

**MINUTES OF A FINANCE COMMITTEE MEETING  
OF THE WATER WORKS BOARD OF THE CITY OF BIRMINGHAM  
May 17, 2016**

A Finance Committee Meeting of The Water Works Board of the City of Birmingham was held on Tuesday, May 17, 2016, at 9:00 a.m., in the principal office of the Board, 3600 First Avenue North, Birmingham, Alabama.

The following Committee Members were present: Ronald A. Mims, Kevin B. McKie, and George Munchus. Director Ann D. Florie, a Non-Committee Member was also in attendance. Director Sherry W. Lewis, a Non-Committee Member entered the meeting at 9:07 a.m.

Inasmuch as all of the Committee Members were present, Chairman Mims declared a quorum in attendance.

The meeting was also attended by: Mac Underwood, General Manager, Michael Johnson and Sonny Jones, Assistant General Managers; Cynthia Williams and George Anderson, Board Employees; Mike Petway, Fuston, Petway & French, LLP; Attorney Clay Ragsdale; Peiffer Brandt and Townsend Collins, Raftelis Financial Consultants; Brian Ruggs, ARCADIS; Dorian Kendrick, The Lewis Group; Theo Johnson, Volkert, Inc.; and L'Tryce Slade, Slade General Contractor.

Chairman Mims called the meeting to order at 9:03. As there was no old business for discussion, General Manager Underwood asked the Committee to hear a presentation from Attorney Clay Ragsdale, as noted in agenda item 3. Attorney Mike Petway was recognized to introduce Attorney Ragsdale. Attorney Petway pointed out that Attorney Ragsdale specializes in securities law. He asked the Committee to hear a presentation from Attorney Ragsdale relative to the Board hiring him on a temporary basis to assist with a legal matter.

Attorney Ragsdale was recognized for introduction. He stated that in the past, he has worked with Attorney Petway on different occasions. He stated that due to his experience with the Securities and Exchange Commissions, he was asked by Attorney Petway to assist the Board and its Attorneys with respect to a legal matter. Attorney Ragsdale stated that his engagement would be limited to the extent of him evaluating rights and remedies of the Board in regards to third parties to determine if there would be means or abilities to recover some money that may be due.

Director McKie commented that he met with Attorney Petway and Attorney Ragsdale during the previous week. He stated that as previously discussed by the Board, Attorney Ragsdale would be paid an hourly rate to investigate the referenced legal matter. If determined that further action would be needed, the Board would re-negotiate with Attorney Ragsdale some sort of hybrid contract agreement. Subsequently, the Committee agreed to move said item to the Board requesting approval. (Attorney Ragsdale left the meeting at 9:04 a.m.)

General Manager Underwood proceeded with the agenda and he stated that the next item would be a request to hear a presentation from Raftelis Financial Consultants (RFC), as noted in agenda item 2. AGM Michael Johnson was recognized for an introduction to said item. He pointed out that it has been a number of years since the last Cost of Service Study (COS). AGM Michael Johnson stated that in operating a utility said study is performed as one of the core processes to establish rates. He stated that RFC is the Board's approved rate consultants who are present to make its first presentation. AGM Michael Johnson commented that upon completion of the COS, established rates would become effective January 1, 2017. Subsequently, Mr. Brandt was recognized to lead the discussion.

Mr. Brandt introduced Mr. Townsend Collins of RFC. He pointed out that Mr. Townsend handles the Bill Frequency Analyses for the Board. Mr. Brandt stated that today's presentation is the kick-off

