RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES **DATE:** MAY 13, 2019

ITEM NO: 12

SUBJECT: **RIVERSIDE PUBLIC UTILITIES MID-CYCLE BUDGET UPDATE**

ISSUES:

Recommend that the City Council approve the Electric Funds (including Public Benefits Fund) proposed FY 2019-20 budget amendments comprising of $3,309,000 reduction in revenues as detailed in Attachment 1 and $7,266,300 increase in expenditures as detailed in Attachment 2, authorize the use of the Electric Fund Designated Capital Repair/Replacement Reserve for heavy-duty vehicle replacements in the amount of $2,400,000, and approve the Water Funds (including Water Conservation Fund) proposed FY 2019-20 budget amendments comprising of $7,830,088 increase in expenditures as detailed in Attachment 4 as part of the Riverside Public Utilities Mid-cycle budget adjustments for FY 2019-20.

RECOMMENDATIONS:

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

1. Approve the Electric Funds (including Public Benefits Fund) proposed FY 2019-20 budget amendments comprising of $3,309,000 reduction in revenues as detailed in Attachment 1 and $7,266,300 increase in expenditures as detailed in Attachment 2;

2. Authorize the use of the Electric Fund Designated Capital Repair/Replacement Reserve for heavy duty vehicle replacements in the amount of $2,400,000; and

3. Approve the Water Funds (including Water Conservation Fund) proposed FY 2019-20 budget amendments comprising of $7,830,088 increase in expenditures as detailed in Attachment 4.

BACKGROUND:

The Riverside Public Utilities (RPU) Electric and Water Funds fiscal year (FY) 2018-20 biennial budget was approved by the Board of Public Utilities on April 23, 2018, and was subsequently adopted by City Council on June 12, 2018. The biennial budget incorporates two (2) fiscal years and was developed in the context of a five-year financial plan. The Electric and Water Funds FY 2018-20 biennial budget and FY 2018-23 five-year financial plans incorporated the Electric and Water five-year rate plans which were approved by City Council on May 22, 2018.

The purpose of a mid-cycle update is to recommend amendments to the previously adopted FY 2019-20 budget based on new financial data and significant events that impact the Electric and Water Funds' finances. This report provides a brief overview of the recommended adjustments to revenues, expenditures, and capital projects for both the Electric and Water Funds. These recommendations will be incorporated into City Finance's FY 2019-20 Mid-Cycle update that will be presented to City Council on May 21, 2019.

DISCUSSION:

The FY 2019-20 proposed budget adjustments reflect a $3.3 million reduction in revenues and a $15.1 million increase in expenditures across the four (4) Public Utilities funds (Electric, Public Benefits, Water and Water Conservation). Proposed budget adjustments comprise primarily of unanticipated costs, previously deferred projects and the shifting of timing on planned projects.

Proposed budget adjustments are limited to those that are critical to the operation of the utilities. Budget assessments considered recent information and events that will have significant financial and operating impacts if no actions are taken in the next fiscal year. Priorities are placed on unavoidable costs, electric and water resource needs, critical infrastructure replacements, safety, and operating efficiency.

Affordability for expenditure adjustments are balanced with new funding sources and continued strategic use of reserves as integrated with the adopted biennial budget and planned with the adopted Electric and Water five-year rate plans. Overall affordability should be viewed with reserve levels in the context of a five-year financial plan and the adopted five-year rate plans.

ELECTRIC FUND

Electric Fund's proposed budget adjustments are primarily in the area of power supply, safety, and operating efficiency. Recommended budget adjustments comprise of $3.3 million reduction in other operating revenues and $7.3 million increase in operating and capital expenditures.

Revenue Budget

Revenue adjustments are recommended in the other operating revenues category, specifically Cap and Trade Auction Proceeds and Renewable Energy Credit Sales.

