

# *Cost Recovery Policy*



*Revised June 2018*





## VISION

Mount Pleasant Waterworks strives to be a trusted leader in our community and the water industry.

## MISSION

The MPW Team provides water services of exceptional quality, value, and reliability, while protecting public health, safety and the environment

## VALUES

The MPW Team is passionately committed to:

- HONESTY:** In all actions by employees and Commissioners.
- FAIRNESS:** To our customers, employees, and other stakeholders.
- QUALITY:** Of our products, services and processes.
- INNOVATION:** By seeking positive change.



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## Introduction

This document contains the Cost Recovery Policies of the Commissioners of Public Works for the Town of Mount Pleasant, South Carolina herein after referred to as “the Commission”. By virtue of SC Code of Laws, *Section 5-31-250*, conducting the financial affairs of the Commission is vested with the elected Commissioners. This document, adopted and approved by the Commissioners, includes the public policies whereby the Commission will recover the cost of providing water and wastewater services to its customers.

### Section 1. Purpose

This policy document provides clear public policies used as guidance by the Commissioners when making financial decisions and plans relating to the provision of water and wastewater service to existing and future customers. These policies are designed to create long-term financial stability for a public utility, while ensuring that the charges for services are as fair, reasonable and equitable as possible. Adopted during the course of public meetings, this document is also amended through the public meeting process.

### Section 2. Cost Recovery Philosophy

#### *Policy 2.1 Cost Recovery*

*To fully and as equitably as possible recover all costs of operating, maintaining, and expanding the water and wastewater utilities from the customers of the service area while maintaining financial stability and sufficiency.*

The mission of the Commission is to provide excellent quality water and wastewater services to its customers, while meeting all applicable Federal, State and local laws and regulations. All of the costs to provide these services must be fully recovered by the Commission. In addition, rates must be as equitable as possible among customer classifications, and between existing and future customers. Financial stability ensures that rates remain reasonable, and that the utility’s borrowing ability is maintained.

#### *Policy 2.2 Fund Disbursement*

*To the nearest extent practical, funds received by the Commission will be used to pay for the services that benefit the customers whose payments generated those funds.*

The Commission has two categories of customers, existing and future. Cost of the ongoing operation of the system and renewal and replacement (R&R) of the existing assets are recovered through the monthly rates and charges to existing customers. Other charges are levied for specific services provided such as connection services, new customer account set up and management and other miscellaneous ancillary services. Cost recovery for the extension and expansion (E&E) of the utility infrastructure to serve future customers is recovered through impact fees and system development charges.



## Section 3. Cost Recovery Administration

### ***Policy 3.1 Authority to Set Rates, Fees and Charges***

*The authority to set rates, fees, and charges rests with the elected Board of Commissioners of Mount Pleasant Waterworks (South Carolina Code 5-31-250).*

### ***Policy 3.2 Authority to Grant Exceptions to Adopted Rates, Fees and Charges***

*The authority to grant exceptions to adopted rates, fees and charges rests with the elected Board of Commissioners of Mount Pleasant Waterworks and may be delegated to the General Manager.*

The Commission will not provide free services nor waive adopted rates, fees or charges to any customer or group of customers because to do so is arbitrary and discriminatory. Special payment schedules based on hardship may be requested in writing to any elected member of the Board of Commissioners or the General Manager. Approval of such requests will be discretionary.

### ***Policy 3.3 Set Rates to Maintain Financial Sufficiency***

*The Commission will establish rates sufficient to meet the operating expenses, reasonable capital improvements to the utility infrastructure and mandatory debt service coverage ratios as required in the existing bond ordinance.*

### ***Policy 3.4 Establish a Rate Structure to Maintain Financial Stability***

*The Commission will establish a rate structure to recover revenue from the customer base in a way that provides for financial stability and the maintenance of the minimum cash reserves. This structure will include fixed charges and variable charges as approved by the Commissioners.*

## Section 4. Policy Review and Amendment

### ***Policy 4.1 Policy Review***

*The Commission will review its cost recovery policies prior to preparation of the annual budget and revise the policy document as often as necessary to maintain consistency with actual cost recovery practices. A comprehensive, independent cost recovery review of rates, fees and charges will be conducted at least every 5 years or more frequently if deemed necessary.*

Cost recovery studies will be conducted more frequently if major changes occur in: 1) cost forecasts, 2) regulations governing system operations, 3) operating technologies, or 4) customer base demographics. The independent review will, at a minimum, produce a comprehensive schedule of rates, fees and charges that reflect stated policies and provide documentation of the calculations used in designing the rates, fees and charges.

