

LAKEHAVEN UTILITY DISTRICT
King County, Washington

SPECIAL BUSINESS MEETING
March 29, 2007

A special meeting of the Board of Commissioners of the Lakehaven Utility District, King County, Washington, was held on March 29, 2007 at Lakehaven Center, 31531 First Avenue South, Federal Way, Washington, 98003.

President Miller called the meeting to order at 1:30 p.m. and asked Commissioner Nowicki to lead the flag salute. Members/officials present were as follows:

Don Miller	President of the Board
Ron Nowicki	Vice President of the Board
Chuck Gibson	Secretary of the Board
Ed Stewart	Commissioner
Beverly Tweddle	Commissioner
Don Perry	General Manager
John Bowman	Engineering/Water Manager
Steve Pritchett	General Counsel
Morgan Dennis	Director of Finance/Information System

APPROVAL OF AGENDA

Upon motion of Commissioner Tweddle, which was duly seconded by Commissioner Nowicki, the Board unanimously **approved** the meeting's agenda as presented

CONSENT ITEMS

Upon motion of Commissioner Tweddle, which was duly seconded by Commissioner Gibson, the Board with Commissioners Tweddle, Gibson, Miller and Stewart voting in the affirmative and Commissioner Nowicki abstaining, **approved** the Consent Agenda as presented below:

1. Accounts Payable Vouchers and Payroll Transactions with the warrant dates of 3/28/07, 3/29/07 and 3/30/07.

Maintenance Fund No. 11-333-0510

- 3/28/07, voucher nos. 8127-8154, total amount of \$22,043.56;
3/29/07, voucher nos. 8155-8271, total amount of \$380,240.91.

Construction Fund No. 11-333-3510

- 3/30/07 voucher nos. 8272-8276, total amount of \$13,019.70.

PWTF Wellsite & Emerg Power Fund No. 11-333-6020

- 3/30/07 voucher nos. 8278-8280, total amount of \$4,091.99.

PWTF Redondo Outfall Fund No. 11-333-6040

3/30/07 voucher no. 8277, total amount of \$7,228.35.

INFORMATION ITEMS

#1, Review of Water and Wastewater Rates: Mr. Pritchett introduced Ed Cebron of the FCS Group who had been retained to perform an independent review of the District's water and wastewater models. Mr. Cebron had provided the Board with the information that he had prepared for this presentation and began the discussion by stating the goal of the presentation was to review the discussion that was held last fall, discuss some policy issues and focus on what the Board determines would be the best way to proceed from there. Mr. Cebron stated that his presentation was an overview of the key utility rate issues that would include discussions of utility fiscal policies, cost-of-service analysis, rate design and lastly, proposed next steps in this issue.

Mr. Cebron began by discussing fiscal policies. Through responsible management practices and sound fiscal policies, the District can ensure the long-term financial integrity of its utilities. He noted that fiscal policies commonly address a number of topics, including capital funding, utility reserves and financial performance. He began with capital funding and stated that utilities commonly turn to a number of sources to obtain funding for capital projects that include grants (developer contributions), Capital Facilities Charges, rates, cash reserves and debt. Cash funding is ultimately less expensive than debt funding; however, this may adversely impact rates. He noted the first thing to consider before determining the type of funding to pursue is to assume that the capital requirements are necessary. If the District were to complete everything planned on the current Capital Improvement Projects (CIP) list, Mr. Cebron stated the District would have to increase the rates by a large margin in order to have the funds to complete the projects. However, since this is not the case, he stated it would be necessary to develop modeling to account for this. He then went on to discuss what he considered to be "Core" capital funding policies. Capital needs will be defined through periodic system planning and evaluation, addressing both capacity and condition. Capital Facilities Charges will be set to recover an equitable share of system costs so as to minimize or avoid subsidy of growth by existing customers. In this area, the Board has held to the principle that growth pays for growth and does not affect the rates. A discussion ensued relative to this item; it was noted that there are different ways to address the issue. Rates will be set to provide an annual contribution toward capital needs at least equal to annual depreciation of assets (net of debt principal repayment). Debt shall be used to finance capital projects when cash resources are not adequate or when debt terms are advantageous. Mr. Cebron noted that different utilities have incorporated their policies in different ways, depending on the need and added that he would advocate some balance.

