SWEETWATER SPRINGS WATER DISTRICT

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

FROM: Ed Fortner, General Manager

Meeting Date: **September 5, 2019**

Subject: **District Unfunded CalPERS Pension Liability**

RECOMMENDED ACTION:

None. Receive and consider staff report.

FISCAL IMPACT:

The FY 2019-20 budget provides for a total of $120,000 for unfunded pension liability expense. Of this, $55,451 is a mandatory payment, and $64,549 is an extra payment. This does not include ongoing pension expenses, budgeted at $95,000 this fiscal year.

DISCUSSION:

Staff has generally made the Board aware of our growing liability to CalPERS for accrued employee retirement benefits. The CalPERS acronym for this liability is "UL", short for "Unfunded Liability": This report is intended to provide more detail to the Board about the reasons behind the increase in our UL over the last few years.

Unfunded Liability -- UL -- is the difference between our pension obligations to present and past employees and the assets we currently have to pay those obligations:

Accrued Pension Liability - Pension Assets Saved = Unfunded Liability (UL)

The District's UL has nearly doubled in the last six years, from approximately $500,000 at the start of FY 2014-15 to $945,634 at the end of FY 2018-19 based on the annual CalPERS Valuation Report received this month. **How did this happen?** Attachment 1 to this staff report is a table which breaks down the numbers for this six-year time period. The three key takeaways from the table are:

1. **Changes in assumptions comprise the bulk of UL additions.** This is illustrated in the red block on the table. In four out of the six years covered by the table CalPERS changed its assumptions, one year regarding the age of death and the other three years regarding assumed investment returns. As the table shows, the price tag for these changes is shockingly high, comprising almost $450,000 of additional UL.

2. **Our annual mandatory UL payment assessed by CalPERS isn't enough to cover interest on our UL debt.** This shortfall is shown in the maroon block on the table. To illustrate, at the beginning of FY 2013-14 our UL was $575,549. That year, our interest rate was 7.5%. Interest alone on this balance would have been approximately

$43,000 (7.5% of $575,549). However, our mandatory payment to CalPERS that year was set at $16,715. The difference -- unpaid interest -- gets added to our UL balance.

3. Investment returns haven't really impacted UL balance. The impact of investment returns are shown is shown in the orange block on the table. During the time period shown in the table, CalPERS assumed its investment returns would be anywhere from 7.5% during the early years on the table to 7% in FY 2018-19. Some years CalPERS did better than assumed, and some years CalPERS did worse. Over the entire 6-year period, the net effect of investment returns actually reduced our UL balance by approximately $45,000. Attachment 2 is a CalPERS Facts at a Glance publication that shows, among other items, a 30-year average investment return of 8.2%.

For the past three years the District has made extra payments to begin addressing our growing UL balance. The current schedule for extra payments aims towards paying off our UL in about 30 years (we are now 3 years in), with higher payments on the front end. **However, because of the high interest rate on our UL staff is recommending a more rigorous extra payment schedule.**

What would this look like? Attachment 3 is a schedule showing level annual payments for various accelerated timeframes.

Where would the funds to prepay on an accelerated schedule come from?

- From the Capital Improvement Program (i.e., fewer or smaller capital projects)
- From customers (i.e. rate increase)
- From employees (current employee retirement share is 7% of base pay)
- From a loan or bond issue (current rates are over 4%)
- From District policy reserve ($1,379,359 in FY 2019-20)
- From some combination of the above sources

What does staff recommend? Staff recommends borrowing from the District's policy reserve to pay off the unfunded liability in two large payments of $500,000 made in FY 2019-20 and FY 2020-21. Our debt would move from CalPERS (who charges 7% interest) to our own Policy Reserve (which wouldn't charge any interest, but would lose out on the approximately 2% it earns at the County). The District would then replenish the Policy Reserve at a rate of $135,000/year for seven years, beginning in FY 2020-21. (Attachment 4 is Ordinance 41 passed in December, 2009, which set up the Policy Reserve parameters and provides for its use.)