### ***Policy 4.2 Policy Amendment***

*The Cost Recovery Policies may be amended from time to time depending on financial circumstances. The Commission will hold a public hearing on any amendments to the policies and adopt any changes in a public meeting of the Commission.*



## Section 5. Financial Plan

### ***Policy 5.1 Financial Plan***

*The Commission will update its Ten-Year Financial Plan annually, to assess the financial feasibility of planned and budgeted activities as they relate to cost recovery objectives.*

The Commission develops two budgets annually, the operating budget and the capital improvements budget. The capital improvements budget includes a) renewal and replacement projects and expenses for existing assets and b) expansion and extension projects and expenses for future service. The Commission forecasts these projects and expenses into the future through use of our financial rate model. This model establishes the overall financial plan for the Commission.

## Section 6. Customer Classifications

### ***Policy 6.1 Customer Classifications***

*The customer classification system will be reviewed prior to each cost recovery study and revised as often as necessary.*

Customers are classified into homogeneous groups for development of cost allocations and applications of charges. Customer classifications will be developed if and when customer groups are deemed to differ.

### ***Policy 6.2 Out of Town Wastewater Customers***

*The Commission will charge an Out of Town Wastewater rate for all customers that receive wastewater service that are not within the corporate limits of the Town of Mount Pleasant as specified by Town Ordinance 11011.*

February 8, 2011, the Town of Mount Pleasant amended the Sewer Use Ordinance by adopting Ordinance 11011 that added Section 51.093 which states the following:

#### Out-Of-Town Wastewater Rates and Charges

(A) *Single-family residential.* For each out-of-town connection to the public wastewater system, the person applying for and/or receiving service shall pay one and one-tenth (1.1) times the current in-town wastewater rates and charges as may be set and determined from time to time by the Commission.

(B) *All other.* For each out-of-town connection to the public wastewater system, the person and/or business applying for and/or receiving service shall pay two times the current in-town wastewater rates and charges as may be set and determined from time to time by the Commission.

### ***Policy 6.3 Municipal Irrigation Customer***

*The Commission will charge the Town of Mount Pleasant irrigation accounts a Municipal Irrigation rate that is equal to the regular residential water volumetric rate.*



Effective April 2012, the Commission approved the Municipal Irrigation rate that equals the regular residential volumetric rate. Furthermore, an allocation of REUs was approved to prevent all selected irrigation accounts from paying excessive use charges. Each account will be charged the appropriate basic facility charge.

## **Section 7. Establishing Rates and Charges**

The basic principles the Commission will use in calculating rates, fees and charges are as follows:

- All costs incurred will be considered investments of resources. These resources include the capital costs of developing facilities and capacity for providing services, the operational costs of providing services from these facilities, and the administrative costs of programs and activities related to the facilities and services provided.
- Utility services are goods and their full costs will be recovered. Rates will be reviewed annually and updated as often as necessary to fully recover costs and meet the requirements of the cost recovery policies.
- As a responsible public entity, the Commission will price its services to recover costs without generating a profit over time.
- The entire pricing system will be as equitable as practicable.

### ***Policy 7.1 Maintain Equitable Charging Practices***

*The Commission will strive for equity among customer classifications and between existing and future customers when setting rates, fees, and other charges.*

- *The Commission will help ensure equity between existing and future customers by following a flow of funds system that indicates the sources of funds, where funds are deposited and held, and where funds are distributed.*
- *Impact fees and other connection charges will be used for system expansion, to ensure that to the extent possible “growth pays for growth”.*
- *Costs will be controlled and the rate program will be planned such that increases in typical monthly bills will not exceed 15 percent in any given fiscal year. Exceptions will be made to this policy only as necessary to meet mandatory requirements.*

The Commission operates as a business enterprise independent of other revenue sources. The utility is managed as an enterprise fund, and prices will approximate those that would prevail in a competitive market.

### ***Policy 7.2 Basic Facility Charge (BFC)***

*Water and Wastewater Basic Facility Charges will recover an amount equal to or greater than the sum of the annual Renewal and Replacement (R&R) debt service expense, a portion of the capital expenditures for the system, a portion of operation and maintenance costs, and a portion of general administrative costs.*

The Commission incurs fixed costs for providing services to its customers including, but not limited to, Renewal and Replacement (R&R) debt service, capital costs, operating and maintenance costs, and general administrative costs.



