

TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER

DEPARTMENT: UTILITIES

DATE: JUNE 15, 2009

CMR: 281:09

REPORT TYPE: CONSENT

SUBJECT: Finance Committee Recommendation to Approve Changes to Guidelines for the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves and the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves

RECOMMENDATION

Staff, the Utilities Advisory Commission, and the Finance Committee recommend that Council approve changes to certain Utilities Fund Reserves. Specifically, the recommendation includes the following changes to the guidelines for the following Utilities Fund Reserves:

1. For the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves, establish a minimum guideline level equal to the City's liability insurance coverage deductible amount;
2. For the Electric Distribution and Gas Distribution Rate Stabilization Reserves, change the minimum and maximum guideline levels equal to 15% and 30% of the annual distribution sales revenue, respectively; and
3. For the Water and Wastewater Collection Rate Stabilization Reserves, change the minimum and maximum guideline levels equal to 15% and 30% of the annual sales revenue, respectively.
4. For the Gas Supply Rate Stabilization Reserves, change the minimum and maximum guideline levels equal to 25% and 50% of the annual supply purchase cost, respectively.

The table below summarizes the proposed changes to the Emergency Plant Replacement (EPR) Reserve and Rate Stabilization Reserve (RSR) guidelines.

| Reserve | Existing Guidelines | Proposed New Guidelines |
|---|--|--|
| Electric, Gas, Water, and Wastewater Collection EPRs | Minimum = greater of: 1) the City's liability insurance coverage deductible; or 2) an amount covering the most expensive critical item | Minimum = the City's liability insurance coverage deductible amount |
| Electric Distribution and Gas Distribution RSRs | Maximum = 50% of sales revenue Minimum = 20% of sales revenue | Maximum = 30% of sales revenue Minimum = 15% of sales revenue |
| Water and Wastewater Collection RSRs | Maximum = 50% of sales revenue Minimum = 20% of sales revenue | Maximum = 30% of sales revenue Minimum = 15% of sales revenue |
| Gas Supply RSR | Maximum = 70% of supply purchase cost Minimum = 35% of supply purchase cost | Maximum = 50% of supply purchase cost Minimum = 25% of supply purchase cost |

BACKGROUND

By Charter or by Council action, a number of Utilities reserves have been established for various purposes. Over time, Council has changed the name, purpose, policies and guidelines for many of the reserves to address certain requirements or to accommodate specific needs.

The Emergency Plant Replacement (EPR) Reserve was established by Article VII, Section 2(e) of the City Charter for the Electric, Water, Gas, and Wastewater Collection Funds for unplanned emergencies (or "contingencies") only.

Council established Rate Stabilization Reserves (RSRs) in May 1993 [CMR: 263:93] for the Water, Electric, Gas and Wastewater Collection Funds. The purpose of the RSRs is to stabilize rates by ensuring funds are available to cover short-term situations when expenditures exceed revenues, to provide a depository of excess funds when expenditures are less than projected or revenues are higher than budgeted, and to plan for certain known future occurrences that are of a one-time nature, or to ramp up if the expense is of an ongoing nature. Over time, the RSR guidelines have been changed to respond to changing needs.

DISCUSSION

Emergency Plant Replacement (EPR) Reserves

The City has rarely used the Electric, Gas, Water, or Wastewater Collection EPRs. The last time any of these EPRs was tapped was in 1998 when the Electric EPR was used to cover the cost to replace a blown transformer. The introduction of the minimum guideline level in February 2007 [CMR: 143:07] was made in recognition of the City's property loss insurance policies.

To ensure that the EPRs can cover the deductible amount, staff recommends that the minimum guideline level be changed to be equal to the liability insurance coverage deductible amount (currently \$1 million). This would ensure that the full amount needed would be available for any unforeseen emergency where equipment needed to be repaired or replaced in order to ensure that the distribution systems continued to operate.

