STOCKTON EAST WATER DISTRICT
Policy Manual

No. 6040 Reserve Policy

Adopted: November 14, 2023

Contents

A. Purpose 1
B. Reserve Fund Types....1
C. SEWD Reserve Funds and their Specific Purposes 2
D. Transfers to/from Reserves....4
E. Policy Review and Revision 4

A. Purpose

The purpose of the Stockton East Water District's (District) Reserve Policy is to promote financial stability of the District by setting guidelines for fund balances in accordance with Generally Accepted Accounting Principles (GAAP). Another critical aspect of fiscal responsibility is to not only anticipate and prepare for future funding requirements for ongoing operations and maintenance expenses and capital expenditures, but also to prepare for disasters and other unforeseen events. In addition, reserves need to be maintained when defined by statute, court determinations, contractual agreements, or bond resolutions.

The term "fund balance" refers to the difference between assets and liabilities under the modified accrual basis of accounting for governmental funds. Unrestricted fund balance refers to the categories of fund balances that include only resources without a constraint on spending unless the constraint on spending is imposed by the government itself. Unrestricted fund balance is a measure of economic stability, and adequate levels of unrestricted fund balance will assure liquidity and will mitigate the risks associated with revenue volatility and unanticipated expenditures.

Reserves will be managed in a manner that allows the District to fund costs consistent with its Capital Improvement Program as well as other long-term plans (such as the Water Supply Master Plan, Water Treatment Master Plan, etc.), while avoiding significant rate fluctuations due to changes in cash flow requirements.

The Reserve Policy covers all reserve funds of the District. At the end of each fiscal year compliance with the Reserve Policy will be reported to the District's Board of Directors as part of each Fiscal Year-End Financial Report.

B. Reserve Fund Types

The District maintains two types of reserve funds:

1. Restricted Reserves are reserves that are restricted by an outside source, such as by statute, court determination, or contract.
2. Designated Reserves are reserves that are established and set aside to be used for a specific, Board designated purpose.

The Board of Directors (Board) have the authority to redirect the use of these reserve funds, as the outside requirements or the needs of the District change. Unrestricted Reserves are planned for use in each update to the Capital Improvement Program to assist in providing for minimal orderly rate increases, consistent with law.

C. SEWD Reserve Funds and their Specific Purposes

- Dry Year Reserve: The Board is authorized by the District Act to establish a reserve fund financed by the transfer of up to ten cents ($0.10) for each acre-foot of water to which the ground water assessment rate or the stream delivered surface water charges levied, in addition to ten cents ($0.10) for each acre-foot of treated water sold by the district under either an existing or future water service contract. Such amounts transferred into a reserve fund shall be a part of, and not in addition to, the above-referenced ground water assessment rates, stream-delivered surface water charges, and contract prices. The reserve fund established under the authority of this section shall be a limited-purpose reserve fund. Expenditures out of such fund shall only be made for the purpose of constructing, leasing or purchasing, maintaining, and operating ground water pumping facilities capable of delivering ground water into the existing district watercourses, water supply, or distribution facilities for the purpose of ensuring the availability, to the extent possible, of a full supply of water to all users during dry years. There are two types of dry year reserves:

    - AG Dry Year Reserve
    - M&I Dry Year Reserves

- Bond Reserve: Account(s) held as a reserve fund by the District, and used by the District in accordance with a Bond Resolution (upon bond issuance).

- Water Treatment Facilities Reserve: The District has established pursuant to the Second Amended Contract (Contract) a Water Treatment Facilities Reserve Fund. At the end of each Year the District deposits into that fund the sums paid to the District pursuant to subparagraphs 5A (10) of the Contract. The District may, at any time, make withdrawals from said Water Treatment Facilities Reserve Fund and expend such funds as the District determines, provided that such expenditures are limited to the following purposes:

    - Debt Service: Debt service, including the call and redemption of loans and/or bonds prior to fixed maturity date.
    - Operation and Maintenance: Operation, maintenance, and repair of the water treatment facilities including the actual administration, maintenance and repair cost directly attributed to Water treatment facilities.

- Replacement and Expansion: Necessary or desirable replacement, expansion, improvement, modification, and increase in the capacity of the water treatment facilities.

- Repair and Replacement Reserve: The District has established pursuant to the Contract a reserve account for the purpose of covering the cost of repairs and replacement of items scheduled and required during the life of the Contract in order to maintain the water treatment facilities in good order and at all times able to meet efficiently the production of the water to be supplied pursuant to the Contract. The fund is supported by an annual payment under the Contract in the amount of $100,000.00, which may be adjusted from time to time by the District to meet actual operating expenses in the manner set forth in the Contract.

