

Finance Committee Meeting

March 22, 2011
7:30 a.m.

Committee Members Present: Larry Dill, Chair, Randall Nishimura
Absent and excused: Leland Kahawai

Board Members Present: Roy Oyama

Staff Present: David Craddick, William Eddy, Keith Aoki, Gregg Fujikawa, Dustin Moises, Faith Shiramizu, Marites Yano, Aaron Zambo and Deputy County Attorney Andrea Suzuki

Guests Present: Jan TenBruggencate, representing Limtiaco Company, Council Member Tim Bynum

Chair Dill called the meeting to order at about 7:45 a.m. Due to time constraints, not all agenda items may be reviewed at this meeting.

Re: Manager's Report No. 11 - 49 - R.W. Beck Report on Financial Planning Analysis and Water Rate Study

The R.W. Beck Report was submitted for review and action. At this point the Report is in Draft format and subject to change. One matter that can be decided is the methodology used to prepare the report. Listed below are some of the issues affecting the rates:

1. Debt Service Coverage
2. Cost of Service
3. System Replacement Needs
4. User Pays Principle
5. Amount of Working Capital
6. Leak Rebates

With agreement on these issues the process to meet these requirements and determination of the rates are fairly rote.

1. A conservative debt service coverage has been suggested during previous rates studies that good bond ratings follow. In this regard there are few if any AAA and AA rated utilities that have debt coverage ratios less than 1.50. One and one half is the debt coverage suggested by R.W. Beck in the previous rate study and what we told R.W. Beck to strive for in the current study. **It is our suggestion to not try and meet 1.5 in the first year and build to it over the five years.** This will avoid the jump you see in the first year.

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2. Cost of Service with guaranteed rate of return on Plant in Place is used by the PUC for most rate determinations. DOW is not a for-profit entity and as such does not try to get any rate of return on its plant in place. Agricultural rates and Private Fire Lines are not meeting cost of service requirements. **It is our suggestion to bring the private fire lines up to cost of service levels.** This will result in about a three percent lower rate or 10% of the total increase in the draft report.
3. We still have over \$500 million in 2020 Plan Projects to complete. As the BAB projects are completed most water systems should not be under restrictions. There is the possibility that one developer could take a disproportional share to the available water and a side Rule may be needed to prevent this from happening. In the rate study we asked the consultant to try and get us back to a point where we are making our debt payments and we still have sufficient cash to continue installing about seven to ten miles of lines per year and still have a little for our tanks and pumps. **It is our suggestion to get the cash funded replacement level up to ten million per year.** The reason for this suggestion is that our current debt ratio is about 0.37. Exceeding this number by much without a very strong economy results in reduced bond ratings. We will possibly need to look at improvement district methodologies for generating more funding than the proposed amount if we feel increasing debt is prudent.
4. The user pay principle requires the user of the service to be the one carrying the financial impact. Both our 2005 Bond and some EPA financed projects were using rate payer funds to cover system expansion debt. These discrepancies have been corrected. The other issue is the labor costs related to approving plans. This is about \$0.5 million per year. The 2010 Bonds are about half for system replacement projects. There is some sort of adjustment for facilities being built to meet system deficits. What caused this is allowing customers to have a guarantee of water without the funds provided to build the needed infrastructure. To pay for expansion related projects the FRC funds should be used but typically rating agencies do not look at impact fees as operation revenue. There are a couple of things we can do.
 - A. Transfer the debt to the FRC fund
 - B. Transfer funding from the FRC to the General Fund, and reduce the debt coverage

It is our recommendation to just move a sum of money over each budget year to cover the debt service and labor costs and reduce the debt coverage. We make this recommendation because moving a portion the bond funds to the FRC fund may result in a flurry of resolutions to make it legally possible to do this once the bonds have been issued.

5. The working capital reserve is also a factor in the bond rating of an agency. Typically a well run utility will look at the worst case scenario where some disaster hits preventing normal collection of revenue. In our case the hurricanes in 1982 and 1992 give the best example and the consultants are recommending four months of revenue. **It is our recommendation to keep a four month operating cash reserve.** We make this recommendation to maintain our bond rating.
6. Leak rebates are in excess of \$0.5 million per year. This amounts to about a 2.5% rate increase which can be avoided by making people responsible for their own lines and not make the other ratepayers cover this expense. **It is our recommendation to eliminate the leak rebate and provide a leak avoidance service.** We make this recommendation as it is not good policy to increase rates while allowing water wastage to continue.

