FINANCE COMMITTEE MEETING

Monday, November 4, 2019

Committee Members Present: Finance Committee Chair Lawrence Dill, Ka`aina Hull and Elesther Calipjo. Also present was Board Chair Thomas Canute *(entered @ 9:28 am)* and Board Member Laurie Ho *(entered @ 9:55 am)*

Staff Present: Bryan Wienand, Marites Yano, Michael Hinazumi, Dustin Moises, Edward Doi, Darrell Acob, Keith Aoki, Marcelino Soliz, Anne Parrott, Val Reyna, Jonell Kaohelaulii, Mary-jane Akuna, DCA Mahea Krafft

Consultants (via teleconference): Sudhir Pardiwala, P.E. and Hannah Phan

Guest(s): Hall Parrott, Private Citizen

Finance Chair Dill called the meeting to order at 8:05 a.m., and quorum was established.

D. ACCEPTANCE OF AGENDA

Mr. Calipjo moved to approve the Finance Committee Meeting Agenda; seconded by Mr. Hull; with no objections, motion carried with three ayes.

E. OLD BUSINESS

1. *Manager's Report No. 17-29* - Discussion and Possible Action on the Financial Management Planning and Water Rate Analysis for the Department of Water for Fiscal Year 2020 through Fiscal Year 2024 and refer to the Finance Committee for Further Discussion and Analysis *(Update)*

BACKGROUND:

Manager Wienand briefed the Finance Committee that an overall workshop approach was done in May by Raftelis Financial Consultants on the proposed rate increases. Since 2017, this proposal was deferred several times by the Finance Committee based on Facilities Reserve Charge (FRC) and updates to the FRC rules. The Department received from the legislature $14M this year with an 80% match. From May 2019, recalculations were done with the $14M funding.

The major update from Water Resources & Planning (WR&P), Engineering, Construction Management and Operations teams reviewed the updated list, scores and the analysis of the construction spending the next five years. The second major factor was the maintenance and operations costs.

Refer to Attachment 3 in the Board packet which was the previous May Workshop packet. Attachment 2 is the Executive Summary.

Water Rate Study packet topics by Ms. Phan:
Agenda – page 7
Main Study Objections – page 8
Key Assumptions – page 9 & 10
O&M Expenses – page 11
CIP Financing Plan – page 12
Proposed Revenue Adjustment – page 13 (recommended a 7% revenue adjustment 2020-2024 but not for 2021)
Financial Plan – page 14
Current Target Reserve – page 15 (no changes on the reserve policy)

Ending Fund Balance – page 16 (on target)

<u>Anne Parrott, Accountant provided comments to the Board</u>
The objective operating expenditures are based on the 2020 budget. Mrs. Parrott observed that no one looked at the historical data. She indicated the Department spent operating expenses at $20M a 30% jump. The 30% rolls on collecting $4M/year x 5 = $20M. If $20M is eliminated, she asked what does that do to the 7% per year? It appears to be eliminated. Mrs. Parrott defined fund balance as spendable cash in a government setting. An enterprise fund looks at the unrestricted net position which the Board does not need to look at does need to look at working capital according to the government finance officer. The reserve amounts are taken away that is needed for 90 days of working capital. Not shown is the $35M for fiscal year 2019 of unrestricted net position. By adding this amount to the working capital equals $55M. If the $29M changes to $55M, Mrs. Parrott asked what could this do to a rate increase?

Mrs. Parrott continued to say if the Board needs more reserves, a Board policy would initiate to set aside money for future pensions and future post employee benefits but it has not been done. Two years ago, she came to the Board to work on financial policies before going into the rate study. Leadership could have completed the policy and management needs to make a decision with Fiscal's support and to start over. Fiscal only added $300,000 to the fund balance this year due to spending $900,000 on trucks.

