



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

## 16.0 RESERVE FUND POLICY

### 16.1 INTRODUCTION

This policy has been developed to maintain prudent management of regional and retail water systems, which requires that reserve funds be established and maintained to fund scheduled and unscheduled expenses including operation and maintenance, debt service, emergencies, capital improvement, repair and replacement, and for the stabilization of water rates. This policy has been revised to re-state and conform the various legacy policies of the four divisions of the Santa Clarita Valley Water Agency (SCV Water, or Agency): Regional (formerly wholesale), Newhall Water Division (NWD), Santa Clarita Water Division (SCWD) and Valencia Water Division (VWD). Regional and retail reserves included in this policy are funded by revenues that exceed budget and reductions in budgeted expenditures over a fiscal year. Existing water rates do not include a charge or amount that contributes directly to building reserves. Any change in the existing rate structure to directly fund reserves through rates shall require Board of Director approval.

This policy describes the prudent reserve fund needs of the regional and retail systems, identifies the sources of funding for such reserves, and recommended target amounts for reserve funds. Reserves are highly regarded by credit rating agencies, credit providers and investors. Although there are numerous methods to establish reserve funding levels, the Agency tends to lean on the metrics utilized by the credit rating agencies, which provide guidance on liquidity and provides peer review through the assignment of credit ratings for bond issues.

### 16.2 STATEMENT OF PURPOSE

The purpose of SCV Water’s Reserve Fund Policy for the regional and retail water systems is to ensure the Agency’s financial stability, and to have sufficient funding available to meet its operating, capital and debt service cost obligations. This plan establishes the level of reserves necessary for maintaining the Agency’s credit-worthiness and ratings and for adequately providing for:

- Cash flow requirements and working capital.
- Economic uncertainties and other financial hardships, including performance of the regional economy and water supply reliability.
- Infrastructure replacements.
- Emergency repairs.
- Local disasters, natural disasters or catastrophic events.
- Loss of significant revenue sources due to variations in water sales resulting from variable weather conditions or conservation.
- Unfunded mandates including costly regulatory requirements.



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

### 16.3 TYPES OF RESERVES

The establishment of reserve funds is in the best interest of SCV Water. Traditional reserve policy categories are typically classified as follows:

- Capital Improvement and Replacement Funds
- Emergency, or Contingency Reserves
- Capital Reserves
- Operating Reserves
- Revenue Rate Stabilization Reserve
- Water Supply Reliability Reserve

Reserve funds are established utilizing the following criteria:

- Distinguish between legally restricted and unrestricted amounts.
- Contain a defined and distinct purpose.
- Contain a target level or a range of target levels.
- Identify events or conditions that prompt the use of the reserves.
- Specify periodic review dates, usually annually as part of the budget process, for balances and target levels.
- Balances should be maintained in amounts sufficient to meet minimum reserve targets in cash and/or cash equivalents.

#### 16.3.1 Capital Improvement and Replacement Funds

These funds are established as reserves for the Agency’s capital program, inclusive of pay-go and debt-funded projects. Funds from this reserve are intended to fund capital and asset replacement costs, plus any contingency amounts in the event other sources of projected capital funding becomes insufficient to complete capital projects. The Agency seeks to set aside specific amounts in each of the Capital Funds of the Regional and the Retail Divisions’, to annually meet respective budgeted capital programs.

**Recommended Target Levels** – Most water agencies are capital intensive and funding is typically needed annually in significant amounts. In determining how much the Agency should set aside in reserves for capital projects, it must first determine how it plans to finance its capital projects in the future. In other words, the Agency must determine its capital structure: the mix of debt, reserves, and pay-as-you-go financing that it will use to pay for capital projects in the future. The Regional Division is expected to finance its capital needs through a combination of pay-go funding and debt transactions. The Retail Divisions are expected to use primarily a pay-go funding approach. This Policy recommends that the Agency and Retail Divisions maintain their pay-go Capital Funds at a minimum target level equal to the budgeted capital projects for the ensuing fiscal year.



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

16.3.2 Emergency Reserves

This reserve is established to provide additional liquidity in the event of a natural disaster, financial crisis, economic uncertainties and financial hardships, loss of significant revenue sources, local disasters or capital obligations, cash flow requirements, unfunded mandates including costly regulatory requirements and other such needs. These amounts should supplement monies received from insurance policies and by state and federal programs.

Recommended Target Levels – FEMA guidelines suggest an amount equal to 1 - 2% of the Agency’s total net plant and equipment.

Regional Division - The Regional Division has a higher risk to natural disaster, economic downturns and water supply disruptions and therefore it is recommended that the Emergency Reserve equal to one year of operating expenses.

Retail Divisions – It is recommended that the Emergency Reserve target level for the Retail Divisions be equal to 2% of the Retail Divisions capital assets, net of depreciation.

