CITY OF PALO ALTO

Finance Committee Staff Report

From: City Manager
Report Type: ACTION ITEMS
Lead Department: Utilities

Meeting Date: April 23, 2024
Staff Report: 2402-2605

TITLE
Finance Committee to Review and Recommend to the City Council to Adopt a Resolution Approving the Fiscal Year 2025 Gas Utility Financial Plan, Including the General Fund Transfer, and 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) as Recommended by the Utilities Advisory Commission

RECOMMENDATION
Staff recommends the Finance Committee review the Utilities Advisory Commission (UAC) recommendation and recommend that the City Council adopt a resolution (Attachment A):

1. Approving the fiscal year (FY) 2025 Gas Utility Financial Plan (Attachment A, Exhibit 1), which includes amending the Gas Utility Reserve Management Practices (Attachment A, Exhibit 2); and
2. Amending Rate Schedules;
    a. G-1 Residential Gas Service,
    b. G-2 Residential Master-Metered and Commercial Gas Service,
    c. G-3 Large Commercial Gas Service, and
    d. G-10 Compressed Natural Gas Service) (Attachment A, Exhibit 3; and
3. Transferring up to 11.9% of gas utility gross revenues received during FY 2023 to the General Fund in FY 2025.

EXECUTIVE SUMMARY
The FY 2025 Gas Utility Financial Plan (Exhibit 1 to the Resolution) includes projections of the utility's costs and revenues for FY 2024 through FY 2029.

An increase the distribution component of the gas rates by 15% is recommended in FY 2025 to bring revenue up to a level closer to recovering the costs of operations and prevent further depletion of reserves. This distribution rate increase is projected to increase overall customer bills by about 9% in FY 2025 if gas supply-related costs remain unchanged. In FY 2021 and FY 2022, the Gas Utility maintained minimal rate increases, leading to revenues struggling to match the rising expenses, resulting in a significant depletion of reserves. Although revenues exceeded costs in FY 2023, some costs associated with FY 2023 were paid in FY 2024. Specifically, carbon offset purchases from FY 2023 were made in FY 2024, and the transfer of prior years' Cap and Trade auction sales revenue from the Operations Reserve to the Cap and Trade reserve, which is a cost item, also occurred in FY 2024. Additionally, FY 2024 costs reflect the Council's adopted revised natural gas purchasing strategy for the 2023 – 2024 winter months to include commodity price insurance against very high market prices. A longer-term strategy for mitigating against potential future gas price spikes will be presented to Council for consideration prior to next winter. Consequently, the Operations Reserve is projected to drop below the risk assessment level by the end of FY 2024. Overall distribution costs are expected to increase by 4% from FY 2024 to FY 2025 and by 6% on average annually from FY 2025 through FY 2029. This distribution cost increase is due to projected increases in operations costs as well as capital costs related to the safety and maintenance of gas pipelines in Palo Alto as well as preparation for electrification-related costs. In addition, increased costs from prior years reduced reserve levels and rates need to be increased to bring reserves gradually back to within guideline ranges.

As part of the annual budget process, Council also determines the amount of the General Fund transfer for the Gas Utility in FY 2025. Each year the City Council may transfer from the gas utility to the General Fund an amount up to 18% of the gross revenues of the gas utility, though Council may choose to transfer a lesser amount. An 11.9%, or $8.9 million transfer for FY 2025, which is within the voter-approved changes codified in PAMC 2.28.185. A continuation of a gradual annual transfer increase to up to 18% of gross revenues by FY 2027 is also recommended. Alternatively, in alignment with Measure L, Council may choose to transfer up to 18% of gas utility gross revenues, or $13,552,380 for FY 2025. The two alternatives and their associated rate increases are shown in the section below titled "Alternative Gas Increase Plans."

BACKGROUND

Every year staff presents the UAC 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 and Canada. The City 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 are 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[1]) 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.

ANALYSIS

An annual assessment of the financial position of the City's Gas Utility is completed to ensure adequate revenue to fund operations, including reserves, 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:

The FY 2025 Gas Utility Financial Plan includes the following proposed actions:

1. Approve the FY 2025 Gas Utility Financial Plan (Attachment A, Exhibit 1), which includes amending the Gas Utility Reserve Management Practices (Attachment A, Exhibit 2); and
2. Increase distribution rates by 15% (for an estimated 9% increase to total rates in FY 2025); and
3. Transfer up to 11.9% of gas utility gross revenues received during FY 2023 to the General Fund in FY 2025.

These proposed actions are described in more detail below and in the FY 2025 Gas Financial Plan (Attachment A, Exhibit 1).

