

NEW BRAUNFELS UTILITIES **FINANCIAL POLICY**

New Braunfels Utilities (NBU) recognizes the importance of having a sound financial condition in order to meet its customer and public service responsibilities. It is NBU's financial policy to strive to provide its electric, water and wastewater services at the lowest possible costs, consistent with high standards of reliability and innovative essential service. This financial policy is intended to form the framework within which NBU will preserve its financial integrity in order to meet its long-term goals. This policy has been developed in consideration of short and long term plans for construction and system additions. A periodic review of this financial policy with necessary revisions may be required to ensure that NBU maintains a high level of financial integrity in order to accomplish these plans. Since NBU's Investment Policy also addresses NBU's financial objectives, NBU's Investment Policy should be used in concert with the Financial Policy.

FINANCIAL OBJECTIVES:

- I. **Financial Stability:** In seeking to fulfill its customer and public service objectives, NBU will maintain a high level of financial stability and will not compromise its long-term financial integrity to achieve short-term benefits.

- II. **Funds From Operations:** NBU will establish rates and charges for services that are sufficient to support the conduct of its activities in an efficient and reliable manner. Funds from operations should provide the necessary funds to support its capital improvements program and maintain a debt service coverage ratio sufficiently in excess of the 1.40x Bond Indenture requirement for the issuance of additional indebtedness. By providing an ample cushion in its debt service coverage ratio, NBU should be in a position to issue additional indebtedness in the market at favorable terms and conditions.

Each year, NBU staff will develop projected revenue levels and the projected reserve requirements for the upcoming fiscal year and estimate its projected impact on the financial condition of the utility. These projections will be developed after consideration for bond ratings, construction requirements, current business conditions, economic projections, load growth assumptions, and the projected size and frequency of rate adjustments. Specifically the electric, water, and wastewater systems shall be managed individually to allow for financial self-sufficiency to the extent practicable with regard to their respective cash inflows and outflows, including, but not limited to revenue, general operating expenses, and capital expenditures.

General Fund expenditures will have the following priorities of obligation:

- A. Payment of all reasonable expenses for the operation and maintenance of the electric, water, and wastewater systems.

- B. Payments to meet all debt service requirements of outstanding bond indebtedness including all Interest and Sinking Funds and Bond Reserve Funds

- C. Payments to any and all Restricted Funds including the System Contingency Fund, Power Stabilization Fund, and other specific funds as directed by the Board of Trustees.
- D. Payment to the City of New Braunfels of an amount based upon a formula approved by a Board of Trustees Resolution or other directive.
- E. All net surplus after payment of A through D above may be used to fund necessary capital equipment purchases, system expansion and renovations. All remaining funds will be applied toward targeting a budgeted ending cash balance of 1/4th or more of the upcoming fiscal year's budgeted operating costs (including purchased power cost and purchase water cost).

III. Revenue: In general, NBU shall rely on individual electric, water, and wastewater service rates for all revenue, however, other sources of revenue will be developed within each of the respective lines of businesses' operation and connection policies. Specific policies regarding Water and Wastewater Capital Recovery Fees (e.g., impact fees) will be maintained with receipts separately accounted for and applied to capital system expansions or extensions.

NBU will develop and design rates to recover its costs of specific services and provide a predictable flow of revenues.

IV. Pricing, Rates, and Reserves: NBU will determine revenue requirements for its electric, water, and wastewater services based upon an equitable allocation of costs. All rates will be cost and/or market based with specific cost-of-service allocations to all necessary areas of required revenues. Cost-of-service updates will be prepared on a periodic basis for comparisons to actual and projected revenue and expenses. Proper and accurate coordination of budget requirements, unusual revenue requirements, and changes in capital requirements will be addressed in each cost-of-service update. NBU will evaluate the proper reserve requirements annually to mitigate NBU's risk.

V. Financing: Since its founding in 1942, NBU has utilized a combination of equity, or revenue surplus, and long-term revenue bonds to finance additions to its electric, water, and wastewater systems infrastructure. Long-term revenue bonds are particularly appropriate in situations where it is desirable to spread the financing cost of the capital assets over their useful lives. Using this approach results in both current and future rate-payers being allocated an equitable portion of the cost of the facilities used to provide their service. In order to have an effective financing source of funds, NBU's capital structure must be such that it has a sufficient equity capital base (i.e., a low to moderate debt leverage in NBU's capitalization) to support long-term debt financing.

