

WATER | ENERGY | LIFE



PUBLIC UTILITIES

Cash Reserve Policy

Adopted on March 22, 2016

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1. Introduction & Purpose

Riverside Public Utilities (“RPU”) is a department of the City of Riverside and manages the City’s water and electric utilities. RPU provides high quality and reliable services to over 109,000 metered electric customers and approximately 65,000 metered water customers throughout the City of Riverside.

RPU is governed by the City Council and the Board of Public Utilities (the “Board”). The City Council sets financial management policies, as recommended by the Board. This Cash Reserve Policy (the “Policy”) is designed to establish guidelines to ensure the fiscal stability of RPU and provide guidance to RPU staff in the management of RPU’s finances.

Properly designed reserve policies send a positive signal to ratepayers, investors, and regulatory and credit rating agencies that the City is committed to maintaining the long-run fiscal strength of RPU. Strong and transparent financial policies, including maintaining prudent reserves for emergencies, rate stability, working capital and capital improvements, 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.

This Cash Reserve Policy describes the following reserves:

- Restricted Reserves,
- Unrestricted - Designated Reserves, and
- Unrestricted, Undesignated Reserves.

The policy sets target (minimum) and maximum levels for the unrestricted, undesignated reserves.

2. Definitions

RPU’s reserves are classified into three categories:

- Restricted Reserves,
- Unrestricted - Designated Reserves, and
- Unrestricted, Undesignated Reserves.

A. Restricted Reserves

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

- Decommissioning Fund for San Onofre Nuclear Generating Station (“SONGS”)
- Regulatory Requirements Reserve (Cap and Trade auction proceeds)
- Unspent Bond Proceeds
- Bond Redemption Reserve
- Electric Public Benefit Fund
- Water Conservation Fund

B. Unrestricted - Designated Reserves

Unrestricted, 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. Current unrestricted, designated reserves are as follows:

- ***Customer Deposits*** (electric and water funds) – Monies held on behalf of the RPU’s customers as required to be utilized if a customer fails to pay their utility bill. The amount held equals amounts collected from electric and water customers based on Board and Council adopted Electric and Water Rules.
- ***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 amount of decommissioning funds held in the restricted reserve are equal to RPU’s proportionate share of the independent Decommissioning Cost Estimate (“DCE”). If the DCE is increased, RPU will need to fund additional monies for decommissioning. Annual funding currently is \$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.
- ***Electric Reliability Fund*** (electric fund only) – Established to accumulate amounts received from retail customers through the Reliability Charge for the purpose of funding debt service for transmission and internal generation projects. Funding for this reserve will inherently fluctuate based on revenue received from customers, offset by approved debt service payments on transmission and internal generation projects.
- ***Mission Square Improvement Fund*** (electric fund only) – Established to accumulate funds for future major improvements to the Mission Square facility. Initial year will be funded by electric utility reserves in the amount of \$240,000, and future funding will be built with an annual contribution equal to 2% of the building value up to a maximum reserve equal to 25% of the building value.

- **Capital Repair/Replacement Reserve** (electric and water funds) – Established to accumulate amounts for repairs and replacement of facilities, vehicles, and technology outside of the Capital Improvement Program. Examples would be roof replacement, vehicle replacement, desktop technology replacement, etc. Funding for this reserve will be built over a three year period based on a historical 10-year averages of replacement costs.
- **Recycled Water Reserve** (water fund only) – Established to set aside funds for a recycled water program. Initial funding was from a legal settlement from the City.
- **Property Reserve** (electric and water funds) - Established to accumulate all proceeds from surplus property sales to be used in the future for the purchase of property needed for operations, or for other long-term capital assets/projects. Funding is from accumulated and future proceeds from the sale of surplus property.

RPU will use designated reserves to mitigate the impacts of known and impending exposures. The withdrawal and replenishment of Council/Board approved designated reserves and their allowable uses will be tracked individually, but the specific use of designated reserves falls outside the scope of this policy and is subject to Board and Council approval.

C. 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 following Unrestricted, Undesignated Reserve Policy addresses the levels, use and replenishment of this type of unrestricted reserves.

3. **Unrestricted, Undesignated Reserve Policy**

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

Overall Policy Statement

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.

