

Preliminary FY 2024 Utility Rate Forecast

UTILITIES DEPARTMENT

Each year the Utilities Department develops a Financial Plan for the electric, gas, water, and wastewater utilities. Analogous to the Long-Range Financial Plan for the General Fund, these plans guide utility budget development and rate setting. Normally preliminary rate projections are discussed by the Utilities Advisory Commission (UAC) and Finance Committee, followed by formal Financial Plan recommendations from staff prior to the budget process. This year no preliminary projections were made due to the sudden retirement of a key staff member. Formal Financial Plan recommendations will be made in March and April.

Preliminary ranges for July 1, 2023 rate changes are shown below. Costs in all utilities have been increasing, primarily due to the replacement of aging infrastructure and rapid construction cost inflation, which are challenges utilities and public agencies across the country are confronting. At the time of this preliminary development, the state of California has seen unprecedented rainfall and flooding. Staff are reviewing the impacts of this storm on rate forecasts and will ensure this is factored into the recommended rate changes for FY 2024. These recommendations are scheduled to be reviewed in April 2023 by the Finance Committee.

Electric Utility

Tentative July 1, 2023 Rate Change:

- Change from current total FY 2023 rates (incl. hydro rate adjuster): -1% to +1% increase
- Base rate: 12% to 14% increase

At present, staff anticipates little or no change in total Electric rates in FY 2024; this is due to the decrease/elimination of in the hydroelectric rate adjuster, offset by a 12% to 14% increase in the base electric rate.

Electric supply purchase costs have risen substantially over the past three years from a combination of higher market energy prices, greater transmission costs, and lower energy generation from the electric utility's hydro resources. Revenues have also declined from lower loads during the COVID-19 pandemic. By the end of FY 2022 these factors had reduced operating reserve balances below minimum. A hydroelectric rate adjuster was activated in April 2022 due to decreased hydroelectric output and increased in December 2022 due to high electric market prices. This adjuster is expected to decrease in July 2023, but base rates are expected to increase due to long-term increases in electric supply costs and capital investment related to aging infrastructure and grid modernization. The net effect would be little or no change in customer bills in FY 2024.

Staff is incorporating a lower long-term forecast for hydroelectric output to stabilize rates during future droughts, minimizing the types of increases seen in 2022. Staff expects 3% to 8% base rate increases for FY 2025 to FY 2028, offset by continuing decreases in the hydroelectric rate adjuster, meaning little or no change to customer bills over the forecast period. In the longer term, load increases are expected to roughly balance increases in utility costs associated with electrification, leading to only modest increases in rates.

Gas Utility

Tentative July 1, 2023 Rate Change:

- Change from current total FY 2023 rates (incl. current commodity prices): -14% to 12%

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decrease

- Distribution Rate: 7% to 9% increase

Currently, Gas rates are expected to decrease for the average customer in FY 2024. Natural gas prices are at unprecedented levels in California and other Western states; the gas utility reserves were severely depleted by an extreme spike in natural gas market prices in FY 2023, which exceeded what could be passed through to customers. Gas market prices are expected to remain elevated through the forecast period, though below FY 2023 levels. The decrease in gas commodity costs from FY 2023 to projected FY 2024 is expected to produce a net decrease in customer bills next year. The decrease in commodity costs will be partially offset by an estimated 7% to 9% increase related to rising gas utility operational and capital costs, and the need to begin to replenish reserves. Capital investment rates and how quickly to refill reserves are major variables being reviewed to finalize rate plans.

Rate increases in the 5% to 9% range are expected over the next three years, while in the longer term increases of no less than 5% are expected as the City electrifies. The City is considering strategies to protect those who are unable to take advantage of electrification from excessive gas bills as the transition proceeds.

Water Utility

Tentative July 1, 2023 Rate Change:

- 7% - 14% increase

At this time, Water rates are anticipated to increase 7-14% in FY 2024 as water supply costs remain the greatest source of uncertainty, and staff will adjust the City's water supply pass-through rate adjuster in July 2023 based on the final water supply rate from the City's water supplier. Palo Alto residents and businesses have responded to calls for water conservation during the ongoing drought. Recovery is projected to be slow and as in prior droughts, some conservation is projected to be permanent. Water supply costs continue to increase due to continuing investment in rehabilitating and seismically strengthening the Hetch Hetchy system. These factors are leading to the need for rate increases over the next several years. Staff will use the water utility's healthy reserve levels to spread increases over multiple years. Rate increases are expected to be around 3-4% annually long-term after FY 2024.

Wastewater Utility

Tentative July 1, 2023 Rate Change:

- 5% - 9% increase

Based on current information, Wastewater rates are anticipated to increase 5-9% in FY 2024 to pay for infrastructure replacement, including replacing and maintaining sewer lines, and replacing aging equipment at the City's Regional Water Quality Control Plant. Staff is evaluating a few rate projection scenarios, including accelerating the sewer mains replacement rate from 1 mile per year to 2.5 miles per year beginning in FY 2026 to allow the wastewater utility to replace aging mains before the end of their life expectancy. This scenario expects 8-9% rate increases over the next four years, and 3-5% in the outer years. The other scenario delays the accelerated sewer main replacement plan to begin in FY 2028 or later to mitigate the impact of rate increases on customers.

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PUBLIC WORKS DEPARTMENT

Each year the Public Works Department evaluates and analyzes the enterprise funds that provide utility services as part of the budget development and rate setting process. Applicable projections and formal recommendations are presented to UAC and Finance Committee in alignment with the process the Utilities Department follows. Preliminary rate changes for July 1, 2023 are shown below.

Stormwater Management Fee

Tentative July 1, 2023 Rate Change:

- 4.9% increase

At this time, the Storm Water Management Fee is expected to increase 4.9% in FY 2024 to keep fund revenues consistent with general cost increases and to provide sufficient funds for planned storm water management capital and operating expenditures. Implementing a 4.9% increase based on the applicable Consumer Price Index is lower than the 6% maximum adjustment specified in the voter approved ballot measure.

Refuse Services

Tentative July 1, 2023 Rate Change:

- 3% increase

Refuse rates are anticipated to increase 3% in FY 2024 to provide sufficient funds for increasing operating expenses and to maintain the long-term health of our Rate Stabilization Reserve. The Refuse Fund has not adjusted commercial rates since FY 2017 and residential rates since FY 2018. The anticipated 3% increase across all sectors in FY 2024 will help to mitigate future potential rate adjustment spikes when the municipal solid waste collection and processing service agreements term out in FY 2026. Staff anticipates higher operating costs when a new agreement is to be implemented in FY 2027.