

2017 MSD Operating Budget Recommendation

EXECUTIVE SUMMARY

MSD submitted a budget request for the Operating Budget of approximately \$129.4M for operations and maintenance (O & M) plus Debt Service of \$114.4M. This document focuses on the O & M portion of the budget. Following this executive summary is an example of the detailed analysis performed by the monitor. This analysis pertains to the Office of the Director (OOD). Similar analyses were performed for each department. This section is intended to provide explanation of the rationale for the County Administration budget recommendation and serve as a template for future budget submissions.

The format and level of detail of the information provided by MSD for the O & M budget request submissions has improved over the past three years, but is still not at a level of detail so as to allow the County to perform a thorough evaluation of the request, and serve as a basis for a recommendation to the Board. As in year's past, there are areas that the County sees as having merit; however, in several areas insufficient information is provided by MSD to allow the County to assess the cost of the activity in contrast with the benefit provided. The County has assessed the available information provided by MSD. The County presented questions to MSD regarding the budget request submission. Unfortunately MSD only provided partial responses that provided minimal additional information and insight.

In light of the limited information provided, County Administration determined to prepare a recommendation for the Board that is bi-furcated by the ally Supported spending (those activities and items that are required and fairly consistent year to year) and the Policy Dependent spending (those items that are more discretionary in nature and tend to vary from year to year). In an effort to be consistent with the 1968 Agreement, the O & M budget was split into personnel and non-personnel categories.

Personnel

MSD's requested 2017 personnel budget represented approximately a 13% increase over the MSD projected spending for 2016. MSD management was required by the Board's 2016 Budget Resolution to provide a Staffing Plan to the County by 1/31/16 to cover the 2016 staffing levels and beyond. To date a staffing plan has not been provided by MSD management. In the absence of the required plan it would appear logical to the County to conclude that the staffing should remain consistent with the 2015 levels. Based on this, and considering the salary increases granted in 2016 and 2017 by the City, wages for 2017 based on Historically Supported levels is recommended to be \$35M.

The calculation of benefit expense is based on a percent of salaries. The percentage MSD used in their 2017 request is 5% higher than the ratio reflected in the 2015 audited financials. The rationale for the increase has not been provided by MSD to date. For purposes of this document, the benefits are estimated at \$11M. The recommendation is that additional personnel costs in the MSD request beyond the County Administration recommendation of approximately \$3M be included in the Policy Dependent spending funding.

Non-Personnel

The non-personnel portion of the MSD requested budget is approximately 10% higher than the approved budget for 2016. When considered in combination with the requested increase in personnel

this appears to be inconsistent. Increasing personnel costs (staff) would normally reduce the use of expert services (supplemental staff). MSD had identified "Additional Requests" that will require the development of supporting documentation by MSD before recommendations could be made on each item by County Administration. Requests for various categories that were consistent with each of the past few years where adequate detail was provided were reviewed. The projected 2017 spending was based on the average historical spending and adjusted to reflect MSD's request plus inflation.

The recommended amount of non-personnel Historically Supported spending is \$58.2M. The resulting amount of Policy Dependent spending in the MSD requested budget is \$9M.

OTEA and Vehicles

For OTEA and Vehicles, the historic spending was evaluated; however this was tempered by the amount of spending in OTEA that would be categorized as capital spending (versus expense). MSD has had a history of charging items to this account that are not capital in nature. (This is a common problem with many of the Allowance type of accounts.) The County has worked with MSD each of the past two years in an attempt to correct the issue. For 2016, through September, of the amount charged to OTEA, approximately 44% appears to be classified as capital according to MSD's draft capital vs expense policy. This is relatively consistent with the past two years. So the OTEA Historically Supported recommendation is ½ of the 2016 approved budget.

For vehicles, MSD has not provided a Vehicle Utilization Study that would demonstrate the justification for the fleet at its current level, let alone for the addition of any new vehicles. Based on the suspected need for replacement equipment for vac-trucks and possibly dump trucks (if warranted) a budget for Vehicles is being recommended at \$800,000. Of this amount, \$700,000 will be classified Policy Dependent.

Debt Service

MSD has projected the debt service for 2017 as \$114.4M. The monitor has not analyzed this information in detail; however, it appears to be reasonable in light of an expected Bond Issuance in 2017.

