**CITY OF BANNING**
**STAFF REPORT**

**TO:** **CITY COUNCIL**

**FROM:** **Douglas Schulze, City Manager**

**PREPARED BY:** **Art Vela, Public Works Director**
**Lincoln Bogard, Administrative Services Director**

**MEETING DATE:** **September 24, 2024**

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

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**RECOMMENDATION:**

Discussion of the Banning Electric Utility Emergency Rate Increase Scenarios and provide staff with direction with which scenario to move forward with.

**BACKGROUND:**

On August 27, 2024, City Council received a report from staff and discussed four options for a potential Banning Electric Utility Emergency Rate In Increase, staff report attached hereto. The four options were are follows:

| | **Option 1** | **Option 2** | **Option 3A/3B** | **Option 4** |
|---|---|---|---|---|
| **Description** | No Action | Maintains Services | Maintains Services and Replenishes Cash with Rate Revenues | Maintains Services and Replenishes Cash $10M Bond |
| **Rate Increase** | None | 13% in FY 2025 | 64% in FY 2025 or 22% in FY 2025 and 22% in FY 2026 | 13% in FY 2025 |

After discussing the options above, Councilmembers selected their preferred option as follows:

- Mayor Sanchez: Option 4
- Mayor Pro Tem Minjares: Option 3B
- Councilmember Wallace: Option 3B
- Councilmember Flynn: Option 3B
- Councilmember Happe: Option 3B

As part of the discussion, Mayor Pro Tem Minjares and Councilmember Flynn requested that staff also provide a revised Option 3 to spread the increases over three years rather than two years.

Staff has evaluated and prepared the following scenarios for Council's consideration:

**Scenario 3B**

This scenario is very similar to the scenario shown to City Council in August and models what kind of rate increase would be required to bring the Electric Utility's cash from negative to positive by the end of fiscal year 2026. This modeling assumes two rate increases – one in November 2024 and one in November 2025. Each of these rate increases is 22.7%. This is slightly higher than the 22% increases shown to Council in August because the analysis in August assumed that the first rate increase would be effective October 1 compared to the November 1 assumption in this update. This analysis assumes that rate increases apply equally to both the energy charge (per kWh) and the Basic Service Charge.

Of the scenarios evaluated for this report, this scenario has the greatest near-term increases.

**Scenario 3C**

Based on a request at the August 27th City Council meeting, this scenario evaluates the annual rate increases needed to bring the Electric Utility's cash from negative to positive by the end of fiscal year 2027. Because this scenario assumes a longer recovery, it requires approximately 14.7% annual rate increases – one in November 2024, one in November 2025, and one in November 2026. Under this scenario, the cash balance stays negative until FY 2027. Similar to scenario 3B above, the modeling for this scenario assumes the energy charge (per kWh) and the Basic Service Charge increase with the rate increases.

Because this scenario has the slowest recovery of the Electric Utility's cash, there is greater risk that unforeseen expenses or cost increases prevent that recovery. Additionally, there is greater risk of further downgrades in the Electric Utility's credit rating because of this slower recovery.

Finally, due to the anticipated timing of a Cost of Service Study, it is likely that the November 2026 rate increase under this scenario will be changed to something other than 14% based on the findings of that study.

**Scenario 4B**

This scenario explores the strategic use of bond funding to facilitate the recovery of Electric Utility's cash position by the end of fiscal year 2026. Unlike the bonds scenario presented to the Council in August (Scenario 4), this Scenario 4B assumes a significantly smaller amount of bond funding raised: $6 million total. That amount is split into $2.2 million raised from a tax-exempt financing and $3.8 million raised from a taxable financing. While the taxable portion is used to replenish fund balance, the tax-exempt portion of the financing is used to address the budgeted capital expenditures in FYE 2025 and 2026. While the entire financing will likely be unrated given the current "BB" credit rating, unlike a taxable interest rate (assumed to be 7%) this analysis assumes a tax-exempt interest rate of 5.5% for a 20-year financing.

Under this scenario, two 13.9% annual rate increases are needed in FY 2025 and FY 2026, followed by additional rate increases in future years to support the debt service. Preliminary modeling suggests that those rate increases beyond FY 2026 are in the 4-6% range.

Unlike Scenarios 3B and 3C above, this Scenario 4B spreads the costs of the capital expenditures and fund balance recovery over a longer period of time. However, because this scenario uses bond financing, there is the cost of long-term bond repayments – though those costs are spread out over 18-20 years.

The table below summarizes of the key comparisons of the three scenarios for the Residential Service Rate. Please note that the projections for FY 2027 will likely change based the findings of the Cost of Service Study:

| | FY 2025 | FY 2026 | FY 2027 |
|---|---|---|---|
| *Date Rate Increases Effective* | *November 1* | *November 1* | *November 1* |
| **Scenario 3B** | | | |
| Rate Increase (Energy Charge Only) | 22.7% | 22.7% | 0% |
| Cost per kWh | $0.174 | $0.214 | $0.214 |
| Basic Service Charge | $37 | $45 | $45 |
| Avg SFR Monthly Bill* | $136 | $165 | $165 |
| **Scenario 3C** | | | |
| Rate Increase (Energy Charge Only) | 14.7% | 14.7% | 14.7% |
| Cost per kWh | $0.163 | $0.187 | $0.214 |
| Basic Service Charge | $34 | $39 | $45 |
| Avg SFR Monthly Bill* | $127 | $145 | $166 |
| **Scenario 4B** | | | |
| Rate Increase (Energy Charge Only) | 13.9% | 13.9% | 5% |
| Cost per kWh | $0.162 | $0.184 | $0.194 |
| Basic Service Charge | $34 | $39 | $41 |
| Avg SFR Monthly Bill* | $126 | $143 | $150 |

**JUSTIFICATION:**

The Electric Utility's cash balance has decreased significantly in recent years due to a combination of capital spending and inflationary pressures. Over Fiscal Years 2020-21 through 2022-23, the Electric Utility 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 would provide relief to the current fiscal challenges faced by BEU.

**FISCAL IMPACT:**

Options 3B, 3C and 4B have different degrees of fiscal impact to the Banning Electric Utility.

**ALTERNATIVES:**

1. Option 3B
2. Option 3C
3. Option 4B
4. Provide alternative direction to staff.

**BUDGETED?:**

No

**CONTRACT/AGREEMENT:**

No

**ATTACHMENTS:**

1. 8.27.24 Electric Rate Increase Options Staff Report.pdf
2. 8.27.24 Electric Rate Increase Power Point NHA Advisors.pdf
3. Option 3B Electric Rate Schedules.pdf
4. Option 3C Electric Rate Schedules.pdf
5. Option 4B Electric Rate Schedules.pdf
6. Financial Analysis of Options.pdf