MARIN WATER

Financial Policy Review

August 24, 2023

Overview of Presentation

- Financial Policy Overview
  - Professional Associations, Best Practices
- District Financial Policy Summary
  - Reserves, Investments, Debt, Rates
- Reserve Targets
  - Industry guidance
  - Agency specific analysis
  - Credit ratings benchmarks
- Recap and Next Steps

Financial Policies: Best Practices and Industry Guidance

- Government Finance Officers Association (GFOA)
    - Guidance for local government financial management
        - Accounting, budget, capital planning, risk, IT
- American Water Works Association (AWWA)
    - Focus on water and wastewater utilities
        - Fiscal and operational guidance
        - Benchmarking surveys
- California Special Districts Association (CDSA)
- International City/County Management Association (ICMA)
- Water Environment Federation (WEF)

Marin Water Financial Policies

- **Board Policy # 33: Investment Policy**
  - Prudent and systematic investment policy
  - Safety, Liquidity, Return
  - Permitted Instruments and Reporting Requirements
- **Board Policy # 45: Rate Review**
  - Regular and routine review (2 year minimum)
- **Board Policy # 46: Reserve Policy**
  - Minimum balances and purpose of 6 reserve funds
- **Board Policy # 51: Debt Management**
  - Maintaining highest possible credit ratings (at least AA+)
  - Debt Capacity of 4x operating expense
  - Debt Service Coverage ratio of 150%

Your Water

- Locally Sourced*
  - **75%** comes from Marin reservoirs
  - **25%** is imported from Sonoma County
- 7 local reservoirs provide storage before water is treated
- 3 water treatment plants operate around the clock
- A network of over 900 miles of pipelines and 100 pump stations
- Over 60,000 service connections
  - 190,000 customers served

*based on long term averages

Organizational Challenge: Marin Water is Unique

Municipal Utility

- Not a business
- Not a municipal government (i.e. town, city, county)

California

- Proposition 218 governs the rate-setting process
- Climate change drives increased risk of drought and wildfire

Marin County

- Topography -> requires more infrastructure to pump water over the hills
- Density -> Low population density reduces economics of scale
- Slow Growth -> Smaller population base to share costs; less benefit from new connection fees