The proposed budget is identified in Table 1.

**MSD 2017 BUDGET REQUEST AND
MONITOR RECOMMENDED OPERATION & MAINTENANCE BUDGET – TABLE 1**

Dept.	MSD 2017 Personnel Request	MSD 2017 Non- Personnel Request	MSD Total 2017 Request		Monitor 2017 Recurring Primary Historic Supported Personnel	Monitor Recurring Primary Historic Supported 2017 Non- Personnel	Monitor Total Recurring Primary Historic Supported 2017 Budget		Monitor Total Policy Dependent Spending 2017 Items
OOD	2.1	2.1	4.2		1.8	1.0	2.8		1.1
WWE	7.8	.8	8.6		6.7	.5	7.2		.6
WWA	6.8	11.2	18.0		5.8	9.5	15.3		1.4
WWT	19.4	28.5	47.9		16.6	25.1	41.7		1.6
WWC	10.3	11.2	21.5		8.8	9.9	18.7		1.7
DIW/RCS	5.1	3.2	8.3		4.3	1.3	5.6		1.5
WO/SBU	2.1	11.5	13.6		2.0	6.3	8.3		2.3
City OH		2.9	2.9			2.9	2.9		
County Direct OH		.3	.3			.3	.3		
County Indirect OH		.2	.2			.2	.2		
Vehicles		1.7	1.7			.1	.1		.7
OTEA		2.2	2.2			1.1	1.1		1.1
O&M Budget	53.6	75.8	129.4		46.0	58.2	104.2		12.0
Debt Service		114.4	114.4			114.4	114.4		
Total Budget	53.6	190.2	243.8		46.0	172.6	218.6		12.0

This evaluation of the operating budget does not consider the impact of the 8/28/16 storm event and the resulting potential increase in SBU. MSD has suggested that as much as \$8M could be required in 2017. This will need to be included in the budget.

Introduction

The Monitor Team, in conjunction with County Administration, performed an evaluation of the budget request submitted by MSD in August for the 2017 rate year. MSD's request represented almost a 17% increase in operating costs over a two year period during a time that federally mandated capital investment will be required at all-time highs. MSD's request is simply not sustainable, nor does it appear justified, when such a heavy capital burden is being placed on the system and rates in addition to the operating and maintenance needs. The County's approach as directed by the Board of County Commissioners over the past three years has been to make sure the necessary operations and maintenance needs of the utility are met, and the non-essential needs are closely evaluated. As a result, the County's approach is to identify and recommend funding the Recurring Primary Historic Supported operating costs, with all other discretionary/non-recurring spending subject to a cost benefit justification. In fairness, MSD did identify some minor cuts and reductions in expenditures, but those reductions pale in comparison to the requested increases.

MSD's budget request focuses on claims that the 2017 request of \$237.9M (excluding an additional request of \$5.9M) is .1% less than the 2016 total MSD budget request of operating and debt service costs. This statement is misleading. In reality, MSD's proposed budget (excluding debt service) represents an 8.7% increase over the 2016 budget (excluding debt service).

The plan proposed by MSD funds a significant increase in employee count and related benefits. However, it does not include a correlating decrease in supplemental contract staff (and the resulting reduction in expert services). In addition, MSD is requesting \$1.7M for vehicles. However, at the same time MSD has itself identified that there are a significant number (83) of underutilized vehicles. Instead of streamlining the fleet in 2016 to rid itself of unused vehicles, reduce maintenance and insurance expense, MSD management chose instead to issue a memo with ideas on how to find reasons and ways to increase vehicle usage. To MSD's credit, according to the last report provided by MSD, they have sold 7 of the 83 underutilized vehicles. To date the County has not received MSD's Vehicle Utilization Study.

