SWEETWATER SPRINGS WATER DISTRICT

TO: Board of Directors **AGENDA NO. V-C**

FROM: Steve Mack, General Manager

Meeting Date: November 5, 2009

SUBJECT: ADOPTION OF ORDINANCE NO. 41 ESTABLISHING A DISTRICT RESERVE POLICY

RECOMMENDED ACTION: Introduce, by reading of title only, Ordinance No. 41, An Ordinance of Sweetwater Springs Water District Adding Policy Number 3510, District Reserve Policy, to the District's Policy and Procedures.

FISCAL IMPACT: Adoption of Ordinance No. 41 would have the financial impact of designating a certain amount of funds as reserves that will be used only in certain, defined situations. The Board will be able to direct use of the funds as long as a plan is established to return the reserves to the designated level.

DISCUSSION:

Reserve policies are common and recommended for public agencies. They provide a "rainy day" fund for unanticipated events, establish a measure of financial health, and they are part of the process for determining how much capital spending an agency can afford.

Over the past 10 years the District has worked hard to improve its financial condition. Today, that condition is good. We are audited each year and recent audits have given the District good marks for financial accountability and openness. Operational, economic, and other possible uncertainties suggest some level of reserves is needed.

At the same time the District needs substantial infrastructure improvements, has an aggressive capital improvement program (CIP) and is asking for funding assistance to construct the projects in the CIP. The annual revenues of the District are not sufficient to fund the needed CIP and funds for these projects will come in part from District reserves, loans, or grants. Some measure of the District's reserves is needed to determine how much of the District's money is available to construct the CIP and still stay in good financial condition and how loans and grants can fit into the District's long term financial picture. A formal reserve policy which sets out the appropriate amount of District funds needed for unanticipated events, will help identify reserves available for the CIP while ensuring the District stays in good financial condition.

Ordinance 41 establishes that reserve policy and places it in the District's Policies and Procedures in Section 3510. The reserve policy is based on setting aside 25% of Operating Budget Expenses, 25% of annual debt principal and interest payments, 25% of a nominal $1 million capital improvement program, and $200,000 cash for ongoing operations. A draft reserve policy based on revenues, but not including a debt payment reserve, was used for the Fiscal Year 2009-2010 (FY10) Budget.

The Board discussed the reserve policy at its September and October meetings. It agreed with the concept of a reserve at the 25% level, directed staff to include debt repayments in the reserve, and directed that the operating reserve be based on expenses rather than revenues. Table 1 shows the amounts that would be in the policy reserves for the FY10 Budget if the Ordinance 41 policy were used, and compares those amounts to those in the adopted FY10 Budget. To summarize Table 1, the Policy Reserve amount in the adopted FY10 Budget is $995,830; using the approach in Ordinance 41 it would be $1,119,754. After Ordinance 41 becomes effective, staff intends to come back to the Board to revise the FY10 Budget to reflect the appropriate Policy Reserve amounts.

Some observations on the recommended District Reserve Policy:

- Use of a nominal $1 million for the Capital Reserve balances out swings in planned capital projects – some years there may be no construction planned; other years (like FY 2009) there may be a doubling up on the projects.

- The switch to expense-based policy does not include direct transfers from the Operating Budget to the Capital Budget, but those are covered by the reserves required for the CIP and debt repayment.

- The reserve policy amount sets a target which the annual budget should not go below. Ordinance 41 provides flexibility by allowing going below the target if there is a plan to get above the target within a reasonable time. The plan could involve raising rates over time, reducing CIP spending in a future year or some other cost reducing or revenue increasing approach.

- Ordinance 41 in Section 3510.3 defines District funds in excess of the Reserve Policy as Reserves above District Policy. That identifies the amount of funding available for the District's Capital Improvement Program

Comparing the District's fund balance with the Ordinance 41 Policy Reserve amount shows that the District currently has funds well in excess of the Policy Reserve – almost $2 million. Table 2 shows how the Reserve Policy, using the amounts in Ordinance 41, can be used to identify available funds for multi-year financial planning. In this particular instance, Table 2 shows that currently the District does not have enough Reserves above District Policy to complete the approved CIP.

