VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 16

TO: Board of Directors

FROM: Edward Burnham, Director of Finance & Internal Operations
Mitch Sears, Executive Officer

SUBJECT: Operating Budget Update

DATE: October 13, 2022

RECOMMENDATION
Informational – no action requested.

OVERVIEW
This update is the first of three discussions leading to Board consideration of VCE's 2023 budget. The purpose of this staff report is to: (1) provide an update on the 2022 Operating Budget, (2) provide an overview of key factors influencing the 2022 and 2023 operating budgets, and (3) provide a preliminary multi-year forecast (2023 through 2025).

VCE's short-term outlook (2022 and 2023) indicates continued volatility in power market prices due to global events outside VCE's control. When combined with September's historic 10-day heat storm, VCE's short-term net income is lower than originally forecast for 2022 by approximately $10M. The mid/longer term outlook (2023-2025) informed by VCE's analysts (CalCCA, MRW), shows VCE recovering lower than forecast net income in 2023 due primarily to lower Power Charge Indifference Adjustment (PCIA) rates.

To date, VCE has been able to absorb 2022 power cost impacts and continue to contribute to reserves without recommending adjustments to rates. This is due primarily to lower PCIA rates in 2022 and forecast for 2023. Beginning in 2023, significant long-term renewable Power Purchase Agreements (PPA's), will be coming on-line helping mitigate power market volatility and contribute to VCE's ability to continue to build reserves and maintain positive margins for the longer-term (2024+).

<u>2022 Adopted Budget</u>
In February 2022, the Board approved the 2022 Operating Budget with $89.8M of operating revenues and $72.3M of operating expenses for a net income of $17.5M. As detailed in the analysis section below, the net financial results are due primarily to significant power cost increases above revenues across the past two fiscal years (2021 and 2022). The 2022 budget is estimated to have a total net income of $6.6M, $10.1M less than forecast in the adopted 2022 Budget. Based on its preliminary analysis of power market, PCIA, and rate forecast information for 2023, staff does expect these revenues to be recovered in 2023 driven primarily by additional decreases in PCIA charges. Note: PG&E's final rate and PCIA report for 2023 will be released in mid-October which will inform staff's draft 2023 budget that will be presented to the Board at its November meeting.

BACKGROUND
In October 2021, staff presented an Operating Budget with several scenarios based on information from several forecasting sources (CalCCA, MRW). PG&E's rate setting process was delayed from the November 2021 meeting until late January 2022 due to a request from the California Public Utilities Commission (CPUC) to evaluate rate options to spread its 2022 rate increase of over 30% over more than the standard 12-month period. In addition, the PCIA decrease for 2022 was revised from a -75% to a -59% based on the incorporation of actual vs. projected value of PG&E's energy portfolio for October and November 2021. The net result of the CPUC proceeding approved an increase of 33% in PG&E's bundled rates and PCIA decrease of 57%.

VCE adopted a budget, taking into account PG&E's approved rates in February, that incorporated a 2.5% rate credit for CARE/FERA and Medical Baseline customers and directed all other revenues to cash reserves for a target of ~85 days cash on hand by the end of 2022.

Staff provided a mid-year financials update to track/report actual customer load demand and revenue during the year and a mid-year rates review to evaluate any needs for mid-year rate adjustments.

ANALYSIS
This report updates information previously provided to the Board during the June 2022 Mid-year Financials Update and August 2022 Rates Update. The section below provides updates on: (1) key factors influencing VCE Operating Budget Results and (2) 2022 Budget Update and Multi-year Outlook.

