OFFICE OF PUBLIC ACCOUNTABILITY

Date: May 10, 2024

To: The Board of Water and Power Commissioners

From: Frederick H. Pickel, Ph.D., Executive Director/Ratepayer Advocate

Subject: OPA Report on Agenda Item L-4, L-5, Fiscal Year 2024-2025 Final Budget of the Department of Water and Power

RECOMMEDATIONS

The Office of Public Accountability (OPA) recommends that the Board of Commissioners (Board) of the Los Angeles Department of Water and Power (DWP) adopt the proposed Final Budget for Fiscal Year (FY) 2024-2025.

Attachment A poses key questions on the Final FY 2024-2025 budget. Attachments B and C show recent and longer-term trends.

1. Additional Recommendations Since the Preliminary Budget

In OPA's opinion, many chronic and unresolved delays in hiring and contracting continue to impair performance of the revenues authorized and collected to date.

Because the water fund revenue increase is the same size as the increase under consideration by the City for the Bureau of Sanitation ("Sanitation"), and because of the current fiscal strain on the City, the reasonableness of the rate impacts for water customers depends upon many conditions yet to manifest within the next fiscal year.

At the same time, the power funds revenue increase is insufficient to offset inflation costs. This revenue suggests a further degradation of the power fund assets and plans.

The DWP continues to lack adequate controls for the changing nature of its business and legal limitations, or fails to execute existing controls. The control issues are many and include employees or retirees working for DWP or DWP-funded contractors.

Lastly, the City has pursued a strategy, long preceding Propositions 26 and 218, of barter between DWP and other City departments. In this context, additional consumer protection is recommended now.

OPA recommends that the Board engage in greater supervision and monitoring of performance, along the following parameters, respectfully suggested for discussion:

a) Monthly updates of net hiring performance, and the issuance of Board resolutions to the City Council to request correction of deficits beyond the Board's control if progress is not on track by the fifth month of the fiscal year.

b) Monthly review of the pace of contracting, and the issuance of resolutions to the City Council to request correction of deficits in capital projects beyond the Board's control, if progress is not on track by the fifth month of the fiscal year. In particular, the Board should be informed if proposed water trunk line work -- funded by 2016 water rate increases -- is not estimated by year end to achieve 80% of the ramp-up schedule from that rate review, whether performed by employees or contractors.

c) Obtains a written reasonableness opinion of OPA for any memorandum of understanding (MOU) that would transfer *additional* cash, above the $900 million to $1.0 billion level of direct costs discussed in OPA's preliminary budget report, to any City department. Additionally, with respect to Sanitation projects:

   i) the OPA opinion provides advice that the MOU controls are adequate to ensure water revenue funding satisfies:
      (1) the standards of regulatory assets in the utility industry,
      (2) ownership-equivalent control of investments,
      (3) avoidance of waste on operational or capital costs that would in any event occur independently of the joint project (including any already operative compliance obligations of Sanitation with respect to contaminants and solids disposal), or involve amenities that are optional add-ons that are ancillary to the purpose of the joint project,
      (4) the equal sharing of costs for a forensic accountant, contracted by the City's Controller, to periodically and regularly report on project compliance with MOU terms and conditions,
      (5) prohibits the contractors of DWP-funded work from retaining DWP employees or retirees for engineering or project management work, setting a higher-than-minimum standard to avoid the appearance of conflict.

   ii) includes a written and public City Attorney opinion that the costs of service for drinking water meet a Proposition 218 standard.

2. Previous Recommendations Related To The Preliminary Budget And Subsequent Procurement (Pitrelli contract number 480)

As OPA has recommended in recent months, the Board could discuss and consider including the following additional Resolution provisions, either separately or within the Final Budget's adopting Resolution.

a. Because only tax revenue can securely adjust the purchasing power of low income and Lifeline bill credits, OPA recommends that the Board request that the City appropriate $1.5 million of utility user tax received in FY2024-2025, to be returned to DWP, and expended to adjust upward the existing bill credits.
    i. Ideally, the City and DWP would start these adjustments effective retroactively to 2008, which would total of $24M. But, even without retroactive adjustment, the $1.5 million per year increased adjustment should begin funding with the City budget for FY2024-2025. Looking forward 16 years, OPA's "small, but steady" recommendation will be as impactful.

b. Because grant funding was secured that entirely offsets the FY2022-2023 costs of free power interconnections to homeless housing developers for their projects (Project PowerHouse and similar programs), OPA recommends that the Board make a finding that no City general tax appropriation is needed in FY2024-2025 to pay this policy's FY2022-2023 costs.

c. Because of ongoing challenges with compliance obligations for the power distribution system, OPA recommends that the Board adopt in resolution form a remediation goal (of the Power Division's choosing) that is included in the budgeted funds for fix-it tickets level 2B ("worker safety").

DISCUSSION

The revenue growth arising from the budgets is what determines, to a large degree, the rate impacts consumers experience on a quarterly, semi-annual, and annual schedule.

The revenue growth of $463M is $87M in the power fund and $376M in the water fund.

- Power Revenue
    - 1.83% over two years (2023-2024, 2024-2025)
    - 0.91% average per year

- Water Revenue
  - 29.71% over two years
  - 14.86% average per year

- Total Revenue
  - 16.9% over two years
  - 8.9% average per year

The key incremental costs are:

- Labor $66M above the expected current year
  - $32M in power division
  - $34M in water division

- Capital carrying costs $121M above the expected current year (bond redemption, interest, insurance, property tax)
  - $83M in power division
  - $38M in water division

These changes will be exceedingly difficult for DWP to execute, and even if they could be, adverse consequences are likely. Both water and power division labor costs are unbalanced and deficient given current economic conditions.

Major projects, and renovation of the headquarters, are unlikely to fit within this budget. Depreciation is a large and continuous erosion of service-worthy equipment, and it will not wait a year.

In evaluating the recommendations, alternative recommendations OPA considered, but found to be less flexible or realistic than those proposed above, included:

1. The Board could discuss and consider a moratorium on all new memorandums of agreement with other City departments that would transfer cash for any reason, until such time as all City bills are current within 120 days.

