BOARD OF WATER AND POWER COMMISSIONERS
INVESTMENT COMMITTEE MEETING AGENDA
April 2, 2018
9:00 AM

Service, Quality, Community

CITY OF BIG BEAR LAKE,
DEPARTMENT OF WATER AND POWER
41972 GARSTIN DRIVE
BIG BEAR LAKE, CALIFORNIA 92315

BOARD MEMBERS
Bob Tarras, Vice-Chair
Alan Lee, Commissioner

STAFF MEMBERS
Reginald A. Lamson, General Manager
Danielle D. McGee, Chief Financial Officer
Steve Wilson. Water Superintendent

OPEN SESSION

CALL MEETING TO ORDER

1. **DISCUSSION/ACTION ITEMS - INVESTMENTS**

   1.1 Review Action Items from November 13, 2017 Committee Meeting
   Committee to review and discuss items requested from prior committee meeting.

   1.2 Current Portfolio – Investment Balances and Performance
   Committee to review and discuss current investments and average returns

   1.3 Review DWP Policy No. 2017-04 Investment Policy
   Committee to review and discuss Investment Policy.

2. **DISCUSSION/ACTION ITEMS - RESERVES**

   2.1 Current Reserve Balances and Targets
   Committee to review and discuss current DWP reserve balances and targets.

   2.2 DWP Policy No 2009-02 Financial Reserve Policy
   Committee to review and discuss the Financial Reserve Policy and discuss potential revisions. Recommendations of the Committee will be presented to the Board of Commissioners for consideration.

ADJOURNMENT

I herby certify under penalty of perjury, under the laws of the State of California that the foregoing agenda was posted in accordance with the applicable legal requirements. Dated this 28th day of March, 2018.

Jack Roberts, Secretary to the Board of Commissioners
DWP Board of Commissioners

AGENDA REPORT

Item 1.1

Service, Quality, Community

DATE: April 2, 2018

TO: Board of Commissioners

FROM: Reginald A. Lamson, General Manager

PREPARED BY: Danielle D. McGee, Chief Financial Officer

RE: **Action Items from Prior Meeting**

Background

The Investment Committee met on November 13, 2017 to review and discuss investment strategies and reserve balances. Follow-up items requested from that meeting were:

1) How do other agencies invest their reserves?
2) What would it cost to hire an investment manager?
3) Are there any benchmarks for appropriate reserve level?

Other Agency Investments

Agency	Amount	Investments	Source of Information
CSD	$ 500,000	Laddered CDs	Amount was provided by CSD Staff
CSD	$ 11,595,741	LAIF	As reported in 2016 Annual Report
City	$ 9,000,000	LAIF	Investment type provided by City staff; amount is estimated from data in 2017 Annual Report
BBARWA	$ 6,357,849	LAIF	As reported in 2017 Annual Report
MWD	$ 1,500,000	LAIF	Per MWD Staff
MWD	$ 3,500,000	Laddered CDs managed by DA Davidson	Per MWD Staff
DWP unrestricted reserves	$ 6,634,000	LAIF	

Investment Managers

Staff contacted the following Investment Managers/Advisors who were present at the annual conference for the California Society of Municipal Finance Officers:

California Asset Management Program www.camponline.com (CAMP)
Government Portfolio Advisors www.gpafixedincome.com (GPA)
Hilltop Securities www.hilltopsecurities.com
Chandler Asset Management www.chandlerasset.com

CAMP

Camp is a joint powers authority that offers pooled investments similar to the Local Agency Investment Fund (LAIF) but with slightly shorter maturity strategies. Yields for CAMP are currently running at 1.52% and earnings are distributed monthly as oppose to the quarterly distribution received from LAIF. LAIF is currently yielding 1.2%. CAMP is a permissible investment under the government code. If this option were selected, the Investment Policy would need minor revisions.

GPA

GPA is a registered investment advisor with over $10 Billion in assets under management. Their client base is primarily in New Mexico, Oregon, and Washington. The company has just started operating in California and has an office Orange County. Their minimum annual fee is $12,000 but based upon an average investment of $3M, they could decrease the cost to a fixed fee of $6,000/year. There would also be additional costs of approximately $2,500 for a trust account. The strategy they proposed was laddered T-notes which in their analysis would improve yields by 73BPS ($21,900) before fees (45BPS after fees).

Hilltop Securities

Hilltop indicated that our balance was too small for them to take under management. They might consider a consulting agreement.

Chandler Asset Management

Chandler did not respond to our inquiry.

Benchmarks for Reserves

See Discussion Item 2.1.

Recommendation

Review and discuss staff's findings.

