

AGENDA


**INVESTMENT AND FINANCE COMMITTEE MEETING
LEUCADIA WASTEWATER DISTRICT**

January 29, 2019 – 9:30 AM
1960 La Costa Avenue, Carlsbad, CA 92009

1. **Call to Order**
2. **Roll Call**
3. **Public Comment**
4. **New Business**
 - A. Comprehensive Financial Plan Tracking Update. (Page 2)
 - B. Recommend that the Board of Directors Adopt Resolution No. 2310 approving the revised Reserve Fund Policy and Receive and File the Annual Review of the LWD Reserve Fund Review Report. (Pages 3-10)
 - C. Recommend that the Board of Directors direct staff to implement option no. 3, "Ad Hoc Basis", to make additional pension payments to CalPERS on a periodic basis to address LWD's CalPERS Unfunded Accrued Liability (UAL). (Pages 11-12)
5. **Information Items**

None.
6. **Directors' Comments**
7. **General Manager's Comments**
8. **Adjournment**

MEMORANDUM

DATE: January 24, 2019
TO: Investment and Finance Committee
FROM: Paul J. Bushee, General Manager 
SUBJECT: **Comprehensive Financial Plan Tracking**

RECOMMENDED:

- 1) This item is presented for information purposes only.

DISCUSSION:

Tactical Goal: Financial / Financial Plan Update

During 2018, LWD updated the District's Financial Plan. The purpose of the Financial Plan is to ensure the financial stability of the District through a long-term financial planning process that projects future financial conditions and provides guidance in our decision-making process. As you may recall, at the January 2018 meeting, the Board approved a professional services agreement with Raftelis Financial Consultants to update the Financial Plan. The Financial Plan Update was completed June 6, 2018.

Each year, following the completion of our annual audit, staff updates the Financial Plan model using these current audited figures and adds the following year's budget figures as well. Staff has completed this year's internal update and will present an overview of how LWD is currently tracking with the 2018 Comprehensive Financial Plan for the committee's information.

rad:PJB

MEMORANDUM

Ref: 19-6499

DATE: January 24, 2019
TO: Investment and Finance Committee
FROM: Paul J. Bushee, General Manager
SUBJECT: Annual Review of LWD Reserve Fund Policy



RECOMMENDATION:

Staff requests that the Investment and Finance Committee (IFC) recommend that the Board of Directors:

1. Adopt Resolution No. 2310 approving the revised Reserve Fund Policy;
2. Receive and file the Annual Reserve Fund Review Report; and
3. Discuss and take other action, as appropriate.

DISCUSSION:

Tactical Goal: Financial / Finance Policy Reviews

In February 2005, the Board of Directors (Board) adopted Leucadia Wastewater District's (LWD) Reserve Fund Policy which established a means for LWD to ensure that sufficient funds are available for current operating and capital needs. The policy was last revised in February 2014.

The Reserve Fund Policy establishes two distinct reserves at LWD: 1) Restricted Reserves and 2) Unrestricted Reserves. The policy also establishes various designations within each type of reserve and calls for an annual review of the reserve balances. This report constitutes that review.

Staff has reviewed the Reserve Fund Policy and is recommending a change to include the Encina Wastewater Authority (EWA) Reserve as a restricted reserve to the existing Reserve Fund Policy. Since LWD reserve funds that have been deposited with EWA are restricted for specific EWA purposes (operating, inventory, and capital), it was determined that they should be included as part of LWD's restricted reserves. In addition, there were some additional minor changes that are administrative in nature. These changes are highlighted in Exhibit A of proposed Resolution No. 2310 (attached).

Staff will provide an overview of the FY 2018 reserve activity during the committee meeting. A copy of the policy is attached for the committee's review.

During November 2018, the Board received the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2018 that included the following reserve balances:

Restricted Reserves:

<u>Reserve Designation</u>	<u>Reserve Balance</u>
Capital Improvement Reserve	\$ 558,097
Encina Wastewater Authority Reserve	\$1,486,800
Total	\$2,044,897

Unrestricted Reserves:

<u>Reserve Designation</u>	<u>Reserve Balance</u>
Operations Reserve	\$ 2,279,588
Replacement Reserve	\$20,910,954
Water Recycling Reserve	\$ 1,265,370
Emergency Reserve	\$ 7,500,000
Total	\$31,955,912

rad:PJB

Attachment

RESOLUTION NO. 2310

**A RESOLUTION OF THE BOARD OF DIRECTORS OF THE
LEUCADIA WASTEWATER DISTRICT
ADOPTING A REVISED RESERVE FUND POLICY**

WHEREAS, the Leucadia Wastewater District (LWD) Board of Directors has adopted a Reserve Fund Policy; and

WHEREAS, the LWD Board of Directors conduct an annual review of the Policy and recommend modifications to the Policy as required;

NOW, THEREFORE, it is hereby resolved as follows:

1. The LWD Board of Directors adopts the LWD Reserve Fund Policy attached hereto as Exhibit "A" and directs that it be implemented consistent with all applicable laws and related District policies.
2. This Resolution supersedes Resolution No. 2242.

