

**Montgomery County Municipal Utility District No. 18**  
**Financial Management Policy Statements**  
**Adopted June 17, 2008**  
**Revised May 10, 2011**

Montgomery County Municipal Utility District No. 18 (MUD 18) considers its goals, objectives and financial policy statements to be important integral parts of the budgetary process. The purpose of these policies is to ensure that financial resources are available to meet the present and future needs of the residents of MUD 18. Specifically, this policy framework mandates the pursuit of the following fiscal objectives:

- I. Revenues**  
Design, maintain and administer a revenue system that will assure a reliable, equitable and sufficient revenue stream to support desired MUD 18 services.
- II. Expenditures**  
Identify priority services, establish and define appropriate service levels and administer the expenditure of available resources to assure fiscal stability and the effective and efficient delivery of services.
- III. Fund Balance/Working Capital/ Net Assets**  
Maintain the fund balance and net assets of the various funds at levels sufficient to protect MUD 18's credit worthiness as well as its financial position from emergencies.
- IV. Capital Improvements**  
Annually review and monitor the condition of MUD 18's capital equipment and infrastructure, setting priorities for its replacement and renovation based on needs, funding alternatives and availability of resources.
- V. Debt**  
MUD 18 strives to minimize the use of debt to finance capital repairs and replacements through the use of a funded capital replacement program and the maintenance of healthy operating fund balances. Debt is intended to be used to finance new assets.
- VI. Investments**  
Invest MUD 18's operating cash to ensure its safety, provide for necessary liquidity and optimize yield.
- VII. Fiscal Monitoring**  
Prepare and present reports for the current period that analyze, evaluate and forecast MUD 18's financial performance.
- VIII. Operating Budget**  
Develop and maintain a balanced budget that presents a clear understanding of the goals of MUD 18 Board.

## I. Revenues

MUD 18 shall use the following guidelines to design, maintain and administer a revenue system that will assure a reliable, equitable and sufficient revenue stream to support desired MUD 18 services.

**A. Property Tax Revenues/Tax Rate**

MUD 18 shall strive to balance its reliance on property tax revenues against user fees. MUD 18 shall also strive to minimize tax rates.

**B. Utility User Fees**

Utility rates shall be set at levels sufficient to cover operating expenditures, meet debt obligations, provide additional funding for capital improvements and provide adequate levels of working capital.

**C. Revenue Estimates for Budgeting**

In order to maintain a stable level of service, MUD 18 shall use a conservative, objective and analytical approach when preparing revenue estimates for current periods. The process shall include analysis of probable economic changes and their impacts on revenues, historical collection rates and trends in revenues. This approach should reduce the likelihood of actual revenues falling short of budget estimates during the year and should avoid mid-year rate changes.

**D. Revenue Collection and Administration**

MUD 18 shall maintain high collection rates for all revenues by keeping the revenue system as simple as possible in order to facilitate payment. MUD 18 shall pursue to the full extent allowed by state law all delinquent taxpayers and others overdue in payments to MUD 18.

## II. Expenditures

MUD 18 shall use the following guidelines to identify necessary services, establish appropriate service levels and administer the expenditure of available resources to assure fiscal stability and the effective and efficient delivery of services.

**A. Current Funding Basis**

MUD 18 shall operate on a current funding basis. Expenditures shall be budgeted and controlled so as not to exceed current revenues plus the planned use of fund balance accumulated through prior year savings.

**B. Avoidance of Operating Deficits**

MUD 18 shall take timely corrective action if at any time during the fiscal year expenditure and revenue re-estimates are such that an operating deficit is projected at year-end.

**C. Maintenance of Capital Assets**

Within the resources available each fiscal year, MUD 18 shall maintain capital assets and infrastructure at a sufficient level to protect MUD 18's investment, to minimize future replacement and maintenance costs and to continue service levels. See IV. Capital Improvements, C. Capital Replacement Program.

## III. Fund Balance / Working Capital / Net Assets

MUD 18 shall use the following guidelines to maintain the fund balance, working capital and net assets of the various funds at levels sufficient to protect MUD 18's creditworthiness as well as its financial position from unforeseeable emergencies.

**A. General Fund Undesignated Fund Balance**

MUD 18 shall strive to maintain the General Fund undesignated fund balance at 80 percent of current year budgeted expenditures. This reserve is intended to serve as a funding source for extraordinary capital repairs and replacements beyond those scheduled in the Capital Replacement Program. In the event that the General Fund is drawn on for such an event, the Board will strive to replenish the General Fund to the targeted balance within three years.

