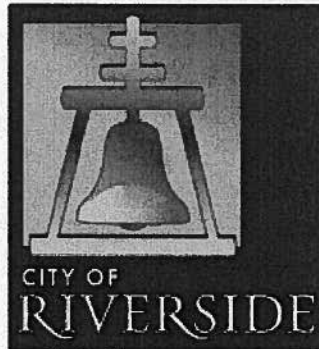




City of Arts & Innovation

Public Works Department

Wastewater Division

**Sewer Enterprise Fund
Reserve Policy**

Adopted ____, 2016

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1. Introduction & Purpose

The City of Riverside Public Works Department, Wastewater Division, is responsible for the collection and treatment of wastewater for over 93,000 customers within city limits. The City of Riverside's facilities consist of over 800 miles of gravity sewers, 19 wastewater lift stations, and the 46 million gallon per day (MGD) Regional Water Quality Control Plant (RWQCP). The City of Riverside also provides wastewater treatment services for the Rubidoux, Edgemont, and Jurupa Community Services Districts (CSDs), and for the unincorporated community of Highgrove.

The City Council, with the assistance of the City Council's Finance Committee, sets legislative financial management policies, as recommended by the Public Works and Finance Departments.

This Cash Reserve Policy (the "Policy") is designed to establish guidelines to ensure the fiscal stability of the Sewer Enterprise Fund and provide guidance to staff in the financial management of the Wastewater Division.

A properly designed reserve policy, is not only a financial best practice but also sends a positive signal to ratepayers, investors, regulatory, and credit rating agencies that the City is committed to maintaining the long-run fiscal strength of the Wastewater Division. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, rate stability, 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 expenditure 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

2. Reserve Definitions

The Wastewater Division's reserves are classified into three categories: (A) Restricted Reserves, (B) Unrestricted - Designated Reserves, and (C) Unrestricted - Undesignated Reserves.

A. 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 Finance 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.

B. 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.

C. Unrestricted - Undesignated Reserves

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 as approved by the City Council. The following Unrestricted - Undesignated Reserve Policy addresses the levels, use, and replenishment of this type of unrestricted reserves.

3. 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, 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.

This Reserve Policy outlines the appropriate types and target (minimum and maximum) levels of several reserve components, based on operational 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.

Operating/Maintenance (Working Capital)

The Operating/Maintenance component of this reserve is intended to ensure sufficient resources to pay budgeted operating and maintenance expenses, recognizing the timing differences between payment of expenditures and receipt of revenues. It also provides a source of funds to allow the Wastewater Division to operate during short term fluctuations in revenues and/or expenditures.

Minimum Level:

Equal to 60 days of operating and maintenance expenses based on the most recent audited financial statements.

Target Level:

Equal to 120 days of operating and maintenance expenses based on the most recent audited financial statements.

Debt Service

The Debt Service component of this reserve is intended to ensure the ability to make debt service payments in an extreme event that may impact the Wastewater Division's ability to provide services, thus impacting revenues at a time when critical infrastructure repairs are needed to restore systems. It is intended to prevent an event where the Wastewater Division would be unable to pay its debt service obligations during such emergencies, or extreme market disruptions.

Minimum Level:

Fifty percent of the maximum annual debt service payment in the upcoming fiscal year.

Target Level:

One hundred percent of the maximum annual debt service payment in the upcoming fiscal year.

Emergency Capital and Equipment

The Emergency Capital component of this reserve is intended to provide funds to ensure the ability to repair the system or replace equipment in the event of an unanticipated breakdown or failure.

Minimum Level: Equivalent to approximately 0.5 percent 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 balance for this component of the Reserve of \$5 million.

Target Level: Equivalent to approximately one percent 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 target balance for this component of the Reserve of \$10 million.

System Improvements Capital (Capital Construction)

The System Improvements Capital component of this reserve is intended to provide funds to ensure continuity of construction over fiscal years to be reimbursed by bond proceeds or other resources.

Minimum Level: Twenty five percent of the projected five-year rolling average CIP expenditures for the Wastewater Division.

Target Level: Fifty percent of the projected five-year rolling average CIP expenditures for the Wastewater Division.

Heavy Equipment Replacement

The Heavy Equipment Replacement component of this reserve establishes a sinking fund to pay for the replacement of mobile heavy equipment as the fleet ages and has reached its expected service life.

Minimum Level: Twenty five percent of the projected five-year rolling replacement schedule of Heavy Equipment for the Wastewater Division.

Target Level: Fifty percent of the projected five-year rolling replacement schedule of Heavy Equipment for the Wastewater Division.

4. Withdrawal & Replenishment of Reserves

The Wastewater Division will treat the minimum reserve levels as practical reserve floors and allow reserves to increase or decrease within the minimum and target level, as approved 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 of the City Council.

5. 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.

This 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.