

# Chelan County PUD

## Business Line Financial Policies

Continuation of updating and extending District-wide financial policies and guidance

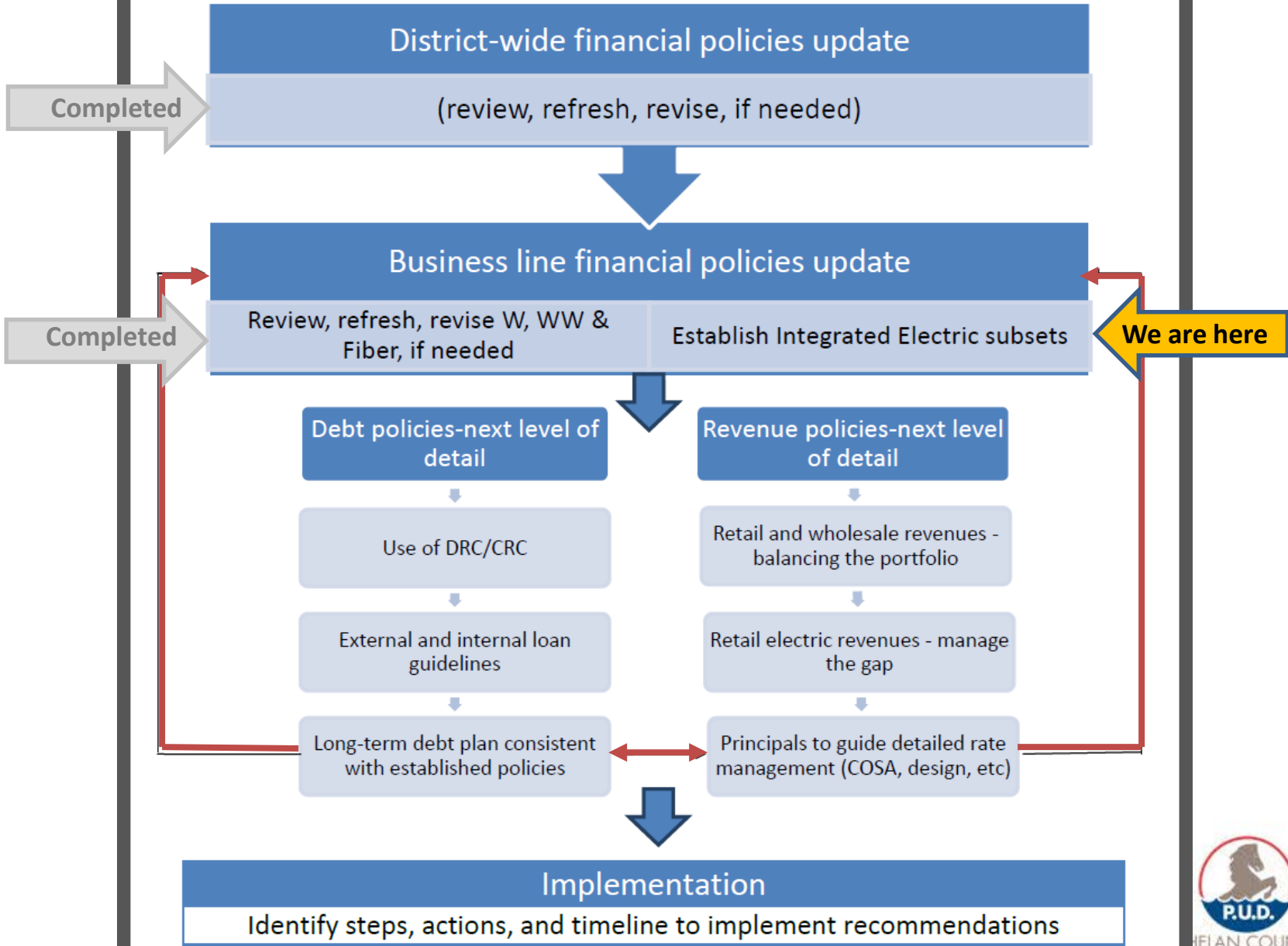
Board Presentation

July 10, 2017



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# Agenda

Overview of District financial forecast & past results

Review potential retail electric planning guidance

Discuss metric / target design options

Next up in the series

*Information Only – No Action Required Today*



# Retail Electric Revenue Planning

## Guidance Goals:

- Enable proactive revenue planning
- Manage for small, incremental rate increases over time, if needed
- Support more detailed rate design effort
- Provide targeted early warning signs
- Reduce the potential for large rate adjustments

