



Memorandum

To: ISO Board of Governors

From: Ryan Seghesio, Chief Financial Officer & Treasurer

Date: December 7, 2016

Re: Decision on draft budget for fiscal year 2017

This memorandum requires Board action.

This memorandum summarizes the final 2017 budget proposal, that the Board is requested to approve and in which will become effective January 1, 2017. A high-level review of the key budget sections follows in the discussion and analysis section; however, a more detailed description and review of the budget can be found in the 2017 Budget and Grid Management Charge Rates book, included as *Attachment A*.

The proposed revenue requirement of \$195.3 million remains within the tight range that the ISO has maintained over the past eleven budget cycles and beneath the FERC approved cap of \$202 million. The ISO is absorbing upward cost pressures in operations and maintenance (O&M) expenses by continuing to achieve efficiencies in non-labor costs and increasing other revenues. The result is a flat revenue requirement compared to 2016 and immaterial changes to the grid management charge rates.

Management recommends the following motion:

Moved, that the ISO Board of Governors approves the 2017 revenue requirement and capital/project budgets as set forth in Attachment A to this memorandum dated December 7, 2016; and

Moved, the ISO Board of Governors authorizes Management to take all necessary and appropriate actions to implement the 2017 grid management charge rates reflected in the 2017 budget.

DISCUSSION AND ANALYSIS

The annual revenue requirement is an integral component of the planning process and reflects the priorities and commitments made in the ISO's strategic vision.

The 2017 revenue requirement, at \$195.3 million, is approximately \$7 million less than the FERC approved \$202 million cap. This amount is flat in comparison to the 2016 revenue requirement and represents an average annual growth rate of 0.3% since 2007. The ISO projects that 2017 transmission volume will decrease to 240.7 TWh, which results in a bundled cost per megawatt-hour (MWh) of \$0.811, or an increase of \$0.007 per MWh from 2016. Our bundled costs per megawatt-hour (MWh) is derived by dividing the revenue requirement by the forecasted transmission volume. The 2017 projected volumes at 240.7 terawatt-hours (TWh), are 2 TWh less than the 2016 budgeted volumes. The 2017 projected volumes are based on the actual annual 2015 volumes and year-to-date 2016 volumes.

The revenue requirement has five components:

- Operating and maintenance (O&M) budget
- debt service;
- cash funded capital;
- other costs and revenues; and
- operating cost reserve adjustment from prior year.

A summary of the 2017 revenue requirement compared to 2016 is as follows.

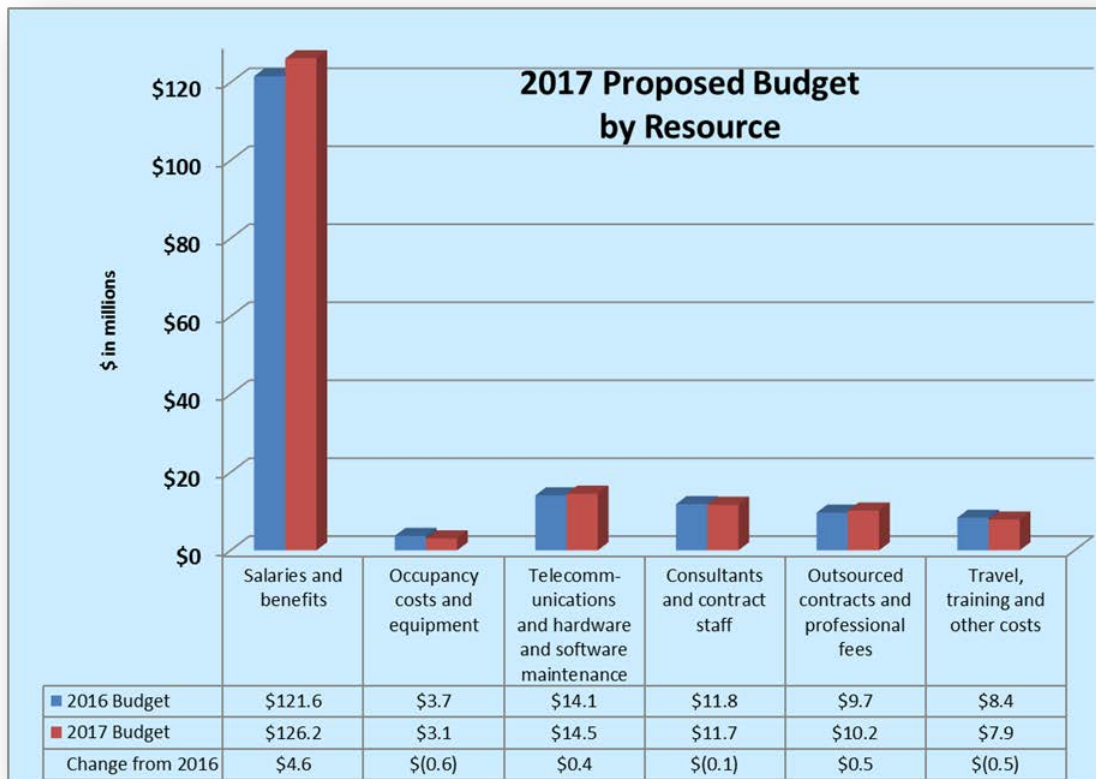
Revenue Requirement Components (\$ in millions)	2017 Budget	2016 Budget	Change \$	Change %
Operations & Maintenance Budget	\$173.6	\$169.3	\$4.3	2.6%
Debt Service (including 25% reserve)	16.9	16.9	-	-
Cash Funded Capital	24.0	24.0	-	-
Other Costs and Revenues	(13.3)	(10.8)	(2.5)	23.1%
Operating Costs Reserve Adjustment	(5.9)	(4.1)	(1.8)	43.9%
Total Revenue Requirement	\$195.3	\$195.3	\$ -	- %
Transmission Volume in TWh	240.7	242.7	(2.0)	(0.5)%
Pro-forma bundled cost per MWh	\$0.811	\$0.805	\$0.006	0.8%

Operating and Maintenance Budget

The O&M budget is the largest component of the revenue requirement; it accounts for 89% of the total revenue requirement. The 2017 proposed O&M budget is \$173.6 million, representing a \$4.3 million, or 2.5%, increase over 2016. The 2017 Budget and Grid Management Charge Rates book, included as *Attachment A*, presents the O&M budget in

three different perspectives: delivery of services (objectives and processes), utilization of resources, and divisional costs.

