

Budget Assumptions for FY 2017/18 and the 10-Year Forecast

Staff has begun the process for preparation of the FY 2017/18 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 delivery starting in 2016; additional support in Collections; solar and stationary battery storage on line; increased sewer rehabilitation starting in FY 19/20; 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 in 2015 and 2016, the 2017 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 a continued emphasis in the next two years, with an increased emphasis in FY 19/20 and beyond, placed on sewer rehabilitation and replacement. FY 2016/17 was the first year with the new photovoltaic array and stationary storage battery systems operational, with their full financial impact in next fiscal year.

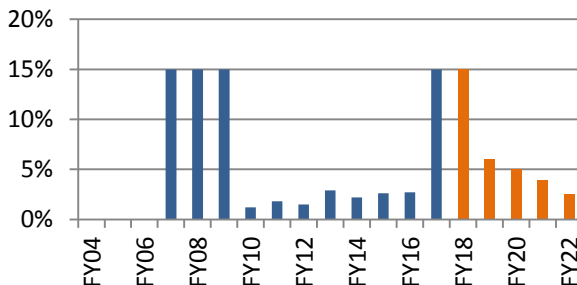
Revenues

Sewer Service Charges

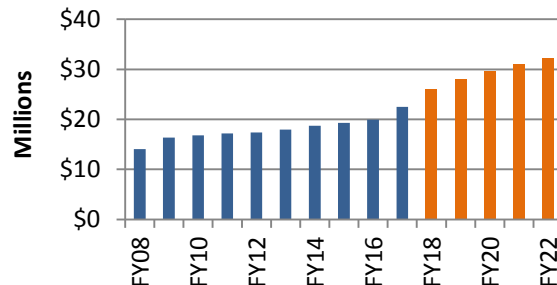
Assumption: Sewer Service Charges/CPI Changes – increase according to the Sewer Service Charge Rates Adopted by Board

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 15% next fiscal year, and increase 6%, 5% and 4% thereafter. For years six 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.

Sewer Service Rate Increases



Sewer Service Revenue



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 NSD 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.**

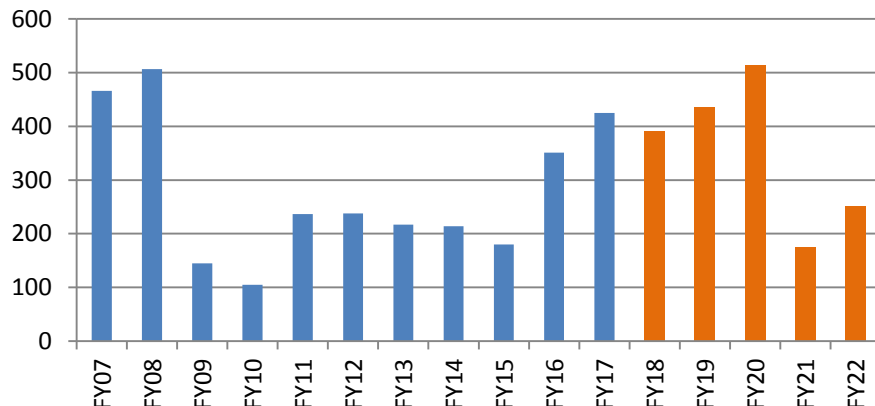
Discussion: After a slowdown in development that lasted 7 years, last fiscal year and the current fiscal year are showing signs of renewed development growth. The projections for the next four years are based on Planning Department referrals and development plans reviewed by the District. Staff estimated 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.

<u>Fiscal Year</u>	<u>Commercial</u>	<u>Residential</u>	<u>Total</u>	<u>Revenue</u>
Current	302	123	425	\$3,804,000
FY 17/18	180	210	390	\$3,630,000
FY 18/19	195	241	436	\$4,200,000
FY 19/20	274	240	514	\$5,125,000
FY 20/21	55	120	175	\$1,806,000

FY 16/17 includes major development by Meritage, the CIP @ Copia, the Jail/Staff Secure Facility, and Meadows expansion. **FY 17/18** includes the beginning of development at Stanly Ranch, the Borreo Building, the Bounty Hunter, the Napa Register Building and residential developments Pear Tree, Keller Apartments, Napa Creek Condos and Anderson Ranch. **FY 18/19** includes additional building by Meritage/Marriott, Stanly Ranch, Napa Commerce Center, Pietro Place, and Soscol Corner, with the beginning of housing by Gasser. **FY 19/20** estimates a continuation of Meritage development, the completion of Stanly Ranch, an expansion of Embassy Suites, and the payment of capacity charges by Gasser, senior housing at Justin-Sienna, and for the First Street Apartments. **FY 20/21** includes development of Costco and the continuation of the Gasser project.

