



# RIVERSIDE PUBLIC UTILITIES

## Board Memorandum

**BOARD OF PUBLIC UTILITIES**

**DATE:** AUGUST 28, 2017

**ITEM NO:** 8

**SUBJECT:** ELECTRIC AND WATER UTILITY 5-YEAR RATE PROPOSAL FY 2018-2022 AND PROPOSAL FOR ANNUAL CONSUMER PRICE INDEX ESCALATORS FOR FY 2023-2027

**ISSUES:**

Recommend that the City Council review the Electric and Water Utility 5-year Rate Proposal developed to repair and replace aging and critical utility infrastructure, maintain public health and safety, maintain utility financial health, and improve customer service as per the City Council's direction on October 6, 2015, to develop a financial plan for the 10-year Utility 2.0 Strategic Plan Option 3; review proposal for annual consumer price index escalators for FY 2023-2027; direct staff to conduct public outreach of this proposal in October and November 2017; and direct staff to return with a public hearing to the Board and final rate recommendation to the City Council in January and February 2018, respectively, with new rates effective April 2018.

**RECOMMENDATIONS:**

That the Board of Public Utilities recommends that the City Council:

1. Review the Electric and Water Utility 5-year Rate Proposal (Utility Rate Proposal) for FY 2018-2022 developed to repair and replace aging and critical utility infrastructure, maintain public health and safety, maintain utility financial health, and improve customer service as per the City Council's direction on October 6, 2015 to develop a financial plan for the 10-year Utility 2.0 Strategic Plan Option 3;
2. Review proposal for annual consumer price index escalators for FY 2023-2027;
3. Direct staff to conduct a citywide community outreach initiative of the Utility Rate Proposal in October and November 2017; and
4. Direct staff to return with a public hearing to the Board and final rate recommendation to the City Council, in January and February 2018, respectively, with new rates effective April 2018.

**BACKGROUND:**

The City Council last approved 5-year and 4-year water and electric utility rate increases in 2006 and 2007, which was about 10 years ago. The last rate increases from these plans were effected in 2010. RPU froze rates immediately after the Great Recession in July 2010, due to the severe economic downturn in the Inland Empire. Further, water rates remained unchanged through the worst drought in more than 125 years, unlike most other water agencies that were required to raise rates because of reduced demand. During the drought RPU was mandated by Governor Brown's executive orders to reduce water sales, even though RPU had sufficient water supplies. RPU sued State regulators and by the time the lawsuit was

resolved, water revenues were reduced by 13%, approximately \$33 million. Over the last 10 years legislation and regulations also have dramatically increased costs to the electric utility. RPU was able to keep rates stable through water independence (achieved through past infrastructure investments), negotiating power supply contracts at the lowest prices available, securing low cost financing with strong bond ratings and reliance on financial reserves. Now, RPU has reached a point where rate increases are unavoidable.

Several joint meetings in Q2 and Q3 2015 were held with the Board and City Council to evaluate and discuss the strategic objectives and roadmaps that support Utility 2.0. On October 6, 2015 the City Council conceptually approved Option 3 of the Utility 2.0 Strategic Plan. The costs presented are an updated version of Option 3, as conceptually approved by City Council, and include items such as cost escalation factors, increased renewable and compliance costs, and reduced conservation costs. The Utility 2.0 Plan can be found on RPU's website at <http://riversideca.gov/utilities/utility20>.

