

Financial Advisory Committee

Regular Meeting – February 25, 2021

Attendance:

Marie Chuang, Commissioner
David Brooks, Chair
Jeffrey Baxter, Member
Rod Ferguson, Member
Joel Friedman, Member
Michele Gutierrez, Member
Richard Kuersteiner, Member
Tom Maloney, Member
Paul Regan, Commissioner Emeritus

Jan Cooke, Finance Director
Ann Ritzma, City Manager
Rich Santiago, Assistant Finance Director
Al Royse, Mayor
Paul Willis, Public Works Director
Rick Simonson, HF&H Consultants, LLC.
Mandy Brown, Senior Management Analyst
Lutfi Kharuf, Best Best & Krieger
Gabriel Sasser, HF&H Consultants, LLC.

FAC Chair David Brooks called the meeting to order at 8:03 a.m. The FAC meeting was conducted in a virtual setting using Zoom.

Item IV Approval of Minutes for December 3, 2020 meeting

Minutes were approved unanimously by roll call vote with no modification. The motion to approve the minutes was made by Richard Kuersteiner and seconded by Jeff Baxter.

Item VII New Business- Recommendation of Five-Year Sewer Rate Series to City Council

Finance Director Jan Cooke began the presentation for the Town of Hillsborough sewer service rate study, stating the agenda and introductions. Ms. Cooke stated purpose of the meeting was to inform the committee of the sewer rate study process and present the analysis, while seeking their input and recommendation for City Council. Ms. Cooke presented the previous sewer rate study information, which was conducted in 2015, and had a five-year rate series with the final rate increase of 7% that went into effect on July 1, 2020 (\$3,543 per household). Those rates were used to cover the mandated cease and desist order, operating cost of the sewer department and capital improvement projects that replaced pipelines and reduced sanitary sewer overflows (SSO). Ms. Cooke reported that the capital upgrades were successful in reducing overflows from an average of 38 per year in 2012 to less than an average of 12 per year since 2019.

Public Works Director Paul Willis presented the proposed five-year projected Capital Improvement Project (CIP) plan for sewer infrastructure, which follows the sanitary sewer master plan recommendations of pipe replacement and reducing I&I. The Town's program strives to replace two miles of sewer pipe per year, as well as replace deficient laterals identified during main line or smoke testing projects. Mr. Willis explained the importance of the smoke testing, as it allows the Town to identify the pipe areas around Town that are higher priority to be replaced. The CIP program also budgets for miscellaneous sewer system repairs when the Town discovers pipe issues or other unforeseen projects. After a question from an FAC member on how many miles of pipe is still needing replacement, Mr. Willis stated the Town has about 98 miles of pipe and that they have repaired approximately 10 miles since he took over the department. The smoke testing and video inspection is important so the Public Works department can identify the areas that need clay pipe replacement sooner. The FAC then discussed the possibility of accelerating the replacement program to more than just two miles per year. Ms. Cooke stated that based on our current target reserves, if the Town chose to accelerate sewer pipe replacement, debt would need to be issued or sewer rates increased to fund the cost. An FAC member also asked if there would be any significant storm sewer projects. Mr. Willis clarified that the Town has a separate sanitary system and stormwater system. The Town has 32 miles of storm drain lines and the drainage goes to the nearest creek and is budgeted separate from sewer capital. Ms. Cooke also clarified to the FAC that storm drain related costs and capital improvements are not included in this rate study since it is currently not being paid by sewer rates.

Mr. Willis gave an update on the San Mateo Wastewater Treatment Plant upgrade. The south portion of Hillsborough sewer flows go to the San Mateo treatment plant, while the north flows to the City of Burlingame's

treatment plant. The Town has been in negotiations with the City of San Mateo for the past few years to determine the Town's share of the treatment plant upgrade cost. The \$921 million project originally had the Town's share costing between \$57 to \$70 million but has been negotiated between \$32.8 to \$48 million based on flow. Mr. Willis also stated that the project was a "design build", which has the guaranteed maximum price from the contractor so there should not be any reason for the total project cost to exceed \$921 million. This project will be financed by San Mateo using various debt, including a low cost WIFIA loan. Since the treatment plant is not the Town's asset, the portion due is an annual cost that goes as an expense contribution to the wastewater treatment plant. The Town's payment amount is based on actual flow to the system and the annual charge could be reduced with a five or ten - year lookback if the flow improves. The costs to San Mateo are higher upfront due to the "lookback" method that was agreed upon.