PASSED AND ADOPTED by the Board of Directors of Leucadia Wastewater District this 13th day of February, 2019, by the following vote:

AYES: Directors: Kulchin, Juliussen, Omsted, Hanson and Sullivan

NOES: None.

ABSENT: None.

ABSTAIN: None.

David Kulchin, President

ATTEST:

Paul J. Bushee, General Manager

(SEAL)

Exhibit A

LEUCADIA WASTEWATER DISTRICT
RESERVE FUND POLICY

Ref: 14-394819-6463

A. POLICY STATEMENT:

One key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital, and debt service cost needs. An additional critical element of fiscal responsibility is to anticipate and prepare for future funding requirements as well as for unforeseen disasters and other unforeseen events. The Leucadia Wastewater District (LWD) will at all times strive to have sufficient funding available to meet its operating, capital, and debt service cost obligations. Reserve funds will be accumulated and maintained in a manner, which allows LWD to fund costs consistent with LWD's Long-Range Capital adopted Asset Management Plan and Long-Range Financial Plan, while avoiding significant rate fluctuations due to changes in cash flow requirements. LWD will also maintain an emergency reserve position that may be utilized to fund unexpected disasters or unanticipated major failures. The Board of Directors will annually review the level of reserve funds maintained.

B. DEFINITIONS:

Restricted Reserves: These reserves have Restrictions-restrictions on their use that are imposed by an outside sources such as creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Reserves: These reserves Hhave no externally imposed use restriction. The use of Unrestricted Reserve funds is at the discretion of the Board of Directors. There are two categories of Unrestricted Reserves: -Designated and Undesignated. At LWD, all Unrestricted Reserves are have been Designated Reserves.

Designated Reserves: These reserves are Sset-aside for a specific purpose, which is determined by the Board of Directors. The Board of Directors also has the authority to redirect the use of these reserve funds as the needs of LWD change.

C. LEUCADIA WASTEWATER DISTRICT RESERVES:

LWD maintains the following reserve funds:

1.0 RESTRICTED RESERVES:

a) Capital Improvement Reserve:

The purpose of the Capital Improvement Reserve is to finance future capital facilities that are expansion-/growth related. These capital improvements are identified in LWD's Asset Management Plan and Comprehensive Financial Plan Update. These reserve funds are accumulated in an orderly manner in conformance with State law and drawn down as required by growth related capital projects.

b) Encina Wastewater Authority Reserve:

LWD is a member agency of the Encina Wastewater Authority Joint Powers Authority (EWA). EWA maintains member agency deposits on hand to meet its operational, inventory, and capital demands during any quarter. These deposits are restricted for that use.

2.0 UNRESTRICTED DESIGNATED RESERVES:

a) Operating Reserve:

Since the majority of operating revenues are received periodically over the fiscal year and operating expenses are incurred uniformly over the fiscal year, an operating reserve is necessary to fund those costs attributable to daily operations. To meet daily operational needs, LWD has established an Operating Reserve balance at 33% of annual budgeted operating expenses.

b) Replacement Reserve:

The Replacement Reserve provides funds for capital replacement and refurbishment of existing wastewater facilities. These capital improvements are identified in LWD's adopted Asset Management ~~Master~~ Plan and ~~Comprehensive~~ Financial Plan Update. Replacement Reserve funds are accumulated in an orderly manner and drawn down as required to fund capital replacement projects. To avoid abrupt sewer service rate changes, this reserve may be used to stabilize rates. The Replacement Reserve shall not exceed the total 20-year capital replacement costs for wastewater facilities as identified in the ~~Comprehensive~~ Financial Plan Update. The yearly average of the 20-year capital replacement costs is the minimum target balance to ensure that LWD is able to fund capital replacements as they are scheduled or needed.

~~LWD's capacity fee represents a system buy-in that takes into account the value of existing capacity pre-built by current users that will benefit future users, and is a source of funding for the Replacement Reserve.~~

c) Water Recycling Reserve:

The Water Recycling Reserve will fund capital improvements and replacement of water recycling facilities. This reserve will can also be used to fund operating expenses in the Water Recycling Fund whenever there is a shortfall of recycled wastewater sales revenue ~~to operating expenses~~. These capital improvements are identified in ~~LWD'S~~ LWD's adopted Asset Management Plan and ~~Comprehensive~~ Financial Plan Update. The Replacement Reserve shall not exceed the total 20-year capital replacement costs for water recycling facilities as identified in the ~~Comprehensive~~ Financial Plan Update.

d) Emergency Reserve:

The Emergency Reserve provides funds for emergency response for potential repair or replacement of capital facilities due to damage from a natural disaster or unanticipated major failure in a period when capital improvements funds have otherwise been purposely spent down to preset limits on planned projects. The Emergency Reserve is at the discretion of the Board of Directors and is maintained at a level of \$7,500,000, which is based on the recommendation by LWD staff and the District Engineer (Exhibit A).

