

ORANGE WATER AND SEWER AUTHORITY

MEETING OF THE BOARD OF DIRECTORS

JANUARY 26, 2012

The Board of Directors of the Orange Water and Sewer Authority (OWASA) held a regular meeting on Thursday, January 26, 2012, at 7:00 P.M. in the Chapel Hill Town Hall, 405 Martin Luther King Jr. Boulevard.

Directors present: Gordon Merklein, Chair; Alan Rimer, Vice Chair; Amy Witsil, Secretary; Fred Battle; Terri Buckner; Will Raymond; Dana Stidham; William Stott; and John A. Young.

OWASA staff: Ed Kerwin; John Greene; Mason Crum; Stuart Carson; Patrick Davis; Greg Feller; Jeremy Fireline; Ed Holland; Heidi Lamay; Andrea Orbich; Kevin Ray; Kelly Satterfield; Stephen Winters; and Robert Epting, Esq., Epting and Hackney.

Others present: Mac Clarke; Tom Davis, Orange County; Jeannie and Wallace Ambrose, residents of Chatham County; Mac Clarke, Chapel Hill resident; Ben Poulson, Associate Director of Energy Services, and Meg Holton, Water, Wastewater, and Stormwater Manager of the University of North Carolina at Chapel Hill.

There being a quorum present, Chair Gordon Merklein called the meeting to order.

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MOTIONS ACTED UPON

1. BE IT RESOLVED THAT the Orange Water and Sewer Authority adopt the resolution titled "Resolution Amending the Orange Water and Sewer Authority Financial Management Policy." (Resolution so titled attached hereto and made a part of these minutes. Motion by Fred Battle, second by William Stott, and unanimously approved.)

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ITEM ONE: ANNOUNCEMENTS

CONFLICT OF INTEREST

Gordon Merklein said any Board Member who knows of a conflict of interest or potential conflict of interest with respect to any item on the agenda tonight is asked to disclose the same at this time. There were none.

### ORANGE COUNTY PRESENTATION

Gordon Merklein said that on January 24, 2012, he provided the Orange County Board of Commissioners an update on OWASA's work with the Water and Sewer Management, Planning and Boundary Agreement (WSMPBA), forestry management and Rogers Road. The focus of his remarks pertained to work on the WSMPBA and Jordan Lake. Commissioner Barry Jacobs commented that Orange County may desire to have Mebane and Durham join the WSMPBA in the future. Commissioner Jacobs also said that if OWASA decides it is necessary to withdraw from WSMPBA, as much advance notice as possible should be provided. It was noted that the OWASA Board continues to work hard to resolve matters with Chapel Hill and Carrboro rather than withdraw from the WSMPBA. Commissioners Jacobs, Gordon and Pelissier all voiced their support on the importance of the WSMPBA.

### UPCOMING MEETING

Gordon Merklein said that on Monday, January 30, 2012, the Chapel Hill Town Council representatives and the Chapel Hill appointees to the OWASA Board will meet at 8:00 A.M. in the OWASA Boardroom to discuss OWASA's draft Drought Response Operating Protocol and other matters.

### WORK SESSION

Gordon Merklein said the OWASA Board will hold a work session on February 9, 2012 at 4:30 P.M. in the OWASA Boardroom, facilitated by the UNC School of Government, on legal authority and balancing interests; and clarifying what we do and how we do it.

### FINANCE COMMITTEE

Amy Witsil said that the Finance Committee met prior to the Board meeting tonight to discuss the financial report for the first six months of the Fiscal Year; and reviewed drafts of the budget planning documents and proposed changes to OWASA Financial Management Policy. The items discussed in the Committee meeting will be discussed during the Board meeting.

### CAN WE HEAL OUR LOCAL WATERWAYS

Will Raymond said that staff and he will participate in Chapel Hill 2020 Special Project presentation of "Can We Heal Our Local Waterways?" from 9:00 A.M. to 1:00 P.M. on Saturday, February 11, 2012 at the North Carolina Botanical Garden in Chapel Hill.

### OWASA'S WATER SUPPLY PRESENTATION

Ed Holland said that he will participate in Chapel Hill 2020 Comprehensive Plan update process and give presentation regarding OWASA and Our Water Supply on Monday, February 6, 2012 in the Council Chamber at the Chapel Hill Town Hall.

ITEM TWO: PETITIONS AND REQUESTS

Gordon Merklein asked for petitions and requests from the public, board and staff; there were none.

