Board of Public Utilities
Prepared Testimony of
Lori Austin
June 2023

Q: Please state your name and your business address.

A: My name is Lori Austin, 540 Minnesota Avenue, Kansas City, KS 66101.

Q: What is your position at the Board of Public Utilities (BPU)?

A: I am the Chief Financial Officer and Chief Administrative Officer (CFO/CAO).

Q: Please summarize your professional qualification and experience.

A: I have a Bachelor of Science degree in Business. I have been with the BPU for over 38 years during which time I have held several positions within the accounting area as well as other areas within Administration. I have been responsible for the activities of the Accounting Division since September 1997.

Q: What are your responsibilities as CFO/CAO?

A: My duties include the administration of BPU finances, oversight of the preparation of the annual budget, financial statements, debt service plan, bond issues, cost of service, revenue requirements and rate analysis as well as the day-to-day functions of Accounting which consist of: Accounts Payable, Inventory, Asset Management, Projects, Cash and Investments, Payroll, Fuel Inventory and Miscellaneous Accounts Receivables. Other areas of responsibility are Financial Planning, Purchasing and Stores, Human Resources, Administrative Services which includes document management and the administrative building facilities and Utility Services which includes Economic Development activities as well as maintaining communication with our key account customers.

Q: What are your responsibilities relating to the current Electric & Water Rate Hearing?

A: My responsibilities are to oversee the Cost of Service, Revenue Requirement Studies and to provide information for the Rate Hearing process.

Q: Did the Board of Public Utilities engage the engineering firm 1898 & Co. to perform an Electric Utility Revenue Requirements, Cost of Service and Rate Study.

A: Yes.

Q: Did the Board of Public Utilities engage the engineering firm Black & Veatch to perform a Water Utility Revenue Requirements, Cost of Service and Rates Study?

A: Yes.

Q: Was there also a review of the Utility's Financial Policies with both engineering firms?

A: Yes.

Q: Did the BPU Board direct staff to set a public hearing on the rate proposals?

A: Yes. The hearing was scheduled for June 14^{th} and June 15^{th} 2023.

Q: Has BPU staff and 1898 & Co. engaged in communication with the intervening group, Sierra Club?

A: Yes.

Q: What are the financial requirements of the utility?

A: The BPU's Revenue Requirement and Cost of Service study for 2023 is based on the approved 2023 budget. The capital improvement plan (CIP), is based on the fiscal year 2023 budget which provides a forecast of projects through 2027. The 5-year CIP is for both Electric and Water. The submissions included capital projects that were critical to the development of the service area and the reliability of the system for the period 2023 through 2027.

Along with operating and maintenance and capital improvement requirements, the utility is also required to meet the components of a financially solid Utility. The financial policies of the BPU are guidelines for operational and strategic decision making related to financial matters. Financial policies establish parameters in which the BPU can operate and provide a standard against which fiscal performance can be judged. The BPU Board has adopted a set of formal financial policies which govern the operating and capital budget, revenue and expenditures, reserves, debt management, and cash and investments. Financial policies are viewed positively by the rating agencies and may even improve the utility's debt rating.

The review of the BPU financial policies were to make recommendations for modifications to improve transparency and align better policies with industry peers and rating agency expectations. The policies were established with the help of the engineering firms 1898 & Co. and Black & Veatch and included a review of recommended practices of the Government Finance Officers Association (GFOA), and comments from rating agency reviews of the utility.

In the study, additional consideration was given to address the current state of the utility's liquidity level for the utility. Early in the process, BPU staff determined an increased cash liquidity should be accomplished within the study period. The primary outcome was the creation of two new reserve funds that will be used to track BPU's minimum cash reserve levels, measured in days cash on hand at the end of each year. The two funds on the electric side are the O&M Reserve Fund and an ERC Reserve Fund. Both funds have a target of 120 days of annual expenses, with the newly established ERC reserve fund being gradually funded to the 120-day target by 2027. Combined, the electric utility will have a combined 120 days of operating expense held in reserve. The electric O&M Reserve Fund will be built up and maintained with base rates and the ERC Reserve will be built up and maintained through the ERC rider. For the water utility, the operating reserve balances were established at a level equal to 60 days.

