City of Arts & Innovation

City Council Memorandum

TO: **HONORABLE MAYOR AND CITY COUNCIL** **DATE: JANUARY 18, 2018**

FROM: **PUBLIC UTILITIES DEPARTMENT** **WARDS: ALL**

SUBJECT: **JOINT WORKSHOP WITH THE BOARD OF PUBLIC UTILITIES FOR THE ELECTRIC AND WATER UTILITY FIVE-YEAR RATE PROPOSAL**

ISSUES:

In October 2015, after several Board and City Council workshops, the City Council directed staff to develop a rate proposal to fund the Utility 2.0 Strategic Plan's Option 3 electric and water utility infrastructure improvements. Option 3 – one of four options discussed – replaced critical infrastructure and managed utility finances in a timely and proactive manner. The proposal was presented to the Council in September 2017 and, subsequent to public input at more than 50 community meetings, a Modified Option 1 proposal – with rates approximately 35% lower than the Option 3 proposal – was presented in a joint workshop to the Board and Council in November 2017.

The second joint workshop of the City Council and the Board of Public Utilities, on January 18th, builds on the discussion during the first joint meeting, presenting additional requested information regarding the electric and water utility five-year rate proposal for 2018-2022. The City Council, after receiving staff's presentation and discussion with the Board, is expected to provide conceptual approval of an electric and water utility five-year rate proposal for presentation to the Board of Public Utilities and City Council in May 2018, with new rates effective July 1, 2018.

RECOMMENDATIONS:

That the City Council and Board of Public Utilities:

1. Receive staff's presentation with additional requested information regarding the electric and water utility five-year rate proposal 2018-2022;

2. Conceptually approve the electric and water utility five-year rate proposal 2018-2022 utilizing the Utility 2.0 Strategic Plan Modified Option 1 for electric and water utility infrastructure improvements over the next ten years, with rates approximately 35% lower than the original five-year rate proposal based on Option 3 infrastructure improvements; and

3. Direct staff to prepare all documents necessary for public noticing of the rate proposal, to update proposed rate schedules and fiscal policies to reflect changes due to the rate proposal, and to update any other documents necessary for the public hearing to be held before the Board of Public Utilities on May 14, 2018 and final rate recommendations to the City Council on May 22, 2018, with new rates effective July 1, 2018.

BACKGROUND:

The City Council last adopted new water and electric utility rates more than ten years ago, with the most recent increases implemented in 2010. RPU then froze electric rates in July 2010 due to the severe economic downturn in the Inland Empire. Utility rates have not been increased for seven years. Bond funds, used to build and repair deteriorating infrastructure, have been exhausted as of June 2016. RPU is now using its reserve funds – a temporary and short-term fix – to build necessary infrastructure. If RPU does not raise rates now, there will be an unavoidable, negative impact to utility infrastructure and operations, reliability of electric and water services, and bond ratings.

During the past seven years, California suffered the worst drought in more than 125 years, and many water agencies were forced to raise rates to make up for reduced demand. Likewise, legislation and regulations have dramatically increased costs for the electric utility. RPU has been able to keep rates stable by being water independent (achieved through past infrastructure investments), negotiating power supply contracts at the lowest prices available, securing low-cost financing with strong bond ratings, relying on financial reserves and controlling staffing to 2014 levels. RPU must now raise rates to maintain reliable electric and water service, as well as to ensure access to low-interest bond funding for necessary infrastructure improvements.

In 2015, RPU conducted a comprehensive strategic and financial planning effort known as "Utility 2.0." Through in-depth staff analysis and multiple presentations and interactive workshops with the Board of Public Utilities and City Council, RPU developed four options for Board and City Council consideration to replace critical infrastructure which is aging and soon will begin failing:

- Option 1: Maintain spending and fall behind on infrastructure replacements.
- Option 2: Increase spending on infrastructure replacements to correct major deficiencies.
- Option 3: Pro-active spending on infrastructure replacements to correct major deficiencies and operational deficiencies.
- Option 4: Aggressive infrastructure replacements to correct all deficiencies.

The Board and City Council expressed a preference for Option 3, which would allow RPU to catch up on pipeline, power pole, and underground cable replacements, build on past core infrastructure investments, and install technologies that improve customer service and efficient operations. Option 3 was identified as providing the best long-term value for the City and its utilities, ensuring Riverside's electric and water systems were maintained and enhanced for the benefit of existing customers as well as for future generations.

