
CITY OF ANAHEIM PUBLIC UTILITIES DEPARTMENT ORDER

115 - CASH AND FINANCIAL RESERVE POLICY

I. BACKGROUND

Department Order (D.O.) 115 establishes the Public Utilities Department's (Department or Utility) policy regarding financial reserves. A properly designed financial reserve policy sends a signal to policy makers, ratepayers, investors, regulatory agencies, credit rating agencies, and other stakeholders that the City is committed to maintaining the long-term financial strength of the Utility. Maintaining prudent reserves for emergencies, rate stability, working capital, and capital improvements is consistent with utility industry best practices and helps mitigate volatility in retail customer rates. Financial reserves for the electric and water utilities will vary from year to year based on many factors including revenues collected and operating and capital expenditures.

Utilities are subject to a variety of financial and operational risks, including fluctuations in energy and water sales, timing differences related to the payment of expenses and the receipt of revenues, significant maintenance costs, unplanned outages, new regulations, and other events. Maintaining prudent financial reserves provides the ability to draw down reserves should an unexpected event occur rather than increase indebtedness or increase rates.

Additionally, investors, ratings agencies, and banks evaluate the financial position of the Utility based, in part, on the Utility's liquidity, which is a measure of the ability to pay financial obligations as they come due. Financial reserves add credibility to the financial viability of the Utility and positively impact the Utility's credit ratings. Strong credit ratings help to minimize the cost of debt and increase the variety of financial options available to the Utility.

Financial reserves mitigate financial risk and help to:

- Maintain stable rates for customers
- Maintain the short-term and long-term financial position of the Utility
- Ensure funds exist for timely payment of financial obligations
- Ensure funds exist for system improvements
- Fund unanticipated cost contingencies
- Serve as a significant positive credit factor in bond ratings

This Financial Reserve Policy describes the following reserves:

- A. Restricted Reserves
- B. Unrestricted - Designated Reserves
- C. Unrestricted - Undesignated Reserves

II. FINANCIAL RESERVES

A. Restricted Reserves

1. Bond Fund (Unspent Bond Proceeds) (electric and water)
Bond proceeds obtained for the purpose of capital improvements or other purposes specified in bond documents shall be used to supplement, not replace, funding generated from rates and shall be spent within the time parameters established for the specific bonds issued. Expenditure of bond funds should be planned and allocated over multiple years in order to minimize the

- number of bond issuances and the costs associated therewith. Bond Funds are to be held and distributed by a third-party fiscal agent hired to act as a trustee of the fund.
2. **Bond Reserve Fund (electric and water)**
Some, but not all, debt issuances require the creation of a separately held reserve fund equal to the reserve requirement specified in the bond issue. Bond reserve funds are held by a trustee and are generally used in the last year of the debt repayment or to offset the amount of bonds needed for refunding the relative bond issue. The bond reserve fund will be maintained at the level required by bond covenants.
 3. **Bond Service Fund (electric and water)**
Bond resolutions require the establishment of a bond service fund by accumulating monthly one-sixth of the interest, which will become due and payable on the outstanding bonds within the next six months, and one-twelfth of the principal amount, which will mature and be payable on the outstanding bonds within the next 12 months.
 4. **Prepaid Purchased Power (electric)**
This fund represents prepaid power costs for fuel acquisition, power production costs, generating station operating and maintenance costs, and cap and trade compliance. Prepaid balances may be utilized to offset increased costs such as those incurred in the event of major power outages, increases in production costs, or increases in fuel costs thereby helping to mitigate the need for rate increases.
 5. **Provision for Decommissioning Costs (electric)**
Federal regulations require the Electric Utility to provide for the future decommissioning costs of its former ownership share of various generating stations and power plants. The Electric Utility has established a provision for decommissioning costs for various plants and the associated costs to restore their local environment to their original state. Separate irrevocable trust accounts will be established for amounts funded, and these amounts are classified as restricted assets.
 6. **Public Benefit Fund (electric)**
This fund supports community service-related programs including energy efficiency incentives, low income rate discounts, lighting incentives, and renewable energy for residential and business customers. The fund balance will fluctuate based on variations in revenue and the timing of Public Benefit project expenditures as required by law.
 7. **Reserve for Renewals and Replacements (electric)**
This reserve is established to accumulate funding for repairs and replacement of plant in service as required by various bond covenants.
 8. **Underground Conversion Funds (electric)**
Funds are accumulated through a surcharge on electric bills and used for the purpose of funding the Electric Utility's Underground Conversion Program, which improves electric system reliability by placing overhead power and Utility communication facilities underground. Funds collected through this surcharge may be used only for the Underground Conversion Program. The fund balance will fluctuate based on variations in revenue and the timing of undergrounding project expenditures. This fund may also be used to pay for bond issues used for the specific purpose of accelerating the underground conversion plan.

