



MESA 2025: FINANCING THE FUTURE CITIZEN COMMITTEE

May 12, 2004

The Mesa 2025: Financing the Future Citizen Committee met in the lower level meeting room of the Council Chambers, 57 East 1st Street, on May 12, 2004 at 6:30 p.m.

COMMITTEE PRESENT

Kyle Jones, Chairman
Kirk Adams
Jill Benza
Rosa Cantor
Pat Esparza
Don Grant
Greg Holtz
Aaron Huber
Eric Jackson
Dennis Kavanaugh
Mark Killian
Robert McNichols
Scott Rhodes
Patricia Schroeder
Robin White

COMMITTEE ABSENT

None

EX-OFFICIO MEMBER

Keno Hawker, Mayor

STAFF PRESENT

Mike Hutchinson

Chairman Jones welcomed everyone to the meeting and said that Committeemember Kavanaugh is going out of town and will have to leave the meeting early.

1. Follow up on items from last meeting.

Chairman Jones encouraged the Committeemembers to write down any questions that arise during the presentation and said staff would respond to them once they have finished.

2. Presentation by the City of Mesa.

Utilities Manager Dave Plumb introduced himself to the members of the Committee and provided an overview of the presentation format, which included department history, system descriptions, comparisons, current challenges, future needs, organization, the four utility divisions (Electric, Gas Wastewater/Water and Resources), and closing comments. He stated that the department is composed of the four Divisions and one Section, which report to him. He added that a member of the City Attorney's Office is housed in the Utility Department and works directly with utility staff on a variety of contracts and issues. He explained that the Resources Division was established in 2000 in an effort to put together all of the elements that impact supply and demand and place them under one manager to coordinate marketing, rates, the acquisition of resources and conservation programs.

Mr. Plumb referred to slides that discussed the responsibilities of the Electric Division and noted that it has four responsibility centers and 42 employees. He also discussed the duties of the Gas Division and reported that the division has four responsibility centers and 83 employees. He outlined the Water Division's responsibilities and said they have 15 responsibility centers and 122 employees. He added that the Resources Division has three responsibility centers and 14 employees and highlighted their duties and commented on the operations of the Utility Service Section and reported that they have two responsibility centers and 24 employees. (Detailed responsibilities are outlined in the hard copy of Mr. Plumb's presentation distributed to the members of the Committee.)

Mr. Plumb discussed the electric utility and noted that Mesa ranks in the top 16% of municipal utilities by revenue and 15% by number of customers. He explained that there is a tendency to view the City's 5.5 miles as relatively small compared to APS or SRP, but in comparison to many publicly owned utilities across the country, Mesa ranks as one of the larger ones.

Mr. Plumb commented on the question of rates and general fund transfers and noted that most utilities in the country are operated at a profit (a net revenue). A portion of that net revenue goes to support other City services. In Mesa, where there is no property tax, they are forced to rely heavily on utility revenue. He referred to graphs that showed the national average (per the American Public Power Association) for transfers from electric utilities is a little under 6% and said that Mesa's average over the last five years has been approximately 22% of their operating revenue. He added that Salt River Project, which serves the rest of the City of Mesa, collects rate revenues for payments to cities, they may collect sales tax on their bills, they collect what are known as "in lieu of taxes" (because they are an entity of the State of Arizona, they don't pay property taxes per se, they pay them "in lieu"). He said that Mesa estimates are based on their assessed valuation in the City and the average primary taxes in the Valley and probably collect in the area of \$700,000 a year from Mesa rate payers that, were there a tax that could pay "in lieu of," would go back to the citizens but currently does not. He added that they do not receive any revenue back into the general fund from Salt River Project and, in effect, they are subsidizing other cities where they do make those payments.

Mr. Plumb discussed staff's intention to meet with the Council to discuss some rate adjustments and said they were going to propose a new rate element called an "Electric Energy Cost Adjustment Factor (EECAF)." He referred to graphs contained in the packets and highlighted the anticipated results of the EECAF. He also reported that a system assessment was

completed in 2003, the purpose of which was to identify high priority system deficiencies and concerns and establish a priority work plan for the next several years. He reported that the transmission system is approximately 35 years old and an assessment to determine the condition of the system revealed a significant number of deteriorating poles. He said the poles deemed in most need are currently being replaced (35) and added that since changes have occurred in the National Electric Safety Code Standards that the City follows, upgrades are also necessary. He stated that long-term, they intend to replace a number of wood poles with steel poles and reported that SRP has had a great deal of success inter-setting every fifth pole with steel. He added that this will decrease the amount of damage that could possibly occur as a result of micro-bursts. He also emphasized the significance of the system in that it delivers the power to the substations where it is transformed into distribution voltage and sent out.

