

EXHIBIT A

Coachella Valley Water District Reserve Guidelines

GOAL

The goal of maintaining adequate reserves is to ensure that there are appropriate levels of working capital in the District's enterprise funds to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees.

Properly designed guidelines send a positive signal to the community of ratepayers, bondholders, rating agencies, and regulatory agencies that the Board is committed to the District's long-term financial health and viability. Prudent financial management and best practices dictate that the District maintains appropriate reserves for emergency use, capital projects, obligations accruing on a current basis that will be paid in the future, and those required as a result of legal or external requirements.

OBJECTIVES:

- To establish sound formal fiscal reserve guidelines to ensure strong fiscal management that guide future District decisions.
- To build adequate reserves over time. This action will provide the District with resources to help stabilize the District's finances, and position it more easily to absorb economic downturns or large-scale emergencies.
- To help smooth rates from year to year, and to promote equity over the years to ratepayers.
- To provide funding for current and future replacement of existing assets as they reach the end of their useful lives.
- To assist the District in meeting its short-term and long-term obligations and to ensure that the District maintains the highest possible credit rating.

RESERVE GUIDELINES

Definitions

Reserves are defined as the amount of Cash and Investments in that fund, plus the Accounts Receivable, less the Accounts Payable and less Amounts due to Others' in the fund. This methodology indicates the relatively liquid portion of total enterprise fund capital, which constitutes a margin or buffer for meeting obligations.

1. **Designated Reserves:** Designated reserves are reserves that are established and set aside to be used only for a specific, designated purpose (classified as unrestricted on the audited financial statements).

2. **Restricted Reserves:** Restricted reserves are reserves that are restricted by an outside source, such as by statute, court, or contract (classified as restricted on the audited financial statements).
3. **Undesignated Reserves:** It is assumed that all reserves will be Designated or Restricted, and therefore, there will be no undesignated funds per guidelines. (These are classified as unrestricted on the audited financial statements).

NOTE: The District's audited financial statements segregate Net Assets, which includes the effects of all assets and liabilities, some of which are non-spendable, not liquid, or have not been included in the current year budget. Therefore, the definition of "Reserves" is different than the Net Assets, and the two terms should not be used synonymously.

Designated Reserves

1. **Operating Reserves** cover operating costs for an established period of time. This reserve will ensure continuity of service regardless of cash flow, and is considered working capital to be used to fund current expenses as needed.

Applicable Funds: All funds except State Water Project, Self-Insurance and Motor Pool funds

Recommendation:

Maintain operating reserves at 90 days, or 25% of current year budgeted expenses (less depreciation). This balance will fluctuate from month to month. However, the year-end objective is to achieve this ending balance.

2. **QSA Mitigation:** The Domestic and Canal Funds have scheduled QSA Environmental Impact payments to be made until 2025. The payment amounts are known but are not the same amount each year. To prevent large rate swings due to the variability of these payments, this reserve will be used to collect the portion of the rate revenues collected for QSA mitigation payments. Subsequent QSA payments would be made from this reserve.

Applicable Funds: Domestic and Canal funds

Recommendation:

Establish this fund with \$10.8 million for the Domestic and \$1.2 for the Canal Funds to fund the difference between amounts collected and amounts paid.

3. **Rate Stabilization:** This reserve covers the smoothing of rates in the event of short to mid-term rate revenue loss, property tax revenue loss and/or higher than anticipated budget costs that cannot be supported by normal revenues. Rate Stabilization funds can be used to balance the budget if revenues are projected to be 10% less than prior year actual revenues, or if expenses are projected to be 10% more than prior year actual expenses.

Applicable Funds: Domestic, Sanitation, Canal and Recharge funds*

*The Stormwater Fund is not included because revenues and expenses are relatively level and not subject to wide swings due to consumption or usage; rates are collected on the property tax roll.

Recommendation:

Establish the reserve at the higher of 10% of current year budgeted rate revenues (which is an amount that could be lost if customers conserve at a higher level) or 10% of total costs less depreciation (which could easily occur due to increased water and power costs).

- 4. *Capital Improvement Program:*** Ongoing replacement of capital facilities and additional investment in capital is essential to maintain the desired level of service for District customers and to meet increased demand upon services. This reserve is designated for funding capital assets and is designed to stabilize funding for capital by accumulated “pay as you go” reserves. This reserve can also be used in concurrence with outside funding sources.

