

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 1

A regular meeting of the Carson City Utilities Advisory Committee was scheduled for 5:30 p.m. on Thursday, December 12, 2002 in the Community Center Sierra Room, 851 East William Street, Carson City, Nevada.

PRESENT: Vice Chairperson Glen Martel
John Degenkolb
Craig Mullet
Larry Osborne
James Polito

STAFF: Andy Burnham, Development Services Director
Tom Hoffert, Utilities Operations Manager
David Heath, Finance Director/Risk Manager
Nick Providenti, Accounting Manager
John Bonow, Consultant (via telephone 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) - Vice Chairperson Martel called the meeting to order at 6:02 p.m. Roll was called; a quorum was present. Chairperson Knecht and Members Langson, Riggs, and Smeath were absent.

B. ACCEPTANCE OF CLERK'S MINUTES - October 10, 2002 and November 14, 2002 (1-0007) - Member Osborne moved to accept the minutes of the October 10th and the November 14th meetings, as presented. Member Degenkolb seconded the motion. Motion carried 5-0.

C. PUBLIC COMMENTS (1-0014) - None.

D. MODIFICATION OF AGENDA (1-0019) - None.

E. DISCLOSURES (1-0022) - Member Osborne advised that he and Member Mullet attended the Chamber of Commerce Manufacturer's Committee meeting and provided an update of the Committee's activities. Vice Chairperson Martel advised of having updated the Builders Association of Western Nevada ("BAWN") Board at their December 10, 2002 meeting. He further advised of a discussion earlier in the day with the BAWN Executive Officer regarding items on tonight's agenda.

F. PUBLIC MEETING ITEMS:

F-1. PRESENTATION BY CONSULTANT AND DISCUSSION REGARDING COMPUTER RATE MODELS (1-0032) - Mr. Bonow reviewed revisions to the Water Rate Model which was distributed to the Committee members, staff, and the public prior to the start of the meeting and replaced the version included in the agenda materials. He provided an overview of his presentation and reviewed the Estimated 20-Year Capital Improvement Program for the Water Utility. He noted the \$85,092,173 total on an inflated dollar basis over the next twenty years, and the substantial costs in

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 2

FY2004-05 due largely to Safe Drinking Water Act requirements. He advised there are currently \$2.5 to \$3 million in reserve funds available to the water utility. Without rate adjustments and access to the bond market, funds would be completely depleted midway through FY2004.

Mr. Bonow referred to the Minimum Rate Adjustments of the Rate Analysis Summary for the Water Rate Model (page 2) and provided an overview of the four scenarios depicted. He discussed rate increases, by customer class, necessary over the next five years to entirely fund the capital program using current year revenues, and referred to the corresponding graphs (page 3). He noted that funding the capital program without using debt financing is not feasible, nor is it functional to use an average approach toward rate increases. "We need so much money in FY2004 that if we don't use debt, we would have to have these large increases." In response to a question, Mr. Burnham advised that the large expansion project is driven by Environmental Protection Agency arsenic standard requirements. Member Mullet inquired as to whether the replacement costs depicted in FY2004 could be moved to later years to reduce some of the impact. Mr. Hoffert advised that the Utilities Department staff shifted "everything we felt comfortable with" to lower replacement costs at the time the 20-year CIP plan was developed. In response to a question regarding expansion projects in FY2004-05, Mr. Hoffert explained that the federal mandate with regard to arsenic standards has nothing to do with expansion projects. Expansion projects include new wells, storage tanks, delivery systems, transmission line upgrades, etc. A portion of the replacement projects is assigned a dollar amount for extra capacity expansion because of increasing the size of undersized lines and thereby adding available capacity for redevelopment or infill lots. In response to a further question with regard to phasing replacement costs, Mr. Hoffert indicated that further phasing is a matter of assumable risk. He advised that once the freeway bypass is underway, phasing projects can again be considered. Mr. Heath advised that City Manager John Berkich, Finance Department staff, and Utilities Department staff studied the program to determine ways to reduce capital costs. In the end, consensus was that the remaining projects are vital; many have already been put off for some time. In response to a question, Mr. Bonow advised that the arsenic compliance costs represent the largest single project over time. The Safe Drinking Water Act requirements represent \$2 million of the \$7.5 million represented in FY2004. Production wells represent \$1 million and there are various tanks, pipelines, and other projects that range from \$30,000 to \$800,000 which make up the balance. In response to a comment, Mr. Bonow advised that the Safe Drinking Water Act requirements total \$6.6 million in FY 2003-2006; \$2 million in FY2004, \$2.6 million in FY2005, and \$1.5 million in FY2006. In response to a question regarding averaging rates, Mr. Bonow acknowledged that funding the costs with debt as opposed to current year revenue would "dramatically smooth out rate requirements."

