Closed Caption Log, Council Meeting, 03/07/12

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>> Cole: I would like to call to order this special session of the austin city council where we are discussing austin energy rates.

Mayor leffingwell will be here shortly.

I just understand from councilmember tovo that he would like to go into executive session, is that correct?

>> Yes, I have a very quick question.

I would just ask that we take maybe five or seven minutes to ask that question of our legal counsel.

>> Cole: Thank you, without objection the city council will go into closed session to take up one item, 071 of the government code.

The city council will consult with legal counsel regarding the following items, legal issues related to austin energy's financial

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policies, reserve funds and revenue implications of various electric rate scenarios, hearing no objection, we will go into executive session.

Sus

>> We have convened the special city council meeting regarding Austin Energy rates.

It's my understanding that Austin Energy has a

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presentation, we will consider that first.

>> Sorry, with me is anne little, haven't of finance, interim cfo for austin energy, mark dryfus, the director of our rates and regulatory affairs.

For today's work session we did prepare some slides.

Really to get in more of a question and answer mode.

I think it really depends on what you all would like.

As we've been working at this for the last year and a half or better, we've had a lot of presentations and sometimes not a lot of dialogue.

>> Cole: I agree with that.

Are are you suggesting take we handle this presentation differently.

>> I think that I would like to start off by talking about a couple issues and then we can talk about this presentation and we can work through it.

Maybe we can talk about that one as soon as I'm done with my opening comments.

My opening comments I wanted to say that we have a proposal that's on the table.

That proposal has a two part rate increase.

There are parts of that proposal that we expected as time went on, they would change, there would be issues that you would have and you would want to take up with us and there would be different parts of it maybe brought back.

But we put our best business case on the table and part of the reason for making this proposal in two pieces, if you will, was that there are a lot of questions of which we're talking approximate today.

Revenue requirements, and death service coverage and -- debt service coverage and a number of very important policy decisions, frankly, that we thought could wait until we got through the first piece on to the second piece if you follow me.

So in other words we would get the initial rate piece in place and then we would have sufficient time over two years, almost, to be able to really dive deeper

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into the financial policies that are set by council and mayor on austin energy's major fiscal metrics as we plan our business.

So having said that, I think that I'm not -- this is the first time that I've had opportunity to say it to you, frankly, and I think it's really important that you understand that's how we came about that proposal is to allow time for some of these more significant issues that we've heard from the stakeholders, the public and you as well, that we need more time to look at some of these deeper, larger, financial issues.

.. we have a presentation today that's focused on debt service coverage.

Debt equity and reserves.

We've given you a paper copy of it.

At this point, if you would like, I can turn it over to mark dreyfus, we can go through it quickly, or we can open it up to specific questions on specific subjects that you have or you want to address.

>> Why don't you have mark go through it pretty quickly.

>> Okay.

>> Thank you, mayor pro tem, councilmembers.

Actually, I have some opening remarks and I will do my best to be very brief.

>> Cole: Y'all are really making this sound like a courtroom.

>> That be followed by anne providing this presentation, which covers the issues in a little bit more detail.

The issues are debt service coverage, debt to equity ratio and reserves.

What I really want to talk to you about is debt service coverage, what it is, how it's used and how we see it and why we have used a cash flow method in setting rates instead the debt service coverage method and then anne is going to dig down into it deeper.

Let me start with asking, what is debt service coverage?

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Very simply, it's assurance to our lenders, our bond holders, that we can pay back their loan and properly maintain the assets underlying the loan.

We set -- it's month end that is set aside, after you've already paid off all of your other expenses, your own, so that the debt service coverage is free cash to provide this assurance to our bond holders.

You can think of it as your home loan.

Where the bank gives you an income test to make sure that after you've paid for all of your expenses, you have income left over to pay off your mortgage and maintain your home.

Your asset.

But debt service coverage is used for other purposes as well.

Debt service coverage is a common metric that is used and you are familiar with debt service coverage ratios that are used by bond rating agencies, as comparative measures assessing credit quality.

So after paying off all your other expenses, how many times annual debt service do you collect in cash?

We have provided you information on some of these metrics from rating agencies, we include it on your table that's recent fitch report from june of 2011 that demonstrates that double a minus municipal utilities like austin energy 48 time debt service ratio.

At this time, this reports that austin energy's dsc 62 times well below our financial 0 of so what do these -- what these dsc metrics tell you, is whether you're within the ballpark of other utilities that look somewhat like you.

What a dsc metric doesn't do is account for unique financial circumstances, goals and objectives of the community or utility.

A dsc metric is good at

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identifying what's an appropriate average, but this simple ratio doesn't necessarily tell the whole picture if you are not average.

When evaluating the credit quality of an institution, rating agencies look much deeper than these simple metrics like debt service coverage.

In addition to being used as a metric, debt service coverage has been used in rate making.

Sometimes used in determining the revenue component of a utility's revenue requirement.

So for example a portion of the revenue requirement is based on a multiple of debt service, for example, a minimum of two times debt service coverage.

So you stack up all of your income sources, then you cover your o and m and the dsc is what's left.

The free cash to pay for your bond repayment, capital program, your reserves and your general fund transfer.

But there's a limitation on using debt service coverage metrics as a basis for rate making.

And that is you are setting your revenue requirement based on a metric that represents some industry average that doesn't account for unique circumstances and goals and objectives of the community.

So why has dsc been used as a basis for setting rates?

As you know, the traditional municipal utility industry is considered extremely low risk.

Prior to beginning of deregulation in the mid 1990s, utilities were self contained, they had little or no exposure to electricity markets or competition.

Costs, particularly fuel costs were relatively stable and predictable with some exceptions, of course, and the regulatory environment was extremely stable with a defined monopoly service territory.

A and captive customers provided bondholders a guarantee of repayment.

In a low risk environment like that, it is not unusual to be highly leveraged and in fact austin energy was at approximately 80% of debt to

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equity as recently as the mid 1990s.

But for every $100 investment in capital, in the mid 1990s, 80% was borrowed and 20% was paid cash.

When you are highly leveraged like that, in setting rates, it's -- it's simple to see that a debt service coverage ratio approach in setting rates can be an advantage.

At 80% leverage, a debt service coverage two times will generate a lot of excess revenue to pay bond holders, to provide for your to build reserves and to pay the general fund transfer.

For a utility that is not highly leveraged, it doesn't really make sense to set rates based on dsc, so consider quickly two utilities, identical in every way, one has an annual debt service of 100 million and another one has one of 20 in.

At setting a rate requirement of two times coverage, that means after making your annual debt payments, the first utility has about $100 million for , reserves, and general fund transfers.

While the second utility has only $20 million for c.i.p.

Reserves and general fund transfer.

It probably doesn't make sense for the second utility to set its rates based on the same dsc criteria as the highly leveraged utility.

No austin energy no longer operates in a low risk environment.

We integrated in the ercot, very sophisticated market operations, subject to the market risks of the ercot as you know the august outage at the fayette power plant costs us about a million dollars an hour during peak hour, extreme regulatory

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legislative risks, decisions made at ercot, public utility commission and the legislature can have significant impacts on us.

Also associated with storms, outages, cyber security.

So we no longer operate in a traditional utility environment of low risk.

We face financial and regulatory risks that simply couldn't have been contemplated as recently as the mid 1990s and we have made new adaptations.

One adaptations is that we are less leveraged.

That's obvious from looking at the housing market today.

Households that have excessive mortgages are stuck with no options, no flexibilities.

By reducing our leverage, by having more equity in our investments, in this higher risk environment, we have more flexibility.

So we're no longer leveraged at 80%, council policy calls us to be leveraged from 40 to 65%.

That's financial policy number 14.

And currently we have a debt to equity ratio of 50/50.

And as a company operating in a high-risk environment with a more moderate debt to equity ratio, it doesn't make sense for us to set rates based on a coverage ratio.

And the public utility commission's rules for municipal utility rate making contemplate and recognize this.

As you know, the public utility commission has original jurisdiction over our transmission rates, the rates that we charge other utilities for the use our wires, as a result of some legislation in 1995.

Back in 1998, austin energy participated in a public utility commission rule rules and guidelines for setting transmission rates for municipal utilities.

In rate making a cash flow method as an option for municipal utility in computing its revenue

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requirement.

That rule making was followed in 2001 when the public utility commission reviewed its rules for setting transmission rates in light of the brand new erwholesale market for selling electricity.

Again advocated for the cash flow method for an appropriate method for establishing requirement for municipal utility.

In their final decision, the clarified that municipal utilities consistent with the actions of a city council with rate setting authority, may use the cash flow method in transmission rate setting.

And that's just what we did in 2006 in p.u.c. docket no.

31462.

That is a fully litigated austin energy case before of texas, setting the transmission rates that we charge other utilities for the use of our system.

In that 2006 case, austin energy proposed, and the public utility commission approved, setting the revenue requirement using a cash flow method.

So in summary, when you are operating in a high-risk environment, with a balanced debt to equity ratio, with goals and objectives that are unique to the community, we have advocated since 1998, at the public utility commission for the option to use the cash flow method as -- as appropriate for austin energy and we did so successfully in the 2006 transmission case.

It is our expectation and it has always been that we will use the cash flow method in this case and that the approve its use for those same reasons that i have explained.

We believe then and we continue to believe today that the cash flow method is the appropriate method to be applied in building our revenue requirement.

So how does cash flow method work?

It's a simple accounting of your expenses and revenues.

You simply stack up your cash flow expenses, o and m,

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capital, debt service, reserve contribution, general fund transfer, you stack up your sources of revenue and you compare it.

The difference is your revenue gap.

That's what we did.

That's all summarized in the rate analysis and recommendations report.

Every expenditure of the utility is documented.

Every revenue source is included.

And we've been guided in developing these revenue requirements by priorities that have been set on strategic objectives developed by austin energy and policy guidance provided by this and prior council of we have the 2003 strategic plan, approved by this council.

Which sets goals for the quality of customer service, economic development, system reliability, double a bond rating, renewable energy targets, energy efficiency, solar energy and kicked off our solar rebate program.

The 2007 climate protection plan, setting goals for austin energy to be the leading utility in the nation for green house gas reductions and more recently passed the austin energy resource generation and climate protection plan to 2020.

Which establishes goals for energy efficiency, renewable -- excuse me, renewable energy, co 2 reduction, affordability and 62 additional line item recommendations for austin energy.

We are also guided by city financial policies including having a minimum debt service coverage of two times.

By detailed targets and types financial reserves found in city financial policies and the general fund transfer formula.

These policy priorities adopted by this and other councils are all in this report.

Every line item in this report can be tied back to a city priority.

The line item may not say exceptional system reliability is called for in the strategic plan or the

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leading utility in the nation for green house gas reductions is called for in the climate plan, but there is a line item for transformers that ties back to electric system reliability and there is a line item for electric vehicle infrastructure and solar rebates and energy efficiency programs that tie back directly to other council objectives.

In summary, we have used the cash flow method, not a debt service coverage related method because we are municipal appeal owned utility and our objectives are -- or adopted and approved by this and prior councils, those were objectives that reflect the value of our community.

In our -- and our vision to be a part of the most liveable community in the country.

I'm going to leave you with three quick points then turn it over to anne.

These topics, [indiscernible] capital structure and reserve policies that we are talking about on this agenda today, as well as austin energy's budget are all interconnected.

As you would just -- as you adjust one, you may have to adjust all of the rest.

These are the tools in our toolbox to going the finances -- to manage the finances in the utility in response to changing circumstances.

If you set overly restrictive policies then we lose the ability to respond to changing financial services.

Secondly, I think that i have said this efficiently, the cash flow method is an appropriate method for austin energy's revenue requirement and finally, that you have adopted extraordinary objectives for us.

We have tried to bring you a revenue requirement that we believe is necessary to carry out those objectives so that we can be part of the most liveable community in the country.

Those are my comments.

Anne is good going to drill down, the slide presentation, then we are happy to take your questions.

>> Cole: Thank you,.

[13:32:00]

>> These slides are developed for discussion, so you can stop me at any point and we can talk about them.

They are organized with a couple of slides on the revenue requirement, then debt equity, then debt service coverage and then the reserves.

So feel free to stop me at any point in time.

This first slide is important because I think that it's important to understand the logic behind the revenue requirements.

I've broken it down into two parts.

And the top box represents austin energy's annual minimum needs for the utility.

I say minimum because they've been normalized to exclude all non-typical items.

For instance, we had a normal year and we didn't have any major storms, we didn't have any major special projects like nodal communication equipment.

If we didn't have an outage.

Then this first box would probably be adequate to cover those costs.

The second box is to cover non-typical events.

And that's what the reserves are for.

So you might could go along for a few years without the reserves, if you had adequate reserves available.

But at this point, austin energy's reserves are pretty much depleted, so the reserves are needed to make us whole.

These were the two phases that larry was talking about.

The first box represents the first phase and then we had proposed to give you a couple of years to discuss and continue discussion on the second box.

