

VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 16

TO: ~~Community Advisory Committee~~ – Board of Directors

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SUBJECT: Preliminary Budget and Potential Policy Strategies for Fiscal Year 2020/21

DATE: May 14, 2020

RECOMMENDATION

1. Provide feedback on potential policy strategies for fiscal year 2020/21 to help inform analysis and Board recommendations.

OVERVIEW

This report addresses three topics related to the fiscal 2020/21 budget: (1) updated electricity demand forecast for COVID/recessionary period; (2) preliminary budget projections; and (3) policy strategies to address potential FY 2020/21 budget shortfall. The demand forecast influences the preliminary budget which in-turn helps reveal the need for potential policy adjustments going forward. Staff is seeking directional guidance from the Board on the preliminary budget and potential policy adjustments and will provide final recommendations at the June Board meeting.

BACKGROUND AND ANALYSIS

Section 1. Updated Load Forecast – COVID + Recession

One of the factors impacting VCE's Fiscal Year 2020/21 Operating Budget is a reduction in load resulting from the COVID-19 global pandemic, shelter-in-place orders to protect public health, and the predicted economic recession. VCE staff have been monitoring the impacts to retail load since shelter-in-place orders were issued in mid-March.

The California Independent System Operator (CAISO), has observed average weekday load reductions of 4.5% since the first full week of the statewide shelter-in-place order. While VCE does not have real time access to load data for its territory, an analysis of similar utility impacts and PG&E regional impacts has informed VCE's estimate of in-territory load changes. We estimate residential load has increased approximately 5% and commercial load has decreased between 14% and 20% during the shutdown. Based on initial feedback from the agricultural community as reported to the Yolo County Board of Supervisors, local agricultural load has not been impacted at this time.

While a timeline for the lifting of shelter-in-place orders has not been defined at the time of drafting of this staff report, the state has indicated that counties will be allowed flexibility based on their ability to reopen in a phased manner while meeting the State's defined criteria. Given the current degree of

uncertainty, VCE has developed three load scenarios to analyze potential budgetary impacts: (1) best case, (2) most likely case, and (3) worst-case. The FY 2020-21 Operating Budget included in Section 2 of this staff report is based on the most likely load scenario.

Brief descriptions of the best-case, most likely, and worst-case load scenarios are described below and summarized in Table 1. The three scenarios apply the same shutdown impacts and assume such impacts last through at least mid-June of 2020. Load recovery from shutdown level depends on a combination of policy and public perceptions that will drive business decisions, subsequent shutdown(s) if case levels rise, and the ability of the community to withstand recessionary impacts.

Scenario 1 Forecast - Best Case

The best-case load scenario forecast shows a 3.8% reduction in 2020 and a 2.3% reduction in 2021 from VCE’s baseline load forecast. This scenario assumes a consistent load recovery rate between June 2020 and the end of 2021. The recovery timeline acknowledges that reopening will be phased, and we will not reach a complete “back to normal” until a vaccine or therapeutics are widely available. This scenario assumes that once all restrictions are lifted, there is no recessionary impact to VCE’s load.

Scenario 2 Forecast - Most Likely

The most likely load scenario forecast shows a 3.8% reduction in 2020, a 3.6% reduction in 2021, a 3.3% reduction in 2022, a 2.5% reduction in 2023, and a 1.6% reduction in 2024 from VCE’s baseline load forecast. This scenario assumes a phased reopening, with phases moving more slowly and/or a lesser degree of shelter-in-place being implemented as hotspots emerge. It shows commercial loads stagnating 2-6% below normal between 2021-2022 due to an economic recession, with the recession impact continuing to a lesser degree through 2024. This scenario also includes a decline in residential load due to extended periods of unoccupied housing stock during the recession.

Scenario 3 Forecast - Worst Case

The worst-case load scenario forecast shows an 8.0% reduction in 2020, an 8.7% reduction in 2021, a 7.3% reduction in 2022, a 3.5% reduction in 2023, and a 1.6% reduction in 2024 from VCE’s baseline load forecast. It assumes an extended recession impact to all commercial classes with no load recovery in 2020 due to a second complete shutdown in fall and/or extended public concern driving businesses not to reopen regardless of policy. This scenario incorporates recessionary impacts to both ag and industrial load as well as earlier/deeper drops in residential load.

