



**Date:** November 5, 2015

**TO:** LOCSD Board of Directors

**FROM:** Kathy A. Kivley, General Manager

**SUBJECT:** **Agenda Item 12G – 12/3/2015 Board Meeting**  
Review and Comment Regarding Revised 2015 District  
Budget Reserve Policy

**DESCRIPTION**

Review and provide comments regarding the Revised 2015 District Budget Reserve Policy.

**President**  
R. Michael Wright

**Vice President**  
Marshall E. Ochylski

**Directors**  
Charles A. Cesena  
Jon-Erik E. Storm  
Louis G. Tornatzky

**General Manager**  
Kathy A. Kivley

**District Accountant**  
Michael L. Doyel

**Fire Chief**  
Robert Lewin

**Battalion Chief**  
Phill Veneris

**SUMMARY OF STAFF RECOMMENDATION**

Staff recommends that the Board provide direction regarding the future adoption of a Revised District Budget Reserve Policy.

**DISCUSSION**

There are many specific reasons for the District to adopt reserve policies. A formally adopted policy promulgates a shared understanding of the proper level and use of reserves, which facilitate a health working relationship between the Board and the community. Revenue decisions represent some of the most controversial and difficult choices that governing boards must face. Utilizing reserve policies reduces political gamesmanship and promotes responsible long-term planning. Public agencies face scrutiny over whether to raise or reduce rates, taxes or fees. Having reserve policies in place prior to such occasions serves as a valuable tool for both making and explaining difficult decisions. Adopting a policy helps the District better communicate to the public the motives for adopting a reserve as well as convey the reasons for maintaining the reserve at a certain level. The fundamental question in maintaining a reserve is, how much is enough? When are reserves too low and when are they too high? These are very delicate questions because unwarranted reserves could undermine taxpayer and ratepayer support, while insufficient reserves could jeopardize the District's long-term sustainability.

It is operationally prudent that the District establish a date when the excess revenue from prior years can be designated and transferred to an existing reserve for the specific fund. It is important to recognize the assessments for drainage, special fire tax and property taxes are due without penalty on December 10 and April 10 of the respective fiscal year. The District receives a cash infusion from the collections twice yearly in December and April. Until December, the respective funds operate by using prior years excess revenues over expenditures as cash flow. It is staff's goal to have the final audit for the prior fiscal year completed by February of the new fiscal year. Until the audit is received and the December revenues are received, it is not fiscally prudent to transfer prior year excess revenues to reserves. The designation may be made at an earlier date, however the actual cash transfer should not occur prior to the infusion of current year revenues and fund and the District is in a positive cash position.

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Staff is requesting the Board of Directors review the current draft Budget Reserve Policy. As you will note there are many changes necessary to bring the Reserve Policy in line with the authorized Reserves by prior Board Action. In addition, many of the Reserves previously authorized by the Board over several prior fiscal years were not included within the prior Reserve Policy established as Resolution No. 2010-07 and Resolution 2012-09. Finally, all information regarding water reserves as addressed in the 2014 Water Financial Plan and Rate Study were included within the draft Budget Reserve Policy.

This original Budget Reserve Policy was presented to the Financial Advisory Committee. No suggestions or corrections were requested. In compiling the information, staff recognized it is highly inconsistent to have established Reserves which are not discussed within the Board's adopted Budget Reserve Policy. Recognizing that fact, staff modified the draft policy for your consideration.

**FINANCIAL IMPACT**

The recommended action of establishing a Budget Reserve Policy has no financial impact on the District. During the annual budget process, this policy will impact the budget document. It is important that all changes are incorporated with the draft Budget Reserve Policy by February 2016 to allow staff sufficient time to prepare the FY 2016/2017 Draft Budget.

Attachments: Draft Resolution and Draft Budget Reserve Policy  
Reserve Statement Effective July 1, 2015  
Special District Reserve Guidelines

**RESOLUTION 2015 – XX**

**A RESOLUTION OF THE BOARD OF DIRECTORS  
OF THE LOS OSOS COMMUNITY SERVICES DISTRICT  
ESTABLISHING BUDGET RESERVE POLICIES**

**WHEREAS**, Community Services District Law is established in Section 61000 et seq. of the Government Code; and

**WHEREAS**, Government Code Section 61040(a) states, in relevant part, “a legislative body of five members known as the board of directors shall govern each district. The board of directors shall establish policies for the operation of the district”; and

**WHEREAS**, Government Code Section 61045(g) states, “the board of directors shall adopt policies for the operation of the district, including, but not limited to, administrative policies, fiscal policies, personnel policies, and the purchasing policies required by this division”; and

**WHEREAS**, Government Code Section 61110(b) states, in relevant part, “the board of directors may divide the preliminary budget into categories, including, but not limited to, the following: (6) Designated reserve for capital outlay. (7) Designated reserve for contingencies”; and

**WHEREAS**, Government Code Sections 61112(a) and (c) state “(a) in its budget, the board of directors may establish a designated reserve for capital outlay and a designated reserve for contingencies. When the board of directors establishes a designated reserve, it shall declare the exclusive purposes for which the funds in the reserve may be spent. The funds in the designated reserve shall be spent only for the exclusive purposes for which the board of directors established the designated reserve. The reserves shall be maintained according to generally accepted accounting principles”; and

**WHEREAS**, based on the Staff Report, staff presentation, and public comment, the Los Osos Community Services District (“District”) Board of Directors finds that water, drainage, fire protection and septic maintenance are vital services to protect the health, safety and welfare of District residents and customers; and

**WHEREAS**, based on the Staff Report, staff presentation, and public comment, the District Board of Directors further finds that these policies help protect the health, safety, and welfare of District residents and customers by establishing a financial plan to:

- A. Address unforeseen and unexpected contingencies of operating District facilities and equipment; and
- B. To timely fund the replacement of District facilities and equipment to insured well maintained infrastructure and equipment; and
- C. To incorporate savings for future projects or emergencies; and
- D. To stabilize rates

**WHEREAS**, the establishment of adequate reserves is critical to the successful and stable short and long term operation of the District, and

**WHEREAS**, pursuant to Community Services District Law, the District, by this Resolution, re-establishes specific reserve categories consistent with the Reserve Statement commencing with the adoption of the Fiscal Year 2015-2016 Budget for the District's fire services, water services, drainage services, wastewater fiduciary funds, Bayridge Estates, administrative functions, and parks and recreation services and to establish the purposes for each of the reserve categories.

**NOW THEREFORE, THE BOARD OF DIRECTORS OF THE LOS OSOS COMMUNITY SERVICES DISTRICT DOES HEREBY RESOLVE, DECLARE, AND DETERMINE THAT:**

**SECTION 1: RESERVE POLICIES**

**A. Fire Department – Fund 301:**

1. A Vehicle & Equipment Replacement Reserve shall be established for the orderly and timely replacement of emergency equipment, apparatus and accessories. The annual funding goal is equal to the amount of depreciation of replaceable equipment for the year increased by inflationary costs determined by the higher of an amount based on CPI change as per Section 3 or an amount based on industry trends on replacement values. During the years that appropriating the annual funding goal is not financially feasible, a minimum funding of \$72,000 \$90,190 is appropriated annually. Until such time that the maximum funding goal is reached, catch-up funding will be appropriated in any year whenever it becomes financially feasible. The maximum funding goal is for the reserves to be equal to the total accumulated depreciation of replaceable equipment increased by inflationary costs intended to approximate replacement costs in any given year. An equipment replacement schedule is prepared by the Fire Chief or his/her designee that will validate increases or decreases to the reserves funding as requested in the budget of the upcoming year in accordance with this section.
2. A Capital Outlay Reserve shall be established for the replacement, upgrade, expansion or improvements of buildings, structures and facilities that are used by the department to house personnel or equipment. Funding goal is an annual appropriation of at least \$10,000, with a cumulative maximum goal of \$5 million.
3. A General Contingency Reserve shall be established to meet contingency expenditures resulting from natural disasters or from unforeseen circumstances. Annual funding goal for this reserve account is \$10,000 with a maximum cumulative goal of at least 15% of the Fire Fund's Operating and Maintenance annual budget Note: Using this fiscal year's budget (15/16), the goal of the General Contingency Reserve account would be about on average amounts to about \$1.3 million
4. A Public Facility Fee Reserve shall be established to manage the Facility Fees received from the renovation and construction of facilities within the Fire District. Funding Goal is thru fees collected by the County of San Luis Obispo for capital improvements for infrastructure, equipment and facilities necessary to meet the demand attributable to commercial and residential development as established by AB 1600.

