ATTACHMENT 1

King County

KING COUNTY AUDITOR'S OFFICE

SEPTEMBER 12, 2023

Staff Capacity and Project Complexity Limit Right-of-Way Revenue

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EXECUTIVE SUMMARY

King County is projecting a $50 million shortfall in General Fund revenue for 2025, increasing the importance of complete and accurate revenue collections countywide. One of the County's newer revenue sources is franchise compensation—payment by water, sewer, gas, and electric utilities for using road rights-of-way in unincorporated areas. King County collected $5 million in franchise revenue in 2021 and 2022 combined, 46 percent lower than the projected $9.2 million the County budgeted. For 2023 and 2024, we estimate that franchise revenues will reach $7.6 million, 37 percent below projected revenues of $12 million. Limited staff capacity, competing priorities, and a lack of guidance on how to raise revenue equitably have hindered the ability of the Facilities Management Division and Real Estate Services to meet strategic and programmatic goals. To help achieve these goals, the County will need to establish program priorities, increase efficiency, and develop an equity lens.

Acknowledgment

We would like to thank the Real Estate Services (RES) Section of the Facilities Management Division under the Department of Executive Services for its collaboration and candor during this audit. RES shared guiding documents, data, and insights about the franchise compensation program through regular meetings and communication exchanges. The agency's interest in establishing a solid foundation for the program was notable and appreciated, as was staff's thoughtfulness about the tradeoffs and complexities involved in the franchise arena.

RES has taken important steps to establish the franchise program. It started developing key performance indicators and work effort estimates that will help with program monitoring and continuous improvement. RES contacted utilities with expired agreements to request franchise applications and began recruitment to add a second employee to the team to increase throughput. At the time of this writing, RES was also negotiating a franchise agreement with a large utility.

REPORT HIGHLIGHTS

What We Found

Through franchise agreements, King County grants utility operators the right to use road rights-of-way in unincorporated areas for the construction and maintenance of their facilities. In exchange, utilities are required to provide reasonable compensation to the County. Franchise agreements also clarify who is responsible for managing risks associated with potentially dangerous conditions in the public right-of-way, reducing risk to the County and its residents.

The County has a backlog of 104 franchise agreements with 89 utilities, delaying revenue collection, creating the potential for risk, and generating uncertainty among utilities. Actual franchise revenues have been well below projections since 2021 due to limited staff capacity. Based on its workload estimates, the Real Estate Services (RES) Section, which began managing franchises in 2023, may need until 2027 to negotiate compensation with all utilities. For the 2023–24 biennium, we estimate that franchise revenues will reach $7.6 million, or 37 percent below projected revenues. The extent to which the County collects franchise revenue over the next few years will depend on how the County staffs and monitors the program as well as how RES organizes its backlog.

Utilities may raise customer rates because of franchise compensation, but the County has not studied the impact of franchise compensation on residents. The County's rules for estimating franchise compensation include a step meant to keep the cost that utilities pass on to customers at a reasonable level. However, since utilities, not King County, set customer rates, the County's rule cannot ensure that cost burdens are affordable or equitably distributed.

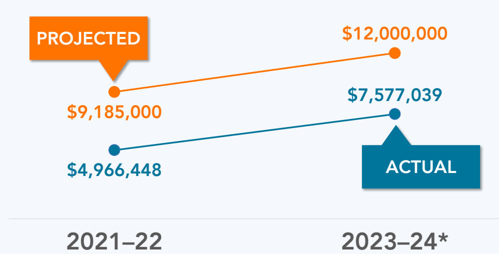
What We Recommend

We make recommendations to consider hiring temporary staff to work the backlog, clarify program priorities and targets, increase efficiency, and improve processes. We also recommend that RES conducts an equity analysis to identify and mitigate potential inequities in franchise compensation.

