

To: Board of Directors
From: Kelly Stacey, Finance Director
Subject: Consolidation Costs Savings Report
Date: October 16, 2018

Introduction

In February of 2015, FCS Group (FCS) was hired by both Oak Lodge Sanitary District (OLSD) and Oak Lodge Water District (OLWD) to evaluate the potential consolidation of the two districts. As a part of this evaluation, FCS examined the characteristics of the two organizations, job functions and materials and services budgets to identify cost savings. In December of 2015, FCS Group submitted an Evaluation of Agency Consolidation of Oak Lodge Sanitary District (OLSD) and Oak Lodge Water District (OLWD) for review with the Board and the public.

This memorandum is intended to be an up-to-date cost savings analysis of the FCS Group report. The report provides a structure and framework for evaluating those specific opportunities and responses to each element in assessing the efficiencies recognized. Some of the items, such as personnel costs related to the vacant positions were recognized from the beginning, others began in the current fiscal year, such as the finance software maintenance. In any case, the figures given are the long-term ongoing savings that will be seen in whole beginning with the 2019/2020 fiscal year.

Summary

FCS Group identified these high-level efficiencies as likely to result from the consolidation efforts. Each of the elements cited are more fully developed and addressed in detail below:

1. Consolidating the two Districts would result in ongoing savings of about \$425,000 per year. These savings would primarily result from eliminating three full-time equivalent (FTE), combining the two separate financial systems, combining the office space, and reducing materials and services budgets in consequence of having one district instead of two.
 - a. \$214,000 of the savings was estimated to come from personnel costs
 - b. \$211,000 of the savings was estimated to come from the materials and services budgets. Any organizational change of this magnitude would be unavoidably complicated.

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2. Three positions were vacant by the January 1, 2017 formation of Oak Lodge Water Services District (OLWSD)—one of the General Managers, one high-level manager and one administrative staff employee. This has two implications under the recommended scenario:
 - a. First, no employees were laid off as part of the consolidation.
 - b. Secondly, the ongoing savings would be realized at the early end of the implementation period, generating sufficient savings to fund the one-time costs. Estimated one-time costs of \$870,000 were identified in the report.
 3. Market and sell the OLSD building.
 - a. Estimate that about \$730,000 of one-time revenue could be generated, which could logically be used to offset the cost of remodeling the current administration building to house all the necessary staff.
 - b. This original assumption has proven to be false. As time has passed, the value of the OLSD building has grown in value, as has the cost of the construction of the new office space due to the refinement of the requirements of the ultimate space and the rapidly rising costs of construction in general within Oregon. Staff is currently looking at what are the likely true costs. This current report will not address any costs or savings related to this portion of the consolidation.

Ongoing Savings and One-Time Costs

FCS evaluated each employees' job function. Based on this analysis they determined through their assumptions the elimination of 3 to 4 FTE and developed two scenarios based on this analysis. The newly formed District opted to choose Scenario 2 which was recommended and would eliminate 3 FTE. The 3 FTE would be a General Manager, a Finance/Administrative Manager, and an administrative support position.

The previous District boards chose to have the FTEs eliminated through attrition rather than a lay off. It was not determined exactly when the retirements or vacancies would take place and the savings would be recognized. As it turned out, all three positions were vacated before the consolidation went into effect on January 1, 2017.

The indirect savings will take longer to achieve. With Scenario 2 the projected savings would be \$425,000 per year beginning the year after all the positions were vacated. This analysis will look at the actual savings and the offsets that are attributed to the positions and other savings related

to the consolidation. It will also address some cost avoidance, purchasing one new financial software at a purchase price of \$150,000, instead of two finance systems each at a \$150,000.

