

EXHIBIT 11-B

Monterey Peninsula Water Management District Financial Policies

Reserves Policy

The Reserves Policy is designed to establish guidelines for the fiscal stability of the District and provide the rules and procedures on how the District will manage Reserves. In addition, this policy is intended to document the appropriate Reserve levels to protect the District's creditworthiness. Specifically, this policy establishes the amounts that the District will strive to maintain in its Reserves, how the Reserves will be funded, and the conditions under which the Reserves may be used.

The District will establish and maintain reserve balances to:

1. Guard its stakeholders and residents against service disruption in the event of temporary or unexpected revenue shortfalls, economic uncertainties, local disasters, financial hardships, or unpredicted one-time expenditures.
2. Provide for fluctuations in revenues and expenditures while ensuring adequate cash flow.
3. Set-aside capital planning reserves for the maintenance, replacement, and upkeep of District facilities or equipment.
4. Demonstrate continued creditworthiness to bond rating agencies and comply with relevant debt covenants.

Background: Government Accounting Standards Board (GASB) Standard 54 establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This Statement classifies fund balance into five categories: nonspendable, restricted, committed, assigned, and unassigned, based on the relative strength of the constraints that control how specific amounts can be spent. The District reserves in this policy will be generally treated as an assigned fund balance, except for general reserves, which may be treated as unassigned. Any transfer of funds from the reserve may only be made upon Board approval or as part of the budget adoption. The policy establishes the following guidelines:

1. **Types of Reserves and Reserve Levels:** - The District establishes various reserves to meet anticipated liabilities and risks. In order to provide liquidity adequate to meet the needs and demands of providing government services, including unanticipated reductions in revenues or unplanned increases in expenses, reserve levels will be maintained and managed within the District's Cash balance and Investment accounts. The policy does not create a separate working capital reserve; instead, unassigned or assigned general reserve may be considered as part of the District's Working Capital.

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The policy formalizes the following District reserves and establishes minimum reserve levels as under:

- a. **General Reserve:** The purpose of the General Reserve is to provide funding for District operations during a reduction in expected or budgeted revenues and unexpected cash shortages, expenses, or losses. The policy establishes a General Reserve target of 50% of the fiscal year's operating budget, generally supporting six months of operations. The operating budget will generally exclude pass-through expenditures. In case of expected on-time expenses or liabilities not covered by other Reserves, including legal liabilities, the minimum target of the General Reserve may be increased to cover the expected payout for such expenses or liabilities.
- b. **Assets Replacement Reserve:** Reserve for replacement costs of facilities, vehicles, and equipment in service. Contributions toward this Reserve will be guided by the total anticipated cost of the facility or facility improvements, spread out over the depreciable life of the asset or the number of years before the asset needs to be replaced.
- c. **Debt Reserve:** Set-aside reserve to contribute towards the District's debt payments. The reserve will follow guidelines established by bond or debt covenants, generally targeting accumulated reserves of *at least* one year of the district's total debt service.
- d. **Pension Reserve:** Reserve to accumulate resources towards the payment of the District's unfunded accrued pension liability (UAL), to buffer increases in the District's PERS payments, and contribute towards a potential Section 115 Trust Fund. Contributions towards this reserve will be generally made to target the specified funded ratio for the District's defined benefit plans at the California Public Employees Retirement System.
- e. **Other Post Employment Benefit (OPEB) Reserve:** Reserve to contribute towards the payment of the District's unfunded accrued OPEB liability and to contribute towards a potential Section 115 Trust Fund. Contributions to this reserve will be generally made to target the specified funded ratio for the District's OPEB plan.
- f. **Flood/Drought Reserve:** Set-aside reserve to provide capital in the event of a local disaster or emergency. No set contributions are assigned to this reserve.
- g. **Capital Project Reserve:** Reserve to accumulate resources for ongoing or future capital expenditures, including new vehicles, equipment, facilities, technology projects, and capital projects that meet the maintenance needs of existing or

