

Overview of Cost Recovery & Containment Study

**Budget and Finance Committee Meeting
February 28, 2018**

**Jack P. Broadbent
Executive Officer/APCO**



**BAY AREA AIR QUALITY
MANAGEMENT DISTRICT**

A HEALTHY BREATHING ENVIRONMENT FOR EVERY BAY AREA RESIDENT

matrix 
consulting group

Firm Overview

- ◆ We are in our 14th year providing financial and management analytical services to local government.
- ◆ We have five offices nationwide, with our headquarters in Mountain View, CA.
- ◆ The key staff proposed for this project include:
 - Courtney Ramos, Project Manager and the leader of our Financial Services practice; and
 - Khushboo Hussain, Lead Analyst with experience in both Financial Services and Management studies.

Scope of Services

◆ Cost Allocation Study

- Identify and review existing indirect support centers
- Ensure compliance with cost principle standards (OMB 2 CFR Part 225)

◆ Cost Recovery Study

- Calculate the total direct and indirect cost associated with services
- Ensure compliance with local and state laws

◆ Provide staff with the knowledge and tools to update annually.

Methodology

- ◆ Categorized Programs
 - Ensured proper direct / indirect designations & allocation basis
- ◆ Reviewed General & Permit General Bill Codes
- ◆ Evaluated Cost Containment
 - Reviewed previous study
 - Gauged implementation progress of past recommendations
- ◆ Assessed and Developed Cost Recovery Database
- ◆ Conducted Issues Analysis

Recommendations (1)

◆ Cost Allocation

- Update allocation metrics to better reflect indirect services provided

◆ Bill Codes

- Better define bill code activities
- Develop new bill code for non-recoverable activities (i.e., Green Business Program, Incident Response for non-permitted source)
- Periodically audit time coded to General and Permit General

Recommendations (2)

◆ Cost Recovery

- Update and educate staff on how to code time more directly to activities
- Review and update cost recovery fee increase brackets

◆ New Production System

- Utilize metrics and data gathered to create future enhancements and benchmarks
- Encourage online submissions

Excel-Based Model

- ◆ Indirect Cost Allocation

- Complies with OMB and GAAP guidelines
- Incorporates allocation metric changes

- ◆ Cost Recovery Calculations

- Utilizes same data as the cost allocation model
- Incorporates results from cost allocation model

- ◆ Projections

- Account for projected changes in expenditures, salaries, and / or personnel.

Cost Recovery

◆ Verified Overall Percentages

- Used FY16/17 time keeping and workload data to assess fee-related costs and recovery levels
- Current cost recovery is at 83%, with an annual subsidy of \$8.9 million from property taxes

◆ Cost Recovery Levels and Fee Updates

- Reviewed current fee increase percentages
- Provided guidance on how to address fees that are significantly under-recovering, or that are above 100% cost recovery

Cost Containment

- ◆ Newly implemented cost containment and efficiency strategies
 - Timekeeping guidance / review, greater field capabilities, workload tracking, public education, online submittals and permit status
 - 70% of the District's facilities are in the new system
 - Roughly 90% of the recommendations made from the previous study have been implemented
- ◆ Future cost containment
 - Utilize the data gathered in the system to develop benchmarks

Questions and Comments



BAY AREA
AIR QUALITY
MANAGEMENT
DISTRICT



Air District Financial Overview: Anticipated Challenges in the Fiscal Year Ending (FYE) 2019 Budget