16.3.3 Capital Reserves

Additionally, the Agency seeks to establish, fund and maintain a Capital Reserve to fund unanticipated capital expenditures, or additional repair and replacement projects.

Recommended Target Levels – It is recommended that the Agency maintain separate Capital Reserves for each Regional and Retail Division at a level equal to their respective rolling average of its three-year depreciation amounts. This is an indicator of the value of depreciable capital assets that are aging and will be in need of replacement or repair.

16.3.4 Operating Reserves

These funds are maintained to safeguard the financial viability and stability of the Agency and are funded from division specific revenues. The Agency has reserve funds to safeguard against unexpected events such as drought and major catastrophic events. Operating Reserves are typically established based on percentage of operating expenses and can range from 20% to 50% of annually budgeted operating expenses, exclusive of interest expense.



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

Recommended Target Levels – Actual funding targets for the Operating Reserve depends on numerous variables, including but not limited to the timing of revenues receipts; the timing of expenses; the variability of water supply and demand; etc.

Regional Division - It is recommended that the Regional Division maintain a minimum target amount equal to 25% of their respective budgeted operating and maintenance expenses and one year of aggregate debt service less restricted debt service reserve amounts. The source of funding should be the available monies remaining after the payment of debt service representing a combination of one percent property tax revenues and Facility Capacity Fees in the proportions those funds pay for debt service.

Retail Divisions - It is recommended that the Retail Division's maintain a minimum target amount equal to 25% of their respective budgeted operating and maintenance expenses, plus one-half year of aggregate debt service less restricted debt service reserve amounts.

#### 16.3.5 Revenue Rate Stabilization Reserve

These funds are maintained to provide the Agency with the ability and flexibility to avoid sharp increases in customers' rates or to smooth out rate increases over an extended time frame. Revenue Rate Stabilization Reserves can be targeted as percentage of revenues, ranging from 10% to 30% of annually budgeted operating revenues.

Recommended Target Levels – Funding targets for the Revenue Rate Stabilization Reserve depends on numerous variables, including but not limited to the timing and volatility of revenues; the variability of water supply and demand; etc.

Regional Division – The Regional Division has more significant revenues and reserves than Retail Divisions and since the use of its Revenue Rate Stabilization Fund benefits rate payers in each Retail Division, a target amount should be equal to 15% of its budgeted operating revenues.

Retail Divisions - It is recommended that the Agency annually maintain Operating Reserves for the Retail Divisions at a minimum target amount equal to 10% of its budgeted operating revenues.

#### 16.3.6 Water Supply Reliability Reserve

These funds are maintained to provide a source of funding for the extraction of water from groundwater banking programs during dry years that will help to further mitigate rate increases. Previously, the Agency has funded water extractions through available fund balances and water rate surcharges. This fund will provide the Agency with



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

additional operating reserves for water supply to safeguard against the potential need to raise rates during future drought conditions and dry years.

Recommended Target Levels – The target for the Water Supply Reliability Reserve will be equal to the cost to produce 5,000-acre feet from the Agency’s banking program in a dry year and be funded by taking 50% of the prior fiscal year’s water surplus that is in excess of what is required to recover operating expenditures and reserves. The Retail Divisions will not be required to fund this reserve.

Regional Division - It is recommended that the Regional Division maintain a target amount equal to the cost to produce 5,000-acre feet from the Agency’s banking program in a dry year.

16.4 REPORTING

The annual Budget document will include a reserve analysis, showing reserve amounts and targets for each type of reserve, and should a major change in conditions threaten reserve levels, the General Manager will provide an analysis to the Board of Directors. This analysis would include an explanation of why reserve levels are below targeted levels and/or a recommended course of action to improve reserve levels.



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

The following tables illustrate the Reserve Fund Policy target levels:

<b>TYPE OF RESERVE</b>	<b>REGIONAL</b>	<b>NWD</b>	<b>SCWD</b>	<b>VWD</b>
<b>Capital Improvement &amp; Replacement</b>	Current budget pay-go projects	Current budget pay-go projects	Current budget pay-go projects	Current budget pay-go projects
<b>Emergency/Disaster</b>	Equal to 365 days of operating expenditures	2% of net capital assets	2% of net capital assets	2% of net capital assets
<b>Capital Reserve</b>	3-YR average of annual depreciation	3-YR average of annual depreciation	3-YR average of annual depreciation	3-YR average of annual depreciation
<b>Operating</b>	25% of operating expenses plus one-year annual debt service less any restricted DSRF	25% of operating expenses plus 6 months of annual debt service	25% of operating expenses plus 6 months of annual debt service	25% of operating expenses plus 6 months of annual debt service
<b>Revenue Rate Stabilization</b>	15% of operating revenue	10% of operating revenue	10% of operating revenue	10% of operating revenue
<b>Water Supply Reliability Reserve</b>	Cost to produce 5,000-acre feet from banking programs	NA	NA	NA



