

Operating Cash Sufficiency Outlook

Five-year period January 1, 2015 through December 31, 2019
The Natomas Basin Conservancy

May 19, 2015

CONTENTS:

Introduction
Executive Summary, *p. 3*
Background, *p. 4*
Status, *p. 5*
Conservancy's cash balance and projections, *p. 6*
Discussion, *p. 8*
Conclusion, *p. 8*
Exhibits
Glossary and Abbreviations, p. 9

Introduction

This Operating Cash Sufficiency Outlook report is a brief on the operating cash outlook for the Conservancy as it performs its role as the “Plan Operator” of the Natomas Basin Habitat Conservation Plan (NBHCP). It provides cash flow projections for the Natomas Basin Conservancy (Conservancy). The projections are made considering the impact of the federal government’s de-certification of flood protection levels in the Natomas Basin and the resultant Natomas Levee Improvement Program (NLIP). Also considered is the projected lifting of the building moratorium in the Natomas Basin imposed by local government and federal flood control authorities. Currently, it is expected that the moratorium will be lifted in June of 2015. Except as briefly discussed, the projections do not include consideration of the various endowment funds maintained by the Conservancy.

The NBHCP Finance Model (Finance Model) is used by the Conservancy and is frequently referenced in this briefing paper. It was most recently recalculated by Economic and Planning Systems (EPS) on behalf of the Conservancy. EPS prepared the original Finance Model that is included as part of the NBHCP. The firm has also prepared most of the subsequent annual updates. Its work is done under contract with the Conservancy.

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Operating Cash Sufficiency Outlook

by
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May 19, 2015

Executive Summary. At the close of 2014, The Natomas Basin Conservancy (Conservancy) looked back at a decade and a half serving as Plan Operator for the Natomas Basin Habitat Conservation Plan (NBHCP) and nearly as long for the Metro Air Park Habitat Conservation Plan (MAPHCP).¹ There have been challenges to HCP implementation, but over the past decade, there have been many successes, and the biological results have been gratifying. The Conservancy remains in a good financial position, as the Finance Model has worked well, largely because it is updated each year as required in the NBHCP. New and updated annual financial results have been consistently integrated into the current and future year's Finance Model calculations.

This paper reviews various financial scenarios with the intention of:

- 1.) keeping those in the Conservancy's community well informed about the Conservancy's financial condition,
- 2.) eliciting comments, observations and recommendations from interested parties about the economic conditions impacting the Natomas Basin and the implications these have on the Conservancy, and
- 3.) refining plans for the smooth operations of the Conservancy in light of possible building moratorium elimination and the resulting expected financial activity for the Conservancy.

The following conclusions³ are reached:

- 1.) Key challenge to returning to a normalized NBHCP Finance Model implementation. The NLIP – and an end to the building moratorium in the Natomas Basin – is by far the most important contributor to the Conservancy’s return to conditions anticipated in the 2003 NBHCP and Finance Model. Once levee re-certification is completed, fee payments to the Conservancy can be restored, and the Finance Model can continue to be implemented as originally conceived.
- 2.) Operating cash sufficiency. Given current projected expenditures, which are likely to be partially offset by limited anticipated revenue,⁴ the Conservancy has enough cash to continue operations through at least 2019 in the worst case assumptions considered here. This assumes continued prudent and careful cash management.

Background. The Conservancy acts as Plan Operator for the “parties” to the HCP, including the City of Sacramento, the County of Sutter and Metro Air Park. Other parties to the HCP include the State of California’s Department of Fish and Wildlife and the U.S. Fish and Wildlife Service.

In carrying out its responsibilities under the HCP, the Conservancy has followed the NBHCP Finance Model, a document that is required to be updated each year under the terms of the HCP and the Implementation Agreement (IA). This annual financial re-evaluation and projection exercise takes current year information, includes it in the economic model, and then makes projections about financial sufficiency going forward. It also serves as the basis for the HCP fee that is to be charged.

The Finance Model assumes a relative steady implementation of the HCP over its 50-year life. In actuality, the first several years of the HCP’s implementation were much more active than the original projected steady state (“straight line”) implementation, as fee income and mitigation requirements (income and expenses) came at a rapid pace. This phenomenon was largely attributable to an extremely strong market for real estate in the Natomas Basin and the nation as a whole.

