A regular meeting of the Carson City Utilities Advisory Committee was scheduled for 5:30 p.m. on Thursday, June 13, 2002 in the Cooperative Extension Conference Room, 2621 Northgate Lane, Suite 12, Carson City, Nevada.

**PRESENT:** Chairperson Ron Knecht
Vice Chairperson Glen Martel
John Degenkolb
Ryan Langson
Craig Mullet
Larry Osborne
James Polito
Jeffrey Smeath

**STAFF:** Andy Burnham, Development Services Director
Larry Werner, City Engineer
Tom Hoffert, Utilities Operations Manager
David Heath, Finance Director/Risk Manager
Tom Minton, Assistant Finance Director
Nick Providenti, Accounting Manager
John Bonow, Consultant (via video down link)
Kathleen King, Recording Secretary

**NOTE:** Unless indicated otherwise, each item was introduced by Chairperson Knecht. A tape recording of these proceedings is on file in the Clerk-Recorder's Office and is available for review and inspection during regular business hours.

**A. CALL TO ORDER AND DETERMINATION OF A QUORUM** (1-0185) **-** Chairperson Knecht called the meeting to order at 5:30 p.m. Roll was called; a quorum was present. Member Riggs was absent. Member Langson arrived at 5:45 p.m.

**B. APPROVAL OF MINUTES - May 9, 2002** (1-0206) **-** Vice Chairperson Martel moved to approve the minutes. Member Degenkolb seconded the motion. Motion carried 7-0.

**C. PUBLIC COMMENT** (1-0220) **-** None.

**D. MODIFICATION OF AGENDA** (1-0233) **-** Mr. Heath suggested modifying the agenda to address item F-3 prior to item F-1 and discussion took place with regard to the same.

**E. DISCLOSURES** (1-0311) **-** Vice Chairperson Martel advised of providing an update of the Committee's discussions to the Board of the Builders Association of Western Nevada. Member Mullet advised of providing a report and distributing copies of the draft objectives to the Manufacturer's Subcommittee of the Chamber of Commerce. He related comments from Supervisor Pete Livermore regarding the Marlette Lake project. Chairperson Knecht advised of his continued consultations with Bob Crowell of the School Board, and provided details of their conversations.

## F. PUBLIC MEETING ITEMS:

**F-1. DISCUSSION AND ACTION ON RECOMMENDING WATER AND SEWER FINANCIAL RATE OBJECTIVES TO THE BOARD OF SUPERVISORS** (1-0390) - Chairperson Knecht referred to the Utility Rate Objectives included in the agenda materials. Mr. Hoffert provided an overview of the revisions made pursuant to the Committee's direction at the last meeting. He offered a further revision to objective 11, as follows: "The current program of auditing all new sewer construction or remodel construction of commercial and industrial water usage accounts to be calculated and compared with the estimated consumption used to calculate the amount of the connection fee originally charged should be eliminated." He advised that the majority of the language was taken directly from the ordinance, and copies of the proposed language were provided to the Committee members. In response to a question, he explained that the proposed revision refers to a function of rate establishment for both sewer and water; that the City should be doing the best job possible at original connection fee calculations instead of reviewing them five years later. In response to a further question, Mr. Werner explained that the language is part of the current rate ordinance and that staff believed the recommendation should be reviewed by the Committee. Mr. Bonow referred to objective 5, and commented that the auditing process result is a "foregone revenue." In that sense, it does affect the rate making process as it pertains to recovering costs. The first step is identifying the costs. Discussion took place regarding the proposed revision, and **Vice Chairperson Martel moved to accept Mr. Hoffert's recommendation for objective 11. Member Smeath seconded the motion.** In response to a question, Chairperson Knecht suggested a method by which to review and approve the individual objectives. He called for a vote on the pending motion; **motion carried 8-0.**