**Budget and Finance Committee
February 28, 2018**

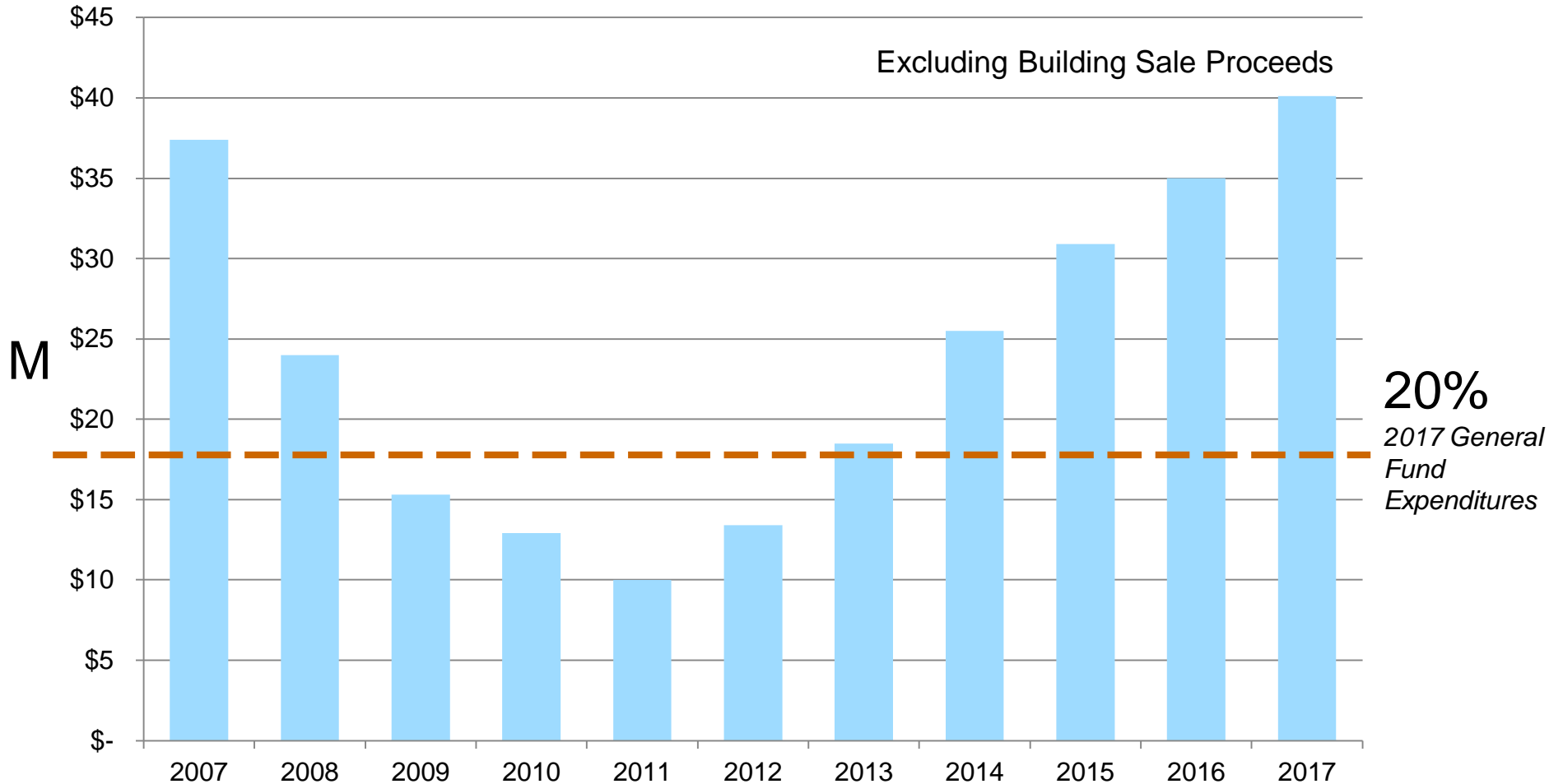
**Jack P. Broadbent
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PREVIOUS AND UPCOMING TOPICS

- *January:* Use of Reserves
- *February:* Anticipated Challenges and Actions
- *March:* First Presentation of FYE 2019 Budget

USE OF RESERVES DURING DOWNTURN





FINANCIAL CHALLENGES AND ACTIONS

- **Challenges**

- Retirement Liabilities
- Costs for New and Enhanced Programs
- Uncertainty in State Funding

- **Actions**

- Cost Recovery (Fees)
- Discretionary Retirement Funding
- Alternative Asset Allocations

