

MINUTES OF THE
FINANCE/INVESTMENT COMMITTEE
OF THE VALLECITOS WATER DISTRICT
TUESDAY, OCTOBER 14, 2008 @ 4:00 P.M.
AT THE DISTRICT OFFICE, 201 VALLECITOS DE ORO,
SAN MARCOS, CALIFORNIA

Director Hannan called the meeting to order at the hour of 4:00 p.m.

Present: Director Hannan
Director Gentry
General Manager Rucker
Assistant General Manager Mason
Director of Finance Scaglione
Director of Engineering and Operations Lamb
Executive Secretary Lewis

REVENUE AND EXPENSE REPORTS FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2008

Director of Finance Scaglione discussed the revenue and expense report for the three months ended September 30, 2008. He noted that although sales revenue was only one-tenth of a percent less than last year, consumption decreased by 7%, mostly from the mandatory agricultural cut-back which resulted in a 28% decrease from the same period last year. Increased rates offset the impact from conservation.

Total operating water and sewer expenses less water purchases had a favorable budget variance of one-and-a-half percent.

Director of Finance Scaglione noted in reviewing the Appropriated Fund Balance Report that as of September 30, 2008, the District has about \$40,000 less than the adopted combined minimum reserve balance (operating, Gasb45, and replacement reserve floors) after transfers to cover the deficit in the sewer capacity fund. This deficit was only short lived as the District received \$984,000 in RDA pass-through from the City of San Marcos three days after month-end. The ending balances in the replacement funds before transfers were above the adopted reserve floors.

This item was for information only. No action was necessary.

LONG-RANGE PROJECTION UPDATE

Director of Finance Scaglione reported on an updated long-range projection. The first year of the projection, fiscal year ending June 30, 2009, includes \$8,000,000 in debt proceeds, and disbursements to the Encina Wastewater Authority for the Phase V expansion in excess of what was budgeted by \$2.2 million. The projection meets the debt service ratio requirement of 1.15 times even without capital facility fees, but does not provide for additional debt capacity for the first two years. The combined minimum reserve will be at a deficit of \$2.7 million unless growth exceeds the number of additional EDU's assumed or staff defers scheduled capital project construction.

This item was for information only. No action was necessary.

INVESTMENT REPORT FOR SEPTEMBER 30, 2008

Director of Finance Scaglione reported on the investment activity for September and the quarter then ended. The weighted average yield at the end of the quarter was 2.876% compared to 2.949% at the end of last quarter, and 147 days weighted average maturity compared to 200 days at the end of the previous quarter. The average maturity of the portfolio will increase as debt proceeds are invested. The District continues to diversify across investment types and maintain liquidity levels above the minimum target levels. The District's portfolio yields have been slightly higher than LAIF, but lower than the San Diego County Investment Pool. All investment balances by category are within adopted policy limits.

This item was for information only. No action was necessary.

DROUGHT RATE STRUCTURES

Director of Finance Scaglione reported that on June 18, 2008, the Board adopted a drought rate response program (Ordinance #159), from a San Diego County Water Authority (CWA) model ordinance that identifies four drought response levels. CWA has also made efforts to provide some degree of countywide consistency for rate structures that would coincide with declared drought response levels.

Director of Finance Scaglione stated that the CWA hosted three meetings recently regarding drought rate pricing: one on September 3rd for a workgroup of mostly General Managers, another on September 9th for Finance Directors, and another workgroup meeting on September 17th. Keith Lewinger from Fallbrook chaired the workgroup meetings, and Eric Saddler from CWA chaired the September 9 regular quarterly finance officers meeting.

A common objective is to have some degree of uniformity in the methodology of drought rate pricing throughout the county. CWA hired Dr. Tom Chestnutt to develop a rate model that can be used by all member agencies. At the first two meetings, Dr. Chestnutt presented his "Drought Response and Revenue Management Model," which included both price- and nonprice-induced conservation. A price elasticity of 20% for summer usage and 12% for non-summer usage is assumed. Padre Dam and Otay were used as test cases. Dr. Chestnutt made his model available to CWA member agencies in mid September.

