



POLICIES, RULES AND REGULATIONS	
Title: UNRESTRICTED RESERVE FUND POLICY	
Approval Date: December 2020	Effective Date: December 2020
Approved By: Board of Directors	DMS #23967

UNRESTRICTED RESERVE FUND POLICY

1.0 INTRODUCTION

There are two types of cash reserves, Restricted and Unrestricted. Restricted reserves are established and utilized for narrowly defined purposes as specified by legal restrictions, bond covenants, and other regulations or ordinances. The Santa Clarita Valley Water Agency (SCV Water, or Agency) at times may have restricted reserves for:

- Unspent Bond Proceeds
- Bond Redemption
- Water Conservation
- Grants

As a specific example, unrestricted reserves do not address investments of debt proceeds held by bond trustees that are governed by the provisions of debt agreements of the Agency, rather than the general provisions of the California Government Code.

This policy does not apply to Restricted reserves.

This policy has been developed to maintain prudent management of the Agency water system, which requires that unrestricted reserve funds be established and maintained to fund scheduled and unscheduled expenses including operation and maintenance, debt service, emergencies, capital investment including repair and replacement, and for the stabilization of water rates. This policy has been revised to integrate the unrestricted cash reserves of the four divisions of the Agency: Regional (formerly wholesale), Newhall Water Division (NWD), Santa Clarita Water Division (SCWD) and Valencia Water Division (VWD).

This policy describes the prudent unrestricted reserve fund needs of the Agency, identifies the sources of funding for such reserves, and target amounts for each reserve. Reserves are highly regarded by credit rating agencies, credit providers and investors. Although there are numerous methods to establish reserve funding levels, the Agency considers metrics utilized by the credit rating agencies, which provide guidance on liquidity and provides peer review through the assignment of credit ratings for bond issues. Funding the unrestricted reserves come from Agency net cash from operations.

2.0 POLICY STATEMENT

The Agency will have sufficient unrestricted reserves to maintain or improve its credit ratings, ensure that operating and maintenance costs will be paid in a timely manner, to pay debt service obligations, and to invest in needed capital improvements and equipment replacement on a timely basis. In addition, the Agency will maintain sufficient reserves to minimize rate increases due to sales volatility resulting from matters



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including, weather and regulatory impacts on demands, emergencies (such as local and natural disasters, catastrophic events), and regulatory changes.

3.0 MANAGEMENT OF RESERVES

Unrestricted reserves are to be managed utilizing the following criteria:

- Distinguish between legally restricted and unrestricted amounts.
None of the reserves covered by this policy are legally restricted. Should a significant event occur that requires immediate funding to minimize damage or health risk, all funds covered in this policy are legally available.
- Contain a defined and distinct purpose.
Sections 4.1 through 4.5 of this policy describes each reserve, the events or conditions that prompt the use of the reserves, and the target balance to be maintained in the reserve.
- Method to replenish reserves to Target levels.
A priority for allocating net cash from operations from the prior year will be determined annually, based on prior year use of reserves and expectations of need in the near term.
- Specify periodic review dates of reserve balances and projected needs.
Unrestricted reserve balances will be reviewed annually as part of the budget process.
- Balances should be maintained in amounts sufficient to meet reserve targets.
To the extent that unrestricted reserves are above the target level, the Board 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, defease outstanding debt, or fund specific strategic objectives.
- Reserve levels below the minimum targeted amounts would leave the Agency exposed to significant operational risks. Should reserves be drawn down below the targeted level (except for the Capital Pay-go reserve that has its own criteria as explained in Section 4.2), the Agency will implement plans to return reserves to their targeted levels within three years. Such plans will be presented to the Finance & Administration Committee within twelve (12) months.



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4.0 UNRESTRICTED RESERVES The Agency will maintain the following unrestricted reserves:

- Operating
- Capital (Pay-go)
- Water Supply Reliability
- Revenue Rate Stabilization
- Emergency

4.1 Operating Reserve

The purpose of this reserve is to maintain the financial viability and stability of the Agency by providing a safeguard against unplanned events including fluctuations in budgeted expenses and revenues, timing differences between revenues and expenses, and the variability of water supply and demand.

Recommended Target Level –The Operating Reserve Fund shall have a minimum amount equal to 120 days of annual budgeted operating expenses including debt service. Note that the calculation of 120 days of annual budgeted operating expenses including debt service is made by dividing the annual total by 360 days then multiplying by 120. This method is commonly used to determine an average daily or number of days of expenditure but does not consider the actual timing of any specific expenditures.

Events or Conditions Prompting Use of the Reserve –This Reserve may be routinely used by the Agency to cover temporary cash flow deficiencies caused by timing differences between revenues and incurring expense obligations and unexpected increases in operating expenses.

Replenishment – If at any time the amount on deposit declines below 120 days of annual budgeted operating expense including debt service, the Agency will take steps to restore the amount on deposit within one year.

