

6.2 Amendment to Council Policy 1-24, San José Clean Energy Financial Reserves Policy.

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.

CEQA: Not a Project, File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment. (Energy/Finance)



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

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

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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/

Rick Bruneau
Director, Finance

/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.

RESOLUTION NO. _____

**A RESOLUTION OF THE COUNCIL OF THE CITY OF SAN JOSE
APPROVING REVISIONS TO CITY COUNCIL POLICY 1-24,
SAN JOSE CLEAN ENERGY FINANCIAL RESERVES POLICY,
TO ESTABLISH A RATE STABILIZATION RESERVE FOR THE
SAN JOSE CLEAN ENERGY PROGRAM AND MAKE
TECHNICAL AND CLARIFYING CHANGES**

WHEREAS, the City Council of the City of San José (“City”) initially adopted City Council Policy 1-24, San José Clean Energy Financial Reserves Policy, (“Council Policy 1-24”) on December 6, 2022, which implemented an Operational Reserve for San José Clean Energy (“SJCE”) with the goal of building a budgeted reserve to 180 days of operating expenses in order to provide sufficient financial capacity to meet short-term obligations and SJCE’s strategic initiatives; and

WHEREAS, 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 for supporting financial covenant compliance and mitigating unplanned rate increases; and

WHEREAS, the City desires to amend Council Policy 1-24 to establish a Rate Stabilization Reserve to complement the Operating Reserve in SJCE’s portfolio of financial reserves, in order to support customer rate stability when faced with fluctuations in power expense costs that result in lower revenues or higher operating expenses, providing SJCE protection against market variability and a tool to maintain compliance with financial covenants, in accordance with Section 26.30.010 of the San José Municipal Code, as well as to make technical and clarifying changes; and

WHEREAS, this policy supersedes the policy adopted on December 6, 2022, by the City Council;

NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF
SAN JOSE THAT:

The revised Council Policy 1-24, entitled “San José Clean Energy Financial Reserves Policy”, attached hereto as Attachment A and incorporated herein by reference as though fully set forth herein, is hereby approved and shall replace Council Policy 1-24 approved by the City Council on December 6, 2022.

ADOPTED this _____ day of _____, 2024, by the following vote:

AYES:

NOES:

ABSENT:

DISQUALIFIED:

MATT MAHAN
Mayor

ATTEST:

TONI J. TABER, CMC
City Clerk

ATTACHMENT A
City of San José, California

COUNCIL POLICY

TITLE San José Clean Energy Financial Reserves Policy	PAGE 1 of 3	POLICY NUMBER 1-24
EFFECTIVE DATE December 6, 2022	REVISED DATE <u>August 13, 2024</u>	
APPROVED BY COUNCIL ACTION 12/6/2022, Item 6.1b, Res. No. 80805; <u>8/13/2024, Item_____, Reso. No._____</u>		

PURPOSE

~~Establishing~~It is the purpose of this policy to establish financial reserves ~~that build over time is for San José Clean Energy (SJCE) as~~ a critical component ~~of~~in enterprise risk management, prudent fiscal management, contingency planning, and funding of long-term program goals. ~~San José Clean Energy (~~

POLICY AND OBJECTIVES

SJCE~~)~~ will prudently manage its operations in a manner that supports its long-term financial independence and stability, ~~provides sufficient financial capacity to bridge shortfalls in cash flow and covers unanticipated expenditures,~~ while providing sufficient financial capacity to meet short-term obligations. SJCE shall strive to build and maintain financial reserves to meet strategic objectives including, but not limited to:

POLICY

~~SJCE shall strive to build and maintain financial reserves as described in this policy to:~~

- ~~• Meet SJCE's strategic objectives and establish long-term business sustainability~~
- a) Secure favorable commercial terms with vendors, including power producers
- b) ~~Secure future~~Maintain stand-alone SJCE credit rating
- c) Develop a source of funds for investment in generation and other local programs
- d) Provide a contingency ~~that supports to support~~ rate stability for SJCE customers
- e) Provide a source of funds to respond to ~~unanticipated~~unforeseen expenditures or market events

RESPONSIBILITIES

The Director of Energy, appointed by the City Manager and subject to their direction and supervision, is responsible for developing resource plans, administering rate setting for

City of San José, California

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the SJCE program, and overseeing the financial accounting of SJCE in coordination with the Finance Department.

