



# Power Supply Adjustment Update, Changes to Charges and Cash Reserve Policy Review

Council Committee on Austin Energy  
August 14, 2014





# Council Committee on Austin Energy

## August 14, 2014

- Quarterly Report (Handout)
- Power Supply Adjustment (PSA) Update
- Regulatory Charge
- GreenChoice®
- Cash Reserves and Policy Review

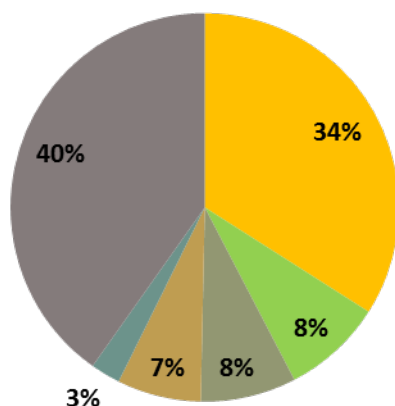


# Changes to Adjustable Charges

Since Published Budget and June 23, 2014 CCAE meeting

## FY2015 Expenditures

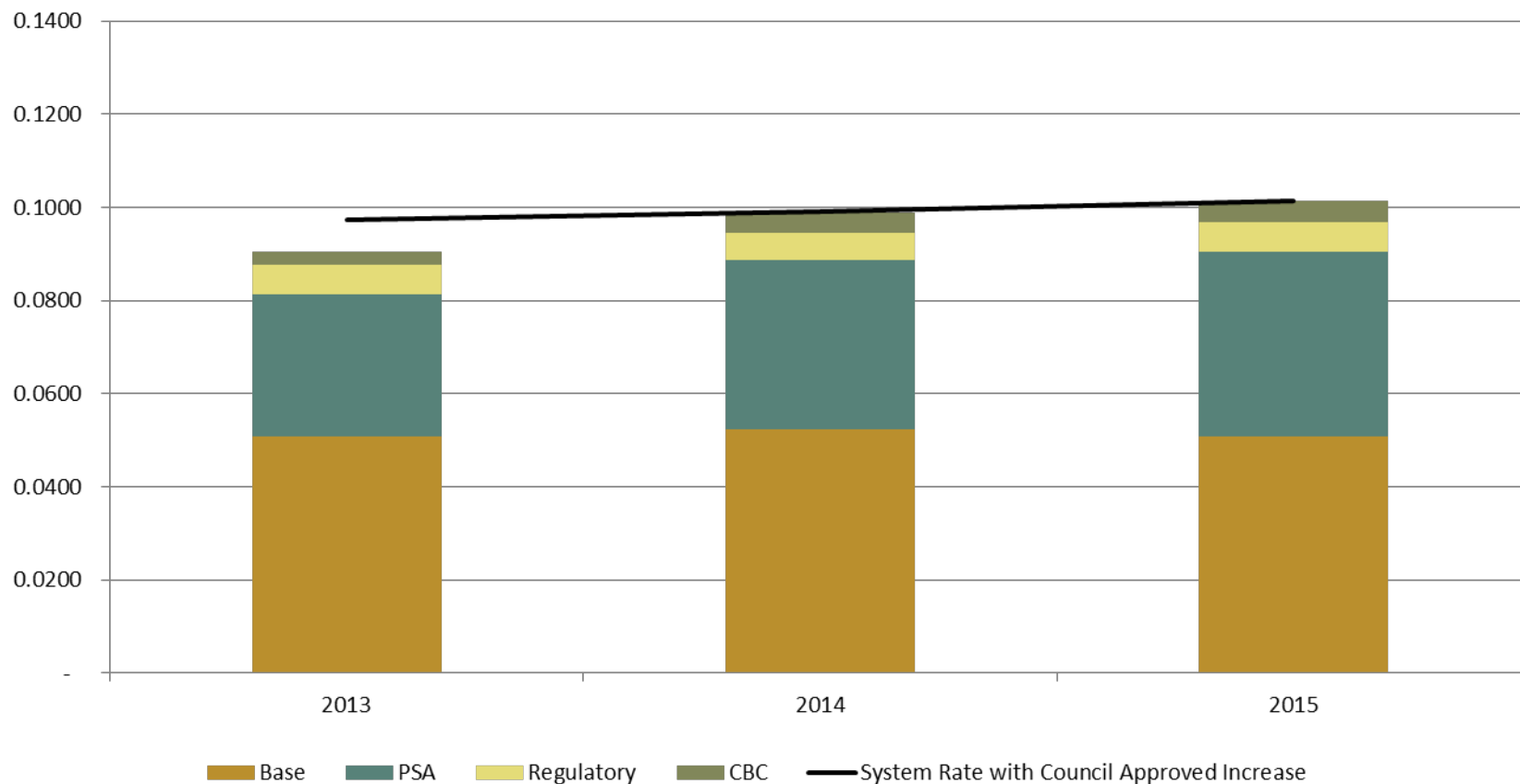
- Power Supply
- Transmission
- Debt Service
- GFT
- City Support Services
- AE Core Operations



- **Power Supply Adjustment (PSA) - update to recover cost**
  - AE absorbed under recovery for over a year
  - Adopted by Risk Oversight Committee
  - Tariff requires rate to be at current Cost of Service
- **Reduce Regulatory Charge by \$19 million**
  - Levelize cost based on forecast
  - Subsequent years increase is expected to be less than 2015 increase



