



RIVERSIDE PUBLIC UTILITIES

Customer Relations/Finance Committee

CUSTOMER RELATIONS/FINANCE COMMITTEE

DATE: JUNE 21, 2021

SUBJECT: APPROVAL OF UPDATED RIVERSIDE PUBLIC UTILITIES CASH RESERVE POLICY

ISSUE:

Recommend the Board of Public Utilities and City Council approve the updated Riverside Public Utilities Cash Reserve Policy.

RECOMMENDATION:

That the Customer Relations/Finance Committee forward a recommendation to the Board of Public Utilities to recommend the City Council approve the updated Riverside Public Utilities Cash Reserve Policy.

STRATEGIC PLAN 2025

On September 15, 2020, the City Council gave preliminary approval of the Riverside 2025 Vision Statement, Cross-Cutting Threads, Strategic Priorities, Indicators and Goals for the Envision Riverside 2025 Strategic Plan. The final Strategic Plan was approved by the City Council on October 20, 2020 and can be located online at <https://www.riversideca.gov/citymanager/strategic-plan-2025>

RPU's Fiscal Policies are aligned with the City Council's Strategic Plan 2025 Cross-Cutting Threads for:

Fiscal Responsibility - Riverside is a prudent steward of public funds and ensures responsible management of the City's financial resources while providing quality public services to all.

Sustainably and Resiliency - Riverside is committed to meeting the needs of the present without compromising the needs of the future and ensuring the City's capacity to persevere, adapt and grow during good and difficult times alike.

The Fiscal Policies also support the City Council Strategic Plan 2025 Priorities and Goals for:

High Performing Government:

Goal 5.4. Achieve and maintain financial health by addressing gaps between revenues and expenditures and aligning resources with strategic priorities to yield the greatest impact.

Infrastructure, Mobility & Connectivity:

Goal 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.

BACKGROUND:

Policy History

On December 18, 2015 and March 22, 2016, the Board of Public Utilities (Board) and the City Council approved the Cash Reserve Policy. On May 23, 2016, and July 26, 2016, the Board and the City Council 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 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.

On November 9, 2020, the Board received an update on the Riverside Public Utility's Cash Reserve Policy, funds, and use of funds. At this meeting, the Board requested a comparative analysis of RPU's cash reserve policies and the credit ratings compared to other similarly sized utility organizations in the region as well as an analysis of potential impacts from the Covid-19 pandemic to RPU's cash reserve. These items are addressed in the attached presentation.

DISCUSSION:

Reserve Policy Purpose

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.

Definitions of Reserves

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

1. Restricted Reserves (Restricted)

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 | | √ |

All reserves that are not limited by regulations are referred to as *Unrestricted Reserves*

2. Unrestricted, Designated Reserves (Designated)

Designated reserves are that portion of unrestricted reserves that meet specific purposes designated (established and approved) 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:

| 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)

Undesignated reserves are the remaining unrestricted reserves (funds that are not restricted by regulation nor designated for an approved purpose) 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:

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

Unrestricted, Undesignated Reserve Policy

The purpose of the Undesignated Reserve Policy is to ensure RPU has sufficient unrestricted, undesignated reserves to mitigate risk and provide stability through the following:

1. To maintain or improve its credit ratings,
2. To ensure that operating and maintenance costs will be paid in a timely manner,
3. To pay debt service obligations, and
4. 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 Policy outlines the appropriate types and provides minimum and maximum levels of unrestricted, undesignated reserves (Attachment 2). Each of the areas of undesignated reserves include considerations for evaluation to determine the appropriate reserve levels. RPU maintains 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's Fiscal Policy includes the ability to 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 which allow for lower borrowing costs that are realized in lower rates.

The size of the line of credit is determined as part of the financial planning process, considering 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 balancing 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 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 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 based on 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.

