

DOWNRIVER UTILITY WASTEWATER AUTHORITY

CASH RESERVE POLICY

INTRODUCTION AND PURPOSE

DUWA is a public body corporate organized pursuant to Act 233. DUWA is responsible for the collection and treatment of sanitary and storm water flows for 13 member Communities. Representatives from DUWA's 13 Communities act as Board Members. DUWA's Board Members exercise all powers of DUWA. The Board Members meet monthly to jointly discuss, deliberate and determine the direction of DUWA's current and future operations. The Board is empowered to set policy for the Authority by a majority vote of the Members. A vote to adopt the policy shall not be used as an argument against the Member in the future on the basis of estoppel or laches.

This Cash Reserve Policy is designed to establish guidelines to ensure the fiscal stability of the System and to provide guidance to advisors in the financial management of the System.

DUWA believes cash reserves are necessary to maintain the fiscal independence of the system and to ensure uninterrupted service to the ratepayers. DUWA believes the policy allows for adequate working capital, funds for emergency repairs and replacements, smoothing of rate increases to member communities, as well as fulfilling the commitment to debtholders and tunnel communities.

RESERVE TYPES AND MINIMUM LEVELS

DUWA will maintain several types of reserves, as follows:

TYPE	BASIS	AMOUNT	PURPOSE
Operating	Unrestricted - Discretionary	3 months of operating expenses or a minimum of \$5.0m, whichever is higher	For working capital to cover the time lag between cash outflows for monthly expenses and revenues coming in from communities as well as to cover budget overruns and/or revenue shortfalls caused by usage volatility
Capital	Unrestricted - Discretionary	Minimum \$5,000,000	Emergency repair and replacement
Tunnel	Restricted - Believed to be legally required	Minimum \$1,600,000	For more than incidental tunnel-specific expenses
Rate Stabilization	Restricted - Required by debt agreement	Minimum \$2,000,000	Required by transfer debt agreement to be available, if needed, to allow for smoothing of rates in years when there would otherwise be significant spikes in rates
Debt Service	Restricted - Required by debt agreement	As required by Bond Ordinance	Required by debt agreements to provide comfort that funds are on hand to make the upcoming payments.

OPERATING RESERVE – DUWA shall maintain operating reserves necessary to meet the operational needs of the system which includes paying the budgeted operating and maintenance expenses. The system has a fiscal responsibility to pay vendors and service providers in a timely manner. Revenues received from owner communities are on a time lag. Revenues are self-reported monthly but are not due to DUWA until 45 days after month-end. DUWA also has certain expenses, such as insurance, that require prepayment. Various industry groups have published recommendations

ranging from one to three months of operating costs. Given that DUWA is an independent system without access to the funds of a larger parent entity, DUWA shall maintain cash operating reserves equal to three months of operating costs or a minimum of \$5 million.

CAPITAL RESERVE – DUWA shall maintain funds to allow for the ability to make repairs or replacements in the event of unanticipated breakdown or failure, as well as to allow for smaller projects without the need to obtain debt financing. With an aging system, unplanned capital expenditures tend to occur at a higher rate. The system is expected to operate on an uninterrupted 24/7 basis. DUWA has an Asset Management Plan that is periodically refreshed and allows DUWA to project when larger capital needs will arise and to plan for debt financing, where appropriate. DUWA also maintains an annual line-item budget for smaller capital outlay which includes an element of unplanned replacements and repairs.