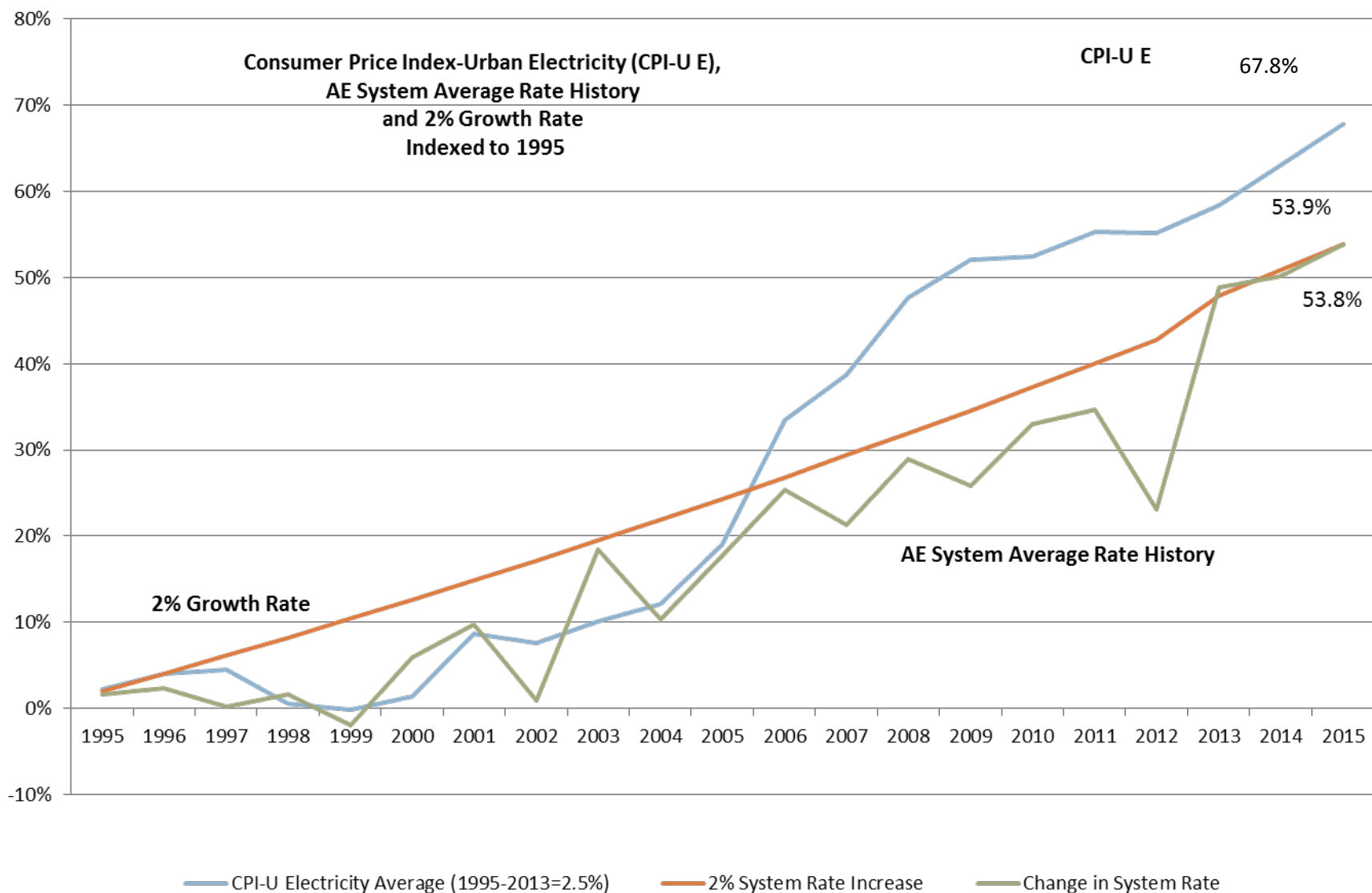
# Affordability Goal



Affordability Goal impacted by inverse relationship between Volumetric kWh and Fixed Revenue



