How Much Net Wholesale Revenue to Assume When Setting Base Rates? (Part 3)

Presentation to City Light Review Panel

December 2, 2011

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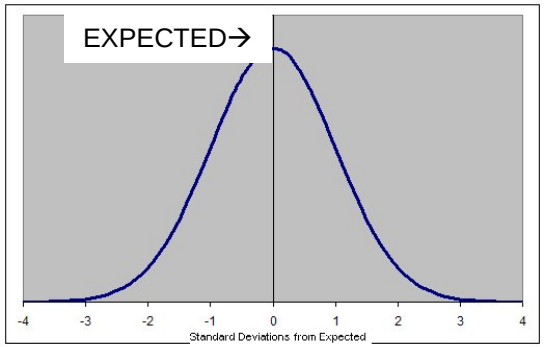
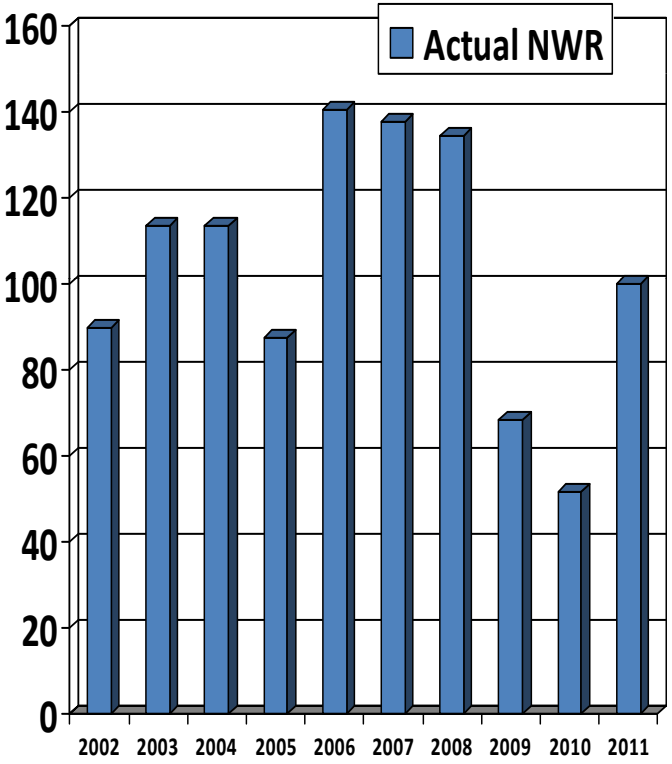
Historical Net Wholesale Revenue (NWR)

- Revenue has been quite variable, ranging from $54-$140 million
- For any given year, NWR is affected by potential prices and volumes, producing a wide distribution of potential revenue outcomes

