

REPORT FROM

OFFICE OF PUBLIC ACCOUNTABILITY

Date: April 23, 2021

To: The Board of Water and Power Commissioners

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

Subject: OPA Report on FY 2021-2022 Preliminary Budget



I. INTRODUCTION

OPA finds that the preliminary budget underfunds key areas, which are likely to diminish key DWP service levels. This may constrain economic recovery in the City. To greatly simplify, OPA is recommending an addition of \$300 million in total compensation costs relative to the preliminary budget.

Many areas within DWP do not have adequate occupancy of staff to meet service expectations. As of the end of March 2021, the net new employees hired for the year were 7. (LADWP Monthly Staffing Report of March 2021.) DWP has experienced slowed employee attrition during the pandemic. (March 9, 2021 Board Presentation on Preliminary Budget, slide 67.) Attrition could jump post-pandemic, compounding this challenge.

DWP is in a tenuous position that cannot be managed with the preliminary budgets presented and a strengthening economy. Growth expectations are near 7%, the highest level since 1984. This follows a contraction of 3.4%, the worst in 74 years. (Reuters, "U.S. Retail Sales Surge," April 15, 2021.) This situation requires a fast snap-back in staffing, and DWP has for many years told OPA it cannot surge staffing levels. This growth situation does not sit within the professional experience of anyone.

To manage this O&M budget increase, DWP needs to *fully* utilize the rate flexibility it was granted in 2016 rates, as supervised by its Board. DWP seeks to optimize its debt levels and interest each year. However, the suddenness of the needs DWP can reasonably expect would benefit from a more balanced, multi-year approach to cash balances in the power fund. The Board can anticipate that both power and water will be

shifting their balance of capital and O&M expenses in the coming years, to align the costs with the flexibility of the current rate structure. Capital expectations have been consistently too high.

Section II presents and discusses our specific recommendations on the Preliminary Budget. Section III provides context and a review of DWP's 5 year rate period, 2015 through June 2020. Section IV discusses how the OPA derived the increased total compensation costs recommended for inclusion in the new Budget. Section V comments on the use of the discretion provided to the Board in the rate ordinance of 2016. Section VI is the conclusion.

II. RECOMMENDATIONS ON PRELIMINARY BUDGET

1. OPA supports the Board adopting the revenue estimates included in the preliminary budget.
 - a. These estimates are \$4,304,153,000 for power and \$1,455,220,000 for water. This represents approximately an increase of \$56.4 million for power and a decrease of \$16 million for water.
 - b. Minor adjustments can be anticipated in connection with OPA's recommendation on compensation, below. The estimates of consumption for water and power are very reasonable and OPA supports them.

2. OPA supports the Board adopting the interest and redemptions estimates included in the preliminary budget. These estimates are \$680,064,000 for power and \$362,924,000 for water.
 - a. This represents approximately an increase of \$33.5 million for power and \$34.4 million for water, despite power balance sheet assets being about two times larger in scale.
 - b. Minor adjustments can be anticipated in connection with OPA's recommendations below.
 - c. DWP uses extremely high levels and varieties of cash, or forms of working capital. Combined with its unique rate structure and current market

conditions, DWP can expect to maintain reasonable financing costs with high confidence.

3. OPA recommends that the Board request the management present a final budget with an increase of \$300 million to wages and salaries, health care and retirement.
 - a. Division Level changes, approximately of:
 - i. an increase from \$722 million of \$85.5 million for the **joint division** that is dedicated to that division and cannot be reallocated or shifted to other divisions,
 - ii. an increase from \$476 million of \$56.4 million for the **water division**, and
 - iii. an increase from \$1,334 million of \$158 million for the **power division**.
 - b. Prior to these adjustments, DWP's preliminary budget had total compensation costs that were a **decrease** of \$12,455,400, composed of a power fund **increase** of \$929,700 to total \$1,731,262,300 and a water fund **decrease** of \$13,385,100 to total \$807,012,700. These amounts are not reasonable in OPA's opinion.
 - c. DWP needs to align its operations and maintenance (O&M) and capital expenditures in the accounts that have the flexibility needed for these increased total compensation expenses. DWP should not expect new, *unsigned* contracts to meet substantially higher levels of capital expenditure. That technique fell short by 45%, as reported at the mid-term review of the 2015 to 2018 period. DWP could better avoid funding O&M with the cash funding portion of unperformed capital work.
 - d. OPA would be particularly pleased to see both field work in power pole and water mainline budgets set closer to the levels needed to reach for DWP's rate targets and goals safely, and consider whether it can use a more revenue-based allocation of joint division costs. These flow through accounts allow DWP to build up more crews. It takes time to grow crews, and because there is significant demand from new business that is also placing demands on those same crews, this demand will increase if the economy recovers as forecast.

- e. In addition to the quantitative recommendation, which will be discussed below, OPA recommends that the Board receive, discuss, and review at its second Board meeting in July and second Board meeting in January, the monthly staffing reports for June and December. These reports show the degree of occupied and funded staff positions. OPA has included a partial snapshot below. The organizational priorities and challenges expressed therein are appropriate for the Board to discuss bi-annually.
- f. For the avoidance of doubt, OPA's recommendation to increase total compensation by \$300 million is assuredly not sufficient, may be only partially executed due hiring delay, and will not obviate the need for a timely rate review. This rate review has already been delayed beyond the Board-specified schedule. The Board should consider this amount the minimum needed for "damage control" purposes. The basis of this amount will be discussed below.
- g. OPA's recommendation was allocated to divisions based on revenues (Item 1.a., above) for the water and power fund, which are 25% water revenues and 75% power revenues. It was further allocated to the joint division based on the compensation ratios of the preliminary budget presentation (slide 6): \$722 million in joint compensation (28.5%), \$476 million in water compensation (18.8%), and \$1,334 million in power compensation (52.7%). This recommendation intentionally alters the cost allocation methodologies generally in place for the sole purpose of identifying the amount of compensation to add to each division.
- h. OPA does not believe that DWP can meet service level expectations without these additional funds. While the timing may be difficult for those customers just re-gaining employment, it cannot come soon enough for the majority of businesses and individual customers who rely on DWP. Special dispensation for bill payment to those affected by the pandemic could be addressed at the same time or immediately after the final budget is approved. Federal funding available to defray this surge of employment or bill relief could be explored.

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4. OPA recommends that the Board both authorize and require that not less than 50% of expected power capital expenditures for the current year (2020-2021) be funded by new bonds, and possibly use higher amounts if utility plant increases can support it.
 - a. The preliminary budget's **power** financial case expected \$1,509 million of capital expenditure would be funded with \$607 million of borrowing. A 50% issuance would be \$147.5 million higher, or \$754.5 million. This is nevertheless far below the \$866M authorized by the Board for the current year. (PS Case 24 dated May 1, 2020.) DWP is already authorized to use 68%, if needed, after considering a multi-year trajectory of revenue, costs, and rates.
 - b. DWP's power division has attempted for over five years to capitalize more costs than OPA has generally seen achieved on a sustained basis. Variation in bond financing during the five-year rate period has gyrated from 62% (FY18-19) to 34% (FY17-18), which for most utilities is not considered a reasonable practice. As set forth in the background below, it is now critical for both water and power that DWP begin to realign O&M and capital expense to achievable levels so that it can meet the service levels expected of it.

