Debt and Other Long Term Liabilities

Construction of the secondary effluent equalization basin in 2014

Completed secondary effluent equalization basin

Debt and Other Long Term Liabilities

The Napa Sanitation District issues long term debt for the construction of significant capital assets. Debt service is the annual or semi-annual payments NapaSan makes to repay the principal and interest on its debt.

Debt Policy

As a matter of policy, NapaSan has a preference to use pay-as-you-go financing for its capital projects and only uses debt financing for improvements that it cannot readily finance from current revenues. Exceptions can be made on a case-by-case basis for no-interest and extremely-low-interest loan programs to pay for capital projects.

Debt can only be used for major, non-recurring capital items, and the debt repayment timeline cannot exceed the expected useful life of the asset being financed.

Debt can only be issued when it has been shown that NapaSan has the ability to pay all of its current obligations from current revenues and still have available 125% of the expected debt service amount to pay the debt service.

NapaSan's complete debt policy can be found in Appendix D, Section 5.

Current Debt Obligations

2003 SRF – In 2003, NapaSan entered into a 20-year loan with the State of California's State Water Resource Control Board Revolving Fund (SRF). The proceeds from this loan, $901,376, were used for replacement of pipes in the collection system. The interest rate on this loan is 2.5%, with annual debt service of $60,247. (See Debt Service Table 1.) Outstanding principal on this debt obligation is $226,646 as of July 1, 2019.

2008 SRF – In 2008, NapaSan entered into a 20-year loan with the State Water Resources Control Board. This loan, which came in two phases, was for a total of $1,559,673 and was used to replace aging infrastructure in the collection system. This is a zero-percent interest loan; however, the annual debt service payment of $93,581 includes a 16.667% state match and is recorded as imputed interest. (See Debt Service Tables 2 and 3.) Outstanding principal on this debt obligation is $846,642 as of July 1, 2019.

Series 2012A – These 20-year Certificates of Participation were delivered and executed to provide funds to repay the outstanding Adjustable Rate Refunding Revenue Certificates of Participation, Series 2009A and to finance $33 million in new capital projects. Annual debt service for this bond in FY 2019/20 is $2,652,975. (See Debt Service Table 4.) Outstanding principal on this debt obligation is $29,485,000 as of July 1, 2019.

Series 2017 – These 10 year Refunding Revenue Bonds were sold in December 2017 to advance refund the 2009B Certificates of Participation. The $14,185,000 advance refunding will save NapaSan ratepayers almost $1.27 million over the life of the bonds. Annual debt service for this bond in FY 2019/20 is $1,776,900. (See Debt Service Table 5.) Outstanding principal on this debt obligation is $13,060,000 as of July 1, 2019.

Debt Covenants

A debt covenant is a requirement imposed on NapaSan by a debt holder. These requirements range from requirements to pay the principal and interest payments on particular days of the year, to preparing and filing audited financial statements, to very specific financial performance requirements.

There is one significant debt covenant that has a financial impact to NapaSan. This covenant applies to all of NapaSan's debt, and is a debt service coverage requirement. Debt service coverage is the ratio of net revenues (revenues minus operating expenses) to annual debt service requirements. NapaSan is required by its bond covenants to maintain a debt service coverage ratio of at least 1.25. For FY 2019/20, the District's coverage ratio is budgeted to be 4.50.

Debt Coverage Ratio Calculation

	Estimated FY 18/19	Budget FY 19/20
Revenue		
Sewer Service Charges	$28,166,000	$29,856,000
Capacity Charges	$5,100,000	$5,178,000
Recycled Water	$979,000	$1,064,000
Interest	$420,000	$452,000
Rents & Leases	$427,000	$126,000
Other Revenue	443,000	383,500
(excl. sale of property and grant revenue)		
Operating Expenses	($14,639,800)	($16,367,200)
Net Revenue	$20,895,200	$20,692,300
Parity Debt Service		
2003 SRF	$60,300	$60,300
2008 SRF	93,650	93,650
2012A COPs	2,663,000	2,663,050
2017 RBBs	1,776,850	1,776,900
Total Debt Service	$4,593,800	$4,593,900
Parity Debt Coverage Ratio	**4.55**	**4.50**
(net revenue ÷ total debt service)		
(must be greater than 1.25)		

Debt Capacity & Debt Limitations

Debt Capacity is the difference between the amount of debt NapaSan has outstanding (sold and authorized) and the maximum amount of debt NapaSan can incur within its legal, public policy and financial limitations.

NapaSan generally does not issue general obligation debt, and as such, there is no legal limitation on the amount of debt it can issue. NapaSan is limited by the debt policies that it sets for itself (described above and in Appendix D) and by financial limitations. Financial limitations include two factors:
1) willingness of the bond market to loan NapaSan money, and 2) limitations on future debt placed on NapaSan by current debt.