MSD's request for rate year 2017 funding appears excessive in comparison to past and the current years' actual expenditures. In an effort to define a budget that more closely approximates the needs of the utility, the County has chosen to do its best, with the limited information provided, to define "Recurring Primary Historic Supported" services and the appropriate level of controlled spending related to those services, while also identifying discretionary spending and requiring justification for such spending. "Recurring Primary Historic Supported" services are loosely defined as those items that are recurring and are essential to the operation of the District in compliance with all applicable Local, State and Federal requirements. "Policy Dependent Spending" are those expenditures that, based on historic spending, vary from year to year and are not essential to the operation of the District. Being that they are more discretionary in nature, they are more appropriately directed by the governing policy makers for the utility. Examples of Policy Dependent Spending could be participation in the student intern academy, expanding the employee base (employees versus staff supplementation), and engaging in pilot endeavors that may provide benefits in the future. These expenditures could be identified as variable expenses (since they vary from year to year) that would be made depending on the interest and needs of the policy board.

Overview

MSD's baseline 2017 request for operations and maintenance (O&M) budget (total operating budget less debt service) is \$123.5M. In addition, MSD is asking the BoCC to consider \$5.9M of additional funding for a total O&M budget request of \$129.4M. It is presumed that in their submission MSD inadvertently placed the cost for jurisdictional billing (billing services performed by 7 jurisdictions within the Hamilton County) in the additional funding category. This service is critical and has been part of the MSD approved operating budgets since 2015 (and prior to 2012). MSD is requesting almost a 17% budget increase over a two year period. MSD's 2016 unadjusted budget (prior to additional funds being appropriated for the greater than 100 year storm event on August 28) is \$118.9M. Of this amount, \$2M of watershed operations, \$1.2M of WWT and \$1.3M of vehicles in the budget were conditional approvals. Additionally, MSD was to prepare a staffing plan to justify any additional employees. No staffing plan has been provided. (This suggests that \$5M of personnel should not be spent until a plan has been approved. This effectively means that as of today, MSD's 2016 approved (and released) operating budget is \$109.4M. MSD's director indicated to the BOCC that MSD would underspend the budget by 8%. This would suggest a spending level for 2016 of approximately \$109.4M. MSD is asking for a \$10.5M increase or 8.7% more than the prior year's budget. This increase is meaningful as MSD's 2016 budget was \$8.2M or 7.4% more than 2015's budget.

MSD 2017 BUDGET REQUEST AND 2016 PERFORMANCE—TABLE 2

Dollars are in millions:	MSD 2017 Personnel Request	MSD 2017 Non-Personnel Request	MSD Total 2017 Request		MSD Total 2016 Legislated Budget	MSD Total 2016 Projected Spend
OOD	\$2.1	\$2.1	\$4.2		\$3.9	\$4.0
WWE	7.8	.8	8.6		7.3	7.4
WWA	6.8	11.2	18.0		15.7	15.8
WWT	19.4	28.5	47.9		46.4	44.0
WWC	10.3	11.2	21.5		20.4	19.0
DIW/RCS	5.1	3.2	8.3		6.8	5.9
WO/SBU	2.1	11.5	13.6		11.6	12.1
City OH		2.9	2.9		2.9	2.8
County Direct OH		.3	.3		.3	.3
County Indirect OH		.2	.2		.2	.2
Vehicles		1.7	1.7		1.3	1.2
OTEA		2.2	2.2		2.1	2.1
O&M Budget	\$53.6	\$75.8	\$129.4		\$118.9(a)	\$114.8
Debt Service		114.4	114.4		119.1	102.8
Total Budget	\$53.6	\$190.2	\$243.8		\$238.0	\$217.6

(a) Based on the above, only \$109.4M has effectively been approved and released as of 11/17/2016

Throughout its request MSD compares their 2017 request to the (full—approved and conditional) 2016 budget. MSD has not provided any analysis to support what it considers its' "baseline" or "Recurring Primary Historic Supported" budget. Without comparable benchmarks to other "best in class" utilities,

it is difficult to determine what the base is or should be. In an attempt to get to a baseline or Recurring Primary Historic Supported budget, the Monitor relied on average historical spending when reviewing MSD's request. The intent is to get to a basic level of O&M spending that represents the essential costs. The expectation is that any spending above and beyond Recurring Primary Historic Supported costs would be separately considered. That is, the funding above the Recurring Primary Historic Supported level would be considered discretionary spending. By reaching or defining a Recurring Primary Historic Supported budget, the utility can be more easily benchmarked to other utilities. This will allow for the identification of areas to focus efficiency improvement activities.

