

**Washington County Service Authority Board of Commissioners
December 2, 2008 Recessed Meeting Minutes**

The recessed meeting of the Washington County Service Authority Board of Commissioners was called to order by the Chairman at 7:06 PM.

ROLL CALL

Commissioners Present:

Mr. Gerald Cole, Chairman
Mr. Joe Chase
Mr. Frank Stephon, IV
Mr. D.L. Stout
Mr. Kenneth Taylor

Commissioners Absent:

Mr. Sam Blaylock
Mr. Scott Rector, Vice-Chairman

Staff Present:

Robbie Cornett, General Manager
Kim Roberts, Controller
Doug Canody, Chief Engineer
Amanda Paukovitz, Administrative Assistant

Consultant Present:

Mr. David Hyder, Municipal & Financial
Services Group

Also Present:

Ms. Dawn Figueiras, General Counsel

3. Approval of the Agenda

Mr. Cornett stated that he had no corrections to the agenda. Mr. Stephon moved to approve the agenda. Mr. Stephon's motion was seconded by Mr. Stout and was approved by a unanimous vote.

**4. Rates/Fees/Charges Workshop:
Municipal & Financial Services
Group**

Mr. Cornett introduced Dave Hyder with Municipal & Financial Services Group, who WCSA has procured to do a Rates/Fees/Charges Study. He explained that the aim for the meeting/workshop tonight is to

outline some alternatives for the Board that we believe are applicable to the Authority as far as rates/fees/charges are concerned. WCSA wanted to do so with the Board's input from the beginning, rather than wait for it until the end. Mr. Cornett explained that the aim is to have the Board involved all throughout the study, hence why we are starting the study off this way. Mr. Hyder introduced himself and thanked the Board for the opportunity to present tonight. He reiterated to the Board Mr. Cornett's summary of the presentation: a discussion, rather than a lecture; especially in regards to the policies and issues. At this point, he got started with his presentation. Mr. Hyder restated the agenda for the evening, which would include: talking about MFSG's background, a Rates 101 section, a Policies/Issues Discussion, in which he hopes to solicit feedback, and talk about what our next steps are. He talked a little bit about the firm (MFSG). They are located in Annapolis, MD. MFSG focuses on financial and management consulting services to local governments. Approximately 80% of their work is dealing with water and sewer settings, such as: water and sewer rates, creating authorities and doing management consulting related to infrastructure. The company was started in 1976 by the President of their firm, Mr. Ed Donahue. In 2002, they set up the firm as a separate entity for engineering firms, accounting firms, etc. In terms of water, they have a lot of experience with big clients like New York City and they've worked

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for very small clients in Alaska; they have a wide gamut of experience. MFSG works for a lot of towns, cities and authorities in Virginia as well. Next, Mr. Hyder wanted to go over the typical approach to setting rates. He gave an overview of the rate setting process. The first step is to identify the objectives: "Why are you doing this study, what do you want to accomplish, and what are the policy issues that are going to frame this study?" He plans to have further discussion with staff and with the Board tonight. Step 2 is to identify the cost to provide the service: "What is the cost of the operating system and what are the revenue requirements?" Step 3 is how we allocate those costs amongst our customers: "Who is causing us to incur the costs we are incurring?" The fourth step is to design the rate structure: "How are we going to price the service? We know how much we will be collecting and from what classes, but how will we price it?" Step 5 would be to implement the rate structure, educate the public, adopt the rates administratively, etc. In regards to the revenue requirements, which stems from Step 2, they include: operating and maintenance costs (any day to day expenses), your outstanding debt (both principal and interest), planned capital improvement projects, and any contributions to reserves. The sum of those building blocks is what it costs to operate the system. They not only want to identify what is in our budget and what is in our CIP, but also what WCSA should be doing; the true possibilities of service. They want to look at our investments vs. their useful lives to

identify what we should be charging for the true possible service, and the cost of it.

Mr. Hyder explained that the next step is to allocate those costs, and that is done based on AWWA Manual M1 Standard of Practice to allocate the cost. The way you typically allocate water costs is by looking at operating costs, which are allocated based on demand and usage. If you have a customer that peaks the system, those costs are allocated based on a max hour and a max day peaking factor.

Administrative costs are allocated based on customer units. For example, if you read a 10" meter vs. a 2" meter, there is no difference in cost. Administrative costs are typically divided by customer units. Capital costs are allocated based on your rate base. That essentially says that if you were to build a lot of storage capacity, the person that peaks the system should pay more than the customer that uses the same amount year round. In regards to Sewer Cost of Service Analysis, expenses are based on hydraulic and pollutant loadings. A higher potency, BOD, etc. causes you to incur higher expenses.

