

# Contra Costa Water District Reserve Policy

## Reserve Policy

The purpose of the Contra Costa Water District's (CCWD or District) Reserve Policy is to ensure that the District will, at all times, have sufficient funding available to meet its operating, capital and debt service cost obligations. Reserves will be managed in a manner that allows the District to fund costs consistent with its annually updated Capital Improvement Program and Ten-Year Financial Plan as well as other long-term plans (such as the Treated Water Master Plan, Urban Water Management Plan, etc.), while avoiding significant rate fluctuations due to changes in cash flow requirements. Operating reserves will be maintained at a minimum level of six months of budgeted operating costs, consistent with the adopted Rate Setting Policy. Adequate reserves and sound financial policies promote CCWD's bond ratings in the capital markets; provide financing flexibility; avoid potential restrictive debt covenants; and ensure the District's customers of stable rates. The Reserve Policy covers all reserve funds of the District. At the end of each fiscal year compliance with the Reserve Policy will be reported to the District's Board of Directors as part of each Fiscal Year-End Financial Report.

## Reserve Fund Types

There are three major types of reserve funds: Legally Restricted Reserves, Board Designated Reserves and Unrestricted Reserves. Legally Restricted Reserves have restrictions imposed by an outside source, such as bond covenants, contractual obligations, etc. Board Designated Reserves are set aside for a specific purpose as determined by the Board of Directors. The Board of Directors has the authority to redirect the use of these reserves as the needs of the District change. Unrestricted Reserves are planned for use in each update to the Capital Improvement Program and Ten-Year Financial Plan to assist in providing for minimal orderly rate increases at or below inflation, consistent with the Board's Rate Setting Policy.

## CCWD Reserve Fund Specific Purposes

### Legally Restricted Reserves

- **Bond Reserve:** This fund is governed by legal bond covenants for the District's revenue bonds. Bond covenants require that this fund be maintained at a level sufficient to fund maximum annual debt service payments. These funds are held by the bond trustee during the term of the bonds and are to be used in the event that the District is unable to meet its required semi-annual debt service obligation.

Reserve funds for each revenue bond issue will be used to make the last two semi-annual debt service payments for that issue. Annual interest earnings on bond reserve funds shall be applied to each year's debt service payments. Reserve funds related to state revolving fund loans shall be treated identically to revenue bond reserve funds as these loans are contractually defined as parity debt to the District's senior lien bonds.

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Revised: 09/20/06; 09/05/07; 09/07/11; 09/21/16; 09/06/17; 11/14/18

- United States Bureau of Reclamation (USBR) Reserve: This fund is required by the District's water service contract with the USBR to have a minimum balance of \$1 million for the purpose of paying any annual obligation to the USBR. If the USBR reserve fund balance is drawn down below \$1 million in a given fiscal year, the fund use must be reported to the USBR, and the balance must be returned to the \$1 million minimum balance by the end of the same fiscal year.

This fund will be maintained at the minimum level of \$1 million as long as the District's water service contract with the USBR requires such a fund. If the District's water service contract with the USBR is amended to exclude this reserve fund requirement, the fund balance shall be transferred to unrestricted reserves.

- Legally-Restricted Project-Related Reserves: The District also maintains legally restricted reserves contract retention, and other funds that are restricted under a contract for a specific project or purpose.

#### Board Designated Reserves

- Rate Stabilization Reserve: This fund was established in accordance with the Master Bond Resolution adopted by the Board in October 1987. The purposes of the fund were to assist in smoothing rates to pay Los Vaqueros Project debt service and to assure that minimum debt service coverage ratios required by the District's bond covenants would be met in the future. Funds deposited into this reserve are treated as operating costs in the year of deposit and will be treated as revenues in years of use for the purposes of computing the District's debt service coverage ratio. The District's bond covenants and the Board of Directors' rate policy specify that the District's coverage ratio must be at least 1.25 to 1 for senior lien debt. This fund is applied in the ten-year financial plan and annual rate model along with other reserve funds to smooth future rate increases.

