

Exhibit “A”
To Resolution No. 2261



MONTECITO WATER DISTRICT RESERVE POLICY

DRAFT

Adopted by the
Board of Directors
June XX, 2023

Montecito Water District

STATEMENT OF RESERVE POLICY

The mission of Montecito Water District is to provide an adequate and reliable supply of high-quality water to the residents of the Montecito and Summerland communities at the most reasonable cost. In addition to supplying high-quality water, the Board is also charged with responsibility for the construction, operation, maintenance, repair and replacement of facilities to transport and deliver that water to District customers, and for the collection and accumulation of revenues necessary to accomplish these purposes. The reserve amounts stated in this document reflect the projected activity as of July 1, 2023, for FY 2024 and will be updated annually or as appropriate.

POLICY STATEMENT

A key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital, and debt service needs. Additionally, fiscal responsibility requires anticipating the likelihood of, and preparing for, unforeseen events. Montecito Water District (District) desires to identify, and provide a calculation methodology to maintain, an appropriate level of reserve funds to meet the necessary existing and future needs of the District. The District's Board of Directors realize the importance of reserves in providing reliable service to its customers, financing unanticipated capital projects, and funding responses to emergencies, should they arise. To this extent, the District will at all times strive to have sufficient funding available to meet its operating, unanticipated capital, emergency, and debt service obligations, as well as to avoid significant rate fluctuations due to changes in cash flow requirements.

The Board may designate specific reserve funds and maintain minimum reserve balances consistent with statutory obligations that it has determined to be in the best interest of the District. The Policy directives outlined in this document are intended to ensure that the District has sufficient funds to meet current and future needs. The Board reviews the types, as well as the amounts, of reserve funds annually. Determinations to continue existing reserve funds, or establish new reserve funds, are based on the following criteria:

- ◆ Purpose of the reserve.
- ◆ Availability and source of funds to continue, replenish or establish the reserve.
- ◆ Operating expenditure levels approved within the annual budget process.
- ◆ Future capital expenditure and debt service requirements of the District.
- ◆ Board approval of the reserve policy.

The District recognizes the importance of operating the District with a sound business plan in place that provides for unanticipated or emergency costs should they arise within a budgeted fiscal year.

It is the Board's intent through this Policy to describe how and why specific reserves are established and maintained by the District, and to provide the District's customers with assurance that reserve balances will be maintained at prudent and fiscally responsible levels.

DEFINITIONS

This Policy describes the reserve funds to be maintained in connection with:

- I. **RESTRICTED FUNDS:** Restrictions on the use of these funds are imposed by an outside source such as creditors, grantors, contributors, laws, or regulations governing use. These funds are specifically governed by a written contract with the District or outlined within the debt covenants of a debt financing.
- II. **UNRESTRICTED FUNDS:** These funds have no externally imposed use restrictions. The use of Unrestricted Funds is at the discretion of the District’s Board of Directors. Unrestricted Funds may be designated for a specific purpose, which would be determined by the Board. The Board also has the authority to redirect the use of these funds as the District’s needs change.

The Unrestricted funds can further be subdivided into “Committed”, “Assigned” and “Unassigned” funds. Committed funds refer to the fund balance amounts that have constraints imposed by formal action of the District’s Board of Directors. Once adopted, the limitation imposed remains in effect until additional action is taken (the adoption of a new resolution) to remove or reverse the limitation. Assigned funds refer to fund balance amounts that are constrained by the Board’s intent to be used for a specific purpose but are neither restricted nor committed. Unassigned funds refer to fund balances that are not restricted, committed, or assigned.

To summarize:

- ◆ **Restricted Fund Balance Amounts** – Restrictions on the use of these funds are imposed by an outside source such as creditors, grantors, contributors, laws, or regulations governing use.
- ◆ **Board Committed Fund Balance Amounts** - Fund balance amounts that have constraints imposed by formal action of the District’s Board of Directors.
- ◆ **Board Assigned Fund Balance Amounts** – Fund balance amounts that are constrained by the Board’s intent to be used for a specific purpose.
- ◆ **Unassigned Fund Balance Amounts** – Fund balance that is not restricted, committed, nor assigned.

GENERAL PROVISIONS

The District will maintain its operating and capital funds in designated accounts in a manner that ensures its financial soundness and provides transparency to its customers. The fund balances are considered the minimum necessary to maintain the District’s fiscal strength and flexibility and adequately provide for:

- ◆ Compliance with applicable statutory requirements.
- ◆ Financing of unanticipated or unplanned capital projects.
- ◆ Cash flow requirements.
- ◆ Economic uncertainties and other financial hardships or downturns in the economy.
- ◆ Contingencies arising from hydrological, meteorological, or man-made changes or emergencies.

