

**FOR BOARD ACTION**

Agenda Item # 9

Meeting Date:

5/31/05

**SUBJECT:** Proposed Revision to RPU's Cash Reserves Policy**PREPARED BY:** Doug Noga, Manager of Finance and AccountingITEM DESCRIPTION:

In 1999 RPU established a cash reserves policy. Since then we have reviewed the policy and would like to propose some improvements in it.

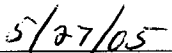
The bond rating agencies have evaluated RPU. One of the few significant factors that they said worked against a better rating for RPU was what they consider our low levels of cash reserves. In a 2004 peer study done by Fitch, RPU's cash reserves was less than fifty percent of the median value for the group. Also in 2004 RPU hired a consultant to recommend a framework for a revision to RPU's cash reserves. (In addition, in 2004 SMMPA hired an outside firm to review and make recommendations to their cash reserves policy. RPU referred to SMMPA's study while working with our consultant.)

The attached policy is the proposal we have put together for you. It incorporates the concepts from our consultant's study, and gets the amount of the reserves up to the levels the bond rating agencies were hoping to see. Also attached is the current policy for comparison.

One of the large assumptions that this policy makes is that SMMPA carries the power supply risk for RPU's load under CROD, and therefore it is SMMPA, not RPU, that needs to incorporate that risk into a cash reserves policy.

Our current five year plan in the electric utility will get RPU quite close to the required amounts under this proposed policy.

  
General Manager

  
Date

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ELECTRIC	(\$ in thousands)				
	2005	2006	2007	2008	2009
Beg. Cash	\$14,217	\$13,644	\$12,052	\$10,878	\$16,362
Net Change in Cash	(\$573)	(\$1,592)	(\$1,174)	\$5,484	\$3,383
End Cash	<u>\$13,644</u>	<u>\$12,052</u>	<u>\$10,878</u>	<u>\$16,362</u>	<u>\$19,745</u>
Rate Change	3.00%	2.00%	2.00%	2.00%	2.00%

WATER	(\$ in thousands)				
	2005	2006	2007	2008	2009
Beg. Cash	\$1,314	\$784	\$1,527	\$1,865	\$2,184
Net Change in Cash	(\$530)	\$743	\$338	\$319	\$505
End Cash	<u>\$784</u>	<u>\$1,527</u>	<u>\$1,865</u>	<u>\$2,184</u>	<u>\$2,689</u>
Rate Change	5.00%	3.00%	3.00%	3.00%	2.00%

	7102	7356	7623	7900
	369	382	395	410
	0.03	0.03	0.03	0.02
	213	221	229	158

Along with the proposed policy is a couple charts showing the proposed dollar amounts over the next five years for each utility calculated in accord with the proposed policy.

UTILITY BOARD ACTION REQUESTED:

This is a discussion item only. Unless your feedback indicates otherwise, we plan to bring this back to you at the June, 2005 board meeting for official adoption.

\_\_\_\_\_  
General Manager

\_\_\_\_\_  
Date

# DRAFT

## 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.

### **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.

### **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.

(Currently we are using a cool summer as the representative event for the electric utility, and a wet summer for the water utility. We will measure these events based on the variance in sales from budget in cool or wet summers, and the impact that has on net operating income in the electric utility, and the impact that has on gross retail revenues in the water utility. We are currently using 2004 as our standard for the variance in sales from budget for a cool or wet summer.)

### **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

# DRAFT

financed for the first two years in RPU's current five year capital and major maintenance plan.

## **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: **DRAFT** April 27, 1999

DATE OF LAST POLICY REVISION: June 28, 2005

POLICY APPROVAL:

\_\_\_\_\_  
Board President

\_\_\_\_\_  
Date

**ELECTRIC**

UNRESTRICTED RESERVES

	2005	2006	2007	2008	2009
<b>Financing of Working Funds:</b>					
Total Working Funds Needed	\$12,991,875	\$13,029,125	\$13,503,375	\$14,190,000	\$14,839,375
Line of Credit Funding for Working Funds	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000
Internal Cash Funding for Working Funds	\$7,991,875	\$8,029,125	\$8,503,375	\$9,190,000	\$9,839,375
Working Funds	\$7,991,875	\$8,029,125	\$8,503,375	\$9,190,000	\$9,839,375
Capital	\$6,743,250	\$6,743,250	\$6,743,250	\$6,743,250	\$6,743,250
Contingency	\$4,100,000	\$4,100,000	\$4,100,000	\$4,100,000	\$4,100,000
<b>Total</b>	<b>\$18,835,125</b>	<b>\$18,872,375</b>	<b>\$19,346,625</b>	<b>\$20,033,250</b>	<b>\$20,682,625</b>
Bandwidth of +/- 10%:					
-10%	\$16,951,613	\$16,985,138	\$17,411,963	\$18,029,925	\$18,614,363
exact	\$18,835,125	\$18,872,375	\$19,346,625	\$20,033,250	\$20,682,625
10%	\$20,718,638	\$20,759,613	\$21,281,288	\$22,036,575	\$22,750,888

**WATER**

	2005	2006	2007	2008	2009
UNRESTRICTED RESERVES					
Working Funds	\$819,250	\$842,875	\$859,875	\$912,625	\$927,125
Capital	\$1,441,000	\$1,441,000	\$1,441,000	\$1,441,000	\$1,441,000
Contingency	\$300,000	\$300,000	\$300,000	\$300,000	\$300,000
Total	\$2,560,250	\$2,583,875	\$2,600,875	\$2,653,625	\$2,668,125
Bandwidth of +/- 10%:					
-10%	\$2,304,225	\$2,325,488	\$2,340,788	\$2,388,263	\$2,401,313
exact	\$2,560,250	\$2,583,875	\$2,600,875	\$2,653,625	\$2,668,125
10%	\$2,816,275	\$2,842,263	\$2,860,963	\$2,918,988	\$2,934,938

ROCHESTER PUBLIC UTILITIES  
BOARD POLICY STATEMENT

POLICY SUBJECT:      Cash Reserve Policy

POLICY OBJECTIVE:

Rochester Public Utility operates and maintains fully integrated systems in the areas of electric and water services. The Board recognizes the need to develop cash reserves by 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 level of reserves needed to cover various uncertainties.

1.     Working Funds - These funds will be used to deal with the day to day cash flow activities of the utilities. The target balance for the fund is fifteen days of the current year's budget for operational expenditures. Transfers between this and the other reserves would occur as needed in order to have adequate funds on hand.
  
2.     Operating Reserves - This reserve is required to deal with unforeseen events that result in the loss of revenue or increases in operational expenditures. This reserve includes a base amount of the current year replacement/capital costs that are expected to be covered by current year revenues. When fully funded this reserve target would not exceed thirty days of current budgeted revenues, with fifteen days as a minimum.
  
3.     Financing /Capital Reserve - RPU's revenues are designed to provide for some, but not all of the current years' capital expenditures. This reserve is for future year's capital expenditures that are expected to exceed the base amount of capital expenditures that a single year's revenues could provide. This reserve would also include future debt service funding.
  
4.     Contingency Reserve - This reserve would provide resources for the self-insurance portion not covered by our property and liability coverage. It would also be funded for the unforeseen impact of regulatory policies, industry changes and other economic events. Management on an annual basis would recommend the funding level for this reserve.

RESPONSIBILITIES:

1.     The General Manager will have the authority to move funds among all the reserves except the contingency reserve. Any transactions will be reported to the Board with an explanation of the circumstances.



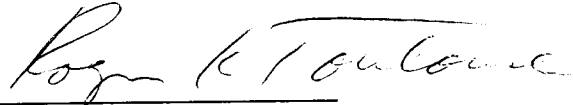
2. Prior approval from the Board would be required for any transaction involving the contingency reserve.
3. A minimum level of twenty five percent of targeted reserve balances would be required in any reserve account unless otherwise indicated in the reserve account or approved by the Utility Board.
4. The priority of replenishing the reserves would occur in this order: working funds, operating reserve, financing/capital reserve, and contingency reserve.
5. Operating and capital budgets have been used to set the initial reserve target levels. Other circumstances may impact if the reserves are actually funded at their target levels.
6. Management on an annual basis would recommend the funding levels for each reserve during the budget process.

EFFECTIVE DATE OF POLICY:

April 27, 1999

DATE OF POLICY REVISION:

POLICY APPROVAL:

  
Board President

5-6-99  
Date