Overview of Cost and Rate Projections and Drivers

Gas Utility costs include supply-related costs, collected through a supply (or commodity) rate that varies monthly based upon market prices, and distribution-related costs, collected through a distribution rate adjusted annually.

Supply costs include the commodity cost of the natural gas itself, gas transmission, and gas environmental charges. Although it is not possible to accurately forecast commodity rates, staff monitors market prices monthly and automatically incorporates market prices into monthly supply rate adjustments, which are passed directly to customers as a line item on their utility bills. Commodity prices are projected to decline in FY 2025 compared with FY 2024 and projects overall supply costs to increase on average about 2% per year from FY 2025 through FY 2029. Supply costs in FY 2024 reflect FY 2023 carbon offset purchases that were paid in FY 2024, the cost for the capped-price winter natural gas purchasing strategy, and zero costs reflected for the

[1] 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.

transfer of Cap and Trade allowance revenues received in FY 2023 from the Operations Reserve to the Cap and Trade Reserve; this transfer is reflected in FY 2024 expenses.

Table 1 shows actual supply costs in FY 2023 and projections in FY 2024 through FY 2029. Weather, transmission, storage, and/or economic forces can shift this course rapidly.

Table 1: Gas Sales, Supply Costs, and Transfers from Operations Reserve to Cap and Trade Reserve

	Actual	Projected					
	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Sales (K Therms)	**28,582**	**24,230**	**27,351**	**27,189**	**27,129**	**27,030**	**26,857**
Market-Based Commodity	$ 38,713	$ 16,449	$ 15,557	$ 15,309	$ 14,891	$ 14,407	$ 13,934
Transportation	$ 4,144	$ 4,483	$ 4,112	$ 4,331	$ 4,514	$ 4,632	$ 4,741
Carbon Offset	$ 871	$ 1,222	$ 2,175	$ 2,270	$ 2,481	$ 2,723	$ 3,133
Cap-and-Trade Compliance Costs	$ 2,198	$ 3,759	$ 4,422	$ 4,985	$ 5,559	$ 6,148	$ 6,740
Sub-Total Supply Costs Without Deferred Items	**$ 45,926**	**$ 25,911**	**$ 26,265**	**$ 26,896**	**$ 27,445**	**$ 27,911**	**$ 28,547**
Transfer from Operations Reserve to Cap and Trade Reserv	**$ -**	**$ 3,074**	**$ 3,327**	**$ 3,612**	**$ 3,866**	**$ 4,109**	**$ 4,340**
Deferred Items from FY 2023 to FY 2024							
Carbon Offset	$ -	$ 1,483	$ -	$ -	$ -	$ -	$ -
Transfer from Operations Reserve to Cap and Trade Reserve	$ -	$ 3,622	$ -	$ -	$ -	$ -	$ -
Sub-total FY 2023 costs reflected in FY 2024	**$ -**	**$ 5,106**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**
Total	**$ 45,926**	**$ 34,091**	**$ 29,592**	**$ 30,508**	**$ 31,311**	**$ 32,020**	**$ 32,887**

Gas commodity prices are anticipated to decrease by around 2% on average from FY 2024 to FY 2025. The mild weather experienced in FY 2024 is contributing to lower gas usage, with expectations of a return to higher levels in FY 2025, aligning with long-term projections. Gas usage is expected to resume a downward trend of 0.5% annually from FY 2025 to FY 2029. FY 2025 total gas supply costs are forecasted to be about 1% higher than FY 2024 total supply costs without deferred items ("Sub-Total Supply Costs Without Deferred Items" row in Table 1). Including deferred items, and transfers from the Operations Reserve to the Cap and Trade Reserve, total supply costs are projected to decrease 13% from FY 2024 to FY 2025 and then increase annually by 3% on average from FY 2025 through FY 2029 ("Total" row in Table 1).

Table 2 shows total gas utility costs. The operations and capital costs are considered distribution costs. Distribution costs include the costs of running the business and operating the distribution system. The attached Financial Plan projects distribution costs to increase 6% on average from FY 2025 through FY 2029.

