Courtney Doyle (00:16):

Welcome to Co-op Energy Talk. I'm Courtney Doyle, communications and member relations manager at Cherry Land Electric Cooperative this month, which is March of 2024. In case you are in the future listening to this, it is March, 2024. Uh, the Cherry Land Board will be voting on a proposed rate change. In this episode of the podcast, we're gonna give you a quick breakdown of what would change, should that be approved, why, and the work that went into making sure that this was the best option for our members. 'cause we, we don't just pull rates out of thin air. There's a lot that goes into it. So today I am joined by Cherryland, CEO, Rachel Johnson, and an invaluable member of our accounting team, our controller, Brad pki. Guys, thank you so much for taking some time to talk greats with us on the podcast. Well, before we dive in, Rachel, can you just start by giving us a quick overview of what is included in this proposed change? Kind of what, what we told the board last month to prepare them to make a decision this month?

Rachel Johnson (01:14):

Yeah, as, as you pointed out Courtney, our rates don't just come out of nowhere. We're a not-for-Profit electric Cooperative. We operate at cost. And so our rates have to reflect our costs. Uh, our members probably remember that last year we made a fairly significant structural adjustment to our rate program and increased our availability charge. We knew at that time that that rate change wasn't going to get us very far if utility inflation continued to be as high as it was. And so we had a sense that we were still looking at additional rate changes. Over the coming years we've been putting work into figuring out what's really going on with our cost in order to make sure that we could align our rates with our costs. So where we're at now based on all of that, all of that data that we got over 2023 and kind of looking forward into the forecast for 2024, we're proposing to our board a a rate increase that will impact all rate classes.

Rachel Johnson (02:07):

I think I'll just talk about the biggest rate class we have, which is our residential members. So 95% of the people we serve are homes, basically are homes. Right. And for the average residential member, what we're looking at is a $4 increase on the availability charge. So the availability charge will go from $28 to $32 and a four mills increase on the energy charge. So that volumetric per kilowatt hour charge will go from 11.70 cents a kilowatt hour up to 12.10 cents a kilowatt hour. What that means at the kind of the bottom line at the end of the month for the average member, our average member uses about 700 kilowatt hours a month. So what they're gonna see starting likely in June, if the board approves this rate increase, is about a 6% increase in their monthly bill. It ends up being between $6 and 50 cents and $7 a month increase in their monthly bill.

Rachel Johnson (02:57):

So that's the, that's the kinda the, the bulk of the rate increase that we're taking to the board. I would encourage anyone listening to this who is in any of the other rate classes, you've got a pull barn, you've got a small business, go check out our website 'cause we have details for how this, what this looks like for the other rate classes and a calculator where you can figure out what it looks like for you. But in general, kind of the, the, the, the takeaway is about a 6% increase for the average member is what we're looking at this year.

Courtney Doyle (03:21):

Yeah. Thank you for uh, sending people to the website. 'cause yes, we're gonna focus on residential today just because it is, like Rachel mentioned, the bulk of our membership. Um, and I did just want to explain quickly for people who may not remember from the last time we talked, uh, significantly about rates, uh, what the availability charge is. The availability charge essentially covers our costs for poles and wire and everything that we require to get power to your house. So it's kind of that base, the availability charge

covers everything we need to make sure that you can turn the lights on. Um, and then the kilowatt hour charge is of course that volumetric charge.

Rachel Johnson (03:56):

It's, it's a fixed charge designed to cover fixed cost is, is the easiest way to, I think, explain it. And one of the things that may not be obvious to our members is a lot of the utility inflation that's driving our rate increase is in our fixed cost materials. And so that's why even though we did increase the availability charge last year, we still need to increase it again this year because we need, we need that fixed charge to cover our fixed costs. And, and the place where we're seeing really a lot of cost pressure is in, is in those materials that go into maintaining the system that has to be there anytime someone wants to, um, flip the switch on the wall.

Courtney Doyle (04:31):

Yeah. And Rachel, that actually leads really great into my next question for Brad. Um, can you talk a little bit about how we come up with these proposed increases? There's a lot of numbers. We look at a lot of things and then we have to kind of decide what's the best way to split this up? Where, where, um, does the increase necessarily need to happen to cover our costs in the most accurate way? So what are, what are some of the things that you do to get us to where we are now where we have a proposal?

