Lakewood Water District
Financial Policies

The purpose of establishing financial policies for the District is to promote the financial integrity and stability of the District and to provide for the sustainability of essential District services. These policies form the foundation of the District and, with routine application, can act as overarching guidelines for consistent decision making.

Some policies are imposed by outside influence, such as minimum debt service coverage, bond reserves, and regulatory compliance, while other polices are specific to the District, such as cash reserve levels, day's coverage, reinvestment protocols, and use of debt.

These policies will assist the District in achieving financial and rate stability from year to year.

A. Fund Accounting

Appropriate segregation of monies should be established and maintained to provide adequate controls as to the sources and uses of funds. This will ensure that funds raised by the District are applied to the appropriate purposes and that equity attained through rate and charge structure is maintained.

1. Operating Reserves

An operating reserve is designed to provide a liquidity cushion to provide for financial viability of the District despite short-term variability in revenues and expenses primarily caused by seasonal fluctuations in billings and receipts, unanticipated cash operating expenses, or lower than expected revenue collections. Target funding levels are generally expressed in number of days' operating and maintenance (O&M) expenses, with the minimum requirement varying with the expected risk of unanticipated needs or revenue volatility. Industry practice ranges from 30 days to 120 days of O&M. The District will maintain the following operating reserves of 90 days.

2. Capital Contingency Reserves

A capital contingency reserve is an amount of cash set aside in case of an emergency, should a major piece of equipment or a portion of the utility's infrastructure fail unexpectedly. Additionally, the reserve could be used for other unanticipated capital needs or capital cost overruns. Industry standard is to maintain a minimum balance in the capital account equal to 1 to 2 percent of utility-fixed assets. The District will establish a target of 1 percent of utility fixed assets.

a. Restricted Debt Reserves

Restricted debt reserves are typically required through the term of debt repayment to provide a safeguard for bondholders in the event the utilities have insufficient funds to meet annual debt service. This reserve is generally equal to one year's debt service payment for each bond issue. As an alternative, bond insurance is sometimes issued in lieu of establishing a bond reserve account. The District will maintain a restricted debt reserve fund throughout the life of each bond issuance with the required level of reserves.

Cash Reserve Summary

The District will maintain a cash reserve of 180 days for O&M and capital expenditures and will maintain an overall cash reserve of $3.5 million. The District will use December 31 of each calendar year as the date to have these reserves on hand, with the balance expected to fluctuate during the year.

3. System Reinvestment Funding

Utilities generally require high levels of capital investment in infrastructure. The District has an ongoing duty to provide adequate service to its citizens; therefore, the District realizes the need to provide for replacement of system facilities. System reinvestment funding specifically addresses the concept of funding repair and replacements (R&R) through a regular and predictable rate provision. This approach is funding of depreciation.

4. Debt Service Coverage Requirements

When revenue bonds are issued, the District agrees to certain terms and conditions related to the repayment of the bonds. Bond coverage is one of those requirements whereby the District agrees to collect enough in annual system revenues to meet all operating expenses and not only pay debt service, but collect an additional multiple of that debt service. The stated coverage in the bond is typically 1.2 and is a minimum requirement; anything less would be a technical default of the bond covenant. The District will maintain coverage of at least 2.0 times its annual revenue bond debt service.

5. Use of General Facilities Charges for Debt Service

General Facilities Charges (GFCs) are charges assessed on new development rather than from the existing customer base. The variability in customer growth from year to year makes this an unreliable revenue stream and subject to large fluctuations.

GFC revenue will be deposited in the capital account of the District and made available for capital purposes only. GFCs can legally be used in two ways—they can be applied to capital project costs directly, or they can be applied toward annual debt service payments. The District will use GFC revenue to directly fund capital expenses.

6. Capital Program Funding/Debt Management

A capital-financing plan supports the execution of the District's capital program. The program will incorporate system replacement and rehabilitation, system upgrade and improvement, and system expansion.

a. Capital Funding

Utilities can draw funds for capital projects from a variety of sources, such as grants, developer contributions, general facilities charges, system reinvestment funding, direct funding from rates, other capital revenues, or debt.

b. Debt Management

Excessive debt is unfavorable for the District and can damage the credit rating of the District, reducing its ability to acquire low-cost debt in the future; yet cash "pay-as-you-go" funding might generate excessive burdens for existing customers. In order to find a balance between debt issuance and cash payments, the District will follow the industry practice of maintaining a debt-to-equity ratio of no greater than 50 percent debt and 50 percent equity.