

CITY OF SEATTLE

RESOLUTION _____

..title

A RESOLUTION relating to the City Light Department; adopting a 2017-2022 Strategic Plan for the City Light Department and endorsing a six-year rate path required to support the Strategic Plan.

..body

WHEREAS, the City Light Department (“City Light”) is the tenth largest public utility in the

nation, serving more than 400,000 customer accounts, and providing safe, affordable, and reliable electricity to its customers; and

WHEREAS, Resolution 31383 of July 2012 adopted City Light’s 2013-2018 Strategic Plan and

endorsed a six-year rate path that supported that plan; and

WHEREAS, Resolution 31383 also specified that City Light would review and update the

Strategic Plan every two years, adding two years to and re-evaluating the remaining four years of the existing Strategic Plan; and

WHEREAS, Resolution 31529 of June 2014 adopted City Light’s 2015-2020 Strategic Plan

Update and endorsed a six-year rate path that supported that plan; and

WHEREAS, City Light has reviewed and updated the Strategic Plan by: (a) reviewing changes

in its operating environment for the 2017-2020 period and making adjustments to remain within the previously approved rate path; and (b) adding a forecast of revenues, expenditures, and investments for two additional years, 2021 and 2022; and

WHEREAS, City Light continues to face challenges which include: (a) slowing load growth

leaving less revenue to cover rising infrastructure costs; (b) technological changes and threats to cybersecurity; (c) an aging workforce stressing the importance of training, succession planning, and workforce development programs; (d) the emergence of electric vehicles, solar power, and other technological advances that promise to change the

1 electric industry landscape; and (e) finding and achieving new operational efficiencies;

2 and

3 WHEREAS, City Light seeks to provide rate predictability and stability in future rates, and to

4 avoid the pattern of volatile rate adjustments that characterized the decade before the

5 adoption of the 2013-2018 Strategic Plan; and

6 WHEREAS, in consultation with the Mayor and the City Council, City Light initiated the

7 Strategic Planning process in 2010 to provide more transparency and accountability for

8 decision-making within City Light; and

9 WHEREAS, Ordinance 123256 establishes the City Light Review Panel (“Review Panel”) to

10 represent City Light ratepayers and requires the Review Panel to review and assess City

11 Light’s strategic plans; and

12 WHEREAS, the Review Panel has reviewed City Light’s progress in carrying out the Strategic

13 Plan on a quarterly basis since 2013, and also reviewed the Utility’s proposed changes for

14 the 2017-2022 Strategic Plan Update; and

15 WHEREAS, the City Council has reviewed the Strategic Plan Update, the associated six-year

16 rate path, the recommendation of the Review Panel, and the results of customer

17 engagement; NOW, THEREFORE,

18 **BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SEATTLE, THE**

19 **MAYOR CONCURRING, THAT:**

20 Section 1. The City Council adopts the City Light Department’s (“City Light”) proposed

21 2017-2022 Strategic Plan Update (the “Strategic Plan”), a copy of which is attached to this

22 ordinance as Attachment A and incorporated by reference.

1 Section 2. To achieve the goals of the Strategic Plan, annual rate increases averaging 4.3
2 percent system-wide per year are anticipated over the period of 2017-2022. The following six-
3 year rate path for City Light rates is endorsed:

4 2017: 5.6%

5 2018: 5.6%

6 2019: 5.0%

7 2020: 3.6%

8 2021: 3.1%

9 2022: 2.5%

10 Section 3. The City Council requests that the executive submit the 2017-2018 City Light
11 Proposed Budget in support of the Strategic Plan.

12 Section 4. The City Council requests that the executive submit the 2017-2018 City Light
13 Rate Proposal in support of the Strategic Plan, including the endorsed system rate increases of
14 5.6 percent in 2017 and 5.6 percent in 2018.

15 Section 5. City Light will continue to review and update the Strategic Plan every two
16 years, adding two years to the Strategic Plan and re-evaluating the subsequent six-year rate path.
17 The next review and adjustment of the Strategic Plan will be finalized in 2018 and will
18 encompass the years 2019 through 2024.

