



Agenda Report

February 24, 2025

TO: Honorable Mayor and City Council

THROUGH: Municipal Services Committee (February 11, 2025)

FROM: Water and Power Department

SUBJECT: **DIRECTION TO CITY ATTORNEY TO PREPARE WITHIN 60 DAYS AN ORDINANCE AMENDING PASADENA MUNICIPAL CODE CHAPTER 13.04 TO REMOVE STRANDED INVESTMENT CHARGE AND RESERVES AND AMEND TO INCLUDE A WORKING CAPITAL RESERVE TARGET (Water & Power Depart.)**

RECOMMENDATION:

It is recommended that the City Council:

- 1) Find that the action proposed herein is not a “project” subject to the California Environmental Quality Act (CEQA) pursuant to California Public Resources Code Section 21065 and within the meaning of State CEQA Guidelines Section 15378(b); and
- 2) Direct the City Attorney to prepare an ordinance and return within 60 days, amending the Pasadena Municipal Code (“PMC”) Chapter 13.04, the light and power rate ordinance to:
 - a. Amend Section 13.04.173 – Power cost adjustment.
 - b. Amend Section 13.04.175 – Reserve for stranded investment and change title to “Reserve for working capital”; and,
 - c. Remove 13.04.176 – Stranded investment surcharge.

MUNICIPAL SERVICES COMMITTEE (“MSC”) RECOMMENDATION:

On February 11, 2025, the MSC approved the staff recommendation to direct the City Attorney’s Office to prepare an ordinance to amend PMC 13.04; the code change would create a working capital reserve target policy. Staff received guidance to also create a minimum level for reserves to establish the point at which reserve levels would be detrimental to the operations of the utility.

The basis for a minimum is recommended to be 60 days, as compared to 90 days for the target, for liquidity reserve for operating expenses (2) the market reserve category, and (3) the contingency risk category. Given that the current minimum reserve level within the City's Fund Balance Reserve Policy for the Light and Power Fund is 60 days of operating expenses, this recommendation is consistent with adopted policy. The revision to the code would also acknowledge that there are many other risks that the utility faces that require sufficient working capital in a rapidly changing industry and world.

EXECUTIVE SUMMARY:

Pasadena Water and Power ("PWP") recommends streamlining PMC code sections that impact the Light and Power Fund's reserves to adopt a working capital reserve target. The proposed target includes amounts to address liquidity needs and several types of risks within the utility. Established target amounts will ensure exceptional creditworthiness as well as resilience to unforeseen circumstances. The proposed PMC change also will include protocol for the use, replenishment, and monitoring of the target amounts. Furthermore, the recommendation is to dissolve the existing narrowly focused Stranded Investment Reserve to address the current working capital needs to enable continuity of services and stability of customer rates.

BACKGROUND:

The Stranded Investment Reserve was established in 1996 as part of a strategy to address above-market energy costs anticipated from the Intermountain Power Project (IPP) and Magnolia projects, which, at the time, were projected to lose value due to industry restructuring. Funded through ratepayer contributions, this reserve was limited to covering stranded investment risks only. Since the establishment of the reserve, however, these assets have retained value, with much lower exposure to stranded costs than initially anticipated. As required by PMC 13.04.175, Council has approved the use of the Stranded Investment Reserve several times in the past, with uses such as the defeasance of \$80 million in bonds and the most recent usage of \$7 million per year from 2018- 2022 to mitigate future rate increases due to the increasing power supply costs.

In today's financial environment, Government Finance Officers' Association and other industry best practices recommend utility reserves focus on operational liquidity, cash flow stability, and risk mitigation for operational and capital needs. Adopting a working capital reserve will allow PWP to realign the stranded investment funds into reserve categories that better address modern utility risks, including unexpected cost fluctuations, seasonal revenue variances, and operational stability; all while considering a long-term perspective on funds management.

In light of the ongoing electric rate study, PWP is seeking policy direction on the amount of reserves deemed appropriate by Council in order to set rates that optimize for both affordability and rate stability.

