

TEHACHAPI-CUMMINGS COUNTY WATER DISTRICT

RESERVES POLICY

A. PURPOSE

The purpose of this policy is to establish various reserve targets and funding priorities. Reserves are maintained to protect the district's creditworthiness and to provide for continuing operations including the maintenance and eventual replacement of existing facilities and infrastructure, the addition of new capital assets, unforeseen and unexpected emergencies, cash flow requirements and to ensure stable services and fees. This reserves policy is to ensure that the district accumulates, manages, maintains and uses certain financial resources only for specified purposes. Working capital (current assets less current liabilities) will be used to determine reserve levels in each of the funds. Working capital is a better measure than either cash or net position for determining the district's ability to meet its short-term (1 to 2 years) financial obligations. Long-term needs, such as replacement of large portions of the district's water importation system, are not addressed by this policy. At this time, it is assumed that such projects will be financed with long-term debt with repayment provided by revenues from a future voter-approved tax levy.

B. TYPES OF RESERVES

The district maintains two types of reserves:

1. Designated Reserves. Designated reserves are reserves that are established by the Board of Directors and set aside to be used only for a specific, designated purpose. The source of their money is the general fund; therefore, the purpose of the reserves may be changed at the Board's pleasure.
2. Restricted Reserves. Restricted reserves are reserves that are restricted by an outside source, such as by statute, court order, contract or bond covenant. These reserves must remain in their respective funds, except for Board-approved short-term borrowing (with full interest repayment).

C. DESIGNATED RESERVES

The district maintains a general fund, which is the district's water enterprise fund. Although it is an enterprise fund, its primary funding source is general property taxes. The fiscal year 2017-18 budget forecasts that 54% of general fund revenues will be from property taxes and 46% will be operating revenues from water sales and services. Costs to perform the district's watermaster duties under the three judgments are also paid from the general fund.

The Government Finance Officers Association recommends that for enterprise funds “governments should start with a baseline of ninety (90) days worth of working capital and then adjust the target based on the particular characteristics of the enterprise fund in question (using 45 days as the minimum acceptable level).” Because the district’s general fund is primarily tax supported and the first installment of property tax revenue is received five months after the start of the fiscal year, the general fund’s July 1 beginning working capital will be equal to or greater than 90 days of operating expenses and at no point during the year will the working capital fall to less than 45 days of operating expenses.

An 85% State Water Project allocation in 2017 will provide more water than the district can import this year, so a portion will be carried over in San Luis Reservoir into 2018, giving the district a cushion for next year.

In addition to this minimum funding level, the district has established four designated reserve funds. Full reserve targets and interim targets (50% of the full targets) are established herein. Money will be accumulated in the reserve funds in the order presented until the interim target is achieved, at which time the next designated reserve will begin to accumulate. Once all four interim reserve targets have been achieved, money will accumulate in each fund in the order presented until the full target for each fund has been reached. All expenditures or transfers from these reserve funds will be replaced as quickly as possible in the manner of priority as described above.

1. Tax Revenue Liability Fund. This fund was established to continue normal operations in the aftermath of property tax revenue losses resulting from taxpayer appeals. Its working capital balance as of June 30, 2017 is estimated at \$591,900. Each year Kern County publishes a tax revenue liability estimate for the district’s general fund. Since it is very unlikely that every taxpayer appeal will be granted, the district will fund this reserve at 50% of the County’s estimate.

2. Emergency Fund. This fund was established in 1986 in recognition of the fact that the district does not have insurance coverage for earthquake or flood damage. Its purpose is to set aside money for (1) repair, restoration or replacement of district facilities damaged as the result of natural disasters, (2) matching fund payments for cost sharing required under federal or state disaster assistance programs and (3) district personnel overtime costs and supplies used during eligible disaster response and recovery activities, including the cost of administering those activities. In 1986, it was funded in the amount of \$50,000 and it now has an estimated balance of \$308,300. It shall be the policy of this district to maintain working capital in this fund at 5% of the general fund’s operating expenses.

3. Major Repairs and Overhaul Fund. This fund is for the purpose of major, unanticipated replacement of the district's water importation system components. Of particular concern is the failure or replacement of one or more natural gas engines at one of the pump plants; however, the funds may be used for the unexpected replacement of other system components as well. This fund's June 30, 2017 estimated balance is \$1,411,500. Going forward, it shall be the policy of this district to maintain working capital in this fund at 5% of the book value of the general fund's capital assets.

4. Rate Stabilization Fund. This reserve is used to normalize fluctuations in revenues so that water rates will be more stable over time. The money is used as a buffer to reduce the frequency of changes to the district's water rates. The amount is intended to fluctuate between 1% and 5% of the general fund's operating expenses. The 6/30/17 estimated balance is \$308,100.

The district has attained its goal of 90 days working capital in the general fund and intends to maintain this minimum funding level in perpetuity. As of June 30, 2017, all four of the general fund designated reserve targets are fully funded. The budget for fiscal year 2017-18 shows that costs will be controlled and sufficient revenues will be generated such that all general fund designated reserve targets will continue to be fully funded.

