Finance Committee
Staff Report

From: Kiely Nose, Assistant City Manager
Lead Department: Utilities

Meeting Date: March 21, 2023
Staff Report: 2303-1141

TITLE

Recommendation to the City Council to 1) Adopt a Resolution Approving the Fiscal Year 2024 Electric Financial Plan and Proposed Reserve Transfers, and Amending Rate Schedules E-HRA (Hydro Rate Adjuster), E-1 (Residential Electric Service), E-2 (Residential Master-Metered and Small Non-Residential Electric Service), E-2-G (Residential Master-Metered and Small Non-Residential Green Power Electric Service), E-4 (Medium Non-Residential Electric Service), E-4-G (Medium Non-Residential Green Power Electric Service), E-4 TOU (Medium Non-Residential Time of Use Electric Service), E-7 (Large Non-Residential Electric Service), E-7-G (Large Non-Residential Green Power Electric Service), E-7 TOU (Large Non-Residential Time of Use Electric Service), E-NSE (Net Metering Net Surplus Electricity Compensation), and E-EEC (Export Electricity Compensation) and 2) Discussion and Potential Direction for a Residential Electric Rebate in 2023

RECOMMENDATION

Staff recommends that the Finance Committee recommend the City Council adopt a Resolution:

1. Approving the Fiscal Year (FY) 2024 Electric Financial Plan modified to reflect the transfers and rate actions listed below in sections 2, 3, and 4;
2. Approving the following transfers at the end of FY 2023:
    a. Up to $12 million from the Supply Operations Reserve to the Distribution Operations Reserve; and
    b. Up to $4.5 million from the Supply Operations Reserve to the Cap and Trade Program Reserve; and
3. Approving the following transfers in FY 2024:
    a. Up to $10 million to the Electric Special Projects (ESP) reserve from the Supply Operations Reserve; and
    b. Up to $8 million to the Hydroelectric Stabilization Reserve from the Supply Operations Reserve; and
    c. Up to $3 million from the Supply Operations Reserve to the Cap and Trade Program Reserve; and
4. Approving the following rate actions for FY 2024:
    a. Deactivation of the hydroelectric rate adjuster from customer bills effective July

1, 2023;

b. An increase to retail electric rates E-1 (Residential Electric Service), E-2 (Small Non-Residential Electric Service), E-4 (Medium Non-Residential Electric Service), E-4 TOU (Medium Non-Residential Time of Use Electric Service), E-7 (Large Non-Residential Electric Service), and E-7 TOU (Large Non-Residential Time of Use Electric Service) of 21% effective July 1, 2023;
c. An increase to the Export Electricity Compensation (E-EEC-1) rate to reflect 2022 avoided cost, effective July 1, 2023;
d. An increase to the Net Surplus Electricity Compensation (E-NSE-1) rate to reflect current projections of FY 2023 avoided cost, effective July 1, 2023; and
e. An update to the Residential Master-Metered and Small Non-Residential Green Power Electric Service (E-2-G), the Medium Non-Residential Green Power Electric Service (E-4-G), and the Large Non-Residential Green Power Electric Service (E-7-G) rate schedules to reflect modified distribution and commodity components, effective July 1, 2023.

On March 1, 2023 the Utilities Advisory Commission (UAC) recommended the Finance Committee recommend to Council the staff recommendation in Staff Report 2301-0844.[1] The staff recommendation above would modify the resolution, Financial Plan, and rate sheets from that staff report to reflect the new staff rate recommendation described in this report.

EXECUTIVE SUMMARY

Since presenting the rate proposal and financial plan to the UAC on March 1, 2023, new information has arisen that materially improves the electric utility's financial position. Staff expects to receive approximately $24 million as part of Northern California Power Agency litigation in the coming months. Based on the information, staff revised the rate proposal provided to the UAC and proposes a net reduction of 5% to electric customers (net average electric rate costs). the $24M payment can be used to replenish reserves with some of the payment left over for rate stabilization, providing adequate reserves to manage hydroelectric risk and enabling rates to be phased over a slightly longer period. More importantly, the replenished reserves enable the HRA to be removed.

