City of Santa Barbara
Public Works Department

Memorandum

DATE: November 17, 2022

TO: Water Commission

FROM: Gabriele Cook, Water Resources Financial Officer

VIA: Joshua Haggmark, Water Resources Manager

SUBJECT: Proposed Reserve Policy Changes

RECOMMENDATION:

That the Water Commission receive a presentation on the proposed Reserve Policy changes and provide a recommendation to the City Council.

DISCUSSION:

Water Resources hired HDR Engineering Inc. (HDR) to review the Water and Wastewater reserve policies and evaluate how they compare to industry standards, regional utilities, and industry best practices. The final report found that in general, the overall level of Water and Wastewater Fund reserves reflects industry and financial best practices. HDR had several recommendations discussed in detail later in this report.

Background

Water and Wastewater Reserves serve many different functions. The challenge in establishing reserves is striking a healthy balance that reflects the level of risk that might reasonably be anticipated. Below are some key points in the consideration of a healthy reserve:

Benefits of Reserves:

- Plays an important role in the City's debt rating, which consequently affects long-term debt interest rates for future issuances.
- Absorbs capital costs related to catastrophic failure of a critical infrastructure component.
- Covers annual deficiencies that may occur for any number of reasons, including recessions, inflationary impacts, droughts, and emergency repairs.

Challenges with Reserves:

- Funds in reserves could be used for other more immediate needs; capital infrastructure upgrades, maintenance and repairs.
- Government reserves are restricted to investments with extremely low risk, which means they often don't keep up with inflation, long-term historical average ~2%. This is challenging when long-term historical inflation is 3% and particularly challenging in times of high inflation (~8% this past year) where reserves can quickly lose buying power.
- Carrying reserves has a direct impact on rates to maintain the higher level of reserves. For every dollar of revenue increase, ~$.25 is set aside for reserves.

It is important to strike a balance in establishing the minimum reserve levels as they should reflect the level of risk the utility might reasonably anticipate to address unexpected challenges (or opportunities) while prudently operating and maintaining critical services.

Existing Reserves

The City's current reserves for Water and Wastewater, include disaster, contingency, capital, rate stabilization, desal dual purpose, water main replacement, and debt service. These reserves have different minimum requirements and specific uses, such as:

Reserve	Purpose	Methodology
Disaster	Financial impacts of natural disasters or events significantly damaging facilities and infrastructure.	15% of the most recently adopted fiscal year budget.
Contingency	Minimize adverse impacts of unexpected events on the organization and community.	10% of the most recently adopted fiscal year budget.
Capital	Funding for major capital costs.	5% of the value of capital assets or the average of the adopted capital program budget for the **previous** three fiscal years.
Rate Stabilization	May be considered revenue for the purpose of debt service coverage in a given fiscal year.	Minimum $1 million and $2.9 million for the Wastewater and Water funds, respectively.
Debt Service	Required when incurring debt, usually for capital infrastructure financing.	Based on requirements of the debt issuance.

Below is a snapshot of Water and Wastewater reserve levels:

Reserves (in millions) *	Water	Wastewater
Disaster	$6.0	$2.6
Contingency	4.0	1.7
Capital	13.9	3.9
Rate Stabilization	7.5	1.0
Desal Dual Purpose	-	n/a
Main Replacement	-	n/a
Debt Service	7.1	1.0
Total Reserves	**$38.5**	**$10.2**

* Reserve levels as of June 30th, 2021

Industry Standards and Reserve Minimums

The City's reserves were evaluated against several industry-standard sources, including:

- American Water Works Association (AWWA) Cash Reserve Policy Guidelines
- Government Finance Officers Association (GFOA)
- Fitch 2019 Medians*
- Standard and Poor's*
- Moody's*

*These Agencies rate utilities for long-term debt.

HDR found that the existing City reserve policies were reasonable when compared to industry metrics. With approximately 212 days of Operating and Maintenance (O&M) expenses in reserves, this reflects the mid or higher-rated utilities when compared to the financial community metrics:

- At current policy levels, the combined disaster and contingency reserves are 25% or 90 days of annual O&M expenses, which meets guidance from AWWA and GFOA for a minimum operating reserve.
- Adding the capital minimum reserve to this, the total cash reflects the target for cash on hand based on the financial community metrics.

If the reserve level is higher than the target minimums it is acceptable if the reserve is accompanied by a long-term financial plan that outlines the use of those funds in the future. A 10-year financial plan is developed during the water and wastewater rate studies which evaluate future projects and reserve targets.

HDR also explored the idea of the City establishing a line of credit as a way of minimizing risk and found that this could be a viable approach, specifically during the construction of large capital projects. The downside is that the City will need to pay a premium to the entity offering a line of credit, which compensates them for hedging the risk on behalf of the City.

Proposed Changes

HDR found that the overall level of reserves, on a combined basis, reflected general industry and financial best practices. Below are proposed revisions to the reserve policy, which incorporate HDR's recommendations:

Reserve	Current Policy	Proposed Change
Disaster	15% of the most recently adopted fiscal year budget.	No change.
Contingency	10% of the most recently adopted fiscal year budget.	No change.
Capital	5% of the value of capital assets or the average of the adopted capital program budget for the previous three fiscal years.	(1) Average of the planned capital budget for the upcoming three fiscal years, excluding major capital projects that will be debt funded (excluding major debt-funded projects establishes the reserves on ongoing, regular, and routine capital improvements). (2) Add a working capital reserve for the replacement of specific critical infrastructure, such as membranes and media, projected to be funded within a ten-year period.
Rate Stabilization	$1 million and $2.9 million for the Wastewater and Water funds, respectively.	Maintain a minimum level, and staff may deposit additional reserves exceeding the minimum for anticipated threats.* At present, the ideal rate stabilization target is $3 million and $7.5 million for the Wastewater and Water Funds, respectively; this will reasonably ensure that all legal obligations continue to be met with the current risk of ongoing drought if there is no new changes to rates, and water conservation becomes mandated.*
Desal Dual Purpose	Maximum reserve level of $7.5 million. Restricted to repair/maintenance of the Desal Plant and to comply with Prop 1 grant requirements.	No change.
Main Replacement	Restricted to maintaining, rehabilitating, and installing new main or transmission pipelines.	No change.
Debt Service	Based on requirements of debt issuances.	No change.

* Threats may include increasing probability of drought and the need for mandatory water conservation or other negative impacts on revenues.

The Finance Department is bringing an updated reserve policy resolution to Council on December 6, 2022, including the above proposed changes. The updated reserve policy also includes direction to staff to consider establishing a line of credit with a banking institution that may be leveraged for financing capital projects and in the event of a disaster.