Some developments have not been included in the forecast for the next few years because of their uncertain nature. These include Montalcino, the Ritz, other Napa Pipe development, and the City of Napa Buildings, among others.

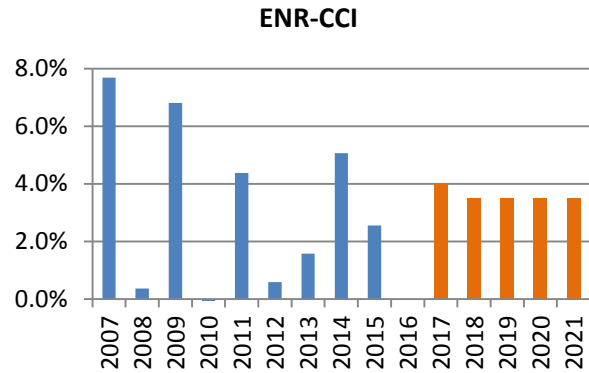
EDU / Capital Development



Construction Inflation

Assumption: Construction CPI – 4.0% for FY 17/18, then 3.5% per year in future years.

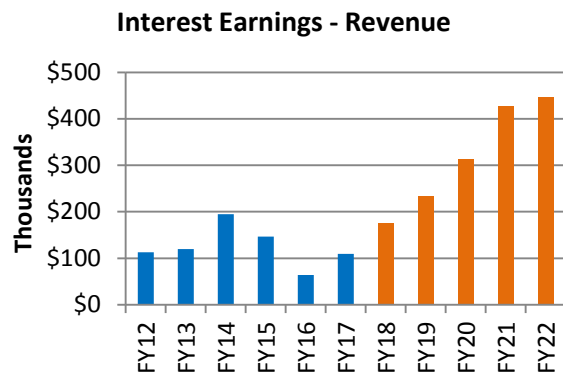
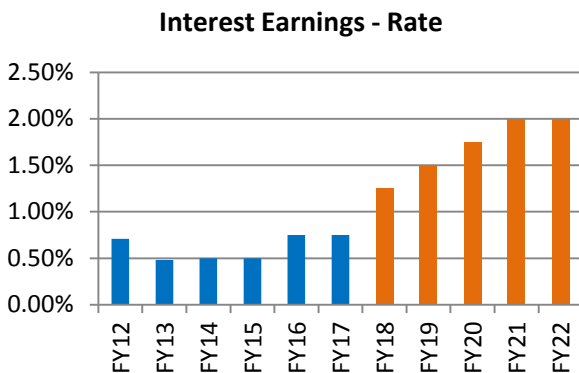
Discussion: The Engineering News Record's Construction Cost Index (ENR-CCI) is used by the District for future increases to the capacity charge rate, as it represents the inflation of construction costs. By District Code, the capacity charge rate increases by the annual change in the ENR-CCI index (February-to-February), rather than a set amount. The annual ENR-CCI in December 2016 (latest data) was 4.1% higher than December the previous year, while the average annual increase for the past 10 years is 3.5%. The recommendation is to assume in the 10-year plan that the construction CPI will increase by 4.0% next fiscal year, and then 3.5% annually thereafter. This would increase the rate from \$8,950 this year to \$9,308 per EDU in FY 17/18.



Interest Earnings

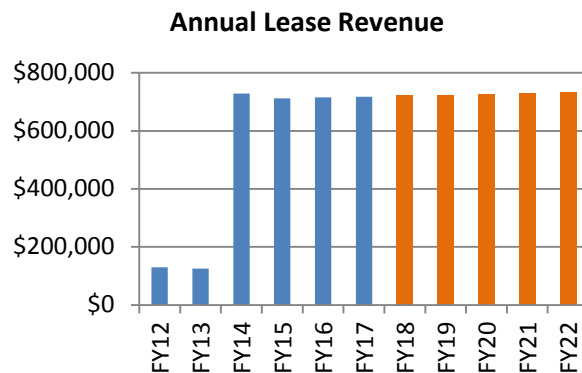
Assumption: Interest Earnings – 1.00% for FY17/18, then increasing to 2.0% by the end of the FY21/22.

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 2017. This assumption is conservative, based on a slowly increasing rate over the next several years, up to 2.0%.



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 for the Real Energy / Napa Biogas project, nor from any other sources. Lease revenues are the source of funding for the Sewer Service Charge Low Income Assistance Program.