**B. Water Department – Fund 500:**

1. A Rate Stabilization Reserve shall be established to:
  - i. Equalize revenues should District income from the Utility billings decrease due to conservation efforts initiated by the District or by the public; and
  - ii. Provide a funding source to offset operation and maintenance revenues associated with fee waivers or reductions approved by the District Board of Directors in accordance with District policies and procedures established pursuant to Government Code Section 61123).(d). Reserves in this category shall be funded by water sales revenues.

The funding goal of this Rate Stabilization Reserve shall be \$32,000 annually until such time as this Rate Stabilization Reserve reaches a total of ten (10%) percent of the total annual water Operation and Maintenance Budget as approved by the Board of Directors from time to time.

2. A General Water Contingency Reserve shall be established for Emergency Operations should a natural or other disaster occur that would temporarily interrupt the District's income from Utility bills, to repair District facilities, and to provide funding for unforeseen circumstances not covered by the District's Operation and Maintenance Budget. The funding goal of this reserve account is an annual appropriation of at least \$25,000 per year up to a maximum cumulative goal of sixty (60%) percent of the District's annual Operation and Maintenance Budget as approved by the Board from time to time.

3. A Water Capital Outlay Reserve will be established for the replacement of water infrastructure. The funding goal of the Water Capital Outlay Reserve is to fund the timely replacement of water infrastructure and facilities as referenced in the District's Water Master Plan or other subsequent water planning documents approved by the District. The annual funding goal of this reserve is at least \$65,000 \$150,000 per annum with a short-term cumulative funding goal of \$470,000 and a long-term cumulative funding goal equal to the total of needed capital improvement projects identified in the Water Master Plan.

4. A Water Quality Trust Reserve shall be established to fund studies on the causes of pollution and contamination of the District's water supply, to mitigate the problem so as to continue delivery of safe drinking water and fund short-term and long-term solutions to prevent and mitigate water contamination problems in the future for the whole community. There is no annual funding set for this Reserve but will continue to exist only as long as there is a balance in the settlement account of a water pollution case received in 2005. When the funds are exhausted, this Reserve will cease to exist.

5. A Water Conservation Reserve is established with an initial funding of \$25,000 in FY 2012/13. No annual funding for this reserve is set but will increase annually by the appropriation balance in the Water Conservation Program account (No. 7348) as of the end of each fiscal year. The cumulative funding goal of this reserve is \$100,000. A designation for an Emergency Capital Reserve is hereby established. No annual funding is set, however, based on climatic conditions and revenue generation, an annual appropriation is when appropriate is recommended at \$25,000. The cumulative funding goal of this Reserve is \$500,000 per the 2014 Water Rate Study.
6. A Designation for Water Basin Management or ISJ Commitments is hereby established. This will be funded by any appropriation balances in account no. 9155, ISJ Costs Inter Agency Cost Sharing, remaining as of the end of each fiscal year that is not otherwise held in a Reserve for Encumbrance or Fund Reservation starting with the close of FY 2011/12. Initially, the cumulative funding goal of this Reserve is \$1 million. The minimum funding goal is . The Reserve is designated for costs associated with the operation of the Basin Management. The funding goal for this Reserve is .
7. A Water Planning Reserve is recommended by the 2014 Water Rate Study. The minimum funding goal for this purpose was recommended at 25% of the annual operating, maintenance and debt service expenses. This equates to approximately \$400,000. The District currently budgets \$122,000, leaving a balance of \$278,000 as a remaining Reserve for consideration. It is recommended as funds become available, the yearly appropriation be set at not to exceed \$25,000. The maximum goal is set at 25% of the annual operating, maintenance and debt service expenses.

**C. Drainage – Fund 800:**

1. A Drainage Capital Outlay Reserve fund shall be established for the replacement of equipment and facilities associated with the operation of District drainage services. The funding goal of this Capital Outlay Reserve will be at least \$10,000 per annum with a total funding goal of \$500,000. The total funding goal may be adjusted by the Board of Directors from time to time as part of the adoption of the annual budget. The maximum goal is set to a level that is sufficient to replace at least half of the drainage equipment and facilities at any point.
2. A General Contingency Reserve shall be established for contingency expenditures resulting from natural disasters or unforeseen circumstances. Funding goal for this reserve account is \$5,000 per annum with a cumulative funding goal of \$50,000. When this goal is reached, it shall be funded with an annual increase in accordance with the CPI index change as per Section 3 applied to the balance of this reserve as of the last audited fiscal year.

**D. Solid Waste – Fund 650: Wastewater Fiduciary Fund 602**

1. General Contingency Reserves not to exceed \$ 300,000 is established to cover expenditures estimated to equal no more than six months of operating costs in the event that the District may find itself operating solid waste collection, disposal and recycling functions should its business partner now franchised to do these functions be unable to continue to provide these services due to an unforeseen event. This reserve provides assurance that solid waste services remain uninterrupted at all times. Annual appropriation for this reserve will be no more than \$ 50,000 annually until the maximum cumulative reserve goal of \$300,000 is reached at which time funding will be equal to the change in the CPI index as per section 3 applied to the balance of this reserve as of the last audited fiscal year. A WW 2002 Bond Redemption Reserve shall be established for the repayment of the bond indenture that required LOCSD to maintain certain bond proceeds in reserve and segregate them into the Debt Service Reserve Fund (LOCSD Improvement Bond Reserve Fund-US Bank). Through the San Luis Obispo County Tax Rolls, US Bank receives the payment and the District is responsible for tracking the payments and insure payment to the Reserve based on the Administrative Overhead Costs collected. The annual Administrative Overhead Cost varies between \$25,170 and \$50,340. The Reserve shall remain in effect until the Reserve goal is reached of \$1,158,500.
2. A Prepaid Assessment Reserve shall be established for the Wastewater 2002 Bond Assessment as outline on the "Sewer Assessment Account Log Received After 08/31/2001" as maintained by Wallace Group. The Reserve is for funds on deposit for those parcels listed on the Log who since the assessment have prepaid the total balance of the assessment owed on the respective parcel. There is no goal for funding as deposits are made at the time the debt is paid in full by the property owner. This Reserve will remain in effect until the WW 2002 Bond is paid in full.
3. A LOCSD Community Fund Reserve is established to track the investment managed by the San Luis Obispo County Community Foundation, Inc. This is a pass through fund investment was created in 2002 to receive gifts in whatever form of money or property, and to administer this fund. The primary purpose of this Reserve is to provide low income families living in Los Osos with financial assistance for costs associate with the LOCSD sewer services. No funding goal was established. There is no annual appropriation and this Reserve remains in effect until the funds are disbursed for their established purpose.
4. A Disputed Reserve Fund is established as delineated in the Bankruptcy Order entered October 15, 2013 for unclaimed distributions. This Reserve was required to be retained for a period of two years from the date of payment to Class 8 unsecured creditors. This Reserve of holds on deposit unliquidated funds based on the face amount of the claim from outstanding creditor checks or funds returned because the prior claim was paid. This Reserve holds funds entitle unclaimed property. Effective February 7, 2016, two years from the distribution date, the funds are the property of the District and the requirements for holding the funds in the Reserve will cease to exist...

