ZONE 7 BOARD OF DIRECTORS
SUMMARY NOTES OF THE FINANCE COMMITTEE

September 21, 2020
3:00 p.m.

Directors present: Sandy Figuers
Laurene Green
Angela Ramirez Holmes

Staff present: Valerie Pryor, General Manager
Osborn Solitei, Treasurer/Assistant General Manager - Finance
JaVia Green, Financial Analyst
Lira Walter, Administrative Assistant

Director Ramirez Holmes called the meeting to order at 3:00 p.m.

1. Public Comment on Items Not on the Agenda – none

2. FY 2019-20 Fourth Quarter Revenue & Expenditure Report (Unaudited)

JaVia Green, Financial Analyst, and Osborn Solitei, Treasurer/Assistant General Manager – Finance, presented the Unaudited Fiscal Year (FY) 2019-20 Fourth Quarter Revenue & Expenditure Report.

Fund 100, the Water Enterprise Operations Fund, receives revenue mostly from water rates. Revenue was $56.3 million. Expenses were $46 million. Revenue exceeded expenditures by $10.3 million. In the third quarter revenue and expenditure report projected revenue was $50.6 million, projected expenses were $47.2 million, and projected reserve balance was $21.9 million.

Projected reserves are about $8.9 million above board policy (the target level). The reason for that is higher revenue, $4.4 million, due to an increase in water demand, as well as a one-time labor savings of $3.5 million due to a 25% vacancy rate. There was also an increase in CIP activities, the labor being charged to the CIP funds so the shifting of labor into the other funds, which has created some savings in Fund 100. Work was deferred due to COVID-19, and there were savings due to lower office supplies, travel and training expenses (related to impact of COVID-19).

Some suggestions for use of one-time savings were emergency reserves; funding long-term pension liabilities; funding for capital projects; funding for water shortages conditions; additional funds for water supply reliability projects; and financial impacts of COVID-19 and uncertain economic conditions.

The budget projected 34,000 acre-feet of water to be sold. What actually materialized was 39,000 acre-feet of water, 18% more than the budget. This relates to certain one-time circumstances, including increasing our water supply to the City of Pleasanton and Cal Water Service because they reduced their own groundwater pumping, which translates to more demands on the Zone 7 water system. Shelter-in-place orders are another factor with more people at home, and not traveling to work and consuming water at work, which led an increase in residential water usage. Additional reasons were a 2 percent growth in the service area, and overall dry conditions.

Director Figuers asked whether, since the fund was already at $28 million, this meant it is already $4 million over the budgeted amount.

Mr. Solitei stated that the board target for the reserve policy is around $18 million. So to fund to the maximum level, it will be around $24.5 million. We already have $28 million, so it is over budget. The balance is unallocated fund reserves.

Director Ramirez Holmes stated that anything over budget goes into reserves, but doesn't necessarily stay there in this case. It can be allocated.

Director Green asked if increased residential water demand has been offset by a lower demand in businesses. She also asked whether there are any numbers showing the decreases for businesses.

Ms. Green stated that they have not observed this, and do not have numbers because they are wholesale, so they would have to ask the retailers.

Director Ramirez Holmes pointed out that the majority of water sales is residential landscaping, and businesses don't necessarily have as much.

Ms. Green explained that Fund 120, the Water Enterprise Capital Fund, receives revenue for Fund 100 for water rates for capital. Revenue is at $15.3 million. $36.3 million was spent this past fiscal year, and we have major ongoing capital projects, such as the Del Valle Ozone project and the Patterson Pass Ozonation and Upgrades project. Reserves decreased by $21 million, from $85 million to $64 million.

Ms. Green stated that in relation to Fund 300 and 310 the board authorized an amendment to the Sites Reservoir agreement for $1 million, and the Los Vaqueros Reservoir project for an additional $1 million. After those funds are expended, we expect to have about $800,000 left in Fund 310.