The BFC is a charge for the reservation of capacity based on the total active REUs assigned to a property. To ensure the purchased capacity remains available, all BFCs must be paid.

***Policy 7.3 Volumetric Rates***

*Water and wastewater volumetric rates will be set to recover all costs and funding requirements that are not recovered from other rates, fees and charges, including minimum fund balance requirements.*

In the interest of encouraging conservation of water resources, water and wastewater rate schedules include flow-based charges. Thus, the customers who use more water and generate more wastewater pay more than those who use less. Volumetric rates for water and wastewater are calculated and levied per 1,000 gallons of metered water per account, rounded downward to the nearest 100 gallons.

***Policy 7.4 Application of Volumetric Rates***

*Water volumetric rates will be applied to all metered water use.*

Some public utilities do not charge the water volumetric rate for lost water or metered water that was wasted due to an extraneous circumstance, such as a broken faucet. Because the utility bears the cost of water lost on the utility's side of the meter, it is equitable for individual customers to bear the cost of water lost on the customer's side of the meter. Thus, the customer will be held directly responsible for all metered water at their household or business. The wastewater volumetric rate may be waived on lost water if the customer can show that the lost water was not discharged to the wastewater system.

***Policy 7.5 Excessive Use Charge***

*An excessive use charge<sup>1</sup> will be levied on all water and wastewater customer classifications as follows:*

***Residential Customers***

- *100% of the water and wastewater volumetric rate for monthly metered water usage in excess of 9,200 gallons per REU*
- *200% of the water volumetric rate for monthly metered water usage in excess of 18,400 gallons per REU*
- *300% of the water volumetric rate for monthly metered water usage in excess of 27,600 gallons per REU*

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<sup>1</sup> The Commission uses the term "excessive use charge" rather than "conservation rate" because this charge is a penalty for excessive water and wastewater use. Unlike the Commission's other charges, the excessive use surcharge is not a cost-of-service rate.



### **Commercial Customers**

- *100% of the water and wastewater volumetric rate for monthly metered water usage in excess of 9,200 gallons per REU*
- *200% of the water and wastewater volumetric rate for monthly metered water usage in excess of 18,400 gallons per REU*
- *300% of the water and wastewater volumetric rate for monthly metered water usage in excess of 27,600 gallons per REU*

*The quantity of water used to calculate excessive usage for customers with irrigation meters is based on the meter size. The current rates are shown on the Commission's website.*

Revenues from the excessive use charge are generated by existing customers that utilize water and wastewater capacity on a monthly basis above their allocated capacity. The excessive use charge is intended to recover capacity charges (impact fees) not paid for, and the additional cost to provide the extra capacity for these customers. This charge creates equity between customers that paid for all the capacity they are using and those that did not.

### ***Policy 7.6 Connection Charges***

*Water and wastewater connection charges will be levied on the owners of new structures and will recover the full costs of system connections. Connection charges will include:*

- *A water connection fee to recover the costs of labor, equipment, water meter and other materials required for water service connection. The water connection fee will apply to all activities associated with setting water meters, including irrigation meters.*
- *A wastewater tap fee to recover the costs of labor, equipment and materials required for MPW to make any tap into the wastewater system. .*
- *A wastewater tap inspection fee to recover the costs for inspection and approval of any third party tap into the wastewater system, and a wastewater tap re-inspection fee for repeating this service, if necessary.*

Connection charges are considered operating revenues, and expenses associated with these services are considered operating expenses, according to generally accepted accounting principles.



### ***Policy 7.7 Miscellaneous Charges***

*Miscellaneous charges will recover the full cost of labor and expenses required to provide ancillary services from the individuals who receive benefit for these ancillary services.*

Miscellaneous charges will be levied only when: 1) a customer or customer group can be identified; 2) the activity produces a significant cost that is not common to all customers; and 3) the cost can be identified and related to the activity. Miscellaneous charges will not be levied to recover general overhead costs or for services that are beneficial to the system as a whole or to a relatively large group of customers.

Although miscellaneous charges are not necessarily based on cost recovery principles, and include penalties to discourage certain actions, they enable MPW to more closely match revenues with costs and thus enhance the fairness of the cost recovery policy.