**E. Administrative Fund – Fund 100:**

1. A Reserve for Information Technology General Contingency is hereby created in the Administrative Fund. This Reserve will fund acquisitions and upgrades of software, hardware and systems that are used to provide centralized services to all funds of the District. This will be funded by total appropriation savings in the Administrative Fund at the close of each fiscal year starting with fiscal year 2011/12 or as otherwise directed by the Board at the adoption of the annual budget. The maximum funding goal is \$200,000. This Reserve will fund services as appropriated by the Board of Directors. There will be no more funds deposited to this Reserve. The balance of the funds will be used as designated by a four-fifths vote of the Board of Directors. When the Reserve is depleted the Reserve will cease to exist.
2. A Contingency Reserve for Septic System Pumping and Maintenance is established with annual funding of about \$17,300. This funding comes from general taxes originally used for drainage basin maintenance which is now funded by Drainage assessments. This reserve will sunset as soon as the sewer system being built by the County becomes operational.

**F. Bayridge Estates – Fund 200:**

1. A Reserve for the Septic System transfer, created by Resolution 2014-16 is hereby added to this policy. This reserve is set aside for decommissioning the septic systems, maintenance improvements and conversion to the County's sewer system. Any excess revenue over the established \$8,000 per year will be transferred automatically to this Reserve. This Reserve will sunset as soon as the sewer system becomes operational and the septic system is connected to the community sewer system.

**G. Restricted Pool Parks and Recreation General Contingency Fund Reserve – Fund 900:**

1. A Restricted Pool Fund Parks and Recreation General Contingency Reserve shall be established. This Reserve is the proceeds from the approval of the March 1996 recreation ballot measure by the voters of CSA9, Zone B pursuant to County Ordinance 2766 adopted for the purposes of "extending service of local parks and recreation services." The beginning balance was established as of August 26, 1997 at \$208,000.

**SECTION 2: RESERVE FUNDING INCLUDING INVESTMENT INCOME**

Reserve funding sources include rates, charges, special taxes, and property taxes collected by the District related to the services referenced in Section 1 of this Resolution.

All interest and other investment income earned on funds held in reserves or designations will be added to the associated Reserve/Designation Balance. Reserves and Designations that have reached their cumulative funding goal will continue to increase with investment income unless the Board approves a specific amount cap to a specific reserve or designation.

In any year where there is a major shortfall in revenues due to unusual circumstances which may or may not be under the control of the Board of Directors, funding for Reserves is held in abeyance and is subsidiary to the funding of Operations and Maintenance expenditure



accounts. After the circumstance is resolved, funding for Reserves for all years that were not fully funded will be restored whenever feasible. A description of the unusual circumstance will be presented to the Board at the time the Proposed Budget or the Final Budget is presented along with a statement of the impact on the reserves funding goals.

### **SECTION 3: INCREASE FUNDING OF RESERVES EQUAL TO THE INCREASE IN THE CONSUMER PRICE INDEX (CPI)**

Funding increases to Reserves on account of the change in CPI Index as used in Section 1 is computed as the percentage change in the average of the annual averages of the last calendar year over the prior calendar year using the Los Angeles-Riverside-Orange CPI and the San Francisco-Oakland-San Jose CPI for all consumer items. This section will apply once certain reserves reach their maximum funding goal and is intended to bring the reserve in line with current values each year.

### **SECTION 4: SPECIFIC ACCOUNTS THAT WILL AUTOMATICALLY GO TO RESERVES OR DESIGNATIONS**

1. Appropriation balances of specific accounts, not otherwise held in a Reserve for Encumbrance or Fund Reservation, as of the end of each fiscal year will automatically roll over to the subsequent fiscal year as increases to the associated reserve/designation unless the Board directs otherwise during the adoption of the annual budget; these accounts are as follows.
  - a. Capital Outlay accounts
  - b. ISJ Charges
  - b c. Water Conservation Program
  - c d. Appropriation for Contingencies
2. Proceeds of sale of fixed assets will automatically roll over to the subsequent fiscal year as increases to the Vehicle, Equipment or Plant Replacement Reserve if one exists or to the Capital Outlay Reserve unless the Board directs otherwise during the adoption of the annual budget.

### **SECTION 5: TRANSFERS**

1. Pursuant to Government Code Section 61112(c), the District Board of Directors may only transfer reserve funds for purposes other than the purposes outlined in Section 1, above, by a four-fifths (4/5) vote of the total membership of the Board of Directors and upon a finding that the reserves are no longer required for the designated purpose. Reserve transfers are limited to funding shortfalls in other related budget categories of the particular service and to funding shortfalls in administrative services budget.
2. It is operationally prudent that the District establish a date when the excess revenue from prior years can be designated by the Board of Directors and transferred to an existing reserve for the specific fund. The date for presentation to the Board of Directors is hereby established as [REDACTED]. It is important to recognize the assessments for drainage, special fire tax and property taxes are due without penalty on December 10 of the respective fiscal year. The District receives a cash infusion from the collections twice yearly in December and April of the flowing calendar year. Recognizing that until December of the respective year, the Funds meet their cash flow needs by operating using prior year's excess revenues over expenditures as cash flow.

**SECTION 6: INCONSISTENCY**

To the extent that the terms or provision of this Resolution may be inconsistent or in conflict with the terms or conditions of any prior District motions, resolutions, rules, or regulations adopted by the District, governing the same subject matter thereof, then such inconsistent and conflicting provisions of prior motions, resolutions, rules, and regulations are hereby repealed.

**SECTION 7: SEVERABILITY**

If any section, subsection, sentence, clause or phrase of this Resolution is for any reason held to be unconstitutional, ineffective or in any manner in conflict with the laws of the United States, or the State of California, such decision shall not affect the validity of the remaining portions of this Resolution. The Governing Board of the District hereby declares that it would have passed this Resolution and each section, subsection, sentence, clause and phrase thereof, irrespective of the fact that any one or more sections, subsection, sentence, clause or phrase be declared unconstitutional, ineffective, or in any manner in conflict with the laws of the United States or the State of California.

**SECTION 8: INCORPORATION OF RECITALS**

The recitals to this Resolution are true and correct and incorporated herein by this reference.

Upon the motion of Director \_\_\_\_\_, seconded by Director \_\_\_\_\_ and on the following roll call vote:

AYES: \_\_\_\_\_  
NOES: \_\_\_\_\_  
ABSENT: \_\_\_\_\_  
ABSTAIN: \_\_\_\_\_

The following Resolution is hereby passed, approved and adopted by the Board of Directors of the Los Osos Community Services District on the \_\_\_\_\_ day of \_\_\_\_\_ 201\_\_.