First, the amount of debt NapaSan can issue is limited by whether there are financial and other institutions and other buyers in the market willing to purchase the bonds that NapaSan wants to issue. In tight capital markets, or if the financial health of NapaSan is in question, the amount of debt NapaSan can issue under favorable terms can be limited.

Second, the debt coverage ratio imposed by existing debt holders also applies to any future debt NapaSan may want to issue. By forecasting operating revenues and expenditures and applying the 1.25 debt coverage ratio, a debt capacity can be calculated.

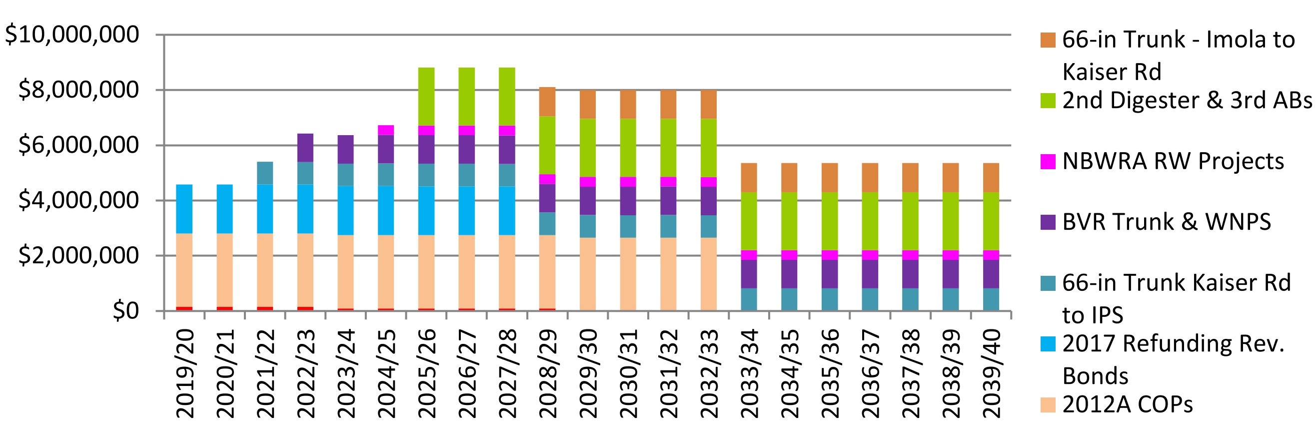
Currently, NapaSan has the capacity to issue approximately $170 million in additional debt (3.5% TIC, 20 year term), assuming that there was a buyer for that debt in the bond market, NapaSan could pay the debt service, and other financial policies are maintained.

Future Debt Issues

The Ten-Year Capital Improvement Plan and the Ten-Year Financial Plan includes debt financing for five future capital projects:

1) **Browns Valley Road Trunk and West Napa Pump Station Replacement** – In FY 19/20, NapaSan intends to execute a 30-year State Revolving Fund loan agreement with the State Water Resources Control Board to construct the Browns Valley Trunk and West Napa Pump Station projects. The loan is for an amount not to exceed $33,466,680, which represents 83.6667% of the maximum project cost of $40 million. In exchange for NapaSan paying the remaining 16.3333% as "local match" directly and not including the amount in the loan, the loan agreement was set at 0% interest for the full 30-year term. The actual amount of the loan and the annual debt service will not be determined until after project construction is completed (estimated in November 2020). The finance package also includes an application for a Green Project Reserve grant for 50% reimbursement of expenses associated with increased energy efficiency, which could result in loan forgiveness of up to $4 million.
2) **Rehabilitation of the 66" Sewer Trunk (Kaiser Rd to IPS)** – this sewer main rehabilitation project is estimated to need $10 million in external financing. It has not yet been determined wither this financing will be secured through the municipal bond market or through private placement. Resources are anticipated to be needed beginning in late spring 2020. For planning purposes, it has been assumed that $4 million in private placement loan proceeds will be received in FY 19/20 and the remaining $6 million received in FY 20/21.
3) **NBWRA Recycled Water Projects** – these projects will be financed through 25% federal grants and federal low-interest water infrastructure loans. Estimated project cost is $5.1 million, with debt service beginning in FY 2024/25.
4) **Second Digester / Third Aeration Basin** – it is assumed that this project will be financed through the issuance of Certificates of Participation ($23.6 million), with debt service beginning in FY 2022/23. The forecast assumes a 25-year loan at 5% True Interest Cost (TIC). The timing and scope of this project is subject to potential changes in the Treatment Plant Master Plan.
5) **Rehabilitation of the 66" Sewer Trunk (Imola to Kaiser Rd)** – this project, to rehabilitate the existing 66" sewer trunk from Imola Avenue south to Kaiser Road, is expected to cost $18 million, with debt service beginning in FY 2028/29. This project will be financed through the issuance of Certificates of Participation (COPs) or some other external financing vehicle. To be conservative, it is assumed the debt will be financed through the issuance of 20-Year COPs at 5% TIC.