He stated that now that we have allocated the costs, the next step is to decide how to price the service. The Rate Design is one of the key aspects of the policy issue. A question that needs to be asked is, "Are there certain behaviors we want to encourage or discourage with how we price the service?" When he says price of service, he means certain things like, should we make it really affordable for someone who only uses a little bit of water vs. expenses

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for someone who uses water extravagantly. That will determine how we will price the service, and also will indicate the kinds of behavior we want to encourage. We want to make sure our expenses drive our revenues. Based upon those policy objectives, we want to develop a pricing structure, Mr. Hyder said. If we really want to make the service affordable for a low user, then there could be a very small minimum charge and a lifelong rate. It is important to be able to explain this rate structure, along with administer it for the public; it has to be administratively simple to explain and implement. If your billing software can't handle it, or if your customers will be left scratching their heads, then it's not a good structure. Lastly, you want to test the structure. You want to create a whole bunch of sample bills and say this is what the structure does to a low user, high user, commercial user, industrial user, etc.; this is to make sure the structure is doing what we want it to do. The three main things we need to do are: identify the costs, allocate the costs, and create a structure to bill the costs.

Next, Mr. Hyder moved into the policy discussion, which is where he was looking for the most feedback. He was hoping to discuss some typical policy issues, ranging from general to specific, based on Mr. Cornett's feedback. The first issue he discussed is paying for growth: "How are you going to pay for growth? Do you want growth to pay its own way, or do you want your distinct customers to pay for a portion of growth?" He explained that if you want growth to pay for growth,

you are essentially saying that we will adopt a connection fee that is going to be set at a level that will fully fund the capacity we are building to serve growth. A potential problem that Mr. Hyder noted is that it can create potentially high connection fees and you have to build that growth prior to it occurring. The problem with that is if the growth does not come as expected, the expense will still have to be paid for come payment time. Another option would be for growth to pay for a portion of growth. This philosophy assumes that some of your existing customers pay for some of your growth, which is often used to encourage economic development. If a company wants a specific type of industry to come into town, you wouldn't want your connection fees to be as high and you are less dependent on growth to fund capital expenses.

Mr. Hyder opened the floor for feedback from the Board. Mr. Cornett explained that he thinks it would be safe to say that Mr. Hyder has a pretty good grasp of the Authority based on his preliminary research. He sought Mr. Hyder's opinion, to which Mr. Hyder said based on his limited preliminary research, he would say WCSA over the years has exercised a policy of growth paying for a portion of growth. Mr. Cornett agrees that he thinks that is what the study will find, and that it is a great topic for discussion. Some pretty sharp criticism most notably from the Industrial Development Association with regards specifically to the system fee component of our connection fee; they believe it is anti-

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development, specifically anti-industrial development. More recently, we have had some prospective residential customers who have affordability concern with our residential connections. Mr. Cornett thinks historically speaking, we have had those two different groups of constituents. He would say our overall total number of connections each year since 2002 has been on the increase. What to consider is whether or not our system fee or connection fee has deterred growth in the county? His short response would be no. Mr. Cornett believes the total number of connections, which includes residential, commercial and industrial, has increased each year since 2002. However, he said that might be a catalyst in bringing up thoughts from the Board as to what might be most important to the Authority, as far as rates are concerned.

Mr. Reynolds asked about the ability to communicate about rates between counties opposed to the IDA's ability to communicate and pay for their expenses. Mr. Cornett shared that he has not spoke to other counties to find out how they manage industrial customers. For example, Pepsi Co. was going to emerge in this area despite the cost due to the location. There are two other ways that utilities like us manage large industrial users: 1) They may have a water treatment facility that is rather large or 2) Their customer base has been declining, so they need to sell water. In the former situation, they need/want growth so they need incentive to get companies in there so they may adjust the connection

fees accordingly to get that user. Other utilities who do not have the resources and would have to develop them to suit a customer of that size might not have the same incentives. What Mr. Cornett has seen happen more commonly, and the IDA partnered with WCSA in 1995 to do this very thing, is: they were preparing to build the Hall Creek Wastewater Treatment Plant and the IDA was building what is now known as Glade Business Park. They wanted to reserve or buy capacity in that treatment plant so they offered to pay a substantial amount of money to own 130,000 gallons of capacity in the system. This was long before the system fee structure, which is what WCSA has now. They bought and paid for 130,000 gallons of capacity. What they paid was probably the true cost of the capacity in that treatment plant; they probably paid the actual cost of the capacity in the plant. He explained that then we introduced the system fee that only requires that growth pays for a portion of growth; the system fee does not account for 100% of the cost to build a water/wastewater treatment plant. What most counties/towns/cities do when they don't also own the water/wastewater capacity that an industry will use is they do exactly what the IDA did in 1995; they pay for a portion of the plant. They have it for their own use to be able to direct that towards any industrial customer they want or wait until an industrial prospect comes along and make that a part of the package from the county and/or the state to the industry. Mr. Cornett does not know what they did in Wytheville as far as

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Pepsi is concerned, but there's another more recent prospect that is looking both here and in Wytheville. They shared the reported cost to connect in Wytheville vs. here, and he offered them some ideas about how Wytheville may manage it. The bottom line is Wytheville can't build water/wastewater treatment plants cheaper than we can; it's a matter of how you finance that. He doesn't know how they are doing it or how they have done it, but Mr. Cornett's guess is that the county is subsidizing it with the Town of Wytheville to get the industry to locate there. Our county seems to be unwilling to do so at this point, but they did do it in 1995.