Item 1.2

Cash and Investment Balances 2/28/18

Fund	Account	Balance	Cash	LAIF	Blackrock T-Fund	Other	Total
Revenue	Operating Cash	$ 840,929.88	$ 840,929.88	$ -	$ -	$ -	$ 840,929.88
Revenue	Credit Card Receipts	31,949.10	31,949.10	-	-	-	31,949.10
Revenue	LAIF Investments	6,633,838.35		6,633,838.35	-	-	6,633,838.35
Revenue	Mark to Market	(12,609.98)		(12,609.98)	-	-	(12,609.98)
Debt Service	2010 Bonds Service Acct	112,741.34	112,741.34				112,741.34
Debt Service	2012 Bond Service Account	168,256.48	168,256.48				168,256.48
Debt Service	2013 Bond Service	98,890.52	98,890.52				98,890.52
Debt Service	IBank Loan Service	19,537.72	19,537.72				19,537.72
Debt Service	IBank Loan Reserve	56,106.34	56,106.34				56,106.34
Debt Service	Reserve - 1996 Bonds	3,442,078.09		3,442,077.09		1.00	3,442,078.09
Debt Service	Reserve 2010 Bond	145,853.27		145,687.71	165.56		145,853.27
Debt Service	1996 Bond Service Account	2,756,087.47			2,756,087.47		2,756,087.47
Debt Service	Reserve 2012 Bond	210,090.60		209,426.10	664.50		210,090.60
Debt Service	Reserve 2013 Bond	133,632.21		133,632.21			133,632.21
Debt Service	Mark to Market	(7,471.32)		(7,471.32)			(7,471.32)
Market Value		**$ 14,629,910.07**	**$ 1,328,411.38**	**$ 10,544,580.16**	**$ 2,756,917.53**	**$ 1.00**	**$ 14,629,910.07**

Restricted Cash	$ 7,143,274.04
Assigned to reserves	3,383,986.00
Unassigned	4,102,650.03
	$ 14,629,910.07

Item 1.3

City of Big Bear Lake, Department of Water and Power
POLICY

Policy #2017-04

INVESTMENT POLICY

Date Established: August 22, 2017
Date Last Amended:

Table of Contents

I. PURPOSE:

To establish a policy for the regular investment of surplus funds by the General Manager (GM) and Chief Accounting Employee (CAE). It is the responsibility of the Board Commissioners (the Board) to adopt this policy; and of the GM and CAE to implement.

II. OBJECTIVES:

A. Preservation of capital
B. Maintain adequate liquidity at all times
C. Maximize return subject to these investment guidelines

III. DEALER QUALIFICATION:

The Agency is authorized to conduct transactions with investment firms that maintain a net worth of at least $50 million and are members of the Securities Investor Protection Corporation (SIPC).

IV. AUTHORIZED SECURITIES GENERAL (REVENUE) FUND INVESTMENTS:

All securities must be registered and quoted on a major exchange, meet the minimum credit ratings listed below and be denominated in U.S. Dollars.

A. Direct obligations of the U.S. Treasury including Treasury Bills, Notes and Bonds
B. Federal Agency Securities
C. Certificates of Deposit
D. Corporate Obligations including commercial paper, corporate bonds, medium term notes. These can be issued by foreign or domestic entities but must meet the credit ratings listed below and be denominated in U.S. dollars.
E. Money Market Mutual Funds which maintain a constant net asset value and provide liquidity
F. Deposits with the Local Agency Investment Fund of the State of California (LAIF), as may otherwise be permitted by law.
G. Repurchase agreements with major investment dealers and commercial banks. Collateral must be U.S. Treasury or Agency obligations and valued at 102% of Market Value

V. CREDIT RATINGS

All securities must meet the minimum credit ratings listed below and be denominated in U.S. Dollars.

A. CD's and Corporate Obligations: A2/A
B. Commercial Paper: A1/P1

VI. CONCENTRATION LIMITS

A. U.S. Treasury or Agency Securities-no limit
B. Money markets – no limits
C. Local Agency Investment Fund of California – no limits
D. All other securities – no more than 10% in any one issuer
E. No holdings shall be in excess of 5% of the outstanding issue

VII. AUTHORIZED SECURITIES DEBT FUND INVESTMENTS

Debt Fund investments are governed by Trust Indenture by and between Union Bank of California, N.A. and the City of Big Bear Lake, Dated August 1, 1996, as amended:

A. Direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury, and CATS and TIGRS) or obligations the principal of and interest on which are unconditionally guaranteed by the United States of America.

