

MEMORANDUM

TO: MAYOR AND CITY COUNCIL

FROM: Martin P. Black, City Manager

DATE: JULY 27, 2004

RE: ALTERNATIVE UTILITY BUDGET PROPOSAL

Background

Last year the prior City Manager had considered recommending the privatization of the entire Utility operations but reported in his budget message that Utility staff had provided an impassioned plea that they be provided an opportunity to address these issues during the course of the current fiscal year. Unfortunately, sufficient progress has not been achieved and we continue to face serious financial challenges with the Utility fund.

As a result of expenditures incurred in the operation and for capital projects in the Utility Department, in excess of \$1.0 million was loaned by the General Revenue Fund to the Utility Fund last year on a cash basis. During the first quarter of FY03/04, Utility consultants were engaged to review the revenue requirements for the Utility Fund and recommended that the City impose a rate increase of 8 percent effective April 2004 to be followed by increases of 2 ½ percent annually in each of the next four fiscal years. During City Council public hearings on the rate increases, City Council directed staff to review expenses of the department with the goal of reducing on-going operating expenses.

With my appointment as City Manager in February and after retired Finance Director McPhail detailed the gravity of the financial situation that existed within the Utility Fund, one of my first official actions was to impose a hiring freeze in the Utilities Department that required an extraordinary review prior to any position being authorized for posting/filling. In addition, retired Finance Director McPhail and I worked together to suspend general administration (G&A) charges to the Utilities Fund as an additional method to assist with the recovery of the Utility Fund balance and return of cash loans to the other revenue accounts. Each of these actions were considered emergency stop-gap measures that were intended to create the opportunity for the management of the Utility department to develop a proposed budget submittal that would provide for a reduction of on-going operating expenses.

During the course of the budget preparations, other departments were directed to take reductions from their proposed budgets. Utility Department management were provided specific instructions to develop a proposed budget that would reduce expenditures in the department in recognition of the negative impacts from the Utility Fund deficit on other city services and increased costs to the community.

The initial department budget proposal developed and presented by the existing Utility management team recommended the elimination of the sole licensed engineer in the department without consideration of any anticipated increases in consulting engineering expenses. As a result of subsequent budget meetings between the City Manager's Office, Finance Department and the Utility management team, the Utilities Department presented their best effort proposal that in the end still provided for an \$186,584 deficit.

As a result, retired Finance Director McPhail, Finance Director James Olson, City Attorney Bob Anderson, Assistant City Attorney Wayne Hall, Administrative Services Director Brenda Digges and myself reviewed alternatives for presenting a balanced budget for City Council consideration.

Two alternatives have been identified for review by City Council to bring the Utility Enterprise Fund operating budget into balance. These two alternatives are:

1. Adopt an additional 2 percent increase in the utility rates effective October 1, 2004 to establish revenues to cover the \$186,584 deficit proposed by the current Utility Department management team.
2. Implement employee privatization of all or a substantial component of the Utility operations to achieve a balanced budget.

Previously the City's wastewater treatment operations had been under private operations through a contract that provided supervisory and line staff functions. Currently the City's fleet management services are provided through a contract for services. These two examples reflect the City's prior willingness to consider privatization of certain services and employee functions if determined to be in the best interest of the City. The City has also faced similar employee position reductions under difficult financial conditions. Several years ago the Airport Enterprise fund was facing deteriorating revenue-expense ratios that led to the elimination of the Airport Manager position and its funding for several years in order to allow the fund an opportunity to build operating reserves. The City now faces a critical decision in reconciling the budget deficit as proposed by the existing Utility management team.

Alternative Impacts

In order to assist with City Council consideration of the two alternatives, staff has prepared a summary of each alternative that describes implementation issues that would need to be addressed in order to pursue either option. Following this summary, my recommendation for proceeding with a careful review prior to implementation is included in order to provide an opportunity for input from the community. Action is required, however, to proceed with one or the other option in order to meet a balanced budget as required under City Charter.

