

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
**Updated as of May 2014**

**Policy Statement**

The Inland Empire Utilities Agency (Agency or IEUA) has historically maintained fund reserves to ensure sufficient funding is available to meet its operating, capital and debt service obligations, comply with legally mandated requirements, and have the ability to respond to unforeseen events. As a regional provider of essential public services and with an extensive investment in public infrastructure, operating facilities, other related assets; the Agency must establish and maintain a prudent level of reserves to meet its commitment to deliver reliable and high quality essential services to its customers. In addition, by maintaining prudent reserves the Agency has the necessary financial flexibility to effectively respond to economic, environmental and regulatory changes, protect its customers against reducing service levels or raising rates and fees because of temporary revenue shortfalls or unforeseen one-time expenditures, and support the Agency's Business Goals.

**Purpose of Fund Reserve Policy**

The policy directives outlined in this document are intended to ensure fund reserves support the Agency's Business Goals adopted by the Board in October 2013, in particular its commitment to *"preserve fund reserves that sustain the Agency's long term fiscal health, high quality credit rating and ensure its ability to effectively address economic variability"*.

The Agency is committed to ensure its customers benefit from reliable, sustainable and high quality water supplies and cost-effective wastewater collection, treatment, and reuse services. Given the direct impact these essential services have to public health and the overall quality of life, very few options exist, if any, for service reduction levels in the event of revenue shortfalls or other funding deficiencies. In recognition of these realities, and consistent with best practices, the Agency has prudently established reserves to ensure delivery of these essential services.

The IEUA Board of Directors (Board) may designate specific reserves and set minimum and target balances to support the various funds (programs) that account for its water, wastewater treatment, recycled water and other activities. Establishing and maintaining adequate reserves for the various programs minimizes the risk of significant fluctuation in rates and charges due to changes, such as a shortfall in revenues or unanticipated expenses.

As an issuer of revenue bonds and recipient of low interest loans, the Agency is committed to its contractual obligation to pay debt service and other financial obligations as imposed by bond covenants and loan agreements. In addition, adequate reserves directly affect the Agency's credit rating and access to more favorable interest rate debt markets resulting in lower borrowing costs.

Sustainment of high quality credit rating will ensure the Agency's ability to finance the construction, expansion and improvement of facilities and infrastructure to meet higher service demands from future growth. The Agency is committed to improving its long term credit to AAA and maintaining a debt coverage ratio that supports such rating. (Business Goal: Fiscal Responsibility).

### ***Roles and Responsibilities***

The Reserve Policy shall be adopted by the Board of Directors and reviewed annually during the budget review process to ensure appropriate use of reserve funds and modification of targeted reserve balances for the various funds (programs). The Agency's Chief Financial Officer shall serve as the designated administrator of the Reserve Policy and shall be responsible for the day-to-day implementation and management.

### **Types of Reserves**

Reserve balances shall be maintained in amounts sufficient to meet appropriate reserve targets, as established by the Board, in cash and/or cash equivalents, and permitted investments as prescribed in the Agency's Investment Policy. The Agency classifies reserves into three major categories as follows:

- **Restricted reserves** – Funds maintained based on externally-imposed restrictions from federal and state regulatory requirements, or legal restrictions imposed by third parties, (e.g. bondholders) through bond indentures or other contractual agreements (e.g. Regional Sewage Service Contract).
- **Designated reserves** – Board imposed restrictions on funds for Agency specific purposes such as mitigating risk from the Agency's self-insurance programs and financing replacement and rehabilitation (R&R) of Agency assets. These funds are not legally restricted.
- **Unrestricted reserves** – The internal policy of the Agency requires maintenance of adequate undesignated (unrestricted) reserves to finance requirements such as investment in capital and operational efficiencies, payment of unfunded accrued liabilities for retirement benefits, and refunding of high interest debt obligations. Funds in these reserves are available for spending with no legal, regulatory, or Board imposed restrictions.

For each of the reserves, the Agency has identified a purpose, appropriate target levels, funding sources, conditions under which they are to be used and replenished, and review dates for determining continued need. Any reserves in excess of the cumulative target amounts will be considered undesignated funds which can be used for any lawful purpose at the discretion of the Board of Directors.