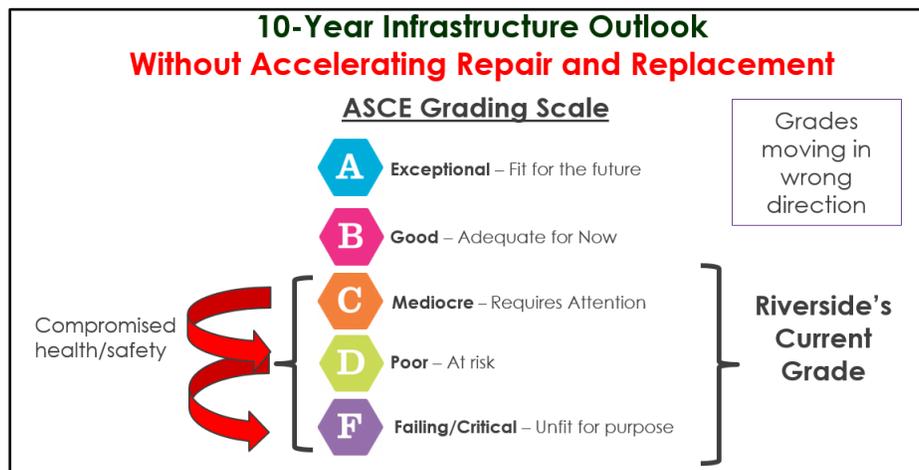
In mid-2015, the Board of Public Utilities approved moving forward with a Cost of Service Analysis (COSA) and Rate Design Study (RDS) for both the electric and water utilities. Each COSA was performed first and used as input into the RDS in order to fairly and objectively determine the required rate restructuring. Each RDS also incorporated and accounted for various regulatory constraints and mandates, including the latest renewable percentage standards (electric) and drought mandates (water). RPU has now completed a COSA for both electric and water; these results have been used to determine the appropriate allocation of revenue requirements to electric and water customer classes. Additionally, RPU has completed each RDS and used these studies to guide the development of the proposed rates. The COSA and RDS for the electric and water utilities can be found in Attachments 5 and 6, respectively.

In addition to the discussion below, many charts and figures relating to this proposal are included in Attachment 1.

## **DISCUSSION:**

### ***RPU Needs Assessment and Costs:***

RPU and the Public Works Department utilized the American Society of Civil Engineers (ASCE) infrastructure grading system to frame each department's current and future infrastructure outlook. This grading system was presented to the City Council on July 10, 2017 and to the Board of Public Utilities on August 14, 2017. This grading system is a simple-to-understand report card of the thousands of assets (wires, pipes, poles, vaults, transformers, valves, etc.) that need repair and replacement. Current grades for RPU fell in the B (Good - adequate for now) to F (Failing/Critical) ranges for the various infrastructure categories, with a substantial portion of infrastructure in the C (Mediocre) to D (Poor) range. Without immediately accelerating repairs to electric and water utility infrastructure – as recommended in the 10-year Utility 2.0 infrastructure plan – RPU's infrastructure will continue to deteriorate and grades will drop to D and F.



**Proposed Revenue Increases:**

Actual rate increases will vary by customer class and consumption levels, but on average, the projected annual average system rate increase is 4.8% for electric and 8.6% for water per year. Attachments 2 and 3 to this report outline all of the proposed rates by Domestic, Commercial and Industrial customer classes for the proposed electric and water five-year rate plan, respectively.

**Ensuring Affordability:**

RPU's electric and water rates are competitive and among the lowest in the region when compared to neighboring utilities. Even after implementing these proposed rate increases, RPU will remain highly competitive with other California utilities that face similar financial challenges and pressures. RPU will also expand its rebates and offerings to assist low-income customers.

RPU has kept the proposed rate increases as low as possible by maximizing the use of ongoing non-retail revenues such as transmission revenues from the use of electric transmission lines, sales of excess renewable power, scheduling coordinator services to other agencies, conveyance of water and wholesale water sales to Western Municipal Water District, and leases of real property owned by RPU; reducing operating costs through use of new technologies, including installing solar networks to reduce water production costs; and proposing the use of a line of credit for electric and water that is a low-cost way to reduce necessary cash levels and increase the Utility's overall liquidity.

**Consumer Price Index Increase Proposal (FY 2023-2027):**

Customers are able to plan for and budget smaller rate increases that are implemented more frequently rather than larger rate increases implemented less frequently. RPU has not increased rates in more than 7 years, during which time the consumer price index (CPI) has increased by 13%. Customers are significantly impacted by a delay in rate increases since they are unable to plan and budget accordingly. In order to prevent this from reoccurring, staff is proposing that the Board and City Council consider for the next five year period beginning 1/1/2023 that an automatic rate increase equal to the CPI, issued by the Bureau of Labor Statistics, be considered each year through 2027 as part of this proposal. As outlined in RPU's fiscal policy, a two-year budget and five-year financial plan is prepared every two years. Projected revenue and costs will be analyzed to determine if the annual CPI is sufficient to cover the revenue requirement. Should it be determined that a higher or lower rate increase is necessary, a proposal will be presented to the Board and City Council for consideration.