Why This Audit Is Important

King County is expecting a $50 million shortfall in its General Fund in 2025. RES estimates that franchise compensation could generate $11 million in General Fund revenue per year. The County could use this revenue flexibly to provide services it might otherwise reduce or eliminate. But collection of franchise revenue has been slow. Rather than issuing an invoice based on set prices, the County must negotiate compensation one-on-one with water, sewer, gas, and electric utilities operating in the rights-of-way of unincorporated King County. For utilities with current contracts to use rights-of-way, the County can limit negotiation to compensation and append the terms to existing contracts. For those with expired contracts, wider ranging agreements are necessary before collection can begin.

Actual revenues missed projections by 46% and 37% in the last two biennia.



*Actual revenues for 2023–24 include collected and negotiated amounts from agreements made as of June 2023.

Source: King County Auditor's Office analysis of county financial data

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Section 1: Franchise Compensation Overview

SECTION SUMMARY

King County grants utilities the right to use road rights-of-way in unincorporated areas through franchise agreements and, in exchange, requires utilities to provide it with reasonable compensation. Franchise agreements between the County and the utility state when and where utilities may operate and who is responsible for managing risks associated with potentially dangerous conditions. This reduces the likelihood of risk to the County and the public. Franchise revenue goes into the General Fund, which is not restricted to any particular use. The Real Estate Services (RES) Section of the Facilities Management Division (FMD) under the Department of Executive Services administers the franchise program. FMD assigned RES to build franchise management from a project to a program in 2023. Based on data provided by the RES and publicly available information, we estimate that 95 water, sewer, gas, and electric utilities are subject to franchise compensation. These utilities vary in size and most commonly provide water and sewer service. Utilities and the County negotiate the cost of franchise compensation, which varies based on the size of the occupied right-of-way and number of utility customers served. Utilities decide whether to pass the cost of franchise compensation on to their customers, which can lead to higher utility bills for county residents. County rules for estimating franchise compensation include a step meant to keep the cost that utilities pass on to residential households reasonable—a threshold currently defined as less than $5 per residential customer per month.

What is a franchise?

A franchise is an agreement between King County and a utility that allows the utility to use county road rights-of-way in unincorporated areas to provide services.[1] The word "franchise" also refers to a franchise area, or the geographical location of the rights-of-way used under that agreement. One franchise agreement can correspond to multiple franchise areas. Throughout this report we will use the terms "franchise agreement" and "franchise area" to distinguish between the two. Franchise agreements state when and where utilities may operate and who is responsible for managing emergencies and risks associated with potentially

[1] King County Road Design and Construction Standards (2016) define rights-of-way as public land, property, or property interest (e.g., an easement), usually in a strip, acquired for or devoted to transportation purposes.

dangerous conditions, reducing the likelihood of risk to the County and the public. For example, franchise agreements help the County ensure that the locations of utilities align with local development plans. Franchise agreements also set insurance minimums that can reduce financial risks associated with utility operation and infrastructure, such as costs related to pollution abatement and vehicle accidents.

What is franchise compensation?

Franchise compensation is an annual payment by water, sewer, gas, and electric utilities to King County to use county road rights-of-way in unincorporated areas. This payment is like rent because the County owns road rights-of way in unincorporated areas. The King County Council passed legislation (Ordinance 18403) approving franchise compensation in 2016.[2] The franchise ordinance states that franchises grant a valuable property right to utility companies, allowing them to profit and benefit in a way not available to the public. In exchange, utilities are required to provide the County with reasonable compensation. Prior to the franchise compensation ordinance, the County charged utilities an application fee to process franchise agreements but did not charge compensation for use of the right-of-way.

How is franchise compensation calculated?

