FC MEETING 1
2/21/2024
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CITY OF PALO ALTO

PRELIMINARY FY 2025 RATE CHANGES

February 21, 2024

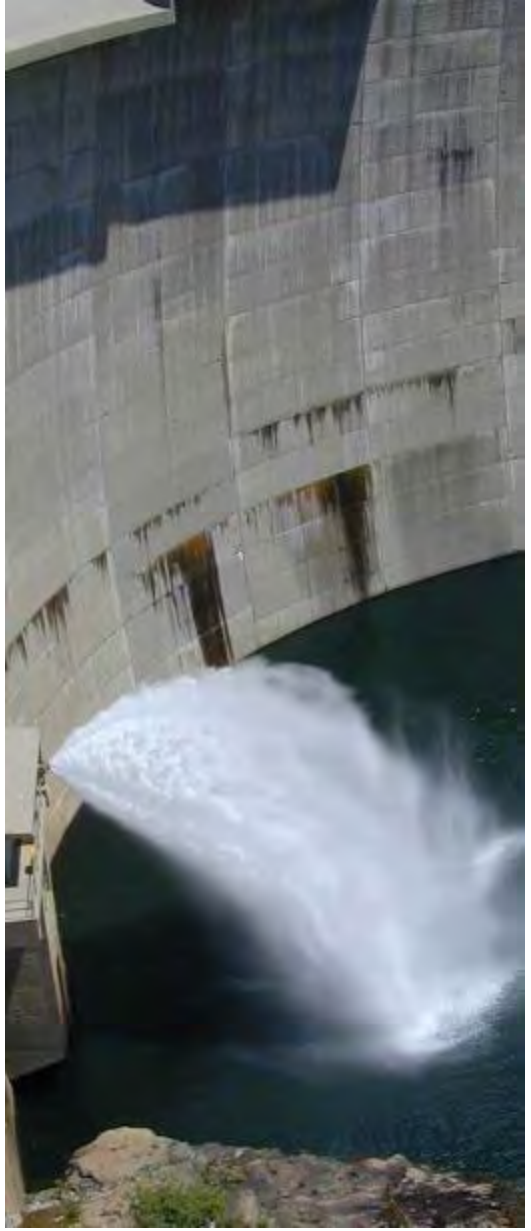
www.cityofpaloalto.org

PRELIMINARY SYSTEM AVERAGE RATE PROJECTIONS

	FY 2024 (effective July 1, 2023)	FY 2025 (Projected)	FY 2026	FY 2027	FY 2028	FY 2029
Electric Utility [1]	-$5.80 -5%	$6.20 8%	$4.50 5%	$4.80 5%	$5.00 5%	$5.30 5%
Gas Utility [2]	$5.20 8%	$6.30 9%	$5.40 7%	$5.70 7%	$5.20 6%	$5.60 6%
Wastewater	$4.00 9%	$7.30 15%	$5.00 9%	$5.50 9%	$5.30 8%	$5.00 7%
Water Utility	$5.20 5%	$9.3 - $13.5 9% - 13%	$10.2 - $10.5 9%	$12.3 - $12.8 10%	$12.2 - $12.6 9%	$7.4 - $7.7 5%
Refuse	$0.00 0%	$0.00 0%	$1.50 3%	$1.50 3%	$1.60 3%	$1.60 3%
Storm Drain [3]	$0.80 5%	$0.40 3%	$0.40 3%	$0.50 3%	$0.50 3%	$0.50 3%
Monthly Bill Change [4]	**$9.40 3%**	**$30.6 - $35 8% - 9%**	**$28.1 - $28.5 7%**	**$31.4 - $31.9 7%**	**$31 - $31.4 7%**	**$26.3 - $26.6 5%**

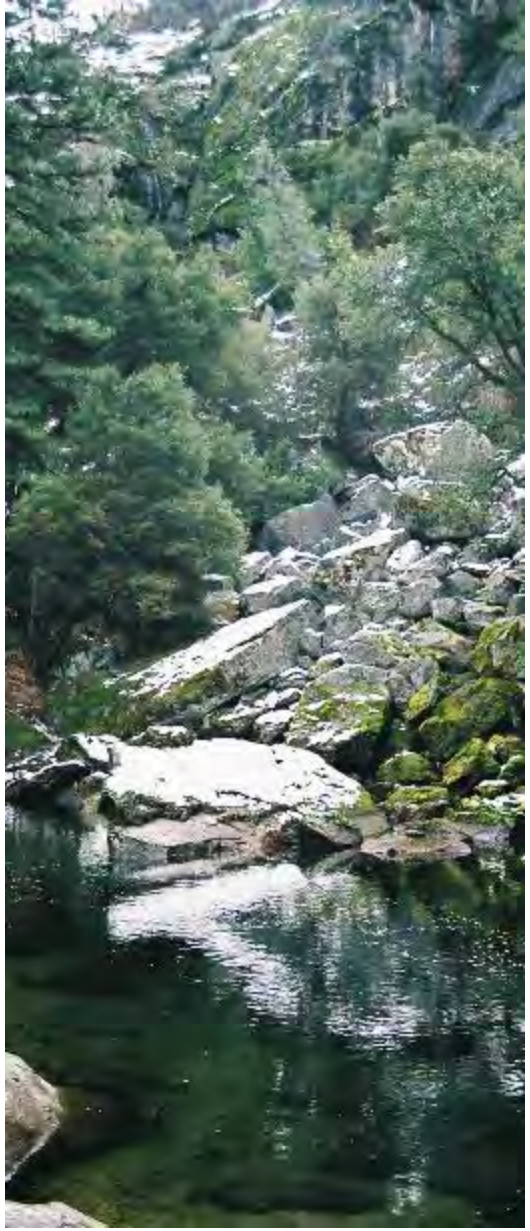
1) *Preliminary projection pending completion of a cost of service analysis.*
2) *Based on general fund transfer of 11.9% of gross revenue in FY25; gas rate changes shown with commodity rates held constant; actual gas commodity rates vary monthly*
3) *Storm Drain fees increase by CPI index annually per approved 2017 ballot measure (2.6% in FY 2025)*
4) *Based on an FY 2023 monthly residential bill of $369*

CITY OF PALO ALTO



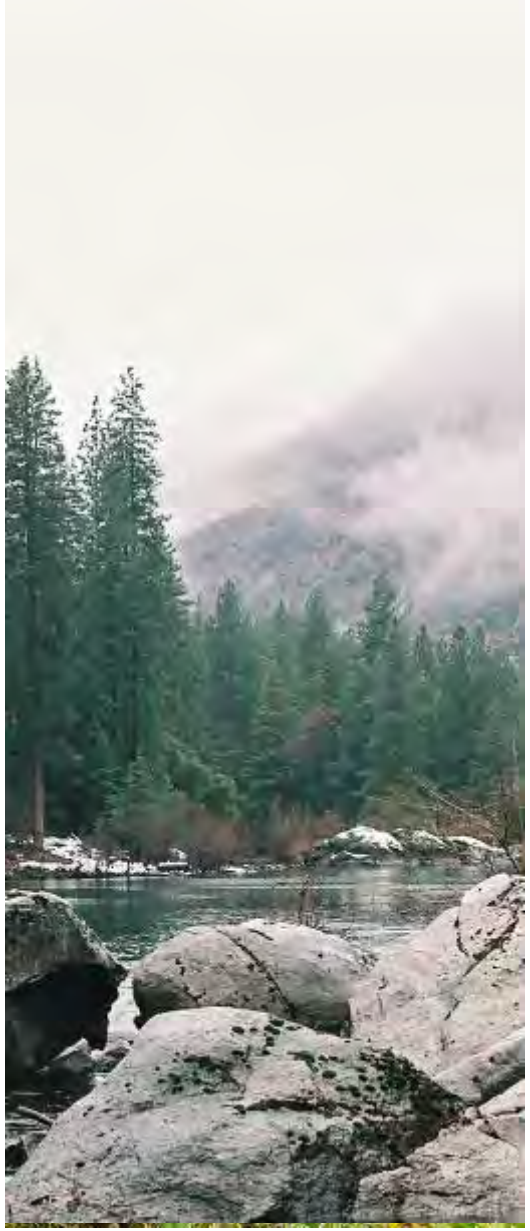
ONGOING COST CONTAINMENT

- Consistent with the Utilities Strategic Plan, cost containment is being instituted as an ongoing priority and annual cycle
  - Winter completion of preliminary out-year rate forecasts
  - Review by all Divisions for alignment of multiyear strategies
- Ongoing management review of personnel actions
  - Review/revision of position classifications to match evolving needs
  - Addition/Deletion of positions to reflect organizational priorities
  - Review/approval to fill individual position vacancies in conjunction with ASD Budget Office and Human Resources
- Regular review of performance metrics and expenditures



RECENTLY IMPLEMENTED COST CONTAINMENT

- Agreement with Valley Water: $250K to $1M/year + up to $16 million in funding for reverse osmosis facility to improve recycled water quality
- Selling surplus Resource Adequacy and RECs ($20+ million/year)
- Negotiated improvements to Western hydroelectric contract ($2 million/year)
- Established a cross-functional field crew to install water, gas, and sewer services simultaneously at new construction sites, reducing hours spent in the field; staff time freed up to be reallocated to sewer replacements
- Implemented mobile workforce applications, reducing administrative data entry time, freeing up staff for other work
- Scheduled larger CIP projects every other year to achieve efficiencies in project management and also better bids / lower construction costs
- Expanding use of bank draft to reduce credit card fees, particularly for large accounts
- BAWSCA water bond refunding to achieve lower debt service payments for wholesale customers, including Palo Alto beginning in 2023
- Negotiating layoff of transmission asset to better monetize resource



FUTURE POTENTIAL COST CONTAINMENT

- Switch to new customer information system with reduced support costs
- Explore prepay of renewable power purchase agreements to monetize municipal tax-exempt debt
- Increased water and energy end use technical training for Customer Service Representatives, reducing transferred phone calls and staff time
- Working to cluster gas main replacements to reduce mobilization costs for construction contractors
- Evaluating in-house (rather than contractor) pipeline materials procurement to reduce construction markups

CITY OF PALO ALTO

ELECTRIC UTILITY

Electric Rate Proposal

FY 2025 proposal:

- Rate changes that vary by customer class and consumption pattern resulting in an 0.5% increase in revenue. 8% ($6.20/month) increase for the median residential customer.
    - Reserves recovering from 2020-2022 drawdown
        - Planned repayment to Hydroelectric Rate Stabilization and Electric Special Projects Reserves will reduce Operations Reserves below minimum levels
    - Net supply costs forecast to decline from improved hydro conditions and lower natural gas prices
        - Revenues from surplus system Resource Adequacy and Renewable Energy Certificates further reducing supply costs

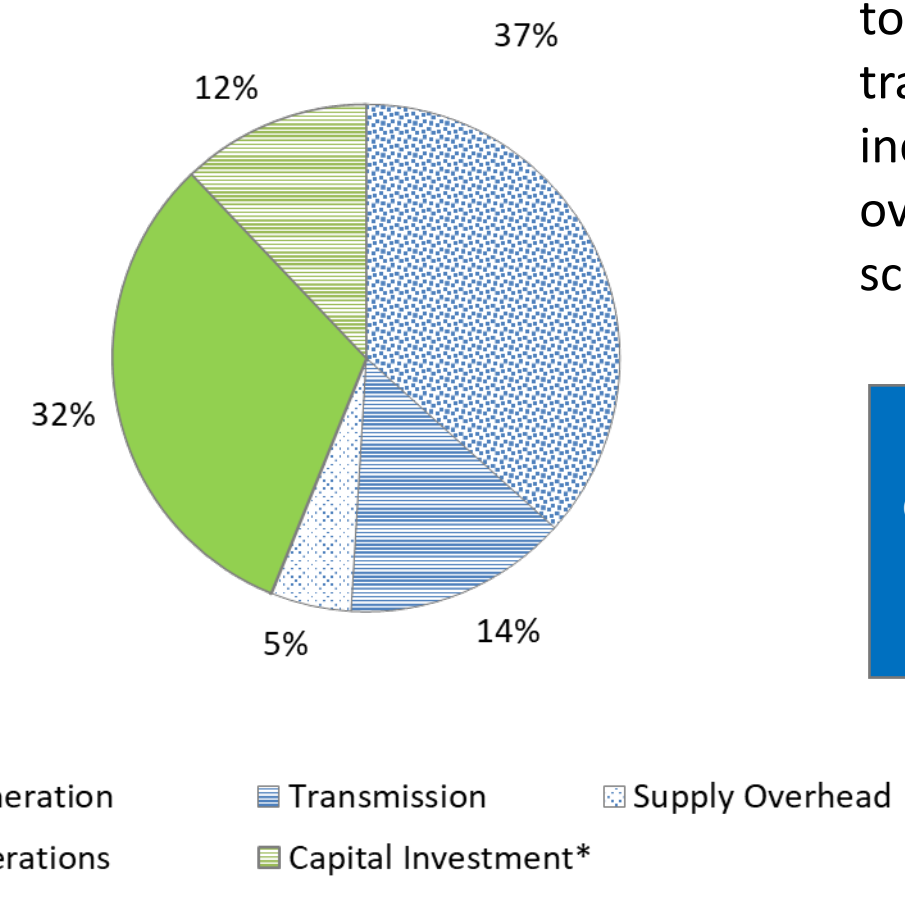
Future years:

- 5% rate increase per year projected for FY 2026-FY 2029
- Issue debt for Grid Modernization by end of FY25

Electric Utility Cost Structure

Electric Distribution costs (in green): $84 million 44%

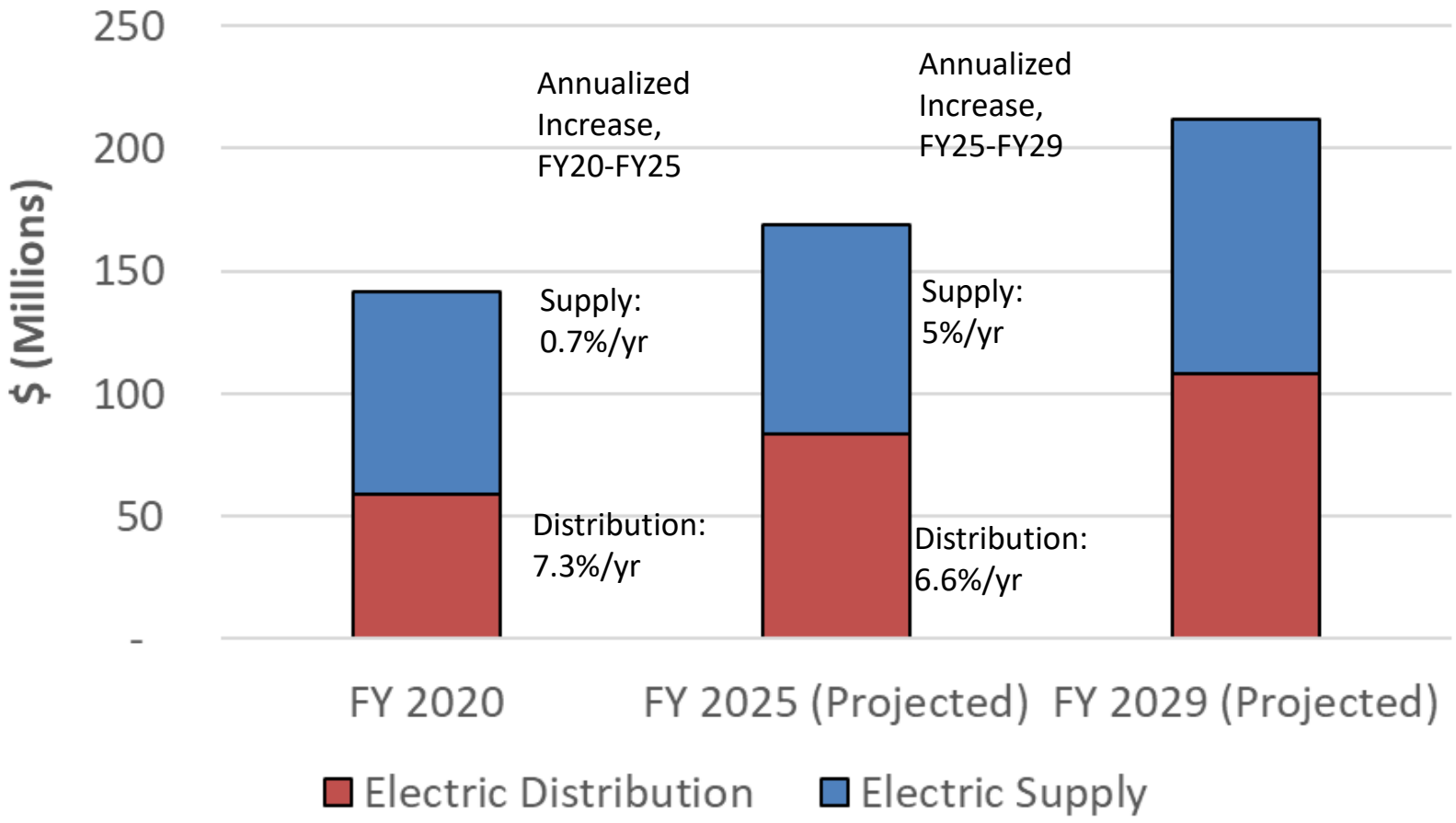
Electric Distribution: The cost to distribute electricity within Palo Alto, including: maintaining and replacing electric infrastructure, customer service, billing, administration, etc.



Electric Supply: The cost to buy electricity and transport it to Palo Alto, including operational overhead (e.g. energy scheduling)

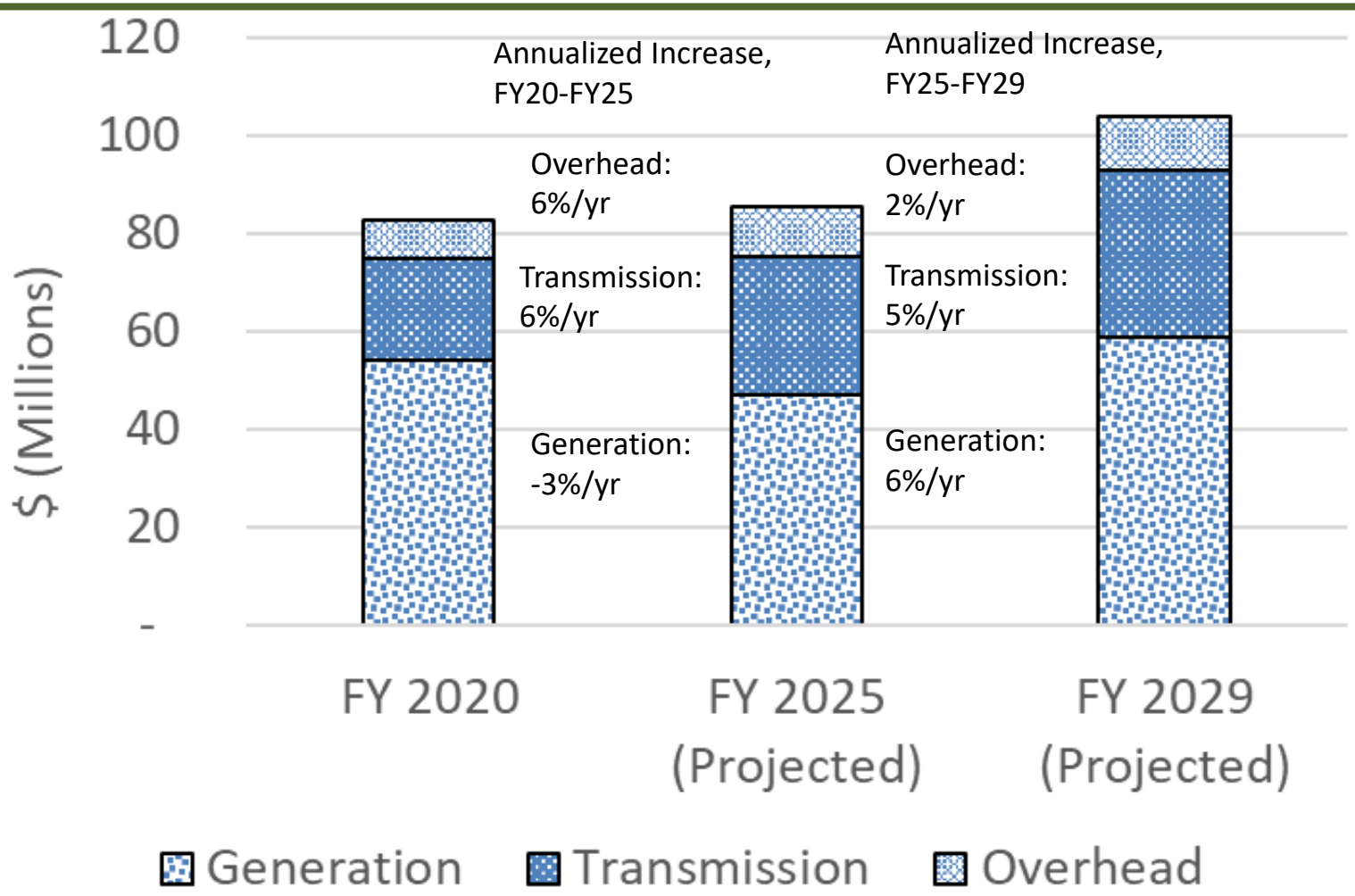
Electric Supply costs (in blue): $107 million 56%

