



RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES

DATE: MAY 8, 2023

SUBJECT: AD HOC COMMITTEE REVIEW AND EVALUATION OF FISCAL POLICIES RELATED TO THE USE OF BOND FINANCING TO FUNDING INTERNAL STAFF LABOR USED TO DESIGN, CONSTRUCT, AND ADMINISTER CAPITAL PROJECTS

ISSUE:

Consider receiving a report the Ad Hoc Committee organized to complete a review and evaluation of the Public Utilities Department and the City fiscal policies related to the use of bond financing to fund internal staff labor used to design, construct, and administer capital projects.

RECOMMENDATIONS:

That the Board of Public Utilities:

1. Receive a report from the Ad Hoc Committee for their review, evaluation, and recommended changes to fiscal policies related to the use of bond financing to funding internal staff labor used to design, construct, and administer capital projects;
2. Discuss Ad Hoc Committee findings and recommendations for any fiscal policy changes; and
3. Request City Council authorization to review any policy reports or recommendations in accordance with Charter section 1202(i).

BACKGROUND:

At the August 8, 2022 Board of Public Utilities meeting, Chair Crohn created an ad hoc committee consisting of Chair Peter Wohlgemuth and Members Nancy Melendez, Gary Montgomery, and Gil Oceguela to (1) review and evaluate the Public Utilities Department and the City fiscal policies related to the use of bond financing to fund internal staff labor used to design, construct, and administer capital projects as further outlined in the document distributed to the Board (Attachment 1); and (2) report back to the Board of Public Utilities by November 30, 2022.

At the September 26, 2022 Board of Public Utilities meeting, Ad Hoc Committee Chair Wohlgemuth provided the Board with an update on the committee progress and discussed the need to extend the November 30, 2022 reporting deadline to January 2023.

DISCUSSION:

The Ad Hoc Committee has held multiple meetings with staff from August 2022 to April 2023 to review and evaluate the Riverside Public Utilities (RPU) and City fiscal policies related to the use of bond financing to fund internal staff labor used to design, construct, and administer capital projects. The Committee's scope of work was specific to the consideration of the impact to the City's Electric and Water Funds.

1. Explore current practice and its supporting strategies
2. Explore practices of other municipal agencies
3. Evaluate advantages and disadvantages of the current practice to current and future ratepayers
 - a. Cost of projects
 - b. Cost to customers
 - c. Equity across all customers
 - d. Impact on fiscal condition of the utility

The requested Committee deliverables to the Board include:

4. Document how the current process is used in the budget and rate setting process
5. Summary of Findings - advantages and disadvantages of current policies
6. Statement of support or recommendation for changes to the current policies

1. Scope of Work - Explore current practice and its supporting strategies

The Committee explored the City of Riverside's and RPU's current fiscal practices and the supporting strategies within the scope of how those policies impact the Electric and Water Utilities. The policies reviewed and discussed included:

RPU's Fiscal Policies

- June 26, 2001 RPU Fiscal Policy
https://riversideca.gov/utilities/sites/riversideca.gov.utilities/files/pdf/RPU%20Fiscal%20Policies-%20Reserve%20UPDATE%209-7-2021%20Final%20%281%29_0.pdf
- July 26, 2016 Updated RPU Fiscal Policies
- July 24, 2018 Updated RPU Fiscal Policies and Cash Reserve Policy
- September 7, 2021 Updated RPU Cash Reserve Policy

City of Riverside Policies

- January 10, 2017 Debt and Cash Flow Management Policies
- <https://riversideca.gov/finance/PDF/2018/Final%20Debt%20Mgmt%20Policy%201-2017.pdf>
- March 20, 2018 Multi-Year Capital Planning and Prioritization of Capital Improvement Projects (CIP) Policies <https://riversideca.gov/finance/PDF/2018/Multi-Year%20Capital%20Planning.pdf>

Capital Improvement Program (CIP)

- 2021_2016 Board and City Council approved for RPU's CIP inclusive of the detail for each of the investment projects <https://riversideca.gov/finance/2023%20CIP.pdf>
- 2022_2024 Board and City Council approved budget for RPU's CIP

