Budget Assumptions for
FY 2020/21 and the 10-Year Forecast

DRAFT
1/9/2020

Staff has begun the process for preparation of the FY 2020/21 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 per Board directive; no other service level changes**

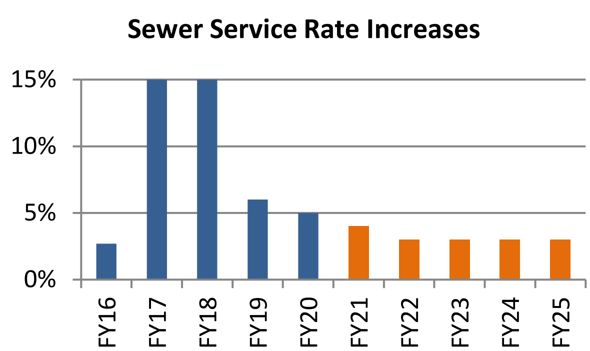
Discussion: With the plant improvements to expand recycled water treatment capacity and the recycled water pipelines to MST and LCWD completed, the 2020 and 2021 recycled water irrigation season should continue to see increases in the amount of recycled water sold and more properties convert to recycled water. The CIP will continue to show a continuing, sustained effort at sewer rehabilitation and replacement in the next decade, with a long-term average of 2% of the system replaced annually.

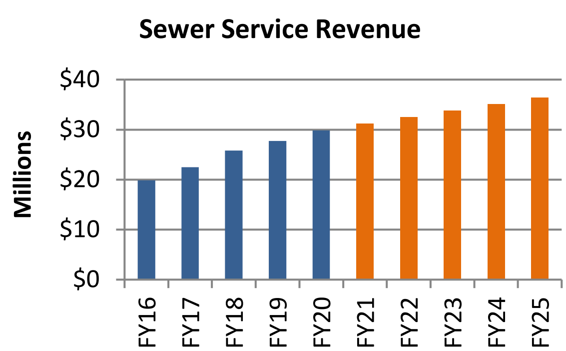
Revenues

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 4% in FY 2020/21. Another Proposition 218 process is expected in Spring 2021. For years two 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 the increase efforts toward sewer rehabilitation and replacement.





Development / Growth in EDU / Capacity Charge Revenue

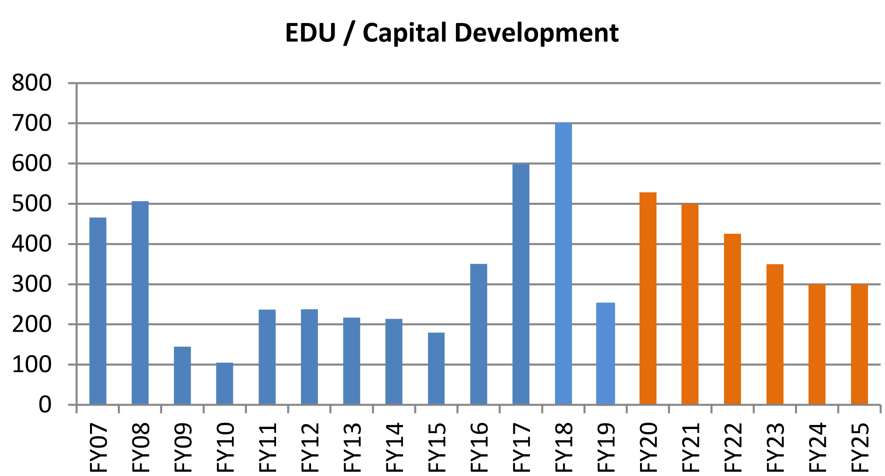
Assumption: **Growth in EDU – for the next four years, projected growth based on estimates of commercial and development projects known to NapaSan staff, plus an assumed baseline of activity for smaller projects. Thereafter, based on assumed growth of 275 EDU annually, consistent with Growth Plan.**

Discussion: The last several years have shown solid signs of development activity, with an expectation of moderate development 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	Capacity Charges
Current-est.	202	191	393	$3,852,600
FY 20/21	190	207	397	$3,950,200
FY 21/22	412	216	628	$6,436,400
FY 22/23	310	125	435	$4,591,900
FY 2023/24	155	120	275	$2,990,000

FY 19/20 (current year) includes payment for increased capacity for several tenant improvements, the beginning of the Stanly Ranch/Vievage development, Stoddard West Apartments, 1st Street Apartments, Keller Apartments and Pear Tree townhomes. **FY 20/21** includes the continuation of the Pear Tree Townhomes project, Redwood Grove project, Manzanita Family Apartments, as well as the beginning of the Meritage/Marriott hotel expansion and the start of the resort project at First and Silverado. **FY 21/22** anticipates the development of Franklin Station, a continuation of the resort at First and Silverado, and the Gasser Phase II project at Tulocay Village. FY 22/23 anticipates the City of Napa blocks downtown being developed and the Zinfandel Subdivision on El Centro.