Discussion ensued relative to the fact that the average design life of an electrical substation is 40 years and the fact that a couple of the City's substations are older than that and others, that are under 35 years in age, are beginning to approach that timeframe; that there are 14 substations (ten 4 kV and four 12 kV); the fact that the older 4 kV substations are nearing the end of design life and staff plans to replace them with fewer 12,000 volt stations; the importance of providing new growth capacity and achieving lower capital, operating and maintenance requirements; and electric meters and the importance of changing out and gradually upgrading them to avoid lost revenues (older meters run slow); employee history; contracting out tree trimming; the fact that unfilled positions still exist; the fact that the system in general experiences a 2% load growth a year as a result of a variety of factors (redevelopment, retail purchases that require electricity, etc.); and the expected impact on the load when the Mesa Arts Center opens.

Mr. Plumb discussed future challenges and said they include the increasing costs of materials (steel, copper, aluminum, poles); physical security for transmission lines and substations (Park Rangers had been performing this task, but the need more to provide cyber protection of utility (Supervisory Control & Data Acquisition System (SCADA) network and substation controls. He noted that they have to replace aging infrastructure (substations, poles, underground cables) and need funding for overhead to underground conversion for community aesthetics and reliability. He said that although citizens strongly prefer undergrounding, the costs are significant. He also commented on the volatility that exists in electric energy markets

Mr. Plumb moved on to the Gas Utility and noted that it has been owned and operated by the City for over 86 years and is the 13th largest public gas system in the nation with 44,031 customers and 1,004+ miles of natural gas system. He referred to a map that showed the City has two service territories, one within the City of Mesa and the Magma system, which is increasing at an alarming rate. He reported that when the City purchased the Magma Gas System in 1980, there were 165 customers. The current meter count is 3,400 and there are 88,264 total planned lots. He added that 13,134 lots committed with a 74% gas market share and emphasized that three out of every five gas meters set monthly is in the Magma territory. He referred to a chart that contained a natural gas residential bill comparison between Mesa and Southwest Gas and encouraged the members to review it in greater detail at a later time.

Mr. Plumb explained how the City prices gas compared to Southwest Gas and said that during the months of May through October, the summer period, the purchase of the gas itself and the actual rate the utility charges for the utility is lower. He said that Southwest Gas, when they

purchase their commodity itself, the natural gas, they charge their customers a 12-month rolling average so when their prices spike in one month, that averages out over the next 11 months. He stated that Mesa currently has a "direct pass through" and whatever the price is during any given month, that is the amount that is factored into the bills that are sent out the following month. He added that staff is looking into this particular area because in this climate, natural gas bills are not what electric bills are. He said that obviously winter gas bills are much lower, but staff is looking into some ways to "smooth that out" for customers.

Discussion ensued relative to the fact that the Gas Utility makes a general fund transfer and a comparison with other municipal utilities; the fact that the City of Safford is considerably smaller than Mesa but is the only other city in the State that has all four utilities; the fact that national data was not available but staff is pursuing additional information; the fact that the number of gas customers has continued to increase since 1996 and concerns regarding the fact that the number of customers per employee is significantly increasing and challenges associated with providing quality service with limited manpower.

Mr. Plumb further discussed the Utility Service Division and noted that they are the first responders and are experiencing the same increase in the number of customers to employee. He noted the significant increase in the miles of gas mains that has occurred and said this factor resulted in contracting out gas installations. He explained that oftentimes, a contractor's cost per linear foot of installation is lower than the City's for a variety of factors and stated the opinion that as long as the quality meets the City's standards, this is a good way to get the systems installed and save money for some of the rate payers. He said that unlike the Electric or Services Utilities, the Utility Service's challenges are "fixed." He explained that tremendous growth is occurring both in the City and within the 300 square miles of the Magma system. He said they will have to focus resources in that area for a number of years. He added that the operation of the Magma system brings revenue back to the City that can be applied to other City needs and added that sufficient operation and maintenance budgets are a big issue for the Gas Utility.