19 Section 6. As part of the next update to the Strategic Plan, the Council requests that City
20 Light prepare options for mitigating and preparing for the financial impacts of possibly flat or
21 declining retail load, including:

1 1. Pursuing state authority for City light to pursue electrification of transportation
2 and Port of Seattle operations that reduce carbon emissions and increase retail
3 load;

4 2. Providing proposals for permanent reductions in costs; and

5 3. Proposing changes to Resolution 31351 establishing policy guidance on rate
6 making. In developing options City Light should consider at least the following
7 topics:

8 a. use of the Rate Stabilization Account to help reduce retail revenue
9 volatility;

10 b. decoupling retail revenue recovery from retail sales;

11 c. changes to rate design; and

12 d. changes to the utility's approach to load forecasting as discussed in City
13 Light's response to Council's 2015 Statement of Legislative Intent 4-1-A-
14 2 (incorporated at Attachment B).

15 Section 7: Workforce Planning. Much of City Light's workforce is eligible to retire, or
16 will be eligible to retire in the near future. Historically, apprenticeships have been used to train
17 and hire the next generation of skilled workers. The apprenticeship program should also provide
18 opportunities for individuals who have historically not been included in the construction
19 industry, including women and people of color, and expansion of the program will allow for
20 greater inclusion of these populations. Council signals its intent to work with City Light to
21 establish new strategies and approaches, including potential legislation that would facilitate
22 recruitment and hiring of apprentices from pre-apprenticeship programs identified in the City's

1 Project Hire Program, to ensure a diverse population is hired into City Light's apprenticeship
2 programs as these will be City Light's future workforce.

3

1 Adopted by the City Council the _____ day of _____, 2016,
2 and signed by me in open session in authentication of its adoption this _____ day of
3 _____, 2016.

4 _____
5 President _____ of the City Council

6 The Mayor concurred the _____ day of _____, 2016.

7 _____
8 Edward B. Murray, Mayor

9 Filed by me this _____ day of _____, 2016.

10 _____
11 Monica Martinez Simmons, City Clerk

12 (Seal)

13 Attachments:

14 Attachment A - 2017-2022 Strategic Plan Update

15 Exhibit 1 - Financial Forecast Assumptions

16 Exhibit 2 - Strategic Initiatives Summary

17 Exhibit 3 - Strategic Plan Metrics

18 Exhibit 4 - Summary of Customer and Stakeholder Outreach

19 Exhibit 4a - City Light Review Panel Meeting: "Utility of the Future," Program

20 Agenda

21 Exhibit 4b - Strategic Plan Update 2017-2022: Customer Survey

22 Exhibit 4c - Strategic Plan Update 2017-2022: Employee Survey

23 Exhibit 5 - May 23, 2016 Letter from Seattle City Light Review Panel to Mayor Murray

Kirsty E. Grainger/Tony Kilduff
SCL 2017-2022 Strategic Plan RES
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1 Attachment B: City Light Response to SLI 4-1-A-2

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JUNE 30, 2016

TO

City Council

FROM

Paula Laschober, City Light Interim CFO

SUBJECT

Response to SLI 4-1-A-2

SUMMARY

The 2015 Statement of Legislative Intent, 4-1-A-2, requests that Seattle City Light (SCL) “work with the Council’s Central Staff, the City Budget Office, and the City Light Review Panel to review its financial policies and to recommend any changes necessary to ensure that they provide adequate protection from the risks associated with the utility’s volatile wholesale and retail revenue streams. The Council further requests that City Light develop any necessary legislation for the Council to consider.”

Earlier this year, SCL and the Seattle City Light Review Panel reviewed City Light’s financial policies to ensure they provide adequate risk mitigation for uncertain wholesale and retail revenue streams. City Light and the Review Panel concluded that:

- Wholesale revenue risk is being managed effectively by the Rate Stabilization Account (RSA) and current policies for its operation.
- Retail revenue risk is still an emerging issue, and options for managing this risk should be analyzed further. Accordingly, City Light proposes incorporating a study of approaches for managing retail revenue uncertainty in the next strategic plan.

BACKGROUND

City Light’s current financial policies were adopted in March 2010 as part of Resolution 31187. Resolution 31187 details two main policies, a rate setting guideline which states that retail rates should be set to achieve a minimum of 1.8 times debt service coverage, and a debt policy which states that 40% of capital investments (CIP) should be funded with operating cash, on average over a 6-year period. Maintenance of a Rate Stabilization Account (RSA) is the third element of City Light’s overall approach to managing its finances, and in particular the mechanism used to handle year-to-year fluctuations in net wholesale revenue.