FINANCIAL RESERVES

1. Operating Reserve

~~It is important to note that the goals listed above are not intended to be a comprehensive list of goals for SJCE. Rather, the above reflect a subset of goals critical to long-term business viability of SJCE.~~

Within the San José Clean Energy Operating Fund, an operating reserve is established. The purpose of this reserve is to provide liquidity for SJCE, supporting the objectives outlined in this policy. The operating reserve will develop to, and ultimately maintain, SJCE shall strive to build and maintain financial reserves with a goal of at least one hundred eighty (180) days of operating costs, including power supply expenses, held in an Operating Reserve liquidity on hand¹, subject to SJCE's ability to meet operational expenditures and maintain competitive rates. The operating reserve will be budgeted in the Operations and Maintenance Reserve and/or as Unrestricted Ending Fund Balance, and reflected on SJCE's Financial Statements as ~~or as~~ unrestricted equity in pooled cash, and investments. Funding for ~~reserves~~the operating reserve will come from an excess of revenues over expenditures. The contributions to and draws on the ~~reserves~~operating reserve will be determined through SJCE's budgeting and rate-setting processes, as approved by the City Council.

2. Rate Stabilization Reserve

Within the San José Clean Energy Operating Fund, a Rate Stabilization Reserve may be maintained at a level deemed adequate as determined by the Director of Energy to meet SJCE's operational needs. The purpose of this reserve is to provide customer rate stability when there are fluctuations that result in lower revenues or higher operating expenses than anticipated. With the Rate Stabilization Reserve, consistent with GASB 62 regulatory accounting, some inflow of operating income in years when financial results are strong can be deferred to future years, where financial results are less strong. In such less financially strong years, SJCE can draw down on the Rate Stabilization Reserve to mitigate impacts to customers. This Rate Stabilization Reserve serves as a protective measure for SJCE against market fluctuations and acts as a tool to ensure compliance with financial covenants.

¹ Days liquidity on hand (DLOH) is calculated as (unrestricted cash) x 365 / (total operating expenses including power purchases, for the prior 12-month period).

City of San José, California

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The Energy Department may periodically make revenue deferrals to and from the Rate Stabilization Reserve consistent with the SJCE Financial Reserves Policy objectives and under the following two (2) conditions:

- a. Deposits: When the projected addition to Net Position² for the year exceeds 5% of total operating and non-operating revenues for that year, as calculated before deferring any resources to the Rate Stabilization Reserve.
- b. Withdrawals: When Net Revenues are projected to be negative or as necessary to satisfy any legal covenants, contractual obligations or to maintain investment grade credit ratings.

Rate Stabilization Reserve Targeted Balance: The Rate Stabilization Reserve will be evaluated at the close of each fiscal year, as described above until the balance equals 10% of the total operating and non-operating revenues in the then current fiscal year. In such cases where the Rate Stabilization Reserve exceeds this cap, it does not need to be drawn on; however, further contributions cannot be made to the Rate Stabilization Reserve.

RESERVES POLICY REVIEW


The Financial Reserves Policy will be reviewed annually to ensure ~~it meets alignment with~~ the needs of the SJCE program. ~~The future~~Future development of SJCE may require the ~~expansion~~creation of new reserves and/or adjustment of reserve targets to support ~~new activities such as major expansion of SJCE activities or the acquisition of generating assets. In addition, the Reserves Policy may be adjusted in the future to respond to changes in the operating activities,~~ industry standards, legislation, or economic conditions.