Discussion ensued relative to the Federal Energy Regulatory Commission (FERC) and the Arizona Corporation Commission (ACC), both of which impact the Gas Utility; the importance of replacing aging infrastructure; the fact that when the cost of natural gas is volatile, the price of the kilowatt hours also becomes volatile; the fact that a number of Arizona plants are no longer in operation either because they are no longer in the market or they over-built for the market; the possibility of entering into prepaid contracts and the fact that although they may not meet all of the City's needs, they would provide fixed prices so that the City could provide customers with greater stability as far as the price of that commodity.

At this point, Chairman Jones stated that he would allow questions from the members of the Commission during the next ten minutes.

Committeemember Kavanaugh asked for an update on the current status of deregulation with respect to the State and not that it could critically affect revenues to the utility and to the City. Mr. Plumb advised that electric deregulation, at least retail competition, is effectively "dead." There are no customers in the State of Arizona who are not being served by their certificated supplier at this point. He said that effective wholesale competition needed to be in place before retail competition could make any sense. The law that governs House Bill 2663 was passed a

few years ago only pertained to the Salt River Project and the City of Mesa, all the other public providers in the State were deemed too small and were excluded. The other utilities in the State, the investor owned utilities and cooperatives, are subject to ACC jurisdiction. He noted that the legislation is still in place and it stipulates certain requirements regarding reporting and so on that need to be met, but the reports are becoming very short, not much is happening.

Committeemember Rhodes questioned why staff was surprised at discovering aging infrastructure. He said he would think that this is an issue that would be anticipated. He also asked whether the cost of replacement infrastructure was built into the rates so that a replacement reserve fund would be in place. He asked whether that had just occurred and whether it will create pressure on future rates and financing.

Mr. Plumb responded that staffing has played a large part in this issue and said that although staffing has been level over the years, it had been targeted at putting in conduit and performing a variety of other jobs rather than going out and checking the infrastructure. He said that the new Director has been the driving force behind investigating the status of the various infrastructure. He explained that the City sells bonds to finance capital improvements in the gas, water and wastewater utilities and currently there are no outstanding electric bonds. He said that staff has suggested that it is probably time to bond some of the improvements to the system over a 20-year period of time. He noted that this would allow future ratepayers to pay for the improvements as well.

Mr. Plumb advised that they do not currently have any utility replacement reserves and said he hopes this is an issue that the Committee considers.

Committeemember McNichols asked how much money was transferred each year from the electric and the gas utility to the general fund and Mr. Plumb responded that they transfer approximately \$90 million from the four utilities.

City Manager Mike Hutchinson advised that the amount varies and said staff would provide him with data that covers the last ten or fifteen years. He added that the figure is closer to \$60 million rather than \$90 as previously stated. He informed the Committeemembers that last year approximately \$10 million was taken out of the Solid Waste operation.

In response to an additional question from Committeemember McNichols, Mr. Plumb said that Magma customers are charged the same rates as City of Mesa customers. He added that they would most likely be subject to ACC regulations if they were charged more. He noted that at the current time, the City collects from that area a percentage of net revenue equivalent to what they are getting in the City. He reported that Magma currently contributes to the City coffers without the City having to establish a differential rate or being subject to regulatory review.

Committeemember McNichols asked whether they could create a separate service district and vote a bond only for expansion into that area that would be repaid by fees collected within that specific area. Mr. Plumb expressed the opinion that it would be possible. He added that the advantage of the current bonding system is that all of the revenues from all of the utilities are used to guarantee the utility bonds, that is the way they are structured. He said the City probably receives a better rating and interest rate because that guarantee is in place. He stated that if the City was only trying to bond Magma, the rating agencies and individuals who buy the

bonds would look at the revenue only from that area and it might result in paying a higher interest rate.

Committeemember Rhodes asked why the ACC has anything to say about the City's rates and Mr. Plumb said that the City is subject to ACC jurisdiction only for safety issues. He noted that under similar circumstances, the Public Utility Commission in Colorado said that as long as they charge the same rates inside and outside of the territory, the rates would not need their approval because they were not differentiating. He said people in those outside territories are not able to vote for Councilmembers and have no influence over their rates. He added that he assumed they might be subject to ACC jurisdiction but said that would be investigated over time. He stated the opinion that if the cost of this system were substantially higher, it would obviously be an incentive for the City to look at some differential.

Mr. Plumb said that although he discussed the issue with the Utility Attorney, he does not have a firm answer on whether that assumption was correct. He added that he was relying on his own experience.

Committeemember Rhodes pointed out that the Arizona Constitution prohibits the ACC from having any jurisdiction over any municipal corporation and said it seems doubtful to him that they could extend their jurisdiction.

