

**BAY AREA WATER SUPPLY AND CONSERVATION AGENCY  
BOARD POLICY COMMITTEE**

**February 8, 2012 – 1:30 p.m.**

**Foster City Community Building, 1000 E. Hillsdale Blvd., Foster City, Port Room**

<b>MINUTES</b>
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**1. Call to Order: 1:35 p.m.**

Committee Chair Larry Klein called the meeting to order at 1:30pm. Eight members of the committee were present, constituting a quorum. A list of the directors present (8) and absent (2) and members of the community who attended is attached.

**2. Public Comments:** There were no public comments.

**3. Consent Calendar:**

Approval of the Minutes from the December 14, 2011 Meeting: Director Pierce made a motion, with the correction on the fourth bullet on page 7, to approve the Minutes. Director Breault seconded the motion. The Committee approved the minutes from the meeting of December 14, 2011. Three committee members abstained.

**5. Action Items:** There were no actions taken.

**6. Discussion items and Special Reports:**

Chair Klein moved item 6B up on the agenda

Potential Bond Issuance to Pre-Pay Capital Debt Owed to SFPUC: Mr. Jensen introduced David Brodsky from KNN, who was invited to the meeting to answer committee members' questions about the potential bond issuance. Mr. Brodsky is one of the two managing Directors of KNN, BAWSCA's financial advisors since 2003. Mr. Brodsky has served as financial advisor to cities, water districts and governmental agencies throughout California. Prior to being with KNN, Mr. Brodsky was Vice-President and Senior Credit Officer with Moody's Investors Service.

Mr. Jensen reported that the objective of the bond issuance would be to help water customers by lowering the cost of water purchased from San Francisco. He explained that under the 1984 Settlement Agreement and Master Water Sales Contract between San Francisco and its Wholesale Customers, agencies repaid San Francisco for their share of infrastructure investments over the life of the assets, which could be 15 to 80 or more years. Under the 2009 Water Supply Agreement, the agencies agreed to pay their proportion of infrastructure investments costs in real time, as a percentage of debt service on bonds or a percentage of revenue-funded projects. At the end of the 1984 contract, there remained a present value of

approximately \$370 million of payments for old projects still owed to San Francisco, and those payments would have stretched out over several decades.

To resolve the outstanding amount owed, the 2009 Water Supply Agreement provides that the \$370 million would be paid amortized over the 25-year life of the Agreement at a 2009 interest rate of 5.13%. The Agreement also provides that the remaining balance can be prepaid at any time without penalty.

San Francisco initiated the discussion of whether BAWSCA could issue bonds to prepay this debt. If BAWSCA issued bonds and were repaid by its members, the bonds could quite possibly be sold at interest rates much lower than 5.13%. Interestingly, everyone may stand to gain in different ways.

BAWSCA member agencies could experience a net cost savings. KNN's preliminary estimate is that the net savings to BAWSCA's members could be as much as \$35 million over the next 25 years. The *net* savings would result from the difference between the payments to BAWSCA and a lower-than-otherwise cost of water from San Francisco.

San Francisco would benefit from the infusion of cash which could reduce the size of San Francisco's anticipated retail rate increase in 2015, increase the SFPUC's reserve cash balance, and have a positive impact on SFPUC's credit rating.

Mr. Jensen stated that it is critical to examine all possible issues that might affect the feasibility and approach to issuing such bonds. One potential issue includes whether BAWSCA's existing authority to issue bonds allows this type of use of bond funds. Mr. Jensen explained that if BAWSCA issued bonds, BAWSCA will be paying debt to San Francisco that is owed by its members, under an agreement to which BAWSCA is not a signatory. If BAWSCA's enabling legislation does not cover issuance of bonds for this purpose, the enabling statute might be able to be modified to enable the water customers to realize the potential benefit.

There are a variety of other financial issues that are being examined by BAWSCA's legal counsel and financial advisor, in conjunction with SFPUC staff. Mr. Jensen expects that outside bond counsel will need to be hired at a modest initial expense to help assess the feasibility of moving forward. He stated that it is important to ensure that the objective of lowering the wholesale customers' cost of water purchased from San Francisco is met. To that end, BAWSCA would need to ensure that San Francisco's use of the funds would not result in increased rates to the wholesale customers, and that allocation of net savings among the 26 wholesale customers would be made in a fair manner.

In addition, identifying an appropriate institutional arrangement might be important for securing good bond ratings. For example, it might be necessary to generate agreements between BAWSCA and each member agency.

The refinance appears to be advantageous to both San Francisco and the Wholesale Customers, and deserves thoughtful considerations.