Brad Pavwaski (04:58):

Well, first we kind of start with a revenue requirements study. So we're basically creating a forecast for 2024 knowing that the weather's been mild, we kept sales fairly kilowatt sales, fairly flat. Um, and then projected out all the costs that we have for our operations. Basically including all of those expected costs with their inflationary adjustments. When we get to the bottom, bottom line there, we see that we're short and we're short by approximately $1.8 million. Um, so then we take that and we have to look, fortunately we just had our cost of service study done in 2022. So we could look back at that and say, how much of that money should be allocated to each of the rate classes? After we determine that, then you go into the each of those rate classes and determine how you, you get collect that money. So how much is going to be in the availability charge, how much is going to be in the, the, um, energy charge?

Brad Pavwaski (05:52):

And you kind of run those numbers multiple times to see what the results are going to be. Um, and when we did that, we kind of, for the residential class, we came up with sort of a 60%, 40%, um, availability charge versus energy. And that really gave us enough revenue to collect everything we needed on a monthly basis while at the same time reducing that disparity that happens between those high energy users and those low energy users in that residential class. So trying to minimize that impact as well as being able to collect everything we need to run the operations.

Courtney Doyle (06:26):

Right. And that's not something that, uh, happens overnight. You guys spend a lot of time on that.

Rachel Johnson (06:32):

One of the hard things, Courtney, I think about the work that, um, we asked of Brad and the finance team this year. Well, there's two things that are hard. It's always hard to figure out. I mean, at the end of the day, the goal is if you are the reason we incurred the cost, your your rates are then, or the where we re where we capture back the revenue for that cost. That's really hard work to do when you really look at the complexity of our system and the complexity of the various rate classes we have. So kudos to the team for that. But the other thing that I think was particularly hard this year for Brad and his team was thinking

about how do we are still in a, a space of incredible volatility. So that forward looking for forecasting is, is hard for us right now because there's so much pressure on utility supply chains and there's so much pressure on utility supply chain costs that are very, very different than what we're seeing in consumer inflation And trying to figure out how to be conservative, not overshoot with the rate increase, but feel good about the data we have.

Rachel Johnson ([07:27](07:27)):

I just wanna say like I'm really, really impressed with the work that the finance team did on this because it's not easy. And, and with the amount of volatility that they had to account for trying to do that forward looking forecast and making sure we would have what we need,

Courtney Doyle ([07:40](07:40)):

I like the assumptions that maybe we used to be able to build in are no longer true and are no longer definable even in some cases <laugh>. And, and so we talked a little bit about what, what the proposed increase is how we got there. Um, Rachel, can you walk us through a little bit of the main reasons, um, that we really need this to happen? Um, you talk about it in your column, you talk about it in your video, but I'd love it if you'd walk us through it, um, here on the podcast as well.

Rachel Johnson ([08:09](08:09)):

So there are really kind of three main cost drivers that are, are, are the reason we're doing this rate increase at this time and kind of driving the amount of the rate increase. And those are tied to labor cost to utility inflation. And I'll explain what that means 'cause it is different than consumer inflation and interest rates on the labor side of things. I always like to remind people 'cause it's something we're so proud of. We are one of the leanest electric cooperatives in the country. We serve more meters per employee than any other electric cooperative of our size. And that's something we're really, really proud of. We're very efficient. We, we have awesome, the part of the reason we can get away with that is 'cause we have really awesome employees who are capable of doing two people's worth of work kind of a thing, but it's also very, very technical work.

Rachel Johnson ([08:54](08:54)):

And so the, the labor inflation inside the utility space is real in that the competition for those highly technically skilled individuals is significant. And in addition to that, when you have really good people, you wanna pay them fair market wages and you certainly don't wanna lose them. And so, um, labor's our second largest cost behind power supply. So anything that puts upward pressure on labor costs is gonna drive up our cost to doing business. It's a fair cost, it's a fair driver of cost. I I think our, our wages are absolutely defensible, but we have to, we have to, you know, we have to manage those costs. The second kind of key driver we're seeing right now, and I would, I would argue one of the harder things for us is tied to utility supply chain inflation. So utility inflation over the last two years has been about 40%. So if you go back two, three years ago, it cost us 40% less to build that mile line than what it's costing us right now. That's obviously significantly higher than what we saw in consumer inflation and is, it's driven by all kinds of three things. We've seen a over a hundred percent increase in the cost of transformers. Uh, I think about a 30% increase in the cost of poles, uh, about a 60% increase in the cost of the kind of cable that we use. And so, and all

Courtney Doyle ([10:04](10:04)):

Necessities, right? Like those are things we can't just do without Exactly.

Rachel Johnson ([10:08](10:08)):

It's not Cooper running around buying gold plated tools over here, <laugh>, the cost of all those materials has gone up. And at the same time, we are a co-op that is growing. There's a lot of pressure to meet the construction needs on our system. So not only have those costs gone up, our exposure to those cost is significant because of the growth on our system. And then all of that wraps up into the cost of borrowing. So our cost of borrowing has gone up about 38% over the last few years. And that's driven by two things. Everything we're purchasing costs more and then we have to finance the things we purchase. So we're borrowing more, we're borrowing more at higher interest rates. And so we have to, um, again, account for that cost. So when you wrap all that together, we're seeing just a, you know, a lot of pressure on our cost.

