AGENDA MATERIAL
DATE 6/17/25 ITEM NO. RA 67, 68

MEMORANDUM

Date: June 16, 2025

To: The Honorable Chair and Members
Pima County Board of Supervisors

From: Jan Lesher
County Administrator

Re: **Additional Information for the June 17, 2025, Board of Supervisors Meeting on Item #67 and 68 for Proposed Wastewater Rate Increase**

The following information assembled by the Finance Department is provided to the Board of Supervisors in response to questions recently raised by Supervisor Christy (Attachment 1).

Each year the Finance & Risk Management Department (Finance) works with the Regional Wastewater Reclamation Department (RWRD), County Administration and the Regional Wastewater Reclamation Advisory Committee (RWRAC) to develop the assumptions for the RWRD Financial Plan based on operational and capital forecast and budget information provided by the RWRD. The forecast information for operations and capital is updated monthly throughout the fiscal year. This process was followed this year with Finance working with RWRD dating back to October 2024 on the Financial Plan and associated assumptions and scenarios presented to the full RWRAC and RWRAC financial subcommittee.

The RWRD Financial Plans dating back to 2019 have been based on maintaining at least $50 million in unrestricted cash, maintaining a debt service ratio of at least 1.30, minimizing interest cost to ratepayers and complying with the Board of Supervisors Pay-as-you-go model by limiting the term of new debt issues and utilizing excess cash to prepay debt. As a result of the prudence taken in prior financial plans, Fitch Ratings upgraded the rating on Pima County Sewer Revenue Obligations to AA from AA- on November 10, 2020.

The primary driver of the rate increases is the need to maintain the 1.30 Debt Service Coverage Ratio which is a calculation of net revenue divided by debt service payments. Based on the April operating and capital forecast and the Tentative Budget, without rate increases the debt service coverage ratio will drop below 1.2 in Fiscal Year 2026/2027. This would violate the debt service covenants on the existing debt triggering a default and possible rating downgrade from the rating agencies thereby providing a mechanism to compel the County to increase rates.

In addition to the increased operating costs of the department spurred by significant inflationary factors, and the reduction in the winter quarter average for residential customers, the 5-year capital program includes $443.8 million for significant investment to maintain the existing system and construct a new Wastewater Reclamation Facility in the Sahuarita area including the associated Sahuarita-Green Valley interceptor.

Due to the expenditure limitation restrictions in Article IX, Section 20 of the Arizona Constitution, the County is limited in its use of available cash to fund capital improvements.

To comply with the expenditure limitation restrictions the County must fund the RWRD capital program with borrowed funds and use available unrestricted cash to pay the associated debt service as well as pay-off existing callable debt in conjunction with recommendations provided by the County's financial advisor.

Rating Agencies complete a comprehensive review of the RWRD financial results and forecast of future revenue, expense and debt service as part of their review prior to the issuance of any new debt. The rating directly impacts the marketability of the debt and resulting interest rate. The rating agencies expect that there is sufficient unrestricted cash to cover future economic uncertainty such as a potential decrease in Wastewater Utility Fees from a downturn in construction.

Regarding each of the Pillars identified in Supervisor Christy's memorandum, the following information is provided:

- Pillar 1 – The unrestricted cash does not impact the debt service coverage ratio, so it does not directly affect the rates, however the rating agencies review does include an evaluation of unrestricted cash sufficiency.

- Pillar 2 – The forecasted information that RWRD provides Finance is fluid, the actual debt service coverage ratio is impacted by many variables such as the number of ratepayers, the amount of water used by rate payers during the winter quarter average, the number of ratepayers receiving discounted rates, the amount of construction activity generating Wastewater Utility Fees, vacancy rates for staff, planned and unexpected operating expenses and the advance or delay in timing for capital projects, etc.

  The fiscal year 2024/2025 budget resulted in a debt service coverage ratio of 1.32. Due to higher-than-expected forecasted revenues and lower than expected forecast expenditures, the forecasted ending FY 2024/2025 ratio is 1.36. There is never a guarantee that actual revenues will meet or exceed budget or that expenses will be at or below budget. Based on the April forecast and the Tentative Budget including the proposed salary increase for employees in Fiscal Year 2024/2025, the current forecast for the debt service ratio is FY 2024/2025 1.36, FY 2025/2026 1.32, FY 2026/2027 1.32, FY 2027/2028 1.34 and FY 2028/2029 1.35.

  It should also be noted that the FY 2025/2026 Wastewater revenue budget was built with the presumption that the proposed rate increase(s) is approved. Should the proposed rate increases not be adopted, Wastewater would need to make expenditure reductions to remain in compliance with the debt service ratio, which could negatively affect operations. A failure to make expenditure reductions if the rate increases are not approved may impact future bond ratings and rating outlooks which could have a negative impact on the marketability of the County's debt which impacts interest rates on the resulting debt issuances.

- Pillar 3 – The County has limited new debt to 15-year maturities for over 25 years. This fiscally conservative policy is considered a strength by the rating agencies and is often mentioned in their rating reviews. If the Board direction is to extend the duration of future debt service, it would increase the overall cost of debt service to the ratepayers. If the future debt service repayment was extended and the annual debt service reduced, it would increase the debt service coverage ratio.

  The interest cost of a debt issue is impacted by several factors, but, assuming a 5% interest rate with equal debt service payments on a $60 million dollar issuance the extension from 10 years to 15 years would cost ratepayers an additional $8.2 million dollars and the extension from 15 years to 20 years would cost an additional $9.3 million dollars for a total increase of $17.5 million for an extension from 10 to 20 years.