Operating (Working Capital)

- Definition and Purpose: Ensures sufficient resources to pay budgeted operating and maintenance expenses, including power supply costs, recognizing the timing differences between payment of expenditures and receipt of revenues.
- Target (Minimum) Level:

- Electric: Equal to 60 days of operating and maintenance expenses, including power supply costs, based on the most recent audited financial statements.
- Water: Equal to 60 days of operating and maintenance expenses based on the most recent audited financial statements.
- Maximum Level:
 - Electric: Equal to 90 days of operating and maintenance expenses, including power supply costs, based on the most recent audited financial statements.
 - Water: Equal to 90 days of operating and maintenance expenses based on the most recent audited financial statements.
- Events or Conditions Prompting Use of the Reserve: This Reserve may be routinely used by RPU to cover temporary cash flow deficiencies caused by timing differences between revenues and incurring expense obligations and unexpected increases in operating expenses.

Rate Stabilization

- Definition and Purpose: Mitigates rate shock due to temporary and transitional regulatory changes, loss of a major resource, sharp demand reduction or market volatility.
- Target (Minimum) Level:
 - Electric: 10% of operating revenues, reflecting the low-end of the risk quantification for power cost uncertainties due to load reduction, market energy price fluctuations, unit contingencies, transmission costs, and regulatory mandates.
 - Water: Equal to 7% of operating revenues, reflecting the low-end of historic fluctuations in retail sales from year to year due to unforeseen events (e.g., recession, drought).
- Maximum Level:
 - Electric: 20% of operating revenues, reflecting the high-end of the risk quantification for power cost uncertainties due load reduction, market energy price fluctuations, unit contingencies, transmission costs, and regulatory mandates.
 - Water: Equal to 15% of operating revenues, reflecting the high-end of projected fluctuations in retail sales from year to year due to unforeseen events (eg. recession, drought).
- Events or Conditions Prompting Use of the Reserve: This Reserve may be used to cover unexpected decreases in operating revenues and increases in operating costs to reduce year-over-year volatility in needed rate increases, as approved by Board and City Council.

Emergency Capital

- Definition and Purpose: Provides funds to ensure ability to repair system after an emergency or natural disaster such as a flood, earthquake or major windstorm

- Target (Minimum) Level: Equivalent to approximately 1% of the value of depreciable capital assets for the Electric and Water Utility, as reported on the most recent audited financial statements.
- Maximum Level: Equivalent to approximately 2% of the value of depreciable capital assets for the Electric and Water Utility as reported on the most recent audited financial statements.
- Events or Conditions Prompting Use of the Reserve: An emergency event requiring the need to fund necessary capital expenditures (e.g. natural disaster causing treatment facility closure, conveyance disruption, loss of substation or generating asset, etc.) as approved by Board and City Council.

System Improvements Capital

- Definition and Purpose: Provide funds to ensure continuity of construction over fiscal years to be reimbursed by bond proceeds or other resources.
- Target (Minimum): 6 months of the following years approved capital improvement expenditures for each Utility.
- Maximum Level: 9 months of the following years approved capital improvement expenditures for each Utility.
- Events or Conditions Prompting use of the Reserve: This Reserve may be used to fund capital expenditures during the year as funding resources are acquired (e.g., bond proceeds, capital contributions, revenues, etc.), as approved by Board and City Council

Debt Service

- Definition and Purpose: Ensures 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. The Debt Service Reserve is intended to prevent an event where RPU would be unable to pay its debt service obligations during such emergencies, or extreme market disruptions.
- Target (Minimum) and Maximum Level: The maximum debt service payment (semi-annual) in the upcoming fiscal year for each Utility.
- Events or Conditions Prompting the Use of the Reserve: The Debt Service Reserve may be utilized in the event RPU is otherwise unable to pay its debt service obligations. It is not anticipated that RPU would ever utilize these reserves absent a significant disaster or extreme market disruption, and only with the approval of Board and City Council.

General Provisions

While these areas of consideration were evaluated in order to determine the appropriate size of the reserves, 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.

4. Withdrawal & Replenishment of Reserves

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

To the extent that unrestricted, undesignated reserves are above the target and below the maximum, the Board and 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 for other strategic purposes.

Reserve levels below the minimum targeted reserves would 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 twelve (12) months.

5. Reporting and Oversight

Reserve levels will be monitored during the fiscal year and reported in the monthly and quarterly financial reports. Reserve target (minimum) and maximum levels will be analyzed annually and an over/under reserve determination shall be made in conjunction with year-end financial results. These results will be 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 will be reviewed annually, and updated (at a minimum once every three years) if there are material changes in the risk exposures or new conditions that require changes in reserve levels.

6. Conclusion

This Policy provides directives to RPU management and staff for decisions and recommendations related to the financial profiles of RPU.

In its most abbreviated form, the Policy sets targets for reserve balances based on the risk profiles of the Electric and Water utilities individually and establishes tolerable maximums. The Policy also provides recommended actions when reserves deviate from the target levels.