***PLEASE NOTE: Since the Glendale City Council does not take formal action at the Workshops, Workshop minutes are not approved by the City Council.**

MINUTES
CITY OF GLENDALE
CITY COUNCIL WORKSHOP
MARCH 7, 2006
1:30 P.M.

PRESENT:	Mayor Elaine M. Scruggs, Vice Mayor Thomas R. Eggleston, and Councilmembers Joyce V. Clark, David M. Goulet, H. Phillip Lieberman, and Manuel D. Martinez
ABSENT:	Councilmember Steven E. Frate
ALSO PRESENT:	Ed Beasley, City Manager; Pam Kavanaugh, Assistant City Manager; Craig Tindall, City Attorney; and Pamela Hanna, City Clerk

1. UPDATED UTILITIES RATES ANALYSIS

CITY STAFF PRESENTING THIS ITEM: Mr. Kenneth Reedy, P.E., Deputy City Manager; Mr. Roger Bailey, P.E., Utilities Director; and Mr. Blaine Bickel, Principal Consultant Black & Veatch.

This is a request for the City Council to review and provide direction on the proposed update to the water and sewer rates.

An annual review of the city's water and sewer rates is consistent with the Council goals of providing financial stability and coordinating exceptional service delivery.

As part of an ongoing contract with consultant Black & Veatch, an annual update of the February 2, 2004 Water Rate Analysis has been completed.

In 2003, Black & Veatch was selected as the consultant to complete the Water Master Plan. Additionally, in 2003 Black & Veatch conducted a water and sewer rate analysis and established a recommended series of water and sewer rate increases for the study period of Fiscal Years 2004 to 2014 in order to meet the future water and sewer revenue obligations. These recommendations are based on a detailed analysis of revenue generated monthly under the existing rate structure and the future needs as determined by the findings detailed in the Water Master Plan and the Utilities Comprehensive Needs Assessment.

In December of 2003, the Council authorized a ten-year annual water or sewer rate increase beginning with the first increase in water rates effective in January 2005. Per Council direction, this authorization was predicated on an annual review of the utilities needs assessment and the water and sewer rates and fee structures.

On June 5, 2001, the Council authorized a three-year series of sewer rate increases beginning in November of 2001 and ending in February of 2004.

The yearly review of the water rate schedule, including any necessary increases, will enable the city to maintain its current level of service to existing residents.

Prior to any formal action by the Council on changing utility rates, public notice is given and public hearings are held.

The report and presentation will provide several alternatives for water and sewer rate adjustments.

The recommendation was to review this item and provide direction on the proposed update to the water and sewer rates.

Mr. Bickel explained the city is required to have debt service coverage of at least 120 percent, with the additional 20 percent intended to ensure funds are available to reinvest in the system once operating and maintenance expenses and principal and interest payments have been paid. He stated some cushion is necessary to carry the city through times when revenue is less than anticipated or expenses exceed expectations. He said, as a result, the city set its target debt service coverage ratio at 140 to 150 percent.

Councilmember Clark asked Mr. Bickel to explain why the city set their ratio at 140 to 150 percent when a ratio of 120 percent is required. Mr. Bickel said staff made the policy decision to maintain the additional coverage, explaining meeting the minimum ratio could result in the city falling below the required coverage level. Councilmember Clark asked why they increased the ratio to 140 percent rather than 125 or 130 percent. Mr. Bickel said the decision was based on previous experience and the amount of fluctuation typically seen in both revenue and expenses. He pointed out the money generated can be used to reinvest in the system. Councilmember Clark asked if they looked at historical fluctuations within the City of Glendale. Mr. Bickel said fluctuations in Glendale's past were taken into consideration as was the impact the ratio has on ratings given to Glendale by the rating agencies.

In response to Vice Mayor Eggleston's question, Mr. Bickel explained the test is defined as net revenues divided by the city's annual principal and interest payments. He stated the minimum requirement can be used to meet ongoing routine annual capital expenses.

Councilmember Goulet asked if a 100 percent ratio would put the city in default. Mr. Bickel stated the city's ordinance requires the debt service ratio to be 120 percent. He reiterated their goal is to ensure they are able to cover the minimum requirement on an annual basis. Councilmember Goulet asked if the trend is for public facilities to have a 120 percent minimum requirement. Mr. Bickel said Glendale made the commitment to the 120 percent minimum requirement prior to going to the bond market. Mr. Reedy clarified the policy has been in place for several years.

Councilmember Martinez asked if the ratio has been given additional cushion due to the significant increases in the cost of construction materials. Mr. Bickel responded no, stating the cushion has been in place for some time and bonds have been sold in the past based on the same minimum requirements. Councilmember Martinez asked if each of the four options being presented is predicated on the 140 to 150 percent ratio. Mr. Bickel indicated they are.

