2023 Power Supply Adjustment Discussion

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September 27, 2022

2023 Power Supply Adjustment Discussion

Agenda for Discussion

- Overview of the Power Supply Adjustment (PSA)
- Primary Factors for the PSA Increase
- Calculation of the 2023 PSA Rate and Impacts
- City Council Options and Potential Impacts

2023 Power Supply Adjustment Discussion

Overview of the Power Supply Adjustment

Power Supply Adjustment Tariff

City Council Ordinance Establishes the Methodology and Requirements for the PSA Rate

Application:
Applies to all electric service whose point of delivery is located within the limits of Austin Energy's service territory, unless otherwise stated. The rates for this pass-through charge are effective November 1.

Character of Service: The Power Supply Adjustment (PSA) provides for the recovery of the preceding year's expenditures for (PSA Costs):

ERCOT Settlements – charges and credits from ERCOT, other than the Administrative Fees.

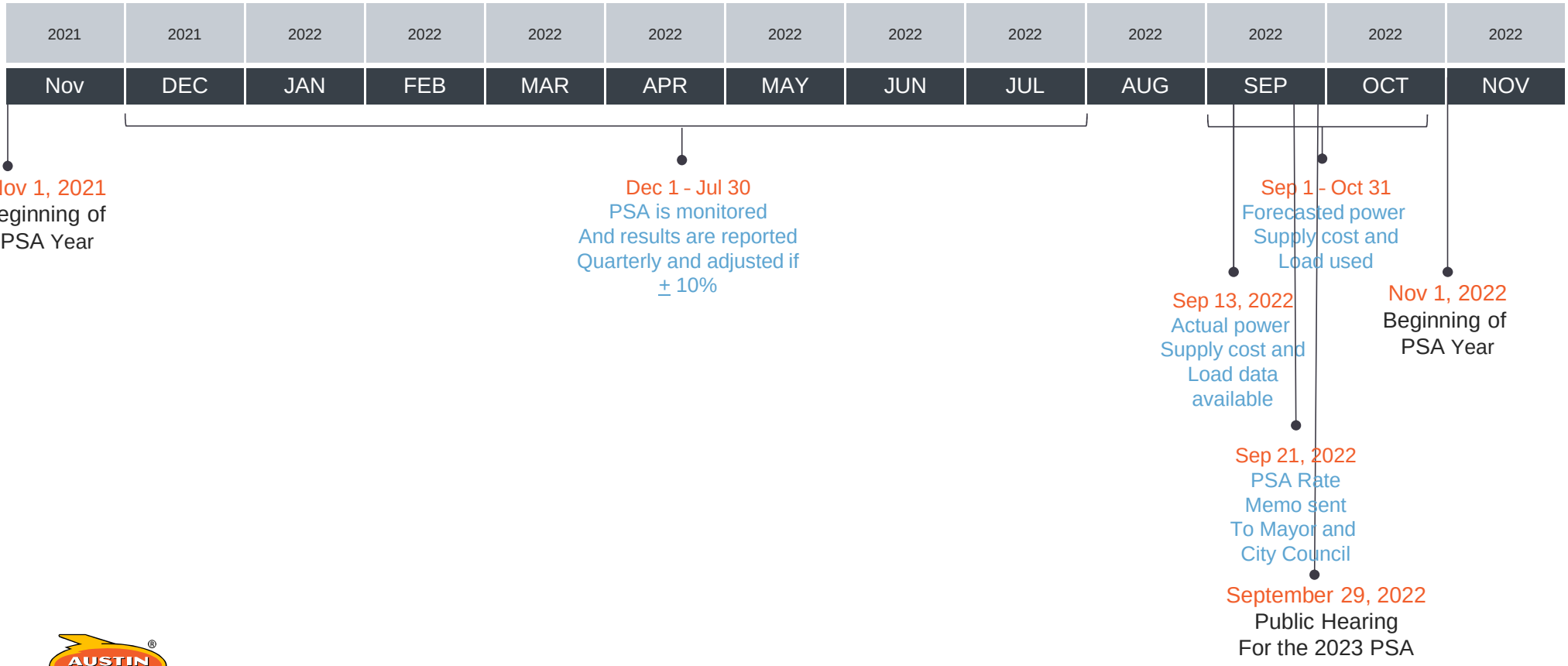
Fuel Costs – costs for fuel, fuel transportation, and hedging gains and losses.

Net Purchased Power Agreement Costs – costs and offsetting revenues (such as, bilateral sales and GreenChoice) associated with short- and long-term purchased power agreements, and costs for distributed generation production.

As part of the City of Austin's annual budgeting process, which includes a public hearing, the PSA is determined by calculating the sum of all net power supply costs divided by the historical twelve-month period service territory sales, plus any existing over- or under-recovery of PSA Costs balance divided by projected service territory sales preceding the effective date of the PSA. This results in an annual uniform system rate per kWh that is adjusted for voltage level and applied to each of the customer classes. At least once each year, the City Manager will publicly present a report to the City Council that provides the underlying calculations for the PSA by system voltage level. The PSA Cost calculation will break out Fuel Costs, ERCOT Settlements, and Net Purchased Power Agreement Costs; it will also show the extent of over- or under-recovery of PSA Costs for the previous twelve months.

From the effective date of the last PSA adjustment, the PSA may be adjusted to eliminate any over- or under-recovery if the balance of net PSA Costs recovered is either over or under 10 percent of the actual PSA Costs incurred during such period. If such over- or under-recovery is projected to remain either over or under 10 percent after 12 months from the effective date of the last PSA adjustment, then the PSA shall be adjusted to eliminate the amount of the over- or under-recovery balance within the next 12 months. Within 30 days of any adjustment of the PSA to eliminate over- or under-recovery of PSA Costs, the City Manager will publicly present a report to the City Council that provides the underlying calculations for the PSA, both pre- and post-adjustment by system voltage level.

