



Financial Policy Review: Reserve Funds

September 28, 2023



Overview of Presentation

- Best Practice and Industry Guidance
- Agency-Specific Considerations
- Comparable Agency Summary
- Initial Recommendations
- Recap and Next Steps

Financial Policies: Best Practices and Industry Guidance

- Government Finance Officers Association (GFOA)
 - Guidance for local government financial management
 - Accounting, budget, capital planning, risk, IT
- American Water Works Association (AWWA)
 - Focus on water and wastewater utilities
 - Fiscal and operational guidance
 - Benchmarking surveys
- California Special Districts Association (CDSA)
- International City/County Management Association (ICMA)
- Water Environment Federation (WEF)

Reserve Targets: Agency Specific Considerations

Industry Best Practices* are to provide sufficient funds for:

- Structural budget risk
 - Baseline expense levels for contingency, water purchases and equipment replacement
 - Revenue volatility
- Unanticipated expenditures
 - Uncertainty: 4 year rate cycle, drought, inflation
 - Unplanned infrastructure repairs
- Strategic or accelerated infrastructure replacements
 - May include grant matching funds
- Emergency replacement for catastrophic events
 - Fire, flood, earthquake
- Litigation and Insurance reserves

* *AWWA Cash Reserve Policy Guidelines, 2018*

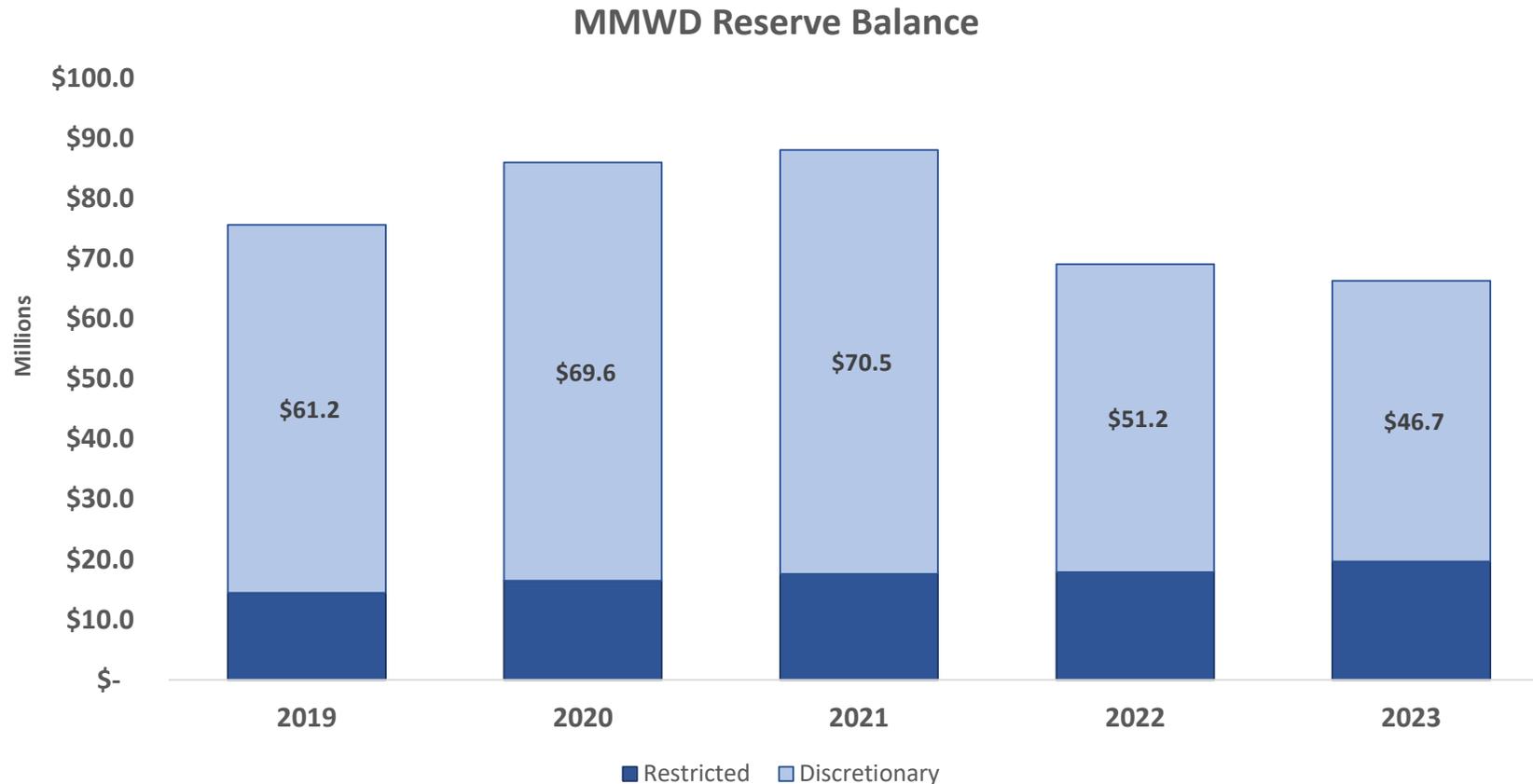
Reserve Level Targets and Balances – Board Policy #46