Rate Stabilization Reserve (RSR)

One of the changes to the RSR guidelines approved by Council in February 2007 [CMR: 143:07] was the requirement that the development of an assessment of the risks facing each fund be undertaken as part of the annual budget and retail rate development and approval process. The annual assessment for the upcoming fiscal year is compared to the guideline levels to assist in the determination of the RSR level target for each fiscal year. This short-term risk assessment has been performed annually starting with Fiscal Year (FY) 2008.

The proposed new minimum reserve guideline level for the Electric Distribution, Gas Distribution, Water, and Wastewater Collection RSRs is 15% of the sales revenue. The proposed maximum guideline level is 30% of the sales revenue. With this change, it is expected that the short-term risk assessment values for these RSRs will lie within that range.

The proposed new minimum reserve guideline level for the Gas Supply RSR is 25% of the sales revenue. The proposed maximum guideline level is 50% of the sales revenue. Although the short-term risk assessment for FY 2011 is higher than the 25% proposed minimum guideline, this amount is higher due to the higher fraction of the portfolio that is unhedged in the second year. Staff expects that as more of the supply is purchased, the short-term risk assessment for FY 2011 will be substantially lower next year during the annual budget and rates review process. No changes are recommended at this time for the Electric Supply RSR as the short-term risk assessment value is in line with the minimum guideline level.

COMMITTEE REVIEW AND RECOMMENDATIONS

The proposed changes to the EPR and RSR guidelines were presented to the UAC at its March 4, 2009 meeting. The UAC voted unanimously to recommend that the Council approve staff's recommendation. The notes from the UAC meeting are provided as Attachment B.

The Council Finance Committee considered the proposed changes to the EPR and RSR guidelines on March 31, 2009. The Finance Committee voted unanimously to approve the staff recommendation to the City Council to change guidelines for the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves and the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves. The notes from the Finance Committee meeting are attached as Attachment C.

RESOURCE IMPACT

There is no impact from the recommended changes to the Electric, Gas, Water, and Wastewater Collection Emergency Plant Replacement Reserves since they are already funded at \$1 million.

There is no resource impact of the recommended changes to the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves as a result of the recommended changes to the guideline levels since the risk assessment calculation is used to determine reserve level targets for the budget years.

POLICY IMPLICATIONS

The recommended action changes the existing reserve guidelines. This recommendation is consistent with the Council-approved Utilities Strategic Plan with regard to 1) managing supply portfolio risk to preserve a supply cost advantage; and 2) to provide low and stable rates, adequate reserves, and budgeted transfers to the General Fund.

ENVIRONMENTAL REVIEW

The recommended action does not meet the definition of a “project” pursuant to Section 21065 of the Public Resources Code, thus no environmental assessment under the California Environmental Quality Act (CEQA) is required.

ATTACHMENTS

- A. CMR: 180:09 – Utilities Advisory Commission Recommendation to Change Guidelines for the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves and the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves (without attachments)
- B. Excerpted final minutes from the March 4, 2009 UAC meeting
- C. Excerpted notes from the March 31, 2009 Finance Committee meeting

PREPARED BY:

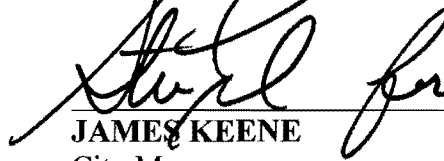
JANE O. RATCHYE
88 Utilities Assistant Director, Resource Management

DEPARTMENT APPROVAL:

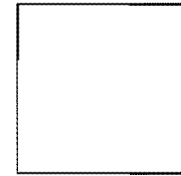


VALERIE O. FONG
Director of Utilities

CITY MANAGER APPROVAL:



JAMES KEENE
City Manager

**BUDGET
FY 2010-FY 2011**

TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER **DEPARTMENT:** UTILITIES

ATTENTION: FINANCE COMMITTEE

DATE: MARCH 31, 2009 **CMR:** 180:09

SUBJECT: Utilities Advisory Commission Recommendation to Change Guidelines for the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves and the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves

EXECUTIVE SUMMARY

Staff regularly reviews Utilities reserve guidelines to determine their adequacy as conditions change. The recommended changes to the Emergency Plant Replacement Reserves will clarify that they should retain sufficient funds to cover the deductible amount on the City's liability insurance policies. The changes recommended to the Rate Stabilization Reserve guidelines will bring them in line with the annual estimate of risks facing each fund. The Utilities Advisory Commission (UAC) unanimously supported the recommended action at its March 4, 2009 meeting.