Committeemember Griswold asked whether the City made money on the irrigation system. Mr. Plumb responded that as a result of recent Council decisions, the City currently "breaks even." He said they recently conducted a cost of service analysis and decided what the "break even costs" would be and the rates were adjusted to meet those costs approximately two years ago.

Committeemember Griswold asked whether any other entities could run that system, the Roosevelt Water Control District (RWCD) or anyone else, if the City decided they no longer wanted to be involved in the business. Mr. Plumb noted that the system is Salt River Project's and stated the opinion that the RWCD probably could not. He said that every time he meets with one of the Associate General Managers at SRP, he encourages them to take over the City's irrigation system, but to date they have shown no interest in doing so.

Ex-Officio Committeemember Hawker asked for an update on the possibility of making a "switch" or "trade" with Southwest Gas so that the City could concentrate on service delivery just within the City of Mesa. Mr. Plumb advised that the last time this issue was brought up, representatives of Southwest Gas said when the City reaches the 10,000-customer mark we should come and talk to them about this matter. He said at the current time the City has 3,400 customers, is growing very rapidly and has tremendous potential.

Chairman Jones thanked everyone for their input and said they would return to the presentation at this time.

Mr. Plumb discussed the Wastewater Utility and reported that the City's wastewater system collects and treats approximately 40 million gallons of sewage a day. He noted that this figure includes flows from the Salt River Pima-Maricopa Indian Community; Gilbert and Queen Creek. He said that the system has 1,430 miles of sewer pipe, 20,200 manholes, 16 sewer lift stations and two water reclamations plants. He added that Mesa is also a part owner of a wastewater

treatment plant in Phoenix and the future Greenfield Water Recreation Plant, which is 60% designed and will be located in Gilbert, but designed, built and operated by Mesa. He also commented on the Northwest Reclamation Plant located at the 202/101 intersection and said the capacity at that site was recently expanded to 18 million gallons a day. He said that the Southeast Water Reclamation Plant is located in the middle of the Superstition Springs Golf Resort and its capacity was also recently expanded to eight million dollars a day.

Mr. Plumb informed the Committeemembers that of the 1,430 miles of sewer pipe system, 4% is more than 45 years old, 9% is 35 to 45 years old, 26% is 25 to 34 years old, 34% is 15 to 24 years old and 23% is less than 15 years old. He referred to a chart that depicted a comparison of wastewater general fund transfers (GFT) with other municipalities and noted that Mesa's percentage is the highest among the various utilities. He also discussed the contents of a chart that shows Mesa's utility charges as well as charges in place in other local communities. He noted that Mesa is "right in the middle of the pack" in the wastewater area.

Mr. Plumb discussed the Water Utility and said that the City produces approximately 34 billion gallons of potable water each year. He stated that some of that water goes to Chandler, Gilbert, the Arizona Water Company and Apache Junction through a variety of agreements that are in place. He reported that in an average day Mesa residents use approximately 93 million gallons. He noted that the utility's peak day was July 14, 2004 when 141 million gallons of water was delivered. He added that the system has about 1,900 miles of lines, 38 wells, 13 reservoirs, one existing water treatment plant and are in the process of building a second.

Discussion ensued relative to the portion of the City that has rights to water from the Salt River Project; the fact that this is water delivered from the Salt River and Verde River systems and is the least expensive water the City has; the fact that the City typically receives an annual allotment of 3-acre feet per acre of City zone but that amount was reduced to 2-acre feet per acre over the last two or three years because of droughts; the fact that the oldest fire hydrant in Mesa was installed in 1948; of the City's 44 well, 7 were drilled in the 1950's, 7 in the 1960's, 7 in the 1970's, 13 in the 1980's and 7 in the 1990's; of the City's 14 reservoirs, the oldest was built in 1952, one was built in 1960 (blue water tank at Falcon Field), 2 were built in the 1970's, 6 in the 1980's and 4 in the 1990's; and the fact that of the 1,924 miles of water main, 4% of the system is more than 45 years old, 11% is 35 to 44 years old, 24% is 25 to 34 years old and 23% is less than 15 years old.