workshop for the BWWB's rate study. He reviewed the agenda items which are as follows: Project Overview, Current Financial State, Rates 101 (Walks through the Process of the Rate Study), a Pricing Objectives Exercise, Results of Pricing Objectives and a Schedule Review. He pointed out that the overall goal is to provide the BWWB with a strategic financial vision. Some objectives would be to confirm financial policies to guide decision making; to calculate rates, charges, and fees consistent with utility objectives and to develop a plan to communicate with the Board's value to stakeholders. (Director Lewis entered the meeting at 9:07 a.m.) Director Munchus asked if the referenced document was for internal purposes only. Mr. Brandt responded yes and General Manager Underwood added that said document is a work in progress until August or September of 2016. Mr. Brandt stated that no proprietary information is included in the COS presentation. Mr. Collins was recognized to discuss the BWWB's data review and the current state. He stated that he would address the O&M Budget, the Capital Improvement Plan, the Systems' Accounts & Demand and Financial Metrics used for benchmarking purposes. Mr. Collins pointed out that there was approximately a 12 and a half percent increase in employee related expenses for 2016. There was also a 12 to 14 percent net increase in license fees, power, labor and transmission & distribution maintenance materials. Mr. Collins reported on the 5-year capital improvement plan. He reported that customer demands are projected to decrease by approximately 0.5 percent per year and accounts are projected to increase by 0.5 percent. This is mainly due to the declining per capita demand. Actual consumption decreased by an average of 2.4 percent per year from 2008 through 2015. Because of annual rate increases revenues have been increasing in line with revenue requirements. Mr. Collins reviewed a chart of consumption history by class such as raw water, residential and non-residential. All classes are on a downward trend and projection is expected to continue due to the decline in per capita demand. Projected trends are based off of the RSE Model and other data received. The 5-year projection is updated on an annual basis as additional data is received. Mr. Collins explained the rate classifications which are as follows: Block 1 refers to 0 ccf's, Block 2 refers to 3-15 ccf's, and Block 3 refers to ccf's greater than 15. He reported that residential Block 2 has more of a decline in capita consumption than residential blocks 1 and 3. Mr. Brandt commented that block 1 is flat; there is some variation within block 2, and block 3 tends to go up and down due to the weather along with all outdoor water usage. Director Florie asked Mr. Collins to elaborate more on block 2. Mr. Collins stated that the decline in per capita demand affects block 2 more than block 1. Consumption drops from 7-8 ccf's to 5-6 ccf's over time. AGM Michael Johnson commented that the majority of consumption usage occurs in block 2. Said block is the predominant behavior of how water is used. Mr. Collins pointed out that since 2004; consumption per average per month for block 1 has been approximately 460,000 ccf's, approximately 550,000 ccf's for block 2 and slightly under 200,000 ccf's for block 3. He stated that consumption for raw water is monitored as well. Director Munchus asked if said data could be provided on a month to month basis if requested. Mr. Brandt responded yes and he added that there is much data that could be provided upon request. Mr. Collins reviewed the Board's rate history. Since 2010 the base charge increased by approximately \$10.00 or 70 percent. Rate charges for blocks 1, 2 and 3 increased by approximately 8 to 10 percent since 2010. Raw water and non-residential water increased a bit more than the residential blocks. Mr. Collins reported that water revenue such as residential water sales, raw water, non-residential water sales, sewer revenue, fire protection and other operating income has increased substantially since 2000. He reported on revenues and rate increases since 2007. The cumulative rate increases since 2007 increased seventy percent and the revenues increased forty-three and a half percent. He pointed out that the annual system expenditures remained stable since 2011. Debt service has continued to increase and PAYGO tends to fluctuate. Operating expenses increased from 2007 to 2011 but has been consistently \$80 million dollars since then. The increases are mainly due to administrative and general expenses. Mr. Collins reported that at the end of December 2015, the BWWB had 443 days of cash on hand. He pointed out that the Board anticipates spending \$35 million dollars in PAYGO financing in calendar year 2016. This would result in a reduction of 331 days of cash on hand at the end of 2016. According to Fitch Medians for 2015, the BWWB would fall in the AA rating category for cash on hand. The total outstanding debt per customer is \$5,081.00. According to Fitch Medians, the all-in debt service percentage of total revenue for the BWWB is 35.8 percent. Mr. Brandt added that the ratings agencies are aware of the Board's outstanding debt and it is always good to recognize said debt and admit that it is being managed. The ratio total outstanding debt to net plant assets for the BWWB is 0.95. The all-in debt