## **RESERVED (RESTRICTED) FUND BALANCES**

### **Operating Contingency Reserve**

Purpose: The Agency is committed to providing wastewater collection, treatment, disposal, and optimizing beneficial use of recycled water and biosolids. The Agency strives to provide and maintain a rate structure that is affordable, stable and fully covers the fund (program) cost of service. However, unforeseen shortfalls in revenues or increases or operating costs require that the Agency periodically adjust rates and charges to achieve full cost of service recovery. This reserve is intended to minimize rate fluctuations as a result of unfavorable economic conditions or other factors beyond the control of the Agency that may result in reduced revenues or increased costs.

The Agency shall maintain an operating contingency reserve equal to a minimum of four (4) months, as mandated by legal requirements, and a target of six (6) months of total operating expenses as identified in the adopted budget for the current fiscal year. This level of reserve will provide customers and outside parties assurance that the Agency can operate for at least four months despite a significant shortfall in revenues or unplanned increase in expenses. The target level minimizes the risk of significant rate fluctuations as a result of unforeseen events.

Usage Requirements: This reserve can only be drawn upon if the Agency's operating revenues are not sufficient to pay operating expenses. Draws from these reserves shall be replenished within twelve months after use.

Target Level: The target level for Operating Contingency Reserve levels shall be maintained at a minimum of four (4) months, as mandated by legal requirements, and a target of six (6) months of the fund (program) adopted operating expenses for the current fiscal year.

Funding Source: Operating Contingency Reserve will be funded from net system revenues, (total operating revenues less total operating expenses).

Review Timeline: Fund balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and Capital Budget.

### **Debt Service Reserves**

Purpose: As required by bond covenants and loan agreements, debt service reserves are maintained to support payment of principal and interest on outstanding obligations.

Usage Requirements: Debt service reserves will only be used to pay debt service costs when pledged net revenues (as defined in the relevant debt instruments) are insufficient to meet the principal and interest payments.

Target Level: The target is equal to the highest annual debt service cost in the ensuing five (5) years. The minimum target will be funded to meet reserve requirements.

Funding Source: Can be one or combination of system revenues, property tax receipts, and/or restricted debt service accounts established as part of the original debt issuance.

Review Timeline: Fund balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and Capital Budget.

### **CCRA Capital Reserves**

Purpose: Capital Capacity Reimbursement Accounts (CCRA) are restricted accounts established by each of the Agency's "contracting member agencies" to hold new EDU connections fees collected in their respective service area, in accordance with the Regional Sewage Service Contract (Regional Contract).

Usage Requirements: Pursuant to the Regional Contract, CCRA funds are restricted to support capital acquisition, construction, equipment and process improvement costs for the Agency's regional wastewater system. The Agency draws, or "calls", CCRA funds from member agencies as needed to finance capital projects in the Regional Wastewater Capital Improvement (RC) fund, if and when, capital construction reserves held by the Agency are not sufficient to support the planned Capital Improvement Plan (CIP).

Target Balance: No set target is defined. CCRA reserve balance will depend on the level of new development and the Agency's funding requirements to support the planned CIP in the RC fund.

Funding Source: New EDU connections fees collected by each contracting member agency for connection to the Agency's regional wastewater system.

Review Timeline: Fund balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and Capital Budget.

### **DESIGNATED FUND BALANCES**

#### **Capital Construction Reserve Funds**

Purpose: Capital construction reserve funds are used to finance capital investments such as construction, improvement or expansion of facilities and infrastructure, as well as acquisition of major equipment and technology. The services provided by the Agency are critical to the health and welfare of the citizens within the Agency's service area. The Agency is committed to ensure that systems are managed and constructed so that 90% of capacity is never exceeded (Business Goal; Wastewater Management Capacity).

Usage Requirements: Accessed, as needed, to fund capital investments based on the Agency's TYCIP and other long term planning documents including but not limited to: the Asset Management Plan, Integrated Resources Plan, Recycled Water Plan, Wastewater Facilities Master Plan, and Energy Plan.

Target Balance: The maximum target level is equal to the total capital requirements for the subsequent three (3) fiscal years as identified in the TYCIP, including unexpended debt proceeds. The minimum target level is equal to the total CIP requirements for the following fiscal year.

Funding Source: Combination of system revenues generated from rates and user charges, property tax receipts, and debt proceeds issued to finance specific capital investments.

Review Timeline: Fund balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and Capital Budget.

