VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 15

TO:	Board of Directors
FROM:	Edward Burnham, Director of Finance & Internal Operations
SUBJECT:	Approve updated reserve policy and dividend program guidelines
DATE:	December 12, 2024

RECOMMENDATIONS
Approve updates to the 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 for Board consideration. VCE has been in operation now for multiple years post-adoption of the existing policy and guidelines. In order to achieve its strategic goals, VCE must maintain liquidity for day-to-day operations and its initial long-term financial target of 180 days operating cash. Both require routine updates to reach VCE's strategic goal of financial strength including reaching VCE's initial investment-grade credit rating and rate stabilization for its customers. This Staff Report and attached draft updated reserve policy and program dividends guidelines include revisions that support our financial strength goals.

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. As part of the process, Staff presented these updates at the Community Advisory Committee May 23, 2024 meeting and received a unanimous recommendation from the CAC supporting the proposed financial and dividend policy updates.

Staff introduced these policy updates at the November 14, 2024 Board meeting as part of the Budget update. Staff is recommending the following policy modifications:

1. Increasing the Operational Financial Reserve <u>minimum</u> from 30 days to 120 days cash on hand.
2. Increasing the Operational Financial Reserve <u>Target</u> from 90 days to 180 days cash reserves (this increase aligns with current minimums typically seen for CCA qualification for investment grade credit ratings).
3. Addition of a Rate Stabilization Reserve with a minimum target of 60 days cash reserves.
4. Until Operational and Rate Stabilization reserve targets are met, increase the minimum net margin allocation from 50% to 75% that is directed to financials reserves when annual net margins are 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.

<u>Attachments</u>
1. VCE Financial Reserve Policy
2. VCE Dividend Program Guidelines

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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 annual budget process and dividend program allocation process.

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 given factors such as, but not limited to, new or changed regulations, increased power costs, and Power Charge Indifference Adjustment (PCIA) charges from the investor-owned utility (PG&E).

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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 determines 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 reserve target is met (Rating agency minimum requirements).
            - At least 25% to Rate Stabilization Reserves until 60 days cash reserve target is 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 surplus allocation to customer dividends will appear as bill credits. Any customer dividends will appear as bill credits in the form of a future rate discount. The prospective bill credit provides for additional financial stability as VCE achieves the primary goals set in the strategic plan.