**Without Proposed Revenue Increases to Accelerate Infrastructure Repair and Replacement:**

Without a rate increase, RPU will experience reserves going below minimum required targets within the next 12 to 18 months. Reserve levels dropping below minimum required targets will require significant reductions to expenditures including drastic reductions in RPU's current capital program, deep cuts to current operations and maintenance spending plans, and decreased funding for planned customer service initiatives. All of which, would require significant personnel reductions that will severely impact response time to customers.

In addition, when reserve levels drop below minimum mandated levels, this will result in lower bond ratings which will increase the cost of borrowing. Based on current cash flow estimates, staff estimates that electric and water reserves will drop below the mandated minimum reserve levels by October 2018 and June 2018, for the electric and water utility, respectively.

In the case of delays to this rate proposal, a substantially larger rate increase would be necessary in the future to cover both the cost of current projects and programs described herein, as well as higher future costs of borrowing. Delaying the rate increase even one year will cause the proposed rates to increase. Investments in aging infrastructure have been deferred as long as practical without impacting reliability and customer service.

### **Legal Considerations:**

In general, California law mandates that the rates for utility service cannot exceed the cost to provide that utility service. RPU developed proposed electric and water rates in accord with California law. Here is a brief summary of the applicable laws:

Proposition 26 (electric) – California voters approved Proposition 26 in November of 2010. Proposition 26 amended Article XIII C of the State Constitution to expand the definition of “tax” to include “any levy, charge, or exaction of any kind imposed by a local government” with listed exceptions. Any charges that did not fall within one of the exceptions now required voter approval. Electric utility rates that do not exceed the cost of such service are an exception to Prop 26’s voter approval requirements, as are any charges that predated Prop 26.

Proposition 218 (water) – California voters approved Proposition 218 in November of 1996. Prop 218 added Article XIII C and Article XIII D to the California Constitution and regulated the imposition of and use of revenue from property-related fees. The California Supreme Court has ruled that Prop 218 applies to water service, meaning that rates for such service cannot exceed the cost to provide the service, and ratepayers must have the opportunity to register their disapproval of such rates prior to adoption. Water rates which exceed the cost of service require voter approval.

City Charter section 104(f) and 1204.1 require that 11.5 percent of gross operating revenues of each utility be annually transferred to the general fund (the “Electric GFT” and the “Water GFT”). Both the Electric and Water GFTs comply with Prop 218 and Prop 26, as voters have approved such transfers.

### **Proposed Rate Restructuring:**

RPU is recommending a redesign of its rates over a five-year period to better align with its cost of serving customers and its revenue requirements. The electric and water rate restructuring is designed to not only fund the 10-year infrastructure program but also allow RPU to meet industry changes by providing better financial and revenue stability. For an outline of the specific key changes to RPU’s rate structure, refer to Attachment 4.

The electric rate restructuring is designed to provide financial stability to support RPU’s efforts to sustainably improve infrastructure reliability, meet renewable energy and energy efficiency goals, follow legal and regulatory requirements and correct the imbalance of costs versus revenue recovery. Rates have been designed to provide a transition to reflect the nature of underlying costs while encouraging the expansion of customer solar and other distributed generation. These changes provide increased revenue stability. Solutions proposed include:

1. Improving fixed cost recovery from 23% currently to 31% which still leaves a gap to get to 58% per the Cost of Service report. In order to do so, RPU is introducing a Network Access Charge for all customers which is a fixed charge for recovery of distribution system costs.
2. Seasonal adjustment for residential customers to extend from 3 months into a 4 month summer season to reflect summer weather and usage patterns.
3. Introducing two new Domestic Time of Use rates for residential electric vehicle customers to encourage adoption and off peak charging.
4. Implementing a regulatory and power cost adjustment to allow for the recovery of unanticipated costs which are out of the control of RPU and its governing bodies.