Staff recommends introduction and subsequent adoption of Ordinance 41 which formally establishes a reserve policy that provides reserves for unanticipated events, establishes a measure of financial health, provides for flexibility in using the District's

reserves, and is an important element in determining how much funding is available for the District CIP.

Table 1. Ordinance 41 Policy Reserves

	2010 Budget, operating revenues	Ordinance 41, operating expenses
2010 Operating Revenues/Expenses	$2,183,318	$1,587,703
Debt P&I Payments	$1,091,314	
10%	$218,332	$158,770
15%	$327,498	$238,155
Operating Reserve (10%+15%=25%)	$545,830	$396,926
Capital Reserve	$250,000	$250,000
Cash on Hand (Operations Fund)	$200,000	$200,000
Debt Payments Reserve		$272,829
Total Policy Reserves	$995,830	$1,119,754
FY 2010 EOY Reserves	$3,069,581	
Funds above Reserve Policy	$2,073,751	$1,949,827

Table 2. Sweetwater Springs Water District Capital Planning Budget, Base Situation, Ordinance 41

	FY 08-09 Projected	FY 09-10 BUDGET	FY 11	FY 12	FY 13	FY 14	FY 15
REVENUE/SOURCES OF FUNDS							
Net Operating Revenues*	374,350	300,000	304,500	309,068	313,704	318,409	323,185
Total Assessments	782,000	782,000	782,000	782,000	782,000	782,000	782,000
Capital Debt Reduction Charge**	170,000	252,426	327,100	404,300	404,300	404,300	404,300
Capital Interest	110,000	95,000	52,668	23,167	98	10,000	10,000
CDC Grants	983,500						
Private Placement Funding (Loan proceeds)	983,500	1,328,000	664,399				
Transfers From CIRF/Reserves			600,000	970,000	900,000	400,000	
TOTAL REVENUE	3,403,350	2,757,426	2,730,667	2,488,535	2,400,101	1,914,709	1,519,485
EXPENSES							
Total Dept Payments	974,307	1,091,314	1,091,314	1,091,314	1,091,314	1,091,314	1,091,314
CIP III	35,000	50,000	80,000				
CIP IV-A (Obligated)	1,967,000						
		CIP IV-B, Proj 1	**CIPIV-B, Proj 2**	**FY 12 CIP**	**FY 13 CIP**	**FY 14 CIP**	**FY 15 CIP**
Annual CIP		**$1,328,000**	**1,515,000**	**1,355,000**	**1,265,000**	**974,000**	**807,000**
In-House Construction Projects	40,000	40,000	40,000	40,000	40,000	40,000	40,000
TOTAL EXPENSES	3,016,307	2,509,314	2,726,314	2,486,314	2,396,314	2,105,314	1,938,314
SURPLUS/DEFICIT	**387,043**	**248,112**	**4,353**	**2,221**	**3,787**	**-190,605**	**-418,829**
FUND AND LOAN BALANCES (EOY)							
Reserves above District Policy	**1,820,291**	**1,949,827**	**1,354,180**	**386,401**	**(509,812)**	**(1,100,417)**	**(1,519,246)**
Begining PP Loan	2,975,899						
EOY PP LOAN	1,992,399	664,399	-				
Total Funding Available for CIP	**3,812,691**	**2,614,226**	**1,354,180**	**386,401**	**(509,812)**	**(1,100,417)**	**(1,519,246)**

*** Projection includes effect of annual 3.5% COLA rate increase for Base Charge and Water Use Charge**

**** Projection includes CDRC rate increases in FY11 and FY12 to pay principal and interest on Private Placement Loan**

ORDINANCE NO. 41

AN ORDINANCE OF SWEETWATER SPRINGS WATER DISTRICT ADDING POLICY NUMBER 3510 TO THE DISTRICT'S POLICY AND PROCEDURES, RESERVE POLICY