City Light has utilized a debt service coverage policy since 1977, excepting a few years following the 2001 west coast energy crisis. From 1977 to 1989 and from 2005 to 2009, the policy called for 2.0x

coverage. From 1989-2001 and since 2010, the policy has been 1.8x coverage. The 2010 change in policy reducing coverage from 2.0x to 1.8x was partially a response to the 2009 recession, and was implemented along with a substantial rate increase (13.8% average). The reduction in coverage requirement did not impact City Light's credit ratings only because it occurred concurrently with the creation of the RSA, which greatly reduced revenue volatility, thereby improving financial stability and greater certainty of achieving the 1.8x coverage target.

The debt, or capital financing, policy requiring 40% of capital investments to be funded with current operating revenue was also put into place in 2010. From 1977 to 1989, financial policy required 50% of general capital investments to be financed with current revenue, though the policy allowed the financing of major new capital projects to be determined by the Mayor and City Council on a case-by-case basis. This policy behaves similarly to the debt coverage policy in that it determines how much debt will be issued to support capital expenditures. City Light's current capital program has been unusually large in recent years, due primarily to a handful of once-in-a-lifetime major projects such as the Alaskan Way Viaduct and Denny Substation, and so this policy has not been treated as binding for rate-setting purposes.

The Council SLI specifically requested a review of financial policies as they pertain to managing risks associated with the utility's volatile wholesale and retail revenue streams. A simple way to improve financial stability in the face of volatile revenue streams would be to make the debt coverage policy or capital financing (debt) policy more stringent. For example, Council could increase the debt coverage policy back to 2.0x, or increase the percentage of capital financed by cash to 50% or greater. The effect of such a policy change would be greater cash financing of capital expenditures, reduced debt, and a significant near-term rate impact. However, this type of policy change would not buffer revenue risk, it would merely provide City Light with more cash to help absorb the risk. Therefore, this SLI response focuses primarily on the third existing policy, the RSA, and other policy options that can specifically help to hedge or offset revenue risk.

The RSA is a reserve of funds that protects against volatility in the wholesale energy market. The basic rules and parameters for operation of the RSA were established by Ordinance 123260 in March 2010. The RSA reserve provides valuable cash liquidity, which is a strong credit positive in the eyes of credit rating agencies. It was initially funded primarily with operating surpluses but the balance now goes up or down depending on how close actual net wholesale revenue (NWR) is to the year's NWR forecast. Furthermore, if the balance grows either too large (\$125 million) or too small (\$90 million or lower), automatic rebates or surcharges are triggered to keep the RSA within an optimal range, as described in the table below.

RSA Balance	Action
Less than or equal to \$90M but greater than \$80M	Automatic 1.5% surcharge
Less than or equal to \$80M but greater than \$70M	Automatic 3.0% surcharge
Less than or equal to \$70M but greater than \$50M	Automatic 4.5% surcharge
Less than or equal to \$50M	City Council initiates a rate review within 45 days to determine actions to replenish RSA to \$100 million within 12 months
Greater than \$125M	City Council initiates a rate review within 45 days to determine actions to reduce the RSA to \$125 million within 12 months

Over the course of its operation since 2011, the RSA mechanism has proven to be very effective at neutralizing risk to NWR, which varies significantly due to wholesale market volatility and uncertain hydro runoff. A 2014 strategic initiative that changed the methodology used to forecast NWR, separating it from historic actuals and instead aligning it with a more conservative forecast, turned out to be a fortuitous move in that it helped to cushion the impacts of an unexpectedly weak wholesale power market. Despite this reduction in the forecast, net wholesale revenues have come in below the forecast in recent years, and consequently, the RSA balance has declined. The balance was at \$125 million in January of 2015 but has dipped to approximately \$90 million in Q2 of 2016, and will likely trigger a surcharge at the end of June 2016. The automatic triggers ensure that the RSA balance will remain adequate to provide City Light with sufficient liquidity, and City Light expects out-year performance of NWR to align more closely with the annual forecasts in place at this time.

