SWEETWATER SPRINGS WATER DISTRICT

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

FROM: Steve Mack, General Manager

Meeting Date: October 1, 2009

SUBJECT: DISCUSSION/ACTION RE DISTRICT RESERVE POLICY

RECOMMENDED ACTION: Consider approval of a District Reserve Policy.

FISCAL IMPACT: No direct impacts.

DISCUSSION:

At the September meeting the Board had its first discussion on adopting a reserve policy. This report is a followup of that discussion. As such, it will not repeat the information contained in the September agenda report. It is intended to be an add on with additional information. Please refer to the September Agenda Report for the earlier discussion on the reserve policy.

Confusion between the reserve policy and accounting practices. Table 1 shows the funds the District uses to manage its money and how much is in each fund. The Reserve Policy is not directly related to these accounting practices, but common sense suggests the reserve policy can be coordinated with the accounting practices. For example, where the names of a fund and a reserve policy item are the same or similar, it would make sense to periodically, perhaps annually, adjust the fund to the reserve policy level.

On the other hand, we don't need a fund for each item of the policy reserve. For example, we are suggesting a 15% Disaster Policy Reserve for the Operating Budget. We don't need a "Disaster Reserve Fund"; we just need to know where that money is kept.

We suggest that we settle on a reserve policy and then the accounting practices can be coordinated with the policy.

Reserves for loan repayment. A principal reason for policy reserves is to have funds available for unanticipated expenses. Loan repayments are very steady – there are no surprises in annual payments. While there could be unanticipated decreases in the

revenues to repay the loans, there will not be increases in the repayment amounts. The policy reserve approach suggested for the Operating Budget includes an economic uncertainty element of 10% which is aimed at the revenue side of reserve needs and a disaster preparedness element of 15% which is aimed at the expense side. The above discussion of the need for loan repayment reserves tends toward the economic uncertainty need for a loan repayment reserve.

Appropriate size of Reserve Policy amounts. There is no recommended or standard reserve amount. A review of reserve policies shows a wide range of amounts and purposes, some general, some very specific. It appears that one of the rationales for reserve policy amounts is the amount of money on hand when the reserve policy was created. That is, the governing board opted for an achievable reserve target.

The FY 2009 Budget used a 25% policy reserve target. That was mostly based on my experience at other agencies, but was also consistent with what I saw as the District's possible reserve needs. At the September meeting Board members inquired what a 50% policy reserve target would look like. Table 2 shows possible policy reserve categories at this higher level. That shows that a 50% target would use up most of the available unbudgeted funds of the District and is only achievable because of the $3,000,000 Private Placement Loan, which was acquired for capital improvements. If we set a policy reserve at that level, we should recognize that time will be needed to achieve it.

More importantly, the policy reserve target level should be based on possible need. In the event of a large catastrophe that required extensive rebuilding and/or large revenue reductions, reserves would needed for immediate response for unanticipated expenses. Presumably a disaster would be declared and funding assistance from the State or Federal Government would in time come in place for funding the total reconstruction of the lost facilities. In most disaster scenarios reserves would be needed for the immediate response, with anticipation of later pay back and mostly complete funding assistance.

There is no one correct answer with respect to policy reserve levels other than unanimous agreement that all public agencies should have a reserve policy and adhere to it. Staff believe that a policy reserve in the 25% range for operating budget and capital program is appropriate and that some level of reserve is appropriate for loan repayments, but not at as high a level because the uncertainty there is only on the revenue side. If used for this budget year, the policy reserve amounts would be those shown in the far right column of Table 2.

Please review the September Agenda Report and the information in this report. Upon direction from the Board, staff will return with an ordinance that will formally establish the reserve policy.

Table 1. District Funds and Reserves			
Fund Name	**Restricted ?**	**Purpose**	**Balance @ July 1, 2009**
CD at Redwood CU	**No**	**4.937% CD maturing in October 2012**	$573,223.48
Operations	**No**	**Fund that receives operating revenues**	$800,352.33
Bldg Fund	**No**	**Fund established to build reserves for office building purchase**	$75,850.00
Operating Reserve	**No**	**Fund established for reserve for Operations Budget**	$225,000.00
Federal Loan	**Yes**	**Escrow Fund for $12 million bonds**	$685,375.36
In-house Construction (formerly FEMA Reserve)	**No**	**Fund established for reserve for in-house construction projects**	$105,158.89
Federal Construction	**No**	**Payment of contractor during construction funded by federal loans - not used at this time**	($0.95)
Capital Improvement Revenue	**No**	**Fund for capital improvement projects**	$1,439,122.53
State Loan #58330	**Yes**	**Fund which accrues for annual payment of state loan #58330**	$24,842.89
State Loan #58830 Reserve	**Yes**	**Fund required for last payment of state loan #58330**	$24,750.00
State Loan 58340	**Yes**	**Fund which accrues for annual payment of state loan #58340**	$148,547.00
State Loan 58340 Reserve	**Yes**	**Fund required for last payment of state loan #58340**	$146,619.86
Private Placement Funding	**No**	**Fund which contains balance of Private Placement Loan acquired in August 2008**	$1,636,464.17
Totals			**$5,885,305.56**

Table 2. Comparison of Reserve Approaches				
	2010 Budget	**25%**	**50%**	**25% +10%**
2010 Operating Revenue	$2,183,318			
Dept P&I Payments	$1,091,314			
10% of Operating Revenue	$218,332	$218,332		
15% of Operating Revenue	$327,498	$327,498		
Operating Reserve (10%+15%=25%)	$545,830	$545,830	$1,091,659	$545,830
Capital Reserve	$250,000	$250,000	$500,000	$250,000
Cash on Hand (Operations Fund)	$200,000	$200,000	$200,000	$200,000
Debt Payments Reserve		$273,171	$546,343	$109,269
Total Policy Reserves	$995,830	$1,269,001	$2,338,002	$1,105,098
FY 2010 EOY Reserves	$3,069,581			
Funds above Reserve Policy	$2,073,751	$1,800,580	$731,579	$1,964,483