



City Council Staff Report

From: City Manager

Report Type: STUDY SESSION

Lead Department: Utilities

Meeting Date: April 17, 2023

Staff Report:2304-1247

TITLE

Study Session Regarding Proposed Electric, Gas, Water and Wastewater July 2023 Rate Changes

RECOMMENDATION

This is an informational report to facilitate the Council study session on customer utility rates. No action by Council will be taken.

EXECUTIVE SUMMARY

The overall system average proposed rate changes in FY 2024 are

- 5% decrease for electric,
- 8% increase for gas (excludes changes in gas market prices),
- 6% increase for water, and
- 9% increase for wastewater.

Across the Electric, Gas, Water and Wastewater utilities, costs continue to increase, including construction cost inflation, commodity price increases and the rising cost to transport energy and water. Additionally, infrastructure is aging and investment is needed to maintain the health of utilities and protect reliability.

Gas market prices spiked this winter; it cost Palo Alto Utilities five times more to buy gas in the markets this January compared to January 2022. Figure 1 summarizes the impact of the proposals on a median residential customer's utility bill and illustrates the magnitude of the gas market price spike impacts on customer bills. With gas market price changes included, gas bills for FY 2024 are expected to be 13% lower than in FY 2023, though forecasts of gas market prices are highly uncertain.

In addition to this study session there are three rates-related items on the agenda for Council's consideration tonight:

- **Public Hearing Action Item: FY 2024 Gas Utility Financial Plan & Rates Staff Report 2303-1219** to adopt a resolution approving the FY 2024 Gas Utility financial plan, including proposed reserve transfers and general fund transfer (recommended at 15.5% of gross revenues), amend the Gas Utility Reserve Management Practices, and increase gas rates by amending gas rate schedules G-1, G-2, G-3 and G-10. Included in this item is the Council decision regarding whether to transfer up to 18% of the gross revenues of the gas utility to the general fund or a lesser amount in FY 2024. The Finance Committee (2-1) recommends a transfer at the 15.5% rate, though the staff report referenced above does outline alternatives for consideration.
- **Public Hearing Action Item: FY 2024 Electric Utility Financial Plan & Rates Staff Report 2303-1235** to adopt a resolution approving the FY 2024 Electric Utility financial plan, including proposed reserve transfers, and modify electric rates by deactivating the hydroelectric rate adjuster and amending electric rate schedules E-1, E-2, E-2-G, E- 4, E-4-G, E-4 TOU, E-7, E-7-G, E-7 TOU, E-NSE, and E-EEC.
- **Public Noticing Consent Item: Water and Wastewater FY 2024 Utility Financial Plan & Rates Staff Report 2303-1218** is a public noticing on consent calendar regarding Water, and Wastewater Collection rates, and recommends approval for a public hearing on June 19, 2023 for Water and Wastewater rates, pending Proposition 218 customer notifications, as recommended by the Finance Committee on March 21, 2023. Finance Committee Staff Report includes the financial plans and rate proposals for water and wastewater utilities presented to the Finance Committee.
- The June 19, 2023 Council packet will include the rates and financial plans for water and wastewater and the CPI increases for storm drain, and fiber rates. No rate changes are recommended for refuse rates in FY 2024.

BACKGROUND

The City absorbed utility cost increases during the pandemic. Increased costs for construction, operations, energy, and water were not fully passed through to customers in 2020, 2021, and 2022 and were instead absorbed from reserves. As a result, revenues are too low to maintain normal operations in all utilities, except water. Reserves are lower than expected, because although the City intended to phase in rate increases slowly using reserves, spiking energy prices, inflation and other factors led to very low reserves in all utilities except water. As drought conditions continued to impact the City's hydroelectric supplies and as energy prices rose and spiked this past winter, the Council took several actions.

2022 Council Rate Actions Responding to Drought and Rising Energy Prices

- Effective April 1, 2022, the Electric Hydro Rate Adjuster went into effect for every CPAU electric customer (see [Staff Report 13905](#))¹.
- On December 19, 2022 the Palo Alto City Council approved an increase to the Electric Hydro Rate Adjuster, increasing the current Electric Hydro Rate from \$0.013/kWh to \$0.048/kWh, effective January 1, 2023. See [Staff Report 14874](#)² for more details. This increase was necessary to reflect hydrological conditions and market purchase costs impacted by ongoing drought conditions at that time.
- On December 19, 2022, the Palo Alto City Council approved an increase to the gas monthly market-based commodity rate cap from \$2.00 per therm to \$4.00 per therm. See [Staff Report 15047](#)³ for more details.

These actions protected the financial health of the electric and gas utilities. However, the rapidly shifting market prices significantly impacted customer bills.

