



NOTICE OF SPECIAL BUDGET & FINANCE COMMITTEE MEETING

Responsible for the review of District finances including: rates, fees, charges and other sources of revenue; budget and reserves; audit; investments; insurance; and other financial matters.

NOTICE IS HEREBY GIVEN that the San Lorenzo Valley Water District has called a special meeting of the Budget & Finance Committee to be held on Thursday, **March 1, 2018 at 6:00 p.m.** at the BCRP Bear Creek Estates County Club, 15685 Forest Hill Dr., Boulder Creek, CA 95006.

AGENDA

1. Convene Meeting/Roll Call
2. Oral Communications
This portion of the agenda is reserved for Oral Communications by the public for items which are not on the Agenda. Please understand that California law (The Brown Act) limits what the Committee can do regarding issues raised during Oral Communication. No action or discussion may occur on issues outside of those already listed on today's agenda. Any person may address the Committee at this time, on any subject that lies within the jurisdiction of this committee. Normally, presentations must not exceed three (3) minutes in length, and individuals may only speak once during Oral Communications. Any Director may request that the matter be placed on a future agenda or staff may be directed to provide a brief response.
3. Old Business:
Members of the public will be given the opportunity to address each scheduled item prior to Committee action. The Chairperson of the Committee may establish a time limit for members of the public to address the Committee on agenda items.
 - A. BEAR CREEK ESTATES WASTEWATER ENTERPRISE FINANCIAL ANALYSIS
Discussion and possible action by the Committee regarding financial analysis of the BCE Wastewater Enterprise.
4. New Business: None
Members of the public will be given the opportunity to address each scheduled item prior to Committee action. The Chairperson of the Committee may establish a time limit for members of the public to address the Committee on agenda items.
5. Informational Material: None.
6. Adjournment

In compliance with the requirements of Title II of the American Disabilities Act of 1990, the San Lorenzo Valley Water District requires that any person in need of any type of special equipment, assistance or accommodation(s) in order to communicate at the District's Public

Meeting can contact the District Office at (831) 338-2153 a minimum of 72 hours prior to the scheduled meeting.

Agenda documents, including materials related to an item on this agenda submitted to the Committee after distribution of the agenda packet, are available for public inspection and may be reviewed at the office of the District Secretary, 13060 Highway 9, Boulder Creek, CA 95006 during normal business hours. Such documents may also be available on the District website at www.slvwd.com subject to staff's ability to post the documents before the meeting.

Certification of Posting

I hereby certify that on February 22, 2018, I posted a copy of the foregoing agenda in the outside display case at the District Office, 13060 Highway 9, Boulder Creek, California and the BCRP Bear Creek Estates County Club, 15685 Forest Hill Dr., Boulder Creek, CA 95006, said time being at least 24 hours in advance of the special meeting of the Budget & Finance Committee of the San Lorenzo Valley Water District in compliance with California Government Code Section 54956.

Executed at Boulder Creek, California, on February 22, 2018.

Holly B. Hossack, District Secretary
San Lorenzo Valley Water District

The background features a light blue gradient that transitions from a pale, almost white hue at the top to a deeper blue at the bottom. Scattered throughout are several water droplets of various sizes, rendered with realistic highlights and shadows to give them a three-dimensional appearance. The droplets are most prominent in the upper and lower right areas.

SLVWD – SEWER FUND

FINANCIAL PAST, CURRENT AND FUTURE

Why is there a separate Sewer Fund?

- GAAP (Generally Accepted Accounting Principles) require proprietary activities, such as the sewer, have its costs and operations financed or recovered primarily through user charges. Our District has two distinct Funds, Sewer and Water.
 - Proprietary Funds / Enterprise Funds: Enterprise Funds are used to account for operations (a) that are financed and operated in a manner to private business enterprises – where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed and recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriated for capital maintenance, public policy, management control, accountability or other purposes.
 - Simply put, each Fund needs to cover its own expenses, including capital/depreciation.
 - We have a small caveat where our District receives some property tax revenue.

Sewer History

- The District was approached to bring water to Bear Creek Estates, as well as take over the sewer system. This all occurred sometime around the 1970's.

The Bear Creek Estates Wastewater Collection System is regulated by the California Regional Water Quality Control Board, Central Coast Region, San Louis Obispo California.

