

POLICY NO. 1.3 Reserve & Financial Benchmark Policy	DISTRICT CODE Chapter 3.09 Sections 3.09.010 – 3.09.070	APPROVAL DATE 12/11/2018 EFFECTIVE DATE 12/11/2018
--	--	---

SECTION 1: POLICY STATEMENT

SECTION 2: DEFINITIONS

SECTION 3: GENERAL PROVISIONS

SECTION 4: FUND TARGET LEVELS AND MANAGEMENT

SECTION 5: EXCESS OF RESERVE REQUIREMENTS (NEW)

SECTION 6: BUDGETARY TRANSFERS

SECTION 7: FINANCIAL BENCHMARKS

SECTION 8: DELEGATION OF AUTHORITY

SECTION 1: POLICY STATEMENT (3.09.010)

A key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital, and debt service needs. Additionally, fiscal responsibility requires anticipating the likelihood of, and preparing for, unforeseen events. Cucamonga Valley Water District (“District”) will at all times strive to have sufficient funding available to meet its operating, capital and debt service obligations. Reserve Funds (Funds) for the Water, Sewer and Recycled Water, as applicable, will be accumulated and maintained to allow the District to fund operating expenses and capital expenditures in a manner consistent with its Annual Operating and Capital Improvement Budget and avoid significant customer rate fluctuations due to changes in cash flow requirements.

Through a variety of policy documents and plans, including the District’s strategic plan, Master Plans and other financial policies, the Board has set forth a number of long-term goals for the District. A fundamental purpose of the District’s policy documents and plans are to link what must be accomplished with the necessary resources to successfully do so.

The Board of Directors (“Board”) may designate specific fund accounts and maintain minimum fund balances consistent with statutory obligations that it has determined to be in the best interest of the District. The Policy directives outlined in this document are intended to ensure that the District has sufficient funds to meet current and future needs. The Board will review the level of Funds in accordance with the review and approval of the Annual Operating and Capital Improvement Budget.

SECTION 2: DEFINITIONS (3.09.020)

There are three types of Funds:

A. 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.

B. CAPITAL FUNDS

Established by action of the Board and designated for specific purposes. This fund is utilized primarily to fund capital and asset costs, for both new and replacement projects.

C. LIQUIDITY FUNDS

Established by action of the Board to safeguard the financial flexibility and stability of the District and to maintain stable customer charges and rates from year to year. Liquidity may be funded from accumulated revenues and when appropriate available short-term liquidity arrangements.

SECTION 3: GENERAL PROVISIONS (3.09.030)

The District will maintain its liquidity and capital funds in separate, designated sub-accounts in a manner that ensures its financial soundness and provides transparency to its ratepayers. Only cash and marketable securities will be used to fund the designated Fund balances as outlined in this Policy. The Fund balances are considered the minimum necessary to maintain the District's creditworthiness and adequately provide for:

- A. Compliance with applicable statutory requirements
- B. Financing of future capital facilities and repair and replacement of existing assets
- C. Financing of water purchases through the Water Banking Program
- D. Cash flow requirements
- E. Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy
- F. Contingencies or unforeseen operating and/or capital needs

In the context of funding future capital facilities and maintaining and replacing existing assets, in each instance, the District will analyze the benefits and trade-offs of utilizing Pay-Go and/or debt financing to determine the optimal funding strategy or combination of funding strategies in accordance with the District's Debt Management Policy 1.5. The analysis will consider the District's current and projected liquidity, capital positions, the impact of inflation, the cost of water and other operational factors of the District and its capital improvement program. The District will measure its liquidity position by calculating "day's cash" or other appropriate liquidity calculations. In addition, the District will calculate its capital positions, as measured by its debt-to-equity ratio and any other appropriate calculation.

The District has established and will maintain the following primary Funds and their respective sub-accounts:

- A. Restricted Funds:** comprised of Bond Proceeds Fund and Developer Fees
- B. Capital Funds:** comprised of the Capital Project Account, the Emergency Account, the Administrative CIP Account, and the Local Water Resource Development Account
- C. Liquidity Funds:** Rate Stabilization Account, Water Banking Account, the Operating Reserve Account, the Compensated Absences Reserve Account, and the Customer Assistance Program Reserve Account

Fund balances will be reviewed on an annual basis to ensure compliance with this Policy. On an as-needed basis, moneys can be moved between the Capital and Liquidity Funds as approved by the Board.

The minimum established for each Fund represents the baseline financial condition that is acceptable to the District from risk and long-range financial planning perspectives. Maintaining reserves at appropriate levels is a prudent, ongoing business process that consists of an iterative, dynamic assessment and application of various revenue generating alternatives. These alternatives (either alone or in combination with each other) include, but are not limited to: fees and charges, water usage, capital financing, investment of funds and levels of capital expenditures.