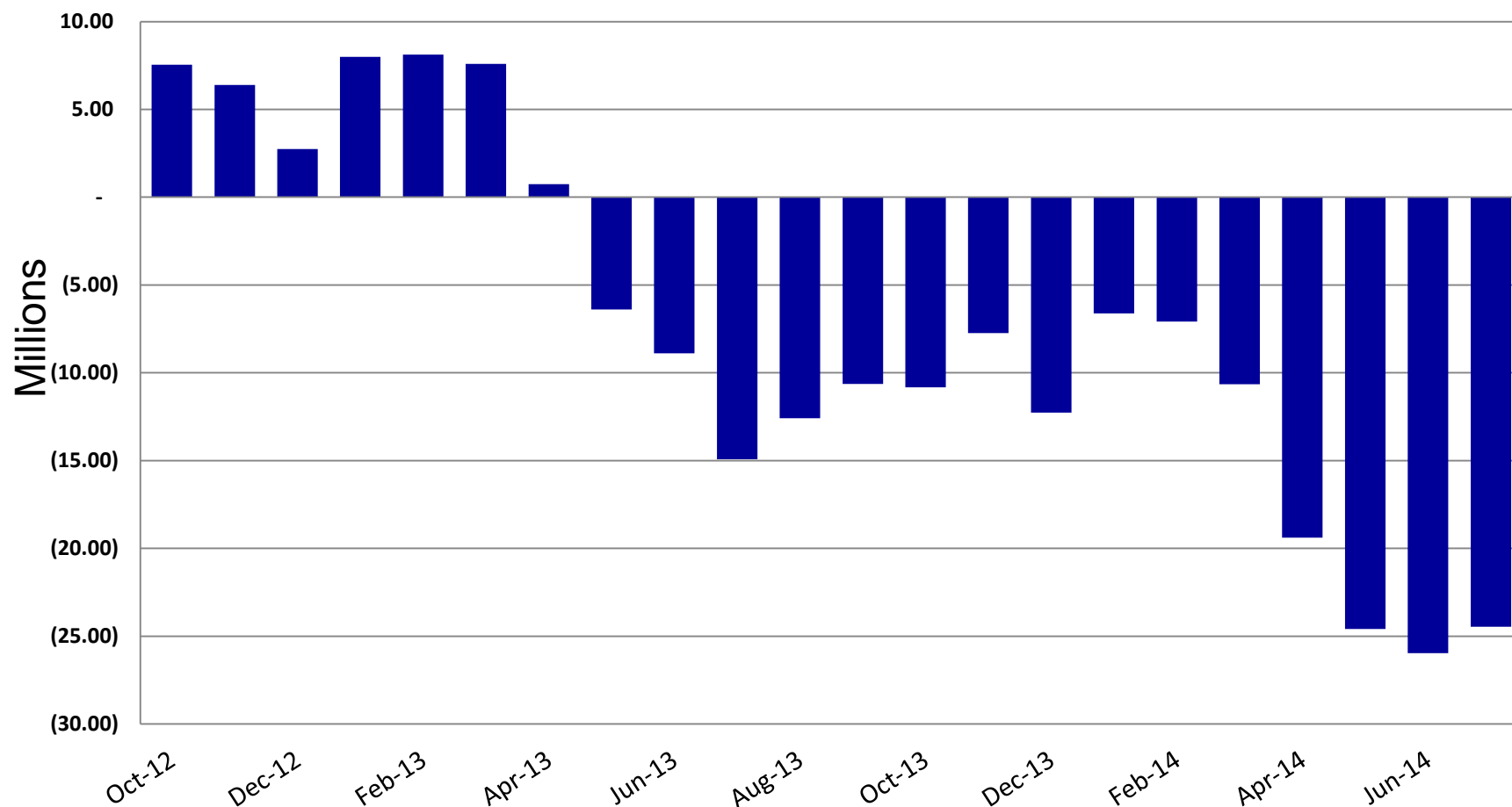
# Affordability Goal





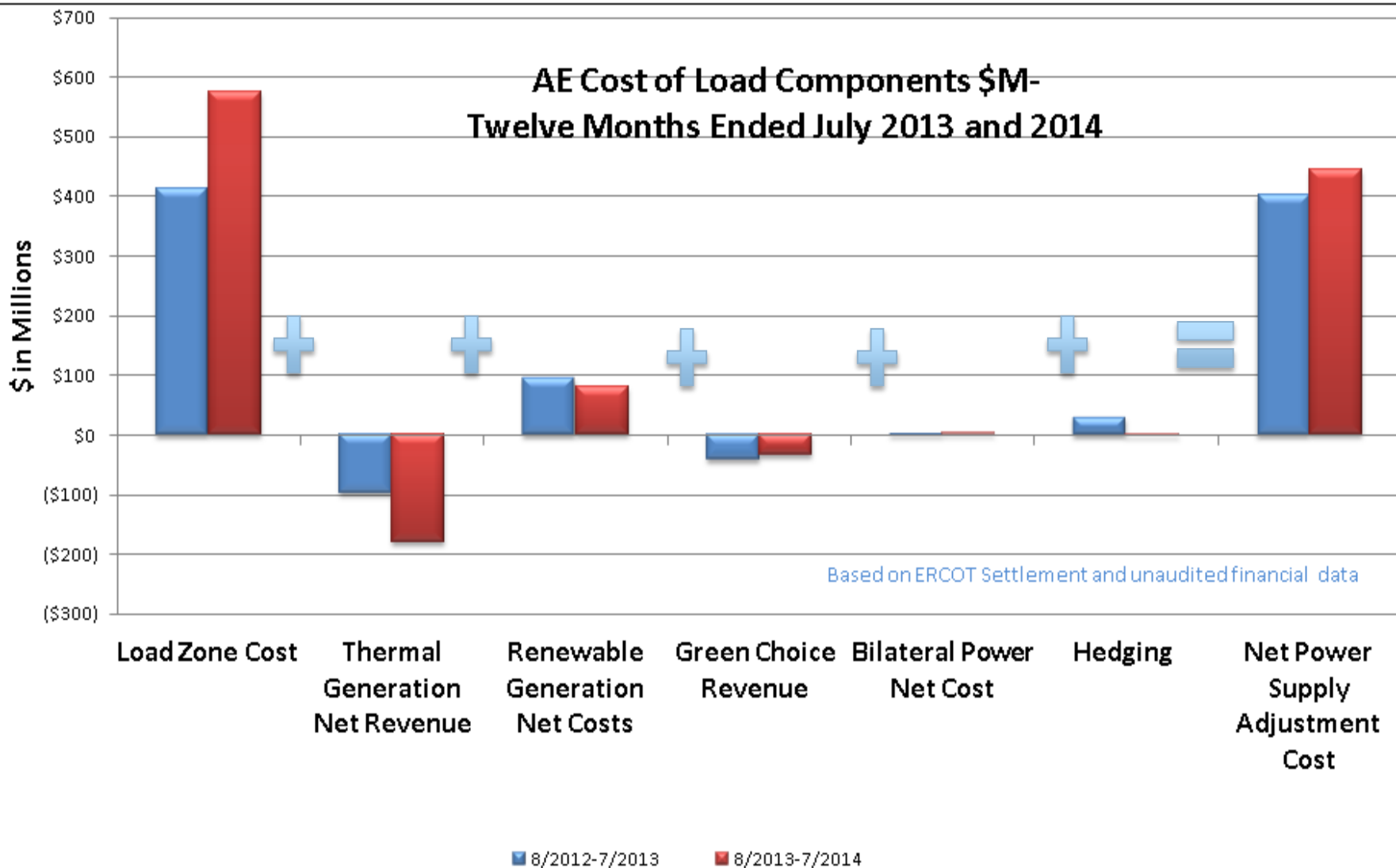
# Cumulative Power Supply Cost Current Under Recovery

