



# City of Palo Alto

## Utilities Advisory Commission Staff Report

(ID # 11145)

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**Report Type: Agenda Items****Meeting Date: 4/15/2020****Council Priority: Fiscal Sustainability****Summary Title: FY 2021 Gas Rates and Financial Plan**

**Title: Staff Recommendation That the Utilities Advisory Commission 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, and Increasing Gas Rates by Amending Rate Schedules G-1 (Residential Gas Service), G-2 (Residential Master-Metered and Commercial Gas Service), G-3 (Large Commercial Gas Service), and G-10 (Compressed Natural Gas Service)**

**From: City Manager****Lead Department: Utilities****Recommended Motion**

Staff recommends the Utilities Advisory Commission (UAC) consider the following Motion: Recommend Council adopt a Resolution approving the FY 2021 Gas Financial Plan, including reserve transfers and an amendment to the Gas Utility Reserves Management Practices, and increasing gas rates by amending Rate Schedules G-1 (Residential Gas Service), G-2 (Residential Master-Metered and Commercial Gas Service), G-3 (Large Commercial Gas Service), and G-10 (Compressed Natural Gas Service).

**Recommendation**

Staff requests that the Utilities Advisory Commission (UAC) recommend that the Council:

1. Adopt a Resolution (Attachment A):
  - a. Approving the fiscal year (FY) 2021 Gas Utility Financial Plan ([Attachment B](#)); and
  - b. Transferring all remaining funds (currently \$2.533 million) from the Rate Stabilization Reserve (RSR) to the Operations Reserve; and
  - c. Transferring up to \$4.5 million from the Operations Reserve to the CIP Reserve; and
  - d. Amending the Gas Utility Reserve Management Practices relating to the CIP and Rates Stabilization Reserves (as set forth in the Financial Plan) ([Attachment C](#)); and
  - e. Increasing gas rates by amending Rate Schedules G-1 (Residential Gas Service), G-2 (Residential Master-Metered and Commercial Gas Service), G-3 (Large Commercial Gas Service), and G-10 (Compressed Natural Gas Service) ([Attachment D](#)).

## **Executive Summary**

The FY 2021 Gas Utility Financial Plan includes projections of the utility's costs and revenues for FY 2021 through FY 2025. Gas utility costs are made up of supply-related costs (41 percent of costs in FY 2019) and distribution-related costs (59 percent of costs in FY 2019). Supply-related costs (and customer rates) vary monthly with the gas markets, but customer rates for gas distribution are evaluated annually and set by Council action like other utility rates. Gas rates related to distribution costs were last increased by 8 percent on July 1, 2019.

The proposed FY 2021 Gas Utility Financial Plan also includes a 5 percent overall system rate (and bill) increase on July 1, 2020, which will be done through an 8 percent increase in distribution rates (because distribution accounts for only 59 percent of the average customer's bill). Further 4 percent overall increases (6 percent distribution increases) are projected over the next three years. CIP expenditures for the last several years have been lower than normal while the City was completing the Upgrade Downtown project, and much of this increase is due to the Gas Utility resuming ongoing main replacement projects.

In addition, the plan proposes transfers to the Operations Reserve of up to \$2.5 million from the Rate Stabilization Reserve, and up to \$4.5 million to the CIP Reserve from the Operations Reserve, to ensure that there are appropriate financial reserves for contingencies, such as high construction costs and unplanned CIP replacement, as well as to provide initial funding for the CIP Reserve to operate as a functional reserve for CIP projects. This will allow the CIP reserve to absorb annual variations in capital cost, rather than the Operations reserve. More on this will be discussed below. The Rate Stabilization Reserve is projected to be at zero balance by the end of FY 2020, consistent with the Reserves Management Practices.

The 2019 Natural Gas Cost of Service and Rates Study was completed last year. Staff updated the model developed as part of the study with current and proposed operating costs, changes to the utilities infrastructure mix, and developing patterns of usage between Palo Alto's customers. The results showed a need for some adjustments between customer classes. While rates for all customer classes will increase in order to cover increasing commodity, capital and operational costs, residential and large commercial customers require a slightly lower rate increase to achieve cost of service (COSA) than small commercial customers. Consumption decreased for all customer classes, but more for small commercial customers than others, meaning that a small amount of additional distribution-related costs need to be recovered for this class, leading to a slightly higher rate G-2 rate increase overall, as shown in Table 1, below.

