



MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

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TO: Commissioners Carlson, Mital, Helgeson, Schlossberg and Brown
FROM: Sue Fahey, Assistant General Manager/CFO; Deborah Hart, Financial Services Manager; and Leslie Kidd, Interim General Accounting Supervisor
DATE: April 26, 2019
SUBJECT: Reserve Fund Status and Transfers/Use of Reserves
OBJECTIVE: Board Direction

Issue

Annually the Board considers how to allocate funds as of December 31st among reserve and designated fund accounts after the independent auditors have issued their opinion on the financial audit. This memo provides recommendations for transfers, and a change to the Electric Operating Reserve target, based on EWEB's strategic plans, financial policies, and the Electric and Water Utilities' financial conditions.

Background

On an annual basis, staff prepares a summary of the year-end reserves and funds balances, compares the balances to the Board Financial Policy targets, and recommends transfers and/or use of funds above target. Additionally, staff reviews targets to ensure that they are reasonable to cover the intended risks. For both the Electric and Water Utilities, cash balances at December 31, 2018 were higher than target due to budgeted and planned-for reserve deposits, as well as positive budget variances.

Discussion

Since the creation of the 2019 budget, there have been several emergent issues that have impacted, or have the potential to impact, both the Electric and Water Utilities' cash position and financial flexibility.

Electric Utility

- Storm Costs - \$4.3 million: The February snowstorm resulted in restoration costs of \$4.3 million. Assuming President Trump signs the disaster declaration, a Federal Emergency Management Agency (FEMA) grant will reimburse 75% of eligible costs. Based on prior FEMA grant timing, reimbursement is not expected this year.
- Purchased Power Costs - \$3 million: In the first quarter purchased power costs were significantly higher than budgeted. Regional power supplies were low due to limited BPA hydro generation as a result of reduced stream flows, renewable resource unavailability, scheduled regional transmission outages, and the unbudgeted shutdown of some EWEB generating units. The reduced regional power supply coincided with increased consumption due to colder than average temperatures and required EWEB to purchase

power at prices significantly above budget. While the 2019 budget protects against power activity volatility by assuming \$3 million less than expected revenue, the net impact of the first quarter volatility is forecasted to result in an additional \$3 million unfavorable variance at year end.

- Emergent capital work - \$3 million: is taking shape for the Electric Utility. These are projects which were not anticipated fully when the 2019 budget was formed.

Electric supply resource decisions are a strategic priority and are being evaluated as part of the Integrated Electric Resource Plan (IERP) work, including EWEB-owned generation facilities. Depending on the outcome of the Board approved plan, a future decommissioning fund may be prudent. IERP approval is scheduled for late 2021, and Finance staff will work with Planning and Generation to determine whether to recommend the creation of a decommissioning fund.

Water Utility

- Emergent capital work - \$2.5 million: is taking shape for the Water Utility. These are projects which were not anticipated fully when the 2019 budget was formed.

Both Utilities

- PERS Employer Incentive Fund – Amount to be Determined: The PERS Board has not finalized the rules that establish the amount of an employer’s lump sum deposit that will qualify for up to 25% matching contributions. Rules are expected to be finalized later this year. Under the current interpretation of the bill, EWEB may be eligible for a match on contributions up to \$22 million. PERS deposits are split 76% Electric and 24% Water.

The above emergent work may result in costs above Board approved budgets. Management is monitoring budgets closely to review alignment with the strategic plan and determine if spending can, and should, be adjusted to reduce potential overages. If necessary, budget amendments will be submitted for the Board’s review.

Given the Electric Utility’s increased first quarter costs and the uncertainty around the timing and amounts of both Utilities’ potential uses for cash, management recommends leaving excess funds in working cash as noted below. Management is also recommending an increase to the Electric Utility’s Operating Reserve target.

Water Utility

A) Working Cash

Management recommends transferring \$2.5 million in excess of target to the Rate Stabilization Fund, as discussed below, and \$147,000, in accordance with financial policies, to the Pension & Post-Retirement Medical Fund. This would leave Working Cash at \$4.7 million above target to cover emergent capital work, as discussed below with the Capital Improvement Reserve, and flexibility for a contribution to PERS pending final legislation and PERS rules.

