, energy management and time of use pumping. Savings of approximately \$1.3 million from the Voluntary Separation Program (VSP) will be realized in FY2012 and has been factored into the forecast. Mr. Erwin encouraged the Committee to review the report on all cost-containment measures and also the customer satisfaction report that were included for the October 19, 2011 Board meeting.

Mr. McGuire asked how TMWA compares to comparable municipalities. Mr. Foree explained that TMWA compares very favorably when compared to the national benchmarks related to efficiency. TMWA ranks between the median and top quartile for the number of customers per employee and that ranking will be even better next year due to the reduction of 15 FTEs due to the VSP. TMWA ranks well into the top quartile for the average million gallons per day delivered per employee.

Components of Water Sale Revenues and Components of Cost of Service

Mr. Erwin explained that revenues and expenses fall into two categories: fixed and variable.

Fixed revenues come from customer charges plus the flat rate customers; variable revenues come from usage volumes. Fixed Water Sales comprise 39 percent while Variable Water Sales comprise 61 percent of total water sale revenue.

Fixed expenses are those that are incurred even if no water is sold, such as wages and benefits, debt payments, repair and replacement costs, and certain services and supplies. Variable expenses, which are predominately power and chemicals, are tied directly to the sale of water. Fixed expenses comprise 91 percent of the total cost to serve customers while variable expenses comprise only 9 percent of the total cost to serve customers.

To highlight this disparity fixed water sales revenue is 39 percent of total water sales while fixed expenses are 91 percent of the cost to serve customers. Variable water sales comprise 61 percent of total water sales and variable cost to serve customers is 9 percent.

Projected Cost of Service and Revenue Deficit

Mr. Erwin said that in FY2014, TMWA's projected total Revenues Required from Rates will be \$80.588 million while the FY2011 Revenues from Rates is only \$71.717 million. This equals a deficit of \$8.871 million. The question is how to close this gap over the next three years. The Committee discussed the issues involved in revenue requirements, how staff reached the financial forecast for FY2014, and why it is so important that the gap be closed during the next three years. Mr. Tissier explained how Unrestricted Cash was used over the past few years to close the gap between revenues required and revenues received and for repairs to the Highland Canal due to the earthquake in 2009. This use of unrestricted cash cannot continue if TMWA is to remain a viable and have cost effective access to the bond market. He asked Mr. Bonow and Mr. Thomas to comment on this.

Mr. Bonow said “Debt Service is TMWA’s single highest fixed component cost at \$32 million annually. As with a lockout period on a personal mortgage, this debt cannot be refinanced at the present time. If the gap of \$8.8 million is not closed over the next few years, TMWA will not be in a position in 2015 to refinance the debt (if the market affords the opportunity). Because you will have burned through your cash, in 2015 the market will not like your credit, resulting in higher interest rates, worse terms and higher borrowing costs. TMWA’s cash reserves are already half of what they were just a few years ago because of a number of factors, the least of which is that you are \$7 million short of where you wanted to be just on the revenue side. There are two major decision points in the capital structure: 1) next year your letter of credit (the line of credit on the commercial paper program) is up for renewal. This is your lowest cost debt and you must present good credit to the market place to get good terms. 2) In three years the various elements of your fixed rate bonds will come up for refinancing. You want to be able (if the market is there and affords you the opportunity) to lower that cost much like you lower your personal fixed-rate mortgage by refinancing it. However, if TMWA continues to burn cash at the rate of \$7 or \$8 million per year just to make up the difference between revenue and cost of service, you will not be in a very good credit position in 2015 to take advantage of that refinancing opportunity. Our goal is to try to position you well enough to do that. There are a number of risks you cannot control: water sales, the weather or interest rates. However, if the interest rates are there, at least that is something we can take advantage of.”

Mr. Thomas said “the only thing I would add is in the short time that I have been able to look at what you are doing, you’ve done a great job of financial planning; this is about executing that plan. To put yourself in the position to be able to take advantage of whatever financial flexibility you can build into the system. If you’re in this position where your cash balances are down below \$20 million , you will have used up everything you can do and you are going to be in a position to have to do something pretty desperate because you are not going to be able to take advantage of the market. You cannot continue on a path where you are just drawing down cash. You do not want to do that so it is all about what is the best way to execute this plan and put yourself in a position in two or three years to execute on that plan.”

Mr. Schmidt asked Mr. Bonow and Mr. Thomas what level of cash reserves needs to be maintained to be able to refinance the debt in three years and does it matter.