Electric - FY 19/20	Adopted	Adjustment	Amended
Revenues			
Cap and Trade Auction Proceeds	8,427,000	(2,927,000)	5,500,000
Renewable Energy Credit Sales	2,415,000	(382,000)	2,033,000
Total Reduction in Revenues - Electric Fund 510		**(3,309,000)**	

- Cap and Trade Auction proceeds are revenues received from the sale of excess greenhouse gas (GHG) allowances in the quarterly auctions under the California Air Resources Board (CARB) Cap and Trade Program (Program). The Program was implemented by CARB to achieve the statewide goals of reducing GHG emissions. The Program requires electric utilities to have GHG allowances on an annual basis to offset GHG emissions associated with generating electricity. CARB will provide a free allocation of GHG allowances to each electric utility to mitigate retail rate impacts. Thereafter, the utilities are likely to be required to purchase allowances through the auction or on the secondary market to offset its associated GHG emissions. Each allowance can be used for compliance purposes in the current year or carried over for use in future year compliance. The Electric Fund's free allocation of GHG allowances is expected to be sufficient to meet the Electric Fund's direct GHG compliance obligations. Any allowance not used for current year compliance or carried over for future use in compliance must be sold into the quarterly allowance auctions administered by CARB. Proceeds from the auctions must be used for the intended purposes as specified in Assembly Bill (AB) 32.

  Due to increased market energy prices, the Intermountain Power Plant Coal facility is projected to produce more energy than previously expected in FY 2019-20. In turn, the Electric Fund will be required to surrender more GHG allowances to CARB, leaving less excess allowances to monetize through the quarterly CARB auction process. The Electric Fund anticipates receiving $2,927,000 less in auction proceeds in FY 2019-20 than previously budgeted.

- For the period in which the Electric Fund has renewable energy in excess of the mandate requirements, the excess can be sold as renewable energy credits. Recent market prices for these credits have been yielding less than previously forecasted. The FY 2019-20 budget for the credit sales is recommended to be reduced by $382,000 to reflect the change in forecasted prices.

Due to the recent legislation and events of the energy market, it is also necessary to adjust the five-year financial plan to reflect the revised forecasts for Cap and Trade Auction Proceeds and Renewable Energy Credit Sales for FY 2020-21 to FY 2022-23.

Assembly Bill 398, signed into law in 2017, extended the Cap and Trade Program by ten years from December 31, 2020 to December 31, 2030. The Electric Fund will continue to receive its free allowance allocations from 2021 to 2030 and these allowance allocations should be sufficient to cover all of Electric Fund's 2021-2030 direct GHG compliance obligations. The Electric Fund anticipates that there will be excess allowance allocations that can continue to be sold in the quarterly CARB auction process. Thus, the Electric five-year financial plan has been adjusted to reflect the projected additional Cap and Trade Auction proceeds for FY 2020-21 to FY 2022-23 (Attachment 3).

Revised forecasts also project that no excess renewable energy credits will be available for sale for FY 2020-21 and forward. The five-year financial plan has been adjusted accordingly (Attachment 3).

Expenditure Budget

Expenditure adjustments are recommended in the following areas:

Electric - FY 19/20	Adopted	Adjustment	Amended
Expenditures			
Transmission	64,378,000	3,225,000	67,603,000
Purchased Power	152,914,491	1,147,000	154,061,491
Power Supply	217,292,491	4,372,000	221,664,491
Professional Services	6,697,223	150,000	6,847,223
Software Purchases and Licenses	1,013,011	80,000	1,093,011
Utilities	728,330	1,269	729,599
Equipment Purchases/Replacements	-	2,400,000	2,400,000
Utililization Charges from Others	3,200,559	184,606	3,385,165
Operations & Maintenance	11,639,123	2,815,875	14,454,998
City IT Projects - Capital Outlay	235,079	82,678	317,757
Total Increase in Expenditures - Electric Fund 510		**7,270,553**	
Adjustment to electricity cost	-	(17,253)	(17,253)
Utililization Charges from Others	175,987	13,000	188,987
Net Decrease in Expenditures - Public Benefits Fund 511		**(4,253)**	

Major recommended adjustments include the following:

- With the recent increase in natural gas and energy prices, power supply costs are forecasted to be higher than the adopted budget in FY 2019-20. Transmission costs are anticipated to be higher due to an increase in projected maintenance costs on transmission lines and an increase in projected Transmission Access Charge (TAC) rate to be applied by the California Independent System Operator (CAISO). Overall, the power supply budget is recommended to be adjusted by $4,372,000 for FY 2019-20.

Looking beyond FY 2019-20, power supply costs are forecasted to continue to be higher than previous projections primarily due to an increase in transmission costs for increase maintenance and higher TAC rate. The five-year financial plan has been adjusted accordingly (Attachment 3).