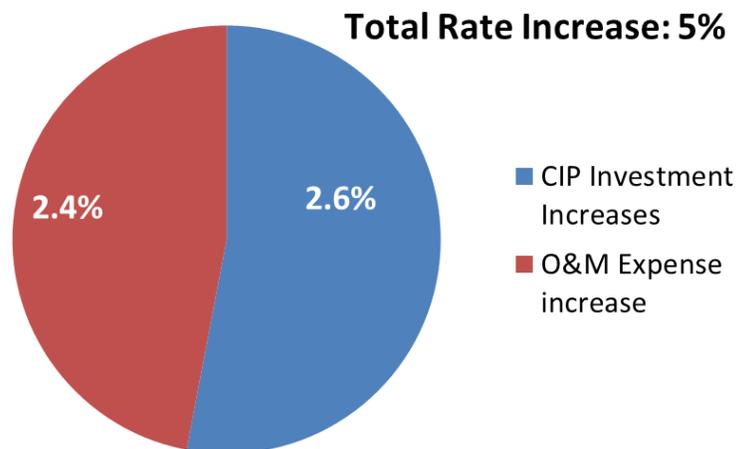
**Table 1: Rate Increases by Customer Class**

Cost of Service Analysis FY 2021	Revenue Increase needed for Distribution Charges	Increase for Combined Commodity and Distribution Charges
<b>G1 - Residential</b>	7.1%	4.9%
<b>G2 - Small Commercial</b>	8.1%	5.2%
<b>G3 - Large Commercial</b>	7.4%	4.4%
<b>TOTAL</b>	7.6%	4.9%

The cost shifts between customer classes are the result of changes in fixed costs, primarily Capital Improvement spending, declining customer usage and shifts to how customers use the gas system.

Figure 1 below shows the primary drivers for the proposed rate change, which are almost equally split between increasing Capital Improvement (CIP) cost and increases in Operations expenses. The increases are discussed in greater depth in the attached FY 2021 Gas Financial Plan:

**Figure 1: Allocation of Distribution Rate Increase**



Supply-related costs (the cost of the natural gas itself, gas transmission, and gas environmental charges) are the most volatile component of the Gas Utility’s expenses, but recent market indications have led staff to project supply cost increases of around 2.5 percent annually for the forecast horizon. Market prices, however, are monitored monthly and automatically incorporated into monthly supply rate adjustments. Therefore, it is not possible to exactly predict what supply rates will be during the planning horizon. Where overall rate increases (supply plus distribution) are referenced in this report, the figures do not attempt to predict or include any supply rate increase or decrease that can occur as a result of the monthly supply rate adjustments.

**Background**

Every year staff presents the Utilities Advisory Commission with Financial Plans for its Electric, Water, Gas, and Wastewater Collection Utilities and recommends any rate adjustments required to maintain

their financial health. These Financial Plans include a comprehensive overview of the utility's operations, both retrospective and prospective, and are intended to be a reference for UAC and Council members as they review the budget and staff's rate recommendations. Each Financial Plan also contains a set of Reserves Management Practices describing the reserves for each utility and the management practices for those reserves.

The City's gas is purchased from a variety of marketers who source gas from throughout the Western United States. The City then pays Pacific Gas and Electric (PG&E) to transport the gas across its gas transmission system to Palo Alto, which is then delivered to customers through Palo Alto's gas distribution system.

The Gas Utility's costs can be divided into two main categories: gas supply costs (which includes the cost of the gas itself, the cost of transmitting the gas to Palo Alto, and environmental costs<sup>1</sup>) and the costs of running the business and operating the distribution system. As noted above, gas supply costs vary with the market, and the costs are passed through to customers through a gas supply rate component that varies monthly.

The UAC reviewed preliminary financial forecasts at its December 4, 2019 meeting. At that meeting, staff also projected an 8% distribution rate increase (or a 5% overall gas rate increase).

## **Discussion**

Staff's annual assessment of the financial position of the City's gas utility is completed to ensure adequate revenue to fund operations and to ensure that the City's rates comply with cost of service requirements set forth in the California Constitution and applicable statutory law. The assessment includes making long-term projections of market conditions, of costs associated with the physical condition of infrastructure, and of other factors that could affect utility costs. Rates are then proposed that will be adequate to recover projected costs.

### Proposed Actions for FY 2020 and FY 2021:

The FY 2021 Gas Utility Financial Plan includes the following proposed actions:

1. Amend gas rate schedules (see [Attachment D](#)) to increase distribution rates by approximately 8 percent (a 5 percent increase on overall rates);
2. Transfer all remaining funds (currently \$2.533 million) from the Rate Stabilization Reserve (RSR) to the Operations Reserve; and,
3. Transfer up to \$4.5 million from the Operations Reserve to the CIP Reserve.
4. Amend the Gas Utility Reserve Management Practices (as shown in redline in [Attachment C](#)).

