

# Eastern Municipal Water District Reserve Policy

## 1. Policy Overview and Objectives

The purpose of Eastern Municipal Water District's (EMWD or District) reserve policy is to ensure that the District will have adequate funding to mitigate risk or uncertainty in revenue and expenses and to meet operating, debt service, capital rehabilitation and improvements, and other obligations.

The policy is intended to be part of the District's overall financial strategy, to be used in conjunction with the biennial budget and long-term financial plans. Prudent fiscal practices and financial management promote the District's commitment to maintaining its long-term financial health which is reflected in bond ratings and provides confidence to ratepayers and investors. Best practices indicate an appropriate level of reserves should be maintained for emergencies, rate stability, capital improvement projects, and other operational obligations.

## 2. Policy Principles

- Maintain the strong financial health of the District.
- Provide operating liquidity for rate stability to customers and help ensure future rate increases are reasonable.
- Ensure funding is available for current and future replacement of assets.
- Provide financial flexibility for unanticipated costs and emergency expenses.
- Assure that the District maintains the highest possible credit ratings.
- Establish bond proceeds and debt service reserves in compliance with bond documents.

## 3. Definition

A reserve is defined as an account with cash, investments, or other liquid assets set aside for anticipated or unanticipated future expenditures to include capital, rehabilitation & replacement, debt service, and other operational expenses. EMWD allocates reserves into two types: Restricted and Board Designated.

## 4. Reserves Summary:

- a. **Restricted Reserves:** These reserves are established and used for narrowly defined purposes as specified by legal restrictions, bond covenants, contractual obligations, and other regulations and ordinances.
- b. **Board Designated Reserves:** These reserves are established and used for specific purposes as determined by the Board of Directors. The Board of Directors has the authority to designate reserves for specific capital and operating purposes which may be redirected if the needs of the District change.

### Reserve Summary Table by Category

	<b>Operating</b>	<b>Debt Service</b>	<b>Capital</b>
<b>Restricted</b>	GO Bond Reserves	Debt Service Reserve	Future Development Bond Improvement
<b>Designated</b>	Operating Reserve Rate Stabilization Research & Development General Liability & Litigation Reserve Workers Comp. Reserve	Annual Operating Debt Service Reserve	System Betterment Rehabilitation & Replacement Equipment Replacement

#### 5. Summary of Reserves & Policy Funding Targets

<u>ACCOUNT</u>	<u>SOURCE</u>	<u>TARGET</u>
<b>RESTRICTED RESERVES</b>		
Future Development Capital Reserves	Connection fees	Required by statute
Bond Improvement Reserves	Bond proceeds	Required by bond documents
General Obligation Bond Reserves	Property taxes	Required by bond documents
Debt Service Reserve	Bond proceeds or general revenue	Required by loan or bond documents
<b>UNRESTRICTED BOARD DESIGNATED RESERVES</b>		
Operating Reserve		90 day minimum
System Betterment Reserve	Water and sewer capital charge	2% net capital assets
Rehabilitation & Replacement Reserve	Non-operating water and sewer revenue	1-year depreciation
Rate Stabilization	Operating revenue	Min: 1-month Max: 2 months of Operating exp.
Research & Development	Operating revenue	\$3,000,000
Equipment Replacement	Operating revenue	\$1,000,000 - \$3,000,000
Annual Operational Debt Service Reserve	Operating revenue	Minimum accrued principal and interest obligations; maximum one year of principal and interest obligations
General Liability & Litigation Reserve	Operating revenue	\$2,000,000
Workers Compensation Reserve	Operating revenue	Average 3 years' experience less liabilities

## 6. Reserves Detail:

### a. Restricted Reserves

#### i. **Future Development Capital Reserves**

Restricted reserves funded from development impact fees, established as a requirement of the California (CA) Government Code 66000, are designated to pay the preliminary and construction costs of the District's Capital Improvement Program related to expansion and future growth. All other non-expansion related projects will be funded from Debt Funded Capital Project Reserves or the Board's Designated Capital Reserve. These funds are required by statute to be segregated.

The following are the restricted Construction Funds established under CA Government Code 66000:

1. Restricted Wastewater Treatment Plant Expansion Fund
2. Restricted Recycled Expansion Fund
3. Restricted Sewer System Expansion Fund
4. Restricted Water System Expansion Fund
5. Restricted Water Tank Fund

#### ii. **Bond Improvement Reserves (Debt Funded Capital Project Reserves)**

The District will periodically issue debt to fund capital projects over multiple years as part of the five-year capital plan. The bond proceeds are Restricted Reserves and are available to pay the preliminary and construction costs of the District's Capital Improvement Program. Segregation of the bond proceeds are required by the bond documents.

#### iii. **Debt Service Reserve**

This restricted reserve may be required under certain loan agreements or bond documents. For State Revolving Fund (SRF) loans, a reserve is required to be maintained by the District until final payment is made. For certain bond issuances, a debt service reserve may be required to be used for the payment of principal and interest if the trustee has not received sufficient funds from the District to make the required debt service payments. The bond documents require this reserve to be retained until the final maturity date for each respective bond issue.

