

Budget Transmittal Letter for Fiscal Year 2017-18

May 9, 2017

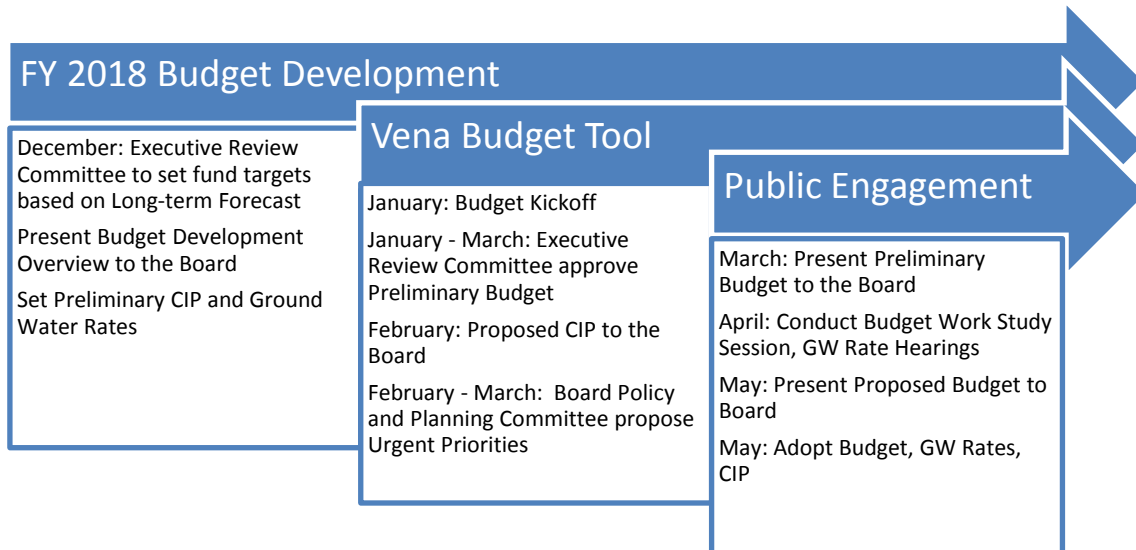
Honorable Members of the Board of Directors of the Santa Clara Valley Water District:

In accordance with the District Policy, I am submitting the Fiscal Year 2017-18 Proposed Budget for the Santa Clara Valley Water District (District). The proposed budget represents the District’s mission of providing Silicon Valley safe, clean water for a healthy life, environment, and economy. This budget 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 the District 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 adopted budget. The budget development process for FY 2018 included several process improvements as well as a new system implementation districtwide. The process included several public hearings and input from the Board about urgent priorities for FY 2018.



District Priorities

In developing the FY 2018 budget, the Board directed our Board Policy and Planning Committee (Committee) to identify and summarize the Board's priorities, in addition to developing a FY 2018 budget message for the community. 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 help the organization achieve results toward the identified priorities as a part of the budget process.

This budget demonstrates a fiscally responsible, balanced budget that meets the community's expectations of the District. This budget focuses on 11 priorities for FY 2018, and these are not in order of priority.

1. Make key decisions regarding the California WaterFix
2. Prioritize the care of our District facilities and assets
3. Advance the District's interest in Countywide stormwater resource planning
4. Provide for a watershed-wide regulatory planning and permitting effort
5. Foster a coordinated approach to environmental stewardship efforts
6. Advance the Anderson Dam Seismic Retrofit Project
7. Advance recycled and purified water efforts with San José and other agencies
8. Finalize the Fisheries and Aquatic Habitat Collaborative Effort (FAHCE)
9. Actively pursue efforts to increase water storage opportunities
10. Advance diversity and inclusion efforts
11. Ensure immediate emergency action plans and flood protection are provided for Coyote Creek

The District is responding to these challenges in several ways, including expanded efforts possible with the help of 18 new positions discussed in greater detail in the sections that follow.

Growth within the appropriation category is limited to essential services that support FY 2018 Board urgent priority and effective use of reserves for one-time costs or priority activities. Working with the Board Planning and Policy Committee, staff identified outcomes and costs related to these efforts. Additionally, the organization will focus on customer service, respectful communications, and engaging the larger community to help achieve the desired results.