Source of funding – Net cash from operations.

4.2 Capital (Pay-go) Reserve

This reserve is established to fund the Agency’s non-debt funded capital expenditure. Funds from this reserve are to be used in both “Pay-go” capital projects and major capital projects. Bond proceeds are not included in this reserve as bond proceeds are legally restricted funds. The Agency will track planned future use of Capital Reserve amounts for projects that are also debt funded in an annual update to the financial forecast.



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Target Level – The balance of this fund at the end of a fiscal year is the maximum that may be spent on pay-go capital projects during the following fiscal year. The purpose of this target is to ensure that at the start of each fiscal year, funds are available to pay for the planned pay-go capital costs. This requirement prevents the Agency from relying on unearned revenues to pay for short term construction obligations and helps to enhance the Agency’s capital project and financial planning processes.

Events or Conditions Prompting Use of the Reserve – Upon the approval by the Agency Board of the capital improvement plan budget, staff is authorized to use funds from the Capital (Pay-go) Reserve to pay for the projects approved in the budget.

Source of funding – Pay-go funding is built into retail rates and is also funded with other non-operating revenue; additional allocations to this reserve may be made from Agency net cash from operations.

4.3 Water Supply Reliability Reserve

This reserve is maintained to provide a source of funding for the extraction of water from groundwater banking programs or acquisition of other necessary water supply during dry years that will help to further mitigate rate increases.

Recommended Target Level – The target balance for the Water Supply Reliability Reserve will be equal to the cost to produce 10,000-acre feet from the Agency’s banking program in a dry year.

Events or Conditions Prompting Use of the Reserve – Upon the recommendation of the General Manager, or designee, the Agency Board may authorize the use of Water Supply Reliability Reserves for the purpose intended by this section 4.3.

Source of funding – Net cash from operations.

4.4 Revenue Rate Stabilization Reserve

This reserve is maintained to provide the Agency with the ability and flexibility to avoid sharp increases in customers’ rates or to smooth out rate increases over an extended time frame. Revenue Rate Stabilization Reserve funding is targeted at 20% of annually budgeted operating revenues.



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Recommended Target Level – The Revenue Rate Stabilization Reserve shall have an amount equal to 20% of annually budgeted operating revenues. Upon the recommendation of the General Manager and notwithstanding the recommended minimum level, the Agency Board may approve the use of all the funds on deposit in the Revenue Rate Stabilization Reserve towards offsetting a proposed rate increase.

Events or Conditions Prompting Use of the Reserve – Upon the approval by the Agency Board, such amounts shall be transferred to the Agency’s revenue fund.

Source of funding – Net cash from operations.

4.5 Emergency Reserves

This reserve is established to provide additional liquidity in the event of a natural disaster, financial crisis, various economic uncertainties or financial hardships, loss of significant revenue sources, local disasters or capital obligations, cash flow requirements, unfunded mandates including costly regulatory requirements and other such needs. These amounts should supplement monies received from insurance policies and by state and federal programs.

Recommended Target Level - The Agency shall maintain an Emergency Reserve equal to 120 days of operating expenses, exclusive of (not including) depreciation, amortization of intangibles and debt service. Note that the calculation of 120 days of operating expenses exclusive of depreciation, amortization of intangibles and debt service is made by dividing the annual total by 360 days then multiplying by 120. This method is commonly used to determine an average daily or number of days of expenditure but does not consider the actual timing of any specific expenditures.

Replenishment – Upon the amount on deposit declining below 60 days on deposit, the Agency will take steps to restore the amount on deposit within two years to the recommended target level.

Events or Conditions Prompting Use of the Reserve – At the recommendation of the General Manager, or designee, the Agency Board may authorize the use of funds from the Emergency Reserve. Upon the occurrence of an event identified above and until such time that the Board can act, the General Manager is authorized to approve the use of an amount of funds equal to 15 days of operating expenses.



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Source of funding –Net cash from operations.

5.0 REPORTING

The annual Budget document will include a reserve analysis, showing reserve amounts and targets for each reserve. Staff will identify any major change in conditions which may threaten reserve levels and the General Manager will provide an analysis to the Board of Directors. This analysis would include an explanation of why reserve levels are below targeted levels and/or a recommended course of action to improve reserve levels.

The following table summarizes the Unrestricted Reserve Fund Policy target levels:
Table 1.0

Reserve Requirements	
Reserve	Target
Operating	120 days of annual budgeted operating expense, including debt service
Capital (Pay-go)	Upcoming year budget for pay-go projects
Water Supply Reliability	The cost to produce 10,000-acre feet from the Agency's banking program in a dry year
Revenue Rate Stabilization	20% of annually budgeted operating revenues
Emergency	120 days of operating expenses, excluding debt service

(Originally adopted November 2018; revised December 2020)