Mr. Plumb further stated that the members were provided copies of charts outlining the Water Utility's average percentage of operating revenues over the last five years as well as a chart that shows how the City compares to a variety of other cities as far as average residential water bills, annual bills. He noted that the department relies on the water and gas meters for revenue and said that a water meter is typically good for about 10 years and at that time their accuracy will range at the 97% to 99% mark. He said that after ten years they begin to slow down and revenues are lost. He stated that they have over 27,000 meters in the system that are over ten years old and although a Change Meter Test Program was established a few years ago, they do not have the resources to keep up with the program. He also commented on the City's rapid response time (34.4 minutes) compared to four other surveyed cities that take up to a full hour to respond. Mr. Plumb discussed staffing and said the division has been fairly stable for a number of years. He noted that any staff additions are the result of expanding capacity at the treatment facility and the need for more operators.

Mr. Plumb referred to a chart that depicted the number of water/wastewater employees per customer in surrounding municipalities and expressed concern regarding the fact that Mesa's ratio is by far the lowest at approximately 0.31 employees per 1,000 residents compared to a high in Phoenix of 1.00 per thousand residents. He said Mesa's number is less than half the average of other smaller Valley cities and said the result is a lack of maintenance and not enough staff to operate and maintain the system the way it should be.

Mr. Plumb said that future challenges for the Water Division include the hiring of an additional 129 employees in order to meet basic operations, maintenance and regulatory requirements of a major water and wastewater facility. He explained that if the positions are not funded, the Water Division would continue to fall further behind in all aspects of the proper management and operation of a public water and wastewater utility. He added that there is a much greater possibility of water and wastewater system failures, which leads to public notifications, service outages, regulatory non-compliance and large expenditures for repairs and replacements. He said that Process Controls has been unable to perform preventive maintenance on the water and wastewater telemetry systems for the past nine years. He stated that due to the growth of the utility systems, only new equipment has been installed, repairs are done as needed and all other maintenance has been deferred.

Mr. Plumb further stated that the City's Wastewater Collection System has never been completely cleaned and never will be at current staffing levels. He noted that in other cities this is performed on a four to seven year cycle. He reported that they have only one fire hydrant crew to maintain the 19,028 hydrants in the City. He added that the four valve crews operate both water and gas valves resulting in the 35,631 water valves throughout the City not be exercised and maintained to water industry standards. He noted that this area has never been adequately staffed. He emphasized that regulations will continue to change and result in additional funding challenges.

Mr. Plumb discussed the issue of rate structures and pointed out that when the City is fairly dependent upon water revenue, there is an immediate impact if they tell people don't use water, but at the same time they need that revenue to continue running the system. He said a department-wide issue for them is the future workforce and reported that Personnel estimates that at this point, 20% of the workforce in the Utilities Department are eligible to retire within the next five years. He added that the City's salary range for Electrical Linemen and Electrical Engineers is the lowest in the Valley and said they are going to need those people. He said that regulatory requirements are also an issue for the Electric Division because of the implementation of spill prevention programs at the transformers at the substations.

Mr. Plumb informed the Committeemembers that the Utilities Department has not budgeted for vehicle replacement for the last four years simply because the budget did not allow for it. He said the only exception was the purchase of a vehicle for the Electric Division that was a combination crane, digger, and bucket truck and they actually replaced three older pieces of equipment. He noted that the cost of maintaining the older vehicles continues to escalate and when the vehicles are not replaced, higher costs occur.

In closing, Mr. Plumb said it is relatively easy to look at the Utility Department as a revenue source because they are and just how much they will find out in the near future. He asked that they keep in mind that safe, reliable and efficient utility services are life necessities. He

commented on the complexity of the systems and the importance of regular extensive maintenance and repair. He said they are subject to heavy regulatory requirements to protect public health, safety and the environment and highly educated, skilled and well-trained employees are needed to plan and maintain the systems. He stated that in many communities, utilities is a resource for economic development and asked that the Committee think of them as more than just a revenue source for the City. He encouraged the members to pose questions to him and any of the Division Directors in the audience.

Chairman Jones thanked Mr. Plumb for his presentation and said it appears that the City's rates are very competitive, but with the aging infrastructure and equipment, the monies that we transfer to the City may need to diminish in order to operate the systems efficiently and effectively. Mr. Plumb agreed and added that otherwise the City would have to identify an alternative source of revenue.

Chairman Jones summarized that the revenues are coming in, but "X" number of dollars is being transferred into the general fund and those monies are desperately needed just to keep the systems operating and to replace old equipment and infrastructure. Mr. Plumb concurred with his remarks.

Committeemember Griswold asked how much Federal and State mandates would add to Mesa's utility costs over the next few years and said he is aware of the fact that there will be an \$11 million arsenic cost.

Mr. Plumb responded that he would be hesitant to guess, but said that staff will research the matter and provide information at a later time.

