

AGENDA

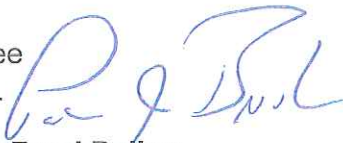
**INVESTMENT AND FINANCE COMMITTEE MEETING
LEUCADIA WASTEWATER DISTRICT**

January 31, 2011 – 9:00 a.m.
1960 La Costa Avenue, Carlsbad, CA 92009

1. **Call to Order**
2. **Roll Call**
3. **Public Comment**
4. **Old Business**
None.
5. **New Business**
 - A. Recommend that the Board of Directors review and approve the proposed revised Reserve Fund Policy; and receive and file the annual Reserve Fund Report. (Pages 1-6)
6. **Information Items**
None.
7. **Director's Comments**
8. **General Manager's Comments**
9. **Adjournment**

MEMORANDUM

Ref: 11-2747

DATE: January 27, 2011
 TO: Investment and Finance Committee
 FROM: Paul J. Bushee, General Manager 
 SUBJECT: Annual Review of LWD Reserve Fund Policy

RECOMMENDATION:

Staff requests that the Investment & Finance Committee (IFC) recommend that the Board of Directors:

1. Review and approve the proposed revised Reserve Fund Policy;
2. Receive and file the annual Reserve Fund Report; and
3. Discuss and take other action, as appropriate.

DISCUSSION:

In February 2005, the Board of Directors (Board) adopted Leucadia Wastewater District's (LWD) Reserve Fund Policy which established a means for the District to ensure that sufficient funds are available for current operating, capital and debt service needs. The policy was last revised in February 2009 following completion of the District's Asset Management Master Plan and Financial Plan Update.

Staff has reviewed the Reserve Fund Policy and is recommending changes that will better reflect the intent of the District's funding strategy. The proposed changes are administrative in nature and are highlighted in the attached policy.

Staff will provide an overview of the proposed policy changes and the reserve balances for the fiscal year ended June 30, 2010. This overview of the reserve balances constitutes the annual review required by the reserve policy.

Restricted Reserves:

| <u>Reserve Designation</u> | <u>Reserve Balance</u> |
|-----------------------------|---------------------------|
| Capital Improvement Reserve | \$3,050,884 |
| Debt Service Reserve | 652,884 |
| Total | <u>\$3,703,768</u> |

Unrestricted Reserves:

| <u>Reserve Designation</u> | <u>Reserve Balance</u> |
|--------------------------------|----------------------------|
| Operations Reserve | \$ 2,184,722 |
| Debt Service Custodial Reserve | 3,253,840 |
| Replacement Reserve | 21,554,781 |
| Water Recycling Reserve | 3,154,544 |
| Emergency Reserve | 7,500,000 |
| Total | <u>\$37,647,887</u> |

cal:PJB

Attachment

**LEUCADIA WASTEWATER DISTRICT
RESERVE FUND POLICY**

Ref: 11-2748

A. POLICY STATEMENT:

One key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital and debt service cost needs. An additional critical element of fiscal responsibility is to anticipate and prepare for future funding requirements as well as for unforeseen disasters and other unforeseen events. The Leucadia Wastewater District (LWD) will at all times strive to have sufficient funding available to meet its operating, capital, and debt service cost obligations. Reserve funds will be accumulated and maintained in a manner, which allows LWD to fund costs consistent with LWD's Long Range ~~Wastewater~~ Capital Plan and Long Range Financial Plan while avoiding significant rate fluctuations due to changes in cash flow requirements. LWD will also maintain an emergency reserve position that may be utilized to fund unexpected disasters or unanticipated major failures. The Board of Directors will annually review the level of reserve funds maintained.

B. DEFINITIONS:

~~There are two types of reserve funds:~~

Restricted Reserves: Restrictions on their use are imposed by an outside source such as creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Reserves: Have no externally imposed use restriction. The use of Unrestricted Reserve funds is at the discretion of the Board of Directors. There are two categories of Unrestricted Reserves -Designated and Undesignated. At LWD, all Unrestricted Reserves are Designated Reserves.