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- new District facilities. This reserve may be created in the future and funded annually at the discretion of the General Manager or designee as part of the budget process.
- h. **Compensated Absences Reserve:** Reserve to pay for accumulated, paid-for employee leaves like vacation and sick time that is owed by the District to employees but has not yet been taken or paid out. New accounting standards, particularly GASB Statement 101, require governments to recognize these liabilities more broadly for both current and future use of leave, whether paid as time off or cashed out upon termination. The minimum target level for this reserve will be the expected employee payout in the next three years, or 25% of the Compensated Absences liability recorded for the preceding fiscal year.
 - i. **Rate Stabilization Reserve:** Reserve to mitigate the impact of fluctuating revenues or increased expenses on customer rates and manage potential rate fluctuations caused by drought, conservation efforts, or unexpected changes in demand. This reserve may be created in the future. The District will maintain water rate structures that are adequate to ensure that any enterprise or special revenue funds remain firmly and separately self-supporting, including the cost of operation, infrastructure maintenance and replacement, indirect cost recovery, and debt service. Contributions towards this reserve may be determined by a rate model when utility rates are adopted, or set during the adoption of the budget.
2. Funding Reserves- Funding will generally come from excess revenues over expenses or one-time revenues and will generally be proposed and funded during the budget adoption.
3. Conditions for Use of Reserves- It is the intent of the District to limit use of the Reserves to address unanticipated and non-recurring needs. Reserves shall not normally be applied to recurring annual operating expenses. Reserves may, however, be used to allow time for the District to restructure its operations in a deliberate manner, with such use in the context of an adopted long-term plan. It shall be the District's policy to draw down general reserves consistent with the following priorities:
- a. The use of reserves for their designated purpose.
 - b. The use of reserves to offset unanticipated increases in expenditures for current programs or projects.
 - c. The use of reserves to offset shortfalls in the collection of revenues.
 - d. The use of reserves for one-time expenditure that generates ongoing cost savings or cost avoidance or generates ongoing revenue enhancements.

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- e. The use of reserves for a one-time expenditure that leverages the expenditure of significant public or private investment in the District by other entities.
- 4. Investment of Reserves: The cash balance in assigned reserves will be deposited or invested as consistent with the District's Investment Policy and other applicable governmental fiscal policies.
- 5. Replenishment of Reserves: In the event that Reserves are used, resulting in a balance below minimum targets, a plan will be developed and included to replenish reserves to their minimum level within a reasonable timeframe, generally not to exceed five years.
- 6. Excess of Reserves: In the event that the Reserves exceed the minimum balance requirements, any excess Reserves may be used in the following ways:
 - a. Fund accrued liabilities, including but not limited to debt service, pension, and other post-employment benefits as directed, or approved as part of the annual budget resolution. Priority will be given to those items that relieve budget or financial operating pressure in future periods.
 - b. Appropriate to lower the amount of bonds needed to fund capital projects in the District's capital plan, if applicable.
 - c. One-time expenses that do not increase recurring operating costs and cannot be funded through current revenues. Emphasis will be placed on one-time uses that reduce future operating costs.
- 7. Assignment of Reserves: General reserve surplus (excess over minimum target levels) arising due to additional revenues over expenses in the District's funds at fiscal year-end may be assigned to select reserves below after the close of the fiscal year in the following order:
 - a. Excess General Reserve arising from capacity fees that are over budget is assigned to the District's Capital Projects Reserve.
 - b. Excess General Reserve after Step A is assigned to Compensated Absences Liability to bring it to the minimum target level.
 - c. Excess General Reserve after Step B is assigned to the OPEB and/or Pension reserves to bring them to the minimum target levels.
 - d. Assignment for all remaining reserves is to be proposed during budget adoption or during mid-year budget amendment(s).
- 8. Periodic Review: The District shall periodically review the minimum target reserve levels and percentages of surplus funds to be assigned in light of changing conditions.