It's alot to consider. Staff recommends a separate discussion of the District's approach towards addressing UL be added to the October meeting. Should the Board wish to review our PERS Valuation report in its entirety, it can be viewed on the CalPERS website at the following link:

https://www.calpers.ca.gov/page/employers/actuarial-services/employer-contributions/public-agency-actuarial-valuation-reports

A Recent History of Sweetwater's Unfunded Liability - 2% @ 55 Plan

Source: PERS Annual Valuation Report

	U/L at Start of FY	Minimum Required Payment	Extra Payment	Total UL Payments	Net toward principal	Unpaid interest (added to UL)	Initial FYE UL (Balance - Principal Pymts + Unpd Interest)	Plus/Minus Impact on UL of Investment Returns	Plus/Minus Impact on UL of Assumption Changes	U/L Carried to Next FY Year	Notes:
FY 2013-14	**$575,549.00**	$16,715.00	$0.00	$16,715.00	$0.00	$25,835.00	$601,384.00	-$252,743.00	$152,063.00	**$500,704.00**	Assumed age of death increased
FY 2014-15	**$500,704.00**	$22,170.00	$0.00	$22,170.00	$0.00	$14,566.00	$515,270.00	$155,419.00	$0.00	**$670,689.00**	
FY 2015-16	**$670,689.00**	$19,980.00	$0.00	$19,980.00	$0.00	$29,587.00	$700,276.00	$201,792.00	$63,905.00	**$965,973.00**	Assumed investment return lowered from 7.5% to 7.375%
FY 2016-17	**$965,973.00**	$28,871.00	$60,000.00	$88,871.00	$15,792.00	$0.00	$950,181.00	-$129,223.00	$73,504.00	**$894,462.00**	Assumed investment return lowered from 7.375% to 7.25%
FY 2017-18	**$894,462.00**	$36,120.00	$75,883.00	$112,003.00	$39,578.00	$0.00	$854,884.00	-$20,698.00	$159,193.00	**$993,379.00**	Assumed investmenet return lowered from 7.25% to 7%. : $123,964 Impact of PERS methodology change: $35,229.
FY 2018-19	**$993,379.00**	$46,731.00	$78,720.00	$125,451.00	$47,745.00	$0.00	$945,634.00	$0.00	$0.00	**$945,634.00**	
FY 2019-20	**$945,634.00**	$55,031.00									
TOTALS:						**$69,988.00**		**-$45,453.00**	**$448,665.00**		

Joined 2% @ 55 in May 2011

Investment & Pension Funding

Facts at a Glance for Fiscal Year 2017–18

Investments (PERF*)

Total Fund Market Value & Total Net Investment Return** 10-year Review

(for FY end 6/30)

	(in billions)	(%)
2018	$354.0	8.6%
2017	$326.4	11.2%
2016	$302.0	0.6%
2015	$301.9	2.4%
2014	$300.3	18.4%
2013	$257.9	13.2%
2012	$233.4	0.1%
2011	$237.5	21.7%
2010	$200.0	13.3%
2009	$180.9	(24.0%)

* *Public Employees' Retirement Fund (PERF)*
** *Net time-weighted rate of returns*

Total Net Investment Return* *(for FY end 6/30)*

FY to date	8.6%
3 years	6.7%
5 years	8.1%
10 years	5.6%
20 years	6.1%
30 years	**8.4%**

