

Purissima Hills Water District

Service To The Hills Since 1955

Purissima Hills Water District
Report by Ad Hoc Committee

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September 20, 2012 Town Council Meeting

Accompanying me this evening are the other members of the Ad Hoc Committee. There are only 11 slides, any of us will be happy to respond to your questions at the end of the presentation.

Formed in 1955, Purissima Hills Water District provides water to 2,000 homes (6,000 residents) in Los Altos Hills. The District is governed by a 5 member elected Board and overseen by Santa Clara County through LAFCO. The District has 8 full time and 2 part time employees.

The formation of this Committee was discussed in the April, May and June Council meetings where inputs were received by the Council from rate payers (some of whom are Council members) which persuaded the Council to form this Ad Hoc Committee. The comments were primarily concerned with whether or not rate increases were too high, but there were other concerns too. We will respond to each one.

Two members of the committee, Allan and I, are CalWATER LA rate payers, not PHWD rate payers and are therefore independent. And, as you know, Gary and John are PHWD rate payers and Gary is a former president of PHWDs Board. Ernie and Steve are currently PHWD Board members and Patrick is the GM of PHWD. (Note for John Radford -- there is no statement of the Ad Hoc committee's mission in the Council minutes.)

But first, briefly, what didn't we evaluate?

What didn't we evaluate?

Safety Matters:

- > Enough water for simultaneous fires
- > Under protected areas
- > Enough guaranteed supply

Administrative matters:

- > Employee compensation

We did not evaluate Safety matters.

The PHWD spends a lot of time on safety issues. They are a matter of focus for the Board. Should there be a future affiliation with CalWATER, it is not clear it will improve this priority. This observation is based on discussion and reading Board minutes.

Administrative matters:

We did not review Employee Compensation but the Board did. An independent consultant delivered a report at the September 12, 2012 PHWD Board meeting and the Board is addressing the results. The survey shows some compensation was higher than comparables, and some lower. The overall result of any changes will be small.

METHODOLOGY AND WORK PERFORMED

Met with:

Board members Jordan and Solomon; Management; Auditors.

Read:

Board minutes (72 meetings); Rate studies; Financial stat's (<http://www.purissimawater.org>), CalWATER LA rate chg app; LAFCO study; BAWSCA, CalPERS and SFPUC annual reports

Reviewed:

Quantitative data from neighboring districts

Limitations:

Knowledge base, examine source data, independent review

Regarding METHODOLOGY, Allan, John and I asked questions, reviewed data and proposed conclusions for the group to discuss and consider.

In the interest of time, we have not repeated the materials presented by PHWD, in its 2012 rate study or hearing in April. Our data complements PHWD's data and does not contradict it. To get a full picture, review PHWD's data (mostly on their website) along with ours.

There is some information we could not get. For example, we received a full set of current financials from CalWATER LA but could not get similar information from other CalWATER managed districts on the peninsula. Much of the comparative data we generated is from 2011 financial reports published by other water districts. More current data is not yet available without a substantially larger time investment.

Allan, John and I did not independently verify PHWDs data although we did look at independently generated information. We tried to be inquisitive and thorough. But our work certainly did not rise to the level of a full professional independent review of PHWD's rate setting process and the underlying data.

With those limitations, it is also fair to say that we do not feel that there is substantially more work to do in order to feel comfortable with our conclusions.

Note: The above referenced data is available from PHWD website <http://www.purissimawater.org> including Board minutes, rate studies, rate presentations and FAQ. Additional information we relied is from the following Agencies – San Francisco Public Utility commission for Hetch Hetchy water rates, Bay Area Water Supply & Conservation Agency "BAWSCA" for consumption information, local water agency websites for financial and rate information, Santa Clara County – Local Agency Formation Commission http://www.santaclara.lafco.ca.gov/service_reviews/water_2011/05%20Purissima.pdf, Santa Clara County Water District for wholesale rate information, and CalWATER Los Altos for its most recent rate application information (available on request by telephone or email). Also, much of this information is available directly from PHWD by request.

Issues From April, May and June Council Meetings:

- > Addressing customer concerns

- > Term limits

- > Capital spending

- > Cost structure

- > Rates

- > Scale (too small to be efficient)

The balance of the presentation discusses each of the listed issues that were raised in the April, May and June Council meetings.