#### iv. **Restricted General Obligation Bond Reserves**

All proceeds from the annual ad valorem tax and delinquency payments from the county shall be deposited into this fund for the sole purpose of paying General Obligation Bond principal and interest payments. Rates are to be evaluated annually and adjusted to ensure that obligations are satisfied. After the final bond payment for a particular improvement district has been made, any remaining funds

in the account are to be transferred to the respective service area's Rehabilitation & Replacement or System Betterment Reserve.

**b. Unrestricted, Board Designated Reserves**

**i. Operating Reserve**

The purpose of this reserve is to ensure sufficient resources to pay budgeted operating and maintenance expenses, recognizing timing differences between payment and expenditures and receipt of revenues. This reserve fund shall, at a minimum, contain 25% of the maintenance and operating costs as approved in the then current operating budget (i.e., 90 days).

**Target:** The reserve fund balance shall be maintained at the 90-day minimum requirement, unless specifically increased by Board action. Any funds in excess of requirements for the then ended fiscal year are to be transferred to the Rehabilitation & Replacement and System Betterment Reserves.

**ii. System Betterment Reserve**

The purpose is to provide funding to ensure the continuity of the District's Capital Improvement Program. The funds will be used to enhance reliability and dependability of the District's capital assets and fund other unplanned projects as necessary to maintain service to existing customers. The major source of revenue is the capital fixed charges for water, sewer, and recycled water sales.

**Target:** This reserve shall equal 2% of net capital assets based on the previous year's published Annual Comprehensive Financial Report.

**iii. Rehabilitation & Replacement Reserve**

This reserve is established to accumulate funding for the rehabilitation and replacement of current District assets over the life of an asset. Reserve funds are accumulated to assure availability of adequate cash to pay for the cost to maintain assets without requiring debt issuance or large rate increases to fund major projects. These projects will include facility and service projects required to maintain service to customers.

**Target:** This reserve shall equal one year of depreciation based on the average of the last three years.

**iv. Rate Stabilization Reserve**

The purpose of this reserve is to mitigate against extraordinary rate increases from the Metropolitan Water District (MWD). In addition, this reserve will also be utilized to mitigate rate fluctuations and to maintain smooth rates year-over-year due to changes in demand, increases in expenses, or unexpected decreases in revenue.

**Target:** This reserve shall equal one month of operating expenses, not to exceed two months.

**v. Research and Development Reserve**

The purpose of this reserve is to accumulate revenue from the water rates to be used to fund research and development of potential resources and/or preservation of existing resources.

**Target:** Continue to collect revenues established in the current water and sewer rates until the reserve reaches \$3,000,000.

**vi. Equipment Replacement Reserve**

The purpose of this reserve is to provide funds for the replacement of capital equipment, including computer hardware, software, and other unanticipated equipment replacements.

**Target:** Continue to fund this reserve from non-operating revenues to be used to purchase computer hardware, software replacement and upgrades, and any other unanticipated capital equipment replacements necessary to continue operations. The balance at the end of each fiscal year shall be between \$1,000,000 to \$3,000,000, the average three-year cost of equipment replacements.

**vii. Annual Operational Debt Service Reserve**

The purpose of this reserve is to accumulate revenue from the water and sewer rates to be used to pay semi-annual and annual debt service on certain loan obligations (currently general obligation bonds, revenue bonds, and loans) intended to benefit long term water supply.

**Target:** Collect revenues established in the current water and sewer rates but pool into a single reserve account. The balance should, at a minimum, represent the accrued principal and interest obligations and, at a maximum, represent one year's annual principal and interest payment for all obligations.

**viii. General Liability & Litigation Reserve**

The purpose of this reserve is to provide a self-insurance reserve pool for unanticipated liability claims and litigation. The established limit is \$2,000,000 and the District purchases excess insurance above the \$2,000,000.

**Target:** The District shall maintain a level of \$2,000,000.

**ix. Workers Compensation Reserve**

This reserve established limits on the reserve to equal the average of the prior three years' actual experience at each fiscal year end.

**Target:** At each fiscal year end, this reserve shall equal the average of the prior three years' actual experience less the current fiscal year's accrued liability. If the average is less than the accrued liability, no reserve is required.

**7. Reserve Procedures, Reporting, and Compliance**

The reserve policy will be referenced and considered when the District completes its biennial budget, long term financial planning, cost of service studies, rate setting, and any other financial decisions and recommendations with large impacts to the District's financials.

Reserve levels will be monitored during the fiscal year and reported to the Board on a quarterly basis. The District will have met the reserve policy targets if the total cash and investments meet the total reserve requirement. The District will make reasonable effort to achieve these targets and if the District falls short, staff will develop a plan and present to the Board for corrective action. The policy will be reviewed biennially and updated as needed with Board approval.