ITEM THREE: SEMI-ANNUAL CONTRACTOR AND CONSULTANT PERFORMANCE REPORT

Amy Witsil noted that the Park Construction for the Bolin Creek Interceptor project did not follow the transportation plan and there was an impact on the swimming pool.

ITEM FOUR: PRESENTATION BY ROBIN SMITH, ASSISTANT SECRETARY FOR PLANNING AND POLICY IN THE NC DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES (NCDENR), ON NCDENR'S ONGOING STUDY OF THE POTENTIAL DEVELOPMENT AND REGULATION OF SHALE GAS IN NORTH CAROLINA

The Board received a report from Robin Smith, Assistant Secretary of the North Carolina Department of Environment and Natural Resources, on the status of the State's study of potential development and regulation of shale gas extraction.

Ms. Smith reviewed the purpose and scope of the study, which the General Assembly directed to be completed by May 1, 2012; key resource agencies and experts participating in the study; a timetable and process for releasing the draft report; and the opportunities for public comment. The draft report is scheduled to be released in early March, 2012. There will be two public meetings. The first will be in Sanford on March 21, 2012 at the River Center and the second on March 27, 2012 at East Chapel Hill High School.

In response to questions from the Board, Ms. Smith stated that recommendations have yet to be developed regarding potential requirements for: disclosure of the chemicals used in process waters, treatment and management of wastewater from fracking, protection of groundwater, etc.

The Board expressed appreciation to Ms. Smith for attending tonight's meeting and looks forward to receiving the final report in May.

ITEM FIVE: FINANCIAL REPORT FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2011

The Board received this item as an information item.

ITEM SIX: PROGRESS REPORT ON OWASA'S STRATEGIC PLAN

The Board received this item as an information item.

ITEM SEVEN: REVIEW OF DRAFTS OF THE FOLLOWING BUDGET PLANNING DOCUMENTS: STATEMENT OF STRATEGIC ISSUES AND POLICES, PLANNING ASSUMPTIONS AND BACKGROUND INFORMATION, FISCAL YEAR 2013 DRAFT BUDGET CALENDAR

The Board received this item as an information item.

ITEM EIGHT: PROPOSED UPDATES TO OWASA'S FINANCIAL MANAGEMENT POLICY AND RESOLUTION AMENDING THE ORANGE WATER AND SEWER AUTHORITY FINANCIAL MANAGEMENT POLICY

Fred Battle made a motion to adopt the attached Resolution Amending the Orange Water and Sewer Authority Financial Management Policy as amended below:

**WHEREAS**, Orange Water and Sewer Authority's Finance Committee recommended a change to the proposed *Financial Management Policy* revision on page six of the revised policy by appending the last sentence under the heading "Rationale" for the Task identified as "Operations and Maintenance Budget Review" with the phrase, "to include cost containment and/or efficiency opportunities that may impact the O&M or CIP budgets": and

The motion was seconded by William Stott and carried by unanimous vote. Please see Motion No. 2 above.

There being no further business to come before the Board, the meeting was adjourned at 8:00 P.M.

Enclosures

**RESOLUTION AMENDING THE ORANGE WATER AND SEWER AUTHORITY  
FINANCIAL MANAGEMENT POLICY**

**WHEREAS**, Orange Water and Sewer Authority recognizes the importance of sound business practices and strong financial policy to support the utility's long-term fiscal sustainability; and

**WHEREAS**, Orange Water and Sewer Authority's *Financial Management Policy* was originally adopted on March 26, 2009; and

**WHEREAS**, Orange Water and Sewer Authority has developed a revised *Financial Management Policy*; and

**WHEREAS**, Orange Water and Sewer Authority's Finance Committee recommended a change to the proposed *Financial Management Policy* revision on page six of the revised policy by appending the last sentence under the heading "Rationale" for the Task identified as "Operations and Maintenance Budget Review" with the phrase, "to include cost containment and/or efficiency opportunities that may impact the O&M or CIP budgets": and

**WHEREAS**, the revised Orange Water and Sewer Authority *Financial Management Policy* reflects sound financial policy and provides guidance for financial practices and procedures;

**NOW, THEREFORE, BE IT RESOLVED:**

1. That the Orange Water and Sewer Authority Board of Directors adopt the attached *Financial Management Policy*.
2. That Orange Water and Sewer Authority's *Financial Management Policy* adopted on March 26, 2009, is hereby rescinded.

Adopted this 26<sup>th</sup> day of January 2012.

