

**ORANGE WATER AND SEWER AUTHORITY  
FINANCIAL MANAGEMENT POLICY  
JANUARY 26, 2012**

**SUMMARY**

*The purpose of this document is to describe a comprehensive and systematic approach to strategic financial planning, related policy decisions, and measurements of financial performance that collectively guide Orange Water and Sewer Authority (OWASA) in its ongoing efforts to provide its customers with high quality water, wastewater and reclaimed water services through responsible, sustainable and creative stewardship of the resources and assets it manages.*

The following excerpt from OWASA's *Mission Statement* provides the framework for development of this approach and related policies.

- *Efficiency and Value - we will perform all services in a financially sound and responsible manner with sufficient revenues to properly operate and fully maintain the water and wastewater system. As OWASA relies solely on user fees, we will continue to be guided by cost-of-service principles with regards to our rates, fees, and charges, and operate the water and sewer system at the lowest rates consistent with our obligation to provide proper and efficient services, now and in the future. We remain committed to continuous improvement in all of our services and will provide high value to our customers.*
- *Sustainability - we will proactively plan, construct, operate, maintain, and finance the water and wastewater system in a manner consistent with the principles of environmental, social and economic sustainability.*

<b>FINANCIAL PERFORMANCE OBJECTIVES</b>		
<b>Measurement</b>	<b>Objective</b>	<b>Section</b>
Working Capital Reserves	The greater of 4 months of O&M budget or 20% of the succeeding 3 years of CIP budget	A.1
Capital Improvements Reserve Fund	Minimum fund balance target of 2% of annual depreciated capital costs	B.1
Debt Service Coverage Ratio	≥ 2.0	D.1
Debt Burden to Asset Value	≤ 50%	D.2
Sufficiency of Revenues Above Debt Requirements	Annual Debt service shall not exceed 35% of annual gross revenues	D.3
Credit Ratings	Aa2 – Moody's; AA+ – Standard & Poor's; AA+ – Fitch	D.4
Cash Financing of Capital	Annual revenues and cash reserves shall provide not less than 30% of CIP funding	E.1
Rate/Revenue Stabilization Fund	Minimum fund balance target of 5% of projected water and sewer revenue	E.2
Service Affordability	Average annual residential bill divided by real median household income shall be ≤ 1.5%.	F.2

In recognition of the dynamic environment in which OWASA operates, the desired results of policy decisions identified in the Financial Management Policy may not always be achievable within short-term operating cycles. These policy decisions should be viewed as guidance for long-term sustainable fiscal performance, with success measured against the entire planning horizon rather than to individual reporting periods.

Although not necessarily explicitly expressed in this document, the Financial Management Policy recognizes OWASA's major legal requirements and obligations arising from State laws and regulations, contractual agreements with bondholders and other stakeholders and OWASA's Sale and Purchase Agreements under which the organization was formed. If not specifically addressed herein, adherence to such requirements is mandated elsewhere.

This document categorizes policy considerations for sound, sustainable financial policies into the categories of general financial; asset management; investment management; debt management; rates, fees and charges; customer care; and annual budgeting process.

## **SECTION A. GENERAL FINANCIAL POLICIES**

- A.1. ***Working Capital Reserves:*** OWASA shall maintain a fund balance at a level to sufficiently provide cash flow for daily financial needs in addition to adequate reserves to counter revenue instability and unanticipated expenses. The budgeted minimum reserve balance shall be equal to the larger of the following: a) 33% (four months) of the Operations & Maintenance (O&M) Budget, or b) 20% of the total estimated cost of the Capital Improvements Program (CIP) identified for the succeeding three years.
- A.2. OWASA shall make conservative, but reasonable estimates of revenues and costs.
- A.3. To the extent practical, the cost of system expansion shall be recovered from parties responsible for the expansion ("growth should pay for growth").
- A.4. If the Executive Director deems it necessary at any time to submit any Budget or other proposal to the Board that does not comply with the parameters set forth in this document, he/she shall seek specific approval from the Board for such a proposal.

## **SECTION B. ASSET MANAGEMENT POLICIES**

- B.1. ***Capital Improvements Reserve Fund:*** OWASA shall maintain a Capital Improvements Reserve Fund with a minimum fund balance target of 2% of the annual depreciated capital costs. The Capital Improvements Reserve Fund shall be an unrestricted reserve that is a component of the General Fund balance. The purpose of this reserve fund is to: ensure more sustainable funding for rehabilitation and replacement of the water and sewer systems and capital equipment; cover major unplanned increases in capital project costs; pay for previously unplanned capital needs; and provide funding flexibility needed in the Annual Budget to adjust for CIP costs carry-over adjustments.