## PSA Over/(Under) Recovery Inception to Date





# PSA COST COMPONENTS





# Power Supply Adjustment Formula

**Under Recovery + ((Historical \$/Historical kWh) x Normalized kWh Forecast for PSA)**  
**\$24+(((\$434/11,869) x (12,935 x 70%))**



**Normalized kWh Forecast for PSA**  
**(12,935x 70%)**

\$ in millions &  
GWh units

1. Over/Under (O/U) recovery from the latest closed month
  - Includes actual O/U as of 7/31/2014
2. Use latest available rolling 12 months as the historical period
  - Historical 12 rolling months (Aug 2013 – July 2014)\*
3. Normalized load forecast (kWh) period is 11/1/2014 - 10/31/2015

*\* Historical numbers may be adjusted for known and measurable changes*



# Power Supply Adjustment Rates

July 31, 2014  
Basis

System Average

Secondary Voltage

Primary Voltage

Transmission  
Voltage

Current Rate  
(cents/kWh)

3.691

3.709

3.625

3.579

Projected Rate  
Effective Nov. 1,  
2014 (cents/kWh)

3.926

3.945

3.856

3.807



# Average Residential Customer Bill Impact

## Average Residential Customer Bill Impact

Unbundled 5-Tier Inclining Block Energy Rate (Inside City of Austin Customer)

Average Monthly Bill	Energy kWh	FY 2014 Rate		FY 2015 Initially Recommended April 2014 Basis	\$ Change	% Change		FY 2015 Affordability Proposed July 2014 Basis	\$ Change	% Change
Customer Charge	Flat Fee	\$10.00		\$10.00	None	None		\$10.00	None	None
Base Electricity Charge	1,000	\$ 43.50		\$ 43.50	None	None		\$ 43.50	None	None
Power Supply Adjustment (PSA)*	1,000	\$ 37.09		\$ 39.43	\$ 2.34	6.3%		\$ 39.45	\$ 2.36	6.36%
Community Benefit Charge (CBC)	1,000	\$ 6.65		\$ 6.65	\$ 0.00	0.0%		\$ 6.65	\$ 0.00	0.0%
Regulatory Charge	1,000	\$ 7.94		\$ 10.27	\$ 2.23	29.3%		\$ 8.30	\$ 0.36	4.5%
<b>Total Monthly Bill</b>	<b>1,000</b>	<b>\$105.18</b>		<b>\$109.85</b>	<b>\$ 4.57</b>	<b>4.3%</b>		<b>\$107.90</b>	<b>\$ 2.72</b>	<b>2.6%</b>

<b>System Average Rate</b>	<b>Affordability Results</b> (increase to overall revenue)	<b>3.4%</b>	<b>Affordability Results</b> (increase to overall revenue)	<b>1.9%</b>
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# GreenChoice® Reduction

**GreenChoice Reduced from 1 cent to .75 cent above PSA**



**Reduction Effective January 2015**



**New Patron Fixed Rate Customer Reduction**



# Proposed Changes to the Patron Offering

- Patron Customer – Commercial customer using 1.2 million kWh annually
- Increase contract length from 3 to 5 years
- Patron offering - 4.4¢ vs. current 4.9¢
  - Based on same analytical process used for previous offer



# GreenChoice® Commercial Offerings

## January 1, 2015

<u>GreenChoice Products</u>	<u>BusinessCents</u>	<u>Energizer</u>	<u>Patron</u>
GreenChoice charge PSA charge	PSA plus 3/4¢  <b>4.696¢ / kWh</b> adjusted upon change in PSA	PSA plus 3/4¢  Same as BusinessCents; adjust with new contract	<b>4.4¢ / kWh fixed rate until December 2020</b>
Eligibility	Commercial account in good standing not subscribed to GC B4, B5, B6.14 or B6.21	Same as BusinessCents	Commercial 1.2 M kWh annually or greater on one or a combination of accounts not subscribed to GC B4, B5, B6.14 or B6.21
Minimum Subscription	100% of account kWh	Same as BusinessCents	Minimum of 100,000 kWh blocks monthly on each account
Contracts	No contract required  (Letter of Acceptance to confirm billing in January 2014)	•12-month contract  Allows qualification for* <b>EPA Green Power Partner Program</b> • <b>AEGB ratings</b> • <b>City of Austin's Green Business Leaders</b> • <b>LEED credits</b>	•5-year contract  Same as Energizer
Commitment	No penalty for unsubscribing; may re- subscribe January 1 of following year	12-month commitment May continue on a month-to- month basis	Existing Committed until December 2016 <b>New – until Dec. 2020</b> May re-subscribe to new product after term expiration