B. Bonds, debentures, notes, or other evidence of indebtedness issued or guaranteed by any of the following federal agencies and provided such obligations are backed by the full faith and credit of the United States of America (stripped securities are only permitted if they have been stripped by the agency itself):

1. U.S. Export-Import Bank (Eximbank) Direct obligations or fully guaranteed certificates of beneficial ownership

2. Farmers Home Administration (FmHA) Certificates of beneficial ownership

3. Federal Financing Bank

4. Federal Housing Administration Debentures (FHA)

5. General Services Administration Participation certificates

6. Government National Mortgage Association (GNMA or "GinnieMae")
    a) GNMA - guaranteed mortgage-backed bonds
    b) GNMA - guaranteed pass-through obligations

7. U.S. Maritime Administration
    a) Guaranteed Title XI financing

8. U.S. Department of Housing and Urban Development (HUD)
    a) Project Notes
    b) Local Authority Bonds
    c) New Communities Debentures - U. S. government guaranteed debentures
    d) U.S. Public Housing Notes and Bonds - U.S . government guaranteed public housing notes and bonds

C. Bonds, debentures, notes, or other evidence of indebtedness issued or guaranteed by any of the following non-full faith and credit U.S. government agencies (stripped securities are only permitted if they have been stripped by the agency itself):

1. Federal Home Loan Bank System
    a) Senior debt obligations

2. Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac")
    a) Participation Certificates
    b) Senior debt obligations

3. Federal National Mortgage Association (FNMA or "Fannie Mae")
    a) Mortgage-backed securities and senior debt obligations

4. Resolution Funding Corp. (REFCORP) obligations

5. Farm Credit System
    a) Consolidated system-wide bonds and notes

D. Money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of AAAm-G, AAA-m, or AA-m, and, if rated by Moody's, rated Aaa, Aal, or Aa2, including such funds for which the Trustee or any of its affiliates acts as investment advisor.

E. Certificates of deposit secured it all times by collateral described in (A) or (B) above. Such certificates must be issued by commercial banks, savings and loan associations, or mutual savings banks. The collateral must be held by a third party and the Owners of the Bonds must have a perfected first security interest in the collateral.

F. Certificates of deposit, savings accounts, deposit accounts, or money market deposits which are fully insured by the Federal Deposit Insurance Corporation.

G. Investment Agreements, including guaranteed investment contracts (GIG's), acceptable to the Bond Insurer.

H. Commercial paper rated, at the time of purchase, "Prime - 1" by Moody's and "A-1" or better by S&P.

I. Bonds or notes issued by any state or municipality which are rated by Moody ' s and S&P in one of t he two highest rating categories assigned by such agencies.

J. Federal funds or bankers acceptances with a maximum term of one year of any bank which has an unsecured, uninsured, and unguaranteed obligation rating of "Prime-l" or "A3" or better by Moody's and "A-1" or "A" or better by S&P.

K. Repurchase agreements that provide for the transfer of securities from a dealer bank or securities from (seller/borrower) to the City (buyer/lender), and the transfer of cash from the City to the dealer bank or securities firm with an agreement that the dealer bank or securities firm will repay the cash plus a yield to the City in exchange for the securities at a specified date.

Repurchase agreements must satisfy the following criteria or otherwise be approved by the Bond Insurer:

1. Repurchase agreements must be between the City and a dealer bank or securities firm that is either
   a) A primary dealer on the Federal Reserve reporting dealer list which is rated A or better by S&P and Moody's, or
   b) A bank rated "A" or above by S&P and Moody's.

2. The written repurchase agreement must include the following:
   a) Securities which are acceptable for transfer are : (1) Direct U.S. governments, or (2) Federal agencies backed by the full faith and credit of the U.S. government (and FNMA & FHLMC);

   b) The term of the repurchase agreement may be up to 30 days;

   c) The collateral must be delivered to the City, the Trustee (if the Trustee is not supplying the collateral), or a third party acting as agent for the Trustee (if the Trustee is supplying the collateral) before/simultaneous with payment (perfection by possession of certificated securities); and

d) The securities must be valued weekly, marked-to-market at current market price plus accrued interest. The value of the collateral must be equal to 104% of the amount of cash transferred by the City to the dealer bank or security firm under the repurchase agreement plus accrued interest. If the value of securities held as collateral slips below 104X of the value of the cash transferred by the City, then additional cash and/or acceptable securities must be transferred. If, however, the securities used as collateral are FNMA or FHLMC, then the value of collateral must equal 105%.

3. A legal opinion must be delivered to the City to the effect that the repurchase agreement meets guidelines under State of California law for the legal investment of public funds.

