VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 13

TO:	Board of Directors
FROM:	Edward Burnham, Director of Finance & Internal Operations Mitch Sears, Executive Officer
SUBJECT:	Draft 2025 Operating Budget & Customer Rates – Update
DATE:	November 14, 2024

RECOMMENDATION
Informational – no action requested.

OVERVIEW
This update is the second of three discussions leading to the Board's consideration of VCE's 2025 budget and customer rates. The purpose of this staff report is to: (1) provide an updated overview of key factors influencing the operating budgets and customer rates, and (2) present an analysis of three draft budget and rate discount/revenue investment scenarios for Board discussion and feedback.

The three 2025 budget scenarios outlined in the analysis section of this report meet VCE's financial policies, updated reserve targets, and customer program expansions with a range between $27.8M net income to $38.8M based on net rate discounts.

VCE's longer-term outlook (2026+), indicates continued financial stability and cost certainty due to long-term PPA's and cost-based rate structure allowing VCE to maintain cash reserves and positive margins.

BACKGROUND
At the VCE board meeting on October 13, 2024, Staff provided Item 15 which included an update on the 2024 Operating Budget, introduced the 2025 preliminary draft operating budget, and updated the multi-year outlook based on analysis by CalCCA, MRW, and TEA. The 2024 Operating Budget included rate discounts to PG&E's rates by 2% for all customers, maintained the 2.5% rate credit for CARE/FERA and Medical Baseline customers, and directed all other revenues to cash reserves to achieve a target of ~180+ days cash on hand by the end of 2024 for VCE.

As discussed in the budget monitoring process in 2024, the California Public Utilities Commission (CPUC) slice of day resource adequacy (RA) requirements for 2025 have increased price volatility in the forward curve for RA costs. Staff has provided updates in July and September on power cost strategies for optimizing the sale of renewable energy credits (RECs) above compliance requirements and to help maintain long-term positive financial outlooks and competitive customer rates. This power cost management approach is similar to other CCA's strategies for the above compliance portfolio RA, RECs, Energy, etc. attributes.

VCE continues to set customer rates to collect sufficient revenue from participating customers to fully fund VCE's Budget while contributing to reserve funds to obtain an initial investment grade credit rating and increase its ability to implement programmatic objectives.

ANALYSIS
This report updates information previously provided to the Board during the October Preliminary Operating Budget Update and Multi-year Outlook (2026 through 2028). To construct the initial 2025 preliminary operating budget estimates staff has incorporated the following assumptions:

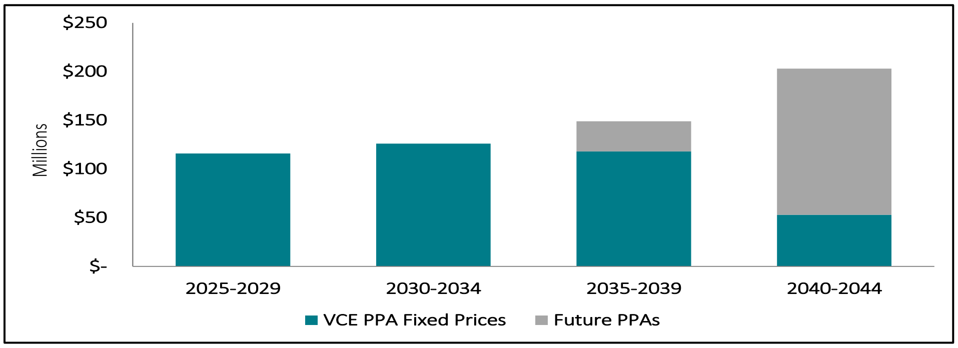
- 2025 Power Charge Indifference Adjustment (PCIA) (Revenue reducing): significant increase due to under-collection in 2024 and lower power cost forwards for 2025.
- PG&E Bundled rates (PCIA & Generation): 2% decrease – Results in approximately $2M reduced gross revenue for 2025
- Resource Adequacy (RA). The CPUC slice-of-day RA model driving Rising RA cost increases has outpaced PPA savings for 2025.
- 2025 Programs Expenditures – VCE has been able to make significant contributions in support of customer programs. VCE anticipates spending $1M in designated program funds in 2025 from non-reimbursable programs and $2M including reimbursable programs (i.e. grants).

