

BAWSCA

Bay Area Water Supply & Conservation Agency

**Please Note
Different Location**

BOARD POLICY COMMITTEE

February 8, 2012

1:30 p.m.

Foster City Community Building, 1000 E. Hillsdale Blvd., Foster City, Port Room
(Directions on page 2)

AGENDA

1. Call To Order, and Roll Call (Klein)
Roster of Committee members (*Attachment*)
2. Comments by Chair (Klein)
3. Public Comment (Klein)
Members of the public may address the committee on any issues not listed on the agenda that are within the purview of the committee. Comments on matters that are listed on the agenda may be made at the time the committee is considering each item. Each speaker is allowed a maximum of three (3) minutes.
4. Consent Calendar (Klein)
Approval of Minutes from the December 14, 2011 meeting (*Attachment*)
5. Action Items (Klein)
None
6. Discussion Items
 - A. Preliminary Fiscal Year 2012-13 Work Plan and Budget (*Attachment*) (Jensen)
Issue: What critical results need to be achieved next year and what resources will be required?
Information to Committee: A memo and oral report on results that must be achieved in the FY 2012-13, and Preliminary Work Plan and Operating Budget Alternatives.
Committee Action Requested: Discussion of Preliminary Work Plan and Budget for FY 2012-13.
 - B. Potential Bond Issuance to Pre-Pay Capital Debt Owed to SFPUC (*Attachment*) (Jensen)
Issue: Is it feasible and beneficial for BAWSCA to pre-pay the debt?
Information to Committee: Memorandum from KNN and oral presentation on issues, status of investigation, steps being taken and timeline.
Committee action requested: Questions and comments
 - C. Board Policy Calendar (*Attachment*) (Jensen)

7. Update and Reports**(Jensen/Sandkulla)**

- A. Meeting with Mayor Lee held Feb. 3, 2012
- B. Long-Term Reliable Water Supply Strategy – Status Report
- C. SFPUC Water Supply Improvement Program – Evaluation of SFPUC Response to BAWSCA Comments (*Attachment*)

8. Comments by Committee Members**(Klein)****9. Adjournment to the next meeting on April 11, 2012 at 1:30pm in the 1st floor****conference room of the BAWSCA office building, at 155 Bovet Road, San Mateo. (Klein)**

*Upon request, the Board Policy Committee of the Bay Area Water Supply and Conservation Agency (BAWSCA) will provide for written agenda materials in appropriate alternative formats, or disability-related modification or accommodation, including auxiliary aids or services, to enable individuals with disabilities to participate in public meetings. Please send a written request, including your name, mailing address, phone number and brief description of the requested materials and the preferred alternative format or auxiliary aid or service at least two (2) days before the meeting. Requests should be sent to: **Bay Area Water Supply & Conservation Agency, 155 Bovet Road, Suite 650, San Mateo, CA 94402** or by e-mail at bawasca@bawasca.org*

*All public records that relate to an open session item of a meeting of the Board Policy Committee that are distributed to a majority of the Committee less than 72 hours before the meeting, excluding records that are exempt from disclosure pursuant to the California Public Records Act, will be available for inspection at **BAWSCA, 155 Bovet Road, Suite 650, San Mateo, CA 94402** at the same time that those records are distributed or made available to a majority of the Committee.*

Directions to Foster City Community Bldg. – 1000 E. Hillsdale Blvd., Foster City

From Hwy. 101, take the Hillsdale Ave. exit East. Turn Right into the parking lot just after the intersection with Shell Blvd. The Community Bldg. entrance is separate from the Library entrance and is marked by signage. The Port Room will be at the top of the stairs on the right, pass the reception station (there is also an elevator).

From the East Bay, take Hwy. 92 West, exiting at Foster City Blvd., and going South on Foster City Blvd. to Hillsdale. Turn Right (West) onto Hillsdale and proceed to Shell Blvd., making a U-turn to be able to pull into parking lot on SE corner of Hillsdale and Shell. See underlined sentence of first paragraph above for remainder of directions.



BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE

Committee Roster:

Larry Klein, City of Palo Alto (Chair)

Rob Guzzetta, California Water Service Company (Vice-Chair)

Ruben Abrica, City of East Palo Alto

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 (BAWSCA Vice Chair)

Tom Piccolotti, North Coast County Water District

Barbara Pierce, Redwood City (BAWSCA Chair)

Bill Quirk, City of Hayward

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

**December 14, 2011 – 1:30 p.m.
155 Bovet Road, 1st Floor Conference Room**

MINUTES

1. Call to Order: 1:35 p.m.

Committee Chair Larry Klein called the meeting to order at 1:35pm. Seven members of the committee were present, constituting a quorum. A list of the directors present (7) 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 October 12, 2011 meeting: Director O’Connell made a motion, seconded by Director Anderson, to approve the minutes from the meeting of October 12, 2011. The motion carried with two abstentions.

5. Reports and Discussion:

Mid-Year 2011-12 Work Plan and Budget Review: As reported in the memorandum included with the agenda, Mr. Jensen reported that anticipated activities for the remainder of the fiscal year can be completed within the budget for FY 2011-12 approved by the Board in May 2011.

Adjustments will need to be made to the existing Work Plan and to the allocation of funds in the Operating Budget to accommodate anticipated activities.

In September, the Board asked that the mid-year budget review project the General Reserve balance at the end of the fiscal year. Mr. Jensen reported that it is expected to grow at year end, and that alternatives for managing the balance according the BAWSCA’s adopted guidelines can be best addressed during budget preparations for FY 2012-13.

The recommended adjustments to the overall Work Plan focus on 4 areas:

- 1) As reported at the November Board meeting, the scope and schedule changes to the Long Term Reliable Supply Strategy will be presented in the Spring of 2012.
- 2) The technical review and oversight of the SFPUC’s Water System Improvement Program (WSIP) will change emphasis from a technical engineering oversight to a construction management oversight. The professional services agreement with a construction management consultant will be increased by \$15,000. An existing \$135,000 contract for technical engineering services approved in the beginning of the fiscal year was terminated before any work was begun. It will be replaced with an agreement for an as-needed support at \$25,000.

- 3) Increased attention and action will be needed to protect the reliability provided by water storage reservoirs in the Regional Water System. The professional services agreement with Strategic Counsel will be increased by \$50,000. Mr. Jensen noted that an errata was provided for this memorandum to reflect the correct amount of increase by \$50,000 instead of a \$100,000 figure.
- 4) As a response to agency requests for added value in the water conservation data base, BAWSCA will increase the budget with the existing consultant by \$75,000 to make the retrieval of data from the database easier and adaptable to the variety of agency reporting purposes.

The total adjustment amounts to \$165,000. The sources of funds come from the termination of the \$135,000 contract for technical engineering support and \$30,000 from the contingency budget.

Mr. Jensen reported that 93% of the budget is projected to be spent by the end of the fiscal year. The unspent funds would increase the General Reserve balance to 43% of the operating budget, if next year's operating budget is the same as the current year's.

It is difficult to estimate the following year's budget and Mr. Jensen proposed that the process for managing the General Reserve be addressed during the development of the budget for FY 12-13.

The Board will be able to consider the same options it considered in November.

Director Pierce asked what BAWSCA's concerns are with the WSIP. Mr. Jensen stated that with the regional projects midway through construction, it would be prudent to produce a report on BAWSCA's assessment of the program's progress and management, and whether it will be completed on schedule, scope and budget. The report will include BAWSCA's recommendations, and would put BAWSCA in a confident position of saying that the program is sound, and if not, what are San Francisco's plans of action.

Director Breault asked for a review of the dollar value and the benefit-cost ratio for the water conservation database, given that the request for contract amendment is 150% of the original cost.

Ms. Sandkulla noted the comment and explained that the original scope for the data base was geared towards getting a large amount of data from several years of the member agencies' conservation programs in a timely fashion. This database would allow for a simplistic approach to store the data for the member agencies in one database source. The data comprise information the member agencies and BAWSCA identified as necessary for planning purposes.

During the development of the database, agencies were not yet prepared to identify specific subsets of data they would like to retrieve from the database on a regular basis. Going into the second year, BAWSCA has gotten some feedback on what types of reports agencies would like to be able to extract from the database through a simple query process.

In response to Director Breault's question of whether \$75,000 would be enough, Ms. Sandkulla stated that it was an appropriate amount to start with, given the number of agencies and the types of reports those agencies might find valuable.

Ms. Sandkulla concluded by saying BAWSCA will be meeting with member agencies on December 15th to determine what kinds of reporting process and results would maximize the value of the database for the agencies as well as for BAWSCA. The mid-year Work Plan and budget adjustments presented to the Board in January will reflect that input.

Director Quirk commented that he is pleased that BAWSCA will continue its oversight of the SFPUC's WSIP through a formal written report.

Director Anderson made a motion, seconded by Director O'Connell, and by roll call vote, the committee unanimously voted to recommend the Board's approval of the four adjustments to the Work Plan and the four adjustments to the Operating Budget:

1. Approve the following revisions to the FY2011-12 Work Plan:
 - a. Prepare scope and schedule changes for the Long-Term Reliable Water Supply Strategy, and present them to the Board the Spring 2012.
 - b. Acknowledge the termination of the original contract for as-needed technical engineering reviews of WSIP design and technical documents because the needs are much smaller than could be envisioned at the time the budget was prepared.
 - c. Take actions needed to protect the reliability provided by water storage reservoirs in the regional water system.
 - d. Respond to agency requests for added value by making data in the water conservation data base easier to retrieve for a variety of agency reporting purposes.

