VALLEY CLEAN ENERGY ALLIANCE
COMMUNITY ADVISORY COMMITTEE

Staff Report – Item 6

TO: Community Advisory Committee

FROM: Edward Burnham, Director of Finance & Internal Operations

SUBJECT: Allocation of 2023 Net Margin

DATE: March 28, 2024

RECOMMENDATION

1. Informational – Discussion and Feedback

OVERVIEW

This staff report presents the various options the Board has in determining how to allocate the estimated net margin for 2023. Staff is presenting this information to the Community Advisory Committee (CAC) for discussion and feedback. VCE's audit is in progress and financial statements will be presented to the Board at the April meeting. Taking into account the Dividend Program parameters, as well as available and forecast cash reserves, Staff is considering various options outlined below for VCE's 2023 net margin of $16.5 million:

- Minimum allocation of $238,000 to the Local Programs Reserve (LPR)
- Minimum allocation of $10,039,500 to cash reserves
- Discretionary Allocation (After Cash Reserves) of $5,510,500

BACKGROUND AND ANALYSIS

The Board adopted the VCE Rate Structure & 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 aspects of the Dividend Program are:

- Every year, the audited Net Margin (Less Principal Debt Payments) is to be allocated amongst Cash Reserves, LPR, and Cash Dividends, at the Board's discretion
- Require a minimum 5% net margin before considering if any dividends are paid

Based on the estimated 2023 Financial Statements, the conditions above have been met. Staff will present the final recommendation of the allocation of net margin to the Board on May 09, 2024, to meet timeline requirements for possible additional rate credits outlined below. 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 up to 5% is to be allocated as follows:
  - At least 5% (of the 5%) goes to LPR for program implementation

  - The balance goes to cash reserves
- Net margin above 5% is to be allocated as follows:
  - At least 50% to cash reserves
  - Remainder allocated amongst customer dividends and LPR

Below is a summary of VCE's Allocation for 2023:

Table 1 - VCE Dividend Program Allocation - 2023

Description		Estimated 2023 Results	Avg. Days Cash	
Electricity Sales		95,330,080	216,000	
Operating Expense		78,830,080		
Operating Margin		16,500,000		
Principal Debt Payments		712,252		
Adjusted Net Margin less principal Debt Payments		15,788,000		
Adjusted Net Margin Percentage		16.56%		
Allocation Amount <=5%		4,767,000		
Allocation Amount > 5%		11,021,000		
Allocation of Net Margin up to 5%	**Percentage**	**Allocation Amount**	**Operating Days Cash**	
Cash Reserves Allocation	95%	4,529,000	21	Minimum
Local Programs Allocation	5%	238,000	1	Minimum
Allocation of Net Margin above 5%	**Percentage**	**Allocation Amount**		
Allocation to Cash Reserves	50%	5,510,500	26	Minimum

Based on the customer dividend program formula above, VCE minimum allocations result in $238,000 to LPR, $0 to dividends, and the balance to cash reserves. The estimated discretionary allocation amount for 2023 is $5,510,500.

<u>Discretionary Allocation Considerations:</u>
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 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 ~2.5%/$1.1M annually in discounts to 25% of customers (CARE and FERA)
- PG&E's additional Transmission/Distribution rate increase in March 2024 (projected +13%)

Staff considered the following allocation scenarios.

Scenario 1:

	Percentage	Allocation Amount	Operating Days Cash	
Discretionary Allocation (After Cash Reserves)	50%	5,510,500	26	Maximum
Cash Reserves	75%	4,132,800	19	
Local Programs (Targeted 2024/25 Spend)	10%	551,100	3	
Customer Dividends (Targeted 2024/25 Spend)	15%	826,600	4	

Scenario 2:

	Percentage	Allocation Amount	Operating Days Cash	
Discretionary Allocation (After Cash Reserves)	50%	5,510,500	26	Maximum
Cash Reserves	70%	3,857,300	18	
Local Programs (Targeted 2024/25 Spend)	10%	551,100	3	
Customer Dividends (Targeted 2024/25 Spend)	20%	1,102,100	5	

Scenario 3:

	Percentage	Allocation Amount	Operating Days Cash	
Discretionary Allocation (After Cash Reserves)	50%	5,510,500	26	Maximum
Cash Reserves	80%	4,408,300	20	
Local Programs (Targeted 2024/25 Spend)	5%	275,500	1	
Customer Dividends (Targeted 2024/25 Spend)	15%	826,600	4	

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.

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. Staff is seeking feedback from the CAC to inform its recommendation on the allocation of the 2023 net margin that is anticipates taking to the Board in May.