

Financial Status Update – Potential Recession/Inflation Discussion

September 27, 2022

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- **Current Economic Situation**
- **Financial Status**
 - **Revenue**
 - **Debt Financing**
 - **CalPERS/OPEB**
- **Imported Water Discussion**
- **CIP Discussion**

Current Economic Situation

- **Inflation**
 - Supply chain issues
 - Higher oil prices
 - War in Ukraine
 - Tight labor market
- **Recessionary characteristics in the current market**
 - Lower consumer sentiment and confidence
 - Lower retail sales
 - Equity markets down
 - Higher consumer and corporate borrowing costs

Definitions:

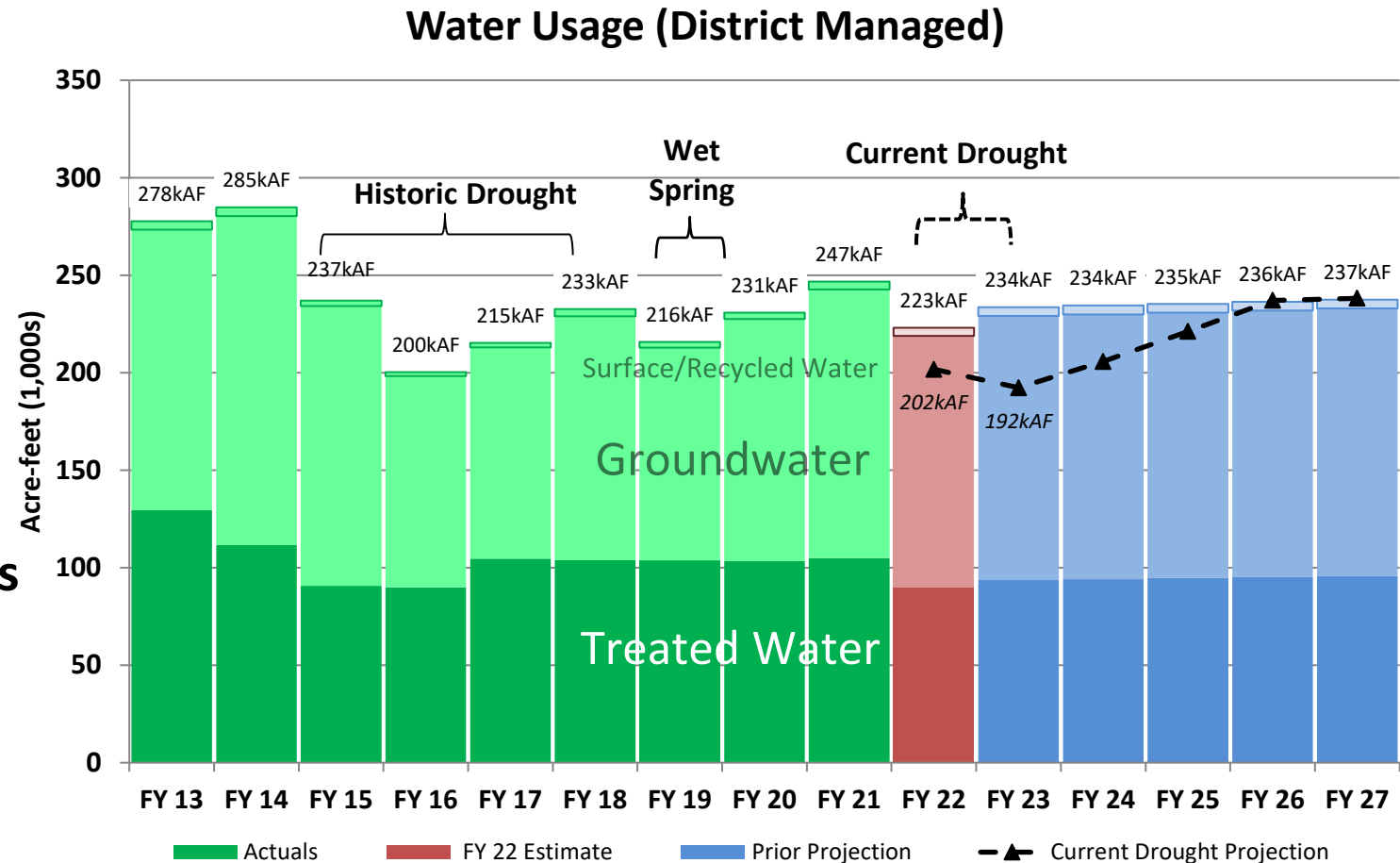
Recession: Two consecutive quarters of negative Gross Domestic Product growth, often accompanied by high, or rising levels of unemployment

