MINUTES OF THE
SPECIAL MEETING OF THE BOARD OF DIRECTORS
OTAY WATER DISTRICT
May 29, 2007

1. The meeting was called to order by Treasurer Bonilla at 5:08 p.m.

2. ROLL CALL

Directors Present:	Bonilla, Breitfelder, Lopez (arrived at 3:53 p.m.) and Robak
Directors Absent:	Croucher
Staff Present:	General Manager Mark Watton, Asst. GM Administration and Finance German Alvarez, Asst. GM Engineering and Water Operations Manny Magana, Chief of Administration Rom Sarno, Chief of Engineering Rod Posada, Chief Financial Officer Joe Beachem, Chief Information Officer Geoff Stevens, Chief of Operations Pedro Porras, General Counsel Yuri Calderon, District Secretary Susan Cruz and others per attached list.

3. APPROVAL OF AGENDA

A motion was made by Director Breitfelder, seconded by Director Robak and carried with the following vote:

Ayes:	Directors Bonilla, Breitfelder and Robak
Noes:	None
Abstain:	None
Absent:	Directors Croucher and Lopez

to approve the agenda.

4. PUBLIC PARTICIPATION – OPPORTUNITY FOR MEMBERS OF THE PUBLIC TO SPEAK TO THE BOARD ON ANY SUBJECT MATTER WITHIN THE BOARD'S JURISDICTION BUT NOT AN ITEM ON TODAY'S AGENDA

No one wished to be heard.

<u>WORKSHOP</u>

5. ADOPT RESOLUTION NO. 4097, APPROVING THE FISCAL YEAR 2007-2008 OPERATING AND CAPITAL BUDGET; APPROVE FUND TRANSFERS FOR POTABLE, RECYCLED, AND SEWER; AND DIRECT STAFF TO PROCEED WITH THE PROPOSITION 218 HEARING AND NOTICES

Chief Financial Officer Beachem indicated that staff is presenting for the board's approval a $66.2 million Operating Budget and $34.5 million Capital Improvement

Project Budget. He indicated that this is the first time in the history of the District that the combined budgets are greater than a $100 million.

He stated that the proposed budgets support the District's Strategic Plan objectives and projected growth of the District. The budgets will also support the maintenance of the District's reserve target levels as per the approved reserve policy and will allow the District to maintain its debt coverage ratio.

He stated that staff is recommending the following to support the proposed budgets:

- A 5.4% rate increase for potable and recycled customers
- A 1.7% rate increase for sewer customers
    - He noted that the increase is quite a bit lower than anticipated and staff will discuss what has made this possible in upcoming slides
- Continued use of reserves in compliance with the Reserve Policy
    - Spending down some reserves to target levels when there is a surplus
    - Building up other reserves to target levels through fund transfers totaling $16 million

He stated that the desire is that the budget be approved prior to July 1, 2007 (the start of the new fiscal year). He indicated that staff will be requesting at today's meeting approval of the FY 2008 budget. He noted that the recommended rate increases, however, cannot be approved until after a hearing as required by Proposition 218. The hearing is planned to be held in either September or October of this year.

Director Bonilla inquired if the board had not already approved increases for a six-year period. General Counsel Calderon indicated that the board only approved the increases proposed in the current fiscal year (2006-2007) which became effective after the Prop 218 hearing that was held during the January 3, 2007 board meeting. Chief Financial Officer Beachem indicated that staff does project out six-years when preparing the budget each year, however, staff only requests that the board approve the budget for the upcoming fiscal year. He stated that there are a few agencies that do approve a two to three year budget and staff is exploring this possibility.

Chief Financial Officer Beachem reviewed the District's Rate Model and indicated that the objective of the Rate Model is to support the budget and maintain the financial strength of the District. He stated that the Rate Model provides staff with the optimum mix of debt, rates and use of reserves. The underpinning assumptions of the Rate Model are to:

- Meet reserve target levels in every reserve in every year
- Increase the debt coverage ratio to above 150%
- Minimize rate increases

He stated that the Rate Model is an excellent planning tool and builds confidence in the District's financial direction not only internally, but with external parties, such as, bond rating agencies, bond insurers, customers and opinion leaders. He stated that the District has good evidence of this with the recent rating upgrade the District received from the rating agencies.

