

CHAPTER 3, ARTICLE 13 - SECTION 3502 RESERVE POLICY

DRAFT
with tracked changes

General

The purpose this Reserve Policy is to ensure that the Agency will, at all times, have sufficient funds available to meet its operating, equipment replacement, capital and debt service cost obligations.

Reserves are to be established to fund estimated future obligations and/or unforeseen needs and are critical to the successful and stable short and long term operation of the Agency.

Reserves will be managed in a manner that allows the Agency to fund costs consistent with its annually updated Capital Improvement Program as well as other long-term plans, with adequate additional funds to avoid ~~ing~~ significant rate fluctuations that might otherwise result from unforeseen needs or emergency situations.

Adequate reserves and sound financial policies promote strong Agency bond ratings in the capital markets; provide financing flexibility; avoid potential restrictive debt covenants; and ensure the Agency's customers of stable rates.

Scope

The scope of this policy extends to the Agency budget units of Agency Wide and Water Division. The Power Division operational, capital and emergency reserve are pursuant to the Middle Fork Project Finance Authority policy and are funded and held by the Middle Fork Project Finance Authority.

Reserve Account Types

There are two types of reserve accounts:

- **Legally Restricted Reserves** have restrictions imposed by an outside source, such as State law, bond covenants and contractual obligations, customer deposits, etc.
- **Board Designated Reserves** are set aside for specific purposes as determined by the Board of Directors. The Board of Directors has the authority to redirect ~~the~~ use of these reserves as the needs of the Agency change.

CHAPTER 3, ARTICLE 13 - SECTION 3502 RESERVE POLICY

DRAFT
with tracked changes

Legally Restricted Reserves

Third party restrictions either by agreements, laws or regulations that impose cash funding requirement on the Agency are considered restricted reserved. Examples of these include debt instruments, unspent debt proceeds or connection charge revenue.

Reserve amounts required for debt or other agreements will be established when the agreement is executed and, as necessary, appropriated annually in the budget process. Typically, funds are set aside from the original transaction and require only slight adjustment, if any, on an annual basis.

Pursuant to California Water Code, Water Connection Charge (WCC) revenue is restricted to use for water capacity increasing infrastructure related costs. These funds will be held in a separate account and their use shall require Board approval.

Board Designated Reserves

The Agency has established, and will continue to dedicate and maintain reserves to meet known estimated future obligations and/or unforeseen needs. These reserves shall be established in the following categories under which sub-categories would be created:

- Operating
- Capital
- Liabilities
- Specific Activities, Programs and Special Projects

Annually, the Director of Financial Services will present a report of reserve activity to the Finance Committee. The report will include a summary of the use of reserves in the prior year and will recommend annual funding and funding targets. The Board, through the annual budget process, will authorize reserve funding allocations and approve the funding targets. Once designated to a reserve fund, the funds may only be used upon approval of the Board of Directors. The use of board designated reserves shall require the approval of the Board of Directors. This approval may occur either through the adoption of the annual budget or the approval of a budget amendment.

Operating Reserve

The Operating Reserve is established to fund planned short-term variations in operating

CHAPTER 3, ARTICLE 13 - SECTION 3502 RESERVE POLICY

DRAFT

with tracked changes

costs and for unanticipated changes in revenues or expenses. The Water Division Operating Reserve shall include sufficient funding to cover potential expense or revenue variations as may result from weather or energy price volatility.

The operating reserve target balance shall be between one hundred days (3.5 months) and one hundred fifty days (5 months) of budgeted operating expenses excluding depreciation, calculated by dividing the total budgeted operating expenses by three hundred and sixty-five and multiplying one hundred fifty (upper range) and one-hundred (lower range). ~~The operating reserve target balance shall be determined during the budget process, before the beginning of the respective fiscal year.~~

Anticipated operating reserve deficiencies noted during the budget process or at year-end will be funded first by any available surplus from the current year, next by an amount funded in the budget process, next from capital reserves. Funding would occur at year-end after the year-end results are known.

The operating reserve shall have the first priority from surplus operating revenue for funding to restore the reserve balance within the established operating reserve range.

Capital Reserve

Capital reserve is established to fund planned repair or replacement of equipment and/or infrastructure and to meet unanticipated equipment and/or infrastructure breakdown or failure costs. For the Water Division budget unit this would include funding for major and minor rehabilitation, renewal and replacement or improvement of system infrastructure, as well as routine capital replacement. For the Agency Wide budget unit, this would include funding of significant maintenance and improvements of the Agency's buildings, facilities and properties, as well as routine capital replacement, which are or will be Agency Wide assets.

For the Water Division budget unit, the capital reserve target balance shall be between the sum of the next two years of projected capital projects costs, excluding expansion (WCC) projects, as determined in the annual Capital Investment Program, and the next five years of projected capital project costs. ~~The capital reserve target balance shall be determined during the budget process, before the beginning of the respective fiscal year.~~

For the Agency Wide budget unit, based on the existing and future capital needs, the capital reserve target balance shall be ~~between \$500,000 and \$2.5 million, determined by the Board of Directors during the budget process.~~

CHAPTER 3, ARTICLE 13 - SECTION 3502 RESERVE POLICY

DRAFT

with tracked changes

Anticipated capital reserve deficiencies will be funded first by any available surplus from the current year, next by an amount funded in the budget process.

Liabilities Reserve

The Liabilities Reserve is established to provide funding for anticipated future costs for currently known or reasonably estimated liabilities. These could include accumulated employee leave, retiree healthcare and pension liabilities, insurance deductibles and claims and similar types of liabilities needing a readily available funding source.

The ~~liabilities-accumulated employee leave~~ reserve target balance shall be between 50% and 100% of the current accumulated employee leave balance. The Director of Financial Services and/or General Manager shall recommend reserve funding levels for insurance deductibles and other liabilities based on an assessment of risk and available funding.

Specific Activities, Programs and Special Projects Reserve

The specific activities, programs and special projects reserve is established to provide sinking funds for identified Agency activities, programs and special projects. Among other matters, this would include: disaster recovery, legal defense, FERC relicensingconsolidation support efforts, stewardship matters, water rights permit extension, catastrophic events, financial assistance program and other activities/projects/programs.

The Director of Financial Services and/or General Manager shall recommend reserve funding levels for specific activities, programs and special projects based on an assessment of need and available funding.