LONG TERM COST TRENDS

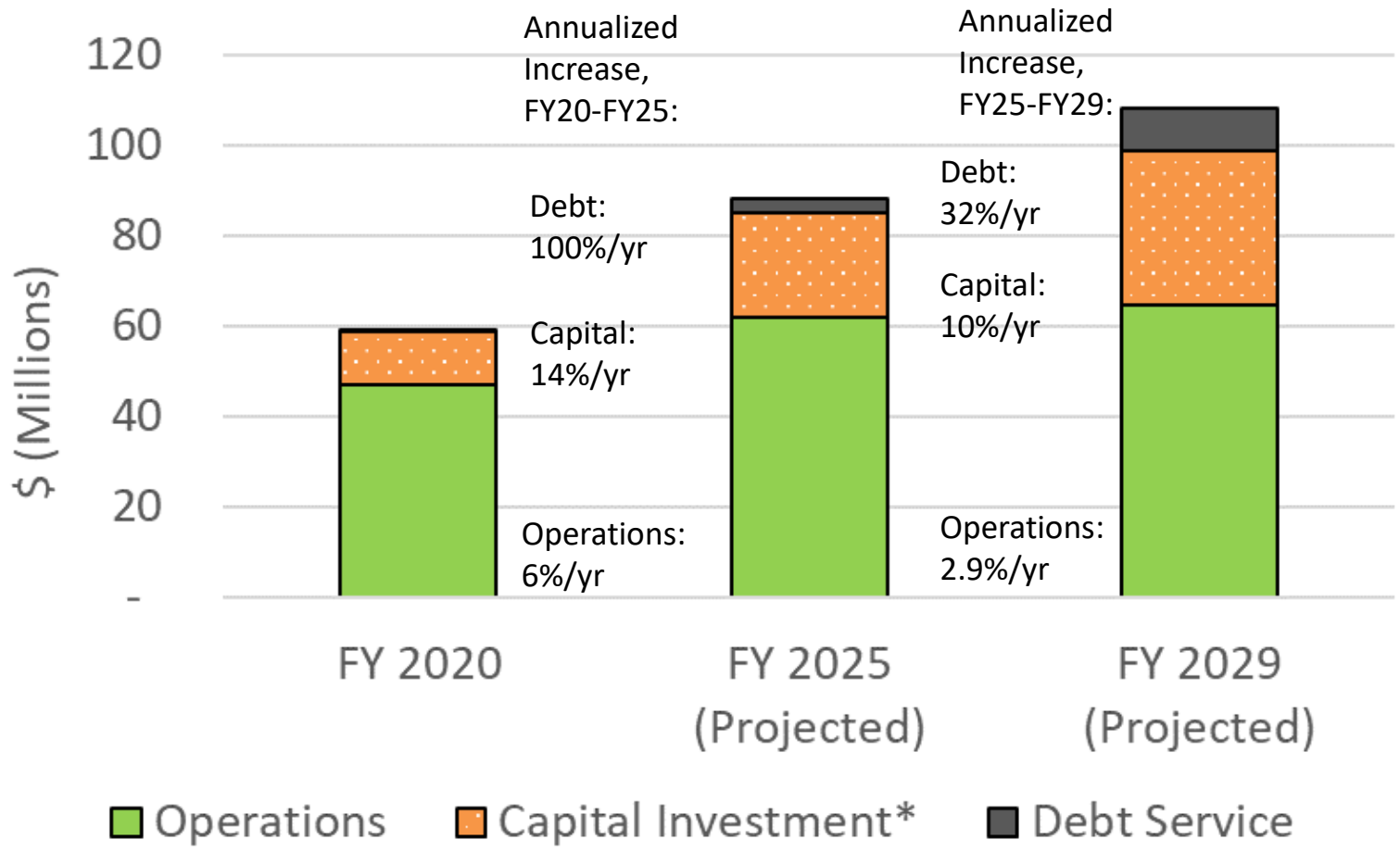


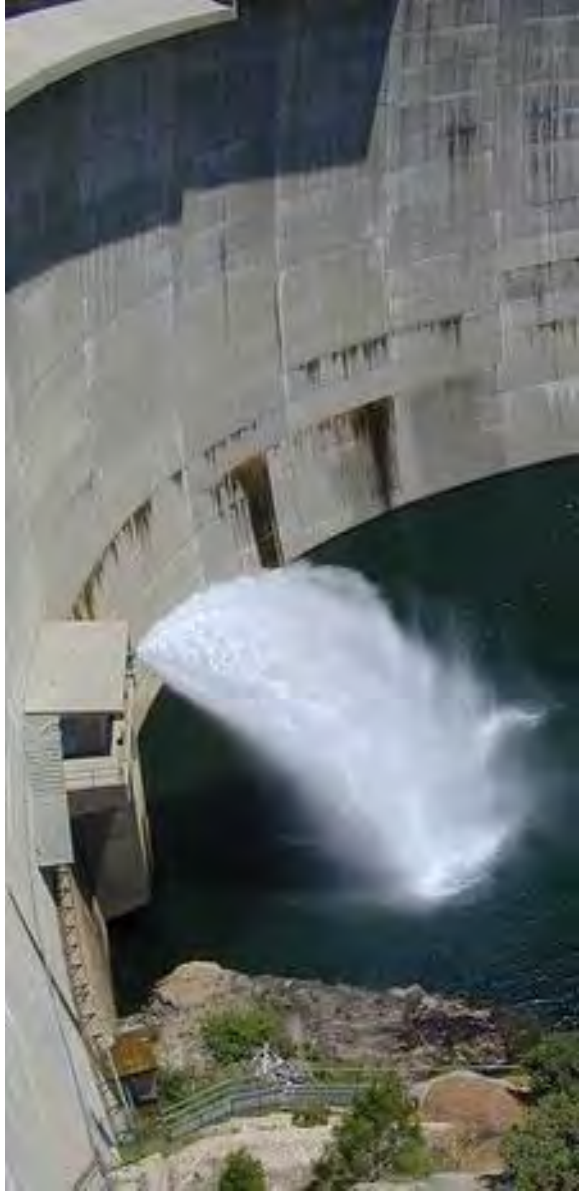
CITY OF PALO ALTO

LONG TERM COST TRENDS: SUPPLY



LONG TERM COST TRENDS: DISTRIBUTION





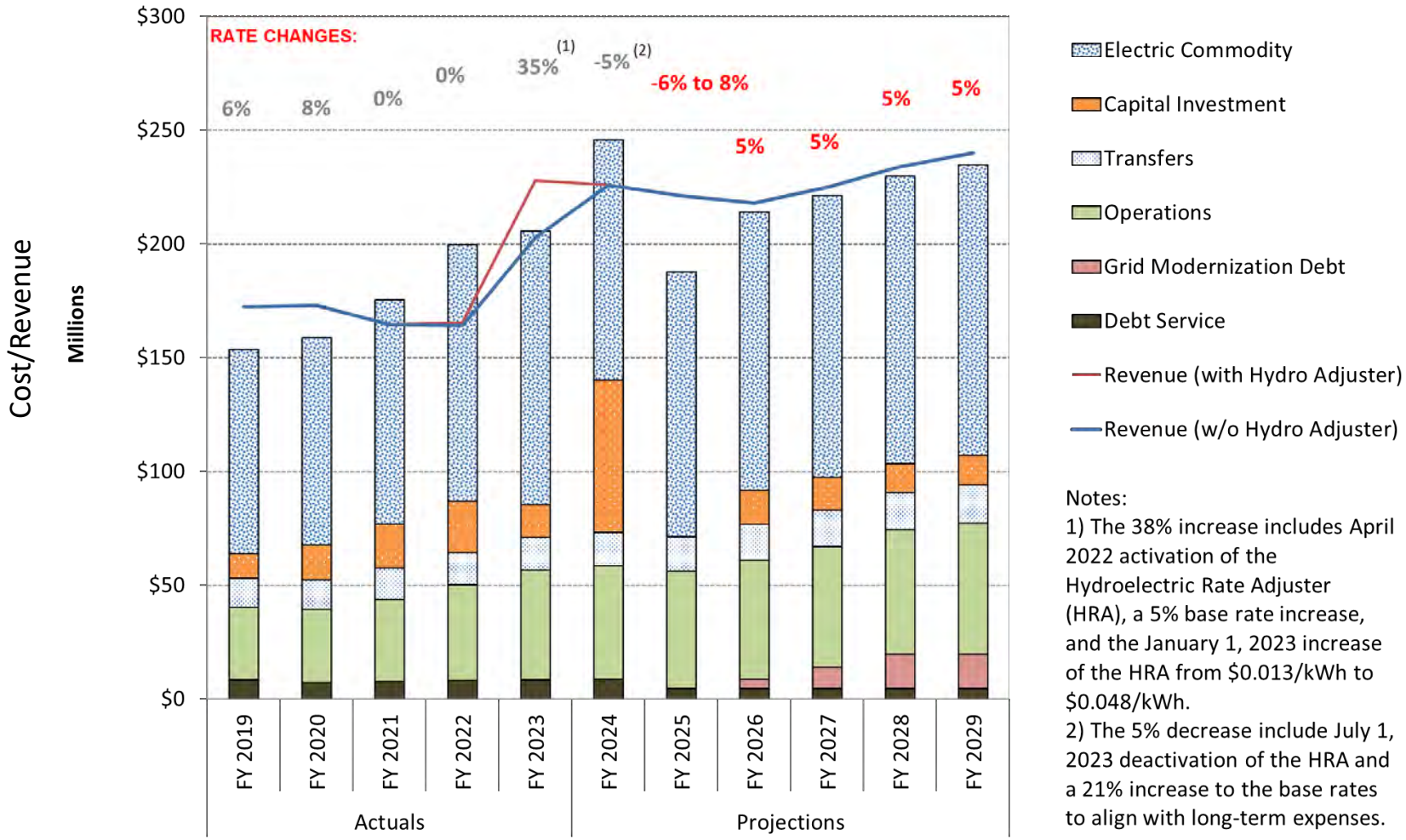
Supply Cost Drivers

- Record high load costs in FY23, double prior 4-year average
- Surplus Resource Adequacy reducing power supply costs by $14.4 million in FY25
- Surplus Renewable Energy Credits reducing power supply costs by $7.6 million in FY25
- Higher hydroelectric generation projections reduced projected supply costs by nearly $4.7 million in FY24
- Transmission costs remain high – still waiting on transmission rate case resolution, refund, and lower rates
- Geothermal Power Purchase Agreement starting 2025, Western Base Resource costs reduced slightly

Distribution Cost Drivers

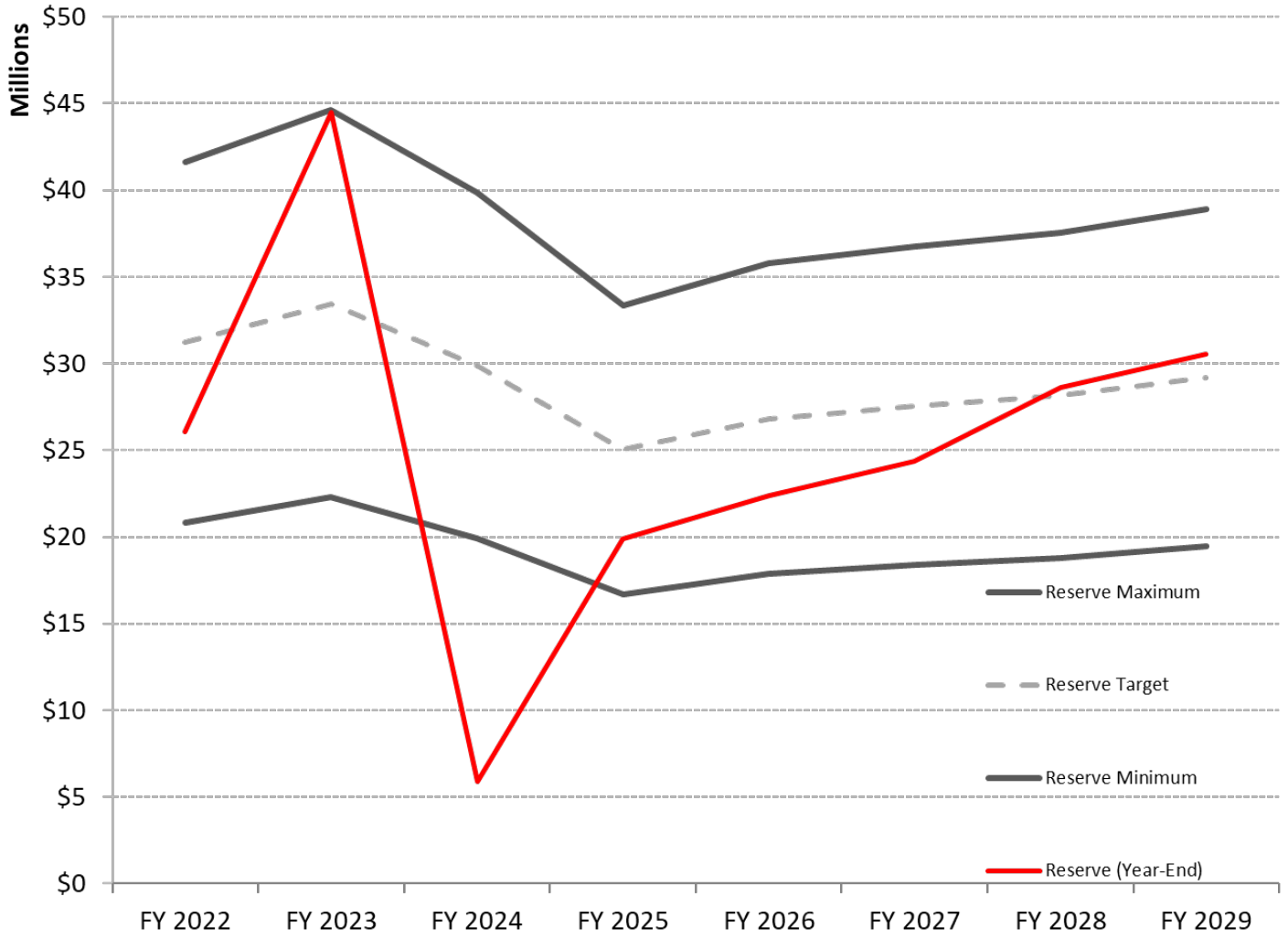
- Inflation
- Medical/retirement benefit costs and associated overhead costs continue to increase
- Increased capital investment in the electric distribution system needed due to system age
- Grid Modernization, which is currently assumed to be bond financed
- Underground construction costs have increased substantially
- Additional contract expense for line crew until internally staffed

FY 2025 Preliminary: Electric Cost and Revenue Projections

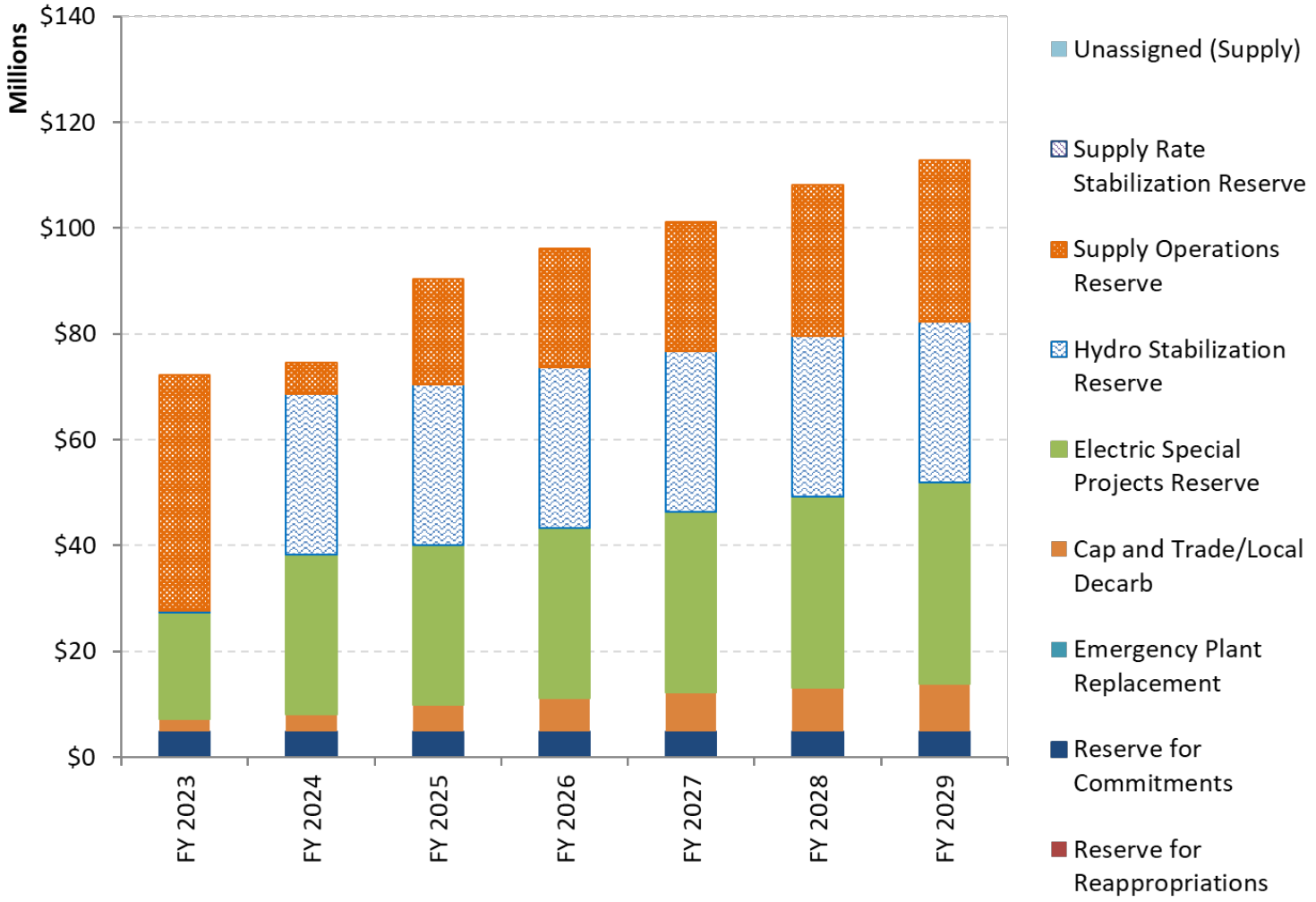


Notes:
1) The 38% increase includes April 2022 activation of the Hydroelectric Rate Adjuster (HRA), a 5% base rate increase, and the January 1, 2023 increase of the HRA from $0.013/kWh to $0.048/kWh.
2) The 5% decrease include July 1, 2023 deactivation of the HRA and a 21% increase to the base rates to align with long-term expenses.

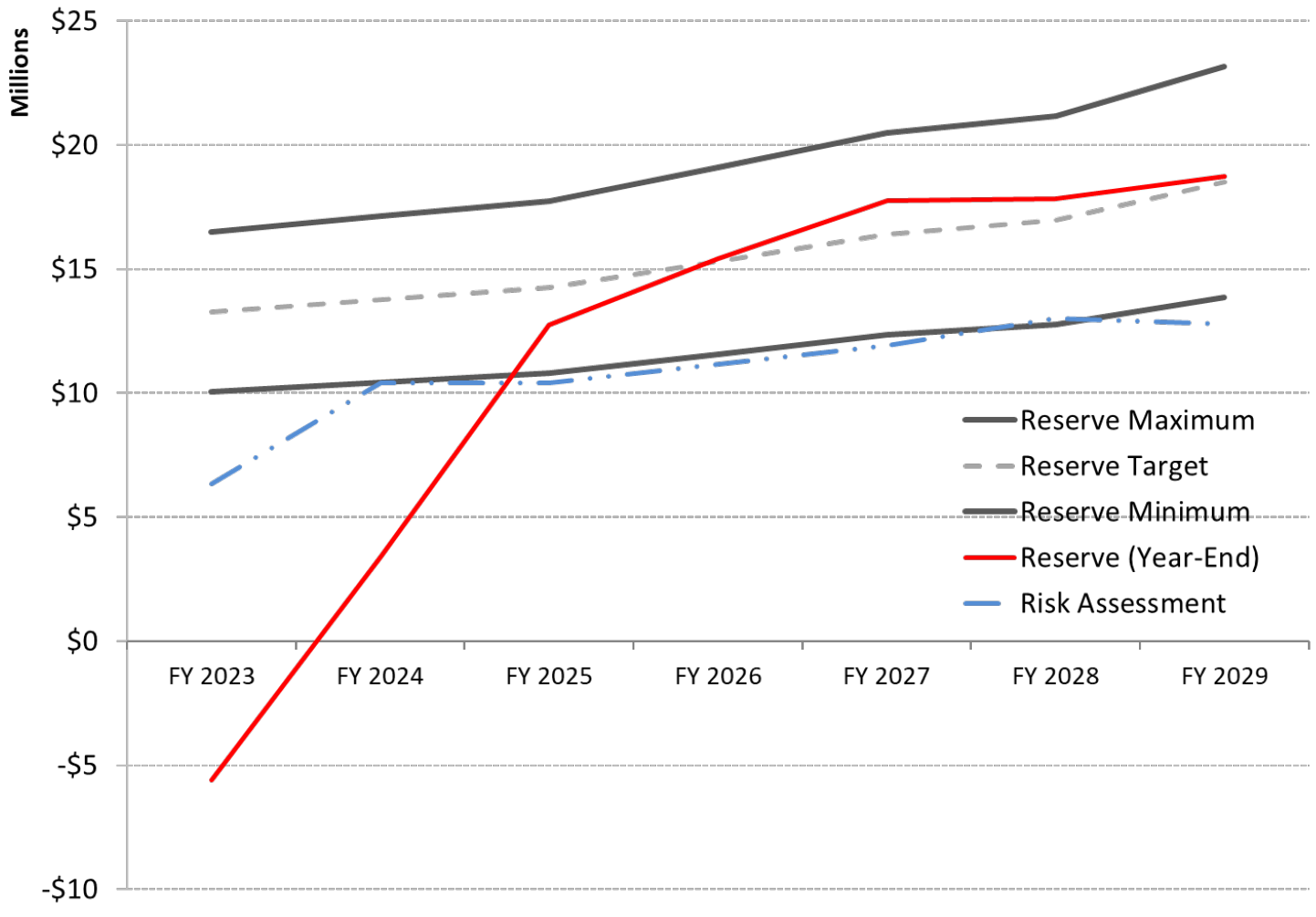
Electric Supply Operating Reserve Projections