The water rate restructuring is also designed to provide financial stability to support RPU’s efforts to improve infrastructure reliability and revenue stability. The rate structure enhancements also center on providing increased revenue stability from both fixed and variable charges, simplifying specific rate structures, and creating new customer classes for distinct user groups. Solutions proposed include:

1. Improving fixed cost recovery from 28% currently to 40% which still leaves a gap to get to 90% per the Cost of Service report. In order to do so, RPU will be implementing a uniform fixed monthly customer charge for each meter size, reducing 41 different customer charges down to 10.

2. Implementing residential tier restructuring to reduce from four tiers to three and reduce the tier 1 allotment based on state recommended usage in order to prepare for future budget based rates.
3. New multi-family rate structure for accounts with 2 to 4 dwelling units which provide tier allotment that properly reflect multi-family indoor usage.
4. Implementing a pass-through cost adjustment to allow for the recovery of unanticipated changes in power and chemical costs.

Staff also recommends moving towards Cost of Service transitionally over the five-year rate plan to avoid significant rate increases to certain utility customers. The two rate classes most affected by transitioning to Cost of Service over the five-year period are water rates relating to Groves (WA-3 and WA-9) and Cemeteries (WA-7). The revenue shortfall from these transitions will be covered by non-retail revenues such as interest and lease income during the transitional period. The Cost of Service reports are included in the Attachments 4 and 5 to this report.

**Community Outreach Plan**

To make sure ratepayers have ample opportunity to comment on this proposal, community presentations will be scheduled across all city wards. Because of the unique nature of the utilities’ needs of the small to large commercial customer, staff will arrange personalized consultations and specialized outreach sessions. In addition, a web page will be created to collect comments, perform predictive rate calculations for residential customers and to house all other documentation to help customers understand the proposed changes. A public hearing will be held before the rates are adopted and required written noticing will be mailed to ratepayers in advance.

**Timeline for Rate Plan**

| PROPOSAL   | OUTREACH  | RECOMMENDATION                                 | IMPLEMENTATION |
|--|-----------|--|----------------|
| August 28 – RPU Board<br>September 26 – City Council | Oct - Nov | January – RPU Board<br>February – City Council | April 2018     |

Following the proposed timeline listed above for rate adoption, RPU can ensure that the utility will continue RPU’s system reliability to the community for the foreseeable future.

**FISCAL IMPACT:**

| Five-Year Rate Proposal 2018-2022                                     | Electric Utility | Water Utility |
|---|------------------|---------------|
| Average Annual Rate Increase  | 4.8%             | 8.6%          |
| Total Revenue From Rate Increase over 5 years                         | \$185,000,000    | \$47,000,000  |
| Total Retail Revenue over 5 years                                     | \$1,731,000,000  | \$349,000,000 |
| % Retail Revenue from Rate Increase                                   | 10.6%            | 13.5%         |
| Total Increased renewables and compliance costs over 5-year rate plan | \$89,000,000     | \$0           |
| Total planned Infrastructure over 5-year rate plan                    | \$246,000,000    | \$171,000,000 |
| Total Bond Proceeds to fund infrastructure over 5 years               | \$197,000,000    | \$113,000,000 |
| % of Infrastructure Financed over 5 years                             | 80%              | 66%           |

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 Approved by: John A. Russo, City Manager  
 Approved as to form: Gary G. Geuss, City Attorney

Certifies availability of funds: Laura Chavez-Nomura, Utilities Assistant General Manager/Finance

Attachments:

1. Presentation
2. Schedule of Proposed Electric Rates by Domestic, Commercial and Industrial Customer Classes for the Five-Year Rate Plan
3. Schedule of Proposed Water Rates by Domestic, Commercial and Industrial Customer Classes for the Five-Year Rate Plan
4. Electric and Water Key Changes to Rate Structures
5. Electric Cost of Service and Rate Design Study
6. Water Cost of Service and Rate Design Study