

ELECTRIC UTILITY RESERVES MANAGEMENT PRACTICES

The following reserves management practices are used when developing the Electric Utility Financial Plan:

Section 1. Definitions

- a) “Financial Planning Period” – The Financial Planning Period is the range of future fiscal years covered by the Financial Plan. For example, if the Financial Plan delivered in conjunction with the FY 2015 budget includes projections for FY 2015 to FY 2019, FY 2015 to FY 2019 would be the Financial Planning Period.
- b) “Fund Balance” – As used in these Reserves Management Practices, Fund Balance refers to the Utility’s Unrestricted Net Assets.
- c) “Net Assets” - The Government Accounting Standards Board defines a Utility’s Net Assets as the difference between its assets and liabilities.
- d) “Unrestricted Net Assets” - The portion of the Utility’s Net Assets not invested in capital assets (net of related debt) or restricted for debt service or other restricted purposes.

Section 2. Supply Fund Reserves

The Electric Supply Fund Balance is reserved for the following purposes:

- a) For existing contracts, as described in Section 4 (Reserve for Commitments)
- b) For operating budgets reappropriated from previous years, as described in Section 5 (Reserve for Reappropriations)
- c) For special projects for the benefit of the Electric Utility ratepayers, as described in Section 6 (Electric Special Projects Reserve)
- d) For year to year balancing of costs associated with the Electric Utility’s hydroelectric resources, as described in Section 7 (Hydroelectric Stabilization Reserve)
- e) For rate stabilization, as described in Section 11 (Rate Stabilization Reserves)
- f) For operating contingencies, as described in Section 12 (Operations Reserves)
- g) For tracking unspent or unallocated revenues from the sale of carbon allowances freely allocated by the California Air Resources Board to the electric utility under the State’s Cap and Trade Program, as described in Section 16 (Cap and Trade Program Reserve)
- h) For tracking funding of City buildings, appliance and vehicle electrification projects and programs, as described in Section 17 (Electrification Reserve)
- i) Any funds not included in the other reserves will be considered Unassigned Reserves and shall be returned to ratepayers or assigned a specific purpose as described in Section 13 (Unassigned Reserves).

Section 3. Distribution Fund Reserves

The Electric Distribution Fund Balance is reserved for the following purposes:

- a) For existing contracts, as described in Section 4 (Reserves for Commitments)
- b) For operating and capital budgets reappropriated from previous years, as described in Section 5 (Reserves for Reappropriations)
- c) As an offset to underground loan receivables, as described in Section 8 (Underground Loan Reserve)
- d) To hold Public Benefit Program funds collected but not yet spent, as described in Section 9 (Public Benefits Reserve)

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- e) For cash flow management and contingencies related to the Electric Utility's Capital Improvement Program (CIP), as described in Section 10 (CIP Reserve)
- f) For rate stabilization, as described in Section 11 (Rate Stabilization Reserves)
- g) For operating contingencies, as described in Section 12 (Operations Reserves)
- h) For tracking revenues earned via the sale of Low Carbon Fuel Credits allocated by the California Air Resources Board to the City, as well as expenses incurred, in accordance with California's Low Carbon Fuel Standard program, as described in Section 15 (Low Carbon Fuel Standard Reserve)
- i) Any funds not included in the other reserves will be considered Unassigned Reserves and shall be returned to ratepayers or assigned a specific purpose as described in Section 13 (Unassigned Reserves).

Section 4. Reserves for Commitments

At the end of each fiscal year the Electric Supply Fund and Electric Distribution Fund Reserves for Commitments will be set to an amount equal to the total remaining spending authority for all contracts in force for the Electric Supply Fund and Electric Distribution Fund, respectively, at that time.

Section 5. Reserves for Reappropriations

At the end of each fiscal year the Electric Supply Fund and Electric Distribution Fund Reserves for Reappropriations will be set to an amount equal to the amount of all remaining capital and non-capital budgets that will be reappropriated to the following fiscal year for each Fund in accordance with Palo Alto Municipal Code Section 2.28.090.