The reserve transfers and proposed changes to the Reserve Management Practices will enable staff to both maintain sufficient funds in the Gas Operations Reserve while establishing a CIP fund to balance the year to year cost swings associated with capital spending, as discussed below. These proposed actions are described in more detail in the FY 2021 Gas Financial Plan ([Attachment B](#)).

### Proposed Gas Rates and Cost of Service Update

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<sup>1</sup> These are the costs of complying with the State's Cap and Trade system and procuring offsets under the City's Carbon Neutral Gas program.

The Gas Utility's rates are evaluated and implemented in compliance with cost of service requirements. The Gas Utility's proposed rates are based on the methodology from the 2019 Natural Gas Cost of Service and Rates Study, presented to Council in June 2019<sup>2</sup>, and updated with current and proposed operating costs, changes to the utilities infrastructure mix from last year, and developing patterns of usage between Palo Alto's customers. Table 2 below shows the results of the analysis and the corresponding revenue and rate increases sought by rate class:

**Table 2: Cost of Service (COSA) results by Customer Class**

Cost of Service Analysis FY 2021 Test Year	Projected FY 2021 Revenues under Current Rates	Net Distribution Revenue Requirement	Projected Deficiency in FY 2021 Revenue based on Current Rates	Revenue Increase needed for Distribution Charges	Increase for Combined Commodity and Distribution Charges
<b>G1 - Residential</b>	\$ 10,345,561	\$ 11,080,902	\$ 735,342	7.1%	4.9%
<b>G2 - Small Commercial</b>	\$ 10,535,487	\$ 11,386,754	\$ 851,266	8.1%	5.2%
<b>G3 - Large Commercial</b>	\$ 3,621,144	\$ 3,889,324	\$ 268,180	7.4%	4.4%
<b>TOTAL</b>	\$ 24,502,193	\$ 26,356,980	\$ 1,854,787	7.6%	4.9%

The COSA estimates a net distribution revenue requirement of \$26.4 million for FY 2021, and its further estimates that the existing rates would only generate \$24.5 million in distribution revenues for FY 2021. A roughly 8 percent increase in distribution rates is necessary to recover this deficiency. Table 2 above outlines how these revenue requirements and distribution charges are allocated amongst the three gas customer classes. Variations in allocations between customer classes, both in general as well as between monthly service charges and volumetric rates, are a function of annual and projected variations in loads, system utilization characteristics by class, as well as changes in costs over time.

Much of the shift in costs between customer classes in the proposed FY 2021 rates ties back to the increased capital spending plan. For several years (2013 to 2019) staff focused on large scale and complex gas main replacement projects (one of which was Upgrade Downtown). This prevented staff from engaging in more routine annual main replacement. With those projects completed staff is planning for routine main replacement over the next five years. This increased capital spending affects different customer classes differently. Staff does not expect future year rate changes to vary as significantly between customer classes, since capital spending is expected to be more stable going forward.

Fixed charges include both customer service and meter reading costs as well as a portion of distribution system costs. As the City resumes regular main replacement for its gas utility, it impacts the fixed charges. In addition, G-2 (small commercial) customer usage is higher than that of G-1 and G-3 customers. Because their utilization of the system is higher than the other two classes, they will have a larger impact to their fixed charges from the re-allocation of the distribution system cost and capital improvements. Stabilization of CIP spending and reserve transfers should help to moderate these types of class swings in the future. For the volumetric distribution charges, the increase is about 10% for all groups. However, as CIP-related costs are weighted more towards peak demands (like winter peaks), Tier 2 residential rates for the G-1 residential group, which collects costs associated with distribution capacity to serve peak demand, are seeing a larger increase than for Tier 1.

<sup>2</sup> Staff Report 10295, 6/17/2019 <https://www.cityofpaloalto.org/civicax/filebank/documents/71892>

Staff proposes to adjust gas rates as shown in Table 3 and Table 4 below, effective July 1, 2020. These changes are projected to increase the system average gas rate (total of supply and distribution) by roughly 5 percent for all classes. These rate changes are included in the proposed amended rate schedules in [Attachment D](#).

