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# RESERVE POLICY

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**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
April 2022

**Table of Contents**

Policy Statement .....	2
Purpose of Policy .....	3
Roles and Responsibilities .....	4
Types of Reserves .....	2
<b>RESTRICTED RESERVES .....</b>	<b>4</b>
Operating Contingency Reserve .....	5
Debt Service Reserves .....	5
Connection fee Reserves.....	6
<b>DESIGNATED RESERVES .....</b>	<b>7</b>
Capital Construction Reserves.....	7
Replacement and Rehabilitation (R&R) Reserves.....	7
Self-Insurance Program Reserve.....	8
Supplemental Water Reserve.....	9
Sinking Fund Reserve.....	9
Employment Retirement Benefit Reserve .....	9
<b>UNDESIGNATED RESERVES .....</b>	<b>9</b>

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
April 2022

**Policy Statement**

The Inland Empire Utilities Agency (Agency or IEUA) has historically maintained fund reserves to ensure sufficient funding is available to meet its operating, capital and debt service obligations, comply with legally mandated requirements, and have the ability to respond to unforeseen events. As a regional provider of essential public services and with an extensive investment in public infrastructure, operating facilities, other related assets, the Agency must establish and maintain a prudent level of reserves to meet its commitment to deliver reliable and high-quality essential services to its customers. In addition, by maintaining prudent reserves the Agency has the necessary financial flexibility to effectively respond to economic, environmental and regulatory changes, protect its customers against reducing service levels or raising rates and fees because of temporary revenue shortfalls or unforeseen one-time expenditures, and support the Agency's Business Goals.

**Purpose of Policy**

The policy directives outlined in this document are intended to ensure fund reserves support the Agency's Business Goals adopted by the Board of Directors (Board) in December 2016, in particular its commitment to *"preserve fund reserves that sustain the Agency's long term fiscal health, high quality credit rating and ensure its ability to effectively address economic variability"*. The Agency is committed to ensure its customers benefit from reliable, sustainable and high- quality water supplies and cost-effective wastewater collection, treatment, and reuse services. Given the direct impact these essential services have to public health and the overall quality of life, very few options exist, if any, for service reduction levels in the event of revenue shortfalls or other funding deficiencies. In recognition of these realities, and consistent with best practices, the Agency has prudently established reserves to ensure delivery of these essential services.

The IEUA Board may designate specific reserves and set minimum and target balances to support the various funds (programs) that account for its water, wastewater treatment, recycled water and other activities. Establishing and maintaining adequate reserves for the various programs minimizes the risk of significant fluctuation in rates and charges due to changes, such as a shortfall in revenues or unanticipated expenses.

As an issuer of revenue bonds and recipient of low interest loans, the Agency is committed to its contractual obligation to pay debt service and other financial obligations as imposed by bond covenants and loan agreements. In addition, adequate reserves directly affect the Agency's credit rating and access to more favorable interest rate debt markets resulting in lower borrowing costs. Sustainment of high-quality credit rating will ensure the Agency's ability to finance construction, expansion, and improvement of facilities and infrastructure to meet higher service demands from future growth. The Agency is committed to improving its long-term credit to AAA and

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
April 2022

maintaining a debt coverage ratio that supports such rating. (Business Goal: Fiscal Responsibility).

**Roles and Responsibilities**

The Reserve Policy shall be adopted by the Board and reviewed periodically during the budget review process to ensure appropriate use of reserve funds and modification of targeted reserve balances for the various funds (programs). The Executive Manager of Finance and Administration /Assistant General Manager shall serve as the designated administrator of the Reserve Policy and shall be responsible for the day-to-day implementation and management.

**Types of Reserves**

Reserve balances shall be maintained in amounts sufficient to meet appropriate reserve levels, as established by the Board, in cash and/or cash equivalents, and permitted investments as prescribed in the Agency's Investment Policy. The Agency classifies reserves into three major categories as follows:

- **Restricted reserves** – Funds maintained based on externally-imposed restrictions from federal and state regulatory requirements, or legal restrictions imposed by third parties, (example: bondholders) through bond indentures or other contractual agreements (example: Regional Sewage Service Contract).