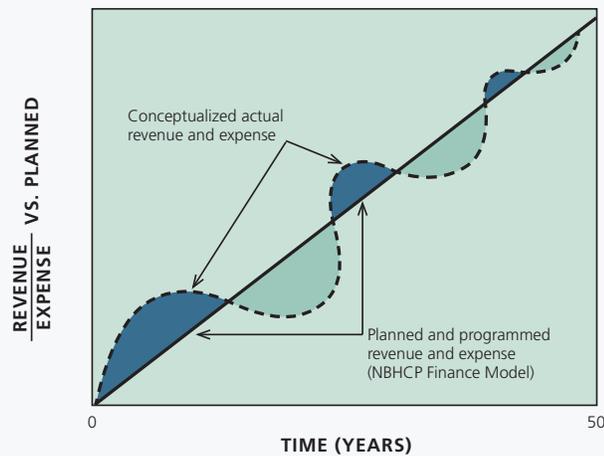
In recent years, however, HCP fee payments have been reduced to near zero. Therefore, the pace of HCP implementation (e.g., HCP fee payments and the resultant demand for mitigation) has dropped markedly. While the Conservancy maintained a positive annual cash flow through 2006, the years since then have resulted in an annual negative cash flow with minor exception. See a conceptualized illustration of how the 50-year life of the HCP has been modeled against theoretical implementation activity in HCP fee payments (Figure 1, “Conceptualized Illustration To Show Actual Revenue & Expense Versus Planned Revenue & Expense in the NBHCP Finance Model”).

³ This assessment does not consider the endowment funds that are an integral part of the HCP. At December 31, 2014, the account balance in the Conservancy’s Endowment Fund was \$16,326,913 and the balance in the Supplemental Endowment Fund was \$2,686,889.

⁴ Anticipated revenue is expected to largely include farm income and minimal supplemental income related to habitat mitigation in the Natomas Basin.

Figure 1

**CONCEPTUALIZED ILLUSTRATION
TO SHOW ACTUAL REVENUE & EXPENSE
VERSUS
PLANNED REVENUE & EXPENSE
IN THE NBHCP FINANCE MODEL**



Question

Did TNBC reserve sufficient revenue during positive cash flow years...

Legend

revenue exceeds expense

...to provide adequate funds to carry the organization through a period when revenue was insufficient to fully fund annual operations?

expense exceeds revenue

In an average year, including a year when there is no restoration and enhancement construction, no land acquisitions and no channel clearing,⁵ it costs approximately \$3 million to operate the Conservancy. The largest fixed expenses are the cost of water and related fees and charges, biological monitoring and property taxes.

Status. At December 31, 2014, the Conservancy finds itself with a cash balance of approximately \$10,184,289 (not including endowment or SAFCA funds). This contrasts with an average annual cash needs amount of approximately \$3 million. Offsetting the draw down of cash is the revenue the Conservancy receives from farm income. This usually totals approximately \$550,000 depending on cash prices for farm commodities and agronomic conditions. Other miscellaneous income is received which also helps offset the draw down of cash. Normally, this would include interest and dividend income on cash balances. However, with interest rates at low levels, such income is small.

⁵ These are typically the most expensive periodic costs that substantially alter annual Conservancy budgets.

Action taken to address the need to conserve cash includes:

- 1.) numerous management decisions have been made which reduce discretionary costs,
- 2.) the Conservancy maintains a small staff given the overall size of its operations and obligations,
- 3.) the last major channel maintenance in the marsh complexes has been completed,
- 4.) opportunities to sell surplus mitigation are sought, provided they meet with the Board of Directors' criteria,
- 5.) supplemental mitigation and related work for the NLIP project have been entered into, and
- 6.) substantial savings have been realized from groundwater exchange agreements.

Conservancy's cash balance and projections. This discussion presents the Conservancy's current and projected cash flow balances. Several illustrations follow which project the cash reserves of the Conservancy under various scenarios. The key condition assumed in the scenarios is the completion of the aforementioned NLIP.

Clearly, the most positive scenario for the Conservancy's economic stability is the earliest levee certification brought about by the re-designation of flood risk in the Natomas Basin. If the A99 flood designation is achieved by June 15, 2015, then HCP fee payments can resume in 2015. This would be the most optimistic scenario (see Figure 2 below).