Stagflation: Combination of high unemployment and high inflation

Financial Status Update – Water Charge Revenue Collections

Assuming 15% Conservation in FY23

- All major retailers current on payments to Valley Water as of 8/01/2022
- Water usage impacted by drought & call for conservation
- FY22 Estimated water usage actuals higher than anticipated as call for 15% conservation not fully achieved



Recession may slightly help achieve conservation goal

Financial Status Update – Property Tax Collections

SCW Special Parcel Tax

- Not affected by recession unless Teeter Plan suspended (unlikely)

State Water Project Tax

- Not affected by recession unless Teeter Plan suspended (unlikely)

1% Ad Valorem Property Taxes

- Budgeted and forecasted conservatively (assume ~3.5% annual growth)
 - FY 21 actual of \$117.3M, 6.1% growth (\$98.6M for Watershed Stream Stewardship Fund)
 - FY 22 actual of \$126.6M, 7.9% growth (\$106.4M for Watershed Stream Stewardship Fund)
 - FY 23 Budget of \$126.1M (\$106.4M for Watershed Stream Stewardship Fund)
- Anticipate FY 23 actual to exceed budget
- FY 24 & beyond may see flattening to negative growth due to recession followed by recovery

Financial Status Update – 1% Ad Valorem Property Tax Projection Analysis

What if potential recession is similar to “Great Recession” of 2008

Watershed Stream Stewardship (WSS) Fund 1% Ad Valorem Property Taxes (\$M)

	FY 21	FY 22	FY 23	FY 24	FY 25	FY 26	FY 27	FY 28	FY 29	FY 30	FY 31	FY 32	FY 23 - 32 Total
Current Budget & Projection	98.6	106.4	106.4	110.2	113.9	117.7	121.6	125.7	129.9	134.2	138.7	143.4	1,242
Y-Y Growth	6.0%	7.9%	0.0%	3.6%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.4%	3.4%	
Revised Projection w/ Recession		106.4	113.8	118.4	115.4	111.1	112.4	115.3	123.9	133.2	143.2	153.9	1,241
Y-Y Growth		7.9%	7.0%	4.0%	-2.5%	-3.7%	1.1%	2.6%	7.5%	7.5%	7.5%	7.5%	

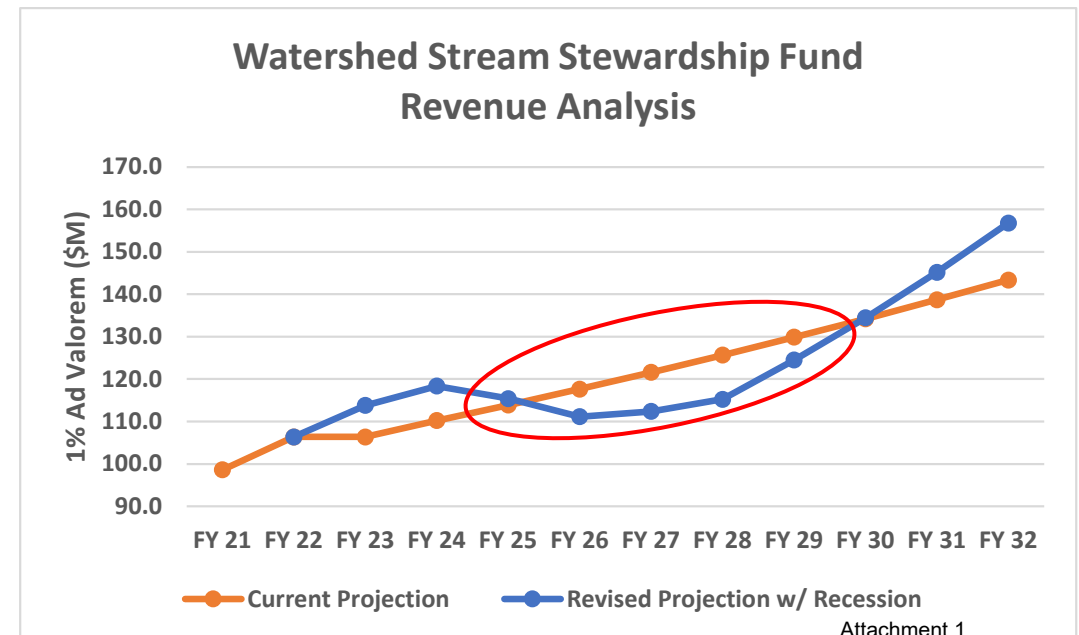
Staff's best
estimate

Same Y-Y growth %'s as
“Great Recession”

