

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the September 12, 2002 Meeting

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A regular meeting of the Carson City Utilities Advisory Committee was scheduled for 6:00 p.m. on Thursday, September 12, 2002 in the Community Center Sierra Room, 851 East William Street, Carson City, Nevada.

PRESENT: Chairperson Ron Knecht

John Degenkolb

Ryan Langson

Craig Mullet

Larry Osborne

James Polito

James Riggs

Jeffrey Sneath

STAFF: Andy Burnham, Development Services Director

Larry Werner, City Engineer

Tom Hoffert, Utilities Operations Manager

David Heath, Finance Director/Risk Manager

Nick Providenti, Accounting Manager

John Bonow, Consultant (via conference call)

Kathleen King, Recording Secretary

NOTE: 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 (1-0001) - Chairperson Knecht called the meeting to order at 6:03 p.m. Roll was called; a quorum was present. Vice Chairperson Martel was absent.

B. APPROVAL OF MINUTES - August 8, 2002 and August 16, 2002 (1-0012) - Chairperson Knecht distributed copies of suggested editorial revisions to the August 16th minutes, and proposed to have them included in the minutes. Mr. Hoffert advised that the recording secretary prepares minutes based on the tape recording of the meeting. He offered to have the suggested editorial revisions included as part of the permanent record, but advised that the minutes cannot be edited. Extensive discussion took place regarding the suggested revisions and the process for approving minutes. **Member Osborne moved to accept the minutes of the August 8th meeting as submitted by staff. Member Sneath seconded the motion. Motion carried 8-0.** **Member Osborne moved to accept the minutes of August 16th as submitted by staff. Member Sneath seconded the motion.** Chairperson Knecht proposed to amend the motion to include the handwritten changes on the three distributed pages. Member Osborne stated that the maker of the motion did not concur with the amendment, nor did the second. Chairperson Knecht called for a second on the motion for amendment and, when none was forthcoming, noted that the motion for amendment died. Further discussion took place regarding Chairperson Knecht's suggested revisions, and Mr. Werner suggested deferring action on the August 16th minutes until the next meeting to give Mr. Bonow a chance to review his own testimony. **Member Osborne withdrew his motion; Member Sneath withdrew his second. Member Osborne moved to table the minutes of the August 16th meeting to a future meeting of the Committee. Member Sneath seconded the motion. Motion carried 8-0.**

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C. PUBLIC COMMENT (1-0455) - None.

D. MODIFICATION OF AGENDA (1-0461) - None.

E. DISCLOSURES (1-0468) - Mr. Bonow advised of having received a telephone call from a citizen, who would not give their name, inquiring about their Carson City water bill. He referred the citizen to the Committee.

F. PUBLIC MEETING ITEMS:

F-1. REVIEW COMMENTS FROM SEPTEMBER 5, 2002 BOARD OF SUPERVISORS MEETING REGARDING DIRECTION ON COST ALLOCATION/RATE MAKING METHODOLOGY, FUNDING OF PLANT EXPANSION, FUNDING OF PLANT REPLACEMENT, AND RECOVERY OF ENERGY COSTS (1-0483) - Mr. Heath provided an overview of the comments offered by the Board of Supervisors. Member Osborne commented that the Board seemed to understand the City is facing a situation which needs to be corrected, and accepted that the Committee will be recommending increases to water and sewer rates. The Board indicated the need for caution and awareness of the ratepayers' concerns, and suggested that the Committee may consider a phased increase. Member Osborne agreed that the Committee's recommendations should be in the best interests of the users, including the need to ensure that funds are available to continue operations and provide for capital improvements. He pointed out that it is not within the Committee's purview to make political decisions based upon the recommendations. It will be the responsibility of the elected officials to make the final decisions regarding implementation of the Committee's recommendations.

Member Mullet expressed agreement with the overview provided by Mr. Heath and the comments provided by Member Osborne. He indicated that the Board of Supervisors seems to be concerned about "shocking" the rate payers. He commented that as the Committee begins to consider the current rate structure and the rates of neighboring communities, a recommendation to further postpone increases will only compound the problem. The City has to "catch up for the last ten years" and move forward with new federal mandates. The rates need to be increased and the inequities eliminated. Member Mullet advised that the City is overcharging its industrial users compared to neighboring counties and undercharging residential users. He expressed a concern, based on the Board's comments, that the Committee develop a rate to provide the necessary budget to address federal mandates.

Member Smeath concurred with the previous comments, and reiterated a comment by Mayor Masayko that the Committee work to generate more public interest in the meetings. Chairperson Knecht concurred with the account of the Board of Supervisors' comments and direction provided by Mr. Heath and the Committee members in attendance at the meeting. He advised of having "pressed the Mayor and the Board" regarding whether the Committee should take a taxpayer/rate payer viewpoint and that the answer seemed to be yes. He advised of his intent to take a taxpayer/rate payer viewpoint on the various economic and policy issues involved in the rate making process.

Member Riggs advised of having watched the meeting on television, and commended Chairperson Knecht on his presentation to the Board of Supervisors. He suggested that the Board seemed concerned about connection fees being appropriate and the affect of less than 3% growth in consideration of long-range planning. He noted that several Board members expressed concern over rate shock and the hope that rate

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increases can be incremental. He further noted the Board's commitment to review rates on an annual basis which will allow them to defer some of the hard choices.

