Budget Assumptions for
FY 2018/19 and the 10-Year Forecast

DRAFT
1/16/2018

Staff has begun the process for preparation of the FY 2018/19 operating and capital budget, as well as year-end projections for the current fiscal year. While no definite projections have been made at this time, some general guidance has been developed for budget preparation:

Service Levels

Assumption: **Increased recycled water as more customers come on line in the MST and Carneros areas; increased sewer rehabilitation; no other service level changes**

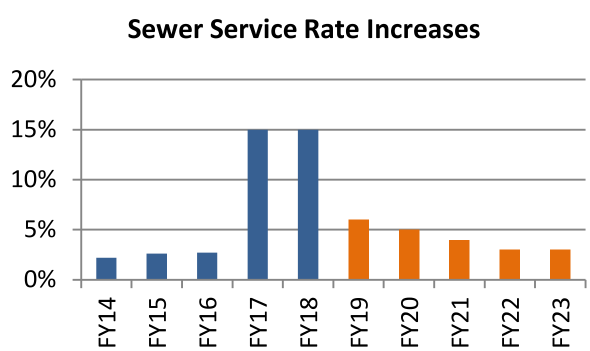
Discussion: With the plant improvements to expand recycled water treatment capacity and the recycled water pipelines to MST and LCWD completed, the 2018 and 2019 recycled water irrigation season should see a significant increase in the amount of recycled water sold and more properties convert to recycled water. The CIP will show an increase in sewer rehabilitation and replacement in the next two years, with a long-term average of 2% of the system replaced annually.

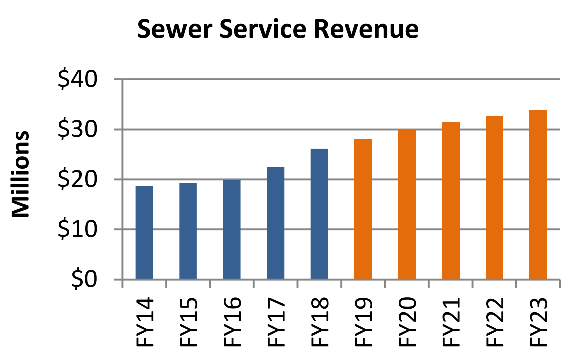
Revenues

Sewer Service Charges

Assumption: **Sewer Service Charges/CPI Changes – increase according to the Sewer Service Charge Rates Adopted by Board**

Discussion: The Board of Directors established maximum rates for sewer service during the rate hearing and rate setting process in Spring 2016. The Board established a maximum rate increase of 6% for FY 2018/19, followed by 5% and 4% in the two following years. For years seven through ten of the forecast, an annual rate increase of 3.0% is assumed. These recommendations are based on analysis of the revenue needs of the District, including the current 10-year capital plan and an increase in funding for sewer rehabilitation and replacement.





Development / Growth in EDU

Assumption: **Growth in EDU – for the next four years, projected growth based on estimates of commercial and development projects know to NapaSan staff, plus an assumed baseline of activity for smaller projects. Thereafter, based on assumed growth of 250 EDU annually, to be consistent with Growth Plan.**

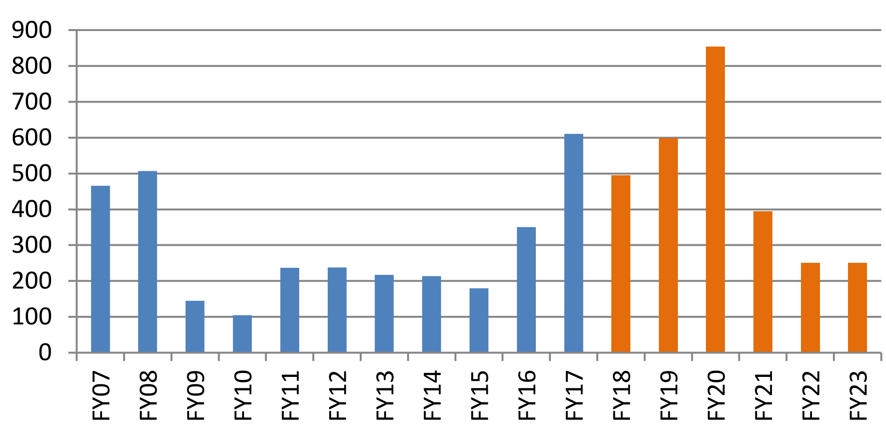
Discussion: After a slowdown in development that lasted 7 years, the last two years have shown signs of renewed development growth, with an expectation of continued growth in the short term. The projections for the next four years are based on Planning Department referrals and development plans reviewed by NapaSan. Staff estimated the potential dates that large developments would proceed to construction and used those estimates in the forecast. The next six years assume a growth level consistent with the General Plan.

