

## POLICY AND PROCEDURE

<b>POLICY TITLE:</b> <b>Reserve Policy</b>	<b>NUMBER:</b> <b>2019-01</b>	<b>PAGE:</b> <b>1 of 11</b>
<b>APPROVED BY:</b> <b>Board of Directors Authorizing Resolution No. 24-106</b>	<b>REVISION: 3</b>	<b>EFFECTIVE DATE:</b> <b>December 18, 2024</b>

### 1. POLICY STATEMENT

The purpose of this policy is to ensure Zone 7 Water Agency (“Zone 7” or “the Agency”) operates in a productive, cost-effective and efficient manner. A robust reserve policy demonstrates to the community of rate payers, bondholders, and rating and regulatory agencies that the Board of Directors is committed to the Agency’s long-term financial health, stability, and viability. Prudent financial management dictates the Agency maintain appropriate reserves for operating and capital needs, debt obligations, and funding for emergencies and unforeseen events.

The Agency will strive to have sufficient funding available to meet its operating, capital, and debt service obligations. Reserve Funds (“Funds”) will be accumulated, designated and maintained to allow Zone 7 to fund operating expenses and capital expenditures in a manner consistent with its budget and capital improvement plan, respectively, and avoid significant customer rate fluctuations due to changes in cash flow requirements. Further, Zone 7 will endeavor to designate funds for all forms of potential disasters, emergencies and unforeseen events to ensure that funds are available to cover the costs associated therewith.

The Zone 7 Board of Directors (the “Board”) adopted a Financial Management Framework (the “Framework”) on November 16, 2011 (Resolution Number 11-4137) which includes planning for current operating and capital resource needs to ensure it can achieve its mission by providing for financial stability and health of the Agency. This Final Reserve Policy has been developed in keeping with the Framework after evaluating the efficacy of an Interim Reserve Policy adopted in 2013. One of the Framework’s goals is to be able to respond to changes in the economic environment and service demands with minimal impact on its customers while maintaining the financial integrity of Zone 7. A fundamental purpose of this policy is to link what must be accomplished with the necessary resources to successfully do so.

The Policy directives outlined in this document are intended to ensure Zone 7 has sufficient funds to meet current and future needs. The Agency shall maintain reserve levels, as directed by the Board, through the strategic planning and budget processes.

## 2. FUNDS

Zone 7 maintains financial assets in separate funds that are clearly identifiable and segregated for specific purposes in accordance with laws and regulations. The Agency shall not commingle funds that are established under different functions of the Agency nor shall it commingle developer fees with operational funding.

This Policy establishes Reserve Funds for each of the following major funding areas.

### **Water Enterprise Operations and Capital Projects Fund (Funds 100 and 120)**

These funds account for enterprise operation and administration, emergency and support services, variable State Water Project charges, water facilities maintenance and operation, water facilities, water resources and water supply planning, and renewal, replacement and system-wide improvement types of capital projects.

### **State Water Project Fund (Fund 110)**

This fund is used for fixed State Water Project charges, including State Water Project bonded indebtedness.

### **Water Enterprise Capital Expansion Fund (Fund 130)**

Expansion is funded by water connection fee revenue imposed on new development to fund new development's fair share of capital projects necessary to accommodate growth. These water connection fees are subject to the provisions contained in the California Mitigation Fee Act (Government Code § 66000 et seq.)

### **Flood Protection Operations Fund (Fund 200)**

This fund provides for general administration and regional flood control services, including renewal, replacement and system-wide improvement types of capital projects to ensure the controlled runoff of the Valley's excess stormwater runoff.

### **Flood Protection Development Impact Fee Fund (Fund 210)**

Expansion is funded by development impact fees imposed on new development to pay for new development's fair share of the acquisition, construction, engineering and improvement of the flood protection and/or storm water drainage elements of the Stream Management Master Plan of Zone 7, or to reduce the principal or interest of any bonded indebtedness thereof. Development fees are collected in accordance with the California Mitigation Fee Act (Government Code § 66000 et seq.)

## 3. RESERVE FUND DEFINITIONS

Restricted Reserves: Restrictions on the use of these funds are imposed by an outside source such as creditors, grantors, contributors, laws, or regulations, for example water connection fees or flood protection developer impact fees per the California Mitigation Fee Act.