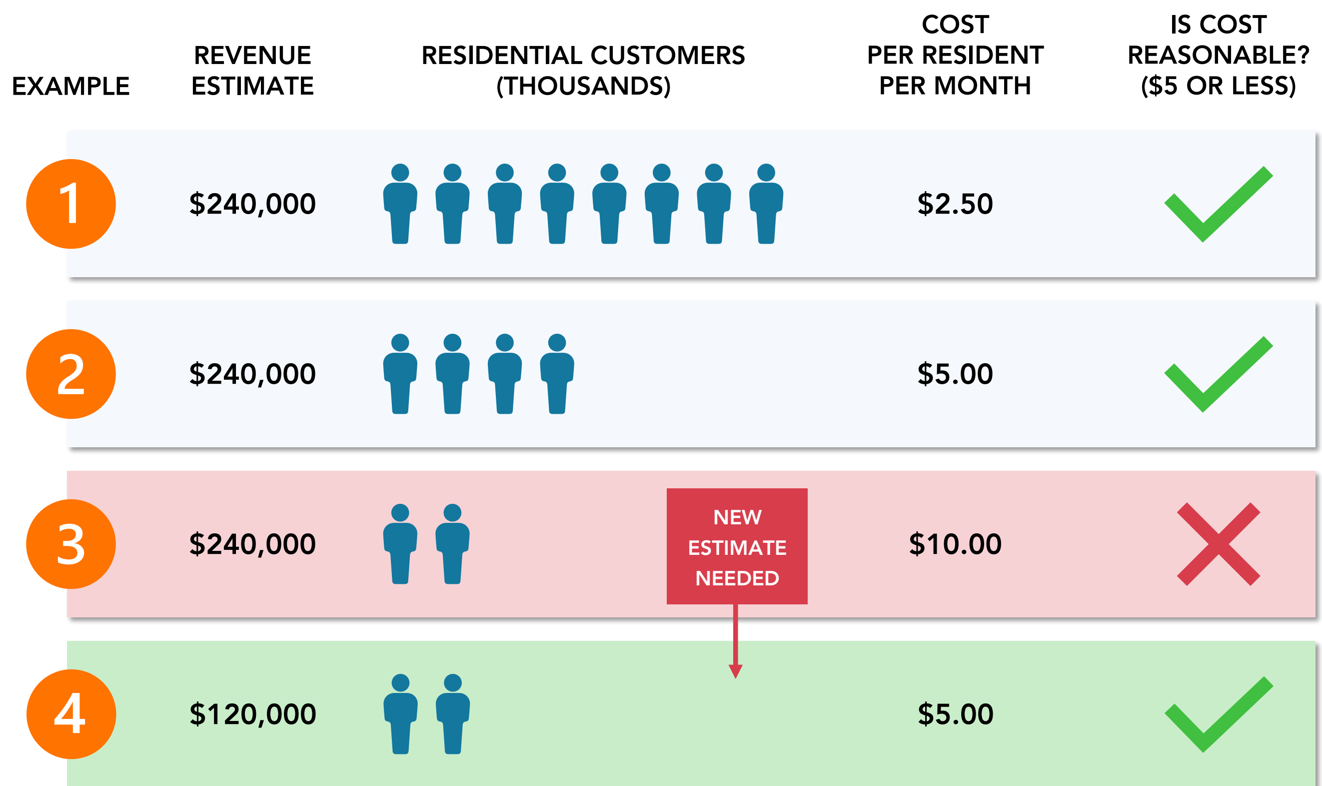
Utilities and King County negotiate franchise compensation. To develop a starting point for negotiations, King County Information Technology's Geographic Information Systems Center (GIS Center) provides data to RES, namely the average value of the taxable properties along the road rights-of-way that a utility uses. RES then discounts the property value for above- and below-ground facilities and multiplies it by a percentage that FMD sets as a reasonable rate of return from that value. Using this information, RES checks that any monetary impact on residents would be reasonable. To do this, RES evaluates whether the revenue estimate averages out to no more than $5 per residential customer per month (see exhibit A).[3] For example, if the annual revenue estimate were $240,000, and the utility had 4,000 residential customers, the average cost per residential customer per month would be

[2] Legal challenges delayed revenue collection until the courts affirmed the County's right to charge franchise compensation in December 2019 and May 2020.

[3] Rules for Determining Franchise Compensation under KCC 6.27.080 (RPM 9-2) 2.4, establish the method for ensuring compensation is reasonable. FMD sets the dollar amount input into that method, which is currently $5.

