

Budget Transmittal Letter for 2019-20

May 14, 2019

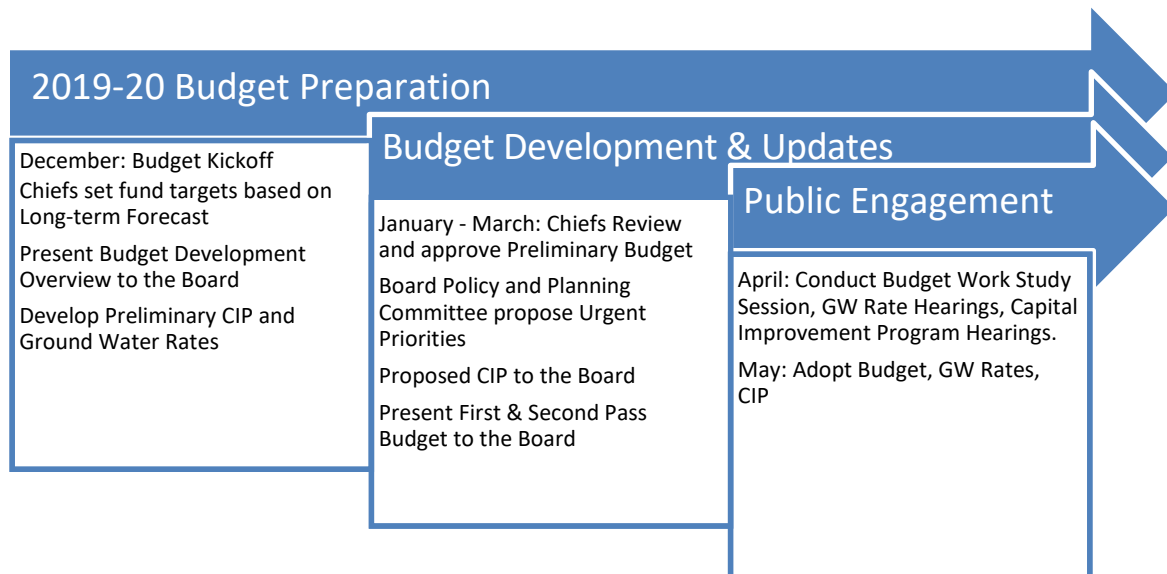
Honorable Members of the Board of Directors of the Santa Clara Valley Water District:

In accordance with the District Policy, I am submitting the Fiscal Year 2019-20 (FY 2019-20) Adopted Budget for the Santa Clara Valley Water District (Valley Water). The adopted budget represents Valley Water's mission of providing Silicon Valley safe, clean water for a healthy life, environment, and economy. It also provides a comprehensive financial plan that includes a forecast of operating and non-operating revenues and expenditures; financing of long-term capital improvement plans to support infrastructure needs; and funding for the repayment of long-term debt.

Financial Overview

The accounts of Valley Water are organized based on fund types and account groups. Each fund is an independent accounting entity with a self-balancing set of accounts comprised of its assets, liabilities, fund equity, revenue, and expenditures or expenses, as appropriate. Fund accounting allows government resources to be segregated and accounted for per their intended purposes, aiding management in demonstrating compliance with finance-related legal and contractual provisions.

The budget development process begins in December of each year and concludes on June 30, with the posting of the budget. The budget development process for FY 2019-20 includes several process improvements and numerous public hearings, as well as input from the Board on urgent priorities and strategies for the upcoming fiscal year.



Valley Water Board Priorities

In developing the budget, the Board directed its Board Policy and Planning Committee (Committee) to identify and summarize the Board's strategies. This budget is the culmination of the Committee's final recommendation, which ultimately resulted in Board action to accept and adopt the Committee's recommendation. In developing this budget, management identified where resources could shift and scrutinized additional funding requests that would help the organization achieve results.