L. Deposits with the Local Agency Investment Fund of the State of California, as may otherwise be permitted by law.

M. Any other investment consented to be the Bond Issuer.

VIII. MATURITY STRUCTURE

A. General Funds

1. Assigned to Capital Reserves, Auto, and Computer Replacement Reserves
    a) All securities shall mature within 18 months from original settlement date
    b) At least 30% of the portfolio shall mature within 30 days of the original settlement date
    c) Average life of the portfolio shall not exceed 12 months

2. Assigned to Operating Reserves
    a) Overnight

3. Unassigned
    a) Overnight

B. Debt Service Funds

1. All Debt Service Funds
    a) Overnight

C. Debt Reserve Funds

1. 1996 Bond Reserve Fund
    a) All securities shall mature within 60 months from original settlement date
    b) Average life of the portfolio shall not exceed 36 months
    c) Two years prior to debt maturity, all investments must mature within 12 months of original settlement date
    d) One year prior to debt maturity, all investments must mature within 3 months of original settlement date
    e) Three months prior to debt maturity, all investments provide overnight liquidity

2. USDA 2010 Bond Reserve Fund
    a) All securities shall mature within 120 months from original settlement date
    b) Average life of the portfolio shall not exceed 60 months
    c) Two years prior to debt maturity, all investments must mature within 12 months of original settlement date
    d) One year prior to debt maturity, all investments must mature within 3 months of original settlement date
    e) Three months prior to debt maturity, all investments provide overnight liquidity

3. Any New Debt Issuance Reserve Fund
    a) All securities shall mature within 60 months from original settlement date, unless otherwise directed by the Board
    b) Average life of the portfolio shall not exceed 18 months, unless otherwise directed by the Board
    c) Two years prior to debt maturity, all investments must mature within 12 months of original settlement date
    d) One year prior to debt maturity, all investments must mature within 3 months of original settlement date
    e) Three months prior to debt maturity, all investments provide overnight liquidity

IX. SAFEKEEPING

All securities firms with whom the Agency does business must be qualified to safe keep securities on the Agency's behalf at no charge. The GM will authorize these firms to hold securities.

X. INVESTMENT POLICY REVIEW

This policy will be reviewed at least annually by the GM and CAE to ensure that it remains consistent with the financial objectives of the Agency and current market conditions. The GM will alert the Board of major market condition changes and or major portfolio changes. The initial policy and all policy revisions will be reviewed and approved by the Board prior to implementation.

XI. INVESTMENT COMMITTEE

As appointed by the Board, the investment committee will meet at least semi-annually to discuss changes in market conditions, analyze portfolio performance and recommend potential changes in investment approach and/or policies. It is the responsibility of the committee to communicate these recommendations to the GM for presentation to the Board and final approval prior to implementation.

XII. REPORTING

The CAE will prepare a monthly Investment Report to accompany the monthly management report that contains the following:

A. Listing of portfolio investments as the date of the report of percentage mix of portfolio by type of investment
B. Average portfolio maturity
C. The rate of return on the portfolio will be compared to an appropriate benchmark (such as the 90-day or 6 month U.S. Treasury Bill rate)
D. The rate of return compared to historical rates earned
E. Status of any investments that might require management attention (such as investments affected by a credit rating change, or similar circumstances that could have an effect on the value and collectability of the Investment.

By: Reg A. L[signature] Date: 8-24-17

Reginald A. Lamson, General Manager

AGENDA REPORT

Item 2.1

Service, Quality, Community

DATE: April 2, 2018

TO: Board of Commissioners

FROM: Reginald A. Lamson, General Manager

PREPARED BY: Danielle D. McGee, Chief Financial Officer

RE: **Reserve Balances and Targets**

Background

The Investment Committee met on November 13, 2017 to review and discuss investment strategies and reserve balances. Follow-up items requested from that meeting were:

3) Are there any benchmarks for appropriate reserve level?

Benchmarks for Reserves

Staff previously emailed recommendations from the Government Finance Officers Association for reserve balances. That article is attached (Attachment 2.1C) along with an update of the DWP's assigned and unrestricted reserves. The DWP's unrestricted reserve balances have been increasing as a result of successful outcomes with grant applications, obtaining low-interest loans, and controlling operating costs.

Attachment 2.1A is an analysis as of February 28, 2018, of the DWP's reserve balances compared to the provisions to the benchmarks outlined in DWP Policy No. 2009-02 – Financial Reserve Policy.

Attachment 2.1B is an analysis as of February 28, 2018, of the DWP's reserve balances compared to the provisions to the benchmarks outlined in the GFOA white papaer.

