FP9

Category: FINANCE

FINANCIAL RESERVES POLICY

I. PURPOSE

This Reserve Policy outlines the appropriate types and levels (minimum, goal, and maximum) of financial reserves as prescribed in the following policy. The primary reason for a reserve policy is to be prepared for contingencies, but other reasons also exist. Seven important purposes of a reserve policy are as follow:

1. **Plan for contingencies.** To maintain sufficient reserves to minimize rate increase due to market volatility(power supply shocks or maintain rate competitiveness), weather impacts on demands, economic downturns, emergencies (such as natural disasters), and regulatory changes.
2. **Maintain good standing with rating agencies.** By maintaining sufficient reserves, SVCE can preserve good credit ratings, allowing it to secure power at lower costs, that is, without posting credit enhancements, in the energy markets.
3. **Avoid interest expense.** To avoid interest expense to cover short-term cash shortfalls by having sufficient reserves to use for this purpose, rather than debt.
4. **Ensure cash availability when revenue is unavailable.** To bridge times of the year that normally see temporary low levels of cash.
5. **Plan for anticipated future rate increases by gradually raising those rates, using reserves to cushion the full impact on customers over an extended time period.** For example, if it is expected that rates are highly likely to increase in 3 to 5 years, higher reserves on hand can cushion those rate increases over a more gradual timeframe by drawing down on the accumulated funds that may be in excess of the reserves' goal.
6. **Manage the risks identified in the Energy Risk Management Policy, which are:**

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- Market price risk,
- Net revenue risk,
- Counterparty credit and performance risk,
- Load and generation volumetric risk,
- Operational risk,
- Liquidity risk, and
- Regulatory/legislative risk.

7. **Establish clear expectations between the Board of Directors and staff.** A formal reserve policy creates a shared understanding of the proper level and use of reserves.

II. POLICY

Reserve Levels Established

Financial reserves shall be set aside as follows:

The **Reserve targets** cover the operations of SVCE over a number of days in the event of emergencies or other significant unforeseen events. Three levels are defined, with the first being baseline. Given the purposes stated above, the Reserve shall be maintained at no less than the minimum described in (a) below. The reserve level described in (b) is recommended as the goal. The Maximum reserve level described in (c) would provide solid reserves for significant fluctuations in revenue or unforeseen circumstances. The Board shall review its reserve levels annually in context of SVCE's overall financial condition of the agency, as well as due to changes to the industry and/or risk factors as described in periodic review of targets below.

(a) ***Minimum Operating Reserve (baseline)*** shall be the minimum maintained to cover 120 days of operations of the annual operating budget;

(b) ***An Operating Reserve*** **goal** of covering 285 days of operations of the annual operating budget;

(c) ***Maximum Operating Reserve*** to cover 490 days of operations of the annual operating budget.

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Conditions for Use of Reserves

For purposes of this policy, use of reserves is defined as a projected or estimated[1] reduction in reserves by fiscal year-end. A temporary reduction in cash consistent with the expected peaks or dips in revenues and expenditures are normal cyclical occurrences to be expected during the fiscal year, and do not constitute a use of reserves.

The reserves may be drawn down upon by the CEO during the year, up to the lesser of 10% of the year's budgeted cost of power supply, or $30 million, to:

1. Cover increases in power supply expenses due to spikes in costs and/or due to higher customer demand;
2. Provide necessary funds to make up for unanticipated revenue shortfalls;
3. Meet any margin or collateral posting requirements under energy supply contracts; and,
4. Provide resources to meet emergency expenditures.

If further use of reserves are needed to manage the operations of the organization, or if the use of reserves would bring the balance below the Minimum Operating Reserve baseline, the CEO must present recommendations to the Board and the Board must authorize any such use.

Replenishment of Reserves

Should SVCE drawdown reserves below the Minimum Operating Reserve level, SVCE will implement plans to return reserves to their minimum targets within two (2) fiscal years. Such plans will be provided in subsequent budget and rate discussions with the Board.

[1] It is not practical to wait the formal fiscal year end closing of the accounting records to determine if the reserves have been "used". Therefore, it is appropriate for staff to estimate reserve levels, with the important amount being what is estimated for fiscal year end.

Excess Reserves

If reserve funds are projected to exceed the maximum level, the CEO shall present options for consideration by the Board of Directors for proper disposition of those reserves during the next budget cycle.

Reserves between Minimum and Maximum

To the extent that reserves are above target and below the maximum, no other action by SVCE would be required.

Periodic Review of Reserve Goals

Reserve goals shall be periodically reviewed for consistency with industry standards. If significant risk factors are eliminated or significant new risks emerge as a result of changes in the industry, legislation, or economic conditions, the basis of the reserve policy shall be reviewed, and the funding level shall be adjusted accordingly. Unless the Reserves are approaching minimum levels, formal Reserve funding discussions with the Board may await the next budget process.

Reporting

Reserve levels will be monitored during the fiscal year and reported in the quarterly financial reports. Reserve target levels (minimum and maximum) will be analyzed annually, and over/under reserve determination shall be made in conjunction with year-end financial results. These results will be reported to the Board of Directors as part of the year-end financial report presentation.

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