Director McLeod asked if the bond ratings of individual agencies could be impacted by BAWSCA issuing bonds. Mr. Brodsky stated that while there are technical issues that call for

due diligence, a positive impact to the member agencies are more likely than an adverse impact.

In response to Director Pierce's question, Mr. Brodsky explained that bond issuance by either BAWSCA is not problematic. The challenging part is the nature of the underlying contracts that secure the bonds because there is no existing system through which BAWSCA charges its members "water rates" that can serve as a basis.

Mr. Brodsky confirmed that the savings of up to \$35M over 25 years is a net present value, and that the interest rate would be at an average of under 4%.

Director Weed noted that the Alameda County Water District recently issued bonds totaling \$47 M at an interest rate of 3.21%.

Director O'Connell asked how long would it take to do all that needs to be done and how long the low interest rates would be available. Mr. Brodsky stated that there are reasons to believe that low interest rates will remain into 2013, however, they can be affected by unforeseen events.

Mr. Brodsky noted that there is a substantial amount of work to be done under a tight schedule, and an August bond issuance would arguably be an ambitious deadline. He stated that progress can also depend on the need for local agency approvals.

Mr. Jensen commented that if agency approvals are needed for contracts, BAWSCA can move the process as it did with the Drought Implementation Plan, Water Supply Agreement, and the creation of BAWSCA, which took approximately four months, once all of the materials and documents had been prepared.

Mr. Jensen stated that the feasibility of issuing bonds, and the pros and cons, would be brought to the Committee before it was brought to the Board to ensure a thorough understanding prior to making a decision. He noted it would also be important to communicate with the member agencies so that they would be informed and prepared to act on any agreements needed to implement the idea.

As a response the Director O'Connell's question about the potential impact of the November elections on interest rates, Mr. Brodsky stated that it is difficult to predict what factors will affect interest rates. He noted that if the market opportunity passes by, the benefit of having developed an intellectual infrastructure to do the financing would put BAWSCA and the agencies in a position to do the financing swiftly the next time a favorable market occurred.

In response to a question from Director Klein, Mr. Brodsky stated that there is high probability that the re-finance can be done. He said to his knowledge, all 26 member agencies could individually issue bonds, and pool together the money to pay off the debt. However, it would be a very complex and cumbersome process. A simple method would be for BAWSCA to issue bonds on behalf of the 26 member agencies.

Mr. Brodsky stated that despite the challenges, he is confident that a method could be developed to secure bonds that can pay off the debt.

Mr. Jensen stated that if the re-finance is feasible, and assuming that issuing bonds is a part of the Work Plan for FY 2012-13, work would begin in Spring or, at the latest, early Summer. A cost of \$50K to look at feasibility is available in the existing budget. The out-of-pocket cost associated with issuing bonds is estimated at \$435,000 and could be funded during FY 2012-13, as he will explain when he presents the preliminary budget for next year.

Director Weed asked how individual agency's debt rating could be impacted. Mr. Brodsky does not see a negative impact to individual agencies, but states that the payments to BAWSCA may be a reportable obligation. Mr. Brodsky stated that since the contracts have yet to be developed, it is unknown how they would be reported. He expects them to be operating contracts which would be considered as off-balance sheet debt, which are typically used to restructure an existing obligation, and are viewed by rating agencies as such.

Director Breault asked if the nature of the existing capital debt repayment and structure, and the authority BAWSCA and the RFA have to issue bonds, require unanimity among all the member agencies, or could agencies opt out? Legal Counsel, Allison Schutte stated that issuance of bonds would require a 2/3<sup>rd</sup>'s vote of the BAWSCA Board.

Director Breault also asked what would happen to debt coverage in the case that an agency defaults.

Mr. Brodsky stated that a tried and true mechanism would be a 25% step-up, which the State Water Contracts applied, but never exercised. Director Weed asked what bond rating KNN had assumed in developing its estimate. Mr. Brodsky replied that they assumed a AA- rating. Mr. Brodsky stated that not all the debt could be tax exempt.

Director Guzzetta asked if there was anything in the law that would allow privately-owned entities to use tax exempt bonds because the benefit is to the customers, and not to the company.

Mr. Brodsky said not at this time, but he was willing to explore that question.

As a response to Director Pierce's question of whether the materials provided in the packet were sufficient, members of the Committee suggested to highlight the potential risk factors, and the inclusion of all the information available at the time the matter is brought before the Board.