Mr. Bonow said “Cash reserves do matter because cash is the only flexible part of TMWA’s financial program, but it is not the only factor. Debt service coverage, the distance between net operating revenue and debt service expense, is a big determinate and then cash balance is probably the second largest determinate in the minds of rating agencies. They need to see that the fund balance trend is being managed; given the magnitude what you cannot manage on the risk side. The rating agencies like to see the percentage of expenses being maintained in cash reserves.”

Mr. Bonow added “I think a good rule of thumb is that cash reserves need to be greater than the \$40 million range to have flexibility when there is an opportunity to be back into the market place. TMWA will have to be in the market place to renew the line of credit on the commercial paper program when it expires next year. The commercial paper program needs to be kept alive as it is TMWA’s lowest source of debt.”

Mr. Tissier talked about debt service coverage. He said that the reason Fitch gave us the

negative watch is because our debt service coverage reached the minimum requirement in our bond covenants of 1.25. That has recovered to the low 1.40s but even at that, TMWA is still not presentable to the market to make any type of meaningful refinancing (refunding) issue.

Ron Turner asked to clarify the senior lien coverage ratio. The minimum coverage ratio that was adopted as policy by the Board is 1.25 with the coverage for FY2011 at about 1.43. With the proposed rate increases, this could comfortably be in the 1.50-1.55 range within a few years, which would be a very positive result for opportunities for refinancing.

Chairman Vorreyer asked how the credit markets will look at deferring capital expenditures.

Mr. Bonow said, "The credit markets are concerned about under investing in the system. They do not like deferred maintenance. It heightens the risk that a system or main will fail; so, if there is a low fund balance, that is particularly troubling to them."

Chairman Vorreyer turned to meeting back over to Mr. Erwin for his presentation on the rate proposal.

Mr. Erwin said that now that the background has been discussed as to why a rate increase is needed, the next part of the presentation is going to be a discussion of the various elements of the plan itself. He said that this is staff's recommendation and the Committee could well have a different recommendation for the Board and staff understands that. Again, a five-year funding plan has been completed from 2012 through 2016. Revenues have been flat the last two years, even with the rate increases in 2009 and 2010. Today we will talk concept with you and get you through the numbers so then you can mull it over; if we get somewhere today great, if not, we have the December meeting.

Mr. Erwin went through the entire presentation, page by page.

- S-1 The changes in the average monthly bills using the proposed increases for ¾" Flat Rate and Metered Rate Single Family Residence

- C-2 through C-4 **Classification of Expenses for FY2014** for the Net Plant, Repair & Replacement, and Operations & Maintenance and Administrative & General into the various categories of commodity, demand, customer and fire.

- C-5 **Summary of the Total Revenue Required to be Derived from Rates.**
In FY2014, the total is \$80,602.

- A-6 and A-7 **Commodity and Demand Allocators** are shown which are used to allocate costs related to consumed volumes by the various customer classes.

- A-8 and A-9 **Customer and Fire Allocators** related to the average number of services for FY2011 used to allocate customer-related costs.

- A-10 and A-11 **Internal Allocators** used for various components of the plant.

- CA-12 and CA-13 **Cost Allocations** of the commodity-related costs to the various classes
- CA-14 and CA-15 **Cost Allocations** for demand-related components
- CA-16 and CA-17 **Cost Allocations** based on the number of customers or weighted service investment or cost of meter.
- CA-18 and CA-19 **Cost of Service Summary** summarizes everything into four components (Commodity, Demand, Customer and Fire). The total is \$80,602 which foots back to C-5 the Total Revenue Required from Rates.
- R-20 **Comparison of Current Revenues to Projected First Year Revenues by Year By Class.** Line 7 shows the estimated year 1 increase in total revenues: 3.52%
- R20-1 and R20-2 **Projected Revenues** for year two and year three.
- R-21 and R-22 **Proposed Rates and Annual Revenue Estimates** shows the Year-end Number of Services. These will continue to be updated to ensure the best available data.
- R-23 and R-24 **Rates.** The proposal does not change the commodity rates for all the residential and commercial metered classes but increases to the monthly customer charge; the first year proposal for ¾" service monthly customer charge increase is \$1.42 a month -- less than 5 cents a day. In the second year, there will also be a change to the blocks in the commercial class-- GMWS (general metered water service), as the blocks are shifting to reflect usage changes within the class. There is a change in the fire protection because the fire component costs have increased over time. The wholesale rates have various changes.

The Committee discussed how rates are set, what is the revenue target number in order to close the deficiency by each class, how quickly to close the gap, what is a reasonable rate increase for a customer, the logic behind staff's recommendation in trying to hit some of these targets, the perception of those who are going to receive the rate increase and the pros and cons of small incremental increases vs. one very large increase.

