Budget Assumptions for
FY 2022/23 and the 10-Year Forecast

DRAFT
1/24/2022

Staff has begun the process for preparation of the FY 2022/23 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: **Gradual increased recycled water as more customers come on line in the MST and Carneros areas; continue sewer rehabilitation per Board directive; no other service level changes**

Discussion: Calendar years 2020 and 2021 were very dry years and recycled water production and sales were record highs. We expect to see the numbers come back down close to normal with a gradual increase in the amount of recycled water sold as more properties in the MST and LCWD areas continue to 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.

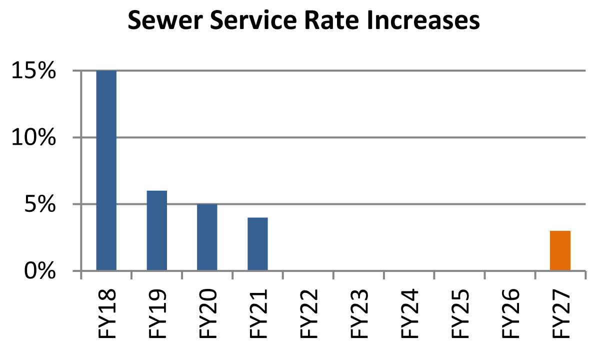
Revenues

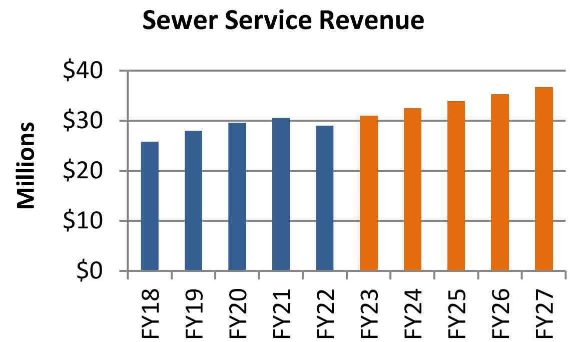
Sewer Service Charges

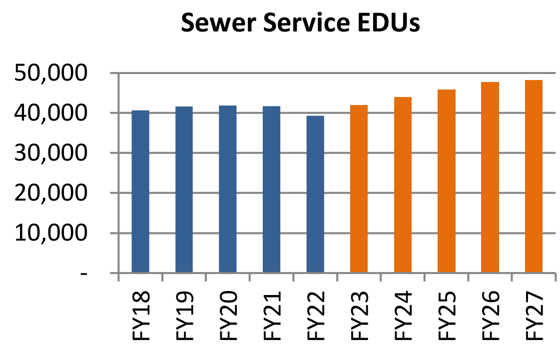
Assumption: **Sewer Service Charges/CPI Changes – increase according to the Sewer Service Charge Rates that will be adopted by Board**

Discussion: The Board of Directors established a rate modification for five (5) years beginning in FY 2021/22 for sewer service during the rate hearing and rate setting process in March 2021. Although the rate modification will keep the sewer service charge rate the same (0% increase), the calculation of the rate will increase the equivalent dwelling units (EDUs) for commercial customers thereby generating an increase in overall revenues by 3%. The revenues generated from sewer service charges are expected to increase about 3% - 4%, which includes projected growth, over the next four (4) years remaining of the five years for which the rates were set. For years six through ten of the forecast, an annual rate increase of <u>3.0% is assumed</u>. These recommendations are based on analysis of the revenue needs of NapaSan, including the current 10-year capital plan and the increased efforts toward sewer rehabilitation and replacement.

Sewer service charge revenues for FY 2021/22 were impacted by the reduction in water usage by commercial customers (about 20%). The school district also experienced a reduction in their sewer service charges due to lower attendance during 2020, which is used as a basis to calculate their sewer service charges. It is expected that water usage during 2021 by commercial customers will still be below historical averages but not as significant as 2020. The school's daily attendance average is expected to be back to normal for FY 2022/23.





