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Initiating Dept./Div.: Administration



BOARD POLICY

FISCAL RESERVES

PURPOSE

To set forth the District's policy for establishing and maintaining fund reserve targets for each of the District's reserve funds. Fiscal reserves provide working capital for operations and maintenance activities, funding for long-term capital improvement requirements; fulfillment of legal, regulatory and contractual obligations and mitigation of risk and liability exposures.

POLICY

This policy is intended to ensure that the District has sufficient cash flow to meet current and future needs and provide transparency to its ratepayers by establishing fund reserve targets for each of the District's reserve funds. Reserve funds are needed to provide funding for planned and unplanned events. Planned events include, but are not limited to:

- accumulating balances to fund operating needs
- capital improvement program needs for capacity expansion and renewal and replacement of existing assets
- debt service obligations,
- providing funds to mitigate cash flow variances throughout the fiscal year, and
- funding for employee related pension and other post-employment benefits

Unplanned events include:

- accounting for revenue shortfalls
- unanticipated expenses
- paying for unforeseen emergency events

The established reserve targets defined herein provide guidance for long-term financial planning and maintaining the District's long-term financial health. Adequate fund reserves are of value to: 1) provide working capital to fund operating needs; 2) provide working capital to fund capital improvement program needs; 3) provide a financial cushion for dealing with unanticipated financial needs and emergencies; and 4) are a component of achieving favorable credit ratings which can help to reduce the costs of issuing debt.

This policy designates specific reserve accounts and establishes certain targets that the Board of Directors has determined to be in the best interest of the District. It also establishes the authority of the Board and staff for the implementation and maintenance of the reserve fund targets defined herein. For each reserve, this policy specifies a targeted level (if applicable), the conditions and procedures for the use or replenishment of the reserve, and authorities for the General Manager (GM) related to such.

Reserve Fund Targets

The District maintains a number of reserve funds. All funds are designated or restricted for specific purposes and are independent of one another. Each year the Board should review its actual and recommended reserve targets and replenish each designated reserve fund as needed.

Definitions:

A. Designated Reserves

Established and designated for specific purposes. These funds are to be utilized to fund such things as operations and maintenance, future capital facilities, repair and replacement of existing assets, economic uncertainties, regulatory requirements, local disasters and other financial hardships.

B. Restricted Reserves

Restrictions on the use of these funds are imposed by an outside source such as creditors, grantors, contributors, laws, or regulations governing use.

Achieving Fund Reserve Targets

Each Designated reserve has been set at a targeted level by the Board through this Policy. The District will update its 10-year rate model each year in order to determine appropriate rate and fee adjustments, or to confirm the continued necessity of multi-year rate actions previously adopted. Rate and fee adjustments should be adopted to achieve and maintain the District's minimum fund reserve targets over the 10-year planning period. This can include phasing in a series of rate increases to gradually restore reserves to target levels over a number of years. For financial planning purposes, it is acceptable for reserves to drop below their target level on a temporary basis, as long as the District takes action to achieve the target over the planning period and as otherwise specified in this policy for each reserve.

Types of Reserves

A. Operations and Maintenance Fund – Working Capital Reserves (Designated)

The operations and maintenance fund provides for the general operations, maintenance and administration of the District. Sewer Service Charge (SSC) revenues are collected by the Contra Cost County Tax Assessor's Office and remitted to the District in two installments in April and December of each year. The Government Finance Officers Association (GFOA) recommends local governments establish a customized target amount of working capital as the measure of available margin or buffer in enterprise funds. Accordingly, in order for the District to pay its ongoing expenses throughout the year, it reserves a specified percentage of prospective budgeted gross operating expenditures at the start of each fiscal year as its targeted working capital reserve. The specified percentage is 41.7% (representing 5 months of annual expenses). This working capital reserve fund is used in the normal course of District operations. For purposes of this policy "working capital" shall be defined as the sum of current unrestricted cash and investments adjusted for year-end closing accruals and other timing issues.

Provisions Regarding Usage:

Calculation of the Reserve: Projections of the reserve are made in connection with financial planning and rate setting, where rates may be set to achieve a targeted reserve level. The year-end reserve amount is re-calculated annually in connection with the annual financial statement closing and audit and compared to the required reserve level. Any variance from the required level would be taken into account when rates and budgets are set for the subsequent year.

Draws from the Reserve: Reductions can be made to cover normal O&M spending up to the overall total O&M budget amount, consistent with the GM delegation of authority.

Any O&M spending in excess of the overall approved O&M budget would require a budget amendment by the Board.

Additions to the Reserve: The Reserve balance would increase with the receipt of revenues. Overall net additions are made annually through planned net income. The ending reserve balance is calculated as part of the annual financial close process.