Mr. Jensen clarified that the feasibility study is being done now. When the bond issuance is proven to be the right thing to do, the Committee and the Board will be asked to authorize the resources needed to move forward. Mr. Jensen stated that the \$435,000 is the estimate for the out-of-pocket cost, and does not include costs that would be paid upon issuance of the bonds. The total cost of issuance would likely exceed of \$2M.

Ms. Schutte noted that compared with ACWD's recent bond issuance, the cost of issuance for BAWSCA with its 26 member agencies would have a higher price tag because of its complexity and the fact that it does not have a history of issuing bonds.

Director Pierce requested that all benefits of establishing the intellectual infrastructure be presented to the Board in March, regardless of how big or little they may be. As well as information on the revenue stream.

Mr. Jensen stated that a graph can be presented to show what the current debt payments look like now in comparison to what they would look like with the bond issuance based on some assumptions.

Director Breault commented that some people may see very little savings over the long period of time and ask, "Why bother?" The Committee agreed with Mr. Jensen who stated that he would not want to answer a question about why an opportunity to save \$35M was not examined.

Director Guzzetta stated that the savings does not have a "wow" factor, but it is the right thing to do. The Committee agreed.

Director Weed suggested that it would be helpful to provide the net present value and the bond rating assumptions.

Mr. Jensen thanked the Committee for the questions and comments.

Preliminary Fiscal Year 2012-13 Work Plan and Budget: Mr. Jensen reported that the preliminary Work Plan for FY 2012-13 covers all activities regardless of the source of funding, whether through the Operating Budget, the Water Management Charge, or payments for Subscription Water Conservation Services.

The Work Plan continues to address BAWSCA's goals of ensuring a reliable supply of high-quality water at a fair price, as well as agency effectiveness. The presentation of the preliminary budget, however, is restricted to the Operating Budget for two reasons: the use of Water Management Charge revenue is restricted to a one-time study and the amount of subscription services and associated revenue depends on decisions made by member agencies once their budgets are adopted.

A substantial portion of the Work Plan has to do with ensuring both near-term and long-term reliability of water supply and delivery.

The work involved in the Long-Term Reliable Water Supply Strategy (Strategy) includes ensuring that reliable, high-quality supply of water is available where and when needed through the year 2035. It also addresses achieving a desired level of drought reliability, as well as providing a consistent and defensible basis for regional water planning. Mr. Jensen noted that the Work Plan includes the development of a common methodology for projecting water demands throughout the 26 service areas.

Near-term decisions stemming from development of the Strategy will focus on achieving sufficient drought reliability. In addition, continued implementation of core and subscription water conservation programs addresses the near-term solutions for water supply reliability.

With respect to the reliability of water delivery, BAWSCA will continue to monitor the SFPUC's WSIP scope, schedule and budget, focusing on construction and overall program management, project schedules and cost control. BAWSCA will take appropriate actions as necessary.

Protecting the members' interests will require BAWSCA's involvement in several major activities that affect water supply reliability including the FERC relicensing process of New Don Pedro Reservoir, the SFPUC's water transfer with Modesto Irrigation District (MID), and the current efforts by proponents of draining Hetch Hetchy reservoir.

The continued administration of the 2009 Water Supply Agreement (WSA) includes an effort to amend the Tier 1 drought allocation formula with the SFPUC, as well as amending the WSA to revise the provision that states "San Francisco will complete construction of the physical facilities in the WSIP by December 31, 2015," a date which the Commission has extended to mid-2016.

Finally, BAWSCA will pursue grant opportunities independently and in coordination with other agencies, and implement the use of Proposition 84 grant funds awarded for water conservation in 2011.

Directors discussed and asked questions about the preliminary Work Plan.

Director McLeod asked whether BAWSCA was considering each agency's other sources of water when looking at drought reliability. Mr. Jensen stated that the efforts to obtain the desired level of drought reliability will be consistent with the approach taken to date, which considers each agency's other sources of supply as local assets and not subject to reallocation unless those supplies are offered for study by the agency. Mr. Jensen noted that the drought allocation between BAWSCA member agencies will expire in 2018, which is one reason the matter appears in the Work Plan for FY 12-13.

Director McLeod asked if BAWSCA participates in any discussions with cities to gain a regional perspective on how cities might be impacted to ensure there is an overall balance.

Ms. Sandkulla stated that BAWSCA does not currently participate in any regional discussions of that nature, however, through the efforts on the Strategy, BAWSCA has initiated discussions among its member agencies about dry-year water supplies, which agencies want it, and at what level. Information is still being compiled and the question of how much to invest in drought reliability will be brought to the Committee and Board for discussion and consideration at a later date.