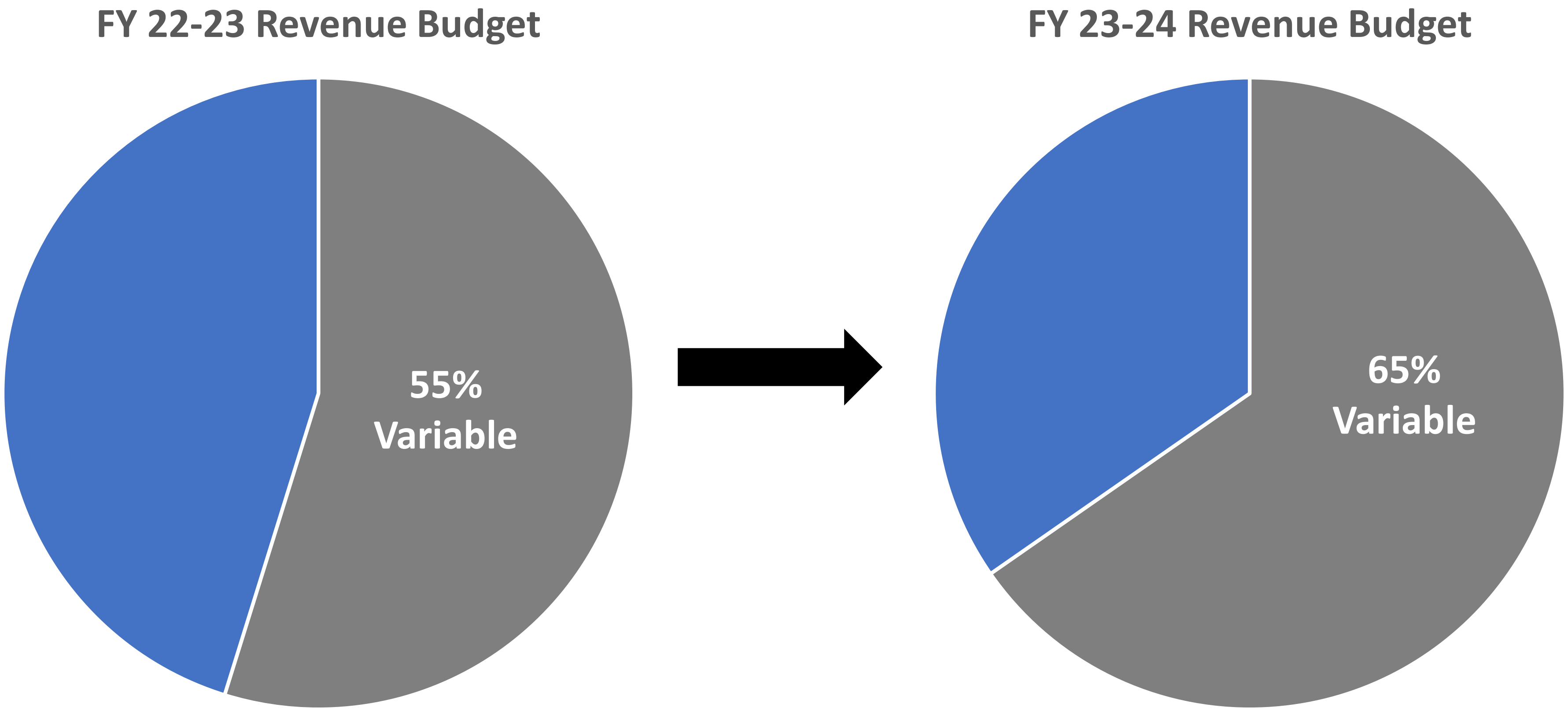
Marin Water

- Oldest municipal water district in California -> significant deferred maintenance
- Local Watershed Management and Water Treatment Operations
- Unlike many Bay Area water suppliers, Marin does not rely on the Sierras or the State Water Project

District Financial Profile

- Total budget of $142 million in FY 2023-24 (all funds)
  - Operating Budget = $104.1 million
    - $9.5 million is for debt service
  - Capital Budget = $32.9 million
    - Funded by a mix of CMF (fixed) and rate revenues (variable)
- In 2023, the District changed its rate structure and increased the budget
  - Rate structure became more dependent on variable water sales
  - Structure for drought rates was established
  - Budgeted increases were primarily for water supply, capital projects and inflation
- Expenditures are 95% fixed (very little correlation to water use)
- Revenues are 65% variable (high correlation to water use)

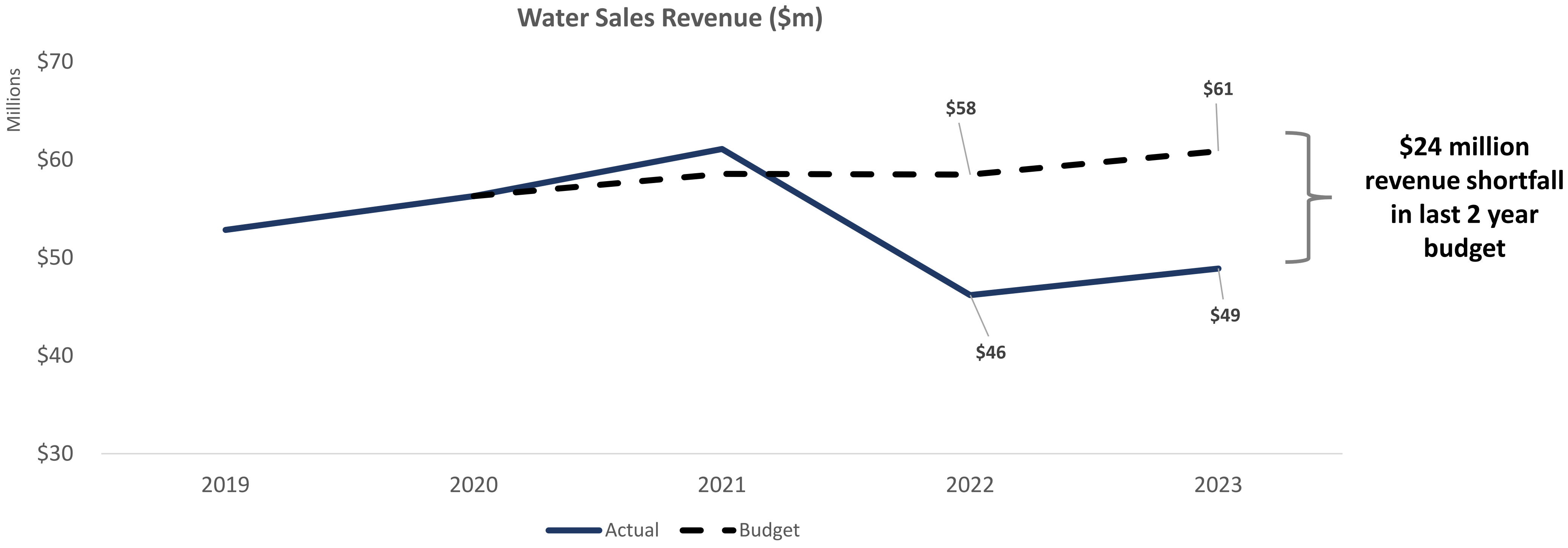
FY 2023-24 Budget: Increased Reliance on Variable Revenues