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Chair Dill reported that the Committee would work through the listed items in the Manager's Report, number by number.

1. Debt Service Coverage

An updated Table 9 from R.W. Beck was not available for this meeting. The 1.5 debt service coverage is a goal we wish to have for the department's finances, and how soon we would have to reach that goal. Line items 70 and 71 were reviewed. We are already meeting the 1.5 goal.

Manager Craddick only has the Table 9 dated March 16, 2011, we do not have the one that shows the 34% here today. It did not include any debt service from the expansion related projects that are going on with the BAB. We were telling R.W. Beck 50% because they were expansion projects. We have asked them to come to 40% due to our ability to get the projects out. Some of these projects may qualify for FRC. If we get a lot more pipelines it could happen where there would be more non-FRC related projects. We feel comfortable at 40%; this current table reflects 50% on Line 52.

Chair Dill felt that 1.5 was a good goal. Chair Dill suggested that we not necessarily try to meet it in the first year but by five years if not sooner.

Chair Dill confirmed to Mr. Nishimura that a higher debt service ratio was better. Manager Craddick noted that SRF loans only require a ratio of 1. Mr. Nishimura noted the consensus seemed to be to get to 1.5, but wanted to reserve the right to see what the numbers will be. Mr. Dill felt we could reach consensus but needed to see the updated Table 9 first.

Mr. Nishimura stated that an option is for the chair to appoint another member at the Regular Meeting on Thursday, March 24 in order to make and second a motion. Chair Dill reinforced that he would like to see the updated Table 9 before making a recommendation to the full Board. This item is subject to receipt and review of Table 9.

2. Cost of Service

There is a suggestion to bring private fire lines up to cost of service levels. The agricultural rate subsidy will not be discussed. Manager Craddick stated it was just an observation of R.W. Beck's that the private fire service lines were not at cost of service. If we did get to cost of service he did not believe it would have a big impact on the rates. His concern is over individual agricultural services, some are using a lot of water. There may be some agricultural lots where they may not be performing agriculture. Manager Craddick noted that to qualify for agricultural water rates they have to show their GE tax information that shows they are filing tax returns on their farm income.

Mr. Nishimura noted that if we are not going to go into agriculture, and he has some concerns with that, could we just focus on the private fire lines issue. If we are going into agriculture, Mr. Nishimura would like to see a proposal from the department on what they propose to do, and the updated Table 9. Manager Craddick will look at the ramifications of bringing private fire lines up to cost of service. He noted we are charging by the inch of the line and if there is water used it is measured by the meter that goes around the check valve. Manager Craddick described the ratio. Some construction activity has been using the lines. Manager Craddick

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confirmed to Mr. Nishimura that it is the stand-by charge that would go up. Chair Dill would be interested in entertaining that proposal if we can see the cost ramifications. Manager Craddick felt that R.W. Beck would probably ask for a change order on the rate study and thought we should look at that at another time, for the small amount of money gained.

3. System Replacement Needs

Line 59 of Table 9 was reviewed.

Manager Craddick noted the pipelines are projects that we will have every year, about 400 miles of line based on 100 year life span, and it is a recurring cost. The more you can cash finance recurring expenses the better it is for the rate-payers. Manager Craddick gave debt financing scenarios; debt payment divided by total assets. It was discussed whether all rate payers should pay for replacing substandard lines in a subdivision or just the people in that subdivision who benefit from the line change. Mr. Moises noted that most pipelines fall into that category and Manager Craddick will find the incremental cost if we did the upgrade.

Chair Dill discussed Line 59 of Table 9. Manager Craddick wished to explore the Community Improvement District funding. Upon query from Mr. Nishimura, Manager Craddick stated that he did not want to push off the rate increase until he does that. That is why the number is low. If we get that funding, the next round would not have to be that high. If we have a revised Table 9 the \$11 million for 2011 will show up. Manager Craddick recognizes the financial times we are in and to get to that level in five years would be a heavy financial burden. If we are able to use the Community Improvement District funds, it would be less than \$10 million. Upon query from Chair Dill on his recommendation, Manager Craddick indicated that it is the Board's decision but what he is proposing is what is in the report. Chair Dill asked by what year did we wish to achieve that goal. Manager Craddick asked if there was consensus on the Community Improvement Districts funds.

Mr. Nishimura asked if, on the February 10, 2011 summary from R.W. Beck, the cost of service and reserves were included in that and Manager Craddick stated they were not. He stated that each million dollars would be a 5% rate increase and you can spread it out over five years and be 1% for each year.