SECTION 4: FUND TARGET LEVELS AND MANAGEMENT (3.09.040)

A. RESTRICTED FUNDS

a. Bond Proceeds Fund(s): Bond proceeds funds are monies derived from the proceeds of a bond issue. Typically, they consist of construction fund monies and a debt service reserve fund (“DSRF”). The use of these proceeds is restricted by conditions set forth in the respective legal bond documents. These funds are usually held by the Trustee in favor of the bond holders.

- i. Target Level – The debt service reserve requirement is established at the time of the bond issue. This amount may be recalculated as the bonds are paid down. Any excess principal and/or interest earnings can be used to pay debt service on the bonds.
- ii. Events or Conditions Prompting the Use of the Fund(s) – As stipulated in the respective bond documents. Construction fund monies are expected to be spent on applicable projects, while DSRF can only be used in the event of a shortfall in revenues to pay debt service or to pay down principal at maturity.
- iii. Periodic Review Dates for Balances – Reviewed by the Trustee and District staff.

b. Development Fees: Monies collected from development fees shall be separately accounted for.

- i. Target Level – Developer Fees are collected as a condition of development in accordance with the District’s Water Code. The balance in this account will fluctuate depending on the amount collected and the amount expended for capital improvement projects for facilities and assets in the District’s Water, Sewer and/or Recycled Water system. Therefore, no minimum or maximum levels will be established.

B. LIQUIDITY FUNDS

Liquidity Funds will be comprised of the following sub-accounts: the Rate Stabilization Fund, the Water Banking Account, the Operating Reserve Account, the Compensated Absences Reserve Account, and the Customer Assistance Reserve Account. The balance in the Liquidity Funds will fluctuate each year.

a. Rate Stabilization Fund: This fund is established in accordance with the terms and agreements listed in the Master Installment Purchase Agreement (Purchase Agreement) dated October 1, 2012. This fund must be maintained by the District as long as payments are due on outstanding debt under the Purchase Agreement.

- i. Target Level – This fund shall be maintained at a minimum level equal to \$2.2 million. The balance in the Rate Stabilization Fund may decline below the minimum level if recommended by the AGM after consultation with the District’s Municipal Advisor and expressly approved by the Board.
- ii. Events or Conditions Prompting the Use of the Fund – The District may deposit or withdraw available monies to or from the Rate Stabilization fund in accordance with the terms of the Purchase Agreement. The Board, on a case-by-case basis, will determine the amount and timing for any use of the fund.
- iii. Periodic Review Dates for Balances – Fund balances will be reviewed by staff and the Board during the preparation and approval of the Annual Operating and Capital Improvement Budget.

b. Water Banking: The Water Banking Account is used for the purchase of available water supplies. Purchases from this fund are typically made to hedge the future rising costs of imported water. This fund is designated by the Board to maintain a reliable supply of water.

- i. Target Level – Funding shall be targeted at a minimum amount equal to 3% of budgeted water sales and services and the maximum amount shall not exceed the cost of purchasing 5,000 AF of Metropolitan Water District (MWD) Tier II untreated imported water.

- ii. Events or Conditions Prompting the Use of the Fund – Upon Board authorization, this fund may be routinely utilized by staff to purchase excess supplies of water.
 - iii. Periodic Review Dates for Balances – Fund balances and target level will be reviewed by staff and the Board during the preparation and approval of the Annual Operating and Capital Improvement Budget.
- c. Operating Reserve Account:** The Operating Reserve Account is used for unanticipated operating expenses. This fund is designated by the Board to maintain a reserve for current operations and to meet routine cash flow needs.
- i. Target Level – Funding shall be targeted at a minimum amount equal to 20% of the District’s budgeted total operating expenses, and the maximum amount shall not exceed 50% of the budgeted total operating expenses in the Water, Sewer and Recycled Water Funds.
 - ii. Events or Conditions Prompting the Use of the Fund – Upon Board authorization, this fund may be routinely utilized by staff to cover temporary cash flow deficiencies caused by timing differences between revenue and expenses or decreases in revenues and unexpected increases in expenses.
 - iii. Periodic Review Dates for Balances – Fund balances and target level will be reviewed by staff and the Board during the preparation and approval of the Annual Operating and Capital Improvement Budget.
- d. Compensated Absences Reserve Account:** Eligible employees earn vacation and sick leave benefits in accordance with Employee Policy 3.11 and 3.13. These benefits accumulate each year and under certain circumstances, typically at separation or retirement, some employees have the option of receiving cash-out payments for some accumulated leave balances. The Compensated Absences Reserve Account is primarily used as a budget-smoothing technique for any leave bank liquidations in the Water, Sewer and Recycled Water Funds, respectively.
- i. Target Level – Funding shall be targeted at a minimum amount equal to 50% of the calculated annual liability for each fund. The maximum amount shall not exceed 100% of the calculated annual liability for each fund.
 - ii. Events or Conditions Prompting the Use of the Fund – Upon Board authorization, this fund may be routinely utilized by staff to cover large, unbudgeted cash-out payments.
 - iii. Periodic Review Dates for Balances – Account balances and target level will be reviewed by staff and the Board annually at year-end.