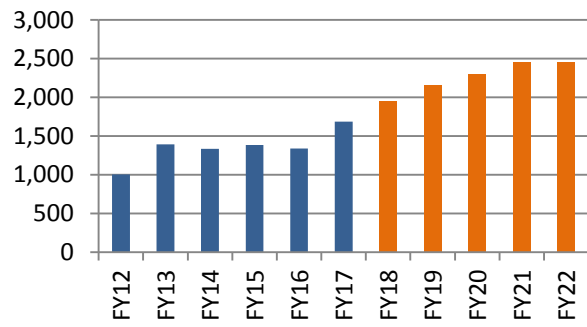
Recycled Water

- Assumption: **Recycled Water Rates – increase for CPI, estimated at 3.3% in 2017 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 2016/17 revenues are expected to increase about 70% because of increased users and the new rate structure that went into effect January 2016. The rate is set to increase with CPI. CPI is estimated at 3.3% for 2016, and at 2.3% for each year thereafter in the forecast.

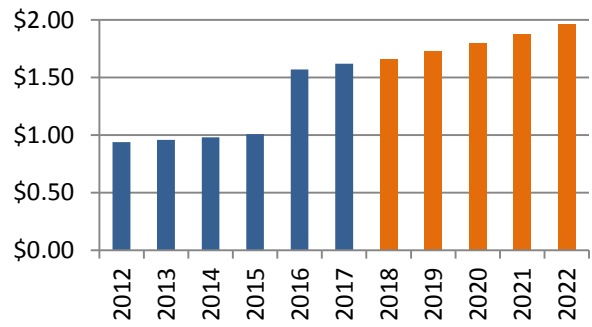
<u>Estimated CPI</u>	<u>2017 Rate</u>
1.0%-1.5%	\$1.59/kgal
1.6%-2.2%	\$1.60/kgal
2.3%-2.8%	\$1.61/kgal
2.9%-3.5%	\$1.62/kgal
3.6%-4.1%	\$1.63/kgal

The amount of water delivered for sale is expected to increase in FY 17/18 and thereafter as more customers in the MST and LCWD areas make conversions to recycled water, and as some new developments commence taking water.

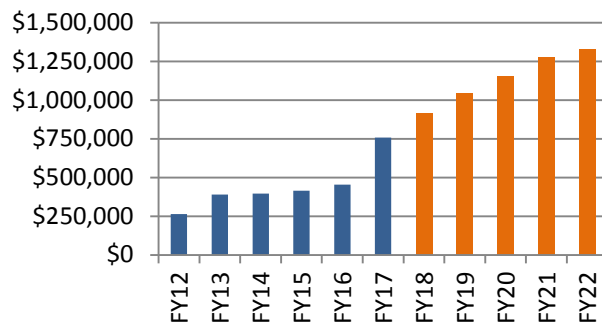
Recycled Water Sold - Acre Feet



Recycled Water Rate per kgal



Recycled Water Revenue



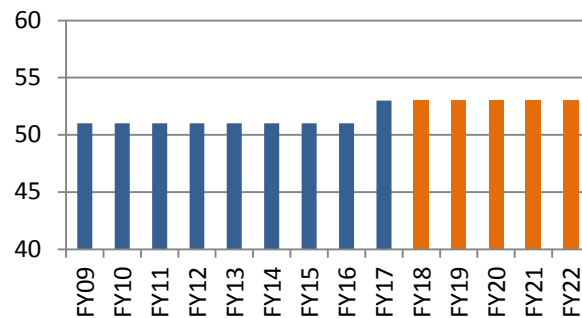
Expenditures

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

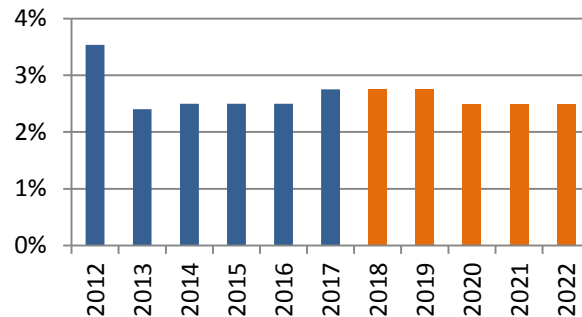


Salary Expenses

Assumption: **Salary Expenses – 2.75% CPI increase in FY17/18, 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 sets 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.

CPI for Wage Estimates



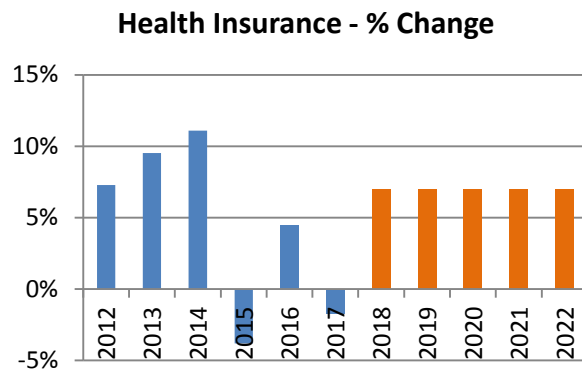
Health Insurance

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

Discussion: A significant majority of employees have Kaiser for health insurance, and the District 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 recent years, with the exception of 2015 where the rates decreased 3.8% and in 2017 with a decrease of 1.75%.