Water Sales Revenue Trends

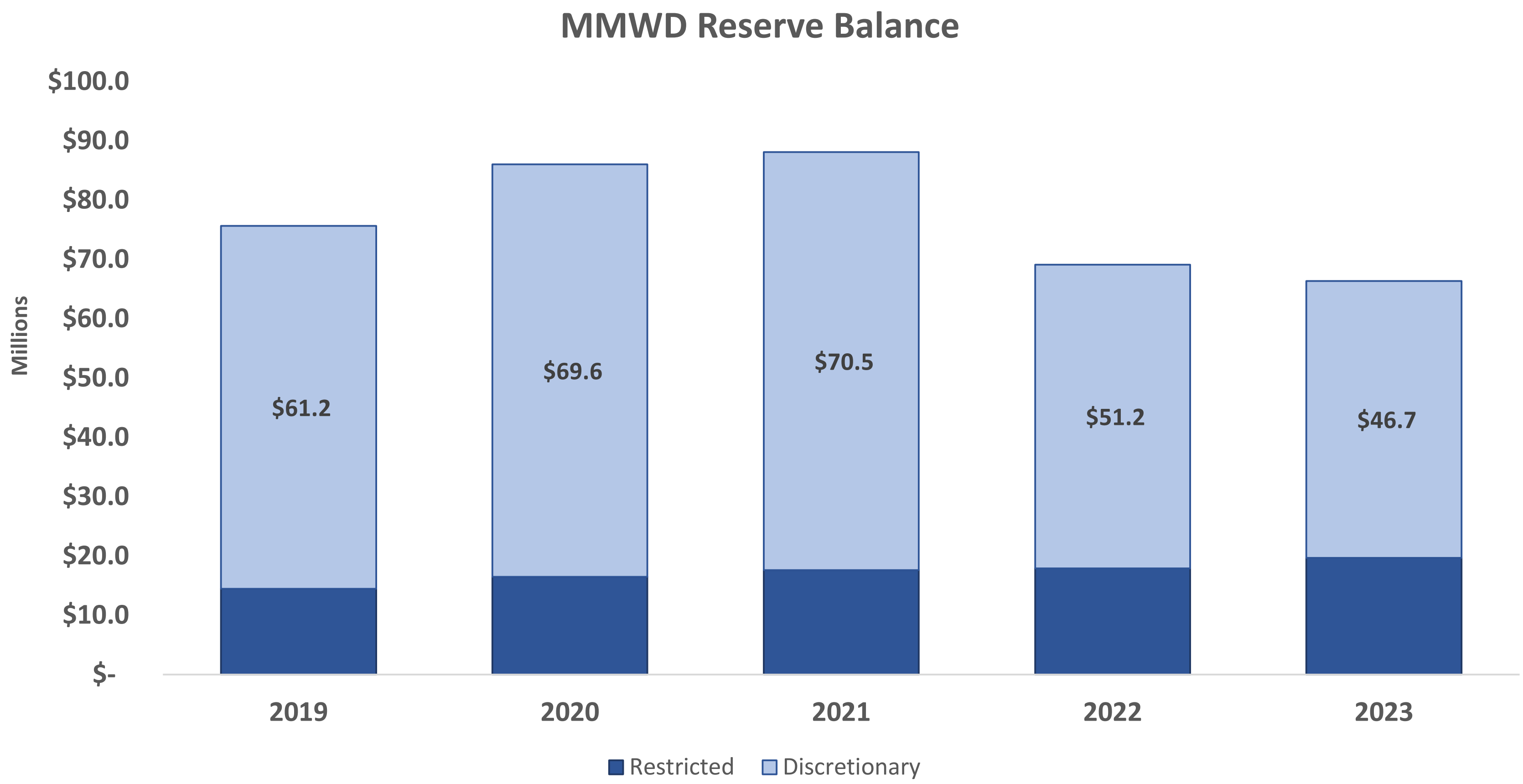
Over the past two years, water sales revenues have decreased due to conservation