Director of Finance Scaglione stated that the District's current rate structure has three tiers at different levels for different categories; governments, schools and churches are not subjected to tiers (i.e., all usage is tier 1). He also discussed the District's adopted M&I rates and stated that Agricultural customers receive the credit and a much flatter tier structure. Tier 1 equals 90% of average use. Tier 2 captures 90% of use within the category.

Director of Finance Scaglione stated that recent drought rate discussions at CWA have covered both tiered rates and budget rates. The budget rate structure at Irvine Ranch has been sited many times and considered by many agencies to be the ultimate conservation inducement. Many agencies have expressed a desire to eventually implement such a structure particularly for the deepest stages of drought cut-backs. Staff believes that a tiered drought rate structure will provide a bridge towards that goal if desired by the Board. The planning and design of a budget structure would involve additional resources and time extending well beyond the first MWD call for cut-backs. Staff presented the Committee with the tiered drought rate structure and requested input and guidance towards its final resolve.

Director of Finance Scaglione stated that staff would recommend preserving the current frugal use discount for any month with use of five units or less. The Tier 1 limit is the usage for the month with the lowest average usage from January 2006 through December 2007. Essentially, for residential, this is mostly indoor usage. The Tier 2 limit is 90% of average monthly use – the same way the existing Tier 1 limit was originally calculated. The Tier 3 limit is 110% of the average month. The Tier 4 limit is the tier that captures 90% of the usage within the category – the same way the existing Tier 2 limit was originally calculated. The Tier 5 limit is the tier that captures 95% of the usage within the category.

No separate category was established with the existing tier structure to allow institutional customers (government, schools, churches) to be subjected to tiers. Agricultural and combined agricultural customers are assumed to be induced to conserve by the existing IAWP allotment surcharges. Temporary construction accounts would be subjected to the highest tier rate.

Director of Finance Scaglione stated that MWD's draft includes cut-back levels from 10% to 50% with increments of 5% in between. The four cut-back scenarios provide an idea of the magnitude of the increases needed. A recommendation for drought rates would include pricing at each 5% interval. Price increases less conservation will result in additional revenues adequate to cover negative impacts from conservation (reduced sales from pump zone charges and sewer customers on flow), increased conservation resources, and MWD allocation penalties. Average residential users at all levels will reduce their water bill if they conserve at the cut-back levels.

Director of Finance Scaglione presented the assumptions that were used in the model presented and/or suggested by Dr. Chestnutt; other considerations discussed at the various meetings attended; and what other agencies are doing.

The Finance/Investment Committee recommended that this item be discussed with the full Board at a Board Workshop.

DEBT FINANCING UPDATE

Director of Finance Scaglione reported that at the August 20, 2008 Board meeting, the Board authorized staff to enter into a contract with Union Bank of California for a private placement loan. He noted that Union Bank of California requires a Board Resolution to

finalize the transaction. A Resolution will be presented to the Board for approval at their meeting on November 5, 2008.

This item was for information only. No action was necessary.

CUSTOMER SERVICE AND FINANCIAL INFORMATION SYSTEMS UPDATE

Director of Finance Scaglione reported that the Customer Service Information System (CIS) portion of the update is the more complex of the two systems, the Finance Information System (FIS) being the second. Customer Service began parallel testing the CIS in May. There were issues with the system primarily due to the Agricultural cutback. The CIS was redesigned and retested again in July with a fewer number of issues. Parallel testing will continue until the current system and the new CIS provide the exact same customer service reports. Director of Finance Scaglione noted that current customer bills include a footer that directs customers to the District's website to see what their new bill will look like. With regard to the FIS, it is moving along nicely and the payroll system is scheduled to go parallel by the end of this calendar year. The entire CIS/FIS is expected to be fully functional by the end of the current fiscal year.

This item was for information only. No action was necessary.

General Manager Rucker distributed a draft ordinance regarding 1" oversized water meters for domestic and fire services. The Committee determined that the draft ordinance should be discussed with the full Board at a Board Workshop. A copy of the draft ordinance was also provided to community member, Mr. Bender. Mr. Bender was asked to review the document and provide General Manager Rucker with suggestions prior to the Board Workshop.

The Finance/Investment Committee recommended that this item be discussed with the full Board at a Board Workshop.

There being no further business to discuss, the meeting was adjourned at the hour of 6:05 p.m.