Recommendation

Review and discuss staff's findings.

Attachment 2.1A

Board Authorized Reserve Balances

	7/1/2017	Q1/Q2 savings	2/28/2018	Total By Category	DWP Policy Target		Funding status per policy (Under)/Over
Vehicle and Equipment Replacement	$ 288,992		$ 288,992				
Vehicle Replacemet		42,455.00	42,455.00				
Software replacement		10,000.00	10,000.00		Accumulated Depreciation on essential assets =		
Office Equipment replacement		8,500.00	8,500.00	349,947.00	$	969,256.23	(619,309.23)
Operating reserve	1,616,910.00		1,616,910.00	1,616,910.00	Three months average gross O&M $	1,616,910.00	-
Assigned Fund - short-lived assets	158,638.00	16,200.00	174,838.00	174,838.00	Installments required by USDA Indenture Agreements		Funded as required
Capital Improvement Reserves							
Assigned Fund - Capital Replc	789,200.00		789,200.00				
Assigned Fund - Pump Plant Replc	158,291.00	4,800.00	163,091.00				
Assigned Fund - Reservoir Replc	120,000.00		120,000.00		50% average annual internally funded capex =		
Assigned Fund - Meter replc	170,000.00		170,000.00	1,242,291.00	$	925,150.00	317,141.00
Total Assigned to Reserves	**$ 3,302,031**	**$ 81,955**	**$ 3,094,994**	**$ 3,383,986**			**$ (302,168)**

Attachment 2.1B

	6/30/2017	GFOA Ratio	GFOA Recommendation	Working Capital Reserve by Purpose	2/28/2018 DWP Current Reserve	Over/(Under) funded	
Gross O&M	$ 6,559,592	25%	$ 1,639,898	$ 1,639,898	$ 1,616,910	$ (22,988)	O&M Reserve
Depreciation Expense	1,806,217	25%	451,554				
Projected Capital Outlay 17/18	1,467,209	100%	1,467,209	1,918,763	1,767,076	$ (151,687)	Capital Improvement Reserves
Total	**$ 9,833,018**		**$ 3,558,661**	**$ 3,558,661**	**$ 3,383,986**	**$ (174,675)**	

DWP's Uncommitted Cash	**$ 4,102,650**

Attachment 2.1C

Government Finance Officers Association

BEST PRACTICE

Working Capital Targets for Enterprise Funds

BACKGROUND:

Enterprise funds distinguish between current and non-current assets and liabilities. It is possible to take advantage of this distinction to calculate working capital (i.e., current assets less current liabilities). The measure of working capital indicates the relatively liquid portion of total enterprise fund capital, which constitutes a margin or buffer for meeting obligations.

It is essential that a government maintain adequate levels of working capital in its enterprise funds to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees.

Working capital is a crucial consideration, too, in long-term financial planning. Credit rating agencies consider the availability of working capital in their evaluations of continued creditworthiness. Likewise, laws and regulations may speak to appropriate levels of working capital for some enterprise funds.

RECOMMENDATION:

GFOA recommends that local governments adopt a target amount of working capital to maintain in each of their enterprise funds. Ideally, targets would be formally described in a financial policy and/or financial plan.

GFOA recommends that governments use working capital as the measure of available margin or buffer in enterprise funds. Although as previously stated, working capital is defined as current assets minus current liabilities, government finance officers should be aware of certain characteristics of working capital that affect its use as a measure. Specifically, the current assets portion of working capital includes assets or resources that are reasonably expected to be realized in cash (e.g., accounts receivable) or consumed (e.g., inventories and prepaids) within a year, which leads to two considerations for an accurate calculation of working capital:

- **Strength of collection practices**. An appropriate allowance for uncollectibles should be established and the amount of the receivable that is expected to be collected in cash within one year should be determined in a manner that is consistent with the collection practices of the government. If the accounts receivable collection practices of the enterprise fund are inconsistent or weak, then less of the accounts receivable amount should be reported as current assets.
- **Historical consumption of inventories and prepaids**. The amount of inventories and prepaids included in current assets should be a realistic estimate of the amount that will be

consumed in one year based on a historical usage pattern and current operating levels (inventories) or based on the time periods to which the items relate (prepaids).

Because the purposes, customers, and other characteristics of enterprise funds can vary widely, GFOA recommends that governments develop a target amount of working capital that best fits local conditions for each fund. However, GFOA recommends that under no circumstances should the target for working capital be less than forty-five (45) days worth of annual operating expenses[1] and other working capital needs of the enterprise fund.* A target of 45-days would only be appropriate for those enterprise funds with the least amount of need for cushion or buffer.