B. Capital Improvement Project Fund – Working Capital Reserves (Designated)

The capital projects fund provides for treatment plant and collection system asset renewal and replacement expenditures, general improvements, and recycled water, as well as office facilities renewal, vehicle and equipment replacement, information systems replacement and miscellaneous capital needs. Property Tax

and SSC revenues, which comprise a significant portion of annual capital project revenues, are also collected by the Contra Cost County Tax Assessor's Office and remitted to the District in two installments in April and December of each year. As noted previously, the GFOA recommends local governments establish a customized target amount of working capital as the measure of available margin or buffer in enterprise funds. Accordingly, in order to meet the cash flow needs of the capital improvements program, the District reserves 50% of the annual non-bond funded capital projects budget at the start of each fiscal year as its targeted working capital reserve (i.e. the 50% requirement excludes projects anticipated to be funded with available bond proceeds in that fiscal year). For purposes of this, "working capital" shall be defined as the sum of current unrestricted cash and investments adjusted for unspent capital project carryforwards, year-end closing accruals, and other timing issues.

Provisions Regarding Usage:

This fund is used in the normal course of District operations. Funds are drawn down on a routine basis through capital project spending and replenished through the receipt of revenues. In addition:

Draws from the Reserve: The reserve would be drawn down through capital project spending.

On a planned basis (in advance of the subject year), the reserve can be drawn down if the reserve balance is higher than the required/targeted level. This would be done by setting rates such that contributions to the fund are less than expenditures. Such reductions are implicitly approved when the Board sets rates and represent underlying assumptions in the financial plan. A forecast of the reserve, including any draw down, is included in the budget book provided to and adopted by the Board.

The reserve is also drawn down during a fiscal year related to timing of SSC and ad valorem tax collections; capital expenditures can occur in advance of such revenues. No specific authorization is required related to this normal use of this reserve.

The reserve may also be drawn down during the year due to:

- (1) Planned capital expenditures that exceed the total approved capital budget (which includes the current year CIB plus prior year carryforward). This would generally be possible if there were additional funds from an unallocated prior year variance or revenues have surpassed the current year's projection.
- (2) Planned capital expenditures due to construction contracts awarded by the Board that exceed the project budget for the subject year; whereas funds are available for that project in the

subsequent year's budget, and funds are not otherwise available to be transferred from the CIB contingency account or another project(s).

Board/Committee approval of such draws described in items (1) and (2) would be required, unless provided for in the GM Delegation of Authority.

Additions to the Reserve: The Reserve balance would increase with the receipt of revenues.

Overall net additions to the Reserve are made when sewer construction fund revenues (including planned transfers) exceed expenses over the course of a year. This can occur on a planned or unplanned basis. On a planned basis, rates would be set to provide additions to the reserve when the reserve balance is below the targeted level. On an unplanned basis, additions to the reserve occur through favorable O&M or capital budget variances.

C. Self-Insurance Fund Reserves (Designated)

The Self-Insurance Fund (SIF) was established in 1986 to allow the District to self-insure a portion of its risks. This reduces the cost of insurance premiums and gives the District greater control over its retained losses. The Board establishes the amount of risk retained and reviews the self-insured retention periodically to align it with the Board's risk tolerance, the District's loss experience, and insurance market conditions.

Government Accounting Standards Board Statement No. 10 (GASB-10) established requirements on how public agencies must fund their self-insured risks. To comply with GASB-10, reserves for certain types of liability risks were segregated into a sub-fund that must be actuarially reviewed at least every two years. In order to fund GASB-10 retained risks this sub-fund ("A") shall maintain a minimum reserve of at least three times the amount of the District's self-insured retention, which is currently \$500,000, and accordingly the fund presently has a targeted level of \$1,500,000. The Self-insurance Fund Reserves and Self-Insurance Catastrophic Loss/Emergency Reserves are comprised of cash and investments within the Self Insurance fund, adjusted for year-end closing accruals and other timing issues.

Provisions Regarding Usage:

Draws from the Reserve: Reserve funds are used to pay claims and claims expenses within the self-insured retention during the fiscal year. Individual payments are reported to the Finance Committee in the monthly expenditures report and to the Administration Committee in Risk

Management Reports. Total fund expenditures are reported to the Board in the Risk Management Annual Report. Payments are governed by the limits set in the GM Delegation of Authority.

Additions to the Reserve: Annually, upon the Board's adoption of the SIF and O&M budgets, this reserve is replenished with an allocation of Sewer Service Charge funds, or a transfer of O&M funds in an amount needed to meet the minimum reserve requirements stated above.