Timing of Costs and Savings

Although the savings of personnel costs came earlier than expected, many of the up-front costs have extended beyond the original timeline. Considering it is past the originally forecasted estimate of a July 1, 2018 move in date to the combined building, we are projecting at least several more years to complete the items related to the consolidation. Legal services continue to be necessary as staff develop new policies which had not been in place or needed updating and to negotiate a variety of new and revised contracts. The District only recently began joint billing and the balance of the financial and permitting software will continue through fiscal year 2018/2019. With that in mind, OLWS will see part of the savings in 2018/2019 and full annual savings beginning in 2019/2020.

At the same time, many savings and costs along with efficiencies in operations occurred early on and will add to continuing savings overtime in the potential costs of providing the current service level for the District. After deferring capital projects for the last several years, the fund balances in Water, Wastewater and Watershed Protection has grown beyond the original amounts mentioned in the FCS report. This money is needed for upcoming capital projects and to possibly fund a PERS side account to offset future increases. It may be necessary to look to other funding sources to construct the new District headquarters as it is unlikely that the \$500,000 (which includes the purchase of additional property) mentioned in the FCS report is a realistic number.

So far, the fund balances have not been tapped to finance the one-time costs associated with the consolidation. As a financial strategy, savings in other areas of OLWS have been reallocated to the areas needing extra funding for onetime expenditures.

Process

Spurred by the opportunity created by the planned retirement of one of the General Managers, the two boards began discussing the potential creation of a single district in 2013 and 2014. A preliminary feasibility study by Steve Donovan of Donovan Enterprises, Inc. was presented to the two boards in June 2014. The Donovan study projected potential ongoing savings of about \$612,000 per year, based mostly on a reduction of five administrative and management positions. The Donovan study also identified potential revenue of \$730,000 from the sale of the OWSD headquarters building.

The Donovan study was a high-level look into the consolidation of the two Districts with unconfirmed assumptions. Even with some overlap of duties, there is extra work required in each of the areas compared to being just one service. Even though there are half the bills, there are still the same number of charges since Water, Wastewater and Watershed Protection are all

separate revenue producers. The same goes with many of the other duties: one payroll but more employees than either of the prior agencies; one accounts payable but nearly twice as many invoices as either function had before; and the list goes on to include the work of the General Manager, Finance Director, Engineer and so on. It was later determined by the FCS Report that it was not feasible to consider reducing staff by five FTEs as stated in the Donovan study.

Per-Employee Benefits

The benefits percentages shown in the FCS report reveal several items regarding the cost of benefits for the two Districts. First, the salary-driven benefits were significantly higher for OLWD than OLSD—24% vs. 18%. Furthermore, per-employee benefits such as health insurance are also more costly to OLWD than they were to OLSD—\$24,231 per employee as opposed to \$20,031 per employee. Among other things, this reflects the fact that OLWD employees paid 5% of their premium cost while OLSD employees paid 10%. In addition, the workers' compensation budget per employee is higher for the OLWD than for the OLSD—\$3,077 per employee as opposed to \$1,677 per employee.

Here we start to see efficiencies in the combined numbers for OLWS. The numbers as a percentage are all better than the weighted average of the two districts. Beginning September 2017, the new rate for Oak Lodge Water Services is 19.69% for Tier 1 & 2 and 12.82% for OPSRP. The PERS rate for OLWS is up from OLSD but down from OLWD. The current tax cost to the OLWS District is 19.79% which is just under the previous total. The current cost per employee for healthcare and other benefits is decreased to \$17,789.15 per employee. This is less than either of the old Districts' costs and is 19.18% of salary. The overall benefits cost as a percent markup of salary cost is 46.475%.

Many factors affect the overall benefits to salaries. Items such as lower average salaries per employee increases the benefits cost as percent of markup since the cost of medical and other insurance is a flat rate. The PERS rates continue to increase. For 2018 the combined PERS equaled 16.34% of salaries. PERS rates will continue to rise, unrelated to the consolidation. The rate is directly related to current and past employees. As Tier 1 and 2 phases out there will be less fluctuation from year to year; however, that is decades away.

