



CITY OF BANNING STAFF REPORT

TO: CITY COUNCIL

FROM: Douglas Schulze, City Manager

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MEETING DATE: August 27, 2024

SUBJECT: Discussion of the Banning Electric Utility Emergency Rate Increase Scenarios

RECOMMENDATION:

Discuss the different alternatives for a possible emergency electrical rate increase and provide direction to staff.

BACKGROUND:

On May 14, 2024 City Council approved Resolution 2024-71, approving a contract with NHA Advisors, LLC (NHA). NHA's scope of work included financial planning, debt management and financial implementation, ballot initiatives and other related services. Recognizing the financial challenges faced by the Banning Electric Utility (BEU), Resolution 2024-71 included a \$100,000 task order to evaluate and assess financing and other options for BEU.

On June 25, 2024, staff presented a report regarding the lowering of the Banning Finance Authority's Outstanding Electric System Revenue Bond rating and requested that City Council consider an interim Electric Rate Adjustment. City Council provided direction to staff to return at a future meeting with options for City Council to consider regarding an Emergency Electric Rate Increase.

City staff worked with NHA, to analyze four preliminary options for an emergency electric rate increase in the to improve operating revenues and replenish cash balances. It is important to note that the analysis presented in this staff report are best estimates available at this time based on a dynamic model, but this modeling is not a cost of service study and NHA is not acting as the City's rate consultant. The City will soon be issuing a request for proposals for a consultant to perform a cost of service study, and is also proceeding with this high level analysis in the interest of time.

Option 1

This option is a "do nothing" scenario and evaluates the impact to BEU of not implementing emergency rate increases. This scenario assumes the first electric utility rate increases happen after the City completes a full cost of service study in conjunction with the electric master plan. Under this scenario, the cash balance is expected to be more negative by FY 2025 end, which will further pressure other City funds and could result in an additional credit rating downgrade. Additionally, it is likely that the BEU will have a covenant default related to the 120% debt service coverage requirement on the 2015 Bonds.

Option 2

Option 2 models the amount of emergency rate increase in FY 2025 needed to simply cover operations and essential expenditures. Using FY 2025 budgeted operating revenues and expenses as the baseline,

it calculates that a 13% one-time rate increase (effective October 1, 2024) would generate sufficient revenues in FY 2025 to allow BEU to fund essential CIP, meet the 120% debt service coverage requirement, and cover operating expenses. The fund balance remains negative and does not see any meaningful improvement under this scenario – which means that other City funds will not be paid back for funds loaned to BEU.

Option 3

Option 3 explores the amount of emergency rate increases needed in FY 2025 and FY 2026 to bring the fund balance back into the black – allowing the Electric Utility to repay what it owes to other City Funds. Analysis of this option calculated that a 64% one-time rate increase in FY 2025, effective October 1, 2024, should generate sufficient revenues to bring BEU cash balance to a positive number after paying back the other City Funds. Under this scenario of Option 3, future years could see a reduction in rates, depending on the findings of the upcoming cost of service study. If stretching that recovery timeline out to two years, two 22% annual rate increases would be needed to bring the fund balance to the same place by the end of FY 2026. Under both scenarios for Option 3, BEU meets its 120% debt service coverage requirement for both fiscal years. Additionally, the BEU replenishes its fund balance within the two-year window given to it by the credit rating agency.

Option 4

Option 4 analyzes the amount of emergency rate increase needed in FY 2025 to cover operations and essential expenditures (similar to Option 2) but expands upon Option 2 to include approximately \$10 million bond financing to bring BEU's cash balance back into the positive (allowing it to repay what it owes to other City Funds). The debt service requires a 13% emergency rate increase in FY 2025, which is similar to Option 2. The trade-off to the benefit of the rapid improvement in cash balance is that this Option 4 also has the interest cost of a financing and long-term annual debt service payments.

Debt service on a bond financing would be structured to have minimal to no payments in the first two years to allow the Electric Utility to build up its reserves and adopt a longer-term rate increase plan. Compared to Option 2, this option would require higher long-term rate increases to support the annual debt service on a bond.

Because of the Electric Utility's current "BB" credit rating, it is likely that a bond financing would be unrated. Additionally, it would be issued on a taxable basis because of IRS limitations on the use of tax exempt debt to reimburse an issuer for prior capital expenditures.

Staff is seeking direction from City Council on which option it would like to proceed with. Staff would return to City Council in September with a resolution for either Option 2, 3 or 4, if one of those are selected.

JUSTIFICATION:

The Electric Utility's cash balance has decreased significantly in recent years due to a combination of capital spending and inflationary pressures. Over the past three years, the Electric Utility has spent \$10 million per year on average toward capital projects. Additionally, while the Electric Utility has historically been able to generate sufficient operating revenues to cover operating expenses, in each of the last three fiscal years – 2022, 2023 and 2024 – operating expenses have been greater than operating revenues. One driver behind this is power purchase costs, which increased 31% from 2019 to 2023.

As a result, the Electric Utility's unrestricted cash and investments balance decreased significantly from over \$18 million in FY 2019 to negative \$9.5 million in FY 2024. Because operating expenses have been greater than revenues in the last three years and cash balances are negative, Electric Utility has needed to borrow from other City funds, which has put significant strain on those funds.

The General Fund's cash balance in FYE 2023 was \$4.5 million after including a \$3.5M amount due from other funds. This is a marked decrease from the General Fund's pooled cash balances over \$13 million in fiscal year 2018. Continued borrowing from the General Fund is not an option to support the Electric Utility. Additionally, the Banning Utility Authority's Water and Wastewater Funds are subject to California's Proposition 218 related to utility rates and charges and having those funds' send cash to the Electric Utility could expose the City to the risk of a legal challenge.

The options listed above, with the exception of Option 1, would provide relief to the current fiscal challenges faced by BEU.

FISCAL IMPACT:

Options 1 thru 4 have different degrees of fiscal impact to BEU.

ALTERNATIVES:

1. Option 1
2. Option 2
3. Option 3
4. Option 4
5. Provide alternative direction to staff.

BUDGETED?:

No

CONTRACT/AGREEMENT:

No

ATTACHMENTS:

1. [Options 1 thru 4.pdf](#)
2. [Staff Report Bond Rating Decrease 6.25.24.pdf](#)
3. [Staff Report Reso 2024-71 NHA Advisors.pdf](#)