MINUTES
NORTHEAST OHIO REGIONAL SEWER DISTRICT
BOARD OF TRUSTEES MEETING
APRIL 26, 2016

Meeting of the Board of Trustees of the Northeast Ohio Regional Sewer District was called to order at 11:13 a.m. by Darnell Brown.

I. Roll Call

PRESENT: D. Brown
R. Sulik
W. O'Malley
J. Bacci
T. DeGeeter
S. Dumas
R. Stefanik

The Secretary informed the President that a quorum was in attendance.

II. Presentation

Mr. Brown advised that the purpose of the meeting was to review the comprehensive cost of service rate study and affordability analysis.

CEO Ciaccia stated that every five years the District revisits the rate structure needed to continue operations. The most recent rate study was initiated near the end of last y ear with many workshops between staff and Hawksley Consulting.

The last rate period from 2011 through 2016 averaged between 11 and 12% per year increases largely driven by the consent order the District entered into in 2010 for managing combined sewer overflow (CSO). The District achieved all financial goals and metrics during that period.

Jason Mumm and Carol Malesky from Hawksley were present to discuss assumptions that went into the determinations, goals, outcomes and financial position needed to carry out the operational core mission; obligations to the consent order; and carry out a reasonable amount of renewal capital replacement.

CEO Ciaccia advised that the District seeks to continue to fund important programs such as the Green Infrastructure Grants Program, Member Community Infrastructure Program and address customer class equity issues as it relates to cost of service and affordability.

Staff has made draft recommendations and intends to work with the Board to come to the final conclusion.

CEO Ciaccia advised that the recommendations are to raise the typical residential bill by 9.5% per year over five years and 8.8% for those on the Homestead Program; raise the industrial surcharge the full cost of service by 2021; enhance affordability programs; and have no increase in the stormwater fee.

Mr. Brown stated that a few Board members were not on the Board the last time the District adopted rates and finalized the consent decree. He noted it was important for everyone to understand that the U.S. EPA was originally pushing for a 13- or 14-year term to comply under a consent decree which would have been significantly more expensive. District staff was able to negotiate a 25-year term and affordability had not been considered for prior consent decrees.

Mr. Brown recalled a conversation in the past during which the U.S. EPA expressed a willingness to include green infrastructure -- which was a new phenomenon at the time -- to be incorporated into the consent decree. The District was at the front end of getting into green infrastructure when others had not even discussed it, which has been good for the region and organization.

Mr. Brown stated that he would like staff to emphasize that the capital program is a large driver for the rate structure itself, and the District has a number of existing facilities.

The District's consent decree would cost $3 billion over 25 years but there was likely another $3 billion in Operations & Maintenance costs for existing facilities over that same period.

The new facilities from the consent decree would add more Operations & Maintenance costs and impact future rates. However, he stated it is important to note the savings the District has achieved from bids and construction that have positively impacted this rating period and should be quantified.

Mr. Brown continued to note that the cost-of-service study implications are important to weigh (?) the rates for commercial versus industrial versus residential, because in some models commercial and industrial costs have been disproportionately borne by residential.

Mr. Brown stated that he would like to see the implications for the inclusion and exclusion of certain District programs not only in terms of the actual rates, but also the benefits to communities, ratepayers and environmental impacts. CEO Ciaccia advised that they will discuss everything Mr. Brown mentioned a nd that they have also considered alternatives with and without certain programs.

Mr. Brown noted that Mayor Bacci was now present.

Ms. Malesky advised that Hawksley began the comprehensive examination of rates and charges in July 2015. The general assumptions drive the rate recommendations and start with a decrease in consumption which drives down revenues. The decline in consumption for this rate period is assumed to hold steady at 2% each year.

The second assumption is a 95% annual revenue collection rate, leaving 5% of revenues uncollectible.

The third assumption is no use of reserves, meaning rate stabilization reserves and equipment repair and replacement reserves.

The fourth assumption is increased incremental Operations & Maintenance costs associated with the capital program.

The fifth assumption is 90% cash flow for capital projects.

Assumption number 6 is that the State Revolving Fund Loan through the Water Pollution Control Loan Fund (WPCLF) will be able to fund $50 million per year of the capital program.

The seventh assumption is that Homestead and Affordability Program participation will increase to 80%.

Mr. Brown inquired whether staff knows the targeted areas where people may be eligible. CEO Ciaccia affirmed and explained that the District reaches 50% of households eligible for the income-based rate. Although they want 100%, for purposes of the study they will assume 80%.

