SENATE COMMITTEE ON ENERGY, UTILITIES AND COMMUNICATIONS
Senator Ben Hueso, Chair
2021 - 2022 Regular

Bill No:	AB 758	**Hearing Date:**	7/12/2021
Author:	Nazarian		
Version:	5/3/2021 Amended		
Urgency:	No	**Fiscal:**	Yes
Consultant:	Nidia Bautista		

SUBJECT: Marks-Roos Local Bond Pooling Act of 1985: electric utilities: rate reduction bonds

DIGEST: This bill expands the existing authority of specified water publicly owned utilities (POUs) to issue rate reduction bonds (RRBs) to finance utility projects by authorizing electric POUs to use RRBs, expands the purposes for which RRBs can be used by electric POUs beyond capital infrastructure, and extends the sunset date for authorizing the use of RRBs by water and electric POUs to 2036.

ANALYSIS:

Existing law:

1) Authorizes, under the Marks-Roos Local Bond Pooling Act of 1985, certain joint powers authorities (JPAs), upon application by a local agency that owns and operates a POU, defined to mean certain utilities furnishing water or wastewater service to not less than 25,000 retail customers, to issue RRBs to finance utility projects, as defined, subject to certain requirements. Under the act, these RRBs are secured by a pledge of utility project property, and the JPA issuing the bonds may impose on, and collect from, customers of the POU a utility project charge to finance the bonds, as provided. (Government Code §6584, et seq.)

2) Authorizes, as part of the Marks-Roos Local Bond Pooling Act, a local agency that owns and operates a POU to apply to specified JPAs to finance costs of a utility project for the POU with the proceeds of RRBs if specified conditions are met, including that the local agency make specified determinations. Requires the California Pollution Control Financing Authority (CPCFA), among other things, to review each issuance of RRBs issued under these provisions, except as provided. (Government Code §6588.7)

3) Defines "local publicly owned electric utility," (electric POU), to mean a municipality or municipal corporation operating as a "public utility" furnishing electric service as provided in Public Utilities §10001, a municipal utility district furnishing electric service formed pursuant to Division 6 (commencing with Public Utilities Code §11501), a public utility district furnishing electric services formed pursuant to the Public Utility District Act set forth in Division 7 (commencing with Public Utilities Code §15501), an irrigation district furnishing electric services formed pursuant to the Irrigation District Law set forth in Division 11 of the Water Code (commencing with §20500), or a JPA that includes one or more of these agencies and that owns generation or transmission facilities, or furnishes electric services over its own or its member's electric distribution system. (Public Utilities Code §224.3)

This bill:

1) Expands the definition of a POU to include a local publicly owned electric utility, as defined, for the purposes of issuing RRBs.

2) Authorizes a JPA to issue RRBs to finance or refinance utility projects for the provision of generation, transmission, or distribution of electrical service.

3) Includes in the allowable costs of a public capital improvement, a utility project, or portion of the improvement or utility project financed with RRBs the cost of tangible and intangible property that is related to all or any part of the cost of construction, renovation, and acquisition of all lands, structures, real or personal property, rights, rights-of-way, franchises, easements, and interests acquired to be used for a public capital improvement or a utility project.

4) Includes in the definition of local agency a party to the agreement creating the authority, or an agency or subdivision of that party sponsoring a project of public capital improvements or other utility project, as defined.

5) Extends the sunset date from December 31, 2026 to December 31, 2036.

6) Makes clarifying changes.

Background

Publicly owned electric utilities. Electric POUs are not-for-profit public agencies that supply and deliver electricity to their communities. Electric POUs are governed by local elected officials, such as city council members or regionally elected directors. There are over 40 electric POUs in the state serving about 25 percent of the state's population, with the majority of California residents served by for-profit investor-owned electric utilities (IOUs). Unlike electric IOU who are rate-regulated by the California Public Utilities Commission (CPUC), electric POUs governing boards set the rates for their customers. Electric POUs range in size from Biggs Electric Utility, which serves 1,800 residents, to the Los Angeles Department of Water and Power (LADWP) which serves 1.5 million residential and business customers. There are four main types of electric POUs in California:

- City municipal departments, such as the Pasadena Department of Water and Power;
- Public utility districts (which typically serve unincorporated county territory), such as the Trinity Public Utilities District;
- Municipal utility districts (which typically serve an entire county), such as the Sacramento Municipal Utility District (SMUD); and
- Irrigation districts (which also provide water services), such as the Turlock Irrigation District.