The initial rate payer comment to the Council was that PHWD does not listen to rate payer concerns as measured by the lack of action taken. The next slide addresses that concern.

Customer Concerns Are Actively Addressed

- > Changes to April 2012 proposed rate increase
 - >> Eliminated COLA auto rate increase
 - >> Eliminated SFPUC rate pass through auto increase
 - >> Eliminated 10/2012 proposed \$0.30 rate increase
 - >> Compensation consultant engaged and recommendations are being made.

- > Public monthly meetings - Standing agenda item

- > FAQ on website / Monthly newsletter

- > Reviewed in LAFCO 2010 report without exception

Both LAFCO in their 2010 review, and this Committee asked whether PHWD's Board is listening to rate payers. It was easy for us to conclude they do listen and are responsive to the extent practical. First, regarding the April 2012 rate increase, although left largely unchanged from the Board proposal, four changes were made and are listed on the slide.

On a recurring basis, the Board maintains an environment that routinely addresses customer concerns as noted on the slide. The LAFCO 2010 report proposed no changes after their review of this area.

Term Limits Are Not Needed Now

Benefits of term limits:

- > Preferred practice
- > Help prevent abuse
- > Fresh thinking

Disadvantages of term limits:

- > Limited qualified candidate pool (technical background)
- > Loss of institutional history / expertise
- > Reduces voter choice

Term limits would not significantly change Board composition

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A rate payer asked that the Town Council consider the need for term limits. He alluded to the trade off between benefits from a governance viewpoint compared to the risk of losing institutional history and perhaps capability and competence.

Term limits is a preferred practice. Applying it to a large entity where staff support compensates for deficiencies in policy makers background and experience is more obvious than applying it to a small population, where the Board work is technical and deals with subjects most people do not confront in their day to day experience.

PHWD has 5 board members who serve for staggered 4 year terms. We noted that:

- a) In the past when openings occurred, a handful of ratepayers expressed interest in serving on the Board;
- b) Since most Board members joined recently, if a term limits policy was adopted similar to the one applied to Town Council, only 1 of 5 members would exceed two terms;
- c) LAFCO in their 2010 report reviewed the issue without proposing changes; and
- d) The election this November is a contested election with four candidates running for three positions.

It is not clear to us that imposing term limits would be advantageous. Rate payers, the Board and LAFCO would have to make these determinations.

Capital Spending Is Well Controlled

- > Competitive bidding / vendor turnover
- > Board level authorization and monitoring
- > Low capital cost
- > Pay as you go accounting
- > Capital replacement cost is \$19/mo per customer
- > Spending decline forecast in 2-3 years

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Another rate payer referenced CalWATER and thought PHWD's capital spending was excessive and not thoroughly reviewed by the Board as evidenced by the absence of ROI analysis preceding the authorization of each project. (We did not consider nor are we qualified to judge whether capital projects are necessary or correctly prioritized.)

Repairing and replacing existing pipelines and related equipment to maintain and improve the existing water delivery infrastructure is only one of the capital spending requirements PHWD faces. Maintaining water tanks for fire fighting and emergency supply, expanding emergency supply and building interties to other systems for emergency supply all are also capital requirements.

We considered each of the points listed on the slide. The first two points are obvious. The others are worth a brief mention.

"For profit" water providers like CalWATER include an 8%+ charge that is a return on undepreciated cost of their capital (real property, personal property and net monetary assets.) That is tantamount to an interest charge. There is no equivalent charge at PHWD. Most of PHWD's capital is bought and paid for by the rate payers the year it is put in service. For the balance, the neighboring fire district has made available short term financing at their cost of capital which is less than 1% today. Most other non profit water districts finance their capital costs with bonds with 5%+ interest rates. As you probably know from mortgage financing, about half the cost of a financed asset is interest. PHWD's capital does not include this cost. So, as compared to other's cost of capital, PHWD invests efficiently.

For those water providers who finance their capital, they amortize the cost into the rate base on a cash flow basis. In other words, in the year acquisition, perhaps 5% to 10% of the cost is passed on to the rate payers and the balance is billed each year over the life of the financing agreement. As previously noted, PHWD charges the entire cost to the rate payers in the year of acquisition or over the next few years. So, to make a fair comparison, this timing difference should be considered (as noted on an upcoming slide.)

