

McKinleyville Community Service District

Designated Funds Policy

POLICY STATEMENT

A key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital, and debt service needs. Additionally, fiscal responsibility requires anticipating the likelihood of, and preparing for, unforeseen events. McKinleyville Community Services District (District) will at all times strive to have sufficient funding available to meet its operating, capital, and debt service obligations. This policy is to develop and ensure the appropriate and necessary funds are accumulated and maintained in a manner consistent with the District's Capital Improvement Plan, Connection and Capacity Fee Plan, and other guiding financial policies. Furthermore, the policy will increase the District's flexibility to avoid significant rate fluctuations due to unforeseen changes in cash flow requirements.

DESCRIPTION OF FUNDS

Reserves are categorized into either unrestricted or restricted reserves. Unrestricted Fund reserves consisting of undesignated funds, such as the Operating Fund, can be used for any lawful purpose at the discretion of the Board of Directors (Board). The monies held within designated funds can be shifted or re-allocated at any time at the Board's discretion. Restricted Fund reserves, such as the Bond Reserve Fund consist of monies with external restrictions imposed by creditors, grantors, contributors, or by laws or regulations of government and can only be used for a specific purpose.

UNRESTRICTED FUNDS

OPERATING FUND

The Operating Fund is an unrestricted fund and serves as a short-term or immediate purpose. Monies held in the Operating Fund meet a variety of potentially competing purposes including paying operating expenses during temporary revenue shortfalls. This fund would also be used to cover timing differences for periodic expenses paid in advance of revenues collected and to pay for expenses for special events not budgeted. In developing the annual operating budget, staff expends a tremendous amount of effort to identify its program expenses and prudent spending levels. However, unforeseen developments can occur which cause the actual program expenses to exceed the budgeted expenses. In addition, opportunities not budgeted for may arise during the fiscal year that require the District to expend monies which will not be reimbursed. Other times the District will pay expenses that will be reimbursed only after the event is complete. The Operating Fund would cover these types of situations.

TARGET CRITERIA: To meet MCSD cash flow needs and unbudgeted expenses, the Operating Fund will be equal to approximately six months (180 days) of the annual budgeted operating expenses.

REPAIR AND REPLACEMENT FUND

The Repair and Replacement Reserve (R&R) Fund reserves for both short-term and long-term purposes. The objective of the R&R Fund is to provide monies for the current and future replacement of existing capital assets as they reach the end of their useful lives. There are three sub-funds within the Repair and Replacement Fund:

CAPITAL ASSET REPLACEMENT - As the Districts' utility and system infrastructure continues to age, there will be increasing demands on this fund to replace or repair these facilities. Generally, maintenance costs for an asset becomes more expensive as that asset ages, and eventually the economic decision is made to replace that asset.

EMERGENCY REPAIRS - Although the preventive maintenance program is intended to increase the predictability of equipment replacement, unanticipated equipment failure is unavoidable. As a result, these funds would be used to cover periodic short-term replacements made necessary by unplanned failures.

SYSTEM ENHANCEMENTS - With the rapid changes in technology, assets are becoming obsolete at a faster rate than originally planned. If these improvements increase productivity, reduce operating cost, or extend the useful life of the Districts' facilities, then expenditures will be made from this fund.

The District recognizes that the R&R Fund will only be sufficient to pay a portion of the full cost of future capital asset replacements and other sources of replacement funding may be needed, such as a bond issuance. This fund will also help normalize the impact of the capital asset replacements on future water rates.

TARGET CRITERIA: Staff recommends funding levels based on projected replacement cost of pipelines and other system infrastructure. To ensure adequate funding and availability for emergency repairs, a minimum R&R Fund reserve balance is recommended. In addition to the minimum, staff recommends using 10% of the projected capital asset replacement cost to determine the target level for the R&R Fund.

COMPENSATED ABSENCES FUND

The Compensated Absences Fund reserves for unpaid employee vacation and sick leave hours that are vested with each individual employee. The liability for compensated absences is calculated annually as part of the fiscal year-end closing process. It is the number of vested hours of accrued leave multiplied by the individual employee's hourly rate.

TARGET CRITERIA: Staff recommends the full liability for compensated absences be fully funded.