7.5% is a conservative assumption, was
9% average after “Great Recession”

- Would cause reduced revenue versus current projection from FY 26 thru FY 29, but total revenue over 10-year time frame would be roughly equal

Need to watch assessed value trend



Financial Status Update – Debt Financing

- Short-term Interest rates expected to increase in near-term as Fed tightening continues; however, interest rates tend to fall during recessions
- Investment portfolio will benefit from higher short-term interest rates, but tempered by laddered structure of investments
- New debt issuances could be more costly
 - For every 0.50% change in rates, potential impact on \$100M debt issuance is appx \$354K/year or \$10M over 30 years in higher debt service payment

Borrowing Rate Projection for Long Term Tax Exempt Fixed Rate Debt		
	Current Projection	Recession Estimate
FY 23	3.3%	4.2%
FY 24	3.6%	4.5%
FY 25	4.0%	4.8%
FY 26	4.4%	5.3%
FY 27	4.9%	5.5%
FY 28	5.3%	5.5%
FY 29	5.5%	5.5%
FY 30	5.5%	5.5%
FY 31	5.5%	5.5%
FY 32	5.5%	5.5%

Debt financing needs driven by capital program

Financial Status Update – WIFIA Loan Update

Background

- WIFIA is a federal low-cost loan program - low interest rate, based on US Treasury rate (3.25% as of 8/22/22)
- Loan repayment over 35 years after construction completion
- Fund up to 49% of eligible project costs, but a max of 80% federal funding per project
- Must complete National Environmental Policy Act (NEPA) review prior to loan closing and comply with other federal requirements

Analysis

- Current WIFIA borrowing rate assumption = 3.0%
- Recession WIFIA borrowing rate estimate = 3.0% to 4.0%
 - WU impact = Higher debt service on Pacheco and Anderson loans up to \$3.9M/yr in FY 26 ramping up to \$11.5M/yr in FY 33
 - SCW impact = up to \$0.6M/yr beginning in FY 24

Fund	WIFIA Prgm	Target Loan	Project
SCW	EPA	\$80M	Upper Llagas Creek, Coyote Creek, Almaden Lake, Sunnyvale East & West, Upper Penitencia
WU	EPA	\$1.2B	Pacheco Reservoir
WU	EPA	\$450M	Anderson Dam (Letter of Interest submitted in September 2022)

WIFIA financing needs driven by capital program

Financial Status Update – CalPERS/OPEB

OPEB

- Actual trust fund rate of return
 - 6.2% for FY 19
 - 3.5% for FY 20
 - 27.0% for FY 21
 - -13.4% for FY 22
- Still on track for unfunded liability payoff by FY 28 or sooner without trust fund contributions

CalPERS

- Actual CalPERS rate of return
 - 6.7% for FY 19
 - 4.7% for FY 20
 - 21.3% for FY 21
 - -6.1% for FY 22
- FY 21 good news offset by FY 22 bad news

6.8% CalPERS earnings target could be challenging in next couple of years

Imported Water Discussion

Without significant rain this winter, cost of emergency transfer water will likely increase significantly

- **FY 22 Actual expenditure was \$28.2M for emergency transfer water**
- **FY 23 Budget includes \$17.5M for emergency transfer water**
- **FY 24 Plan includes \$20.0M for emergency transfer water**

Emergency water needs driven by drought

Capital Improvement Program Discussion

- **Revised Construction Cost Escalation Rate (12% for planned construction in FY 24) will increase FY 2024-28 CIP vs Adopted FY 2023-27 CIP**
 - However, recession may mean more competition & some cost relief
- **Significant project cost increases will impact the health of the Funds and may trigger key decision points for the Board**
 - Fund 61 – Increase rates to maintain current commitments vs. Identify projects to be deferred
 - Fund 12 – Identify projects that can be deferred or constructed in phases
 - Fund 26 – Identify projects that can be deferred or constructed in phases
- **Investing now is still most cost-efficient way to get critical multi-year projects done; however, based on rising costs, projects may need to be prioritized for funding sequencing**

Board to confirm priority investments

Capital Improvement Program Discussion continued...

