



**SAN BERNARDINO VALLEY MUNICIPAL
WATER DISTRICT**

RESERVE POLICY

July 2012

San Bernardino Valley Municipal Water District

STATEMENT OF RESERVE POLICY

This Board is charged with responsibility for providing an imported water supply to customers located within the District's boundaries, for the construction, operation, maintenance, repair and replacement of facilities to transport and deliver that water to District customers, and for the collection and accumulation of revenues necessary to accomplish these purposes.

POLICY STATEMENT

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. San Bernardino Valley Municipal Water District ("SBVMWD" or District) desires to identify and provide a calculation methodology and/or maintained level of all existing and future needs of the District where reserve funds are required and/or necessary. The SBVMWD Board of Directors realize the importance of reserves in providing reliable service to its customers, financing long-term capital projects, and the funding of emergencies, should they arise. In this context, SBVMWD will at all times strive to have sufficient funding available to meet its operating, capital, and debt service obligations. Funds will be accumulated and maintained to allow SBVMWD to fund expenditures in a manner consistent with SBVMWD's Capital Improvement Plan ("CIP"), and avoid significant rate fluctuations due to changes in cash flow requirements.

The 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 SBVMWD. The Policy directives outlined in this document are intended to ensure SBVMWD has sufficient funds to meet current and future needs. The Board will annually review the level of reserve funds. Considerations to continue or the establishment of a new reserve fund will be determined based on the following criteria:

- ◆ Reason for the reserve.
- ◆ Availability and source of funds to continue, replenish or establish the reserve.
- ◆ Operating expenditure levels approved within the annual budget process.
- ◆ Future capital expenditure and debt service requirements of the District.
- ◆ Board approval of the reserve policy.

SBVMWD recognizes the importance of operating the District with a sound business plan in place that provides for unanticipated/emergency costs should they arise within a budgeted fiscal year.

It is the Board's intent through this Policy to describe how and why specific reserves are established and maintained at SBVMWD and to provide SBVMWD's taxpayers with assurance that reserve balances will be maintained at prudent and fiscally responsible levels.

DEFINITIONS

This Policy describes the reserve funds to be maintained in connection with: i) the State Water Project (SWP); ii) Devil Canyon Castaic (DCC) funds and iii) the General Fund. In general, there are two types of reserve fund classifications:

- I. **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. These funds are specifically governed by a written contract with SBVMWD or outlined within the debt covenants of a debt financing.

- II. **UNRESTRICTED FUNDS:** These funds have no externally imposed use restrictions. The use of Unrestricted Funds is at the discretion of the SBVMWD Board. Unrestricted Funds are designated for a specific purpose, which is determined by the Board. The Board also has the authority to redirect the use of these funds as the needs of SBVMWD change.

The Restricted and Unrestricted funds can further be subdivided into Capital Funds and Liquidity (Operating) Funds. The Capital Funds are designated for specific purposes and utilized primarily to fund capital and asset replacement costs. The Liquidity Funds are established to safeguard SBVMWD's financial viability and stability and are funded from accumulated revenues.

Further, for internal control purposes, SBVMWD accumulates, maintains, and segregates its reserve funds into the following categories:

- ◆ *Restricted and Designated Reserves* – Reserve funds that are designated for a particular purpose and whose use is restricted to only that purpose. The Restricted and Designated Reserves consist of the State Water Project Fund, Devil Canyon/Castaic Fund, Project Specific Rate Stabilization Fund, and State Water Project Maintenance and Repairs Fund.
- ◆ *Board Designated Reserves* – Reserve funds earmarked for the purpose of funding items such as new capital facilities, repair or replacement of existing facilities, and general operating reserves designated for a specific purpose and use by the Board. The Board Designated Reserves are comprised of the following reserve accounts: Reserve for Operations, Rate Stabilization Reserve, and Reserve for Self Insurance.
- ◆ *Board Restricted (Obligated) Reserves* – Reserves set aside to meet financial commitments for services not yet fulfilled and purchases that will take place in the future. These reserves consist of the Reserve for New Infrastructure and Reserve for Repairs and Replacements.
- ◆ *Contractually Restricted Reserves* – Funds held to satisfy limitations set by external requirements established by creditors, grant agencies or contributors, or law. Examples include stipulated bond covenants, capital improvement fees, and service deposits. At present SBVMWD does not hold any Contractually Restricted Reserve Funds.

GENERAL PROVISIONS

SBVMWD will maintain its operating and capital funds in designated accounts in a manner that ensures its financial soundness and provides transparency to its customers. The fund balances are considered the minimum necessary to maintain SBVMWD's fiscal strength and flexibility and adequately provide for:

- ◆ Compliance with applicable statutory requirements.
- ◆ Financing of future capital projects and repair and replacement of existing assets.
- ◆ Cash flow requirements.
- ◆ Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy.
- ◆ Contingencies or unforeseen operating or capital needs.

