EWEB

# MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

Rely on us.

| | |
|---|---|
| TO: | Commissioners Brown, Carlson, Barofsky, McRae and Schlossberg |
| FROM: | Deborah Hart, CFO; TiaMarie Harwood, Financial Services Manager; Aaron Balmer, Fiscal Services Supervisor; Alicia Voorhees, Lead Financial Analyst, and Ryan Hawkins, Senior Financial Analyst |
| DATE: | September 28, 2022 |
| SUBJECT: | 2023 Draft Budgets, Long-Term Financial Plan Update, and Price Proposal Overview |
| OBJECTIVE: | Direction on 2023 Budget and Price Changes |

## Issue

Board Policy SD6 and Oregon Statutes require staff to prepare Electric and Water Utility balanced budgets for Board approval prior to the beginning of the next fiscal year. The foundations of the Electric and Water Utilities' budgets are the long-term financial plans (LTFP), which help ensure financial stability for both utilities in order to accomplish organizational goals and objectives in line with EWEB's strategic plan. Staff have prepared draft 2023 budgets and updated LTFPs for the Board's consideration.

Based on Board direction provided at the October 6th meeting, staff will develop budgets and price proposals for consideration at the November 1st Board meeting and request approval at the December 6th meeting. Public hearings specific to budget proceedings will present the opportunity for community members to provide testimony, as well.

## Background

A primary focus for 2023 and beyond continues to be updating infrastructure that supports EWEB's strategic direction of *Fostering Customer Confidence, Positioning for Flexibility,* and *Resilient Delivery,* as well as upholding the organizational values of Safe, Reliable, Affordable, Environmental, and Community. The current financial plans incorporate the level of capital spending recommended at the July 5th Board meeting, which will support these values and organizational priorities.

The July Integrated Capital and Financial Plan provided an update of the strategic and operational priorities and the capital plans required to meet those objectives. This included an overview of the assumptions and the financial and rate impacts of those decisions. The plan includes funding for key strategic priorities, such as Advanced Meter Infrastructure (AMI), new Willamette water treatment plant, transmission and distribution system enhancement to the electric system, base-level water storage, as well as compulsory and risk-based projects. Any further direction on capital spending, including impacts of the Leaburg hydroelectric project (direction set at year-end), will be incorporated into plans going forward.

Budgets inform each Utility's Cost of Service Analysis (COSA). The results of this analysis can include proposals to modify pricing among or within customer classes for retail water and power supply service. The COSA will be presented at the November board meeting.

## Discussion

Draft and Prior Year Changes in Revenue Requirement and Budgets:

| | $ (000s) | |
|---|---|---|
| **Electric** | 2023 (Draft) | 2022 |
| Change in Revenue Requirement | 3.25% | 3.25% |
| Capital Budget | $74,157 | $55,016 |
| O&M Budget (includes debt service) | $328,054 | $272,831 |
| **Electric Total** | **$402,210** | **$327,847** |
| **Water** | | |
| Change in Revenue Requirement | 6.00% | 4.00% |
| Capital Budget | $32,458 | $29,131 |
| O&M Budget (includes debt service) | $41,119 | $30,469 |
| **Water Total** | **$73,577** | **$59,600** |
| **Total Electric & Water Budgets** | **$475,787** | **$387,447** |

**<u>Overarching Forecast Assumptions and Outcomes</u>**

A year ago, inflationary pressure was deemed transitory, and economists anticipated inflation would normalize to the ~2-3% range in 2022. Earlier this year, inflation figures were running at double digit levels, and recent indicators remain uncomfortably high. The Federal Reserve has raised interest rates by 3.00% since last fall and is messaging further rate increases will be needed to check inflation and regain price stability. The Federal Reserve is taking aggressive action to return to inflationary levels closer to their 2.0% target. Accordingly, EWEB's 2023 budgets assume greater inflationary pressure in the next few years, although they maintain that in the long run, inflation will normalize around the Federal Reserve's target.

Materials and supplies required to provide ongoing water and electric services continue to be a challenge to source without delay (long lead times) and at reasonable prices. Worldwide shortages of labor, raw materials, components, transportation, a growing backlog of orders across the industry, rising inflation, and increased global tensions continue to make it difficult to meet demand and prices continue to escalate. Staff continue to work diligently at minimizing the impact of material supply shortages while focusing on essential work, such as compliance-driven or restoration efforts, and deferring internally driven reliability (risk-based projects) and strategic work. Developers and other potentially impacted customers are being asked to plan for potential delays caused by material shortages in their active and upcoming construction and renovation projects. There are no indications we will see any improvements in the supply chain in the near future.

The following assumptions have been used in developing the current forecasts and are anticipated to be used in creating the 2023 budget. Utility specific assumptions are noted on the Attachments.