- Net revenue loss to the District of $24 million over 2 years
  - Offset by expenditure reductions (personnel & capital)
- Backfilled by use of reserves and will need to be replenished



Reserve Target Considerations

- Prior to 2021, District Reserves were well-funded
- Reserves were utilized over past 2 years to offset revenue losses stemming from the drought



Reserve Level Targets:
Industry Standards and Risk Analysis

Reserve Level Targets – Board Policy #46

Reserve Fund	Minimum Balance (per policy)	Policy Target (FY 2024)	Preliminary Balance* (6/30/23)
Insurance	Six times self insured retention (SIR)	$18.6M	$6.2M
Workers Compensation	Determined by Actuary	$6.6M	$6.6M
Capital Reserve	Annual budget for capital expenditures	$32.9M	$5.9M
Unrestricted Reserve	Six months of the annual operating budget	$52.1M	$21.2M
Rate Stabilization	N/A	n/a	$1.9M
Water Supply Project	N/A	n/a	$0M
Total		$110.2M	$41.8M

*Pending final year end accrual adjustments

Operating Reserve Targets: Industry Standards

Organization	Target Balance
Government Finance Officers Association (GFOA)	No less than 45 days of expenses
International City/County Management Association	One to two months of expenses
Water Environment Federation (WEF)	One to three months of expenses

- Industry Best Practices: Minimum of 2 months of operating budget*
  - Guidance recommends adjustments for agency specific factors:
    - Budget structure
    - Revenue volatility
    - Asset condition
    - Credit rating objectives

** AWWA Cash Reserve Policy Guidelines, 2018*

Reserve Targets: Agency Specific Considerations

Industry Best Practices* are to provide sufficient funds for:

- Structural budget risk
  - Baseline expense levels for contingency, water purchases and equipment replacement
  - Revenue volatility
- Unanticipated expenditures
  - Uncertainty: 4 year rate cycle, drought, inflation
  - Unplanned infrastructure repairs
- Strategic or accelerated infrastructure replacements
  - May include grant matching funds
- Emergency replacement for catastrophic events
  - Fire, flood, earthquake
- Litigation and Insurance reserves