Discussion and analysis on Fiscal Policies and Practices included:

- Discussion without a completed analysis for the possibility for RPU to have a separate Debt Management Policy from the City of Riverside;
- Review of the first recorded instance for the issuance of Water and/or Electric Bonds – July 1, 1887 City Council minutes, Riverside Improvement Company to lay water pipe, Bonds and agreements;
- January 10, 2022 Board report and presentation for the Introduction to Bond Financing and the Role of the Fiscal Policy Strategy of the Utility; and
- FY 99/00 to FY 21/22 – Analysis for the use of Bonds to Finance Capital Projects, compared with the full Capital Project Expenditures per fiscal year from to determine the percentage of total bond funding for CIP.

Table 1

| Use of Bonds to Finance Capital Projects, compared with the full Capital Project Expenditures per fiscal year | | | | | |
|---|------------------------------|----------|----------|----------|-------------------------|
| Electric - Actual (amounts in 1,000) | | | | | |
| | FY 21/22 | FY 20/21 | FY 19/20 | FY 18/19 | FY 17/18 |
| Total CIP Budget (Includes Carry Overs) | 280,755 | 271,586 | 145,725 | 152,317 | 150,424 |
| Total CIP Actual Expenses | 30,621 | 39,141 | 42,125 | 42,226 | 28,372 |
| 2019A Bond (Bond funds depleted in 21/22) | 7,473 | 25,217 | 23,827 | 29,760 | 18,275 |
| Total Bond Funded CIP | 7,473 | 25,217 | 23,827 | 29,760 | 18,275 |
| % of CIP Bond Funded | 24% | 64% | 57% | 70% | 64% |
| Water Actual - (amounts in 1,000) | | | | | |
| | FY 21/22 | FY 20/21 | FY 19/20 | FY 18/19 | FY 17/18 ⁽¹⁾ |
| Total CIP Budget (Includes Carry Overs) | 57,466 | 51,515 | 39,892 | 36,107 | 41,489 |
| Total CIP Actual Expenses | 21,608 | 15,344 | 18,461 | 21,538 | 22,957 |
| 2019A Bond | 14,923 | 9,053 | 11,759 | 12,691 | |
| Total Bond Funded CIP | 14,923 | 9,053 | 11,759 | 12,691 | - |
| % of CIP Bond Funded | 69% | 59% | 64% | 59% | 0% |
| 1) Bond Funds were depleted, reserve funded. | | | | | |
| Electric - Actual (amounts in 1,000) | | | | | |
| | FY16/17 ^(1&2) | FY 15/16 | FY 14/15 | FY 13/14 | FY 12/13 |
| Total CIP Budget (Includes Carry Overs) | 151,798 | 176,688 | 207,361 | 208,822 | 201,717 |
| Total CIP Actual Expenses | 27,696 | 27,699 | 37,573 | 36,108 | 33,950 |
| 2010A Bond | | 21,420 | 32,250 | 31,219 | 22,737 |
| 2010A Mission Square ⁽³⁾ | | 27,000 | | | |
| 2010B Bond | | | | | 5,530 |
| Total Bond Funded CIP | | 48,420 | 32,250 | 31,219 | 28,267 |
| % of CIP Bond Funded | 0% | 77% | 86% | 86% | 83% |

Table 1 cont.

| Water Actual - (amounts in 1,000) | | | | | |
|---|------------------------------------|------------------------------|-----------------|-----------------|-----------------|
| | FY16/17^(1&2) | FY15/16⁽¹⁾ | FY 14/15 | FY 13/14 | FY 12/13 |
| Total CIP Budget (Includes Carry Overs) | 59,654 | 50,324 | 57,343 | 55,739 | 69,061 |
| Total CIP Actual Expenses | 18,051 | 14,917 | 22,908 | 21,143 | 21,298 |
| 2009B Bond | | | 9,277 | 15,641 | 15,976 |
| Total Bond Funded CIP | | | 9,277 | 15,641 | 15,976 |
| % of CIP Bond Funded | 0% | 0% | 40% | 74% | 75% |
| 1) Bond Funds were depleted, reserve funded. | | | | | |
| 2) In 2017 RPU adopted a capital policy that mandated RPU will strive to fund no less than 10% of the current budget year CIP through the use of rates or current revenues such as contribution in aid of construction or other reimbursements. | | | | | |
| 3) This is to purchase the Mission Square building. | | | | | |