Figure 2

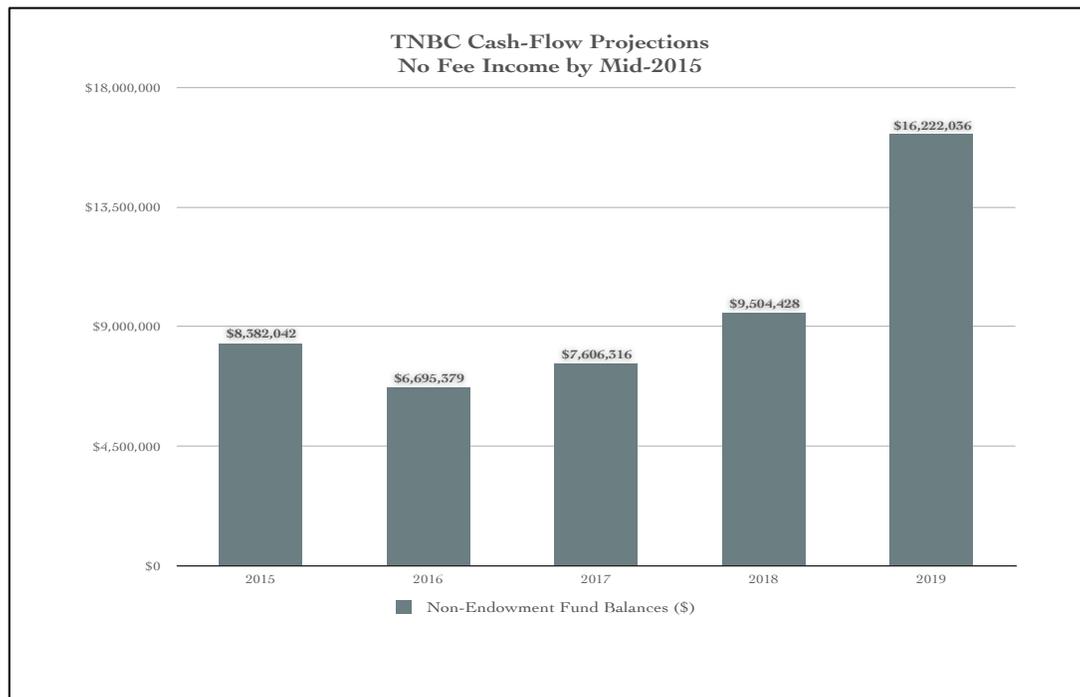


Figure 3 (below) presents the middle scenario, and Figure 4 (below) presents a more pessimistic scenario. It shows that Natomas levee certification is achieved by December 31, 2017, and reveals the projected amount of operating cash the Conservancy has on-hand at that

time. Finally, Figure 5 (below) shows the worst-case scenario, revealing that the Conservancy runs out of operating cash by December 31, 2019. The illustrations do not take into account unforeseen expenses or income not otherwise already factored into the Finance Model by the HCP and IA.