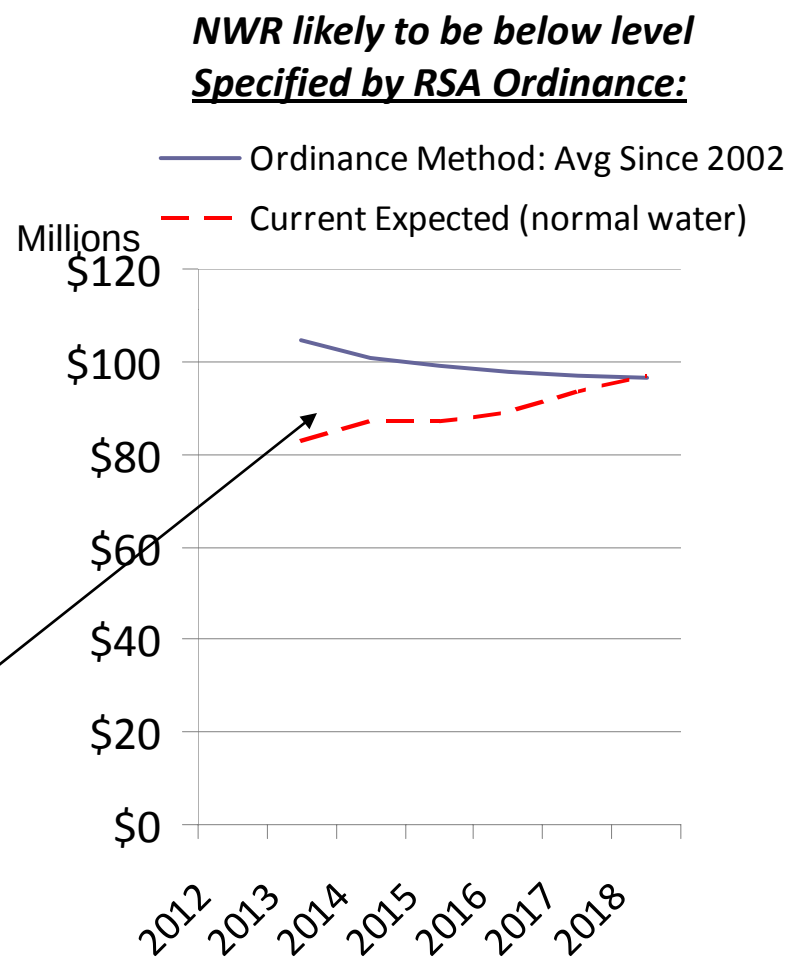




Rate Surcharges Likely As Our NWR Estimate is Too High

- Rate Stabilization Account ordinance requires specifies how much net wholesale revenue to assume when setting rates. Amount is too high:
  - Higher prices in past
  - Doesn't reflect change in resource portfolio (BPA contract change)

- Consequences:
  - Gap causes RSA to be drawn down
  - RSA account falls below specified levels
  - Higher potential for surcharges from 2012-



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At Last Meeting, We Presented Three Potential Solutions to Reduce the Likelihood of Surcharges

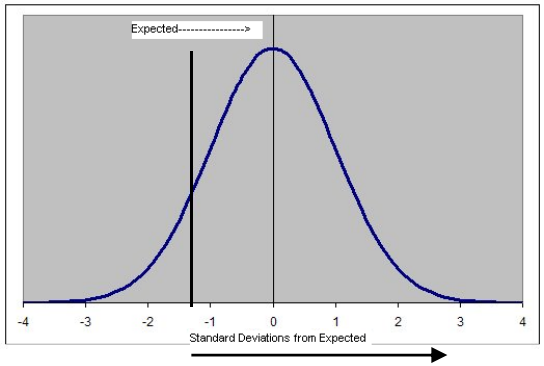
<u>Option</u>

1. Existing Method, with Adjustment for Change in Supply Portfolio

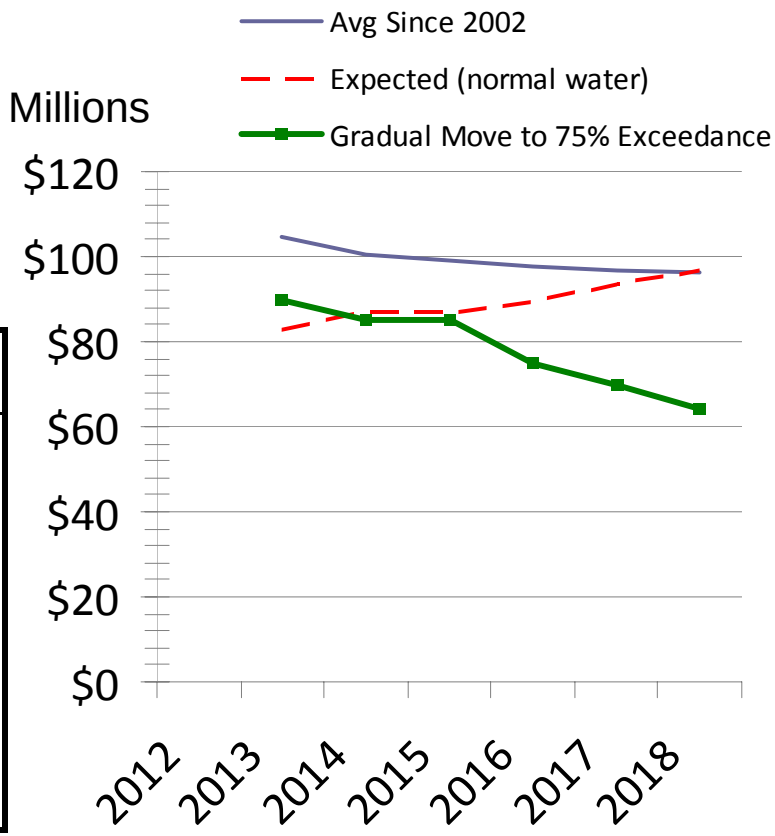
2. Move to Six Year Rolling Average, also adjusted Change in Supply Portfolio

3. Move to a conservative number (one we are likely to exceed 3 out of 4 years, or “75% exceedance”) over time, and reduce size of RSA to mitigate rate impacts along the way

We Recommend Option 3, Gradually Reducing Our Reliance on Net Wholesale Revenue When Setting Rates



3 of 4 chance that revenues will exceed this figure



Key Features

- Move to 75% exceedance while reducing size of RSA Account from $100M to $60M, cushioning impact of transition
- Significantly reduces the likelihood of surcharges, and will likely provide refunds in out years

Rate Impact Summary

Benefits:

- New RSA proposal has much lower expected surcharges, and credits are likely in the out years (and beyond 2018)
- Actual Bills when taking expected surcharges and credits into account are very similar during this period

