

## LANSING BOARD OF WATER & LIGHT

## POLICY

MINIMUM CASH RESERVE REQUIREMENT

EFFECTIVE: 7/01/2025

COMMISSION

POLICY

TYPE: COMMISSION

**SCOPE:** This Policy describes the calculations that determine the minimum cash reserve requirement for each year of the succeeding six-year forecast period and impacts the budget and forecast approved by the Board of Commissioners.

**PURPOSE:** BWL's Minimum Cash Reserve Requirement Policy ("Policy") is one of several planning tools used to help assure uninterrupted delivery of critical utility services. The Policy guides the organization's operations along a path of continued financial stability, in line with BWL's Strategic Plan. By defining BWL's minimum cash reserve requirement, the Policy promotes the utilization of effective planning strategies to maintain financial strength and continuity of operations.

The Policy was compiled using a review of best practices from credit rating agencies, utility experts, and other municipal utilities. Rather than setting a fixed dollar amount, the Policy establishes a methodology for the calculation of a minimum cash reserve requirement. The minimum cash reserve requirement will be recalculated each year and presented to the Board of Commissioners ("Board") during the annual budget and forecast process. The Board is responsible for approving and accepting the forecasted minimum cash reserve requirement as a component of the BWL's budget and forecast. For purposes of this Policy, minimum cash reserve includes all unrestricted cash and cash equivalents, including bank deposits and liquid investments, and will be measured in terms of days cash on hand.

The Policy enforces the Board's commitment to financial stability and desire to maintain or improve BWL credit ratings. Since strong credit ratings reduce the cost of borrowing, they are essential to maintaining low customer rates. BWL debt issuance is currently rated by the following agencies:

- A. Moody's – Most recent rating of Aa3 with stable outlook on 12/26/2023. This rating indicates an obligation of high quality with very low credit risk.
- B. Standard & Poor's – Most recent rating of AA- with stable outlook on 2/28/2025. This rating indicates an investment-grade obligation whose issuer has a very strong capacity to meet financial commitments.

**POLICY:** The minimum cash reserve requirement is determined using a risk-based calculation of five key cash requirements: Net O&M Expense, Return on Equity to the City of Lansing (the City), Historical Plant in Service, Debt Service, and Six-Year Net Capital Improvement Plan. Each cash requirement is multiplied by its associated risk factor and summed up to determine the minimum cash reserve requirement. This calculation is applied to each of the BWL's utilities individually and then aggregated to determine the overall BWL minimum cash reserve requirement. Listed below are descriptions of each cash requirement along with the associated risk factor.

1. Net O&M Expense – Net O&M Expense represents total annual operating expenses, excluding depreciation.
  - a. The risk factor reflects an estimated lag time in the revenue collection cycle.
  - b. The risk factor is calculated by dividing the estimated lag time in days by 365 days.
  - c. The risk factor for Net O&M Expense is 12.3% (the result of a 45-day lag time ÷ 365 days).
2. Return on Equity to the City ("ROE") – ROE represents the estimated amount to be transferred to the City for a fiscal year.

- a. The risk factor reflects the maximum amount to be transferred at any one time during the fiscal year.
- b. The risk factor for ROE is 25% since the BWL makes quarterly payments.

3. Historical Plant in Service – Historical Plant in Service represents the full historical cost of BWL’s utility plant.

- a. The risk factor is calculated based on the depreciation percentage, or age, of the system by dividing accumulated utility plant depreciation by historical investment.
- b. The risk factor is assumed to be 1.0% where utility plant is less than or equal to 40% depreciated (newer system).
- c. The risk factor is assumed to be 1.5% where utility plant assets are 41%-50% depreciated.
- d. The risk factor is assumed to be 2.0% where utility plant assets are 51%-55% depreciated.
- e. The risk factor is assumed to be 2.5% where utility plant assets are 56%-65% depreciated.
- f. The risk factor is assumed to be 3.0% where utility plant assets are over 65% depreciated (older system).

4. Debt Service – Debt Service represents the BWL’s total annual debt service payments (bond principal + bond interest).

- a. The risk factor reflects the BWL’s debt service obligation. This risk factor is limited due to the requirements already established for debt service in the form of bond covenants.
- b. The risk factor for Principal Debt Service is 50% to provide for at least half of the annual obligation.
- c. The risk factor for Interest Debt Service is 25% to provide for at least half of the semi-annual obligation.

5. Six-Year Net Capital Improvement Plan – The Six-Year Net Capital Improvement Plan represents the total six-year forecast cost for capital improvements, less any portion to be funded by external sources.

- a. The risk factor reflects the average net annual capital improvement cash outlay over the six-year forecast.
- b. The risk factor for the Six-Year Net Capital Improvement Plan is 16.7% (the result of 1 year ÷ 6 years).

The Board will annually review the proposed budget and forecast to ensure the minimum cash reserve requirements are met as defined in this Policy.

In addition, to help maintain BWL’s credit rating and ensure sufficient reserves, a minimum of 150 days of cash on hand is expected, therefore, the minimum cash reserve should be the higher of 150 days or the calculated days based on this Policy.

In the event actual results fall short of the budget to such a degree that the reserve balance falls below the required minimum, consistent with this Policy, the Board will require the succeeding year’s budget and forecast to include the corrective actions necessary to restore cash reserves to the required level by the end of the next fiscal period.

**REFERENCES:** Resolution 2025-05-08

**RESPONSIBLE AREA & DEPT NAME:** Accounting, Finance & Planning Department

**EXECUTIVE DIVISION:** Assistant General Manager & Corporate Services

**EXECUTIVE RECORD OF APPROVAL DATE:** 05/20/2025

**POLICY REVIEW:**

REVIEWED BY	DATE	DUE DATE NEXT REVIEW
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Scott Taylor	04/14/2025	As needed
REVIEWED BY - INTERNAL AUDITOR	DATE (*not to exceed 5 years)	COMMENTS