Mr. Plumb advised that the next day he would address the Council regarding the Electric Energy Adjustment Factor that staff is proposing. He stated that an element exists in the City's electric rates that states rates can be adjusted based on the cost of fuel and purchase power. He noted that the City has never used that provision, which is fairly inexact with little detail on how it should be used. He said that staff is proposing a different system that is more carefully defined in terms of what the actual costs are to be allocated. He added that they are also looking at something that will help smooth out those kinds of anomalies in the system. He explained that they have witnessed tremendous spikes, primarily as the price of natural gas moves the price of electricity moves with it on the open market. He stated that staff is looking at a mechanism that will allow the City to pass those costs onto the customers without markup and to do it in a smooth manner so they don't experience big spikes. He pointed out that the problem with electric is that it spikes in the summer and the prices spike in the summer when the bills are the largest. He said staff would like to find some ways to eliminate dramatic swings.

Ex-Officio Member Hawker asked if staff were going to predict out the best practices for repair and maintenance and had sufficient ongoing monies in an account to do the best practices for the utility, exactly what they would require.

Mr. Plumb commented that the question is a very broad one. Ex Officio Member Hawker noted that they are doing a 2025 Financing Plan and he would like to know what it would take to bring the utilities up to par so that the City can stop playing catch up and wasting money. Mr. Plumb

commented that the question was a good one and said that staff will work on putting that information together.

Discussion ensued relative to manpower utilization and the fact that certain positions could be switched to different areas depending on needs but retraining would be required; CAP and SRP water rates and the fact that several years ago the City decided to go with a "postage stamp rate" with the exception of pumping costs; the fact that the City does charge some differential in the very high zones throughout the City because there are physically some energy costs that go into getting water up there; the fact that SRP costs are fixed other than growth within that area and there won't be a lot of additional SRP water being used; the fact that the larger area is served by the Central Arizona Project (CAP) and a lot of what happens to the rates is dependent upon what happens to the CAP; the fact that there is a capital cost associated with acquiring a right to CAP water and every year the CAP assesses an O&M (operations and maintenance) cost per acre foot and some energy costs per acre foot; the fact that a major shortage of CAP water or a major increase in the cost, there would be major impacts and that is the reason the City stores groundwater; and the fact that the City currently has in excess of 300,000 acre-feet of credits that belong to them and should the need arise, they can pump some of them as a routine matter to meet summer peaks.

Committeemember Grant commented that it sounds as though the City should invest more in the utilities and asked what the return rate would be to the City. He stated the opinion that utilities provide a significant portion of a percentage more than other cities and asked whether they would fall in line with them if they were doing the maintenance. He asked whether the City would still be more efficient than they are and asked how they would wind up in the rating. He noted that they seem to be contributing a lot more because we are understaffed and not performing preventative maintenance.

Mr. Plumb said he would like staff to conduct an analysis on that issue and bring the information back to the Committee.

In response to a question from Committeemember Rhodes, Mr. Plumb said that the rates change nearly every year as part of the budget process. He added that tomorrow they will be looking at the Utility Department budget and potential changes in the rates. He stated that the general fund transfer rate is set into the budget. Committeemember Rhodes asked whether it was correct to assume that when they are deciding upon a proposed rate, some cost of service figure is developed and they then have to add to that amount whatever the assumption is for the general fund transfer. Mr. Plumb responded that his description is accurate with one caveat. He explained that over the last few years, staff has begun putting together a cost of service studies. He added that a water and wastewater study was done last year, an electric cost of service study was done the year before that and gas will be the next one. He noted that they help ensure that the structure of the rates is good and on top of that that they recover their costs and recover the cost for the transfer.

Committeemember Rhodes asked whether they built on another margin for their own improvements or is there any rate of return to the utility that is calculated. Mr. Plumb responded that they do not. He concurred with the statement that consumers assume that they are paying a premium or a tax of whatever that general fund transfer is over the rate of the cost of providing the service to the ratepayers.

Committeemember Rhodes commented that if you look at it as a tax, there is no way for an average citizen to look at a water bill and determine that. He asked whether the City identifies a 22% or whatever percentage user fee, franchise fee or tax on the bills and Mr. Hutchinson said they do not. He added that Councilman-Elect Rawles has suggested that they ought to be doing that on the utility bills and said he agrees with the recommendation. He said that for years they have said there is no magic involved, the City does not have a property tax, they make their profit on the utilities and transfer those funds to the general fund. He added that they ought to be communicating this to the public. He said it would be a little complicated breaking it down by utility service but agreed that it would be a good thing.

