

## WASTEWATER COLLECTION UTILITY RESERVES MANAGEMENT PRACTICES

The following reserves management practices shall be used when developing the Wastewater Collection Utility Financial Plan:

### Section 1. Definitions

- a) “Financial Planning Period” – The Financial Planning Period is the range of future fiscal years covered by the Financial Plan. For example, if the Financial Plan delivered in conjunction with the FY 2015 budget includes projections for FY 2015 to FY 2019, FY 2015 to FY 2019 would be the Financial Planning Period.
- b) “Fund Balance” – As used in these Reserves Management Practices, Fund Balance refers to the Utility’s Unrestricted Net Assets.
- c) “Net Assets” - The Government Accounting Standards Board defines a Utility’s Net Assets as the difference between its assets and liabilities.
- d) “Unrestricted Net Assets” - The portion of the Utility’s Net Assets not invested in capital assets (net of related debt) or restricted for debt service or other restricted purposes.

### Section 2. Reserves

The Wastewater Collection Utility’s Fund Balance is reserved for the following purposes:

- a) For existing contracts, as described in Section 3 (Reserve for Commitments)
- b) For operating and capital budgets re-appropriated from previous years, as described in Section 4 (Reserve for Re-appropriations)
- c) For cash flow management and contingencies related to the Wastewater Collection Utility’s Capital Improvement Program (CIP), as described in Section 5 (CIP Reserve)
- d) For rate stabilization, as described in Section 6 (Rate Stabilization Reserve)
- e) For operating contingencies, as described in Section 7 (Operations Reserve)
- f) Any funds not included in the other reserves will be considered Unassigned Reserves and shall be returned to ratepayers or assigned a specific purpose as described in Section 8 (Unassigned Reserves).

### Section 3. Reserve for Commitments

At the end of each fiscal year the Reserve for Commitments will be set to an amount equal to the total remaining spending authority for all contracts in force for the Wastewater Collection Utility at that time.

### Section 4. Reserve for Re-appropriations

At the end of each fiscal year the Reserve for Re-appropriations will be set to an amount equal to the amount of all remaining capital and non-capital budgets, if any, that will be re-appropriated to the following fiscal year in accordance with Palo Alto Municipal Code Section 2.28.090.

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## **Attachment D**

### **Section 5. CIP Reserve**

The CIP Reserve is used to manage cash flow for capital projects and acts as a reserve for capital contingencies. Staff will manage the CIP Reserve according to the following practices:

- a) The following guideline levels are set forth for the CIP Reserve. These guideline levels are calculated for each fiscal year of the Financial Planning Period and approved by Council Resolution.

Minimum Level	20% of the maximum CIP Reserve guideline level
Maximum Level	Average annual (12 month) <sup>1</sup> CIP budget, for 48 months of budgeted CIP expenses <sup>2</sup>

- b) Changes in Reserves: Staff is authorized to transfer funds between the CIP Reserve and the Reserve for Commitments when funds are added or removed from to that reserve as a result of a change in contractual commitments related to CIP projects. Any other additions to or withdrawals from the CIP reserve require Council action.
- c) Minimum Level:
- i) If, at the end of any fiscal year, the minimum guideline is not met, staff shall present a plan to the City Council to replenish the reserve. The plan shall be delivered by the end of the following fiscal year, and shall, at a minimum, result in the reserve reaching its minimum level by the end of the next fiscal year. For example, if the CIP Reserve is below its minimum level at the end of FY 2017, staff must present a plan by June 30, 2018 to return the reserve to its minimum level by June 30, 2019. In addition, staff may present, and the Council may adopt, an alternative plan that takes longer than one year to replenish the reserve, or that does so in a shorter period of time.
- d) Maximum Level: If there are funds in this reserve in excess of the maximum level staff must propose in the next Financial Plan to transfer these funds to another reserve, return the funds to ratepayers, or designate a specific use of the funds for CIP investments that will be made by the end of the next Financial Planning Period. Staff may also seek City Council to approve holding funds in this reserve in excess of the maximum level if they are held for a specific future purpose related to the CIP.

### **Section 6. Rate Stabilization Reserve**

Funds may be added to the Rate Stabilization Reserve by action of the City Council and held to manage the trajectory of future year rate increases. Withdrawal of funds from the Rate Stabilization Reserve requires Council action. If there are funds in the Rate Stabilization Reserve at the end of any fiscal year, any subsequent Wastewater Collection Utility Financial Plan must result in the withdrawal of all funds from this Reserve by the end of the Financial Planning Period.

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<sup>1</sup> Each month is calculated based upon 1/12 of the annual budget.

<sup>2</sup> For example, in the Financial Plan for FY 2022, the 48 month period to use to derive the annual average is FY 2022 through FY 2025. In the FY 2023 Financial Plan, the 48 month period to use to derive the annual average would be FY 2023 through FY 2026 etc.

## **Attachment D**

### **Section 7. Operations Reserve**

The Operations Reserve is used to manage normal variations in costs and as a reserve for contingencies. Any portion of the Wastewater Collection Utility's Fund Balance not included in the reserves described in Section 3-Section 6 above will be included in the Operations Reserve unless this reserve has reached its maximum level as set forth in Section 7(d) below. Staff will manage the Operations Reserve according to the following practices:

- a) The following guideline levels are set forth for the Operations Reserve. These guideline levels are calculated for each fiscal year of the Financial Planning Period based on the levels of Operations and Maintenance (O&M) and commodity expense forecasted for that year in the Financial Plan.

Minimum Level	60 days of O&M and commodity expense
Target Level	105 days of O&M and commodity expense
Maximum Level	150 days of O&M and commodity expense

- b) Minimum Level: If, at the end of any fiscal year, the funds remaining in the Operations Reserve are lower than the minimum level set forth above, staff shall present a plan to the City Council to replenish the reserve. The plan shall be delivered within six months of the end of the fiscal year, and shall, at a minimum, result in the reserve reaching its minimum level by the end of the following fiscal year. For example, if the Operations Reserve is below its minimum level at the end of FY 2014, staff must present a plan by December 31, 2014 to return the reserve to its minimum level by June 30, 2015. In addition, staff may present, and the Council may adopt, an alternative plan that takes longer than one year to replenish the reserve.
- c) Target Level: If, at the end of any fiscal year, the Operations Reserve is higher or lower than the target level, any Financial Plan created for the Wastewater Collection Utility shall be designed to return the Operations Reserve to its target level within four years.
- d) Maximum Level: If, at any time, the Operations Reserve reaches its maximum level, no funds may be added to this reserve. Any further increase in the Wastewater Collection Utility's Fund Balance shall be automatically included in the Unassigned Reserve described in Section 8, below.

### **Section 8. Unassigned Reserve**

If the Operations Reserve reaches its maximum level, any further additions to the Wastewater Collection Utility's Fund Balance will be held in the Unassigned Reserve. If there are any funds in the Unassigned Reserve at the end of any fiscal year, the next Financial Plan presented to the City Council must include a plan to assign them to a specific purpose or return them to the Wastewater Collection Utility ratepayers by the end of the first fiscal year of the next Financial Planning Period. For example, if there were funds in the Unassigned Reserves at the end of FY 2015, and the next Financial Planning Period is FY 2016 through FY 2020, the Financial Plan shall include a plan to return or assign any funds in the Unassigned Reserve by the end of FY 2016. Staff may present an alternative plan that retains these funds or returns them over a longer period of time.

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