Bill Impacts

Natural gas prices were extreme this winter due to changes in market supply and demand. However, gas prices are dropping. March customer gas bills were less than 50% of February and April gas bill projections are expected to be even lower. Customer gas bills are expected to continue to decline through June. Although it is not possible to precisely predict 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. Staff projects commodity prices to decline in FY 2024. Beyond FY 2024 the forecast assumes (consistent with current gas market forecasts from various sources, including forward gas contracts on exchanges, forecasts from suppliers, and the Federal Energy Information Administration) overall supply costs will increase gradually from FY 2025 through FY 2028, remaining higher than historical gas prices.

Figure 1 shows monthly median residential bills and how they increased to unprecedented levels as the natural gas market prices spiked. The figure also shows the projected bills for this summer in June and then in July to illustrate the impacts of these proposed rate increases that are proposed to be effective July 1, 2023. Next winter (January 2024), the forecast does not anticipate another gas price spike; however, gas commodity prices are highly variable, and weather or economic factors could shift this forecast rapidly, in which case any changes in

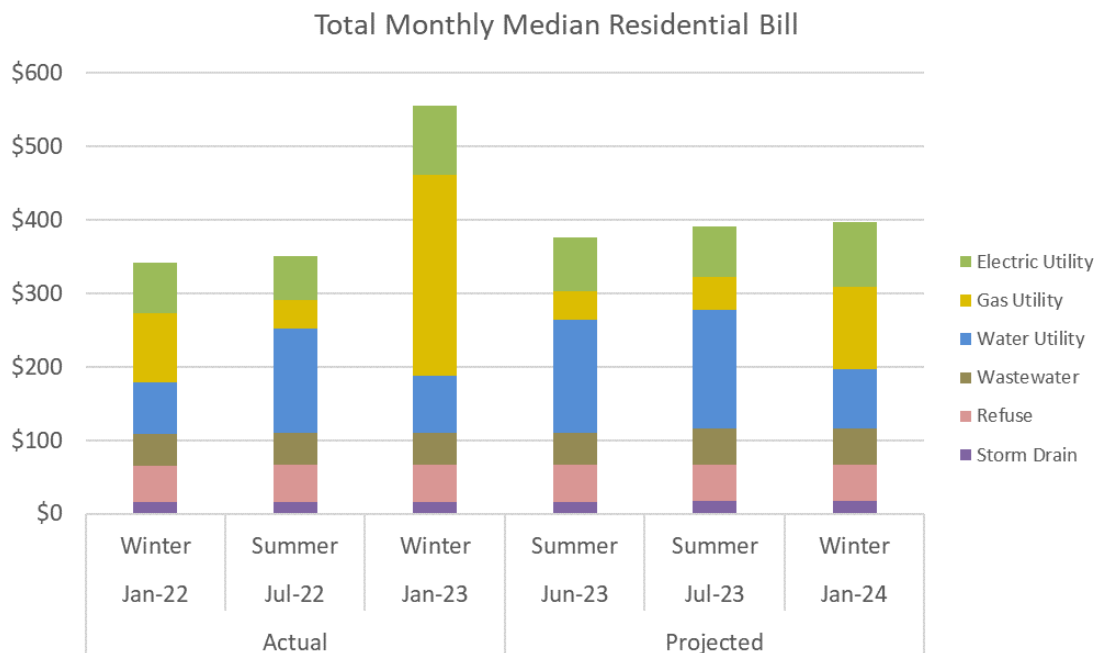
¹ Council Staff Report 13905 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20220314/20220314pccsm-amended-final-revised-ppt.pdf>

² Council Staff Report 14874 <https://portal.laserfiche.com/Portal/DocView.aspx?id=46283&repo=r-704298fc>

³ Council Staff Report 15047 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20221219/20221219pccsm-amendedtime.pdf>

commodity costs would be passed through to customers via the monthly varying commodity rate adjuster.

Figure 1: Total Monthly Median Residential Bill



Communications

The Utilities Department has been conducting outreach on the proposed rates as well as high winter gas bills through CPAU's website www.cityofpaloalto.org/ratesoverview⁴ in addition to sharing public communication through OpEds and press releases for publication in the local media, blog posts, social media, Nextdoor, bill inserts, fliers for community events, utilities and other City newsletters, with neighborhood groups and key account customers, and providing customer service or other public-facing staff and management groups with frequently asked questions (FAQs).

⁴ City of Palo Alto Utilities Rates Overview webpage
<https://www.cityofpaloalto.org/Departments/Utilities/Customer-Service/Utilities-Rates>

Efficiency Programs

The City acknowledges that many may be struggling with high utility bills and is offering ways to help.