Fiscal Year	Commercial	Residential	Total	Revenue
Current	137	358	495	$4,603,000
FY 18/19	186	413	599	$5,771,000
FY 19/20	458	397	855	$8,525,000
FY 20/21	345	50	395	$4,076,000
FY 21/22	150	100	250	$2,670,000

FY 17/18 includes the beginning of Vista Tulocay (Gasser housing development), the Borreo Building, the Cambria hotel, and several smaller developments, such as the Napa Courtyards and Anderson Ranch developments. **FY 18/19** includes development at WaterMark (senior housing at Justin-Sienna), housing development on Pear Tree, the Stoddard (Gasser) project, the beginning of development on Stanly Ranch, the Napa Register Building, and a resort development on 1st Street at Silverado Trail. **FY 19/20** estimates a continuation of Meritage development, Stanly Ranch, and 1st Street resort, along with the Bounty Hunter, and the Pietro Place housing development. **FY 20/21** includes development of Costco and the continuation of the Gasser project and resort on 1st Street.

Some developments have not been included in the forecast for the next few years because of their uncertain nature. These include Montalcino, Black Elk, Foxbow, the City of Napa buildings, the Wine Train Hotel, and Napa Pipe development (other than Costco).

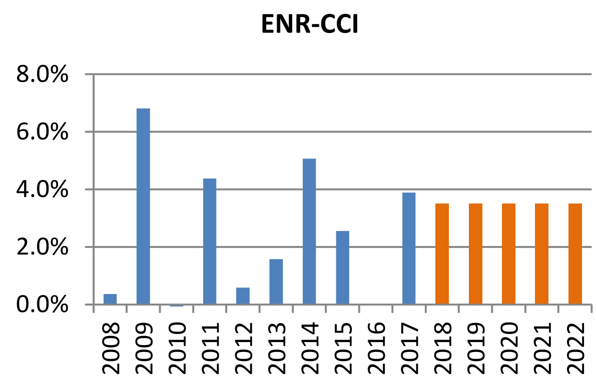
EDU / Capital Development



Construction Inflation

Assumption: **Construction CPI – 3.5% for FY 17/18, and 3.5% per year in future years.**

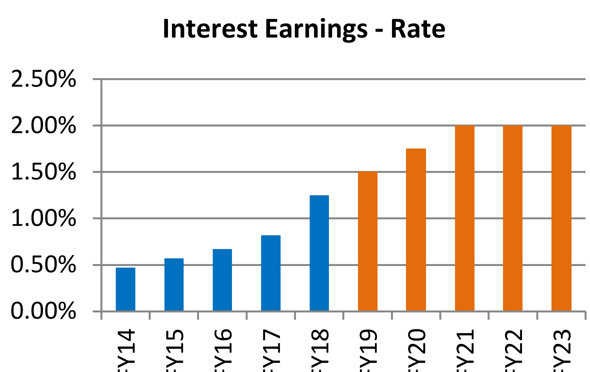
Discussion: The Engineering News Record's Construction Cost Index (ENR-CCI) is used by the District for future increases to the capacity charge rate, as it represents the inflation of construction costs. By District Code, the capacity charge rate increases by the annual change in the ENR-CCI index (February-to-February), rather than a set amount. The annual ENR-CCI in December 2017 (latest data) was 3.5% higher than December the previous year, while the average annual increase for the past 10 years is 2.5%. The economy is still strong, with strong indications of continued growth in the construction sector. The recommendation is to assume in the 10-year plan that the construction CPI will increase by 3.5% next fiscal year, and then 3.5% annually thereafter. This would increase the rate from $9,299 this year to $9,624 per EDU in FY 18/19.