This fund was established in an amount sufficient to provide for average bond coverage of 1.275 times over the term of the District's outstanding bonded and other parity debt. The initial 1.275 times ratio was seen as prudent as it was moderately higher than the minimum debt service coverage required by the bond covenants. There is no industry-wide protocol for establishing the funding level for this reserve, and no requirement within the bond covenants to retain funding at this ratio. The Rate Stabilization Reserve Fund is to be drawn down to smooth rate increases consistent with the District's Rate Setting Policy and to ensure that minimum debt service coverage is met. Specifically, the fund will be applied in any year where other revenues are not sufficient to meet the required ratio of 1.25 times debt service coverage. The fund will also be applied if meeting only minimum coverage levels could result in the District's bond ratings being downgraded. The fund balance will be re-evaluated against future requirements annually, and any proposed adjustments presented to the Board of Directors for consideration.

- Capital Improvement Reserve: This fund was established by the Board in FY94 to fund revenue funded capital projects as planned in the Capital Improvement Program (CIP) and the two-year budget. This designated reserve shall provide funding for planned revenue-funded

capital projects for the upcoming fiscal year. The reserve shall assist with timing adjustments inherent in most capital projects as it will include funding for capital projects that require rebudgeting from one fiscal year to the next. This fund is applied in the ten-year financial plan and annual rate model, along with other reserve funds, to smooth future rate increases.

This fund will be drawn down annually as revenue capital expenditures are made. At the end of each fiscal year, the fund balance will be evaluated and replenished based on the upcoming year's revenue funded capital requirements reflected in the budget and/or CIP. Annual replenishment shall be reported to the Board of Directors as part of each Fiscal Year-End Financial Report.

- Vehicle Replacement Reserve: This fund was established in FY89 to fund planned replacement of vehicles and heavy equipment that have reached the end of their useful lives. This fund is utilized to cover equipment replacement while smoothing cash flows in the ten-year financial plan and annual rate model to minimize annual pressure on rates.

This fund will be drawn down annually as replacement vehicles are purchased, consistent with the adopted budget. At the beginning of each fiscal year, funds will be deposited in this sinking fund as provided for in the adopted fiscal year budget. Budget levels will be based generally on annualized deposit requirements as determined by the District's Ten-Year Financial Plan. Annual deposits shall be reported to the Board of Directors as part of each fiscal year-end financial report. In addition, interest earnings on fund balances will be deposited into the fund as will the net proceeds of the sale of replaced vehicles and equipment. These additional deposits are to provide for inflationary increases to replacement vehicle and equipment costs. This fund shall be maintained at a minimum balance of the funds required for the following year's budgeted fleet replacements. The balance shall not exceed total expenditures planned in the Capital Improvement Program and Ten-Year Financial Plan.

- Facility Reserve Charge (FRC) Reserves: A portion of each FRC charge for a new connection to the District's system is designated for future facilities to meet the demands of its future customers. The amounts collected for future facilities will be deposited into the designated reserves and will be used to fund the share of capital costs for future facilities associated with growth.
  - Future Water Supply Reserve: A portion of each FRC charge for a new connection to the District's system is designated for the purchase of new water supplies for both additional supply and improved supply reliability. The amount collected per new connection is based on the District's adopted Future Water Supply Study and the Facility Reserve Charge Study. These funds are set aside in a designated reserve for future water purchases as necessary to meet demand reliably.

The designated future water supply component of every charge for a new connection will be deposited into this reserve fund. The growth element of this fund will be used to purchase future water supplies, options, transfers, etc., to ensure that sufficient supply is available to serve planned growth in the District's service area. The reliability element may be used at the Board's discretion to fund capital projects to improve water supply and/or

quality reliability or to purchase water supplies aimed at improving reliability. Fund balances will be re-evaluated against future requirements following each update of the Future Water Supply Study, and any proposed adjustments will be presented to the Board of Directors for consideration.

- Future Capacity Reserve: A portion of each charge for a new connection to the District's system is designated for increasing water conveyance capacity to address the full demands of its future customers. The amount collected per new connection is based on the District's adopted Facility Reserve Charge Study. The designated components of every charge for a new connection will be deposited into this reserve fund. The funds in this reserve will be used for growth's share of capital costs associated with increasing water conveyance capacity.
- Liability Self-Insurance Reserve: This fund was established to pay extraordinary liability claims and expenses up to the self-insured retention levels specified in the District's insurance policies. The self-insured retention level is the amount that must be paid by the District before the insurance policy will respond to the loss. Use of these funds requires Board of Directors approval. If the amount of funds transferred in a given year results in a fund balance of less than \$1,250,000 at year-end, the fund shall be replenished over the next two years to reach the target funding level of \$1,250,000. Annual replenishments from unrestricted reserves shall be reported to the Board of Directors as part of the fiscal year-end financial report.
- Workers' Compensation Self-Insurance Reserve: This fund was established in FY07 to pay workers' compensation obligations from claims initiated in fiscal years prior to FY07 under a large self-insured retention (SIR) level insurance program. The District changed from a \$0 SIR level to a \$350,000 SIR level workers' compensation insurance program in FY17. In May 2016, the Board of Directors authorized the amount of the current annual premiums (in excess of the new annual premiums and claims payments) to be accumulated in the workers' compensation reserve until the reserve account reaches three times the SIR level. The level of SIR can be reconsidered based on the needs of the District.

