



CITY OF REDDING, CALIFORNIA
COUNCIL POLICY

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BACKGROUND

The Electric Utility’s historical financial management policy, known as the Rate Reserve Policy, was adopted by Resolution 89-94 on March 21, 1989. The Rate Reserve Policy served the Electric Utility (REU or the Utility) well for over 25 years. Since the late 1980s, REU’s business has become increasingly complex and subject to a number of significant environmental, market, and regulatory considerations on national, state, and local levels. This policy was drafted to replace the Rate Reserve Policy and to maintain focus prudently managing the financial profile of the Utility in consideration of current and anticipated environments.

PURPOSE

REU is a publicly-owned community asset for the City of Redding that seeks to provide safe, reliable, competitively-priced electric service to all of its customers. As a community asset, and in consideration of its mission, REU prepared this policy with the intent of establishing guidelines for prudently managing the financial profile of the Utility for current and future customers.

POLICY

This policy establishes a target of 1.80x Debt Service Coverage (DSC) Without Reserves and establishes a target of Unrestricted Reserves sized at 150 Days’ Cash. The policy anticipates that in practice there is a range of acceptable results and a balance between cash flow and reserve levels is warranted. As such, the policy recommends that the City Council consider different rate adjustments under different conditions.

A rate increase should be considered if any of the following conditions (the “Rate Increase Conditions”) are projected in the five-year forecast:

- DSC Without Reserves will be less than 1.80x.
- End-of-year Reserves will be less than 75 Days’ Cash.
- Any future projected rate increase would be greater than six percent.
- A major expenditure is expected.

Rate increases indicated by the above conditions that would exceed six percent in any one year can be spread over multiple years provided that doing so does not reduce Reserves in any forecast year below 100 Days’ Cash.

No rate increase should be considered if DSC Without Reserves is projected (for both years in the two-year budget) to be greater than 1.00x and Reserves (for both years in the two-year budget) are projected to be greater than 180 Days’ Cash.



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A rate decrease may be considered if none of the Rate Increase Conditions discussed above are projected, and if all of the following three conditions are projected in the five-year forecast:

- DSC Without Reserves will be greater than 2.00x.
- End-of-year Reserves will be greater than 180 Days’ Cash.
- No rate increase would be greater than three percent (after accounting for any rate decrease under consideration).

Recommendations in the policy are associated with projected financial conditions for Fiscal Year End of future years. Actual results will vary based on weather, market conditions, etc. In addition, Reserves and cash flow may be more or less robust within a Fiscal Year, relative to the Fiscal Year End but considering such fluctuations within a year would overly complicate monitoring with only marginal benefit.

The policy also generally recommends that the Full Obligations Coverage Ratio be targeted to equal no less than 1.20x so that all of REU’s debt holders (both on- and off-balance sheet) can see ample cash flow to meet the payment obligations that are owed, but the policy does not suggest rate actions related to the maintenance of the Full Obligations Coverage Ratio.

For purposes of this policy, the following definitions would apply.

“Adjusted Annual Revenues” – Net Revenues plus the amount of Available Reserves.

“Available Reserves” – The amount of Unrestricted Reserves in the electric revenue fund. Also known as “Reserves.”

“Days’ Cash” –Unrestricted Reserves for a given fiscal year divided by a ratio equal to M&O Expenses for the same fiscal year divided by 365 , calculated thus as Unrestricted Reserves/(M&O Expenses/365) .

“Debt Service Coverage” – Adjusted Annual Revenues for a given fiscal year divided by Debt Service for the same fiscal year.

“DSC Without Reserves” – Net Revenues for a given fiscal year divided by Debt Service for the same fiscal year.

“Full Obligations Coverage Ratio” – (Net Revenue – In-Lieu of Tax Payment to the General Fund + Off-Balance Sheet Debt Service) / (Debt Service + Off-Balance Sheet Debt Service). The Full Obligations Coverage Ratio also is referred to with different terms by different rating agencies (e.g. Moody’s calls this ratio “Fixed Obligation Charge Coverage Ratio”).



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“Maintenance and Operation Expenses” – The following costs (but not exclusive of other costs): (a) all costs of electric energy and power generated or purchased, costs of transmission, fuel supply and water supply in connection with the foregoing, (b) all expenses of management and repair and other expenses necessary to maintain and preserve the Utility in good repair and working order, (c) all administrative costs that are charged directly or apportioned to the operation of the Utility, such as salaries, wages, and benefits of employees, overhead, and insurance premiums, (d) transfers to Major Maintenance and Rolling Stock, (e) any other cost or expense that, in accordance with GAAP, is to be treated as a cost of operating or maintaining the Utility, but excluding in all cases depreciation, replacement, and obsolescence charges or reserves; therefore, and amortization of intangibles, the expenditure of Major Maintenance and Rolling Stock funds, the payment in lieu of taxes and any capital investment.

“Net Revenues” – Revenues less the M&O Expenses.

“Reserves” – The amount of Unrestricted Reserves in the electric revenue fund. Also known as “Available Reserves.”

“Revenues” – All gross income and revenue received or receivable by the City from the ownership or operation of the Utility, including all rates and charges received by the City for the Utility and the other services and facilities of the Utility, all proceeds of insurance covering business interruption loss relating to the Utility, and all other income and revenue howsoever derived by the City from the ownership or operation of the Utility or otherwise arising from the Utility, but excluding refundable deposits made to establish credit and advances or contributions in aid of construction and line extension fees.

“Unrestricted Reserves” – Total cash reserves less funds set aside for various purposes including, but not limited to: deposits, long-term maintenance funds, Rolling Stock funds, restricted revenues, encumbrances, accrued principal and interest payable on REU’s direct debt obligations, and any proceeds of a bond issue except to the extent that such proceeds are intended and permitted to be used to fund Reserves. Also referred to as “Available Reserves” or “Reserves.”

IMPLEMENTATION

In order to provide further background and rational for this policy and in order to provide further details on the purpose, objectives, and compliance with this policy, the City incorporates by reference into this policy the “Financial Management Policy Whitepaper, ” which is attached to the policy as Attachment A.