In the 1990's, studies found elevated nitrate levels in surface water and groundwater in the San Lorenzo River Watershed. The Regional Board adopted new nitrogen control measures in the issuance of new or revised waste discharge requirements.

In 2005, the District moved forward with a capital project to attempt to meet these requirements. Requirements have not continually been meet.

In 2016, the Regional Board issued a Notice of Violation of Wastewater Discharge Permit to the District citing ongoing violations with insufficient total nitrogen reduction since 2007. It required the District to provide an engineering report on the issues. The District is currently still moving forward with many of the recommendations from the engineer. This work is expected to be completed by March 31, 2018.

How do SLVWD Funds function compared to other agencies?

- For SLVWD, the Sewer Fund is significantly smaller than the Water Fund.
 - There are only 56 sewer connections compared to the 7,900 water connections.
 - Sewer revenue is only around \$100,000 vs. the \$7M+ Water revenue.
 - The Sewer Fund has limited direct revenue and expenses.
 - The Sewer Fund is too small to warrant dedicated staff and higher level expenses, therefore, staff and other general expenses run through the Water Fund and are allocated to the Sewer Fund.

Other agencies, like cities or counties, have larger Funds/divisions that will have dedicated staff, individual revenue sources and expenses specific to them. A lot of them will still have a central finance or HR division that oversees all the Funds as a whole.

So in general our Funds operate similar to others, our Sewer Fund is just very small in comparison. This is where economies of scale will come in.

Economies of scale and the impact

- Economies of scale is an economics term that describes a competitive advantage that large entities have over smaller entities. It means that the larger the business, non-profit or government, the lower its costs. For example, the cost of producing one unit is less when many units are produced at once. In our case it is more an economy of scope.

Why do some things seem so much more expensive for the Sewer Fund?

- Simply put, some are. If a report for each Fund costs \$5,000 regardless, that means Sewer customers would pay about \$89 each and water customers would pay \$0.63 each.
- However, there are also benefits. If the Sewer Fund was private or true stand alone, it would likely have to bear the costs of a full time employee, benefits, accounting, insurance, etc. This is where being part of the larger entity (SLVWD as a whole) has positive economies of scope for the Sewer Fund.

How are Sewer expenses and revenue tracked?

The District's chart of accounts allows us to track by Fund. An account is structured as follows XX-XXX-XXXX. A common Sewer account is 02-600-5200 Prof./Contract Services.

XX – is the Fund, Sewer is 02

XXX is the department, Sewer is 600

XXXX – the accounts vary by the different category and sub-categories we have

- Direct revenue or expenses specific to the Sewer Fund are coded directly.
 - Examples include the monthly sewer fee as revenue, the PG&E bill specific for the wastewater plant, and direct time of staff spent on sewer activities.
- Indirect expenses are booked as part of an allocation entry
 - Employee overhead and a general amount for certain other shared expenses are common
 - Over the years these have been done different ways. We have been working on a consistent way to book going forward.

Allocation past and future:

- In the past, a flat \$4,000 was allocated to the Sewer Fund for all general expenses.
- In the future (FY1718), specific accounts or expenses will be allocated based on the ratio of Sewer to Water customers. Currently about 0.7%.
 - Account example: the Admin. building utilities expense will be multiplied by 0.7% and allocated to the Sewer Fund. So a \$10,000 bill would have \$70 go to Sewer.
 - Specific expense example: the annual audit expense will be multiplied by 0.7% and allocated to the Sewer Fund.
- A more formal allocation process is best practice. This will likely result in higher costs being allocated to the Sewer Fund. My initial estimate is \$25-30K.

Account coding and allocation consistency will be more formally adopted and used going forward. We will work on this at the Budget & Finance Committee meetings.

Financials/Audits

- The District completes third party annual audits, which are discussed publicly and posted to our website. The website has audits going back to FY1998 posted. We have internally completed a 25 year review of the Sewer Fund financials to help with the financial history analysis.

The audit looks at SLVWD as a whole, but later breaks out the Sewer Fund in the supplemental information sections. This is typically where it will show if there are monies due to or from the two Funds.

There are multiple parts to the financial information, we will start to go over. But in general the costs (expenses, including depreciation) are to be recovered through user charges.