Chair Dill asked if we should defer this until we find out about the Community Improvement District grant. The Community Improvement District surcharge would only affect the people in those districts. If it doubles people's water bills that is not an option. Chair Dill deferred this item until we find out the impacts of the Community Improvement District grant. Chair Dill also asked if we should use 50 years rather than 100 years but Manager Craddick thought it would be more than 50 years.

Mr. Nishimura asked for clarification on the miles of pipeline, is it 4 or 7 or 10. Manager Craddick indicated this is because we are very far behind and Mr. Nishimura asked how long it would take to catch up. Manager Craddick stated it is about \$150 per foot for 6 inch line, \$800,000 per mile.

4. User Pays Principle

Manager Craddick noted this is where the user of the service is the one carrying the financial impact, which is what the Board tries to follow, though there may be some instances where it

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was not followed and these are being corrected. Chair Dill asked if this meant that existing users do not pay for system expansions. They pay to replace, operate and maintain but not expand the system. The Board has hired a public relations group to present this to the public. The community feels that is how it should be done. Our focus group was primarily made up of rate payers not developers. The focus groups would be different for the FRC than the rate study. We are obligated to use whatever we have to, to pay the bond so if we do not have enough FRC income we would have to do resolution to borrow from one fund to the other.

A. *Transfer the debt to the FRC fund*

Once we issue bonds based on our revenues, people would be looking to that source at a minimum to repay those. You may not have any people coming in to build. It would be an understanding between the Board and the Council that we would repay our bonds.

B. *Transfer funding from the FRC to the General Fund, and reduce the debt coverage*

Ms. Yano noted that our water utility fund has more cash flow than the FRC fund and felt we should use our water utility and at the end of the year if the FRC has collected enough revenues to service that debt then the water utility fund can be reimbursed. She confirmed to Mr. Nishimura that we have been paying debt service from water utility in the past. Only now Manager Craddick is saying the FRC projects should be paid for by FRC funds. If this is what the Board decides, then that is the accounting that they will use. Manager Craddick stated that this is more how we present this to the public. User pay is easy to present to the public provided that is what you are doing. Though not only do we have the physical cost of construction, and the debt service, plans have to be reviewed, expenses of the people that manage the contracts and inspections. All of those labor costs are involved in getting those projects out. It is covered by the water rates right now. We are not suggesting that we cover all the labor out of the FRC but we do capitalize this at the end of the year. We have to budget for these real costs. It gets capitalized every year but there is no payment from the FRC. We do not charge a permit fee, which is another way to recover some costs.

Chair Dill presumed Ms. Yano used the FRC to reimburse the water utility fund only for expansion not replacement to stay in line with the user pay principle. Manager Craddick stated there are some projects that are hybrid and gave examples. Special Projects has come up with a table showing going from one size to another size pipeline and what the percentage of cost is. Mr. Moises distributed this table. Manager Craddick will be updating his table to more clearly see what might be FRC related.

Upon query from Chair Dill, Manager Craddick's recommendation was item B, *Transfer funding from the FRC to the General Fund, and reduce the debt coverage.*

Chair Dill agreed with the recommendation, however, he wished to see what the ramifications are by updating Table 9. Manager Craddick stated this is covered in Line 52. We will make a payment on the Piwai which is entirely FRC related and that will be shown in the budget. This shows 50% of the BAB and the next table will be 40% not 50%. Mr. Nishimura asked that, assuming that you do not get the demand on the FRC, then what happens to these monies, how do they get paid and accounted for.

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Ms. Yano reported that previously it was paid from the water utility to try to pay the FRC.

Mr. Nishimura stated there are two separate issues:

1. The rates to continue to finance projects
 2. FRC which may be five times higher, the rate might be 5 times higher
- The cost of making these improvements are still there and we still need to reimburse the utility fund to make up the improvements.

Manager Craddick noted that the FRC is based on 1% growth, it just covers principal cost, not the interest cost. If it were to go up five times, we would collect \$2.5 million per year which is close to covering full debt service cover at 40% of the BAB. There may be a big rush in at the current low rate, then a lull when the new fees kick in.

Chair Dill reported that the committee needs the updated Table 9 and the Community Improvement District evaluation costs.

Re: Manager's Report No. 11-28 – Request Board Approval of Facilities Reserve Charge Changes

This report was not discussed.

Due to time constraints, the Finance Committee meeting duly adjourned at about 8:42 a.m.

Respectfully submitted,



Carol A. Beardmore
Secretary

Approved,



Randall Nishimura
Secretary – Board of Water Supply

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