



Honolulu Board of Water Supply
Stakeholder Advisory Group

Meeting 11 – Tues. January 10, 2017 4:00 to 6:30 pm
Neal S. Blaisdell Center, Hawaii Suites
777 Ward Avenue. Honolulu, HI 96812

Meeting Notes

PURPOSE AND ORGANIZATION OF MEETING NOTES

The purpose of these notes is to provide an overview of the Board of Water Supply (BWS) Stakeholder Advisory Group meeting. They are not intended as a transcript or as minutes. Major points of the presentations are summarized herein, primarily for context. Copies of presentation materials were provided to all participants and are available on the BWS website. Participants made many comments and asked many questions during the meeting. These are paraphrased to be more concise.

ATTENDEES

There were 14 stakeholders present, as well as BWS and CDM Smith staff present. The stakeholders represent diverse interests and communities island-wide.

The following Stakeholders Advisory Group members attended:

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|------------------|-------------------------------------|
| Eric Au | Sheraton—Waikiki |
| Pono Chong | Chamber of Commerce Hawai'i |
| Bill Clark | Resident of Council District 6 |
| Mark Fox | The Nature Conservancy of Hawai'i |
| Shari Ishikawa | Hawaiian Electric Co. |
| Helen Nakano | Resident of City Council District 5 |
| Alison Omura | Coca-Cola Bottling Co. |
| Elizabeth Reilly | Resident of Council District 4 |
| Jon Reppun | KEY Project |
| Cynthia Rezentes | Resident of Council District 1 |
| Josh Stanbro | Hawaii Community Foundation |
| Cruz Vina Jr. | Resident of Council District 8 |
| Christopher Wong | Resident of City Council District 7 |
| Suzanne Young | Honolulu Board of Realtors |

MEETING AGENDA

- Welcome
- Public Comment on Agenda
- Accept Notes from Meetings 9 and 10

- BWS Updates
- Financial Plan Policies
- Typical Customer Identification for Rate Impact Evaluation and Water Rates Process
- Summary and Next Steps

WELCOME

Dave Ebersold, meeting facilitator and Vice President of CDM Smith, welcomed the group and introduced several new people in the room and at the table, including:

- Joe Cooper, the Waterworks Controller for the Board of Water Supply, who will be a familiar face as we move through our approach to the Long-Term Financial Plan and Rates Study.
- Robert Morita, from the BWS Executive Support Office, responsible for budgeting along with other important areas.
- Brian Thomas, with Public Financial Management, a subconsultant to CDM Smith. Brian leads that firm's water/wastewater practice in the Western US with clients that include the Metropolitan Water District of Southern California, Los Angeles Department of Water and Power, and Las Vegas Valley Water District.
- Theresa Jurotich, a senior financial analyst with CDM Smith who specializes in rate modeling, cost of service analysis, and many aspects of financial management the Stakeholder Advisory Group will cover over the coming months.

PUBLIC COMMENT ON AGENDA ITEMS

None

ACCEPTANCE OF NOTES FROM MEETINGS 9 AND 10

Accepted. There were two questions about the notes from both meetings. The first asked if the group had discussed any reduced costs that may be associated with the fewer number of water main breaks. That topic had not been discussed at Meeting 9 and the meeting notes were approved as written. The second asked if Hawai'i Kai Neighborhood Board should have been included in a list of groups commenting on the draft Water Master Plan (WMP) in the Meeting 10 notes. However, while the NB received a presentation and provided feedback in person, it did not send in written comments on the draft WMP. The notes for Meeting 10 were approved as written.

BWS UPDATE

Ernest Lau, BWS Manager and Chief Engineer, updated stakeholders on BWS activities, particularly related to continuing outreach and community communications. Ernest reiterated his appreciation for the time and work of the Stakeholder Advisory Group, calling them a very important asset to the Board of Water Supply whose feedback and input to this process is greatly appreciated.

Ernest informed the group of a presentation the BWS made to the State legislators in the State Capitol, with thanks to Jill Kuramoto for making the arrangements. The presentation attracted many legislators and staffers, with a focus on the Water Master Plan and Red Hill concerns.

Next, he extended appreciation to Stakeholder Advisory Group member Helen Nakano for arranging a community presentation about the Water Master Plan to about 150 individuals through Mālama Mānoa. The audience included about 15 VIPs. Among them was Ray Soon, the Mayor's Chief of Staff, who commented on his being very impressed with BWS's efforts to improve communications and engage the community as partners.