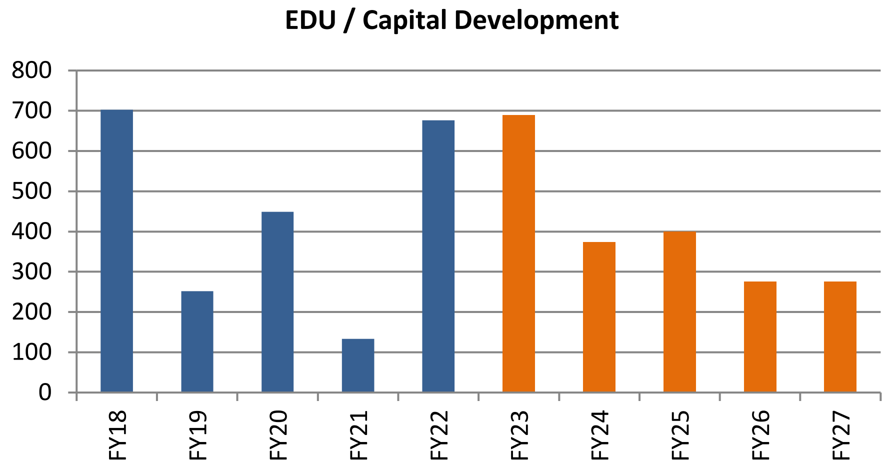


Development / Growth in EDU / Capacity Charge Revenue

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 General Plan.**

Discussion: Some development projects that were delayed due to the economic slowdown have started to move forward. The projections for the next three 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 timing of these projects are difficult to pin down and may shift. The next five years assume a growth level consistent with the General Plan.

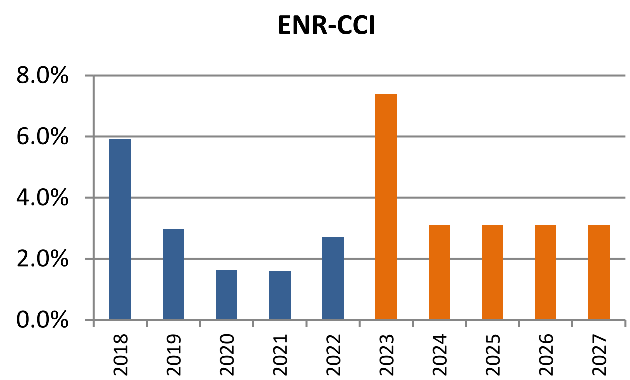
Fiscal Year	Residential	Commercial	Total	Capacity Charges
Current-est.	224	452	676	$6,914,100
FY 22/23	436	253	689	$7,568,700
FY 23/24	225	148	373	$4,224,600
FY 24/25	250	150	400	$4,670,800
FY 25/26	125	150	275	$3,310,700



Construction Inflation / Capacity Charge Fee

Assumption: **Construction CPI – 7.4% for FY 2022/23, then 3.1% per year thereafter.**

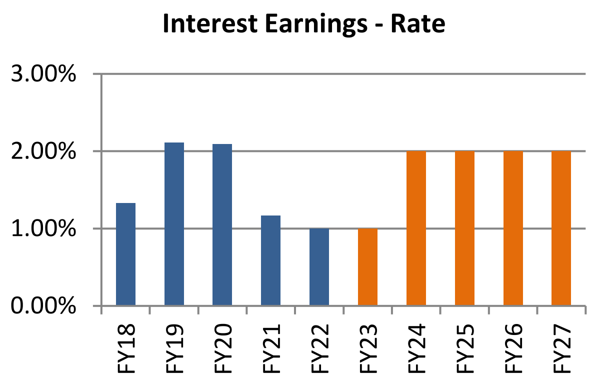
Discussion: The Engineering News Record's Construction Cost Index (ENR-CCI) is used by NapaSan for future increases to the capacity charge rate, as it represents the inflation of construction costs. With recent changes to District Code, the capacity charge rate may increase annually up to the ENR-CCI's 20-city average index (February-to-February). The annual ENR-CCI index in December 2021 (latest data) was 7.4% higher than December the previous year, and the average annual increase for the past 10 years is 3.1%. The COVID-19 pandemic has caused construction costs to increase due to material shortages and unforeseen delays as a result of a disruption in the availability of supplies. The recommendation is to assume in the 10-year plan that the construction CPI will increase by 7.4% next fiscal year, and 3.1% annually thereafter. This would increase the rate from $10,228 this year to $10,985 per EDU in FY 22/23.