WHEREAS, the District wishes to establish a formal policy regarding financial reserves for District funds for the purposes of providing information to District elected officials and staff, District customers, and other observers of the District that demonstrate the financial health of the District, provide consistent designations for different categories for the reserves, define standards for the minimum amounts to be maintained in the designated reserves, and provide flexibility in using District funds; and

WHEREAS, reserve policies are common and recommended for public agencies because they provide a "rainy day" fund for unanticipated events and establish a measure of financial health; and

WHEREAS, adequate levels of reserves, or funds designated for various important purposes, are critical to the successful and stable operation of the Sweetwater Springs Water District; and

WHEREAS, maintaining adequate reserves can translate into rate stabilization from year to year for customers and provides assurance that the District can respond to short-term emergencies, including water quality issues and natural disaster recovery, and economic uncertainties; and

WHEREAS, the Board has determined that the levels of reserves enumerated below are the appropriate levels for the purposes of the reserve policy; and

WHEREAS, determining the level of reserves for the purposes designated in the reserve policy is an essential part of the process for determining how much capital spending the District can afford; and

WHEREAS, the District's reserve policy will be most readily understood and accepted if it is formally adopted; and

WHEREAS, staff presented and the Board considered and discussed the reserve policy at the September 3 and October 1, 2009 meetings.

NOW THEREFORE BE IT ORDAINED by the Board of Directors of the Sweetwater Springs Water District, County of Sonoma, as follows:

Section 1. Policy Number 3510 of the Sweetwater Springs Water District Policy & Procedures is hereby added as follows.

3510. District Reserves.

3510.1. Purposes of District Reserve Policy. The purposes of the District Reserve Policy are to provide information to District elected officials and staff, District customers and other observers of the District that demonstrate the financial health of the District, provide consistent designations for different categories for the reserves, define standards for the minimum amounts to be maintained in the designated reserves, identify funding available for future capital improvement projects, and provide flexibility in using District reserves.

3510.2. Components of Designated District Reserves.

3510.21. Operating Budget Cash Reserve. The District will have a cash reserve of $200,000 at the start of each fiscal year to provide for prompt payment of operating expenses for the coming fiscal year.

3510.22. Operating Reserve. The District will establish and maintain a reserve equal to 10% of its annual operating budget expenses for the purposes of providing for one-time costs, dealing with economic uncertainty, The District will establish and maintain a reserve equal to 15% of its annual operating budget expenses for the purposes of dealing with emergencies and disaster-related expenses. In combination, the Operating Reserve will have a target of 25% of the Operating Budget expenses.

3510.23. Capital Reserve. The District will establish a Capital Reserve of $250,000, which is equal to 25% of a nominal $1,000,000 Capital Program. The Board may increase the Capital Reserve by resolution when adopting the annual budget.

3510.24. Debt Repayment Reserve. The District will establish a debt payment reserve which is equal to 25% of all payments for principal and interest on all District loans in the annual operating and capital budgets.

3510.25. District Policy Reserves. The combined amount of reserves designated by Sections 3050.21-24 are known as District Policy Reserves.

3510.3. Undesignated Reserves. Reserves in District funds in excess of the amounts designated in sections 3050.21-24 above are undesignated, are known as Reserves above District Policy, and are available for use for District purposes, such as funding the Capital Improvement Program.

3510.4. Annual Review of District Funds and Reserve Levels. The District Policy Reserves levels will be reviewed as part of the annual District Budget approval process. The District may drop below the District Policy Reserve levels only if a plan is developed as part of the budget approval process that shows

how the District will reestablish reserves that meet the District Policy Reserve amount.

Section 2. Effective Date.
This ordinance shall become effective thirty (30) days after the date of its adoption by the Board of Directors.

This Ordinance was introduced this 5th day of November, 2009, on roll call by the following vote:

Jim Quigley _____
Gaylord Schaap: _____
Victoria Wikle: _____
Wanda Smith: _____
Sukey Robb-Wilder:_____

_____
Victoria Wikle
President of the Board

ATTEST:

_____
Julie A. Kenny
Clerk of the Board