5. As DWP undertakes to act on any Board direction along the lines recommended above, OPA would suggest the Power Division align its increased labor costs 50% with the O&M flow through accounts, and 50% with the capital flow through accounts.
 - a. As of FY 2019-2020, power was \$205.3 over-spent on O&M rate budgets, and this division needs to align those costs with flow-through accounts.
 - b. Subject to that higher priority of putting craft workers where needed, OPA recommends power capital expenditures no higher than \$1,653 million, which is \$144 million *more* than the current year's expected \$1,509 million. This increase is enough to cover three years of growth over the 2016-2020 rate period. (DWP moved from \$1,173M to \$1,408M over 5 years, or about \$47M per year.)

- c. OPA recommends Power System Reliability Program (PSRP) capital expenditures of *at least* \$587 million, which is \$10 million higher than DWP's preliminary budget. OPA will revisit this level after receipt of its biannual PSRP distribution report the first week of May. DWP has also asked OPA for advice on reclassification of base capital and Renewable (RPS) or PSRP items. OPA will report to the Board further on this topic in May.
6. As DWP undertakes to act on any Board direction along the lines recommended above, OPA would suggest the Water Division also align its increased labor costs 50% with the O&M flow through accounts, and 50% with flow through capital accounts.
- a. As of FY 2019-2020, Water Division was \$81M over-spent relative to water O&M rate budgets, and it needs to align those costs with flow through accounts.
 - b. Subject to the higher priority of putting craft workers where needed, OPA recommends water capital expenditures no higher than \$947M. This amount is equal to the current year's March 31, 2021 bond report estimate of \$816M, plus \$131M for the San Fernando Valley groundwater cleanup contracts already signed. This is \$147M *higher* than DWP's preliminary budget proposal of \$800M. This is \$2M *lower* than the authorized FY17-18 rate budget of \$949M.

Before a final budget is presented, and depending on direction given by the Board, OPA will work with DWP's divisions and financial services staff, in evaluating the expected rate impacts of these recommendations, which may be minimized, but will be larger than proposed. OPA will maintain coordination on this topic with the Board through the Board's assigned budget staff.

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A truncated summary of these recommendations, without suggestions affecting procedures or monitoring, is as follows:

	Water		Power	
	DWP (prelim)	OPA	DWP (prelim)	OPA
Sales	195.8 mhcf	195.8 mhcf	21,152 GHW	21,152 GHW
Labor	\$807M	add \$78	\$1,721M	add \$222
Capital	\$800M	\$947M	\$1,790M	\$1,653M
20-21 Debt ("new bonds")	\$410M*	\$410M	\$607M	>=\$754.5M*
System Average Rate	\$7.54/hcf	tbd	20.3c/kwh	tbd
Rates Jan '22 estimate	tbd		tbd	

Joint Division Labor **\$722M add \$85.5M** (this addition included above)

*Note that the preliminary budget amount for Water Division’s new bonds this year has been subsequently updated in a report to the Board dated March 31, 2021 (p.3). The preliminary budget number (water financial case #1) was \$290M. Also, the Power Division’s new bonds should reflect at least half of DWP’s best estimate of capital it will complete in the current year, which may be lower than the preliminary budget estimate of \$1,509M. For example, if a revised estimate of \$1,400M is made, half in the form of new bonds for the year would be about \$700M.

III. CONTEXT AND REVIEW OF THE DWP’S FIVE YEAR RATE PERIOD, 2015 TO 2020

The DWP has completed the five-year rate period covering Fiscal Year (FY) 2015-2016 through 2019-2020, and the audited results are now publicly available. OPA believes it will be helpful in guiding the Board’s budget policies and decisions to briefly review the major components of this most recent rate period because the mid-term rate review is now very stale. All figures below are *relative* to rate budgets forecasted in spring of 2015, which at this point is a very long time ago. In OPA’s experience, most larger utilities cannot forecast very well beyond a second year. These variances inform OPA’s opinions above regarding next year’s budget.

1. Revenue

Revenue came in \$1.061 billion less than planned (\$950M power; \$111M water), cumulative for FY15/16 through FY19/20. This required DWP to adjust its rate budgets

accordingly, one year at a time, as the years passed. This lowered the top line of DWP's business. It is worth noting that these lower consumption levels corresponded with a fairly strong macro-economic climate.

2. Increase In Fund Net Assets

DWP had an increase in fund net assets that was \$716M higher than planned (\$518M power; \$198M water), cumulative for FY15/16 through FY19/20. This built up the bottom line of DWP's business.

Fund net assets is generally thought of as similar to retained earnings. Due to planned growth in property, plant, and equipment, the DWP planned to grow this part of its balance sheet, as it is necessary to maintain DWP's high quality and low-cost financing. OPA supports growth in fund net assets that are in line with borrowing for and adding to utility-owned facilities (not paper assets), and found these values had dropped far too low prior to the rate review.

Building up this asset value, as was sorely needed after the last recession, added to pressure created by revenue variances, by bringing the top line of the business (revenue) and the bottom line (net assets) closer together. Combined, these two effects total \$1.777 billion.

3. Capital Expenditures, Leverage, and Debt Costs

Due to many factors, including the two above, capital expenditures were \$3.4 billion less than planned (\$1.392 billion power; \$2.023 billion water), cumulative for FY15/16 through FY19/20. These lower capital expenditures created the following, related reductions:

- Debt service: \$615M lower (\$215M power; \$435M water).
- Depreciation expense: \$568M lower (\$452M power; \$116M water).
- Debt issued: \$2.881 billion lower (\$907M power; \$1.974 billion water).
- Non-current debt (or long term): \$1.43 billion lower (\$920M power; \$510M water).

Note that depreciation expense is called a "non-cash expense" because it is built into the revenue required and the rates for the purpose of being used to fund *with* that revenue (cash) the physical assets that are always aging out of the network of plant. Delay often attends the conversion, hence this sometimes is perceived as a misnomer for utilities that immediately fund capital with the income originated by this "expense."

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The leverage ratios applicable and related to these expenditures, according to the published and audited financial statements, are as follows:

in thousands of \$								
		FYE 2014r	FYE 2015	FYE 2016	FYE 2017	FYE 2018	FYE 2019	FYE 2020
Water								
	Assets	8,059,629	8,601,975	9,466,284	10,298,512	10,157,779	10,547,940	10,931,821
	LTD, noc	4,115,000	4,496,962	5,162,410	5,467,914	5,682,565	6,029,872	6,198,644
	Leverage	51.06%	52.28%	54.53%	53.09%	55.94%	57.17%	56.70%
Power								
	Assets	15,948,409	16,711,450	16,862,539	17,957,716	18,182,324	18,700,000	19,081,272
	LTD, noc	7,937,180	8,568,281	8,943,376	9,276,230	9,507,256	10,106,782	10,528,489
	Leverage	49.77%	51.27%	53.04%	51.66%	52.29%	54.05%	55.18%

(LTD, noc means long term debt, net of the current portion.) There are a large variety of other metrics for leverage, but *for the purpose of steering the budget*, this simple one suffices, and can be readily verified.

During this time, DWP power’s “effective” interest rate (all interest paid divided by all long-term debt **on** the balance sheet) has risen by only 0.6% to reach 5.9%. DWP water fund’s effective interest rate has risen by only 0.7% to reach 5.2%. These are very reasonable costs for debt service and new capital, by any measure of comparison appropriate. “Effective” interest rates should not be compared to the “true interest cost” of a particular bond issuance: this measure is intentionally different and for the Board’s year-to-year guidance at budget time. It indicates more generally a cost of capital, and how DWP is balancing its rate structure, borrowing, and execution. These amounts can be thought of somewhat loosely as reflecting a margin of safety for investors, inflation, *and* interest.