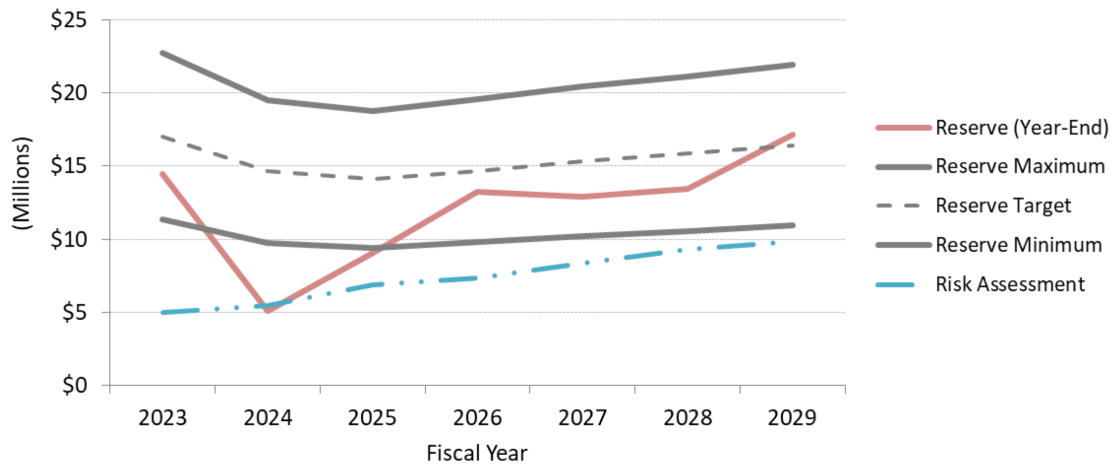
Table 2 Gas Utility Costs for FY 2023 to FY 2029 ($,000)

Expenses ($000)	Actual	Projected					
	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Supply Costs	**45,926**	**27,395**	**26,265**	**26,896**	**27,445**	**27,911**	**28,547**
Commodity	38,713	16,449	15,557	15,309	14,891	14,407	13,934
Transportation	4,144	4,483	4,112	4,331	4,514	4,632	4,741
Carbon Offset	871	2,705	2,175	2,270	2,481	2,723	3,133
Cap-and-Trade	2,198	3,759	4,422	4,985	5,559	6,148	6,740
Distribution Costs	**28,008**	**38,527**	**40,238**	**39,433**	**47,125**	**50,684**	**51,184**
Operations	25,176	30,629	30,867	32,598	34,816	36,331	38,083
Capital	2,832	7,897	9,371	6,836	12,310	14,353	13,100
TOTAL	**73,934**	**65,921**	**66,503**	**66,329**	**74,571**	**78,595**	**79,731**

The Gas Utility last increased distribution rates on July 1, 2023, which resulted in an estimated 8% increase in the total system average gas rate (the supply rate plus the distribution rate). The attached Financial Plan includes an increase in distribution rates effective July 1, 2024 that will result in about a 9% increase to the total system average gas rate and includes additional 7% increase in FY 2026 and in FY 2027 and 6% annually from FY 2028 through FY 2029.

The unprecedented and extreme gas prices experienced in FY 2023 had a significant impact on the Gas Utility's reserves. To bring the reserves back within guideline levels in FY 2025, double-digit increases in the gas distribution rate would be necessary. The rate increases in the attached Financial Plan partially replenish the gas utility’s reserves over the next several years. The FY 2025 Financial Plan proposes to allow the Operations Reserve to be below the risk assessment levels for FY 2024 and FY 2025 and return to within the guideline range by the end of FY 2026, one year earlier than last year's forecast. The Gas Utility Reserves Management Practices require returning reserves to within minimum guidelines (60 days of O&M and commodity expense) within one year unless an alternative plan is approved by Council. Figure 1 shows the actual year-end balance in the Operations Reserve for FY 2023 and projected year-end balances for FY 2024 through FY 2029.

Figure 1: Operations Reserve Projection



In addition to replenishing Gas Utility reserves, distribution rate increases are needed to pay for increasing operations costs and Capital Improvement Project (CIP) expenditures in the distribution system. Distribution system operations costs are increasing primarily due to inflationary increases across all cost categories including salary and benefit, administrative costs, and capital costs. This Financial Plan projects increases in capital and operational costs that align similarly with the City's Budget and Long-Range Financial Forecast and average approximately 6% per year over the next five years. The priority for the City's Gas Utility is operating the system safely, which requires the replacement of higher risk PVC and steel mains on a reasonable timeline. The cost of gas main replacement continues to rise. For this reason, failing to increase the gas main replacement program budget steady would result in a reduction of the rate of main replacement over time. This Financial Plan addresses these challenges in a way that will allow CPAU to meet its main replacement needs by increasing the main replacement budget beginning in FY 2025 and including a 5.4% annual construction inflationary increase thereafter. An application for grant funding for the upcoming main replacement project 25 through the Natural Gas Distribution Infrastructure Safety and Modernization grant opportunity is underway and expected to be applied for annually. In addition, the attached Financial Plan includes transfers of between $4 million to $7 million each year from FY 2026 to FY 2029 in order to bring the currently zero dollar CIP Reserve to within the guideline range gradually by the end of the forecast period.