Member Polito also advised of having watched the meeting on television, and noted that a number of the Supervisors had expressed favor for reduction in the subsidy across classes. He clarified that this did not come across as a majority viewpoint but that it was clearly expressed by a number of the Supervisors. He indicated that the Supervisors did not seem to contemplate "a one-year flash cut but some sort of glide path." He heard the same Board members expressing a movement toward greater distinctions between the tiers as the subsidy between industrial and residential classes diminishes. He also heard from a number of the Board members a preference for financing alternatives that would spread the costs over a number of years which would correspond to the taxpayer and rate payer perspective. He suggested that the Board members also expect an increase in connection fees to cover the deficiency.

Member Degenkolb referred to the minutes of the August 8th Committee meeting and commented that the City will "run out" of funding in three years "so something has to be done." He referred to the action taken by the Committee to use an embedded cost approach rather than a marginal cost approach and suggested there "has to be a blending of the two some way." He referred to the AWWA Manual and commented that the marginal cost example provided "isn't the way to go." He discussed the benefits of conservation and suggested that marginal cost concepts should be incorporated into the embedded cost method. He commented that increases in revenue are inevitable.

Chairperson Knecht commended Members Polito and Riggs on taking the time to watch the Board of Supervisors meeting, and thanked Mr. Bonow for attending the meeting. In response to a question, Member Osborne advised that the reason rates have not been increased over the years according to the recommendations of the 1989 study is, "no one pushed for it." Member Degenkolb commented that the City is in trouble now because there was no follow-through. In response to a question, Mr. Werner advised that staff has received no additional questions or comments from the Board of Supervisors since the September 5th meeting.

F-2. DISCUSSION AND POSSIBLE ACTION REGARDING PRESENTATION BY CONSULTANT REGARDING DIFFERENCES IN THE WAY BASE/EXCESS AND COMMODITY/DEMAND ALLOCATE COSTS TO THE COST COMPONENTS AND DISTRIBUTE THEM TO THE CUSTOMER CLASSES (1-0811) - Mr. Bonow referred to the Comparison of Embedded Cost Allocation Methods document which was distributed to the Committee members and staff during the meeting. He reviewed the fundamental differences between the Base/Excess Capacity Method and the Commodity/Demand Method. He advised that both methods ultimately allocate costs in a way that provides the same revenue, but they differ in the way base costs are actually recovered. The base/excess capacity method includes fundamental costs to read meters, bill customers, and collect revenue as well as hydrant-related costs for direct fire protection. The costs which remain are capital and operating costs associated with the entire water system, except for meters and hydrants, i.e., pumps, treatment plant, water mains, distribution network. Those costs, which represent the bulk, are differentiated from each other. All capital and operating costs associated with average water use, such as staff, the size of the treatment plant, the size of the mains to deliver water on an average, annual basis, are allocated to the base. All costs above that average, those which are related to the oversized nature of the system that would deliver water at a rate higher than the average rate, are allocated to the excess capacity. The base/excess capacity method uses a test year for costs and allocates them based on an average sized system,

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if there was less variance or static water use in every day or month throughout the year, and differentiates that from the system the City currently has which addresses peaking needs in the summer.

Mr. Bonow expressed the opinion that the Commodity/Demand Method is much more difficult to understand in terms of how costs are allocated. The method is not familiar in terms of modeling because it is not generally used among municipal entities. Mr. Bonow called the American Water Works Association to clarify his understanding, as well as partners in his firm who used to work for the Philadelphia Water Department, one of the larger water entities that considered the commodity/demand method and decided not to use it. He explained that the commodity/demand method considers costs differently from the base/excess capacity method. Total costs are the same, but they are allocated as follows: Instead of considering what the system would look like if the same amount of water was used every month, the commodity/demand method considers the nature of costs relative to how many of them are related to the source of supply and how many are directly related to whether or not the treatment plant is running. Those costs, which vary directly with the amount of water used and certain overhead costs allocated only to the source of supply, are allocated to the commodity component. The commodity component is limited to the true variable costs associated with the system and source of supply costs. All other costs that aren't customer related (meter reading, billing, fire protection) and these true variable costs, are allocated to the demand component. The demand component is the "catch all." In the base/excess capacity definition, there is an average system and an oversized system which is everything above the average. In the commodity/demand method, the system is defined as everything from the first gallon of water delivered up to the peak and, in general, all of those costs except for certain variable costs are allocated to the demand component.

Mr. Bonow referred to page 2 of the Comparison documents, and advised that the costs reflected were not from the Carson City Water Utility. He explained that because of the way Carson City Water Utility costs are currently audited, defined, and outlined, they don't fall neatly into the AWWA categories listed. He used the costs found in the AWWA Manual examples and applied them to the circumstances of the City; those circumstances being an allocation of costs based on maximum day and maximum hour demand. The City Utilities Department does not have data on maximum hour demand so there is less differentiation on the water use side which somewhat simplifies the example. Mr. Bonow explained that there are four cost allocation categories under base/excess capacity: base element, excess capacity element, customer costs, and fire protection costs. He referred to the Average Daily Flow and Maximum Daily Flow figures in the upper left hand corner of the Cost Allocation. The maximum daily flow represents a proxy for the size of system required to deliver that amount of water in one day. Mr. Hoffert acknowledged that the maximum day is a single day and not an average over the maximum month or week.