The Committee discussed the increase to flat rate customers compared to the metered residential customers which as a class are using roughly twice as much water as the average metered residential customer.

They discussed how events and circumstances can change over a three year period. Due to the large fixed cost component, it is important to look over a three year process.

The Board recommended that staff look to increase the customer charge or fixed cost component, which resulted in the change to the customer charge from \$15.70 to 17.12, about a nickel a day -- a 3.5% increase for the ¾" customer although it may vary throughout the classes. In year two this would increase again \$1.42 per month to \$18.54, and then in year three to \$19.42 which would close the gap over the three year period.

Mr. Erwin asked Mr. Thomas what the monthly customer charge would be at Los Angeles

Metropolitan. Mr. Thomas said it varies from approximately \$24 to \$50.

Mr. Bonow indicated that you lose revenue flexibility so if you do have an uptick in sales you have a big increase in costs from the positive or negative side you are stuck with a relatively narrow range of revenues again that you can collect and you cannot respond to the circumstances. So there is a risk management dynamic to that.

Mr. Schmidt asked Mr. Bonow if the community would perceive increasing the customer charge rather than the commodity charge as a better way of implementing a rate increase because of our fixed costs.

Mr. Bonow replied “In this day and age it helps because of the recent history of a downward trend in sales. On an organizational level, concerns are mitigated if there is a lot of cash which gets back to the revenue, unrestricted cash balance question. When you get to 2015, not having a cash balance of a sizable amount further restricts your ability to do anything. However, even if you cannot refinance your debt, you have the opportunity to pay it off with cash. If interest rates are still 1 or 2 or 3%, the 5% debt can be paid off and you are effectively making a 5% investment with that cash. You will not have that opportunity if you have to keep a small cash balance.”

Mr. Erwin summarized that staff has tried to minimize the number of rates to be changed. The customer charges on a few classes were changed by a minimal 3.5 percent which matches the needed overall revenue increase. Slight increase to the usage rates of the wholesale class will bring them closer to cost recovery, although nowhere near where they should be but the rates are slowly moving towards that end.

The committee discussed why the entire deficiency by year three was not made up. Mr. Erwin replied that when rates are set, staff looks to see what can be gleaned in terms of total revenues, the response of the community to accepting these rates, and what deficiency can be managed and then builds a little hope into the strategy for a slight economic recovery and a possible positive change in the weather.

Mr. McGuire asked Mr. Bonow and Mr. Thomas if there was anything that they know about ratemaking that is different or better than the proposal that staff had just made.

Mr. Bonow said “My observation is that there is more transparency here than we see other places; there is more granularity here than we see other places; that you all spend your time digging into the minutia is pretty unusual. Usually it is just a palatability question where an advisory committee is taking a pulse of their respective constituencies and see what will pass but at a very high level. I think the proposal certainly stands up to our scrutiny. The one thing that, as Mr. Erwin just acknowledged is, if sales do not turn around and if you did not start or end FY2011 with a 1.43 coverage ratio then you would not have this luxury of a slight glide path to see how May is going to look. If you have a very wet cold year again and sales are down, you might have a different adjustment. But I think from that sense it is a reasonable position to take. You have done most of what you can on the cost side; I do not think there is a lot of appetite in this day and age and in this economy to do a lot of adjustments on the commodity rate.”

Mr. Thomas said, “cost of service is traditional ratemaking and a demand accounting method is what you see a lot of people use. This is the first time I have heard the rate proposal and to listen

to Mr. Erwin talk about some of the decisions that he has made in terms of whether to put a little more on the fixed charge vs. the commodity charge, those policy decisions often times are made by the analysts. As John Bonow described the policy makers just want to know what the impact is on the average bill but those kinds of decisions really do affect the customer classes differently. The idea that you are not going to increase a class over the next three years because they are basically at or above their cost of service, those are policy decisions that sometimes get buried so to Mr. Bonow's point of transparency, that is helpful. I think Mr. Erwin is more generous than I would be; I would be trying to close the gap a little more in year three but that is just me."

Mr. Erwin said he would be making a few adjustments to the proposal; some of the numbers will change but should not change the proposed rate changes.

Mr. Schmidt asked what would happen to the rate proposal if the merger goes forward. Mr. Foree responded that this analysis is a separate, independent analysis without taking the merger into consideration. If the merger happens, rates and charges will be discussed and formulated with the consideration that TMWA customers are not impacted by the merger. One option, for example, could be to put Washoe County customers on TMWA's rate, and then use a surcharge to those customers, if needed, rather than use two completely different commodity and customer charges.

