

# Coachella Valley Water District

## Reserve Policy

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### 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 and to ensure that the District maintains a credit rating of AA or better.

### RESERVE POLICIES

#### Definitions

**Reserves** are defined as the amount of Cash and Investments in that 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).
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. (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 the 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. In this context, the following designated reserve categories represent the minimum reserve targets 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 level.

### **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 is 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 funds of capital financing such as debt financing. 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 in a manner consistent with the District’s expected capital funding needs over the 5-year capital planning horizon and it is recognized 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 reserve levels for Canal of 2% of gross capital asset value, and Stormwater 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 5yr 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 fees 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 this reserve shall be credited to this reserve. There should be a positive balance in each of these funds at all times, unless there is a specific repayment plan identified.

2. ***Reserve for Debt Service:*** Most debt issuances require the creation of 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 State Water Project. These payments will vary depending upon the availability and supply provided to the District in each year, however, the revenues collected remain fairly steady.

### ***Recommendation:***

District engineers have done a thorough analysis on past hydrology patterns, and based on the expenses for the wettest five-year period (2002-2007), they have determined that the reserve should be \$26.4 million.

## **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 are still 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 plan that includes a strategy to build the reserves back to the minimum targeted levels over the following five years.