MINUTES OF THE
SPECIAL MEETING OF THE
BOARD OF DIRECTORS
OTAY WATER DISTRICT
May 23, 2016

1. The meeting was called to order by President Lopez at 3:09 p.m.

2. ROLL CALL

   Directors Present: Croucher (arrived at 3:20 p.m.), Lopez, Robak and Smith

   Directors Absent: Thompson (out-of-town on vacation)

   Staff Present: General Manager Mark Watton, General Counsel Daniel Shinoff, Asst. GM German Alvarez, Chief Financial Officer Joe Beachem, Chief of Engineering Rod Posada, Chief of Operations Pedro Porras, Chief of Administration and Information Technology Adolfo Segura, Asst. Chief of 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 Smith, seconded by Director Robak and carried with the following vote:

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

   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. ADOPT RESOLUTION NO. 4302 TO APPROVE THE FY 2016-2017 OPERATING AND CAPITAL BUDGET; APPROVE FUND TRANSFERS FOR POTABLE, RECYCLED, AND SEWER; APPROVE WATER AND SEWER RATE CHANGES ON ALL BILLINGS THAT BEGIN IN CALENDAR YEAR 2017 (THIS MAY INCLUDE SOME SERVICES PROVIDED IN DECEMBER 2016); ADOPT THE SALARY SCHEDULE; ADOPT ORDINANCE NO. 555 AMENDING THE CODE OF ORDINANCES APPENDIX A WITH THE PROPOSED WATER AND SEWER RATE CHANGES; AND DIRECT STAFF TO SEND RATE INCREASE NOTICES

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

- Review of the FY 2017 - 2018 Strategic Plan
- Present for approval a $91.7 million Operating Budget
- Present for approval a $10.7 million CIP Budget
- Request approval of average rate increases of 5% for water and 3% for sewer effective January 1, 2017
- Request approval of the annual fund transfers
- Request approval of the Salary Schedule

General Manager Watton highlighted some challenges the District will be facing in FY 2017 that included:

- State Water Board’s adoption of the California Code of Regulations, Title 23, section 866 and re-adoption of sections 863, 864, 865 on May 5, 2015 mandating that residential users cut back water use by 20% compared to their 2013 water use.
- State Water Board’s extension of the mandatory conservation measures on February 2, 2016, with a revised water use cutback from 20% to 12%
    - The State Water Board will allow retail agencies to self-certify through their wholesale water supplier as long as all member agencies agree on the conservation level. It is expected that the San Diego region will most likely self-certify with a 0% conservation level.
- It is estimated that customers’ water use will be down 18% in FY 2017 versus the estimated 20% in FY 2016.

General Manager Watton noted that if the region is able to self-certify at 0%, it does not mean that conservation is no longer required, the District will still require that customers use water wisely. He also commented that the District expects that the reduction in water sales is more permanent then in the past, primarily because customers who have changed their landscaping to drought tolerant plants will, thus, continue to use less water. He also reviewed some strengths that has helped enhance the District’s efficiency (slide number 8 in the presentation).

He 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 2016 and beyond.

Mr. London indicated that the economy has been on a long, slow recovery and most indicators tell us that this year (2016), as well as the past several years, have been banner years by almost all measures, including payroll and the employment rate. He indicated that we are at the lowest levels of unemployment and noted that job growth has been the largest in the construction industry this year.

He reviewed population growth and demographics in the Otay Water District (Otay WD) service area in comparison to San Diego County (County) from 2000 to 2016 (reference slide number 5 in the *Economic Outlook* presentation). Otay WD's growth was much higher from 2000 to 2010 in comparison to the County's with 49.6% growth versus 10% growth for the County. From 2010 to 2016, Otay WD grew 13.2% and the County grew 7%, approximately double the County's rate.

He stated that the residential resale market has been increasing in terms of price throughout the County and sales have been at a fairly robust pace. He indicated with regard to non-residential, there has been a significant drop in the office sector and the retail sector is not adding space, but remodeling existing space. The industrial market is seeing a small increase.

He indicated that foreclosure activity is negligible within the District's service area and the housing market in the City of Chula Vista is continuing the trend towards more multifamily units. There is little single family units being permitted. He noted that much of the multifamily units are townhomes. San Diego's Regional Planning Agency (SANDAG) is reporting that over the next 30 years (their 2050 forecast), it is expected that 82% of new housing construction will be in the multifamily category.