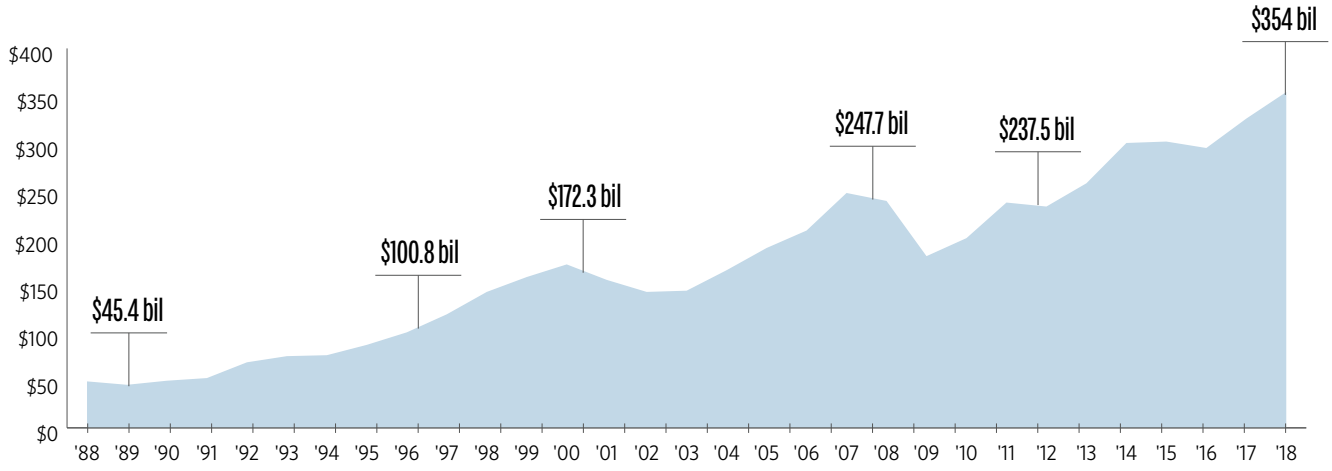
* *Net time-weighted rate of returns*

Discount Rate Changes

2017–18* (State)	7.5%	→	7.375%
2018–19* (School/PA)	7.5%	→	7.375%
2018–19* (State)	7.375%	→	7.25%
2019–20* (School/PA)	7.375%	→	7.25%
2019–20* (State)	7.25%	→	7.0%
2020–21* (School/PA)	7.25%	→	7.0%
2012	7.75%	→	7.5%
2004	8.25%	→	7.75%

* *FY required contribution*

Total Fund Market Value 1988–2018 *(for FY end 6/30)*

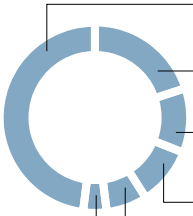


CalPERS

Facts at a Glance is a compilation of information of interest to board members, staff, and the general public. Every effort has been made to verify the accuracy of the information, which is intended for general use only.

Investments (cont'd)

Current Asset Allocation



48.8% Public Equity
22.5% Global Fixed Income
10.8% Real Assets
7.7% Private Equity
5.9% Inflation Assets
4.2% Other:
- **3.3%** Liquidity
- **0.9%** Total Plan Level

Asset Allocation

	Current Allocation	Strategic Asset Allocation *
Public Equity	48.8%	49.0%
Global Fixed Income	22.5%	22.0%
Real Assets	10.8%	12.0%
Private Equity	7.7%	8.0%
Inflation Assets	5.9%	6.0%
Liquidity	3.3%	3.0%
Total Plan Level**	0.9%	—

* *Adopted on December 18, 2017; implemented July 1, 2018*

** *The Total Plan Level includes multi-asset class, transition and plan level portfolios. These assets do not have targets because they are not components of the Total Fund Policy benchmark.*

California Investments

$33.6 billion

California investments as percentage of the total fund

	Fair Value (in millions)
Total California Investments	**$33,556**
Public Equity	$17,157
Global Fixed Income	$5,559
Private Equity*	$821
Real Assets*	$10,019

** As of March 31, 2018*

Sustainable Investing

CalPERS actively engages with the companies we own to **protect the long-term sustainability of our investment**. From issues regarding environmental responsibility to safe labor practices, we keep an open dialog with company leaders and vote our proxies.