Figure 3

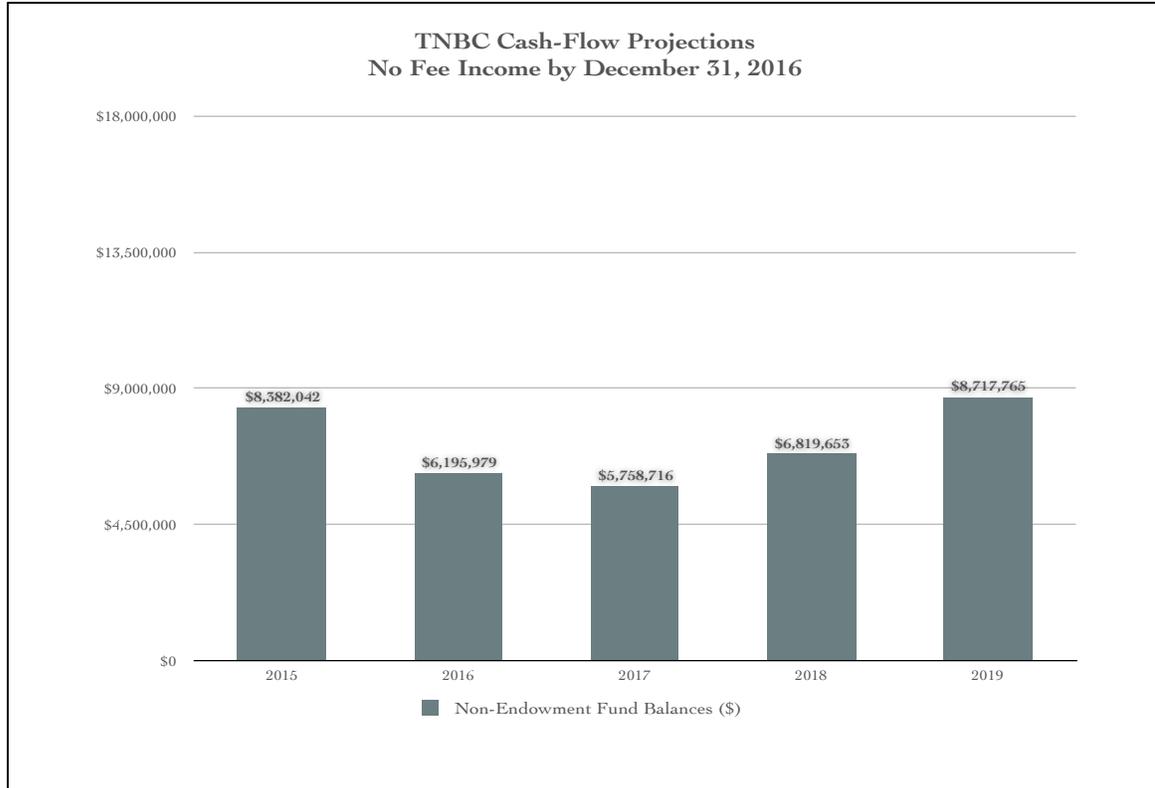


Figure 4

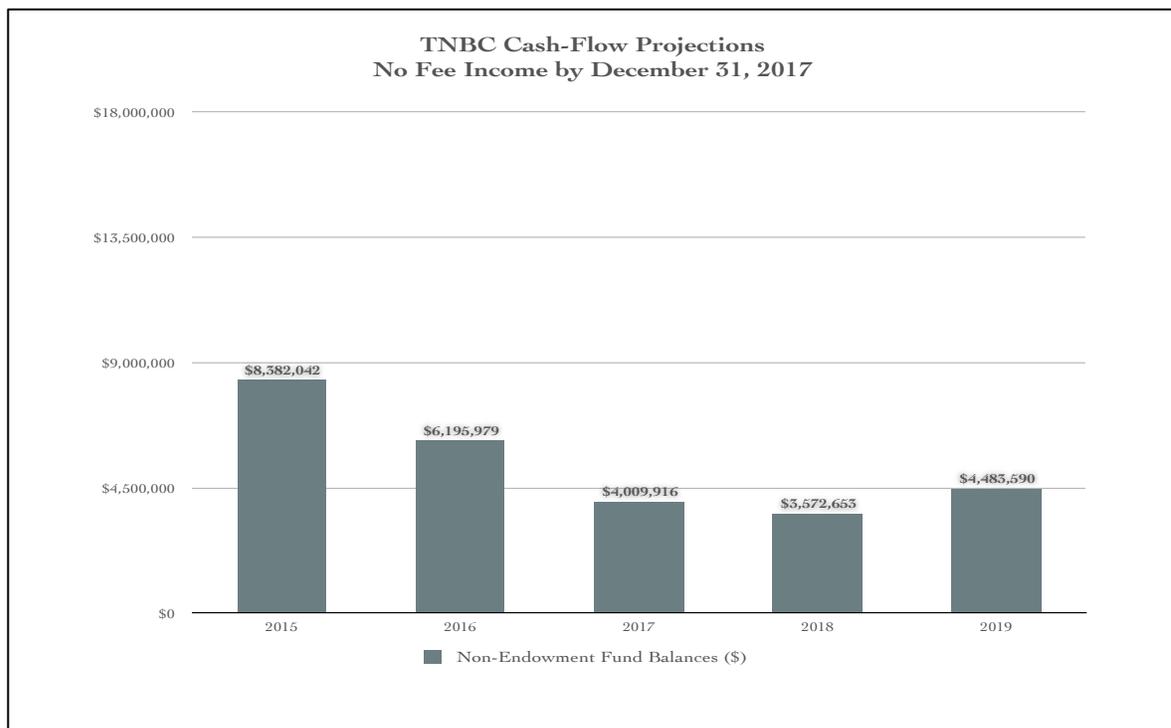