He stated that most of the developable lots in the County are in the Otay WD's service area. However, most of the demand is not in the District's service area; the demand is in the central north city and north county. He stated that the County has a fundamental disconnect between the availability of lots and where the demand is located, but nevertheless, we will see an increase in residential housing construction in the District's service area because this is where developable land is available.

SANDAG is projecting that the County will grow approximately 30,000 persons a year, which it has done each year. Much of the growth will be from new births and the remaining 30% will be from people relocating to this region. He stated that there are more people moving to the County than leaving and the regions service agencies need to be prepared to accommodate the growth each year. The Otay WD, in particular, needs to be prepared as this service area is where much of the growth will take place. He indicated with regard to the economic recovery, we are in about the 7^{th} inning.

Director Robak inquired what Mr. London feels will precipitate the next economic downturn. Mr. London indicated that there really is no way of predicting. He stated it would not be an interest rate increase as an increase signals a healthy economy. He stated that there will be an event, but he could not guess what the event would be at this point.

The board thanked Mr. London for his work and presentation.

Chief of Information Technology and Administration Adolfo Segura provided a presentation on the District's 2017-2018 Strategic Plan. He stated that the District is in the second year of the four year plan and the District's mission, vision , statement of values and key challenge remain unchanged (reference slides 14-17 in the presentation). He reviewed the objectives and measures for each department within the fiscal year 2017 (FY 2017) plan (please reference slides 19 to 29). He noted that staff would be deleting three (3) measures based on QualServe information and will replace them with new measures:

1. The injury incident rate will be moved to a national average which targets specific utility industries (water, sewer, treatment plant operations, etc.).
2. The customer accounts per fulltime equivalent (FTE) will be compared with the District's surrounding water agencies and with American Water Works Association's (AWWA's) benchmark for Region 4.
3. Include the trend for the percentage of customers who pay their bills electronically (70% of the District's customers pay their bill electronically).

Director Croucher stepped off the dias at 3:50 p.m.

Chief of Information Technology and Administration Segura clarified, in response to an inquiry from Director Lopez, that the (three) QualServe measures will be removed and replaced with measures that reflect the latest AWWA measures.

Director Croucher returned to the dias at 3:55 p.m.

Director Robak inquired if staff had ever compared the District's measure for customer accounts per FTE with the private water and sewer industry. General Manager Watton indicated that the private industry does not share that information with the public. They consider it as proprietary information. So the District is unable to make that comparison.

Director Smith suggested that the District add an Engineering Objective that focuses on recycled water supply purchases and use. General Manager Watton indicated that he felt that that was an appropriate objective to add to the District's Strategic Plan.

Chief Financial Officer Beachem reviewed the items that are input into the rate model to develop the FY 2017 Operating and Capital Budgets. He noted that a new impact to the six-year rate model is the Governor's mandate for conservation (please reference slide number 32 in the presentation). He indicated that staff is budgeting for an 18% level of conservation.

He reviewed the budget objectives for FY 2017 (please reference slide number 33 in the presentation). He stated that a key to the District's budget is maintaining the debt coverage ratio. The minimum required debt coverage ratio is 125%. The District's current ratio is well above the 125% minimum at 196%, which includes developer capacity fees. He indicated that the District does not control growth and cannot rely on capacity fees, thus staff develops a target, 150%, that excludes capacity fee. The District's debt coverage ratio without growth is above the target at 160%.

Chief Financial Officer Beachem indicated with each budget, staff requests approval for two types of fund transfers. Inter-fund transfers from one reserve fund to another and from the operating budget revenues to the various reserve funds. He reviewed in detail the fund transfers that staff is recommending for the board's approval (please reference slide numbers 35-36 in the presentation).

He presented highlights from the operating budget noting items that are holding rates down (please reference slide number 37 in the presentation) and items that are putting an upward pressure on rates (please reference slide number 38 in the presentation). He reviewed the potable and recycled budget (please reference slide number 39) and indicated that staff is proposing an average rate increase of 5% for potable and recycled water. He also reviewed the sewer budget (please reference slide number 40) and stated that staff is proposing a 3% average rate increase for sewer. The sewer rate increase is due to a slight increase in the sewer CIP which will be funded through the District's cash fund and the issuance of debt.