- **Free efficiency assessments.** The City is providing free assessments from CPAU's home energy advisor, the [Home Efficiency Genie](https://www.cityofpaloalto.org/Departments/Utilities/Residential/Home-Efficiency-Genie)⁵, to help people reduce consumption and save money.
<https://www.cityofpaloalto.org/Departments/Utilities/Residential/Home-Efficiency-Genie>
- **Extended payment.** The City is offering payment plan arrangements for those who need extra time paying their winter gas bills. Payment can be extended for 6-8 months. Customer may pay bills in installments, by contacting Utilities Customer Service at (650) 329-2161, or visit our [Utilities Customer Service](https://www.cityofpaloalto.org/Departments/Utilities/Customer-Service) web⁶ page.
<https://www.cityofpaloalto.org/Departments/Utilities/Customer-Service>
- **Rate assistance**⁷ and free home energy upgrades for income-qualified customers. Residents struggling to pay their utilities bills may qualify for CPAU's [Rate Assistance Program](https://www.cityofpaloalto.org/Departments/Utilities/Residential/Utilities-Assistance/Rate-Assistance-Program-RAP), which provides a 25% discount on gas and electricity charges and a 20% discount on storm drain service fees. <https://www.cityofpaloalto.org/rap>
- **Residential Energy Assistance Program**⁸. Customers may be able to reduce energy and water costs by having CPAU help improve their home's efficiency through the [Residential Energy Assistance Program](https://www.cityofpaloalto.org/Departments/Utilities/Residential/Utilities-Assistance/Residential-Energy-Assistance-Program-REAP).
- **ProjectPLEDGE**⁹. CPAU's [ProjectPLEDGE](https://www.cityofpaloalto.org/Departments/Utilities/Residential/Utilities-Assistance/Project-Pledge) may be able to help customers in need with one-time assistance. Please call Utilities Customer Service at (650) 329-2161 to determine your eligibility.
- **California Arrearage Payment Program (CAPP):** This newly established [California Arrearage Payment Program \(CAPP\)](https://www.cityofpaloalto.org/News-Articles/Utilities/California-Arrearage-Payment-Program-CAPP)¹⁰ will offer financial assistance for California energy

⁵ Home Efficiency Genie <https://www.cityofpaloalto.org/Departments/Utilities/Residential/Home-Efficiency-Genie>

⁶ City of Palo Alto Utilities Customer Service webpage

<https://www.cityofpaloalto.org/Departments/Utilities/Customer-Service>

⁷ Rate Assistance Program <https://www.cityofpaloalto.org/Departments/Utilities/Residential/Utilities-Assistance/Rate-Assistance-Program-RAP>

⁸ Residential Energy Assistance Program

<https://www.cityofpaloalto.org/Departments/Utilities/Residential/Utilities-Assistance/Residential-Energy-Assistance-Program-REAP>

⁹ ProjectPLEDGE <https://www.cityofpaloalto.org/Departments/Utilities/Residential/Utilities-Assistance/Project-Pledge>

¹⁰ California Arrearage Payment Program <https://www.cityofpaloalto.org/News-Articles/Utilities/California-Arrearage-Payment-Program-CAPP>

utility customers to help reduce past due energy bill balances that increased during the COVID-19 pandemic.

Gas & Electric Utility Rebates

Additionally, on March 27, 2023, Palo Alto City Council approved a one-time residential natural gas rebate to mitigate the extraordinarily high January 2023 gas bills. On April 10, 2023, Palo Alto City Council will consider final approval of both a gas and electric utility rebate totaling \$2.5 million to be funded by the City's General Fund. Below is a table of the combined gas and electric rebates if a residential customer has both gas and electric utility services. City staff will calculate the individual residential rebate amount based on the number of services, RAP enrollment, and arrearage status. The rebates will be applied on customer's April or May 2023 utility bill as "Winter Rebate" depending on their billing schedule. Customers who apply for the Winter Rebate hardship program will receive a subsequent rebate after their application is approved.

Jan 2023 Residential Bill	# of Accounts ¹	% of Total Accounts	Cost	Gas Rebate	Electric Rebate	Combined Rebate
High Bill	2,626	5.7%	\$ 245,380	\$ 100.00	\$ 65.00	\$ 165.00
Med/High Bill	9,013	19.5%	\$ 698,465	\$ 85.00	\$ 45.00	\$ 130.00
Low/Med Bill	34,592	74.8%	\$ 1,277,540	\$ 70.00	\$ 20.00	\$ 90.00
SubTotal		100.0%	\$ 2,221,385			
Rate Assistance Program	1,101		\$ 110,100	\$ 100.00	\$ 100.00	\$ 200.00
Arrearage > 180 days	669		\$ 66,900	\$ 100.00	\$ 100.00	\$ 200.00
Winter Rebate Application	700		\$ 70,000	\$ 100.00	\$ 100.00	\$ 200.00
SubTotal			\$ 247,000			
		Total Cost	\$ 2,468,385			
¹ One customer may be grouped in multiple bill tiers and qualify for both electric and gas rebates						

A customer with a low January bill (less than \$400 gas bill and less than \$300 electric bill) will receive a rebate of \$90; they may also qualify for an additional \$400 rebate if they are enrolled in RAP and have arrearages greater than 180 days. A customer with a high January bill (greater than \$800 gas bill and greater than \$500 electric) will receive a rebate of \$165, they may also qualify for an additional \$400 rebate if they are enrolled in RAP and have arrearages greater than 180 days.

