VALLEY CLEAN ENERGY ALLIANCE

Staff Report – Item 15

TO: Board of Directors

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

SUBJECT: Preliminary Draft Operating Budget Fiscal Year 2021-2022

DATE: April 8, 2021

RECOMMENDATION
Informational – no action requested.

OVERVIEW
This Board item is the first of three discussions over the next three meetings leading to the adoption of the FY 2021-2022 operating budget in June 2021. The purpose of this staff report is to: (1) provide an update on the current fiscal year budget and (2) introduce the preliminary draft operating budget for FY 2021-2022 (2022 Budget). After gathering initial feedback at the April Board meeting, staff will return with the next iteration of the draft 2022 Budget for Board review/feedback at the May Board meeting. The final draft 2022 Budget will be presented to the Board for consideration at the June 10th Board meeting.

As detailed in the body of this report, the current fiscal year is anticipated to be approximately $0.8M better than the approved budget for FY 2020-2021 and the preliminary estimate for the 2021-2022 FY is approximately $0.9M lower than the forecast presented to the Board during budget discussions last June. When considering the two fiscal years together, the net $0.1M difference from forecasted budgets is less than 1%.

BACKGROUND AND ANALYSIS
Current Operating Budget Overview - FY 2020-2021
In June 2020, the Board approved a $52.5M Operating Budget for FY 2020-2021 which includes purchased power and other operating expenses. As discussed and approved by the Board last June, the FY 2020-2021 budget resulted in a net loss of $2.8M, after factoring in fiscal mitigation policy adjustments. The primary drivers of that loss included the increasing/unpredictable Power Charge Indifference Adjustment (PCIA) and the volatility in Resource Adequacy (RA) power pricing due in part to CPUC market design efforts. For reference, the current operating budget was based on the following key factors:

- Covid-19. The 2020-2021 FY Budget included substantial reductions in load and revenue related largely to COVID and anticipated recessionary factors.
- PG&E Generation Rates. 1.4% increase of PG&E's generation rates in FY 2020-2021.

- Power Charge Indifference Adjustment (PCIA). PCIA increase to the cap of approximately 3.2 cents per kWh in May 2020 and a further increase to 4.4 cents per kWh in 4th quarter 2020 due to an expected cap exception trigger. Overall, an approximately 44% increase.
- Power costs. $6.1 million increase in forecasted power costs over the previous FY power budget – due primarily to increasing Resource Adequacy (RA) costs and an anticipated delay in generation from pending long-term solar projects.
- Policy adjustments. The budget reflected the inclusion of two policy options approved by the Board to partially mitigate the financial loss:
    - Power Planning Resource Adjustment, which projected to lower power purchase costs by $2.25 million.
    - Accepting large hydro allocations from PG&E, which avoided a net $125,000 expenditure for GHG free energy.
- Other operating expenses. Non-power costs were effectively flat compared to the previous FY budget, reflecting a 1.3% increase – lower than CPI.

<u>Current FY Update - Year to Date Actual plus Forecast FY 2020-2021</u>
The YTD actual net financial position for the 7 months ending January 31, 2021 plus the forecast for the remaining months of FY 2020-2021 through June 2021, are favorable to the approved budget by approximately $0.8M due mainly to the following factors:

Negative Impacts:
- The net effect of PG&E's average generation rate change (+2.8%) and PCIA increase requires VCE to reduce its average rate by approximately 1.4% to maintain rate parity.
- COVID-19 net impact resulted in higher than forecasted demand driving additional short-term power purchases at higher costs.

Positive Impacts:
- Revenue increases from higher than forecasted customer KWh usage. This increase was partially offset by increased costs for relatively expensive short-term energy purchases to serve this additional load noted in the negative impacts above.
- Lower actual expenditures related to marketing, new member agency on-boarding, legal support and contingency.
- Contract labor expenditures below budget due to staffing model changes – transition to in-house staffing.