The projected increases in power supply costs for FY 2019-20 to FY 2022-23 will primarily be offset by the increase use of Cap and Trade auction proceeds to pay for renewable energy purchases, which in turn will free up funds to pay for the projected additional power supply costs. As previously discussed, with the extension of the Cap and Trade Program to 2030, the Electric Fund anticipates the availability of additional excess GHG allowance allocations that can continue to be sold in the quarterly CARB auction process. One of the allowable uses of auction proceeds under AB 32 is the procurement of renewable resources.

- Electric Field uses a variety of vehicles to enable crews to maintain a reliable electric service to its customers. These vehicles need to be in safe, operable condition and compliant with state and local emissions regulations. To ensure operating efficiency, employee productivity and public safety, vehicles that have reached the end of their economic and useful life need to be replaced in a timely manner.

  There are four (4) leased heavy-duty vehicles with lease terms expiring July 2020 and two (2) aging heavy-duty vehicles that are in need of replacement. These vehicles are not stock items and the lead times for new vehicles can extend beyond 12 months. In consideration of build times, it is important that the procurement process be initiated at the beginning of FY 2019-20, in order that there will be no lapse between the old leases expiring and replacement vehicles being purchased, built and delivered. An adjustment is recommended to add the purchase of six (6) heavy-duty replacement vehicles at an estimated cost of $2,400,000 to the FY 2019-20 budget. The alternative is to continue paying month to month which is considerably more expensive, requires more frequent and expensive repairs and there is no vehicle ownership at the end of the lease.

  Electric Fund also recommends that the Designated Capital Repair/Replacement reserve be utilized to fund the vehicle purchase. The Designated Capital Repair/Replacement reserve was established to accumulate funds for repair and replacement of facilities, vehicles, and technology outside of the capital improvement program. The current balance in the designated account is $4.9 million.

Other smaller recommended expenditures adjustments are detailed in Attachment 2.

WATER FUND

Water Fund's proposed budget adjustments are primarily in the area of replacing critical infrastructure and professional services to support the various water studies and plans that are critical to meet existing and future water needs. Recommended budget adjustments comprise of $7.8 million increase in operating and capital expenditures.

Revenue Budget

No adjustments are recommended for the revenue budget.

Expenditure Budget

Expenditure adjustments are recommended in the following areas:

Water - FY 19/20		Adopted	Adjustment	Amended
Expenditures				
Electric Costs		4,437,472	16,968	4,454,440
Professional Services		1,962,140	1,350,000	3,312,140
Utilization Charges from Others		9,809,148	763,000	10,572,148
	System Operations	16,208,760	2,129,968	18,338,728
Distribution System Facilities Replacements		1,500,000	750,000	2,250,000
Main Replacements		3,807,860	2,250,000	6,057,860
Pump Station Replacements		1,087,960	3,388,791	4,476,751
City IT Projects		87,088	30,629	117,717
	Capital Outlay (CIP)	6,482,908	6,419,420	12,902,328
	Debt Service	19,846,914	(400,000)	19,446,914
	General Fund Transfer	7,025,300	(332,300)	6,693,000
Total Increase in Expenditures - Water Fund 520			**7,817,088**	
Utililization Charges from Others		33,156	13,000	46,156
Total Increase in Expenditures - Water Conservation Fund 521			**13,000**	

Major recommended adjustments include the following:

- Since the time the biennial budget was prepared, certain events and circumstances have occurred which require the need to shift priorities and move certain projects forward. Professional services will need to be obtained to help address critical water related matters stemming from local and state legislation requirements; the identification of new local partnership opportunities; increased local development and densification, and changes in customer consumption habits; and threats to groundwater supply and groundwater quality. These developments have major impacts to water resources and should be addressed at the present time to assure compliance and proper planning to meet existing and future water needs. A total of seven (7) studies and plans with an estimated cost of $1,350,000 are recommended for FY 2019-20. See Attachment 4 for the list of recommended studies and plans. Funding for these professional services will come from debt service savings generated from the recent refunding of Water revenue bonds.