This adopted budget demonstrates a fiscally responsible, balanced budget that meets the community's expectations of Valley Water. This budget was developed based on the Board's FY 2019-20 strategies highlighted below:

1. Actively participate in decisions regarding the **California Delta Conveyance Project**.
2. Pursue opportunities to **expedite regulatory permit processes and streamline** permit reviews.
3. Attain net **positive impact on the environment** when implementing flood protection and water supply projects.
4. Advance the **Anderson Dam Seismic Retrofit Project**
5. Lead **recycled and purified water** efforts with the City of San José and other agencies
6. Finalize the **Fisheries and Aquatic Habitat Collaborative Effort (FAHCE)**
7. Actively pursue efforts to increase **water storage** opportunities
8. Ensure **Emergency Action Plans and flood preparedness measures** are provided jointly with local cities, for Flood Hot Spots throughout the County.
9. **Engage and educate** the community, local elected officials and staff on future water supply strategies in Santa Clara County.
10. Promote the **protection of creeks, bay, and other aquatic ecosystems** from threats of pollutions and degradation.
11. Diversity and inclusion, succession planning, and long-term resource planning strategy (TBD)
12. Affordable and effective cost of service strategy (TBD).

Valley Water is responding to these challenges in several ways, including expanded efforts possible with the proposed addition of 18 new positions discussed in detail in the following sections.

The organization will incorporate specific activities that address the Board's urgent priorities into its workplan and periodically update the Board Policy and Planning Committee and the full Board throughout the fiscal year and bring adjustments back to the Board if needed.

Revenue

The FY 2019-20 budget includes projected revenues of approximately \$501.8 million. These revenues are a net increase of \$53.9 million (12%) from the \$448.0 million included in the FY 2018-19 adopted budget. The net \$53.9 million increase is primarily derived from higher water revenue (\$31.2 million), 1% ad valorem property taxes (\$8.1 million), and special parcel tax (\$1.5 million), capital reimbursement revenue (\$9.7 million), interest and other operating and non-operating revenues (\$4.7 million), and offset by a net decrease of Benefit Assessment revenues (-\$1.3 million).

Appropriations/Outlays

Net total operating and capital outlays for the FY 2019-20 budget is \$528.9 million. This figure does not include capital carry forward appropriated by the Board in prior years and is net of General Fund intra-district reimbursements and Internal Service Funds charges.

Operating Outlays

FY 2019-20 appropriations for operating outlays are \$405.3 million, an increase of \$15.0 million compared to the FY 2018-19 adopted budget. The increase in net outlays reflects continued efforts to maintain service levels that support key strategic objectives and the Board's end policies.

Capital Outlays

FY 2019-20 capital project appropriations total \$204.5 million, a decrease of \$0.6 million compared to the FY 2018-19 adopted budget. It is anticipated that \$71.2 million of the FY 2018-19 adjusted budget for capital projects will be carried forward into FY 2019-20 as most capital improvement projects will require multiple years to complete. The capital budget represents the projects that have been identified and prioritized in the Five-Year Capital Improvement Program (CIP).

Intra-district Reimbursements

The primary funding sources for the General Fund and Service Funds are intra-district reimbursements. For FY 2019-20, the total is \$80.8 million. Intra-district charges reimburse the General Fund and Service Funds for functions such as finance, accounting, payroll, human resources, information technology, facilities, organizational leadership, and fleet management.

Other Financing Sources/Uses

Other financing sources and uses include proceeds from debt issuance to fund capital improvement projects. For FY 2019-20, Valley Water anticipates issuing approximately \$59.6 million in debt to finance various Water Utility capital improvement projects.

Reserves

There are ten major restricted reserves used at Valley Water and the detail information is included in the Reserve Policy and Fund Balances section of the summary budget document. The Water Utility Enterprise Fund had seven restricted reserves prior to FY 2019-20: Rate Stabilization Reserve for Bond Covenant, San Felipe Emergency Reserve, Silicon Valley Advanced Water Purification Center Reserve, Supplemental Water Supply Reserve, Drought Reserve, State Water Project Tax Reserve, and Public-Private Partnership (P3) Reserve.