In addition, with the ongoing discussions and direction from City Council related to electrification of homes and neighborhoods throughout the City and transitioning away from natural gas, the City may be able to retire some PVC and steel mains through aggressive electrification in neighborhoods with these types of mains. Staff is working to develop an efficient phasing plan for electrification and the scaling back of the gas infrastructure both operations and financial implications. Decommissioning and electrification costs, if needed, are included in CIP budgets. The CIP budgets include $4 million in gas decommissioning costs and an additional $3 million annually from FY 2027 through FY 2029 for electrification-related costs.

The City's natural gas rates are based on the 2019 Natural Gas Cost of Service and Rates Study, updated with current and proposed operating costs. In order to move towards full cost recovery and replenish gas reserves, while minimizing rate impacts, a distribution rate increase to all customer classes of 15% is recommended, estimated to result in an approximate 9% system average rate increase, if commodity rates remain unchanged from FY 2024.

Proposed Gas Rates

Proposed adjustments to gas rates are shown in Table 1 and Table 2 below, effective July 1, 2024. These changes are projected to increase distribution rates by 15% resulting in a total system average gas rate (total of supply and distribution) increasing by roughly 9% for all classes. These rate changes are included in the proposed amended rate schedules in (Exhibit 3 to the Resolution).

Table 1: Current and Proposed Monthly Service Charges

Rate Schedule	Current Rates (as of 7/1/23)	Proposed Rates (effective 7/1/24)	Change ($)	Change (%)
G-1 *(Residential)*	$ 14.01	$ 16.11	$ 2.10	15%
G-2 *(Small Commercial)*	129.78	149.24	19.46	15%
G-3 *(Large Commercial)*	593.79	682.85	89.06	15%
G-10 *(CNG)*	87.77	100.93	13.16	15%

Table 2: Current and Proposed Gas Distribution Charges

	Current Rates (as of 7/1/23)	Proposed Rates (effective 7/1/24)	Change ($)	Change (%)
G-1 *(Residential)*				
Tier 1 Rates	$ 0.6807	$ 0.7828	$ 0.1021	15%
Tier 2 Rates	1.7406	2.0016	0.2610	15%
G-2 *(Residential Master-Metered and Small Commercial)*				
Uniform Rate	0.8941	1.0282	0.1341	15%
G-3 *(Large Commercial)*				
Uniform Rate	0.8852	1.0179	0.1327	15%
G-10 *(CNG)*				
Uniform Rate	0.0145	0.0166	0.0021	14%*

*Adjusted downward due to rounding

Bill Impact of Proposed Rate Changes

Table 3 shows the impact of the proposed July 1, 2024 rate changes on the median residential bill. The average annual gas bill for the median residential customer is projected to be 9% higher in FY 2025 than FY 2024, excluding supply-related cost changes. However, since customer gas usage varies and the price of commodities changes monthly, the actual change may be different. Table 3 shows a representative winter period (November thru March) and summer period (April through October) bill comparison.

Table 3: Impact of Proposed Gas Rate Changes on Residential Bills

Usage (Therms/month)	Bill Amount (Current Rates)	Bill Amount (Proposed Rates)	Change	
			$/mo.	%
Summer				
10	$ 29.30	$ 32.42	$ 3.12	11%
18 (median)	41.54	45.47	3.94	9%
30	68.80	75.45	6.65	10%
45	105.65	116.14	10.49	10%
Winter				
30	$ 64.65	$ 69.81	$ 5.16	8%
54 (median)	105.15	112.77	7.62	7%
80	169.71	184.03	14.33	8%
150	362.05	395.88	33.82	9%

Table 4 shows the impact of the proposed July 1, 2024 rate changes on various representative commercial customer bills. The overall increases for the G-2 and G-3 classes are projected to be about 8-14% on an annual basis, excluding supply-related cost changes.

Table 4: Impact of Proposed Gas Rate Changes on Commercial Bills

Usage (Therms/month)	Bill under (Current Rates)	Bill under (Proposed Rates)	Change	
			$/mo	%
250	$ 167.60	$ 189.86	$ 22.26	13%
1,000	281.32	311.96	30.65	11%
3,200	613.69	668.91	55.22	9%
35,000	5,428.68	5,839.31	410.63	8%
250,000	38,145.93	41,001.25	2,855.32	7%

FY 2025 Financial Plan's Projected Rate Adjustments for the Next Five Fiscal Years

Table 5 shows the projected rate adjustments over the next five years and the impact of distribution rate increases on the median monthly residential gas bill (54 therms/month in winter, 18 therms/month in summer) of $70.05 in FY 2024, assuming commodity rates are static.