One of the contributing factors to low debt costs is high working capital levels, in the form of different types of current assets and cash. DWP’s peak working capital in the current year (2020-2021) was \$3.135 billion, or 56% of the expected \$5.59 billion of water and power revenue. By the last day of the year, when all obligations are met, DWP expected working capital of \$2.350 billion, or 42% of revenue. (FSO Activity Report January 2021, pp. 6, 12.) This helps secure low financing costs.

OPA has no experience with working capital levels this high; however, paired with the rate flexibility DWP can and should use until its next rate review, finds it unobjectionable given all the other fiscal constraints of managing two funds in one enterprise.

4. Operations & Maintenance Expenditures

Due to many factors, including a low rate budget for total compensation expenditures, O&M expenses came in \$804M higher than planned (\$599M power; \$205M water).

The O&M and capital expenditures planned in the rate budgets proved to be too large a strain, and were predicated on outsourcing to a very high degree. This issue is landing squarely before the Board at a very challenging time for balancing rates and economic growth.

Now that the joint benchmarking study has completed, the Board can move forward confident that more employees is an effective and efficient approach for work that is consistent with DWP's stated rate commitments, goals and objectives.

5. Total Compensation Expenditures

Due to many factors, the last year of the rate period, FY 2019-2020, had total compensation expenditures that were \$416M more than forecasted. (This is approximately \$258M power and \$163M water. Note that the fund level information adds to \$421M due to rounding error, and immaterial estimation errors in how the power and water fund share certain joint resources.) This is \$611 million, when comparing budgets, rather than actual expenses, for FY 2019-2020. This approximately \$200 million gap between budgets and expenses will be discussed further below, with regard to staffing.

Comparing rate budgets to annual budgets in the full five years 2015-2020, total compensation variance from the rate budgets was \$1.2 billion. This is approximately of the same magnitude as the lower-than-planned debt issuance (\$1.451 billion), beyond that explainable by lower-than-planned long term debt (\$1.430 billion).

Due to many factors, out-sourced capital expenditure work was running slightly less than half of the unexecuted capital in FY 2017-2018. OPA has requested an update of this from DWP. (i.e., an MRR-20 report.)

Of the \$25.5 billion planned in the rate review, all of the relative changes mentioned above account for 99% of the forecasted dollars. The remaining 1% can be traced to a variety of much smaller forecast variances ("errors"). DWP is currently verifying these amounts and OPA will update the Board when that is complete if significant changes result.

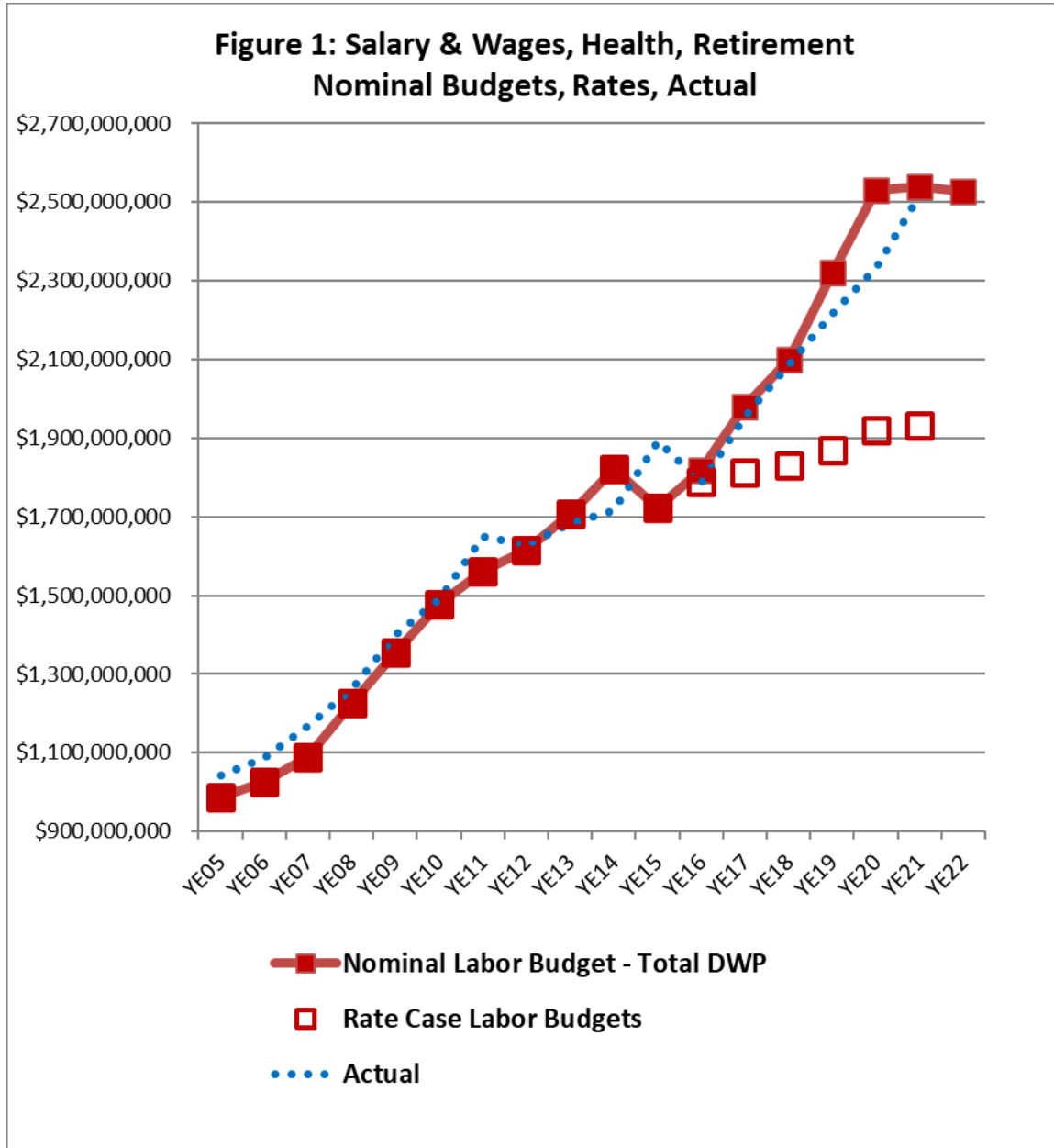
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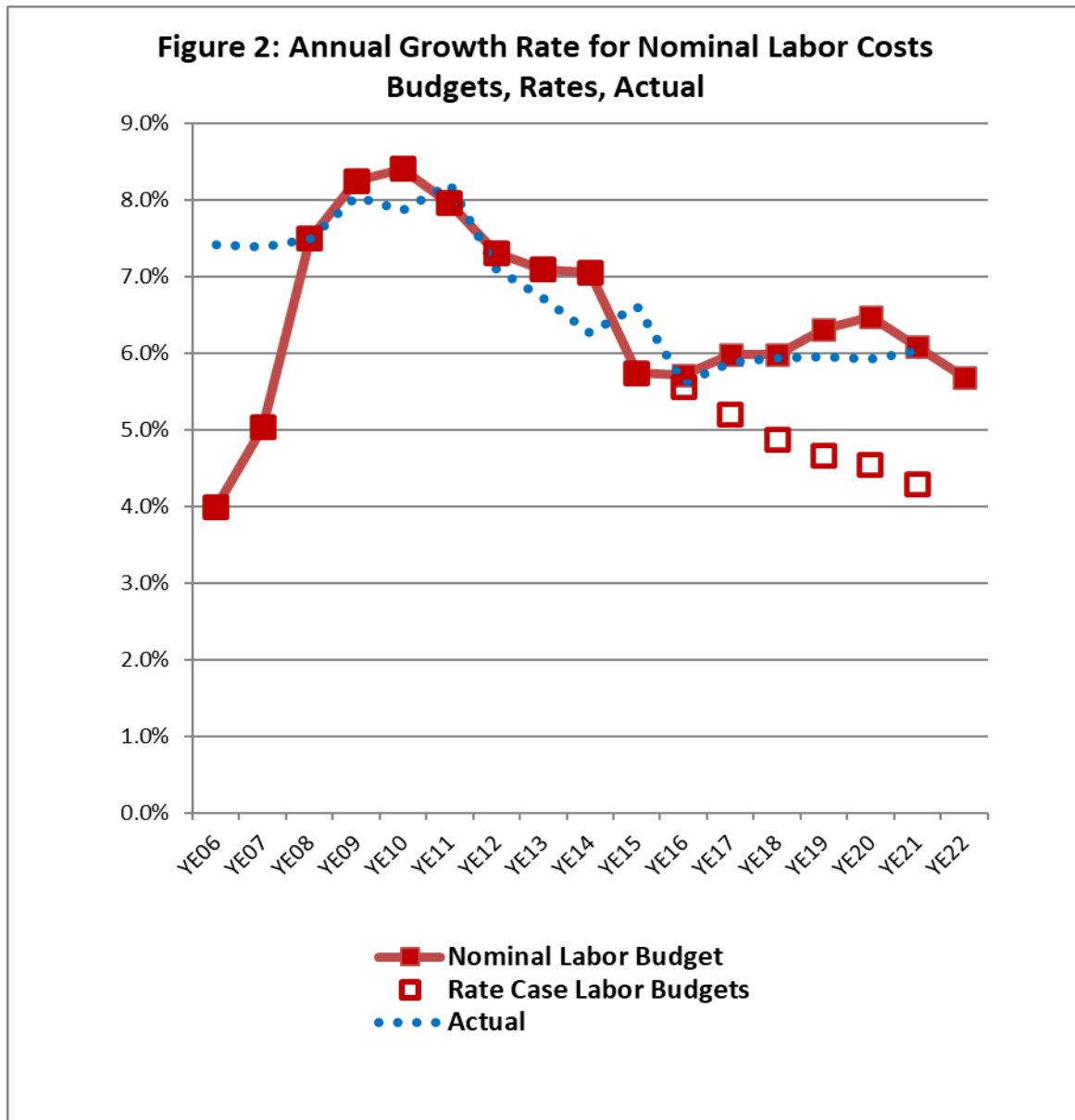
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IV. HOW OPA DERIVED THE INCREASED TOTAL COMPENSATION COSTS RECOMMENDED

