Budget Assumptions for
FY 2019/20 and the 10-Year Forecast

Staff has begun the process for preparation of the FY 2019/20 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**

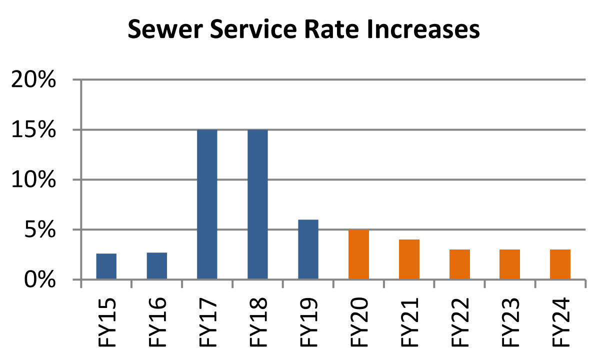
Discussion: With the plant improvements to expand recycled water treatment capacity and the recycled water pipelines to MST and LCWD completed, the 2019 and 2020 recycled water irrigation season should continue to see increases in the amount of recycled water sold and more properties convert to recycled water. The CIP will 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.

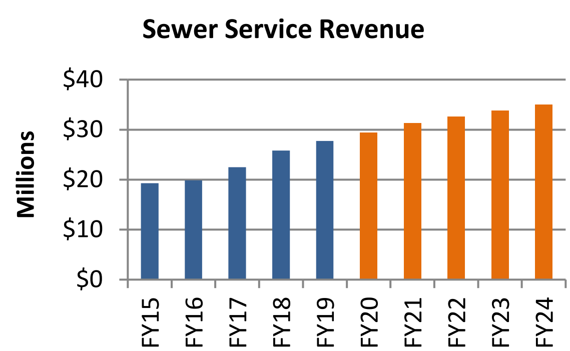
Revenues

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 5% for FY 2019/20, followed by 4% in the following year. Another Proposition 218 process is expected in Spring 2021. For years three 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

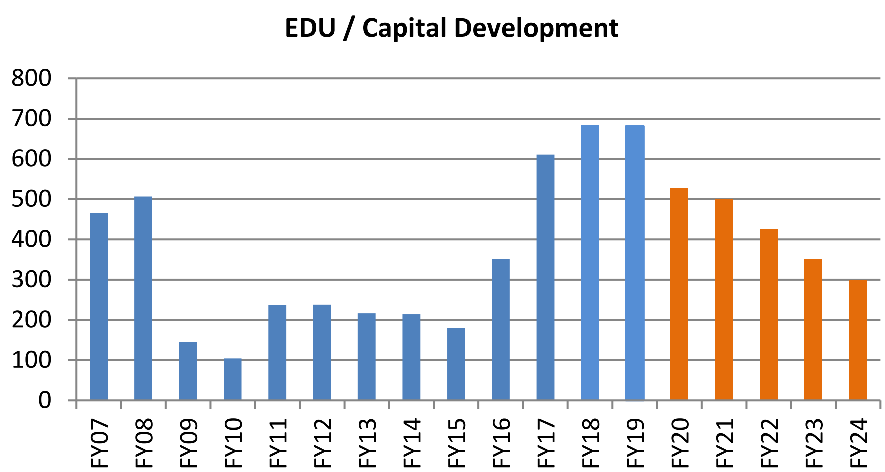
Assumption: **Growth in EDU – for the next four years, projected growth based on estimates of commercial and development projects know to NapaSan staff, plus an assumed baseline of activity for smaller projects. Thereafter, based on assumed growth of 300 EDU annually, consistent with Growth Plan.**

Discussion: The last three years have shown solid signs of development activity, with an expectation of slower growth in the next few years. 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 following six years (FY23/24 to FY28/29) assume a growth level consistent with the General Plan (300 EDU per year).

Fiscal Year	Commercial	Residential	Total	Revenue
Current	95	586	681	$6,483,000
FY 19/20	181	347	528	$5,117,500
FY 20/21	380	120	500	$5,099,000
FY 21/22	275	150	425	$4,485,800
FY 22/23	175	175	350	$3,823,400

FY 18/19 (current year) includes payment for increased capacity at two winery-related operations, and residential development on Pietro Place, Pear Tree, the Stoddard (Gasser) project, Napa Creek Villages, and others. **FY 19/20** assumes two hotel expansions, along with a continuation of the Gasser Vista Tulocay housing development and the 1st Street Apartments and Manzanita Family Apartments projects. **FY 20/21** includes the continuation of the Marriott, development of the Widewater Hotel, and other developments. **FY 21/22** anticipates the beginning of development of the resorts on First Street and at Stanly Ranch.