Committeemember Rhodes stated that at the current time, it looks as though the City is charging a hidden tax and, unlike property taxes, it cannot be deducted.

Chairman Jones said that before them is an article he submitted to the paper last week that has not yet run. He stated that it basically explains that the utilities are a business and the City Council serves as the Board of Directors with all of Mesa's citizens being the shareholders. He stressed the importance of informing citizens of this and letting them know that nothing is being hidden. He said they need to evaluate how they are going to get that information out in the future.

Committeemember Rhodes commented that what he is hearing is that the rate of transfer is so high a cost for the utilities that they are not able to perform maintenance, equipment replacement and long-term planning that is crucial for a business of that kind. Chairman Jones agreed that this is an area that definitely needs to be looked at.

Committeemember Holtz estimated that approximately 36% of utility monies are going back into the general fund, in the range of \$60 to \$70 million. He said he never realized that the utilities were in such bad shape. He said he wanted staff to clarify a staffing matter and it is his understanding that they have 122 employees in the Water Division, yet one of the charts listing challenges indicates that 127 additional people are being requested, more than a 100% increase. Mr. Plumb explained that they are currently running at about .31 employees per 1,000 and the Valley-wide average is in the .7 range so they are talking about doubling staff in the Water Division. He noted that this would not happen overnight and said they recognize the budget constraints the City is facing. He added that they will target areas where they have the greatest need and hopefully over time have the resources necessary to maintain the system.

Additional discussion ensued relative to the fact that understaffing is a nationwide concern and infrastructure is becoming a very scary topic; the fact that staff attempts to get the revenues and expenditures to come out even with some contingency; the fact that the Council will look at proposed rate increases tomorrow and might decide to reduce some; the fact that a tentative budget will be developed and it goes to a public hearing at the first meeting in June where citizen input is obtained; the fact that sometimes the Council then decides to adjust the rates as they did last year; the fact that the maintenance issue has been exacerbated over the last three years of the fiscal crunch; the fact that they are trying to build some money into this year's budget to get Mr. Plumb's department get back on track; the fact that only one other city in the Valley that does not have a property tax (Paradise Valley); the fact that if SRP paid the City an in lieu tax, it would amount to approximately \$700,000, but they are completely unwilling to

consider doing so; and the fact that in lieu payments are made by SRP to every other city, but because Mesa has no property tax, they are not included and they do not obtain a cheaper rate.

Ex-Officio Member Hawker asked whether the City needed to hold onto the Pinal County Water Farm as a resource or if it should be sold at some future date. He also questioned the maximum per day that the City can recharge and whether it is cost effective to recharge effluent and then pump it back if compared to CAP water.

Mr. Plumb provided brief history relative to the Pinal County Water Farm and said the City's intent when it purchased the 12,000 acres that had an annual yield of 30,000 acre feet of water, was to some day collect that water and bring it back to the City or exchange it. He stated that they were going to collect it and put it back in the Central Arizona Project Canal and then take water, for example, that would have been Tucson's CAP allotment and trade with them. He added that in the meantime, they have been farming the land to maintain the water rights and they typically break even every year in the cost of administering the lease and what the lessees pay the City for the use of the land. He explained that Pinal County has a Planned Depletion Aquifer and an Aquifer Management Area and the idea was that over time agriculture would be replaced by urbanization and the water demands would decrease. He said they viewed that as being a potentially excellent source of water and over the years as they evaluated that they have begun to discover that a number of the wells have nitrates, which are not a problem if they are being put on crops but if the nitrates are in drinking water and it goes into the canal and it is sent to Tucson, there would be a major problem. He stated that if they are going to proceed they are talking about a significant amount of clean up and added that the wells are spread over 12,000 acres and somehow all of that would have to be collected and put into the system. He said his short answer would be "yes," and they are looking at the possibility that they may not need that resource but the following must also be considered.

Mr. Plumb commented that the reason the City might not need it is because they are able to recharge groundwater and get credits or recharge the groundwater and get credits from reclaimed water. He said that the cost of reclaimed water is hard to determine when you finish the wastewater treatment process and treat the reclaimed water. He said that the least expensive water they have today is Salt River Project water and the cost per unit is pretty low so when they treat it and then send it out in the system, it remains the lowest cost. He indicated his intention to have staff prepare an analysis as to the cost of CAP with treatment compared to when groundwater is pumped and said it varies throughout the system as well. He noted that energy costs will be higher as well and said they will try to provide the Committee with at least some averages.

