Scroll to page 2

March 15, 2018

TO: MCE Board of Directors

FROM: David McNeil, Manager of Finance

RE: Proposed Amendment to MCE Policy 013: Reserve Policy (Agenda Item #07)

ATTACHMENTS: A. MCE Policy 013: Reserve Policy
B. Proposed Amended MCE Policy 013: Reserve Policy

Dear Board Members:

SUMMARY:

In February 2016 your Board approved MCE Policy 013: Reserve Policy to guide the building of Reserves at the agency. Adequate Reserves enable MCE to satisfy working capital requirements, procure energy at competitive rates, adhere to loan covenants, cover unanticipated expenditures, support rate stability, and help MCE obtain a strong credit rating.

Staff review the Reserve Policy annually and propose changes as needed. Changes proposed at this time appear in the attached proposed Reserve Policy and include the following;

1. A revised methodology for calculating the Reserve target
2. Extending the target date for achieving MCE's Reserve target from March 31, 2019 to March 31, 2020

The Reserve target is currently calculated as the sum of 90 days of operating expenses plus 15% of revenues. Operating expenses formerly included energy costs for budgeting purposes. Staff proposes to set the Reserve target at an amount equal to 40% of energy and operating costs for the upcoming year. For instance, the FY 2018/19 target net position would be equal to 40% of projected operating and energy expenses in FY 2019/2020.

The proposed methodology is intended to simplify and clarify the method of calculating Reserve targets and approximate the current target amounts. Extending the target date for achieving Reserve targets is intended to reflect the growth of the agency resulting from the onboarding of new communities in April 2018.

Additions to MCE Reserves are established through the budget and rate setting processes. Reserves contribute to MCE's liquidity. Liquidity – defined as unrestricted cash, marketable investments and unused bank lines of credit – is important for ensuring MCE's financial strength and "days liquidity on hand" is an established metric used by industry participants and rating agencies to assess MCE's credit worthiness. 140 days liquidity on hand is generally associated with organizations that have strong credit ratings.

The Reserve and liquidity calculation methodologies appears in Table A below for information and illustrative purposes and are intended to be read in conjunction with the proposed Reserve Policy.

Table A: Reserve and Liquidity Projections[1]

	Reserve Projections	**FY 2017/18**	**FY 2018/19**	**FY 2019/20**
A	Reserve target (%)	40%	40%	40%
B=AxK	Reserve target ($)	132,419,600	140,052,400	146,618,400
C	Projected reserves ($)	51,909,000	105,764,000	148,787,000
D=C/B	Projected reserves as a % of target	39%	76%	101%
	Liquidity Projections	**FY 2017/18**	**FY 2018/19**	**FY 2019/20**
E	Projected unrestricted cash and investments	36,656,000	75,382,000	117,982,000
F	Projected unused bank line	25,000,000	30,000,000	30,000,000
G=E+F	Total projected liquidity	61,656,000	105,382,000	147,982,000
H=G*365/K	Projected days liquidity on hand	68	110	147
I	Target days liquidity on hand	140	140	140
J=K*I/365	Liquidity target ($)	126,978,000	134,297,000	140,593,000
	Annual Expenses	**FY 2018/19**	**FY 2019/20**	**FY 2020/21**
K	Projected annual operating expenses + cost of energy for the upcoming fiscal year	331,049,000	350,131,000	366,546,000

1. Projections are based on MCE's current retail electricity rates

Fiscal Impacts: The proposed Reserve Policy has an indirect fiscal impact by providing a policy framework for adding to and maintaining Reserves as part of MCE's annual budget and rate setting processes.

Recommendation: Approve the proposed MCE Policy 013: Reserve Policy.