**Table 3: Current and Proposed Monthly Service Charges**

Rate Schedule	Monthly Service Charge (\$/month)		Change	
	Current (as of 7/1/19)	Proposed for FY 2021	(\$)	(%)
G-1 (Residential)	\$13.35	\$11.98	(\$1.37)	(10.3%)
G-2 (Small Commercial)	104.95	107.37	2.42	2.3%
G-3 (Large Commercial)	690.45	524.44	(166.01)	(24.0%)
G-10 (CNG)	70.98	72.62	1.64	2.3%

**Table 4: Current and Proposed Gas Distribution Charges**

	Current (as of 7/1/18)	Proposed for FY 2020	Change	
			(\$)	(%)
G-1 (Residential)				
Tier 1 Rates	\$0.4835	\$0.5279	\$0.0444	9.2%
Tier 2 Rates	1.0426	1.2756	0.2330	22.3%
G-2 (Residential Master-Metered and Small Commercial)				
Uniform Rate	0.6102	0.6726	0.0624	10.2%
G-3 (Large Commercial)				
Uniform Rate	0.6056	0.6665	0.0609	10.1%
G-10 (Compressed Natural Gas)				
Uniform Rate	0.0100	0.0110	0.0010	10.0%

**Bill Impact of Proposed Rate Changes**

Table 5 shows the impact of the proposed July 1, 2020 rate changes on various levels of residential bills. The average increase for the residential class is roughly 5 percent based on last year's commodity prices, but lower usage G-1 customers may see a bill decrease due to the decrease in the monthly service charge, and higher users will see larger bills as Tier 2 prices increased more than Tier 1 did.

**Table 5: Impact of Proposed Gas Rate Changes on Residential Bills**

Usage (Therms/month)	Bill under Current Rates	Bill under Proposed Rates	Change	
			\$/mo.	%

Winter (Using December 2019 commodity prices)				
30	\$ 44.47	\$ 44.44	(\$ 0.04)	(0.1%)
54 (median)	69.37	70.40	1.03	1.5%
80	106.41	111.99	5.58	5.2%
150	218.17	240.06	21.89	10.0%
Summer (Using July 2019 commodity prices)				
10	\$ 22.56	\$ 21.64	(\$ 0.93)	(4.1%)
18 (median)	29.93	29.36	(0.57)	(1.9%)
30	46.20	47.93	1.72	3.7%
45	68.41	73.62	5.22	7.6%

Table 6 shows the impact of the proposed July 1, 2020 rate changes on various representative commercial customer bills. The overall increases for the G-2 and G-3 classes are projected to be 5.2% and 4.4%, respectively.

**Table 6: Impact of Proposed Gas Rate Changes on Commercial Bills**  
(Using December 2019 commodity prices)

Usage (Therms/month)	Bill under Current Rates	Bill under Proposed Rates	Change
			%
500	687	721	4.9%
5,000	5,926	6,240	5.3%
10,000	11,747	12,373	5.3%
50,000	58,669	61,548	4.9%

FY 2021 Financial Plan's Projected Rate Adjustments for the Next Five Fiscal Years

Table 7 shows the projected rate adjustments over the next five years and their impact on the annual median residential gas bill (54 therms per month in winter, 18 therms per month in summer). Note that as the residential increase in FY 2021 falls largely on the second tier and the monthly service charge is decreasing, the median customer bill's impact is relatively less than it would be otherwise.

**Table 7: Projected Rate Adjustments, FY 2021 to FY 2025**

	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Gas Utility	5%	4%	4%	4%	2%
Estimated Bill Impact (\$/mo)*	\$0.10	\$1.77	\$1.85	\$1.92	\$1.00

\* estimated impact on median residential gas bill, which is currently \$44.36 for CY 2019

One of the main drivers for the increase in the Gas Utility's short-term costs (and therefore rates) over the next several years are increases in capital improvement costs to maintain a safe and reliable system. In FY 2015 and FY 2017, costs for the gas utility were unusually low as new main replacements were not planned. In FY 2014 and FY 2015, staff was completing a prior major gas main replacement project, the largest in utility history, which included replacement of most ABS gas mains in Palo Alto. FY 2017 included replacements of gas mains on University Avenue, a project that has evolved into the Upgrade Downtown project, involving a coordinated replacement of several different types of infrastructure to

avoid multiple disruptions to the business district. This was a multi-year planning effort, completed in 2019, which did not allow for design of other new projects. Also, as government agencies regionally and nationally spend more on infrastructure improvement, contractor bids for underground construction have risen greatly from where they were in years past.