Ernest then launched the discussion for the evening, focusing on BWS's development of a Long-Term Financial Plan. A 30-year horizon was chosen for the Long-Term Financial Plan to match the BWS's 30-year Capital Plan and Water Master Plan. Ernest pointed out that reaching this far into future for financial planning is not the norm for municipal water agencies, but he wants to ensure that the BWS is looking forward at how we are going to pay for things in the WMP.

QUESTIONS AND ANSWERS

Q. Are you looking primarily at rates to bring in revenue, or are you looking at any and all sources of funding? The EPA has just announced a one billion dollar financial incentives act. There's also funding from the State Revolving Fund, and from the Clean Air Act if you're looking to retire some of your old trucks.

A. We are looking for any and all opportunities for alternative sources of funding, including grants from the Federal government. We are pursuing Federal Hazard Mitigation funding through FEMA to purchase mobile emergency generators. We also have talked about Special Purpose Revenue Bonds issued for purposes like dam improvements that may be applicable to our Nu'uano Reservoir number 4. We're looking into private funds for potential redevelopment of BWS property, the parking lot behind the BWS's headquarters on Beretania Street. It might work to develop that and create potential lease revenue.

FINANCIAL PLAN POLICIES

Dave reviewed some of the basics of Long-Term Financial Planning and the rate making process, to set the context for further discussion.

The BWS's authority to make rates is established by City Charter, which makes the Board responsible for decisions about water rates. This is in contrast to privately-owned utilities which are regulated by the Public Utilities Commission.

Cost-based rate-making processes, which is what the BWS is undertaking, have three basic objectives as described by the American Water Works Association, an international professional organization for water utilities that has established the most widely used guidance:

1. Provide sufficient funding to build, operate, maintain and invest in the system.
2. Provide safe and reliable drinking water and fire protection.
3. Allow for economic development and community sustainability.

This type of rate-making involves 3 basic steps:

1. Assessment of revenue requirements, which assures there's sufficient income to cover operating and maintenance costs, and capital costs to ensure strong credit ratings. (If we were making a pie, it would tell us how big the pie needs to be.)
2. Cost of service identifies the cost to serve each of the BWS's four customer classes. (This is like the cost of the ingredients that go into the pie.)
3. Rate design is how we divide costs fairly and equitably to customers, while also reflecting community values like affordability for low-income residents, supporting local agriculture, and encouraging conservation. (This is how we slice the pie.)

When we look into the Revenue Requirements "pie", there are four components of the Financial Plan that drive these requirements out to the future, and thus drive water rates:

- Operations and maintenance costs
- The size of our Capital Improvement Program and how we fund it; how much is paid in cash, how much is borrowed funds
- Financial policies for credit ratings and stability
- How we choose to prepare our response to changing trends and risks, like economic cycles and climate change.

Dave showed a list of financial policy questions to stakeholders and asked that they keep them in mind during the next speaker's presentation. Dave said he would come back to these questions to ask for the group's input on BWS's current and future financial policies.

Dave introduced Brian Thomas, Public Financial Management, to talk about the kinds of policies that guide long-term financial planning. Brian told the group that the hard part of developing a Water Master Plan is to determine how to pay for it.

Brian told the group that building a financial plan begins with identifying revenue requirements. He said getting policies in place helps make sure that the revenue requirement is as stable as possible over time.

In financial planning, we ask these kinds of policy questions:

- How much working capital is needed?
- How much should the BWS fund capital projects?
 - How much from debt vs. revenues?
- What is an appropriate level of debt service coverage (e.g., like paying off the mortgage)?
- What is the maximum ratio of debt to equity?

Water utilities like the BWS consider several things when thinking about working capital (amount of cash on hand that can be put to work to meet the needs of providing water service). How much money is needed to pay the bills? If there is a lag in revenues coming in, what amount is needed to pay ongoing operating expenses? How many days of operating expenses should we have in reserve if something bad happens?

Some agencies pay for 20% of their capital improvement plan (CIP) using cash from revenues; others pay 50% from cash and 50% through borrowing. An important thing for the BWS in financial planning is to determine: What is the right combination of using cash and borrowing over time? Brian pointed out several things to consider related to borrowing:

- Do we want to have a certain amount of debt? How much is optimal?
- Where is the cheapest source of funding?
- To pay for debt service coverage, how much in excess of the annual “mortgage” should we collect?
- How much do we need to put in reserves?
- What’s the leverage that we want to have?

Some organizations are very leveraged. This means they have a lot of outstanding debt and a comparatively small amount of equity. In private industry, when bad things happen to highly leveraged companies, they tend to go bankrupt. The current policy of the BWS is to have 45 days operating expenses plus and including debt service.