**ORANGE WATER AND SEWER AUTHORITY  
FINANCIAL MANAGEMENT POLICY  
JANUARY 26, 2012**

**SUMMARY**

*The purpose of this document is to describe a comprehensive and systematic approach to strategic financial planning, related policy decisions, and measurements of financial performance that collectively guide Orange Water and Sewer Authority (OWASA) in its ongoing efforts to provide its customers with high quality water, wastewater and reclaimed water services through responsible, sustainable and creative stewardship of the resources and assets it manages.*

The following excerpt from OWASA's *Mission Statement* provides the framework for development of this approach and related policies.

- *Efficiency and Value - we will perform all services in a financially sound and responsible manner with sufficient revenues to properly operate and fully maintain the water and wastewater system. As OWASA relies solely on user fees, we will continue to be guided by cost-of-service principles with regards to our rates, fees, and charges, and operate the water and sewer system at the lowest rates consistent with our obligation to provide proper and efficient services, now and in the future. We remain committed to continuous improvement in all of our services and will provide high value to our customers.*
- *Sustainability - we will proactively plan, construct, operate, maintain, and finance the water and wastewater system in a manner consistent with the principles of environmental, social and economic sustainability.*

<b>FINANCIAL PERFORMANCE OBJECTIVES</b>		
<b>Measurement</b>	<b>Objective</b>	<b>Section</b>
Working Capital Reserves	The greater of 4 months of O&M budget or 20% of the succeeding 3 years of CIP budget	A.1
Capital Improvements Reserve Fund	Minimum fund balance target of 2% of annual depreciated capital costs	B.1
Debt Service Coverage Ratio	≥ 2.0	D.1
Debt Burden to Asset Value	≤ 50%	D.2
Sufficiency of Revenues Above Debt Requirements	Annual Debt service shall not exceed 35% of annual gross revenues	D.3
Credit Ratings	Aa2 – Moody's; AA+ – Standard & Poor's; AA+ – Fitch	D.4
Cash Financing of Capital	Annual revenues and cash reserves shall provide not less than 30% of CIP funding	E.1
Rate/Revenue Stabilization Fund	Minimum fund balance target of 5% of projected water and sewer revenue	E.2
Service Affordability	Average annual residential bill divided by real median household income shall be ≤ 1.5%.	F.2

In recognition of the dynamic environment in which OWASA operates, the desired results of policy decisions identified in the Financial Management Policy may not always be achievable within short-term operating cycles. These policy decisions should be viewed as guidance for long-term sustainable fiscal performance, with success measured against the entire planning horizon rather than to individual reporting periods.

Although not necessarily explicitly expressed in this document, the Financial Management Policy recognizes OWASA's major legal requirements and obligations arising from State laws and regulations, contractual agreements with bondholders and other stakeholders and OWASA's Sale and Purchase Agreements under which the organization was formed. If not specifically addressed herein, adherence to such requirements is mandated elsewhere.

This document categorizes policy considerations for sound, sustainable financial policies into the categories of general financial; asset management; investment management; debt management; rates, fees and charges; customer care; and annual budgeting process.

## **SECTION A. GENERAL FINANCIAL POLICIES**

- A.1. ***Working Capital Reserves:*** OWASA shall maintain a fund balance at a level to sufficiently provide cash flow for daily financial needs in addition to adequate reserves to counter revenue instability and unanticipated expenses. The budgeted minimum reserve balance shall be equal to the larger of the following: a) 33% (four months) of the Operations & Maintenance (O&M) Budget, or b) 20% of the total estimated cost of the Capital Improvements Program (CIP) identified for the succeeding three years.
- A.2. OWASA shall make conservative, but reasonable estimates of revenues and costs.
- A.3. To the extent practical, the cost of system expansion shall be recovered from parties responsible for the expansion ("growth should pay for growth").
- A.4. If the Executive Director deems it necessary at any time to submit any Budget or other proposal to the Board that does not comply with the parameters set forth in this document, he/she shall seek specific approval from the Board for such a proposal.

## **SECTION B. ASSET MANAGEMENT POLICIES**

- B.1. ***Capital Improvements Reserve Fund:*** OWASA shall maintain a Capital Improvements Reserve Fund with a minimum fund balance target of 2% of the annual depreciated capital costs. The Capital Improvements Reserve Fund shall be an unrestricted reserve that is a component of the General Fund balance. The purpose of this reserve fund is to: ensure more sustainable funding for rehabilitation and replacement of the water and sewer systems and capital equipment; cover major unplanned increases in capital project costs; pay for previously unplanned capital needs; and provide funding flexibility needed in the Annual Budget to adjust for CIP costs carry-over adjustments.

