



Orange County Sanitation District

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STEERING COMMITTEE

Agenda Report

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Agenda Item No: 5.

FROM: James D. Herberg, General Manager
Originator: Lorenzo Tyner, Assistant General Manager

SUBJECT:

COVID-19 FINANCIAL IMPACT UPDATE

GENERAL MANAGER'S RECOMMENDATION

RECOMMENDATION:

Information Item.

BACKGROUND

The Board of Directors requested a staff report on potential financial impacts related to COVID-19. Staff has summarized the potential financial impacts to date.

ADDITIONAL INFORMATION

Revenues

The Orange County Sanitation District (Sanitation District) has a broad-based revenue program. Although 85% of its income comes from two sources (65% from general user fees and 20% from property taxes), the income is collected from nearly one million different users. This distribution reduces the potential impact on the Sanitation District by any individual ratepayer. Additionally, both of these revenues are collected through the County of Orange (County) semi-annual property tax collection process. At present, the County has announced no change to its collection of these fees or the disbursement of funds to the Sanitation District as a result of COVID-19. We anticipate receiving our next County apportionment later this month.

The Sanitation District does receive 15% of its revenues from other sources that may be negatively impacted. However, those revenues are also broad-based, split between various permittees, other government agencies, and interest income. As such, any risk to Sanitation District revenue should be manageable. However, should the pandemic continue, this risk would increase.

Investment Portfolio

The Sanitation District portfolios remain conservatively positioned and are weathering the volatility in the markets fairly well given the circumstances.

However, all indications are that the short-term impact of the shutting down of major portions of the US economy due to the COVID-19 virus are going to be material.

We have already seen a large monetary policy response from the Federal Reserve, and we expect a significant fiscal response, both domestically and globally, to help mitigate the economic impact of the virus on the global economy.

The US consumer and overall US economy was in a solid position prior to the impact of the virus which should also help the markets recover when we get past the volatility and uncertainty, which is likely to last for several more weeks.

With respect to portfolio, the Sanitation District's positioning is conservatively positioned, with approximately 60% of the holdings in government securities and 5-year government securities that were purchased as a hedge against interest rate drops.

At present, there are no underlying concerns with the portfolio holdings. Chandler Assets, our portfolio manager, is monitoring the market and portfolio with the ongoing volatility. Our Finance Division and our portfolio manager, Chandler Assets, are both set up to work remotely to ensure all transactions are completed and monitored.

Pension Liability

Due to the lag in evaluating actuarial results, we do not anticipate any changes to our contribution rates as a result of COVID-19 until July 1, 2021.

Orange County Employees Retirement System (OCERS) actuarial funding policy calls for investment gains/losses to be smoothed in over five years and are then amortized over 20 years. So, investment returns below 7% as of December 31, 2020 will create an actuarial loss. Those losses will be smoothed into the valuation over the subsequent five years (as the investment gains from 2019 will be smoothed in over five years as well).

This summer, OCERS will complete its triennial study where all assumptions will be re-evaluated. Changes in assumptions will also impact the UAAL and contribution rates. Those new assumptions, once approved by the OCERS board, will be incorporated into the actuarial valuation as of December 31, 2020.

The rates from the 2020 valuation will go into effect July 2022, the soonest employers will start to see this year's events (and changes in assumptions) hit their contribution rates. However, staff has already started to project these changes and will build in our assumptions in to the next two fiscal budgets. Attached is a message from the OCERS Chief Executive Officer regarding their response to COVID-19.

Expenditures

Staff is tracking all COVID-19 related expenditures. While there have been both staffing and material expenditures directly related to the pandemic, these have been minimal in relation to the Sanitation District's full operating budget. However, as the pandemic continues, we anticipate additional expenses to increase.

Potential State Actions and History

The impacts of COVID-19 will undoubtedly affect the US and California economies. As such, there have been concerns that the State may elect to temporarily fill any of its revenue gaps by borrowing from or otherwise changing its financial relationships with other government entities.

In 1992/93 and 1993/94, to resolve serious budget deficits, the State legislature permanently shifted \$3.6 billion of annual property tax revenue from counties, cities, and special districts to the Educational Revenue Augmentation Fund (ERAF I and ERAF II).

In 2004/05 and 2005/06, a temporary (2 year) shift of an additional \$1.3 billion was enacted by the legislature (ERAF III). Approximately \$16 million of Sanitation District funding was taken as a result of that shift. Subsequently, State legislation was passed that prevented future reallocations without repayment to the special districts (Proposition 1A 2004).

In 2009/10, the State borrowed \$1.9 billion of property tax revenue from counties, cities, and special districts. Approximately \$5 million was borrowed from the Sanitation District. Approximately \$2.5 million was taken from the first installment of property taxes and \$2.5 million was taken from the second installment of property taxes and each amount was repaid within a month of being taken.

In 2010, Proposition 22 was approved, which prohibits the state from redirecting property tax revenue as it did in 2009-10.

Proposition 22 (2010)

In 2010, voters approved Proposition 22, which, among other things, prohibits the State from redirecting property tax revenue as it did in 2009-10. Specifically, Proposition 22 eliminates the State's authority to borrow property tax revenue from local governments as previously allowed under Proposition 1A and prohibits the State from requiring redevelopment agencies to shift revenue to K-14 districts or other agencies. As discussed in the link below (also included as an attachment), the prohibition on shifting redevelopment funds contributed indirectly to the dissolution of redevelopment agencies in February 2012. <https://lao.ca.gov/reports/2012/tax/property-tax-primer-112912.aspx>.

RELEVANT STANDARDS

- Protect Orange County Sanitation District assets
- Ensure the public's money is wisely spent

ATTACHMENT

The following attachment(s) may be viewed on-line at the OCSD website (www.ocsd.com) with the complete agenda package:

- Memo from OCERS
- Understanding California's Property Taxes Information