Mr. Bonow referred to the base/excess capacity method which differentiates between what the system would look like if there was typical average water use every month or every day, and what the system looks like in reality given the fact that there are maximum flows. Under the base/excess capacity method, the costs allocable to customers are split based on their average use and how much the system and the operating costs related thereto are associated with the maximum use. Mr. Bonow referred to the sample costs listed and indicated that they are, in most cases, split among the base and the excess capacity on the difference between the average and the maximum daily flow. The method is applied to all costs other than those associated with customer service and direct fire protection.

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In response to a question, Mr. Bonow distinguished between reservoirs associated with pumping and peaking requirements and those associated with storage. He advised that the example in the AWWA Manual pertains to a source of supply that would be of the same acre feet magnitude regardless of how much was used on a per day or per month basis. This is why the reservoir under "Source of Supply Plant" is entirely allocated to the base; its size is not dependent upon the peaking of the system. Mr. Bonow acknowledged that when the allocation is done, he will have to make judgements as to the purpose and nature of the reservoirs, of land, of pumping plant structures, etc. in Carson City. He advised that science only goes so far in the allocation methods. At some point, a determination has to be made regarding how large the reservoir would be if there was "average use of x amount"; cost allocations are made based on that art. Mr. Bonow acknowledged that it is an educated guess.

In reference to the Comparison of Embedded Cost Allocation Methods, Mr. Bonow acknowledged that it is possible to use a range of different bases. The average is an open definition which can be anywhere from the minimum to any number higher than that. Mr. Bonow further acknowledged that work papers substantiating allocations will be available for review. He advised that most of the allocations will be based on flow data; those that aren't will have to be documented in some fashion through discussions with staff and the Committee. In response to a question, Mr. Bonow advised that to the extent there is no rigid method in terms of average versus maximum flow, a definition for average will have to be jointly developed. Professional judgements will be required where the data doesn't support the calculations. In response to a further question, Mr. Bonow advised that professional judgement and documentation will apply to the commodity/demand method as well, although they will be "different types of judgements."

Member Polito inquired as to which of the methods will be easiest for staff to replicate on an ongoing basis. Chairperson Knecht agreed that a process is necessary which "will outlive this Committee and that the staff can use to provide guidance to the Board of Supervisors in the future." Mr. Bonow expressed the view that the base/extracapacity method is the easier of the two methods in terms of quantification and a formula which can be relied upon to apply future circumstances and allow for allocation of costs. The base/extracapacity method has more rigidity to those types of formulas than other methods. Mr. Bonow suggested developing a formula for the percentage of overall costs that would be allocated outside of some type of formula. He referred to the Source of Supply Plant category example which depicts costs entirely allocated to the base, and stated that development of the rationale for that allocation should be readily translatable into a formula upon which staff can rely in the future. Member Polito referred to the commodity/demand capacity method and suggested that it would be easier to assign costs by category to either the commodity or the demand. He requested further explanation regarding how the formulas are involved in the commodity/demand method. Mr. Bonow advised that the same kind of typical all-in-one category provided in the example would be expected in a real-world outcome. While on its face it seems simpler to take costs in bulk and apply them to one category or another without a lot of cost allocation among different categories, he explained that this does not readily allow for a flexible and defensible method of having a minimum revenue stream with at least enough revenue to meet contractual obligations to bond holders and to pay minimum costs. Because of that, he suggested that commodity/demand creates more guess work and, on one level, a little more uncertainty than the base/extracapacity method. He acknowledged that his preference is related to rate design and stability issues rather than anything inherent in the cost allocation process. If done properly, using either method, the outcome should be the correct amount of revenue "at least with the benefit of hindsight."

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In response to a question regarding the commodity/demand method producing an uncertainty in revenue streams, Mr. Bonow advised that there is an inherent uncertainty in any embedded cost method because of relying on the past to be some indicator of the future. In the studies he reviewed, Mr. Bonow advised that the rate design which normally results from the commodity/demand cost allocation approach has much of its revenue dependent on the amount of water actually flowing through the system and on the accuracy of the demand forecast. "If you're wildly off in your demand projections, you are going to be similarly off in your revenue realization." The difference in base/extra capacity is that there is more of a fixed charge base which can be relied upon to satisfactorily meet mandatory obligations. Member Polito advised that he was expecting to see most of the demand costs recovered through some type of fixed charge independent of commodity usage. Mr. Bonow advised that this could be done but there are not many examples in the rate designs which have come out of the commodity/demand approach. It is somewhat the opposite in terms of demand charges generally being flow-based rather than fixed-base. Mr. Bonow acknowledged there is another set of professional judgements to be made not just at the cost allocation step but also at the rate design step. He indicated his firm belief that the City should be able to have a rate design which would result in a reasonable amount of revenue with very little revenue risk under either cost allocation method. Designing rates to recover the costs allocated under the methods is certainly open for adjustment to respond to the City's circumstances. Mr. Bonow responded to questions regarding revenue stability as related to fixed charges, the base/extra capacity method allocation formulas, the process for allocating various costs to customer classes, and documentation to be made available for review.