- B.2. The annual budget shall provide 100% funding for maintenance activities required to ensure the operational integrity and safety of facilities and facility components.
- B.3. OWASA shall use a comprehensive approach to properly maintain all capital facilities, equipment, vehicles, etc.
- B.4. An amortization schedule shall be established for each physical asset to reflect the reasonable useful life of the asset.
- B.5. The costs of this comprehensive maintenance and rehabilitation program shall be reflected in OWASA's annual budget and five-year CIP budget.

### **SECTION C. INVESTMENT MANAGEMENT POLICIES**

- C.1. Cash management and treasury activities shall be managed in a manner that reflects efficient use of interest rates and maximizes fund performance balanced against investment risk and cash flow needs.
- C.2. OWASA shall attempt to reduce investment risk and maximize return on investments by participating in a variety of authorized investment instruments and financial institutions.
- C.3. Investment of OWASA funds shall not expose the assets to undue or unreasonable risk.

### **SECTION D. DEBT MANAGEMENT POLICIES**

- D.1. ***Debt Service Coverage Ratio***: OWASA's Bond Order requires a minimum annual required Debt Service Coverage Ratio of 1.2. The minimum annual debt service coverage ratio shall be 2.0; provided, however, that the minimum coverage ratio for any single year when severe weather anomalies or other unforeseen circumstances occur which negatively impact revenues and/or expenses shall not be less than 1.5 during the Fiscal Year.
- D.2. ***Debt Burden to Asset Value***: The comparison of outstanding debt to infrastructure value is a reasonable indicator of debt capacity. OWASA's debt to plant ratio (outstanding debt divided by the book value of fixed assets) shall not exceed 0.5 (50%).
- D.3. ***Sufficiency of Revenues above Debt Requirements***: OWASA shall maintain debt service as a percent of revenue at or below 35% of revenues.
- D.4. ***Credit Ratings***: OWASA shall maintain Credit Ratings of at least Aa2, AA+ and AA+ from Moody's, Standard & Poor's and Fitch, respectively.
- D.5. Debt issuance shall be limited to financing the costs of capital asset project planning and design, land acquisition, buildings, permanent structures, attached fixtures and



equipment, and the cost of debt issuance and capital reserves as may be required by creditors.

- D.6. The repayment of debt shall be structured in such a manner that the repayment period does not exceed the expected useful life of the assets acquired with the debt proceeds.

#### **SECTION E. RATES, FEES AND CHARGES POLICIES**

- E.1. ***Cash Financing of Capital:*** Annual revenues and cash reserves shall provide not less than 30% of the funds required for OWASA's CIP.
- E.2. ***Rate/Revenue Stabilization Fund:*** OWASA shall maintain a Rate/Revenue Stabilization Fund with a minimum fund balance target of 5% of the projected water and sewer revenue for the applicable year. The Rate/Revenue Stabilization Fund shall be an unrestricted reserve that is a component of the General Fund balance. The purpose of this reserve fund is to provide sufficient funding for the cost of maintaining, repairing and operating the water, wastewater and reclaimed water systems during extended periods when expenditures are higher and/or revenues are lower than budgeted while offsetting the need for rate increases and spending changes during the fiscal year.
- E.3. OWASA shall maintain a system of rates, fees and charges that effectively recovers allocated costs to customers and customer classes in reasonable proportion to their differing service requirements and their responsibility for the costs incurred by the utility. Adherence to the cost-of-service principle (benefiting party pays) as mandated by the Sale and Purchase Agreements and Bond Order shall be a primary guiding philosophy.
- E.4. OWASA's rates, fees, and charges shall be reviewed on an annual basis, and adjusted as necessary, to ensure that rate and revenue levels are adequately funding OWASA's financial, capital and operational goals, objectives and requirements.
- E.5. Rates shall be sufficient to generate income necessary to meet OWASA's revenue requirements. Revenue recovery from rates shall ensure financial stability as measured by adequate fund balance, operating reserves, debt service ratio, specified reserves and other measures established by OWASA.
- E.6. Rates should provide incentives for cost-effective use of facilities, conservation of water and efficient use and reuse of water resources, including rate surcharges during periods of water shortage.
- E.7. When OWASA determines that a rate increase is required, OWASA will strive to have such an increase be no higher than the general rate of inflation. However, OWASA shall set rates so that revenues will be sufficient at all times to provide for the cost of maintaining, repairing and operating the water, wastewater and reclaimed water systems, to pay the principal and interest on all issued or assumed debt, and to ensure the organization remains fiscally sound and financially sustainable.