2. The Board could discuss and consider offsetting intra-City bills to DWP with one-quarter of past due bills aged one year or more.

3. The Board could request an internal audit of any City invoices incorrectly submitted to DWP and paid "in" 2023-2024, for inclusion in an intra-City bill *to* the City, or apply these amounts to offset inter-City bills from the City. (Because the audit process does not close the books until December, "in" the

fiscal year can involve corrections half-way into the next fiscal year.)

4. The Board could discuss and consider suspending work on jointly funded water recycling and storm capture projects, until such time as the City puts in place the controls triggered by Proposition 218 and 26, and segregates rate revenue from tax revenues more formally. (For more specific details, see OPA Report Requested by Board Resolution 022-097, Governance Review and Recommendations, dated February 25, 2022.) To these recommendations, OPA would add periodic and independent auditor review of access by City departments to DWP wholesale commodity prices or billing, the benefits of which are traditionally shared by all retail customers.

5. The Board could limit participation in existing programs to the load ratio of each government customer's aggregate retail load. For example, a government customer with 4% of DWP's retail load may not access more than 4% of a program's allotted funds or defined allocations.

6. The Board could adopt a moratorium of new or discounted rates for City accounts, even if riders or contracts that include discounts are developed for other commercial customers.

CONCLUSION

OPA's total of nearly $1B dollars that are direct costs transferred from DWP to the City in FY2022-2023 excluded other amounts that are not easily quantified. (See OPA's report on the preliminary budget for FY2024-2025, dated March 26, 2024.)

While OPA's budget recommendations may initially seem wide-ranging, that should be judged from a perspective that includes the many additional costs ratepayers bear from added *indirect* costs. Four of many examples illustrate how indirect cost transfers arise from the City's ownership and control of DWP's cash and personnel:

1. DWP is not using industry practices in commercial bill collection, which involves late fees or interest charges that reflect prevailing interest rates.

2. DWP is unable to secure new business because of unmet personnel needs.

3. DWP is unable to hire specialized technical skills it needs, including IT.

4. DWP is unable to plan and predict cash levels at year end, thus increasing working capital amounts above industry standards.

cc: The Honorable Karen Bass, Mayor
Martin L. Adams, General Manager & Chief Engineer, Department of Water & Power

Final Budget
Attachment A
Last Year, This Year, Next Year

FY 2024 - 2025

Final FY 24-25 Budget: Last Year, This Year, Next Year

	How much is Re-Estimate FY2023/24 vs. Actual FY2022/23?		How is performance in Re-Estimate FY2023/24 vs. Approved FY2023/24?		How big a step-up is Proposed Final FY2024/25 vs. Re-Estimate FY2023/24?		
System/Organization	FY2022/23 Actual, last year	FY2023/24 Re-Estimate vs. Actual FY2022/23 (last year vs. this year re-estimated actual)	FY2023/24 Approved, this year	FY2023/24 Re-Estimate vs. Approved FY2023/24 (this year budget vs. re-estimated actual)	FY2023/24 Re-Estimate of Actual, this year	FY2024/25 Proposed Final vs. Re-Estimate FY2023/24 (this year vs. next year)	FY2024/25 Proposed Final Budget, next year
Power System	$ 3,749	-5.5%	$ 3,925	-9.8%	$ 3,542	17.6%	$ 4,166
Water System	$ 1,207	-11.0%	$ 1,053	2.0%	$ 1,074	2.9%	$ 1,106
Joint System -Total	$ 3,124	9.2%	$ 3,666	-6.9%	$ 3,412	13.4%	$ 3,869
Total - LADWP	$ 8,079	-0.6%	$ 8,644	-7.1%	$ 8,028	13.9%	$ 9,141
	What can they do?		How are they doing?		Can they do it?		

$ in millions, combined capital and O&M budget

Source for budgets: LADWP FY 2023-24 Proposed Final Budget presentation,

Board of Water & Power Commissioner Meeting, May 14, 2024, Agenda Item L-4, L-5, Slide #21

Final Budget
Attachment B
Recent Financial Performance

FY 2024 - 2025

Long Term Debt (net of current portion) Is At The Upper Limit of “Prudent” for A Utility

Under 45% or Over 55% Produces Inter-generational Inequity (too much now or too much later)

in thousands of $		0	1	2	3	4	5	6	7	8	9
		FYE 2014r	**FYE 2015**	**FYE 2016**	**FYE 2017**	**FYE 2018**	**FYE 2019**	**FYE 2020**	**FYE 2021**	**FYE 2022**	**FYE 2023**
Water											
	Assets	8,059,629	8,601,975	9,466,284	10,298,512	10,157,779	10,547,940	10,931,821	11,740,508	12,519,950	13,054,895
	LTD, noc	4,115,000	4,496,962	5,162,410	5,467,914	5,682,565	6,029,872	6,198,644	6,592,366	6,706,501	7,158,875
	Leverage	51.06%	52.28%	54.53%	53.09%	55.94%	57.17%	56.70%	56.15%	53.57%	54.84%
Power	Assets	15,948,409	16,711,450	16,862,539	17,957,716	18,182,324	18,700,000	19,081,272	20,233,673	22,417,480	22,037,172
	LTD, noc	7,937,180	8,568,281	8,943,376	9,276,230	9,507,256	10,106,782	10,528,489	11,093,929	12,057,939	12,117,868
	Leverage	49.77%	51.27%	53.04%	51.66%	52.29%	54.05%	55.18%	54.83%	53.79%	54.99%
		r=revised									

Effective Interest Paid

source: audited financials				
POWER		**FYE 21**	**FYE 22**	**FYE 23**
Interest		358,959	371,045	399,111
LTD, noc		11,093,929	12,057,939	12,117,868
implied interest rate		3.24%	3.08%	3.29%
WATER		**FYE 21**	**FYE 22**	**FYE 23**
Interest		208,656	206,965	217,421
LTD, noc		6,592,366	6,706,501	7,158,175
implied interest rate		3.17%	3.09%	3.04%