For further detail of the sources and uses of the above reserves please refer to following section "D".

D. SOURCES AND USE OF FUNDS:

This section describes the sources and uses of funds for LWD reserves and includes maximum and minimum reserve balances and other informational notes.

RESERVE	SOURCE OF FUNDS	USE OF FUNDS	NOTES
----------------	------------------------	---------------------	--------------

RESTRICTED RESERVES

<u>RESERVE</u>	<u>SOURCE OF FUNDS</u>	<u>USE OF FUNDS</u>	<u>NOTES</u>
Capital Improvement	Interest earned on reserve	Growth related capital expenditures	Funds previously accumulated from capacity fees. Now, capacity fees reflect 100% buy-in to the system and are transferred to the Replacement Reserve
<u>EWA</u>	<u>Funds transferred from LWD to EWA for deposit with EWA</u>	<u>Funds transferred back from EWA to LWD due to reduction in deposit requirements</u>	<u>Deposit balances determined by EWA approved financial reserve policy. Deposit is for EWA Operating, Inventory, and Capital demands during any quarterly period</u>

UNRESTRICTED DESIGNATED RESERVES

<u>RESERVE</u>	<u>SOURCE OF FUNDS</u>	<u>USE OF FUNDS</u>	<u>NOTES</u>
Operating	Operating income and interest earned on reserve	Wastewater Operating expenses	Reserve balance maintained at 33% of budgeted operating expenses. Excess (deficit) funds transferred to/ (from) Replacement Reserve
Replacement	<u>Property taxes, interest earned on reserve and other non-operating income, -100% of Capacity Fees, and other non-operating income. Also Excess operating revenues income transferred from Operating Reserve, and excess interest earned on emergency reserve</u>	Replacement related capital expenditures and rate stabilization	<u>Limited to Maximum reserve balance is 20-year capital replacement costs as identified in the Comprehensive Financial Plan Update. Minimum reserve target balance is the yearly average of the 20-year capital replacement costs as identified in the Financial Plan</u>
Water Recycling	Recycled Water sales, <u>grant income</u> , and interest earned on reserve	Recycled Water capital improvement and replacement as well as	<u>Limited to Maximum reserve balance is 20-year capital replacement costs as identified in the</u>

		<u>water recycling</u> operating expenses	Comprehensive Financial Plan Update.
Emergency	Originally funded by board action. Interest earned on reserve	Emergency repair or replacement expenditures	Reserve balance maintained at \$7,500,000 level. Excess funds transferred to Replacement Reserve

EXHIBIT A

Leucadia Wastewater District Discussion of Emergency Reserve Fund

Maintenance of an Emergency Reserve Fund (ERF) would provide the benefit of providing funds for emergency response for repair or replacement of capital facilities potentially necessary due to natural disaster damage or unanticipated major failure in a period when capital improvement funds have otherwise been purposely spent down to preset limits on planned projects. Separately, Capital Reserve Funds will be accumulated in a planned manner through financing, setting aside a portion of sewer service fees, or a combination of both methods, as determined by Board policy.

The amount to be recommended for maintenance in the ERF has been evaluated and discussed by Leucadia Wastewater District (LWD) staff and the District Engineer. The following table lists some pros and cons for three potential levels of ERF.

ERF Alternatives	Pros	Cons
Alternative 1: LWD maintain small ERF of \$1.0 million	<ol style="list-style-type: none"> 1) Reduces initial reliance on borrowing. 2) Would extend period of reduced rate increases. 	<ol style="list-style-type: none"> 1) Not enough reserve to respond to many reasonably possible emergency events. 2) Increased risk at point of ERF exhaustion that emergencies could not be responded to timely. 3) Reduced District liquidity and lesser financing qualifications. 4) Increased long term reliance on borrowing.
Alternative 2: LWD maintain a Moderate ERF of \$7.5 million	<ol style="list-style-type: none"> 1) Sufficient funds to adequately replace or repair two major District facilities on an emergency basis. 2) Sufficient funds to replace or repair about 	<ol style="list-style-type: none"> 1) Ties up \$7.5 million of funds that could be used to offset or defer rate increases. 2) May be considered as ability to pay discretionary fines in the potential event of a major wastewater spill.

