# GENERAL MANAGER'S REPORT TO THE BOARD

**For the May 12, 2015 Meeting**

## AGENDA ITEMS

A. PRE-QUALIFICATION OF CONTRACTORS – Staff is requesting approval to add Tapani Inc. of Battleground, WA to Klickitat PUD's Large and Small Works Rosters for the 2015 period.

B. SET PUBLIC HEARING DATE & TIME. Staff is recommending that the Board set a date for the water and wastewater public rate hearing for Tuesday, May 26, 2015. Time for the hearing can be discussed at the meeting next week.

C. EXECUTIVE SESSION: Potential Litigation – Old Hwy 8 Fire. Staff will provide an update during executive session.

D. EXECUTIVE SESSION: Potential Real Estate Option – Renewable Natural Gas. Staff will provide an update on the RNG project during executive session.

E. **6:00pm** – PUBLIC HEARING – Electric Rates. The public hearing is scheduled to begin at 6:00pm, as advertised. I recommend moving this portion of the meeting into the larger room to accommodate public attendance. Staff will be prepared to provide a presentation to the public during the hearing to explain the rate increase requirement. (See attachment)

F. RESOLUTION No. 1692 - Electric Rates. Following the public rate hearing, the Board will be considering the 9% rate increase proposal presented by staff.

## NON-AGENDA ITEMS

1. 2006 B Bond Refinancing – We are formally starting our work toward the refinancing of approximately $70 million in tax exempt financing. As you know, we could refinance these bonds late 2016, but we can advance refinance with certain provisions. Given the current low interest rates and the anticipation that the Fed will be increasing interest rates later this year, advance refinancing them soon would provide interest rate stability. The team includes Pacifica Law group as our General Counsel and Bond Counsel, Alan Dashen & Associates as Financial Advisor and Barclays Bank as underwriter. John Janney with Lands Energy will be working in an advisory capacity as well.

   We are also working toward advance refinancing of approximately $30 million in July or August of this year to take advantage of the current low interest rates. We cannot advance refinance the remaining $40 million, unless they become taxable bonds, which carry a higher interest rate. As a result, we are reviewing alternatives to secure the current interest rate environment. It is anticipated that the refinancing activities would result in long-term cost savings in excess of $5 million.

2. Article: "UPS Becomes Nation's Largest User of Renewable Natural Gas in Shipping Industry" – Attached is an article dated May 5, 2015 for reading. Clean Energy Renewable Fuels (CERF) is a one of the entities we are exploring a potential RNG project with. Some high level website information from CERF and Aria Energy is also attached for your reading.

_X_ Action Item
__ Discussion Item
_ Department Report
__ Bid Opening
__ Public Hearing
___ Other

# KPUD Board of Commissioners

Agenda Item Cover Sheet

**Commission Meeting Date:** May 6, 2015

**Commission Agenda Item:** Public Electric Rate Hearing

**Submitted By:** Jim Smith, General Manager

**Recommendation:** Review and discuss Cost of Service Analysis (COSA) and financial forecasts presented by staff to provide background for public input.

**Motion for Consideration:** None.

**History:**

## Cost of Service Analysis (COSA) and Rate Study

The Board reviewed the second draft of the COSA performed by EES Consulting at the March 24, 2015 public meeting. Staff completed revisions as requested and we discussed the second draft at the April $14^{th}$ public meeting. The only changes from the second draft to the final draft surround rate recommendations. The final COSA electric rate across the board increase is 3.3%.

The COSA focuses on our Transmission and Distribution (T&D) business only. It is exclusive of the various business lines the District operates. Those impacts are addressed in the overall financials of the District to be discussed after the COSA discussion. As such, our McNary Hydro project is included in the COSA as it is part of the wholesale supply of power to our customers. Excluded are: H.W. Hill Landfill Gas facility, White Creek Wind I and our 230 kV business line.

The EES report concludes that electric rate adjustments that add 3.6% to our retail electric rates are warranted. It further states that our current rate structure is accurately allocating costs to individual rate classes. It goes on to recommend that over time, the District may want to consider increasing our base fees and demand related charges. It is important to note that in the results of COSA in both the "100 demand" and the "minimum system" approaches, the numbers are as a result of internal cost analysis, not external market forces. By that I mean that issues such as the potential increase in the cost of capacity related wholesale power resources are NOT in their analysis. Specifically, the demand numbers do not include potential changes to the value of capacity.

As per past COSA studies, our cost allocation suggests that although likely within the range of accuracy, there could be room to adjust general service and irrigation rates over time more than residential rates.

