MOULTON NIGUEL WATER DISTRICT
RESERVE POLICY

PURPOSE

This policy outlines the funding, utilization, and replenishment of the District's reserves consistent with the financial controls established as part of its annual budget process. Additionally, this policy establishes the target reserve balances necessary for maintaining the District's credit worthiness and for adequately providing for:

- Funding infrastructure replacement and refurbishment
- Economic uncertainties, extraordinary costs, and other financial impacts
- Loss of significant revenue sources such as property tax receipts or connection fees
- Local disasters or catastrophic events
- Losses not covered by insurance
- Future debt or capital obligations
- Cash flow requirements

POLICY

A. GENERAL RESERVES

1. General Operating Reserve (Fund 1)

The District will maintain a General Operating Reserve in order to provide sufficient liquidity for funding the day-to-day operating expenses and supporting the District's cash flow needs during normal operations. There is often a delay between the receipt of revenues and the payment of expenses and the establishment of a reserve to mitigate or eliminate the risk of monthly negative cash positions represents prudent financial planning. The target balance of the General Operating Reserve will equal three months of operating expenses consistent with best practices in the industry for agencies with monthly rate revenue. Sufficient funding for the General Operating Reserve shall be identified at the beginning of each fiscal year and maintained within Fund 1.

2. Self-Insurance Reserve (Fund 4)

The District will maintain a Self-Insurance Reserve in order to fund property and liability insurance deductibles, losses exceeding insurance limits, and unemployment benefit payments in the event that a claim is made. The target amount of the Self-Insurance Reserve will equal five times the current JPIA property insurance deductible (current deductible is up to $50,000). Sufficient funding for the Self-Insurance Reserve shall be provided at the beginning of

each fiscal year via budget transfers and maintained in the Self-Insurance Fund (Fund 4).

3. Rate Stabilization Reserve (Fund 52)

Since one of the biggest risks and impacts on rates would be a loss of property tax revenues and due to the timing in the receipt of property tax, to avoid large fluctuations in customer water and sewer rates, the District will fund a Rate Stabilization Reserve to provide for losses of revenue, significant increases in water purchase costs, and other extraordinary financial impacts to revenues and expenses. The target balance of the Rate Stabilization Reserve will be set equal to fifty percent of the District's budgeted 1% ad valorem property tax revenue. The Rate Stabilization Reserve will be maintained in the Rate Stabilization Fund.

B. CAPITAL IMPROVEMENT RESERVES

The Replacement and Refurbishment (R&R) Reserve, the Emergency Reserve, the Water Supply Reliability Reserve, the Planning and Construction Reserve, and the Capital Facilities Restricted Reserve will constitute the District's Capital Reserves. Key objectives for accumulating these Reserves are to fund projects identified in the Long Range Financial Plan and the Ten-Year Capital Improvement Plan, to reduce the volatility of water and sewer rate increases and to quickly repair critical assets in the event of a natural disaster or facility failure.

1. Replacement and Refurbishment (R&R) Reserve (Fund 7)

The R&R Reserve will fund the ongoing costs related to the replacement and refurbishment of existing assets in conjunction with the District's Capital Improvement Plan. All amounts will be maintained in a separate R&R Fund. Funding for the R&R Reserve will be from new debt issuances or fund transfers as part of the budget process.

2. Emergency Reserve (Fund 1)

The Emergency Reserve will provide funds to enable the District to quickly repair critical assets in the event of a natural disaster or facility failure. The target balance of the Emergency Reserve will equal 2% of the replacement costs of the District's assets, as outlined in current guidelines from the Federal Emergency Management Agency (FEMA).

3. Water Supply Reliability Reserve (Fund 12)

The Water Supply Reliability Reserve will fund the development of new water or recycled water supplies as identified in the District Capital Improvement Plan. All amounts will be maintained in a separate Water Supply Reliability Fund. Funding for the Water Supply Reliability Reserve will be from new debt issuances or fund transfers as part of the budget process.

