MINUTES
NORTHEAST OHIO REGIONAL SEWER DISTRICT
BOARD OF TRUSTEES SPECIAL MEETING
JUNE 14, 2016

A Special Meeting of the Board of Trustees of the Northeast Ohio Regional Sewer District was called to order at 10:30 a.m. by Darnell Brown. The purpose of the meeting was to conduct a working session with District staff to review and consider rate adjustment scenarios, options and related items for years 2017-2021.

I. Roll Call

PRESENT: D. Brown
R. Sulik
W. O'Malley
J. Bacci
T. DeGeeter
S. Dumas (arrived at 11:00 a.m.)
R. Stefanik

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

II. Presentation

Mr. Brown thanked everyone for continuing the due diligence required with respect to the setting of the rate structure for the Northeast Ohio Regional Sewer District. At the end of the last meeting the Board was presented with a number of scenarios. The Board asked for an opportunity to review them and be in a setting to ask questions specific to things that impact the proposed average rate structure for the following five years.

Summarizing recent meetings, CEO Ciaccia stated that the rate-setting process began with the hiring of a rate consultant, Hawksley Consulting, to conduct a rate study that started early last year. 2016 was chosen as the base year in projecting forward based on assumptions over a 10-year period, while targeting the next five years for the purposes of rate authorization.

The District held a number of internal workshops early this year with the rate consultant, during which staff and rate consultant worked through issues related to the assumptions and revenue needs. Ultimately, staff presented the Board a recommendation of a scenario that was essentially a 9.5% per year increase in revenues. Subsequently, the Board held a Special Meeting Work

Session, during which 13 alternative scenarios were presented. The next regular Board Meeting included the addition of four more scenarios from scenario number 8.

That scenario would access the Water Pollution Control Loan Funds (WPCLF) more significantly by endeavoring to get as many qualified projects funded through it as possible as opposed to through bond funds because of lower interest rates and issuance costs. CEO Ciaccia explained that once he confirmed with the director of that program that the funds would be available, he felt very confident that scenario would be the best.

Staff determined that this scenario might result in a higher potential rate during the second five-year rate period than they were comfortable with and formulated four hybrids of that scenario.

CEO Ciaccia advised that the first scenario under consideration included 100% WPCLF loans, establishing the Member Community Infrastructure Program (MCIP) for $7 million in 2017 and 2018, $12 million in 2019, $15 million in 2020 and $20 million in 2021. The program was intended to increase to a maximum of $30 million over time. This scenario does not contemplate utilizing rate stabilization funds.

Scenario No. 2 includes 100% WPCLF loans and phasing in the slightly reduced MCIP. The result is an 8.5% per year increase but yields a better result in the next rate period.

CEO Ciaccia explained that what happens during 2017 through 2021 will have a major effect on the next rate period. Successfully carrying out Project Clean Lake or the Capital Improvement Program in a more economical way would have positive effects, but if everything were static the next rate period is projected for 9.7% per year increases. The goal would be to have a lower rate by that time.

Scenario No. 3 includes 100% WPCLF loans with no MCIP, which results in an 8.5% per year increase, but the next rate period is lower because there would be no expenditures for the MCIP.

Scenario No. 4 includes 100% WPCLF loans, keeping the MCIP at a higher level and using the Rate Stabilization Fund one time while replenishing it. The result would be an 8.3% revenue increase in this rate period and a little higher in the subsequent rate period.

Scenario No. 5 is 100% WPCLF loans, phasing in the MCIP and using the Rate Stabilization Fund. This result has the most favorable results from a percentage standpoint: 8.3% in this rate period and 9.6% in subsequent rate periods.

CEO Ciaccia advised that rating agencies have changed how they look at the use of the Rate Stabilization Fund, and it will not be very beneficial for what it had been originally intended. However, the District is sitting at 600 days cash while only required to have 400 days by our bond indenture. During the rate-setting process the goal was to use $200 million of that cash to keep rates low. That action is included in the numbers and the use of the Rate Stabilization Fund is not that big of a risk during this rate period because it will be replenished.

CEO Ciaccia stated that the only risk with these scenarios is if the State cannot make the loans available, but he is confident the District will be successful.

Mr. Brown stated that the original presentation was a 9.5% per year increase and it is now 8.3% to 8.5%. The question is what is reasonable based on the long-term control program and other operational costs. Based on assumptions and predictive models, the District determines what mitigates risk as an organization while being cognizant that ratepayers will be asked to support it.

The District has a major opportunity for 100% WPCLF project eligible loans for what is needed for projects and operating costs. The issue becomes how much those loans costs over that period of time. While utilizing the Rate Stabilization Fund should not be done routinely, utilizing it once and replenishing it keeps the District in good standing with the rating agencies. He further stated that another critical issue will be the criteria for the MICP and making sure projects associated with it bring the benefits that were intended. One of the tenets of over the next rating period is the affordability program and the impact identifying more eligible customers who have not taken advantage of it.

Mr. Brown stated that had the District not saved $300 million through value engineering the rate increases for the next five years would have been 10.4%. He expects similar value engineering during the next five-year period and should it be a factor in the subsequent five-year rating period, possibly resulting in a lower rate for that second rating period.