Ms. Green then referred to restricted funds. Fund 110, State Water Project Fund, receives revenue from property taxes. Revenue was $27.4 million, and expenses were $24.3 million. State Water Project expenses for our budget was about $27 million. Ms. Green added that DWR reports trending about 7% under budget this calendar year.

This is due in part to shelter-in-place orders and deferred capital projects. She stated that we should anticipate that those expenses will be added with our 2021 Statement of Charges

Ms. Green stated that Connection fee revenue projection for Fund 130, the Connection Fee Fund for projects related to growth, was 1100 connections, $32.6 million. Actual connection fee revenue was 796 connections, $22.5 million. She pointed out a correction from the staff report. The staff report stated 976, but correct amount is 796 connections. This was due to a slowdown in development related to COVID-19, shelter-in-place orders, and overall economic slowdown. Expenses were $34 million, vastly made up of debt service payments to the State Water Project, and capital projects. She pointed out that this fund pays for 60% of the Patterson Pass Upgrades and Ozonation Project. The fund balance decreased from $113 million to $106.8 million, but was still in compliance with board policy.

Ms. Green stated that the Flood Protection Fund 200, the Flood Protection Operations Fund, receives revenue from property taxes. Other revenue was $1.7 million, and expenses were $9.5 million. Revenue exceeded expenses by about $2 million.

Ms. Green further stated that Fund 210, the Flood Protection Development Impact Fee Fund, fund receives revenue from developers for each square foot of impervious service area that is developed. This fund experienced a slowdown in revenue, $2.7 million, which compares to about $3.2 million for the entire fiscal year 2018-19. Revenue exceeded expenditures. The fund balance increased by $2.5 million. Our reserves are in compliance with board policy.

Ms. Green stated that, based on unaudited balances at June 30, 2020, restricted funds were $228 million, about 70% of the total. Unrestricted funds were $99 million, about 30% of the total.

Director Green asked if funding for water shortage conditions meant putting money aside to buy water that we might not have otherwise planned. Ms. Green explained that if we have a water shortage, we may have to absorb a loss of revenue from less water sales.

3. Funding Strategies to Establish IRS Section 115 Trust for Pension

Mr. Solitei explained that a consultant from the Public Agency Retirement System (PARS) provided a report on how we can address some of our increasing costs for pensions. It is suggested that the best method is establishing what's called an Internal Revenue Service Section 115 that funds future pension payments. He further noted that in the audited Comprehensive Annual Financial Report (CAFR) for year ending June 30, 2019, the proportionate share of the Agency's Net Pension Liability (NPL) was around $26.3 million. As background, Mr. Solitei stated that in 2018 the share was around

$20 million, in 2017 around $25.5 million, in 2016 it was $24.9 million, and in 2015 the share was $22.2 million. He pointed out the Agency funds pensions through Alameda County, and that ACERA calculates an employer retirement contribution for the county that each employer is required to pay per employee.

Mr. Solitei stated options for funding the contribution included having a fixed cost of, for example, $100,000, $0.5 million, or $1 million, or have a deposit of a percentage of 2019 net pension liability of, say, 1%, 2%, or 3%.

Mr. Solitei stated that the committee needed to consider the advantages and disadvantages of the Agency becoming one of the participating employers within ACERA. He stated that we still have to follow up with the county and start discussions of how can we be a participating employer within ACERA. Mr. Solitei noted that if you are a participating employer within ACERA, you will get your own actuarial valuation.

Mr. Solitei further stated that there is some financial risk for setting up a trust fund. The contributions are irrevocable; it can only be used for pension. Consequently, the money will no longer be available for general operations of the Agency. To mitigate this risk, the Agency should ensure each investment in the fund does not jeopardize current operations.

Director Green asked whether this means setting up something that's going to be followed in a pattern in subsequent years. Mr. Solitei stated that that was correct. It could be set up as a one-time, or it doesn't have to be set it up every year, but he suggested that good governance is making sure you can have that contribution ongoing.

Director Figuers pointed out that it is stated that money could be put into the reserve funds, but in the text it says annual contributions could be made after the funds have reached target levels. He stated that he is unaware of that board policy.

