

JOINT OUTFALL
FINANCIAL RESERVE POLICY

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Joint Outfall System Financial Reserve Policy

1. Policy Statement

The Joint Outfall System is comprised of 17 individual County Sanitation Districts¹ (each, a “District” and, collectively, the “Districts”) that are party to the Joint Outfall Agreement². The Joint Outfall System provides essential public services and, to that end, has made an extensive investment in public infrastructure, operating facilities, and other related assets and. Given the impact these essential services have on public health, the environment, and the overall quality of life, very few options exist for service reduction levels in the event of revenue shortfalls or other funding deficiencies. Maintaining prudent financial reserves provides the resources to allow the Joint Outfall System to continue to fulfill its commitment to deliver reliable and high-quality service to its customers. Financial reserves provide significant benefits including:

- Stabilizes user charge rates, creating more certainty so ratepayers can better plan their budgets;
- Minimizes risk associated with borrowing, which can result in lower interest costs;
- Demonstrates financial stability to credit rating agencies;
- Improves liquidity so capital projects can be constructed in a timely fashion, despite fluctuations in cost from year to year;
- Allows the Joint Outfall System to effectively respond to economic, environmental, and regulatory changes.

2. Treasurer; Administration

- 2.1 Each District, through its duly adopted Investment Policy, has appointed the District’s Chief Engineer and General Manager as the Treasurer of each District.
- 2.2 The Treasurer, or his or her designee, is hereby authorized to implement this Policy, and establish and maintain all financial reserves in accordance with this Policy and all provisions of law.
- 2.3 The Treasurer shall develop procedures to implement this Policy and shall report to the Board of Directors of each District (“Board”) in accordance with the requirements of law and this Policy.

3. Types of Funds/Reserves

District No. 2, on behalf of the Joint Outfall System, will maintain its financial assets in various Funds as described in this Policy. Fund balances will be maintained in amounts sufficient to meet appropriate target goals, as established in this Policy in cash and/or cash equivalents, and permitted investments as

¹ The 17 Joint Outfall System Districts are County Sanitation Districts Nos. 1, 2, 3, 5, 8, 15, 16, 17, 18, 19, 21, 22, 23, 28, 29 and 34 of Los Angeles County, and South Bay Cities Sanitation District of Los Angeles.

² The most recent Joint Outfall Agreement is entitled *Joint Outfall Agreement* dated July 1, 2022, as amended.

prescribed in each District's Investment Policy. The Joint Outfall System Funds are categorized under this Policy as Unrestricted, Designated, or Restricted as follows:

3.1 Unrestricted

The Unrestricted Reserve Funds include all monies collected or generated by or on behalf of the Joint Outfall System except those that have been deemed to be Designated or Restricted.

3.2 Designated

Designated Reserve Funds are the group of Funds for which District No. 2, on behalf of the Joint Outfall System, has imposed restrictions on the use of the monies in them for specific purposes such as capital facilities, land acquisition, and repair and replacement of existing assets. These monies are not otherwise legally restricted and District No. 2, on behalf of the Joint Outfall System, has the discretion to redesignate the actual or intended usage of these monies.

3.3 Restricted

Restricted Reserve Funds are the group of Funds that have been established to comply with restrictions that have been imposed externally through law (federal, state, or local governments), administrative action (adopted ordinances of the Districts), or contractual arrangements (e.g., bond indentures, State Revolving Fund installment sales agreements). The monies in Restricted Reserve Funds can only be used for the purpose for which they were established or dedicated until the restrictions are removed by the party that imposed them or the contractual agreement that created them has expired.

4. **Unrestricted Reserves**

4.1 Operating Fund

4.1.1 Purpose

Monies in the Operating Fund may be used for any purpose consistent with the budget; other direction from District No. 2, on behalf of the Joint Outfall System; legal requirements; and this Policy. Operating Fund monies include all types of revenue unless otherwise designated or restricted. The Operating Fund must be sufficient to meet the cash flow needs of the Joint Outfall System and to meet current and anticipated expenses in accordance with the long-term budgetary projections.

4.1.2 Targeted Goal

The minimum targeted goal balance on July 1 of each fiscal year is the projected net expenses during the first six months of that fiscal year. Net expenses shall be equal to all projected expenses less any anticipated revenues (e.g., industrial wastewater surcharges) and funding sources (e.g., State Revolving Fund loans).