**Designated reserves** – Board imposed restrictions on funds for Agency specific purposes such as mitigating risk from the Agency's self-insurance programs, unfunded liabilities for retirement benefits, and financing replacement and rehabilitation (R&R) of Agency assets. These funds are not legally restricted. In the event of emergency, the Board has the discretion to reassign the spending from the reserve.

- **Unrestricted reserves** – The internal policy of the Agency requires maintenance of adequate undesignated (unrestricted) reserves to finance requirements such as investment in capital and operational efficiencies and refunding of high interest debt obligations. Funds in these reserves are available for spending with no legal, regulatory, or Board imposed restrictions.

For each of the reserves, the Agency has identified a purpose, appropriate reserve levels, funding sources, conditions under which they are to be used and replenished, and review dates for determining continued need. Any reserves in excess of the cumulative target amounts will be considered undesignated funds which can be used for any lawful purpose at the discretion of the Board.

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
April 2022

**RESTRICTED RESERVES**

**Operating Contingency Reserve**

Purpose: The Agency is committed to providing wastewater collection, treatment, disposal, optimizing beneficial use of recycled water and biosolids, and regional conservation and water use programs. The Agency strives to provide and maintain a rate structure that is affordable, stable and fully covers the fund (program) cost of service. However, unforeseen shortfalls in revenues or increases in operating costs require that the Agency periodically adjust rates and charges to achieve full cost of service recovery. This reserve is intended to minimize rate fluctuations as a result of unfavorable economic conditions or other factors beyond the control of the Agency that may result in reduced revenues or increased costs.

The Agency shall maintain an operating contingency reserve equal to a minimum of four (4) months, as mandated by legal requirements, and a target of six (6) months of total operating expenses as identified in the adopted budget for the current fiscal year. This level of reserve will provide customers and outside parties assurance that the Agency can operate for at least four months despite a significant shortfall in revenues or unplanned increase in expenses. The target level minimizes the risk of significant rate fluctuations as a result of unforeseen events.

Usage Requirements: This reserve can only be drawn upon if the Agency's operating revenues are not sufficient to pay operating expenses. Draws from these reserves shall be replenished within twelve months after use.

Reserve Level: The Operating Contingency Reserve levels shall be maintained at a minimum of four (4) months, as mandated by legal requirements, and a target of six (6) months of the fund (program) adopted operating expenses for the current fiscal year.

Funding Source: Operating Contingency Reserve will be funded from net system revenues, (total operating revenues less total operating expenses).

Review Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's operations and maintenance (O&M) and capital budget.

**Debt Service Reserve**

Purpose: As required by bond covenants and loan agreements, debt service reserves are maintained to support payment of principal and interest on outstanding obligations.

Usage Requirements: Debt service reserves will only be used to pay debt service costs when pledged net revenues (as defined in the relevant debt instruments) are insufficient to meet the principal and interest payments.

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
**April 2022**

Reserve Level: The target is equal to the highest annual debt service during the life of the obligation. The minimum level will be funded to meet next fiscal year debt service requirements.

Funding Source: Includes one or combination of system revenues, property tax receipts, and/or restricted debt service accounts established as part of the original debt issuance.

Review Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and capital budget.

**Connection Fees Reserve**

Purpose: New users connecting to the Agency's regional wastewater or water distribution systems and existing users that significantly increase demand on the system are required to pay a connection fee. The connection fee is intended to recoup the incremental cost of expansion or improvement to regional facilities necessary to accommodate the additional demand. The amount of connection fees collected are accounted for in accordance with the Agency's Board adopted Water Ordinance and the Regional Sewage Service Contract (Regional Contract).

Usage Requirements: Funds are restricted to support for capital expansion, improvement, and replacement and rehabilitation of physical assets, or paydown of existing debt.

Reserve Level: No minimum or target level is established for this reserve. The amount of money deposited into this reserve is dependent on the level of new connections to regional systems and the Agency's funding requirements to support the planned capital projects.