A slide was also presented showing the rate increases projected last budget cycle for FY 2017 (please reference slide number 41). It was projected last budget cycle (for FY 2017) that a rate increase of 6.2% would be required for potable and recycled water and no rate increase (0%) would be needed for sewer last year. The proposed rate increases during this year's budget cycle for FY 2017 is 5% for potable and recycled water and 3% for sewer. It was noted that the debt coverage ratio is also higher at 160% than projected last year at 147%.

Chief Financial Officer Beachem indicated that the entire 5% rate increase for potable and recycled water will go to pay the San Diego County Water Authority (CWA) [92%], City of San Diego [5%] and SDG&E [3%] rate increases.

He presented a slide showing how the District's water rate will compare to all other CWA member agencies following the implementation of the proposed rate increases (please reference slide number 43). Otay WD's average monthly water bill, based on 11 units of water, will be $77.18. It is estimated that the District will be the eleventh (11th) lowest water cost agency among the 22 agencies. With regard to the District's sewer rate, it will be the fifth (5th) lowest among the 28 sewer providers in San Diego County; dropping two (2) positions compared to last year.

Director Croucher stepped off the dias at 4:09 p.m.

Director Smith commented that the District had projected that customers would reduce water use by 12% in response to the Governor's mandate, but customers actual water use was reduced by 18%. He indicated the District needed to increase rates in March as the increase implemented in January was not enough due to customer conservation. Director Smith observed that we missed the customer estimated savings by 6% last year and are projecting customer savings of 18% in FY 2017, he inquired if customers save 3 to 5% more than projected, would the District still be fine financially. He stated he did not want to be in a position where the District must ask for more money again. General Manager Watton indicated that because the District implemented two (2) rate increases last year, those increases provided the District's budget the needed stability. He indicated if projections are missed by 3 to 5% in FY 2017, that it would impact the FY 2018 budget and future rate increases.

Director Croucher returned to the dias at 4:11 p.m.

In response to another inquiry from Director Smith, Finance Manager Kevin Keoppen indicated that in FY 2016 the debt coverage ratio was projected to drop below the target of 150%, but that it would then be built back up. Chief Financial Officer Beachem further explained that the minimum debt coverage ratio, including growth revenues, is 125%. The target is 150%, which allows the District to weather some financial challenges, such as the reduced water use mandate, before dropping below the target level. He stated with a fairly conservative projection of 18% conservation level relative to 2013 water use, the District can handle a good amount of decreased water use before its debt coverage ratio would drop below the target. He indicated that he felt that the proposed rate increase of 5% would be adequate.

Director Croucher stepped off the dias at 4:18 p.m.

Finance Manager Keoppen indicated, in response to an inquiry from Director Robak, that the District has a medium/average debt load compared to other public agencies. General Manager Watton indicated that it depends on each agency; some have growth some do not. An agency may prefer to fund projects with cash; the Otay WD likes to use a mix of debt and cash. There are many different philosophies and each agency has their own philosophy.

Director Croucher returned to the dias at 4:24 p.m.

Director Smith requested if staff could provide information on what other agencies are doing in terms of rate increases and, if there is a rate increase, how much is for water cost increases and how much is for the agencies' internal operations. Staff indicated that they would provide that information once all the agencies have set their rates for the next fiscal year.

Director Robak stepped off the dias at 4:32 p.m.

Chief of Engineering Rod Posada presented the District's projected six (6) year CIP from 2017 to 2022. He stated that staff utilized Mr. London's and the developers' projections to develop the District's growth projections (please reference slide number 46). He indicated that staff expects growth in FY 2017 to be flat, but expects substantial growth from 2018 to 2022. He indicated that 91 units of single-family homes are expected to be built in FY 2017 in contrast to 204 condominiums and 519 apartment units. Multi-family construction will outpace single-family home construction seven (7) to one (1). In the next six years (FY 2017 to 2022), single-family home construction will increase, but will still be outpaced by multi-family construction by two (2) to one (1). It is also projected that there will be approximately $16 million in permitting revenues for commercial development.

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

He reviewed projected meter sales for FY 2017 (please reference slide number 47) and the guidelines used to develop the CIP budget for FY 2017 (please reference slide number 48).