RECOMMENDATION

Staff and the UAC recommend that the Finance Committee recommend that Council approve changes to certain Utilities Fund Reserves. Specifically, the recommendation includes the following changes to the guidelines of the following Utilities Fund Reserves:

1. For the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves, establish a minimum guideline level equal to the City's liability insurance coverage deductible amount;
2. For the Electric Distribution and Gas Distribution Rate Stabilization Reserves, change the minimum and maximum guideline levels equal to 15% and 30% of the annual distribution sales revenue, respectively; and
3. For the Water and Wastewater Collection Rate Stabilization Reserves, change the minimum and maximum guideline levels equal to 15% and 30% of the annual sales revenue, respectively.

4. For the Gas Supply Rate Stabilization Reserves, change the minimum and maximum guideline levels equal to 25% and 50% of the annual supply purchase cost, respectively.

The table below summarizes the proposed changes to the Emergency Plant Replacement (EPR) Reserve and Rate Stabilization Reserve (RSR) guidelines.

| Reserve | Existing Guidelines | Proposed New Guidelines |
|---|--|--|
| Electric, Gas, Water, and Wastewater Collection EPRs | Minimum = greater of: 1) the City's liability insurance coverage deductible; or 2) an amount covering the most expensive critical item | Minimum = the City's liability insurance coverage deductible amount |
| Electric Distribution and Gas Distribution RSRs | Maximum = 50% of sales revenue Minimum = 20% of sales revenue | Maximum = 30% of sales revenue Minimum = 15% of sales revenue |
| Water and Wastewater Collection RSRs | Maximum = 50% of sales revenue Minimum = 20% of sales revenue | Maximum = 30% of sales revenue Minimum = 15% of sales revenue |
| Gas Supply RSR | Maximum = 70% of supply purchase cost Minimum = 35% of supply purchase cost | Maximum = 50% of supply purchase cost Minimum = 25% of supply purchase cost |

BACKGROUND

By Charter or by Council action, a number of Utilities reserves have been established for various purposes. Over time, Council has changed the name, purpose, policies and guidelines for many of the reserves to address certain requirements or to accommodate specific needs.

Emergency Plant Replacement (EPR) Reserve

This reserve is established by Article VII, Section 2(e) of the City Charter for the Electric, Water, Gas, and Wastewater Collection Funds for unplanned emergencies (or "contingencies") only. The Charter directs that EPR reserve balances are not to exceed 5 percent of the net book value of the fixed assets of the fund. In 1988, Council approved [CMR: 293:8] minimum funding of the EPR reserves to be 5 percent of the annual increase in the net book value of the fixed assets of the fund. At that time, Council also directed that the balance of the reserve should be equal to an amount that covers the most expensive item of equipment which, if lost, would cause interruption in the normal activity of that utility. As required by the City Charter, these funds are available for use only for replacement or emergency repairs of damaged equipment; and such uses require special appropriation by Council.

In February 2007, Council approved a change to the EPR guidelines for the Electric, Water, Gas, and Wastewater Collection Funds [CMR:143:07]. At that time, a minimum guideline for the EPR for the Electric, Water, Gas, and Wastewater Collection Funds Staff was established as the greater of 1) the City's liability insurance coverage deductible amount or 2) an amount that covers the most expensive item of equipment which, if lost, would cause interruption in the normal activity of that utility.

