

Operating Cash Sufficiency Outlook

Five-year period January 1, 2023 through December 31, 2027
The Natomas Basin Conservancy

October 5, 2022

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This report is a brief on the financial outlook for the Natomas Basin Conservancy (Conservancy) as it performs its role as the “Plan Operator” of the Natomas Basin Habitat Conservation Plan (NBHCP). It provides a financial projection for the Conservancy. Except as briefly discussed, the projections do not include the influence of the endowment funds maintained by the Conservancy.

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

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by
The Natomas Basin Conservancy
October 5, 2022

Introduction. This purpose of this paper is to discuss the Conservancy's cash flow situation going forward. It provides a discussion of the Conservancy's current cash sufficiency, and then makes various assumptions that both positively and negatively impact cash resources necessary to carry out the Conservancy's program of work. It is, above all, a discussion piece used for long-range financial planning.

More specifically, its intention is to:

- 1.) keep those on the Conservancy's Board of Directors informed about the organization's operating cash availability,
- 2.) elicit comments, observations and recommendations about the economic conditions impacting the Natomas Basin and the implications these have on operating capital needed by the Conservancy, and
- 3.) refine plans for operating the Conservancy for it to successfully carrying out its mission.

Executive Summary. The Conservancy has served as Plan Operator for the Natomas Basin Habitat Conservation Plan (NBHCP) for over 20 years 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 two decades, there have been many successes. The Conservancy remains in a good financial position, as the NBHCP Finance Model has worked well, largely because it is required to be updated each year with new and current financial results integrated into current and future year's calculations.

In the current and likely next few years at least, there is one key challenge, which is the potential for an economic downturn. This, if realized, will undoubtedly have an impact on the Conservancy's financials.

The following conclusions are reached:

- 1.) The NBHCP Finance Model and NBHCP implementation have worked well during both booms and busts in various economic cycles. The NBHCP Finance Model has proven itself to be a reliable economic planning tool in addition to its other functions. Staff believes it can continue to be relied upon to assist in financial and economic planning.
- 2.) The key components to restoring the Conservancy's positive financial outlook lies in two areas. The restoration of mitigation fee payments and the investment performance of the Conservancy's endowment

¹ Collectively, for the purposes of this paper, the two HCPs are simply referred to as the HCP or HCPs.

funds are seen as the key drivers to economic well-being. Other sources of revenue such as groundwater exchange program participation, non-HCP mitigation, and farm revenue are secondary sources of income in terms of impact and ability to make a significant difference in the Conservancy’s long-range financial outlook.

3.) Operating cash sufficiency is a Conservancy priority. Given current projected expenditures, the Conservancy has enough cash to continue operations well beyond December 31, 2027. This assumes continued prudent and careful cash management, and no significant additional HCP fee payments.

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 by the terms of the HCP and the Implementation Agreement (IA) to be updated each year. This annual financial projection exercise takes current information, includes it in the economic model, and then makes projections about financial sufficiency going forward.

The NBHCP Finance Model assumes a relative steady implementation of the HCP over its 50-year life. In actuality, the first several years of the HCPs’ 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 a strong market for real estate in the Natomas Basin and the nation as a whole.

Following that start-up period, HCP fee payments were reduced to significantly lower levels. Therefore, the pace of HCP implementation (e.g., HCP fee payment and the resultant demand for mitigation) dropped. While the Conservancy maintained a positive annual cash flow through 2006, the years between then and 2016 often resulted in an annual negative cash flow. However, the Conservancy began seeing an uptick in mitigation starting in 2016 and has slowly increased into 2022.

See a conceptualized illustration of how the 50-year life of the HCP has been modeled against theoretical implementation activity in HCP fee payments (see Figure 1, “Conceptualized Illustration to Show Actual Revenue & Expense Versus Planned Revenue & Expense in the NBHCP Finance Model”).

