

**TEHACHAPI-CUMMINGS COUNTY WATER DISTRICT
RESERVES POLICY**

A. PURPOSE

The purpose of this policy is to establish various reserve targets, funding priorities, and accomplish prudent financial planning to ensure 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. This reserves policy serves to ensure Tehachapi-Cummings County Water District's (TCCWD's) reserves are accumulated, managed, and maintained to protect the District's creditworthiness; to provide for continuing operations including cash flow requirements, maintenance and eventual replacement of existing facilities and infrastructure, addition of new capital assets, unforeseen and unexpected emergencies; to ensure certain financial resources are used only for specified purposes; and, to facilitate stable services and fees.

The policy directives outlined in this reserve policy are intended to ensure TCCWD has sufficient funds available to meet current and future needs. The Board of Directors of TCCWD ("Board") shall designate the specific fund accounts and maintain minimum fund balances consistent with the Fund definitions and funding levels outlined in the Policy. The Board will annually review the level of Funds. For purposes of compliance with this Policy, TCCWD will use Working Capital (current assets less current liabilities) as of the final day of each fiscal year to calculate the fund levels. Working Capital is a better measure than either cash or net position to determine the District's ability to meet its financial obligations and to accomplish its financial plans.

Through this Policy and the Strategic Plan document, TCCWD has set forth a number of its short-term, mid-term and long-term goals. A fundamental purpose of the Policy and Plan is to link what must be accomplished with the necessary resources to successfully do so. Upon Board adoption of this Reserve Funds Policy, TCCWD will take the necessary actions to comply with this Policy.

B. GENERAL PROVISIONS

TCCWD will maintain its Funds in separate, designated sub-accounts in a clearly identifiable manner that provides transparency to its ratepayers. Moneys that are legally restricted will be held in Restricted Reserves. Moneys that are not legally restricted will be held in unrestricted Designated Reserves and General Fund accounts.

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. Once a Designated Reserve's working capital target is funded, any surplus unrestricted funds may be reallocated.

In assessing the funding of future capital facilities and maintaining and replacing existing assets, TCCWD will analyze the benefits and tradeoffs of utilizing pay-as-you-go and/or debt financing and determine the optimal funding strategy. The analysis will consider TCCWD's current and projected working capital fund levels.

In the event the Designated Liquidity Funds balances exceed the established levels, excess moneys will be transferred annually into the Designated Capital Funds. Moneys from the Designated Capital Fund can be moved to pay for operating **emergencies** to supplement the Designated Liquidity Funds. In addition, in the event the Capital Fund balances exceed the established maximum, the Board will make a determination regarding the reallocation of excess moneys.

Interest income will be credited to the fund on which it was earned until the funds maximum balance is achieved. Once the maximum balance is reached within a specific reserve fund, the surplus interest earnings

will be reallocated to other reserve funds whose funding level is below the minimum or maximum requirement recommended by this Policy.

C. TYPES OF RESERVES and FUNDS

The district maintains two types of reserves: 1) **Designated Reserves**, and 2) **Restricted Reserves**. Designated Reserves include two types of Funds: 1) **Liquidity Funds**, and 2) **Capital Funds**.

1. **Designated Reserves.** Designated Reserves are unrestricted reserve funds established by an action of the Board of Directors and set aside for a designated, specific purpose to ensure flexibility and stability. The source of their money is the general fund; therefore, the Designated purpose may be changed by the Board. **Liquidity Fund Reserves** may be changed or made available for short-term operating loans, when deemed appropriate. **Capital Fund Reserves** may be changed or made available for borrowing when deemed necessary in **emergency** situations resulting from extreme, unforeseen, or unexpected circumstances.

2. **Restricted Reserves.** Restrictions on the use of these funds are imposed by an outside source such as creditors, grantors, contributors, statutes, court orders, contracts, or bond covenants governing use. These reserves must remain in their respective funds, except for Board-approved short-term borrowing (with full interest repayment).

D. DESIGNATED RESERVES

1. Liquidity Funds

General Fund. 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 2020-21 budget forecasts that 60% of general fund revenues will be from property taxes and 40% 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 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. From time-to-time, moneys in excess of 90 days operating expenses may be set aside within the General Fund Reserve and earmarked by the Board as **Water Banking Reserve** to cover the cost to replace or extract the District's banked water.

The anticipated 20% (3,860 AF) State Water Project Table A allocation in 2020 is inadequate to meet the District's customer demand and BWRA requirements. To meet demand, banked water will need to be withdrawn. The District plans to withdraw approximately 2,000 AF from in-District banked supply and 2,800 AF from San Joaquin Valley banked supply. These supplies, along with 711 AF of 2019 Table A water carried over into 2020, will provide an imported water supply of approximately 9,342 AF, which falls short of our annual goal of 10,000 AF, but satisfies projected demand.

In addition to the General Fund Reserve, the District has established four (4) Designated Liquidity Fund Reserves and one (1) Designated Capital Fund Reserve. Full reserve targets and interim targets are established herein. All expenditures or transfers from these reserve funds will be replaced as quickly as possible in the manner of priority as described in the above General Provisions.