### ***Policy 7.8 Damage to Assets/System Charges***

*The Commission shall levy charges against the responsible party(s) for the costs of damage or loss to the Commission's system and/or assets. Costs include, but are not limited to, direct and indirect labor, external contractors, supervision, materials, equipment usage, sales tax, and administrative fees. The Commission shall also levy costs of collection, if necessary, to include, but not limited to, attorney's fees, administrative cost and out-of-pocket expenses. The Commission retains full authority as to the restoration of the system and/or repair or replacement of assets.*

On occasion damages or loss to the Commission system and assets occurs. Costs are incurred to restore or replace the damage or loss to the Commission's system or assets. In addition to the direct cost of restoration or replacement, are costs associated with the administration and handling of the damage or loss. Legal and collection fees may be incurred in order to recover the costs. The Commission, after assignment of responsibility, shall assess the cost of the damage or loss and invoice the responsible party(s).

### ***Policy 7.9 Cost of Freedom of Information Request***

*The Commission shall levy against parties, the cost of searching for and making copies of records in accordance with South Carolina Law section 30-4-30(b) of the Freedom of Information Act (FOIA).*

Requests are received by the Commission for production of records and documentation as allowed by the SC FOIA. Costs to research and obtain, to copy and to comply with the request must be recovered. State law provides for the reasonable recovery of charges for compliance with the request. The Commission shall require a reasonable deposit to recover the cost of providing the requested documents prior to releasing the requested records or documents.



## Section 8. Cost recovery from Future Customers

Infrastructure to serve future customers must be planned and developed in advance of the need by future customers. Impact fees are capital development charges that recover the cost of extending and expanding the major infrastructure to serve residential and commercial development/property. Utilities must make sizable investments ahead of time in order to have concurrency of capacity to serve development when it occurs. Impact fees recover these investments. Major infrastructure includes wastewater treatment plants, regional pump stations, transmission force mains, major collectors, outfalls, water treatment plants, pumping facilities, storage tanks, main transmission pipelines, and administrative facilities and equipment.

### ***Policy 8.1 Impact Fees***

*Impact fees will recover major capital costs associated with expanding water and wastewater service facilities, including but not limited to water treatment plants, storage facilities, pumps and distribution mains, wastewater collection, transmission, storage and treatment facilities, and other capital equipment.*

- *A comprehensive, independent cost recovery review of impact fees will be conducted at least every 5 years or more frequently if deemed necessary in order to maintain equity to both existing and future customers.*
- *Impact fees will be indexed annually for changes in the ENR (Engineering News-Record Construction Cost Index (CCI)) plus the cost of money based on the current SRF interest rates. The Index will be established for a five-year period and will not vary from year to year within that period.*
- *Impact fees will recover the costs of both the excess capacity in existing capital facilities, and new facilities planned specifically for growth.*
- *The impact fee cost basis will be the original costs (without deducting depreciation) and planned costs discounted through build out.*
- *Impact fees will recover, to the extent possible, interest expense on outstanding and anticipated extension and expansion project debt discounted through build out.*
- *A “double payment credit” will be deducted from the impact fee to prevent future customers from paying for debt-financed capacity in both their impact fee and their monthly rates.*

Impact fees are charges assessed against new development to recover part of the capital costs of expanding the water and wastewater infrastructure to serve them. Considered as a capital-recovery charge, impact fees allow recovery of the capital costs of developing the new service directly from the customers who will benefit from the service.



**Policy 8.2 Residential Equivalent Units**

*All customer accounts are assigned Residential Equivalent Units (REU) according to the number of REU for which impact fees have been paid.*

*In no event will the number of REU on an account be lowered without approval of the General Manager.*

**Section 9. Debt Funding and Recovery of Debt Service**

**Policy 9.1 Debt Funding**

*The Commission will use debt funding for the provision of utility infrastructure as necessary.*

**Policy 9.2 Project Funding**

- *Cash fund renewal and replacement capital projects and assets with estimated useful lives of ten years or less.*
- *Fund renewal and replacement and extension and expansion capital projects and assets with estimated useful lives of over ten years by using debt or cash financing, depending on prevailing economic conditions.*

It is the intent to cash fund renewal and replacement (R&R) and extension and expansion (E&E) whenever possible, while maintaining fund balances and rates, fees and charges at reasonable levels. However, for assets of higher value, longer-life, and the policy will provide for the use of debt financing if market conditions dictate that such funding would be a better solution for all customers.