Section 6. Electric Special Projects Reserve

The Electric Special Projects Reserve (ESP Reserve) will be managed in accordance with the policies set forth in Resolution 9206 (Resolution of the Council of the City of Palo Alto Approving Renaming the Calaveras Reserve to the Electric Special Project Reserve and Adoption of Electric Special Project Reserve Guidelines). These policies are included from Resolution 9206 as amended to refer to the reserves structure set forth in these Reserves Management Practices:

- a) The purpose of the ESP Reserve is to fund projects that benefit electric ratepayers;
- b) The ESP Reserve funds must be used for projects of significant impact;
- c) Projects proposed for funding must demonstrate a need and value to electric ratepayers. The projects must have verifiable value and must not be speculative, or high-risk in nature;
- d) Projects proposed for funding must be substantial in size, requiring funding of at least \$1 million;
- e) Set a goal to commit funds by the end of FY 2025;
- f) Any uncommitted funds remaining at the end of FY 2030 will be transferred to the Electric Supply Operations Reserve and the ESP Reserve will be closed;

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Section 7. Hydroelectric Stabilization Reserve

The Hydroelectric Stabilization Reserve is used to manage the supply cost impacts associated with variations in generation from hydroelectric resources. Staff will manage the Hydroelectric Stabilization Reserve as follows:

- a) Projected Hydro Output: Near the end of each fiscal year, staff will determine the actual and expected hydro output for that fiscal year, compare that to the long-term average annual output level (495,957 MWh as of March 2018), and multiply the difference by the average of the monthly round-the-clock forward market prices for each month of the current fiscal year.
- b) Changes in Reserves. Staff is authorized to transfer the amount described in Sec. 7(a) from the Operations Reserve to the Hydroelectric Stabilization Reserve for hydro output deviations above long-term average levels, or transfer this amount from the Hydroelectric Stabilization Reserve to the Operations Reserve for hydro output deviations below long-term average levels.
- c) Implementation of HRA. The level of the Hydroelectric Stabilization Reserve *after* the transfers described above shall be the basis for staff's determination, with Council approval, of whether to implement the Hydro Rate Adjuster (Electric Rate E-HRA) for the following fiscal year.
- d) Reserve Guidelines. Staff will manage the Hydroelectric Stabilization Reserve according to the following guideline levels:

Minimum Level	\$3 million
Target Level	\$19 million
Maximum Level	\$35 million

Section 8. Underground Loan Reserve

At the end of each fiscal year, the Underground Loan Reserve will be adjusted by the principal payments made against outstanding underground loans.

Section 9. Public Benefits Reserve

The Public Benefits Reserve will be increased by the amount of unspent Public Benefits Revenues remaining at the end of each fiscal year. Expenditure of these funds requires action by the City Council.

Section 10. CIP Reserve

The CIP Reserve is used to manage cash flow for capital projects and acts as a reserve for capital contingencies. Staff will manage the CIP Reserve according to the following practices:

- a) The following guideline levels are set forth for the CIP Reserve. These guideline levels are calculated for each fiscal year of the Financial Planning Period and approved by Council resolution.

Minimum Level	20% of the maximum CIP Reserve guideline level
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Maximum Level	Average annual (12 month) ¹ CIP budget, for 48 months of budgeted CIP expenses ²
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- b) Changes in Reserves: At the end of each fiscal year staff will transfer from the Distribution Operations Reserve to the CIP Reserve an amount equal to the amount of electric utility unspent CIP budget at the end of the fiscal year reduced by the amount of any contractual commitments and reappropriations. Any other additions to or withdrawals from the CIP reserve require Council action.
- c) Minimum Level:
 - i) If, at the end of any fiscal year, the minimum guideline is not met, staff shall present a plan to the City Council to replenish the reserve. The plan shall be delivered by the end of the following fiscal year, and shall, at a minimum, result in the reserve reaching its minimum level by the end of the next fiscal year. For example, if the CIP Reserve is below its minimum level at the end of FY 2017, staff must present a plan by June 30, 2018 to return the reserve to its minimum level by June 30, 2019. In addition, staff may present, and the Council may adopt, an alternative plan that takes longer than one year to replenish the reserve, or that does so in a shorter period of time.
- d) Maximum Level: If there are funds in this reserve in excess of the maximum level staff must propose in the next Financial Plan to transfer these funds to another reserve or return them to ratepayers in the funds to ratepayers, or designate a specific use of funds for CIP investments that will be made by the end of the next Financial Planning period. Staff may also seek City Council to approve holding funds in this reserve in excess of the maximum level if they are held for a specific future purpose related to the CIP.

Section 11. Rate Stabilization Reserves

Funds may be added to the Electric Supply or Distribution Fund's Rate Stabilization Reserves by action of the City Council and held to manage the trajectory of future year rate increases. Withdrawal of funds from either Rate Stabilization Reserve requires action by the City Council. If there are funds in either Rate Stabilization Reserve at the end of any fiscal year, any subsequent Electric Utility Financial Plan must result in the withdrawal of all funds from this Reserve by the end of the Financial Planning Period. The Council may approve exceptions to this requirement, when proposed by staff to provide greater rate stabilization to customers.