Rachel Johnson (10:51):

None of it is frivolous, none of it is us going out, you know, doing wild things. In fact, I, when I look at the 2024 budget, we cut a lot of things. We were able to decrease the tree trimming we were doing in 2024. We decreased some of the pull to pole inspections that we were doing in 2024. But those are short-term fixes to what is clearly going to be a long-term sustained problem for us as it pertains to utility inflation. And if we kept cutting those things for a long time, what's gonna happen is our members are gonna see a decrease in their reliability, which is absolutely the wrong thing for us to do. And so this rate increase is a part of making sure not only that we cover our costs, but that we are able to continue to invest in our system and provide the reliability and service that our members expect. Um, but it's, it's a tough time to be in a utility because of those pressures and, and, and they're going to continue and it's gonna be something we're gonna have to continue to, to grapple with as an organization.

Courtney Doyle (11:43):

Well, and when you talk about an increase, a 38% increase in, in borrowing costs, 111% increase in transformers, things like that, at the end of the day, a 6% increase spread out across the membership, um, you know, feels pretty reasonable when you look at how extreme the increases are in other areas.

Rachel Johnson (12:04):

Yeah, I I, I obviously I I think so. And again, that's the, that's the result of a lot of hard, hard work, not just from the team that put together the rate increase, but from the teams that are overseeing all the things we're purchasing and trying to make sure we're being really good stewards of our member members money. Because one of the things that I don't know that all our members really get is I don't have investors. I I can't just do less in dividends this year in order to keep my rates reasonable, every single dollar has to come from somewhere. Right? And as a not-for-profit utility, that's a, that's a challenge because we do take the need to keep rates affordable really seriously, and that's gonna get harder and harder in this environment. And we're doing everything we can to keep those rate increases reasonable despite those very high utility inflation pressures.

Courtney Doyle (12:52):

I do wanna dive a little further into the, the unique way that interest rates impact, um, our industry as being so capital intensive. So Brad, can you talk a little bit about how that borrowing impacts us in, in a unique way and talk a little bit about like our debt service coverage and what those numbers mean and how that, you know, impacts the bigger picture right. Of the revenue that we bring in and things like that.

Brad Pavwaski (13:18):

Sure. Um, the debt service coverage in, in fact the, it's part of our, our, um, it, our loan covenants. Um, it's actually the modified debt service coverage. They take our, our margins that we have during the year and then subtract out the non-cash portion of capital credits, um, from our capital credit partners like our g and t or software providers, lenders, things like that. And then add back depreciation. And you're taking that and dividing it by the annual long-term debt payments that we're making for principal and interest. And

what you're trying to achieve be with the, um, um, score that's required is a 1.35 times, so you should be able to pay for that debt 1.35 times out of those margins. The requirement is that we achieve that score in two out of the last three years. So you have to have at least a 1.35 in two out of those last three years. We know that last year we did not do that, so we have to make sure that 2024 is a year that we do that. And not only that, but it gives us a basis for the follow for the future years. Um, because anything we do with, with 2024 is going to affect 25 and 26. So we really need to do that in the interest rates. It's, it's incredible. Not helping,

Courtney Doyle (14:35):

Not

Brad Pavwaski (14:35):

Helping, not helping at all. Um, the interest expense, everything that we're doing. I mean, every dollar that we spend on interest, we're not able to pay for those other things that we would normally pay for. So of course we're having to borrow more just because of the interest. So yeah, it just, it's a snowball effect.

Courtney Doyle (14:52):

Well, and you mentioned that 1.35 is what we're required to meet, right? And, and at we at Cherryland have set a goal, the board has set a goal to be a little higher than that even to keep it comfortable, <laugh> and not,

Brad Pavwaski (15:06):

And because of the interest rates, we would like to have it at a 1.6 because if we stay at that 1.35, we we're still forced to borrow more than we would like. And it's just adding more interest expense and longer payments for, for the future for everyone. That's, that's on our lines. So

Courtney Doyle (15:22):

And so by implementing this rate increase on the timeline, we are anticipating too, should the board approve it, that will put us in a place to meet our goal. And so, um, another I think important piece of this is the longer we wait, so should we, should we not do any rate increase this year, we are not going to meet that right <laugh>? No. And so the longer we wait to implement a rate increase, the higher the rate increase would need to be because we'd have a shorter amount of time, right?