"Effective" Interest Rate: What Ratepayers Experienced

- Interest On The Income Statement Divided by All Long Term Debt (net of current portion) On The Balance Sheet Goes Into The Revenue Requirement And Rates

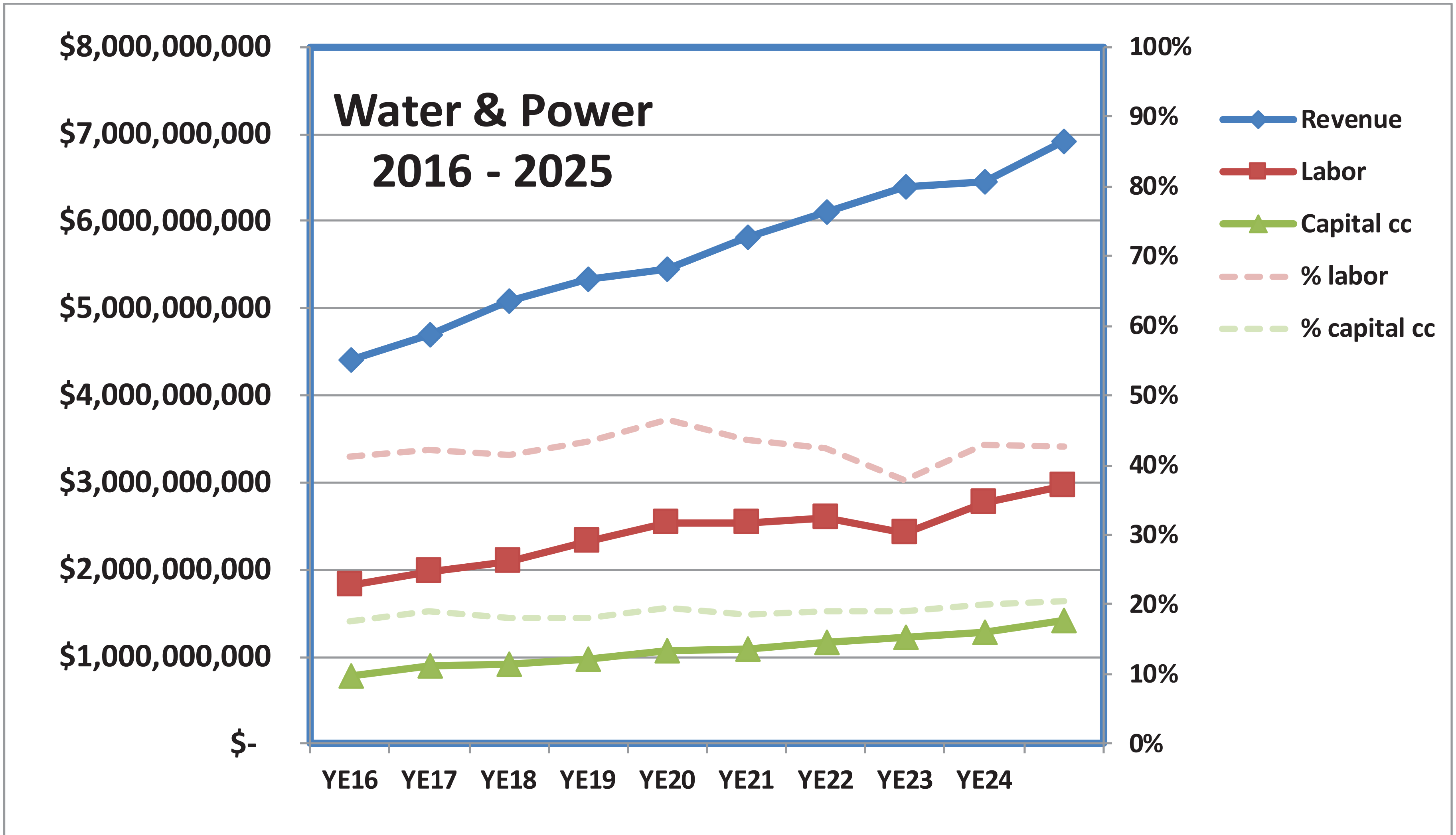
  - Other off balance sheet debt has its own, separate reserve funds, and typically passes through an "off-take" agreement a commodity price (with the interest rolled into it).

  - Indirect ownership *and* control.