Both Utilities

- Conservative revenue assumptions to mitigate volatility:
  - 95% of historical 5-year average Water consumption for the first five years, resulting in a contribution margin risk tolerance of approximately $1.1 million in 2023
  - 90% of expected surplus hydro for Electric, resulting in a contribution margin risk tolerance of approximately $14.6 million per year for the first five years
- Labor Cost Escalation – fully loaded costs are indexed to a combination of inflation factors and expected labor market comparators and benefit cost escalations
- Non-Labor O&M Escalation – 2023 is escalated at 4.0%, 2024 at 2.5%, and longer-range inflation is modeled at 2.0%
- 5% inflation in capital plan through 2025 (3% thereafter), and a contingency is included on a project-by-project basis based on the specific nature and risks for the project
- 5% interest rates on future borrowing
- Capital improvement plans generally as presented in July ($345 million 10-year water capital, $585 million 10-year electric capital, not including Leaburg hydroelectric investment)
- Updated reserves, bond, and rate funding assumptions for Capital Improvement Plan (CIP)

Since July, the financial plans have been updated to reflect more current information for both utilities:

- A base year of 2023 preliminary budget instead of 2022 budget
- Updated labor costs
- Revised reserves balances based on projected 2022 year-end balances
- Updated revenue forecasts

**LTFP Update**

Electric

In July, the Electric Utility was anticipating an overall average revenue requirement increase of 4.00% in 2023 and a compound 10-year growth rate of 37.65% (~3.25% per year, within Board guidance). The current projections are 3.25% and 37.35% respectively.

Revenue requirement increases of 3.25% - 3.5% per year are modeled through the first five years of the LTFP and do not include substantive investments needed to address the long-term disposition of Leaburg. With the price assumptions noted, financial metrics are within Board targets for all years of the plan. The Electric LTFP outcome is included in Attachment 1.

Water

In July the Water Utility was anticipating an overall average revenue requirement increase of 6% in 2023 and a compound growth rate of 63.04%. The current projections are 6% and 70.71% respectively (43.45%, 3.67% per year, without a new water treatment plant).

Rate increases for the Water Utility will fund capital investments for reservoirs and include a new water treatment plant and river intake on the Willamette River with a capacity to meet our current minimum demand. All Board approved financial metrics remain within target across the ten-year plan. The Water LTFP outcome is included in Attachment 2.

**2023 Budgets**

Draft budgets were developed in alignment with EWEB's strategic priorities and total $475 million for the combined Water and Electric Utilities. The high priority capital projects include resiliency and reliability work, modernization projects, as well as continued Carmen-Smith relicensing work.

Significant changes from 2022 budget year:

- Electric Utility Purchased Power cost is $44 million higher than 2022 due to market volatility and scarcity, higher budgeted volumes and prices[1], which impacted both purchased power and wholesale revenue
- All Other Electric O&M is $10.3 million higher than 2022. The primary drivers include higher generation costs for dam safety and operations, and higher transmission and distribution costs
- Electric Capital investments are $19 million higher due to delayed project work at Carmen, upcoming investments at Currin substation, and the electric utility share of the EWEB Enterprise Solutions (EES) project
- 2023 Watershed Recovery investments are budgeted at $10.4 million. Elevated watershed efforts account for $6.2 million of the increase compared to Water's 2022 O&M budget, with some increasing budgeted efforts/costs anticipated to be funded by grant revenue. Not all identified grant sources have been awarded to date, and therefore are not modeled as revenue
- Water Capital investments are $3.3 million higher due to upcoming transmission main work and the water utility share of the EES project

Total budgets are higher in 2023 as compared to 2022 and an increase in the overall revenue requirement is required for both Utilities. As a public utility, EWEB sets pricing based on the cost to serve each customer class. At the November Board meeting, staff will present the results of the cost-of-service analysis which will recommend price changes within customer classes.

If the conservative assumptions noted earlier are not sufficient to mitigate volatility and absorb the additional inflation, EWEB can "turn the dials", through timing and scope of capital investments (primarily risk-based projects), adjustments to program offerings, or changes in service levels.

## Recommendation

Management recommends the Board direct staff to prepare the 2023 proposed budgets using the assumptions set forth in this document.

## Requested Board Action

Management is not requesting Board action at the October 6th meeting; however, staff are requesting that the Board provide direction on the assumptions included in the draft budget. In addition, staff are requesting direction on investment levels for future capital plans. At the November 1st Board meeting, Management will present the budgets and price change proposals which are scheduled to be approved at the December 6th Board meeting.