Table 5: Projected Distribution Rate Adjustments, FY 2025 to FY 2029

	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Gas Utility	9%	7%	7%	6%	6%
Estimated Bill Impact ($/mo)*	$6.30	$5.40	$5.70	$5.20	$5.60

<u>Reserve Balances</u>

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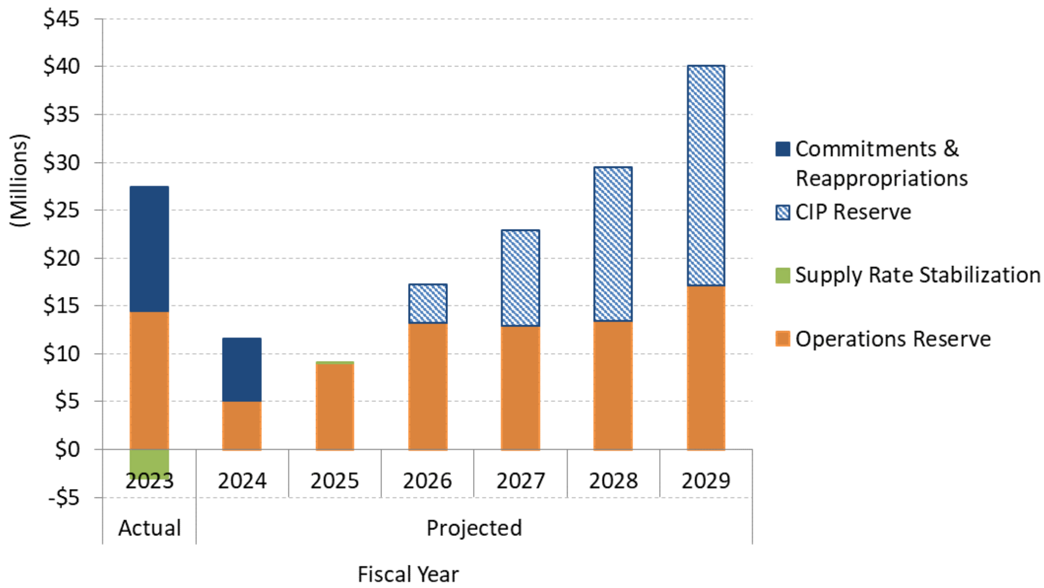
Table 6: Operations, Rate Stabilization and CIP Reserve Starting and Ending Balances, Revenues, Transfers To/(From) Reserves, Capital Program Contribution To/(From) Reserves, and Reserve Guideline Levels for FY 2024 to FY 2029 ($000)

	Fiscal Year	2024	2025	2026	2027	2028	2029
	Starting Reserve Balances						
1	Operations Reserve*	11,360	5,133	9,045	13,217	12,920	13,470
2	CIP Reserve	-	-	-	4,000	10,000	16,000
3	Cap and Trade	6,731	13,427	16,754	20,366	24,232	28,341
4	Debt Service Reserve	378	378	378	378	-	-
	Revenues						
5	Total Revenues	57,958	67,087	70,889	76,030	81,035	86,055
6	Cap and Trade	3,074	3,327	3,612	3,866	4,109	4,340
	Expenses						
7	Non-CIP Expenses	(52,665)	(53,806)	(55,881)	(58,396)	(60,133)	(62,290)
8	Planned CIP	(7,897)	(9,371)	(6,836)	(12,310)	(14,353)	(13,100)
	Transfers						
9	Operations Reserve*	(6,696)	(3,327)	(7,612)	(9,487)	(10,109)	(11,340)
10	CIP Reserve	-	-	4,000	6,000	6,000	7,000
11	Cap and Trade	6,696	3,327	3,612	3,866	4,109	4,340
12	Debt Service Reserve	-	-	-	(378)	-	-
	Ending Reserve Balances						
1+5+6+7+8+9	Operations Reserve*	5,133	9,045	13,217	12,920	13,470	17,135
2+10	CIP Reserve	-	-	4,000	10,000	16,000	23,000
3+11	Cap and Trade	13,427	16,754	20,366	24,232	28,341	32,681
4+12	Debt Service Reserve	378	378	378	-	-	-
	Operations Reserve Guidelines						
13	Minimum	9,758	9,392	9,780	10,235	10,560	10,953
14	Maximum	19,516	18,783	19,559	20,469	21,121	21,906
	CIP Reserve Guidelines						
15	Minimum	6,365	8,634	8,103	9,573	13,331	13,727
16	Maximum	12,729	17,268	16,206	19,145	26,663	27,453