In order to arrive at a customized target amount of working capital, governments should start with a baseline of ninety (90) days worth of working capital and then adjust the target based on the particular characteristics of the enterprise fund in question (using 45 days as the minimum acceptable level). The primary characteristics to think about when customizing a working capital target are presented below. The appendix to this Best Practices provides more detailed considerations for these characteristics as they pertain to common types of government enterprise funds.

- **Support from general government**. Some enterprise funds may be supported by general taxes or transfers from a general government. These enterprise funds may require lower levels of working capital if they are supported by these contributors. For a heavily subsidized enterprise fund the 45-day minimum working capital recommendation contained in this Best Practice might be met through support from the general government, if a financial buffer or cushion for the enterprise fund is to be provided by the general government (or other outside contributor).
- **Transfers out**. If the enterprise fund is expected to make a transfer to the general government or to some other fund, then this sort of claim on the enterprise funds assets may call for higher levels of working capital to maintain flexibility. Transfers could include an enterprise funds contributions to overhead/support functions, subsidies granted to other operations, or any other transfer of resources. Regardless of the rationale of the transfer, governments should take into account the claim on working capital when setting a target amount.
- **Cash cycles**. Does the enterprise fund experience large peaks and valleys in its cash position during the year? For example, a water enterprise fund may experience significantly higher levels of cash on hand during the summer months compared to the winter. Volatile cash cycles call for higher levels of working capital. Another consideration is the length of the billing cycle. A longer billing cycle would call for higher levels of working capital because the enterprise fund will have longer durations between major infusions of cash.
- **Customer concentration**. Is the enterprise fund dependent on a few customers for a large portion of its revenues or is the customer base diversified? For example, a port enterprise fund may be dependent on a few major shippers or commerce in a niche product. Lower customer concentration may mean that the enterprise fund can safely operate with lower levels of working capital.
- **Demand for services**. Does the enterprise fund face a steady demand for service or is demand potentially volatile, thereby leading to volatility in of income? For example, the demand for utility services is steady compared to demand for air travel. Also consider the impact of competitive position on demand. Direct competitors or the availability of reasonable substitutes could lead to greater volatility in demand for the enterprise funds services. More volatility implies greater need for working capital margins.
- **Control over rates and revenues**. Does the enterprise fund have the ability to change rates, implement new charges, or otherwise raise revenues from its customers in a simple fashion? For example, transit enterprise funds are often constrained from raising rates by political

pressure. Other enterprise funds may be subject to a rate control board. Those that face competitors in their market may have less effective control over their rates and revenues. More revenue constrained enterprise funds may need higher levels of working capital.

- **Asset age and condition**. What is the age and condition of the enterprise fund's infrastructure? Older infrastructure has greater exposure to extraordinary repair needs. Enterprise funds with newer and/or well maintained capital assets may be able to operate with less working capital than other enterprise funds.
- **Volatility of expenses**. Are the expenses of the enterprise fund volatile or does the enterprise fund have a high degree of control over its expenses? For example, the expenses of a solid waste enterprise fund tend to be fairly stable throughout the year. In another example, water or sewer enterprise funds may be more vulnerable to large expense spikes from extreme weather. Enterprise funds with more stable expenses can safely operate with less working capital than other enterprise funds.
- **Control over expenses**. Consider the enterprise funds level of fixed and variable costs and the ability to reduce variable costs in response to lower revenues. For instance, if a convention center does not book an event, it does not need to hire temporary help and incur other expenditures in support of the event. An enterprise fund with a high percentage of operational costs which vary depending upon revenues or operating levels may operate with lower levels of working capital.
- **Management plans for working capital**. Working capital includes assets, which can include both truly unrestricted resources and resources that have internal limitations placed upon them (e.g., board-designated) and/or that may be committed for future capital spending. These amounts may appear as unrestricted on the balance sheet but, in actuality, may be unavailable in the future to serve as a buffer or tool to help manage financial risk. If these types of limitations exist, the working capital target should be adjusted to arrive at an amount that represents a true amount available as a tool to manage financial risk.
- **Separate targets for operating and capital needs**. Depending on the nature of the enterprise fund, governments might also consider designating separate targets for operating and capital needs, especially when the enterprise fund is very capital intensive. For example, there might be a separate amount identified for equipment replacement or debt service. In such a case, targets should be separately evaluated based on the particular features of the isolated amounts.
- **Debt position**. Enterprise funds often carry significant amounts of debt, which is used to acquire capital assets. The amount and type of debt an enterprise fund carries can have important ramifications for working capital targets. For example, an enterprise fund with a large amount of variable rate debt may need additional buffer to manage the risk associated with interest rate volatility. In addition, uneven and increasing or lump-sum debt principal payments to be made in future years may raise the amount of working capital that the enterprise fund should maintain. Viewing the amount of working capital in this broader context will help ensure that resources are available to make debt payments as they come due.