Rate Stabilization Reserve (RSR)

Council established RSRs in May 1993 [CMR: 263:93] for the Water, Electric, Gas and Wastewater Collection Funds. The RSRs were created by combining the System Improvement Reserve in these funds and the Transfer Stabilization Reserve for the Water, Gas, and Electric Funds. This decision reflected the change in the use of the reserves to a mechanism to stabilize rates. At the time of the creation of these reserves and their associated guidelines, staff advised Council that “selecting a guideline involves a degree of judgment and uncertainty, the adequacy and prudence of these guidelines will be reviewed internally each year and, if appropriate, revised guidelines will be recommended.”

The purpose of the RSRs is to stabilize rates by ensuring funds are available to cover short-term situations when expenditures exceed revenues, to provide a depository of excess funds when expenditures are less than projected or revenues are higher than budgeted, and to plan for certain known future occurrences that are of a one-time nature, or to ramp up if the expense is of an ongoing nature.

In May 1998 [CMR:194:98], Council split the Gas and Electric Fund RSRs into Supply and Distribution RSRs when the retail rates in those funds were unbundled into supply and distribution components of the rate. The Gas and Electric Funds were split into supply and distribution business units to clarify the financial picture of the cost of distribution services (including the Capital Improvement Program [CIP]), operations and maintenance, transfer to the General Fund, rent, administration, allocated charges and other expenses) and supply services (including the cost of purchased commodities, direct and indirect administrative overhead allocated to the supply services) for the funds. The reserve guidelines established at that time were consistent with the approach taken in the development of the original 1993 reserve guidelines where cost contingencies were evaluated.

1. Water and Wastewater Collection Rate Stabilization Reserves – Guidelines for these reserves were set by Council at the time of the reserves’ creation in May 1993 [CMR: 263:93]. At that time, the minimum reserve level was set to the sum of: 1) 15 percent of sales revenue for that year; and 2) the estimated annual net sales revenue decline due to abnormal weather. The maximum reserve balance guideline was set to twice the minimum guideline, with the target level halfway between the maximum and the minimum levels.

In February 2007 [CMR:143:07], Council revised the guidelines for the Water and Wastewater Collection RSRs setting the minimum guideline level to 20% of sales revenue and the maximum guideline level to 50% of sales revenue.

2. Electric and Gas Distribution Rate Stabilization Reserves – At the time Council created these reserves in 1998 [CMR:194:98], the minimum reserve level guideline was set at 15 percent and 20 percent of the distribution sales revenue for the Electric and Gas Distribution RSRs, respectively. The maximum guideline level was twice the minimum and the target was the midpoint between the minimum and maximum.

In December 2003 [CMR: 483:03], Council revised the guidelines of the Electric Distribution RSR so that the minimum reserve level guideline was set at 19 percent of the distribution sales revenue. The minimum reserve guideline for the Gas Distribution RSR

was examined, but unchanged. The guidelines for both the Electric and Gas Distribution RSRs were determined to be adequate to cover the impact of electric and gas distribution cost contingencies, including: 1) a 10% decline in sales revenue for two years, 2) rise in ongoing operating expenses for two years, and 3) unusual one-time cost contingencies (e.g. potential seismic upgrades at the Municipal Service Center, effectiveness of efficiency programs, regulatory and legal cost uncertainties or expansion of the CIP). As before, the maximum guideline level was twice the minimum and the target was the midpoint between the minimum and maximum.

In February 2007 [CMR:143:07], Council again revised the guidelines for the Electric and Gas Distribution RSRs setting the minimum guideline level to 20% of sales revenue and the maximum guideline level to 50% of sales revenue.

3. Electric and Gas Supply Rate Stabilization Reserves – At the time Council created these reserves in 1998 [CMR:194:98], the minimum reserve level guideline was set at 30 percent and 20 percent of the budgeted commodity sales revenue for the Electric and Gas Supply RSRs, respectively. The maximum guideline level was twice the minimum and the target was the midpoint between the minimum and maximum.

In May 2001 [CMR:248:01], Council revised the guidelines for the Electric and Gas Supply RSRs so that the minimum reserve level guideline was set at 40 percent and 20 percent of the budgeted supply purchase cost for the Electric and Gas Supply RSRs, respectively. The maximum guideline level was twice the minimum and the target was the midpoint between the minimum and maximum.

