SOUTH TAHOE PUBLIC UTILITY DISTRICT

FISCAL YEAR 2024/25 BUDGET MESSAGE

May 16, 2024

District Customers and Board of Directors:

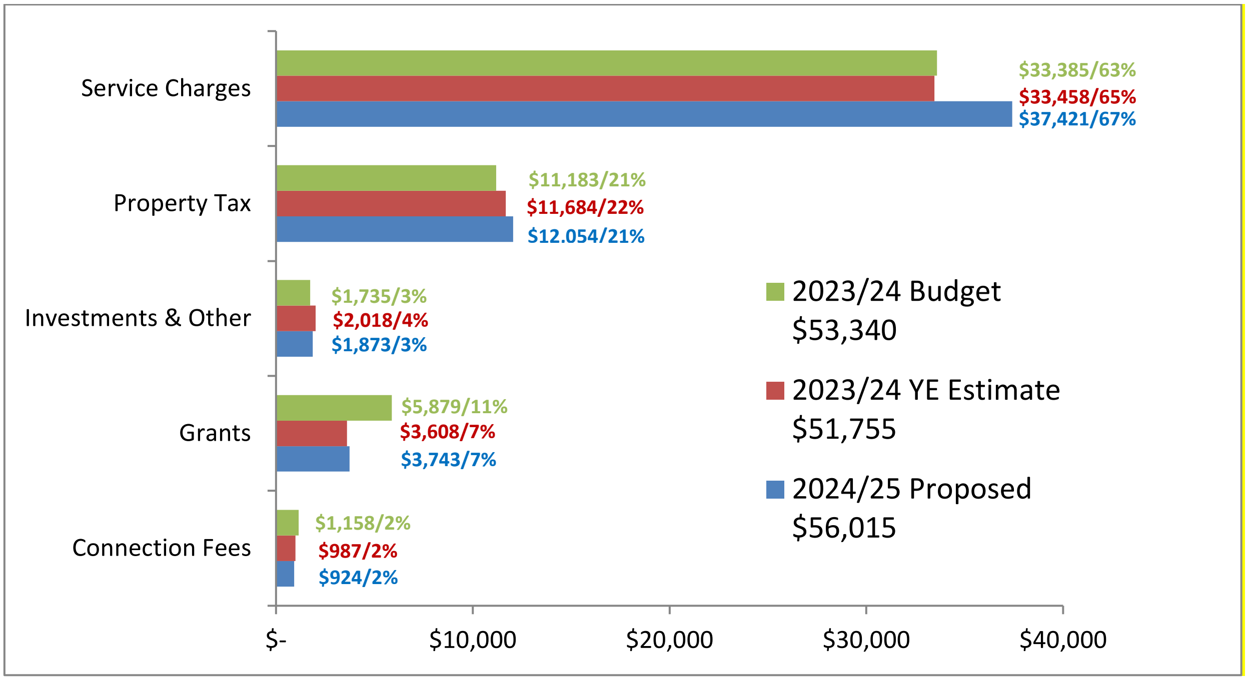
The South Tahoe Public Utility District staff submit to you the adopted Fiscal Year 2024/25 budget and long-range forecast. This budget message is meant to provide a summary of the adopted budget and long-range forecast and is intended to be read in conjunction with the other information in the budget document, including the revenue and expense summaries and detail, graphical depictions, departmental descriptions, service charge rate data and other budget schedules to receive all information prepared for the adopted 2024/25 budget and long-range forecast.

In October 2023, at the beginning of the budget process, District staff informs each department of the budget expectations including: no change in total operating and maintenance (O&M) expenses without valid justification and no change to current staffing levels without General Manager approval. The General Manager is not recommending any additional permanent positions be incorporated into the adopted budget. Further discussion below in the “Salaries and Benefits” section.

The adopted budget and long-range forecast as developed are balanced, comply with adopted reserve policies, and meet required debt coverage ratios. The adopted budget incorporates the “Needs Based” water and sewer capital improvement plans (CIPs). The total amount of the sewer and water ten-year engineering CIPs are $133 million and $131 million respectively. The District will be issuing a five-year Proposition 218 notice prior to the beginning of fiscal year 2024/25 which will include a five-year rate increase schedule necessary to complete the ten-year CIPs. By ordinance, the Board of Directors adopts the rates in year one of the schedule, but on an annual basis must confirm the rates in each of the remaining years. The recommended rate adjustments of 9.5% for water and 13.5% for sewer were confirmed by the Board of Directors for fiscal year 2025 at the May 16, 2024 regular Board meeting.