| Electric - Actual (amounts in 1,000) | | | | | |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|
| | FY 11/12 | FY 10/11 | FY 09/10 | FY 08/09 | FY 07/08 |
| Total CIP Budget (Includes Carry Overs) | 199,502 | 246,189 | 275,096 | 237,263 | 266,552 |
| Total CIP Actual Expenses | 36,701 | 48,367 | 59,636 | 70,152 | 68,381 |
| 2005A&B Bond | | | | | 26,961 |
| 2008D Bond | 28,151 | 46,828 | 53,246 | 61,096 | 24,802 |
| 2010A Bond | 942 | | | | |
| 2010B Bond | 2,041 | | | | |
| 2011A Bond (Release of Reserve) | 2,874 | 1,230 | | | |
| Total Bond Funded CIP | 34,008 | 48,058 | 53,246 | 61,096 | 51,763 |
| % of CIP Bond Funded | 93% | 99% | 89% | 87% | 76% |
| Water Actual - (amounts in 1,000) | | | | | |
| | FY 11/12 | FY 10/11 | FY 09/10 | FY 08/09 | FY 07/08 |
| Total CIP Budget (Includes Carry Overs) | 63,695 | 66,872 | 107,083 | 71,956 | 57,357 |
| Total CIP Actual Expenses | 21,703 | 28,395 | 24,425 | 32,944 | 18,625 |
| 2005 Bond | | | | | 8,781 |
| 2008B Bond | | | 18,819 | 29,678 | 11,755 |
| 2009A Bond | | 11,921 | 1,428 | | |
| 2009B Bond | 16,709 | 10,969 | | | |
| 2011A Bond | 3,748 | 302 | | | |
| Total Bond Funded CIP | 20,457 | 23,192 | 20,247 | 29,678 | 20,536 |
| % of CIP Bond Funded | 94% | 82% | 83% | 90% | 110% |

Table 1 cont.

| Electric - Actual (amounts in 1,000) | | | | | | | | |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | FY 06/07 | FY 05/06 | FY 04/05 | FY 03/04 | FY 02/03 | FY 01/02 | FY 00/01 | FY 99/00 |
| Total CIP Budget (Includes Carry Overs) | 72,790 | 78,217 | 125,519 | 117,366 | 36,508 | 66,102 | 26,611 | 22,262 |
| Total CIP Actual Expenses | 41,476 | 57,133 | 94,480 | 27,501 | 19,387 | 50,645 | 13,560 | 9,574 |
| 1998 Bond | | | | 3,669 | 6,182 | 3,539 | 5,487 | 8,028 |
| 2001 Bond | | | | | 4,938 | 39,335 | | |
| 2004A&B Bond | 383 | 23,368 | 67,291 | 10,227 | | | | |
| 2005A&B Bond | 19,630 | 15,116 | | | | | | |
| Total Bond Funded CIP | 20,013 | 38,484 | 67,291 | 13,896 | 11,120 | 42,874 | 5,487 | 8,028 |
| % of CIP Bond Funded | 48% | 67% | 71% | 51% | 57% | 85% | 40% | 84% |
| Water Actual - (amounts in 1,000) | | | | | | | | |
| | FY 06/07 | FY 05/06 | FY 04/05 | FY 03/04 | FY 02/03 | FY 01/02 | FY 00/01 | FY 99/00 |
| Total CIP Budget (Includes Carry Overs) | 41,475 | 38,278 | 28,377 | 30,232 | 47,904 | 44,000 | 34,660 | 21,353 |
| Total CIP Actual Expenses | 23,047 | 16,844 | 11,497 | 18,253 | 20,656 | 12,032 | 9,298 | 6,205 |
| 1998 Bond | | | | | | 740 | 1,985 | 3,346 |
| 2001 Bond | | | 4,584 | 8,517 | 6,186 | 509 | | |
| 2005 Bond | 15,050 | 6,150 | | | | | | |
| Total Bond Funded CIP | 15,050 | 6,150 | 4,584 | 8,517 | 6,186 | 1,249 | 1,985 | 3,346 |
| % of CIP Bond Funded | 65% | 37% | 40% | 47% | 30% | 10% | 21% | 54% |

2. *Scope of Work - Explore practices of other municipal agencies*

The Committee has reviewed the fiscal practices of the following other municipal utility agencies as defined by the respective debt management policies of each organization.