Through a variety of policy documents and plans, including SBVMWD's CIP and Rate Model, the Board has set forth a number of long-term goals for SBVMWD. A fundamental purpose of SBVMWD's policy documents and plans is to link what must be accomplished with the necessary resources to successfully do so. At least every four years, an engineering review study will be conducted on the SBVMWD's CIP to ascertain adequate reserve fund balances are meeting the goals outlined in this Policy

SBVMWD has established and will maintain the reserve funds outlined in the following sections. A principal tenet of SBVMWD's Reserve Fund Policy shall be the crediting of interest income to specific funds. Unless otherwise stated in this Reserve Fund Policy, interest derived from reserve balances will be credited to the reserve account from which it was earned. Fund balances will be reviewed by the Financial Manager on a monthly basis, as well as annually during the budget review process in order to determine how reserve fund balances compare with the budgeted projections and how they measure against the goals outlined in this Policy.

The minimum established for each reserve fund represents the baseline financial condition that is acceptable to SBVMWD from risk and long-range financial planning perspectives. Maintaining reserve funds at appropriate levels is a prudent, ongoing business process that consists of an iterative, dynamic assessment and application of various funding alternatives. These alternatives (either alone or in combination with each other) include, but are not limited to: rates, loans and grants, debt financing, investment of funds, and levels of capital expenditures.

The Board shall approve any reallocation of funds or any transfers among reserve funds.

SPECIFIC PROVISIONS

SBVMWD will maintain the following reserve funds and respective target levels:

1. Restricted Reserves.

(a) State Water Contract Fund. All revenue collected from taxes levied on real property within the District's boundaries to pay amounts due and owing to the State of California Department of Water Resources ("DWR") pursuant to the District's contract with the State ("State Water Contract") for participation in the State Water Resources Development System shall be deposited into the State Water Contract Fund. The revenues deposited into the State Water Contract Fund may be utilized only to pay the District's financial obligations on the State Water Contract as approved by the Board. The District shall endeavor to maintain money in the State Water Contract Fund in an amount which is more than the total of the previous year's invoices from DWR, but not more than the sum of two times the total of such invoices, so that a reserve may be maintained to absorb temporary increases in charges from DWR, help to stabilize District tax rates, and protect against economic conditions which could result in the failure of numerous District taxpayers to pay their taxes. The reserves maintained in the State Water Contract Fund may be invested in the same manner as other District funds. Investment earnings thereon as determined by the District shall be credited to the State Water Contract Fund and shall be used only to pay State Water Contract obligations, as approved by the Board.

(b) Devil Canyon / Castaic Fund. The Devil Canyon / Castaic Fund is established to facilitate the District's tracking of payments under the Devil Canyon-Castaic contract for costs of the Devil Canyon-Castaic facilities allocable to power generation. Funding will be based on taxes levied on real property within the District's boundaries allocated for this project. The District shall endeavor to maintain money in the Devil Canyon / Castaic Fund in an amount which is more than the total of the previous year's invoices from DWR but not more than the sum of two times the total of such invoices. The reserves maintained in this fund may be invested in the same manner as other District funds with investment earnings on this fund credited back to this fund and used only to pay Devil Canyon / Castaic project obligations.

(c) Project Specific Rate Stabilization Fund. This reserve is established as a sub-fund to the State Water Contract Fund to facilitate the District's segregation and tracking of expenses and obligations related to the District's share of State Water Project specific projects. The fund is not limited to one project but currently includes specific projects as East Branch Extension II. The

board will evaluate each year the need to add other specific projects through the budget process. In order to plan ahead, the District has established this reserve and has been contributing to this reserve through the budget process each year. The District will periodically review the balance in this fund and adjust its annual contributions accordingly.

(d) State Water Project Repair and Replacement Fund. This reserve has been established as a sub-fund to the State Water Contract Fund for the purpose of providing funding for the repair and replacement of the State Water Project distribution pipelines, pump stations and reservoirs. The District has identified a minimum target balance of \$30 million for this reserve.

2. Unrestricted Reserves.

(a) Reserve for Operations. A “Reserve for Operations” is hereby created for the District, to which the Board may appropriate unrestricted District revenues. The Reserve for Operations may be utilized to pay the cost of operating the District’s general system including unanticipated costs of operations. This reserve is designated by the Board to maintain working capital for current operations and to meet routine cash flow needs. The District shall endeavor to maintain in the Reserve for Operations an amount sufficient to pay for a minimum of 90 days and a maximum of 180 days of normal operations of the District excluding depreciation expense and payments to DWR, as reflected in the annual audit of the District presented to the Board each year. However, the funds appropriated to the Reserve for Operations may be accessed at any time for any other District purpose, upon approval by the Board. Funds appropriated to the Reserve for Operations may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District’s General Fund.