Fiscal Year 2024/25 Projected Revenues: Water and Sewer Combined $54,695 (000's) Compared to FY 2024 Budget and 2024 Estimated Year End

Figure 1

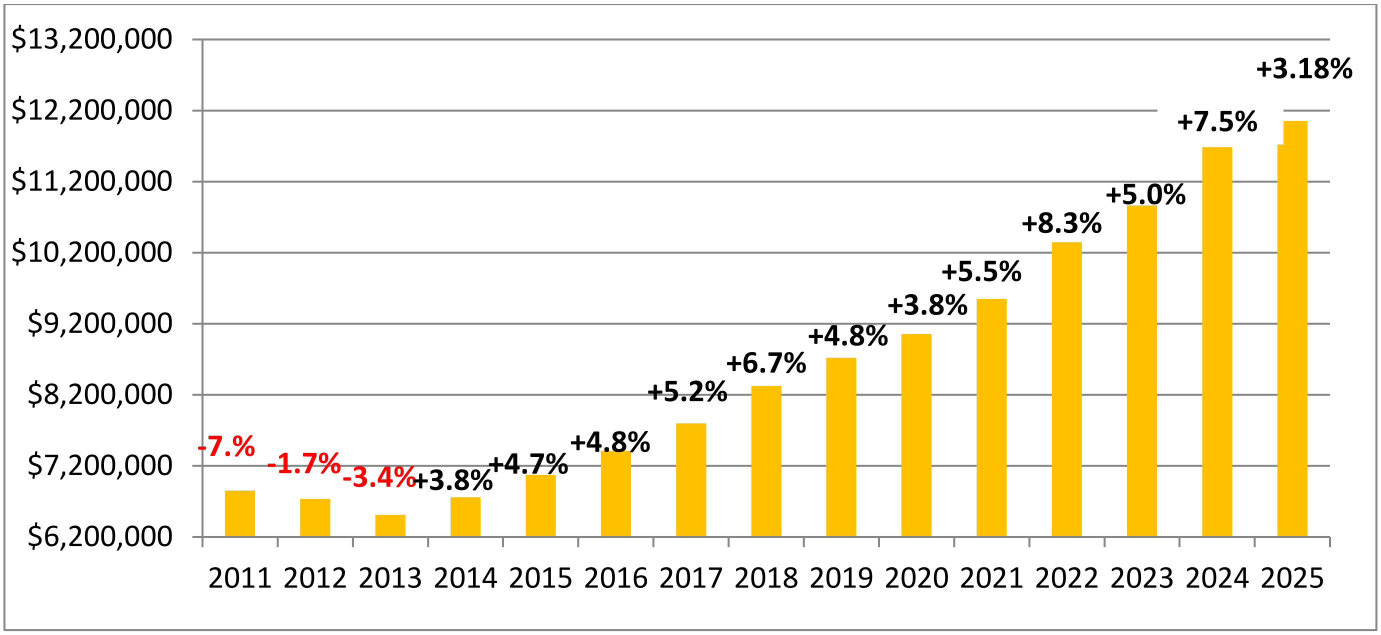


Total water and sewer revenues projected for fiscal year 2024/25 are $56 million, not including expected loan reimbursements of $22.1 million, and are up by $2.7 million compared to the current year budget. The variance is due to an increase in Service Charges of $4 million, in Property Taxes of $871K, and Other Income of $138K offset by a decrease in Grants of $2.1 million and Connection Fees of $234K.

Property Taxes – Property tax revenues are projected at $12 million, a 3.18% increase over the current year's actual amount. For fiscal year 2024/25, property tax is budgeted 67% in the sewer fund and 33% in the water fund. This ratio incrementally increases by 2 – 3% for that budgeted to water through year 2028/29 then changes to a 56/44 sewer/water ratio. Property tax transfers from the District to the South Tahoe Redevelopment Successor Agency are projected to be $560,000 in 2024/2025 or 4.6% of projected gross property tax revenues. This tax transfer is estimated to continue until 2041, when all bonded debt of the Successor Agency is satisfied.