Recommendation

In a vote of X to X, the Water Commission supported the Draft Reserve Resolution, specifically as it relates to the Water and Wastewater enterprise funds, and supports the City Council making similar findings.

ATTACHMENT: Technical Memorandum from HDR – 2022 Reserve Fund Review
Draft Reserve Resolution

Technical Memorandum

Date:	**11/08/2022**
Client:	**City of Santa Barbara**
To:	**Gabriel Cook,** *Water Resources Financial Officer – City*
From:	**Shawn Koorn,** *Associate Vice President – HDR* **Josiah Close,** *Senior Financial Analyst – HDR*
Subject:	**2022 Reserve Fund Review**

Introduction

The City of Santa Barbara (City) has established reserve policies to guide the water and wastewater utilities. As part of the recent rate studies, these policies were reviewed and discussed. While the policies in place were maintained, City staff requested further review of the reserve policies based on industry standard approaches, approaches used by other regional utilities, and industry best practices.

Purpose of Reserves

The first step in establishing cost-based utility rates is performing a revenue requirement analysis. The revenue requirement analysis provides the basis for the cost to provide service. In development of the revenue requirement, it is an additive process where costs related to the operations and maintenance (O&M) of the utility are included as well as capital costs related to maintaining and improving the existing system. The capital costs may include annual rate or reserve funding of capital as well as "outside funding" such as long-term debt issuances. Another component that is often identified and included in the development of the revenue requirement is related to prudent financial planning criteria or key financial metrics. This component is not just a single financial metric but rather generally includes a suite of metrics which can then impact the level of the revenue requirement. One of the more important metrics that is analyzed is the target minimum level of reserve funds. The utility industry, and the City, has conveyed that it views reserve funds as critically important and that it is also very important to have strong written policies around its handling of reserves.

There are many benefits and other impacts that the level of reserves can play for the City's utilities. First, it plays a very important role in the City's debt rating, and consequently affect long-term debt interest rates for any future issuances. It is also important that the City maintain a prudent level of reserve funds to absorb any capital costs related to a catastrophic failure of a single or critical infrastructure component necessary to provide service. Additionally, a third function and important role that reserve funds can play for the City is to cover annual deficiencies that may occur for any number of reasons (e.g., inflationary impacts, unforeseen costs, droughts, emergency repairs). The level of available reserves, in part, reflects the level of risk the utility is

willing to take given the increasing costs of capital infrastructure, the need to maintain and replace infrastructure, and revenue impacts due to unforeseen circumstances (e.g., drought, customer characteristic changes, loss of large industrial customer). The minimum target level of reserves provides the utility with the ability to address the challenges while prudently operating and maintaining critical services.

Types of Reserves

There are several different types of reserves that utilities may maintain. In general, these can be categorized as restricted, or funds set aside for a specific use or legally required (e.g., bond covenants), or un-restricted which may be used by the utility for ongoing needs. Typical reserve fund types include an operating reserve, a capital reserve, a rate stabilization, or emergency reserve, and if required a debt service reserve. In general, the first three reserves are un-restricted while the debt service reserve is an example of a restricted reserve. Each of these reserves has a specific purpose and water or wastewater utilities may view the needs differently. In addition, addition reserves, or "sub-funds", can be developed for specific purposes. One example could be a reserve for growth related fees and charges (e.g., capacity charges, impact fees). In some cases, these funds can be restricted for the purpose for which they are in place to provide, or legally restricted due to the purpose of the revenue (e.g., capacity charge or impact fee). Provided in Table 1 is a summary of some of these typical types of reserves and the purpose being served by each reserve fund.

Table 1
Overview of Reserve Funds

Operating	*Cash flow requirements, potential revenue shortfalls, supplemental capital funding*	*Un-restricted*
Capital	*Annual capital funding needs, specific future capital improvements, system replacement*	*Un-restricted*
Rate Stabilization / Emergency	*Minimize rate impacts, major infrastructure failure, severe drought, extraordinary expenses*	*Un-restricted*
Capacity Charge	*Store revenues received from new customers connecting to the system to be applied to funding infrastructure expansion on the system*	*Restricted (to growth infrastructure costs)*
Debt Service	*Annual debt service*	*Restricted*

An operating fund is generally in place to cover cash-flow needs, unexpected operating expenses (under normal conditions), lower than expected revenue collection, or funding of minor annual capital needs. As noted, these funds are un-restricted and can be used to fund the City's utility expenses as approved by management (i.e., staff and Council).

The capital fund is generally set in place to provide funding for annual capital improvement needs. A capital fund can be further differentiated between annual renewal and replacement needs and improvement capital projects (regulatory or growth related). In this way, the utility will have funds available for future capital on an ongoing basis for both renewal and replacements and system improvements. These funds are generally un-restricted, although a utility may "restrict" the funds for a specific future project. Another "type" of capital fund may also be established to fund specific future or recurring capital projects. This is sometimes referred to as a renewal and replacement reserve that is put in place to reflect a specific replacement schedule of infrastructure or facilities. A good example of this type of reserve would be a membrane replacement reserve fund. The idea being funds are stored up annually towards the replacement of the membranes then when the fund pays for the replacement the cycle starts over. This reserve would be in addition to the capital reserve target minimum.

Generally, a rate stabilization fund is in place to minimize the impacts of unanticipated rate increase needs or to "buy down" the anticipated rate increases due to a change in annual expenditures. It is important to note that the use of rate stabilization funds is a one-time revenue and should the unexpected increases in expenses, or decreases in revenues, continue, rates will need to be adjusted in the future absent additional rate stabilization fund revenue. In tandem with, or separate, utilities may maintain an emergency fund. This fund can be established to reflect the immediate funding needs as a result of infrastructure failure or natural disaster. In the latter case, the City could evaluate the timing of the reimbursement of expenses due to the natural disaster from the appropriate agency (e.g., FEMA, Cal OES) and the level of funds necessary to have on hand. These funds are un-restricted and are generally used with approval from the utility governing body. If established as part of the City's overall bond documents, a rate stabilization fund may be used as a revenue source for debt service coverage calculations.

As part of the overall funding approach for the City's water and wastewater utilities, capacity charges were implemented. These charges reflect the "value" of the system that new customers are receiving the benefit of having been put into service. The revenues from these charges are required to be tracked separately from other revenues and are generally placed in a separate reserve fund to accumulate a level of reserves sufficient to fund a future growth or expansion related project. These funds are generally considered un-restricted but are legally restricted in their use. These funds may only be used to fund growth or expansion related infrastructure or annual debt service related to financed past growth or expansion related infrastructure. A similar approach may be used for other City funds where "impact" or "development" fees are charged and the City will need to "account" for those funds and uses of the funds. For these funds there is generally not a minimum reserve given the nature of the fees and charges and uses of the resulting revenues. However the City may determine that a minimum level is appropriate, while still meeting the legal requirements of the uses of the revenue.

