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## BOARD OF PUBLIC WORKS OF THE CITY OF LEWES CASH RESERVE POLICY

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### INTRODUCTION

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Cash reserve policies and guidelines are often established by utilities to maintain appropriate cash reserves to help ensure:

1. Cash exists for timely payment of bills
2. The short term and long term financial health of the Utility
3. Stable rates for customers
4. Cash exists to fund unanticipated cost contingencies

In recent years the compounded impacts of power supply cost uncertainties, a sluggish economy, volatile energy prices, and rising capital improvement costs have posed challenges to maintaining stable retail rates and reserves. It is important for utilities to maintain the financial flexibility to help smooth rate increases and stagger retail rate adjustments for customers of the utility.

Minimum cash reserve guidelines proposed in this policy should be set to allow reserves to float up or down above the minimum guidelines. The decision to hold more money than the established minimum cash guidelines should be based on the assessments of uncertainties and other financial policies such as:

- The financial risk facing the utilities
- Rate setting policies
- Variability in power costs
- Debt policies
- Future capital improvements needed by utility
- Line Extension policies

The adequacy of the guidelines shall be reviewed by the BPW Treasurer and General Manager each year, and if appropriate, revised guidelines may be recommended. The efficient and discrete management of these reserves, when combined with their fortification add additional assurance that the desired levels of service reliability and quality will continue into the future.

To help ensure timely completion of capital improvements and enable Lewes BPW to meet requirements for large unexpected expenditures, a minimum cash reserve policy shall be established. Minimum cash reserves attempts to quantify the

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minimum amount of cash Lewes BPW should keep in reserve, the actual cash reserves may vary substantially above the minimum and is dependent on the life cycle of assets currently in service.

The total of the Cash Reserve Funds are broken down into six types, Working Capital Lag, Risk Management Reserve, Current Year Capital Improvement Program, Five Year Capital Improvement Program, Customer Deposit and Self Insurance. With the exception of Customer Deposits, the five remaining funds may float up or down above minimum guideline independently of one another. Customer deposits shall be maintained at 100%.

**Working Capital Lag** - Timing differences exist between when expenses are incurred and revenues are received from customers. Establishing a minimum cash reserve helps ensure cash exists to pay expenses in a timely manner.

- **The cash reserve policy will include twenty five percent (25%) of budgeted annual operating expenses.**

**Risk Management Reserve** – Catastrophic events may occur that require substantial investments to replace damaged assets. Some examples of catastrophic events include ice storms, earthquakes, wind storms, floods, or tornadoes. Many of these catastrophic events may allow the utility to recover the cost of damages from FEMA; however FEMA reimbursements can take between 6 months to 2 years to recover. The utility should ensure adequate cash reserves exist to replace the assets in a timely fashion and to arrange short term financing options. The minimum reserve levels are often combined with emergency funding from banks or bonding agencies. The percent to the minimum cash reserves are dependent on the age of the assets in service and the level of risk of catastrophic type events. Current FEMA guidelines suggest 2% of the historic costs of the utility assets.

- **The cash reserve policy will include 2% of the historical investment in assets as recorded in the financial statements.**

**Capital improvement program** – Some capital improvements are funded through bond issuances and some through cash reserves. The establishment of a minimum cash reserve level helps to ensure timely replacement or construction of assets and timely payments to contractors.

- **The cash reserve policy shall include 15% of the current year capital improvement program.**

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- **The cash reserve policy shall include 15% of the five year capital improvement program.**

**Customer Deposits** – Certain customers are required to make a deposit prior to receiving utility services. The majority of deposits are associated with electric service. Persons requesting development plan review are required to establish an escrow account.

- **The cash reserve policy shall include 100% of the funds held as customer deposits and escrow accounts.**

**Self-insurance** – It is not economically justifiable for Lewes BPW to carry some types of insurance on some of the BPW facilities and operations. Examples are flood insurance on the wastewater lift stations and a portion of the water reclamation plant plus pollution insurance on stormwater and wastewater operation. Insurance deductibles are also included in the self-insurance reserve.

- **The cash reserve policy shall include 100% of amounts identified as self-insurance and current insurance deductibles.**

If certain events occur that results in cash reserves falling below the minimum cash reserve levels the Board will take action to restore the cash reserves to the minimum levels over the next five years through a detailed replenishment plan. These actions may consider a number of factors including:

1. Rate Adjustments
2. Cost reductions
3. Issuance of bonds to fund capital improvement programs
4. Modification of the assumptions used to determine the cash reserve levels

The calculated minimum cash reserves are listed below and will be updated and reviewed by the Board on an annual basis.