For planning purposes only – does not impact the discretion of the Board to set future rates



# District Longer-Term Financial Forecast

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Cover	2.8	2.8	2.8	2.8	2.1	2.0	1.8	1.6	1.5	2.5
Debt Ratio	32.2%	26.7%	23.8%	21.7%	19.1%	19.4%	20.0%	21.0%	20.6%	21.6%
Debt	\$452	\$368	\$331	\$306	\$272	\$285	\$305	\$330	\$326	\$352
Liquidity	\$284	\$228	\$230	\$225	\$191	\$194	\$201	\$208	\$206	\$203

## Notes:

- Cover weakens in ~2022 and drops below target in ~2024
- Debt Ratio weakens and Debt Balance starts to grow starting ~2023
- Liquidity drops to minimal levels and triggers debt issuance starting in ~2023
- Overall, combined financials remain strong, but forecasted to weaken in 5-10 years

*The information in this schedule contains forward-looking projections. Such projections are necessarily subject to various risks and uncertainties. Actual results could, and likely will, differ materially from those projected. Unusual/stressed conditions, like lower market prices, would further weaken these forecasted results.*



# Historical “Bottom-Line” Results

## (For Perspective)

(millions)	2013	2014	2015	2016	2017*
Combined District	\$92.0	\$89.1	\$102.0	\$95.7	\$85.4
Retail Electric Gap (loss)	(\$11.1)	(\$11.5)	(\$14.3)	(\$16.4)	(\$20.3)

### Notes:

- Combined District results have stayed relatively stable over the last 5 years
- Retail Electric net gap (negative margin) has increased because costs have grown while loads have been stable and electric rates remain unchanged

\* 2017 based on approved budget

# Retail Electric Revenue Planning Discussion

## Integrated Electric Bottom-Line Forecast

(\$M)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Market-Based Activity	46	41	31	26	24	21	19	19	20	21
Cost-Based Activity	33	33	33	32	33	34	34	32	32	32
Retail Electric Gap	(23)	(23)	(25)	(23)	(27)	(29)	(32)	(37)	(40)	(44)
Other	10	6	7	8	9	8	7	6	6	6
<b>Integrated Electric</b>	<b>66</b>	<b>57</b>	<b>46</b>	<b>43</b>	<b>39</b>	<b>34</b>	<b>28</b>	<b>20</b>	<b>18</b>	<b>15</b>

**Staff recommends establishing metrics for Retail Electric to help provide more detailed direction in designing electric rates (needed for DG, EV, HDL, etc.) and indicate early warning signs when rate action may be needed**

Early indicators help accomplish rate action, if needed, in small, incremental steps over time - consistent with the preference we have heard from our customer-owners

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# Proposed Retail Electric Revenue Planning Guidance

- Revenue planning should manage for small, incremental rate increases over time, if needed
- Consider inflationary rate increases to represent “small and incremental”
- Revenue base is smaller than cost base so higher increases needed to keep pace with cost inflation which means early planning is needed to help reduce the potential for large rate adjustments
- Avoid over-reliance on wholesale electric revenues to fill the gap
- Use totality of financial metrics to determine ultimate rate actions (no single metric should drive rate decisions)
- Potential to add further revenue planning guidance as we learn from these initial guidelines

***Note:** To be used for planning purposes only - does not impact the discretion of the Board to set future rates*





# Retail Electric Specific Metric Options

1. Total cost coverage ratio - initial target >65%
  - Includes all expenses associated with providing retail electric service
  - Target less than 100% as portion of operations and capital planned to be covered by wholesale electric revenues and borrowing
  - Currently forecasted to drop below threshold around 2023-24 and planning may suggest small adjustments begin earlier
  - Transparent for full amount of electric rate supplement provided
  - Manages the gap as all costs change over time
2. Operating expense ratio - initial target >90%
  - Includes operating, maintenance & taxes, excludes depreciation
  - Target less than 100% as portion of operations planned to be covered by wholesale electric revenues
  - Currently forecasted to drop below threshold around 2023-24 and planning may suggest small adjustments begin earlier
  - Would be similar to other Business Lines' metric
  - Manages the gap as some costs change over time