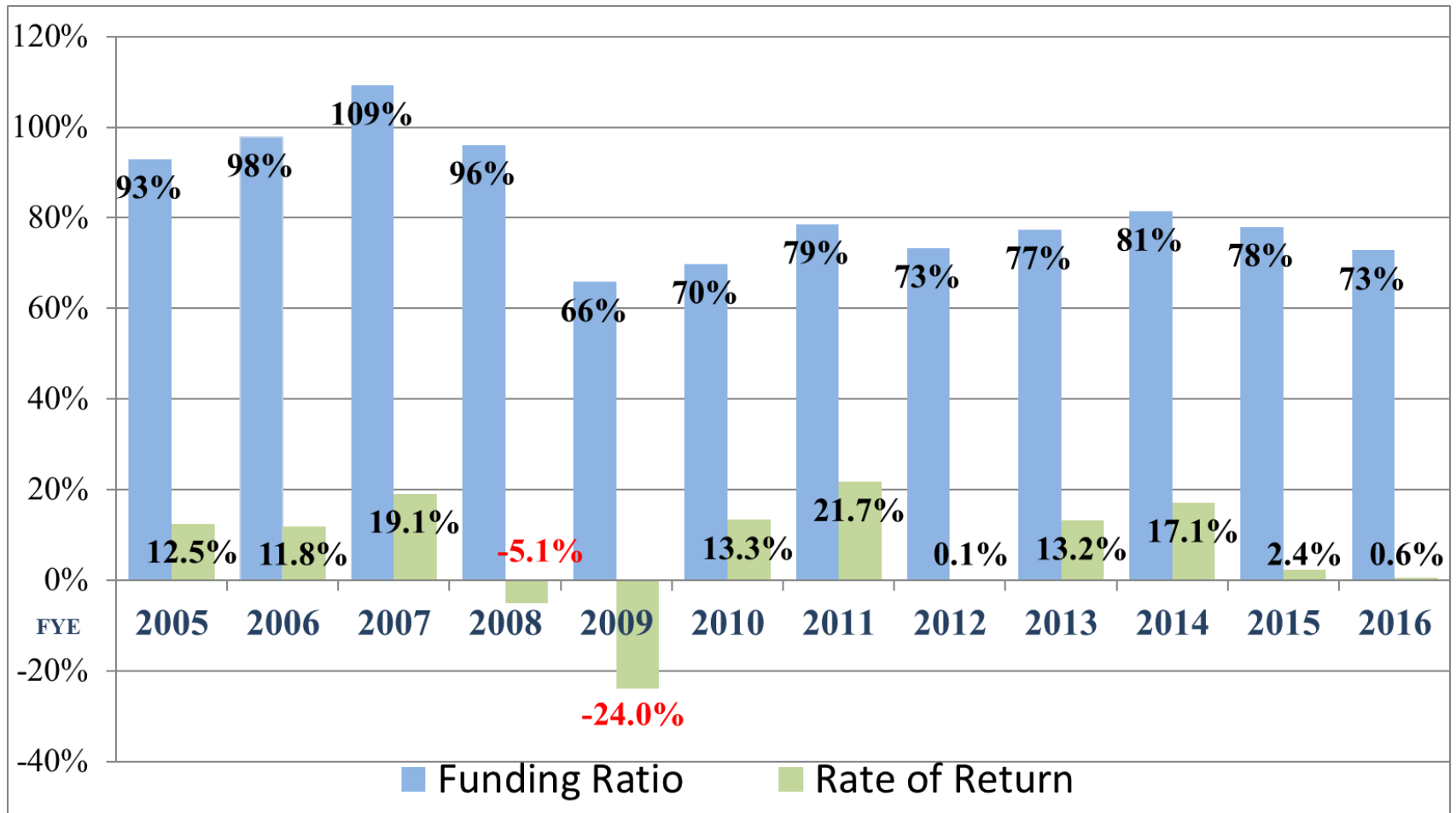


RETIREMENT LIABILITIES

1. CalPERS

2. Medical (OPEB)

CALPERS PENSION PLAN HISTORICAL RATE of RETURN



2017 Rate of Return = 11.2%



CALPERS PENSION PLAN CHANGES

1. Split Employer's Required Contribution

- Unfunded Liability Payment
- Normal Cost Rate (based on Payroll)

2. Change to Discount Rate over 3 years

- 7.5% to 7.0% (possibly lower)
- Increases Required Contribution



CALPERS PENSION BENEFIT PLAN

Air District Implementation

- **Air District Pension defined-benefit plan**
 - Two benefit structures
 1. Classic Members 2% @ 55
 2. PEPRA Members 2% @ 62



CALPERS PENSION PLAN

Air District Employer/Employee Normal Cost

- **Current Fiscal Year Employer/Employee Normal Cost (% of salary):**

FYE 2019 Fiscal Year Normal Cost			
Benefit Structure	Total Normal Cost	Employer Normal Cost	Employee Normal Cost
CLASSIC (2%@55)	14.4%	7.4%	7.0%
PEPRA (2%@62)	11.2%	5.7%	5.5%



AIR DISTRICT CALPERS FUNDING STATUS

With 7.375% Discount Rate

- **CalPERS Retirement:**
 - Obligation: \$283 M
 - Funded: \$207 M (73%)
 - Unfunded: \$76 M (27%)