# CASH RESERVES





# Reserves = Liquidity

- **Rating agencies are focused on Reserves and Days Cash on Hand as a mitigating factor for increased risk**

## Examples of Unplanned Events:

- fuel price volatility, counterparty risk
- major generation disruptions
- water curtailment
- extensive infrastructure improvements
- technology improvements
- significant environmental legislation that increase costs but not output
- expenditures in response to natural disasters and weather events
- replacement power
- market price volatility and ERCOT market caps
- financial crisis similar to 2008

*Key Indicator*

*Liquidity is key to Credit Quality*



# Reserves Mitigate Risk

Austin Energy operates in a high risk environment

- Utilities owning generation have a higher risk profile
- 70% of AE's cost of service is generation related

- Market Risks
  - AE competes every day with fortune 500 companies
  - Subject to ERCOT market risk 24/7
- Regulatory and legislative risks are increasing
- Traditional risks of the utility industry associated with storms and outages
- New risks of technology and cyber security.

***In ERCOT's risky market, liquidity is critical***



# Necessity of Adequate Reserves

*Since utilities have an obligation to serve, they cannot sit out adverse market conditions and wait for a more favorable economic environment. They have to have the flexibility to serve under any condition.*

## **Cash Reserves provide flexibility and mitigate risk**

- Utilities are both capital intensive and have an obligation to serve, so it is important that they have highly rated debt
- Higher ratings allow utilities to finance at lower rates which reduces customer cost



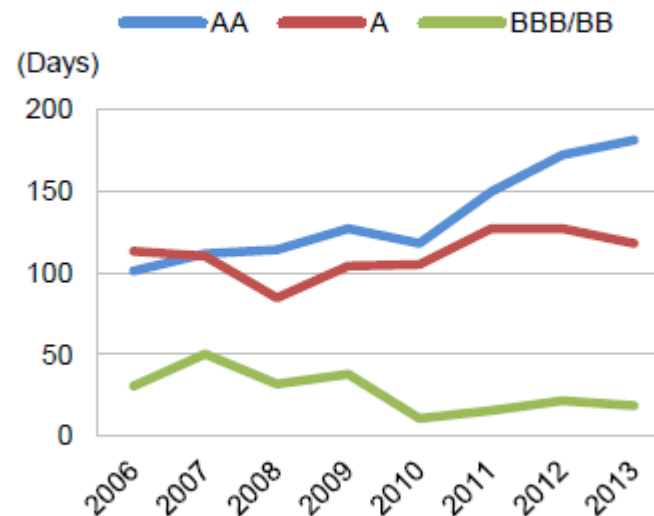
# Rating Agency Liquidity Criteria

Utilities that maintain adequate cash balances to deal with the opportunities and challenges posed by a restructuring industry maintain important flexibility.

[WWW.STANDARDANDPOORS.COM/RATINGSDIRECT](http://WWW.STANDARDANDPOORS.COM/RATINGSDIRECT)

## Days Cash on Hand

Indicates financial flexibility, specifically cash and cash equivalents, relative to expenses.



Source: Fitch Ratings.

