SWEETWATER SPRINGS WATER DISTRICT

TO: Board of Directors **AGENDA NO. V-C**

FROM: Steve Mack, General Manager

Meeting Date: April 6, 2017

SUBJECT: DRAFT FY 2017-2018 BUDGET AND DISTRICT CALPERS UNFUNDED ACCRUED LIABILITY

RECOMMENDED ACTION: Receive a report on the Draft District FY 2017-2018 (FY 18) Budget, including the District's proposed water rates based on a 3% increase, and the District's CalPERS Unfunded Accrued Liability (UAL). Provide direction to staff and the ad hoc Budget Subcommittee on how to address increasing unfunded retirement liability expenses, including direction on whether and to what extent to proceed with exercising an option for USDA loan funding

FISCAL IMPACT: Provides financial direction for FY 2017-2018 and beyond

DISCUSSION:

The draft FY18 Budget was presented at the March meeting. At that meeting we gave the normal draft budget presentation with examples of the proposed water rates, draft line item budget detail and general description of the highlights of the Budget. I mentioned our concern about the CalPERS unfunded accrued liability cost increases and where they might go in the future. Since then staff have discussed this in more detail and we believe we need a better discussion of this prior to moving forward with the Budget. On March 29, the Budget Subcommittee discussed this issue and recommended having a full discussion with the Board.

CalPERS's UAL (and defined benefit retirement programs UAL in general) have been getting a fair amount of attention lately. Valuation changes brought about by PEPRA, poor investment returns in FY 2013-14 and FY 2014-15, and most recently a change in PERS's assumption of future investment returns have each added large amounts to the District's UAL.

How large is our UAL?

The District's UAL through 06/30/2017 including accrued interest is $722,863. **However**, this figure only includes investment returns and assumption changes through 6/30/2015, plus interest thru 6/30/2017. Because we know investment returns were poor in FY 2015-16 (0.6%) and because we know PERS has changed their assumed rate of return from 7.5% to 7.0%, staff expects our UAL to increase by about $200,000 next year, plus an unknown amount in the succeeding years as the change to the assumed rate of return is put in place. Therefore, staff believes it is reasonable to assume our UAL is really about $1

million, carrying a 7.5% interest rate. We will know more about this at the next valuation but we won't get that report until August 2017.

The District's long-range planning has reflected a desire to self-fund our capital projects, keep rate increases to a level consistent with recent history, while still having the flexibility to meet unexpected costs. Staff has long been aware that CalPERS charges a high interest rate for unfunded liabilities. Twice in the past the District has prepaid unfunded liabilities to avoid paying this interest. It may be time to consider a third prepayment effort, but this time the size of the District's UAL means a prepayment would impact the District's long range financial plan.

What can we do? We have some options:

1. Do nothing. Our payments for the current UL would follow the PERS amortization schedule, attached, which is a ramp-up/ramp down plan: early years have lower payments that do not even cover interest and payments increase each year. Based on liabilities yet to be factored into this schedule as discussed above, expect payments to soon exceed scheduled amounts by about 20%. In a few years, UAL payments will likely approach the $100,000 range -- a much larger expense than we have been using in past budget forecasting.

2. Pre-pay the UAL over the next few years using existing cash reserves above District policy. Because District cash reserves have been decreasing in recent years this option would likely require paring down planned capital improvements, decreasing other expenses, increasing rates to increase income, or some combination of the three. It would also leave little room for unplanned expenses.

3. Pre-pay the UAL in FY 2017-18 using cash reserves AND exercise the option to use USDA loan funds for all or part of CIP 2017. This option would bring in the cash needed to make a significant payment on the UL while still proceeding with planned capital improvements and allowing some room for unplanned expenses. Moreover, the USDA loan carries an interest rate of 2.25% compared to the 7.5% interest rate on the UL. However, it would add to District debt payments for 40 years.

There are other issues to consider:

Can we prepay UAL? We need to get CalPERS confirmation that we can make payments on a different schedule other than what we have been presented. We have a number of questions about our assumptions on this that require CalPERS staff confirmation.

Using USDA funding has issues - USDA requires preapproval of any bid documents, one contract for the entire project, and we have Phase 1 of the 2017 CIP out for bid.