The Affordable Care Act (ACA) is still current law, although it is likely that there will be significant changes proposed with the new administration. The “Cadillac Tax” was a likely contributor to keeping Kaiser rates slightly lower for 2017, but this penalty for “expensive” plans is unpopular and may be delayed or rescinded, thus removing this pressure to cap premium growth. On the other hand, there were requirements in the ACA that contributed to premium increases, such as the required inclusion of certain medical procedures (e.g. pregnancy and baby delivery) and the inclusion of dependents up to age 26. There is much uncertainty regarding the law at this time, and it is almost impossible to predict the trend of future premium increases.

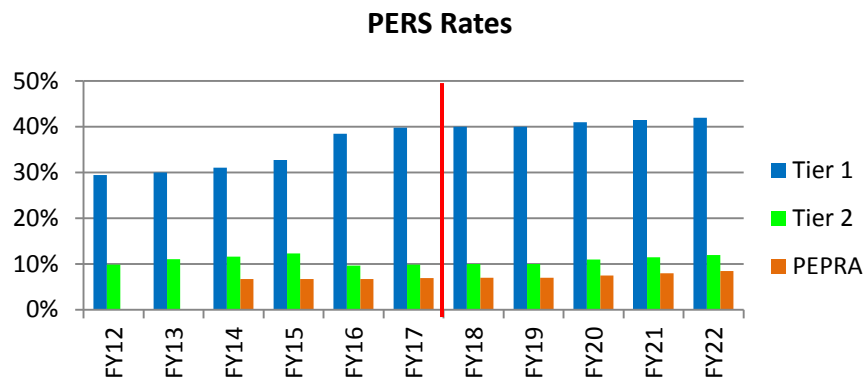
Health care benefit costs are known for calendar year 2017. For budget development purposes, staff recommends planning for a 7% increase in costs in calendar year 2018 and beyond.



Retirement Expenses

Assumption: **Tier 1 – 40% for the next two years, then gradually increasing.**
Tier 2 – 10% for the next two years, then gradually increasing.
PEPRA – 7% for the next two years, then gradually increasing.

Discussion: PERS has provided the employer rate for FY 2017/18 (40.0%) and has provided an estimate of 40% for FY 2018/19 for Tier 1 employees. Tier 2 employees remained stable at 10%, while the PEPRA rate has increased by 0.1% to 7.0%. Several changes in the PERS system are likely to increase employer contributions in the future. These include the assumption that mortality will continue to improve, and that the discount rate will gradually reduce from the current 7.5% to 6.5% over the next 20 years. The CalPERS Board voted in December to lower the discount rate to 7.375% in FY 18/19, to 7.25% in FY 19/20, and to 7% in FY 20/21. The District currently has 39 Tier 1 employees, 5 Tier 2 employees, 8 PEPRA employees and 1 vacancy.



Services & Supplies

Assumption: **Services & Supplies, Generally – For FY 17/18, 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, offset by impacts of stationary storage and solar PPA.

Chemicals –Increase in hypochlorite based on increased recycled water production.

Discussion: The Service & Supplies budget adopted for FY 16/17 was \$5,568,310, compared to the final budget of \$5,474,638 in FY 12/13. This represents a total increase of 1.7%, or an annual average increase of 0.43% for the last 4 years. 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 the District. 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 consumption is expected to increase as more recycled water is delivered to the MST and LCWD areas. This increase will be partially offset by lower electricity costs from the solar array. Chemical costs, particularly hypochlorite, are also expected to increase somewhat as recycled water delivery expands.

Services & Supplies – One-Time Only Expenses

- Discussion: **Asset Management** - The current fiscal year includes one-time only expenses predominantly for the development of the Asset Management Plan. It is expected that the development of the plan and its implementation will continue into FY 2017/18.
- Outfall Abandonment** - There is an anticipated project in the summer 2018 to abandon an outfall. This \$100,000 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.
- 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.
- Special Studies** – the Board may direct staff as part of its Spring 2017 Strategic Planning efforts to conduct studies that are not part of the current budget. These may be in the areas of winery waste management, climate change, or energy, to name a few possibilities. The forecast will include \$250,000 in FY 17/18 for such studies as a placeholder, pending Board direction.

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 regarding future recycled water improvements funded through NBWRA.
- The Board gave 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, including additional sewer replacements starting in FY19/20.
- Staff will continue to priorities I&I and sewer replacement projects that are likely to result in reduced recycled water chloride levels.