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Power Prepay – Authorize CEO to Enter Into Agreements To Finalize Power Prepayment for Submittal to SVCE Board

SVCE Finance and Administration Committee

September 15, 2020

Overview

Transacting Parties:

1. Tax-exempt Load Serving Entity (LSE, also called "Prepay Buyer")
2. Taxable financial counterparty (bank, called "Prepay Supplier")

Process:

1. Prepay Supplier assigned into existing energy supply contract(s) held by LSE
2. Municipal bonds issued by conduit, amounting to combined notional value of assigned contracts
3. Prepay Supplier pays the contract price to PPA Seller, immediately transferring all electricity and attributes to LSE
4. LSE pays the Prepay Supplier at discounted rate, achieving procurement cost savings

Takeaway:

- Prepay Supplier holds and utilizes capital, creating taxable vs. tax-exempt arbitrage that enables discount

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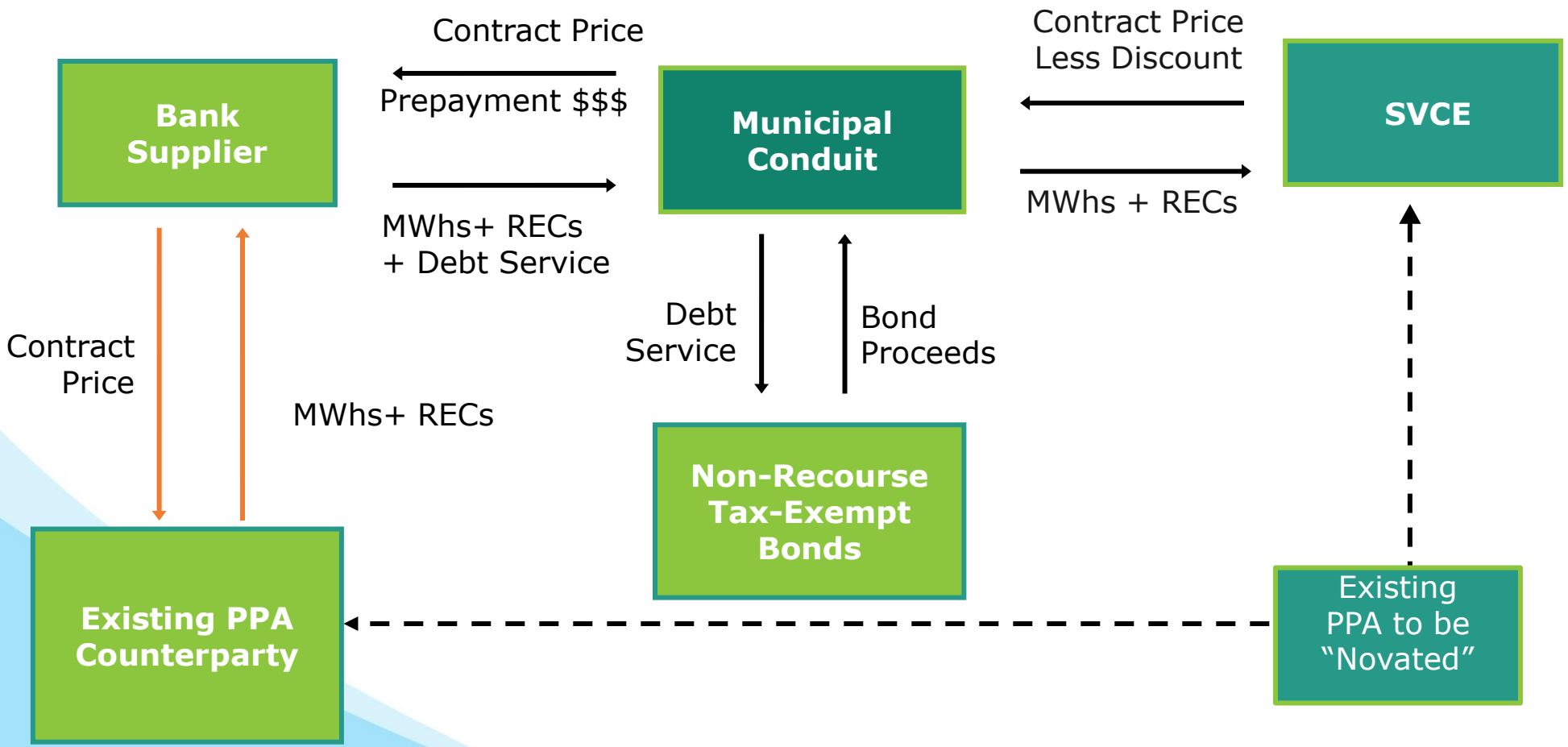
Structure Overview