\_\_\_\_\_  
R. Michael Wright  
Vice President, Board of Directors  
Los Osos Community Services District

ATTEST:  
  
\_\_\_\_\_  
Kathy A. Kivley  
General Manager and Secretary to the Board

APPROVED AS TO FORM:  
  
\_\_\_\_\_  
Michael W. Seitz  
District Legal Counsel

**RESERVE STATEMENT**  
**Effective July 1, 2015**

Acct Code	Category & Fund	Beginning BALANCE 06/30/2013	Budget FY 2013/2014	Additions (Other uses)	Gain/ (Use) FY 2013/2014	Total FY 2013/2014	Adopted Budget FY 2014/2015	Gain/ (Use) FY 2014/2015	Total FY 2014/2015	Adopted Budget FY 2015/2016	Additions (other uses)	Gain/ (Use) FY 2015/2016	Projected Ending BALANCE
<b>100 - Administration</b>													
3111	General Contingency Reserve	20,918				20,918	(20,994)	75	(0)				(0)
3164	Information Technology Reserve	28,741				28,741		175	28,916				28,916
3166	Septic Maintenance Reserve (Fire Station)	15,801				15,801		1,500	17,300				17,300
	<b>Total - 100 - Administration</b>	<b>\$65,460</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$65,460</b>	<b>(\$20,994)</b>	<b>\$1,750</b>	<b>\$46,216</b>				<b>46,216</b>
<b>200 - Bayridge Estates</b>													
3109	Septic System Decommission Reserve	0	\$8,000			\$8,000	\$8,000	31	\$16,031	8,000			24,031
<b>301 - Fire</b>													
3110	Replacement Reserve - Vehicle, Equip & Fire Engines	247,962	109,099		67,986	425,047	92,206	645	517,898	53,334	36,856		608,088
3111	General Contingency Reserve	61,381				61,381		1,942	63,323	(36,856)			26,467
3115	Public Facilities Fee Reserve	51,193			429	51,622		3	51,622	(12,716)			38,906
3160	Capital Outlay Reserve	613,873				613,873		837	614,710	(38,152)			576,558
	<b>Total - 301 - Fire</b>	<b>\$974,409</b>	<b>\$109,099</b>	<b>\$0</b>	<b>\$68,415</b>	<b>\$1,151,924</b>	<b>\$92,206</b>	<b>\$3,423</b>	<b>\$1,247,553</b>				<b>1,250,019</b>
<b>400 - Vista de Oro</b>													
3193	Reserve - Internal Loan	1,517.00	2 \$30,000	(\$1,567)	(\$15,151)	\$14,799		(\$11,451)	\$3,348				3,348
<b>500 - Water</b>													
3050	Water Quality Trust Reserve	91,517				91,517			91,517				91,517
3110	Replacement Reserve - Vehicle, Equip & Fire Engines	42,197				42,197		(42,197)	0				0
3111	General Contingency Reserve	178,783	25,000	30,000	(30,000)	203,783	25,000	(31,801)	8 196,982	25,000			221,982
3160	Capital Outlay Reserve	493,407	65,000		665	559,072	65,000	(57,258)	6 566,814	65,000		(125,000)	506,814
3163	Water Stabilization Reserve	128,856	32,000			160,856	32,000		192,856	32,000			224,856
3165	Basin Management Plan Reserve	39,288				39,288			39,288				39,288
3167	Water Conservation Reserve	25,031				25,031		(20,000)	5,031				5,031
	<b>Total - 500 - Water</b>	<b>\$999,079</b>	<b>\$122,000</b>	<b>\$30,000</b>	<b>(\$29,335)</b>	<b>\$1,121,744</b>	<b>\$122,000</b>	<b>(\$151,256)</b>	<b>\$1,092,488</b>				<b>1,089,488</b>
<b>600 - Wastewater Enterprise</b>													
3191	Restricted Funds-SRF	1,407,913			(1,405,977)	1,936	(1,935)		0				0

**RESERVE STATEMENT**  
**Effective July 1, 2015**

Acct Code	Category & Fund	Beginning				Adopted				Adopted				Projected Ending BALANCE
		BALANCE 06/30/2013	Budget FY 2013/2014	Additions (Other uses)	Gain/ (Use) FY 2013/2014	Total FY 2013/2014	Budget FY 2014/2015	Gain/ (Use) FY 2014/2015	Total FY 2014/2015	Budget FY 2015/2016	Additions (other uses)	Gain/ (Use) FY 2015/2016		
<b>602 - Wastewater Fiduciary</b>														
3091	Restricted-2002 Bond Redemption Reserve	726,664	1 25,000		6,435	758,100	4,000	99,066	861,166	50,340				911,506
3120	LOCSD Community Fund	0	4		173,995	173,995		(2,147)	10 171,848					171,848
3159	Prepaid Assessment Reserve					142,670	(6,192)	166	136,643			2,946		139,589
3161	Disputed Reserve Fund				103,103	103,103		(100)	9 103,003					103,003
	<b>Total - 602 - WW Fiduciary</b>	<b>\$726,664</b>	<b>\$25,000</b>	<b>\$0</b>	<b>\$283,533</b>	<b>\$1,177,868</b>	<b>(\$2,192)</b>	<b>\$96,985</b>	<b>\$1,272,661</b>					<b>1,325,947</b>
<b>650 - Solid Waste</b>														
3111	General Contingency Reserve	\$186,052	7	\$16,479	\$246	\$202,777	(\$37,914)	\$542	\$165,405	1,616				167,021
<b>800 - Drainage</b>														
3111	General Contingency Reserve	27,238	5,000			32,238	5,000	553	37,791	5,000				42,791
3160	Capital Outlay Reserve	184,995	10,000		60	195,055	10,000	276	205,331	10,000				215,331
	<b>Total - 800 - Drainage</b>	<b>\$212,233</b>	<b>\$15,000</b>	<b>\$0</b>	<b>\$60</b>	<b>\$227,293</b>	<b>\$15,000</b>	<b>\$829</b>	<b>\$243,123</b>					<b>258,123</b>
<b>900 - Parks &amp; Recreation</b>														
3090	Restricted Pool Funds	\$303,838	5	\$0	\$918	\$304,756	\$0	\$577	\$305,333					305,333
						<b>\$4,274,622</b>			<b>\$4,392,157</b>					<b>\$4,469,525</b>

1 Managed by US Bank

2 Internal Loan from Water Reserves

3 CD Matures 03/18/2016

4 Managed by Community Foundation

5 Beginning Balance adjusted based on LAIF; according to prior legal opinion issued January 31, 2000 this Reserve should not be restricted

6 Authorized use: \$60,000; interest: \$2,742

7 Reserve adjustment from FY 2011/2012 & FY 2013/2014

8 Authorized use: \$32,803; interest: \$1,002

9 Bank Analysis Fee Charge

10 Loss on investment



California Special  
Districts Association  
*Districts Stronger Together*

# Special District Reserve Guidelines

SECOND EDITION



**A GUIDE TO DEVELOPING A PRUDENT RESERVE.**



## Acknowledgements

In preparing the Special District Reserve Guidelines, the California Special Districts Association (CSDA) greatly benefited from individuals who were generous with their time and insightful with their views. Our task force consisted of finance staff and general managers from independent special districts, as well as professional financial consultants.

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## The Formation of Special District Reserve Guidelines

Answering a  
Call, Fulfilling  
a Need

The genesis for CSDA's Special District Reserve Guidelines was a 2000 Little Hoover Commission report entitled, *"Special Districts: Relics of the Past or Resources for the Future?"* The report included a section on special district reserves with an introductory finding that stated: *"Hundreds of independent special districts have banked multi-million dollar reserves that are not well publicized and often not considered in regional or statewide infrastructure planning."*

The 2000 report raised a number of issues relating to special district reserves including:

- Lack of guidelines and consistency
- Lack of visibility and publication of district financial information
- Lack of understanding among constituents and policymakers of district finances
- Lack of districts incorporating reserve information into infrastructure planning

News media reacted to the Little Hoover Commission report with banner headlines claiming that "obscure" public agencies have "hoarded" billions in reserves. Legislative hearings on special district finances were held and interest was spiked among grand juries, leading them to investigate how special districts within their counties handle reserves.