Brian told the group about other current BWS financial policies:

- The amount set aside for annual debt service is 1.6 times the amount for senior liens (who gets paid first) and 1.3 times the amount for junior liens (next in line to be paid).
- The BWS maintains a 40-50% debt to net assets ratio.
- The BWS has no specific contingency reserves.
- The BWS maintains good relationships with rating agencies.

He said that the BWS is highly rated: AA+ (Fitch); AA2 (Moody's).

Brian talked about the purpose of having reserve funds. Reserves are one way to address risks and mitigate rate increases into the future. They lead to higher credit ratings, which allows borrowing at lower rates. He said that rating agencies look at what’s in the agency’s long-term plan and how we go about developing it. Involving the community is an important element of that process, and is viewed favorably by the rating agencies.

He then discussed minimum recommended funding levels. The Government Finance Officers Association recommends having 90 days cash, and never less than 45 days cash. Brian said additional working capital could be set aside for:

- Unanticipated high-cost repair and replacement
- Emergencies
- Disaster recovery
- Rate stabilization

Brian showed what other comparable municipal water agencies have in in terms of reserve policies.

- DC Water reserve policy is 60 days cash for working capital, 120 days cash for operations, and \$35 million for renewal and replacement.
- San Antonio Water System’s policy is 60 days cash for working capital, and 300 days cash for its total operating reserve (which includes the above-mentioned working capital).

- Las Vegas Valley Water District's policy is 180 days cash for working capital, which is approximately 1 year of the average CIP; and about 1% of its depreciable assets for unforeseen events.
- San Diego Water's policy is a minimum of 30 days cash with a target of 45 days cash in reserve, including for emergencies.
- The Los Angeles Department of Water and Power's policy is to keep an operating reserve of 150 days cash to meet any/all needs.

He described what two other Hawai'i counties are doing:

- Maui County has an unrestricted fund balance of 5-15% of revenues; an emergency reserve of 20% of General Fund revenues; about 10% of revenue requirements for debt service; and net debt per capita less than or equal to \$2500. These policies are for the county as a whole, and not limited to the Maui County Department of Water Supply.
- Hawai'i County has a disaster emergency fund with a \$10 million target; funds for preservation and open space; 0.25% of tax revenue up to a maximum of \$3 million used to maintain the properties acquired by the County; and a budget stabilization fund. As above, these policies are for the county as a whole, and not limited to the Hawai'i County Department of Water Supply.

Brian discussed rating categories and levels of cash reserves available for paying off bonds. Most utilities rated as AAA have well above 250 days cash on hand. For a AA rating, which is the Board of Water Supply is today, those utilities have between 150 to 250 days cash on hand. However, a certain number of days cash on hand isn't going to guarantee a AA rating, but it's one of the important financial criteria.

He said that one important factor for financial policy planning is the debt service coverage ratio:

$$\text{Net operating revenue} \div \text{annual debt service} = \text{debt service coverage ratio}$$

The BWS's debt service coverage ratio is: $\$106.6 \text{ million} \div \$17.9 \text{ million} = 5.96$. Based on guidance from rating agencies, strong AA rated municipal water utilities typically are in the range of 1.7 – 2.0. However, those strongly AA rated utilities may have a much higher debt service ratio than that.

Brian said that we talk a lot about debt because we have many things we want to accomplish and debt helps us achieve them. For example: The cost of the CIP goes up and down year-to-year. If we pay to implement the CIP using only cash, then rates would have to also go up and down, and customers would experience rate shock. Debt helps smooth out the spikes.

Our bond rating makes a difference in what we ultimately pay.

- The difference between A and AA ratings can be 50-75 basis points (0.50% – 0.75%).
- WMP includes \$800 million of expenditures over next 10 years.

- Difference in annual debt service (A vs. AA rating) is approximately \$3.0 -- \$6.1 million (per year).
- That adds up to \$90 -- \$183 million over 30 years.
- The higher bond rating (AA) increases the BWS's purchasing power by 10-20%.

QUESTION AND ANSWERS

Q. When you showed where BWS is on the ratings slides, it looks like it's head and shoulders above peer groups.

A. Relative to the benchmarks, this organization is doing really well at this point. As we move forward implementing the WMP, we will do things over time that will bring these ratios down. Also, some of the utilities shown have more cash on hand than their target – they have about a year's worth, maybe more.

Q. What are some of the other things that rating agencies consider when they're looking at how they'll rate an organization? Why isn't the BWS rated higher?