1. Updated 2025 Operating Budget Key Factors:
VCE, along with all other California CCAs, receives PG&E PCIA and generation rate modeling produced by financial analysts under contract with CalCCA. This updated forecast incorporates updated information based on PG&E’s October filing from the annual Energy Resource Recovery Account (ERRA) Proceeding as part of the annual rate and PCIA rate setting process. Based on the most updated PG&E filing and market price benchmarks for RA and RECs set by the CPUC’s energy division, PCIA has moved from a significant increase forecasted at 150% to a decrease to near zero.

As previously experienced, real-time power market increases drive future decreases to PG&E’s PCIA due to the fact that power market increases make PG&E’s portfolio more valuable. As discussed in mid-year updates, counter acting the PCIA decrease are RA and RECs cost increases in 2024 and 2025 hedging. The forecasted decrease in the PCIA has resulted in a ~$23M increase in gross revenues to VCE compared to prior forecasts for 2025. PCIA is outside of VCE’s control and influence. Additional consideration of VCE's long-term fixed prices and policy requirements (e.g. 100% renewable portfolio goals), are additional factors incorporated into the budget adoption and rates-setting process.

<u>VCE’s Long-term Fixed Costs</u>
VCE’s fixed price renewable contracts have rate stabilization effects while significantly increasing VCE's renewable content. This has been a primary driver in VCE’s ability to continue to recover costs and build healthy cash reserves for maintaining its financial strength, renewable portfolio standards, and customer rate discounts. Staff does note that VCE, along with all other California CCAs, will face increased PPA prices in the longer horizon based on current PPA market price forwards as displayed in Table 1. These higher costs for new PPA’s are driven in large part by delays in interconnecting to the transmission and distribution grid.

TABLE 1 – VCE Fixed Price Power Costs



Note: The above table does not include additional PPA or REC costs related to VCE's strategic goal of 100% renewable by 2030

<u>VCE's Reserve and Dividend Policy Revisions</u>

VCE has been in operation now for multiple years post-adoption of the initial reserve policy and dividend program guidelines. Both require routine updates to reach VCE's strategic goal of financial strength including reaching VCE's initial investment-grade credit rating. The proposed Reserve and Dividend policy modifications are listed below. Staff has presented the draft revisions to the CAC which made a unanimous recommendation to the Board in support of the proposed policy updates. Staff will be bringing a final recommendation to the Board at the December meeting based on final analysis and budget recommendations.

The proposed policy modifications include:

1. An increased Operational Financial Reserve minimum from 30 days to 120 days
2. An Increased Operational Financial Reserve Target of 180 from 90 days (this increase aligns with current minimums typically seen for CCA qualification for investment grade credit ratings)
3. Addition of a Rate Stabilization Reserve minimum target of 60 days
4. Increased the minimum net margin allocation of 75% from 50% towards financials reserves of net margin above > 5%
5. Administrative updates and references to VCE cost recovery rate policy and rate adjustment policy.
6. Definitions of uses for Operational Financial Reserves and Rate Stabilization Reserves.

As noted, the creation of a Rate Stabilization fund is included in the proposed draft updates to the policies. VCE's current operational reserve funds would be used to meet VCE's strategic objectives, secure favorable commercial terms, secure future stand-alone VCE credit rating(s), and provide a source of funds for unanticipated expenditures. VCE's Rate Stabilization fund would be a contingency to provide rate stability for VCE customers given increasing regulations, power costs, and Power Charge Indifference Adjustment (PCIA) charges from the investor-owned utility (PG&E).

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2. Draft 2025 Operating Budget & Rate Discount/Revenue Investment Scenarios

Staff have developed three budget scenarios to model various rate discounts/revenue investments to show impacts to VCE's short-term and long-term financial outcomes. All scenarios incorporate the same power cost assumptions based on the best available market information and forecasts for the PCIA and PG&E generation rates. Based on the direction received from the Board at the July meeting, 2025 budget forecasts incorporate the initial sale of 50K RECs ($4.6M). Note: VCE retains 160K RECS above compliance under each of modeled 2025 fiscal scenarios analyzed in this report.

Consistent with prior Board direction, staff believes that these scenarios represent a disciplined and financially prudent approach.

Rate Discounts/Revenue Investment

- Revenues can be "invested" in rate discounts, programs, increased procurement of clean energy resources (e.g. short-term RECs), or a combination of these and other elements.
- Every 1% discount results in approximately $1.50/month reduction in the average residential customer bill and approximately $3.75/month reduction in the average small commercial customer bill
- Every 1% discount would be approximately $1M in reduced net income available for cash reserves, rate stabilization, programs, and procurement of additional clean energy resources. Net Income allocations for reserves and programs are normally evaluated in May as part of VCE's audited financial results.
- If selected, rate discounts are best implemented during PG&E rate changes (e.g. January), to minimize billing efforts, risk of errors, and customer messaging.

