

**ADMINISTRATIVE CODE
BOARD OF COUNTY COMMISSIONERS**

CATEGORY: UTILITIES

CODE NUMBER: AC 10-4

TITLE: LEE COUNTY UTILITIES – BUSINESS UNIT
FISCAL POLICIES – UTILITY ENTERPRISE FUND

ADOPTED: 06/25/2013

AMENDED:

ORIGINATING DEPARTMENT: UTILITIES

I. PURPOSE/SCOPE:

A. GENERAL

The Lee County Utilities – Business Unit (the "Utilities Department") recognizes that one of the keys to the long-term sound financial management of the County's water and wastewater enterprise fund (the "Enterprise Fund" or the "System") is the adoption of a formal fiscal policy associated with the financial management and creditworthiness of the Utilities Department. This view is confirmed by bond rating agencies, investors and the Government Finance Officers Association. This fiscal policy is primarily intended to help protect the Enterprise Fund's financial resources through:

1. Formal adoption of industry recognized best practices for utility financial management;
2. Guiding the Enterprise Fund and its managers in the financial planning cycle and decision making process;
3. Establishing appropriate levels of operating and capital cash reserves and provide available funds for emergencies and extraordinary expenditures;
4. Developing a process to efficiently finance necessary capital improvements;
5. Providing a framework for the Enterprise Fund to achieve and maintain a strong credit rating, and
6. Maintaining reasonable and well justified levels of rates and fees to promote the sustainability of the Enterprise Fund.

B. POLICY OBJECTIVES

The primary objectives of this fiscal policy are to maintain:

1. Operations and maintenance programs and the necessary funds to finance priority and ongoing capital projects in order to deliver high-quality water and wastewater services;

2. Funds and access to financial resources to quickly respond to emergency, catastrophic and Force Majeure Incidents and to allow for the continuation of water and wastewater service;
3. A strong financial condition aimed at preserving and enhancing the Enterprise Fund current bond ratings to minimize capital project financing costs and promote long-term System sustainability; and
4. Reasonable and well-justified levels of rates and fees over the long-run, in accordance with good business practices and this fiscal policy.

In general, these financial management policies are more restrictive and require higher standards than the minimum legal requirements contained in the Bond Resolution as defined below. These fiscal policies are in addition to other policies that may be adopted from time to time by the Board, including the Lee County Debt Management Policies (AC-3-18), and will be reviewed periodically and updated when appropriate.

C. DEFINITIONS

1. **Appropriation.** The authorization of the County to incur liabilities for goods, services, or Capital Improvements used for purposes specified in the budget in amounts not in excess of those specified for each purpose.
2. **Board.** The Lee County Board of County Commissioners.
3. **Bond Resolution.** Resolution No. 93-06-04 adopted by the Board on June 30, 1993, as amended and supplemented from time to time, which is the agreement between the County and senior lien bond holders and delineates the terms, conditions and covenants for the issuance of senior lien bonds.
4. **Capital Improvements.** Expenditures utility plant additions, betterments, replacements, and upgrades that benefit future periods and are capitalized for financial reporting and cost recovery purposes. Capital improvements are not considered as an Operating Expense.
5. **Capital Improvement Plan (CIP).** The capital expenditures for the System utility plant-in-service identified over a multi-year period, generally five (5) to ten (10) years that are planned to be constructed by the County and which are included in the budget and financial / rate plan for the Enterprise Fund.
6. **Cash Reserves.** The amount of cash or cash equivalents (short-term highly liquid investments that is readily convertible into cash within six months) on deposit, net of liabilities and encumbrances, which are held in a separate account or fund for use by the County.
7. **Debt Service.** The annual deposits required from System revenues to a sinking fund, loan repayment fund, or its equivalent as required by the Bond Resolution for the principal and interest payments made by the Enterprise Fund for repayment on outstanding Senior Lien bonds of the System.
8. **Debt Service Coverage.** Requirement of County's bond and loan agreements and represents the ratio of the Net Revenues divided by the Debt Service. The ratio

indicates the ability of revenues, after the payment of Operating Expenses, to meet the annual Debt Service obligation.