A. Each of the rating agencies looks at utilities differently. All look at management. They look at rate-setting history. Has the agency done long-term planning? Did they raise rates in a timely basis? Are there political objections or difficulty raising rates? They look at age of the system and how old it is compared to peer groups. They look at the totality of the condition of the system, any operating issues, litigation or potential litigation. They also look at what the local economy is like. Hawai'i has a tourism-based economy. BWS's current ratings of A+ and Aa2 are really good, strong ratings.

Ernest noted that Honolulu's customer base is very stable. He said that BWS has tried to get a rating upgrade, but was declined multiple times. Ernest indicated the BWS will keep trying.

Q. I noticed (on the chart of comparative financial policies) that Hawai'i County has a disaster emergency fund. Do you think that we should see what they did and learn if some would apply to BWS?

A. Yes. This would be something to look into and see how that compares with other financial metrics. The information shown on the chart reflects the county as a whole, not just the Hawai'i County Department of Water Supply

Q. How does the BWS work with the Fire Department on fire protection? How are the responsibilities divided?

A. The BWS provides the fire hydrants and water for the Fire Department to use for fire protection. During the development of the WMP, we evaluated fire flow to make sure that the infrastructure was appropriately sized. The WMP includes recommendations to upgrade the fire protection system.

Q. This looks very good financially. But, on the flip side, one could say you're charging too much and you're not using the resources to do maintenance or increase quality of programs

A. Ernest noted that's a good point. Before he became Manager, the BWS took action to adopt five years of rate increases to ramp up to funding \$80 million per year for the CIP. We've been able to get projects awarded, but the contracts are still in process. As we move

forward, we will keep in mind that we have this money now, but we also need to factor in what will be happening with expenditures and rates as we move into the future.

Q. When you go out into the market for a revenue bond, does the BWS go alone or do you attach the city in some way?

A. Ernest explained that when he was Manager on Kauai, the water utility had the full financial capacity of the county behind those bonds. On O'ahu we do not have that option. Credit is based on the strength and ability of the BWS to pay back its loan. The city is not named in the prospectus or covenants.

Q. Does the BWS self-insure or do you buy insurance for disaster emergency funds?

A. The BWS is self-insured and we also purchase insurance coverage. In a disaster, like if a hurricane devastates our facilities, then we would work with Hawai'i Emergency Management and the Federal Emergency Management Agency to seek grants through their public assistance programs. But that's on a reimbursable basis, so, we need to have the capital in hand for repairs, and then seek reimbursement.

Q. If your reserves and safety net are too large, other agencies that are not doing as well may try to tap into the BWS's money. Do you have enough legal safeguards to protect BWS if others try to take this money from you?

A. This is one of our fundamental challenges. We want to be sure we are financially strong to weather any type of disaster or recession. At the same time, there are others who may feel that the BWS is sitting on cash that could be used for other city infrastructure. This is a challenge we saw with last year's Charter Commission proposals.

Q. We see more and more developments on this island. Currently, new water lines to the development are ultimately turned over to the BWS for maintenance and repair. Is there some way that the development could be set up to retain responsibility for maintaining the water lines it requires. As more and more mileage is added to the water system, all customers end up paying for the additional pipelines. Could there be a new look at how this is done?

A. If you look at the City Charter, it's clear that the BWS is responsible for the water system in the county. Developments are required to submit plans to be certain the systems they create are designed to our standards. We review the designs and we inspect the construction so we know that we can accept the addition to the water system. The developers pay the capital cost. This has been a long-standing policy.

Dave brought back the list of questions he showed earlier. These questions included:

- Are BWS's current financial policies adequate?
- What additional policies should be developed, e.g. rate stabilization, disaster recovery, repair and replacement?
- What levels of reserves and working capital should be associated with those policies?
- What should the BWS do (or not) from a financial policy perspective about trends and risks like climate change, conservation, and economic cycles?

Discussion of these questions and issues included:

C. It is very important for customers to really understand how many different kinds of costs need to be covered. The customers need to be comfortable with the BWS having good reserves. We live in a coastal area. The general population hasn't begun to think about how much it will take to deal with this. It is important for the BWS to identify the many costs so that the public can really understand.

Q. Water is one of the more important things to the community but it is not the only important thing. On O'ahu, if ratepayers aren't paying for 90 days cash, is that the biggest issue we are dealing with on the island? Is the current financial policy (of 45 days cash) adequate?

A. Keep in mind that we want to have a strong bond rating so that we borrow money at the lowest rate. We also want to minimize rate shock. Meeting these objectives also requires that we have cash on hand.

