

FOR BOARD ACTION

Agenda Item # 9.

Meeting Date:

1/31/06

SUBJECT: Financial Liquidity Policy -- Paragraph #4 - Special Capital and Major Maintenance Reserve

PREPARED BY: Curt Kraft, Director of Corporate Services

ITEM DESCRIPTION:

In June of 2005 the Board approved an update to a policy that provides for different types and levels of reserves needed to cover various risks and needs. One of the types set up was a Special Capital and Major Maintenance Reserve. The purpose of that reserve is to set aside monies for specific projects that would minimize or eliminate the need for external financing. (A copy of the Board Policy is attached.)

In 2005 the Board approved moving forward with installation of emission equipment at SLP as part of the 2005-2030 Electric infrastructure plan. The 2006 budget has \$ 750,000 for preliminary engineering work to be done this year and \$ 35,000,000 of external expenses in 2007-2009.

Based on the Clean Air Act, RPU has been receiving SO2 emission credits since 2000. Every year any excess credits have been sold in the SO2 market and the funds have been deposited in the general working funds of the Electric Utility. Also under the new agreement with MMPA, where we are selling energy into the market; we are receiving a credit for the allowances consumed each day because of those sales.

Staff recommends that the proceeds from the sale of excess SO2 allowances, including the proceeds from the December 2005 transaction and credits from the energy market activity, be put in a special capital reserve to help fund the cost of the emissions control project.

UTILITY BOARD ACTION REQUESTED:

Using paragraph #4 of the Board Financial Liquidity Policy as a guide, direct staff to setup a special reserve that would be funded by the SO2 excess allowance sales and energy market credit activity. These funds would be used for the cost incurred on the emissions project at SLP.


General Manager


Date

ROCHESTER PUBLIC UTILITIES

ROCHESTER PUBLIC UTILITIES
BOARD POLICY STATEMENT

POLICY SUBJECT: Financial Liquidity Policy

POLICY OBJECTIVE:

The Board recognizes the need to develop access to liquid reserves, using financial targets as a guide to determining future revenue requirements. Funding levels may vary as circumstances dictate.

POLICY STATEMENT:

The Board intends to establish the types and levels of reserves needed to cover various risks and needs. These reserves, and their levels, are intended as guides only, and are meant to apply under normal circumstances. However, the Board intends to work with the General Manager to take the necessary steps to attain the reserve levels established in this board policy. The required reserves may be a combination of internally financed reserves and access to external liquid reserves.

1. Working Funds Reserve. Ordinarily, this reserve is used to handle the day-to-day cash flow activities of the utilities. The target amount for this reserve is forty-five days of the current year's budgeted annual operating expenses plus in lieu of tax payments. Transfers and replenishments between this and the other reserves occur as needed.
2. Contingency Reserve. This reserve is used for emergency circumstances as needed, and as determined by the Board and the General Manager. (Examples of emergency circumstances include: Loss of a large revenue customer; Significant increase in fuel prices; Loss of a generating unit for a long time at a critical time, etc.) The amount of this reserve is based on the estimated financial impacts of a single proxy emergency event.
3. Capital and Major Maintenance Reserve. This reserve is meant to pay for that portion of the current year's external expenditures for typical annual capital and major maintenance projects that is *not* externally financed and that the current year's revenues cannot finance. This reserve will equal fifty percent of the average of the external expenditures for typical annual capital and major maintenance projects that is not externally financed for the first two years in RPU's current five year capital and major maintenance plan.
4. Special Capital and Major Maintenance Reserve. This reserve is meant to pay for that portion of significant capital and major maintenance projects' external expenditures that is *not* externally financed. There will be one reserve for each significant project. Each reserve will be funded over the number of years, and up to a certain amount of the project's planned total expenditures, as determined by

the Board and the General Manager for each significant project. These reserves will be set up and used only as needed.

The General Manager will have the authority to move funds among all the reserves. When practical, the General Manager will consult with the Board before moving funds involving the *Contingency Reserve*. In that case he will report to the Board as soon as practical when he authorized such transactions without first informing the Board.

Ordinarily, the order of replenishment among these reserves is as follows:

1. Working Funds Reserve
2. Capital and Major Maintenance Reserves
3. Contingency Reserve
4. Special Capital and Major Maintenance Reserves

Annually at budget time the General Manager will recommend funding levels for each reserve, the percentage variation from the targets that should be considered acceptable, timeframes within which to expect to reach targeted levels, etc.

This policy is intended as a guide only. The reserve levels are meant to be long-term average balances. It will usually take several months to achieve the revised reserve levels this policy requires (based on annual recalculations due to updates to RPU's long term plans). There will be times when the reserve balances will fall outside the established acceptable levels. The General Manager will advise the Board on various matters related to the reserves, such as whether a current deviation from the established acceptable levels are expected to be short-term or whether any action needs to be taken, etc.

EFFECTIVE DATE OF POLICY:

April 27, 1999

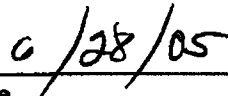
DATE OF LAST POLICY REVISION:

June 28, 2005

POLICY APPROVAL:



Board President



Date