And then we could discuss and develop those financial policies over the next two years.

So that was the original proposal or the one on FEBRUARY THE 2nd.

Okay.

As mark said, the cash flow

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methodology is -- is fairly new to texas.

And it prescribes -- the public utility commission actually prescribes the line items it uses, it's different from other return methodologies that use a percentage of -- of rate based or debt service coverage.

So this one has specific line items.

That's how we develop the return in the revenue requirement.

The first one is the debt service.

And of course we need that to comply with our bond covenant requirements.

The next one is internally generated construction funds.

And that's the cash portion of our capital improvement program.

The general fund transfer is also part of that return.

And then the last two, the contribution to reserves and the decommissions reserves are really the only discretionary piece of that return.

And so that's another reason that those have been deferred to the phase 2 section of our proposal.

>> Mayor pro tem?

Question?

>> Councilmember morrison?

>> Morrison: You offered to have us stop you in the middle so I just want to make sure that we keep up with things.

You were focusing on the last two as being the ones that are discretionary.

Actually, what -- I clearly understand the debt service is not discretionary.

You get -- we promise to pay the debt money back and we are going to pay that money back come hell or high water.

That's always number one.

In terms of the -- of the capital improvements, the second one, I thought that's why we were talking about how you would decide to use different debt equity ratios things like that.

Since there are ranges out there, if we're talking about different debt equity ratios, ie how much money, how much cash you are going to spend on your capital investments, building power plants, versus debt,

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wouldn't that be under the second box or would that be under the second box?

>> It would.

But typically, when you file a return, you would use a historical item.

What we are following the p.u.c. rate filing packet.

And it requires us to use historical data.

So anything that you would change like your debt equity ratios or anything like that would be going forward.

It wouldn't necessarily be on this filing.

>> So you are saying when -- I appreciate the discussion about cash flow versus debt service coverage because basically this is the way i do my own budget at home.

It's easy to understand, not always necessarily easy to comply with.

You figure out how much money you've got coming in, figure what you have got to pay out, you hope those line up or in our case here we want to make sure that there's a whole lot left over because we want to safe, right?

So can't we say at this point when we line up how much cash is going to be going out, can't we say we want to follow a pattern of say 40% instead of 60% of cash flow covering our capital.

>> Yes, you can.

>> Morrison: In our rate making we can do that?

>> Right.

That's key.

That's a very good point.

Because going forward, if policy changes, going forward, how we do that, then we have to do our business planning on that basis.

If you can imagine, our capital goes up and down every year.

We have commercial paper program, I think that -- basically how we do -- so our projects go up and down.

What we use is a three-year average capital, reasonable three year average that was normalized to put into the test year.

I think it was $111 million of cash, total capital.

Cash supported.

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It was 222 million.

If going forward that metric is more 60/40, then we can change the future, we can change those numbers to reflect that.

>> In our rate making case, right.

>> I anticipated that in making the pitch of the last proposal, during the next two years we had better figure that out.

>> Morrison: I thought you only suggested that we figure out different reserves, this is different than a reserve.

>> No, I think that we contemplated that we would look at all of our financial metrics set by council in that time period.

In other words, if there's a way to take a lot of these higher level financial policy strategic decisions off the table for a while, that proposal did that.

It gave us the revenue to operate $88 million or so, if I remember right, the rest of that, $40 million, we will set aside and visit that over those two years --

>> Morrison: Okay or alternative we could say hey instead of 50% cash versus debt on our capital, we decide for right now we want to go with 45% and maybe still talk about it, but that would change the -- the numbers in the second box on our slide.

>> It would change how I do the budget for next year.

>> Morrison: But would it not also change our revenue requirement?

>> You would have to look at all of the different components kind of like mark talked about.

>> Morrison: Absolutely.

>> You couldn't just change one.

For instance if you --

>> Morrison: I know that, I know that.

>> Okay.

[Multiple voices]

>> I see your points.

>> Morrison: You can change that number and it will ripple and change different things.

But we could change that 111.

>> On an example year yes, you could.

You could take that year and you could reshuffle that.

Again, back to our proposal that's on the table, it isn't going to reshuffle that piece of it --

>> Morrison: Put off -- [multiple voices] right.

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Then I just wanted to say one other thing, I think this whole issue of discussion for all of us to understand of cash flow versus debt service, debt service so what I'm getting is debt service is not something that you set in the beginning.

It's just that we figure out how much money we need, how much money we have coming in, then we do a calculation to see where we are at the end, hopefully it's over 2.0.

If it's not we have to do something about it.

>> That's correct.

I will say, though, as mark, mark went into this very well, but very simply there are a lot of public power systems across the country that don't have the same environment here as here in on these issues.

And you solve for debt service.

>> Morrison: Exactly.

>> That's the number that you solve for.

Look at a 10 year financial forecast going forward with your capital expectations and all things you want to do, you can see the debt 0 all the way through, you can see how much additional revenue you need from rates in every one of those years.

You might decide that you are going to dip below for a while because you know that you are going to have a rate increase in a certain year and that gets you back in the saddle, so to speak.

>> If we were for instance to do our revenue requirement, calculate the debt service ratio at that point in coverage and it 05 we would know that we were in trouble, that 105 is not high enough.

But once it gets high enough it's not like you set the debt service and figure out from there.

It comes from the end.

>> So if you look historically back at austin energy, it's probably been all over the place depending on certain years and some years you may have had a lot of capital that didn't come forward, you didn't spend, a lot of things that change it.

That's where it gets

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complicated because if we change the number in that second box, then our debt service calculation might not be enough, so we would have to then do an adjustment.

So I think this is important for -- for the simpler point that I'm getting.

>> I would like to make one other comment about that.

That is today we're at 50/50.

If you set a target for us to beat at 60/40, it takes a while to get there because we're a big ship with a lot of debt.

It moves slowly, the debt to equity ratio moves slowly.

As I mentioned we were at 80/20 in 1996, it took a decade to get to a lower ratio similar to what we have today.

If we were to move to 60/40, it wouldn't happen overnight.

It would happen over the course of several years.

>> I would jump in here, too, that there is another way to do this, too, instead of doing it by percentages you do it by dollar target.

In the test case year we have 111 million in cash going into capital.

You can pick a number.

You can say well the most that you are ever going to contribute by cash into capital in any given year would be $50 million for example.

That means on your capital planning you have to be pretty clever looking forward to make sure that your debt service, projects that you need, how much you're going to go to the market and get that, that becomes a larger management problem in the long run as a strategy of borrowing, if you do that.

That's done by a lot of public systems do it that way.

In fact there's a lot of public systems that borrow 100% of their capital.

They have tried to get away from that for obvious reasons, but -- but it is -- it is done.

>> It might depend on what [indiscernible] you are in if there are low interest --

>> or if you are a big generator, how big you are, a lot of different criteria that's there.

I think in austin energy's case, you know, what I have

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observed in last almost two years that I have worked there is that this is a high growth utility.

Very high growth utility.

We have -- we have a new substation going in for formula 1 right now, power lines, all kind of things going in for all of the developmen that takes on a little bit different financial strategy than one that is slower growing.

>> Morrison: In fact that's one the issues that we've heard from the public.

That is hey if we're paying a lot of money for the growth, we want to build that into making it so that the people that are here in the future can help pay for it as opposed to just us paying for it, those of us that are here that means put it into debt.

>> We have a work session coming up on that, I saw that.

>> We do.

>> Cole: I just wanted to clarify a couple of things that councilmember thomas talked about and that you hit on -- councilmember morrison talked about and that you hit on.

Number one, we have an existing financial policy and that a range of debt for equity from 40 to 65% which in my opinion gives y'all the greatest flexible.

Second you have offered in your proposal to actually study this for us and tell us what the options are on our revenue requirement for the next budget year; is that correct.

Correct.

>> The rate proposal has an 8% --

>> I'm not exactly asking what you propose.

I'm asking that I remember that these issues about the debt to equity ratio and the reserves were items that you wanted to put on the table that needed further study because we were asking lots of questions about them.

Because like you just called it the ripple effect.

If we change that rate it impacts the whole system including city finances so

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that during these sessions i would think we would want to be giving you as much guidance as we can, just like councilmember morrison said, there are people in this community who are concerned that some of our new growth is not the future, people are not paying for that.

So we would say to you larry we want to try to build that into the debt model at a reasonable basis, I don't know if that's 2%, I don't know if that's 5%, we want to see what kind of effect that's going to have on the revenue requirement.

Now, what type of analysis, how long would something like that to you to figure out?

>> Well, as I said, we anticipated that -- that we would have time after this initial step, that we would have time over the next two years to do that and -- and but what you hit on is really important because the sooner we have those strategic objectives, the policies laid out to us, then we put that at our plans going forward and then we can achieve that.

It takes us a while to move to that.

It doesn't take five years to move to it.

It takes just a few years.

>> Having it as a goal, we have given you a goal from 40 to 65%, but if it needs to be from 35 to 70% or 40 to 50, constricted or enlarged, I would think prudent thing to do would be to come back and give us a range.

It doesn't have to be 50/50, but that's the kind of input I think these sessions --

>> to get into that level requires us to look down the road for 10 years at all of our capital planning so we could walk into it.

In other words if you said we want 40% cash, 60% debt on new projects, capital going forward, for example.

Then we would have to look at all of our projects going forward and knowing that we're going to borrow that much, we have to put that into our strategy as well and so we have to do a whole plan on that.

So all of the capital

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planning that austin energy has been doing over a number of years here has been based on the 50/50.

So that's what we have now.

We change that, we can do that, but we have to phase it in.

So that time span, those couple of years, gives us a chance to do the work.

To move in that direction.

Does that make sense?

>>

>> Cole: Yes, thank you.

>> Mayor?

>> Councilmember tovo?

>> Tovo: I have a couple of quick questions.

One I wanted to say one of the documents in front of me talks about the range being 35 to 60%, I'm sorry, yeah, 35 to 65% and so we might just check that, whether the bottom is 35 or 40.

>> What you are reading is the equity.

In the financial policy it talks about the equity portion.

The equity portion is the 35 to 60.

So the inverse is the debt.

>> Okay.

>> So you have to make sure when you are looking at ratios or reading the policy, which side of the formula they are talking about because it is confusing.

>> Tovo: I did want to ask you about, I know mr.

Dreyfus talked about it's currently at 50/50, you said it has been for some time.

I was looking at some of the budget documents you included in this, I think it was the rfi from yesterday.

Now is probably a good time to say thank you very much for all of this work in putting together of the primer, it had very good links, I imagine that took a great amount of work, thank you for that and taking the time to answer all of these questions, one of the pages in the budget documents talks about capital improvement plan funding.

It looked like some of them are funded at a higher level of debt than 50%.

Like the distribution projects are funded with 65 debt, 35 revenue, transmission 60% debt.

So am I comparing two different things?

It doesn't seem like the projects listed are at 50-50.

>> Yeah, that's a really good point.

Because each business unit

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has a different formula.

And it needs to be that way because of the risks.

So transmission our debt equity ratio, the debt speakers is 60%, whereas distribution it's around 65%, for generation then it depends on the project and what's going on.

So all of that together forms the -- the debt equity ratio.

So it's not 50% for every single project.

>> So you want to reach an average across the -- across all of the projects at 50/50.

>> That's the simplest way to say it.

What you are shooting for is an average over time.

It's not going to be exactly that over that period of time.

Strategically, depending on what we're doing year to year.

For example, we have sand hill, the [indiscernible] cycle edition coming up in a few years, we have pushed it out a couple of years already.

We would make a different kind of capital debt equity decision on that piece of investment versus a different type of investment.

But overall, it gets to the 50/50.

>> Again, I just want to clarify, we have gotten some very expert folks who suggested maybe a more appropriate ratio or a ratio to be considered would be 40% cash, 60% debt while interest rates are low.

So that's one reason why i was glad to see this on our early work session because it does -- it will have an impact on revenue requirement.

Though I take your point that it impacts, increases, we have to increase then our debt service coverage and other things.

So it's not like you can just take that off the top of the revenue requirement.

It requires other adjustments as well.

But it still could be a way of, at least in the short term, lowering the revenue requirement.

>> You have to make sure that you have the cash revenue that you generate to cover the additional debt coverage on that.

And as I said before, sits attainable.

All of it is attainable, it

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just has to take place over a period of years.

You can't adjust to it that quickly.

>> It really depends on the capacity to borrow.

I guess really the next slide kind of shows that.

If you will let me move on to that.

What this does is basically illustrate how all of the ratios work together.

You can see the debt equity and the reserves are the mainly pieces of that.

That's what the rating agencies look at.

That's what we look at because one of our strategic goals is to achieve a double a rating.

The debt equity and reserve are cumulative.

They are balance sheets.

So they are cumulative ratios.

From -- from the beginning of austin energy over 100 years ago.

The balance has moved forward.

Our current debt about 5 billion, current is about 3 billion that gives you your 50/50 ratio.

You can see since they are cumulative, that moves rather slowly.