Funding Source: Reserve is comprised of two major components:

- Water connection fees levied on new or upsized connections to the Agency's regional water distribution system. Water connection fees are collected by the Agency and based on meter equivalent units (MEUs).
- Wastewater connection fees levied on new or upsized connections to the Agency's regional wastewater system. Pursuant to the Regional Sewage Service (Regional Contract), wastewater connection fees are based equivalent dwelling unit (EDUs) and are collected by the contracting member agencies in their respective jurisdictions on behalf of the Agency. Contracting member agencies hold wastewater connections fees in a Capital Capacity Reimbursement Accounts (CCRA) until called by the Agency to support capital investments.

Review and Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and capital budget.

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
April 2022

**Other Reserves**

From time to time, it may be necessary to establish other restricted reserve funds in accordance with law or other statutory requirements or with contractual agreements to which the Agency is a party. The Executive Manager of Finance and Administration/ Assistant General Manager will create such Reserve Funds as mandated and will establish appropriate targeted goals, reviews, and funding mechanisms.

**DESIGNATED RESERVES**

**Capital Construction Reserve**

Purpose: Capital construction reserve funds are used to finance capital investments such as construction, improvement or expansion of facilities and infrastructure, as well as acquisition of major equipment and technology. The services provided by the Agency are critical to the health and welfare of the residents within the Agency's service area. The Agency is committed to ensure that systems are managed and constructed so that 75% of capacity is never exceeded (Business Goal; Wastewater Management Capacity).

Usage Requirements: Funds in this reserve will fund capital investments based on the Agency's Ten-Year Capital Improvement Plan (TYCIP) and other long-term planning documents including but not limited to; the Asset Management Plan, Integrated Water Resources Plan (IRP), Recycled Water Plan, Wastewater Facilities Master Plan, and Energy Plan.

Reserve Level: The maximum target level will be reviewed annually for each program fund and will be equal to ten-year average of pay-go times three (3) fiscal years, as identified in the Ten Years Capital Improvement Plan (TYCIP). Pay-go for capital construction is CIP costs net of bond or loan proceeds.

The minimum level is equal to ten-year average of CIP pay-go costs.

Funding Source: Combination of system revenues generated from rates and user charges, property tax receipts, and debt proceeds issued to finance specific capital investments.

Review Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and capital budget.

**Replacement and Rehabilitation (R&R) Reserve**

Purpose: Maintaining assets in an operating condition to meet the Agency's level of service commitment to provide reliable and high-quality services requires timely and adequate investment in replacement and rehabilitation (R&R) of Agency assets. R&R is defined as an

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
**April 2022**

expense which will extend, as opposed to maintain, an asset's useful life. The basis for R&R requirements will be end of useful life and condition assessments conducted by Engineering, Maintenance and Operations and reported in Asset Management Report updated every 3 to 5 years. The Agency's ultimate goal is finance planned R&R requirements with user rates and charges. This goal is consistent with the Regional Sewage Service Contract which requires the volumetric EDU rate to fully support operating, administration and R&R costs for the regional wastewater program.

Usage Requirements: As needed to finance unplanned R&R requirements, including R&R requirements identified in the Agency's asset management report but scheduled in subsequent fiscal years.

Reserve Level: The maximum target level will be reviewed annually and can apply one of the following options to calculate the target reserve in reference to the program fund's R&R costs and funding support (e.g. bond or loan proceeds):

- a) Maximum target level is equal to ten-year average of R&R costs times three (3) fiscal year, or
- b) Maximum target level is equal to ten-year average of R&R pay-go times three (3) fiscal years, as identified in the TYCIP. Pay-go is R&R costs net of bond or loan proceeds.

The minimum target will be the total ten-year average R&R costs.

Funding Source: System revenues generated from rates and user charges, net of operating costs and debt service costs.

Review Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and capital budget.

**Self-Insurance Program Reserve**

Purpose: An exposure/liability reserve shall be maintained for costs not covered by the Agency's insurance policies, such as claim costs within the Agency's deductibles, self-insurance retentions, and/or costs associated with disasters, and other events that are not reimbursable from insurance. The reserve shall also provide funding to mitigate various catastrophic and other events that may or may not be covered by insurance. These events may include, but are not limited to; legal settlements, terrorist attacks, natural disasters, such as earthquakes, and severe weather storms.