County Finance is coordinating with the full RWRAC committee to establish a meeting with the County's Financial Advisor, RBC Capital Markets, in the August/September time frame to further discuss the concerns posed by Mr. Sullwold and Mr. Matthewson. Further, Finance Director, Art Cuaron, will be meeting with Mr. Sullwold and Mr. Matthewson in July to address these concerns as well.

JKL/anc

Attachment

c: Carmine DeBonis, Jr., Deputy County Administrator
Steve Holmes, Deputy County Administrator
Art Cuaron, Director, Finance and Risk Management
Jackson Jenkins, Director, Regional Wastewater Reclamation Department
Andy Welch, Deputy Director, Finance and Risk Management

ATTACHMENT 1

PIMA COUNTY BOARD OF SUPERVISORS

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Stephen W. Christy
Supervisor, District 4

MEMORANDUM

DATE: June 12, 2025

TO: Jan Lesher, County Administrator

FROM: Steve Christy, District 4 Supervisor

SUBJECT: **Consideration of Proposed Pima County Sewer Rate Increase, Your Memo dated February 14, 2025**

Following the receipt of your memorandum on this subject, I have met with my representatives on the Regional Wastewater Reclamation Advisory Committee (Eric Sullwold and Charles Matthewson) to discuss the development of the County's FY 2025/2026 Financial Plan for the Wastewater Department. I am aware that there was little or no citizen input received during the various public hearings on the proposed sewer rate increase.

On behalf of the residents of District 4, I am committed to ensuring that the County does not increase its sewer rates unless it is required by necessity to do so. We should not take general inflationary trends or general utility industry trends or citizen silence, by themselves, as license to increase rates for our sewer users. We should insist that the Wastewater enterprise fund is managed with the specific interests of its customers and the specific circumstances of the Department and its fund as paramount considerations. The distinction between that fund and the County's general fund, and the Board's dual role in governing each fund, is an important one for all of us to observe and respect.

I understand that the County Finance Department has led the effort to develop the next Financial Plan and that it has provided some "key financial metrics" or "financial pillars" to both RWRD and the RWRAC in establishing the draft Financial Plan. These metrics/pillars, and their impact on preserving a favorable (AA) bond rating for the Wastewater fund have been used to justify the proposed rate increase. I have questions about whether these metrics/pillars have been correctly established and applied to necessarily require the aggregate 12 percent, 8.25 percent, and 8.25 per cent increases for the wastewater utility (connection) fee, the sewer volume (user) fee, and sewer service charge, respectively.

Pillar 1 is to maintain an unrestricted cash surplus of approximately $50 million in addition to the $93 million of restricted or partially restricted reserves that the enterprise fund maintains. I question the necessity of that much of a cash surplus. If that metric was reduced, say to $25 million, would there be an impact on the need to increase rates, either at the percentages being recommended or the durations being recommended?

Pillar 2 is to maintain a debt service ratio of 1.3 (or 130%). Assuming this is the correct metric to observe, the draft Financial Plan sets targets of 1.35, 1.35, 1.36 and 1.38 for the next four fiscal years, and it forecasts a ratio of 1.38 for the current fiscal year. Since a ratio of 1.2 is what is required by our bond covenants, I question the necessity of funding targets that round off to 1.4 instead of 1.3. If those annual targets were reduced, say to the 1.30 to 1.32 range, would there be an impact on the need to increase rates, either at the percentages being recommended or the durations being recommended?

Pillar 3 is to approach a Pay-As-You-Go policy for the enterprise fund by limiting new debt maturities to a range of 10 to 15 years, depending on the debt issuance level. I question the necessity of those limits when the infrastructure being funded has a life that is easily double that term. While shorter maturities cost the County less overall, they are less affordable for the County's ratepayers from year to year. If those maturity restrictions were eased, say to the 15 to 20 year range, would there be an impact on the need to increase rates, either at the percentages being recommended or the durations being recommended?

While I am aware that there have been extensive discussions on these pillars in RWRAC meetings, and particularly at RWRAC Financial Subcommittee meetings, I am not at all aware of the extent that the County Finance Department has run alternative scenarios to test the actual necessity of requiring the 12 and 8.25 per cent rate increases being recommended over the next four years. But I can't help but think that making a combination of concessions to the firmness of the three pillars discussed could result in maintaining our AA bond ratings while saving our ratepayers some money.

I would greatly appreciate it if you could ask the Finance Department to consider my concerns and address my questions prior to the Board's anticipated discussion and action on the rate increase next month.

Further, it's my understanding that Finance Director Cuaron has agreed to host a meeting with Mr. Sullwold, Mr. Matthewson and the County's financial advisor (RBC) later in the summer to discuss the validity of the existing financial pillars and the sensitivity of the AA sewer revenue bond ratings.

While I greatly appreciate Mr. Cuaron's leadership in facilitating this meeting, I would urge that it be scheduled sooner rather than later. I'm not sure it can be arranged prior to the Board's consideration of the rate increase in June, but doing so would certainly help with how I proceed with the discussions and deliberations related to the 2025/2026 Financial Plan and its recommendations.

Thank you for your assistance in helping to manage this important subject.

c: Carmine DeBonis, Jr., Deputy County Administrator
Steve Holmes, Deputy County Administrator
Art Cuaron, Director, Finance and Risk Management Department
Jackson Jenkins, Director, Regional Wastewater Reclamation Department