B. Unrestricted - Designated Reserves

Unrestricted, designated reserves represent the portion of unrestricted reserves set aside for specific purposes. The Utility's current unrestricted, designated reserves include:

1. **Customer Deposits (electric and water)** - Funds collected from and held on behalf of customers to be used if a customer fails to pay their utility bill.
2. **Rate Stabilization Account (RSA) (electric)** - These funds, as specified in the Rate Stabilization Adjustment Rate, provide operational and billing flexibility to mitigate material fluctuations in the cost of energy, loss of revenue, or unplanned costs including unexpected long-term loss of a generating facility, unplanned limits on the ability to transmit energy to the City of Anaheim, the impacts of legislative or environmental costs, or major disasters.

The RSA facilitates smoothing of rate adjustments in order to avoid substantial rate increases.

3. Rate Stabilization Account (RSA) (water) - This fund was established as a means to provide more stable retail water rates to customers and to maintain financial performance indicators and goals specified in bond covenants. Funding sources are described in the water rates, rules and regulations.

C. Unrestricted - Undesignated Reserves

Undesignated reserves represent the remaining unrestricted reserves that may be used for any lawful purpose and have not been designated for specific capital or operating purposes. Undesignated reserves help ensure sufficient resources are available to pay for budgeted operating and maintenance expenses including power and water supply costs, general maintenance, and administrative costs including payroll.

Many of the Department's customers are billed bi-monthly. Undesignated reserves provide liquidity to pay for operations and mitigate the timing lag between when expenses are incurred and when revenues are billed and collected.

The Utility shall maintain 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, the Utility will maintain sufficient reserves to minimize rate increases due to market volatility, fluctuations in demands, emergencies, and regulatory changes.

The Utility's operating reserves will vary from year to year depending on the economy, forecasted sales and expenses, and capital investment needs. The target minimum unrestricted reserve level is equal to 90 days of operating and maintenance expenses for the Electric Utility and 120 days of operating and maintenance expenses for the Water Utility.

If projected operating reserves fall below the Utility's target levels, action will be taken to restore operating reserves to appropriate levels during the subsequent three-year period. Management may consider a number of actions including but not limited to:

1. Cost reductions
2. Rate stabilization adjustments
3. Base rate adjustments
4. Issuance of bonds to fund capital improvements

III. OPERATING CONTROLS

A. Draws From Trustee Accounts

1. Expenditures for reimbursable capital spending are identified and documented using work order system reports to support the draw request.
2. A Requisition for Disbursement Form (from bond documents) and wiring instructions are prepared by accounting staff and then reviewed and initialed by the Public Utilities Controller.
3. The Requisition for Disbursement form with wiring instructions is then forwarded to the AGM – Finance & Administration for review and signature.
4. The approved Requisition for Disbursement Form with wiring instructions is then submitted to the appropriate bank official and the City Finance Director and/or Treasurer indicating the appropriate general ledger account to post.

5. When the funds are received by the City Finance Director and/or Treasurer they then post the funds to the appropriate general ledger account.
 6. Wire amount received by City Finance is reconciled by the Department's Principal Accountant to determine that the proper amount was recorded and posted correctly.
- B. Draws On Line(s) of Credit
1. Expenditures for specific needs identified in the Line of Credit documentation and City Council guidelines are documented.
 2. A Notice of Borrowing or Notice of Refunding Borrowing is prepared indicating Electric or Water and the type of borrowing (Taxable, Taxable Term or Tax-Exempt Note).
 3. The appropriate Notice is then reviewed and initialed by the Public Utilities Controller for documentation and completeness.
 4. The Notice is then presented to the AGM – Finance & Administration for review and signature.
 5. The Notice is then provided to the City Finance Director and/or Treasurer or their designee for additional approval.
 6. The Notice is then submitted to the appropriate bank official and the City Finance Director and/or Treasurer indicating the appropriate general ledger account to post.
 7. When the funds are received by the City Finance Director and/or Treasurer they then post the funds to the appropriate general ledger account.
 8. Wire amount received by the City Finance Director and/or Treasurer is reconciled by the Department's Principal Accountant to determine that the proper amount was recorded and posted correctly.

IV. DEPARTMENT ORDER RESPONSIBILITIES

- A. Administrative Control (Implementation, Interpretation) – Utilities Strategic Planning Manager, or designee
- B. Communication and Training – Utilities Strategic Planning Manager, or designee
- C. Updating – Utilities Strategic Planning Manager, or designee

APPROVAL

Submitted:

4/26/2017

Dukku Lee
Public Utilities General Manager

Date

Approved by the Public Utilities Board on April 26, 2017.