The next item of discussion was capital reinvestment. Rate funding is central to long-term reinvestment strategies to sustain viable utility systems. Common conceptual approaches to replacement funding include the following: fund as needed; establish a funding objective based

on a funding benchmark such as depreciation less debt principal, depreciation expense, replacement-based depreciation or sinking fund and a financial performance measure such as defined debt coverage requirement, define debt/equity ratio and defined limits on reserve accumulation. Mr. Cebon went on to explain each of the points he made and a discussion followed regarding the advantages and possible impacts that could occur. He noted that he would like to come back to the Board with a discussion of consequences the District could realize, based on the discussion of these approaches. Mr. Cebon next reviewed a proposed capital reinvestment strategy that included the following suggestions for consideration: rates fund annual transfers equal to net depreciation; replacement funds are part of utility construction resources; fund balance is limited to five years of (original cost) depreciation expense – annual funding is ramped down while fund surplus remains and then ramped back up when balance declines below a defined threshold; debt is used to augment cash funding as needed; if fund is lagging replacement needs, consider ramping to a higher benchmark such as full depreciation funding or a calculated long-term funding need. Mr. Cebon then reviewed utility reserves and explained some common types of reserves, which were an operating reserve, a capital or construction reserve, a rate stabilization reserve and a debt reserve. Included in his information were core reserve policy elements and their impacts. He then noted another responsible utility management practice relates to gauging the financial performance of the utility, setting specific performance goals and establishing a basis for determining whether or not existing rates are sufficient in cash flow, debt coverage and earnings. He stated that core financial performance policies include 1) Cash – revenues must be sufficient to satisfy cash needs for operating expenses, debt service, depreciation funding and additions to reserves and 2) Coverage – revenues (excluding CFCs) must be sufficient to cover operating expenses plus 1.50 times annual debt service. Other policy considerations include the use of connection charges and how they affect what rates pay. Another consideration discussed was a near-term rate strategy and how should the District handle its near-term revenue needs. Mr. Cebon provided some suggestions for the Board to consider on both of these items.

Next, Mr. Cebon discussed the Cost of Service Analysis. He noted he had gone through this area of the study conceptually and proceeded to review the methodology as follows: establish a rate revenue requirement; allocate costs to functions of service; allocate costs to customer; design utility rates. He then summarized the key water cost of service findings and used the 2005 actual water rate revenue in his calculations. Based on the analysis, he suggested a shift in cost recovery between the different customer classes. He noted his proposed next steps in this area would include the following: develop a multi-year statistical basis for cost allocation; review the cost allocation principles; review customer classes and update and revise the water cost-of-service analysis. He also suggested the following for sewer cost-of-service: develop a cost-of-service analysis; review customer classes and determine cost-of-service allocations. The Board then discussed the suggestions.


The final step of the rate study process is to design a utility rate structure that recovers the allocated costs from customers. Mr. Cebon stated that key rate design considerations include: practicality – how easy is the proposed rate structure to implement and are there any limitations

attributable to political or other qualitative considerations; equity – how well does the proposed rate structure achieve its goal of recovering costs from customers based on the demands that they place on the system; effectiveness – how well does the proposed rate structure achieve the Districts’ policy goals of encouraging responsible usage and ensuring the financial stability and integrity of the utility. Mr. Cebron emphasized the need for a flexible and adaptive plan to allow for any unplanned expenses that could be imposed on the District. He went on to review the existing water rates and how much they would change by increasing them. Also discussed was imposing the increase on the fixed charge and/or the different blocks of usage. Also discussed were non-residential water rates and how they would change with a rate increase. Mr. Cebron suggested core rate structure policies for the Board’s consideration that included the following: rates will be developed to reflect cost of service and recovery of cost equitably and proportionately; shifts in cost recovery will be phased in to mitigate rate impacts; rates will be structured to encourage and promote efficiency and conservative use of water and system capacity; rates will be structured to provide affordable service for “lifeline” users; preference will be given to rate structures that are practical and understandable. Lastly, Mr. Cebron suggested the next steps to take relative to the rate structure. These included for water: evaluate the single family rate alternatives, standardize non-single family rate classes and evaluate rate impacts. In addition, suggested steps for sewer to consider included review volume-based rates, review strength classes and charges and review capacity lease structure.

At the conclusion of the presentation, a discussion ensued and questions were asked and answered. Subsequent to the discussion, the Board thanked Mr. Cebron for the informative presentation. It was noted that Lynn Takaichi of Kennedy/Jenks, Inc. would be attending the next Board meeting to discuss Capital Facility Charges.

ADJOURNMENT

There being no further business to come before the Board, the meeting was adjourned at approximately 3:35 p.m.



President Miller

Yea Nay Abstain

ATTEST:



Vice President Nowicki

Yea Nay Abstain

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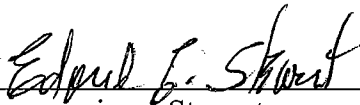
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Secretary Gibson


Yea

Nay

Abstain



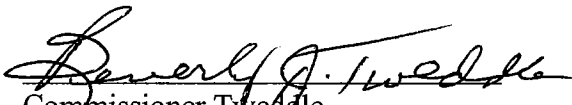
Commissioner Stewart




Yea

Nay

Abstain



Commissioner Tweedle



Yea

Nay

Abstain