We can either reject these bids, rebid the entire project which would require delay and probable start of construction a year from now, or self fund Phase 1 and use the USDA funding for Phases 2 and 3 - Phases 2 and 3 would start next year with this approach. We would get less benefit from the USDA funding but would still get the added flexibility and better annual District Reserves. Tables 2 and 3 show how the UAL affects long-term planning with and without the USDA funding.

Moving Forward:

You will have many questions with this presentation; we may have some of the answers but likely not all - staff still needs to get questions answered by CalPERS, as well.

Bid opening for Phase 1 of the 2017 CIP is on April 13; award of contract was to be at the May meeting. Do we go forward with Phase 1? This is a decision that can be made at the May meeting.

We propose bringing the draft budget back to the Board at the May meeting with answers for questions and a revised draft budget. We propose having the public hearing for the Budget at the June Board meeting.

Table 1. FY 2017-2018 Budget Preparation (Revised)	
Approved Capital Improvement Program	December 1, 2016
Introduce Budget Process	January 5, 2017
Budget Committee meetings	February/March 2017
Draft Budget to Board for Discussion/Action, Including Direction on Water Rates	March 2, 2017
Prop 218 Mailing for Water Rate Increase	March 20, 2017
Draft Budget to Board for Discussion/Action	April 6, 2017
Approve Budget • Prop 218 Public Hearing on Rates	May 4, 2017

Table 2. OPERATING AND CAPITAL BUDGET SUMMARY - 3% Increase, Phased 2017 CIP, No USDA Loan, Increased UAL

Water Rate, CDRC Increase = 3% Sales Flat

		FY16 Actual	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
1	**REVENUE**									
2	**OPERATING REVENUE**	Reduced WS	Flat	Flat….						
3	**Water Bill Revenue**									
4	**Capital Debt Reduction Charge**	261,565	270,500	278,615	286,973	295,583	304,450	313,584	322,991	404,300
5	**Total Water Sales**	2,245,959	2,042,600	2,103,878	2,206,092	2,272,275	2,340,444	2,410,657	2,482,977	2,557,466
6	**Total OPERATING REVENUE**	**2,245,959**	**2,313,100**	**2,382,493**	**2,493,066**	**2,567,858**	**2,644,894**	**2,724,240**	**2,805,968**	**2,961,766**
7	**Total NON-OPERATING REVENUE**	**126,559**	**118,915**	**119,600**	**112,702**	**114,655**	**116,647**	**118,679**	**120,751**	**122,865**
8	**Total Income**	2,372,518	2,432,015	2,502,093	2,605,768	2,682,513	2,761,541	2,842,919	2,926,719	3,084,631
9	**EXPENSES**					**New GM**				
10	**Total Salary**	**882,336**	**889,200**	**905,120**	**923,222**	**971,687**	**991,121**	**1,010,943**	**1,031,162**	**1,051,785**
11	**Total Benefits**	**281,186**	**314,769**	**342,180**	**352,445**	**363,019**	**373,909**	**385,127**	**396,680**	**408,581**
12	**SALARY & BENEFITS**	**1,163,522**	**1,203,969**	**1,247,300**	**1,275,668**	**1,334,706**	**1,365,030**	**1,396,070**	**1,427,842**	**1,460,366**
	Unfunded Liability Increase			**97,000**	**65,592**	**74,665**	**82,966**	**85,455**	**88,019**	**90,659**
13	**SERVICES & SUPPLIES increase =**									
14	**SERVICES & SUPPLIES**	**440,732**	**513,860**	**515,900**	**521,059**	**526,270**	**531,532**	**536,848**	**542,216**	**547,638**
15	**TOTAL OPERATING EXPENSES**	1,604,254	1,717,829	1,860,200	1,862,319	1,935,640	1,979,528	2,018,372	2,058,077	2,098,663
16	OPERATING SURPLUS/DEFICIT	**$768,264**	**$714,186**	**$641,893**	**$743,449**	**$746,873**	**$782,012**	**$824,547**	**$868,642**	**$985,967**
17	**FIXED ASSET EXPENDITURES**	**62,633**	**62,000**	**22,000**	**60,000**	**20,000**	**60,000**	**20,000**	**60,000**	**20,000**
18	**Tfers to CIRF for CDR Revenue**	261,565	270,500	278,615	286,973	295,583	304,450	313,584	322,991	404,300
19	**Tfers to CIRF**	320,000	330,000	390,000	450,000	420,000	490,000	500,000	560,000	570,000
20	**Total TRANSFERS TO OTHER FUNDS**	621,565	640,500	708,615	776,973	755,583	834,450	853,584	922,991	1,014,300
21	SURPLUS/DEFICIT	**84,066**	**11,686**	**-88,722**	**-93,524**	**-28,710**	**-112,438**	**-49,037**	**-114,349**	**-48,333**
22	**Capital Budget**									
23	**REVENUE/SOURCES OF FUNDS**									
24	**Net Operating Revenues****	404,066	341,686	301,278	356,476	391,290	377,562	450,963	445,651	521,667
25	**Assessments**	775,481	775,481	775,481	775,481	775,481	775,481	775,481	775,481	775,481
26	**Capital Debt Reduction Charge*****	261,565	270,500	278,615	286,973	295,583	304,450	313,584	322,991	404,300
27	**Capital Interest**	8,367	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
28	**Transfers From CIRF/Reserves**	772,515	570,000		390,000		105,000		130,000	
29	TOTAL REVENUE	2,221,994	1,967,667	1,365,374	1,818,931	1,472,354	1,572,494	1,550,028	1,684,123	1,711,448
30	**EXPENSES**									
31	**Total Debt Payments**	**1,035,961**	**1,099,017**	**1,013,550**	**995,550**	**995,550**	**995,550**	**848,811**	**848,811**	**848,811**
32		CIP 2016	CIP 2017-1		CIP 2017-2	Replace GSF	CIP 2017-3		CIP 2023	CIP 2024
33	**Annual CIP**	**1,149,979**	**823,963**		**842,741**	**250,000**	**648,200**	**200,000**	**914,000**	**675,000**
34	**In-House Construction Projects, etc.**	36,042	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
35	TOTAL EXPENSES	2,221,982	1,962,980	1,053,550	1,878,291	1,285,550	1,683,750	1,088,811	1,802,811	1,563,811
36	SURPLUS/DEFICIT	**12**	**4,687**	**311,824**	**-59,360**	**186,804**	**-111,256**	**461,217**	**-118,688**	**147,637**
37	**FUND AND LOAN BALANCES (EOY)**									
38	**Ending Funds ab District Policy (DP)**	**1,070,574**	**505,261**	**817,085**	**367,725**	**554,529**	**338,272**	**799,489**	**550,801**	**698,438**
	Funds ab DP and Debt Payments	**34,613**	**(593,756)**	**(196,465)**	**(627,825)**	**(441,021)**	**(657,278)**	**(49,322)**	**(298,010)**	**(150,373)**
39	**NET CAPITAL FUNDING******	**413,518**	**298,650**	**351,824**	**433,381**	**476,804**	**471,944**	**701,217**	**705,312**	**862,637**

