



## CITY OF BANNING STAFF REPORT

**TO:** CITY COUNCIL

**FROM:** Douglas Schulze, City Manager

**PREPARED BY:** Art Vela, Public Works Director  
Art Vela, Public Works Director

**MEETING DATE:** June 25, 2024

**SUBJECT:** Discussion Regarding the Lowering of the Banning Financing Authority's Outstanding Electric System Revenue Bond Rating and Consideration of an Interim Electric Rate Adjustment

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### **RECOMMENDATION:**

Discussion and direction regarding an interim electric rate adjustment.

### **BACKGROUND:**

#### Electric System Revenue Bonds

In 2007 the Banning Finance Authority, through the City of Banning, issued a series of electric system revenue bonds ("Electric System Series 2007 Bonds") to assist in the financing of improvements including new substations, circuit breakers, underground feeders, land and other improvements. The amount of the Electric System Series 2007 Bonds was \$45,790,000.

In 2015, City Council (acting as the Banning Finance Authority) adopted Resolution 2015-02FA authorizing the refunding of the revenue bonds ("Electric System 2015 Refunding Revenue Bonds") with the intent to take advantage of historic low interest rates which were to save the City approximately \$1,050,000. At the time of the refunding, the Electric System Series 2007 Bonds had an outstanding aggregate principal amount of \$40,045,000. The Electric System 2015 Refunding Revenue Bonds were authorized in an amount of not-to-exceed \$45,000,000.

For clarity purpose, a revenue bond is a type of municipal bond. Municipal bonds act like loans, with bondholders becoming creditors. In exchange for borrowed funds (i.e. funds invested by bondholders) the bondholders/investors are promised interest on their invested amount. Revenue bonds are secured by revenues generated by the issuer which, in the City's case, is the City's Electric Utility.

#### Electric System 2015 Refunding Revenue Bonds Ratings

Credit ratings are provided by credit rating agencies, such as S&P Global, that specialize in evaluating credit risk. Credit ratings are forward looking and provide investors with independent opinions about an issuer's, such as a corporation or state/city government, to meet its financial obligation. Typically, ratings are expressed as letter grades that range from 'AAA' to 'D' to communicate the agency's opinion of relative level of credit risk.

From the S&P Global's website: "Our studies have shown that the higher the ratings, the lower the default rates, and vice versa. For example, our historical statistics show a 3-year cumulative default rate for a 'BBB' rated company of 0.91%, vs. 4.17% for a 'BB' rated one, 12.41% for a 'B' rate one and 45.67% for a 'CCC/CC' rate one."

On March 20, 2024 the City of Banning received notice from S&P Global that they had lowered the underlying rating from 'A-' to 'BBB' and put on Credit Watch, see attached correspondence and back up analysis.

On May 2, 2024, the City of Banning received notice from S&P Global that they had again lowered the underlying rating from 'BBB' to 'BB' with an "outlook for this rating as negative", see attached correspondence and back up analysis ("May 2024 S&P Analysis").

In summary, according to the May 2024 S&P Analysis the recent downgrading of the Electric System 2015 Refunding Revenue Bonds was a result of the following:

- The use of interfund borrowings to meet financial obligations.
- Lack of proactive rate setting.

May 2024 S&P Analysis also describes that the outlook is negative which "reflects our view that rates are not anticipated to be raised before fiscal-year end 2025.

#### Fiscal Year 2024/2025 Budget

In an effort to improve the Banning Electric Utility's financial position the City has taken to following approach reflective in the planned Fiscal Year (FY) 2024/2025 budget:

- Continued implementation of the Power Cost Adjustment Factor (PCAF; Estimated at \$1.1M). The PCAF began on January 1, 2022.
- Continued to sell Renewable Energy Credits (RECs; Estimated at \$2.48M)
- Reduced the utility's Capital Improvement Plan from \$16.4M to \$1.1M
- Collection of delinquencies (\$1.9M). Shutoff notices resumed in April, 2024.

With the above changes the Electric Utility is projected to have a FY 2024/2025 budget shortfall of \$1,200,130.

It is also projected that the Electric Utility will have a FY 2025/2026 budget shortfall of \$1,135,060.

For reference, the Electric Utility will have a budget shortfall of approximately \$4.7M at the end of FY 2023/2024. Although the utility is expecting a \$2.5 million Aid In Construction payment to be recorded before June 30, 2024, which will reduce that expected net loss to approximately \$2.2 million.

One option for City Council's consideration would be an interim rate adjustment in order to avoid further deterioration of the Banning Electric Utility's cash position, which is projected to be negative \$8.8M at the end of FY 2023/2024. If City Council provides direction to staff to proceed with this option, staff will present an analysis and recommendation to City Council at the August 27, 2024 City Council meeting.

The rate adjustment would be considered "interim" while staff hires a consultant to develop a complete Cost of Service (COS)/Rate Study, which would likely be completed during the fourth quarter of FY 2024/2025.

#### **JUSTIFICATION:**

According to the May 2, 2024 S&P Analysis, the Electric System 2015 Refunding Revenue Bonds rating could be further downgraded if the Banning Electric Utility is not able to rebuild and maintain a sustained track level of positive reserves and improve its structural balance.

The May 2024 S&P Analysis indicates that the "negative outlook" is a result of rates likely not being raised prior to fiscal year end 2025.

**FISCAL IMPACT:**

The projected budgetary shortfalls for FY 2024/2025 and FY 2025/2026 will continue to negatively impact the utility's cash balance, which may result in a higher rate increase in the future.

**ALTERNATIVES:**

Do not proceed with Interim Electric Rate Adjustment.

**ATTACHMENTS:**

1. [Resolution No. 2015-02 FA Electric Refunding Bonds.pdf](#)
2. [March 2024 S&P Rating Downgrade.pdf](#)
3. [May 2024 S&P Rating Downgrade.pdf](#)
4. [S&P Rating Scale.pdf](#)
5. [FY25 and FY26 Electric Budgets, pdf.pdf](#)