Councilmember Lieberman asked what the city's revenue surplus was last year and if that money went into the general fund or into a special contingency fund for water and sewer. Mr. Reedy said the funds are separate and placed in an enterprise fund. He explained the transfer that occurs between the Utility Fund and the General Fund covers the cost of doing business. Councilmember Lieberman pointed out there should be $2 million in surplus funds. Mr. Reedy explained the Utility Fund repays the city for services it provides to the utility. Councilmember Lieberman asked if they defray other costs with the surplus. Mr. Reedy answered yes. Mr. Bailey said at the end of the year the fund balance was $1.4 million. He stated, however, they reassess rates on an annual basis to ensure they meet the minimum requirement. He said the total revenue last year was approximately $57.5 million and the total revenue requirement was $53.4 million. Councilmember Lieberman said he supports the 140 percent ratio because of the significant increase in construction costs.

Mayor Scruggs said staff is asking Council to give direction to continue with the 140 to 150 percent debt service ratio. She pointed out the city has made commitments to bonding agencies that it will maintain the ratio. She asked how the 140 to 150 percent can be considered held in reserve when it is used. She also asked if the city would be in default the moment they fall below the 120 percent ratio. She expressed concern that she has told people that the city's water and sewer rates are based on the actual cost of providing the service when, in fact, they are actually 140 to 150 percent of the cost of providing the service. Mr. Bickel explained the coverage test is based on net revenues relative to debt service. He explained net revenue consists of total revenue, minus operation and maintenance expenses. He said operation and maintenance expenses are only a part of the total cash requirements of a utility in any given year and other expenses and cash requirements have to be paid out of revenues. He said once a city falls below the 120 percent ratio it is in technical default; however, it is doubtful the bond trustee would proceed with appointing someone to take over utility operations if it only happened once. He explained when calculating the coverage ratio they can only use money generated in the fiscal year in which the test is being performed. He said balances available that are carried into a fiscal year cannot be counted as revenue for the current fiscal year test because they were already counted for the previous year's test. Mayor Scruggs asked if the cushion is available to be used. Mr. Bickel said the money can be used for anything in addition to operating and maintenance expenses and debt service payments, such as cash financing for capital projects, routine repairs and replacements and funding emergency reserves. Mr. Reedy said in the General Fund they have done bond payments for certain types of projects as well as pay-as-you-go capital. He said they could do the same thing in the Utility fund. Mayor Scruggs pointed out the additional 20 to 30 percent cushion costs rate payers anywhere from $3 to $4 million.

Councilmember Clark said she does not remember any discussion concerning the 120 percent debt service ratio. She asked when the ordinance was passed. She asked if the ratio applies only to enterprise funds or to all bond indebtedness. Mr. Shuey explained the original ordinance was adopted by Council on December 4, 1984 and amended on September 14, 1993. He said the ordinance actually establishes three different tiers, with 120 percent required for the city to issue new obligations and avoid going into default. He stated in the year after bond obligations are sold the level must actually be 125 percent. He said the ratio is unique to the city's water and sewer system, but not unique to water and sewer systems throughout the country. He stated such coverage levels are expected by bond holders and financial markets. He explained, while a person could not obtain a mortgage without first showing that after paying other living expenses they will have sufficient funds to pay the mortgage payment, the city cannot obtain an obligation that would deplete all of its revenue. He stated if the city drops below 1.2 percent coverage in any given year the city is in default. He said, regardless of whether or not the trustee takes action, the city never wants to be in default. He said the ratio is not a measure of how much cash is available to spend, but a measure of their revenue and expenses.

Mayor Scruggs asked why the city is having enormous rate increases when projections indicate the city will be collecting 283 percent. Mr. Shuey explained the projections assume no growth or new development to show bond holders the city has enough coverage to cover their debt. He stated Glendale will of course continue to grow and have infrastructure needs and Black and Veatch's proposal represents what the city will have to do to maintain the 140 to 150 percent coverage ratio in the future.

Councilmember Clark asked if the deficits shown in some of the alternatives reflect the 140 to 150 percent debt ratio coverage. Mr. Bailey clarified deficits will occur in the event one of the alternatives is not adopted. He noted the projections mentioned by Mr. Shuey do not reflect revised cost estimates. He said their proposal attempts to address the additional costs in the non-growth related CIP.