**Operations Reserve represents the Gas Supply Fund Rate Stabilization Reserve and the Gas Distribution Fund Operations Reserve combined.*

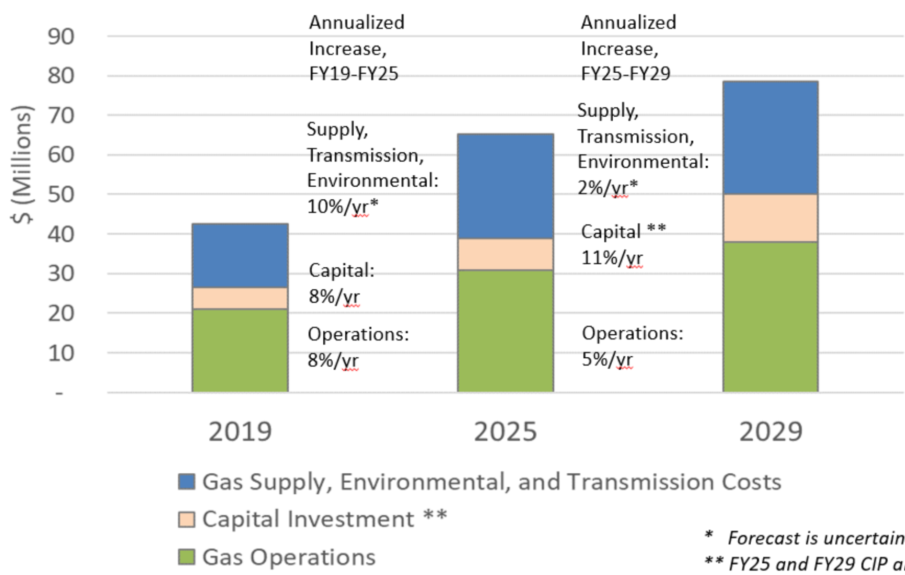
Figure 2: Actual Reserve Levels for FY 2023 and Projections through FY 2029



<u>Cost Trends</u>

Figure 3 below illustrates the projected long run changes in the Gas Utility's costs. Cost increases over the FY 2019 to FY 2029 time period are mainly from supply costs, followed by operations and capital expenses, including the electrification placeholders. Gas supply costs are projected to increase by 10% annually on average from FY 2019 through FY 2025 and 2% annually on average from FY 2025 through FY 2029. This includes projected declines in gas usage in Palo Alto of 0.5% annually from FY 2025 through FY 2029 and projected declines in commodity prices of 2.8% annually on average from FY 2025 through FY 2029.

Figure 3: 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.*

Despite the low increase from FY 2025 to FY 2029 in gas commodity cost estimates, there are several components of supply costs that are increasing more rapidly during that time period. Cap and Trade allowance costs are projected to increase by 11% annually on average. Transmission costs are projected to increase by 4% annually. Carbon offset costs are projected to increase by 10% annually.

