

CITY OF LONG BEACH

Consolidation of Water and Gas Utilities Feasibility Report



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Prepared by:

BB&E

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INTRODUCTION

At the request of the City of Long Beach's (the "City") utilities, Bell Burnett and Edwards ("BB&E") has prepared this Feasibility Report (the "Report") for the City's exclusive use and consideration. The purpose of the Report is: (i) to assess the preliminary feasibility of merging the City's water utility and gas utility into a single, consolidated entity (the "Consolidation"), (ii) to identify certain high-level considerations that the City may want to evaluate in connection with the Consolidation, (iii) to make a preliminary finding as to the potential economic benefit or cost of the Consolidation and (iv) to outline potential next steps should the Consolidation merit further examination.

BB&E is a management and strategic consulting firm serving the utility and transportation industries. We offer an independent development, review and assessment of strategic plans and initiatives by our clients in the private and public sectors. Our team brings an interdisciplinary approach from capital improvements to operations to finance. We draw on the principals' past experience working at the highest levels in the utility, banking and consulting industries. Our approach centers on optimization, increasing efficiency and building sustainability with services designed to enhance our clients' governance, communication, project delivery, resources, and systems integration.

APPROACH AND METHODOLOGY

In connection with the Report, BB&E has reviewed information provided by the City. While BB&E does not make representation as to the completeness or accuracy of such information, BB&E's findings are based on our review of the City's Annual Budget FY2020, Budget Summary FY2020 for Long Beach Water, FY2020 Budget Summary for the Energy Resource Department, City of Long Beach Water Department Strategic Plan, summary of overhead allocations by department, and FY2020 Adopted Capital Improvement Program Budget.

In order to reach the preliminary findings herein, BB&E has focused on four primary policy, business and operational considerations. These areas include: i) governance, ii) labor, iii) customer service levels, and iv) budget, operations, maintenance and capital improvements. In the opinion of BB&E, these are meaningful areas to focus on initially and provide reasonable breadth to make a preliminary assessment as to the feasibility and potential benefit or cost of Consolidation.

In reaching the summary of economic benefit or cost, we would also highlight that these estimates are tied to the ultimate implementation plan of any Consolidation. The speed, breadth and timing of any changes resulting from Consolidation will impact the level and timing of any potential savings, and actual result may vary. How the City elects to capture any inefficiency, what corresponding organizational changes may or may not be implemented and the timing of any re-purposing and attrition associated with these changes will all meaningfully

impact the ultimate economics of Consolidation. Some changes may be faster or easier to implement and some may take more time. Not all changes will have commensurate economic or organizational value. In order to address this timing consideration, the Report provides a range of economic benefit by estimating short-term impacts, which are assumed to be more modest and immediate, and long-term impacts, which are assumed to grow over time and be realized over the next five years as the City learns from and reacts to the potential Consolidation.

This list of considerations is not intended to be exhaustive or all inclusive, and additional work may be necessary to expand on the preliminary findings of the Report, including identification of any additional stakeholders that may be impacted by the Consolidation, additional detailed analysis to confirm the preliminary cost and benefit estimates, and expanded analysis should additional policy, organizational, cultural, operational and financial considerations merit further study.

SUMMARY OF FINDINGS

Consolidation is a large and complex undertaking. There will be meaningful and significant organizational, cultural, operational and financial considerations. The City will need to carefully develop and implement a detailed plan for the Consolidation that takes these factors into consideration. The timing and effectiveness of this plan will govern the success of the Consolidation. Assuming the successful deployment of this plan, BB&E believes it is reasonable to assume significant benefits for the gas, water, and sewer customers, the utilities themselves, and the City. It is further reasonable to assume that these benefits will be realized in policy design, governance, operations, capital programming, and finance and will meaningfully increase over time.