## MOODY'S INVESTORS SERVICE

EXHIBIT 7

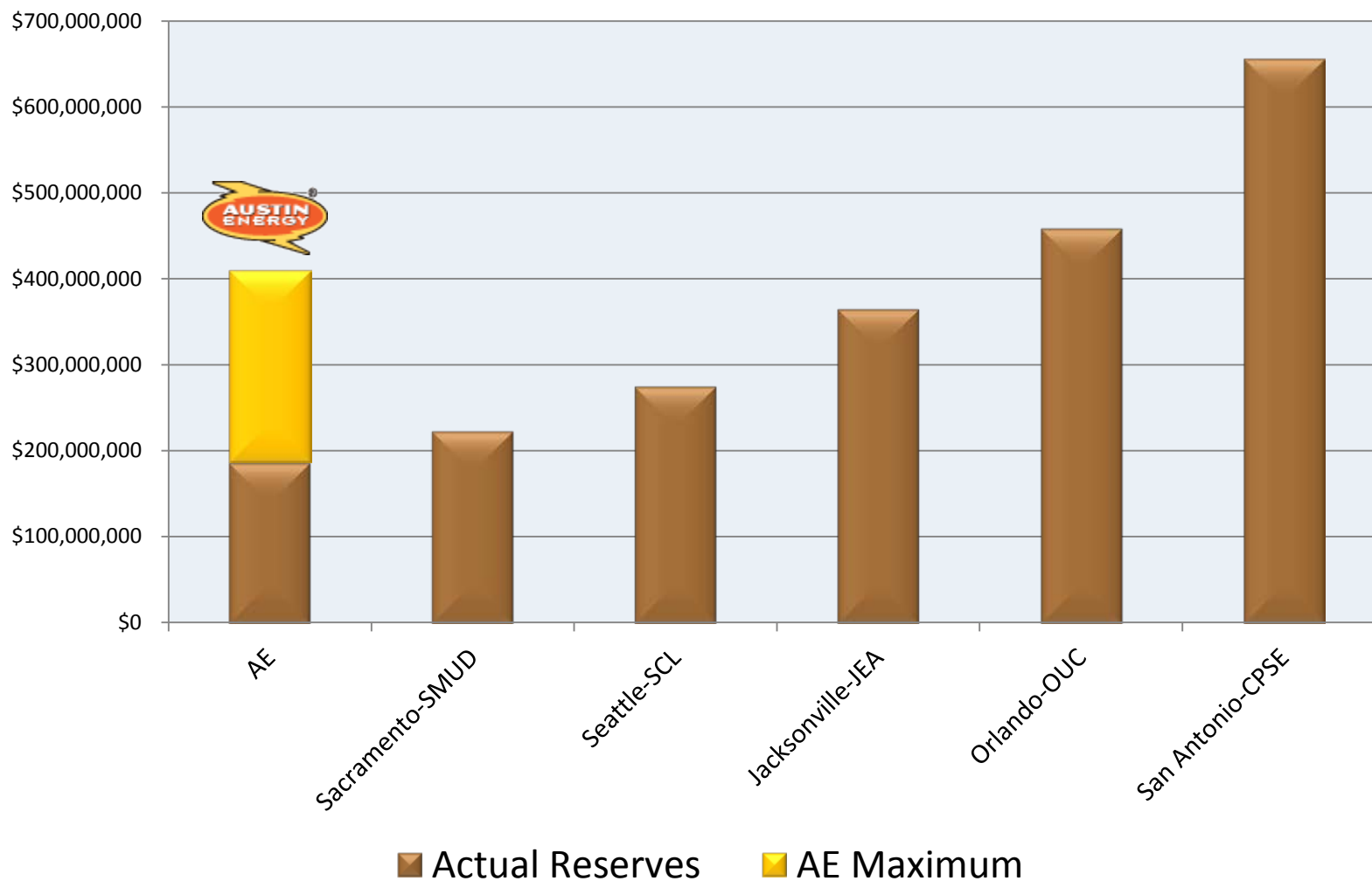
Financial Strength (35%)

Days Cash on Hand (12.5%)

Aaa	Aa	A	Baa	Ba	B and Below
> 250 Days	250 Days ≥ n > 150 Days	150 Days ≥ n > 35 Days	35 Days ≥ n > 15 Days	15 Days ≥ n > 7 Days	≤ 7 Days



# 2012 Cash/Reserve Comparison





# Current State - Cash Reserves

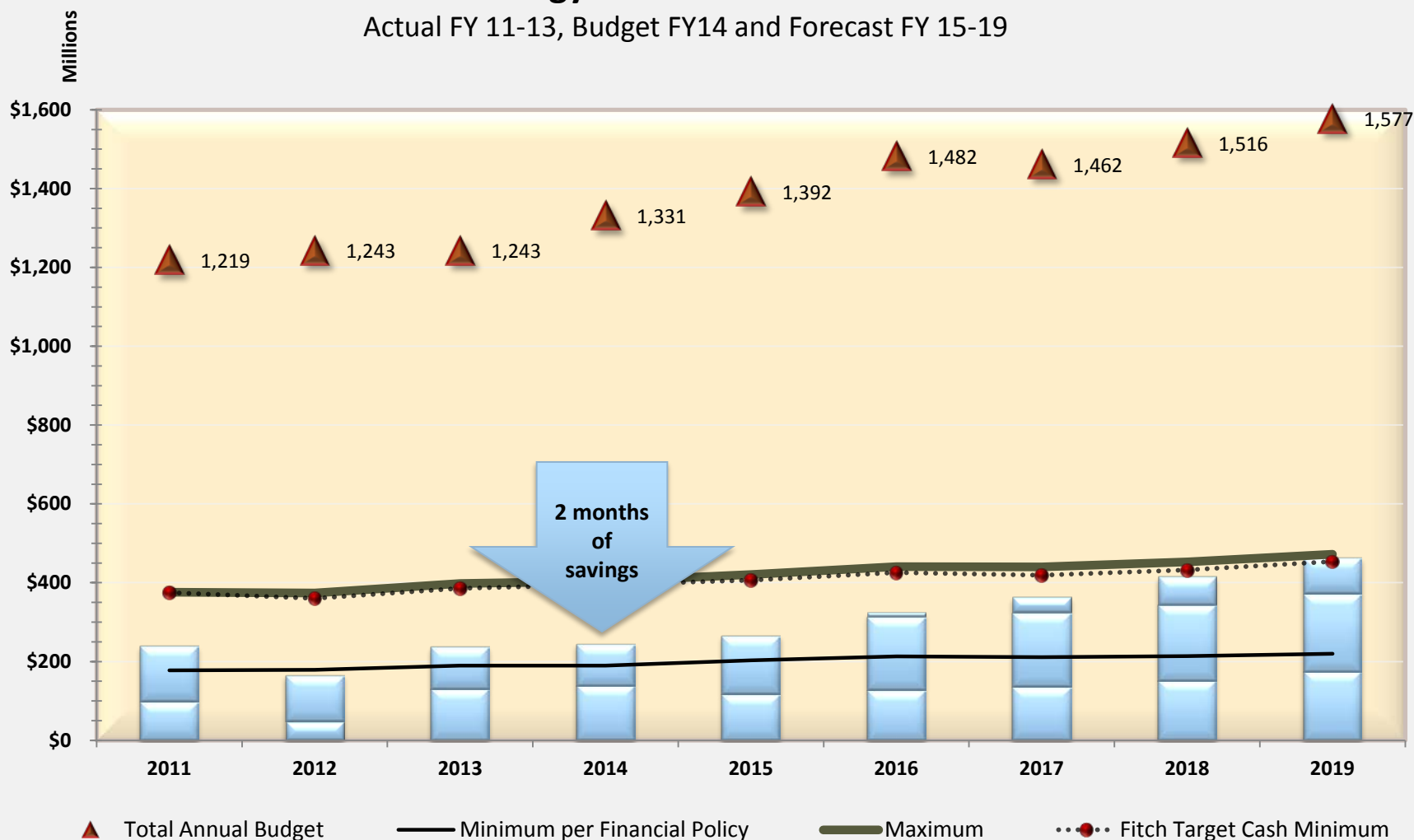
* In compliance		\$ in Millions		
Reserve Name (in order of funding)	Basis for Level of Funding	June 2014	After 2014 Transfer	Minimum Maximum
*Working Capital (Operating Cash)	Minimum requirement - 45 days of O&M less fuel & purchased power	\$ 102	\$ 72	\$ 60 min
*Strategic Reserve-Emergency	Minimum requirement -60 days of O&M less fuel & purchased power	80	80	80 min
Strategic Reserve-Contingency	Minimum requirement- 60 days of O&M less fuel & purchased power	27	57	80 min
Repair and Replacement	Maximum balance-1/2 of annual depreciation expense	0	0	75 max
Strategic Reserve-Rate Stabilization	Maximum balance-90 days of power supply costs	0	0	118 max
Non-Nuclear Decommissioning Reserve	Funding set aside over a minimum of 4 years prior to plant closure	0	0	56 min
Total Cash and Reserves		\$ 209	\$ 209	\$ 469
Days of Cash on Hand (DCOH)	Rating criteria minimum is 150 DCOH	54	54	122