Mr. Bonow referred again to page 2 of the Rate Analysis Summary and discussed rate adjustments using debt financing for capital requirements. He reviewed the corresponding graphs (page 3), and noted the more modest rate increases over time. He advised that averaging of the debt is not reflected; the graphs depict the year-to-year adjustments to each customer class in order that they would absorb and pay for their full share of revenue requirements. He expressed the view that the scenario is a more agreeable approach to funding. In response to a question, Mr. Bonow advised that rates would have to stay higher for a longer period under a debt funded approach than under a pay-as-you-go approach because of the interest component on the debt.

Mr. Bonow referred to the Average Rate Adjustments by Customer Class (page 5) and provided an overview of his calculations. He noted that scenario 1b depicts a "smooth set of increases" which can be annualized. He reviewed the corresponding graph on page 6. In response to a question, Mr. Bonow

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 3

explained that scenario 1b represents a gradual approach to eliminating the subsidy between residential and commercial customer classes. He noted that the approach could be more gradual, but the purpose was to balance things after five years. Even with the 4% reduction, the commercial customer class is still contributing “much more than its revenue requires it to do for all revenues of the system.” In response to a comment, Mr. Bonow acknowledged that the 40% reduction in the Minimum Rate Adjustments table represents an immediate removal of interclass subsidy. Member Polito suggested that a 40% cut in commercial rates and a 7% increase in residential rates “might be difficult for some to digest.” Mr. Bonow suggested that adjustments every ten years rather than every five years in the averaging approach would result in an approximate 6% annualized increase to the residential customers and an approximate 2.5% to 3.5% annualized decrease to the commercial customers. “The further you go out, the more they converge because you spread ... removal of that subsidy ... out further over time.” Mr. Bonow acknowledged that any attempt to spread the adjustments over a longer period of years would result in leaving the cross-subsidy in place. He clarified that the numbers reflect minimum adjustments. If a mechanism, other than 100% debt financing is used, the increases in the near-term will have to be larger or, conversely, the commercial decrease could be less because of the large near-term impact on rates. The less capital financed, the more rates will have to be increased. Mr. Bonow acknowledged that the 7.25% increase and the 4% decrease reflected in the Average Rate Adjustments table for residential and commercial customer classes, respectively, are actual increases and decreases. He advised that the percentages are based on the existing rates per thousand gallons in each class. Commercial is higher per thousand gallons on a particular tier than residential, so the commercial customer class reflects a decrease from a higher number, which will result in a decrease to the bill.

Mr. Bonow explained the central conclusions are that the notion of debt financing has the great benefit of allowing a smoothing of the near-term impact caused by the large capital costs. It does carry with it incremental interest which would be somewhat mitigated by inflationary adjustments in later years. It allows for a more gradual introduction of rate adjustments over time. Mr. Bonow noted that there is a range of options regarding how much capital to debt finance, and he provided several examples. He explained that he took the approach of preserving the cash the utility has now and considering the minimum adjustments. He emphasized that the mechanism by which capital projects are funded will be “the largest driver in ... ultimate rates.” In response to a question, Mr. Bonow explained that by preserving existing fund balances into FY2004 and debt financing all capital at the assumed rates, customer rates would have to be increased by the figures depicted or there would not be enough revenue in the current year to service debt and pay operating expenses without tapping the fund balance. Raising rates above the figures presented would result in building fund balances or allowing for something less than 100% debt financing. Vice Chairperson Martel recalled discussions regarding the balance which should be maintained in the water fund, and that the remaining amount is “close to being critical.” He expressed the understanding that the fund balance should not be further depleted. In response to a question, Mr. Heath advised that there is a measure of fund balance available to consider smoothing or mitigating the impact. Member Osborne commented that debt financing expansion may not require reserving \$2.5 to \$3 million in the water fund. He acknowledged the importance of maintaining an operating reserve. In response to a question, Mr. Heath advised that six months of annual debt service is one of the reserve components. More debt financing results in the need for more reserve, in the eyes of the rating agencies, in order to maintain a good debt rating. Mr. Bonow acknowledged that six months is a good range especially since the City has a general obligation pledge on its debt where reserve funds are funded with cash rather than bonds. Without the general obligation pledge, the rating agencies would require one year’s worth of cushion in a reserve just for debt. Mr. Heath advised that, over the next five years, the City is looking at \$18-19 million in capital

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 4

improvements which will ultimately lead to just under \$2 million in debt service. An additional \$1 million in reserve will be required to accommodate the impact of the five-year capital program.