The two most significant benefits in our opinion will surround customer service and governance. While these benefits are harder to quantify economically, we would suggest that they may be the most impactful. Having a single regulatory body governing decisions, priorities and rate setting should not only create greater transparency, oversight, consistency, and efficiency, but also enhance customer service. The City's customers can expect better communication, a better ability to voice concerns and a transparent rate setting process based on a holistic approach. Service delivery should be improved over time, while utility pipeline street work will be better coordinated so as to be less disruptive to the streets and traffic in Long Beach neighborhoods. Regardless of the potential economic value, consistent and holistic policy development should meaningfully enhance customer service, and this potential benefit of Consolidation is arguably the most valuable.

Based on our review of the information provided, BB&E believes it is reasonable to assume that there will be benefits from the Consolidation, and these benefits will be governance, service, financial, operational and capital related.

BB&E makes the following findings:

- From a governance perspective, we believe that there is significant value in consolidating under a single City Department, and it is reasonable to assume more efficient and streamlined operations over time, with greater efficiency, transparency and prioritization in program delivery, policy design and rate setting.
- From a labor perspective, we believe that it is reasonable to assume that cost savings will not need to rely upon any initial labor reduction and that any changes to the labor force will be driven by attrition and re-purposing over time. Further, we believe that Consolidation will create new opportunities for employees in skills' development and cross training that will be beneficial by increasing mobility and career advancement opportunities.
- From a service perspective, we believe that is reasonable to assume that there will be no negative and only positive impact on customers, subject to the governance and organizational management of any Consolidation. This benefit will be realized from holistic utility rate setting, less disruption in the delivery of services, and enhanced emergency response, among other factors.
- From a budget perspective, financial benefits include cost savings over time. From an operating and maintenance perspective, we believe it is reasonable to assume increased efficiency of operations over time with increased flexibility in resource development and deployment, including personnel and equipment. We estimate modest initial cost savings of \$2,750,000, growing to \$6,500,000 over the next 5 years, depending on the speed and course of implementation. Further, there should be increased efficiency in the development and deployment of capital resources, including the coordination of project delivery in regard to pipeline construction, replacement and maintenance.

GOVERNANCE

We believe it is reasonable to assume that the City will accrue significant benefits from a governance perspective through Consolidation. This is not to say that the current governance structure has been problematic or ineffective. In contrast, the City's utilities have delivered high level customer service. While less quantifiable, we believe as a qualitative factor that governance can only be improved by consolidating leadership. We believe it is reasonable to assume that there are two areas where there could be potential enhancements in governance. The first is the consolidation of governance under a single City Department, rather than today's dual but separate governance of the City Manager overseeing the gas utility while the Water Board of Commissioners separately oversees the water and sewer utilities. The second is the consolidation of the utility enterprise funds under a single Utilities Commission, overseeing the utilities and accountable to the customers and ultimately to the City Council.

Potential improvement in governance comes from setting clear and integrated policies, priorities and implementation in program design and execution. While the City Council will remain as the ultimate regulatory body governing the utilities' budgets and rates, a Utilities

Commission can provide a holistic approach to customer programs and alignment of priorities. Utility rates will not be set separately under different policy frameworks, and just as customers receive a single utility bill, rates will be set on an integrated basis with overall household cost impacts being a meaningful component of policy decision making.

Streamlining processes by consolidating under the Utilities Commission structure should also reasonably lead to process efficiencies, as well as making clear the bright line between policymakers and administrators. It should allow the policymakers additional time to consider the will of the public as opposed to dealing with incremental administration issues. The City Manager, on a daily basis, oversees and manages major operations involving police, fire, parks and recreation, libraries, public works, health, and other services offered to Long Beach residents and most recently, responding to the COVID-19 crisis. It is understandably unrealistic, and inappropriate, to expect that the City Manager also provide anywhere near a similar level of oversight of the City's gas utility despite its provision of a critical service to virtually every Long Beach resident and business. In contrast, the current Water Commission provides policy oversight solely focused on the City's water utility and the services it provides. A Utilities Commission, by definition, should provide both an additional buffer and filter for the City Council in reviewing the issues specific to the operations and direction of the utilities.

A Utilities Commission is arguably better for customers as well. Just as the Utilities Commission becomes a central point for reviewing and vetting utility-centric issues, customers know that they have a governing body that is focused on the priority issues of the utilities. There is now a single place for residents to raise questions and voice concerns that are utility specific.