**Policy 9.3 Debt Service**

*It is the intent of the Commission to recover the debt service for R&R projects through basic facility charges and rates and debt service for E&E projects through impact fees.*

**Policy 9.4 Bond Rating**

*The Commission will maintain an uninsured bond rating of “AA” or better (as rated by both Moody’s and Standard and Poor’s) for the combined water and wastewater utilities.*

**Policy 9.5 Debt Service Coverage**

*The Commission will maintain rates to meet the coverage tests required by its bond ordinance:*

Test 1

$$\frac{\text{Net Operating Revenues (Operating Revenues – Operating Expenses)}}{\text{Total Debt Service}} \geq 1.00$$

And:

Test 2

$$\frac{\text{Net Operating Revenues + Impact Fees Revenue}}{\text{Total Debt Service}} \geq 1.2$$



***Policy 9.6 Debt Service Coverage Action Trigger***

*Whenever Test 1 is estimated to equal 2.00 or less, the Commission will take necessary corrective actions to ensure that the ratio remains at or above the mandatory level. These corrective actions may include increasing rates and charges, reducing operating expenses, or retiring existing debt.*

Each month during the fiscal year, financial projections are made to determine if the debt coverage ratio will remain above 2.00 at the end of the fiscal year. These projections are reported to the Commissioners in order to take corrective action in time to avoid non-compliance with debt covenants.

**Section 10. Fund Balances**

For the purpose of maintaining financial stability, the Commission will maintain fund balances or cash reserves for use as intended. These cash reserves are considered as available for use under certain circumstances as defined by each policy.

***Policy 10.1 Operating Fund Balance***

*The Commission will meet or exceed minimum Fund<sup>2</sup> balance requirements and maintain a minimum balance of not less than 200 days of unrestricted cash<sup>3</sup>.*

Unrestricted cash-on-hand gives the Commission flexibility in setting aside funds for the scheduled repair or replacement of capital assets with projected useful lives of ten years or less, acquiring unbudgeted but necessary items, paying for capital cost overruns, implementing small capital projects without bonding, and providing cash for emergency situations, such as a critical asset failure, hurricanes, or economic downturns.

It is at times prudent to decrease the amount of cash-on-hand in order to defray debt, avoid or delay a bond issue by cash-funding capital projects, or prevent or lessen the need for a rate increase.

***Policy 10.2 Maintain Operating Fund Balance***

*If cash reserves fall below the objective of 200 days of unrestricted cash, the Commission will make it a priority to build them back up to that level as soon as possible. Mid-year rate increase may be adopted to meet this objective, as well as other actions.*

***Policy 10.3 Capital Project Fund Balance***

*The Commission will maintain a minimum fund balance as a contingency for the Capital Improvements Plan. The minimum balance will be equal to at least 10% of the total annual Capital Improvement Plan projected for R&R projects for the next five years.*

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<sup>2</sup> A Fund has a legal definition. It may be a single bank account or a group of accounts and may be held by MPW or by a trustee.

<sup>3</sup> This sum will equal 200/365 times the total annual operating budget, excluding debt service.



***Policy 10.4 Impact Fee Fund Balance***

*The Commission will maintain a minimum fund balance of impact fees as a contingency fund for the debt service payments and funding of E&E projects. The minimum fund balance will be at least equal to the debt service payment for the E&E debt for the next year or 10% of the average annual Capital Improvement Plan projected for E&E projects for the next five years, whichever is greater.*

***Policy 10.5 Medical Reserve Fund Balance***

*The Commission will maintain a Medical Reserve fund balance equal to 25% of the budget for Health Insurance Expense as a contingency for significant medical expense that exceed the budgeted allotment in a given year.*

***Policy 10.6 Out-of-Town Wastewater Fund Balance***

*The Commission will maintain an Out-of-Town-Wastewater Fund. The source of the fund is from the out-of-town wastewater surcharge.*

## **Section 11. Funds Management**

The term “flow of funds” refers to the binding system of money management that has been established in the Commission’s existing bond ordinance. Under the Commission’s flow of funds system, specific revenues must be deposited into specific funds and then applied to specific types of expenditures in order of importance to the bondholders. Any revenues remaining after these requirements have been met, or revenues from sources which were not pledged toward bond repayment, may be managed and dispersed at the Commissioner’s discretion. Additional Funds may be created, as long as their requirements do not diminish the rights of the bondholders or conflict with the required system.