1. Liquidity Funds, continued

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, 2020 is estimated at \$308,846. Each year Kern County publishes a tax revenue liability estimate for the District's General Fund. Since it is unlikely that all taxpayer appeals will be granted, the District will fund this reserve at 50% of the County's estimate. The interim target shall be set at 50% of the full target.

Emergency Fund. This fund was established in 1986 to mitigate the fact that the district does not carry 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. It now has an estimated balance of \$416,343. It shall be the policy of this district to maintain working capital in this fund at 5% of the general fund's operating expenses. The interim target shall be set at 50% of the full target.

Major Repairs and Overhaul Fund. This fund is for the purpose of major, unanticipated repairs or 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, 2020 estimated balance is \$1,625,002. 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. The interim target shall be set at 50% of the full target.

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 6/30/20 estimated balance is \$613,471. The interim target shall be set at 50% of the full target.

2. Capital Funds

Equipment/Infrastructure – Replacement/Upgrade. This fund was established and designated for future capital needs to fund the cost of both new and replacement projects as a part of the District's Strategic Planning. The fund was created with the approval of the FY 2019-2020 budget. The Strategic Plan document sets out a short-term (1-2 years), mid-term (3-5 years), and long-term (6-10 years) capital improvement plan. The current fiscal year capital improvement needs shall be funded from the General Fund and included in the annual budget process. The full reserve target shall be equal to 20% of the mid-term capital improvement plan. The interim target shall be set at 50% of the full target. Any water rate revenues greater than debt service obligations and the cost of natural gas shall be designated for transfer to this fund annually. The Designated purpose of this fund may be changed or made available for borrowing when deemed necessary in **emergency** situations resulting from extreme, unforeseen, or unexpected circumstances. Any expenditure or transfer from this fund will be replaced as quickly as possible to ensure funding stability.

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, 2020, all four (4) of the generally funded, Designated Liquidity Funds' reserve targets are fully funded. The generally funded, Designated Capital Fund reserve targets are being funded in the manner described in the General Provisions. The budget for fiscal year 2020-21 shows that costs will be controlled, and sufficient revenues will be generated such that all General Fund Designated Reserves will continue to be funded in accordance with this Policy to meet the targets and manner of priority set out in the General Provisions.

E. RESTRICTED RESERVES

The District maintains five (5) Restricted Reserve Funds:

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 **Ad-Valorem** tax sufficient to cover all current costs under its two water supply contracts. The reserve balance is maintained at a level sufficient to cover six-months of operating expense obligation and one-half (1/2) of the Fund's **tax revenue liability** as determined by the Kern County Auditor-Controller. All unspent moneys in this fund remain in the fund.

Prop 1 Grant Fund. This fund is for separating the 2020-21 anticipated grant-related expenditures and reimbursement revenues from the Department of Water Resources for the District's Westerly Cummings Basin Recharge Project. This fund requires a cash-flow reserve to accommodate DWR's reimbursement schedule. **Note**, this fund was previously named the **Prop 84 Grant Fund**. As of 6/30/19, the project associated with Prop 84 was completed and the remaining fund balances were closed to the General Fund.

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 moneys in this fund remain in the fund for future maintenance and replacement of its flood control facilities. The District sets a reserve target for this fund at 50% of the estimated replacement cost of the facilities. The estimated replacement cost is calculated as the original construction cost adjusted for inflation.

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 moneys in this fund remain in the fund for future maintenance and replacement of its flood control facilities. The District sets a reserve target for this fund at 50% of the estimated replacement cost of the facilities. The estimated replacement cost is calculated as the original construction cost adjusted for inflation.

Benefit Assessment District No. 1. This fund is for the purpose of providing flood control within the discrete area known as AD1. Property within AD1 is subject to a special benefit assessment which funds this service. All unspent moneys 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. The estimated replacement cost is calculated as the original construction cost adjusted for inflation.

Reserve targets for the three (3) flood control districts are not fully funded and are not anticipated to be so for quite some time. Ideally, these reserves should be adequate to repair or replace structures damaged in a flood event. 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 requiring rebuilding. Some funds may become available from federal or state agencies in a declared disaster event, but it is possible that facilities could be damaged in a localized flood event that is not part of a declared disaster. In the event of a declared disaster, 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 10-20% of total cost) to secure the disaster assistance funds.

F. MANAGEMENT OF RESERVE FUNDS

Fund balances will be reviewed, at a minimum, on an annual basis to ensure compliance with this Policy. The General Manager will be responsible for managing the accumulation of reserves in the various funds in accordance with Board policy. Only the Board shall approve any reallocation of funds or any transfers between Funds. The Board will 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.

The minimum established for each Fund represents the baseline financial condition that is acceptable to TCCWD from risk and long-term 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 revenue generating alternatives. These alternatives (either alone or in combination with each other) include, but are not limited to: Fees and charges, energy usage, capital financing, investment of funds, and levels of capital expenditures.