



Funding Capital Replacement Reserve Accounts



IN THIS DOCUMENT

You'll learn how to meet our loan conditions to keep a special account to pay for repairs and improvements to your system.

To prepare for a catastrophic event, your system must keep cash on hand to bring assets back online to sustain public health and economic vitality. For this reason, the Nevada Division of Environmental Protection (NDEP) requires your utility to make annual deposits to a capital replacement reserve account if you receive funding from the State Revolving Fund.

By setting aside money each year, a capital replacement reserve account helps your system operate without interruption, both through the normal life cycle of its assets and through catastrophic events that could cripple those assets. This ensures your system keeps its technical, managerial, and financial responsibilities. NDEP does not consider your system sustainable if it is financially unable or unwilling to support its assets and infrastructure in this way.

What to expect in the conditions of your loan

- 1. Applies to specific loans.** This requirement applies to your system if you are seeking:
 - a. Clean water loans for public works construction projects.
 - b. Clean water principal forgiveness loans for a construction project.
 - c. Drinking water principal forgiveness loans for a construction project.
- 2. Annual deposits.** Your loan contract will require you to contribute at least annually to a capital replacement reserve account. The annual contribution is based on your system's short-lived capital assets using a straight-line methodology (See "Calculation example"). NDEP counts short-lived assets as capital assets with a life expectancy of 15 years or less. A schedule for making these deposits will be established at the completion of your project, becoming a binding condition of your loan.
- 3. Five-year updates.** You will be expected to list the short-lived assets of your system in a fiscal sustainability plan (FSP) that is updated and reviewed at least every five years. The updated replacement costs in your FSP will update the amount to fund into this account.
- 4. Written notices.** Your utility must notify NDEP's Office of Financial Assistance, in writing, when it uses money from the reserve fund to pay for a capital improvement. This notice must include the amount and nature of the expense.
- 5. Financial reporting.** On its financial statements, your system will be required to clearly identify its annual contribution to this fund — along with the fund balance.



Confused? Find definitions of key terms at the end of the document.

How your system may use the reserve account

Your system may only use reserve funds for capital improvements. Importantly, these improvements are not restricted to your system’s short-lived assets.

Figure 1. How you may and may not use the reserve account

You may use the reserve account to...

- ✓ Bring a new facility into service.
- ✓ Plan or design a new facility that will enhance the existing system.
- ✓ Extend the life or enhance the value of an asset with better quality materials or system upgrades.
- ✓ Repair short-lived assets like pumps, meters, and data collection equipment.

You may not use the reserve account to...

- ✗ Pay for operation expenses like service contracts.
- ✗ Cover maintenance costs.
- ✗ Buy day-to-day supplies like repair clamps, tools, inventory parts and fittings, spare pipes, paint, or grease.
- ✗ Expand your system, like extending main lines or adding new services.

Calculation example

In this example, you would contribute \$7,500 annually to the short-lived asset account. Asset A, for example, costs \$10,000 to replace. In order to set aside enough money to replace it in five years, you would contribute \$2,000 each year.

Asset D is not included in the contribution because its lifespan is longer than 15 years. However, your system could use funds from the account to replace (not repair) Asset D.

Table 2. How much to deposit based on asset lifespan and cost

Asset	Lifespan	Replacement cost	Amount to deposit annually
Asset A	5 years	\$10,000	\$2,000
Asset B	10 years	\$25,000	\$2,500
Asset C	15 years	\$45,000	\$3,000
Asset D	20 years	\$50,000	\$0

Table 3. Total amount to deposit annually

Total cost to replace all assets	Total amount to deposit annually
\$130,000	\$7,500



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What if my system already has a reserve account?

Your system may already have a reserve account to meet the requirements of another program. Both the United States Department of Agriculture-Rural Development Office and the Capital Improvement Grants Program, for example, require systems to fund a short-lived asset reserve account. Accounts like these may require different contribution amounts, calculations, and methodologies than what we require at NDEP. For these situations, however, NDEP lets your already established reserve accounts satisfy the conditions mentioned here.

Document notification

NDEP began including this condition in all borrower contracts for principal forgiveness funding in the 2018 intended use plans for both the Clean Water and Drinking Water State Revolving Funds. These plans were noticed for 30 days on NDEP's website and directly mailed to all systems on the current priority lists. The intended use plans describe how all money in the State Revolving Funds will be used. They also explain programs for disadvantaged communities, how funds are used for disadvantaged communities, and the criteria and procedures for distributing funds to any potential borrower from the programs¹.



Key terms

Capital asset: Any moveable or immovable property owned by a system that will last greater than one year and is critical to the mission of the system. Examples include land, buildings, machinery, vehicles, permits, and any expenses incurred to bring the asset online (shipping, setup, testing, etc.)

State revolving fund: The Nevada Clean Water State Revolving Fund and the Nevada Drinking Water State Revolving Fund Reserve account: A restricted financial account where money is reserved for specific activities, such as replacing capital assets.

Principal forgiveness loan: A loan from the state revolving fund programs where the entity does not have to pay back the principal and interest does not accrue on any balance.

Straight-line amortization: Spreading the cost of replacement over multiple periods at an even amount each period.

Fiscal sustainability plan: A plan developed by a system to identify capital assets of the system, the criticality of those assets during a catastrophic failure, the current condition and life expectancy, and an estimated replacement schedule. This plan can also be similar to an asset management plan.

¹ Nevada Administrative Code 445A.67575