Projected Debt Service Summary



Pensions

NapaSan contributes to the California Public Employees' Retirement System (CalPERS), a cost-sharing multi-employer public employees' retirement system that acts as a common investment and administrative agency for participating public entities.

NapaSan has three different benefits plans, based on the date of initial employment with NapaSan and enrollment in the CalPERS system. Tier 1 is a closed plan, with new employees not eligible to enter. Tier 2 is open to new employees who have previously been enrolled in CalPERS prior to January 1, 2013 (and meet other requirements). PEPRA is open to all other new employees:

Tier 1	Hired prior to September 5, 2009
Tier 2	Hired on or after September 5, 2009
PEPRA	Hired on or after January 1, 2013

As of June 30, 2017 (last available date), NapaSan had unfunded accrued liabilities and funded ratios as follows:

	Unfunded Accrued Liability (UAL)	Funded Ratio
Tier 1	$ 12,816,573	69.1%
Tier 2	$ 117,396	90.3%
PEPRA	$ 7,147	96.0%

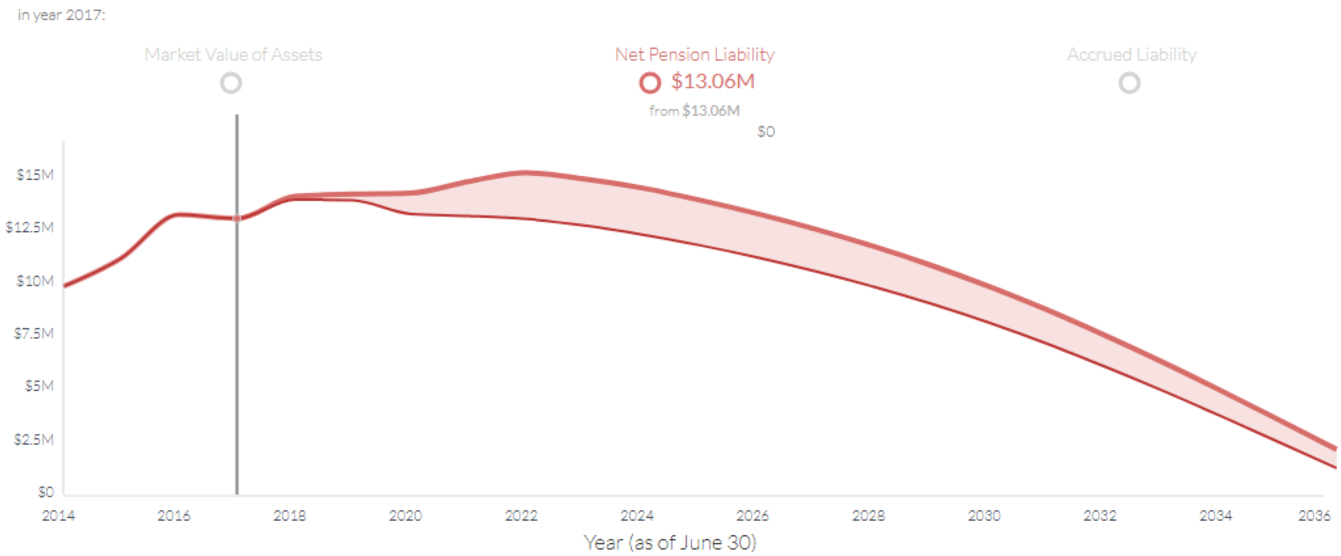
For FY 2019/20, NapaSan will pay 15.097% of Tier 1 employees' salaries, 10.868% of Tier 2 employees' salaries, and 7.072% of PEPRA employees' salaries to CalPERS for the Normal Cost. In addition, NapaSan will pay $1,346.093 toward the Tier 1 UAL, $16,710 toward the Tier 2 UAL, and $3,831 toward the PEPRA UAL.

These payments toward the UAL are the minimum required contribution to CalPERS. NapaSan has also budgeted $135,000 in FY 2019/20 as an additional voluntary contribution toward the Tier 1 UAL.

The 10-Year Financial Forecast includes an assumption to pay additional voluntary contributions toward the UAL as follows, based on the implementation of NapaSan's Financial Policies. These additional payments are estimated to reduce the UAL by over $4 million over the next thirty years:

Fiscal Year	Additional Contribution
2019/20	$ 135,000
2020/21	651,873
2021/22	560,356
2022/23	489,164
2023/24	460,181
2024/25	429,451
2025/26	397,838
2026/27	365,316
2027/28	331,859
2028/29	297,441

The following graph illustrates the difference in the projected unfunded pension liability with and without the additional voluntary contributions.

