VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 17

TO: Board of Directors

FROM: Mitch Sears, Interim General Manager
Edward Burnham, Director of Finance & Internal Operations

SUBJECT: Fiscal Year 2021-2022 Draft Operating Budget Update

DATE: May 13, 2021

RECOMMENDATION
Informational – no action requested.

OVERVIEW
This update is the second of three budget discussions leading to Board consideration of the final FY 2022 budget in June. The purpose of this staff report is to provide updates on: (1) budget impacts associated with the annual electricity demand forecast recently completed by SMUD, (2) current fiscal year 2021 actuals, and (3) an overview of key factors influencing the draft 2022 Budget. After gathering Board feedback, staff will return with a recommended 2022 Budget for consideration at the June 10th Board meeting.

As detailed in the body of this report, FY 2021 is anticipated to be approximately $1.0M net more favorable than the approved budget and the updated estimate for the upcoming FY 2022 is approximately $0.6M net less favorable than the financial forecast presented to the Board during the October 2020 mid-year budget update. When considered together, the changes in the forecasts for the two fiscal years roughly balance each other out leaving VCE in a financial position in line with forecasts dating back to early 2020.

BACKGROUND
Over the past 16 months the energy sector and overall economy have been highly volatile. In May 2020 staff, in conjunction with SMUD, presented mid-year load and budget updates in an attempt to forecast COVID-19 related impacts on VCE's load and revenue. Due to the unprecedented circumstances surrounding the pandemic, staff, SMUD, and the Board acknowledged at the time that these forecasts were approximations and subject to adjustment. In June 2020 the Board adopted a budget for fiscal year 2021 based in part on those forecasts.

In addition, as part of the budget analysis last June, staff presented a forecast for FY 2022 and scheduled a mid-year Board update in the Fall to track/report actual customer load demand and revenue during the pandemic. The June 2020 forecasted net deficit for FY 2022 was approximately $6.0M; the follow up mid-year update in October 2020 showed a net $7.1M deficit. Note: this deficit includes the Board approved policy adjustments in June 2020 that partially off-set short-term financial losses by deferring purchase of renewable energy credits in 2021. This policy adjustment topic is addressed in more detail in the report for agenda item 15 of this May 13th Board meeting.

The primary drivers for the increased deficit between the May 2020 forecast and the October 2020 forecast were:

- A hot summer in 2020 driving higher than expected load demand and the need to purchase relatively expensive power on the short-term market to meet the increased demand.
- Increasing Resource Adequacy costs and forward market prices for energy.

As detailed in the analysis section below, the net result is that VCE's deficits across the current fiscal year (2021) and the coming fiscal year (2022), are roughly equal to those forecast last June.

ANALYSIS

This report updates information provided to the Board last month. The sections below provide updates on: (1) budget impacts associated with the annual electricity demand forecast recently completed by SMUD, (2) current fiscal year 2021 actuals, and (3) an overview of key factors influencing the draft 2022 Budget.

1. Annual Electricity Demand Forecast Update – FY 2022 Budget Impacts

Each April, SMUD conducts an annual electricity demand forecast for VCE. This demand forecast was completed several weeks ago and staff is currently incorporating the results into the draft budget for FY 2022. In summary, the update showed a projected 0.5% increase in demand for FY 2022. The major contributing factor to this load increase is that SMUD no longer anticipates a lasting recession from COVID which results in higher forecasted demand for FY 2022. As with past demand forecasts, SMUD uses the most recent available data, normalized weather impacts, and customer growth.

In tracking load demand, staff and SMUD will continue to monitor:

- Load shape changes related to the transition of customers to Time of Use (TOU) rates
- Load changes as COVID related impacts moderate over time
- Data availability from PG&E that can reduce the accuracy of VCE's forecast

Since launching in 2018, the overall financial impact of the load forecast updates have been relatively minor. Revenue increases generally balance out the additional power costs associated with serving a higher load. The additional forecasted load for FY 2022 has resulted in approximately $250K in additional power costs that have been incorporated into the draft FY 2022 Budget shown in Attachment 1.

2. Current Operating Budget Update - FY 2021

As presented to the Board last month, actual revenue and cost information is replacing forecast numbers as the current fiscal year nears a close. Due to more favorable actuals through March

2021 than forecasted in October 2020, the current fiscal year net income grew by approximately $1.0M. This net positive is due mainly to the following combination of factors:

Negative Impacts:

- Lower interest earnings than forecast due to Federal Reserve rate setting measures during COVID-19.