Mr. Bonow advised of speaking with American Waterworks Association staff, and inquired as to whether or not the two alternatives presented in objective 3 could be blended together. He proposed combining the values of imbedded cost elements and the forward-looking nature of marginal cost elements into one method. Chairperson Knecht advised of a meeting with City staff and the consultants to discuss the feasibility and practicality of implementing marginal cost concepts. He inquired as to whether adding the words "at least" would provide the latitude requested by Mr. Bonow. Mr. Bonow suggested that the two alternatives appear to be distinct which would call for a strict marginal cost analysis. He expressed a preference to rephrase the objective to blend the two approaches thereby incorporating the benefits of each. In response to a question, he explained that an imbedded cost analysis takes the approach of a base extra capacity analysis or a commodity demand analysis which are the two main approaches of deriving revenue requirements. Debt service coverage requirements under bond documents can be incorporated together with other elements particular to government-owned utilities. As such, the benefits of a traditional or an imbedded cost analysis is that it more appropriately captures the elements particular to government. On the other hand, marginal cost analyses involve a very forward-looking mindset but, when considering the revenue requirements typically generated, some of the government-specific items may not be incorporated.

Chairperson Knecht referred to his concerns expressed during the conference call with City staff and Mr. Bonow. Mr. Bonow acknowledged that incorporating the proposed language to include the governmental elements of an imbedded cost analysis would still focus on the commodity versus monthly customer usage issue in the rate design. He suggested there are certain basic costs of doing business for the utility and certain commodity-based charges that result in how much of the utility is actually used by existing customers and how much, on a forward-looking basis, may be used in the future. If those two elements can be captured, the variable nature of that use, the "lion's share of the commodity-based costs," would be included. In response to a question, Mr. Bonow suggested the following language: "That the alternatives presented to the Board of Supervisors should include the benefits of a forward-looking approach related to a marginal cost analysis and the government-specific benefits of a traditional approach to rate making that allocates book costs across different classes." In response to a comment, Mr. Bonow explained that the benefits of a marginal cost analysis are that it forces a look into the future instead of relying on the past as an indication of what will happen, and it allows for consideration of the costs of providing service in the past as well as how they may change as the system expands and different regulations are implemented. Chairperson Knecht commented that the marginal cost analysis is forward looking but also focuses on the variable costs and not on the imbedded and fixed costs. Mr. Bonow acknowledged that this was consistent with his understanding, but indicated that the elements of both can be blended to capture the governmental, fixed costs that result in having the system in place together with the commodity or variable-based costs, and recover them in the rate base using something closer to a marginal cost approach.

Member Mullet provided an overview of the discussion which took place at the last meeting regarding the objectives. Mr. Bonow suggested inserting the words "elements of" after the word "include" in objective 3. The Committee will then be free to choose among marginal cost elements and traditional cost elements. Member Polito agreed with the purpose for combining the elements, but advised that the reason for including the two alternatives was because the Committee agreed there should be at least two distinct approaches. In response to a comment, Mr. Bonow advised he would not recommend doing only a marginal cost study because of the governmental utility outlines he previously described. He acknowledged that his suggestion was "to be somewhere in that spectrum rather than two distinct things that don't learn from one another." He suggested the first alternative should indicate that the consultants take a marginal cost approach to the analysis with the caveat that the circumstances are such that a strict, marginal cost analysis would not be possible "as used in the rate making world" but that it will incorporate elements of the marginal cost analysis.

Chairperson Knecht indicated that Mr. Bonow understands the concerns and issues and is attempting to get guidance and appropriate leeway so as not to be constrained by the words of the objective, but will make a good faith effort to reflect the two strains of thought being pursued. He entertained a motion that, for purposes of moving the draft for final discussion and amendment, the words "elements of" be added after the word "include" in objective 3. **Vice Chairperson Martel so moved. Member Osborne seconded the motion. Motion carried 8-0.** Mr. Bonow acknowledged that the revision provides the "leeway and security" for him to work within the general intent of the document.