In the meantime, agencies are looking to the State for ways to offset future increases and be more in control of their budgets for retirement. The 2018 Legislature passed Senate Bill 1566, which was the result of the Governor's Unfunded Actuarial Liability Task Force last year. The bill provides incentives for employers to make unfunded actuarial liability (UAL) lump-sum payments to PERS to reduce their contribution rates in the future. The District is examining its options for participating in the buy-down program offered by the State. Additional information will be brought to the Board once the analysis is complete.

Vacation and Sick Leave Accruals

The OLSD was slightly more generous with vacation accruals, though it varied with an employee's tenure. By year 2020, the accrual rates were the same. The OLWD had a more generous cap, allowing its employee to accrue up to 400 hours, compared with 220 hours for the OLSD. A higher cap creates a higher vacation payoff when employees leave their position.

For the combined Districts, the vacation accruals moved to the prior OLSD's slightly more generous and the prior OLWD's more generous cap. However, there is no longer the ability to sellback excess vacation. The increased cap does add an increased liability to OLWS when employees leave employment as there could be a substantial payout.

For sick leave, the accrual rates for both prior Districts were the same, at 96 hours per year. After ten years of service the OLWD allowed 25% of accrued sick leave to be cashed out upon separation, but its cost exposure is somewhat limited by capping sick leave accrual at 920 hours. Prior employees eligible for the sick leave payout have been compensated resulting in a one-time expense. OLSD did not offer any sick leave cash-out upon separation, and therefore had less need of a sick leave cap. There is no longer this benefit which will save OLWS money in future years when employees retire.

These differing approaches to employee accruals were apparent in the financial statements. On June 30, 2014, OLWD's total liability for accrued compensated absences was \$126,255. For the OLSD—with more than double the annual salary cost—the figure was only \$131,640.

OLWS has taken a new approach. Employees now do not have the ability to cash in vacation hours each year, and they do not get paid out for any compensatory time they have earned. They do get the higher cap on their vacation hours of 400 hours and their compensatory time is capped at a rolling 80 hours. On June 30, 2017 the OLWS's liability for accrued compensated absences was \$193,406, or 75% of the prior Districts' combined 2014 total.

Savings from Consolidation

Personnel Costs

For personnel costs a study was done for only the positions where it was thought potential overlap for work tasks performed by the two former Districts might occur. Existing administrative and management functions were looked at, by position and then by function, with estimated time data provided by District officials. The time required for each function was measured in FTEs. In total, there were 18.0 FTEs of management and administrative employees in the two Districts.

For each function, assumptions were made about the degree of duplication between the two agencies. The assumed percentage of duplication gave a basis on which to assess the time which

would be required for each function if the two agencies were combined. The result of this part of the analysis was a theoretical finding that 4.0 FTEs could be eliminated due to consolidation.

Two scenarios were constructed that identified particular positions for a combined organization, along with the cost of those positions. Scenario 1 matched the functional analysis by assuming that 14 administrative and management positions would be needed by a combined District, thus saving 4.0 FTEs as compared to the two separate Districts. Scenario 2 is deliberately conservative by assuming that 15 administrative and management positions would be needed by a combined organization, thus saving only 3.0 FTEs. Where there were salary differences in what seem like comparable positions, the scenarios assumed the OLWS would choose the higher salary levels. The implication of this assumption is the savings generated by reducing positions would be partly offset by the cost of increasing the salaries of OLWD employees who become part of a new combined District.

While both scenarios seem to work on paper, Scenario 2 was more conservative and probably more realistic. Because of the then existing vacancy and planned retirements, Scenario 2 also would allow a consolidation to take place without employee layoffs. Between the two scenarios, the OLWS opted to go with Scenario 2 and eliminated three positions. All three positions were vacated prior to the January 1, 2017 formation of the OLWS.

Materials and Services Costs

After arriving at estimates of which positions might be needed by a combined agency and the personnel cost savings associated with each scenario, the spotlight was turned to the materials and services (M&S) part of the budget. The consolidation has four main drivers of M&S savings. Some M&S costs would go down simply because of having one organization instead of two organizations. For example, with the consolidation, there is one board, one budget committee with one set of required legal notices, and postage for one set of customer bills with the three services billed on only one bill.

