



Finance Committee

City of Arts & Innovation

TO: FINANCE COMMITTEE MEMBERS DATE: OCTOBER 12, 2016

FROM: FINANCE DEPARTMENT WARDS: ALL
PUBLIC WORKS DEPARTMENT

SUBJECT: RESERVE POLICY FOR THE SEWER ENTERPRISE FUND - DIRECT SUBMITTAL

ISSUE:

Recommend the City Council adopt the Sewer Enterprise Fund Reserve Policy.

RECOMMENDATIONS:

That the Finance Committee recommend that the City Council:

1. Adopt the Sewer Enterprise Fund Reserve Policy; and
2. Direct staff to review the Sewer Enterprise Fund Reserve Policy during the City's two-year budget process; and
3. Direct staff to return to Finance Committee with an update at a minimum, once every three years.

BACKGROUND:

The Public Works Department, Wastewater Division, is responsible for the collection and treatment of wastewater for over 93,000 customers within city limits. The facilities include over 800 miles of gravity sewers, 19 wastewater lift stations, and the Riverside Regional Water Quality Control Plant (RWQCP) which has the capacity to treat 46 million gallons per day. The RWQCP provides wastewater treatment for the Edgemont, Jurupa, Rubidoux Community Services Districts, and for the unincorporated community of Highgrove.

The Sewer Enterprise Fund Reserve Policy (Policy) was designed in an effort to establish guidelines to ensure the fiscal stability of the Sewer Enterprise Fund and to provide guidance to staff in the financial management of the Wastewater Division. It also sends a positive signal to ratepayers, investors, regulatory, and credit rating agencies that the City of Riverside is committed to maintaining the long-run fiscal strength of the Wastewater Division.

Importance of a Reserve Policy

The importance of a strong and transparent financial policy, including maintaining prudent reserves for emergencies, working capital, and capital improvements are consistent with

Government Accounting Standards and are important to the Wastewater Division as they help to:

- Maintain the short-term and long-term financial health of the Sewer Enterprise Fund.
- Maintain stable rates for customers and help ensure manageable rate increases.
- Fund unanticipated cost contingencies.
- Ensure funds exist for system improvements.
- Ensure cash exists for the timely payment of bills.
- Act as a significant positive credit factor in bond ratings.

Policy Development

The Finance and Public Works Departments created the Policy to conform to current best practices. Staff has been working with Carollo Engineers, who has specialized expertise in the wastewater industry, to develop the Policy. This Policy will establish guidelines to maintain the long-term fiscal health of the Sewer Enterprise Fund.

Types of Reserves

The Wastewater Division's reserves are classified into three categories: (1) Restricted Reserves, (2) Unrestricted–Designated Reserves, and (3) Unrestricted–Undesignated Reserves.

1. Restricted Reserves

Restricted reserves are established and utilized for narrowly defined purposes as specified by legal restrictions, bond covenants, emergencies, and other regulations or ordinances as approved by the City Council. Current Restricted Reserves include:

- 2009 Bonds Debt Service Reserve
- A cash amount equal to 10% of annual operating expenses of the division

If Restricted Reserve Levels fall below the 10% annual operating equivalent, the Chief Financial Officer will replenish the reserve from Unrestricted-Undesignated Reserves, Cash Balances or other funds as appropriate. If no funds are available, staff will be required to submit a report to the City Council outlining a plan to bring up the reserves to the amounts required in this policy.

2. Unrestricted – Designated Reserves

Unrestricted-Designated Reserves are that portion of unrestricted reserves that meet specific purposes set aside by the City Council. Designated reserves may be held for specific capital and operating purposes. Examples of current unrestricted-designated reserves are as follows:

- *Customer Deposits* – Monies held on behalf of the Sewer Enterprise Fund's customers as required to be utilized per policy.
- *Sewer Public Benefit Funds* – Monies held by the Sewer Enterprise Fund to provide an ongoing public awareness campaign and rebate incentives for residential, commercial, institutional, and industrial customers to reduce flow and/or pollutant discharge into the City's sewer system.

The Wastewater Division may also use Unrestricted-Designated Reserves for other programs to mitigate the impacts of known and impending exposures in consultation with the Finance Department and upon approval of the City Council. The withdrawal and replenishment of the City Council approved designated reserves and their allowable uses will be tracked as designated by the Chief Financial Officer according to the City’s Charter and Municipal Code.

3. Unrestricted – Undesignated Reserves

Unrestricted-Undesignated Reserves are the remaining unrestricted reserves that may be used for any lawful purpose and have not been designated for specific capital and operating purposes. The following Unrestricted-Undesignated Reserve Policy addresses the levels, use and replenishment of this type of unrestricted reserves.

Unrestricted – Undesignated Reserve Policy

The Wastewater Division will have sufficient Unrestricted-Undesignated Reserves to maintain or improve its credit ratings, ensure that operating and maintenance costs will be paid in a timely manner, to pay debt service obligations, to invest in needed capital improvements and equipment replacement and other uses on a timely basis. In addition the Wastewater Division will maintain sufficient reserves to minimize rate increases due to market volatility, weather impacts on demands, contingencies, and regulatory changes.

The Reserve Policy outlines the appropriate types and target (minimum and maximum) levels of several reserve components, based on operation benchmarks, (as prescribed below) that combine to the overall Unrestricted-Undesignated Reserve target. While these areas of consideration were evaluated in order to determine the appropriate size of the reserves, the Wastewater Division will maintain such monies pooled in the Unrestricted-Undesignated Reserve. These reserve allocations are consistent with industry standards for similar wastewater utilities.