In December 2003 [CMR:483:03], Council revised the guidelines so that the maximum reserve level guideline was set at 103 percent and 75 percent of the supply purchases costs for the Electric and Gas Supply RSRs, respectively. The guidelines for both the Electric and Gas Supply RSRs were determined to be adequate to cover the impact of electric and gas supply cost contingencies. As before, the minimum guideline level was twice the maximum guideline level.

In February 2007 [CMR:143:07], Council again revised the guidelines so that the minimum reserve level guideline was set at 50 percent and 35 percent of the supply purchase cost for the Electric and Gas Supply RSRs, respectively. The maximum guideline level was twice the minimum guideline level.

DISCUSSION

Emergency Plant Replacement (EPR) Reserves

The City has rarely used the Electric, Gas, Water, or Wastewater Collection EPRs. The last time any of these EPRs was tapped was in 1998 when the Electric EPR was used to cover the cost to replace a blown transformer. The introduction of the minimum guideline level in February 2007 [CMR: 143:07] was made in recognition of the City's property loss insurance policies.

- One of these policies is liability insurance, for which the City is currently self-insured up to \$1 million for disasters. This means that the first \$1 million in costs must be covered by the City before the liability insurance coverage would apply.

- In addition, the City has property loss insurance, which protects the City's property against physical loss or damage by theft, fire or other means. The City's property loss insurance covers certain property and equipment identified in an annual appraisal done for this purpose. The appraisal provides a statement of each item covered and the limit of coverage for each item. The limit is generally equal to the replacement cost of the item although some small exclusions may apply. Not all of the City's assets are listed in this appraisal. For example, the water, gas, and wastewater collections pipes and the electric wires are not included. For items that are listed in the appraisal, the coverage extends to the limit less the deductible. Currently, the deductible for property loss is \$10,000 per item. Assets or equipment that are not specifically listed in the appraisal are "unscheduled" and the deductible for "unscheduled" losses is \$500,000.
- Claims for damage due to earthquakes or floods would be made to the Federal Emergency Management Agency (FEMA).

The guideline also requires the calculation of an amount that covers the most expensive item of equipment which, if lost, would cause interruption in the normal activity of that utility. The last time these calculations were made for the Electric, Gas, Water, or Wastewater Collection Funds, they totaled \$1 million for the Electric Fund (for replacement of large transformers), \$750,000 for the Gas Fund (for damage to a gas receiving station), \$1.2 million for the Water Fund (for damage to a reservoir and pump station), and \$1 million for the Wastewater Collection Fund (for damage to a main sewer trunkline). If losses were found to be due to negligence, any amount over \$1 million should be covered by liability insurance.

To ensure that the EPRs can cover the deductible amount, staff recommends that the minimum guideline level be changed to be equal to the liability insurance coverage deductible amount (currently \$1 million) with no reference to the cost to repair or replace an expensive piece of equipment in each fund. This would ensure that the full amount needed would be available for any unforeseen emergency where equipment needed to be repaired or replaced in order to ensure that the distribution systems continued to operate.

Rate Stabilization Reserve (RSR)

One of the changes to the RSR guidelines approved by Council in February 2007 [CMR: 143:07] was the requirement that the development of an assessment of the risks facing each fund be undertaken as part of the annual budget and retail rate development and approval process. The annual assessment for the upcoming fiscal year is compared to the guideline levels to assist in the determination of the RSR level target for each fiscal year. This short-term risk assessment has been performed annually starting with Fiscal Year (FY) 2008.

The table below reflects the annual short-term risk assessment for the RSRs. For the Electric Distribution, Gas Distribution, Water, and Wastewater Collection RSRs, the minimum guideline level is 20% of budgeted sales revenue, but the short-term risk assessment is lower than 20%. For the Electric Supply RSR, the minimum guideline level is 50% of purchase costs and the short-term risk assessment is almost equal to that. For the Gas Supply RSR, the minimum guideline level is 35% of purchase costs and the short-term risk assessment ranges from 22% to 42% of purchase costs.