He indicated that the board's direction has been that the District pass-through CWA and MWD increases, have steady small increases when required, and that staff meet the adopted target levels for each reserve. He stated that 100% of the increase proposed for the upcoming fiscal year (2008) can be attributed to increases from CWA and MWD which are higher than originally projected.

He noted that there have been some changes to the Rate Model. On the potable side, there were a number of changes that netted out one another and, overall, there was "no change." The District is where staff had anticipated and the projected rate increase of 5.4% for potable water in Fiscal Year 2008 is still on target. It is still anticipated that the same increase of 5.4% will be required in FY09 and then dropping down to 5.1% for the following three years (FY10, FY11 and FY12). He noted that there were still a number of future uncertainties that can affect rates in the future. He stated that if the City of San Diego moves forward with the SD17 project, it could save the District millions of dollars in Capital Improvement Projects and would affect the District's debt and rates. He stated that if the City of San Diego's reclaimed water rates rise or decrease or CWA and MWD change their rate projections, the District's CIP increases to cover proposed IRP Projects, growth projections change, etc. Any changes can affect our rates positively or negatively.

Chief of Water Operations Pedro Porras indicated that there are three components that affected sewer rates which lowered the proposed rate increase to 1.7%:

- Cost Shifts:
    - Power costs were more accurately split between sewer and recycled and $61,200 was moved and charged to the recycled system
    - Labor costs of $176,700 was also moved and charged to the recycled system
- Lowered Metro Costs of $141,200 as the metro rates for 2006 were lower as 2006 was a dry year (no rain) and less water was sent to the Metro system for treatment.

Director Robak inquired if electrical costs to send recycled water to the City of Chula Vista were being charged to sewer customers. Chief of Water Operations indicated that the Treatment Plant has three treatment levels: 1) primary 2) secondary; and 3) tertiary. The tertiary treated water is strictly for recycled customers. He stated that in the past, the cost was split 50/50 between sewer and recycled customers. The cost is now split more accurately based on true cost of treatment. Director Robak inquired if this was the only cost of this type that was not allocated accurately. Chief of Water Operations indicated that the cost for chlorine is also part of the cost, but mainly it is the energy cost that was not split accurately. Chief Financial Officer

Beachem indicated that he does not believe the historical equity is very far off, however, the District has better tools now and can better identify and allocate costs.

Chief Financial Officer Beachem shared some financial tools utilized by the District to manage its financial position:

- Manage the CIP and Operating budgets by building the budget from $0 (zero based budgeting)
- Set appropriate developer fees (annexation fees were reset last year and are quarterly adjusted based on the ENR indez) to assure that ratepayers to do not subsidize growth (growth pays for growth)
- Draw/spend down reserves and transfer available reserves per the District's reserve policy to assure they are utilized in the best way possible
- Issue debt to shift cost of facilities over the useful life of the facility so that the users pay for the new facility. Without debt, the District's rate would be significantly higher as the fund would need to be funded through cash.
- Adjust customer rates, if needed, as a last resort to maintain the financial health of the District.

He reviewed the reserves and how they will change over the next six years. He stated that at the beginning of FY08 the reserve will total $102.9 million and at the end of the six-year period (in 2013) the District will be down to $89 million in reserves. He stated that the reserve target is $78.5 million in 2013. He noted that the District will be issuing debt in 2009 and 2011 (each to cover a two year period) and this is the reason that the reserve totals increase in those years, but then drop down closer to target levels as the funds are utilized for CIP projects. He also noted that the gap between the reserve target figure and the projected reserve balance is due mainly to the sewer reserves. He indicated that the general replacement and sewer funds are over target as there are a number of future uncertainties. He stated that if the city of San Diego's sewer treatment waiver is not renewed, the impact to sewer will be significant and the reserves may not be enough to cover the impact. The District is also looking to develop a formal replacement plan and when it is complete, the District may have a significant need for sewer replacement. Until the uncertainties are resolved, staff recommends that the reserves be held should they be required.