# Retail Electric Specific Metric Options

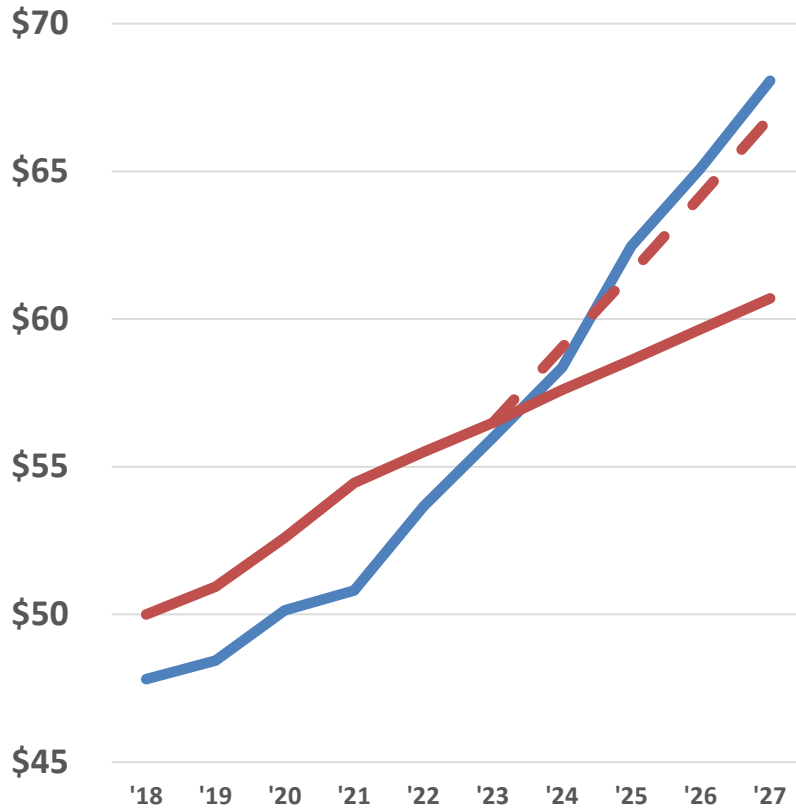
3. Retail electric gap - initial target <\$25M (fixed or in 2017 \$'s)
  - Retail electric revenue less related cost of providing service (costs exceed revenues)
  - Limits reliance on wholesale electric revenues by limiting the gap
  - Currently forecasted to exceed threshold around 2021-23 range and planning may suggest small adjustments begin earlier
  - Would be relatively fixed and not adjust with cost growth
  - Once limit is exceeded, inflationary rate actions may not be sufficient (revenue base is smaller than cost base so higher increases needed to keep pace with cost inflation = early planning to avoid large increases)
  
4. Market-based margin - initial target >\$25M
  - Market-based wholesale revenue minus related cost of production
  - Harder to effect change as margin is influenced by both market prices and cost of production
  - States a minimum threshold – not adjusted for cost or price changes
  - Overreliance on volatile results could result in unexpected, large increases to maintain metric