ANALYSIS

Overall, staff with the Utilities Advisory Commission and Finance Committee are recommending the following rate changes:

Projected Change in Residential Median Utility Bill

	FY 2023 (Rates in effect Jan 1, 2023) ¹⁾			FY 2024 (Projected)	FY 2025	FY 2026	FY 2027	FY 2028
	FY 2021	FY 2022						
Electric Utility	\$0.00 0%	\$0.00 0%	\$22.70 37%	(\$4.20) -5%	\$3.90 5%	\$4.10 5%	\$4.40 5%	\$4.60 5%
Gas Utility 3)	\$1.28 2%	\$1.60 3%	\$2.60 4%	\$5.20 8%	\$4.90 7%	\$3.70 5%	\$3.90 5%	\$4.10 5%
Wastewater	\$0.00 0%	\$2.00 3%	\$1.30 3%	\$4.00 9%	\$4.40 9%	\$4.80 9%	\$4.60 8%	\$3.10 5%
Water Utility	\$0.00 0%	\$0.00 0%	\$8.00 9%	\$5.90 6%	\$4.20 4%	\$3.30 3%	\$3.40 3%	\$5.80 5%
Refuse	\$0.00 0%	\$0.00 0%	\$0.00 0%	\$0.00 0%	\$1.50 3%	\$1.50 3%	\$1.60 3%	\$1.60 3%
Storm Drain 4)	\$0.40 3%	\$0.30 3%	\$0.60 4%	\$0.80 5%	\$0.70 4%	\$0.70 4%	\$0.70 4%	\$0.80 4%
Monthly Bill Change 5)	\$1.68 1%	\$3.90 1%	\$35.20 11%	\$11.70 3%	\$19.60 5%	\$18.10 5%	\$18.60 4%	\$20.00 5%

- 1) 37% increase includes 4/1/22 hydro rate adjuster (HRA) activation (10%), 7/1/22 5% rate increase, and 1/1/23 HRA increase (19%)
- 2) -5% change includes a 21% increase to base electric rates and removal of the HRA
- 3) Gas utility rates shown exclude gas market price changes. FY 24 bill forecast w/ market price changes is (-13%). Actual rates will vary.
- 4) Storm Drain fees increase by CPI index annually per approved 2017 ballot measure.
- 5) Analysis based on an FY 2023 average monthly bill of \$369

This study session is seeking to inform the full Council and the public of rate discussions that have occurred through March 2023 with the Utilities Advisory Commission and the Finance Committee. It is intended to allow for a comprehensive understanding of the total customer bill impact expected beginning July 1, 2023 should these plans be approved. The report specifically is organized by utility as follows:

- Shared drivers of recommended rate changes
- Electric Utility
- Gas Utility
- Water Utility
- Wastewater Utility

Following these specific utility discussions is the expected schedule for approval including the potential approval of gas and electric utility rates on this same April 17 Council agenda with the remaining rates as well as fiber customer rates to be considered for adoption on June 19, 2023.

Shared Drivers of the Rate Changes

The skyrocketing winter energy prices are just one of several trends that will affect people's utility bills in 2023, but they are one of the most impactful. However, as energy supply costs decline from the extremely high winter 2022/2023 levels, the City will continue to pass those supply cost declines through to customers through the monthly gas commodity rate adjuster and by deactivating the electric utility's hydroelectric rate adjuster in July.

There are several shared drivers of rate increases across the four utilities. Costs continue to increase across the Electric, Gas, Water and Wastewater utilities. Construction inflation remains a difficult challenge for all public agencies in the Bay Area, and other types of inflation has affected all utility costs, including salary and benefit costs. The utilities are also recovering from the pandemic. During the pandemic the City kept rate increases low to help customer suffering from economic impacts, so in all utilities revenues are currently below costs.

The City of Palo Alto had hoped to phase in needed rate increases gradually after the pandemic using reserves, but in most utilities that is no longer possible. For electric and gas, the winter 2022/2023 energy supply cost spikes were not passed through completely to customers, and the difference was absorbed from reserves. Reserve levels in both utilities will be very low by the end of FY 2023, making it impossible to phase in rate increases slowly without bringing reserves even further below minimum guideline levels. The Wastewater Collection utility will have low reserves by the end of FY 2023 as well.

Electric Utility

Staff and the Finance Committee is proposing a set of rate changes that will decrease bills by 5%. Staff is proposing to deactivate the hydroelectric rate adjuster while increasing base electric rates 21%, for a net decrease in utility bills of 5%. This is in contrast to the original staff proposal recommended for approval by the UAC in March of this year, which involved a 50% reduction in the hydroelectric rate adjuster and a 14% increase in the base electric rates. The new proposal is made possible by the expected receipt of a \$24 million refund from the Bureau of Reclamation of overcharges associated with the Central Valley Project, where the City gets most of its hydroelectric power, as a result of a successful result in litigation the City participated in against the Bureau.