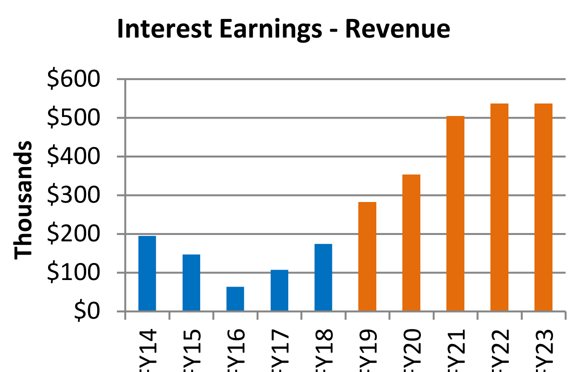


Interest Earnings

Assumption: **Interest Earnings – 1.5% for FY 18/19, then increasing to 2.0%.**

Discussion: The Federal Reserve increased the Federal Funds rate by 0.25% in December, and indicated that the Fed intended to continue to raise rates potentially three times in 2018. The interest rates for the Napa County Investment Pool in October 2017 (most recently reported month) was 1.16%. The recommended assumption is conservative, assuming only 1.5% for FY 18/19, increasing to 2.0% for FY 20/21, and remaining at 2% thereafter.

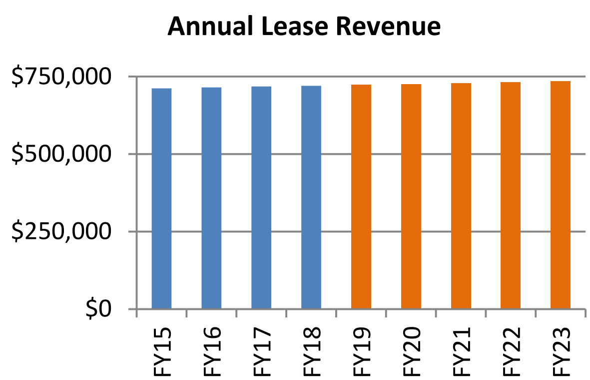




Lease Revenue

Assumption: **Lease Revenue – Payment for Somky lease; contractual increases for Eagle Vines. No other lease revenue.**

Discussion: The lease rates for Eagle Vines are set by contract and increases with local CPI. The forecast assumes this continues for the next decade. Lease payments for the Somky property have continued with the new leasee at the contractual rate of $600,000 per year. That agreement does not have a rate escalator; therefore it is projected to stay at $600,000 per year in the forecast. No lease revenue has been assumed from any other sources. Lease revenues are the source of funding for the Sewer Service Charge Low Income Assistance Program.

