



***Public Works Department***

**MEMORANDUM**

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**To: Board of County Commissioners**  
**From: Ron Roman, Interim Public Works Director**  
**Subject: Lake Tahoe Enterprise Funds Financial Condition Update**  
**Date: January 18, 2018**

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**INTRODUCTION:**

This memorandum is being submitted in compliance with Enterprise Funds Policies, Section #8, "Rate Making Policy and Procedure," which requires the Public Works Director and staff to present a report to the Board of County Commissioners (the "Board") detailing the prior fiscal year's actual revenues and expenses in each of the enterprise funds.

At Lake Tahoe, Public Works manages and oversees the following Enterprise Funds:

- Lake Tahoe Water Utility (Fund 327)
  - Zephyr Water Utility District (327-316)
  - Cave Rock/Uppaway (327-319)
  - Skyland (327-320)

For prior years, a comparison of the projected "modeled" versus actual revenues, expenditures and ending fund reserves were presented.

The revenues and expenses for Fiscal Year 2017, ending June 30, 2017, are presented in the same format for consistency and in compliance with Section #8, Rate Making Policy and Procedure. Summaries of the financial data for the Zephyr Water Utility District (Fund 327 – 316), Cave Rock/Uppaway (Fund 327 - 319) and Skyland (Fund 327 – 320) are attached for reference.

**BACKGROUND:**

Rate studies for the Lake Water Systems were last updated in 2014. During the rate setting process, the Board considered a number of options, including the staff's recommendation that the three (3) Lake Tahoe water utilities be consolidated. After considerable debate and deliberations, the Board decided to leave the water systems as

separate enterprise funds. However, the Board found that it was more efficient and cost effective to financially consolidate the three enterprise funds into a single fund for budgeting purposes. Subsequently, the Lake Tahoe Water Utility Fund (327) was adopted with Zephyr Water, Cave Rock/Uppaway and Skyland as separate departments within the fund with full independent cost accounting and rate structures.

After a series of hearings, water rates for the three Lake Tahoe water systems were set for Fiscal Years 2014 – 2015 and 2015 – 2016. The water rates were initially set for two (2) years to give time to complete the necessary Preliminary Engineering Reports (“PERs”) to identify and develop the needed capital improvements to meet fire code and State Water Law. The PERs are complete and in early 2017 Public Works held public workshops to present the finding of the reports. Douglas County is currently in litigation with customers in the Cave Rock/Uppaway department of the Lake Tahoe Water Utility Fund. Representatives from the Cave Rock area are in discussions with the County regarding the subsidies they have received from the County and the subsidies that have been received by the Uppaway water customers. The parties are working toward an amicable resolution to this lawsuit which will be brought to the Board for discussion.

In setting the water rates for the various Lake Tahoe Water Utility Fund departments, the Board deviated from its financial policies regarding system reinvestment to help mitigate the rate impact on the utility customers. Monies were also transferred from the General Fund to help reduce the water rate impact on these water customers. Specifically, the Board approved General Fund transfers to fund system reinvestment for the short-lived assets and to ensure debt coverage for this fund met the County’s 1.25 coverage policy.

## **ADMINISTRATIVE POLICIES:**

To ensure the fiscal stability and overall financial health of the utility funds, the Board adopted Financial Policies for the Enterprise Funds. The County’s rate models are structured to achieve the minimum and, when practical, the established goals for the various reserves.

An overview of the Enterprise Funds Policies follows:

### ***Enterprise Fund Policies***

#### ***Section #1. General Policies***

- *It shall be the policy of Douglas County to establish enterprise funds for all County owned utilities and, to the extent possible given rate considerations, fully recover all direct and indirect costs under its control through user fees, connection fees and related charges. The goal is for each utility to establish water user rates, connections fees and related charges sufficient to provide for payment of general operations and maintenance expenses, capital improvements, annual depreciation, annual debt service, and to establish and maintain reserves necessary to ensure the financial stability of each fund. The Board may utilize other available funding sources in accordance with State law to assist the enterprise funds with operating and capital needs to keep rates at levels deemed acceptable to the Board.*
- *Cash reserves are a necessary and appropriate part of prudent utility management practices. The County maintains separate accounting for operating, capital, and other cash reserves, as described below. Reserve levels are established for each type of reserve.*

#### ***Section #2. Operating Reserve***

- *Operating reserves provide a cushion to ensure sufficient working capital to meet daily and periodic expenses. Reserve levels are generally expressed in number of days of cash operating expenses, with the minimum requirement varying with the expected risk of unanticipated needs. The funding level shall be a minimum of 60 days with a goal of 90 days (25%) of annual O&M expenses.*