Line#		2012	2013	2014	2015	2016	2017	2018	2013-2018 AVG
1	**Preferred Path with Current NWR Approach**								
2	Typical Residential Bill (base rates)	$ 55.05	$ 56.91	$ 60.39	$ 64.46	$ 67.41	$ 70.43	$ 72.69	
3	Annual Rate Increase	3.2%	3.4%	6.1%	6.7%	4.6%	4.5%	3.2%	**4.7%**
4									
5	Expected RSA Surcharge	0.3%	3.2%	2.7%	1.8%	1.8%	1.5%	0.1%	
6	Typical Res Bill (w/ surcharge)	$ 55.21	$ 58.73	$ 62.03	$ 65.65	$ 68.66	$ 71.48	$ 72.79	**$ 66.56**
7	Annual Rate Increase (w/surcharge)		6.4%	5.6%	5.8%	4.6%	4.1%	1.8%	**4.7%**
8									
9	**Preferred Path with Proposal NWR Approach**								
10	Typical Residential Bill (base rates)	$ 55.05	$ 56.92	$ 60.38	$ 64.61	$ 69.38	$ 73.06	$ 75.76	
11	Annual Rate Increase	3.2%	3.4%	6.1%	7.0%	7.4%	5.3%	3.7%	**5.5%**
12									
13	Expected RSA Surcharge/(Credit)		2.0%	1.2%			-0.15%	-2.61%	
14	Typical Res Bill (w/ surcharge/credit)	$ 55.05	$ 58.08	$ 61.12	$ 64.61	$ 69.38	$ 72.95	$ 73.79	**$ 66.65**
15	Annual Rate Increase (w/surcharge/credit)		5.5%	5.2%	5.7%	7.4%	5.1%	1.1%	**5.0%**

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Certain Aspects of the Rate Stabilization Account Would Be Changed:

- NWR assumed for setting rates gradually declines from $90M in 2013 to $64M by 2018 (the 75% exceedance number)
- Draw down RSA balance from $100M to $60M by 2016, using funds to mitigate rate impacts
- RSA Maximum Balance is $15M above RSA Target Balance (excess used to reduce rates in following year)
- RSA Surcharge Parameters: 1.5%, 3.0%, 4.5% surcharges applied at $10M increments below target balance in 2013-2014 and $6M increments in 2015-2018

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Evaluation of Proposal

Criteria	Achievement
•Rate Transparency	More difficult to compute, but more conservative
•Stability of Rates Year to Year	Very Good
•Substantially eliminates likelihood of surcharges	Very Good (probability of surcharges in 2018 reduced from 54% to 16%)
•Average Bills over the period	Acceptable (essentially = to status quo)
•Base Rate Impact	Acceptable
•Ability to Stay within Established 6 Year Rate Path	Very Good
•Credit Rating Impact	Neutral?
•Probability of RSA Balance falling below 0	Reduced versus current approach

Next Steps

- Further documentation and analysis in Financial Policy study
- Proposal included in Strategic Plan
- Develop ordinance for required changes to RSA, effective for 2013

Appendix

11. Example Operation of the Revised RSA
12. Sensitivity Analysis
13. An Alternative to Further Mitigate Rate Impacts

The following example shows how the Rate Stabilization Account would operate during while moving to a more conservative NWR figure while reducing size of RSA

Line#		2012	2013	2014	2015	2016	2017	2018
1	**RSA Parameters**							
2	City Light Expected NWR	51.2	82.8	87.1	86.9	89.5	93.4	96.8
3	Proposed RSA NWR Target	102.1	90.0	85.0	85.0	75.0	70.0	64.0
4	RSA Target Balance	100.0	85.0	70.0	60.0	60.0	60.0	60.0
5	RSA Surcharge Trigger	90.0	75.0	60.0	54.0	54.0	54.0	54.0
6	RSA Max	none	105.0	95.0	75.0	75.0	75.0	75.0
7								
8	**Example of RSA**							
9	Beginning RSA Balance	130.4	80.6	72.3	69.0	62.6	77.6	78.3
10	RSA Deviation Transfers	-50.9	-7.2	2.1	1.9	14.5	23.4	32.8
11	RSA Surcharge Revenue, net of taxes	0.0	12.9	8.2	0.0	0.0	0.0	0.0
12	Interest Earnings	1.0	1.1	1.4	1.6	2.0	2.3	2.3
13	RSA Withdrawals	0.0	-15.0	-15.0	-10.0	0.0	0.0	0.0
14	Transfer of Funds over Max	0.0	0.0	0.0	0.0	-1.4	-25.1	-34.5
15	Ending RSA Balance	80.6	72.3	69.0	62.6	77.6	78.3	79.0
16								
17	Expected Annual Average Surcharge Percent		2.0%	1.2%	0.0%	0.0%	0.0%	0.0%
18	Expected Annual Average Credit Percent		0.0%	0.0%	0.0%	0.0%	0.1%	2.6%

- Yellow highlighted numbers are the 75% exceedance numbers for those years
- Blue highlighted numbers are RSA withdrawals used to mitigate base rates
- Pink highlighted numbers: Surcharges and Credits shown above are expected values, actual values are very uncertain and will depend on actual NWR in current and preceding years

The Proposed Revision to the RSA Safeguards the Effectiveness of the Account Under Stress Conditions and Reduces the Likelihood of Surcharges

Example of Persistently Adverse NWR:
What if actual NWR turned out to be $50M every year?

