TO: HONORABLE CITY COUNCIL

FROM: DEAN BATCHELOR, DIRECTOR OF UTILITIES

DATE: MAY 05, 2020

SUBJECT: AGENDA ITEM NUMBER 3 - Staff and the Utilities Advisory Commission Request the Finance Committee Recommend the City Council Adopt a Resolution Approving the Fiscal Year 2021 Electric Financial Plan and Reserve Transfers, Amending the Electric Utility Reserve Management Practices

AGENDA ITEM NUMBER 4 - Staff and the Utilities Advisory Commission Request the Finance Committee Recommend the City Council Adopt a Resolution Approving the Fiscal Year 2021 Gas Utility Financial Plan, Including Proposed Transfers and an Amendment to the Gas Utility Reserve Management Practices

In the interest of providing options to help the community keep its utility bills low during the economic crisis created by the COVID-19 pandemic, the Utilities Department is presenting an alternative rate plan to the Finance Committee involving no rate increases for two years and no more than 5% rate increases in the subsequent three years. This differs from the staff proposal presented on April 15, 2020 to the Utility Advisory Commission (UAC). On that date the UAC approved and recommended to Finance the staff recommendation of electric rate increases of 2% and gas rate increases of 3% for the fiscal year (FY) 2021.

While the Department normally presents only five year projections, the projections below rely on a full ten-year forecast. Utilities staff normally recommends rate plans that balance costs and revenues and bring reserves to their target level by the end of the five-year forecast period, since forecasts become more uncertain six to ten years into the future. To achieve two years of 0% rate increases without large rate increases in FY 2023 through FY 2025 or major long-term service reductions, staff recommends relaxing this standard and using a ten year forecast period. By doing this staff can better maintain the City’s priorities for its utilities (safety, reliability, cost-effectiveness, and sustainability) over the forecast period.
The rate projections for each utility would be as follows:

### Table 1: Ten-Year Rate Projections by Utility

<table>
<thead>
<tr>
<th></th>
<th>FY 2021</th>
<th>FY 2022</th>
<th>FY 2023</th>
<th>FY 2024</th>
<th>FY 2025</th>
<th>FY 2026</th>
<th>FY 2027</th>
<th>FY 2028</th>
<th>FY 2029</th>
<th>FY 2030</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Gas</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>3%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Water</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>7%</td>
<td>6%</td>
<td>6%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Sewer</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>6%</td>
<td>5%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>

In order to achieve these rates, some one-time cost reductions would be required in the next few years.

### Table 2: Cost Reductions Required By Utility, FY 2021 – FY 2025

<table>
<thead>
<tr>
<th>Utility</th>
<th>Reductions Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric</td>
<td>$1.5 million</td>
</tr>
<tr>
<td>Gas</td>
<td>$13.8 million</td>
</tr>
<tr>
<td>Water</td>
<td>No reductions needed</td>
</tr>
<tr>
<td>Sewer</td>
<td>$5.5 million</td>
</tr>
</tbody>
</table>

The savings for different types of customers as compared to the proposals presented to the UAC is shown in Table 3.

### Table 3: Example Customer Savings Compared to Staff Proposal

<table>
<thead>
<tr>
<th>Customer Type</th>
<th>As of July 1, 2020</th>
<th>As of July 1, 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median Residential Customer</td>
<td>$0.31 per month</td>
<td>$8.80 per month</td>
</tr>
<tr>
<td>Small business</td>
<td>$54 per month</td>
<td>$81 per month</td>
</tr>
<tr>
<td>Restaurant</td>
<td>$54 per month</td>
<td>$108 per month</td>
</tr>
<tr>
<td>Hotel</td>
<td>$156 per month</td>
<td>$271 per month</td>
</tr>
</tbody>
</table>

---

1 Staff’s proposal to the UAC included July 1, 2020 rate increases of 2% in electric and 3% in gas and July 1, 2021 rate increases of 2% in electric, 6% in gas, 3% in water, and 5% in wastewater
Cost reductions (preliminary estimates) would need to be implemented in each utility. Examples of the types of actions that could be taken by the Electric Utility to reduce costs without impacting safety, reliability, and infrastructure investment include:

- Postpone non-critical capital investment like utility undergrounding rebuilds ($2.2 million for FY 2021)
- Release funds from the Electric Special Projects Reserve to offset economic impacts or to internally finance certain types of expenses. (Reserve balance is currently $41.6 million, of which $5.0 million for FY 2021 and $7.0 million for FY 2022) is tentatively designated for the City’s Advanced Metering Infrastructure (AMI) project.
- Temporarily reduce utility efforts in energy efficiency in the sectors with longer payback periods for efficiency investments (residential and small and medium business customers). (Exact amount subject to internal review of various programs to review payback periods. Total annual electric efficiency spending is approximately $3.5 million per year.)
- Postpone Utilities Department support for building electrification for two to three years. Electric vehicle programs could be continued due to the availability of a segregated state funding source (Low Carbon Fuel Standard program). (~$1 million for FY 2021 and FY 2022)
- Reduce the amount of renewable energy purchased by the utility below 100% Carbon Neutral. (~$3 million to $6 million per year for FY 2021 and FY 2022, depending on market prices and the amount sold.)
- Two year postponement of installation of advanced metering infrastructure ($12 million) and phase 2 construction of the fiber network expansion to support AMI and SCADA. (~$2 million)
The gas utility would need to make the most significant reductions, $13.8 million. To make reductions this large, temporarily bond financing capital expenditures would typically be a reasonable option. But given the City’s ambitious building electrification goals, long-term bond financing may not be prudent. This means that staff may need to temporarily make significant reductions in capital investment for this utility. Examples of the types of actions that might need to be taken by the Gas Utility include:

- Ending the City’s Carbon Neutral Gas carbon offset program (~$1 million to $1.5 million per year, depending on market prices)
- Temporarily reduce utility efforts in energy efficiency in the sectors with longer payback periods for efficiency investments (residential and small and medium business customers). (Exact amount subject to internal review of various programs to review payback periods. Total annual gas efficiency spending is approximately $600,000 per year.)
- Postponing or eliminating cross-bore\(^2\) inspections (~$1 million in FY 2021 and FY 2022)
- Postpone installation of advanced metering infrastructure and gas meter replacement (~$3 million in FY 2022)
- Cutting back on capital investment by postponing or reducing project scope of work of gas main PVC pipe replacement (up to $10 million)
- The impacts of the above cost reductions would impede sustainability efforts, leave the City at some level of risk from cross-bores, delay customer availability of hourly usage data for several years, and slow down the rate of replacement of PVC gas mains, which have glued joints that are at higher risk of leakage during an earthquake. To mitigate the safety risk of these cost reductions, Utilities would increase the frequency of citywide gas surveying (mobile and walking) for gas leaks ($100,000).

\(^2\) Gas lines are usually installed through horizontal drilling if a gas line is accidentally drilled through a sewer line, this is referred to as a “cross-bore.” It is dangerous if a plumber clears the sewer line with a cutting tool, cutting the gas line. The City has inspected a significant portion of its sewer lines for cross-bores and has found very few, but many sewer lines remain to be inspected.
The Water Utility does not require any cost reductions to hold rates flat for two years due to delays in CIP projects and no projected supply rate increases from SFPUC until FY 2023. Staff’s preliminary recommendation to the UAC this year was to hold rates flat for two years because costs looked to be relatively flat. In later years costs were expected to increase by 5%, as would rates. Based on UAC feedback and internal staff discussion, staff later decided that it was preferable to have some smaller, earlier rate increases to enable later year rate increases to be 3% to 4% rather than 5%. For the City to hold rates flat for two years, staff would simply need to reinstate its original recommendation.

The Wastewater Utility is particularly limited in the types of service reductions it can make. However, bond financing some infrastructure investment may be a viable alternative for this utility. Examples of the types of actions that could be taken by the Wastewater Collection Utility include:

- Cutting back on capital investment by postponing or reducing scope of work of sewer main replacement, or bond financing several years of capital investment. (~$5.3 million)
- Determining whether Regional Water Quality Control Plant investments can be delayed to reduce projected wastewater treatment charges. (Savings depend on which investments are delayed)
- Staff would not recommend cuts to sewer cleaning, maintenance, and inspection activities. If capital investment were postponed staff would need to focus additional maintenance efforts on areas of the system in poorer condition that are currently scheduled for replacement.

These projections do assume impacts from an economic downturn over the next five years. These assumed impacts include:

- Modest FY 2020 impacts due to shelter in place. The electric utility is seeing a 10% decrease in sales, which is assumed to continue through the end of the fiscal year. The revenue loss for the electric utility is roughly $3.75 million, which is offset by roughly $2.25 million in supply cost savings for a net loss of $1.5 million. Other utilities have not seen any decrease in sales, so no sales decreases are assumed. Significant utility bill defaults by restaurants, retail, and hotels are also assumed for FY 2020 ($2.4 million for the electric utility, $540,000 for the gas utility, $257,000 for the water utility, and $229,000 for the wastewater utility)
• For the electric utility, sales are assumed to be reduced by 10% compared to pre-COVID forecasts in FY 2021, 5% in FY 2022, and 3% in FY 2023. Note that during the Great Recession, the electric utility experienced no more than 3% reductions in sales over the entire course of the recession, and sales reductions were typically 1% to 2%.

• Water and gas sales are assumed to drop by twice as much as they did during the Great Recession. During that recession sales dropped by 1% to 3% after accounting for other impacts (e.g. drought and weather), so this forecast assumes post-COVID impacts on sales of 2% to 6% for several years.

• No projection is included for utility bill defaults beyond FY 2020 because staff does not have adequate information to make a projection. Utility bill defaults were not significant during the Great Recession (only a few hundred thousand dollars per utility over the course of the entire recession), so if staff based its projections on the Great Recession, the impact of utility bill defaults would be negligible. This is the greatest source of uncertainty in the forecast, since defaults are likely to be much more significant in the coming years than they were in the Great Recession. Staff will work to improve these forecasts as it tracks delinquent payments over the next few months.

Dean Batchelor
Director of Utilities Department

Ed Shikada
City Manager