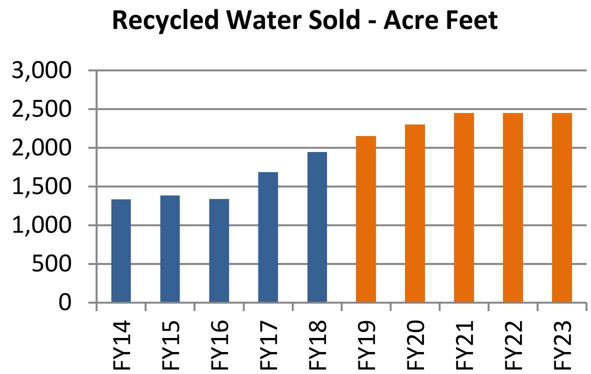


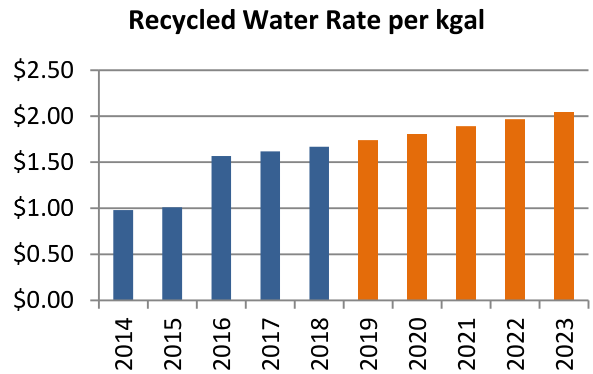
Recycled Water

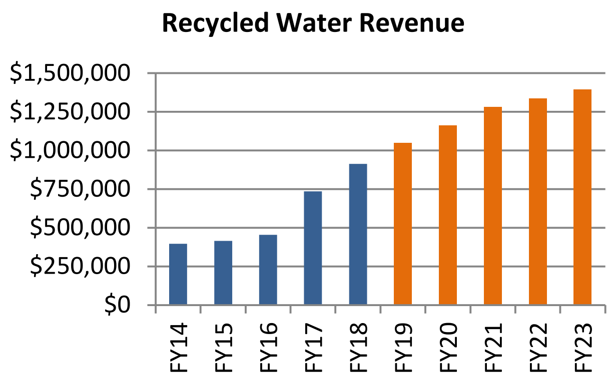
Assumption: **Recycled Water Rates – increase for CPI, estimated at 3.0% in 2018 and 2.3% thereafter; additional 2% for Renewal & Replacement reserve starting in 2019. Gallons sold increases based on estimates for expansion of service.**

Discussion: FY 2017/18 revenues are expected to increase about 20% because of increased users and the annual rate increase. The rate per thousand gallons for 2018 is not yet know, but is expected to be about 3% based on prior month CPI numbers. CPI is estimated at 2.3% for each year thereafter in the forecast. Water delivery is also expected to increase over time as more properties in the MST and LCWD areas connect to the system and begin to use water.

Estimated CPI	2018 Rate
1.0%-1.5%	$1.64/kgal
1.6%-2.1%	$1.65/kgal
2.2%-2.7%	$1.66/kgal
2.8%-3.3%	**$1.67/kgal**
3.4%-4.0%	$1.68/kgal
4.1%-4.6%	$1.69/kgal


Recycled Water Sold - Acre Feet
3,000
2,500
2,000
1,500
1,000
500
0
FY14
FY15
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23


Recycled Water Rate per kgal
$2.50
$2.00
$1.50
$1.00
$0.50
$0.00
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023


Recycled Water Revenue
$1,500,000
$1,250,000
$1,000,000
$750,000
$500,000
$250,000
$0
FY14
FY15
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23

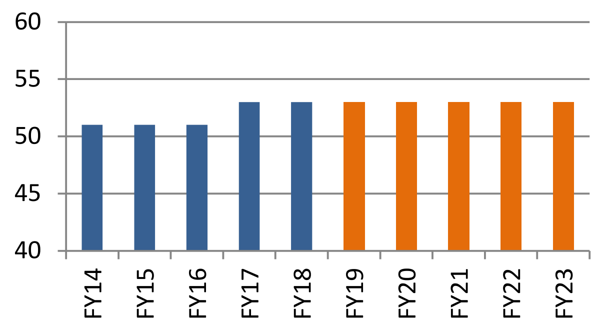
Expenditures

Staffing Levels

Assumption: **Staffing Levels – no change**

Discussion: FY 17 saw the implementation of changes recommended in the Employee Master Plan approved by the Board in early 2015 included a recommendation to move or change several positions in the District, and to increase the staffing level of the Collection System by two FTE. There are no planned changes in staffing level for future years beyond this recommendation.

Approved FTE

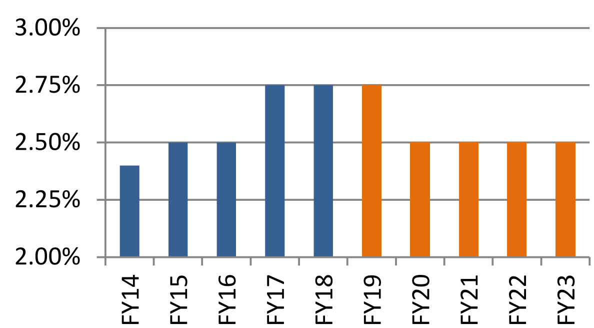


Salary Expenses

Assumption: **Salary Expenses – 2.75% CPI increase in FY 18/19 and FY 19/20 per the approved labor MOUs, then an assumed 2.5% annually.**

Discussion: A new MOU was approved effective July 2014. The new contract set the salary increases for 6 years through 2020. For the remaining years of the 10-year forecast, a salary increase of 2.5% per year will be assumed. This assumption is not an indication of intent regarding future labor negotiations. Note that the salary increases for the current labor agreement (FY14 to FY20) includes an annually increased contribution by employees to PERS (starting at 1.0% in FY14, increasing to 4.25% in FY18 and expected to reach 6.75% in FY20 when the agreement ends).