A summary of the 2017 O&M budget by resource compared to 2016 is as follows.



- Salaries and benefits grew due to merit and benefit burden increases, as well as the addition of 7 headcount.
- Occupancy costs and equipment decreased due to the vacating of the Alhambra leased site.
- Telecommunications and hardware and software maintenance costs increased due to industry driven increases in hardware and software maintenance expenses offset by a reduction in telecommunication costs.
- Consultants and contract staff costs decreased primarily due to an overall reduced need for external resources.
- Outsourced contracts and professional fees increased primarily due to our increased dependency on Software as a Service (SaaS) applications in our environment.
- Training, travel and other costs decreased due to a variety of reasons but most notably due to the closure of the Alhambra site (thus reducing the need for across state travel) and a shift in the categorization of corporate training expenses.

Debt Service

The debt service component of the 2017 revenue requirement will be \$16.9 million, the same as in 2016. Debt service includes the amounts due, plus the required 25 percent reserve.

A summary of debt service is as follows.

Debt Service (\$ in millions)	2017 Budget	2016 Budget	Change
Principal payments	\$4.6	\$4.5	\$ 0.1
Interest payments	8.9	9.0	(0.1)
Subtotal	13.5	13.5	-
25 % Debt Service Reserve	3.4	3.4	-
Total	\$16.9	\$16.9	\$ -

Capital and Project Budget and Cash Funded Capital

The proposed revenue requirement will allow for the collection of \$24.0 million for cash funded capital. Excess amounts collected will be used to fund future projects.

The 2017 capital/project budget is projected to be between \$18 million to \$20 million. A prioritization is underway that will result in the highest priority projects being proposed.

Other Costs and Revenues

Other revenue increased by \$2.5 million to \$13.3 million; these revenue items help bring the revenue requirement below the new \$202 million cap.

A summary of other costs and revenues is as follows.

Other Costs and Revenue (\$ in millions)	2017 Budget	2016 Budget	Change
Energy Imbalance Market Administrative Charges	\$4.8	\$2.5	\$2.3
Interest Earnings	2.1	2.0	0.1
Intermittent Resource (wind and solar) Forecasting Fees	2.1	2.1	-
California-Oregon Intertie Path Operator Fees	2.0	2.0	-
Large Generation Interconnection Fees	1.9	1.8	0.1
Scheduling Coordinator Application and Other Fees	0.4	0.4	-
Total	\$13.3	\$10.8	\$2.5

Operating Cost Reserve Adjustment

The operating cost reserve adjustment is primarily the cumulative result of the actual results versus the budgeted revenue requirement and the 25% debt service reserve collection from the prior year. As with other revenue, this credit adjustment helps bring the revenue requirement below the \$202 million cap.

A summary of the operating reserve adjustment is as follows.

Operating Cost Reserve Adjustment (\$ in millions)	2017 Budget	2016 Budget	Change
Increase/(decrease) in 15% reserve for O&M budget	\$(0.6)	\$(0.6)	\$ -
25% debt service collection from prior year	3.4	3.4	-
True-up of actual to forecast revenues and other expenses	3.1	1.3	1.8
Total	\$5.9	\$4.1	\$ 1.8

Grid Management Charges

The ISO recovers its costs through separate GMC charges to market participants. The design provides for three service categories and five associated fees.

A comparison of the preliminary 2017 rates with 2016 rates is as follows (\$ per unit).

Grid Management Charges	2017 Rate	2016 Rate	\$ Variance
Market Service Charge	\$0.0854	\$0.0850	\$0.0004
Systems Operations Charge	\$0.3025	\$0.2979	\$0.0046
CRR Services Charge	\$0.0059	\$0.0049	\$0.0010
Miscellaneous Fixed Fees			
Bid Segment Fees	\$0.005	\$0.005	n/a
Inter-SC Trade Fees	1.00	1.00	n/a
SCID Fees (monthly)	1,000	1,000	n/a
TOR Fees	0.24	0.24	n/a
CRR Auction Bid Fees	1.00	1.00	n/a

Budget Process

The ISO has provided several opportunities for public review and comment on the draft budget. This public input process commenced with a June budget kickoff meeting with stakeholders and followed with a stakeholder call held in September. The ISO posted materials from the meetings as well as stakeholder comments and ISO responses on its website. The stakeholder comments primarily consisted of clarifying questions regarding items such as the Alhambra decommissioning, Lincoln building, and general O&M questions however the consensus was the stakeholders were generally supportive of the revenue requirement. Stakeholders also had the opportunity to present comments on the draft budget to the Board at its October meeting. With Board approval, the ISO will post the proposed GMC rates on its website to be effective on January 1, 2017.

It should be noted that post-decision minor adjustments are sometimes required to line items within the O&M budget due to final year-end headcount and cost center reorganizations. These year-end adjustments will not affect the final total approved budget.

Conclusion

The proposed budget will provide sufficient funding to enable the ISO to deliver on the commitments made in the ISO's strategic plan while still maintaining the costs to customers. Therefore, Management recommends that the Board approve the budget attached to this memorandum.