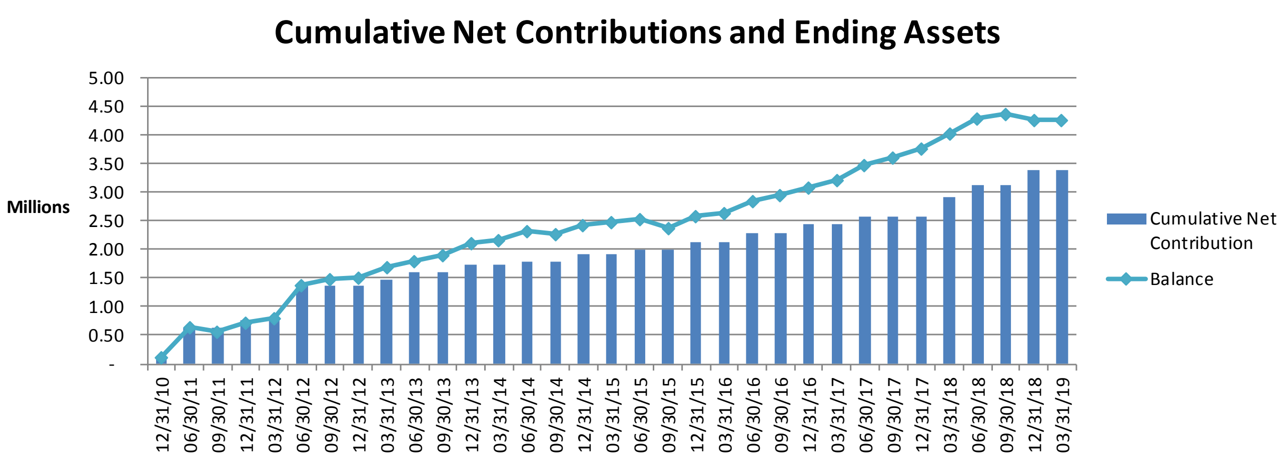


OPEB

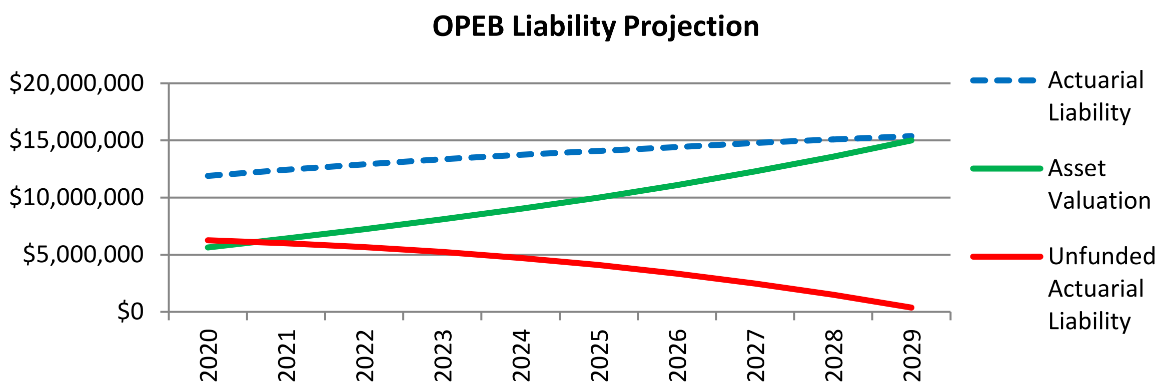
Other Post-Employment Benefits (OPEB) are benefits, other than retirement pensions, that are provided to retirees of NapaSan. These include health care, life insurance and vision insurance. Beginning in 2010, NapaSan started to contribute at least the Normal Cost, if not more, of OPEB costs to a trust account invested and administered by CalPERS. Assets in this trust account can be used to net against NapaSan's total OPEB liability.

The FY 2019/20 budget includes a payment to the OPEB trust of $504,950 and direct benefit payments of $413,500.

Assets in NapaSan's OPEB Trust were greater than the actual contributions (as of March 31, 2019) because of investment earnings:



Based on the current actuarial report for the OPEB benefits, it is projected that the unfunded OPEB liability will be eliminated as early as 2029, assuming that NapaSan continues to transfer the actuarial determined contribution (less direct payments) to the OPEB trust on an annual basis.


OPEB Liability Projection
$20,000,000
$15,000,000
$10,000,000
$5,000,000
$0
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029
Actuarial Liability
Asset Valuation
Unfunded Actuarial Liability