	<p>six or seven concurrent intermediate size facility problems at any given time.</p> <p>3) Unlikely to deplete ERF in a time period that would not allow establishment of additional financing, if necessary.</p> <p>4) Provides opportunity for investment of modest amount of about 1.5 years worth of sewer service fee collections.</p> <p>5) Provides ability to fund one to two years of typical CIP schedule projects, while additional funding is being established.</p> <p>6) Increases liquidity of District that would be considered positively by financial markets when considering other financing issues.</p>	<p>3) Over time, it may be determined that the \$7.5 million amount should be decreased or increased depending on facility performance and risk tolerance.</p>
<p>Alternative 3: LWD maintain a Large ERF of \$15 million</p>	<p>1) Very little risk that any emergency situation would result that funds were not available for immediate response.</p>	<p>1) Maintenance of large reserves is considered by some watch dog entities as a negative attribute.</p>

Based on an analysis of the above three ERF funding alternatives above, LWD staff and the District Engineer recommend that LWD adopt Alternative 2 – LWD Maintain a Moderate ERF of \$7.5 million.

MEMORANDUM

Ref: 19-6523

DATE: January 24, 2019
TO: Investment and Finance Committee
FROM: Paul J. Bushee, General Manager
SUBJECT: California Public Employees' Retirement System (CalPERS) Update



RECOMMENDATION:

Staff recommends that the Investment and Finance Committee (IFC) recommend that the Board of Directors:

- 1) Direct Staff to implement option no. 3, "Ad Hoc Basis", to make additional pension payments to CalPERS on a period basis to address the District's CalPERS Unfunded Accrued Liability, and
- 2) Discuss and provide direction as appropriate.

BACKGROUND:

Tactical Goal: Financial/ PERS Unfunded Accrued Liability/ Evaluate and Present Options

At the March 2018 Board meeting, staff presented an overview of recent changes to the CalPERS assumptions and the impact they will have on LWD's future employer contributions. At that time, the Board directed staff to follow-up with potential options to address this issue once CalPERS completed its fiscal year (FY) 2017 actuarial report, which was expected to be released in October 2018. This item was subsequently included as a goal in LWD's FY 2019 Tactical Plan and LWD received the CalPERS FY 2017 actuarial report in October as expected.

At the November 8, 2018 Board meeting, staff, after reviewing the latest CalPERS actuarial report, presented an update on the recent changes to the CalPERS assumptions and the impact they will have on LWD's future employer contributions. It was noted that District's Accrued Pension Liability for its Classic employees was 76% funded, and its corresponding Unfunded Accrued Liability (UAL) was growing over time. Several options were presented to address the UAL. The Board directed staff to come back with a recommended option.

By way of background, CalPERS charges both an "employee" rate and an "employer" rate for its retirement system. LWD employees pay their full share of the employee rate. LWD's employer rate is further broken down into two categories: the normal cost and the unfunded accrued liability (UAL). The normal cost reflects the annual cost of service and is paid as part of payroll, whereas the UAL reflects the cost needed to fund past service credit earned by retired and current employees. LWD currently pays its UAL expenses annually based on a 30-year amortization period.

DISCUSSION:

As referred to above, CalPERS recently made a significant change to its discount rate assumption – lowering it from 7.5% to 7.0% over a three-year period beginning in FY 2019. The discount rate

is the assumed rate of return that CalPERS expects its investments to earn over time. This change increases LWD's PERS contribution costs for both normal costs and UAL payments.

The impact to the normal costs is being phased in over the three-year period, while the increase to LWD's UAL is being phased in over the next seven years. As a result, the increases in the required contributions are expected to continue for seven years from FY 2019 through FY 2025. During this period, employer contributions are expected to almost double from approximately \$373,000 in FY 2018 to \$694,000 in FY 2025.

In addition, the composition of the employer payments changes over this 7-year period. The UAL payment portion grows from about 45% in FY 2018 to about 62% in FY 2025. Since almost half of the employers UAL payments, over the current 30-year amortization period, is interest expense there are some potential options LWD could use to reduce the UAL expense. The following options were presented to the Board for discussion:

1. Status Quo – Current 30 Year Amortization.
2. Fresh Start – Reduce Amortization Period.
3. Ad Hoc Basis – Make Additional Payments on a periodic basis.
4. Pay Off – Pay off current UAL balance in full.

Staff is recommending that the Board of Directors direct Staff to implement option no. 3, "Ad Hoc Basis", to make additional pension payments to CalPERS on a periodic basic to address the District's CalPERS Unfunded Accrued Liability. The additional payments would vary year to year and would be in the \$188,000 to \$239,000 range. This option, if implemented over the 10-year period, will save the District approximately \$2.2 million in interest expense, will take advantage of dollar cost averaging to reduce investment risk, and gives the District the most flexibility.

At its November 8, 2018 board meeting the Board expressed a preference of option no. 3, the "Ad Hoc Basis". By taking action, the Board would approve moving forward with this approach beginning with the development of next year's budget (FY 2020).

rad:PJB