B) Self-Insurance Reserve

The Self-Insurance Reserve is to fund third-party claims against EWEB. EWEB self-insures the first \$2 million for most liability claims and splits the reserve between both utilities. Target funding is \$280,000 for the Water Utility. Excess liability insurance protects EWEB after the self-insurance retention is exhausted.

Management is currently considering self-insuring for dental benefits. If implemented, that may require an increase in this reserve which would be brought to the Board for approval in the future.

C) Capital Improvement Reserve

At December 31, 2018 this fund was approximately \$3.3 million over target and included \$2.5 million previously designated for 2019 and 2020 meter upgrades. As noted above, the Water Utility has \$2.5 million of emergent work, which will likely put pressure on its capital budget. The budget is being closely monitored by both Water and Finance staff, and Management is not recommending a transfer at this time. Authorization to spend in excess of budget would require a Board approved budget amendment.

D) Rate Stabilization Fund

The Rate Stabilization Fund is intended to enhance the Utility's agility during financial challenges and minimize or smooth rate impacts to customers. Funds will be used for one-time expenses, emergent items and/or to reduce future borrowing depending on future Board approvals. Bond covenants allow withdrawals from this fund to be included as income for the Debt Service Coverage Ratio (DSC) calculation which is an important metric to bond rating agencies. Conversely, deposits to the fund reduce income for the DSC calculation. The Water Utility's 2018 DSC ratio was well above Board target, allowing flexibility to transfer funds. With potential bond issuances for a second filtration plant, rate stabilization funds will assist in strategically managing DSC, and Management recommends adding \$2.5 million to this fund.

E) Pension & Post-Retirement Medical Fund

PERS costs during 2018 were lower than budgeted by \$147,000. Board Financial Policies require the variance to be transferred to this fund.

Electric Utility

A) Working Cash

Management recommends transferring a total of \$2.3 million in excess of target to the Operating Reserve and the Pension & Post-Retirement Medical Fund. Working cash would remain \$9.9 million over target to mitigate unbudgeted purchased power and storm costs; to cover emergent capital work, as discussed below with the Capital Improvement Reserve; and to provide flexibility for a contribution to PERS pending final legislation and PERS rules.

B) Operating Reserve

Operating reserves are used to smooth out the effects of revenue shortfalls or unforeseen expenses not covered by the Power Reserve. The February storm cost \$4.3 million. The 2016 storm was also in excess of \$4.0 million. Given the uncertainty of timing and unknown future availability of FEMA funds, Management recommends transferring \$2.0 million in Working Cash to the Operating Reserve and raising the target to \$4.0 million.

C) Self-Insurance Reserve

Like the Water Utility, the Electric Utility has a self-insurance fund, with target funding of \$1.7 million. Should EWEB choose to self-insure dental benefits, which may require an increase to this reserve as well, and would be brought to the Board for consideration at that time.

D) Power Reserve

The level of funding for this reserve is evaluated annually. In determining sufficiency of this

reserve, risks from prices, load, resources, and credit exposure are considered. Based on the analysis, Management is not recommending a change to the Power Reserve at this time.

E) Capital Improvement Reserve

At December 31, 2018, this fund was \$3.7 million over target including \$2.2 million previously designated for 2019 meter upgrades. As noted above, the Electric Utility has approximately \$3 million of emergent work, which will likely put pressure on its capital budget. The budget is being closely monitored by both Electric and Finance staff. Authorization to spend in excess of budget would require a Board approved budget amendment, and Management is not recommending a transfer at this time.

F) Rate Stabilization Fund

Management is not recommending any transfers affecting this fund.

G) Pension & Post-Retirement Medical Fund

PERS costs were lower than budgeted by \$325,000. Board Financial Policies require the variance to be transferred to this fund.

Attachments 1 and 2 provide detail on reserve balances and recommended transfers for the Water and Electric Utilities, respectively.