- e. Customer Assistance Program Reserve Account:** The Customer Assistance Program (CAP) was established to assist low-income households with their water utility costs through fixed savings on their utility statement. The CAP is funded by unrestricted cellular tower rental income and must be approved by the Board each year. Participation in this program varies each year and is not guaranteed. In order to fund unanticipated CAP participation from year-to-year, this reserve account will be established.
- i. Target Level – Funding will only be transferred to this account in the event that excess funding accumulates due to lower than expected participation. At the end of each fiscal year, any excess funding shall be deposited in this account for future year program funding.
 - ii. Events or Conditions Prompting the Use of the Fund – In the event that CAP participation exceeds the amount allocated by the Board of Directors, the General Manager/CEO has authority to transfer funds in accordance with Section 6.
 - iii. Periodic Review Dates for Balances – Account balances will be reviewed by staff and the Board annually at year-end.

C. CAPITAL RESERVE FUNDS

The District will strive to maintain the established minimum balances in the Capital Reserve Funds. The Capital Reserve Funds will consist of the following sub-accounts:

- a. Capital Project Account:** The Capital Project Account is used for the funding of new capital assets or the replacement of capital assets when they reach the end of their useful lives.
- i. Target Level – The District may set aside replacement funds on a project-by-project basis. The minimum target level the District will strive for is 100% of the current budgeted pay-go capital project plus 25% of subsequent year's pay-go capital projects for each of the Water, Sewer, and Recycled Water Funds, respectively.
 - ii. Events or Conditions Prompting the Use of the Fund – Staff will recommend new assets to be constructed or assets to be replaced during the annual Capital Improvement Budget preparation. As projects are approved, funds will be appropriated from reserve funds or available revenues.
 - iii. Periodic Review Dates for Balances – Fund balances and projected improvement projects will be reviewed by staff and the Board during the

preparation and approval of the Annual Operating and Capital Improvement Budget.

b. Emergency Account: The Emergency Account may be used in the event of economic events that negatively impact either revenues or expenses, or causes a material decline in other reserve accounts; to purchase equipment and infrastructure at any time or to begin repair of the water system after a catastrophic event, such as a severe earthquake or fire, while long-term financing is being arranged, State or Federal Assistance is obtained, or insurance claims are being processed. The District may use funds herein for either capital or operating purposes.

- i. Target Level – Funding shall be targeted at a minimum equal to 1% of the net capital assets of the District’s Water and Sewer systems with a maximum level set at 2%, based on current Federal Emergency Management Agency (FEMA) guidelines.
- ii. Events or Conditions Prompting the Use of the Fund – The Board may designate use of this fund after establishing that conditions exist as called out in the definition and purpose of the fund.
- iii. Periodic Review Dates for Balances – Fund balances and target level will be reviewed by staff and the Board during the preparation and approval of the Annual Operating and Capital Improvement Budget.

c. Administrative Capital Improvement Account: The Administrative Capital Improvement Account can be used to fund certain general, administration and overhead projects. It is intended to fund (or partially fund) office equipment, fixtures, furnishings, vehicles and other equipment on a Pay-Go basis. The Board will appropriate funds for specific projects during the Capital Improvement Project budgetary process.

- i. Target Level – This fund has no specific target level for each component. However, The District shall seek to maintain a minimum balance of 100% of each current budgeted vehicle, filed and office related capital projects for each of the Water, Sewer, and Recycled Water Funds. The maximum targeted balance in this account is equal to the minimum balance with an annual inflationary adjustment. Special projects can be funded on an as-needed or project-by-project basis.
- ii. Events or Conditions Prompting the Use of the Fund – Improvement projects will be identified by staff and recommended to the Board during the preparation of the Capital Improvement Project budgetary process. As projects are approved, funds will be appropriated from available funds.
- iii. Periodic Review Dates for Balances – Fund balances and projected improvement projects will be reviewed by staff and the Board during the

preparation and approval of the Annual Operating and Capital Improvement Budget.