Mr. Brown indicated he appreciate setting milestones for each year.

Ms. Malesky stated that assumption number 8 is that as costs and rates increase the affordability discount of 40% will be applied to the fixed charge.

The ninth assumption is that the Member Community Infrastructure Program will be funded and begin in 2017.

The tenth and final assumption is smooth or gradual rate increases.

Ms. Dumas questioned whether the affordability discount being applied to the fixed charge has been historic. CEO Ciaccia explained that the Cleveland Water Department moved to a fixed rate structure a couple of studies ago and the District moved towards one and did not have that discount on the fixed rate for Homestead . This round includes a proposal to put the 40% discount on the fixed rate for the Homestead customers.

CEO Ciaccia stated that staff is proposing to increase the fixed rate and that becomes more burdensome to those on Homestead. That is why staff felt it was necessary to apply the 40% discount on those customers.

Ms. Malesky advised that there are three management targets that drive revenue requirements.

In order to maintain a good credit rating and good standing with bonding agencies the District will need to meet the debt service coverage targets. The target set by management for total debt service is 1.5 times the annual debt service. The management target for revenue bonds is 2 times the annual revenue bond debt service.

Item 2 is to maintain at least 400 days' cash on hand, which is a good indicator of strong liquidity.

The third target is funding 25% of the capital improvement program which would be funded each year with cash rather than debt.

Ms. Dumas inquired what the debt service requirement on revenue bonds is. Ms. Malesky advised that for your bond covenants 1.0 times annual debt service is a coverage goal, but the Board has set a target of 1.05 times all debt, while management is targeting 1.5.

For revenue bonds, the bond covenant states that the coverage requirement of 1.15 is the target. The Board set a target of 1.25 times annual revenue bond debt service, and the management target of 2.0 is significant and substantially satisfying what bond agencies like. The bond agencies like to see high debt coverages ratios and expect them in order to award a high bond rating. Maintaining healthy coverage ratios will help maintain the strong bond rating and reduce the cost of debt, thereby reducing the cost to your customers.

Ms. Malesky advised that Hawksley also ran scenarios with higher and lower debt service percentages. Mr. Brown stated that the Board would like to see other scenarios and their impacts on rates.

Ms. Malesky advised that cash balance targets are key towards a good bond rating. Hawksley proposes to draw down cash on hand to the minimum of 400 days. Funds in the capital project accounts can be used for capital projects and programs and some operating reserves that are proposed to be drawn down.

The ending reserve fund balance does not fall below $200 million per year, which will help reduce future borrowing by drawing down cash but maintaining a good credit rating by keeping liquidity.

Mr. Sulik inquired what would happen if it were to go to 300 days' reserve. Ms. Malesky explained that the rating agencies have different scales and scores they award to a borrower.

Jennifer Demmerle, Chief Financial Officer (CFO), advised that 400 days' reserve is what bond rating agencies prefer as a minimum for those with the District's credit rating. The District will issue so much debt over the next 5 to 15 years that they like to see liquidity to offset that. 400 days is their minimum for an AA+, Aa1 credit rating, such as the debt service coverage of 2.0 and 1.5. Dipping below those coverages and days of cash could affect the credit rating.

Mayor Stefanik inquired what the cash balance targets were for the last rate period of 2011 to 2016. CFO Demmerle indicated that she would get back to the Board with that information. However, the District's credit rating was upgraded in 2010.

Mr. Sulik questioned what the difference would be in the bond rating to go below those coverages. CFO Demmerle stated that the agencies would probably downgrade the District at least one notch which would be an interest rate of 15 basis points. A $300 million issue over 30 years would cost an additional $7 million.

Ms. Malesky stated that the projected change in annual revenue requirements increases by 14% from $273.5 million in 2016 to $313.1 million in 2017. The remaining is driven by additional expenses for SSES studies and operations and maintenance on completed capital projects.

That jump in Operations & Maintenance costs and operating expenses is due to the incremental costs for new capital projects. The Member Community Infrastructure Program is also expected to commence in 2017. After 2017, Operations & Maintenance costs average an increase of 3% per year due to the inflation rate and the individual inflation assumptions on each operating cost categories.

Capital improvement projects planned during this 5-year rate period include both CSO-related and non-CSO related projects. 75% of the capital program will be for CSO projects.

Mr. Brown stated that the end of the next rate period would be about 10 years into the 25-year program and questioned what percentage of required capital construction projects will have been completed. James Bunsey, Director of Engineering & Construction, advised that the District will be $2 billion into it, and it is somewhat front-end loaded.

