

RECOMMENDED RESERVE POLICY FOR ELECTRIC AND WATER ENTERPRISE FUNDS

**PUBLIC UTILITIES
DEPARTMENT**

Finance Committee
February 10, 2016

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Background

1. Reserve Policy has been in place since 2001
2. Utility industry in California has continued to change
3. Regulatory, hydrologic, and market risks continue to evolve, including drought risk
4. Update policy to be consistent with Utility 2.0 strategic objectives
5. Board recommendation on 12/18/15 to move forward revised policy to City Council

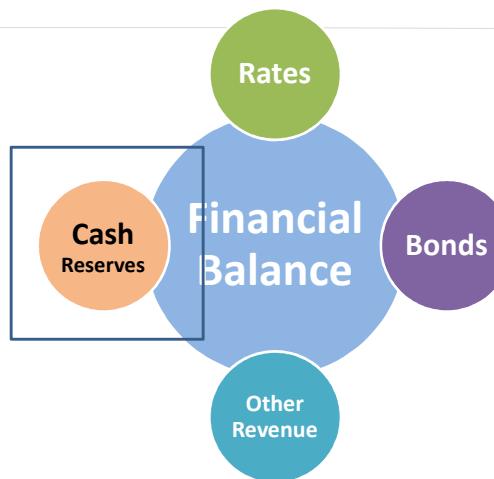
Utility 2.0 – Substantial Investments in Riverside's Future

Conceptual Approval by City Council-10/6/15	Financial Investment
Electric Infrastructure	\$464 - \$538 million
Water Supply	\$102 - \$124 million
Water Infrastructure	\$279 - \$357 million
Total	\$845 - \$1,019 million

Conceptual Approval by City Council - 10/6/15

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Balance Financial Tools

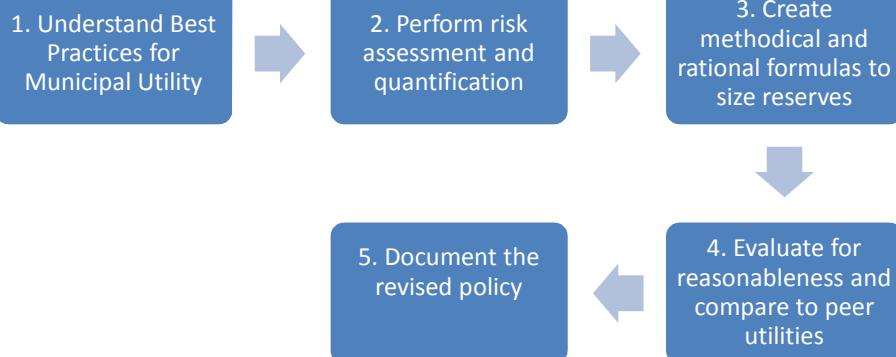


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Updating the Reserve Policy



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Reserve Policy is Consistent with Utility Industry Practice

1. “One size does not fit all” – GFOA
2. Reserve policy recognizes the unique risks that Riverside must face
3. Reserve policy is developed to mitigate rate increases and provide long-term benefits to all ratepayers
4. Reserve policy supports strong credit ratings

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Purpose of Reserve Policy

Define and set goals in a transparent manner.

Ensure adequate levels are maintained.

Provide guidelines for target levels, use, and replenishment.

Policy aligns with City Charter, other financial policies and support strategic and operational plans.



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Updated Reserve Policy Responds to Current Risks

1. Establishes minimum targets to mitigate different risks:
 - a. Operating
 - b. Emergency
 - c. Regulatory
 - d. Climate
2. Sets maximum level for unrestricted reserves



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Risk Assessment & Quantification

Utility industry is complex. California is more complex than other states.

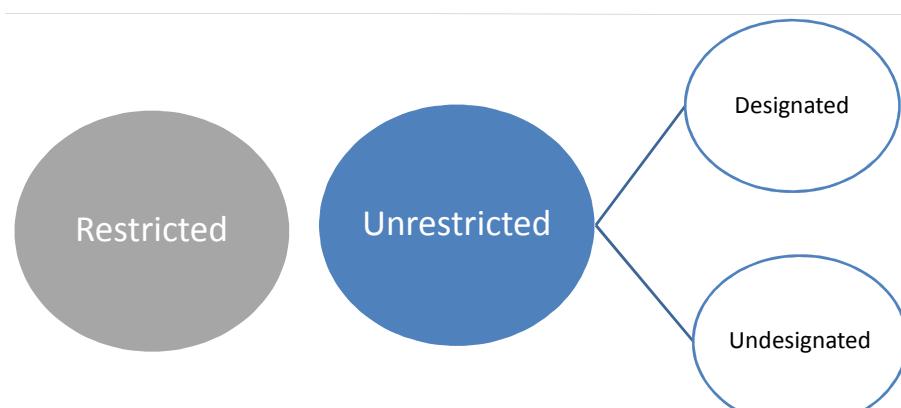
Significant number of environmental, market and regulatory issues (Local, State, National).