Chief Financial Officer Beachem indicated that staff is also recommending the transfer of funds totaling $16 million to maintain target reserve levels. He stated that the transfers will follow the Reserve Policy guidelines. He reviewed the transfers in detail (see attached copy of presentation).

Director Robak inquired if the recommended transfers were consistent with what has been done in the past. Chief Financial Officer Beachem indicated that it is consistent with last year.

Chief Financial Officer Beachem presented a graph showing how Otay's proposed water rate compares with other county water agencies based on the average residential water use of 15 units. He stated that the District would be about eighth from the bottom (lowest cost) among the 22 agencies surveyed which is about the same level as last year. He noted that when developing the chart, some agencies were uncertain of what their rate increase would be. The District projected a 6% rate increase for these agencies. With an average residential water use of 10 units (conserving water user), the District's proposed water rate would place it about sixth from the bottom (lowest cost).

He presented a similar graph for the proposed sewer rates and among the 28 surveyed sewer providers, Otay falls within the middle (13th from the bottom).

It was discussed that the District's sewer rates are higher than the County of San Diego because of the size of it customer base. The base is much smaller than the County (5,000 versus 24,000), so the District does not have the benefit of economies of scale as the County.

Chief Financial Officer Beachem also presented a slide illustrating the District's debt ratio from 2008 through 2013. He indicated that the debt ratio without growth revenue will stay above the required 125% debt coverage ratio and will climb above the 150% target by 2013.

He stated that the District will not be issuing debt in FY2008, but will be proposing that the District issue debt in the next fiscal year. Staff is recommending $16 million in fund transfers and the following rate increases:

- 5.4% for Potable
- 5.4% for Recycled
- 1.7% for Sewer

Accounting Manager Rita Bell then reviewed staff's proposal in how the rate increases will be implemented into the rates. She indicated that it is very challenging to set rates. When a 5.4% rate increase is implemented, it does not mean that every fee will increase by 5.4%. She stated that staff tries to balance the fees by:

- Maintaining a ratio between fixed and variable charges
    - BMP 11 recommends that fixed fees be no more than 30% of the fees
- Making an effort to match revenue and costs:
    - For example, when passing thru CWA energy increases, staff tries to match the increase based on the district's actual cost
- Making an effort to keep the rate structure between potable and recycled equitable, such that, fees are matched to the actual service

She indicated that for potable, the increase is purely to cover the cost of water for FY08 and is a pass-through rate increase from our wholesale water suppliers. She presented a chart showing how the variable rate increase would affect rates based on how many units a customer utilized:

Units Use	Existing Rate	Proposed Rate
0-5	$1.08/unit	$1.12/unit
0-10	$1.78/unit	$1.85/unit
11-35	$1.94/unit	$2.01/unit

She noted that staff is proposing an increase in the energy charge of 5.25%. This charge has not been changed since 2000 and will ensure energy charges collected matches potable pumping costs to deliver water. It is recommended that the system fee be increased 9% from $11.30 per residential customer to $12.30. She indicated that staff researched this fee with other agencies and Otay is still below the norm of other agencies and is in compliance with BMP 11. This fee will add stability to the District's revenue stream. She noted that if the District had a high rainfall year, the water revenues would be reduced, but the fixed fees would provide revenues to cover the District's fixed costs.

Accounting Manager Bell reviewed the CWA and MWD fixed charge increase and indicated that a $.30 increase for the average residential customer (utilizing a ¾" meter) is being recommended. Director Breitfelder inquired if the fee was raised last year. Accounting Manager Bell indicated that the fee was raised from $2.85 to $3.55 last year. She stated that it was a larger increase last year because the fixed costs had increased over $1 million last fiscal year and this year it increased $562,000.