Mr. Brown inquired whether there are projects the District is required to build as part of the consent decree during this period of time. Mr. Bunsey indicated that the majority is consent decree-driven by schedule. Cash flow must be moved out as far as possible. Mr. Brown stated that he still like to know what it is.

Ms. Dumas requested such information be more folded into the presentation in terms of the bulk of activities by way of rate increases and required money is mandated in the consent decree. CEO Ciaccia stated that staff will follow up with a presentation specifically on that.

Mayor Bacci noted that what was supported by grant or federal dollars in the past is no longer supported.

Mr. Brown stated that making investments in local communities makes impacts environmentally and perhaps in terms of reducing the number of future projects. Quantifying that would be helpful because the ratepayers who pay increasing costs could see there is a benefit to member communities and the District.

CEO Ciaccia advised that the proposed Member Community Infrastructure Program would be supported by the Sewer System Evaluation Studies and has a two-fold benefit: communities with stormwater problems and limited funding would be incentivized to take on projects and the overall environmental benefit. The Board has not adopted this program yet, but was included in this rate study from a financial standpoint.

Moving forward in the discussion, Ms. Malesky advised that the typical bill by 2021 for a regular customer will include 37% going towards mandated CSO capital projects and 35% towards operating expenses.

The capital program cost translates into funding and the results are the capital revenue requirement.

Internally-generated capital funds are the cash piece that funds the capital program and the debt service is the result of either getting a loan or revenue bond for the rest of the projects. The split between loan and revenue bonds is almost 50/50.

Ms. Dumas questioned whether "the split" meant half through WPCLF and half through floating debt. Ms. Malesky stated that the 50% is actual debt service that results from borrowing; the $50 million per year would result in a debt service payment. Over time it is about 43% with the loans and 57% would be revenue bond debt service each year.

CEO Ciaccia explained that for the purposes of the study, staff is contemplating $50 million per year from state loans because they have a lower interest rate and issuance cost. Previously state loans were only 20-year terms with no refinancing; restrictions made them less competitive than bond funds. Now that the restrictions were loosened the interest rate and issuance costs are more attractive than bonds.

Ms. Malesky advised that if the District did not change rates, revenues would decline entirely due to declining consumption. To address those changes the proposal is to increase rates by 9.5% per year. The current rate structure in 2017 would have a revenue shortage of $39.6 million; the annual increases will recover the shortfalls.

Ms. Malesky explained that the proposal is not to increase rates uniformly across the current rate structure. The following was proposed the existing rate structure. The proposed increase would be to increase the proportion of revenue collected from the fixed cost recovery charge and would be billed monthly instead of quarterly; the Affordability and Homestead discounts would be applied to that fixed charge; and the industrial surcharges would be adjusted to reflect the cost of service. A cost-of-service analysis was conducted to determine the cost to remove pollutants from the system.

Ms. Malesky advised that offsetting these changes to the fixed-cost recovery charge and the industrial surcharge, would be to a change to the volumetric charges. The existing fixed-cost recovery charge recovers 3.25% of total rate revenue and covers inflow and infiltration (I&I). Although those costs are not billable, they are real.

Ms. Malesky stated that a fixed charge is based on billing and administrative costs. This charge would recover a bigger portion of the fixed costs of the system and would increase by 9.34% by 2021. This change would be phased in over the five-year rate period; it will go from $3.90 in 2017 to $9.90 per month by 2021.

Mr. Brown stated that treating unmetered stormwater essentially spreads the cost across the ratepayers and ultimately he does not want to let member communities off the hook for their responsibility in terms of I&I. CEO Ciaccia stated that a good portion of unbilled water is in the combined system and it is designed to take unbilled water.

Mr. Brown stated that the bigger issue is exfiltration. CEO Ciaccia advised that is one of the things he hopes to accomplish through the Member Community Infrastructure Program and take on some of the I&I challenges.

CEO Ciaccia explained that staff thought I&I was a convenient way to recover fixed costs, but I&I is flow and volumetric whether it goes through the meter or not. Such flow belongs as part of the volumetric charge and that is why they are moving to the billing and administrative methodology for capturing the fixed costs.

Mr. Brown stated that if that works in the future there could be a flattening of the rates if volumes are reduced. CEO Ciaccia advised that of the 90 billion gallons per year, 64% of the water the District treats never passes through a meter,. Removing some of that flow would drive down Operations & Maintenance costs and that is a goal.

Ms. Malesky stated that annually the fixed charge increases by $1.50 through 2021.