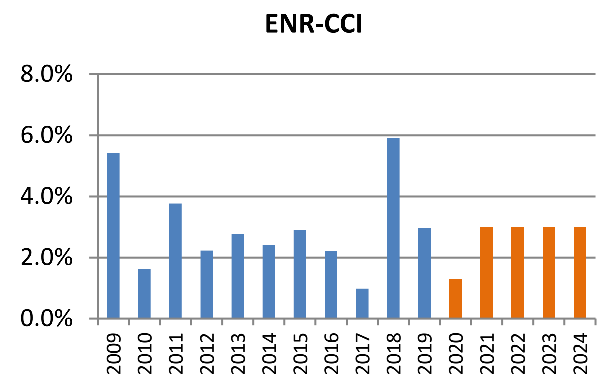
Some developments have not been included in the forecast for the next few years because of their uncertain nature. These include Montalcino, Black Elk, Foxbow, Bounty Hunter, the Wine Train Hotel, Creekside East Apartments, and Napa Pipe development.



Construction Inflation / Capacity Charge Fee

Assumption: **Construction CPI – 1.8% for FY 2020/21, then 2.8% per year thereafter.**

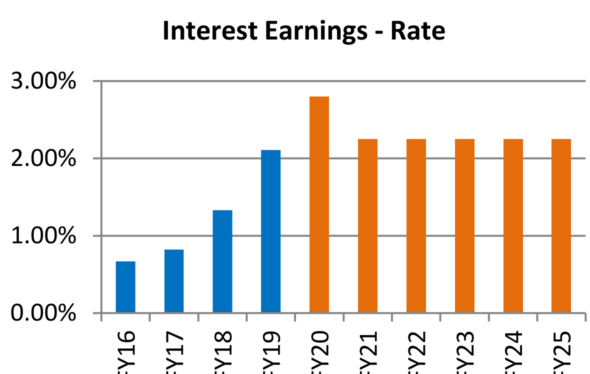
Discussion: The Engineering News Record's Construction Cost Index (ENR-CCI) is used by NapaSan for future increases to the capacity charge rate, as it represents the inflation of construction costs. With recent changes to District Code, the capacity charge rate may increase annually up to the ENR-CCI's 20-city average index (February-to-February). The annual ENR-CCI index in December 2019 (latest data) was 1.75% higher than December the previous year, and the average annual increase for the past 10 years is 2.8%. 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 1.8% next fiscal year, and 2.8% annually thereafter. This would increase the rate from $9,803 this year to $9,979 per EDU in FY 20/21.

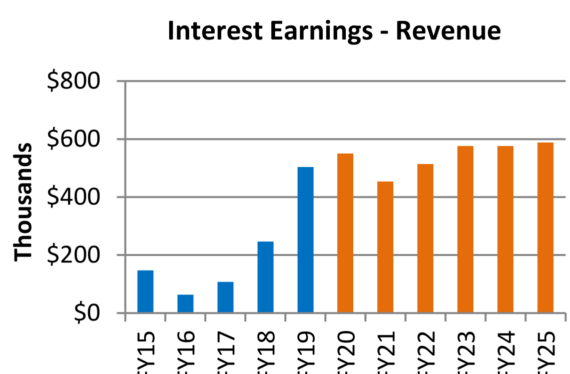


Interest Earnings

Assumption: **Interest Earnings – 2.25% for FY 20/21 and 2.25% in future years.**

Discussion: The Federal Reserve increased the Federal Funds rate by 0.25% three times in 2018, before lowering the rate several times in 2019. Depending on wage and inflationary trends, the rate is likely to remain stable or decrease slightly in the near future. The current Fed target is 2.00-2.25% for short-term rates. The interest rate earned for the Napa County Investment Pool in November 2018 (most recently reported month) was 2.8%, with the LAIF rate at 2.57%. The recommended long-term assumption is for the interest earnings rate to be just slightly higher than the assumed long-term inflation rate, at 2.25%.