$5.[4] Since this meets the reasonable cost test, RES would use this revenue estimate to enter negotiations with the utility. However, if there were only 2,000 residential customers for the same franchise area, the average cost would increase to $10 per residential customer per month, and RES would adjust the estimate to meet the $5 threshold before sending it to the utility to begin negotiations.

EXHIBIT A: King County lowers its annual revenue estimates for franchise compensation when it finds the cost per resident is too high.



Note: This is a simplified theoretical example for purposes of explanation. These examples do not account for non-residential customers, which would affect the new value calculation.

Source: King County Auditor's Office

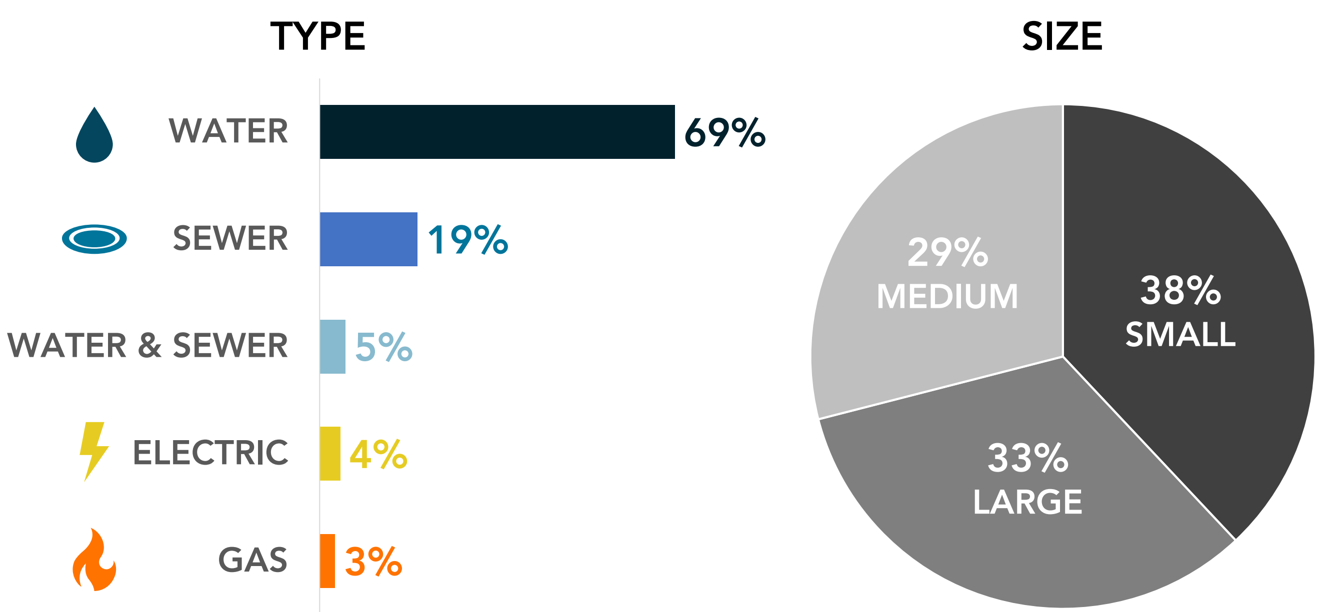
How many utilities need to negotiate franchise compensation?

As of June 2023, there were 95 utilities required to negotiate franchise compensation with King County. About 70 percent of their franchise agreements

[4] Annual compensation ($240,000) divided by 12 months ($20,000) divided by 4,000 customers ($5).

were for water service and 20 percent were for sewer (see exhibit B). Across all utilities, each varied in size. Water and sewer utilities ranged from small to large, while all gas and electric utilities were large. The County defines small utilities as those occupying up to 10,000 linear feet of road rights-of-way, medium utilities as those occupying between 10,000 and 100,000 linear feet, and large utilities as those occupying more than 100,000 linear feet. Because they occupy more road rights-of-way, larger utilities are likely to pay higher compensation. As a result, even though about 70 percent of franchise agreements were for water service, these agreements only accounted for 28 percent of estimated revenue from franchise compensation due to their size.