There are quarterly financial reports generated and presented at Board meetings that will show quarterly revenue and expenses. It is important to note that some of the Sewer Fund allocations will not occur until year end.

Sewer Rate History

MONTHLY SEWER CHARGE EQUIVALENT



- As you can see, there are significant spans of time where the rates remained unchanged. We will go into the background and impact this has at a later point.
- This is a monthly equivalent representation. The District switched to monthly billing in May of 2014.
 - Prior bi-monthly bills were \$298.

Financial Intro

1. Schedule of Net Position: assets, liabilities and Fund balances. Fund balance is the difference between assets and liabilities— in essence, what would be left over if the assets were used to satisfy the liabilities. It is broken into 3 categories:
 - Net investment in capital assets
 - Restricted for debt services
 - Unrestricted (deficit)

(Running in an unrestricted deficit can be a poor financial indicator)
2. Schedule of Revenues, Expenses and Changes in Net Position: this is the income statement. In short, the revenue minus the expenditures is the change in Fund balances which ties into the Net Position above.
 - This will include depreciation
3. Due To/From or Internal Balances is made up of: the changes from cash equivalent assets/liabilities, revenue, and operating, capital, and debt expenses.
 - This is more of an internal relationship. If it is favorable or unfavorable will show up in the main financial sections above.

Financial History: Schedule of Net Position

- While it is good that there at least is a positive total net position, the concern is with the Unrestricted deficit.
 - The continued deficit simply means there is not enough revenue to cover the expenses.
- From the prior slide, the Fund balance/net position is in essence what would be left over if the assets were used to satisfy the liabilities.
 - The issue here is that the capital assets of the Sewer Fund could not realistically be liquidated to satisfy a liability.
- The change in net position between years will tie into the next slide for the income statement.
 - $FY2017\ 385,085 - FY2016\ 445,806 = (60,721)$ change in net position.

FISCAL YEAR	INVESTED IN CAPITAL, NET DEBT	UNRESTRICTED (DEFICIT)	TOTAL NET POSITION
1993	1,035,405	(175,601)	859,804
1994	1,010,470	(164,048)	846,422
1995	991,131	(172,217)	818,914
1996	961,925	(165,104)	796,821
1997	937,745	(157,468)	780,277
1998	907,606	(123,314)	784,292
1999	883,176	(139,920)	743,256
2000	853,054	(128,267)	724,787
2001	830,472	(120,639)	709,833
2002	806,671	(117,300)	689,371
2003	790,776	(118,352)	672,424
2004	799,310	(40,954)	758,356
2005	922,724	(190,676)	732,048
2006	902,704	(202,033)	700,671
2007	860,932	(205,972)	654,960
2008	819,159	(233,306)	585,853
2009	777,386	(238,725)	538,661
2010	735,614	(210,654)	524,960
2011	693,841	(195,136)	498,705
2012	652,068	(172,830)	479,238
2013	610,295	(143,043)	467,252
2014	568,523	(94,772)	473,751
2015	526,750	(55,207)	471,543
2016	506,043	(60,237)	445,806
2017	505,545	(120,460)	385,085

Financial History: Schedule of Revenues, Expenses and Changes in Net Position (Income Statement)

- Per accounting standards, the Fund should be able to have revenue cover expenses, including depreciation.
 - In the past for rate setting, this has been excluded as a way to keep costs down in hopes of finding another capital Funding source.
- 2014 was an outlier for low expenses, this was due inaccurate coding of some water analysis charges to the Water Fund.
- 2016 & 2017 have had higher expenses - part of this is due to the catch-up of time needed to be spent on the Sewer Fund.
 - While 2017 may appear to have a temporary inflated expense run rate, the new allocation analysis will likely result in similar expense results going forward.

