



# MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

*Rely on us.*

TO: Commissioners Brown, Carlson, Barofsky, McRae, and Schlossberg

FROM: Deborah Hart, CFO; TiaMarie Harwood, Financial Services Manager; Aaron Balmer, General Accounting & Treasury Supervisor; and Matthew Miller, Sr. Accounting Analyst

DATE: April 27, 2022

SUBJECT: Reserve Fund Status and Transfers/Use of Reserves

OBJECTIVE: Board Direction

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## **Issue**

Annually the Board considers how to allocate funds as of December 31 among reserve and designated fund accounts after the independent auditors issue 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, staff prepare a summary of the year-end reserve balances, compare the balances to the Board Financial Policy targets, and recommend transfers and/or uses of funds above target. Additionally, staff review targets to ensure they are reasonable to cover the intended risks. For both the Electric and Water Utilities, cash balances at December 31, 2021 were above target. In addition, targets were evaluated for adequacy, and debt service coverage requirements were met for the year.

## **Discussion**

The 2022 adopted budget includes draws on reserves of \$3.4 million for Electric and \$2.4 million for Water. Investments in aging infrastructure and inflationary pressures, as well as investments in source protection within the Water Utility following the Holiday Farm Fire, have increased budgeted expenditures for both capital work and operations and maintenance.

In addition, lingering COVID-19 impacts are continually being evaluated and supply chain pressures are an increasing concern. Demand for electricity was budgeted to rebound from 2021 but is expected to remain below pre-pandemic levels. Consumption for water was budgeted using 95% of the five-year average.

Excess funds above working cash targets provide flexibility for strategic decisions needed on capital investments, increased operations and maintenance costs, continuing COVID-19 impacts, and investments in the McKenzie watershed following the Holiday Farm Fire. Given a continued state of uncertainty, Management recommends leaving excess funds in working cash as noted below.

## **Water Utility**

### **Working Cash**

Management recommends transferring \$151,000, in accordance with Financial Policies, to the Pension & Post-Retirement Medical Fund and \$5.3 million to the Rate Stabilization Fund. The 2022 adopted budget includes a \$2.4 million draw on working cash reserves. Working Cash will remain \$6.6 million above target. Remaining

funds in excess of target align with budgeted expectations and position the Board to dynamically navigate tactical or strategic uses, such as supply chain issues or capital project construction.

#### **Operating and Self-insurance Reserves**

Recommended transfers from the Operating and Self-insurance reserves to working cash are \$12,200 and \$8,700, respectively. Staff consider these transfers to be housekeeping items to match reserves more closely with targets.

#### **Capital Improvement Reserve**

At December 31, 2021, this fund was approximately \$7.3 million over target. With large capital projects on the horizon, Management is not recommending a transfer at this time. The year-end balance was aligned with budget expectations, and the 2022 adopted budget includes a \$7.0 million draw on capital improvement reserves as a source of funds for current year projects.

#### **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. Under existing bond covenants, deposits to the fund reduce the Debt Service Coverage ratio, while withdrawals increase the ratio. Funds may be used for one-time expenses and emergent items to be allocated based on the Board's direction.

Management recommends transferring \$5.3 million to the Rate Stabilization Fund which maintains the 2021 Debt Service Coverage ratio at 3.0x, still well above the Board's target range. Having an additional \$5.3 million available to draw from the Rate Stabilization Fund represents approximately a 14% rate impact over a single year and will help smooth rate impacts over several years. In the most recent long-term financial plan (LTFP) from fall 2021, draws from the Rate Stabilization Fund to defray large capital construction projects are modeled to begin in 2027. Use of \$14.0 million in excess of target to reduce future borrowings represents approximately 2.4% in avoided rate increases.

#### **Pension & Post-Retirement Medical Fund**

PERS costs during 2021 were lower than budgeted by \$151,000. Board Financial Policies require the variance to be transferred to this fund.

