



City of Palo Alto

Finance Committee Staff Report

(ID # 11077)

Report Type: Action Items

Meeting Date: 3/3/2020

Council Priority: Fiscal Sustainability

Summary Title: FY 2021 Preliminary Rate Forecasts

Title: Preliminary Financial Forecasts and Proposed Rate Changes for Electric, Gas, Water and Wastewater Collection Utilities for Fiscal Year 2021

From: City Manager

Lead Department: Utilities

Recommendation

This item is for discussion and no action is requested. Staff will use input from the Finance Committee on its preliminary rate projections for the Electric, Gas, Water and Wastewater Collection utilities to finalize its recommended FY 2021 Financial Plans and proposed rate changes for each utility.

Executive Summary

At the meeting staff will provide a presentation describing staff's preliminary rate projections for the Electric, Gas, Water and Wastewater Collection utilities. A similar presentation was provided to the Utilities Advisory Commission (UAC) at its December 4, 2019 meeting. The staff presentation is available for review prior to the meeting at the following link:

[Staff Presentation on Preliminary Rate Projections,
http://cityofpaloalto.org/civicax/filebank/blobdload.aspx?BlobID=75286](http://cityofpaloalto.org/civicax/filebank/blobdload.aspx?BlobID=75286)

The preliminary retail rate forecast over the next five fiscal years is shown in the table below, along with the overall impact to the median residential bill. The rate changes shown are preliminary estimates. Actual rate changes will be based on updated financial data and the cost of service methodologies and studies for each utility, and may differ by customer class and for individual customers depending on consumption patterns. An updated cost of service study for Wastewater Collection is underway and will be factored into staff proposals for FY 2021. Cost of Service studies for Water and Gas were completed in 2019, and Electric was completed in 2016.

Table 1: Projected Rate Increases

	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Electric Utility	\$1.20	\$1.20	\$1.90	\$2.60	\$2.70	
	2%	2%	3%	4%	4%	
Gas Utility *	\$2.40	\$1.50	\$1.00	\$1.10	\$1.10	
	5%	4%	3%	2%	2%	
Wastewater	\$2.10	\$1.70	\$1.80	\$1.90	\$1.50	
	5%	4%	4%	4%	3%	
Water Utility	\$0.00	\$2.70	\$2.80	\$3.80	\$4.00	
	0%	3%	3%	4%	4%	
Refuse	\$0.00	\$1.50	\$1.50	\$1.60	\$1.60	
	0%	3%	3%	3%	3%	
Storm Drain	\$0.40	\$0.50	\$0.50	\$0.50	\$0.50	
	3%	3%	3%	3%	3%	
Monthly Bill	\$13.72	\$6.10	\$9.10	\$9.50	\$11.50	\$11.40
Change **	5%	2%	3%	3%	3%	3%

** Gas rate changes are shown with commodity rates held constant. Actual gas commodity rates will vary monthly with wholesale market fluctuations*

*** Based on an FY 2020 monthly bill of \$305.24*

Based on current data, reserve levels are projected to remain within guideline levels. Staff will continue to monitor customer consumption patterns and refine operating and capital cost projections over the coming months to determine whether any adjustment from this preliminary forecast is needed. Staff seeks input from the Finance Committee prior to finalizing the Utilities Financial Plans and developing recommendations for rate changes that would be effective July 1, 2020. The proposed rate adjustment recommendations, along with each utility's Financial Plans, are currently scheduled to be presented to the Finance Committee in April for the Water and Wastewater Collection Utilities. The Electric and Gas Utilities financial plans and rates will be presented in May.

Background

Every year staff presents the UAC and Finance Committee with financial forecasts for the Electric, Gas, Water, and Wastewater Collection utilities and recommends any rate adjustments required to maintain their financial health. These forecasts are memorialized in Financial Plans that comprehensively discuss the outlook for each utility. Before providing recommended Financial Plans and rate changes, staff typically presents a preliminary forecast to get early feedback.

Electric

Costs for electric supply purchases have been increasing, primarily as a result of increases in statewide transmission costs. Recent hydro conditions have led to a short-term increase in surplus energy revenues, but staff's forecasts assume normal ongoing hydro conditions over the long term. As of January 1, 2020, total precipitation is at 74% of average for this date. These short-term revenue surpluses will be used to fund reserves, and, in the short term, they will also help to lower needed rate increases.

