<u>Let's Talk Rates</u>

By William L. Caynor Sr., Price Electric CEO

Recently, a Rate and Cost of Service Study was conducted by the engineering firm of Power Systems Engineering (PSE). This study is used to evaluate the financial recovery required for the different rate classifications and is the first such study conducted for PEC since 2012. This was a cost-based rate design, which recovers costs by rate class, being: farm, home, seasonal, small commercial and large power. The cost-based rate design ensures that no one class is subsidizing another and equal sharing occurs in the cost to provide service. The fundamental requirement of a Rate and Cost of Service Study is to establish a rate design that determines the minimum revenue needed to conduct business and to meet your cooperative's financial obligations.

The study examines both the Service Availability charge (customer/facility) and the energy rate by rate class. The Service Availability charge accounts for approximately 70% of the fixed costs associated with providing energy to your home or business. Essentially, this seventy percent encompasses the expenses of maintenance and operations, the annual depreciation of these lines and equipment, the expenses related to customer accounting, billing and meter reading and principal and interest payments of the primary lines, poles and equipment. This is fundamentally the cost to ensure that energy is available at your residence so that when you arrive, you can flip the switch to turn on the lights and then would be billed for consumption based on the energy rate. PEC's current Service Availability charge is on the low end in comparison with other Wisconsin cooperatives. A good rule of thumb is, "the higher the density, the lower the Service Availability charge." Density is defined as members per mile. In turn, the energy rate collects the remaining costs, to include the cost of purchasing this energy from Dairyland Power Cooperative (DPC), which is 47% of operating expenses.

<u>What makes us a little different than the norm</u>

Given there are 1,807 miles of distribution line and only 9,126 accounts, your cooperative collected $6,595 in 2015 to maintain a mile of line, as opposed to the average cooperative, which collected $15,000, or an investor owned utility (IOU) who collected $75,500 for an equivalent mile. This is attributed to both the amount of energy consumed and the density of members per mile. PEC has five members per mile, whereas an average cooperative has 7.4 and an investor owned utility 34. Municipalities have 40 consumers per mile and amass $113,000 for that mile. Just imagine the possibilities of accumulating an additional $106,405 of revenue per mile when comparing your cooperative to a municipality?

Another factor to consider is your cooperative's aging infrastructure and the costs to replace conductor, poles and equipment that have exceeded their life expectancy. To build just one mile of three phase overhead primary line is $83,500. This number has increased by 46% over the last 11 years. If you need to increase the voltage, conductor size for ampacity, or wish to install this line underground, the cost goes up vastly. Just by placing the same ampacity conductor underground increases expense by 25% and the life expectancy declines to less than half that of overhead. These estimates don't account for the need to transfer and remove old lines and poles but rather to build anew, and the expenditures continue to increase every year.

Another factor that sets your cooperative apart is our average residential and seasonal energy consumption is less than average in comparisons to other utilities. You would think that it would be higher, given the colder temperatures in the Northwoods, but many of the cooperative's members are using alternative home heating, water heating and clothes drying options as opposed to electrical modes. In fact, your cooperative is one of the lowest in the state among cooperatives for average monthly residential energy consumption, which was 787 kWh's in 2015. The average consumption is 384 kWh's less than the national median when compared to over 300 other cooperatives. Also, 45% of your membership is seasonal, whose average monthly usage was 218 kWh's in 2015, ranking second to last among cooperatives responding to a cooperative survey. In addition, the milder weather conditions over the past two years have deteriorated total energy sales to the second and third lowest sales over the last 15 years. The decline in sales was not only in our region, but throughout the state.

The demographics of your membership is yet another factor that constrains sales. Having a make-up of 96% residential and seasonal means that our sales will be predominately driven by weather. A diverse portfolio with more industrial and commercial could help balance the non-predictabilities of weather. Interesting enough, 61 cents of every dollar of your cooperative's operating revenue in 1959 came from farmers whereas 58 cents of that inflated dollar valued today at $8.25 comes from a residential customer with a small dash of farmers intermixed within.