4.1.3 Review Timeline

The minimum targeted goal shall be reviewed annually in conjunction with the adoption of the Joint Outfall System's final budget.

4.1.4 Funding

All revenues other than those placed in a Designated Reserve Fund or Restricted Reserve Fund shall be placed in the Operating Fund.

5. Designated Reserves

The Designated Reserve Funds include the Emergency Fund, the Operations and Maintenance Financial Stability Fund, the Capital Projects Financial Stability Fund, and any other funds designated by District No. 2, on behalf of the Joint Outfall System, other than Restricted Reserve Funds and Unrestricted Funds.

5.1 Emergency Fund

5.1.1 Purpose:

The Joint Outfall System budget is developed for all anticipated expenditures, but emergencies and unforeseen circumstances can occur during the course of the year. The Emergency Fund is intended to provide funding for work that must be undertaken to address emergencies or unforeseen circumstances and to ensure the Joint Outfall System can continue to provide all of its vital public services.

5.1.2 Targeted Goal:

The targeted goal balance is 0.5% of the Net Sewerage Operations Capital Assets as identified in the most recently filed Comprehensive Annual Financial Report of the Joint Outfall System multiplied by the ratio of the total number of sewage units in the Joint Outfall System to the total number of sewage units in all of the Joint Outfall System.

5.1.3 Review Timeline:

The targeted goal will be reviewed and adjusted annually in conjunction with the adoption of the District's final budget.

5.1.4 Funding:

The Treasurer will, on July 1 of each year, transfer from or to its Operating Fund an amount sufficient to meet the Emergency Fund's targeted goal specified in Section 5.1.2.

5.2 Operations and Maintenance (O&M) Financial Stability Fund

5.2.1 Purpose:

The O&M Financial Stability Fund is a dynamic fund that will be used to facilitate wastewater rates transitioning smoothly from year to year. Monies will be withdrawn from this Fund in some years, allowing expenses to be met without having to impose spiked increases in wastewater rates. In other years, monies will be deposited into this Fund, replenishing it in lieu of having spiked decreases in wastewater rates. In any given year, as the need arises, the Joint Outfall System may use up to 10% of the Fund for any purpose without authorization from the District No. 2 Board, in addition to any use previously authorized as part of the rate setting and budget process. When monies are

used from this Fund that drop the balance below the targeted goal, the Treasurer will prepare a plan to fully restore the Fund to its targeted goal by the latter of

- (a) five years; or
- (b) six years of the date for which the last adopted service charge becomes or has become effective.

5.2.2 Targeted Goal:

The long-term targeted goal balance is equal to six months of O&M expenses plus one year of debt service (excluding any debt service that has a Debt Service Reserve Fund).

5.2.3 Review Timeline:

The targeted goal will be reviewed and adjusted annually in conjunction with the adoption of the Joint Outfall System's final budget.

5.2.4 Funding:

The Treasurer will annually transfer moneys from the Operating Fund to the O&M Financial Stability Fund an amount equal to the annual targeted goal.

5.2.5 Additional Monies

District No. 2, on behalf of the Joint Outfall System, may also place additional monies into the O&M Financial Stability Fund at any time so that the balance exceeds the targeted goal. Monies in excess of the targeted goal can be withdrawn at any time without prior authorization from the District No. 2 Board as part of the overall plan to stabilize rates.

5.3 Capital Projects Financial Stability Fund

5.3.1 Purpose:

The size and scope of capital projects (and the associated cost) varies from year to year, which could result in peaks and valleys in user charge rates if the projects are to be funded dollar-for-dollar in the year in which the expenses are incurred. This Fund will ensure that monies are not only available to meet capital expenses over the long-term, but also to meet the annual demand without requiring significant rate fluctuations.

5.3.2 Targeted Goal:

The targeted long-term average goal balance will be equal to the greater of:

- (a) The difference between the projected maximum and average annual capital expenditures to be cash funded from revenues identified in the Capital Improvement Plan over the ensuing ten years; or
- (b) \$100,000.