Similarly, having operations consolidated under one City Department should allow for operational efficiencies over time as business and administrative functions are reviewed. Given internal service allocations and transfers of revenues, having one City Department oversee the totality of operations and costs should help rationalize these costs and allocations because Consolidation will give the City the opportunity to consider broader utility organizational changes over time. The current organizational structure of the entity as whole does potentially lend itself to greater efficiencies with a Consolidation. Given additional process and workflow reform, there may be opportunities for increased efficiencies or potential re-purposing over time in administration, clerical, procurement, information services, security, customer service, warehousing, fleet, AMI, finance and analysis groups, depending on a more detailed analysis of their job functions and as the City learns from and reacts to lessons learned as Consolidation is implemented.

It is also worth noting that consolidated utilities are a strategy that other municipalities have used to great success and many of the potential benefits for the City have been realized elsewhere. It is common in other California cities to have utility services combined into one operation. For example, in Southern California alone, the cities of Anaheim, Azusa, Banning, Burbank, Colton, Glendale, Los Angeles, Pasadena, Riverside, and Vernon all operate combined electric and water utilities. This is not to discount the need for distinct operational and accounting separation. However, each of these communities has been able to realize the

benefits in rate setting, operations and policy development from a consolidated governance structure.

One reason that these communities have been successful with consolidated utilities is because some level of business and operational functions typically appear in multiple areas of an organization. In our experience, it is reasonable to assume that efficiencies could be gained by Consolidation over time, even via the historical attrition rate of 5% and organizational repurposing as circumstance warrant. These potential efficiencies would have to be tempered by operational requirements and by a class specification review to ensure impacted classifications could, in fact, be combined without a restructuring under the current rule set, subject to meet and confer discussions involving the appropriate organized labor groups. Further, a market analysis of those potentially consolidated positions may be considered to ensure general market parity, employee retention, and employee attraction.

LABOR

One key consideration in the success of any Consolidation is the potential impact on the City's water, sewer and gas labor force. Importantly, the Report assumes that there will be no reduction in the labor force resulting from the Consolidation other than assumed attrition over time. Without the need to have the projected economic benefit of Consolidation predicated on an assumed reduction in the labor force, we believe that it is reasonable to assume that employees can benefit from the Consolidation. This benefit is assumed to result from the ongoing and increasing cross fertilization of the business lines.

A consolidated entity should provide existing employees with various opportunities in job and skills training and career advancement. The very nature of the Consolidation should promote the benefit of skills diversification, and indeed, the City should welcome and proactively promote greater training and corresponding career advancement for employees. This will result in more efficient operations, a healthy culture, greater employee retention/attraction and the highest level of customer service. As employees, or some subset, grow their skills to cover potentially different enterprises, it will only make them more valuable to the City, and we would expect that an increase in value will similarly lead to an increase in compensation over time.

In terms of expected attrition, we believe it is reasonable to assume 3% to 5% moving forward. Total personnel related costs are approximately \$54 million based on the FY20 Budget. Depending on actual attrition rates, this would result in short-term saving (years 1-2) of \$0.5 million, growing to \$1.6 to \$2.7 million within 5 years. In our experience this is a conservative estimate as once labor and management buy into the potential benefits of Consolidation, they both realize that the efficiencies actually make their jobs easier, less bureaucratic and with greater opportunity for advancement.

We believe it is desirable to integrate the work force directly into the discussion about any merits or concerns they might have resulting from Consolidation. Our experience is that employees will have direct and actionable ideas on where best to extract efficiencies in operations, maintenance and capital delivery. We further believe that the organized labor unions can be a tremendously effective advocate and their support should be welcomed.

SERVICE LEVELS

The underlying premise and requirement of any Consolidation is that customer service will be improved. The City will continue to provide exemplary customer service and in large part, the Consolidation is intended to be invisible to the customer. That said, to the extent that the City can identify areas where greater efficiency can be extracted, we believe it is reasonable to assume that the customer experience will benefit over time. This benefit comes from better coordination and streamlining of services in many of the areas that touch customers each day, including the call center, billing and payments, on site customer calls and the delivery of capital projects in the customers' neighborhoods. Given these areas, we believe it is reasonable to assume that customer service can be positively impacted over time.

