

Coachella Valley Water District

Reserve Policy

GOAL

The goal of maintaining adequate reserves is to ensure that there are appropriate levels of working capital in the District's enterprise funds to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses), to ensure stable services and fees, and to obtain and maintain a credit rating of AA or better.

Properly designed policies send a positive signal to the community of ratepayers, bondholders, rating agencies, and regulatory agencies that the Board is committed to the District's long-term financial health and viability. Prudent financial management and best practices dictate that the District maintain appropriate reserves for emergency use, capital projects, obligations accruing on a current basis that will be paid in the future, and those required as a result of legal or external requirements.

OBJECTIVES:

- To establish prudent fiscal reserve policies to ensure strong fiscal management to guide future District decisions.
- To build and maintain reserves that lead to an AA rating or better. This action will provide the District with resources to help stabilize the District's finances, and position it to absorb economic downturns or large-scale emergencies.
- To help smooth rates from year-to-year, and to promote equity over the years to ratepayers.
- To provide funding for current and future replacement of existing assets as they reach the end of their useful lives.
- To assist the District in meeting its short-term and long-term obligations.

RESERVE POLICIES

Definitions

Reserves are defined as the amount of Cash and Investments in a fund, plus the Accounts Receivable, less the Accounts Payable and less Amounts due to Others in the fund. This methodology indicates the relatively liquid portion of total enterprise fund capital, which constitutes a margin or buffer for meeting obligations.

1. **Designated Reserves:** Designated reserves are reserves that are established and set aside to be used only for a specific, designated purpose (classified as unrestricted on the audited financial statements because the District retains authority to re- or de-designate funds).
2. **Restricted Reserves:** Restricted reserves are reserves that are restricted by an outside source, such as by statute, court, or contract (classified as restricted on the audited financial statements).

- 3. Undesignated Reserves:** It is assumed that all reserves will be Designated or Restricted, and therefore, there will be no undesignated reserves per policy, but reserves may be temporarily undesignated when they are received and until they are designated or restricted. (These are classified as unrestricted on the audited financial statements).

NOTE: The District's audited financial statements segregate Net Position, which includes the effects of all assets and liabilities, some of which are nonspendable, not liquid, or have not been included in the current year budget. Therefore, the definition of "Reserves" is different than "Net Position," and the two terms should not be used synonymously.

Designated Reserves

Maintaining adequate reserves is important for providing reliable service to customers, financing long-term capital projects, and the funding of emergencies, should they arise. The following designated reserve categories represent the minimum reserve target for each fund. However, the District's goal is to have 365 days of cash on hand District-wide to ensure sufficient funding is available to meet its operating capital and debt service obligations. Days of cash on hand is determined by the amount of unrestricted reserves on hand divided by one day's worth of operating and maintenance expenses (excluding depreciation).

- 1. Operating Reserves** cover operating costs for an established period of time. This reserve will ensure continuity of service regardless of cash flow, and is considered working capital to be used to fund current expenses as needed.

Applicable Funds: All funds except Internal Service Funds: Workers' Compensation, Dental PPO, and Motorpool

Recommendation:

Maintain minimum operating reserves at 90 days, or 25% of current year budgeted operating expenses (less depreciation and capital outlay). This balance will fluctuate from month to month. However, the year-end objective is to achieve this ending balance.

- 2. Rate Stabilization:** This reserve covers the smoothing of rates in the event of short to mid-term rate revenue loss, and/or higher than anticipated operating expenses that cannot be supported by normal revenues.

Applicable Funds: Domestic, Sanitation, Canal and Replenishment Funds*

*The Stormwater Fund is excluded because revenues consist of property taxes, which are relatively stable.

Recommendation:

Establish the reserve at the higher of 10% of current year budgeted rate revenues or 10% of total budgeted operating expenses less depreciation, capital outlay, and State Water Project expense. For Sanitation, establish the reserve at 10% of the nonresidential rate revenues.

- 3. Capital Improvement Program (CIP):** Ongoing replacement of capital facilities and additional investment in capital are essential to maintain the desired level of service for District customers and to meet increased demand upon services. This reserve is designated for funding the capital

improvement program and unforeseen capital projects. It is designed to stabilize funding for capital by accumulated “pay as you go” reserves to reduce reliance on other sources of capital financing, such as debt. This reserve can also be used in concurrence with outside funding sources.

Applicable Funds: Domestic, Sanitation, Canal, Stormwater, East Replenishment, West Replenishment

Recommendation:

This reserve should be set consistently with the District’s expected capital funding needs over a 5-year capital planning horizon and these needs and funding amounts will vary. As such, the amount needed in this fund will be subject to Board review and discussion with District management. The appropriate level for the capital reserve will be set based on the desired level of “pay as you go” funding in conjunction with other forms of capital funding, such as grants and debt. The District will strive to achieve a minimum funding level of 25% of the average, five-year, forecasted, pay-as-you-go capital-improvement expenditures for all funds except Stormwater and Canal. The District will strive to achieve Canal reserve levels of 2% of gross capital asset value, and Stormwater reserves of 70% of the average five-year CIP.

4. ***Emergency Reserve:*** These reserves help to ensure continued service to the District’s customers and service areas for events which are impossible to anticipate or budget. The ability of the District to quickly restore facilities and services is critical to the public health and safety of our residents. This fund will assist in covering emergency cash needs for any reason.