A debt service reserve is in place to support the long-term borrowing undertaken by the water or wastewater utility. These funds are generally restricted and are based on the level of indebtedness of the utility. These funds are typically outlined as part of the borrowing agreement between the utility and the provider of the funding.

As noted in the capital reserve discussion, additions to these typical reserve funds may be made to fit the need of each utility or enterprise fund. While they may be established around a specific project, or need, they can be in addition to those minimum reserves, or not included in the calculation of available unrestricted funds to meet overall minimum policy levels. Again, a simple example would be a reserve fund for a specific project or system improvement. While these funds may technically be un-restricted, the City may "restrict" these funds for the specific use. In this way, the City has established the funding, in part or in whole, for the project or system improvement and the policy to support this approach.

Existing City Reserve Fund Policies

Reserve funds and there governing policies can be defined in as many different ways as the number of utilities across the county given the unique and specific situation of each utility or enterprise fund. Each reserve fund and accompanying policies will likely reflect the nuances to how each specific utility is operated and how risk is viewed. In general, the first area many utilities identify, and address is an operating reserve fund. This reserve or set of reserves is typically aimed at providing a reserved source of funds to maintain the operations of the utility should an impact to operations occur. Although many utilities may opt for a single operating reserve, for the City's water and wastewater utility, there are two that are in place to address these issues: the disaster reserve and the contingency reserve. The next area of focus for utilities regarding developing reserve funds is around a capital reserve which the City does and has policies about the target minimum levels of reserves.

Disaster Reserves

The City's disaster reserve is restricted to use in addressing the financial impacts of natural disasters, such as floods, fires, tsunamis, earthquakes and other event(s) that results in significant damage to City facilities and infrastructure. The use of disaster reserves should generally be limited to federal or state declared disasters. The use of disaster reserves is also allowable in cases where the natural disaster is less severe, such as a major fire to a City building that requires temporary facilities to be leased. Disaster reserves may be used only after other available funds are exhausted, including the contingency reserve.

According to Council reserve policy, the disaster reserve fund balance is calculated as 15% of the most recently adopted fiscal year operation budget. The reserve policy also notes examples for when the disaster reserve can be utilized such as when extraordinary costs are incurred in connection with the immediate emergency response to address public safety matters. Another use may be revenue losses resulting from a significant decline or temporary halt in visitors to the City due to major damage to facilities, infrastructure, and local businesses. Other applicable costs include additional costs necessary to maintain City operations and long-term costs incurred to rebuild City facilities and infrastructure.

Contingency Reserves

The purpose of the contingency reserve is to allow for the orderly implementation of a balancing strategy to address the fiscal impacts of unexpected events in order to minimize the impacts to the organization and community. The most common of these events would be an economic recession that results in a significant impact on key revenues such as sales, transient occupancy or property taxes. The general intent of the contingency reserve is for unexpected events or situations. In general, its purpose is not to fund known or anticipated financial impacts, such as negotiated salary and benefit increases or scheduled increases to health insurance premiums or retirement costs. Contingency reserves may also help the City cover costs until an agency such as the Federal Emergency Management Agency (FEMA) or California Office of Emergency Services (Cal OES) is able to provide assistance.

Based on Council reserve policy, the calculation for the contingency reserve is 10% of the most recently adopted fiscal year operation budget. Some of the typical uses identified in the policy include natural disasters, as described above for disaster reserves. Another use may be when there are revenue impacts resulting from State of California actions or unfunded State mandates or unexpected loss of external funding from sources such as grants or entitlements. In addition, an unplanned loss of, or damage to, a City facility such as the loss of a building due to fire may warrant use of contingency reserves. Lastly, the trigger for utilizing reserves may be mitigation of an emergency that poses a threat to public health and safety.

Capital Reserve

As mentioned above, there are two general or popular types of reserves revolving around operating reserves and capital reserves. The first two reserves discussed – disaster and contingency – are more related to operating reserves. The City also has an established capital reserve and adopted policies around its purpose and usage. Whereas operating reserves more typically focus on the maintaining daily operations of a utility, capital reserves focus more on the investment in capital additions to the utility system to maintain level of service, safety, or reliability.

As per Council reserve policy, each enterprise or utility will establish a capital reserve funded to at least 5% of the value of its capital assets. Alternatively, the amount may be established at an amount equal to the average of the adopted capital program budgets for the previous three years. The goal of the capital reserve is to provide funding for major capital costs.

Rate Stabilization Reserve

As part of past water and wastewater debt issuances the City established a rate stabilization reserve. As part of the 2016 wastewater bond issuance, $1 million was placed in the wastewater rate stabilization fund. However, no target, minimum reserve, or policy appears to have been established as part of the process. Similarly for water, the 2013 certificate of participation resulted in $2.9 million being placed in the rate stabilization. Since that time, the City has made additional deposits to the water rate stabilization reserve. Again, no target minimum has been established outside of the original pledge in the bond documents.. As outlined in the bond

documents, these reserves are available and can be considered as revenue for debt coverage calculations so long as the funds are transferred no later than 150 days after the end of the fiscal year. For establishing minimum reserve levels it is recommended that the current reserve balances in the rate stabilization funds be used as the minimum target at this time. As a point of reference, these levels are greater than the minimums outlined in the bond documents. However, as the City continues to evaluate reserve balances, and funding needs, the City should evaluate the necessary level of rate stabilization reserves. Based on this review, it is recommended that the City target $7.5 million and $3.0 million for water and wastewater respectively. This is based on an evaluation of meeting legally required debt service requirements, no changes in annual rate levels, and declining consumption levels. This level of rate stabilization reserves should provide the City with sufficient reserves to maintain the borrowing requirements.

Water Main Replacement Reserve

Previous Council direction resulted in the establishment of a water main replacement reserve. Funds are added to the main replacement reserve at the end of the year if funds are available in the capital project account, or capital funds not spent in current year. The water main replacement reserve is in place and limited to maintaining, rehabilitating, and installing new water main or transmission pipelines.