Designated Reserves: Funds set aside for a specific purpose determined by Zone 7's Board of Directors as documented by minute order, resolution or ordinance. The Board of Directors has the authority to redirect the use of these funds as needs of the Agency change.

Unrestricted Reserves: Have no imposed restrictions as to their use.

#### **4. GENERAL PROVISIONS**

##### Purpose of Reserve Funds

Reserves are established to:

- Comply with applicable statutory requirements
- Finance future capital facilities, finance improvements, and repair and replacement of existing assets
- Assure cash flow requirements are met
- Provide for economic uncertainties, local disasters, and other financial hardships or downturns in the local or national economy
- Provide for contingencies, emergencies or unforeseen operating or capital needs
- Meet bond covenant requirements

##### Segregation of Funds

The Agency will not transfer moneys between reserve funds that are established under different functions of the Agency. The Agency may complete interfund borrowing between reserves of different functions of the Agency at current market rates. The Board shall approve any reallocation of funds or any transfers among Reserve Funds.

##### Periodic Review Dates for Balances

Fund balances and target levels will be reviewed by staff, the Board and the public during the development and approval of each budget, annual financial audit and periodic water rate discussions.

#### **5. POLICY COMPLIANCE**

The Minimum established for each reserve represents the target that is acceptable from both risk and long-range financial planning perspectives, as well as demonstrating financial stability to the rating agencies and lending institutions. Maintaining fund balances at appropriate levels is a prudent, ongoing business process that consists of an iterative, dynamic assessment and application of various revenue generating alternatives and cost management measures. To ensure reliable service to its ratepayers and to maintain fiscal responsibility, in every fiscal year Zone 7 will maintain balances in its Reserve Funds that are financially prudent.

Upon Board adoption of this policy, necessary actions will be taken to comply with this policy. Periodic reviews will ensure that reserves are in compliance with policy. In the event that a reserve has fallen below the minimum, and other reserves are above minimum and/or maximum, a transfer(s) shall be made from other reserve(s) within that fund to bring the non-compliant reserve to the minimum level. If reserves are depleted, the reserves shall be replenished within the two (2) year budget period to the established or re-established target through revenue generating alternatives and/or cost management measures. If cumulative reserves within a fund exceed maximum levels, a report will be made to the Board and alternative solutions considered.

Revenue-generating alternatives and cost management measures (either alone or in combination with each other) include, but are not limited to:

- rates, fees and charges
- capital financing
- investment of funds
- grants
- energy efficiencies
- pooled services/equipment agreements
- chemical purchase consortiums
- deferral or acceleration of capital projects, as appropriate

## **6. RESERVE FUND TARGET LEVELS AND MANAGEMENT**

The following section describes Zone 7 reserves, target levels and management of funds.

### **WATER ENTERPRISE OPERATIONS FUND RESERVES**

The Water Enterprise Operations fund has three reserve categories:

- A. Operating Reserve
- B. Emergency Reserve
- C. Reserve for Economic Uncertainties

#### **A. OPERATING RESERVE**

The Operating Reserve is designated by the Board to maintain a reserve for current operations and to meet routine cash flow needs. The amounts in this reserve will fluctuate depending on the annual operating expenses of Zone 7. Money on deposit in this reserve may be used for:

- unanticipated operating expenses
- daily cash flow requirements
- minor emergencies such as unanticipated infrastructure failures.
- supplement losses to water sales revenue resulting from impacts of drought conditions

- use during periods of unanticipated fluctuations in treated water rate revenues and cost of service in order to offset significant increases in water rates

**Minimum Level**

The minimum level shall be equal to sixty (60) days of the current annual budgeted total operating expenses.

**Target Level**

Zone 7 shall strive to maintain a target level equal to ninety (90) days of the current annual budgeted total operating expenses.

**Maximum Level**

The maximum level shall not exceed one hundred twenty (120) days of the current annual budgeted total operating expenses.

**Events or Conditions Prompting the Use of the Fund** – This reserve may be routinely utilized to cover temporary cash flow deficiencies caused by timing differences between the receipt of revenue and actual expenses or extraordinary decreases in revenues and unexpected increases in expenses.