Member Polito reviewed the bookends, i.e., one rate structure that eliminated all subsidy and one that preserved the subsidy. In response to a question, Mr. Bonow advised that the bookend information is available for 2004. He acknowledged that there was no way to make a comparison because the base/extra capacity method, in effect, redirects costs as a matter of course. The subsidy then has to be engineered or preserved by delaying rate increases for residential customers or delaying rate decreases for commercial customers. The magnitude of the change, with the pay-as-you-go approach in 2004, is the best indicator of that bookend. Mr. Bonow advised that he could provide the dollar amounts of the subsidy between residential and commercial customers under the average rate adjustment approach, if desired by the Committee. He acknowledged that the average rate adjustment analysis eliminates the subsidy over five years. In response to a question, Mr. Bonow advised that the costs are allocated according to the base/extra capacity method so the costs each customer class is supposed to bear are allocated without adjustment. Based on existing rates, commercial customers pay a higher rate per thousand gallons than residential customers. The average rate adjustments analysis slowly brings the two rates into an equal state. As costs increase, overall revenue requirements increase, so commercial rates are slowly decreased and residential rates slowly increased until a point in time where the per thousand gallon rate is equal and each class is still covering all its costs. In response to a question, Mr. Bonow explained that costs are based purely on usage of the system and, in that sense, each class is bearing costs associated with its use. [Vice Chairperson Martel recessed the meeting at 6:51 p.m. and reconvened at 7:00 p.m.]

Mr. Bonow reviewed the graphs depicted on page 4 which showed every customer equal on a per thousand gallon basis to residential and adjusted accordingly to cover respective costs. He noted that this would eliminate the subsidy "in every way, shape, and form instantaneously." To avoid this, the averaging approach shown on page 6 is used. Mr. Bonow emphasized that the conclusions are largely based on the policy approach of the method for funding capital. Using the 100% debt financing approach results in the lowest near term impact on rates but adds the most cost on a nominal basis over time; however, the rates presented allow the City to avoid tapping its existing fund balances. Vice Chairperson Martel reiterated an earlier concern that although the existing fund balances represent a "cushion," they are not sufficient to consider utilizing. Consensus of the Committee was to assume the debt financing approach, and Mr. Bonow commented that debt financing, or slightly higher rate increases in the case of residential customers or slightly lower rate decreases in the case of commercial customers will allow a growing fund balance or more of a pay-as-you-go approach. He noted the importance of the decision-makers understanding this dynamic. Vice Chairperson Martel acknowledged that the Committee will have to justify the debt financing recommendation. Mr. Bonow referred to page 5, and discussed the 31% annual increase for each of the next five years in order for the State to cover its share of costs in 2008. He acknowledged that the State has a separate contract with the City and explained that, although the actual dollars and cents "are not huge," the percentage increase is consistent with the method of allocating costs. Mr. Bonow advised that using the method agreed to for allocating costs among classes, on a pay-as-you-go approach, there are approximately \$14.5 million in costs for FY2004 which need to be allocated among all the customer classes. Approximately \$1.1 million of that figure is allocated to the State, which represents 7-8% of the overall system revenue requirements. Mr. Bonow pointed out that to cover all costs, it will not be necessary to use any of the fund balance to fund any of the costs beginning in FY2004 if the rate increases are adopted and the City debt finances all capital at agreeable interest rates. He suggested presenting the rate increases as the minimum adjustments on an annual basis with a multi-year adoption and an annual review

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 5

to determine if additional adjustment is necessary. Member Polito suggested that Mr. Bonow be prepared to explain the effect of averaging the increases over a longer period of time to “true up” the rates in a later year rather than in 2008.

Mr. Bonow referred to the note that consumption rates are based on a connection fee per equivalent residential unit (“ERU”) of \$3,968, and reviewed the calculations. He advised that the connection fee rate will generate just under \$1.2 million in revenue per year which is deducted off the top of the total revenue requirements based on flow by class. Each class then will fund the balance from consumption rates. He noted that the assumption for connection fee revenue is “pretty conservative,” so in terms of true up, future year increases could be somewhat mitigated if growth continues to be robust or at least above the conservative assumptions used. In response to a question, Mr. Hoffert advised that the current water connection fee is \$3,334; the sewer connection fee is \$2,226. In response to a comment, Mr. Bonow suggested that, based on the agreed upon methodology, the number of connections won’t impact the actual connection fee but will impact the revenue. The connection fee is based on book value not on actual numbers of ERUs added to the system. Member Osborne noted that if, on an annual basis, the revenue generated by the connection fee exceeds expectations, an adjustment to water utility rates may be in order. Mr. Bonow agreed and advised that, if growth is robust, the number of ERUs dividing into the book value will increase and, therefore, keep the connection fee minimized in terms of annual adjustment. If the growth pace outstrips the pace of book value increase, there could actually be a decrease in connection fee, but this would only happen with a “pretty aggressive growth rate.”