Table 2

| | | |
|----------------------------------|-----------------------------------|-----------------------------------|
| City of Banning | City of Burbank | City of Moreno Valley |
| City of Palo Alto | City of Pasadena | City of Sacramento |
| Coachella Valley Water District | Eastern Municipal Water District | Imperial Irrigation District |
| Inland Empire Utilities Agency | Los Angeles Dept of Water & Power | Lassen Municipal Utility District |
| Western Municipal Water District | | |

The Committee determined that the City of Riverside and RPU policies related to the use of bonds for long term financing of CIP is consistent amongst the policies of other municipal utility organizations.

3. *Scope of Work - Evaluate advantages and disadvantages of the current practice to current and future ratepayers*

a. *Cost of projects*

The Committee received information on how RPU and the City equally treat the costs associated with external and internal labor involved in activating CIP projects. The internal labor cost allocation includes the salary expenses for the time allocated to the associated CIP work order for actual payroll costs plus overhead costs for the employee. The overhead cost allocation is calculated each fiscal year based on actual costs related to staff members. The current overhead calculation is 133% for Electric employees and 118% for Water employees. Pension Obligation Bonds are charged to the Electric and Water funds via debt service and are not included in direct staff labor costs or the overhead calculations.

The Committee was advised that the RPU Biennial Budget accounts for anticipated CIP internal labor costs for CIP work orders. The anticipated internal labor charges for CIP work orders are then allocated from the division to the capital project fund section which offsets the planned labor expenditures for that fiscal year. This chart represents the actual charges for RPU labor involved in construction, inclusive of both RPU capital improvements and developer paid improvement along with the estimated amount of bond funds used for RPU CIP internal labor costs.

Table 3

| Personnel Costs Charged to Capital Projects (RPU and Development) | | | | | | | | | | | |
|---|-----------------|------------|-----------|------------|----------------------|--------------------------|-------------------------|-----------------------------|---|--------------------|-----------------|
| Fiscal Year | Total Personnel | Electric | Water | Total | Est. % for CIP labor | Total Principal Payments | Total Interest Payments | Total Debt Service Payments | Est Costs for Debt Service for Internal CIP Labor | | |
| | | | | | | | | | Est. Principal Cost | Est. Interest Cost | Est. total Cost |
| 12/13 | 66,920,457 | 10,849,737 | 5,734,405 | 16,584,142 | 24.80% | 23,255,000 | 34,121,521 | 57,376,521 | 5,767,240 | 8,462,137 | 14,229,377 |
| 13/14 | 67,566,947 | 11,703,428 | 5,436,215 | 17,139,643 | 25.40% | 25,045,000 | 33,125,797 | 58,170,797 | 6,361,430 | 8,413,952 | 14,775,382 |
| 14/15 | 70,825,027 | 10,919,263 | 5,937,733 | 16,856,996 | 23.80% | 19,935,000 | 34,826,357 | 54,761,357 | 4,744,530 | 8,288,673 | 13,033,203 |
| 15/16 | 72,473,424 | 8,950,786 | 6,522,170 | 15,472,956 | 21.30% | 21,085,000 | 33,922,034 | 55,007,034 | 4,491,105 | 7,225,393 | 11,716,498 |
| 16/17 | 74,421,223 | 8,420,417 | 6,791,748 | 15,212,165 | 20.40% | 18,500,000 | 33,033,251 | 51,533,251 | 3,774,000 | 6,738,783 | 10,512,783 |
| 17/18 | 76,333,240 | 8,326,841 | 6,465,579 | 14,792,420 | 19.40% | 19,210,000 | 32,636,144 | 51,846,144 | 3,726,740 | 6,331,412 | 10,058,152 |
| 18/19 | 80,936,630 | 11,951,278 | 7,550,182 | 19,501,460 | 24.10% | 20,080,000 | 30,744,627 | 50,824,627 | 4,839,280 | 7,409,455 | 12,248,735 |
| 19/20 | 83,824,189 | 10,689,652 | 6,848,587 | 17,538,239 | 20.90% | 13,705,000 | 34,883,000 | 48,588,000 | 2,864,345 | 7,290,547 | 10,154,892 |
| 20/21 | 80,829,757 | 9,679,499 | 6,462,311 | 16,141,810 | 20.00% | 21,690,000 | 34,831,329 | 56,521,329 | 4,338,000 | 6,966,266 | 11,304,266 |
| 21/22 | 69,750,314 | 8,473,634 | 6,048,873 | 14,522,507 | 20.80% | 22,675,000 | 33,747,261 | 56,422,261 | 4,716,400 | 7,019,430 | 11,735,830 |
| 22/23 Budget | 96,728,663 | 11,836,270 | 7,272,435 | 19,108,705 | 19.80% | 23,675,000 | 32,664,776 | 56,339,776 | 4,687,650 | 6,467,626 | 11,155,276 |
| 23/24 Budget | 99,225,000 | 16,430,531 | 7,482,694 | 23,913,225 | 24.10% | 24,730,000 | 31,529,492 | 56,259,492 | 5,959,930 | 7,598,608 | 13,558,538 |