Positive Impacts:

- Revenue increases from higher than forecasted customer usage. Note: This increase was partially offset by increased costs for relatively expensive short-term energy purchases to serve this additional load during COVID-19.
- Continued lower actual to budgeted expenditures related to marketing, new member agency on-boarding, legal support and contingency.
- Continued contract labor and SMUD support expenditures lower than budgeted due to a transition to in-house staffing.

Based on the best available load and revenue information, staff anticipates that this slightly favorable budget trend should continue through the remainder of the current fiscal year and is expected to provide a small offset of the net negative impacts forecast for FY 2022.

Table 1 below shows the comparison of fiscal year forecasts, including the FY 2021 difference between the October 2020 mid-year forecast and the current May 2021 forecast.

3. FY 2022 Draft Budget

The FY 2022 Draft Budget shown in Attachment 1 includes a forecasted operating budget of $56.94M with a net income loss of $7.70M. As shown in the forecast comparison in Table 1 below, this loss is approximately $0.6M greater than the October 2020 mid-year forecast. The increased net loss is due primarily to the following major factors that are outside of VCE’s direct control:

- Average market power prices have increased by approximately 7% since adoption of the current fiscal year budget in June 2020.
- Time of Use (TOU) rate transitions for non-residential customers are lower than anticipated due to the methodology applied by PG&E. This has resulted in lower revenue from the customers who have remained on non-TOU rates. Staff is working with PG&E on this issue and expects a formal response from PG&E during the month of May. If confirmed, 100% transition of these non-residential customers will be completed by PG&E resulting in an increase of revenue of approximately $0.3M for the fiscal year. Since resolution of this issue is uncertain, staff is not including it in the current draft of the FY 2022 budget.

Table 1 – Fiscal Year Forecasts Comparison Table

May-20 Forecast	FY2020	FY2021	FY2022
Revenue	$ 55,249	$ 49,467	$ 49,400
Power Cost	$ 41,538	$ 47,695	$ 50,335
Other Expenses	$ 4,346	$ 4,611	$ 4,992
Net Income	$ 9,365	$ (2,839)	$ (5,927)
Oct-20 Forecast	FY2020	FY2021	FY2022
Revenue	$ 55,249	$ 53,038	$ 51,159
Power Cost	$ 41,538	$ 50,630	$ 53,288
Other Expenses	$ 4,346	$ 4,671	$ 4,990
Net Income	$ 9,365	$ (2,263)	$ (7,119)
May-21 Forecast	FY2020	FY2021	FY2022
Revenue	$ -	$ 54,926	$ 49,218
Power Cost	$ -	$ 51,740	$ 52,095
Other Expenses	$ -	$ 4,470	$ 4,827
Net Income	$ -	$ (1,284)	$ (7,703)
Difference Oct-20 vs May-21		FY2021	FY2022
Revenue	$ -	$ 1,888	$ (1,941)
Power Cost	$ -	$ 1,110	$ (1,193)
Other Expenses	$ -	$ (201)	$ (163)
Net Income	$ -	$ 979	$ (584)

Table 1 also shows that the net losses of the forecasts across the two fiscal years are roughly equal. The October 2020 forecast net income loss for FY 2021 plus FY 2022 is $9.38M; the current May 2021 forecast loss for the two fiscal years is $8.99M. Though clearly not desirable and making draws on VCE's cash reserves necessary to maintain competitive rates, these losses are in line with forecasts dating back to early 2020 and have been incorporated into VCE's financial planning.

Overall, the FY2022 financial outlook has not changed significantly since the Board approved the current fiscal year budget in June 2020. VCE still anticipates the following dynamics, which were also present when the last budget was approved:

- Power costs close to, or exceeding, revenue – making it difficult to cover operating costs without experiencing negative net income
- Continued significant revenue erosion from PCIA
- Continued significant power cost increase due largely to increased Resource Adequacy (RA) costs
- Cash reserves being utilized to stabilize customer rates until it nears a zero balance by the end of FY2022 (these numbers do not reflect any borrowing from the line of credit)

The expectation is that various regulatory, legislative and/or market factors will lead to a greater normalization of PCIA and RA power costs in 2023 and beyond, but margins will be very low or negative until that occurs.