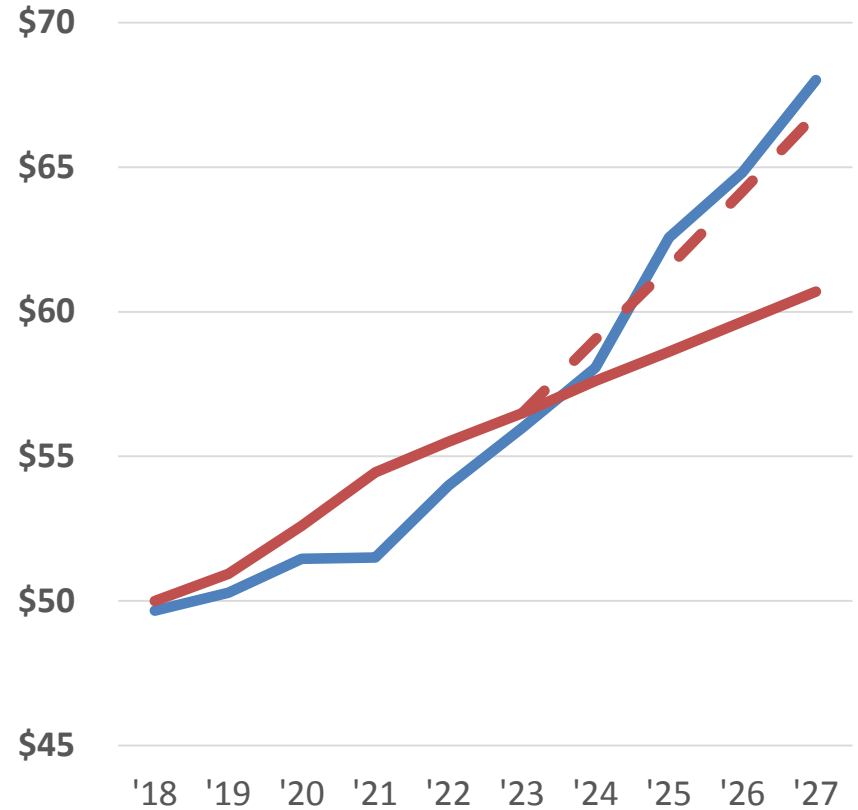
# Retail Electric Cost-Focused Metrics

## Guidance Examples

Total Cost Ratio - target 65%



Operating Expense Ratio - target 90%