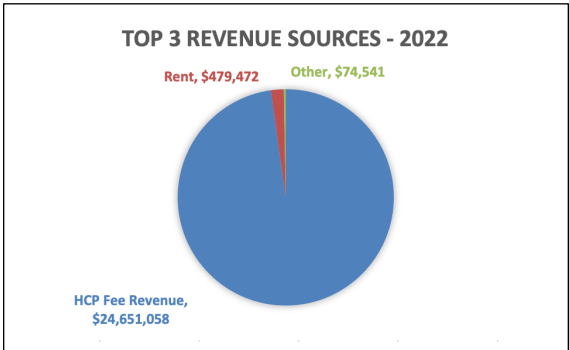
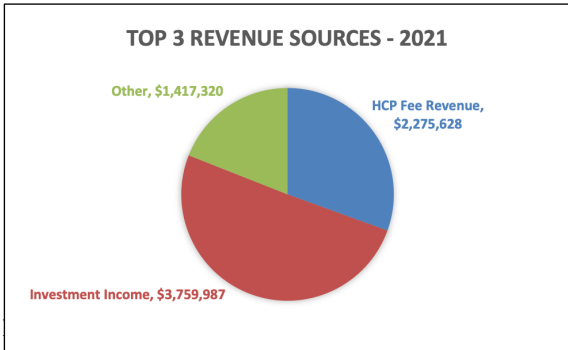
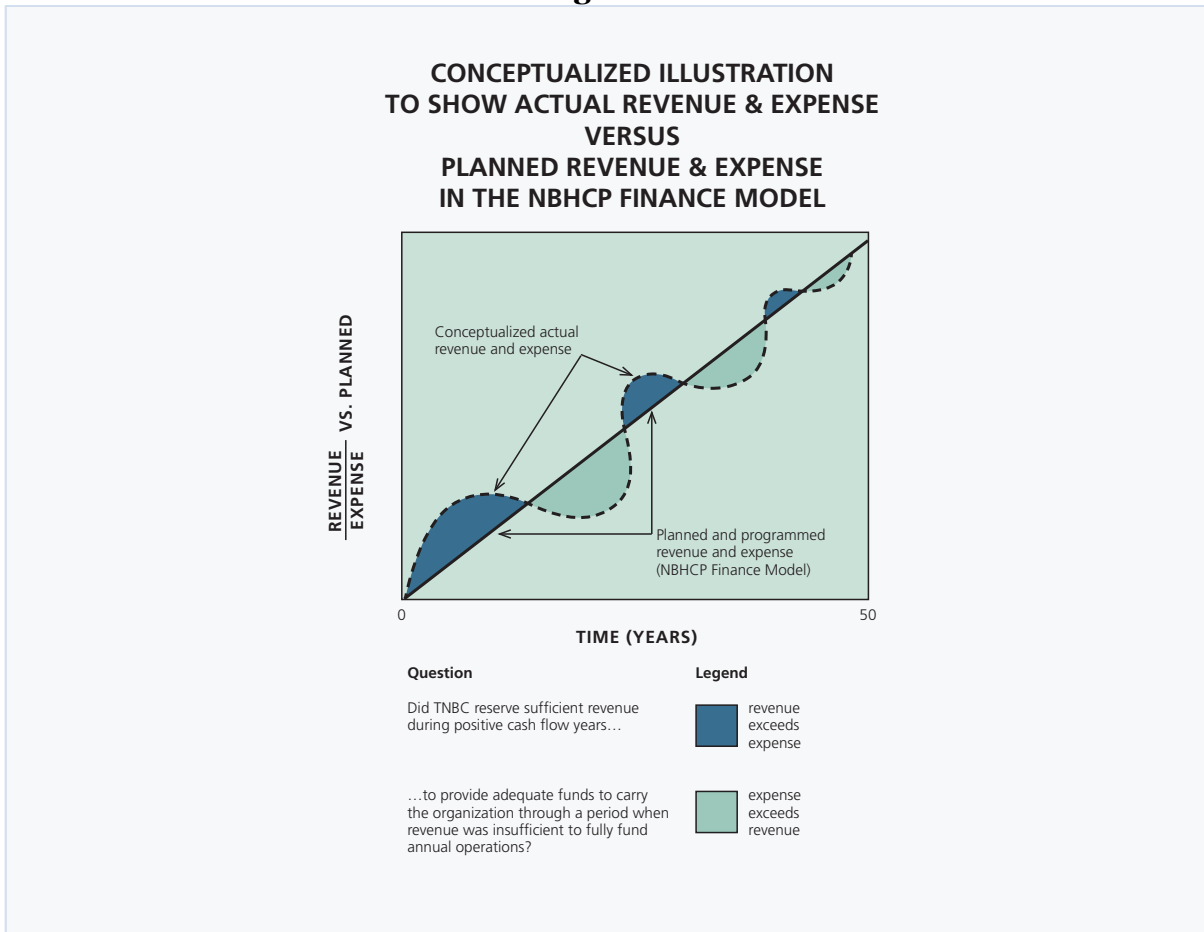