Chair Dill agreed with Mrs. Parrott and asked the consultant to respond to her points. Mr. Pardiwala responded that there is 25% of operating expenses after depreciation for working capital. The insurance deductible of $1M is set aside typical for water agencies. He recommended a capital fund but the Department has various grants and loans. Mr. Pardiwala requested to have Mrs. Parrott's explanation on the $55M. Mrs. Parrott said the unrestricted net position at the end of 2019 is $35M. Out of the $35M due to accounting changes, $20M of pension liability and post-employment benefit liability is currently spendable money. This would be added to the unrestricted position to get to money that the Department actually has to be spendable. By adding current assets less liabilities, the number is smaller because the Department has $20M sitting in long-term investments. The Government Finance Officers Association (GFOA) says organizations needs to look at how their organization operates to come up with these numbers. The long term investments are in Freddie's ad Fanny's that are publically traded. Monies could be acquired in 30 days. This money could go into spendable pot because the Department is fat rich. Mrs. Parrott indicated that after the last rate study, the Department got lots of money which could be divided between the divisions but they could never spend all of the money. She is not in favor of asking for a rate increase at this time. She suggested to revisit the capital plan. With a 7% per year increase when compounded is 30% for the customers, this is not fair for the public.

Chair Dill agreed that 7% per year is a large increase. He wanted to know if all of the extra funds set aside such as the Other Post-Employment Benefits (OPEB) that are invested benefits? Mrs. Parrott said that was not true because they were expensed with an accounting change. A policy could make it nonspendable money to be analyzed to set aside 5 or 10 years.

Waterworks Controller Mrs. Yano said there is $20M in the operating expenses but need to consider adding $8M per year in debt service. Mrs. Parrott was not speaking to the debt service or the capital but only for the inflated operating expense. Mrs. Yano explained that the $20M in employee benefits is a long term liability of the Department of Water (DOW) that is set aside in the financials. The Board could decide how the money is used or could be available funds. Chair Dill said to set aside money, there is no policy that confirms this which Mrs. Parrott said yes. The projections were based on this year's budget. Chair Dill asked if the Department based the projected numbers on the high expenses on historical data and Mrs. Parrott said yes. Cash expenditures need to be separated from accruals which could be difficult with pension accruals for long term liabilities. Mrs. Yano handled the expenses from the County, Admin., offsets by the hydrants and the rate study plan. Mrs. Parrott suggested someone should work with everybody in the Department because the budget is not right.

Manager Wienand shared that the rate model will show on how to adapt the various changes. Ms. Phan explained the O&M costs that is going into the budget for the rate study has accrual total amounts of $26.3M for 2020, $27M for 2021 and $26M for 2022. Mrs. Yano said the actual fund balance was provided for fiscal year 2019 and the actual operating expenses for 2019 was $23.M with interest in the June statement. Expenses are considered debt service. Ms. Phan did not see cash flow because she put in the fund balance at the end of 2019 and beginning of 2020 is $39 net encumbrances.

At 8:40 a.m., Mr. Calipjo exited the meeting
At 8:45 a.m., Mr. Calipjo re-entered the meeting

At 8:41 a.m., Chair Dill Recessed the meeting.
At 9:07 a.m., Chair Dill Reconvened the meeting.

Chair Dill addressed two significant issues 1) Liability for future retirement expenses also a statewide issue. Only the County of Kaua'i and the DOW have current liabilities. Liabilities need to be current for the retired employees, to the rate payers and tax payers. Missing was the Board policy to confirm the management of this. He commended the Department for making sure the future liabilities are funded and it needs to be done for rates to be captured in the future. The Manager will need to establish a Board policy and 2) the manner of projecting future expenses on actual expenses required for rate increases. He would like to see adjustments to the model to base projected needs on rate increased on recent trends of actual expenses as opposed to fiscal year 2020 budget. Often numbers are picked with the Department's expenses. If the Department has a revenue challenge, this could be revisited with the Board to make sure the costs are covered.

Mr. Hall Parrott, private citizen provided his testimony.