CALPERS CONTRIBUTION REQUIREMENT

Increase because of change in Discount Rate

- **CalPERS FYE 2018 Air District Contribution:**
 - \$8 M
- **CalPERS Future Contribution (within 3 years):**
 - \$13 M

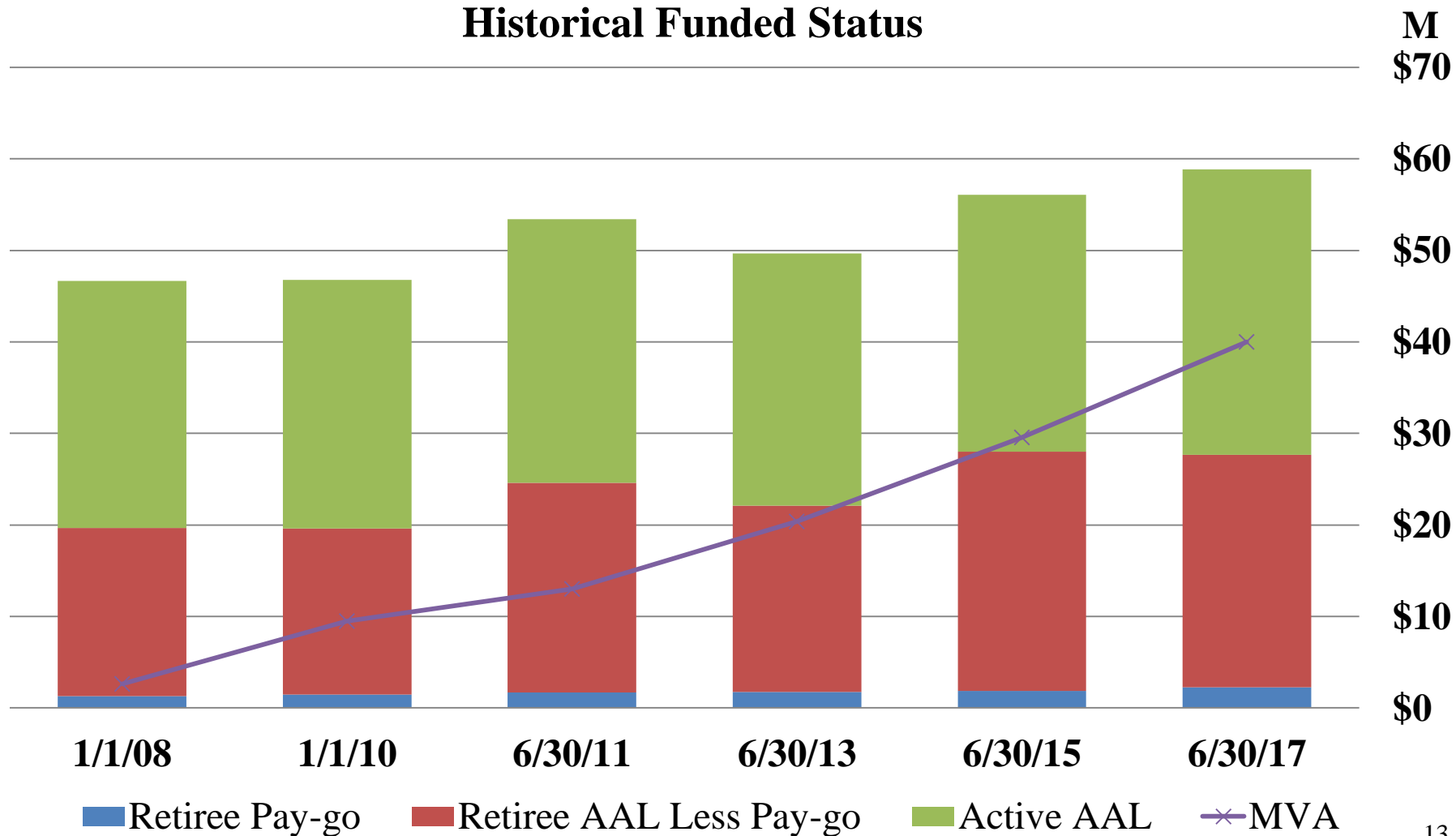
An aerial photograph of a city, likely San Francisco, taken during sunset or sunrise. The city's lights are visible, and the sky is a mix of orange, pink, and blue. The image is partially obscured by a blue gradient bar at the bottom.

