



UTILITIES ADVISORY COMMISSION MEETING – SPECIAL MEETING FINAL MINUTES OF FEBRUARY 13, 2013

CALL TO ORDER

Chair Cook called to order at 7:05 p.m. the meeting of the Utilities Advisory Commission (UAC).

Present: Commissioners Chang, Cook, Eglash, Foster, Hall, Melton, Waldfogel
Absent: UAC Liaison Scharff

Chair Cook left the meeting at 7:38 p.m. in the beginning of the discussion on Item #2 (Presentation on Financial Projections for the City's Electric, Gas, Water, and Wastewater Collection Utilities).

Commissioner Eglash left the meeting at 8:04 p.m. before the discussion of Item #1 (Utilities Advisory Commission Review and Discussion of the 2013 Preliminary Assessment of Water Resource Alternatives), which was moved to after Items #2 and #3.

ORAL COMMUNICATIONS

None.

APPROVAL OF THE MINUTES

Director Fong proposed amending the minutes from the January 9, 2013 UAC special meeting. The last sentence on page 6 of the draft minutes, referring to comments by Commissioner Eglash, reads: "He doesn't want to spend any amount of money to get the last little bit of carbon neutrality when that additional cost could be extreme." Director Fong proposed amending the sentence as follows: "He doesn't want to spend an inordinate amount of money to get the last little bit of carbon neutrality when that additional cost could be extreme." The minutes were approved as amended.

AGENDA REVIEW

Chair Cook switched the order of the New Business Items #1 (Utilities Advisory Commission Review and Discussion of the 2013 Preliminary Assessment of Water Resource Alternatives) and #3 (Appointment of Commissioners to an Ad Hoc Budget Committee for FY 2014 Budget) so that Item #3 was discussed first and Item #1 was discussed after Item #3 and Item #2.

REPORTS FROM COMMISSION MEETING/EVENTS

Vice Chair Foster stated that he attended the Council study session on February 11 about the Palo Alto Green Program. He told the Council that PA green got lots of varied input from UAC members, but it was a discussion and no decision was requested. Foster asked when staff would bring a proposal back for UAC consideration. Director Fong responded that the item was preliminarily scheduled for the UAC's April meeting.

Commissioner Eglash reported that the Finance Committee unanimously supported the Carbon Neutral Plan with the limitations recommended by the UAC. He stated that the committee was happy that carbon neutrality could be achieved at a low cost due to the ability to get renewable energy contracts at a reasonable price.

UTILITIES DIRECTOR REPORT

1. **Water Supply Conditions Update:** Precipitation at Hetch Hetchy is about 110% of median for the water year to date (October 2012-January 2013) after a very wet December and a very dry January. While continuing to monitor the water year precipitation and snowpack conditions, the SFPUC is not anticipating the need for voluntary rationing at this time.
2. **Demand-Side Management Update:**
 - a. Palo Alto Unified School District (PAUSD) Award---after submitting their buildings using the DOE's Energy Star Portfolio Manager process, the PAUSD won the "Leaders Top Performer" award for having such high ratings across multiple buildings. (This award reflects an even higher standard than what we use for the City's Green Leader Awards.) We are coordinating with the school district on ways the City can potentially acknowledge this extra accomplishment.
 - b. Spring Efficiency Workshops---to capitalize on the interest staff is developing workshops timed to coincide with around Earth Day for water saving, PV and solar water heating installations. In addition, we are coordinating a 5K race on April 27 to celebrate Earth Day and Water Leak Awareness Week. The Tuolumne River Trust and Water Hayes Elementary School are working with staff to coordinate.
3. **Communications Update:**
 - a. PG&E Pipeline Project Status---The Palo Alto portion of the Line #109 project up on Miranda has been temporarily repaved. The area will be permanently repaved when the entire project is finished in late March. Meanwhile, work will begin later this month on the only last unfinished segment of the pipeline---the section under Matadero Creek. Once begun, this part of the project will take about 3 weeks to complete and will include about 7-10 days of rather noisy "hammer boring."
 - b. Gas Main Replacement ---our latest phase will get underway later this month. We intend to ramp up our outreach to neighborhoods impacted by the project---such as Barron Park-- to help residents know what to expect and emphasize how the short-term inconvenience of having us on their streets will translate into long term benefits.
 - c. "Magnetic Attraction"---the new *HOW TO REACH US* magnets we created have been well received with over 700 customers calling to request them within a month of our

announcing their availability. We also now include these magnets in all our New Customer Welcome Packets, which are sent to 150 households per month on average.