Table 1 – Scenario Comparison, Impact on Power Costs & Revenue v. Base Case

| | | Best Case* | Most Likely* | Worst Case |
|-------------|-------------|------------|--------------|------------|
| 2020 | Retail Load | -3.8% | -3.8% | -8.0% |
| | Power Costs | -1.9% | -1.9% | -4.0% |
| | Revenue | -4.2% | -4.2% | -8.3% |
| 2021 | Retail Load | -2.3% | -3.6% | -8.7% |
| | Power Costs | -1.6% | -2.7% | -6.0% |
| | Revenue | -2.3% | -3.7% | -8.5% |

*Forecast retail load, power cost, and revenue match for 2020 in the Best and Most likely scenarios due to assumed drop related to the COVID stay at home orders being gradually lifted over 2020.

VCE has analyzed the impact of these scenarios on power costs and revenues; as shown in Table 1 neither scale on a perfect 1:1 basis with load. Power costs decrease to a lesser degree than customer electricity load due to the nature of future energy procurement hedging, the need to continue to purchase Resource Adequacy to meet peak demand, and fixed contract renewable costs for 2020 and 2021. In addition, the revenue loss is slightly greater than the overall load loss due to the disproportionate loss from the commercial classes, which tend to have higher per kWh revenues as well as recovery of demand charges. In total, isolating the COVID and associated recessionary impacts for the most likely scenario show a potential revenue decline of \$2.25 million for 2020 and \$2.08 million for 2021. These impacts are included in the Preliminary Budget analysis in Section 2 below.

As forecasting experts in the energy sector work toward a reliable forecast for planning, there is widespread recognition of the remaining uncertainty. Information is changing daily, which may result in some assumptions being outdated even before the Board meeting is held on May 14. VCE will continue to closely monitor and adjust the load forecast as warranted by additional data.

Despite the uncertainty, staff have utilized the best available information to develop these forecasts which have been incorporated into the preliminary budget discussed in Section 2 of this report.

Section 2. Preliminary Budget Update

The purpose of this section of the staff report is to provide an update on the preliminary operating budget for FY 2020/21 (2021 Budget), that staff introduced at the March 2020 Board meeting and further expanded upon at the April 2020 Board meeting. Following this budget update, Section 3 of the staff report provides information on several potential policy decisions that may help offset anticipated negative net income in the 2021 Budget.

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

2021 Budget

At the March 12, 2020, Board meeting staff presented the 2021 Preliminary Budget. At the April 9, 2020, Board meeting staff further expanded upon the budget and provided potential mitigation measures. The budget presented in April forecasted a negative Net Income of -\$5.6 million which has now been adjusted to -\$5.2 million based on updated information. The significant negative income is due primarily to three factors that are outside of VCE's direct control, offset by one favorable factor:

- First, the 2021 Budget is impacted from anticipated negative revenue trends in FY 20/21 resulting from a significant increase in Power Charge Indifference Adjustment (PCIA) costs;
- Second, VCE faces a large increase in power costs due to rising 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;
- Third, as outlined in Section 1 of this staff report, VCE is impacted by an anticipated

reduction in load resulting from the COVID-19 global pandemic, shelter-in-place orders to protect public health, and the predicted economic recession;

- Somewhat offsetting these negative factors is an expected 3% increase in PG&E generation rates, anticipated to be effective in the summer of 2020; this is more favorable than the previously estimated reduction in PG&E generation rates. Since VCE matches PG&E generation rates, this is a direct impact on VCE's revenue

Additional detail on these primary drivers includes:

PCIA – The revenue decline is driven by the following rate impact factors:

PCIA increased by 18% to approximately 3.2 cents per kWh starting May 2020 and will increase an additional 38% to approximately 4.4 cents per kWh starting in November 2020 due to the expectation that PG&E will file a cap exception trigger in 2020. 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.