Section 12. Operations Reserves

The Electric Supply Fund and Electric Distribution Fund Operations Reserves are used to manage normal variations in the costs of providing electric service and as a reserve for contingencies. Any portion of the Electric Utility's Fund Balance not included in the reserves described in Section 4 to 11 above will be included in the appropriate Operations Reserve unless the reserve has reached its maximum level as set forth in Section 12 (e) below. Staff will manage the Operations Reserves according to the following practices:

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- a) The following guideline levels are set forth for the Electric Supply Fund Operations Reserve. These guideline levels are calculated for each fiscal year of the Financial Planning Period based on the levels of Operations and Maintenance (O&M) and commodity expense forecasted for that year in the Financial Plan.

Minimum Level	60 days of Supply Fund O&M and commodity expense
Target Level	90 days of Supply Fund O&M and commodity expense
Maximum Level	120 days of Supply Fund O&M and commodity expense

- b) The following guideline levels are set forth for the Electric Distribution Fund Operations Reserve. These guideline levels are calculated for each fiscal year of the Financial Planning Period based on the levels of O&M expense forecasted for that year in the Financial Plan.

Minimum Level	60 days of Distribution Fund O&M expense
Target Level	90 days of Distribution Fund O&M expense
Maximum Level	120 days of Distribution Fund O&M expense

- c) Minimum Level: If, at the end of any fiscal year, the funds remaining in the Supply Fund or Distribution Fund's Operations Reserve are lower than the minimum level set forth above, staff shall present a plan to the City Council to replenish the reserve. The plan shall be delivered within six months of the end of the fiscal year, and shall, at a minimum, result in the reserve reaching its minimum level by the end of the following fiscal year. For example, if the Operations Reserve is below its minimum level at the end of FY 2014, staff must present a plan by December 31, 2014 to return the reserve to its minimum level by June 30, 2015. In addition, staff may present an alternative plan that takes longer than one year to replenish the reserve.
- d) Target Level: If, at the end of any fiscal year, either Operations Reserve is higher or lower than the target level, any Financial Plan created for the Electric Utility shall be designed to return both Operations Reserves to their target levels by the end of the forecast period.
- e) Maximum Level: If, at any time, either Operations Reserve reaches its maximum level, no funds may be added to this Reserve. Any further increase in that fund's Fund Balance shall be automatically included in the Unassigned Reserve described in Section 13, below.

Section 13. Unassigned Reserves

If the Operations Reserve in either the Electric Supply Fund or the Electric Distribution Fund reaches its maximum level, any further additions to that fund's Fund Balance will be held in the Unassigned Reserve. If there are any funds in either Unassigned Reserve at the end of any fiscal year, the next Financial Plan presented to the City Council must include a plan to assign them to a specific purpose or return them to the Electric Utility ratepayers by the end of the first fiscal year of the next Financial Planning Period. For example, if there were funds in the Unassigned Reserves at the end of FY 2016, and the next Financial Planning Period is FY 2017 through FY 2021, the Financial Plan shall include a plan to return or assign the funds in the Unassigned Reserve by the end of FY 2017. Staff may present an alternative plan that retains these funds or returns them over a longer period of time.

Section 14. Intra-Utility Transfers between Supply and Distribution Funds

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Transfers between Electric Distribution Fund Reserves and Electric Supply Fund Reserves are permitted if consistent with the purposes of the two reserves involved in the transfer. Such transfers require action by the City Council.

Section 15. Low Carbon Fuel Standard (LCFS) Reserve

This reserve tracks revenues earned via the sale of Low Carbon Fuel Credits allocated by the California Air Resources Board to the City, as well as expenses incurred, in accordance with California's Low Carbon Fuel Standard program. At the end of each fiscal year, the LCFS Reserve will be adjusted by the net of revenues and expenses associated with California's LCFS program.

Section 16. Cap and Trade Program Reserve

This reserve tracks unspent or unallocated revenues from the sale of carbon allowances freely allocated by the California Air Resources Board to the electric utility, under the State's Cap and Trade Program. Funds in this Reserve are managed in accordance with the City's Policy on the Use of Freely Allocated Allowances under the State's Cap and Trade Program (the Policy), adopted by Council Resolution 9487 in January 2015. At the end of each fiscal year, the Cap and Trade Program Reserve will be adjusted by the net of revenues and expenses associated with the Cap and Trade program.

Section 17. Electrification Reserve

This reserve is used to track funding of City buildings, appliance and vehicle electrification projects and programs, including development and implementation costs and associated financial incentives, loans and rebates for participating customers. The reserve may be funded by any lawful source of funds available for such programs, including new or ongoing utility revenues derived from customer participation. The reserve balance shall be annually adjusted based on the net of revenues and expenses associated with the City's building appliance and vehicle electrification projects and programs using this reserve.