- E.8. Although at times, operational or fiscal constraints may necessitate more aggressive or accelerated rate adjustments, rate levels and structures should be implemented through gradual programmed implementation of rate adjustments if possible.
- E.9. OWASA shall consider using the services of a qualified independent consultant to conduct a comprehensive rate study at approximately five year intervals.

#### **SECTION F. CUSTOMER CARE**

- F.1. OWASA shall operate the water and sewer system at the lowest rates consistent with its obligation to provide proper and efficient services, now and in the future.
- F.2. *Service Affordability* is an important consideration for OWASA. The target for average annual residential water and sewer bill divided by real median household income is  $\leq 1.5\%$ .
- F.3. When setting rates and evaluating rate structures, OWASA will carefully consider the impact such rates and rate structures will have on low income customers, while ensuring that cost-of-service principles are met.
- F.4. OWASA endorses and will promote the Taste of Hope customer assistance program. Donations made to the program by OWASA customers shall be provided to the Inter-Faith Council to help customers in need to pay their OWASA bill.
- F.5. Customers, citizens, and elected officials shall be provided timely, clear and understandable information and opportunities for constructive citizen participation in OWASA's rate decisions.

#### **SECTION G. ANNUAL BUDGETING PROCESS**

The preparation of the following documents on an annual basis is a key component of OWASA's annual budgeting and rate setting process. Those documents followed by an asterisk (\*) shall be presented for Board of Directors adoption.

**Budget Calendar:** The budget calendar shall include the proposed dates of all Board meetings and work sessions at which budget matters are to be discussed, and shall list the dates by which major budget tasks have been or are to be completed by staff.

**Statement of Strategic Issues and Policies (SIP):** The SIP shall identify the major issues, policies, and concerns that should be addressed in the upcoming annual budget and capital improvements deliberations.

**Financial Planning Assumptions and Background Information Document:** This document lists the major assumptions upon which the financial plans and budgets are to be based.

**5-Year CIP Budget\***: The CIP provides for the orderly repair and replacement of existing facilities, helps identify lead time for project planning, regulatory approvals, land acquisition, design, and construction, and provides a framework for strategically analyzing a wider range of acceptable alternatives, and for identifying, ranking, and executing projects.

**15-Year Financial Planning Model Report**: The planning model report provides a long-term perspective for assessing the adequacy of rates and fees and the timing and amount of anticipated debt financing. It also provides a means of evaluating the economic feasibility of implementing the long range CIP.

**Annual Budget\***: The annual budget provides the appropriation necessary to operate during the ensuing fiscal year.

The specific process and timeline for completing key components of OWASA’s annual budgeting and rate setting process will vary from year-to-year; however, the following table sets forth guidelines to which OWASA should generally adhere.

Task	Time Frame	Rationale
Review strategic issues, policies and economic assumptions	November/December	Staff, the Finance Committee and Board shall review strategic issues, policies, and economic assumptions that are expected to impact and the preparation of budgets (O&M and CIP) and rates. The identification of these key issues will help shape the annual budgeting process.
Capital Improvements Plan Review	February/March	The CIP provides for the orderly repair and replacement of existing facilities, lead time for project planning, regulatory approvals, land acquisition, design and construction, a framework for strategically analyzing a wider range of acceptable alternatives, and a framework for identifying, ranking, and executing projects. The Finance Committee and Board will review and comment on the draft CIP.
Operations and Maintenance Budget Review	March/April	The O&M budget provides funding for properly operating and maintaining OWASA’s services and programs. The Finance Committee and Board will review the draft O&M budget to

Task	Time Frame	Rationale
		include cost containment and/or efficiency opportunities that may impact the O&M or CIP budgets.
Financial Planning and Rate Review	April	Upon completion of CIP and O&M budgets, this information and other planning assumptions shall inform OWASA's 15-year financial plan. Staff will review the financial plan with the Board and recommend increases or decreases in rates.
Conduct Public Hearings	May	The OWASA Board shall hold public hearings on the draft O&M budget; CIP budget; and proposed rates, fees and charges for the coming year.
Adopt Budgets and Rates	June	The OWASA Board shall adopt the O&M budget, CIP budget and rate schedule for the coming year.