Power Supply Adjustment Timeline



2023 Power Supply Adjustment Discussion

Primary Factors for the PSA Increase

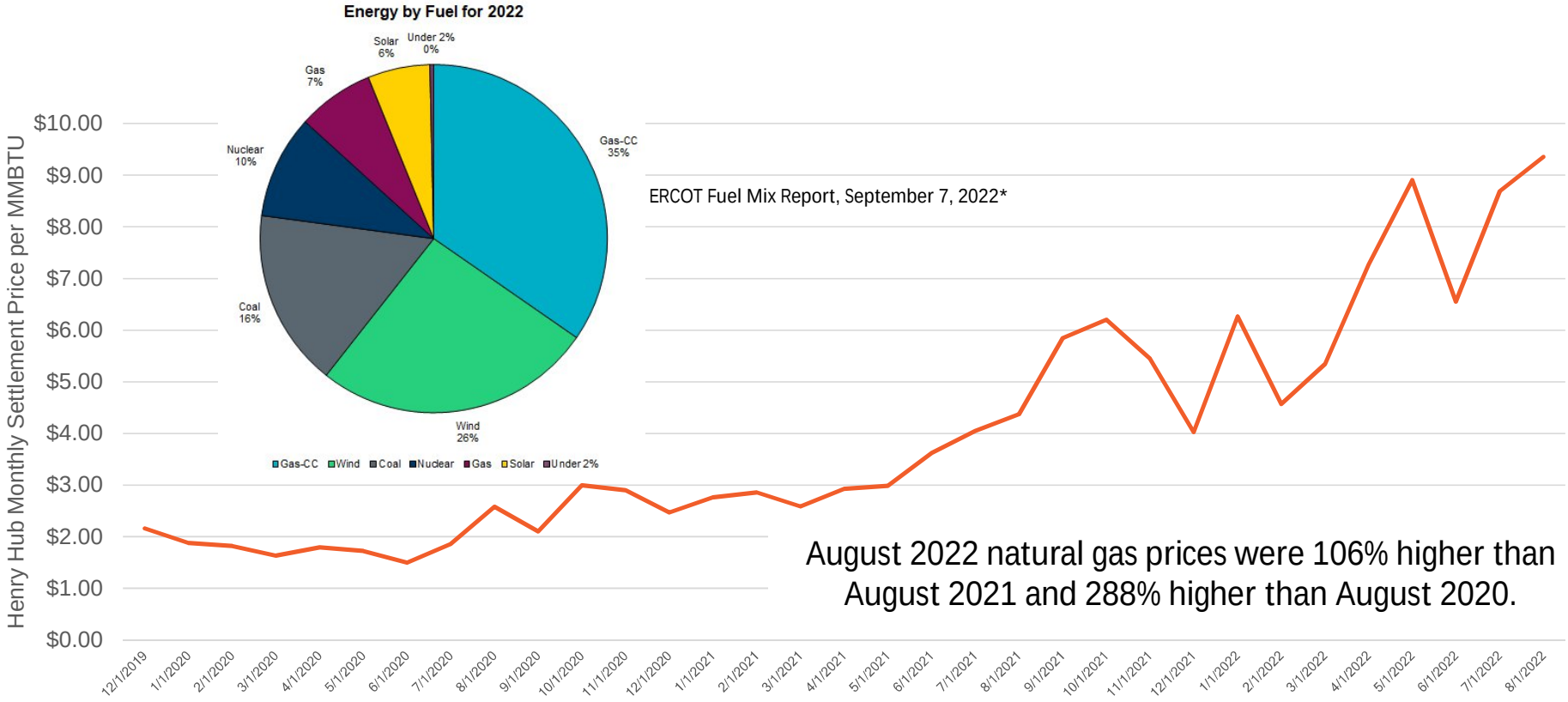
Primary Factors for the 2023 PSA Increase

Summary from the September 21, 2022, Memorandum to Mayor and City Council

- Natural gas prices for electricity production were higher this fiscal year than in any previous fiscal year since 2008. August prices this year were 106% higher than last year and 288% higher than August of 2020.
- Transmission congestion costs were higher than any previous year throughout the ERCOT system. Higher transmission congestion costs are in addition to the cost to produce energy which leads to higher costs of providing electricity to local customers.
- ERCOT has become more conservative in its operations because of Winter Storm Uri. This is leading to increased costs throughout the system. The ERCOT Independent Market Monitor estimates these costs have amounted to over $1.5 billion for the first two-thirds of fiscal year 2022.
- Last fiscal year, Council set the PSA at a level below ongoing costs to reflect the revenues earned by our generation fleet during Winter Storm Uri. That revenue return has been accomplished.