Joint exercise of powers. The Joint Exercise of Powers Act (Act) allows two or more public agencies to use their powers in common if they sign a joint powers agreement. Sometimes, an agreement creates a new, separate government called a joint powers agency or JPA. Agencies that can exercise joint powers include federal agencies, state departments, counties, cities, special districts, school districts, federally recognized Indian tribes, and even other JPAs. The Act allows a JPA to specify its own mission, structure, governing board, each member's financial obligations, and provisions for members to enter and exit the JPA, among other items. This structure allows multiple agencies to collaborate on addressing public needs, such as financing public infrastructure, forming insurance pools, and enhancing planning and regulation. The Marks-Roos Local Bond Pooling Act established in 1985 allows public agencies to use JPAs to finance infrastructure. These JPAs issue Marks-Roos Act bonds and loan the capital to local agencies for public works, working capital, and insurance programs

Rate reduction bonds (RRBs). RRBs are asset-backed securities structured to minimize a local agency's borrowing costs by allowing them to qualify bonds for more favorable credit ratings. If a bond receives a higher bond-rating (AAA), instead of a lower rating, the utility can borrow funds at an interest rate that is well below the rate that would otherwise apply to a utility's long-term debt. To increase the likelihood for a bond to qualify for AAA rating, financing for RRBs typically includes:

- Statutory authority to impose a dedicated charge on utility customers, referred to as a utility project charge, to repay the bonds;
- A requirement that bonds be issued, and the dedicated charge must be imposed, by a bankruptcy-remote special purpose entity, such as a JPA;

- A "true-up" mechanism by which charges collected to pay debt service are regularly adjusted to ensure that bonds are paid off at the final maturity date; and
- A pledge made by the state not to impair the right to collect charges until bonds are paid in full.

History of RRBs. Electric IOUs initially developed the RRB securitization structure to recover so-called "stranded" costs of investments the electric utilities made before deregulation of the electricity market in the 1990s. For example, California's electric IOUs used RRBs when the state restructured its energy industry. In that instance, the California Infrastructure and Development Bank (I-Bank) formed a trust that issued the bonds on behalf of the electric IOUs. A bankruptcy-remote entity is an entity established for the sole purpose of issuing debt and securities. If the underlying local agency that issued the bonds goes bankrupt, it does not affect the bankruptcy-remote entity because the entity's debt is considered separate from the local agency's debt. For example, in 2001, Pacific Gas and Electric (PG&E), an electric and gas IOU, declared bankruptcy following the state's energy crisis, but had already issued RRBs secured by utility charges on customers' bills. The rating agencies affirmed the AAA rating of the outstanding RRBs because they were not considered subject to the utility's bankruptcy proceedings and bondholders continued to receive payments.

RRB authority expanded to water service POUs. In response to substantial demands for investments in projects to enhance water quality, conservation, and water supplies, AB 850 (Nazarian, Chapter 636, Statutes of 2013) allowed JPAs to issue RRBs to finance projects for water service POUs with at least 25,000 retail customers. In this case, the JPA serves as the bankruptcy-remote entity. Eligible projects must be for conservation or reclamation purposes or must be necessary to respond to, or comply with, a water quality mandate, such as the Safe Drinking Water Act. Projects can include storm water capture and treatment, water recycling, development of local groundwater resources, groundwater recharging, and water reclamation. RRBs can finance many costs associated with these projects including:

- All or any part of the cost of construction, renovation, and acquisition of all lands, structures, real or personal property, rights, rights-of-way, franchises, easements, and interests acquired or used for a public capital improvement or a utility project;
- The cost of demolishing or removing any buildings or structures on land, including the cost of land acquisition, machinery, and equipment;
- Finance, interest charges, and provisions for working capital;
- Architectural, engineering, financial and legal services, plans, specifications, estimates, and administrative expenses; and,

- Other expenses necessary or incidental to determining the feasibility of constructing any project or financing any capital improvement or utility project.