The City has identified areas of similar operations between the gas and water utilities that may present the opportunity for greater efficiency and the potential for cost savings. These include the following:

- Pipeline Installation
- Engineering
- Inspection services
- Customer service
- Quality control
- Meter installs
- Meter testing
- Meter reading/AMI
- Utility billing
- Regulatory affairs
- Warehouse
- Purchasing
- Conservation
- SCADA systems
- Customer turn-ons
- Customer turn-offs
- Electrical
- Utility call center
- Accounting
- Personnel administration
- Payroll
- Utility rate setting
- Regulatory compliance
- Pipeline maintenance
- Budgeting
- Accounts payable
- Commodity procurement
- Equipment maintenance
- GIS
- Dispatch
- Legislative affairs
- Cathodic protection
- Welding
- Industry organizations
- Executive administration
- Construction crews
- Emergency response
- Safety
- Security
- Marketing
- Temporary paving
- Permanent paving
- Leak detection
- Planning
- 24-hour system control
- Pipeline repair
- Equipment purchases
- Training

Many of these areas impact customers on a day to day basis. As straight forward as it seems, coordinating project delivery can be hugely impactful for residents. Disruptions in the streets and in front of customers' homes can be minimized. Consolidating functions can lead to greater efficiency in the delivery of customer service. For example, as the labor force diversifies

and builds its skills sets, it can only enhance the utilities response for both normal and emergency circumstances. To the extent that any of these efficiencies ultimately lead to cost savings, it will only help to provide enhanced customer service and/or rate setting.

BUDGET, OPERATIONS, MAINTENANCE AND CAPITAL IMPROVEMENTS

One important consideration in evaluating the feasibility of the Consolidation is looking at the budget for the respective enterprises. Specifically, we can look at the different categories within the FY20 budget to see where potential savings might accrue in operations, maintenance and capital improvements. This gives the City the ability both to evaluate the magnitude of the potential opportunity and to frame the likelihood of success in realizing any benefit.

For purposes of this report, we have focused much of the budget evaluation on the entire Water Department (“Water”), which currently includes both the water and sewer operations, but for the Energy Resources Department, the enterprise functions of oil and SERRF were excluded so as to focus on the gas utility operation (“Gas”) along with any other utility support functions. Water expenditures (including sewer) for FY2020 are projected at \$156.3 million. These expenditures are broken out into 12 categories as outlined below:

<u>Category</u>	<u>WATER DEPARTMENT</u>	
	<u>FY 2020 Budget (\$000)</u>	<u>% of FY 2020 Budget</u>
Purchase, Pump & Treatment	43,768	28%
Personnel	32,230	21%
Capital Improvement	30,716	20%
Gen Fund Transfer	14,772	9%
Materials and Supplies	8,444	5%
Interdepartmental Charges	11,483	7%
Debt Service	6,207	4%
Contracts/Outside Services	4,213	3%
Alamitos Barrier	1,069	1%
Cap. Equipment	2,180	1%
Power	102	0%
Overhead Transfer	1,069	1%
Total Expenditures	156,253	100%

When we look at these categories on a more granular level, we would note that only 8% of the FY20 Budget relates to materials and supplies and contracts/outside services. The balance (92%) appears to be for non-discretionary operating costs, capital related, internal cost allocations and consistent with the voter-approved City Charter. This leaves \$12.7 million in materials and supplies and contracts/outside services where potential savings might accrue.

The magnitude of any savings will be dependent on how much, if any, of these Water costs are duplicative with Gas and what kind of efficiencies might be extracted from taking a joint approach to resource procurement and deployment.

Energy Resource Department Fund expenditures for FY2020 are projected to be \$233.8 million, which includes roughly \$90 million for Gas with the balance related to the City’s oil and SERRF enterprises. We have focused on the Gas expenditures as that is the utility enterprise being considered for consolidation with Water. From the Gas expenditures, we can break out in more detail by use of funds within the adopted FY20 Budget. Using a similar methodology to the Water Fund, we note that approximately 13% or \$12.0 million of the FY20 Budget for Gas relates to materials and supplies and contracts/outside services.

