

Tahoe City Public Utility District Financial Policy

Enterprise Funds Unrestricted Net Position and Reserves Policy Policy Number: 2015

I. PURPOSE

This Policy is established to set forth the parameters and guidelines for the management of reserves in the Enterprise Funds. This Policy is intended to manage the cyclical nature of revenue and expenditures; reduce the risk of financial impacts resulting from natural disasters or other catastrophic events; respond to the challenges of a changing economic environment, including prolonged downturns in the local, state or national economy; and to demonstrate continued prudent fiscal management and creditworthiness. The Government Finance Officers Association (GFOA) and American Water Works Association (AWWA) consider establishment of a reserve policy as a best practice and a key component of a sound financial management plan.

II. POLICY OVERVIEW

The establishment of this Policy will help provide financial and rate stability, as well as improving the District's ability to mitigate current and future risk.

The Enterprise Funds Net Position consists of total assets plus deferred outflows less total liabilities and deferred inflows and serves as a useful indicator of the Enterprise Funds financial position. Net Position consists of three components as follows: Net Investment in Capital Assets, Restricted, and Unrestricted. The Unrestricted component of net position is further classified into two categories: Designated and Undesignated. The Designated Unrestricted Net Position is established by Board policy and is intended for a specific purpose or use per the Board's policy or the Board designee's directions. Undesignated is what is available after designation.

Adequate designation of Unrestricted Net Position and reserve funds set aside for various legitimate purposes is critical to the successful and stable short and long-term operation of the District. Following sound financial practices and adhering to GFOA and AWWA recommendations, the District's designated reserves include those for anticipated and unanticipated expenditures. The Policy sets forth guidelines to determine adequate reserves for water and sewer operations in order to ensure that customers experience gradual increase to rates for service; and so that the District can respond to emergency situations. Adequate reserves ensure that the District will, at all times, have sufficient funding available to meet its operating, capital and debt service cost obligations, including future debt or capital obligations; any unfunded mandates; and any costly regulatory requirements as they may arise. Prudent reserve levels are also critical for the District's ability to issue future long-term debt. The financial markets view the establishment of reserve policies and adequate fund balances favorably which may result in higher ratings and lower overall borrowing costs.

The following table highlights the components of Net Position and its relevance to the Enterprise Funds Unrestricted Net Position and Reserve Policy.

Components of Net Position	Relevant to Enterprise Funds Unrestricted Net Position and Reserve Policy
Net Investment in Capital assets	No
Restricted	No
Unrestricted <ul style="list-style-type: none"> • Designed • Undesignated 	Yes – Set reserve target Yes – What is available after designation

III. DEFINITIONS

As used in this Policy, the following terms shall have the meanings specified below:

- a. American Water Works Association – The American Water Works Association (AWWA) is the industry recognized scientific and educational association for the water utility industry.
- b. Board – The lawfully elected or appointed governing body of the TCPUD.
- c. Constituents – Residents, property owners, ratepayers, customers, beneficiaries of services, business owners, and voters within the District’s boundaries.
- d. District – The Tahoe City Public Utility District (District or TCPUD).
- e. Government Finance Officers Association (GFOA) - An industry-recognized national organization. GFOA's mission is to advance excellence in state and local government financial management.
- f. Long-Term Financial Plan (LTFP) – A document separate from the budget process which supports the long-term financial planning process. The LTFP contains trend projections, analysis, decisions and an execution strategy.
- g. Operating Expenses – Expenditures incurred as a result of performing normal and routine business operations of the District.
- h. Net Position – Net position in financial statements is assets, plus deferred outflows of resources, less liabilities, and deferred inflows of resources. $[(\text{Assets} + \text{deferred outflows}) - (\text{Liabilities} + \text{deferred inflows})] = \text{Net Position}$.
- i. Policy – This “Enterprise Funds Unrestricted Net Position and Reserves Policy.”
- j. Unrestricted Net Position Designated – A subset of Unrestricted Net Position which requires action by the Board to set aside portions of working capital for a specific purpose.
- k. Unrestricted Net Position Undesignated - Represents a remainder balance of working capital that is available to be designated for other uses.
- l. Working Capital – Current assets less current liabilities, and measures the relative liquid portion of the Enterprise Fund capital available to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees.

III. PROCESS

Annually, a reserve analysis will be prepared for the Enterprise Funds which will evaluate current reserve levels and consider any resetting of amounts. Any changes to reserve levels shall be approved by the Board. If resetting the reserves creates a negative Unrestricted Net Position, the District will develop a one to five year replenishment plan to meet the reserve targets of this Policy.