Chairperson Knecht entertained a motion to approve the objectives as amended in order to discuss and approve them. In response to a question, he suggested approving the draft for discussion and then making clerical revisions and addressing the Committee members' exceptions. **Member Polito so moved. Member Langson seconded the motion. Motion carried 8-0.** Member Polito suggested revisions to objectives 1 and 7, and **moved to incorporate them into the document. Member Degenkolb seconded the motion. Motion carried 8-0.** Member Mullet suggested revisions to objective 9, and **moved to incorporate them into the document. Vice Chairperson Martel seconded the motion. Motion carried 8-0.**

Mr. Bonow suggested that part of the difficulty thus far has been a matter of semantics. With regard to objective 5, he advised there are two main methods by which governmental utilities allocate costs: one is on the base extra capacity method and the other is on the commodity demand method. He advised that the

Committee will be hearing those two phrases in the future, and indicated the need to ensure a proper understanding between commodity demand and the commodity based approach referenced in objective 5. Member Osborne expressed appreciation for the clarification and referred to the material provided to the Committee members by Mr. Hoffert. He commented that the terms are contained in the material and that the Committee members will become familiar with them as this process continues.

Member Degenkolb discussed his understanding of fire protection requirements. He referred to the Uniform Fire Code which requires at least 1500 gallons per minute, and inquired as to the chapter in the materials provided by Mr. Hoffert which indicates that the cost of installing fire protection, hydrants and water system, is funded by ad valorem or other property tax. He inquired as to whether the cost of installing piping in a new development will be considered in this process and suggested that fire demand should be a key factor. Chairperson Knecht advised that facilities design is not within the purview of the Committee in a water utilities sense, but that connection and the infrastructure behind connection is within the Committee's purview. He inquired as to whether the City's general design specifications accommodate necessary fire flow in both the general infrastructure and in the connections or if there is occasionally a need to upgrade pipe. Mr. Werner advised that installation of fire hydrants and new systems is done during new construction. The utility generally does not install hydrants and mains unless for the general good, and maintenance of fire hydrants is funded through water utility rates. The Fire Department is charged with inspecting hydrants as a general fund obligation which is not reimbursed by the water utility. Mr. Werner acknowledged that fire demand is the driving force behind pipe size, pressure, delivery, and reserve/storage requirements. In response to a question, Mr. Hoffert advised of the requirement for the developer to provide a model demonstrating necessary fire flows and sewer capacity for any new commercial, industrial, or residential development. He acknowledged that the cost of new systems is not within the Committee's purview. Mr. Werner clarified that the Committee's purview extends to capitalization of future repair and replacement. He advised of a project near City Hall in which new water mains are being installed to replace existing water mains, and discussed spacing, sizing, pressure, and delivery requirements for fire hydrants. In response to a question, Mr. Werner explained that the material provided to the Committee outlines examples of how to fund installation and maintenance of fire suppression/protection facilities. He acknowledged that Carson City does not use ad valorem taxes to do so. In response to a question, he advised that the Committee has been charged with determining the rate structure. Mr. Bonow acknowledged that his analysis will recognize the role of fire flow in design parameters to the extent that cost information is available. An understanding of costs must first be reached in order to determine how to recover them. Separate data for capital or ongoing maintenance costs associated with fire suppression or protection can be folded into the rate analysis.

Chairperson Knecht requested that staff and the consultant determine the extent to which fire suppression/ protection issues can be incorporated into all the analyses as appropriate and as data is available within the time and budget constraints. Mr. Werner advised that fire suppression costs are not broken out and will most likely not be an issue. **Member Osborne moved to adopt the utility rate objectives as presented with the modifications approved this evening. Member Smeath seconded the motion. Motion carried 8-0.** Mr. Werner advised that staff will make revisions and provide an original for the members' signatures.

**F-2. DISCUSSION AND ACTION ON PRESENTATION OF THE RATE OBJECTIVES TO THE BOARD OF SUPERVISORS AT THE JULY 3, 2002 MEETING** (1-2395) - Mr. Werner requested one or two Committee representatives to appear at the Board of Supervisors meeting with staff. He advised that staff will present the material and requested a Committee representative to provide brief comments. He estimated the presentation to last no longer than 4-5 minutes. Member Osborne requested that the item be agendized with a specific time. Mr. Hoffert advised that staff will inform the Committee members once the agenda is established. Chairperson Knecht volunteered to attend. Mr. Hoffert will post the meeting as a possible quorum of the Committee. **Vice Chairperson Martel moved that staff present the rate objectives as approved at this meeting to the Board of Supervisors at their July 3rd meeting, and that Committee members, as they deem appropriate, are encouraged to attend. Member Osborne seconded the motion. Motion carried 8-0.**

