



Resiliency and Cash Balance Policy

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Agenda

- I. Purpose**
- II. Observations and Trends**
- III. Risk Analysis**
- IV. Next Steps**
- V. Supporting Data**



I. Purpose of the Resiliency and Cash Balance Policy





Purpose of a Resiliency and Cash Balance Policy

- **Utilities require a stable level of cash reserves to:**
 - Address risk that may materialize over the course of the year
 - Provide rate stability to customers
 - Allow for solid credit ratings from the rating agencies
- **Determining appropriate level of cash involves risk analysis:**
 - Revenues that may not materialize
 - Expenses that may be more than forecast
 - Working capital must be appropriate to address the delays in the billing cycle
 - Capital reserves need to be sufficiently flexible to address construction projects
- **Several Tools also provide stability along with a Cash Balance Policy:**
 - *Budgeting* *Assumptions with cash reserve targets as a critical metric*
 - *Insurance* *Manages unexpected/exceedingly expensive risk*
 - *Hedging* *Manages expected and unexpected risks*
 - *Borrowing* *Provides liquidity for uncertainty*



Executive Summary

- **Study examined many facets of IPL's strategy, operations and finance:**

- Revenue Risk
- Expense Risk
- Working Capital
- Capital

“Bottom Up” Review of Risk and providing
(1) Dollar value to address that risk
(2) Based on three categories (Less Conservative, Moderate, More Conservative Levels)

- **Develops a target for Cash Balances (will have bandwidth of +/- 10%)**

– Current Cash on Hand =	\$82.9 million
– Recommended Cash level =	\$67.0 million

- **Reviewed and approved by PUAB**

- **Way Ahead:**

- Review by City Council and establish as Policy
- Brief and discuss with Rating Agencies (will be viewed positively)
- Incorporate into the budget cycle for IPL and the City



II. Observations and Trends





Observations and Trends

IPL Cash Balance in 2019 and 2020

Account	30-Jun-20	30-Jun-19
Total Cash	\$102,946,940	\$101,685,047
Less: Legally Restricted Funds		
Debt Service Reserve	<u>\$16,351,730</u>	<u>\$17,269,630</u>
Available after Legally Restricted Funds	\$86,595,210	\$84,415,417
Less: Unrestricted BUT Unavailable funds		
Bond Construction	(0)	1,050,546
Customer Advance Payments	2,783,980	2,649,377
Operating Reserve - Dogwood SP	61,500	61,500
Operating Res - SPP Int Market	5,240	5,109
Operating Res SPP Coll Intan	<u>887,978</u>	<u>875,037</u>
Total: Unrestricted BUT Unavailable	3,738,698	4,641,569
Amount Unrestricted AND Available	82,856,512	79,773,848

- 1 Total IPL Cash (year end)
- 2 Less: Legally required Debt Service Reserve for existing bonds
- 3 Less: Funds available but designated for other purposes
- 4 Equals: Funds available for the cash reserve target, \$82.9 million on June 30, 2020

~20% of IPL cash balances are “Unavailable” and designated for specific purposes



Observations and Trends

- Uncertainty of COVID-19 permeates the analysis:
 - Federal programs have helped
 - Lack of renewed stimulus could be problematic
 - Unclear about the strength, depth and breadth of the economic recovery
- Independence can be characterized by:
 - Stable employment rates
 - Consistent, but slow, economic growth
 - Strong customer base, large percentage of residential/commercial (+90%)
 - Low turnover of the largest 12 customers of the system
- Some challenges remain in the service territory:
 - Low median income compared to state and U.S.
 - Elevated unemployment rate (8.8% in August)
 - Past variability in IPL sales during periods of economic downturns (-6%) has been significant



Observations and Trends

- Energy markets have been characterized by:
 - Natural gas prices drive the overall price for electricity
 - Currently near historically low levels
 - Just as volatile as in years past due to economic and weather factors
- Recently, IPL has experienced a lower cost of electricity. However:
 - Highly variable costs based on season and time of day
 - IPL benefits from participation in the regional energy market (SPP)
- Renewable energy continues to make inroads:
 - While older renewables are expensive, newer ones are cheaper
 - Missouri and the region is turning away from coal, but the process is slower than experienced in other regions of the nation
 - Consumer demand continues to “prefer” green
- Unclear how COVID will impact electric markets:
 - Majority of utilities across U.S. have seen reductions of 5-10%



