

# **UTILITY CASH RESERVE POLICY FOR WATER POLLUTION CONTROL**

## **Purpose**

To help ensure financial stability, timely completion of capital improvements and enable the utility to meet requirements for large unexpected expenditures, a targeted cash reserve policy should be established. The cash reserve policy establishes a target as well as a bandwidth amount of cash the utility should keep in reserve to address the operational and financial risks of the utility. Actual cash reserves may vary substantially above the minimum and is dependent on the life cycle of assets, future capital plan, rate setting policies, and debt policies.

Funds available for the Cash reserve target shall not include funds that are legally required for debt service or funds available but designated for other purposes.

## **Methodology**

The methodology outlined in this policy is based on certain assumptions related to:

1. Revenue Risk
2. Expense Risk
3. Working Capital
4. Capital Reserve

After the reserve minimum is determined, management should consider the target “in total” and not each individual category. Percentage risk factors for Revenue, Expense, Working Capital, and Capital Reserve will be subject to City Council review and approval as part of the annual budget process [Initial recommended risk factor percentages are included below for illustrative purposes for the current fiscal year]

## **Calculation and Risk Factors Used**

### **Revenue Risk**

#### **General Sales Decrease Economic Recession**

**Purpose:** Cover fixed costs due to large scale economic shock similar to the Great Recession of 2008-2012. The fixed costs represent the total amount of operating expenses historically assumed or experienced to be fixed and add debt service, the necessary 10% coverage of debt service as well as the PILOT to the City.

**[The cash reserve will include 7.00% of fixed costs over a 12-month period]**

#### **Loss of Top Customer**

**Purpose:** Cover fixed costs due to the loss of one of the top customers and also represents loss of sales due to conservation efforts.

**[The cash reserve will include 3.1% of fixed costs over a 12-month period]**

### **Interest Income**

**Purpose:** Address risk of loss of interest income on invested cash.

**[The cash reserve will include up to 100 basis points (1%) of interest income from short-term investments over a 12-month period]**

### **Expense Risk**

#### **Treatment and Disposal**

**Purpose:** Address risk of an increase in the cost of treatment and disposal.

**[The cash reserve will include a 3.0% assumed variance on an increase in treatment and disposal over a 12 month period]**

#### **Other expenses – Collection, Lab Services and Administration & General**

**Purpose:** Address risk of operating expenses incurred by the department.

**[The cash reserve will include a 1% assumed variance for a small increase in operating expenses over a 12-month period]**

### **Working Capital**

**Purpose:** Represents a level of cash on hand to address the billing cycle (up to 60 days to convert WPC treatment and delivery costs to an account receivable to cash).

**[The cash reserve will include up to an assumption of 90 days of working capital]**

### **Capital Reserve**

**Purpose:** Represents a level of cash on hand to allow for the flexible execution of both routine and unexpected capital projects.

**[The cash reserve will include up to the average annual depreciation levels]**

### **Targeted Cash Reserve Calculation**

The targeted cash reserve calculation considers the risk “in total” and not each individual category. The recommended level is \$16.5 million

If certain events occur that results in cash reserves falling below the targeted cash reserve levels, Manager should make recommendations to the City Council to restore cash reserves to the targeted levels over the subsequent three years. These actions may include a number of options:

- rate adjustments
- cost reductions
- issuance of bonds to fund capital improvement programs rather than the use of “PayGo”
- funds on hand
- modification of the assumptions used to determine the cash reserve levels

It is important to emphasize this is a recommended targeted cash reserve. Actual cash reserves may vary substantially above the target and is dependent of the life cycle of assets, future capital plan, rate setting policies, and debt policies. The cash reserve calculation should be updated annually as part of the budget process.