RATE STABILIZATION FUND

The Rate Stabilization Fund operates as a buffer to water rates during any period where there are unexpected increases in operating costs or decreases in revenues. For example, in the event an unexpected rate increase from Humboldt Bay (HBMWD) is approved and the District chooses not to pass the increase on to its customers immediately, this fund could cover the shortfall in revenue. In addition, in a severe drought or extremely wet conditions, it is reasonable to expect that water sales could fluctuate significantly. As such, the Rate Stabilization Fund will absorb these types of fluctuations in operations and help stabilize rates.

TARGET CRITERIA: As discussed above, water rates can fluctuate for many different reasons. Staff recommends a target level to be sufficient to cover reduced net sales by as much as 20% for up to two consecutive years.

CATASTROPHE FUND

The Catastrophe Fund consists of funds used to begin repair of the water system after a catastrophic event, such as a severe earthquake or fire, while long-term financing is being arranged or insurance claims are being processed.

TARGET CRITERIA: Following current Federal Emergency Management Agency (FEMA) guidelines, staff recommends funding levels shall be targeted at two (2%) percent of the District's total plant and equipment.

RETIREE OPEB FUND

The Retiree OPEB Fund consists of rate revenue monies set aside to fund Other Post Employment Benefits. These funds will be transferred to the third party administrator of the Trust that makes disbursement to the medical insurance carrier.

TARGET CRITERIA: Staff recommends, as does the trustee, a target funding level based on the actuarial calculated liability for OPEB.

RESTRICTED FUNDS

BOND RESERVE FUND

The Bond Reserve Fund consists of bond proceeds that provide additional security for the payment of annual debt service if rates and other funds are insufficient or not available. The bonding institution establishes the restricted account at the time the debt is issued. The funds cannot be used for any other purpose.

TARGET CRITERIA: The debt service reserve requirement is established at the time of the obligation is issued. This amount may be recalculated as the debt is paid-off.

CUSTOMER AND DEVELOPMENT DEPOSITS FUND (SELF FUNDED – RESTRICTED)

The Customer and Development Deposits Fund consist of monies held on behalf of District customers as required for their utility account or as cash bonds for development projects. As deposits on utility accounts are released, they will be refunded to the customer. When development projects are complete, the projects will be closed and a final accounting will be completed. Excess deposit monies will be returned to the development customer.

TARGET CRITERIA: Customer deposits required are based upon the process outlined in District's Rules and Regulations for Water and Sewer service; as are deposit requirements for development projects. The balance in this account will fluctuate depending on the number of utility customer deposits required and the number of development projects in process. Therefore, no minimum or maximum levels will be established.

CAPACITY FEES FUND

The Capacity Fees Fund consists of monies received through development impact fees (system capacity fees) and is utilized to offset new development related capital improvements as outlined by the District's Capital Improvement Plan.

TARGET CRITERIA: Capacity Fees are development driven as are the costs incurred; therefore, no minimum or maximum levels will be established.

TARGETS AND ALLOCATION

From risk and long-range financial planning perspectives, the targets established for each Fund represents the baseline financial condition that is acceptable to the District. Maintaining funds at appropriate levels is a prudent, ongoing business process that consists of an iterative, dynamic assessment and application of various revenue generating alternatives. These alternatives (either alone or in combination with each other) include, but are not limited to fees and charges, water usage, capital financing, investment of funds, and levels of capital expenditures.

Table 1 outlines the process the District will use each year to allocate net revenues to the various designated funds and the priority of each designated fund.

Table 2 provides the amount of funds currently unassigned and available to fund reserves.

Table 3 illustrates how the October 30, 2011 cash balance will be distributed as well as the target amount and target date for each designated fund.

DELEGATION OF AUTHORITY

The Board has sole authority to amend or revise the Designated Funds Policy. Through approval of this Policy, the Board has established written procedures for staff to follow in the management of District Unrestricted and Restricted Funds.