Accounting Manager Bell indicated that staff is also recommending a 5.4% increase in the recycled rate. She stated that it is proposed that the recycled variable rate be increased by 1% to maintain the rate structure ratio wherein recycled cost is 85% of potable cost. Staff is also recommending a 5.25% energy charge increase to match the potable energy charge and an increase of 26.5% in the District's system fee. This increase will bring recycled customers in-line with potable customers (system fee plus CWA's and MWD's fixed charge). She presented a chart showing the current and proposed rate for the recycled system fee (see attached copy of presentation) and noted that a 2" meter customer's system fee would be increased from $59.60 to $75.40. She explained that because such customers' fixed charge is relatively small to their usage—these are large consumption customers—their overall charge would still be a 5.4% increase.

Accounting Manager Bell indicated that staff is recommending a 1.7% increase in monthly sewer rates. She stated that the average sewer customer's bill would increase from $32.70 to $33.25 and through the new winter-consumption based methodology, this increase would be spread evenly between fixed and variable charges. This will meet the legal requirement to have a nexus between cost and rates (customers who use less water would pay less and customers who use more would pay more).

Director Bonilla inquired how many potable ¾" meters were being served compared to 1" meters. Accounting Manager Bell indicated that she did not have the figure available at the moment, but she would provide the information. Director Lopez inquired concerning the energy charge if it had been increased or decreased since

2000. Accounting Manager Bell indicated that the District decreased the charge in the late 1990's, however, it has not increased the charge since 2000.

Chief of Engineering Rod Posada indicated that the Otay Water District has experienced unprecedented growth since 1998 and the City of Chula Vista remains one of the fastest growing cities in the United States. He stated that the housing market in the region, however, is slowing down to a more normal pace. He indicated that the District expects that meter sales will increase from 870 in FY07 to 1030 in FY08. He indicated that it is expected that growth will increase 2.1% (a slight increase from last year of 1.8%) and material and labor will increase 5% in FY07 and in FY08. He stated that facilities for expansion, betterment and replacement are included within the CIP and expenditures are planned to be as level as possible.

He stated that the material and labor costs are based on the Economic Study (dated Jun 9, 2006) which was commissioned by CWA. He stated that they concluded that costs will increase by approximately 10% over the next two years (FY07 and FY08) for construction work such as pipelines, pump stations, flow control facilities, etc. He stated that staff also investigated the Engineering News Record (ENR) and it indicates that the cost of cement and aggregate is increasing at a faster rate, while steel is decreasing in cost.

He stated that the CIP is developed based on the District's Water Resources Master Plan (WRMP), Urban Water Master Plan (UWMP) and the Integrated Water Resources Plan (IRP). He stated that all projects within the plans goes through an iterative process evaluating the financial, growth and service levels of each project. The proposed six year CIP Plan (FY08 through FY2013) is then developed from this iterative process.

Staff also evaluates the condition of existing facilities, condition of operating systems, water and sewer deficiencies, regulatory and permitting requirements, developer project schedules, economic outlook and growth projections and board and management directives. He stated that last year, the District estimated its six-year CIP cost at $221.7 million. He stated that this year, the upcoming six-year CIP cost is estimated at $191.5 million. The reason for the reduction is that the high cost projects have been completed, such as the 30" Recycled Water Pipeline Project, and are no longer included in the six-year CIP plan.

Chief of Engineering Posada indicated that the CIP Budget is broken down into four categories. He reviewed the CIP cost difference between FY07 and FY08:

	FY07	FY08
• Capital Backbone	$28.1 M	$24.9 M
• Developer Reimbursement	$ 3.4 M	$ 1.5 M
• Replacement/Renewal	$ 3.9 M	$ 6.6 M
• Capital Purchases	$ 1.7 M	$ 1.5 M

	TOTAL:	$37.1 M	$34.5 M

He noted that replacement and renewals are increasing to $6.6 million as the District is moving more toward a maintenance enterprise from an expansion enterprise. He stated that we would see this area increase in the future. He stated that the FY08 CIP plan requires $34.5 million.

Director Breitfelder inquired why there was a dramatic difference in the six-year CIP total between FY07 and FY08. General Manager Watton indicated that the District is now moving forward to FY08 and dropping FY07 from the six-year CIP plan. He stated that based on studies, projects will also move forward or move out of the six-year period. He stated that we are primarily seeing that projects are moving out further based on studies and needs. He also shared that if SD17 is completed, several projects will be dropped from the CIP plan.