Looking at M&S savings, as stated in the FCS report, there are four main drivers of the savings:

- First, will be a look at savings simply because of having one organization.
- Second, costs driven by the number of employees.
- Third, the costs related to one headquarters building vs two. Some of these savings have not yet come to fruition so cannot be substantiated. One financial system, one GIS system, and other systems will be looked at.
- And the fourth is more related to one-time costs related to bringing everyone to one headquarters and well as other items that have been identified.

In examining the actual costs, the attention will be on savings as well as added costs. They will be netted to come to the ongoing costs related to the OLWS.

After examining the M&S line items in detail, FCS estimated that consolidation would yield annual savings for M&S of about \$211,000 under Scenario 2.

According to the report, adding together the total ongoing savings in both personnel and M&S costs would result in an estimated consolidation savings of about \$425,000 per year under Scenario 2.

Savings in Personnel Costs

Potential Time Savings by Function

After obtaining rough time estimates for each individual employee, the data was sorted by standard function rather than by employee, to determine how much total time was being spent on each standard function.

Based on the time estimates given by the District's employees and the degree of overlap assumed for the various functions, it was determined that a total of 3.4 FTEs could be saved from the standard functions if the two Districts were combined into a single District.

It is still too early to tell if this hypothesis was an accurate one. Much of this first year has been spent in the consolidation of the Districts, most notably, the financial software implementation. This has required extra hours of work that will be continuing for several months as the cleanup will take some time to complete. In addition, there are other items on the horizon that will occupy the administrative staff's time such as the new meter change-outs which require data to be entered into the financial system. Administrative staff worked many hours of overtime and temporary staff were hired to help with the added workload attributed to the consolidation and financial software implementation and may need to be continued for much of this fiscal year as the workload continues to be high.

Translating Potential Time Savings into Dollars

At the time of the official consolidation, three positions had been vacated; one General Manager, the Administration Services Manager, and one Administrative Assistant position. At this point there is no plan to reduce staff any further. As staff's time is freed up in one area there may be some shifting of duties to cover areas that are currently lacking.

At the consolidation onset, OLSW's General Manager had retired leaving OLWD's General Manager as the General Manager of the new District. He has since retired, and there is a new General Manager.

Per the assumption of the FCS report, the OLWD's Finance Director is now the Finance Director of the new District and serves as the manager of the administration staff.

Also, as predicted in the FCS report, the administrative position at the wastewater treatment plant retired in June of 2016, thus giving OLWS the three vacant positions as the work of consolidating the two Districts began.

Salary Reconciliation

As noted earlier, OLSD had generally higher salaries than OLWD. In constructing scenarios, FCS assumed that salaries for positions that appear comparable would be reconciled to the higher level. There are two reasons for this assumption:

First for the managers: one potential rationale for the OLSD's higher management salaries was the fact those managers were part of a larger organization, and had more employees reporting directly or indirectly to them. A consolidated District would be even larger than either of its component Districts, so the rationale for higher salary levels would still apply.

For the non-managers: one important factor explaining the OLSD's higher salaries was the unionized workforce. Because a successor District would inherit the union contract, it would not be able to reduce salaries for non-management OLWS personnel. Therefore, the new District's only option was to either reconcile to higher salaries or continue the salary disparity. Continuing the salary disparity was viewed as unacceptable, so reconciling to the higher level was the result.

