Customer Driven. Community Focused.℠

MEMORANDUM

TO: Mayor and City Council

FROM: Jackie A. Sargent, General Manager, Austin Energy JAS

DATE: August 27, 2020

SUBJECT: Results of Rate Adequacy Review

The purpose of this memo is to inform City Council of the results of Austin Energy's Rate Adequacy Review as indicated at the Austin Energy Utility Oversight Committee meeting on August 19, 2020. This review is required to be completed a minimum of every five years under Austin Energy's Council-approved financial policies.

Executive Summary

Austin Energy has completed a Rate Adequacy Review using 2019 audited financial data as the test year. The review indicates that current base rate levels are adequate to meet current needs and bond covenant requirements, showing a potential revenue surplus of less than 1.5% of total revenues. There are, however, a number of significant changes occurring now and coming in the near future that will impact Austin Energy's finances. These changes include generating unit shutdowns at Decker, exiting the Fayette Power Project, the effects of the pandemic and associated economic impacts on our customers, and the potential impact on Austin Energy's accounts receivable. These factors cannot be adequately reflected in the 2019-based Rate Adequacy Review. Due to this uncertainty during challenging times, Austin Energy plans to maintain current base rates and delay any further rate review processes until the impacts of these events are better known and can be accounted for in a future cost-of-service study.

Rate Adequacy Review

Austin Energy Financial Policy No. 17, states that "a rate adequacy review shall be completed every five years, at a minimum, through performing a cost-of-service study." The policy also provides that Austin Energy's electric rates shall be designed to generate revenues sufficient to support operations and satisfy financial objectives. Additionally, Austin Energy is subject to a Master Bond Ordinance and state law, which require rates to be revised as necessary to ensure revenues sufficient to satisfy all bond requirements. Austin Energy reported to the Electric Utility Commission and City Council earlier this year that it was undertaking a cost-of-service study consistent with the policy.

Austin Energy conducted a cost-of-service study using the audited results of Fiscal Year 2019 as the test year (Test Year 2019). It examined in detail the utility's costs incurred to provide electric services to customers during Test Year 2019 and adjusted those costs as necessary to reflect normal operations. Austin Energy then compared those costs to the amount of revenues collected under current rates during the same time period adjusted for various factors including weather and customer count to "normalize" the results. If Austin Energy knows that a certain cost will change in the near future, it adjusts that cost element to the level it knows it will incur. These cost adjustments are referred to as "known and measurable" and ensure that the cost-of-service study best reflects the conditions when the rates become effective.

The cost-of-service study indicates that Austin Energy's current base rates produce an approximately $19 million revenue surplus, which is less than 1.5% of projected total retail revenues. Importantly, this projected revenue surplus is likely overstated as it is based on assumptions that do not consider impacts of the pandemic or anticipated changes to Austin Energy's generation portfolio. These ongoing and anticipated changes discussed below – which are not yet known and measurable – will impact revenues and cannot yet be adequately accounted for. Minimal changes to costs or revenues could easily eliminate the forecasted over-recovery, potentially putting Austin Energy's financial position at risk. Therefore, Austin Energy does not plan to change base rates at this time, which will avoid rate volatility for customers.

Impact of Future Events

The cost-of-service study is based on Test Year 2019 and does not account for the immediate or lasting effects of the COVID-19 pandemic on the economy and customer electricity usage. The most significant issues for Austin Energy are increasing accounts receivable and the change in how customers are using electricity during the pandemic. While total energy consumption is approximately in line with historic levels, there is a shift in energy consumption and demand among customer classes.

In the months since the pandemic began, residential customer electricity consumption has increased by 6%, commercial customer electricity consumption has decreased by 7%, and average secondary demand is down by 5%. However, Austin Energy does not know if the change in consumption and demand is a short-term event or is something that should be accounted for in future rates. There is also uncertainty with regard to the economic downturn and outstanding accounts receivable.

In addition, the *Austin Energy Resource, Generation, and Climate Protection Plan to 2030* approved by Council in March 2020 identifies specific actions that will result in adjustments to base rates. Decker Creek Power Station Steam Unit 1 will cease operations after the summer of 2020, Steam Unit 2 will cease after the summer of 2021, and Austin Energy will exit the Fayette Power Project (FPP) by year-end 2022. These actions will impact Austin Energy's cost-of-service study, both with regards to determination of the utility's revenue requirements and the allocation of those costs to various customer classes.

While these resource changes will occur prior to the end of the next five-year period, the financial impact of these events cannot be included in the known and measurable adjustments to the 2019 Test Year as sufficient milestones to make such adjustments have not yet been reached for all of these actions. A future cost-of-service study reflecting these impacts could show a revenue deficiency rather than a surplus. While this typically occurs to some extent in the ratemaking process, the magnitude of the current unknown and unmeasurable changes creates an additional degree of uncertainty that should be carefully considered. If rates are changed based on the current cost-of-service study results, they would likely need to be changed again in quick succession, causing rate volatility. To provide rate stability, Austin Energy will maintain existing base rates until the impact of these events can be considered in a future cost-of-service study.

<u>Conclusion</u>

Austin Energy has completed a Rate Adequacy Review on a five-year cycle through the performance of a cost-of-service study, as required by its financial policies, and has confirmed that current electric base rates comply with existing financial policies and bond covenants. Austin Energy has identified future events that are likely to have substantial effects on its cost of service with regards to both revenue requirements and cost allocation. The long-term impacts of the ongoing pandemic, retirement of Decker steam units, and exit of FPP will become known and measurable before the next five-year rate adequacy review and make a delay of rate changes for at least one year a prudent course of action.

No specific action is requested of Council at this time. Austin Energy will continue to monitor and report its financial performance and compliance with financial policies and bond covenants to the City Council. Additionally, Austin Energy is looking at ways to provide additional support for customers in Fiscal Year 2021. We continue to examine possible assistance measures and hope to bring forward a proposal for Council's consideration when we adjust pass-through rates. In the meantime, if you have any questions, please contact me.

Cc: Spencer Cronk, City Manager
Mark Dombroski, Interim Chief Financial Officer