

Tacoma Power Financial Update & 2023-24 Revenue Requirement

Public Utility Board

11 May 2022



Agenda

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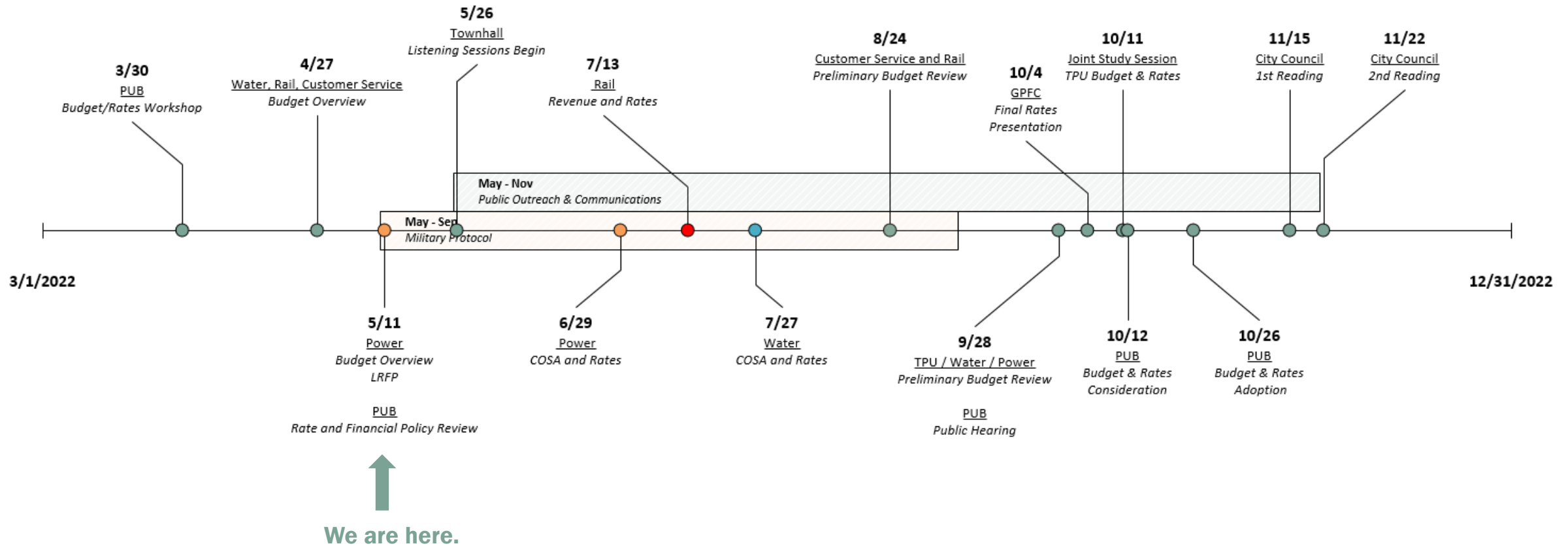
Appendix

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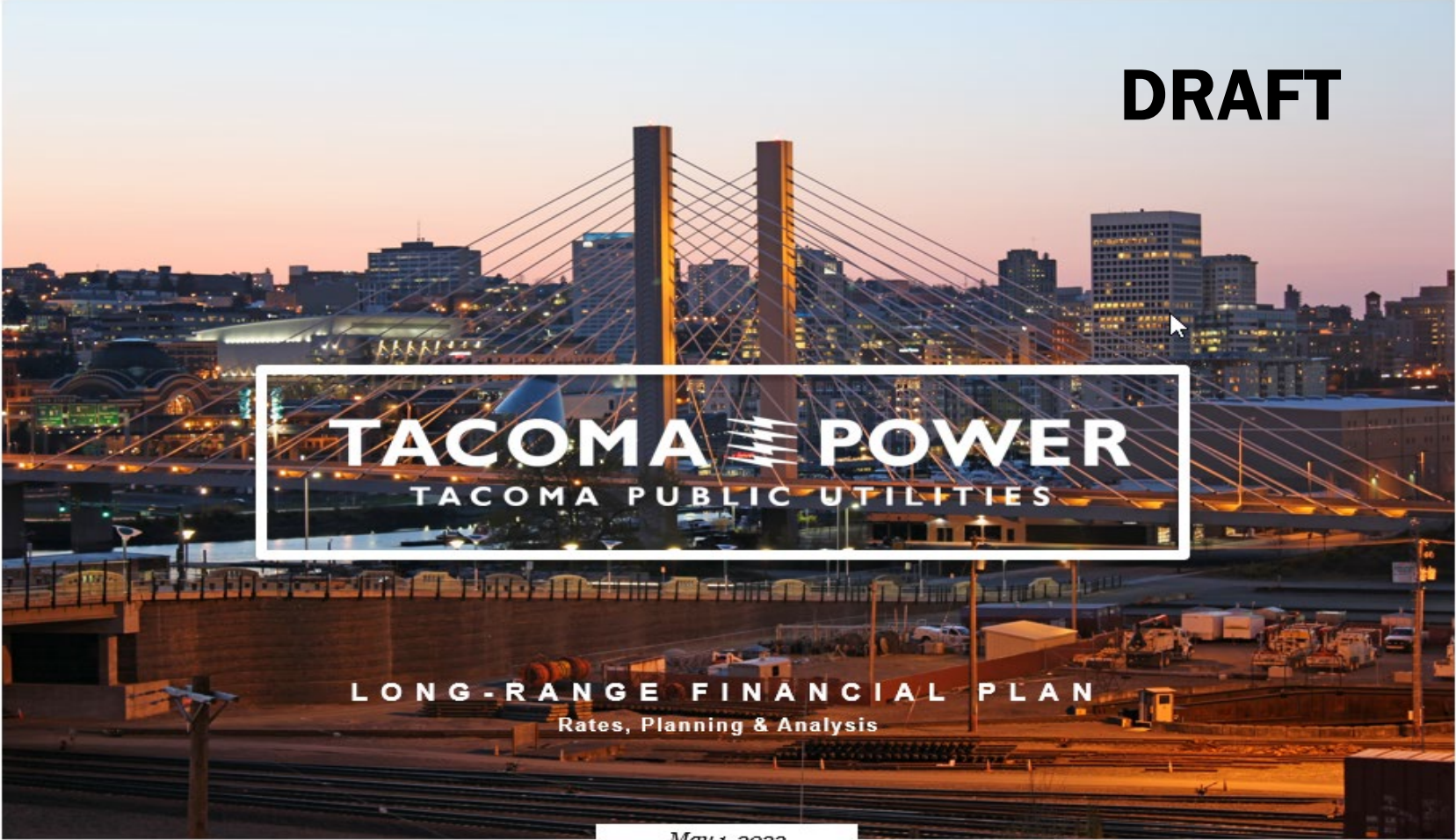
Section 1

Introduction

Rates and Budget Timeline



2022 Update of Tacoma Power Long-Range Financial Plan



DRAFT

Long-Range Financial Plan (LRFP) is available at mytpu.org

Before we start, a reminder...