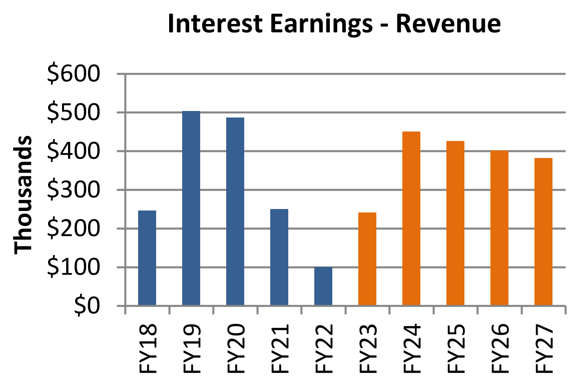


Interest Earnings

Assumption: **Interest Earnings – 1.0% for FY 22/23 and 2.00% in future years.**

Discussion: The United States inflation rate had climbed to 7.0% for 2021, the highest increase since 1982. The inflation rate for San Francisco was 4.24%, not as high as the US but still the highest in three years. The Federal Reserve has been maintaining interest rates between 0.00% and 0.25%. However, it plans to shift its focus from stimulating spending to tackling the rise in inflation, which has been running at more than double the 2% target in recent months. It is projected that the Fed will increase interest rates to 0.90% by the end of 2022 and 1.6% by the end of 2023. The Fed forecasts that inflation rates will decrease down to 2.6% for 2022 and 2.3% in 2023. The interest rate earned for the Napa County Investment Pool in November 2021 (most recently reported month) was 0.91%, with the LAIF rate at 0.203%. The recommended long-term assumption is for the interest earnings rate to remain at 1.0% for FY 2022/23 and increase to 2.0% thereafter.

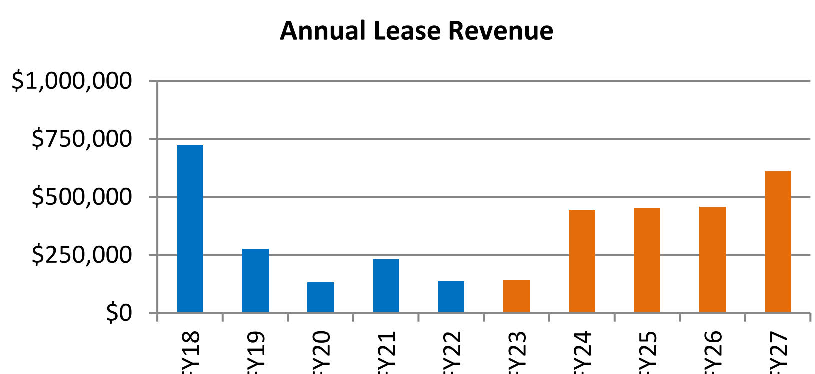




Lease Revenue

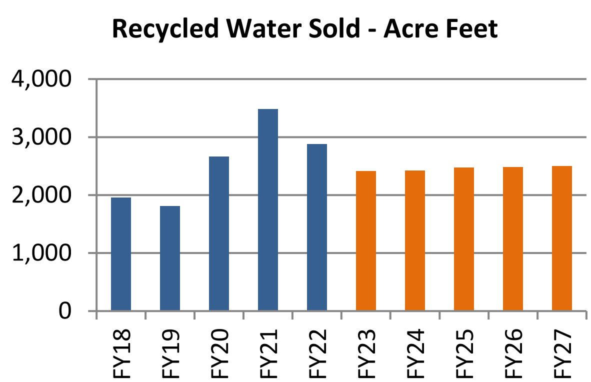
Assumption: **Lease Revenue – Contractual increases for Eagle Vines. Lease revenue from other NapaSan properties beginning in FY 2023/24.**