Revenue Required

Retail Rate Revenue

Rate Revenue w/2.5% inflationary increase

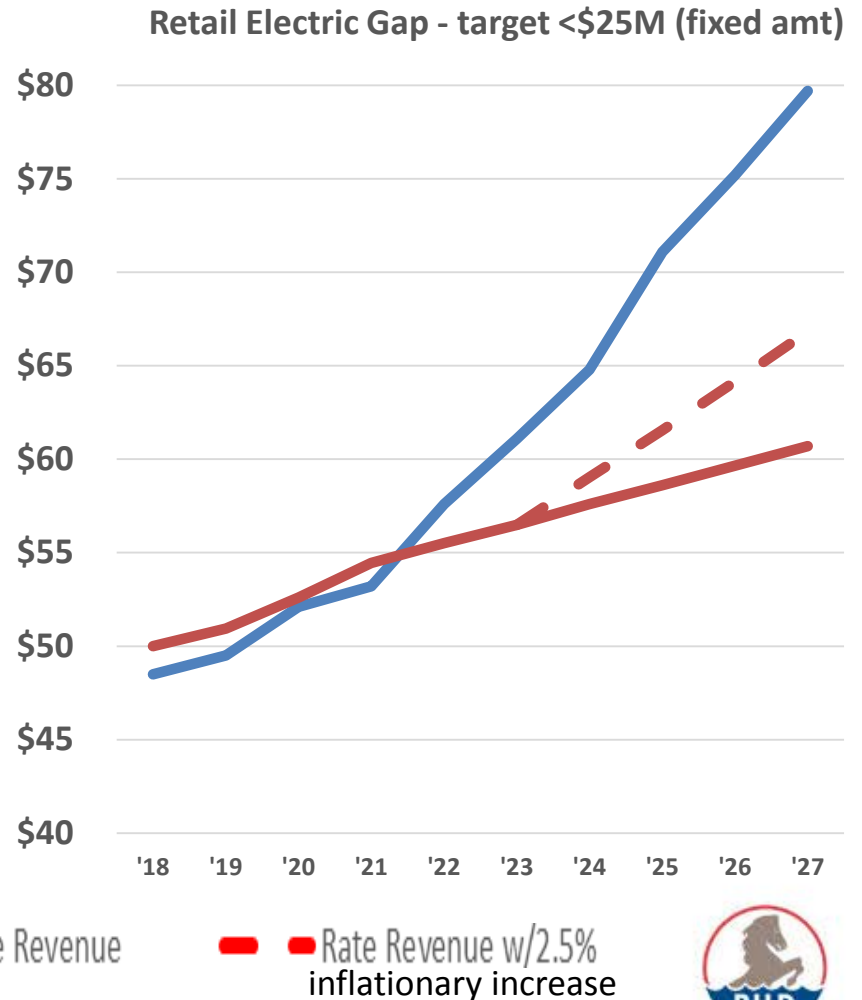
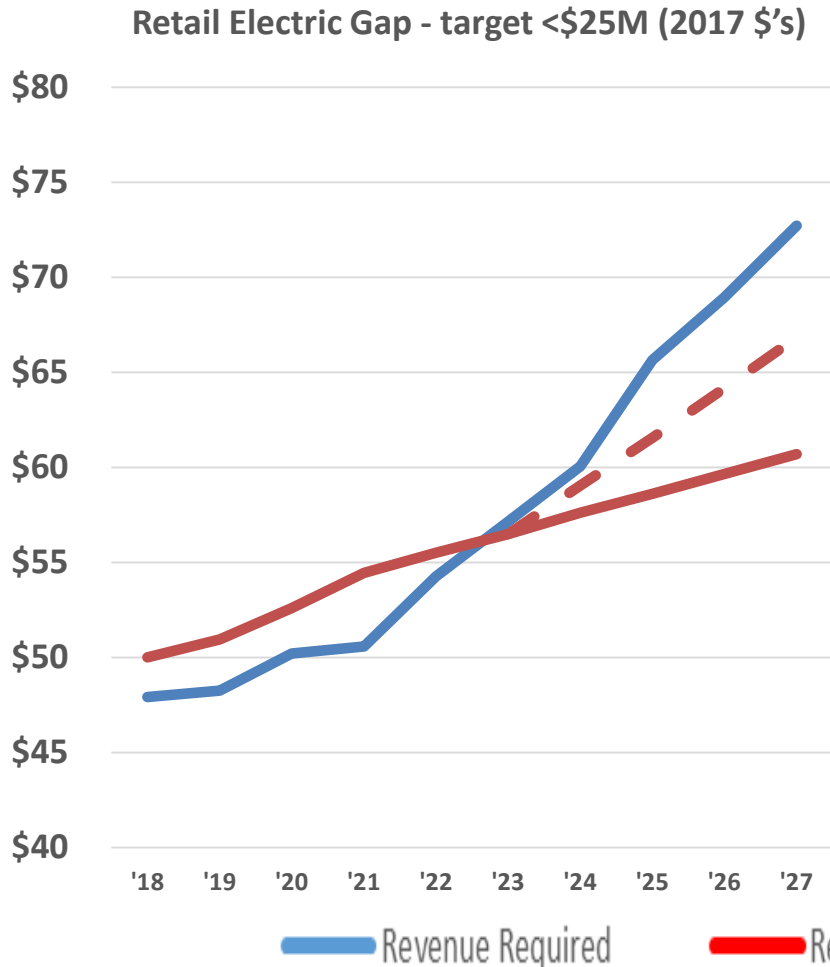