- Water Deficiency Reserve Fund: In order to furnish its Urban Contractors with a minimum of 20,000-acre feet of water per year, the District will establish, consistent with the Contract, a Water Deficiency Reserve Fund into which it shall deposit annually a sum set by the Board, which will not exceed an amount equal to ten cents multiplied by the total number of acre feet of water delivered to the water treatment plant during the subject Year. Funds in said Water Deficiency Reserve Fund may from time to time be applied by the District as appropriate for the construction or other acquisition of such wells, pumps, conduits, and related facilities, and to do any other acts necessary on the part of the District in its judgment to furnish the base supply of treated water to Contractors annually.

- Emergency Reserves: The Emergency Reserve is a designated reserve fund set aside for emergencies and these funds must remain liquid. The ability of the District to quickly restore facilities and services is critical to the public health and safety of residents. The Emergency Reserves shall be expended solely for the purpose of responding to and maintaining the District operations during a natural disaster and/or emergency. AWWA recommends an emergency reserve amount equal to the cost of the most expensive critical equipment that may fail. The District will make annual deposits based on an itemized schedule of equipment, listing the equipment type, the original cost, and the expected service life, to the equipment replacement fund. The total annual deposit is the sum of the annual deposits for each asset. When an asset on the equipment replacement fund list is replaced, the amount is drawn from the fund, and the schedule of annual deposits is adjusted accordingly to reflect the value and service life of the new asset(s).

- Capital Reserve: The Capital Reserve is a designated reserve, which has been established by the Board to maintain a minimum level of funding to meet the cash flow requirements of the Capital Improvement Program and fund up to one-year of capital improvements. Capital improvements are designed to meet regulatory requirements, improve system reliability, and address future water demand in the District. The District is to set an amount aside for the future replacement of worn-out equipment. The Capital Reserve will be established to support the future capital needs of the District water. This may include replacements costs for of existing facilities or equipment as it reached the end of its useful life and funding major repairs that extend useful life of facilities/equipment. The District's current source of funding for capital improvements is from water charges and one-time revenues.

- Goodwin Dam Reserves: The District shall put reserves aside annually to a fund dedicated to Goodwin Dam replacement, as outlined within Section 5 and 5.1 of the Tri-Dam Agreement (AGR 0007). The amount reserved each year shall be approved by the Board and determined by proration of replacement cost less current reserve balance over projected replacement period. The fund balance and interest income generated in this account shall only be used for Goodwin Dam operation, maintenance and capital improvements. The intent is to add sufficient funding year until such time that the District collects one-third of the Goodwin Dam reconstruction costs.

- Operating reserves: The District will maintain at a minimum level equal to six months of budgeted operating costs, consistent with the District Act. Adequate reserves and sound financial policies promote the District's bond ratings in the capital markets; provide financing flexibility; avoid potential restrictive debt covenants; and ensure the District's customers of stable rates.

D. Restrictions on Transfers to/from Reserves

The District shall keep distinct accounts for each of the reserve types outlined above. Funds in the reserve accounts will not be used for any other purpose than they were intended as set forth above unless approved by the Board.

- Interest Received on Reserve Funds: All interest income received by the District by virtue of the investment of the funds on hand in any reserve fund, shall be added to the respective reserve fund generating the interest and shall be expended for the purpose of the fund.

- Debt Reserve: Funds in the reserve can be transferred only when the associated debt is paid off or the lender authorizes a reduction in Debt Reserve. At that time the Debt Reserve is returned to the operating account and redistributed.

- Emergency Reserve: Funds in the Emergency Reserve can be transferred only for emergency purposes. Emergencies are limited to disasters, drought, fire or any other unforeseeable event. The funds are not to be used for operating capital, debt payments, capital improvements or replacements, maintenance or any other foreseeable event.

- Capital Reserve: Funds in the Capital Reserve account can be transferred only for capital replacement projects for the designated enterprise. The funds are not to be used for operations, refurbishing, debt payment, or emergencies.

E. Policy Review and Revision

This Reserve Policy shall be reviewed annually by the General Manager and the Administration Committee, and may be amended by the Board of Directors as conditions warrant. This Reserve Policy was approved by the Board of Directors on November 14, 2023 and replaces any previous reserve policies of the District.