In response to an additional question from Ex-Officio Member Hawker, Mr. Plumb discussed San Diego's "Toilet to Tap" program and said that name basically killed the program. He said they can reclaim the water, treat it to near drinking water or even to drinking water standards but the perception continues to be that wastewater is flowing through their taps. He stated the opinion that the issue is political and perceptual rather than technical.

Ex-Officio Member Hawker asked whether the City's usage per year was around 300,000 acre feet of credits or more and staff advised that they are using approximately 100,000 to 105,000. He added that they are at 138 for water surface capacity at the current time and 141 is the maximum capacity. Mr. Plumb explained that the CAP plant, which is currently at 48 M.G.D., is

in the process of being expanded to 72. He added that the share of the Val Vista Plant that they share with Phoenix is at 90, so there is 132 in capacity or 138 today with expansion. He stated that they hit the 141 by running the plants pretty full steam ahead and by running wells to supplement them. He said at this point, other than chlorination, there is no treatment and a couple of the wells have arsenic treatment, but that's all.

Committeemember Rhodes requested information on the book value of the City's electric system. Mr. Plumb said that the information is available but he failed to bring it with him. He added that a study was conducted approximately two years ago and he will provide the Committee with that information.

Committeemember Grant questioned whether the City's philosophy is to go for the high capital costs and then the low cost on running the facility or whether they go for low capital cost and then maybe incur higher maintenance and operating costs. He also asked whether an ROI is done.

Mr. Plumb responded that there is always a balance and that they neither go to either extreme to minimize costs and spend capital at great additional costs nor do they ignore the operation. He stated the Design Engineers that they work with to do the expansions are always looking at the latest technologies and energy savings available and they build whatever they can into the process to reduce the operating costs. He added that at the same time, with the exception of a brand new plant, they are working with some existing infrastructure and so there is some need to match what you have for the benefit of operations and consistency while at the same time improving whatever aspects possible. He said on many of the projects they've looked at they've felt that if they can get a return on investment (ROI) within five years, it's probably a good thing especially if they are building a plant that's going to be there for the next 40 to 50 years.

Committeemember Griswold asked whether the new Greenfield Plant will provide the City with the capacity necessary to handle their own waste and get their own effluent. Mr. Hutchinson said the short answer is "no." Mr. Haney added the opinion that they are in it for the long haul and said they have a very large investment in the plant, but more importantly, they have some commitments as far as the effluent itself goes. He discussed the City's commitments to Palo Verde and the Buckeye Irrigation District. He noted that they have a commitment of 19 million gallons a day and they own 29 million gallons. He said he will never support putting another penny into expanding the City's share of that because of the costs involved in keeping the plant going and expanding it. He stated that they understand that the City will always have commitments in maintaining what is already there but they do not want to become any more involved. He expressed the opinion that because of the value of the effluent, the City would prefer to keep the water within our own City limits.

Discussion ensued relative to the fact that over the last 15 years the City's philosophy has changed due to the increased value of effluent and the City's efforts to build ore plants and perform re-use; the fact that theoretically as Avondale and Glendale grow they could replace the City's position but the fact that the City went through such an exercise with Peoria and it was extremely complicated; the fact that the City informally adopted the policy that they would not take any new partners into the facility in the future; the fact that at full capacity, Greenfield could not replace that; the City's cooperative agreement with the SROG cities, the 91st Avenue Treatment Plant, which runs extremely well; the fact that the City paid approximately \$2,800 an

acre for the water farm and an estimate that the land could be worth \$6,000 to \$10,000 an acre and will only continue to increase; and staff's estimate that it is worth \$25 million and will be paid off in 2007.

Chairman Jones thanked Mr. Plumb for his presentation.

3. Current issues/miscellaneous items.

There were no items discussed under this agenda item.

4. Schedule next meetings:

Wednesday, May 26, 2004, 6:30 p.m.

Wednesday, June 9, 2004, 6:30 p.m. – Tour

5. Adjournment.

Without objection, the Mesa 2025: Financing the Future Citizen Committee adjourned at 9:14 p.m.

I hereby certify that the foregoing minutes are a true and correct copy of the minutes of the Mesa 2025: Financing the Future Citizen Committee meeting of the City of Mesa, Arizona, held on the 12th day of May 2004. I further certify that the meeting was duly called and held and that a quorum was present.

BARBARA JONES, CITY CLERK

lgc