# Future State - Cash and Reserves

## Austin Energy Cash & Reserves Forecast

Actual FY 11-13, Budget FY14 and Forecast FY 15-19





# Financial Policy Boundaries

## Reserves-Current Order of Funding

for Non-Typical Events

**Operating Cash**

**Strategic Reserve-Emergency**

**Strategic Reserve-Contingency**

**Repair & Replacement**

**Strategic Reserve-Rate  
Stabilization**

## Reserves-**Alternative** Order of Funding

for Non-Typical Events

**Operating Cash**

**Strategic Reserve-Emergency**

**Strategic Reserve-Rate  
Stabilization**

**Strategic Reserve-Contingency**

**Repair & Replacement**



# Alternative - Financial Policy Boundaries

## Reserves

for Non-Typical Events

Operating Cash

Strategic Reserve:

Emergency

Rate Stabilization

Contingency

Repair & Replacement Reserve

## Maximum

for Non-Typical Events

*Min-45 days of O&M less Fuel*

Strategic Reserve:

*Min/Max-60 days of O&M less Fuel*

*Min-60 days of Power Supply Cost &  
Max-90 days of Power Supply Cost*

*Max-60 days of O&M less Fuel*

*½ of Annual Depreciation*



# Liquidity = Reserves

*For AE, reserves provide flexibility and mitigate risk.  
For the customer, reserves provide rate stabilization.*

**AE expects to:**

- 1. Rebuild reserves over a 5 year period**
- 2. Plan and prioritize use of reserves**
- 3. Balance ratios with adequate reserves to maintain Credit Rating**



# QUESTIONS?



# *Appendices*



## Rating Agency Comments – 2012 Bond Issue

*Rating Agency ratings and comments are “forward” looking*

S&P: Upgrade to AA-/Stable. Excerpts from rating review:

- Comments on general creditworthiness:
  - Competitive rates, even with the recent rate increase adopted in fiscal 2013, and a rate structure that also includes a **separate cost-recovery component that allows Austin Energy to true-up for fuel costs or purchased-power costs;**
  - **Strong liquidity, including designated cash reserves that the city codified through a comprehensive risk-management plan**



# Rating Agency Comments – 2012 Bond Issue

*Rating Agency ratings and comments are “forward” looking.*

Fitch: AA-/Stable. Excerpts from ratings review:

- WHAT COULD TRIGGER A RATING ACTION
  - INSUFFICIENT RATE SUPPORT: Any meaningful reluctance on the part of AE and its governing bodies **to promote and approve rate increases necessary to achieve the utility's financial plan would result in downward pressure on the rating or Outlook.**
- CREDIT PROFILE
  - Financial metrics stabilized somewhat in fiscal 2011 as energy sales grew by a favorable 6% over the prior year. DSC improved to 1.9x as a result, although **liquidity remained low with just 83 days cash on hand (DCOH).** General fund transfers have averaged 8.4% of total operating revenues over the prior three years with little deviation. The transfers are limited to 12% of AE's non-fuel revenue with a \$105 million minimum transfer amount required each year.