CPI for Wage Estimates

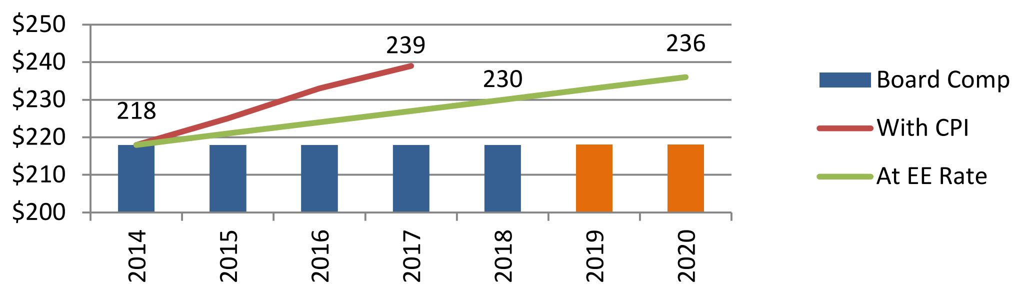


Board Compensation

Assumption: **Board Compensation –Continue with earnings of $218 per meeting.**

Discussion: Board compensation is established in District Code as $218 per meeting. For Board Compensation to increase, the Board must pass an amendment to the Code. The last increase was in December 2013. Compensation may increase annually by no more than 5% per year. If Board compensation had increased with CPI, the current rate would be $239 per meeting. If Board compensation had increased at the same rate as employee earnings, the 2018 rate would be $230, and the projected 2020 rate would be $236 per meeting.

Current Board Compensation Per Meeting



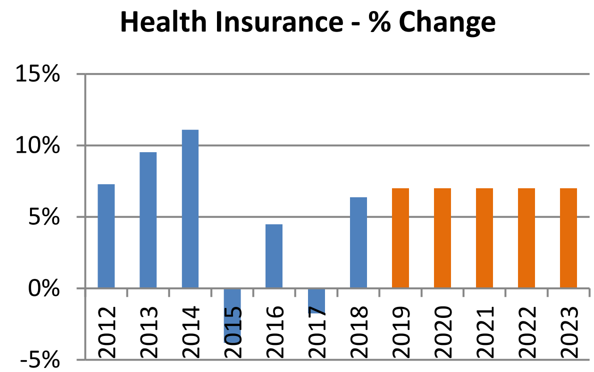
Health Insurance

Assumption: **Insurance Expenses –** 7% per year increases for health insurance, other insurance expenses at known costs.

Discussion: A significant majority of employees have Kaiser Permanente for health insurance, and NapaSan uses the Kaiser rate to establish the maximums for employer contributions. The history of Kaiser insurance rates has shown growth in excess of CPI in the past, with exceptions related to volatility in the market since the adoption of the ACA.

The Affordable Care Act (ACA) is still current law as it relates to large employers. Repeal of the "Cadillac Tax" was not included in the recent federal tax reduction and reform legislation and is still schedule to go into effect in 2020, although there is bipartisan support to eliminate it. If not eliminated, it could have a significant impact on the employer costs for this benefit in high-cost markets, such as the San Francisco Bay Area. It is likely that CalPERS would make changes to the Kaiser plan (and others) to avoid the payment of the "Cadillac Tax if it is not repealed or delayed. For this reason, it is recommended that the forecast not include the 40% excise tax penalty associated with these rules.

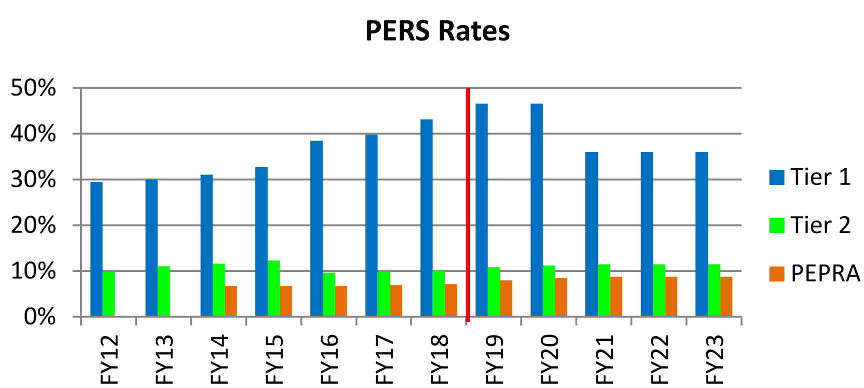
Health care benefit costs are known for calendar year 2018. For budget development purposes, staff recommends planning for a 7% increase in costs in calendar year 2019 and beyond.