10,900+ Number of proxy votes CalPERS cast in 2018 at companies worldwide (calendar year)

Pension Funding

Funded Status of Retirement Plans by Member Category

	State	School	PA	Total
2016–17	**65.8%***	**68.7%***	**69.5%***	**67.9%***
2015–16	62.3%	67.8%	66.2%	68.3%
2014–15	69.4%	77.5%	74.5%	73.1%
2013–14	72.1%	82.0%	77.9%	76.3%
2012–13	66.1%	76.2%	70.5%	69.8%
2011–12	66.1%	75.4%	70.1%	69.6%

** Based on a 7.0% discount rate; does not include the 8.6% return for FY 2017-18.*

Contributions, 10-Year Review *(in thousands)*

	Employer Contributions	Member Contributions	Investment & Other Income
2017–18	**$19,917,796***	**$4,415,129**	**$27,448,098**
2016–17	$12,329,837	$4,214,578	$32,977,020
2015–16	10,892,489	4,015,754	1,548,442
2014–15	9,997,705	3,826,072	6,702,997
2013–14	8,777,602	3,775,038	45,598,044
2012–13	8,123,833	3,897,078	30,291,983
2011–12	7,772,913	3,598,437	(196,014)
2010–11	7,465,397	3,600,089	43,907,436
2009–10	6,955,049	3,378,867	25,577,529
2008–09	6,912,379	3,882,355	(57,363,899)

** Amount includes an additional $6 billion dollar contribution by the state.*

Funded Status Total PERF*

2016–17** 2017–18***

* *Public Employees' Retirement Fund (PERF)*

** *Estimate using a 7.0% discount rate; does not include the 8.6% investment return for FY 2017-18; equivalent of 70.1% based on the CAFR using a discount rate of 7.375% for schools, 7.25% for public agencies and state.*

*** *Estimate based on using a 7.0% discount rate; includes the 8.6% investment return for FY 2017-18.*

Total Employer Contributions

School districts and Charter Schools
$2.1 billion / 12%

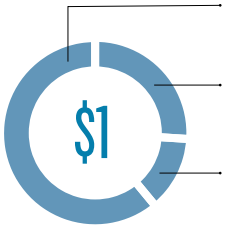
State of California
$11.7 billion* / 54%

Public agencies
$6.1 billion / 34%

** Amount includes an additional $6 billion dollar contribution by the state.*

Shared Responsibility

Every dollar paid to CalPERS retirees comes from three sources:



Investment earnings
59¢

CalPERS employers
28¢

CalPERS members
13¢

Various payoff schedules to pay off current PERS unfunded liability*

Approximate unfunded liability to address (FY 2018-19):	**$945,634***
Interest rate:	**7%**

			TOTAL PYMTS:
1	**Current Plan: We are 3 years into a 30-year payoff, adding add'l liabilities as accrued**	For now, $79,000/year but more in the first years, less in the later years. Total payments:	$2,130,000
2	**10 years**	$135,000/year	$1,347,000
3	**7 years**	$177,000/year	$1,229,000
4	**5 years**	$231,000/year	$1,154,000
5	**3 years**	$361,000/year	$1,081,000
6	**Staff recommendation**	$135,000/year for 7 years to reimburse Policy Reserve (0% interest after 2 years)	$976,828

**** Only considers <u>current</u> PERS UL, not future changes to the total.***

SWEETWATER SPRINGS WATER DISTRICT

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

FROM: Steve Mack, General Manager

Meeting Date: December 3, 2009

SUBJECT: ADOPTION OF ORDINANCE NO. 41 ESTABLISHING A DISTRICT RESERVE POLICY

RECOMMENDED ACTION: Adopt, by reading of title only, Ordinance No. 41, An Ordinance of Sweetwater Springs Water District Adding Policy Number 3510, District Reserve Policy, to the District's Policy and Procedures.

FISCAL IMPACT: Adoption of Ordinance No. 41 would have the financial impact of designating a certain amount of funds as reserves that will be used only in certain, defined situations. The Board will be able to direct use of the funds as long as a plan is established to return the reserves to the designated level.

DISCUSSION:

Ordinance 41 was introduced at the November 5, 2009 Board meeting. In introducing the ordinance, the Board modified Ordinance 41 by changing the Operations Fund from $200,000 to 15% of Operating Budget expenses and deleting a sentence in Section 3050.23 that allowed modification of the Capital Reserve by resolution. Table 1 shows the amounts of funds that would be designated by the Ordinance 41 reserve policy compared to the draft reserve policy used for the FY 2010 Budget. Table 1 also shows the amount of funds available to the District for construction of capital improvement projects. After Ordinance 41 becomes effective, staff anticipates coming back to the Board to revise the FY10 Budget to reflect the appropriate Policy Reserve amounts as part of a mid-year budget adjustment.