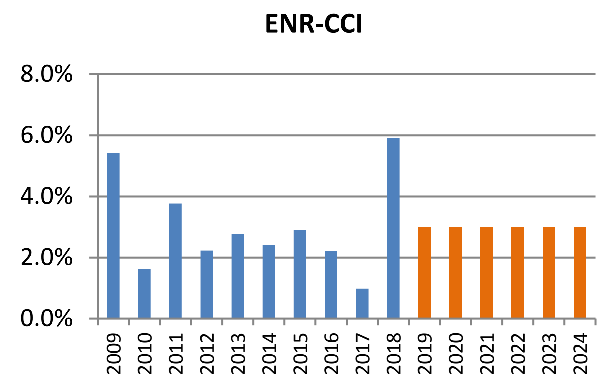
Some developments have not been included in the forecast for the next few years because of their uncertain nature. These include Montalcino, Black Elk, Foxbow, the Wine Train Hotel, and Napa Pipe development.



Construction Inflation

Assumption: **Construction CPI – 3.0% for FY 19/20, and 3.0% per year in future years.**

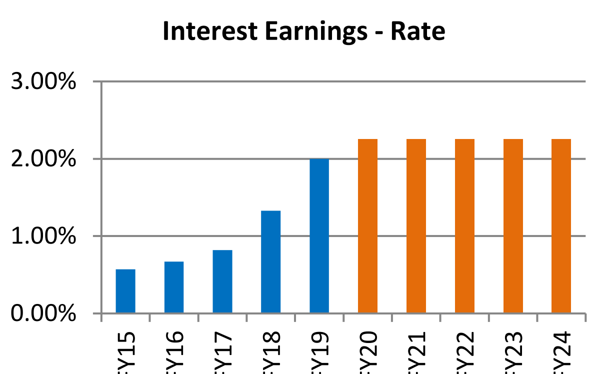
Discussion: The Engineering News Record's Construction Cost Index (ENR-CCI) is used by NapaSan for future increases to the capacity charge rate, as it represents the inflation of construction costs. With recent changes to District Code, the capacity charge rate may increase annually up to the ENR-CCI's 20-city average index (February-to-February). The annual ENR-CCI index in February 2019 was 3.0% higher than February the previous year, and the average annual increase for the past 10 years is just under 3%. The economy is still strong, with indications of continued growth in the construction sector, at least in the short term. The recommendation is to assume in the 10-year plan that the construction CPI will increase by 3.0% next fiscal year, and 3.0% annually thereafter. This would increase the rate from $9,520 this year to $9,806 per EDU in FY 19/20.

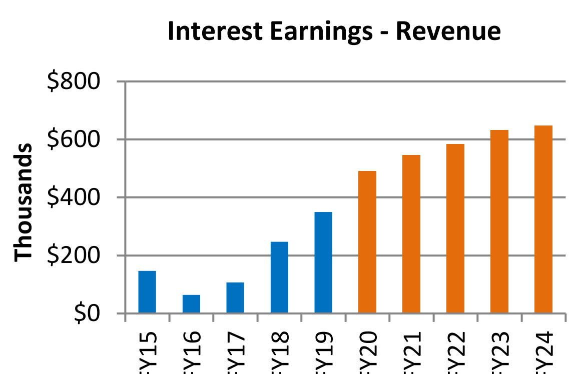


Interest Earnings

Assumption: **Interest Earnings – 2.25% for FY 19/20 and future years.**

Discussion: The Federal Reserve increased the Federal Funds rate by 0.25% three times in 2018, and has indicated that the Fed might raise rates one more time in 2019, depending on wage and inflationary trends. The interest rates for the Napa County Investment Pool in December 2018 (most recently reported month) was 2.01% (on a rising trend), with the LAIF rate at 2.16% (and rising). The recommended assumption is conservative, assuming 2.0% for the rest of the current year, increasing to 2.25% and staying steady thereafter.





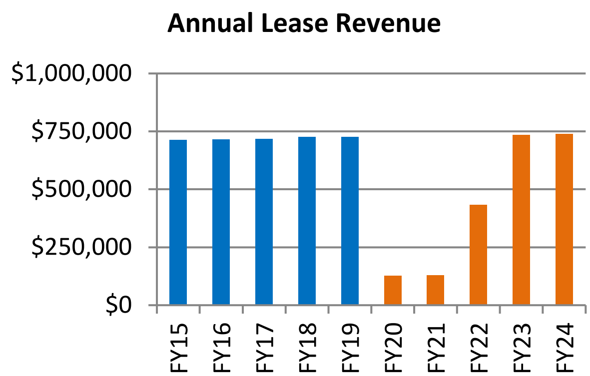
Lease Revenue

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.