Category	GAS FUND	
	FY2020 Budget (\$000)	% of FY2020 Budget
Personnel	22,153	24%
Utilities	256	<1%
Gas purchase, sale, storage and Transmission	31,490	34%
Contracts/Outside Services	10,795	12%
Materials and Supplies	1,195	1%
Debt Service	1,420	2%
Interdepartmental Charges	11,307	12%
Transfers	12,801	14%
Total Expenditures	91,419	100%

We believe it is reasonable to assume that joint services such as administration, finance, warehouse/purchasing and the use of outside services/contracts will produce some efficiencies. This is not to say that all of these expenses are duplicative, and indeed, we understand that many of these services and supplies are essential in continuing to provide exemplary customer service. However, the different departments do separately spend on materials and services in the same areas, and the question would be if some level of greater efficiency could be extracted through joint procurement, economies of scale benefits, and/or coordination of delivery. Potential examples that may merit additional evaluation include paving, landfill, construction and building contracts, machinery and equipment repair, software maintenance, fleet purchasing and maintenance, customer service and call center, temp staffing, office supplies and memberships.

It is also worth noting that the operational and technical requirements of each of the utility enterprises are distinct. Water handles its own fleet procurement and maintenance while Gas relies upon the City’s Fleet Services, under the Department of Financial Management, for its procurement and fleet maintenance. However, even without consolidating fleet services on a wholesale basis, there may be areas of procurement or routine maintenance that might be valuable candidates for cost savings without negatively impacting the delivery of services or the

operations of the respective enterprise. Another example might be in billing and collections or other traditional back office functions. Key will be having a holistic view as to business functions and seeing what areas over time, or even subsets of existing business functions, offer the best opportunity for increases in efficiency and cost savings.

On a short-term basis, if the City could realize 5% in savings from jointly procuring outside contracts and services (\$15 million), this could result in \$750,000 in savings based on the FY2020 Budget with an objective to grow these savings to realize 10% greater efficiency or \$1.5 million over the next five years. If the City was able to realize a 5% efficiency in the joint budget for materials and supplies for the Gas, Water and Sewer enterprises (\$10 million), this could result in approximately \$500,000 in savings based on the FY2020 Budget, growing to 10% or \$1,000,000 over the next five years.

We have also taken a preliminary look at the Capital Improvement Programs for the different utilities. Water and Sewer are projecting FY20 capital expenditures of \$30.7 million with water at \$25 million and sewer at \$5 million. Gas is projecting capital expenditures of \$8 million. Importantly, this is not to suggest that these expenditures are duplicative or the need for or prioritization of capital expenditures would change under Consolidation. It is to note, however, that one significant expenditure category of all three enterprises is to replace aging infrastructure.

We believe that it is reasonable to assume that the coordination of water, sewer, and gas pipeline projects will result in efficiencies and cost reduction. Gas estimates approximately \$16.8 million in the FY2020 Budget for pipeline construction and maintenance (inclusive of emergency response and cathodic protection and corrosion control), and Water is projecting \$3.8 million in pipeline improvements, replacement and repair. A 5% benefit coordinating pipeline construction and replacement could result in \$1 million in savings based on the FY2020 Budget with the objective to grow this efficiency over time to 10% or \$2 million.

In addition, the benefit of coordinating pipeline projects is not tied solely to reducing costs by tearing up and replacing the streets fewer times. Better coordination of these services results in greater resident satisfaction since project work is performed all at once instead of piecemeal. The underground nature of replacing pipelines puts a premium on coordinating delivery of these projects so the street dislocation and repair as well as resident impact are all minimized. Regardless of any potential cost savings, the potential benefit to residents of minimizing dislocations is hugely impactful. As with all utilities, residents want their utilities to work, be cost effective and not impact their day to day lives. Coordinating project delivery is a key component of customer satisfaction and can only benefit from Consolidation.