4. **Energy / Compost Facility and Standby Rates:** On January 28 the City Council approved the recommended energy purchase policy for the Energy/Compost facility as well as the proposed standby rates. Public Works will incorporate this policy into their RFP for development of the facility which they hope to issue in February.
5. **Carbon Neutral Plan Action:** On February 5, the Finance Committee voted unanimously to recommend approval of the plan to the Council. The Council is scheduled to consider the Carbon Neutral Plan on March 4. We are planning various outreach activities to spread the word about the Plan, if it is approved.
6. **Water Utility Debt Refinancing Savings**
Along with the other 26 members of BAWSCA, we recently refinanced our Water Utility's capital debt to the SFPUC. Palo Alto's net present value savings were \$4.9 million, which works out to about \$289,000 saved per year. The refinancing savings were over twice what was expected for a variety of reasons, including aggressive marketing and favorable market conditions. For the BAWSCA members as a whole, the net present value savings from this refinancing---at an interest rate of 3.14%---are over \$62 million on a total debt of over \$356 million. The savings from this refinancing effort will help offset expected future water rate increases.

Vice Chair Foster asked what the ratings were for the individual PAUSD buildings. Director Fong said that she will provide him the ratings.

UNFINISHED BUSINESS

None.

NEW BUSINESS

ITEM 1: DISCUSSION: Utilities Advisory Commission Review and Discussion of the 2013 Preliminary Assessment of Water Resource Alternatives

Commissioner Eglash left meeting at 8:04 pm after advising that he is an employee of Stanford University and the Stanford Research Park may receive recycled water from the project. In an abundance of caution, and after discussions with the City Attorney's Office, he decided to recuse himself from discussions on this item since recycled water is one water supply alternative evaluated in the report.

Commissioner Hall stated that he is an employee of East Bay Municipal Utility District, which supplies water and wastewater to a service area distinct from the San Francisco Public Utilities Commission's (SFPUC's). He also consulted the City Attorney's office and determined that he does not have a conflict of interest and will stay for the discussion.

Senior Resource Planner Nico Procos provided a presentation summarizing the Preliminary Assessment of Water Resource Alternatives. The presentation provided background information on the City's current supply mix and highlighted the objectives for the effort. The subject areas to be evaluated include groundwater, Santa Clara Valley Water District (SCVWD) treated water connection, recycled water, and a supply entitlement sale.

Vice Chair Foster asked about the water quality issue for recycled water. Procos indicated that the salinity in recycled water may have an impact on sensitive species such as certain trees. Procos added that this subject is complex and currently a major focus of the environmental review for the project. Staff discussed the timeline to bring the EIR to Council within a year and a potential financing plan and recommendation to the UAC shortly thereafter.

Commissioner Hall asked if the costs in Table 1 reflect the West Pipeline extension. Procos explained that the current and projected SCVWD water rates do not include any West Pipeline extension costs.

Public Comment:

Resident Peter Drekmeier commented that the Tuolumne River Trust co-hosted a forum on budget-based water rates, which would establish a budget for each customer and costs would go up if use increased above the budget amount. Sustainable budgeting is another idea that could be something that CPAU could consider. He mentioned harvesting water from the dewatering of basements as another source of water. Also, recycled water could be used to recharge groundwater. Palo Alto should work with East Palo Alto (EPA) regarding a water entitlement transfer. EPA is at risk of exceeding its entitlement and has extremely low per capita water use. Palo Alto could share its surplus entitlement with EPA.

Resident Dhruv Khanna mentioned that he sent a 3-page letter with comments on the report. He stated that the report overstates the future demand and understates the future cost of SFPUC water. There is a large strategic issue since all the water supplies are from SFPUC, which is vulnerable to cuts due to the lengthy pipes from the source to Palo Alto. He encourages Palo Alto to develop its local resource, groundwater. He expressed the view that large users will look at alternative water supplies and switch to avoid paying the higher cost water. Mr. Khanna stated that he is on the SCVWD Agricultural Advisory Board and is happy to help the commission, staff, or Council.