** AWWA Cash Reserve Policy Guidelines, 2018*

MMWD Agency-Specific Analysis by Component

	Low	Medium	High	Note
Budget Structure				
Industry Minimum Standard	$8,650,000	$17,325,000	$26,000,000	1-3 Months of Operating Budget (AWWA minimum)
Operating Budget Contingency	$0	$2,600,000	$5,200,000	0-5% of Operating budget
Dedicated Replacement Funds	$0	$1,000,000	$2,000,000	Emergency replacement for vehicles and technology
Water Purchases	$0	$2,000,000	$4,000,000	Reserve for average cost above the minimum contract
Revenue Volatility				
Rate Structure Risk	$4,500,000	$6,750,000	$9,000,000	Revenue shortfalls under 5-10% consumption reduction
Drought Reserve	$4,500,000	$6,750,000	$9,000,000	Additional revenue shortfalls under 11-20% conservation scenario
Asset Condition				
Deferred Maintenance	$5,000,000	$7,500,000	$10,000,000	Unanticipated Repairs (25-50% of CIP)
Grant Matching Funds	$6,250,000	$9,375,000	$12,500,000	25% Local Match for $25-$50m
Natural Disaster and other Risk				
Wildfire, Flood Earthquake	$5,000,000	$12,500,000	$20,000,000	Response and mitigation costs, Insurance Deductible, FEMA match
Insurance Claims (SIR)	$4,800,000	$8,100,000	$12,700,000	Self Insured retention for workers comp. plus one to six events
Total	**$38,700,000**	**$73,900,000**	**$110,400,000**	

- High level analysis shows a range of $38 million to $110 million for MMWD reserve targets
  - Middle of range is $73.9 million, which is about equal FY 2021 reserve levels

Reserve Targets – Credit Ratings Implications

- MMWD was upgraded to AA/Stable in 2019
  - Primarily due to addition of Capital Maintenance Fee (fixed revenue source)
  - Financial metrics were “expected to remain well above bond covenant minimums”
- Credit ratings agencies use formulas to evaluate agencies creditworthiness
  - Primary factors* are:
    - Size and health of system (30%)
    - Financial strength of operations (40%)
    - Strength of rate management and regulatory compliance (20%)
    - Legal provisions (10%)
- Financial Strength includes the following metrics
    - Annual Debt Service Coverage: Operating surplus divided by annual debt service
    - Days of Cash on Hand: Unrestricted reserves divided by annual O&M
    - Debt to Operating Revenue: Net debt divided by operating revenue

** Moody’s US Municipal Utility Revenue Debt Methodology (2022)*

Reserve Targets – Credit Ratings Metrics

EXHIBIT 1

US Municipal Utility Revenue Debt Scorecard Overview

Factor	Factor Weighting	Sub-factor	Sub-factor Weighting
System Characteristics	30%	Asset Condition (Remaining Useful Life)	10%
		System Size (O&M)	7.5%
		Service Area Wealth (Median Family Income)	12.5%
Financial Strength	40%	Annual Debt Service Coverage	15%
		Days Cash on Hand	15%
		Debt to Operating Revenues	10%
Management	20%	Rate Management	10%
		Regulatory Compliance and Capital Planning	10%
Legal Provisions	10%	Rate Covenant	5%
		Debt Service Reserve Requirement	5%
Total	100%	Total	100%

** Moody's US Municipal Utility Revenue Debt Methodology (2022)*

Reserve Targets – Financial Strength Credit Rating Factors

Factor: Financial Strength (40%)

EXHIBIT 3

Financial Strength (40%)	Aaa	Aa	A	Baa	Ba	B and Below
Annual Debt Service Coverage (15%)	> 2.00x	2.00x ≥ n > 1.70x	1.70x ≥ n > 1.25x	1.25x ≥ n > 1.00x	1.00x ≥ n > 0.70x	≤ 0.70x
Days Cash on Hand (15%)	> 250 Days	250 Days ≥ n > 150 Days	150 Days ≥ n > 35 Days	35 Days ≥ n > 15 Days	15 Days ≥ n > 7 Days	≤ 7 Days
Debt to Operating Revenues (10%)	< 2.00x	2.00x < n ≤ 4.00x	4.00x < n ≤ 7.00x	7.00x < n ≤ 8.00x	8.00x < n ≤ 9.00x	≥ 9.00x

Source: Moody's Investors Service

** Moody's US Municipal Utility Revenue Debt Methodology (2022)*

Recap and Next Steps

- Budget and rate structure were modified in 2023
  - Reduced fixed fees => Increased risk due to reliance on variable water sales
- Reserve Policy has the greatest impact on fiscal health of the organization
  - Reserves have been depleted over the past two years
    - Served as a drought reserve to offset water sales losses
- Fiscal Policy language should be updated to better align with fiscal structure and future risks
  - Revise minimum targets and clarify calculation methodology
- Staff will return in September with specific recommendations on reserve targets and initial discussions on Debt Management Policy