



CITY OF BANNING STAFF REPORT

TO: CITY COUNCIL

FROM: Robert Fisher, Acting City Manager

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MEETING DATE: February 25, 2025

SUBJECT: Discussion of Next Steps in the Banning Electric Utility Financial Recovery Plan

RECOMMENDATION:

City Council previously approved a strategy for recovering the Banning Electric Utility's (BEU) cash balance including a 13.9% rate increase each November 2024 and 2025, and \$6 million debt issuance to replenish cash balance ("BEU Financial Recovery Plan"). Staff requests a discussion and confirmation of the next step (debt issuance) or alternative Council direction.

BACKGROUND:

Prior to November 2024, the Banning Electric Utility (BEU) last increased rates overall in 2013. During the intervening years, the BEU saw increased pressure from operating expense inflation, increasing power purchase costs (increasing 31% from 2019-2023), and increased capital expenditures. During this time, BEU's average monthly single family residential bill was significantly lower than neighboring cities served by Southern California Edison.

During the three-year period from fiscal years 2020-21 through 2022-23, BEU expended approximately \$10 million per year on capital projects (compared to a prior 6-year average of \$3.5 million per year). Prior to fiscal year 2020-21, the BEU's reserves remained above \$15 million (higher than the ~\$11 million policy). However, with the increased capital expenditures beginning in Fiscal year 2020-21, BEU's reserves and cash balance saw dramatic decreases during the subsequent three-year period. In fiscal year 2023-24, BEU did not generate sufficient revenues to cover its operating costs, debt service, and capital expenditures (though capital expenditures were reduced to the minimum amount possible in fiscal year 2023-24). As a result, BEU had a bond debt service coverage covenant default (debt service coverage was well under the 120% required in the bond documents). Additionally, BEU ended fiscal 2023-24 with a negative \$6.5 million cash balance. BEU operating expenses and debt service payments were made through borrowing from other City Funds, putting pressure on those funds – including the City's General Fund.

As a result of this deteriorating financial position, S&P Global Ratings took several actions to decrease the BEU's rating from "A-" (June 2022) to "BB-" (November 2024). They met with City staff twice in 2024 to discuss the financial condition and the City's plan to improve the condition of its finances over the next two years. The most recent downgrade to "BB-" in November 2024 also had a negative outlook – which means that S&P plans to further downgrade the credit rating if BEU's financial position does not increase materially over the next year or two.

At the August 27, 2024, City Council meeting, Council received a report from staff and discussed four

options for a potential BEU Emergency Rate Increase, staff report attached hereto. Those four options ranged from “do nothing” to implementing a one-time 64% emergency rate increase to replenish the BEU’s cash position and remedy its coverage covenant default. After discussion, Councilmembers selected an initial option which included two 22% emergency rate increases (one in November 2024 and the second in November 2025). Council also requested that staff evaluate some additional scenarios and present an updated analysis at a subsequent meeting.

At the September 24, 2024, City Council meeting, Council reviewed updated analysis of options available to bring the Electric Utility’s cash balance from negative to positive by the end of fiscal year 2026, staff report attached hereto. Staff presented three scenarios at that meeting – a scenario (3B) that reflected 22.7% rate increases each November 2024 and November 2025, a second scenario (3C) that spread those rate increases over a 3-year period (14.7% per year, each November 2024-2026), and a third scenario (4B) that targeted a 13.9% rate increase each November 2024 and 2025, and \$6 million debt issuance to replenish cash balance (“BEU Financial Recovery Plan”). City Council indicated a preference for the third (4B) scenario, with the assumption that the debt financing component would be evaluated at a subsequent meeting.

At the October 22, 2024 City Council Meeting, City Council took action to adopt Resolution 2024-169 that authorized an emergency 13.9% rate increase, effective November 1, 2024 and authorize a second 13.9% emergency rate increase, effective November 1, 2025. The understanding is that the actual rate increase on November 1, 2025, will be subject to the findings of an electric rate study. That electric rate study is underway and Staff expect that it will be completed in Fall 2025.

Based on this background and the adopted 13.9% rate increases, staff wish to discuss the financing component of the BEU Financial Recovery Plan to get further direction from City Council.

JUSTIFICATION:

The City Council took action in October 2024 to authorize two 13.9% emergency rate increase each November 2024 and November 2025. These rate increases are deemed necessary to maintain the solvency of BEU and ensure that there are sufficient revenues to pay for operating expenses, power purchase costs, and minimal, but essential capital projects.