Updates to the Cash Reserve Policy

The updates to the Cash Reserve Policy are included in Attachment 1 and are summarized below:

1. Unrestricted, *Designated* Reserves

Additional Decommissioning Liability Reserve (electric fund only) – Reflects the increase in annual funding to the SONGS Additional Decommissioning Liability Reserve from \$1.6M to \$2.0M annually beginning in fiscal year 2020/21. On June 8, 2020 and June 16, 2020, the Board of Public Utilities and City Council approved this increase.

- ***Additional Decommissioning Liability Reserve*** (electric fund only) – Established to accumulate funds for the uncertainty of costs associated with the SONGS Decommissioning activities. These funds are in addition to RPU's funded trust held by the trustee (restricted reserve). The decommissioning funds held in the restricted reserve represent RPU's proportionate share of the independent Decommissioning Cost Estimate ("DCE"). If the DCE is increased, RPU will need to fund additional monies to the trust for decommissioning. On June 8, 2020 and June 16, 2020, the Board of Public Utilities and City Council, respectively, approved the increase in annual funding to the SONGS Additional Decommissioning Liability Reserve from \$1.6M to \$2.0M annually beginning in fiscal year 2020/21, due to an anticipated increase in the SONGS DCE. Annual funding of the designated reserve is currently \$1.6M which equaled the amount contributed annually to meet RPU's proportionate share of the restricted decommissioning trust. This amount can be evaluated and adjusted as needed.

2. Unrestricted, *Undesignated* Reserves

Operating (Working Capital) – The calculation excludes operating and maintenance expenses funded with restricted or unrestricted, designated reserves.

- **Target (Minimum) Level:**
 - Electric: Equal to 60 days of operating and maintenance expenses, including power supply costs, and less operating and maintenance expenses funded with restricted or unrestricted – designated reserves, based on the most recent audited financial statements.
 - Water: Equal to 60 days of operating and maintenance expenses and less operating and maintenance expenses funded with restricted or unrestricted – designated reserves, based on the most recent audited financial statements.
- **Maximum Level:**
 - Electric: Equal to 90 days of operating and maintenance expenses, including power supply costs, and less any operating and maintenance expenses funded with restricted or unrestricted – designated reserves based on the most recent audited financial statements.
 - Water: Equal to 90 days of operating and maintenance expenses and less operating and maintenance expenses funded with restricted or unrestricted – designated reserves, based on the most recent audited financial statements.

System Improvements Capital – The calculation excludes capital improvement expenditures funded with restricted or unrestricted, designated reserves other than bond proceeds. The calculation will also change from using the following year's capital improvement program (CIP) to the three-year average CIP including the previous year expenditures, current year budget, and following year budget.

- Target (Minimum): 6 months of the following years three year average of approved ongoing capital improvement plan expenditures or budget including previous year audited actual expenditures, current years original budget expenditures, and the following years original budget expenditures for each Utility. The calculation is exclusive of any capital improvement expenditures funded with restricted or unrestricted – designated reserves other than the unspent bond proceeds restricted reserve.
- Maximum Level: 9 months of the following years three year average of approved ongoing capital improvement plan expenditures or budget including previous year audited actual expenditures, current years original budget expenditures, and the following years original budget expenditures for each Utility. The calculation is exclusive of any capital improvement expenditures funded with restricted or unrestricted – designated reserves other than the unspent bond proceeds restricted reserve.

The Chief Financial Officer/City Treasurer concurs with the updates to the RPU Fiscal Policies.

FISCAL IMPACT:

While the approval of the Cash Reserve policy updates does not have an immediate direct impact on the current financial health of RPU, the adoption of the policies sets guidelines and parameters for ongoing activities that will direct the financial management of RPU for the future.

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Approved as to form: Kristi J. Smith, Interim City Attorney

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

Attachments:

1. RPU Fiscal Policies, including Cash Reserve Policy (redline)
2. Summary of Undesignated Reserve Levels
3. Presentation