b. Cost to customers

The Committee was advised of how RPU’s budget includes the cost of the debt service for internal labor related to CIP and to change the policy to fund the CIP related internal labor through non-borrowed sources would necessitate an increase to the operational costs for the budget. Any increases to the budget are included in the Cost of Service Analysis (COSA) and the respective rate designs for both utilities. Any significant changes to the Utility budgets will necessitate higher rate increases to pay the costs.

Staff provided an estimate on the increase for utility rates to cover the cost of internal CIP labor costs. Using the assumptions for fiscal year 2022/2023, the total internal labor costs related to capital improvement projects for the year are estimated to be \$11,836,270 for Electric and \$7,272,435 for Water. Of those amounts, not all labor costs are expected to be paid through bond financing. For example, internal labor used to design and construct developer projects are paid directly through developer fees and not bond financing. The estimated portion of the annual internal labor costs expected to be funded through bond financing is approximately 52% for Electric and 64% for Water, or \$6,202,205 and \$4,654,358, respectively. The correlating rate increase necessary to fund the internal labor on these projects as a direct budget expense instead of bond financing would be a 2% increase to the Electric rates and a 6% increase to the Water rates. The financial impact to an average residential customer is estimated at \$60 per year. A revised cost of service analysis would need to be completed to fully analyze adding the extra costs related to adding \$6,202,205 to the Electric budget and \$4,654,358 to the Water budget instead of bond financing those costs which is the current practice.

FY 22/23 and FY 23/24 Biennial Budget expenses, as adopted by City Council on June 21, 2022, using the current City’s Debt Management Policy and the Multi-Year Capital Planning and Prioritization of CIP Policies.

Table 4

| | FY 22/23 | | | FY 23/24 | | |
|---|----------|-------|---------------|----------|-------|---------------|
| | Electric | Water | Totals | Electric | Water | Totals |
| <i>CIP Internal Labor Charges (estimated)</i> | 11.8 | 7.3 | 19.1 | 16.4 | 7.5 | 23.9 |
| <i>CIP Internal Labor Charges Est to be funded by Bonds (estimated)</i> | 6.2 | 4.7 | 10.9 | 8.6 | 4.8 | 13.4 |
| <i>Debt Service for single year CIP labor</i> | 0.26 | 0.2 | 0.46 | 0.37 | 0.2 | 0.57 |

*Budget for Debt includes all bonds and is not exclusive to bonds with internal CIP labor

The fiscal impact of a change to the fiscal policies to discontinue the use of bond funds for internal staff CIP labor is estimated as:

Table 5

| Summary (in millions) | | |
|-----------------------|---|------------------------------|
| | Increased need for cash to fund Personnel Costs | Decreased Debt Service Costs |
| FY 22/23 | 10.9 | 0.46 |
| FY 23/24 | 13.4 | 0.57 |

