

CARMICHAEL WATER DISTRICT

Directors' Policy Manual

POLICY TITLE: Reserve Policy

POLICY NUMBER: 9610

9610.10 The key to long-term financial stability is the ability to anticipate and prepare for significant financial obligations, to avoid and/or mitigate financial risk and to be able to respond responsibly and proactively to changing conditions and circumstances.

9610.11 To achieve these goals, a portion of the Carmichael Water District's (District) net position, available resources, should be held in reserve for specified purposes. The District has certain contractual, legal and other requirements to reserve a portion of its available resources and/or District capital, including debt covenants to satisfy specific claims on District assets or the District's earning capability. Managing financial risk and providing stable funding to meet the District's long-term replacement and rehabilitation needs will assist the District in minimizing extra ordinary water rates adjustments over the long-term and help ensure continued reliable water service.

9610.12 This policy establishes reserves to minimize adverse annual impacts from anticipated and unanticipated District expenses to mitigate and minimize risk and provide a mechanism to help ensure funding for long-term capital improvement needs.

9610.20 The Reserve Structure

9610.21 Unrestricted Reserves: General Operating Fund – The General Operating Fund is the primary fund within the District. Most of the water system's revenues, including water rate revenues, flow into the General Operating Fund; all operating and maintenance costs, including debt service payments, are paid out of this fund. Funds are also transferred from the General Operating Fund to the Capital Fund to help pay for capital projects intended for new and replacement facilities.

9610.22 Board Designated Reserves: Capital Funds – Established by action of the Board of Directors (Board) and designated for specific purposes. This fund is utilized to fund capital and asset costs, for both new and replacement projects.

9610.23 Legally Restricted Reserves: Restricted Funds – Restrictions on the use of these funds are imposed by an outside source such as creditors, grantors, contributors, laws, or regulations governing use.

9610.30 Policy

9610.31 Unrestricted Reserves: General Operating Fund – The following reserve is established consistent with the 2015 Business Plan, to be included within the District's overall General Operating Fund.

9610.312 Operating Reserve: The purpose of the Operating Reserve is to provide sufficient funds for working capital and cash flow purposes, as well as funds for continued operation in the event of unplanned operating and maintenance expenditures. The District should maintain water rates and other revenues at such levels to maintain, at the end of each fiscal year, a minimum Operating Reserve balance equal to 50 percent of budgeted operating and maintenance costs, including debt service. This end-of-year balance is intended to ensure adequate working capital is available at the times that debt service payments are due, as well as to meet other ongoing cash flow needs throughout the year.

9610.313 This fund contains all operating and non-operating revenues not specifically allocable to other funds which may be used for the general purposes of the District. All operating and non-operating expenses identified and approved in the budget process, are financed from this fund. The use of the Operating Reserve is at staff's discretion for the purpose of meeting the District's financial obligations during each year.

9610.314 The Board should annually ensure that water rates and other charges are sufficient to meet or exceed the Operating Reserve target minimum balance at the end of each fiscal year.

9610.315 If at any time, during the course of normal operations, the Operating Reserve balance falls below 10 percent of budgeted operating and maintenance costs, including debt service, then the District should consider increasing the minimum year-end target amount, as well as prepare cash flow projections to verify that financial obligations will be met in the current year.

9610.32 Board Designated Reserves

9610.321 Capital Fund Reserves: The following reserves are established by action of the Board and designated for specific purposes. These funds are utilized to fund capital and asset costs, for both new and replacement projects consistent with the 2020 Business Plan. The Capital Fund Reserves contain three reserve components.

a. Membrane Replacement Reserve: This is established to provide funds for the periodic replacement of membrane filters at the District's water treatment plant (WTP). Annual funding of this reserve is intended to reduce the financial impacts of large (concentrated) membrane purchases, and smooth rate increases. Moneys in the Membrane Replacement Reserve should be used, at staff's discretion, only for purchase of new membrane filters at the District's WTP. The District will accumulate funds into this reserve balance at the rate of \$200,000 per annum.

b. Filter Skid System and Ranney Collector Replacement Reserve: This reserve is established to meet the needs of future replacement of 1) entire filtration process including all the skids with filter modules, support structures, and associated appurtenances, collectively the "filter" and 2). The Ranney Collectors (Collectors Numbers 1, 2, and 3). Annual funding of this reserve is intended to reduce the burden for future financing and smooth upward rate adjustments. Annual funding will continue until the funding and the reserve fund are abolished by the Board. Interest income earned on the accumulated funds will be allocated and contributed to the reserve fund.

Funds in the Filter Skid Replacement Reserve shall be used upon Board approval for implementation at staff's discretion, including but not limited to design, construction and purchase, of new filters at the District's WTP. The District will accumulate funds into this reserve

balance at the rate of \$650,000 per annum through 2035 or until the completion of the Filter Skid Replacement Project whichever comes first.

Funds in the Ranney Collector Reserve shall be used, upon Board approval, for the design and construction and/or rehabilitation of the Ranney Collectors. The District will accumulate funds into this reserve at the rate of \$500,000 per annum.

c. Capital Replacement Reserve: This is established to provide funds in support of the District's on-going capital replacement program and to minimize or avoid the need for future long-term debt. This reserve balance is also intended to provide resources for eventual replacement of equipment, facilities, and infrastructure within the District.