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.

Power Costs – Power costs have increased substantially from 2020 Budgeted amounts to the preliminary 2021 Budget power cost forecast. The increase of \$8.3 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: (1) a tightening market as fossil fuel baseload energy resources are retired and (2) 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.

Note that the recession impacts have reduced projected power costs from our previous budget by approximately \$1 million.

COVID/Recession Impacts – As noted in Section 1 above, the COVID and recessionary impacts for the most likely scenario show a potential revenue decline of \$2.3 million for calendar year 2020 and \$2.1 million for 2021, resulting in a \$2.5 million revenue reduction for FY 2021 and

associated \$1.0 million reduction in power cost. See staff report Section 1 for additional details.

PG&E Generation Rates – In past budget updates, VCE staff had assumed a 4% decline in PG&E generation rates for 2020. We are now assuming a 1.5% increase, which is comprised of flat generation rates until July 2020, at which point we are assuming a 3% increase due primarily to the PG&E General Rate Case (GRC). The regulatory experts that VCE and CalCCA utilize have modified their forecast of generation rates as new filings and updates have occurred.

Preliminary 2021 Budget Key Assumptions/Factors

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 energy content;
2. COVID and recession impacts have been factored into the customer load, revenue and power costs;
3. 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 677 GWh (down from 722 GWh in last budget update, due to COVID and recession impacts);
4. Energy cost includes: (1) system energy, (2) eligible renewables and (3) carbon free attributes which are estimated at \$36.6 million, or 73.3% of the total power costs. Resource adequacy cost is forecasted at \$13.3 million, or 26.7% of the total power costs.

Budget Sensitivities

Impacts of Various COVID & Recession Impacts

The forecasted COVID and recessionary impacts are analyzed in Section 1 of this report, including the development of three scenarios: (1) Best, (2) Most Likely, and (3) Worst cases.

- The Best Case scenario has a more rapid recovery from COVID and recessionary impacts with more of the positive impacts in future fiscal years, but still has a revenue reduction of \$2.3 million compared to pre-recession forecasts, with a power cost reduction of \$900K, resulting in an overall \$1.4 million Net Income reduction.
- The Most Likely scenario, which represents our base case preliminary budget for FY 2021, features a revenue decrease of \$2.5 million and associated power cost decrease of \$1.0 million, resulting in a \$1.5 million overall recessionary impact to Net Income.
- The Worst Case scenario results in more significant impacts, with slower recovery and a revenue reduction of \$5.2 million in FY 2021, offset by a power cost reduction of \$2.7million, netting in a \$2.5 million overall reduction to Net Income.

Budget Impact Summary

As outlined above, VCE faces a challenging 2021 fiscal year, affected by COVID/recessionary impacts, rapidly escalating PCIA costs, and rising resource adequacy expenditures. Any one of these factors would create a challenging budget scenario, but the combination of all three has created a situation where VCE is facing a forecast loss of over \$5 million. VCE staff believes that this is a great enough potential loss that the Board should consider implementing one or more policy levers in order to mitigate the budgeted loss while still enabling VCE to maintain it's customer, environmental, and operational goals. Section 3 of this Staff Report addresses those

potential policy strategies in detail.

Section 3. Potential Policy Strategies

As noted in the sections above, VCE and other CCA's face mounting fiscal challenges in the next several years. The potential policy strategies outlined in this section of the report are designed to help offset anticipated reduced net income in future budget cycles and assist with bridging the gap until lower cost long-term renewable energy contracts come on-line in late 2021/ early 2022. Staff is seeking feedback from the Board to help inform analysis and staff recommendations. Preliminary financial analysis associated with the potential strategies is introduced, which will continue to be analyzed leading up to Board consideration of the 2020/21 FY Budget on June 11th.

Community Advisory Committee Consideration

The Community Advisory Committee (CAC), considered and provided initial feed-back on the policy strategies at their April 23rd meeting. Generally, CAC members supported action by VCE to address anticipated financial issues but agreed that potential impacts on customer opt-outs associated with the policy options should be carefully considered. CAC comments and assessments are summarized in the discussion below. Note: CAC relative priorities based on Staff summary of CAC discussion.