Ultimately, the Little Hoover Commission recommended that guidelines for prudent reserves be established, and that investment policies and practices be reviewed to determine if additional oversight was warranted.



...many independent special districts already have established reserve policies and most, if not all, special district officials recognize their fiduciary responsibilities and take them seriously.

## **CSDA Reserve Guidelines Task Force**

Although special district advocacy organizations disagreed with some of the Little Hoover Commission's findings and data interpretation, CSDA concurred that the establishment of reserve guidelines would assist special district governing officials and administrators in fulfilling their fiduciary responsibilities. To accomplish this, CSDA formed a task force in 2001 to identify both the essential elements of a reserve policy and the issues to be discussed during policy development.

The Special District Reserve Guidelines were developed by the task force as a tool for special district governing officials and administrators to assist them in fulfilling their commitment to provide cost-effective and efficient public services for the communities they serve.

## **Special District Reserve Guidelines**

Second Edition

Today, with over a decade having passed since CSDA convened its original task force in 2001, many special districts have utilized the guidelines to evaluate their reserve policies, develop new reserve policies, and/or promote comprehensive and easily understood policies.

Through this decade-long process, special districts have gained new insights on improved best practices. Furthermore, certain accounting practices and terminologies have evolved. Therefore, in order to ensure the most accurate and updated guidelines, and in continuance of efforts to promulgate widespread adoption, CSDA commissioned a second task force in 2012 to produce a Special District Reserve Guidelines, Second Edition. CSDA encourages district officials to incorporate these new guideline elements into their policies, where applicable, based on size and services offered.

In developing and updating the second edition, the CSDA task force recognized that many independent special districts already have established reserve policies and most, if not all, special district officials recognize their fiduciary responsibilities and take them seriously. What may have generated most of the concern regarding special district reserves in 2000 is not lack of policy, but lack of outreach to constituents and others regarding district operations. It is essential that special districts continue to promote understanding outside their boardroom and perform outreach on district financial management to facilitate understanding among the public, media and legislators.



## Introduction

Reserves are the foundation of the sustainable delivery of core services.

### *Importance of Maintaining a Reserve*

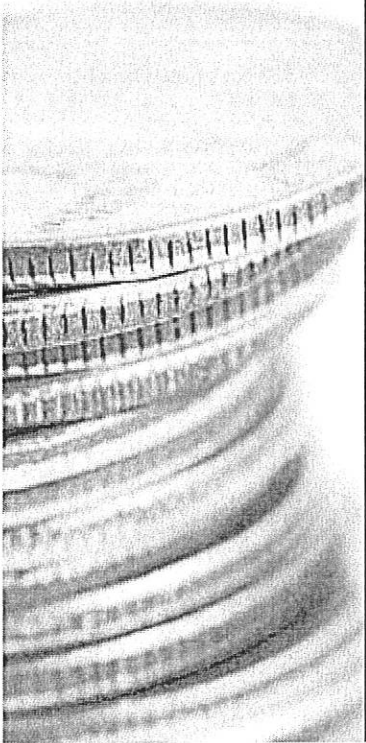
Reserves are the foundation of the sustainable delivery of core services. Through prudent reserves, special districts offer taxpayers and ratepayers significant benefits including:

1. Savings to balance budgets
2. Emergency preparedness
3. Stable rates
4. Well-maintained infrastructure
5. Investment in the future

The fundamental question in maintaining a reserve is, how much is enough? In other words, when are reserves too low and when are they too high? These can be delicate questions because unwarranted reserves could undermine taxpayer and ratepayer support, while insufficient reserves could jeopardize the district's long-term sustainability.

There is also the question of where reserve funds should be spent. Pressure to expend reserves on making current services cheaper, rather than planning for the future, is all too frequent. Adopting a reserve policy will assist your agency in answering these fundamental questions.

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## Reasons for Adopting a Reserve Policy

In addition to the over-arching taxpayer and ratepayer benefits of reserves noted earlier, there are many specific reasons for a special district to adopt reserve policies:

### Shared Vision:

A formally adopted policy promulgates a shared understanding of the proper level and use of reserves, which facilitates healthy working relationships.

### Objectivity:

Revenue decisions represent some of the most controversial and difficult choices that governing boards must face. Utilizing reserve policies reduces political gamesmanship and promotes responsible long-term planning.

### Fiscal Justification:

Inevitably, public agencies will face scrutiny over whether to raise or reduce rates, taxes or fees. Having reserve policies in place prior to such occasions serves as a valuable tool for both making and explaining difficult decisions.

### Public Awareness:

Keeping the public informed about what you do is a fundamental responsibility for any public agency. They are the boss, after all, and all of us understand from personal experience that our jobs are a lot easier and a lot less stressful when the boss knows about and approves of what you are doing. Adopting a policy can help the district better communicate to the public the motives for adopting a reserve, as well as convey the reasons for maintaining the reserve at a certain level.



### Important questions about reserves

The fundamental question in maintaining a reserve is, how much is enough? In other words, when are reserves too low and when are they too high? These can be delicate questions because unwarranted reserves could undermine taxpayer and ratepayer support, while insufficient reserves could jeopardize the district's long-term sustainability.



## Prudent Accumulation and Management of Reserves: Developing Policy

Each special district should develop and adopt a reserve policy.

The Special District Reserve Guidelines reflect the common belief among special districts that there should be a clear and well-articulated rationale for the accumulation and management of reserve funds. Each special district should develop and adopt a reserve policy as a commitment to financial prudence and careful stewardship of community assets. It is critical to understand that a reserve fund is designated by a public agency to carry out specific purposes in a manner consistent with other financial policies, budgetary practices, district programs, and legal requirements.

### *Reserve Policy Objectives:*

1. To provide adequate funding to meet the agency's short-term and long-term plans.
2. To minimize adverse annual and multi-year budgetary impacts from anticipated and unanticipated expenditures, thus minimizing the possibility of unplanned service fees or rate fluctuations.
3. To strengthen the financial stability of the agency against present and future uncertainties in an ever-changing environment.

### *Foundational Elements of a Reserve Policy:*

Prior to developing a reserve policy, a district should first establish the three prerequisites below.

1. Clear, organizational philosophy/mission.
2. Policy-oriented board of directors, with long-term focus on fiscal sustainability.
3. Standardized method of financial reporting, such as Governmental Accounting Standards Board (GASB) Statement Nos. 34 and/or 54.

Communicating regularly  
about district financials and  
reserve priorities creates trust.