This is a snapshot in time.

The amount of revenue we will receive each year is uncertain.

The amount of power that will be consumed by our customers is uncertain.

Actual rate increases may fall outside of this range and are dependent upon market conditions, financial performance, and the actions we may take in future years.

As has happened before -

These projections will change.

Entering 2022: Review of the Last Three Years

2019	2020	2021	2022
A very challenging financial year due to near-critical water conditions and significantly lower wholesale revenues.	The global COVID pandemic reduced power consumption, retail revenues, and significantly increased unpaid accounts.	Finally, the Power utility experienced financial relief due to above average water and higher wholesale market prices.	Year of inflation and supply chain delays?

2022 Long-Range Financial Plan Review

Policy Guidance

Board Strategic Directives



Financial Stability

Provide safe and reliable power over the long term.



Rates

Rates will be adequate, fair, just, and reasonable.

Electric Rate and Financial Policy

Outlines objectives and policies when setting rates including financial targets and the Rate Stabilization Fund usage.

Sections

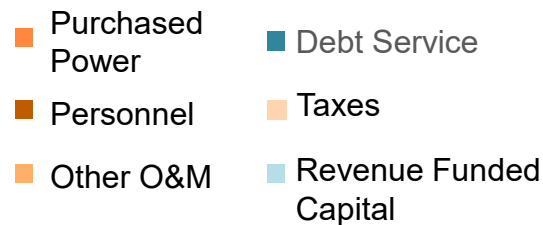
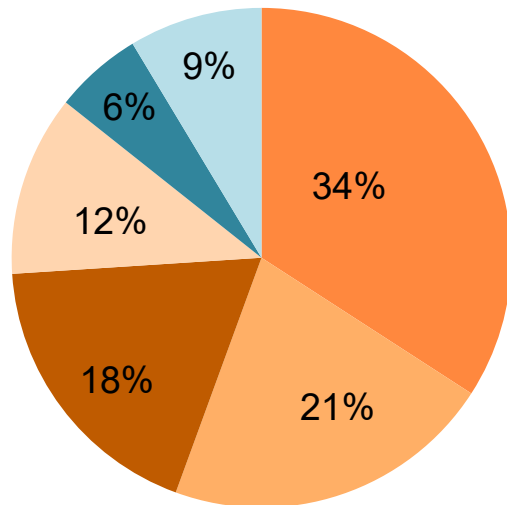
- I. Rate Setting Objectives
- II. Rate Review Process
- III. Rate Setting Policies
- IV. Financial Targets and Rate-Setting Practices
- V. Rate Stabilization Fund



These elements form the foundation of the LRFPP and are used to inform our base case and budget.

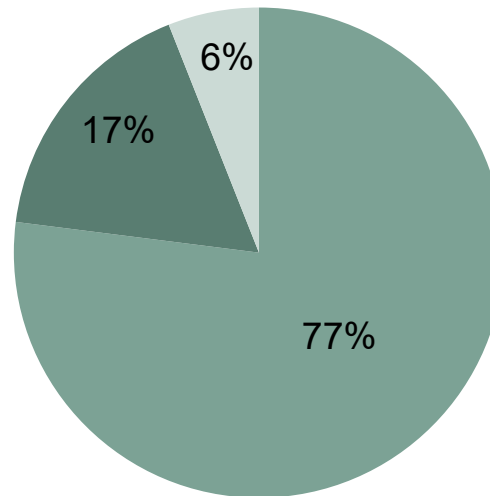
Expense Assumptions

As of December 31, 2021
(unaudited)

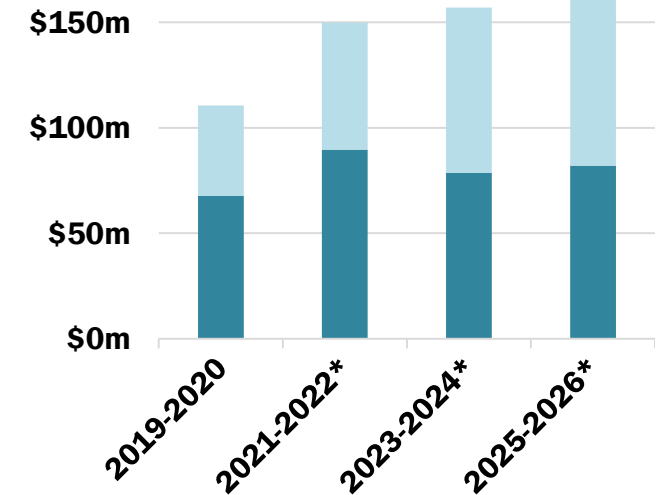


Revenue Assumptions

As of December 31, 2021
(unaudited)



Credit, Debt, & Reserves



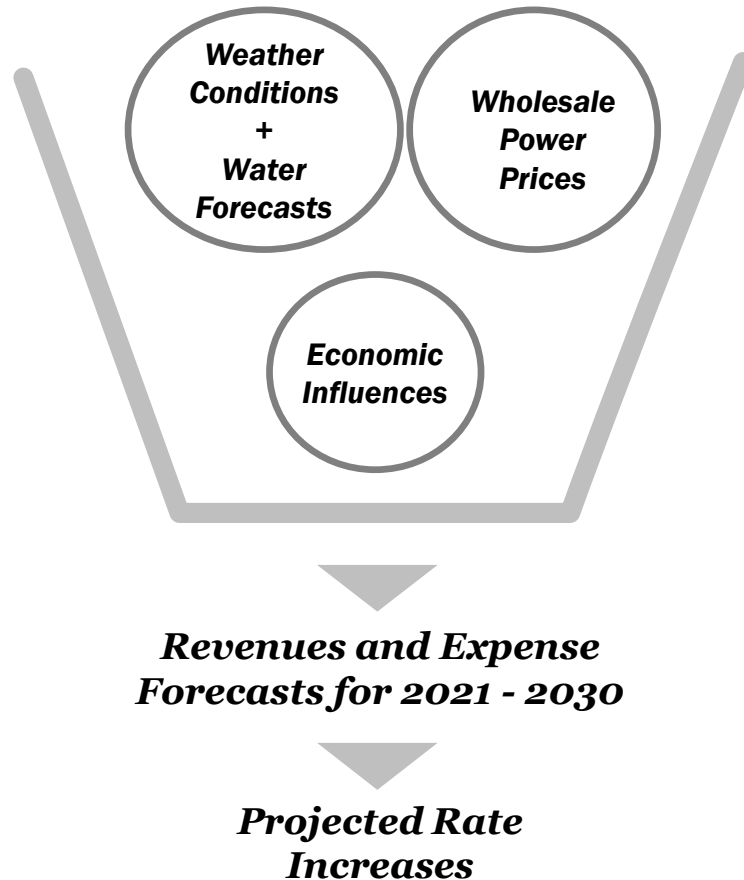
■ Bond Funded Capital

■ Revenue Funded Capital

* Projections as of March 31, 2022

Risks & Opportunities

Planning for Uncertainties



Internal Risks



- Compliance with Regulatory Mandates
- Technology Changes
- Aging Infrastructure
- Aging Workforce