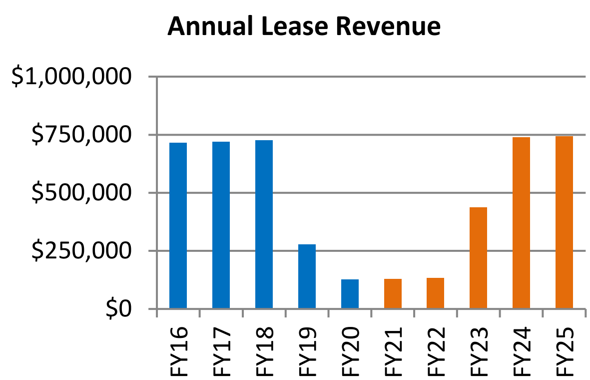




Lease Revenue

Assumption: **Lease Revenue – Contractual increases for Eagle Vines. No lease revenue from Somky until FY 2022/23. 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 been assumed at $0 until a new lease for Somky or a lease for Jameson is developed, assumed for FY 2022/23. 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.

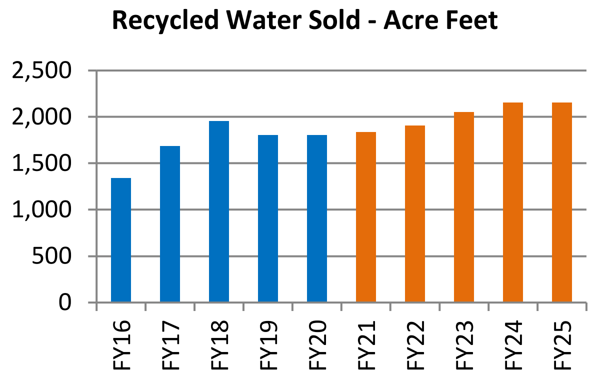


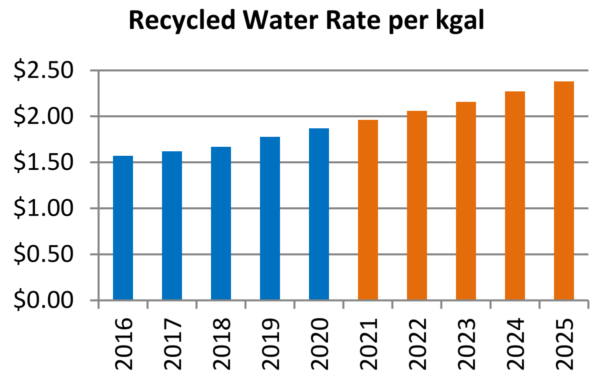
Recycled Water

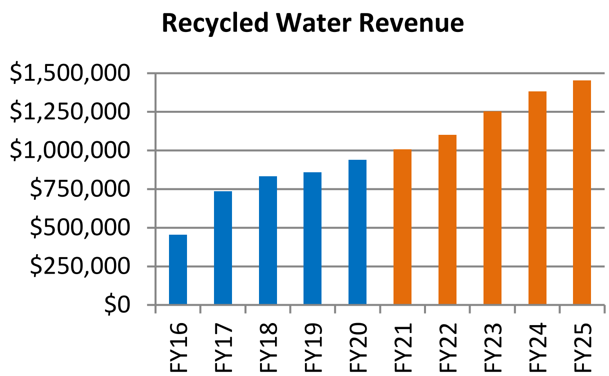
Assumption: **Recycled Water Rates – increase for CPI, estimated at 3.0% in 2020 and 3.0% thereafter; additional 2% for Renewal & Replacement reserve (second year). Gallons sold increases based on estimates for expansion of service.**

Discussion: FY 2019/20 revenues are expected to increase slightly because of increased users and the annual rate increase. The rate per thousand gallons for 2020 is not yet known, but is expected to be about 3.0% based on October 2019 CPI numbers. CPI is estimated at 3.0% 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	2020 Rate (Including 2% for R&R)
1.1%-1.6%	$1.84/kgal
1.7%-2.2%	$1.85/kgal
2.3%-2.7%	$1.86/kgal
2.8%-3.3%	**$1.87/kgal**
3.4%-3.8%	$1.88/kgal
3.9%-4.4%	$1.89/kgal
4.5%-5.0%	$1.90/kgal


Recycled Water Sold - Acre Feet
2,500
2,000
1,500
1,000
500
0
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23
FY24
FY25