Ms. Cooke discussed the sewer rate study process, and that the Town began work in November 2020 after a Request for Proposal process where HF&H Consultants, LLC, were awarded the rate study work. The Town has been working HF&H regarding the project objectives, analysis and results, and the five-year rate series options. The proposed Proposition 218 process timeline is intended to have the sewer rates adopted in time to be on the San Mateo County tax roll for fiscal year 2021-22. Annual operating costs increasing at the rate of inflation, continued capital improvement projects and the increase in costs for the San Mateo Clean Water program expense have all been the driving issues impacting a need for increasing the Town's sewer rates. The current sewer rates would result in the revenue not meeting the expenditure's rate of growth. There also is no profit making built into the rate series and the revenue requirement is only to cover the revenue requirement. Ms. Cooke stated that for rate setting the Debt Reserve, which meets the debt covenants, is about \$0.8 Million. Also, the Operating Reserve provides the working capital throughout the fiscal year and is timed with the lag between the revenue being received. Since the sewer rates are on the property tax roll, the Town receives the revenue in December and April of each fiscal year. Along with Operating and Maintenance (O&M) costs, the Operating Reserve is set for any unforeseen contingencies such as natural disasters. Ms. Cooke informed the FAC that the current Town policy for reserves is 20% of annual O&M costs and debt service payments. However, common practice for rate setting is six to nine months liquidity, which is 50% of annual O&M, and this was used for the rate study. The other reserve used in rate setting is the Capital Reserve, which for the Town is an annual average of \$3.8 million. Added with the other reserve components, the Town's target reserve is approximately \$9.9 million.

Ms. Cooke outlined the options for the rate setting discussions with staff and consultants; whether to increase rates, use reserves or a combination of the two. Rick Simonson, consultant from HF&H, presented the model for developing the sewer rate increases for the Town. With the combination of using rate increases and reserves, Mr. Simonson presented two separate scenarios, with a 4% and 3 % annual residential rate increase, respectively. The 4% scenario would have the Town use reserves in fiscal years 2021-22 and 2022-23 before they start to build up again. By the at the end of the 5th year, the Town would be close to the \$9.9 Million target reserve. The smoothing of the rate increases of 4% would avoid any one year from an extreme increase over another. Mr. Simonson also reiterated this included an estimated cost for the San Mateo wastewater treatment plant upgrades and that there will be a lookback period so if the costs to the Town end up being less, these savings would increase the reserves. The 3% annual increase scenario would result in the Town meeting the current reserve policy but not the targeted reserve of \$9.9 million. The rate series is a five-year plan that City Council will be asked to consider adopting, however, the Town adopts the annual sewer rate increase one year at a time.

After the HF&H presentation, the FAC discussed that the rate dollar increase of \$142 for fiscal 2021-22 would be less than the prior sewer increase of \$231 in fiscal year 2020-21. This then led to a further discussion on whether the sewer capital improvements should get completed sooner than scheduled in this plan to reduce risk. The FAC also discussed whether the annual sewer rate increases should be "front loaded" to achieve the reserve levels recommended in the rate study sooner than five years (i.e., the rate study uses reserves the first few years and then builds to near the recommended level by the end of the five years). The FAC widely debated front loading the rates to achieve the reserve levels, affordability for ratepayers and other competing needs for Town funding from ratepayers. The FAC recommended that City Council adopt the proposed sewer rate study so that rates can be adopted in time for the July tax roll, with a specific request for a review of the sewer capital plan. A review would clarify the benefits and costs of accelerating the 20 Year Sewer Master Plan capital program pace and the impact accelerating the program would have to overall funding for the Sewer Fund. It was understood that sewer rates may need to increase to fund the additional capital.

FAC recommendation:

1. FAC recommended that City Council adopt the proposed five-year sewer rate series, with a 4% annual increase.
2. FAC also recommends a review of the sewer capital plan to better understand how the capital program pace is determined to reduce risks and whether the pace can be accelerated.

The motion to approve the FAC recommendation was made by Rod Ferguson and seconded by Richard Kuersteiner.

FAC Chair David Brooks adjourned the meeting at 9:36 a.m.