(2-1090) In response to a question, Mr. Werner advised that the expectation of the July 3rd Board of Supervisors meeting is approval of the Utilities Rate Objectives. Mr. Hoffert advised that each of the Board members may provide input regarding their priorities in moving forward from the objectives. If so, their comments will be agendized for review by the Committee at the next meeting. In response to a question, Mr. Hoffert advised Mr. Bonow to plan on going forward from this point. Staff will provide any additional comments from the Board of Supervisors for additional clarification or consideration after July 3rd.

**F-3. OVERVIEW OF FINANCIAL STATEMENTS AND COST RECOVERY** (1-2575) - Mr. Heath advised that this item was agendized at the request of Member Riggs. He distributed a combining balance sheet of enterprise funds and advised that one of Member Riggs' concerns was the large cash balances in the sewer and water funds. He reviewed the current assets (restricted) and the accumulated depreciation, and advised that the City currently has very little in reserve for plant replacement. In response to a question, he advised that the cash and investments were accumulated through the collection of depreciation, all of which is not being recovered, and that the cash balance has been diminishing. Since the previous study, the philosophy of the Board of Supervisors has been to avoid rate increases as long as the working capital is positive.

Mr. Heath responded to questions regarding interest income, investments, and emergency cash reserves required by the Environmental Protection Agency ("EPA"). In response to a question, Mr. Werner explained that certain percentages of grants must be perpetually maintained in emergency reserve to cover major facility failures. In response to a question, Mr. Heath advised that the amounts reflected in the "Due from other governments" line item represent freeway project improvements to be paid by the Nevada Department of Transportation. He acknowledged that the amounts are project-specific. Mr. Heath reviewed the retained earnings (deficit) in the water fund, and explained that the amount represents undercollected depreciation. The positive number reflected in the sewer fund is largely due to the EPA grant.

Mr. Heath responded to questions regarding land and other property valuation, general obligation bonds and notes payable, GASB-34 requirements, and valuation of water rights. In response to a further question regarding the difference between the amounts reflected in the fund equity and the long-term liabilities line items, Mr. Heath explained that the previous study implemented a policy to finance plant expansion only. He acknowledged that the life of the plant is greater than the life of the financing instruments by a factor of two. Mr. Bonow advised of a tax law limitation on the period of time bonds can be sold relative to the useful life of the asset being financed. The City has been well short of what is allowed under the law.

Mr. Heath reviewed the Projected Income Statement for the Water Fund. He explained the strategy to bond for expansion and recover debt service on the bonding through connection fees. He advised that the

$979,000 reflected in the Estimate column of Operating Income Loss is due to the City's meter program. He explained that the Board of Supervisors changed the capitalization policy a year ago to expense the value of each meter rather than treat them as a capital addition. The water meter program is in its final phase and will not enter into future revenue requirements. He estimated an approximate $275,000 loss in the water fund in coming years.

In response to a question regarding a comparison of operating revenue and unrestricted cash on hand, Mr. Heath explained that working capital was considered when beginning the present study. Replacing the plant without issuing debt would require a large amount of working capital. Mr. Werner advised that the amounts in the current assets (restricted) line item would be used for unanticipated expenditures. He further advised that $1-2 million is spent annually on capital and that a $20 million plant expansion project will be required in about two years. Growth and changes in the standards are driving the cash-on-hand requirement. (2-0001) Mr. Heath acknowledged that the City's policy is to "pay for it as you use it not pay for it so that future generations can use it."

Mr. Hoffert responded to questions regarding salaries and wages and the reduction in billing staff. Mr. Heath responded to questions regarding the differences between the Actual, Estimate, and Tentative columns of the Sewer Maintenance Operating Expenses, the approximate 8% rate of increase in the total annual operating expenses for the sewer fund, the differences in total operating expenses in the water fund, and the decrease in interest revenues for the water and sewer funds.

