VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 15

TO: Board of Directors

FROM: Edward Burnham, Director of Finance & Internal Operations

SUBJECT: Allocation of 2022 Net Margin

DATE: July 13, 2023

RECOMMENDATION

Adopt a resolution approving the allocation of the $5.3M 2022 Audited Net Margin between cash reserves and local program reserve (LPR) as follows:

1. $4,611,000 to cash reserves to reach cash reserve targets for this fiscal year;
2. Balance of 2022 net margin of $712,500 to the Local Programs Reserve (LPR).

OVERVIEW

This staff report presents options related to the allocation of VCE's audited net margin for 2022. VCE's audited financial statements can be found here. Taking into account the Board adopted Dividend Program policy (2019), as well as available and forecast cash reserves, Staff analyzed options outlined below for VCE's 2022 net margin of $5.3 million. Based on this analysis, Staff concluded that the following allocation met VCE's policy objectives while providing the greatest material net benefit:

- Minimum allocation of $217,000 to the Local Programs Reserve
- Minimum allocation of $4,611,500 to cash reserves
- Discretionary Allocation (After Cash Reserves) of $495,000

BACKGROUND AND ANALYSIS

The Board adopted the VCE Rate Structure and Dividend Program Guidelines on June 17, 2019, to guide the allocation of the audited net margin for each year. The guidelines can be found here.

Key test of the Dividend Program:

- Basic Test: A minimum 5% net margin must be achieved before considering allocation of net margin above 5% to Cash Reserves, Local Program Reserves, and/or Cash Dividends

Based on audited 2022 Financial Statements, VCE achieved a 6.14% net margin, meeting the basic Dividend Program test. Therefore, the Board must consider how to allocate the net margin above 5%. As noted when the Board adopted the Dividend Program Policy in June 2019, a 5% minimum net margin is in the lower range of typical net margin goals for the utility sector and most other industries.

Dividend Program Formula

The adopted Dividend Program formula recommends allocating the net margin as follows:

- Net margin less than or equal to 5% is to be allocated as follows:
  - At least 5% of the first 5% of net margin goes to VCE's Local Programs Reserve for program implementation
  - The balance goes to cash reserves

- Net margin above 5% is to be allocated as follows:
  - At least 50% to cash reserves until reserves targets are met
  - Remainder allocated amongst dividends and Local Program Reserve (Board discretion)

Staff applied the Dividend Program formula above to VCE's 2022 audited net margin. The following table summarizes the analysis.

Table 1 – 2022 Audited Net Margin Summary

Description		Audited 2022 Results	
Electricty Sales		86,662,000	
Operating Expense		80,897,000	
Operating Margin		5,765,000	
Prinipal Debt Payments		441,000	
Adjusted Net Margin less prinicpal Debt Payments		5,324,000	
Adjusted Net Margin Pectentage		6.14%	
Allocation Amount <=5%		4,333,000	
Allocation Amount > 5%		991,000	
Aloocation of Net Margin up to 5%	**Perectage**	**Allocation Amount**	
Cash Reserves Allocation	95%	4,116,000	Minimum
Local Programs Allocation	5%	217,000	Minimum
Aloocation of Net Margin above 5%	**Perectage**	**Allocation Amount**	
Allocation to Cash Reserves	50%	495,500	Minimum
Discretionary Allocation (After Cash Reserves)	**50%**	**495,500**	Maximum

As shown in Table 1, applying the basic Dividen Program formula results in $495.5K of discretionary funds.

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Allocation Scenarios

Staff analzyed three basic scenarios related to the allocation of discretionay funds to help inform its recommendation and the Board decision.