Risk Category	Purpose	Minimum Level	Target Level	Events or Conditions Prompting Use of the Reserve
Operating/Maint (Working Capital)	Ensures sufficient resources to pay budgeted O&M expenses recognizing the timing differences between payment of expenditures & receipt of revenues.	Equal to 60 days of O&M expenses. The minimum level is currently estimated at \$5,940,000.	Equal to 120 days of O&M expenses. The target level is currently estimated at \$11,880,000.	This component may be routinely used by the Wastewater Division to cover temporary cash flow deficiencies caused by timing differences between revenues, incurring expense obligations and unexpected increases in operating expenses.
Debt Service	Ensure ability to make debt service	50% of the annual debt service	100% of the annual debt service	The Reserve may be utilized in the event the Wastewater

	<p>payments in an extreme event that may impact the Wastewater Division's ability to provide services, thus impacting revenues at a time critical infrastructure repairs are needed to restore systems. Intended to prevent an event where the Wastewater Division would be unable to pay its debt service during such emergencies.</p>	<p>percent in reserve. This is currently estimated at \$14,370,000.</p>	<p>percent in reserve, which is currently estimated at \$28,730,000.</p>	<p>Division is otherwise unable to pay its debt service obligations. It is not anticipated that the Wastewater Division would ever utilize these reserves absent a significant disaster or extreme market disruption, and only with the approval of the City Council.</p>
<p>Emergency Capital & Equipment</p>	<p>Provides funds to ensure ability to repair system or replace equipment in the event of an unanticipated breakdown or failure.</p>	<p>Equivalent to approximately 0.5% of the replacement value of depreciable capital assets for the sewer system (Collections & RWQCP). The replacement value of the sewer system is currently estimated at \$1 billion, yielding a minimum reserve balance of \$5,000,000.</p>	<p>Equivalent to approximately 1% of the replacement value of depreciable capital assets for the sewer system (Collections and RWQCP). The replacement value of the sewer system is currently estimated at \$1 billion, yielding a minimum reserve balance of \$10,000,000.</p>	<p>An emergency event requiring the need to fund necessary capital expenditures (e.g. natural disaster causing significant damage to the collections system or RWQCP) as approved by the City Council.</p>

<p>System Improvements Capital (Capital Construction)</p>	<p>Provide funds to ensure continuity of construction over fiscal years to be reimbursed by bond proceeds or other resources.</p>	<p>25% of the projected five-year rolling average CIP expenditures for the Wastewater Division, which is currently estimated at \$7,910,000.</p>	<p>50% of the projected five-year rolling average CIP expenditures for the Wastewater Division, which is currently estimated at \$15,820,000.</p>	<p>This Reserve may be used to fund capital expenditures during the year as funding resources are acquired (e.g., bond proceeds, capital contributions, revenues, etc.), as approved by the City Council.</p>
<p>Heavy Equipment Replacement</p>	<p>Establishes a sinking fund to pay for the replacement of mobile heavy equipment as the fleet ages and has reached its expected service life.</p>	<p>25% of the projected five-year rolling replacement schedule of Heavy Equipment for the Wastewater Division, which is currently estimated at \$170,000.</p>	<p>50% of the projected five-year rolling replacement schedule of Heavy Equipment for the Wastewater Division, which is currently estimated at \$340,000.</p>	<p>This Reserve may be used to fund capital purchases of fleet equipment on an as needed basis approved by the City Council.</p>

Withdrawal and Replenishment of Reserves

The Wastewater Division will treat the minimum reserve levels as practical reserve floors and allow reserves to increase or decrease, as directed by the City Council during the City’s two-year budget process or as needed by the Finance Department.

To the extent that Unrestricted-Undesignated Reserves are above the target levels, the Council has the flexibility to direct staff to utilize those available funds to pay for capital projects (reducing the need for future debt), pay down unfunded liabilities such as pension obligations, buy-down outstanding debt, reduce rates, or fund other strategic objectives. No other action by the Wastewater Division would be required if reserves are between the minimum and maximum level unless directed by the City Council.

Reserve levels below the minimum targeted reserves would leave the Wastewater Division exposed to significant operational risks. Should the Wastewater Division draw down these reserves below the minimum targeted level, the Wastewater Division and/or the Finance Department will implement plans to return reserves to their minimum targeted levels within three years upon approval by the City Council.

Reporting and Oversight

Reserve levels will be monitored during the fiscal year and reported in the monthly and quarterly financial reports as provided by the Finance Department. Reserve minimum and target levels will be analyzed annually by the Wastewater Division and an over/under reserve determination

shall be made in conjunction with year-end financial results by the Chief Financial Officer per the City Charter. These results will be reported to the City Council as part of the year-end financial report presentation. Should Unrestricted-Designated or Undesignated Reserve levels need adjustment due to new risk factors due to changes in the industry, these will be brought to the City Council as part of the year-end report or sooner as determined by the Wastewater Division and/or the Finance Department.

The Policy will be reviewed during the City's two-year budget process and updated if needed, (at a minimum once every three years) if there are material changes in the risk exposures or new conditions that require changes in reserve levels.

FISCAL IMPACT:

While not having an immediate impact on the current financial health of the Sewer Fund, adoption of a reserve policy sets guidelines and parameters for ongoing activities that will protect the financial health of the fund in the future.

Prepared by: Kris Martinez, Public Works Director
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Certified as to

Availability of funds: Scott G. Miller, PhD., Chief Financial Officer/City Treasurer

Approved by: Al Zelinka, FAICP, Assistant City Manager

Approved as to form: Gary G. Geuss, City Attorney

Attachments:

1. Sewer Enterprise Fund Reserve Policy
2. Presentation