

# Pajaro Valley Water Management Agency Cash Reserve Policy

**Updated by Board of Directors 5-18-16**

## Introduction

The Pajaro Valley Water Management Agency (PVWMA or the Agency) Cash Reserve Policy establishes general guidelines on cash reserves that will help to ensure the Agency's long-term financial and operational stability. In this capacity, the Cash Reserve Policy articulates a comprehensive set of reserves that seek to mitigate operational, capital, and debt service risks PVWMA may encounter.

The Cash Reserve Policy is being established in the context of PVWMA's current and expected capital improvement program and borrowings associated with the Basin Management Plan (BMP). Since reserve targets are based on certain assumptions and estimated costs and risks for PVWMA, the Cash Reserve Policy and established reserve levels will be reviewed annually or more often if there is a material change in the risk exposures to PVWMA. It is noted that the Cash Reserve Policy is established to provide general guidelines for fiscally responsible cash management. The Cash Reserve Policy is not intended to set strict limits that must be adhered to in a vacuum, nor is it intended to be all-inclusive in the sense that there remain a variety of factors outside the purview of the policy that could materially impact PVWMA's financial condition. Certain risks and risk probabilities have been considered to be sufficiently remote or to require a scale of reserves that would be prohibitive as compared to the probability of such an outcome, and this policy does not purport to address such risks. Instead, these guidelines are intended to serve as a management decision-making tool in planning for and evaluating activities or transactions that could have a significant impact on the level of cash on hand.

## Categories of Cash Reserves

The Cash Reserve Policy recommends the creation of four separate reserve funds:

- Operation & Maintenance Reserve
- Repair & Replacement Reserve
- Debt Service Reserve
- Rate Stabilization Reserve

## Summary of Recommended Reserve Levels

<b><i>Reserve Category</i></b>	<b><i>Recommended</i></b>
<b><i>Operation &amp; Maintenance Reserve</i></b>	<b>Start at 30 days of expenditures and build to 180 days</b>
<b><i>Repair &amp; Replacement Reserve</i></b>	<b>Start at 10% Annual Depreciation and build to 25 %</b>
<b><i>Debt Service Reserve</i></b>	<b>20% for Debt Service obligation that do not have their own reserve</b>
<b><i>Rate Stabilization Reserve</i></b>	<b>As determined</b>

Each reserve is summarized below with an explanation as to the methodology that was used to size each reserve.

# Operation & Maintenance Reserve

## Purpose

The purpose of the Operation & Maintenance Reserve is to provide greater stability in annual operations even under unforeseen and changing circumstances as relates to both revenues and expenses. Utilities such as PVWMA are subject to a broad array of risks, which may vary from small, temporary disruptions of business to substantial events. The intent of the Cash Reserve Policy is to set an overall reserve level that is reasonable, defensible and consistent with the aggregate risk profile that PVWMA faces in effectively managing water supplies in the Pajaro Valley.

## Methodology

Many water utilities, which generally operate on a monthly billing cycle, maintain operating reserves at a level of 60 to 180 days of operating expenses. Typically it is utilities in the most stable operating environments that are able to manage with reserves on the smaller end of this range, while many agencies with significant annual volatility in revenues or expenditures or those undergoing significant expansion have substantially larger operating reserves.

## Operation & Maintenance Reserve Policy

PVWMA will maintain an Operation & Maintenance Reserve equal to 30 days of operating expenses and build to 180 days over a 5 year period.

See Exhibit A.

# Repair & Replacement Reserve

## Purpose

PVWMA's BMP is made up of projects that will increase water supply to the Pajaro Valley and significantly expand PVWMA's existing infrastructure. The purpose of the Repair & Replacement Reserve is to fund the unplanned repair or replacement of capital assets and to allow PVWMA to absorb fluctuations in the capital plan without an immediate rate impact to customers.

## Methodology

Given the significant capital improvements in which the Agency has invested over the past several years and the sizeable capital plans associated with implementation of the BMP, the creation of a Repair & Replacement Reserve to ensure the availability of funds to respond to unexpected needs is prudent.

## Repair and Replacement Reserve Policy

PVWMA will maintain a 10% Annual Depreciation reserve and increase to 25% over a 5 year period. See Exhibit A.

# Debt Service Reserve

## Purpose

The purpose of the Debt Service Reserve is to provide PVWMA with funds dedicated to paying the Agency's debt service obligations in the event of a significant, unexpected decrease in operating revenue during which operating funds may be insufficient to meet such obligations.

## **Methodology**

Typical municipal bond covenants require the establishment of a debt service reserve fund in an amount equal to maximum or average annual debt service on the bonds. Such a requirement exists in connection with the Agency's Series 1999 Certificates of Participation. It would be prudent for PVWMA to also set aside reserves in connection with its other debt as these loans are significant.

## **Debt Service Reserve Policy**

PVWMA will maintain a debt service reserve to be funded at level equal to 20% for Debt Service obligation that do not have their own reserve.

See Exhibit A.

# **Rate Stabilization Fund**

## **Purpose**

The Rate Stabilization Fund is established to provide short-term rate stability in case of an unexpected drop in revenue or increase in expenses. Among other things, the rate stabilization reserve affords PVWMA with added flexibility in meeting its financial covenants to bondholders in the event of a financial shock to the Agency resulting from disaster or unforeseen financial circumstances.

## **Methodology**

Unlike other reserves, the rate stabilization reserve is typically not a percentage or ratio, but rather a fixed amount. The funding of such a reserve is highly dependent upon the expected variability in PVWMA's revenue stream, budgeted expenditures, political matters, legal matters and the level of total annual debt service, among other factors.

## **Rate Stabilization Fund Policy**

PVWMA will maintain a rate stabilization fund reserve as determined by management and the board. See Exhibit A.

# **Annual Review Process**

PVWMA plans to review and reevaluate the reserve funding levels annually. Since reserve targets are based on certain estimates, assumptions, and risk probabilities, the Cash Reserve Policy will be revisited more frequently if there is a change in PVWMA's operations, capital program, or debt service obligations that would warrant review of these policies.

**Pajaro Valley Water Management Agency**  
**Cash Reserve Policy**  
**Exhibit "A"**  
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<b>Operations &amp; Maintenance Reserve</b>	<b>FY 13/14</b>	<b>FY 14/15</b>	<b>FY 15/16</b>	<b>FY 16/17</b>
Projected Operating Expenditures (\$MM)	5.79	7.27	5.98	6.81
Projected Reserve Amount (\$KK)	482	1,212	1,496	2,837

<b>Repair &amp; Replacement Reserve</b>	<b>FY 13/14</b>	<b>FY 14/15</b>	<b>FY 15/16</b>	<b>FY 16/17</b>
Projected Annual Depreciation (\$MM)	2.4	2.419	2.495	2.5
Projected Reserve Amount (\$KK)	242	363	499	625

<b>Debt Service Reserve</b>	<b>FY 13/14</b>	<b>FY 14/15</b>	<b>FY 15/16</b>	<b>FY 16/17</b>
Projected Debt Service Payments (\$MM)	4.21	4.24	3.98	3.55
Restricted Funds for Debt Covenants (\$KK)	754.2	754.2	251.9	251.9
Projected Reserve Amount (\$KK)	691	697	747	661

<b>Rate Stabilization</b>	<b>FY 13/14</b>	<b>FY 14/15</b>	<b>FY 15/16</b>	<b>FY 16/17</b>
Projected Reserve Amount (\$KK)		500	500	500

<b>Total Cash Reserve (\$MM)</b>	<b>1.42</b>	<b>2.77</b>	<b>3.24</b>	<b>4.62</b>
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