He stated in the development of the CIP budget for FY 2017, 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 2017 is $10.7 million. The six-year CIP Budget total for FY's 2017 to 2022 is $89.2 million. He indicated in preparing the FY 2016 CIP budget last year, staff forecasted the FY 2017 budget needs to be $20.1 million and over the six-year period (FY 2016 – 2021) to be $96.2 million. He indicated that staff has pared down the budget as a result of reprioritizing and deferring projects.

Chief of Engineering Posada presented the high profile CIP projects planned for FY 2017 through 2022 (please reference slide numbers 50 and 51). He indicated, of the $89.2 million projects in the CIP Budget, $63.2 million (70%) is designated for replacement/renewal projects, $23.8 million (27%) for capital facility projects (including developer reimbursement projects), and $2.8 million (3%) for capital purchases. In response to an inquiry from Director Smith, Chief of Engineering Posada indicated that the District was anticipating to start the construction of the Campo Road Sewer Replacement Project. The project has been delayed to FY 2018 as easements still need to be acquired. Also, the 870 Pump Station Project has been delayed due to environmental limitations, which impacts the 571-1 Reservoir improvements project. This reservoir is critical to the service area and it cannot be taken out of service during the summer months, so the reservoir improvements will be moved to the winter (FY 2017) months along with the 870 Pump Station Project.

Finance Manager Kevin Koeppen presented the details of the FY 2017 Operating Budget and the how the budget was developed. He indicated that the District's water sales projections for FY 2017 are based on FY 2016 projections plus 1% drought recovery. He stated that water use projections were also based on growth rates from The London Group projections. He presented a slide showing potable water sales from FY 2012 to projections for FY 2017 (please reference slide number 57). He reviewed the proposed potable rate which will be based on the California Urban Water Conservation Council's Best Management Practice 1.4 (BMP) that indicates that no more than 30% of revenues can come from fixed revenues. In FY 2016, 36% of revenues came from fixed revenues and staff is proposing that the District rebalance the rate and return to the 30% threshold for fixed revenues. This will shift $1.1 million from fixed revenues to variable revenues. Staff is also proposing to pass-through, to District customers, the fixed portion of the San Diego County Water Authority's (CWA) and Metropolitan Water District's (MWD) rate increase of $600,000 (please reference slide number 58).

He indicated that projected potable water sales revenues for FY 2017 is $2,454,900 where $1,548,300 will be from the proposed FY 2017 rate increase and $906,600 from the FY 2016 rate increase and water sales volume changes.

Finance Manager Koeppen also presented that recycled water sales are projected to decrease in FY 2017 and revenues will decrease $215,700 (or 2.4%). He stated a big portion of the decrease is due to the loss of the CWA and MWD rebates from reduced recycled water sales.

He also reviewed the sewer sales revenues and indicated that sewer revenues will decrease $287,400. The main driver of the decrease is the completion and elimination of the phase in of the $1.30 system fee and an overall reduction in the winter average use due to conservation.

He noted the District receives revenues from other sources and indicated:

- Property Tax Revenues will increase $135,200 (3.5%)
- Capacity Fee Revenues will decrease $113,400 (10%) due to a decrease in developer activity
- Non-operating revenue increase of $305,700 (16.3%) from the PIO/PICO expense reimbursements and standard rate increases related to cell site leases.

He stated that the District's water cost is increasing $1.4 million or 3.1% mainly due to rate increases from the District's wholesale water suppliers (please reference slide number 65).

He lastly shared that power costs will decrease $174,800 (5.6%) in FY 2017 mainly due to customer conservation exceeding the projected FY 2016 budget.

Director Smith commented that he felt that the District needs to address the take or pay agreement with the City of San Diego as 50% of the recycled water that the District has paid for is not being used.

In response to an inquiry from Director Robak, Finance Manager Rita Bell indicated with regard to customer water billing, not considering the conservation tier, the first tier is the base tier, the next tier is 30% higher than the base tier, and the last tier is 100% higher than the base tier. In response to another inquiry from Director Robak, General Manager Watton indicated that the rates presented were developed with the rate study the District performed before the City of San Juan Capistrano lawsuit. Staff is currently in the process of performing a rate study following the City of San Juan Capistrano lawsuit and the outcome of the study will be presented to the board in a few months.