service coverage for the BWWB is 1.3 four times. Mr. Brandt added that the senior debt service coverage for the Board is higher due to the systems subordinating debt. Mr. Collins commented that the Board need rates and rate growth to outpace the growth in the O&M expenses. Director Munchus asked if the forecast for raw water usage is expected to continue declining or if it has flattened. Mr. Brandt responded that usage for 2016 has flattened and it is holding steady. Raw water usage is being monitored as future usage is unknown. Mr. Brandt commented that new development in the Birmingham area as well as new home developments in Hoover would help mitigate the challenge relative to raw water usage. Director Munchus asked if the base charges applied to all customers in blocks 1, 2 and 3. Mr. Brandt responded yes and he stated that said charges are determined by meter size. AGM Sonny Jones added that base charges would not apply to customers with irrigation taps. Mr. Collins asked the Board to bear in mind that for the last 10 years rate increases for BWWB customers have been below industry averages. Next, Mr. Brandt addressed the settings for the COS which are to confirm financial policies, to develop a financial plan and cost of service rate design (calculate rates) and to communicate the results. Mr. Brandt stated that the importance of financial policies is to provide internal guidelines relative to cash reserves, capital financing, credit ratings, debt coverage, operating cost increases and affordability. The external importance for having financial policies relates to rating agency guidance. The goal is to guide financial decision making to achieve strategic vision. Mr. Brandt reviewed the current policies which are to maintain rate increases below industry average of 5.5%, to keep O&M increases less than 5 percent and to reach the goal of 25 percent of Capital Budget funded from PAYGO by 2017. He commented that RFC recently kicked off a COS for Montgomery County in Ohio and for the Sewer Utility Company in Greenville, South Carolina. Mr. Brandt pointed out that the goal of developing cost of service rates is to plan for equitable financial sustainability and system reinvestment. This would consist of the following three (3) components: An analysis to promote equitable recovery of revenue through rates; a model to serve as a tool to analyze historical results and project future needs, as the financial plan would become the roadmap for utility finances. The goal for communicating the results would be to provide comprehensive, transparent, and understandable deliverables for the BWWB and its customers. Communication would consist of draft reports and final reports, presentations to the Board and Stakeholders and a decision on how to handle public outreach. Mr. Brandt commented that there could be public outreach after the results of the study or there could be an outreach during discussion of the COS. Reaching out to the public during the COS could possibly include some public input, which could a risk. Mr. Brandt commented that some utilities gladly accept public input relative to the Cost of Service Study while others allow public input on the back end. Mr. Brandt expressed the importance of being clear, precise and consistent in conveying the base charges to the public along with reasons for said charges. Mr. Brandt reviewed the following five (5) step approach for the rate study: 1) to identify financial & pricing objectives; 2) to identify revenue requirements & demand projections; 3) to allocate costs; 4) to design rate structure; and 5) to assess effectiveness in addressing pricing objectives. The pricing objectives include the following: cost of service based allocations, financial sufficiency, customer understanding, ease of implementation, administrative burden, water efficiency, rate stability, minimal customer impacts, economic development, revenue stability, affordability to disadvantaged customers and equitable contributions from new customers. Mr. Brandt pointed out that prior to concluding the presentation, he would ask the Board and Senior Executive Management to prioritize and group said objectives in categories such as: critical, very important, important and not quite as important. Director Munchus asked if there were any known cases wherein water systems own and operate other private entities not related to water. Mr. Brandt responded that he is not aware of any such cases. He commented that Spartanburg Water owns an ice business with many self-serve ice huts. Spartanburg Water feels that owning the ice business fits with their overall mission and goodwill. Director McKie asked Mr. Brandt if his definition of economic development referred to setting rates to encourage businesses such as dropping raw water rates or dropping other rates to encourage different types of businesses. Mr. Brandt responded yes. Director Munchus commented that he would rely on managements input relative to prioritizing pricing objectives. Mr. Brandt pointed out that the referenced objectives are Board policies plus it is important to receive Board input concerning them. Mr. Brandt stated the objective for utility financial planning is to balance system reliability, sustainability and financial integrity with customer costs and impacts. He stated that system revenues are a function of customer accounts and consumption and user