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

**Regional Target Level**

<b>TYPE OF RESERVE</b>	<b>FY 2019 Estimated Balance</b>	<b>FY 2019 Target Balance</b>	<b>% of Target</b>
<b>Capital Improvement &amp; Replacement</b>	\$10,799,500	\$10,399,500	104%
<b>Emergency/Disaster</b>	29,273,400	26,140,200	112%
<b>Capital Reserve</b>	3,204,700	17,267,793	19%
<b>Operating</b>	26,052,500	24,789,050	105%
<b>Revenue Rate Stabilization</b>	0	3,976,043	0%
<b>Water Supply Reliability Reserve</b>	3,000,000	3,000,000	100%
<b>TOTAL</b>	<b>\$72,330,100</b>	<b>\$85,572,586</b>	<b>85%</b>
<b>Days Cash Ratio</b>	<b>1,010</b>	<b>1,195</b>	

**NWD Target Level**

<b>TYPE OF RESERVE</b>	<b>FY 2019 Estimated Balance</b>	<b>FY 2019 Target Balance</b>	<b>% of Target</b>
<b>Capital Improvement &amp; Replacement</b>	\$2,560,262	\$2,937,000	87%
<b>Emergency/Disaster</b>	1,500,000	1,646,037	91%
<b>Capital Reserve</b>	0	2,987,406	0%
<b>Operating</b>	623,723	2,634,209	24%
<b>Revenue Rate Stabilization</b>	1,566,625	1,274,737	123%
<b>TOTAL</b>	<b>\$6,250,610</b>	<b>\$11,479,388</b>	<b>54%</b>
<b>Days Cash Ratio</b>	<b>244</b>	<b>449</b>	



<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

**SCWD Target Level**

<b>TYPE OF RESERVE</b>	<b>FY 2019 Estimated Balance</b>	<b>FY 2019 Target Balance</b>	<b>% of Target</b>
<b>Capital Improvement &amp; Replacement</b>	\$9,535,700	\$9,535,700	100%
<b>Emergency/Disaster</b>	2,200,000	2,255,600	98%
<b>Capital Reserve</b>	3,221,090	4,660,138	69%
<b>Operating</b>	8,928,000	9,532,725	94%
<b>Revenue Rate Stabilization</b>	5,458,365	3,595,590	152%
<b>TOTAL</b>	<b>\$29,343,155</b>	<b>\$29,579,753</b>	<b>99%</b>
<b>Days Cash Ratio</b>	<b>385</b>	<b>388</b>	

**VWD Target Level\***

<b>TYPE OF RESERVE</b>	<b>FY 2019 Estimated Balance</b>	<b>FY 2019 Target Balance</b>	<b>% of Target</b>
<b>Capital Improvement &amp; Replacement</b>	\$333,000	\$3,137,000	11%
<b>Emergency/Disaster</b>	141,723	1,942,840	7%
<b>Capital Reserve</b>	0	2,739,469	0%
<b>Operating</b>	439,885	7,979,116	6%
<b>Revenue Rate Stabilization</b>	424,369	3,335,272	13%
<b>TOTAL</b>	<b>\$1,338,977</b>	<b>\$19,133,696</b>	<b>7%</b>
<b>Days Cash Ratio</b>	<b>24</b>	<b>341</b>	

\*Prior to becoming a public water utility, Valencia Water Company did not carry significant reserves. The most recent rate case for Valencia Water Division includes provisions to gradually build reserve levels over the next 10 years.





<b>POLICIES, RULES AND REGULATIONS</b>	
Title: <b>RESERVE FUND POLICY</b>	
Policy No.: 16.0	Section Nos.: 16.0 – 16.4
Approval Date: November 2018	Effective Date: November 2018
Approved By: Board of Directors	

**Total Target Level**

<b>TYPE OF RESERVE</b>	<b>FY 2019 Estimated Balance</b>	<b>FY 2019 Target Balance</b>	<b>% of Target</b>
<b>Capital Improvement &amp; Replacement</b>	\$23,228,462	\$26,009,200	89%
<b>Emergency/Disaster</b>	33,115,123	31,984,677	104%
<b>Capital Reserve</b>	6,425,790	27,654,806	23%
<b>Operating</b>	36,044,108	44,935,099	80%
<b>Revenue Rate Stabilization</b>	7,449,359	12,181,641	61%
<b>Water Supply Reliability Reserve</b>	3,000,000	3,000,000	100%
<b>TOTAL</b>	<b>\$109,262,842</b>	<b>\$145,765,423</b>	<b>74%</b>

*(Originally adopted November 2018)*