In this policy document, flow of funds refers to the Commission’s total system of money management including requirements of the existing bond ordinance.

Exhibit 1 to this policy document describes the Commission’s flow of funds system.

### ***Appropriate Disbursement of Operating Revenues***

Operating revenues, generated from existing customers, are used to cover operating expenses that benefit these existing customers.<sup>4</sup>

Debt service payments represent the cost of capital facilities that benefit both existing and future customers and are paid with a mixture of operating revenues and impact fees, adding equity to the cost recovery system. If impact fee revenues are unavailable for debt service, payment will come from operating revenues. Such an event would decrease equity between existing and future customers, but would protect the Commission’s financial strength.

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<sup>4</sup> An exception is connection charges, which are generated from new customers, and are included in operating revenues. Because expenses involved with new connections are only incurred when new connections occur, these connection revenues and expenses are considered equal and therefore do not create an inequity with this policy.

Another appropriate expenditure of operating revenues is for renewal and replacement (R&R) capital expenditures, including, but not limited to, budgeted routine capital outlays for equipment such as automobiles, and capital projects such as reverse osmosis membrane replacement or other short-term assets.

#### ***Appropriate Disbursement of Impact Fee Revenues***

Impact fee revenues will be expended only for capital items that directly benefit the future customers for which they were paid. Two types of expenditures are appropriate:

- Direct costs of planning, designing, or constructing capital facilities that will be extended or expanded (E&E) for future customers.
- Debt service payments for capital facilities planned, designed, or constructed for future customers, if available.
- Each year, as a part of the budget resolution, the Commission will determine the amount of water and wastewater E&E cash to transfer to the General Revenue Fund pay towards E&E debt. It is the intent of the Commission to continue the transfers until all E&E debt is paid through impact fee revenues.

#### ***Appropriate Disbursement of Non-Operating Revenues***

Depreciation is a real, but non-cash, expense. Each year, fixed assets become older, and at some point in time, will need R&R. To keep the cost recovery system equitable, the Commission will recover the cost of the future R&R over time from the customers who will benefit from the R&R.

#### ***Appropriate Disbursement of Debt Proceeds and Grants***

In most cases, disbursement of bond proceeds (restricted to specific capital projects) will be controlled by a trustee or the State Budget and Control Board. Grant funds will be disbursed for the capital projects for which they were obtained.

#### ***Inter-fund Transfers***

The Commission may provide for transfers of funds between the general fund, the water impact fee fund and the wastewater impact fee fund as deemed necessary. Such transfers are considered as internal loans between the funds to be reimbursed as soon as reasonably possible. Transfers may include funds for operating and/or capital related expenditures and debt service. The Commissioner's shall approve the transfers and subsequent reimbursements.

#### ***Customer Security Deposits***

Customer security deposits are deemed as restricted assets and will be maintained and accounted for in a separate cash account. Deposits will be disbursed according to Operating Policy 4.1.3. Security deposits are liabilities and the fund balance is not counted towards any fund balance goal.

#### ***Escrow (Maintenance Bond Deposits)***

Maintenance bond deposits are deemed as restricted assets and will be maintained and accounted for in a separate cash account. Deposits will be disbursed according to the Commission's Guidelines for Development. Maintenance bond deposits are liabilities and the fund balance is not counted towards any fund balance goal.



***Medical Reserve Account***

The medical reserve account funds are deemed as restricted assets and will be maintained and accounted for in a separate cash account. The account is designated to provide funding to cover medical claims in excess of budget during the fiscal year. The medical reserve account is a liability and the fund balance is not counted towards any fund balance goal.

***Reserve Funds***

Reserve funds may be required to be established by the Commissioners from time to time. The action establishing such reserve funds will define the restricted/unrestricted nature of the fund, the segregation of the fund, the use and disbursement policy, the accounting and management of the fund, and the inclusion or exclusion of the fund balance towards any fund balance goal.

***Out of Town Wastewater Funds***

The out-of-town wastewater surcharge funds are deemed as restricted assets and will be maintained and accounted for in a separate cash account. The account is designated to provide funding for out-of-town wastewater projects and out-of-town LMI customers for connections charges, home plumbing repairs and bill payment assistance. The source of funding is from the out-of-town wastewater surcharge. The fund balance is not counted towards any other fund balance goal.