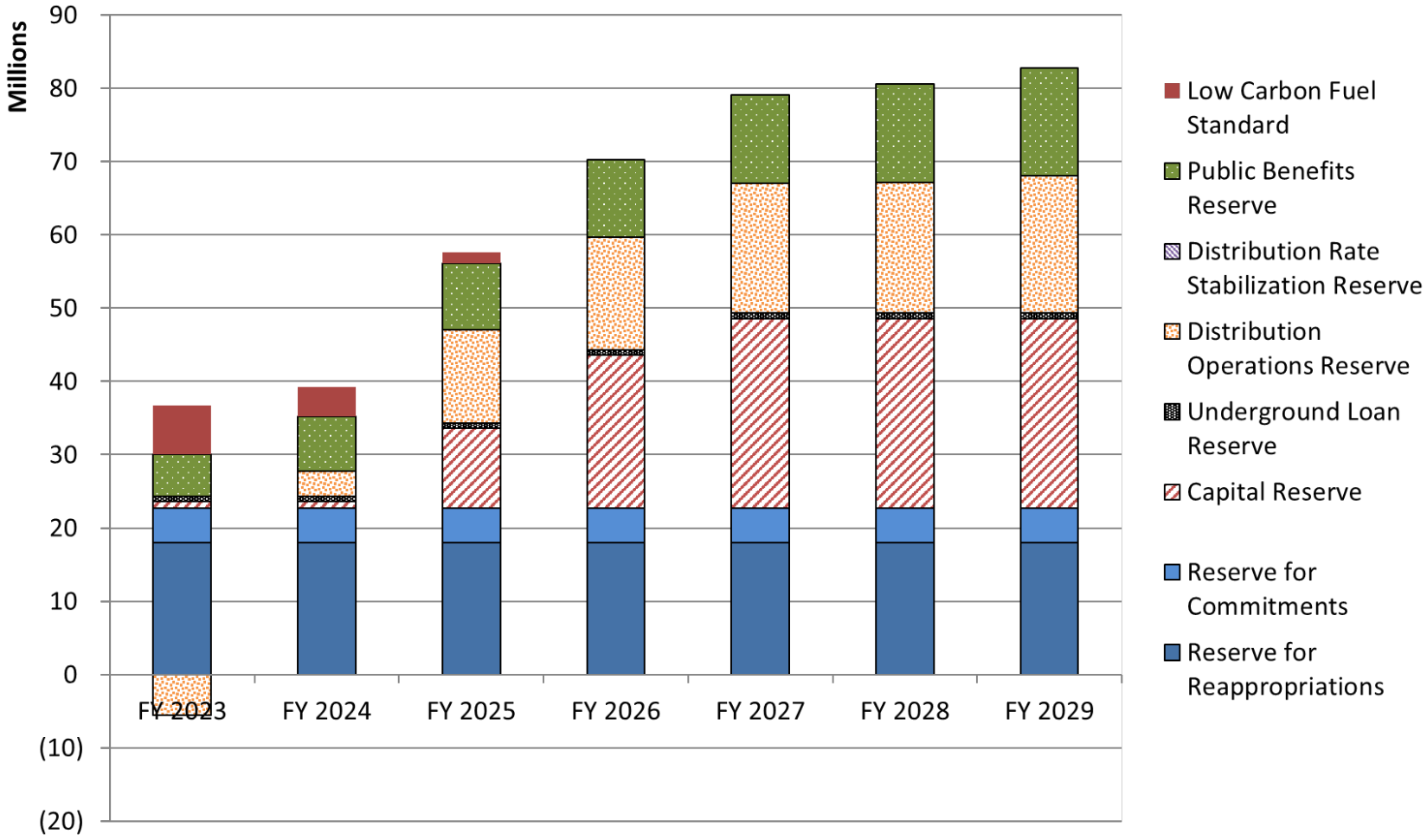
Electric Supply Reserve Projections



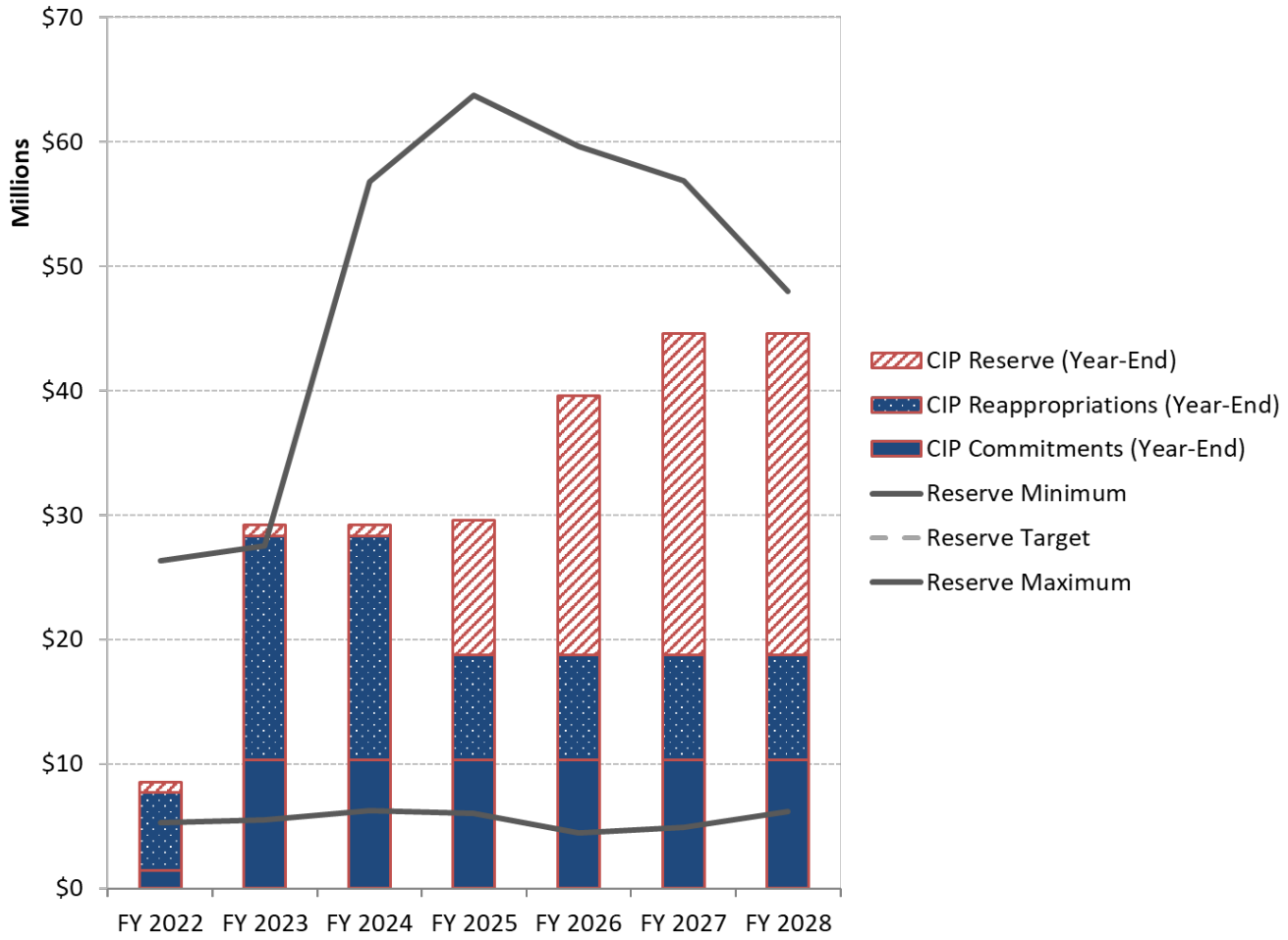
Electric Distribution Operating Reserve Projections



Electric Distribution Reserve Projections



Electric Distribution CIP Reserves



CITY OF PALO ALTO

GAS UTILITY

Preliminary Gas Rate Projections

FY 2025 Projection

- 9% overall rate increase to customer bills, due to 15% distribution rate increase
- 7% overall rate increase in FY 2026 and FY 2027, 6% annually in FY 2028 and FY 2029
- Feedback requested on FY 2025 Measure L transfer (PAMC 2.28.185)
- Supply costs expected to remain stable this winter

Preliminary Gas Projections

- FY 2023 Year-end Ops Reserve above minimum guideline level

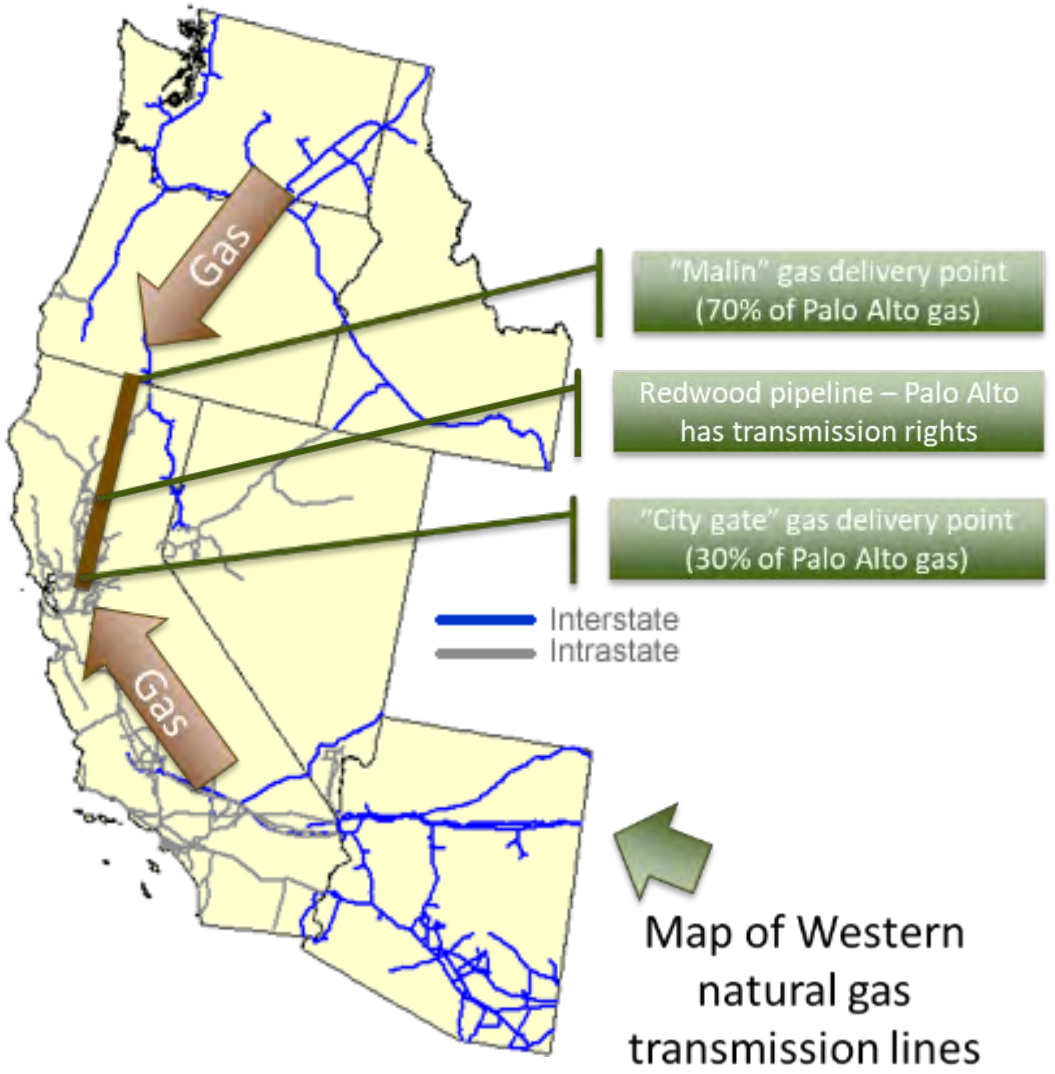
  Compared with Forecast

  - +$5.6M – sales higher than forecasted; high gas consumption
  - +$2.1M – purchases lower than forecasted; lower Cap-and-Trade and Carbon offset costs
- FY 2024 Year-end Ops Reserve Forecasted to be below risk assessment guideline level
  - -$2.3M – FY23 Cap-and-Trade auction sales revenue transfer to reserve deferred to FY24
  - -$1.4M – FY23 Carbon offset costs deferred to FY24
- FY 2025 Year-end Ops Reserve forecasted to be at risk assessment guideline level and expected to return near target guideline level by FY 2029

Gas Utility Basics

City of Palo Alto gas distribution system:

- 20,000 meters
- 205 miles of mains
- 18,000 service lines

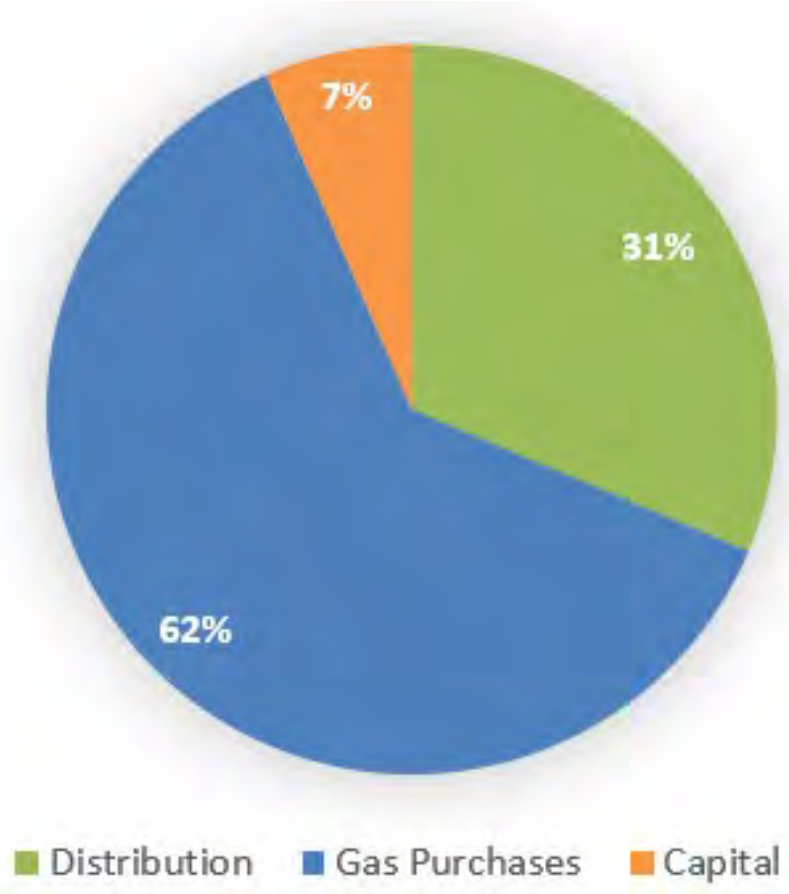


Map of Western natural gas transmission lines

Gas Rate Design

- About one-third to two-third of the rate is “supply-related:” gas supply, transmission, and environmental charges. These rates vary monthly according to market-driven costs that are passed directly to customers
- The remaining portion of the rate is set based on the City’s costs for maintaining its gas distribution system (gas mains, services, related equipment). **These rates are being discussed here tonight.**

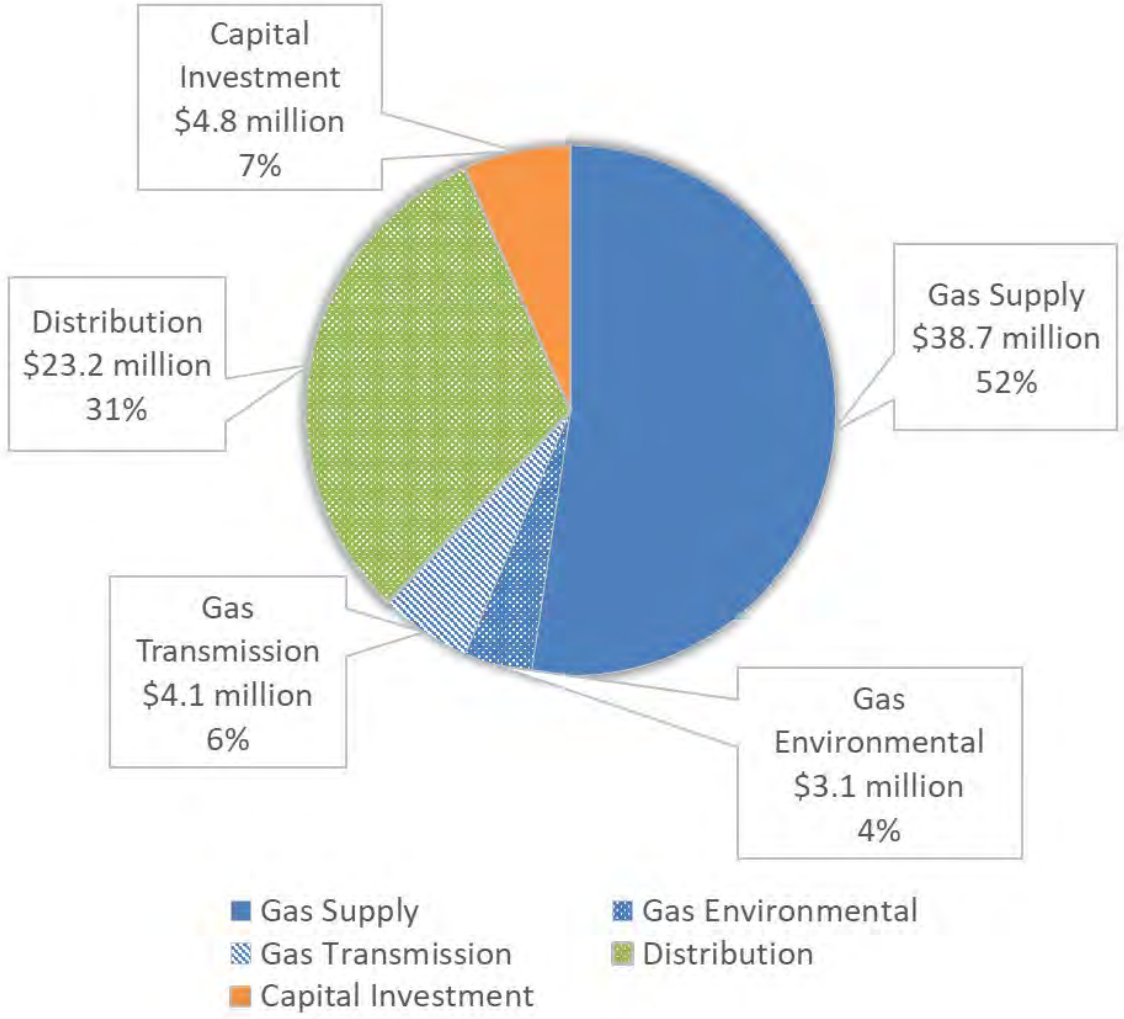
FY 2023



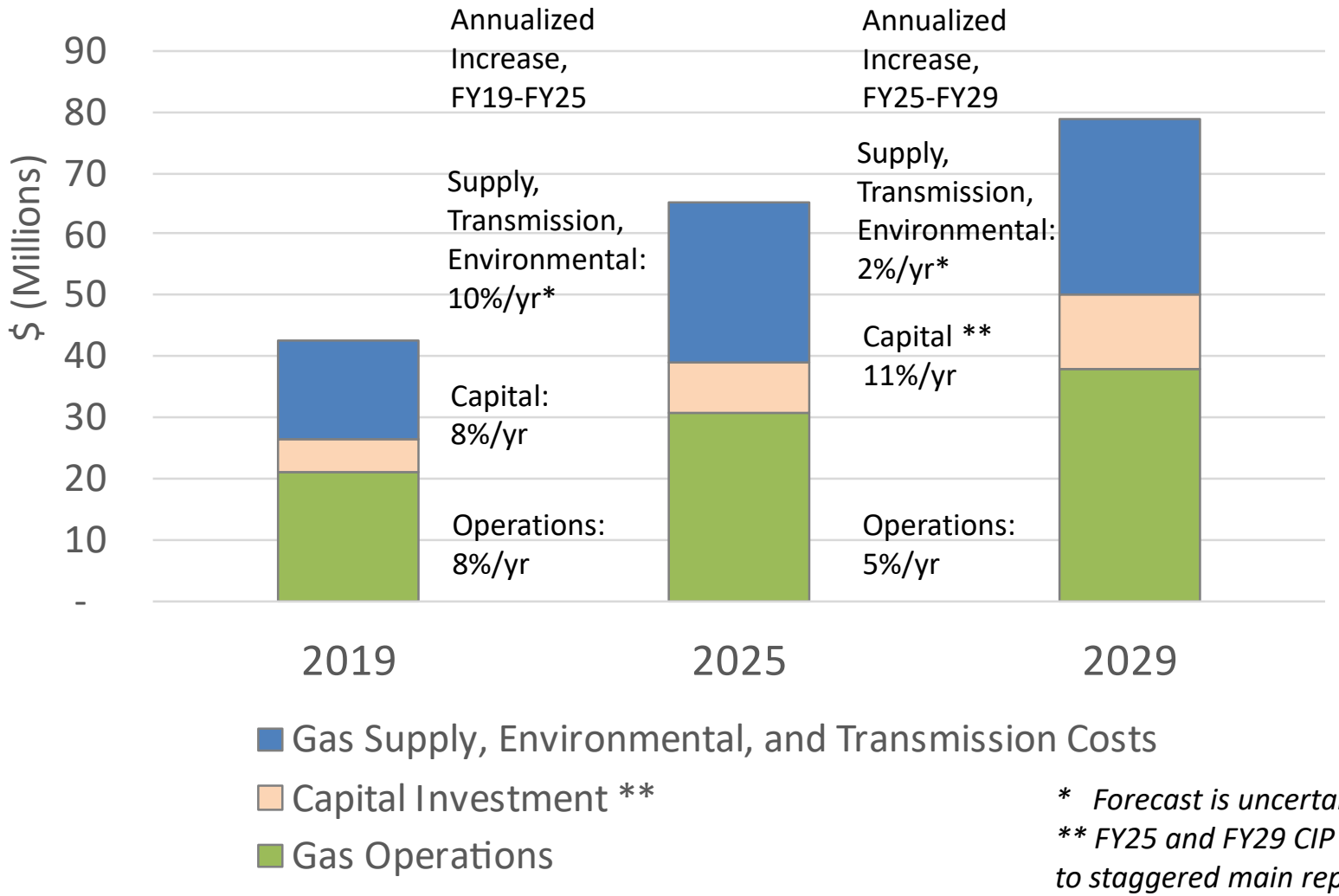
Gas Utility Cost Structure *(FY 2023)*

Gas Distribution (in Green): The cost to distribute gas within Palo Alto, including: maintaining and replacing gas infrastructure, customer service, billing, administration, etc.

Gas Supply, Transmission, and Environmental (in Blue):
All pass-through



Long Term Cost Trends



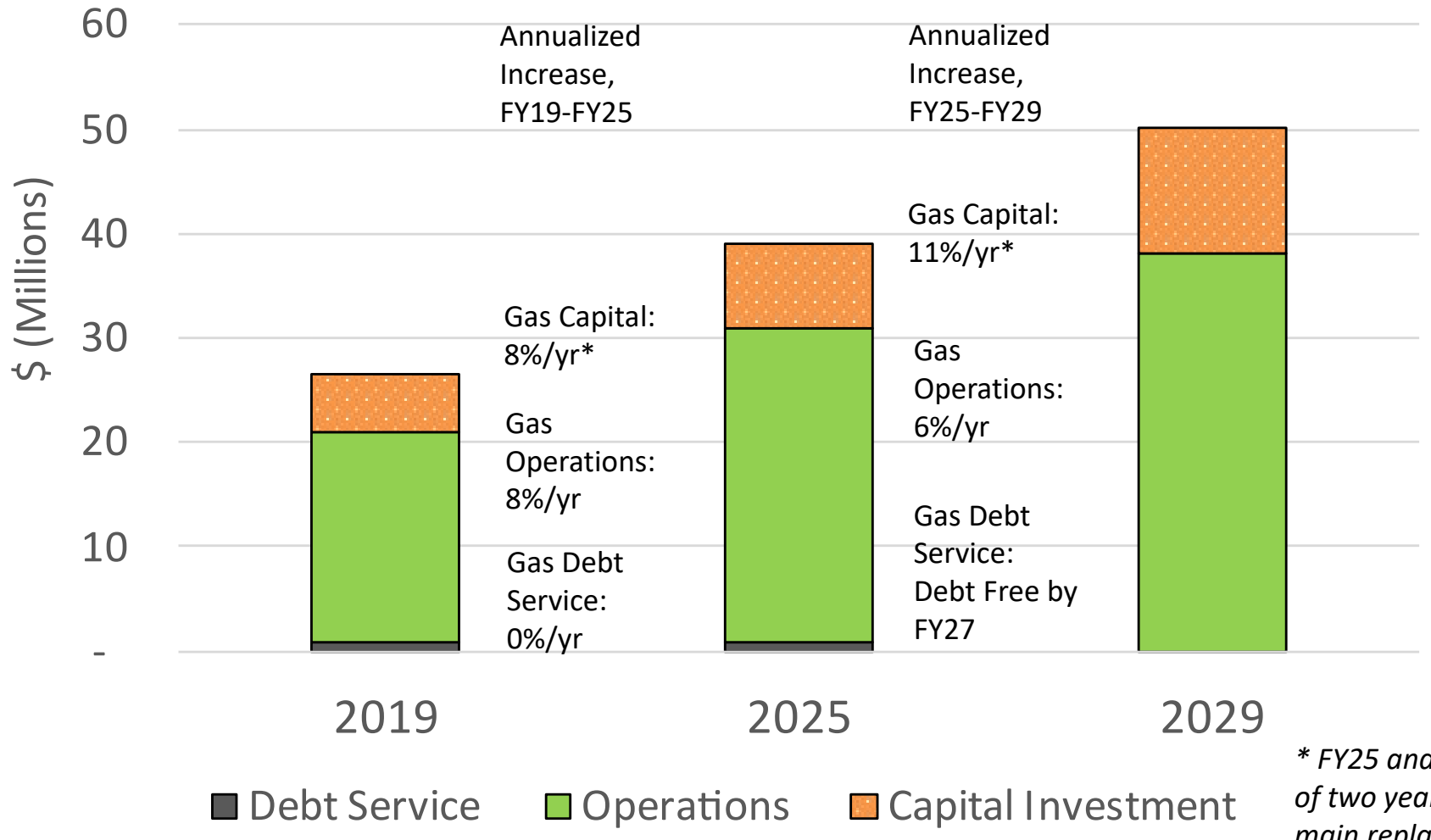
** Forecast is uncertain and will vary with market prices*
*** FY25 and FY29 CIP are an average of two years due to staggered main replacement schedule.*

Gas Supply Cost Drivers*

- PG&E gas transmission rates continue to rise steadily to fund safety investments
- Insurance purchased in response to winter 22/23 natural gas market volatility
- Cap and Trade costs continue to rise (as intended by design)
- Carbon Neutral Gas Plan; carbon offset purchases