External Risks



- Climate Change
- Weather Fluctuations
- Customer Demand Volatility
- Economic Cycles and Inflation
- Policy or Regulatory Changes
- Environmental Regulations
- Seismic Events
- A Pandemic

May Update: Forecast Sensitivities

Scenarios:

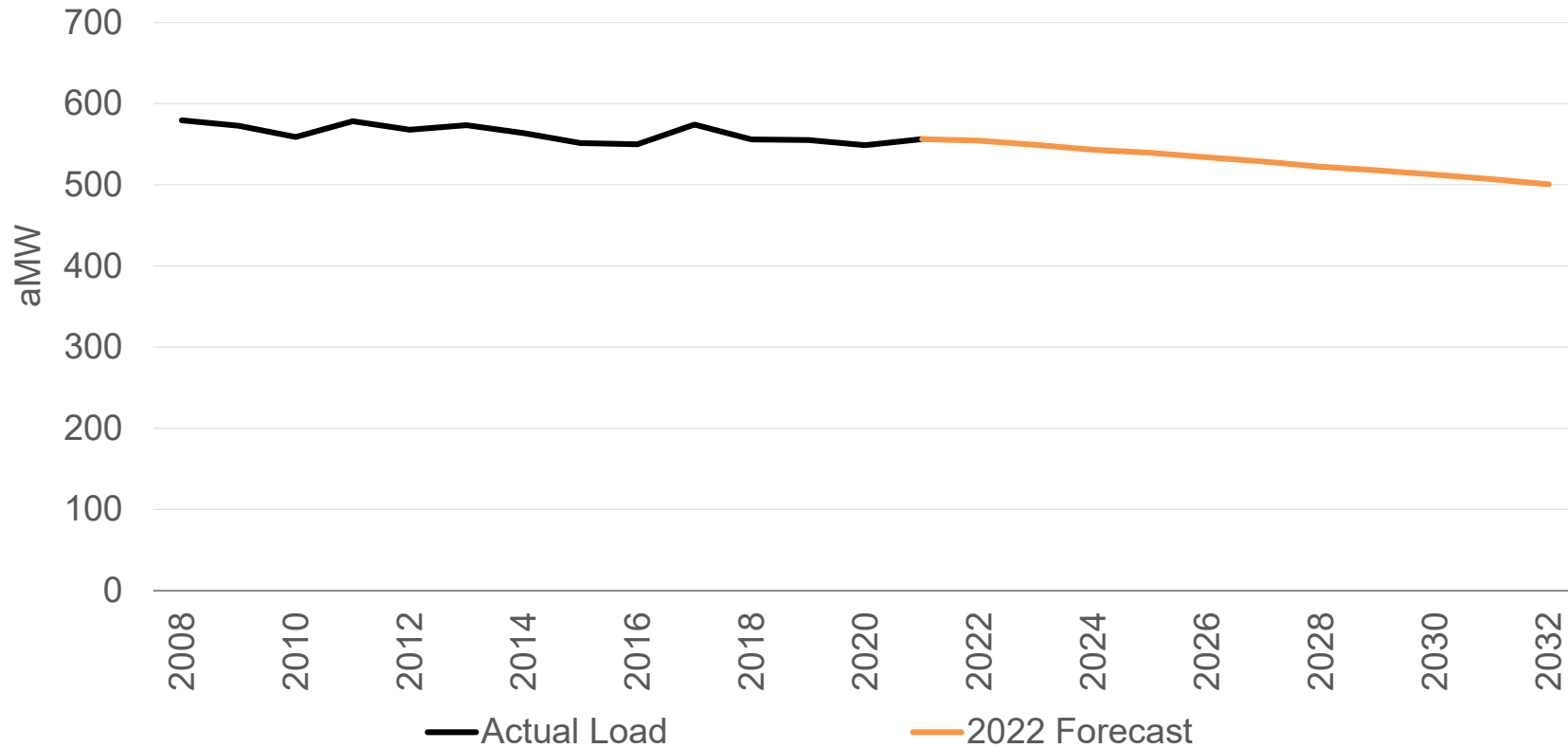
- **Recession in 2023 through 2024**
- **Loss of large load in 2023**
- **Critical water in 2023 and 2024**
- **Adverse water in 2023 and 2024**
- **Wholesale price collapse**
- **High inflation in 2023 and 2024**