The RSA is also a significant part of City Light’s cash on hand, which is sufficient to fund about 166 days of operating expenses. This is low compared with peers, who typically maintain cash on hand in the 300-500+ days’ range. City Light’s financial advisors feel it is critical to retain this liquidity to ensure a strong credit rating to support the utility’s substantial debt issuance plans.

Retail revenue has historically been considered a stable revenue source, typically fluctuating by only a percentage point or two. However, in recent years, retail revenue has come in lower than expected due to weather, the regional economic climate, and changing customer consumption patterns. In particular, improved energy efficiency seems to be driving per-customer consumption downward at an unexpectedly high rate. In 2015, unseasonably warm weather along with unprecedented levels of customer efficiency caused a 5% retail revenue shortfall, and similar weather impacts are being seen in 2016.

In February of 2016, City Light reviewed financial policies and RSA policy options with the City Light Review Panel. The Panel found the RSA to be effective at neutralizing wholesale revenue risk stemming from highly volatile wholesale market prices and hydro flows, and the \$100 million RSA cash reserve sufficient to prevent financial risk from being passed directly to retail customers. The Panel’s prevailing view on retail revenue risk is that it is still an emerging area of risk, which they would like to analyze

further before recommending a mitigation solution. The Panel’s recommendations are reflected in the areas for future study detailed below.

As part of the next Strategic Plan, City Light recommends exploring the following approaches for managing retail revenue risk:

1. Revenue Decoupling

There is industry-wide precedent for retail revenue stabilization mechanisms, which are commonly known as “decoupling mechanisms.” With decoupling, the amount of retail revenue earned by the utility is “decoupled” from the amount of energy used by customers. Rates are adjusted after the fact to true up to a pre-determined revenue amount. Both Puget Sound Energy and Avista Utilities were recently granted decoupling mechanisms by the Washington Utilities and Transportation Commission.

2. Retail Revenue RSA

Using the RSA to manage retail revenue risk would provide similar benefits to decoupling, but would leverage the cash in the RSA to buffer customer rates from immediate impacts of revenue fluctuations, the same way it does for wholesale revenue. Developing prudent rules for operation would be critical to the stability of a combined retail and wholesale RSA mechanism.

3. Rate Design

Rate design weighted towards variable charges (particularly per-kWh charges) adds uncertainty to retail revenue streams. In particular, City Light’s residential rates include a relatively high second block rate. This structure amplifies revenue impacts of load fluctuations (which might be due to weather, efficiency or other reasons). Adjusting the rate structure to emphasize fixed charges to support fixed costs such as distribution/infrastructure and public purpose programs would help to stabilize revenue.

4. Revised Load Forecast

There has long been precedent for using a conservative estimate of hydroelectric generation volumes when budgeting and rate-setting. For example, both Tacoma and Snohomish PUD use a hydro scenario that is lower than normal water when budgeting. Analyzing customer end-use trends could yield better understanding of load drivers and provide a supplemental view to the current econometric load forecast models. Better understanding of customer use patterns could help inform whether recently observed load declines will be a short-term or enduring phenomenon.

5. Other Factors Affecting Retail Revenue

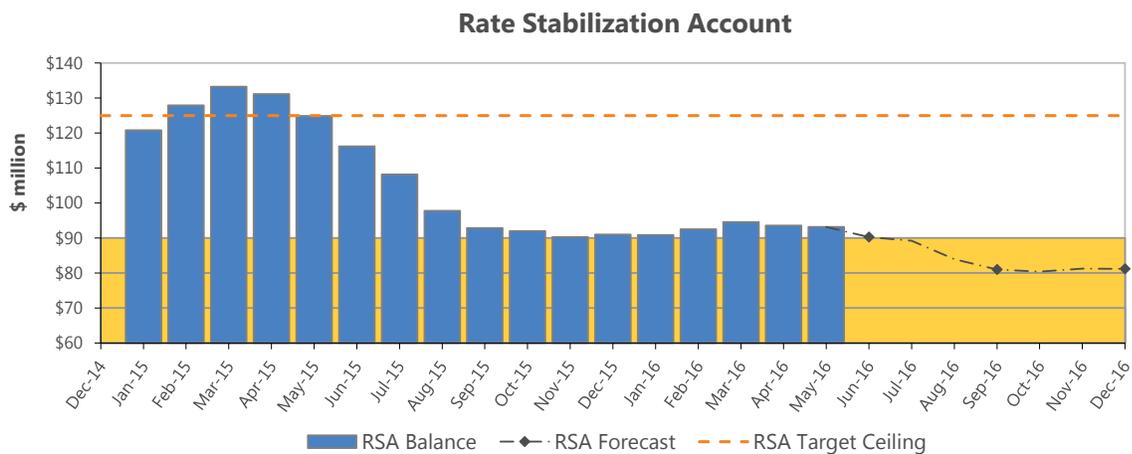
Policy decisions may impact revenue stability. For example, policy decisions around City Light’s low-income rate assistance program (e.g., expanding the size of the program, type and size of discount offered) will impact the amount of revenue that must be collected from customers.