Summary - Benefits and Risk Prepay Program

- **Benefits**
  - ✓ Savings over the 30-year term expected to be 8% - 12% per year on power quantities delivered under the pre-pay structure compared to spot market purchases / current contracts
  - ✓ Equates to @$2.5MM to $3.5MM per year or @0.50% to 0.75% rate reduction
  - ✓ Favorable risk allocation where SVCE only pays for energy that is delivered (same as contracts today)
  - ✓ Debt is non-recourse to SVCE
  - ✓ Rating agencies comfortable with comparable deals at SMUD, SCPPA, others
- **Risks**
  - – Loss of savings and back to square one
  - – Lost investment of staff time

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Timing and Cost

- **Timing**
  - Transaction is dependent on number of market factors which are in constant fluctuation; opportunities to transact can be episodic
  - Moving forward and preparing paperwork takes months
  - Invest the time now to prepare for future approval, execution and success
- **Cost**
  - Majority of the costs are contingent and paid through bond proceeds at closing
  - Various parties involved: bond underwriter, energy supplier, lawyers (bond/tax/disclosure/underwriter's), municipal advisor, and rating agencies
  - Estimated costs of $1.5MM (paid for by bond issuance)
  - Exploring creation of a JPA Conduit Issuer at a cost of $15k (out of pocket)

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Getting Ready

Bond Conduit Formation

- SVCE, EBCE, MCE, CCCE
- Work has been initiated
- To be completed in Q4 2020 or Q1 2021
- Minimal cost ~$15K

Documentation and Transaction Terms

- SVCE & EBCE
- Work has been initiated
- To be completed by Q1 2021
- Select pre-pay supplier, hire legal counsel, municipal finance advisor and other necessary professionals; nearly all fees are contingent on a deal being transacted.

Agreements with Professionals to Complete Transaction

- SVCE needs to secure professional assistance to complete the work necessary to develop, draft, and finalize appropriate documents to bring the complete Prepayment Transaction
  - bond counsel,
  - tax counsel,
  - issuers counsel,
  - disclosure counsel,
  - municipal financial advisor,

and any other consultant needed to support the completion of the Prepayment Transaction

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Professionals selected by EBCE/SVCE

Bond Counsel: Orrick, Herrington & Sutcliffe	• Role: Represent bondholders
Tax Counsel: Orrick, Herrington & Sutcliffe	• Role: Provide tax opinion on transaction
Issuer's Counsel (also known as Prepay Counsel or Prepaid Counsel): Chapman & Cutler LLP	• Role: Represent issuer's interests, supporting drafting and negotiating terms of prepay agreement and associated energy supply agreements
Disclosure Counsel: Chapman & Cutler LLP	• Role: Prepare Official Statement / Prospectus
Municipal Advisor: TBD, solicitation in process	• Role: Advise Prepay Buyer in negotiations; required by Municipal Securities Rulemaking Board (MSRB)

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Fiscal Impact of this Recommendation

- There is no negative fiscal impact to SVCE. Funds for the agreements shall be contingent upon the Board's approval of the final Prepayment Transaction. Contracts would be paid directly from the proceeds from the sale of the bonds