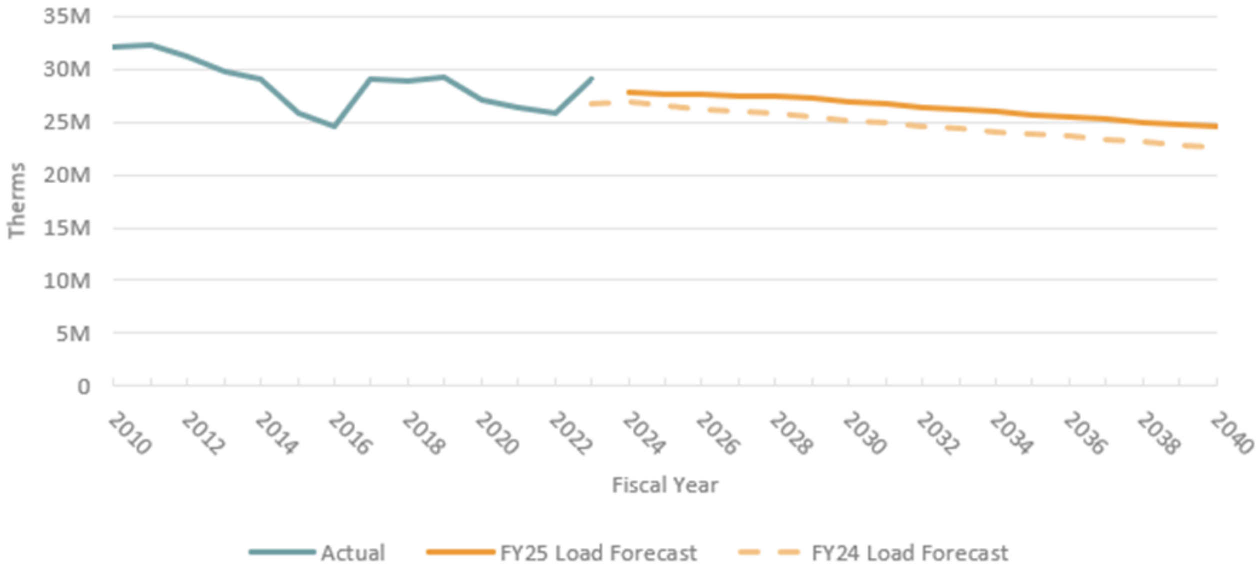
Operations costs are projected to increase by about 5% annually on average from FY 2025 to FY 2029, primarily due to inflation and salary and benefit increases. Operations costs assumes the proposal for the cross-bore funding program is approved. However, if the Council approves a lower level of funding for the program, staff recommends the same rate trajectory and the operations reserve would recover more quickly to within the minimum guideline range. 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. While a majority of sewer laterals have been inspected, staff has come across several services which are unable to be scoped, either due to infiltration by roots or broken/collapsed pipe segments. The estimated expense is $0.9 million in FY 2025 and $0.4 million in FY 2026 to complete the cross-bore program for higher risk areas.

Gas Purchases Forecast

Gas usage in Palo Alto declined from FY 2020 to FY 2022, mainly due to the Covid pandemic and drought in California. The increase in gas usage in FY 2023 was likely due to modest usage recovery from Covid and lower than normal average temperature during the winter. However, as seen with prior economic and drought-related gas usage declines in the past, it is likely that consumption will not come back to pre-conservation/pandemic levels but will likely become a long-run usage decline. Further changes, such as the voluntary replacement of gas appliances with electric appliances, building electrification of new construction as mandated by the 2019 Reach Code, and customer behavior are also expected to lower long run usage. In addition, separate strategic planning and financial analysis will be performed separate from this Financial Plan to address a financial and infrastructure strategy for the gas utility during a transition to an electrified community. Any insights from separate analyses will be integrated into future Financial plans.

The latest forecast in Figure 2 below anticipates gas supply purchases for FY 2025 at 27,711,370 therms, about 4% higher than forecasted in the FY 2024 Financial Plan. This upward projection may have been influenced by increased consumption in FY 2023, which has slightly altered the long-term trend. Long term declining gas consumption will put upward pressure on rates, as generally increasing and fixed costs to operate and distribute gas will be spread across fewer units of sale.

Figure 1: Gas Supply Purchases Forecast



<u>Gas Bill Comparison with Surrounding Cities</u>

Table 7 presents the median residential bills for Palo Alto and PG&E customers from FY 2022 to FY 2024. In FY 2023, the annual gas bill for the median Palo Alto residential customer was $940, about 4% higher compared to a PG&E customer with equivalent consumption. This is attributed to the gas price spike during the winter of 2022/2023, which impacted all California utilities except PG&E, which avoided exceptionally high gas prices.

Looking ahead to FY 2024, the anticipated annual gas bill for the median Palo Alto residential customer is expected to be about 11% lower than that of a PG&E customer with equivalent consumption. PG&E's gas transportation rates continue to rise to fund system improvements for pipeline safety and maintenance.

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

Table 7: Residential Monthly Natural Gas Bill Comparison ($/month)

Time Period	Median Usage (therms)	Palo Alto	PG&E Zone X	% Difference
FY 2022	Annual (400 Thms)	$ 688.84	$ 776.36	(13%)
FY 2023		940.33	903.73	4%
FY 2024*		752.90	836.26	(11%)
FY 2024 Summer*	Monthly (18 Thms)	41.54	38.70	7%
FY 2024 Winter*	Monthly (54 Thms)	105.15	131.67	(25%)

**Calculated based on actual and projected supply-related costs*

A more extensive review of commercial rates competitiveness is underway as part of a comprehensive Cost of Service Adjustment. Updates will be provided during the FY 2026 rates setting.