For Somky, NapaSan staff has received indications that this lease payment will not be made in the current and in future fiscal years. The lease is currently set at $600,000 per year. The forecast assumes that, if the lease payments are defaulted on, then NapaSan will move to replace this lease revenue with an additional source of lease income, but that it will take 18-24 months to implement such a change.

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.



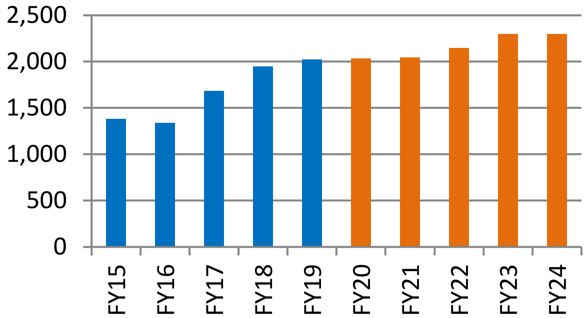
Recycled Water

Assumption: **Recycled Water Rates – increase for CPI, at 4.5% in 2019 and 3.0% thereafter; additional 2% for Renewal & Replacement reserve starting in 2019. Gallons sold increases based on estimates for expansion of service.**

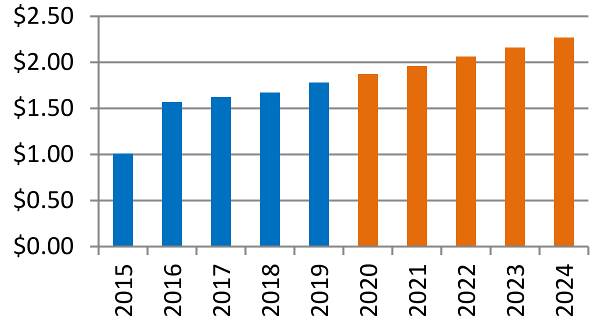
Discussion: FY 2018/19 revenues are expected to increase about 20% because of increased users and the annual rate increase. The rate per thousand gallons for 2019 is $1.78 per 1,000 gallons, based on December CPI numbers of 4.5%, plus 2% for the renewal & replacement reserve. CPI is estimated at 3.0% 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.

Calendar Year	Estimated CPI	RW Rate
2019	4.5%	$1.78/kgal
2020	3.0%	$1.87/kgal
2021	3.0%	$1.96/kgal
2022	3.0%	$2.06/kgal
2023	3.0%	$2.16/kgal
2024	3.0%	$2.27/kgal

