



# UTILITY FINANCIAL RESERVE POLICY

Policy Number 2010-01

ADOPTED: February 16, 2010

## I. Purpose.

In order to maintain stable rates and provide reliable service, The City of Anoka must have various tools to deal with changes in costs or operational performance. Maintaining appropriate financial reserves is one such tool. Financial reserves can absorb short-term financial variability resulting from unexpected operating results or can reduce the need for debt issuances. This policy establishes a Capital Reserve (CR), which is used to cover the following year's capital projects, and an Operating Reserve (OR), which addresses short-term financial volatility. The City will establish a Capital Reserve and Operating Reserve for each of the four utilities – electric, water, sewer and storm sewer.

## II. Capital Reserve (CR).

This reserve is established to cover the following year's capital projects so the City can avoid issuing bonds to pay for street renewal projects or normal work order projects. It is not the intent of the CR to pay for extraordinary and costly projects, such as a new water tower or substation. Those investments should be covered by a Capital Improvement Plan.

A. Funding Amount. The Target CR level is set annually to equal the following year's capital projects as approved by the Council in the Five Year Capital Improvement Plan. Since the CR changes annually for each utility, this policy does not address the specific amount of reserves dedicated to the CR. These amounts are found in the City's annual Budget.

B. Funding Sources. The sources of funds for the CR come from the undesignated fund balance of each utility.

## III. Operating Reserve (OR). This reserve is established to address short-term financial variability resulting from unexpected operating results and to address those financial risks that have a more immediate potential impact on the existing cost structure.

A. Financial Risk Exposures. Potential sources of cash flow variability addressed by the OR include the following risk exposures:

1. Reductions in overall customer demand,
2. Changes in total system load resulting from the actions of large customers,
3. Failure to achieve the budgeted level of net income,
4. Changes in the cost of purchased power,
5. Changes in interest income, and
6. General operational exposures, such as a timing mismatch between revenue receipts and expense payments, unforeseen maintenance costs, regulatory compliance costs, and other unexpected increases in the operating budget.

- B. Funding Amount. The Target OR level has been set at 120 days of total budgeted operating expenses for Electric and 60 days of total budgeted operating expenses for Water and Sewer. Since the OR changes annually for each utility, this policy does not address the specific amount of reserves dedicated to the OR. These amounts are found in City's annual Budget.
- C. Funding Sources. The sources of funds for the OR come from the undesignated fund balance of each utility.
- IV. **FINANCIAL RESERVES HIERARCHY OF FUNDING:** The following list of priorities applies individually to each of the four utilities. There is no co-mingling of funds.
- A. Since normal capital expenditures are known, budgeted amounts, and it is not the City's intent to borrow money to cover these expenditures, excess cash generated by the utility shall first be used to fund the CR to the Target level.
- B. Once the Target CR level is achieved, excess cash shall be applied to the OR.
- C. Once the OR Target level is achieved, action shall be as described in the section titled, **OPTIONAL USES OF CASH.**
- V. **FINANCIAL RESERVES REPLENISHMENT:** The above section describes the hierarchy of funding of the reserves. The following describes what actions may be taken to generate the cash and replenish the reserves under different scenarios of each of the three utilities.
- A. IF THE CR AND OR ARE AT THE TARGET LEVEL: Take no action.
- B. IF THE CR IS AT THE TARGET LEVEL AND THE OR IS BELOW THE TARGET LEVEL: Take no action during the current year. If the OR does not increase to the Target level during the calendar year, reevaluate the following year and reduce expenses and/or raise rates, if necessary, to reach the Target level within the next three years.
- C. IF BOTH THE CR AND OR ARE BELOW THE TARGET LEVEL: Take no action during the current year. If the CR and OR do not increase to the Target level during the calendar year, reevaluate the following year and reduce expenses and/or raise rates, if necessary, to reach the Target level for both reserves within the next five years.
- D. IF BOTH THE CR AND OR ARE ABOVE THE TARGET LEVEL: If projected to remain above the Target reserves level for the next three years, address with one of the **OPTIONAL USES OF CASH.**
- VI. **OPTIONAL USES OF CASH:** If financial reserves are above the Target levels (both CR and OR) for any of the three utilities and are projected to remain above the Target reserves level for the next three years, the Council will consider the following options for uses of cash:
- A. Debt Management: Debt reduction through defeasance of bonds.

- B. Retain for Longer-term Rate Stability: This option has the practical effect of increasing reserves. These reserves would then be available in future years either to delay/reduce future rate increases or for capital and debt management.
- C. Sustained Rate Reduction: Reduce rates if it is projected that the rate reduction could be sustained for a specified period.
- D. Transfer Excess Funds for a Specific Project: This option allows funding of a particular project or priority.

**VII. FINANCIAL RESERVES FUNDING LEVEL AND FUND BALANCE REVIEWS:**

The Target levels and fund balances are to be reviewed as follows:

- A. Target Level Review: Though the actual monetary values are reviewed annually when approving the budget, the Target CR and OR funding levels are to be re-evaluated at least every three years. For example, the Council could revise (reduce or increase) the OR Target level of 120 days of commodity expenses for the electric utility.
- B. Financial Reserves Fund Balance Review: The OR and CR fund balances are to be monitored monthly by the Finance Department and reviewed annually during budget review process by the Council. The CR and OR fund balances may also be reviewed if an event were to suddenly reduce the fund balance.