MEDICAL RETIREMENT (OPEB)

Other Post Employment Benefits (OPEB)

MEDICAL RETIREMENT (OPEB)

Historical Funded Status





OTHER POST EMPLOYMENT BENEFIT

Current Obligation

- **OPEB Obligation as of June 2017 Valuation:**
 - Obligation: \$59 M
 - Funded: \$40 M (68%)
 - Unfunded: \$19 M (32%)



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NEW AND ENHANCED PROGRAMS

- **Regulation 11, Rule 18**
 - Reduction of Risk from Toxic Emissions at Existing Facilities
- **Assembly Bill 617**
 - Nonvehicular air pollution: criteria air pollutants and TACs

NEW AND ENHANCED PROGRAMS

Resulting General Fund Expenses

Representative values – to be updated with March Draft Budget

- Personnel:
 - 22 new positions approved in FYE 2018
 - 15 anticipated in FYE 2019 (approximate)
 - \$6 M / Year Result
- \$1 M / Year Equipment
- \$1 M / Year Data Analysis



FINANCIAL CHALLENGES AND ACTIONS

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An aerial photograph of a city, likely San Francisco, taken from a high vantage point. The city is densely packed with buildings, and the Golden Gate Bridge is visible in the distance. The sky is a mix of orange, pink, and blue, suggesting a sunset or sunrise. The overall tone is somewhat somber and uncertain, which fits the theme of the slide.

UNCERTAINTY IN STATE FUNDING FOR AB 617

- State Provides \$5M in FYE 2019
- No certainty that funding will recur
- State dependence on Capital Gains taxes



SUMMARY OF CHALLENGES

Representative values – to be updated with March Draft Budget

- Annual Retirement Requirements increase by \$5M / yr
- New and Expanded Programs: \$8M / yr
- State \$5M annual funding may not persist



FINANCIAL CHALLENGES AND ACTIONS

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FEES AND COST RECOVERY - PAST

- Air District can recover 100% of costs through fees
- Cost Recovery was 65% in 2011
- Board adopted policy to reach at least 85%
- Reached 83% in FYE 2017



FEES AND COST RECOVERY - FUTURE

- New and enhanced programs reduce Cost Recovery
- Cost Recovery will drop substantially in FYE 2018
- Three more years needed for 85% Cost Recovery
- Fee increases assumed to average approximately 6%
- Balanced budget assumes annual \$5M from State



FEES: SUMMARY

- The current Cost Recovery policy is sufficient to fund the new and enhanced programs
- If State funding for AB617 does not persist, other actions may be necessary:
 - Vacancies Unfilled
 - Postponed Expenditures
 - Deferred Capital Investment



FINANCIAL CHALLENGES AND ACTIONS

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CALPERS DISCRETIONARY FUNDING

Current Status

- **\$283 M Obligation:** 73% Funded (\$207 M)
- **Funding Policy:** 90% Funding Level (\$255 M)
 - No Target Date
 - FYE 2018 discretionary funding: \$1M



CALPERS DISCRETIONARY FUNDING Recommendation

- **Policy Recommendation:**
 - Establish a 20 Year target to reach 90% funding
 - Use 6.5% discount rate to calculate contribution
 - Achieves 90% funding in FYE 2039
 - Results in FYE 2019 contribution of \$1M



OPEB DISCRETIONARY FUNDING

Current Status

- **\$59 M Obligation:** 68% Funded (\$40 M)
- **Funding Policy:** 90% Funding Level (\$53 M)
 - No Target Date
 - FYE 2018 pre-fund: \$4M

An aerial photograph of a city, likely San Francisco, taken from a high vantage point. The city is densely packed with buildings, and the Golden Gate Bridge is visible in the distance. The sky is a mix of orange, pink, and blue, suggesting a sunset or sunrise. The overall tone is serene and scenic.

OPEB DISCRETIONARY FUNDING Recommendation

- Continue with annual \$4M prefund
- Allows annual \$4M to be reallocated to CalPERS required contributions in approximately 3 years



ALTERNATIVE ASSET ALLOCATIONS

- Allocate portions of the CalPERS and OPEB discretionary funds to alternative investments such as 115 Trusts after the budget cycle.
 - Public Agency Retirement Services (PARS)
 - California Employers' Retiree Benefit Trust (CERBT) Fund
 - Self Directed 115 Trust (allows green investment)