**B. EMERGENCY RESERVE**

This reserve serves as working capital to address early stages of repairs and other activities while the Agency reviews accessing insurance, Federal Emergency Management Agency (FEMA) and other reimbursements, developing other revenue streams or other funding mechanisms to address long term repairs. Funds in the Emergency Reserve can be used for any operating or capital purpose (i) to begin repair of the water enterprise system after a catastrophic event or disaster, such as, but not limited to, an earthquake, fire, terrorist event, or storm while insurance claims are being processed or (ii) in the event of severe financial events that impact the financial soundness of Zone 7. FEMA may provide reimbursement to utilities after a catastrophic event; however, the reimbursement may take up to three years. It is important to have immediate funding available for the repairs, especially given the seismic vulnerability of the region and potential multi-year delays in reimbursement.

**Minimum Level**

The minimum level shall be equal to two percent (2%) of the capital assets of the Agency's water enterprise system to provide cash on hand for emergency repairs, particularly due to the seismically active location of the Agency.

**Target Level**

Zone 7 shall strive to maintain a target level equal to two- and one- half percent (2.5%) of the capital assets of the Agency's water enterprise system to provide cash on hand for emergency repairs, particularly due to the seismically active location of the Agency.

**Maximum Level**

The maximum level shall not exceed three percent (3%) of the capital assets of the enterprise system to provide cash on hand for emergency repairs, particularly due to the seismically active location of the Agency.

**Events or Conditions Prompting the Use of the Fund** – The Board may designate use of this reserve after establishing that conditions exist as called out in the definition and purpose of the fund and declaring a local state of emergency. Funds will be transferred to the appropriate capital or operating fund as necessary.

**C. RESERVE FOR ECONOMIC UNCERTAINTIES**

The Agency shall maintain a reserve for uncertain economic conditions. A reserve of this level is prudent to maintain a high bond rating and to protect the Agency from the effects of fluctuations in water usage and the cost of imported water to which the Agency is vulnerable, and other unforeseen events such as a natural disaster, water shortage emergency, or other unanticipated adverse situations.

**Minimum Level**

The minimum level shall be equal to 10% of current annual budgeted volume-based water sales revenue.

**Target Level**

The Agency will strive for target level equal to 15% of the current annual budgeted volume-based water sales revenue.

**Maximum Level**

The maximum level shall not exceed 20% of the current annual budgeted volume-based water sales revenue.

**Events or Conditions Prompting the Use of the Fund** – The Board may designate use of this reserve after establishing that conditions exist as called out in the definition and purpose of the reserve.

**DEBT SERVICE RATE STABILIZATION RESERVE**

Debt Rate Stabilization Reserves established by bond requirements may be used to pay debt service if revenues are insufficient to satisfy annual debt service requirements. These reserves shall be within the Water Enterprise Renewal & Replacement and System-Wide Improvements and the Water Enterprise Capital Expansion funds. The target amount shall be equal to two years of each fund's respective share of the 2018 Series A Bonds debt service payment.

**Minimum and Maximum Levels**

This Reserve will not be required to have a minimum or maximum level.

**Target Level**

The Agency will strive for target level equal to two years of each fund's respective share of the 2018 Series A Bonds debt service payment.

**Events or Conditions Prompting the Use of the Fund** – The Board may designate use of this reserve to pay debt service if revenues are insufficient to satisfy annual debt service requirements. If funds from this reserve are used, the Agency is required to replenish the reserves as required by bond covenants.

**WATER ENTERPRISE RENEWAL & REPLACEMENT AND SYSTEM-WIDE IMPROVEMENTS RESERVE**

In 2017, the Board adopted Resolution No. 17-52 approving a Debt Policy. The policy provides guidelines under which specific projects may be best financed. Under the policy, debt issuance should be evaluated on a case-by-case basis as well as within the Agency's general debt management program. The Agency has historically relied on Water System Reserves to fund capital projects on a pay-as-you-go basis. This approach can work well during periods in which net revenues are strong and capital funding needs are modest. The Agency, under the direction of the Board of Directors will retain full flexibility in determining the best funding approach on a case-by-case basis.