In response to a question regarding which of the methods allocates more cost to the residential customer class, Mr. Bonow advised that there is no disproportionate burden of costs among customer classes depending upon cost allocation method. The rate design is still up to the Utilities Department and the Committee's discretion. In practice, the goal is to try to allocate the same total amount of costs to each customer class regardless of the cost allocation method used. If residential customers are bearing \$8 million of total costs under the base/extra capacity method, they would be bearing \$8 million in total costs under the commodity/demand method. It's a useful starting point because if there is any variance from that, it certainly warrants a discussion. In allocating costs to the various customer classes, Mr. Bonow acknowledged there is a reasonably wide range of professional judgement regardless of which approach is used. He stated that this is the point where the political or policy realities impose themselves on the rate making process. Without the benefit of knowing how the City got into its current situation, the perceived subsidy between commercial and residential customers could be viewed as by design. Mr. Bonow advised that if the Committee and the Board of Supervisors decide a subsidy exists and to phase it out over a period of years, the allocation of costs among residential and commercial customers will shift over time regardless of the method used. This indicates latitude in terms of allocating costs among customers from year to year, otherwise there wouldn't be a smoothing of the cost transference among the classes over time. In response to a question, Mr. Bonow expressed the opinion that a different consultant would likely provide a "very close initial cut" on the customer class allocations because it would generally be based on measurable factors such as number of customers and flow, and on certain proxies for equivalent residential units. Member Smeath commented that the two methods are supposed to cover costs. How things are divided from there is what ends up benefitting the commercial or residential customer classes. He suggested that the Committee needs to get to the end and figure out where the subsidies are. [Member Osborne left the meeting room at 7:36 p.m. A quorum was still present.]

Mr. Bonow referred to page 3 of the Comparison documents, and advised that he had purposely left off the commodity/demand method. He explained that the costs listed represent actual, unaudited operation and

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maintenance costs from fiscal year 2002, which have been allocated using the base/excess capacity method. He advised that the reason for using only the base/excess capacity method was that in trying to allocate costs using the commodity/demand method, there were more unanswered questions in terms of the nature of the costs. He was unable to qualify each of the costs because the information was not readily available. He pointed out that costs were not expressed in every category because the City's method of summarizing costs is simply different than the five major cost areas typically used in water utility rate making. The costs can be readily redistributed among the different categories, and Mr. Bonow indicated that this is what he attempted to do. Mr. Bonow acknowledged that a different accounting framework may result in some variation in the results of the cost allocation, but that it would be a fairly minor variation. He indicated that as long as the total costs are correct, the number one goal to recover all of the costs should be met. The manner of recovering costs, whether from a fixed charge or a flow based charge, should be close to the same total revenue number. In response to a question, Mr. Bonow indicated he would have difficulty quantifying slight variations in customer class allocations. He acknowledged that there are some categories of utility costs which couldn't be allocated under the commodity/demand method because the required information is not available. Member Polito pointed out that adopting the commodity/demand method would require development of a new system of record keeping. Mr. Bonow indicated that, at the very least, each of the costs would have to be reviewed in consideration of their nature to determine an allocation for every dollar. Discussion took place regarding various ways to apply costs under the commodity/demand method. Mr. Bonow responded to questions regarding the terminology "rate base" and "operations and maintenance," and his recommendation of the base/excess capacity method.

Member Langson expressed a preference for the base/excess capacity method because it is easier to understand and will be easier to present to the Board of Supervisors and the general public. With regard to establishing rates for water and sewer and in consideration of the asset investment, Member Riggs inquired as to the method used to determine which costs will be covered by connection fees and which will be covered in the base. Mr. Bonow acknowledged that Member Riggs' question was as much an issue of cost allocation as rate design, but advised that the answer was much more dependent on less quantifiable factors. A formula is presently in place which provides answers that do not translate into a rate. Once the costs associated with growth are identified and agreed upon, the challenge still remains to determine whether or not all or some of the costs will be recovered through a connection fee mechanism or some type of capacity charge, or borne by the rate base. There is a return to the same fundamental question of where costs are allocated but rather than being base/excess capacity, it is existing service area versus new growth.

Chairperson Knecht suggested coming to a conclusion on choosing one or both of the allocation methods. In response to a question, Mr. Bonow expressed a strong preference for the Committee to choose one allocation method or the other. **Member Polito moved that the Committee act to adopt the base/excess capacity method of cost allocation for use in the Carson City rate making. Member Langson seconded the motion.** Member Riggs expressed the opinion that the base/excess capacity method is the best approach; that it is easier to understand and will be easier to explain. Member Smeath commented that the Committee has "chased this subject around a lot in previous meetings." Both of the methods have good points and he agreed that it was time to make a decision. Member Mullet expressed the opinion that the difficulty with the commodity/demand method will come in attempting to allocate costs at a tiered level. Member Degenkolb expressed support for the base/excess capacity method, and commented that there will be "trouble with the other one." Member Polito advised that there were a number of factors which influenced his decision: The base/excess capacity method may provide the Committee with the means to ensure greater revenue consistency; the consultant has more experience and expertise in implementing it;

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on a going forward basis, it will be easier for staff to implement the method with available information; and some of the accounting methods and information necessary to use the commodity/demand method are not available.