Current capital spending and distribution system maintenance spending is currently lower than budgeted, primarily because staffing shortages have prevented the electric utility from performing the levels of capital improvement and distribution system work desired. Additional crews are being contracted to perform these functions in upcoming years until full staffing can be reached. As such, operational and capital costs are projected to increase substantially over the forecast horizon if the utility can achieve its targeted staffing levels and capital and maintenance spending levels.

There has been some decrease in the City's electric load as well, which creates an upward pressure on rates. Usage has decreased by about 2% each year over the last three years, compared to an average annual decrease of about 0.3% in the prior decade. Most of the decrease has been in the medium and small commercial customer groups (E4 and E2 rate schedules).

Staff is projecting a preliminary rate increase of 2%, but will continue to monitor revenue and cost projections. The current year (FY 2020) financial plan for the Electric utility (approved June 17, 2019) is available at:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=60223.49&BlobID=71361>

Gas

Gas fund expenses are currently split at about 40% supply and 60% for distribution and capital. Most of the supply costs are market driven and set to be pass-through charges on customers' bills that change monthly according to market conditions. The long-term gas rate increases shown in Table 1 will go towards funding the distribution and capital improvement costs of the gas utility. As discussed in the prior year's financial plan, the Utility recently resumed regular scheduled main replacement. A large main replacement project is planned for every other year, and the majority of any proposed rate increase would go towards capital improvements. Prior to this, from FY 2018 to FY 2020, only one gas main replacement project was funded due to staffing issues and competing priorities. Rates were held low during that time because capital spending was low, but as staff resumes regular scheduled capital spending for the gas utility, rates need to rise to fund that capital spending. In addition, construction costs have risen significantly during that time.

Staff is projecting a preliminary rate increase of 5%, but will continue to monitor revenue and cost projections. The current year (FY 2020) financial plan for the Gas utility (approved June 17, 2019) is available at:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=60939.34&BlobID=71364>

Water

In FY 2019, expenses were lower than forecasted due to delays in capital projects. The delayed capital projects are expected to be completed in FY 2020 and FY 2021, and changes to budget have resulted in a larger than expected ending reserve in FY 2019.

Staff is projecting that no rate increase is needed in FY 2021. This is because SFPUC's latest available estimate is that no increase is needed in wholesale water rates and because the water utility's reserves are sufficient to provide funding for some major one-time planned infrastructure projects in the next two years.

The current year (FY 2020) financial plan for the Water utility (approved June 17, 2019) is available at:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=61704.19&BlobID=71368>

Wastewater Collection

Costs are projected to rise over the next several years due primarily to increasing treatment costs related to capital improvements costs and attendant debt service at the Regional Water Quality Control Plant (RWQCP). Collection system CIP work is also increasing, but at a lower rate. Operations and maintenance costs for both Treatment and Collections are expected to increase with inflation. Current projected rate increases are slightly lower but generally similar to last year's projections.

Staff is working on a cost of service study for the Wastewater Collection utility. Factoring in the results from the study may change rate impacts to individual customer groups in the FY 2021 proposal.

The current year (FY 2020) financial plan for the Wastewater Collection utility (approved June 17, 2019) is available at:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=61290.09&BlobID=71366>

Commission Review

The UAC reviewed the preliminary financial forecasts at its December 4, 2019 meeting. No recommendation was requested at that meeting, but staff sought input from Commissioners regarding the preliminary rate adjustment recommendations. Commissioners asked questions, but did not request staff re-examine any of the rate changes listed in Table 1. An excerpt of the draft minutes from the UAC's December 4, 2019 meeting is located ([here](#)).

Next Steps

The UAC is scheduled to review the long-term Financial Plans and proposed rate adjustments for the Water and Wastewater Collection utilities in March and the Electric and Gas utilities in April.

The Finance Committee is tentatively scheduled to review the long-term Financial Plans and proposed rate adjustments in April (for the Water and Wastewater Collection utilities) and in May (for the Electric and Gas utilities). Once the Finance Committee has provided its recommendation, notification of any recommended Water and/or Wastewater Collection rate adjustments will be sent to customers, giving them the opportunity to protest the proposed changes as required by Article XIID of the State Constitution (added by Proposition 218). The Financial Plans and proposed new rate schedules will be considered by the City Council with the FY 2021 budget, at which time the public hearing required by Article XIID of the State Constitution will be held.