~~—Designated Reserves:~~ Set-aside for a specific purpose, which is, determined by the Board of Directors. ~~Designated Reserves can be either restricted or unrestricted.~~ The Board of Directors also has the authority to redirect the use of these reserve funds as needs of LWD change.

C. LEUCADIA WASTEWATER DISTRICT RESERVES:

LWD maintains the following reserve funds:

1.0 RESTRICTED RESERVES:

a) Capital Improvement Reserve:

The purpose of the Capital Improvement Reserve is to finance future capital facilities that are expansion /growth related. These capital improvements are identified in LWD's Asset Management Master Plan and Comprehensive Financial Plan Update . These reserve funds are accumulated in an orderly manner in conformance with State law and drawn down ~~as required by growth related capital projects in a manner consistent with LWD's Comprehensive Financial Plan Update.~~

b) Debt Service Reserve:

~~The Debt Service Reserve is governed by legal bond covenants. Bond covenants require that the Debt Service Reserve be maintained at a level sufficient to fund maximum annual debt service payments, The Debt Service Reserve funds are held by the bond trustee during~~

~~the term of the bonds and are to be used in the event that LWD is unable to meet its required semi-annual debt service obligation.~~

2.0 UNRESTRICTED DESIGNATED RESERVES:

a) Operating Reserve:

Since the majority of operating revenues are received periodically over the fiscal year and operating expenses are incurred uniformly over the fiscal year, an operating reserve is necessary to fund those costs attributable to daily operations. To meet daily operational needs LWD has established an Operating Reserve balance at 36.4% of annual operating expenses.

b) Replacement Reserve:

The Replacement Reserve provides funds for capital replacement and refurbishment of existing facilities. These capital improvements are ~~also~~ identified in LWD's Asset Management Master Plan and Comprehensive Financial Plan Update. ~~These Replacement~~ reserve funds are accumulated in an orderly manner and drawn down ~~as required to fund capital replacement projects in a manner consistent with the District's Capital Improvement Program.~~ To avoid abrupt sewer service rate changes, this reserve may be used to stabilize rates. The Replacement Reserve shall not exceed the 20-year capital replacement costs as identified in the Comprehensive Financial Plan Update.

LWD's capacity fee represents a system buy-in that takes into account the value of existing capacity pre-built by current users that will benefit future users, and is a source of funding for the Replacement Reserve.

c) ~~Debt Service Custodian Reserve:~~

~~LWD has executed a custodian agreement with a bank for the deposit of securities. All principal payments and interest earnings from the securities are designated for installment payments due on the 1997A Wastewater Revenue Refunding Bonds. Instructions on the use of these funds are revocable at any time by LWD.~~

d) Water Recycling Reserve:

The Water Recycling Reserve will fund capital improvements and replacement of water recycling facilities. This reserve will also be used to fund operating expenses in the Water Recycling Fund whenever there is a shortfall of recycled wastewater sales revenue to operating expenses. These capital improvements are identified in the Long Range Wastewater Capital Plan and the Long Range Financial Plan. The Replacement Reserve shall not exceed the 20-year capital replacement costs as identified in the Long Range Financial Plan.

e) Emergency Reserve:

The Emergency Reserve provides funds for emergency response for potential repair or replacement of capital facilities due to damage from a natural disaster or unanticipated major failure in a period when capital improvements funds have otherwise been purposely spent down to preset limits on planned projects. The Emergency Reserve is at the discretion of the Board of Directors and is maintained at a level of \$7,500,000, which is based on the recommendation by LWD staff and the District Engineer (Exhibit A).

D. SOURCES AND USE OF FUNDS:

| RESERVE | SOURCE OF FUNDS | USE OF FUNDS | NOTES |
|---------|-----------------|--------------|-------|
|---------|-----------------|--------------|-------|

RESTRICTED RESERVES

| | | | |
|-------------------------|--|---|--|
| Capital Improvement | Interest earned on reserve | Growth related capital expenditures | Funds previously accumulated from capacity fees. Now, capacity fees reflect 100% buy-in to the system and are transferred to the Replacement Reserve |
| Debt Service | Originally funded by bond proceeds and interest earned on reserve | Debt service if District unable to pay | As per bond covenants. Interest transferred to Debt Service Custodian Reserve |