The following table provides a summary of the Utility 2.0 planning process:

Date	**Meeting**	**Documentation\Direction**
February 12, 2015	Board Strategic Planning	Meeting Summary
February 27, 2015	Board Strategic Planning	Meeting Summary
May 7, 2015	Joint City Council and Board Workshop #1	Meeting Summary
July 13, 2015	Board Strategic Planning	Meeting Summary
July 29, 2015	Board Strategic Planning	Meeting Summary

Date	Meeting	Documentation\Direction
August 28, 2015	Joint City Council and Board Workshop #2	Meeting Summary
September 1, 2015	City Council Workshop – RPU Finance 101	
October 2, 2015	Board Meeting	Direction: Board approved in concept, and recommended that the City Council approve in concept, the Utility 2.0 Strategic Plan with Option 3 infrastructure, technology and workforce trajectories to provide guidance to staff for final financial planning and recommendations.
October 6, 2015	City Council Meeting	Direction: City Council approved in concept the Utility 2.0 Strategic Plan with Option 3 infrastructure, technology and workforce trajectories to provide guidance to staff for final financial planning and recommendations.

Summaries and documents for the above meetings are linked and can be downloaded from the following webpage: http://www.riversideca.gov/utilities/utility20/popup.asp.

As directed, RPU completed cost of service and rate design studies to finance Option 3 objectives in 2017. A rate proposal based on these studies was presented to Board and City Council in August and September, respectively. The following table provides a summary of these meetings:

Date	Meeting	Direction
August 28, 2017	Board Meeting	Direction: Board recommended to City Council to direct staff to conduct a citywide community outreach initiative on the rate proposal and collect public input, which would then be presented to the Board and Council at a joint workshop in November.
September 26, 2017	Council Meeting	Direction: City Council directed staff to conduct a citywide community outreach initiative on the rate proposal and collect public input, which would then be presented to the Board and Council at a joint workshop in November.

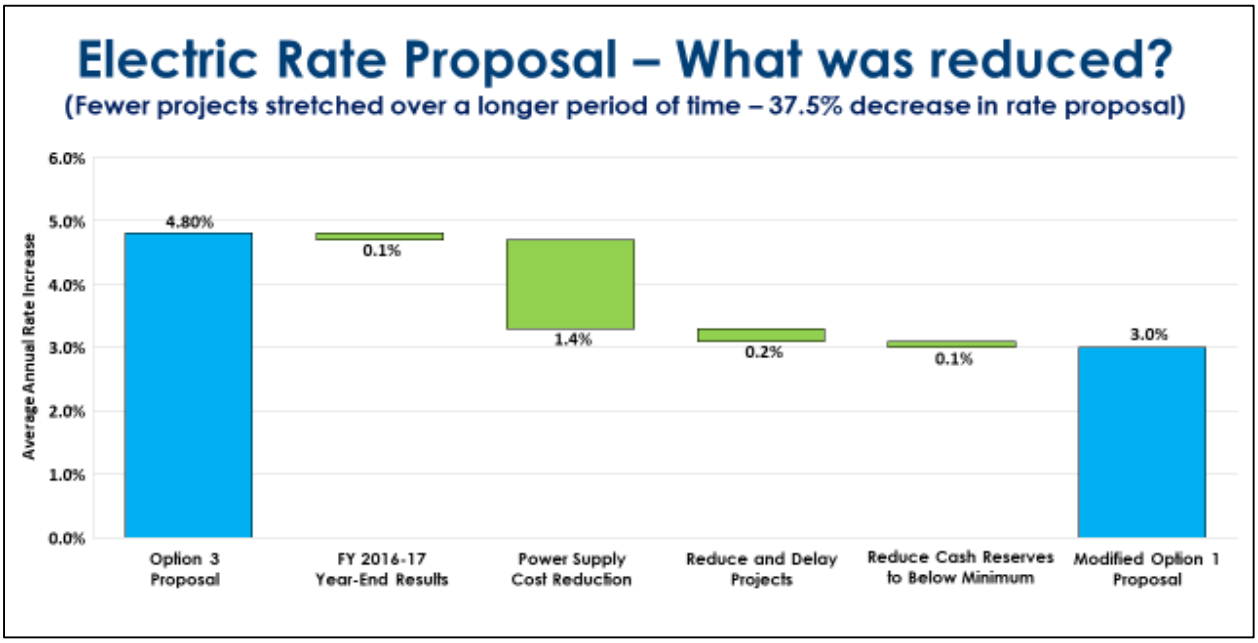
In October and November 2017, RPU provided more than 50 presentations at various community meetings, including six RPU-hosted meetings in six of the seven wards (Wards 6 and 7 were a combined meeting) and special meetings to address agricultural and low-income customer concerns. Meeting summaries are linked and can be downloaded from the following webpage: http://www.riversideca.gov/utilities/rateplan/documents.asp.