Benchmark Salaries and Average Benefit Percentage

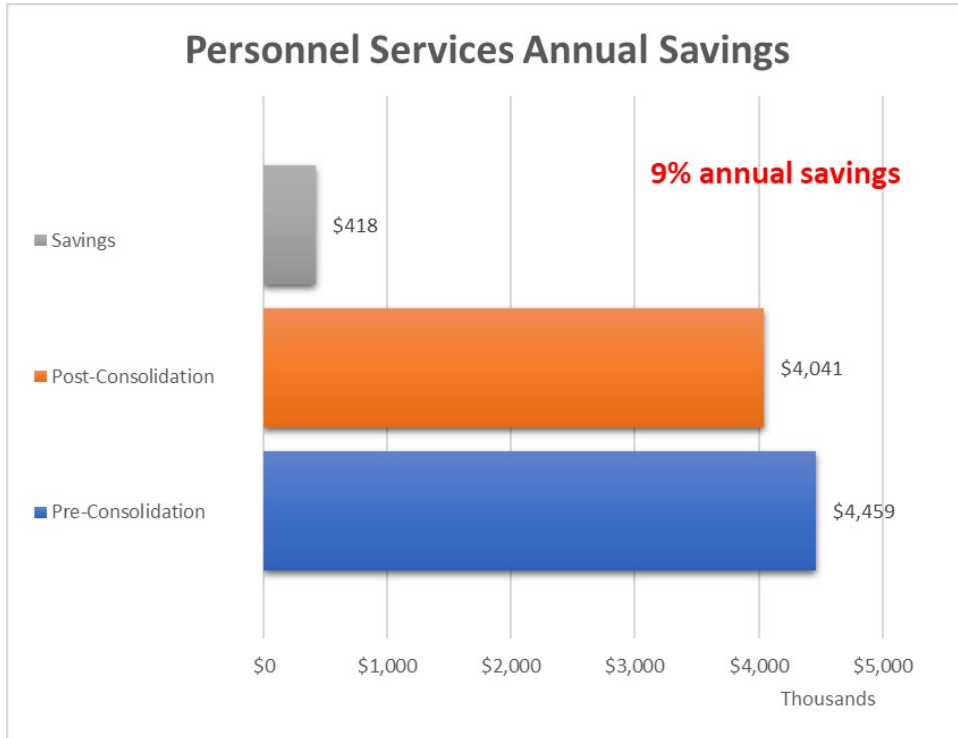
In constructing scenarios with positions for a combined District, rather than using the actual salaries of current employees, FCS used "benchmark salaries" set to 95% of the top of the range. This was to allow decisions about particular positions to be abstracted from incumbents. Individual employees earned more or less than the benchmark salaries, but in the aggregate, the total benchmark salary cost was approximately the same as total actual salaries.

FCS also averaged the benefit percentage for the two Districts. Mostly due to differing PERS charges, former OLWD benefits average 56% of salary cost, while former OLSD benefits average 41% of salary cost. The scenarios in the FCS report used the weighted average benefits percentage, which was 46%.

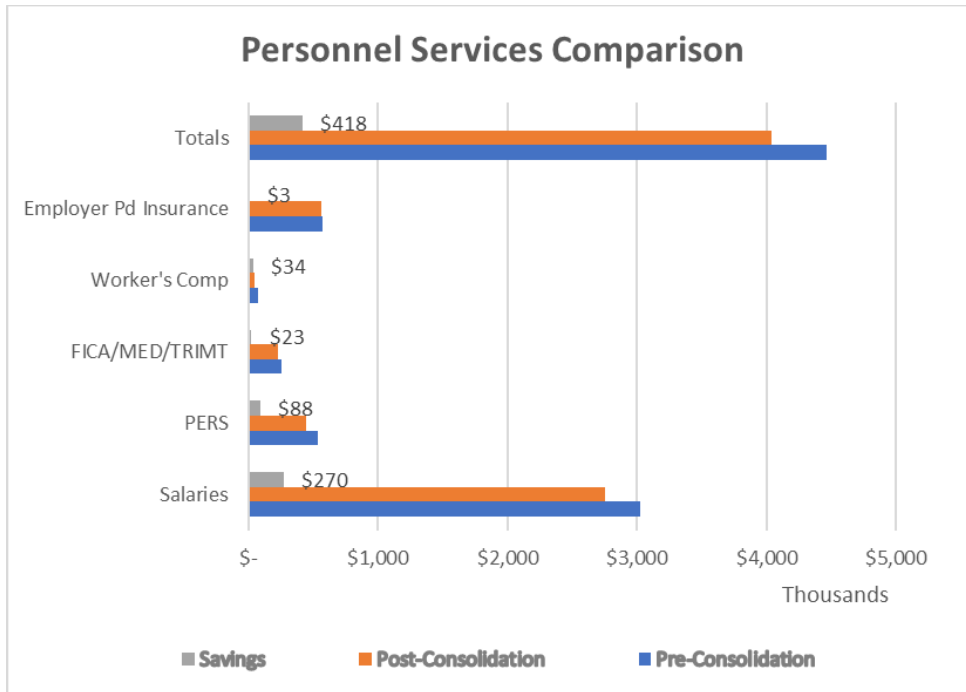
Since the purpose of this report is to highlight savings and costs that prevent savings, all personnel costs are being analyzed together. The comparison is to the salaries at the time the positions were vacated and all other salaries on December 31, 2016 with the salaries at July 1, 2017, which was after the union negotiations.