9. **Debt Service Reserve Account.** A fund established by the Bond Resolution which generally equates to the maximum annual Debt Service payment on Senior Lien Bonds to reduce the risk of non-payment of the annual Debt Service. Based on the terms of the Bond Resolution and the terms regarding the issuance of each series of Senior Lien bonds, this account may be funded by cash, a reserve account insurance policy, or reserve account letter of credit.
10. **Encumbrance.** The amount of cash (either on account or secured through financing, grant commitment, etc.) that has been committed by the County to pay an expenditure established by contract, purchase order or some other means at a future date and restricts the cash for such specific expenditure (is not available for any other purpose of the County).
11. **Enterprise Fund.** A fund type established by Generally Accepted Accounting Principles (GAAP) which is used to report any activity for which a fee is charged to external users for goods and services and generally is used when debt is solely backed by fees and charges and there is a legal or policy decision to recover the cost of providing services, including capital improvements.
12. **Enterprise Fund Financial Management Policy or Financial Management Policy.** The policy applicable to the County's water and wastewater Enterprise Fund,
13. **Flow of Funds.** The disposition of Gross Revenues to the various funds as established in the Bond Resolution.
14. **Force Majeure Incidents.** Events beyond the reasonable control of the County that causes inability to meet the objectives of this policy. Event caused by the usual and natural consequences of external forces (severe weather event).
15. **Gross Revenues.** The total revenues derived from the operations of the System and includes income from rates, fees and charges, income on investments, and other revenues associated with the operation of the System. Gross Revenues does not include property and cash capital contributions and non-recurring fees such as government grants for capital, contributed utility plant and water and wastewater connection (impact) fees received by the County as part of the land development process.
16. **Net Fixed Assets.** The total depreciable and non-depreciable capital assets (utility plant-in-service), including construction-work-in-progress, less accumulated depreciation and amortization.
17. **Net Revenues.** Gross Revenues less Operating Expenses.
18. **Operating Expenses.** The expenses for the operation, maintenance, repairs and replacements with respect to the System, and includes bulk water and wastewater payments, administrative expenses, insurance, and other payments calculated in accordance with Generally Accepted Accounting Principles. Operating Expenses does not include depreciation and amortization expenses (non-cash expenses) or the payment of interest expense on Outstanding Debt.

19. **Outstanding Principal.** The total principal amount of all forms of debt previously issued by the County paid from the Net Revenues of the System, including Senior Lien debt and Subordinate Lien debt, that has not yet been paid by the Enterprise Fund and represent a liability to the System. Outstanding principal does not include accrued interest due on bonds; interest is an expense of the System.
20. **Senior Lien.** The priority of the payment of Debt Service from Net Revenues and has the highest priority of payment after the payment of Operating Expenses.
21. **Senior Lien Bonds.** Debt that has been issued in accordance with the terms and conditions of the Bond Resolution.
22. **Subordinate Lien.** The priority of the payment of Debt Service from Net Revenues and has a lower priority of payment when compared to Senior Lien debt.
23. **Subordinate Lien Debt.** Debt that has not been issued in accordance with the terms and conditions of the Bond Resolution but through some other financing or loan agreements with the debt provider and is paid after the payment of the Senior Lien Bonds.
24. **Working Capital.** Current assets less current liabilities which is the amount available to meet current the Enterprise Fund current obligations and non-recurring or extraordinary expenditures or changes in revenues that would affect the Net Revenues of the System. Working Capital in this policy relates to the amount of cash available to meet current obligations after recognition of the current liabilities payable from such cash balances.

II. POLICY/PROCEDURE:

A. FISCAL POLICIES

The following fiscal policies will guide the Utilities Department financial management and utility rate activities for the Enterprise Fund:

1. **Cash Reserve Policy**

Cash Reserves provide a measure of the immediate liquidity of the System and the ability to meet unanticipated expenditures and changes in cash flow. Further, cash reserves serve to reduce the short-term financial risk of the System. The maintenance of Cash Reserves promotes the financial stability of the Utilities Department and reduces overall financial risk. The Utilities Department will segregate and maintain separate cash reserves for the purposes of: i) daily utility operations; and ii) ongoing and recurring capital expenditures associated with the cost of major extensions, improvements or additions, to, or the replacement or renewal of capital assets of the System or extraordinary repairs of the System (referred to as "Renewals and Replacements").

- 1.1 Operating Reserve Policy – The Utilities Department will establish and maintain a cash funded operating reserve (the "Operating Reserve") to provide adequate levels of Working Capital to: i) mitigate current and future risks regarding revenue shortfalls and unanticipated expenses; and ii) to ensure stable services and rates. The Utilities Department will maintain a minimum unencumbered operating reserve balance equal to one hundred and twenty (120) days of the current fiscal year budgeted operation and

maintenance expenses, exclusive of depreciation and amortization expenses (the "Operating Reserve Target"). The Operating Reserve Target may not fall below forty-five (45) days of the current fiscal year budgeted Operating Expenses.