You have to look forward in order to adjust those.

The debt service coverage is the one-time snapshot of your coverage accommodate to cover your debt when you pay your operating costs.

You can't just take one, like the numerator and say that needs to be higher and it also depends on the balance.

Like the reserve reduce the risk and provide the flexibility.

So you may not have the capacity to borrow an additional amount, if you don't keep those in sync.

This was pulled straight from the auditor's report.

This kind of helps explain that interreaction between those as well.

[13:54:01]

This is a debt equity ratio that the -- that moody's uses.

Their debt, they say that their debt for a double a rated utility should be in the range of 26 to 50%.

So what that means is for a double a rated utility, you should use 50% to 75% cash to finance construction.

So it kind of goes back to your question, we're at 50% right now.

We don't have any reserve.

So it would hard for us to go over the 50% and maintain our ratings until we build those reserves because that helps balance that ratio.

>> Tovo: It was my understanding, though, that austin energy had an aa minus rating right now.

>> We do, that's with fitch.

With moody's we have an a 1 and where our goal is to get to a double a.

>> Tovo: Because you just talked about maintaining your rating, seems to me that these were goals for -- for attaining an aa rating.

Ism in the auditor's report or your information that there's any danger of -- of -- of going down, of getting a -- what do you call it?

A declining rating because you've adjusted the debt equity ratio.

I mean, it seemed like there was plenty of peer cities, maybe this is a question for the auditor, but it seemed like there were peer utilities that had high levels of debt and still enjoyed the same rating.

>> Uh-huh.

>> With, again it's --

>> no, I'm sorry, go ahead.

>> I -- generally I don't disagree with you.

That you can do that.

The difficulty working with all the rating agencies as a public utility, it really goes beyond this metric itself.

There's a lot of other factors.

So I just want to say that because I don't want you to

[13:56:00]

focus entirely on this as a rating slip or increase.

There's a lot of different factors.

The well-being and the economy your service area is huge.

We're in good shape there.

And we have a lot of these factors.

You can work with a variety of different ranges here on the amount of cash that we use or not use.

But I think the -- the really important point is that you have to plan for that going forward, you really can't look back and adjust anything or make anything different about the past with it.

In fact you can't go back and borrow money and repay your cash.

It doesn't work that way in finance, everything is moving forward.

I think your point is we are not a double a.

We would like to be, we are really close to it.

All of the information that I have is that austin energy is -- is very capable in getting there.

The city is triple a as you know, and so -- so -- so i just want to make sure that we're real clear and honest with you that this is on-- this is a -- the best metric that we think that we could be at in the industry.

When I look around peer utilities around the country, I'm not going to name them, but there's a few that I would look at.

I did look at them.

They are at about 50/50, not every year, but that's their goal to be right there.

>> Tovo: Thanks, I wanted to be sure that we don't think if we adjust it as a city that we would be in any danger of being downgraded.

>> Right.

>> Martinez: I wanted to ask a couple more questions on this slide, because i assume that moody's also has multiple requirements for achieving double a rating.

What is, if any, what is their requirement for reserve status to achieve double a rating?

>> I believe you have -- on reserves, you have in the past, the council and mayor, have taken action to set specific targets for strategic reserves, not

[13:58:01]

every public utility does that.

They basically have a liquidity position and they don't really assign it.

Having done that, in the past, my guess is your financial advisor really encouraged you to do that.

Having done that, that is a strength that those agencies look at.

They look at the fact that we are held to holding certain reserves that are specifically targeted for what they're targeted for and they're fully funded, it's very important in getting a good credit rating.

>> Martinez: I understand that.

Having a good policy is one thing, but being able to achieve that policy is what they're really looking for.

>> Yes.

>> Martinez: Do we achieve that policy on the reserve side?

As I understand it, our reserves are woefully low.

I assume we are not achieving our goals.

>> On the strong reserves, we are there.

>> Cash on hand.

>> Cash on hand, that's where we're getting down.

That's something that changes fairly fast.

You can change it fairly fast and it gets in --

>> Martinez: So the point that I'm driving at with asking these questions is if approximate we were to use more debt, wouldn't you also argue to those rating agencies that that is to achieve more reserves and cash on hand --

>> on the operating fund, yes, sir --

>> to comply with those policies that you say.

>> Going forward, right.

>> That you say they --

>> you could do that, but it would take -- we would have to do projections based on presumed capital, it would take several years, I know that you know this, it would take several years to grow back into it, but you could.

Depending on how that would move depends on how big our capital program is.

>> Martinez: I understand.

I just wanted to make sure that we got on to the table there are so many other factors other than saying -- it even says debt should be in a range of that percent, there are lots of shoulds, wants, coulds, it's not an exact science in these rating agencies, you have to articulate your policies and -- and where you are in your current structure and that also helps in achieving those rating.

>> My experience with it, it's the whole package.

So you are correct, it's the whole package.

>> Martinez: Thank you.

[One moment please for change in captioners]

>> and they both wanted to add on to their house and they might -- the first one might go to the banker and -- and ask for a 50,000-dollar loan, and if the banker had the same criteria, he might look at their financials and say, well, you have 50/50 debt-to-equity ratio but you are at the top end of that so let me look at your financials.

So, for instance, if this person said, well, I am making money and my revenues are greater than my expenses and I have $100,000 in my savings account, I think the banker might say, okay, that's a balanced equation.

I will give you the 50,000-dollar loan.

Let's say his neighbor that had a 50/50 debt-to-equity ratio came in, too, and said I need a 50,000-dollar loan, and this person said, you know, I have only got $5,000 in the bank but that is my emergency fund and will get me by for a couple of months but the banker will probably look at that and say, you need a little bit more money in order to balance this equation.

And as he looked at the financials a little closer, he would notice that maybe the expenses were greater than the revenues.

So I think what he would do is say, before I can give you a loan, you need to increase your savings, you need to increase your revenue somehow so you can build those savings and then come back and I will give you a 50,000-dollar loan and austin energy is kind of in that second position.

We have low reserves, low cash.

Our earnings are not as high as they should.

In fact, they very negative for 3 out of the 4 years, so I don't think that we have the capacity to borrow a lot until we build the rest of the equation.

And that's why that phase two would help the us give us time to build all of that up and increase our reserves, increase our earningsing and then we could come back and talk about increasing the borrowing capacity.

>> Martinez: Mayor, I think that's an understandable example, but I would like an example more to a business model as opposed to somebody's private residence, because as a business model, you would go into the same financial institution and clearly be able to demonstrate that if you give me this 50,000-dollar loan, I can increase my earning capacity by x amount, therefore, demonstrating that it may not be as high of a risk, even though my carbohydrate though my cash reserveare low, that is more appropriate of what austin energy spacing, as opposed to straight up -- you own a house and the neighbor owns a house because what we are trying to demonstrate to the lenders is we need this cash to meet demand but to also increase the revenue side of austin energy by expanding our service territory.

>> And the business side -- on the business side, in order to do that, as you know, you have to have really good story and a very good plan and it is achievable.

It is achievable.

If you have a really good plan.

back to real world, a week ago, last wednesday, how did that go?

>> Austin energy did?

The city did.

the city did.

I thought it was austin energy, sorry.

>> Oh.

No.

I don't want to right now.

[Laughter]

>> mayor.

To follow up on what council member martinez said in terms of, you know, being -- sort of like how you phase different things.

One of the things I am curious about, I know building up our reserves and there is questions about what the appropriate reserves are and replenishment rates and all of that, but your two phased approach is suggesting we don't start building our reserves for three years.

I would think that it would make sense to build -- building up some of those reserves now, adjusting some of the other things now and really getting at it and i guess I want to get that in front of the table with my colleagues here because i hear two different, sort of overarching approaches to things.

One is, let's do something that austin energy feels is really, really secure about and all of that.

Right now and put off building the reserves and figure out some of these things later.

That's one approach.

The other approach that i think we'rously need to explore is to look at how can we steps to make sure we are secure, there is absolutely no question about that, to move towards some -- to move towards some edges of the ranges, like with the cip, that will lessen the need for revenue because the bottom line is the rate impacts are a huge problem for the people that we are hearing from.

So if we can move toward those ranges right now and then, including -- including allowance for some rebuilding of the reserves so we are keeping everything in the mix but really trying to minimize the revenue and work through these issues that you are talking about in those next three years because if we have another rate case in three years or whatever, and, frankly, for me, I really strongly want to take a look at how can we make sure that we are secure but also minimizing within safe ranges the revenue requirements.

>> My response to that is that in the planning of putting that last proposal forward, the idea was not to deplenish our money anymore, and my job with the staff to look at capital planning going forward with all a of the projects and we have been so busy with rates that we have got to get around to that and when we know what our future looks like with this -- wrapping our hands

around the proposal, when we put it together when thought about it, looking at the capital planning and everything and going forward can also maybe minimize some of the contributions and get the policy straight so we know what the future is and I think with that first step, we also get to the place where we go to the rating agencies and get a rating and do some borrows and actually get to the place where if we are going to do down the road where we are going to do more borrowing for capital, we are at a place we can do that.

>> Morrison: I guess in terms of capital planning if I recall correctly, navigant had recommendations -- it was one of the recommendations for prioritizing.

>> It always is.

>> Morrison: Right.

But I guess I just like to keep on the table those two different approaches because the fact of the matter is, the numbers I have seen in terms of moving to a 40% of equity as opposed to 50% has a pretty significant -- I know it's not direct, but it can have a pretty significant impact on the revenue gap, to the tune of 15 million or something like that.

And so that's why I would like to take it effective.

It is bigger if you go --

>> Cole: I have a question for you council member morrison.

pro tem cole.

>> Cole: Thank you, mayor.

You talked about two concerns you have.

One, of course, is the rates that we ultimately charge based on the revenue requirement, and that if we used a higher amount of debt maybe we could are reduce the amount that we need for the rates.

And then, second, you talked about the concern in the community for new growth and that needing to be borrowed money because, then, there is a kind of widespread sentiment that the people who are coming are going to be participating in that.

Did I understand you right?

>> Morrison: Right.

>> Cole: Because I thought that was an interesting argument.

>> Morrison: Those two points are consistent.

>> Cole: You feel strongly about that?

>> Morrison: I think moving from 50 to 40, say, could have significant impact on decreasing the revenue gap and that is an additional argument for it, that it's a fair thing -- it's sort of a fair approach to things, and that is to have the people that are here in the future participate in paying for it.

That's what that does for you.

That those are two very consistent -- consistent approaches and that could have a significant impact on what we have to -- what we have to charge for our rate increase.

And so -- but being fully aware that there is additional work to do and if we are going to try to have rate cases more often, then that would allow us to adjust at that point.

>> I think that -- you just the hit on that.

That is the key and that's why we are spending so much time on it right now because it has been so many years that this has been really addressed.

>> Morrison: Right.

>> That those financial policies of which, my opinion, none of them are exactly right.

It's the one -- it's the one that we operate by, that financial policy, plus or minus a little bit, to make myself clear, that it's not a -- within this business, it's not exactly 50%.

It's -- you have goals.

You are try to shoot for it.

But if we know what those policies are going forward, the then we can plan for that and we can make those differences happen, absolutely.

>> Cole: I just interjected to your comment because i think pretty soon we are going to discuss line extensions, and I think that's one way to sort of get at the issue of new growth and new growth paying for itself and so i understand that sentiment so you know there is kind of an interest on the council for that.

And I am probably on the other end with wanting to believe that if we need to be more stable as possible as opposed to the 40-50%, but I understand everything you said and I am getting there.

>> Morrison: Great.

>> Mayor leffingwell: okay.

So if you change -- I am hearing conflicting information, at least in my mind.

I thought I heard you say a while ago if you changed that ratio, from 50 down to 40, that that would have an effect over time, but would not have a significant or appreciable effect in this year or maybe next year.

Which is it?

>> It would not have appreciable effect until a few years.

We would have to forecast that out, that's correct.

It wouldn't change anything right now this year.

>> Mayor leffingwell: That's what I thought i heard and I wanted to make that clear because I thought I heard the number $15 million off of this year's revenue requirement are perhaps because of that.

>> Well, I am -- I am responding from the context of the a rate proposal we have on the table, which has a piece of $88 million of the revenue requirement and then the other piece.

What we are talking about really affects that latter piece, if you think about it that way.

In other words -- in other words, if you change where we have to take this utility in the next few years with a different phosphorylation financial metric on what we have been operating on and our financial assumptions then we take it where you want us to take it.

we can say where to take it right now but the point is does it have an effect on the revenue requirement now?

>> Morrison: Does it have --

>> mayor leffingwell: Council member morrison.

>> Morrison: Thank you.

I appreciate you bringing this up to make sure we can get it straight because in our revenue requirement, in the cash flow analysis, i understand that there is $111 million in there for capital equity investment.

>> Morrison: Transferred of cash to capital.

>> Cash to capital.

>> Morrison: Exactly and that's assuming that we are going to put 50% of our cash in, and if we instead decided to put 40% of our cash in, would that 111 figure go down?