The following steps will take place to evaluate and reset the reserve targets:

- a. Budget and Fiscal Viability - The District will prepare its annual budget and long term financial plan forecast which includes the planned change in Unrestricted Net Position and target reserves. The analysis will take into consideration the annual operating and capital budgets by Fund and a five-year forecast.
- b. Setting amounts within the Unrestricted Net Position - Annually, the Unrestricted Net Position for each Enterprise Fund shall be reevaluated and reset as outlined in this Policy. The Board shall approve the amounts to be designated within the Unrestricted Net Position within the categories set forth below:
 - **Operating Reserve** – This reserve shall be used only in extraordinary circumstances to mitigate unforeseen significant fluctuations in current operational expenses; for annual revenue shortfalls; changes in the economic environment; and/or a significant, one-time unanticipated expenditure.
 - **Fleet & Equipment Replacement Reserve** – This reserve shall be used for the planned replacement of current and future fleet and heavy equipment.
 - **Sewer Infrastructure Capital Replacement Reserve** – This reserve may be used to fund capital expenditures that exceed the anticipated annual rate revenues available for capital and may provide funding for future capital infrastructure.
 - **Water Infrastructure Capital Replacement Reserve** – This reserve account may be used to fund capital expenditures that exceed the anticipated annual rate revenues available for capital and may provide funding for future capital infrastructure.
 - **Water System Acquisition & Infrastructure Improvement Property Tax Reserve** – This reserve shall be used for future purchases of private water systems within District boundaries and for infrastructure improvements to those systems.

At any time, the Board may amend these reserves categories and/or targets or amounts, to allow for funding of the District's operating, capital and debt service obligations or to provide funding for unanticipated events. Reserves will be established, replenished and used only in a manner which allows the District to fund costs consistent with the Capital Improvement Plan, Five-Year Financial Plan, Five-Year Strategic Plan, Long-Term Financial Plan, Rate Study, and other Board adopted actions; and in a manner that requires minimal annual adjustment to water and sewer rates. The District's Enterprise Funds Unrestricted Net Position and Reserves Policy shall be periodically reviewed and adjusted to respond to the needs of the District.

The following table sets forth the Enterprise Fund reserve categories and outlines the targets as established and adopted by the Board:

ENTERPRISE FUND RESERVES	
Description	Target
<p style="text-align: center;"><u>Operating Reserve</u></p> <p>This reserve shall be used only in extraordinary circumstances, to mitigate unforeseen significant fluctuations in current operational expenses; for annual revenue shortfalls; changes in the economic environment; and/or a significant, one-time unanticipated expenditure.</p>	<p>Reserve target shall be defined as ninety (90) days of the annual operating budget excluding depreciation per Enterprise Fund.</p> <p>Reserve levels will be determined annually as part of the budget process and approved by the Board.</p> <ul style="list-style-type: none"> • Use requires Board approval
<p style="text-align: center;"><u>Fleet & Equipment Replacement Reserve</u></p> <p>This reserve shall be used for the planned replacement of current and future fleet and heavy equipment.</p>	<p>Reserve target shall be defined as the annualized value of the 15-year fleet and equipment replacement plan per Enterprise Fund. The reserve will be increased annually by the 15-year annualized value and reduced annually by the current year fleet and equipment purchases as approved by the Board.</p> <ul style="list-style-type: none"> • Use requires Board approval
<p style="text-align: center;"><u>Sewer Infrastructure Capital Replacement Reserve</u></p> <p>This reserve account may be used to fund capital expenditures that exceed the anticipated annual rate revenues available for capital and may provide funding for future capital infrastructure.</p>	<p>Minimum reserve shall be set at \$1.5 million. Maximum reserve shall be set at 10 years of annual capital funding from sewer rates per the 2019 Rate Study (\$1.5 million/year).</p> <ul style="list-style-type: none"> • Min. Balance – \$1,500,000 • Max. Balance – \$15,000,000 • Annual increase – As determined by Board • Use requires Board approval
<p style="text-align: center;"><u>Water Infrastructure Capital Replacement Reserve</u></p> <p>This reserve account may be used to fund capital expenditures that exceed the anticipated annual rate revenues available for capital and may provide funding for future capital infrastructure.</p>	<p>Minimum reserve shall be set at \$1.5 million. Maximum reserve shall be set at 5 years of annual capital funding from water rates per the 2019 Rate Study (\$2.5 million/year).</p> <ul style="list-style-type: none"> • Min. Balance – \$1,500,000 • Max. Balance – \$12,500,000 • Annual increase – As determined by Board • Use requires Board approval
<p style="text-align: center;"><u>Water System Acquisition & Infrastructure Improvement Property Tax Reserve</u></p> <p>This reserve shall be used for future purchases of private water systems within District boundaries and for infrastructure improvements to those systems.</p>	<p>Reserve target shall be set at \$3.0 million. Funding of this reserve should come from property tax revenues.</p>