Recycled Water Rate per kgal
$2.50
$2.00
$1.50
$1.00
$0.50
$0.00
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025


Recycled Water Revenue
$1,500,000
$1,250,000
$1,000,000
$750,000
$500,000
$250,000
$0
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23
FY24
FY25

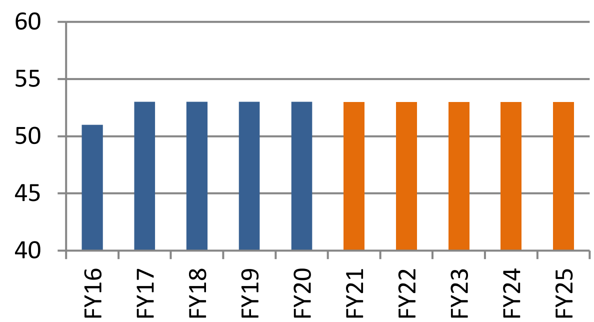
Salary & Benefit Expenditures

Staffing Levels

Assumption: **Staffing Levels – no change**

Discussion: FY 2016/17 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.

Approved FTE

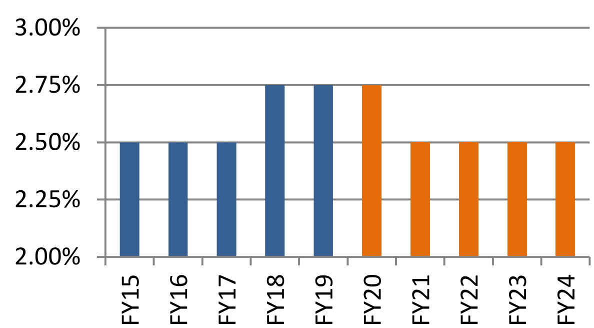


Salary Expenses

Assumption: **Salary Expenses – 2.75% CPI increase in 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 under the current labor agreement (FY14 to FY20) have included an annually increased contribution by employees to PERS. That contribution currently, in this final year of the agreement, is 6.75%. The forecast does not assume any additional increase from this level.

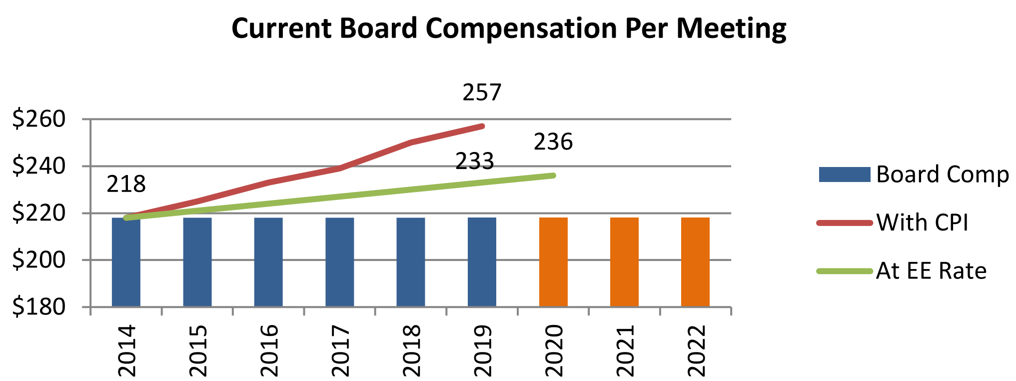
CPI for Wage Estimates



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 $257 per meeting. If Board compensation had increased at the same rate as employee earnings, the 2019 rate would be $233 and the projected 2020 rate would be $236 per meeting. If the Board increased compensation next year by the 5% maximum, the rate would be $228.90 per meeting.



Health Insurance

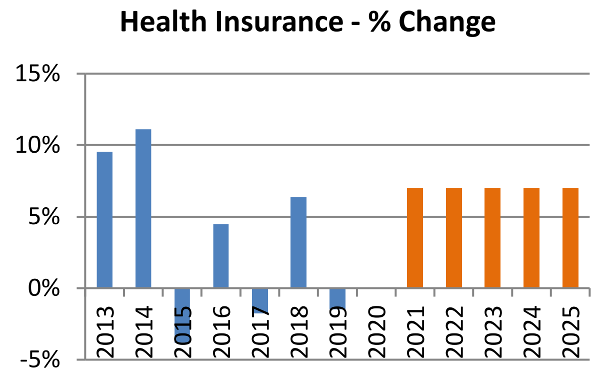
Assumption: **Insurance Expenses –** 7% per year increases for health insurance, other insurance expenses at known costs.

