The City of Gallup's Electric Department may very well be on its way to raising its electricity rates, according to a 10-year financial plan. And it's all hinged on supply and demand.

After addressing a timeline of financial landmarks within the last couple of years at the City Council's work session meeting on Jan.12, Electric Director Richard Matzke, said the city hired RBC Capital Markets to conduct a 10-year financial plan for the City of Gallup's electric department.

“We want to look at our long-range capital improvements, to come up with memo and fund balance recommendations, annual fund balance projection, and annual revenue requirements that will inform future rate decisions,” he said.

Paul Cassidy, managing director, for RBC Capital Markets was hired to conduct the 10-year financial plan for the purpose of developing a revenue requirements model. He also said that he would like to conduct a future analysis with the city’s electric utility compared to other comparable electric utilities.

“It is not a rate analysis. We don’t do rate studies but what it will do is help you decide how to raise the rates among your various entities,” he said. “The way that you typically allocate those costs is through a rate study.”

The city currently is in charge of the electricity component and they are also responsible for the overall rates set into place by the council to instill operating funds for infrastructure and service expansion.

According to the report, the top 10 customers use about 17 percent of the annual consumption of power and they generate about 16 percent of the annual revenue.

In 2010, the power demand declined. Residential demand decreased by 7 percent, commercial demand decreased by 11 percent and industrial demand has increased by 64 percent.

“First of all, residential revenue has been falling. People are implementing efficient appliances such as solar,” he said. “They are doing a lot of things to control their own use. While we have seen a decline, historically, we assume that we are going to have a 2 percent continued decline on the residential side in terms of demand.”

Overall revenue of the enterprise has increased by 8 percent during a time when the demand is decreasing. The residential revenue has increased by 10 percent, commercial revenue has increased about 5 percent, and industrial revenue has increased by 95 percent.

In 2015, the energy charges for the residential, for general, for medium-sized and non-residential and the other categories, a residential user was paying an initial charge of $6.41 and paying about $ .1068 per KWh for anything above 50 KWh.

In 2014, it was higher because the cost of power was higher. The city dropped the rates in 2015 and in past years, the rates were at nine to 10 cents.

As far as electric system power supply, the city does not own its own generating resources; however, there has been discussion to add a solar plant, Cassidy said. For now, the City of Gallup buys everything that is produced and delivered. There are five substations that can retain 89 megawatts. Overall, the City currently needs 41 megawatts of power.

The city purchases power from two entities: Continental Divide Electric Corporation, with whom they are in contract with until the year 2022, and Western Area Power Administration.

“On June 30th of 2014, we started our first year of contract with Continental Divide Electric Cooperative. During that first year of contract, we had approximately a $5 million dollar decrease of our wholesale power cost,” Matzke said.

With the aid of the city staff and RBC Capital Markets, both entities were able to come up with estimations based on expense growth, the power cost growth, and the growth of demand in terms of electricity usage from the various categories of customers.

Also, the staff put together strategic goals for the next four years, which includes four major items such as fiscal responsibility, service delivery excellence, infrastructure development, and quality of life and community identity.

“The study period for numbers really goes out ten years,” Cassidy said. “The four major items are number one, fiscal responsibility. We want to develop a financial plan that results in the city if you have to borrow in the future, as at least an ‘A’ category bond rating from the major investment rating agencies and to maintain competitive electric rates.”

He said the targeted recommendation is 150 days cash on hand, which is basically 5 months of cash on hand, at the end of 10 years.

When looking at the financial overview from the actual audited financials from fiscal year 2012-14, and actual unaudited financials of 2015, based on an accrual basis of what the income statement might look like, the total revenues for 2012 were $23 million and in 2015 it dropped to $18 million.

The total expenses of the enterprise in 2012 totaled $16.9 million. In 2014, it was $19 million because of fuel and purchase power costs were higher in that fiscal year compared to where it will be this year. Total expenses for 2015 were $16.5 million.

The operating income, net income before transfers, showed $4-6 million and has been as high as $9 million. So, the Enterprise does cash flow; however, it did show to have a lot of capital outlay reflected as well as transfers going out for city operations.

Capital outlay is funds that the city lobbies from the State of New Mexico via legislators. The State puts funds into the capital outlay project for projects needed in the community used for infrastructure, roads, water, and sewer lines.

“We need to talk about as we go forward, one of the major drivers is going to be in the cost of power that we look at because those costs will be going up and the other is the Capital Program that you need to always continue to reinvest in the enterprise,” Cassidy said.

He goes on to state when addressing the historical and budgeted net revenue available for debt service on a cash basis, based off the same numbers as the financial overview for fiscal years 2012-15, the problem is that there are no historical balance sheets that are on an accrual basis, just for the electric enterprise.

