



RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES

DATE: NOVEMBER 9, 2020

ITEM NO: 8

SUBJECT: RIVERSIDE PUBLIC UTILITIES CASH RESERVE POLICY UPDATE

ISSUE:

Receive this update on the Riverside Public Utilities Cash Reserve Policy.

RECOMMENDATION:

That the Board of Public Utilities receive this update on the Riverside Public Utility's Cash Reserve Policy, funds and use of funds.

BACKGROUND:

Policy History

On December 18, 2015 and March 22, 2016, the Board of Public Utilities (Board) and the City Council, respectively, approved the Cash Reserve Policy. On May 23, 2016, and July 26, 2016, the Board and the City Council, respectively, approved the existing 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 January 10, 2017, the City Council adopted the City's existing Debt Management Policy to satisfy the requirements of Senate Bill (SB) 1029.

On May 22, 2017 and July 11, 2017, the Board and City Council, respectively, approved the Dark Fiber Leasing Program, which included establishing uniform lease rates for the use of the dark fiber infrastructure, physical and cyber security policies, a master fiber lease license agreement, and a new cost center within the Electric Fund for related expenses and revenue with an appropriation of \$1,800,000 for the dark fiber program construction and management activities. The Board and City Council also approved the transfer of \$1,800,000 to a new dark fiber designated reserve to fund leased fiber activities.

On May 22, 2018, the City Council approved rates that include the use of a Line of Credit (LOC) as part of the 5-Year Rate proposal to keep utility rates as low as possible. Utilizing a LOC reduced

the electric and water rates by approximately 1% and 3%, respectively. A 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. 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 June 25, 2018 and July 24, 2018, the Board and City Council, respectively, approved the updated RPU Fiscal Policies and Cash Reserve Policy which included providing a reference and link to the City's Debt Management Policy within the RPU Fiscal Policies, removing the separate appendix for a RPU Debt Management Policy, including the Dark Fiber Designated Reserve in the Cash Reserve Policy, and adding the use of the LOC to the Cash Reserve Policy.

DISCUSSION:

Importance of Reserve Policy

Properly designed reserve policies send a positive signal to ratepayers, investors, and regulatory and credit rating agencies that the Board and City Council are committed to maintaining the long-term fiscal strength of RPU. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, rate stability, working capital, capital improvements and debt service, are consistent with best practices in the utility industry and are important to RPU as they help to:

- Maintain the short-term and long-term financial health of RPU.
- Maintain stable rates for customers and help ensure manageable rate increases.
- Fund unanticipated cost contingencies.
- Ensure funds exist for system improvements.
- Ensure cash exists for the timely payment of bills.
- Act as a significant positive credit factor in bond ratings.

Types of Reserves

RPU's reserves are either restricted or unrestricted and are classified into three categories:

1. Restricted Reserves

Restricted reserves are established and utilized for narrowly defined purposes as specified by legal restrictions, bond covenants, and other regulations or ordinances.

The restricted reserves are as follows:

Restricted Reserves	Electric	Water
San Onofre Nuclear Generating Station ("SONGS") Decommissioning	√	
Regulatory Requirements Reserve	√	
Bond Proceeds to Fund Capital Projects	√	√
Bond Redemption Reserve (Debt Service)	√	√
Electric Public Benefits Fund	√	

Water Conservation Fund		√
-------------------------	--	---

2. Unrestricted, Designated Reserves

Designated reserves are that portion of unrestricted reserves that meet specific purposes set aside by the Board and City Council. Designated reserves may be held for specific capital and operating purposes.

The unrestricted, designated reserves are as follows:

Unrestricted- Designated Reserves	Electric	Water
Customer Deposits	√	√
Additional Decommissioning Liability	√	
Electric Reliability	√	
Mission Square Improvements	√	
Capital Repair/Replacement	√	√
Recycled Water		√
Property		√
Dark Fiber	√	

3. Unrestricted, Undesignated Reserves

Undesignated reserves are the remaining unrestricted reserves that may be used for any lawful purpose and have not been designated for specific capital and operating purposes.

The unrestricted, undesignated reserves are as follows:

Unrestricted- Undesignated Reserves	Electric	Water
Operating (Working Capital)	√	√
Rate Stabilization	√	√
Emergency Capital	√	√
System Capital Improvements	√	√
Debt Service	√	√

Unrestricted, Undesignated Reserve Policy

RPU will have sufficient unrestricted, undesignated reserves to maintain or improve its credit ratings, ensure that operating and maintenance costs will be paid in a timely manner, to pay debt service obligations, and to invest in needed capital improvements and equipment replacement on a timely basis. In addition, RPU will maintain sufficient reserves to minimize rate increases due to market volatility, weather impacts on demands, emergencies (such as natural disasters), and regulatory changes.

The Cash Reserve Policy outlines the appropriate types and target (minimum) and maximum levels of unrestricted, undesignated reserves as follows:

Unrestricted – undesignated Reserves	Purpose	Target (Minimum) Calculation	Rationale	Maximum Amount	Electric	Water
Operating Reserve (Working Capital) - Operations & Maintenance, including Power Supply Costs	Ensures sufficient resources to pay budgeted operating, maintenance expenses, including power supply costs, recognizing the timing difference between payment of expenses and receipt of revenues.	Equal to 60 days of operating expenses based on the most recent audited financial statements.	Billing and collection cycle is 60 days – difference between delivery of service and receipt of payment.	Equal to 90 days of operating expenses based on the most recent audited financial statements.	✓	✓
Rate Stabilization	Mitigate rate shock due to temporary and transitional regulatory changes, loss of a major resource, sharp demand reduction or market volatility.	10% of Operating Revenues	Based on low-end of risk quantification for power cost uncertainty due to load reduction, market energy price fluctuations, unit contingencies, transmission costs, and regulatory mandates.	20% of Operating Revenues	✓	✓
		7% of Operating Revenues	Based on historic fluctuation of retail sales from year to year due to unforeseen events (eg. recession, drought).	15% of Operating Revenues	✓	✓