Primary Factor: Cost of Natural Gas

The Market Price of Electricity in ERCOT is Tightly Correlated with the Price of Natural Gas



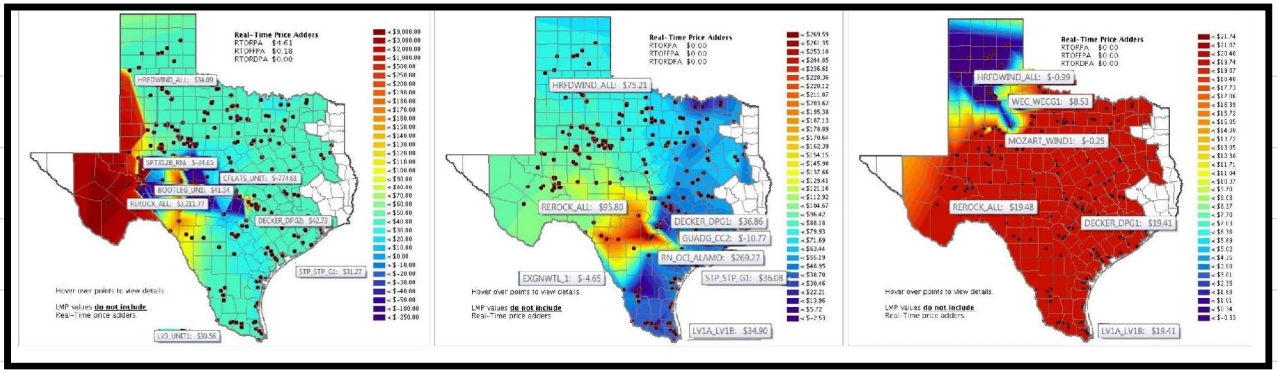
ERCOT Fuel Mix Report, September 7, 2022*

August 2022 natural gas prices were 106% higher than August 2021 and 288% higher than August 2020.

* https://www.ercot.com/gridinfo/generation

Primary Factor: Congestion in ERCOT

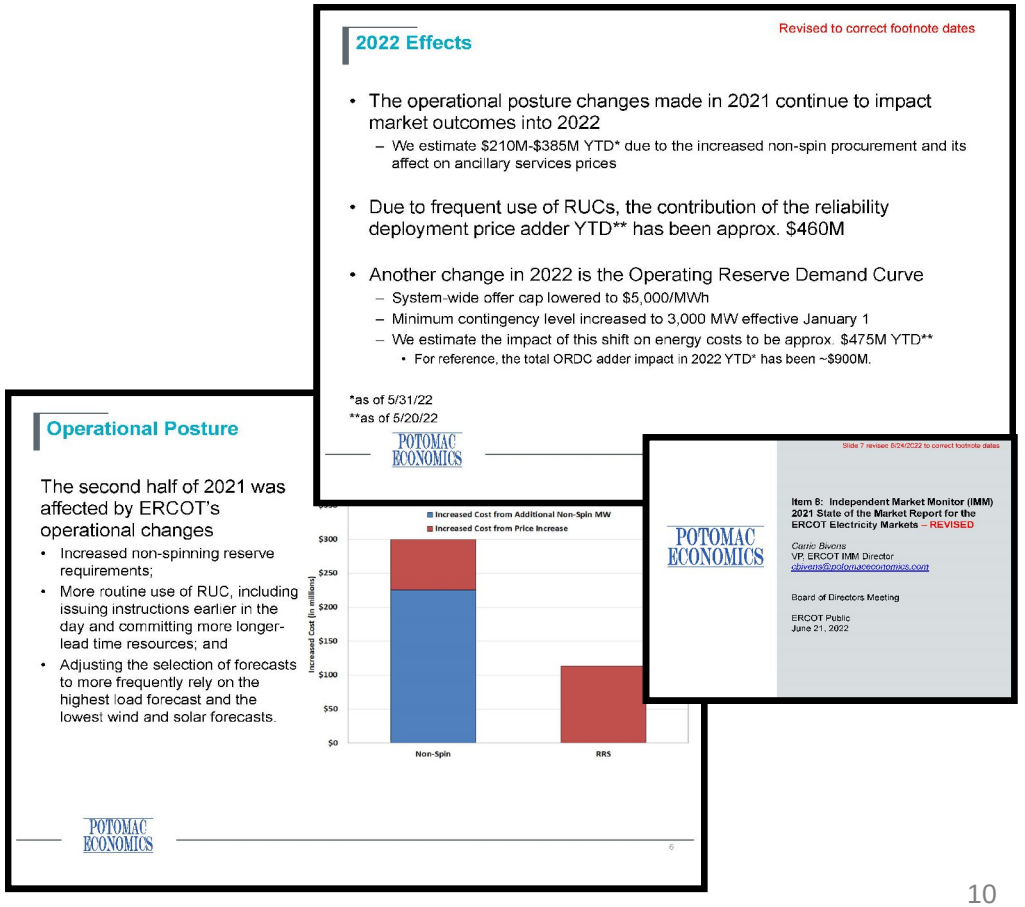
Austin Energy's Net Congestion Costs Since November 1, 2021, are Approximately $128 million, which is Three Times the Normal Amount