FISCAL YEAR	REVENUE	EXPENSES	DEPRECIATION	CHANGE IN NET POSITION
1992	37,539	(28,051)	(29,935)	(20,447)
1993	24,404	(24,820)	(29,935)	(30,351)
1994	40,796	(24,243)	(29,935)	(13,382)
1995	34,663	(32,121)	(30,050)	(27,508)
1996	42,268	(44,216)	(30,145)	(32,093)
1997	44,070	(30,473)	(30,141)	(16,544)
1998	48,208	(14,054)	(30,139)	4,015
1999	43,215	(54,129)	(30,122)	(41,036)
2000	43,280	(31,627)	(30,122)	(18,469)
2001	44,758	(29,459)	(30,253)	(14,954)
2002	44,520	(34,488)	(30,494)	(20,462)
2003	45,981	(32,434)	(30,494)	(16,947)
2004	46,139	(31,114)	(30,494)	(15,469)
2005	46,185	(41,999)	(30,494)	(26,308)
2006	48,660	(45,784)	(34,253)	(31,377)
2007	46,199	(50,138)	(41,772)	(45,711)
2008	47,038	(74,372)	(41,773)	(69,107)
2009	81,466	(86,885)	(41,773)	(47,192)
2010	89,519	(61,447)	(41,773)	(13,701)
2011	99,764	(84,246)	(41,773)	(26,255)
2012	99,199	(76,893)	(41,773)	(19,467)
2013	98,668	(68,881)	(41,773)	(11,986)
2014	101,637	(53,365)	(41,773)	6,499
2015	100,088	(60,523)	(41,773)	(2,208)
2016	98,262	(84,549)	(39,450)	(25,737)
2017	102,107	(120,471)	(42,357)	(60,721)

Financial History: Due To/From Balances

- In general, the easiest way to see the movement of money between the Funds is to look at the Due To/From, or more recently called Internal Balances. This is shown here as the income or (loss).
- This factors in all the revenue earned, changes in cash equivalent asset/liab., operating expenses, debt repayment and capital expenses. It essentially is depicting the cash equivalent earned or owed.
 - What it does not factor in are the more non-cash items such as depreciation.
- This trends similarly as the Unrestricted (deficit) net position.

	15,715	Beg. Balance
Fiscal Year	Annual Income (Loss)	Running Income (Loss)
1993	5,620	21,335
1994	(4,712)	16,623
1995	(21,577)	(4,954)
1996	(12,585)	(17,539)
1997	(7,062)	(24,601)
1998	13,537	(11,064)
1999	(36,324)	(47,388)
2000	(12,046)	(59,434)
2001	43,732	(15,702)
2002	6,336	(9,366)
2003	(3,418)	(12,784)
2004	(25,047)	(37,831)
2005	(150,338)	(188,169)
2006	(15,037)	(203,206)
2007	(2,999)	(206,205)
2008	(27,807)	(234,012)
2009	(5,694)	(239,706)
2010	28,768	(210,938)
2011	14,503	(196,435)
2012	26,414	(170,021)
2013	29,824	(140,197)
2014	45,425	(94,772)
2015	39,565	(55,207)
2016	2,416	(52,791)
2017	(62,971)	(115,762)

Due To/From In More Detail

Fiscal Year	Revenue	Change in Asset/Liab.	Operating Expenses	Capital Expense	Debt Expense	Annual Income (Loss)	Running Income (Loss)
1993	26,724	16,036	(12,723)	0	(24,417)	5,620	21,335
1994	43,124	(1,265)	(12,894)	(5,000)	(28,677)	(4,712)	16,623
1995	36,663	1,592	(21,601)	(10,711)	(27,520)	(21,577)	(4,954)
1996	43,392	5,302	(34,662)	(939)	(25,678)	(12,585)	(17,539)
1997	44,652	302	(21,851)	(5,961)	(24,204)	(7,062)	(24,601)
1998	48,372	(617)	(6,745)	0	(27,473)	13,537	(11,064)
1999	43,215	(211)	(48,466)	(5,692)	(25,170)	(36,324)	(47,388)
2000	43,280	1,794	(27,374)	0	(29,746)	(12,046)	(59,434)
2001	44,758	35,972	(29,459)	(7,539)	0	43,732	(15,702)
2002	44,520	3,129	(34,488)	(6,825)	0	6,336	(9,366)
2003	45,981	(2,366)	(32,434)	(14,599)	0	(3,418)	(12,784)
2004	46,139	(1,044)	(31,114)	(39,028)	0	(25,047)	(37,831)
2005	46,185	(616)	(41,999)	(153,908)	0	(150,338)	(188,169)
2006	48,660	(3,680)	(45,784)	(14,233)	0	(15,037)	(203,206)
2007	46,199	940	(50,138)	0	0	(2,999)	(206,205)
2008	47,038	(473)	(74,372)	0	0	(27,807)	(234,012)
2009	81,466	(275)	(86,885)	0	0	(5,694)	(239,706)
2010	89,519	697	(61,448)	0	0	28,768	(210,938)
2011	99,764	(1,015)	(84,246)	0	0	14,503	(196,435)
2012	99,199	4,108	(76,893)	0	0	26,414	(170,021)
2013	98,668	37	(68,881)	0	0	29,824	(140,197)
2014	101,637	(2,846)	(53,366)	0	0	45,425	(94,772)
2015	100,088	0	(60,523)	0	0	39,565	(55,207)
2016	98,262	7,446	(84,549)	(18,743)	0	2,416	(52,791)
2017	102,107	(2,748)	(120,471)	(41,859)	0	(62,971)	(115,762)