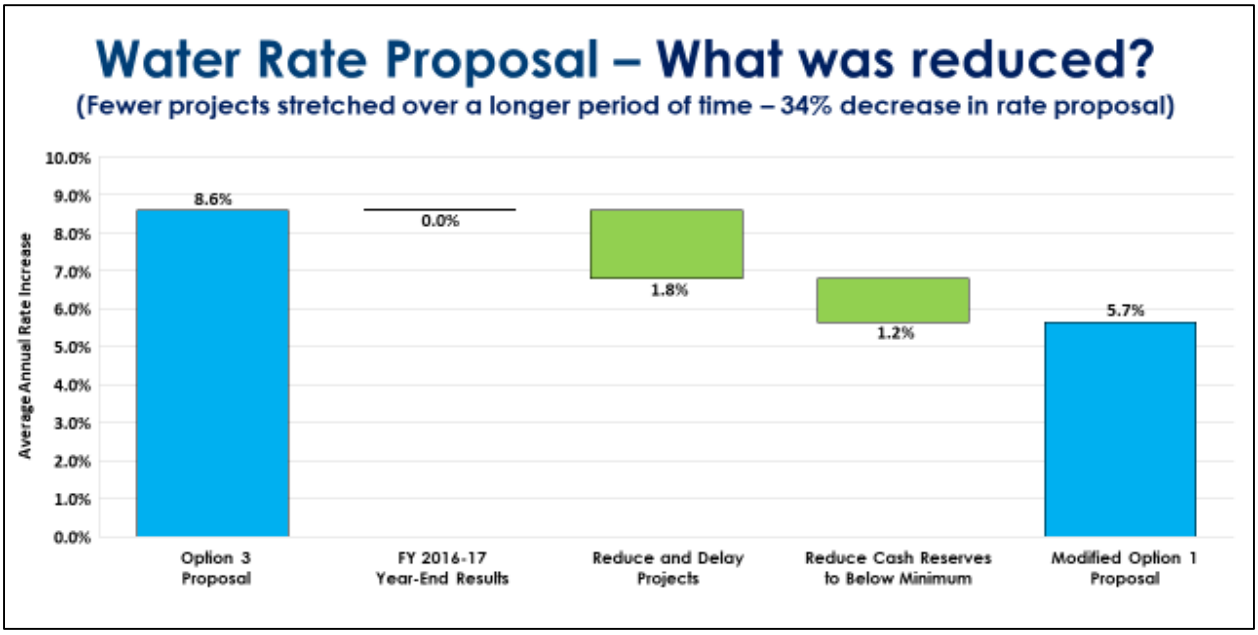
Based on what RPU heard from the community, RPU staff presented for Board and City Council consideration at their November 28, 2017 joint workshop the following revised rate proposal:

- **Revise the Utility 2.0 ten-year electric and water infrastructure plans from Option 3 to a modified Option 1**, reducing capital expenditures by $300 million over the next decade by delaying, deferring, and reducing infrastructure projects that improve electric and water system reliability, resiliency, and customer experience. Examples include a 45% reduction in distribution water pipeline replacements, a 47% reduction in electric pole

replacements, a 75% reduction in neighborhood streetlight retrofits, the reduction of reservoir maintenance and treatment filter replacements, the elimination of a new Arlanza substation, and the delay in deploying advanced metering infrastructure ("smart" meters) by 1-3 years. The impact of these decreased investments in infrastructure and technology is long-term reduced reliability, increased outages and leaks, and lower-quality customer service balanced by the increased affordability of near-term rates. Basic infrastructure – neighborhood pipelines, streetlights, and electric poles and wires – will not be replaced at a sustainable pace, resulting in higher costs for future ratepayers, but the most vital infrastructure – substation transformers, wells and transmission mains – will be maintained. For detailed information on the impact of reducing infrastructure and technology investments from Option 3 to Modified Option 1, see Attachments 4 and 5.