Desal Reserve

In 2018 the City received a significant grant to operate and maintain the desalination plant. The requirements of receiving the grant included specific stipulations. In order to ensure compliance with the grant requirements and provide funding for ongoing life-cycle management for infrastructure, the City established the Desal reserve. This reserve fund addresses the first issue in that the desal plant will need to be run near-continuously. Should this not occur, this reserve provides a funding source should a portion, or all, of the grant be repaid. The second purpose of this reserve fund is to provide a funding source for ongoing repair and maintenance of the plant. In this way, the City has an established funding source to maintain the facility and meet the near-continuous operations of the plant. In 2021 the City established a maximum reserve level of $7.5 million. The desal reserve will be funded annually, adjusted for inflation, through other water system revenues, primarily a portion of the revenues received from the City of Montecito Water District Water Supply Agreement.

Debt Service Reserve

The City also maintains debt service reserve funds. This review has not evaluated the debt reserves as those are outlined in the loan documents. It is assumed that all debt service reserve funds are maintained based on the requirements of the debt issuance or City policies established at the time of the debt issuance.

Given the total minimum reserves per the City's current policies for the water and wastewater utilities, they can be compared and evaluated based on other agencies approaches, industry standard approaches, and how the financial community views available cash.

Examples of Reserves from other Agencies

Another way in which to both evaluate the existing reserves as well as identify possible additions of reserves and policies to is look at the policies from other local surrounding agencies. Often other agencies and utilities in the area are having to deal with similar issues and constraints. Although no comparison is a true apples to apples comparison, reviewing other surrounding utilities can help to inform and give context to the challenges and how others have chosen to address them as well as what things have been considered. Table 2 shows a number of utilities that the City wanted to specifically look at as part of this review.

Table 2
Examples from Other Agencies

City of Santa Monica	Pasadena
Operating – *based on industry and bond rating agency best practices* ***Capital –*** *based on industry and bond rating agency best practices* ***Rate Stabilization –*** *based on industry best practices*	***Working Capital Reserves*** *- equal to two months (one month for Refuse Fund) current year operating appropriations*
SF PUC	**Las Virgenes District**
Fund Balance Reserve *– minimum of 90 days or 25% of O&M (including programmatic projects and excluding debt service and revenue-funded capital) throughout the forecast period. Amounts in excess of the minimum will be considered for contingencies and rate stabilization*	***Operating Reserve*** *- 25% of the current year operating budget* ***Rate Stabilization Reserve*** *- $8.0 million* ***Emergency Reserve*** *– 2.0% of total value of assets* ***Capital Replacement Reserve*** *- equal to the most recent three years of depreciation*

Industry Reserve Fund Policies

There are several industry standard sources for referencing typical reserve types for municipal water and wastewater utilities as well as the typical uses for each reserve and the establishment of the minimum or target. For this memo, several sources are highlighted: AWWA Cash Reserve Policy Guidelines, Government Finance Officers Association (GFOA), Fitch 2019 Medians, Standard and Poor's, and Moody's. The latter three being used when an agency is being evaluated for long-term debt by the financial market.

Table 3
Summary of Industry Materials

Reserve Target	AWWA	GFOA	Fitch 2019 Medians	S&P	Moody's
Operating	*WEF – 1–3 months of O&M*	*Minimum of 45 days of O&M*			
Capital	*-Annual Dep Exp* *-% of total assets* *-Avg annual CIP*				
Days of Cash on Hand			*Unrestricted cash divided by operating expenditures minus dep. exp. / 365. 570 days (AAA) and 430 days (A)*	*Includes all available, unrestricted, cash as compared to O&M. >150 days is highest assessment, 30-90 days is mid point assessment*	*Unrestricted cash and liquid investments times 365 / O&M expenses. >250 days (Aaa), 35-150 (A)*

As noted, the above industry approaches are specific for water and wastewater utilities. It is also important to note that the days of cash on hand as outlined by the financial community generally reflects all un-restricted cash which would combine the available cash in the City's policies for disaster, contingency, and capital.

Review of Existing City Reserve Fund Policies

Below in Table 4 is a summary of the City's existing reserve policies. For ease of comparison, the specific stated target has been converted into days of cash on hand.

Table 4 Summary of the City's Reserves			
Reserve	**City's Target**	**City's Target** (days of O&M)	**Comparison to Industry Metrics**
Contingency	*10% of O&M*	*37*	
Disaster	*15% of O&M*	*55*	
Capital	*5% of Assets or Avg 3-yr CIP*	*≈120*	
Total		***212***	
Fitch 2019			*430 - 570 days*
S&P			*30 – 90 = midpoint* *150+ = highest*
Moody's			*35 – 150 days = A* *>250 days = Aaa*
2018 AWWA Benchmarking			*386 – 431 days*

As can be seen in Table 4, the City's existing policies are reasonable when compared to industry metrics, excluding the desalination and main replacement reserves, which may be included in the calculation as they are not specifically restricted. However, for purposes of this review they have been excluded as the City has these funds set aside for specific funding and ensuring the grant revenue received for the desalination plant. At approximately 212 days of O&M, this reflects the mid or higher rated utilities when compared to the financial community metrics. In this sense, the City has established minimum reserve polices that reflect industry standard approaches. However, it is important to review these policies periodically to determine if they still reflect the City's goals and objectives. Furthermore, it is important to evaluate the purpose of the reserves.

Establishing Minimum Target Reserve Levels

When prudently operating a municipal utility or enterprise fund, it is important to take steps to plan for the future and attempt to mitigate risks. Risk management is a major component of planning for the future to help make sure the utility can weather unforeseen storms or other issues that may arise in the future. Reserve funds are often looked at as a risk management tool.

This risk is directly related to determining the target minimum level for reserve funds. One example of the approach is outlined in the GFOA best practices Fund Balance Guidelines for the General Fund. While the following excerpts from GFOA are related to a "General Fund", the principles and discussion are applicable to enterprise funds such as the City's water and wastewater utility funds. The GFO best practice notes the following:

> *"It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates."*

In other words, and in terms of the review of the City's water and wastewater funds, or other City enterprise funds, the City should maintain a level of reserves to mitigate the possible risks of that specific fund, while also maintaining stable revenues, or rate levels for the City's water and wastewater utilities. This balancing of risk is the critical assumption. This is included in the City's current policy for water and wastewater, and is outlined in part, in the disaster and contingency reserve policy approach. While this may "cover" a multitude of impacts, the City could focus more generally on an overall minimum target level to reflect the various impacts to revenues and expenses.