Mr. Bonow acknowledged that the allocation issues between the various cost components are separate from the customer class allocations and the rate design phases. In response to a question, Mr. Bonow advised that revenue stability is not necessarily a function of the cost allocation method, but revenue assurance relative to the reality of how the system operates is a bit stronger with base/excess capacity. Chairperson Knecht commented that he was "thoroughly agnostic" on the choice between the two methods because, in his opinion, both of them could be done "equally well or equally poorly." He expressed the further opinion that the only assurance one has that the methods actually result in a sound allocation is if either one is gone through in great detail. Otherwise, the judgement of the person implementing the method has to be accepted. He expressed confidence in Mr. Bonow, and indicated that neither he nor anyone else will most likely be going through and checking each allocation. He noted the majority preference expressed by the Committee and the consultant for the base/excess capacity method and expressed support for the motion. He expressed the opinion that neither he nor any other Committee member could provide a compelling explanation to the Board of Supervisors or to the public as to why one of the methods is more fair, reasonable, and reliable than the other. He called for a vote on the pending motion; **motion carried 7-0.**

[Chairperson Knecht advised of having been informed by Member Osborne of a previous commitment which would require his early departure from the meeting. He recessed the meeting at 8:02 p.m. and reconvened at 8:13 p.m.]

Chairperson Knecht inquired as to whether, in the course of doing the work, Mr. Bonow could provide detail for one or two cost classifications. Mr. Bonow suggested that it may be more helpful, as the process moves forward and when City costs are identified in a way that fits some of the categories more appropriately and completely, a couple could be picked out and the consultants could try to discern, given a certain rate design, whether or not the allocation method would influence the amount of the revenue that is the responsibility of a certain customer class. Chairperson Knecht requested him to do so and include it in the work. He indicated that the point would be to have an example of what difference the Committee's choices have made. He clarified that it will not be held out as a definitive statement but just an example of one major cost classification or two. Mr. Bonow reiterated that he would have no problem doing so, but cautioned the Committee that one variance in one direction under one cost allocation method should result in a variance in the other direction for a different item. The intuition that we may have had customer class x bearing less of the overall costs given a certain rate design if we had chosen a different cost allocation method will not be a valid conclusion.

F-3. DISCUSSION AND POSSIBLE ACTION REGARDING PRESENTATION BY STAFF ON DEBT FINANCING REVENUE REQUIREMENT SCENARIOS (1-2278) - Mr. Hoffert distributed Revenue Requirement Scenarios to the Committee members and staff. Mr. Heath referred to the scenarios provided to the Committee during a previous meeting, and advised that a third has been added showing financing replacement, to the extent possible, which reflects a smaller increase in revenue requirement over the years. He further advised that the cost of replacement could not be financed entirely and still maintain debt coverages of 1.2. He explained that the .2 provides a cushion in the event revenues come in lower than projected and also ensures that the City can maintain a healthy debt rating in order to receive preferred interest rates when bonding.

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In response to a question, he advised that the 1.2 times debt coverage represents prudent judgement by staff and is generally preferred by rating agencies as a minimum. A 1 times coverage basically results in barely met cash requirements if revenue projections turn out correctly. Another consideration is that, without any cushion, a rate increase is simultaneously required when debt is issued in the following year at the same time debt service increases as a result of new debt issuance. The 1.2 times debt coverage basically allows some "breathing capacity" relative to working capital or cash. Chairperson Knecht referred to the percent projected increases in the three scenarios beginning in year 03/04, and commented that the series of increases reflected in Scenario 3 smooths the revenue path over time more than the "spike" that is reflected in Scenarios 1 and 2. Mr. Heath indicated that the reality of increasing rates in any of the three scenarios will need to be smoothed out. He advised that the amounts are reflective of how the raw data falls out at this point. He acknowledged that a similar outcome would apply to the sewer fund.

Member Polito suggested that, given the comments by the Board of Supervisors, the Committee should present some alternatives to recovering costs, and that all three scenarios should be presented to the Board at some point. Mr. Bonow advised that the 20% coverage referred to by Mr. Heath is not cash which goes unexpended. It is typically for any entity that has capital projects because it is determined prior to capital costs being incorporated. Chairperson Knecht requested documentation of the practice of maintaining coverage levels by various water and sewer utilities as advocated by various rating agencies and other financial sources. Mr. Bonow advised that major rating agencies publish medians which are averages for items such as this in the various rating classifications. Coverage is one of those items and the documentation may be available from the rating agencies since the City pays for the ratings as part of each bond issue. In response to a question, Mr. Bonow advised that the rating agencies sometimes have a median range but this would depend upon the category being considered; oftentimes coverage is an average. Mr. Heath acknowledged that this information could be provided to the Committee at the next meeting.