>> Yes.

>> Morrison: So the rate that we need -- the total revenue gap would change?

So -- excuse me, mayor.

So I -- it's my understanding that it would, in fact, change so we need to get this straight.

well, I do think we need to get it straight.

So what I heard from now weis, is two different answers in the last one minute.

[Laughter]

>> well, yes, you did because I was answering it from two different perspectives.

When you look at the test year that we ran and the revenue requirement they ran, if you ran that with the different debt-to-equity ratio, that would drop the amount of cash you need correspondingly, that's correct.

But what we didn't factor in is the additional debt that we would have to take in that scenario and so that's -- that's the other piece that I don't have the answer for.

Okay.

So fair enough.

So it's kind of -- it is not really absolute yes or no answer.

I am sorry.

>> Morrison: But, in fact, 111, would go down to 88 but then you actually have to add some money back in because your debt service changes and you have more --

>> and debt service of two and all of that.

>> Morrison: But the bottom line is the rate gap -- the revenue gap would decrease?

>> Correct. correct.

>> Mayor leffingwell: Council member riley.

>> Riley: And just following up on that, if part of our challenge is to get through this immediate problem in a way that mitigates the pain for our ratepayers, isn't it possible that we could phase the -- our planning on this so that, for instance, for the next -- just for the next couple of years we could go up to -- we could start relying more on debt for that capital program, just to get the

revenue requirement down in this rate case but mindful of the fact we would like to get to a double a rating and generally our our say of utilities will get double a rating utilities don't get -- they don't get the cash component below 50%.

We know we want to be up in that category, that -- with that in mind, that we would aim to get back to 50/50 approach within a couple of years.

It seems that would make sense because it would essentially be a way of achieving the same kind of phasing that you are aiming for, to try to get through the next couple of years that sort of transitions us into an approved position for the utility, but, yet, doing so in a way that mitigates the pain for the ratepayers.

>> That's a good point and i think we could do something like that in the revenue requirement.

The only danger is that our capital improvement program is, it has generation distribution transmission, but it also has got a lot of items that do not have a 30 year life, and we can only finance with debt items that have a 30-year life.

So, for instance, when we do a lot of things like the billing system or communication equipment and software related to the nodal market, a lot of those types of requirements that we had to meet and will have to meet in the future can't be financed with that.

And so that's why you will see when you look at our cip program closely, that in transmission and distribution we are already at the top limit and generation is about the only place where you can really start moving that debt equity -- the debt side up so if you have big generation projects out there, out it would be pretty easy to change this and then move forward without get going another deficit position.

So you just have to be careful with the make-up.

And that -- I think that's the only fear in just saying we are going to increase the debt over a short period of time because we may not have the assets or the capital projects out there in order to increase that, you know, year by year.

It varies from year to year.

>> Riley: And it is challenging for us on a council to be so familiar with the capital plan that we can take those considerations into account.

So what would be really help theful is if the utility could offer some suggestions about how we could -- how we could achieve this.

>> Well, listening to you talk about having a goal of 50/50 and a allowing the utility to not have that goal in the time period, i think anne is right, it really depends on what capital projects we have on the table right now.

We have, an example, system control center that is out there, it is a long life, large facility.

With we are going to finance it with 100% debt.

And so, again, the clear -- the best message to us is to give us clear direction about the policy that you set going forward and we plan around that the best we can.

In fact, that even determines what year we would do things and what year we would not do things, to make sure we hit the metrics that anne was talking about.

>> Riley: For whatever it is worth, my sense right now is that we should aim over the long term to keep -- to stick with at least 50% cash on our capital plan, but for the short term, it seems like we could deviate from that without too much harm and some deviation would help us get the revenue requirement down for purposes of this rate case.

>> Mayor leffingwell: Council member tovo.

>> Tovo: Yes, I agree and i think, too, there is another goal of getting us a little further down the row and reducing the rate impact right now and that is the contracts coming up in 2015.

That would allow the opportunity to get those industrial contracts that are currently about $25 million under the cost of services.

Is that the correct way to express it?

That would allow them the opportunity to share in these costs as well.

So I think that is a goal.

I was going to direct my colleagues to some memos i know we received from data foundry.

I think we all received them on january 23 and february 6 and they have actually done the calculations of what 37% equity ratio would look like and how that reduces the revenue requirement, and I -- we do have some representatives here today, if anybody has any questions.

And I -- I think, base on my calculations it resulted, even with the debt service factored in, it resulted in about an 18 million-dollar decrease.

Is that about right?

>> I think it reduces to 78% capital need and 15% additional to increase debt service coverage.

>> Council member, I would like to point out, we have seen those memos but we have not validated those numbers and before we would really have a discussion about those values, I the think we would like to have a chance to validate them so we can have an even discussion.

>> Tovo: Sir, I guess the general point, though, would be it would have impact -- adjusting the ratio would have impact of adjusting the revenue climate even if you factored in that coverage?

>> When I use my engineer brain and not my financial bring in this kind of stuff, it is about a number that is in there, so, yes, it does drop the revenue.

It does drop the revenue requirement, but fundamentally, it also triggers a lot of forward thinking about what you are going to do in your business plan going forward and i think that -- that -- their proposal nor anybody else can contemplate what the real consequences of that are but they are not significant if you can plan for them and you can get yourself down the road.

>> Tovo: Right.

I know you mentioned and that's an interesting point, not all capital expenditures can be financed with debt.

So thank you for providing those budget pages, again, that show us what the planned capital projects are.

>> Mayor leffingwell: Council member martinez.

>> Martinez: Larry, I want clarification, to make sure I didn't misheard you, did you say the system control center is 100% cash.

>> Debt.

100 Percent debt.

Ididymus hear you.

Thank you.

did you want something?

>> Cole: Let me get back to the slide we were on.

I --

>> mayor leffingwell: Council member cole.

>> Cole: Thank you.

I wanted to say I agreed with council member riley's comment that council member tovo also agreed with which is that it would be helpful if we stayed with our current parameterses of 50/50 but the utility provided us options with the short term of going below that and what would be reasonable, like cumulative information that the data foundries had rather than us trying to guess that.

>> Okay.

Question do that.

>> And on the short term and the way that I would direct us to approach it would be to strict approximately from -- wouldbe to strictly from basis of cash and no to a specific metric if that makes sense to you.

>> Mayor leffingwell: Right.

You have the flexibility to do that now.

>> Yes, sir.

>> Spelman: Mayor.

>> Mayor leffingwell: Council member spelman.

>> Spelman: I was going to hold off until they finished the presentation but I won't why should I be the only one.

[Laughter] if we did this, we are generally talking about here is backing off on on our financial strength and all of those ratios within some reasonable limits, with the same that the long run policy isn't going to change and in subsequent years, 2014, 2015, something like that, we will catch up.

Are there any costs to the utility of playing that game as opposed to keeping our financial policies exactly where they are and taking taking your loss immediately?

>> Just generally saying -- I would say any time you get into more debt, you are getting into a cost, but my quick answer on it is we can manage our way around that, provided we know that's the fiscal direction we are heading in.

There is a time where we will get ourselves into a position and we will get ourselves back into a 50/50.

It may take five, ten years to do it all, to get it right but it really comes down to our capital planning and what projects we have coming along.

Because they vary year to year.

>> Spelman: That's something which hasn't been on the table yet so let me put that on the table.

We are talking about the equity share in capital expenditures, or not talking about amount of capital expenditures and you have the criminal of timing of the capital expenditures.

Is that from your point of view something we can talk about?

>> Yes, it is very important and back to the rate proposal that is on the table, in these next c%uple of years, that's a high priority, a very high priority.

Capital planning is a very long-term business objective and austin energy has done a good job of planning that, but the projects we are d were planned for five years ago with the exception of short term like substation here or there for a new particular industry or load but for the most part all of the capital that austin energy is spending on today, these projects didn't come up last year.

They have been planned a number of years so to answer your question, you would take this point forward and look down the road and a recognize how much debt you are going to put on these projects and how much cash you are going to put in and what your limitations are and what we get out of these rates or don't get out of the rates when it is finalized and t we will know what direction to go in.

Does that make sense to you?

>> Spelman: Somewhat it does.

Let me see if I can be more specific.

In the early 1990s, one of the mistakes that the city council -- previous city council with which nobody in this room had anything to do with, one of the previous mistakes of previous council was to back off on the amount of money it spent on road reconstruction.

And when it reconstructed roads, when they needed to be reconstructed, they used basically the smaller foundation to put the road on.

The road only lasted ten years rather than 20 years.

What that meant over the long haul is the city ended up having to spend a lot more money on roads than it would have, had it bit the bullet and actually built the roads right the first time.

In the same way, I can imagine an argument and I am hoping you won't make it, but if you have to make it, I want you to do it, that if we put off some capital expenditures to get us through to avoid rate shock in the middle -- at the end of recession -- I hope it is the end of recession if we are still in one.

Avoid rate shock and put off capital expenditures, will it cause us more trouble downstream than we are saving from rate shock down the road.

>> I understand what you are saying, it wouldn't chara the same way in our business.

I think we would defer projects.

That's how we manage capital, we defer.

So a new substation upgrade, for example, in one of our 80 substations in the system, we would defer maybe replacing a 2 million-dollar power transformer and upgrades in that station and we may suffer reliability issue from that.

It's possible.

>> Spelman: Right.

>> It's managing load growth.

We would have to take our priorities, so I would go to our electric service division and I would say, okay, you need to prioritize what is the most important reliability investment you can make and which ones can we do next year and I want to understand what vulnerability we put ourselves in.

>> Spelman: Right.

>> And, you know, with that, I should say, while we are talking about that -- austin energy has extremely reliable electric system and our employees are extremely proud of it and we have pulled back a lot on the investment and that work, though, to go and dig deep into that capital to see if we can't move things here or there has not been done, but generally speaking, it is not probably the same as the road example, but it -- it does have, if you go too deep, it does have an overall reliability effect and it does cost you more later if you go to do it.

A really good example now is power or line upgrades and right-of-way.

If you are in the middle of getting a transmission line built and you are all set to go and it all gets deferred a few years down the road, you have to go back and get right-of-way again, it is more expensive.

Wire is more expensive and poles are more expensive.

But that goes with all of our capital planning.

>> Spelman: But you are talking about inflationary effect, wires and poles cost more.

Holding inflationary aspect, or maybe it is different than the rest of the economy, is there there any reason to expect things different in the future if you take into consideration maintenance and holding aside reliability.

>> I may have a case or no, generally speaking no.

>> We can do it now or later, as long as the reliability effect isn't noticeable and large, then that would be okay from your point of view.

>> Yes.

>> Spelman: Roughly what percentage of the capital program -- this is one of those questions which you will not give me an answer to but I want to put it on the table so you can find it.

About what percentage of our 220 million-dollar capital improvement program are we talking about that is conceivably deferrable?

>> You didn't want me to answer that, though.

>> Spelman: I want you to go find out.

>> Well, I am looking at it right now.

>> Spelman: Okay.

>> And we have, for example, in every year -- again, it is part of a system growth.

Part of it is this great service area we have in this incredible city that we live in and we have distribution substations at 8, 11 -- I am reading it, this is year 10 through 16, 8, 11, 8, 12, 17, and 23 million-dollars for total of $71 million for substations that's for customer growth.

Okay.

The distribution area where we have customer growth, we typically are 50-60 million dollars a year, again, that's customer growth and maintenance and if you fall behind on maintenance in a system like this, with the weather that can come here, we end up outages and things like that.

There is a lot of referral in certain areas and whether we can defer more, I don't know.

But the starting last budget cycle, because that was really the first one I was here for, we cut back quit a bit already in the capital.

So we have weaned it out pretty good.

The power production, the generation, what we did there specifically is we took -- we got 178 million in 15, 16 year.

That was up in the 13, 14, at one time, wasn't it?

>> Yes, it was.

>> And that's the sand hill -- the combined additional cycle turbine there to finish out the power plant.

Right now steam turbine and a gas turbine.

Other gas turbine makes it more efficient plant and finisheses it out and we deferred that by two years already so that's in there.

And then the other capital is relatively insignificant but it varies there is this whole period of time between 10 and 16, the 143 million to 289 million a year, 289 million a year being the last year that has that combined cycle addition in there.

And the decision about which one of these are cash and which one of these are done with debt, is one that is based on what anne was talking about earlier.

We tend to use more of the debt on specific projects that have to do with long life, large capital, single purchase big items.

>> Spelman: What you are telling me, I probably knew was true but hadn't heard expressed so directly before, that you actually have backed off on your capital expenditures plan?

>> Yes.

>> Spelman: Fairly considerably the last couple of years anyway.

>> Yes.

>> Spelman: Where is the document I can look at so i can measure and look and explain.

>> You mean capital program?

>> Yes.

>> There is a capital program --

>> Spelman: The capital program that we had to do with before the relative data baby relative to the cost and that is what we have.

>> Current to past one?