Alternative Gas Increase Plans

The Gas Utility's transfer to the City's General Fund is a component of the City's gas rates. City voters first authorized the transfer in 1950, and in November 2022 voters approved Measure L affirming the continuation of this practice by amending the Municipal Code. The attached Financial Plan includes two alternatives for this transfer for FY 2025 as follows:

1. **Transfer 11.9%:** The primary proposal in the attached Financial Plan recommends this lower percentage due to the substantial commodity revenues generated in FY 2023. This alternative suggests transferring 16.5% of the FY 2024 gas utility gross revenue for FY 2026, followed by 18% of gross revenue for FY 2027 and subsequent years. This approach allows for a gradual increase in the transfer up to 18% by FY 2027.
2. **Transfer 18%:** This is the maximum transfer allowed in accordance with Measure L. However, this results in a high transfer amount in FY 2025 that would significantly negatively impact the Gas Utility's reserves and require a higher rate increase in FY 2025.

Table 10 summarizes the overall rate changes without supply-related changes, and Table 11 summarizes the gross revenue transfer percentages and dollar amounts associated with the two alternatives.

Table 10: Summary of Rate Changes for Alternatives (Excludes Supply Rate Changes)

	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029
Transfer 11.9%	9%	7%	7%	6%	6%
Transfer 18%	15%	5%	5%	5%	6%

Table 11: Proposed / Projected and Alternate Transfers as % of Gross Revenues Two FY Prior[2]

	Approved (Council Resolution 10101)	Proposed / Alternate	Projected	
	FY 2024	FY 2025	FY 2026	FY 2027
Gas Utility Gross Revenue Two Fiscal Years Prior ($000)				
	$49,721	$75,291[3]	$61,032	$70,414[4]
				$73,618
Percent of gas utility gross revenue to transfer				
	15.5%	**11.9%**	16.5%	18%
		18%	18%	
Transfer amount ($000)				
Transfer 11.9%	$7,707	$8,960	$10,070	$12,674
Transfer 18%		$13,552	$10,986	$13,251
Change in Transfer from Prior Fiscal Year (%)				
	7%	16%	12%	26%
		76%	-19%	21%

<u>Next Steps</u>

The City Council will consider adopting the Financial Plan and rate adjustments as part of the FY 2025 budget review and adoption process in June 2024. If Council approves the proposed rate changes, the rates will become effective July 1, 2024.

FISCAL/RESOURCE IMPACT

The resource impact of the recommendations summarized in this report is the continued financial solvency of the Gas Utility and, as the City is a ratepayer, an increase to General Fund expenses (due to the rate increases) and revenues (due to the General Fund transfer). Normal year sales revenues for the Gas Utility in FY 2024 are projected to increase by roughly 9% or $5 million as a result of the proposed rate increases, not including fluctuations in commodity revenue/cost. The change in General Fund revenues from FY 2024 to FY 2025 would depend on the General Fund transfer alternative chosen by Council, as shown above in Table 10. Under the 11.9% transfer in FY 2025 alternative, which was supported by UAC members during their discussion of preliminary rates in January 2024, the General Fund transfer would increase from $7,707,000 million in FY 2024 to $8,959,629 million in FY 2025, an increase of about $1,252,629 million.

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[2] Measure L authorizes a transfer based on 18% (or a lesser percentage if approved by Council) of the revenue for two fiscal years prior, so the FY 2024 transfer is based on FY 2022 revenue.

[3] Represents actual gas utility gross revenues for FY 2023.

[4] There are two values for gross revenue in FY 2027 because there are two possible rate trajectories shown in Table 3 that would impact the forecasted revenue for FY 2025 (two fiscal years prior to FY 2027); the first would increase rates by 9% in FY 2025 leading to forecasted revenues of $70.414 million and the second would increase rates by 15% in FY 2025 leading to forecasted revenues of $73.618 million.

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 the California constitution and industry-accepted cost of service principles. As noted in the Reserves Management Practices (Exhibit 2 to the Resolution), if reserves fall below the minimum guidelines, Council approval is required for a rate plan that requires more than one year to return reserves to within guideline levels.

STAKEHOLDER ENGAGEMENT

On March 6, 2024, staff discussed the proposals at the UAC meeting on the FY 2025 gas rate increases. UAC commissioners unanimously approved the proposed rates and the 11.9% staff recommended gas general fund transfer for FY 2025. This proposal will be presented to City Council in June 2024 during the budget adoption process.

ENVIRONMENTAL REVIEW

The UAC's review and recommendation to the Finance Committee on the FY 2025 Gas Financial Plans 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: Gas Resolution FY25
- Attachment A Exhibit 1: Gas Financial Plan FY25
- Attachment A Exhibit 2: Gas Reserve Management Practices FY25
- Attachment A Exhibit 3: Gas Rate Schedules FY25

APPROVED BY:

Dean Batchelor, Director of Utilities