Date of Hearing: April 28, 2021

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Cecilia Aguiar-Curry, Chair
AB 758 (Nazarian) – As Amended April 19, 2021

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

SUMMARY: Expands the authorization for specified joint powers authorities (JPAs) to issue rate reduction bonds (RRBs) for local publicly owned water utilities to also include publicly-owned electric utilities, and makes other changes to that authorization. Specifically, **this bill**:

1) Changes the definition of "cost," as applied to a public capital improvement, a utility project, or portion of the improvement or utility project financed pursuant to the Marks-Roos Local Bond Pooling Act of 1985, to include 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 or used for a public capital improvement or a utility project.

2) Changes the definition of "publicly owned utility" to include a local publicly owned electric utility, as defined in Section 224.3 of the Public Utilities Code.

3) Changes the definition of "utility project" to include the acquisition, construction, installation, retrofitting, rebuilding, or other addition to, or improvement of, any equipment, device, structure, improvement, process, facility, technology, rights or property, located either within, or outside of, the State of California, and that is used, or to be used, in connection with future operations of a publicly owned utility (POU), and changes the purposes for these projects to include:

    a) For the provision of generation, transmission, or distribution of electrical service; and,

    b) For any other utility purpose designated a "utility project" by a POU.

4) Extends the sunset date for the authorization to issue RRBs from December 31, 2026, to December 31, 2045.

5) Makes conforming and technical changes.

6) Makes a number of findings and declarations regarding local publicly owned electric utilities and the value in allowing them to use RRBs.

EXISTING LAW:

1) Authorizes, under the Joint Exercise of Powers Act (Joint Powers Act), two or more public agencies (i.e. federal government, any state, any state department or agency, county, county board of education, county superintendent of schools, city, public corporation, public district, and regional transportation commission in any state) to enter into a joint powers agreement to exercise jointly any power common to the contracting agencies that each can do by itself.

2) Authorizes JPAs to issue tax-exempt bonds for a variety of purposes.

3) Authorizes JPAs to issue RRBs for local publicly-owned water utilities to finance projects necessary to comply with water quality, water conservation, or water reclamation mandates, as specified.

4) Regulates POU activities and rates at the local level, through locally-elected boards and/or city councils.

5) Defines, pursuant to Section 224.3 of the Public Utilities Code "local publicly owned electric utility" to mean a municipality or municipal corporation operating as a "public utility" furnishing electric service as provided in Section 10001, a municipal utility district furnishing electric service formed pursuant to Division 6 (commencing with Section 11501), a public utility district furnishing electric services formed pursuant to the Public Utility District Act set forth in Division 7 (commencing with Section 15501), an irrigation district furnishing electric services formed pursuant to the Irrigation District Law set forth in Division 11 (commencing with Section 20500) of the Water Code, or a joint powers authority 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.

FISCAL EFFECT: This bill is keyed fiscal.

COMMENTS:

1) **Bill Summary**. This bill makes a number of changes to the authority of JPAs to issue RRBs for POUs as follows:

   a) Expands the types of POUs that can use this financing method to include POUs that provide electric service;

   b) Expands the types of projects that can be financed with RRBs to include projects used in connection with **future** operations of a POU, and changes the purposes for these projects to include:

      i) For the provision of generation, transmission, or distribution of electrical service;

      ii) For any other utility purpose designated a "utility project" by a POU;

   c) 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; and,

   d) Extends the sunset date for the authorization to issue RRBs from December 31, 2026, to December 31, 2045.

   This bill is sponsored by the California Municipal Utilities Association (CMUA).

2) **Author's Statement**. 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 capital 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.

   "By allowing POUs to have the same ability to utilize rate reduction bonds already available to other utilities, AB 758 will reduce borrowing costs for POUs and their customers when making investments to meet the state's climate goals, mitigate wildfires, enhance safety, as well as address debt that has accumulated due to some customers' inability to pay their electric bills during the continuing COVID-19 emergency."

3) **Background**. California's Joint Powers Act authorizes the joint exercise of powers by federal, state, and local public agencies that jointly perform functions that each entity may perform on its own. This structure allows multiple agencies to collaborate on addressing public needs, such as financing public infrastructure, forming insurance pools, and enhancing planning and regulation. A joint exercise of powers can be limited to a joint powers agreement (akin to a contract) among participating agencies. It can also include the creation of a new, separate entity that administers the joint powers agreement. These are variously called joint powers agencies or JPAs.

   POU activities and rates are regulated by locally elected boards and/or city councils. POUs are subject to the Ralph M. Brown Act, the Public Records Act, and competitive bid requirements.

