

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 Ocegueda 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)											
									Est Costs for Debt Service for Internal CIP Labor		
Fiscal Year	Total Personnel	Electric	Water	Total	Est. % for CIP labor	Total Principal Payments	Total Interest Payments	Total Debt Service Payments	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
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Attachment:	Presentation
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