As previously mentioned, a cost-of-service analysis was completed to review the cost to treat pollutants, total suspended solids, biological oxygen demand (BOD) and chemical oxygen demand (COD).

BOD and COD work together so surcharge customers are charged the higher of the two. They are also charged for extra strength. Industrial surcharge customers still pay for normal domestic strength, but anything over the domestic limit a surcharge is applied.

This fee is proposed to increase significantly because the current surcharges recover only 31% of the cost of treating high-strength waste. The residential customers, in their rates, have been picking up the difference.

Mr. Brown inquired whether shifting costs to where they should be results in a positive impact to residential customers. CEO Ciaccia affirmed that collecting costs from those incurring them has a positive impact on the residential class.

Ms. Dumas questioned whether industrial customers are aware of the severity of the increase. CEO Ciaccia stated that there are 150 customers they have not officially been informed of the analysis.

Mr. Brown inquired whether there was a relationship between the charge against them and what they are required to do in terms of pretreatment. If they did more towards pretreatment that they discharged less, would that be reflected in the charge. Scott Broski, Supervisor of Environmental Services, advised that it would and the surcharge thresholds for these pollutants are not limits. A business can decide whether it more cost effective to install treatment and reduce pollutants or to pay the surcharge.

Mr. Sulik questioned how much revenue is generated from the 150 accounts. CEO Ciaccia indicated it is about $2.6 million; by 2021 that figure would reach $8.6 million.

Mayor Stefanik inquired whether such rate increases were typical throughout the country. Ms. Malesky indicated that many other utilities were already charging higher rates than the District. The industry's approach to calculating surcharges is on a cost-of-service basis. Hawksley follows the Water Environment Federation Manual of Practice for determining surcharge units and surcharge costs.

Mayor Bacci questioned where the District's industrial rates stood in terms of the region. CEO Ciaccia advised that staff will look into that; the previously rate study indicated that the District was higher than center. The District and Cleveland Water have raised rates for many years and invested billions of dollars in infrastructure. Many cities have invested very little in their infrastructure and have not raised rates.

Mr. Brown stated that all of them will have to make those investments eventually and the District is ahead of the curve in terms of the condition of its facilities. For those reasons some rates might be misleading.

CEO Ciaccia advised that staff will formulate a chart. Prior to the consent decree, the District invested over a billion dollars for CSO. Any deferred action results in the escalation of costs for these big programs. Every day of deferral is about $230,000 a day worth of additional escalation costs.

Mayor Bacci questioned how other regions intend to catch up. CEO Ciaccia stated that they will be under consent orders like Akron, which has increased their rates by over 260% in the last 10 years.

Ms. Malesky stated given the changes in the fixed charges and in the industrial surcharges we will have to recover the full revenue requirement through the volumetric rates. She then referred to a table and advised that in 2016 the fixed-cost recovery charge on a monthly basis is $2.40. The Homestead/Affordability rate is the same, but the Subdistrict 1 regular volumetric rate is $78.05 per MCF.

The proposed rates for 2017 contain the fixed charge for regular customers of $3.90 per month and the fixed charge for Homestead would be $2.30. The volume rate per unit would be $83.90 for Subdistrict 1 and the Homestead rate would be $50.35. On average the rates increase 7.7% under the management target scenario.

Typical bills for a regular Subdistrict 1 customer and regular Subdistrict 2 customer assume usage of 0.625 MCF per month.

During 2016, a bill for a Subdistrict 1 customer would be $51.18 and would increase by $5.16 per month to $56.34. Adding the stormwater fee to the bill the customer would result in $5.16 for a Subdistrict 1 residential customer. The difference in cost for Homestead and Affordability customers is about $2 for Subdistrict 1 and just shy of $2 in the first year in Subdistrict 2.

Mayor Stefanik stated that customers are used to paying quarterly rather than monthly and questioned whether the stormwater fee will be included on the regular sanitary bill next year. CEO Ciaccia affirmed but pointed out that some accounts only get a stormwater fee on a separate bill.

Ms. Malesky advised that projections for 2021 for the typical user has the same monthly usage and the fixed portion is \$9.90, with the volume portion at \$71.41 per month for a total of \$81.31 of a monthly bill.

Mr. Mumm stated that affordability has been a major component of the study. Hawksley developed analytical methods for testing outcomes against the socio-economic demographics for the District almost in real-time. They were keenly aware that even within a census track income can be distributed vastly differently. The points on mitigating rate impacts speak to the programs currently in place and their importance in the community.