Revenue

The FY 2018 budget includes projected revenues of approximately \$444.1 million. These revenues are a net increase of 7.4% from the \$413.6 million included in the FY 2017 adopted budget. The net \$30.5 million increase is primarily derived from increases in water revenue (\$28.4 million), 1% ad valorem property taxes (\$6.3 million), special parcel tax (\$1.0 million), capital reimbursement revenue (\$2.6 million) offset by a decrease in State Water Project property tax (-\$7 million) and a net decrease to other revenues (-\$0.8 million).

Appropriations/Outlays

Net total operating and capital outlays for the FY 2018 budget is \$501.2 million. This figure does not include capital carry forward that was appropriated by the Board in prior years and is net of General Fund intra-district reimbursements and Internal Service Fund charges.

Intra-district Reimbursements

The primary funding sources for the General Fund and Service Funds are intra-district reimbursements. For Fiscal 2018, the total is \$81.4 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. In general, 51% of intra-district is paid by the Water Utility Enterprise, 37% Watersheds, 7% General Fund, and 5% Internal Service Funds.

Capital Outlays

FY 2018 capital project appropriations total \$218.3 million, a decrease of \$22.4 million from the FY 2017 adopted budget. It is anticipated that \$98.8 million of the FY 2017 adjusted budget for capital projects also will carry forward into FY 2018 at the close of the current fiscal year as most capital improvement projects will require multiple years to complete. The capital budget represents those projects that have been identified and prioritized in the Five-Year Capital Improvement Program (CIP).

Other Financing Sources/Use

Other financing sources include debt financing proceeds to fund capital improvements. For FY 2018, planned Bond Proceeds of \$62 million and Commercial Paper proceeds of \$140 million are to finance Water Utility (\$118.9 million) and Watersheds (\$83.5 million) capital improvement programs.

Reserves

There are nine major restricted reserves in the District, further detail is found in the summary budget document pages 3–40. The Water Utility Enterprise Fund has seven restricted reserves, the Rate Stabilization Reserve for Bond Covenant, San Felipe Emergency Reserve, Silicon Valley Advanced Water Purification Center Reserve, Supplemental Water Supply Reserve, Drought Reserve, Debt Service Reserve, and the State Water Project Tax Reserve.

The Safe, Clean Water Fund has two restricted reserves for Currently Authorized Projects Reserve, and Operating and Capital Reserve.

There are four major committed reserves in the District. The committed reserves include Liability/Workers' Compensation Self-Insurance Reserve - Risk Fund, Property Self-Insurance/Catastrophic Reserve - Risk Fund, Operating & Capital Reserve - except for Safe, Clean Water Fund, and Currently Authorized Projects Reserve - except for Safe, Clean Water Fund.

Overall, budgeted reserves for FY 2018 are expected to increase \$51.5 million to \$359.4 million. The increase primarily occurs in the committed reserve portion with the largest increases in the Special Revenue Funds (\$34.5 million) and in the Water Enterprise Funds (\$22.2 million) including a \$2.0 million increase to the Drought Reserve. These increases are primarily offset by restricted and committed currently authorized projects reserve decreases (\$18.6 million). Please see the summary table below for the FY 2018 reserve budget.

(\$ in Thousands)	FY 2016 Year-End	FY 2017 Adopted	FY 2017 Projected Year-End	FY 2018 Proposed	Change from FY 2017 Adopted
Restricted Reserves					
General Fund	\$0	\$0	\$0	\$0	\$0
Special Revenue Funds	\$153,108	\$169,294	\$92,831	\$162,071	(\$7,223)
Water Enterprise Fund	\$37,094	\$42,029	\$42,029	\$45,625	\$3,596
Internal Service Funds	\$0	\$0	\$0	\$0	\$0
Subtotal	\$190,202	\$211,323	\$134,860	\$207,696	(\$3,627)
Committed Reserves					
General Fund	\$10,274	\$5,868	\$6,301	\$5,152	(\$716)
Special Revenue Funds	\$64,851	\$34,986	\$50,446	\$69,558	\$34,572
Water Enterprise Fund	\$64,742	\$41,042	\$93,828	\$63,272	\$22,230
Internal Service Funds	\$23,193	\$14,652	\$19,378	\$13,703	(\$949)
Subtotal	\$163,060	\$96,548	\$169,953	\$151,685	\$55,137
Grand Total	\$353,262	\$307,871	\$304,813	\$359,381	\$51,510