D. Self-Insurance Catastrophic Loss/Emergency Reserves (Designated)

In order to mitigate the financial impacts and maintain uninterrupted service in the event of an emergency or catastrophic event the District maintains a Catastrophic Loss/Emergency Reserve balance of \$7.5 million in the SIF. There is an expectation that the targeted level of the Catastrophic Loss/Emergency Reserve balance level will be adjusted biennially to reflect inflation and other appropriate factors as part of the biennial policy review. The Self-insurance Fund Reserves and Self-Insurance Catastrophic Loss/Emergency Reserves are comprised of cash and investments within the Self Insurance fund adjusted for year-end closing accruals and other timing issues.

This reserve (housed in the SIF (Sub Fund C)), holds funds for the following purposes:

1. Insurance premium payments and related expenses
2. Claims settlements and expenses for self-insured losses not governed by GASB 10
3. Costs to initiate claims against others
4. Funds reserved to respond to emergency conditions as determined by the Director of Emergency Services.

Provisions Regarding Usage:

Draws from the Reserve:

- Draws for items 1, 2, and 3 shall be made in accordance with the GM's authority outlined in Resolution 2016-046 or updates thereto.
- Draws for item 4 shall be made in accordance with the authority granted to the Director of Emergency Services as outlined in Resolution 2010-089 or updates thereto.

Additions to the Reserve:

- This fund is replenished annually upon the Board's adoption of the SIF Budget. This reserve is replenished with an allocation of Sewer Service Charge funds, or a transfer of O&M funds in the amount needed to maintain a reserve of \$7.5 million.

E. Debt Service Reserves "Bond Reserve" (Restricted)

The District has the capacity to finance capital projects through the issuance of bonds and various types of debt financing. A requirement of some types of debt may include the establishment and maintenance of a contingency reserve that is defined in the debt documents. If required, the Bond Reserve funding level will be set at the amount required in the debt documents. Changes to the reserve amount typically only occur due to: (1) additional debt being issued; (2) the required reserve amount changes due to normal amortization and repayment of debt; and (3) the debt is fully amortized and the reserve is extinguished.

As of October 2021, there is no Debt Service Reserve/Bond Reserve in place.

Provisions Regarding Usage:

Draws from the Reserve: Use of the reserve to pay debt service would occur if the funding requirement decreased, in this case, excess funds would be applied to next required debt payment; or funds were otherwise unavailable to pay debt service and would only occur in extraordinary situations. In such circumstances, the GM would notify the Board of the planned use of the reserve, and report via GM written announcement at a subsequent next upcoming Board meeting.

Additions to the Reserve: are made in connection with a Board approved bond issuance during the bond closing process.

F. Rate Stabilization Fund “RSF” (Designated)

The District aims to establish rates that are stable and not unduly volatile, while meeting necessary financial metrics and providing adequate funding for the District’s programs (the revenue requirement). The 2018 Bond Indenture allows for the establishment of a Rate Stabilization Fund (RSF) that can be used towards those ends. The 2018 Bond Indenture allows for draws from the RSF for the purpose of paying debt service on the Bonds or any lawful purpose of the Wastewater System.

The Rate Stabilization Fund level shall be considered by the Board of Directors concurrent with Sewer Service Charge rate proposals and reviews of the long-term Financial Plan.

Provisions Regarding Usage:

Draws from the Reserve:

- Any draw from the RSF shall require Board of Directors approval:
 - The RSF may be drawn down during or after the close of a fiscal year in order to meet a specified Debt Service

- Coverage level (either 1.00x, 1.25x per bond covenants, or the Debt Management policy specified level of 2.0x).
- The RSF may be drawn down on a planned basis (during rate setting) to avoid the need for higher than desired rate increase.
- The RSF may be drawn down for any legal use specified by the Board of Directors, as permitted by the 2018 Bond Indenture of Trust.
- As provided for in the 2018 Bond Indenture of Trust, amounts so transferred from the Rate Stabilization Fund to the Wastewater System Funds shall constitute Gross Revenues for such Fiscal Year for purposes of the Debt Service Coverage requirements of the Bond Indenture. Such transfers may be made until (but not after) 180 days after the end of such Fiscal Year.

Additions to the Reserve:

- Additions (other than interest earnings) to the RSF shall require Board of Directors approval, and may take place:
 - After the close of a fiscal year through the disposition of year-end variances.
 - When rates are set to contribute a specified amount to the RSF.
- Amounts transferred from Wastewater System Funds to the Rate Stabilization Fund shall constitute a reduction in Gross Revenues for the Fiscal Year such funds were budgeted.

G. GASB 45 OPEB Trust (Restricted)

The District has negotiated and provides Other Post Employment Health Care Benefits (OPEB) for retired employees that meet certain criteria. Biannually, the District updates funding requirements needed to provide these benefits by conducting an actuarial study. While the OPEB Trust is not a District reserve, the District's funding intent is to perform biennial actuarial studies and deposit into the trust the recommended actuarially determined contribution. The investments in the OPEB Trust are managed by an investment advisor with oversight by District staff and the Board Finance Committee.