Mr. Bonow referred to the residential and commercial billing examples included in the agenda materials, and reviewed the differences in total monthly charges between existing rates and the five-year averaging approach. He explained that on a percentage basis, high end users are more affected because the extra capacity is attributable to them and they will bear their “fair share” of costs imposed on the system. In response to a question regarding the percentage increase in the monthly bill, Mr. Bonow explained that the 7.25% is the amount of increase in each of the tiers. Another component to the fee is the monthly service charge of \$8.10. Based on the agreed upon allocation methodology, the monthly service charge would decrease dramatically to approximately \$2.25 because there are not many costs allocated to meters and customer billing costs. Member Polito suggested that this information would be useful to present in conjunction with the 7.25% increase so the Board of Supervisors understands that the total bill impact won’t be that high. Mr. Bonow reviewed the small residential billing example provided and the differences if rates were increased by 7.25%. He noted that, in some cases, using debt financing and averaging rates would result in rate decreases because there is not only an allocation of costs among classes but an allocation of costs within classes. Low end customers will bear none of the costs of the extra capacity of the system because they don’t contribute to the needs of the extra capacity. At Mr. Burnham’s request, Mr. Bonow reviewed the medium residential billing example.

Mr. Bonow explained that there are multiple ERUs per bill for commercial customers rather than the one ERU per bill for residential customers. Mr. Hoffert acknowledged that large commercial customers with two meters receive separate bills for landscape and consumption; that the two meters are calculated the same but without a sewer charge added to one. In response to a question regarding which customer class bears the cost increase, Mr. Bonow reviewed the magnitude of increase in overall costs and the method by which revenues are generated. Using 100% debt financing for new capital, in 2003 the total funding uses is approximately \$7.5 million. In 2004, it increases to \$8.1 million so another \$600,000 in revenue is needed to avoid tapping the existing fund balance. Mr. Bonow advised that high end users effectively bear

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 6

all of that cost based on the cost allocation methodology. He emphasized that the residential class, in general, is by far the largest component of system revenues and by far the largest user of the system. The high end commercial customer will be impacted by the rate adjustments but less than their counterparts on the residential side. In response to a question, Mr. Bonow advised that, in 2001, there were two residential customers who used more than 1 million gallons for the year. Twenty-two residential customers used at least 500,000 gallons; 112 commercial customers used at least 500,000 gallons. He responded to questions regarding the percentage of customers these numbers represented, and reviewed the number of customers which used at least 500,000 gallons in September 2001 which was the highest consumption month. He advised that there were 40% more high end use residential customers than commercial in the heavy consumption months. He noted that this dynamic is one of the things driving the system.

Mr. Bonow reviewed the large commercial billing example and the differences in total actual charges using the 4% reduction in consumption. He advised that the overall impact of the bill is 5.62% lower based on the meter charge and the consumption charge using the new rates. Eliminating the fire sprinkler charge will result in an approximate 5.8% reduction. Assuming debt financing of everything, which is the lowest near-term impact on rates, every other customer category in residential and commercial will see a slight decrease in their bills. Mr. Bonow advised that the medium use commercial customer would see an 11% decrease in their bill and the small commercial customer would see a 38% decrease driven largely by the meter charge. In response to a question, Mr. Bonow advised that if the commercial customer didn't change their consumption and all costs came in as projected, they would see a further decrease in their bill each year. He acknowledged that the commercial customer would receive "substantial rate relief" but in 2008, the commercial class would be generating only enough revenue to cover all the allocated costs. An increase in the required revenue in 2009 would result in a rate increase. Mr. Bonow contrasted the debt financing approach to the pay-as-you-go approach for the commercial and residential customer bills.