Estimate of Short-Term Risks for Rate Stabilization Reserves

| RSR | Short-Term Risks | FY 2008 | FY 2009 | FY 2010 | FY 2011 | Minimum Guideline Level | |
|------------------------------|-----------------------------|---------|---------|---------|---------|-------------------------|------------|
| | | | | | | Current | Proposed |
| Electric Distribution | in \$thousands | 4,000 | 4,588 | 5,584 | 5,897 | | |
| | % of budgeted sales revenue | 12.1% | 13.8% | 16.2% | 15.8% | 20% | 15% |
| Gas Distribution | in \$thousands | 3,300 | 3,390 | 3,759 | 4,168 | | |
| | % of budgeted sales revenue | 15.7% | 16.6% | 18.8% | 18.2% | 20% | 15% |
| Water | in \$thousands | 3,300 | 3,594 | 3,765 | 4,040 | | |
| | % of budgeted sales revenue | 12.4% | 13.5% | 13.7% | 13.4% | 20% | 15% |
| Wastewater Collection | in \$thousands | 1,700 | 1,698 | 1,716 | 1,928 | | |
| | % of budgeted sales revenue | 12.4% | 12.4% | 12.5% | 12.3% | 20% | 15% |
| Electric Supply | in \$thousands | 44,200 | 33,800 | 33,600 | 37,100 | | |
| | % of budgeted purchase cost | 73% | 48% | 49% | 50% | 50% | 50% |
| Gas Supply | in \$thousands | 3,700 | 6,500 | 5,800 | 11,600 | | |
| | % of budgeted purchase cost | 14% | 23% | 22% | 42% | 35% | 25% |

The proposed new minimum reserve guideline level for the Electric Distribution, Gas Distribution, Water, and Wastewater Collection RSRs is 15% of the sales revenue. The proposed maximum guideline level is 30% of the sales revenue. With this change, it is expected that the short-term risk assessment values for these RSRs will lie within that range.

The proposed new minimum reserve guideline level for the Gas Supply RSR is 25% of the sales revenue. The proposed maximum guideline level is 50% of the sales revenue. Although the short-term risk assessment for FY 2011 is higher than the 25% proposed minimum guideline, this amount is higher due to the higher fraction of the portfolio that is unhedged in the second year. Other risks for FY 2011 are also expected to decline in FY 2011 and staff expects that the short-term risk assessment for FY 2011 will be substantially lower next year during the annual budget and rates review process. No changes are recommended at this time for the Electric Supply RSR as the short-term risk assessment value is in line with the minimum guideline level.

COMMISSION REVIEW AND RECOMMENDATIONS

The proposed changes to the EPR and RSR guidelines were presented to the UAC at its March 4, 2009 meeting. The UAC asked how lowering the reserve guideline levels would appear to ratings agencies. Staff indicated that the City will maintain adequate reserves to ensure that it is fiscally responsible and that ratings agency guidelines will be met to ensure the City has access to the best rates on bonds it may elect to sell.

The UAC voted unanimously to recommend that the Council approve staff's recommendation. The notes from the UAC meeting are provided as Attachment A.

RESOURCE IMPACT

There is no impact from the recommended changes to the Electric, Gas, Water, and Wastewater Collection Emergency Plant Replacement Reserves since they are already funded at \$1 million.

There is no resource impact of the recommended changes to the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves as a result of the recommended changes to the guideline levels since the risk assessment calculation is used to determine reserve level targets for the budget years.

POLICY IMPLICATIONS

The recommended action changes the existing reserve guidelines. This recommendation is consistent with the Council-approved Utilities Strategic Plan with regard to 1) managing supply portfolio risk to preserve a supply cost advantage; and 2) to provide low and stable rates, adequate reserves, and budgeted transfers to the General Fund.

ENVIRONMENTAL REVIEW

The recommended action does not meet the definition of a "project" pursuant to Section 21065 of the Public Resources Code, thus no environmental assessment under the California Environmental Quality Act (CEQA) is required.