The City uses a hydroelectric rate adjuster because of the year to year variability of output from its hydroelectric resources. On average these have been low cost resources, but the costs are largely fixed and the amount of electricity generated varies year to year. This can lead to higher energy supply costs during dry years and lower energy supply costs during wet years. The City manages this variability using the hydroelectric stabilization reserve, which accumulates reserves during wet years and spends them down during dry years, and the hydroelectric rate adjuster,

which is a surcharge on electric customer bills activated when the hydroelectric stabilization reserve reaches low levels (less than \$11 million) and dry conditions continue.

The hydroelectric stabilization reserve is currently at critically low levels (\$400,000), so staff would normally not recommend removing the hydroelectric rate adjuster, even with an improved outlook for hydroelectric generation. Without funds in the stabilization reserve, removing the rate adjuster entirely would make it likely that the adjuster would need to be activated again next year if next winter's precipitation is low. However, the pending receipt of the refund from the Central Valley Project litigation allows the City to partially refill the hydroelectric stabilization reserve. Staff is proposing adding \$8 million to the reserve, with the expectation that the improved outlook for hydroelectric generation will generate enough electricity supply savings to bring the stabilization reserve above \$11 million. This would greatly reduce the chance that the hydroelectric rate adjuster needs to be reactivated in the next year even if conditions are dry this upcoming winter. With this increase to the reserves, staff and the Finance Committee are comfortable recommending removal of the hydroelectric rate adjuster.

Staff is also recommending that the base electric rates be increased 21%. This recommendation is due to two factors:

- First, without the hydroelectric rate adjuster, FY 2024 electric utility revenues are projected to be approximately \$32 million below costs. This is due to several factors:
 - Rates were not increased during the pandemic while costs continued to increase.
 - Hydroelectric output has been low and is forecasted to be lower on average going forward than it was historically.
 - Electricity supply costs increased greatly in late 2022 and early 2023 and are expected to remain elevated in future years, though lower than winter of 2022/2023.
- By the end of FY 2023 the Electric Utility Supply and Distribution Operations Reserves, which are the risk management reserves for the utility, 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.
- In addition to being below the minimum guidelines the City has loaned \$10 million from its Electric Special Projects Reserve to the Operations Reserves, which is due to be repaid over the next several fiscal years.

When Operations Reserves are above minimum guidelines, they can be drawn down to phase in rate increases over multiple years, but that is not possible this year. The Operations Reserves are currently not only below minimum guidelines but also have an outstanding internal loan. Staff is recommending closing most of the electric utility's annual deficit this year with a 21% increase to base rates. Staff is proposing to repay the \$10 million outstanding internal loan using part of the refund, which means the City does not need to raise rates further than 21% to repay this internal loan over the next few fiscal years. And because Operations Reserves are already so far below minimum, staff is proposing adding \$6 million from the refund to the Operations Reserves

to bring them closer to the minimum guidelines. Even with this addition and the rate increase, the Operations Reserves are only expected to reach minimum levels in FY 2025.

In summary, staff is proposing to use the \$24 million refund as follows:

- Transfer \$8 million to the Hydroelectric Stabilization Reserve to help facilitate elimination of the Hydroelectric Rate Adjuster.
- Repay \$10 million in internal loans and avoid the need for additional internal loans, which also allows rates to be slightly lower in FY 2024 since future loan repayments are no longer needed.
- Add \$6 million to the Operations Reserves to bring them closer to the minimum guidelines.

All \$24 million of the refund is being used in ways that reduce rates indirectly in one way or another, which is why the current staff proposal results in a net 5% bill decrease as compared to the prior staff proposal presented to the UAC, which resulted in no net change in customer bills.

Additional detail on the staff proposal is available in report [11](#), March 21, 2023.