Capital spending for Safety concerns (seismic and emergency supply) from 2004 - 2012 are 71% of capital spending. Very few safety type projects can be analyzed on a return on investment basis since none will produce more revenue and only a few will actually reduce cost. So an ROI analysis is of limited benefit. Separating the recurring capital cost for system maintenance from the safety requirements, the capital cost to the rate payer is roughly \$19 per month at PHWD i.e. for non safety capital spending. While not an inconsequential cost, it is also not a driving force behind costs and rate increases.

Finally, capital spending for the past few years has been high due to seismic retrofitting of the system. Those expenditures will be completed in or before 2015 and then capital spending should drop significantly.

For these reasons, the Ad Hoc Committee does not propose changes to capital spending practices.

Cost structure – PHWD v. CalWATER LA

Fiscal Year Budget 2013					
		PHWD 6/30 *		CalWATER 12/31	
Description		\$000's	%	\$000's	%
Revenue from rate payers		4,759	100%	23,696	100%
Uncontrollable costs:					
Water and electricity		2,777	58%	11,161	47%
Controllable costs:					
System maintenance		975	20%	4,318	18%
Back office		814	17%	4,075	17%
Capital improv's ** (Deprec)		600	13%	1,904	8%
Total costs		5,165	109%	21,457	91%
Income (loss) before other items		(405)	-9%	2,239	9%
Property tax income		450	9%		
Other income (cell antennae)		250	5%		
Income taxes				415	2%
Excess of revenue over costs		295	6%	1,824	8%
* 6/13/12 proposed 2012-13 budget pdf					
** 2012-13 budget proposes \$0 CapEx - used Pakpour rate study tabl 3 \$600k					

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Comparing PHWD to CalWATER LA, this slide shows an 18 percentage point cost difference as a percent of Revenue, primarily in three areas - water (11%), capital (5%) and maintenance (2%). Water will be covered on the next slide. We believe the capital cost difference is largely due to timing differences. Cal Water LA finances its projects and PHWD pays as it goes. Based on CalWater's historical spending, applied on the same basis, we believe capital cost differences would be small. It should also be noted that capital expenditures are very much district specific depending on pipe, topography, and system condition. A significant amount of PHWD's capital spending is for seismic, safety and fire reasons. The 2% difference in maintenance costs we have insufficient data to explain, however it is entirely offset by the 2% of revenues for income tax paid by "for profit" Cal Water.

Rates are higher than CalWATER Los Altos

Residential customer billed per CCF Year	PHWD CalWATER	
	6/2012	12/2012
Residential meter billing (000)	\$3,837	\$13,296
Residential CCF sold (000)	795	3,912
\$ per CCF sold	\$4.83	\$3.40
Difference	<u>\$1.43</u>	or 30%

Why the difference?

Water cost \$/ CCF :	\$2.93	\$1.60
Difference		<u>\$1.33</u>
Percent t of Difference (\$1.33 / \$1.43)		<u>93%</u>

Why are PHWD's rates higher than what other Town residents pay CalWATER LA? This slide presents the answer in a new way.

PHWD for the current year is 30% higher than CalWATER for residential metered water billing.*

93% of the difference is the cost of water. PHWD gets its water from SFPUC which comes from the Hetch Hetchy reservoir in the Sierra's. CalWATER gets 75% of its water from the Sacramento River delta via Santa Clara County Valley Water District and the rest from local well water. Hetch Hetchy water is more expensive than Sacramento River delta water + local well water. Hetch Hetchy water did not used to be more expensive. But now we are in the middle of a \$4.6 billion upgrade program. It appears to me that about 1/3 of that cost has already hit PHWD rate payers. There is more to come. But, CalWATER users have not yet been billed for any of the planned improvements to the delivery system for Sacramento River delta water. None of these system upgrade \$ amounts or timing is firm. It is only clear that PHWD water is more expensive than CalWATER LA's water now and costs are going up for both systems.

I have done this analysis in different ways and although the results vary, the conclusions do not. CalWATER's rates could catch-up to PHWD's rates. I am told 10 years ago they were about the same. CalWATER has the 8+% cost of capital disadvantage built into their rates compared to PHWD. But, the Hetch Hetchy infrastructure upgrade could prove to be more expensive for its users than the forthcoming Sacramento River Delta water system upgrades is for its users. Predicting future rates is beyond what I am willing to attempt except to say water costs will go up for both PHWD and CalWATER LA.

