VALLEY CLEAN ENERGY ALLIANCE
COMMUNITY ADVISORY COMMITTEE

Staff Report – Item 8

TO: Community Advisory Committee

FROM: Edward Burnham, Director of Finance & Internal Operations

SUBJECT: Allocation of 2022 Net Margin

DATE: June 22, 2023

RECOMMENDATION

Recommend that the VCE Board of Directors approve the following allocation of the $5.3M 2022 Audited Net Margin:

1. $712,500 to the Local Programs Reserve (LPR); $0 to dividends
2. The balance of $4,611,000 to cash reserves to reach cash reserve targets.

OVERVIEW

This staff report presents the various options the Board has in determining how to allocate the audited net margin for 2022. VCE's audited financial statements can be found here. Taking into account the Dividend Program parameters, as well as available and forecast cash reserves, Staff considered various options outlined below for VCE's net margin of $5.3 million:

- Minimum allocation of $217,000 to the Local Programs Reserve (LPR)
- Minimum allocation of $4,611,500 to cash reserves
- Discretionary Allocation (After Cash Reserves) of $495,000

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

For the audited 2022 Financial Statements, the conditions above have all been met. Therefore, consideration of the allocation of net margin will be going to the Board on July 13, 2022. 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 dividends and LPR

Below is a summary of VCE's Allocation:

Description		Audited 2022 Results	
Electricty Sales		86,662,000	
Operating Expense		80,897,000	
Operating Margin		5,765,000	
Prinipal Debt Payments		441,000	
Adjusted Net Margin less prinicpal Debt Payments		5,324,000	
Adjusted Net Margin Pectentage		6.14%	
Allocation Amount <=5%		4,333,000	
Allocation Amount > 5%		991,000	
Aloocation of Net Margin up to 5%	**Perectage**	**Allocation Amount**	
Cash Reserves Allocation	95%	4,116,000	Minimum
Local Programs Allocation	5%	217,000	Minimum
Aloocation of Net Margin above 5%	**Perectage**	**Allocation Amount**	
Allocation to Cash Reserves	50%	495,500	Minimum
Discretionary Allocation (After Cash Reserves)	**50%**	**495,500**	Maximum

Considerations

Actual and forecasted cash reserves are an important consideration. VCE ended 2022 with $3.8M in unrestricted cash. Although VCE is expected to build additional cash reserves in the next two years, Staff anticipated ongoing power cost increases and regulatory pressures related to changing resource adequacy requirements. In addition, the Board has set reserve targets to increase to 180+ days of cash on hand to better position VCE to obtain it's initial investment grade credit rating. Cash Reserves are utilized primarily to enhance rate stability for customers to help meet VCE rate objectives (i.e., match PG&E rates) and absorb unexpected power costs such as the 2022 heat wave.

Based on the customer dividend program formula above, VCE minimum allocations result in $217,000 to LPR, $0 to dividends, and the balance to cash reserves. The discretionary allocation amount for 2022 is $495,000. Staff considered the following allocation scenarios.

Scenario 1: Additional Programs Funds (Staff Recommended)

Discretionary Allocation (After Cash Reserves)	**50%**	**495,000**	Maximum
Cash Reserves	0%	-	
Local Programs (Targeted 2024 Spend)	100%	495,500	
Customer Dividends (Targeted 2024 Spend)	0%	-	

Scenario 2: Additional Cash Reserves

Discretionary Allocation (After Cash Reserves)	50%	495,000	Maximum
Cash Reserves	100%	495,500	
Local Programs (Targeted 2024 Spend)	0%	-	
Customer Dividends (Targeted 2024 Spend)	0%	-	

Scenario 3: Customer Dividends

Discretionary Allocation (After Cash Reserves)	50%	495,000	Maximum
Cash Reserves	0%	-	
Local Programs (Targeted 2024 Spend)	0%	-	
Customer Dividends (Targeted 2024 Spend)	100%	495,500	

Based on the cash reserve forecast in the coming years, Staff is recommending the Board allocate the discretionary allocation of $495,000 to LPR and $0 to dividends. Staff considered the following factors in related to this recommendation.

- This amount of additional cash reserves would not have a material effect in obtaining VCE's initial investment grade credit rating
- Available funds for dividends provide less than a 1% discount; small impact on customer bills.
- VCE currently provides a ~2.5%/$1M annually in discounts to 25% of customers (CARE and FERA)
- Additional program funds needed to execute VCE's adopted VCE's 3-Year Programs Plan; staff believe this provides the largest positive material impact related to the available discretionary revenues.

In the near future, there is an increased likelihood that the dividend can be implemented as additional VCE power purchase agreements become operational, regulatory factors improve, and additional cash reserves are built for financial stability.

For reference, if the Board decided to institute a small dividend this year rather than the $0 recommended by Staff, the effects would be:

- A 1% dividend would be a reduction of $800,000 in cash reserves and reduce days cash on hand going forward by approximately five days
- A 2% dividend would be a reduction of $1,600,000 in cash reserves and reduce days cash on hand going forward by approximately ten days

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 its recommendation for VCE's 2022 audited $5.3M net margin is fiscally prudent, considering the factors outlined above. If approved by the Board, the net margin allocation between cash reserves, dividends, and local program reserve (LPR) would be as follows:

- $712,500 to the Local Programs Reserve (LPR)
- $0 to dividends, given the ending cash balance and reserve targets
- The balance of $4,611,000 to cash reserves to reach cash reserve targets.