Another option to protect against low retail revenue scenarios would be to strengthen the debt service coverage policy to a more conservative ratio than 1.8 times. This would provide more cash for low revenue scenarios, but would increase rates considerably in the short-term.

RSA History

The RSA is a large cash reserve established to buffer volatile revenues from surplus wholesale energy sales, also known as net wholesale revenue or NWR. The RSA was implemented on January 1, 2011, and has rules governing its use prescribed by Ordinance 123260, which was adopted in March 2010. Per Ordinance 123260, automatic surcharges are triggered to replenish the RSA should it become depleted.

The chart below shows the historical balance of the RSA since late 2014, with a forecast through the end of 2016. At the beginning of 2015, the RSA balance was \$114 million, and due to a record early hydro runoff, it rose to over \$130 million by March 2015. Since then, the RSA balance has steadily declined, and since late 2015, has been hovering just above the \$90 million surcharge threshold. Hydro forecasts indicate that it is highly likely that the RSA will drop below \$90 million before the end of 2016, which will trigger an automatic 1.5% rate surcharge. This would be the first surcharge to be triggered automatically since the RSA began operation in January of 2011.



In its early years, RSA stability was an issue because wholesale prices were declining rapidly, causing NWR to fall far short of the forecast (which was based on a historical average) year after year. Fortunately, SCL had surplus operating revenues available to deposit into the RSA to bring the balance up again, thus avoiding a surcharge.

As part of the 2014 strategic plan, an initiative was adopted that would address this issue and make the NWR forecast more conservative. Rather than be based on a historical average, the NWR forecast was adjusted to use more recent actual performance. In 2012, the NWR forecast for the year was just over \$100 million. For 2016, the forecast was reduced to \$60 million, and by 2022, it drops to \$40 million per the proposed 2017 to 2022 strategic plan (see table below).

RSA Activity History and Forecast

\$ Million	2011	2012	2013	2014	2015	2016	2017	2018
RSA NWR Budget	\$96.8	\$102.1	\$90.0	\$85.0	\$65.0	\$60.0	\$60.0	\$60.0
NWR Actual/Forecast	\$98.4	\$63.9	\$51.6	\$88.6	\$33.6	\$47.9	\$52.1	\$68.1
NWR Surplus (Shortfall)	-\$1.6	\$38.2	-\$38.4	\$3.6	-\$31.4	-\$12.1	-\$7.9	\$8.1
RSA Starting Balance	\$79.3	\$141.5	\$128.3	\$110.0	\$114.4	\$85.5	\$84.5	\$89.4
RSA Transfers for NWR	\$1.6	-\$38.2	-\$38.4	\$3.6	-\$31.4	-\$12.1	-\$7.9	\$8.1
RSA Surcharge Revenue	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$9.8	\$11.6	\$7.1
Discretionary Transfers	\$61.4	\$22.0	\$21.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Other Transfers*	-\$0.8	\$3.0	-\$0.9	\$0.8	\$2.5	\$1.3	\$1.3	\$1.5
RSA Ending Balance	\$141.5	\$128.3	\$110.0	\$114.4	\$85.5	\$84.5	\$89.4	\$106.1

*Interest, True-ups

Forecast 5/13/16

In conclusion, City Light feels that the current financial policies serve the utility and its customers well. However, the recent changes outlined above related to NWR and retail revenues require that City Light continue to monitor these emerging issues and develop plans to address them. As part of the next strategic plan, City Light proposes assessing options for strengthening existing policies, as well as exploring potential new risk mitigation strategies, particularly in the area of retail sales.