² The addition to Net Position is calculated as the total operating and non-operating revenues less total operating and non-operating expenses for the fiscal year. On the Statement of Revenues, Expenses, and Changes in Net Position this is identified as the Change in Net Position.

FINANCIAL RESERVES POLICY UPDATE

August 13, 2024

Zach Struyk, Acting Director
Jennifer Stevenson, Principal Accountant

SAN JOSE 
CLEAN ENERGY
A Program of the City of San José

STAFF 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.

RATE STABILIZATION RESERVE (RSR)

- Financial tool used by regulated utilities who set rates according to cost of service to manage fluctuations in costs or revenue
- Purpose is to keep rates stable for customers considering expense fluctuations (i.e., PCIA, market cost of energy) while maintaining debt coverage ratios and positive net position
- Accounting in accordance with GASB 62, consulted with auditors (MGO) on policy and implementation



RSR – INDICATIVE EXAMPLE (1 OF 2)

Deferral Year – defer \$30M from revenue

Statement of Revenues, Expenses, and Changes in Net Position		Statement of Net Position	
Operating Revenues		Assets	
Power Sales		Deferred Outflows	
Rate Stabilization		Liabilities	
Total Operating Revenues		Deferred Inflows	
Operating Expenses		Rate Stabilization Reserve	
Operating Income		Net Position	
Nonoperating Revenues (expenses)			
Net Position			

(\$30M) → \$30M

Note: dollar values for illustrative purposes only, actual deferral for FY24 will be no more than \$50M.

RSR – INDICATIVE EXAMPLE (2 OF 2)

Withdrawal Year – Recognize \$10M in revenue

Statement of Revenues, Expenses, and Changes in Net Position	
Operating Revenues	
Power Sales	
Rate Stabilization	\$10M
Total Operating Revenues	
Operating Expenses	
Operating Income	
Nonoperating Revenues (expenses)	
Net Position	

Statement of Net Position	
Assets	
Deferred Outflows	
Liabilities	
Deferred Inflows	
Rate Stabilization Reserve	\$20M
Net Position	

Note: dollar values for illustrative purposes only

MECHANICS AND REPORTING (1 OF 2)

Deferrals at year end

- Allowable only when net position is greater than 5% of total revenues for the year
- Reserve balance capped at 10% of total revenues for year

Withdrawal at any time during year

- As necessary to satisfy any legal covenants, contractual obligations, or to maintain investment grade credit ratings



MECHANICS AND REPORTING (2 OF 2)

Reporting

- Source and Use of Funds Statement in Proposed and Adopted Operating Capital Budgets and Annual Report
- SJCE quarterly and annual financial statements
- During annual rate setting process
- Quarterly information memoranda to Council on SJCE regulatory compliance and power procurement



LEGAL CONSIDERATIONS

- Reserves have been held to be a legitimate cost of electric service and are usually funded by charging a certain margin above other costs.
- Proposition 218 (1996) has an explicit exemption for gas and electric service fees
- Proposition 26 (2010) does generally apply to community choice aggregators like SJCE, with an exception for charges that do not exceed the reasonable costs of providing service.
 - In a recent court challenge of CCA rates under Prop 26, the reasonable costs of the CCA included a rate stabilization reserve.

STAFF 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.

FW: Comments for today's Council meeting, item 6.2

City Clerk <city.clerk@sanjoseca.gov>

Tue 8/13/2024 9:36 AM

To: Agendadesk <Agendadesk@sanjoseca.gov>

 1 attachments (81 KB)

Niemeyer Comments on Item 6.2 - Energy Financial Reserves Policy.docx;

From: Victor Niemeyer [REDACTED]

Sent: Tuesday, August 13, 2024 9:24 AM

To: City Clerk <city.clerk@sanjoseca.gov>

Cc: Struyk, Zachary <Zachary.Struyk@sanjoseca.gov>; Mitchell, Lori <Lori.Mitchell@sanjoseca.gov>

Subject: Comments for today's Council meeting, item 6.2

[External Email]

Attached are comments on today's Council meeting item 6.2. Please post them to the record. Thank you.