Capital - Emergency	Provide funds to ensure ability to repair system after an emergency or natural disaster such as a flood, earthquake or major windstorm	1% of depreciable capital assets as reported on the most recent audited financial statements.	Consistent with APPA guidelines for emergency reserves. Provides funds to pay for needed expenditures to be reimbursed by FEMA or other sources	2% of depreciable capital assets as reported on the most recent audited financial statements.	✓	✓
----------------------------	--	---	---	---	---	---

Capital – System Improvements	Provide funds to ensure continuity of construction over fiscal years to be reimbursed by bond proceeds or other resources.	6 months of the following year's approved Capital Improvement expenditures (CIP).	Provides sufficient funding to meet planned capital expenditures – recognizing the time to procure funding (e.g., bond sale, grant)	9 months of the following year's approved Capital Improvement expenditures (CIP).	✓	✓
Debt Service	Ensure ability to make debt service payments in an extreme event that may impact RPU's ability to provide services, thus impacting revenues at a time critical infrastructure repairs are needed to restore systems.	Maximum debt service payment (semi-annual) in the upcoming fiscal year.	Prevent an event where RPU would be unable to pay its debt service.	Maximum debt service payment (semi-annual) in the upcoming fiscal year.	✓	✓

While these areas of consideration were evaluated in order to determine the appropriate reserve levels, RPU will maintain such monies pooled in each utility's unrestricted, undesignated reserve. These reserve allocations are consistent with industry standards for similarly rated electric and water utilities. Each component of the reserves is sized at less than the maximum possible exposure for each component because it is unlikely several of the risks each enterprise faces would materialize simultaneously.

Line of Credit

RPU may obtain and utilize a LOC as an alternative to holding cash reserves to meet its target minimum reserve level as prescribed. A LOC is a low-cost financing arrangement between a bank and RPU that establishes an available amount of credit that RPU can draw on if needed. Utilizing a LOC to augment RPU's cash reserves will benefit RPU during periods of capital spending allowing RPU to utilize cash reserves on capital projects and reduce rate impacts to customers, while remaining in compliance with target minimum reserve levels. RPU does not plan to draw on the LOC. Instead, it provides flexibility and operating liquidity similar to cash reserves if there is an emergency need and also allows RPU to meet the overall liquidity and reserve levels that support RPU's strong credit ratings. The size of the line of credit will be determined as part of the financial planning process, taking into account forecasted revenues and other funding sources, timing of debt issuance, as well as projected fiscal performance to meet long-term financial goals. Should the Board and City Council decide to no longer utilize a LOC as a reserves balance tool, staff will provide the financial planning and increase in rates necessary to build back cash reserves to minimum required targets.

On January 14, 2019 and on January 22, 2019, the Board and City Council, respectively, approved and RPU subsequently obtained a single LOC for the Electric and Water Utilities in an aggregate amount of \$60 million, with \$35 million allocated to the Electric Utility and \$25 million allocated to the Water Utility.

Withdrawal and Replenishment of Reserves

RPU treats the targeted reserves as practical minimums and allow reserves to increase or decrease as necessary within the minimum and maximum prescribed levels.

To the extent that unrestricted, undesignated reserves are above the target and below the maximum, the Board and City Council have the flexibility to direct staff to utilize those available funds to pay for capital projects (reducing the need for future debt), pay down unfunded liabilities such as pension obligations, defease outstanding debt, or fund other strategic objectives. No other action by RPU would be required if reserves are between the minimum and maximum level unless directed by the Board and City Council.

If reserve funds exceed the maximum level, RPU would seek Board and City Council approval to use the excess to finance capital improvements on a pay-as-you-go basis, pay down existing debt, offset other long-term liabilities such as pension obligations, reduce rates or fund other strategic initiatives.

Reserve levels below the minimum targeted reserves will leave RPU exposed to significant operational risks. Should RPU draw down reserves below the minimum targeted level, RPU will implement plans to return reserves to their minimum targeted levels within three (3) years. Such plans will be provided within 12 months.

Reporting and Oversight

Reserve levels are monitored throughout the fiscal year and reported in the monthly and quarterly financial reports. Reserve target (minimum) and maximum levels are analyzed annually and an over/under reserve determination is made in conjunction with year-end financial results. These results are reported to the Board and City Council as part of the year-end financial report presentation. Should unrestricted designated or undesignated reserve levels need adjustment due to new risk factors due to changes in the industry, these will be brought to the Board and City Council as part of the year-end report.

The Policy is to be reviewed annually, and updated (at a minimum of every three years) if there are material changes in the risk exposures or new conditions that require changes in reserve levels.

Next Steps

Staff expects to return to the Board by Late Spring 2021 for proposed updates to the Cash Reserve Policy in compliance with the three-year requirement.

FISCAL IMPACT:

There is no fiscal impact associated with this informational report.

Prepared by: Carlie Myers, Utilities Assistant General Manager/Business and Customer Services
Approved by: Todd M. Corbin, Utilities General Manager
Approved by: Al Zelinka, FAICP, City Manager
Approved as to form: Gary G. Geuss, City Attorney

Certifies availability
of funds: Edward Enriquez, Chief Financial Officer/City Treasurer

Attachments:
1. Cash Reserve Policy
2. Presentation