Ref		2013	2014	2015	2016	2017	2018
1	**New Proposal**						
2	Adverse NWR Scenario	50.0	50.0	50.0	50.0	50.0	50.0
3	RSA Baseline, Net Wholesale Revenue	90.0	85.0	85.0	75.0	70.0	64.0
4	Expected Ending RSA Balance	44.9	25.7	13.7	24.6	43.0	52.2
5	Expected Annual Average RSA Surcharge	2.95%	4.50%	4.50%	4.50%	4.50%	2.52%
6							
7	**Current Method**						
8	Adverse NWR Scenario	50.0	50.0	50.0	50.0	50.0	50.0
9	RSA Baseline, Net Wholesale Revenue	104.8	100.6	98.9	97.7	96.8	96.4
10	Expected Ending RSA Balance	47.0	27.3	11.2	(2.1)	(13.1)	(22.6)
11	Expected Annual Average RSA Surcharge	3.82%	4.50%	4.50%	4.50%	4.50%	4.50%

Conclusion: With the proposed revision, the RSA is better able to handle consecutive low NWR years than the current method

Monte Carlo Probability Analysis Results

	Proposed RSA Method	Current RSA Method
Probability of RSA balance going below $0 during 2016-2018	12%	14%
Probability of a surcharge in 2018	27%	54%

To further mitigate rate impacts during 2013-18, the Utility could defer some bond principle repayments for issuances during this period

Line#		2012	2013	2014	2015	2016	2017	2018	2013-2018 AVG
1	**Preferred Path (without addressing Net Wholesale Revenue)**								
2	Typical Residential Bill (base rates)	$ 55.05	$ 56.91	$ 60.39	$ 64.46	$ 67.41	$ 70.43	$ 72.69	
3	Annual Rate Increase	3.2%	3.4%	6.1%	6.7%	4.6%	4.5%	3.2%	**4.7%**
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5	Expected RSA Surcharge	0.3%	3.2%	2.7%	1.8%	1.8%	1.5%	0.1%	
6	Typical Res Bill (w/ surcharge)	$ 55.21	$ 58.73	$ 62.03	$ 65.65	$ 68.66	$ 71.48	$ 72.79	**$ 66.56**
7	Annual Rate Increase (w/surcharge)		6.4%	5.6%	5.8%	4.6%	4.1%	1.8%	**4.7%**
8									
9	**Preferred Path Including NWR Fix, and Principal Deferrals**								
10	Typical Residential Bill (base rates)	$ 55.05	$ 56.92	$ 60.38	$ 63.52	$ 66.72	$ 70.20	$ 73.84	**$ 65.26**
11	Annual Rate Increase	3.2%	3.39%	6.09%	5.19%	5.04%	5.21%	5.19%	**5.0%**
12									
13	Expected RSA Surcharge/(Credit)		2.0%	1.2%			-0.2%	-2.7%	
14	Typical Res Bill (w/ surcharge/credit)	$ 55.05	$ 58.08	$ 61.12	$ 63.52	$ 66.72	$ 70.06	$ 71.84	**$ 65.22**
15	Annual Rate Increase (w/surcharge/credit)		5.5%	5.2%	3.9%	5.0%	5.0%	2.6%	**4.5%**
16									
17	*Principal Deferral Information*								**Total**
18	Total Annual Principal Payment on New Debt Issues (2013-2018)			3.6	10.3	17.5	24.1	30.2	**85.6**
19	Amount of Principal Repayment Deferred			3.6	7.0	17.5	20.0	15.0	**63.1**
20	Remaining Principal Payment in this year			0.0	3.3	0.0	4.1	15.2	**22.5**

-Alternate shows rate benefit of deferring $63M of Principal Payments over this time period. Principal would be repaid in future years, without extending the 20 year life of each bond.
-Debt to Capitalization would be app. 2% (59.5% vs. 57.4%) higher at year-end 2018 if the principle was deferred in this manner.
-Could resume scheduled principle payments in 2018 (make full $30.2M payment), increasing rates in that year by 3.1% to 5.7% on a net basis, and the 6 year average increase to 5.1%.

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