### **Section #3. Capital Project Reserve**

- *Capital reserves hold capital-related revenues (such as connection charge revenue), and transfers from the operating fund designated for capital construction projects. The capital reserve is intended to mitigate the impact of unanticipated capital costs on rates. The County's goal is to fund the capital reserve at 2.0% of the total (original) cost of utility capital assets.*

### **Section #4. Emergency Reserve**

- *Emergency reserves provide funding for minor equipment failures. These reserves are not intended to cover the costs of system-wide failures resulting from catastrophic events; a more common practice is to carry insurance for such purposes. The minimum balance will be \$50,000 with a goal of \$75,000.*

### **Section #5. Debt Proceeds Reserve**

- *Debt proceeds reserves provide for the unspent proceeds of the debt, including related interest earnings. Debt proceeds and the interest earned on these proceeds will be maintained in restricted accounts until expended.*

### **Section #6. System Replacement Reserve**

- *System replacement reserves (annual depreciation) provide for the replacement of aging and failing infrastructure to ensure sustainability of the system for ongoing operations. Consistent with common industry practice, the County uses depreciation expenses as the benchmark for the appropriate level of funding from rates. Annual depreciation is a non-cash expense intended to recognize the consumption of utility assets over their useful lives. Collecting the amount of annual depreciation expense through rates helps to ensure that existing ratepayers pay for the use of the assets serving them (rate equity), with cash flow funding a portion or all of the eventual replacement of those assets.*
- *It is not appropriate to use system replacement funds received from existing customers for system expansion. Funds for the expansion of the system should come from contributed capital from new development, connection fees, assessments or other sources so that those benefiting directly from the improvement contribute the funds for its construction.*
- *For all existing assets, the County's goal is to fund system replacement at 20% annually until 100% of annual depreciation expense is funded. Annual depreciation funding for new assets will be 100% from the date of system acquisition or acceptance (notice of completion of offer of dedication).*

### **Section #7. Debt Service Coverage**

- *The coverage test is based on a commitment made by the County when issuing bonds. Annual coverage equal to or above the debt service payment is a requirement of bond issues and some other long-term debt. Failure to comply with minimum annual coverage requirements can lower the County's bond rating and jeopardize its ability to sell revenue bonds in the future. Higher coverage levels can result in more favorable bond terms.*
- *The minimum required coverage factor assuming debt financing through the Nevada State bond Bank is 1.0 – meaning no additional cushion above the level of annual debt service is required. However, the County's goal is to set rates sufficient to maintain a coverage factor of at least 1.23. This practice enhances the County's creditworthiness and improves its financial position should the County ever require debt financing from selling its own revenue bonds, which typically require a factor around 1.25 to 1.35. Excess revenues generated to meet the internal policy can be used to fund capital projects or to help build other under-funded reserves.*

### **Section #8. Rate Making Policy and Procedure**

- *Each year in January the Public Works Director and staff shall present a report to the Douglas County Board of County Commissioners detailing the prior fiscal year's actual revenues and expenses in each of*

*the enterprise funds. This report shall address the fiscal condition of the fund and make recommendations to the Board for changes in rates to achieve the stated financial policies. Any rate changes shall be heard at public hearing in February of that year with implementation effective July 1 of the new fiscal year.*

**Section #9. General Authority**

- *Nothing contained within this policy prohibits the Board of County Commissioners from deviating from the County's financial policies and funding goals, as they find reasonably necessary, to address economic conditions as part of any rate-setting process provided, however, any change does not violate state law, existing bond or loan covenants, or generally accepted accounting practice.*

**ANALYSIS:**

In reviewing the data, a certain degree of caution and consideration must be given to the reported variances between the projected and actual financial figures for any given year. The data can be misleading given a number of factors. Variances between projected and actual revenues, expenses and ending reserves may vary (plus or minus) in any given year due to many factors. These factors include: 1) annual year usage, 2) changes in staffing, 3) timing of capital projects, 3) unanticipated emergencies, and 4) the timing of loan proceeds and disbursements.

Given the complexity of utility systems and their operations, operational expenses are not necessarily uniform from year-to-year. Similarly, capital projects and major repairs vary dramatically over time. For these reasons it is important to maintain adequate reserve balances to address the needs of the utility.

**SUMMARY:**

Actual revenues versus projected "modeled" revenues for The Lake Water Systems were positive. The Preliminary Engineering Reports for the three water systems identified significant capital needs in the respective water systems. Once a long-term strategy for the PER process is implemented, the Lake water rate structures must be updated.