Q: How were the debt coverage ratio requirements and the reserve funds determined?

A: The level of the reserve funds and the debt coverage ratio requirements were determined based on the BPU's proposed financial guidelines. This document is presented and filed as (BPU Exhibit-2). The proposed financial guidelines state each section of the Utility is to maintain a debt service coverage ratio excluding payment-in-lieu-of-taxes (PILOT) revenue of no less than 1.60 times on Bonds. Also, each section of the Utility is to maintain a debt service coverage ratio including PILOT revenue of no less than 2.0 on Bonds. Also, the proposed financial guidelines state each section of the Utility should maintain an Operating Reserve of one hundred twenty (120) days or better, measured at the end of each fiscal year. The Operating Reserve is equal to the sum of the O&M Reserve and the ERC Reserve as defined below:

> **O&M Reserve**: Each section shall maintain a cash reserve for operation and maintenance (O&M) expenses of one hundred twenty (120) days or better of annual O&M expenditures (accounts 50000 through 93200, excluding costs recovered through the ERC).
>
> **ERC Reserve**: The electric section shall maintain a cash reserve of one hundred twenty (120) days or better of annual expenditures recovered though the Energy Rate Component (ERC). The annual target reserve amount shall be calculated by dividing the current year budget for expenditures recovered through the ERC by 365 and multiplying by 120.

Q: Does the study achieve the debt service coverage and cash targets?

A: BPU staff directed 1898 & Co., and Black & Veatch to develop rates that would meet the proposed Utility's financial guidelines excluding and including PILOT within the study period. The electric utility was able to meet the objective and maintain the coverage levels through the study period. Within the water rate study, with the water revenue increases, the debt coverage was able to be met by the end of the proposed rate increases.

For the cash targets, the electric study projects by 2025, the electric utility, with the electric revenue increases and funding the ERC reserve, would improve the O&M Reserve to 120 days by 2025. The water study projects cash reserves would be able to maintain the O&M Reserve of 60 days.

For the electric utility, days cash on hand under existing rates would range from 74 days in 2023 to 24 days by 2027. If the recommended increases are implemented, the days cash on hand would be from 74 days in 2023 to 132 days by 2027.

Q: Explain the importance of credit ratings.

A: The importance of maintaining a strong and stable credit rating translates to reduced cost of debt financed borrowings. The credit rating of the Utility has an impact on the cost to insure Revenue Bonds. The ability to maintain a high rating leads to a secure investment and lower cost to insure the Revenue Bonds can be purchased on its underlying rating.

In 2022, Standard and Poor's and Fitch Ratings affirmed the BPU's rating of A and Moody's Investors affirmed a rating of A2 (BPU Exhibit-3). In the report the rating agencies identified future credit drivers which would be key to maintaining a solid credit rating. The key credit concerns and challenges included:

- The utility's ability to implement planned rate increases which would result in narrowing operating cash margins or further narrowing of liquidity levels.

- The utility's modest growth in the last several years and the potential for long-term negative growth which could impact financial margins.

- The electric and water system's weakened liquidity levels over the 2021-2025 time period and is considerably below its peer median.

- Inability to implement the capital improvement plan over the next 5 years due to lower liquidity levels and inability to issue debt.

- The weakened liquidity position may limit the rate flexibility with the current level of contributions to the UG and the economic stresses of the industrial and commercial base.

Targeted financial objectives include Debt Service Coverage levels of 160 times without PILOT and cash liquidity of approximately 120 days of operation and maintenance expenses.

Q: What is the impact if revenue increases are not implemented?

A: Under the current existing rates, the annual revenue deficits will erode the BPU's ability to meet target debt service coverage levels, draw down the cash reserve fund balances, and reduce the utility's ability to adequately fund and implement the Capital Improvement Plan. With the existing rates the BPU forecasts an electric operating deficit beginning in 2024 of $900 thousand and the deficit will increase to $11.9 million by 2027. With existing water rates, the BPU forecasts a water operating deficit of approximately $4 million through 2025. The need to spend down the system development reserve would be required to maintain positive cash.