Does NOT include depreciation

We will focus on more events in future slides, but in general you can see some of the history playing out here:

- The sewer assessment bond phased out in 99/00, which masks the rate related revenue increase in 1999.
- Around 2005 the treatment system capital project occurred to reduce the nitrate regulations (~\$225K).
- The next rate increase was in 2008, shown in the FY2009 revenue. This was for the capital improvements that were already completed in 2005.
- The 2005 plant upgrade and future improvements resulted in increased operating costs, which we see increasing in 2008.
- The past 2 years have had more activity in consulting and beginning phases for the next capital needs.

Graphical Representation of Prior Data

There are some basic observations noted below:

- (1) Expenses excludes depreciation
- Revenue is not covering operating expenses
- Part of that revenue surplus has been used to repay the Due To
- The trend of the Due To and unrestricted deficit follow similar trend lines



Current Rate Increase Proposal – How Did We Get Here?

1. If you go back to the rate history, there are a lot of flat years without a rate increase. This naturally spells disaster for when the “true-up” will need to occur. At a minimum, rates should follow inflation.
 - Why were there not at least inflationary increases? Even inflation increases call for a Prop 218 process. For the 2008 increase, the Prop 218 process started in 2006 and took 2 years before it passed. My understanding is that the 1999 process was similar. So for a customer base of .07%, I can start to understand the fewer rate increase attempts.
2. Not factoring in future capital needs. Depreciation expense or planned capital should be factored in to rates to build reserves for the continually aging infrastructure needs. Depreciation is an easy baseline for what you spent in the past, that you will likely have to replace in the future. Basing on planned future capital will factor in any changes and inflation, but can be more intricate to figure out. Either way, some sort of capital expense should be factored in.
 - In the past, some of the rates were set not factoring this in. There have always been hopes of getting grant money or other financing, but if those don't pan out, the cash needed for capital become more severe.
 - The current Rate Study's rate proposal did factor in the capital needs.

What was the 2008 rate increase for?

- The main purpose of the 2008 increase was to cover the capital expenditures that were completed around 2005.
 - The capital project was to meet mandated nitrate reduction standards:
 - In May 2005 - The District moved forward with the installation of the two stage trickling filter and associated pumping – The filters were installed to meet the required 50% reduction in nitrogen. The 50% reduction was not achieved.
 - Due to the reduction not being achieved, additional plumbing modifications and additional trickling filters were completed in 2008 & 2009.
 - All of these changes in operations increased costs in electricity, consultant time, staff time and wastewater sampling.
 - The rate increase was to repay the Water Fund, similar to a loan, for the project.
 - You can see the Due To increase during construction. This was the cost of the capital assets.
 - The interest expense has never been charged to the Sewer Fund.
 - A small portion of the 2008 rates were to cover increased operating expenses at the time.... It did not factor in the increased operating costs of the new system.

What are the main takeaways?

1. The Sewer Fund is currently at a \$115K deficit, owed to the Water Fund
 - This is from re-paying the 2005 projects and increased operating expenses over the years.
2. Operating expenses alone are/will be around \$120K per year, current revenue is only \$100K.
 - If this gap does not get covered, the deficit will only get worse.
3. The system is out of compliance and at the end of its life.
 - The collection system is from original construction around the 1970's.
 - The plant is still out of compliance and near the end of its life.
4. A plan needs to be made to:
 - Cover operating expenses, this includes any special consulting for capital planning, loans or potential grants.
 - Pay off the deficit.
 - Plan for the future capital needs. Either through rates to build reserves or strategic debt financing.