Mr. Parrott addressed the electrical company's returns that are unused money collected for unused expenses. The public has a choice of receiving cash or deducted on their bill. He noted 1st quarter's expenses are budgeted at $3M and spent $2M ($1M at the end of the year would be $4M that goes to water fund (is not tracked, not identified & is lost). Expenses are $55M and next year this amount will go up. What of he went the newspaper and asked, what is the DOW doing?

Chair Dill asked how Mr. Parrott up with $55M? Anne Parrott said $55M which is conservative, but he says it is $62M. Mr. Parrott said there are pluses and minus that was pulled from seven different accounts. He said to work with the GFOA for a report.

DISCUSSION:
Mr. Hull inquired on the vacant positions and salaries allocated, what was the process of budget transfers? Does the Board review transfers? Mrs. Yano explained that the operating expenses are approved by the Manager in Board Policy No. 3. The approved budget transfers, depending on the category are capital expenditures less than $10K. Manager Wienand said historically, salaries and wages have been over budgeted for vacancies. The Department can transfer funds within salaries and wages from a different vacant positions to position. Many positions budgeted for 2019 are still in DHR going through the process of getting a positions filled.

Mr. Dill requested to see how the operating maintenance expenses budget is revised to project expenses.

Mr. Hull was not comfortable without addressing the retirement liabilities and agreed with Chair Dill and asked if there is a specific rate? Mrs. Yano explained that the state engages the services of an actuarial consultant. Every government participates with that procurement study that includes the

DOW. From inactive employee's retirement and active/future employees, it determined the unfunded liability amortized over 30 years. Included is the performance of the investment and takes out administrative expenses to determine the balance at year end. Mr. Hull asked if the formula is based on the State formula? The State is trying to catch up with this statewide formula. Contributions are future liabilities on the payroll percentage incurred yearly. Mrs. Yano commented that statewide all counties determine what each liability is on what the Department puts in every year paying 100%. This is put into the rate study for future expenses on the projected actuarial study. Mr. Hull said the statewide system has an unfunded liability established because the State of Hawai'i was not funding at 100%. He asked if the Department have to make up of their loss in commitments to payments? Mrs. Yano said no and that each county submits a record of retirees based on the study. The Department has its own accounting. Mrs. Parrott mentioned 1) what should to be funded this year and a portion of the unfunded. Money is sent to the retirement individuals. What is recorded on the financials is the extra 30 years' worth. She added do we set aside the whole 30 years' worth of cash or half of it? GFOA has not given any guidance on this. If money is set aside, it is not paid to the State.

Mr. Hull mentioned the large amount is above the formula for the DOW to pay the Employee Retirement System (ERS) which Mrs. Parrott agrees due to the accounting change. Government Accounting Standards Board (GASB) made projections difficult and if expensed, it comes out of the fund balance (unrestricted net position). This policy was put in place for transparency by disclosing this number, according to Mrs. Parrott, it tells the public more information. The Department would have to analyze this to cover cash liability.

Mr. Dill understood that the Department is doing the minimum requirement. Mrs. Parrott commented that the Department would set aside the cash to fully fund the pension for the next 30 years and restrict the cash for the debt service reserve and emergency reserve. This is not included in the current year contribution (unfunded).

Manager Wienand asked if the current approach is to set aside the full amount or a Board policy would it set aside a number in between that the Board choose 10, 15 or 20 years? According to Mrs. Parrott, the Board could set aside any amount and it could be funded. Mrs. Yano mentioned this is funding the unfunded liability in Fiscal's account. Whatever is left out from $20M, is a net position, which is broken down into restricted funds, Build America Bond fund, Facilities Reserve Fund (FRC a restricted fund), restricted Emergency Fund and Debt Service fund.

Mr. Hull would be okay if the Department is aligning the same process with the County of Kaua'i (COK). He mentioned that the last Council meeting was to have the DOW under the council's review with a Charter amendment. If the Department has a 7% rate hike over the next several years, putting away a certain amount of money that is not calculated into expenses would allow for a lower rate hike.