The Monitor's budget recommendation is represented in two parts: Recurring Primary Historic Supported and Policy Dependent Spending. The Recurring Primary Historic Supported budget is defined as the minimum funding MSD requires to conduct required activities and purchases. The Policy Dependent Spending budget is for those items or initiatives above the very basic level that should be brought forward separately for approval. Each of the Policy Dependent Spending items should be considered in light of the benefit to be provided to the rate payers from the expenditure of the required funds. It is expected that all discretionary expenditures will provide an economic benefit to the rate payers.

It is important to note that the definition of Recurring Primary Historic Supported versus Policy Dependent Spending budget items is very clear. However, based on the information provided by MSD, the categorization of the activities within the proposed budget, as either Recurring Primary Historic Supported or Policy Dependent Spending is not as clear. As a result, it is expected that adjustments will be required as 2017 unfolds.

Monitor Recommendation Summary

MSD's requested growth in the operating budget is not sustainable. After some evaluation, it has been determined that for the proposed MSD budget (less debt service), the Recurring Primary Historic Supported budget for 2017 is \$104.2M and the Policy Dependent Spending budget is \$12.0M. MSD may bring forward the scope of services or purchase requests for all Policy Dependent Spending items to be separately approved. Even though the recurring budget amount (\$104.2M) agrees very well with the projection of the two low budget years (2012 and 2015), it must be recognized that the development of the recurring budget is approximate due to the lack of detail information. Therefore, the Monitor suggests that the BOCC consider increasing the recurring historic budget by \$3M and decreasing the Potential Policy Directive budget by \$3M.

Below is a summary of the monitor recommendation for both Recurring Primary Historic Supported and Policy Dependent Spending amounts for the fiscal 2017 year budget. The total Recurring Primary Historic Supported (\$104.2M) and Policy Dependent Spending (\$12M) budget (excluding debt service) combined is calculated to be \$116.2M. This amount ensures that all critical operation and maintenance activities of the district are fully funded. By defining that Policy Dependent Spending funding is subject to justification and further review, it ensures the Board's ability to control and fund the appropriate activities of the utility. The recommendation represents approximately a 1% increase over the MSD total 2016 projected spend.

**MSD 2017 BUDGET REQUEST AND
MONITOR RECOMMENDED OPERATION & MAINTENANCE BUDGET – TABLE 3**

Dept.	MSD 2017 Personnel Request	MSD 2017 Non- Personnel Request	MSD Total 2017 Request	Monitor 2017 Recurring Primary Historic Supported Personnel	Monitor Recurring Primary Historic Supported 2017 Non- Personnel	Monitor Total Recurring Primary Historic Supported 2017 Budget	Monitor Total Policy Dependent Spending 2017 Items
OOD	2.1	2.1	4.2	1.8	1.0	2.8	1.1
WWE	7.8	.8	8.6	6.7	.5	7.2	.6
WWA	6.8	11.2	18.0	5.8	9.5	15.3	1.4
WWT	19.4	28.5	47.9	16.6	25.1	41.7	1.6
WWC	10.3	11.2	21.5	8.8	9.9	18.7	1.7
DIW/RCS	5.1	3.2	8.3	4.3	1.3	5.6	1.5
WO/SBU	2.1	11.5	13.6	2.0	6.3	8.3	2.3
City OH		2.9	2.9		2.9	2.9	
County Direct OH		.3	.3		.3	.3	
County Indirect OH		.2	.2		.2	.2	
Vehicles		1.7	1.7		.1	.1	.7
OTEA		2.2	2.2		1.1	1.1	1.1
O&M Budget	53.6	75.8	129.4	46.0	58.2	104.2	12.0
Debt Service		114.4	114.4		114.4	114.4	
Total Budget	53.6	190.2	243.8	46.0	172.6	218.6	12.0

Process

In order to assess the budget, the Monitor reviewed spending for the past three years. Spending for the past three years was considered as a good indicator of the required spending. This information was supplemented with information provided by MSD where the detail was sufficient. The approach was to average the spending for the three year period in order to level out one-time peaks. In addition, the three year data set was considered for trends (increasing/decreasing/stable). This approach serves to use historical spending to project the required spending for the future. Where information was provided, this information was considered in establishing the recommendation. This approach was required since the level of information and justification (cost benefit-analysis or business case) for proposed expenditures was not sufficient for the monitor to offer a positive recommendation.