4) **Rate Reduction Bonds**. RRBs are asset-backed securities that are structured to minimize borrowing costs by qualifying for AAA credit ratings, which allow borrowing at an interest rate that is well below the rate that would otherwise apply to a utility's long-term debt. To qualify for a AAA rating, RRB financing typically includes:

   a) Statutory authority to impose a dedicated charge on utility customers to repay the bonds;

   b) A requirement that the bonds must be issued, and the dedicated charge must be imposed, by a "bankruptcy-remote special purpose entity;"

c) A “true-up” mechanism that allows the dedicated charge to be regularly adjusted to ensure that the bonds are paid off at the final maturity date; and,

d) A pledge made by the state not to impair the right to collect the dedicated charge until the bonds are paid in full.

RRBs were introduced in response to electricity market deregulation in the 1990s to allow investor-owned utilities (IOUs) in deregulated markets to recover so-called “stranded” costs of investments the utilities made before deregulation. California’s 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 IOUs. Market analysts expect to see an uptick in RRB activity as IOUs look for ways to recover from damages sustained in recent natural disasters – for example, California’s wildfires and the cold snap in Texas.

5) **AB 850 of 2013 – RRBs for California’s POUs**. California’s POUs were first authorized to use RRBs by AB 850 (Nazarian), Chapter 636, Statutes of 2013. This enabling legislation allowed JPAs to issue RRBs to finance specified projects for specified POUs. The bill included the following parameters:

a) Types of POUs were limited to POUs that provide water service;

b) Size of POUs was limited to POUs that have at least 25,000 retail customers; and,

c) Types of projects were limited to infrastructure projects for conservation or reclamation purposes, or projects necessary to respond to or comply with a water quality mandate (such as a mandate under the Safe Drinking Water Act).

Bond proceeds were allowed to fund projects that reduce the amount of potable water supplied by the utility or reduce the amount of water imported by the utility. This included projects for storm water capture and treatment, water recycling, development of local groundwater resources, groundwater recharging, and water reclamation.

LADWP sought this financing structure because it qualifies for a higher bond-rating (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% lower during the course of the ensuing five years than they would have been absent the financing approach allowed by AB 850.

6) **Role of the California Pollution Control Financing Authority (CPCFA)**. The CPCFA is housed in the State Treasurer's office, and provides low-cost financing for projects that control pollution. It also assists with clean-up of contaminated sites. Among other activities, CPCFA assists the California Alternative Energy and Advanced Transportation Financing Authority, which provides financing for facilities needed to develop and commercialize advanced transportation and alternative energy technologies that reduce air pollution, conserve energy, and promote economic development and jobs.

Amendments to AB 850 adopted in the Senate required CPCFA to review each issue of bonds and determine whether the issue is qualified for issuance under the bill's provisions, "in order to allow the state to review the issuance of RRBs, collect data, ensure transparency, and conduct an independent analysis of the effectiveness of the use of RRBs." It also required CPCFA to report annually to the Legislature on its activities related to the bill.

7) **AB 305 of 2019**. Although enacted in 2013, the authority to issue RRBs had not yet been exercised when AB 305 (Nazarian), Chapter 225, Statutes of 2019, was introduced to address challenges LADWP had encountered in using the financing mechanism. According to LADWP, the utility had formed a JPA in October of 2016, completed stakeholder and city review and approvals, and engaged in extensive interaction with CPCFA. LADWP made substantial progress toward issuing RRBs in 2017, including production of near final documents and opinions which involved extensive feedback on the rating agency requirements. Unfortunately, work on the issuance of the RRBs stopped as the result of problems with the implementation of a new billing system at LADWP, which prevented the utility from meeting rating agency requirements for the direct billing and collection of the utility project charge.

   AB 305 contained changes to the RRB statutes that LADWP reported were necessary as a result of 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, or the result of LADWP's interactions with CPCFA. AB 305 made a number of changes to the authorization to issue RRBs, including the following:

   a) Expanded the types of POUs allowed to form JPAs and issue RRBs to include those that provide wastewater service;

   b) 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;

   c) Allowed RRBs to be used to refinance projects;

   d) Altered the determinations a POU with 500,000 or more retail customers must make as a condition of applying for RRB financing;

   e) 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;

   f) 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;

   g) Made a number of additional changes to the RRB statutes; and,

h) Extended the sunset date until December 31, 2026.

Despite these additional changes, according to CPCFA's annual reports, no one has ever submitted an application for review. Every year the report indicates that CPCFA anticipates receiving an application, but that appears not to have materialized.

8) **Policy Considerations**. The Committee may wish to consider the following:

a) The existing RRB statutes limit the size of water POUs that qualify to those with at least 25,000 retail customers. This bill allows electric POUs of any size to qualify. The Committee may wish to consider if a size limitation should be placed on the electric POUs that may use RRB financing.

b) The stated intent of this bill is to allow POUs that provide electrical service to use RRB financing in the same manner as what is allowed in current law. The bill, however, includes a number of additional changes. Specifically, it expands the types of projects that can be financed with RRBs to include projects used in connection with ***future*** operations of a POU, and changes the purposes for these projects to include "***any other utility purpose designated a 'utility project' by a POU***."

The bill also 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 ***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.