Scenario 1: Additional Programs Funds (Staff Recommended)

Discretionary Allocation (After Cash Reserves)	50%	495,000	Maximum
Cash Reserves	0%	-	
Local Programs (Targeted 2024 Spend)	100%	495,500	
Customer Dividends (Targeted 2024 Spend)	0%	-	

Scenario 2: Additional Cash Reserves

Discretionary Allocation (After Cash Reserves)	50%	495,000	Maximum
Cash Reserves	100%	495,500	
Local Programs (Targeted 2024 Spend)	0%	-	
Customer Dividends (Targeted 2024 Spend)	0%	-	

Scenario 3: Customer Dividends

Discretionary Allocation (After Cash Reserves)	50%	495,000	Maximum
Cash Reserves	0%	-	
Local Programs (Targeted 2024 Spend)	0%	-	
Customer Dividends (Targeted 2024 Spend)	100%	495,500	

Based on the cash reserve forecast in the coming years, Staff is recommending the Board allocate the discretionary allocation of the full $495.5K to local programs. Key factors in staff's analysis of these options include:

- Cash Reserves Option. This amount of additional cash reserves would not have a material effect in obtaining VCE's initial investment grade credit rating
- Dividend Option. Available funds for dividends would provide less than a 1% discount (3approx. $1.50/month reduction in the average residential customer bill); small impact on customer bills. Note: VCE currently provides a ~2.5%/$1M annually in discounts to 25% of customers (CARE and FERA)
- Local Programs Option – Recommended. Additional program funds are needed to execute VCE's adopted VCE's 3-Year Programs Plan; staff believes this provides the largest positive material impact related to the available discretionary revenues.

Note: In the near future, there is an increased likelihood that the dividend can be implemented as additional VCE power purchase agreements become operational, regulatory factors improve, and additional cash reserves are built for financial stability.

For reference, if the Board decided to institute a small dividend this year rather than the $0 recommended by Staff, the effects would be:

- Each 1% dividend would be a reduction of $800,000 in cash reserves and reduce days cash on hand going forward by approximately five days

Notes: (1) a 1% dividend would be approximately $1.50/month reduction in the average residential customer bill and an approximately $3.75/month reduction in the average small commercial customer bill; (2) anecdotal information from other CCAs indicate that these levels of customer dividends/discounts while helpful in communicating a CCA's value do not have significant effects on customer retention or new customer recruitment.

Community Advisory Committee (CAC) Consideration

The staff recommendation was presented to the CAC at its June 22, 2023 meeting. The CAC unanimously supported the staff recommendation.

CONCLUSION

Based on the factors outlined above, staff believes its recommendation for VCE's 2022 audited $5.3M net margin is fiscally prudent and results in the most significant material impact.

ATTACHMENTS:

1. Resolution – Allocation of 2022 Net Margin

VALLEY CLEAN ENERGY ALLIANCE

RESOLUTION NO. 2023 - ___

A RESOLUTION OF THE BOARD OF DIRECTORS OF VALLEY CLEAN ENERGY ALLIANCE APPROVING THE RECOMMENDED ALLOCATION OF NET MARGIN FOR THE AUDITED YEAR ENDED DECEMBER 31, 2022

WHEREAS, Valley Clean Energy ("VCE") was formed as a community choice aggregation agency ("CCA") on November 16, 2016, under the Joint Exercise of Power Act, California Government Code section 6500 et seq., among the County of Yolo, and the Cities of Davis and Woodland, to reduce greenhouse gas emissions, provide electricity, carry out programs to reduce energy consumption, develop local jobs in renewable energy, and promote energy security and rate stability in all of the member jurisdictions. The City of Winters, located in Yolo County, was added as a member of VCE and a party to the JPA in December of 2019; and,

WHEREAS, the Board adopted a Rate Structure & Dividend Program Guidelines (Dividend Program) on June 17, 2019, to be effective starting at the beginning of the following fiscal year on July 1, 2019; and

WHEREAS, the Dividend Program specifies how audited positive Net Margin for each fiscal year can be allocated amongst cash reserves, customer dividends, and local program reserve (LPR), at the Board's discretion; and

WHEREAS, VCE staff analyzed the allocation options for Board consideration based on the final, audited Net Margin for the year ended December 31, 2022.

NOW, THEREFORE, the Board of Directors of Valley Clean Energy resolves as follows:

1. For the audited year ended December 31, 2022, allocate the Net Margin of $5.324 million as follows: $712,500 to local program reserve, $0 to cash dividends, and the $4.611 million balance to cash reserves.

PASSED, APPROVED AND ADOPTED, at a regular meeting of Valley Clean Energy, held on the ____ day of _______________, 2023, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

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Tom Stallard, VCE Chair

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Alisa M. Lembke, VCE Board Secretary