ATTACHMENT

A. Draft Notes from the March 4, 2009 UAC meeting

PREPARED BY:

JANE O. RATCHYE

Utilities Assistant Director, Resource Management

DEPARTMENT APPROVAL:

VALERIE O. FONG

Director of Utilities

CITY MANAGER APPROVAL:

JAMES KEENE

City Manager

Excerpt from Final Minutes of March 4, 2009 UAC Meeting**ITEMS 3: ACTION ITEM: Changes to Certain Utilities Reserve Guidelines**

Utilities Assistant Director Jane Ratchye stated that this proposal was first mentioned at the February meeting and that the proposal was to align the long-term Rate Stabilization Reserve (RSR) guideline levels with the short-term risk assessment values that have been done for the last three years.

Commissioner Waldfoegel asked why the guidelines for the Electric Supply RSR were not recommended to be changed. Ratchye explained that the minimum guideline for that reserve was already roughly equal to the short-term risk assessment value, so that a change did not seem warranted. She also noted that the Electric Supply RSR has the highest guidelines levels due to the high level of risk associated with the hydroelectric generation.

Chair Dawes asked if there is enough experience with doing the risk assessment calculations to know if the guideline levels are sufficient. Ratchye noted that for the Gas and Electric Distribution, Water, and Wastewater Collection RSRs, the risk assessment is based on changes in demand levels. Dawes indicated that he was more interested in the Gas and Electric Supply RSRs. Ratchye indicated that the short-term risk assessment numbers haven't changed much in the three years that they have been calculated, but acknowledged that this was the extent of the applicable history. She explained that the short-term risk assessment is what is used to help determine adequate reserves in the short-term, but that the long-term guidelines are used for longer-term financial planning.

Council Member Yeh asked how ratings agencies view lowering reserve levels given that the Water Fund is planning to issue debt in the short-term. Administrative Services Director Lalo Perez replied that the rating agencies have taken a more proactive approach to review financial conditions of municipal governments and that the City is interested in maintaining adequate reserve levels. Historically, the City has been viewed as being fiscally prudent and has been seen to be able to maintain reserves and make rate adjustments as appropriate.

ACTION: Commissioner Rosenbaum moved the staff recommendation to recommend that Council approve the changes to the Emergency Plant Replacement Reserves and the Rate Stabilization Reserves, as proposed. Commissioner Melton seconded the motion. The UAC voted to approve the motion unanimously (5-0).

Special Meeting
March 31, 2009

The Finance Committee of the City of Palo Alto met on this date in the Council Chambers at 7:04 p.m.

Present: Burt (Chair), Council Member Klein, Morton, Council Member Yeh
Absent: None

Excerpted Minutes:

4. Utilities Advisory Commission Recommendation to Change Guidelines for the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves and the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves

Assistant Director of Utilities for Resource Management, Jane Ratchye stated the above-noted item was reviewed by the Utilities Advisory Committee (UAC). She agreed with the UAC's recommendations and the proposed clarification in the electric, gas, water, and wastewater collection emergency plant replacement reserves. She stated Staff also proposed small modifications to some of the rate stabilization reserves which in all cases lowered the minimum guideline to a level more consistent with the annual risk assessment for these reserves.

Vice Mayor Morton was surprised that the electrical reserves used a liability number as a minimum in the new guideline, on page 2 of the report.

Ms. Ratchye stated what he referred to was the emergency plant replacement reserves for electric, gas, water and wastewater collection. She stressed the existing guideline was not entirely clear. The liability insurance coverage existed.

MOTION: Council Member Klein moved, seconded by Vice Mayor Morton, that the Finance Committee approve Staff recommendation to the City Council to Change Guidelines for the Electric, Gas, Water and Wastewater Collection Emergency Plant Replacement Reserves and the Electric Distribution, Gas Distribution, Gas Supply, Water, and Wastewater Collection Rate Stabilization Reserves

MOTION PASSED: 4-0