Mr. Reynolds asked Mr. Hyder if he has had experience working with any of the counties mentioned, mentioned such as Pulaski, etc. Mr. Hyder responded that the farthest south they've worked with is Albemarle County. They have a very strong policy where growth pays for growth; they have the university there, and economic development is not an issue, he said. Mr. Hyder complimented Mr. Cornett on his input. Mr. Hyder said that there is no right answer, but when you have excess capacity, a majority of your costs to operate are fixed. If there is an excess of capacity, it would make sense to potentially lower connection fees. However, if you have limited capacity and you do lower those connection fees, you either need a subsidy through the county or your users in the county will have to subsidize it. It is do-able, but each entity has to ask whether or not that type of arrangement works for them.

Is economic growth worth everyone else's fees being higher?

Mr. Cornett shared that basically, our two extremes of revenue are connection fees and monthly user fees. For us to sell capacity in the form of user fees, all the money that is not collected through user fees has to be collected through connection fees. Also, what unfortunately happens sometimes, as it did in West Jefferson, NC, is Bristol Compressors built a facility there a couple years ago and West Jefferson invested a lot of capital in treatment. A few short years later, Compressors left and it left a big lawsuit because they had all kinds of debt associated with West Jefferson because they had anticipated covering that debt but was no longer going to be their customer; it put the town of West Jefferson in serious financial difficulty. These types of situations will vary from each county/municipality/utility to another. However, going back to the initiation of the WCSA System Fee, one of the attributes that led the Authority Board to approve system fees, which leads a "growth paying for a portion of growth" approach, is that monthly user fees were rising at an alarming rate; one of the substantial contributors was that WCSA was subsidizing growth. That was one of the drivers that led to the adoption of the system fee.

Mr. Cole said that the Board has been dealing with, to date, growth paying for at least part of the growth. He has heard this multiple times and has even said it himself, but when the water users of the county are paying for all of the growth, it is an additional feeling of taxation that we

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give to the county. We feel like the county shouldn't, or at least someone else should feel this burden rather than the citizens of the county. Where we are located puts us at a unique level because when industry comes to Washington County, how many of those jobs are actually filled by residents of Washington County? We are a lot more optimal to at least stay in the state. Because of the geography, the jobs seem to go a lot of places. What Mr. Cole has seen is that the Board has chosen, since 2003 when we developed more of a permanent rate setting, to have growth start paying for growth, rather than saying that everyone pays the same fees and user fees. We've never really had a scientific approach to it at all other than the last few years. Mr. Taylor explained that there is nothing scientific about it; it's all about competition. In years past, people would pay to come into a location. Now, people concern themselves with who has the best package. Mr. Cornett noted that he's been told that when other counties solicit financial support from that state to have a certain industry locate in the county, they incorporate the cost of treatment or the system fee in what they ask the state to provide. He said he can't say whether or not our county does that, given the dialogue over the last 8 years or so. Secondly, the county tends to be the financial beneficiary of that prospective industry locally. Not just in the sense that they provide jobs for families, but property tax increases; whether for new people moving in, or because of an increase in commercial sales at the local

markets. Mr. Cornett is afraid that the county ends up being the financial beneficiary and WCSA finds that the only other alternative is to raise monthly user fees.

Mr. Chase asked Mr. Hyder, based on his work with the previously mentioned counties, do you ever see us going with the "growth pays for growth" approach?" Mr. Hyder explained that we could set the connection fees so that "growth pays for growth". However, in practice, it is always very difficult to say whether or not growth will pay for 100% of growth because you have to bill in large chunks. Another county said they would not pay for growth in any way, shape or form. So, they set up availability fees and performed the study back in 2001 when the housing market was booming. Their home sales have plummeted and they are unable to pay for growth with growth. However, that was the policy they wanted to administer. In our financial audit, we will try to allocate costs to growth vs. non-growth and calculate what a connection fee should be if growth were to actually pay for growth. Mr. Hyder said at this point, it's important to examine where we are and that relationship.