Primary Factor: Operational Market Changes

The Operational Posture has Changed Significantly Since the PSA was set in 2021

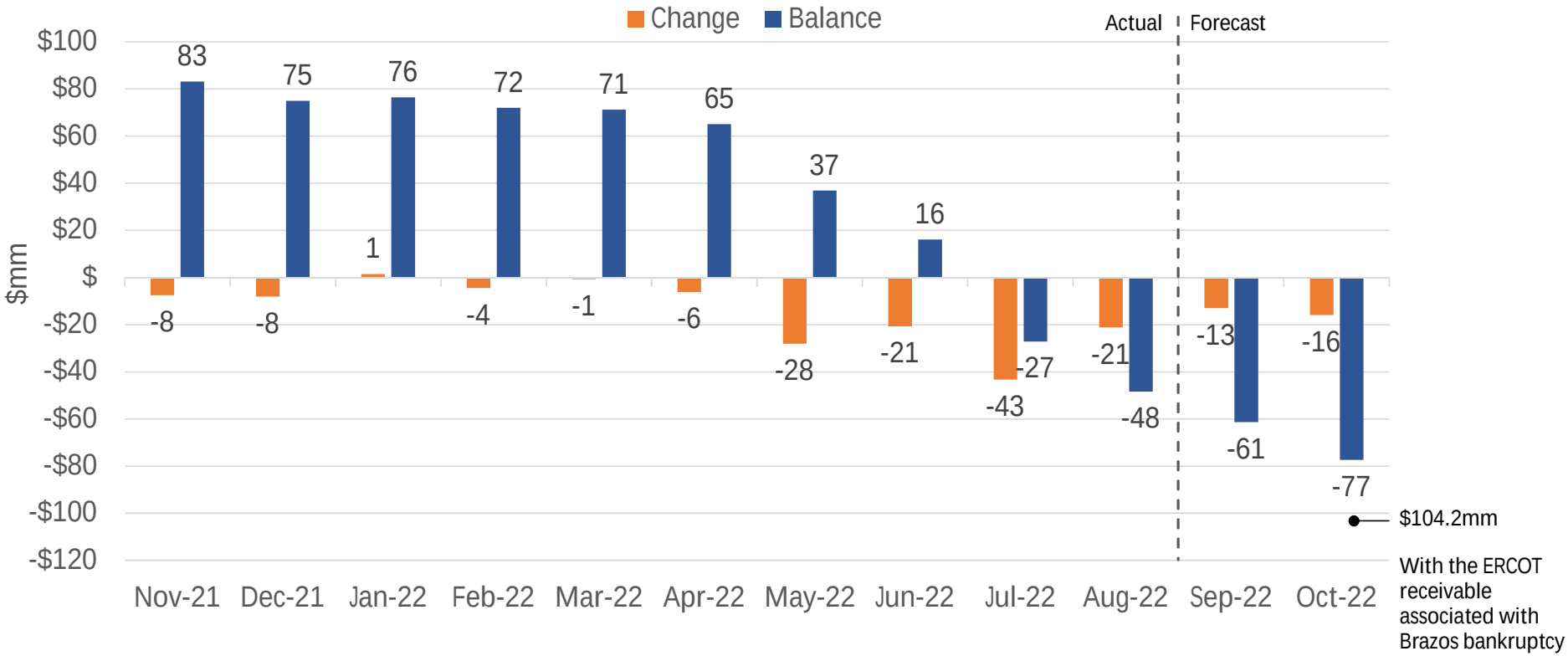
- ERCOT's Independent Market Monitor* has estimated that the costs of operational changes due to Uri have increased by $1.5 billion during the first eight months of 2022
- Austin Energy's share of those costs is approximately $60 million



* https://www.ercot.com/calendar/event?id=1652123528276

Primary Factor: Over/Under Collection of Power Supply Costs

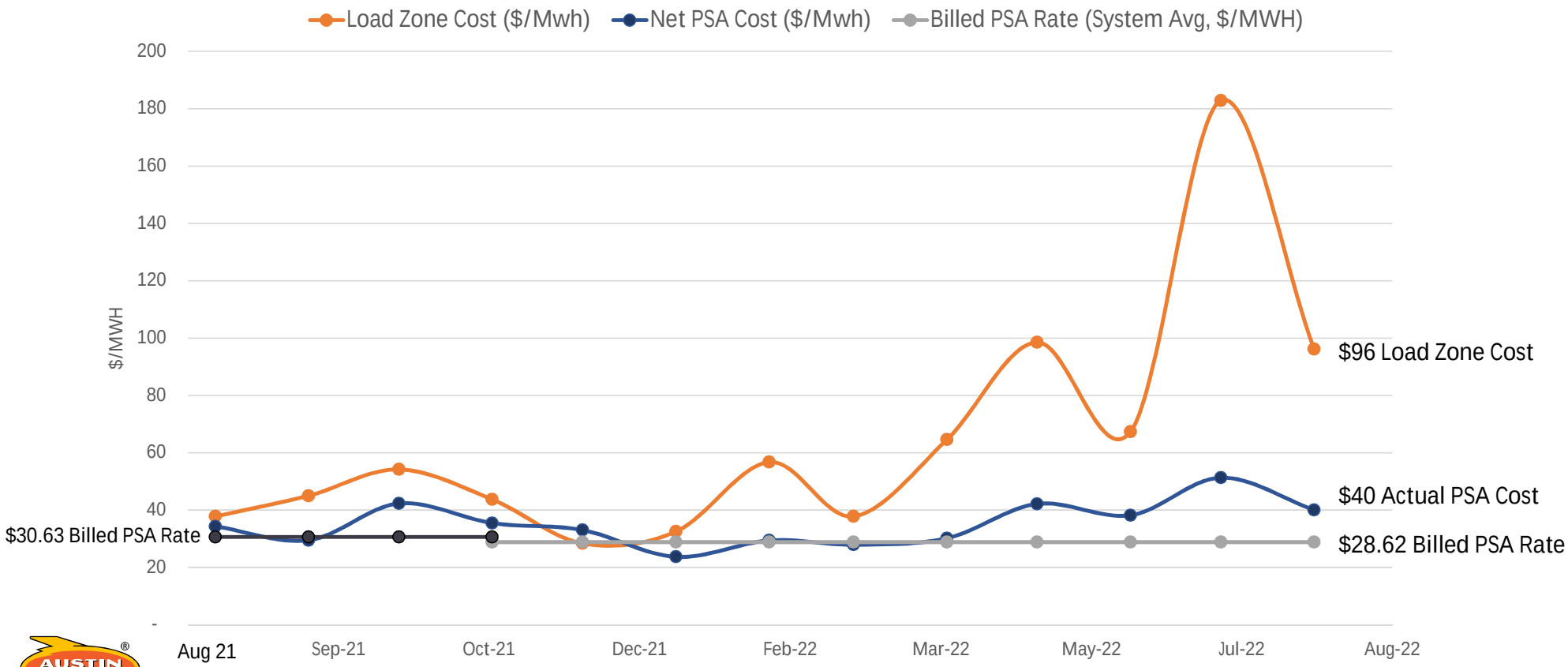
Uri Funds Passed to Retail Customers while May-August was $113 million Under Collected



Disclaimer: Accounting data and ERCOT settlement is subject to change. Default uplifts, resettlement and true-up cycles, and CRR Auction Revenue completion may alter these results.