Preliminary Draft 2022 Budget
The Preliminary Draft 2022 Budget includes a forecasted net income loss of $6.9M. This is an approximately $0.9M greater loss from the $6.0M net loss forecasted and presented to the Board last June. The increased net loss is due primarily to the following major factors that are outside of VCE's direct control:

- RA cost volatility/increase. VCE faces a significant increase in power costs due higher than forecasted resource adequacy costs. Primary drivers for RA cost increases in this time period include a tightening market as fossil fuel baseload energy resources are retired and shifting market rate design and requirements mandated by the CPUC. VCE and SMUD actively monitor and manage the long-term portfolio of RA to remain compliant with reliability requirements and Board Policy. Note: staff is currently exploring lower cost short-term energy contracts and additional deferral of REC purchases to off-set rising RA costs and to bridge the gap as long-term PPA agreements commence.

- COVID-19. Load forecast uncertainty related to Covid-19 is anticipated to be present through at least the first 3-6 months of the 2022 fiscal year. Additionally, changes in long-term load requirements related to post COVID conditions create uncertainty and result in more conservative forecasting.
- TOU rate transitions. Some classes of non-residential customers have been authorized by CPUC decisions to remain on their legacy rates rather than transition to TOU rates in March 2021. This has an undetermined impact on VCE revenues which may or may not be significant. Staff will be developing additional analysis on this potential fiscal impact for the May Board meeting on the draft budget.

<u>Other Operating Expenses</u> – Preliminary Budget Other operating expenses (not including power costs) are nearly flat compared to the FY2021 budget, reflecting only a 1.0% increase – lower than CPI. Primary increases in costs are related to VCE Community Programs and Strategic Plan Implementation, which are offset by expenditure reductions in new member support and legal support.

Primary factors in this category of expenses include:

- Services currently under contract
- Shift of labor mix more heavily towards internal VCE staff and away from SMUD services
- 1.5% annual inflation rate on most expenses not under contract
- 5% contingency rate for unanticipated operating expenses for post COVID transition.

Other Considerations – PCIA is incorporated into the draft preliminary FY 2022 at the previously forecasted net increase of 39%. Generation Rate is forecasted with a 1% increase in PG&E generation rates resulting in VCE increasing its rates to match with corresponding increases in revenue as per the adopted rate setting policy. Both the PCIA and PG&E's generation rate setting are factors outside of VCE control. Staff will continue to monitor potential changes that may have financial impacts.

CONCLUSION

The preliminary draft FY 2022 operating budget reflects a -14% net margin; less than 1% difference from the net margin position forecasted and presented to the Board last June. The preliminary draft FY 2022 operating budget net margin position does not meet VCE's 5% minimum annual net margin goal to maintain financial stability.

Staff has prepared the preliminary draft FY 2022 operating budget based on the best available information on PG&E generation rates and PCIA exit fees. As noted in the staff report, continuing volatility and uncertainty in the RA market, PCIA and load forecast due to Covid-19 are the primary drivers of the negative net margins forecast in the preliminary draft FY 2022 budget. Projected use of existing reserves for customer rate stabilization will allow VCE to maintain rate competitiveness with PG&E and bridge the gap until long-term renewable contracts come on-line beginning in late 2021.

Based on the Board feedback and direction, staff will return with an updated draft Operating Budget for FY 2022 in May**.**

ATTACHMENTS

1. Preliminary draft FY 2021-2022 budget summary table

VALLEY CLEAN ENERGY
PRELIMINARY OPERATING BUDGET SUMMARY

	APPROVED BUDGET FY 2020-21	ACTUAL YTD JAN 31, 2021 (7 MO) + FORECAST (5 MO) FY 2020-21	PRELIMINARY BUDGET FY 2021-2022
OPERATING REVENUE	$ 49,638	$ 53,981	$ 49,047
OPERATING EXPENSES:			
Cost of Electricity	47,670	51,663	51,082
Contract Services	2,723	2,577	2,559
Marketing	241	177	241
Programs	12	3	135
Staff Compensation	1,132	1,116	1,164
General, Administration and other	772	577	829
TOTAL OPERATING EXPENSES	52,550	56,113	56,010
TOTAL OPERATING INCOME	(2,912)	(2,131)	(6,964)
NONOPERATING REVENUES (EXPENSES)			
Interest income	135	101	139
Interest expense	(57)	(56)	(42)
TOTAL NONOPERATING REV/(EXPENSES)	78	45	97
NET MARGIN	$ (2,834)	$ (2,086)	$ (6,866)
NET MARGIN %	-5.7%	-3.9%	-14.0%