

POLICY NO. 1.3 Reserve & Financial Benchmark Policy	DISTRICT CODE Chapter 3.09 Sections 3.09.010 – 3.09.080	APPROVAL DATE 05/09/2023 EFFECTIVE DATE 05/10/2023
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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 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 Reserve Funds 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 Operating and Capital Improvement Budget.

SECTION 2: DEFINITIONS (3.09.020)

There are three types of Reserve Funds under the Net Position part of the Statement of Net Position in the Annual Comprehensive Financial Reports (ACFR) of the District:

A. NET INVESTMENT IN CAPITAL ASSETS

This category represents the current book value of all Capital Assets, net of any related outstanding debt. It is calculated using a formula, see Note 9 in the Notes of the Basic Financial Statements within the ACFR. This item is not part of this Policy.

B. 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.

C. UNRESTRICTED - BOARD DESIGNATED FUNDS

These funds are unrestricted but established and used for specific purposes as defined by the Board of Directors. The Board has the authority to designate Reserve Funds for specific capital and operating purposes which may be redirected by and action of the Board if needs of the District change.

Reserve Summary Table by Category

	Debt Service	Liquidity Funds	Capital Funds
Restricted	Bond Proceeds		Development Fees
Unrestricted		Rate Stabilization	Capital Project
		Water Banking	Capital Emergency
		Operating	Administrative Capital Improvement
		Compensated Absences	Local Water Resource Development
		CAP Carry-Over	

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

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 District will do this analysis in the context of funding future capital facilities and maintaining and replacing existing assets. 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.

Fund balances will be reviewed on an annual basis to ensure compliance with this Policy. On an as-needed basis, money 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)

RESERVE TYPE	SOURCE	TARGET LEVELS
<u>RESTRICTED FUNDS</u>		
Bond Proceeds	Proceeds from bond issuance	Required by Bond documents
Development Fees	Developer fees Revenue	Required by Statute
<u>UNRESTRICTED – BOARD DESIGNATED FUNDS</u>		
LIQUIDITY FUNDS:		
Rate Stabilization	Operating water revenues	Min: \$2,200,000
Water Banking	Operating water revenues	Min: 3% of Budgeted water sales; Max: cost of 5,000 AF MWD Tier II water
Operating Reserve	Operating revenues	Min: 20% of Budgeted operating expenses; Max: 50% of Budgeted operating expenses
Compensated Absences Program	Operating revenues	Min: 50% of calculated annual liability;

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		Max: 100% of calculated annual liability
CAP Carry-Over	Tower lease revenues	Excess Budget of CAP expense; Limit \$200,000
CAPITAL FUNDS:		
Capital Project	Operating & non-operating revenues	Min: 100% of current year's pay-go capital budget plus 25% of subsequent year's Max: 100% of current year's pay-go capital budget plus two subsequent years'
Emergency	Operating & non-operating revenues	Min: 1% of total capital assets Max: 4% of total capital assets
Administrative Capital Improvement	Operating & non-operating revenues	Min: 100% of current capital budget of vehicle, field and office related projects Max: minimum amount inflated by CPI
Local Water Resource Development	Operating & non-operating water revenues	Min: \$4,000,000 (est. cost of one new groundwater well) Max: \$8,000,000

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 may include a debt service reserve fund (“DSRF”), if such was deemed necessary. 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. Source of Fund(s) - Any excess principal and/or interest earnings can be used to pay debt service on the bonds.
- ii. 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.
- iii. 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.
- iv. Authority – Based on related bond documents, District staff can initiate transfer.
- v. Review Dates– Reviewed by the Trustee and District staff.

b. Development Fees: Statutes mandate that monies collected from development fees shall be accounted for separately.

- i. Source of Fund – Water, Sewer and Recycled Water developer fees are collected as a condition of development in accordance with the District’s Water Code.
- ii. Target Level –The balance in this account will fluctuate depending on the amount collected and the amount expended. Therefore, no minimum or maximum levels will be established.
- iii. Use of the Fund – Funds may be utilized for capital improvement projects for facilities and assets in the District’s Water, Sewer and/or Recycled Water systems.
- iv. Authority – Board approval is necessary.
- v. Review Dates – Fund balances will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.

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 Program 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. Source of Fund – Unrestricted portion of surplus of combined operating and non-operating water revenues.
- ii. 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 General Manager (“GM/CEO”), or Director of Finance and Technology Services after consultation with the District’s Municipal Advisor and expressly approved by the Board.
- iii. 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.

- iv. **Authority** - The Board, on a case-by-case basis, will determine the amount and timing for any use of the fund.
 - v. **Review Dates**– Fund balances will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.
- 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. **Source of Fund** – Unrestricted portion of surplus of combined operating and non-operating water revenues.
 - ii. **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.
 - iii. **Use of the Fund** – This fund may be routinely utilized by staff to purchase excess supplies of water.
 - iv. **Authority** – Board approval is necessary.
 - v. **Review Dates**– Fund balances and target level will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.
- 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 cash flow needs.
- i. **Source of Fund** – Unrestricted portion of surplus of combined operating and non-operating Water, Sewer or Recycled Water revenues.
 - ii. **Target Level** – Funding shall be targeted at a minimum amount equal to 20% of the District’s budgeted total annual operating expenses, and the maximum amount shall not exceed 50% of the budgeted total annual operating expenses in the Water, Sewer and Recycled Water Funds.
 - iii. **Use of the Fund** –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.