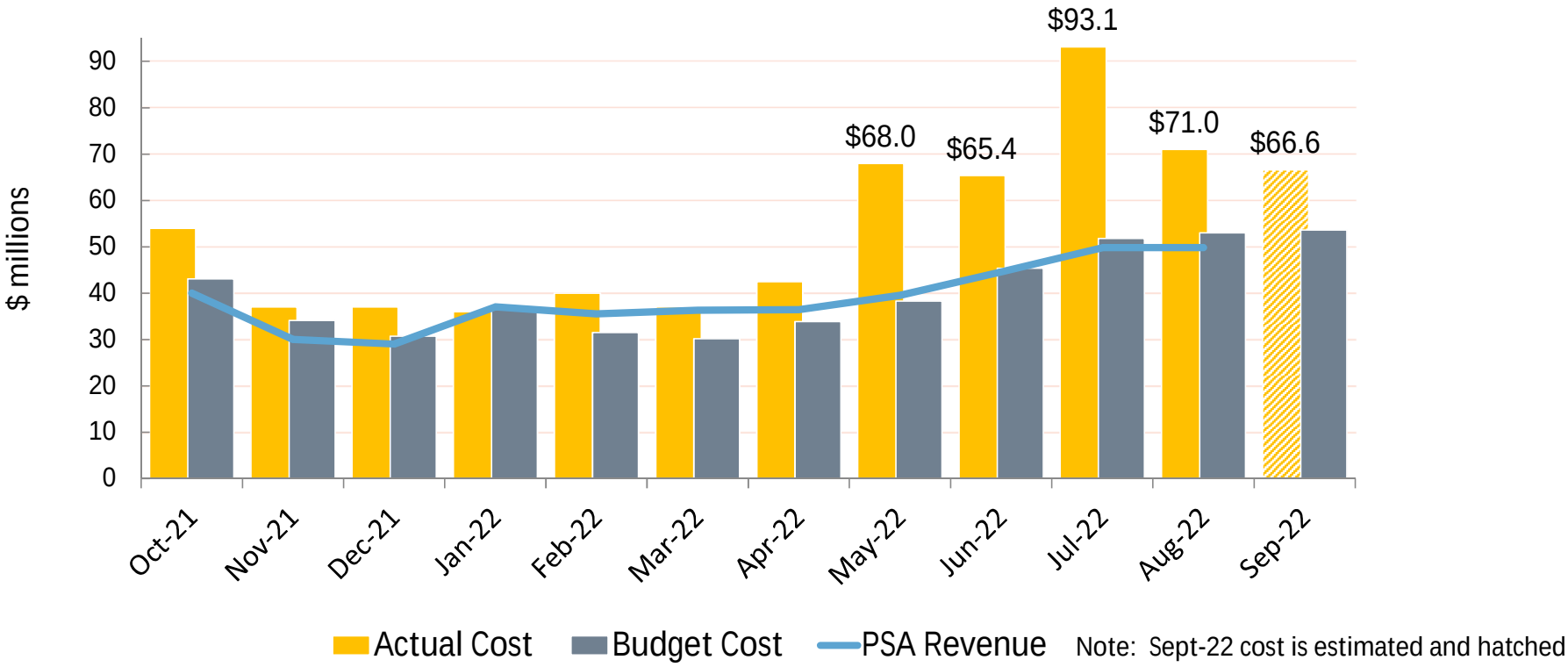
Cost to Purchase Power Increased Significantly After May 2022