## **EXHIBIT 1**

### **Flow of Funds System**

*MPW's current flow of funds system is illustrated on the following page.*

The six major sources of funds are:

1. Operating revenues primarily generated from existing customers,
2. Non-operating revenues primarily generated from the investment of existing operating revenues,
3. Debt proceeds from lenders for specific projects for existing or future customers
4. Grants or special funds from governmental agencies for specific projects for existing or future customers,
5. Growth-related revenues primarily generated from water and wastewater impact fees paid principally by homebuilders or developers for capacity expansion, and
6. Escrow funds primarily paid by developers as maintenance warranties related to new water and wastewater systems contributed to the Commission.

#### ***Operating Revenues***

Operating revenues are the Commission's primary source of funds. These revenues come from monthly use charges including basic facility charges, water and wastewater volumetric rates, water and wastewater connection charges for new customers, and miscellaneous charges for ancillary services.

The bond ordinance requires that these revenues be deposited into a Gross Revenue Fund (comprised of all revenues from all sources) and transferred out as needed to protect the interests of the bond holders. The transfers that are to be made are:

1. A sum sufficient to cover Operations and Maintenance costs of the System (i.e., compensation and benefits, contractual services, supplies and materials, travel and education and other O&M expenses),
2. A sum sufficient to cover Debt Service payments due monthly, quarterly or semi-annually as required by the individual debt instruments (these payments are to be transferred to the Trustee at least 5 days before a debt service payment is due), and
3. A sum sufficient to cover expenses for capital projects and capital outlays.