Mr. Cornett explained that one of the things that would be good would be to examine how much of our growth are our fees not covering. Whether it is a residential, commercial or industrial development, it is important to examine how much of the connection is being subsidized by the remaining customer base. He thinks that is good to know from a business standpoint, but also in case we are criticized or challenged with

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regards to our connection fees. When it comes to budget time each year, we can examine that compelling relationship. Mr. Cornett thinks our customer base is substantially subsidizing our connections. He doesn't think we'll ever get to a point of growth pays for growth; we'll always have growth pay for a part of growth, but we can improve it and know where we stand. Mr. Stout brought to light individuals on Mendota Rd. who are struggling to come up with the \$700 to finish off their down payment, and he thinks that is something we should be sensitive to. He said he doesn't know if our connection fees are too high or too low but for someone who is struggling, maybe we should charge them a connection fee that equals the actual cost of connection. Mr. Cornett explained that we are charging them less than what it costs now. He explained that it is a two-part connection fee: the Connection fee is \$1,100, the remaining \$800 is the system fee, and that allots them 5,000 gallons of capacity; 5,000 gallons of capacity costs much more than \$800 to produce. Mr. Cornett explained that the connection fee is much closer to the actual cost than is the system fee (which we charge significantly less for). He said that later in the presentation, there should be alternatives discussed for the Board to consider in regards to those who struggle with connection fees.

Mr. Hyder went on to discuss the policy issue of "Does the Authority allow for reduced connection fees?" He explained that WCSA currently charges a tap or connection fee of \$1,100 and a system fee of \$800, for

a combined fee of \$1,900.

Historically, some customers have asked the Authority to reduce or waive the connection fees; typically, the reduced fees have been for individuals in petitioned projects. Prior to the system fee, the DHCD has funded projects and connection fees were reduced because they had additional funding; that is no longer the case. The Authority does allow for financing for the connection fee if the customer can put \$700 down. There are now funds also available for the Appalachian Regional Commission (ARC) and others for those who qualify. Because we are trying to forecast revenues, Mr. Hyder said, we can't reduce fees without some type of a system. It is easier if fees are set at actual cost or a reduced cost for everyone, opposed to those in certain cases. There are always programs that can contribute additional funding. He referenced examples in the District of Columbia, and with Bank of America. In those programs, an outside source was determining who was eligible based on income, opposed to having those inside the organization make the judgment call; from his perspective, that is the cleanest way to do it. It would be unfair to do reduced rates for some and not all. A Board member asked if we had some type of program to help someone if they are struggling. Mr. Cornett responded that we didn't; we just have organizations that we could direct them to that could help. He also added that the gentleman from People Incorporated (PI) that spoke at a prior meeting stated that their organization would contribute \$1,000 to an individual's

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fees if they were eligible. Granted, there is still a \$900 gap there, but at least PI could contribute a good portion. Mr. Cornett added that WSCA is not set up administratively to do income surveys. If we were to do something like that, WSCA would need to bulk up administratively, and even so, he doesn't know if we would be the right agency to do that. He thinks it would be best to associate with an agency that specializes in that. Mr. Stephon suggested that we have an application available to fill out regarding their income and direct them to the group they should take it to for assistance. He explained that since our previous meeting, he has learned that the lady who spoke loudest for the Mendota project doesn't own the property she was speaking for; she was representing the owner, who is a family member. Mr. Stout explained that he understood PI's process of contributing \$1,000. He asked if we would still require that resident to put \$700 following that contribution, and pay the rest later. Mr. Cornett explained that he thought the \$1,000 would cover the \$700 down payment, plus an additional \$300. That would mean that under our current policy, the remaining \$900 would be divided into equal payments over the next 12 months. Mr. Cornett explained that is something we could still talk about. He said that from what Mr. Donahue and Mr. Hyder have told him, most utilities no longer offer interest free financing or payment plans. Mr. Cornett said that is another topic we could think about during this rate study process, especially if we are

considering allowing longer terms of financing, such as over 12 months. Mr. Stout's thought was why run a water line down Mendota Road if 2/3 of the residents can't afford it? Mr. Cornett said that, in response to Mr. Stephon's previous suggestion, why couldn't we hand out outside assistance information to residents when they first petition for water? He explained that if he personally were petitioning WSCA for water, he knows that it will take anywhere from 2-6 years before the line is actually built. That means the resident has at least that long to be saving towards the connection fee. Possibly in moving forward in the petition process, Mr. Cornett suggested that we encourage customers to start saving at the beginning of that petition process, and also direct them towards these agencies that provide assistance to get themselves in position to be taken care of. He said that Lime Hill Road is probably the project that has developed the fastest, and it took 2 years. The monthly water bill is \$20-\$30 per month (a minimum of \$17.50). If that is affordable for them, why couldn't a customer start putting that amount of money aside each month towards the connection fee over a 5-6 year period? He said the savings would grow substantially towards the cost of connection; we could encourage saving during the interim.