Austin Energy Reduced Load Zone Costs with Power Sales to ERCOT and Hedging



Actual to Budget Analysis: Power Supply Adjustment

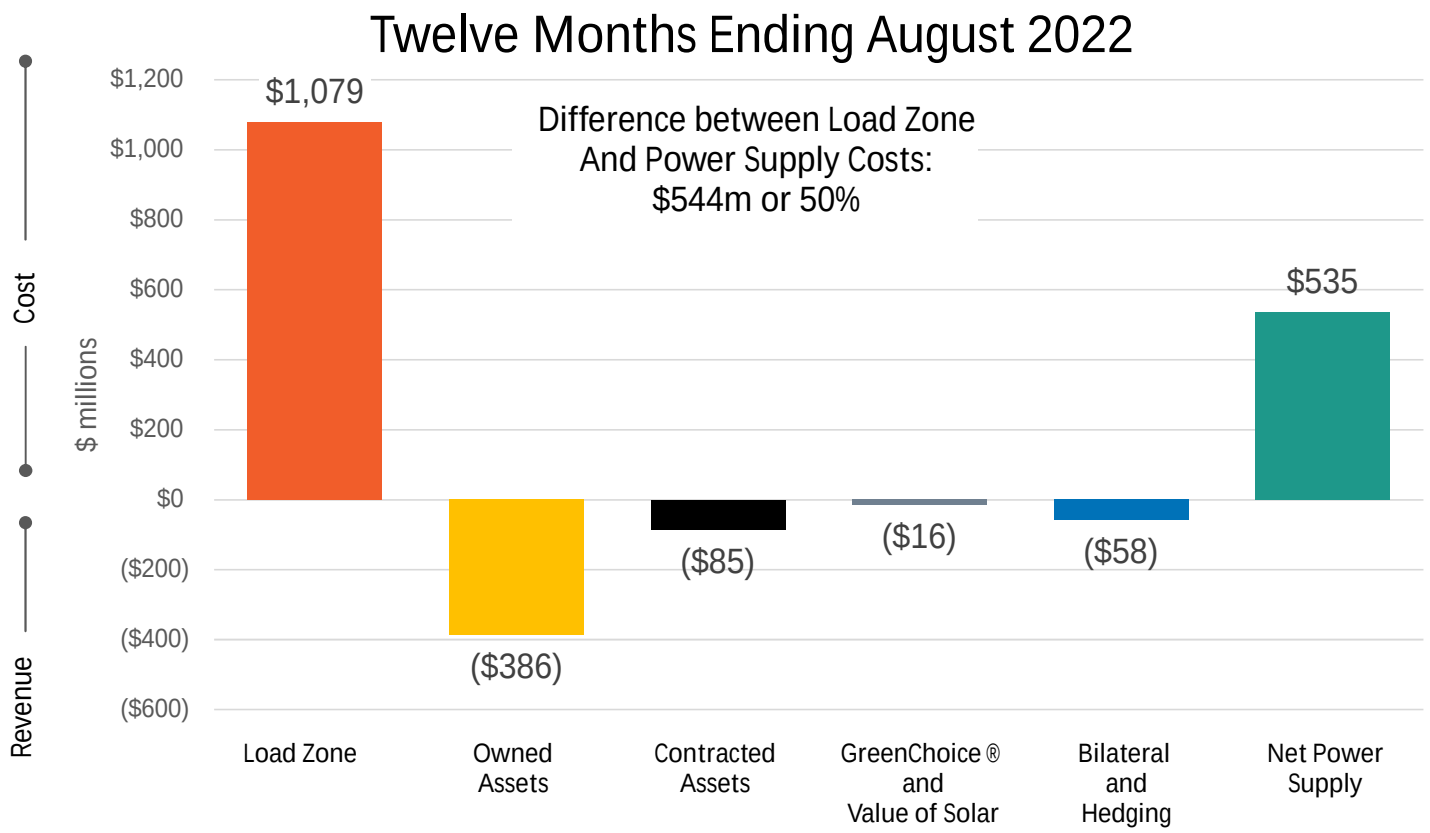
As Presented during 3rd Quarter Financial Update in August 2022 with Updated July & August Results



This information is unaudited and should be read in conjunction with the audited Comprehensive Financial Reports for the City of Austin, when published on http://finance.austintexas.gov/web/controller/annual_comprehensive_financial_report/annual_comprehensive_financial_report_2021.pdf

Power Supply Adjustment Cost Components

As Presented during 3rd Quarter Financial Update in August 2022 with Updated July & August Results



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2023 Power Supply Adjustment Discussion

Calculation of the 2023 PSA Rate and Impacts

Underlying Calculations for the 2023 PSA

Austin Energy utilizes a standard formula to develop the PSA average system rate, as shown below:

$$\left(\frac{\text{(Over) or Under Recovery}}{\text{Normalized GWh Forecast}}\right) + \left(\frac{\text{Historical Costs}}{\text{Historical GWh}}\right)$$

Historical costs and load (GWh or kWh) and the over- or under-recovery amount may be adjusted to reflect known and measurable changes to account for one-time events, abnormal weather, abnormal operating conditions, or other events not reflected or improperly reflected in the historical numbers. The current PSA average system rate, developed in September 2021, utilized adjusted historical costs and an over-recovery balance as of August 31, 2021, a forecast of over- or under-recovery for September 1 through October 31, 2021, and a normalized load forecast for the period of November 1, 2021, through October 31, 2022. The result was an average system rate of 2.862 cents per kWh, calculated as shown below (in millions of dollars and GWh):

$$\left(\frac{-\$51.0\text{M}}{12{,}038\ \text{GWh}}\right) + \left(\frac{\$401.9\text{M}}{12{,}230\ \text{GWh}}\right)$$

The proposed 2023 PSA average system rate utilizes adjusted historical costs as of August 31, 2022, the forecasted under-recovery amount as of October 31, 2022, and a normalized load forecast for the period of November 1, 2022, through October 31, 2023. The result is an average system rate of 4.893 cents per kWh, calculated as shown below (in millions of dollars and GWh):

$$\left(\frac{\$104.2\text{M}}{12{,}548\ \text{GWh}}\right) + \left(\frac{\$535.0\text{M}}{13{,}167\ \text{GWh}}\right)$$