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. He indicated that the District has reduced the number of staff members from 174.75 in 2007 to 135 in 2017; a reduction of 39.75 employees or 23%. The cumulative cost savings from the reduction in staffing is approximately $30,052,900 (including all outside labor services) from 2007 to 2017. From an efficiency standpoint, the customer to employee ratio has increased from 301 customers serviced per employee in 2007 to 406 customers serviced per employee in 2017 or an increase of 35%. He also reviewed labor costs and indicated that salaries and benefits have increased $518,900 (2.5%) and noted the items impacting labor costs (please reference slide numbers 72 to 73).

Director Smith complimented staff and the board for the years of effort that has gone into accomplishing these efficiencies for the District's ratepayers. He stated that the District somehow needs to get this information to its customers. He indicated that he knows that we have shared it, but it is not always heard and somehow we need to get it heard.

Assistant Chief of Operation Jose Martinez presented on the District's materials and maintenance costs and indicated that the overall costs have decreased $156,500 (4.3%). He reviewed items that have impacted materials and maintenance costs (please reference slide numbers 75 to 76).

He also highlighted areas where the District has been able to keep costs down that included the reduction of fuel consumption by 39%, reducing the number of vehicles (pool and construction) and equipment (generators, backhoes, vactor trucks, etc.) by 17%, the reduction of recycled water DEH charges for inspection fees from

$40,900 to $6,000 (or 85%) over the last six (6) years, keeping water loss below the 5% target at 3.1%, and decreasing paving costs by 65% over the last six (6) years.

Finance Manager Koeppen then reviewed the District's Administrative Costs and indicated that the District's overall administrative costs decreased $237,700 (4.4%). He noted the items that are impacting administrative costs (please reference slide number 83).

He stated that staff is presenting for the board's consideration a potable budget of $79,822,200, a recycled budget of $8,909,000 and a sewer budget of $3,010,300 for a total budget of $91,741,500. The budget is supported by a 5% average rate increase for water and a 3% average rate increase for sewer. The presented budget also supports the water and sewer needs of the District's customers and the Strategic Plan.

Director Smith inquired about the shifting of staff from the Operations Division to the Engineering Division. Chief of Engineering Posada indicated that the District consolidated recycled inspections with the Engineering inspections group and moved the operations aspects of their jobs to the Operations Division. This will enhance efficiency and allow for the reduction of two (2) FTEs.

Director Lopez stepped off the dias at 5:18 p.m.

In response to another inquiry from Director Smith, staff indicated that the expense for ergonomic office furniture of $589,000 is expenditures over the life of the Capital Improvement Project for Furniture Capital Purchases. The funds budgeted for office furniture is $15,000 for FY 2017 and approximately $50,000 for the next four (4) years.

Director Lopez returned to the dias at 5:21 p.m.

Chief of Administration and Information Technology Segura indicated in response to an inquiry from Director Lopez that the training budgeted in the Administration Services Division is centralized training under the Human Resources Department. Each department has access to a training budget that is specific to the needs of their department.

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

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

To adopt Resloutionn No. 4302 to approve the FY 2016-2017 Operating and Capital Budget; approve the fund transfers for potable, recycled and sewer; adopt Ordinance No. 555 amending Appendix A with the proposed 5% average water rate increase and 3% average sewer rate increase on all billings that begin in calendar year 2017; adopt the salary schedule; and direct staff to send rate increase notices.

Director Robak indicated that the District implemented a rate increase six (6) months ago due to the City of San Diego recycled water rate increase and stated that he was concerned about that increase and wished to look at the detail for that proposed increase. He also stated that he is not happy with the proposed rate tiers, but respects the fact that the District is making an effort to perform a study in response to the City of San Juan Capistrano lawsuit. He indicated that he believes the board and staff are all on the same page and are looking for efficiencies where we can. However, over the last six (6) months he has not seen any work on the District Optimization Committee and has left a message with President Thompson to discuss the committee. He stated that the reason he voted to abstain is that the District still needs to hold a public hearing on the proposed rate increases and between now and the hearing, he would like to have a meeting of the committee. General Manager Watton explained that the District had adopted a five-year blanket increase under Proposition 218 and a hearing was not required for this fiscal year.

President Lopez thanked staff for the good work they have done on the budget.

7. ADJOURNMENT

With no further business to come before the Board, President Lopez adjourned the meeting at 5:29 p.m.

President

ATTEST:

District Secretary