Vice Chair Foster asked Mr. Khanna if he supports that groundwater should be used for normal year usage, or only in emergencies or droughts. Mr. Khanna replied that he supports the use of groundwater for normal year usage.

Commissioner Hall asked if the cost of the West Pipeline would impact the cost of water from the SCVWD. Staff responded that it would since the capital costs would be included in the treated water charge. Commissioner Hall questioned if there was a lack of identifiable supply to serve West Pipeline demand. He mentioned the District has many resource alternatives. The Bay Delta Conservation Plan could increase costs of District water. He is interested in

reviewing the range of costs from the SCVWD. There are reliability benefits to be connected to another source of supply. Even with the SFPUC's capital program, there are vulnerabilities in the SFPUC system.

Commissioner Melton supports a second connection to SCVWD, but is concerned about a statement that the water supply is not guaranteed and asked what the SFPUC contract allows for. Procos stated that the contract allows for alternative supplies, but that a minimum take requirement would be imposed. Procos added that the City would likely have two minimum take requirements, one from the SCVWD and one from SFPUC.

Commissioner Waldfogel asked if we reduced our use of SFPUC water, would SFPUC change its pricing and recover its costs one way or the other. Procos responded that the SFPUC has the ability in the contract to change the rate structure to ensure there is cost recovery, but the contract specifies there must be discussion with the BAWSCA members. Procos added that the SFPUC has indicated an interest in evaluating alternative rate structures, but appears to have postponed activity on this for now. If we face the same costs even if reduce the usage, then the costs for well rehab or treated water line would only be additive so need to figure out ways to protect ourselves from that.

Commissioner Chang asked if it's possible to decouple rates from revenue as has been done by electric utilities. She asked if this be done with our water rates to protect from having cost recovery issues if demand decreases.

Commissioner Melton commented that the high costs of recycled water are to move the water from the treatment plant to the Research Park. He asked if we could use groundwater instead of recycled water to irrigate. Ratchye said that the groundwater can be pumped by anyone in the county, but they would have to pay the SCVWD pump tax. Procos added that there are several entities that do this now, but the quality issues are not that different between recycled water and upper aquifer groundwater.

Commissioner Melton asked what the 1500 acre-feet per year (AFY) limitation in groundwater usage means. Vice Chair Foster stated that the question is a good one for the City Attorney to consider as the evaluation continues to the next phase.

Mr. Khanna stated that the water usage will decline over time (not increase as projected in the report) and that those with more options will be better off.

Regarding the 1500 AFY limitation, Commissioner Hall asked if it is possible to use more and provide the recharge of the groundwater basin.

Vice Chair Foster commented that lower usage by everyone means that everyone pays the same for less water.

Commissioner Waldfogel asked how much water our biggest users use and for what purpose. He added that we could subsidize those users to use groundwater and reduce our SFPUC usage. Procos responded that the departure of those customers could impact our ability to recoup our own fixed costs, so there could be equity issues that would need to be addressed.

Commissioner Waldfogel asked if the economics for the sale of the Individual Supply Guarantee (ISG) are consequential. Procos responded that we don't know, but recent indications are it has value. Staff is proposing a very preliminary evaluation at this stage.

Commissioner Melton said that a sale of the ISG is only worthwhile if it would pay a significant part of the cost of another source, such as recycled water. He stated that he would support the sale of the ISG since it never seemed like it had much value and if it could be monetized. Procos added that the ISG currently has some value in its role in the Tier II drought allocation formula. If it was reduced there would be an impact to dry year supplies. This will be evaluated in the next phase.

Waldfogel asked if we had the ability to charge a groundwater rate to charge customers who would walk away from our system. He asked if we have an ability to superimpose a fee for groundwater extraction. The City Attorney indicated that she would have to look into the question.

Vice Chair Foster asked about the timeline for this evaluation. Director Fong indicated that staff will need to incorporate the feedback and continue the investigation to collect data to develop a recommendation. Foster commented that we should include an alternative that reduces our dependence on SFPUC, both from cost and reliability perspectives.

ITEM 2: PRESENTATION: Presentation on Financial Projections for the City's Electric, Gas, Water and Wastewater Collection Utilities

Assistant Director Jane Ratchye stated that the presentation on the financial forecasts is a preview of next month's discussion. This month no information was provided in advance of the presentation, but next month the full report will be provided with all information. In this presentation, we will be showing options for the water and wastewater funds and would like to get some feedback from the commission on these options.