Member Mullet commented that he was expecting, in Scenario 3, the compounding of interest. He suggested that "it almost looks like it's beneficial to finance it all." Mr. Heath acknowledged that compounded interest would have occurred in later years if the scenario had been further projected. He explained that the assumption is issuance of 20-year debt and the City receives fairly low percentage rates of approximately 5%. Chairperson Knecht advised that he had a different expectation, that there would be a lower revenue stream in the early years and a higher revenue stream than there would have been in the out years but, because the expectation is for the revenue stream to decline in the out years, an increasing revenue stream from current levels wouldn't necessarily occur. The preferred scenario brings the Committee back to the question of the corporate point of view with the City or the rate payer/taxpayer point of view. Chairperson Knecht observed that if the rate payer/taxpayer discount rate is higher than the 5% at which the City can finance the debt, then rate payers would prefer to have the City finance it. Mr. Werner expressed a concern that the out years will be more expensive than the front years, and advised that the City doesn't have the option to refinance. Chairperson Knecht expressed the opinion that the fundamental question is what the City can finance and keep the enterprise healthy. Staff will provide additional information regarding a 1.2 coverage level. Chairperson Knecht suggested that if this keeps the enterprise healthy, it will provide a "flatter, long-term stream of revenues and ... a better benefit from the rate payer/taxpayer viewpoint." Mr. Werner pointed out that Scenario 3 reflects five years of replacement. It doesn't show all the capital that will have to be replaced over the life of the system. Every five years, the same amount of debt will have to be reissued and rate increases will be required to keep up with the debt financing. Mr. Werner acknowledged that the City does not have depreciation funding. The choice

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is to debt finance replacement today which normally would be done with depreciation as reflected in Scenario 2. Mr. Werner acknowledged that principal repayments would take place over time out of the revenues collected from year to year. He provided examples of blocked increases of debt service, and advised that it does not flatten out. In response to a comment, he advised that the issue is financing replacement of the existing plant not future growth. In response to a question, he advised that the Utilities Department has developed a five-year capital plan based on "what we think is going to fall apart in the next five years." Realistically, infrastructure exists in the streets which is approaching 25-30 years old. It also has to be replaced and depreciation financing is no longer available. Mr. Werner expressed a concern that the debt financing scenario, without considering the full capital program, will artificially lower the rate increases needed for the first five years. He acknowledged that staff is developing a longer-term financial forecast for evaluation purposes, and advised that the numbers would plug into a rate structure. In response to a further question, Mr. Werner advised that Utilities and Development Services staff are in the process of developing a master plan which "is somewhat independent of the charge of the Committee." The charge of the Committee is to develop a rate structure that will accommodate the funding requirements. He suggested that it may be premature to focus on rate increases needed today. He acknowledged that, as staff sees it, the Committee's job is to develop a legitimate method for establishing rates so that increases can take place as needed. He noted that operating practices of the utility may warrant some discussion as well. The main thing, at this point, is a methodology. Member Polito agreed and pointed out that, as recommendations are presented to the Board of Supervisors, they will make the decision regarding revenue requirements. Chairperson Knecht suggested that the Board is interested in the maximum range of options. He clarified earlier comments that considering the revenue requirements "in a present-worth sense," borrowing money at 5% and avoiding borrowing it at 8% as a rate payer and a taxpayer, "you're better off." Mr. Werner agreed "from a simplistic standpoint" and, in response to a question, advised that there are uniform requirements for debt service. He suggested that Chairperson Knecht's comments assume one issue over a twenty-year period when, in fact, there could be five issues over a twenty-year period. Bringing the present worth back to the base, each one being at 5%, the combined effect of the present worth is greater than 5%. Additional discussion took place with regard to the same.

In light of the foregoing discussion, Member Riggs expressed a concern regarding presentation of financing recommendations to the Board of Supervisors without knowing what the need will be. He agreed that the Committee can develop a legitimate method for establishing rates, but financing will be "a different subject altogether." Chairperson Knecht commented that a financing approach is implicit in a rate setting method, and advised that the Committee's recommendations will be subject to revision on an ongoing basis. Member Riggs advised that one of his chief concerns when reviewing the City's records was "there was nothing for a rainy day fund." In determining whether to finance or build up reserves, the Committee can develop a method for covering costs but not knowing what the financing needs will be in the future is a large variable. Member Riggs agreed that the 1.2 times debt coverage could serve as a rainy day fund, but stated that it takes time. "You don't start in year number one with a large reserve. It takes years to build those things up." He expressed understanding for staff's comments regarding building up large debt, having it accumulate, and only paying a fraction of it each year instead of "as you go." He suggested that "somewhere down the road" the debt will be "humongous," and covering the interest on it will be something the rate payers won't appreciate.

In response to a question, Mr. Werner suggested that Utilities staff may be able to work with Mr. Heath and Mr. Providenti to develop a longer-term projection which could be presented as a revenue requirements scenario. Member Riggs suggested that it may be worthwhile to consider a "mixture." Mr. Heath

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suggested that staff could present a scenario showing what rates would look like if depreciation was charged and what they would look like if depreciation was financed. This should demonstrate the point and provide the Committee adequate insight to make a choice and provide a recommendation. In response to a question, Mr. Heath advised that the assumptions become more broad as the projection goes further out. The assumptions used for the five-year period will be used and stretched out to twenty years. In response to a question regarding GASB-34 standards, Mr. Heath advised that staff expects no effect whatsoever on the sewer and water enterprise.