Policy Strategy Options

Staff have been researching and analyzing potential policy strategies to partially mitigate the negative net income highlighted in the preliminary FY 2020/21 Budget summary. As noted in previous Board reports and presentations, the potential policies range from rate adjustments to modification of energy procurement goals. The potential policies may be employed individually or in combination to off-set projected negative net income. Staff also notes that some policy options are available in the short-term (e.g. procurement modifications), while others may be better suited to study and longer-term implementation (e.g. rate changes).

In addition to the discussion below, staff has attached a summary table outlining several factors associated with each potential policy change (i.e. estimated fiscal impact, timing, etc.) (Attachment 1). Notes: (1) fiscal reserves will allow VCE to buffer PCIA and cost increases over the short-term. Therefore, while reserves can cushion the potential impact, early implementation of policy strategies may be fiscally advantageous; (2) staff will utilize Board feedback to inform recommendations for consideration at the June 11th Board meeting.

1. Rate Changes

Potential options:

- a. VCE has rate making authority and could choose to increase its combined generation rate (generation, PCIA and Franchise Fee Surcharge), above PG&E's generation rates. For every 1% that VCE's rates are above PG&E's generation rates, annual revenue will increase by approximately \$800,000.
 - **CAC Feedback – Assessment:** *Not feasible without significant risk of high customer opt-out; Relative Priority: infeasible.*
 - **Staff – Assessment:** *Not feasible without significant risk of high customer opt-out; Relative Priority: lowest (see staff assessment in 1.b below).*

- b. Add a third choice for customer rates that could be set near 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 "cost plus" rate. This approach has been employed by Clean Power Alliance (LA/Ventura CCA).
- **CAC Feedback – Assessment:** *General support but additional study needed to understand the advantages/disadvantages. Strong concern expressed by one CAC member about the difficulty of reversing the action (new rate choice), if VCE found it advantageous to do so in the future to advance other goals; **Relative Priority:** low/moderate.*
 - **Staff – Assessment:** *Helps address rate competitiveness and opt-out potential; could focus on price sensitive customer classes rather than creating a new rate. Could be combined with option 1.a "rate increase" policy option to maintain cost competitiveness for more price sensitive customer classes. Deeper evaluation could be tied to strategic planning process (longer-timeframe needed); **Relative Priority:** moderate. Suggest CAC Task Group on rates work with staff to investigate.*

2. Power Resource Planning Adjustments

Potential options:

- a. 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 analysis of the potential savings, which are dependent on timing of the adjustments and the level of transition out of short-term contracts, indicates VCE could save several million dollars over a 2 to 3 year period while still meeting VCE's renewable goals and state renewable standards.
- **CAC Feedback – Assessment:** *General support with minor concern regarding potential impact on short-term power content label listing; **Relative Priority:** highest.*
 - **Staff – Assessment:** *provides flexibility in power procurement planning, ability to meet compliance requirements, cost savings with relatively low opt-out risk. Serves as bridge to long-term renewable contracts that will provide 50% of overall energy needs beginning in late 2021; **Relative Priority:** highest.*

3. Additional Policy Levers

- a. Accept the GHG-free large hydro and nuclear allocations from PG&E, at a potential benefit of \$0.25 million and \$0.4 million respectively. As the analysis previously presented to the CAC and Board indicates, these savings are speculative and would only be realized if a market exists in which to realistically sell these characteristics.
 - **CAC Feedback – Assessment:** *Support for hydro only. Relative Priority: highest (for hydro only).*
 - **Staff – Assessment:** *Support for hydro only. Relative Priority: highest (for hydro only).*

- b. 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.
 - **CAC Feedback – Assessment:** *Expressed general concern that reductions in operating expenses beyond current levels would limit organizational capacity. Relative Priority: low.*
 - **Staff – Assessment:** *Current operational expenses are below previous fiscal year budget. Relative Priority: N/A.*

Note: in addition to the above policy options, VCE may consider joint ventures with other CCA's as a strategy to reduce cost per customer served. Staff considers this a long-term prospect requiring additional analysis and discussion with potential partners.