The best practice goes on to state the following:

> *"The adequacy of unrestricted fund balance in the general fund should take into account each government's own unique circumstances. For example, governments that may be vulnerable to natural disasters, more dependent on a volatile revenue source, or potentially subject to cuts in state aid and/or federal grants may need to maintain a higher level in the unrestricted fund balance. Articulating these risks in a fund balance policy makes it easier to explain to stakeholders the rationale for a seemingly higher than normal level of fund balance that protects taxpayers and employees from unexpected changes in financial condition. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures."*

Again, the above statement is identifying possible risks, and impacts to expenses and revenues that must be mitigated for the specific fund. Given this, GFOA recommends a minimum of no less than two months of operating revenues or expenses.

At the current policy level, the combined disaster and contingency reserves is 25% of annual O&M expenses. In comparison to Table 3, this combined level is 90 days of O&M which would meet, or reflect, the guidance by AWWA and GFOA for a minimum operating reserve, which would be more general as an un-restricted fund balance. While this level is below the target levels of cash on hand as outlined by the financial community, it is important to note that this only reflects the operating reserve. AWWA and other industry standard approaches also generally include an additional capital reserve. When adding the City's capital policy, and minimum reserve, to the two prior reserves, the total un-restricted cash is reasonable and reflects the target for un-restricted days cash on hand based on the financial community metrics.

GFOA also notes that "...a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level…". Such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time." This fits with the City's ongoing evaluation and review of the water and wastewater utility through periodic rate studies. This also outlines that in some cases, reserve level may be "significantly" greater than target minimums, and when accompanied by a long-term financial plan that outlines the use of those funds in the future, it

can be acceptable. Again, for the water and wastewater utility the 10-year financial plan aspect of the rates studies evaluates this aspect of the study.

It is also important to evaluate how the funds will be used, and then replenished if the available funds fall below the target minimum. The policy should outline the "accepted" uses of the funds and also how the funds will be repaid. Ideally this replenishment of reserves would occur as quickly as possible but can generally take one to three years to minimize impacts to rates and fees that support the fund. Another aspect of the replenishment is the timing. As an example, the current drought has continued to impact the level of revenues for the City's water and wastewater funds. Given this, a portion of the proposed rate revenue adjustments was to maintain minimum reserve levels. This type of situation can compound the requirement as reserves are being used to supplement reduced revenues, while also attempting to replenish reserves during the event. In Resolution No. 12-066 the City outlines the approach for the timing of maintaining and replenishing reserves in both normal and abnormal times. However, for the water and wastewater utility, it is important that overall rate impacts are balanced in times of revenue deficiencies when evaluating minimum reserve levels.

Another method to minimize the risk and level of reserves on hand would be through a policy related to a line of credit. This is also a viable risk management approach, specifically during the construction of large capital projects. This tool is beneficial as the City does not need to carry the funds in a reserve in order to benefit from the risk avoidance. The downside is that the City will need to pay a premium to the entity offering a line of credit which is essentially compensating them for hedging the risk on the behalf of the City. It is important to note that this approach is generally not used to pay for operating expenses but more frequently costs related to capital investment. This can be used in many different ways, however, the general approach is to balance cash flow needs for large capital projects. Many low interest financing programs are on a reimbursement basis. Given this, the use of a line of credit would provide the City with cash flow prior to being reimbursed for the eligible project expenses, and paid back when reimbursed for the expenses. In this way, existing cash, or available reserve balances, are not impacted by the funding of the capital project. In other cases, utilities have issued a line of credit to "finance" a project. In this example, line of credit is used to fund project expenditures, and once complete, alternative funding (e.g., revenue bond) is issued and the line of credit repaid. It is important to note that interest expense is generally accrued during this period or funded on an ongoing basis in this approach. Alternatively, the City can use the line of credit to balance other cash flow constraints. However, if not repaid as outlined in the credit agreement, interest would accrue or need to be paid. Given this, unless future cash flow is projected to be sufficient to fund ongoing costs and borrowed funds through the line of credit, it is not a frequently used approach.

Proposed Revisions to Reserve Fund Policies

Given the above discussion, the overall level of reserves on a combined basis reflects general industry and financial market practices. However, it may be more reasonable to establish an operating, capital, and rate stabilization reserves based on industry standard methods while

meeting the financial community metrics to maintain a high credit rating for the City's various funds.

The creation of the operating reserve would appear to be helpful in creating increased liquidity from reserves which is very helpful with cash flow variations. An operating reserve would perform the same functions as the current disaster and contingency funds currently do and provide similar risk avoidance benefits. Currently, the emergency and contingency funds target 25% of annual O&M expenses, or approximately 90 days of annual O&M. HDR would recommend a minimum target balance of 90 days of O&M. By developing an operating reserve, this would provide additional liquidity to not only reflect short-term disaster response but also cash flow timing issues. This would apply to both the water and wastewater utilities. A comparison of the present and proposed operating reserve is shown in Table 5 below.

Table 5
Proposed Operating Reserve

Target	FY 2022 - Water	FY 2022 - Wastewater
90 Days of O&M	$10,408,347	$4,273,355
Existing Disaster + Contingency Target	***$10,552,908***	***$4,332,707***

A capital reserve is the next recommended reserve fund. While currently established based on 5% of capital assets or the average of the adopted capital budget for the previous three years. HDR would recommend that the capital reserve be developed based on future capital needs for a specific period of time. Generally speaking, a the next three to five years is appropriate to establish the average annual capital reserve level. It is also recommended that the target reserve exclude those projects that are extraordinary in nature, or major improvements that are not routine that may also be debt financed and a debt service reserve may be established. For example, increasing the target balance for a treatment plant expansion, may not reflect the funding or cash flow needs that need to be reflected in a capital reserve target balance. In this way, the target minimum reserve level is based on the ongoing, more routine, capital improvement needs over the next several year period. Table 6, below, shows a comparison of the present and proposed capital reserve target.

Table 6
Proposed Capital Reserve

Target	FY 2022 - Water	FY 2022 - Wastewater
3-Year Avg	$20,781,982	$6,805,782
5-Year Avg	$17,470,763	$6,140,000
Existing Capital Reserve Target	***$14,002,259***	***$6,015,954***

As mentioned previously, another type of capital reserve is one that is specifically designed to help store funds for a particular capital replacement with recurring frequency. An example of this would be developing a membrane replacement reserve fund for the desalination plant membrane replacement. The function of the reserve would be to hold funds that would be added to annually through a transfer and then ultimately used to fund the replacement of the membranes. In order to establish the annual transfer amount, the City must have the anticipated cost of the replacement and then the frequency at which the replacement will need to occur. The capital cost – escalated annually to represent the inflation of future costs – is then divided by the number of years that is anticipated to save the money for the replacement. The City's main replacement reserve is similar reserve. HDR would recommend, where applicable, the City implement this approach as a component of the overall capital reserve policy. The addition of this reserve minimum target would be in addition to the minimum target capital reserve. Given the purpose of reserves is to minimize risk, a more conservative approach would be to add this reserve to the capital reserve, while also making sure that when these funds are used, the City is not below the minimum target capital reserve level.