D. RESTRICTED RESERVES

The district maintains five restricted funds:

1. State Payment Fund. This fund is for the purpose of paying the obligations of the Kern County Water Agency contracts for State Water Project costs. The district levies a special tax sufficient to cover all current costs under its two water supply contracts, and maintains sufficient working capital for a six-month operating reserve and half of its tax revenue liability reserve as determined by the Kern County Auditor-Controller. All unspent monies in this fund remain in the fund.

2. Prop 84 Grant Fund. This fund is for the purpose of separating the grant-related expenditures and reimbursement revenues from the Department of Water Resources for the district's Water Use Efficiency Project. This fund requires a cash-flow reserve to accommodate DWR's reimbursement schedule.

3. Improvement District No. 2. This fund is for the purpose of providing flood control within the discrete area known as ID2. Property within ID2 is subject to property taxes which fund this service. All unspent monies in this fund remain in the fund for future maintenance and replacement of its flood control facilities. Reserves must be adequate to repair or replace structures damaged in a flood event. Although some funds may become available from federal or state agencies in a declared disaster event, it is possible that facilities could be damaged in a localized flood event that is not part of a declared disaster; therefore, the district sets a reserve target of 50% of the estimated replacement cost of the facilities. The estimated replacement cost is calculated as the original construction cost adjusted for inflation.

4. Improvement District No. 3. This fund is for the purpose of providing flood control within the discrete area known as ID3. Property within ID3 is subject to property taxes which fund this service. All unspent monies in this fund remain in the fund for future maintenance and replacement of its flood control facilities. Similar to ID No. 2, the reserve target for this fund is set at 50% of the estimated replacement cost of the facilities.

5. Benefit Assessment District No. 1. This fund is for the purpose of providing flood control within the discrete area known as AD1, also known as the Tehachapi Watershed Project. Property within AD1 is subject to a special benefit assessment which funds this service. All unspent monies in this fund remain in the fund for future maintenance and replacement of its flood control facilities. The district shall maintain working capital in this fund equal to 50% of the estimated replacement cost of the facilities.

Reserves in the State Payment Fund are fully funded now. Reserve targets for the three flood control districts are not fully funded, nor does it appear that they will be any time soon. Flood control assets tend to stay in place for long periods of time and function without damage under normal conditions. However, they can be damaged or destroyed by natural disaster events (100-year flood, for example), which would require rebuilding of the structures. In such events, it is likely that FEMA and CalEMA would provide funding assistance to the district to rebuild the flood control facilities. Under this scenario, the district's reserves would be used for matching funds (typically 10% to 25% of total cost) to secure the disaster assistance funds.

E. MANAGEMENT OF RESERVE FUNDS

The General Manager will be responsible for managing the accumulation of reserves in the various funds in accordance with Board policy. Only the Board of Directors may authorize the expenditure or transfer of money from any of the district's reserve funds. The Board annually will review the balances of the reserve funds, work collaboratively with the General Manager to ensure the accuracy of the annual report, and evaluate the goals and purposes of each reserve fund and adopt policy changes as may be necessary or desirable.

Reserves	Reserve Formula	Full Reserve Target	Interim Reserve Target	Actual Reserve 6/30/16	Forecast Reserve 6/30/17	Reserve Target Met?
Designated Reserves:						
<u>General Fund</u>						
Working capital	90 days of operating expenses (prior year audit)	\$ 1,376,400	\$ 1,376,400	\$ 3,487,078	\$ 3,969,200	Full - Yes
Water banking reserve	Cost to spread 4,000 AF of imported SWP water	1,286,960	1,286,960	1,569,338	1,318,400	Full - Yes
<u>Tax Revenue Liability Fund</u>						
Tax revenue liability reserve	50% of Kern County's liability estimate	591,900	295,950	383,022	591,900	Full - Yes
<u>Emergency Fund</u>						
Emergency reserve	operating expenses (prior year audit)	275,300	137,650	305,303	308,300	Full - Yes
<u>Major Repairs / Overhaul Fd</u>						
Asset maintenance / replacement reserve	5% of capital assets' book value (prior year audit)	1,411,500	705,750	1,241,037	1,411,500	Full - Yes
<u>Rate Stabilization Fund</u>						
Rate stabilization reserve	1 to 5% of general fund operating expenses	275,300	137,650	305,079	308,100	Full - Yes
Restricted Reserves:						
<u>State Payment Fund</u>						
Six-month operating reserve	50% of current year expenditure budget	1,333,500	1,333,500	1,264,613	1,828,600	Full - Yes
Tax revenue liability reserve	50% of Kern County's liability estimate	152,400	152,400	117,954	152,400	Full - Yes
<u>Prop 84 Grant Fund</u>						
Matching funds	per grant	-	-	62,878	-	Full - Yes
<u>Improvement District No. 2</u>						
Asset maintenance / replacement reserve	50% of construction cost indexed for inflation	229,400	229,400	88,583	92,700	No
<u>Improvement District No. 3</u>						
Asset maintenance / replacement reserve	50% of construction cost indexed for inflation	509,800	509,800	170,957	158,700	No
<u>Assessment District No. 1</u>						
Asset maintenance / replacement reserve	50% of construction cost indexed for inflation	1,461,700	1,461,700	690,692	756,100	No