Fiscal responsibility requires anticipating and preparing for both foreseen and unforeseen events.

Prudent financial planning ensures sufficient funding for both.

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Types of Reserves



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Restricted Reserves

- **Restricted reserves are limited to specific purposes by statute, court, contract, etc.**
 1. Decommissioning Funds
 2. Regulatory Requirement Reserve
 3. Unspent Bond Proceeds
 4. Bond Redemption Reserve
 5. Electric Public Benefit Fund
 6. Water Conservation Fund



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Unrestricted–Designated Reserves

- **Reserves that are designated by the Board/Council**
 1. Customer Deposits
 2. Additional Decommissioning Liability Reserve
 3. Recycled Water Reserve
 4. Property Reserve
 5. Electric Reliability Fund
 6. Mission Square Improvement Fund
 7. Capital Repair/Replacement Reserve

CURRENT

ADDITIONAL



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Policy Specifies Purpose for Unrestricted-Undesignated Reserves

- Unrestricted-Undesignated Reserves established for the following risks:
 1. Working Capital – Operations and Power Supply
 2. Rate Stabilization
 3. Capital – Emergencies and System Improvements
 4. Debt Service

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Target (Minimum) and Maximum for Unrestricted, Undesignated Reserve

Risk Type	Target (Minimum)	Maximum
Working Capital – O&M and Power Supply	60 days of operating expenses	90 days of operating expenses
Rate Stabilization	Electric: 10% of Operating Revenues	Electric: 20% of Operating Revenues
	Water: 7% of Operating Revenues	Water: 15% of Operating Revenues
Capital – Emergency	1% of depreciable capital assets	2% of depreciable capital assets
Capital – System Improvements	6 months of annual CIP	9 months of annual CIP
Debt Service	Maximum debt service payment (semi-annual) in the upcoming fiscal year.	Same as minimum

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Withdrawal and Replenishment of Reserves

Target reserve levels should be treated as practical minimums.

May increase or decrease as necessary between minimum and maximum.

Above maximum, Board/Council approval to use for CIP paygo, pay down debt, reduce rates, or other strategic purposes.

Below target, report to Board/Council and implement plans to return reserves to target levels within 3 years.

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Policy Administration

Reserve levels analyzed annually with year end financial results and reported to Board and City Council.

Recommendations made to Board and City Council when levels deviate from target (minimum) and maximum levels, also when adjustments are necessary due to changes in risk factors.

Policy will be reviewed annually, and updated at a minimum every 5 years, depending on risk exposure or other conditions RPU faces

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Undesignated Reserve – Electric Reserve Level Calculations 6-30-15

Risk Type	Target (Minimum)		Maximum	
Working Capital	60 days	\$40,765,000	90 days	\$61,148,000
Rate Stabilization	10% of Op. Rev.	\$33,791,000	20% of Op. Rev.	\$67,582,000
Capital – Emergency	1% of cap assets	\$9,533,000	2% of cap assets	\$19,065,000
Capital – System Improvements	6 mos. of annual CIP	\$15,306,000	9 mos. of annual CIP	\$22,959,000
Debt Service	Highest Payment	\$26,755,000	Highest Payment	\$26,755,000
TOTAL UNRESTRICTED, UNDESIGNATED RESERVE		\$126,150,000		\$197,509,000
Days Cash on Hand Equivalent		186		291

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Undesignated Reserves – Water Reserve Level Calculations 6-30-15

Risk Type	Target (Minimum)		Maximum	
Working Capital – O&M	60 days	\$5,883,000	90 days	\$8,824,000
Rate Stabilization	7% of Op. Rev.	\$4,305,000	15% of Op. Rev.	\$9,225,000
Capital – Emergency	1% of cap assets	\$6,056,000	2% of cap assets	\$12,112,000
Capital – System Improvements	6 mos. of annual CIP	\$8,046,000	9 mos. of annual CIP	\$12,069,000
Debt Service	Highest Payment	\$8,583,000	Highest Payment	\$8,583,000
TOTAL UNRESTRICTED, UNDESIGNATED RESERVE		\$32,873,000		\$50,813,000
Days Cash on Hand Equivalent		335		518

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Total Unrestricted Cash Reserves – Target and Maximum vs. Actual - 6/30/15