Chief of Engineering Posada reviewed the major projects within the capital backbone category (please see attached copy of presentation) for both potable and recycled water.

Director Robak noted that the project noted under “Potable Water” projects, Otay River Groundwater Well Demineralization/Development and the Otay Mountain Groundwater Well Development project, would only move forwarded if the studies showed that the project is sensible/worthwhile and financially feasible. Chief of Engineering Posada indicated that that was correct.

Chief of Engineering Posada also noted that SD17 is another project that is in negotiations/exploratory stage and could possibly not be built. He stated that if SD17 is not built, other projects will be added to the CIP plan in its place. He stated that all other projects listed are planned for construction.

Chief of Engineering Posada presented a slide presenting the details of all CIP projects that are in contingency, slated for construction, and scheduled to be completed in FY08 and their projected costs (see attached copy of presentation). He noted that in FY08, 26 CIP projects have increased in cost, 15 have decreased in cost and 24 have remained unchanged. He stated that the total net change was $112,000, or .06% of the total proposed CIP budget of $191,500,000 for FY08. He also shared that included in the FY08 CIP budget are three (3) projects that will require an additional year of cost and two (2) projects that changed in budget approach and scope that are now showing in the six-year review with a total cost of $4,142,000. He reviewed the CIP’s that increased, decreased, remained unchanged, and that changed in approach or required an additional year in detail (see attached copy of presentation).

Director Robak indicated that it was difficult to determine which project was which. For instance the 640-1&2 Reservoir, where is this project located. He inquired if there was a way to hyperlink the CIP that is on the network to a map with information about the project. Chief of Information Technology Stevens indicated that that can certainly be done. He stated that staff could create a layer in the GIS project that links to information about CIP projects.

Chief of Information Technology Geoff Stevens indicated that the Information Technology projects are focused on three major items.

- Improving the quality and integrity of the District's data.
- Adding new technology projects that take advantage of innovation
  - Adding GPS technology to the field vehicles
  - Implementing automation in the field
- Integrating the key District data systems, such as, GIS, utility billing, finance systems and IMS.

He stated that the District is continuing to improve the integration of the OIS systems and is starting to see the benefits from the integration. Business processes are becoming more efficient (processes are speeding up) and the systems' data is becoming much more accurate. The District can also run reports automatically with the new systems. He noted that a second data center is being added in the operations building which will further improve reliability. He also stated that the new field mobile computers are allowing data to be input into the work orders as work is completed in the field. He stated that these systems are increasing speed and accuracy which is enabling the District to hold the employee headcount steady and, thus, reduce costs.

Accounting Manager Bell indicated she wished to follow-up on Director Bonilla's question earlier during the meeting concerning the current number of District potable meters. She indicated that the District has approximately a total of 45,600 meters of which 92% are residential and 8% are commercial. She stated of the 45,600 meters, 91.7% are ¾" meters.

She then continued with staffs' presentation on the budget and indicated that staff is presenting a balanced budget which represents a diversified water supply. The budget includes water purchases from CWA and the City of San Diego for both potable and recycled water. She indicated that debt is no longer shown in the General Fund and will be included in the rate model within the funds that receive the debt funding. Lastly, property tax revenue assumptions are based on a better methodology and she indicated that the total estimated property tax revenue would be presented later during the meeting.

Accounting Manager Bell indicated that staff is projecting to serve approximately 48,640 individual customer accounts in the upcoming fiscal year (FY08). She stated that Finance had worked with the Engineering Department to develop the six-year meter sales projection (by potable, recycled and meter size) and had estimated last year a growth rate of 1.8%. She indicated that the District will be on target with this estimate. Next year, a 2.1% increase in potable meter sales and a 4.8% in recycled meters sales are projected. She presented a slide showing historical meter sales from FY03 to projected sales through FY13 and noted that at the height of growth in FY03 the District sold just under 2500 meters. She noted that sales have dipped to under 1000 meters in FY06 and is expected to climb to approximately 2000 meters in FY13, but sales are not expected to hit the FY03 levels in the future.

