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ADOPTED BY: ~~2013-265~~

DATED: ~~December 17, 2013~~

April 26, 2022

**PURPOSE:**

Public entities accumulate and maintain adequate reserves levels to help ensure both financial stability and the ability to provide core services during difficult times. Adequately funded reserves allow for: 1) funding infrastructure replacement, 2) economic uncertainties and other financial hardships, 3) future debt and capital obligations, 4) cash flow requirements, 6) improved credit ratings, 5) unfunded mandates including costly regulatory requirements.

**BACKGROUND:**

The City's Sewer Enterprise Funds account for specific services funded directly by fees and charges users of the City's sewer system. These funds are intended to be self-supporting as well as restricted and cannot be used for other City services. They account for revenues and expenses related to the City's sewer programs, including maintenance and expansion of the City's conveyance system and payment of San Diego Metro wastewater treatment costs.

The Sewer Service Revenue Enterprise Fund accounts for revenue collected from monthly sewer service charges for all properties that are connected to the City's sewer system. These funds can only be used for sewer related operations and maintenance. The primary use of these funds is payment for the City's annual San Diego Metropolitan Sewer Capacity and to fund maintenance and operational costs associated with the sewer collection system.

The Government Finance Officers Association (GFOA), an international organization that promotes the professional financial management of governments for the public interest, recommends maintaining minimum reserve balances. A government's particular situation may require levels of reserves significantly in excess of their recommended minimum levels. Cities with higher reserve levels are better positioned to protect public services during economic downturns.

GFOA recommends that in establishing a policy governing the level of reserves or working capital in enterprise funds, a government should consider a variety of factors, including but not limited to the following:

- The predictability of its revenues and the volatility of its expenditures (i.e. higher levels of reserves may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile.)
- Liquidity (i.e. a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained).
- Designations (i.e. governments may wish to maintain higher levels of reserves to compensate for any portion of available fund balance already designated for a specific purpose).

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POLICY:

This Policy establishes four distinct reserves within the Sewer Service Revenue Fund:

1. Working Capital and Rate Stabilization Reserve
2. Emergency Reserve
3. Vehicle Replacement Reserve
4. ~~U.S. Environmental Protection Agency (USEPA) Permit Renewal Liability Reserve~~

Working Capital and Rate Stabilization Reserve

Working Capital and Rate Stabilization reserves in the Sewer Service Revenue Fund will be restricted to maintaining and operating the wastewater collection system and paying treatment charges to City of San Diego Metropolitan Wastewater (“Metro”). The reserve will be funded from revenues accumulated in the Sewer Service Revenue Fund. It is intended to accommodate any natural variability in revenues and expenditures, including potential disruptions of cash flows due to varied billing methodology, short term fluctuations and annual cycles. The reserve will also assist in addressing shortfalls which may occur due to unanticipated cost increases in labor or energy and other consumption based goods and services, such as wastewater treatment services provided by Metro. The reserves represent unrestricted resources available for appropriation by the City Council addressing unforeseen needs for sewer services.

The Working Capital and Rate Stabilization Reserves will assist the City in addressing the following items:

- Rate Stabilization – the reserves will allow the City the flexibility to “smooth” rates and phase increases in over multiple years, which is prudent given the potential variability in the City’s payments to Metro.
- Revenue Collection Fluctuations - the reserves will be used to protect the City from natural fluctuations in revenue and expenditure cycles which is prudent given that the City bills customers at different points in time but incurs expenses continuously throughout the year.
- Rates of delinquencies – delays in collection of outstanding revenues.
- Payroll cycles – the timing of a fixed cash requirement for payroll, as related to the timing of revenue cycles.
- Unanticipated expenses - expenses whose characteristics make accurate estimation difficult, such as increases in wastewater treatment services provided by the City of San Diego, energy costs, labor benefits and other consumption based goods and services.

The City shall maintain a Sewer Revenue reserve equivalent to 90 days of operating expenditures and a Rate Stabilization reserve equivalent to 90 days of operating expenditures for a minimum combined total of 180 days and a maximum reserve balance of 125% of the minimum balance.

