



Cash and Reserves Policy Review

Austin Energy Utility Oversight Committee
August 27, 2015



Necessity of Adequate Cash and Reserves

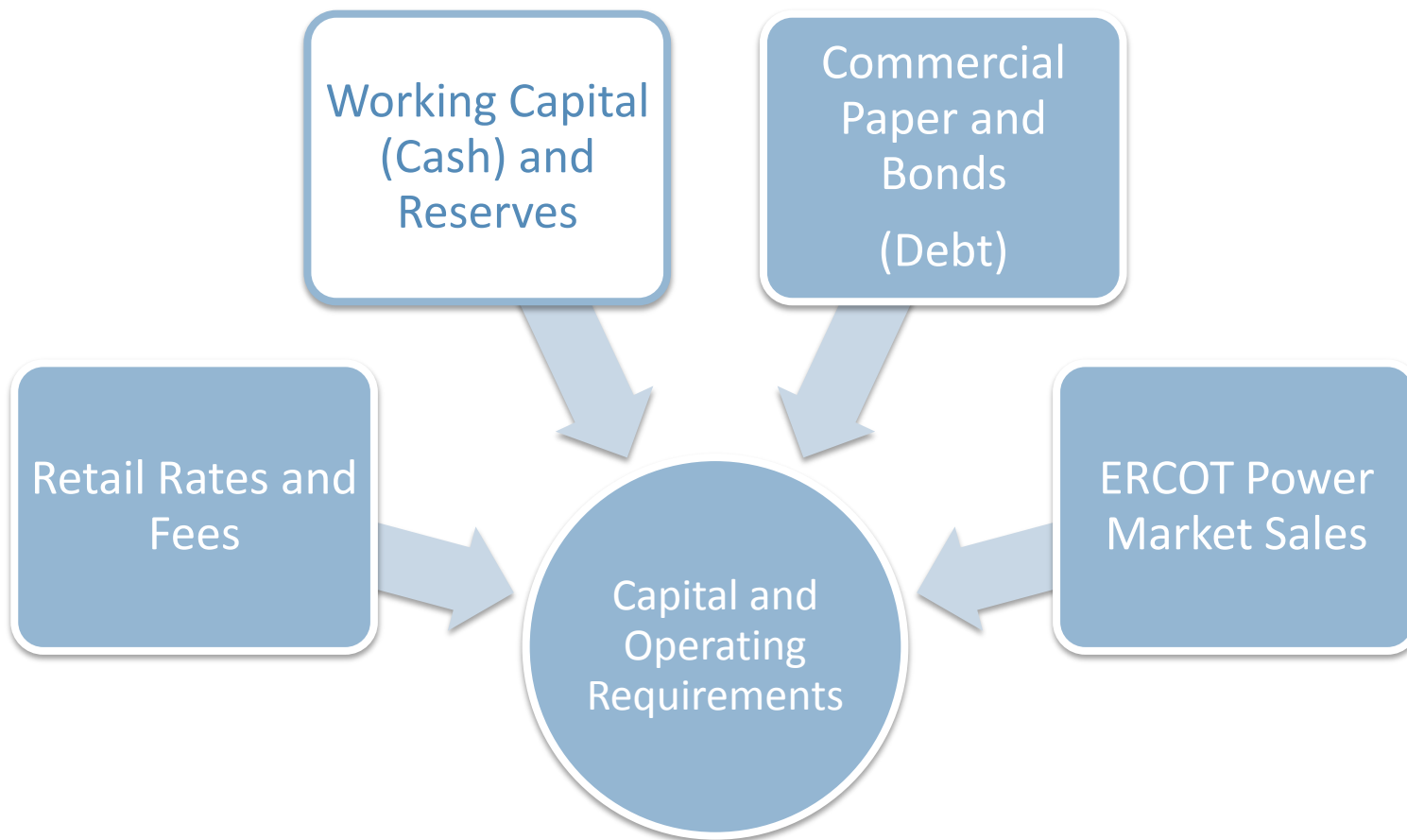
Since utilities have an obligation to serve, they cannot sit out adverse market conditions and wait for a more favorable economic environment. They have to have the flexibility to serve under any condition.

Cash and Reserves provide flexibility and mitigate risk by:

- Providing immediate funding to respond to an emergency or crisis
- Offsetting increase in business risk as a result of operating in the ERCOT market
- Issuing debt in an orderly manner
- Leading to higher bond ratings and lower cost of debt
- Reducing the leverage effect on the capital structure and make earnings more predictable
- Providing a cushion if financial situations change
- Providing support in meeting Affordability Goals



Funding for Operations



Positive net revenue from retail base rates generates working capital for Austin Energy



Financial Health Criteria



FY 2014 Audited

Debt/Equity Ratio = 46%

Debt = \$1,452,067,712

Equity = \$1,682,357,772

Debt Service Coverage (DSC) = 2.42

Days Cash on Hand = 90 days

Adequate Cash and Reserves balance the equation by reducing risk and providing credit support



Current Policies on Cash and Reserves

- Austin Energy has 21 adopted financial policies, 4 address our cash and reserves. These policies are memorialized and adopted by ordinance each year during the budgeting process. They are published in Volume II of the City of Austin's budget.
 - #11, Operating cash levels
 - #15, Repair and Replacement Fund uses and levels
 - #16, Strategic Reserve Fund uses and levels
 - Emergency Reserve
 - Contingency Reserve
 - Rate Stabilization Reserve
 - #21, Non-Nuclear Plant Decommissioning Fund establishment