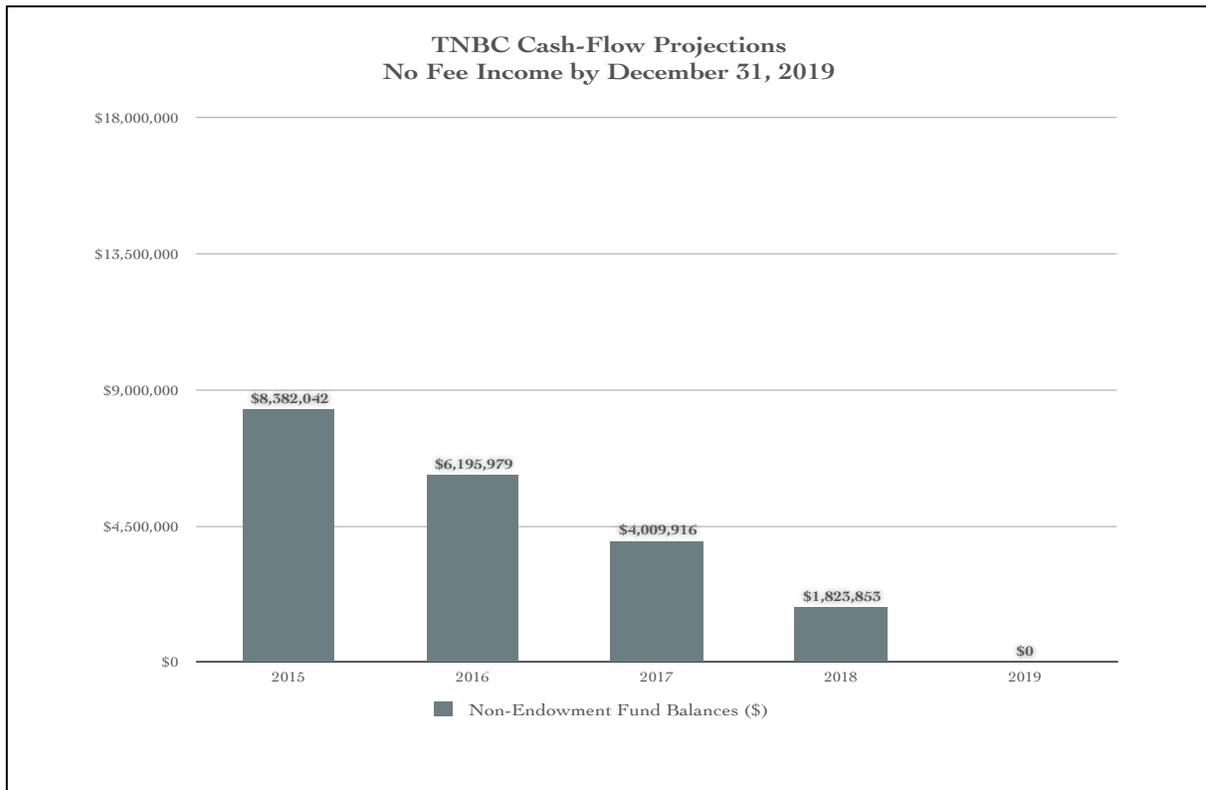
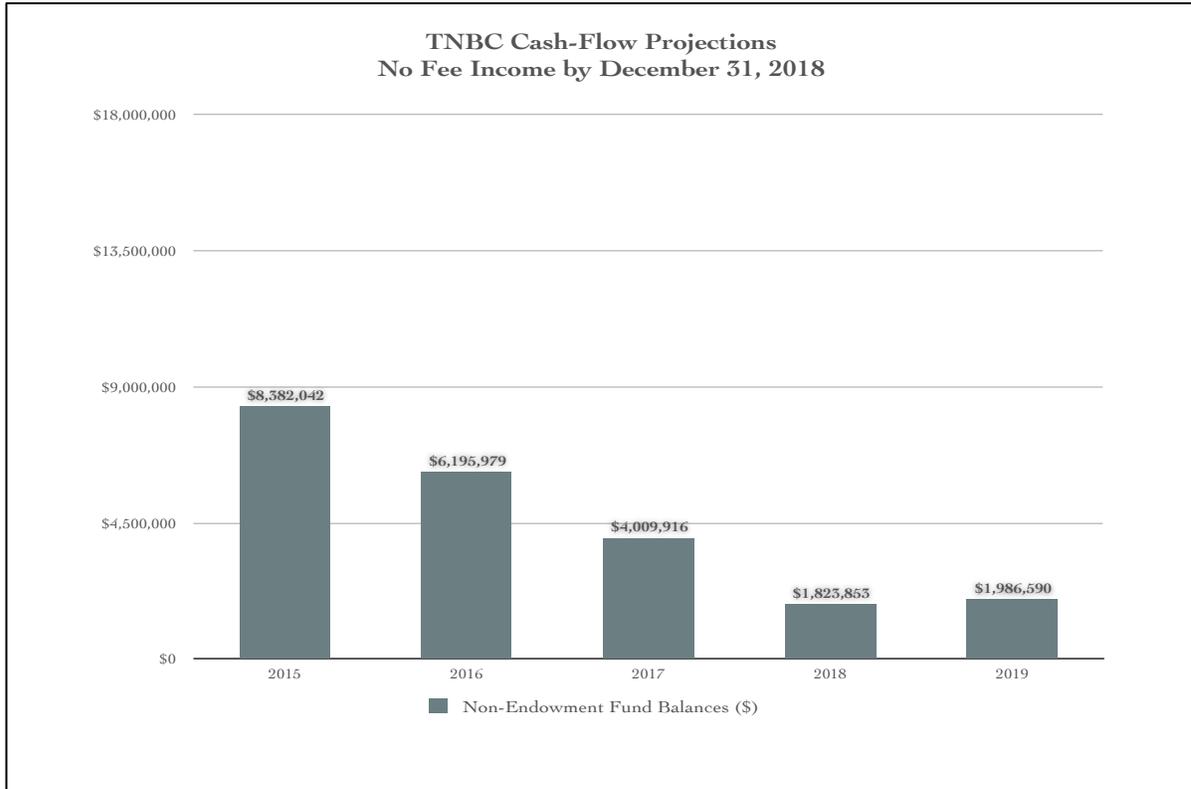