** All of the above costs are pass-through and not included in rate increase*

Gas Distribution Cost Trends



** FY25 and FY 20 CIP is an average of two years due to staggered main replacement schedule.*

Gas Distribution Cost Drivers

- Health, retirement, and associated overhead costs continue to increase
- Underground construction costs have increased substantially as well
- Continued funding for crossbore investigations
- Increases in transfers to capital projects fund

Current Gas Bill Comparisons *($/Mo. or Yr.)*

Residential

Season	Usage (Therms)	Palo Alto	PG&E Zone X	% Difference
Summer	10	$ 29	$ 21	29%
	(Median) 18	$ 42	$ 38	7%
	30	$ 69	$ 68	2%
	45	$ 106	$ 104	1%
Winter	30	$ 64	$ 70	(10%)
	(Median) 54	$ 104	$ 129	(24%)
	80	$ 167	$ 198	(19%)
	150	$ 358	$ 391	(9%)

Palo Alto median residential bill is projected to be about 10% below PG&E's median bill in FY 2024, based on actuals and projected supply rates

Commercial

Staff is in the process of doing a more extensive review of commercial competitiveness and will provide updates in the future

Preliminary - Gas General Fund Transfer

- Measure L: 18% of gas utility gross revenues from two fiscal years prior; Council may elect to transfer less
- Council approved transferring up to 15.5% of FY 2022 gas utility gross revenues to the general fund in FY 2024
- Equity Transfer Alternatives:
  - **Transfer 11.9% (Staff Recommended):** lower transfer amount due to high commodity revenue in FY 2023, gradual transition to 18% transfer by FY 2027
  - **Transfer 18%:** transfer full amount allowed under Measure L 18% cap

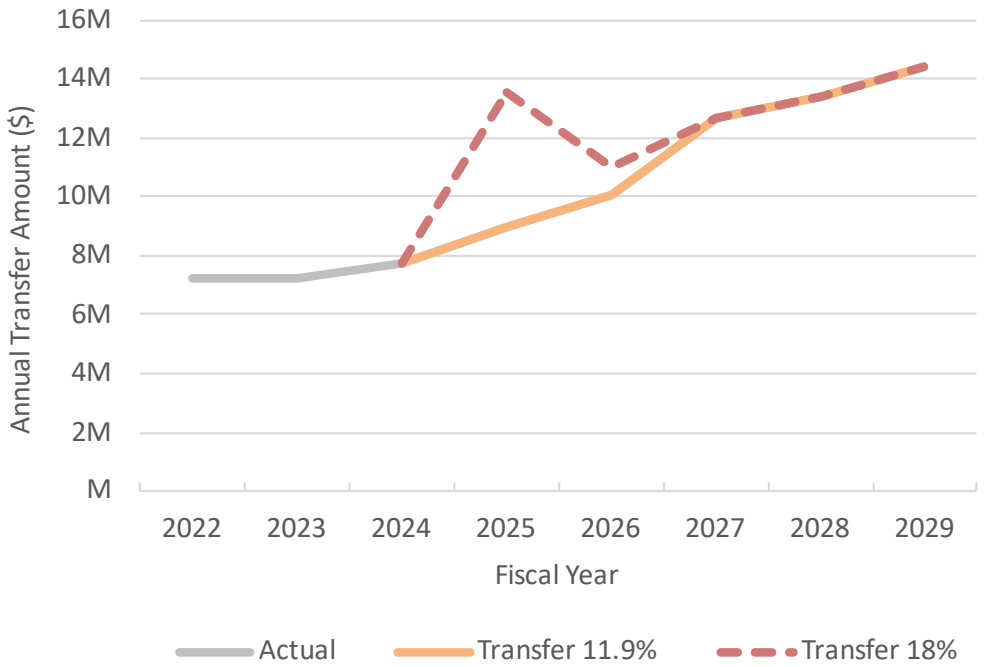
FY 2025 General Fund Transfer Alternatives and Gas Rate Projections

Summary of Overall Rate Changes

Fiscal Year	2024	2025	2026	2027	2028	2029
Transfer 11.9%	8%	9%	7%	7%	6%	6%
Transfer 18%	8%	15%	5%	5%	5%	6%
FY 2024 Financial Plan	8%	7%	5%	5%	5%	-

Percent of Gross Gas Utility Revenue to Transfer

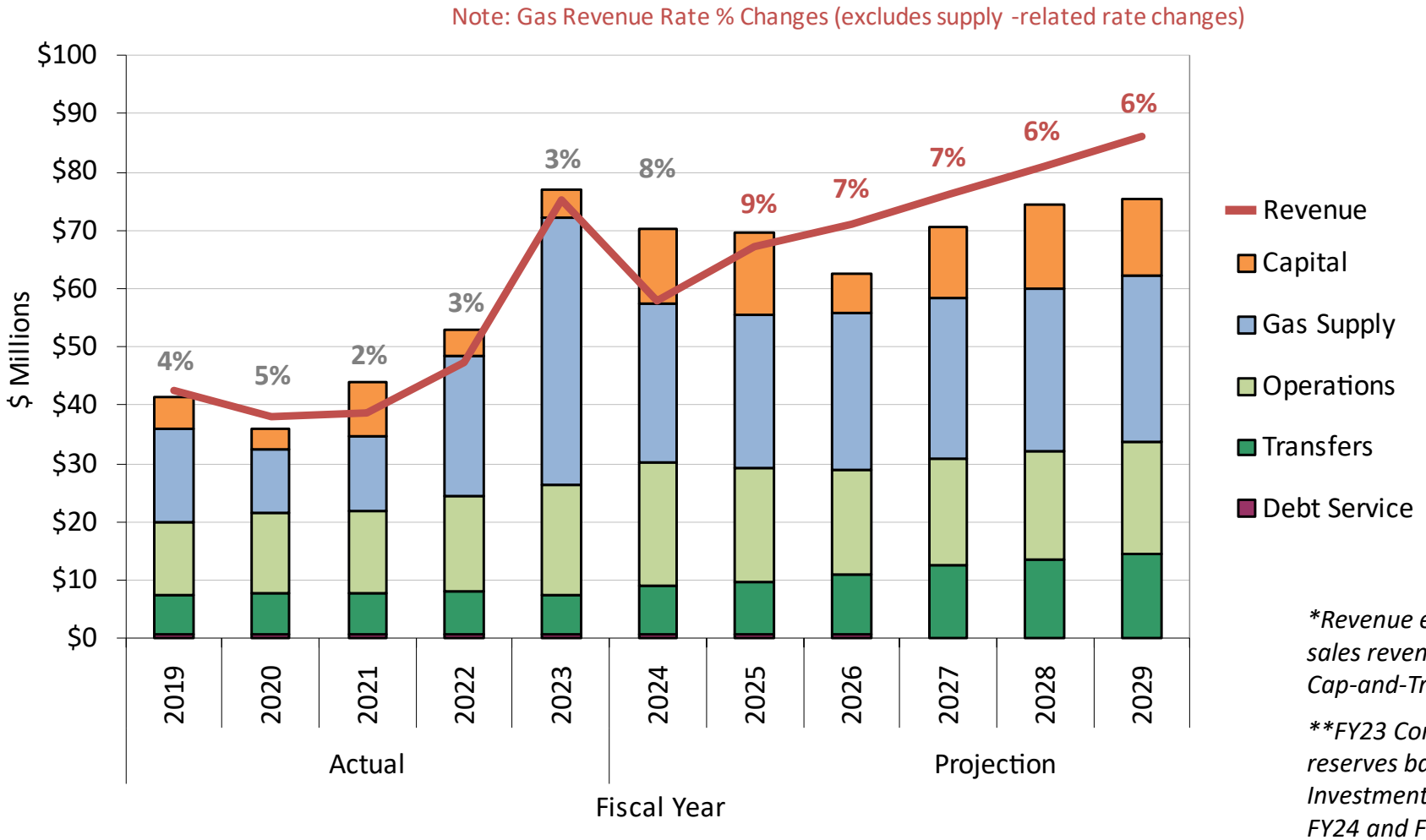
Fiscal Year	2024	2025	2026	2027	2028	2029
Transfer 11.9%	15.5%	11.9%	16.5%	18.0%	18.0%	18.0%
Transfer 18%	15.5%	18.0%	18.0%	18.0%	18.0%	18.0%
FY 2024 Financial Plan	15.5%	11.1%	12.9%	13.1%	12.8%	-



Note: Revenues can fluctuate depending on gas commodity market prices

Gas Cost and Revenue Projections

Transfer 11.9%



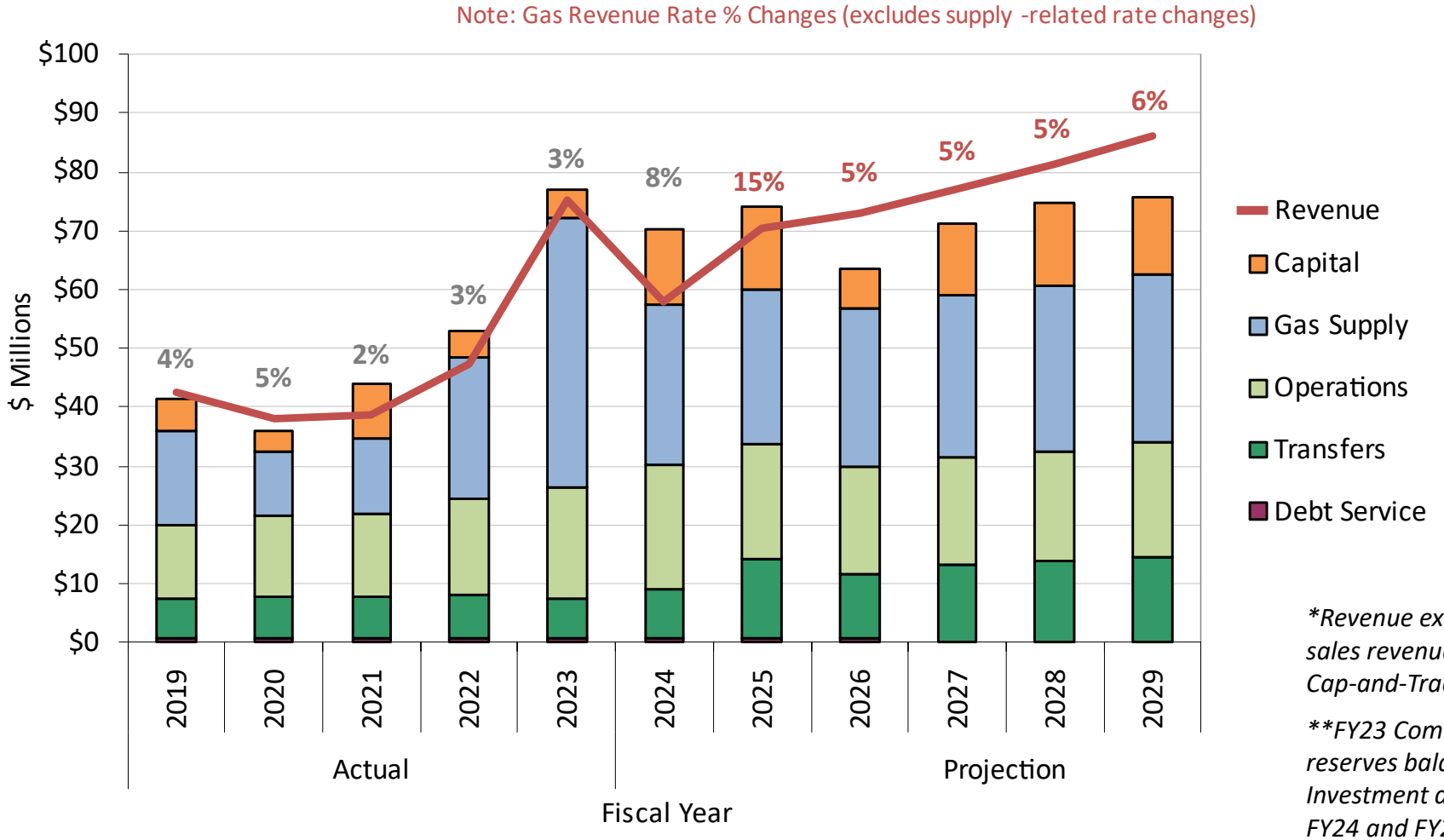
**Revenue excludes Cap-and-Trade auction sales revenue, which goes directly to the Cap-and-Trade reserve*

***FY23 Commitments and Reappropriations reserves balances for Operations and Capital Investment are anticipated to be utilized in FY24 and FY25*

CITY OF PALO ALTO

Gas Cost and Revenue Projections

Transfer 18%



**Revenue excludes Cap-and-Trade auction sales revenue, which goes directly to the Cap-and-Trade reserve*

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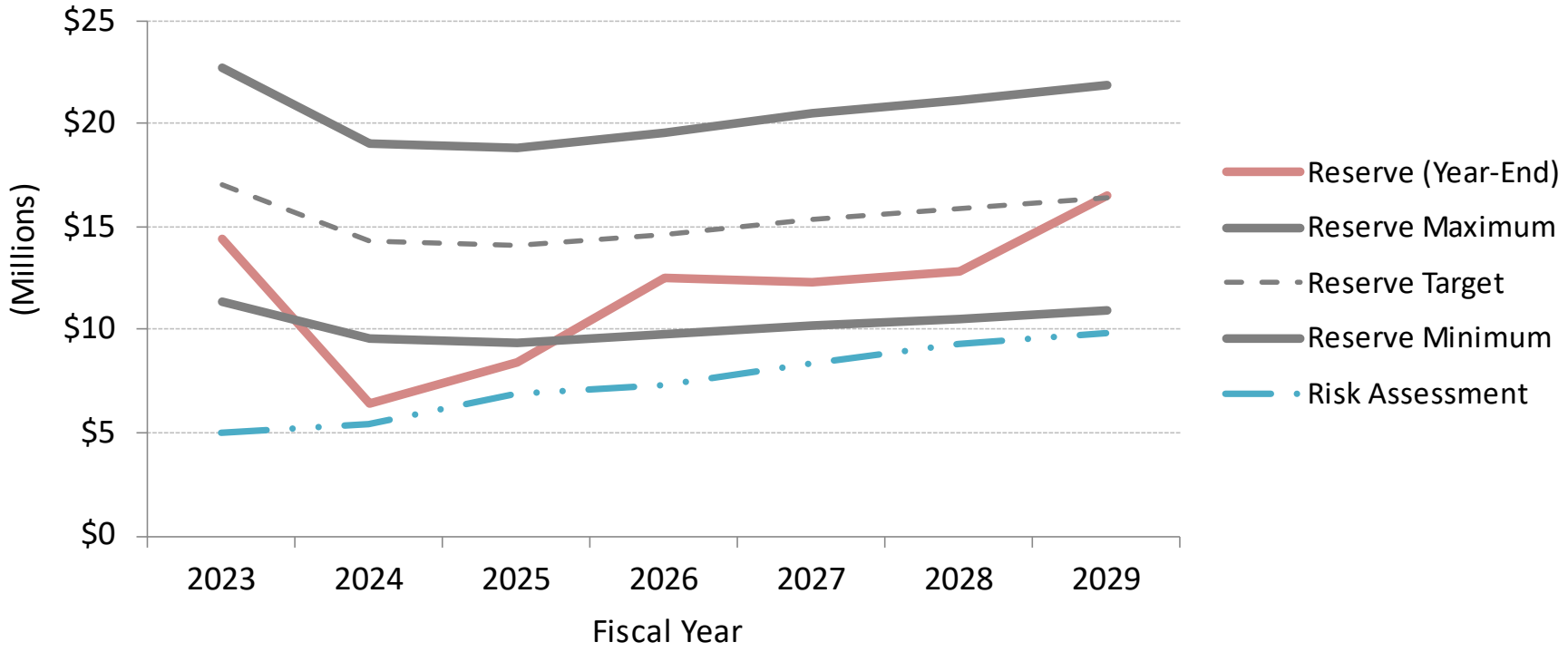
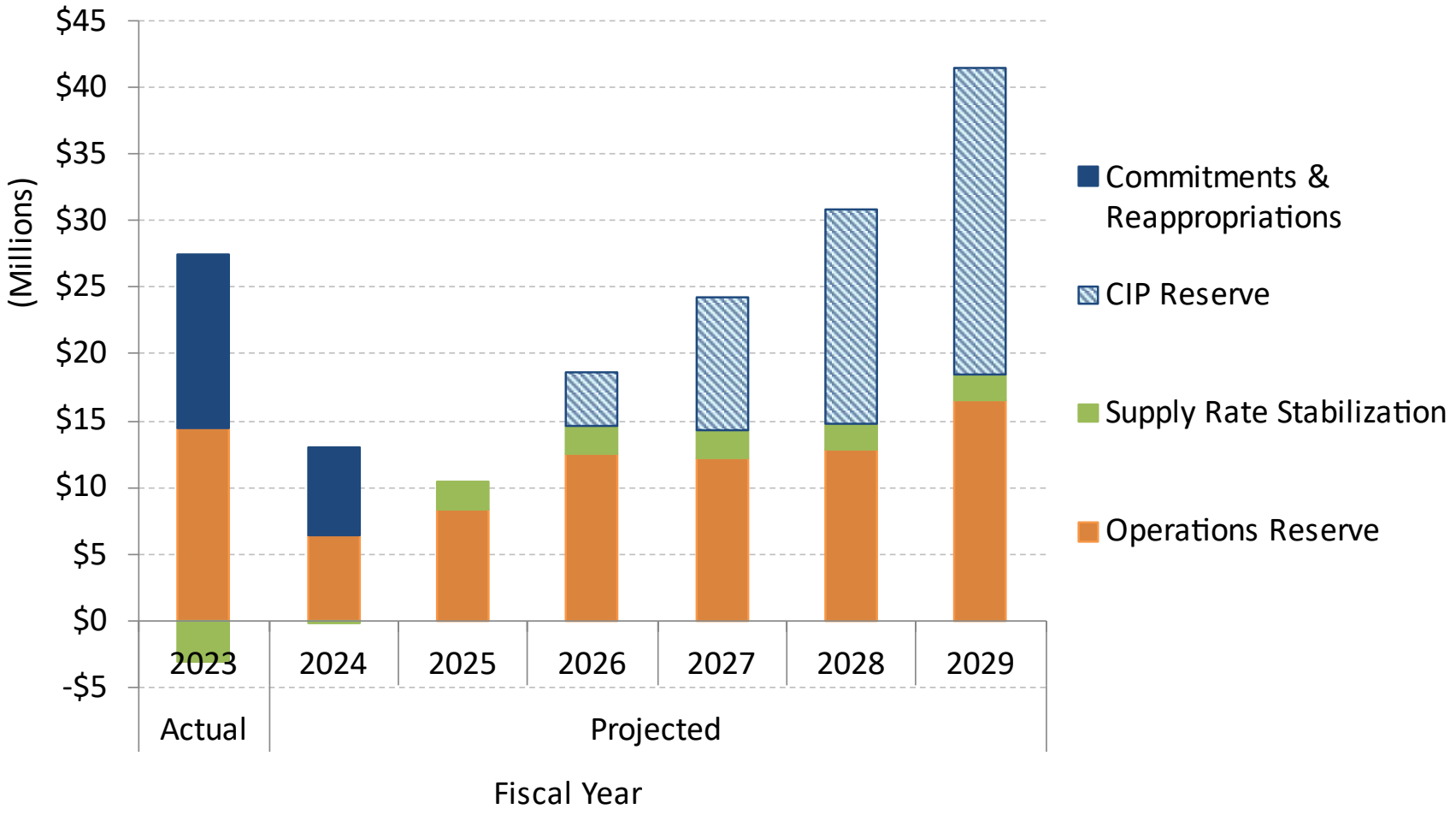
CITY OF PALO ALTO

Gas Operations Reserve Projections

Transfer 11.9%



Gas Reserve Projections



Note: Excludes Cap and Trade Reserve

CITY OF PALO ALTO

WATER UTILITY

Preliminary Water Rate Projections

- **Proposal FY 2025 - 13% Distribution Rate Increase**
  - FY 2023 year-end Operations Reserve near minimum guideline due to drought
  - Projected Water Distribution Rate Changes

Fiscal Year	2024	2025	2026	2027	2028	2029
Current Projection	2%	13%	14%	15%	13%	6%
FY 2024 Plan	2%	7%	6%	6%	6%	-

  - Projected Total Water Rate Changes

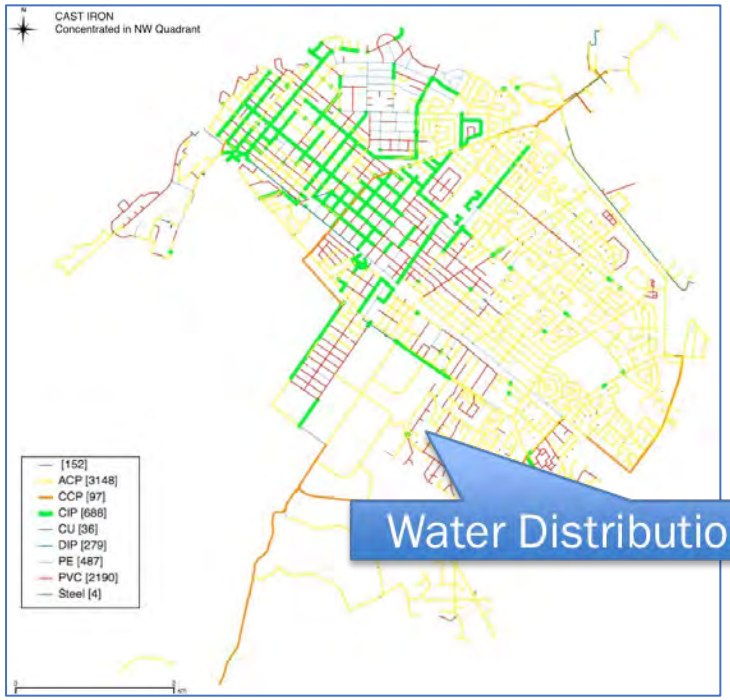
Fiscal Year	2024	2025	2026	2027	2028	2029
Current Projection	5%	9% - 13%	9%	10%	9%	5%
FY 2024 Plan	5%	4%	3%	4%	6%	-

    - Commodity rate projected to increase between 4.2% and 13.1% based on latest SFPUC projection (January 2024); highly uncertain and subject to change due to uncertain regional drought usage rebound and weather
    - Water main replacement acceleration not included
    - One Water supply alternatives not included