Flat to minimal growth is another factor. PEC has netted a total of 83 new accounts in four years, and large consumers such as commercial accounts have decreased to 295 from 300 in 2012. In 1999, there were 80 dairy producers on the system, and last year there were about half that number. Minimal growth of approximately twenty additional meters a year, and primarily within the seasonal membership, does not allow the cooperative the ability to even absorb the increased annual expenses such as the US inflation rate of 1.7% at the end of 2016 or the predicted climb above 2% in 2017.

Conclusion

The results of the Cost of Service Study were presented to your Board of Directors at a special meeting in January of this year to evaluate and approve any changes required to recover the cost of providing service to you, our members. The conclusion, after much review and discussion, was that an increase would be required in order to achieve the revenue requirements and thus a rate increase was approved by the Board to take effect on April 1, 2017.

The increase amounts to 4.3%, but depends on the individual's consumption as the three mil Power Cost Adjustment (PCA) was rolled into the energy rate. Large energy users will see a smaller percentage increase to their monthly bill than the members that use little energy. This is attributed to the increase in the Service Availability charge and a subsequent decrease in the energy rate. The Service Availability charge will increase on the residential, farm, small commercial and seasonal accounts from $30 to $35. These dollars will recover the fixed costs needed and assist in stabilizing the operating revenue in mild climatic years where energy sales are low, such as 2015 and 2016, which were 3M kWh's and 2M kWh's under budget respectively. The rate increase amounts to an additional $4.84 on an average residential monthly bill which consumes 787 kWh's and $4.06 on an average seasonal account consuming 218 kWh's. It is also projected that slightly less of an increase will be required in 2018.

These increases are consistent with historical rate increases from 2003 to 2013, although your cooperative has been absorbing annual increases and budgeting flat for the last three years with just a three mil PCA in 2015, which amounted to a little over $2 per month for the average residential consumer. As mentioned before, this was rolled into your new rate increase, which accounted for 1.7%. The last time the Service Availability charge increased was 2008. In the future, you will still see the PCA on your bill because DPC debits or credits your cooperative each month depending on whether they are plus or minus 10% of their budget. This is a straight pass through which amounted to an approximately twenty-seven additional dollars to the average member last year.

There has also been some discussion related to the construction of your cooperative's new Member Service Center and office on the land purchased on Springs Drive, south of Phillips. The discussion is related to the potential of increasing rates, its impact and reasoning. The benefits of a new Member Service Center and office are countless to the daily operations and efficiencies. The impact to the financial condition is in debt, depreciation, interest and principal expenses. Waiting only increases interest rates and construction expenses as the financial forecast for your cooperative is consistent and not anticipated to change. The present office complex was constructed in 1951 with an addition of a boardroom and a couple of offices in the early 1970's. A thorough review of this project was approved by both the member committeepersons and your PEC Board of Directors for the future needs of the cooperative. Given this is the largest capital expense a cooperative can make, the decision to proceed was not taken lightly, but rather evaluated and decided upon for the future of the Cooperative. The costs associated with the new Member Service Center and office will account for roughly half of the rate increases mentioned previously.

Most recently, DPC was awarded a $73.5M settlement from the federal government in response to costs related to an ongoing breach of contract with the La Crosse Boiling Water Nuclear Reactor (LACBWR), DPC's shut-down nuclear facility. The Nuclear Waste Policy Act (NWPA) of 1982 gave the government responsibility for storage of the nation's used nuclear fuel, and without an authorized repository, the government was in breach and thus DPC and the cooperatives they serve incurred continual expense to store the spent fuel. DPC's Board approved the return of $47.6M of this settlement to the cooperatives affected. PEC received $796,087.87 in which your Cooperative Board elected to allocate to the cost of the new building. This decision will assist with decreasing the amount of borrowing needed and the quarterly interest and principal payments.

Rest assured that we will do everything within our power to find ways to enhance the items identified that make us different than the norm, but at present there are no forecasted projections that change our financial condition; thus finding ways to increase energy loads, consumption, membership and possible diversity, along with good data and metric collection and evaluation to make good choices going forward is essential to maximizing our service and reliability and minimizing rate increases to you, our members.

We at your cooperative encourage you to contact us if you have any questions regarding the rate changes or your electric bill. Please contact Greg Bortz (Manager of Member Services) or myself at 715-339-2155. We look forward to speaking with you.