- iv. Authority – Board approval is necessary.
 - v. Review Dates– Fund balances and target level will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.
- 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. Source of Fund – Unrestricted portion of surplus of combined operating and non-operating Water, Sewer or Recycled Water revenues.
 - ii. 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.
 - iii. Use of the Fund – This fund may be routinely utilized by staff to cover large, unbudgeted cash-out payments.
 - iv. Authority – Board approval is necessary.
 - v. Review Dates – Account balances and target level will be reviewed by staff and the Board annually during the preparation and approval of the ACFR.
- 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. Source of Fund – 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. Target Level – No minimum amount, but maximum is limited at \$200,000 based on Administrative Policy 1.9, Customer Assistance Program.
- iii. Use of the Fund – In the event that CAP participation exceeds the amount allocated in the annual Budget by the Board of Directors, this reserve fund can be utilized to supplement the budget shortfall for the fiscal year.
- iv. Authority – The General Manager/CEO has authority to transfer funds in accordance with Section 6 of this policy.
- v. Review Dates – Account balances will be reviewed by staff and the Board annually during the preparation and approval of the ACFR.

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. Source of Fund – Unrestricted portion of surplus of combined operating and non-operating Water, Sewer or Recycled Water revenues.
 - ii. 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. The maximum target level is set to be 100% of the current and two subsequent years' pay-go capital budget.
 - iii. Use of the Fund – Staff will recommend new assets to be constructed or assets to be replaced during the Capital Improvement Budget preparation.
 - iv. Authority – As projects are approved by the Board, funds will be appropriated from reserve funds or available revenues.
 - v. Review Dates – Fund balances and projected improvement projects will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.
- 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. Source of Fund – Unrestricted portion of surplus of combined operating and non-operating Water, Sewer or Recycled Water revenues.
 - ii. Target Level – Funding shall be targeted at a minimum equal to 1% of the total capital assets of the District’s Water and Sewer systems with a maximum level set at 4%, based on current Federal Emergency Management Agency (FEMA) guidelines.
 - iii. Use of the Fund – Funds can be used to replace or repair equipment or infrastructure that gets damaged in case of a natural disaster. During a major economic downturn, funds can be used for operating purposes.
 - iv. Authority - The Board may designate use of this fund after establishing that conditions exist as called out in the definition and use of the fund.
 - v. Review Dates – Fund balances and target level will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.
- 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. Source of Fund – Unrestricted portion of surplus of combined operating and non-operating Water, Sewer or Recycled Water revenues.
 - ii. Target Level – The District shall seek to maintain a minimum balance of 100% of each current budgeted vehicle, field, 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.
 - iii. 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 as available.
 - iv. Authority - The Board will appropriate funds for specific projects during the Capital Improvement Project budgetary process. Special projects can be funded on an as-needed or project-by-project basis, also requiring Board approval.

- v. Review Dates – Fund balances and projected improvement projects will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.
- 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. Source of Fund – Unrestricted portion of surplus of combined operating and non-operating Water, Sewer or Recycled Water revenues.
 - ii. Target Level – Funding shall be targeted at a minimum amount equal to \$4 million, the approximate cost of a new groundwater well, and a maximum of \$8 million, the estimated cost of two new groundwater wells.
 - iii. Use of the Fund – 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.
 - iv. Authority – Board approval is required.
 - v. Review Dates – Fund balances and projected improvement projects will be reviewed by staff and the Board during the preparation and approval of both the Operating and Capital Improvement Budget and the ACFR.

SECTION 5: EXCESS OF RESERVE REQUIREMENTS (3.09.050)

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 provides the maximum amount of savings to the District due to early prepayment. This analysis will consider any other factors, such as pre-payment penalties, call provisions, restricted debt service reserve funds and the current interest rate environment.
- iii. Staff will 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 (3.09.060)

CVWD adopts a Biennial Operating and Capital Improvement Budget that is balanced on a fiscal year basis. Management staff will make every effort to stay within the allotted annual budget amount 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 Limit	Review/Approval Level
Max. \$25,000	Department Managers/Directors
Max. \$50,000	Assistant General Manager or GM/CEO
Over \$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 the 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 (3.09.070)

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 resources 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 balanced 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 aggregate total of annual debt service payments.

SECTION 8: DELEGATION OF AUTHORITY (3.09.080)

The Board has sole authority to amend or revise the Reserve and Financial Benchmark 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

05/09/2023 (Resolution No. 2023-5-3)
03/23/2021 (Resolution No. 2021-3-9)
12/08/2020 (Resolution No. 2020-12-1)
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