A simple view of the DWP's power and water total compensation expenditures, as proposed in the preliminary budget, is as follows:

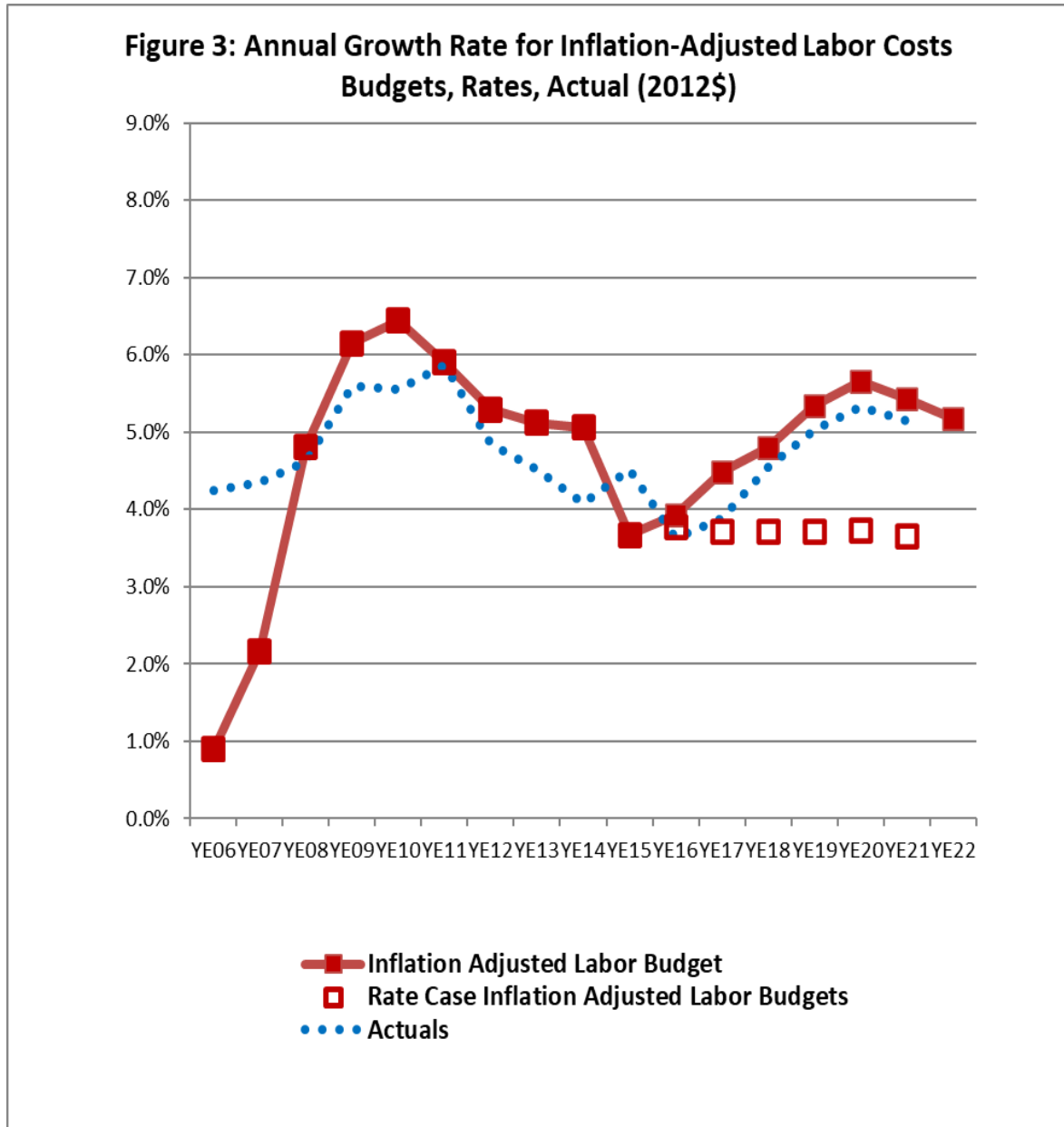


The nominal growth rate associated with this trend is as follows:



Note that the DWP’s actual, nominal growth rate for total compensation has been about 6% since 2016-2017. This rate of change includes cost of living increases previously authorized by the City Council and Mayor, increases in the cost of health insurance, decreases in the ratio of retirement contributions since the Tier 2 pension was adopted, increases due to promotion when vacancies are filled and employees move up in the organization, the locally applicable labor inflation, and the generational scarcity in certain types of utility skills, both professional and craft. This should not be thought of as a cost of living issue: it is a much more complex measure of a utility’s labor costs.