Mr. Erwin said that he would make any edits to the proposal and that the Committee would be sent the proposal when that packet goes to the Board for their November 16 meeting.

Chairman Vorreyer called for a motion.

Mr. Heffner made the observation that as a businessman, he had been on the receiving end of budget cuts all his life and was extremely impressed with what TMWA had been able to do with their operating costs over the last several years. He said "I think if you did not show this 18-20 percent cost reduction, you would have a hard sell but I know how hard it is to bring your costs down to that level in that short a period of time and you have done a terrific job in justifying both from a cost reduction point of view and a revenue need point of view what you are asking for. I think this is a very professional piece of work."

The Committee complimented staff on the presentation and the thoroughness of the graphs and backup materials used to justify the increase.

Before making a motion, there was a discussion of the following points:

- The pros and cons of a three-year vs. a one-year rate increase. Will the assumptions made at this time still be valid in another year or two?
- The need to review financial information prior to the year two and year three rate adjustments to ascertain whether or not the increase as proposed is still adequate, necessary and defensible?
- The need to retain cash reserves. It is important to take steps so that cash reserves are not depleted.
- The impact on the public of a three-year increase as opposed to bringing this issue back

to the community each year. Would there have to be a public process each year if a three-year proposal is not approved?

- The impact of a three-year vs. a one-year rate increase on rating agencies and the bond market.
 - Mr. Bonow said that this type plan should be sufficient for the rating agencies, especially as TMWA has taken action and is monitoring progress.
 - Mr. Thomas said it seemed to him that a three-year base case is needed so people know what the future looks like if the assumptions are correct. If the assumptions turn out not to be correct in year two or three, then the board has the flexibility to change the rates in year two and/or year three no matter what it approved this year.
- The wording of the motion so the Committee can review all information prior to the second and third year rate increase automatically taking effect.
- The importance of keeping the rate increase separate from any merger discussions.
- The rate review process, which Mr. Pagni explained:
 - At the last rate increase, the Board voted to adopt both rate increases with the staff to report back in a year's time to determine if the assumptions that were made were still in place. If those assumptions had changed then the Board at that time could make adjustments, otherwise the two increases were already approved. If everything was tracking as predicted, there was no need to go through the entire process including public hearings.
 - Although the Committee can make recommendations, it is the Board's decision on how the rate increase would be implemented.
 - The proposal is to be vetted through the Committee and at a public workshop before presenting it to the Board at the first reading on November 16. At that time, the Board will be presented with the recommendations of the Committee as well as input from the Workshop. The Board does not approve the proposal at the first reading. At the second reading and public hearing on January 18, 2012 at 6 p.m., the Board will make the final decision as to whether or not to implement a rate increase. In between the first and second reading, there is opportunity for additional input.

Upon motion duly made and seconded, and carried by unanimous consent of the members present, the Committee recommended to the Board their agreement with the three-year plan with increases as proposed in staff's rate study presented at this meeting with the caveat that on or before December 2012 and December 2013, the Committee is provided audited financial information to reaffirm the recommendation for the rate increases in the plan presented at this meeting before the second and third year increases automatically go into effect . The Committee understands that this would give the Board adequate time to act on any

alternative recommendation prior to the effective date of the subsequent increases.

7. DISCUSSION ON THE DATE FOR THE NEXT MEETING AND FUTURE SAC AGENDA ITEMS

Upon motion duly made and seconded, and carried by unanimous consent of the members present, the Committee set the date of the next meeting as December 6, 2011 at 3 p.m. and requested the following items be placed on future agendas:

- 1. Status report on the merger of the Washoe County Department of Water Resources water utility functions into TMWA**
- 2. Update on the potential rate adjustment**

8. COMMITTEE ITEMS

Mr. Buchner commented that any rate increase is very difficult for people on a fixed income.

Mr. Schmidt commented that it would be nice to have someone on the Committee to represent customers billed on the flat-rate.

9. STAFF ITEMS

Lora Rose Richards distributed a topic paper on rates. She said she would schedule a tour of Independence Lake and the Glendale Treatment Facility in 2012 as soon as weather permits. She said that she would be contacting those members whose term expires on December 31, 2011 regarding renewing their membership on the Committee.

10. PUBLIC COMMENTS

There were no public comments.

11. ADJOURNMENT

With no further items for discussion, Chairman Vorreyer adjourned the meeting at 5:48 p.m.

Approved by the Standing Advisory Commission in session on December 6, 2011.

Corinne Cassell, Recording Secretary

*Jeannie Redinger, Paul Rose and Jim Smith were absent for the vote on items 6 through 11.