EXHIBIT B: Among franchise agreements, water service is most common; the amount of total right-of-way a utility occupies varies, depending on its size.



Note: Utility type is among all 111 franchise agreements. Utility size is among 97 of 111 franchise agreements where size data is available. King County defines small utilities as those occupying up to 10,000 linear feet of road rights-of-way, medium utilities as those occupying between 10,000 and 100,000 linear feet, and large utilities as those occupying more than 100,000 linear feet.

Source: King County Auditor's Office analysis

What is the process for getting a franchise?

The franchise agreement process can last up to 19 months and involves five phases: application, Executive review, negotiation, Council review, and signing. The process officially starts when a utility submits a franchise application to the Clerk of the Council, which is responsible for recording franchise applications (see exhibit C).[5] The Clerk then forwards the application to RES, which starts the Executive review process. Because of the potential risks involved with operating utilities on public land, during Executive review, RES gets input from the Department of Local Services (Roads Services Division and Permitting Division) and the Utilities Technical Review Committee (UTRC). The UTRC checks whether water and sewer utilities have current planning documents, which are necessary before a franchise can be issued (more on this in section 2). RES then drafts a proposed agreement and sends it to the utility to begin negotiation. RES consults the Prosecuting Attorney's Office during negotiations as needed. Once RES and the utility agree on terms and the Executive transmits legislation, Council review begins. The Land Use and Local Services Committee hears public comment and refers the franchise agreement to Council for a vote. Once approved, the utility and RES each sign the agreement.

EXHIBIT C: The franchise agreement process involves five phases, lasting up to 19 months.

Source: King County Auditor's Office analysis of Real Estate Services information

How are residents affected?

Residents may see varying utility rate increases as utilities decide whether and to what extent to pass the cost of franchise compensation on to their customers. Both Seattle City Light (SCL) and Soos Creek Water & Sewer District (Soos Creek) passed on the cost of franchise compensation, while the City of Redmond did not (see exhibit D). SCL said its 8 percent rate increase would mean that a typical residential customer would pay about $7 more per month, which is higher than the County's reasonableness benchmark of $5 per month. Since each utility negotiates franchise compensation with the County, rate increases can add up

[5] RES requires franchise applications for utilities with expired franchise agreements as a prerequisite of granting permits to do construction in the right-of-way. RES had franchise applications from 83 percent of utilities with new or expired franchises as of June 2023.

across multiple bills. For example, a household with water and electric bills would pay a total of $120 more per year if each utility raised rates $5 per month. While neither has started negotiations with the County, both Tanner Electric Cooperative and Ames Lake Water Association notified customers that they expected to increase monthly utility bills by about $4 or $5.[6] Rate increases will depend on negotiated compensation, the number of residential customers served, the utility's ability or willingness to cover the cost, and, in some cases, state oversight bodies like the Washington Utilities and Transportation Commission.[7] Where utilities raise customer rates by a percentage of usage, like SCL and Soos Creek, residents can reduce their financial impact by conserving resources, for example by using less electricity and water, to the extent they are able.

EXHIBIT D: Utilities increased customer rates because of franchise compensation starting in 2021.

Utility	Increase in monthly bill	Date of increase
City of Redmond*	$0	N/A
Soos Creek Water & Sewer District	6% of usage	Feb 2021
Seattle City Light	8% of usage	Jan 2023

*City of Redmond includes both City of Redmond and City of Redmond - Novelty Hill.

Source: King County Auditor's Office

Where do revenues from franchise compensation go?

Franchise revenue goes into the General Fund, which the County can use flexibly to support government services and policy initiatives. The General Fund is about $1.2 billion, comprised of three categories of about $400 million each. The County chooses how to spend one of those three categories, while the other two, directed by state requirements and contract agreements, go to things like policing, jails, and public defense. In 2025, the County expects to see a $50 million, or 12

[6] Separately, effective in 2023, Tanner Electric Cooperative added a fee of $2 per month to residential and commercial customers to cover legal fees it incurred challenging the County's right to charge franchise compensation in court.