Current Financial Policy Boundaries

Reserve	Basis for Level of Funding	September 2010	September 2011	September 2012	September 2013	September 2014	July 2015
Working Capital (Operating Cash)	Minimum requirement – 45 days of O&M less fuel & purchased power	\$134	\$71	\$49	\$119	\$151	\$223
Strategic Reserve:							
Emergency	Minimum requirement – 45 days of O&M less fuel & purchased power	\$66	\$68	\$69	\$81	\$81	\$91
Contingency	Up to a maximum – 60 days of O&M less fuel and purchased power	\$66	\$68	\$47	\$25	\$25	\$17
Rate Stabilization	Maximum balance – 90 days of power supply costs			\$0	\$0	\$0	\$0
Competitive Reserve	No minimum/maximum policy	\$9	\$4				
Total Strategic Reserve:		\$141	\$140	\$116	\$106	\$106	\$108
Repair and Replacement	Maximum balance – ½ of annual depreciation expense	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1
Non-Nuclear Decommissioning Reserve	Based on engineering study and funding begins minimum of 4 years prior to date of plant closure.	\$15	\$20	\$15	\$11	\$8	\$7
Total		\$290	\$231	\$180	\$236	\$265	\$338
Target for all Cash and Reserves		\$198	\$225	\$373	\$400	\$419	\$452



Independent Review of Reserve Funds

- Austin Energy contracted with NewGen Strategies & Solutions which completed an independent reserves study in July 2015. Includes:
 - Benchmarking review of decommissioning costs for Fayette and Sand Hill.
 - Engineering cost estimate for the decommissioning of Decker Creek.
 - Recommend changes to the policies and funding methodologies for the Rate Stabilization, Strategic, Working Capital, and Repair and Replacement funds.



Independent Review of Reserve Funds

- Conclusions from the Independent Review regarding the policies and funding methodologies for reserves:
 - Reserves levels do not meet minimum funding requirements per policy
 - Reserves levels are too low to meet AE's credit rating objectives
 - Reserve structure is confusing and overlapping
 - AE maintains a greater number of reserve funds than other utilities and calculates compliance differently
 - Reserve funding requirements are out of balance



Independent Review of Reserve Funds

Recommended Reserve Funding Criteria

Name	Description	Minimum Funding Requirement	Maximum Funding Requirement
Working Capital	Reserve to meet the day-to-day normal expense obligations associated with O&M expense, less Net Power Supply	45 Days of O&M expense, less Net Power Supply	60 Days of O&M expense, less Net Power Supply (or other reasonable level as identified by AE)
Contingency	Reserve to meet emergencies or to replenish other reserves	60 Days of O&M expense, less Net Power Supply	60 Days of O&M expense, less Net Power Supply
Rate Stabilization	Reserve to mitigate unpredictable fluctuations in Net Power Supply costs in order to stabilize rates and meet affordability goals	90 Days of Net Power Supply expenses	120 Days of Net Power Supply expenses
Capital (formerly Repair and Replacement)	Reserve to meet the equity funding requirements for all capital projects	½ of prior year's annual depreciation	None ⁽¹⁾
Non-Nuclear Decommissioning	Reserve to provide sufficient resources to decommission non-nuclear generation plants	Initial funding at Decker decommissioning cost estimate	Initial funding at Decker decommissioning cost estimate

Notes:

- 1) The expectation is that total unrestricted reserves, excluding the Non-Nuclear Decommissioning Reserve and the CIP Fund, would be greater than or equal to 150 Days Cash on Hand, per rating agency measurement.



Independent Review of Reserve Funds

	FY 2014 Actual	FY 2014 Per Financial Policies	NewGen Recommendation		
			Basis Range	Low Range	High Range
Unrestricted Reserves					
Working Capital	\$151	\$63	45 to 60 days	\$63	\$90
Emergency	\$81	\$84	Eliminated	\$0	\$0
Contingency	\$26	\$84	60 days	\$84	\$84
Capital	\$0.1	\$75	150 day goal	\$145	\$83
Rate Stabilization	\$0	\$124	90 to 120 days	\$124	\$165
Subtotal Unrestricted Reserves	\$257	\$429		\$416	\$416
Additional Reserves to Meet Credit Rating Goal of 150 Days Cash on Hand	\$158	\$(13)		\$0	\$0
Subtotal Unrestricted Reserves with Credit Rating Goal	\$416	\$416		\$416	\$416
Non-Nuclear Decommissioning	\$8	\$8	Decker	\$28	\$28
Total Reserves	\$424	\$424		\$443	\$443



Cash and Reserves Policies

- Next steps:
 - Adopt FY2015-16 budget with existing policies
 - AE staff develop revised policy language based upon findings of independent review for Electric Utility Commission and City Council review in the Fall of 2015
 - AE evaluate cash and reserves levels during the rate review currently underway and submit to Hearings Examiner in Spring of 2016
 - City Council approve revised policies as a part of the rate review in Fall of 2016
 - Adopt the FY2016-17 budget with revised policies