As you can see in the graph below, property tax receipts have been on a steady incline since 2014. The actual increase for the current year was 3.18%. District staff believes assessed values will continue to increase through the rest of the current fiscal year but at a lesser rate due to decreased inventory within the real estate market, increased mortgage rates and modest increases to home values. The historical low mortgage rates we witnessed from approximately 2013 through the second half of calendar year 2022 are over for the foreseeable future. Due to these impacts to the real estate market, staff is not projecting an increase to property tax revenues beyond the 15-year average of 3.18% for fiscal year 2024/25 and beyond. District staff still plans to remain conservative when projecting future changes to assessed property values. With the impact the latest recession had on property values, the District prefers to take a more conservative approach as to not be overly aggressive or optimistic with long-term projections. One year with a negative change in values has a dramatic impact on long-term property tax collections and revenues.

Figure 2 GROSS PROPERTY TAX REVENUE

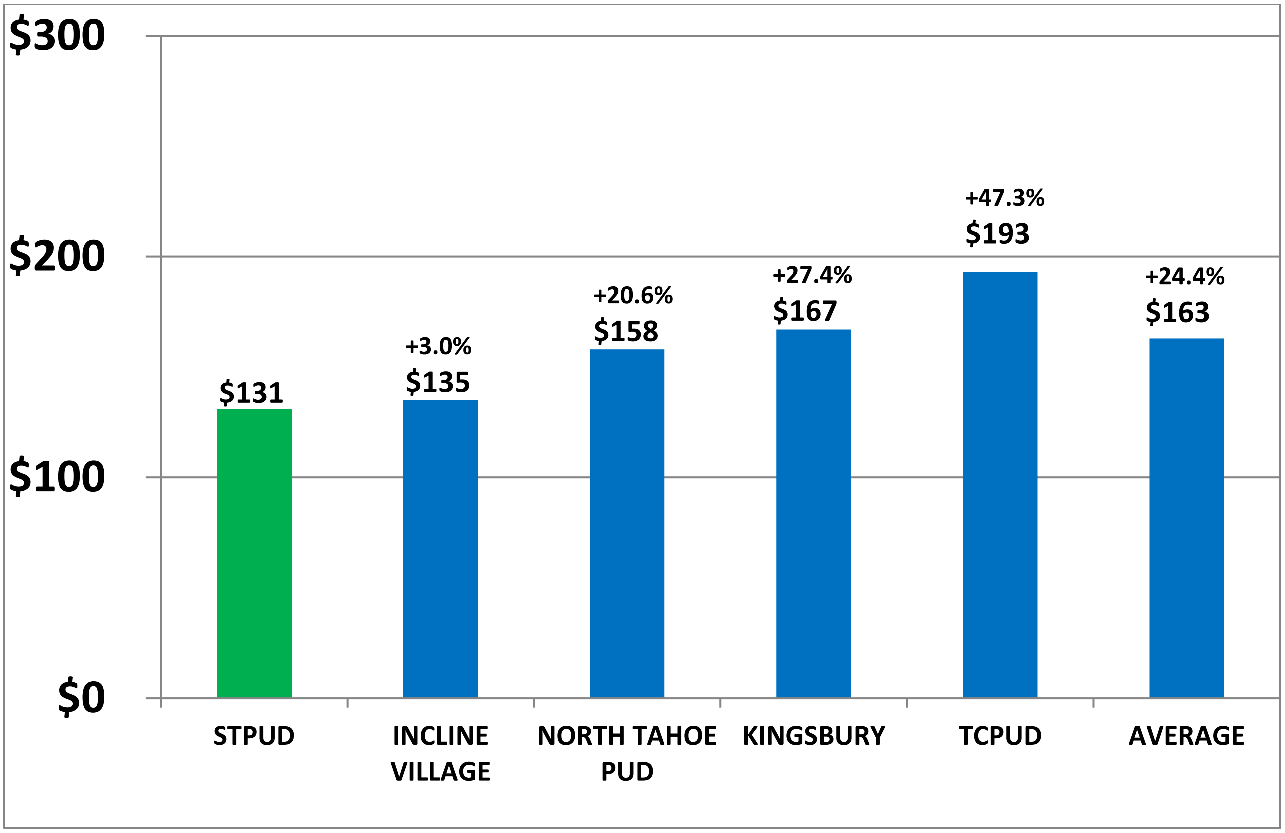


Service Charges – Total water and sewer service charge revenue projected for 2024/25 is $37.4 million. As mentioned above, the adopted budget has been prepared with a 13.5% increase for sewer rates and 9.5% for water which allows the District to continue completing projects from the "Needs Based" CIPs. The long-range forecast is currently prepared with the assumed rate increases of 9.5% in years two through ten pending the next Prop 218 five-year cycle (FY 2029/30).