The BPU currently does not have adequate operating cash reserve funds to maintain the liquidity in accordance with the proposed financial guidelines. The operating reserve target should be 120 days of operating and maintenance expenses in a preceding 12-month period. Based on the financial forecast for the electric utility, the minimum cash operating reserve should be approximately $55 million in 2025 and increase to $68 million by 2027. Based on 2022 audited year end information, the forecasted cash operating reserve balance for the Utility is approximately $44.5 million.

If the rate increases are delayed the annual revenue deficits will erode the BPU's ability to meet targeted financial metrics, draw down cash reserve fund balances, face potential credit rating downgrades and reduce the utility's ability to adequately fund and implement the Capital Improvement Plan.

Q: What are the recommendations for the revenue increase?

A: The cost-of-service study for the electric and water utility were performed to provide a recommendation that would fund the electric and water utility's revenue requirements. There are many issues that can lead to the need for rate increases. The most common that have impacted the BPU are inflationary increases to operating and capital costs over the last several years and the annual energy growth expected to remain mostly flat, with increases of approximately 0.1% annually from 2023 – 2025.

Revenue requirements for electric consist of fuel expenditures, operation and maintenance expenses, debt service requirements, transfer to the Unified Government, reserve fund requirements, cash financed capital projects and other non-operating expenses. The fuel expenditures are recovered through the Energy Rate Component Rider (ERC) and are treated as a pass-through expense. The operation and maintenance expenses are based on the BPU's 2023 approved budget and escalated based on percent assumptions regarding labor and burden cost, bad debt expense and non-labor expenses. The Capital Improvement Plan (CIP) baseline is the 2023 budget which provides a five-year capital plan. The electric CIP plan identifies $198 million in capital improvements that are required to maintain the integrity of BPU's electrical system plus 80% of common technology and facility improvements. Also included in the capital plan is $50 million in revenue bonds to help support capital projects that provide long-lived assets for the community.

The water CIP plan identifies $135.4 million in new capital projects within the study period which includes 20% of the Common technology and facility improvements. This will replace aging water mains and outdated control systems to improve the system reliability. The preferred source of funding for the CIP is with annual operating revenues. Since operating revenues are not sufficient to finance the entire CIP, state revolving loans or revenue bonds are used to provide financing for the capital projects and to spread the cost of long-lived assets over a period of 25 to 30 years. The study projects state revolving loans to be issued in approximately 2024 and 2026. After loan financing, the remaining CIP of $50.5 million will be financed with annual operating revenues.

The recommended base rate adjustments are considered the minimum level required to maintain prudent financial operations for the BPU and to meet the appropriate levels of debt service coverage ratios and adequate reserve fund levels as well as meet the operating expenses and the capital improvement program of the utility. The recommended base rate adjustments address the debt service coverage and the reserve fund levels. If a rate increase is not implemented, the utility will be unable to issue revenue bonds or state revolving loans and therefore will not be able to provide the necessary funding to meet the utility's capital improvement program.

Based on the forecast of revenues using the existing rates and revenue requirements, the recommended base rate percentage adjustments for the electric utility are a series of two 2.5% annual increases effective July 1, 2023 and July 1, 2024. The water utility recommends a series of revenue increases of 6% to go into effect July 1, 2023, 2024 and 2025.

Q: What is the recommendation for the Electric Energy Rate Component Reserve (ERC)?

A: After a review of the financial policies and the electric rate study, it is recommended to create an Energy Rate Component Reserve fund (ERC Reserve). Over the past several years there has been very volatile power supply costs which have often put pressure on the Utility's cash balances. Winter storm Uri in 2021 and winter storm Elliot in 2022 are two events which had the potential for creating a negative cash impact of reducing reserves within a single event. If the BPU's generation resources were not able to perform, the BPU would have to rely on the very volatile market for its power needs.