- Cost is estimated to be between $1-1.5 million

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Next Steps - Timing

August 2020	• SVCE Finance Committee Briefing #1
September 2020	• SVCE Board Briefing on Getting Ready to Transact a Power Prepay
September 2020	• SVCE Finance Committee Discussion #2
October 2020	• SVCE Board Authorizes CEO to get Prepayment Transaction Finalized for Board Consideration
Q4 2020 - Q1 2021	• Documentation and Transaction Terms Developed • Conduit JPA to SVCE Board
TBD - Q1 2021 or later	• Transaction brought to SVCE Board for approval when market is ready

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Request

- Request the Finance Committee recommend the SVCE Board authorize SVCE's CEO to enter into agreements necessary to carry out the tasks to finalize the Prepayment Transaction that will be subsequently submitted to the Board
  - These professional services would be compensated only if the Prepayment Transaction is approved by the Board and subsequently closes and would be paid directly from the proceeds of the sale of the bonds

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Additional Background Slides

Glossary of Terms

Power Purchase Agreement "PPA" – contract to receive and pay for a specific type of energy (i.e. renewable solar, wind, etc.) at a specific price over the term of the contract (i.e. 15 years)

Tax-exempt Prepayment – payment in advance by a municipal utility for a number of years of contracted energy and financing the prepayment with tax-exempt debt

"Novate" – to assign a PPA contract to another party for a some or all of the contract term

"Recourse to…" – secured or guaranteed by the referenced entity

"Non-recourse…" – not secured or guaranteed by the referenced entity

"Conduit issuer" – entity formed to issue debt but not responsible to repay the debt (non-recourse!)

History and Tax Law Behind Municipal Prepaid Energy Transactions

- Municipal electric and gas utilities (and tax-exempt entities such as CCAs) in the US can prepay for a supply of electricity or natural gas from a taxable (corporate) entity and fund that prepayment with tax-exempt municipal bonds:
  - Must sell that commodity to their retail end-users that reside within their traditional service area.

- Prepayment transactions are legal and Codified in US Tax Law: Since first prepayments of natural gas were done in the early 1990's, the IRS issued rules allowing tax-exempt prepayments and Congress enacted legislation specifically allowing the transactions (National Energy Policy Act of 2005; Section 1327).

- Over 90 municipal prepayment transactions totaling over $50 Billion have been completed in the US – over 95% of them for natural gas. Natural gas is much easier to "prepay" because the commodity is homogenous and is easy to store.

- Prepayments have saved utility ratepayers (natural gas, electricity from gas fired power plants and energy from renewable power projects) billions of $ in reduced rates and energy charges and will continue to do so over the 30-year life of the transactions.

Renewable Energy Prepayment -Key Elements of an SVCE Transaction -

- Existing Renewable PPA's are assigned or "novated" to the taxable prepaid supplier
- SVCE continues to take and pay for energy and attributes delivered through the contract
- Maintains the existing terms of PPAs, including scheduling and operations
  - Preserves critical PCC-1 and "long-term" attributes for renewable contracts
- Debt associated with program is issued through a conduit and is non-recourse to SVCE; does not impact SVCE's balance sheet or credit metrics,
- Debt is recourse to (guaranteed by) the bank that receives the prepayment
- If program terminates early or prepaid supplier fails to perform, the SVCE forgoes the future savings and assigned contracts return to status quo

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Eleven Prepayments Totaling Over $5.7 Billion Have Been Completed in California

Date	Amt. ($000)	Issuer	Description	Beneficiary
6/2006	230,845	Vernon Nat. Gas Fin Auth	Nat Gas	City of Vernon Elec
1/2007	209,350	Roseville Natural Gas Fin Auth	Nat. Gas	City of Roseville Elec
5/2007	757,055	Northern Ca Gas Auth No. 1	Nat. Gas	SMUD
9/2007	887,360	Long Beach Bond Fin Auth	Nat. Gas	City of Long Beach
10/2007	504,445	So. Ca. Pub. Power Auth	Nat. Gas	Multiple MOUs
10/2007	251,695	Long Beach Bond Fin. Auth	Nat. Gas	City of Long Beach
8/2009	901,620	M-S-R Energy Authority	Nat. Gas	MID/Redding/SVP
10/2009	514,160	So Ca Pub Power Auth (Windy Flats)	Elec (Wind)	LADWP, Mult. MOUs
4/2010	778,665	Cal. Statewide Comm Dev Auth	Nat. Gas	SMUD
2010/11	394,700	So Ca Pub Power Auth (Milford 1 & 2)	Elec (Wind)	LADWP, Mult. MOUs
12/2018	539,615	Northern Ca Energy Auth	Gas/Elec	SMUD
Total	**5,717,815**			