This is mainly due to the fact that at one time, the water, wastewater, and electric departments, were all combined. The city recently separated them so that they could better track their expenses/income from different entities.

According to Cassidy, in a separate study, which the report did not reflect, the cash and utilities were separated and it showed a $9 million dollar cash balance.

“It is going to be a little higher number,” he said. “So, your days cash on hand is going to be significantly higher for the beginning years compared to where you are going to end up after we do the capital items that we need to do. One of the decisions of Council will be financing that capital or not, and there are rate implications as a result of that.”

Going off the projected net revenue available for debt service and coverage for fiscal years 2016-26, solar growth will increase 3 percent a year, industrial demand will be flat, meaning, no substantial growth and a .5 to 3 percent decline in other commercial use.

On the expense side, there will be a 2.5 percent growth in personnel and operating expenses, the continuation to impose a franchise tax of 5 percent of operating revenues that will be an expense of the system, the General Fund Transfer out will be 8 percent of operating revenues and purchase power grows based on contract with CDEC.

“The price currently for the fiscal year 2015, is $34.71 per MWh (mega watt hours),” Cassidy said. “In this fiscal year, we are currently in; it jumped 26 percent, to $43. It is going to continue to grow, from 3-10 percent for the remaining term of this contract. So you could expect that you are going to have an increase of cost.”

However, he said no bonds will be issued and it is recommended to cash fund projects in progress would be beneficial to avoid debt exposure, assuming a capital plan is incorporated to take into account some inflation of the cost of those capital plan items.

The beginning cash balance is $9.6 million as of July 1, 2015 and at the end of June 2016, it is predicted it to go to $11.5 million. Since there is no rate increase this year, it is remains zero.

In 2017, there is a projected 8.75 percent required revenue increase and according to Cassidy, in order to get days cash on hand at the end of the study period, down to 153-day range, and deal with capital costs, a 8.75 percent revenue increase should be implemented every year from here through 2026.

“We knew we would have a revenue increase this year because we dropped rates and we have a 26 percent increase in the cost of power, which is a major cost, obviously, to this utility.”

Based off the projected net revenue available for debt service and coverage, assuming bond issuance and major capital outlay requirements, for fiscal years 2017-19, $4.5 million dollars worth of capital items could be financed through a public market. Through strategic financing, a lowered annual rate increase could be imposed from 8.75 percent by 7.8 percent by 1 percent lower.

“Weren’t you saying here starting with year 2021 all the way out to 2026, that we were operating in the negative money available for debt service?” District 2 City Councilor Allan Landavazo asked.

Cassidy responded that the general fund transfer would not be netted out, but would add to the general funds transfer at $1.8 million dollars, which would be a transfer out, once the debt service is paid.

Landavazo feels that after year five or six based upon the capital outlay, there was not going to be enough revenue or cash flow to support the expense base, an aspect that needs a closer look.

“There was some information that they didn’t extend on there that technically was supposed to be in the black and to me, it was incomplete,” he said. “They didn’t give a complete report and I’d like to see another report and a series of cash projections there but this wasn’t complete.”

Based off the historical data in terms of electric system demand in kWh (kilowatt hour), in 2010, for each major category of service of customers, for example, the refinery, dropped 56 percent in terms of demand, the medium commercial, small commercial, demand increased, joint utilities demand decreased, and municipal services decreased. Also, the signal lights and street lights, the demand has decreased with a 7.9 percent reduction period.

The total KWh demand has gone from 222 million kWh and decreased to 205 million kWh, or an overall, 17 million kWh since 2010.

“As we talk about demand, we look into the future with economic development and the demand of economic development, you sell more utilities, would generate more revenue… how is that whole conversation woven into the presentation?” Landavazo asked.

Cassidy stated that this plan does not assume success; however, reviewing data annually and taking new demand items into account, adjusting future rate increases should help.

He mentioned some items that he advised the city to consider, which is to conduct a rate ordinance, a process that takes some time, and a cost of service study that could be completed by fall.

Mayor Jackie McKinney added that the topic will be back as an agenda item in the future, and what to do what our rates as well as a rates survey in the future.

“It is exciting times for the city,” he said. “We are in a good financial condition. At least our utility department is on solid ground. It will be something that we will want to see. It’s always been, where we can say our costs of power right now is a lot cheaper than Albuquerque’s, it’s a lot cheaper than Farmington’s. We need to keep that public knowledge.”

The City of Gallup owns four public utilities: solid waste, water, wastewater, and electric. The day-to-day operations of the system consist of two directors: Electric Utility and Director of

Water/Wastewater/Solid Waste Utilities. The department has a total of 67 employees in the Utility department and 25 employees in which that work in the electric utility.