5.3.3 Review Timeline:

The targeted goal will be reviewed and adjusted annually in conjunction with the adoption of the Joint Outfall System's final budget.

5.3.4 Funding:

The Treasurer will annually transfer monies from its Operating Fund to the Capital Projects Financial Stability Fund an amount equal to the annual targeted goal. If the transfer would cause an undue financial hardship on the Joint Outfall System or result in a significant rate hike, the Treasurer may transfer less than the targeted goal provided a plan has been prepared to achieve the target goal within ten years. In no case shall the fund balance be less than \$100,000 immediately after the annual transfer.

5.3.5 Additional Monies

District No. 2, on behalf of the Joint Outfall System, may place additional monies into the Capital Projects Financial Stability Fund at any time so that the balance exceeds the targeted goal. Monies in excess of the targeted goal can be withdrawn at any time without prior authorization from the District No. 2 Board as part of the overall plan to stabilize rates.

5.4 Other Reserve Funds

From time to time, the Board of Directors of District No. 2 may deem it prudent to establish other designated reserve funds in order to further the mission of the Joint Outfall System. The Treasurer will create such Reserve Funds as directed and will establish appropriate targeted goals, review timelines, and funding mechanisms. This Policy will be amended and will not become effective until approved by each of the Joint Outfall System District's Boards.

6. **Restricted Reserves**

6.1 Debt Service Reserve Fund

6.1.1 Purpose:

Some debt instruments (e.g., bond indentures, installment sales agreements) may require a Debt Service Reserve Fund, typically equal to the maximum annual debt service over the life of the debt. A separate Debt Service Reserve Fund will be established for each debt instrument that requires it. The monies in each Debt Service Reserve Fund will only be used in accordance with the terms and conditions of the debt instrument.

6.1.2 Targeted Goal:

The targeted goal balance for any Debt Service Reserve Fund must equal the amount required by the associated debt instrument.

6.1.3 Review Timeline:

Each Debt Service Reserve Fund balance will be reviewed at least annually as part of the continuing disclosure process required under the debt instrument, but no less than such increments of time as required by any debt instrument.

6.1.4 Funding:

Each Debt Service Reserve Fund will generally be funded at the time the debt is incurred, using a portion of the debt proceeds, if allowable. If the debt proceeds cannot be used to fund the Debt Service Reserve Fund, the Debt Service Reserve Fund may be funded from any allowable District's monies. If the Joint Outfall System makes a draw on the Debt Service Reserve Fund, the Debt Service Reserve Fund must be replenished in the time and manner specified in the debt instrument.

6.2 Capital Fund

6.2.1 Purpose:

New users and existing users that significantly increase their wastewater discharge are required to pay a connection fee. The Joint Capital portion of the connection fee is deposited into the Capital Fund in accordance with the Master Connection Fee Ordinance of each of the Districts in the Joint Outfall System. Funds are withdrawn as necessary to fund capital projects.

6.2.2 Targeted Goal:

There is no targeted goal balance for the Capital Fund. The amount of money deposited into the Capital Fund is dependent on the rate at which additional burdens are placed on the wastewater system. The Capital Fund balance varies depending on connection fee revenues, expenditures for capital projects, and permitted borrowing from the Fund.

6.2.3 Review Timeline:

Connection fee rates will be reviewed annually.

6.2.4 Funding:

The Joint Capital portion of the connection fees will be deposited into the Capital Fund in accordance with the Master Connection Fee Ordinance of each of the Districts in the Joint Outfall System.

6.3 Other Reserve Funds

From time to time, it may be necessary to establish other restricted reserve funds in accordance with law or other statutory requirements or with contractual agreements to which the Joint Outfall System is a party. The Treasurer will create such Reserve Funds as mandated and will establish appropriate targeted goals, reviews, and funding mechanisms.

7. Wastewater Financial Reserve Policy Adoption

This Policy will become effective on the later of the approval of the Joint Outfall Agreement dated July 1, 2022 or July 1, 2022. This Policy will be reviewed on an annual basis and any modifications must be approved by each District's Board of Directors. Prior to such review, the matter will be referred to the Personnel Committee (comprised of the Chairpersons of the Board of Directors of each active County Sanitation District of Los Angeles County) for its consideration.

Adopted this ____ day of _____.