1. Prepayments May Help SVCE Reduce Cost of Energy

- Same Tax-Law and similar transaction structure can be used to reduce the cost of electricity produced from renewable resources; though this same structure can be used to pre-pay other energy transactions too
- Opportunity to reduce Purchased Power costs by 8-12% through a prepayment of existing and future PPAs
- Prepayment structures have up to a 30-year term – the "longer the better" – to maximize savings and introduce minimal incremental risk to the CCA

2. Sample Transaction Terms

Master Power Supply Agreement

- Between SVCE and a municipal conduit issuer (e.g. CSCDA or a "to be formed" CCA specific conduit issuer) which issues the bonds allowing for:
  - SVCE to assign long term power contracts into the program and purchase power at a discount to existing price

Term of Prepayment

- Up to a 30-year agreement, subject to early termination if program terminates early

Minimum Savings

- Approximately 8-12% discount for initial reset period (first 5-7 years). Savings are generated by the difference between the taxable borrowing cost of the prepaid supplier (bank) and the tax-exempt rate on the bonds issued to fund the prepayment.

2. Transaction Terms (continued)

Tax-Exempt Debt, other Financial Terms and Conditions

- SVCE will not be party to, responsible for, or account for any bond offering. If program terminates early or prepaid supplier fails to perform, the SVCE forgoes the future savings and assigned contracts return to status quo
- Prepaid supplier (bank) is responsible for the tax-exempt debt. Debt associated with program is issued through a conduit and is non-recourse to SVCE; does not impact SVCE's balance sheet or credit metrics
- The municipal conduit will issue tax-exempt bonds which will be refinanced in 5-7 years, subject to market conditions
- If bank doesn't perform, cannot remarket the bonds or if SVCE needs to exit prepay for some reason, the assigned contracts revert back to SVCE at the original price and terms

3. Next Steps – Getting Ready

Allows SVCE to transact when the spread between taxable and non-taxable interest rates are favorable

Transaction and Consultant Costs

- Initial exploratory costs borne by SVCE should be minimal to review legal and regulatory questions regarding the prepayment
- SVCE would need to identify and contract with:
  - Prepaid Supplier – "A" rated (or better) bank to take prepayment and guaranty the bonds
  - Legal Counsel – to provide necessary legal opinions to SVCE and assist in negotiating transaction documents
  - Municipal Financial Advisor – assist in negotiating the financial terms of the transaction
- Traditionally, these consultants and all other fees paid to complete the prepayment transaction would be paid from bond proceeds if and only if the transaction closes – so minimal financial risk to SVCE to initiate and negotiate a transaction.

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Employee Benefit Option – Health Savings Account

Finance and Administration Committee

September 15, 2020

Why a Health Savings Account Option?

- SVCE currently offers a generous set of benefits
  - Health Premiums, funded up to $1000 / month / employee
  - Health Reimbursement Account (HRA), a $500 / month / employee contribution
  - Flexible Spending Accounts (FSAs); a $200 / month / employee contribution (includes Health FSA, Parking, Transportation, and Dependent Care options)

- Some employees could benefit from additional options, however

- Adding a High-Deductible Health Plan (HDHP) and Health Savings Account option would provide additional flexibility and be cost neutral

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An Option: Health Savings Accounts

A Health Savings Account (HSA) is like a personal savings account, but it can only be used for qualified healthcare expenses. To be eligible, you must be enrolled in a High-Deductible Health Plan (HDHP). HSAs also have some important tax advantages.