This reserve shall be drawn down annually to pay workers' compensation obligations of the District and shall be evaluated annually for replenishment with budgeted funds and/or unrestricted reserves. The reserve shall be maintained at three times the SIR level and at an amount not that is no less than projected obligations based on the most recent actuarial valuation. The actuarial valuation shall estimate the District's outstanding liability on workers compensation claims. Annual replenishments shall be reported to the Board of Directors as part of the fiscal year-end financial report.

- Sacramento/EBMUD Mitigation Reserve: This reserve fund was established in 2005 to provide funding for wheeling up to 3,200 acre-feet per year of the District's Central Valley Project water allocation through East Bay Municipal Utility District (EBMUD) untreated water facilities to meet the District's source water quality needs.

The reserve will be maintained at a level sufficient to fund three years of wheeling charges to EBMUD for use of its untreated water facilities to transport up to 3,200 acre-feet annually of

the District's Central Valley Project water allocation. During the past 10 years, EBMUD's use of its wheeling facilities has been infrequent and the District has found that its cost prohibitive to take deliveries when EBMUD is not using its facilities. Therefore the District expects to incur the wheeling charges on a schedule that matches EBMUD's use, which is during dry periods only. The Board reset this reserve balance in 2016 to a balance equal to three years of wheeling charges.

- OPEB Reimbursement Reserve: To comply with Government Accounting Standards Board (GASB) Standard 45, the District established a trust fund in early FY08 to fund the actuarial value of other post-employment benefits (OPEB) for retirees and their beneficiaries, primarily medical insurance premiums. Employee contributions to the OPEB Trust were initiated in September 2011, pursuant to agreements reached with all District employees. A term of those agreements provides that employee contributions plus 5% interest would be reimbursed when an employee separates from District service prior to vesting in the OPEB benefit. Internal Revenue Service regulations prescribe that OPEB Trust assets cannot be used for any purpose other than to fund the OPEB benefit. Consequently, such reimbursements will be made from this Board designated reserve fund.

The fund was established in FY12 with an initial allocation of \$100,000 from unrestricted reserves. At the end of each fiscal year, the fund balance will be adjusted to maintain the target balance of \$100,000. Annual adjustments shall be reported to the Board of Directors as part of each fiscal year-end financial report.

- Drought Contingency Reserve: Water sales revenue may be impacted under drought conditions due to regulatory or State and Federal mandated reductions in supply. The balance in this reserve may be increased or decreased as authorized by the Board based on the continuance and severity of a drought. This fund was established in September 2007 to supplement water sales revenue at the direction of the Board of Directors. The balance was fully withdrawn in FY17 to support operations as the District recovered from the drought. The plan to replenish the reserve, including the amount and time period for doing so, will be proposed in FY18.
- Emergency Response Reserve: The purpose of this reserve is to provide funding for events the Board may deem as "emergency". The reserve shall fund repairs to critical facilities or assets damaged from emergency events. Use of this reserve shall be approved by the Board of Directors. This fund shall be maintained at a minimum level of \$500,000. The balance in this reserve shall be evaluated annually and may be increased or decreased as authorized by the Board.

#### Unrestricted Undesignated Reserves

Unrestricted reserves will be drawn down over time to smooth rate increases. The balance will be maintained at a level equivalent to a minimum of six months of annual operating budget requirements, consistent with the Board's Rate Setting Policy. In any period, not to exceed twelve continuous months, when the balance may fall below the six-month requirement, the required minimum may be satisfied by considering unrestricted reserves in conjunction with funds available

within the Rate Stabilization Reserve. The planned use and replenishment of unrestricted reserves is re-evaluated annually in conjunction with the update of the Capital Improvement Program and Ten-Year Financial Plan.