* Revenue from the standard monthly meter charge is different for the two providers and that is not factored in here because the data needed to include it was not available from CalWATER.

Are rates too high as measured by:

Average rates paid by others receiving Hetch Hetchy water?
Probably not.

Are District's controllable costs too high (driving up rates)?
Probably not.

Rates paid by others in District fair (rate tiering)?
We did not conclude on this.

Average rates paid to CalWATER by other LAH residents?
Yes, but appears to be temporary.

A lot of information has been presented. Lets review the original question. Are PHWDs rates too high? Going down the "as measured by" list:

Are PHWD rate payers paying more than rate payers at other districts who are using Hetch Hetchy water? The data presented by PHWD in the rate payer case material (on the website) suggest that the answer is no. However, that information is an analysis of rate tiers and not overall average rates. (It has previously been published by PHWD and is included as a handout with updated numbers. We attempted to compare PHWDs overall average rates with other Peninsula water district Hetch Hetchy users. The best we could find is 2011 data from some (not all) of the these other agencies. The data is total water revenue divided by water sold to derive an average rate. While that information suggested that PHWDs rate are a little higher than average, they are not substantially higher than average. And with the limitations of the data, we went no further.

Are PHWDs controllable costs too high (driving up rates)? Controllable costs are basically maintenance and administrative costs. Unfortunately comparative information from other agencies financial statements is not classified consistently enough to be helpful. LAFCO (in its 5 year audit cycle most recently reported for 2010) also considered this and did not propose changes. Year after year, PHWD is actively attempting to keep controllable costs down. An example is Pension Costs. To our surprise and contrary to the Town and most other public agencies, pension costs are actually in a net prepaid position resulting in as a low an annual pension cost as a % of payroll costs as I have seen. So, overall, on this point, the best we can say is that controllable costs appear to be reasonable.

We spent time looking at and discussing the tier pricing structure used by PHWD. It was not mentioned in Council meetings and is a debated subject among the PHWD board. PHWD uses more tiers than most other local Water districts for two reasons: 1) water conservation – i.e. to discourage big landscape water users with higher rates; and 2) to encourage all users to conserve because present and historical usage exceeds PHWDs guaranteed supply. The evidence we reviewed indicates PHWDs strategy is working. All peninsula users in recent years have used less water which is attributed to weather but PHWD users conserved significantly more than the others. If the Board chose to further reduce the number of pricing tiers, it would likely raise the rates of those who use less water and who are the most vocal critics of the current pricing. Two handouts have comparative updated tier pricing data.

Are CalWATER LA users getting lower rates than PHWD users. Yes, for now. But, for reasons discussed, CalWATER's rates are going up. Whether or not they will go up faster or as much as PHWD's rates is speculation. But, it would be imprudent not to consider this possibility.

Conclusions

> Major upsides:

>> Bring CalWATER opportunity to a conclusion

>> Develop closer relationship with Fire District

> PHWD is well managed

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The Ad hoc committee studied each of the concerns raised by ratepayers. We found the recent rate increase was necessary and reasonable, and is largely due to uncontrollable cost increases imposed on PHWD, with higher water costs being the principal factor in PHWD's higher rates than CalWATER LA. We believe the Board appropriately studied the matter, debated alternative views, and considered rate payers input, which ultimately were reflected in the adopted rates.

We thank the District for its whole-hearted cooperation with our study, without which we would have been unable to timely complete our work, and compliment them on their commitment and positive results. We found them focused on rate payer's interests.

No one likes rate increases, but unfortunately they are often necessary and not a sign of poor governance or management. Due to expected SFPUC water rate increases, PHWD's rates will continue to increase rapidly for the next few years.

We see opportunities that may improve the future rate picture. Discussions with CalWATER, already underway, could deliver a good result.

The working relationship and synergies between PHWD and the Fire District are good and improving. We encourage the PHWD to continue to develop that relationship. We have discussed a few ideas while preparing this report that are too tentative to present here, but may prove useful.

And finally to the skeptical PHWD rate payers whose concerns gave rise to this ad hoc Committee, I think that if you look at PHWD as hard as we did, you will share our conclusions.

Thank you.