



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Rick Bruneau
Lori Mitchell

SUBJECT: Amendment to Council
Policy 1-24, San José Clean
Energy Financial Reserves
Policy

DATE: July 22, 2024

Approved

Date:

7/24/24

COUNCIL DISTRICT: Citywide

RECOMMENDATION

Adopt a resolution amending Council Policy 1-24, San José Clean Energy Financial Reserves Policy, to establish a Rate Stabilization Reserve for the San José Clean Energy program and make technical and clarifying changes.

SUMMARY AND OUTCOME

Approving the resolution results in amending Council Policy 1-24, San José Clean Energy's (SJCE) Financial Reserves Policy (Policy), to establish a Rate Stabilization Reserve to support rate stability when faced with fluctuations in power expense costs, in accordance with Section 26.30.010 of the San José Municipal Code, as well as to make technical and clarifying changes.

BACKGROUND

On December 6, 2022, City Council approved Council Policy 1-24, which implemented an Operational Reserve for SJCE with the goal of building a budgeted reserve to 180 days of operating expenses to provide sufficient financial capacity to meet short-term obligations and SJCE's strategic initiatives. The Policy requires the Energy Department to perform an annual review of the Policy to ensure it meets the needs of the SJCE program, with any proposed changes submitted to City Council for review and approval.

The initial Policy addressed the need to build "liquid" operating reserves. Given SJCE's strong current financial position, above 180 days liquidity on hand in the operating reserve at 2023-2024 year-end, the organization has financially matured to allow for an

additional reserve devoted to rate stabilization that is considered an industry best practice.

One of the key tenets of SJCE's Business Plan¹ is to develop reserves to support rate stabilization. The implementation of a Rate Stabilization Reserve is a best practice for supporting financial covenant compliance and mitigating unplanned rate increases among investment grade credit rated California Choice Aggregation programs, and utilities in general.

ANALYSIS

Establish a Rate Stabilization Reserve

Staff recommends establishing a Rate Stabilization Reserve to complement the Operating Reserve in SJCE's portfolio of financial reserves. While the budgeted Operating Reserve focuses on maintaining 180 days of liquid assets to support the financial operations and strategic objectives of the entity, the Rate Stabilization Reserve focuses on providing customer rate stability when there are fluctuations that result in lower revenues or higher operating expenses.

The Rate Stabilization Reserve provides SJCE protection against market variability and a tool to maintain compliance with financial covenants. Creation of a Rate Stabilization Reserve allows the deferred inflow of resources in years of high net revenues to a Rate Stabilization Reserve account that can be drawn on in years of high operational expenses, to stabilize the net revenue performance of the entity. In this way, SJCE can better manage its financial position and compliance reporting without relying solely on near-term customer rate adjustments.

The Rate Stabilization Reserve will be accounted for under Governmental Accounting Standards Board Statement No. 62. Contributions to the Rate Stabilization Reserve are made from excess net revenues over expenses. Contributions to the Rate Stabilization Reserve account will only be made in years where a minimum net revenue threshold is achieved, to ensure that an appropriate net position is reported for the year and to maintain strong financial covenant reporting. The minimum net revenues threshold is deemed achieved when the SJCE Fund's change in net position (total revenue less total expenditure) is greater than 5% of total year end revenues. The Rate Stabilization Reserve amount is capped at a maximum of 10% of the total operating and non-operating revenues reported for the current year. In such cases where the Rate Stabilization Reserve exceeds this cap, due to lower subsequent years revenues, it

¹ SJCE Business Plan Assessment by Deloitte:

<https://www.sanjoseca.gov/home/showpublisheddocument/80624/637752767690970000>

does not need to be drawn on; however, SJCE cannot contribute to it in these years. The Rate Stabilization Reserve will be evaluated at the close of each fiscal year. The contribution to, and draws on, the Rate Stabilization Reserve will be maintained at a level deemed adequate as determined by the Director of Energy to meet SJCE operational needs and ensure compliance with financial covenants. As the Rate Stabilization Reserve will receive deferred revenues that will not be recognized on a budgetary basis, per Governmental Accounting Standards Board 62, the Rate Stabilization Reserve will not appear in the Funding Sources Resolution or the Appropriation Ordinance; however, the Rate Stabilization Reserve will be included in the Source and Use of Funds Statement that appears in the Proposed and Adopted Operating Capital Budgets and be accounted for in the SJCE Fund's audited financial statements. The Energy Department will report to the City Council on the status of the Rate Stabilization Reserve in the quarterly informational memoranda submitted to City Council, during the annual rate setting process, and in the City Manager's Annual Report.

Technical "Clean-ups"

A few technical clean-ups are recommended with the proposed Policy revisions. These clean-ups address minor, clarifying, changes to the Policy including defining a new calculation for the Operating Reserve's "180 days" to align to industry standard days liquidity on hand.

EVALUATION AND FOLLOW-UP

No additional follow up action with the City Council is expected.

COST SUMMARY/IMPLICATIONS

With City Council's approval of the Rate Stabilization Reserve, the Energy Department anticipates deferring up to \$50.0 million of the projected \$531.0 million revenue received in 2023-2024. The final amount of deferred revenue placed in the Rate Stabilization Reserve in 2023-2024 will be confirmed by the end of August 2024 and be reflected in the City Manager's 2023-2024 Annual Report.

COORDINATION

This item has been coordinated with the City Attorney's Office and the City Manager's Budget Office.

HONORABLE MAYOR AND CITY COUNCIL

July 22, 2024

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Page 4

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the August 13, 2024 City Council meeting.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

CEQA

Not a Project, File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/

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/s/

Lori Mitchell
Director, Energy

The principal authors of this memorandum are Rick Bruneau, Director, Finance and Zach Struyk, Assistant Director, Energy. For questions, please contact them at rick.bruneau@sanjoseca.gov or zachary.struyk@sanjoseca.gov.