TABLE 1: RESERVE POLICY PROCESS

Unrestricted Funds		Restricted Funds	
Funding Source: Operating Revenue		Funding Source: Various	
Tier 1	Operating Fund		Bond Reserves Fund
Target	180 Days of Annual Operations & Maintenance	Source	Debt Issuance
Limit	360 Days of Annual Operations & Maintenance	Target	Established at the time of issue
		Limit	None
Tier 2	Repair and Replacement Fund		Customer & Development Deposits Fund
Target	10% of Capital Asset Replacement Costs (minimum of \$500,000)	Source	Customer & Development Deposits
Limit	No set limit as funds can be collected over time to fund large capital projects	Target	N/A
Note:	Rate revenue collected to cover annual depreciation is primary funding source		
		Limit	N/A
Tier 3	Compensated Absences Fund		Capacity Fees Fund
Target	Full Liability for compensated Absences	Source	Capacity Fees
Limit	Full Liability	Target	N/A
		Limit	N/A
Tier 4	Rate Stabilization Fund		
Target	Sufficient to cover reduced water sales by 20% for up to two consecutive years		
Limit	60% of rate revenue		
Tier 5	Catastrophe Fund		
Target	2% of District's total plant and equipment		
Limit	2% of District's total plant and equipment		
Tier 6	Retiree OPEB Fund		
Target	Based on the actuarial calculated liability		
Limit	Actuarial calculated liability		

TABLE 2: FUND BALANCE (AS OF OCTOBER 31, 2011)

	Parks & General 001	Streetlight 005	Water 501	Sewer 551	Total
Investment in Capital Assets, Net of Related Debt:					
Net Capital Assets	2,957,575	217,115	6,377,035	11,759,024	21,310,749
Capital Asset Debt	-	-	(3,568,888)	(1,426,821)	(4,995,709)
Total	2,957,575	217,115	2,808,146	10,332,204	16,315,040
Restricted for Debt Covenants:					
Davis-Grunsky Loan	-	-	594,198	-	594,198
I-Bank Loan	-	-	60,000	-	60,000
USDA Sewer Bonds	-	-	-	127,153	127,153
Total	-	-	654,198	127,153	781,351
Assigned for Capital Reserve	-	-	-	98,114	98,114
Unassigned Fund Balance	692,418	(38,604)	1,559,259	3,158,796	5,371,870

TABLE 3: ALLOCATION OF UNASSIGNED FUND BALANCE (AS OF OCTOBER 31, 2011)

Unassigned Fund Balance Distribution:	Parks & General	Streetlight	Water	Sewer	Total
Operating Fund					
Operating Costs	1,464,925	-	2,151,424	1,713,140	5,329,489
Target, 180 days	722,429	-	1,060,976	844,836	2,628,241
Maximum, 360	1,444,858	-	2,121,952	1,689,672	5,256,482
Distribution	286,573	-	386,935	1,229,496	1,903,004
Repair and Replacement Fund					
Investment in Capital Assets, Net of Related Debt:	2,957,575	217,115	2,808,146	10,332,204	16,315,040
Target, 10%	295,758	21,712	280,815	1,033,220	1,631,504
Distribution	295,758	-	280,815	1,033,220	1,609,793
Compensated Absences Fund					
Total Vested Hours	27,034		64,431	64,431	155,896
Target, Actual	27,034		64,431	64,431	155,896
Distribution	27,034		64,431	64,431	155,896
Rate Stabilization Fund					
Rate Revenue	-		1,807,779	1,443,000	3,250,779
Target, 20% x2 years Rate Revenue	-		723,112	577,200	1,300,312
Distribution	-		723,112	577,200	1,300,312
Catastrophe Fund					
Investment in Capital Assets, Net of Related Debt:	2,957,575	217,115	2,808,146	10,332,204	16,315,040
Target, 2%	59,152	4,342	56,163	206,644	326,301
Distribution	59,152	-	56,163	206,644	321,959
Retiree Medical/OPEB					
Actuarial Estimate	23,902		47,804	47,804	119,510
Target, Actuarial Estimate	23,902		47,804	47,804	119,510
Distribution	23,902		47,804	47,804	119,510
Available Funds (Unassigned Fund Balance)	692,418	(38,604)	1,559,259	3,158,796	5,371,870
Total Reserves Target	1,128,274	26,054	2,233,300	2,774,136	6,161,764
Amount Allocated to Reserves	692,418	(38,604)	1,559,259	3,158,796	5,371,869
Undesignated	-	-	-	-	-
Target Fully Funded / (Shortfall)	(435,856)	(64,657)	(674,041)	384,660	(789,894)

Note: A reserve policy for the Library Fund is not recommended at this time