Debt Overview

The FY 2018 debt portfolio total outstanding principal of \$810 million includes \$231 million for Watersheds and \$579 million for the Water Utility Enterprise. Annual debt service budget of \$49.7 million includes repayment of principal, interest and various banking and legal fees for the debt portfolio.

The District's debt management strategy includes the use of very low cost short term Commercial Paper (CP) Program with a maximum program capacity of \$225 million, supported by a \$150 million Letter of Credit (LOC) from Bank of Tokyo Mitsubishi UFJ, LTD. (BTMU) and a \$75 million Revolving Line of Credit from Wells Fargo Bank, National Association (WFB).

The long-term strategy is to issue CP to provide short-term just-in-time funding for capital expenditures. As the outstanding CP reaches the program capacity, the outstanding CP would then be refunded with long-term debt to be repaid over 30 years. For the Water Utility Program, the issuance of long-term debt helps keep water charges low and stable over the long-term while resulting in inter-generational equity and allows for the completion of capital projects in a timely manner. The water charge study shows that Water Utility finances will be healthy despite the issuance of debt, assuming that forecasted water charge 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.

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

Bond Ratings

The bond ratings for the District's outstanding debt reflect high grade investment quality debt. They are based on the District's positive fiscal policy and financial strengths. 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 2018.

Bond Rating

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

Staffing

The FY 2018 budget includes 809 positions, an increase of 18 new positions from the FY 2017 Adjusted Budget. The new positions' cost totals \$3.0 million. The 18 new positions support the Watersheds' stream maintenance and Safe, Clean Water programs (8.0), Water Utility water supply (3.0), External Affairs (3.0), and Administration (4.0).

Position Count by Organization Area

	Adjusted Budget FY 2016	Adjusted Budget FY 2017	Proposed Budget FY 2018	Position Change from FY 2017	% Change from FY 2017
Board Appointed Officers	60	35	35	0	0%
External Affairs	0	25	28	3	12%
Administration	178	191	195	4	2%
Water Utility	311	329	332	3	1%
Watersheds	209	211	219	8	4%
Total	758	791	809	18	2%

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The chart above includes the FY 2017 Adopted Budget approved 783 positions, with an additional eight positions added during the year to ramp up for the Safe, Clean Water projects that obtained permits and are ready to advance to construction.

In FY 2017, the Board also approved the addition of the Office of Chief of External Affairs to increase community engagement and achieve a consolidated approach to governmental relations. During the FY 2018 budget development process, 18 regular positions were added to address the Board's urgent priorities.

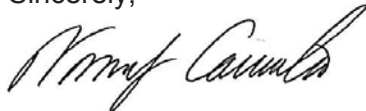
FY 2018 Outlook

It is important to maintain a long-term outlook with major infrastructure investments coming in the next 10 years. The District has an ambitious capital program to help ensure a reliable and safe water supply. Planning for the future means acting now. This planning is evident when looking at the FY 2018 proposed increase to water charges alongside the proposed total Water Utility budget decrease of \$11.4M, not including capital carryforward from FY 2017.

The District's retail customers prefer a smooth and stable water rate projection, consequently staff employs "rate smoothing" mechanisms to help avoid rate volatility. Water Utility costs are projected to increase in general, but can swing significantly up or down from year to year due to the nature of capital infrastructure spending. So, while the proposed FY 2018 Water Utility budget is a decline from the prior year, the FY 2018 water charge increase reduces the need to borrow in FY 2018, which frees up borrowing capacity for future years when capital infrastructure spending is projected to spike. Consequently, future year rate increases will be more smooth and stable than they otherwise would be.

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 FY 2018 and bring adjustments back to the Board as needed.

Sincerely,



Norma Camacho
Interim Chief Executive Officer

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