



# HUNTSVILLE UTILITIES POLICY

Approval Date: Waterworks Board-10/31/2017	Date Posted: 12/19/2017	Implementation Date: 12/1/2017
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**Policy #:** FM-08

**Policy:** Waterworks Financial Reserve Policy

**Purpose:** To help ensure financial stability, timely completion of capital improvements, and enable the utility to meet requirements for large unexpected expenditures, a minimum cash reserve policy should be established. This policy attempts to quantify the minimum amount of cash the utility should keep in reserve. Actual cash reserves may vary substantially above the minimum and is dependent on the life cycle of assets, future capital plan, planned rate increases, and issuance. As budgets are prepared each year, the actual target minimum cash reserve will be calculated each year in compliance with this policy.

**Methodology:**

The methodology outlined in this policy is based on certain assumptions related to:

- Operation and maintenance expense
- Historical investment in assets
- Debt service
- Five-year capital improvement plan
- Property/casualty insurance fund target
- Workers compensation fund target

After the reserve minimum is determined, management should consider the minimum “in total” and not each individual category.

**Risk Factor Calculation**

- The cash reserve policy will include 12.3% of annual operating expenses excluding depreciation expense. These amounts will be taken from the prior years audited financial statements.
  - 12.3% was derived by assuming a 45 day lag between billing and payment receipt from customers. (45 days/365 days).
- The cash reserve policy will include 1% to 3% of the historical investment in assets as recorded in the prior years audited financial statements.
  - The following table will be used to determine the risk factor as assets are added and depreciated:

Risk Table		
Depreciation Percent	0 - 49%	1.0%
Depreciation Percent	50 - 55%	2.0%
Depreciation Percent	Over 55%	3.0%



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- The cash reserve policy will include 100% of the current year portion of debt service including both interest and principal.
- The cash reserve policy will include 20% (1/5<sup>th</sup>) of the five-year capital improvement program less any improvements funded through the issuance of bonds, reimbursements, aid to construction and major one time capital investments.
- The cash reserve policy will include the current targeted amount of \$1,000,000 for a property/casualty insurance fund.
- The cash reserve policy will include the current targeted amount of \$2,000,000 for a workers compensation insurance fund.

### Minimum Restoration

If certain events occur that results in cash reserves falling below the minimum cash reserve levels, the Waterworks Board should take action to restore cash reserves to the minimum levels over the subsequent three years. These actions may include a number of options:

- Rate adjustments
- Cost reductions
- Issuance of bonds to fund capital improvement programs (the utility should strive to fund normal capital improvements through water rates and cash generation and bond for extra-ordinary capital improvements.)
- Modification of the assumptions used to determine the cash reserve levels

The minimum cash requirements will be compared with all Waterworks cash reserves excluding restricted funds. Board designated cash reserves are not considered restricted for purposes of this policy, but customer deposits are considered restricted. The methodology outlined in this policy should be used to update the minimum cash calculation during the annual budget process.

**Original Issue Date:** 12/1/17

**Revision/Review Date:** 1/09/2020 (NC)