III. Risk Analysis





Revenue Risk Summary

(\$ in Millions)	Recommended	
	Cash Level	Discussion
Revenue Risk		
General Sales Decrease	\$7.4 million	- Represents risk to the national and regional economy - Significant COVID-19 risk still remains - Recommended level based on 2009 historical sales reduction
Loss of a Large Customer	\$2.5 million	- Represents loss of a large customer and distributed generation - Significant COVID-19 risk still remains - Recommended level based on the sales to a large customer
Interest Income	\$1. million	- IPL has ~100 million of cash invested at any given point - Interest income can provide additional revenue - Current interest rates are now at all-time lows
Amount Reserved for Revenue Risk	\$10.9 million	

- Revenues and Sales may not materialize as budgeted
 - Historical sales decrease as experienced during “The Great Recession”
 - Some of IPLs largest customers may experience financial difficulty
 - National trend of largest customers providing their own power, primarily to meet corporate renewable goals
- If these revenues are lower than expected, IPL would still be required to pay a fixed level of operating and other expenses



Expense Risk Summary

(\$ in Millions)	Recommended	
	Cash Level	Discussion
Expense Risk		
Loss of Generating Station	\$1.3 million	- Represents the unexpected loss of a generating station - IPL would need to purchase the lost electricity on the market - Risk that purchase needs to be made when prices are high
Natural Gas Risk	\$2.6 million	- IPL needs natural gas for its generating stations - Natural gas prices greatly influence the electric market - Risk that gas purchases need to be made when prices are high
Purchased Power and Capacity Risk	\$8.7 million	- IPL has retired several coal plants - IPL must re-purchase this loss and meet regulatory requirements - Risk that these purchases need to be made when prices are high
Renewable Energy Risk	\$.3 million	- Renewable energy tends to be expensive - Renewable energy generated may be higher than budgeted - IPL required to purchase higher amount of renewable energy
Amount Reserved for Expense Risk	\$12.9 million	

- Expenses may be higher than budgeted
- IPL required to pay these higher expenses
 - Higher reliance on the energy and commodity markets (natural gas)
 - These markets can experience high levels of variability
 - Risks generally represent purchasing electricity and natural gas when prices are elevated above the budgeted level



Working Capital and Capital Reserve

(\$ in Millions)	Recommended	
	Cash Level	Discussion
Working Capital		
Working Capital	\$30.6 million	- IPL requires ~\$340,000 a day to meet general expenses - Billing cycle can take ~60 days from electricity to payment - Recommended level of 90 days based on economic conditions

- The general billing cycle takes time:
 - Provide energy Day 1
 - Send customer bill Day 30
 - Customer allowed 30 additional days to pay
 - However, IPL incurred the expense on Day 1!
- Economic recovery from COVID is uncertain

(\$ in Millions)	Recommended	
	Cash Level	Discussion
Capital Reserve / Renewal and Replacement		
Capital Reserve	\$12.6 million	- IPL facilities require annual maintenance efforts - Prior years capital projects have exceeded \$16 million - Annual depreciation of IPL assets is ~\$19 million - Average level of maintenance has been ~\$12 million

- To provide reliable service, a utility must invest in its system
- Levels for the capital reserve can be dictated by:
 - Annual depreciation expense has ranged from \$13 to \$19 million
 - Historical Capital Improvement Plan has ranged from \$5 to \$13 million
- Recommended level represents average planned execution over the next 2 years



Observations and Trends

(\$ in Millions)	Recommended
	Cash Level
Revenue Risk	\$10.9 million
Expense Risk	\$12.9 million
Working Capital	\$30.6 million
Capital Reserve	\$12.6 million
Target Level	\$67 million

- Recommended Level = **\$67 million** ←
- IPL should operate withing a +/- 10% bandwidth for flexibility
 - Upper Level = \$73.7 million
 - Lower Level = \$60.3 million
- IPL has \$82.8 million of unrestricted cash available (as of June 2020)
- Unrestricted cash level exceeds the recommended target (\$15.8 million and bandwidth (\$9.1 million to \$22.5 million)
- Several options exist for the cash level above the target:
 1. Defease IPL's 2010 bonds, creating savings for utility and customers
 2. Defease IPL's 2010 bonds and use remaining cash available to partially defease the 2012A Bonds in 2022
 3. Contribute to additional CIP needs, eliminating future required rate increases for these projects
 4. Targeted rate adjustments (likely one time)
- Rating Agencies would view the adoption of the policy favorably



IV. Next Steps





Next Steps

- **Schedule**

- 2020 Update to PUAB
November 19

- Revisions Received

- Policy Updated

- Review Policy with new
targets by City Council

December 14

- City Council Approve
Targets and Policy

December 21



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