Environmental Review

The Finance Committee's review of the preliminary financial projections does not meet the definition of a project, pursuant to Section 21065 of the California Environmental Quality Act, thus no environmental review is required.

Stakeholder Engagement

Staff met with the Utilities Advisory Commission on December 4, 2019. Notices of proposed rate changes will be distributed throughout the city as recommendations are finalized.

Resource Impact

The FY 2021 Budget is being developed concurrent with these rates. Depending on final rates, adjustments may be necessary in the FY 2021 Budget at a later time. Based on the preliminary rate increases as shown, the estimated revenue impacts would be an increase of \$1.2 million in wastewater collection and \$318,000 in gas. Due to projected load losses in Electric, the forecast rate increase would be relatively revenue neutral for the fund.

Attachments:

- Attachment A: 12-04-2019 UAC Excerpt Minutes Item 3



UTILITIES ADVISORY COMMISSION MEETING MINUTES OF DECEMBER 4, 2019 REGULAR MEETING

CALL TO ORDER

Chair Danaher called the meeting of the Utilities Advisory Commission (UAC) to order at 7:00 p.m.

Present: Chair Danaher, Vice Chair Forssell, Commissioners Jackson, Johnston, Segal, and Smith
Absent: Commissioner Scharff

ITEM 3: DISCUSSION: Discussion of Preliminary Rate Change Projections for the Electric, Gas, Water and Wastewater Collection Utilities for Fiscal Year 2021.

Eric Keniston, Senior Resource Planner, reported a wastewater cost of service study is underway and should be complete in time for staff to utilize it in calculating new wastewater rates to meet the expected July 1st date for new rates. Fiscal Year (FY) 2021 preliminary rate projections are a 3% increase for the Electric Utility, a 5% increase for the Gas Utility, a 6% increase for the Wastewater Utility, a 0% increase for the Water Utility, and a 0% increase for Refuse. In water, gas, and wastewater collection, staff is planning to stagger main replacement projects but to allocate funds periodically to the CIP Reserve so that the CIP Reserve reflects project expenditures and fluctuations caused by main replacement projects occurring every other year. Beginning this year in the Water Fund, there will be a level amount of funding going to the CIP Reserve to begin establishing this process.

In response to Commissioner Smith's request for cost containment measures provided in the agreement with Valley Water, Jonathan Abendschein, Assistant Director of Resource Management, explained that Valley Water's \$16 million payment will fund construction of the reverse osmosis facility. If there was no \$16 million payment, sewer and water ratepayers would have to fund the construction. The cost containment measure is ratepayers not having to fund construction of the plant. In reply to Commissioner Smith's question of whether the listed cost containment measures apply to the rate projections, Abendschein indicated most of them do. Almost any of the cost containment measures directly reduce the cost associated with the individual utility.

Keniston continued the presentation, stating Electric Utility Operations Reserves are projected to fall within the guideline ranges. FY 2019 was a good year for hydroelectric power, and CPAU was able to sell its surplus energy, which reduced purchase costs.

In answer to Commissioner Johnston's inquiry about disposition of surplus funds, Keniston advised that initially surplus funds are deposited into the Operations Reserve and then transferred to the other Reserve Funds. Staff proposes to repay the \$10 million loan from the Special Projects Reserve and increase the Hydroelectric Stabilization Reserve Fund to the target level.

Keniston further reported 40% of electric costs are related to distribution and 60% to supply. Transmission costs continue to grow rapidly because of the cost to expand the statewide system. Generation costs should remain stable.

In reply to Vice Chair Forssell's inquiry regarding increased costs from renewable projects coming online, Abendschein indicated newer contracts for renewable projects are generating some savings. Between 2009 and 2015, many renewable projects were not online, and CPAU benefited from low gas prices. As CPAU increased its renewable contracts, it was no longer exposed to low gas prices, which raised the cost of the electric supply.