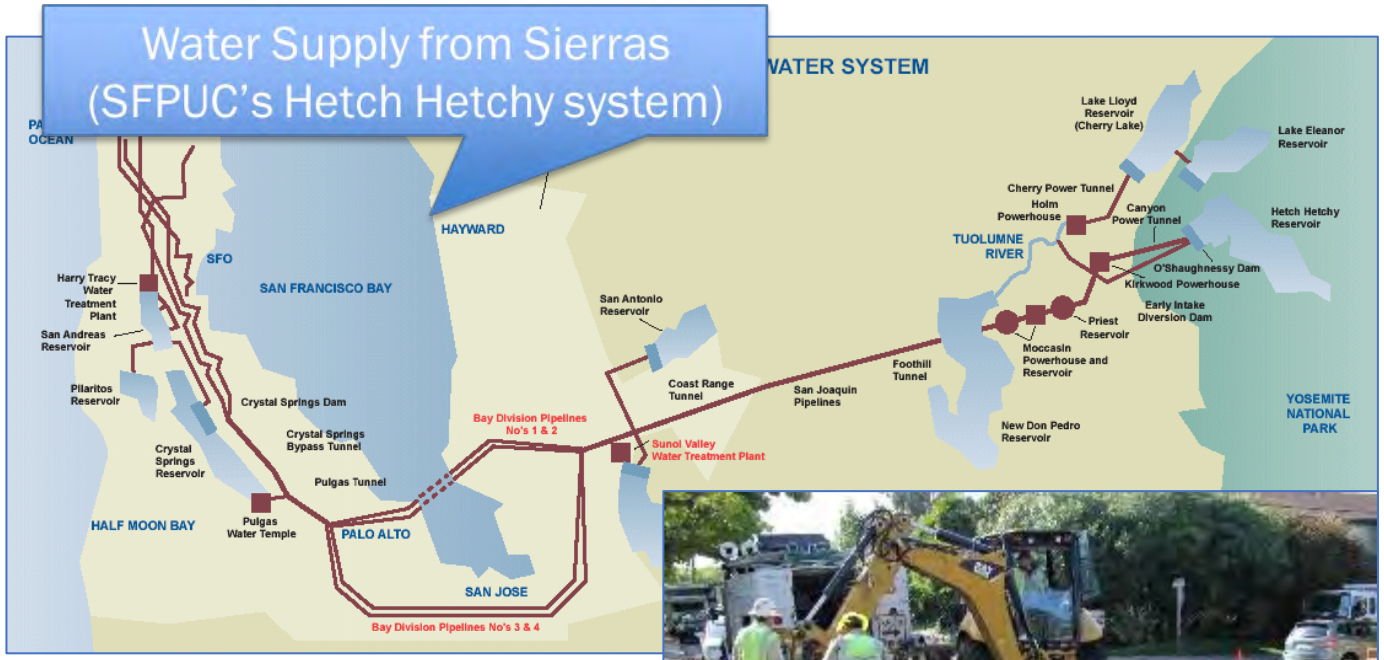
Preliminary Water Rate Projections

- FY 2023 Year End Ops Reserve below target
    - Water sales (net of supply cost savings) $2.4M lower than forecasted
    - Expenses $1.6M higher than forecasted (including transfers out, accounting adjustment to beginning balance, CIP)
- Ops Reserve projected to be close to minimum guideline range for 4 years and return to target guideline levels in FY 2029;
- CIP Reserve below minimum temporarily in FY 2026 and returns to within guideline range by the end of FY 2027 due to two one-time tank replacements/rehabilitation in FY 2026 and FY 2027
- Sales forecast updated to reflect drought rebound by FY 2026 and 2-5% lower water sales annually during the forecast period

WATER UTILITY BASICS



Water Distribution in Palo Alto

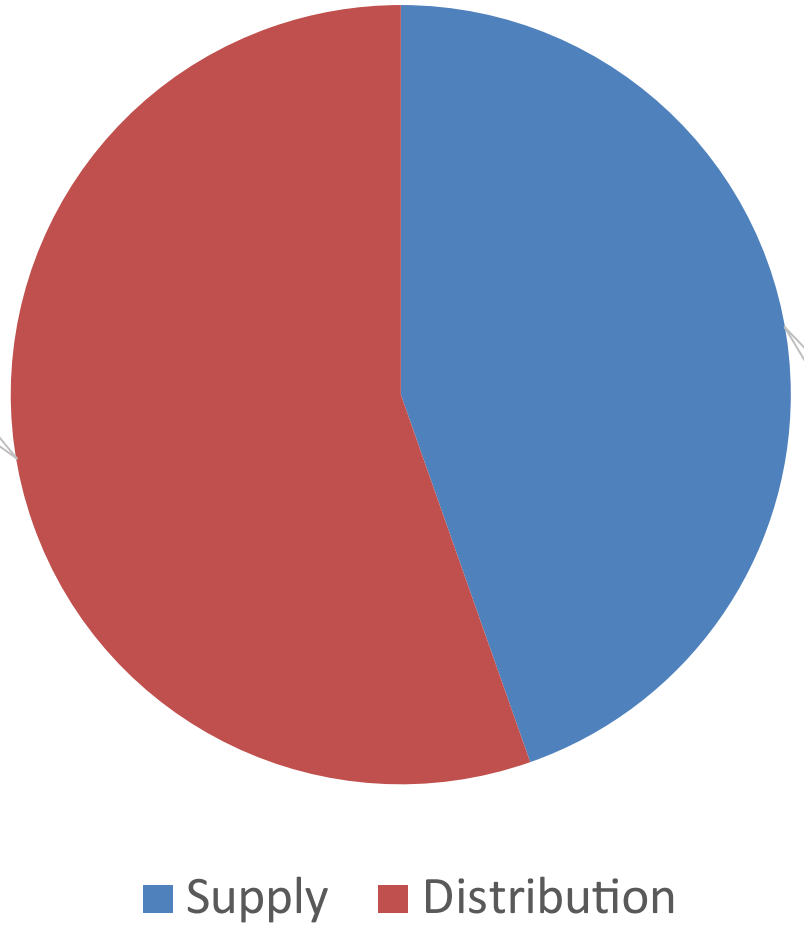


CITY OF PALO ALTO

WATER UTILITY COST STRUCTURE

Distribution
$32.2
million
55%

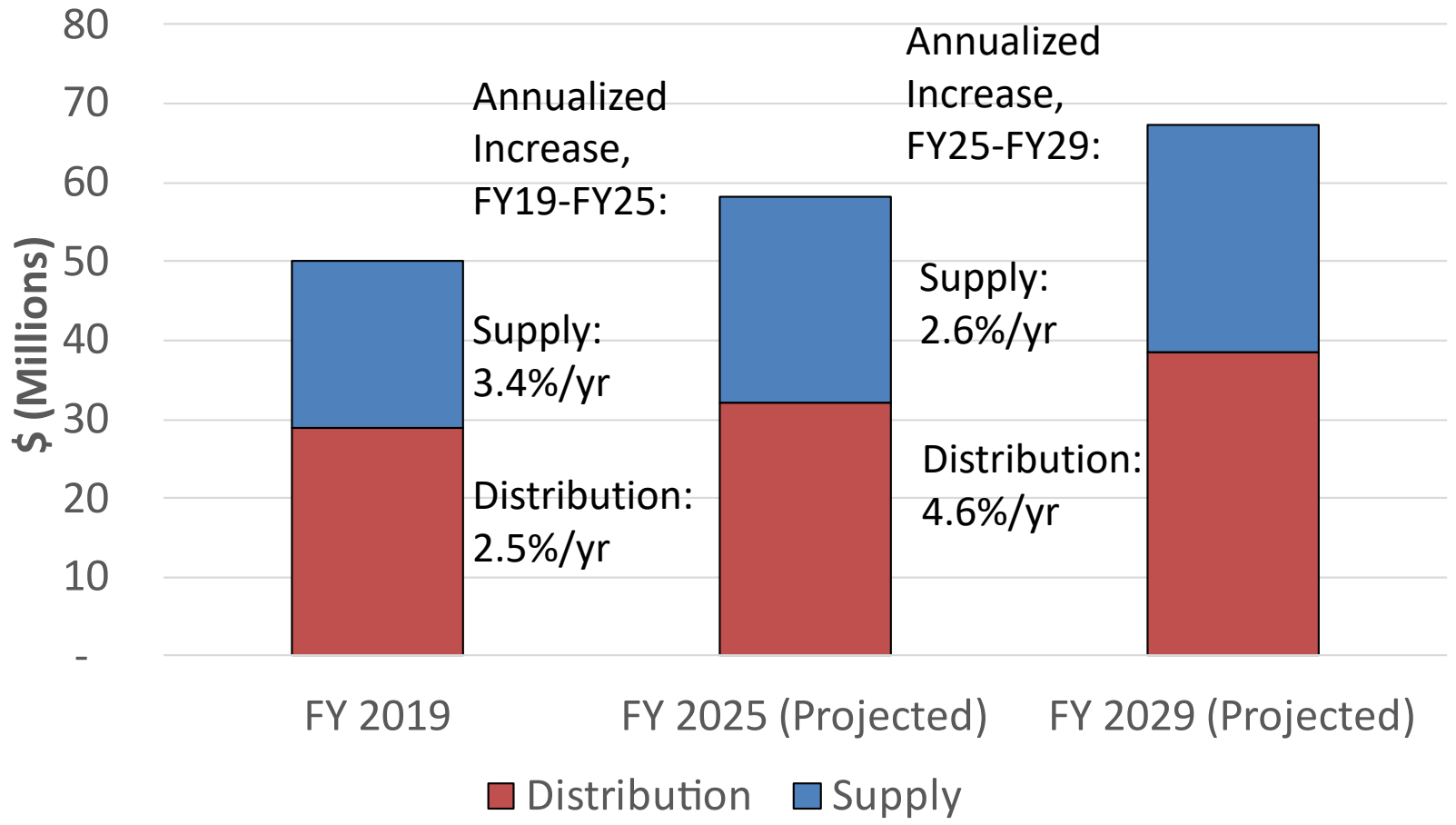
Cost to distribute water within Palo Alto, including: maintaining and replacing water infrastructure, customer service, billing, administration, etc.



Cost to bring the water to Palo Alto

Supply
$25.9
million

LONG TERM COST TRENDS



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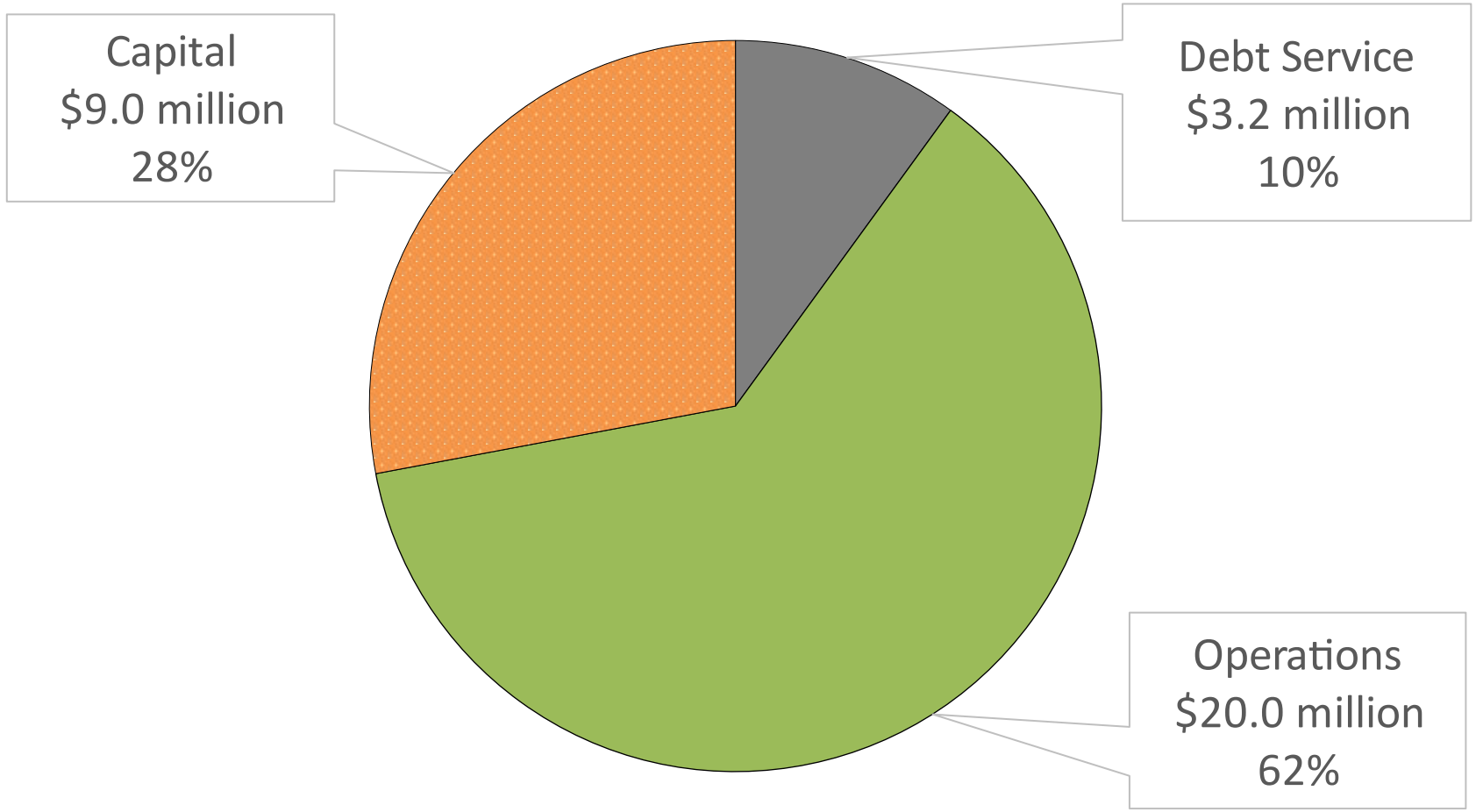
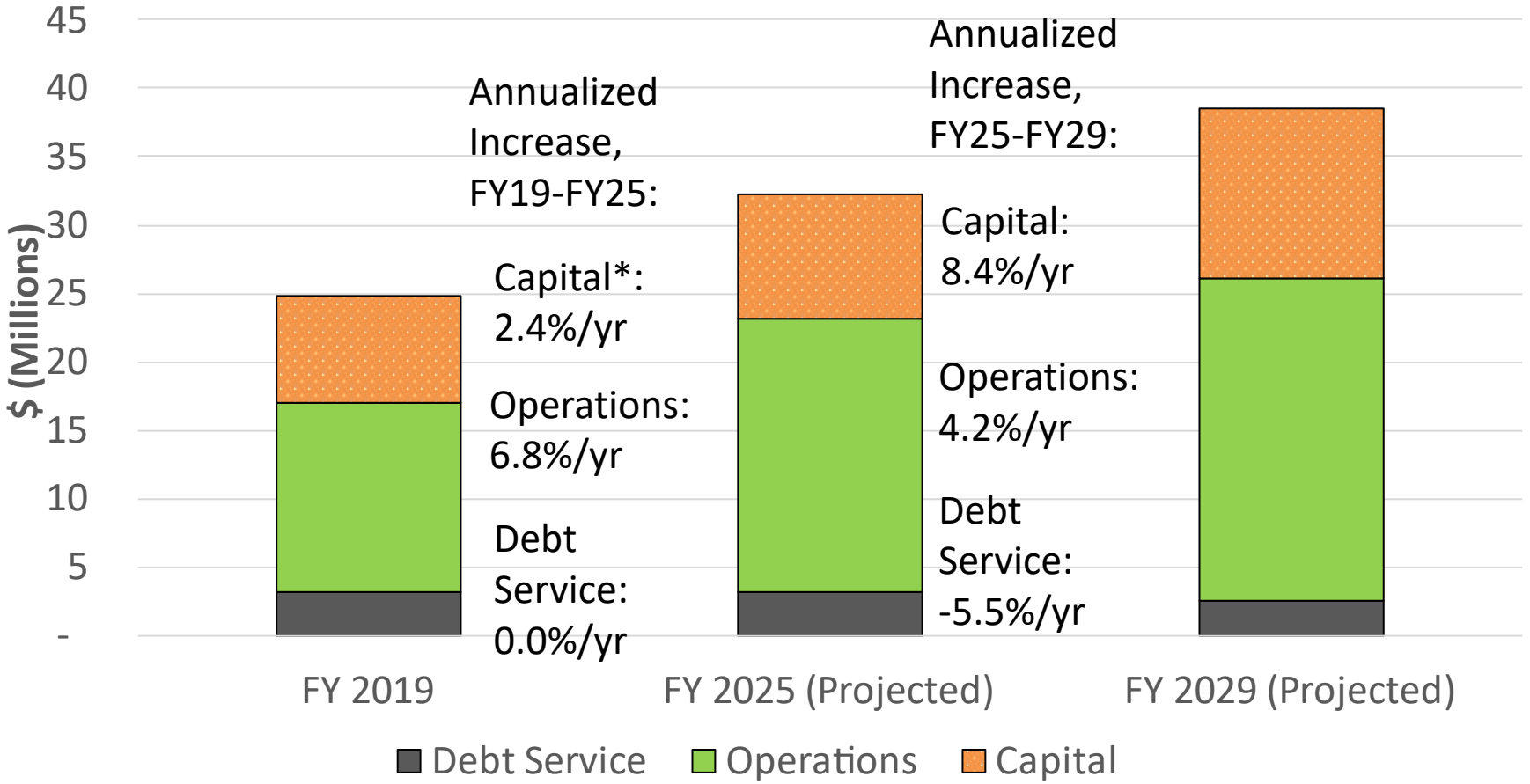
WATER DISTRIBUTION COSTS



WATER DISTRIBUTION COST TRENDS



- Capital in 2019 includes an average of 2019 and 2020 and includes capital contribution to the CIP Reserve in 2025 and 2029

WATER OPERATIONS & CAPITAL COST DRIVERS

Operating

- Drought-related water sales reductions
- Health, retirement, and associated overhead costs continue to increase

Capital

- Construction costs have not declined
- Large one-time costs for reservoir rehabilitation/replacement
- Planned increase in costs for generator backup at pumping stations and for emergencies

WATER SUPPLY COST DRIVERS

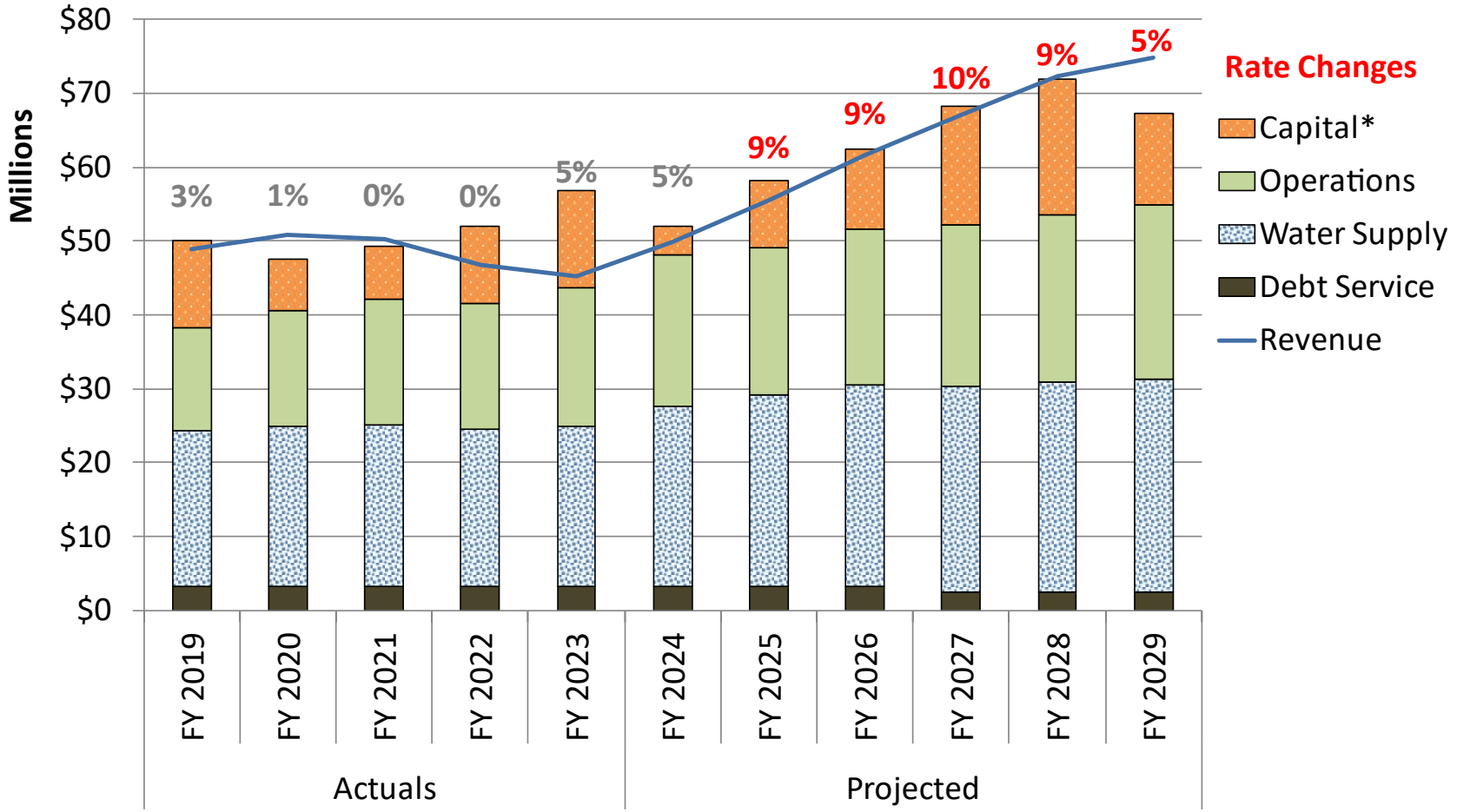
- Water System Improvement Program (WSIP)
- 2002: advocacy by wholesale customers results in AB 1823 requiring SFPUC to adopt and implement the WSIP
- In 2010 construction began - $4.8B, one of the largest water projects in the nation
- Level of service goal: return to service in 24 hours after an earthquake

WATER SUPPLY COST DRIVERS

- WSIP spending 98.9% complete as of September 2021
- “Upcountry” system in the Sierra still needs work.
- Wholesale customers (via BAWSCA) advocating for improvements in long-term capital planning
- Necessary and improves reliability, but supply costs will increase in the future as a result