For pay-as-you-go funding, capital reserve funds are accumulated to provide for current and future funding needs of the various capital programs and to facilitate completion of multi-year projects. The amount on deposit in the Water Enterprise Renewal & Replacement and System-Wide Improvements Reserve is earmarked by the Board of Directors for capital projects to meet regulatory requirements, replacement needs and system reliability of Zone 7's water enterprise. These capital projects are included in the Water System Capital Improvement Plan and the Asset Management Program (AMP), both of which are reviewed and approved by the Board of Directors periodically.

**Minimum Level**

The minimum level shall be equal to 100% of the estimated pay-go capital budget for the fiscal year immediately succeeding the then-current budgeted fiscal year.

**Target Level**

Not applicable

**Maximum Level**

Zone 7 will not have a maximum level for this reserve, but rather the fund shall accumulate sufficient reserves to pay for future projects set forth in the AMP and the reserve balance shall be consistent with the reserve balances forecast in the most recent Asset Management Plan and the

current Capital Improvement Plan. Funds on deposit in the Debt Service Rate Stabilization Reserve shall not be considered in connection with the calculation of minimum levels.

**Events or Conditions Prompting the Use of the Fund** – Staff will recommend that assets be constructed, replaced, upgraded and/or repaired during the development and approval of the annual budget. Funds will be appropriated from the Water Enterprise Renewal & Replacement and System-Wide Improvement Reserve for renewal, replacement, or system-wide improvement capital projects.

### **WATER ENTERPRISE CAPITAL EXPANSION RESERVE**

In 2017, the Board adopted Resolution No. 17-52 approving a Debt Policy. The policy provides guidelines under which specific projects may be best financed. Under the policy, debt issuance should be evaluated on a case-by-case basis as well as within the Agency's general debt management program. The Agency has historically relied on Water System Reserves to fund capital projects on a pay-as-you-go basis. This approach can work well during periods in which net revenues are strong and capital funding needs are modest. The Agency, under the direction of the Board of Directors will retain full flexibility in determining the best funding approach on a case-by-case basis.

For pay-as-you-go funding, capital reserve funds are accumulated to provide for current and future funding needs. Money in the Water Enterprise Capital Expansion Reserve is earmarked by the Board of Directors for capital projects to meet additional demands created by development. In furtherance of meeting such needs the Agency incurred certain non-discretionary financial obligations associated with capital expansion projects. Within this fund are four separate reserves to be used for:

1. The construction of improvements and enlargements to the South Bay Aqueduct (the "SBA Sinking Fund"); and,
2. The Future Contractors' share of the South Bay Aqueduct construction (the "FCSBA Sinking Fund"); and,
3. Any year when revenues are insufficient to satisfy annual debt service requirements (Debt Service Rate Stabilization Reserve).
4. The Water Enterprise Capital Expansion Reserve is used for the funding of capital projects to accommodate development.

#### **Minimum Level**

The minimum level shall be equal to 60% of the current annual budgeted non-discretionary amount.

#### **Target Level**

Not applicable



**Maximum Level**

Zone 7 will not have a maximum level for this fund, but rather the fund shall accumulate sufficient reserves to pay for future capital expansion projects as set forth in the capital improvement plan. The Agency may satisfy the minimum amount through the use of lines of credit, interim inter-fund borrowings or other financing arrangements. Funds on deposit in the Debt Service Rate Stabilization Reserve SBA Sinking Fund and FCSBA Sinking Fund shall not be considered in connection with the calculation of minimum or maximum levels of the Water Enterprise Capital Expansion Reserve.

**Events or Conditions Prompting the Use of the Fund** – Staff will recommend new assets to be constructed during the development and approval of the annual budget. Funds will be appropriated from the Water Enterprise Capital Expansion Reserve for expansion capital projects.

**Periodic Review Dates for Balances** – Fund balances and projected capital projects will be reviewed by staff, the Board and the public during the development and approval of each budget.

**FLOOD PROTECTION OPERATING RESERVE**

The amounts in the Flood Protection Operating Reserve Fund will fluctuate depending on the receipt of property taxes and the annual operating expenses of Zone 7. The Flood Protection Operating Reserve is designated by the Board to maintain a reserve for current operations and to meet routine cash flow needs.

Money on deposit in this fund may be used for unanticipated operating expenses, daily cash flow requirements and emergencies.