A summary of the detailed analysis follows:

Personnel

The three year average personnel cost is \$45M which is approximately 42% of MSD's three year average O&M budget. Audited amounts for 2015 as recorded in the object code groupings 7100s (Wages) and 7500s (Benefits) were \$43M, and of this, \$10.6M was for benefits which were 32.5% of wages. Excluding the impact of changes in long-term liabilities for pension and healthcare, personnel costs are projected by MSD to be \$46.2M in 2016. MSD has a current plan to increase staffing and is recommending that personnel be increased by over 15% (or approximately 85 employees) in 2017 to \$53.6M.

In its 2016 O&M Budget authorization, the Board required MSD to submit a staffing plan by 1/31/16 that detailed the benefits of additional staff. MSD has not provided the required analysis to justify the addition of staff. The City Manager in a communication dated 10/18/16 provided a high level analysis in recent correspondence to the County Administrator. However, the analysis was not clear and did not provide the detail required in the 2016 budget resolution. There was the expectation that the additional staff would have replaced more costly supplemental staff (reported to be 43 staff supplementation as of mid-2015), resulting in an expected, corresponding larger decrease in non-personnel costs (expert services).

To calculate the Recurring Primary Historic Supported personnel budget (prior to any increase in staffing), 2015 personnel costs per the audited financial statements were used and adjusted for the 2016 and 2017 raises enacted during the fourth quarter of 2016 by the City. Recurring Primary Historic Supported wages would be approximately \$35M without adding additional staff. This same calculation using the 2016 personnel budget and reflective of newly hired employees resulted in wages of \$37M. The \$2M increase is deemed to be Policy Dependent Spending personnel, until MSD can demonstrate a significantly greater reduction in Expert Services due to the elimination of supplemental staff, and a staffing plan to demonstrate the need for the position.

As noted above, benefits (for budgeting purposes) were 32.5% of wages. Based upon wages calculated above, or \$35M, Recurring Primary Historic Supported benefits are estimated at \$11M. Based upon 2016 budgeted wages, benefits are estimated at \$12M for an increase in Policy Dependent Spending personnel of \$1M. Total Recurring Primary Historic Supported personnel cost is \$46M or (\$35M+\$11M). The difference between personnel based upon 2016 budgeted payroll and the Recurring Primary Historic Supported amount of \$46M, is \$3M and is deemed the Policy Dependent Spending addition to personnel.

It would be expected as indicated above that an increase in personnel costs of \$1 will result in an approximate \$2 decrease in non-personnel costs (expert services) due to the multipliers for staff supplement contractors. This is considering that MSD has consistently reported to the County Administration that all necessary functions of the utility have been funded in previous budgets. The Policy Dependent Spending addition to payroll would require more than offsetting savings to have the funds released. The \$3M growth is not sustainable unless MSD can reduce the non-personnel budget elsewhere by approximately \$6M. This issue is further complicated by the lack of staffing plan and the determination of the appropriate utilization of staffing when compared to industry norms.

Furthermore, capitalization rates for WWE appear to be low, suggesting that WWE does not have sufficient project work. This is somewhat supported by the fact that MSD has performed approximately 50% of the CIP the past three years. Another example is that inspectors are only capitalizing 40% of their time. The low rate of capitalization suggests that the inspection staff is underutilized which could be the result of the excessive use of staff supplementation or underperformance of the CIP.

Below is a matrix comparing MSD's request and the Monitor's personnel cost allocation recommendation based on the observations above:

MONITOR'S PERSONNEL RECOMMENDATION –TABLE 4

Department	2016 MSD Projection	2017 MSD Request	MSD Request % Increase Over 2016 Projection	Monitor 2017 Recurring Primary Historic Supported Budget	Monitor 2017 Policy Dependent Spending Budget	% Recurring Primary Historic Supported Inc (Dec) Over 2016 Projection
OOD	\$1.7	\$2.1	23.5%	\$1.8	\$.1	5.8%
WWE	7.0	7.8	11.4%	6.7	.4	(4.2%)
WWA	5.8	6.8	17.2%	5.8	.4	0%
WWT	17.5	19.4	10.8%	16.6	1.1	(5.1%)
WWC	8.8	10.3	17.0%	8.8	.6	0%
RCS	4.0	5.1	27.5%	4.3	.3	7.5%
WSO	1.1	1.2	9.0%	1.2		9.0%
SBU	.3	.9	200%	.8	.1	166%
Total	\$46.2	\$53.6	16.01%	46(a)	\$3.0	(.4%)

(a) This amount is consistent with the 2015 spending adjusted for 2016 and 2017 increases.

