VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 10

TO: Valley Clean Energy Alliance Board of Directors

FROM: Mitch Sears, Interim General Manager
George Vaughn, Director of Finance & Internal Operations

SUBJECT: Update - Operating Budget Fiscal Year 2020-2021

DATE: April 9, 2020

RECOMMENDTION
Informational – no action requested.

OVERVIEW
The purpose of this staff report is to provide an update on the preliminary operating budget for FY 2020-2021 (2021 Budget), that staff introduced at the March 2020 Board meeting. The report also provides additional information on several potential fiscal mitigation strategies that may help offset anticipated negative net income in the 2021 Budget. Preliminary financial analysis associated with the potential mitigation strategies is introduced, which will be analyzed in more depth for the May 15th Board meeting.

Final adoption of the 2021 Budget is scheduled for the June 11th Board meeting.

BACKGROUND AND ANALYSIS
<u>2021 Budget</u>
At the March 12, 2020, Board meeting staff presented the 2021 Preliminary Budget, which forecasted a negative Net Income of -$6.4 million (now -$5.6 million – see below), due primarily to two major factors that are both outside of VCE's direct control:

- First, the 2021 Budget suffers from anticipated negative revenue trends in FY 20/21 resulting from an estimated 44% increase in Power Charge Indifference Adjustment (PCIA), costs and a 4% decrease in PG&E generation rates.
- Second, VCE faces a large increase in power costs due to significant increase in resource adequacy (RA) costs and the assumption that the upcoming long-term solar projects will not begin delivering energy until the end of 2021 instead of mid-2021 as originally forecast.

Additional detail on these primary drivers includes:

PCIA/Rates – The revenue decline is driven by the following rate impact factors:
- PCIA will increase by 18% to approximately 3.2 cents per kWh starting May 2020 and

will increase an additional 44% to approximately 4.6 cents per kWh starting in October 2020 due to the expectation that PG&E will file a cap exception trigger in 2020. Note: VCE, through CalCCA, is investigating options to defer and/or smooth this PCIA spike in late 2020. Staff will continue to be engaged in this discussion and report to the Board as these issues move through the CPUC process.

- PG&E generation rates are forecast to decrease by an overall average of 4% for calendar year 2020 and then increase 2% in calendar year 2021; this results in a revenue decline as VCE's policy is to match PG&E generation rates.

Power Costs/Mix – Power costs have increased substantially from 2020 Budgeted amounts to the preliminary 2021 Budget power cost forecast. The increase of $9.4 million is due primarily to the market cost of RA increasing substantially over the past several years. Primary drivers for RA cost increases in this time period include a tightening market as fossil fuel baseload energy resources are retired and shifting market rate design and requirements mandated by the CPUC. Other less significant contributing factors impacting VCE power costs include:

- Adding Winters load
- Renewable Energy Credit (RECs) cost increase
- Carbon-free energy cost increase
- Brown power market cost decrease

Rising RA costs have been a significant problem for the industry, with CCAs across the state also grappling with the issue. VCE and SMUD actively monitor and manage the long-term portfolio of RA to remain compliant with requirements and to procure power in as cost-effective way as possible. VCE also addresses RA cost volatility through direct participation and CalCCA involvement in regulatory proceedings.

<u>Preliminary 2021 Budget Key Assumptions/Factors</u>

The Preliminary 2021 Budget includes the following key assumptions/factors:

1. Power mix reflected in the Preliminary 2021 Budget remains unchanged from the prior year's budget with 42% renewable and 75% clean content.
2. The load forecast has been updated for 2020 and 2021 using actual load data, opt-out rates and opt-up rates. The retail load forecast for the FY 2021 is estimated at 722 GWh.
3. Energy cost includes: (1) system energy, (2) eligible renewables and (3) carbon free attributes which are estimated at $37.6 million, or 73.9% of the total power costs. Resource adequacy cost is forecasted at $13.3 million, or 26.1% of the total power costs.

UPDATES ON PCIA AND FISCAL MITIGATION STRATEGIES

<u>PCIA Update</u>

As stated in the March 12, 2020 Board PCIA staff report, the CPUC issued its Final Decision on PCIA & ERRA. This decision largely adopted the Proposed Decision (PD), recommendations but did include approximately $93 million in overall PCIA reductions for PG&E. This $93 million reduction was one of the topics VCE and EBCE addressed in its joint meetings at the CPUC in February 2020.

Staff has analyzed the impacts of the $93 million reduction in PCIA. The overall positive impact on the VCE 2021 Budget is an increase of $0.8 million in operating revenue, lifting negative Net Income from -$6.4 million to -$5.6 million (12.5% change).

Potential Mitigation Strategies

Staff have begun researching and analyzing potential strategies to partially mitigate the negative Net Income highlighted in the preliminary 2021 Budget.

1. Rate Changes

VCE could increase its combined generation rate (generation, PCIA and Franchise Fee Surcharge), beyond PG&E's generation rates. For every 1% that VCE's rates are higher than PG&E's generation rates, revenue will increase by approximately $800,000.

Another rate related option being analyzed by staff is to add a third rate choice for customers that would be set at the minimum State standards for renewable energy content. This would allow customers the option to choose a more cost-effective rate (perhaps set at PG&E's generation rate), while maintaining VCE's other two current rate options that deliver higher renewable and GHG free attributes at a premium.

2. Power Resource Planning Adjustments

Currently VCE's long-term renewable PPA's are anticipated to begin delivering energy and associated RA in mid-2021, displacing more expensive existing short-term renewable contracts (PCC1) and GHG free resources. Staff is analyzing the timing of these power deliveries in 2021 and when to dial back the existing short-term contracts. Aligning the actual start dates and end dates may result in a period where overall renewable and GHG levels in VCE's portfolio are much lower but averaged out to meet VCE's goals over a 2 or 3 year period as the higher levels of renewables from the long-term contracts come on-line. These power resource planning adjustments may result in a net cost savings over this 2-3 year period while still meeting VCE's regulatory compliance requirements. Staff is analyzing the potential savings which are dependent on timing of the adjustments and the level of transition out of short-term contracts.

3. Additional Mitigation Levers

- Accept the GHG-free large hydro and nuclear allocations from PG&E, at a potential benefit of $0.5 million and $0.8 million respectively. These savings are speculative and would only be realized if a market exists in which to realistically sell these characteristics.
- Seek additional reductions in operating expense beyond those already captured. Although VCE has already crafted an operating budget that is lower than the current FY 2020 Budget, staff could present a set of more austere measures that could result in additional incremental operational expense savings. The scale of these measures would represent the smallest potential savings of the mitigation options outlined in this report.

CONCLUSION

Staff is continuing to analyze information and budgetary options for FY 2021 and will present an additional update to the Board in May and a final draft Budget for consideration in June.