Included in this budget document is a summary sheet illustrating the five-year water and sewer rates. The rates were developed through formal rate studies prepared by HDR Engineering. Also included is historical rate information and comparisons with other local water and sewer providers. Figure 3 below illustrates the current average combined monthly water and sewer bill of local comparable providers is $163, compared to the District's 2024/25 combined rate of $124. Staff will continue to monitor and report future rate data annually.

Current Monthly Combined Water & Sewer Rate Comparison w/STPUD 2024/25 Increases

Figure 3



Connection Fees – Capacity charges collected by the District can only be spent on infrastructure or to pay the debt service on loans for infrastructure. For the adopted fiscal year 2024/25 budget, staff has projected sewer capacity and connection charges equivalent to 60 typical residential connections and water charges equivalent to 30 typical residential connections. The difference is due to expansion projects, or teardown rebuilds, which usually require additional sewer capacity without the need for a larger water connection. Due to the unknown nature of commercial connections, we have projected total commercial development equivalent to 100 plumbing fixture units and one four-inch water connection. To account for a declining inventory of available buildable lots, the long-range forecast assumes a 10% reduction in sewer capacity fees annually. Although capacity charges projected for 2024/25 only represent approximately 2.0% of the total proposed revenue budget, they are an important revenue source to support capital projects.

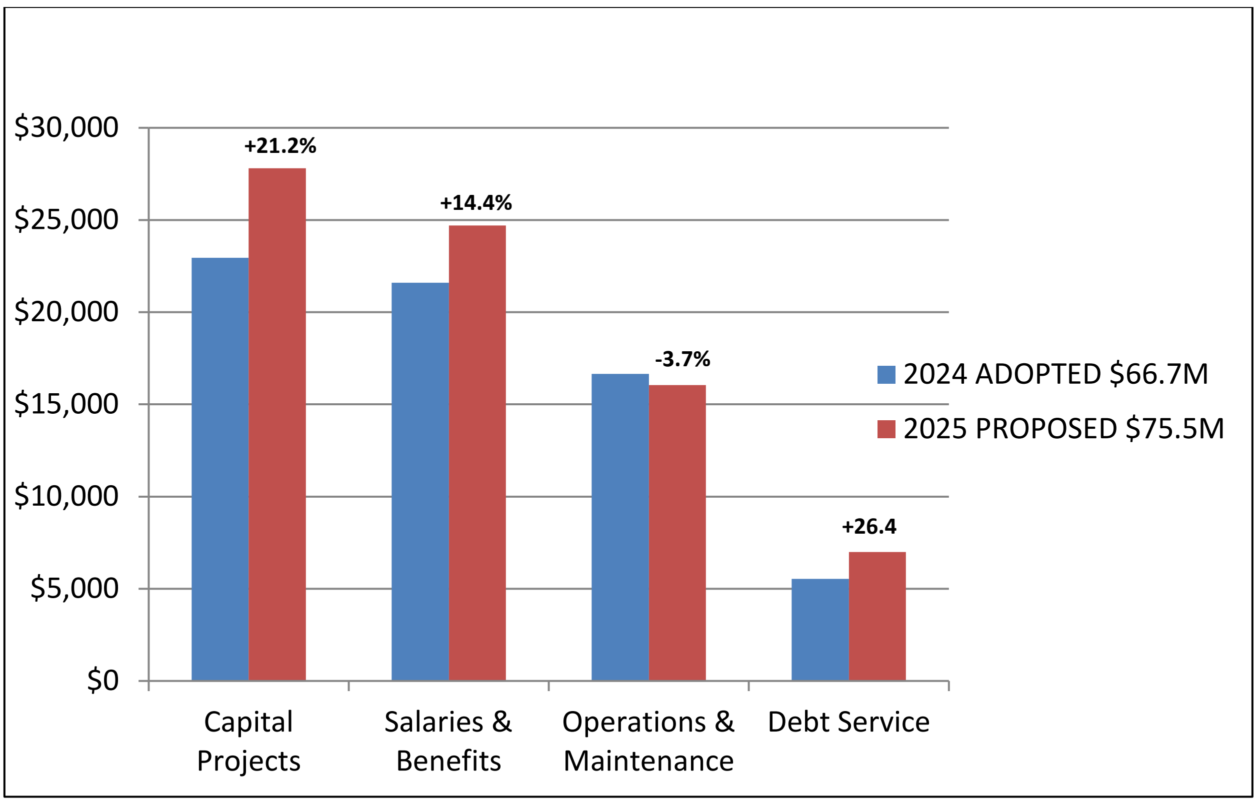
Investment Revenues – Projected investment earnings generated from the District's portfolio have been well below historical averages as interest rates were at or near record lows for years. California government code requires local governments to invest in programs with little to no risk, guaranteeing principal preservation. For this reason, investment returns on the District's portfolio are not a significant source of annual revenues. Projected earnings for 2024/25 are $359,000 compared to $539,000 in the current year budget although actual earnings could exceed expectations if current higher rates remain strong into 2024/25. Although low rates have negatively impacted District investment revenues for many years, the District has been able to take advantage of record low-interest rates on new debt to fund infrastructure improvements and refinance higher interest debt. The long-term savings of interest expense on new debt is greater than the reductions we have seen on investment revenues.