Reserve Fund	Minimum Balance (per policy)	Policy Target	Preliminary Balance* (6/30/23)
Insurance	Six times self insured retention (SIR)	\$18.6M	\$6.2M
Workers Compensation	Determined by Actuary	\$6.6M	\$6.6M
Capital Reserve	Annual budget for capital expenditures	\$32.9M	\$5.9M
Unrestricted Reserve	Six months of the annual operating budget	\$52.1M	\$21.2M
Rate Stabilization	N/A	TBD	\$1.9M
Water Supply Project	N/A	TBD	\$0M
Total		\$110.2M	\$41.8M

*Pending final year end accrual adjustments

Reserve Target Considerations

- Prior to 2021, District Reserves were well-funded
- Reserves were utilized over past 2 years to offset revenue losses stemming from the drought



MMWD Agency-Specific Analysis by Component

	<u>Low</u>	<u>Medium</u>	<u>High</u>	<u>Note</u>
Budget Structure				
Industry Minimum Standard	\$8,650,000	\$17,325,000	\$26,000,000	1-3 Months of Operating Budget (AWWA minimum)
Operating Budget Contingency	\$0	\$2,600,000	\$5,200,000	0-5% of Operating budget
Dedicated Replacement Funds	\$0	\$1,000,000	\$2,000,000	Emergency replacement for vehicles and technology
Water Purchases	\$0	\$2,000,000	\$4,000,000	Reserve for average cost above the minimum contract
Revenue Volatility				
Rate Structure Risk	\$4,500,000	\$6,750,000	\$9,000,000	Revenue shortfalls under 5-10% consumption reduction
Drought Reserve	\$4,500,000	\$6,750,000	\$9,000,000	Additional revenue shortfalls under 11-20% conservation scenario
Asset Condition				
Deferred Maintenance	\$5,000,000	\$7,500,000	\$10,000,000	Unanticipated Repairs (25-50% of CIP)
Grant Matching Funds	\$6,250,000	\$9,375,000	\$12,500,000	25% Local Match for \$25-\$50m
Natural Disaster and other Risk				
Wildfire, Flood Earthquake	\$5,000,000	\$12,500,000	\$20,000,000	Response and mitigation costs, Insurance Deductible, FEMA match
Insurance Claims (SIR)	\$4,800,000	\$8,100,000	\$12,700,000	Self Insured retention for workers comp. plus one to six events
Total	\$38,700,000	\$73,900,000	\$110,400,000	

- High level analysis shows a range of \$38 million to \$110 million for MMWD reserve targets
 - Middle of range is \$73.9 million, which is about equal FY 2021 reserve levels

Reserve Level Targets – Comparable Agency Summary

Reserve Fund	Marin Water	East Bay MUD	Alameda County Water	San Ramon Services District	Contra Costa Water
Insurance	6X (SIR)	85% SIR	N/A	N/A	\$1.25M
Workers Compensation	Determined by Actuary	Determined by Actuary	N/A	N/A	\$350K
Capital Reserve	1 Year CIP	No target	1 year depreciation	2 years CIP	2 Years CIP
Unrestricted Operating Reserve	6 months expense	3 months expense	3 months revenue	4 months expense	6 months expense
Rate Stabilization	No Target	20% Revenue	50% variable revenue	4 months expense	No Target
Water Supply Project	N/A	N/A	N/A	N/A	N/A
Other			\$10M Emergency	2 Yrs Debt Service	Emergency & Vehicle Repl.
Total as % of Operating Budget*	50%	40%	75%	67%	50%

**Excluding capital reserves*

Initial Recommendation: Insurance

	Current Policy	Amount
Purpose	To pay for exceptionally large self-insured claims	
Minimum Balance	6x Self Insured Retention	\$18.6M
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To provide funding for the self insured retention portion of insured loss claims	
Minimum Balance	1x Self Insured Retention	\$3.1M
Target Balance	2x Self Insured Retention	\$6.2M

