

HUMBOLDT BAY MUNICIPAL WATER DISTRICT

RESERVE POLICY

The Secretary/Treasurer of the Humboldt Bay Municipal Water District hereby submits the following District Reserve Policy.

Introduction

The District is the regional wholesaler for 80,000 water users. Its seven municipal customers have no viable alternative for all the water they need, so service reliability is the key concern. Even though well maintained, the District's infrastructure is 50 years old and is located in an active seismic area. There can be numerous unforeseen emergencies given the size and geography of the region that the water system encompasses.

The District's municipal customers have consistently requested stable rates and a flat billing amount each month (their share of budgeted costs divided by 12 months). So stability in costs and rates are also a key concern as they reduce the need for the municipalities to perform rate studies which lead to rate increases for their ratepayers.

Discussion

Special districts have authority under Article XIII B of the California Constitution to establish such reserve funds as the districts "deem reasonable and proper". Cash reserves are developed as part of an overall financial management strategy for a district.

Reserves are not surplus funds but funds needed for important specific purposes. Reserves:

- Are critical to the successful and stable short- and long-term operation of the district and its financial strength.
- Ensure that customers experience a highly reliable water supply service and the security that the district can respond to unforeseen events and short-term emergencies, especially those affecting supply reliability or water quality.
- Are an important factor in providing stable rates and mitigating rate increases for the district's customers.

The District needs to maintain existing reserve funds and may need to add new ones as necessary to accomplish these objectives. In addition, it needs to fund the General Reserves to adequately meet the future needs of the District and its customers. Factors to be considered in establishing the amount of General Reserves include:

- Short-term cash flow or "working capital" requirements.
- Economic uncertainties and/or financial hardships including loss of revenue, unexpected expenditures and the need for rate stabilization.
- Capital replacement or additions.

Reserve Policy

1. The District hereby segments its reserves into the following categories:

- Restricted Reserves – funds held to satisfy limitations set by external requirements of creditors, grantors, contributors, law or by internal requirements of ordinances or contracts. The District's

existing restricted reserves are the State Revolving Fund Reserve and the Drinking Water Filtration Plant Reserve.

- Partially Restricted Reserves – funds that have some restriction but beyond that are discretionary in their use. The District's existing partially restricted reserve is the Municipal Supplemental Reserve Account (MSRA Reserve). (See attached)
- Unrestricted But Designated Reserves – funds established by the Board that can be utilized at the discretion of the District. The District's existing unrestricted but designated reserve is the General Reserves as defined by Ordinance 16.

2. The District hereby establishes the maximum allowable threshold amount that can be held in its General Reserves at \$4 million effective July 1, 2009. This amount includes the amount held in the MSRA Reserve.

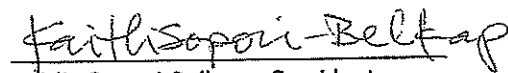
3. The District hereby further segments its General Reserves into the following components and establishes a target amount for each component based on consideration of the factors above:

- Working Capital – funds designated for short-term cash flow requirements. The District hereby establishes the target amount of Working Capital at \$1 million (approximately 3 months of the District's total operating expenses).
- Operations Reserve and Rate Stabilization – funds that provides the District with financial flexibility to respond quickly to unforeseen events or required emergency repairs and water quality issues. This component also allows the District to balance short-term fluctuations in revenues without unplanned, unforeseen significant rate increases that could severely impact ratepayers. The District hereby establishes the target amount of Operations Reserve and Rate Stabilization at \$2 million. This component includes the amount held in the MSRA Reserve.
- Capital Improvement/Replacement – funds to support application for grants or low interest loans, to help secure financing, or to fund a portion of large projects involving capital facility refurbishment, replacement and construction. The District hereby establishes the target amount of Capital Improvement/Replacement at \$1 million.

4. General Reserves are replenished through the District's budget process as "Additions to Reserves". The amount of additions that can be made each year is limited by Ordinance 16. The District will endeavor to reach the target amounts in #3 above conditioned upon this limit, the ability of the municipalities to pay, and consideration of projects competing for funds in any given year. The Board approves all Additions to Reserves.