ZEPHYR WATER UTILITY DISTRICT (FUND 327-316)  
 UPDATE ON PROJECTED FUND BALANCE VS ACTUAL FUND BALANCE  
 FOR FISCAL YEAR ENDED 6/30/17

	<b>FY 16/17</b>		
	<b>Projected</b>	<b>Actual</b>	<b>Variance: Pos/(Neg)</b>
<b>Revenue</b>			
Water Revenue	628,004	652,985	24,981
Other Revenue	-	12,613	12,613
Total Revenue	<u>628,004</u>	<u>665,598</u>	<u>37,594</u>
<b>Annual Expenditures:</b>			
Operating	494,811	458,902	35,909
Capital Outlay	-	12,913	(12,913)
Total Annual Expenditures	<u>494,811</u>	<u>471,815</u>	<u>22,996</u>
<b>Net Revenue</b>	<u>133,193</u>	<u>193,783</u>	<u>60,590</u>
<b>Ending Reserves</b>	<u>641,383</u>	<u>1,051,826</u>	<u>410,443</u>
* PY Fund Balance greater than projected			<u>334,147</u>
Operating services & supplies savings			35,909
Water revenue growth/(decline)			24,981
Interest income, late charges, disconnect fee			12,613
Capital outlay PER 15W03			(12,913)
			<u>60,590</u>
<b>Reserve Components:</b>			
Operating			120,211
Capital			503,938
Emergency			50,000
System Reinvestment			<u>377,677</u>
<b>Reserve Total</b>			<u>1,051,826</u>

CAVE ROCK/UPPAWAY (FUND 327-319)  
 UPDATE ON PROJECTED FUND BALANCE VS ACTUAL FUND BALANCE  
 FOR FISCAL YEAR ENDED 6/30/17

	<b>FY 16/17</b>		
	<b>Projected</b>	<b>Actual</b>	<b>Variance: Pos/(Neg)</b>
<b>Revenue</b>			
Water Revenue	755,180	756,062	882
Other Revenue	32,680	132,063	99,383
Total Revenue	<u>787,860</u>	<u>888,125</u>	<u>100,265</u>
			-
<b>Annual Expenditures:</b>			
Operating	758,194	698,785	59,409
Capital Outlay		36,663	(36,663)
Total Annual Expenditures	<u>758,194</u>	<u>735,448</u>	<u>22,746</u>
Net Revenue	<u>29,666</u>	<u>152,677</u>	<u>123,011</u>
<b>Ending Reserves</b>	<u>890,959</u>	<u>1,604,755</u>	<u>713,796</u>
* PY Fund Balance greater than projected			<u>324,340</u>
Water revenue growth/(decline)			882
Other revenue (connection fees, late charges)			99,383
Water Rights			13,565
Operating costs, repairs & Maint.,misc supplies			45,844
Other capital outlay			(36,663)
			<u>123,011</u>
<b>Reserve Components:</b>			
Operating			131,659
Capital			1,133,149
Emergency			50,000
System Reinvestment			289,947
<b>Reserve Totals</b>			<u>1,604,755</u>

SKYLAND WATER SYSTEM (FUND 327-320)  
 UPDATE ON PROJECTED FUND BALANCE VS ACTUAL FUND BALANCE  
 FOR FISCAL YEAR ENDED 6/30/17

	<u>FY 16/17</u>		
	<b>Projected</b>	<b>Actual</b>	<b>Variance: Pos/(Neg)</b>
<b>Revenue</b>			
Water Revenue	298,381	310,671	12,290
Other Revenue	500	16,777	16,277
Total Revenue	<u>298,881</u>	<u>327,448</u>	<u>28,567</u>
<b>Annual Expenditures:</b>			
Operating	281,445	249,759	31,686
Capital Outlay		24,355	(24,355)
Total Annual Expenditures	<u>281,445</u>	<u>274,114</u>	<u>7,331</u>
Net Revenue	<u>17,436</u>	<u>53,334</u>	<u>35,898</u>
<b>Ending Reserves</b>	<u>532,823</u>	<u>802,875</u>	<u>270,052</u>
* PY Fund Balance greater than projected			237,883
Water revenue growth/(decline)			12,290
Operating services & supplies			31,686
Other revenue (connection fees, late charges, water rights)			16,277
Other capital outlay (SCADA, PER)			(24,355)
			<u>35,898</u>
<b>Reserve Components:</b>			
Operating			81,690
Capital			588,935
Emergency			50,000
System Replacement			82,250
<b>Reserve Totals</b>			<u>802,875</u>