In response to Director McLeod's question about compliance with State greenhouse emission regulations, Ms. Sandkulla explained that since BAWSCA is not a supplier, it is not required to comply. However, because the SFPUC and individual agencies address it in their facilities plans, compliance is covered. Ms. Sandkulla noted that if BAWSCA develops a water supply project, BAWSCA's role relative to compliance may change depending on how such a project was implemented.

To ensure fair price, BAWSCA will continue to perform matters delegated to it by member agencies through the WSA. In addition, BAWSCA would pursue whether wholesale customers

would benefit from BAWSCA issuing bonds to retire capital debt owed to San Francisco, as discussed earlier.

BAWSCA will continue to support member agencies in receiving reliable communication of water quality events, and coordinate member agency participation in Water Quality Committee established by the WSA.

In the context of developing new water supplies or implementing water transfers, Director McLeod asked about how the mix of different water sources is addressed to ensure high quality water, and if there would be some value gained from a discussion that could set a minimum standard that exceeds basic drinking water requirements. Mr. Jensen explained that the WSA address water quality impacts if BAWSCA or member agencies transfer water through the San Francisco Regional Water System facilities.

Director Weed commented the inclusion of the number of personnel hours required to accomplish each of the functions in the Work Plan, and how the workload is distributed. Mr. Jensen stated that charts can be provided to show where the relative levels of efforts are associated.

Director Weed stated that one of BAWSCA's biggest challenges is the effort to drain Hetch Hetchy and that he finds it valuable to encourage the SFPUC to have water system tours to educate the government leaders, agency staff and others about the significance of system, and to gain a full understanding of it.

Mr. Jensen noted that BAWSCA's predecessor organization, BAWUA, used to conduct tours, which later evolved to a sponsorship of the Water Education Foundation's (WEF) tour of the Hetch Hetchy system. The tours stopped three years ago after proponents of draining Hetch Hetchy consumed a disproportionate use of the tour to promote their agenda. Mr. Jensen will discuss the idea with the SFPUC.

Mr. Jensen also noted that the Work Plan includes assessing the risks associated with efforts to drain Hetch Hetchy, and that he welcomes members of the Board to contact him with any questions.

Director Guzzetta stated that aside from the efforts of Restore Hetch Hetchy, he stated that there might be value in educating agency staff members who deal with the system and the public on a daily basis. It may not involve going to Hetch Hetchy, but perhaps an educational program that would provide information so agency staff can become better ambassadors of the system. The Committee agreed to request the CEO look into what resources would be needed to provide such a program.

Mr. Jensen reported that the preliminary Operating Budget is estimated at a range between \$2.6M and \$3M. The upper end estimate included \$435,000 associated with the possibility of issuing bonds.

Funding alternatives included funding the \$435K for issuing bonds through the General Reserve, should the Board decide to move forward with that activity.

Another alternative included decreasing the as-needed consulting budgets by 10% to reduce the budget by \$30K and increasing the contingency budget by \$30K for the CEO to use if and when needed.

Options for reducing the size of the preliminary budget include removing salary and benefit adjustments that are included in the initial estimate. Due to recent economic conditions and cost-cutting actions taken by many member agencies, BAWSCA has deferred making adjustments to staff position salary ranges to reflect the results of compensation surveys or implement COLA adjustments. The preliminary budget number included top-step salary adjustments for two positions, which totaled \$7,400, and COLA adjustments for positions other than the CEO amounting to \$17,000. Mr. Jensen stated that the budget could be reduced by \$24,400 if these adjustments were omitted.

Mr. Jensen then reported that the budget can be funded without an increase to the assessments. He noted that the General Reserve would continue to grow even if bonds were issued using the General Reserve funds.

Several alternatives were examined for managing the General Reserve balance. One that Mr. Jensen recommends is to either use a portion of the General Reserve to pay the out-of-pocket costs for issuing bonds, or rebate a similar amount to agencies in the event bonds are not issued. In addition, reduce assessments by 7% as part of the budget process for FY 2013-14.

Other alternatives included reducing assessments by 15% the first year, and increasing assessments by 9.5% the following year.

The Committee discussed and offered comments on the preliminary Work Plan, Operating Budget and funding plan.

Director O'Connell and other members asked that the presentation of budget alternatives be clarified.

Director O'Connell expressed her concern with removing the top-step salary adjustments for two positions. She said that while all cities continue to cut back and freeze wages, BAWSCA's personnel are unlike those of other cities. The skill set of BAWSCA's personnel positions fit the unique need of the agency and its member agencies. To lose a person would mean a lot of training for the replacement, and she would be interested in retaining the employees as opposed to losing them to save \$7,400.

