VALLEY CLEAN ENERGY ALLIANCE
COMMUNITY ADVISORY COMMITTEE

Staff Report – Item 9

TO: Community Advisory Committee

FROM: Edward Burnham, Director of Finance & Internal Operations

SUBJECT: Review and consider the recommendation on updated reserve policy and dividend program guidelines.

DATE: May 23, 2024

RECOMMENDATIONS
Recommend that the VCE Board adopt the attached updated financial reserve policy and dividend program guidelines.

OVERVIEW
The purpose of this report is to share the draft updated reserve policy and dividend program guidelines with the CAC for feedback and recommendation before the item goes to the Board for consideration. VCE has been in operation now for multiple years post-adoption of the existing policy and guidelines. Both require routine updates to reach VCE's strategic goal of financial strength including reaching VCE's initial investment-grade credit rating. This Staff Report and attached updated reserve policy and program dividends guidelines are scheduled to be shared at the June 13, 2024, VCE Board meeting.

BACKGROUND AND ANALYSIS
The Board adopted the Financial Reserve Policy (FRP) on December 14, 2017, and the Dividend Program Guidelines (DPG) on June 17, 2019, to establish cash reserve targets and guide the allocation of the audited net margin for each year. VCE has used these documents for guidance through multiple budgets, customer rate settings, financial audits, and within-year changes such as COVID-19, heat waves, droughts, etc. VCE reached the targeted 90+ operating days cash target for the year ending December 31, 2023, and began the customer dividend program in 2024. Additionally, VCE repaid all outstanding loans from member agencies and River City Bank.

As part of the evaluation of VCE's ability to obtain an initial investment grade rating, VCE recognizes the need to increase the cash reserve targets and develop cash reserves for rate stabilization. Staff has evaluated the existing Policy and Guidelines based on the Financial Strength strategic goal objectives and direction from the Board of Directors. Based on this evaluation, Staff is recommending the following modifications:

Modifications:

1. An increased Operational Financial Reserve minimum from 30 days to 120 days
2. An Increased Operational Financial Reserve Target of 180 from 90 days (this increase aligns with current minimums typically seen for CCA qualification for investment grade credit ratings)
3. Addition of a Rate Stabilization Reserve minimum target of 60 days
4. Increased the minimum net margin allocation of 75% from 50% towards financials reserves of net margin above > 5%
5. Administrative updates and references to VCE cost recovery rate policy and rate adjustment policy.
6. Definitions of uses for Operational Financial Reserves and Rate Stabilization Reserves.

CONCLUSION

If adopted, the proposed updates are expected to have a positive fiscal impact improving VCE's financial stability while building customer trust and loyalty as designed.

<u>Attachments</u>

1. VCE Financial Reserve Policy
2. VCE Dividend Program Guidelines

VALLEY CLEAN ENERGY ALLIANCE

FINANCIAL RESERVE POLICY

The VCE Board recognizes the importance of developing cash reserves to:

- Ensure financial stability
- Ensure access to credit at competitive rates
- Ensure rate stability
- Fund local programs

To achieve these objectives, VCE targets an operating cash reserves account minimum balance of 120 days of operating expenses, with a goal of building and maintaining a reserve of 180 days of operating expenses. Additionally, VCE targets a Rate Stabilization Reserve account with a minimum balance of 60 days of operating expenses. VCE Local Programs and Dividends are designated by the Board of Directors during the budget process and dividend program allocation annually.

VCE Rates, Power Portfolio Resource mix, and Operating Budget will be adjusted as needed to meet and maintain VCE's target reserves and an investment grade credit rating. If the Reserves are projected to fall below the minimum balance, VCE will implement plans, such as increasing rates/lowering VCE's discount by use of the rate adjustment policy, to return Operating Reserves to the target of 180 days within two years. Such plans will be provided in subsequent budget and rate discussions with the Board of Directors.

Definitions

Operational Reserve – As described above, operational reserve funds are used to meet VCE's strategic objectives, secure favorable commercial terms, secure future stand-alone VCE credit rating(s), and provide a source of funds for unanticipated expenditures.

Rate Stabilization Reserve – Rate stabilization funds provide a contingency to provide rate stability for VCE customers giving increasing regulations, power costs, and Power Charge Indifference Adjustment (PCIA) charges from the investor-owned utility (PG&E).

VALLEY CLEAN ENERGY ALLIANCE

DIVIDEND PROGRAM GUIDELINES

Purpose: VCE's customer dividend program allows VCE to provide rate relief to customers, maintain financial stability and focus on its primary goals: a cleaner environment, meeting the members' climate action goals, building agency reserves, offering custom tailored programs, and awarding customers for their loyalty and trust.

Program Guidelines:

- VCE, at a minimum, reviews and sets customer rates on an annual basis as outlined in VCE's cost recovery rate policy. VCE's rate adjustment policy is used for within-year rate adjustments for significant cost impacts.

- VCE requires a minimum 5% net margin (less principal debt payments) before consideration of providing dividends to VCE customers. Customer dividends are provided in the form of bill credits.

- Annually based on the audited financial statements:

    - Calculate the Net margin less principal debt payments

    - If Net margin < 5% - no customer dividends and Board determine allocation of net margin to Cash reserves and & Local Program reserves

    - If Net margin > 5% - Board determine allocation of any surplus (over 5%) to Cash reserves, Local Program reserves and Customer Dividends

- Guidelines of Allocation of Net Margin

    - Net Margin <= 5%

        - Up to 95% to Cash Reserves (Until 180-days of operational cash reserves met)
        - At least 5% to Local Program Reserves

    - Net Margin > 5%

        - Follow guidelines for Net Margin up to 5%
        - Net margin in excess of 5%:

    - At least 50% to Operational Cash Reserves until 180 days cash reserves are met (Rating agency minimum requirements)
    - At least 25% to Rate Stabilization Reserves until 60 days cash reserves are met
    - Discretionary Board Allocations (above 75% until the minimum cash reserve targets are met)
        - Remaining excess allocated between additional cash reserves, customer dividends, and Local Programs Reserve at the discretion of the Board annually

- Board approves allocation of Net Margin on or around the April Board meeting

- Any customer dividends will appear as bill credits in the form of a future rate discount.