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MEMORANDUM - DRAFT FOR REVIEW

DATE: **April 2021**

TO: **David Thompson**

CC: **Jim Daniel**

FROM: **Lynn Lanier**

RE: **Line Extension Allowance Review**

PEC has requested that GDS review its current Line Extension Policies in regard to the continued justification for providing investment allowances for requested extensions.

Perhaps a little history of the origins of line extension allowances is in order. The Rural Electrification Act that brought the rural electrification program into being in the mid 1930's, clearly provided that the purpose of the Act and the rural electric program was to make central station power available throughout the rural areas of the Country as quickly as possible. It was an economic development program, intended to help lift the Country out of economic malaise, and particularly farmers and ranchers, who had suffered greatly. Unfortunately, most residents, farmers, and ranchers had very little money, as the Country was in the midst of the Great Depression. It was so bad that many people who wanted electric service did not even have the $5.00 for a membership that the co-ops required in order to justify a line in the area. Organizers, in many cases, paid the membership fee for the people, in order to have the commitments needed to build lines in the area. In order to be able to extend lines in the rural areas, the RE Act provided for 35 year loans at 2.0% interest with a 2-3 year principal deferment period, which was intended to allow co-ops to build the lines, hook-up consumers, and then generate a revenue stream to be able to make principal payments on the loans. Initially, all the lines were built without any requirement that the consumer pay for the line to be extended to them. This was done out of NECESSITY. It was NECESSARY in order to get lines extended throughout the rural areas. In fact, the Rural Electrification Administration that was established to administer the program issued numerous bulletins and guidance to co-ops on how to establish and run an electric utility. The REA's policy on extensions was known as "Area Coverage," and stated basically that extensions should be made to all who wanted to receive service with no requirement for a contribution-in-aid of construction, to the maximum extent possible. For many years, continuing to today, many co-ops have extended service to anyone who requested it, for "permanent establishments," without charge. Again, in the early days, it was NECESSARY.

The question for Pedernales now becomes: Are extension allowances still NECESSARY, in order for service to be extended to those requesting it?

The majority of service extensions are for residential service. Almost all residential requests for service are for high-end developments and for underground service, throughout. In 2020, PEC connected almost 19,456 new services. Of those, approximately 17,788 or 91% were for Residential Extensions. The majority of the Residential Extensions were in large, high-end developments. For Extensions not in developments the economics of extending service are favorable for the member to make that investment. PEC's current Residential Extension Allowance of $2,000, while economically justified, pales in comparison to home prices and it is obvious that such allowances are no longer NECESSARY.

For non-residential service extensions the PEC board aligned the construction allowance with that of the Residential Extension for simplicity and equity. The non-residential class has not historically had a necessity that the cooperative provide an allowance for service extensions.

Should PEC decide to eliminate line extension allowances, it's not as though its consumers have had something taken away without receiving anything in return. Elimination of the Residential Allowances would conserve approximately $25 - $30 million each year in capital expenditures. Even for PEC, that is significant. Debt financing is used heavily to support capital expenditures, on the order of $100 million per year. Reducing that to $70 – 75 million per year will begin to have an impact on overall revenue requirements and that impact will accumulate year-by-year. Thus, rate levels for all consumers will eventually be lower than they otherwise would have been. This is the quid pro quo to eliminating extension allowances.

A reasonable conclusion can therefore be made that extension allowances really no longer serve any NECESSARY purpose as far as encouraging extension of service or making the extension of service feasible for the developer or consumer. PEC has no legal or regulatory obligation to provide extension allowances and it is purely a decision of the Board as to whether extension allowances are needed to accomplish the objectives of the Cooperative.

Our suggestion would be that PEC definitely eliminate extension allowances for any kind of developments. However, consideration should be given to those few extension requests in the truly rural areas served by PEC, as to whether any extension allowances should be made in these situations. If allowances, in such cases, are not deemed to be NECESSARY, in order for the applicants to receive service, allowances for these type extensions could also be eliminated.

LML: LML

CC: Jim Daniel
Attachments