Mr. Hyder shared the other policy issue, which pertains to "Requiring connection fees from wholesale customers." He explained that when there has been an inter-municipal agreement, historically the Authority has not charged connection fees to these customers. Typical industry

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practice would be to charge them a connection fee; they are purchasing capacity in the system. It is typically done through a connection fee or a surcharge on the rating; the surcharge would exist for the first five years, as they are paying towards that connection fee. He didn't know if that policy was done consciously, in an effort to encourage that agreement.

Mr. Cornett explained that everything will be examined in regards to our bond covenants, but another effort that has been made in regards to altering/changing/reducing our connection fees is that our bond covenants require us to do certain things with our customers, connection fees, etc.

Mr. Hyder shared that one of, if not the most influential policy issue is our Rate Design and how to charge the service. He referenced the Rate Structure we currently use, which includes fixed and variable charges. At our current rates, the typical water customer pays \$17.50 and they get 1,000 gallons of water per month. The next 2/3/4,000 gallons are \$3.10 each, and after 4,000 gallons, they pay \$3.70 each. He stated that our structure is called an inclined block rate: the more you use, the more it costs. Mr. Hyder explained that our block rate is not very steep; he's seen much steeper. He said that if you think about it, if a customer uses 10,000 gallons more over the 4,000 gallon mark, it costs them \$.60 more or \$6.00. In terms of what the structure is doing, Mr. Hyder isn't sure if it is encouraging conservation; it won't have a large impact necessarily on the bill. In regards to the wastewater rates,

there are minimum charges by customer class. Different minimum amounts are included in the customer class and then everyone pays the same rate following. To Mr. Hyder, the rationale doesn't necessarily make sense. He can understand the reasoning for charging industrial [customers] a higher minimum; they typically have a stronger sewage and the minimum charge is set higher to accomplish that. Other than that, he is unsure of the rationale [for the residential and commercial minimum rate]. He further defined the two main elements of the chart: fixed and variable charges. Fixed charges are charges paid by the customer regardless of the wastewater usage amount. There are two key policy issues related to the fixed charge. The first is that the higher the fixed charge is, the greater the cash flow is. For example, if you have an astronomical fixed charge, your cash flow will be flat, because you will receive the same amount every year based on usage. That is good because essentially, your costs to operate a system are fixed; roughly 80% of your costs are fixed, and don't vary much based on usage. The downside of having a higher fixed charge is that it doesn't encourage someone to conserve; they will pay the fixed charge regardless of the amount of water or sewer they use. It will also hurt the really small user. The other policy is based on the units used to create that fixed charge. The use of a basis such as meter size matches charge with customer potential demand on the system. The size of the meter will help determine the demand and

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amount used. You would charge \$1 for a 5/8" meter or \$80 on an EDU basis for a 10" meter. The AWWA has a Meter Equivalent Table, which says a 5/8" meter = 80 10" meters. It's also done sometimes based on number of fixtures, number of beds in a hospital, etc. However, meter size is typically the most common. Mr. Hyder opened the floor for discussion of our current minimum charge. He added that our minimum charge of \$17.50 for water is within the median for minimum monthly water charges. He asked if there had been thought of utilizing meter size instead to generate rates. Mr. Cornett expressed that it's at least an option to consider. He said that in 1998 or 1999, they right-sized all the meters based on customer usage patterns. He explained that the information made it to the meter books, but he's not sure if it made it to the billing system (in case that is the better alternative). Mr. Cornett explained that we could look up the data and make sure it is accurate. He thinks the policy of charging based on meter size is fairly easy to administer. Mr. Hyder explained that what they typically do is model/determine revenue requirements now and provide scenarios, such as "If you do not change your rate structure, you will have to generate 20% more revenue and here is what your rates would be." Also, they would provide several other alternatives that would generate the same amount of revenue. The alternatives would allow WCSA to see what structure we like best, and also how it would affect the various customers. He said we would also look at what

kinds of behavior we would like to encourage or discourage. Mr. Cornett offered Mr. Hyder a recap, having had discussions with various Board members. He said staff has also recognized some usage patterns that could be of concern (Note: they are listed in no particular order). In recent years, we have seen an increase in the agricultural use of our water. The CREPS Program is a good program; it's helped get cattle and livestock out of the streams. However, it has led to a number of new connections to our system in order to water livestock. It's not a bad thing, he said, but it does represent a sharp increase in demand on our system. They've also seen a sharp increase in water for irrigation use over the past 10 years. That's another increase in demand on the system that they were unable to forecast and has led to an increase in water demand above the level of population growth in the county. He said that in addition to that, we have a local industry who is bottling our water for resale. That's not necessarily a bad thing, but we work to provide drinking water and they are selling drinking water. They have assumed a large amount of our capacity at a premium price. Those are some of the factors that Mr. Cornett and the Board have discussed over the past 6-10 years. Mr. Chase asked what rate residents were receiving water at for agriculture and irrigation purposes. Mr. Cornett explained that as far as water is concerned, there is one rate for residential, commercial and industrial customers. It is \$17.50 for a minimum bill, \$3.10 for the 2nd, 3rd

