# SWEETWATER SPRINGS WATER DISTRICT

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

**FROM:** Steve Mack, General Manager

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**Meeting Date: September 3, 2009**

**SUBJECT: DISCUSSION/ACTION RE DISTRICT RESERVE POLICY**

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**RECOMMENDED ACTION:** Consider approval of a District Reserve Policy.

**FISCAL IMPACT:** No direct impacts.

**DISCUSSION:**

This purpose of this report is to discuss the adoption of a permanent reserve policy and the appropriate amount of reserves that the District should maintain.

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 for 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.

The District has multiple funds in which it places its revenues. These funds are listed in Table 1. District Funds and Reserves. The money in each fund, with the exception of the certificate of deposit at Redwood Credit Union, resides with Sonoma County. Apparently, the funds were set up in this manner in the late 1990's.

The funds can be characterized as restricted or non restricted. Restricted funds have a sole purpose and can only be used for that purpose. As such it is not appropriate to count these funds as being available in an unrestricted reserve discussion – the money in the restricted funds is not available for unanticipated events.

Table 1 is based on historical practice; there is no record that this approach to fund setup was formally adopted by the Board. Other historical practices include:

- Operating revenues, the revenues collected in bimonthly billing, are deposited in the Operations Fund. Surpluses in the Operating Budget were to be placed in the Operating Reserve with a target of $500,000 in the late 1990's. The Certificate of Deposit (CD) at Redwood Credit Union was funded by the Operating Reserve.

- The annual assessment (Flat Charge) and connection fee were to be deposited in the Capital Improvement Fund (CIRF) which then would fund the restricted funds and any capital projects. In the event that there was not enough revenue for this (and there hasn't been) revenues would be transferred from the Operations Fund or the fund was depleted.

- It's important to note that one of the funds in Table 1, Private Placement Funding, contains the proceeds from a loan acquired in August 2008 to fund the CIP. It is borrowed money.

Money has built up in the various funds and the District has embarked on an aggressive CIP to improve the District's inadequate and aging infrastructure. The District has restructured its rates, has a policy in place for an annual cost of living increase in the base rate and water use rate, and is asking for funding assistance from other agencies to hslp fund the CIP. What should be the appropriate level of reserves to guard against uncertainties, economic, disaster-related, or other? How much money does the District have to fund the CIP?

A quick review on the Internet showed that reserve policies mostly range between 25-50% of annual operating budgets. For the 2010 budget, we used the following reserve targets:

- $200,000 cash for ongoing operations - equivalent to the Operations Fund
- 10% of the Operating Budget revenues for a budget reserve for unanticipated expenses - $218,332
- 15% of the Operating Budget revenues for economic uncertainty - $327,498
- Capital Reserve of 25% of a nominal $1 million CIP - $250,000
- Total Reserve Amount = $995,830

Some observations on the reserve policy used for the FY 2010 Budget and considerations for a formal 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 2010 reserve approach does not include having a reserve for annual debt payment expenses which are approximately $1.1 million.

- The reserve policy amount sets a target which the annual budget should not go below. One approach for flexibility is to allow 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.

Comparing the unrestricted fund balance with the suggested policy reserve amount shows that the District currently has funds well in excess of the policy reserve. The funds above the reserve policy identifies how much money is available for funding the District's multi-year CIP. Table 2 from the application to Sonoma County Redevelopment Agency for grant funding shows how the reserve policy 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 funds above reserve policy to complete the approved CIP.

Staff recommends the policy reserve levels presented in this report with possible addition of an additional amount for debt payments. Upon concurrence by the Board, staff will return with an ordinance that will formally establish the reserve policy.