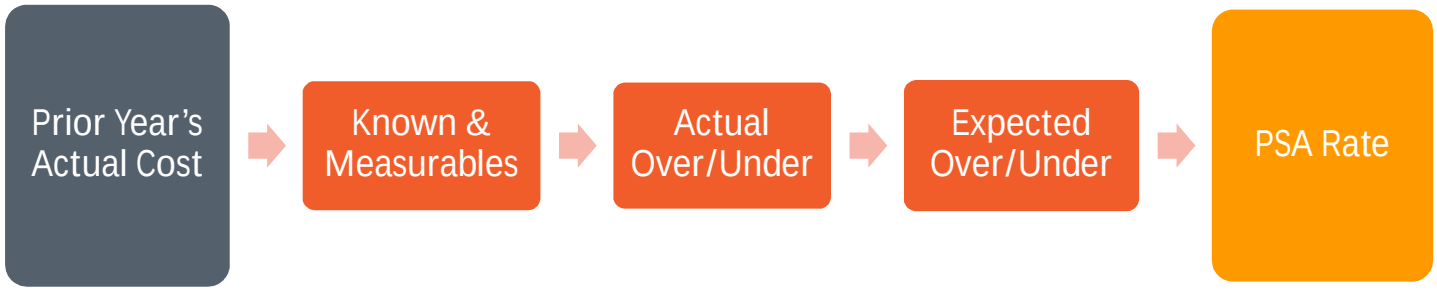
Power Supply Adjustment Components

Costs and Recovery Balances

Millions of $	2022	2023	Change	As a %
Prior Year's Actual Costs	$382.7	$539.3	$156.6	40.0%
Known and Measurables	$19.2	($4.3)	($23.5)	-122.2%
Uri Over Recovery	($69.0)	$0.0	$69.0	-100.0%
Actual Over/Under	($2.1)	$75.2	$77.3	-3,602.0%
Estimated Over/Under	$20.1	$29.0	$8.9	44.1%
Total	**$350.9**	**$639.2**	**$288.3**	**82.2%**

Power Supply Adjustment Calculation

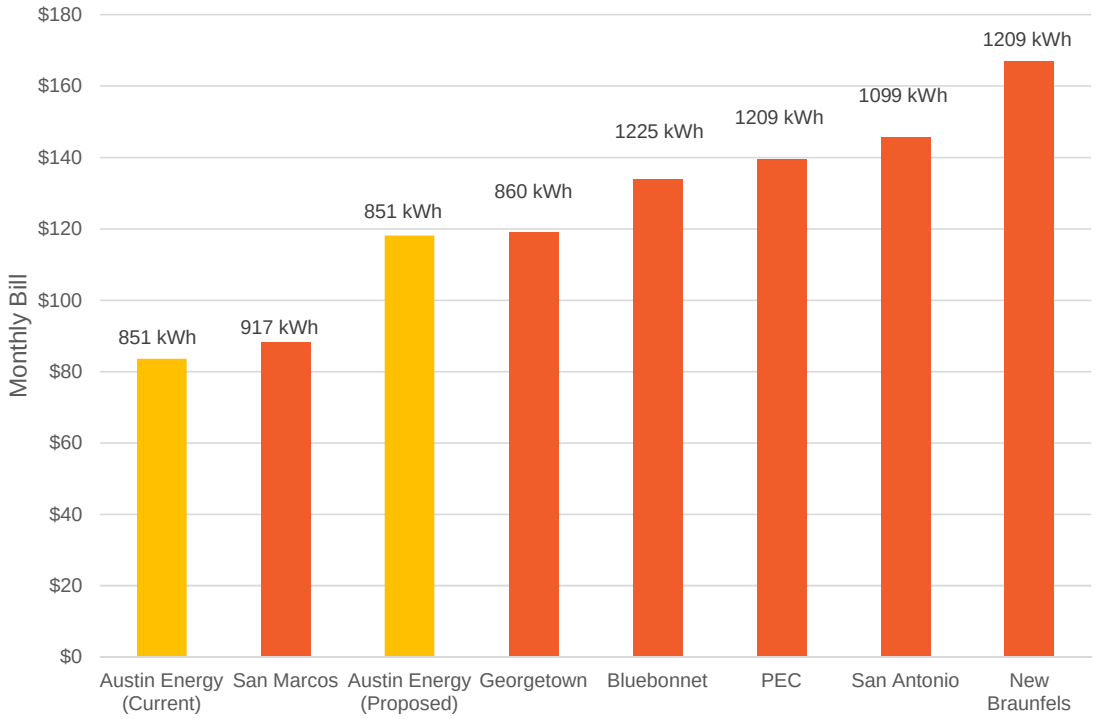
System Average Costs as Calculated per PSA Tariff on a per Kilowatt Hours Basis



2022 Rate	2.303¢	+	0.983¢	+	(0.591¢)	+	0.167¢	=	2.862¢
2023 Rate	4.096¢	+	(0.033¢)	+	0.599¢	+	0.231¢	=	4.893¢

Residential Electric Utility Bill Comparison

Monthly Bill Using Average Residential Consumption as Reported By Utility



- Data from the CY 2020 Energy Information Administrative Form 861.
- Published tariff sheets from the respective utility's website as of September 22, 2022.
- Proposed based rates utilizing the $35.7M increase in revenue requirements and September 21, 2022, proposed Power Supply Adjustment and Regulatory Charge.