Based on the COSA and other input, I would recommend the following:

- Any rate increase be consistent for all rate classes.
- Increases to each component (demand, energy and base fees) be evenly applied as well. I think shifting costs to demand at this time is premature. I also think that by increasing the demand portion and decreasing the energy charge portion of a bill provides less price signaling for conservation of energy. That is counter to many of our programs. BPA has not shifted their cost structure with respect to demand for full requirement customers.
- We have discussed base fees and the potential impacts of distributed generation. I believe at this time we should be exploring a "value of the Transmission and Distribution (T&D) system" approach to properly price our infrastructure in the future. That could be in the form of a T&D rate or even a demand charge for residential customers. I believe that now is not the time to implement these ideas given current legislation, but we should be looking at this type of mechanism rather than increasing base fees moving forward.
- Some food for thought is that a base fee that represents the cost of the account and metering, along with a T&D charge, could more accurately allocate costs to small and large customers equitably. A base fee is applied equally to customers in a rate class regardless of the power usage of individual customers. In the COSA, the "100% demand" base fee is composed of account charges only for reference. For a residential customer, that base fee is $8.60.
- I also don't see large behavioral changes with respect to demand as a result of the demand charges we currently apply, and is a very controversial / misunderstood charge. For example, the majority of our irrigators are not demand charge driven. Large irrigators run 24 / 7 for water rights reasons. We already have a Time of Use irrigation rate, and there does not appear to be a large shift in usage to low load hours, with their lower energy and demand charges.
- We could consider moving the irrigation annual minimum charge to a monthly base charge, versus an annual minimum in the future.

The rate sheets to be presented will reflect these recommendations, although the 3.3% is modified as per the following discussion.

## Financial Projections 2015 – 2017

The COSA study looks at purely the cost of operating our traditional electric Transmission and Distribution (T&D) business that supplies power to our rate payers. In addition to serving our customer directly, we have developed other business lines over the past 20 years. These are White Creek Wind I, H.W. Hill Landfill Gas generation facility and the 230 kV business line. Ultimately, our rates and these business lines together must be sustainable. Therefore, any electric rate setting must include these financials, not just the COSA.

As you are aware, there have been significant declines to the forward price curves for electric power since 2009, and these declines have not just affected the Pacific Northwest. This timeframe has extended long enough now that even contracts to sell power and Renewable Energy Credits (RECs) obtained in 2009 – 2012 have expired and more will be expiring the end of 2016. Recently there have also been significant declines in future prices. This is in spite of low water forecasts for the Columbia River System and winter time temperatures.

The change in market forecasts directly affects our forward financial outlook, which we modeled for this presentation through 2017. These changes have not only affected the District, but have also affected every utility with surplus generation, including Bonneville Power, and generators alike. As such, we have revised our forward looking financials to reflect this change.

As a result, I asked our financial department to create a presentation derived on electric rate scenarios that are BASED ON THE CURRENT ELECTRIC MARKET FORECASTS. What we know for certain is that these markets change regularly and quickly. Markets could continue to decline and there are certainly reasons we could forecast that; and markets could significantly improve and there are certainly reasons we could forecast that as well.

However, we have current conditions as a basis to look forward, consider and discuss, along with our COSA. If the current markets, or our business actions, do not change, the result is a negative cash flow position that needs to be corrected. 2015 results do not appreciably change between the rate scenarios presented, as most of our power and RECs are pre-sold through 2016. As anyone would expect, a prolonged downturn in pricing, without other actions, will require rate increases to support the financial stability of the District.

So there are two things to consider. First is the likelihood of extended depressed markets out for three to five more years and what could happen if they get worse or better. Second are external factors and their impacts on us. Specifically, I am referring to the rating agencies who rate our bonds.

Their ratings of our bonds have several impacts discussed in the presentation, but there are two distinct impacts on our business operations I want to touch on. First, is the most direct, and that is increased costs of borrowing as a lower rating will increase our cost of capital. At this time, we estimate the costs of a BBB+ rating versus an A- rating is in the order of $3 million over a 20-year refinancing. Second is the effect on our hedging operations and credit facilities. In order to financially hedge our power sales, we must have access to a Line of Credit facility within a certain period of time. As a result, we have in place a Credit Facility that allows us access to a Letter of Credit within 3 days. We don't need to obtain an actual Letter of Credit unless our counterparties exceed a certain level of exposure. That level of exposure is set by the contracts and the better our credit rating is, the lower our exposure. A downgrade from an A category to a B category impacts when we may need to provide a Letter of Credit. In addition, our credit facility provider, Bank of the West, could potentially withdraw as our Credit Facility if we are downgraded. That would prevent us from entering into financial hedging activities and could impact the outstanding hedging contracts already in place. We do not know whether they would, and we have over $10 million dollars in accounts invested in their institution, but it is a risk.

**The item for discussion and decision at this time is a rate increase for 2015**. The trade-off is the size of rate adjustment, the reaction of rating agencies, the potential impacts of that reaction, the changes in the markets that are beyond our control, and the potential for us to increase revenues from our assets and decrease our costs in the future. We have a talented and hard-working staff and their efforts in cutting costs and controlling expenditures have exceeded budget expectations set by the Board. We have accomplished much in the past 6 years, made difficult decisions and very importantly, in the past few months have developed financial tools to better see our financial situation more clearly. We know the market place is getting more volatile year after year due to legislative changes, declining natural gas prices and changes in the renewable incentive programs. Through all of that we have made adjustments and responded accordingly. With the Board's continued support and direction we will continue making the appropriate decisions to maintain financial stability.