- B.2. The annual budget shall provide 100% funding for maintenance activities required to ensure the operational integrity and safety of facilities and facility components.
- B.3. OWASA shall use a comprehensive approach to properly maintain all capital facilities, equipment, vehicles, etc.
- B.4. An amortization schedule shall be established for each physical asset to reflect the reasonable useful life of the asset.
- B.5. The costs of this comprehensive maintenance and rehabilitation program shall be reflected in OWASA's annual budget and five-year CIP budget.

### **SECTION C. INVESTMENT MANAGEMENT POLICIES**

- C.1. Cash management and treasury activities shall be managed in a manner that reflects efficient use of interest rates and maximizes fund performance balanced against investment risk and cash flow needs.
- C.2. OWASA shall attempt to reduce investment risk and maximize return on investments by participating in a variety of authorized investment instruments and financial institutions.
- C.3. Investment of OWASA funds shall not expose the assets to undue or unreasonable risk.

### **SECTION D. DEBT MANAGEMENT POLICIES**

- D.1. ***Debt Service Coverage Ratio***: OWASA's Bond Order requires a minimum annual required Debt Service Coverage Ratio of 1.2. The minimum annual debt service coverage ratio shall be 2.0; provided, however, that the minimum coverage ratio for any single year when severe weather anomalies or other unforeseen circumstances occur which negatively impact revenues and/or expenses shall not be less than 1.5 during the Fiscal Year.
- D.2. ***Debt Burden to Asset Value***: The comparison of outstanding debt to infrastructure value is a reasonable indicator of debt capacity. OWASA's debt to plant ratio (outstanding debt divided by the book value of fixed assets) shall not exceed 0.5 (50%).
- D.3. ***Sufficiency of Revenues above Debt Requirements***: OWASA shall maintain debt service as a percent of revenue at or below 35% of revenues.
- D.4. ***Credit Ratings***: OWASA shall maintain Credit Ratings of at least Aa2, AA+ and AA+ from Moody's, Standard & Poor's and Fitch, respectively.
- D.5. Debt issuance shall be limited to financing the costs of capital asset project planning and design, land acquisition, buildings, permanent structures, attached fixtures and

equipment, and the cost of debt issuance and capital reserves as may be required by creditors.

- D.6. The repayment of debt shall be structured in such a manner that the repayment period does not exceed the expected useful life of the assets acquired with the debt proceeds.

#### **SECTION E. RATES, FEES AND CHARGES POLICIES**

- E.1. ***Cash Financing of Capital:*** Annual revenues and cash reserves shall provide not less than 30% of the funds required for OWASA's CIP.
- E.2. ***Rate/Revenue Stabilization Fund:*** OWASA shall maintain a Rate/Revenue Stabilization Fund with a minimum fund balance target of 5% of the projected water and sewer revenue for the applicable year. The Rate/Revenue Stabilization Fund shall be an unrestricted reserve that is a component of the General Fund balance. The purpose of this reserve fund is to provide sufficient funding for the cost of maintaining, repairing and operating the water, wastewater and reclaimed water systems during extended periods when expenditures are higher and/or revenues are lower than budgeted while offsetting the need for rate increases and spending changes during the fiscal year.
- E.3. OWASA shall maintain a system of rates, fees and charges that effectively recovers allocated costs to customers and customer classes in reasonable proportion to their differing service requirements and their responsibility for the costs incurred by the utility. Adherence to the cost-of-service principle (benefiting party pays) as mandated by the Sale and Purchase Agreements and Bond Order shall be a primary guiding philosophy.
- E.4. OWASA's rates, fees, and charges shall be reviewed on an annual basis, and adjusted as necessary, to ensure that rate and revenue levels are adequately funding OWASA's financial, capital and operational goals, objectives and requirements.
- E.5. Rates shall be sufficient to generate income necessary to meet OWASA's revenue requirements. Revenue recovery from rates shall ensure financial stability as measured by adequate fund balance, operating reserves, debt service ratio, specified reserves and other measures established by OWASA.
- E.6. Rates should provide incentives for cost-effective use of facilities, conservation of water and efficient use and reuse of water resources, including rate surcharges during periods of water shortage.
- E.7. When OWASA determines that a rate increase is required, OWASA will strive to have such an increase be no higher than the general rate of inflation. However, OWASA shall set rates so that revenues will be sufficient at all times to provide for the cost of maintaining, repairing and operating the water, wastewater and reclaimed water systems, to pay the principal and interest on all issued or assumed debt, and to ensure the organization remains fiscally sound and financially sustainable.