State requires transparency of RRBs. The CPCFA, housed in the State Treasurer's Office, provides low-cost financing for projects that control pollution, and assists with the clean-up of various types of environment contamination, among other responsibilities. AB 850 requires CPCFA to independently review each RRB issuance to ensure it is transparent. CPCFA reviews the issuances of RRBs to local agencies which are not subject to review by a ratepayer advocate in accordance with Government Code, §6588.7(b)(A)-(B) and §6588.7(c), including:

- Qualification as water or wastewater utility project furnishing water service to no less than 25,000 customers or wastewater utility project furnishing wastewater service to no less than 25,000 customers is verified.
- Utility project property and the utility project charge are verified as source of payment for utility project costs and financing costs.
- The rates of the publicly owned utility plus the utility project charge are verified as expected to be lower than the rates if the project was financed by revenue bonds, or other substantial benefits to the public utility are verified if the utility has more than 500,000 retail customers.

According to CPCFA's annual reports, no one has used this authority to issue RRBs, so CPCFA has yet to review a bond issuance.

Challenges issuing RRBs. Since AB 850 authorized water service POUs to use RRBs, the LADWP has sought to implement a RRB program. LADWP sought this financing structure because it qualifies for a AAA than other types of financing available to the utility, reducing interest rates and financing costs and, ultimately, rates for its customers. At the time, LADWP estimated that ratepayers would save as much as $3 million per year for each $100 million of financing under the provisions of AB 850. In the case of LADWP, with its planned spending for water quality and local water supply projects, rates were projected to be 2-4 percent lower during the course of the ensuing five years than they would have been absent the financing approach allowed by AB 850.

LADWP formed a JPA in October 2016, went through public review and city approval, and worked with CPCFA to ensure that it met the agency's requirements. In 2017, it was prepared to issue bonds, but LADWP's billing system could not meet rating agency requirements for direct billing and collection of the utility project charge. LADWP now expects its initial issuance of rate reduction bonds in 2022.

AB 305 (Nazarian, Chapter 225, Statutes of 2019) made changes to the RRB statutes that LADWP reported were necessary for various reasons, including rating agency requirements raised in connection with the attempt to issue RRBs in 2017, clarifications the RRB working group realized were needed resulting from LADWP's efforts to implement a RRB program, and the result of LADWP's interactions with CPCFA. AB 305 made a number of changes to the authorization to issue RRBs, including the following:

- Expanded the types of POUs allowed to form JPAs and issue RRBs to include those that provide wastewater service;
- Expanded the types of projects that may be financed to include projects that facilitate the use of wastewater by a POU for conservation purposes, and wastewater recycling;
- Allowed RRBs to be used to refinance projects;
- Altered the determinations a POU with 500,000 or more retail customers must make as a condition of applying for RRB financing;
- Required CPCFA to determine that an issue of RRBs is qualified for issuance solely on the basis of submitted documentation, and prohibited the determination from being conditional in any respect, including conditional on the submission or review of additional material after the determination;
- Eliminated CPCFA review of the issuance of RRBs if the determinations of the local agency that must be made before the agency can apply for RRB financing are subject to review by a ratepayer advocate or similar entity whose function is to provide public independent analysis of a public utility's actions as they relate to water or wastewater rates;
- Made a number of additional changes to the RRB statutes; and,
- Extended the sunset date until December 31, 2026.

Despite these additional changes, according to CPCFA's most recent annual report, *2020 Annual Report to the California Legislature: Tax-exempt Bond and Rate Reduction Bond Financing Programs* (issued March 2021), CPCFA has not received any requests to review applications for RRBs.

AB 758. This bill expands the types of POUs that can use RRBs to include electric POUs. This bill further expands the types of projects that RRBs can finance to include projects: used in connection with future operations of a POU; for the provision of generation, transmission, or distribution of electrical service; and, for any other utility purpose designated a "utility project" by a POU.