In accordance with the Bond Resolution, at least one-twelfth of the current fiscal year Operating Expenses budget will be held in the Operation and Maintenance Account for the payment of Operating Expenses. The remainder of the Operating Reserves will be held in the Utility Reserve Account established by the Bond Resolution. If the County amends the Bond Resolution to establish a Rate Stabilization Account as a component of the Utility Reserve Fund, amounts on deposit in that fund will be recognized as a component of the Operating Reserve. To the extent that the Operating Reserve cash balance at the end of the preceding fiscal year is less than the Operating Reserve Target, the Utilities Department will develop and submit to the Board a plan to re-establish the Operating Reserves in an amount equal to the Operating Reserve Target over a period not to exceed three (3) fiscal years, except in the case of Force Majeure Incidents, which may require a longer re-establishment period.

- 1.2 Capital Reserve Policy – The Utilities Department will establish and maintain an ongoing cash funded capital reserve for Capital Improvements (the "Capital Reserve") to: i) mitigate risks regarding unanticipated capital expenditures or increases in materials, labor, or other costs from on-going or planned capital projects; ii) provide for changes in capital expenditure priorities resulting in the advancement or addition of certain capital projects; and iii) promote the availability of funds for capital reinvestment for the for the existing infrastructure intended to limit outages and inability to provide service from equipment or infrastructure failures or as a result of Force Majeure Incidents due to weather events and other occurrences; and iv) to ensure reliable service and ameliorate the effects to monthly service rates from unanticipated costs.

The Utilities Department will maintain a minimum unappropriated and unencumbered capital reserve balance equal to one and one-half percent (1.5%) of the prior years' reported depreciable gross fixed assets (utility plant), exclusive of construction-work-in-progress balances (the "Capital Reserve Target"). The Capital Reserve will be held in any one or several capital related funds or accounts as established by the Bond Resolution or by the Utilities Department. The capital reserve will be in addition to the funds held on deposit for purposes of maintaining a minimum Operating Reserve as described in Section 1.1 herein.

The moneys on deposit included as a component of the Capital Reserve may be expended on Capital Improvements to meet the overall financial objectives and funding needs of the Enterprise Fund. Recognizing that the funding of Capital Improvements may vary from year to year based on the nature of the expenditures required, the Capital Reserve Target may not fall below fifty percent (50%) of the Capital Reserve Target. If the capital reserve balance at the end of the preceding fiscal year is less than the Capital Reserve Target, the Utilities Department will develop and submit to the Board a plan to re-establish the capital reserves in an amount equal to

the Capital Reserve Target over a period not to exceed three (3) fiscal years. The rebuilding of capital reserves will be in addition to deposits required pursuant to Section 3 (Capital Re-investment Policy), and may not be achieved through the deferral of maintenance or capital reinvestment.

- 1.3 Other Required Deposits and Reserves – All other funds and accounts established by the Bond Resolution or separately established by the Utilities Department i) in accordance with the Flow of Funds delineated in the Bond Resolution; ii) for a specific Operating Expense of Capital Improvement funding purpose; or iii) as may be required under a separate policy approved by the Board, will be funded in accordance with the terms and conditions of the documents or policies for which the funds were established. When necessary and prudent, the Utilities Department may create additional accounts within the Utility Reserve Account for a specific purpose. These accounts may include funding for specific capital projects or periodic but non-recurring expenditures, risk management and revenue or rate stabilization, among others.
- 1.4 Other Provisions – The Utilities Department will regularly evaluate cash needs and provide a current status of the reserve funds each year to the Board and County Administration staff. All funding alternatives will be considered in order to meet financing needs and to achieve the most cost efficient operation of the Enterprise Fund.

2. **Debt Capacity and Coverage Policy**

For the purpose of evaluating compliance with this policy the Utilities Department will recognize all outstanding debt and long-term liabilities incurred for the financing of capital improvements, additions, renewals, replacements, and betterments to the System or to establish reserves as a condition of issuing the debt (referred to as "All-in Debt"). All-in Debt includes, but is not limited to, Senior Lien bonds issued in accordance with the Bond Resolution and Subordinate Lien debt such as, but not limited to, State of Florida Revolving Fund loans administered by the Florida Department of Environmental Protection, bank-qualified loans, commercial paper, bond anticipation notes, lines of credit, capital leases, and other forms of indebtedness.

