SWEETWATER SPRINGS WATER DISTRICT

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

FROM: Steve Mack, General Manager

Meeting Date : May 4, 2017

Subject: ADDRESSING DISTRICT CALPERS UNFUNDED ACTUARIAL LIABILITY

RECOMMENDED ACTION: Receive a presentation from staff on the District's CalPERS unfunded actuarial liability (UAL) and provide direction to staff.

FISCAL IMPACT: Looks at alternatives for funding District UAL.

DISCUSSION:

At the April Board meeting staff made a presentation on the District's UAL, including possible impacts on future budgets, possible solutions, and remaining questions. Staff stated that we were expecting to talk to CalPERS staff and that we would attempt to get answers to our questions. The Board referred the issue to the Budget Subcommittee and staff promised an updated presentation for the May meeting. Because of this issue, staff has recommended putting off adopting the FY 2017-2018 Budget until the June meeting.

As we stated at the April meeting, the District's UAL through 06/30/2017 including accrued interest is $722,863. 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.

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 planning for the next few years.

At the April meeting staff presented the following options for addressing the UAL:

1. Do nothing. Our payments for the current UL would follow the PERS amortization schedule 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.

Questions that staff and the Board had at the April meeting included:

- Can we prepay UAL? We have talked with CalPERS about this and we can prepay our UAL and the amounts we prepay are 100% credited to the District (no general funding of the retirement pool that the District is part of).

  The UAL has different "buckets", so for prepayment we need to designate our payments for the appropriate bucket(s) to reduce future interest costs.

- 2017 CIP Phase 1 construction costs?: the bid for this project came in under the Engineer's Estimate of Probable cost so no surprises here; completing this project does not negatively affect our approach.

- Can PARS (Public Agencies Retirement Services) play a role in addressing this issue?: staff has looked into the type of services PARS provides, and contacted PARS about how they could provide useful services for the District. We have asked PARS staff to make a presentation to the Board at the June meeting. PARS is not essential to the immediate steps that the District can take, but we do see how they could play a role in the District's overall approach to managing the UAL.

  One example for the role of PARS is as a place to put District Policy Reserves with a better chance of getting a decent return on investment with minimal risk. PARS has investment portfolios with a return on investment and risk similar to CalPERS. Funds in PARS can only be used to pay retirement-related expenses, but in addition to current year expenses, expenses up to 2 years in the past can be reimbursed from PARS funds. If the District adopts a level payoff approach to the UAL and PARS was used as one of the repositories of District Reserves, up to approximately $200,000 could be accessed from those funds to pay for

emergencies. There are other scenarios about how PARS can be used for District reserves and retirement funding strategies.

- USDA funding issues: We can use the USDA funding for Phases 2 and 3 of the 2017 CIP but not for Phase 1. The USDA funding would include the original funding amount - $2.59 million but since the total project cost would be reduced to approximately $1.8 million, unused funds would be returned to USDA. The annual payments would remain at approximately $100,000 but the length of the loan would be reduced to something like 30 years.

- Staff have looked into the possibility of short-term borrowing from the County against our assessment revenue (e.g., getting a September loan for December assessment revenue deposit by the County). That is not possible, but it may be possible to get a short-term loan from WestAmerica Bank which holds some of the District's funds.

Staff discussed the above issues at an April 20 meeting of the Budget Subcommittee who generally concurred with these observations.

Moving Forward:

One question we haven't answered: what are the cost differences between following the CalPERS ramped UAL payoff approach versus a level payoff approach that tries to minimize interest buildup on the UAL? Staff have been unable to duplicate CalPERS's ramping approach to determine the interest versus principal elements of the currently scheduled annual payments for the current UAL. We believe the savings to the District should be substantial but those savings won't accrue until several years when the CalPERS payments have ramped up to be higher than the level payments favored by District staff. CalPERS staff have promised to send details of the ramping approach that will allow us to better understand the math of their approach but until we get those details we cannot give you a quantitative measure of the long-term savings of a level payment approach.

What we do know:

- The 2017 CIP bid came in near the Engineer's Estimate of Probable Cost so we don't need to rework the Budget to make that project happen, regardless of which approach we decide to take.

- Because of the size of the UAL, reducing it will be a multi-year process. It need not be a budget destroying expense in any one year if addressed on a yearly basis, even with an accelerated or level payment approach.

- The UAL payment approach, whichever direction we choose to go, is a year-by-year decision. However, making prepayments on the UAL schedule cannot be fully recaptured; once we make a payment it is gone to CalPERS. CalPERS is not an investment account. PARS can help with an investment strategy; that discussion is for a future meeting.

- Staff believes the CalPERS approach (ramping) to paying down the UAL does not even cover the interest in the early years, thus adding to our UAL. For examples, interest on our UAL for this fiscal year (FY 2016-2017) is approximately $53,000, yet our annual payment for the UAL was $28,000. Next year it will be approximately $70,000 yet our required payment is $37,000. The difference in these payments is added to our UAL, plus interest.