Resource Planner Eric Keniston provided an overview of the 5-year financial forecasts for all funds, stating it was possible to not have any rate increases for FY 2014. This is different from last year's financial projections, which had forecast the need for increases of 15% for water and 9% for wastewater. Electric and gas show no need for changes at this time. There have been some significant savings related to Capital Improvement Programs (CIP).

For the Electric Fund, no rate increases were shown to be needed, but supply costs (renewables, transmission) were projected to increase, and distribution costs were projected to decrease due to decreased Capital Improvement Program (CIP) budgets in the next two years.

This was due to a backlog of projects as well as vacancies (under-filled positions, retirements, fewer trainers for new employees). No rate increases are shown to be needed until FY 2016.

Commissioner Cook asked why there were vacancies in this economy, and whether it was a structural issue. Director Fong stated that for skilled positions such as electric and gas engineers there is a shortage.

Commissioner Eglash added that this is an industry wide problem for utilities.

Commissioner Hall observed that the large drop in CIP expenses is significant, and Commissioner Cook asked whether this could cause a problem in the future with operations. Director Fong stated that if a project came up that was required immediately, those would be done.

Vice Chair Foster asked if there were zero dollars budgeted for undergrounding for FY 2014. Keniston confirmed that this is true.

Regarding the Gas Fund, Keniston stated that since all customers now have market rate gas commodity costs, the net revenue profile is relatively steady. In addition, other components were brought into alignment with cost of service study as of the rates effective July 1, 2012. CIP deferrals for two years will cause distribution costs to fall significantly so that the distribution rate stabilization reserve (RSR) levels are projected to rise above the maximum guideline level for several years. Options are to let the reserves be where they are, or to have rate decreases (with increases later). The gas supply RSR is more of a cash flow reserve as market-based commodity costs are passed through to customers. With a two month lag between billing and revenue collection, funds should be in place to cover the potentially expensive float needed for winter gas.

Commissioner Cook asked if the minimum and maximum guidelines are legal requirements. Keniston replied that they are not legal requirements.

Commissioner Melton asked whether the high amount for the gas distribution RSR was all due to CIP deferrals. Keniston confirmed that it was.

Commissioner Eglash asked if, given market prices for gas sales, whether RSR needs been re-assessed. Assistant Director Ratchye stated staff will reassess the appropriate reserve levels after completion of a rates policy. Director Fong added that the reserve is needed for cash flow, so the reserve needs may not necessarily be reduced, but may be based on when we pay for gas and when we receive the corresponding revenue from customers.

Keniston stated that the Water fund has seen large cost increases over the last few years. In FY 2014, it is possible to have no rate increase, although large increases would be needed starting in FY 2015 if there were no rate increase for FY 2014. The reasons for lower expenses this year include a return of capital funds in FY 2013 and a deferral of main replacement projects by one

year. Therefore, the Water RSR will be near to the maximum guideline level instead of the minimum for FY 2013. Keniston stated that an alternative rate increase profile would be 7% annual increases for the 5-year period.

Commissioner Hall asked if the SFPUC rates rising will be offset by the CIP decreases. Keniston replied that this is the case for next year.

Commissioner Melton stated that if there is no rate increase next year, the following year increase will be much higher and that in the past, the UAC generally counseled against that.

Commissioner Hall stated he preferred a level rate increase trajectory.

Regarding the wastewater fund, Keniston stated last year a 9% increase was projected for FY 2014, but with CIP main replacement deferrals of one year, revenues are expected to be above expenses and the wastewater RSR is expected to be above the maximum guideline for FY 2014. A double digit rate increase will possibly be needed in FY 2015. An alternative plan could have a small increase in FY 2014, but reserves would be pushed above maximum guideline levels with anything more than a small increase.

Commissioner Melton asked whether the cost growth was due to the treatment plant cost going up. Keniston confirmed that this was the case.

Commissioner Melton stated that temporarily exceeding the maximum guideline level is not as significant as dipping below the minimum guideline level. A one year peak over maximum is not a big deal.

Commissioner Eglash stated he was uncomfortable with taking more money from ratepayers simply to bank it for future cost increases. He would rather leave the money with ratepayers, especially when the reserve levels are above the maximum guideline level.