2. Approve the reallocation of funds and authorize the CEO to take the actions specified below:
 - a. To support the proposed revisions to the Work Plan, reallocate the following funds: \$135,000 from as-needed technical engineering support, \$50,000 from the administration support, and \$30,000 from the contingency budget.
 - b. Authorize the CEO to amend the existing contract with Mr. Terry Roberts to add \$15,000 for additional investigations of WSIP program and construction management for a revised contract total of \$135,000.
 - c. Authorize the CEO to execute a contract with an as-yet unidentified consultant for engineering review of WSIP design and technical documents for an amount not to exceed \$25,000.
 - d. Authorize the CEO to amend the existing contract for Strategic Counsel by \$50,000 to assist the CEO and legal counsel with activities to protect the water supply reliability provided by Hetch Hetchy Reservoir, for a revised total contract amount of \$200,000.
 - e. Authorize the CEO to amend the existing contract with Brown and Caldwell to add \$75,000 for a revised total contract amount of \$125,000 to develop improved reports of data in the Water Conservation Data Base and provide on-call technical support.

Fiscal Year 2012-13 Work Plan and Budget Preparation: Mr. Jensen reported that the development of the annual Work Plan and Budget begins with identifying major challenges the agency must address over the next one to 25 years, articulating the critical results needing to be achieved next year, the tasks for achieving those results, and the resources needed to complete those tasks. A table presenting this long-term context was presented. The same table will be updated and presented to the Board in January.

A list of major challenges and issues expected in FY 2012-13 were the focus of committee discussion. Mr. Jensen noted that while some of the items may not require a significant amount of time, they are nonetheless important issues that deserve attention. For example, BAWSCA must maintain a strong relationship with San Francisco as it transitions to Mayor Lee's administration, the appointment of a new General Manager following Ed Harrington's retirement and reappointment of commissioners, or possibly appointment of new commissions, by Mayor Lee and confirmation by the Board of Supervisors.

In FY 2012-13, the Work Plan will include the Board's consideration of specific projects to pursue in the implementation of the Strategy, the development of a uniform method for projecting member agency water demands and SFPUC purchases to support long-term regional planning, and the amendment of the current Water Supply Agreement so that it reflects the revised completion date of the WSIP.

Additionally, it would be appropriate for BAWSCA to pursue an amendment of the Tier 1 drought allocation formula that is in the agreement with San Francisco. Mr. Jensen explained that if drought allocations of SFPUC water are calculated using the existing formula in the agreement and the decreased water use throughout the service area, San Francisco's Wholesale Customers would need to cut back during a drought, but San Francisco Retail Customers would not.

The proponents of draining Hetch Hetchy Reservoir intend to ask San Francisco voters in November 2012 to require the SFPUC to prepare a plan to do so. BAWSCA will follow the developments of this effort closely to protect the interests of the wholesale customers.

With regard to developing a uniform method for projecting water demands, Director O'Connell asked whether agencies are being asked to agree on a specific way to project water demands. Mr. Jensen explained that BAWSCA has not recommended a specific method and is not wedded to a method that was used before. The proposal is to identify a method that can be customized to each agency's unique land use and water use characteristics. A presentation to the Water Supply Management Representatives indicated their support for this effort.

Mr. Jensen reported that a new issue for the Board's consideration in FY 2012-13 is whether member agencies would benefit from issuing bonds to retire old capital debt they owe to San Francisco. Mr. Jensen will meet with Legal Counsel and BAWSCA's financial consultants in January to look into the possible value of refinancing that debt using lower interest rates currently available. Initial estimates suggest a potential savings of up to \$50M, although there are several issues to consider in greater detail in order to make an informed recommendation. The preliminary investigation with the financial consultants will look into the value of the

effort, and determine whether the complexity to pursue it as a region, much more by individual agencies, is worth the value of the perceived savings.

Director Piccolotti asked whether agencies could pay off their share independently of the other agencies. Legal Counsel, Allison Schutte explained that the debt is collective among the member agencies and is built into the SFPUC's wholesale water rates.

Mr. Jensen continued to present the challenges anticipated for years 2013 through 2035. They include the completion of the Strategy, extending the sunset provision of AB1823 prior to 2015, guarding against potential adverse water supply impacts from the Federal Environmental Regulatory Commission relicensing process of the New Don Pedro Hydroelectric Project, representing members' interests in San Francisco's decisions about the 184 mgd supply limitation before 2018, and San Francisco's decision about whether to make San Jose and Santa Clara permanent Wholesale Customers or assist in identifying a long-term supply for those members. He noted that by 2035, the Water Supply Agreement will expire and should be re-negotiated, and that new water supplies should be brought online for agencies requiring additional water.

Director Breault noted that he sees potential activities that may impact the Work Plan for FY 2012-13 such as the SFPUC's consideration of water transfers from MID and how that might affect member agencies.

Mr. Jensen reported that the issues of cost allocation and who benefits from the SFPUC's water transfers with the Modesto Irrigation District (MID) are being examined with the SFPUC. It will be included in the Work Plan for FY 2012-13 and necessary actions to address any issues will be brought to the Board.

The Committee also discussed potential activities that may come up after the completion of the WSIP, including asset management in general, rate setting or the development of a 2-year budget plan.

In response to Director Quirk's question, Mr. Jensen clarified that the SFPUC's proposed water transfers with MID would have a neutral impact on the lower Tuolumne River, but result in lower stream flows on the upper Tuolumne River between Hetch Hetchy Reservoir and New Don Pedro Reservoir.

Director Quirk asked a question about deliveries from San Francisco above 184 mgd and possible concerns of the Tuolumne River Trust. Mr. Jensen stated that most of the water supply alternatives BAWSCA is analyzing through the Long-Term Reliable Water Supply Strategy focus on projects that do not require additional withdrawals from the Tuolumne River. That said, BAWSCA will continue to monitor San Francisco's compliance with the provisions in the 2009 Water Supply Agreement that require it to preserve its water rights. BAWSCA will also continue to maintain the Wholesale Customers' reserved claim that San Francisco is obligated to supply them with additional water in excess of the Supply Assurance.

Amendment to Policies and Procedures for the Purchase of Equipment and Supplies/Award of Contracts: Mr. Jensen presented the proposed amendment to the existing policies and procedures for purchase of equipment and supplies or awards of contracts.

The issue is whether to increase the CEO's discretionary spending authority. Mr. Jensen presented his use of his discretionary spending authority during FY10-11. He cited the following example in which the existing limit on contract amendments created a practical constraint to accomplishing necessary work. The existing limitation on contract amendments is the lesser of \$10,000 or 10% of the original not-to-exceed amount.

Last Spring, the professional services contract with KNN needed to be amended by \$15,000 to address a time-sensitive issue with San Francisco's water rate setting. The existing limit on contract amendments constrained the CEO's authority to amend the contract to just \$4,000 (10% of \$40,000). The contract was amended by that amount to begin the immediate work needed. The CEO brought the Board a request for the additional funds needed to complete the work.

Because the Board meets only every two months, the proposed revision to the policy would provide greater latitude, and allow critical work to proceed. The proposed revision includes a requirement that the use of the CEO's discretionary spending authority be reported in the budget status reports included on each Board agenda. Director Quirk asked why the limit of \$10K remains the same instead of changing it to \$25K. Mr. Jensen explained that BAWSCA does not build anything, and Legal Counsel added that the labor community prefers the \$10K limit for public agencies.

Director Breault noted that the committee also requested the omission of Section VI, Adjustments of Amounts according to CPI, and made a motion seconded by Director Anderson. By roll call vote, the Committee voted unanimously to recommend the Board adopt the proposed resolution revising the Procurement Policy to:

- 1) Increase the CEO's discretionary spending authority to \$25,000 for purchases of equipment and supplies and services, while retaining the existing limit of \$10,000 for construction expenses.
- 2) Limit the CEO/General Manager's authority to approve change orders and amendments \$25,000.
- 3) Require the CEO/General Manager to report all change orders and amendments to the Board.
- 4) Increase the limits for formal solicitation of bids for purchases of equipment and supplies.

Discussion items and Special Reports:

Long-Term Reliable Water Supply Strategy – Water Transfer Policy Discussion: Mr. Jensen stated that the purpose of the agenda item and discussion is to obtain advice from the Committee on how to best schedule a discussion on water transfers.

A Board discussion on the topic is needed to clearly distinguish the different types of water transfers and help the Board understand which types of transfers the Strategy will focus on in the policy decisions by the BAWSCA Board. The discussion will also help contrast the proposed MID/SFPUC water transfer, as well as identify the types of policy issues expected to arise.

In general, “water transfers” could include:

- The transfer of portions of individual supply guarantees between BAWSCA agencies,
- The transfer of water for specific development projects;
- The transfer of water into the region for normal year supplies; and
- The transfer of water into regional to lessen drought impacts.

BAWSCA will focus the Strategy on transfers of water into the region for normal years and drought supplies.

Ms. Sandkulla stated that the discussion will go through the meanings of each type of water transfer so that members of the Board will have a better understanding of the different types of transfers, the issues that must be addressed, and what decisions are required and by which entities. This background will support informed discussion and decision making for the types of policy issues that will be brought to the BAWSCA Board of Directors.

Director Pierce suggested using a matrix that presents the types of transfers and the other information.

Director Breault commented that it would be difficult for BAWSCA as an agency to get in a position of pursuing a transfer of a member agency’s excess ISG. Mr. Jensen agreed, and said that such decisions must be between willing sellers and buyers.

Director Pierce noted that the matrix would be for the purpose of facilitating conversation. Director O’Connell agreed and stated that the matrix would provide the Board and agencies a way to identify what roles agencies and/or BAWSCA could take in the different types of transfer opportunities.

Mr. Jensen stated the policy issues related to water transfers include identifying the investment value, the actions needed for implementation, the method for distributing benefits and costs, and consideration of alternatives.

The committee agreed to call the discussion a “study session” to clarify that the purpose is educational and informational.

The committee also considered whether to have the study session at a special meeting of the Board or at a regularly scheduled Board meeting, and whether the study session should be scheduled to occur prior to a regular meeting.