>> We can do that.

>> The only difference between the sand hill and the pullback on it.

>> It sounds like you are deferring stations?

>> Yes, yes, I have to talk to the staff about that and find out specifically what to do.

>> Spelman: Okay.

Last point, at least for now, we have been talking about equity share of a fixed amount of capital expenditures.

Now we are talking about a combination or a balance of equity share and the amount expenditures and there is two ways to back off on revenue requirements.

What is the right way to think about the proper balance?

>> My recommendation to you would not be to doing it based on what our capital budget is, because that can change and swing so significantly and, again, i talked about lot of it having to do with growth.

If the economy comes back and we have to do three substations upgrades a year, that capital number is really not a decision point for us.

It's really a service and reliability issue for us.

This then we have to recover.

So I think I am answering.

>> Spelman: You suggesting we have less control over our scaup toll improvement we have.

It's not discretionary.

If you have to have a substation --

>> that's right.

It is not totally discretionary and so the control variable of how much debt you issue or not, that is the larger amount of control issue more than the specific capital projects that you are doing, with the exception of some of the very large ones that come along, like the new power plant, for example.

>> Spelman: No power plants we can defer without much trouble.

Substations we think we can defer but our hand may be called by me.

>> Yes, let me give you another example.

This year we signed two very large power contracts for wind energy and we just bought the power.

We with didn't enter into any debt.

We didn't get into any ownership issues.

The day will be coming probably to meet target of generation plan, we probably will be doing some kind of debt structural long the way and that will be a pretty big debt issue and that will really drive these number, to the order of 250 million, $300 million, and so you don't put it all in one year, because you won't spend it in one year but you will have bumps in large capital that you will need to do and that will be on top of it and that will be more important discussion and a more significant from this perspective than any of these capital improvement programs which I call more routine, routine capital, to maintain the system growth.

>> Spelman: This is the egg in the snake, you can see outline of the in the snake?

>> Right.

And that's the trickiest part of planning in the publically owned utilitieses, is that one, very, very large capital investments that make better sense and you have to stage them in and bring them in just at the right time and move them through.

>> Council member spelman.

>> Spelman: Yes.

>> If I could speak to one point on the deferral of the power plant investment.

We are fortunate right now that as we are deferring that investment market conditions are also attractive so that we can buy power on the open market at lower cost and there doesn't seem to be an increased cost to our customers from deferring that power plant investment, but over time, those conditions could change.

We -- we are buying more and more power from the market as we defer that type of investment so should market conditions change and our customers could experience higher costs because we haven't -- we haven't capped their costs based on the cost of owning that power plant.

>> The power plant is kind of a hedge against what the proposed would be?

>> A and as we go through this, this is a good opportunity to educate you something to make sure we are really clear about this.

We are proposing today and when our proposal -- with our proposal going forward, all of the power that we purchase, all of the purchased power agreements that we have, all of the fuel, coal, natural gas, nuclear fuel it's all in the fuel charge and the fuel charge and the mechanism to do it and the mechanism to manage it is not part of the rates.

It is.

But we are not proposing any changes to that.

Not proposing any changes to that.

The o and m, the employees and the debt service for any of our generation debt facilities is in our o and m budget, okay, so as we go through this, you have to think about those two different components that are out there.

So as we enter new contracts for wind energy and for other renewables and other purchase power agreements and what mark just talked about, exposing ourself to more purchases power in the ercot market, that flows through in our fuel charge to customers and we could become -- we have to manage that because we could become more vulnerable if we expose ourselves to too much market conditions versus generation, that's a strategy going forward that we actually are going to bring to council this fall, is what our long-term generation strategy is going to be.

And that's more of your metaphor about the snake and absorbing that debt.

Yeah.

>> Spelman: Okay.

But you aren't talking right now about any changes in the constitution of the fuel adjustment factor?

>> No.

We are going to keep it the same as it is today.

The management of it the same.

And so I just want to make sure y'all understood that because there are discussions where those two get mentioned up and they are not -- they are not in the same --

>> Spelman: Let me see if i can summarize accurately.

If I miss something on it feel free to correct me.

We have the capacity within some limits to make changes in our capital improvement plan and to, defer some expenses but we are very limited in our capacity to defer expenses because we have to respond to growth as necessary and because we have -- we are buying too much power on the open market that we would like to have a hedge against that by creating our own.

We have a little bit more control on the short run on equity share of the capital expenses but then of course we have other limitations, some things we cannot buy-out of debt, we have to pay for with cash and so on.

There are limitations on that, too, but on balance, probably we have more leeway on the equity share in the short run and it is not going to cost us anything in the long run other than we are going to have to spend a little more in two or three years to make-up for the fact we aren't spending it right now.

And if we explain this -- there is a way to explain this reasonably to fitch and the other guys, they will understand what we are doing, we are slowly ramping up to exactly the same destination rather than getting there a little more quickly.

>> And my suspicion is i know they have heard that story many, many times before from different utilities.

The individuals who rate austin energy specifically rate public power across the country.

They are specialized in this market and so -- and they pay attention to what we are doing and what everybody else is doing for that very reason, because, really -- we are really the held in measure against our peer group because it's the only peer group -- that's how you do it.

>> Spelman: Right.

>> Right.

>> Spelman: So our peers are pretty much saying the same thing we are saying here, our peers have had discussions exactly like the one we are having here, and fitch says, okay, take your number.

Wait your turn.

give me the same story we have been hearing before.

>> For like size utility it is competition in that area, create the best rating you can and being -- but, again, the number one metric that is really working for us is the system growth and the robust environment that our service area has because the

>> because the revenues keep increasing year after year we have more leeway.

>> Yes, but a capital program of keeping up with the growth, too.

>> Spelman: Thank you.

i want to clarify a couple of things I heard in this conversation for myself.

Maybe everybody else understands them, but first of all with regard to new generation, whether it be wind or something else, as you know our current generation plan has some affordability constraints built into it.

The 2% per year, the remaining 50% of the rate structure, state in the state of texas for all utilities.

So I want to make sure that we haven't built in an escape to that cost containment, not saying, okay, we roll it into the fuel charge and we can spend whatever we want on any type of new generation capacity and it doesn't count against those constraints, so how does that work?

Verify that for me.

>> Yes, I will.

It is very good.

It is included in the rate.

It is included in the rate.

If you look at a customer's bill and add up the component in there, the fuel charges in there, and my point is that we aren't proposing to change any of the ways that that fuel charge is calculated or used.

so you are constraining, with any new generation capacity, you are -- those constraints apply?

>> Yes.

the other thing I want to discuss real briefly as we talked about, if we don't keep up our generation capacity up to meet our needs, internally, and i know you deal with a grid every day and decide whethers it is better to generate internally or buy it off the grid, but if we are forced to buy it off the grid, then we are at the mercy of the market, so to speak, and I think we have seen particularly last summer, that that market can be pretty brutal, and most of the time, I think, we have been on the positive side of it but if we are on the negative side, and especially going forward, which what I am hearing, the capacity of the ercot grid is getting tighter and tighter, so small disturbances could create big price fluctuations if we are having to buy into the market because we haven't kept up our generating capacity.

Then we could really be subject to some big losses from having to buy off the grid, especially on a continuing basis.

Is that --

>> yes.

That's correct.

I think you really summarized it, and we -- we -- our power market operations, what these folks do, they are very talented at what they do and they look forward on that even if we can enter into a power contract in case we lose one of our existing contracts, those contracts entered into are very expensive.

So there is a cost associated with the risk.

and the point I was trying to make and I think it was clear, was that the ercot grid, because other utilities around the state, not us, but other utilities around the state are not increasing their generating capacity the way they would like to because of various constraints, so that margin of -- that you have to draw on potentially may or may not be there, depending on the situation?

>> Right.

At ercot, most of the ercot market is relying a lot on private generation, so as a public -- --

>> mayor leffingwell: Exactly what I was talking about.

Yes.

>> Yes.

and they are not building the power plants now that they had planned a few years ago they planned to build?

>> Right.

Gas prices are so low -- historically low and the incentive for private developers to enter into -- develop, build new plans and put new generation online, i haven't been involved in one recently in the numbers on that but my guess is that it's probably a pretty tough market to look at right now.

>> Mayor leffingwell: yes.

And I think we saw about 13 months ago how that can play, because we had our generating capacity here but because other private utilities around the state were constraining their potential -- shutting down plants and so when they ran short, we had to furnish part of our capacity to them.

We didn't really have any choice to do that.

It was an ercot decision, even though we had it here, we had it short because we had some of it out of our city and up am not being critical to our policy because it can work the other way, too, some day and that's the way it is designed to work.

Council member tovo.

>> Tovo: I wonder if this might help us transition into the next section about reserves because I had some questions about the reserves generally and about the replenishment rate and hoped we would talk about options there but in particular, i wanted to talk about the rate stabilization fund and this does relate to what we were just discussing in terms of fuel costs.

One of the documents you provided us with talked about the rate stabilization fund would help minimize the need to use the fuel adjustment in future years, and --

>> do you want me to explain that?

>> Tovo: Well, sure.

But I think -- you know, i have heard some concerns from people about the rate stabilization fund.

In fact, we do have a mechanism for recouping fuel costs if there are spikes as there were this summer, and so rate stabilization fund is in some ways, you know, having customers prepay against the possibility of meeting future increases so, again, I want to sort of transition us into a fuller discussion about the reserve funds, but with regard to the -- since we have a concrete example from last summer.

As though funds -- am i right this in thinking -- i am looking at the response you provided.

So there were some unexpected costs.

You have pointed out in fuel factor memo.

One was the fuel -- the fuel charges, south texas nuclear plant around the coal plant needed expensive --

>> correct.

>> Tovo: And you are recovering that 1/12 at a time this fiscal year and do you anticipate it to be 47 million in recovery.

>> $47 Million.

And the way that works is it was the cost accrued last year and so what we do is we look backwards and we say, okay, that's what it cost us last year and the next twelve months going forward, we will recover that.

The reserve issue is we had to take the 40 something million dollars and go out and buy power immediately to replace that so we deplinished our reserves to buy the power and then next year we get the money back but presumably we don't let that happen again and so if you think about it this way, building a shock absorber into the equation so you don't get hit so bad, that's where our rate stabilization fund would come into effect on that and I will turn it over to anne to make sure i am explaining it with the rate stabilization fund idea which is not funded right now, nor is it being contemplated to be fully funded with this proposal that we have on the table.

>> Tovo: But there is some -- I believe some of it was built into the revenue requirement?

Am I right in thinking there was almost 4 million, something like that?

>> Yes, I think there was a small amount of money, yes.

>> Tovo: As the 112 comes in and you get fuel to recover the costs, where does the money go?

Is it going into the rate stabilization fund?

Is it going into staying in the operating cash fund or the operating fund, where does it go.

>> Goes into the operating fund and back into the operating fund and it is a true-up.

So you spend what you need in order to buy the fuel and make our net settlement payments at our cost and then we look -- right now the current fuel policy says that if, when you are comparing the actual to what we bill the customers, if that varies within a 10% range then we will adjust the fuel factor.

If we had a rate stabilization fund and it had enough adequate funds in there when fpp went down in the summer, we could have taken that one-time event and we could have pulled that $30 millions from the rate stabilization fund into the operating fund and we would not have had to increase the customer's fuel charge in january.

So that's kind of an illustration of how it might work.

>> I always explained it.

It is a common tool.

I always explained like as a shock absorber, so that when you have that -- when you have that -- it smooths out the volatility of your fuel charge year to year, I guess is another way to say it.

It allows you to do that.

But, on the other side of it is you -- you've taken cash from customers to the end of th and in short-term thinking, if -- and I am not going to pick on customers here, but some customers think in really short term and some customers think in long-term.

Long-term customers in my experience think this is a good idea.

Short-term thinking customers, they are caring about this year and next year, building of any reserves is not necessarily anything they would like to see us do.

>> Tovo: Well, I think in deference -- in their deference, it is tough financial time -- in their defense, it is short economic times and they want to bring in the contract customers to do that.

>> They do share the same one, the contract customers.

>> Tovo: Right but not the building at of the reserves.

If building of the reserves is built in this rate proposal they can't share in that because their contracts won't be adjusted until 2015.

>> But we wouldn't receive the additional revenue from them, either, so making the deficit larger for austin energy.

It is kind of a combination of the two.

>> Tovo: So just to be clear, because I thought i heard two different things.

So the money is for the -- over for the charges that were unexpected came out of reserves or came out of operating?

>> The operating fund is a reserve.

So I always -- characterize operating fund as a checkbook.

Like a checkbook.

So all we did was draw down the checkbook to cover power to cover fayette and stp in last summer stp and now we will refill the checkbook every month, take 47 million, divide it by 12 and put that money back in and if we have a good operating year this year and it's not hot and we don't lose fayette, we don't lose stp again, we won't repeat the problem.

But that's the real risk we have in any of our power plants is that we are depending on economical dispatch, good clean operation and when you are a generator and we generate with a lot of electricity here.