- 2.1 Debt Capacity – The Outstanding Principal amount of debt compared to the Net Fixed Assets or utility plant investment of the System indicates how much the Utilities Department has leveraged the cash flow of the Enterprise Fund for utility plant capital investment (the "Debt Ratio"). The Debt Ratio presents the net equity of the System and provides an indication of the reliance on debt to fund existing assets as well as the flexibility in terms of funding future capital assets and overall rate stability. The Utilities Department will maintain a Debt Ratio that will not exceed fifty percent (50%) during any year of the outstanding principal of the All-in Debt. The Debt Ratio will be determined as follows:

Debt Ratio =
$$\frac{[\text{Outstanding Principal All-in Debt} - \text{Cash Balance in Debt Service Reserve Account} - \text{Principal Component on deposit in Debt Sinking Fund}]}{[\text{Net Fixed Assets} + \text{Unspent Proceeds of Outstanding All-in Debt}]}$$

Recognizing that the funding of Capital Improvements during the utility plant asset life-cycle is not linear and that the Debt Ratio will fluctuate, if the Debt Ratio exceeds fifty percent (50%) for the current Fiscal Year, the Utilities Department will develop, and submit to the Board, a plan outlining the time frame and means to reduce the ratio to below the target maximum. The objective of the Utilities Department is that the Debt Ratio will not exceed the maximum target by more than three (3) consecutive fiscal years.

- 2.2 Debt Coverage – The debt service coverage ratio indicates the ability, after the payment of Operating Expenses, to pay the annual principal and interest due on the outstanding All-in Debt (the "Debt Coverage Ratio"). The Debt Coverage Ratio provides a measure of the ability of the Net Revenues of the System to pay the annual Debt Service on All-in Debt and provide funds to meet other expenditures (after payment of the annual All-in Debt service payments). The ratio also provides an indication of future leveraging capability in the event of a significant event triggering the need for the issuance of additional indebtedness. The Utilities Department will establish rates, fees, and charges for services (the "Rates") that will provide in each Fiscal Year Net Revenues that are equal to or greater than 150% of the annual All-in Debt Service payment.

The County must maintain a minimum ratio of Net Revenues, including Connection (impact) Fees, divided by the annual Debt Service equal to 120% as delineated in the Bond Resolution. This Financial Policy targets a coverage ratio above the minimum requirement to maintain a strong credit and to reduce the cost of future borrowings with the objective to provide for long-term rate stability and overall lower rates.

The Debt Coverage Ratio will be determined as follows:

$$\text{Debt Coverage Ratio} = \text{Annual Net Revenues} / \text{Annual All-in Debt Service Payments from Net Revenues}$$

The Utilities Department may not establish Rates that do not meet the rate covenant contained in the Bond Resolution or covenants associated with the issuance of other System debt.

3. **Capital Re-investment Policy**

The Utilities Department will establish an annual capital re-investment policy that will set forth the level of funds to be deposited annually from Rates to ensure that needed capital assets and improvements receive appropriate consideration in the budget process. This policy is necessary to plan for large expenditures, promote the continuity of service at the lowest cost over the long-term, to minimize the necessity of debt for existing infrastructure renewals and replacements on the System, and to minimize deferred maintenance. The Capital Re-investment policy provides the framework for prioritizing capital expenditures and identifying funding needs and sources.

- 3.1 Capital Budget – The Utilities Department will prepare a five-year capital expenditure and funding plan (the "Capital Plan") each fiscal year that includes the following for each individual capital project: i) the name and capital project number; ii) the required annual appropriation for the project

by fiscal year; iii) the prior period encumbrances by capital project through the current fiscal year if not identified in the Capital Plan appropriation; iv) the planned funding sources associated with project financing; and v) a description of the project.

The first year of the Capital Plan will constitute the budget for the respective fiscal year. Annually and as part of the Capital Plan development process, the Utilities Department will prioritize the budget expenditures recognizing the following criteria: regulatory compliance, safety, expansion, criticality of asset renewal and replacement, efficiencies in joint project construction with other public agencies, availability of funding sources, affordability, and other factors prescribed from time to time by the Utilities Department and its Consulting Engineers.