Director Breault noted that it would be helpful if the study session were not scheduled to start prior to the regular meeting time because directors had other obligations.

Mr. Jensen thanked the Committee for its input and advice, and said he will work out the details of the schedule with the Chair of the Board.

SFPUC Water System Improvement Program – Status Report: Ms. Sandkulla noted that copies of a December 7th letter from Mr. Jensen to SFPUC General Manager were included in the packet for

the Committee's reference. The letter presents BAWSCA's review of the WSIP as of December 1, 2011, cites concerns related to the WSIP's completion within schedule, budget and scope, and provides specific recommendations to the SFPUC.

Ms. Sandkulla stated that the objective of BAWSCA's review is to assist the SFPUC in successfully completing the WSIP.

BAWSCA's first recommendation addressed the SFPUC's Quarterly Report and the need to clearly present to the Commissioners and the public any problems with the program, trends, the use of budget and schedule contingencies, and how those factors might affect completion of the overall program.

Given the size of construction contracts in the \$4.6 billion WSIP, even small percentage change orders can have a dramatic dollar impact on program spending. BAWSCA recommended examining whether delays in change order processing is causing project delays and impacting the overall cost of the program. BAWSCA also recommends that change order management be reviewed to ensure that change orders are needed, and whether the existing change order policy is achieving the results it was intended to provide.

Lastly, the SFPUC's Independent Review Panel (IRP) is in the process of finalizing a report to the Revenue Bond Oversight Committee. BAWSCA recommended that the Commission ensure that the IRP has sufficient resources to appropriately conduct the investigations it may be assigned. Having sufficient resources is vital for the panel, the panel's work products and the WSIP to have credibility.

Ms. Sandkulla reported that Mr. Jensen addressed the Commission at its meeting on December 13th regarding an agenda item related to the New Irvington Tunnel project. The project has encountered a combination of problems that could not reasonably have been anticipated, and the item on the SFPUC agenda requested an extension of the contract.

Mr. Jensen's testimony raised two questions that were not addressed in the staff memo and were significant enough for the Commission's consideration prior to acting on the item. While the memo addressed why the schedule extension is necessary and that additional delays can be expected because of the complexity of the project, the staff memo did not address whether the extension requested is sufficient, or whether the extension could affect completion of other WSIP projects or the WSIP as a whole.

The Commission approved the schedule extension without pursuing the issues raised by Mr. Jensen. Mr. Jensen reported that he ensured his comments were in the record.

The SFPUC is preparing a written response to Mr. Jensen's letter of December 7th. BAWSCA will consider the SFPUC's response to its recommendations and follow up with the SFPUC management and the Commissioners.

BAWSCA's mid-construction review of the WSIP will begin in January. The report will document BAWSCA's assessment of the progress and recommend actions to address any issues that deserve attention.

Director Pierce asked if the resources needed to complete this report are available. Mr. Jensen stated that the resources are included in the mid-year budget adjustments, and will be available if the Board approves the recommended action.

Director Breault asked if the SFPUC has a policy in place to determine acceptable vs. unacceptable change orders based on design errors and omissions, and whether this type of information will be included in BAWSCA's mid-construction report.

Ms. Sandkulla stated that the SFPUC is looking into this more closely to determine whether the nature of the change orders are in-house or from the designers, and whether appropriate actions are taken in response to actual errors.

BAWSCA's recommendation is for the SFPUC to examine the categories of the change orders, and to conduct an audit if necessary to ensure the change orders are classified correctly. It will be up to the SFPUC to complete this task and make the information public. If the SFPUC chooses not to do so, BAWSCA can pursue it.

Director Pierce asked if this trend is expected to continue. Ms. Sandkulla stated that project designs are done, and the question is whether we have reached the maximum level of potential change orders. Change orders are expected to occur throughout a program of this nature, and it is vital that the SFPUC, and BAWSCA, to continue to monitor the need for change orders, whether they are necessary to the success of the program, and what their impact may be on program budget and schedule.

Director Klein noted the rising percentage of change orders for the overall WSIP. Ms. Sandkulla noted that the program has ramped up significantly in its construction, and that the Bay Division Pipeline #5, a major tunnel and pipeline project, has had a higher percentage of change orders than other projects, which would impact the numbers for the overall WSIP.

Director Klein added that change orders are ways contractors can make up for the low bids awarded for the contract. Ms. Sandkulla stated that the SFPUC is very aware of that and is actively monitoring the occurrence of change orders on projects that were awarded at low bids.

From this discussion, Mr. Jensen will ask Terry Roberts to examine the possibilities of distinguishing the change orders that relate to the unforeseeable field conditions from the others, and to characterize them in terms of percentages and dollars. Because some of the problematic field conditions, while anticipated, occurred at an unexpected degree, change orders of that nature should be examined separately.

Director Breault stated that change orders stemming from site conditions can still be considered as an error in the contractor's planning, if, for example, geotechnical site reviews were unsatisfactory.

Director Piccolotti asked about the level of oversight in the construction inspection process. Ms. Sandkulla reported that an extensive QA/QC process has been put in place for the WSIP. The contractor has a requirement for quality control of their products. For the SFPUC, there is a regional manager with quality control oversight for each major project.

Ms. Sandkulla offered to ask for further information about construction inspection from the SFPUC. She reported that the inspection oversight is something the SFPUC is currently reviewing for its BDPL #5 project, which had some bad welds which both the contractor and in-house staff did not detect.

Ms. Sandkulla reported the SFPUC is doing an investigation of the recent water pipeline break in South San Francisco on November 25th. There is a scheduled discussion this evening at the South City Council Chambers.

The SFPUC reported that its emergency water management procedures went as planned. The water service was uninterrupted, however some residents were displaced due to local flooding that occurred.

The SFPUC's investigation will focus on the causes and implications. The event took place at a WSIP project sight, therefore the SFPUC is working with the contractor of project in its investigation.

Ms. Sandkulla noted that the connection at the event site is similar to 35 other connections in the WSIP and it was important to raise with the SFPUC, the questions Mr. Jensen emailed to Julie Labonte and Ed Harrington. The list of questions is in the memo included in the agenda packet.

Mr. Jensen reported that Ms. Labonte immediately gave the investigation the highest priority. A copy of the SFPUC's presentation for tonight's discussion was sent to BAWSCA, and results of the investigation will be shared with the Board.

Comments by Committee Members: There being no further comments, the committee adjourned.

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

Respectfully submitted,

Arthur R. Jensen, Chief Executive Officer and Secretary

ARJ/le

Attachments: 1) Attendance Roster

**BAY AREA WATER SUPPLY AND CONSERVATION AGENCY
Board Policy Committee
December 14, 2011**

Attendance Roster

Committee Members Present:

Larry Klein	City of Palo Alto (Chair)
Robert Anderson	Purissima Hills Water District
Randy Breault	City of Brisbane/GVMID
Irene O'Connell	City of San Bruno
Tom Piccolotti	North Coast County Water District
Bill Quirk	City of Hayward (by Teleconference)
Barbara Pierce	City of Redwood City

Committee Members Absent:

Rob Guzzetta	California Water Service Company (Vice Chair)
Ruben Abrica	City of East Palo Alto

BAWSCA Staff Members Present:

Arthur Jensen	Chief Executive Officer
Nicole Sandkulla	Water Resources Planning Manager
Lourdes Enriquez	Assistant to the CEO
Allison Schutte	Legal Counsel, Hanson Bridget, LLP.

Guests:

Phillippe Daniel	Camp Dresser McKee
Peter Drekmeier	Tuolumne River Trust
Michelle Sargent	San Francisco Public Utilities Commission
Sharyn Saslafsky	San Francisco Public Utilities Commission
Nico Procos	City of Palo Alto

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BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE

Agenda Title: **Preliminary Fiscal Year 2012-13 Work Plan and Budget**

Summary:

This memorandum presents the preliminary results to be achieved, a preliminary Operating Budget estimate, a preliminary assessment of how the work could be funded, and identifies specific budget issues requiring input from the Board of Directors before the budget can be finalized.

The memorandum differs from previous presentations by summarizing major conclusions and placing details in appendices at the end.

The preliminary Work Plan remains aligned with BAWSCA's legislated authority and its three goals: a reliable supply of high quality water at a fair price.

Alternative estimates have been prepared for initial consideration. The alternatives differ on the basis of which items are included in the Work Plan. One alternative includes all Work Plan activities but suggests that decisions about whether to move forward with selected items are made after feasibility or importance have been determined.

The agency's three major sources of revenue are annual assessments, payments for subscription-based water conservation services, and the Board-approved Water Management Charge.

The preliminary estimates for the next year's Operating Budget range from about \$2,590,000 to \$3,080,000. In any case, the budget could be funded without increasing the level of assessments for the fourth year in a row.

The General Reserve could be used as the source of funding for one-time projects that appear in the Work Plan. The amount of the General Reserve that would be spent, and the size of the remaining balance, would depend on which activities were included in the final Work Plan adopted by the Board. Further consideration will need to be given as to whether the level of assessments should be lowered.

Recommendation:

That the Board Policy Committee provide:

- 1) Comments and suggestions concerning the results to be achieved, the preliminary Operating Budget estimate, alternatives for funding the budget and managing the General Reserve, and**
- 2) Suggestions concerning presentation of the preliminary budget to the Board of Directors in March.**

Preliminary Work Plan:

Next year's Work Plan addresses all of the ten forward-looking issues discussed with the Board Policy Committee in December and with the Board in January.

The list of results to be achieved also assumes that the feasibility of issuing bonds has been determined during FY 2011-12 and that a decision on whether or not to move forward is made in May or July 2012.

Major efforts that affect the Operating Budget also include efforts to protect water supply reliability for customers outside San Francisco, active participation in the relicensing of New Don Pedro Reservoir to protect regional water supplies, completing the Long-Term Reliable Water Supply Strategy, and moving forward on initial actions to improve drought reliability.