Applicable Funds: All funds except Workers’ Compensation, Self-Insurance and Motorpool

Recommendation:

Domestic, Sanitation, West Replenishment, and East Replenishment Funds: establish reserves at one percent (1.0%) of the net capital assets; Canal Fund: establish reserves at one percent (1.0%) of the replacement cost of fixed assets.

Stormwater Fund reserves at \$17.6 million, per previous Board policy.

5. ***Vehicle and Equipment Replacement Reserve:*** The Vehicle and Equipment Replacement reserve provides capital replacement funding as the District’s rolling stock and high value equipment is depreciated over its useful life.

Applicable Funds: All enterprise funds and the Motorpool Fund

Recommendation:

- Average of 5 year CIP for replacement vehicles per fund
- The Board will determine an amount appropriate to set-aside in the Vehicle and Equipment Replacement Reserve to fund the replacement of high cost equipment assets based on forecasted needs.

6. ***Other Special Purpose Reserves:*** The Board may, at its discretion, set aside reserves for a special project or purchase.

Applicable Funds: All funds

Restricted Reserves

1. ***Reserves for Future Capital Commitments:*** These reserves are established by Board Ordinances to ensure that specific fee proceeds are set aside to provide for future purchases of imported water and expansion of the domestic water and sanitation systems. The following fees are in place at this time:

- a. Water System Backup Facilities Charge (WSBFC)
- b. Sanitation Capacity Charge (SCC)
- c. Supplemental Water Supply Charge (SWSC)

Recommendation:

Interest earned in these reserves shall be credited to these reserves. There should be a positive balance in each of these funds at all times, unless a specific repayment plan is identified.

2. ***Reserve for Debt Service:*** Most debt issuances require a separately held reserve equal to one year of debt service, to be held by the trustee (if required), and used in the last year of the debt repayment.

Debt service reserves are presently established for Assessment Districts and Community Facility Districts, which are not liabilities of the District. Certain borrowings such as SRF loans, publicly issued bonds and federal loans through the WIFIA program may also require the funding of a debt service reserve, on a loan-by-loan basis.

Recommendation:

Establish a debt service reserve for the Domestic Water Fund per the requirements of the Drinking Water State Revolving Fund loan. In addition, the funding of a debt service reserve will be analyzed for each fund prior to the issuance of debt, based on the requirements of the legal documents as well as the preferences/requirements of the rating agencies and creditors at that time.

3. ***State Water Project (SWP):*** The District collects funds through the property tax rolls to make payments to the SWP. These payments will vary depending upon the availability and supply provided to the District in each year. Revenues primarily derive from property taxes based on the approved property tax rate and property value assessments updated on an annual basis.

Recommendation:

Establish a SWP reserve comprised of four components, as outlined below, that ensure sufficient funds on hand to pay full contractual obligations to allow for full water delivery, if available.

- Working Capital - Established at 50% (6 months) of the operating budget. This target is set on a 6 months of operating budget basis due to the fund's major revenue source (property taxes) being primarily paid only two times per year in January and May, while expenses fluctuate significantly due to varying hydrology, and are paid at varying amounts throughout the year. The significant potential variability in cash flow timing requires an above average working capital reserve to ensure contractual obligations are met.
- Rate Stabilization – Established at 10% of budgeted property tax revenue to promote a stable SWP property tax rate despite unanticipated costs passed on by DWR. This target is necessary to compensate for the high risk of unanticipated and unbudgeted expenses being invoiced by DWR for the SWP due to the nature of the SWP contract which allows the State to pass on CVWD's share of any legitimate expense necessary to operate, maintain, repair, and replace the system, despite limited availability of accurate advanced projections from the State.
- Mandatory Water Purchase – This target is established at the SWP variable transportation cost for delivering 50% of the Table A SWP Allocation and the SWP variable transportation cost for delivering the 9,500 acre-feet base amount of water for the Rosedale Rio Bravo agreement. CVWD routinely budgets for delivery of a Table A allocation of 50% based on an assumption of probable delivery amounts on an average year. This reserve target sets aside sufficient funding to pay for the unbudgeted incremental costs of a full 100% Table A allocation year, such as in 2023, so that CVWD would receive the full benefit of its base entitlement. Under the same wet year assumption yielding a 100% Table A allocation, the base allotment of 9,500 acre-feet would be offered and required to be purchased from the Rosedale Rio Bravo Agreement. This water is delivered via the SWP system, invoiced by DWR, and the SWP variable transportation costs are funded by the SWP Fund.
- Optional Water Purchase – This target is established at the SWP variable transportation cost for delivering the full 7,000 acre-feet of optional water from the Rosedale Rio Bravo agreement assuming its availability due to favorable hydrologic conditions. This water is also delivered via the SWP system, invoiced by DWR, and funded by the SWP Fund. As this water is optional and based on less common hydrology, it is not routinely budgeted for and requires a set aside of reserves to allow for the full delivery and benefit of this water should conditions materialize.

Reserve Procedures

- The Finance Department will perform a biennial reserve review to be submitted to the General Manager and Board of Directors.
- In addition, a reserve review will be required when a major change in conditions threatens the reserve levels established by this policy.
- The biennial review determines if the funding levels remain appropriate and aligned with Board goals and objectives.

- During the annual budget process, staff will recommend approval of the one-year capital improvement budget. If adequate funding is not available, the CIP reserve funds will be used.
- If the balance in any reserve category falls below the minimum targeted reserve level for two consecutive years, the Board of Directors will strive to adopt a 5-year strategy to restore reserves to the minimum targeted level.