[1] Titled "Staff Recommends the Utilities Advisory Commission Recommend that the Finance Committee Recommend that the City Council Adopt a Resolution Approving the Fiscal Year 2024 Electric Financial Plan and Proposed Reserve Transfers, and Amending Rate Schedules E-HRA (Hydro Rate Adjuster), E-1 (Residential Electric Service), E-2 (Residential Master-Metered and Small Non-Residential Electric Service), E-2-G (Residential Master-Metered and Small Non-Residential Green Power Electric Service), E-4 (Medium Non-Residential Electric Service), E-4-G (Medium Non-Residential Green Power Electric Service), E-4 TOU (Medium Non-Residential Time of Use Electric Service), E-7 (Large Non-Residential Electric Service), E-7-G (Large Non-Residential Green Power Electric Service), E-7 TOU (Large Non-Residential Time of Use Electric Service), E-NSE (Net Metering Net Surplus Electricity Compensation), and E-EEC (Export Electricity Compensation)" https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/utilities-advisory-commission/archived-agenda-and-minutes/agendas-and-minutes-2023/03-mar-2023/03-01-2023-item-4.pdf

In addition to the rate proposal outlined in this report, Attachment A provides options for consideration for providing rebates to electric customers to offset high winter energy bills.

BACKGROUND

On March 8, the City of Palo Alto learned about the timing of a financial payment in the City's favor related to the litigation of the Central Valley Project Improvement Act (CVPIA) operated by the U.S. Bureau of Reclamation and anticipates receiving approximately $24 million in the coming months. The payment comes after years of litigation by Northern California Powers Agency members that the United States government did not follow the CVPIA legislation and overcharged Palo Alto Utilities $24M when collecting CVPIA on an annual basis from 1992-2020. The timing, amount, and form of repayment were unknown until March 8 and therefore,
was not included in the financial plan presented to the Utilities Advisory Commission (UAC) on March 1, 2023.

DISCUSSION

Since presenting the rate proposal and financial plan to the UAC on March 1, 2023, new information has arisen that materially improves the electric utility's financial position. Based on the new information, the expected $24 million payment as part of NCPA litigation, staff revised the FY 2024 rate proposal and financial projections reviewed by the UAC and proposes a new FY 2024 5% reduction in net average rate in the electric utility. This revised recommendation reflects the impacts of the expected payment . This report covers the following two topics for Committee consideration:

1. Staff recommends a net 5% rate reduction that customers will benefit from beginning July 2023; this is the combination of 1) deactivating the hydroelectric rate adjuster (HRA) and 2) increasing the electric utility rate by 21%. The previous plan presented to UAC recommended a continuation of the current overall electric utility cost to the customer.

   This net reduction can be achieved with the allocation of the $24 million payment to repay loans in the amount of $10M, transfer $8M to stabilize reserves, and allocate $6M for future electric rate relief. The HRA is able to be removed in full with the recommended replenished reserves mitigating the risk associated with dependency on electricity generated by water.

2. Staff has provided options for consideration of rebates to electric customers to offset high winter energy bills at the direction of the City Council on February 13, 2023, as part of the FY 2023 Mid-Year Budget reivew. (Attachment A)

Recommended FY 2024 Electric Utility Cost – net 5% reduction to customer costs

Staff is recommending rate changes resulting in a 5% decrease in the electric utility system average rate effective July 1, 2023. This involves two key actions, 1) deactivating the hydroelectric rate adjuster completely and 2) increasing the electric utility base rate by 21%. This updated rate proposal generates $208.4 million, or roughly $11 million less than the financial plan presented to the UAC on March 1st that generated $219.8 million in revenue. The changes recommended to the electric utility financial plan that enable the net 5% decrease in customer costs, including the recommended use of the $24M in revenues from the payment, are summarized below:

- **Repay $10 million in internal loans & repeal recommended additional internal loans:** The Council has approved previous internal loans of $10 million from the electric utility's Electric Special Projects Reserve to its Operation Reserves. The Financial Plan proposed included an additional $8 million internal loan, for a total liability of $18 million paid back over three years. These loans have been used to mitigate electric utility customer rate increases and allow a phased approach to cost escalation and pauses in rate adjustments during the pandemic. Staff is proposing to forego the additional $8 million internal loan and use $10 million of the $24 million payment to repay the remaining outstanding $10 million internal loan. This reduces electric utility revenue needs in future years since internal loan repayment is no longer needed.