**Standard
Planning
Scenarios**

Near-Term: Anticipated Slight Load Decline

2022 Retail Load Forecast

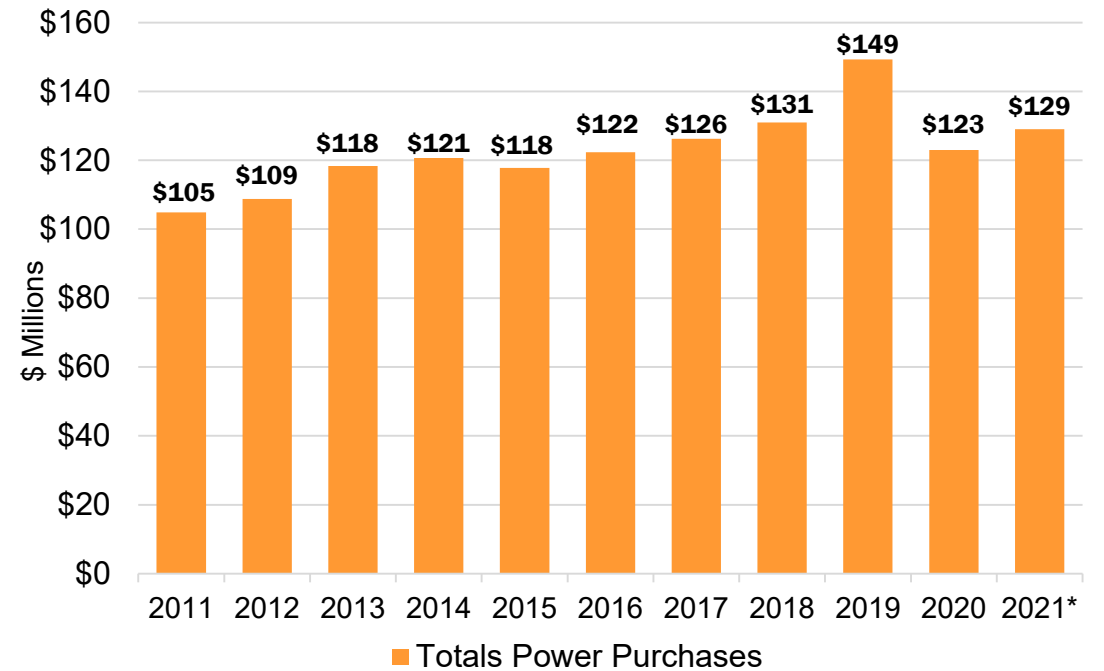
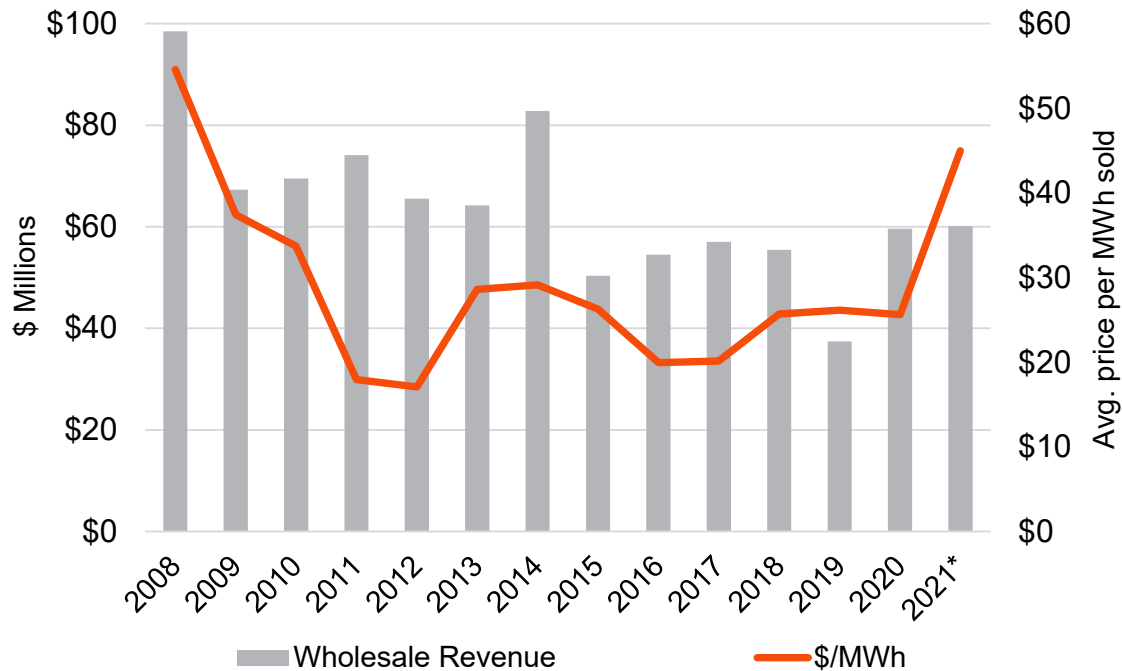


Retail loads have slightly declined annually over the last ten years by about -0.4%.

Volatile Wholesale Revenues and Increasing Purchased Power Costs

Wholesale revenues fluctuate between 12% to 20% of total revenues due to unpredictable weather and wholesale market power prices.

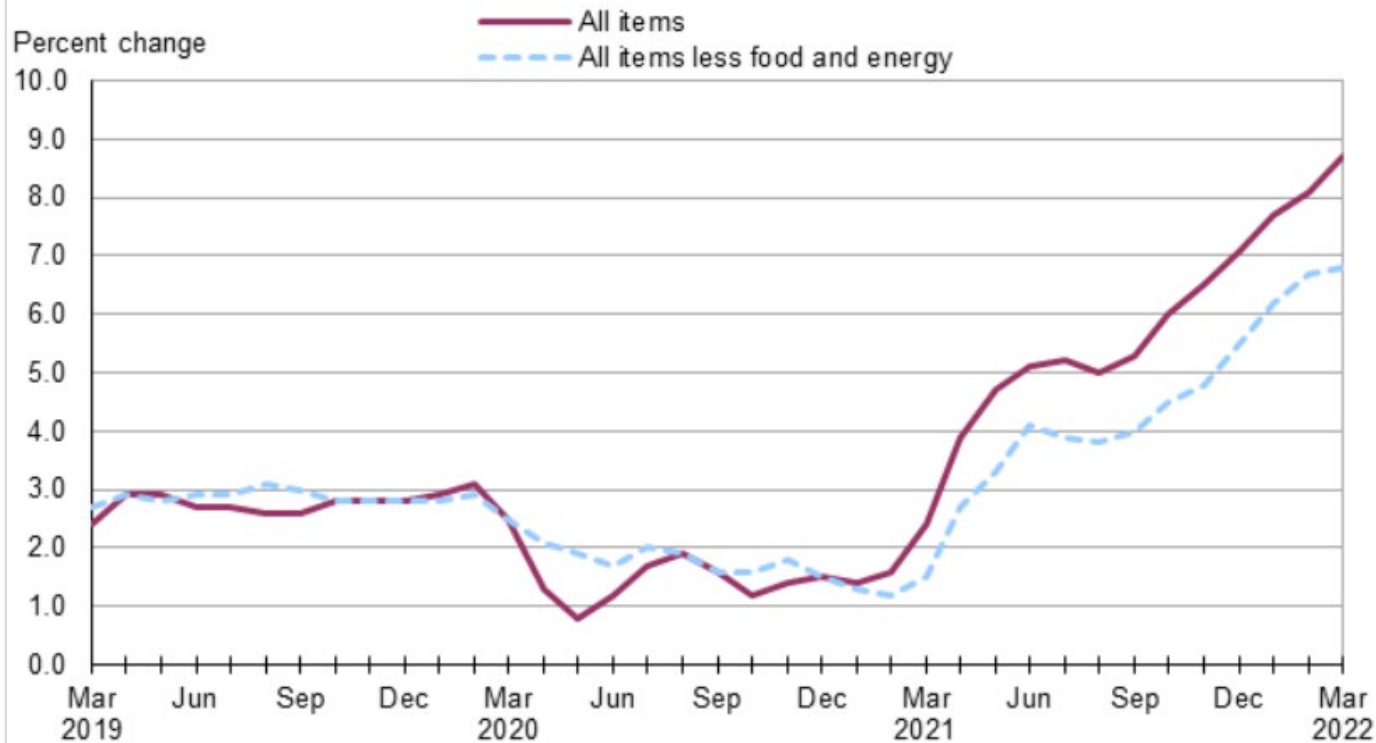
Power Purchases are approximately 34% of total expenses and main driver of increasing costs.