- We will have occasional one-time funding coming. The River Lane parcel sale looks likely to happen sometime this summer or fall and will bring to the District approximately $60,000. We could consider making a payment on the UAL this fiscal year in anticipation of that payment. We can always reduce a future payment if it doesn't happen.

- Using the USDA loan for Phases 2 and 3 of the 2017 CIP gives the District more financial flexibility. Table 1 shows the updated planning model with increased UAL payments and Phases 2 and 3 included for FY18. The UAL payments affect the bottom line but do not restrict the District's need to complete capital projects.

Recommendations for the FY 2017-2018 Budget:

Staff is recommending adding a line item to the Budget to show payments for the UAL and that the FY18 Budget include a payment of $90,000.

Staff recommends moving forward with the USDA loan for Phases 2 and 3 of the 2017 CIP (finishing the River Road/Old River Road Project) adding the loan revenue and estimated construction costs to the Budget.

Adding these items to the Budget will get the District started in addressing its UAL and saving interest costs on the UAL, get these needed Capital projects completed next year, allow the District better budget freedom in the near term, and save the District money in the long term.

Table 1. OPERATING AND CAPITAL BUDGET SUMMARY - 3% Increase, Phased 2017 CIP, USDA Loan, Incrd UAL Pmt

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**
13	**Unfunded Liability Increase**			**90,000**	**77,158**	**73,046**	**68,934**	**68,934**	**68,934**	**68,934**
14	**SERVICES & SUPPLIES increase =**									
15	**SERVICES & SUPPLIES**	**440,732**	**513,860**	**515,900**	**521,059**	**526,270**	**531,532**	**536,848**	**542,216**	**547,638**
16	**TOTAL OPERATING EXPENSES**	1,604,254	1,717,829	1,853,200	1,873,885	1,934,022	1,965,497	2,001,852	2,038,993	2,076,939
17	OPERATING SURPLUS/DEFICIT	**$768,264**	**$714,186**	**$648,893**	**$731,883**	**$748,491**	**$796,044**	**$841,067**	**$887,726**	**$1,007,692**
18	**FIXED ASSET EXPENDITURES**	**62,633**	**62,000**	**22,000**	**60,000**	**20,000**	**60,000**	**20,000**	**60,000**	**20,000**
19	**Tfers to CIRF for CDR Revenue**	261,565	270,500	278,615	286,973	295,583	304,450	313,584	322,991	404,300
20	**Tfers to CIRF**	320,000	330,000	300,000	340,000	390,000	390,000	460,000	460,000	540,000
21	**Total TRANSFERS TO OTHER FUNDS**	621,565	640,500	618,615	666,973	725,583	734,450	813,584	822,991	984,300
22	SURPLUS/DEFICIT	**84,066**	**11,686**	**8,278**	**4,910**	**2,909**	**1,594**	**7,484**	**4,735**	**3,392**
23	**Capital Budget**									
24	**REVENUE/SOURCES OF FUNDS**									
25	**Net Operating Revenues****	404,066	341,686	308,278	344,910	392,909	391,594	467,484	464,735	543,392
26	**Assessments**	775,481	775,481	775,481	775,481	775,481	775,481	775,481	775,481	775,481
27	**Capital Debt Reduction Charge*****	261,565	270,500	278,615	286,973	295,583	304,450	313,584	322,991	404,300
28	**Capital Interest**	8,367	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
29	**Transfers From CIRF/Reserves**	772,515	590,000				580,000		130,000	
30	**USDA Loan**			1,613,000	get loan funds late FY18					
31	TOTAL REVENUE	2,221,994	1,987,667	2,985,374	1,417,364	1,473,972	2,061,525	1,566,549	1,703,207	1,733,173
32	**EXPENSES**							State Loan Done		
33	**Total Debt Payments**	**1,035,961**	**1,099,017**	**1,013,550**	**1,095,550**	**1,095,550**	**1,095,550**	**948,811**	**948,811**	**948,811**
34		CIP 2016	CIP 2017-1	CIP 2017-2-3	rpl GSF					
35	**Annual CIP**	**1,149,979**	**839,305**	**1,463,000**	**250,000**		**914,000**		**675,000**	
36	**In-House Construction Projects, etc.**	36,042	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
37	TOTAL EXPENSES	2,221,982	1,978,322	2,516,550	1,385,550	1,135,550	2,049,550	988,811	1,663,811	988,811
38	SURPLUS/DEFICIT	**12**	**9,345**	**468,824**	**31,814**	**338,422**	**11,975**	**577,738**	**39,396**	**744,362**
39	**FUND AND LOAN BALANCES (EOY)**									
40	**Ending Funds ab District Policy (DP)**	**1,070,574**	**635,919**	**1,250,743**	**1,282,557**	**1,620,980**	**1,052,955**	**1,630,692**	**1,540,088**	**2,284,450**
41	**Funds ab DP and Debt Payments**	**34,613**	**(463,098)**	**237,193**	**187,007**	**525,430**	**(42,595)**	**681,881**	**591,277**	**1,335,639**
42	**NET CAPITAL FUNDING******	**413,518**	**298,650**	**358,824**	**321,814**	**378,422**	**385,975**	**617,738**	**624,396**	**784,362**

*** 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**