[7] The Washington Utilities and Transportation Commission regulates private, investor-owned electric and natural gas utilities, such as Puget Sound Energy, and private water companies with 100 or more connections or with annual charges of more than $557 per customer, such as Burton Water Co-op, Gold Beach Water Company, and Washington Water Service.

percent, shortfall in the $400 million portion of General Fund spending that it controls.[8] The General Fund supports programs for both unincorporated and incorporated areas of King County.[9] [10]

[8] The director of the County's Office of Performance, Strategy and Budget gave this estimate to the Budget and Fiscal Management Committee of the King County Council on June 14, 2023. The director noted that agencies affected by the shortfall include Public Health – Seattle & King County, Department of Executive Services (which includes RES), Department of Local Services, Elections, and Department of Natural Resources and Parks.

[9] For example, in the 2023–24 budget, $11 million of General Fund money went to support projects in unincorporated areas such as code enforcement and other initiatives.

[10] The General Fund is not the main source of funding for roads projects, which are mainly supported by Real Estate Excise Tax funds.

Section 2: Franchise Revenue Risks Further Delay

SECTION SUMMARY

RES has consistently missed budget targets for franchise revenue due to limited staff capacity and a significant backlog in new and expired franchises. Our analysis suggests that RES may need four years to negotiate franchise compensation with all utilities with two full-time staff. The amount of revenue these agreements will yield, however, is uncertain as revenue estimates are imprecise. In addition, RES does not have clear revenue targets as capacity and work priorities remain in flux. Finally, as RES works through its backlog and franchise revenue increases, the County is likely to find its revenue controls lacking. We make recommendations to consider hiring temporary staff to work the backlog, establish realistic revenue targets, clarify program priorities, increase efficiency, and improve policies and procedures.

Limited staff capacity delayed progress

King County has lacked staff capacity to negotiate franchise agreements since negotiations began in 2020, delaying revenue to the County's General Fund. As of June 2023, RES was hiring for a new position to bring total staff for the franchise program to two.[11] Prior to the enactment of franchise compensation in 2016, franchise agreements lasted 25 years, limiting administration. Since the County has started charging franchise compensation, franchise terms have come down to 10 years, with an option to extend up to 15 more years, and more duties have emerged, including the need for new templates, procedures, and rate calculations. In addition, the COVID-19 pandemic significantly affected local government operations in myriad ways by the time the Superior Court issued its order in favor of franchise compensation in May 2020.

FMD had one temporary employee working on franchise compensation until 2023. That year, FMD assigned RES to take over franchise administration with one full-time employee. When RES took on the program, there were no standard operating procedures for franchise administration, and the number of franchise areas with expired agreements had grown to 87 from 73 in 2019.

[11] Under county code, RES can recover from utilities staff time costs used to approve franchises that exceed the application processing fee of $2,500. If utilities incur this one-time cost, the County credits it to their first franchise compensation payment.

RES has not assessed the extent to which temporary staff could help clear its franchise agreement backlog, delaying additional capacity. King County guidelines state that agencies can hire temporary employees for terms of three years to do the non-routine work of initiating a county function while assessing whether it needs more full-time staff. RES developed workload estimates to support its request for a second employee. Although RES said these estimates were of limited reliability due to the complexity of negotiations and a lack of performance data,[12] these estimates suggest that with two full-time staff it would take four years for RES to negotiate franchise agreements with all 89 utilities that lack compensation terms (see exhibit E).

EXHIBIT E: Real Estate Services faces a backlog of 104 franchise agreements with 89 utilities to collect franchise compensation.

	Required	Done – Negotiated	Backlog – Not Negotiated
Utilities	95	6	89
Franchise agreements	111	7	104
—Expired, new	–	–	—64
—Current	–	–	—40

Note: One utility may have multiple franchise agreements. For example, Soos Creek Water & Sewer District has both water and sewer franchise agreements.