1. Key factors – Operating Budget Results
Key factors influencing the 2022 and 2023 Budget results include:

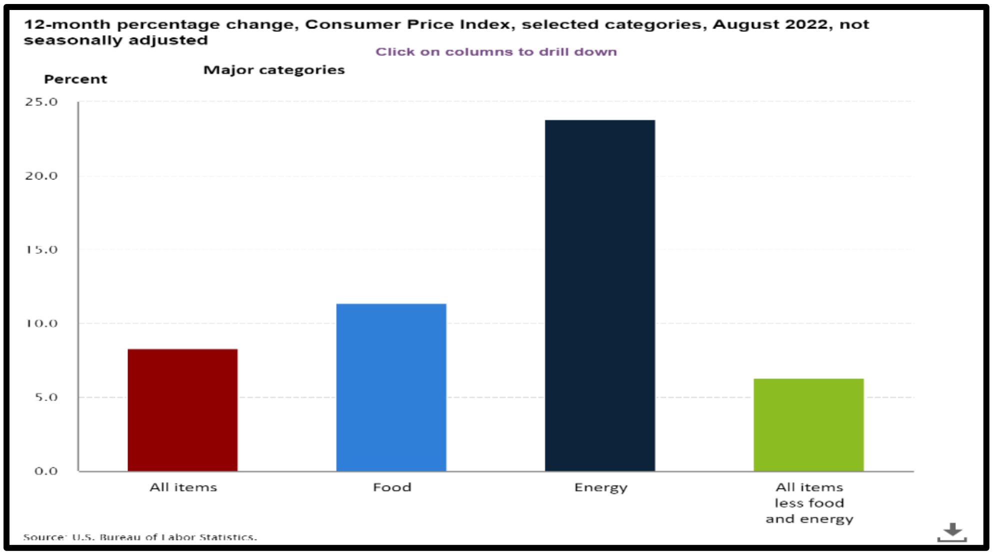
- Load Forecast. As shown in Table 1, in the first half of 2022 energy use in several sectors out-paced forecasts. For example, two large sectors showed higher than forecast energy use: (1) residential energy use (e.g. TOU transition, return to work/hybrid, heat storms, etc.), and (2) commercial energy use related to agriculture (e.g. droughts, mild winter, heat storms, etc.). Even after accounting for these factors, the 2022 actual vs. load forecast remains within 5% of the overall forecast.

Table 1 – Load Update (2022 Actuals)

Load								
Month	Res	Sm Comm	Med Comm	Lg Comm	Ind	Ag	Light	Total
1	89%	85%	94%	102%	114%	105%	89%	93%
2	89%	87%	96%	110%	119%	179%	94%	101%
3	85%	90%	95%	102%	108%	140%	100%	98%
4	89%	91%	101%	100%	106%	127%	107%	101%
5	104%	97%	96%	106%	103%	109%	117%	104%
6	108%	99%	96%	102%	97%	121%	116%	108%

- Power Prices. Average forward market power prices have increased significantly in recent months due to the geopolitical climate resulting from the Ukraine conflict and multiple heat storm events. This has increased total long-term energy hedging prices for calendar year 2023 and day-ahead purchase prices in the recent months of 2022. Power prices are expected to remain at elevated levels through the remainder of 2022 and into 2023. Table 2 below helps illustrate the relative impact to energy sector prices vs. other major categories in the US economy resulting from economy wide financial impacts.

Table 2 – CPI for Selected Categories, 12 Month Percentage Change



- Supply Chain interruptions. Covid-19 pandemic impacted manufacturing and supply chains causing delays in construction and completion of renewable projects, including several large solar + storage projects under contract with VCE which are forecasted to help moderate and stabilize VCE's fixed portion of 2023 power costs. These delays have been addressed and the first of these PPA's is scheduled to come online beginning in Q2 of 2023 and the second in 2024.

As noted, high power market prices are forecast to continue into 20223 which will create downward pressure on the PCIA. Currently, based on analysis by CalCCA, staff anticipate a near zero to negative PCIA rate for 2023. The net result is revenues originally forecast for 2022 are pushed into 2023. As summarized in Section 2 below (Multi-year forecast), the changes to PCIA and VCE's long-term renewable PPA contracts are forecasted to provide mid/long-term financial relief. These long-term renewable contracts will also have rate stabilization effects while significantly increasing VCE's renewable content.