*** Starting values based on actual FY16 EOY**

**** =Transfer to CIRF plus net operating surplus**

***** =Transfers from CDRC**

****** =Net Operating Revenues + Assessments + CDRC + Capital Interest - Total Debt Payments**

Table 3. OPERATING AND CAPITAL BUDGET SUMMARY - 3% Increase, Phased 2017 CIP, USDA Loan, UAL

Water Rate, CDRC Increase = 3% Sales Flat

		FY16 Actual	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
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22	**Capital Budget**									
23	**REVENUE/SOURCES OF FUNDS**									
24	**Net Operating Revenues****	404,066	341,686	301,278	356,476	391,290	377,562	450,963	445,651	521,667
25	**Assessments**	775,481	775,481	775,481	775,481	775,481	775,481	775,481	775,481	775,481
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	USDA Loan			1,490,941	get loan funds late FY18					
29	TOTAL REVENUE	2,221,994	1,967,667	2,856,315	1,818,931	1,472,354	1,572,494	1,550,028	1,684,123	1,711,448
30	**EXPENSES**									
31	**Total Debt Payments**	**1,035,961**	**1,099,017**	**1,013,550**	**1,055,550**	**1,055,550**	**1,055,550**	**968,811**	**968,811**	**968,811**
32		CIP 2016	CIP 2017-1	CIP 2017-2-3	rpl GSF				CIP 2023	CIP 2024
33	**Annual CIP**	**1,149,979**	**823,963**	**1,490,941**	**250,000**			**200,000**	**914,000**	**675,000**
34	**In-House Construction Projects, etc.**	36,042	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
35	TOTAL EXPENSES	2,221,982	1,962,980	2,544,491	1,345,550	1,095,550	1,095,550	1,208,811	1,922,811	1,683,811
36	SURPLUS/DEFICIT	**12**	**4,687**	**311,824**	**473,381**	**376,804**	**476,944**	**341,217**	**-238,688**	**27,637**
37	**FUND AND LOAN BALANCES (EOY)**									
38	**Ending Funds ab District Policy (DP)**	**1,070,574**	**505,261**	**817,085**	**900,466**	**1,277,270**	**1,649,213**	**1,990,430**	**1,621,742**	**1,649,379**
	Funds ab DP and Debt Payments	**34,613**	**(593,756)**	**(196,465)**	**(155,084)**	**221,720**	**593,663**	**1,021,619**	**652,931**	**680,568**
39	**NET CAPITAL FUNDING******	**413,518**	**298,650**	**351,824**	**373,381**	**416,804**	**411,944**	**581,217**	**585,312**	**742,637**