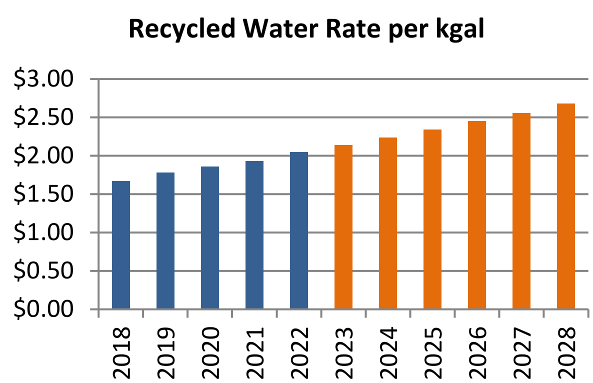
Discussion: The lease rates for Eagle Vines are set by contract and increases with local CPI. The forecast assumes this continues for the next decade. It is assumed that lease activities for other NapaSan properties will begin in FY 2023/24. Lease revenues are the source of funding for the Sewer Service Charge Low Income Assistance Program.

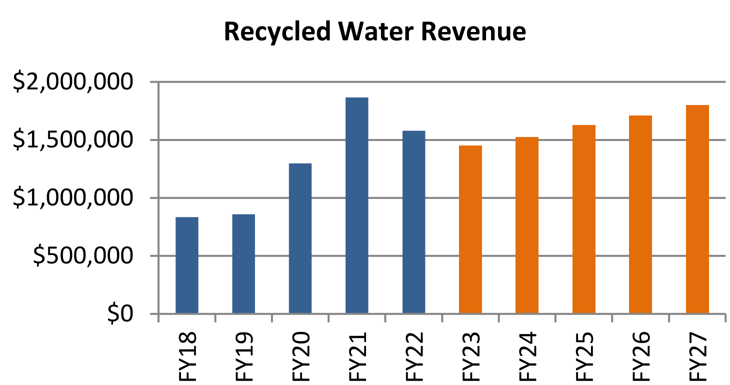


Recycled Water

Note:	*Recycled water rate study currently underway. Preliminary numbers from the study will be brought back to the finance committee in April for discussion. The assumptions below are based on the current rate structure.*
Assumption:	**Recycled Water Rates – increase for CPI, 4.2% in 2022 and 2.5% thereafter; additional 2% for Renewal & Replacement reserve. Gallons sold increases based on estimates for expansion of service.**
Discussion:	FY 2020/21 revenues were higher than normal due to the drought causing an increase in demand. FY 2021/22 are also expected to be higher than normal. However, the forecast for FY 2022/23 is expected to be back to average usage with an increase slightly because of increased users and the annual rate increase. Based on the December 2021 CPI, the rate per thousand gallons for 2022 is $2.05, an increase of 4.2% plus 2.0% for the renewal and replacement reserve. CPI is estimated at 2.5% 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.





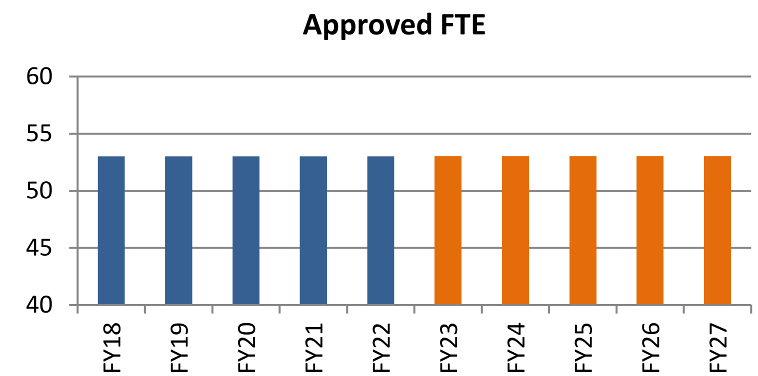


Salary & Benefit Expenditures

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 at NapaSan, and to increase the staffing level of the Collection System by two FTE. There are no planned changes in staffing level for future years.