Mr. Heath distributed the Sewer Fund Projected Income Statement for FY ending June 30, 2003 and reviewed the same. He indicated that Mr. Bonow felt this was a good place to start the rate methodology and cost recovery discussions. He referred to the variable costs column and explained that the labor costs are for a seasonal work force. The $1.1 million in services and supplies represents utility ($954,000) and chemical treatment ($175,000) costs. The remainder of the operations costs were deemed fixed, including depreciation. The amounts reflected in the capital costs column are primarily associated with engineering planning. Mr. Heath advised that the fund is deficient by $1.7 million due to unrecovered depreciation and no provision for plant replacement. In response to a question, he explained that utilities and chemicals were considered to be the most variable costs relative to production of commodity. Mr. Hoffert explained that sewer maintenance is the actual infrastructure within the community and the plant is the facility at Fifth and Edmonds. Mr. Heath explained that the $1.7 million represents "the best we could do" in the slowest winter month to keep the plant open and running.

Mr. Heath reviewed the Water Fund Projected Income Statement and pointed out that the operating loss is only $273,000. He advised that utility costs are $1,020,000 and chemicals are approximately $75,000. In response to a question, Mr. Bonow discussed fixed costs associated with an existing system. He suggested that the titles and groupings will change and expand as costs are identified. He acknowledged "there is something akin to base and extra capacity the way this is outlined."

Mr. Werner acknowledged that water resource costs are fixed and paid annually regardless of the amount of water used. Discussion took place regarding an estimate of water costs for new wells, and Mr. Werner advised that new growth is the smallest portion of the cost. Mr. Burnham acknowledged that staff has a good understanding of the incremental water resource cost. In response to a question, Mr. Bonow advised that incremental costs are considered when meeting increased demand from existing users or to accommodate growth.

Mr. Heath referred to the Calculation of Connection Fees - Water and Sewer and reviewed the same. He advised that the City will make the debt service payment which guarantees plant expansion to serve new customers. In the end, the shortfall is on the replacement side and, when the time comes, a fairly significant portion of the plant will have to be replaced. The City will have to bond for it and include those debt service costs in user fees which is contrary to the policy adopted by the Board of Supervisors at the time of the previous study. In response to a request for clarification, Mr. Heath advised that plant replacement would be funded through internally-generated cash, and that any significant replacement at this point would be impossible given the $4-$5 million in cash. Current costs are not being recovered as indicated on the operating statement.

In response to a question, Mr. Heath advised that consideration will need to be given to the engineering estimate of costs to build out and the number of new connections anticipated during that window to determine a connection fee. A very high fee will mean that existing customers had a "cheap buy in" which will need to be balanced. Mr. Hoffert acknowledged that connection fees have always been lower than the projected estimates. Discussion took place regarding the need to consider the issues associated with connection fees. Mr. Bonow commented that this highlights an important issue that connection fees are clearly not recovering what they were intended to recover. Two issues will need to be considered: How to implement a fee going forward and how, if at all, to recover the inadequacies of the last ten or twelve years.

**G. INTERNAL COMMUNICATIONS AND ADMINISTRATIVE MATTERS** (2-1067) - In response to a question, Mr. Hoffert advised that the Utilities Department recently received an award for the "best tasting drinking water in the State of Nevada for 2002."

**G-1. FUTURE AGENDA ITEMS** (2-0922) - Mr. Hoffert reviewed the items already scheduled for the next agenda pursuant to the work plan. Chairperson Knecht requested staff to agendize, for a future meeting, a report on costs associated with the federal government's requirement to terror-proof utilities. Mr. Werner advised that City staff has not yet received a final version of the guidelines, and suggested postponing the report until such time as the guidelines have been received and reviewed. Chairperson Knecht suggested a programmatic overview of the proposal and key measures on terror-proofing. Mr. Hoffert advised that staff could provide an overview of the existing system and realistic security measures which can be focused on and planned for over the next year.

**H. ADJOURNMENT** (2-1078) - Member Smeath moved to adjourn the meeting at 7:28 p.m. Member Mullet seconded the motion. Motion carried 8-0.

The Minutes of the June 13, 2002 meeting of the Carson City Utilities Advisory Committee are so approved this 11th day of July, 2002.

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RON KNECHT, Chair