

SEACOAST UTILITY AUTHORITY

ADMINISTRATIVE DIVISION M E M O R A N D U M

TO: Seacoast Utility Authority Board

FROM: Rim Bishop, Executive Director

DATE: February 12, 2008

RE: **SUA REVENUE SHORTFALL - EXPENSE REDUCTION
ALTERNATIVES**

A preliminary analysis performed by the firm Howard C. Osterman, Inc. confirms that South Florida Water Management District's Water Shortage Emergency restrictions are depressing Seacoast revenue by approximately \$300,000 per month. To help mitigate the need for a Revenue Restoration Surcharge, Seacoast's Board has directed staff to investigate expense reduction alternatives. Following is staff's summary.

WORK FORCE EXPENSE (Current Average Monthly Cost = \$500,000)

Since 1986, Seacoast has reduced its work force from 144 full-time employees to 126 full-time and 4 part-time employees. During that period, the number of Seacoast customers has increased by over 60%. We have no new positions budgeted for the current fiscal year and we currently have only one position unfilled. Nearly 25% of our workforce is comprised of licensed treatment plant operators needed to meet legal shift coverage requirements at Seacoast's three treatment plants. In nearly all respects, our pay and benefits package is modest, particularly compared to competing area employers. In short, we have already pared both the number of employees and the compensation they receive to the bare minimum, and any further reduction in either will, in my opinion, adversely impact the quality of service to our customers.

MEMBRANE REPLACEMENT PROJECT (Reduce Size of Plant)

We could alter our Membrane Conversion Project, downsizing the proposed water plant by some 20%, perhaps saving as much as \$6,000,000 or \$30,000 per month in interest and principal. We would do that by projecting current Phase II per capita water demand through build out and downsizing the plant from the projected 30.5 MGD to, say 22.5 MGD (remember, I'm just picking numbers off the top of my head here). The down side of this is that if SFWMD ever realizes that there is no water shortage emergency in this area and lifts its restrictions, we may not have sufficient capacity to meet peak day demand.

RENEWAL AND REPLACEMENT PROGRAM (Defer R&R Projects)

Over the past few years, we have averaged about \$2.5 million per year in renewal and replacement expenditures. This year we propose to spend significantly more, and while we could indeed offset all or part of the \$2.5 million revenue deficit by deferring renewal and replacement activities, the key word here is DEFER. The need to renew and replace utility assets never goes away, it just gets more expensive over time, and the risk of critical asset failure with resulting catastrophic environmental, public health, or customer convenience consequences increases with asset age. In my judgment, deferring renewal, replacement or maintenance activities is highly risky, unjustifiably short sighted, and precisely the opposite of a cost saving measure.

OPERATION AND MAINTENANCE BUDGET

Reviewing the 2007 budget by object analysis (page 11), I am struggling to find any material discretionary expenses in those line items. As you know better than most, we budget for that which we MAY need, but we only purchase that which we DO need. We've already discussed payroll, benefits, maintenance and capital opportunities; we will save variable costs such as power and chemicals only to the extent that we don't pump and treat water; professional services are only used when they are required, though we could achieve some engineering savings by deferring renewal and replacement projects (see no. 3 above); and if we cut out all memberships, subscriptions, training, etc., we would save about \$7,000 per month while isolating our work force from the rest of the professional world. Though there may be symbolic opportunities, I do not believe that there are material discretionary costs here.

SPENDING DOWN OF RESERVE ACCOUNTS

Conceivably, we could alter our financing plan to deplete all or part of the \$10 million that we propose to hold in reserve after completion of the Membrane Conversion. Spending down that cash would correspondingly reduce debt service – spending all of it would reduce debt service by approximately \$50,000 per month. However, this would leave us without the ability to meet unforeseen or emergency needs without further borrowing, and I strongly oppose this alternative. With \$150 million in infrastructure operating every day, opportunities for costly system failures are all around us, and we need to be able to address these in a prompt and responsible manner.

SUMMARY

In summary, Seacoast's current rate system is designed to provide sufficient revenue to cover its costs – that's all. It is not designed to generate surplus cash. In fact, our long term plan is to utilize existing cash balances, primarily for renewal and replacement activities, from the current \$40 million to approximately \$12 million over the next five years or so. If SFWMD settles on year round Phase II restrictions, which seems currently to be the general consensus, and we do not implement well researched and conceived Water Shortage Emergency rates but continue on the current revenue and expense track, we will deplete all of our cash reserves before the membrane conversion project is completed. Therefore, my preliminary conclusion, subject to your review and comment, is that there is no safe and responsible alternative to implementation of a SFWMD Water Shortage Emergency rate system.