### **Replacement and Rehabilitation (R&R) Reserves**

Purpose: Maintaining assets in an operating condition to meet the Agency's level of service commitment to provide reliable and high quality services requires timely and adequate investment in replacement and rehabilitation (R&R) of Agency assets. R&R is defined as an expense which will extend, as opposed to maintain, an asset's useful life. The basis for R&R requirements will be end of useful life and condition assessments conducted by Engineering, Maintenance and Operations and reported in Asset Management Report updated every 3 to 5 years. The Agency's ultimate goal is finance planned R&R requirements with user rates and charges. This goal is consistent with the Regional Sewage Service Contract which requires the volumetric EDU rate to fully support operating, administration and R&R costs for the regional wastewater program.

Usage Requirements: As needed to finance unplanned R&R requirements, including R&R requirements identified in the Asset Management Report but scheduled in subsequent fiscal years.

Target Balance: The target will be the total projected R&R costs over the subsequent three (3) fiscal years. The minimum target will be the total R&R costs budgeted in the following fiscal year.

Funding Source: System revenues generated from rates and user charges, net of operating costs and debt service costs.

Review Timeline: Fund balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and Capital Budget.

### **Self-Insurance Program Reserve**

Purpose: An exposure/liability reserve shall be maintained for costs not covered by the Agency's insurance policies, such as claim costs within the Agency's deductibles, self-insurance retentions, and/or costs associated with disasters, and other events that are not reimbursable from insurance. The reserve shall also provide funding to mitigate various catastrophic and other events that may or may not be covered by insurance. These events may include, but are not

limited to; legal settlements, terrorist attacks, natural disasters, such as earthquakes, and severe weather storms.

Additionally, the Agency has elected to self-insure for potential workers' compensation claims. With a workforce of nearly 300, the Agency's exposure to work-related injuries increases.

Usage Requirements: Accessed as needed for non-recoverable expenses associated with claims against the Agency. In the event of a claim in excess of policy limitations and available operating funds, the reserve will be used to satisfy that claim. In the event of a workers' compensation claim(s) in excess of policy limitations and available operating funds, the reserve will be used to satisfy the claim and/or to pay legal expenses defending the claim

Target Level: The target level will be set at \$6,000,000, including \$1,000,000 maximum exposure per occurrence for workers compensation claim.

Funding Source: Property tax receipts allocated to the Administrative Services (GG) fund and inter-fund transfers from other funds, as needed.

Review Date: To be analyzed by Risk Management every two years to determine an appropriate funding level.

### **Employee Retirement Benefit Reserve**

Purpose: The Agency provides postemployment pension and medical benefits to eligible employees who retire from the Agency. For pension benefits, the Agency contributes to a defined benefit pension plan under the California Pension Employees' Retirement System (CalPERS). CalPERS is also the provider of retiree medical coverage benefits (referred to as Other Post Employment Benefits-OPEB).

Like most public Agencies, the Agency is facing growing unfunded accrued liabilities (UALs) for postretirement benefits. In 2013, UALs for pension and medical benefits were estimated to be \$60 million. A key objective of the Agency is to develop a funding strategy to fully fund UALs over an appropriate period of time in order to safeguard retiree benefits and the Agency's financial health.

Usage Requirements: To mitigate the impact of annual increase of the annual contribution amounts in excess of the budgeted amount

Target Level: This minimum target amount will be set at \$6 million and increased annually up to the target level. The target level will be adjusted based on the total Annual Required Contribution (ARC) amount budgeted in the subsequent fiscal year.

Funding Source: Combination of property tax receipts and indirect allocation of employment costs across all Agency funds (programs) from the Administrative Services (GG) fund.

Review Timeline: Reserves will be adjusted in conjunction with the annual actuarial valuation updates for pension and biennially for OPEB.

## **UNDESIGNATED FUND BALANCES**

### **Supplemental Water Resources Reserve**

Purpose: This reserve will enable the Agency to fund water resources projects for purposes of increasing water use efficiency, water quality, and water reliability and sustainability in the Chino Basin (Business Goal: Water Reliability). Projects include but is not limited to; water use efficiency and conservation, investigation, construction or contractual programs which are intended as a feasible water alternative to Metropolitan Water District water of Southern California (MWD); maximizing the beneficial use of existing water infrastructure, and investment in development of local water resources, protection of land throughout the region for optimization of groundwater recharge.

Usage Requirements: Finance water resource management projects identified in the Agency's long term planning documents, such as; Integrated Resources Plan and Urban Water Management.

Target Level: A minimum target level of \$10 million and a target level of \$30 million.

Funding Source: Combination of property tax receipts, monthly meter charges and acre foot (AF) surcharges imposed on imported water deliveries, and net proceeds from the sale of surplus and recharged water.

Review Timeline: Fund balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and Capital Budget.