Notes:

[1] The recommendation is to use annual operating expenses which include depreciation expense. If, however, annual depreciation expense is significantly more or less than the anticipated capital outlays of the next period to be paid from working capital consideration should be given to adjusting the benchmark. An appropriate adjusted benchmark may be annual operating expenses annual depreciation expense + capital outlays of the next period to be paid from working capital.
* Subject to the exception for heavily subsidized enterprises, described later in this Best Practice.

This best practice was previously titled Determining the Appropriate Levels of Working Capital in Enterprise Funds.

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Item 2.2

Service, Quality, Community

City of Big Bear Lake, Department of Water and Power
POLICY

Policy #2009-02
Financial Reserve Policy (including but not limited to: Operating Reserves, Capital Improvement Projects Reserves, Vehicle and Equipment Replacement Reserves)

Date Established: June 23, 2009
Date Last Amended: February 24, 2015

Article I. CONTENTS

Article II. DEFINITIONS

Board – the Board of Commissioners of the City of Big Bear Lake, Department of Water & Power.

DWP or City of Big Bear Lake Department of Water and Power – a Department of the City of Big Bear Lake that provides water service to the areas of Big Bear Lake, Erwin Lake, Fawnskin, Moonridge, Lake William, Sugarloaf, and portions of Big Bear City.

Financial Reserve – a designation applied to cash balances whereby the assigned funds are reserved for a defined purpose.

> Capital Improvement Projects Reserve – a Financial Reserve assigned to Capital Improvement Projects including, but not limited to, new capital improvements and rehabilitation of existing systems.
>
> Debt Service Reserve – a Financial Reserve restricted for the repayment of debt including, but not limited to, the 1996 Revenue Refunding Bonds, the USDA 2010 Bonds Reserve, the USDA 2012 Bond Reserve, and the USDA 2013 Bond reserve.
>
> Operating Reserve – a Financial Reserve assigned to the payment of operating costs including, but not limited to, repairs, maintenance, administrative costs and property taxes.
>
> Vehicle and Equipment Reserve – a Financial Reserve assigned to the major repair and replacement of vehicles, heavy equipment (Backhoes, Dump Trucks, etc.), field equipment (compressors, cement mixers, etc.) and office equipment (computers, printers, copiers, mailroom equipment, etc.).

Fiscal Agent – Union Bank of California or its successor-in-interest to the Trust Agreement dated August 1, 1996, and the First Supplement to the Trust Indenture and Fiscal Services Agreement dated June 2, 1993, or any other trustee contracted for future fiscal services related to debt service or other financing arrangements.

Fiscal Budget – the Fiscal Year Budget as approved by the Board.

GM – the DWP General Manager or designee.

Cash Balances – cash balances, the use of which has not been otherwise restricted by policy, ordinance, indenture agreement or state or federal law.

Article III. PURPOSE

This document establishes the policy and administrative process for the DWP's governmental Fund Balance designations and financial reserves.

Financial Reserves provide a safeguard against unforeseen problems including, but not limited to, natural or other disasters, economic downturn, revenue shortfalls, and other capital emergencies, and to provide funding for the replacement of essential vehicles and equipment. The Reserve Fund Policy shall be evaluated annually during the budget process and adjusted based on operational costs and capital replacement costs, the DWP's revenue sources, annual budget, and reserve funds available.

The provisions of the Reserve Fund Policy are subordinate to covenants and requirements of indenture agreements related to the sale of bonds or other financings which may be inconsistent with the Reserve Fund Policy.

Article IV. ACCOUNTING FOR FUND BALANCES

Pursuant to Government Accounting Standards Board Statement Number 54 (GASB 54), *Fund Balance Reporting and Government Fund Type Definitions*, effective for financial statement periods beginning after June 15, 2010, this policy formalizes the reserve policy as described below:

Non-spendable Fund Balance: The non-spendable fund balance category cannot be spent either because it is not in a spendable form (e.g. Reserve for inventories) or it is the result of a legal or contractual requirement to be maintained intact. The Chief Accounting Employee, or designee, is responsible for establishing and maintaining the Non-Spendable Fund Balance in accordance with Generally Accepted Accounting Principles as well as the legal and contractual requirements that are the basis for this fund balance categorization.