Reserve Policy Target Components

The proposed Reserve Policy Target includes four main reserve categories, each tailored to mitigate specific risks and provide targeted financial stability:

1) Liquidity Reserve

- a) **Purpose:** Provides liquidity to meet routine operational expenses and cash flow during times of revenue variability.
- b) **Target Level:** Equivalent to the sum of 90 days of operating expenses, one-year principal payment for outstanding bonds, approved General Fund transfer amount, and one year capital improvement budget. This reserve helps PWP manage short-term financial disruptions, such as seasonal variations in revenue or unexpected operational expenses.
- c) **Risk Mitigation:** Protects against revenue volatility by ensuring sufficient funds are available to cover costs without needing immediate rate adjustments. This reserve level will also support debt service obligations, enhancing PWP's credit profile.

2) Market Exposure Reserves

a) Energy Services Charge Reserve

- i) **Purpose:** Provides a buffer against fluctuations in energy costs and unexpected energy purchase needs. Energy markets can be volatile, impacting the cost of purchased power.
- ii) **Target Level:** Set at 90 days of projected energy costs.
- iii) **Risk Mitigation:** Enables PWP to manage unexpected energy price spikes or supply disruptions without impacting rate stability. The reserve also helps maintain rate stability by offsetting temporary increases in energy procurement costs.

b) Transmission Reserve

- i) **Purpose:** Covers potential increases in transmission costs or investments needed for maintaining or upgrading transmission infrastructure. This reserve addresses cash needs arising from unforeseen transmission expenses that may arise from infrastructure wear, system expansion, or regulatory changes.
- ii) **Target Level:** Based on projected annual transmission costs amounting 90 days of PWP's annual transmission-related obligations.
- iii) **Risk Mitigation:** Supports the continuity of service by covering unanticipated transmission expenses without needing to increase customer rates or reduce service quality. A dedicated transmission reserve also ensures that PWP can meet short-term needs related to system upgrades or unexpected outages.

3) Contingency Reserve

- a) **Purpose:** Acts as a safeguard for extreme or unforeseen events that exceed standard operating and capital contingencies, including emergencies or regulatory changes requiring immediate capital outlays.
- b) **Target Level:** 90 days of annual operating expenses and capital workplan.
- c) **Risk Mitigation:** Enhances PWP's financial resilience to sudden disruptions that could impact service delivery, such as natural disasters or unexpected regulatory

mandates requiring rapid response. The contingency reserve is an essential part of a strong reserve structure, ensuring operational continuity in critical times.

Proposed Policy Implementation

The conversion of the Stranded Investment Reserve into the Working Capital Reserve Target with established reserves will involve:

- 1) **Reclassifying Funds:** Allocating the existing balance from the Stranded Investment Reserve into the Working Capital Reserve based on PWP's needs and recommended reserve levels.
- 2) **Establishing Utilization and Replenishment Policies:** Defining criteria for withdrawals and required approvals to ensure that funds are used appropriately and replenished as needed to maintain established targets.
- 3) **Annual Review and Adjustment:** Regular assessment of reserve levels by the General Manager, reviewing as necessary to meet changing operational and market conditions.

COUNCIL POLICY CONSIDERATION:

The recommendations are consistent with the City Council's goals to maintain fiscal responsibility and stability; improve, maintain, and enhance public facilities and infrastructure; and increase conservation and sustainability.

ENVIRONMENTAL ANALYSIS:

CEQA excludes, from environmental review, actions that are not "projects" as defined by California Public Resources Code (PRC) CEQA Guidelines Section 21065 and within the meaning of CEQA Guidelines Section 15378(b). PRC Sections 21065 and CEQA Guidelines Section 15378(b) define a project as an action which may cause either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment. CEQA Guidelines Section 15378 excludes from the definition of "project" administrative activities of governments that will not result in direct or indirect physical changes in the environment. The actions proposed herein, amending the municipal code to establish a consolidated working capital reserve for the Light and Power Fund, is an administrative activity, and therefore is not a "project" as defined by CEQA. Since the action is not a project subject to CEQA, no environmental document is required.

FISCAL IMPACT:

This amendment requires no additional ratepayer contributions, as the funds are currently available within the Stranded Investment Reserve and Light and Power Fund Balance. By realigning these funds, PWP will improve financial stability, protect ratepayers from abrupt rate adjustments, and provide enhanced fiscal resilience for the utility. There is no impact to the General Fund.

Respectfully submitted,



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