Contributions to HSAs generally aren't subject to federal income tax, and the earnings in the account grow tax-free.

Unspent money in an HSA rolls over at the end of the year so it's available for future health expenses.

Cannot have an HRA/Health FSA and an HSA at the same time.

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Before/After Introduction of HSA

- Current

Traditional health plan options through CalChoice

HRA contribution from SVCE

FSA contribution from SVCE used for parking, transportation, dependent care, and/or health spending

- With an HSA Plan

Additional high deductible health plan options through CalChoice

Employees can choose an HSA instead of an HRA and Health FSA

Employees choosing the HSA still get the parking, transportation, and dependent care FSA

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Employee Interest in HSA Option?

- 1 employee currently has a personal HSA, and so forgoes SVCE HRA and Health FSA contributions

- August 28th presentation to staff with follow-up survey
  - 15 staff attended
  - 8 staff completed exit survey
  - 5 staff indicated potential interest in HSA option

- CalChoice offers several HDHP plans open to SVCE employees; Igoe (FSA Administrator) offers HSA plan administration

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Cost-Neutral Implementation

- SVCE currently contributes up to $1500 / month / employee for benefits, including premiums and HRA contributions
- Current employee expenditures are closer to $900 / month
- However, HDHP / HSA-compatible premiums are generally lower than HMO / PPO premiums, potentially saving SVCE hundreds per month
- Note: FSA contributions remain constant across options, and are excluded from the analysis

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Cost-Neutral Example

	SVCE Cost - Maximum	SVCE Cost – Current (example)	SVCE Cost – HDHP / HSA (example)
Health Premium	$1000	$750	$500
HRA Contribution / Expenditure	$500	$150	$0
Total SVCE Contribution / Expenditure	$1500	$900	$500
Potential HSA Contribution	$0	$0	Up to $400

Amounts are per employee per month

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Proposed SVCE HSA Contribution Amount

- SVCE Benefits Analysis shows that reduced HDHP health premiums plus reduced HRA contributions could yield up to $400 / month available for contribution to an HSA
- HSA Contributions are limited by the IRS each year and are currently set at:
  - $3550 for individuals / $7100 for families
- Staff proposes contributing the following:
  - $296 / month for individuals (up to the IRS individual limit)
  - $400 / month for families (based on analysis of cost-neutrality)

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Implementation Steps

- Seek recommendation for approval from Finance & Administration Committee
- Seek Board of Directors approval at October 14th meeting
  - Delegate implementation to CEO
- Employee communications (October - December)
- Open enrollment period (January 2021)
- HSA in place February 1, 2021 (new benefits year)