Finally, HDR would recommend that the City maintain the current rate stabilization reserves. These reserves were established by the City during prior long-term debt issuances. The key element of these reserves is that the City may use these funds are available for debt service coverage purposes if transferred within 150 days of the end of the fiscal year. Given this, these reserve funds are restricted and must be maintained and used only for this purpose.

The City also maintains a desalination reserve established in 2021 to reflect the requirements of the 2018 grant received for the desalination plant. HDR recommends the City maintain this reserve and would treat this reserve as a restricted reserve given the need to support the desalination plant operations and maintenance and grant requirements.

It should be noted that this review assumes that any required debt service reserves are funded and maintained at the levels required in the agreements. It is also recommended that the City establish a policy around the replenishment of, or meeting current minimum targets, during an emergency, disaster, or other revenue reducing or increasing expense period. This policy would provide the City with the ability to defer, or ideally a transition to, meeting the policies during the time period to minimize the impacts to rates and fees. However, it is important to note that the delay of meeting, or replenishing reserves, even during an "event" may result in greater impacts to rates and fees in the future as the revenue may not be available as a result of changing customer characteristics (e.g., reduced use) or overall system demographics (e.g., reduced customers).

Summary

The City has existing reserve funds and policies outlining target minimum levels. In general, the City has established reserve targets and levels that reflect industry standard approaches and reflect financial metrics expected by the financing community. In addition, the City has

established rate stabilization reserves which are available to meet debt service coverage requirements which provides an additional level of financial security. Additionally, the City has the desalination reserve which has been restricted by the City for specific uses at the desalination plant.

This review was intended to provide the City with a summary of industry standard approaches and alternatives to evaluate the appropriateness of the City's current approach. The recommendations reflect industry standard approaches and simplify the City's reserve target minimums. As noted, this review did not review the debt reserves that are in place or may be required in the future. However, HDR would recommend the City continue to maintain adequate debt service reserves when issuing new long-term borrowing to support the utilities. While the focus of the review was for the water and wastewater utilities, these approaches and methods outlined for evaluating reserve minimums can be applied to other City enterprise funds. However, it is important to evaluate the risk associated with each enterprise fund and the purpose of maintaining specific minimum reserve levels.

RESOLUTION NO._____

A RESOLUTION OF THE COUNCIL OF THE CITY OF SANTA BARBARA ESTABLISHING POLICIES FOR RESERVES FOR THE CITYS GENERAL FUND, ENTERPRISE FUNDS AND INTERNAL SERVICE FUNDS, AND AMENDING RESOLUTION NO. 12-066 AND RESCINDING RESOLUTION NO. 18-056.

WHEREAS, the City desires to establish policies regarding reserves for the various City funds for the purpose of providing consistent designations for different categories of reserves, ensuring fiscal security for the funds, and defining standards for minimum ~~and maximum~~ amounts to be maintained in reserves;

WHEREAS, such reserves policies will be most readily communicated and understood if they are consolidated and formally adopted in a single document;

WHEREAS, the Council has considered the proposed reserves policies applicable to the General Fund, Enterprise Funds, and Internal Service Funds at a regular Council meeting on ~~June 12, 2012 and subsequently adopted the policy on October 3, 2012~~; and

WHEREAS, the Council has considered the proposed reserve policies applicable to the General Fund, Enterprise Funds, and Internal Service Funds at a regular Council meeting on _____.~~not proposed changes to reserve policies applicable to Enterprise Funds, which are contained in Council Resolution Nos. 95-157 and 99-066, but are nonetheless incorporated into this policy document~~City desires to update the reserve policy to address ongoing pension expenses and liabilities.~~

NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SANTA BARBARA THAT the following reserves policies are adopted:

SECTION 1: CALCULATION OF RESERVE AMOUNTS

Final reserve balances will be calculated at end of each fiscal year after the closing of the City's accounting records. An amount will be established for each fund, as applicable, as a commitment of fund balance for each type of reserve established by this policy.

As soon as practical after the close of a fiscal year, staff will provide City Council a report showing the status of reserves as of June 30. At any time it is proposed to utilize reserves pursuant to this policy, staff will provide a similar report on reserves and projected fiscal impact from the proposed use of reserves.

SECTION 2: DISASTER RESERVES

The amount of the required Disaster Reserve is calculated based on 15% of the most

recently adopted fiscal year operating expenditure budget.

The Disaster Reserve is restricted to use in addressing the financial impacts of natural disasters, such as storm, floods, wildfires, droughts, tsunamis, earthquakes and any other event that results in significant damage to City facilities and infrastructure or a significant reduction of normal operating revenues.

The use of Disaster Reserves should generally be limited to federal or state declared disasters. The use of Disaster Reserves is also allowable in cases where the natural disaster is less severe, such as a major fire to a City building that requires temporary facilities to be leased. Disaster reserves may be used only after other available funds are exhausted, including the Contingency Reserve.

Examples of financial impacts that would justify the use of Disaster Reserves include:

- Extraordinary costs incurred in connection with the immediate emergency response to address public safety matters.
- Revenue losses resulting from a significant decline or temporary halt in ~~visitors to the City~~services due to major damage to facilities, infrastructure and local businesses.
- Additional costs necessary to maintain City operations.
- Long-term costs incurred to rebuild City facilities and infrastructure.

SECTION 3: CONTINGENCY RESERVES

The Contingency Reserve is calculated based on 10% of the most recently adopted fiscal year operating expenditure budget.

The purpose of the Contingency Reserve is to allow for the orderly implementation of a balancing strategy to address the fiscal impacts of unexpected events in order to minimize the impacts to the organization and community. The most common of these events would be an economic recession that results in a significant impact on key revenues such as sales, transient occupancy or property taxes.

Other unexpected events for which these reserves could be used include the following:

- Natural disasters, as described above for Disaster Reserves;
- Revenue impacts resulting from State of California actions or unfunded State mandates;
- Unexpected loss of external funding from sources such as grants or entitlements;
- An unplanned loss of, or damage to, a City facility such as the loss of a building due to fire;
- Mitigation of an emergency that poses a threat to public health and safety; and
- An adverse judicial action that requires large cash payments to third parties and is not covered by insurance.

