

WASTEWATER
FINANCIAL RESERVE POLICY

County Sanitation District No. ___
of
Los Angeles County

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Wastewater Financial Reserve Policy

County Sanitation District No. __ of Los Angeles County

1. Policy Statement

County Sanitation District No. __ of Los Angeles County (District) is a provider of essential public services and, to that end, has made an extensive investment in public infrastructure, operating facilities, and other related assets. 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 District 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 the District's 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 District to effectively respond to economic, environmental, and regulatory changes.

2. Treasurer; Administration

- 2.1 The District, through its Investment Policy, has appointed the District's Chief Engineer and General Manager as the Treasurer of the 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 (Board) in accordance with the requirements of law and this Policy.

3. Types of Funds/Reserves

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

3.1 Unrestricted

The Unrestricted Reserve Funds includes all monies collected or generated by or on behalf of the District, without regard to the source, except those that have been deemed to be Designated or Restricted.

3.2 Designated

Designated Reserve Funds are the group of Reserve Funds for which the Board 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. The Board may designate these purposes either through specific action or through approval of the annual budget. These monies are not otherwise legally restricted and the Board has the discretion to redesignate the actual or intended usage of these monies.

3.3 Restricted

Restricted Reserve Funds are the group of Reserve Funds that have been established to comply with restrictions that have been imposed externally through law (federal, state, or local governments), administrative action (District adopted ordinances), 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. System Funds

The District may participate with other members of the County Sanitation Districts of Los Angeles County (collectively, the Districts) in separate agreements (e.g., the Joint Administration, Joint Outfall System, and Solid Waste System Agreements). Funds necessary for operations related to these agreements will be pooled. Except for Funds dedicated solely to the Solid Waste System and the Joint Outfall System, all pooled Funds will be held and managed by County Sanitation District No. 2 of Los Angeles County as the administrative district for the Districts in accordance with the respective agreements and District No. 2's Wastewater Financial Reserve Policy. District No. 2 will separately adopt a Solid Waste Reserve Policy for all Solid Waste Funds. The Joint Outfall System Districts will separately adopt a Joint Outfall System Financial Reserve Policy for all Joint Outfall Funds.

5. Unrestricted Reserves

5.1 Operating Fund

5.1.1 Purpose

Monies in the Operating Fund may be used for any purpose consistent with the budget, other Board direction, legal requirements and this Policy. Operating Fund monies include all types of revenue unless otherwise restricted. The Operating Fund must be sufficient to meet the cash flow needs of the District and to meet current and anticipated expenses in accordance with the long-term budgetary projections.

5.1.2 Targeted Goal

The minimum targeted goal balance on July 1 of each fiscal year is twenty percent (20%) of projected revenues fiscal year.

5.1.3 Review Timeline

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

5.1.4 Funding

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

6. Designated Reserves

The Designated Reserve Funds include the Natural Disaster and Self-Insured Retention Fund, and any other funds designated by the Board of Directors other than Unrestricted and Restricted Reserve Funds.

6.1 Natural Disaster and Self-Insured Retention (SIR) Fund

6.1.1 Purpose:

The Natural Disaster and SIR Fund is designated to pay for: 1) short-term costs in the event of an earthquake or other natural disaster in order to continue District operations until state or federal relief funds are received; 2) costs related to a natural disaster that do not result in reimbursement; and 3) costs incurred due to an insurance claim that requires the use of the Districts' SIR amount. This can include funding immediate repairs to existing facilities and, if the Joint Administration Office becomes unusable, securing other office space. The Natural Disaster and SIR Fund will be pooled, shared proportionally among the Districts and Solid Waste entities.

6.1.2 Targeted Goal:

The initial targeted goal balance for the pooled Natural Disaster and SIR Fund is \$17 million. The targeted goal and the appropriate share for each District and Solid Waste entity may be revised, as needed, to account for changes to risks, property values and SIR requirements.

6.1.3 Review Timeline:

The targeted goal balance will be reviewed and adjusted every five years with the first review to be completed by June 30, 2022.

6.1.4 Funding:

At the end of each five-year review period, the Treasurer will make a transfer from the Operating Fund to the Natural Disaster Fund, as necessary, for the District's share of any increase in the targeted goal.

6.2 Other Reserve Funds

From time to time, the Board of Directors may deem it prudent to establish other designated reserve funds in order to further the mission of the District. 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 to reflect the Board's direction with respect to any additional Designated Reserve Funds.

7. Restricted Reserves

7.1 Other Post-Employment Benefits (OPEB) Reserve Fund

7.1.1 Purpose:

The Districts collectively provide health care and dental benefits for all retired employees and their dependents or survivors. The Districts have voluntarily elected to enter into a prefunding plan for their OPEB program. The OPEB funds must be held by a qualified third-party trustee.

7.1.2 Targeted Goal:

The yearly targeted goal will be to transfer to the OPEB Reserve Fund an amount equal to the Districts' annual required contribution (ARC) as determined by a qualified actuarial consultant.

7.1.3 Review Timeline:

The actuarial review is required at least biennially.

7.1.4 Funding:

Each year the Treasurer will collectively transfer the ARC to the third party trustee in installments as required under the terms of the agreement with the trustee. Each transfer shall be apportioned among the Districts and Solid Waste entities in proportion to the salaries incurred by the District or Solid Waste entity since the previous transfer was made.

7.2 Debt Service Reserve Fund

7.2.1 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:

- (a) to support payment of principal and interest of outstanding obligations if revenues pledged for repayment are insufficient to meet the required payment; or
- (b) to extinguish the debt.

7.2.2 Targeted Goal:

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

7.2.3 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.

7.2.4 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 District 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.

7.3 Bond Construction Fund

7.3.1 Purpose:

When bonds are issued, all of the proceeds are received at the time of issuance. Except for a small portion which is used for the cost of issuance, the proceeds are placed into a Bond Construction Fund and can only be used for the purposes identified in the Official Statement, Tax Certificate, and Installment Purchase Agreement for the bond issuance.

7.3.2 Targeted Goal:

The amount of money in the Bond Construction Fund is dependent on the size of the bond issuance, with the expectation that the proceeds will be expended in the time frames detailed in the Tax Certificate.

7.3.3 Review Timeline:

No review is necessary as there is a single deposit into each Bond Construction Fund.

7.3.4 Funding:

Bond proceeds, except for the cost of issuance, capitalized interest, any required debt service reserve funds, and refunding escrows, will be deposited into the Bond Construction Fund at the time of issuance.

7.4 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 District is a party. The Treasurer will create such Reserve Funds as mandated and will establish appropriate targeted goals, reviews, and funding mechanisms.

8. 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 the Board. 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 _____.