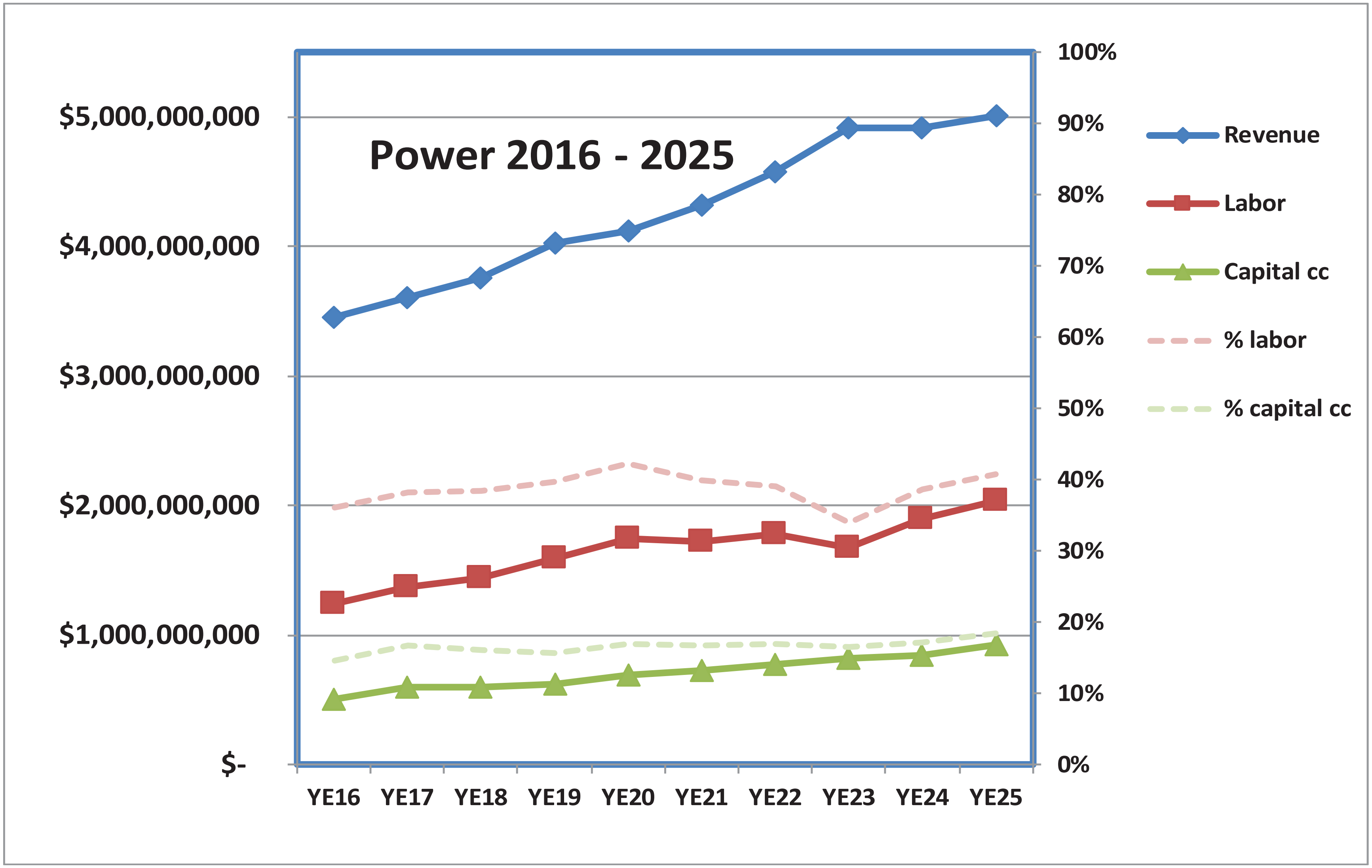
- This measure normalizes for financing choices that management makes: it evaluates past choices first.

