

MINUTES OF THE BOARD OF DIRECTORS
ZONE 7
ALAMEDA COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT

SPECIAL BOARD MEETING

October 5, 2011

Vice-President Palmer called the special meeting to order at 6:00 p.m. The following were present:

DIRECTORS: JOHN GRECI
AJ MACHAEVICH
CHRISTOPHER MOORE
SARAH PALMER
RICHARD QUIGLEY
BILL STEVENS

DIRECTORS ABSENT: SANDS FIGUERS

ZONE 7 STAFF: JILL DUERIG, GENERAL MANAGER
KURT ARENDS, ASSISTANT GENERAL MANAGER, ENGINEERING
JOHN YUE, ASSISTANT GENERAL MANAGER, FINANCE
TAMARA BAPTISTA, FINANCIAL & SYSTEMS SERVICES MANAGER
JUDY RECTOR, BOARD SECRETARY

COUNSEL: REN NOSKY, DOWNEY BRAND

Item 3 - Citizens Forum – None.

Vice-President Sarah Palmer announced that Ren Nosky, General Counsel from Downey-Brand, is leaving Zone 7 to be the City Attorney for the City of Santa Clara. This Board meeting is his last with Zone 7. David Aladjem from Downey Brand will be working with Zone 7 during the transition.

Item 4 – Status of Zone 7’s Water Enterprise Reserve Funds

John Yue, Assistant General Manager, Finance, reminded the Board that the staff report that came with the agenda has background information but there is also a presentation on reserves by Tamara Baptista, Financial & Systems Services Manager.

Ms. Baptista explained that her presentation is split into two components: basic reserves and how we calculate them, the surplus and deficit, the concept of reserves, Fund 52 (water enterprise reserves), Fund 73 (renewal/replacement & system-wide improvements) and Fund 73 (expansion fund).

Ms. Baptista’s presentation included slides that showed by example how if the funding requirement is more than the revenues received, the difference is taken out of reserves. For instance, with a 5% rate increase, using the beginning fund balance, adding revenue, and subtracting operating expenses and the transfer to the rate stabilization fund, revenues do not cover the operating expenses and transfer, and Zone 7 is short \$1.7 million which would have come from reserves. By using the reserve policy, staff takes the reserves from the operating/emergency, rate stabilization and unrestricted reserves. The balance is the same, it is just where the money is used.

Director Greci felt getting the same ending numbers is shuffling money to see if we are going to use the unrestricted reserves for rate stabilization and not have an increase. He remembers instituting a policy for reserves to cover emergency expenses and feels that is good business. If Zone 7 is playing the game of shuffling money to eliminate the increase in the water rates, it is not a good business practice. The Board set up policies for a reason: to protect Zone 7 customers and not have to implement big raises of 30-40% as happened during the '90s drought. This is the best insurance Zone 7 can give ourselves. We may not please all of our customers because we increase rates but they would be a lot more upset with us had we not planned properly and slapped a big raise on them because we did not have the diligence to look ahead, forecast as we have been doing, and keep those reserves; they are there for a reason.

Director Moore has no issue with the current levels of operating reserves and can see adjusting them upwards or downwards for a specific purpose, likewise rate stabilization. The reserve policy implemented by the Board to protect us so we didn't have wild swings. The unrestricted reserves sound more like a budget surplus. We are conservative, we spend less than we budget, and with reserves we are always going to have enough, but it is a budget surplus and without a designation of what that surplus is, it has been termed as a "slush fund" by the retailers. It is a budget surplus that could offset the rate increase but it is a surplus you are hanging onto even though there is no designation for it. Even the Retailers said, if you wanted to, you could increase the percentage of your Operating Reserves, which is a Board policy, but don't leave undesignated money out there and let it continue to grow, a better use would be to offset rate increases. One aspect of the discussion at the Finance Committee was the undesignated surplus and what you should do with it.

Vice-President Palmer said it bothers her, too, to say it is all the same at the end because it is designated as unrestricted and leaves the question that maybe it is not needed.

Director Stevens asked if you put \$2 million of reserves into our "bucket," would that reduce the rate 2%? Ms. Baptista confirmed \$2 million would be 2%. Director Stevens asked if \$1 million was taken from reserves, would that decrease the rate by 1%? Ms. Baptista confirmed and Director Stevens replied that we would have to get \$10 million from reserves to get a 0% water rate increase.

Director Stevens also asked if there is insurance for emergencies, like earthquakes or pipe ruptures, which can be bought? John Yue replied that we are currently self-insured. But if there is a policy change to go out and buy coverage for the first \$10 million in losses, then it would be an extra cost. Director Stevens asked if it would be viable to buy insurance instead of a rate stabilization policy? Mr. Yue said the rule of thumb is for the first few million dollars of loss coverage, buying the insurance policy is going to be more expensive than being self-insured due to the deductible and premium cost.

General Manager Jill Duerig said that as part of Alameda County, we are limited by their risk management programs. We have begun to look into how we will handle insurance if we do separate from the County but we do not have any decisions right now.

Director Stevens also asked where these reserves are kept? Are they kept in a money market certificate earning interest? Ms. Baptista replied that the County invests our money for us. If we get 5% interest, we do get that money back. We also get a monthly investment report from Alameda County.

Director Stevens then said he likes the idea of a percentage on the rate stabilization. A flat rate of \$5 million doesn't make sense because if you add up all the reserves, we are at 40% of our revenue which seems excessive.