We have a lot of generation, that puts us at a spot of vulnerability and the alternative is to get into long term contracts which also puts you into vulnerability because they are generally indexed and there is ways they make sure that they are not harmed as well, so, anyway.

>> It's designed similar to the budget stabilization fund and the general fund, you know, that can be used in order to keep property taxes or the general fund balanced even.

So the rate stabilization is really the same concept.

>> Tovo: Except, I guess, the difference here is that austin energy always has the ability to do the fuel factor -- to do the increase in fuel factor, so if there is unexpected event, you have the ability to go to the customers and recoup that charge?

>> Whether it's good or bad, the fuel adjustment that austin energy is a one-year time period.

Some utilities have six month, so you get six months to recover it from, but then that also puts a little bit more value tillty in terms of the -- volatility in terms of recovery from your customers.

>> Tovo: Is there emergency provision, though?

I thought I remember there was an emergency provision.

>> In our policy.

>> Tovo: For coming back more quickly than a year, if there was some kind of emergency.

>> Currently the 10% limit.

>> Tovo: That's right.

Percent.

So I guess, two, on reserves we will discuss that because it seems there might be some value in continuing to rely on the fuel factor to recover those charges and not necessarily at this point fully funding -- or funding at the levels that you suggested the rate.

>> Let me clarify one point, if I may.

The $47 million that we have referred to is the sum total of three items that led to the need to adjust the fuel factor, but the fuel factor hovers around even, basically, inflows and outflows being the same.

Sometimes it is over, sometimes it is below.

We were in an overcollected position earlier this year, we incurred unusual costs.

We were undercollected position.

So we are just coming back to the middle.

We aren't coming back up to the overcollected position so there is not a full $47 million that we will be collecting over the course of a 12-month basis.

We are just targeting being back in the range of plus or minus 10%.

So whatever the collections are, it is somewhat less than that.

>> Morrison: Mayor.

could I just -- I think it was it was analogized this fund was liable the stabilization reserve fund for the general operating budget and we do have policy limits on how much we invade that stabilization fund.

Is there such a limitation or policy guidance on the austin energy equivalent to that?

>> Well, as I understand it, we were going to establish a new rate stabilization fund and, as such, I am not sure we had a policy associated with it.

>> That's correct.

>> So it is new.

It's going to be new.

it might be something to think about.

What might be appropriate there.

Council member morrison.

>> Morrison: Thank you.

I also just want to point on the general fund.

Don't we actually create that -- the analogous to the rate stabilization fund, don't we actually create that by sweeping any excess revenue over as opposed to explicitly a adding to our property tax increase or line item to check for that fund?

>> That's exactly what we do.

Remember, back on the cash flow methodology, the return components, that is the excess revenue.

That's exactly the same philosophy.

>> Morrison: But we are actually building in something to the tune of $4 million in termses of terms of what we are proposing in the proposal, to collect to actually sweep that in there so that would be analogous of us saying let's build in .001 cents property tax, so there is another difference there.

>> And then in our proposal, though, we didn't propose that in the first step.

That was --

>> Morrison: Exactly.

>> That was in the next step and I want to give you another example of that.

I used to run a utility that had a lot of hydropow with water and our rate stabilization fund was very large because there might be a year where you don't have any water and those year you had any water you used that money instead of making your customers pay for it and the next year when you had a lot of water, you talk about sweeping account and we sold some of that excess energy because we had so much water and take the extra revenue and we would move that back into the rate stabilization fund.

>> Morrison: And I want to make a couple of comments because unfortunately I have a previous engagement and i have to speak on panel at 30 and will be leaving in a minute and I want to first thank staff because I think what we all need to be doing here, coming to the table is just being in frank conversation about where we really would like to see us headed to be able to manage some of the rate shocks for the rate makers -- I mean for the ratepayers in the community and it really is a matter of understanding.

You have the proposals you made and your judgment but to be able to have your help like this, to s hash through different options to come total tax get where we feel we all need to be is very important and briefly, with regard to reserves, it appears to me that there are two options on the table that we can be looking at.

It does make sense to talk in more detail about these different reserve funds and whether we have the right days of cash on hand and all but the bottom line, we could look at, as you proposed, just making sure we are neutral with respect to the reserves and put off the 30 million in our revenue -- or decrease our revenue gap by 30 million for r now by not rebuilding the reserves right now and going by your proposal that we look at all ofs those policies between now and the next rate case.

That's one option and then the other was thrown -- was described in the answers to council member tovo's questions, in that as of yesterday, because these -- all but one of these reserves funds does not have a replenishment period specified, all but one, if you actually go and shift them all except for the ten year one, to a ten-year replenishment period, instead -- excuse me, five year replenishment period, instead of what's sort of thrown out there as three years, that does give us a decrease of, I think, 7 million so that's another way that we can all be looking at.

I think that's two different ways that we can all be looking a at to try to pull us back some in terms of the rate increase that we are going to be charging our customers.

>> Mayor leffingwell: Council member riley.

>> Riley: In fact, larry, on the latest proposal, aren't we aiming for five year replenishment period?

>> No, three year.

>> Riley: I thought revised proposal, 3-5?

>> No, three years except the reserves, decommissions, nonnuclear decommissioning is ten years.

>> Still get going 2014.

>> That's right.

>> So three years but deferred until 2014.

>> Riley: I did deferred until 2014.

>> You can say five in real terms because would be starting today.

>> Riley: It is still five.

It would be three years starting a little bit later.

>> That's correct.

>> And, again, the risk we -- the risk the utility takes is making sure the generating units run fine and we manage our fuel and generations so we don't put ourselves in place where we have very large hits to -- to our operating costs in the year, and we have tools that we can put in place to make sure that we are okay.

>> Riley: I want to come back to rate stabilization fund reserve since it is at 0 now.

To the extent that periodic adjustments to the fuel charge, that serve a purpose that is similar to the stabilization reserve, would there be anybody benefit to moving toward something like a 6 month adjustment period rather than one month period in order to improve our ability to respond to it.

[One moment, please, for change in captioners] .. it works, it's one way to do it.

It's a risk model set up for it.

A risk model set up for it.

And did I break it?

My light is on.

Anyway -- is this on?

It's not on either, okay.

[Tapping on microphone]

>> power outage.

>> Test, test.

>> [Laughter]

>> that I don't know.

[Laughter] .. let's see.

.. what I was saying is there are within publicly owned utilities, there are various methodologies to do the fuel adjustment and that and I looked at well we can change ours, but I think that's still possible on the table going forward.

But I would like to do that after we get, you know, a -- a couple of years under our belts with the new rates, start taking a look at that.

Part of that is the floating adjustment.

And there are cases where those adjustments are done very frequently.

And utilities have gotten very ambitious about making monthly adjustments.

But it depends on where your sources of generation are.

What market you're in, in the north america.

.. so I concede we will stick with what we have today.

>> Riley: Is that a p.u.c.

Issue?

>> No, I don't believe so it is.

>> Riley: Why would it be such a problem to go from month -- from a year to --

>> well, it's staffing, analytical and risk management issue that really changes the fundamental way that austin energy has been running for a while.

I'm certainly not opposed to looking at it.

I would like to look at changing it.

I would like to wait until we get these rates in place and everything else.

Frankly it doesn't change the rate increase.

Just how quickly we react to fuel costs and changes in the purpose.

>> It would serve the purposes of soft physical therapying the peaks and valleys, especially the rate --

>> that's correct.

It would, in effect, maybe erode the need for a rate stabilization fund, that's correct, that is correct.

>> Riley: Okay.

>> Mayor.

>> Mayor Leffingwell: Can I ask you where you are in your presentation?

>> That's a good question.

[Laughter] I think --

>> Mayor Leffingwell: For planning purposes, I think we're going to start to lose members here and perhaps 00, so --

>> I think that we've covered a lot of this and we've got into reserves and on -- on the slide I think we're actually in -- if we could go to page 10, i think, do you want to cover some of the others?

>> If -- if there's no discussion, on debt service coverage, we can skip that section.

>> Mayor Leffingwell: I think we've been discussing it for the last hour.

>> Cole: Mayor, I think that we have clarifying direction that we want to give before --

>> Mayor Leffingwell: Councilmember cole.

>> Cole: I think we want to be clear that we would like to follow up on the clear direction with moving from a three year replenishment period to a five year period and that we want to look at maintaining the 50/50 ratio for the long term, but a shorter period -- I mean 40 to 50 for the shorter period and the impact that -- what I'm trying to do is we don't have these meetings and

talk and talk and talk and y'all don't know what we're still trying to give you direction to do or want further action on.

>> Uh-huh.

>> Mayor Leffingwell: Well, what I think we ought to do is just kind of keep track of these suggestions for further direction and not have that be formalized until we get to end of the process because we have a long way to go.

>> We are doing that.

>> Mayor Leffingwell: For example, it's going to be a couple of months before we hear the auditor's report.

So we'll -- we've always said that that would be our basis for moving forward.

That we would want to have that revenue requirement number somewhat finalized in -- in the auditor's report, of course we'll have a big part in that.

So we can keep track of these, but for the time being, it's tentative direction.

>> Mayor?

>> Morrison: I think that I understand that the debt service coverage number that we're going to work to will drive the iteration if you move us through these changes and I would like to be able to look at a scenario where the debt service coverage that we're working to is 2.0.

>> Okay.

>> So if you could show us those numbers.

If you want to show us other numbers, too, but I would like to see the numbers for 2.0.

>> Mayor Leffingwell: Also, all of this has to be factored into where does this put us with respect to the rating agencies and what's the best outlook on what effect each action would have on that.

>> I was just thinking about that, mayor, because I think at some point, just so you know, we will work with the financial advisors to city and to austin energy as to -- with public financial management, we will make sure that we've -- we talked to them along the way so we don't have to -- to do something and go back and then come back with their information, because we work with them very closely.

>> Mayor Leffingwell: That's yet another reason why we would want to defer any formal direction at that point.

Councilmember tovo.

>> Tovo: Mayor, thanks for that clarification, I would say, too, the initial work plan talked about some preliminary action after revenue requirement, after cost allocation, again so we can get a general sense of where we're going, understanding that once we've come to the end we may need to adjust some of those earlier decisions.

But I think it's very helpful to kind of get a sense of -- a sense of what some of the consensus points because I think we -- it is going to be a long process and I sure don't want to have to talk again about --

>> Mayor Leffingwell: I think there's a consensus those are things we ought to be considering.

I'm just saying that I don't think there's consensus, total consensus yet.

>> Tovo: Sure, understandable.

But since you mention the auditor, I do want to say we can't discuss the schedule today.

There are challenges with the work schedule that we set out.

One of them is in compressing it we forgot to account for the fact that the auditor report is not going to be finished until the end of april.

So it's scheduled far too early on our work schedule.

We'll need to make those adjustments and some others.

But --

>> Mayor Leffingwell: We have to -- that's something I agree has to be done, we have to make sure that we're posted to change that schedule because I think it was a council action.

>> Tovo: Again, since you mentioned the auditor, you wanted to bring it up.

We do have some guidance from the auditor in our first report about how debt service coverage and debt equity ratios and things, you know, fall, fit within ratings.

I think that we have kind of covered that here today but I think we do have room to make some adjustments and still -- still hit some of the same targets that the other utilities at the auditor's office asserted.

..

>> I have a question.

>> Your turn, go ahead.

You've been answering, now you get to ask one.

Thank you, sir.

>> I want to make sure that mayor and council that you fully understand the policies that you have and the reserve limits that you have set in the past.

Do you have all of that information?

So because we have -- we have a slide in here I think that shows the policy and it shows the different funds.

Is it this one?

I think so.

>> This one has the different --

>> this one.

This is the policies.

I just want to reinforce that this is set by you.

And so everything that we have built around our business model here has been based on these policies.

So I just wants to make sure that -- I just want to make sure that we --

>> thanks for pointing it out.

You still -- you have more questions?

>> Tovo: I thought that i would kind of move us into talking about the reserves if we could.

>> Mayor Leffingwell: Sure.

>> Tovo: Thanks, is extremely useful chart, i appreciate you providing this to us.

So the financial policy sets limits for the strategic reserve emergency and the strategic reserve contingency.

Now, are those fully funded right now?

>> Yes.

>> Okay.

So right now those two that the financial policy dictates be fully funded are fully funded.

>> Yes.

>> It does change every year because it's based on o and m, they may be short approximately a million dollars, maybe 400,000 apiece, we need to check on that.

>> Right now those are in full compliance --

>> right.

Those are fully funded.

>> Tovo: So together that gives us let's see, 38ish, 136?

Million.

And what is the amount for cash on hand?

The 120 days cash on hand?

Isn't that about the same amount?

>> Well, the 120 days of cash on hand that many of the rating agencies talk about does not necessarily take out fuel.

And so it does vary a little bit.

But it's close to that.

So right now we are hitting the target for -- with our current existing reserves, we have hit the targets for the cash on hand that our financial advisor I'm not sure what his title is, advised us.