Retirement Expenses

Assumption: **Tier 1 – 46.6% for next two years, then 36% annually to account for payoff of side fund.**
Tier 2 – 11.2% of salary for FY19, then 11.5% thereafter.
PEPRA – 8.5% of salary for FY19, then 8.75% thereafter.
Additional contribution to liability: TBD

Discussion: PERS has provided the employer rate for FY 2018/19 (46.6%) and has provided an estimate roughly the same for FY 2019/20 for Tier 1 employees. Tier 2 employees increased to 11.2% with a slight increase expected the following year, while the PEPRA rate has increased by 8.5% with a slight increase the following year. Several changes in the PERS system have contributed to these increases, including the assumption that mortality will continue to improve, and that the discount rate will gradually reduce from the current 7.5% to 7.0% over the next 20 years. [Placeholder here for any direction received by Finance Committee regarding future PERS payments.]



Services & Supplies

Assumption: **Services & Supplies, Generally – For FY 18/19, as justified, but no more than CPI, expect for contracted and known increases. A 2.3% assumed increase annually thereafter in the forecast for inflation.**
Electricity –Increase in electricity based on increased recycled water pumping to MST and LCWD.
Chemicals –Increase in hypochlorite based on increased recycled water production.

Discussion: The Service & Supplies budget adopted for FY 17/18 was $5,814,350, compared to the final budget of $5,474,638 in FY 12/13. This represents a total increase of 6.2%, or an annual average increase of 1.21% for the last 6 years, even while increasing its production and distribution of recycled water. Staff has been able to maintain this extremely low level of growth through efficiencies, particularly in chemistry and electricity, the two highest non-payroll operating expenses for NapaSan. This level of continued efficiency is unlikely to be sustainable in the long term. Staff recommends that the Service & Supplies budget be assumed to increase at the rate of inflation in the future years, estimated at 2.3%.

Electricity and chemical consumption is expected to increase as more recycled water is delivered to the MST and LCWD areas.

Services & Supplies – Significant One-Time Only Expenses

Discussion: **FY 2018/19**
Asset Management - the development of the asset management plan and its implementation of Phase 1 will continue into FY 2018/19.

FY 2019/20
North Napa Pump Station Force Main Abandonment - When the siphon was install to cross the Napa River and decommission the North Napa Pump Station, the force main was maintained as a backup in case the siphon did not operate as designed and intended. The siphon has proven to be reliable. To avoid I&I and the possibility of a collapse of the force main, the line should be abandoned. This $218,000 project does not result in a new asset or the extension of an asset's useful life, so it is not a capital project. It is expected that this project will be completed in FY 19/20.

FY 2020/21
Salt/Nutrient Management Plan – The Regional Water Quality Control Board is developing requirements for those agencies that discharge into San Francisco or San Pablo Bay to develop management plans for salt and nutrients. It is expected that NapaSan will have to comply with this requirement during Fiscal Year 2020/21. Current estimate is $250,000 for completion of the study.

FY 2022/23 and FY 2023/24
Outfall Abandonment - There is an anticipated project to abandon a decommissioned river outfall near the Influent Pump Station. This $180,000 expenses is not capital in nature, as it does not result in an asset to the District, so needs to be planned for as a Services & Supplies expense.

Capital Projects

Assumption: **Capital Projects – Continuation of the existing 10-year capital plan.**

Discussion: Capital projects identified in prior year 10-year plan will be continued as scheduled. Adjustments will be made to prior plans based on changes approved by the Board.

The Board has provided specific direction regarding sewer replacement schedules and I&I efforts during the rate discussions and hearings in Spring 2016. The forecast will continue with the direction provided by the Board at that time, to reach and sustain the goal of 2% system rehabilitation or replacement annually.

Staff will continue to priorities I&I and sewer replacement projects that are likely to result in reduced recycled water chloride levels.

Staff will continue to work with staff at the State Water Resources Control Board to secure a low interest loan for the Browns Valley Road Truck and West Napa Pump Station Improvements.