1. Rate Increase Option

City Council adopted an 8 percent increase in Utility rates effective in April and an additional 2½ percent to be effective October 1. An additional 2 percent increase would be required to eliminate the current budget deficit and would require specific direction for staff and the City Attorney's Office to develop required rate ordinance amendments. Selection of this option would provide for a balanced budget this year, result in a single year increase of 12½ percent to local residents and would provide no net increase in funding for additional capital repairs and replacement projects. Additional rate increases in subsequent years may be needed dependent upon the results of collective bargaining; capital improvement needs and anticipated annual costs of business increases. Coincident with the budget adoption, rate ordinance amendments would be required to implement this alternative.

2. Privatization Option

The privatization alternative is more complex and requires additional steps for successful implementation. While a range of options in privatization is available, we have focused on resolving the budgetary implications associated with the current Utility management budget deficit proposal. In lieu of complete privatization of the Utility fund, a multiple prong approach has been developed to optimize potential savings and create a balanced Utilities Department budget proposal. This alternative has been developed and if, selected, is recommended to include provisions intended to lessen the immediate impact on those current employees whose responsibilities would be privatized. This alternative has the potential to provide for an estimated savings of \$1.5 to \$1.75 million over the course of a five-year initial contract term and would require the following actions by City Council:

1. Privatization of sixteen of the senior management and support positions in the Utilities Department that have an annual cost of over \$1.1 million in FY03/04 and that are reflected in Exhibit A.

2. Re-assignment of Assistant Utilities Director Chris Sharek, P.E. to the City Manager's Office to fill a newly created position of Utility Manager to provide direct oversight of a Utilities management services contract and to continue to provide utility engineering and development coordination. Approval would require implementation of the revised organization chart presented in Exhibit B and authorization for an administrative assistant in support of these functions.
3. Waiver of the City's Purchasing Policy requirements as an emergency measure to ensure the integrity of the system and ensure compliance with the City's operating permits. The City Attorney and Purchasing Director have confirmed that the waiver would be considered valid based upon the need to ensure that the City maintain a licensed A' Operator as required in the City Wastewater Plant Operating Permit and for the overall security and efficient operation of the system.
4. Approval of a five-year contract with a preferred vendor to provide the management and administration services currently performed by the sixteen positions identified in Exhibit A. A proposed contract would be required to be finalized by the City Attorney's Office.
5. Approval of severance agreement offers to each affected incumbent employee as a result of the privatization of their positions at a recommended rate of one week of severance for each full year of service with a minimum of three weeks and not to exceed ten weeks of severance and with a requirement that acceptance of the severance agreement waives any right or ability to seek any claims against the City and remaining employees. There is a one time approximate cost of \$85,000 for this provision that is dependent upon the ultimate number of employees who elect to sign the release and accept the severance.
6. Authorization to provide outplacement services to impacted employees through the Administrative Services Department.

Senior management have met and completed a review of the impacts of the privatization alternative and solicited formal proposals from two qualified vendors who already provide similar services to other local governments in Florida. Proposals were submitted by Severn Trent Services, Inc. (Severn Trent) (a subsidiary of Severn Trent Plc, an international utility services group of companies) and by Operations Management International, Inc. (OMI) (a subsidiary of CH2MHILL Companies, Ltd., an employee-owned multinational firm providing engineering, utility operations, environmental and related services).

Both firms presented proposals that would provide for an annual cost of management services in the area of between \$723,000 and \$740,000, or for an annual savings of approximately \$350,000 as compared to the current year budget. The senior management team have evaluated both firms qualifications and proposals and find that OMI is the preferred vendor based upon their proposed approach, particularly as relates to safety and environmental compliance training, additional cost savings strategies in years two through five proposed through their draft contract, and the explicit provisions relating to continuing the City s role in coordination of bargaining unit employees. Copies of each proposal are available for review through the City Clerk s Office.

Recommendation

In order to provide an opportunity for careful consideration of these alternatives by the Mayor, City Council, public and employees, I recommend the following course of action:

1. Set a special meeting for August 16, 2004 to review the proposed budget and to implement an alternative Utility budget option.
2. Direct staff and the City Attorney to draft any required amendments to implement the rate change so they may be reviewed by City Council at the August 16, 2004 special meeting.
3. Direct staff and the City Attorney to complete review of the proposed contract with the preferred vendor so that it may be considered by City Council at the August 16, 2004 special meeting.

cc: Charter Officers
Department Directors
Utility Department staff