This current financial plan works to address these challenges in a way that will allow City of Palo Alto Utilities (CPAU) to meet its gas main replacement (GMR) needs. The next focus of the GMR program will be the replacement of all Polyvinyl Chloride (PVC) mains with Polyethylene (PE) mains. CPAU installed PVC pipes from the early 1970s to mid-1980s. Some of the City's PVC pipe is approaching 50 years of service, and according to industry data, PVC pipes have a much higher leakage rate than PE mains after 20 years of service due to potential disbandment of fittings and joints. This financial plan includes approximately \$9 to 10 million every other year for main replacement construction instead of \$5 to 6 million annually, starting in FY 2021. This shift to larger main replacement construction projects every other year will slightly lengthen the amount of time needed to replace all PVC pipes in the system but will ideally attract more contractors and better bid pricing on the larger projects. Additionally, this main replacement project schedule for gas will be staggered with water and wastewater (water and wastewater construction every even year and gas construction every odd year), which will ease scheduling difficulties for inspection coverage due to shared inspection staff across water, wastewater, gas, and large development services projects. This arrangement is likely to be a short-term solution (3-5 years) until project capacity can be increased and upward pressure on utility rates has eased.

Because of this staggered CIP approach capital spending will vary from year to year. Staff proposes modifications to the Gas Utility Reserves Management Practices to synchronize them with the staggered main replacement schedule and to use the CIP account/Reserve to absorb the year to year variation.

Specifically, the modifications would set a new maximum CIP Reserve guideline level equal to the average annual (12 month) CIP budget, for 48 months of budgeted CIP expense<sup>3</sup>. Staff also proposes that the Gas Utility Reserves Management Practices be amended to provide that if there are funds in this reserve in excess of the maximum level, staff must propose in the next Financial Plan to transfer these funds to another reserve, return the funds to ratepayers, or designate a specific use of the funds for CIP investments that will be made by the end of the next Financial Planning Period.

Although this Financial Plan includes a forecast period of five years, or 60 months, an even number of years (48 months or 4 years) is used for the CIP Reserve maximum calculation, because of the staggered main replacement schedule including a larger main replacement project every other year.<sup>4</sup> The new minimum CIP Reserve level is 20% of the maximum CIP Reserve guideline level. This maximum in FY 2021 is \$8.9 million and the minimum in FY 2021 is \$1.8 million.

Table 8 below shows the reserve balance changes for each reserve from FY 2019 and projected through FY 2025. Staff is requesting up to a \$4.5 million transfer from the Operations Reserve to the CIP reserve in FY 2020. This transfer will allow the CIP Reserve to hold enough funds to manage cost variances in CIP projects or the need for modest amounts of emergency CIP spending. Staff may seek to add more funds to the CIP reserve if FY 2020 ending reserves are healthier than projected.

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<sup>3</sup> Each month is calculated based upon 1/12 of the annual budget

<sup>4</sup> For example, in this Financial Plan for FY 2021, the 48 month period to use to derive the annual average is FY 2021 through FY 2024. In the FY 2022 Financial Plan, the 48 month period to use to derive the annual average would be FY 2022 through FY 2025 etc

**Table 8: Operations, Rate Stabilization and CIP Reserves Starting and Ending Balances, Revenues, Transfers To/(From) Reserves, Capital Program Contribution To/(From) Reserves, and Operations Reserve Guideline Levels for FY 2020 to FY 2025 (\$000)**

		FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
	Starting Balance						
1	Operations Reserve	9,966	8,814	8,508	7,664	7,595	9,030
2	CIP Reserve	3,820	8,320	1,320	3,570	70	3,070
3	Rate Stabilization	2,533	-	-	-	-	-
	Revenues						
4	Total Revenue	40,121	40,870	43,051	45,447	47,730	49,362
	Transfers						
5	Operations Reserve	(1,967)	7,000	(2,250)	3,500	(3,000)	3,000
6	CIP Reserve	4,500	(7,000)	2,250	(3,500)	3,000	(3,000)
7	Rate Stabilization	(2,533)	-	-	-	-	-
	Expenses						
8	Non CIP Expenses	35,964	35,893	37,621	37,949	39,184	40,436
9	Planned CIP	3,342	12,283	4,024	11,067	4,111	11,319
	Ending Balance						
1 + 4 + 5 + 8 + 9	Operations Reserve	8,814	8,508	7,664	7,595	9,030	9,638
2 + 6	CIP Reserve	8,320	1,320	3,570	70	3,070	70
3 + 7	Rate Stabilization	-	-	-	-	-	-
	Operations Reserve Guidelines						
10	Minimum	5,912	5,900	6,184	6,238	6,441	6,647
11	Maximum	11,824	11,800	12,369	12,476	12,882	13,294