rates and charges. Said components are interrelated as revenue is based on customer usage and growth. Mr. Brandt reported on costs allocation. He stated that the goal is to achieve equity with attempts to recover costs from users in proportion to their use of the system by recognizing the impact of each class on system facilities and operations. The goal is to recover approximately \$175 million dollars in revenue requirements through residential, non-residential and raw water customers, as well as miscellaneous fees associated with turn-ons and shut-offs of water service. The next step would be to design the rate structure. He pointed out that this is the process where input from the Board and Senior Executive Management is needed. The goal is to align rates and charges with pricing objectives. Director Munchus asked how most water utilities treat the affordability issue. Mr. Brandt responded that there is actually no good answer for the referenced question. He stated that there was a good discussion during the CFO Forum attended by him and AGM Michael Johnson held in Portland, Oregon approximately one (1) month ago relative to pricing objectives. Mr. Brandt pointed out that utilities view their responsibility towards affordability differently. Some utilities strongly believe that they should focus on affordability. Other utilities feel they should focus on providing services while other organizations within the City concentrate on affordability. Mr. Brandt added that there are some state laws that prevent subsidizing from one class to another. He suggested that staff consult with the Board's Attorneys regarding said issue. Director Munchus inquired if other utilities have foundations or programs regarding affordability. Mr. Brandt responded that some utilities have programs similar to the BWWB's H2O Foundation. He stated that a big challenge would be to distinguish customers in need such programs compared to customers wanting use of such programs. Mr. Brandt stated that the next Cost of Service Workshop would involve a conceptual design. The goal is to hear and discuss some thoughts on different rate structures. Mr. Brandt reiterated the BWWB's current water rate structure and water rates. Rates per ccf for 2016 are as follows: charges for 1-3 ccf's is \$2.27; charges for 4-15 ccf's is \$2.69; charges for CCF's greater than 15 is \$4.01; non-residential charges is \$3.51; and raw water charge is 0.89 cents. Director Munchus asked why the raw water rate was so low. Mr. Brandt responded that rate was low due to raw water not being treated. General Manager Underwood added that most of the raw water comes from Inland Lake, which is gravity flow. The small cost associated with raw water relates to pipes and maintenance compared to pumping cost. Director Munchus asked if raw water customers are aware that they receive gravity flowing water. General Manager Underwood responded that the referenced customers are aware of the gravity flowing water, plus they were and are informed when the source changes. He added that water from Inland Lake is very clean. Director McKie commented that said reasons should not prevent the Board from increasing the raw water rates due to the general decline in usage within the industry as the Board may need to recover revenue in other areas. General Manager Underwood pointed out that USX has a treatment process in place (a holding pond). He stated that instead of using the amount of water as they previously did, USX recycles water in their holding pond for re-use. General Manager Underwood added that the BWWB is unique relative to raw water since most utilities do not provide raw water. He commented that more customers are finding ways to use less water. AGM Sonny Jones commented that the BWWB's raw water system is very limited. He stated that there are some manufacturing plants serviced by the BWWB that are charged a non-residential cost of \$3.51. Director McKie inquired if there are ways to block out the non-residential water in tiers similar to the residential water blocks. Mr. Brandt responded that it is possible to do so; however it would be a challenge due to the fact that usage for non-residential water varies. He stated that one way to charge said customers would be to categorize the blocks based on their average consumption. These businesses would be categorized and charged relative to usage during peak times. There was discussion of separating the wholesale customers into a different class. Mr. Brandt pointed out that the separation could provide an opportunity to grow wholesale service. The last step for the rate study approach relates to evaluating rate effectiveness. This would involve some things such as an analysis of customer impact, to review price elasticity of demand, to compare with other communities, and to ensure objectives are met. Mr. Brandt commented that the next step would be public outreach. Appropriate rates would need to be determined to meet the Board's objectives. The next step would be to develop a plan to ensure objectives and proposed rates are understood and accepted by customers.