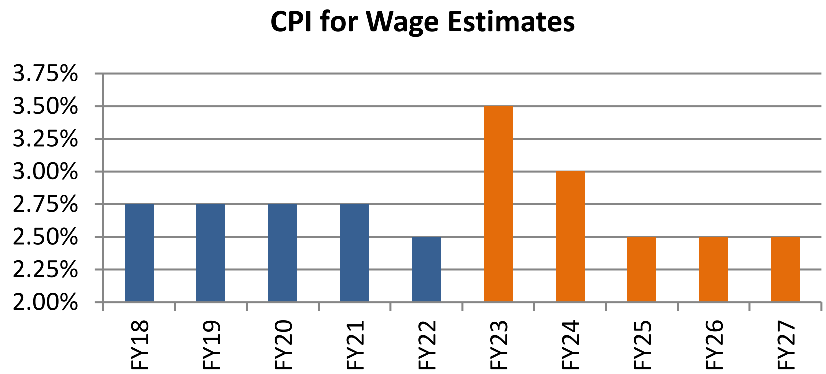


Salary Expenses

Assumption: **Salary Expenses – 3.50% and 3.00% CPI increases in FY 2022/23 and FY 2023/24, respectively, pending the outcome of the reopener of the labor MOUs, then an assumed 2.50% increase annually.**

Discussion: A new MOU with a four year term was approved effective July 2020. The new contract set the salary CPI increases for the first two (2) years through FY 2021/22 with a reopener to negotiate the appropriate salary increases for FY 2022/23 and 2023/24. As a placeholder, pending the outcome of the reopener, a CPI increase of 3.50% for FY2022/23 and 3.00% for FY 2023/24 were used. For years three through ten of the 10-year forecast, a salary increase of 2.50% per year will be assumed. The assumptions made are not an indication of intent regarding the upcoming reopener or any future labor negotiations.

Note that the salary increases included an annually increased contribution by employees to PERS in Year 1 and Year 2 of the current contract. Both Tiers 1 and 2 are now contributing their full employee share of the pension contribution which is 8% for Tier 1 and 7% for Tier 2.



In addition to the annual CPI increases, certain employee classifications were approved for a market adjustment during the term of this labor contract. The adjustments range from increases of 2.6% to 24.2%. These increases a phased in and happen over the four year term of the contract. The phase-in approach will be as follows:

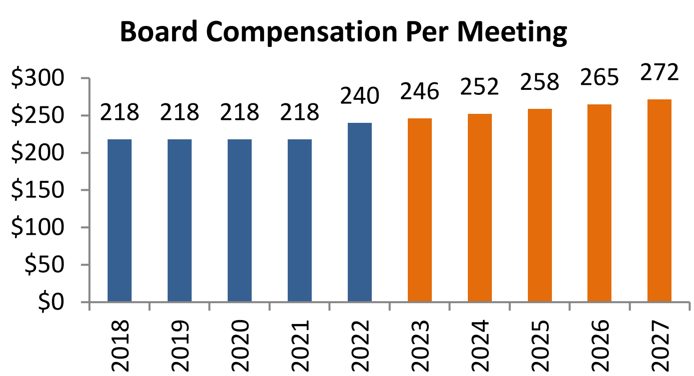
- Year 1 will be adjusted by 35% of the total percentage increase
- Year 2 will be adjusted by 25% of the total percentage increase
- Year 3 will be adjusted by 20% of the total percentage increase
- Year 4 will be adjusted by 20% of the total percentage increase

The cost escalation in salaries with the market adjustments for FY 2022/23 and 2023/24 are 2.10% and 6.36%, respectively.

Board Compensation

Assumption: **Board Compensation – Continue earnings of $240 per meeting.**

Discussion: Board compensation is established in District Code as $240 per meeting. For Board Compensation to increase, the Board must pass an amendment to the Code. The Board amended the Code to increase their compensation from $218 to $240 in December 2021. Prior to that, the last increase was in December 2013. Compensation may increase annually by no more than 5% per year. The 10-Year Forecast assumes that Board Compensation will increase with CPI – 2.50% annually.



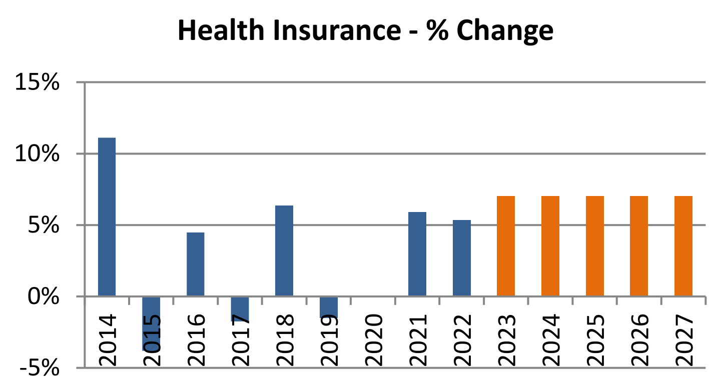
Health Insurance

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.