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# Retail Electric Gap-Focused Metrics

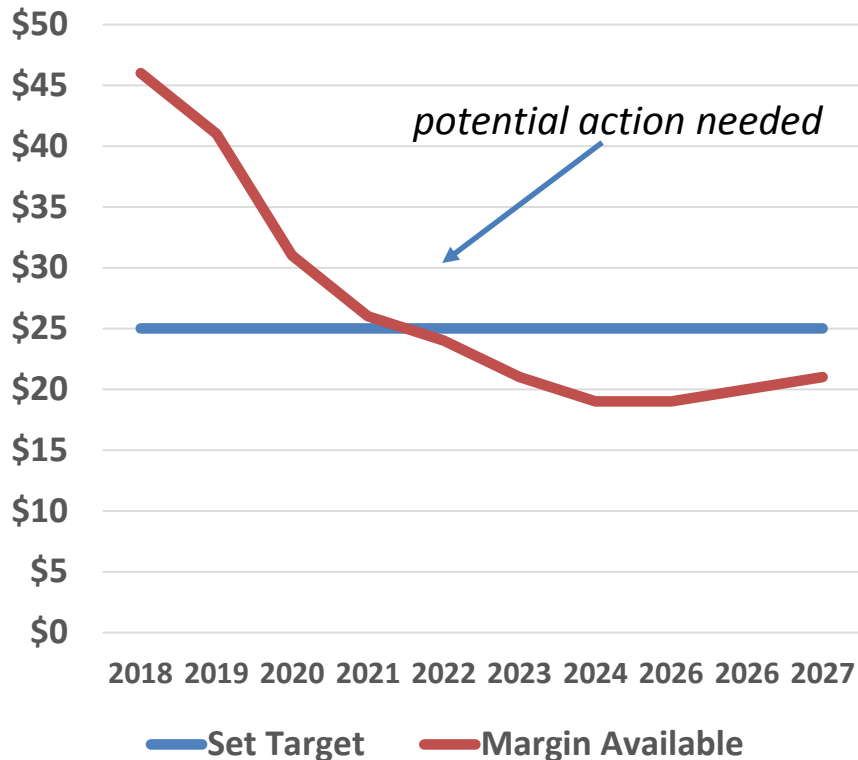
## Guidance Examples



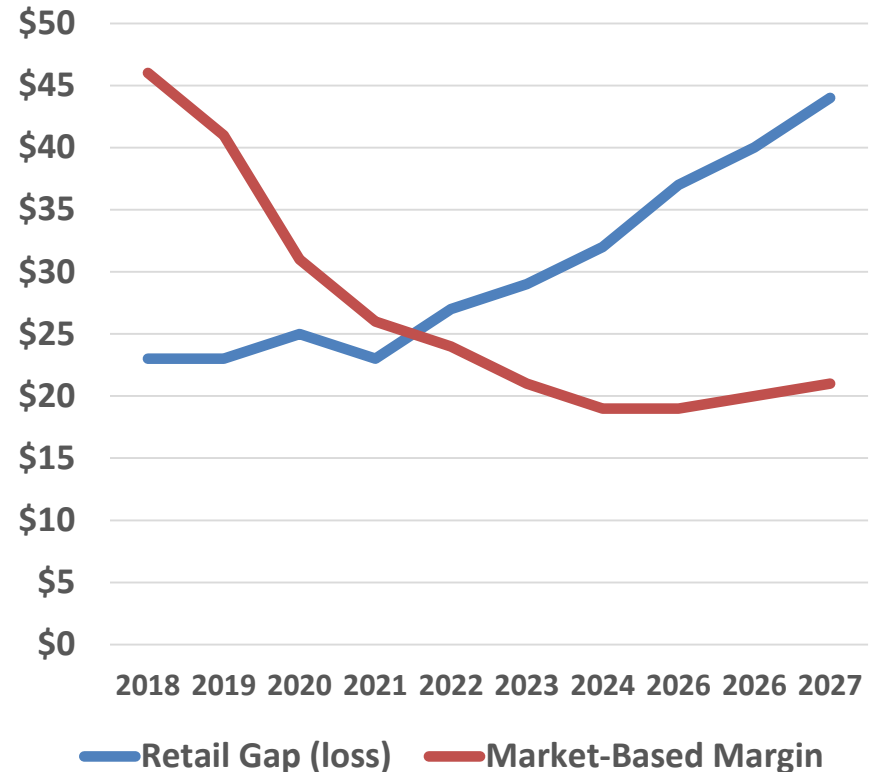
# Market-Based Margin-Focused Metrics

## Guidance Examples

Market Based Margin >\$25M



Market Based Margin vs. Retail Gap



# Planning Guidance – Next Steps

1. Confirm guidance of managing electric retail revenues for small, incremental (inflationary) rate increases over time, if needed
2. Monitor and report on selected metric(s) during a trial period to test the effectiveness of providing revenue planning guidance
3. Use applicable metric(s) to initiate discussions for detailed rate design
4. Reiterate back through the process, if needed, based on detailed rate design efforts

***For planning purposes only – does not impact the discretion of the Board to set future rates – helps to enable early recognition and small rate steps over time***



# Benefits for Customer-Owners

- Enables early recognition and modest rate steps over time
- Helps reduce the potential for large rate adjustments
- Clearly communicates total cost of service for retail electric



# Financial Strategy Sessions – Next Steps

Goal: Conduct series of Board strategy sessions to adjust and affirm long-term financial policies, Integrated Electric business line financial policies, rate philosophies, power contract guidelines, COSA guidelines and internal debt funding philosophies

Review and refresh District Financial Policies by the end of Q1 March 20, 2017

**Review, refresh and establish Business Line Financial Policies by the end of Q2** (extending to Q3) Q2 2017

Board guidance on Water, Wastewater and Fiber June 5

Overview of Integrated Electric planning (part 1) June 26

Discuss Integrated Electric metrics (part 2) July 10

Board guidance on Integrated Electric (part 3) July 24

Requesting Board guidance at next mtg

Establish long-term revenue guidance by 12/1 Q4 2017

Establish long-term internal/external debt guidelines by 12/1 Q4 2017



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