Staff is proposing to add an eighth restricted reserve - Guiding Principal #5 (GP5) Reserve. This reserve would set-aside Board-approved funds to finance various water conservation related programs for communities and agencies who currently pay State Water Project tax but receive 85% of their water supplies from non-Valley Water managed sources. The GP5 reserve will be established in FY 2019-20 as a sub-category of the Rate Stabilization Reserve to set aside the unspent/unencumbered balances approved by the Board in FY 2018-19. Per the Water Utility Parity System Master Resolution No. 16-10 adopted by the Board on February 23, 2016, the GP5 reserve must be accounted as a sub-category of the Rate Stabilization Reserve to allow this one-time source of funds, which may be utilized in future years, to be included in the debt service coverage calculation in the future year(s) when the funds are expended. Without this accounting mechanism, Valley Water's future debt service coverage

ratio, as reported in future debt issuance Official Statements as well as the Annual Continuing Disclosure reports, will be lower to the extent that a non-current source of funds (GP5 reserve) is used to pay for a current expenditure. The Safe, Clean Water Fund has two restricted reserves: Currently Authorized Projects Reserve, and Operating and Capital Reserve.

Valley Water has four major committed reserves. The committed reserves are Liability/Workers' Compensation Self-Insurance Reserve - Risk Fund, Property Self-Insurance/Catastrophic Reserve - Risk Fund, Operating & Capital Reserve (not including Safe, Clean Water & Natural Flood Protection Fund), and Currently Authorized Projects Reserve (not including Safe, Clean Water & Natural Flood Protection Fund).

Overall, budgeted reserves for FY 2019-20 are estimated at \$342.9 million, an increase of \$8.9 million compared to the FY 2018-19 budget. The increase is in the restricted portion of Water Enterprise fund (\$8.6 million), committed portion of the Water Enterprise Funds (\$13.4 million), Watershed Stream Stewardship fund (\$5.6 million), and Internal Service Funds (\$4.9 million). The decrease is in the restricted portions of Safe, Clean Water & Natural Flood Protection Funds (-\$23.3 million) and Committed General Fund reserve (-0.3 million).

(\$ in Thousands)	Actual 2017-18	Adopted Budget 2018-19	Projected Year End 2018-19	Adopted Budget 2019-20	Change from	
					Adopted \$ Diff	2018-19 % Diff

Restricted Reserves

Safe, Clean Water & Natural Flood Protection Fund	136,612	139,404	126,430	116,073	(23,331)	(17%)↓
Water Enterprise Funds	58,467	56,919	63,157	65,529	8,610	15%↑
Subtotal	195,079	196,323	189,587	181,602	(14,721)	(7%)↓

Committed Reserves

General Fund	3,934	4,565	2,767	4,318	(247)	(5%)↓
Watershed Stream Stewardship Fund	113,673	76,588	99,220	82,195	5,607	7%↑
Water Enterprise Funds	62,496	43,878	62,252	57,267	13,389	31%↑
Internal Service Funds	33,079	12,640	27,701	17,500	4,860	38%↑
Subtotal	213,182	137,671	191,940	161,280	23,609	17%↑
Grand Total	408,261	333,994	381,527	342,882	8,888	3%↑

Debt Overview

The FY 2019-20 debt portfolio total outstanding principal of \$753 million includes \$74 million for Watersheds, \$575 million for the Water Utility Enterprise, and \$104 million of Commercial Paper for Safe, Clean Water & Natural Flood Protection and Water Utility Enterprise projects. Annual debt service budget of \$59 million includes repayment of principal, interest and various banking and legal fees for the debt portfolio.

Valley Water's debt management strategy includes the use of a short-term Commercial Paper (CP) Program with a maximum program capacity of \$150 million, supported by a \$150 million Letter of Credit (LOC) from Bank of Tokyo Mitsubishi UFJ, LTD.

The long-term strategy is to issue CP to provide short-term funding for capital expenditures. As

the outstanding CP reaches the program capacity, the outstanding CP is refunded with long-term debt to be repaid over the remaining of life of the assets. For the Water Utility Program, the issuance of long-term debt helps keep water charges stable over the long-term while resulting in inter-generational equity and allows for the completion of capital projects in a timely manner. The long-term financial forecast model shows that the Water Utility finances will be healthy despite the issuance of debt, assuming that forecasted water charges increases are implemented.