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. The adjustment had a one-time impact to the 2020 rates and only increased by less than 0.5%. The rates for 2022 is a 5.3% increase. Future rates are expected to continue to increase higher than what was seen in 2020.

Health care benefit costs are known for calendar year 2022. For budget development purposes, staff recommends planning for a 7% increase in costs in calendar year 2023 and beyond.

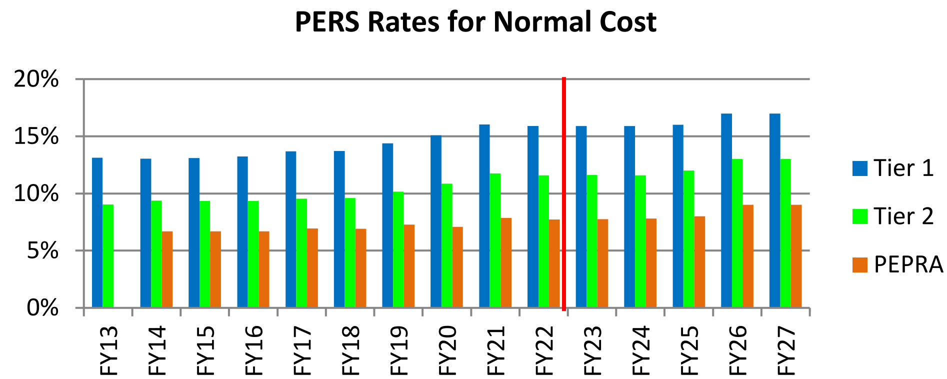


CalPERS Retirement Expenses - Normal Cost

Assumption:

	Tier 1	Tier 2	PEPRA
FY 22/23	**15.90%**	**11.61%**	**7.76%**
FY 23/24	**15.90%**	**11.60%**	**7.80%**
FY 24/25	**16.00%**	**12.00%**	**8.00%**
Thereafter	**17.00%**	**13.00%**	**9.00%**

Discussion: CalPERS has provided the employer rate for FY 2022/23. The CalPERS Board recently completed its Asset Lability Management process, which is done every four years to examine risk and return characteristics of possible assets allocations. It is in effort to improve long-term pension and health benefit sustainability of the pension fund. The Board voted to lower the discount rate from 7.0% to 6.8%. However, the rate of return for FY 2020-21 was 21.3%. The impact of these two factors on employer required contributions are expected to be comparable or slightly lower than previously determined contribution requirements. The recommended assumptions are proposed based on data received from the most recent pension valuation report.



CalPERS Retirement Expenses - Unfunded Liability

Assumption: **Make liability payments based on a 15-year amortization schedule.**

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 payment was made, the amount matching the annual savings from refinancing debt in FY17/18.

In FY 2019/20 NapaSan paid off the Tier 1 “side fund” to PERS which resulted 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.

Additionally, NapaSan could see an annual savings on the refinancing of its Series 2012A Certificates of Participation beginning in FY 2022/23.

In FY 2021/22, the Board budgeted funds to make an additional payment towards the unfunded liability to keep the contribution amount at $1,529,035 – the FY 2019/20 minimum contribution for Tier 1 before the side fund was paid off. The goal was to continue making the same payment until the minimum contribution reached that amount, which would have been in about 7 years.

On the current amortization schedule, at Year 7, the minimum contribution for Tier 1 is forecasted to be $1,525,371, about $4,000 less than the FY 2019/20 minimum contribution. The next several years after that, it incrementally increases and tops out at about $1,641,000 in 10. In Years 11 through 14, the minimum contribution gradually drops to about $1,550,000. It sharply drops to about $800,000 in Year 15 and incrementally decreases until the end of the amortization schedule after Year 23.

A 15 year amortization schedule keeps the payment level at $1,522,995 and has a savings of about $1,850,000. Similarly to our current schedule, the contribution amount can fluctuate based on changes to assumptions and/or differences between assumptions and actuals.