A formal capital reserve of \$5 million is established for the following reasons:

1. **Unplanned or accelerated infrastructure replacements** – repair and replacement – general measures include one year’s depreciation (\$4.5 - \$5 million) or percent of total assets
2. **Smooth out budget impact of fluctuating capital requirements** – typically, DUWA’s non-debt financed asset purchases have been budgeted at \$2m and paid from current annual revenues versus reserve spend down
3. **Moderate level capital costs that don’t rise to the level where bonding is cost effective** – the availability of cash reserves eliminates interest costs and the time necessary to issue debt. If necessary, DUWA spends down and replenishes in the same year.
4. **Emergency capital expenses** – taking into consideration:
 - a. Risk factors – types of natural disaster, extreme weather or force majeure that may be a threat and estimate the damage that could occur
 - b. Cost to replace critical facilities immediately
 - c. Availability of other funds – Line of credit, Veolia loan or loan from member communities
5. **System expansion or longer-term replacement** – DUWA would anticipate bonding for longer-term projects

TUNNEL RESERVE – The tunnel reserve has been in place for many years and has been set at a minimum of \$1.6 million. The Tunnel Reserve was initially established as part of the State Revolving Fund (SRF) financing for the tunnel construction. It was only financed by those communities that participated in the tunnel project. An initial maximum fund amount was established, and further contributions were stopped after the maximum amount was reached. The fund is available for rehabilitation/replacement needs or for emergency needs for the tunnel. To date, no specific funding needs for the tunnel have been determined. Therefore, it has been treated as a fund to address emergency needs for the tunnel. As inspections of the tunnel are conducted and the system ages, use of the Tunnel Reserve and its magnitude may be periodically reassessed.

RATE STABILIZATION RESERVES - The debt agreement for the System transfer debt states that transfers are “at the written direction of an Authorized Officer to the Trustee, to the Rate Stabilization Fund any such amounts as the Authority may deem advisable for the System, pursuant to policies or resolutions adopted by the Board of Commissioners from time to time”. During the rate setting process, the Finance Committee’s normal process is to set rates at a level that does not require the use of net position (reserves). The rate stabilization level was initially set at \$3.2m as it was tied to an analysis that was done for the System transfer debt issuance. In that analysis, annual rate increases were capped at 4% and the \$3.2m was the amount of the cumulative shortfall that was predicted to exist in 2 of the 5 years used in the projection. However, given that the \$3.2m is not a mandated amount and is subject to change, coupled with the philosophy that DUWA does not expect to use net position to subsidize rates, this balance shall

be maintained by DUWA at a level to provide for some cushion should rate setting assumptions not come to fruition, thus ultimately requiring a subsidy when none was planned or to provide for a planned subsidy in years when the known need for non-recurring expenses has a significant impact on rates. This reserve shall be maintained at \$2 million which is roughly 10% of total operating costs. Any past occasional rate subsidy has not approached \$2m.

DEBT SERVICE RESERVES - DUWA will maintain legally required debt reserves. The debt agreement for the system transfer debt is very clear in terms of funds that need to be set aside for upcoming principal and interest payments as well as general debt reserves. DUWA's accounts with the trustee are set up in such a manner as to appropriately fund these reserves before monies are made available in the unrestricted accounts.

WITHDRAWAL AND REPLENISHMENT OF RESERVES

DUWA will treat the minimum reserve levels as practical reserve floors. As appropriate expenditures of reserves occur, DUWA will allow for a decrease of the minimum level. Should the reserves be drawn down below the minimum reserve level, DUWA shall immediately replenish the reserve with non-reserved operating funds. If no such funds exist, the Board shall work with the Finance Committee to implement a plan to return reserves to their minimum targeted level within 3 years.

Interest earned on the funds (restricted or otherwise) will be accounted for as general reserves and may be transferred out of the fund at anytime to the Authority's Operating Reserve Fund.

REPORTING AND OVERSIGHT

Reserve levels will be monitored during the fiscal year by the System's accountant and reported to the Finance Committee as part of their regularly scheduled meetings. The reserves will also be analyzed annually as part of the System's financial statement audit and reported within the audit. The Finance Committee should review the reserve levels as part of the annual rate-setting process. Should minimum reserve levels need adjustment due to new risk factors or System changes, these will be brought to the Board.

Adopted by DUWA Board on June 9, 2022