Provisions Regarding Usage:

Draws from the Trust: A planned draw from the OPEB Trust may be included in a Board adopted budget and executed by the GM. Only premiums, claims, and/or administrative costs for OPEB related expenses paid for by the District for the current year or one year back are eligible for reimbursement or distribution through the OPEB Trust. Health care costs or other premiums for current active employees are not eligible.

Additions to the Trust: An amount may be included in a Board adopted budget to pay down unfunded employee related liabilities for pension or OPEB obligations. If specifically designated for OPEB, the GM may direct such funds be deposited into the OPEB Trust. The Board may also direct that other funds, such as those available from favorable budget variances are also directed to the OPEB Trust.

H. Section 115 Pension Prefunding Trust (Restricted)

The District has established an IRS Code Section 115 Pension Prefunding Trust to allow for voluntary contributions toward pension obligations. The name of the Trust per the resolution is the “Public Agencies Post-Employment Benefits Trust”, which is a multi-employer trust administered by PARS. This Pension Prefunding Trust allows contributions to count toward the unfunded liability (and as a result the funded ratio) while not placing the contributions with the Contra Costa County Employee’s Retirement Association (CCCERA). Only premiums, claims, and/or administrative costs for pension related expenses paid for by the District for the current year or one year back are eligible for transfer, payment, or reimbursement from the Prefunding Pension Trust.

The Pension Prefunding Trust may be withdrawn by the District and contributed to CCCERA at a time convenient for the District. Uses for this Trust may include mitigating rate volatility, or to offset normal cost expenses that are required even when all liabilities have been met. The District may make budgeted and planned contributions to the Pension Prefunding Trust, or may make contributions based on the availability of funds from favorable budget variances in either case, subject to Board approval. The investments in the Pension Prefunding Trust are managed by an investment advisor with oversight by District staff and the Board Finance Committee. The Section 115 Pension Prefunding Trust is not a District reserve.

Provisions Regarding Usage:

Draws from the Trust: A planned draw from the Pension Prefunding Trust may be included in a Board adopted budget to pay required CCCERA pension contributions, and withdrawals up to that amount may be executed by the GM. Withdrawals in excess of that amount would require additional Board authorization.

Transfers, payment and reimbursement from the Pension Trust are allowed for the following:

- Transfer to a Qualified Trust for employer contribution (e.g., retirement system);
- Distribution directly to insurer, third party administrator, service provider or other entities providing services in connection with determining the employer’s pension obligation; and

- Reimbursement to the employer for employer contributions made to a Qualified Trust and/or related pension administrative costs paid by the employer.

Additions to the Trust: An amount may be included in a Board adopted budget to pay down unfunded employee related liabilities for pension or OPEB obligations. If specifically designed for pension liabilities, the GM may direct such funds be deposited into the Pension Prefunding Trust. The Board may also direct that other funds, such as those available from favorable budget variances are also directed to the Pension Prefunding Trust.

Management Responsibility

The GM is authorized to establish and implement procedures to support this policy. Management will ensure that these funds and reserves are reviewed during the annual budget cycle and are adjusted as necessary to remain within the guidelines outlined in this document. Management will report on the use of the reserve funds as required above, and through recurring financial reporting mechanisms.

Investing Reserve Funds

Reserve Funds will be invested according to the District's Statement of Investment Policy, BP 005. Furthermore, the Restricted fund investments are managed by Public Agency Retirement Services (PARS) the Trust Administrator, Highmark Capital Management is the Investment Manager, and US Bank is the Trustee Custodian of assets.

Inter Sub-Fund Borrowings and Transfers of Reserve Funds

- Temporary borrowings: Movement of cash or investments between sub-funds (Running Expense, Sewer Construction, and Self-Insurance) on an interim basis for cash management purposes may be effectuated by the GM consistent with the GM delegation of authority and are not "inter-fund transfers" pursuant to generally accepted accounting principles with the condition said funds must be repaid in full. Such temporary borrowings are recorded as a due to/due from in each sub-fund and are typically cleared when monies are available in the recipient sub-fund in a timeframe not to exceed one year from the fiscal year-end balance sheet date. Pursuant to generally accepted accounting principles, balances unpaid beyond one year are considered inter-fund borrowings and must be approved by the Board and should bear interest.
- Permanent transfers: Inter-fund transfers between sub-funds on a permanent basis may be specified in the District's financial plan and budget, and must be approved by the Board through the adoption of the annual budget, rates or other specific Board action. Inter-fund transfers may be authorized by the Board

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following the adoption of the annual budget through the authorized disposition of annual budgetary favorable variances or other Board action. Such inter-fund transfers do not require an appropriation amendment as the action only constitutes a transfer of reserves from one of the District's sub-funds to another.

[Original Retained by the Secretary of the District]