- **Reduce the water and electric rate increase proposal by 35 percent**. The reduction in the proposed rates is due to reduced infrastructure investments and reprioritized projects, increased revenues from renewed California Cap & Trade Program, updated assumptions based on improved financial performance over the prior year, and reduced cash reserves.





- **Increase support for low-income and fixed income customers** through expanded eligibility and outreach, seeking to double program participation in the first 18 months of the proposed rate increase.

- **Recommend that the Board establish an Ad Hoc Agricultural Water Rates Task Force (Ag Task Force)** to develop agricultural rate alternatives for Board and City Council consideration within two years, with minimum interim rate increases.

- **Provide annual financial forecasts** comparing approved rates with updated financial data and a preview of recommended future rate adjustments to avoid "stair-step" rate increases.

At the November workshop, the Board recommended and the Council approved in concept the increase in low-income support and the establishment of annual financial forecasts. The Council also approved in concept the establishment of an Ag Task Force, subject to the Brown Act, for one year while freezing agricultural rates at current levels. The Board recommended but the Council declined to support the revised rate increase. At the request of the City Manager, after the November workshop City Council members had submitted questions on the rate proposal to the City Manager and the RPU General Manager; written responses to these questions are included with this staff report.

DISCUSSION:

CITY COUNCIL QUESTIONS AND STAFF RESPONSES

As of December 20, 2017, staff received 39 questions and comments from six City Council Members. Attachment 1 includes staff responses, and Attachment 2 provides further information on tiered and seasonal water rates.

OVERVIEW OF RATE PROPOSAL

RPU is proposing a five-year (2018-2022) electric and water utility rate plan that will result in a five-year system average annual rate increase of 3.0% for electric and 5.7% for water. For an

individual customer, the rate increases and associated bill impacts will vary by customer class and consumption levels. For a typical residential customer, the estimated five-year annual electric rate increase will be $3.10 per month, and the estimated five-year annual water rate increase will be $3.50 per month. For additional customer impact estimates, see Attachment 6, slides 53-66.

The revised – and lowered – rate increases will have impacts on the condition of the water and energy infrastructure, and reliability of utility services. The charts below summarize delays and/or reductions in infrastructure investment necessary to go from Option 3 (staff's initial proposal based on Utility 2.0) to Modified Option 1.





The proposed rate increase is required in part to help fund – over 10 years – $815 million in electric and water infrastructure projects consistent with Utility 2.0 Modified Option 1. An overview of the proposed infrastructure projects and costs by project category is included in Attachment 6, slides 21-26 (electric) and slides 31-39 (water). The cost of infrastructure projects proposed under Modified Option 1 are $257 million, or 24%, less than the infrastructure projects proposed under Option 3. An overview of reduced costs of Modified Option 1 compared to Option 3 is included in

Attached 6, slide 27 (electric) and slide 40 (water). More detailed information related to specific projects and project costs is included in Attachments 4 and 5.

Additionally, the proposed rate increase is required to cover part of the $65 million in costs over the next ten years to meet new State renewable energy regulatory requirements. Staff have been able to reduce power supply ten-year budget projections by $190 million to reflect changed carbon compliance costs, reduced coal plant output at the Intermountain Power Project due to lower market energy prices, and reduced California Independent System Operator charges.

The rate increase is also required to cover increasing system operations costs, including system maintenance, fleet fuel and maintenance, and staffing. The rate proposal includes no funding for additional employees over the next ten years. As a matter of fact, several personnel efficiencies had been identified resulting in significant savings – and lower rate increases. For example, two executive management vacancies have been eliminated, including Deputy General Manager and Assistant General Manager for Customer Relations. In addition, the City recently entered into long-term union contracts requiring all existing employees to pay their full share of retirement costs. These personnel measures together result in savings of approximately $11.2 million over the next five years, minimizing rate increases.

Finally, the rate increase is required to maintain minimum levels of cash required to pay bills, provide funding for unanticipated infrastructure failures and emergencies, and maintain bond ratings in order to keep debt interest low.