Commissioner Waldfogel stated the reserves should reflect deferred or accrued maintenance cost. It sounds like there isn't a plan to try and catch up with CIP projects.

Commissioner Eglash agreed, saying he was on a UAC committee reviewing the CIP in the past and was impressed with the long-term plan to be current with infrastructure replacements. It is a reason to be very proud of CPAU, but the notion when you can't spend at the rate you would like to, or to treat CIP deferrals as a savings instead of a known cost or deferred expense for the future creates some unease.

Director Fong added that CPAU has always practiced 'pay as you go' for CIP expenditures. The consideration of budgeting for future CIP expenses is possibly in conflict the idea of not holding more of ratepayer funds than actual expenses indicate.

Commissioner Eglash wondered if there is a matter of degree and of predictability that makes CIP different, but agreed that there is a conflict in objectives.

Commissioner Melton agreed that, if because of other limitations we have to defer CIP, it seems appropriate to bank funds for the future when costs start coming along, including that, as a representative to the City's Infrastructure Task Force, this is how the General Fund got into trouble. If in the future Utilities has to do three years of work to get back on track, there should be money in an infrastructure reserve fund to handle that.

Vice Chair Foster asked if there would be a situation of doing multiple projects at once in the future, or if this would be a steady deferral out one year. Director Fong stated it was the latter.

Commissioner Waldfogel stated that ratepayers should expect to pay a portion of the life of infrastructure, even if there are no expenses in one year, that it should not be a 'jubilee' of sorts. Director Fong stated this would be an excellent discussion for the rates policy.

Assistant Director Ratchye asked whether the UAC had any direction for staff as to the proposals to be provided in March.

Commissioner Eglash said that he is supportive of a flatter rate increase for water, rather than zero in FY 2014, as this has always been expected. However, he would support zero for wastewater as the reserves would go above the maximum guideline level.

Commissioner Melton said that he supports the steady, moderate rate increase alternative for water as he would like to avoid double digit rate increases in water in the future. However, he said he feels less strongly for wastewater since the dollars are not that large.

Commissioner Eglash encouraged staff to think about the input provided on the CIP funding as he is very interested in not treating the CIP deferrals as savings, but look at opportunity to bank the money for catching up with the CIP projects.

Commissioner Melton asked about how much of the fixed costs for the gas distribution and water costs are collected with fixed charges and how much is collected with volumetric charges. Ratchye stated that according to the cost of service study, some of the fixed costs are assigned to be collected with fixed charges, but not all the fixed costs.

Commissioner Waldfogel asked if staff will be coming back with the fiber fund financial information. Keniston said that there are no plans to do that at this time since rate increases for the fiber fund are based on the Consumer Price Index.

Director Fong stated that the City Auditor completed an audit of CPAU's reserves and that their advice was not to store money in reserves, but to only charge customers what is needed in a particular year.

Vice Chair Foster indicated his support for steady rate increases for water, but said that he did not have a strong opinion on wastewater.

ITEM 3: ACTION: Appointment of Commissioners to an Ad Hoc Budget Committee for FY 2014 Budget

ACTION:

Chair Cook appointed Commissioners Waldfogel and Melton to the committee.

ITEM 4: ACTION: Selection of Potential (Topics) for Discussion at Future UAC Meeting

Commissioner Hall stated that human resource limitations that caused CPAU to defer CIP projects may merit further discussion since the drop-offs were so significant. Director Fong indicated that the issue is a rebuilding of staff to address these issues and that it takes time to do it. Commissioner Melton said that when he was on the UAC committee reviewing the CIP plans in the past, he was told that Utilities would be caught up with its infrastructure needs by 2015. He stated that it sounded like this goal will not be met. Commissioner Melton indicated that he will look into the CIP when serving on this year's ad hoc budget committee.

Commissioner Waldfogel asked that a city official responsible for city-wide emergency coordination be present at the March meeting when the emergency water supply update is scheduled for discussion.

Vice Chair Foster indicated that he would like a further review of Propositions 26 and 218 when and if there is a court decision on any cases pending.

ACTION:

No action was taken.

COMMISSIONER COMMENTS

None.

Meeting adjourned at 9:50 p.m.

Respectfully submitted,
Marites Ward
City of Palo Alto Utilities