Preliminary Water Projections

Cost/Revenue



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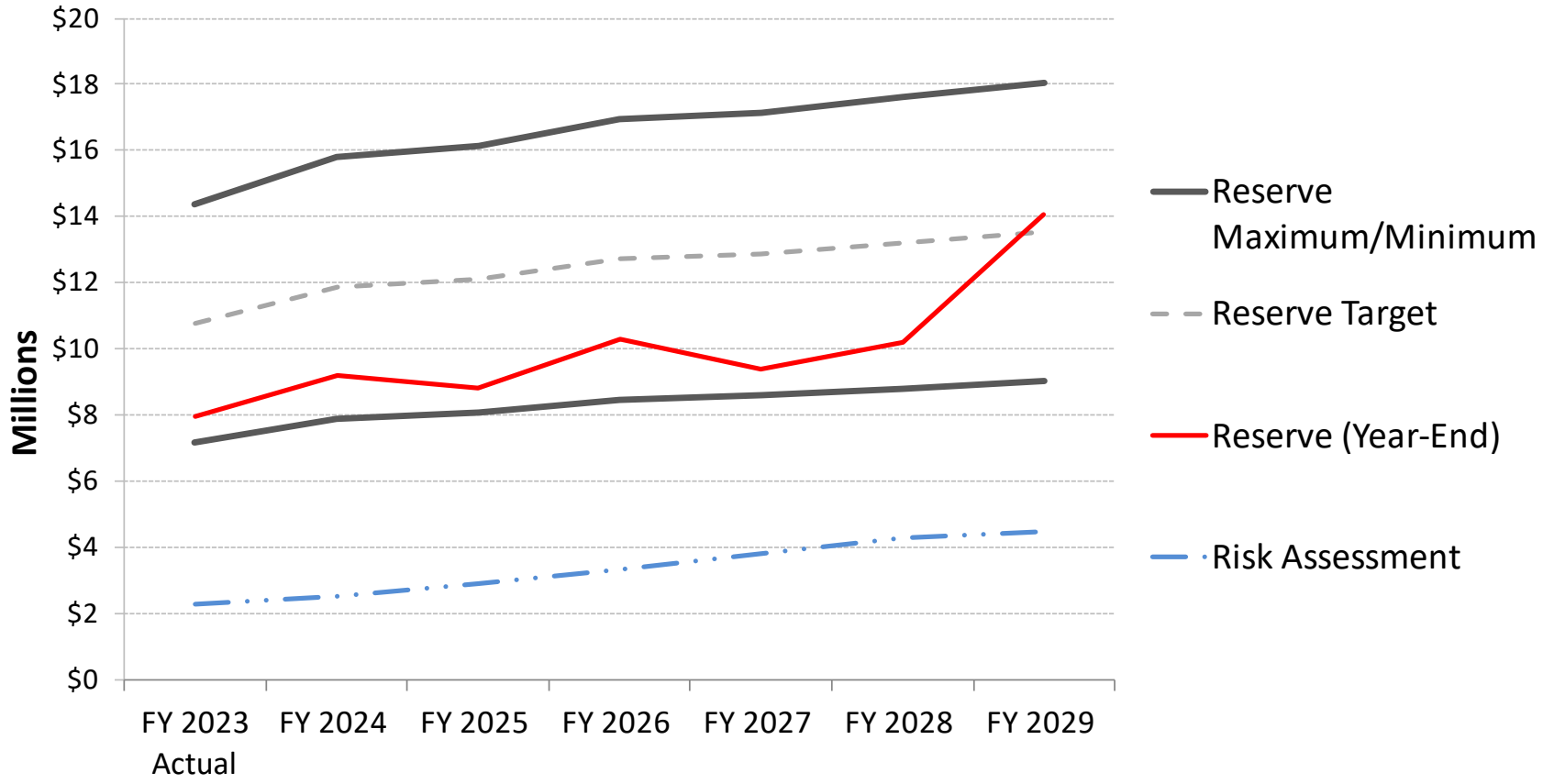
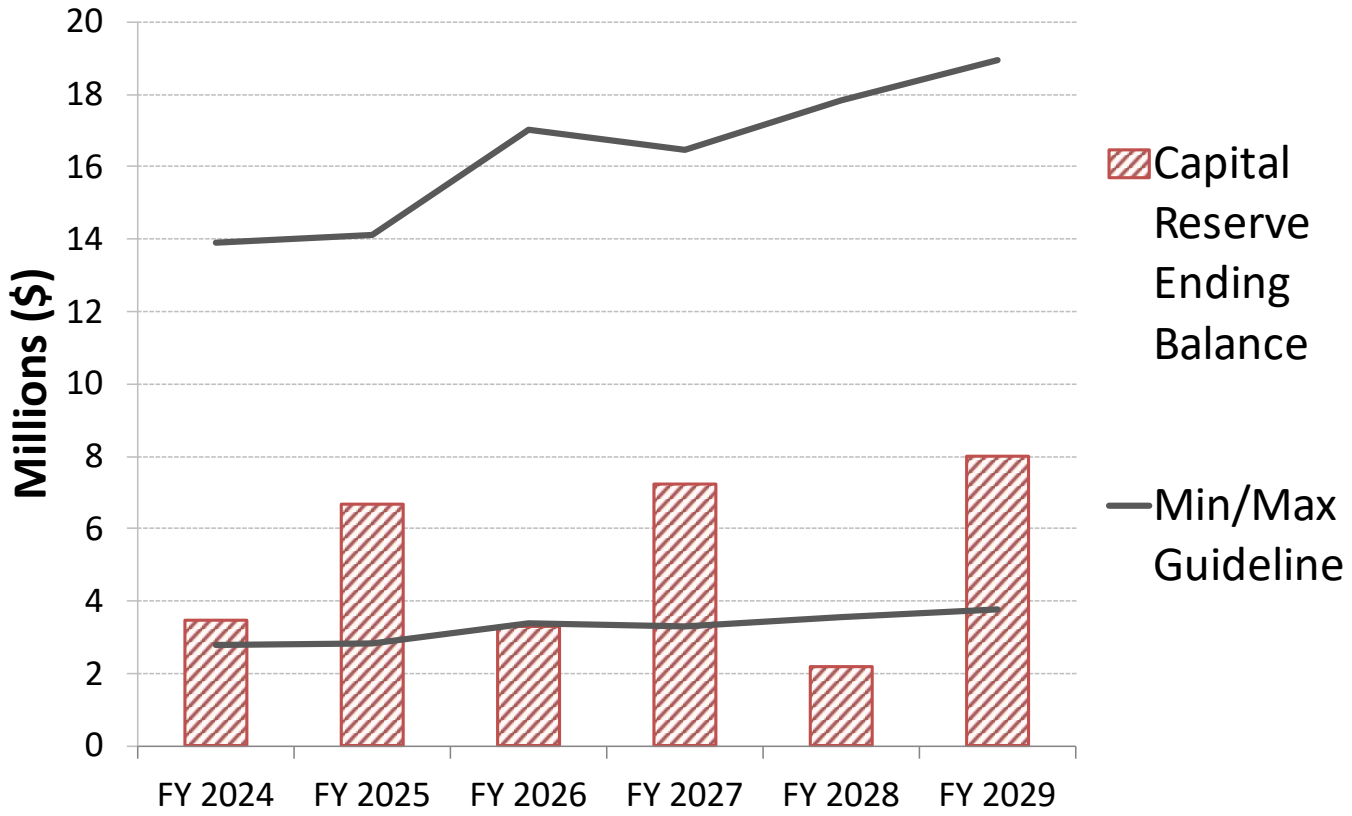
WATER OPERATIONS RESERVE PROJECTIONS

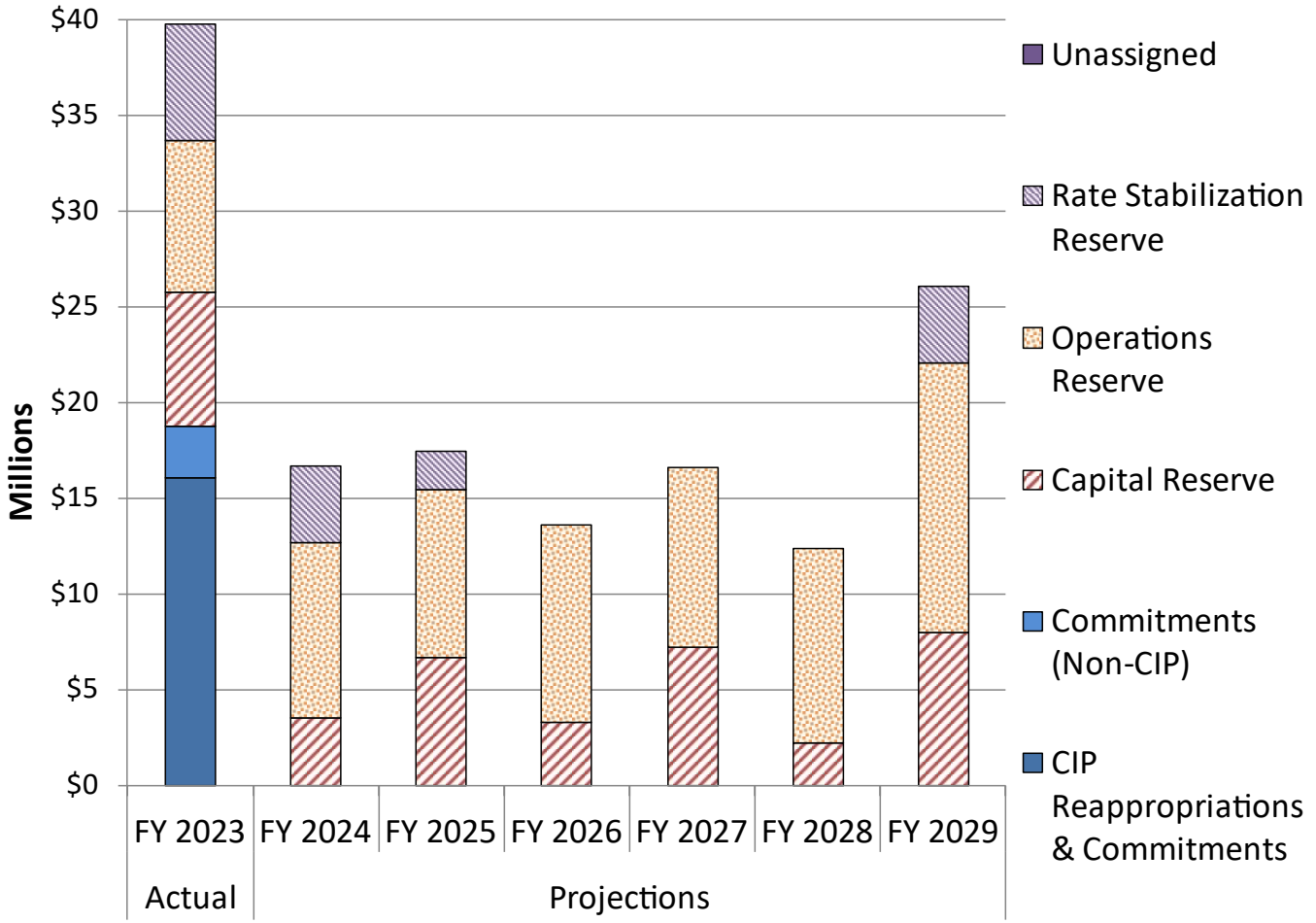


WATER CIP RESERVE PROJECTIONS

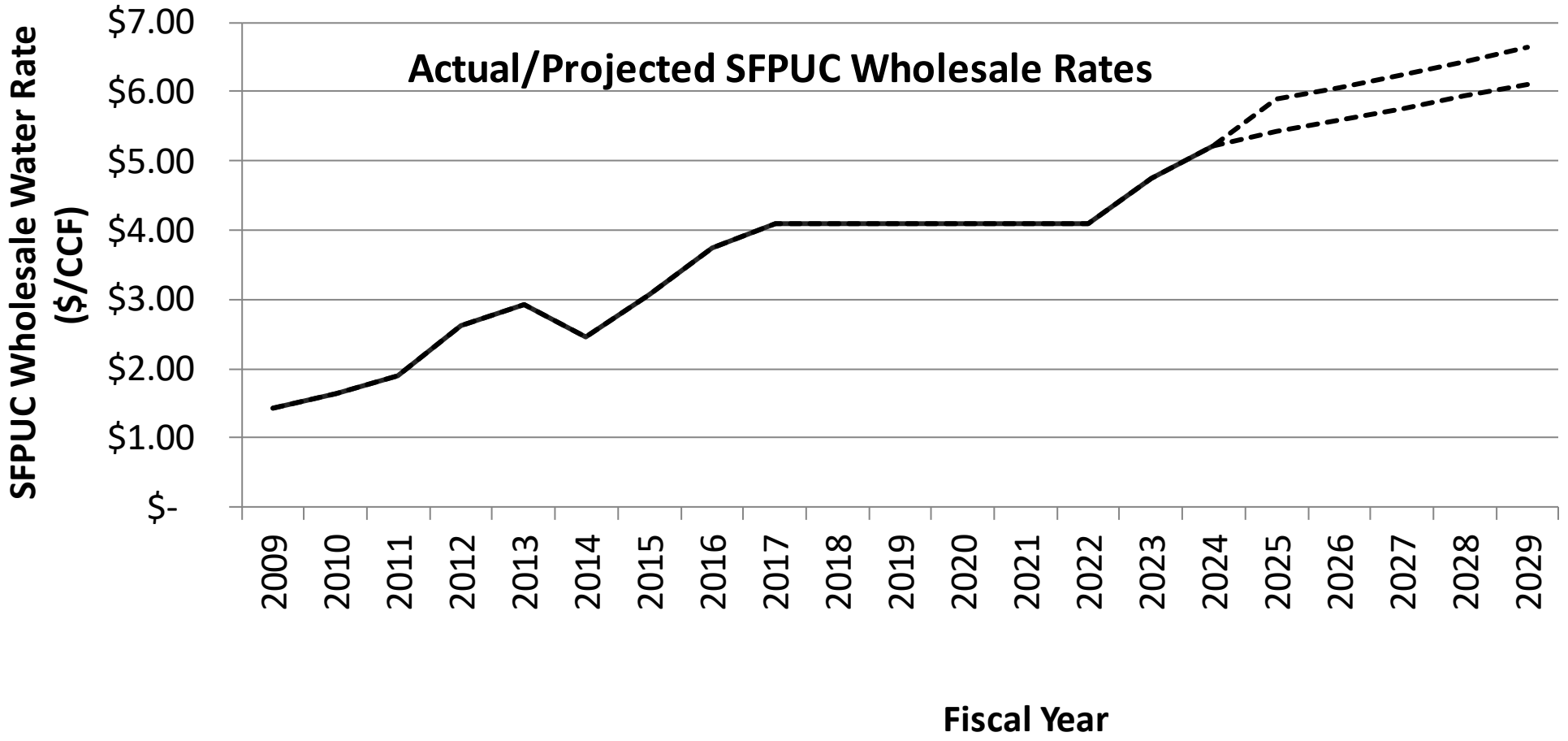


CITY OF PALO ALTO

WATER RESERVE PROJECTIONS



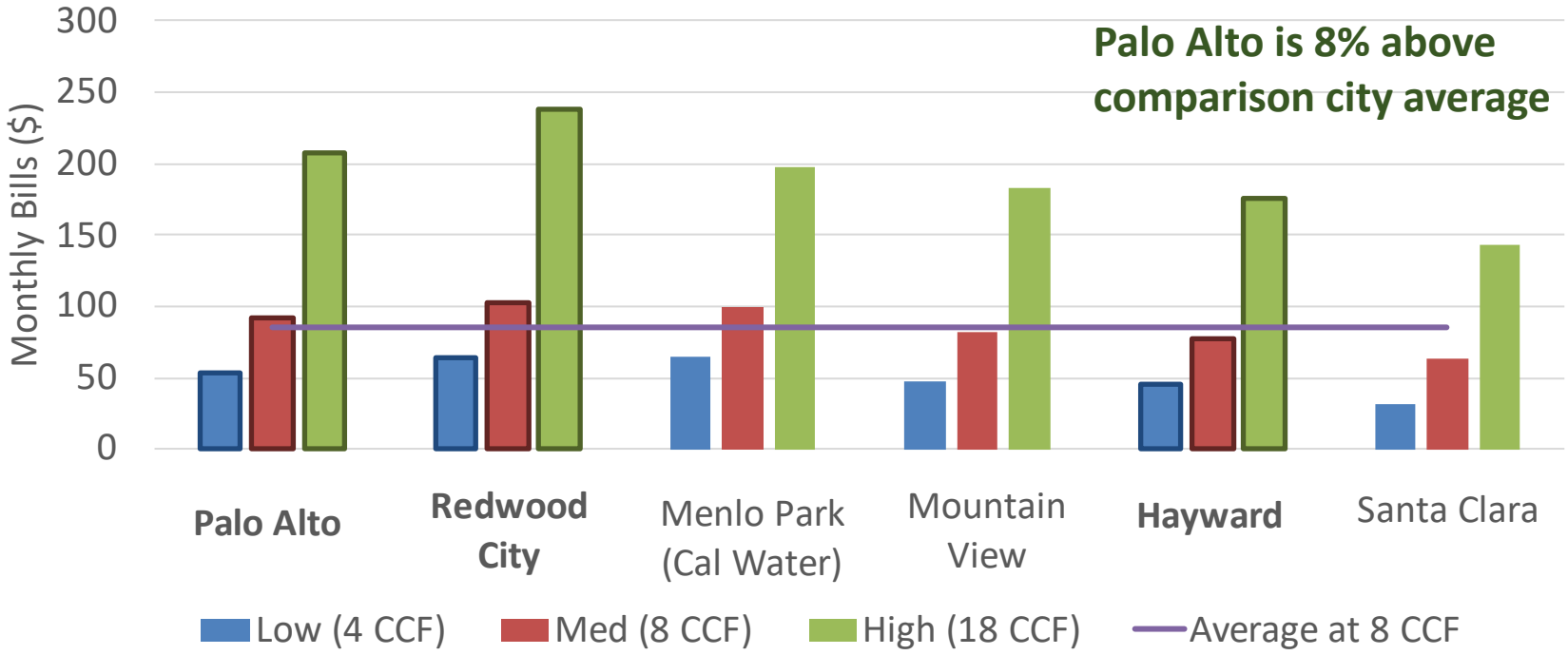
WATER SUPPLY RATES FORECAST



CITY OF PALO ALTO

MONTHLY WATER BILL COMPARISON

Single-Family Residential

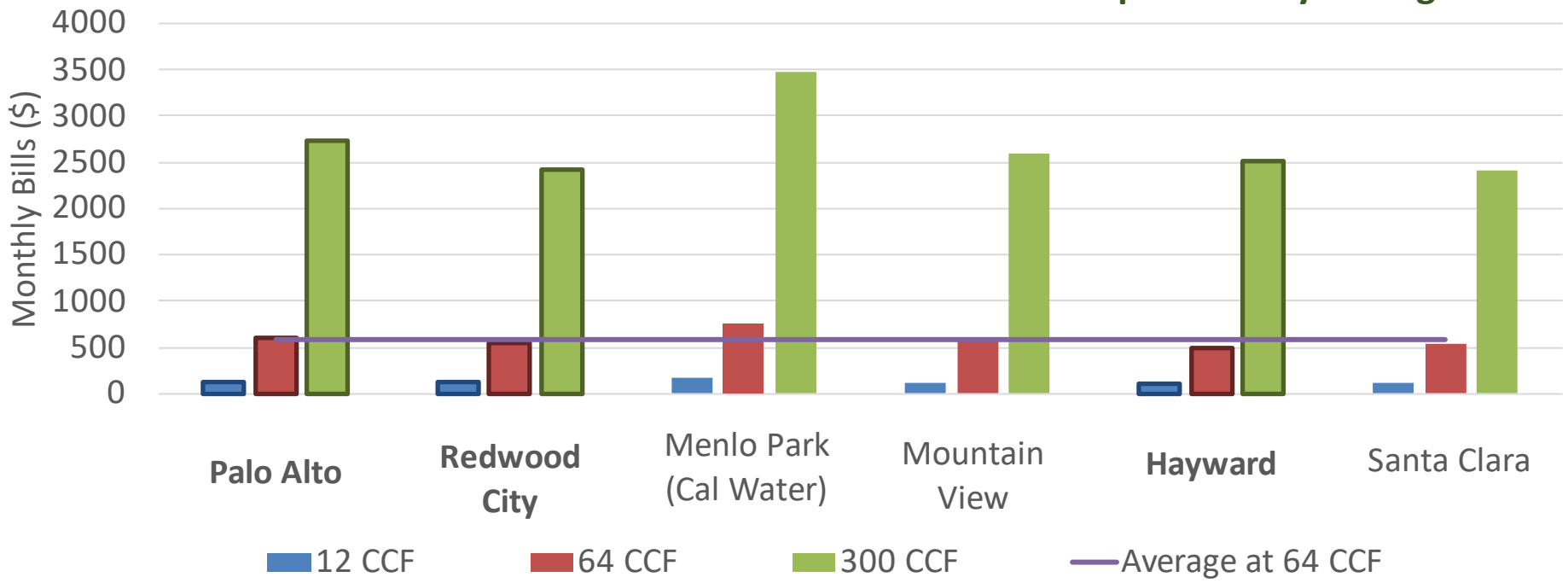


Bold indicates 100% of Water Supply from SFPUC

MONTHLY WATER BILL COMPARISON

Commercial

Palo Alto is 2% above comparison city average



Bold indicates 100% of Water Supply from SFPUC

CITY OF PALO ALTO

WASTEWATER COLLECTION

Wastewater Alternatives

- Staff Recommendation: 15% rate increase in FY 25, $7.29 per residential customer per month
  - Continue with planned sewer replacement with $1M in FY 25 and $2M in FY 26
  - $2M Pump station retrofit in FY 28
- Alternative: 9% rate increase in FY 25, $4.37 per residential customer per month
  - Defer FY 25 and FY 26 of planned sewer replacement
  - Defer pump station retrofit
- Both alternatives resume 2.5 miles per year of sewer main replacement in FY 28

Alternative Rate Projections:

Fiscal Year	2024	2025	2026	2027	2028	2029
Staff Recommendation	9%	15%	9%	9%	8%	7%
Alternative	9%	9%	9%	9%	9%	9%
FY 2024 Financial Plan	9%	9%	9%	8%	5%	5%

Wastewater Alternatives & Residential Bill Impacts

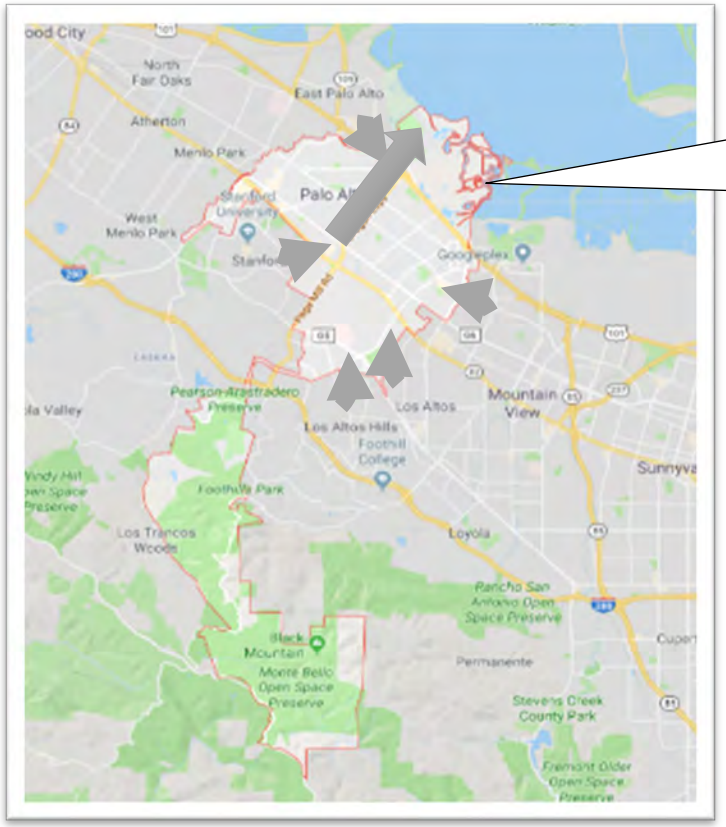
	FY 2025 – FY 2026 Main Replacement [a]		FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	Age of Last Remaining Sewer Main Replaced
	Budget	Length (miles)						
Proposal: 15% in FY 2025	$3M	~ 1.25	15% ***$7.29***	9% ***$5.03***	9% ***$5.48***	8% ***$5.31***	7% ***$5.02***	110 years
Alternative: 9% in FY 2025	$0	0	9% ***$4.37***	9% ***$4.77***	9% ***$5.20***	9% ***$5.66***	9% ***$6.17***	111 years

a) The estimated budget for a 5-mile sewer main replacement in FY 2025 – FY 2026 is $11.6 million.

