VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 18

TO: Valley Clean Energy Alliance Board of Directors

FROM: Mitch Sears, Interim General Manager
George Vaughn, Director of Finance & Internal Operations

SUBJECT: Preliminary Operating Budget Fiscal Year 2020-2021

DATE: March 12, 2020

BACKGROUND AND ANALYSIS

Operating Budget FY 2019-2020

In June 2019, the Board approved the Operating Budget of $46.4 M for fiscal year 2019-2020 and includes purchased power and other operating expenses. The operating budget was based on the following:

- VCEA rates set to match PGE&E's generation rates, net of PCIA and Franchise Fees
- Power Mix of 42% renewable, 75% GHG-free for the default product
- Contingency of 5% of other operating expenses due to uncertainty surrounding an entity in the second year of operations

YTD Actual plus Forecast FY 2019-2020

The YTD actual financial position for the 7 months ending January 31, 2020 plus the forecast for the remaining part of the fiscal year 2019-2020 are below the approved budget mainly due to the following:

Negative Impacts:

- Reduction of Wholesale and Retail Load due to lower Customer KWh usage, down from forecasted load
- Power costs increased slightly due to changing market prices
- Costs related to potential acquisition of PG&E assets

Positive Impacts:

- Contingency in the budget offsets the PG&E-related expenditures
- Labor below budget due to leaner staffing model

Preliminary Operating Budget FY 2020-2021

The preliminary operating budget for FY 2020-2021 reflects a negative Net Income of $6.4 million due primarily due to two major factors that are both outside of VCE's direct control. First, the budget suffers from anticipated negative revenue trends in FY 20/21 resulting from an estimated 44% increase in PCIA costs and a 4% decrease in PG&E generation rates. Second, VCE faces a large increase in power costs due to significant increase in 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.

Additional detail on these primary drivers includes:

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

- PCIA will increase by 18% to approximately 3.2 cents per kWh starting May 2020 and will increase an additional 44% to approximately 4.6 cents per kWh starting in October 2020 due to the expectation that PG&E will file a cap exception trigger in 2020
- PG&E generation rates will decrease by an overall average of 4% for calendar year 2020 and then increase 2% in calendar year 2021; this results in a VCE revenue decline as our policy is to match PG&E generation rates

Power Costs/Mix – Power costs have increased substantially from FY 2020 budget to the preliminary FY 2021 budget. The increase of $9.4 million is due primarily to the market cost of RA increasing substantially in the recent past. Other contributing factors include:

- Adding Winters load
- 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 dealing with the issue. VCE and SMUD actively monitor and manage the long-term portfolio of RA to remain compliant with requirements and as cost-effective as possible.

The power mix reflected in the preliminary budget remains unchanged from the prior year's budget with 42% renewable and 75% clean content. 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 2020-2021 is estimated at 722 GWh. Energy cost includes system energy, eligible renewables and carbon free attributes which are estimated at $37.6 million, or 73.9% of the total power costs. Resource adequacy cost is forecasted at $13.3 million, or 26.1% of the total power costs.

Other Operating Expenses – Staff has reviewed the non-power operating expenses (labor, etc.), and proposes a preliminary budget that is lower than the FY 2020 budget due to careful consideration of costs and efficiency tactics. Overall, non-power related expenses in the preliminary budget are approximately 9% of VCE's budget, down slightly from FY 19/20. The budget has been updated based on the following:

- Services currently under contract
- Shift of labor mix more heavily towards internal VCE staff and away from SMUD professional services augmentation, resulting in lower overall cost
- 2.5% annual inflation rate on most expenses not under contract
- 5% contingency rate for unanticipated operating expenses due to VCE still being a relatively new enterprise

Mitigation Strategies – As noted in the staff presentation on the potential impacts of the 2020 PCIA/ERRA at the February Board meeting, staff have begun researching and analyzing potential strategies to partially mitigate these financial impacts.

In order to mitigate the fiscal impacts listed above, staff is analyzing several policy levers for Board consideration at future meetings:

- Increase VCE combined generation rate (generation, PCIA and Franchise Fee Surcharge) beyond PG&E's generation rates
- Temporarily lower VCE goals for renewable and/or carbon free portfolio resource mix, while still maintaining compliance with minimum State standards
- Accept the GHG-free large hydro and nuclear allocations from PG&E
- Adjust energy hedging strategies (i.e., increase potential risk to reduce costs)
- Look for additional reductions in operating expense beyond those already captured

CONCLUSION

The preliminary operating budget reflects a -13.1% net margin which does not meet VCE's 5% minimum annual net margin goal to maintain financial stability. Staff has prepared the preliminary operating budget for FY 2020-2021 based on the best available information on PG&E generation rates and PCIA exit fees. The 2020 PG&E generation rates and PCIA exit fees will be effective May 2020 and the PCIA cap exception triggered rates are assumed to start in the fourth quarter of 2020. All these factors will be included in the final proposed Operating Budget for FY 2020-2021 that will be presented to the Board for consideration later this Spring.

Despite the negative projections for the FY 2021 budget, VCE is not projected to require use of its line of credit until at least late 2021 – beyond the period of this budget. This is due to VCE having an adequate cash reserve.

Based on the Board feedback and direction, staff will return with a final recommended Operating Budget for FY 2020-2021 for consideration in May.

Attachment:

Preliminary Operating Budget FY 2020-2021

VALLEY CLEAN ENERGY
PRELIMINARY OPERATING BUDGET
FY 2020-2021

	APPROVED BUDGET FY 2019-2020	ACTUAL YTD JAN 31, 2020 (7 MO) + FORECAST (5 MO) FY 2019-2020	PRELIMINARY BUDGET FY 2020-2021
OPERATING REVENUE	$ 55,708	$ 54,744	$ 49,227
OPERATING EXPENSES:			
Cost of Electricity	41,575	41,689	50,941
Contract Services	2,910	2,966	2,908
Staff Compensation	1,183	1,101	1,113
General, Administration and other	728	569	776
TOTAL OPERATING EXPENSES	46,396	46,325	55,738
TOTAL OPERATING INCOME	9,312	8,419	(6,511)
NONOPERATING REVENUES (EXPENSES)			
Interest income	132	115	135
Interest expense	(155)	(130)	(57)
TOTAL NONOPERATING REV/(EXPENSES)	(23)	(15)	78
NET MARGIN	$ 9,289	$ 8,405	$ (6,433)
NET MARGIN %	16.7%	15.4%	-13.1%