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; however, more recent annual adjustments have been either negative or smaller increases.

For the 2020 rates, CalPERS restructured their rates, reducing the number of regions from five to three. The result was to lower the average rates for Bay Area agencies. It is likely that this adjustment will have a one-time impact, and future rates will increase higher than what was seen in 2020.

The Affordable Care Act (ACA) is still current law as it relates to large employers. Repeal of the “Cadillac Tax” was included in the most recent federal spending package signed by the President in December 2019. This repeal eliminates a large uncertainty about the future of Cal-PERS sponsored health benefit plans. However, there is still litigation pending in the appeals courts that could result in the nullification of the ACA.

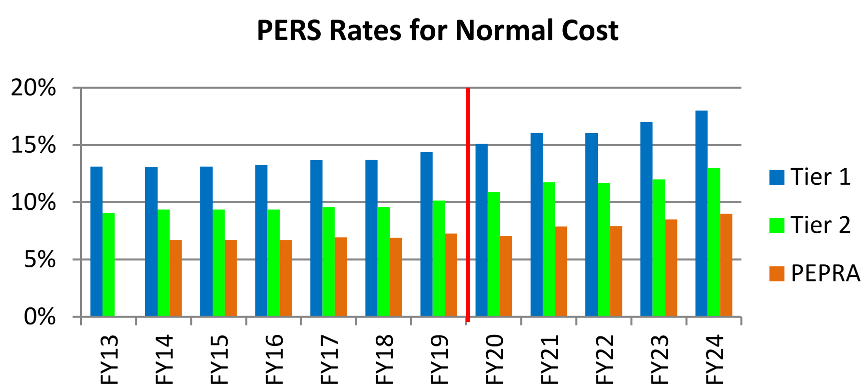
Health care benefit costs are known for calendar year 2020. For budget development purposes, staff recommends planning for a 7% increase in costs in calendar year 2021 and beyond.



CalPERS Retirement Expenses - Normal Cost

Assumption:		Tier 1	Tier 2	PEPRA
	FY 20/21	**16.0%**	**11.7%**	**7.9%**
	FY 21/22	**16.0%**	**11.7%**	**7.9%**
	FY 22/23	**17.0%**	**12.0%**	**8.5%**
	Thereafter	**18.0%**	**13.0%**	**9.0%**

Discussion: PERS has provided the employer rate for FY 2020/21 and an estimate for FY 2021/22. According to CalPERS Chief Actuary, it is anticipated that Miscellaneous Plans will increase from 1-3% of payroll over the next several years due to changes in investment/discount rate assumptions, amortization methods and mortality assumptions. The recommended assumptions proposed here represent the higher end of the Actuary's estimate.



CalPERS Retirement Expenses - Unfunded Liability

Assumption: **Freeze the Tier 1 liability payment at FY19/20 levels for next ten years.**

Discussion: NapaSan Financial Policy is to contribute additional payments toward the pension unfunded liability. In FY 18/19 and 19/20, an additional $135,000 annually was budgeted, the same as the annual savings from refinancing debt in FY17/18.

FY 19/20 is the last year NapaSan will be paying off the Tier 1 "side Fund" to PERS and will result in an annual reduction in minimum contribution to CalPERS of approximately $500,000. Current NapaSan policy encourages the use of freed up budgetary capacity from this reduction, and the reduction from debt refinancing, towards additional CalPERS payments.

To attain these policy goals, the recommended assumption is for NapaSan to make a payment of $1,529,035 in FY 2020/21, and then retain this same payment for the next nine years. This will attain the stated policy goals.