She indicated that potable revenues are expected to increase 10.1% or $4,375,700 which includes revenues from water sales, system fees, energy fees, MWD and CWA fixed fees and penalties. She noted that recycled revenues are expected to increase 33.3% or $1,491,900. The increase in revenues includes credits from MWD and CWA for recycled water sales, water sales, system fees, energy fees and penalties. She stated the increases are related to growth and rate increases from the prior year and upcoming year.

Director Robak inquired if there was a specific timeframe in which the District can receive those credits. It was noted that the agreement with MWD expires in 2016 and CWA's expires in 2022 for the credits. The credits are based on the District's acre foot (AF) sales of recycled water. CWA's rate per acre foot is reviewed yearly and could be adjusted (generally it is increased, but it could also be adjusted downward). It was noted that the credit was increased this year to $200/AF. MWD's credit is fixed at $185/AF.

Director Bonilla inquired how staff determines penalty revenues. Accounting Manager Bell indicated that staff looks at water sales. If water sales are expected to increase 5%, then penalties are expected to increase 5%. It was noted that the district did not collect all penalty fees last year as some issues occurred during the implementation of the fees within the new system. The issues have been fixed and the District will be collecting all penalty fees. Director Bonilla indicated that he would like to review the penalty fees at a future meeting.

Director Bonilla indicated that he is scheduled to take a flight that evening and must leave in approximately ten minutes. He indicated that he would like to make a motion to vote on the FY08 budget prior to the completion of the presentation. Following the vote, the board could continue with staffs' presentation.

A motion was made by Director Bonilla, seconded by Director Breitfelder and carried with the following vote:

Ayes:	Directors Bonilla, Breitfelder, Lopez and Robak
Noes:	None
Abstain:	None
Absent:	Director Croucher

to adopt Resolution No. 4097 to approve the 2008 Operating and CIP Budget, approve the fund transfers, and direct staff to proceed with the Proposition 218 hearing and notices for the recommended rate increases. If there are any material changes when continuing staffs' presentation, that the budget would be brought back for consideration and a revote by the board at another meeting.

Accounting Manager Rita Bell continued staffs' presentation and indicated that staff is projecting a 4.3% increase or $111,000 in sewer revenues. The increase in revenues is mainly due to the rate increase implemented during the last half of the fiscal year and the proposed 1.7% rate increase that will be implemented in January 2008. She stated that the revenues also include penalties.

She noted that other revenues include:

- Meters Fees increasing by 14.4% ($40,000) due to higher meter sales estimates based on growth (1.8% in FY07 to 2.1% in FY08)
- Capacity Fees increasing by 41.4% ($414,300) due to under-budgeting of operating projects funded by capacity fees in the prior year
- Non-Operating Income increasing by 0.4% ($6,100) due to:
    - Grant revenue increase of $172,000 and there is a related expense which will be presented later during staffs' presentation
    - Property rentals decrease of $230,000: This is tied mainly to the cell site leases as many of the cell site contracts were not signed and there is rental income associated with the cell sites.
- Tax Revenues increasing by 16.8% ($576,400) due to:
    - 5% growth in FY08 (This percentage was an estimate from the County of San Diego. It is very conservative figure. However, based on the housing market, staff did not wish to be to aggressive with the growth figure.)
    - 11.8% adjustment to FY07 projection which is based on what was actually collected in FY07.

Director Robak inquired when staff refers to cell sites leases, were they referring to existing leases not being renewed. Accounting Manager Bell indicated that they were new cell site contracts that were pending. She stated that last fiscal year the District had nine pending contracts and three were completed. She stated that the pending contracts may or may not happen.