Table 1 lists all of the major results to be achieved. The activities are grouped according to the benefits they would provide.

Table 2 lists the items that are not included in the preliminary budget. Any of these items could be added at a later date, if needed.

Table 1. Results to be Achieved in FY 2012-13

RELIABLE SUPPLY -- WATER SUPPLY MANAGEMENT PROGRAM

1. Long-Term Supply Solutions: Ensure a reliable, high quality supply of water is available where and when needed.

- a. Reliable Water Supply Strategy – Complete Phase II A of the Long-Term Reliable Water Supply Strategy by to ensure supply reliability through the year 2035, including evaluation of projects to pursue, present policy-decisions for board consideration, review and compilation of projected population and water demands from member agency UWMP.
- b. Drought Reliability – Pursue projects that would enhance near-term drought reliability for all agencies.
- c. Consistent and Defendable Regional Planning – Select a uniform method for projecting future water needs of agencies for development in FY 2013-14.

2. Near-term Supply Solutions: Water Conservation

- a. Implement Core Water Conservation Programs - Programs that benefit all customers.
- b. Implement Subscription Water Conservation Programs - Rebate and other programs that benefit, and are paid for by, agencies that subscribe for these services.

3. Facility Reliability: Monitor SFPUC Water System Improvement Program

- a. Monitor WSIP scope, cost and schedule as San Francisco continues an aggressive construction schedule through 2015. Press the SFPUC and the city's political leadership to meet the city's adopted schedule, satisfy the requirements of AB 1823 and respond promptly to BAWSCA's reasonable requests. Focus resources from technical review to monitoring project and program performance during construction.

4. Protect Members' Interests in a Reliable Water Supply

- a. FERC – Ensure resources for legal and technical monitoring and intervention in the FERC Re-licensing of New Don Pedro Reservoir are sufficient to protect the customers' long-term interests in Tuolumne River water supplies.
- b. MID/SFPUC water transfer – Protect members' water supply and financial interests.
- c. Proponents of draining Hetch Hetchy Reservoir – Assess risks associated with efforts to drain the reservoir and take actions needed to protect water supply reliability for water customers.

5. Take Actions to Protect Members' Water Supply Interests in the Administration of the 2009 Water Supply Agreement

- a. Pursue amendment of the Tier 1 drought allocation formula with SFPUC.
- b. Amend the Water Supply agreement with San Francisco to revise the completion date for the WSIP.

6. Pursue Grant Opportunities Independently and in Coordination with Regional Efforts

- a. Implement use of Proposition 84 grant funds awarded for water conservation programs.

FAIR PRICE

7. Perform Matters that Members Delegated to BAWSCA in the Water Supply Agreement

- a. Administer the Water Supply Agreement with San Francisco to protect interests of members and their customers in a fair price for water purchased from San Francisco.
- b. Consider whether Wholesale Customers would benefit from BAWSCA issuing bonds to retire capital debt owed to San Francisco.

HIGH QUALITY WATER

8. Support Member Agencies in Receiving Reliable Communication of Water Quality Events

Coordinate member agency participation in Water Quality Committee established by the 2009 Water Supply Agreement to ensure it addresses Wholesale Customer needs.

AGENCY EFFECTIVENESS

9. Maintain Community Allies and Contacts with Environmental Interests

Maintain close relationships with BAWSCA's powerful allies (state legislators, business, labor, local government, water customers, and the media) and activate them if necessary to safeguard the health, safety and economic well-being of residents and communities. Respond to requests from local legislators. Maintain a dialogue with responsible environmental and other groups, who will participate in the project permitting and approval process for rebuilding the system.

10. Manage the activities of the agency professionally and efficiently

Table 2: Activities Not Included in Proposed Operating Budget for FY 2012-13

Reliable Supply

1. Drought-year water purchases and wheeling.
2. Independent analysis of why water use is down in recent years.
3. Extended or complex application for grant funds. Application for water conservation grants will continue to be made through or with the Bay Area Water Agency Coalition, the California Urban Water Conservation Council or other agencies.
4. Introduction of new legislation or supporting or opposing legislation initiated by others. If necessary, the agency would be able to respond to major legislative efforts by redistributing resources, use of the contingency budget or accessing the general reserve, subject to prior Board approval.
5. Evaluating how sub-metering of mobile home parks or multi-family dwellings could be implemented to encourage conservation. Other utilities have investigated these opportunities and their information and methods are available to BAWSCA members.
6. Support for agencies in forming alliances to comply with Senate Bill 7X (20% by 2020).
7. Estimating the volume of water savings that result from BAWSCA and local agency water conservation activities.

Fair Price

8. Evaluating potential economic or water supply impacts of State efforts to fix the Delta and other State water management projects.
9. Development of alternative wholesale rate structures that the SFPUC might consider. Actions will be limited to review of SFPUC proposed rate structure modifications.
10. Development of alternative retail rate structures that member agencies might consider for stabilizing water rates and water revenues.
11. Arbitration of issues related to the 2009 Water Supply Agreement.

High Water Quality

12. Technical work related to water quality and San Francisco's treatment of the water it delivers to the BAWSCA agencies.
13. Major efforts for advocating changes to water quality regulations or the manner in which San Francisco or member agencies treat water for drinking and other purposes.

Agency Efficiency

14. Resources to support additional Board, Board committee or technical committee meetings.
15. Conducting tours of the Regional Water System. The Preliminary Operating Budget does not include funds to co-sponsor a tour by the California Water Education Foundation.
16. Conducting tours of member agency facilities to acquaint Board members with potential supply projects and their neighboring jurisdictions.

Preliminary Operating Budget Estimate:

Several alternative budgets were examined. All of the alternatives could be funded without increasing the level of assessments. Two preliminary estimates, representing an upper end and a lower end, are presented below.

As the budget estimates are refined, further consideration will need to be given to reducing the size of assessments.

Preliminary upper-end budget estimate

The initial estimate of the Operating Budget needed to accomplish the entire preliminary Work Plan would be \$3,080,520, which is about 18% higher than the current year's budget, and includes the one-time cost of moving forward with BAWSCA issuing bonds.

**Table 3. Preliminary Upper End Operating Budget Estimate
by Major Expenditure Category**

Cost Category	Approved FY 2011-12 Budget, dollars*	Preliminary Estimate FY 2012-13 Budget, dollars	Difference, dollars
Consultants/ Direct Expenditures			
Reliability	833,930	885,162	51,232
Fair Pricing	233,000	646,000	413,000
Administration	112,000	95,000	(17,000)
<i>Subtotal</i>	1,178,930	1,626,162	447,232
Administration			
Employee Salaries & Benefits	1,075,875	1,089,758	13,883
Operational Expenses	258,900	280,600	21,700
BAWUA	1,100	1,100	0
<i>Subtotal</i>	1,335,875	1,371,458	35,583
Total Operating Expenses	2,514,805	2,997,620	482,815
Capital Expenses	6,000	4,000	(2,000)
Budgeted Contingency	97,500	77,500	(20,000)
Regional Financing Authority	1,400	1,400	0
Grand Total	2,619,705	3,080,520	460,815

*As amended by the Board on January 19, 2012.

Budget alternatives examined

Several alternatives were examined for reducing the size of the budget and managing the General Reserve balance.

1. **Defer decision on whether to issue bonds until feasibility has been established.**

The budget would be reduced by 18% if the cost to issue bonds were removed.

If feasibility can be demonstrated, this one-time effort could be funded using the General Reserve.

A variety of factors may affect the feasibility and timing of moving forward.

Feasibility is being examined this spring, and it should be possible to bring a recommendation to the Board in July or September 2012

If bonds were ultimately issued next fiscal year and the General Reserve was used to fund the issuance of bonds, the projected FY 12-13 year-end General Reserve balance would be approximately 30% of the preliminary Operating Budget, or 5% below the 35% guideline.

If, ultimately, bonds were not issued, the projected year-end General Reserve balance would approach 48% of the Operating Budget, well in excess of the 35% guideline.

2. **Same as alternative #1, and pool a portion of the budgets for as-needed consultants.**

One of the largest uncertainties in budgeting for the agency is how much of the as-needed consulting budget will ultimately need to be spent.

An approach discussed during this last year was to reduce the budgets for as-needed consulting support by 10%, remove half of that amount from the budget, and place the other half into the budgeted contingency. The CEO would be given authority to distribute the contingency to those consultants whose work was critical to achieving results.

This approach would reduce the estimated Operating Budget by about \$30,000.

Under this alternative, the estimated Operating Budget would be slightly less than the current year Operating Budget.

If bonds were ultimately issued, the end of year General Reserve Balance would be about 33%, within the 35% guideline.

If bonds were not issued, the end of year General Reserve balance would be approximately 50%, well above the 35% guideline.

3. **Additional budget reducing measures.**

The initial estimate for the Operating Budget includes salary adjustments for some positions which were deferred last year and which may need to be deferred again, given the continuing economic conditions and the sacrifices being made by most member agencies.

A salary survey conducted in 2010 determined that two positions were approximately 4 and 5 % below the market median for comparable positions. Those adjustments add \$7,400 to the salary and benefits budget.

Using the traditional cost-of-living index, a COLA adjustment for all positions except the CEO adds an additional \$17,000 to the salary and benefits budget.

Eliminating both increases would reduce the budget about \$24,400.

Preliminary lower-end budget estimate.

A preliminary lower-end Operating Budget estimate reflecting the combination of alternative 2 and alternative 3 appears in Table 4.