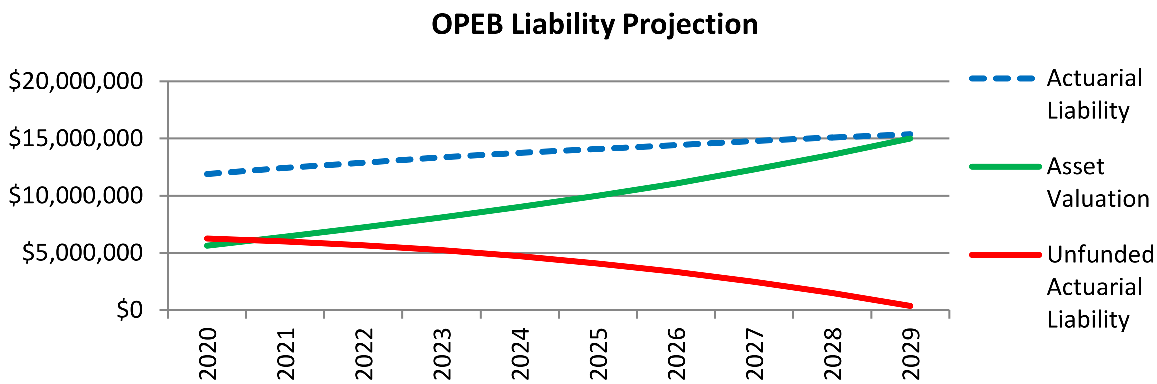
Fiscal Year	Tier 1 CalPERS minimum payment	Recommended Liability Payment	Additional paid toward liability
2019/20	1,394,035	1,529,035	135,000
2020/21	886,308	1,529,035	642,727
2021/22	1,008,371	1,529,035	520,664
2022/23	1,108,889	1,529,035	420,146
2023/24	1,171,765	1,529,035	357,270
2024/25	1,238,107	1,529,035	290,928
2025/26	1,272,155	1,529,035	256,880
2026/27	1,307,139	1,529,035	221,896
2027/28	1,343,085	1,529,035	185,950
2028/29	1,380,020	1,529,035	149,015

OPEB Payments

Assumption: **Set OPEB contribution at 16.95% of payroll (2.7% annual increase in FY 2020/21)**

Discussion: NapaSan Financial Policy is to contribute toward OPEBs through direct payment of retiree insurance premiums and a contribution to the OPEB Trust (CERBT), to equal the Actuarially Determined Contribution (ADC). Current projections show that the unfunded liability will be paid off in FY 2035/36, using current assumptions regarding return on investment and health care cost inflation. The ADC is projected to decrease over the next ten years. However, non-attainment of actuarial assumptions can result in unplanned increases in the ADC, negatively impact future operating budgets.

If NapaSan were to maintain its OPEB contribution at a set percentage of payroll over time (16.95%), and not make any reductions, NapaSan is projected to be on target to reduce the unfunded portion of the liability by 2029.



Estimated Impact of Assumptions: 3.2% increase in Salary & Benefit Expenses

Services & Supplies

Assumption: **Services & Supplies, Generally – For FY 20/21, as justified, but no more than CPI, expect for contracted and known increases. A 2.0% 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 and known chemical unit costs.

Discussion: The Service & Supplies budget adopted for FY 19/20 was $6,066,800, compared to the final budget of $5,474,638 in FY 12/13. This represents a total increase of 10.8% over 7 years, or an annual average increase of 1.48%, even while increasing the 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 assumptions increase at the rate of 2.0% per year.

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

Services & Supplies – Significant One-Time Only Expenses

Discussion: **FY 2020/21**

North Napa Pump Station Force Main Abandonment - When the siphon was installed 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 20/21.

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

Future Debt

Assumptions: **FY 19/20 – Browns Valley Trunk and West Napa Pump Station Project**

Debt agreement with State Water Resources Control Board for Browns Valley Trunk and WNPS project was finalized in January 2020. Anticipate debt financing for $40 million project will coincide with construction, with debt service beginning in FY 2022/23. (Actual loan will be for approximately $36 million after Green Project Reserve loan forgiveness deductions.)

FY 20/21 – Rehabilitation of Main Sewer Trunk

Anticipate bond financing of 66" Sewer Trunk Rehabilitation. Project is in the Capital Improvement Plan to cost approximately $15 million. Debt issuance in FY 2020/21, with debt service payments beginning in FY 2021/22.

FY 21/22 – Refinance Series 2012A Certificates of Participation

Plan for potential refinancing of Series 2012A COPs in 2022, if appropriate.

FY 24/25 – Second Digester and Third Aeration Basin

Anticipate bond financing of completion of the second digester and construction of the third aeration basis. Project is in the Capital Improvement Plan to cost approximately $26 million. Debt issuance in FY 2024/25, with debt service payments beginning in FY 2025/26. This issuance could be in conjunction with the refinancing of the 2012A COPs, with the rehabilitation of the main sewer trunk and/or could be issued in multiple tranches.

Not Included in Forecast

Revenue: **Sale of Land and Additional Lease Revenue**

The 10-Year forecast does include an assumption of additional lease revenue starting in 2023 to replace the revenue lost from the Somky property lease, but is not specific about which property is leased, nor does it include the sale of any property.