- Adjustments to Utilization Charges from Others of $763,000 is recommended primarily to properly classify expenditures. Utilization Charges from Others represent costs from other divisions or departments that are directly attributable to the receiving department, in this case the Water Fund. On December 10, 2018 and February 19, 2019, the Board of Public Utilities recommended and the City Council approved the Memorandum of Understanding between Public Works and Public Utilities Departments and an expenditure for $3.75 million in five (5) annual payments of $750,000 for the Water Fund's share of the recycled water system improvements at the Riverside Regional Water Quality Control Plant. Because the payment is between two (2) departments, the expenditure should be classified as a Utilization Charge from Public Works instead of a capital expenditure. The budget of $750,000 for the FY 2019-20 payment is currently budgeted in FY 2018-19. This adjustment is to shift the budget from FY 2018-19 to FY 2019-20 and to properly classify the expenditure. Subsequent annual payments of $750,000 through FY 2022-23 have been reflected on the five-year financial plan in the same expenditure category.

  In addition, a small adjustment of $13,000 in Utilization Charges from Others is recommended to reflect Water Fund's portion of personnel cost related to the City's efforts for the development of a Citywide Sustainable and Resilient Riverside Policy. This cost is shared by multiple City departments including the Electric Fund, Public Benefits Fund, Water Fund and the Water Conservation Fund. Each respective fund/department will have its share of the cost.

- Mid-cycle adjustments are needed on the Capital Improvement Program (CIP) for distribution facilities and pipelines due to shifting of priorities to address the overtime burden resulting from emergency service lateral leaks, aged and undersized water mains, and insufficient pumping capacities of two (2) pump station facilities. Much of this work had been previously identified but was scheduled further out in the CIP plan.

  Due to recent evaluation of the conditions of mains and facilities, staff recommends that certain main replacements and pump station replacement projects be moved forward to FY 2019-20 from FY 2020-21 through FY 2022-23. It is critical that these infrastructures be replaced sooner rather than later.

  There has also been an increase in emergency service lateral leaks in the current fiscal year that occurred after hours which required field crews to work overtime hours. Due to the age of the service laterals, increasing leaks will continue to occur which may result in additional overtime hours. To address the overtime burden, staff recommends implementing a service lateral replacement program in which service laterals will be replaced on a systematic basis, rather than on an emergency basis, where work can be scheduled during regular working hours. The FY 2019-20 budget for the program will come from a reduction of main replacement projects in FY 2020-21.

  A total of $6,388,791 in CIP budget for Distribution System Facilities Replacement, Main Replacements and Pump Station Replacements is recommended to be moved forward to FY 2019-20 from FY 2020-21 through FY 2022-23, with a net zero impact to the 5-year CIP plan. The majority of the projects will be funded by bond proceeds with the balance to be funded by rates and reserves as planned with the adopted Water five-year rate plan.

  An adjustment is also needed for City-wide IT projects of $30,629 for hardware replacements which were originally planned for FY 2020-21 and are now recommended to be moved forward to FY 2019-20, bringing the total CIP recommended adjustment to $6,419,420. The five-year financial plan has been adjusted to reflect the shifting on the timing of projects (Attachment 5).

- In February 2019, the Water Fund issued $114 million in revenue bonds. A portion of the bond proceeds was used to refund previously issued bonds to capture interest rate savings. Total generated cash flow savings is $13 million over the next 20 years with approximately $400,000 in debt service savings for FY 2019-20 and $680,000 annually for subsequent years through 2038. Debt service for FY 2019-20 is recommended to be reduced by $400,000 to reflect the savings. The five-year financial plan has been adjusted to reflect the debt service savings as well. These savings will be utilized to fund the much needed water resources studies and plans previously discussed.