- **Transfer $8 million to the Hydroelectric Stabilization Reserve & Eliminate the Hydroelectric Rate Adjuster (HRA):** The hydroelectric rate adjuster (HRA) is activated during periods of lower hydroelectric output (typically drought conditions) only when there are insufficient funds in the Hydroelectric Stabilization Reserve to fund the purchase of additional electricity needed to meet customer demand with that lower output of electricity generation by water. Currently there is only $400,000 in the Hydroelectric Stabilization Reserve. The target level for the reserve is $19 million and the HRA is typically activated when reserves are below $11 million. To mitigate a potential reactivation of the HRA due to dry weather as early as next year, a $8.4 million Hydroelectric Stabilization reserve ($8.0 million increase) is recommended. Although not at targeted minimum levels, staff recommends this lower value managing the risk of future weather conditions and expecting to increase reserve levels if FY 2024 hydroelectric generation exceeds projections.
- **Allocate $6 million for future rate relief:** The remaining $6 million is recommended to be added to the Supply and Distribution Operations Reserve which are projected to be at $19.5 million at the end of FY 2023, which is $11.3 million (36%) below the minimum guidelines of $31 million. These funds will be used to phase in future rate increases needed to stabilize the financial health of the electric utility gradually over the forecast period.

The recommended changes above are modeled in the tables and charts outlined below.

The proposed rate trajectory (including the HRA) can be seen in Figure 1 below. The revenue from the receipt of the CVPIA $24 million payment is not shown, but it is included in the reserves charts that follow. The rates proposed for July 1, 2024 are 5% lower than the January 1, 2023 rates, but would generate more revenue because they would be in effect the entire fiscal year (July 1, 2023 to June 30, 2024) whereas the January 1, 2023 rates will only be in place for six (6) months.

Figure 1: Electric Utility Revenues, Expenses, Rate Changes

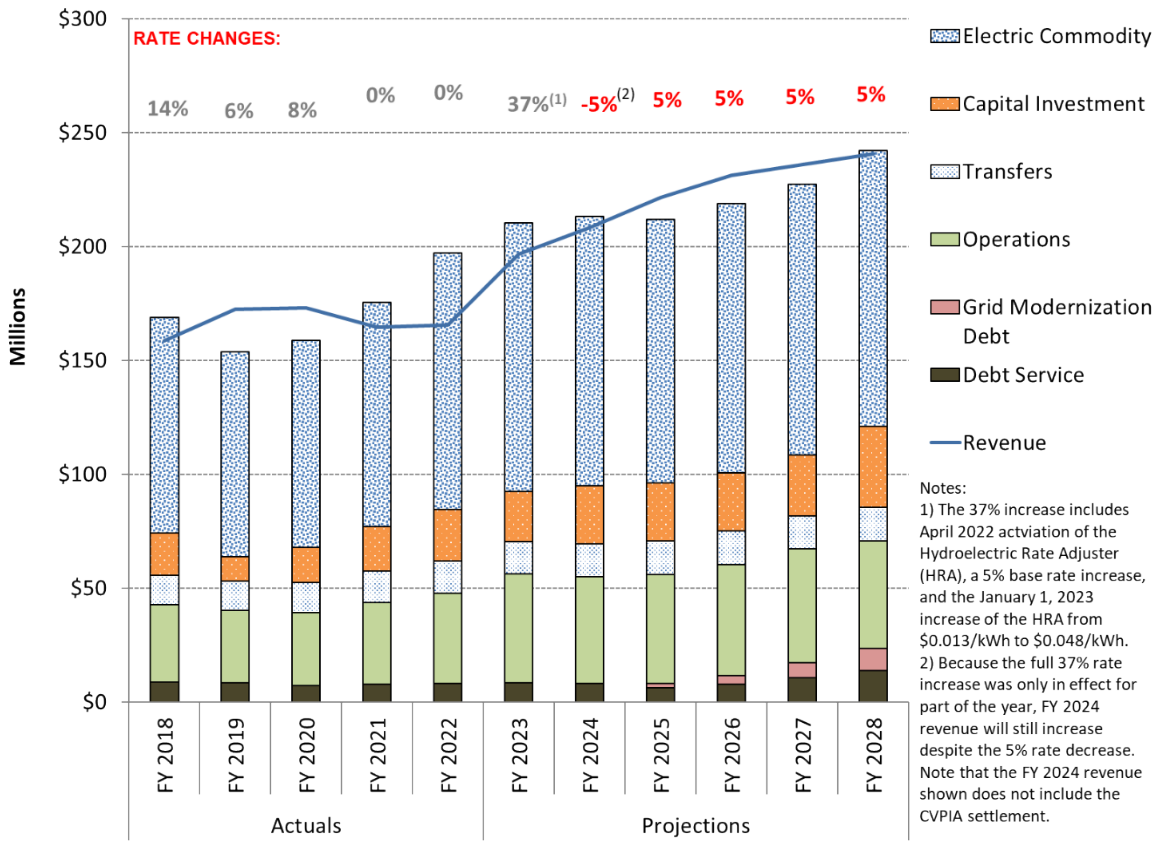
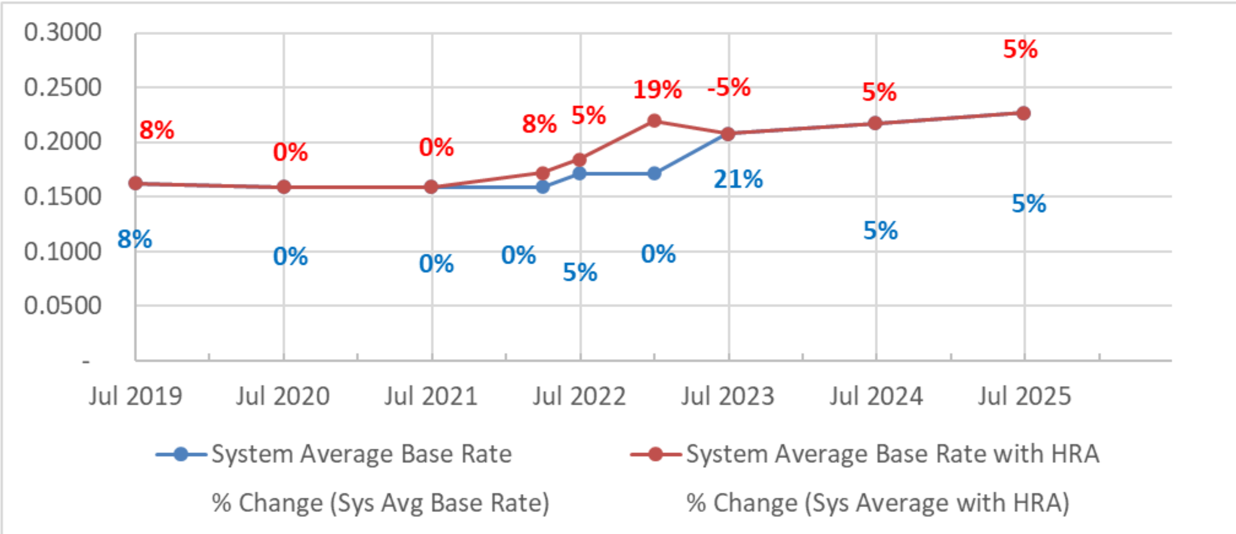