Q. Is there going to be another opportunity to come back to financial policies?

A. Yes, but it needs to be soon. Major decisions about financial policies need to be made before we divvy up the pie among customer categories. We will be finishing this part of the financial process in the first quarter of 2017. We will use a financial model to give us a clear understanding of the fiscal impacts of different policy options.

Q. Do I need to bring up agricultural rates now? Will there be an opportunity to discuss ag rates from a policy standpoint?

A. There will still be opportunity to discuss ag rates and other areas that may have subsidized rates. The BWS has recently been asked about subsidizing affordable housing for example. We will come back to this.

C. We need to have something in mind in case there is an impact to our aquifers that causes us have to find another way to get good safe water to our customers who are affected.

Q. What do we do with wastewater and our wastewater system? The BWS is regularly criticized about costs while wastewater fees are twice what water costs.

A. Ernest said that he and the director of the Department of Environmental Services (ENV) have been discussing the potential to separate the bills of the two services.

Q. If you have a fund for disaster relief, is it more defensible as a stand-alone fund? Do rating agencies look at that?

A. That's a good question and we will look into that. But generally, rating agencies look at the total amount of days cash in reserve.

TYPICAL CUSTOMER IDENTIFICATION FOR RATE IMPACT EVALUATION

As part of the upcoming rate development process, Dave said just looking at the impact of potential changes in rates on the four broad customer classes is not enough, and not very informative. This is because there is a lot of variability in water use among different types of customers within each class. So, we want to expand our comparisons to include a total of 12 to 15 "typical" customers among the four customer classes. We can then better estimate

the impacts of potential rate changes on these types of customer's, based on "typical customer" actual water use so the Stakeholder Advisory Group can see the financial impact of specific rate options.

Dave showed a chart of typical customers, including single family residential, multi-family residential, commercial/industrial, and agriculture. Using the example of the Single Family Residential customer class, Dave showed how the team subdivided it into limited income, average water use, and high water use. He asked stakeholders for feedback on the chart, and for input on additional subdivisions under each customer class.

Discussion of this included:

Q. How do we consider homes with a high number of people (e.g. twenty) living there?

A. Dave indicated that there are multiple approaches (and tradeoffs). This has been the topic of recent discussions to address the issue of such a high number of people in a single household.

C. A recommendation was made to look at how other utilities are handling similar issues, including the possibility of a preferential rate for people living home full time, differentiated from people who have a second home on island. Dave indicated this would be brought forward for discussion.

C. Remember that golf courses developed after the mid 1990s are required to use non-potable water, or other water not provided by the municipal water utility.

Other suggestions were for the commercial class to include: shopping centers, perhaps even separating large centers and strip malls; parks (may be similar to golf courses); schools and colleges; and cemeteries (again, large landscaped area similar to parks or golf courses).

Q. What about government customers, like the State, parks, military, and others?

A. Government customers don't have a special class. They pay the rate that corresponds to the type of usage, e.g. residential rates for government housing, etc.

C. A suggestion was made to include condo hotels and time-shares. A condo hotel is legally condominiums and can be operated as a hotel (similar to time-shares), and may be built as condos in the same building as commercial on lower floors.

C. When do we get to the point where we differentiate between potable and non-potable water use -- to incentivize and accomplish some of the things we're trying to do in the WMP? When and how can we get people off potable water that could alternatively be supplied with non-potable water ... dual lines and so on?

Q. How do other municipalities approach subsidizing rates vs. actual user cost?

A. We have great case studies we can share with the group.

Q. What are some of BWS's non-potable water customers?

A. We have a wide range of non-potable customers. They include a cement facility, an airport, Transit-Oriented Developments, freeway landscaping, golf courses, a school and some industries. The use of recycled water shouldn't be restricted to customers who irrigate. Our lower non-potable rates are drivers to use this water instead of drinking water. Looking forward, we are considering case-by-case and site-specifically where we can require the use of non-potable water and where we might provide incentives.

C. For new developments coming up, the BWS should provide an incentive to put in dual water systems.

A. Some new developments are installing non-potable lines in every street and putting in a reservoir.

The discussion will be continued and results refined at the next Stakeholder Advisory Group workshop.

SUMMARY AND NEXT STEPS

Dave reminded the group of the next Stakeholder Advisory Group meeting, Tuesday, February 7, 2017 from 4 to 6:30pm, at the Blaisdell Center, in the Hawai'i Suites. Topics will include the 30-Year Capital Improvement Program including more detailed information about levels of main break replacement tied to rates of main breaks, more about customer classes, and further refinement about financial planning scenarios.