Gas Utility

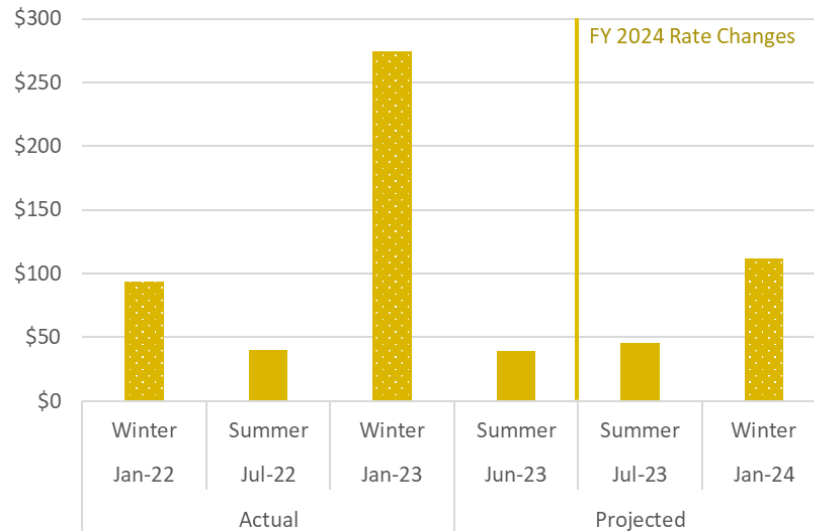
The FY 2024 Gas Utility Financial Plan includes projections of the utility's costs and revenues for FY 2023 through FY 2028. Gas utility costs are made up of gas supply costs (60 percent of costs in FY 2023), which represent the cost of buying gas and transporting it to Palo Alto, as well as environmental charges, and distribution-related costs (40 percent of costs in FY 2023), which represent the cost of operating Palo Alto's gas distribution system, administration, customer service, and other day to day operations. Gas supply revenues to cover gas supply costs are collected through four rate components (commodity, transmission, cap and trade, and Carbon Neutral Gas) that pass gas supply costs through directly to customers, and which change as frequently as monthly. Gas distribution revenues are collected through a distribution rate that is typically adjusted annually. Distribution rates last increased on July 1, 2022, which resulted in a roughly 3 percent increase in the total system average gas rate (the supply rates plus the distribution rates). Staff is proposing an increase to distribution rates that is projected to increase overall customer bills approximately 8%. Note that the actual net change to customer bills will vary depending on usage and the variation in gas supply costs.

Gas market prices rose to unprecedented levels in FY 2023, leading to far higher gas supply costs for Palo Alto in FY 2023 than are projected for FY 2024 through FY 2028. As shown in Figure 2 below, customer gas bills spiked in the winter of 2022/2023 and are expected to decrease significantly by June 2023, just before this rate change would take effect, and are not currently forecasted to reach similar levels next winter, though these forecasts are uncertain.

¹¹ Finance Committee Staff Report 2303-1109

<https://cityofpaloalto.primegov.com/meeting/document/1854.pdf?name=Item%204%20Staff%20Report>

Figure 2: Monthly Median Residential Gas Bill



Staff is proposing to increase the distribution component of the gas rates in FY 2024 to ensure the utility is recovering its costs of operations. Revenues were already below costs after keeping rate increases low through the pandemic, but construction inflation and other factors have driven costs up. The distribution rate increase is projected to increase overall customer bills approximately 8%, though changes to gas supply costs mean that the actual impact to customer bills may be higher or lower. This 8% increase in customer bills results from increasing the distribution component of the rates 21% to fully recover distribution costs and avoid decreasing reserves further.

Even with this distribution rate increase, based on current market forecasts staff expects average annual customer gas bills to decline 13% in FY 2024 compared to FY 2023 because gas supply costs were extremely high in FY 2023, particularly in the winter. FY 2024 annual gas supply costs are forecasted to be about 36% lower than FY 2023. Gas market prices are uncertain, however, and these forecasts can change.

The distribution rate increase is driven by two things: 1) the need to replenish reserves, which were depleted by significant losses due to FY 2023 commodity costs that were not be fully passed through to customers under the City's commodity rate cap of \$4 per therm, and 2) continuing increases in capital and operating costs. Distribution rates did not keep up with these increased costs as the City pursued a Council policy to minimize rate increases during the economic downturn associated with the COVID-19 pandemic.

The gas utility's transfer to the City's General Fund is another 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 adding section 2.28.185 to the Municipal Code. 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. Staff is seeking a Council decision on the amount of the FY 2024 transfer as part of its rate change proposal at tonight's (April 17, 2023) Council meeting (Staff Report 2303-1219). All rate and cost discussions in this staff report are based on Alternative 2, which involves transferring up to 18% of gas utility gross revenues in FY 2023 and 15.5% in FY 2024. The UAC recommended Alternative 2 for adoption (with one dissenting vote for reasons unrelated to the transfer), as did the Finance Committee (with one dissenting vote specifically related to the transfer).

Additional detail on the staff proposal is available in [Staff Report 2302-0946¹²](#), March 21, 2023 and Staff Report 2303-1219 on tonight's (April 17, 2023) Council agenda.

Water Utility

The City's water rate schedules consist of a volumetric charge for each CCF (100 Cubic Feet or 748 gallons) of water consumed during the billing period and a monthly service charge for each customer, based on water meter size. The volumetric charge has two parts: a wholesale commodity rate (or San Francisco Public Utilities Commission or SFPUC wholesale rate), and a customer volumetric rate. Water rates are designed to recover the City's costs of buying and distributing water while maintaining adequate financial reserves. The customer volumetric rate and the monthly service charge together are considered the distribution rates; revenue from those rates pay for the upkeep of Palo Alto's distribution system. Revenue from the wholesale commodity rate pays for the City's cost of buying water from the SFPUC.

Staff and the Finance Committee are proposing a 2% water distribution rate increase (Staff Report 2303-1218, April 17, 2023). CPAU's operational costs for the water utility have increased by approximately 4.8% per year over the last five years and are projected to increase 3% per year on average over the next five years. Primary reasons for the cost increases are allocated charges (charges allocated to the water utility for administrative services provided by the General Fund) and operations and maintenance costs (including engineering). Capital costs have fluctuated from year to year.