Recommendation and Requested Board Action

Management is requesting direction on the above strategies and based on that direction will request approval of transfers and reserve targets at the June Board meeting.

Attachment 1 – Water Utility Schedule of Cash Reserves

Attachment 2 – Electric Utility Schedule of Cash Reserves

ATTACHMENT 1

Water Utility Schedule of Cash Reserves

| | FINANCIAL POLICY REFERENCE | TARGET | BALANCE ¹ 12/31/2018 | RECOMMENDED USE OF CASH | BALANCE AFTER |
|--|-------------------------------|---------------------|------------------------------------|----------------------------|----------------------|
| Working Cash | Rate Sufficiency | \$ 3,400,000 | \$ 10,744,817 | \$ (2,647,000) | \$ 8,097,817 |
| DESIGNATED FUNDS | | | | | |
| Operating Reserve | Rate Stability | \$1,000,000 | \$1,012,184 | \$ - | \$ 1,012,184 |
| Self-Insurance Reserve | Rate Stability | 280,000 | 288,712 | - | 288,712 |
| Capital Improvement Reserve | Capital Reserve | 7,000,000 | 10,283,765 | - | 10,283,765 |
| Rate Stabilization Fund | Rate Stability | 1,000,000 | 1,307,263 | 2,500,000 | 3,807,263 |
| Water Stewardship Fund - Septic Repairs | | - | 82,114 | - | 82,114 |
| Business Growth & Retention Loan Fund | | - | 209,546 | - | 209,546 |
| Alternate Water Supply Fund | | - | 6,377,023 | - | 6,377,023 |
| Pension & Post Retirement Medical Fund | | - | - | 147,000 | 147,000 |
| DESIGNATED FUNDS TOTAL | | \$ 9,280,000 | \$ 19,560,607 | \$ 2,647,000 | \$ 22,207,607 |
| CASH & DESIGNATED FUNDS TOTAL | | \$12,680,000 | \$30,305,424 | \$ - | \$ 30,305,424 |

1. The Capital Improvement Reserve includes \$2.5 million designated in 2018 for meter installations in 2019 and 2020.

ATTACHMENT 2

Electric Utility Schedule of Cash Reserves

| | FINANCIAL POLICY REFERENCE | TARGET ¹ | BALANCE ² 12/31/2018 | RECOMMENDED USE OF CASH | BALANCE AFTER |
|--|-------------------------------|----------------------|------------------------------------|----------------------------|-----------------------|
| Working Cash | Rate Sufficiency | \$ 36,000,000 | \$ 48,218,813 | \$ (2,325,000) | \$ 45,893,813 |
| DESIGNATED FUNDS | | | | | |
| Operating Reserve | Rate Stability | \$ 2,000,000 | \$ 2,082,704 | \$ 2,000,000 | \$ 4,082,704 |
| Self-Insurance Reserve | Rate Stability | 1,720,000 | 1,773,975 | - | 1,773,975 |
| Power Reserve | Rate Stability | 17,000,000 | 17,000,000 | - | 17,000,000 |
| Capital Improvement Reserve | Capital Reserve | 22,000,000 | 25,692,599 | - | 25,692,599 |
| Rate Stabilization Fund | Rate Stability | 5,000,000 | 37,048,759 | - | 37,048,759 |
| Business Growth & Retention Loan Fund | | - | 1,993,249 | - | 1,993,249 |
| Pension & Post Retirement Medical Fund | | - | - | 325,000 | 325,000 |
| DESIGNATED FUNDS TOTAL | | \$ 47,720,000 | \$ 85,591,285 | \$ 2,325,000 | \$ 87,916,285 |
| CASH & DESIGNATED FUNDS TOTAL | | \$ 83,720,000 | \$ 133,810,099 | \$ - | \$ 133,810,099 |

1. Management has proposed an increase in the Operating Reserve target from \$2 million to \$4 million.
2. The Capital Improvement Reserve includes \$2.2 million designated in 2018 for meter installations in 2019.
The Rate Stabilization Fund includes \$21.5 million previously designated to reduce future borrowings.