**Table 4. Preliminary Lower-End Operating Budget Estimate
by Major Expenditure Category**

Cost Category	Approved FY 2011-12 Budget, dollars*	Preliminary Estimate FY 2012-13 Budget, dollars	Difference, dollars
Consultants/ Direct Expenditures			
Reliability	833,930	843,162	9,232
Fair Pricing	233,000	196,000	(37,000)
Administration	112,000	95,000	(17,000)
<i>Subtotal</i>	1,178,930	1,134,162	(44,768)
Administration			
Employee Salaries & Benefits	1,075,875	1,065,527	(10,348)
Operational Expenses	258,900	280,600	21,700
BAWUA	1,100	1,100	0
<i>Subtotal</i>	1,335,875	1,347,227	11,352
Total Operating Expenses	2,514,805	2,481,389	(33,416)
Capital Expenses	6,000	4,000	(2,000)
Budgeted Contingency	97,500	106,000	8,500
Regional Financing Authority	1,400	1,400	0
Grand Total	2,619,705	2,592,789	(26,916)

*As amended by the Board on January 19, 2012.

Following discussion with the Board Policy Committee, the funding plan and management of the General Reserve will be refined and presented to the Board at its March meeting as the Preliminary Budget.

Additional Attachments:

Attached to this memo are several appendices (A-I) which present additional detail about the Operating Budget.

Appendices

Appendix A: Funding for Subscription Conservation Programs

As in prior years, a portion of operating expenses would be reimbursed by agencies that participate in BAWSCA’s subscription water conservation programs. The staff time to be devoted to those programs during FY 2012-13 is estimated to be 617 hours. The reimbursement for those hours is estimated to be \$24,000. Agencies participating in subscription programs also pay for associated consultant support and direct expenses. As in prior years, those consultant costs and direct expenses are not included in the Operating Budget.

Appendix B: Funding for the Long-Term Reliable Water Supply Strategy

The Operating Budget does not include the cost of consulting services for developing the Long-Term Reliable Water Supply Strategy, which is being funded through the Water Management Charge authorized by the Board in July 2010. A summary of the current budget status will be included in the preliminary budget report to the Board in March.

Appendix C: Value for the Cost

The formula for BAWSCA assessments results in equivalent cost per gallon throughout BAWSCA’s members. All BAWSCA costs are ultimately passed on to water customers through the water rates of the local city, district or private utility. The current cost of assessments to residential customers in the BAWSCA area averages about \$6.00 per household per year.

Appendix D: Historical Assessments

Table 5 displays the history of assessments and year-end reserves.

Table 5. Historical Annual Assessments and Year-End Reserves

Fiscal year	Assessments	Year-End Reserves
2003-04	\$1,668,550	\$276,480
2004-05	\$1,641,995	\$246,882
2005-06	\$1,953,998	\$240,000
2006-07	\$2,117,904	\$654,000
2007-08	\$2,117,904	\$691,474
2008-09	\$2,309,000	\$507,474
2009-10	\$2,517,000	\$407,192
2010-11	\$2,517,000	\$653,763
2011-12	\$2,517,000	\$1,146,900 (est.)

Appendix E: Preliminary Budget for the Bay Area Water Users Association (BAWUA)

The Board will consider a separate action to approve the proposed FY 2012-13 budget for BAWUA of \$1,100. This amount appears in the BAWSCA budget.

Appendix F: Preliminary Budget for the Regional Financing Authority Budget

The BAWSCA Board of Directors has continued to agree to fund nominal administrative costs for the Regional Financing Authority (RFA), at least until it became more actively involved and required significant resources. Assuming a low level of activity in FY 2012-13, the proposed RFA budget is \$1,400. The RFA will formally consider and adopt this budget in July 2012.

Appendix G: History of Salary and Benefits Adjustments

Salary adjustments have been deferred for several years.

FY 2011-12: The Operating Budget included no adjustment to the salary for any employee for COLA, merit or any other reasons.

FY 2010-11: The Board approved a 3.01 percent increase to the top step of staff salary ranges. Those adjustments were consistent with the December value for the Consumer Price Index for Urban Wage Earners and Clerical Workers in the San Francisco-Oakland-San Jose. COLA increases for employees are not automatic but can be granted by the CEO on the basis of merit.

FY 2009-10: There was no COLA adjustment. An allowance for merit adjustments was budgeted for employees not yet at top step.

Appendix H: Uses of Professional Services. Outside professional services are used to provide specialized services and augment staff.

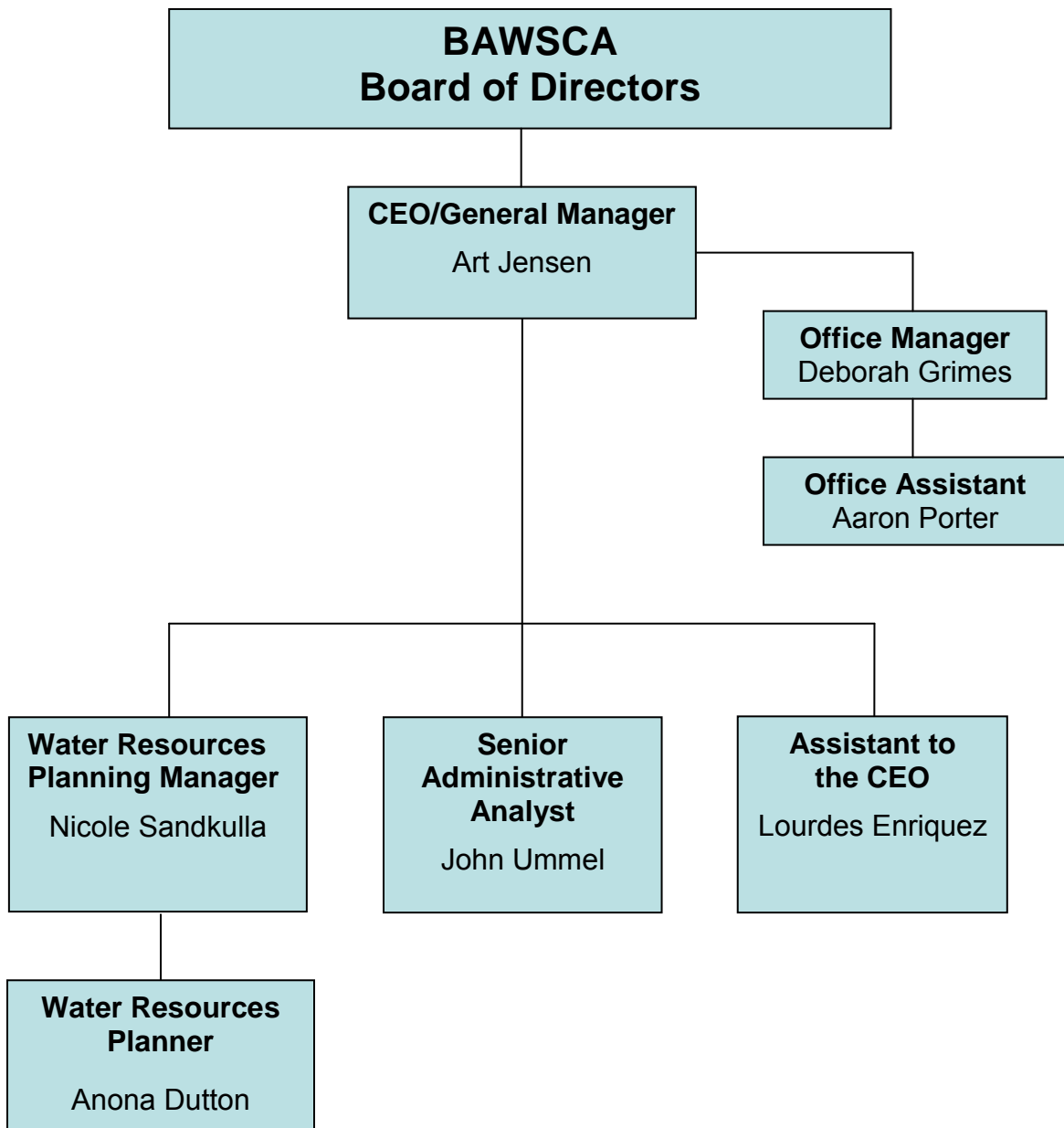
1. Professional engineering services for: a) developing a long-term strategy to ensure a reliable supply of water; b) implementing and tracking water conservation efforts; c) evaluating Water System Improvement Program project scopes during design and construction; d) monitoring WSIP project cost estimates, bids and schedules; e) monitoring and assessing San Francisco's performance in implementing the overall WSIP; e) assessing San Francisco's method for cost estimation, application of contingencies and addressing cost inflation during the WSIP; f) providing specific constructive recommendations for keeping the WSIP on or ahead of schedule; and g) analyzing hydraulic records used by San Francisco in setting the wholesale water rates.
2. General legal services for BAWSCA and the RFA; specialized legal services to support administration of the Water Supply Agreement; specialized legal services for addressing matters related to water supply reliability.
3. Strategic counsel for identifying and addressing strategic and political issues associated with maintaining the progress of the Water System Improvement Program, assisting the Board and the CEO in developing and implementing an effective policy making process that supports the development of the Long-Term Reliable Water Supply Strategy, providing legislative and political support, and

providing advice to the CEO and the Board on other issues significant to the water customers and the effectiveness of the agency.

4. Financial advisory services to conduct specified capital financing and rate impacts analyses on a task order basis.
5. Accounting/auditing expertise to assist with implementing the new water agreement, as well as an independent auditor to prepare and review annual financial statements.

Appendix I: Organization and Staffing. Figure 1 represents the current reporting relationships in the organization. No new positions are proposed in the preliminary FY 2012-13 Operating Budget. The staffing level has not changed in eight years.