**B. Capital Fund/Surplus Funds**

Virtually all new facilities have been completed under budget, with no cost over-runs. This has resulted in a Capital Fund surplus which can be judiciously applied to minor construction projects, thereby avoiding

the issuing of bonds for those projects. These funds can also be used for extraordinary maintenance in the event that would be necessary.

**C. Renewal and Replacement Fund**

MUD 18 is currently funding as part of the annual operating budget an amount designated for the replacement of capital assets over a regular schedule of up to 5 years, the Capital Replacement Program. As some of these funds are retained each year for larger items that require multi-year funding, a special fund has been created to track these funds, the Renewal and Replacement Fund. The Renewal and Replacement Fund is a sub-account of the General Fund. The Renewal and Replacement fund is a Board designated fund and is therefore not counted in the General Fund Undesignated Fund Balance goal. See IV. Capital Improvements, C. Capital Replacement Program.

**D. Use of Fund Balance/ Net Assets**

Capital expenditures should generally be funded first from the Capital Fund’s Surplus Funds. These funds are from bond proceeds and are subject to arbitrage rebate and should therefore be targeted for expenditure prior to other available funds. The Renewal and Replacement Fund shall be used to fund the Capital Replacement Program. General Fund Balance/ Net Assets shall be used only for emergencies, non-recurring expenditures, or major capital purchases that cannot be accommodated through Capital Fund Surplus Funds, the Renewal and Replacement Fund or current year savings. Should such use reduce the General Fund balance below the appropriate level set as the objective for that fund, recommendations will be made on how to restore it over a three year period.

**IV. Capital Improvements**

**A. Capital Expenditures and Improvements**

MUD 18 shall annually review and monitor the condition of MUD 18’s capital equipment and infrastructure, setting priorities for its replacement and renovation based on needs, funding alternatives and availability of resources.

**B. Capital Improvements and Replacement Program**

MUD 18 shall annually review and revise the Capital Improvements and Replacement Program (CIRP), which includes potential new projects, replacement and renovation of MUD 18’s infrastructure and preventive maintenance and programmed revisions to current facilities and replacement and renovation needs, updating the program as appropriate. All projects, ongoing and proposed, shall be prioritized into a 5 year schedule based on an analysis of current needs and resource availability. For every project, all operation, maintenance and replacement expenditures shall be fully costed. The CIRP shall also present the proposed funding source: general fund, capital surplus or new debt.

The general fund budget for this is currently set at \$300,000 per year. Such amount shall also be reviewed annually. The first upgrades are those that will reduce operating costs and improve reliability. Examples are the replacement of sewage lift station pumps with more reliable technology, routine sewer line inspection by remote television cameras, etc. In another program, the District assessed the state of water meters and decided that all meters will be replaced by modern meters with electronic communication. The estimated \$500,000 cost of this will not be covered by a bond issue. Instead the District authorized a 5-year program of replacement at a cost of approximately \$100,000 per year, and the operating budget has been set to recover this cost via water and sewer fees and maintenance taxes.

One objective of the Capital Improvements and Replacement Program is to provide funding for projects that are beyond the “run and maintain” items covered in the operating budget and are inappropriate for funding from bonds. Some very large projects may require multi-year accrual of funds prior to start of the project. Candidate items for the Capital Improvements and Replacement Program have some of the following characteristics:

- Infrequent -- happen only once or once every few years.
- Have discretionary timing -- things can be pushed forward or backward a couple of years.
- Have preventive or plannable aspects -- not a response to a surprise.
- Cost more than the typical "run and maintain" activity.
- Provide a better base from which to operate in the future -- not just restoring the status quo.
- Provide new information or insight about the operation.

- Board spends time understanding the items and approving them.
- May set a precedent or lead to a change in policy, even an unstated "policy."

The Capital Improvement and Replacement Program general fund budget amount is deposited each year into the Renewal and Replacement Fund. Similarly, expenditures under the Capital Improvement and Replacement Program are drawn from the Renewal and Replacement Fund.

**C. Capital Expenditure Financing**

MUD 18 recognizes that there are several methods of financing capital requirements. It can budget the funds from current revenues, it can take funds from the Capital Fund Surplus Funds, it can take the funds from the Renewal and Replacement Fund for the Capital Replacement Program, it can take the funds from General Fund balance/retained earnings as allowed by the Fund Balance/ Net Assets Policy or it can borrow money through debt. Guidelines for assuming debt are set forth in the Debt Policy Statements.