Grants – The District has benefited significantly from a successful grant program for nearly 20 years. From meter installations, waterline replacement and upsizing, water conservation programs, erosion control projects, etc., the District's rate payers have received millions of dollars in system improvements that could not have been completed without grant awards, State Revolving Fund Loans or significant rate increases. The proposed 2024/25 budget includes $3.7 million of awarded grant funds for various projects.

Total Expenditures - Total water and sewer proposed expenses for fiscal year 2024/25 are $69.1 million compared to $66.7 million in the current year adopted budget (Figure 4); $23.4 million or 34% is allocated to capital projects, $23.5 million or 34% for salaries and benefits, $16.1 million or 23% for operating and maintenance expenses, and $6.1 million or 9% for debt service. Each expenditure category is discussed below.

Fiscal year 2024/25 proposed expenses compared to current adopted expenses:

Figure 4



Operating and Maintenance Expenses – Total water and sewer operating and maintenance (O&M) expenses adopted for fiscal year 2024/25 are $16 million, $619K or 3.7% less than the current year budget. The change is primarily due to a change in ongoing expenses to include the following decreases: $288K for Sewer Crossings Assessment, $55K for Cathodic Protection, $10K for Solar Support and $35K for Blue Ribbon.

Although District staff will continue to pursue savings whenever possible through efficiencies, purchasing programs, and improved or extended maintenance schedules, the long-range forecast as developed includes an annual 2% escalator to account for inflationary increases.

Salaries and Benefits – Total salaries and benefits included in the adopted 2024/25 budget are $24.7 million and account for approximately 33% of the total proposed expenditure budget. FY 2023/24 budgeted salaries in the amount of $14.4 million are increasing by approximately $2.1 million or 14.4%, while FY 2023/24 budgeted benefits in the amount of $7.2 million are increasing $1 million or 14.3%. The combined increase is $3.1 million or 14.4%. Negotiations for the succeeding contract have been completed and include a 3.5% COLA retroactive for FY 2023-24 and a range for FY 2024-25 COLA from a minimum of 2.5% to a maximum of 4.5%. As such there is a projected increase of 2.5% for COLA. In addition, those new employees not at the top of their respective wage scale receive a 5% step increase. As noted in the current employment contract, the District is in the process of completing a Compensation Study for which a residual 6.5% increase remains for salary realignments.

The largest impact to benefits is an increase of 12% or $292,000 to health insurance premiums as well as the benefits tied directly to the 6.5% placeholder Compensation Study realignments and 3.5% retroactive COLA, $748,000. These increases are offset with a decrease in the CalPERS expense of approximately $150,000 due to the retirement of employees in the Classic Plan and the new employee participants in the less expensive PEPRA Plan (see more information on CalPERS below). Lastly, due to the increase in salaries, Social Security/Medicare expenses are expected to increase approximately $45,000 and other miscellaneous benefits are increasing approximately $45,000 also due to the increases in salaries noted above.