#### **Electric Utility**

##### **Working Cash**

Management recommends transferring \$258,000 to the Pension & Post-Retirement Medical Fund and \$4.0 million to the Power Reserve fund. With the addition of small transfers from the Operating and Self-insurance Reserves to Working Cash, the balance would be \$2.8 million above target. The 2022 adopted budget includes a \$3.4 million draw on working cash reserves using conservative budget assumptions. Revenues from the first quarter of 2022 have been favorable and continued performance at expected levels would result in a deposit to working cash this year.

##### **Operating and Self-insurance Reserves**

Recommended transfers from the Operating and Self-insurance reserves to working cash are \$82,700 and \$54,000, respectively. Staff consider these transfers to be housekeeping items to match reserves more closely with targets.

##### **Power Reserve**

The level of funding for this reserve is evaluated annually. In determining sufficiency of this reserve, risks from prices, loads, resources, and credit exposure are considered. Based on the analysis, Management is recommending an increase to the Power Reserve target of \$4.0 million primarily due to price risks. Rising

wholesale power prices have increased the value of generation within the Utility's portfolio, and accordingly, have increased the potential loss of value the Utility could experience in the event of lower generation. Increasing the reserve will help guard against potential negative price movement that could occur as the market experiences greater volatility. A corresponding transfer of \$4.0 million is recommended from Working Cash to the Power Reserves to achieve the targeted balance.

### **Capital Improvement Reserve**

As of December 31, 2021, this fund was above target and exceeded budget expectations. Management recommends increasing the target by \$1 million to \$23.0 million to account for a meter replacement reserve. Remaining funds above target present an opportunity to deposit to the Rate Stabilization Fund. With large capital projects on the horizon, and future Debt Service Coverage ratios being a stressed metric in the long-term financial plan, Management is recommending a transfer of \$2.2 million. Remaining funds align the year-end balance with budget expectations.

### **Rate Stabilization Fund**

Funds above target in the Electric Rate Stabilization Fund have been modeled as a funding source for future capital spending in the long-term financial plan and will help reduce future borrowing. Under existing bond covenants, deposits to the fund reduce the Debt Service Coverage ratio, while withdrawals increase the ratio. Funds may be used for one-time expenses and emergent items to be allocated based on the Board's direction.

Management recommends transferring \$2.2 million to the Rate Stabilization Fund which maintains the 2021 Debt Service Coverage ratio at 2.1x and still above the Board's target range. Having an additional \$2.2 million available to draw from the Rate Stabilization Fund represents approximately a 1.3% rate impact over a single year and will help smooth rate impacts over several years. Use of \$20.0 million in excess of target to reduce future borrowings represents approximately 0.76% in avoided rate increases.

The 2022 adopted budget includes a draw of \$9.9 million from Rate Stabilization Funds for capital project funding. Early indications of project delays due to supply chain lead times and material scarcity will likely defer capital outlays to future years. The budgeted draw on Rate Stabilization Funds will be re-evaluated next year once 2022 performance is certain and current indications are it will not be needed.

### **Pension & Post-Retirement Medical Fund**

2021 PERS costs were lower than budgeted by \$258,000. Board Financial Policies require the variance to be transferred to this fund.

