



REVIEW AND EVALUATION OF FISCAL POLICIES RELATED TO THE USE OF BOND FINANCING TO FUNDING INTERNAL STAFF LABOR USED FOR CIP

Board of Public Utilities, Ad Hoc Committee for Bond Funding
Internal Staff CIP Labor

Board of Public Utilities
May 8, 2023

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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:

- a. 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 ; and
- b. Report back to the Board of Public Utilities by November 30, 2022.



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BACKGROUND

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



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DISCUSSION

The Ad Hoc Committee has held multiple meetings with staff from August 2022 to April 2023 to review and evaluate the 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.



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COMMITTEE'S SCOPE OF WORK

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



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COMMITTEE'S DELIVERABLES

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



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#1 EXPLORE CURRENT PRACTICE AND 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
- 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
- March 20, 2018 Multi-Year Capital Planning and Prioritization of Capital Improvement Projects (CIP) Policies

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
- 2022_2024 Board and City Council approved budget for RPU's



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#1 EXPLORE CURRENT PRACTICE AND STRATEGIES

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.



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#2 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.

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.

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		

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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of the Cost of Projects.

- Discussed how RPU and the City equally treat the costs associated with external and internal labor involved in activating CIP projects

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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

- Review of the internal labor costs:
 - 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.



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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

- Discussed 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 allocated from the division to the capital project fund section which offsets the planned labor expenditures for that fiscal year.
- The Committee reviewed data on 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.



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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of the Cost to Customers.

- Discussion on RPU's budget including 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 as those costs would need to be paid with cash.
- 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 with cash.



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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of the Cost to Customers.

- Staff provided an estimate on the increase for utility rates to cover the cost of internal CIP labor costs for fiscal year 2022/2023 to cover the additional cash costs for CIP labor.
- Using the assumptions for fiscal year 2022/2023, the total internal labor costs used to activate capital improvement that are also estimated to be paid via bond funding for CIP for FY 22/23 are \$11,636,270 for Electric and \$7,272,435 and of those amounts, bond funding is approximately 52% for Electric and 64% for Water, or \$6,202,205 and \$4,654,358 respectively.
- The rate increase for FY 22/23 was estimated to be a 2% increase to the Electric rates and a 6% increase to the Water rates.*
- The annual financial impact to an average use residential customer is estimated at \$60.



* A revised cost of service analysis would need to be completed for both Electric and Water to study the extra costs related to removing the budget reduction for CIP labor used for CIP to provide accurate rate impacts.

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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of the Cost to Customers.

The Committee requested an estimate to the budget impacts for a policy change to not use bond funding for internal CIP labor:

	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

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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of the Cost to Customers.

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:

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

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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of the Cost to Customers.

The Committee requested that staff provide an estimated cost for 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%.



#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee requested that staff provide an estimated cost for 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:

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



#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the analysis of 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:

- Define total rate revenue requirements based on a financial forecast
- Allocate revenue requirements based on the system function that they provide
- Allocate functionalized revenue requirements to billable components
- Allocate component costs to customer classes based on usage patterns
- Calculate rates
- Currently, the Committee agreed that costs are equitably distributed amongst all customer classes.



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#3 ADVANTAGES AND DISADVANTAGES TO RATEPAYERS

The Committee evaluated the current practice to current and future rate payers through the decision on the 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.



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#4 DOCUMENT HOW THE CURRENT PROCESS IS USED

The Committee deliverable to document how the current process is used in the budget and rate process was completed through the scope of work and requests for fiscal estimates.

- 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.



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#5 SUMMARY OF FINDINGS

The Committee deliverable to provide a summary of findings for the advantages and disadvantages of current policies* include:

- 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%



* The Committee's review of policies and practices was limited to the City's Electric and Water Funds only.

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#5 SUMMARY OF FINDINGS

- 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.



* The Committee's review of policies and practices was limited to the City's Electric and Water Funds only.

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#6 STATEMENT OF SUPPORT OR RECOMMENDATION FOR CHANGES

The Committee deliverable to provide a Statement of Support or Recommendation for Changes to the current fiscal policies*

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).



* The Committee's review of policies and practices was limited to the City's Electric and Water Funds only.

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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).



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