RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES **DATE: JANUARY 10, 2022**

SUBJECT: INTRODUCTION TO BOND FINANCING AND THE ROLE OF THE FISCAL POLICY STRATEGY OF THE UTILITY

ISSUE:

Consider receiving an introduction about how Riverside Public Utilities uses bond financing and the role of the fiscal policy strategy of the utility.

RECOMMENDATIONS:

That the Board of Public Utilities:

1. Receive the introduction on how Riverside Public Utilities uses bond financing and the role of the fiscal policy; and
2. Provide feedback to staff regarding the fiscal policies that direct the use of bond financing for Riverside Public Utilities.

COMMITTEE RECOMMENDATION:

On October 18, 2021, the Board of Public Utilities Customer Relations/Finance Committee with Board Chair Sanchez-Monville and Members Crohn, Oceguera and Cherney met to receive the introduction on how Riverside Public Utilities uses bond financing, the role of the fiscal policy; and to provide feedback to staff regarding the fiscal policies that direct the use of bond financing for Riverside Public Utilities. Following discussion, the item was unanimously approved with Member Oceguera abstaining, inclusive of the direction to include additional discussion including clarification on rate translations and reserve impact, debt service coverage ratio, and Clean Renewable Energy Bonds and Renewable Energy Production Incentives.

LEGISLATIVE HISTORY:

Senate Bill (SB) 1029 became effective on January 1, 2017. Among other things, SB 1029 requires issuers of bonds after January 1, 2017, to have adopted a "local debt policy" that contains certain enumerated items. Issuers must certify compliance with this requirement to California Debt and Investment Advisory Commission (CDIAC) at least 30 days before the pricing date for bonds (where the certification occurs on or after January 1, 2017), meaning that appropriate policies must be adopted by an issuer's governing board by the time of certification.

Here are the items that SB 1029 requires the debt policy to include:

(A) The purposes for which any debt proceeds may be used.

(B) The types of debt that may be issued.

(C) The relationship of the debt to, and integration with, the issuer's capital improvement program or budget.

(D) Policy goals related to the issuer's planning goals and objectives.

(E) The internal control procedures that the issuer has implemented, or will implement, to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

BACKGROUND:

On May 23, 2016, and July 26, 2016, the Board and the City Council, respectively, approved the Riverside Public Utilities (RPU) Fiscal Policies which incorporated the Cash Reserve Policy in Appendix A. The approved policies documented and adopted financial goals for both the water and electric utilities and established policies for long-term, as well as day-to-day operations of both utilities. The policies cover a number of areas including financial reporting, cash reserves, operating and capital budgeting, debt management, investments, risk management, financial planning, and others.

On June 25, 2018, and July 24, 2018, the Board of Public Utilities (Board) and the City Council, respectively, updated Riverside Public Utilities Fiscal Policies and the Cash Reserve Policy to:

1. Remove the separate appendix for the RPU Debt Management Policy as it was no longer needed;

2. Update the Cash Reserve Policy to reflect the establishment of a Dark Fiber Designated Reserve to accumulate proceeds from fiber leasing activity and account for expenditures of the dark fiber program; and

3. Include the use of the Line of Credit to the Cash Reserve Policy as an alternative to holding cash reserves to meet its target minimum reserve level;

    a. An LOC is a low-cost financial tool available to entities with strong credit ratings that provides flexibility and operating liquidity similar to cash reserves if there is an emergency need.
    b. The LOC allows RPU to reduce the rate impact to customers by enabling RPU to spend cash reserves on capital projects while the LOC is used in lieu of cash to meet the overall liquidity and reserve levels necessary to maintain RPU's strong bond ratings.

On July 19, 2021, the Board's Customer Relations/Finance Committee requested information on Riverside Public Utilities (RPU) uses of bond financing for capital project expenditures inclusive of a discussion on the use of bond financing for capital improvement projects that include RPU staff labor costs.

DISCUSSION:

The attached presentation includes an introduction to the bond financing life cycle used at RPU. The bond financing life cycle consists of capital planning, asset capitalization, funding considerations, municipal bond issuance, and debt management. Throughout the presentation, each component of the cycle is discussed inclusive of the applicable fiscal policies. Each of these fiscal policies are available to the public online at the link provided below:

RPU Fiscal Policy (Attachment 1):
http://www.riversidepublicutilities.com/about-rpu/pdf/RPU%20Fiscal%20Policies-%20Reserve%20UPDATE%209-7-2021%20Final.pdf

The City's Multi-Year Capital Planning Fiscal Policy (Attachment 2):
https://www.riversideca.gov/finance/PDF/2018/Multi-Year%20Capital%20Planning.pdf

Debt Management Policy (Attachment 3):
https://www.riversideca.gov/finance/PDF/2018/Final%20Debt%20Mgmnt%20Policy%201-2017.pdf

Use of bond financing for RPU labor is included in the RPU Fiscal Policy, Asset Capitalization inclusive of installation costs:

> **Asset Capitalization**
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> Capitalization policies establish the minimum cost that shall be used to determine the capital assets that are to be recorded in RPU's annual financial statements.
>
> As a policy, assets with an acquisition value of $5,000 or more and a useful life of more than one year are capitalized, except for those assets that are capitalized at lower amounts due to industry standards, such as electric and water meters, and transformers. Acquisition value includes the cost of the equipment and any associated costs incurred to make the equipment ready for service in the purpose for which it was intended, including installation costs. Intangible assets, such as software, that cost more than $100,000 with useful lives of at least three years are capitalized at cost.