Figure 5



Discussion. Projecting Conservancy cash reserves at future year-ends is subject to numerous variables. At present, the key is to adjust and adapt to the hiatus in the demand for mitigation caused by the federal decertification of flood protection levees that surround the Natomas Basin⁶ by FEMA. Also to be considered is the impact of the economy, which also impacts the demand for mitigation in the Natomas Basin.

There is a high degree of confidence that if the fee payments could be restored at even modest levels in the near term, the Finance Model's ability to continue to guide long-term outlook, and successfully guide financial and economic sufficiency to the Conservancy, will be realized. In the meantime, the Conservancy will continue to look for cost reduction opportunities, particularly those that will not compromise the implementation of the HCP. So far, HCP implementation has continued, and the biological performance of the preserves has been excellent. There is no reason to believe that this will change given continued adequate financial resources.

Conclusion. This paper's intention is to inform interested parties regarding the Conservancy's operating cash position on a contemporaneous and going-forward basis. It also seeks to inform those who may offer creative ideas on how to refine cash management practices in light of the flood protection levee certification issues confronting the Natomas Basin and the current recession in the real estate market. The goal is to conserve available cash until the Natomas Basin's flood protection levee re-certification can be achieved and HCP fee payments continue. Conservancy staff believes that while worst-case scenario planning is important management and planning exercise, the most likely scenario is that shown in either Figure 2 or Figure 3 in this report. Conservancy staff's operational worst case scenario is that illustrated in Figure 4 of this report. In either case (Figure 2, 3 and 4), the Conservancy's cash flow projection is positive.

It is important to remember that this paper covers cash balances only. The Conservancy's Endowment Fund and Supplemental Endowment Fund are not considered here. At December 31, 2014, balances in these two accounts were \$16.3 million and \$2.7 million respectively.

⁶ This event was not among the "unforeseen circumstances" listed in the 2003 NBHCP. See NBHCP page VI-38+ for a discussion of this issue. Funding deficiency does not constitute a changed circumstance.

