

# **WEST BASIN MUNICIPAL WATER DISTRICT**

## **Designated Funds Policy**

### **1.0 Introduction**

West Basin Municipal Water District's Board of Directors ("Board") has developed a Strategic Business Plan to provide continuous direction for planning, budgeting, implementing, evaluating and reporting. The Strategic Business Plan sets the overall policy direction and strategic priorities established by the Board. In order to achieve the Strategic Business Plan, the Board developed goals, objectives and strategies in the areas of Water Reliability, Water Quality, Customer Service, Sound Financial & Resource Management and Environment.

One of the objectives of the Strategic Business Plan is to complete and maintain a long range financial plan. A long range financial plan provides an agency a financial outlook while addressing the business objectives. Among other things, the long range financial plan ensures an entity develops or modifies financial policies to sustain fiscal integrity into the future.

A Designated Funds policy ("Policy") sometimes referred to as a Reserve policy is a part of West Basin Municipal Water District's ("West Basin") financial policies. The Policy will help to ensure that adequate designated fund balances are established for protection and furtherance of West Basin's mission.

### **2.0 Roles and Responsibilities**

The Policy shall be initially adopted by the Board and reviewed annually to ensure designated funds and targets are established to achieve an appropriate overall minimum target balance. Future updates, if necessary, to the Policy require the approval by the Board.

The Chief Financial Officer is the designated administrator of the Policy. The Chief Financial Officer shall have the day-to-day responsibility and authority for implementing and managing the Policy.

### **3.0 Purpose**

Designated funds can be defined as "fund(s) maintained to account for specific purposes and are not externally restricted."

Prudent financial planning and fiscal responsibility includes anticipating and preparing for future funding needs as well as unexpected emergencies. The Policy establishes designated funds for its long term organizational and operational stability and also helps to minimize significant rate fluctuations due to unforeseen cash flow requirements.

Adequate designated funds further serve to boost the confidence of external interested parties such as creditors, bondholders, and rating agencies that place a high degree of importance on strong, healthy fund balances as a cushion against steep revenue declines, and unexpected and uncontrollable expenses.

#### **4.0 Types of Funds**

West Basin maintains two major types of funds, either restricted reserves or unrestricted reserves. Unrestricted reserves are maintained within the general fund and consist of designated and undesignated funds. Each designated fund is established with a target amount and a target date (see section 6.0) and any funds in excess of the cumulative target amounts will be considered undesignated funds. Both the designated and undesignated funds can be used for any lawful purpose at the discretion of the Board of Directors.

Restricted reserves consist of funds with external restrictions imposed by creditors, grantors, contributors, or by laws or regulations of government and can only be used for specified purposes and are not governed by this policy.

#### **5.0 Target Levels**

Using a target amount approach to funding West Basin's designated funds will provide more rate certainty and predictability. Each Board approved designated fund will be established with a target amount and target date. The target amounts are based on West Basin's experience, the current operating budget and/or capital improvement plan. The sum of all the targets will provide an overall target amount which will serve as a trigger for the Board to consider options when funding levels fall near or below the overall target. If water sales decline and reserve levels approach the minimum level, the Board would have time to consider reducing operating costs and or capital costs before increasing water rates. If reserve levels exceed the minimum, the Board could consider retiring outstanding debt, reducing future debt by placing the undesignated funds into a System Expansion Fund or placing the undesignated funds into a Rate Stabilization Fund.

#### **6.0 Description of funds**

As part of the annual budget development, the designated funds, their purpose and targets will be evaluated to determine the appropriate minimum cash balance. The current designated funds can be divided into two main categories: Core categories and Other categories.

##### **6.1 Core Categories**

- a. Operating Liquidity – Provides for a variety of potentially competing purposes such as paying operating expenses during temporary revenue shortfalls, expenses not originally budgeted and fluctuations in revenues and expenses caused by timing of billing cycles and/or timing of debt service.

- i. Target Amount – Daily budget operating expenses x 60 days (operating expense includes water purchases, program expenses and debt service).
    - ii. Target Date – Annual (June 30<sup>th</sup> of each fiscal year).
  - b. Operating Contingency – Provides protection in the event of variability against budgeted expenses as unforeseen developments can occur which cause actual expenses to exceed the budget (e.g. Recycling O&M).
    - i. Target Amount – 5% of Recycling O&M budget.
    - ii. Target Date - Annual (June 30<sup>th</sup> of each fiscal year).
  - c. Emergency Repairs – Provides for major failures of plant and equipment and gives the ability to fund an immediate response without financial disruption. Although preventive maintenance is intended to increase the predictability of equipment replacement, unanticipated equipment failure is unavoidable. This fund would be used to cover replacements made necessary by unplanned failures.
    - i. Target Amount – Ranges from cost of major repair/replacement or 1-2% of plant assets. An annual assessment will be performed by West Basin’s engineering and operations staff to assist in determining the appropriate target amount.
    - ii. Target Date – Annual (June 30<sup>th</sup> of each fiscal year).
  - d. Capital Contingency – Provides a cushion for unexpected capital cost increases and/or unanticipated capital projects that arise.
    - i. Target Amount – 10% of annual capital budget.
    - ii. Target Date – Annual (June 30<sup>th</sup> of each fiscal year).
  - e. Rehabilitation & Replacement (R&R) – Provides an immediate resource for ongoing R&R of the system. As West Basin’s assets continues to age, there will be increasing demands to replace its facilities. As a general rule, maintenance costs for an asset becomes more expensive as that asset ages, and eventually the economic decision is made to replace the asset.
    - i. Target Amount – Ranges from 1% of depreciable assets to annual depreciation. An annual assessment will be performed by West Basin’s engineering and operations staff to assist in determining the appropriate target amount.
    - ii. Target Date – Annual (June 30<sup>th</sup> of each year).

## 6.2 Other Categories

- a. System Expansion – Establish a sinking fund in which “excess” revenues are set aside for future needs. Since it is not feasible for West Basin to entirely fund construction of large-scale new capital facilities with current revenues or assets, a portion of future costs will be set aside and the remaining balance will be funded through issuance of long-term debt.
  - i. Target Amount – 5% cash financing for future large-scale capital projects.
  - ii. Target Date – Based on projected start of construction date.
- b. Rate Stabilization – Provides a resource to manage the level of water sales fluctuations from year to year. This fund operates as a buffer during any period where there are unexpected decreases in revenues or an expected rate increase from Metropolitan Water District (MWD) occurs.
  - i. Target Amount – Holding account for any “excess” funds.
  - ii. Target Date – Not Applicable.

## 7.0 **Objectives**

As described in Section 6.0 above, West Basin has two main categories of designated funds, a core category and other category.

- 7.1 The core category is made up of five separate designated funds, each with its own target amount and with the same target date (June 30<sup>th</sup>). The sum of the five target amounts will be used to achieve a minimum cash target balance. This minimum cash target balance will be calculated annually and used to update the West Basin’s long range financial plan as well as the upcoming fiscal year’s operating budget.
- 7.2 The designated funds which are included in the other category (Section 6.2) will also be reviewed annually to determine the appropriate target amount and target date. As the target date for the System Expansion designated fund is based on large-scale capital projects and their construction start dates, the target amount will be excluded from the minimum cash target balance determined in Section 7.1.