- The District should seek to maintain an amount in the Capital Replacement Reserve sufficient to cover annual capital replacement program costs, as scheduled, with consideration of annual contributions to the reserve. Funds in the Capital Replacement Reserves should be used exclusively for capital projects planned and approved by the Board.
- The District should establish an annual transfer of funds from the General Operating Fund at a level sufficient to achieve the required target amount as identified in long-term financial planning analyses.
- Actual annual transfers should be determined based on near-term and long-term capital replacement needs, and not solely on immediate capital improvement project requirements.

d. Capital Facility Fees Reserve: The District collects capital facility fees from new development for capacity in the water system. This money is available to pay for capital facilities/expenditures that expand facilities in water system or otherwise extend the useful life of the existing facilities or assets. Water capital facilities fee revenue can be combined with the Capital Replacement Reserve and used for capital projects, provided it is only spent on projects as explained above. The District staff will estimate, on a yearly basis, amount to be reserved in this reserve balance which will be based on the budgeted facility fees revenue.

e. Sacramento County (County) Impact Projects: This is established to provide funds for Sacramento County accelerated District requirements. County improvements require any permitted public utility to relocate its encroachment at the utility's expense within the time specified per Section 1463 of the Streets and Highways Code.

- When County funding comes available, the County projects are ready to go out to bid with little or no notice to the community and utilities. The County may receive accelerated federal grant funding money that may move certain projects ahead of their projected and/or scheduled dates. The District has established an annual budget for District required work for County Projects in its annual Capital Budget.
- The District should establish an annual transfer of funds from the General Operating Fund at a level sufficient to achieve the required target amount as identified in long-term financial planning analyses.
- Actual annual transfers will be determined by the staff for Board Approval based on both near-term and long-term County projects.

f. California Pension Retirement System (CalPERS) Unfunded Actuarial Liability (UAL) Pay-Down Reserve: The District recognizes its commitments to employees for retirement benefits and establishes a CalPERS UAL Pay-Down Reserve. The District will annually fund the reserve to pay-down pension amortization bases within the CalPERS until the unfunded liability is fully funded.

9610.33 Legally Restricted Reserves

9610.331 Debt-Related Funds and Reserves: The District recognizes that borrowing long-term funds for the purpose of enhancing, improving or acquiring infrastructure and facilities may be necessary. When the District determines that borrowing is necessary to fund such asset acquisitions, all funds borrowed should be accounted for in accordance with the covenants, terms and conditions as set forth in the bond agreement, Certificate of Participation Official Statement (COP's), Installment Sales Agreement or other similar documents. The following District reserve and fund categories are established to meet long-term debt covenants and to assist the District in its long-term debt obligations:

a. Rate Stabilization Reserve Fund: A Rate Stabilization Reserve Fund was established and should be maintained at a level of \$500,000 to provide funds for meeting the District's debt service coverage requirement. The District may deposit surplus Net Revenues transferred from the General Operating Fund attributable to a fiscal year, or moneys derived from any other legally available source, into the Rate Stabilization Reserve Fund. The District may, at any time, withdraw moneys from the Rate Stabilization Reserve Fund and deposit such amounts into the General Operating Fund. For purposes of debt service coverage, amount established as the Rate Stabilization Reserve Fund shall be deducted from Net Revenues and moneys withdrawn from the Rate Stabilization Reserve Fund shall be added to Net Revenues.

- Use of the Rate Stabilization Reserve Fund may concurrently ensure financial and customer rate stability in responding to conditions including but not limited to:
 - Unforeseen operating and/or capital expenditures.
 - Revenue losses due to water shortages, drought or other conditions.
 - Natural or man-made disasters.
 - Major transmission or distribution main failures.
- The District's Business Plan includes a water shortage financial analysis and recommends a multi-prong financial strategy, which includes using a portion of money available in the Rate Stabilization Reserve Fund to help mitigate the financial impacts of a water shortage and reduced water sales that create an unplanned financial deficit.
- As described in the District's Business Plan, under water shortage conditions with mandatory water use restrictions, the Rate Stabilization Reserve Fund could be used in conjunction with water shortage rate surcharges. Conditions for utilization of such reserves and a plan for fund replenishment will be directed by the Board in conjunction with the budget approval.

b. Debt Service Reserve Fund: A Debt Service Reserve Fund has been established and is used to maintain the Reserve Requirement, as required by bond related documents. A Debt Service Reserve Fund is held and maintained by a Trustee for the District. Funding and usage of the Debt Service Reserve Fund must be consistent with debt covenants.

9610.332 OPEB Reserve Trust Account: The District recognizes its commitments to employees for post-employment benefits and establishes an OPEB Reserve Trust Account, (held by an outside trustee). The District will annually fund the Trust Account until the unfunded liability is fully funded.

9610.40 **Conclusion**

The District's Business Plan outlines the necessary reserves' targets needed to meet current and future obligations. Maintaining, regularly updating, and adhering to an appropriately constructed reserve policy is a good business practice recognized by the Government Finance Officers Association, and is among the factors considered by the credit rating and investment community when assessing the credit-worthiness of the District. Therefore, the adequacy of the target reserves and/or annual contributions will be reviewed annually during the budgeting and rate setting process and may be revised as necessary.

- 9610.41** Any additional revenue sources that become available may enable the District to:
- a. Fund depleted or unfunded reserves; and
 - b. Reduce future rate increases when reserve targets are met.