F-2. DISCUSSION AND ACTION TO APPROVE ALTERNATIVE RATE SCHEDULES - BASED ON MODELS AND FORWARD TO BOARD OF SUPERVISORS (1-1923) - Extensive discussion took place regarding the rate schedules and various financing scenarios. Mr. Hoffert and Mr. Burnham responded to questions regarding the purpose of the public workshop and the Committee's work schedule. In response to a question, Member Osborne suggested that the Committee should present options to the Board of Supervisors, together with a recommendation. Consensus of the Committee was to defer action on this item to the January 9th meeting, have Mr. Bonow present the sewer rate model, and decide on a workshop date at that time. Mr. Burnham acknowledged that the Board of Supervisors has been provided information and materials pertinent to the Committee's progress.

In response to a question, Mr. Bonow inquired as to whether the Committee wants to be in a position to make funding decisions on capital or focus purely on recommending a certain rate level or rate impact. He suggested that the funding decisions will fall out of whatever rates are chosen by the Committee. Member Osborne expressed support for this approach, and indicated that the Board of Supervisors should determine the funding policy. Mr. Bonow suggested crafting two or three options so that in January he can present two or three "concrete scenarios from any angle." One approach would be keeping residential rate impacts in the single digits and removing the subsidy within five years or by the fifth year date. Discussion took place regarding various scenarios, and Member Polito expressed an interest in reviewing information regarding increases and decreases to customer bills.

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 7

Member Mullet reviewed the Committee's status, as follows: the methodology for developing rates has been established. Using that methodology, the two bookend scenarios have been developed: pay-as-you-go and total debt financing. The scenarios can be articulated into a spreadsheet to compare to current bills, which can be further detailed to show the rate impact. He discussed various examples which could be presented. Mr. Bonow discussed a comparison of bills for three types of customers within each class at the highest and lowest months of total consumption to show how they would be impacted by the bookends and perhaps a third choice of keeping all customers from a double digit increase at least in the near term. In response to a question, he advised that these types of examples usually resonate with elected officials. The Committee members concurred with Mr. Bonow's suggestion.

Mr. Bonow clarified that the middle ground will be an approach which focuses on the impact of a customer's bill, presented under the current rate structure and under a rate structure designed to keep the worst impact on any customer's bill in the single digits. Before and after for each class of customer will be compared and, within the larger types of classes, the high use, low use, and average customers represented in the highest and lowest consumption month will be reviewed. The Committee will be able to substantiate a rate increase that stays below the double digits. Member Polito expressed a concern that a single digit increase allows "a lot of leeway," and discussion took place with regard to the same. Mr. Bonow clarified that average customers would have to be defined within customer classes. Member Polito suggested presenting to the Board that the parameters have been re-established, the subsidy will be eliminated over five years, the average residential customer won't have a rate increase of more than 5%, which still allows the minimum rate increases. Mr. Bonow advised that a 5% average customer rate increase would still allow for some pay-as-you-go funding. Mr. Burnham acknowledged that staff had sufficient direction with which to proceed with the consultant.

Consensus of the Committee was to define an average customer in each class, and compare no change and a 5% change to the customer. Member Polito requested information regarding how the zero and 5% change in the bill translates into the rate increase. Mr. Bonow advised that the biggest impact will be from the residential customer class, and that starting with the residential customer is the best way to frame the issue. He reviewed the direction of the Committee, as follows: Define an average customer in each class; for the average residential customer, a determination will be made regarding the funding decisions for a zero increase over the next five years for that average customer; all other rates will just fall out from that. Then take that exact same average residential user and set the average increase at 5% over the next five years; then consider all the other impacts. Mr. Bonow explained that one of the impacts in both cases will be after five years determining the rate subsidy, if any. The Committee members agreed with this approach.

Mr. Hoffert acknowledged that the same types of scenarios for the wastewater utility would be presented. Vice Chairperson Martel requested staff to agendize discussion regarding the presentation and how to summarize the information for the public and the Board of Supervisors. Discussion took place regarding the Committee's meeting schedule, and consensus of the Committee was to schedule meetings for January 3rd, January 24th, the public workshop for January 30th, and the Board of Supervisors presentation for February 6th. Mr. Hoffert will provide a memo to the Board of Supervisors regarding the Committee's revised work schedule. Mr. Bonow acknowledged that he would be present at the public workshop and the Board of Supervisors presentation.

CARSON CITY UTILITIES ADVISORY COMMITTEE

Minutes of the December 12, 2002 Meeting

Page 8

G. ADJOURNMENT (1-2975) - Member Mullet moved to adjourn the meeting at 8:45 p.m. Member Osborne seconded the motion. Motion carried 5-0.

Respectfully submitted this 15th day of April, 2003.

ALAN GLOVER, Clerk-Recorder

By:

Kathleen M. King, Deputy Clerk/Recording Secretary
to the Carson City Utilities Advisory Committee