Restricted Fund Balance: The restricted fund balance category contains fund balance constraints externally imposed (e.g. debt covenants, grant requirements, contributor specifications) or imposed by law (e.g. constitutional provisions, enabling legislation). *Enabling legislation* as defined in GASB 54 authorizes the collection of payment for a specific purpose. The Chief Accounting Employee, or designee, is responsible for establishing and maintaining the Restricted Fund Balance in accordance with Generally Accepted Accounting Principles as well as the externally and legally imposed constraints that are the basis for this fund balance categorization. For restricted fund balance, the table below shows the targeted fund balance and appropriate uses established by this policy:

Type	Target	Use
Debt Service	A minimum of one-year prepayment of principal and interest for any and all outstanding parity debt shall remain on deposit with the Fiscal Agent.	To be used as dictated by the Trust Indenture Agreement.

Unrestricted Fund Balance: The unrestricted fund balance category contains fund balances that do not meet the criteria for categorization as non-spendable or restricted. Within the category of unrestricted, there are three subcategories: *Committed*, *Assigned*, and *Unassigned.*

Committed: The committed fund balance subcategory is established and utilized pursuant to the formal action of the governing body prior to the end of the fiscal year (June 30). Examples of fund balances categorized as committed include contingency reserves, replacement reserves, and infrastructure improvement reserves. Contributions to and uses of reserves during a fiscal period are initially established by resolution during the budget adoption process and are reevaluated as needed. Budgeted contributions and uses may also be adjusted throughout the year with the consent of a simple majority of the governing body. Regardless of when formal action is made, any recommendation to establish a contribution to or use of committed reserves requires formal authorization of the governing body. For each type of committed fund balance, the table below shows the targeted fund balance and appropriate uses established by this policy:

Type	Target	Use
Capital Improvement Reserve	50% of average annual capital improvement project costs that are internally funded.	To repair, replace or upgrade existing infrastructure (e.g. general facilities, water system infrastructure).
Operating Reserve	3-months average operating costs, to be averaged based upon the Fiscal Budget for the prospective year.	To be used for unforeseen required operational or maintenance expenditures for which no other funding is available.
Vehicle and Equipment Replacement Reserve	Annual reserve provisions equal to depreciation expense. Target balance is total accumulated depreciation of essential assets.	To be used for unforeseen repairs and replacement of essential vehicles and equipment.

In the event that annual cash flows are insufficient to adequately fund the Financial Reserves as outlined, the GM shall provide a strategy during the annual budget preparation for restoring Financial Reserves to the prescribed levels.

Assigned:

The assigned fund balance subcategory contains amounts that are intended to be used for a specific purpose but are neither restricted nor committed. Funds reserved for encumbrances and compensated absences are examples of assigned fund balances. Unlike the other fund balance designations, assigned fund balances do not require formal action of the governing body to establish or adjust. The governing body, by way of policy adoption, assigns authority for determining such assignments to a management position; in this case, the Chief Accounting Employee, or designee, has been assigned such authority.

Unassigned: The unassigned fund balance subcategory is the residual (undesignated) fund balance in the General Fund. This portion of the fund balance has not been restricted, limited or assigned to a specific purpose, The General Fund is the only fund that will report a positive unassigned fund balance. The other governmental funds, may report a negative unassigned fund balance if expenditures exceed the amounts restricted, committed, or assigned for the specific purpose for which the fund exists.

Recognition Criteria: For financial reporting purposes, it is necessary to establish the recognition criteria for uses of restricted and unrestricted fund balances. This policy establishes that expenditures are considered to be incurred when restricted and unrestricted fund balances are used, regardless of whether the unrestricted fund balance is categorized as committed, assigned, or unassigned. For example, the use of vehicle replacement reserves to purchase a replacement vehicle will be considered an expenditure at the time of purchase, at which time the use of reserved fund balances will be transferred out to cover the expenditure. Likewise, the use of contingency reserves for cash flow purposes will be transferred out to cover operating expenditures and will be considered expended at the time of transfer.

Article V. PROVISIONS FOR FINANCIAL RESERVES

In the event that annual cash flows are insufficient to adequately fund the Financial Reserves as outlined, the GM shall provide a strategy for restoring Financial Reserves to the prescribed levels.

Article VI. USE OF FINANCIAL RESERVES

Financial Reserves are to provide a safeguard against unforeseen problems and provide funding for future replacements. Adequate planning and management of the agency's assets and operations would typically provide sufficient Cash Balances to fund seasonal and anticipated operating shortfalls. Financial Reserves may be drawn upon at the discretion of the GM, with approval of the Board, to fund the agency's operations in emergency situations or as a short-term loan against receivables or other anticipated revenues.