Glossary and Abbreviations

CDFW	California Department of Fish and Wildlife.
Conservancy	The Natomas Basin Conservancy. A California non-profit public benefit corporation serving as “plan operator” of the Natomas Basin Habitat Conservation Plan. (See: The Natomas Basin Conservancy below.)
EPS	Economic and Planning Systems. This is the consulting economist used to recalculate the NBHCP Finance Model.
HCP	Habitat Conservation Plan(s). See NBHCP and MAPHCP below.
Finance Model	The NBHCP Finance Model. A pro forma financial model that analyzes the projected revenues and expenditures of the Conservancy dependent on a forecast of development of the Natomas Basin and the corresponding habitat mitigation required. Based on various assumptions, the financial model calculates the Mitigation Fee that would be required of new development.
MAPHCP	Metro Air Park Habitat Conservation Plan (MAPHCP). This term refers to final approved Habitat Conservation Plan for the Metro Air Park Project located in the unincorporated portion of the Natomas Basin within Sacramento County, specifically, “Habitat Conservation Plan for the Metro Air Park Project in the Natomas Basin, Sacramento County, California, Prepared by Metro Air Park Property Owner’s Association, Dated 2001.”
Mitigation Fees	As defined in Chapter VI, the term “Mitigation Fees” means the one time, up-front fees levied upon an Authorized Development site (in gross acres) that is used to pay for the Mitigation land acquisition, enhancement, management, monitoring, and other activities required under the NBHCP. The Mitigation Fees must be paid prior to the issuance of an Urban Development Permit by the Land Use Permittee. The components of the Mitigation Fee include: Land Acquisition, Restoration & Enhancement, Administration O&M, O&M Endowment Fund, Supplemental Endowment Fund, and Fee Collection Administration as defined in Chapter VI.
Mitigation Lands	The term “Mitigation Lands” means the reserve lands acquired through collection and use of Mitigation Fees from Authorized Development, and in some cases land which has been accepted for dedication from Authorized Development, which will be set aside and managed at a ratio of one-half (½) acre of land protected or preserved for every one (1) acre of land converted to Authorized Development. The NBHCP Operating Conservation Program will result in 8,750 acres of Mitigation Lands to be established and managed by TNBC.
Plan Operator	The term “Plan Operator” means The Natomas Basin Conservancy, the entity responsible for implementing the NBHCP.
Plan Participants	The term “Plan Participants” means parties actively involved in implementing the NBHCP, including the Wildlife Agencies (USFWS and CDFW), the Permittees (City of Sacramento, Sutter County, Natomas Central Mutual Water Company and RD 1000), and the Plan Operator (TNBC).
The Natomas Basin Conservancy	The terms “The Natomas Basin Conservancy,” “the Conservancy” or “TNBC” shall mean the independent entity established for the purpose of implementing the Natomas Basin Habitat Conservation Plan on behalf of the City of Sacramento, Sutter County and other Potential Permittees. The TNBC is also a Permittee for purposes of implementation of the reserve system.
Unforeseen Circumstances	The term “Unforeseen circumstances” is defined at 50 C.F.R. 17.3 as changes in circumstances affecting a species or geographic area covered by a conservation plan that could not reasonably have been anticipated by plan developers and the USFWS at the time of the NBHCP’s negotiation and development, and that result in a substantial and adverse change in the status of the Covered Species. Unforeseen circumstances are discussed in Chapter VI, Section K of the NBHCP.
NBHCP	Natomas Basin Habitat Conservation Plan. The NBHCP applies to the 53,341-acre interior of the Natomas Basin, located in the northern portion of Sacramento County and the southern portion

of Sutter County. The Basin contains incorporated and unincorporated areas within the jurisdiction of the City of Sacramento, Sacramento County and Sutter County. The purpose of the NBHCP is to promote biological conservation along with economic development and the continuation of agriculture within the Natomas Basin. The NBHCP establishes a multi-species conservation program to mitigate the expected loss of habitat values and incidental take of protected species that would result from urban development, operation of irrigation and drainage systems, and rice farming. The goal of the NBHCP is to preserve, restore, and enhance habitat values found in the Natomas Basin while allowing urban development to proceed according to local land use plans. The NBHCP is a supporting document for federal Section 10(a)(1)(B) and State Section 2081 permit applications. Section 10(a)(1)(B) of the federal Endangered Species Act allows incidental take of endangered or threatened species subject to its permit requirements. Similarly, State Section 2081 of the California Fish and Game Code allows the California Department of Fish and Wildlife to enter into management agreements that allows activities which may otherwise result in habitat loss or take of individuals of a state listed species.

NLIP

Natomas Levee Improvement Program. An effort by the Sacramento Area Flood Control Agency to secure 100-year and then 200-year flood protection for the Natomas Basin. Until such time as benchmarks are reached in the progress of this project, there is a prohibition against issuing building permits for most structures in the Natomas Basin.

USFWS

United States Fish and Wildlife Service.