The current BEU Financial Recovery Plan assumes 13.9% annual rate increases each November 2024 and November 2025. Additionally, it assumes that the City issues a \$6.1 million bond, split into two series: a \$2.3 million tax exempt series to be used to address capital needs through fiscal year 2026 and a \$3.8 million taxable series to be used to repay a portion of what BEU owes to other City Funds and bring BEU cash balance positive by the end of fiscal year 2025-26.

Because of BEU’s current credit rating (“BB-“), a debt financing would likely be issued without a credit rating. Additionally, given the size and anticipated term (20 years or less), the bonds would be sold through private placement process to a single investor (typically a regional or national bank). Given the BEU’s financial position, we would expect that an investor would require a significant risk premium in the interest rate. Additionally, since a portion of the financing would be issued on a taxable basis, we would anticipate that portion to have an interest rate in the 6-7% range. In addition, NHA Advisors informed staff that there may be additional options available to more comprehensively address the liquidity needs through a larger restructuring of the existing debt of BEU. These options require further research to validate, but would still require City Council’s approval to issue new money debt for the purposes outlined in the original plan.

Upon direction from City Council, staff will work with NHA Advisors (the City’s "Municipal Advisor") and other financing professionals (legal counsel, placement agent) to solicit financing proposals from regional and national banks. City staff will work with NHA Advisors to evaluate the proposals, select the best proposal, and bring a financing agreement before council at a subsequent meeting for consideration. It’s important to note that soliciting financing proposals does not obligate the City to enter into a financing

agreement.

If BEU does not issue debt, the timeline for BEU's cash balance to return to a positive position (and repay all inter-fund loans to other City funds) is extended two more years – fiscal year 2027-28. As an alternative option to debt financing, the City could explore higher rate increases in fiscal year 2025-26 (higher than the 13.9% approved by Council in October 2024) to bring BEU's cash balance positive by the end of fiscal year 2025-26. City staff can work with its rate consultant and municipal advisor to determine the magnitude of rate increases needed under this alternative.

FISCAL IMPACT:

There is no fiscal year 2024-25 budgetary impact from Council directing staff to solicit financing proposals from banks. The City would be under no obligation to enter into a financing agreement after soliciting proposals. Said financing proposal would be brought to Council at a future meeting for consideration. The issuance costs of financing (likely ~2% of principal) are paid on a contingent basis (contingent upon successful completion of the financing) and would be paid out of the financing and amortized over the life of the loan. First debt service payments would not commence until fiscal year 2025-26.

If BEU does not bring its cash balance positive by the end of fiscal year 2026, it is possible that S&P would further downgrade BEU's 2015 Bonds. Since the 2015 Bonds were sold with a fixed interest rate, changes in the credit rating (up or down) do not impact the annual debt service on those bonds. Rather, the current credit rating impacts the future cost of issuing bonds or debt financing future capital projects. All else being equal, higher credit ratings translate into lower cost of borrowing.

In addition to the credit rating considerations, BEU's negative cash balance is only possible through extensive inter-fund borrowing. This borrowing puts stress on other City funds, namely the General Fund. Failure to improve BEU's cash balance and bring it into the positive territory would continue to have a negative impact on the General Fund's available cash balance and could impact City services.

ALTERNATIVES:

1. Direct City staff to work with its Municipal Advisor to assemble a finance team to solicit bank bids for a private placement of approximately \$6.1 million in BEU debt and evaluate a potential restructuring of existing debt.
2. Direct City staff to work with its rate consultant to provide a comparison of rate impacts with and without debt financing. This alternative will essentially eliminate or defer the debt financing step include as part of the BEU Financial Recovery Plan, lead to a potential downgrade of BEUs credit rating and defer capital investments (i.e. infrastructure and equipment).
3. Provide alternative direction to staff

BUDGETED?:

Yes

CONTRACT/AGREEMENT:

No

ATTACHMENTS:

1. [Staff Report - August 27 2024 \(BEU Rate Increase Options\).pdf](#)
2. [Staff Report - September 24 2024 \(BEU Rate Increase Options\).pdf](#)
3. [Resolution 2024-169 - October 22 2024 \(Approving BEU Rate Increases\).pdf](#)
4. [Summary of BEU Recovery Plan.pdf](#)