Mayor Scruggs said the comments made by staff and those made by Black and Veatch appear to be contradictory, pointing out Mr. Shuey said the projections do not address future growth, but Mr. Bickel talked about non-growth CIP projects. Mr. Bailey stated the bond obligations sold a few weeks ago will go towards paying for both growth and non-growth related projects. He clarified the rate issue before the Council covers non-growth related aspects of the CIP while the development impact fees will help pay for the growth-related portion of the CIP.

Councilmember Clark said it was her understanding the Operating and Maintenance provided for expenditures required under the non-growth items and that rate increases were growth driven. Mr. Bailey said when staff initially presented the needs assessment they looked at the entire operation. He stated certain portions of the operation, including the distribution system and collection system, underwent a comprehensive assessment to proactively address problems with the city's aging infrastructure. He said proactively addressing the aging infrastructure will require the city to do much more than pay-as-you-go. Councilmember Clark asked if the proactive approach being taken is new to the city. Mr. Reedy said the city has had some capital programs in the past for minor replacement projects, but staff discussed with Council a couple years ago the need to move toward a maintenance driven operation. He said the city needs to have a capital program to replace the city's infrastructure as it continues to age. He pointed out the city has historically had a balance between bond related costs and ongoing pay-as-you-go capital costs. He stated their goal is to use pay-as-you-go capital to level costs out over the years. Councilmember Clark asked if the city has historically focused on its aging infrastructure. Mr. Reedy said the city has had a replacement program for the past twenty years, but the program has not kept pace with the aging infrastructure. He noted things other than the city's water and sewer lines also need to be rejuvenated; therefore the city needs to shift more of its attention to replacement issues.

Mayor Scruggs asked if the CIP program that will come to Council in the next few weeks is predicated on the Council approving the semi-annual rate increases. Mr. Reedy responded yes. Mayor Scruggs asked if the 140 to 150 percent debt service ratio is set forth in the city's ordinance. Mr. Shuey said the highest percentage set by the ordinance is 125 percent of the maximum annual debt service for the year following the sale of the bonds.

Councilmember Lieberman asked Mr. Shuey to explain the different tiers. Mr. Shuey identified the three tests set forth in the ordinance as being; 1) 120 percent debt service ratio, 2) the net revenues for the system for the recently completed year are not less than 110 percent of the senior outstanding water and sewer revenue bonds, and 3) 125 percent of the maximum annual debt service for the year following the sale of the bonds.

Mayor Scruggs asked if the debt management study is due to come out in the next couple months. Mr. Shuey responded yes, stating they plan to bring it to Council in early May. Mayor Scruggs recommended they schedule the study for a Council workshop session.

Councilmember Martinez asked if the additional cushion can be used to implement the proactive replacement program. Mr. Reedy explained when a replacement project is identified they have the Engineering Department design it and hire a contractor to construct it and, at that point, they decide whether they will use cash money or bond money. He said they typically use bond money cash flow to cover the estimated projects already in the pipeline.

Councilmember Lieberman asked if they attempt to identify the cost of maintenance at the start of any project. Mr. Reedy answered yes. He pointed out the Capital Improvement Program is also taken into consideration because they have to figure out when debt service will increase to pay for the new projects. Councilmember Lieberman commented it is strange that the Council has never before discussed this issue.

Mayor Scruggs pointed out the Council has never before been presented with such startling proposed rate increases.

Vice Mayor Eggleston asked if staff will be presenting an increase in the CIP budget. Mr. Bailey said there has been an increase which reflects a combination of both the growth related and non-growth related portions. He pointed out the number of water main breaks increased from 27 in FY 2004/05 to 29 so far in the current fiscal year. He noted the city has to remain in compliance with certain federal mandates. Vice Mayor Eggleston asked if the 120 percent ratio relates only to debt service. Mr. Shuey responded yes.

Councilmember Martinez asked if the ordinance needs to be modified to increase the ratio to 140 to 150 percent. Mr. Reedy answered no, explaining the model has always assumed a 140 to 150 percent ratio.

Mayor Scruggs pointed out the ordinance says revenues must be at least 120 percent of operating expenses. Mr. Shuey explained following the issuance of the debt the city cannot fall below 125 percent. He said the ratio relates to net revenues, which equals operating revenues less operating expenses.

Mr. Bickel continued his presentation, stating when looking at FY 2006/07 the Water Utility needs to generate about $3.5 million in additional revenue and the Sewer Utility needs to generate about $2.5 million in additional revenue. He said they prepared several alternatives for Council's consideration; noting they all meet total revenue requirements.