*** Starting values based on actual FY16 EOY**

**** =Transfer to CIRF plus net operating surplus**

***** =Transfers from CDRC**

CalPERS to Lower Discount Rate to Seven Percent Over the Next Three Years

December 21, 2016

Communications & Stakeholder Relations
(916) 795-3991
Brad W. Pacheco, Deputy Executive Officer
Wayne Davis, Chief, Office of Public Affairs
Contact: Megan White, Information Officer
newsroom@calpers.ca.gov

SACRAMENTO, CA – The California Public Employees' Retirement System (CalPERS) Board of Administration today voted to lower the discount rate from 7.5 percent to 7.0 percent over the next three years. This incremental lowering of the discount rate will give employers more time to prepare for the changes in contribution costs.

"This was a very difficult decision to make, but it is an important step to ensure the long-term sustainability of the Fund," said Rob Feckner, president of the CalPERS Board of Administration. "We know this will have an impact on the state, schools, and public agencies that partner with us, and we're committed to making sure the changes are implemented in a phased approach so our employers and affected members have time to plan their budgets responsibly."

The discount rate changes approved by the Board for the next three Fiscal Years (FY) are as follows:

- FY 2017-2018: 7.375%
- FY 2018-2019: 7.25%
- FY 2019-2020: 7.00%

In addition, the Board approved separate timelines for implementing the new rate for state, school, and public agencies. The new discount rate for the state would go into effect July 1, 2017. The new discount rate for the school districts and public agencies would take effect July 1, 2018. The difference allows schools and public agencies additional time to plan for rate increases.

Lowering the discount rate, also known as the assumed rate of return, means employers that contract with CalPERS to administer their pension plans will see increases in their normal costs and unfunded actuarial liabilities. Active members hired after January 1, 2013, under the Public

Employees' Pension Reform Act will also see their contribution rates rise. Normal cost is the cost of pension benefits for one year.

"Employers have made commitments to their public servants to pay pensions and CalPERS is committed to fulfilling those commitments for generations to come," said Marcie Frost, CalPERS chief executive officer. "Today's action was a necessary step to ensure this happens."

The three-year reduction of the discount rate will result in average employer rate increases of about 1 percent to 3 percent of normal cost as a percent of payroll for most miscellaneous retirement plans, and a 2 percent to 5 percent increase for most safety plans.

Additionally, many CalPERS employers will see a 30 to 40 percent increase in their current unfunded accrued liability payments. These payments are made to amortize unfunded liabilities over 20 years to bring the Fund to a fully funded status over the long-term.

Beginning in 2017, the Board will start reviewing the Fund's asset allocation mix during the next Asset Liability Management process. The process, which includes a review of the discount rate, will conclude in February 2018.

Today's decision was made after an extensive review by the Board on the current funding status of the Fund, projected investment return rates over the next decade, an overview of CalPERS assets and liabilities, and discussions with stakeholders. The CalPERS Board last lowered the discount rate, from 7.75 percent to 7.5 percent, in 2012.

Over the past several years, the CalPERS Board of Administration has taken several important steps to reduce risks to the Fund and ensure long-term stability:

- 2013: Changing amortization and smoothing policies that spread rate increases or decreases over a five-year period
- 2014: Adopting new demographic assumptions that show retirees are living longer
- 2015: Approving a new funding risk mitigation policy to incrementally lower the discount rate during good economic times

In making its decision, the Board reviewed recommendations from CalPERS staff, external pension and investment consultants, and input from employer and employee stakeholder groups.