>> No.

We would need much more cash.

We would need equivalent to the 138 million doubled.

Because the -- because the contingency and the emergency reserve are not included in the days of cash on hand.

That's why if you look at some of the reports like the fitch report, you will see that we only have 55 days of cash on hand.

It's mosh lower than that today than it was in 2011 when they did that.

>> That was one of the questions that I asked, i need to kind of backtrack and compare it to -- to short -- can you talk about how you are defining cash on hand and whether there's any -- any other viewpoints out there about how to define cash on hand.

And this was the answer to number 12.

So the emergency and contingency fund, so the -- so the days of cash on hand --

>> each rating agency looks at that a little bit differently.

But the -- but it -- and in every utility handles it a little bit differently.

That's kind of what larry was talking about earlier.

A lot of them just keep it in their operating cash instead of moving it into different funds.

These other funds don't have a minimum balance, the repair and replacement and the rate stabilization.

So they don't have a minimum balance.

So they may be included in the days of cash on hand.

And they are zero, so that's when we are in trouble.

All of those funds are at zero, have a zero balance at this point.

>> Tovo: So you are saying that you don't consider -- you don't consider contingency an emergency as cash on hand because they are -- because they have a minimum balance?

But they are in fact cash --

>> the rating agencies do not.

You can look at the current reports like the fitch report and the 55 days does not include the reserve and contingency fund.

>> Okay.

Thanks.

I'm going to have a slide put up here that you have seen this before.

But this is the operating fund ending balance and reserves.

And that -- this really demonstrates what anne has been talking about.

It's kind of hard to read.

But it's been in a couple of the presentations, but what it's showing right now is that we're at 38 million in 2012, the last time we did it, 138 million, that $138 million is the red.

If you can look back on that, you will see that it's -- this goes all the way back to 1994.

You can see that apparently in 1997 there was a change in policy for the utility and I believe that new, i think elian hart told me that there were new financial policies put in place at that time and that's when these policies have been in place since that time, this is where it's been operating.

The yellow is -- is the -- the repair or replacement fund and there's also a small piece on top and non-nuclear decommissioning, those are completely at zero.

>> Mayor Leffingwell: Councilmember martinez.

>> Martinez: On the 2012 line, it show his, is that a one million dollar non-nuclear decommissioning account.

>> Yes, I think it's eight.

>> Martinez: How come in the decommissioning reserve we reflect zero.

>> This is dedicated to holly.

In the rate proposal, we're talking about non-nuclear dedecommissioning for fayette and decker.

>> I understand.

Thank you.

>> Good question.

Anyway, I just wanted to put this slide up, I thought maybe it would help.

>> Spelman: If I may, i added up the maximum, according to policy and topping off all of those funds we would be at $353 million, is that about right?

Which is about what we were between 2009-2010 and 2010 fairly recently we were actually at the reserve targets.

We were considerably above that for the previous years.

I wonder if you could comment on that.

Why were we so far above -- I'm going to slide -- slide 16.

Right before that.

Here's the reason.

Through the 1990s, austin energy had huge growth.

I apologize, the slide may not be in front of you, this is from the february 2nd presentation.

And -- and it starts in 1993 and this history the year to year growth -- this is the year to year growth.

'93 Was 6% growth over '92.

Every one of those years, that was an average annual kilowatt hour growth of 6%.

Then in 2001 they had the dot-com bust, 2002 the 9/11 recession, 2003 a moderate amount of growth.

Every year has a story after that.

That it is really the driver of -- of what happened to the revenues.

At austin energy.

In addition to some capital expenditures that were made in the sand hill facility, in particular.

That was cash was used for that.

And it was done strategically to put it in a very low cost position.

..

>> Mayor?

>> Councilmember tovo.

>> Tovo: I'm glad that you brought that up.

I was trying to find the data.

That was about $5 million in cash for sand hill, am i right?

I was just rereading an article this morning in the statesman.

>> It was at various times the gas turbines, the original ones were 200 something million, the combined cycle was another 200 million.

>> Sounds about right.

Sounds good right.

Keep in mind there's -- there's multiple machines out there.

And they were done over time.

So there's -- I think six [indiscernible] units and then a combined cycle facility.

It's the sand hill facility has got a lot of generation out there.

>> There three separate investments over the course of a decade.

>> But in terms of -- of looking at those numbers and seeing how some of the reserves went down, certainly $500 million over time in cash purchases is part of what happened there.

>> Well, it was still operating along the same basis of the 50/50.

That was the long term objective.

>> Mayor Leffingwell: So was it -- I guess that I'm not following that.

So it wasn't a cash purchase?

>> It was.

>> It was a cash purchase.

But during that time, our debt equity ratio remained --

>> I see --

>> that's correct.

>> Okay.

>> Spelman: If we found ourselves if the same situation as we did in 2005 when we had reserves gone wrong, I remember about $500 million, thank you, that large number there, that's 2007, we

have 500 million in reserves, our policy is calling for 350 million or so, what would be our response to that?

>> That we had more reserves than we needed?

>> Spelman: Yeah.

It can happen.

>> Well --

>> Spelman: It's happened before.

>> I would probably want to go spend it.

No.

>> Spelman: Wrong answer, try again.

>> Well, I can't -- I can't tell ya.

But I mean it would -- what it would have told me was looking at the performance year, other chart, 2005 was a heck of a -- a heck of a sales year, looked like.

That's reflected on here.

But if you see that trend start to go up, in effect it can affect your actual electric rates.

In other words, you wouldn't want to increase them.

And if they were too high, generally speaking, people don't roll them back.

Because they know that times will change.

But I can't really speak to it because I wasn't here at the time.

>> Spelman: That's what we got the reserves for is to guard against --

>> that's right.

>> If you remember, we did forecast that we needed a rate increase in 2006, so that was in essence for rate stabilization we used that in order to keep, to exist because we did not raise the rates at that time.

>> Spelman: Sure, but the whole point behind having rate stabilization at $90 million or whatever it is, is to prevent having to change the rates every time it looks like things are going to move around.

>> That's correct.

>> Spelman: Let me tell you what I think the right answer is, you tell me what's wrong with it.

If we hit $500 million in reserves, which might happen if we have a dramatic increase in the number of customers, for example, i can imagine a bunch of things that might cause that to happen to get those numbers, looks like it's going to continue for a while, dramatically in excess of our policies which we feel is a prudent maximum, it seems to me that we need to be prepared to consider reducing our rates.

>> That's exactly why we put the caps on those funds.

>> The most important part of that, that's why you do a frequent cost of service study.

That's your tool.

By policy now, you require us to do that every five years.

So you would come back, do a cost of service analysis every five years, and you might find, you know, a different kind of shift, a different formula, and -- and my experience a couple of times there's been a reduction in commercial rates because the commercial industry grew so much and they were using so much and their cost of service so less and you had that kind of windfall situation with respect to your generation costs went down.

And then you made an adjustment.

>> So we would expect to true this stuff up every couple of years.

We wouldn't see our rates, if it skyrocketed for a year or two, we knew that there would be a ceremony of trueing up coming up very soon.

>> Customers would watch us pretty closely.

If they saw reserves starting to pile up, they would want their money back in effect, right?

>> Yes.

>> So you wouldn't want to be feeding that.

That's pretty typical.

>> Spelman: Thank you.

>> Mayor?

>> Mayor Leffingwell: Councilmember tovo?

>> Tovo: I wondered, when we radioed at the auditor's -- when we looked at the auditor's report, mr.

Moore you and your staff had reached some conclusions about how the reserves compared to peer utilities.

I wondered, I know that you have continued to do more work, you've been working with austin energy staff trying to use the same universe.

But I just wanted to ask you if you had a sense at this point of how well conclusions still hold?

I'll read you what I took away of some of the conclusions from the initial audit.

That this -- that the rate proposal was increasing the levels of reserves from about 20% to about 31%.

And that that would result in a higher level of reserve compared to some peer utilities.

And I think the number that I where down was from -- well, I don't -- I no longer remember what that meant, 4% to 17%, I think.

Somehow those numbers played into that discussion.

But the basic point was that this represented a significant increase in the level of reserves at austin energy and that it would put us on the high end of reserves compared to peer utilities.

So I wondered if you nitrogen just comment on that -- you on that compares.

Certainly the reserves are a big part of the revenue requirement.

Under the initial proposal.

Austin energy proposal.

>> No microphone]

>> can you remind me what the four and 17 referred to.

>> This -- what we have done as a result of the mayor's request the last time we met, we are meeting with austin energy and we've actually adopted the -- the new set of -- utilities that they were using to try to make it more comparable.

But at this time we're still working with them and we don't have a final result of it, though.

We are hoping by next week we should have that portion of it.

>> Tovo: Thanks.

But did I accurately summarize some of those initial conclusions in your first report?

That it was a higher level compared to some of the peer utilities?

>> I will let walt to make sure that I'm saying the right thing.

Walt is assistant city auditor who is the manager over the project.

>> Councilmember, in the -- in the report that we released back in january, what we tried to do was answer the question of -- of austin energy is proposing, in the rate proposal, they are proposing having these reserve funds and -- and answer the question, how does that compare to comparable utilities.

What kind of funds do they have in the number and balance of those funds.

And what we have found, first of all, it's not a straightforward apples to apples comparison.

What we have found is when we are looking at the financial statements for these other utilities, we've looked at their notes, looked at the bond os and other documents and in some cases talked to the -- to the folks at the utilities, and -- and each one of them differs in how they account for reserve funds.

Some utilities have very few reserve funds and -- and so it's -- it's a difficult measure to make.

But we're working with austin energy right now to -- to try to reconcile, repair a -- prepare a reconciliation so you can see how we came up with our numbers versus what they came up with.

Back to the january report, what we have found is the ones that we compared to at that time generally had fewer reserve funds and the balances that they retained as a percent of their revenues were generally somewhat lower than austin area.

>> Tovo: Thanks, we'll just await your final report which I understand is a ways in the future, but thank you.

weis I guess I wonder if you could talk about -- dreyfus talked about risks or at high risk, obviously what the situation that austin energy faces is not always akin to peer utilities, but I wonder if you might address whether there is a need for more reserves here within -- within -- why would we be a little bit on the high end of our peer utilities.

>> Well, I -- I think that I'll -- I'll also wait until the auditor's office is done with their work.

But here's what happens inside publicly owned utilities.

Is basically it's a measure of liquidity.

There isn't any standard had the industry for public -- standard in the industry for publicly owned utilities to call reserves anything.

Wisely, I think.

Years and years ago, the city and austin energy was advised to earmark funds by title.

In other words, a strategic reserve fund.

Not every public utility does that.

And in fact some don't have any labeled reserve funds.

What they have is they have unrestricted cash.

In their balance sheet.

And that's what they count as reserves.

So the rating agencies and the financial advisors in the industry are really the key individuals to explain it.

Not me.

But I think that -- but i think that the financial advisors to the city, certainly you could call upon them and have them explain it.

They work with public power utilities as -- as at cities across the country.

And -- and so -- so that's the apples and apples comparison and then when you do that, when you look at peer groups of ours, I think that our reserves are right where they should be.

I think the difference is, for me professionally coming here, was they've got titles to them and they are council requirements that they be at these levels.

My previous employer we did not do that.

We just had a liquidity and it was cash on hand.

I don't know if I'm explaining that right.

>> Tovo: Thanks.

I know we will have a more extensive discussion, I know there are differences in how you are approaching the data, we will wait for that through all of the discussions.

>> Mayor Leffingwell: I think it's a good discussion to have internally about how you label various parts of the cash on hand.

But I really my guess is that it probably doesn't make any difference to the people who do the ratings because they see that anyway.

I mean, they deal with -- that's their business every day.

Is trying to analyze the balance sheets of public utilities.

So from that perspective, i don't think it makes any difference.

Okay.

Your next slide or are you done?

>> It's up to y'all.

If you all would like to talk about any more of them --

>> Mayor Leffingwell: Okay.

Any more questions?

[One moment please for change in captioners]

>> we have really three funds, replayer and replacement, the strategic reserve and the decommissioning.

And the strategic reserve has those three components, the emergency contigency and the rate stabilization.

And the maximums are set in the financial policies, but just like you saw in the other slides of our previous fund balances, they vary all the time, so it's very rare that achieve the maximum amount.

So these dates help establish just that cap.

So the repair and replacement is set at one-half of depreciation expense.

And the emergency is 60 days of o and m less fuel, the same as the contigency.

The difference in the emergency and contigency are that they have a minimum balance.

And that means that if you use anything out of them you have to cure that or replenish that within two years.

So that's why they cannot be included in the day's cash on hand because they're not cash available.

They have to keep that balance in there at all times.

The others do not have those limits.

>> Spelman: What is the minimum balance?

60 Days for each one.

It's approximately the 138 million.

>> Spelman: So the maximum is the same as the minimum and how much money we're going to keep in that account.

>> That's correct.

And then the rate stabilization is 90 days of power supply.