Several new positions have been requested by multiple departments, but the General Manager is not recommending incorporating any of them into the adopted budget, nor have they been approved by the Board. Earlier this fiscal year the Board approved the new position of Director of Operations. With the elimination of the Assistant General Manager position it was demonstrated that the needs of the entity required the caliber of this position in the Management of the Daily Operations to ensure cost effectiveness and general overall efficiency. The approximate total annual cost of this position is $203,194 plus benefits and will be split evenly between the water and sewer funds budget.

CalPERS – The California Public Employees Retirement System continuously adjusts actuarial assumptions in an effort to improve the funding level of the retirement system. These adjustments impact the required employer contribution rates. In 2013, the legislature adopted the Public Employee Pension Reform Act (PEPRA) effective January 1, 2013. This act created a new pension plan with lower benefit levels for new public employees, or previous public employees who have moved to a different California public agency, but with a six month or more gap in employment. While the CalPERS Board believes PEPRA will improve the sustainability of the retirement system, they do not expect to see a large impact for another 15 years or more. Due to this delay, as well as lower than expected returns on investments, the CalPERS Board acted a few years ago to reduce the expected rate of return on investments from 7.5% to 7.0%. The reduction was phased in over a three-year period beginning with year 2018/19. If the assumption is less revenue from investments, then more revenue is required from employer contribution rates. For 2024/25 the increase to the Classic plan (51 employees enrolled) employer rate is 8.748% of salaries, bringing the contribution rate up to 37.36% of salaries. The increase is due to the number of retirees from this plan which results in a decrease at the base. Despite the increase in the contribution rate, the actual expense decreases by $51K. The PEPRA plans (69 employees enrolled) employer contribution rate is increasing slightly by 0.190% of salaries, but the cost of the plan is increasing due to an increased number of newer employees enrolled in the plan. The PEPRA employer contribution rate for 2024/25 is 7.870% of salaries. The total estimated CalPERS increase for the year is $130.5K.

Debt Service – The District would prefer to fund infrastructure improvements with cash but must issue debt in order to complete necessary projects while keeping service charge rates at moderate levels. Also, it is reasonable to fund assets that have long service lives with long-term debt. The District also issues debt when interest rates are low to refinance older borrowings which can create substantial savings for our customers. Some of the refinancing in the past has created millions in savings over the remaining loan terms. For the year 2024/25, debt service is projected at $6.9 million, an increase of approximately $1.5 million over the current year. The increase is due to the new debt service payments associated with the bundled General Sewer Loan #1 and Secondary Clarifiers 1 & 2 as well as the Miscellaneous Water Project Loan.

The CIPs incorporated in the proposed budget and long-range forecast require additional borrowings. The sewer fund forecast includes $64 million, while the water fund includes $45.8 million in assumed new borrowings over the next ten years.

When possible, the District intends to utilize the State Revolving Fund program to complete other sewer and water projects over the next ten years. This program offers subsidized interest rates that are typically lower than the general tax-exempt market. If this funding is not available, or if project completion is time sensitive, the District can utilize other funding sources. Borrowings outside of the SRF program are currently forecasted with a 4.5% interest rate, which is 2% greater than rates estimated for SRF loans.

Capital Outlay – Total water and sewer capital outlay adopted for fiscal year 2023/24 is $27.8 million; $16.9 million for sewer projects, and $10.9 million for water projects. The ten-year engineering CIPs are $133.2 million and $131 million for sewer and water projects respectively and include a 3% annual inflation adjustment. Although inflation today is higher than 3%, District staff is comfortable using 3% as a long-range average inflationary factor. As discussed during the February 18, 2024, CIP workshop, the “Needs Based” CIPs are dependent on water and sewer rate increases of at least 13.5% and 9.5% respectively for fiscal year 2024-25. Of course, amendments will be required if the Board decides to move forward with a different rate increase or CIP approach.

I would like to acknowledge the work completed by District department heads and staff in the preparation of this year’s proposed budget and long-range forecast.

Andrea Salazar, Chief Financial Officer