CONCLUSION

Staff is seeking feedback and direction from the Board on these sets of policy options. Based on this feedback and continuing analysis, staff will bring back a package of policy recommendations for consideration by the Board as part of its June action on the FY 2020/21 budget.

ATTACHMENT

1. Potential Policy Options – Table

ATTACHMENT 1 - Potential Policy Options Table

| Policy | Potential Savings | Ease of Implementation | Timing | Notes/Other Considerations | Relative Priority |
|-------------------------------------|----------------------------|---------------------------------------------------------------------------------------|----------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|
| Rate Change – Rate Increase | \$800,000 to \$2.4 million | Medium-high difficulty due to outreach efforts and opt-out risk | Could start shortly after BOD approval and start seeing immediate revenue impact | Revenue increase is \$800K per 1% change – assume 1-3% target for Potential Savings | CAC – Infeasible Staff - Lowest |
| Rate Change – Additional Rate Class | \$0.25 to \$1.5 million | Medium to high difficulty due to complexity of the roll-out and communication efforts | Could start shortly after BOD approval and start seeing immediate revenue impact | One example scenario could assume ag rates slightly below PG&E gen rate; commercial at PG&E rate; and residential slightly above PG&E rate. Other scenarios possible | CAC – Low/Moderate Staff - Moderate |
| Power Resource Planning Adjustment | \$0 to \$3.1 million | Low end of the range less difficult | Throughout fiscal year '21 – '22 | Power Content Label impacts; Will require BOD approval | CAC – Highest Staff - Highest |
| GHG Free – Large Hydro | \$0 to \$240,000 | Low end of the range less difficult | Q3-Q4 2020 | Volume is unknown; market interest/ability to resell may be low | CAC – Highest Staff - Highest |
| GHG Free – Nuclear | \$0 to \$420,000 | Low end of the range less difficult | Q3-Q4 2020 | Volume is unknown; market interest/ability to resell may be low; reputational risk | CAC – Lowest Staff - Lowest |
| Operations Reductions | \$25,000 to \$100,000 | Low end of range less difficult; high end of range difficult | Impact spread throughout FY 2021 budget | Significant strategic trade-offs between program effectiveness and marginal cost savings | CAC – Lowest Staff – N/A |

Notes:

1. Policies not listed in priority order.
2. Combination of policies possible.
3. CAC Relative Priority based on Staff summary of CAC discussion.

VCE PRELIMINARY OPERATING BUDGET

| | APPROVED BUDGET FY 2019-2020 | ACTUAL YTD MAR 31, 2020 (9 MO) + FORECAST (3 MO) FY 2019-2020 | PRELIMINARY BUDGET FY 2020-2021 |
|-----------------------------------|---------------------------------------------|----------------------------------------------------------------------------------|------------------------------------------------|
| OPERATING REVENUE | \$ 55,708 | \$ 54,941 | \$ 49,513 |
| OPERATING EXPENSES: | | | |
| Cost of Electricity | 41,575 | 41,004 | 49,920 |
| Contract Services | 2,910 | 2,890 | 2,982 |
| Staff Compensation | 1,183 | 1,069 | 1,118 |
| General, Administration and other | 728 | 527 | 771 |
| TOTAL OPERATING EXPENSES | <u>46,396</u> | <u>45,491</u> | <u>54,790</u> |
| TOTAL OPERATING INCOME | 9,312 | 9,450 | (5,277) |
| NONOPERATING REVENUES (EXPENSES) | | | |
| Interest income | 132 | 108 | 135 |
| Interest expense | (155) | (117) | (57) |
| TOTAL NONOPERATING REV/(EXPENSES) | <u>(23)</u> | <u>(9)</u> | <u>78</u> |
| NET MARGIN | \$ 9,289 | \$ 9,441 | \$ (5,199) |
| NET MARGIN % | <u>16.7%</u> | <u>17.2%</u> | <u>-10.5%</u> |