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POLICY STATEMENT NO. 695
KIRKWOOD MEADOWS PUBLIC UTILITY DISTRICT
OPERATING AND CAPITAL RESERVES POLICY

A. NEED FOR RESERVES AND RESERVE POLICY

The District has the fiscal responsibility to set aside cash reserves to prepare for planned and unexpected expenses in the future. Reserves for planned expenses are largely for capital expenditures needed to replace aging infrastructure or expand capacity. Reserves for unplanned expenses are largely to cover shortfalls in operating revenues, but also for unplanned capital replacements associated with equipment failures.

The following provides targets for both operating and capital reserves, describes sources for building reserves, and describes when use of reserve funds is recommended. This Policy is intended to help guide budget and rate setting decisions while recognizing that unpredictable winters, decisions by the Resort and property owners, new regulations, and public rate setting and borrowing procedures may require decisions that do not meet the ideals and targets described in the Policy.

B. OPERATING RESERVES

Description and Target

Operating reserves generally reside in KMPUD's General Fund. The operating reserve target is 25% of annual expenses. Annual expenses currently approach \$8 million, establishing an operating reserve target of \$2 million. Because of the highly seasonal nature of utility use in Kirkwood, and therefore highly variable monthly cash in-flows, the target describes the lowest desirable level of operating cash available at the end of any single month during the year (usually December).

This Policy establishes a single target for KMPUD rather than establishing separate targets for each Department. At this time, it is most practical to simply establish that at the end of each fiscal year each department should have a positive operating

cash balance. In future years, if growth or a modified rate structure allows, separate Department operating reserve targets similar to the overall target may be established.

Sources of Operating Reserves

1. The primary source of operating reserves is cash generated by revenues greater than cash operating expenses. Ideally, the rate for each utility is established so that demand in an average year will generate revenue that contributes cash to the operating reserve for that utility.
2. If a department is not able, on its own, to achieve a positive operating cash at the end of a fiscal year, and other departments achieve surpluses, the one with a shortfall can borrow from ones with surpluses, provided that a plan approved by the Board is established to repay the loans, with interest.
3. Alternatively, or in conjunction with #2 above, property taxes returned to the District from the Counties may be used to add to operating reserves, although the primary uses of property taxes are those described in Part 5 of this Policy.
4. When necessary, a shortfall may be covered through borrowing from an external source, provided such borrowing is consistent with the District's Debt Policy.

Uses of Operating Reserves

Operating reserves may be used to:

1. Cover temporary shortfalls in monthly cash flow, as often happens during off-season months.
2. Cover longer-term shortfalls in annual cash flow, as may happen during low snow years.
3. Lend to departments with inadequate cash balances at the end of a fiscal year, contingent on a repayment plan.
4. Transfer to capital reserves if operating reserves are projected to continually exceed the 25% goal described above.

C. CAPITAL RESERVES

Description and Target

Capital Reserves reside in several accounts:

1. Capital Reserve account: Capital reserves for all departments except KVFD and Snow Removal reside in this account. Capital reserves within this account are recorded for each Department.
2. KVFD Reserve: Capital reserves specifically for capital purchases needed by the Kirkwood Volunteer Fire Department.
3. Snow Removal Reserve: Capital reserves specifically for capital purchases of snow removal equipment.
4. Capital reserves are for purchases of property, equipment and other assets, the values of which are depreciated over their useful lives.

This Policy establishes that each Department target a capital reserve equal to 25% of the five years of cash needed for expenditures listed in the District's approved 5-year Capital Plan. The 5-year Capital Plan is developed and approved annually as part of the District's annual budget and includes itemized budgets for capital expenditures by each Department.

Sources of Capital Reserves

The 5-year Capital Plan provides for two types of capital expenditures: expenditures to replace existing assets and expenditures to expand capacity. The following are the sources of capital reserves for each type of expenditure.

1. Ideally capital reserves for replacements are generated by revenue that exceeds expenses including non-cash expenses such as depreciation. Since depreciation represents the aging of capital assets, it is appropriate that the portion of operating cash flow, when available, equal to depreciation be placed into capital reserves, for use in eventually replacing the capital assets. Additionally, a portion of connection fees associated with new construction also contribute to replacement of the existing system to which they connect and derive benefit.
2. Ideally capital reserves for increasing capacity are generated through connection fees associated with new construction. Since new construction generally represents increased demand for a utility, connection fees are an

- appropriate source.
3. Property taxes can contribute to capital reserves, consistent with Part 5 of this Policy.
 4. Capital reserves may also be generated through a variety of loans, consistent with the District's Debt Policy.
 5. Grants for all departments and donations to the KVFD's 501c3 are important sources of capital reserves and should be actively sought.

Uses of Capital Reserves

As indicated above, capital reserves are used to acquire new capital assets of two types: those that replace existing assets because of age or new regulatory requirements, and those that increase the District's capacity to accommodate increased demand. Capital reserves are also used to pay off principal balances on loans that were taken to fund a capital asset.

Part 4: Other Reserve Accounts

The District will often have other reserve accounts; for example, associated with issuance of bonds or certificates of participation. These reserve accounts are established to comply with the requirements of those particular types of borrowing. The District may also have reserve accounts associated with its roles in particular types of programs. The reserves in these accounts can only be used for the purposes specified.

Part 5: Uses of Property Taxes

The following establishes the District's prioritized use of property tax revenues.

1. First to ensure the RUS Tier ratios relative to outstanding loans are covered.
2. Cover any cash losses in departments.
3. Used to fund capital expenditures.
4. If the above allocations are covered, property taxes will be used to fund a cash reserve (operating or capital) or other use determined by the Board.

A significant annual variable is the property tax allocations required to achieve the RUS Tier ratios requirement due to the uncertainty of the GASB 68 & 75 expenses imposed by CalPERS.