Non-Personnel

Non-personnel costs are discussed below by department. Within each of those analyses the categories are broken down into their primary components. An example of the analyses is provided for the OOD.

Office of the Director (OOD) (Department 410)

MSD is asking for non-personnel costs of \$2.1M. This request includes \$1.4M for services, \$28K for materials and supplies and \$623K for fixed charges. Within services, MSD provides some support for expert services, (\$805K primarily for financial management and the rate study) but declines to address approximately \$.5M of other items within this category other than \$64.5K for training. Further, the financial management cost and rate study costs are not defined, nor is the scope or purpose for each of these major projects spelled out, thus leading the County to conclude that the costs represent conceptual estimates which need to be refined at a later date. Using the 3-year average for the services category other than expert services and overhead recorded in 2013, Recurring Primary Historic Supported services are \$372K. The additional \$805K will be included in the Policy Dependent Spending

portion of the total services budget, and preferably split into rate study costs and financial management costs along with other non-defined services of \$245K.

MSD identifies \$28K for supplies which appears reasonable. OOD's 3 year average cost for fixed charges is \$1.1M, and MSD is currently asking for \$.6M. Amount is reasonable.

The Monitor recommends that OOD's Recurring Primary Historic Supported budget be \$1.02M.

MONITOR'S OOD NON-PERSONNEL RECOMMENDATION – TABLE 5

	MSD Request	Monitor Recurring Primary Historic Supported Budget	Monitor Policy Dependent Spending Budget
Services	\$1.42M	\$.37M	\$1.05M
Materials	.03M	.03M	
Fixed Charges	.62M	.62M	
Total	\$2.07M	\$1.02M	\$1.05M

Each of the other departments was analyzed similarly. The results of the analyses are provided in Tables 1 and 3.

Vehicles

MSD is requesting \$1.7M. Since a vehicle utilization study that properly justifies the request has not been provided, and as MSD has itself identified that there are a significant number of underutilized vehicles (more than 40% of the passenger vehicles), MSD's request appears unsupportable.

Unfortunately this is one account where it is glaringly apparent that the account has not been managed appropriately, and that additional controls are necessary. MSD is to review their request and prioritize the vehicles to be purchased within a Recurring Primary Historic Supported budget of \$0.1M (Policy Dependent Spending portion is \$.7M). Any vehicle purchases made in 2016 for \$100K or more are required to receive County approval prior to the expenditure. This approach should be taken for 2017 as well. Additionally, until a Vehicle Utilization Study report is provided to and approved by the county no passenger vehicles should be acquired.

OTEA

MSD is requesting \$2.2M which is the same amount as the 2016 budget. MSD has been instructed to follow the capitalization policy that identifies only amounts exceeding \$5,000 are to be capitalized. There are numerous transactions that were recorded that do not meet this threshold. As an example, almost \$50,000 of exercise equipment was capitalized, but the descriptions appear to indicate that many of the items were less than the \$5,000 capitalization threshold. This does not consider that the purchases were not approved by the Board. Accordingly, ½ or \$1.1M is recommended to be moved into Policy Dependent Spending until MSD can show that they are adhering to their established capitalization threshold. Similar to vehicles above, any purchase made in 2016 for \$100K or more is required to be presented to the County with a justification memorandum for the expenditure.

Debt Service

MSD's 2017 budget request for debt and interest payments is \$114.4M. It should be noted that MSD's 2016 budget for debt service was \$119.1M or \$7.9M more than their current projection of \$111.2M. Recently, the debt service projection for 2016 has been reduced to approximately \$104M. This is 87% of the projection. MSD has a history of not accurately projecting their debt service costs. We trust that MSD has calculated existing required payments and anticipated future needs based upon the timing of future encumbrances. Debt service of \$114.4M appears reasonable.