She reviewed the details of the estimated FY08 expenditures for water (see attached copy of presentation) which is projected to be $66,169,200. This is $7,098,600 above FY07 budgeted expenditures. She also presented a slide showing the District's sources of water which includes the new sources of potable water from the City of San Diego's Lower Otay Reservoir and reclaimed water from their South Bay Water Reclamation Plant. She noted that the Lower Otay Reservoir will not be able to operate at maximum as previously anticipated, so the District has revised its estimate to a match what the city is able to deliver. As such, the District will not be purchasing as much water as it originally estimated from the Lower Otay Reservoir. Accounting Manager Bell indicated that the change is revenue neutral as there is an expense offset of lower fuel costs as the District will no longer need to pump as much water from the Lower Otay Reservoir into the District's service area.

She stated overall, the District has a water cost increases of 11.1% or $3,014,300 which includes:

- Variable Cost Increase
    - Potable increase of $2,765,900

        - Estimated water purchases reflects the District's growth increase of 2.1%
    - Recycled decrease of $313,700 as the District will be purchasing less expensive water from the City of San Diego South Bay Water Reclamation Plant.
- Fixed Cost Increase of $562,100
    - Represents rate increases from MWD/CWA and City of San Diego

Accounting Manager Bell indicated that power cost for FY08 will increase 4.7% or $127,000. This includes the following cost increases:

- Water demand increase of 2.1%
- SDG&E rate increase of 2.5% effective on January 1, 2008
    - She noted that the increase is mainly attributed to SDG&E rebates going away in FY08 and, thus, the District will be paying the full cost for power
- New pumping costs from the South Bay Water Reclamation Plant to the District's recycled service area

Chief of Administration Rom Sarno reviewed the labor and benefits expenditures proposed for FY08. He indicated that the senior management team reviewed personnel requests from the departments based on work load requirements and existing vacancies. After the review, it was determined that the District can delete two vacant positions reducing the FTE count from 174.75 to 172.75. General Manager Watton indicated that the two positions were from the Engineering Department. He stated that staff is always evaluating vacancies and where it can redeploy human resource assets. He stated that the Engineering Department recently did a study on outsourcing and the department needs. It was determined that, with the additional outsourcing, the department was able to delete the two vacant positions. It was noted that the workload is not being reduced, the District is just utilizing a different means to accomplish the work.

Chief of Administration Sarno indicated that salary and fringe benefits increased 6.8% or $998,100. He reviewed the costs in detail (see attached copy of presentation) which included a labor cost decrease of 0.2% or -24,500 due to vacancies, two deleted positions, in-range adjustments and a cost of living increase of 3%; benefit cost increases of $223,500; and the shifting of labor cost from the CIP budget to the Operating budget totaling $797,800.

Accounting Manager Bell then reviewed the District's estimated administrative costs which increased 25.6%. She stated the increases are due to three main categories:

- Significant long-term planning projects in the Engineering Department
    - Water Resources Master Plan ($250,000)
        - This is a two-year project and it is estimated that the District will spend approximately $500,000 over two years
    - Rehabilitation and Replacement ($150,000)

        - It is estimated that the project would cost approximately $400,000 over two years.
- Costs Associated with Conservation Grants
    - Incentive budget was increased to $259,900 for the following projects/programs
        - Valhalla High School Artificial Turf Installation Project, $90,000
        - Monte Vista High School Artificial Turf Installation Project, $120,000
        - Cash for Plants Program, $20,000
        - Large Landscape Program, $18,500
    - Offsets to the Incentive budget include:
        - Valhalla High School Artificial Turf Installation Project Grant of $50,000
        - Monte Vista High School Artificial Turf Installation Project Grant of $100,000
        - Cash for Plants Program Grant of $14,000
        - Large Landscape Program Grant of $8,000
    - The total net budget impact is $78,900
- One-time legal expenses for pending litigation of $538,000.

Director Robak inquired if the District has money budgeted for artificial turf installation incentives for residential customers. Conservation Manager William Granger indicated that the monies budgeted for artificial turf incentives are mainly for commercial installations. He stated that the "Cash for Plants" program does have a little flexibility and provides incentives for artificial turf installation (about 25% of single family homes could involve some artificial turf installation). There are conversations at CWA to explore the Las Vegas model and in July the MWD board will vote on a program which reimburses homeowners $.30/square foot for the installation of artificial turf. He stated that CWA is proposing $.20/square foot for a total incentive of $.50/square foot for both commercial and residential customers. It was noted that the District does not have its own incentive, but is eligible to provide the $.50/square foot incentive to its ratepayers.