The others are days of o and m less fuel.

And so the rate stabilization is the fuel, just the reverse of that.

And just as larry explained, that is to stabilize your fuel factor as well as your base rates because within that you can capture some money to pay for the cash portion of new generation.

And if you have a huge generation plant it would be wise to collect enough money in that to pay some portion.

It doesn't have to be 50%, but some portion, maybe 20%, whatever you target for a huge generation plant.

The decommissioning reserve is based on a study that will be made in the future for each of those.

In this analysis that we did, we used the holly decommissioning cost per kilowatt and we adjusted that according to fayette and decker, and established an estimate for how much it would cost to close those plants.

And then we amortized that over 10 years.

And of course as that got closer, then we would do a study and adjust that amount.

>> Spelman: That one i understand completely.

You don't want to put more in than is needed or decommission the plant.

How is it we hit on o and m less fuel as being our emergency and contigency metric and how is it we hit on 60 days as being the right number?

>> Those were established years ago, and the working capital monday, which is really our checking account, that has -- that is required to have 45 days.

And that's established by the public utility commission.

That's kind of a standard.

So for the emergency and contigency, it's a similar approach.

You just need to have a certain amount.

If you have an emergency or a contigency, then you're likely to need cash for 60 days in order to get a plant back online or recover from a disaster or something like that.

And in this industry we do have a lot of double contigencies.

So if we have an outage it can quickly drive the market price up.

So you can have two or three of those things happen at the same time.

>> Spelman: Bad news comes in three's.

>> Excuse me, I asked eless than in a to come up here.

She has the history of how they were set up years ago with some of the funds.

>> I actually was instrumental in helping craft the change from the original 1996 debt management fund to rename this the strategic reserve fund.

Between these three pieces, the first two were based on operating risk, and we were trying to craft a way that we had two buckets of money to handle either emergency operating risks, and a contigency fund.

We excluded the fuel because we do have a fuel fact they are has an ability within that 10% range to adjust it.

So we felt like that the risk of having problems on the future side was taken care of to some extent at the time by that.

But we were really looking for a way to mitigate some of our operating risk of fronting a utility that had a generator.

So that's where that came from.

But the last piece on the rate stabilization is looking at having your operating risks primarily handled and funded.

You've got a fuel adjustment factor that credit rating agencies actually love to see for utilities so that you have that quick fix if you need it to pass through costs.

But it was really designed to have a longer term ability to manage the risk of owning generation.

As anne said you could have excess revenues in one year and put it in that to pay the cash portion of having to build generation, thus when had you to build the generation, if you couldn't issue 100% debt you would already have the cash funding available.

So it was -- it's a trade-off between all of them, but one was to address the operating risk, the other was to begin addressing better some of the generation side risk that we were seeing.

That we might be facing.

>> Spelman: How is it that we pick 60 days of one and 90 of the other?

>> I can explain the 90 days.

We actually ran some scenarios through our production simulation model.

And we actually looked at one of our plants, one of our nuclear units being down for 30 days.

Appeared then also gas prices increasing during that time by I believe 50%.

The total of that, which could happen, will happen, is just a matter of when, is so that was the basis.

>> So you came up with a reasonable worst case scenario and figured out what you're going to need to cover it?

>> That's correct.

>> The 60 day guidelines were modeled exactly after the general fund.

The general fund has an emergency reserve, and the contigency reserve, and they both use 60 days, so at the time we thought that was a good measure.

We didn't do any studies, we just modeled ours exactly like the general fund had modeled theirs.

>> Spelman: Is it reasonable to expect in some alternative universe we could do a simulation study as anne was just suggesting?

>> I'm sure we could come up with a study, yes.

>> Spelman: The reason i mention is because we have a history now of the kinds of things which we need that fund for.

How frequently they occur and how much they cost when they do occur.

It seems we have the basic stuff we need to figure out how much money we need in that fund to cover those things.

>> Sure.

We've had good experience over the last 15 years.

One of the largest uses was when the financial crisis occurred and all of the bond insurance companies lost their credit ratings.

We had 12 months to come up with $44 million of cash to cure our bond ordinance provisions.

So that's the one I like to go back to because it was entirely uncontrollable.

And you had to remedy within a specified time period.

So had we not had the reserves, we would have likely had to have had some sort of emergency surcharge to our customers to come up with that kind of cash.

We couldn't borrow it.

>> Spelman: But that would have been something we could have done is put in the emergency surcharge, it's one way we could handle that.

>> Might have been one way to handle it.

I'm not sure how quickly we could have gotten that taken care of.

But that would have been a last resort.

>> Spelman: Let me ask you, why is it a last resort?

Something really strange happens, a bunch of plants are out.

It's a terrible situation.

Why not have a surcharge instead of backing off slightly on the other reserve amounts here.

>> Primarily it's the stability of the financial position and stability for your customers who don't like to see these periodic spikes in their rates, especially some of the large customers.

It also helps with your credit rating.

>> Spelman: I was going to say interest rates.

If you have a day-to-day cash management and you're going to take the risk, I'm not sure I would be wanting to be in front of a rating emergency explaining that one.

>> Spelman: I'm not suggesting that.

>> I'm just saying that the borrowing costs under any of those scenarios would be extreme.

Now, I will say that I do know this for a fact that across the country back in 1970's and 80's that there were some significant events that required utilities to do surcharges on their customers, very quick rate increases that they just had to do to get the money in.

I do know it's happened.

And I don't know that they made a conscious effort to say let's not have reserves or bring down our reserves and let's operate that way.

Since the energy crisis of 2000, which it was in california, but it affected the whole country, the financial markets, the rating agencies and everybody, has really made public power step up in risk coverage and reserve coverage.

They are looking at our balance sheet and our performance and our management and everything more thoroughly than I have ever experienced before the year 2000.

But I have a very limited executive experience prior to that.

But I think that that changed the world as we know it in public power.

And the recent financial events internationally and otherwise have only further reinforced it.

>> Spelman: What we're doing here is establishing insurance policy for our customers in large part.

You pay us a little bit more now so that we can put it in a reserve and it's going to be guarding against having rates spike up and down in the future in a contigency if something else happens.

>> Right.

>> There are two good examples of how these funds and their operating reserves assisted our customers.

When we had the gas -- natural gas price spikes in 2001 and later I believe it was 2003, we didn't do a one-step surcharge or increase in our fuel factor for our customers.

And primarily it was because some of the spikes began happening in the summer months.

And so you would have the additional fuel charge, the increase in the hottest months.

So we spread those fuel factor changes over a two or three step over an 18 to 24 month period of time.

We had the cash on hand to be able to do that on behalf of our customers instead of immediately charging them.

Yes, we lost interest because we didn't have those funds invested, but we felt like we were doing our customers, our ratepayers a service, by spreading it out over a long period of time.

>> Same idea.

>> Spelman: Last question on this.

Repair and replacement reserve is half of depreciation expense, is that industry standard?

Where does that come from?

>> That's typical.

With a lot of utilities they use their depreciation reserve kind of as a target to see how old their plant is.

Because as it depreciates, it builds up that reserve.

>> Spelman: Depreciation happens on a very steady basis, though.

And my guess is rhett pair and replacements, you can plan in advance at least a little bit what repair and replacement needs you will have.

Does it make more sense to have this be a flat amount or does it make more sense for it to go up and down based on on what your planned replacement needs are?

This is only covering contigencies, things that you didn't expect to have to do?

>> Well, I think part of the planning right now is post-holly power plant, and what happened there with taking it apart is really inch what created the idea of let's start another fund for decker facility in particular, which is aging.

But that really ties into our generation plan and everything.

I know we've been discussing it internally, this particular fund I'm talking about.

>> Spelman: Repair and replacement reserve?

>> Decommissioning.

I'm sorry, I thought you were talking about decommissioning.

>> Spelman: No, i understand --

>> investor-owned utilities actually get to recover their depreciation expense.

And so that's why this is kind of a typical target for municipals because they do -- since they're on a cash basis they do not recover their response and depreciation rates.

>> Spelman: So we'll have a fund there of a half a depreciation expense and that fund is going to cover expected --

>> aging plants.

>> Spelman: Aging plant stuff.

>> Maintenance.

>> Spelman: Is there a clear relationship between aging plant stuff like repairs and replacements and half that depreciation expense?

Over the long run I would suggest that the salvage value of the plant is half the book value.

That's how you get half to make sense, isn't it?

>> That's true.

We don't include salvage value in our depreciation expense.

That's another thing we don't do.

And we have not had a depreciation study.

Typically municipals don't do that, they just use straight line depreciation and make that assumption that you just made.

>> Spelman: Okay.

So is there -- is this the right amount of money for us to put in repair and replacements?

Is that about how much we spend on repair and replacement every year?

>> I haven't really run the numbers on that.

But it would be for the non-typical replacement, so it's a little bit different than just taking the wear and tear on the plant.

>> In some sense it depends on your priorities and your objectives because these types of investments are lumpy.

So maybe we don't have one of those investments for several years, but then we bought the new peekers out of the repair and replacement fund.

So I think you have to evaluate your objectives if you want to reevaluate what the fund targets are.

>> Spelman: We have an experience base for this as we do for contigency, do we not?

We've been repairing plants for a long time.

We have a sense of how much money we need for atypical things going on.

we would have to do a study to come up with that.

>> Spelman: I'm not asking for a study -- we're asking for lots of studies.

I don't want another study.

Is there a way of showing what the repair and replacement expenses have been on an annual basis for awhile back?

Just so we get a sense for what numbers we're talking about.

>> We could pull that study.

>> Spelman: Just a print onout.

>> We'll pull that data.

>> Mayor Leffingwell: For what it worth, I just think that any determination on what your reserves should be, whatever kind, should really be based on a very long-term study.

For something like a utility.

I don't know going back over the last five or 10 years would be enough to establish long-term trends.

So it would have to be a very lodge look as it is -- a very long look as I said it is for other utilities.

Anything else?

>> Tovo: One quick question, mayor.

With regard to this last issue we're discussing, there's also money in the budget in the cip part of the budget for those kinds of expenses as well.

So in taking -- in following up with councilmember councilmember spelman's suggestion of looking at some of those costs in recent years, can you help us understand how much of that would have been covered by the cip funds that are in the operating budget?

>> I think there's planned replacement that we actually budget for, that we know that we're going to do.

And then these reserve funds are used for unplanned replacements that we frankly didn't plan for.

I'll give you an example of I've heard stories of -- there's big hail storms and rain storms around here.

Let's say when he some major line washed out or had to replace a major piece of our system, something like that, that's an unexpected repair and replacement fund.

But as far as a capital planning going forward, we put that in our budget.

>> Tovo: So there's no room within your annual budget right now to cover any unplanned breakages?

>> We have that for overtime and for labor and for other components of it, but what we're talking about is for major capital -- major pieces of equipment and operating pieces that we have in the system.

>> For instance, if we had a large transformer that just broke.

>> That's a better example.

>> Tovo: Is that also recoverable through the fuel --

>> not in our t and d system, no.

It's not a part of it.

>> Tovo: So if the nuclear plant, I know, was part of the driver for the fuel factor increase, so that is recoverable through the fuel adjustment.

>> Correct.

>> Not the construction.

Not the repair of the plant.

Only the replacement fuel.

>> Tovo: Okay.

>> So the power that we purchased from the marketplace in order to substitute for the power that we would have generated ourselves.

That's recoverable.

>> That's recoverable.

>> And we pay for the plants that we don't own out right in a different way than we do for south texas project, for example.

>> Tovo: Back to the repair and replacement and the capital funds -- funds that are already included, what you're saying is that the ordinary budgeted amount for maintenance in your estimation is not sufficient in the event that there is some kind of extraordinary --

>> well, yeah.

Lane brought up a really good example.

If we're budgeting to replace a large power transformer in a substation.

Those are lead time, very expensive items.

We would put that in our capital planning and say that x substations are going to have this upgrade down the road.

But if one fails right now, that can be really expensive to replace and then we would need a reserve to be able to pull on that.

So that's the difference.

>> Tovo: Okay.

Thanks for that distinction.

And then is the contingent -- let me make sure I get the names right.

Would the contigency -- the strategic reserve contigency fund works that also be an option that you could turn to for those kinds of extraordinary repairs or unplanned repairs?

>> We could, but we have to replenish that within two years.

Just like on this slide right here.

Currently today if any of those things happen we do not have enough cash in our operating fund to cover those.

And we would have to go directly to the contigency fund.

And then we have to replenish that shortly.

And we have no excess cash to replenish it.

So that's why those funds are at the level that they are, so that you can reduce your risk if something like that happens.

>> Tovo: So in the event that there was storm damage, you would go to the repair and replacements fund and then the next one in line would be a contigency.

You would want to not get to the contigency because that has a short-term replenishment.

>> That's correct.

>> Tovo: Okay.

Thank you.

>> Mayor Leffingwell: Anything else?

Okay.

Without objection, we stand adjourned at 3:53 p.m.