Figure 1. Organization Chart



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Date: January 6, 2012

To: Art Jensen
CEO and General Manager, BAWSCA

From: David Brodsky and Dan Cox
KNN Public Finance

Re: Proposal to prepay capital cost recovery component of water contract with bond proceeds

As you know, we have been in discussions with representative of several investment banks, as well as lawyers and SFPUC staff about the possibility of issuing bonds to prepay the capital cost recovery payments currently being made under the Water Supply Agreement to amortize regional assets acquired prior to the contract. The main benefit to the SFPUC would be an increase in its cash reserves, which have fallen primarily due to falling water sales. The main benefit to BAWSCA members would be reduction in the cost of water attributable to replacing the current obligation to amortize the remaining \$370 million of this obligation at an interest cost of 5.13%. If bonds could be issued under current market conditions to prepay this obligation, and if all the savings accrued to the benefit of BAWSCA members, the total revenue requirement could be lowered by about \$2 million a year, saving some \$35 million on a present value basis.

There are a number of hurdles that have to be overcome to achieve those savings, which are reviewed herein:

- Establishing a payment stream sufficient to repay bonds that satisfies the credit concerns of the municipal investment community;
- Establishing a methodology for allocating costs and benefits associated with the refunding;
- Determining that at least most of the bonds can be issued on a tax-exempt basis, owing to restrictions on the use of tax-exempt debt.

We believe that the potential for savings merits additional analysis of the idea. There are a few ways we could proceed to further develop this notion, which will reflect your preferences. These include working the SFPUC staff and their financial team, assembling a BAWSCA team based on our knowledge of interest and qualification, or soliciting proposals from bond counsel and bond underwriters. We think it would be useful to caucus with you on whether and how to best proceed.

1. Potential “Refunding” Savings

During negotiations for the new Water Supply Agreement, it was agreed that regional improvements that had not been fully depreciated under the old contract would be amortized under the new contract. The remaining asset base is being amortized over 25 years, at an interest rate based on then current bond rates. The rate agreed to was 5.13%, representing the interest that BAWSCA might have paid had it financed the existing assets at the

time The Agreement also allowed wholesale customers to prepay this amount of the rate base, without penalty.

Since negotiating the contract, interest rates have fallen to historic levels. According to our recent updated analysis, if bonds could be sold in the current market to refund the capital recovery charge component of suburban revenue requirement, the tax-exempt portion would bear an interest cost below 4%. Based on a number of assumptions as to structure, including an assumption that 17% of the issue would be taxable to accommodate Cal Water and Stanford, this could translate into a savings of about \$35 million on a present value basis, or nearly 9.7% on a \$370 million repayment.

There are a number of practical obstacles that initially lead us to conclude that a bond refunding of the capital cost recovery charge was not a practical alternative to paying SFPUC the 5.13% rate. Several factors have made us reconsider this opinion. First, the size of the potential savings in itself merits additional consideration. Also, further evaluation of the obstacles leads us to believe that there may be solutions available. Finally, the fact that BAWSCA is considering financing new water supplies for its members suggests that additional efforts could provide the intellectual infrastructure for such future financings, even if the market opportunity for refunding goes away.

The following discusses the challenges and some thoughts on how to address them.

2. Legal Authority and Credit Structure

A fundamental challenge to a refunding is determining a legal authority to issue and, more importantly, collect revenues to pay bonds, and developing a legal structure that will be viewed as creditworthy by investors. Because BAWSCA has not served in the role of a utility or serviced debt, there is not a ready legal structure available. We considered whether San Francisco could independently issue such bonds, but under the terms of its existing bond indenture, that would be impractical.

We have reviewed both the BAWSCA and RFA statutes to consider what powers these two agencies have that could be relied upon to support a refunding. Relevant extracts appear as an Attachment. Both agencies have powers to issue bonds and to incur other forms of indebtedness, and both have the power to collect certain revenues. Both statutes describe how bond proceeds can be used to undertake projects, which may not precisely fit the facts of a refunding of prior investment; possibly a reimbursement for prior expenditures falls within these statutory boundaries. BAWSCA's permitted use of bond proceeds is broader—they can be used on “any work”—while the RFA's is limited to “projects designed and intended in substantial part to improve the reliability of the regional water system”. The challenges of these statutory restrictions might be addressed by the solution to the tax challenges discussed in the next section.

Probably a more significant challenge is developing a revenue stream to repay bonds that would be acceptable to the rating agencies and investors. The RFA statute grants what would probably be the best source of repayment, a surcharge on current water charges collected by San Francisco. Unfortunately, the limitations on the use of proceeds might necessitate the use of BAWSCA as the financing agency. BAWSCA has powers to impose “assessments sufficient to pay the operating expenses” and “reasonable rates, fees, and charges...for any program or service provided or work performed by the agency”. We would need to further explore the enforceability of these charges, any history of prior collections, and the remedies that would be available in the event of a non-payment.

One feature of water revenue debt that may be difficult to replicate under the two statutes is the ability to charge “coverage,” that is, to create revenues that are in excess of debt service needs. Given the limited nature of either agency, there is no need to charge for pay-as-you-go capital replacement, which is the source of

coverage for most utilities. We could explore your ability to build a “step-up” into your charges (where additional payments are triggered by a participant’s default), or other mechanisms to provide additional security.

A broader menu of options would be available with the approval of all of the governing boards of the BAWSCA membership of a new set of contracts. We assume that BAWSCA would prefer to avoid such an effort, and note that the additional time required to execute would increase the risk that the refunding savings would erode with market movement.

3. Tax-Exemption

The restrictions of Federal tax law on the use of tax-exempt bond proceeds raise a number of additional questions. While tax-exempt bond proceeds can generally be used to pay for public improvements, there are time and procedural limits for the use of proceeds to meet prior expenditures, which this reimbursement would not satisfy. Similarly, prepayments for services—and arguably this would be a prepayment of water bills—cannot be financed with tax-exempt bonds. While there may be some other exception that would create a basis for tax-exempt debt, the most obvious is for San Francisco to use the prepayment proceeds as a source of capital funding within a three year period. If these prepayment proceeds were used in lieu of previously planned pay-as-you-go funding, then the funding previously slated for pay-go could go to building up reserves over time.

We need to further explore the implications of changes in the mix of financing sources on the calculation of the wholesale revenue requirement to ensure that any such solution to the tax challenges does not have unintended consequences on BAWSCA members.

An additional tax challenge is that a significant portion of your revenues would come from at least one non-exempt user, the California Water Service Company (Stanford University would also raise tax questions, for which there may be a resolution). We have assumed for purpose of our analysis that any financing would require a combination of taxable as well as tax-exempt debt. If a solution cannot be developed to the tax challenges discussed above, then all of the refunding debt would need to be issued at taxable interest rates. That would reduce savings, perhaps below an acceptable level.

4. Logistics

To date, our discussions on this matter have been informal. We have had prolonged conversations with several investment banks (Wells Fargo, Mitsubishi Securities, and Goldman Sachs), and have met with lawyers at Jones Hall, a bond counsel firm that served as the SFPUC’s bond counsel until last year, and now serves as San Francisco’s disclosure counsel on all bond transactions. We have also had conversations with your counsel, Alison Schutte of Hanson Bridges, and with staff of the SFPUC.

If BAWSCA wants to proceed with this endeavor, which seems appropriate to us, then we need to agree on next steps. We think adding a bond counsel to the team is important, as both State law and federal tax law advice will be necessary. Obviously, Alison needs to be involved. Involving SFPUC staff in at least some of these discussions would also be helpful, since how the funds are expended will be important as well. Though this discussion was initiated by investment bankers, their selection can be deferred until there is greater confidence that this will proceed.

We suggest that, after you have had an opportunity to digest this, we meet or have a conference call with Alison and yourselves to agree on whether and how to proceed.

Attachment
Statutory Powers

Bay Area Water Supply and Conservation Authority (BAWSCA)

81427. The agency may borrow money, incur indebtedness, and issue notes and bonds, as provided in this division or as otherwise authorized by law.

81428. (a) The agency may issue revenue bonds... [T]he agency need not conduct an election or otherwise secure the approval of the voters.

81433. The board may impose assessments sufficient to pay the operating expenses included in the budget

81434. The agency may use proceeds of bonds authorized by this division for the construction, reconstruction, or improvement of any works carried out by the agency. The agency may also make proceeds of bonds authorized by this division available to other local public agencies on mutually satisfactory terms and conditions to assist in the construction, reconstruction, or improvement of works designed and intended in whole or in part to furnish water to the members of the agency.

81435. The agency may impose reasonable rates, fees, and charges...for any program or service provided or work performed by the agency. These rates, fees, and charges shall be at least sufficient to generate revenue to pay the principal and interest on any bonds issued by the agency to carry out the work.

San Francisco Bay Area Regional Water System Financing Authority (RFA)

81652. The authority may borrow money, incur indebtedness, and issue notes and bonds as provided in this division, or as otherwise authorized by law.

81653. (a) The authority may issue revenue bonds ...[T]he authority need not conduct an election or otherwise secure the approval of the voters.

81658. (a) The proceeds of revenue bonds issued by the authority in accordance with this division may be used only on projects designed and intended in substantial part to improve the reliability of the regional water system.

(b) The terms and conditions [for use of proceeds] shall include... San Francisco's entering into one or more legally binding contracts with the authority that...[r]equire San Francisco, on behalf of the authority, to impose a surcharge ... in an amount that will generate sufficient revenue to pay the debt service on bonds issued by the authority.