Member Polito inquired as to whether the Committee is now contemplating presentation of a recommendation on the various scenarios to the Board of Supervisors. Chairperson Knecht expressed the understanding that the Committee could present the three scenarios with or without a recommendation. If the Committee wants to present a recommendation, more information would be better, particularly with regard to the long-term effects. Member Polito referred to comments by Member Osborne at a previous meeting regarding the debt financing undertaken by the City also being subject to review by another committee. Mr. Heath explained the function of the Debt Management Commission, but advised that as long as debt financing is legal and within statutory debt limits there shouldn't be an issue. He acknowledged that the Debt Management Commission would not be the "decision makers." Mr. Bonow commented that the answer is only true, relative to the overall impacts of the Debt Management Commission, if the City continues to pursue its current method for securing bonds which are both revenues of the utility and, if need be, the general obligation backing of the City. The question would have a different answer if only revenue was considered without the "backstop" which currently reduces the interest rate to its lowest possible. Mr. Bonow acknowledged that if the City does achieve 1.2 times coverage, it would not have to issue double barrel bonds. The goal is to have the enterprise stand on its own so that every time utility debt is issued, it doesn't count against the overall legal debt limit. Until that coverage level is reached, the City won't have that ability. In response to a question, Mr. Bonow advised that coverage is typically defined as the difference between net operating revenue compared to debt service. As long as there is a lot of pay as you go capital expenditures, even with the legal limit of 1.2 on the bond documents, given the size of capital expenditures, 1.4 or 1.5 coverage or something higher will probably be required. "Rarely do people operate at their minimum."

Member Polito stated that if water and sewer utility debt counts toward the statutory debt limit, he will not be able to make a recommendation on an approach or on debt financing without an understanding of the total. He expressed reluctance to "even go down that path" because the Committee will most likely not be in a position to understand the overall City operations. Mr. Heath advised that staff would provide the information at the next meeting. Chairperson Knecht suggested that, as staff does the longer-term outlook, it would be very essential to know the assumed general inflation rate that matches the interest rate. He expressed an interest in knowing the general inflation rate consistent with that and the real economic growth rate of the economy, not just of Carson City, but in general. He suggested checking with people who do interest rate forecasts to determine what economic growth rates they are using relative to their interest rate levels and provide "some feel for ... general inflation and real economic growth rates" consistent with the interest rate forecast. He further suggested that if staff uses "some source," they might also come up with some other benchmarks such as a corporate double A bond rate so the Committee can "put these things in perspective." He suggested that Mr. Bonow may be helpful in that regard, and Mr. Bonow offered to work with staff. No formal action was taken.

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F-4. DISCUSSION AND POSSIBLE ACTION REGARDING PRESENTATION BY STAFF ON MARGINAL COSTS FOR SUMMER PEAK VERSUS TAIL BLOCK RATE LEVEL (1-3188) - Mr. Hoffert referred to the September 12th memo distributed prior to the start of the meeting and reviewed the same. In response to a question, he advised that the parameters for "average annual usage" need to be defined. Member Smeath inquired as to the availability of day-to-day and month-to-month information. He commented that taking a complete average ends up in seasonality and suggested that breaking it down further would reveal a little more of the mid-ground. Mr. Hoffert referred to the month-by-month consumption data for 1999 and 2000 presented by Mr. Bonow in a previous meeting, and advised that averages by customer class can be determined using this information. Mr. Hoffert indicated that the information pertinent to this agenda item can be detailed or simple, but that he would need the Committee's direction. He advised that he used the simplest approach which allows for some outside irrigation. There were no cross-subsidies represented in his comparison; all customer connections were treated as a single unit with the same rights and benefits. At the request of Mr. Werner, Member Smeath clarified that he was interested in reviewing the median numbers of daily usage. Chairperson Knecht indicated that he was interested in a simple comparison using the current rate levels in the tail block for the various classes to a marginal or incremental cost for water resource on the peak day so that a determination could be made regarding whether the tail block rate fully covers the most expensive water resource on the highest send out day. This would focus on a marginal or incremental cost to indicate costs for bringing such things as new wells into production every year as some approximation to the marginal cost of the resource. Chairperson Knecht suggested taking the cost to build, finance, and operate wells, deciding what level of output the costs would be spread over, and turning the cost in terms of total dollars into a cost per gallon on peak.

Mr. Hoffert referred to page 2 of the memo and advised that he needed to define what the facility should look like to supply a base rate. Anything above that allows a definition for which production facilities would be required to establish the cost above that level in order to break them out and define costs associated with wells, etc. He reviewed page 2 of the memo, and expressed the opinion that he wouldn't have to have as much storage if he didn't have to meet a greater peak. He advised that he will be able to quantify and establish what costs would be associated with the additional facilities to determine the number of gallons per minute, the costs associated with that, and provide the Committee with a price per thousand gallons. Chairperson Knecht indicated that he was assuming Mr. Hoffert has a list of water resources, i.e., existing, emergency, and future construction. In response to a comment, Mr. Werner advised that resources are used according to demand. There is no consideration of dollars. Quill Ranch is cheapest and, if possible, it is used first; everything else is second. Mr. Hoffert explained that within Carson City there are at least twelve different water systems that operate independently but are able to flow in and out. The supplies in those water systems meet the peak if surface water is not treated to be able to run it all over town first. Each area of town has different priorities and different tanks that command the water sources which flow into them.