(b) Reserve for New Infrastructure. A “Reserve for New Infrastructure” is hereby created for the District’s general account, to which the Board may appropriate unrestricted District revenues. The Reserve for New Infrastructure may be utilized to construct or procure new infrastructure for the District; expenditures include but are not limited to transmission and distribution capital assets, buildings, pumping equipment, technical equipment, furniture and fixtures and transportation equipment. The District shall endeavor to maintain the Reserve for New Infrastructure in an amount not to exceed approximately 100% of the next three (3) year capital improvement expenditure (CIP) projections (inclusive of the current fiscal year’s expenses)

identified in the District's current fiscal year budget. The minimum balance in the Reserve for New Infrastructure shall at all times equal or exceed 100% of the Pay-Go portion of the current fiscal year's CIP, 50% of the Pay-Go portion of the following fiscal year's CIP, and 25% of the Pay-Go portion of the next succeeding fiscal year's CIP. However, the funds appropriated to the Reserve for New Infrastructure may be accessed at any time for any other District purpose, upon approval by the Board. Funds appropriated to the Reserve for New Infrastructure may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District's General Fund.

(c) Rate Stabilization Reserve. A "Rate Stabilization Reserve" is hereby created, to which the Board may appropriate unrestricted District revenues. The Rate Stabilization Reserve may be utilized to protect District ratepayers from temporary increases in the cost of providing water service, such as fluctuations in the cost of energy, for example. The District shall endeavor to maintain the Rate Stabilization Reserve in an amount approximately equal to a minimum of 60 days of annual budgeted operating expenses, not including amounts paid to DWR in satisfaction of State Water Contract obligations and depreciation and amortization, and a maximum of 180 days of annual budgeted operating expenses, excluding depreciation and amortization and amounts paid to DWR in satisfaction of State Water Contract obligations. However, the funds appropriated to the Rate Stabilization Reserve may be accessed at any time for any other District purpose, upon approval by the Board. Funds appropriated to the Rate Stabilization Reserve may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District's General Fund.

(d) Reserve for Repairs and Replacements. A "Reserve for Repairs and Replacements" is hereby created for the District's general account, to which the Board may appropriate unrestricted District revenues. The Reserve for Repairs and Replacements may be utilized to repair and/or replace the District's physical plant, as needed. The District shall endeavor to maintain the Reserve for Repairs and Replacements in an amount approximately equal to the accumulated amount of depreciation of the District's physical plant (not including the State Water Project facilities), adjusted for inflation (i.e., the inflation-adjusted depreciation) as reflected in the annual audit of the District presented to the Board each year. However, the funds appropriated to the Reserve for Replacements may be accessed at any time for any other District purpose, upon approval by the Board. Funds appropriated to the Reserve for Repairs and

Replacements may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District's General Fund.

(e) Reserve for Self Insurance. This reserve is established by the District for the purpose of self insuring the District against any claims made against the District and to provide for the necessary cash flow to begin repair of the District infrastructure after a catastrophic event, such as a severe earthquake or fire, while long-term financing is being arranged. The Board has designated a minimum balance of \$15 million in this reserve. The balance in the reserve will be reviewed periodically to ensure that it is maintained at a level that would adequately protect the District. Funds appropriated to the Reserve for Self Insurance may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District's General Fund.

(f) Reserve for Other Post-Employment Benefits. A "Reserve for Other Post-Employment Benefits" is hereby created for the District, to which the Board may appropriate unrestricted District revenues. The Reserve for Other Post-Employment Benefits may be utilized to pay the costs of health and other non-pension benefits for retirees. This reserve is designated by the Board to maintain adequate money to cover the future costs of retiree health insurance or other benefits. The District shall endeavor to annually increase the Reserve for Other Post-Employment Benefits by one tenth of the Actuarial Accrued Liability as reported in the District's most recent Actuarial Valuation of Postretirement Healthcare Program as required by Governmental Accounting Standards Board Statement 45 up to a maximum of the total Actuarial Accrued Liability. However, the funds appropriated to the Reserve for Other Post-Employment Benefits may be accessed at any time for any other District purpose, upon approval by the Board. Funds appropriated to the Reserve for Other Post-Employment Benefits may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District's General Fund.

3. Additional Reserves

In addition to the reserves identified above, the Board may approve the creation of such additional accounts, whether temporary or permanent, as the Board deems necessary or appropriate, by amendment to this resolution or by simple motion. In such event, the Board will identify the purposes for which such additional accounts are created, provide guidance as to the amount which the District should endeavor to maintain in each such fund or account, and establish the limits and restrictions pertaining thereto.

ANNUAL REPORTS

Each year the District's General Manager shall provide the Board with a report indicating the beginning and ending balance for each of the reserve funds or accounts created pursuant to this policy and the purposes for which expenditures have been made therefrom, and shall make recommendations to replenish or augment fund or account balances as appropriate.