Brad Pavwaski (15:50):

Yep. Essentially we need to, we need to collect that $1.8 million. So if we aren't able to do it on the timeframe we're looking at, it's just going to increase the amount of increase we're going to have to have. So instead of a $4 increase in the availability charge, it's gonna have to be something greater. Um, and the longer we wait, the higher that's going to have to be mm-Hmm. <affirmative>. So the sooner we can implement the better.

Courtney Doyle (16:11):

Gotcha. And, and Rachel kind of touched on it earlier as a not-for-profit, we don't really have a whole lot of incentive to <laugh> to do things frivolously or to do it, um, without reason to, to just to meet our needs. And so that may mean more frequent increases, but a lot of care put into making them as modestly as possible,

Brad Pavwaski (16:37):

They can be managed better. Yeah. So we're not increasing so high that we could have years with really high margins that we really didn't need. Mm-Hmm. <affirmative>. Um, so by go looking at it year by year, we're actually doing that at a, I think at a better rate. Mm-Hmm.

Courtney Doyle (16:51):

<affirmative> and a more comfortable rate Yes. For the members so that it doesn't feel like an overwhelming, huge increase to their electricity bill because we strive to be affordable. Right. Like <laugh>. So that's what we're working through there. And um, and Rachel, can you, do you have anything that you wanna share on about this, this kind of approach we're taking with addressing it kind of year by year and, and making sure we're not having a huge increase to get us through a few years, but kind of being really mindful about these maybe more frequent, more manageable increases?

Rachel Johnson (17:25):

Sure. Yeah. And I'll also just reiterate something that Brad said, but I think the best, um, analogy I can think of is, think of it like kind of feathering the break. So we, we know that these cost pressures are gonna continue. We also recognize, and this is, this is important that Brad said we would be doing an an, an egregious disservice to our members if we don't meet our debt service coverage requirements, our ability to borrow on their behalf is vital to our ability to keep the doors open. Forget about keeping the lights on, I'm talking about keeping the doors of the cooperative open. So this is a, this is a part of the financial prudence that, that is expected of us, that is required of us and, and that the members have entrusted us with. But we also recognized, to your point, Courtney, that we could, we could justify probably a 10 to 12% rate increase right now based on what we think is gonna happen long term with these costs over the next few years.

Rachel Johnson (18:19):

That would be such a rate shock thing to do to our members and things could change. So taking this approach of let's do the minimum amount that we need to do while still maintaining that financial prudence we are obligated to do and that we owe this community, that's the approach we're taking. So that 6% really is a very conservative increase. And I think that, you know, I would encourage the members to keep in mind, we're thinking there could be another small increase in 2025 and maybe in 2026, but we won't know till we get there. And that's, this has bought us the ability to do the, the minimal amount we need to not do a massive rate increase, get really high margins for a year or two and write it down instead, we're really trying to like feather the break towards these like good, good years that are acceptable in terms of our margins and our debt service without necessarily introducing rate shocks to our membership. So it's gonna be an interesting couple years as we continue to navigate that.

Courtney Doyle (19:13):

And just kind of going back to what we talked about earlier too, is the, these variables that we used to kind of be able to count on for more, uh, solid forecasts if you will, it allows us a little more flexibility in, um, taking a closer look at that year by year instead. Anything else you guys want to add? Um, I'm gonna talk a little bit about the information sessions that are coming up, but I just wanted to give you guys both an opportunity if there's anything else you want to, um, to add about what the members should know about this upcoming proposal.

Rachel Johnson (19:44):

I will just say that, you know, we work really hard to keep our members informed. We've come up with a lot of ways to communicate this, but if anyone has questions, um, they're welcome to reach out directly to me and I'm happy to, uh, have those conversations. We want, we want our members to understand this because the better they understand their rates, the better they can engage with the co-op. And ultimately

transparency and engagement with our members is one of our high level values. And so, um, feel free to reach out directly to me with any questions they have.

Courtney Doyle (20:09):

Great, well thank you Rachel. Thank you Brad for taking some time to talk through this. Um, as I mentioned, we will be having a couple opportunities to learn more about this proposed rate change. There's gonna be an informational session on Tuesday, March 12th. Again, it is 2024 in case you're listening to this in the future. Um, so March 12th, 2024 at 5:30 PM here at the office in groan. Or we'll also have a formal rate hearing at the board meeting, which is on Monday, March 18th at 9:00 AM Just pop into the office and ask to speak to the board. Um, of course you can find all the information about the rate change on our website, uh, cherryland electric dot co-op slash rate change, um, and in your Michigan Country Lines magazine. So thanks again for joining us and tune in next time for more co-op Energy talk.