The Committee requested that staff provide an estimated cost to the utility for using bond financing as part of the CIP projects that include internal labor. As each bond issuance has a different interest cost associated with the long-term financing solution, the example for the estimated premium cost is from the most recent issuance to calculate an estimate. The 2022A Water Revenue Bonds were sold with a total interest cost of 4.24%. Example for cost analysis:

Table 6

| Amount of CIP Bond | Est amount of the total CIP Internal Labor for the same bond issuance – estimated to be 11% of the same bond) | 30 Year Interest cost on the CIP Internal Labor on the same bond | Annual additional cost for the same bond for 30 Years | Total Cost for CIP Internal Labor on the same bond |
|--------------------|---|--|---|--|
| \$58,025,000 | \$6,382,750 | \$4,956,782 | \$165,226 | \$11,339,532 |

c. Equity across all customers

The Committee was advised regarding how RPU’s budget includes the cost of the debt service payments as a component of the Cost of Service Analysis (COSA) and the respective rate designs for both utilities. During this process, RPU staff and approved external consultants do the following:

1. Define total rate revenue requirements based on a financial forecast
2. Allocate revenue requirements based on the system function that they provide
3. Allocate functionalized revenue requirements to billable components
4. Allocate component costs to customer classes based on usage patterns
5. Calculate rates

Currently, the Committee agrees that costs are equitably distributed amongst all customer classes.

d. Impact on fiscal condition of the utility

The Committee requested and received rough financial estimates on the approximate costs for assumed changes to the financial health of the utility and the potential rate impact if RPU discontinued using bond financing and paid off all current bonds related to CIP. The data included several assumptions and estimations and demonstrated a significant cost would impact RPU’s financial health with costs increases that would be borne by rate payers.

4. Deliverable – Document how the current process is used in the budget and rate setting process

The Committee’s review of RPU and City fiscal policies and practices was limited to the City’s Electric and Water Funds only. As the Committee reviewed the current process and requested fiscal estimates, the documentation was provided for the current processes of how RPU budgets for and accounts for bond funded CIP. This is inclusive of internal staff labor which is demonstrated in the Scope of Work sections that include how dollars are budgeted and set in the rate setting process.

5. Deliverable - Summary of Findings - advantages and disadvantages of current policies

The Committee’s review of RPU and City fiscal policies and practices was limited to the City’s Electric and Water Funds only. Generally, the Committee found the following:

- The use of bond funding for internal CIP labor is a common practice across other municipalities and utilities.
- Labor costs covered by bonds not only include construction labor, but also that for design and management support/testing.
- Percentages of bond funding have remained relatively constant since 2000.
- Use of bonds to cover internal labor is anticipated in the budget process at ~20%.
- If the use of bonds for funding internal labor is eliminated, rates will need to be raised and/or staff will face layoffs.
- If bonds are not used for internal labor in the future, rates will increase moderately.
- If bonds are not used for internal labor in the future and previous costs are paid off, rates will increase significantly.
- Currently, the costs are equitably distributed amongst all customer classes.

6. Deliverable - Statement of support or recommendation for changes to the current policies

The Committee’s review of RPU and City fiscal policies and practices was limited to the City’s Electric and Water Funds only.

The Committee members will discuss their statements of support and/or recommendations for changes with the Board at the meeting. City Charter section 1202(i) provides that the Board may “make such reports and recommendations in writing to the City Council regarding the Department of Public Utilities as the City Council shall deem advisable.” In order for the Board to review and make policy recommendations to the City Council, prior authorization needs to be sought from the City Council in accordance with section 1202(i).

FISCAL IMPACT:

There is no fiscal impact with the receipt of this report.

Prepared by: Todd M. Corbin, Utilities General Manager
Approved by: Peter Wohlgemuth, Ad Hoc Committee Chair
Approved by: Rafael Guzman, Assistant City Manager
Approved as to form: Phaedra A. Norton, City Attorney

Certifies availability of funds: Edward Enriquez, Interim Assistant City Manager, Chief Financial Officer/City Treasurer

Attachment: Presentation