Board Policy Calendar for FY 2011-12

Board Meeting	Purpose	Issue or Topic
July	D&A D&A S&D	Rules of the Board – Proposed modifications General Reserve policy SFPUC WSIP analysis of construction bids
September	D&A S&D S&D	Management of General Reserve SF WSIP – Annual Progress Report & Compliance with AB 1823 Water Supply Agreement – Report on second year administration
November	D D&A	Water Supply Strategy – Policy decisions and schedule CEO Performance review
January	D&A D&A S&D D	BAWSCA Mid-year progress and budget review Management of General Reserve Water Supply Strategy – Progress report Discussion of results to be achieved during FY 2011-12
March	D D&A	Discussion of preliminary Work Plan and budget for FY2012-13 Water Supply Strategy – Study Session on Water Transfers
May	D&A D&A	Adoption of Work Plan and Operating Budget for FY 2012-13 Approval of annual contracts for FY2012-13

Key: D = Discussion, A = Action, S = Status Report

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San Francisco Water Power Sewer

Operator of the Hetch Hetchy Regional Water System

1155 Market Street, 11th Floor
San Francisco, CA 94103
T 415.554.1856
F 415.934.3943

January 27, 2012

RECEIVED
1/30/12

Mr. Arthur R. Jensen, Chief Executive Officer
Bay Area Water Supply and Conservation Agency
155 Bovet Road, Suite 650
San Mateo, CA 94402

RE: BAWSCA Letter Titled "Review of WSIP Status as of December 1, 2011"

Dear Mr. Jensen:

We appreciate the support and constructive input offered by the Bay Area Water Supply and Conservation Agency's (BAWSCA's) on the Water System Improvement Program (WSIP) in recent years. Given the significant challenges associated with the delivery of the WSIP, we understand the questions raised in your December 7, 2012 letter regarding our ability to deliver the program within the most recently adopted schedule and budget.

We agree that the site conditions encountered at the New Irvington Tunnel and the Calaveras Dam Replacement projects represent formidable challenges. However, I can assure you that these challenges are being managed in a proactive and effective manner. For example, mitigation measures for some of the issues encountered on these two projects were identified in advance through our Risk Management Program, which allowed us to take timely actions and minimize project impacts.

The WSIP's forward looking approach combines the continuous analysis of project-specific changes, trends, and risks. These analyses are performed using state-of-the-art systems that result in conservative estimates of potential impacts on costs and schedules. The available construction contingency for each project is continuously being monitored not only against approved and pending changes, but also against proposed changes, as well as trends and risks. This provides SFPUC/WSIP management early awareness of all potential cost overruns and/or schedule delays, and project teams an opportunity to mitigate impacts early.

Our response to each of the six recommendations presented in your letter titled "Review of WSIP Status as of December 1, 2011" is included in Attachment A and our comments on your Findings and Conclusions are in Attachment B. We hope this response provides you with the reassurance you are looking for. Please do not hesitate to contact me directly if you wish to discuss further the approach being implemented to successfully deliver the WSIP.

Sincerely,

Ed Harrington
SFPUC General Manager

Edwin M. Lee
Mayor

Anson Moran
President

Art Torres
Vice President

Ann Moller Caen
Commissioner

Francesca Victor
Commissioner

Vince Courtney
Commissioner

Ed Harrington
General Manager

CC: Anson Moran, President of the SFPUC



With only 5 of the WSIP's 46 regional projects remaining in pre-construction, the following response focuses mostly on the construction aspect of the program.

Recommendation 1: Include a frank presentation in the WSIP Quarterly Reports on trends and the implications for the completion of the program on schedule and within budget.

WSIP reports were purposely crafted to satisfy the needs of various audiences. Quarterly Reports are designed to provide high level information and the overall status of the program to the general public. These reports are more detailed than those provided to the public for most other large infrastructure programs. Quarterly Supplemental Reports provide more detailed performance data to address the needs of stakeholders that are closely tracking the WSIP's progress and performance. Finally, SFPUC shares various construction management reports with BAWSCA to ensure total transparency. Trends in the construction contracts are reflected in the Quarterly Report within "Cost and Schedule Variances" for the construction phase. We believe that the current approach and report format is sufficient but will take the following actions to address BAWSCA's recommendation:

- Discuss major project-specific trends in bi-weekly WSIP reports to the Commission.
- Direct Project Managers to provide a more detailed discussion of the reasons for the reported cost and schedule variances in the "Issues and Challenges" section of their project-specific status updates of the Quarterly Report.
- Add a section titled "Implication of Major Trends on Program Completion" to the Quarterly Report cover letter.
- Review the threshold criteria used to highlight the status of cost and schedule variances in the Quarterly Report.

Recommendation 2: Review key projects to determine if schedule and budget projections are accurate or if delivery issues exist that need to be addressed. The SFPUC should ensure that schedule and budget projections are conservative and prepared with a common purpose and objective, soundly based and consistent so that they can be relied upon with confidence.

It is our opinion that using conservative schedule and budget projections may not be the best approach for a program well into construction. It is our opinion that it is best to rely on sound projections that are based on past experience and the information available at the time. For example, higher cost projections can indicate willingness on our part to cover the additional costs of proposed changes and impact our negotiating position with construction contractors. Furthermore, our experience shows that project teams tend to manage their work activities based on the prescribed parameters. Increasing budget and schedule projections to be conservative, instead of imposing slightly more aggressive targets that are realistic and feasible, could result in a decrease in overall performance.

It is also important to recognize that once a construction contract is awarded for a project, the Contractor signs a contract that fixes the scope, budget, and schedule. These three variables can only be changed through approved change orders. After a notice to proceed (NTP) is issued, the Contractor is required to submit a detailed cost-loaded critical path method (CPM) schedule that is reviewed by the SFPUC and eventually accepted as the Baseline Schedule. Subsequently, the Contractor is required to submit Revised Schedules on a monthly basis. While we can offer comments or point out disagreement on delay responsibilities during the

review of these schedules, we must not dictate activity durations and/or sequencing as they are part of the Contractor's means and methods. Our schedule projections (trends and forecasts) are based on the Baseline Schedule or subsequently approved Revised Schedules. That is, once a project transitions to construction, the monthly scheduling requirements in our contract documents to a great extent control our project schedule projections.

Cost projections are handled differently to reflect the negotiation status of project changes. It is not unusual for the Contractor and the City to have strong disagreement on the validity and cost of Contractor's change order requests (CORs) and City-initiated proposed change orders (PCOs). For our trends and projections, we therefore cannot rely exclusively on the Contractor's cost proposal for each COR and PCO. The construction management (CM) teams are responsible to develop parallel cost estimates for any substantial COR and PCO to assist in our negotiations with the Contractor. These parallel estimates also help establish more realistic budget projections.

Cost projections are relatively conservative, based on the fact that they include all change orders (approved, pending and potential) and trends. Although risks are not directly included, they are reviewed on a monthly basis and may be converted to trends if their probability of occurrence increases and effective measures to mitigate them cannot be implemented. CM Procedure 016 (Construction Change Management) establishes the formal process used to document, evaluate and approve (or reject) changes to construction contracts. The change management module of the Construction Management Information System (CMIS) is used to compile the status of all change orders and trends. The cost information included in that module is used to develop cost projections at the phase and project levels.

In summary, we are confident that the systematic approach currently being implemented to track, control and forecast costs and schedules equals or exceeds the best industry practice. The findings and comments of many experts who have independently reviewed our program and construction management practices over the last few years are consistent with that opinion.

Recommendations 3: Determine how Change Order processing delays impact project schedules and budgets and use the WSIP Quarterly Reports to indicate any expected impacts. If necessary, conduct an audit of change order document processing to determine whether delays are resulting in project schedule slippage or added project costs.

We do not allow delays in processing change orders to impact construction schedules. Our CM Procedures are designed so the work associated with urgent change orders can proceed using a Force Account, where the Contractor is instructed to execute the changed work and keep track of incurred costs. To control the cost of the work to be performed under this scenario, CM Procedure 036 (Administration of Force Accounts) requires that a "not to exceed" budget be established for all Force Account work. It also requires that the Contractor notify the City when the cumulative costs incurred by the Contractor for the Force Account work equal 80% of the budget pre-established by the CM Team. At that point the Contractor and CM Team may negotiate a revised cost limit for the remaining work. The Contractor will not be compensated for Force Account work exceeding the "not to exceed" budget amount if the Contractor fails to provide the required notice before exceeding 80% of the Force Account budget.

We have had situations where the number of change orders has exceeded the CM Team's and Contractor's available resources for processing these changes (the Sunol Valley Water Treatment Plant [SVWTP] project for example). In those cases we have authorized additional

resources to be mobilized by the CM Team and Contractor to reduce the backlog. This surge in staff resources is recognized as an additional cost to the Construction and CM contracts.

It should be noted that in a few different circumstances we may purposely slow down the processing of a change order to allow us to develop a stronger negotiating position with a Contractor. However to reiterate, delays in the processing of change order do not impact the construction schedules of WSIP projects because work either proceeds on force account or unilateral change order while change orders are being resolved.

Recommendations 4: Conduct an audit to determine whether the number of change orders by type (i.e. owner requested changes, contractor requested changes, etc.) are reasonable, and ensure that the reasons and costs for change orders are clearly understood.

WSIP policies and procedures require all entitled changes to be identified by either the CM Team or the Contractor. Where entitlement is confirmed the City is obligated to initiate a PCO. The relatively high number of PCOs compared to CORs initiated by the Contractor reflects the timely and proactive change order management action on the part of City.

A very thorough change management program was put in place to track and manage all WSIP construction changes. It requires that all changes be classified as per our program's pre-established change categories (differing site conditions, design omission, owner initiated, etc.) and that each change be thoroughly documented and justified. Furthermore, CM Procedure 016 (Construction Change Management) was revised to require client-initiated changes (i.e., changes from the SFPUC Water Enterprise) over \$50K to be reviewed and approved by a Change Control Board (CCB) comprised of Senior SFPUC Managers, before being presented to the WSIP Director for final approval.

A WSIP Construction Contract audit completed in January 2011 by the San Francisco Controller's Office addressed the change orders of two WSIP projects – Tesla Treatment Facility and East/West Transmission Main. The auditors tested for best practices in CM and contract administration, and found change orders to be well supported and documented. We will make sure that all future audits of our WSIP construction contracts by the City Controller's Office assess whether the number of change orders is reasonable and determine whether they are justified.