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and 4th thousand gallons, and anything over 4,000 is \$3.70/thousand gallons; they pay the same rates as you, I or anyone else would pay. Mr. Cole added that over the past few years, that may be why we are seeing less water availability. He said we need to have some means of encouraging water conservation; the way we are set up currently, we are not [encouraging it]. He said we have talked about it for years; we have tip-toed around it, but have never done anything about it. Mr. Stout asked how we get people to conserve. Mr. Hyder shared that it is a very difficult thing to do, especially since it will not affect their expenses, unless by a fraction. When you consider that people have a phone bill of about \$100, cable bill of \$100, and a water bill of \$30; even if the bill went up to \$40, it wouldn't be enough to effect behavior. Change in water conservation levels is typically achieved through education rather than pricing. There are effects on the reverse side as well; these customers are costing us a significant amount of money. It is important to have the facilities to accommodate the demand. Higher increments do cost more, so there would be cost reasons and ideology reasons to make the change. Mr. Cornett added that they have talked about different rates for different customers. The problem is in knowing *who* is using their water for irrigation purposes. He gave the example of Virginian residents who have two meters; one for irrigation and one for residential use. Their situation is not typical. Therefore, he thinks it would be very difficult to segregate water customers into rate

classes. Some families run water into a trough from the same meter that runs water to their house. Mr. Cornett thinks a block structure or a structure involving meter size could capture some of those usages. Mr. Hyder explained there are a couple things you can do so that people pay more for their irrigation. One way is to look at usage during the seasons and set seasonal averages so when customers exceed the average, a block rate will take effect. Another is to look at their quarterly rate, so when they go over the rate in the summer, they would be charged a peak rate to address residential pricing. For commercial, it is difficult; we could apply the quarterly rates.

Mr. Canody explained that could be a problem in some areas, especially if you live close to 2,000 feet. In the winter time, they have to keep their water running overnight; it's wasteful. However, when there is not a penalty for wasting the water, that is what people do. Mr. Cornett added that for them, it is cheaper to waste water than to have to pay to replace broken pipes. He thinks some of our water summary reports will show, depending on the severity of the winter, we could meet the same peak demands in January as we would August. Part of this is based on elevation, but also on practice; some of these lines were not built as deep as they should have been. People have learned through experience that the line will freeze; we are moving away from that as new homes are being built. Mr. Hyder explained that he had never experienced frozen pipes or running

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water like that in Michigan. He was glad to know that now. Mr. Hyder went on to talk about various rate structures. He started talking about Uniform charges, which is what we typically have for sewer rates now; the same rate for each unit that is used. There is an inclining block rate, which is where rates fall within blocks, and if usage falls within the first block, you pay that rate, and so on; this is what we have for water rates, in the form of two blocks. Here are some of the alternatives. He mentioned seasonal rates earlier, which is where customers pay a certain rate based on the season; if their usage exceeds the average, they pay a peak rate. There is also a pyramidal rate in which there is a rate incline for customers, but after awhile, the rate drops down to accommodate industrial users. Another approach would be to have an inclining block rate for residential customers and a flat line rate for non-residential users; non-residential users use typically the same amount year round. One recommendation they have is to move to a uniform rate to some degree because we are not accomplishing much with such a small differential between blocks. If we want to encourage conservation, we really need to segregate those blocks more so there are bigger jumps between them.

Mr. Cornett explained that part of the reasoning for the inclining block rate we have now is because we developed those blocks based on the current customer usage rates. We've been able to apply those rates and stats to the budget workshops we have now along with

live data from the year before to see what kind of revenue we generate; that was the ideology for the inclined block rate we have now. This was done with the understanding that in time, if we wanted to adjust that, we could do so accordingly, knowing what our revenue would be. Mr. Hyder asked if we saw 4,000 gallons of usage as kind of the cut-off before. Mr. Cornett explained that some of the thinking was folks who might have the ability to be careful with the amount of water they consume wouldn't end up with an astronomical monthly bill; that was represented in the first block. However, the folks who may be a little more liberal with their water use (i.e. washing cars, filling pools, watering lawns, etc.) represented another block. The final block would capture any type of user who would exceed the 4,000 gallons of usage. We have had the inclining block rate structure in place since 2006. It has only been in place for a short time, but it had accomplished our revenue needs.