	Electric			Water		
	Target (Minimum)	Maximum	Actual	Target (Minimum)	Maximum	Actual
Undesignated	\$126,150,000	\$197,509,000	\$181,264,000	\$32,873,000	\$50,813,000	\$50,322,000
Designated	\$46,161,000	\$46,161,000	\$46,161,000	\$33,542,000	\$33,542,000	\$33,542,000
Total Unrestricted Reserves	\$172,311,000	\$243,670,000	\$227,425,000	\$66,415,000	\$84,355,000	\$83,864,000

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Rating Agencies Care About Reserves

1. Reserve levels and reserve policy are important to rating agencies
2. One measure of reserves used by the rating agencies is “days cash on hand”
3. Days cash on hand measures the number of days the utility can fund its operating costs from reserves
4. Consistent measure

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Reserve Policy Results in Levels Consistent with Similarly Rated Utilities

Fitch Rating Category - Days' Cash Medians ⁽¹⁾			
Rating Category	AAA	AA	A
Electric Retail Utility Reserve Medians	-	182	92
Water and Sewer Utility Reserve Medians	481	442	366

⁽¹⁾Source: Fitch

Peer Utility Days' Cash Levels						
Electric Utilities						
	RPU Target/Total Cash	Pasadena Water & Power	LADWP	Anaheim Public Utilities	Sacramento Municipal Utility District	San Francisco Public Utilities Commission
Rating (M/S/F)	-AA-/AA-	-/AA-/AA	Aa3/AA-/AA-	-/AA-/AA-	Aa3/AA-/AA-	-/A+/AA-
Days' Cash ⁽¹⁾	186/254	402	203	136	207	560

Water Utilities						
	RPU Target/Total Cash	Irvine Ranch Water District	Inland Empire Utilities Agency	Anaheim Public Utilities	Eastern MWD	Western MWD
Rating (M/S/F)	Aa2/AAA/AA+	Aa1/-/AAA	Aa2/AA/-	-/AAA/AAA	Aa3/AA-/AA	-/AA+/AA
Days' Cash	335/677	934 ⁽²⁾	439 ⁽²⁾	166 ⁽¹⁾	628 ⁽¹⁾	644 ⁽³⁾

⁽¹⁾Source: S&P/Fitch

⁽²⁾Source: Each Utility's respective CAFR

⁽³⁾If purchased costs associated with wholesale water sales are included in operating costs, days' cash is equal to 314 days

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Use of Available Reserves

- Reserves above the target can be used for many purposes:
 1. Capital improvements – reduce future debt
 2. Pay down existing debt – provide additional flexibility
 3. Strategic investments (e.g., land, equipment) – secure long-term positions
 4. Reduce future rate increases

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Impact of Reserves on Future Rates

Reducing Future Debt

1. Reserves can be used for capital investment to reduce the need for future borrowing
2. Estimated rate impacts
 - a. Every \$10 million of debt = \$580,000
 - b. Maintaining coverage ratios of 2Xs = \$1.2 million per year
 - c. Long-term rate impact of **0.4%** for electric and **2.1%** for water

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Impact of Reserves on Future Rates

Reducing Pay as You Go Expenditures

- Estimated rate impacts - \$10 million expenditure
 - Every \$10 million of expenditure
 - a. About 3.3% rate impact for electric utility
 - b. About 17.5% rate impact for water

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Prudent Reserves Provide Long-term Benefits to Ratepayers

1. Reserves protect against emergencies and other contingencies
2. Reserves are a strong credit positive, leading to lower borrowing costs
3. Reserves mitigate future rate increases due to market disruptions and weather events
4. Reserves help reduce the probability of rate shocks

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Recommendations

That the Finance Committee recommend that the City Council:

1. Adopt the RPU Cash Reserve Policy, including approval of the following designated reserve funds: Customer Deposits, Additional Decommissioning Liability Reserve, Electric Reliability Fund, Mission Square Improvement Fund, Capital Repair/Replacement Reserve; Recycled Water Reserve and the Property Reserve; and
2. Dissolve the Electric Utility's Operating Reserve, Regulatory Risk Reserve and the Energy Risk Reserve Accounts and transfer the balances as of June 30, 2015 of those accounts (\$143,031,000, \$15,000,000 and \$30,000,000, respectively) into the Electric Utility's Undesignated, Unrestricted Reserve; and

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Recommendations (continued)

3. Dissolve the Water Utility's Operating Reserve Account and transfer the balance as of June 30, 2015 (\$30,435,000) into the Water Utility's Undesignated, Unrestricted Reserve Account; and
4. Direct staff to annually review, and update the Policy at a minimum, once every five years.

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