RPU, as presented in the August and September 2016 presentations to Board and City Council, is also 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 not only to fund the ten-year infrastructure program but also to allow RPU to meet industry changes by providing better financial and revenue stability. These changes are reflected in the overall rate increases proposed. For an outline of the specific key changes to RPU's rate structure, please see Attachment 3.

Consistent with Council action on November 28, RPU is providing the first preview of recommended future rate adjustments to maintain infrastructure investments consistent with Utility 2.0 Modified Option 1 while avoiding future "stair-step" rate increases. RPU's current estimate for rate requirements in 2023-2027 – the five years following the current five-year rate proposal – is 3.0% system average annual increases for electric and 6.5% system average annual increases for water. Starting in 2019 and every year thereafter, the Board and City Council will be provided with new financial data and an updated future rate preview.

Revised Rate Proposal – Modified Option 1

	Years 1-5 (2018-2022)		Years 6-10 Preview (2023-2027)
Electric	July 2018	2.95%	Estimated rate requirement Average annual 3.0%
	July 2019	3.0%	
	July 2020	3.0%	
	July 2021	3.0%	
	July 2022	3.0%	
Water	July 2018	4.50%	Estimated rate requirement Average annual 6.5%
	July 2019	5.75%	
	July 2020	5.75%	
	July 2021	5.75%	
	July 2022	6.50%	

Based on system average, rate increases vary by customer class and consumption levels.

ALTERNATIVES AND RISKS

Without a rate increase, RPU will experience reserves going below minimum required targets by July 2018 for water and by the end of 2018 for electric. Reserve levels dropping below minimum required targets will require significant reductions to expenditures, including reductions in RPU's current capital program, deep cuts to current operations and maintenance spending plans, decreased funding for planned customer service and operational efficiency initiatives, and significant personnel reductions that will severely impact response time to customers. In addition, when reserve levels drop below minimum mandated levels, RPU's bond ratings will fall and its cost of borrowing will increase, costing future ratepayers millions in higher debt payments.

Staff has prepared information on rate increases that are lower than what is being proposed. All of these alternatives will have a negative impact on electric and water system reliability and resiliency, negatively impact customer experience, and burden future generations with higher costs and poorer utility services. These alternatives are presented as a form of "triage," where projects are reduced, delayed, or eliminated in a way that diminishes reliability as slowly as possible. Reduced infrastructure maintenance (e.g., reduced electric pole and water pipeline replacements resulting in longer outages) will result in negative customer experience (e.g., longer wait times for service calls and outages), postponing City priorities and previously approved projects (e.g., LED streetlights). See Attachments 4 and 5, and Attachment 6 slides 67-81, for a more detailed presentation of prioritization choices and resulting customer impacts associated with lower rate increases.

NEXT STEPS

Direction from Board of Public Utilities/City Council at Joint Workshop	January 18, 2018
Update Rate Schedules Based on Revised Revenue Requirements and Effective Dates	February 2018
Public Hearing – Board of Public Utilities	May 14, 2018
Rate Recommendation – City Council	May 22, 2018
New Rates Effective	July 1, 2018

FISCAL IMPACT:

Total additional revenue over the five-year period for this rate increase is projected to be $175 million ($137 million for the electric utility and $38 million for the water utility), averaging $35 million per year for each of the next five years. This revenue is essential to finance infrastructure, renewable energy, operations and maintenance, and financial policies consistent with Utility 2.0 Modified Option 1. The current combined water and electric utility budget for Fiscal Year 2017-18 is $479.5 million. Not making these necessary investments now will result in increased costs to future ratepayers. Annual rate increases are proposed to be implemented in July 2018, July 2019, July 2020, July 2021, and July 2022 in alignment with sewer rate increases.

Prepared by:	Girish Balachandran, Utilities General Manager
Certified as to availability of funds:	Adam Raymond, Chief Financial Officer/City Treasurer
Approved by:	John A. Russo, City Manager
Approved as to form:	Gary G. Geuss, City Attorney

Attachments:

1. Staff Responses to City Council Questions from November 28, 2017 Workshop
2. Tiered and Seasonal Water Rates
3. Key Changes to Electric and Water Utility Rate Structures
4. Electric Utility Rate Alternatives – Project Impacts
5. Water Utility Rate Alternatives – Project Impacts
6. Presentation