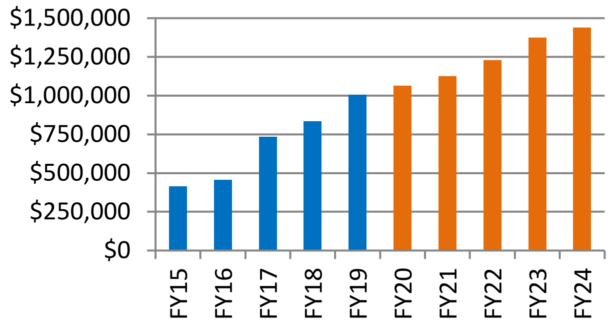
Recycled Water Sold - Acre Feet



Recycled Water Rate per kgal



Recycled Water Revenue

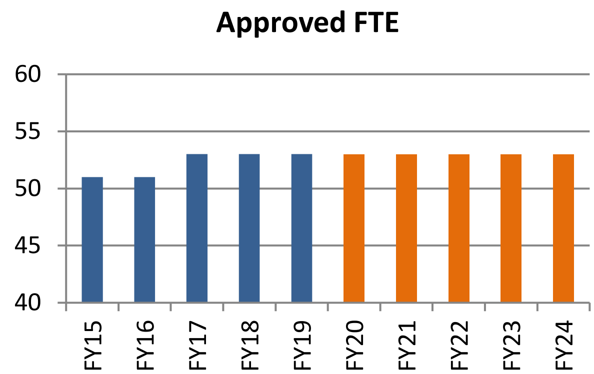


Salary & Benefit Expenditures

Staffing Levels

Assumption: **Staffing Levels – no change**

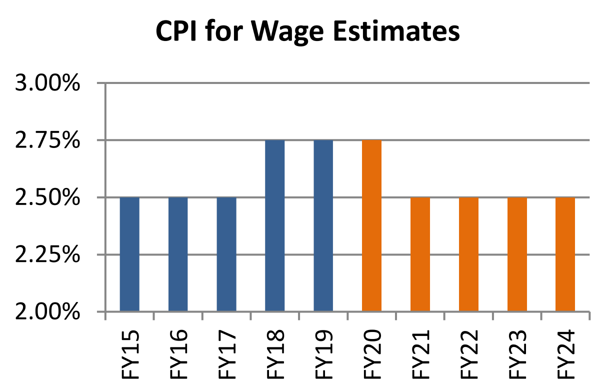
Discussion: FY 2016/17 saw the implementation of changes recommended in the Employee Master Plan approved by the Board in early 2015 included a recommendation to move or change several positions in the District, and to increase the staffing level of the Collection System by two FTE. There are no planned changes in staffing level for future years.



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 for the current labor agreement (FY14 to FY20) includes an annually increased contribution by employees to PERS (6.75% in FY20 when the agreement ends).

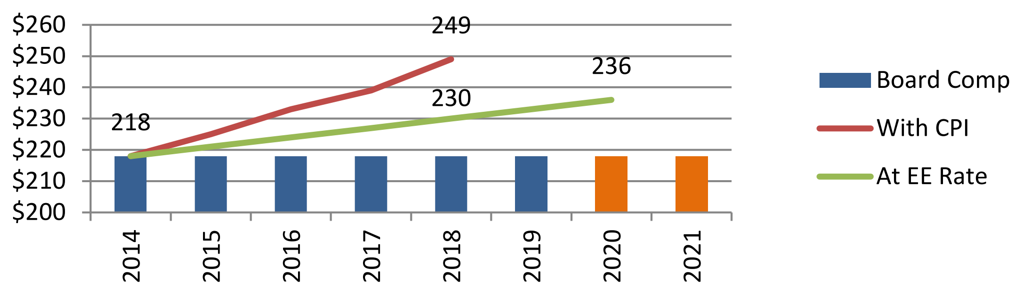


Board Compensation

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 $249 per meeting. If Board compensation had increased at the same rate as employee earnings, the 2019 rate would be $230, and the projected 2020 rate would be $236 per meeting.

Current Board Compensation Per Meeting



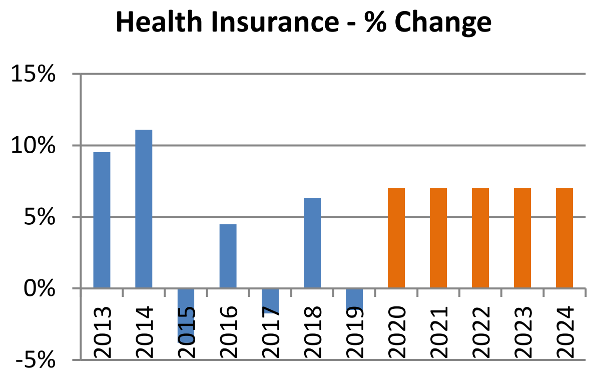
Health Insurance

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 schedule to go into effect in 2022, 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 2019. For budget development purposes, staff recommends planning for a 7% increase in costs in calendar year 2020 and beyond.

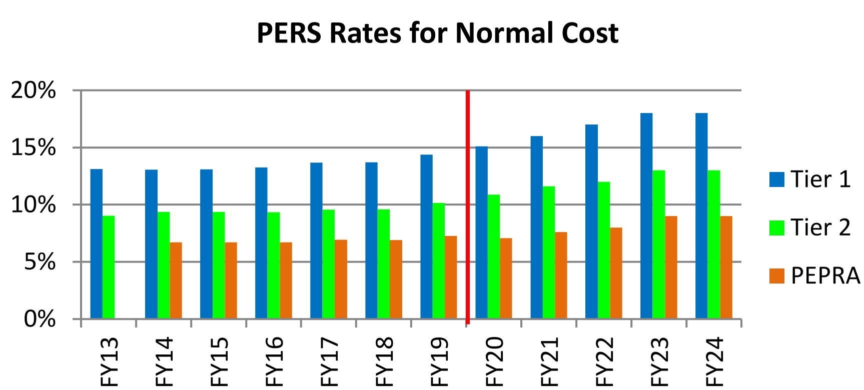


CalPERS Retirement Expenses - Normal Cost

Assumption:

	Tier 1	Tier 2	PEPRA
FY 19/20	**15.1%**	**10.9%**	**7.1%**
FY 20/21	**16.0%**	**11.6%**	**7.6%**
FY 21/22	**17.0%**	**12.0%**	**8.0%**
FY 22/23	**18.0%**	**13.0%**	**9.0%**
Thereafter	**18.0%**	**13.0%**	**9.0%**