The Water Utility's healthy reserve levels allowed the Water Utility to hold rates flat for two years (FY 2021 and FY 2022). In FY 2022 and FY 2023, drought conditions and voluntary water use restrictions led to sales revenue declines and the Water Utility's reserves had adequate funding to manage these reductions together with a 4% distribution rate increase in July 2022. The proposal for the Water Utility uses remaining reserves to mitigate distribution rate increases to 2% in FY 2024, 7% in FY 2025 and 6% annually from FY 2026 through FY 2028 while still funding essential capital investments.

Customers have a separate commodity rate for purchased water from the San Francisco Public Utilities Commission (SFPUC) relative to the rest of the distribution-related portion of the volumetric rates. This commodity charge passes through SFPUC rate increases to customers. The

¹² Council Staff Report 2302-0946 <https://portal.laserfiche.com/Portal/DocView.aspx?id=46283&repo=r-704298fc>

pass-through commodity rate is currently \$4.75 per hundred cubic feet (CCF) and will increase to \$5.30 per CCF on July 1, 2023, according to SFPUC's February 2023 forecast. The SFPUC will not determine its final wholesale customer rate for FY 2024 until May. If SFPUC's final rate for FY 2024 does increase, Palo Alto will notify customers 30 days in advance of the pass-through rate increase via their billing statements or by any other mailing by CPAU to the customer's regular billing address.

Staff expects the combination of the 2% water distribution rate increase together with the 11.6% commodity rate increase to have an overall combined average rate impact on water customers of 6%. If the Council does not approve the water distribution rate increase, this will put more upward pressure on water rates in subsequent years. The Council does not need to take action to pass through the SFPUC commodity rate increase as these rate changes are automatically passed-through as approved by Council on June 17, 2019 ([Resolution 9844](#))¹³.

Wastewater Utility

Staff and the Finance Committee are proposing a 9% Wastewater Collection rate increase in FY 2024, 9% annual rate increases in FY 2025 and FY 2026, 8% in FY 2027 and 5% in FY 2028, to cover current and projected costs. [Staff Report 2302-0944](#)¹⁴ to the Finance Committee on March 7, 2023 contains detailed bill and rate impacts of the Wastewater Collection rate proposals. The Financial Plan projects costs to rise over the forecast horizon due to increasing treatment costs related to capital improvements and operational costs at the Regional Water Quality Control Plant (RWQCP), as well as increasing collection system operational and Capital Improvement Program (CIP) costs. Staff recommends accelerating the rate of main replacements, from 1 mile to 2.5 miles per year beginning in FY 2026. This acceleration will allow the Wastewater Collection Utility to replace the last main no more than approximately 8 years beyond its anticipated 100-year life expectancy. Staff and the Finance Committee's recommendation attempts to minimize rate impacts while also prudently managing the City's infrastructure and maintaining an acceptable level of risk.

TIMELINE

For Gas rates, Council may vote on the gas item on the agenda tonight to approve the Gas Financial Plan, rate changes, reserve and general fund transfers and changes to the reserve management policies and the gas rates would go into effect July 1, 2023.

¹³ Resolution 9844 <https://www.cityofpaloalto.org/files/assets/public/city-clerk/resolutions/reso-9844.pdf?t=69020.51>

¹⁴ Finance Committee Staff Report <https://cityofpaloalto.primegov.com/meeting/document/1691.pdf?name=Staff%20Report>

For Electric rates, Council may vote on the electric item on the Council agenda tonight, the Council would also approve the Electric Financial Plan and rate changes and the approved rates would go into effect July 1, 2023.

For Water rates and Wastewater rates, by approving the consent item on the Council agenda tonight, the Council would approve moving forward with the water and wastewater rate proposals for Council consideration and a public hearing on June, 19, 2023; staff will notice customers in accordance with Prop 218 requirements during April and May. Additionally, for the water commodity pass-through rate, staff expects SFPUC to vote on a wholesale water rate increase in May that will also become effective July 1, 2023. Upon final approval of the wholesale rate increase by the SFPUC, staff will provide Palo Alto customers with notice of any adjustments to the wholesale rate increase and pass through the increase.

For Storm drain and Fiber customer rates, Council will receive these CPI increases at its June 19, 2023 meeting for adoption effective July 1, 2023.