**V. Debt**

MUD 18 shall use the following guidelines for debt financing which will provide needed capital equipment and infrastructure improvements while minimizing the impact of debt payments on current and future revenues.

**A. Use of Debt Financing**

Debt financing shall be used to purchase or construct new capital assets. Debt payments should be structured to provide that capital assets, which are funded by the debt, have a longer life than the debt associated with those assets. The desired outcome is to issue new bonds only for the purposes of securing new assets. There is, however, a possibility that someday bonds may have to be issued for over-arching upgrades of existing facilities -- for example, for compliance with a legislative mandate. The only legislation being discussed today relates to conversion of utility districts from groundwater to surface water or to conservation practices such as recycling of water. MC MUD 18 also intends to fund central facilities pro-rata from each bond issue when infrastructure for new lots is acquired/financed.

**B. Amortization of Debt**

MUD 18 shall structure new debt issue payment schedules to achieve level debt service payments.

**C. Affordability Targets**

MUD 18 primarily focuses on the impact on the debt service tax rate in the calculation of debt affordability. New issues must not require an increase in the projected debt service tax rate. Projections of value must be conservative and based on recent home building experience within the District.

**D. Sale Process**

MUD 18 shall use a competitive bidding process in the sale of debt unless the nature of the issue warrants a negotiated bid.

**E. Rating Agency Presentations**

Full disclosure of operations and open lines of communication shall be made to the rating agency. MUD 18 consultants, led by the financial advisors, shall prepare the necessary materials and presentation to the rating agency.

**F. Continuing Disclosure**

MUD 18 is committed to continuing disclosure of financial and pertinent credit information relevant to MUD 18's outstanding securities.

**G. Debt Refunding**

MUD 18's financial advisor shall monitor the municipal bond market for opportunities to obtain interest savings by refunding outstanding debt. MUD 18 has a goal of 5% of refunded principal for present value savings.

**VI. Investments**

MUD 18’s available cash shall be invested according to the standard of prudence set forth in Section 2256.006 of the Texas Government Code. The following shall be the objectives of MUD 18 Investment Policy listed in their order of importance: preservation of capital and protection of investment principal, maintenance of sufficient liquidity to meet anticipated cash flows, diversification to avoid unreasonable market risks and attainment of a market value rate of return.

**VII. Fiscal Monitoring**

Reports shall be prepared and presented on a regular basis to analyze, evaluate and forecast MUD 18’s financial performance and economic condition for the current year.

**A. Financial Status and Performance Reports**

Monthly reports shall be prepared comparing expenditures and revenues to current budget for fiscal year-to-date, and to prior year actual fiscal year-to-date.

**VIII. Operating Budget**

MUD 18 shall establish an operating budget, which shall link revenues and expenditures to the goals of the MUD 18 Board. The MUD 18 budget approval process is as follows:

**March**

The Board will review contracts with consultants and service providers for the budget year according to the following schedule:

1. For fiscal years that start in an odd numbered year, the following contracts will be reviewed:
  - a. Operator
  - b. Bookkeeper/Investment Officer
  - c. Tax Collector & Delinquent Tax Attorneys
  - d. Auditor
2. For fiscal years that start in an even numbered year, the following contracts will be reviewed:
  - a. Engineer
  - b. Attorney
  - c. Fiscal Advisor
  - d. Web site services
  - e. Waste Management
3. If new services are added, they should be added to the above schedule.

The Board member that serves as the contact with the service provider should review the contract and provide a recommendation to the Board for consideration.

**April – May**

The District’s Engineer and Operator develop a proposed update to the District’s five year Capital Replacement Program.

**June**

The Board approves the Capital Replacement Program which includes the funding required from the next year’s operating budget.

In preparation for the July meeting, the Board Treasurer develops a preliminary budget, with input from the District’s major service providers, based on the following:

- Recent income and expense trends and projections for next year’s expenses.
- Growth in occupied homes that will influence income and expense
- Preliminary property values within the District.

- Capital Replacement Program funding requirements from the next budget year.

**July** The Board reviews preliminary budget and identifies changes or areas for further work.

**August** In preparation for the August meeting, the Treasurer receives the certified property values within the District. A proposed budget based on previous discussions and a proposed maintenance tax rate is prepared for Board review.

The District's financial advisor recommends a tax rate for debt service requirements.

The Board reviews and approves the budget and the maintenance and debt service tax rates for the next year.

**September** If the Board did not approve the budget and tax rates at the August meeting, the Board will approve an acceptable budget and tax rates at the September meeting

These policies were adopted by the MUD 18 Board on June 17, 2008 and revised on May 10, 2011.