Mr. Hyder went on to discuss two more policy issues, one of which is funding capital projects (a more financial issue). There are three typical outlets for funding capital projects: cash (which may be from current revenues, reserves or a fund balance), financing (long term debt, notes, loans, SRF) or grants. What they would do is drop the CIP into the financial model and ask, how are we going to fund these projects? One of the issues is how much do we want to rely upon cash when people pay as they go, or do we want the cash to accumulate and pay in one lump sum? Also, we

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could use financing vehicles instead; the use of cash is conservative, but it can make the rates too high. If we can build cash into the rate over time, we essentially would get customers used to paying for capital projects. We would in the end do less growth and more replacement with this rate system. Using financing vehicles does create a better match in terms of life of the asset. For example, if you get a 30 year loan and the asset lasts 50 years, the vehicle better matches the asset's useful life. The downsides of this form of financing is you incur interest expenses, it is a long-term liability, and you tie-up capital. He asked if there was a policy of how WCSA wants to finance capital projects. Mr. Cornett explained that we've used cash, paying out of our reserves and financing. Our CIP agenda has allowed us to pay-as-we-go when it comes to capital improvements. When it comes to extensions, we have almost exclusively used the "pay-as-we-go" philosophy to make upgrades to the existing system. Some of the extensions have involved replacement of short sections of waterline. Another exception is that significant capital is utilized in replacement projects, such as waterline expansions. An expansion project we are working on now had to come out of reserves, and our WTP expansion project has involved financing. That has been our practice, not necessarily our formally adopted policy. Mr. Hyder said we would be able to play with some of those elements within a model to see what effects they have. He moved onto a related topic, which is establishing several types of

reserves. Mr. Hyder shared that a lot of utilities have an Operating Reserve, or a "Working Capital Reserve". There is also a Debt Service Reserve, which is based on Bond Covenants and a Repair, Replacement and Renewal Reserve; this is essentially how we look at it: the delta between what we've been doing and what we should be doing. With the exception of Debt Service Reserve, reserves are set up based on the policy of the utility. The question to ask is what reserves should you establish? Mr. Chase asked what kind of reserves we have. Mr. Cornett explained that we have essentially one reserve; it is one account for all of our money to reside, but is sub sectioned into restricted and non-restricted reserves. The restricted reserves are required by our bond covenants and the non-restricted reserves contain the cash we use to fund our line replacement projects and at times, operations and maintenance. He thinks we should take a look at our reserves, for example, to see how much we have in our reserves designated for the various purposes. As an example, what type of cash failure should we prepare for? Say for example, something happens and we are unable to provide service for a month, we don't have that revenue coming in, and we've got our debt associations out there; we now have a fixed cost associated with the Authority and we need to have reserves ready to cover those types of times. However, is it realistic for us to plan for those types of times and keep those funds in our reserves? Mr. Cornett has heard many suggestions for what amount

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of time to plan for, many of which have said to have up to a year in reserves; he thinks that is far too long. Mr. Cornett thinks a month or more worth of reserves is very realistic. He thinks this is something we ought to think about during this rate study and we need to eventually address these policy issues.

Mr. Hyder said that there are standards out there if you are regulated by the Virginia Commerce State Corporation; they would require you to have 90 days operating in your reserves. Typically, those funds are in order to have something to fall back on, if need be. The last policy issue is, "How do I handle rate increases?" Do we separate increases that will last for several years so that in the first few years, we are getting surplus revenues and the last few years, we are running deficits and hope that we are covering our costs? There are pros and cons to this policy. The cons are that the period you designate could have a quite sizable increase, which could bring about a lot of disgruntled customers. The positive side from a public standpoint is that they know what their bill will be year in and year out. An alternative approach would be that you do a sizable increase the first year and following, do small increases to keep things alive. The public response could be that there is an annoyance that the rates are continually going up, but it's typically not enough to really notice, especially for small usage patterns. Also, credit agencies like to know that you have a plan to continually raise rates. He said we would look at a ten year period and a little longer

so that for us, we can look at setting rates for a multiple year period. In the past, it has required the Board to yearly address rate increases.

Mr. Cornett added that in the past, while our CIP list goes out for 5-6 years, we have taken rate increases one year at a time based on the previous year's performance. This year, for the first time, we did look at a mid-year increase in regards to the wastewater connection fees. Apart from that, we typically adjust rates yearly. In our past, he said, we have had mixed experience with rates.

Approximately, for the 20 year period prior to 1996, we had substantial increases almost every year; a lot of those increases were related to growth not paying for almost any of the growth. He thinks we can find some documentation to support that. Beginning around 1996 and 1998 through utility performance improvements and the implementation of the system fee, we went several years at a stretch without any rate increases (i.e. connection or monthly user fees).