Chairperson Knecht inquired as to whether there is any consideration of the costs of placing additional resources into service on peak days. Mr. Hoffert reiterated that water delivery is driven by demand. At 18 million gallons a day, every production source in Carson City will have to be run for 24 hours to meet the demand and increase storage for the next day. Demand typically increases from 18 million gallons until a weather pattern hits the City; then it decreases. Approximately 200,000 or more gallons need to be produced per day. Mr. Hoffert advised there were many days this year at 18 million gallons or more and most of the production facilities were running 24/7. In response to a question regarding the time table for

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bringing in a new well, Mr. Hoffert advised that because of the complications caused by federal mandates, land availability, etc., it takes approximately 18 months from identification of a source to production within the system. Mr. Werner advised that location is based on quality supply.

Chairperson Knecht indicated that he was trying to focus the cost per gallon of new resources as opposed to the tail block rate. Member Polito expressed an understanding that the question was whether rates charged to the last tail block are covering the costs of providing it, and discussion took place regarding a method to determine an answer. Mr. Werner advised that even when the City plans for a future well, it is not necessarily planned to be used for peak days. New wells have as much to do with the base demand as they do with peak demand, and this may relieve other wells which can then be used for peak demand. Mr. Werner stated that every time the City builds a new well, it is not necessarily a cost that can be associated with the peak. Member Polito advised that the Board of Supervisors indicated a need to ensure that the tail block is covering its costs, but acknowledged that there appears to be no way to find that out.

Chairperson Knecht made the following inquiry: "If looking two years out, if we assume that, just for argument sake, our peak day was going to be 24 million and that the top ten percent of the days were going to be at 21 million and up, or whatever number you find is realistic, to tell me where the cut off is on the top ten percent or five percent, say ten percent of the days, if we looked at what our expectation and our planning basis is and now we ask the question, suppose that that top ten percent cutoff or threshold was 2 million higher and you had to do something today to plan for that, are you able to give us an estimate of what the cost per gallon would be based on a two million higher assumption?" Mr. Werner advised that the cost will be nominal because it doesn't drive additional staff or additional general plant. It might drive additional power costs and additional wells which may result in a half million dollars worth of well or two wells. Mr. Hoffert advised that until the well is drilled and put into service, there is no way to determine the gallons per minute. He acknowledged that assumptions can be made. Chairperson Knecht clarified that he was not trying to anticipate the result. If the cost is nominal, he stated he would "cheerfully live with that" because that is what the Board of Supervisors wants to know and the tail block rate would easily cover it. Mr. Werner advised that there would be additional energy and capital costs because staffing probably won't change. He explained that staffing levels change by the size of the system not necessarily by the number of wells. Member Mullet suggested that at some point additional wells will require additional staff. Mr. Werner agreed but advised that this would not be an issue until some time in the distant future. Chairperson Knecht noted that he did not mean to suggest that the tail block rate is too low. His purpose in asking the question was for the Committee to be able to provide a confident answer to the Board of Supervisors. Mr. Werner advised that when the rate was set initially, it was done by customer block studies. Member Polito suggested that the question may be answered when the blocks are examined in the course of the study. Mr. Hoffert clarified that he only needs the excess facilities above whatever base scenario is used for peaking factors. He acknowledged that the memo contains costs to establish a rate that would cover the cost to satisfy above average consumption which can be compared to the tail block rate. No formal action was taken.

F-5. DISCUSSION AND POSSIBLE ACTION REGARDING CONNECTION FEES - Deferred.

F-6. REVIEW, DISCUSSION AND POSSIBLE ACTION TO MODIFY WORK PLAN (2-0106) -

Chairperson Knecht inquired as to whether an additional meeting would be necessary. Member Polito reviewed the agenda topics scheduled for this meeting and the October meeting and suggested that

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neither one of the listed tasks would be able to occur at the next meeting. He suggested that the work plan should be modified to some extent. In response to a question, Mr. Bonow discussed the work he anticipated to be accomplished over the next few weeks. He advised that the Committee's decision to pursue the base/extra capacity method was good direction for the consultants, and suggested that the next major step will be finding a way to understand the nature of all the costs, cash and otherwise, that need to be allocated under that method. This will require detailed discussions with staff. He suggested agendizing discussion regarding allocation of costs among the customer classes. Discussion took place regarding additional meetings. Mr. Werner advised that staff could be prepared by October 4th to address the deferred items from this meeting's agenda. Member Polito requested information regarding current rates using existing rate structure blocks and subsidies, what would current rates be if all the subsidies were removed, and the glide path to get there. He expressed support for two additional meetings. Discussion took place regarding the proposed agenda for the October 4th and October 10th meetings. No formal action was taken.

F-7. DISCUSSION OF ISSUES/CONCERNS BROUGHT UP BY CITIZENS CONCERNING UTILITIES RATES/PRACTICES - Deferred.

G. INTERNAL COMMUNICATIONS AND ADMINISTRATIVE MATTERS

G-1. FUTURE AGENDA ITEMS (2-0099) - Chairperson Knecht requested staff to reagenda items F-4 and F-5. (2-0407) Chairperson Knecht reviewed the proposed agenda for the October 4th meeting. Discussion took place regarding the meeting time and staff agreed to poll the absent Committee members with regard to the same.

H. ACTION ON ADJOURNMENT (2-0500) - Member Degenkolb moved to adjourn the meeting at 9:46 p.m. Member Riggs seconded the motion. Motion carried 7-0.

The Minutes of the September 12, 2002 meeting of the Carson City Utilities Advisory Committee are so accepted this 10th day of October, 2002.

RON KNECHT, Chair