### **Recommendation and Requested Board Action**

Attachments 1 and 2 provide detail on reserve balances and recommended transfers for the Water and Electric Utilities, respectively. Management is requesting direction on the above strategies and 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		BALANCE	RECOMMENDED	BALANCE
	REFERENCE	TARGET	12/31/21	USE OF CASH	AFTER
Working Cash	Rate Sufficiency	\$ 3,400,000	\$ 15,459,638	\$ (5,430,104)	\$ 10,029,534
<b>DESIGNATED FUNDS</b>					
Operating Reserve	Rate Stability	\$ 1,000,000	\$ 1,012,184	\$ (12,184)	\$ 1,000,000
Self-Insurance Reserve	Rate Stability	280,000	288,712	(8,712)	280,000
Capital Improvement Reserve	Capital Reserve	7,000,000	14,345,616	-	14,345,616
Rate Stabilization Fund	Rate Stability	1,000,000	10,000,000	5,300,000	15,300,000
Water Stewardship Fund- Septic Repairs		-	57,474	-	57,474
Business Growth & Retention Loan Fund		-	-	-	-
Alternate Water Supply Fund		-	5,253,796	-	5,253,796
Pension & Post Retirement Medical Fund		-	395,000	151,000	546,000
<b>DESIGNATED FUNDS TOTAL</b>		<b>\$ 9,280,000</b>	<b>\$ 31,352,781</b>	<b>\$ 5,430,104</b>	<b>\$ 36,782,885</b>
<b>CASH &amp; DESIGNATED FUNDS TOTAL</b>		<b>\$ 12,680,000</b>	<b>\$ 46,812,420</b>	<b>\$ -</b>	<b>\$ 46,812,420</b>
<b>RESTRICTED FUNDS</b>					
Construction Funds		\$ -	\$ 3,401,675	\$ -	\$ 3,401,675
SDC Reserves		-	3,536,074	-	3,536,074
Debt Service Reserves		-	1,491,748	-	1,491,748
<b>RESTRICTED FUNDS TOTAL</b>		<b>\$ -</b>	<b>\$ 8,429,497</b>	<b>\$ -</b>	<b>\$ 8,429,497</b>

Attachment 2

**Electric Utility Schedule of Cash Reserves**

	FINANCIAL POLICY		BALANCE	RECOMMENDED	BALANCE
	REFERENCE	TARGET	12/31/21	USE OF CASH	AFTER
Working Cash	Rate Sufficiency	\$ 36,000,000	\$ 42,924,494	\$ (4,121,321)	\$ 38,803,173
<b>DESIGNATED FUNDS</b>					
Operating Reserve	Rate Stability	\$ 4,000,000	\$ 4,082,704	\$ (82,704)	\$ 4,000,000
Self-Insurance Reserve	Rate Stability	1,720,000	1,773,975	(53,975)	1,720,000
Power Reserve	Rate Stability	21,000,000	17,000,000	4,000,000	21,000,000
Capital Improvement Reserve	Capital Reserve	23,000,000	26,424,242	(2,200,000)	24,224,242
Rate Stabilization Fund	Rate Stability	5,000,000	24,468,927	2,200,000	26,668,927
Business Growth & Retention Loan Fund		-	-	-	-
Pension & Post Retirement Medical Fund		-	1,006,000	258,000	1,264,000
<b>DESIGNATED FUNDS TOTAL</b>		<b>\$ 54,720,000</b>	<b>\$ 74,755,847</b>	<b>\$ 4,121,321</b>	<b>\$ 78,877,168</b>
<b>CASH &amp; DESIGNATED FUNDS TOTAL</b>		<b>\$ 90,720,000</b>	<b>\$ 117,680,341</b>	<b>\$ -</b>	<b>\$ 117,680,341</b>
<b>RESTRICTED FUNDS</b>					
Construction Funds		\$ -	\$ 34,456,786	\$ -	\$ 34,456,786
Harvest Wind Escrow		-	549,012	-	549,012
Debt Service Reserves		-	6,694,987	-	6,694,987
Wildlife Reserve		-	48,947	-	48,947
Customer Care Fund		-	1,006,203	-	1,006,203
Customer Deposit Reserves		-	519,721	-	519,721
<b>RESTRICTED FUNDS TOTAL</b>		<b>\$ -</b>	<b>\$ 43,275,657</b>	<b>\$ -</b>	<b>\$ 43,275,657</b>

Recommended Target Changes:	Current	Recommended
Power Reserve	\$17,000,000	\$21,000,000
Capital Improvement Reserve	\$22,000,000	\$23,000,000