Mr. Bickel explained Alternative 1 assumes concurrent semi-annual increases beginning in July for Water and Sewer. He said for a residential customer that uses 13,000 gallons per month, the monthly bill for combined water and sewer will increase to $62.51, which represents a $7.86 per month increase. He stated Alternative 2 is also based on semi-annual increases beginning in October and was created in the event the rate increase cannot be implemented in time for the July effective date called for in Alternative 1. He said under Alternative 2 the combined bill for the typical residential customer would be $65.66 which represents an increase of about $11. He explained Alternative 3 is based on concurrent annual increases and result in the average bill increasing to $61.22.

Mr. Bickel compared the impacts of the proposed alternatives to the rates charged by other cities in Maricopa County, pointing out Glendale would remain at the median for the nine cities under Alternatives 1, 3 and 4. He stated, while Alternative 2 puts Glendale slightly higher than Scottsdale, Scottsdale anticipates implementing an increase in the immediate future. He pointed out the base charge for usage up to 3,000 gallons per month would not change.

Mr. Bickel said, based on their study, they recommend the Council implement one of the four recommended alternatives. He recommended they give serious consideration to the smaller, more frequent increases and that they revisit the rate issue annually so they can take into account changes in revenue and expense trends.

Councilmember Lieberman asked if Alternative 2 results in an 18 percent increase over the next 12 months. Mr. Reedy said the alternative calls for a nine percent increase in October and a second nine percent increase in March. Councilmember Lieberman pointed out the 18 percent increase includes both Water and Sewer. He stated there will be another nine percent increase in October 2007 and a five percent increase in March 2008 for a total of 14 percent. Mr. Reedy said that is what the current analysis shows will be necessary. He stated, however, staff will come back next year to evaluate whether costs have gone up or down.

Councilmember Clark referred to the Sewer Non-Growth Capital Fund, stating it appears sewer stays in the black through FY 2013/14. She asked why they are proposing to increase sewer at this time when it appears to pay for itself for the next ten years. Mr. Bickel directed Councilmember Clark to Table S-6, explaining the increased revenue is shown on lines 2, 3 and 12 beginning in FY 2006/07. He stated the revenues on line 1 are under existing rates, whereas lines 2 through 12 represent additional revenues that will be generated under the Alternatives presented by staff.

Mr. Bickel said the coverage test also applies here, but on a combined water and sewer basis.

Councilmember Clark asked why they have interrelated sewer and water, pointing out they are dramatically different in terms of their needs. Mr. Reedy agreed there are differences; stating, however, the $3 million revenue shortage is the significant issue. He explained the goal is to come up with solutions that level the increases and make them no worse than necessary. Councilmember Clark said she is troubled by the fact that over the next ten years they are looking at a 67 to 81 percent increase on the water side, depending on the alternative selected. She said on the sewer side they are looking at an increase of 66 to 75 percent, again depending on the alternative selected. She stated, while they understand rate increases are inevitable and the need to be proactive in replacing aging infrastructure, she finds the tremendous increases called for over the next ten years very troublesome. She asked if any adjustments are made to take into account the compounding that will occur. Mr. Reedy responded yes. He said the proposed alternatives represent the best the Utilities can do to meet their ongoing costs. Councilmember Clark said an average citizen would assume ongoing costs relate solely to the cost of providing water or sewer service, when, in actuality, it includes capital improvement projects, rehabilitation of older infrastructure, and debt service ratio coverage. Mr. Reedy stated the cost of replacing infrastructure as it breaks will be more expensive than establishing a proactive replacement program. He stated all of the pieces fit together and make up the utilities' ongoing costs.

Mayor Scruggs said Mr. Bailey phrased the repair of the older infrastructure in such a way that it implied it was a new strategy. She stated Mr. Reedy then clarified they have always used the strategy. She said, however, Mr. Reedy then said if the city is to take a proactive approach then the proposed rate increases will be necessary. She asked why increases up to 80 percent are necessary if they have been using a proactive strategy all along. With regard to construction cost increases, she said there is no reason to believe those cost increases will continue at the same rate over the next ten years. She stated she does not feel she can justify the proposed exorbitant increases to the citizens of Glendale. Mr. Bailey said when they originally conducted the needs assessment in 2003 they talked about the collection system, distribution system and the water treatment plants. He stated, since that time, they have moved forward with the CIP program predicated on the assumption that every year they would replace certain portions of the city's distribution and collection systems. He said they have moved forward with Phase I of the Distribution System Replacement Program. He stated the estimated cost of the program is the only thing that has changed and the additional costs represent revisions based on increases in the construction market. Mayor Scruggs stated, in terms of transportation, she keeps hearing that costs are leveling off and even coming down. She asked if the numbers would be different if they waited until they review the CIP in late April. Mr. Reedy explained there are several factors involved, including projects related to regulatory requirements and increases in the cost of replacement programs as well as fuel, electrical, and personnel cost increases. He said construction costs are driving the issue and, while the cost increases could level off, they have no information that indicates the costs will be less than they are today.

