

AGENDA

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

Monday, January 31, 2022 – 11:00 a.m.
Via Teleconference

Pursuant to the State of California Executive Order N-29-20, and in the interest of public health, the District is temporarily taking actions to mitigate the COVID-19 pandemic by holding meetings by teleconference. The general public may not attend this meeting at the District's office due to social distancing requirements.

Members of the public attending via teleconference will be provided with an opportunity to comment on each agenda item prior to Committee discussion.

To join this meeting via Teleconference please dial: (669) 900-6833
Meeting ID: 812 8106 1893 Password: 788387

1. **Call to Order**
2. **Roll Call**
3. **Public Comment**
4. **New Business**
 - A. Annual Review of LWD Reserve Fund Policy. (Pages 2-7)
5. **Information Items**

None.
6. **Directors' Comments**
7. **General Manager's Comments**
8. **Adjournment**

MEMORANDUM

Ref: 22-7856

DATE: January 27, 2022
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 and Finance Committee (IFC) recommend that the Board of Directors:

1. Receive and file the Annual Reserve Fund Review Report; and
2. Discuss and take other action, as appropriate.

DISCUSSION:

Tactical Goal: Financial / Finance Policy Reviews

In February 2005, the Board of Directors (Board) adopted Leucadia Wastewater District’s (LWD) Reserve Fund Policy which established a means for LWD to ensure that sufficient funds are available for current operating and capital needs. The policy was last reviewed in February 2021 and last revised in February 2020.

The Reserve Fund Policy establishes two distinct reserves at LWD: 1) Restricted Reserves and 2) Unrestricted Reserves. The policy also establishes various designations within each type of reserve and calls for an annual review of the reserve balances. This report constitutes that review.

Staff has reviewed the Reserve Fund Policy and is recommending no changes to the existing Reserve Fund Policy. A copy of the policy is attached for the committee’s review.

During November 2021, the Board received the Annual Comprehensive Financial Report (ACFR) for the fiscal year ended June 30, 2021 that included the following reserve balances:

Restricted Reserves:

| <i>Reserve Designation</i> | <i>Reserve Balances</i> |
|--|-------------------------|
| <i>Capital Improvement Reserve</i> | \$ - |
| <i>Encina Wastewater Authority Reserve</i> | \$2,041,200 |
| Total | \$2,041,200 |

Unrestricted Reserves:

| <i>Reserve Designation</i> | <i>Reserve Balances</i> |
|--------------------------------|-------------------------|
| <i>Operations Reserve</i> | \$ 2,831,306 |
| <i>Replacement Reserve</i> | \$12,870,043 |
| <i>Water Recycling Reserve</i> | \$ 1,469,106 |
| <i>Emergency Reserve</i> | \$ 7,500,000 |
| Total | \$24,670,455 |

Staff will provide an overview of the FY 2021 reserve activity during the committee meeting.

reg:PJB

Attachment

Exhibit A

LEUCADIA WASTEWATER DISTRICT
RESERVE FUND POLICY

Ref: 20-7013

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 adopted Asset Management Plan and 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:

Restricted Reserves: These reserves have restrictions on their use that are imposed by outside sources such as creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Reserves: These 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 have been Designated.

Designated Reserves: These reserves are set-aside for a specific purpose, which is determined by the Board of Directors. The Board of Directors also has the authority to redirect the use of these reserve funds as the 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 Plan and Financial Plan. These reserve funds are accumulated in an orderly manner in conformance with State law and drawn down as required by growth related capital projects.

b) Encina Wastewater Authority Reserve:

LWD is a member agency of the Encina Wastewater Authority Joint Powers Authority (EWA). EWA maintains member agency deposits on hand to meet its operational, inventory, and capital demands during any quarter. These deposits are restricted for that use.

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 33% of annual budgeted operating expenses.

b) Replacement Reserve:

The Replacement Reserve provides funds for capital replacement and refurbishment of existing wastewater facilities. These capital improvements are identified in LWD's adopted Asset Management Plan and Financial Plan. Replacement Reserve funds are accumulated in an orderly manner and drawn down as required to fund capital replacement projects. To avoid abrupt sewer service rate changes, this reserve may be used to stabilize rates. The Replacement Reserve shall not exceed the total 20-year capital replacement costs for wastewater facilities as identified in the Financial Plan. The yearly average of the 20-year capital replacement costs is the minimum target balance to ensure that LWD is able to fund capital replacements as they are scheduled or needed.

c) Water Recycling Reserve:

The Water Recycling Reserve will fund capital improvements and replacement of water recycling facilities. This reserve can also be used to fund operating expenses in the Water Recycling Fund whenever there is a shortfall of recycled wastewater sales revenue. These capital improvements are identified in LWD's adopted Asset Management Plan and Financial Plan. The Water Recycling Reserve shall not exceed the total 20-year capital replacement costs for water recycling facilities as identified in the Financial Plan.

d) 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).

For further detail of the sources and uses of the above reserves please refer to following section "D".

D. SOURCES AND USE OF FUNDS:

This section describes the sources and uses of funds for LWD reserves and includes maximum and minimum reserve balances and other informational notes.

RESTRICTED RESERVES

| RESERVE | SOURCE OF FUNDS | USE OF FUNDS | NOTES |
|---------------------|--|---|--|
| 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 |
| EWA | Funds transferred from LWD to EWA for deposit with EWA | Funds transferred back from EWA to LWD due to reduction in deposit requirements | Deposit balances determined by EWA approved financial reserve policy. Deposit is for EWA Operating, Inventory, and Capital demands during any quarterly period |

UNRESTRICTED DESIGNATED RESERVES

| RESERVE | SOURCE OF FUNDS | USE OF FUNDS | NOTES |
|-----------------|---|--|---|
| Operating | Operating income and interest earned on reserve | Wastewater Operating expenses | Reserve balance maintained at 33% of budgeted operating expenses. Excess (deficit) funds transferred to (from) Replacement Reserve |
| Replacement | Property taxes, interest earned on reserve, 100% of Capacity Fees, and other non-operating income. Also excess operating net income transferred from Operating Reserve, and excess interest earned on emergency reserve | Replacement related capital expenditures and rate stabilization | Maximum reserve balance is 20-year capital replacement costs as identified in the Financial Plan. Minimum reserve target balance is the yearly average of the 20-year capital replacement costs as identified in the Financial Plan |
| Water Recycling | Recycled Water sales, grant income, and interest earned on reserve | Recycled Water capital improvement and replacement costs as well as water recycling operating expenses | Maximum reserve balance is 20-year capital replacement costs as identified in the Financial Plan. |
| Emergency | Originally funded by board action. Interest earned on reserve. Additional funding as needed to maintain Reserve level. | Emergency repair or replacement expenditures | Reserve balance maintained at \$7,500,000 level. Excess (deficit) funds transferred to (from) 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.