<u>Attachments</u>
Attachment 1 - Summary of Electric LTFP Price Assumptions and Outcomes
Attachment 2 - Summary of Water LTFP Price Assumptions and Outcomes

1 $80/MWh melded mid-market price curve in 2023 compared to $51/MWh in 2022

**Attachment 1**

## Summary of Electric LTFP Revenue Requirement Assumptions and Outcomes (000's omitted)

***Yellow = within 10% of target***

***Red = below target***

| Key Metrics (Dollars in $000's) | Target | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Reserves and Cash | | $121,000 | $109,000 | $92,000 | $91,000 | $92,000 | $94,000 | $96,000 | $100,000 | $102,000 | $107,000 |
| Meter Reserve | | $3,000 | $4,000 | $5,000 | $6,000 | $2,000 | | | | | |
| Total Cash Reserves | $85,720 | $124,000 | $113,000 | $97,000 | $97,000 | $94,000 | $94,000 | $96,000 | $100,000 | $102,000 | $107,000 |
| Annual Capital Investment | | $74,000 | $48,000 | $63,000 | $81,000 | $59,000 | $55,000 | $52,000 | $54,000 | $61,000 | $41,000 |
| Bond Funding | | $49,000 | | | $86,000 | | | $73,000 | | | |
| Rate Stabilization Reserves Funding | | $12,000 | $10,000 | | | | | | | | |
| Debt Service Coverage Ratio | 1.75 | 2.98 | 2.73 | 2.21 | 2.55 | 2.04 | 2.43 | 2.48 | 2.00 | 2.10 | 2.00 |
| Days Cash | >150 Days | 156 | 185 | 157 | 162 | 159 | 155 | 152 | 152 | 152 | 151 |

| Revenue Requirement Assumptions | 10 Year Compound | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| General Rate Increase | | 3.25% | 0.75% | 3.25% | 0.75% | 3.50% | 1.25% | 3.75% | 0.25% | 2.75% | 0.25% |
| BPA Increase | | | 2.50% | | 2.50% | | 2.50% | | 2.50% | | 2.50% |
| Average Impact Resulting from Change in Revenue Requirement | 37.35% | 3.25% | 3.25% | 3.25% | 3.25% | 3.50% | 3.75% | 3.75% | 2.75% | 2.75% | 2.75% |

Key Assumptions

- Retail load approximately 2.4 million MWh's, roughly on track with 2022 forecast load, and roughly 2% higher than 2020 actual load due to economic recovery and anticipated warmer summers. Electrification load approximately 9,200 MWh's in 2023 increasing to 54,200 MWh's in 2032
- Contribution margin risk tolerance of $14.6 million representing 90% generation. Similar contribution margin risk tolerance is modeled through 2027, with expected conditions 2028-2032
- BPA rate increase of 6% assumed in October 2023, 2025, 2027, 2029, and 2031, which translates to 2.5% for EWEB customer-owners
- $80/MWh melded mid-market price curve in 2023 decreasing to $57/MWh in 2032
- Environmental Commodities represent roughly $3.4 million of wholesale revenue
- Leaburg generation revenue not included in the financial plan through 2032. Significant outlays to address Leaburg canal are not included pending future Board decision on the facility

**Attachment 2**

## Summary of Water LTFP Revenue Requirement Assumptions and Outcomes (000's omitted)

*Yellow = within 10% of target*

*Red = below target*

| Key Metrics (Dollars in $000's) | Target | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Reserves & Cash | $12,680 | $27,600 | $23,000 | $24,600 | $24,400 | $20,900 | $18,000 | $17,100 | $17,500 | $18,700 | $14,300 |
| AWS Reserve Balance | | $3,500 | | | | | | | | | |
| Meter Reserve | | | $300 | $800 | $1,400 | $2,000 | $2,500 | $3,100 | $3,600 | $4,200 | $4,800 |
| Total Cash Reserves | $12,680 | $31,100 | $23,300 | $25,400 | $25,800 | $22,900 | $20,500 | $20,200 | $21,100 | $22,900 | $19,100 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Annual Capital Investment | | $32,458 | $25,562 | $41,680 | $58,708 | $53,727 | $36,833 | $25,294 | $25,359 | $25,484 | $19,900 |
| Bond Funding | | $43,000 | | | $77,500 | | $46,000 | | | | |
| Rate Stabilization Reserves Funding | | $6,980 | $7,330 | | | | | | | | |
| DSC | 2.00 | 4.11 | 3.79 | 3.25 | 3.57 | 2.12 | 2.27 | 2.01 | 2.03 | 2.12 | 2.01 |
| Days Cash | > 150 days | 311 | 299 | 325 | 316 | 258 | 218 | 208 | 209 | 216 | 168 |

| | 10 Year Compound | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Average impact resulting from change in revenue requirement | 70.71% | 6.00% | 6.50% | 8.00% | 8.00% | 8.00% | 8.00% | 5.00% | 2.50% | 2.00% | 1.25% |

Key Assumptions

- Consumption of approximately 7.9 million kgal, which represents 95% of 5-year average consumption
- Contribution margin risk tolerance of $1.1 million in 2023
- Annual revenue requirement without second sources increases 43.45%, compounded over the next 10 years
- Annual contributions to AMI reserve begin in 2024 and are based on 20-year estimated life
- $720,000 System Development Charge reserve draw for debt service payments in 2023
- Includes watershed recovery fee funding and expenditure. Grant revenues are also anticipated to fund watershed efforts. Grants not yet awarded are not modeled as revenue sources