Discussion: PERS has provided the employer rate for FY 2019/20 and an estimate for FY 2020/21. 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. **Based on these assumptions and the unfunded liability assumptions (below), the overall CalPERS payment is estimated to increase 8.0% in FY 2019/20.**



CalPERS Retirement Expenses - Unfunded Liability

Assumption: **Set additional CalPERS payment at $135,000 in FY 2019/20, then freeze the overall liability payment at that level for future years.**

Discussion: NapaSan Financial Policy is to contribute additional payments toward the pension unfunded liability. In FY 18/19, an additional $135,000 was budget, the same as the annual savings from refinancing debt the prior year.

FY 19/20 is the last year NapaSan will be paying off the “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.

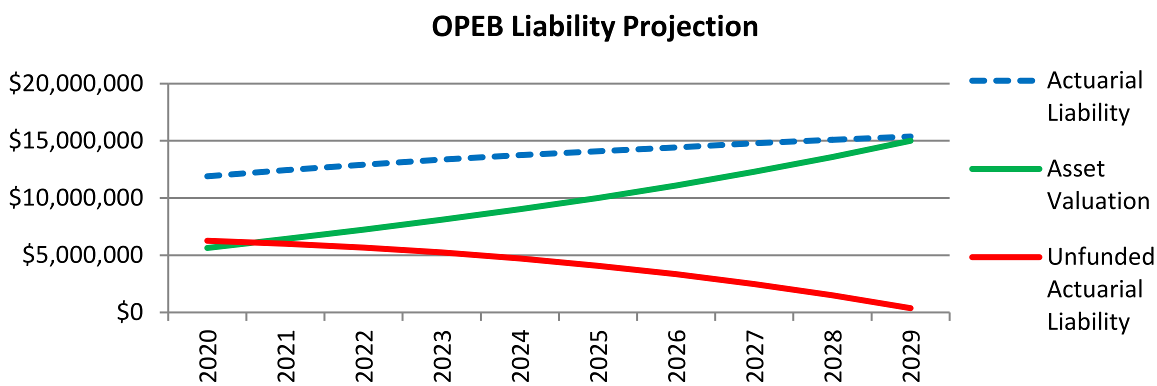
To attain these policy goals, the recommended assumption is for NapaSan to make a payment of $1,529,035 in FY 2019/20, and then retain this same payment for the next nine years. This will attain the stated policy goals.

Fiscal Year	Tier 1 CalPERS minimum	Liability Payment	Additional toward liability
2019/20	1,394,035	1,529,035	135,000
2020/21	877,162	1,529,035	651,873
2021/22	968,679	1,529,035	560,356
2022/23	1,039,871	1,529,035	489,164
2023/24	1,068,854	1,529,035	460,181
2024/25	1,099,584	1,529,035	429,451
2025/26	1,131,197	1,529,035	397,838
2026/27	1,163,719	1,529,035	365,316
2027/28	1,197,176	1,529,035	331,859
2028/29	1,231,594	1,529,035	297,441

OPEB Payments

Assumption: **Set OPEB contribution at 100% of ADC (3.0% annual increase in FY 2019/20)**

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.



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

Services & Supplies

Assumption: **Services & Supplies, Generally – For FY 18/19, as justified, but no more than CPI, expect for contracted and known increases. A 2.0% 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.

Discussion: The Service & Supplies budget adopted for FY 18/19 was $6,003,100, compared to the final budget of $5,474,638 in FY 12/13. This represents a total increase of 9.65% over 6 years, or an annual average increase of 1.55%, 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 as more recycled water is delivered to the MST and LCWD areas.

Services & Supplies – Significant One-Time Only Expenses

Discussion: **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 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**

Finalize debt agreement with State Water Resources Control Board for Browns Valley Trunk and WNPS project in early 2019. Anticipate debt financing for $29 million project in 2019 and 2020 to coincide with construction, with debt service beginning in FY 2021/22. (Actual loan will be for approximately $20 million after Green Project Reserve loan forgiveness and Local Match 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 $45 million, but is likely to be reconsidered as more information is learned through the development of the Collection System Maser Plan.

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

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

FY 21/22 or later – 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 $24 million. Debt issuance in FY 2021/22, with debt service payments beginning in FY 2022/23, or later if justified by the Treatment Plant Master Plan.

Not Included in Forecast

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

The forecast does not include the sale or lease of the North Napa Pump Station, Hartle Court or Jameson Ranch properties, nor the lease of Ponds 3 and 4 for floating solar.