Director McLeod concurred with Director O'Connell.

Director Breault suggested that it should be noted to the Board that the funding alternatives presented by Mr. Jensen are alternatives that the Board Policy Committee discussed and found that no further development of information to be necessary.

The Committee supported the results to be achieved, the preliminary Operating Budget, the use of the General Reserve to fund the possible issuance of bonds and the schedule for reducing assessments by 7%. The Committee also agreed that it does not support removing the top-step salary adjustments for two positions to save \$7,400.



**Update and Reports:**

Meeting with Mayor Lee held February 3, 2012: Director Pierce reported that a meeting with San Francisco Mayor Lee was arranged by Assembly Member Jerry Hill on February 3rd. She attended the meeting on behalf of BAWSCA with Art Jensen, Director Chuck Reed, and Bud Wendell. San Francisco members included Ed Harrington and Tony Winnicker.

Two messages delivered at the meeting were that the mayor consider the regional significance of the water system and the importance of the Wholesale Customers who pay the majority of regional system costs when he appoints a new SFPUC general manager to succeed Ed Harrington, and when he makes appointments or reappointments for the three seats on the commission for which the current terms expire this year.

Top priorities for the new general manager must remain completion of the WSIP on schedule and within budget, as well as ensuring water customers would be protected should the movement to drain Hetch Hetchy Reservoir go forward.

Mr. Jensen reported that Mayor Lee was receptive to BAWSCA's concerns and pledged to have Ed Harrington work with Art Jensen to address protection of water customers. Mayor Lee also acknowledged his understanding of the regional nature of the water system and pledged to pick Ed's successor with care.

Long-Term Reliable Water Supply Strategy – Status Report: Ms. Sandkulla reported that the Study Session with the Board about water transfers will be scheduled for the March Board meeting. A presentation will be given and will require no Board action. The objective is to achieve a common level of understanding about water transfers, and provide information to support further Board decisions with respect to drought and water supply reliability.

Director Breault suggested that information should be provided in a simple format with lots of graphics.

SFPUC Water System Improvement Program – Evaluation of SFPUC Response to BAWSCA Comments: Ms. Sandkulla reported that BAWSCA received the SFPUC's response to its December 7<sup>th</sup> letter containing six recommendations regarding the WSIP. The letter had a positive response and was appreciative of BAWSCA's efforts on behalf of the wholesale customers.

The SFPUC agreed with two of BAWSCA's recommendations and will include additional information on cost and schedule trends in reports submitted to the Commission and the public, including the Quarterly Reports. The SFPUC will also analyze approved WSIP change orders to confirm conformance with existing policy.

BAWSCA will follow up with Julie Labonte and her staff to discuss other outstanding areas of concern, including the inclusion of trends in both cost and schedule estimates, and how sufficient information on WSIP trends could be provided to the public and policy makers to help set realistic expectations. Any further developments will be shared with the Board at future meetings.

**Comments by Committee Members:** Regarding current water supply conditions, Ms. Sandkulla reported that in spite of this relatively dry winter, San Francisco anticipates no mandatory rationing given the continued low water use and last year's wet season.

**Adjournment:** The meeting was adjourned at 3:20pm.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Arthur R. Jensen". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Arthur R. Jensen, Chief Executive Officer and Secretary

ARJ/le

Attachments: 1) Attendance Roster

**BAY AREA WATER SUPPLY AND CONSERVATION AGENCY  
Board Policy Committee  
February 8, 2012**

**Attendance Roster**

**Committee Members Present:**

Larry Klein	City of Palo Alto (Chair)
Rob Guzzetta	California Water Service Company (Vice Chair)
Robert Anderson	Purissima Hills Water District
Randy Breault	City of Brisbane/GVMID
Jamie McLeod	City of Santa Clara
Irene O'Connell	City of San Bruno
Barbara Pierce	City of Redwood City
John Weed	Alameda County Water District

**Committee Members Absent:**

Ruben Abrica	City of East Palo Alto
Tom Piccolotti	North Coast County Water District

**BAWSCA Staff Members Present:**

Arthur Jensen	Chief Executive Officer
Nicole Sandkulla	Water Resources Planning Manager
John Ummel	Sr. Administrative Analyst
Lourdes Enriquez	Assistant to the CEO
Allison Schutte	Legal Counsel, Hanson Bridget, LLP.
Dave Brodsly	KNN Public Finance

**Guests:**

Peter Drekmeier	Tuolumne River Trust
Marilyn Mosher	City of Hayward
Michelle Sargent	San Francisco Public Utilities Commission
Nico Procos	City of Palo Alto