Staff recommends adoption of Ordinance 41. If adopted at this meeting the ordinance will become effective in 30 days on January 4, 2010 and will become a part of the District's budget process. Below is a summary of the staff report for the November meeting that provides background on the reserve policy, revised to reflect the ordinance introduced at the November meeting:

Reserve policies are common and recommended for public agencies. They provide a "rainy day" fund for unanticipated events, establish a measure of financial health, and they are part of the process for determining how much capital spending an agency can afford.

Over the past 10 years the District has worked hard to improve its financial condition. Today, that condition is good. We are audited each year and recent audits have given the District good marks for financial accountability and openness. Operational, economic, and other possible uncertainties suggest some level of reserves is needed.

At the same time the District needs substantial infrastructure improvements, has an aggressive capital improvement program (CIP) and is asking for funding assistance to construct the projects in the CIP. The annual revenues of the District are not sufficient to fund the needed CIP and funds for these projects will come in part from District reserves, loans, or grants. Some measure of the District's reserves is needed to determine how much of the District's money is available to construct the CIP and still stay in good financial condition, and how loans and grants can fit into the District's long term financial picture. A formal reserve policy which sets out the appropriate amount of District funds needed for unanticipated events, will help identify reserves available for the CIP while ensuring the District stays in good financial condition.

Ordinance 41 establishes that reserve policy and places it in the District's Policies and Procedures in Section 3510. The reserve policy is based on setting aside 25% of Operating Budget Expenses, 25% of annual debt principal and interest payments, 25% of a nominal $1 million capital improvement program, and cash equivalent to 15% of the Operating Budget for ongoing operations at the start of the fiscal year. A draft reserve policy based on revenues, but not including a debt payment reserve, was used for the Fiscal Year 2009-2010 (FY10) Budget.

The Board discussed the reserve policy at its September and October meetings and Ordinance 41 at its introduction at the November meeting. It agreed with the concept of a reserve at the 25% level, directed staff to include debt repayments in the reserve, and directed that the operating reserve be based on expenses rather than revenues. At the November meeting the Board revised the draft Ordinance 41 to have the Operations Fund at 15% of Operating Budget expenses and deleting a sentence in Section 3050.23 that allowed modification of the Capital Reserve by resolution. Table 1 shows the amounts that would be in the policy reserves for the FY10 Budget if the Ordinance 41 policy were used, and compares those amounts to those in the adopted FY10 Budget. To summarize Table 1, the Policy Reserve amount in the adopted FY10 Budget is $995,830; using the approach in Ordinance 41 it would be $1,157,910.

Some observations on the recommended District Reserve Policy:

- The reserve policy amount sets a target which the annual budget should not go below. Ordinance 41 provides flexibility by allowing going below the target if there is a plan to get above the target within a reasonable time. The plan could involve raising rates over time, reducing CIP spending in a future year or some other cost reducing or revenue increasing approach.

- Ordinance 41 in Section 3510.3 defines District funds in excess of the Reserve Policy as Reserves above District Policy. That identifies the amount of funding available for the District's Capital Improvement Program.

Table 1. Ordinance 41 Policy Reserves

	2010 Budget, operating revenues	Ordinance 41, operating expenses
2010 Operating Revenues/Expenses	$2,183,318	$1,587,703
Debt P&I Payments		$1,091,314
Operating Reserve (10%+15%=25%)	$545,830	$396,926
Capital Reserve	$250,000	$250,000
Cash on Hand (Operations Fund)	$200,000	$238,155
Debt Payments Reserve		$272,829
Total Policy Reserves	$995,830	$1,157,910
FY 2010 EOY Reserves	$3,069,581	
Funds above Reserve Policy	$2,073,751	$1,911,671

ORDINANCE NO. 41

AN ORDINANCE OF SWEETWATER SPRINGS WATER DISTRICT ADDING POLICY NUMBER 3510 TO THE DISTRICT'S POLICY AND PROCEDURES, RESERVE POLICY