- d. Local Water Resource Development Account:** The Local Water Resource Development Account is used for the funding of the development, improvement, or acquisition of local water resource projects or efforts. This fund is designated by the Board to reduce the District's reliance on costly imported water. The District may use funds herein for either capital or operating purposes in accordance with Board approval.
- i. Target Level – Funding shall be targeted at a minimum amount equal to \$2 million, the approximate cost of a new groundwater well, and a maximum of \$5 million.
 - ii. Events or Conditions Prompting the Use of the Fund – Upon Board authorization, this fund may be utilized for projects or efforts to develop local water resources, such as but not limited to: purchase of water supplies/rights, development of groundwater or surface water supplies, and any other type of effort to reduce the District's reliance on imported water.
 - iii. Periodic Review Dates for Balances – Fund balances and projected improvement projects will be reviewed staff and the Board during the preparation and approval of the Annual Operating and Capital Improvement Budget.

SECTION 5: EXCESS OF RESERVE REQUIREMENTS (3.09.XXX)

In the event that reserve accounts have reached their maximum target levels, the Board may instruct staff to utilize excess reserves in the following ways.

- i. Advance fund any of the District's short-term or long-term liabilities, including but not limited to bonded debt service, capital leases, SRF loans, interfund loans, pension liabilities, and Other Post-Employment Benefit liabilities.
- ii. Staff will prepare an analysis with the advice of its Municipal Advisor to determine which of the above liabilities provide the maximum amount of savings to the District due to early prepayment. This analysis will consider any other factors, such a pre-payment penalties, call provisions, restricted debt service reserve funds and the current interest rate environment.
- iii. Staff will be present this analysis to the Finance Committee and the Board of Directors for review and approval of the recommended option(s).
- iv. In the event the District's Master Plan Documents and Long-Range Financial Plan identify large future spending plans, excess reserves can be transferred to the Capital Project Account.

SECTION 6: BUDGETARY TRANSFERS (3.09.050)

CVWD adopts an Operating and Capital Improvement Budget on an annual basis. Management staff will make every effort to stay within the allotted budget for each operating account and each capital project. Occasionally it may be necessary to transfer allotted funds between operating accounts or capital projects. These budget transfers may only be done within one of the three main categories; wages, operating expenses, or capital projects, not between categories. All budget transfers undergo Finance Review that ensures funding availability and adherence to policy before final processing. The authority for approving budget transfers without the use of reserve funds is listed in the following table:

Amount up to:	Review/Approval Level
\$25,000	Department Managers/Directors
\$50,000	Assistant General Managers or GM/CEO
\$50,000+	Finance Committee and Board of Directors

Budget transfers requiring the use of reserve funds less than \$50,000 may be approved by the GM/CEO or an AGM. Budget transfers requiring the use of reserve funds in excess of \$50,000 must be reviewed by the Finance Committee and approved Board of Directors.

SECTION 7: FINANCIAL BENCHMARKS (3.09.060)

The District strives to maintain a strong credit profile in order to provide assurance to customers, bond holders, rating agencies and other stakeholders that the District proactively manages its financial resource and is financially sustainable. These benchmarks will be evaluated on an annual basis and communicated to the Board. The District has set forth the following financial benchmark goals:

- A. **Debt Ratio:** The Debt Ratio is a financial ratio that indicates the percentage of the District’s capital assets that are provided via debt financing. It is the District’s goal to maintain a Debt Ratio between 30 to 40 percent.

- B. **Credit Rating:** The District’s credit rating has a direct impact on the access to financial markets and the cost of incurring debt. It is the District’s goal to maintain AA+ (Standard & Poor’s), Aa1 (Moody’s) and/or AA+ (Fitch).

- C. **Number of Day’s Cash:** The District’s liquidity position has a large impact on the District’s credit rating. It is the District’s goal to maintain a level of Days Cash between 365 and 400 days.

- D. **Capital Improvement Funding Levels:** In accordance with the District’s Debt Management Policy 1.5, the District will evaluate the benefits of utilizing Pay-Go and/or debt

financing to determine the optimal funding strategy of capital improvements. It is the District's goal to utilize a balance approach to capital project funding at a level of 40% debt, 30% Pay-Go and 30% reserve funding.

- E. **Debt Service Coverage:** The District is required to maintain a minimum debt service coverage ratio as set forth in the outstanding bond documents. It is the District's goal to exceed the minimum coverage ratio with a goal of 2.25 times the annual debt service payment.

SECTION 8: DELEGATION OF AUTHORITY (3.09.070)

The Board has sole authority to amend or revise the Reserve and Financial Benchmark Funds Policy. Through approval of this Policy, the Board has established written procedures for staff to follow in the management of the District's Reserve Funds. This policy shall be reviewed on a biennial basis and the Board must approve modifications, if any.

POLICY REVISION DATES

12/11/2018 (Resolution No. 2018-12-1)
05/24/2016 (Resolution No. 2016-5-6)
11/24/2015 (Resolution No. 2015-11-5)
02/18/2012