CEO Ciaccia advised that the district has not accessed State loans to this level because of the way they were structured. The Board has not yet adopted the MCIP and a discussion will be held in the future in terms of the criteria and how it will be managed. Outreach regarding the affordability program will expand. Staff is having discussions with the U.S. Environmental Protection Agency (EPA) about modifying the consent decree, which could result in additional savings, but that is presumptive at this point.

James Bunsey, Director of Engineering & Construction, explained that the best savings opportunity is during the planning phase of a job. The majority of large savings over the next 10 years have been identified. While savings are expected during the second rate period, the largest percentage has been identified in the planning phase.

Kellie Rotunno, Chief Operating Officer, stated that much of the value engineering that has been identified that could lower rates during the next rate period is contingent upon the U.S. EPA accepting value engineering modifications. Those savings cannot be counted upon until the terms of the consent decree are successfully negotiated.

Mr. Brown inquired when that will occur. COO Rotunno advised that a meeting with the attorneys may occur in July. Technical teams have flushed out most of the details and identified more cost-effective projects.

Mr. Brown stated that what was learned during that five-year period would carry over to the next period of planning and execution of contracts. While future value engineering may not reach $300 million in savings, perhaps it could reach $100 million to $200 million. He inquired whether those figures were included in its effect on the second rate period. Mr. Bunsey explained that the next five years do include the impact of value engineering. Any savings accrued during the next five years would be from changes in construction.

Mayor Stefanik questioned whether anticipated value engineering savings is included in the second five-year rate period projections. CEO Ciaccia affirmed and explained that the projected rates for 2022-2026 is a frame of reference based on the current trajectory. The previous rate study projected 9.5% per year increases for 2017 through 2021. The numbers presented now are 8.3% to 8.5%; staff hopes to achieve a lower rate than the projection by the time the Board must consider rates for 2022 through 2026.

Mr. Brown stated that the bottom line is managing expectations and setting realistic goals for the Board to hold staff accountable. He was looking at the five years beyond the next rate period and trying to get to a level of comfort that the 9.6% rate takes into account similar value engineering results. What the District does now will impact subsequent rating periods and he wants to be clear with the Board and public where it is going.

CEO Ciaccia stated that the District will adopt rates for 2017 through 2021 that will be lower than projected during the last rate period. The current projections for 2022 through 2026 are merely frames of reference staff wants to change. Should the EPA agree to the District's proposed consent decree changes most of the benefits will be realized during the third rate period.

Jennifer Demmerle, Chief Financial Officer, explained that every year during the budget process staff presents a 10-year financial plan, which would show whether the District was veering off course.

Mr. Sulik inquired whether the MCIP has a matching fund with communities. CEO Ciaccia indicated that it may be 75% District and 25% community, but the details are yet to be determined. He further stated that phasing in the program may be more advisable.

Referring to previous conversation regarding a customer's typical bill, Mr. Brown stated that the combined sewer overflow (CSO) program was 35% of it and operating expenses were 33%. He asked for clarification regarding what is calculated in operating expenses. CFO Demmerle explained that a typical bill in 2021 would be $86, broken by categories. 49% of every dollar goes towards operating expenses -- salaries, benefits, chemicals, maintenance, and the other half was the capital program, of which 38 cents of every dollar goes towards Project Clean Lake or the CSO program. The remaining capital program was everything outside of the CSO program.

Mr. Brown stated that he wanted to know how much exactly makes up those percentages in terms of a dollar amount. CSO is broken down by cost and maintenance, and he inquired about the funding demands of the cost and maintenance of the capital program. Historically, staff knows the costs of the long-term control plan, but other infrastructure is another $3 billion.

Ms. Dumas inquired regarding the factors used for operating expenses. CFO Demmerle indicated that staff uses the 2016 budget as the baseline and escalates an average of 3% in either direction. Some percentages were 2% for personnel, 9% for benefits and various others averaged 3%.

Mayor Bacci requested showing the Board biannually a meter where the District is in the five-year plan. CEO Ciaccia stated that an update could be incorporated into the quarterly financial report in August.

Ms. Dumas inquired whether the rate projections were too conservative in terms of value engineering savings five years in the future. CEO Ciaccia explained that the initial 9.5% rate was conservative and that the 8.3% to 8.5% rate is less; 100% State loans have a certain risk.

CFO Demmerle stated that the 8.3% to 8.5% rates are more aggressive because they assume funding of $200 million per year without changes to the rules. The scenarios also reduce the uncollectable rate from a 5% to 4%. Consumption decrease is projected at 2% but in the past has been 3%. Operating expenses escalate an average of 3% and in the past was 4 to 5%.

Mr. Brown stated that an outcome of consistently meeting metrics is that the bar gets higher and should translate to more efficiency and less cost. His concern was setting a rate that is affordable but does not adversely put the District at risk in terms of its fiduciary responsibilities to rating agencies and customers.

Mr. Brown reiterated that he would like to see what comprises the 13% of other capital for the next rating period. CEO Ciaccia advised that the information would be supplied.

V. 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 2:34 p.m. Without objection, the motion carried unanimously.

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

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