**Minimum Level**

The minimum level shall be equal to twenty percent (20%) of the Agency's current annual budgeted flood protection operating expenses, excluding capital.

**Target Level**

Not applicable

**Maximum Level**

The maximum level shall not exceed fifty percent (50%) of the current annual budgeted flood protection operating expenses, excluding capital.

**Events or Conditions Prompting the Use of the Fund** – This fund may be routinely utilized by staff to cover temporary cash flow deficiencies caused by timing differences between revenue and expenses and/or shifts in the allocation of property taxes to Zone 7.

## **FLOOD PROTECTION CAPITAL PROJECT RESERVE**

The Flood Protection Capital Project Reserve holds the balance of funds once the Flood Protection Operating Reserve Fund achieves levels that are consistent with this Policy on an annual basis. The amount on deposit in the Flood Protection Capital Project Reserve is earmarked by the Board of Directors for capital projects to meet Zone 7's flood protection needs. Capital projects are identified and funded during the budget process. The forthcoming Flood Management Plan will direct the Agency's future flood capital projects.

**Minimum and Maximum Levels** – This Reserve will not be required to have a minimum or maximum level.

### **Target Level**

Not applicable

**Events or Conditions Prompting the Use of the Fund** – The Flood Protection Project Reserve may be used at any time for flood protection maintenance or improvement projects not related to development.

## **FLOOD PROTECTION DEVELOPMENT IMPACT FEE PROJECT RESERVE**

The purpose of the Flood Protection and Storm Water Drainage Development Impact Fee (DIF) Project Reserve is to ensure that Zone 7 is able to meet current and future needs for Flood Protection facilities and is intended to provide funding for any Flood Protection facilities required to mitigate the impacts of new development. This Reserve will hold development impact fees in connection with Flood Protection improvements related to development.

**Minimum and Maximum Levels** – This Reserve will not be required to have a minimum or maximum level.

### **Target Level**

Not applicable

**Events or Conditions Prompting the Use of the Fund** – This Reserve may be used at any time for flood protection projects required to mitigate the impacts of new development.

## **STATE WATER FACILITIES RESERVE**

The amounts in the State Water Facilities Reserve Fund fluctuate depending on the receipt of property taxes and the annual expenses of Zone 7 related to fixed charges for the State Water Project. The State Water Facilities Reserve Fund is designated by the Board to maintain a reserve for fixed costs related to the State Water Project that are not tied to development. This reserve may be used for unanticipated operating expenses, daily cash flow requirements and emergencies related to State Water Project fixed costs. The State Water Project costs are highly volatile and challenging to predict. This reserve will also accumulate funds to offset volatile future increases in

State Water Project capital costs, allowing for smoothing of future property tax override collections.

### **Minimum Level**

The minimum level shall be equal to fifty percent (50%) of the following year's projected annual operating expenses.

### **Target Level**

Not applicable

### **Maximum Level**

Zone 7 will not have a maximum level for this reserve. The reserve shall accumulate funds to pay for future State Water Project costs. The maximum level shall be reviewed at least every five years.

**Events or Conditions Prompting the Use of the Fund** – This fund may be routinely utilized by staff to cover temporary cash flow deficiencies caused by timing differences between revenue and expenses and extraordinary decreases and/or unexpected increases in expenses.

## **VEHICLE REPLACEMENT RESERVE**

The purpose of this reserve is to fund planned replacement of vehicles and equipment that have reached the end of their useful lives. This reserve is funded by direct charges to departments for actual maintenance and operation costs, interest earnings and net proceeds from the sale of replaced vehicles and equipment. The reserve will be drawn down as replacement vehicles and equipment are purchased. This reserve shall have no minimum, maximum or target.

## **7. POLICY REVIEW**

The General Manager, or designee (Treasurer/Assistant General Manager – Finance), will be responsible for reviewing and updating this Reserve Policy every five years, and presenting any recommended revisions to the Board of Directors for adoption.

## **8. HISTORY**

<b>Date</b>	<b>Action</b>	<b>Resolution</b>
August 8, 1985	Originally adopted	Minute Order
September 28, 2016	Updated	16-166
May 15, 2019	Updated	19-37
December 18, 2024	Updated	24-106