Adjusting DWP's nominal growth rate for total compensation shows an actual, inflation adjusted growth rate of about 5.1%, using the current year's estimates:



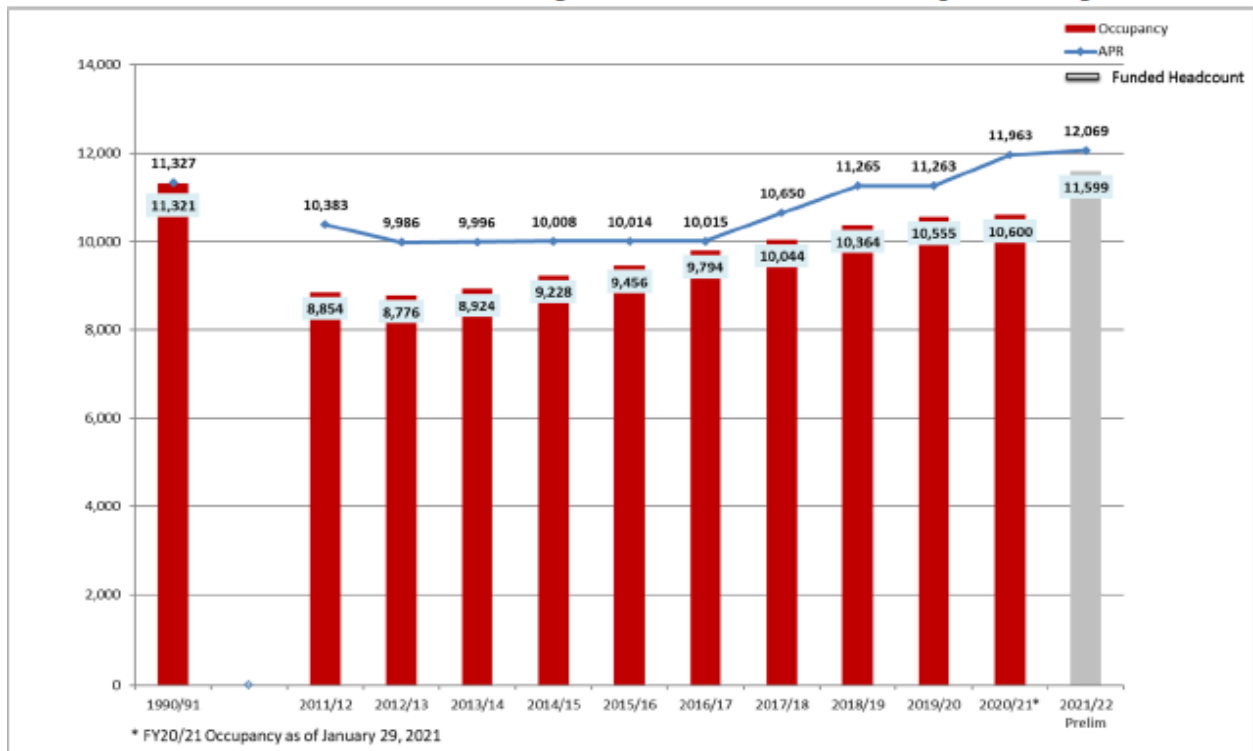
As the Board can observe, the actual trend has turned down, and this renders it infeasible to increase capital expenditures or complete other projects-in-process that need O&M expense. DWP has sought to capitalize as much as it can, but many expenses needed to run projects, including those of the joint division, are supportive in nature.

OPA's recommended \$300 million increase was derived using two perspectives. First, by reflecting on the cumulative area between the rate budgets and actual, which is a \$1.162 billion variance. In the FY 2019-2020, the final year of the rate budget, the amount

was \$416 million. Increasing this cost by \$300 million is, for scale, ¾ of that already experienced in a single year’s variance. Second, it is also roughly the size of the current year’s expected costs of \$2.520 billion, increased by 6% twice, for the two years that are flat. (e.g., $\$2.520 \times 1.06 \times 1.06 = \2.831 billion, or \$303 million above the proposed \$2.528 billion.) It is a small down-payment ratepayers could make on the \$3.4 billion of planned capital expenditures that have been deferred. Deferral was how DWP managed to stay within the outer limits of its rate budgets and estimated rate impacts through 2019-2020, while adjusting for \$1 billion of revenue that did not occur, despite a growing economy.

Funded APR is needed to get DWP’s 1000 person increase of APR to occur. DWP management has a lot of practice with austerity situations. Giving DWP an ability to snap back with the economy involves restoring its growth rate in total compensation. Unfortunately, in FY2021/22, DWP needs to do this before it is clear how the consumption might change. It would be helpful to the Board to have its March 9, 2021 budget presentation, on slide 5 (below), augmented with funded APR in every year, so it can understand the gap that remains between APR and what budgets provide for funded APR over time. This will enhance the Board’s understanding of how this persistent gap has evolved, and explore the controls and obstacles to closing that gap as it further considers changes in governance and transparency. Note that APR and occupancy were extremely close in 1990-1991, before this feature became prominent.

LADWP Preliminary APR & Occupancy Trend



V. OPA ENCOURAGES THE BOARD TO EXERCISE THE DISCRETION GIVEN TO IT IN THE RATE ORDINANCE OF 2016

At this time, the Board has the discretion to determine how much DWP can use accounts that automatically adjust to the expenditures made, and true-up when and if the budgeted amounts are not achieved. *This will be the second year since the rates were adopted that there is no adopted rate budget to guide the Board as a reference point.* For this reason, OPA frequently gives the Board reference points from that period with which to evaluate the magnitude of changes being described.

Adjusting features of the rate structure are called “flow through” accounts. This is a short-hand reference to all the adjusting mechanisms that are not the “base rates.” Of the flow through accounts, the ones affecting revenue are often referred to as “decouplers,” for they secure the financing by decoupling revenue forecasting variances driven by sales estimates (consumption), net of bad debt expensed and experienced in the due course of collecting customers’ accounts receivable.

1. Sales Forecasts: These Estimates Adopted With The Budget Drive Rate Impacts And Are Reasonable

Two of these accounts covers changes in forecasted power and water sales, net of uncollected accounts receivable. OPA has seen DWP improve its sales accuracy over this time period, and would commend DWP management for taming what was, in 2015, an unrealistically high and self-imposed source of continually catching up with overly optimistic sales. This is important to the Board because the budget’s estimated power and water rate impacts depend upon on good sales estimates, well grounded in recent experience.

It is also worth taking stock of the policies that support conservation have divorced growth of Los Angeles’ economy from the growth of power and water consumption, to a significant degree from a rates and budget perspective. In fact, it is entirely plausible that conservation will accelerate, independent of policy mechanisms or rebates, simply in response to the power and water rates themselves. Innovation is increasingly agile and focused on this area. If the last 10 years are any indication, another 10 years of very low or no growth could ensue. DWP has the rate adjustment mechanisms needed.

DWP’s current approach to conservative sales forecasts ensures an added source of financial stability that is helpful to its balancing of other variances. In particular, it will be difficult for DWP to predict how and when its pandemic-induced customer arrears eventually normalize. These forecast errors are adjusted by the flow-through accounting after an account balance is written off as uncollectable, and therefore this uncertainty is not impinging upon other budgets right now, but bears monitoring as FY 21-22 progresses.

Unfortunately, it is likely that some of the pandemic-elevated power consumption dissipates over the next year. Water consumption is even harder to forecast at this time, because of the pandemic-depressed sales, and because the state has re-entered very dry conditions. DWP's proposed sales forecasts for both water and power are reasonable under these circumstances. OPA is emphasizing the uncertainty DWP faces for this key variable in rate impacts.

It would be useful to the Board to also have, before adopting a budget, a rougher estimate for the rate impact for January 1, which expresses the decoupling adjustments in actions that will come before the Board this fall. For example, revenue that was recognized in FY 19-20, for purposes of determining the January 1, 2021 decoupled rate impacts, were overstated. Significant adjustments in both power and water can now be expected from that prior year, and combined with new estimates for the current year, to give the Board an early indication of how this feature of the rates is likely to express itself. Continued uncertainty about the end of the current year's sales will remain.