SUMMARY OF ESTIMATED ECONOMIC COST/BENEFIT

Provided below, we summarize the different components of the Report that contribute to the overall assessment of any financial cost or benefit from Consolidation. We would again caution

that these are estimates predicated in the ability to extract greater efficiency through joint resource planning, procurement and deployment, and actual results may vary.

We would also highlight that these economic estimates are only one component of the broader list of potential benefits – some of which may be arguably more important - that we have presented in our findings. We have not calculated a value on any benefits to governance in terms of policy and program design, customer service or skills training and career development for employees, but all of these benefits are real and meaningful. Having a unified management structure can only help the City in making coordinated and informed decisions about resource deployment and in meeting the City’s mission to provide exceptional service to its customers and residents. We believe it is reasonable to assume that the benefits in terms of governance and ultimately customer service may be the most impactful considerations, regardless of any potential economic savings.

There are considerable variables that will impact the level and timing of the actual results, not the least of which how any plan for Consolidation is developed and actually implemented. How the City elects to capture any inefficiency, what corresponding organizational changes may or may not be implemented and the timing of any re-purposing and attrition associated with these changes will all meaningfully impact the ultimate economics of Consolidation. Some changes may be faster or easier to implement and some may take more time. Not all changes will have commensurate economic or organizational value. In order to address this timing consideration, the Report provides a range of economic benefit by estimating short-term impacts, which are assumed to be more modest and immediate, and long-term impacts, which are assumed to grow over time and be realized over the next five years.

We have identified certain areas that may yield greater operational flexibility and efficiency and would further caution that additional and more detailed analysis may be warranted to vet and refine these estimates, especially given the detailed and distinct technical nature of the different enterprise funds. Our forecast for reductions in personnel costs do not assume any change in labor other than through attrition over time. We do believe that these estimates are illustrative and supportive of the broader trends and conclusions that can be drawn in regard to the potential Consolidation. A summary of the estimated economic benefit is found below.

CATEGORY	EST. POTENTIAL SAVINGS	EST. POTENTIAL SAVINGS
	SHORT-TERM	OVER NEXT 5 YEARS
Personnel	\$500,000	\$2,000,000
Contract/Outside Services	\$750,000	\$1,500,000
Operations and Maintenance	\$,500,000	\$1,000,000
<u>Capital Improvement Program</u>	<u>\$1,000,000</u>	<u>\$2,000,000</u>
TOTAL	\$2,750,000	\$6,500,000

CONCLUSION

In conclusion, the Consolidation is a large and complex undertaking. There will be meaningful and significant organizational, cultural, operational and financial considerations. Should the City decide to move forward, it will need to carefully develop and implement a detailed plan for the Consolidation that takes these factors into consideration. The timing and effectiveness of this plan will govern the success of the Consolidation. Assuming the successful deployment of this plan, BB&E believes it is reasonable to assume significant benefits for the City, the utilities and its customers. It is further reasonable to assume that these benefits will be realized in policy design, governance, operations, capital programming, and finance and will meaningfully increase over time.

NEXT STEPS

If the City elects to proceed with evaluating the Consolidation further, BB&E recommends that the City consider:

- Updating and expanding the Report as needed to include: i) the identification of any additional stakeholders that may be impacted by the Consolidation, ii) additional detailed analysis to confirm the preliminary cost and benefit estimates, and iii) expanded analysis should additional policy, organizational, cultural, operational and financial considerations merit further study.
- Evaluating the potential benefit of retaining a workflow processing consultant. The objective would be to conduct a comprehensive review of joint business functions to identify where resources could be potentially re-programmed over time while maintaining or improving customer service levels. As but one example, we have experience with utilities who found that work process flow analysis discovered where many more employees were “touching” a document than were needed, resulting in unnecessary time and expenditure.
- Developing a Utility Consolidation Implementation Plan (“UCIP”) that would: i) detail required steps for the Consolidation, ii) outline milestones for implementation and iii) lay out the timing of each step and milestone. The goal of the UCIP would be to develop a transparent plan to build stakeholder consent and a clear blueprint for the implementation of the Consolidation.

DISCLAIMER

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