Mr. Solitei state that it is not a board policy, but that it is an option. A board policy can be set up saying that when you reach target levels, X amount can go to the pension.

Director Ramirez Holmes asked what we budgeted for employer retirement contributions.

Mr. Solitei stated that we budgeted a lump sum for labor, which includes actual salaries and benefits, such as pension, because we don't have our own actuarial valuation report. We don't receive a budget from ACERA that says this is how much Zone 7 should be paying. The county does have line items for all categories of benefits, medical, pensions, and a credit that applies to this categories, but we really don't know how much the Agency annual required contribution (ARC) for pensions is. We can only have the pension required contribution if we are a participating employer in ACERA.

Director Ramirez Holmes asked if there was some historical data that tells us it is, say, roughly million dollars a year. She stated that technically we could potentially pull that out in a line item. Mr. Solitei agreed.

Director Ramirez Holmes asked if Section 115 contributions can also be used for an annual contribution for the employer share.

Mr. Mitch Barker, PARS, stated that there were two ways to use the money in the trust. You could reimburse yourself for pension related expenses, or take the money out of the trust and send it directly to ACERA to make your employer contribution amount for that year.

Director Ramirez Holmes asked if there was a penalty for using it that way. Mr. Barker said there wasn't, and that you can take the money out at any time for any reason.

Director Ramirez Holmes asked Mr. Barker if he had any thoughts in terms of the options that were given for how to fund it. Mr. Barker noted that there were 220 agencies that have adopted the pension trust so far. One particular policy he liked was a percentage of the audited fiscal year in budget surplus. We have the ability to choose whatever percent makes sense for the Agency.

Director Ramirez Holmes asked Mr. Solitei whether the cost to administer is a percentage of what we put in. Mr. Solitei stated that the administrative costs would be paid from the trust fund investments.

Director Ramirez Holmes offered two policy suggestions. Firstly is an initial funding strategy, given our surplus this year, something in the neighborhood of $1.5 million, because that allows us to fund the reserves potentially at the maximum level, and then have some of the rest of it go to this. Secondly, an annual contribution made up after all three reserve funds have reached target level, but with an 'up to' amount.

Director Ramirez Holmes further stated that we need to revisit the policy in two to three years because it is hard to say this year. In future years possibly there could be zero funding. We could potentially write a draft policy with a revisited timeline before we finalize.

Director Green agreed. She felt that it allows us some flexibility, but sets a pattern and gives us a review point.

Director Ramirez Holmes stated that this needs to come back to the Finance Committee with a draft policy. She stated that we would depend on Mr. Solitei and Mr. Barker and others regarding what percentage to consider as an option. Director Ramirez Holmes further stated that we need to see examples, like if it were 20%, this is the amount that you would have funded this year.

Director Green stated that we need some criteria to understand how you settle on something like that. Director Ramirez Holmes explained that there are two pieces; the initial funding, as well as how we would fund it on an annual basis.

Director Ramirez Holmes pointed out that there's $8.9 million of surplus this year. She stated that staff were suggesting that we fund the reserves at the target level, our maximum level, which would then leave $4 million remaining. She suggested that we could take $1.5 million and use it for an initial funding for a pension trust fund. She also felt that we should allocate more money to run the Mocho Groundwater Demineralization facility more often to help reduce the levels of PFAS.

Director Green asked if it was possible to take any piece of this and put it towards building PFAS treatment facilities. Director Ramirez Holmes stated that it is possible, and that we need to talk about PFAS as an overall funding strategy.

Valerie Pryor, General Manager, noted that the Mocho Groundwater Demineralization Plant (MGDP) operates at all times. Any time the Mocho wells are operating, MGDP is operating. She stated that there have been two instances in the past where it was not operating when the wells were operating; during the economic crisis of 2008, to save funds, and during the drought.

Ms. Pryor stated that regarding what to do with that the fund balance, we do not need to make the definitive decision now, or at any time soon. The funds would just stay in Fund 100. Some of it goes to the reserves to maximum, or some of it goes to a pension liability fund, the rest can just sit there and we can see how this year unfolds.