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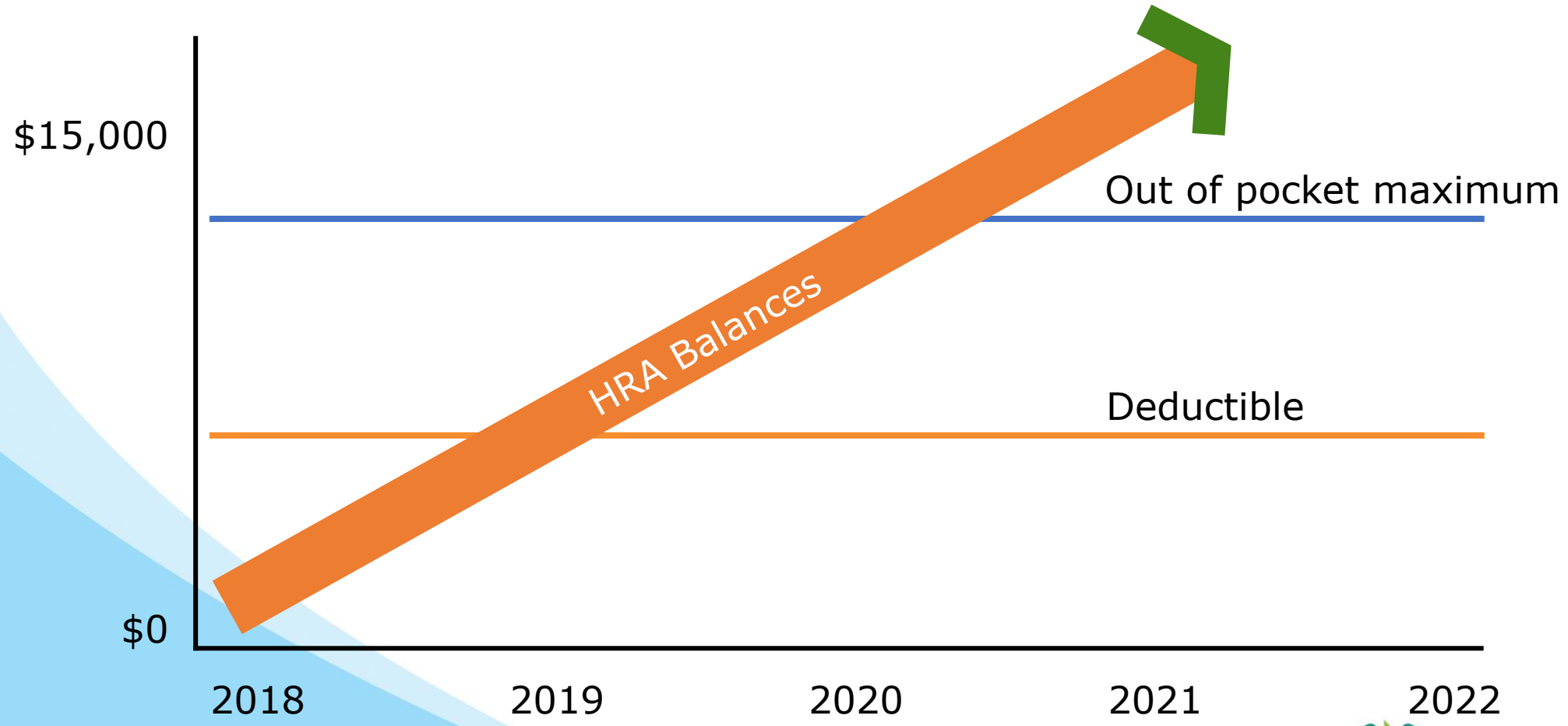
Questions?

Projected HRA Balances



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HRA Balance Projection

Key Observation: By 2023, most employees will have more dollars in their HRA than they could possibly spend on in-network medical costs for their family in a year.

Average Balance Per Employee 1/31/20	$4,639				
Months of Growth	12				
Growth Per Month	$387				
	1/31/2020	*1/31/2021*	*1/31/2022*	*1/31/2023*	*1/31/2024*
Months Since Establishment	12	24	36	48	60
Average Balalance Per Employee	$4,639.00	$9,278.00	$13,917.00	$18,556.00	$23,195.00

METHOD OF ANALYSIS

- Using reports from TASC, examined accumulated account balances as of 1/31/20 for 19 employees with full $6000 contribution for the preceding plan year
- Assumes <4% annual rate of increase in federal out-of-pocket limits

OTHER DATA

- In 2020, out-of-pocket limits typically can't be more than $8,150 for an individual and $16,300 for a family

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Budget Neutral HSA Contributions

2020 HDHP Rate	Trend	Expected 2021 HDHP Rate	SVCE Max Contribution to Premium	SVCE Premium Savings	Additional Savings from Avoided SVCE HRA Spend	SVCE Gross Savings	Federal Maximum HSA Contribution	SVCE Net Savings
$445.56	8.27%	$482	$1,000	$518	$150	$668	$296	$372

Final projected budget will incorporate actual rather than potential cost exposure, which in some cases has been less than $1,000
HDHP plans will be most attractive to single employees; HDHP Rate based on single employee rate
Dollar figures are monthly

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