After much discussion of different options regarding rate structures and variable charge options, Mr. Brandt asked the Board and Senior Executive Management to participate in a Pricing Objective Exercise. Documentation for said exercise was distributed to the referenced participants along with a Water and Wastewater Pricing Objectives Description Sheet. (copies of said documents are on file in Diligent Boardbooks). Mr. Brandt asked the participants to place three (3) of the twelve (12) objectives in each of the four (4) categories. The categories are as follows: Critical, Very Important, Important and Less Important. Upon completion of the exercise, Mr. Collins was tasked with calculating the results. As the results were being calculated, Mr. Brandt proceeded with the presentation. He reviewed the next steps and timeline. Mr. Brandt pointed out that the goal is to provide monthly updates during Regular Board of Directors' Meetings, unless there is a need for another workshop. The update in June 2016 would be to review and discuss conceptual design and financial policies. The update for July 2016 would relate to cost allocation. In August 2016 the update would be to review and discuss draft rate recommendations. The final rate recommendations would be reviewed and discussed in September 2016. The RSE Model would be updated based on recommendations in October 2016. Last, a Public Hearing would need to be scheduled for November 2016. Mr. Brandt informed the meeting body that Mr. Collins was happy to be in attendance today as he has a sister-in-law that lives in Crestwood, Alabama. Director Florie left the meeting at 10:43 a.m.

Director Munchus asked the meeting body to hear comments from Ms. L'Tryce Slade. He stated that Ms. Slade is an engineer by training, a lawyer and a business owner. Director Munchus stated that he hopes that there is an opportunity for Ms. Slade to do some business with the BWWB. Ms. Slade was recognized for comments and she distributed her business cards. She expressed thanks to the Board for allowing her to speak. Ms. Slade informed the meeting body that she has been in business since 2006 and her office is located in the Office Depot Building. She commented that she is a licensed General Contractor that provides Environmental Consulting, Geotechnical Services, and Construction Material Testing. She added that Slade General Consulting/General Contracting has performed project work for a number of businesses in the City of Birmingham. Some of the projects include: the Baron's Baseball field, the Negro League Baseball, the Negro League Museum and the Westin Hotel. Ms. Slade indicated that she would like the opportunity to be considered for some projects with the BWWB in the future. Director Munchus commented that he highly recommends Ms. Slade and he suggested that she meet with General Manager Underwood and AGM Darryl Jones. Director Munchus asked Chairman Mims if he knew Ms. Slade. Chairman Mims commented that he did know Ms. Slade and he concurred with Director Munchus relative to Senior Executive Management meeting with Ms. Slade for future work with the BWWB.

Mr. Brandt reviewed the results of the Pricing Objectives Exercise. He stated that the most critical objectives were rate stability and financial sufficiency. The less important objectives were ease of implementation, equitable contributions and administrative burden. Some very important objectives were affordability to disadvantaged customers, economic development and water efficiency. He pointed out that the results would be compared to results received 5-years ago. Mr. Brandt also stated that he would forward the results to General Manager Underwood to share with the Board. Mr. Brandt concluded his presentation.

General Manager Underwood informed the meeting body that he would review a portion of today's presentation with the Managers during the Manager's meeting scheduled for later today.

As there was no further business to come before the Committee, at 10:47 a motion was duly made and seconded, and the meeting was adjourned.

\_\_\_\_\_/s/\_\_\_\_\_  
Mac Underwood  
General Manager

\_\_\_\_\_/s/\_\_\_\_\_  
Ronald A. Mims  
Chairman/President

\_\_\_\_\_/s/\_\_\_\_\_  
Kevin B. McKie  
First Vice-Chairman/First Vice President

\_\_\_\_\_/s/\_\_\_\_\_  
George Munchus, Ph.D.  
Secretary-Treasurer