2. Other Adjustable Accounts

Other flow-through accounts involve specified costs and types of activity that DWP sought flexibility for, unsure of how much or when it would be ready to deploy those funds some six or more years into the future.

In general, OPA supports DWP moving its annual budgets to the O&M levels it has grown into thus far, with some room in flow-through accounts to do *additional* work defined in those areas.

OPA does not support very high capital expenditures that DWP cannot actually do, but which generate sufficient cash flow to fund O&M. Recalibrating both power and water capital expenditures and O&M is a multi-year process, and the Board can begin this process now by asking for five year budgets starting in its spring 2022 review of the FY 22-23 budgets.

DWP has reached an upper limit to how much capitalizing of costs it can do, and meet its priority goals and objectives. A gradual shift must therefore ensue, or staffing will continue contracting. OPA suggests several budget policies that the Board may wish to consider now or at a future time.

a. Using Rate Flexibility Already Provided

DWP needs to use its flow-through accounts, particularly those for O&M, to give itself the flexibility needed to run a utility business that is not overly focused on large jumps in staff or capital that it cannot execute. This is to a degree a self-imposed habit, formed during long periods without a rate review.

DWP management could seek guidance from the Board on an acceptable percentage range of rate impacts, with a lower and upper bound, prior to preparing the FY 22-23 preliminary budget. Once it has that, it could schedule a briefing of those levels with the City Council President, Mayor and Board representative.

DWP management could provide sufficient information before seeking this guidance so that the Board has ranges of rate impact for both July and January rate changes.

b. Debt Optimization And Consequences

Right now, unfilled but funded staff positions create extra cash, and that cash can be considered an excess (above budget expectations) when DWP finalizes and optimizes its debt costs for the fiscal year in progress. Choosing to cash fund 70% of the capital puts downward pressure on rate metrics in future years and puts downward pressure on staffing for the next year. It will not necessarily trigger a rate review because DWP's rates now have so much flexibility.

This ratcheting of the debt optimization cycle against the unmet gains for the hiring cycle is particularly concerning because of the pandemic. Many people have postponed leaving their jobs under these circumstances. A sudden pick up in exits may leave DWP sorely depleted, and service quality to customers is already showing signs of stress from a variety of pandemic related changes to operations. (March 9, 2021 Board presentation on the preliminary budget, slides 86, 87, and 90.)

More limitations face the Board in adopting more EV rebates or pandemic bill relief due to current staffing levels. Reaching out to those customers who have fallen behind to offer custom pay plans would require IT work sought and funded, but not executed in the last five years because litigation demands drove priorities. At the same time, user acceptance testing is underway for the billing system upgrade. Outsourcing of this customer pay plan function cannot be done quickly or safely for DWP customers.

The Board could adopt policies that ensure multi-year cash levels allow funded staff at 97-103% of authorized levels across division and sub-division levels, at any time the Board chooses to take a snapshot of the situation. OPA's recommendation is to start gradually, with two key points in the fiscal year.

c. Rate Stabilization Fund

OPA recommends the Board consider a policy that places that no less than half of cash that is above the year-end budget in the rate stabilization fund, to offset what is habitually an impractical rate review cycle. This practice can stabilize and balance the interests of investors, ratepayers, and employees. This requires ongoing review of capital expenditure rates and new bond issuance levels as a part of budget review.

d. Multiple year budgets

The Board can ask that each annual budget be placed in the context of five-year budgets and staffing plans. This will provide some forward rate impact estimates and ability to plan around year-end issues. Since the Board is responsible for the rate impacts of the annual budget, they need better forward visibility on large, multi-year projects, cash reserves, and bond metrics. Matching the capital and staffing in a five year window would stabilize DWP, and reduce pressures on the joint division from the more annual nature of staffing struggles in operating divisions.

e. Funded Annual Personnel Resolution (APR) Updates

The Board can ask that it received the information about how many funded positions are occupied in each functional area (as below), both at mid-year and before budget season, so it can better evaluate what authorized work is being done, and what has been postponed. The funded APR levels at the end of December 2020 were as follows:

TOTAL LADWP STAFFING					
Organization	FY 20/21 APR ¹	FY 20/21 Approved Headcount	Adjusted Occupancy	Adjusted Occupancy less Temporary Training Classes ⁴	Adjusted Occupancy less Temporary Training Classes % FY 20/21 Headcount
Joint (Other)	221	182	128	126	69%
Joint (CAO)	1,965	1,921	1,639	1,626	85%
Joint (External & Reg. Affairs)	1,271	1,271	1,125	1,125	89%
Joint (FSO)	301	301	246	246	82%
Joint (Retirement)	69	69	61	61	88%
Water	2,299	2,180	2,135	2,133	98%
Power	5,837	5,445	5,243	5,243	96%
LADWP TOTAL POSITIONS	11,963	11,369	10,577	10,560	93%

It is difficult for the Board to understand from its budget information that the funded positions it authorizes are not necessarily filled.

The Board can authorize 106 more positions in the FY 21-22 budget, but it will have no way of knowing whether those funded positions were filled, or need to be filled and

funded again, without more information. DWP management has very muted control over many of the elements that create 6% growth in total compensation. It can fill or not fill vacancies, but it does not control benefit costs, cost of living increases, the rate of attrition, and other forces negatively impinging upon a trained and safe staff. DWP cannot use a generally applicable vacancy number for the City and work well in all stages of the macro-economic cycles.

Due to turnover at the Board level, it is very challenging for the Board to appropriately supervise the balance between rate impacts and staffing consequences. OPA was very pleased to hear both the assistant general managers for water and power tell the Board on March 9, 2021 that they lacked the people needed. This is one small step in the right direction. As the chart directly above shows, those two executives have the best occupancy levels (98% and 96%), so these comments should be proportionately amplified when considering the joint division's current occupancy status.