Let me know if you have any questions.

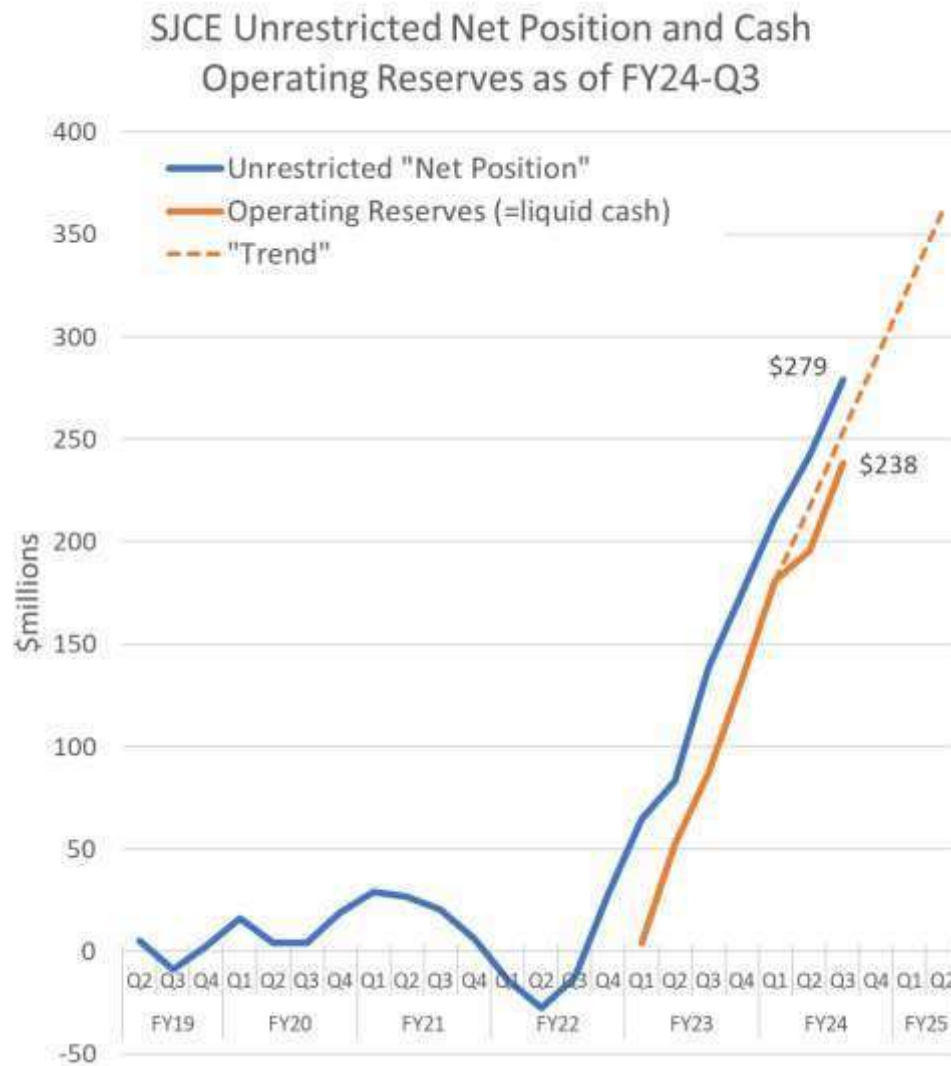
Cheers,
Victor Niemeyer
[REDACTED]

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August 13, 2024

Comments on Energy Financial Reserves Policy

1) SJCE's finances are strong and getting stronger.



- 2) A serious amount of customer money is at stake here: \$30-50M
- 3) Proposed policy is complicated: a lot to take in, formula-based policies risk unintended consequences
- 4) Proposal memo was released only 2 working days ago
- 5) There has been no Climate Advisory Commission input

I suggest the Council return the proposal to Staff for Commission input.

There is no need to rush this.

Victor Niemeyer, San José Resident