Additionally, the Agency has elected to self-insure for potential workers' compensation claims. With a workforce of over 300, the Agency's exposure to work-related injuries increases.

Usage Requirements: Accessed as needed for non-recoverable expenses associated with claims against the Agency. In the event of a claim in excess of policy limitations and available operating funds, the reserve will be used to satisfy that claim. In the event of a workers'

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
**April 2022**

compensation claim(s) in excess of policy limitations and available operating funds, the reserve will be used to satisfy the claim and/or to pay legal expenses defending the claim

Reserve Level: The minimum level will be set at \$3 million and target level will be set at \$6 million, including \$1,000,000 maximum exposure per occurrence for workers compensation claim.

Funding Source: Property tax receipts allocated to the Administrative Services (GG) fund and inter-fund transfers from other funds, as needed.

Review Date: Reserve balances to be analyzed by Risk Management every two years to determine an appropriate funding level.

**Supplemental Water Reserve**

Purpose: This reserve will support investment in supplemental water purchases for purposes of increasing water use efficiency, water quality, water reliability and water sustainability in the Chino Basin (Business Goal: Water Reliability).

Usage Requirements: Acquisition of supplemental water to support the water reliability and water quality in the Chino Basin.

Reserve Level: No minimum or target levels are established for this reserve

Funding Source: Combination of property tax receipts, net proceeds from the sale of supplemental water, and inter-fund loans, as needed.

Review Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's O&M and capital budget.

**Sinking Fund Reserve**

Purpose: Sinking fund reserves are the systematic accumulation of funds set aside for a specified time frame for the specific purpose of funding major capital projects that cannot be funded by rates/fees or issuance of new debt. Reserves can be used for the design, capital acquisition, construction, equipment and process improvement costs and debt defeasance

Usage Requirements: This reserve can only be drawn upon for the designated purpose for which it was established, unless otherwise approved by the Board.

Reserve Level: The maximum target balance in the Sinking Fund Reserves shall be determined based on the designated capital needs as approved by Agency's Board of Directors.

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
**April 2022**

Funding Source: Sinking Fund Reserve will be funded by property tax receipts and if needed, rates and charges.

Review Timeline: Reserve balances and target level will be reviewed by staff and the Board as part of the preparation and approval of the Agency's operations and maintenance (O&M) and capital budget.

**Employee Retirement Benefit Reserve**

Purpose: The Agency provides postemployment pension to eligible employees who retire from the Agency. For pension benefits, the Agency contributes to a defined benefit pension plan under the California Pension Employees' Retirement System (CalPERS).

Like most public Agencies, the Agency is facing growing unfunded accrued liabilities (UALs) for postretirement benefits. A key objective of the Agency is to develop a funding strategy to fully fund UALs over an appropriate period of time in order to safeguard retiree benefits and the Agency's financial health.

Usage Requirements: To mitigate the impact of annual increase of the annual contribution amounts in excess of the budgeted amount

Reserve Level: This minimum level amount will be set at \$6 million and increased annually up to the target level. The target level will be the highest of the minimum or Annual Required Contribution (ARC) amount budgeted in the subsequent fiscal year, based on the actuarial valuation report from CalPERS.

Funding Source: Combination of property tax receipts and indirect allocation of employment costs across all Agency funds (programs) from the Administrative Services fund.

Review Timeline: Reserve levels will be adjusted in conjunction with the annual actuarial valuation updates for pension.

**Other Reserves**

From time to time, the Board of Directors may deem it prudent to establish other designated reserves in order to further the mission of the Agency. The Executive Manager of Finance and Administration/ Assistant General Manager will create such Reserves as directed and will establish appropriate minimum and target levels, review timelines, and funding mechanisms. This Policy will be amended to reflect the Board's direction with respect to any additional Designated Reserve Funds.

**INLAND EMPIRE UTILITIES AGENCY**  
**RESERVE POLICY**  
April 2022

**UNDESIGNATED RESERVES**

The Undesignated Reserve includes all monies collected or generated by or on behalf of the Agency, without regard to the source, except those that have been deemed to be Designated or Restricted. These monies are available for spending with no legal, regulatory, or Board-imposed restrictions.