The general intent of the Contingency Reserve is for unexpected events or situations. In general, its purpose is not to fund known or anticipated financial impacts, such as negotiated salary and benefit increases or scheduled increases to health insurance premiums or retirement costs.

SECTION 4: COUNCIL APPROVAL OF DISASTER AND CONTINGENCY RESERVES

Any use of the Disaster or Contingency reserves described in Sections 2 and 3 requires a majority vote of approval by the City Council.

When the use of reserves is recommended to the City Council by staff, the justification should include the following elements:

An Assessment of the Fiscal Condition and Outlook:

This assessment should include an objective evaluation of the operating fund's fiscal condition and an evaluation of the impacts of the event that triggered the need to use ~~of~~ reserves. The purpose of this evaluation is to measure and define the scope and duration of the problem to assist in developing an appropriate balancing strategy.

This assessment of fiscal condition should include the use of available and relevant financial and non-financial data, including economic and demographic indexes and trends; historical revenue and expenditures results; and local economic forecasts developed by recognized academic and financial institutions and paid consultants.

Balancing Strategy

The balancing strategy should include measures that minimize the use of Contingency Reserves, such as:

- Expenditure reductions achieved through efficiency measures, cuts to programs, services and associated staffing;
- Revenue enhancement measures that generate new or increased revenues;
- Use of existing one-time funds; and
- Use of available reserves in other funds, as allowable and appropriate.

The balancing strategy should also be consistent with the nature of the fiscal impact. For example, a one-time impact may be resolved fully with the use of reserves, depending on its severity. However, an event that has an ongoing financial impact, such as decline in revenues due to a major recession, will require a balancing strategy that includes ongoing budget and programmatic adjustments to minimize the use of reserves.

Plan of Replenishment

The replenishment plan should include the following elements, as appropriate:

- A one-time (one-year) use of reserves should be accompanied by a specific plan for how and when the reserves will be restored.

- An extended use of reserves for more than one year should be accompanied by a long-term strategy that includes a more general plan for how the reserves

will be restored.

SECTION 5: ENTERPRISE FUNDS

Enterprise Funds will be subject to the same Disaster and Contingency Reserve and approval requirements as described in Sections 2, 3 and 4 of this resolution.

~~In addition, e~~Each Enterprise Operating Fund will establish a Capital Reserve, funded to at least 5% of the value of its capital assets. ~~In the a~~Alternatively, the Capital Reserve ~~amount~~ may also be established at an amount equal to the average of the ~~adopt~~planned~~ed~~ capital program budgets for the ~~previous~~upcoming three fiscal years, excluding major capital projects that will be debt funded. Appropriations from ~~these~~ Capital reserves ~~will be~~are intended to ~~fund major capital costs~~address an unexpected capital project or unanticipated increase in capital projects. Capital reserves might also be funded in excess of the minimum in preparation for major (pay-go or cash funded) ~~used to build up and fund major~~ capital projects.

Another option for funding major future capital projects is a Working Capital reserve. These specific capital reserves would be designated for the replacement of critical infrastructure projected to be funded within a ten-year period. There is no minimum for these reserves as they will function as a working capital reserve for funding of large and costly infrastructure on a routine basis. These include the Council approved Desalination Reserve (Resolution No. 21-082), as well as Main Replacement Reserves (restricted to maintaining, rehabilitating, and installing new main or transmission pipelines) in the Water and Wastewater Enterprise Funds.

Bond funding for the Water and Wastewater Enterprise Funds requires a rate stabilization reserve (as outlined in the 2013 and 2016 bond documents, Resolution No. 13-029 and 16-168 respectively). The minimum reserve requirement for the rate stabilization fund is $2.9 million and $1.0 million for the Water and Wastewater Funds respectively. These funds are differentiated from Disaster, Contingency and Capital reserves as they can be considered revenue for the purpose of debt service coverage in a given fiscal year, if they are transferred within 150 days of the end of the prior fiscal year. These reserve funds are restricted and must be maintained and used only for this purpose. Staff may make additional deposits to this reserve if there are anticipated threats to revenues that might exceed the minimum reserve. This might include increasing probability of drought and the need for mandatory water conservation, or other negative impacts on revenues that might reasonably be expected. Deposits into the rate stabilization fund must be reflected as reductions in revenues for the year the deposits are made.

The ~~Water, Wastewater,~~ Solid Waste and Clean Energy Enterprise Operating Funds shall utilize the contingency reserve ~~as a rate stabilization reserve~~ to buffer a significant loss in revenue or the impacts of significant rate increases. The use of these reserves should be considered one-time revenue as future rates ~~should~~will need to be adjusted to address any ongoing expense increases to operating the enterprise.

For the Waterfront Enterprise Fund, the Capital Reserve requirement will be met through

reserves accumulated in the Harbor Preservation Fund (HFP). Pursuant to Chapter 17.40 of the Santa Barbara Municipal Code, the HFP is required to maintain reserves of no less than $2 million for preservation, enhancement and management of Waterfront and State Tidelands Trust properties.

Where applicable, each Enterprise shall maintain any required debt service reserve to support the long-term borrowing and shall be restricted to the level of indebtedness of the utility.

The City shall also consider establishing a line of credit with a banking institution that may be leveraged for financing capital projects and in the event of a disaster. Leveraging a line of credit is a viable risk management approach and may address short-term cash flow needs and lessen the need to require disaster reserves in the future. A line of credit shall not be used to pay for operating expenses. The cost of establishing a line of credit shall be considered in relation to the investment earnings that may be achieved through investing funds in line with the City's investment policy and other operating considerations.

SECTION 6: RESERVE REQUIREMENTS FOR INTERNAL SERVICE FUNDS

Internal Service Funds are not subject to the reserve requirements for Disaster Reserves or Contingency Reserves. Instead, Internal Service Funds will maintain an operating reserve equal to 10% of the operating budget of the most recently adopted budget. This reserve will be available to address unexpected events and natural disasters that affect the operations and revenue streams of the Internal Service Funds.

~~Within the City budgetary structure there are a number of Internal Service Funds that are used to provide services to operating departments throughout the City. These Internal Service Funds include the following:~~

~~Information Systems Fund~~
~~Fleet Maintenance Fund~~
~~Facilities Management Fund~~
~~Self-Insurance Fund~~

All ~~of the~~ Internal Service Funds ~~listed above~~ will be subject to the 10% reserve requirement, with the exception of the Self-Insurance Fund, which by design builds up assets for the payment of claims several years into the future, and the Facilities Management Fund, which is based on 10% of the adopted Building Maintenance Program Budget. As a result, there should be adequate cash reserves to cover unanticipated costs. In addition, the reserve requirements do not apply to Internal Service Funds that are specifically designed to accumulate reserves for capital, such as the Vehicle Replacement Fund.