Initial Recommendation: Workers Compensation

	Current Policy	Amount
Purpose	To accumulate reserves sufficient to pay current and future workers compensation claims	
Minimum Balance	Actuary	\$6.6M
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To provide funding for the net claim liabilities as determined by actuarial analysis	
Minimum Balance	Determined by Actuary	\$6.6M
Target Balance	Determined by Actuary	\$6.6M

Initial Recommendation: Capital

	Current Policy	Amount
Purpose	To accumulate reserves that may be used for current and future capital construction and equipment purchases	
Minimum Balance	1 Year CIP	\$32.9M
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To provide funding project cost contingencies, unanticipated capital projects and for grant matching funds.	
Minimum Balance	25% Annual CMF Revenue	\$4.3M
Target Balance	50% Annual CMF Revenue	\$8.6M

Initial Recommendation: Unrestricted Operating

	Current Policy	Amount
Purpose	To accumulate reserves which may be used for any purpose of the District	
Minimum Balance	6 months annual budget	\$52.1M
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To provide funding for operating cost contingencies, emergency response or any other purpose of the District.	
Minimum Balance	2 Months Operating Budget	\$17.3M
Target Balance	3 Months Operating Budget	\$26.0M

Initial Recommendation: Rate Stabilization

	Current Policy	Amount
Purpose	To accumulate reserves which may be used for transfer to gross revenues to be used in the calculation of the District's debt coverage ratio or for any other lawful purpose of the District.	
Minimum Balance	N/A	
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To provide funding to mitigate the impact of revenue fluctuations and to assure minimum debt service coverage ratios can be met.	
Minimum Balance	10 percent variable water revenue	\$8.9M
Target Balance	20 percent variable water revenue	\$17.9M

Initial Recommendation: Water Supply Project

	Current Policy	Amount
Purpose	To accumulate reserves to support water supply enhancement and resiliency projects	
Minimum Balance	N/A	
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To accumulate funds to support large scale investments in supplemental water supply enhancement and resiliency projects.	
Minimum Balance	Annual contribution of \$2.5M	\$10M
Target Balance	Annual contribution of \$2.5M	\$10M

Initial Recommendation: Pension Stabilization (new)

	Current Policy	Amount
Purpose	N/A	
Minimum Balance	N/A	
Target Balance	N/A	

	Recommended Policy	Amount
Purpose	To provide funding for required Unfunded Accrued Liability (UAL) payments resulting from investment market shortfalls and/or actuarial assumption changes	
Minimum Balance	35% of UAL payment (4 year impact of 0% investment gain)	\$3.5M
Target Balance	60% of UAL payment (4 year impact of 5% investment loss)	\$6.0M

Initial Recommendation: Summary

	Current Policy	Current Policy Amount	Minimum Balance	Minimum Amount	Target Balance	Target Amount	Purpose
Insurance	6X SIR	\$18,600,000	1X SIR	\$3,100,000	2X SIR	\$6,200,000	Insurance Deductible
Workers Comp	Actuary	\$6,600,000	Actuary	\$6,600,000	Actuary	\$6,600,000	Workers Comp expenses
Capital	Annual Capital Budget	\$32,900,000	25% CMF revenue	\$4,250,000	50% CMF revenue	\$8,500,000	Contingency, Grant Match
Operating	6 months Operating Expense	\$52,100,000	2 months Operating Expense	\$17,333,333	3 months Operating Expense	\$26,000,000	Unanticipated Expenses
Rate Stabilization	No Target	\$0	10% Variable Water Sales	\$8,900,000	20% Variable Water Sales	\$17,900,000	Revenue Fluctuations, Debt Service Coverage
Water Supply Project	No Target	\$0	\$2.5M per year	\$10,000,000	\$2.5M per year	\$10,000,000	Supplemental Water Supply & Grant Matching
Pension Stabilization (NEW)	No Target	\$0	4 year impact of 0% return	\$3,500,000	4 year impact of (-5%) return	\$6,000,000	Required payments for PERS
	Total	\$110,200,000		\$53,683,333		\$81,200,000	

Recap and Next Steps

- Budget and rate structure were modified in 2023
 - Reduced fixed fees increases financial risk due to reliance on variable water sales
- Reserve balances have significant impact on fiscal health of the organization
 - Reserves have been depleted over the past two years
 - Served as a drought reserve to offset water sales losses
- Staff recommends revisions to Reserve Policy to:
 - Define/Refine purpose for each reserve fund
 - Establish minimum balance and add target balances for each reserve fund
- Staff will return to the Board with recommended revisions to policy language