

# DIABLO WATER DISTRICT

## REGULATION NO. 14

### RESERVE FUND MANAGEMENT

#### Section I. Policy

The complex nature of Diablo Water District's (District) operations and its various legal, legislative, contractual, and fiduciary requirements, dictate a multifaceted and sophisticated financial structure. A key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital improvements, debt service, repair and rehabilitation of existing assets, and unplanned future emergencies. In order to meet these requirements, funds will be accumulated, maintained, expended, and restored according to this regulation and when appropriate, invested per the District's investment policy.

#### Section II. General Provisions

- a. Reserve balances are considered the minimum necessary to maintain the District's creditworthiness and adequately provide for:
  1. Compliance with applicable statutory requirements
  2. Financing of future capital facilities and replacement of existing assets
  3. Cash flow requirements
  4. Economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy
  5. Contingencies for unforeseen operating or capital needs
- b. In the context of funding future capital facilities and replacing existing assets, the District will analyze the most cost effective and efficient method to finance a project, be it through debt financing, pay-as-you go (PAYGo) financing, use of reserves, use of grant proceeds,

or through some combination of those sources.

c. The District has established the following two categories that comprise its reserves:

1. Restricted Cash and Investments – comprised of unspent bond proceeds, bond reserve funds (held by trustee), facilities reserve charges, and catastrophic emergency.

a. These funds require a resolution of the Board to access funds that are not part of an approved budget. Additionally, unspent bond proceeds and bond reserve funds can only be spent according to the legal bond documents.

2. Unrestricted Cash and Investments – comprises of funds to be spent on capital repair and rehabilitation, unforeseen operating expenses, seasonal cash flow fluctuations, temporary revenue reductions due to economic or drought-induced, and other prudent expenses authorized by the Board.

a. These reserves can be encumbered through annual budgets, board approval, or by staff adhering to this regulation.

### Section III. Reserve Funds and Target Levels

a. Rate Stabilization Fund

1. Events or Conditions Prompting the Use of the Fund: Up to 10% temporary revenue reductions due to economic or drought-induced conditions, larger than budgeted increases in wholesale water rates, minor fluctuations in cash flow, and other prudent expenses authorized by the Board.

2. Authorization Required: None. This is the default fund that is automatically reduced for month-to-month cash flow coverage. If exhausted, the next reserve to be accessed is the General Fund Operating Reserve.

3. Target Level: \$1,000,000, has been established by the District's 2021 Water Rate Study. The contribution level will be periodically reviewed at intervals that coincide with future water rate cost of service studies.

b. General Operating Reserve

1. Events or Conditions Prompting the Use of the Fund: Working capital to meet cash flow shortfalls, unexpected capital asset replacement, and minor emergencies (less than \$1 million).
2. Authorization Required: Staff will provide a recommendation to the Board when operating reserves are expected to be needed. Board authorization required.
3. Target Level: 3 Months of current fiscal year operating and maintenance expenses.
  - a. Example: FY O&M expense = \$10,000,000 x .25 = \$2,500,000 in budgeted reserves.

c. Capital Reserve

1. Events or Conditions Prompting the Use of the Fund: Repair and rehabilitation of capital assets for PAYGo projects or a combination of PAYGo and debt-financed projects.
2. Authorization Required: Staff will provide a recommendation to the Board as needed or during the annual budget setting process when capital reserves are expected to be needed. Board authorization required.
3. Target Level: \$2,000,000 has been established by the District's 2025 Water Rate Study. The contribution level will be periodically reviewed at intervals that coincide with future water rate cost of service studies, and/or future capital repair and rehabilitation plans. This reserve will be funded incrementally and is expected to be fully funded by June 30, 2027.

d. Emergency Reserve

1. Events or Conditions Prompting the Use of the Fund: Catastrophic emergency and natural disaster expenses required to keep the District operational and start repairs, moderate to severe temporary revenue reduction due to economic or drought-induced conditions, or other force majeure events.
2. Authorization Required: These reserves may only be accessed after the depletion of the rate stabilization reserve. An emergency declaration via Board resolution and Board authorization is required.
3. Target Level: \$3,000,000 has been established by the District's 2025 Water Rate Study. The contribution level will be periodically reviewed at intervals that coincide with future water rate cost of service studies, and/or future capital repair and rehabilitation plans. This reserve will be funded incrementally and is expected to be fully funded by June 30, 2033.

e. Bond Proceeds (held by Trustee)

1. Events or Conditions Prompting the Use of the Fund: Can solely be spent on the projects approved in the bond legal documents.
2. Authorization Required: Surplus/excess bond proceeds can be spent on other eligible projects, subject to bond counsel and Board approval via a resolution.
3. Target Level: Zero
4. Bond proceeds should equal expected project expenses and be spent on qualified projects within three years of issuance.

f. Bond Debt Service Reserves (held by trustee)

1. Events or Conditions Prompting the Use of the Fund: Can solely be used towards the payment of the associated bond.

2. Authorization Required: No Board or Staff discretion.
3. Target Level: As established in the bond legal documents and must be maintained at this level.

g. Facilities Reserve

1. Events or Conditions Prompting the Use of the Fund: Projects, assets, staffing, etc., identified in District's Facilities Master Plan that are for the capacity (or preservation thereof), expansion and/or improvement of the District' systems due to new development.
2. Target Level: 3 years' worth of facilities funds debt payment expenditures.
  - a. Example: FY Facilities Fund debt expenditure = \$900,000 x 3 = \$2,700,000.

Section IV. Management of Reserves

- a. The General Manager or their designee is responsible for adherence to this regulation. Further management guidance is provided below:
  1. The board shall approve any reallocation of funds or any transfers among funds.
  2. Any reserve that is accessed for eligible uses shall have an adopted restoration/repayment plan adopted at the time of access of the reserve fund.
  3. The exception is the rate stabilization fund that should be fully restored during the annual budget setting process or at maximum within two years of depletion.
  4. Eligible reserve funds may be used to perform interfund loans.
  5. The interest rate shall be adjusted annually to equal the December 31<sup>st</sup> Local Agency Investment Fund rate.
  6. Length of loan and repayment schedule are to be determined on a case-by-case basis and in consultation with General Counsel.

7. Reserve funds that are invested shall be credited interest income.
8. Investments of Debt Service Reserve Funds should mature prior to the first optional redemption date. If advance refunding of outstanding bonds is being considered, then Debt Service Reserve Fund balances should remain liquid.
9. Reserve balances will be reviewed, at minimum on an annual basis during annual budget preparation to ensure compliance with this regulation.
10. To preserve its strong credit ratings, in every fiscal year, the District shall endeavor to maintain 150 to 270 days of operating cash.
11. The target established for each fund represents the baseline financial condition that is acceptable to the District from risk and long-range financial planning perspectives.