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CITY COUNCIL AGENDA ITEM

ACTION REQUESTED:

Receive the report on the 2018 Electric Rate Study and approve staff's recommendation on rates, realignment of the Purchased Power Adjustment base, early payoff of the Water Utility loan, and increased capital

DEPARTMENT: Electric Utility

SUBMITTED BY: Mark Curran, Director

BOARD/COMMISSION REVIEW:

On September 20, 2018, the Public Utility Advisory Board (PUAB) unanimously approved staff's recommendation on rates, realignment of the Purchased Power Adjustment base, early payoff of the Water Utility loan, and increased capital.

BACKGROUND:

Naperville's Electric Utility provides high-quality, reliable electric service to more than 57,000 customers. Over the last 50 years, the utility has purchased power through a variety of sources, including ComEd, J. Aron/Goldman Sachs and currently through an agreement with the Illinois Municipal Electric Agency (IMEA).

At the conclusion of the Utility's last rate study in 2015, the City Council approved a rate increase to continue to align the cost of purchase power with revenues. This resulted in an 8.3% rate increase effective February 1, 2016, and average 2.4% increases across the various customer classes effective January 1 of 2017 and 2018.

In 2016, the Electric Utility also implemented a Purchase Power Adjustment (PPA). This adjustment

on customers' monthly electric bills is designed to recoup, or credit, the difference in costs associated with power purchases. This is done to ensure customers are not over, or under, charged for what electricity they use. This tool is used by approximately 75% of public power systems and all investor-owned utilities to address variability in the power market. This action was a measured approach which allowed the Utility to improve cash flow while also maintaining the City's competitive residential rate position with ComEd.

Third, the Electric Utility recommended a phased approach in returning to the recommended level of capital spending of \$12 million a year in 2019 (\$8.3 million, \$8.3 million, and \$10 million in 2016 through 2018, respectively). These dollars are used for infrastructure maintenance and replacements, system expansions for new developments, right-of-way utility relocations in support of intergovernmental projects, and the Utility's share of citywide capital projects.

With these three items in place, the Electric Utility's cash balance has followed very closely with the rate study design throughout the years and is expected to be at \$25.2 million at the end of 2018. This is \$2.7 million over the \$22.5 million number projected by the study and can be primarily attributed to fiscally conservative capital spending in 2016.

The Electric Utility is in the third and last year of the 2015 rate study. In preparation for the next three years, the Utility contracted with Utility Financial Solutions (UFS), which also completed the 2015 study, to perform its current rate study. The 2018 rate study provides a financial plan for the Electric Utility through 2021.

DISCUSSION:

Recommendations

Through the 2018 rate study, the Electric Utility has developed the following recommendations for the next three years. Many factors influenced their development, including compliance with City financial policies, limiting debt, fully funding capital through rates, the appropriate level of capital funding to ensure high reliability, and competitiveness in the residential and commercial marketplace.

1. Implement rate decreases for each customer classification by 2% for each of the three years.

Rate reductions are possible due to the projected overall decrease in IMEA power supply costs over the next three years. Power supply costs are anticipated to decrease 1.7%, increase 0.8% and decrease 4.7% in 2019, 2020, and 2021, respectively. The significant decrease in power supply costs in 2021 is due to the retirement of IMEA debt of Trimble County Unit One. This rate reduction is reflective of a \$24 per year savings for the average residential customer; as of January 2019, residential customers will be paying below the ComEd rate. At this time, the Utility does not recommend any shifts among rate classes, as the rate study's cost of service analysis showed classes are within acceptable ranges.

2. Adjust the PPA base to realign it with the purchase power cost.

As noted earlier in this memo, a PPA is a tool used by utilities to help ensure that customers are not over, or under, charged for the electricity they use. The PPA will recoup, or credit, the difference in purchased power costs based on what is happening in the purchased power market.

Through the rate study, it is recommended that the baseline purchased power cost amount that determines the PPA be raised from \$83 to \$85.51/MWh. By taking this action to better

align with projected power costs, residential customers will pay approximately 1.8% less than they would have paid if the base was not adjusted.