This reserve fund is generally established for capital items/projects with a cost of \$5,000 or more and a useful life of three years or greater.

Applicable Funds: Domestic, Sanitation, Canal, Stormwater, Recharge, Non-Potable funds

Recommendation:

Since the District currently utilizes pay-go financing of capital projects, this reserve should be set at two years depreciation expense.

- 5. *Emergency Reserve:*** These reserves help to ensure continued service to the District’s customers and service areas for events which are impossible to anticipate or budget. The ability of the District to quickly restore facilities and services is critical to the public health and safety of our residents. This fund will assist in covering emergency cash needs for any reason.

Applicable Funds: All Funds except State Water Project, Self-Insurance and Motor Pool

Recommendation:

Domestic, Non-Potable, Sanitation and Lower Recharge funds: Establish reserves at one percent (1.0%) of the net capital assets; Canal Fund: Establish reserves at one percent (1.0%) of the replacement cost of fixed assets.

Stormwater and Upper Recharge fund reserves at \$17.6 and \$2.0 million, respectively, per previous Board policy.

- 6. *Motor Pool Replacement Reserve:*** The motor pool reserve provides capital replacement funding as the District’s rolling stock is depreciated over its useful life.

Applicable Funds: Motor Pool Fund

Recommendation:

The target amount should be set at one year’s depreciation expense.

- 7. *Self-Insurance Reserves:*** These reserves fund the District’s self-insurance programs including workers compensation, preferred provider medical benefits, and general liability, property, and casualty losses that exceed coverage, as well as deductible costs or losses not covered by insurance.

Applicable Funds: Self-Insurance Funds (Workers Compensation, PPO Health Benefits and General Liability)

Recommendation: *Minimum reserve levels are based on an annual evaluation of outstanding claims and actuarial analysis. There is no maximum on this reserve since it is based on a case by case basis.*

8. **Other Post-Employment Benefits (OPEB) Reserve:** A reserve was established by Board policy in the amount of \$2,197,000, to be adjusted annually based upon the General Manager's recommendation following actuarial analysis of the District's future obligation. The District currently funds the OPEB on a pay-go basis.

Applicable Funds: All Funds incurring an OPEB liability.

Recommendation:

The District should adjust this amount periodically based on updated actuarial valuations of the District's unfunded OPEB liability as of year-end.

Note: Many other agencies hold the OPEB funds in an irrevocable trust, which is not considered a reserve of the District and would not be reflected on the District financial statements or in the District's reserves balances.

9. **Other Special Purpose Reserves:** The Board, may, at its discretion, set aside reserves for a special project or purchase.

Applicable Funds: All Funds

Restricted Reserves

1. **Reserves for Future Capital Commitments:** These reserves are established by Board Ordinances to ensure that specific fees are set aside to provide for future purchases of imported water and expansion of the domestic water, sanitation and irrigation/drainage systems. The following fees are in place at this time:

- a. Water System Backup Facilities Charge (WSBFC)
- b. Sanitation Capacity Charge (SCC)
- c. Supplemental Imported Water Charge (SIWC)

Recommendation:

The target amount is represented by the fees collected during the year. Interest earned in this reserve shall be credited to this reserve.

2. **Reserve for Debt Service:** Most debt issuances require the creation of a separately held reserve fund equal to one year of debt service, to be held by the trustee and used in the last year of the debt repayment. The District's only debt at this time is a Certificates of Participation (COP), which have a surety bond that replaced the requirement for the debt service reserve. In the future if the District issues more debt it may be required to establish a legally restricted debt service reserve.

Debt Service Reserves are presently established for Assessment Districts and Community Facility Districts, which are not liabilities of the District.

3. ***State Water Project (SWP):*** The District collects funds through the property tax rolls to make payments to the State Water Project. These payments will vary depending upon the availability and supply provided to the District in each year, however, the revenues collected remain fairly steady.

Recommendation:

District engineers have done a thorough analysis based on past hydrology patterns, and based on five years of 100% SWP allocation, it has been determined that the minimum amount in this reserve should be approximately \$62.0 million.

Reserve Procedures

- The Finance Department will perform a biennial reserve review to be submitted to the General Manager and Board of Directors.
- In addition, a reserve review will be required when a major change in conditions threatens the reserve levels established by this guideline.
- The biennial review determines if the funding levels are still appropriate and aligned with Board goals and objectives.