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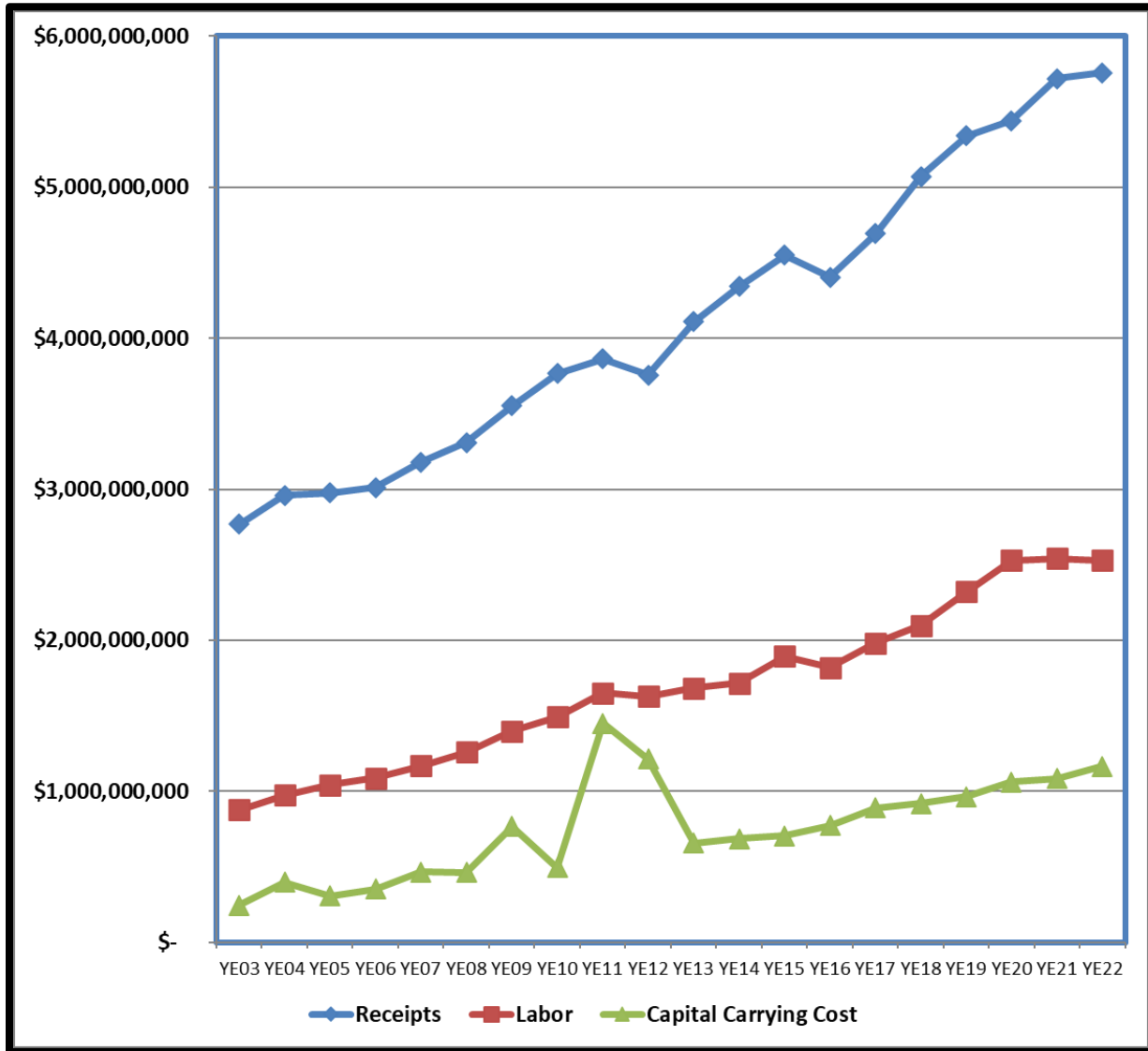
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VI. CONCLUSIONS

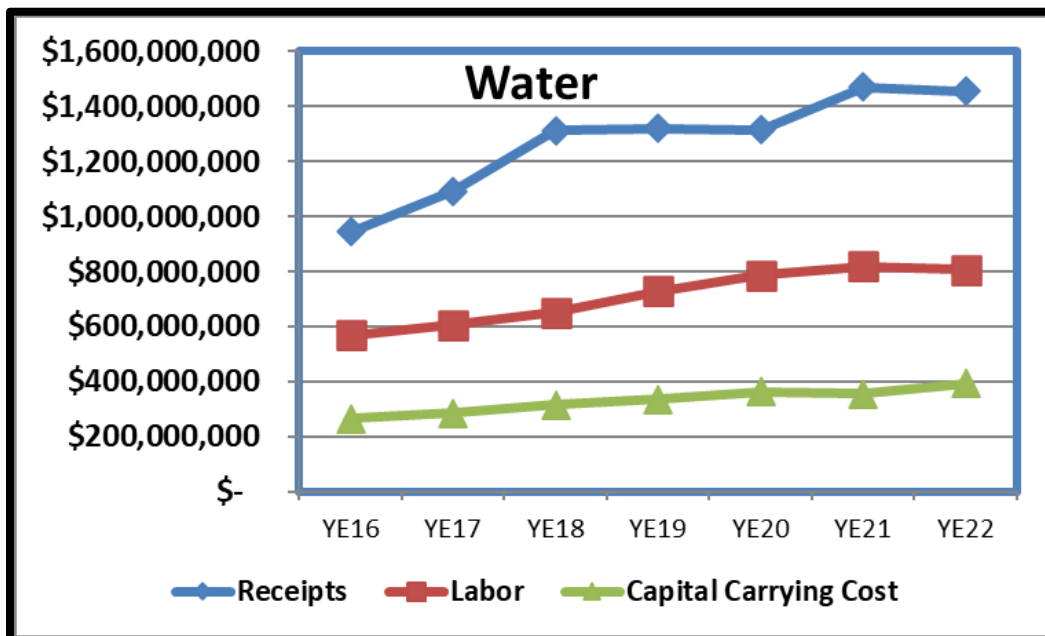
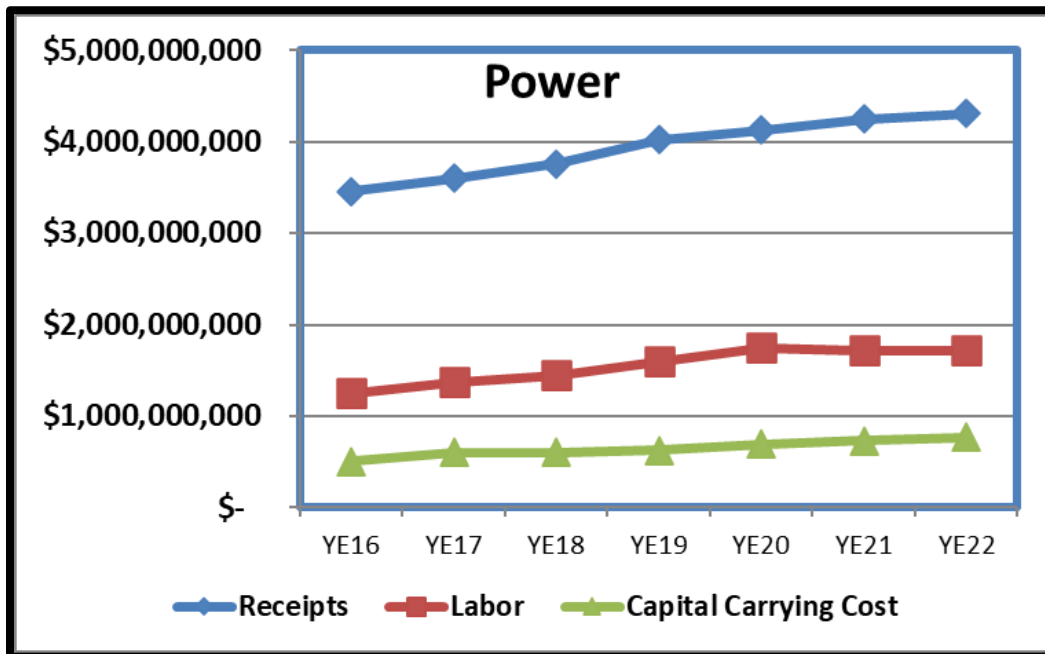
OPA would commend to the Board a wider, long term view of the DWP's revenue, the cost of labor, and the cost of capital support ("carrying costs"), as it evaluates and questions OPA's advice.



Capital carrying costs include interest and redemptions (financing), insurance, and real estate taxes, sometimes called "FIRE" as a short-hand.

Shorter term views for each fund are on the next page.