Anecdotal information from other CCAs indicates that customer dividends/discounts while helpful in communicating a CCA's value do not have significant impacts on customer retention or new customer recruitment. Staff would note that there is currently a high degree of customer sensitivity to costs in all economic sectors, including electricity. Therefore, while past feedback from other CCA's is important to consider, staff believes that affordability is a key consideration. In addition, as noted in previous analyses, rate discounts can also help demonstrate and communicate the value of CCAs to other potential member agencies, legislative representatives, and regulatory bodies furthering environmental mission impacts.

The budget options detailed in Table 2 below incorporate the following rate forecasts:

- Scenario 1: Continuation of current rate 2% rate discounts to PG&E generation rate; approximately $3.5M net revenue reduction in 2025;
- Scenario 2: Increase to a 5% rate discount to PG&E generation rate; approximately $6.5M net revenue reduction in 2025;
- Scenario 3: Increase to a 10% rate discount to PG&E generation rate[1]; approximately $11.5M net revenue reduction in 2025;

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[1] This option is a rate discount which is considered by staff as an aggressive and potentially less sustainable rate discount in future years.

Table 2 – Customer Rate Discount Comparison

			Actual YTD August 31 (8 MO) + Forecast (4 MO)	Budget Scenarios	Preliminary Forecast*		
Scenario 1	2022	2023	2024	2025	2026	2027	2028
Customer Revenue	85,323	95,430	103,478	109,930	95,810	99,350	100,140
Power Cost	75,130	68,528	80,490	63,970	75,090	72,080	68,800
Other Expenses	4,469	6,030	6,250	7,200	7,200	7,920	8,712
Net Income	5,724	20,872	16,738	38,760	13,520	19,350	22,628
Scenario 2	2022	2023	2024	2025	2026	2027	2028
Revenue	85,323	95,430	103,478	104,430	91,020	94,380	95,130
Power Cost	75,130	68,528	80,490	63,970	75,090	72,080	68,800
Other Expenses	4,469	6,030	6,250	7,200	7,200	7,920	8,712
Net Income	5,724	20,872	16,738	33,260	8,730	14,380	17,618
Scenario 3	2022	2023	2024	2025	2026	2027	2028
Revenue	85,323	95,430	103,478	98,940	86,230	89,420	90,130
Power Cost	75,130	68,528	80,490	63,970	75,090	72,080	68,800
Other Expenses	4,469	6,030	6,250	7,200	7,200	7,920	8,712
Net Income	5,724	20,872	16,738	27,770	3,940	9,420	12,618

* Revenues are highly subject to VCE seasonal load variation and PG&E filings that impact generation rates and PCIA.

Note: forecasted financials are based on the most current available data and assumptions, as displayed in Table 2 – Customer Rate Discount Comparison. These scenarios rely on the use of future rate adjustments, reserves, or both to mitigate future power cost volatility.

Additional Considerations – Preliminary 2025 Budget Other operating expenses (not including power costs) are nearly flat compared to the 2024 budget, reflecting only a 3% increase – equal to 2024 CPI at ~3.5%. Staff is evaluating market adjustments resulting from a salary survey that may be proposed in the December proposed budget. The primary factors of increased costs are related to programs and the addition of one full-time analyst position to power cost management and financial analysis. Other categories include strategic plan development and execution, initial investment grade credit rating, consultants, and other administrative costs.

CONCLUSION

The draft 2025 operating budget scenarios meet VCE's current and anticipated fiscal policy updates while providing funds for rate relief and/or other customer focused investments (e.g. programs, additional clean energy procurement).

Staff has prepared the draft 2025 operating budget/rate scenarios based on the best available information on PG&E generation rates and PCIA as of October 2024 CPUC filings. PG&E's 2025 PCIA and rates are scheduled to be released in late November, allowing VCE to set 2025 rates at the December Board meeting. Based on the Board's feedback and direction, staff will return with an updated Operating Budget/customer rates recommendation for 2025 in December.

Draft 2025 Operating Budget & Customer Rates Scenario 1:

Budget Scenario 1 incorporates a net rate discount of 2% for all customers and an additional 2.5% discount to CARE/FERA/Medical baseline customers (4.5% total); the net impact for 2025 is a reduction of $3.5M. This option includes a current rate discount from the current ERRA forecasts, which is considered by staff as a solid baseline outcome.