FISCAL/RESOURCE IMPACT

Utility fund resource impacts of the recommendations summarized in this report include the continued financial solvency of the various utilities through the revenue increases described below. The estimated FY 2024 revenue impact of the recommendations in this report would be:

- A \$12 million increase or 6% compared to FY 2023 levels in the Electric Fund (excluding expected monies to be received from the CVPIA payment).
- Sales revenues for the Gas Utility in FY 2024 are projected to increase by roughly \$5.7 million or 8% compared to FY 2023 levels as a result of the proposed rate increases, not including fluctuations in commodity revenue/cost.
- Staff projects estimated revenue for the Water Utility in FY 2024 to increase by \$2.9 million or 6% compared to FY 2023 levels. This estimate includes the SFPUC wholesale rate increase of 11.6% (projected by SFPUC in February 2023; staff expects the Commission to approve a final wholesale water rate increase in May 2023).
- For Wastewater Collection, staff projects revenues in FY 2024 to increase by approximately \$1.8 million or 9% compared to FY 2023 levels because of the proposed rate changes.

The recommendations summarized in this report are reflected in the FY 2024 Proposed Operating Budget except for the Water Utility, which will require revenue and expense adjustments to align with the final SFPUC wholesale rate increase, as that information was not available at the time the budget was produced. Staff will bring these water adjustments forward for Council consideration through the annual budget process.

General Fund resource impacts of the recommendations summarized in this report are revenues from the gas transfer to the General Fund and utility bill costs to the General Fund. The difference

between the City Council transferring 18% and 15.5% of the gross revenues of the gas utility to the General Fund in FY 2024 is approximately \$1.2 million (see Staff Report 2303-1219 on the Council’s agenda tonight for more detail).

As the City’s General Fund departments are utility ratepayers, staff expects the proposed rate changes to increase General Fund utility bill costs by \$0.37 million in FY 2024 as a result of these rate changes relative to General Fund utility bills in FY 2024 without the proposed rate changes. Table 1 summarizes the required General Fund cost increases for utility services.

*Table 1: General Fund Utility Expense Increases in FY 2024
Resulting from Proposed Rate Changes*

Utility	General Fund Utility Expense Increase (\$ millions)
Electric	\$0.14
Gas	\$0.06
Wastewater	\$0.01
Water	\$0.16

STAKEHOLDER ENGAGEMENT

- On June 13, 2022 the Palo Alto City Council reviewed and approved staff’s proposed utility rate changes for fiscal year 2023, (see [Staff Report 13661](#)¹⁵ for more details). Systemwide average rate increases included 5% for electric, 4% for gas, 8.9% for water, 3% for sewer, 4.2% for stormwater and 4.2% for fiber.
- Wastewater Collection main replacement: on October 12, 2022, the Utilities Advisory Commission reviewed three alternative approaches to accelerate the sanitary sewer main replacement ([Staff Report #14610](#))¹⁶ and on November 20, 2022, the Finance Committee considered series of alternative rate trajectories to accelerate the sanitary sewer main replacement ([Staff Report #14611](#))¹⁷. The UAC and Finance Committee provided feedback on additional scenarios they wanted to be reflected in the Financial Plan and staff incorporated this feedback into the final Financial Plans presented to the UAC and Finance Committee.

¹⁵ Council Staff Report 13661 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20220613/20220613pccsm-final-amended-linked.pdf#page=102>

¹⁶ Council Staff Report 14610 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/utilities-advisory-commission/archived-agenda-and-minutes/agendas-and-minutes-2022/10-12-2022/10-12-2022-uac-agenda.pdf>

¹⁷ Finance Committee Staff Report 14611 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/finance-committee/2022/20221129/20221129pfscsm-linked.pdf>

- On [March 1, 2023¹⁸](#) the Utilities Advisory Commission (UAC) reviewed and approved the FY 2024 Electric, Gas, Water and Wastewater Collection Utility Financial Plans and Rate Proposals.
- On [March 7, 2023¹⁹](#), the Finance Committee reviewed the FY 2024 Water and Wastewater Collection Utility Financial Plans and Rate Proposals. The Finance Committee approved the Water Utility proposals and asked staff to return with additional information for further evaluation for the Wastewater Utility.
- On [March 21, 2023²⁰](#), the Finance Committee reviewed the FY 2024 Electric, Gas, Water, and Wastewater Collection Financial Plans and Rate Proposals and unanimously approved the Electric, Water and Wastewater Collection Proposals; the Finance Committee approved the Gas Utility Proposals 2-1 with Council Member Stone voting no.

ENVIRONMENTAL REVIEW

The Council's study session on utility rates does not meet the California Environmental Quality Act's definition of a project, pursuant to Public Resources Code Section 21065 and CEQA Guidelines Section 15378(a) because it will not cause a direct or indirect physical change in the environment.

APPROVED BY:

Dean Batchelor, Director Utilities

Staff:

Jonathan Abendschein, Assistant Director of Utilities

Lisa Bilir, Sr. Resource Planner

¹⁸ Utilities Advisory Commission Staff Reports <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-agenda-and-packet.pdf>

¹⁹ Finance Committee Staff Report

<https://cityofpaloalto.primegov.com/meeting/document/1704.pdf?name=Staff%20Report>

²⁰ Finance Committee Staff Report

<https://cityofpaloalto.primegov.com/Portal/Meeting?meetingTemplateId=11228>