The average residential customer received a PPA credit of \$2 in 2016, paid \$16 in 2017 and is anticipated to pay \$21 in 2018. The Utility expects customers to save \$22 in 2019 with the PPA base adjustment. Again, whether a customer pays or receives a credit is due to natural fluctuations in the purchased power market, and that fluctuation will impact the PPA moving forward. With the base adjustment, the average resident can now expect to pay \$8 in 2019, versus the original \$30, \$19 in 2020, and receive a credit of \$23 in 2021.

3. Implement an early payoff of the loan from the Water Utility by the end of 2018.

This action results in interest expense savings of \$456,000 for the Electric Utility fund by paying off the loan two years early.

4. Increase capital budget spending from \$12 million to \$14 million per year over the next 3 years.

As the Utility's financial position has improved and become stable, it has slowly built back up its capital spending to \$12 million. This conservative approach has caused a backlog of maintenance work on the Utility's mainline feeders and a slowdown of cable replacement work within subdivisions. For the next three years, the Electric Utility is proposing to invest an additional \$2 million per year on infrastructure to catch up on this back log while continuing to complete planned, and reactive, work on the system to mitigate future risk of significant outages to customers.

Impact of Rate Study on Cash Reserve Level

Five main factors are considered for the Electric Utility when determining a cash reserve level:

1. Working capital lag -
Time between customer billing and payment receipt by the city;
2. Power supply expenses -
Higher demand in summer months results in higher per kilowatt-hour cost;
3. Capital improvement cost -
Cost to maintain the system;
4. Debt service payment schedule; and
5. Catastrophic event -
Retaining enough money to start the repair and replacement, not to fund the entire event.

With the implementation of the above recommendations, the Electric Utility's projected cash balance at the end of the rate study is \$30.3 million. The analysis completed through the 2018 rate study recommends a minimum reserve requirement of \$30 million, with a PPA in place. With these proposed recommendations, the Utility is projected to be at this reserve level at the end of 2021. It should be noted that the Financial Advisory Board is reviewing cash reserve levels across all funds and will have recommendations available in 2019 for City Council consideration.

Areas to Watch

Staff continuously monitors legislation on all levels and remains cognizant of new legislative

mandates that may have an impact on future purchase power cost. Any new legislative mandates will be analyzed and the PUAB, and City Council, will be informed of any recommended adjustments.

Public Utilities Advisory Board (PUAB) Recommendation

At its September 20 meeting, PUAB discussed the 2018 rate study and the Utility's recommendations. The board raised several considerations, including the possibility of price fluctuations in power markets and the ability of the Electric Utility to sustain itself through supply cost fluctuations after having committed to a three-year rate reduction. Members also discussed the ability and willingness of the City to raise Electric Utility rates in the event of a large supply cost increase in years two and three. Finally, members indicated support for the request to increase spending on infrastructure to ensure system reliability while maintaining competitive rates among neighboring communities. PUAB unanimously approved staff's recommendations.

Next Steps

The Electric Utility's mission is to provide reliable, quality, responsive, and cost-efficient services for its customers in support of the health, welfare, and growth of the City. In keeping with this mission, and as a result of the 2018 Electric Rate Study, staff is requesting Council approve the following recommendations:

1. A decrease in rates by 2% per year for the next three years for all rate classes;
2. Move the PPA base from \$83.00 to \$85.51/MWh;
3. Pay off the Water Utility loan in 2018; and
4. Increase capital spending by \$2 million to a total of \$14 million per year for the next three years (2019-2021).

Should Council approve these recommendations, staff will bring back the ordinance codifying the rate adjustments for first reading on October 16 and on November 7 for adoption. Accordingly, rate adjustments would go into effect January 1, 2019, and every January through 2021. The Utility will work with the City's Communications Division to appropriately communicate these actions to customers.

FISCAL IMPACT:

N/A