2. Operating Budget Update (2022)

As presented to the Board in July, VCE experienced a $4.2M decline in net income compared to Budget through June 2022. This resulted in a revised net estimated income of $13.3M for 2022. Based on the most recent financials that incorporate the energy purchased during the historic September heat storm, the 2022 forecast has been revised downward by an additional $6.4 M. This second revision results in a revised net estimated income of $6.6M for 2022. As shown in Table 3 below:

Table 3 - 2022 Proforma Budget (Unaudited)

Description	APPROVED 2022 BUDGET	2022 Proforma (6 Month Actuals + 6 Month Budget)	Variance
Revenue	$ 89,750	$ 86,760	$ (2,990)
Power Cost	$ 66,990	$ 75,050	$ (8,060)
Other Expenses	$ 5,292	$ 5,080	$ 212
Net Income	$ 17,468	$ 6,630	$ (10,838)

2022 Operating Budget Key Factors:

- Power Costs and September heat storm. September energy demand resulting from the historic 10-day heat storm exceeded load hedges that required additional purchases in the relatively expensive day-ahead energy market for an additional $5M+. Generally, rising power costs since early 2022 account for the remainder of the power cost variance from the forecast.

- Budgeted revenues. The 2022 Budget incorporated revenues associated with extreme temperatures and drought conditions. These revenues have not fully materialized in the actuals for 2022. The primary revenue variance is related to June, which was relatively mild when compared to expected energy usage and revenues. Staff will continue to evaluate the revenue forecasting model to normalize the accuracy of future forecasts.

Multi-Year Forecast

As presented to the Board in July, for the three years from 2023 to 2025, staff forecasted a total of $47M net income for 2023-25. Based on the most recent information/analysis from CalCCA and MRW, staff have increased the total 3-year net income forecast from $47M to $50M. This is due primarily to lower PCIA over the period. Staff believes this is a cautious forecast based on current expectations from CalCCA and analysts for 2023 which will be calibrated again in mid-October when PG&E releases its latest 2023 rates and PCIA forecast.

Table 4 below summarizes the preliminary long-term financial forecast. As shown in the table, the loss in net income during 2022 would be recovered by the end of 2023 through a reduced PCIA. Table 4 incorporates this latest information, showing a total of $50M for 2023-25 and $22M ($10.1M Increase) for 2023. The 2023-2025 net increase of $3M over the July estimate includes a 5% power cost contingency of $8.3M.

Table 4 – Multi-Year Forecast

	Actuals				2022 Proforma (8 Month Actuals + 4 Month Budget)	Preliminary Forecast*		
Description	FY2019	FY2020	FY2021	FY2022	2022	2023	2024	2025
Customer Revenue	51,035	55,249	54,657	29,366	86,760	96,800	73,500	71,050
Power Cost	38,540	41,538	54,234	30,139	75,050	68,880	53,500	50,820
Other Expenses	3,850	4,346	4,267	2,285	5,080	5,938	6,100	6,178
Net Income	8,646	9,365	(3,844)	(3,058)	6,630	21,982	13,900	14,052

* The Multi-Year Forecast includes a 60% PCIA decrease in 2023 with no rate changes. This forecast is based on analysis by CalCCA and MRW, discounted based on power and PCIA volatility in previous years.

Multi-Year Forecast - Operating Budget Key Factors:

- Resource Adequacy (RA). Rising RA costs for calendar year 2023 may have additional negative fiscal impacts on VCE. SMUD is currently filling VCE's remaining 10% open RA positions for 2023. These costs will be incorporated into the draft budget that will be presented to the Board at its November meeting.

- Long-term power contracts (PPAs). When VCE's two largest PPA's begin full deliveries in 2023, approximately 60% of VCE's load will met with lower cost energy and RA. This amount grows to 80%+ by 2024. This trend toward more stable power costs is shown in the updated multi-year forecast table above.

CONCLUSION

Staff will present the 2023 preliminary draft budget to the Board in November. The draft budget will incorporate financial results from September and PG&E's forecasts from its annual rate and PCIA proceeding with the CPUC. Though the table above indicates continued profitability and building of reserves for our credit rating in 2023 and 2024, staff notes that there continues to be likely climate related impacts (heat/drought) and market volatility that may change or delay expected results. Staff will also be presenting the Rate Adjustment System in December to assist in normalizing any customer rate impacts from such events.