Figure 1



In an average year, it costs approximately \$3.5 million to operate the Conservancy, especially a year when there is no restoration and enhancement construction, no land acquisitions and no managed marsh channel clearings.² Year in and year out, the largest fixed expenses are, 1) the cost of water and related fees and charges, 2) biological monitoring, 3) habitat land management, and 4) property taxes.

Status. At September 26, 2022, the Conservancy found itself with an operating cash balance of approximately \$18,500,000 (not including endowment funds or SAFCA project funds). This contrasts with an average annual cash needs amount of approximately \$3.5 million. Offsetting the drawdown of cash is the revenue the Conservancy receives from investment income, fee income, occasional participation in groundwater exchange programs and farm income. The amount derived from these revenue sources is highly variable and often unreliable (e.g., the groundwater exchange program largely requires water shortages, especially in south-of-Delta areas).

Action taken to date to address the need to conserve cash includes:

² These are typically the most expensive periodic costs that substantially alter annual Conservancy budgets.

- 1.) numerous management decisions have been made which reduce discretionary costs,
- 2.) the Conservancy maintains a very small staff given its size of operations and obligations; where appropriate, contractors are engaged to fill needs that staff might otherwise fulfill,
- 3.) channel maintenance in the marsh complexes has been deferred (e.g., conducted in smaller segments over time),
- 4.) opportunities to sell surplus mitigation have been taken (this also lowers “carrying costs”), and
- 5.) supplemental mitigation and related work for the NLIP project have been entered into, as has participation in groundwater exchange programs.

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. Figure 2 (below) presents a side-by-side of the 2020 version of this exercise along with the 2023 version. Three scenarios are presented. The first scenario assumes the HCP Finance Model numbers or a best-case scenario, showing mitigation fees being received at a steady rate over time.

The second scenario is what we call a middle scenario. It shows impacts of three consecutive years *without mitigation revenue* and reveals the projected amount of operating cash the Conservancy would have on hand on that date.

Finally, the last is a worst-case scenario with five consecutive years *without mitigation revenue*, revealing that the Conservancy has sufficient operating cash balances well beyond December 31, 2027. The illustrations do not take into account any other possible unforeseen expenses or income not otherwise already factored into the HCP Finance Model by the HCP and IA. This scenario was requested by a previous Board of Directors and became known as “the worst case” scenario.

Discussion. Projecting Conservancy cash reserves at future year-ends is subject to numerous variables. The key is to adjust and adapt to years in which the demand for mitigation is absent or low. There is a high degree of confidence that if HCP fee payments are restored at modest levels, maintaining good cash flow sufficiency will be realized. The Conservancy will continue to look for cost reduction opportunities that minimize demands on cash, particularly those that will not compromise the implementation of the HCP.

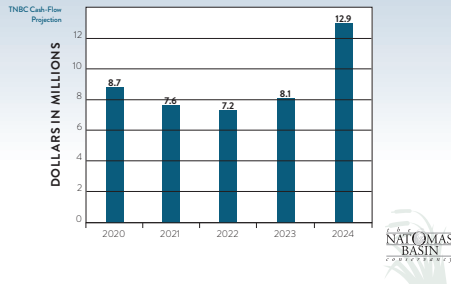
Essential to the Conservancy having sufficient financial resources to effectively implement the HCPs is having HCP fee revenue. Central to that is the ability of either fee payers or the Conservancy (or both) having access to acquirable and approvable mitigation land. At present, there is concern that an inadequate supply of mitigation land will constrain HCP fee payments, and thus revenue for operations. That has significant implications for this discussion, as well as these illustrations. It also has the potential to severely impact the Conservancy’s ability to function, at least at the level envisioned in the HCPs.