# Rating Agency Comments – 2012 Bond Issue

*Rating Agency ratings and comments are “forward” looking.*

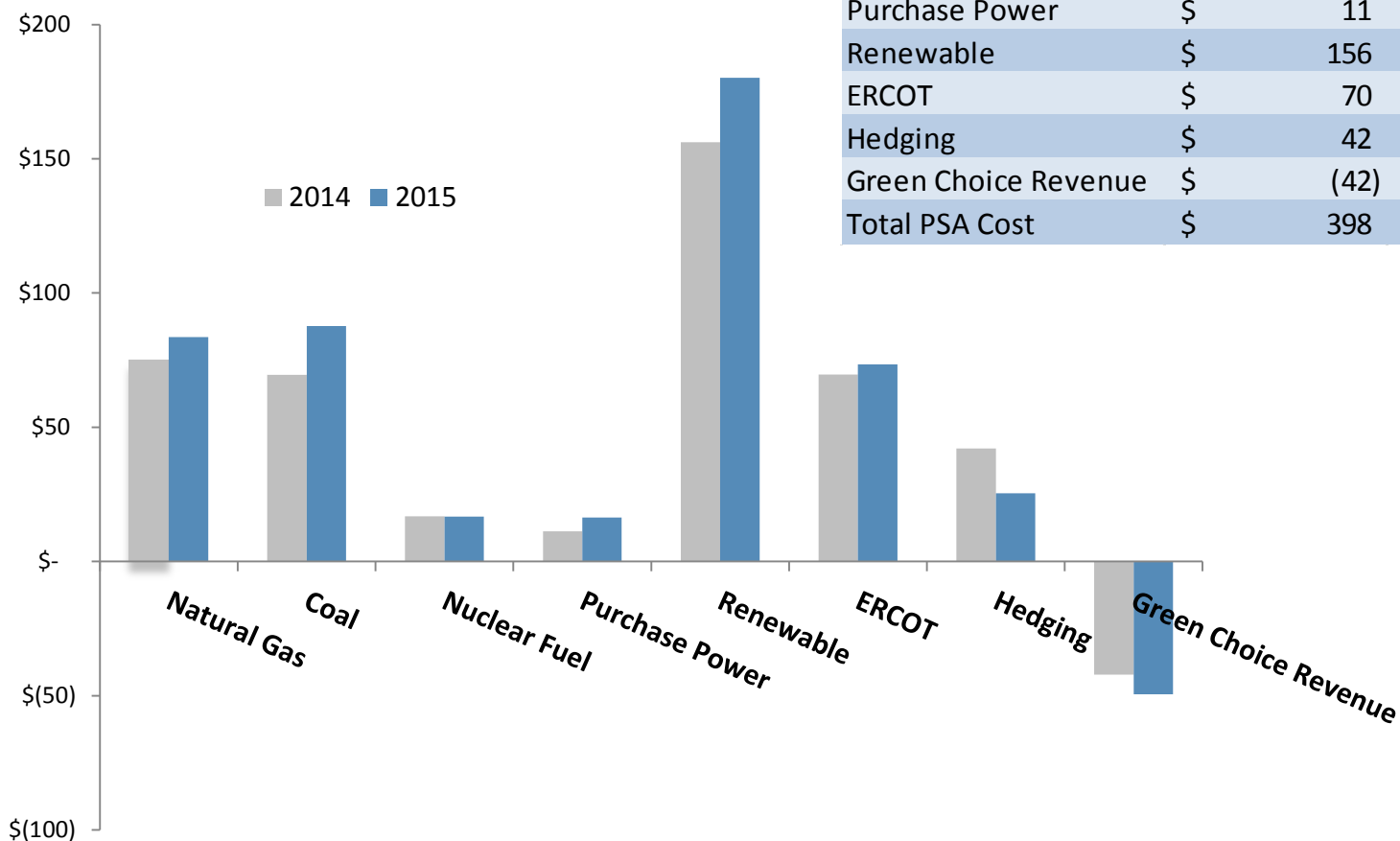
Moodys: A1/Stable. Excerpts from ratings review:

- SUMMARY RATING RATIONALE
  - The electric base rate increase **and other periodic rate adjustment mechanisms approved by the City Council as part of the recent rate decision are expected to provide a good opportunity for Austin Energy to restore its key financial metrics to historically stronger levels in support of the A1 rating.**
- What Could Change the Rating-UP:
  - The rating could be upgraded if prospective financial performance exceeds our current expectations, **including achieving adjusted days liquidity on hand near 150 days and adjusted debt service coverage of at least 2.0 times on a sustainable basis.** Successful implementation of the generation supply strategy while avoiding any significant increase in the currently sound debt ratio would also be credit positive.
- What Could Change the Rating-DOWN:
  - **Failure to implement rate increases in a timely manner would be credit negative. Adjusted debt service coverage below 1.5 times or adjusted days liquidity on hand of less than 100 days for an extended period could lead to a downgrade**



# PSA COST COMPARISON

\$ in millions



(\$ in millions)	2014		2015	
Natural Gas	\$	75	\$	84
Coal	\$	69	\$	88
Nuclear Fuel	\$	17	\$	17
Purchase Power	\$	11	\$	16
Renewable	\$	156	\$	180
ERCOT	\$	70	\$	73
Hedging	\$	42	\$	25
Green Choice Revenue	\$	(42)	\$	(50)
Total PSA Cost	\$	398	\$	434