

RESERVE POLICY

OCTOBER 2020



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Purpose

Reserves preserve the financial health of the District and allow for future flexibility. This policy provides guidelines for the overall funding and maintenance of reserves and analysis of the District's liquidity position.

The objectives of the policy are to:

- 1) Establish the framework for reserves, including targets, use and replenishment; and
- 2) Outline the authorization, oversight and reporting requirements.

Reserve Definitions

The policy shall apply to the overall balance contained in the following reserves to be maintained by the District:

- Rate Stabilization Reserve
- Capital Improvement Fund
- Other Unrestricted Cash (including the Power Supply Adjustment Reserve)

Balances in the above reserves shall be used to calculate the District's *days cash on hand* ratio ("days cash on hand"). Days cash on hand provides a measure of available liquidity by calculating the number of days of operations the District's cash balances could fund, assuming no future revenue. Days cash on hand is a common financial measure used by stakeholders, investors and the major national credit rating agencies to assess the financial health of a utility. S&P Global Ratings ("S&P") and Fitch Ratings ("Fitch") are the two national rating agencies actively engaged to rate the District's debt. Each rating agency uses a unique days cash on hand metric when determining the District's credit rating.

- S&P evaluates the sufficiency of a utility's liquidity by calculating a *days' liquidity* ratio and defines it as "a measure of unrestricted cash, investments and equivalents, as well as restricted cash and investments that is legally and readily available to meet operating requirements and/or debt service." The S&P liquidity ratio is calculated by taking available reserves divided by net operating expenses and multiplying by 365. (Source: S&P Global Ratings)
- Fitch similarly evaluates the sufficiency of a utility's liquidity by calculating a *liquidity cushion* and defines it as "a utility system's unrestricted cash and investments, and available lines of credit against average daily cash operating expenses." (Source: Fitch Ratings)

For the purposes of this policy, the District's days cash on hand shall be calculated as follows, based on the most recently available audited financial statements at the time of the calculation:

$$\text{Days Cash on Hand} = \text{Total Unrestricted Funds} / (\text{Operating Expenses less Depreciation}) * 365$$

Days Cash on Hand Target

The aggregate balances of the District’s reserves – the Rate Stabilization Reserve, the Capital Improvement Fund, and Other Unrestricted Cash (including the Power Supply Adjustment Reserve) shall be maintained at a level not less than 225 days cash on hand with a target of between 225 and 275 days cash on hand, based on calculations from the audited financial statements. If the calculated days cash on hand ratio is below this target, the CFO/AGM of Financial Services, will provide a plan to replenish the appropriate reserves to the target level within three years, in accordance with any restrictions in the Board policy for the applicable reserve(s). This plan will be presented to the General Manager (GM) and Chief Operating Officer (COO) for their review and approval. Once the GM and COO have reviewed and approved the replenishment plan, the replenishment plan will be presented to the Board of Directors for review and approval. If the days cash on hand ratio exceeds the targeted level, the CFO/AGM of Financial Services may present options to the GM and COO to spend down cash with a preference towards (1) pay as you go capital and (2) defeasance of outstanding debt. Once the GM and COO have reviewed and approved the spend down of cash options, the spend down options will be presented to the Board for review and approval.

Testing/Compliance

On an annual basis after the audited financial statements are received, the days cash on hand ratio in this policy should be calculated and reported to the Board.

Definitions

Days Cash on Hand - Total Unrestricted Funds / (Operating Expenses less Depreciation) * 365

Total Unrestricted Funds - Cash and investments available for short-term liquidity needs with no limitations on use. Funds restricted solely by board or management policy and/or available for general system purposes, including debt service, may also be included. Funds explicitly restricted for construction or other capital investment are not considered unrestricted

Operating Expenses less Depreciation - Operating Expenses (including debt service of the Tuolumne Wind Project Authority and the Walnut Energy Center Authority debt service) less depreciation, amortization and other non-cash items (e.g. change in pension obligations)