REPORT FROM

OFFICE OF PUBLIC ACCOUNTABILITY

Date: March 26, 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 P.9, Fiscal Year 2024 to 2025 Preliminary Budget of the Department of Water and Power

RECOMMENDATIONS

The Office of Public Accountability (OPA) respectfully recommends that the Board of Commissioners (Board) of the Los Angeles Department of Water and Power (DWP) include two additional Resolution provisions, separately or together with the Resolution submitting the preliminary budget of DWP for Fiscal Year (FY) 2024 to 2025.

1. 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.

2. Because grant funding was secured that entirely offsets the FY2022-2023 costs of free power interconnections to homeless housing developers for their projects, OPA recommends that the Board find no City general tax appropriation is needed in FY2024-2025 to pay this policy's FY2022-2023 costs.

DISCUSSION

More than ten years have passed since two limitations began affecting intra-City payments between DWP funds and City funds. OPA tracks and monitors these flows of funds in order to issue opinions about the reasonableness of rates, concurrent with regular rate adjustments that occur quarterly, semi-annually, and annually. Reasonable rates have a component of justice, which underscores the non-discriminatory principles of rate setting, and leads to the phrase "just and reasonable" in common practice. An important component of justice in DWP's case involves ensuring non-discriminatory practices with respect to the City as a customer of water and power services. No other customer has a similar opportunity to transfer its cost of business to DWP, or alter the otherwise applicable rates and practices.

DWP would have higher levels of public trust if there were a regular, institutionalized mechanism to ensure that costs incurred by DWP, when final and audited, are correctly allocated to rate revenue or tax revenue. Final and audited costs in a prior year (e.g., FY2022-2023) are available in January of a current year (e.g., FY2023-2024), to inform corrected allocations in the coming preliminary budget for the next year (e.g., FY2024-2025). The City regularly addresses multi-year budgeting issues, and many consider a five year forecast framework to be best practice when addressing municipal budgets generally.

In OPA's opinion, the most efficient method of correctly allocating costs in any grey zone between rate revenues and tax revenues arises with DWP's preliminary budget, which can timely advise the City and Mayor of appropriations in the next year, if any are triggered by non-rate policies, programs, and practices in the prior year.

The upcoming Fiscal Year 2024-2025 presents two such opportunities to secure inter-City, multi-year appropriations in the aftermath of Propositions 218, 26, and the settlement of the power transfer litigation. The most recent and audited year of origination is DWP's Fiscal Year 2022-2023. During that year, two important policy choices – favoring homeless housing and equity towards disadvantaged customers – were acted upon by the DWP Board. Before taking up these two subjects, a brief review of intra-City fund flows sets out the context of these two, relatively small areas of expenditure.

1. Inter-City Flow of Funds, Fiscal Year 2022-2023

Excluding sanitation billings, in FY 2022-2023 DWP transferred to City accounts:

- $232,043,000 for the transfer of surplus money from the Power Fund,
- $450,846,521 for the utility users tax,
- $136,438,324 for services rendered to the DWP, an amount that includes $46,280,050 in street damage restoration fees, and
- $129,515,441 for past due water and power bills of the City, of which $91,165,149 were over 120 days past due.

The cumulative amount for all items above, using only the bills over 120 days, is $910,492,994, or $864,212,944 excluding the street damage restoration fee.

An aspect of monitoring these fund flows involves evaluating the relative change since the power and water base rates were last reviewed. Are these changes within the DWP's ability to pay, without reducing or delaying needed infrastructure in its capital improvement plans?

To answer this question, OPA examines marginal changes, and it is in that context that policy expenditures without a nexus to cost of service can arise.

- First, due to a litigation settlement, the transfer of surplus money from the Power Fund is down $20,957,000 from the 2013-2014 cost history that was used in the last rate case ($253,000,000).
- Second, the utility users tax has increased by $120,237,521 from $330,609,000.
- Third, the inter-departmental services have increased by approximately $30-$40M, a range that reflects some variation in the baseline years before the rate review ($55M FY2012-2013 to $64M FY2013-2014). This marginal change excludes the street damage restoration fees, initiated after 2016.
- Fourth, the accounts receivable has approximately doubled, although assessment is complicated by controlled and uncontrolled changes in DWP's billing systems.

The cumulative change is at least $129,280,521, using the lower figure for inter-departmental services, and excluding (i) changes to City accounts receivable, and (ii) street damage restoration fees (a new fee of approximately $46M). With all of these costs included, the changes are between $200 - $250M.[1]

Total sales budgeted for the FY2022-2023 by DWP was $6,397,674,000. Therefore these changes in the intra-City fund flows with DWP have not exceeded 3-4% of sales. DWP's unit labor costs and unit non-labor costs have produced sufficient net income to buffer the scale of these changes since the last rate review. However, it cannot be said that adding non-rate costs to this amount is free of adverse consequences to ratepayers.

2. Diminished Purchasing Power of Low Income and Lifeline Credits For Power Customers

The combined FY2009-2010 expenditure on low income and Lifeline credits was $33,887,913. This amount is grandfathered in the current rates. (This is composed of approximately $13.9M for low income and $19.9M for Lifeline.) Much has already been

[1] Final power case 143 from the last rate case forecasted a power transfer amount of $360M for FY2021-2022, which did not occur due to the litigation settlement. It is worth noting that such an increase ($107M), had it occurred, would not necessarily have insulated DWP customers from increases in inter-department charges.

written about the loss of purchasing power associated with these credits for disadvantaged customers.

Every year that passes reduces the value of these 2010 credits further. While many alternative proposals have been put forward, none of the proposals curb the effects of waiting. In OPA's opinion, a gradual, annual adjustment for inflation, is long overdue.

A reasonable objective is to double the funds in a 20 year horizon, which is an addition of $1.5M each year. Had this been done over the last 10 years or so, the funds available would have expanded by $15M, leaving the City with $120,237,521 minus $15,000,000 or a net $105,237,521 increase in utility users tax. This result would have yielded the City 97% of the utility users tax.

OPA is unaware that the DWP Board has ever requested of the City Council and Mayor an appropriation that would return a portion of DWP's utility users tax for this purpose. OPA recommends making this request now for $1.5M, and adding $1.5M to it each year in the future.

Such a request is timely, and it need not wait for any other remedies brought about by federal or state appropriations, collaboration with non-profits, or referendums seeking relief from Proposition 26 by the Los Angeles voters. All other tax revenue sources or voter-approved exceptions that may later be applied would be welcome. If they occur later, these options can only help purchasing power "catch up" after 14 years.

3. Emergency Authorization for Homeless Housing Developments and Interconnections

The policy of providing free power interconnections to homeless housing developments has been grant funded for the only year with audited and final costs. As such, the policy does not at this time trigger any recommendation to seek an appropriation from tax revenues.

However, as time passes and the emergency-related costs change, the annual preliminary budget of DWP would be the most efficient and effective time to apprise the City of this policy's costs. The Board's existing resolution should serve to annually apprise the Board of costs in January, so it can incorporate requests for appropriations of tax revenues in the submission of the DWP's preliminary budget. That is a time when the City's budget process can consider whether and when reimbursement is desired by the City Council and Mayor.

CONCLUSION

OPA's total of nearly $1B dollars transferred from DWP to the City in FY2022-2023 excludes other amounts that are not easily quantified. In this setting of transfers that have grown significantly, it is not too much to ask the City Council and Mayor to return to DWP $1.5M of utility users tax in FY2024-2025. DWP has demonstrated with pandemic aid funding that it can administer this form of additional assistance, which is the most immediate and secure revenue source available.

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