NBU will selectively utilize sourcing of funds through long-term debt financing by maximizing the use of funds from operations in order to protect NBU's financial

soundness and to preserve NBU's access to the long-term debt market. This market access should provide NBU with adequate sources of capital for the growing needs of its customers at a reasonable overall cost of capital.

It is important to generally establish appropriate levels of debt and equity financing. However, substantial changes in the financial markets may arise due to changing political, economic, global, or other significant factors. As a result, it may be necessary at times to alter NBU's guidelines which could impact NBU's interest rates on new issuances of debt and its overall capital structure. Under current conditions, the following financial policy is adopted:

- A. NBU will use long-term debt financing for capital assets having long useful lives and will attempt to establish amortization and debt service payment schedules which coincide with the lives of the related assets.
 - B. NBU will establish rates and debt financing structures, terms, and repayment schedules sufficient to generally maintain a system wide debt to capitalization ratio of 50% or less and a debt service coverage ratio of at least 2.4x.
 - C. NBU has established and maintains a Board-approved Investment Policy which establishes permitted investments and allowable allocation parameters for the various approved investment vehicles. The primary driver is focused on preservation of principal.
 - D. In conjunction with the overall financial policy, NBU has established and maintains an Energy Risk Management Policy and a Credit Risk Management Policy.
 - a. The Energy Risk Management Policy has been approved by the NBU Board of Trustees and provides the framework for the Power Supply Team to identify and measure risk exposure to the wholesale energy markets and to develop and implement strategies to manage, monitor, measure and report on those risks.
 - b. The Credit Risk Management Policy has been approved by the NBU Board of Trustees and provides the framework for the Energy Risk Team to monitor and report on the management of energy credit risk, primarily in the areas of reviewing and approving counterparties, monitoring their creditworthiness, and establishing credit limits based on guidelines approved by NBU's Board of Trustees.
- VI. Capitalized Interest: In order to partially defer the rate impact of debt service requirements until the asset being financed is placed in service, NBU may opt to capitalize interest proceeds from bonds for an appropriate period (generally, not to exceed 3 years). Accountability of capital associated interest shall be kept separate with capital fund requirements recognizing anticipated interest proceeds.

VII. Alternative Financing: As market conditions evolve, NBU will evaluate alternatives to conventional long-term revenue bond financing to determine the feasibility of such financings based on their terms and conditions and their impact on NBU's overall cost of capital.

A. Commercial Paper – If market conditions are favorable, the use of commercial paper as a short term financing vehicle can help offset some of the interest rate risk. The parameters of the program are as follows:

- a. 10% of assets program limit
- b. At least \$50 million in size
- c. Roll program into long term debt if:
 - authorized amount is fully utilized
 - determined that market conditions are no longer favorable or
 - the program is at the end of the program term

VIII. Documentation and Reports: NBU will comply with all statutory and bond and debt reporting requirements on a timely basis. In this regard, NBU will provide the following:

- A. A monthly operating and financial report, requiring review by the Board of Trustees, in such detail as the Board deems necessary.
- B. An annual budget and financial operating plan detailing revenues, expenses, and capital expenditures presented for approval at the June Board of Trustees meeting. In the event a midyear revision to the fiscal year budget is requested, then an analysis and update shall be presented to the Board of Trustees for approval.
- C. An annual audit by an outside professional auditing firm will include necessary details in reconciling all of the year's financial operation. The audit will be submitted for review and approval to the Board of Trustees shortly after the end of the NBU's fiscal year.

Copies of the approved audit will be provided to the City Council of New Braunfels and arrangements made for the presentation and discussion of the audit to City Council, if requested. Compliance with internal audit procedures will be reviewed with the Audit Committee of the Board of Trustees in conjunction with the external auditor's report.

- IX. Summary: This policy establishes management guidelines for NBU's financial accountability in order to provide a financial structure conducive to controlling service rates and optimizing service reliability to NBU's customers. It is understood that this policy is a guide and that financial objectives may change over time. This financial policy is intended to be used as a vehicle to preserve NBU's financial integrity in order to meet NBU's long-term goals.