Table 3 – Budget Scenario 1 (2% net rate discount for all - baseline)

VALLEY CLEAN ENERGY DRAFT BUDGET SUMMARY 2025 - BUDGET SCENARIO 1	APPROVED BUDGET 2024	ACTUAL YTD AUG (8 MO) + FORECAST (4 MO) 2024	DRAFT BUDGET 2025
OPERATING REVENUE	**$ 106,500**	**$ 102,808**	**$ 109,930**
OPERATING EXPENSES:			
Cost of Electricity	75,200	80,490	63,970
Contract Services	2,261	2,154	2,350
Outreach & Marketing	300	247	300
Programs	2,018	1,680	2,200
Staffing	1,632	1,628	1,860
General, Administration and other	1,139	1,141	1,310
TOTAL OPERATING EXPENSES	**82,550**	**87,340**	**71,990**
TOTAL OPERATING INCOME	**23,950**	**15,468**	**37,940**
NONOPERATING REVENUES (EXPENSES)			
Interest income	550	670	820
Interest expense			
TOTAL NONOPERATING REV/(EXPENSES)	**550**	**670**	**820**
NET MARGIN	**$ 24,500**	**$ 16,138**	**$ 38,760**
NET MARGIN %	**23%**	**16%**	**35%**

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Draft 2025 Operating Budget & Customer Rates Scenario 2:

Budget Scenario 2 incorporates a net rate discount of 5% for all customers and an additional 2.5% discount to CARE/FERA/Medical baseline customers (7.5% total); the net impact for 2025 is a reduction of $6.5M. This option includes a current rate discount from the current ERRA forecasts, which is considered by staff as a moderate and sustainable rate discount based on current financial projections.

Table 4 – Budget Scenario 2 (5% net rate discount for all - Moderate)

VALLEY CLEAN ENERGY DRAFT BUDGET SUMMARY 2025 - BUDGET SCENARIO 1	APPROVED BUDGET 2024	ACTUAL YTD AUG (8 MO) + FORECAST (4 MO) 2024	DRAFT BUDGET 2025
OPERATING REVENUE	**$ 106,500**	**$ 102,808**	**$ 104,430**
OPERATING EXPENSES:			
Cost of Electricity	75,200	80,490	63,970
Contract Services	2,261	2,154	2,350
Outreach & Marketing	300	247	300
Programs	2,018	1,680	2,200
Staffing	1,632	1,628	1,860
General, Administration and other	1,139	1,141	1,310
TOTAL OPERATING EXPENSES	**82,550**	**87,340**	**71,990**
TOTAL OPERATING INCOME	**23,950**	**15,468**	**32,440**
NONOPERATING REVENUES (EXPENSES)			
Interest income	550	670	820
Interest expense			
TOTAL NONOPERATING REV/(EXPENSES)	**550**	**670**	**820**
NET MARGIN	**$ 24,500**	**$ 16,138**	**$ 33,260**
NET MARGIN %	**23%**	**16%**	**32%**

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Draft 2025 Operating Budget & Customer Rates Scenario 3:

Budget Scenario 3 incorporates a net rate discount of 10% for all customers and an additional 2.5% discount to CARE/FERA/Medical baseline customers (12.5% total); the net impact for 2025 is a reduction of $11.5M. This option includes a current rate discount from the current ERRA forecasts, which is considered by staff as an aggressive and potentially less sustainable rate discount based on current financial projections.

Table 5 – Budget Scenario 3 (10% net rate discount for all - aggressive)

VALLEY CLEAN ENERGY DRAFT BUDGET SUMMARY 2025 - BUDGET SCENARIO 1	APPROVED BUDGET 2024	ACTUAL YTD AUG (8 MO) + FORECAST (4 MO) 2024	DRAFT BUDGET 2025
OPERATING REVENUE	**$ 106,500**	**$ 102,808**	**$ 98,940**
OPERATING EXPENSES:			
Cost of Electricity	75,200	80,490	63,970
Contract Services	2,261	2,154	2,350
Outreach & Marketing	300	247	300
Programs	2,018	1,680	2,200
Staffing	1,632	1,628	1,860
General, Administration and other	1,139	1,141	1,310
TOTAL OPERATING EXPENSES	**82,550**	**87,340**	**71,990**
TOTAL OPERATING INCOME	**23,950**	**15,468**	**26,950**
NONOPERATING REVENUES (EXPENSES)			
Interest income	550	670	820
Interest expense			
TOTAL NONOPERATING REV/(EXPENSES)	**550**	**670**	**820**
NET MARGIN	**$ 24,500**	**$ 16,138**	**$ 27,770**
NET MARGIN %	**23%**	**16%**	**28%**