* Includes wholesale revenue set-aside in the Rate Stabilization Fund to apply toward future debt service.

Inflation: expense increases and supply chain delays

Chart 1. Over-the-year percent change in CPI-U, West region, March 2019–March 2022



Source: U.S. Bureau of Labor Statistics.

Consumer Price Index

Inflation increased 8.7% in 2021 in the Western U.S.

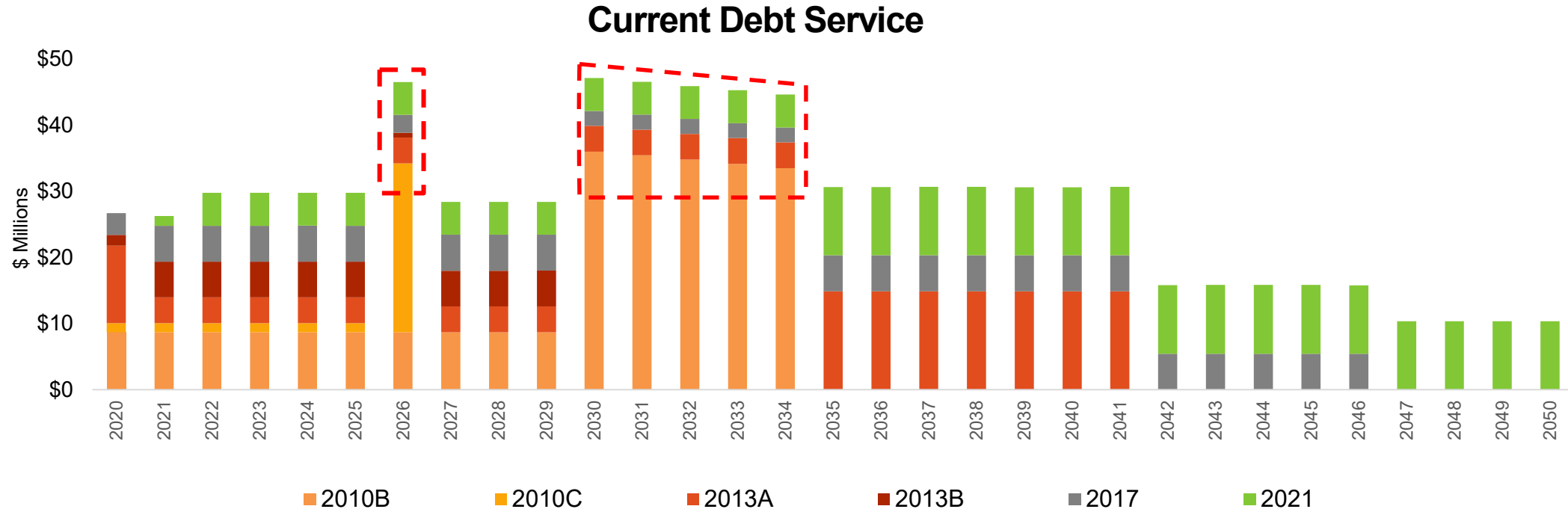
- Vehicle costs up 22.5%
- Health benefit costs up 18.2%
- +20% increase in some Represented wages over past 2 years

Supply Chain Delays

Shortages of transportation and steel

- 4-8X the normal lead time for delivery on transformers, insulators, switches
- Shortages on poles from Canada
- 120 items that are late from 25+ vendors

Spikes in the debt repayment schedule



This chart shows the combined principal and interest payments due by Bond and arranged by year.

The Long View:

Large debt service payments within the next ten years.

Long-Range Financial Plan incorporates plans to levelize spikes.

Initial System Average Rate Forecast

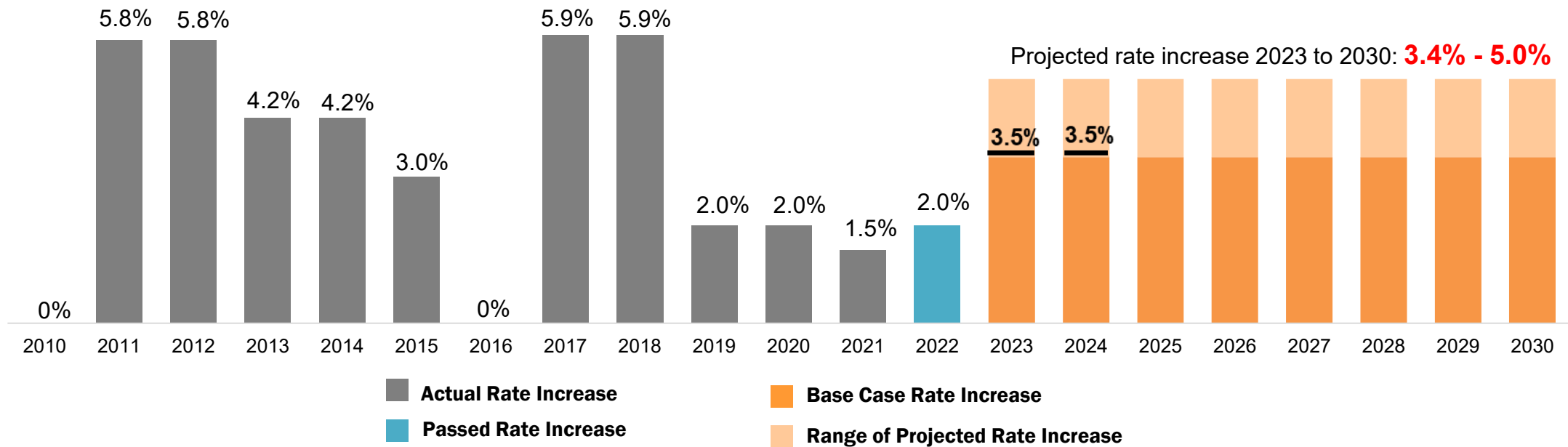
Determination of recommended average rates



Recommended: 3.5 percent annual rate increases in 2023 & 2024

Policy Decision

This forecast is subject to change, and is dependent upon actual financial performance in future years.