Wastewater Projections

- FY 2023 Year End Ops Reserve below minimum guideline and below zero ($0.7M) due to
  - $3M – higher CIP-related (including admin costs)
  - $0.5M – revenue lower than forecasted
  - $0.3M – higher transfers out to capital projects
- Sanitary Sewer Replacement 31 moved up a year from FY 2024 to FY 2023 due to coordination with CalTrans; $9.3M in the reappropriations reserve for this project
- Current year revenue projected to be $0.7M below projection due to non-residential revenue declines as a result of wet weather and reductions in winter water usage
- Defer construction in FY 25 and FY 26 of planned sewer replacement and pump station retrofit;
- Reductions are temporary as the fund increases revenues to sustainable level

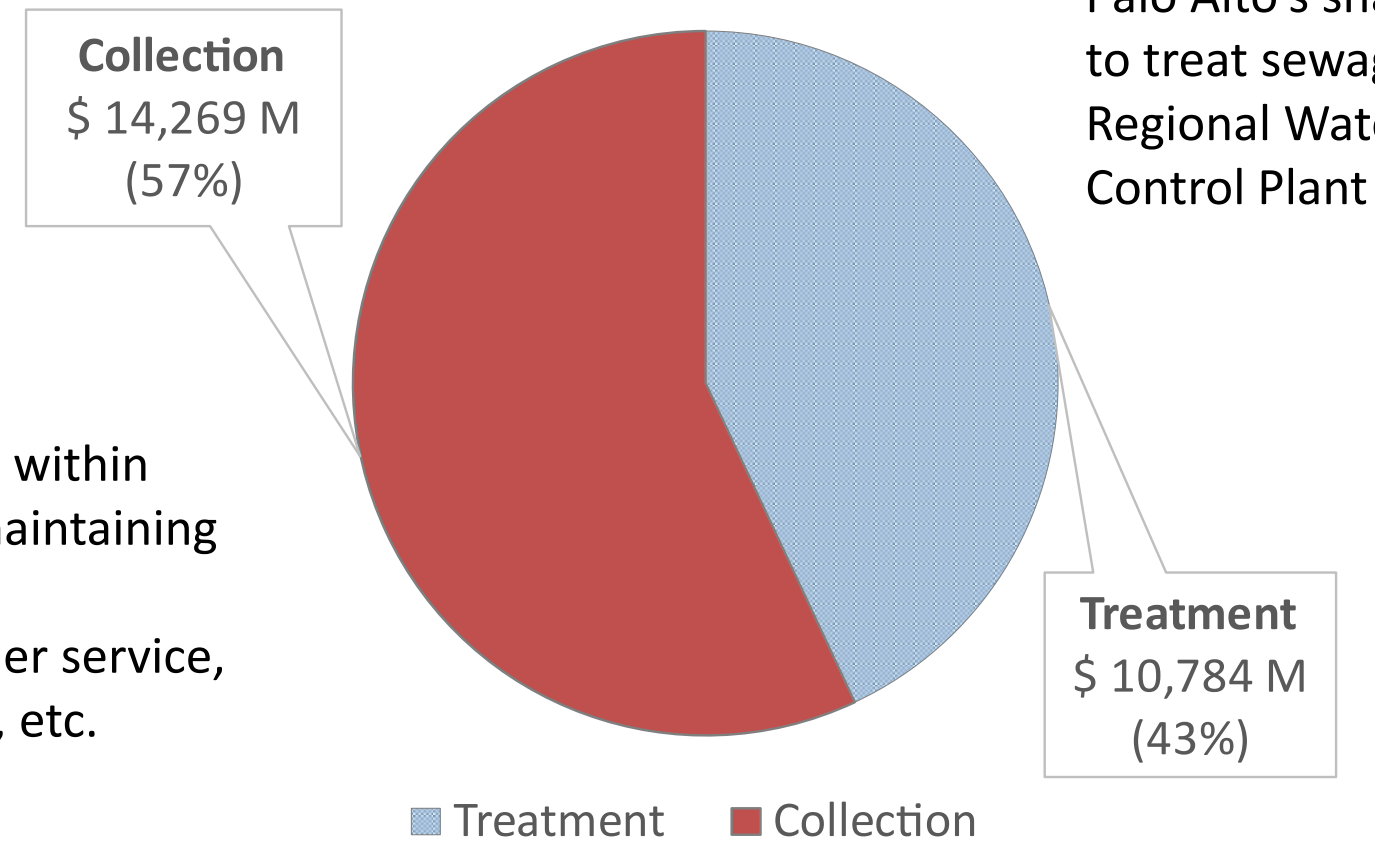
Wastewater Utility Basics



- Treatment Plant has five partners: Stanford, East Palo Alto, Los Altos Hills, Los Altos, and Mountain View
- Wastewater drains from partner systems through the City of Palo Alto Collection System, and into the City of Palo Alto Regional Water Quality Control Plant (RWQCP) for treatment
- City of Palo Alto Utilities Department manages collection system, Public Works manages the RWQCP

CITY OF PALO ALTO

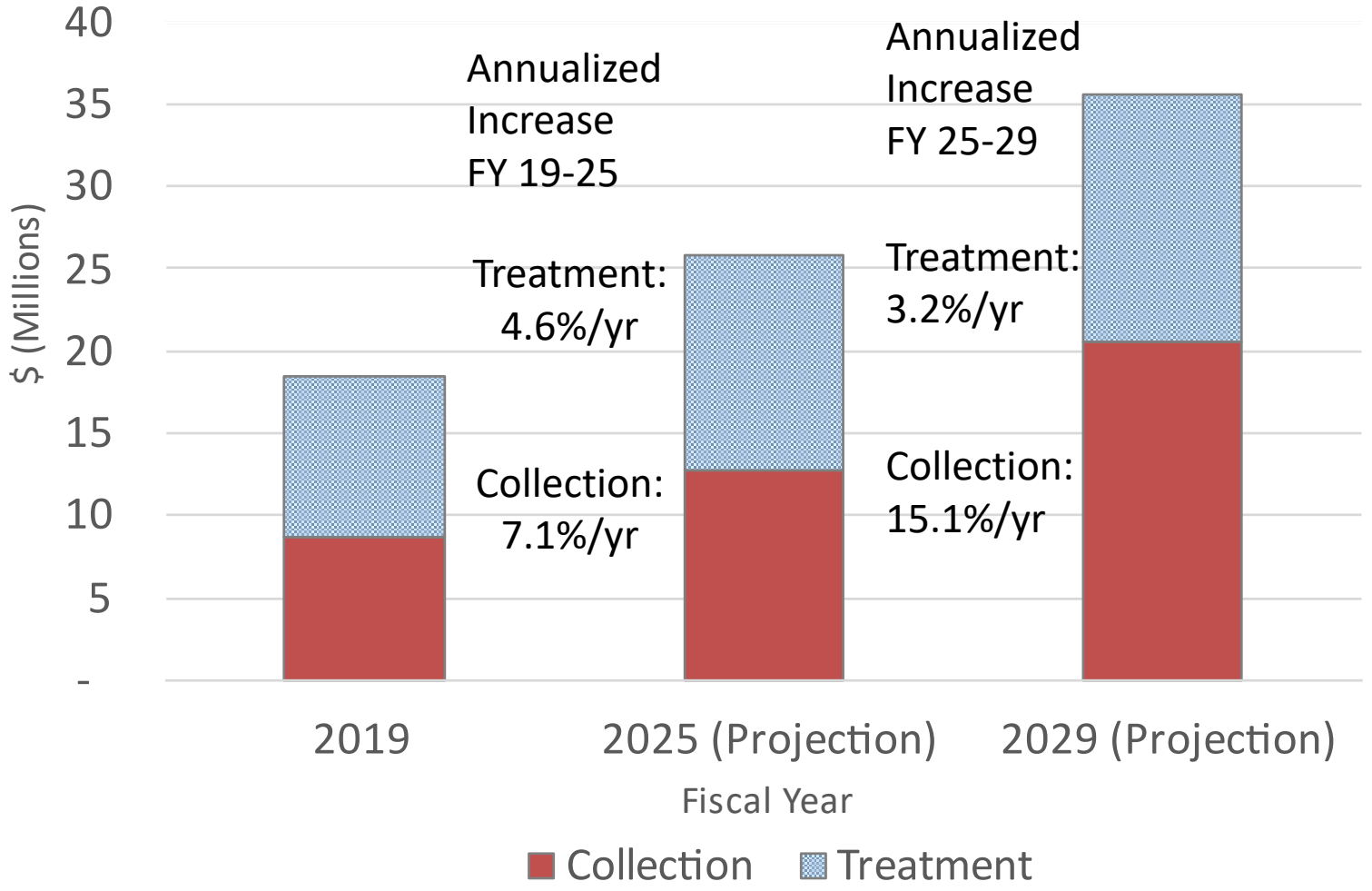
Wastewater Utility Cost Structure



Palo Alto's share of the cost to treat sewage at Palo Alto's Regional Water Quality Control Plant

Cost to collect sewage within Palo Alto, including: maintaining and replacing sewer infrastructure, customer service, billing, administration, etc.

Long Term Cost Trends



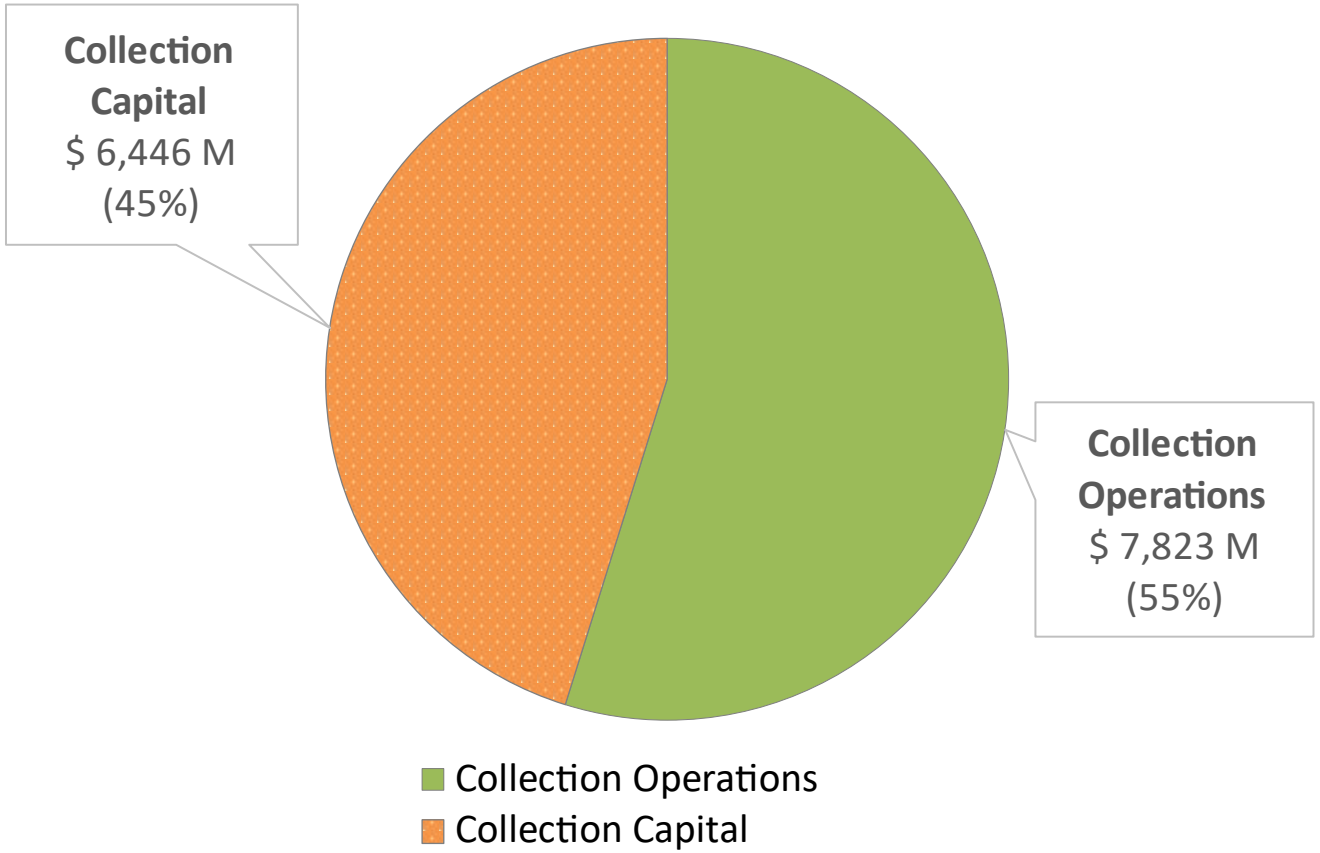
Note: Collection Capital reflects Two-Year Average

CITY OF PALO ALTO

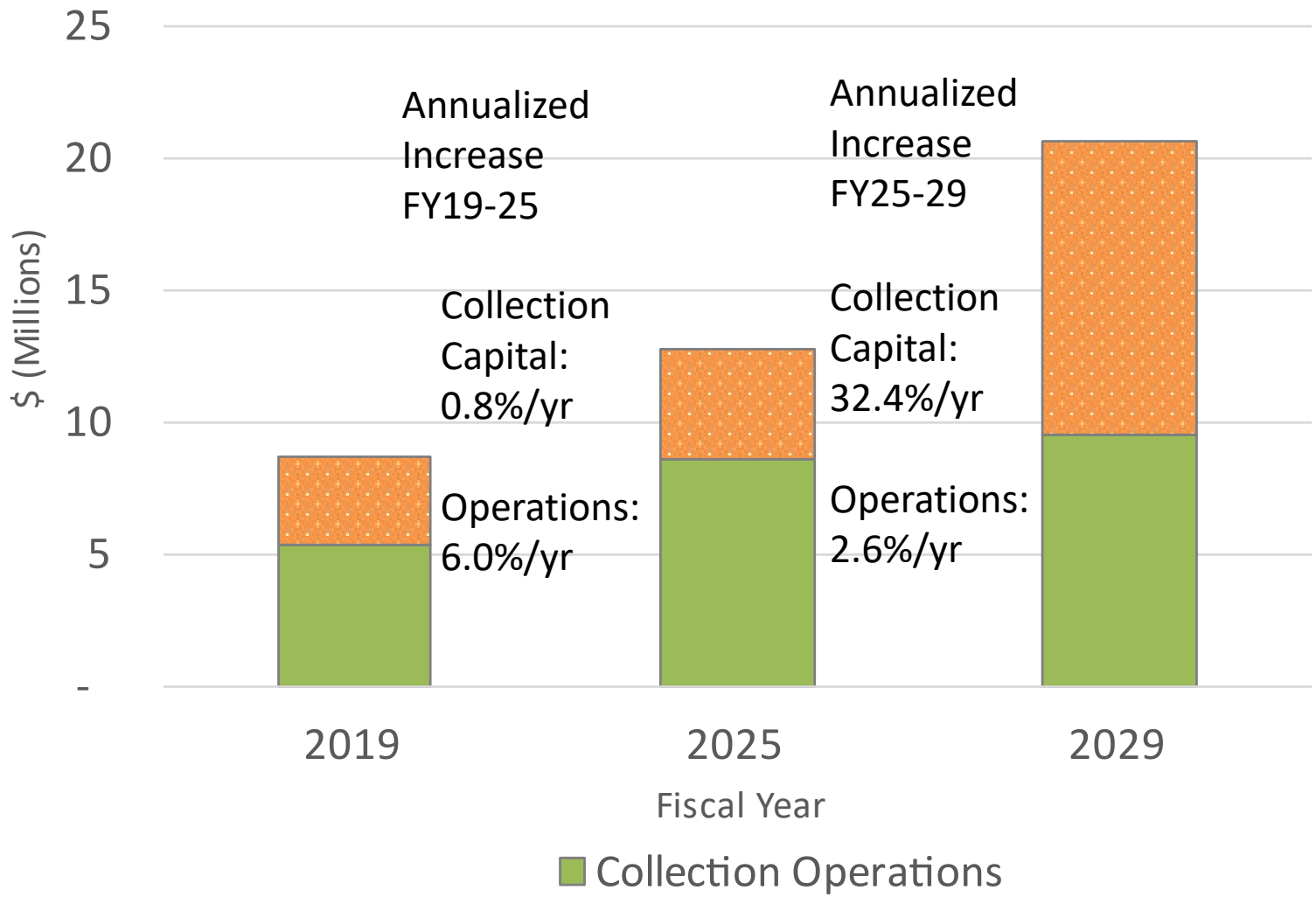
Treatment Cost Drivers

- Regional Water Quality Control Plant needs rehabilitation
- Long Range Facilities Plan completed in 2012, currently being updated including partner cost-share re-evaluation
- Near Term Major Projects:
  - Sedimentation Tank ($19.4M)
  - Outfall Pipeline ($17.8M)
  - Laboratory/Operations Center ($48.5M)
  - Secondary Treatment Upgrades ($193M)
- Applying for grant funding from Valley Water (estimated $11.2M available to Palo Alto from 2024 through 2033);
- Forecast assumes $7.4M available from FY 26 – FY 29

Wastewater Collection Costs



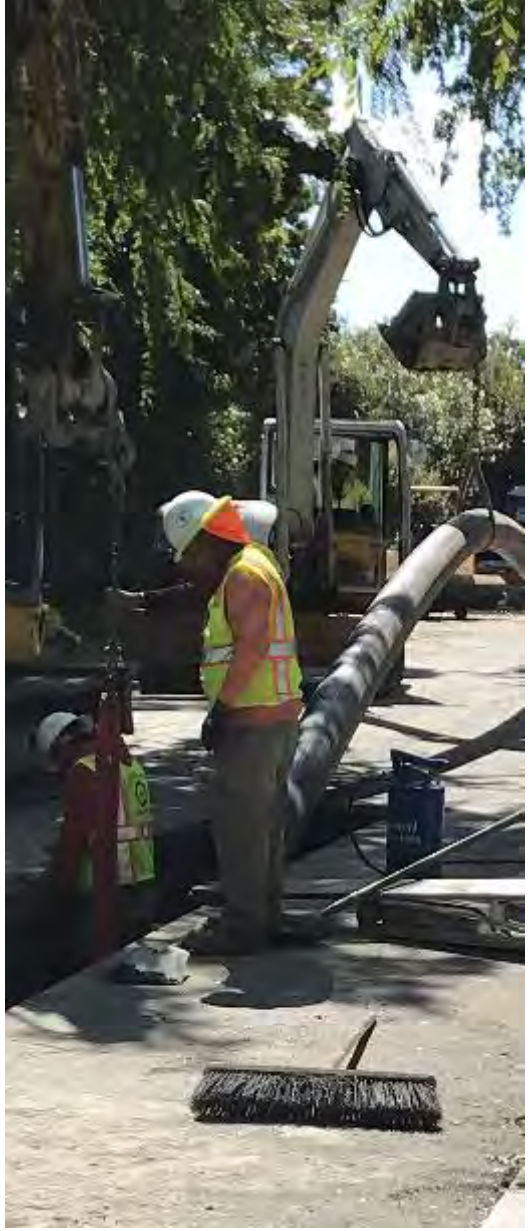
Wastewater Collection Cost Trends



Reflects Reduced-Size Sewer Replacement in FY 2025 and FY 2026

Note: Capital & Debt Service reflects two-year average

CITY OF PALO ALTO



OPERATIONS/CAPITAL COST DRIVERS

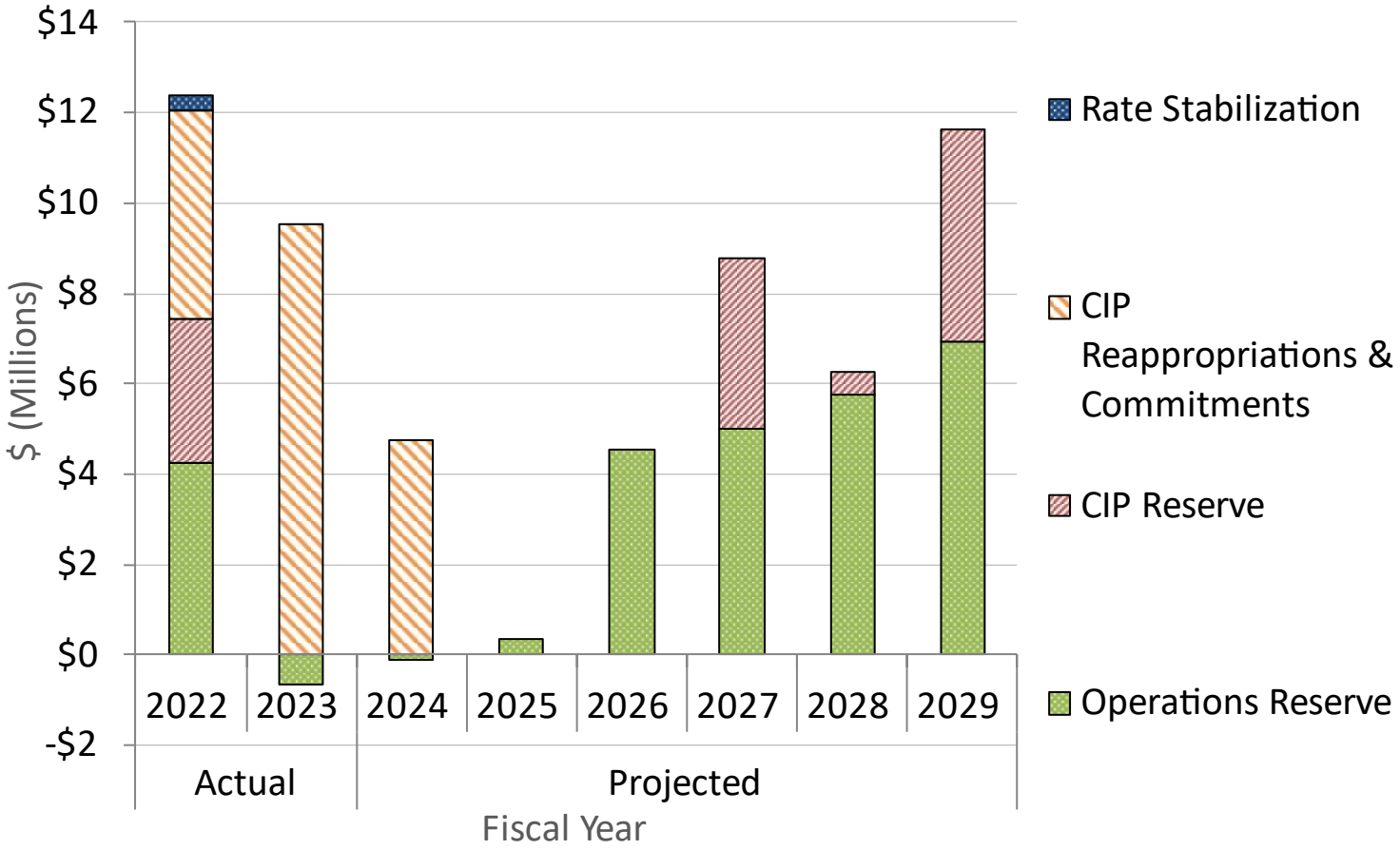
Operational Costs

- Salary and benefit costs for existing staff
- 3-4% annual inflation for other operating costs
- Revenue reduction expected in current year $700K, estimated recovery by FY 2027
- Lower connection, capacity fees and interest income