<u>Chair Dill requested the Department to provide answers for recommendation to the Board</u>:
1) Determine what the Board Policy on how to fund the liability and to what extend?
2) Issue projected expenses with the actual expenses for the recent history of the DOW
3) Continue the rate study presentation and to come back to the Board with more answers.
4) The Finance Committee needs more information on what the policy should be on retirement.
5) What is the industry standard?
6) What are other agencies around the State are doing?
7) Is DOW setting the standard? Are calculations with the County Finance the same as DOW?

Ms. Phan continued the Water Rate presentation:
Existing Water Rates - page 18 – will cover the additional revenue adjustments if FY 2020 effective February if the 7% rate will change. The Board should look at the rate structure.

FY 2015 Customer Data - page 19- 22

Proposed Rate Structure - page 23 – consultant recommended metric rates that are differentiated by the customer class, not by meter size.
Proposed Monthly Meter Charges – FY 2020 - page 19
Proposed Monthly Private Fire Meter Charges – FY 2020 - page 25
Proposed Volume Rates - page 26
Proposed Volume Rates FY 2020 - page 27
Customer Impacts – FY 2020 - page 28

At 9:55 a.m., Ms. Ho entered the meeting.

Mr. Hull asked what type of single family falls in Tier 3 or if single family falls in Tier 1? Why isn't "all other" tiered? Mr. Pardiwala commented that most single family fall under 3 tiers that provides for conservation, commercial customers, and single family for conservation. Tier 1 is for indoor use and is the lowest customer use and lowest rate, Tier 2 is average consumption and Tier 3 are for customers that use more than the average use / irrigation and pay the highest rate. Mr. Hull mentioned that if someone was running a commercial business, they could reduce cost. Mr. Pardiwala mentioned if a tier was used for non-residential customers, it is based on historical usage each year. Tiers are not set for non-residential customers but could be set.

Mr. Hull inquired what is the qualification for an agriculture rate? Manager Wienand indicated the qualification is in Part 4 of the rules by submitting taxation documents to the State and proof of an annual backflow inspection. Mrs. Yano's discussions with the consultants proposed that ag rate users have a hybrid component rate structure. If they had a residential house, the DOW proposed a domestic usage and ag rate.

Mr. Hull asked Manager Wienand what is the Transient Vacation Rental usage? Would it be in "all other" or fall under the tiers of single family residence? Mrs. Yano said this would be categorized as single family. Mr. Pardiwala said single family rentals would be under single family and multi-family would fall under "all other." Mr. Hull mentioned that the vacation single family unit is like a resort and if it would fall under single family residence or "all other rates." This is hard to know if it is a resort or part time single family use. Under the Tier 3 level, there would be no problem. If they are using less usage, there are about 4,000 rentals who may be taking advantage of a single family component paying compared to a commercial under "all other." Manager Wienand said the billing system would have to be identified by TMK customers who would be in the TVR and to analyze if their usage is consistent with single family. If the rates are changed, the billing system would have to be restructured. Once the Finance Committee makes a recommendation to the full Board and if the full Board gives their approval that would be the internal go ahead to reconfigure the billing system to make sure it is accurate before finalizing the rule change that goes public within three months. By looking at TVR's, this could delay the rate making process but also the internal testing.

Mr. Hull asked what are the figures if the "all other" was tiered? Mr. Pardiwala said the industry standard is to have ag and everything in the commercial category. You would have to analyze usage for all customers and to ensure that it can be done on the current data on meter size. Currently the consultant did not have the historical data. Mr. Hull inquired if they could look at the multi-family usage? By comparing the multi-family rate to a single family residence at 0 to 7,000 gallons a month, it should be lower with or without landscape usage. There could be a residential tier level to incorporate a multi-family. Chair Dill asked if there was a justification for the tiered rate for multi-family in addition to single family? **The consultant will address tiers for multi-family residence.**

A follow up meeting will rescheduled based on the questions posed today.

At 10:09 a.m., Chair Dill deferred the Finance Committee meeting.

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