WHEREAS, the District wishes to establish a formal policy regarding financial reserves for District funds for the purposes of providing information to District elected officials and staff, District customers, and other observers of the District that demonstrate the financial health of the District, provide consistent designations for different categories for the reserves, define standards for the minimum amounts to be maintained in the designated reserves, and provide flexibility in using District funds; and

WHEREAS, reserve policies are common and recommended for public agencies because they provide a "rainy day" fund for unanticipated events and establish a measure of financial health; and

WHEREAS, adequate levels of reserves, or funds designated for various important purposes, are critical to the successful and stable operation of the Sweetwater Springs Water District; and

WHEREAS, maintaining adequate reserves can translate into rate stabilization from year to year for customers and provides assurance that the District can respond to short-term emergencies, including water quality issues and natural disaster recovery, and economic uncertainties; and

WHEREAS, the Board has determined that the levels of reserves enumerated below are the appropriate levels for the purposes of the reserve policy; and

WHEREAS, determining the level of reserves for the purposes designated in the reserve policy is an essential part of the process for determining how much capital spending the District can afford; and

WHEREAS, the District's reserve policy will be most readily understood and accepted if it is formally adopted; and

WHEREAS, staff presented and the Board considered and discussed the reserve policy at the September 3 and October 1, 2009 meetings, and

WHEREAS, Ordinance 41 was introduced at the November 5, 2009 meeting.

NOW THEREFORE BE IT ORDAINED by the Board of Directors of the Sweetwater Springs Water District, County of Sonoma, as follows:

Section 1. Policy Number 3510 of the Sweetwater Springs Water District Policy & Procedures is hereby added as follows.

3510. District Reserves.

3510.1. Purposes of District Reserve Policy. The purposes of the District Reserve Policy are to provide information to District elected officials and staff, District customers and other observers of the District that demonstrate the financial health of the District, provide consistent designations for different categories for the reserves, define standards for the minimum amounts to be maintained in the designated reserves, identify funding available for future capital improvement projects, and provide flexibility in using District reserves.

3510.2. Components of Designated District Reserves.

3510.21. Operating Budget Cash Reserve. The District will have a cash reserve of 15% of the annual Operating Budget expenses at the start of each fiscal year to provide for prompt payment of operating expenses for the coming fiscal year.

3510.22. Operating Reserve. The District will establish and maintain a reserve equal to 10% of its annual operating budget expenses for the purposes of providing for one-time costs, dealing with economic uncertainty, The District will establish and maintain a reserve equal to 15% of its annual operating budget expenses for the purposes of dealing with emergencies and disaster-related expenses. In combination, the Operating Reserve will have a target of 25% of the Operating Budget expenses.

3510.23. Capital Reserve. The District will establish a Capital Reserve of $250,000, which is equal to 25% of a nominal $1,000,000 Capital Program.

3510.24. Debt Repayment Reserve. The District will establish a debt payment reserve which is equal to 25% of all payments for principal and interest on all District loans in the annual operating and capital budgets.

3510.25. District Policy Reserves. The combined amount of reserves designated by Sections 3050.21-24 are known as District Policy Reserves.

3510.3. Undesignated Reserves. Reserves in District funds in excess of the amounts designated in sections 3050.21-24 above are undesignated, are known as Reserves above District Policy, and are available for use for District purposes, such as funding the Capital Improvement Program.

3510.4. Annual Review of District Funds and Reserve Levels. The District Policy Reserves levels will be reviewed as part of the annual District Budget

approval process. The District may drop below the District Policy Reserve levels only if a plan is developed as part of the budget approval process that shows how the District will reestablish reserves that meet the District Policy Reserve amount.

Section 2. Effective Date. This ordinance shall become effective thirty (30) days after the date of its adoption by the Board of Directors.

This Ordinance was adopted this 3rd day of December, 2009, on roll call by the following vote:

Jim Quigley _____
Gaylord Schaap: _____
Victoria Wikle: _____
Wanda Smith: _____
Sukey Robb-Wilder:_____

_____
Victoria Wikle
President of the Board

ATTEST:

_____
Julie A. Kenny
Clerk of the Board