Ms. Duerig clarified that those unrestricted reserves are projected to be used during the next few years to dampen the rate increases. It will be drawn down to almost zero and that is how those unrestricted reserves are being used. Ms. Baptista has also compared where we are right now in comparison to other agencies but that number will reduce substantially over the next four years as we are buffering those rate increases and bringing those unrestricted reserves down to nearly zero and are going to be closer to below average. Fund 73 is related to Developer Impact Fees and the Mitigation Fee Act says we cannot co-mingle the fees that we collect from developers. Director Stevens asked if we were avoiding touching Fund 73 reserves because it would not be prudent but Ms. Duerig said it would not be legal.

Director Stevens would like staff to come up with an explanation/recommendation for rate stabilization because the current \$5 million balance needs to be looked at. Ms. Baptista said she can give more history and back-up on the Rate Stabilization reserve. Zone 7 does have a balance of unrestricted reserves, but Alternative 2, our 5% water rate model, decreases unrestricted reserves. Director Stevens added that what the Retailers are saying is use more of the reserve now. We know it will go to zero but use more of it now for the next couple of years. But Ms. Baptista said if we use more of the unrestricted reserves now, it will defeat our ability to smooth out water rate increases and keep them as low as possible. If we have a smaller water rate increase now, that will make the future years' increases higher and that is why we try to smooth it out.

Mr. Yue said the Rate Stabilization Reserve at \$5 million, given our current revenue, is roughly in the ballpark for general guidelines for rate stabilization and drought contingency reserves. However, because it is at a dollar number right now, some clarification on the percentage pegging it to annual sales would allow it to take care of itself as time goes on.

Ms. Duerig said this could tie in with the discussions on the Reliability Policy because if we talk about up to a 15% shortage one year of a drought, then perhaps a 15% number would be appropriate.

Director Moore said we have been using the unrestricted reserves for smoothing but if we had an intended purpose for it, rather than call it unrestricted, it should be Board policy to say that is what we are doing. By our budgeting that is what we are doing, but we should be clearer.

Vice-President Palmer said the public understands the reserves the least of any of the budgetary things we do so it is a good idea to make it all crystal clear.

Ms. Duerig said most agencies name what we call our Rate Stabilization Fund, a Drought Contingency Fund, and what we call our Unrestricted Reserves is Rate Stabilization or cash-on-hand. This is part of the confusion and perhaps the Board can rename those reserves and make it clearer to the public. Staff can come back with a recommendation.

Director Quigley said the reserves are our insurance policy for drought, for mitigating a large rate increase. It is incumbent upon us as a Board to take that \$2 million in an unknown bucket and put a label on it somewhere. He feels good about the Board reserve policies when compared to neighboring water districts because we have a low number as a total. Every year during the rate discussions the Retailers ask for a 0% rate increase. We have to manage our business so if we have a break in a pipeline or the cost of chemicals go up, we have some contingency funds and designated reserves to get a band-aid. Rather than have the reserves sitting there, special undesignated reserves unknown with a question mark, he wants to appease the retailers and give the public a clear vision of what our intent is because he feels that is important.

Dan Martin, Utilities Superintendent for the City of Pleasanton, representing both the City of Pleasanton and City Council, reiterated their position that they are requesting no increase for 2012. He recognizes that there are elements going forward that we have to be aware of in having those reserves available for emergencies. What they are saying is that if we are going to use some of the reasoning for an increase based on either a reserve policy that is not clear, or using the reserve levels to justify a rate increase, but we are not sure what those reserves are available for, they are not comfortable using that justification without an explanation. They are not suggesting that all funding of Asset Management Plan transfer levels and repair and replacement projects be stopped, they are being funded now, they are going to be funded in the future without a rate increase, they are simply saying that now is not the time to add additional projects on top of that current plan. It is called a plan so we can look at it and determine whether or not it is truly a critical function that needs to be repaired or not and go forward. It has been suggested that at a 0% rate increase, there will be a decrease in reliability. Does that mean that there will be a 50% decrease in reliability which would not be acceptable to anyone? Is there going to be 5% decrease or is it going to be 0.5%? If we are saying we cannot go to a 0% increase, then we have to explain to our constituents and customers what that means. He knows exactly what is being talked about because he does those things to maintain his budget, but what he is not convinced that 0% is not an option. He is not at this meeting asking for 0% in the hopes of a 2.5%; he is saying he and the City of Pleasanton are not convinced the Board can't do a 0% water rate increase.

Mr. Martin gave the Board Secretary a letter from the Mayor of Pleasanton and a Resolution to give to the Board for consideration. Ms. Duerig said we will include the letter in the packet for the October 19th discussion on water rates but this meeting was strictly on reserves.

Director Stevens asked if reserves will be discussed as an action item at the next Board meeting before we decide on a rate increase or is the Finance Committee going to decide on the Reserve Policy? Director Moore clarified that it is a Board policy that has to be done at the full Board level. Now that the Board has heard the discussion on reserves and what is appropriate, the Finance Committee would like to come up with recommendations for the Board, but it might not be presented in time for the water rate discussion on October 19th. Perhaps around the beginning of the year the Board will have this discussion and come up with applications and guidelines on what the Board reserve policy should be.

Director Machaevich concurred that the plan by the Finance Committee had been to have a better understanding of how the reserves were set up and terminology, then maybe the numbers are not unrealistic, but it has to be acceptable to the public. He does not see it ready by October.

Ms. Duerig said she thought that was President Figuers' view as well and that he wanted to have the Finance Committee re-visit the policies to see if they needed to be changed and that would include re-naming or clarifying them. He wanted to have the understanding of what reserves meant prior to the water rate discussion on October 19th.

Vice-President Palmer said she found the discussion useful because it is the first time she has actually seen where we are in relation to other agencies and what the recommendations are for special districts.

Item 5 – Verbal Reports - None

Ms. Duerig added that Judge Wanger retired the end of September. Judge Wanger's decisions on Delta pumping have had a significant impact on water supplies statewide.

The meeting adjourned at 6:50 p.m.