<b>Principles for Developing a Reserve Policy:</b>
<p><b>1. Identify the uniqueness of the district.</b></p> <ul style="list-style-type: none"> <li>a. Consider district goals, needs and constraints.</li> <li>b. Utilize life-cycle analysis if district is capital intensive.</li> <li>c. Regularly measure condition of assets.</li> </ul>
<p><b>2. Form a complete understanding of the district's core business and significant cost drivers for district operations.</b></p>
<p><b>3. Engage in strategic planning.</b></p> <ul style="list-style-type: none"> <li>a. By developing, regularly evaluating and, when necessary, modifying strategic plans, districts can more efficiently plan and shape their futures. Strategic planning can help district boards anticipate and adapt to changing environmental, regulatory and demographic conditions. This assists districts in establishing appropriate reserve funds and adopting adequate target levels.</li> <li>b. Seek community input in the strategic planning process, i.e., ratepayers and taxpayers, business groups, community organizations, other public agencies serving the same constituency, etc.</li> </ul>
<p><b>4. Make communicating a priority.</b></p> <ul style="list-style-type: none"> <li>a. A regular newsletter and annual report are good starting points; it is critical for districts to reach out to the public and explain their financial position.</li> <li>b. Seek input through customer surveys, community meetings, and other meaningful engagement.</li> <li>c. Inform customers and constituents of output and seek their input in evaluating policies.</li> </ul>
<p><b>5. Recognize that a good reserve policy must be consistent with other financial policies, such as a balanced operating budget and investment policies.</b></p>
<p><b>6. Create and maintain a well-developed capital improvement plan.</b></p>
<p><b>7. Estimate the ebb and flow, or "seasonality," of cash-flow during the fiscal year and build a basic understanding of the degree of short-term borrowing necessary to meet such needs.</b></p>
<p><b>8. Clearly identify reserves—both categories and purposes. Set target levels for reserves that are consistent with the district's mission, the district's uniqueness and the philosophy of the district's board and community.</b></p>
<p><b>9. A broad reserve policy may include many elements or sub-policies. Some areas that may need sub-policies include:</b></p> <ul style="list-style-type: none"> <li>a. Rate-stabilization funds</li> <li>b. Fees and charges</li> <li>c. Debt issuance and management</li> <li>d. Deferred maintenance</li> <li>e. Level of unrestricted (contingency) funds</li> <li>f. Long-term repair and replacement</li> </ul>



## Fund Balance and Net Position/Net Assets

Every district has unique circumstances and a proper fund balance should be considered on a case-by-case basis.

There are many factors that must be considered when establishing an appropriate fund balance and ensuring the prudent management of your district's finances. Every district has unique circumstances and a proper fund balance should be considered on a case-by-case basis. Thoughtfully accounting for variables such as your district's revenue sources and income volatility will assist your district in determining its reserve amount. On the following pages are issues that should be considered when adopting a reserve level.



## Specific Considerations for Budgeting and Allocating Fund Balance or Net Position/Net Assets

### Considerations

1. Define the special district's fiscal objectives:

- a. Short-term
- b. Long-term
- c. Operating
- d. Capital

2. Identify where funds are used:

- a. Operating revenues are the general-purpose funds through which ongoing activities are funded.
- b. Special-purpose revenues often are legally restricted for a particular use. For example, a special assessment for infrastructure must be separately accounted for and spent on designated infrastructure costs.
- c. Debt proceeds should be used to fund costs that provide a benefit across fiscal years. The issuance of debt allows the district to allocate these costs by spreading the debt service to these periods. Debt proceeds should never be used for short-term operating costs because this would entail allocating current operating costs to future periods.
- d. One-time revenues should be used for one-time expenses. If a special district gets one-time revenues and uses it to provide additional full-time positions or to fund on-going operating costs, it may lead to a budget crisis when the one-time funding runs out.



### One-time Revenue

According to the Government Finance Officers Association, "Examples of one-time revenue include: infrequent sales of government assets, bond refunding savings, infrequent revenues from development and grants. These revenue may be available for more than one year (e.g., a three-year grant) but are expected to be non-recurring."

### One-time Expenditures

According to the Government Finance Officers Association, "Examples of expenditures which a government may wish to use one-time revenue include start up costs, stabilization (e.g. to cover expenditures that temporarily exceed revenues), early debt retirement, and capital purchases."



## Components of Fund Balance

In governmental funds, "reserves" typically comprise a portion of the total fund balance. Fund balance reporting standards play a part in describing how much of fund balance might be available for a reserve and how much is limited to other purposes. GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, changes how fund balance has traditionally been reported.

In the past, reporting of fund balance focused on whether resources were available for appropriation (i.e., budgeting) and distinguished between "unreserved fund balance" (i.e., available for appropriation) and "reserved fund balance" (i.e., not available for appropriation). GASB Statement No. 54 changes the focus to the "extent to which the government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent" and establishes five different components of fund balance:

### COMPONENTS OF FUND BALANCE

NONSPENDABLE FUND BALANCE	RESTRICTED FUND BALANCE	COMMITTED FUND BALANCE	ASSIGNED OR DESIGNATED FUND BALANCE	UNASSIGNED OR UNDESIGNATED FUND BALANCE
This category is inherently nonspendable, such as the long-term portion of loans receivable, the principle of an endowment and inventories.	This classification has externally enforceable limitations on the use of fund balance, imposed by parties such as creditors, grantors or laws or regulations of other governments.	This encompasses limitations imposed by the special district upon itself at its highest level of decision making (e.g., governing board through a resolution). For example, the governing board might commit a portion of fund balance to a "stabilization fund" to provide a cushion against unknown economic shocks and revenue declines.	This portion is earmarked for an intended use. The intent is established at either the highest level of decision making or by a body or official designated for that purpose. For example, a share of fund balance might be assigned to offset a gap in the budget stemming from a decline in revenues or an allotment could be assigned for an upcoming special project.	This comprises all fund balances that are left after considering the other four categories. Use is least constrained in this category of fund balance.



Unassigned fund balance is typically the primary subject of a reserve policy. However, committed and assigned fund balance may also be thought of as part of a reserve policy as the governing board or management, respectively, has some control over the balances. Conversely, restricted fund balances or nonspendable fund balances are fundamentally constrained, making it unnecessary to place parameters on them through reserve policy in order to achieve prudent savings and expenditures of public resources.

It is recommended that every district establish policies regarding minimum fund balance and spending priorities in order to communicate to users the importance of a reserve for economic uncertainties, why it consists of amounts that are unassigned and that it is not available for spending.

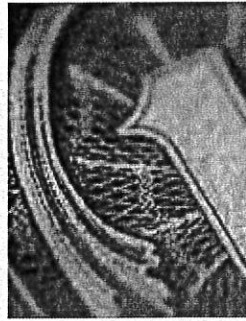
Districts' policies should specify the order in which fund balances are spent when more than one amount is available for a specific purpose. Where such policies do not exist, GASB 54 prescribes that the default order in which these amounts should be spent is committed, assigned, and then unassigned.



#### **GASB 54**

According to the Governmental Accounting Standards Board, statement No. 54 was issued after, "...research revealed that the existing standards guiding fund balance reporting were being interpreted inconsistently by different governments. Consequently, the fund balance information reported by many governments also was inconsistent. It also became clear that the understandability of fund balance information was affected and that financial statement users were unable to readily interpret reported fund balance information."

*GASB fact sheet about Fund Balance Reporting and Governmental Fund Type Definitions*



#### **Sample Policy Language**

The "X" district maintains a minimum unassigned fund balance of not less than "X" percent of budgeted general fund expenditures and other financing uses as a reserve for economic uncertainties. The district believes a reserve of this level is prudent to maintain a high bond rating and to protect the district from the effects of fluctuations in property tax revenues to which special districts are vulnerable. Because amounts in the nonspendable, restricted, committed and assigned categories are subject to varying constraints on their use, the reserve for economic uncertainties consists of balances that are otherwise unassigned.