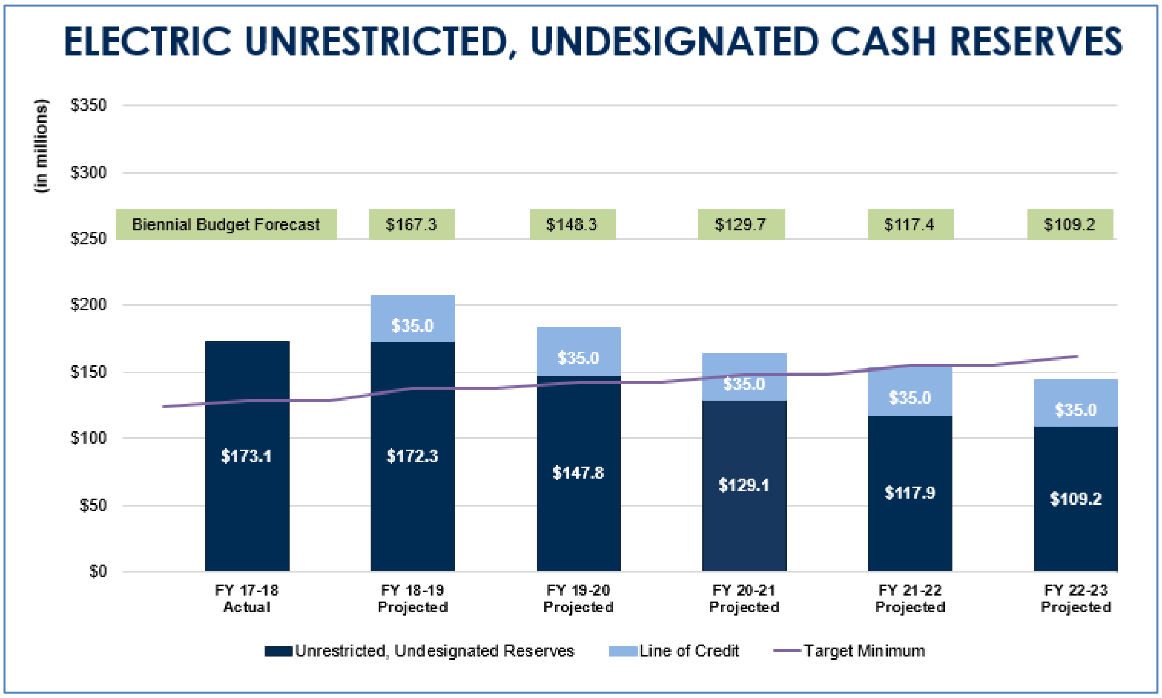
- General fund transfer for the current year is based on prior year's gross operating revenues including adjustments. The adopted FY 2019-20 budget for general fund transfer is based on the estimated revenues of FY 2018-19. Due to higher than anticipated rainfall in FY 2018-19, retail sales are projected to come in lower than budget by $3 million at June 30, 2019. A reduction in budget of $332,300 is recommended for FY 2019-20 general fund transfer to reflect the projected reduction in FY 2018-19 retail sales. Actual FY 2019-20 general fund transfer will be determined after FY 2018-19 financial statements have been audited and issued and the budget will be adjusted to the actual amount at that time.

Other smaller recommended expenditures adjustments are detailed in Attachment 4.

