

Reserves

By Randy Hellbusch, Circuit Rider

NeRWA has assisted small water systems with over 1,000 rates studies in my time with the association. Many times when we are called to assist it is either that the system is contemplating a major project or upgrade to the system and is interested in knowing what the payback is going to be on any potential new debt or that the system is just to the point where they have to do something due to several years of running in the red. The latter, unfortunately, occurs too often. Many boards are reluctant to raise rates and understandably so. It is not a very popular thing to do politically. So, many times when a rate hike is inevitable, the rate increase is only sufficient enough to cover the losses that have occurred and no thought is given to any type of reserve fund.

In the big scheme of things, reserve funds are an essential aspect to running a viable utility. There are several types of reserve funds that any water system should strongly consider according to the Utility Management Guide of NRWA. Below are examples of a couple funds that I would suggest to all water and wastewater systems.

DEBT SERVICE RESERVE: Debt service reserves are often established by the lender and are often 10% of the annual debt service payment. These reserves are usually collected until it equals one year of debt service. This is a good practice, whether mandated by the lender or not.

REPAIR AND REPLACEMENT RESERVE or OPERATING RESERVE: Repair and Replacement reserves should be between 3 and 5% of revenues for general repairs and maintenance. A good rule of thumb for R&R reserves for small water and wastewater systems is that the total in the reserve account plus revenues should equal an Operating Ratio of 1.35 or higher. Below is a simple calculation to illustrate.

Operating Ratio =
$$\frac{\text{Total Operating Income} + \text{Operating Reserves}}{\text{Total Operating Costs}^*}$$

* Not including debt or debt related costs

Water and wastewater utilities' operating costs vary widely from year to year. The basic notion of an R&R reserve is to cover those years when costs run high without having to constantly adjust rates or take drastic budget cutting measures.

If more small utilities implemented reserve policies such as these, it could often eliminate the need for huge rate hikes and help the utility avoid RATE SHOCK. It would show that the utility is being well managed and that can often be a huge step in positive public relations.