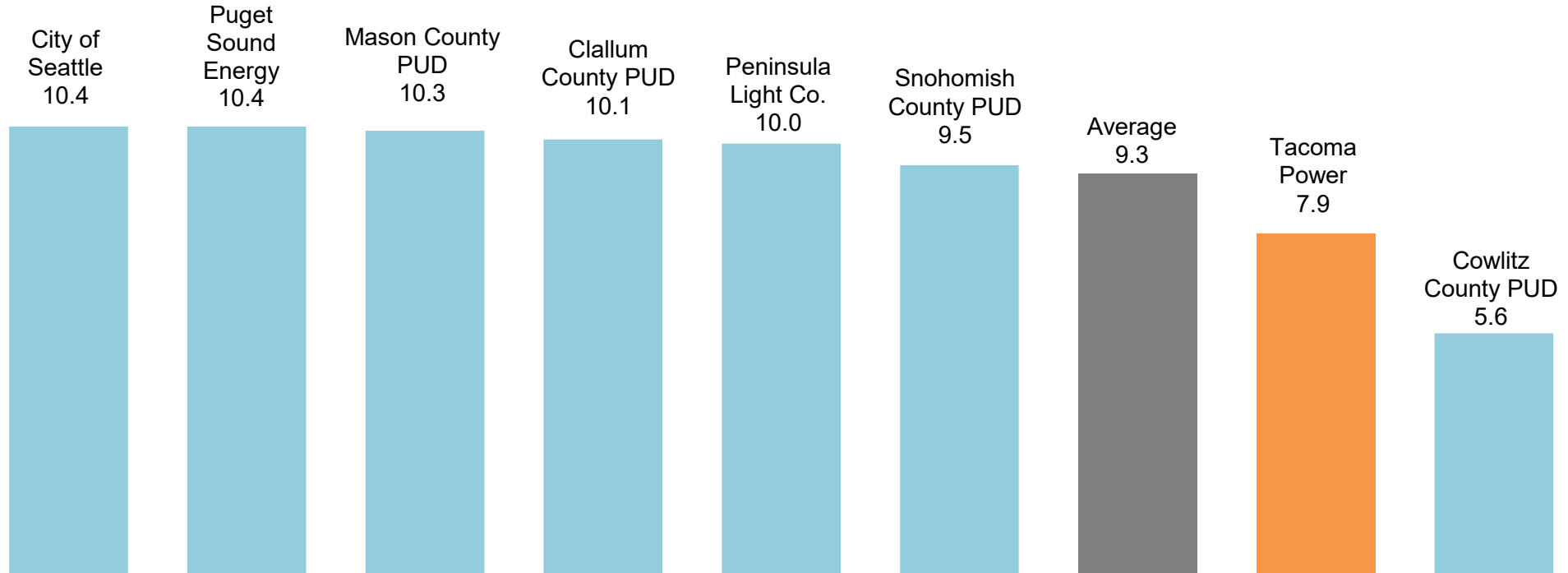


The **Electric Rate & Financial Policy** was modified in 2018 to explicitly support low and steady rate increases.

Strategic Directive SD-3 on Rates, Value 4 states “TPU values planning gradual and consistent utility rate changes that are stable and predictable over the long term and avoid sudden or large changes within customer classes.”

Rates Remain Low and Competitive

Comparative Western WA System Rates (cents/kWh)



Source: Energy Information Administration, Form 861, 2020.

Keeping Rates Reasonable

Power is working to stay in the rate trajectory of previous Long-Range Finance Plans

Assumptions affecting the 2023 and 2024 financial and average rate forecast

Revenue Assumptions

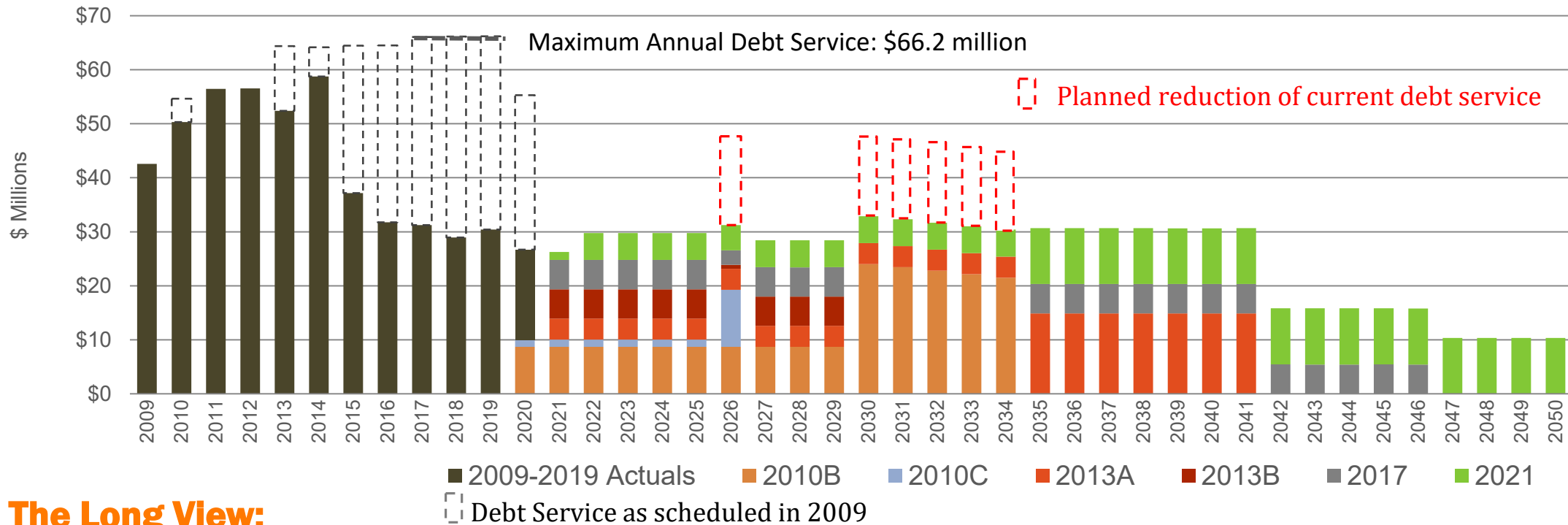
- 2022 Load Forecast
- Adverse water assumed for Wholesale Revenues in 2023/2024
- Incorporation of enhanced income-constrained programs through increase in uncollected residential revenue assumptions

Expense Assumptions

- 5% annual inflation in Personnel, Other O&M, and Assessment costs in 2023 & 2024
- 2.5% annual increase assumed in contracted Purchased Power expenses
- Annual revenue-funded capital spending in 2023 & 2024 close to actuals of 2021
- Plan to absorb increases in bad debt expenses from moratorium

Manage Debt Profile to Minimize Long-Term Rates

Historical and Current Debt Service



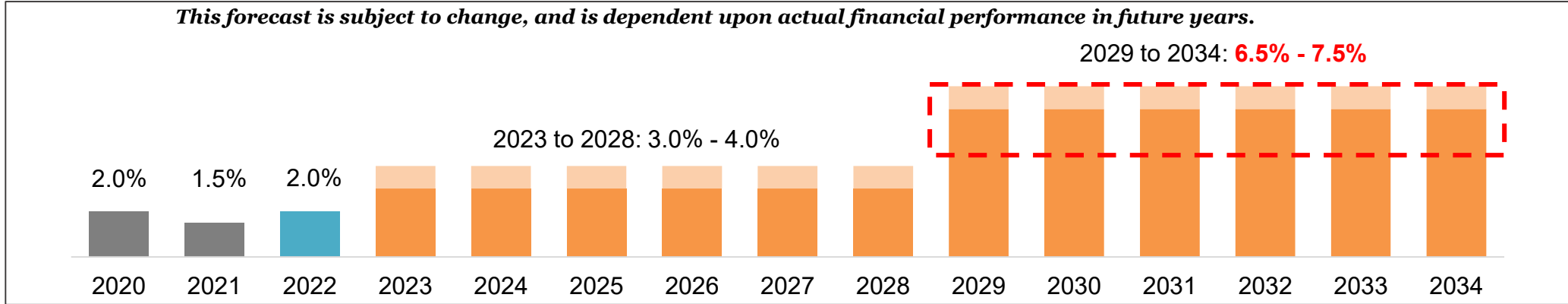
The Long View:

Managing debt service has produced significant savings to date.

