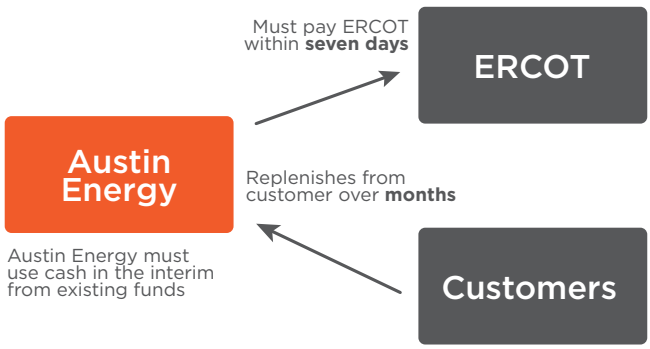
Liquidity Risks

Liquidity refers to the cash on hand that organizations need to pay their obligations. As an electric utility and a part of the Electric Reliability Council of Texas (ERCOT) market, Austin Energy is required to have sufficient cash on hand for its market operations. Two major liquidity needs are requirements for payments and for collateral.

ERCOT Payments and Liquidity

State law and ERCOT rules require Austin Energy to sell the power it generates into the market and buy all of the power it needs to serve its customers from the market. When Austin Energy makes that purchase, payment is due to ERCOT within seven days. However, due to billing cycles, it is often months before Austin Energy receives payments from its customers for that same power. This time gap can create a liquidity stress and a cash shortfall for Austin Energy. The utility's cash on hand is reduced because Austin Energy has made the required payment to ERCOT but has not yet recovered those funds from customers. On a day-to-day basis, this is usually a manageable issue. It becomes a concern, however, when power prices are suddenly very high, such as during an extreme weather event or season, or a transmission restriction. In cases when there is a large imbalance between costs and revenues in the market, it may take many months to recover any large ERCOT payment. Austin Energy has to bridge the gap with existing cash on hand, as it did from 2022 through 2024, when it funded $102M of market costs by December of 2022 that were only fully recovered from customers in June 2024.

Liquidity Needs — Payment Flow



ERCOT Collateral Requirements and Liquidity

In addition to cash transfers for payments, ERCOT also requires liquidity from Austin Energy for collateral. Collateral is cash sent preemptively to ERCOT to compensate other market participants in the unlikely event that Austin Energy does not pay its ERCOT bills. All market participants place such collateral with ERCOT, and this mechanism reduces risk for all market participants, though it can tie up a lot of cash.

ERCOT's required collateral amounts change every day. ERCOT calculates Austin Energy's collateral requirement using formulas that include the difference between Austin Energy's load and its generation, as well as traded market prices for electricity. The formulas are complex, and in volatile times, the results can change by tens of millions of dollars each day. When this occurs — as it did in the summers of 2022 and 2023 — Austin Energy must transfer those tens of millions of dollars to ERCOT within two days of the extreme market conditions.

Risks and Liquidity

The consequences of insufficient liquidity can be serious. If Austin Energy were to miss a payment or a collateral transfer to ERCOT, Austin Energy would be in default on its market participation agreement with ERCOT. This default could mean that financial agreements with all of Austin Energy's suppliers and lenders might be jeopardized, Austin Energy's bond ratings might be lowered, and the City's ability to own and operate a municipally owned utility may be impacted. Bankruptcy courts might need to intervene so that Austin Energy could continue to purchase fuel for plants and pay other bills to continue operations.

Real-World Examples

An extreme example of an ERCOT liquidity need occurred during Winter Storm Uri in February of 2021. Brazos Electric Cooperative was unable to make required payments to ERCOT. Due to the market conditions and the composition of its generation portfolio at that time, Brazos incurred $1.8 billion in ERCOT costs in just a few days. Given time, Brazos could potentially have raised rates for its customers and recovered this amount, but it did not have the liquidity, as cash on hand, to meet the need. Brazos declared bankruptcy and was restructured by its stakeholders, and it no longer generates power in the ERCOT market.

Winter Storm Uri could also have damaged Austin Energy's liquidity, if not for certain generation facilities that were online at that time. During the six days from February 14 to February 19, Austin Energy's load costs soared to $1.7 billion, roughly equivalent to four years of total load cost under normal conditions. Fortunately for the utility's customers, Austin Energy's generation revenue offset this cost almost exactly, and left roughly $100 million of net revenue left over. But one generator which is no longer online, Decker Steam Unit 2, supplied $195 million of that offset, and the Fayette Power Project supplied $494 million. If the utility had not had the Decker Steam and Fayette units, it might have resulted in net costs of $589 million, and the utility might also have owed collateral to ERCOT in a volatile range from $500 million up to $1.3 billion. The requirement to pay these bills in a short amount of time emphasizes the immediate need for cash on hand.

Even outside of extreme weather conditions Austin Energy can be impacted by market conditions. In August of 2023, Austin Energy experienced significant market costs and had to transfer $100 million to ERCOT that it had not yet recovered from customers and $120 million to ERCOT to meet collateral requirements. These conditions reduced the utility's cash balances by $220 million overall and exacerbated other cash shortfalls versus the utility's policy targets.

Managing the Risk Through Resource Planning

Liquidity risk can be managed, and one important opportunity to do so is to match Austin Energy's generation to its load as closely as possible, in quantity, time, location, and response to weather conditions. Gaps between Austin Energy's generation and its load can expose the utility to large payments and large collateral calls, while matching generation to load can add stability to the utility's ERCOT payments and can lower Austin Energy's collateral needs. In its resource planning analysis, Austin Energy is estimating the liquidity risk associated with each of the portfolios that are under review for the 2035 Resource Generation Plan. This overview is intended to provide context to the liquidity risk metric that will be shown, and to convey the importance of assessing Austin Energy's liquidity risk when making resource decisions.

Notes:

4815 Mueller Blvd, Austin, TX 78723 | phone: **512-494-9400** | web: **austinenergy.com**

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