Using rounded totals, in Scenario 1 the FCS report estimated ongoing personnel savings of \$214,000 per year. FCS used benchmark salaries as described above. This analysis is based

on actual dollars spent previously and currently. As shown in the charts below, the savings realized far exceeded the estimate with a \$418,284 annual savings in salaries and benefits. That is a 9% annual savings.



The next graph shows savings (in thousands) were realized in all the listed categories. One remarkable thing about this is in the Employer Paid Insurance category: for all the former OLWD employees, life insurance value increased from \$10,000 to \$50,000, along with the addition of both short-term and long-term disability and yet there was still just over \$3,000 in annual savings.

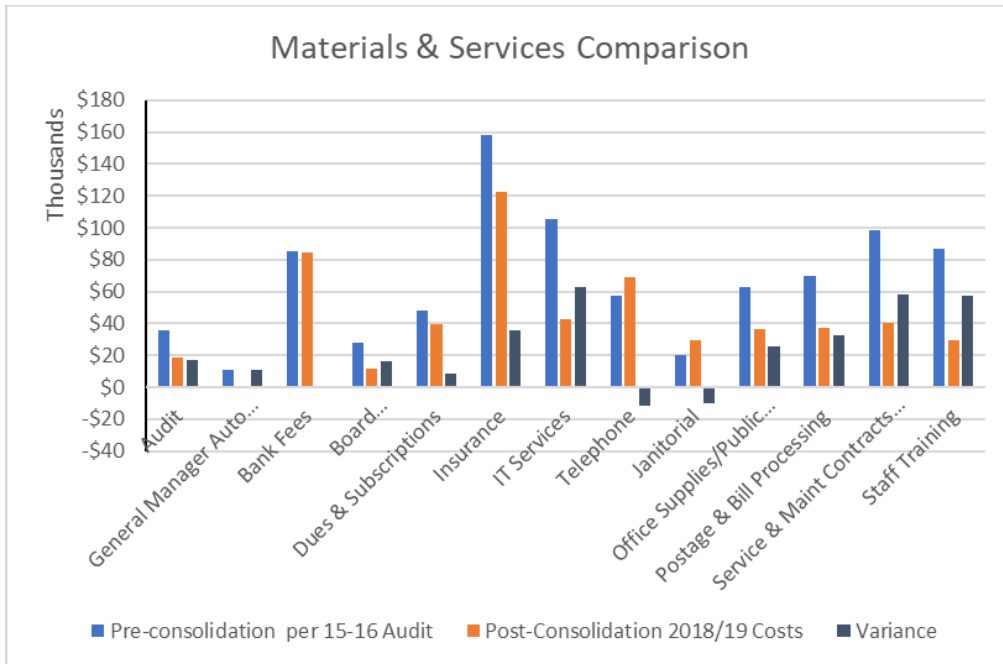


Savings in Materials and Services Costs

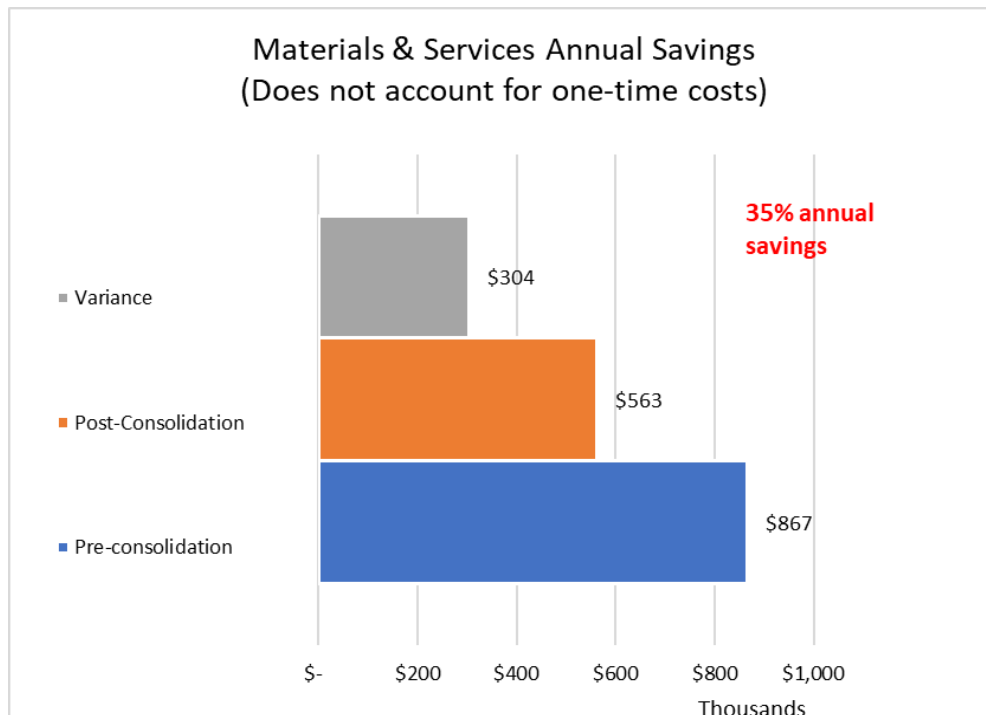
The M&S savings are driven by various factors. Some costs are saved simply because there is now one District instead of two. An example of this type of savings would be postage for mailing out customer bills. Other M&S costs are reduced because the number of employees would be reduced. Another example would be savings from having only one financial system. The M&S savings from combining headquarters buildings is not addressed here.

FCS estimated the consolidation of the two Districts would save \$88,861 in materials and services; reducing employees would save \$45,735 and changing IT software would save \$46,300 for a total savings of \$180,896. However, FCS also estimated there would be costs related to reducing to one building before cost savings might accrue which will be analyzed in a separate report to be developed later by staff for the Board of the OLWS.

The chart below outlines twelve key areas where FCS forecasted reduced costs or increased cost. To date the cost of telephones and janitorial has seen increases. With the telephones the District chose to keep the more robust albeit more expensive system. Even with the overall reduction of total telephone lines the cost of the service is now nearly \$12, 000 more expensive than the combined total of the prior Districts. As for janitorial services, the former OLWD paid slightly less than the current cost, however, it was discovered OLWD had not used a state required company for their service. Also, the new janitorial service offers more services than were being performed prior to the consolidation. The increase of \$9,766 also includes the increase in the OLSD contract now taken over by OLWS. In all other areas a reduction in cost has been realized.



Focusing on the thirteen areas outlined the combined District is experiencing annual savings in M&S of \$303,822. This represents a 35% savings as demonstrated in the graph below.