Therefore, it is recommended creating a reserve that is tied directly to variable fuel and purchased power costs that are recovered in the ERC. In prior rate cases, if the cash balances were declining due to the timing of the cost recovery through the ERC rider, operating cash funded through base rate increases was the only option for making up the temporary differences. Also, under recoveries through the year would impact the Utility's ability to fund the capital improvement program or meet operating and maintenance needs. The creation of an ERC Reserve helps to reduce that risk. In order to fund the ERC Reserve, it is recommended that BPU gradually fund the reserve over five years, rather than all at once. Based on current projections of costs recovered through the ERC, the reserve fund will be approximately $27 million by 2027. The recommended funding should generally be equal amounts by increasing the quarterly ERC amount by $1.5 million, which translates to an increase fund of about $6 million per year.

Q: What is the recommendation for rate design and rate application changes?

A: Highlights of the recommendations for the electric rate design and rate application manual include:

- Merging of the standard Residential and Residential Electric Heat classes into one residential class that reflects the rate design of the current residential electric hearing rate.
- Continuing the trend of increasing the Customer Charge to reflect cost of service and recovery of more fixed costs through fixed charges.
- Modifying the ERC rider to allow for additional recovery over costs to build and maintain an ERC Reserve Fund.
- Creation of a Green Rider for customers that want to procure energy with renewable attributes.
- Other language changes with the Rate Manual to align the language with current BPU practice.
- Increase the Non-ERC Capacity Purchase by $2.0 million to capture all the non-ERC capacity purchases in the base rate.

Each of these changes have been designed to clarify billing provisions identified by BPU staff or to improve the accuracy of rate mechanisms.

Highlights of the recommendations for the water rate application changes include:

- Implement cost of service-based water rates by 2025.
- Transition the existing Monthly Charge for retail customer to the proposed Monthly Charge, derived based on cost of service by July 1, 2025.
- Continue with the existing 3-tier block structure for the volumetric rate structure for retail customers.
- Adopt the proposed rate schedule for 2023, 2024 and 2025.

Summary of recommended based rate adjustments for the Utility.

- In order to meet the credit concerns of the rating agencies and to work toward maintaining or improving the credit rating of the Utility, approval of the multiple year base rate adjustments is needed to provide firm financial guidance to the rating agencies and to investors in any debt the Utility will issue in the next three years.
- The Utility should be allowed to meet its Board directed debt service coverage and operating reserve targets over the next three years. Approval of the proposed base rate increases for electric and water utilities will achieve this goal. In addition, approval of the revised Operating Reserve and the establishment of the ERC Reserve will provide further support in achieving the Board directed financial goals and address future funding concerns of the rating agencies.
- Approval of the multiple year base rate adjustments will demonstrate to the rating agencies the commitment of the BPU to meet its financial

obligations and goals. In addition, it will allow BPU to plan its capital and operating budgets over a multiple year period to maintain the systems and provide for timely renewals and replacements to its infrastructure.

- Approval of multiple year base rate adjustments will also give clarity to customers in planning and budgeting their electric and water utility costs. This clarity is particularly needed for our large users which, like BPU, plan and operate based on approval of their annual operating and capital budgets. The series of base rate increases is needed to reduce the bill impact on our customers from large one-time rate adjustments.

Q: What is the recommendation of the BPU staff in this public hearing as to the electric and water revenue changes to the Utility and how to satisfy those revenue requirements?

A: After engaging in a comprehensive cost of service study for both the electric and water utilities the results indicated a need for rate increases in both the electric and water utility.

The electric utility of the BPU last had a rate increase in 2018. Based on the results from the electric cost of service study, the BPU staff is recommending a two-year, gradual increase to electric operating base rate revenues. This overall increase rates over the two-year period approximately 2.5%, July 1, 2023 and approximately 2.5%, July 1, 2024. Also, BPU staff is recommending to fund the ERC Reserve by $1.5 million a quarter in order to reduce the risk of variable fuel and purchased power costs.

The BPU's water utility's last rate increase was in 2013. Based on the results from the water cost of service study, the BPU staff is recommending a three-year, gradual increase to water operating base rate revenues. This would increase rates over the three-year period 6.0%, July 1, 2023, 6.0%, July 1 2024 and 6.0%, July 1, 2025.

Q: Does this conclude your written testimony?

A: Yes, it does.