M E M O R A N D U M

EUGENE WATER & ELECTRIC BOARD

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TO: Commissioners Helgeson, Brown, Mital, Simpson and Carlson

FROM: Sue Fahey, Chief Financial Officer; Aaron Balmer, Interim General Accounting Supervisor

DATE: April 21, 2017

SUBJECT: Reserve Fund Status and Transfers/Use of Reserves

OBJECTIVE: Board Direction

Issue

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

Background

On an annual basis after the financial audit, 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.

For both the Electric and Water Utilities, the cash balances at December 31, 2016 were higher than target due to budgeted and planned for reserve deposits, as well as positive budget variances.

Discussion

Attachments 1 and 2 provide the detail on recommended transfers for the Water and Electric Utilities, respectively. Management's rationale for the recommendations are summarized below.

Water Utility

For several years the Water Utility's financial challenge was extremely low cash reserves primarily due to the loss of its largest customer (Hynix) and low consumption as a result of the recession and cooler than average summers. To improve the Utility's financial condition, in 2012 the Board approved price design changes that made revenues less susceptible to weather fluctuations and a price increase built on lower consumption to align with what the Utility had been experiencing. Over the last few years, sales have been higher than budgeted, and several cost saving initiatives have been implemented allowing the Water Utility to accumulate reserves in excess of target.

The Water Utility owes the Electric Utility approximately $17 million principal for its share of debt as a result of prior Electric Utility bond issuances for the Roosevelt Operations Center and prepaid retirement obligations. Management believes it is in the best interest of both Utilities for the Water

Utility to use reserves in excess of target and pay off $11 million of the amount owed to the Electric Utility.

A) Working Cash

Management recommends transferring $800,000 of the $3.5 million in excess of target to the Pension & Post-Retirement Medical Fund (Post-Retirement Fund). Financial policies require that the amount actual pension costs were under budget be transferred to the Pension Fund. Additionally, the Water Utility bears 24% of EWEB's retirement benefit obligations while the Electric Utility is responsible for 76%. Transferring $2.5 million to the Post-Retirement Fund aligns the Utilities' balances to those percentages. Management recommends using the remaining excess to pay off debt payable to the Electric Utility.

B) Capital Improvement Reserve

Management recommends using the $5 million excess above target to pay off debt payable to the Electric Utility.

C) 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 and emergent items to be allocated based on the Board's direction. Management recommends using $5 million of the Rate Stabilization Fund to pay off debt payable to the Electric Utility.

D) Alternate Water Supply Fund

The Alternate Water Supply Fund was created in 2014 to be used for costs related to developing a second water source. Three percentage points of the 2014 retail rate increase are specifically dedicated to this fund which results in annual deposits of approximately $1 million. Until costs are refined, Management does not recommend transferring additional moneys to this fund.

E) Pension & Post-Retirement Medical Fund

PERS costs were lower than budgeted by $800,000 due to budgeting a higher PERS rate in anticipation of the July 2017 PERS rate increase. Board Financial Policies require this variance to be transferred to this fund. As explained in the Working Cash narrative, Management also recommends transferring an additional $1.7 million so that the Electric and Water Utilities' balances align with their respective share of obligations. Management is monitoring PERS reform legislation and intends to make a recommendation on the use of these funds within the next year.

Electric Utility

A) Working Cash

Working Cash is $10.2 million above target. The 2016 budget anticipated a deposit to working cash of $8.7 million, and the $1.5 million difference is primarily due to reduced expenses in anticipation of 2017 budget reductions and lower debt requirements due to the defeasance and refunding. Management recommends reallocating the amount above target to the Post-Retirement Fund as per financial policy and the remainder to the Rate Stabilization Fund.

B) Power Reserve

The Power Reserve target has been recalculated according to policy. Due to low power prices, the credit and price components of the reserve have dropped resulting in a $17 million recommended target.

Management recommends transferring the $10.4 million over the updated target to the Rate Stabilization Fund.

C) Capital Improvement Reserve

Depreciation has increased over the last few years with the enhanced ability to track assets in the centralized Work and Asset Management system, including short-lived assets such as software that were not previously depreciated. Management has recommended an increase to the Capital Improvement Reserve target to $22 million. The capital true-up budget amendment approved by the Board in April indicated that $2.5 million of capital reserves would be needed to fund the 2017 capital plan. Capital spending has ranged from 58% to 77% of budget since 2011. Based on historical underspending, Management recommends transferring the $4.3 million over target to the Rate Stabilization Fund. If additional funds are needed, staff will request that the Board approve a transfer.

D) Rate Stabilization Fund

Use of the Rate Stabilization Fund is intended to enhance the Utility's agility during financial challenges and minimize rate impacts to customers. Funds will be used for one-time items such as storm costs in excess of the Operating Reserve, Capital projects, reduced load due to weather, and other emergent issues and will be allocated based on the Board's direction.

EWEB has a unique one-time opportunity to positively impact the Electric Utility's future debt service coverage ratio (DSC) which is the Utility's most challenged financial metric. Under the current bond Master Resolution, transfers to and from the rate stabilization fund have no impact on the DSC.