The bill provides that eligible costs the RRBs can finance include both tangible and intangible property. Additionally, AB 758 extends the sunset date for the authorization to issue RRBs from December 31, 2026, to December 31, 2036. This bill makes other technical changes, changes to term definitions, and includes findings and declarations to support its purposes.

Proponents of this bill contend that authorizing electric POUs to include RRBs as an additional financing tool would benefit their customers. Electric POUs note there are several challenges electric utilities are facing, including demands and mandates to transition to renewable and carbon-free energy resources, wildfire mitigation, electric grid upgrades, transportation and building electrification, and many others. The POUs state that RRBs may not be useful in all scenarios, but could prove beneficial for some utilities to finance some projects. Electric POUs note a list of varied projects that might benefit from the financing afforded by the RRBs, including: procurement of renewable and zero-carbon energy resources, natural gas power plant conversion projects, electric grid management technologies, vegetation management, electric grid upgrades, building and transportation electrification investments, and others.

As noted above, this bill would authorize any electric POU, regardless of size, to utilize RRBs, whereas water service POUs are limited to those serving 25,000 or more customers. Electric POUs note that there are many fewer electric POUs (just over 40) versus water utilities (about 3,000). As a result, such size limitations would be too limiting as a majority of electric POUs not meet that threshold. Additionally, this bill would allow electric POUs to use RRBs for a very broad category of "utility projects," as defined by the electric POU. The electric POUs contend that "financing flexibility to incorporate a wide variety of projects is key, especially since what one POU and their governing board chooses to invest in may not be the chosen solution for another POU and their governing board." In this regard, the electric POUs may be correct. However, the expanded definitions while providing flexibility, could also result in financing of projects with RRBs that may be better suited to other financing options or could be argued by some that these projects should not be financed at all. The philosophy that public borrowing must be carefully controlled is a philosophy that historically has guided the development of California's statutory and constitutional provisions regarding public indebtedness. This could be a reason as to why POUs, in general, have not been authorized by statute to utilize RRB financing. While POUs are accountable to the local governing boards, the state would share in the responsibility of the use of this particular mechanism by authorizing the broad use of RRBs by electric POUs. Should the Legislature support the expansion of the use of RRBs, as proposed in this bill, additional reporting to relevant policy committees could be useful to further promote accountability and monitor the developments of the use of these mechanisms. *As such, the author and committee may wish to amend this bill to require the Treasurer's Office to submit the annual report of the CPCFA to* *the relevant policy committees that oversee activity of the electric POUs, including this committee.*

Prior/Related Legislation

AB 305 (Nazarian, Chapter 225, Statutes of 2019) expanded the definition of a POU for these purposes to include publicly owned wastewater utilities and expand the eligible costs to include refinancing as well as financings.

AB 850 (Nazarian, Chapter 636, Statutes of 2013) authorized JPAs to issue RRBs to finance publicly owned water utility projects until December 31, 2020.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

SUPPORT:

California Municipal Utilities Association, Sponsor
Burbank Water and Power
California Special Districts Association
City of Palo Alto Utilities Department
League of California Cities
Sacramento Municipal Utility District
San Francisco Public Utilities Commission
Trinity Public Utilities District

OPPOSITION:

None received

ARGUMENTS IN SUPPORT: According to the author:

> Maintaining affordable electric rates is critically important for Californians. POUs offer electric rates that are, on average, 15% lower than private utilities. But upward pressure on rates is growing and maintaining customer affordability has become more challenging as regional, state and local efforts have ramped up to address climate change and wildfire mitigation, alongside the ongoing financial impacts of COVID-19. Rate reduction bonds typically offer lower interest rates than traditional revenue bonds and are, therefore, a financing tool that POUs should be able to utilize to save on project and program costs. However, while this cheaper financing tool is currently available to local public water and wastewater utilities, and to IOUs, it is not

available to POUs and their customers. There is no public policy rationale for this inequity in the law.

In the meantime, California's POUs are making significant investments in energy-related projects such as renewable and other greenhouse gas (GHG) free generation, energy storage, grid improvements, and wildfire mitigation. These projects support California's climate and energy sector goals. They also place upward pressure on electric rates and many Californians are having a tough time paying their electric bills. This challenge has been exacerbated by the negative impacts of COVID-19 on our economy.

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