For the Safe, Clean Water Program, issuing debt allows the projects to be completed earlier as it bridges the timing difference between when the voter approved special parcel tax revenues are collected versus the desired project delivery schedule based on the Board approved CIP. The Safe, Clean Water special parcel tax was approved by voters on November 6, 2012 and has a sunset date of June 30, 2028.

Valley Water proactively manages its debt portfolio to ensure access to the credit markets at the lowest available borrowing cost, preserve strong credit standing with the municipal rating agencies, fulfill its fiduciary responsibility to its customers, and provide high quality water service, stream stewardship and flood protection at the lowest possible cost.

Bond Ratings

The bond ratings for Valley Water outstanding debt reflect a high-grade investment quality debt. They are based on Valley Water’s positive fiscal policy and financial strengths. In FY 2018-19, the Standard & Poor rating agency upgraded the Watershed Stream’s debt rating from AA+ to AAA. The bond ratings are either the highest for a water related governmental entity in the State of California or among the highest. Bonds issued at this credit rating result in lower interest rates and corresponding lower debt service payments.

Please see table below for ratings going into FY 2019-20.

	Water Utility		Watershed
	Senior Debt	Parity Debt	Debt
Moody's	Aa1	Aa1	Aa1
Standard & Poor's	AA-	N/A	AAA
Fitch	AA+	AA+	AA+

Staffing

The FY 2019-20 Adopted Budget includes 842 regular positions and 4 fellowships, an increase of 18 positions from the FY 2018-19 Adjusted Budget. The new positions' net cost totals \$3.2 million. The new positions would support Valley Water’s in-house construction management program, support Water Utility field and facility maintenance activities, and augment resources for various State and Federal compliance and reporting requirements. In addition, the new positions would work on various Board priorities and strategies as well as support a variety of operations and operating projects. For a comprehensive schedule of district-wide salaries and benefits, please refer to the Salaries & Benefits in the “Financial Overview” section of the FY 2019-20 Operating and Capital Budget document.

Position Count by Organization Area

	Regular Positions				
	Adopted Budget 2017-18	Adjusted Budget 2018-19	Adopted Budget 2019-20	Change from 2018-19	% Change from 2018-19
Board Appointed Officers*	35	103	104	1	1.0%↑
External Affairs	28	35	36	1	2.9%↑
Water Utility**	332	341	341	0	NA
Watersheds**	219	223	239	16	7.2%↑
IT & Administration***	195	122	122	0	NA
Total Authorized Positions ****	809	824	842	18	2.2%↑

*Board Appointed Officers include Office of the Chief Executive Officer, District Counsel and Clerk of the Board

**Total 2019-20 positions reflect the Water Utility and Watershed Fund's staff reorganization implemented in April 2019.

***In 2018-19, Human Resources Division was merged from IT & Administration with the Office of the CEO.

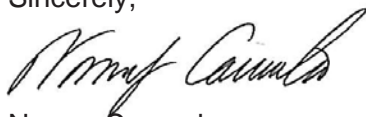
****The four Fellowship positions (a pilot program) are not included in the Total Authorized Positions.

Financial Outlook

Valley Water maintains long-term financial models that help smooth out water charges over time, and inform funding decisions. The future financial health of the organization looks strong as measured by projected reserve levels at or above minimums per policy (despite a lower water charge projection versus prior year in both groundwater benefit zones for the Water Utility). Valley Water is planning to invest over \$3.3 billion over the next ten years to repair and modernize dams, treatment plants, and pipelines that provide reliable water supply to the county. Key capital projects include Anderson Dam Seismic Retrofit, which will help ensure public safety and bolster future water supply reliability, the Pacheco Reservoir Expansion, which will provide additional emergency water supply, and the Rinconada Water Treatment Plant Upgrade, which will extend the plant's service life for the next 50 years. Over \$600 million is planned to be invested over the next ten years for flood protection and environmental stewardship.

This FY 2019-20 Adopted Operating and Capital budget positions the organization well to deliver much needed services and facility improvements to the community over the next decade.

Sincerely,



Norma Camacho
Chief Executive Officer