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If funds are appropriated from the Sewer Revenue Working Capital and Rate Stabilization Reserves, the funds should be replenished in the budget process during subsequent fiscal years to the minimum reserve balance. If the magnitude of the event caused the Sewer Revenue Working Capital and a Stabilization Reserves to be less than 30 days of the operating and maintenance budget, the Finance Director shall provide the City Council with a plan to incrementally replenish the reserves to the 180 days minimum reserve balance.

#### Emergency Reserve

The Sewer Service Revenue Fund Emergency Reserve is necessary to secure funding for insurance deductibles, unforeseen liabilities/litigation and settlement costs related to the City's wastewater system.

The City shall maintain a minimum Sewer Service Revenue Fund Emergency Reserve target level of 5% of the operating and maintenance budget and a maximum reserve balance of 125% of the minimum balance. If funds are appropriated from the Sewer Revenue Emergency Reserves due to unanticipated needs, the Finance Director shall provide the City Council with a plan to incrementally replenish the reserves to the minimum reserve balance.

#### Vehicle Replacement Reserve

The Sewer Service Revenue Fund Vehicle Replacement Reserves represents monies set aside to fund the replacement of aging vehicles. The allocation is funded from revenues accumulated in the Sewer Service Revenue Fund.

The City shall maintain a minimum Sewer Service Fund Vehicle Replacement Reserve target of 2% of the operating and maintenance budget. This reserve will ensure that vehicles utilized for sewer operations are replaced as scheduled and available to deploy as needed.

To achieve a minimum impact to cost of services and rates, funds will be included in the proposed budget on an annual basis as identified in the City's Vehicle Replacement schedule. The cost of replacing all the vehicles will be averaged over the lifespan of the existing fleet. This will generate a more normalized cost of services by evenly distributing revenue requirements on a year-to-year basis offsetting temporary cash flow deficiencies and avoid significant increases in rates charges to customers in the years the replacement cost are incurred.

#### USEPA Permit Renewal Liability Reserve

~~The Sewer Service Revenue Fund USEPA Permit Renewal Liability Reserve will account for monies set aside to fund the City of San Diego Metropolitan Wastewater costs related to the potential upgrade of the Point Loma Wastewater Treatment Plant (PLWTP) or other alternative for secondary treatment. The reserve will be funded from revenues accumulated in the Sewer Service Revenue Fund.~~

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~~Metro's USEPA waiver expires in FY 2015 and may not be renewed. If denied, Metro would need to develop and implement improvements to achieve secondary treatment level at PLWTP. Current cost estimates to establish full secondary treatment at PLWTP as well as possible alternatives are all significant (>\$1Billion). As a contributing member to the regional treatment plant, the City of Chula Vista's share in the cost of any upgrade would be approximately 10 percent for the capital improvements and any increase in the overall treatment cost. It is expected that Metro will have 10 years after the expiration of the USEPA waiver to institute secondary treatment or alternative. This reserve establishes a dedicated fund that will offset a portion of the City's share of any obligation related to the PLWTP USEPA waiver. By actively planning for the PLWTP upgrade or alternative, the City will be in a stronger financial position to afford such costs while mitigating impacts to ratepayers.~~

~~The Permit Renewal Liability Reserve will be funded through annual contributions with the intent to reach a target balance of 20% of Chula Vista's share of the upgrade cost by FY 2024/25 (10 years after the expiration of the waiver). If substantial increases in Metro-related costs occur sooner than expected, the City may draw down reserve levels prior to FY 2024/25 to manage impacts to ratepayers. To be consistent with the City's policy for managing balances for its other utility reserves, if funds are appropriated from the reserve before its intended use, the funds should be replenished in subsequent fiscal years. If the magnitude of the withdrawal is material, the Finance Director shall provide the City Council with a plan to incrementally replenish the reserves.~~

~~If the actual costs for the PLWTP upgrade or alternative are less than anticipated, any unspent reserves will be rolled into the Working Capital and Rate stabilization reserve and utilized to fund City sewer programs, including maintenance and expansion of the City's conveyance system and payment of San Diego Metro wastewater treatment costs.~~