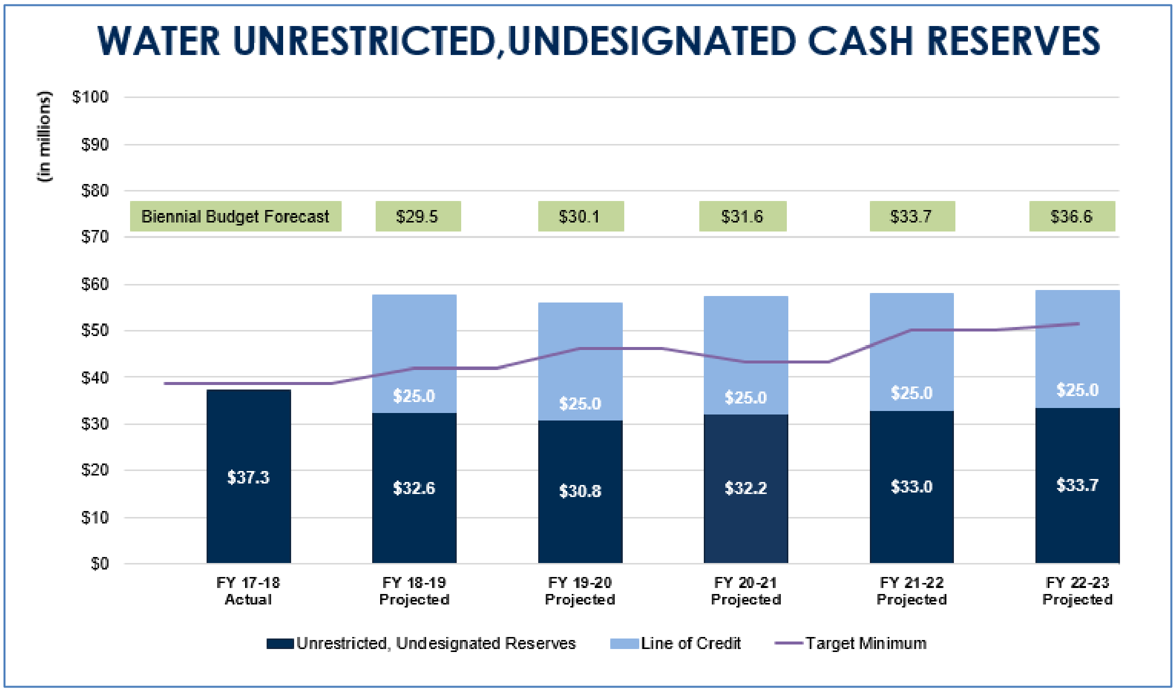
<u>ELECTRIC AND WATER RESERVES</u>

The adopted Electric and Water FY 2018-20 biennial budget and five-year financial plans were prepared to be consistent with the adopted Electric and Water five-year rate plans. The use of restricted, designated and undesignated reserves was incorporated into the biennial budget as a tool to balance the budget.

As provided in RPU Fiscal Policies, the use of reserves to balance the budget is permitted in the event a balanced budget is not attainable. If the use of reserves is expected to continue beyond one year, the planned use of reserves must be developed as part of a strategic financial plan. The use of electric and water reserves in the biennial budget is planned within the adopted rate plan. The financial strategy within the adopted rate plan is to draw down reserves to minimum required levels in order to keep the rate increases as low as possible. In addition, as part of the adopted rate plans, RPU is to establish a line of credit (LOC) to provide flexibility and operating liquidity similar to cash reserves so that cash levels can be reduced and target minimum reserve can be maintained at levels acceptable by bond rating agencies to maintain current bond ratings. In February 2019, a $35 million and $25 million LOC were established for the Electric and Water Fund, respectively.



At the time of the biennial budget adoption, with the use of the LOC, the Electric Fund anticipated to maintain target minimum reserve level as established by the RPU Cash Reserve Policy through FY 2020-21. The Electric Fund reserve level was also projected to drop slightly below the target minimum in FY 2021-22 and 2022-23, which is allowed by the reserve policy so long as the Electric Fund has plans to return reserves to the minimum target level within three years. The Electric Fund is projected to return its reserve level to the minimum target within three years, by FY 2024-25. After incorporating the proposed mid-cycle budget adjustments for FY 2019-20 and related effect for FY 2020-21 to FY 2022-23, Electric Fund's projected unrestricted, undesignated reserve level through FY 2022-23 remains consistent with the reserve level projected at the time of biennial budget adoption.



For the Water Fund, with use of a line of credit, the Water Fund's unrestricted, undesignated reserve is brought back to within the target minimum and maximum level in FY 2018-19 and continues to be above target minimum through FY 2022-23. After incorporating the proposed mid-cycle budget adjustments for FY 2019-20 and related effect for FY 2020-21 to FY 2022-23, the Water Fund's projected unrestricted, undesignated reserve level through FY 2021-22 remains consistent with the reserve level projected at the time of biennial budget adoption, with FY 2022-23 at $3 million below previous projection. While the FY 2022-23-reserve level is below previous projections, the updated projected reserve level remains consistent with the adopted Water five-year rate plan.

<u>FISCAL IMPACT</u>:

The Electric Funds (including Public Benefits Fund) proposed FY 2019-20 budget amendments total $3,309,000 reduction in revenues and $7,266,300 increase in operating and capital expenditures. The Water Funds (including Water Conservation Fund) proposed FY 2019-20 budget amendments total $7,830,088 increase in operating and capital expenditures.

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Certifies availability of funds:	Brian Seinturier, Utilities Fiscal Manager

Attachments:

1. Electric FY 2019-20 Proposed Revenue Adjustments
2. Electric FY 2019-20 Proposed Expenditure Adjustments
3. Electric Fund Five-Year Financial Plan
4. Water FY 2019-20 Proposed Expenditure Adjustments
5. Water Fund Five-Year Financial Plan
6. Presentation