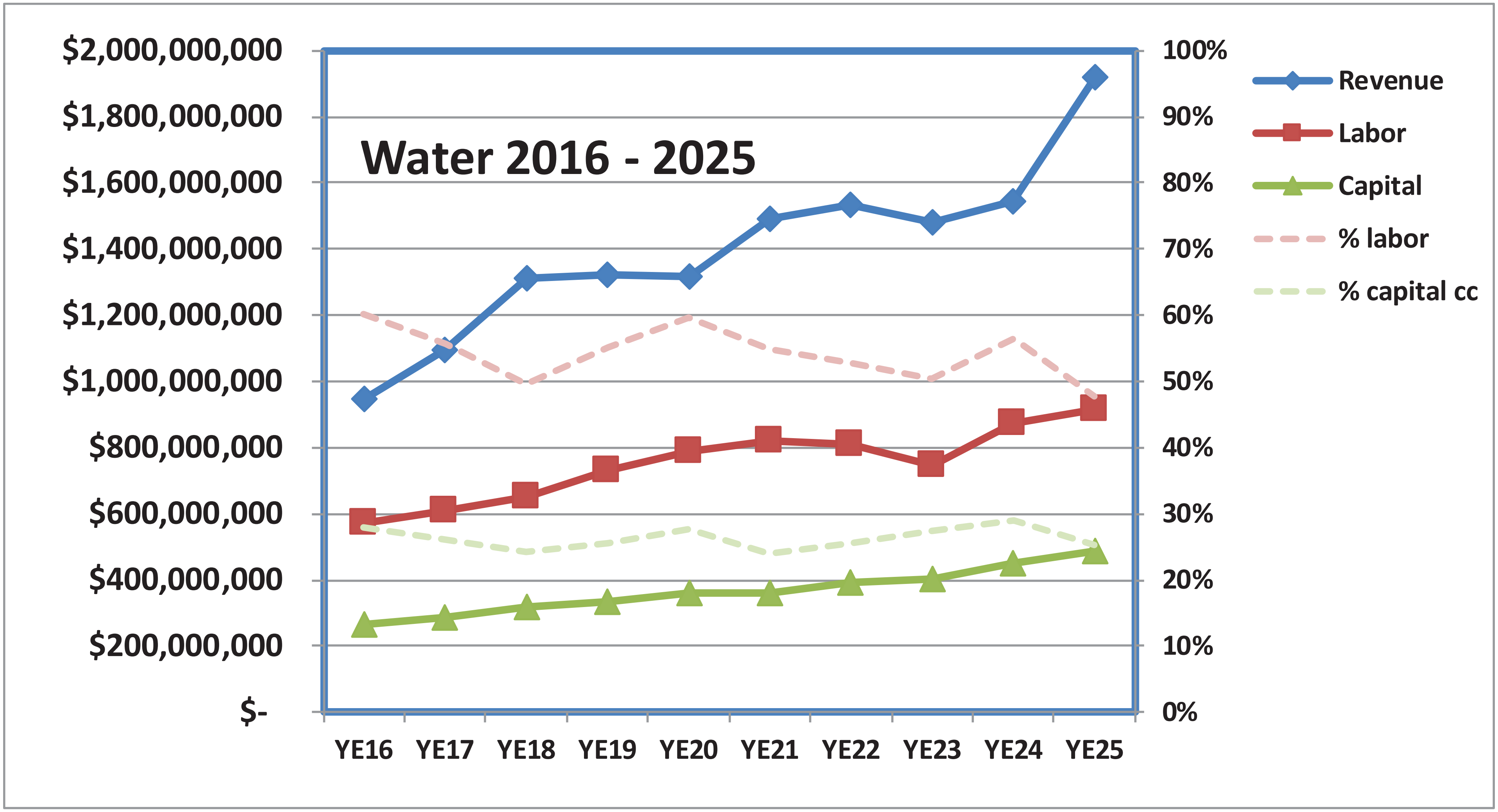
Final Budget
Attachment C

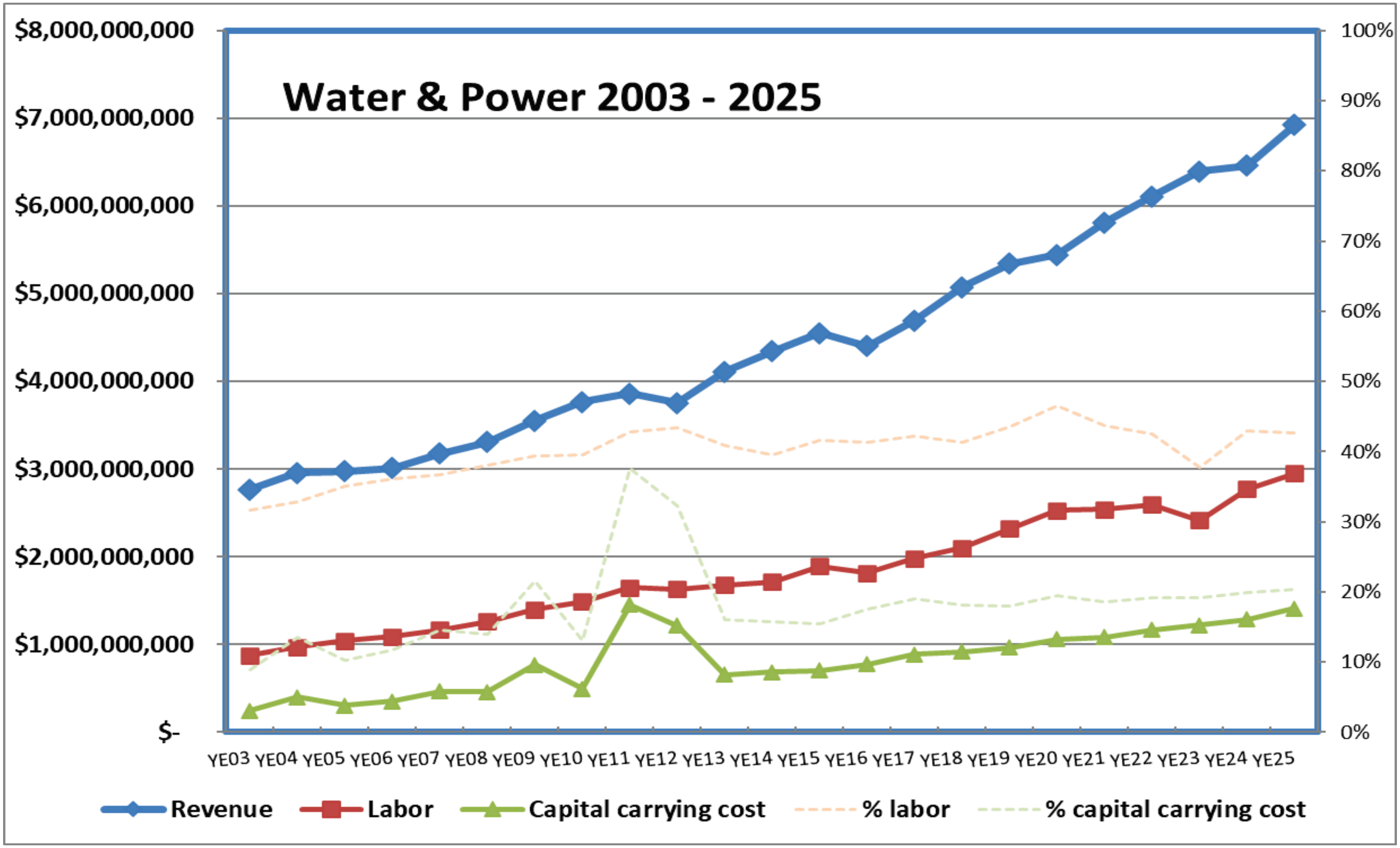
FY 2024 - 2025

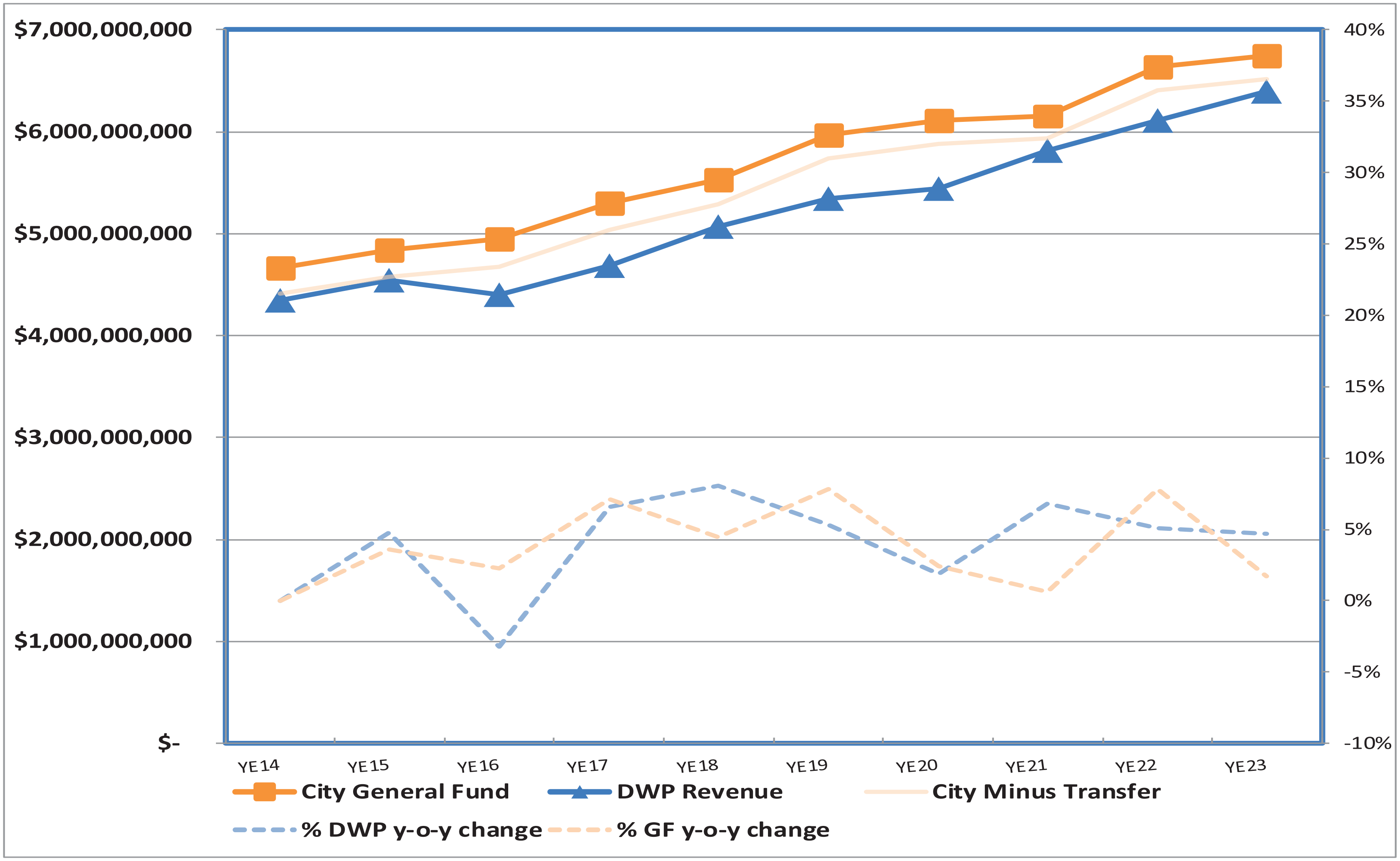


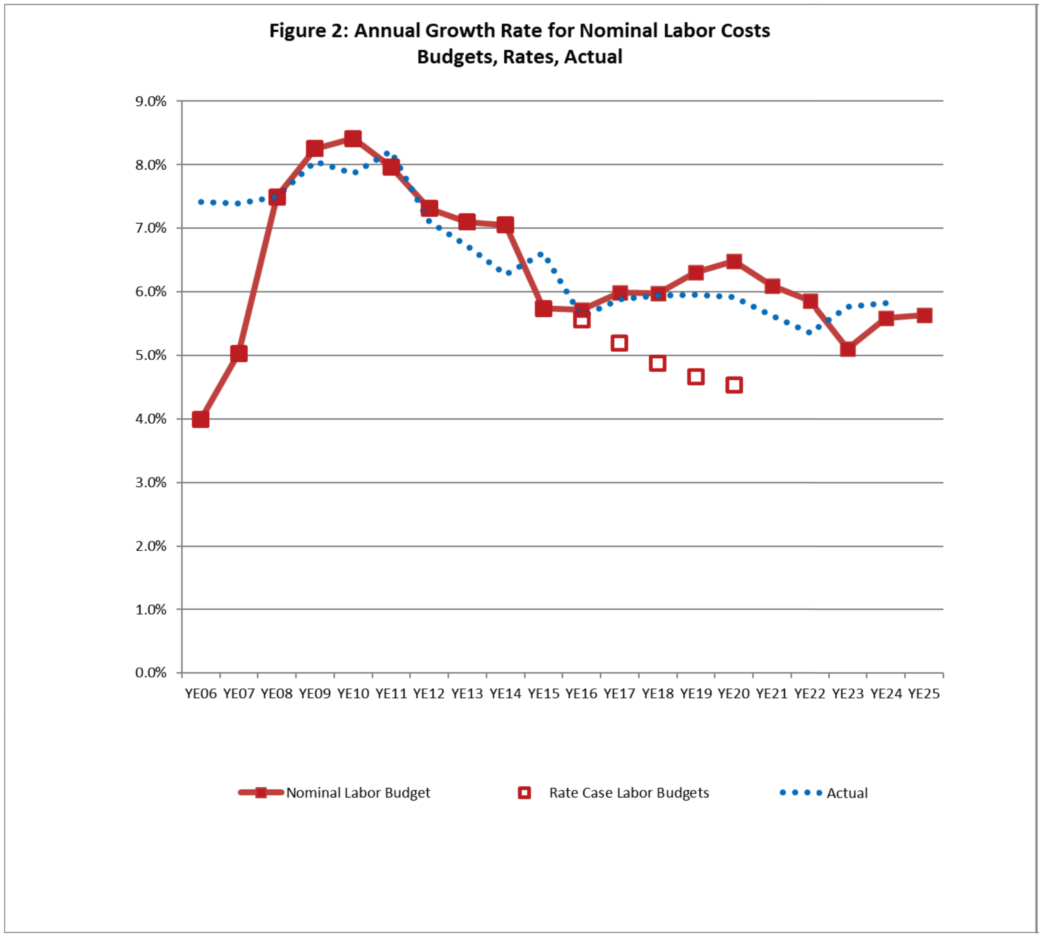
Water & Power
2016 - 2025
$8,000,000,000
$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$-
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
YE16
YE17
YE18
YE19
YE20
YE21
YE22
YE23
YE24
Revenue
Labor
Capital cc
% labor
% capital cc