The RPU policy, to include the cost of labor directly related to the implementation of the asset, is in alignment with the Financial Account Standards Board Source of Authoritative (FASB ASC) generally accepted accounting principles (GAAP) and the established regulatory accounting and financial reporting requirements set forth by the Federal Energy Regulatory Commission (FERC).

The generally accepted accounting principles (GAAP) requires the capitalization of costs associated with the acquisition or construction of property, plant, and equipment (PPE). The cost of a capital asset should include all charges necessary to place the asset into its intended location and condition for use, which includes internal labor. In alignment with the GAAP principles is FASB ASC, 970-360-20 and 970-160-25-3.

> **Application of internal resources**
>
> Governments sometimes apply internal resources (such as salaries) to acquire, construct, develop, or improve capital assets. It is recommended that the amount capitalized include both *project costs* (costs directly attributable to a specific asset) and *indirect project costs* (a proportionate share of costs clearly related to the construction, development, or improvement of capital assets as a group, but not to the construction, development, or improvement of a specific capital asset).[36]

36. This recommendation is modeled on private-sector guidance for the capitalization of real estate project costs (FASB ASC, 970-360-20 and 970-360-25-3), which identifies indirect project cost as those "incurred after the acquisition of the property, such as construction administration (for example, the costs associated with a field office at a project site and the administrative personnel that staff the office), legal fees, and various office costs, that clearly relate to projects under development or construction. Examples of office costs that may be considered indirect project costs are cost accounting, design, and other departments providing services that are clearly related to real estate projects."

According to FERC, the components of construction costs that can be capitalized include labor. Labor includes the pay and expenses of employees of the utility engaged on construction work, and related workmen's compensation insurance, payroll taxes and similar items of expense.

Bond Funds or Cash for RPU Labor for Capital Improvement Projects

The initial discussion on the potential fiscal impact using the adopted Capital Improvement Project budget uses percentage estimates for RPU Labor costs and an estimated percentage of bond funded Capital Projects. If the Board of Public Utilities and City Council direct a change to the fiscal policy to use cash vs bond financing for the full cost of capital asset installations, additional analysis would need to be provided to demonstrate the impact on the Electric and Water funds as well as any anticipated impacts to customer rates.

STRATEGIC PLAN ALIGNMENT:

This item contributes to Strategic Priority No. 6 *Infrastructure, Mobility & Connectivity* and Goal No. 6.2. - Maintain, protect, and improve assets and infrastructure within the City's built environment to ensure and enhance reliability, resiliency, sustainability, and facilitate connectivity.

This item aligns with EACH of the five Cross-Cutting Threads as follows:

1. **Community Trust** – The use of bond proceeds to finance capital expenditures supports the City of Riverside's Multi-year Capital Planning Fiscal Policy, which establishes transparent fiscal guidelines for project planning to ensure the trust and interest of RPU ratepayers is upheld.

2. **Equity** – Using bonded indebtedness to fund long-term capital projects ensures generational equity. The repayment of the cost of the facility (20 to 30 years) is made by the generation of ratepayers that receive the actual benefits of the project.

3. **Fiscal Responsibility** – Proactive planning and flexibility allows the Utility to enter the bond market at the most advantageous time in terms of cost of capital and availability of resources.

4. **Innovation** – Ensuring accessibility to the tax-exempt capital securities market allows Riverside to expand and upgrade to meet the future needs of its ratepayers.

5. **Sustainability & Resiliency** – Sound analysis and consideration of all funding options are the key to Riverside's resilient and sustainable debt portfolio.

<u>FISCAL IMPACT</u>:

There is no fiscal action associated with the Bond Financing informational update.

The fiscal impact of funding internal labor for capital projects with cash versus including the costs in the approved bond financing is illustrated with the following example. Using an assumption for RPU's annual capital budget equal to $25M and the average cost of internal labor is 7% of the total project cost (range 5%-10%), the annual fiscal impact to fund with cash is $1,750,000 compared to an annual debt service payment of approximately $120,000. There is a significant difference between the cash requirements of the two methodologies. Further detailed analysis would be most appropriate during the next electric and water rate plan analysis. Making the change in methodology during the current rate cycle could have an impact on the utility's ability to meet is target reserve levels, provide funding for unfunded projects and potentially require RPU to exercise its line of credit in the water fund. The impacts of the Covid pandemic and slowed growth rates in demands coupled with increase challenges in the collection of billed revenue have contributed to increasing pressure on cash balances.

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Attachments:

1. RPU Fiscal Policies – Reserve Update
2. Multi-Year Capital Planning
3. Final Debt Management Policy
4. 10/18/2021 Customer Relations/Finance Committee Draft Minutes
5. Presentation