In response to Commissioner Johnston's noted between FY 2021 and 2022 revenues decrease even though rates increase. Keniston stated revenue includes hydroelectric revenues, Renewable Energy Certificate (REC) sales, and other projected revenues. Staff anticipates REC sales will decrease in FY 2022 and less hydroelectric revenue; revenue will be more normalized by FY 2022. Abendschein clarified that FY 2019 and FY 2020 revenues exceed costs because of the sale of surplus hydroelectric. Staff has questions about the FY 2021 forecast from the Western Area Power Administration. Chair Danaher added that CPAU will not have surplus hydroelectric power to sell, which will decrease revenue.

Keniston continued the presentation by listing the distribution cost drivers of medical and retirement benefits, capital investment, and underground construction. Staff projects a 3% rate increase in FY 2021 and 4-5% rate increase thereafter. The main drivers of the rate increase are increased supply costs, increased operations costs, increased CIP expenses, increased non-retail revenues, and decreased sales. Also, without the additional hydroelectric revenues a larger rate increase would have been needed. The Electric Supply Operations and Distribution Operations Reserves are above target levels and projected to remain above target levels.

In response to Commissioner Segal's query about the rationale for a rate increase if reserve funds are healthy and revenues exceed costs, Keniston explained that without a rate increase, the balances will begin to fall below the minimum reserve level. Abendschein added that a one-time surplus can be used to defer rate increases for a year or two, but a rate increase will be needed eventually. By deferring rate increases, the reserves decrease such that few funds are available for adverse situations, and greater rate increases are needed.

Keniston further reported staff projects a 5% rate increase for the Gas Utility in FY 2021 due to decreases in distribution and increases in CIP cost projections.

In answer to Vice Chair Forssell's inquiry about the impact of reach codes on gas sales, Abendschein indicated all-electric construction would affect 100-150 projects.

Keniston continued his presentation, advising that 50% of overall gas costs are related to distribution. Abendschein clarified that the main driver for rate increases over the next five years is investment in the gas distribution system. Of the 5% rate increase, 3.7% is related to CIP expenses and 1.3% is related to operations and maintenance (O&M) expenses. Staff has transferred funds from the Rate Stabilization Reserve Fund to the Gas Operations Reserve Fund. Projected rate increases will slowly increase the Reserve Fund to the target level.

Lisa Bilir, Acting Senior Resource Planner, reported staff projects a 6% rate increase in FY 2021 for the Wastewater Collection Utility because of increases in treatment and collection costs. The largest expense increase is CIP projects. Wastewater costs are divided 50% for treatment and 50% for collection. 2.4% of the 6% rate increase is related to treatment expenses, 1.2% to O&M expenses, and 2.4% to an existing revenue shortfall. The Wastewater Operations Reserve is projected to remain within target levels.

In reply to Commissioner Johnston's question about partner agencies utilizing Palo Alto pipelines for wastewater, Keniston indicated Los Altos Hills utilizes Palo Alto's collection system starting in the foothills, and Stanford University enters the collection system along Embarcadero Road.

Bilir further reported staff's projection for a 0% rate increase for the Water Utility. The Operations Reserve Fund is currently above the maximum guideline but should fall to the target level by the end of FY 2021.

In answer to Vice Chair Forssell's query regarding the cause of the reserve being above target level, Bilir explained that the chart shows the Operations Reserve but does not show the balances of all the reserves. When the Operations Reserve reaches the maximum guideline level, the additional funds above that level are reflected in the unassigned reserve, which can be seen in the stacked bar chart.

Chair Danaher remarked that CPAU cannot change gas commodity prices or PG&E's transmission costs. The only thing CPAU can do is defer or accelerate construction projects or manipulate reserve fund balances to fall within target levels.

In response to Commissioner Segal's inquiry about gas billing and cost fluctuations, Keniston advised that the policy is to reflect the bid week price plus any expected loss or shrink. Reserve funds should absorb the extra cost. Collecting the extra cost the following month would not be appropriate.

In reply to Vice Chair Forssell's question of customer backlash in response to the gas bill increases, Catherine Elvert, Communications Manager, did not recall any customer comment.

Commissioner Johnston remarked that explaining the rate increases in light of projected revenues exceeding projected costs could be a challenge. Abendschein indicated the challenge would be explaining wastewater and gas rate increases because of the plan to alternate years of CIP projects.

Chair Danaher commended staff for maintaining fund balances within target levels and averaging rate increases over time.

In answer to Vice Chair Forssell's question about the cost of service study, Bilir reported a consultant is conducting the study.

ACTION: None