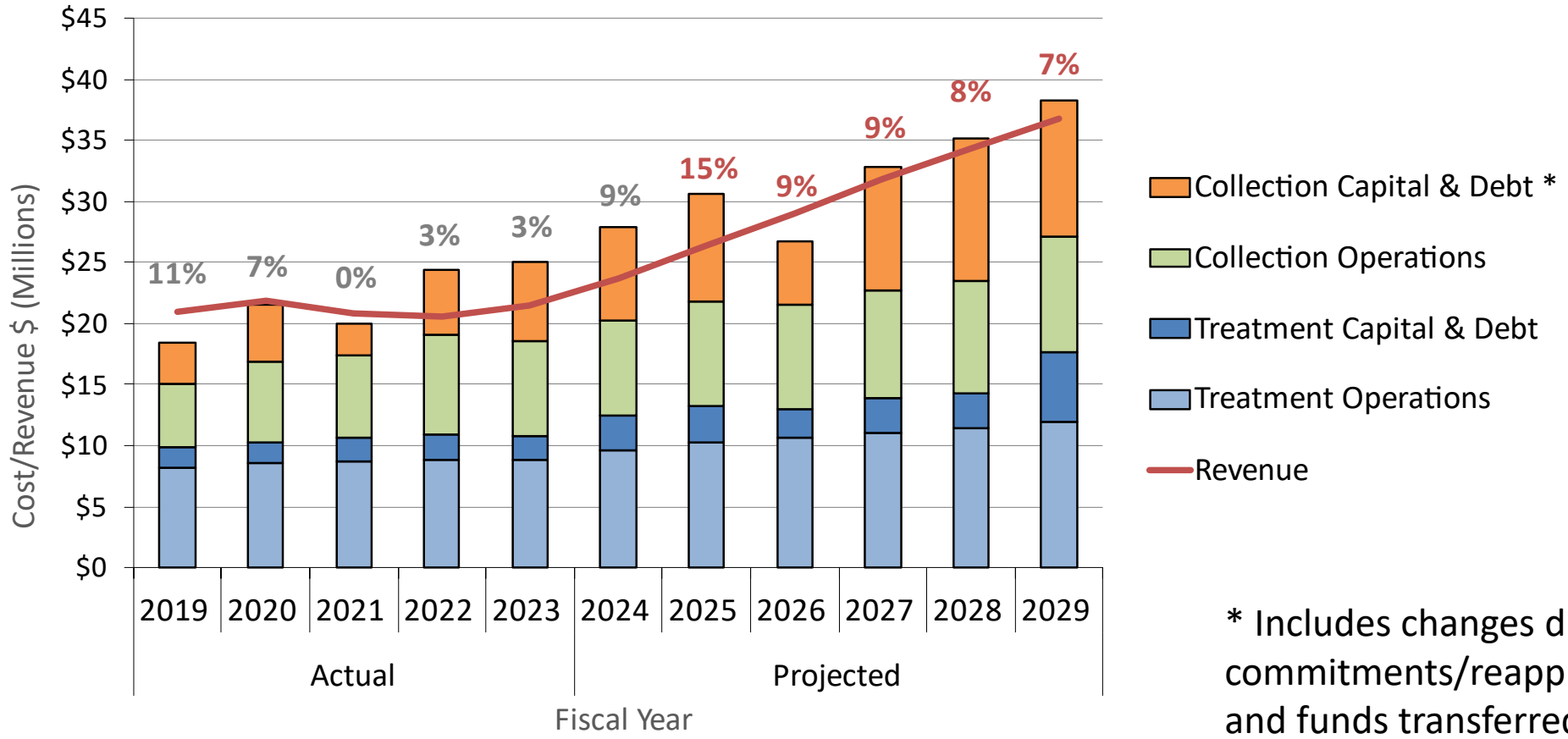
Capital Costs

- Underground construction cost increases
- Allocated cost increases
- Sanitary Sewer Replacements at the rate of 2.5 miles per year after fund recovers

Wastewater Reserve Projections



Preliminary Wastewater Cost and Revenue Projections



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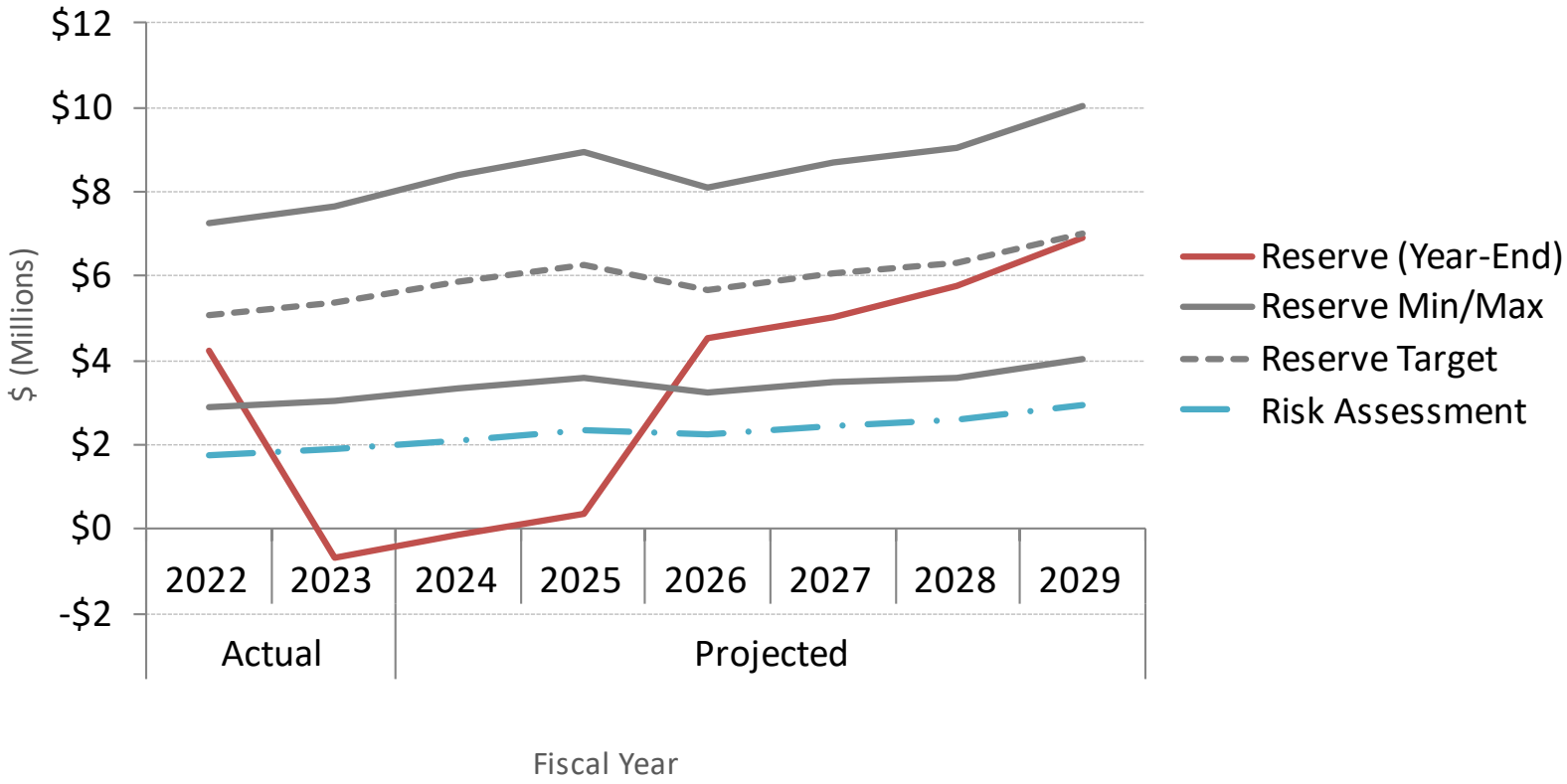
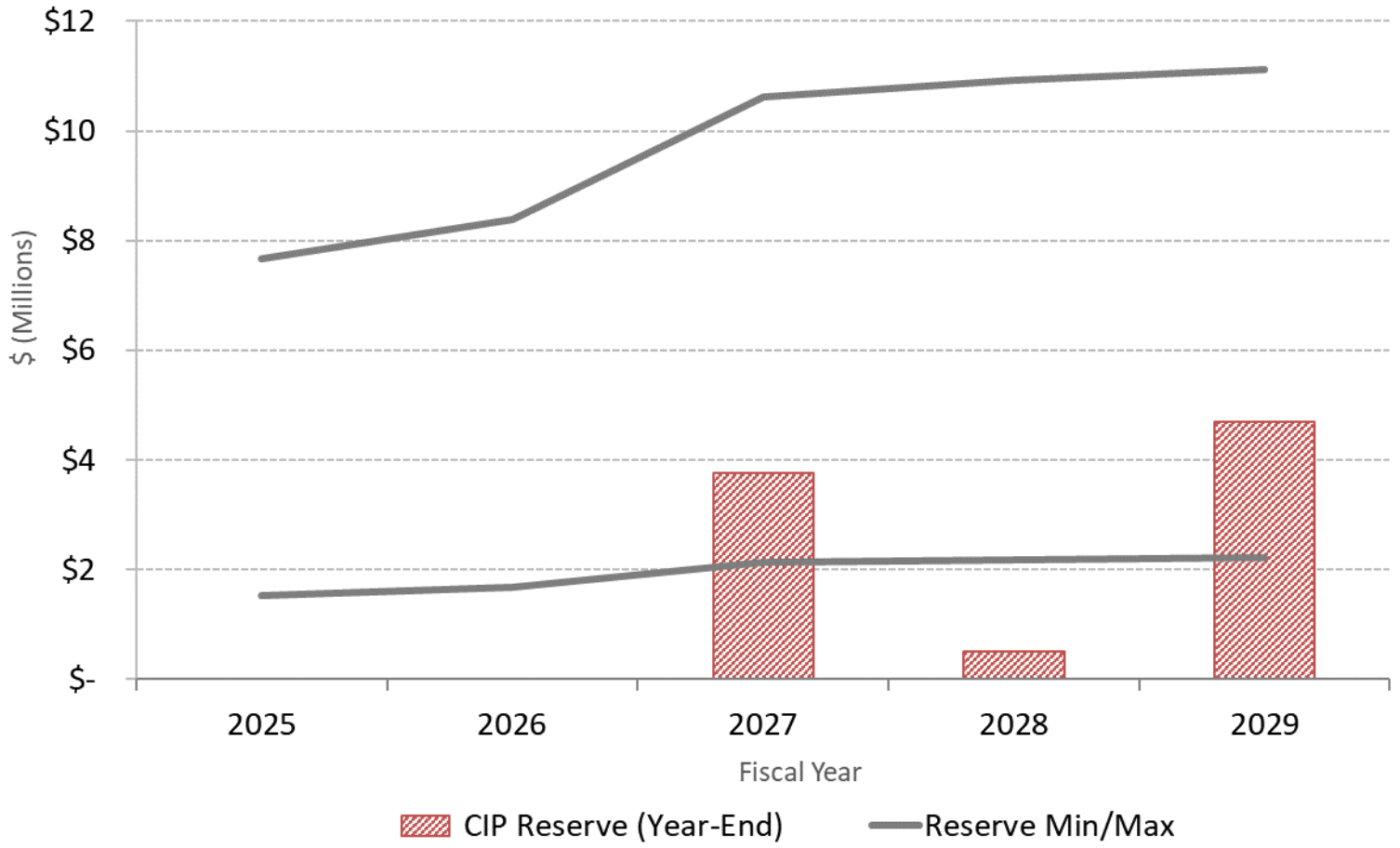
CITY OF PALO ALTO

Wastewater Operations Reserve Projections



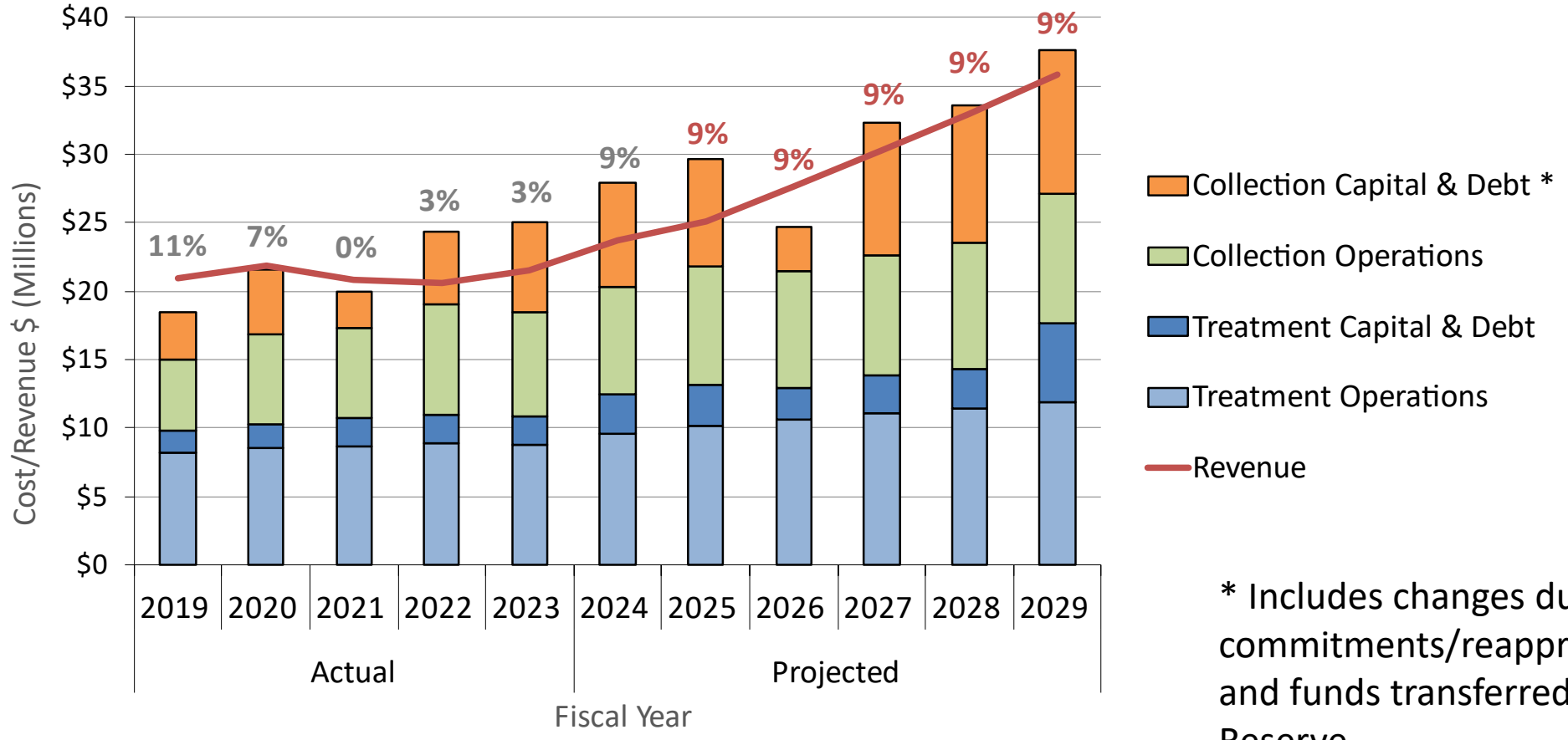
Wastewater CIP Reserve Projections



CITY OF PALO ALTO

ALTERNATIVE Preliminary Wastewater Projections

9% in FY25

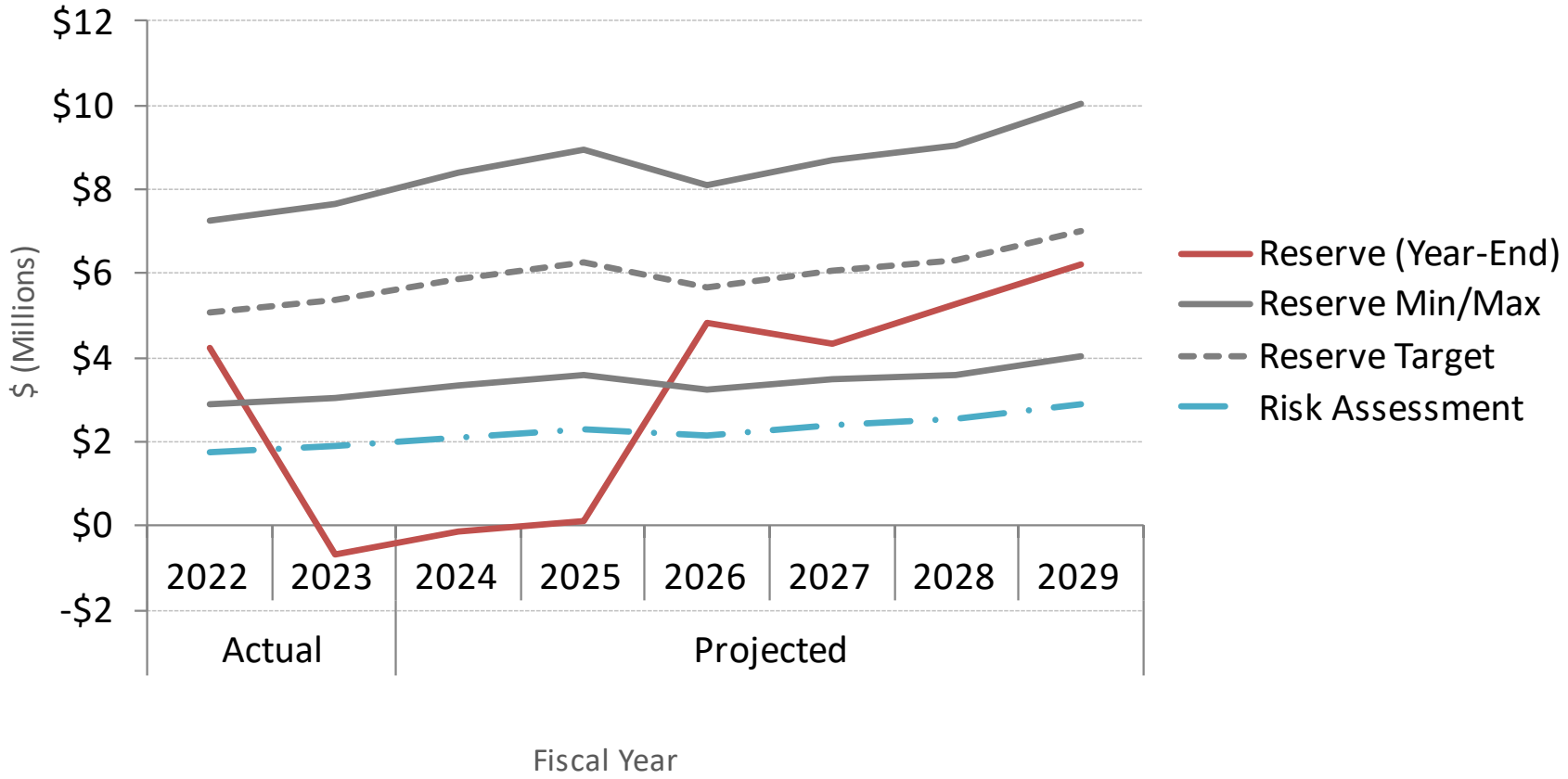


* Includes changes due to commitments/reappropriations and funds transferred to the CIP Reserve

CITY OF PALO ALTO

ALTERNATIVE: Wastewater Operations Reserve Projection

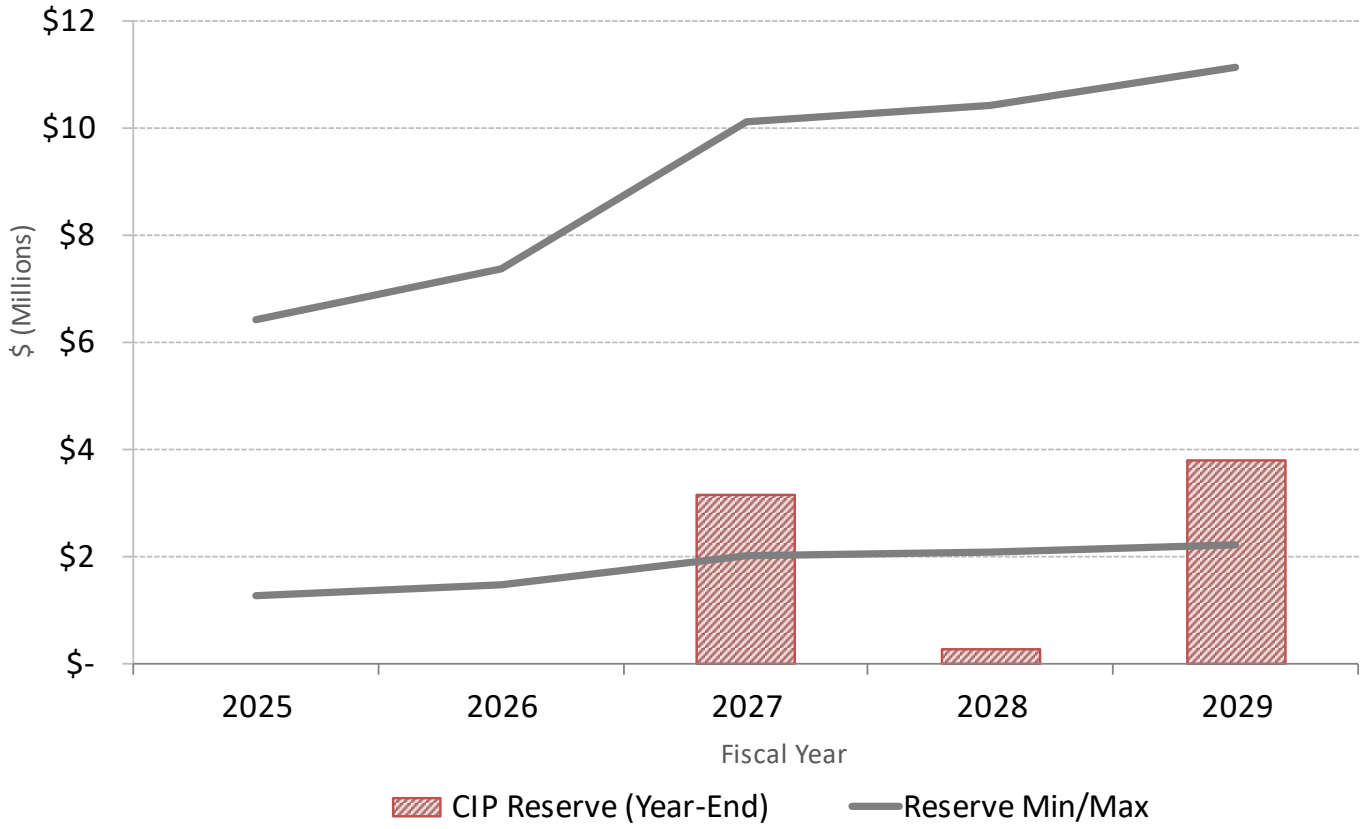
9% in FY25



CITY OF PALO ALTO

ALTERNATIVE: Wastewater CIP Reserve Projection

9% in FY25



CITY OF PALO ALTO

WASTEWATER MONTHLY RESIDENTIAL BILL ($) NOVEMBER 2023

Palo Alto is 26% below comparison city average

	Neighboring	Neighboring Communities					
Palo Alto	Community Average	Menlo Park	Redwood City	Santa Clara	Mountain View	Los Altos	Hayward
48.64	65.38	108.83	89.28	48.28	53.10	51.47	41.29

CITY OF PALO ALTO

WASTEWATER MONTHLY NON-RESIDENTIAL BILL ($) NOVEMBER 2023

Commercial: Palo Alto is 9% higher than comparison city average
Restaurant: Palo Alto is 7% below comparison city average

	Palo Alto	Neighboring Community Average	Neighboring Communities					
			Menlo Park	Redwood City	Santa Clara	Mountain View	Los Altos	Hayward
General Commercial	127.12	116.17	147.28	117.74	82.18	166.18	89.54	94.08
Restaurant	514.90	553.44	842.08	765.70	520.60	517.18	243.02	432.06

Summary of Proposal and Alternative Residential Bill Impacts

	Alternatives	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Estimated Bill Impact for Residential Customers ($/mo.) and Rate Increase Percentage (1)	Proposal: 15% in FY 2025	*7.29*	*5.03*	*5.48*	*5.31*	*5.02*
		15%	*9%*	*9%*	*8%*	*7%*
	Alternative: 9% in FY 2025	*4.37*	*4.77*	*5.20*	*5.66*	*6.17*
		9%	*9%*	*9%*	*9%*	*9%*
Estimated Monthly Sewer Bill ($)	Proposal: 15% in FY 2025	*55.93*	*60.96*	*66.44*	*71.75*	*76.77*
	Alternative: 9% in FY 2025	*53.01*	*57.78*	*62.98*	*68.64*	*74.81*
Net Difference in Monthly Bills ($)	15% vs. 9% in FY 2025	*2.92*	*3.18*	*3.46*	*3.11*	*1.96*

(1) estimated impact on residential wastewater monthly bill, which is currently $48.64.