## Reserve Level Targets

A reserve policy must set a target level of reserves to maintain. The target is typically defined in terms of unrestricted fund balance as a percentage of either regular operating revenues or regular operating expenditures. The choice between revenue and expenditures as a basis depends on which element is more predictable. A government that relies heavily on property taxes typically would choose revenues, whereas a government with a less predictable revenue portfolio might choose expenditures. In either case, the base should only reflect operating numbers and should remove the effect of unusual spikes or drops that would distort long-term trends.

With the basis of the target defined, the next step is to select a reserve-level target number. The Government Finance Officers Association (GFOA) offers guidance as to the amount of unassigned fund balance governments should maintain in their general fund operating revenues or regular general fund operating expenditures, regardless of size. As special-purpose governments, special districts should carefully balance such general advice with the unique circumstances associated with the district's operational environment.

In considering what constitutes adequate reserves, a special district may want to establish key benchmarks or ratios. Many industries have key equity target formulas or ratios that establish minimums to provide a red flag warning when equity may be too low. Some of those ratios may include the following:

- Debt to Equity
- Property Taxes to Equity
- Current Ratio
- Capital Outlay to Equity
- Capital Outlay to Operating Expenses

Certain districts may establish their own ratios based on the unique aspects of the district or an operating environment that may be different than other organizations in their industry.



### Local Conditions as a Basis

The Government Finance Officers Association notes that fund balance is ultimately a local decision based on local conditions. "...Finance staff should analyze the risks that influence the need for maintaining reserves as a hedge against uncertainty and loss."

*(p.57, GFOA, Financial Policies)*

## Articulating Financial Position and Decisions

Is this organization in good financial shape? That depends on the condition of the current assets and the short-term and long-term needs of the organization as they relate to its resources. If there exists significant current infrastructure needs, then financing may be required. Is enough set aside for contingencies? If water costs increase by 10 percent, or new environmental or health standards are issued, how will that affect total net assets?

Governmental entities collect, hold and expend resources in public trust. If too little is collected, they risk failing to meet mandated needs. If too much is collected, they overburden the public and tie up resources that taxpayers and ratepayers could use in the economy. Historically, governments have been known to spend most of their resources each year and too often fail to properly plan for long-term needs. Special districts should carefully examine their operations and budget to ensure that expenses, such as capital needs and contingencies, are anticipated and appropriate resources are set aside.

Some governments, either through good fortune or good planning, have reserved net assets for future plans and needs. What most governments have failed to do, as emphasized in the 2000 Little Hoover Commission's report, is to effectively communicate their plans for the net assets and explain why the balance is appropriate.

Each special district needs to:

1. Analyze its financial position.
2. Examine its current and long-term needs, including a capital improvement plan.
3. Establish its target fund balance or net assets.
4. Outline its goals and needs through policy, budgets and enhanced financial statement note disclosures.
5. Anticipate public scrutiny of financial statements and proactively communicate how finances are being used in a manner the public can easily digest.

It is recommended that special districts, at minimum, conduct a review of their reserve policy annually to ensure it meets the needs of the district and is in compliance with any requirements/standards that may have changed.

## Conclusion

Each special district's financial and legal professionals should review reserve policies prior to adoption to ensure they are in compliance with all current laws and regulations. Reserve policy should be established based on each district's unique financial situation. Any reserve policy needs to be reviewed regularly as the financial environment within which it functions is dynamic and there may be applicable legislative or regulatory changes.

The 2000 Little Hoover Commission report concluded that there was a disconnect between special districts and their constituents and other local government entities. Therefore, it is important that each agency not only develop a reserve policy, but ensure that stakeholders know and understand the district's financial position and decision-making process.

Districts should consider preparation of a public outreach program to communicate financial and program information on a regular basis to affected or interested populations. How involved each respective public outreach program is for a district is typically determined by the size and complexity of the district. A first step may be as simple as adding the information to an agency's website or the development of an annual report. CSDA encourages districts to take the next step and proactively engage the public to ensure its awareness.

We hope you find these guidelines helpful and if you have any comments or suggestions on how we can improve this document, please contact us at 877.924.2732.



## Addendum I: Glossary

**Assigned Fund Balance:** Amounts that are intended to be used by the special district for specific purposes but do not meet the criteria to be classified as restricted or committed.

**Capital Improvement Program (CIP):** A short-range plan that identifies capital projects and equipment purchases, provides a planning schedule and identifies options for financing the plan.

**Committed Fund Balance:** Amounts that can only be used for the specific purposes as determined by a formal action of the special district's highest level of decision-making authority.

**Net assets:** The amount of assets in excess of liabilities. For non-enterprise fund types, this excess is referred to as "fund balance." For enterprise-fund types, this excess is referred to as "net assets" or, as of July 1, 2012, "net position."

**Nonspendable Fund Balance:** Amounts that cannot be spent or where cash has been spent previously to produce a fund balance – for example, inventory, pre-paid expenses or restricted assets.

**Pay-Go:** Is the practice of financing expenditures with funds that are currently available rather than borrowed.

**Restricted Fund Balance:** Amounts that can only be spent for specific purposes which are stipulated outside the control of the special districts, such as the constitution, external resource providers (such as granting entities) or enabling legislation.

**Unassigned Fund Balance:** The residual of all other funds that are not nonspendable, restricted, committed or assigned. Unassigned balances are not in special revenue, capital projects, permanent or debt service funds unless the fund is in deficit.



## Addendum II: Special District Reserves Talking Points

### **PRUDENT RESERVES MAKE FOR SOUND BUDGETING**

For countless families, saving for a rainy day is common-sense. For special districts, reserve funds are not just money in a bank; they are fundamental resources for ensuring reliable core services and community security.

#### *How Taxpayers and Ratepayers Benefit*

Special districts designate money toward savings in order to balance their budget, respond to emergencies, keep rates affordable, maintain current infrastructure and plan for future public works projects.

- **Balancing Budgets** – Over the course of the fiscal year, short-term reserves help balance the ebb and flow of revenues verse expenditures.
- **Emergency Preparation** – In the event of a disaster, communities can't afford not to have savings readily available to quickly repair critical local infrastructure and bring core services back online.
- **Affordable Rates** – With appropriate savings, special districts are able to use resources wisely and smooth out the highs and the lows of volatile economic conditions, rather than spend their entire surplus and then seek new revenue or jeopardize services.
- **Infrastructure Maintenance** – Reserves mean the pipes are fixed, roofs are patched, and worn equipment is replaced without going back to the taxpayers or ratepayers to pay for routine upkeep.
- **Planning for the Future** – A long-term, thoughtful approach to public infrastructure requires the foresight to plan for, and discipline to save for, future needs.

#### *Reserves are Much More than Liquid Assets*

- What comprises a reserve fund? Reserve fund balances and net assets are not just cash and investments. They also include the net value of capital facilities, land and equipment measured from the very inception of the district.
- Assigned funds are budgeted for specific long-term public needs as planned by the board of directors.
- Committed funds are set aside via established policies for specific uses such as cash-flow, capital improvements, contingencies, and rate stabilization.
- Restricted funds are limited by legal or contractual requirements, or cannot otherwise be spent.

#### *Best Practices for Sensible Budgets*

- Historically, governmental agencies and departments have been known to spend everything they have before the end of the fiscal year in order to justify increased future allocations from their larger bureaucracy.
- Special districts are different because they empower core local service providers with budgetary control, encouraging efficiency and fiscal restraint rather than punishing it.
- The CSDA Reserve Guidelines Task Force identified both the essential elements of reserve policies and key issues to be discussed during reserve policy development to assist districts in fulfilling their commitment to provide cost-effective and efficient public services to their communities.