The number of participants currently in the Homestead or Affordability programs is about 30,000. There are almost 31,000 households that are eligible but not yet participating. Tenants not billed by the District are sent to the property owner. They are not eligible but also do not receive a bill directly. About 83% of the households served by the District are either participating in these programs or are tenants who do not qualify. That leaves room for improvement. About 50% of eligible households are participating. Management and staff would like to increase that by 2021 to 80%.

Ms. Dumas questioned why tenants who are not eligible would be part of the focus group for the program. Mr. Mumm advised that it was to identify a large segment of the population that does not receive bills therefore when looking at how to expand the program you come up against this issue..

Ms. Dumas stated that there is no possibility of expanding a program to a poor tenant because the owner pays the bill. CEO Ciaccia explained that it is important from the point of trying to understand the households that are 200% in poverty to whom the District is serving water. There is a sense that a large number of people cannot afford their bills but only 33% of them receive them. He noted that the District must be sensitive to renters because those costs are passed on.

CEO Ciaccia advised that he was recently on a blue-ribbon panel for the City of Detroit regarding affordability. The poverty level in Detroit is somewhat higher than Cleveland's but not appreciably, and they were being criticized for turning off service to those who did not pay their bills. He contemplated why the Cleveland area did not have the same problem.

CEO Ciaccia noted that in Detroit they bill to "resident" rather than property owner, so they billed those in poverty at a rate much higher than the District's 33%. It was important to understand the complete population of homes in poverty in order to do this analysis.

CEO Ciaccia stated that the next steps are to meet with key stakeholders, including Cleveland Mayor Jackson, the Suburban Council of Governments and Cuyahoga County Executive Budish.

Constance Haqq, Director of Administration &External Affairs, advised that the District's goal to provide audiences with an understanding of the need and process we used for rate increases, and to make customers aware of how the dollars are being used. Staff also wanted to demonstrate in tangible ways how the District has been fiscally responsible and efficient over the last five years and what is planned. The District will be conducting four "road shows" to talk about the work of the District and special presentations on how rates are calculated.

District staff will also have editorial board meetings with Crain's, *The Plain Dealer* and *Akron Beacon Journal*.

The overall goal is for communication is so no one is blindsided by the rates and everyone who has questions has an opportunity to ask them.

CEO Ciaccia advised that the one item for consideration today is a resolution request authorizing the distribution of proposed revisions of Title 1 and Title 5 of the Code of Regulations to member communities pursuant to District bylaws/procedures. He explained that any time rates are modified they also must modify Title 1, which by bylaws are sent to the communities as information. Title 5 is the Stormwater Program, which has no increase in fee but the dates are being extended through the five-year period.

Mr. Brown expressed concern that communities might infer that this is the proposed rate structure the District will be seeking and he thinks more discussion is needed. He requested copies of the questions asked today along with responses and the communications plan. Ms. Dumas stated a preference for leader outreach before sending out notices.

CEO Ciaccia accepted that approach and stated that when it comes time to change Titles 1 and 5 staff will, in accordance with the bylaws, put out a 30-day notification.

Mr. Brown further requested scheduling a couple of working meetings for the Board for due diligence. CEO Ciaccia advised that he will schedule at least one special meeting for this specific topic.

Mayor Stefanik stated that he would like to convey under the summary part of the resolution for the 30-day notice that this is a recommendation from the consulting firm that staff has vetted and is recommending to the Board to consider.

Mayor DeGeeter requested a list of the 150 industrial customers, and additionally, to see an example of the "road show" presentation during the next Board meeting.

Mayor Bacci requested data on the road shows as it relates to attendance and how the District is pushing back on the consent decree in terms of the 2% household for sewer rates threshold.

Ms. Dumas inquired whether there is a plan for getting to 80% affordability participation. Ms. Haqq affirmed and explained that knowing where those residents are makes it easier.

Ms. Dumas asked Mr. Mumm and Ms. Malesky whether Hawksley has conducted rate studies for other utilities. Ms. Malesky affirmed that they have worked for a number of similar utilities.

Mr. Brown requested a list of the utilities.

III. Adjournment

MOTION – Mr. Brown stated business having been concluded, he would entertain a motion to adjourn. Mayor Bacci moved and Mr. Sulik seconded the motion to adjourn at 12:57 p.m. Without objection, the motion carried unanimously.

Walter O'Malley

Walter O'Malley, Secretary
Board of Trustees
Northeast Ohio Regional Sewer District

Darnell Brown

Darnell Brown, President
Board of Trustees
Northeast Ohio Regional Sewer District