SECTION 7: APPROPRIATED RESERVES

An Appropriated Reserve will be included in each operating fund's adopted budget to

provide for unanticipated expenditures or to meet unexpected small increases in service delivery costs within the fiscal year. For the General Fund, the appropriated reserve should be at least $~~1~~250,000. For Enterprise and Internal Service operating funds, this reserve will be at least one-half of one percent of the operating budget. Any unused portion of the appropriated reserve in each fund will be returned to fund balance at the end of the fiscal year.

~~The use of the General Fund appropriated reserve requires an affirmative vote of a majority of the City Council; use of appropriated reserves in Enterprise and Internal Service Funds requires approval of the appropriate department head.~~

SECTION 8: ALLOCATION OF GENERAL FUND, ENTERPRISE FUNDS AND INTERNAL SERVICE FUNDS YEAR-END SURPLUS TO ~~CAPITAL~~PENSION EXPENSES AND LIABILITIES

At the end of each fiscal year, any General Fund, Enterprise Funds and Internal Service Funds surplus realized from actual revenues exceeding actual expenditures including the annual capital program will be used to maintain reserve balances at levels required by this policy as well as address pension-related expenses and future liabilities. The amount of reserves to be transferred to a Section 115 trust to address pension-related expenses and future liabilities will be determined based on the proportional burden of expenses and liabilities in each fund. Maintaining reserve balances will be the highest priority, followed by addressing pension-related expenses and future liabilities.~~as follows:~~

- ~~50% will be used to fund any deficit and/or maintain reserve balances at levels required by this policy.~~
- ~~The remaining surplus of at least 50% will remain in the General applicable Fund reserve balance or be transferred into a capital sinking fund that will be available for capital improvements and replacements~~Section 115 Trust to be used to address pension-related expenses and future liabilities~~.~~

~~To the extent less than 50% of the surplus is needed to maintain required reserve balances, the remaining balance will remain in the Generalapplicable Fund resesrve balance or be transferred into the capital sinking fund~~Section 115 Trust~~.~~

~~Any allocation of year-end surplus towards capital should not be used to supplant the annual capital program funding. Therefore, the calculation of the year-end surplus will be after including the expenditures for the annual capital program.~~

SECTION 9. RESOLUTION NO. 18-056.

Resolution No. 18-056 is hereby rescinded in its entirety.

City of SANTA BARBARA

ONE WATER CITY OF SANTA BARBARA

PUBLIC WORKS DEPARTMENT

WATER RESOURCES DIVISION

PROPOSED RESERVE POLICY CHANGES

Water Commission
November 17, 2022

Overview of Presentation

- Background
- Existing Reserves
- Industry Standards and Minimum Reserves
- Proposed Changes
- Recommendation

Background

- Water and Wastewater Reserves
- Benefits
- Challenges

Existing Reserve

Reserve	Purpose	Methodology
Disaster	Financial impacts of natural disasters or events significantly damaging facilities and infrastructure.	15% of the most recently adopted fiscal year budget.
Contingency	Minimize adverse impacts of unexpected events on the organization and community.	10% of the most recently adopted fiscal year budget.
Capital	Funding for major capital costs.	5% of the value of capital assets or the average of the adopted capital program budget for the **previous** three fiscal years.
Rate Stabilization	May be considered revenue for the purpose of debt service coverage in a given fiscal year.	Minimum $1 million and $2.9 million for the Wastewater and Water funds, respectively.
Debt Service	Required when incurring debt, usually for capital infrastructure financing.	Based on requirements of the debt issuance.

Existing Reserve - Snapshot

Reserves (in millions) *	Water	Wastewater
Disaster	$6.0	$2.6
Contingency	$4.0	$1.7
Capital	$13.9	$3.9
Rate Stabilization	$7.5	$1.0
Desal Dual Purpose	-	n/a
Main Replacement	-	n/a
Debt Service	$7.1	$1.0
Total Reserves	**$38.5**	**$10.2**

* Reserve levels as of June 30th, 2021

Industry Standards

Summary of Industry Materials					
Reserve Target	AWWA	GFOA	Fitch 2019 Medians	S&P	Moody's
Operating	*WEF – 1–3 months of O&M*	*Minimum of 45 days of O&M*			
Capital	*- Annual Dep Exp* *- % of total assets* *- Avg annual CIP*				
Days of Cash on Hand			*Unrestricted cash divided by operating expenditures minus dep. exp. / 365.* *570 days (AAA) and 430 days (A)*	*Includes all available, unrestricted, cash as compared to O&M.* *>150 days is highest assessment* *30-90 days is midpoint assessment*	*Unrestricted cash and liquid investments times 365 / O&M expenses.* *>250 days (Aaa), 35-150 (A)*

City Reserves Compares to Industry Standards

Summary of the City's Reserves			
Reserve	City's Target	City's Target (days of O&M)	Comparison to Industry Metrics
Contingency	10% of O&M	37	
Disaster	15% of O&M	55	
Capital	5% of Assets or Avg 3-yr CIP	≈120	
Total		212	
Fitch 2019			430 - 570 days
S&P			30 – 90 = midpoint 150+ = highest
Moody's			35 – 150 days = A >250 days = Aaa
2018 AWWA Benchmarking			386 – 431 days

Proposed Changes

Reserve	Current Policy	Proposed Change
Disaster	15% of the most recently adopted fiscal year budget.	No change.
Contingency	10% of the most recently adopted fiscal year budget.	No change.
Capital	5% of the value of capital assets or the average of the adopted capital program budget for the previous three fiscal years.	(1) Average of the planned capital budget for the upcoming three fiscal years, excluding major capital projects that will be debt-funded (excluding major debt-funded projects establishes the reserves on ongoing, regular, and routine capital improvements). (2) Add a working capital reserve for the replacement of specific critical infrastructure, such as membranes and media, projected to be funded within a ten-year period.
Rate Stabilization	$1 million and $2.9 million for the Wastewater and Water funds, respectively.	Maintain a minimum level, and staff may deposit additional reserves exceeding the minimum for anticipated threats.* At present, the ideal rate stabilization target is $3 million and $7.5 million for the Wastewater and Water Funds, respectively; this will reasonably ensure that all legal obligations continue to be met with the current risk of ongoing drought if there are no new changes to rates, and water conservation becomes mandated.*

Recommendation

- That Water Commission support the Draft Reserve Resolution, specifically as it relates to the Water and Wastewater enterprise funds, and supports the City Council making similar findings

Questions?