# VALLEY CLEAN ENERGY ALLIANCE

**Staff Report – Item 18**

---

**TO:** Board of Directors

**FROM:** Edward Burnham, Director of Finance & Internal Operations

**SUBJECT:** Allocation of 2023 Net Margin

**DATE:** April 11, 2024

---

**RECOMMENDATION**

Adopt a resolution approving the allocation of the $20.9M 2023 Audited Net Margin between cash reserves, local program reserve (LPR), and Customer Dividends program as follows:

1. $17,997,300 (90%) of Net Margin to cash reserves;
2. $1,008,500 (05%) of Net Margin to the Local Programs Reserve (LPR).
3. $1,154,200 (05%) of Net Margin to the Dividends Program in the form of increasing Rate Credits by 1% for all customers starting July 1, 2024

**OVERVIEW**

This staff report presents options related to the allocation of VCE's audited net margin for 2023. VCE's audited financial statements as presented in the preceding Item 18. Taking into account the Board adopted Dividend Program policy (2019), as well as available and forecast cash reserves, Staff analyzed options outlined in the analysis section below for VCE's 2023 net margin of $20.9 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 $238,000 to the Local Programs Reserve as required by the VCE Dividend Program policy
- Minimum allocation of $12,226,500 to cash reserves as required by the VCE Dividend Program policy
- Discretionary Allocation (After Cash Reserves) of $7,694,500

**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 2023 Financial Statements, VCE achieved a 21.13% 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 the net margin goes to VCE's Local Programs Reserve for program implementation
  - The balance (up to 95%) 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 2023 audited net margin. The following table summarizes the analysis.

Table 1 – 2023 Audited Net Margin Summary

| Description | | Estimated 2023 Results | Avg. Days Cash | |
|---|---|---|---|---|
| Electricity Sales | | 95,429,500 | 204,000 | |
| Operating Expense | | 74,557,400 | | |
| Operating Margin | | 20,872,100 | | |
| Principal Debt Payments | | 712,252 | | |
| Adjusted Net Margin less principal Debt Payments | | 20,160,000 | | |
| Adjusted Net Margin Percentage | | 21.13% | | |
| Allocation Amount <=5% | | 4,771,000 | | |
| Allocation Amount > 5% | | 15,389,000 | | |
| **Allocation of Net Margin up to 5%** | **Percentage** | **Allocation Amount** | **Operating Days Cash** | |
| Cash Reserves Allocation | 95% | 4,532,000 | 22 | Minimum |
| Local Programs Allocation | 5% | 239,000 | 1 | Minimum |
| **Allocation of Net Margin above 5%** | **Percentage** | **Allocation Amount** | | |
| Allocation to Cash Reserves | 50% | 7,694,500 | 38 | Minimum |

As shown in Table 1, applying the basic Dividend Program formula results in $7.7M of discretionary funds.

///

///

Discretionary Allocation Considerations:

Based on the current and forecasted cash reserve for 2023 and previous direction from the Board regarding reserve targets, Staff is considering a recommendation to allocate the majority of the discretionary allocation to cash reserves for the initial investment grade credit rating. VCE is estimated to have ended 2023 with ~90+ days cash on hand and is currently projected to end 2024 with ~180+ in unrestricted operating cash. The Board has set reserve targets to increase to 180+ days of cash on hand in 2024 to better position VCE to obtain its initial investment grade credit rating. All scenarios described later in this report provide for additional program funds and dividend funds in the form of additional rate discounts starting as early as July 1st.

Staff considered the following factors related to this preliminary recommendation.

- Power Costs - Staff anticipates ongoing power cost increases and regulatory pressures related to changing resource adequacy requirements (increased costs = decreased days cash on hand)
- VCE's current 180 day cash reserve target does not include rate stabilization. An additional 30-90 days would provide for long-term rate stabilization.
- Available funds for dividends would increase VCE's current 1% discount during peak season.
- CPUC has approved increased security requirements in the proposed decision of phase one of the provider of last resort proceeding.
- VCE continues to provide an additional rate discount to qualified low-income customers (CARE and FERA): ~2.5%/$1.1M annually in discounts to 25% of VCE customers
- PG&E's additional Transmission/Distribution rate increase in March 2024 (projected +13%)