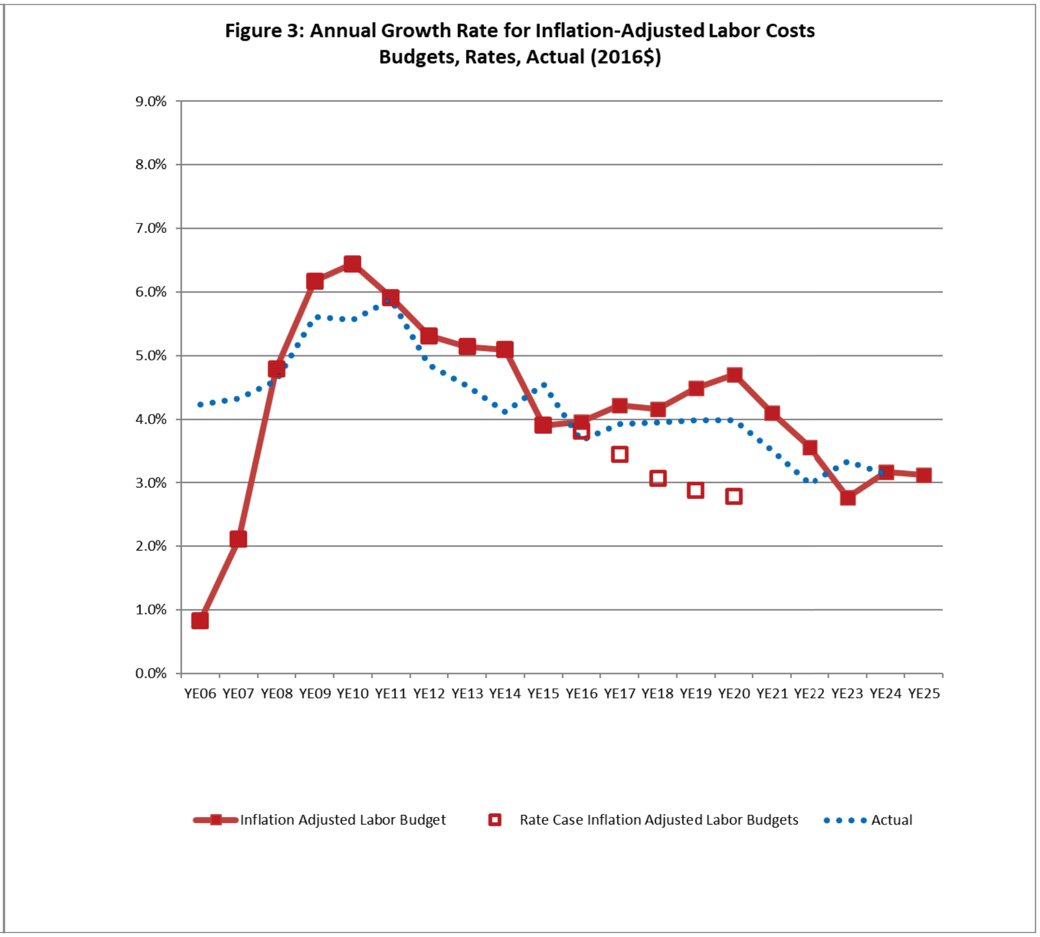

Power 2016 - 2025
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$-
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
YE16
YE17
YE18
YE19
YE20
YE21
YE22
YE23
YE24
YE25
Revenue
Labor
Capital cc
% labor
% capital cc


Water 2016 - 2025
$2,000,000,000
$1,800,000,000
$1,600,000,000
$1,400,000,000
$1,200,000,000
$1,000,000,000
$800,000,000
$600,000,000
$400,000,000
$200,000,000
$-
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
YE16
YE17
YE18
YE19
YE20
YE21
YE22
YE23
YE24
YE25
Revenue
Labor
Capital
% labor
% capital cc