- 3.2 Capital Re-investment – The Utilities Department will annually make a deposit into the Renewal and Replacement Fund and/or any other account established within the Utility Reserve Account to provide funds for the purpose of paying the cost of major extensions, improvements or additions to, or the replacement or renewal of capital assets, or extraordinary repairs of the System. The annual deposit to the established capital accounts may not be less than ten percent (10%) of the Gross Revenues derived from Rates for the preceding Fiscal Year or an amount determined by the Utilities Department Consulting Engineer (the "Capital Re-investment Rate"). The deposit will be made annually from Rates regardless of the level of Capital Improvement expenditures budgeted for the respective Fiscal Year.

The disposition of Gross Revenues and deposits to the funds has a priority of deposit requirement and must be made to comply with the provisions of the Bond Resolution. Such flow generally requires payments in the following order: i) payment of Operating Expenses; ii) payment of Debt Service on Senior Lien Bonds; iii) deposits to the Renewal and Replacement Fund for the funding of ongoing or recurring Capital Improvements; iv) payment of subordinated debt not issued pursuant to the Bond Resolution; and v) deposits to the Utility Reserve Account for any expenditure need of the System.

If the Utilities Department establishes a separate funding allowance or mechanism for a specific asset, such as replacement of vehicles and equipment or replacement of water treatment membranes, those amounts will be considered in the determination of the capital re-investment funding analysis and also when measuring the Capital Re-investment Rate. Unless specifically identified as a component of the Capital Plan, the determination of the Capital Re-investment Rate does not include payments made to the City of Fort Myers for capacity entitlements in its wastewater treatment facilities that the County has capacity entitlement interests or other future water or wastewater treatment by contract; such expenditure transfers would be in addition to the annual capital re-investment amount funded from Rates.

4. Rates and Financial Position Policy

4.1 The Utilities Department will use formal forecasting and expenditure monitoring process in the evaluation of the financial position of the System. These processes are intended to: i) give the County adequate lead time to phase in smaller annual rate increases for large capital projects and avoid larger rate increases in the future; ii) minimize financing costs through proper planning for Capital Improvement spending and financing needs; iii) obtain formal endorsement by the Board for long-term financial needs and sources of financing; and iv) maintain or strengthen the Utilities Department credit worthiness and favorable bond credit ratings.

4.2 The Utilities Department will analyze the financial position of the System annually to evaluate the need for changes in Rates and fees. If increases in Rates are necessary, the resulting impact to customers will be minimized or phased over time. The level of Rates charged to System customers will be based on the following principles, in order of priority:

- a. Funding the operations and repairs and maintenance of the System and the capital expenditure requirements as prioritized by the Utilities Department and identified in the Capital Plan for expansion, changes in regulations, renewals and replacements and for unanticipated conditions;
- b. Meeting debt service coverage and cash reserve requirements delineated in the Bond Resolution covenants and this fiscal policy;
- c. Maintaining competitive Rates, primarily with the County's neighboring utilities in Southwest Florida, recognizing the complexity of the facilities and service requirements of the System; and
- d. Allowing new development pay for the capital cost of meeting the capital and capacity demands in water and sewer infrastructure required to serve new development.

As part of the annual financial planning process, the Utilities Department will prepare multi-year Rate forecasts and recommend the Board's adoption of multi-year Rate resolutions to limit the amount of financial risk to the Enterprise Fund, provide a surety to bondholders of the certainty of Revenues to be received, and provide overall revenue stability in the funding of Enterprise Fund expenditures.

4.3 The Utilities Department will be run in a business-like manner. Rates will be set to ensure the full recovery of System operating expenses, including capital repair and replacement. This practice will ensure the future of the Enterprise Fund is secure with reduced financial risk in meeting Federal, State, and local regulations and service area demands.

4.4 The Utilities Department annual operating budget: i) will be structurally balanced, with revenues sufficient to meet expenses (those that are ongoing in nature); ii) set Rates at levels intended to fund the identified costs of operating and maintaining the System; and iii) will reflect this policy and include amounts necessary to maintain the required Operating

and Capital Reserves. The intent is to provide the lowest reasonable and sustainable Rates over time, not necessarily the lowest fees and user charges during the current Fiscal Year.

- 4.5 The Utilities Department will prepare resolutions for the adoption of Rates that reflect multi-year rates to promote revenue stability and certainty in the collection of Gross Revenues to meet the expenditure needs of and financial policy objectives for the System.