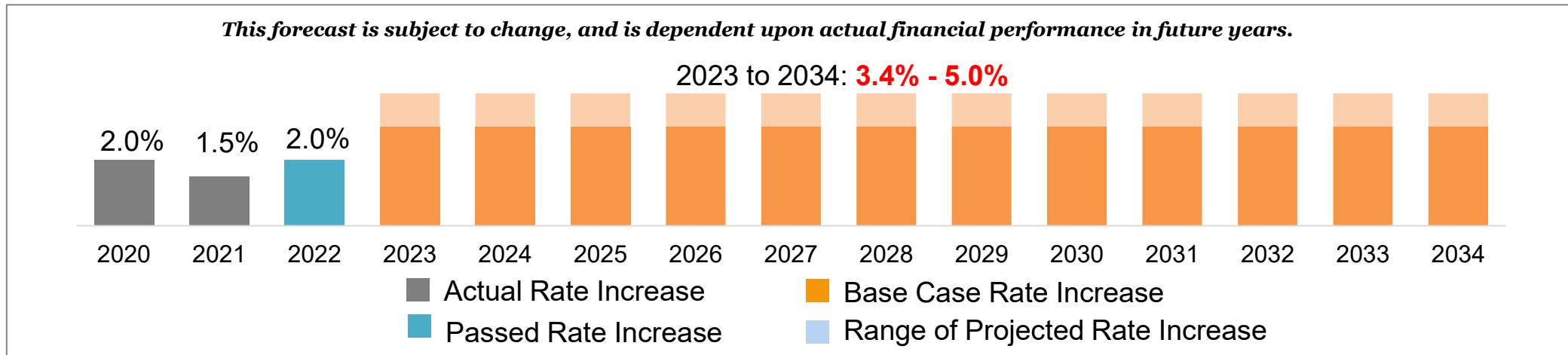
A bond refunding or repayment in 2023 and defeasances in 2026 and 2030-2034 are assumed to manage debt service and keep rates low.

Future Debt Service Impacting Short-term Rates

Projected rate increases with spikes in debt service



Projected rate increases with levelized debt service



Income-Constrained Assistance Programs

Last Biennium: Expanded Existing Programs

2021/2022 Biennium	Bill Credit Assistance Program (BCAP)	Low-Income Elderly/Disabled Discount Rate
	Widen the Net	Strengthen the Net
Recommended Change	150% Federal poverty level → 60% of area median income	30% discount on bill → 35% discount on bill
Justification	Area median income reflects the cost-of-living in the Tacoma area.	Relieve cost pressure on uniquely vulnerable populations.
Total Program Cost	\$166 thousand (2021 actual)	\$2.031 million (2021 actual)
Budget	Same as 19/20 Budget.	Reduction in expected retail revenue.

This Biennium: Adjust BCAP Mechanics

Policy
Decision

	Bill Credit Assistance Program (BCAP)	BCAP Plus
2023/2024 Biennium	Basic Assistance: Initial Monthly Credit Regardless of Bill Payment	Incentive Opportunity: Additional Payment for Payment In-Full and On-Time
Recommended Credit	\$17.90[†]	\$21
Justification	Set to equal customer charge for Power customers. <i>†To be adjusted as customer charge changes</i>	Current incentive for in-full & on-time payment → 22% of 2021 average bill.
Cost Increase due to Change	+\$3.5 million per year at 50% participation	+\$0 <i>(current program)</i>
Total Program Cost	Expected \$3.5 million per year; up to \$7 million per year at full participation	\$165,700 per year*

**at current participation rates (~7%). At higher participation, BCAP Plus total cost will rise proportionally.*

New BCAP Design: The Best of Both Worlds

Basic Credit:


- **Equivalent to waiving customer charge for Power customers**
- **Removes impact of customer charge increases on income-constrained customers**
- **Keeps per-kWh charge incentive to manage usage**

Plus Credit:

- **Incentivizes good payment behavior**
- **Keeps customer on track to prevent disconnection**
- **Increases possible discount to 40% of 2021 average bill**


Income-Constrained Conservation Assistance Scope

- Tacoma Power has emphasized income-constrained conservation programs for over a decade
- Customers are income-qualified at 80% area median income
- Review of previous study session material

<i>2022/23 Conservation Biennium</i>	Owner Occupied Single Family	 Rental Energy Efficiency Program	Agency Partnerships
Target Segment	Income-qualified owner-occupied up to fourplex	Income-qualified tenant-occupied up to fourplex	Agencies that serve income-constrained communities
Programs	<ul style="list-style-type: none"> • Insulation • Heat pumps • Heat pump water heater • Windows 	<ul style="list-style-type: none"> • Insulation • Heat pumps • Windows 	<ul style="list-style-type: none"> • Insulation • Heat pumps • Heat pump water heater • Windows

Income-Constrained Conservation Assistance Budget

- Budgets amounts represent planning values
- Incentives include: rebates, grants, deferred loans**, zero interest loans, and external contracts
- Staff support represents overhead to implement programs per biennium

<i>2022/23 Conservation Biennium</i>	Owner Occupied Single Family	 Rental Energy Efficiency Program	Agency Partnerships
Incentives	\$2,900,000	\$440,000	\$370,000
Staff Support	\$160,000	\$180,000	\$40,000
Total Budget	\$3,060,000	\$620,000*	\$410,000

**Deferred loans for owner occupied single family

*Preliminary budget.