For more than eight decades, CalPERS has built retirement and health security for state, school, and public agency members who invest their lifework in public service. Our pension fund serves more than 1.8 million members in the CalPERS retirement system and administers benefits for 1.4 million members and their families in our health program, making us the largest defined-benefit public pension in the U.S. CalPERS' total fund market value currently stands at approximately $303 billion.

30-Year Amortization Schedule and Alternatives

	Current Amortization Schedule		Alternate Schedules			
			20 Year Amortization		15 Year Amortization	
Date	Balance	Payment	Balance	Payment	Balance	Payment
6/30/2017	722,863	37,000	722,863	54,580	722,863	66,264
6/30/2018	738,715	45,592	720,488	56,217	708,373	68,252
6/30/2019	746,848	54,665	716,237	57,904	690,735	70,300
6/30/2020	746,184	58,372	709,918	59,641	669,652	72,409
6/30/2021	741,626	62,966	701,325	61,430	644,800	74,581
6/30/2022	731,963	64,855	690,232	63,273	615,833	76,819
6/30/2023	719,617	66,801	676,396	65,171	582,373	79,123
6/30/2024	704,328	68,805	659,555	67,127	544,014	81,497
6/30/2025	685,814	70,869	639,423	69,140	500,318	83,942
6/30/2026	663,771	72,995	615,693	71,215	450,809	86,460
6/30/2027	637,871	75,185	588,034	73,351	394,976	89,054
6/30/2028	607,758	77,441	556,084	75,552	332,266	91,726
6/30/2029	573,047	79,764	519,457	77,818	262,082	94,477
6/30/2030	533,325	82,157	477,733	80,153	183,782	97,312
6/30/2031	488,143	84,621	430,459	82,557	96,671	100,231
6/30/2032	437,016	81,557	377,146	85,034		
6/30/2033	385,232	78,232	317,267	87,585		
6/30/2034	333,012	74,634	250,252	90,213		
6/30/2035	280,606	70,750	175,486	92,919		
6/30/2036	228,297	66,566	92,308	95,706		
6/30/2037	176,402	33,113				
6/30/2038	155,300	34,106				
6/30/2039	131,585	35,130				
6/30/2040	105,031	36,183				
6/30/2041	75,393	26,349				
6/30/2042	53,728	24,751				
6/30/2043	32,095	17,586				
6/30/2044	16,268	9,969				
6/30/2045	7,153	1,878				
6/30/2046	5,742	5,953				
Totals		**1,598,845**		**1,466,586**		**1,232,447**
Estimated Savings				**132,259**		**366,398**

Current CalPERS Board policy prioritizes the order for which lump sum contributions in excess of the required employer contribution shall be applied. Excess contributions shall first be applied toward payment on the plan's side fund, and any remainder shall then be applied toward the plan's share of the pool's unfunded accrued liability.

Please contact the plan actuary before making such a payment to ensure that the payment is applied correctly.

Employer Contribution History

The table below provides a recent history of the required employer contributions for the plan, as determined by the annual actuarial valuation. It does not account for prepayments or benefit changes made during a fiscal year.

Fiscal Year	Employer Normal Cost	Unfunded Liability Payment ($)
2016 - 17	8.377%	28,871
2017 - 18	8.418%	37,000

Funding History

The funding history below shows the plan's actuarial accrued liability, share of the pool's market value of assets, share of the pool's unfunded liability, funded ratio, and annual covered payroll.

Valuation Date	Accrued Liability (AL)	Share of Pool's Market Value of Assets (MVA)	Plan's Share of Pool's Unfunded Liability	Funded Ratio	Annual Covered Payroll
06/30/2011	$ 2,553,783	$ 2,089,749	$ 464,034	81.8%	$ 670,010
06/30/2012	2,825,632	2,180,735	644,897	77.2%	714,362
06/30/2013	3,072,808	2,497,259	575,549	81.3%	720,008
06/30/2014	3,460,337	2,959,633	500,704	85.5%	707,660
06/30/2015	3,758,656	3,087,967	670,689	82.2%	691,449
6/30/2016			700,276		
6/30/2017			722,863		