Allocation Scenarios

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

Scenario 1: Balanced Allocation (Staff Recommended)

| | Percentage | Allocation Amount | Operating Days Cash | |
|---|---|---|---|---|
| Discretionary Allocation (After Cash Reserves) | 50% | 7,694,500 | 38 | Maximum |
| Cash Reserves | 75% | 5,770,800 | 28 | |
| Local Programs (Targeted 2024/25 Spend) | 10% | 769,500 | 4 | |
| Customer Dividends (Targeted 2024/25 Spend) | 15% | 1,154,200 | 6 | |

Scenario 2: Increased Customer Dividends

| | Percentage | Allocation Amount | Operating Days Cash | |
|---|---|---|---|---|
| Discretionary Allocation (After Cash Reserves) | 50% | 7,694,500 | 38 | Maximum |
| Cash Reserves | 70% | 5,386,100 | 26 | |
| Local Programs (Targeted 2024/25 Spend) | 10% | 769,500 | 4 | |
| Customer Dividends (Targeted 2024/25 Spend) | 20% | 1,538,900 | 8 | |

Scenario 3: Increased Cash Reserves

| | Percentage | Allocation Amount | Operating Days Cash | |
|---|---|---|---|---|
| **Discretionary Allocation (After Cash Reserves)** | **50%** | **7,694,500** | **38** | Maximum |
| Cash Reserves | 80% | 6,155,500 | 30 | |
| Local Programs (Targeted 2024/25 Spend) | 5% | 384,700 | 2 | |
| Customer Dividends (Targeted 2024/25 Spend) | 15% | 1,154,200 | 6 | |

Based on the cash reserve forecast in the coming years, Staff is recommending the Board allocate the discretionary allocation Scenario 1. Key factors in the staff's analysis of these options include:

- Cash Reserves Allocation. VCE's strategic goal of obtaining its initial investment credit rating by 2028 will require a minimum of +180 days of operating cash reserves. Staff will be returning with recommendations to update the reserve policy for an additional 30 to 60 days of operating cash reserves for rate stabilization to remain competitive by creating a financial buffer against outside factors such as PCIA, regulatory and legislative changes, and weather events.
- Customer Dividend Allocation. Available funds for dividends would increase the current rate credits from a 1% discount to 2% for all customers starting July 1, 2024. . Note: VCE would maintain its additional ~2.5%/$1M rate credits to 25% of qualified low-income residential customers (CARE and FERA)
- Local Programs Allocation– VCE currently has $840K in program fund allocations. Additional program funds are needed to execute VCE's adopted VCE's 3-Year Programs Plan for long-term outcomes beyond 2024.

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 presented to the CAC at its March 28, 2024 meeting for discussion and feedback based on estimated results. CAC feedback was aligned with the recommended scenario 1 providing customer dividends in the form of rate credits, continuing to build programs, and building cash reserves towards the minimum 180+ cash reserve targets.

**CONCLUSION**

Staff believes that these scenarios represent a disciplined and financially prudent approach to building reserves and providing some additional level of rate relief. The longer-term outlook (2024+) shows increased stability and cost certainty due to VCE's fixed price long-term renewable power purchase contracts coming fully online combined with a cost-recovery based rate structure. Staff will be returning in May to the CAC for discussion on updating the reserves policy and dividend program for updates to current targets and requirements for VCE's initial investment grade credit rating before returning to the Board.  Staff will be including additional financial updates as part of the presentation of the net margin allocation recommendation.

Based on the factors outlined above, staff believes its recommendation for VCE's 2023 audited $20.9M net margin (Scenario 1), is fiscally prudent and results in a balance between building/maintaining a strong financial foundation and direct customer/community benefits in the form of rate discounts and local programs.

**ATTACHMENT:**

1. Resolution 2024-XXX – Allocation of 2023 Net Margin

**VALLEY CLEAN ENERGY ALLIANCE**

**RESOLUTION NO. 2024 - ___**

**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, 2023**

**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, 2023.

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

1. For the audited year ended December 31, 2023, allocate the Net Margin of $20.9 million as follows: $1,008,500 to local program reserve, $1,154,200 to cash dividends, and the $17,997,300 balance to cash reserves.

**PASSED, APPROVED AND ADOPTED**, at a regular meeting of Valley Clean Energy, held on the ____ day of _______________, 2024, by the following vote:

AYES:
NOES:
ABSENT:
ABSTAIN:

_______________________________________
Lucas Frerichs, VCE Chair

____________________________________
Alisa M. Lembke, VCE Board Secretary