It is not entirely clear what could be included in a RRB financing under these new terms, or why they are necessary. This financing tool has been, until now, limited to capital/infrastructure projects. Long-term debt financing for local agencies is generally limited to capital improvements. Because these terms are unclear, the Committee may wish to consider striking them from the bill.

c) This bill extends the sunset date for the authorization to issue RRBs from December 31, 2026, to December 31, 2045. As noted above, RRB financing for water POUs was first authorized via AB 850 in 2013. When that bill was moving through the legislative process, the Senate Governance and Finance Committee analysis noted the following:

"Government programs start with the best intentions but, if no one pays attention, they can sometimes go awry. Recent experiences in the financial markets demonstrate that complex structured-financing mechanisms that receive AAA ratings don't always work as expected and can harbor unanticipated risks. The type of securitization financing AB 850 authorizes ***has never been used by public agencies to finance the types projects described in the bill***. Fundamental assumptions underlying a JPA's decision to issue RRBs may prove to be flawed. A projection that ratepayers will pay lower overall rates as a result of RRB financing is no guarantee that ratepayers will actually realize those savings.

"Allowing local utilities to use off balance-sheet accounting for assets involved in RRB financing may distort measures of a public utilities fiscal condition. ***Legislators***

sometimes use sunset clauses, evaluations, reports, and oversight hearings to make sure that new programs stay on track and function properly. However, imposing a sunset clause on provisions authorizing long-term financing can be counter-productive, sometimes creating uncertainty among investors about the long-term security of the debt. As an alternative approach to oversight, the Committee may wish to consider amending AB 850 to:

i) Authorize RRBs to be used to finance a fixed number of projects statewide.

ii) Require a state entity, such as the I-Bank or the State Treasurer's Office, to review and approve the use of RRB financing for each project.

iii) Require the California Debt and (Investment) Advisory Commission to evaluate the results of the financing used for the authorized projects."

The Legislature subsequently chose to limit the bill in the following ways:

i) Required eligible water POUs to service not less than 25,000 retail customers;

ii) Established a review process and reporting requirements at CPCFA; and,

iii) Terminated the authority to issue RRBs after December 31, 2020.

When AB 305 of 2019 was being considered in the Assembly, the Assembly Local Government Committee analysis noted the following:

"This bill eliminates the sunset date on the RRB authority in existing law as well as the changes this bill makes to that law. ***Given that no one – including the agency that requested it – has yet used this authority, it would seem prudent to retain a sunset date to allow the Legislature to review its progress and implementation***. LADWP indicates it expects to begin issuing RRBs in 2022. The Committee may wish to consider amending the bill to re-establish a sunset date of December 31, 2026."

The bill was subsequently amended to do so.

An argument certainly can be made that a sunset date that is too short could inhibit the use of RRBs. Another case can be made that extending the existing sunset by nearly 20 years for a financing tool that has yet to be used is too far into the future for the hard-stop Legislative review of the overall authorization that a sunset date provides. The Committee may wish to consider extending the existing sunset of December 31, 2026, to December 31, 2036.

9) **Committee Amendments**. In order to address some of the concerns outlined above, the Committee may wish to amend this bill to change the sunset date do December 31, 2036.

10) **Arguments in Support**. CMUA, sponsor of this measure, writes, "The Legislature has already set up a specific rate reduction bond process for water and wastewater agencies, but POUs are not included in the statutory structure. AB 758 (Nazarian) will ensure that POUs can take advantage of the same statutory authority to issue rate reduction bonds their sister water and wastewater agencies currently have.

"IOUs also regularly take advantage of the low-cost financing offered by rate reduction bonds. For example, IOUs relied on rate reduction bonds after the 2001 energy crisis to finance billions of dollars of debt incurred by DWR to be paid off by IOU customers and more recently, IOUs used rate reduction bonds to finance new DWR debt falling on IOU ratepayers to support a wildfire fund authorized by AB 1054 (2019). IOUs have also used rate reduction bonds to finance costs and expenses authorized by SB 901 (2018) arising out of catastrophic wildfires, and just this past year to finance COVID-19 related debt authorized by AB 913.

"The issuance of rate reduction bonds would be subject to local oversight, just as is the case with traditional revenue bonds. In particular, if AB 758 (Nazarian) passes, the issuance of rate reduction bonds would be overseen by the elected boards and council that provide direct oversight of POU operations. The California Pollution Control Financing Authority has a role too, under specific circumstances.

"In closing, maintaining affordable electric rates is critically important and doing so 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. While there are many factors that impact affordability, CMUA strongly believes AB 758 will provide POUs with an important financing mechanism that can help our effort in balancing state and local goals with keeping rates affordable."

11) **Arguments in Opposition**. None on file.

REGISTERED SUPPORT / OPPOSITION:

Support

California Municipal Utilities Association [SPONSOR]
Burbank Water and Power
California Special Districts Association
City of Palo Alto
Northern California Power Agency
San Francisco Public Utilities Commission
Southern California Public Power Authority (SCPPA)
Trinity Public Utilities District

Opposition

None on file.

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