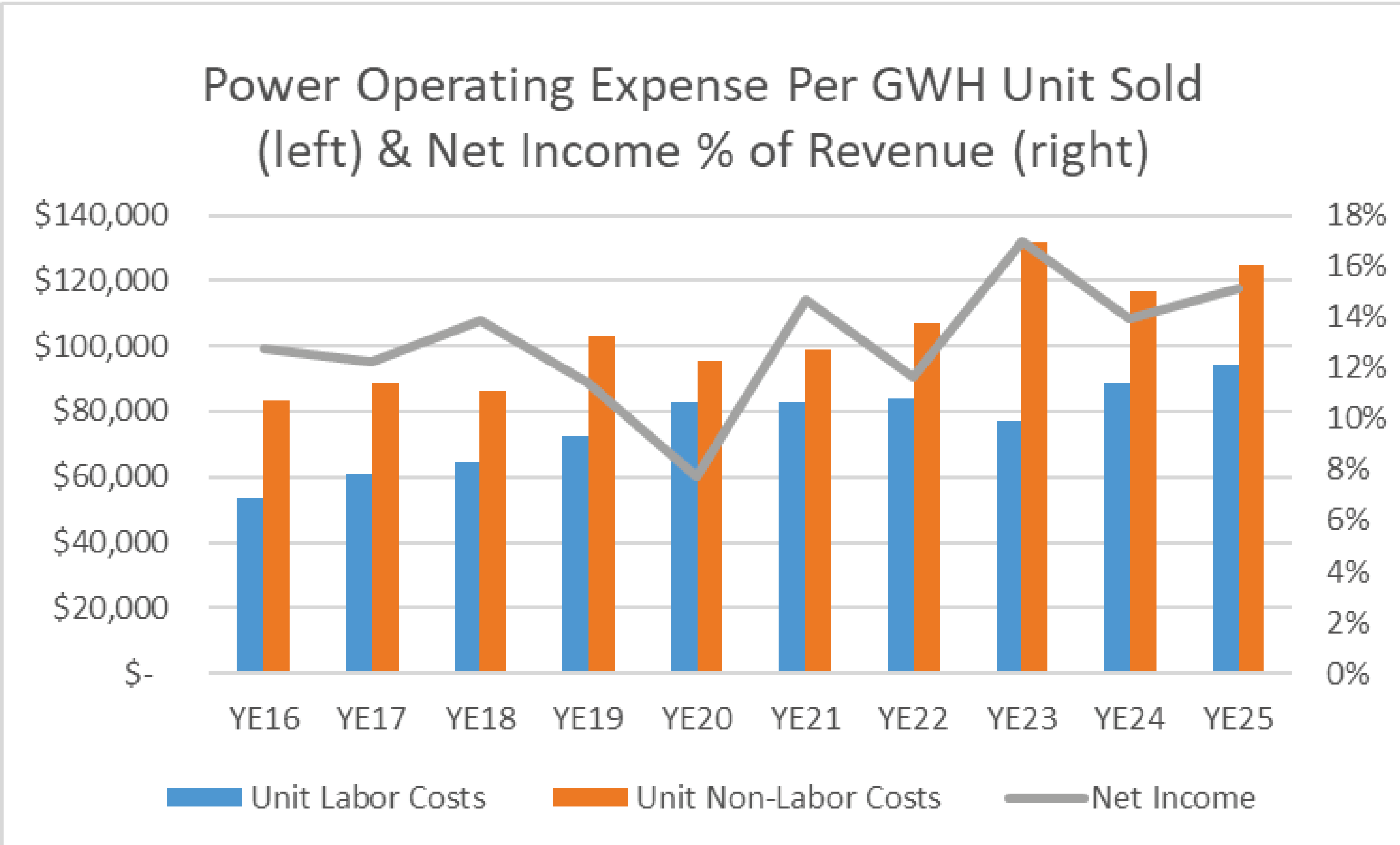

Water & Power 2003 - 2025
$8,000,000,000
$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$-
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
YE03 YE04 YE05 YE06 YE07 YE08 YE09 YE10 YE11 YE12 YE13 YE14 YE15 YE16 YE17 YE18 YE19 YE20 YE21 YE22 YE23 YE24 YE25
Revenue
Labor
Capital carrying cost
% labor
% capital carrying cost

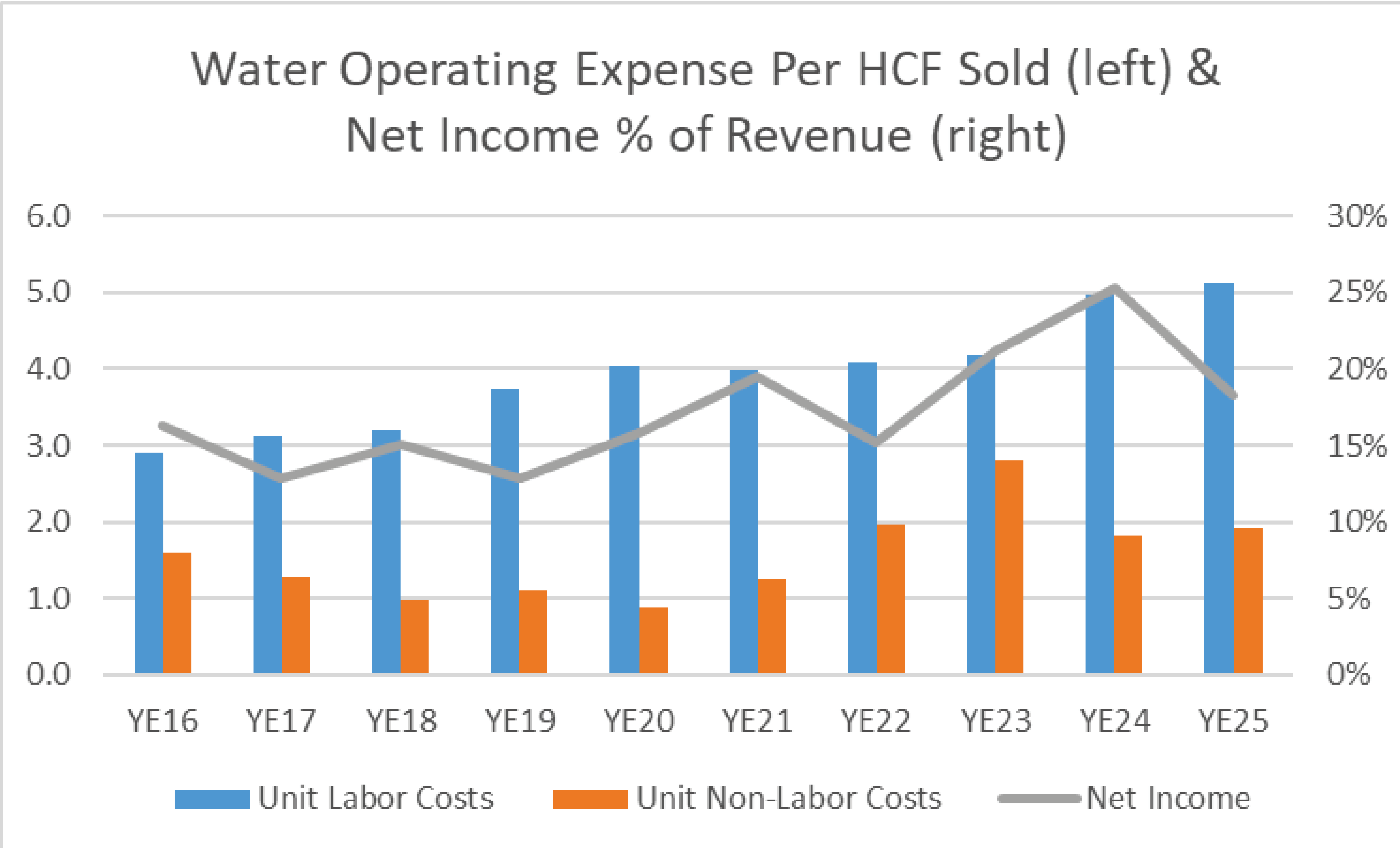

$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$-
40%
35%
30%
25%
20%
15%
10%
5%
0%
-5%
-10%
YE14
YE15
YE16
YE17
YE18
YE19
YE20
YE21
YE22
YE23
City General Fund
DWP Revenue
City Minus Transfer
% DWP y-o-y change
% GF y-o-y change





Note: YE24's blue dot is an estimate. Changes are anticipated.


Power Operating Expense Per GWH Unit Sold (left) & Net Income % of Revenue (right)
$140,000
$120,000
$100,000
$80,000
$60,000
$40,000
$20,000
$-
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
YE16
YE17
YE18
YE19
YE20
YE21
YE22
YE23
YE24
YE25
Unit Labor Costs
Unit Non-Labor Costs
Net Income


Water Operating Expense Per HCF Sold (left) &
Net Income % of Revenue (right)
6.0
5.0
4.0
3.0
2.0
1.0
0.0
30%
25%
20%
15%
10%
5%
0%
YE16
YE17
YE18
YE19
YE20
YE21
YE22
YE23
YE24
YE25
Unit Labor Costs
Unit Non-Labor Costs
Net Income