5. The Board approves all planned draw downs of General Reserves including the MSRA component.

Approved by Board of Directors: July 9, 2009



Kaitlin Sopoci-Belknap, President
Humboldt Bay Municipal Water District

CONTRACT FOR SUPPLY OF MUNICIPAL WATER

Amendment No. 3

This Amendment No. 3 to the various parties' "Contract For Supply of Municipal Water" is entered into as of this 21 day of April, 2009 by and between HUMBOLDT BAY MUNICIPAL WATER DISTRICT, a special district (hereinafter HBMWD), and the City of Arcata, the City of Blue Lake, the City of Eureka, the Fieldbrook-Glendale Community Services District, the Humboldt Community Services District, the Manila Community Services District, and the McKinleyville Community Services District (collectively "Municipal Water Customers") with reference to the following:

WHEREAS, HBMWD has enacted an Ordinance 16 "Establishing Rates, Charges, and Conditions of Service For Water Sales to Municipal Water Customers," and

WHEREAS, HBMWD has entered into a "Contract For Supply of Municipal Water" with the Municipal Water Customers, as of the following dates:

- a. City of Arcata on August 30, 1999,
- b. City of Blue Lake on July 1, 1999,
- c. City of Eureka on July 1, 1999,
- d. Fieldbrook Community Services District on July 1, 1999,
- e. Humboldt Community Services District on July 1, 1999,
- f. Manila Community Services District on July 1, 1999,
- g. McKinleyville Community Services District on July 1, 1999, and

WHEREAS, the contracts between HBMWD and each Municipal Water Customer incorporate Ordinance 16 by reference, and

WHEREAS, Ordinance 16 sets forth at Paragraph 7.2 a series of provisions governing Price Factor 2 charges (Operations/Maintenance/Capital Costs), and

WHEREAS, the Municipal Water Customers had requested a provision in Paragraph 7.2.4., providing for regular monthly payments of 1/12th of budgeted Price Factor 2 Charges in order to avoid fluctuations in their monthly charges, and

WHEREAS, Paragraph 7.2.4. of Ordinance 16 states that in the event actual Price Factor 2 charges are less than what was billed throughout that fiscal year there will be a refund credit given to the following fiscal year's Revenue Credits, and

WHEREAS, for Fiscal Year 08/09 it appears that actual Price Factor 2 charges will be less than what was billed and collected during Fiscal Year 08/09, and

WHEREAS, each party deems it appropriate and in its best interest in light of recent events and as a matter of prudent planning and fiscal policy to establish a reserve account of these funds generated in Fiscal Year 08/09 as a one time only action,

NOW, THEREFORE, the parties do hereby agree as follows:

1. There is hereby established by HBMWD a new reserve fund called the Municipal Supplemental Reserve Account ("MSRA") consisting solely of excess Price Factor 2 charges accumulated during Fiscal Year 08/09 that would otherwise be the subject of refund credits in Fiscal Year 09/10 under Paragraph 7.2.4. of Ordinance 16.
2. HBMWD shall use the MSRA solely for the general benefit of the Municipal Water Customers and shall not comingle these funds with any general reserve fund, or any other funds held by HBMWD, or use the MSRA for the benefit of any Industrial Water Customer(s).
3. This Amendment No. 3 may be executed in counterparts.
4. Except as specified herein, the Contract For Supply of Municipal Water between HBMWD and the various Municipal Water Customers and Amendments 1 and 2 thereto shall remain unchanged and in full force and effect.

HUMBOLDT BAY MUNICIPAL
WATER DISTRICT

CITY OF ARCATA

Kaitlin Saponi - Belknap
 By: Kaitlin Saponi - Belknap
 Its: Board President

 By: _____
 Its: _____

CITY OF BLUE LAKE

CITY OF EUREKA

 By: _____
 Its: _____

 By: _____
 Its: _____

FLDDBROOK-GLENDALE
COMMUNITY SERVICES DISTRICT

HUMBOLDT COMMUNITY
SERVICES DISTRICT

 By: _____
 Its: _____

SM Davidson
 By: Stephen M. Davidson, P.E.
 Its: General Manager

MANILA COMMUNITY
SERVICES DISTRICT

McKINLEYVILLE COMMUNITY
SERVICES DISTRICT

 By: _____
 Its: _____

 By: _____
 Its: _____