In the meantime, in response to BAWSCA's recommendation, the WSIP Team will perform an analysis of the changes recorded for WSIP projects to determine the distribution amongst the various change categories and the adequacy of the program's change order documentation. The scope of the analysis will be developed so it can identify actions to be taken to further control future changes.

Recommendation 5: Review the current construction change order authorization policy to ensure that all change orders are essential for the project to meet Level of Service goals prior to authorizing the change.

A majority of the WSIP change orders to date are due to different site conditions, regulatory requirements, and design errors and omissions. These changes are non-discretionary and in some cases may not directly contribute to the system's level of service (LOS) goals. They instead are required to compensate the Contractor for unavoidable changes that are essential to delivering project functionality or proceed with the construction of the project. For example, the

change associated with the removal of swallow nests and hatchlings in the filters of the SWWTP was not directly related to any LOS goals.

The construction change authorization policy is based on the required cost and schedule level of approval and does not directly address LOS goals. Requiring that an analysis for compliance with LOS goals be conducted for the hundreds of construction changes being processed is in our view impractical and onerous. It could result in significant construction delays, which in turn would cause major cost increases.

The discretionary Owner-requested changes are those that are most likely to be above and beyond the LOS goals. These currently account for approximately 21% of the change order costs to date. As mentioned above, a CCB was established to evaluate client-initiated changes greater than \$50K to make sure they are reasonable and justified. On the positive side, owner-initiated scope changes allow deficiencies to be corrected, which results in improved facilities. We try to minimize these changes to the extent that we can but it is typically more efficient and cost effective to perform the work under an ongoing contract.

Recommendation 6: Ensure that the Independent Review Panel is given sufficient latitude, time, resources and access to information so that its findings, conclusions and recommendations can be as helpful as possible, and so that it can fulfill the expectation that its review brings added confidence and is helpful to the WSIP manager, staff, the program management consultant, the Commission and the public.

The most recent review by the Independent Review Panel (IRP) was controlled by the Revenue Bond Oversight Committee (RBOC). The WSIP Team was and continues to be very cooperative with RBOC on the review process and dedicated significant resources to support the panel's efforts. The IRP was afforded unlimited access to people, project sites, or any information they requested.

From the start, the WSIP Team/Director advocated for a less ambitious scope that focused on a smaller number of questions to ensure in depth analysis of fewer topics. The WSIP Team/Director also advocated longer timelines for report preparation to ensure the quality of the IRP work product.

Comments on BAWSCA's Findings and Conclusions

Our response to BAWSCA's Findings and Conclusions below makes reference to comments provided to the Revenue Bond Oversight Committee (RBOC) on recent draft reports prepared by the Independent Review Panel (IRP) and Dr. Bill Ibbs. These reports have since been finalized. The final reports do incorporate some of our comments but we still believe that there is a misunderstanding on some of our construction management (CM) practices. The WSIP Team plans to give follow up presentations to members of the RBOC in February and March 2012 in an effort to further clarify the practices that seem to still be misunderstood.

A. *While the WSIP project budgets and schedules were revised only six months ago, as of the end of September the forecasted budgets and schedules for several projects already exceed the values and dates adopted by the Commission.*

- See response to Recommendation 1 in Attachment A.
- The criteria developed for performance indicators are very sensitive and conservative. A project is currently being reported as "need attention" if it meets one of the two following conditions:
 1. Forecasted Cost is over the Approved Budget by greater than \$50k and less than 10%.
 2. Forecasted Schedule is over Approved Schedule by greater than 1 month and less than 6 months and less than 10%.

Given the size and complexity of the program, these criteria may not be appropriate. As indicated in our response to Recommendation 1 in Attachment A, the WSIP Team will review the threshold criteria used to highlight the status of cost and schedule variances in the Quarterly Report.

B. *The high use or forecasted use of schedule and budget contingencies generated questions about the ability to complete projects on schedule.*

- See WSIP Team December 19, 2011 comments provided to the Revenue Bond Oversight Committee (RBOC) on the recent draft reports prepared by the Independent Review Panel (IRP) and Dr. Bill Ibbs. The comments made regarding the misunderstanding and misinterpretation of data concerning program cost and schedule status, as well as the use of cost and schedule contingencies apply to the findings reported in Section B of the Findings and Conclusions attached to the BAWSCA December 7, 2011 letter.
- See response to Recommendation 2 in Attachment A.

C. *Change Orders (CO) are taking too long to process.*

- All change cost and time impacts are carried as potential changes or trends and are therefore reflected in cost and schedule forecasts regardless of total processing time and are carried in WSIP Quarterly Reports under the cost and schedule variances.
- See response to Recommendation 3 in Attachment A.

D. *The Independent Review Panel's recent draft report for the Revenue Bond Oversight Committee contained many deficiencies, which may be due to limited time and resources available to them for their review.*

(1) *The panel's review is particularly timely, given the schedule and budget extensions observed since the Commission approved revised budgets and schedules less than six months ago.*

- It should be noted that some of the recent project variances are related to pre-construction issues and the review by the IRP focused exclusively on the Construction Phase of projects.
- See WSIP Team December 19, 2011 comments provided to the RBOC on the recent draft reports prepared by the IRP and Dr. Bill Ibbs.

(2) *The draft IRP report cites that 96% of the WSIP construction schedule contingency is expected to be used with only 41% of the work completed or invoiced. But the report does not indicate whether or not the forecasted use of contingencies is conservative, provides no analysis or conclusions about how future project schedules and budgets might be impacted, and presents no recommendations for improving project delivery or managing within the approved schedules.*

- See WSIP Team December 19, 2011 comments provided to the RBOC on the recent draft reports prepared by the IRP and Dr. Bill Ibbs. The comments made regarding the misunderstanding and misinterpretation of data concerning program cost and schedule status, as well as the use of cost and schedule contingencies apply to the findings reported in Section B of the Findings and Conclusions attached to the BAWSCA December 7, 2011 letter.

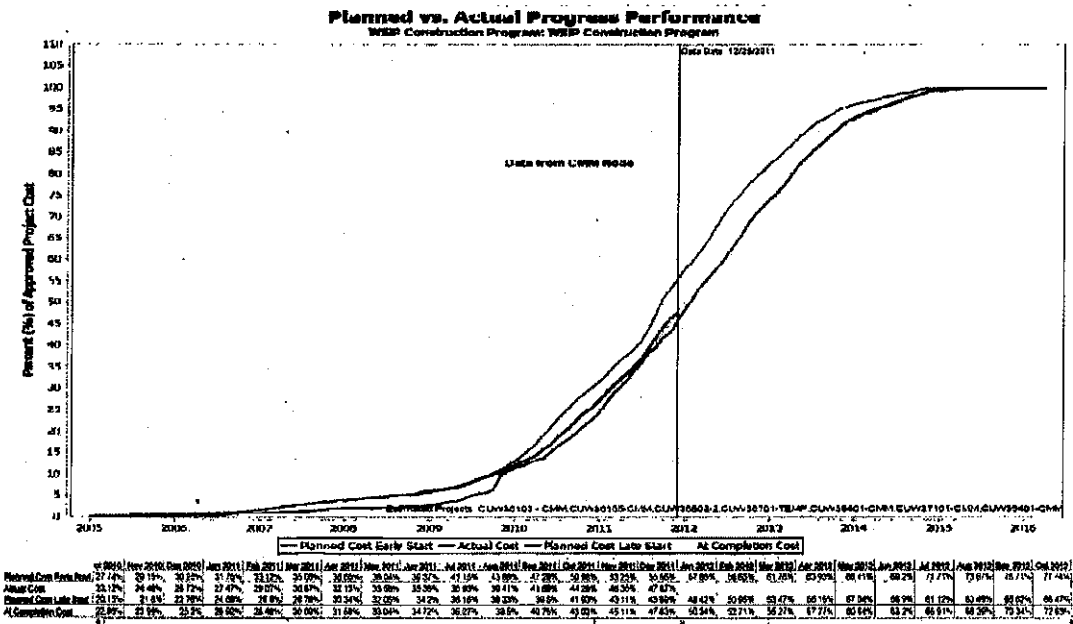
(3) *The draft IRP report indicates that soft costs are "within industry norms" but gives no source for its conclusion. Soft costs are \$1.2 billion, about one-third of the program costs. Better documentation is needed to determine whether or not this sizable program cost is appropriate or deserves further attention.*

- According to our data, soft costs account for about 26 percent of the total program costs.
- The IRP found the WSIP CM costs to be somewhat high but concluded that they are reasonable for a program of the complexity and magnitude of the WSIP and the value provided.
- Before making cost comparison between programs it is important to understand the definition of various soft costs that apply to a program with the magnitude and complexity of the WSIP. Comparison to other programs may not be appropriate unless one can confirm that the categorization and tracking of cost expenditures by other public agencies are similar to that of the WSIP. To be valid, a comparison needs to be made with a large program (preferably a multi-billion dollar program) with multiple projects, with a similar scope (cannot compare to vertical construction projects), in a comparable location (preferably in California),

with a similar level of regulatory requirements and risks. For example the system shutdown component of the WSIP involves significant costs.

(4) The IRP draft report did not review performance measures in detail and therefore did not consider or report on how past performance might affect future performance.

- We do not understand this comment. Please explain.
- The following Planned vs. Actual Performance S curve for the WSIP Regional Construction Program is prepared by rolling up the Early and Late Planned Progress from the approved contractor Baseline CPM Schedules and comparing it to the updated progress as reported in the latest payment application cycle which closed December 25, 2011. The curve takes into account past performance of regional construction contracts and projects the performance through program completion.



As can be seen from the curve, the Actual Progress curve is well within the envelope provided by the Early and Late Planned Progress curves, demonstrating that the rate of progress achieved to date is keeping track with the planned progress. While the construction program has faced formidable challenges the CM Teams are effectively managing the delivery of the construction contracts and are mitigating potential impacts as they arise.