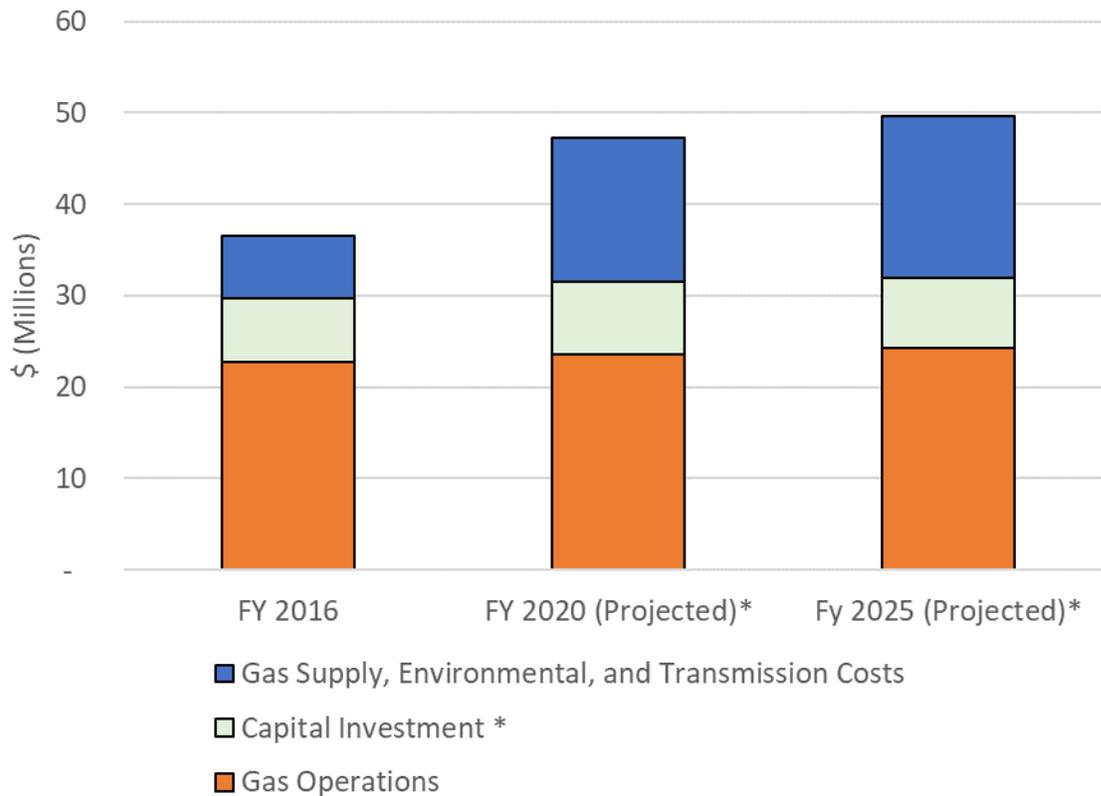
Table 8 above shows the anticipated CIP Reserve transfers in FY 2020 through FY 2025. There is also approximately \$3.8 million in CIP that was budgeted in 2019 or prior years that is reappropriated or carried forward from previous years, and is currently in the CIP Reappropriations and CIP Commitments Reserves. That total includes approximately \$1.2 million in commitments (CIP Commitments Reserve) and \$2.6 for ongoing projects (CIP Reappropriations Reserve).

Over the longer term, gas commodity costs are the most variable factor in customer gas bills, being subject to market forces, and are currently projected to grow by about 2.5 percent per year. Increases to Operations costs are projected to increase at 3 to 4 percent annually, although there is a near term large one-time increase in costs to pay for phase two of a cross-bore safety verification program.

The cross-bore safety program ensures that gas pipelines have not crossed through sewer laterals, which is rare but possible during trenchless installation. This is referred to as a “cross-bore,” and while they are very rare, if they exist they pose a risk of gas leaks if a plumber uses a cutting tool to clear a sewer line and accidentally cuts the gas line. The project will video inspect, determine and repair any unintended conflicts between gas service pipelines and sewer laterals. Phase two of this program is estimated to require \$1 million per year for the next two years, although the project may require additional funding depending on what inspections show.

Figures 2 below illustrates the projected long run changes in the Gas Utility’s costs. Cost increases over the FY 2016 to FY 2025 time period are mainly from commodity costs, followed by operations and capital expenses.

**Figure 2: FY 2016, FY 2020 and FY 2025 costs**



\* Note that FY 2020 and FY 2024 Capital Investment costs are displayed as an average of two years’ cost, as FY 2025 has a \$9 million main replacement project while FY 2020 does not.