Some potentially helpful interventions may include:

- Reduced and more stable power costs as VCE long-term power purchase agreements (PPA's) start coming on-line in 2021, 2022, and 2023.
- PCIA costs normalizing due to regulatory/legislative decisions (e.g. SB 612/PCIA Settlement Agreement)

For purposes of strategic cash flow decisions, staff believes that VCE should not rely on positive outcomes from these interventions for the next several years and that the organization should continue to make financial decisions through a lens of prudency.

<u>Other Operating Revenues & Expenses</u> – As shown in the draft Budget in Attachment 1, Other revenues are $83K lower compared to last month's draft due to lower anticipated interest earnings as Federal Reserve rates are expected to remain low through calendar year 2022. In response, staff has reduced the budget contingency in the current FY 2022 draft budget from 5% to 3% for a savings of $87K. Staff feels this is an appropriate reduction in the budget contingency since it has not been utilized significantly since launch of operations in 2018 except for expenditures related to the PG&E bankruptcy last fiscal year.

<u>Other Considerations</u> – Staff continues to evaluate possible mitigation options to reduce and/or defer costs to strengthen financial sustainability. One of the options includes extending the power procurement approach used for calendar year 2021 into calendar 2022 to reduce power costs. This option will be presented to the Board at this same May 13th Board meeting (see Board meeting packet agenda item 15 for associated staff report).

CONCLUSION

Staff has prepared the updated draft FY 2022 operating budget based on the best available information through April 2021. Staff will return with a final recommended FY 2022 Budget in June.

<u>ATTACHMENTS</u>

1. Draft operating FY 2021-2022 budget summary updated table
2. Draft operating FY 2021-2022 budget summary comparison table

VALLEY CLEAN ENERGY
DRAFT OPERATING BUDGET SUMMARY UPDATE

	APPROVED BUDGET FY 2020-21	ACTUAL YTD March 31 (9 MO) + FORECAST (3 MO) FY 2020-21	DRAFT BUDGET UPDATE FY 2021-2022
Energy - Megawatt Hours	**717,987**	**753,546**	**773,652**
OPERATING REVENUE	**$ 49,638**	**$ 54,926**	**$ 49,218**
OPERATING EXPENSES:			
Cost of Electricity	47,670	51,740	52,095
Contract Services	2,723	2,594	2,559
Outreach & Marketing	241	224	241
Programs	12	2	135
Staffing	1,132	1,135	1,164
General, Administration and other	772	544	742
TOTAL OPERATING EXPENSES	**52,550**	**56,238**	**56,937**
TOTAL OPERATING INCOME	**(2,912)**	**(1,313)**	**(7,718)**
NONOPERATING REVENUES (EXPENSES)			
Interest income	135	80	56
Interest expense	(57)	(52)	(42)
TOTAL NONOPERATING REV/(EXPENSES)	**78**	**28**	**15**
NET MARGIN	**$ (2,834)**	**$ (1,284)**	**$ (7,703)**
NET MARGIN %	**-5.7%**	**-2.3%**	**-15.7%**

VALLEY CLEAN ENERGY
DRAFT OPERATING BUDGET SUMMARY UPDATE
2021-2022 - COMPARISON APRIL VS MAY

	PRELIMINARY DRAFT BUDGET FY 2021-2022	DRAFT BUDGET UPDATE FY 2021-2022	PRELIMINARY VARIANCE FY 2021-2022
Energy - Megawatt Hours	**769,935**	**773,652**	**3,717**
OPERATING REVENUE	**$ 49,047**	**$ 49,218**	**$ 171**
OPERATING EXPENSES:			
Cost of Electricity	51,082	52,095	1,013
Contract Services	2,559	2,559	-
Outreach & Marketing	241	241	-
Programs	135	135	-
Staffing	1,164	1,164	-
General, Administration and other	829	742	(87)
TOTAL OPERATING EXPENSES	**56,011**	**56,937**	**926**
TOTAL OPERATING INCOME	**(6,964)**	**(7,718)**	**(754)**
NONOPERATING REVENUES (EXPENSES)			
Interest income	139	56	(83)
Interest expense	(42)	(42)	-
TOTAL NONOPERATING REV/(EXPENSES)	**97**	**15**	**(83)**
NET MARGIN	**$ (6,866)**	**$ (7,703)**	**$ (837)**
NET MARGIN %	**-14.0%**	**-15.7%**	