Making an official change to the amortization schedule is called a Fresh Start. Once it has been changed, NapaSan would be required to make the new annual contribution amounts. Instead of committing to the higher contribution payment, another option would be to do a “Soft Fresh Start”, whereas it would not be an official change to the amortization schedule but instead, NapaSan would voluntarily make additional payments to match the contribution amount of the 15 year amortization schedule. NapaSan would then have the flexibility to choose not to make the additional payment without any penalties or consequences if there were unforeseen events that created financial constraints. An evaluation at midyear can be done by staff to determine if the additional payment can be made reasonably.

The recommended assumption is for NapaSan to make the minimum required payment and after a midyear analysis proving that it is financially reasonable, make an additional payment toward the unfunded liability to match the minimum required payment of the 15 year amortization schedule. This will attain the stated policy goals.

Fiscal Year	Tier 1 CalPERS minimum payment	Recommended Liability Payment	Additional paid toward liability
2022/23	1,162,363	1,522,995	360,632
2023/24	1,249,396	1,522,995	273,599
2024/25	1,339,887	1,522,995	183,108
2025/26	1,398,075	1,522,995	124,920
2026/27	1,453,112	1,522,995	69,883
2027/28	1,488,752	1,522,995	34,243
2028/29	1,525,371	1,522,995	(2,376)
2029/30	1,563,001	1,522,995	(40,006)
2030/31	1,601,666	1,522,995	(78,671)
2031/32	1,641,390	1,522,995	(118,395)
2032/33	1,627,245	1,522,995	(104,250)
2033/34	1,611,201	1,522,995	(88,206)
2034/35	1,572,214	1,522,995	(49,219)
2035/36	1,505,993	1,522,995	17,002
2036/37	785,941	1,522,995	737,054

OPEB Payments

Assumption: **Set OPEB contribution at 13.9% of payroll.**

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 2034/35, using current assumptions regarding return on investment and health care cost inflation. Non-attainment of actuarial assumptions can result in unplanned increases in the ADC, negatively impacting future operating budgets.

If NapaSan were to maintain its OPEB contribution at a set percentage of payroll over time (13.9%), and not make any reductions, NapaSan is projected to be on target to reduce the unfunded portion of the liability by 2035.

Estimated Impact of Assumptions:
2.10% increase in Salary & Benefit Expenses

Services & Supplies

Assumption: **Services & Supplies, Generally – For FY 2022/23, as justified, but no more than CPI, except for contracted and known increases. The inflation rate rose to 7.0% in the United States at the end of calendar year 2021 (4.24% in San Francisco). Financial experts predict that inflation will fall back down to 2.6% by the end of 2022 and 2.3% by the end of 2023. A 3.5% inflation rate is used for FY 2022/23 and 3.0% increase in FY 2023/24. An annual increase of 2.5% is assumed 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 21/22 was $6,796,650 compared to the final budget of $6,037,110 in FY 16/17. This represents a total increase of 13.0% over 6 years, or an annual average increase of 2.1%, even while increasing the production and distribution of recycled water. Staff has been able to maintain costs at CPI level 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. In anticipation of a slow return to average inflation rates of about 2.0%, staff recommends that the Service & Supplies budget assumptions increase to 3.5% in 2022/23, 3.0% in 2023/24 and then back down 2.5% per year thereafter.

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 2025/26

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 25/26.

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. The forecast will continue with the direction provided by the Board, 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 22/23 – Refinance Series 2012A Certificates of Participation**

The refinancing of Series 2012A COPs began in FY 2021/22 but will be completed and issued with the first payment due on August 2022.

FY 27/28 – Rehabilitation of 66-inch Trunk Sewer Phase 2

Anticipate bond financing of 66" Sewer Trunk Rehabilitation. Project is in the Capital Improvement Plan to cost approximately $18 million. Debt issuance in FY 2027/28 with debt service payments beginning in FY 2028/29.

FY 28/29 – 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 $30 million. Debt issuance in FY 2028/29, with debt service payments beginning in FY 2030/31.

FY 29/30 – NBWRA Projects

Recycled water expansion projects to meet future recycled water demands. Project components are anticipated to include additional treatment capacity and additional treated water storage capacity.

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 FY 2023/24, but is not specific about which property is leased, nor does it include the sale of any property.