Conclusion. The intention of this paper is to inform and to seek creative ideas that could help refine cash management and cash sufficiency. In the worst-case scenario modeled in this paper, the Conservancy will be able to get through the year 2027 and beyond without calling on its endowment funds for operating cash.

2020 Projections

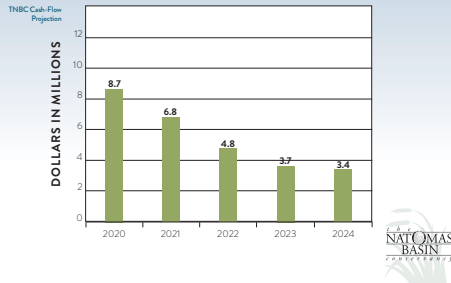
Operating Cash Balances

Hypothetical #1 – Current NBHCP Model Projections



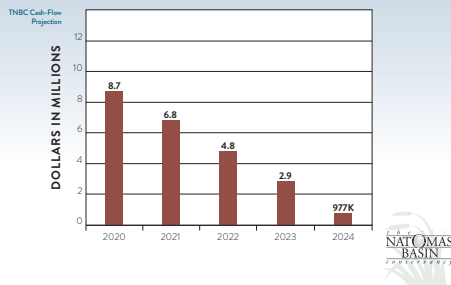
Operating Cash Balances

Hypothetical #2 – No Mitigation Fees Until 2023



Operating Cash Balances

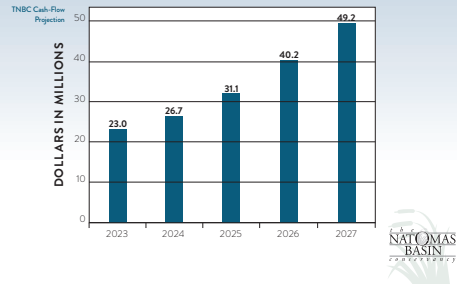
Hypothetical #3 – No Mitigation Fees Until 2025



2023 Projections

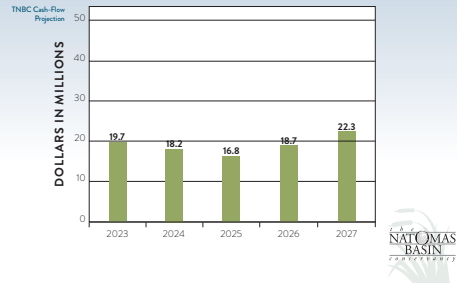
Operating Cash Balances

Hypothetical #1 – Current NBHCP Model Projections



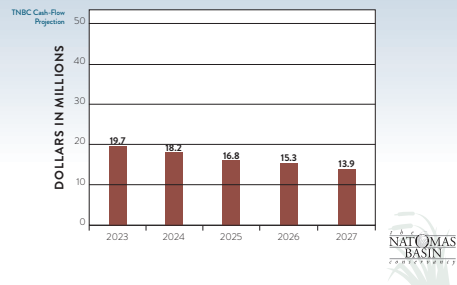
Operating Cash Balances

Hypothetical #2 – No Mitigation Fees Until 2025



Operating Cash Balances

Hypothetical #3 – No Mitigation Fees Until 2027



TNBC Bar Charts for Cash Balance.v5.comparison.October2022

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.
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 expenses 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.
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 Endangered Species Act (ESA) Section 10(a)(1)(B) and California Fish and Game Code Section 2081 permit applications. Section 10(a)(1)(B) of the federal ESA allows incidental take of endangered or threatened species subject to its permit requirements. Similarly, state Section 2081 allows the California Department of Fish and Wildlife to enter 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.
SAFCA	Sacramento Area Flood Control Agency.
USFWS	United States Fish and Wildlife Service.