Accounting Manager Bell indicated that material and maintenance expenses decreased 3.7% or $170,800 overall for FY08. She noted the decreases included:

- Metro O&M costs are down for an overall decrease of $141,200
- Fuel & Oil decreased overall by $196,000 due to:
    - The need to pump less water from the City of San Diego's Lower Otay Reservoir which decreases fuel costs by $209,400 which is offset with an overall fuel cost increase of $13,400
- Increase in cost of contracted services of $107,500 which includes janitorial services, air conditioning repair/maintenance, landscaping services, painting, gates and fencing, and parking lot maintenance.
- Increase in supply costs of $58,900 for chemicals, meters, parts and supplies (mainly in the operations department).

She indicated that the last area she wished to cover was the District's reserve funding. She noted that last fiscal year the District mainly funded its replacement reserve. Staff is recommending that the District fund the Replacement, Expansion and Betterment reserves from the General Fund in addition to the $16 million reserve fund transfers. She stated the funding would be in accordance to the Reserve Policy.

She summarized the revenues and expenditures budgeted for the District's services for FY08:

• Potable Revenues and Expenditures	$57,235,500
• Recycled Revenues and Expenditures	6,125,200
• Sewer Revenues and Expenditures	2,819,400
TOTAL of	$66,180,100.

Accounting Manager Bell indicated that staff is presenting a balanced budget which meets the needs of its customers and is supported by a proposed 5.4% potable and recycled water rate increase and a 1.7% sewer rate increase. She noted that the rate increases would be presented for approval following a Proposition 218 Hearing which is scheduled to be held in September or October 2007.

Chief Financial Officer Beachem indicated that the District's rate model and budget build process provides staff a high level of confidence that the District is firmly grounded financially and is headed in the direction of the District's policies. He thanked the board for approving the FY08 budget.

Director Robak inquired with regard to the category "General Expenses" what the expenses included. Accounting Manager Bell noted that the items included in "General Expenses" can be referenced on page 35 of the presented proposed budget document (attached). It includes legal fees, general insurance, interest and benefits.

Director Robak also inquired how the District would plan for its finances during a drought. Chief Financial Officer Beachem indicated that as part of the BMPs, the District evaluated, approximately nine months ago, what a drought would do to the District's rates and reserves. He stated that with reduced water sales through mandatory cutbacks, the District would need to draw on its reserves as revenues would decrease. The District then would need to replenish the reserves through rate increases. He stated that a drought would not have a large dramatic affect, as the District plans its budget each year based on a six-year window, so the impact would be spread over the six years.

General Manager Watton also noted that there could be spike increases from MWD and CWA which would also need to be factored into the six-year rate model. He stated, again, with a six-year window, the effect on rates is "smoothed" over a six year period.

Director Breitfelder indicated that he recalled the District discussing a multi-phase plan for drought management. He inquired if the District had formally adopted a plan. General Manager Watton indicated that staff had touched upon it when discussing bonding and other District policies in case of a drought, however, he did not believe a plan was formally adopted. Director Breitfelder indicated that he recalled a workshop approximately a year ago in which staff had presented a very well thought out plan. He indicated that if the District had not adopted something formally, he felt that it should do so.

General Manager Watton suggested that staff could bring a discussion back in approximately three to four months. He stated that the District is currently working to schedule a Joint Agency Board Meeting with Helix WD, Padre Dam MWD, Sweetwater Authority and Lakeside ID to discuss water supply. Following this meeting, the District could schedule a follow-up meeting/workshop to discuss the District's plan for drought management.

Director Lopez commended staff for their good work on the budget. General Manager Watton asked Chief Financial Officer Beachem to convey to staff the District's thank you for their hard work. He thanked the board for their support.

6. ADJOURNMENT

With no further business to come before the Board, Vice President Lopez adjourned the meeting in at 5:37 p.m.

____
President

ATTEST:

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District Secretary