Director Figuers stated that we need more discussion on where the money comes from. He suggested that since one of the reserve funds already is in excess of over $4 million, we could pull it out of that reserve fund.

Mr. Barker suggested acquiring enough funds to pay off the annual contribution amount, such that we would be able to go to the pension fund to do that. He stated that we could work in successive years to get up to an annual contribution amount for that year as a goal. That way, if we have a really tough budget year, emergency or otherwise, we can go to the trust fund to make our annual payment to ACERA.

Director Figuers asked how far behind we are in our pension liability to pay pensions.

Director Ramirez Holmes stated that $26.3 million was the amount that was on our last CAFR.

Mr. Solitei stated that it is just about having more of an annual contribution, a small amount, so you are not put in a bind to come up with a lot of money. He stated that staff would come back to the Finance Committee with those options outlined, with examples.

Director Figuers asked if there is a limit to the amount of money you would want in such a fund. Mr. Solitei stated that since it is a 30-year amortization, incremental will be better.

Director Figuers asked when you would pull out of it, and whether you would make partial contributions to employees' retirement from that.

Director Ramirez Holmes suggested that the Board rather not give the money to ACERA, but control it themselves for as long as possible.

Ms. Pryor stated that every year we have a long-term pension liability that's calculated, so we would never have the amount of this trust fund be more than that long-term pension liability.

4. Proposed Calendar Year 2021 Municipal & Industrial Water Connection Fees

Ms. Green stated that every year staff brings the Municipal and Industrial Water Connection fees to the Finance Committee to consider increases based on inflation. She noted that in 2017, a study was performed by a consulting firm NBS. The study results showed about a 9% increase in the connection fees and recommended to continue adjusting the connection fees every year based on inflation. The next study will be no later than 2022. Ms. Green stated that for the 2021 fees, the recommendation is to adjust the change in the Engineering News Record Construction Cost Index or ENRCCI from September 2019 to September 2020, which is 1.7%.

Mr. Solitei stated that with the Finance Committee's concurrence, staff would bring this report to the October Board meeting for adoption.

Director Figuers pointed out that the presentation states that connection fees were assessed to new development in order to fund the system, but that the title says municipal and industrial water connections. He asked who pays this fee. Ms. Green stated that both developers of commercial property as well as residential pay this fee.

Director Ramirez Holmes noted that the study was done to determine the amount that we would need to fund the items included in the study, but that we have not completed all of the projects that we've said per the amount we're charging. Ms. Green stated that that was correct. She stated that it is a 30 year horizon.

Director Ramirez Holmes asked if we are behind since all those assignments were not completed during this time period. Mr. Solitei stated that based on the 2017 study nothing has shifted far out. The deferred projects will be completed in the next few years. We still need to collect that money to be able to fund those projects.

Director Ramirez Holmes asked if the next study was going to be finished at the end of 2022. Mr. Solitei replied that it was.

Director Ramirez Holmes stated that we should have a discussion this year about this given COVID and other things. Since it's just 1.7%, we could keep the amount the same this year.

Director Figuers further suggested that we could pull the money from the reserve fund we have to stabilize the rate stabilization fund. Ms. Green stated that is not allowed because the Water Rate and Connection Fee funds cannot comingle.

Director Ramirez Holmes felt that we should give connection fees a break and allow our economy to heal a little bit. Director Figuers seconded that suggestion.

Ms. Green stated that the connection fee study looks at a 30-year planning horizon, so we looked at the amount of revenue that is going to come to ensure that it covers the projected costs. Costs go up as years increase, so we probably see a higher long-term expansion program cost when we do the study.

Director Ramirez Holmes noted that we have to set a fee in time for it go into effect in January.

Director Ramirez Holmes moved to take it to the full board to consider freezing the rates for one year. Director Figuers agreed.

5. Verbal Reports - none

6. Adjournment

Director Ramirez Holmes adjourned the meeting at 4:34 p.m.