## Addendum III: Capital Planning

A Capital Improvement Program (CIP), also referred to as a capital plan, exists to identify and prioritize a special district's need for capital goods. A CIP should prioritize the importance and timing of the various assets to be acquired. In addition, a CIP should contemplate how those goods will be paid for – cash (equity) or debt. A capital plan is a strategic and comprehensive plan for the acquisition and implementation of the district's capital assets over time. In that sense, it is different from a finance plan, which focuses on individual acquisitions and how to pay for them.

To fulfill their mission, every district makes capital investments. Debt, especially tax-exempt debt, is recognized as an important and continuing source of a district's capital to fund improvements necessary to achieve its mission and strategic objectives. A CIP provides the framework by which decisions will be made regarding the use of cash and debt to finance capital projects.

Debt is defined to include all short and long-term obligations, guarantees and instruments that have the effect of committing the district to future payments. The assumption of debt, both direct and indirect, is subject to the district's approval. Any debt issued by subsidiary entities is subject to these policies. In satisfying their fiduciary responsibilities, it is important that a district's board and management know the extent of debt obligations.

### CIP Objectives

1. To provide guidelines to management on the use of reserves and debt to support a special district's capital needs while achieving the lowest overall cost of capital.
2. To provide selected financial measures, with specific targets, to ensure that the district continues to operate within appropriate financial parameters while allowing the agency to maintain financial stability and the highest acceptable credit rating that permits it to issue debt at favorable rates.
3. To bridge the cash flow gap between the district's available funds and its capital needs when the assumption of debt is deemed prudent.

### Creating a Capital Plan

1. Establish goals
2. Assess needs
3. Determine pay-go or borrow
4. Identify methods available for funding
5. Design the loan—the tactical plan
6. Organize approach

*Details on the following pages.*



### **Establish Goals**

The key elements in setting clear capital plan goals include:

- 1. Understanding the role of the planning horizon.** Planning horizons are important considerations in well-developed capital plans. For example, it makes little sense to try to plan for a 10-year or 20-year horizon if innovation, technology, demographics or legislative threats to the plan occur frequently or on short notice. Conversely, agencies that are in low-technology businesses and stable demographic circumstances can more effectively and more appropriately plan for long periods. Planning horizons should mirror long-term repair and replacement requirements of existing facilities.
- 2. Integrating the use (or lack thereof) of reserves.** The extent to which a particular district has accumulated reserves will dramatically impact the CIP. The development of, and adherence to, strong reserve policies can greatly simplify funding choices for a capital plan, but blind adherence to arbitrary reserve levels can be just as inhibiting as no reserves at all. The key is to make reserve accumulation, or depletion, work in harmony with the CIP, operating budget and risk management of the district.
- 3. Recognizing the repetitive nature of implementing the CIP.** A capital plan is by its nature repetitive. For that reason, many districts choose to review and update it annually, usually as an adjunct to deliberation of the operating budget. This keeps the CIP current and tempered by present information on the priorities of the district.

### **Assess Needs**

Every capital plan starts with a needs assessment. The assessment should be based on a comprehensive review of the agency's assets at the time an asset is recorded and an estimated useful life is assigned to each asset. This information later will be used as an indicator of when an asset is scheduled to be replaced. Estimated future replacement costs need to be obtained in order to reasonably estimate CIP fund requirements within an agency's long term financial plan.

### **Determining Pay-Go or Borrow**

The "pay-go" method of using current revenues to pay for long-term infrastructure and other projects is often considered when sufficient revenues and reserves are available and long-term borrowing rates are higher than expected cash reserve fund earnings.

On the other side of the spectrum, the "pay-as-you-use" or "borrow" strategy limits the need for building of major amounts of equity in capital assets. Such accumulation can be less economically efficient, particularly for those districts that are capital intense and whose capital goods are "used up" over long periods of time. Similarly, financing of smaller capital goods, or those with short or uncertain useful lives, is also inefficient. The rationale behind the borrow approach is that the district's stakeholders should "pay" for the assets required to deliver the goods or services of the agency over a time period that more closely mirrors the useful life of those assets.

Most districts use a blended approach based on their debt management policy. Often, a district's approach is dictated as much by affordability as by philosophy, given that few public bodies are capable of paying cash for all capital assets.

### ***Identify Methods Available for Financing***

Once the goals have been set, the needs assessed and the decision whether to pay cash or finance the asset has been made, some thought must be given to the method of financing. For example, even if an asset is to be procured for cash, and the cash is on hand in a reserve set aside for that purpose, a decision still must be made on whether to replenish or restore that reserve, and over what time period and from what source it will be replenished.

Choosing to issue debt means that the following choices must be made: form of debt, mode (fixed or variable rate), repayment terms and method of sale. These are the tactical decisions that often blur the understanding of the strategic elements of the capital plan.

### ***Design the Loan – The Tactical Plan***

If a decision is made to borrow, an array of choices will follow. Some districts choose to borrow from banks or private lenders; others choose public offerings of debt. Lease financing may be considered as an alternate to bond financing. Some districts pool their needs with other similarly situated districts in order to reduce costs through economies of scale.

Regardless of the choice of lenders or approach matching the useful life of the financed asset to the borrowing term is an important consideration. Common sense tells us that we should hesitate to finance automobiles with 30-year bonds. By the same token, a water treatment plant with a design-life of 50 years can be safely and prudently financed over long periods of time. Still, debt issuances over 30 years are rare.

This element of the CIP should also carefully consider other needs within the strategic plan when pledging assets or revenues to lenders. A generous package to a lender on today's asset may make tomorrow's asset financing problematic or impossible. The key is to ensure that each tactical financing plan within the capital plan works harmoniously with other elements of the plan and is flexible enough to allow for the inherently changing nature of the CIP.

### ***Organize the Approach***

The successful capital planning process looks a great deal like the successful budgeting process. The end-result articulates the goals and objectives of the organization to all stakeholders and relies on an accurate and unbiased assessment of needs. It provides for an evaluation of the desired assets to distinguish between "wants" and "needs." It is written and shared with the district's stakeholders.

The capital plan is revisited often and provisions for changing or amending it are straightforward. Finally, it incorporates periodic analysis of results and achievements for management and the governing body.

## **Summary**

A CIP need not be elaborate or weighty to be effective. Many effective capital plans consist of a single spreadsheet and several paragraphs of supporting text. The development of the program is vital to the efficient use of capital. It is a key ingredient in a lender's assessment of management's effectiveness and control. It is among the most important tools an elected official possesses to discharge the duties of office.

Readers who are interested in additional information about the development of capital plans should consider a variety of books, and other information sources, on the topic. Some suggested examples are shown in the attached resource listing at the back of this document.



## Addendum IV: Resources

The Government Finance Officers Association (GFOA) is a great source for more information regarding various government financial matters, including fund balance and financial reporting. GFOA has an extensive publications department. View a list of its full offerings at [www.gfoa.org](http://www.gfoa.org). The following publications may be useful:

1. "An Elected Official's Guide to Financial Reporting"
2. "Best Practice – Replenishing Fund Balance in the General Fund"
3. "Governmental Accounting, Auditing, and Financial Reporting"
4. "Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting"

The Governmental Accounting Standards Board (GASB) has a number of user guides written by the standard setter for use in many types of governments. These include:

1. *An Analyst's Guide to Government Financial Statements—revised, updated, and significantly expanded*
2. *What You Should Know about the Finances of Your Government's Business-Type Activities—a completely new guide for 2012*
3. *What You Should Know about Your Local Government's Finances*

In addition, in 2013, GASB is expecting to publish a guide directed at "Business-Type Activities." Most special districts in California are "Business-Type Activities."



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