The shorter term view for each fund is:



OPA can update these graphics for the final budget so that the Board can better appreciate the mix of capital and labor that is in that budget.

cc: The Honorable Eric Garcetti, Mayor
Martin L. Adams, General Manager & Chief Engineer, Department of Water and Power

APPENDIX A

- OPA's labor exhibit from the rate case is incorporated herein as an attachment (i.e., "L-1", and in particular, Section A).
- The joint division total compensation proposed in the preliminary budget is \$84M higher than FY19-20 rate budgets.
- The joint division total compensation proposed in the report above by OPA is \$169.5M higher than FY19-20 rate budgets.
- The Board may direct the allocation of the total compensation amounts above FY 19-20 for wages, retirement, and health care costs of the Joint Division into Water and Power flow thru accounts.
 - OPA would encourage the DWP to use relative preliminary budget revenue amounts of the Power Fund (75% & \$4.30B) and Water Fund (25% & \$1.45B) expected in the coming year (FY21-22) to make these allocations.

L-1 OPA DATA REQUEST ON LABOR COSTS								
A. Three Systems' Labor Costs								
		FY14-15 APRV	FY15-16 E	FY16-17 E	FY17-18 E	FY18-19 E	FY19-20 E	FY20-21 E
1	Power System							
a	wages (CE 10 & 11)	\$ 503,670	\$ 527,303	\$ 539,581	\$ 553,130	\$ 565,263	\$ 594,653	\$ 598,176
b	pensions	219,133	199,307	192,439	180,689	173,054	164,578	151,084
c	healthcare	97,667	113,419	120,548	127,760	139,528	149,283	159,821
2	Water System							
a	wages	\$ 200,387	\$ 204,615	\$ 207,108	\$ 211,693	\$ 218,004	\$ 224,404	\$ 230,095
b	pensions	96,665	89,172	86,143	80,692	77,231	73,524	67,454
c	healthcare	43,083	50,745	53,962	57,055	62,269	66,691	71,354
3	Joint System							
a	wages (CE 10 & 11)	\$ 330,902	\$ 353,263	\$ 359,697	\$ 369,752	\$ 380,568	\$ 391,690	\$ 402,878
b	pensions	160,138	156,104	151,304	142,087	135,776	129,245	118,595
c	healthcare	71,373	88,834	94,781	100,466	109,472	117,234	125,453
	TOTAL DEPARTMENT	\$ 1,723,019	\$ 1,782,761	\$ 1,805,564	\$ 1,823,322	\$ 1,861,164	\$ 1,911,303	\$ 1,924,910
B. Two Funds' Labor Costs								
		FY14-15 APRV	FY15-16 E	FY16-17 E	FY17-18 E	FY18-19 E	FY19-20 E	FY20-21 E
1	Power Fund							
a	wages (CE 10 & 11)	\$ 707,222	\$ 746,727	\$ 763,627	\$ 783,637	\$ 804,478	\$ 840,768	\$ 851,371
b	pensions	320,089	299,456	289,573	271,978	260,288	247,611	227,281
c	healthcare	142,663	170,410	181,396	192,308	209,862	224,599	240,424
		\$ 1,169,973	\$ 1,216,593	\$ 1,234,596	\$ 1,247,923	\$ 1,274,627	\$ 1,312,978	\$ 1,319,075
	From Water (transfer)							
d	wages (CE 10 & 11)	\$ 92,124	\$ 96,640	\$ 100,188	\$ 101,160	\$ 101,619	\$ 103,412	\$ 106,686
e	pensions	42,809	40,428	40,040	36,916	34,876	32,841	30,205
f	healthcare	19,080	23,006	25,082	26,102	28,120	29,789	31,952
		\$ 154,013	\$ 160,074	\$ 165,310	\$ 164,179	\$ 166,615	\$ 166,041	\$ 168,842
	To Water (transfer)							
g	wages (CE 10 & 11)	\$ (76,962)	\$ (79,942)	\$ (80,984)	\$ (88,565)	\$ (91,011)	\$ (86,358)	\$ (91,290)
h	pensions	(33,152)	(32,091)	(31,241)	(33,773)	(32,434)	(27,247)	(26,176)
i	healthcare	(14,776)	(18,262)	(19,570)	(23,880)	(26,150)	(24,715)	(27,689)
		\$ (124,889)	\$ (130,295)	\$ (131,795)	\$ (146,217)	\$ (149,595)	\$ (138,320)	\$ (145,155)
	TOTAL Power Fund	\$ 1,199,097	\$ 1,246,372	\$ 1,268,112	\$ 1,265,885	\$ 1,289,647	\$ 1,340,700	\$ 1,342,762
2	Water Fund							
a	wages (CE 10 & 11)	\$ 327,737	\$ 338,453	\$ 342,760	\$ 350,938	\$ 359,358	\$ 369,979	\$ 379,779
b	pensions	155,848	145,128	140,313	131,489	125,773	119,737	109,852
c	healthcare	69,461	82,587	87,896	92,972	101,407	108,609	116,204
		553,046	566,169	570,968	575,399	586,537	598,324	605,834
	From Power (transfer)							
d	wages (CE 10 & 11)	\$ 76,962	\$ 79,942	\$ 80,984	\$ 88,565	\$ 91,011	\$ 86,358	\$ 91,290
e	pensions	33,152	32,091	31,241	33,773	32,434	27,247	26,176
f	healthcare	14,776	18,262	19,570	23,880	26,150	24,715	27,689
		124,889	130,295	131,795	146,217	149,595	138,320	145,155
	To Power (transfer)							
g	wages (CE 10 & 11)	\$ (92,124)	\$ (96,640)	\$ (100,188)	\$ (101,160)	\$ (101,619)	\$ (103,412)	\$ (106,686)
h	pensions	(42,809)	(40,428)	(40,040)	(36,916)	(34,876)	(32,841)	(30,205)
i	healthcare	(19,080)	(23,006)	(25,082)	(26,102)	(28,120)	(29,789)	(31,952)
		\$ (154,013)	\$ (160,074)	\$ (165,310)	\$ (164,179)	\$ (164,615)	\$ (166,041)	\$ (168,842)
	TOTAL Water Fund	\$ 523,922	\$ 536,390	\$ 537,453	\$ 557,437	\$ 571,517	\$ 570,603	\$ 582,147
	TOTAL DEPARTMENT	\$ 1,723,019	\$ 1,782,761	\$ 1,805,564	\$ 1,823,322	\$ 1,861,164	\$ 1,911,303	\$ 1,924,910
C. Rate Revenue Required, Given Stated Capitalization of Labor Costs								
		FY14-15 APRV	FY15-16 E	FY16-17 E	FY17-18 E	FY18-19 E	FY19-20 E	FY20-21 E
1	Power Fund							
a	O&M	\$ 713,382	\$ 744,242	\$ 755,255	\$ 778,966	\$ 800,473	\$ 825,089	\$ 840,609
b	Capitalized	485,716	502,130	512,857	486,918	489,175	515,610	502,154
	TOTAL Revenue Required	\$ 1,199,097	\$ 1,246,372	\$ 1,268,112	\$ 1,265,885	\$ 1,289,647	\$ 1,340,700	\$ 1,342,762
2	Water Fund							
a	O&M	\$ 301,680	\$ 307,369	\$ 314,778	\$ 334,070	\$ 345,129	\$ 337,323	\$ 346,566
b	Capitalized	222,242	229,020	222,675	223,367	226,388	233,280	235,582
	TOTAL Revenue Required	\$ 523,922	\$ 536,390	\$ 537,453	\$ 557,437	\$ 571,517	\$ 570,603	\$ 582,147
	TOTAL DEPARTMENT	\$ 1,723,019	\$ 1,782,761	\$ 1,805,564	\$ 1,823,322	\$ 1,861,164	\$ 1,911,303	\$ 1,924,910
Recommendations:								
Use "e" for estimates; use accrual accounting unless footnoted othe Alternatively, discuss other options with OPA.								
Source: LADWP Data Request Response FSO_FY16_22_Labor Costs Excel								