Councilmember Lieberman said he hypothetically put in a cash payment from the contingency fund into the Water and Sewer Enterprise Fund in an attempt to lower the amount; however, the disadvantage of lowering the amount is that when they start on their annual increases they are starting at a much lower rate. He stated, in talking with a representative from a construction firm, he was told the price of materials has increased so fast that small contractors have had to declare bankruptcy because they cannot meet obligations they made just six months ago. He noted the minimum housing value increase in Glendale over the past 12 months has been 47 percent. He stated, while he does not like the idea of a nine percent increase with an additional nine percent increase compounded on top of that increased rate, he does not have another answer at this point. He said the city cannot stop providing water or buying equipment or stop planning for the development of the Oasis Water Treatment Plant.

Councilmember Martinez referred to the comparison to other cities, noting other cities have increased their rates over the past year. He said, in looking at the other cities' rates, Glendale still ranks in the middle. He stated, while he does not necessarily like the idea of implementing the increases, he believes it is something they must do. He stated they need to rely on the expertise of their experts.

Mayor Scruggs pointed out that, while the city looks good in comparison to other cities in terms of water, it does not compare as well in terms of sewer. She asked if the sewer side is what is driving the significant increases.

Councilmember Clark pointed out the water bill only shows through January 1, 2007, stating they are talking about a model that compounds over the next ten years. She said she is bothered by the fact that they are predicating an entire ten year package on a snapshot of current construction costs. She stated if those construction costs level off the utilities will end up with surpluses. Mr. Reedy clarified if they generate more revenue than they need to spend, they will not borrow as much; thereby reducing their debt service costs. Councilmember Clark questioned whether that would ever be reflected and if staff would ever come back to Council with a recommendation to reduce the rates. Mr. Reedy said he recommends they do the one year rate increase, but come back next year to look at the various cost estimates and Capital Improvement Projects to see if they are still accurate. He assured Councilmember Clark that staff will recommend adjustments if they find the utilities have more revenue than needed. Councilmember Clark asked if staff is looking for a 16 percent increase in both Water and Sewer the first year under Alternative 1, an 18 percent increase in both under Alternative 2, a 15 percent increase in both under Alternative 3, and a 28 percent increase on the sewer side under Alternative 4. She also asked when Council will be asked to make its final decision with regard to the rate increases. Mr. Reedy said state requirements dictate the timeline and if they hope to proceed with a rate increase in July the Council will need to make its decision when the Capital Improvement Program is presented on April 4.

Councilmember Lieberman asked on which alternative the rate comparison between cities is based. Mr. Reedy said Alternative 1.

Councilmember Clark asked what is the average bill. Mr. Bailey said $64.65.

Vice Mayor Eggleston referred to his personal bill, noting he uses considerably less water per month than the average user. He asked if they would be able to lessen the increases if every customer implemented water conservation measures. Mr. Reedy said certain fixed costs, such as maintaining the water lines, do not relate to demand. He stated, however, conservation measures would have an impact on demand related costs. He pointed out the city has actually seen an increase in the per-household demand.

Mayor Scruggs said, in reality, costs actually increase when less water is used because the system was built based on a certain amount of usage. To highlight her point, she referred to a March 3 article concerning Tempe water savings which says the city's water fund, which encompasses water, sewer and flood irrigation services, faces a projected $9.4 million shortfall this fiscal year. She stated the article goes on to say, while the city will probably cover the losses with its estimated $63 million water fund reserve, decreased water conservation and infrastructure costs may spur annual deficits for several years. She stated Tempe's City Manager and financial experts were quoted as saying the good news is that their water conservation program is working, but the bad news is that their water conservation program is working. She noted the predicted shortfall came after the Council approved a three year water rate increase in 2005, starting with a 9.5 percent increase. She stated several factors created the shortfall, but the city's water fund is almost entirely dependent upon consumer's water use for revenues and overall water use is down.

Mr. Reedy clarified the average bill reflects the average use over a 12 month period.

Councilmember Lieberman noted last year was a bad year to use as an example because of the unusual amount of rain that fell during January, February and March. He said he is not opposed to the proposed increases because he does not see any other choice.

Vice Mayor Eggleston expressed his opinion people will take little comfort in the fact that Glendale's rates are not the highest in the valley. He said people will not appreciate nine percent increases every six months.

ADJOURNMENT

The meeting was adjourned at 3:40 p.m.