Reasons for Projected Savings

Following is a summary of the reasons for the projected ongoing savings. This analysis is compared to scenario 2 since the new District is operating under that scenario. With FSC

projecting savings of \$392,000 per year excluding costs related to the building (elections expense is actually a biennial cost, it is shown as an annual cost for purposes of this report), the ongoing annual savings has far exceeded expectations coming in at \$711,106.

Personnel savings due to reduced staff time spent in billing and collections, front desk/customer reception, overall district management, Board support, annual budget process, budget monitoring, financial reports, and maintaining the account database for general ledger, accounts payable, billing system, GIS, and purchasing functions are where the FCS forecasted the greatest savings by the reduction of 3 FTEs for a total savings of \$418,284.

M&S items highlighted come in at a savings of \$292,822. The reason for on-going cost savings changes include:

- Postage and mailing service cost reduced because of having fewer bills to mail out.
- All Board expenses reduced because of having one Board instead of two. This includes Board compensation, Board training and travel, board meeting expenses, and Board elections.
- Annual audit reduced because one District instead of two.
- Auto allowance reduce because new General Manager has no auto allowance compared to both General Managers in the old Districts.
- Cost of memberships, training and conferences, and mileage reimbursements are all reduced because of having three less FTEs and having one District.
- Office supply costs lower due to fewer administrative employees.
- The need for computer equipment, software, and related computer services reduced because of having fewer administration employees.
- One legal notice instead of two because of having one District instead of two.
- Reduced cost of web site maintenance, newsletters to the public, and Board meeting expenses because of having one district instead of two.
- Annual licensing costs for financial system reduced because of combining the two existing systems onto one system.
- Increased phone and janitorial cost because of choosing the richer plans of the two districts.

The savings of \$711,106 realized from the formation of the new District is significant and instrumental in offsetting one-time expenses. This includes temporary personnel related to the

software conversion, consultancy cost for a risk assessment to aid in the development of new policies and procedures, financial system setup, and other finance assistance related to the consolidation, and additional attorney fees to review policies and initial contractual agreements of the new District.

The one-time cost related to the purchase of the new financial software could be viewed as cost avoidance since both prior districts were looking at purchasing new software soon, consolidation meant only one finance system needed to be purchased.

There will be future increases such as the annual licensing costs for expanding the maintenance management system to add water items and the GIS system since the combine services increases the pipe segments raising OLWSD to a new cost tier.

The benefits in efficiencies continue to surface as the field crews from water and collections work together on projects that ultimately save the District money. Recently they were involved in building a driveway at the plant that saved the cost of hiring a contractor. During some periods of low staffing on the sanitary crew, the water crew has been able to help with driving the solids truck to the disposal site. Many of the field workers have started cross-training to cover in times of need.

There have been some unanticipated issues during the consolidation process which have interrupted the timeline and created some hardships which needed to be worked through. The District has had to fill nine of the thirty-four positions due to employees vacating their positions for new endeavors. Filling the positions and keeping services going has caused additional work for the remaining employees and has been time consuming. It has also caused some lag in the timelines initially anticipated. OLWS is now fully staffed and is focused back on track to complete the steps of the consolidation while welcoming and training the nine new employees.

As stated in the FCS report there is a difference between cost savings and a reduction in the budget or rates. In this case, we are talking about cost savings, which might not lead to a reduced budget or rates. The normal cost pressures of inflation, capital projects, or regulatory requirements can lead to increased costs independent of the effect of a consolidation. For example, if a new position were to be needed to meet a stormwater regulatory requirement, that would offset the savings created by consolidating the districts. But even in that instance, it would still be accurate to state (assuming Scenario 2 savings) that the District expects the ongoing cost of a single District to be less than the combined ongoing cost of two separate Districts by about \$711,000 per year in 2016 constant dollars. Just to provide a frame of reference: savings of \$425,000 per year represented about 5% of the combined operating budget of the two Districts, or roughly two years of inflation. The savings of \$711,000 is nearly 8% of the 2019 operating budget.