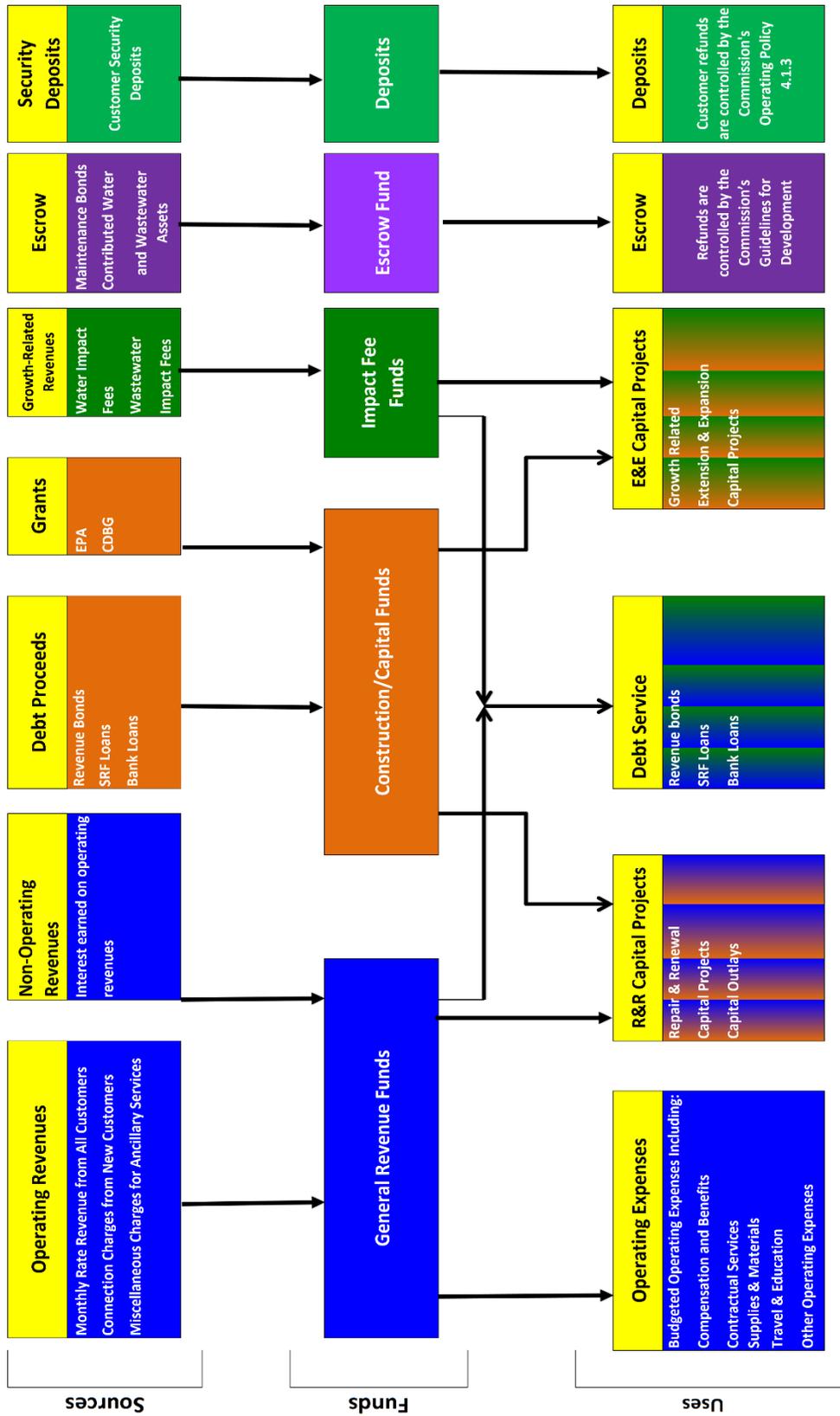
#### ***Non-operating Revenues***

Non-operating revenues include interest earned primarily on General Revenue Funds and other miscellaneous sources of revenue, such as insurance reimbursements, that are not generated from normal operations. Non-operating revenues are not a steady source of revenue because the amount received depends upon the total amount of money invested at a given time, the interest rate at which it is invested, and other extraneous circumstances. Because these funds are generated from revenues from existing customers, the most appropriate use of the funds is to help pay for R&R capital projects and capital outlays that benefit existing customers.



# Flow of Funds Diagram

*Flow of Funds Diagram*



### ***Impact Fee Revenues***

Impact fees are payments made by homebuilders and developers to pay for capital projects and debt service payments of debt funded facilities that benefit future customers. Case law requires that impact fees be used for the direct benefit of future customers. Therefore, the flow of these funds is kept separate from other revenues.

### ***Debt Proceeds and Grants***

Debt proceeds and grants are sources of funds provided by lenders or public agencies that are restricted to expenditures on specific capital projects, regardless of the intended beneficiary. Therefore, they are kept separate from other revenues in a construction or capital account.

### ***Escrow (Maintenance Bond)***

Escrow funds are warranty-type payments by developers to provide funds for any repairs or replacements needed to water and wastewater assets within a given time frame of contributing the system to MPW (usually two years). These funds are restricted to only repairs or replacements to specific assets for a specific term, and are therefore kept separate from other revenues. If not used, the funds are refunded to the developer.

### ***Security Deposits***

Security deposit funds are received from customers to provide funds to cover unpaid water and wastewater bills. These funds are restricted and disbursement is controlled by the Commission's Operating Policy 4.1.3.



## Addendum # 1

### *Bond Ordinance – Definitions*

“**Expenses of Operating and Maintaining the System**” shall mean the current expenses, paid or accrued, of operation, maintenance and current repair of the System, as calculated in accordance with generally accepted accounting principles and shall include, without limiting the generality of the foregoing, salaries, wages, employee benefits, cost of material and supplies, cost of water, cost of power, cost of gas, cost of routine repairs, renewals, replacements and alterations occurring in the usual course of business, cost of billings and collections, cost of insurance, cost of audit, taxes, if any, and other administrative and overhead expenses. Expenses of Operating and Maintaining the System shall not include debt service on any Indebtedness or any allowance for depreciation or renewals or replacement of capital assets of the System.

“**Net Earnings**” shall mean the Revenues of the System after deducting the Expenses of Operating and Maintain the System.

“**Net Operating Revenues**” shall mean the Operating Revenues of the System after deduction the Expenses of Operating and Maintaining the System.

“**Operating Revenues**” shall mean all Revenues other than impact fees, as determined, in accordance with generally accepted accounting principles.

“**Revenue**” shall mean all fees, tolls, rates, rentals and charges to be levied in connection with, and all other income and receipts of whatever kind of character derived from the operations of the System, except the proceeds of grants, customer deposits and special assessments for water or sewer improvement, or any amount collected by the Town representing sales tax or user fee with are required by law or agreement to be paid to the State of South Carolina. Revenue shall include any water or sewer tap-in fees, connection fees and impact fees, less any adjustment for refunded impact fees.