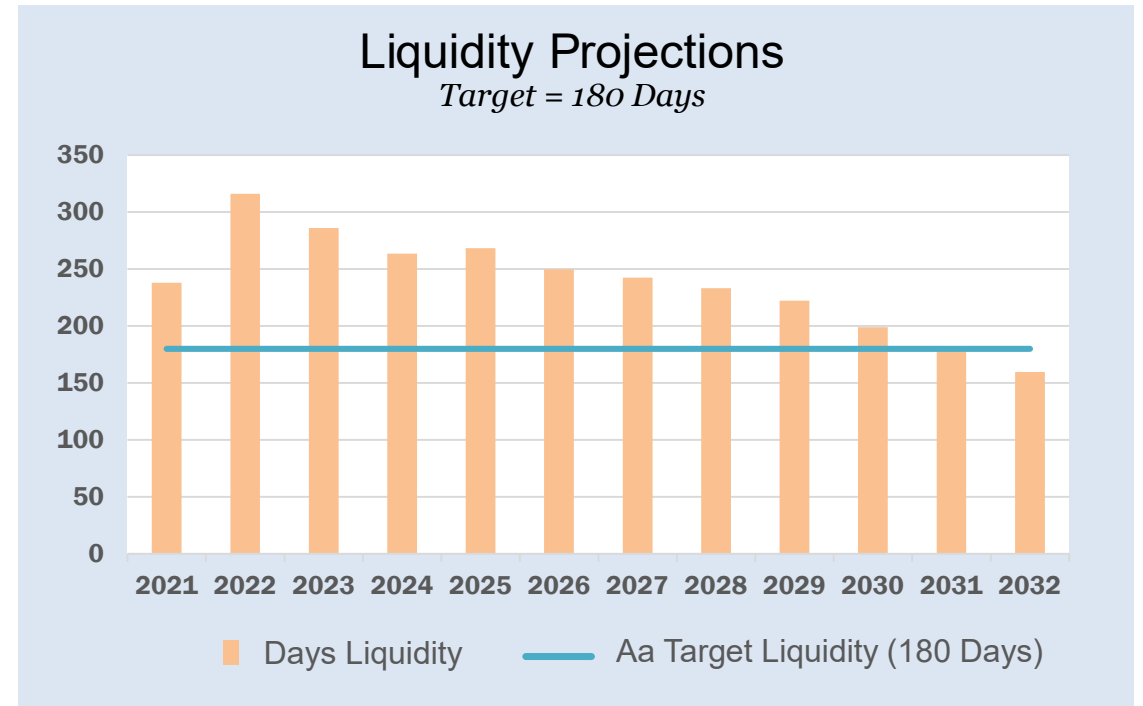
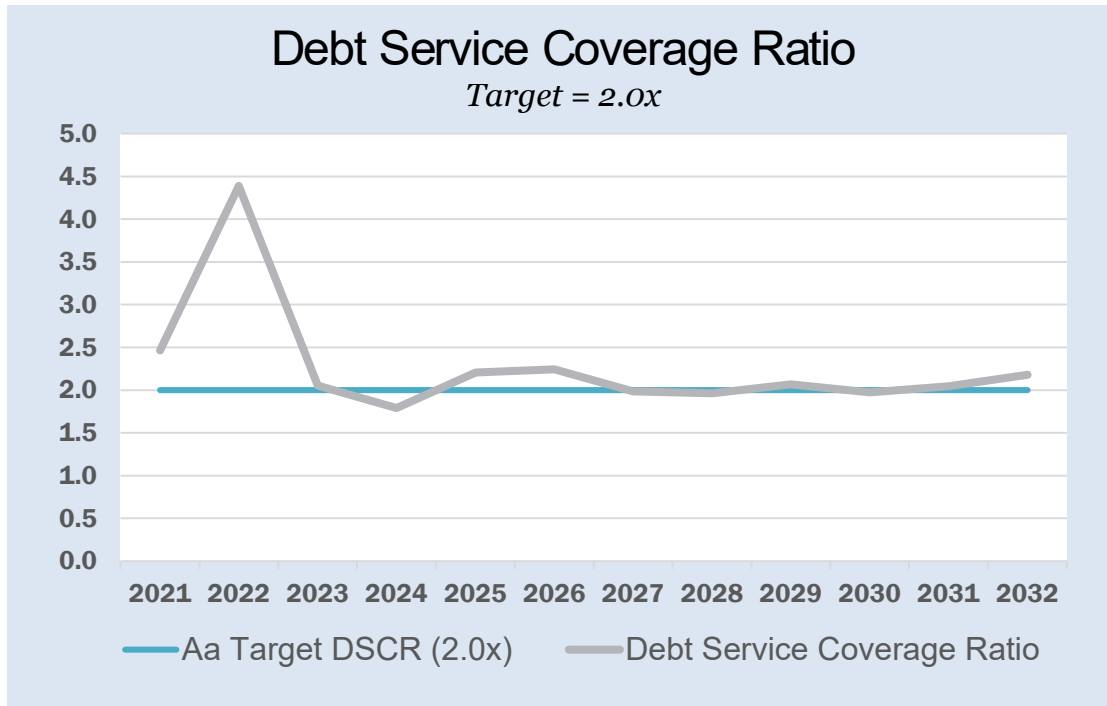
Section 6

Appendix

Adverse Water: Annual 3.5 percent rate increases

Scenario	Projected Rate Increases											
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Base Case: Average Water Conditions	1.5%	2.0%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
Budget: Adverse Water in 2023 & 2024	1.5%	2.0%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Critical Water in 2023 & 2024*	1.5%	2.0%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%
Loss of Large Customer in 2023	1.5%	2.0%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%
Lower Wholesale Prices 2023-2032	1.5%	2.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Economic Downturn in 2023 & 2024	1.5%	2.0%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
High Inflation in 2023 & 2024	1.5%	2.0%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%

Base Case Financial Metrics



Tacoma Power has AA credit ratings

High ratings enable:

- Access to financing (e.g. Keybank agreement)
- Lower interest rate on bonds

Electric Rate & Financial Policy:

- Requires debt-service coverage ratios and days cash on hand consistent with current rating
- Mandates low and consistent rate increases to minimize customer impact
- Approved by TPU Board and City Council

Strategic Directive SD-2 on Financial Sustainability:

- Outcome 4: “AA-level bond rating, or better, to facilitate access to lower-cost financing and produce sustainable debt service expenses.”
- Outcome 7: “Financial management of debt service over the long term to maintain reasonable debt-service requirements and meet debt service coverage ratios.”

Rating agencies are interested in different things

	Moody's*	S&P	Fitch
<i>Investment Grade</i>	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
	A1	A+	A+
	A2	A	A
	A3	A-	A-
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
Baa3	BBB-	BBB-	
<i>Non-Investment Grade Speculative</i>	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
	B1	B+	B+
	B2	B	B
	B3	B-	B-
	Caa1	CCC+	
	Caa2	CCC	
	Caa3	CCC-	CCC
	Ca	CCC	
	C		DDD
		D	DD
			D

This table compares the different rating scales for the three credit rating agencies, with Tacoma Power's current rating highlighted.

— Target ■ Current Tacoma Power Rating

* Moody's current rating for Tacoma Power only applies to Bonds issued before 2017.