Water Utility

- **Repair and Rehabilitation of Existing Infrastructure:**
 - **Fixing Anderson Dam**
 - Address public health and safety concerns and relieve operational restrictions
 - **Complete Rinconada Water Treatment Plant**
 - Extend service life for next 50 years and expand plant capacity
- **New Infrastructure:**
 - **Building local storage with Pacheco Reservoir Expansion Project**
 - Add water storage to help face extended droughts
 - **Expanding Purified Water Project**
 - Provide incremental drought proof water supply
- **Partnership Projects:**
 - **Los Vaqueros Expansion**
 - Improve operational flexibility and add out-of-county storage capacity
 - **Delta Conveyance**
 - Improve imported water supply reliability and mitigate regulatory and water supply interruption risks

Board to confirm priority investments

Capital Improvement Program Discussion continued...

Watersheds Stream Stewardship

- **Repair and Rehabilitation of Existing Infrastructure**
 - Watershed Asset Rehabilitation Program
 - Palo Alto Flood Basin Tide Gate Structure Improvements
 - Guadalupe River – I880 to Tasman Drive
 - Lower Llagas Creek Capacity Restoration
- **New Infrastructure:**
 - Lower Berryessa Creek Flood Protection - Phase 3 (construction)
 - Calabazas/San Tomas Aquino Creek-Marsh Connection

Board to confirm priority investments

Capital Improvement Program Discussion continued...

Safe, Clean Water and Natural Flood Protection

Voter approved new infrastructure investments include:

Flood Protection

- **Upper Llagas Creek Flood Protection Project (2b)**
- **Coyote Creek Flood Protection Project**
- **Sunnyvale East & West Channels Flood Protection Project**
- **San Francisco Bay Shoreline Flood Protection Project**
- **San Francisquito Creek Flood Protection Project**
- **Upper Guadalupe Flood Protection Project**
- **Lower Berryessa Flood Protection Project – Phase 3 (planning/design)**
- **Upper Penitencia Creek Flood Protection Project**

Water Resources Stewardship

- **Almaden Lake Creek/Lake Separation Project**

Board to confirm priority investments

Capital Improvement Program Discussion continued...

Funding Filters for Prioritization:

1. Repair/Replace Existing Infrastructure Projects
2. Public Health and Safety Projects
3. Shovel Ready (Permits and Land Rights Secured) Projects
4. Multi-Benefit Projects
 - a. Environmental Justice Benefit Projects
5. Partially External-Funded (Grants and Partnerships) Projects

Likely Impacts of Potential Recession:

- **Revenue – Negligible impact on Water Utility and Safe Clean Water, but need to watch Watershed Stream Stewardship Fund**
- **Debt Financing – Rising borrowing rates will impact Water Utility and Safe Clean Water Funds in a few years, partially offset by higher investment portfolio earnings**
- **O&M Costs – Inflation causing increases for supplies and services and employee benefits, but recession may ease inflation. Continued drought may cause higher imported water costs than anticipated.**
- **Capital Costs – Inflation will cause FY 2024-28 CIP to be higher than Board adopted FY 2023-27 CIP, but recession may ease inflation and create more competition for capital work**
- **Increasing costs will likely warrant preparation of funding scenarios that incorporate prioritization/sequencing of capital projects based on funding filters & other Board input**

Staff Approach After Discussion with CIP Committee

- 1. Apply Funding Filters for Prioritization to inform funding sequencing analysis and funding scenarios for future Board consideration**
- 2. Take advantage of recession opportunities; such as:**
 - a. Favorable conditions for hiring (to replace retirements, etc..)**
 - b. Competitive bids for capital construction**
- 3. Provide periodic updates to Capital Improvement Program (CIP) Committee including:**
 - a. Recession/inflation impact reviews as needed and elevated to Board if necessary**
 - b. Proceed with CIP annual schedule and ongoing project implementation reviews per CIP Committee Work Plan**

Next Steps

 **9/27/22 Board Meeting (Recession/Inflation Discussion with Confirmation of Staff approach)**

10/17/22 CIP Committee (Overview of Annual Process, review list of newly validated, unfunded projects)

11/8/22 Board Meeting (Overview of Annual Process, review list of newly validated, unfunded projects)

11/14/22 CIP Committee (Review significant project plan updates)

11/22/22 Board Meeting (Water Rate Planning Overview, Scenario discussion)

12/12/22 CIP Committee (Preliminary CIP Overview, Fund financial analysis with Scenario discussion)

1/10/23 Board Meeting (Prelim CIP, Prelim Water Rates, Prelim Fund financial analysis with Scenarios)