Through a variety of policy documents and plans, the Board of Directors has set forth a number of long-term goals for the District. The fundamental purpose of the District's policy documents and plans is to link what must be accomplished with the necessary resources to successfully do so. The Board will continually evaluate the implementation of these policy documents and plans to ascertain adequate reserve fund balances are meeting the goals outlined in this Policy.

The District has established and will maintain the reserve funds outlined in the following sections. A principal tenet of the District's Reserve Policy shall be the generation of interest income on accumulated cash balances. Unless otherwise stated in this Reserve Policy, interest derived from reserve balances will be considered unrestricted and unassigned in nature. Reserve balances will be reviewed by the Business Manager on a monthly basis, as well as annually during the budget review process, in order to determine how reserve fund balances, compare with the budgeted projections and how they measure against the goals outlined in this Policy. The minimum established for each reserve fund represents the baseline financial condition that is acceptable to the District from risk and long-range financial planning perspectives. Maintaining reserve funds at appropriate levels is a prudent, ongoing business process that consists of an iterative, dynamic assessment and application of various funding alternatives. These alternatives (either alone or in combination with each other) include, but are not limited to rates, loans and grants, debt financing, investment of funds, and levels of capital expenditures.

The Board shall approve any reallocation of funds or any transfers among reserve funds.

SPECIFIC PROVISIONS

The District will maintain the following reserve funds and respective target levels:

1. Restricted Reserves

(a) CCWA Rate Coverage Reserve – These are reserve funds held by CCWA that approximate 25% of the annual charge by CCWA to the District for the fixed and variable charges from the State Water Project, in addition to the proportionate share of CCWA's administrative costs. The CCWA Rate Coverage Reserve is established in the amount of **\$1,495,258**.

(b) WSA Debt Service Coverage Deposit– These reserve funds held by the City of Santa Barbara represent an amount equal to the District's portion of City's debt service coverage deposit required pursuant to the City's State Revolving Fund loan for the desalination plant. The WSA Debt Service Coverage Deposit is in the amount of **\$481,580**.

(c) WSA Debt Service Reserve Deposit – These reserve funds held by the City of Santa Barbara represent the District's portion of the debt service reserve deposit required pursuant to the City's State revolving fund loan for the desalination plant. The WSA Debt Service Reserve Deposit at the end of FY2024 is in the amount of **\$740,892**.

(d) Thomas Fire/Debris Flow CalOES/FEMA Reserve– A result of the settlement between the District and Southern California Edison in connection with damages caused by the 2017 Thomas Fire, a portion of the settlement (referred to as "holdback funds") was held in escrow until reconciliation of project funding was complete. The reconciliation determined **\$1,492,830.71** is due back to CalOES. These funds will remain in reserve until their return is requested by CalOES/FEMA.

2. Unrestricted Reserves

Board Committed Funds

The District's Board Committed Funds consist of a Rate Stabilization Fund. The Rate Stabilization Fund includes various cash reserves serving specific purpose as described below. The Board desires a minimum Board Committed fund balance target, composed of the Reserve for Operations, Reserve for Emergencies, and Reserve for Unanticipated or Unplanned Capital Repair & Replacement of \$5,000,000.

(a) **Rate Stabilization Fund.** The Rate Stabilization Fund is comprised of cash reserves that can mitigate the impacts of operational, debt service and capital expenditure fluctuations year over year. Reserves can be transferred out of the rate stabilization fund and used to help meet debt service coverage requirements. Rate stabilization reserves can help smooth revenue variability and ensure adequate fiscal resources during periods that might otherwise require rate increases.

All retained earnings from water rates not allocated to any other funds may be placed in the Rate Stabilization Fund. Funds appropriated to the Rate Stabilization Fund may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the Unrestricted Fund balance.

Below are components of the Rate Stabilization Fund:

- **Reserve for Operations.** The Reserve for Operations may be utilized to pay the cost of operating the District's system, including unanticipated costs associated with operations. This reserve is designated by the Board to maintain working capital for operations and to meet routine cash flow needs. The District shall endeavor to maintain in the "Reserve for Operations" an amount sufficient to pay for approximately 90 days of normal operations of the District. The District's 5-year financial plan and *Water Cost of Service and Rate Study* produced by Raftelis, dated May 7, 2020, suggests a reserve balance of \$3.4 million. The Board may, at its discretion, appropriate additional Unassigned Funds to the Reserve for Operations. The Board of Directors establishes a Reserve for Operations in the amount of **\$2,800,000**.
- **Reserve for Emergencies.** The "Reserve for Emergencies" may be utilized in the event of a hydrological, meteorological, or man-made emergency in which the District's infrastructure is severely damaged. While the District strives to have adequate insurance coverage and protection for events of this nature, it may be necessary for the District to have cash available in the interim. The funds appropriated to the "Reserve for Emergencies" may be accessed at any time for any other District purpose, upon approval by the Board. Funds appropriated to the "Reserve for Emergencies" may be invested in the same manner as other District funds, and the earnings thereon shall be credited to the District's Unassigned fund balance. The 5-year financial plan and *Water Cost of Service and Rate Study* produced by Raftelis, dated May 7, 2020, suggests a reserve amount of \$0.5 million. The Board of Directors establishes a Reserve for Emergencies in the amount of **\$500,000**.
- **Reserve for Unanticipated or Unplanned Capital Repair & Replacement.** The "Reserve for Unanticipated or Unplanned Capital Repair & Replacement" may be utilized to construct or procure new infrastructure for the District; expenditures include but are not limited to transmission and distribution capital assets, buildings, pumping equipment, technical

equipment, and transportation equipment. The District's 5-year financial plan and *Water Cost of Service and Rate Study* produced by Raftelis, dated May 7, 2020, suggests a reserve balance of \$0.5 million. The Board of Directors establishes a Reserve for Unanticipated or Unplanned Capital Repair & Replacement in the amount of **\$500,000**.

- **SWP Prefunding Reserve**

The State Water Project (SWP) Prefunding Reserve is used to fund the District's annual SWP fixed payment. The reserve is funded through current rates and funds the subsequent fiscal years SWP payment. The SWP payment is for the District's proportionate share of Central Coast Water Authority's SWP fixed payments, which includes Department of Water Resources fixed payments. The District's SWP fixed payment for FY2024, as budgeted is **\$4,352,473**, and the monthly SWP prefunding amount is **\$362,706**.

- **WSA (Desal) Prefunding Reserve**

In September 2020, the District consummated a 50-year Water Supply Agreement (WSA) with the City of Santa Barbara, supported by the City's desalination facility. Water deliveries pursuant to the WSA began January 2022. The District's 2020 *5-Year Financial Plan* and *Water Cost of Service and Rate Study* incorporated 3.5 year of WSA expenses (Jan 2022 through June 2025) spread over a 5-year period to help smooth water rates. This approach prefunded WSA expenses between July 1, 2020, and December 31, 2021. This prefunding is used monthly to supplement current rate revenue to fund monthly WSA payments. In June 2022, the Board allocated an additional \$1,200,000 to WSA Prefunding to cover increased costs. The WSA prefunding balance as of July 1, 2023, is **\$3,821,605**, and is reduced monthly by **\$159,233**.

Board Assigned Funds

Board Assigned Fund balances can vary over the fiscal year depending on their intended use. The Board Assigned Fund include the following:

- a) **WSA Pay-Go Capital Reserve**

The WSA Pay-Go Capital Reserve is to be used to fund pay-go capital expenses associated with the City of Santa Barbara's Desalination Plant, which is central to the District's participation in the Water Supply Agreement (WSA). Pay-Go Capital consists of capital improvements that are funded in full using cash reserves. As a condition of the WSA, the District must fund a portion of the costs of maintaining the City's Desalination Plant, and associated infrastructure. This reserve is funded \$300,000 annually to a maximum of \$1.2M. As of July 1, 2023, the District has funded this reserve over 4 years to the maximum \$1,200,000. The WSA Pay-Go Capital Reserve is used monthly to fund Pay-Go Capital pursuant to the WSA and the reserve balance as of July 1, 2023, is **\$655,109**.

Board Unassigned Funds

The Board desires to allocate retained earnings not allocated to any other fund, i.e., unassigned funds, to the Rate Stabilization Fund and to maintain a Board Unassigned Funds balance of \$0.

3. Additional Reserves

In addition to the reserves identified above, the Board may approve the creation of such additional reserve accounts and/or funds, whether temporary or permanent, as the Board deems necessary or appropriate, by amendment to this resolution or by simple motion. In such event, the Board will identify the purposes for which such additional reserve accounts and/or funds are created, provide guidance as to the amount which the District should endeavor to maintain in each such reserve accounts and/or funds, and establish the limits and restrictions pertaining thereto.

ANNUAL REPORTS

Each year the District's General Manager or Business Manager shall provide the Board of Directors with a report indicating the beginning and ending balance for each of the Restricted and Unrestricted Reserves, or accounts created pursuant to this policy, and the purposes for which expenditures have been made therefrom and shall make recommendations to replenish or augment fund or account balances as appropriate.

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