4. Planning and Construction Reserve (Fund 14)

The Planning and Construction Reserve will fund the development of new capital facilities that do not result in new water or recycled water supplies as identified in the District Capital Improvement Plan. All amounts will be maintained in a separate Planning and Construction Fund. Funding for the Planning and Construction Reserve will be from new debt issuances or fund transfers as part of the budget process.

5. Capital Facilities Restricted Reserve (Fund 15)

The Capital Facilities Restricted Reserve will fund the development of new district-wide capital facilities or replacement or refurbishment. All amounts will be maintained in a separate Capital Facilities Restricted Reserve Fund and transferred to Funds 7, 12, or 14 as part of the annual budget process. Funding for the Capital Facilities Restricted Reserve will be from capacity fees charged to new developments to buy into existing assets.

C. DEBT SERVICE RESERVE

1. Debt Service Reserve

The District will fund Debt Service Reserves, which are held in trust with a third party trustee as provided for in bond covenants. Increases and decreases to these reserves will be consistent with bond covenants. The District's accounting records show these amounts in various debt funds.

D. PROCEDURE FOR USING RESERVE FUNDS

1. General Operating, and Self-Insurance

General Operating, and Self-Insurance Reserves can be used at any time to meet cash flow requirements of District operations. Authority to use the funds will be consistent with the District's Purchasing Policy.

2. Rate Stabilization Reserve

The Rate Stabilization Reserve can be used at any time to meet cash flow requirements of District operations. The use of the Rate Stabilization Reserve will require Board authorization.

3. Capital Improvement Reserves

The Board of Directors will authorize the use of the Replacement and Refurbishment, Planning and Construction, and Water Supply Reliability Reserves during the budget process. Funds from the Capital Facilities Restricted Reserve are transferred to the R&R, Planning and Construction, and/or Water Supply Reliability Reserves as part of the budget process. The Emergency Reserve is also available for unplanned (unbudgeted) capital replacement and emergency expenditures in the event of a natural disaster or

facility failure. When appropriate, the Board may adopt Reimbursement Resolutions as necessary to advance reserves prior to obtaining external capital financing. Authorization for the use of Capital Improvement Reserves for unplanned capital replacement will be consistent with the District's Purchasing Policy.

E. PROCEDURE FOR REPLENISHING RESERVE FUNDS

1. General Operating, Self-Insurance, and Rate Stabilization Reserves

General Reserves are replenished from the District's revenues with the General Operating and Self-Insurance Reserves taking precedence to the Rate Stabilization Reserve. General Operating and Self Insurance Reserves will be replenished by the end of each fiscal year. The Rate Stabilization Reserve will be replenished as soon as possible with replenishment to commence within 12 months of any Rate Stabilization Reserve draw to bringing the reserve in line with targets.

2. Capital Improvement Reserves

The R&R, Planning and Construction, and Water Supply Reliability Reserves are replenished at year end as part of the budget process via transfers or through debt issuances. The Emergency Reserve is replenished from the District's revenue as quickly as possible after an emergency outside of the budgeting process. The Capital Facilities Restricted Reserve is funded by developer's capacity fees throughout the year and transferred to the R&R, Planning and Construction, and Water Supply Reliability Reserves as part of the budget process. The District's General Manager or Director of Finance/Treasurer will do a full review of the District's Long Range Financial Plan and cash flow models to determine if corrective actions are needed to replenish the funds in the event of a draw on the Emergency Reserve.

F. PROCEDURE FOR MONITORING RESERVE LEVELS

The General Manager or Director of Finance/Treasurer will submit a reserve analysis to the Board of Directors upon the occurrence of the following events:

- Board of Directors' consideration of the annual budget;
- Board of Directors' consideration of a water and sewer rate increase; and
- When a major change in conditions threatens the reserve levels established within this Policy.

If the analysis indicates projected or actual individual reserve levels would fall 10% or more below the target levels outlined in this Policy, at least one of the following actions shall be included with the analysis:

- An explanation of why the reserve levels are not at the targeted level; and/ or

- Actions needed to bring reserve levels within the target levels prescribed.

In addition, the district will utilize the internal Long Range Financial Plan and 10 year and monthly cash flow models to determine forecasted reserve target shortfalls and report on needed corrective actions.