The new Master Resolution takes effect after the 2001 bonds are paid off or defeased. This resolution considers transfers to the Rate Stabilization Fund as a reduction to revenues available for debt service. Accordingly, under the new resolution, transfers *to* the rate stabilization fund will reduce the DSC. Conversely, transfers *from* the Rate Stabilization Fund increase revenues available for debt service and therefore the DSC is higher. Management recommends $7.3 million to be transferred from Working Cash, $4.3 million from excess Capital Improvement Reserve funds, and $10.4 million from the Power Reserve. Management also recommends using approximately $24.2 million from the Rate Stabilization Fund plus the $11 million from the Water Utility repayment to defease 2001 bonds.

E) Carmen-Smith Fund

This fund was created when capital costs originally paid with working cash were reimbursed by funds from the 2011 bond issuance. Management recommends using these funds to reduce the next bond issuance.

F) Pension & Post-Retirement Medical Fund

PERS costs were lower than budgeted by $2.9 million due to budgeting a higher PERS rate in anticipation of the July 2017 PERS rate increase. Board Financial Policies require this variance to be transferred to this fund from excess working cash. Management is monitoring PERS reform legislation and intends to make a recommendation on the use of these funds within the next year.

Use of Cash

The Electric Utility has approximately $42 million of debt payments over the next ten years that carry interest rates as high as 7.2%. The bond agreement for this debt does not allow refinancing and accordingly, the only way to legally remove the debt from EWEB's books and debt service calculations is to defease the debt. After the above Management recommended transfers and Water Utility intercompany debt payment, cash is in excess of targets by over $70 million. Management recommends using approximately $35.2 million to defease debt. The actual amount will depend on market conditions at time of defeasance. Management also recommends using the Water Utility intercompany debt repayment and Rate Stabilization Funds as the source of defeasance.

Recommendation and Requested Board Action

Management is requesting feedback on the above strategies and will request approval 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[1]	BALANCE 12/31/2016	RECOMMENDED TRANSFER TO/(FROM)	BALANCE AFTER TRANSFER
A)	Working Cash	Rate Sufficiency	**$ 3,400,000**	**$ 6,855,619**	**$ (3,455,619)**	**$ 3,400,000**

DESIGNATED FUNDS

	Operating Reserve	Rate Stability	$ 1,000,000	$ 1,012,185	$ -	$ 1,012,185
	Self-Insurance Reserve	Rate Stability	280,000	288,712	-	288,712
B)	Capital Improvement Reserve	Capital Reserve	7,000,000	12,000,176	(5,000,176)	7,000,000
C)	Rate Stabilization Fund	Rate Stability	1,000,000	6,351,468	(5,044,205)	1,307,263
	Water Stewardship Fund- Septic Repairs		-	88,950	-	88,950
	Business Growth & Retention Loan Fund		-	127,979	-	127,979
	McKenzie River Trust Commitment		-	250,000	-	250,000
D)	Alternate Water Supply Fund		-	5,237,197	-	5,237,197
E)	Pension & Post Retirement Medical Fund		-	1,889,312	2,500,000	4,389,312
	DESIGNATED FUNDS TOTAL		**$ 9,280,000**	**$ 27,245,979**	**$ (7,544,381)**	**$ 19,701,598**
	CASH & DESIGNATED FUNDS TOTAL		**$ 12,680,000**	**$ 34,101,598**	**$ (11,000,000)**	**$ 23,101,598**

Management recommends using $11 million of funds above target to pay down intercompany debt owed the Electric Utility.

1. Target represents management recommendations presented at May 2, 2017 Board meeting.

ATTACHMENT 2
Electric Utility Schedule of Cash Reserves

		FINANCIAL POLICY REFERENCE	TARGET[1]	BALANCE 12/31/2016	RECOMMENDED TRANSFER TO/(FROM)	RECOMMENDED USE OF CASH	BALANCE AFTER TRANSFER
A)	Working Cash	Rate Sufficiency	**$ 24,000,000**	**$ 34,161,037**	**$ (10,161,037)**		**$ 24,000,000**

DESIGNATED FUNDS

	Operating Reserve	Rate Stability	$ 2,000,000	$ 2,082,704	$ -		$ 2,082,704
	Self-Insurance Reserve	Rate Stability	1,720,000	1,773,975	-		1,773,975
B)	Power Reserve	Rate Stability	17,000,000	27,359,486	(10,359,486)		17,000,000
C)	Capital Improvement Reserve	Capital Reserve	22,000,000	26,286,517	(4,286,517)		22,000,000
D)	Rate Stabilization Fund	Rate Stability	5,000,000	17,084,316	21,907,040	(24,200,000)	14,791,356
	Business Growth & Retention Loan Fund		-	1,963,286	-		1,963,286
	McKenzie River Trust Commitment		-	250,000	-		250,000
E)	Carmen-Smith Fund		-	15,790,304	-		15,790,304
F)	Pension & Post Retirement Medical Fund		-	10,949,929	2,900,000		13,849,929
	DESIGNATED FUNDS TOTAL		**$ 47,720,000**	**$ 103,540,517**	**$ 10,161,037**	**$ (24,200,000)**	**$ 89,501,554**
	Water Utility Intercompany Debt Payback		-	-	**$ 11,000,000**	**$ (11,000,000)**	**$ -**
	CASH & DESIGNATED FUNDS TOTAL		**$ 71,720,000**	**$ 137,701,554**	**$ 11,000,000**	**$ (35,200,000)**	**$ 113,501,554**

Management recommends using the proposed $11 million Water Utility repayment and approximately $24.2 million of rate stabilization funds to defease 2001 bonds. Actual amount will vary based on market conditions when the debt is defeased.

1. Target represents management recommendations presented at May 2, 2017 Board meeting.