UNRESTRICTED DESIGNATED RESERVES

| | | | |
|-----------------------------------|---|--|--|
| Operating | Operating income and interest earned on reserve | Wastewater Operating expenses | Reserve balance maintained at 36.4% of budgeted operating expenses. Excess (deficit) funds transferred to/from Replacement Reserve |
| Replacement | Property taxes and other non-operating income, 100% of Capacity Fees, Excess operating revenues, and Interest earned on reserve | Replacement related capital expenditures and rate stabilization | Limited to 20-year capital replacement costs as identified in the Comprehensive Financial Plan Update |
| Debt Service Custodian | Originally funded by board action. Interest earned on reserve | Debt service of 1997A Phase IV bonds | Tied to 1997A Phase IV bond debt service, which will be paid off in FY 2015. Revocable. Excess funds transferred to Replacement Reserve |
| Water Recycling | Recycled Water sales and interest earned on reserve | Recycled Water capital improvement and replacement as well as operating expenses | Limited to 20-year capital replacement costs as identified in the Comprehensive Financial Plan Update . |
| Emergency | Originally funded by board action. Interest earned on reserve | Emergency repair or replacement expenditures | Reserve balance maintained at \$7,500,000 level. Excess funds transferred to Replacement Reserve |

EXHIBIT A

Leucadia Wastewater District Discussion of Emergency Reserve Fund

Maintenance of an Emergency Reserve Fund (ERF) would provide the benefit of providing funds for emergency response for repair or replacement of capital facilities potentially necessary due to natural disaster damage or unanticipated major failure in a period when capital improvement funds have otherwise been purposely spent down to preset limits on planned projects. Separately, Capital Reserve Funds will be accumulated in a planned manner through financing, setting aside a portion of sewer service fees, or a combination of both methods, as determined by Board policy.

The amount to be recommended for maintenance in the ERF has been evaluated and discussed by Leucadia Wastewater District (LWD) staff and the District Engineer. The following table lists some pros and cons for three potential levels of ERF.

| ERF Alternatives | Pros | Cons |
|--|--|--|
| Alternative 1: LWD maintain small ERF of \$1.0 million | <ol style="list-style-type: none"> 1) Reduces initial reliance on borrowing. 2) Would extend period of reduced rate increases. | <ol style="list-style-type: none"> 1) Not enough reserve to respond to many reasonably possible emergency events. 2) Increased risk at point of ERF exhaustion that emergencies could not be responded to timely. 3) Reduced District liquidity and lesser financing qualifications. 4) Increased long term reliance on borrowing. |
| Alternative 2: LWD maintain a Moderate ERF of \$7.5 million | <ol style="list-style-type: none"> 1) Sufficient funds to adequately replace or repair two major District facilities on an emergency basis. 2) Sufficient funds to replace or repair about six or seven concurrent intermediate size facility problems at any given time. 3) Unlikely to deplete ERF in a time period that would not allow establishment of additional financing, if necessary. 4) Provides opportunity for investment of modest amount of about 1.5 years worth | <ol style="list-style-type: none"> 1) Ties up \$7.5 million of funds that could be used to offset or defer rate increases. 2) May be considered as ability to pay discretionary fines in the potential event of a major wastewater spill. 3) Over time, it may be determined that the \$7.5 million amount should be decreased or increased depending on facility performance and risk tolerance. |

| | | |
|--|---|---|
| | <p>of sewer service fee collections.</p> <p>5) Provides ability to fund one to two years of typical CIP schedule projects, while additional funding is being established.</p> <p>6) Increases liquidity of District that would be considered positively by financial markets when considering other financing issues.</p> | |
| <p>Alternative 3: LWD maintain a Large ERF of \$15 million</p> | <p>1) Very little risk that any emergency situation would result that funds were not available for immediate response.</p> | <p>1) Maintenance of large reserves is considered by some watch dog entities as a negative attribute.</p> |

Based on an analysis of the above three ERF funding alternatives above, LWD staff and the District Engineer recommend that LWD adopt Alternative 2 – LWD Maintain a Moderate ERF of \$7.5 million.