Figure 2 below reflects the system average rate with and without the HRA included. This chart shows the changes to customers net bill impact over the previous 4 years and the projected new rate proposal impacts moving forward.

Figure 2: Electric Utility With and Without the HRA



The Operations reserve remains below minimum guidelines through FY 2024, as shown in Figures 3 and 4 below, however, staff believes this is an acceptable proposal because the Electric Special Projects reserve will be fully funded and could be used in an emergency. The Hydroelectric Stabilization Reserve would also have some funds to protect against a dry winter in FY 2024.

Figure 3: Electric Utility Supply Operations Reserve

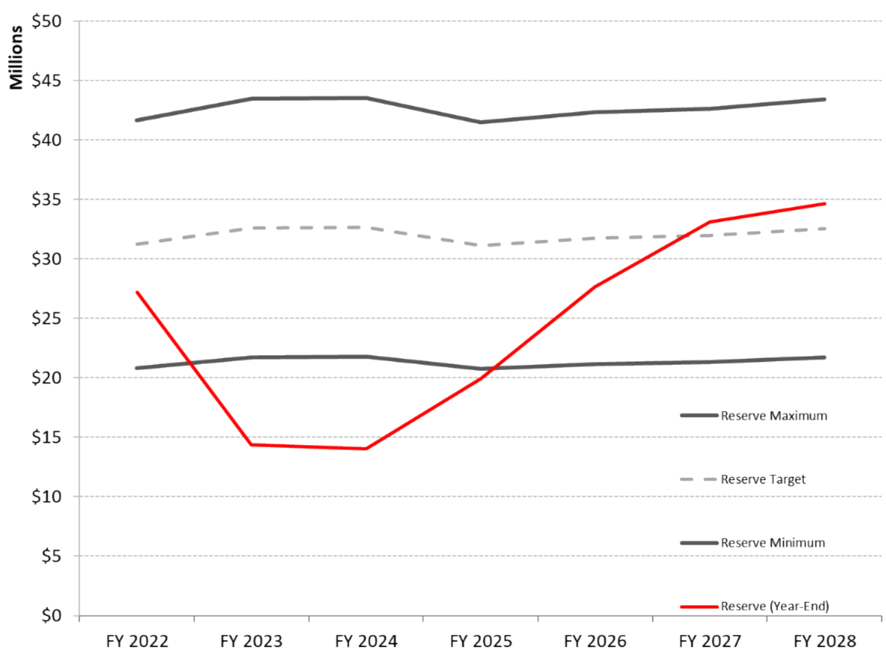
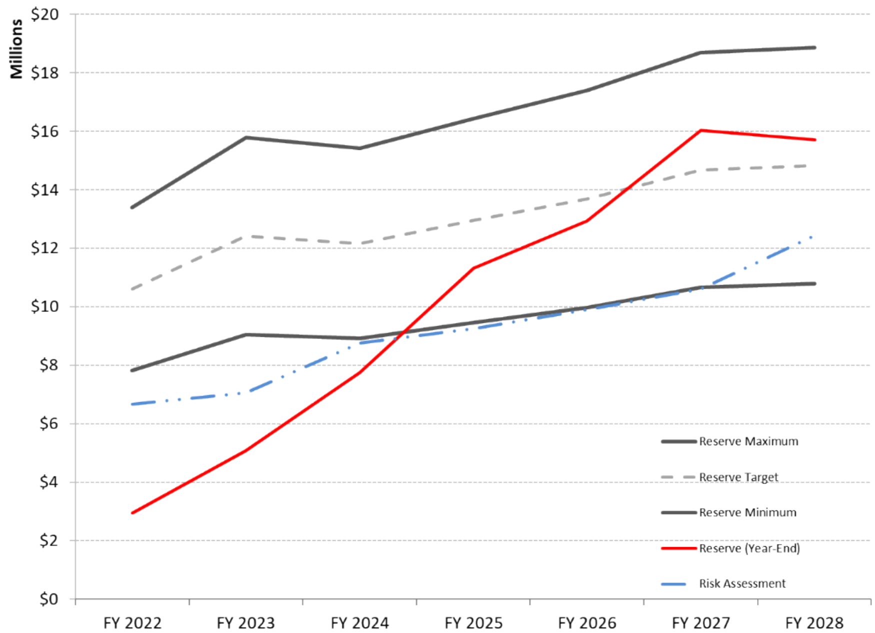


Figure 4: Electric Utility Distribution Operations Reserve



<u>Consideration of rebates to electric customers to offset high winter energy bills</u>

Council asked staff to return to the Finance Committee with potential residential electric rebate options. These options are described in more detail in Attachent A. Also of note, on March 27th, the Council is scheduled to consider a gas rebate program for 2023 as well at a cost of up to $1.8 million.

Potential electric rebate program options for a cost of up to $720,433:

- Option 1: 20% rebate of $720,433 to all residential electric customers based on their electric consumption in January 2023;
- Option 2: Flat rebate of $27.05 to every residential electric customer in January 2023 totaling $720,369, based on an average January residential electric bill of $135.26.

TIMELINE

The City Council will consider adopting the Financial Plan and rate adjustments as part of the FY2024 budget review and adoption process. If Council approves the proposed rate changes, the rates will become effective July 1, 2023.

FISCAL/RESOURCE IMPACT

FY 2024 revenues are projected to increase by $12 million[2] (6%) compared to FY 2023 levels if Council adopts this report's recommendations, despite the fact that rates would decrease 5%. This is because the current rates were effective January 1, 2023, and were only in place for 50% of the fiscal year, while the proposed rates would be in place a full fiscal year.

[2] This revenue calculation excludes expected monies to be received from the CVPIA payment.

The City is a utility customer, so the rate change will also result in estimated City expenses of about $5,800,000, approximately $2,030,000 of that being in the General Fund. Resource impacts to City departments and funds of the recommended rate adjustments will be programmed in the FY 2024 Proposed Operating Budget. If the final rates adopted by Council in June differ from those proposed in this report, further adjustments may be brought forward as part of the annual budget process.

STAKEHOLDER ENGAGEMENT

Stakeholder engagement for the rate adoption process includes review by the UAC, Finance Committee, and City Council, as well as outreach to residents via the website and social media. At the Utilities Advisory Commission (UAC) March 1, 2023 meeting, staff presented the attached Financial Plan and the recommendation was approved unanimously.

ENVIRONMENTAL REVIEW

The Finance Committee's review and recommendation on the FY 2024 Electric 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: Residential Electric Rebate Options

APPROVED:

Dean Batchelor, Director of Utilities
Staff: Jonathan Abendschein, Assistant Director Utilities