Gas usage was trending downward over the last several years, most likely due to relatively warm winter heating seasons, as well as lower hot water usage during the drought, but a cooler winter and the end of drought restrictions has brought increased usage in FY 2019. Gas usage has nearly recovered to levels seen back in 2013, but as with water, it is difficult to determine whether or when long run usage will resume the declining trend seen over the last few decades. The long-term forecast includes the impact of the new Reach Code that mandates new all-electric residential construction, but does not include assumptions related to existing building electrification. In 2020 and 2021 the community will update the Sustainability and Climate Action Plan, updating its goals for electrification of existing buildings, and staff will also be analyzing the impacts to the gas utility’s finances and potential mitigations. Staff will incorporate its findings into next year’s gas utility financial forecasts.

Gas Bill Comparison with Surrounding Cities

Table 9 presents winter and summer residential bills for Palo Alto and PG&E at several usage levels for commodity rates in effect as of July 2019 (to illustrate a summer month bill) and December 2019 (to illustrate a winter month bill). The annual gas bill for the median residential customer for calendar year

2019 was \$532.32, about 3% lower than the annual bill for a PG&E customer with the same consumption. PG&E’s distribution rates for gas have increased substantially to collect for needed system improvements for pipeline safety and maintenance.

The bill calculations for PG&E customers are based on PG&E Climate Zone X, an area which includes the surrounding communities.

**Table 9: Residential Monthly Natural Gas Bill Comparison (\$/month)**

Season	Usage (therms)	Palo Alto	PG&E Zone X	% Difference
Winter (December 2019)	30	44.47	43.79	1.6%
	(Median) 54	69.37	82.27	-15.7%
	80	106.41	135.31	-21.4%
	150	218.17	278.10	-21.5%
Summer (July 2019)	10	22.56	13.74	64.2%
	(Median) 18	29.93	24.74	21.0%
	30	46.20	48.25	-4.2%
	45	68.41	77.86	-12.1%

Table 10 shows the monthly gas bills for commercial customers for various usage levels for rates in effect as of December 2019. Bills for CPAU customers at the usage levels shown can vary between 11% lower to 25% higher for commercial customers than for PG&E customers. This is a substantial improvement over the calendar year 2013 bill comparison, when commercial gas bills for CPAU customers were 27% to 44% higher than for PG&E customers. This is primarily attributable to PG&E’s higher distribution rates as the commodity rates for CPAU and PG&E are very similar, both being based on spot market gas prices.

**Table 10: Commercial Monthly Average Gas Bill Comparison  
(for Rates in Effect December 2019)**

Usage (therms/mo)	Gas Bill (\$/month)		% Difference
	Palo Alto	PG&E	
500	687	618	11%
5,000	5,926	5,882	1%
10,000	11,747	10,356	13%
50,000	58,669	47,104	25%

## **Timeline**

The Finance Committee is scheduled to review the FY 2021 Gas Financial Plan in May 2020. The City Council will consider adopting the Financial Plan, including the updated Reserve Management Practices, and rate adjustments as part of the FY 2021 budget review and adoption process. If Council approves the proposed rate changes, they will become effective July 1, 2020.

## **Resource Impact**

Normal year sales revenues for the Gas Utility are projected to increase by roughly 5 percent (\$1.9 million) as a result of the proposed rate increases, not including fluctuations in commodity revenue/cost. The FY 2021 Budget is being developed concurrent with these rates and, depending on the final rates, adjustments to the budget may be necessary at a later time. See the attached FY 2021 Gas Financial Plan for a more comprehensive overview of projected cost and revenue changes for the next five years.

## **Policy Implications**

The proposed gas rate adjustments are consistent with Council-adopted Reserve Management Practices that are part of the Financial Plan, and were developed using a cost of service study and methodology consistent with industry-accepted cost of service principles.

## **Stakeholder Engagement**

The UAC reviewed preliminary financial forecasts at its December 4, 2019 meeting, and the Finance Committee reviewed the preliminary forecasts at its March 3, 2020 meeting. Staff and the UAC's recommendation on the FY 2021 gas rate increases will go to the Finance Committee in May, and be presented to City Council in June during the budget adoption process.

## **Environmental Review**

The Utility Advisory Commission's review and recommendation to Council on the FY 2021 Gas Financial Plan and rate adjustments does not meet the California Environmental Quality Act's definition of a project, pursuant to Public Resources Code Section 21065, thus no environmental review is required.