- E.8. Although at times, operational or fiscal constraints may necessitate more aggressive or accelerated rate adjustments, rate levels and structures should be implemented through gradual programmed implementation of rate adjustments if possible.
- E.9. OWASA shall consider using the services of a qualified independent consultant to conduct a comprehensive rate study at approximately five year intervals.

#### **SECTION F. CUSTOMER CARE**

- F.1. OWASA shall operate the water and sewer system at the lowest rates consistent with its obligation to provide proper and efficient services, now and in the future.
- F.2. *Service Affordability* is an important consideration for OWASA. The target for average annual residential water and sewer bill divided by real median household income is  $\leq 1.5\%$ .
- F.3. When setting rates and evaluating rate structures, OWASA will carefully consider the impact such rates and rate structures will have on low income customers, while ensuring that cost-of-service principles are met.
- F.4. OWASA endorses and will promote the Taste of Hope customer assistance program. Donations made to the program by OWASA customers shall be provided to the Inter-Faith Council to help customers in need to pay their OWASA bill.
- F.5. Customers, citizens, and elected officials shall be provided timely, clear and understandable information and opportunities for constructive citizen participation in OWASA's rate decisions.

#### **SECTION G. ANNUAL BUDGETING PROCESS**

The preparation of the following documents on an annual basis is a key component of OWASA's annual budgeting and rate setting process. Those documents followed by an asterisk (\*) shall be presented for Board of Directors adoption.

**Budget Calendar:** The budget calendar shall include the proposed dates of all Board meetings and work sessions at which budget matters are to be discussed, and shall list the dates by which major budget tasks have been or are to be completed by staff.

**Statement of Strategic Issues and Policies (SIP):** The SIP shall identify the major issues, policies, and concerns that should be addressed in the upcoming annual budget and capital improvements deliberations.

**Financial Planning Assumptions and Background Information Document:** This document lists the major assumptions upon which the financial plans and budgets are to be based.

**5-Year CIP Budget\***: The CIP provides for the orderly repair and replacement of existing facilities, helps identify lead time for project planning, regulatory approvals, land acquisition, design, and construction, and provides a framework for strategically analyzing a wider range of acceptable alternatives, and for identifying, ranking, and executing projects.

**15-Year Financial Planning Model Report**: The planning model report provides a long-term perspective for assessing the adequacy of rates and fees and the timing and amount of anticipated debt financing. It also provides a means of evaluating the economic feasibility of implementing the long range CIP.

**Annual Budget\***: The annual budget provides the appropriation necessary to operate during the ensuing fiscal year.

The specific process and timeline for completing key components of OWASA’s annual budgeting and rate setting process will vary from year-to-year; however, the following table sets forth guidelines to which OWASA should generally adhere.

Task	Time Frame	Rationale
Review strategic issues, policies and economic assumptions	November/December	Staff, the Finance Committee and Board shall review strategic issues, policies, and economic assumptions that are expected to impact and the preparation of budgets (O&M and CIP) and rates. The identification of these key issues will help shape the annual budgeting process.
Capital Improvements Plan Review	February/March	The CIP provides for the orderly repair and replacement of existing facilities, lead time for project planning, regulatory approvals, land acquisition, design and construction, a framework for strategically analyzing a wider range of acceptable alternatives, and a framework for identifying, ranking, and executing projects. The Finance Committee and Board will review and comment on the draft CIP.
Operations and Maintenance Budget Review	March/April	The O&M budget provides funding for properly operating and maintaining OWASA’s services and programs. The Finance Committee and Board will review the draft O&M budget to

Task	Time Frame	Rationale
		include cost containment and/or efficiency opportunities that may impact the O&M or CIP budgets.
Financial Planning and Rate Review	April	Upon completion of CIP and O&M budgets, this information and other planning assumptions shall inform OWASA's 15-year financial plan. Staff will review the financial plan with the Board and recommend increases or decreases in rates.
Conduct Public Hearings	May	The OWASA Board shall hold public hearings on the draft O&M budget; CIP budget; and proposed rates, fees and charges for the coming year.
Adopt Budgets and Rates	June	The OWASA Board shall adopt the O&M budget, CIP budget and rate schedule for the coming year.