

ARTICLE 4. DESIGNATED FUNDS POLICY

4-1.401 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 agency's 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") 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.

4-1.402 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.

4-1.403 PURPOSE²

Designated funds are 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 long term organizational and operational stability and to help 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.

4-1.404 TYPES OF FUNDS³

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 designated and undesignated funds can be used for any lawful purpose at the discretion of the Board.

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

4-1.405 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, if applicable. The target amounts are based on West Basin’s experience, the current operating budget, outstanding long-term debt, 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 may consider setting aside monies into the Standby Charge Defeasance Fund in order to retire outstanding debt in the future and eliminate the annual standby charge or placing the undesignated funds into a System Expansion Fund or a Rate Stabilization Fund.

4-1.406 DESCRIPTION OF FUNDS⁴

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 three main categories: Core categories, Standby Charge Defeasance Fund and Other categories.

(a) Core Categories

- (1) 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 180 days (operating expense includes program expenses and debt service but excludes the pass-through costs from water purchases and charges from Metropolitan Water District of Southern California (MWD)).
 - (ii) Target Date: Annual (June 30th of each fiscal year).
- (2) 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 30th of each fiscal year).
- (3) Capital Contingency: Provides a cushion for unexpected capital cost increases and/or unanticipated capital projects.
 - (i) Target Amount: 10% of 3-year average of capital budget.

- (ii) Target Date: Annual (June 30th of each fiscal year).
- (4) Rehabilitation & Replacement (R&R): As West Basin's assets continue to age, there will be increasing demands to replace its facilities. As a general rule, maintenance costs for an asset become more expensive as that asset ages, and eventually the economic decision is made to replace the asset. Although preventive maintenance is intended to increase the predictability of equipment replacement, unanticipated equipment failure is unavoidable. As part of its annual Operating Budget, West Basin includes money for anticipated R&R projects. This Fund will cover all emergency repairs and expenditures in excess of the amount included in the annual Operating Budget for R&R.
 - (i) Target Amount: 1% of all depreciable assets as of the fiscal year-end.
 - (ii) Target Date: Annual (June 30th of each year).
- (b) Standby Charge Defeasance Fund: A separate fund so that the Board may consider eliminating the standby charge if it determines that the original estimate of 70,000 to 100,000 acre-feet per year (AFY) of recycled water production will be or has been met and sufficient funds are available in the Standby Charge Defeasance Fund to pay off all remaining debt associated with those deliveries. Contributions to the Standby Charge Defeasance Fund are subject to Board discretion to cease making contributions to this fund or to re-allocate funds from this fund to other designated funds.
 - (1) Target Amount – Remaining principal, accrued interest and prepayment penalties, if any.
 - (2) Target Date – Not Applicable.
- (c) Other Categories
 - (1) System Expansion: A sinking fund in which revenues in excess of operating and maintenance costs, debt service and deposits to

required reserves are set aside for future needs. Since it is not feasible or practical 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.
- (2) Rate Stabilization: Provides monies to help manage the level of water revenue fluctuations from year to year. This fund operates as a buffer during any period where there are unexpected decreases in revenues or an unexpected rate increase from Metropolitan Water District (MWD) occurs.
- (i) Target Amount: 100% of one (1) year of potable, recycled and desalter water sales.
 - (ii) Target Date: Not Applicable.

4-1.407 OBJECTIVES⁵

As described in Section 6.0 above, West Basin has three main categories of designated funds, a Core category, Standby Charge Defeasance and Other category.

- (a) The Core category is made up of four separate designated funds, each with its own target amount and with the same target date (June 30th). The sum of the four 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.
- (b) The minimum cash target balance, as described in Section 7.1, must be met before any monies are placed into the designated funds in the Other category described in Section 6.3.

- (c) The Standby Charge Defeasance fund will be reviewed annually (Section 6.2). The Board may set aside up to 100% of surplus net revenues. The target amount will change from time to time as outstanding debt is paid or new debt is issued and will be excluded from the minimum cash target determined in Section 7.1. A target date will not be established as the amount of funding will vary from year to year as it is based on surplus net revenues, if any, the Board sets aside.
- (d) The designated funds which are included in the Other category (Section 6.3) will also be reviewed annually to determine the appropriate target amount and target date, if applicable.

4-1.408 DEFINITIONS

- (a) Actual Debt Coverage is calculated based on net revenue divided by annual debt service at the completion of any one fiscal year.
- (b) Budgeted Debt Coverage is calculated based on net revenues divided by annual debt service as determined in the adopted Fiscal Year budget.
- (c) Debt Service is the principal and interest payment on bonds or other debt instruments used to finance capital facilities.
- (d) Surplus Net Revenues is calculated as annual debt service multiplied by the difference between the actual debt coverage and the budgeted debt coverage.
- (e) Net Revenue is the difference between revenues and operating expenses. Revenues include all water revenues, Metropolitan Water District local resources program incentive, fixed revenue, conservation or other income. Operating expenses include water purchases and operating expenses, but excludes non-cash items like depreciation or amortization. For the purpose of this definition, net revenue will exclude capital grants and capital reimbursements.

- (f) Standby Charge is an annual charge paid by property owners in West Basin's service area to fund the debt service obligation on West Basin's water recycling facilities.

LIST OF CHANGES TO PART 4, CHAPTER 1. ADMINISTRATIVE MATTERS

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- ¹ Section 4-1.301 amended by Resolution 2-16-1027 on February 22, 2016.
 - ² Section 4-1.403 amended by Resolution 2-16-1027 on February 22, 2016.
 - ³ Section 4-1.404 amended by Resolution 2-16-1027 on February 22, 2016.
 - ⁴ Section 4-1.406 amended by Resolution 2-16-1027 on February 22, 2016.
 - ⁵ Section 4-1.407 amended by Resolution 2-16-1027 on February 22, 2016.
 - ⁶ Section 4-1.502 amended by Resolution 2-16-1027 on February 22, 2016.
 - ⁷ Section 4-1.504 amended by Resolution 2-16-1027 on February 22, 2016.
 - ⁸ Section 4-1.505 amended by Resolution 2-16-1027 on February 22, 2016.
 - ⁹ Section 4-1.506 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹⁰ Section 4-1.507 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹¹ Section 4-1.509 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹² Section 4-1.512 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹³ Section 4-1.601 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹⁴ Section 4-1.605 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹⁵ Section 4-1.606 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹⁶ Section 4-1.607 amended by Resolution 2-16-1027 on February 22, 2016.
 - ¹⁷ Section 4-1.613 amended by Resolution 2-16-1027 on February 22, 2016.