### **Attachments:**

- Attachment A: Resolution Adopting the FY 2021 Gas Financial Plan and Transfers

\* NOT YET APPROVED \*  
Resolution No. \_\_\_\_\_

Resolution of the Council of the City of Palo Alto Approving the Fiscal Year 2021 Gas Utility Financial Plan, Including Proposed Transfers and an Amendment to the Gas Utility Reserve Management Practices, and Increasing Gas Rates by Amending Rate Schedules G-1 (Residential Gas Service), G-2 (Residential Master-Metered and Commercial Gas Service), G-3 (Large Commercial Gas Service), and G-10 (Compressed Natural Gas Service)

R E C I T A L S

A. Each year the City of Palo Alto (“City”) regularly assesses the financial position of its utilities with the goal of ensuring adequate revenue to fund operations. This includes making long-term projections of market conditions, the physical condition of the system, and other factors that could affect utility costs, and setting rates adequate to recover these costs. It does this with the goal of providing safe, reliable, and sustainable utility services at competitive rates. The City adopts Financial Plans to summarize these projections.

B. The City uses reserves to protect against contingencies and to manage other aspects of its operations, and regularly assesses the adequacy of these reserves and the management practices governing their operation. The status of utility reserves and their management practices are included in Reserves Management Practices attached to and made part of the Financial Plans.

C. Pursuant to Chapter 12.20.010 of the Palo Alto Municipal Code, the Council of the City of Palo Alto may by resolution adopt rules and regulations governing utility services, fees and charges.

D. On \_\_\_\_, 2020, the City Council heard and approved the proposed rate increase at a noticed public hearing.

The Council of the City of Palo Alto does hereby RESOLVE as follows:

SECTION 1. The Council hereby adopts the FY 2021 Gas Utility Financial Plan.

SECTION 2. The Council hereby approves the transfer of up to \$2.533 Million from the Rate Stabilization Reserve to the Operations Reserve, and up \$4.5 Million from the Operations Reserve to the CIP Reserve, as described in the FY 2021 Gas Utility Financial Plan approved via this resolution.

SECTION 3. The Council hereby approves the amendments to the Gas Utility Reserves Management Practices.

\* NOT YET APPROVED \*

SECTION 4. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule G-1 (Residential Gas Service) is hereby amended to read as attached and incorporated. Utility Rate Schedule G-1, as amended, shall become effective July 1, 2020.

SECTION 5. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule G-2 (Residential Master-Metered and Commercial Gas Service) is hereby amended to read as attached and incorporated. Utility Rate Schedule G-2, as amended, shall become effective July 1, 2020.

SECTION 6. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule G-3 (Large Commercial Gas Service) is hereby amended to read as attached and incorporated. Utility Rate Schedule G-3, as amended, shall become effective July 1, 2020.

SECTION 7. Pursuant to Section 12.20.010 of the Palo Alto Municipal Code, Utility Rate Schedule G-10 (Compressed Natural Gas Service Service) is hereby amended to read as attached and incorporated. Utility Rate Schedule G-10, as amended, shall become effective July 1, 2020.

SECTION 8. The City Council finds as follows:

- a. Revenues derived from the gas rates approved by this resolution do not exceed the funds required to provide gas service.
- b. Revenues derived from the gas rates approved by this resolution shall not be used for any purpose other than providing gas service, and the purposes set forth in Article VII, Section 2, of the Charter of the City of Palo Alto.

SECTION 9. The Council finds that the fees and charges adopted by this resolution are charges imposed for a specific government service or product provided directly to the payor that are not provided to those not charged, and do not exceed the reasonable costs to the City of providing the service or product.

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\* NOT YET APPROVED \*

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SECTION 10. The Council finds that approving the Financial Plan and amending the Gas Utility Reserves Management Practices does not meet the California Environmental Quality Act's (CEQA) definition of a project under Public Resources Code Section 21065 and CEQA Guidelines Section 15378(b)(5), because it is an administrative governmental activity which will not cause a direct or indirect physical change in the environment, and therefore, no environmental assessment is required. The Council finds that changing gas rates to meet operating expenses, purchase supplies and materials, meet financial reserve needs and obtain funds for capital improvements necessary to maintain service is not subject to the California Environmental Quality Act (CEQA), pursuant to California Public Resources Code Sec. 21080(b)(8) and Title 14 of the California Code of Regulations Sec. 15273(a). After reviewing the staff report and all attachments presented to Council, the Council incorporates these documents herein and finds that sufficient evidence has been presented setting forth with specificity the basis for this claim of CEQA exemption.

INTRODUCED AND PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

\_\_\_\_\_  
City Clerk

\_\_\_\_\_  
Mayor

APPROVED AS TO FORM:

APPROVED:

\_\_\_\_\_  
Assistant City Attorney

\_\_\_\_\_  
City Manager

\_\_\_\_\_  
Director of Utilities

\_\_\_\_\_  
Director of Administrative Services