2023 Power Supply Adjustment Discussion

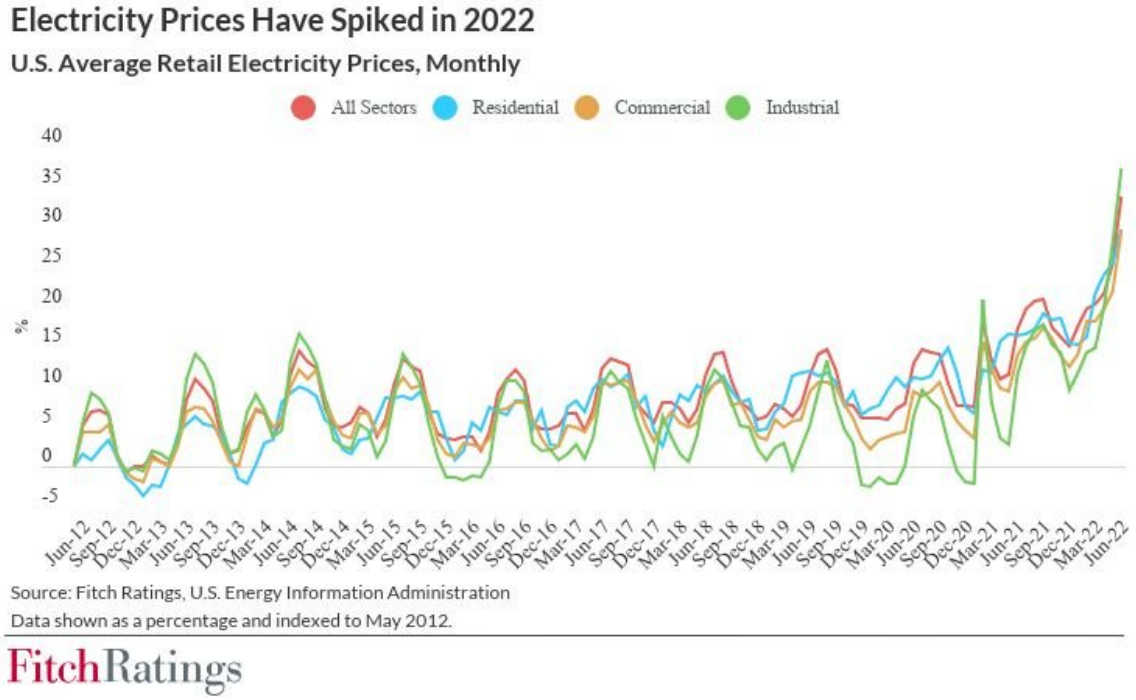
City Council Options and Potential Impacts

Significant Increases in Electric Prices Nationally

The Investment Community and Credit Agencies are Concerned about Cost Recovery

Rising Fuel Costs and Inflationary Trends Pressure Public Power*:

- Inflationary pressures and rising fuel costs could weaken credit quality across the public power sector if costs are not recovered in a timely manner, Fitch Ratings says. The US Energy Information Administration (EIA) forecasts power prices could double in 2022 from 2021 across the US as a result of higher commodity prices and capacity constraints that reduce available supplies of wholesale power. While increased fuel and purchased power costs are largely being passed through to retail and wholesale customers, broader inflationary pressures, including supply chain delays and capital investment escalation, could require additional rate increases to support credit quality, particularly if current trends persist in 2023.
- Utilities are experiencing operating and capital cost pressures that are likely to require even greater base rate increases that could prove challenging against a backdrop of an economic recession, strained affordability, or if the political appetite for rate action falters.



* Fitch Wire, released Tuesday, August 30, 2022, at 1:09 PM ET fitchratings.com/research/us-public-power-finance/.

Options For City Council in Setting the Power Supply Adjustment

Option	Option 1: As Proposed	Option 2: 3-Year Gradual for Under-Recovery	Option 3: Eliminate Under-Recovery with non-AE Funds	Option 4: Provide Austin Energy a Target PSA Value
Impacts*	4.917¢ per kWh or a 71% Increase $17.55 on a Typical 860 kWh Monthly Bill	4.371¢ per kWh or a 52% Increase $12.85 on a Typical 860 kWh Monthly Bill	4.097¢ per kWh or a 42% Increase $10.49 on a Typical 860 kWh Monthly Bill	To Be Determined Range from 71% to 42% Increase
Positive Attributes	• Meets requirements of existing PSA tariff • Recovers cash expended • Reflects actual costs to acquire power • Consistent with past PSA-setting practices	• City Council can modify tariff requirements • Recovers cash, but over a longer period • Consistent with the method used for other "pass-through" charges to stabilize bills • Reduces PSA burden on customers	• City Council can modify tariff requirements • Reduces PSA burden on customers	• City Council can modify tariff requirements • Allows City Council to determine what is affordable
Negative Attributes	• Significant increase for retail consumers • Risk of over-recovery if market prices decline	• Jeopardized cash recovery unless off-set by a reduced cost or increased revenue that can be applied to PSA • Reduces increase for retail customers, but still a significant increase	• Reduces increase for retail customers, but still a significant increase • Austin Energy does not have the cash to fund this option; it must be off-set by a reduced cost or increased revenue that can be applied to PSA • Not consistent with existing utility rate making and potential negative credit impacts	• Not consistent with existing utility rate making and potential negative credit impacts • Similar negative attributes as seen in Option 2 and Option 3

* PSA costs per kWh are presented using proposed rates for residential customers

Austin Energy's Options are Limited by Cash Available

- Cash balance decreased from $402M in October 2020 to $184M in August 2022 – down $218M
  - Under-recovered balances in PSA and Regulatory Charge total $123M
  - Funding for current operations consumed $95M
- Low cash balances limit Austin Energy's options to defer recovery of PSA

Future Power Supply Adjustments

Considerations for Improving and Reducing Volatility in the PSA Rate

Challenges

- Power supply costs are becoming more volatile and are trending higher
- Adjusting the PSA rate during the budget period which can be the most volatile time of the year
- Current methodology uses the prior year's cost to set the current period rate – historical cost may not be reflective of future cost
- Annual accumulations of over/under recovery amounts can contribute to volatility in rate changes
- Benefits of conservation and efficiency are in the PSA, but the PSA rate is flat and fixed for the entire year

Opportunities

- Evaluate the frequency at which we adjust the PSA rate
- Evaluate changing PSA rate during non-summer months
- Evaluate using both historical and forward-looking power prices to anticipate market movements
- Evaluate mandatory Time-of-Use PSA rates to send conservation and efficiency signals to customers

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Community Focused.