Through utility performance improvements and implementation of the system fee, it has allowed us to do that. That's not to say that there isn't more opportunity for improvements of our proficiency and performance to realize additional benefits there. Sometimes, when you cut the amount of chemical you use, you can only cut it once, along with electricity and things. He believes the low hanging fruit may already be picked. We are at a stage now where, along with the need to expand the drinking water plant, we have consciously, over the past couple years, looked at more than

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one year of raised rates. The last two years, we've realized that we are beginning to incur some debt with the water plant expansion; however, we have not set rates out beyond that first year. We said let's go for 30% this year, figuring we would probably have to do 30% the next year and 30% the year after that. Beyond that, we have only gone with one year's actual rate setting. Mr. Hyder said that the general rule is that if you are unable to cut costs once you reach a certain efficiency level, and you don't have growth, you have to raise rates; expenses go up. He said it's nice to think that we can go long stretches without raising rates, but that is not reality. When people do that, they experience tremendous rate hoists. He concluded that was it for policy issues. As far as the study, they are just getting started. They plan on having further discussions with Robbie & Kim. MFSG is still obtaining data from us through data requests. That data will allow them to further pursue the first step, which is to establish revenue requirements and they will have a progress meeting to inform staff what those requirements should look like. He opened the floor for discussion. Mr. Cole said he took a look at what Mr. Hyder presented and it made him realize we don't really have any policies. He thinks back to all the time that has been spent talking about rates and it makes him realize how much time could be saved if we just had policies. Mr. Cornett agreed, saying that policies can still be changed down the road; they should be reviewed annually or every couple years. However, he thinks it

would help the Board and help the staff in terms of going from one year to the next with planning and budgeting. To have those policies, to know what they are, to be able to review them and see how well they did or did not work and make adjustments if needed is necessary. It provides an added benefit of being able to communicate with our customers. We could inform our potential and current customers by saying, "This is our policy."; at best, we can now say "This is our practice" One of the expected outcomes of this study is that we'll be able to reduce this to writing and adopt it as policy.

Mr. Cole added that this not only could be shared with our customers, but agencies that look over us. If they knew what our policies were, we could have them give us input; we would be able to better understand their realistic expectations. He thinks it would help us all get along a little better.

Mr. Cornett added that in regards to working with Mr. Hyder & Mr. Donahue, they've talked about whether or not they should hold meetings with certain stakeholder groups; they've decided that we probably should. Mr. Cornett's asked the IDA, along with the Board of Supervisors, if they would like to meet with us or the whole Board. He's asked them to meet with us so we can receive their input as far as the study's concerned. For us to hear from them, for them to know their voice has been heard, and for them to be a part of that meeting on the front end, [past experience points that] we can hear them out and our decision in result could be

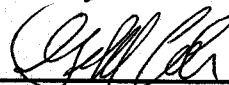
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pretty compelling. Anything we haven't shared with them before could be heard; when you look at it from a policy perspective, they will voice their wants and needs. Our response can be, "Where should those funds [for those requests] come from to provide this water/wastewater treatment capacity?" Depending on what their response is, our only other source of revenue is user fees. He thinks they'll stop short of saying what they've advocated for in the past, which is to raise monthly user fees. They've said that off the record, but when it comes down to it, this process/policy is going to be pretty compelling and difficult for them to still say raise monthly user fees. If there are other avenues to go about which he doesn't know about, he'd like to know if there are in other counties when they solicit industry to come in. When funding comes from the county and the state to bring industry in, they are the primary beneficiary. Our county did when they bought 130,000 gallons of capacity from us. Once we introduced the system fees, it was as if the policy was foreign to them. Mr. Cornett had many conversations with the county in recent months reminding them that they are buying that capacity. We have invited them to participate in a workshop-type format with regards to our rates and fees, and he said hopefully they'll be able to attend later this month. Mr. Chase asked when the projected date was for this [rate study] to be completed. Mr. Hyder shared that he believes their work plan said they allotted for 12 weeks to do the study, but that is dependent on when they


get started and receive the info. He projected completion by the end of February or early March. Mr. Cornett added that after talking with Mr. Donahue, the deadline is predicated on when we get the data to them. There may be a draft or enough progress that we would be able to review in late January, and try to wrap it up in February/March so that we have what we need for the upcoming budget process. The anticipation is that whatever we decide to do, we can ideally implement July 1, 2009; that should be do-able if we wrap up by March.

5. Adjourn or Recess

Mr. Stephon made a motion to adjourn the meeting. Mr. Stephon's motion was seconded by Mr. Stout. The motion passed 5-0-2. The Board adjourned at 8:35 p.m.



Mr. Gerald Cole, Chairman



Amanda Paukovitz, Assist. Secretary