



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Maria Oberg
Lori Mitchell

SUBJECT: SEE BELOW

DATE: May 12, 2025

Approved

Date:

5/19/25

COUNCIL DISTRICT: Citywide

**SUBJECT: 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 increase the maximum contribution amount to the Rate Stabilization Reserve for the San José Clean Energy program to 25% of the total operating and non-operating revenues reported for the current year.

SUMMARY AND OUTCOME

Approving the resolution results in amending Council Policy 1-24, San José Clean Energy's (SJCE) Financial Reserves Policy (Policy), to increase the maximum contributions to the Rate Stabilization Reserve that supports rate stability when the program is faced with fluctuations in program revenues and power expense costs, in accordance with Section 26.30.010 of the San José Municipal Code.

BACKGROUND

On December 6, 2022, City Council approved Council Policy 1-24, which established an operational reserve for SJCE with the goal of building a budgeted reserve equal to 180 days of operating expenses to provide sufficient financial capacity to meet short-term obligations and advance SJCE's strategic initiatives. The Policy also addressed the need to build "liquid" operating reserves and requires the Energy Department to perform an annual review to evaluate the Policy's alignment with the SJCE program's needs, with any proposed changes submitted to the City Council for review and approval.

On August 13, 2024, the City Council approved an amendment to the Policy establishing a Rate Stabilization Reserve to support rate stability when the organization is faced with fluctuations in power expense costs and changes in the regulatory environment. The establishment of the rate stabilization reserve aligned with industry best practice for supporting financial covenant compliance and mitigating unplanned rate increases among investment grade credit rated Community Choice Aggregation programs, and utilities in general. The implementation of a rate stabilization reserve reflected SJCE's strong financial position at the close of Fiscal Year (FY) 2023-2024, with more than 180 days liquidity on hand in the operational reserve and supports one of the key tenets of SJCE's Business Plan¹ to develop reserves that support long-term rate stabilization.

ANALYSIS

The rate stabilization reserve provides SJCE protection against market volatility and a tool to maintain compliance with financial covenants. The reserve allows the deferred inflow of net revenues in strong financial years into a dedicated account, which can then be drawn upon in years marked by elevated operating expenses or revenue shortfalls. In this way, SJCE can better manage its financial position and compliance reporting without relying solely on near-term customer rate adjustments to address market fluctuations that result in lower revenues or higher operating expenses.

Contributions to the rate stabilization reserve are only made in years when SJCE achieves a minimum net revenue threshold, thereby preserving the integrity of the annual net position and ensuring continued alignment with financial reporting requirements. The minimum threshold is met when the SJCE Fund's change in net position (total revenues less total expenditures) exceeds 5% of total year-end revenues.

Currently, the policy caps the rate stabilization reserve amount at 10% of the total operating and non-operating revenues reported for the fiscal year. Staff recommends amending the policy to allow contributions to the rate stabilization reserve account up to a maximum of 25% 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 does not need to be drawn on; however, SJCE cannot contribute to it in these years.

Since the rate stabilization reserve receives deferred revenues that are not recognized on a budgetary basis, per Governmental Accounting Standards Board

¹ SJCE Business Plan Assessment by Deloitte:

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

62, the rate stabilization reserve does not appear in the Funding Sources Resolution or the Appropriation Ordinance; however, the rate stabilization reserve is included in the Source and Use of Funds Statement that appears in the Proposed and Adopted Operating Budgets and is accounted for in the SJCE Fund's audited financial statements. The Energy Department reports 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.

Given that SJCE operates within a complex and highly regulated energy market, the proposed amendment to increase the maximum allowable contributions to the Rate Stabilization Reserve to 25% of total annual operating and non-operating revenues will enhance SJCE's ability to manage potential financial impacts arising from future regulatory changes. One such example is the California Public Utilities Commission's recent decision to reopen the Power Charge Indifference Adjustment (PCIA) rulemaking proceeding (R.25-05-002). This proceeding has the potential to significantly alter the existing PCIA framework, with the risk of substantially increasing PCIA-related charges on customer bills. Preliminary estimates by SJCE staff suggest that the near-term impacts of the proceeding are likely to roughly triple the 2025 PCIA cost for the average SJCE residential customer in 2026 (with potential for significantly greater increase), which would increase costs to SJCE by approximately \$50.7 million.

The recommendation to increase the rate stabilization reserve would allow SJCE to more effectively use the reserve to manage such year-to-year fluctuations and maintain stable rates to the greatest extent possible. The alternative of utilizing the operating reserve to cover a potential revenue shortfall would result in a negative change in net position in the SJCE annual financial statements. This would likely result in violating a covenant of the credit facility in place with JPMorgan Bank, as well as a potential downgrade in the SJCE credit ratings, which would likely increase SJCE's power supply costs and collateral requirements with suppliers. Additionally, it is important to keep the 180-day operational reserve to protect against other risks such as energy market disruptions, opt-outs, revenue collection issues, etc.

Figure 1 below shows the fluctuation of the PCIA in recent years.



The rate stabilization reserve will be evaluated at the close of each fiscal year. Contributions to, and withdrawals from, the rate stabilization reserve will continue to be maintained at the level deemed adequate as determined by the Director of Energy to meet SJCE operational needs and ensure compliance with financial covenants. The Energy Department will continue to report to the City Council on the status of the reserve in the quarterly information memoranda submitted to City Council, during the annual rate setting process, and in the City Manager's Annual Report.

EVALUATION AND FOLLOW-UP

The 2026 PCIA will be finalized in late December 2025. If the 2026 PCIA is much lower than current estimates, staff will evaluate options for reducing the rate stabilization reserve. Those options could include customer bill credits and lower SJCE rates, which could be brought to City Council in spring 2026 for consideration if appropriate.

COST SUMMARY/IMPLICATIONS

The amount of deferred revenue currently in the Rate Stabilization Reserve is \$50.0 million. With City Council's approval of the amendments to the Rate Stabilization Reserve, the Energy Department anticipates deferring up to \$60.0 million in FY 2024-

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2025, thereby increasing the total amount reserved to a potential \$110 million. The final amount of deferred revenue placed in the Rate Stabilization Reserve in FY 2024-2025 will be reflected in the City Manager's 2024-2025 Annual Report.

COORDINATION

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

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the June 3, 2025 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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Director, Finance Department

/s/
Lori Mitchell
Director, Energy Department

For questions, please contact Zach Struyk, Assistant Director, Energy Department, at (408) 535-4868 or zachary.struyk@sanjoseca.gov.