Source: King County Auditor's Office analysis

RES could cut backlog processing time to two years if it hired two temporary staff in addition to its two full-time employees.[13] Beyond that, additional staff could run up against process bottlenecks related to the Council review period. The Local Services and Land Use (LSLU) Committee that reviews franchise agreements meets once a month and has not reviewed more than two agreements per meeting in recent years. LSLU would have to accommodate an average of three agreements per meeting to review all 64 new and expired agreements in two years. County code

[12] King County signed six agreements between 2020 and 2022. RES does not have reliable data on work effort for each of these negotiations.

[13] RES had filled one of the two full-time positions, while the other was open for recruitment as of June 2023.

requires Council review for new and expired, as opposed to current, franchise agreements.

Recommendation 1

The Facilities Management Division should determine whether to hire temporary employees to reduce backlog processing time and document and implement its decision.

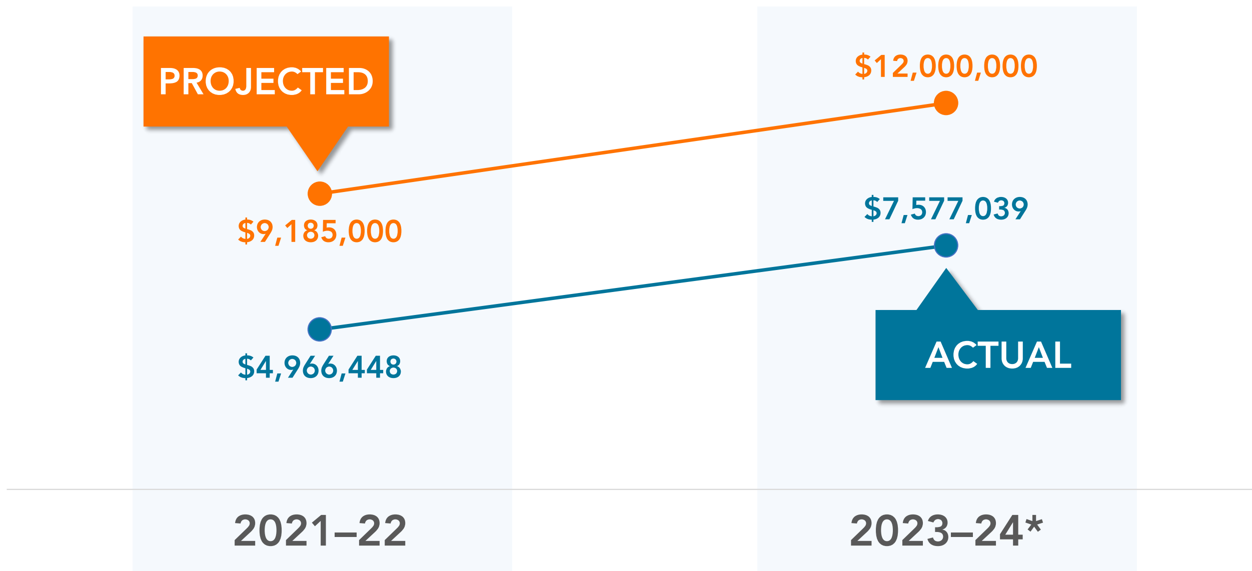
Budget estimates not realistic

Budgeted revenues for franchise compensation lacked realistic productivity estimates, leading to gaps between budgeted and actual revenue. King County aims to forecast revenues in a consistent and objective manner, according to revenue policies in its Comprehensive Financial Management Policies. In the 2021–22 biennium, actual franchise revenues were 46 percent below those projected in the budget (see exhibit F). Based on contracts signed as of June 2023, we estimate that actual franchise revenues for the 2023–24 biennium will reach $7.6 million, or 37 percent below projected revenues of $12 million. RES computes franchise revenue estimates and submits them to the Office of Performance, Strategy and Budget (PSB) to include in the County's proposed budget. RES's latest total revenue estimate across all utilities was about $11 million in annual franchise revenue.[14] Between 2021 and 2024, budgeted franchise revenues averaged $5.3 million per year, about half of the estimated total.[15]

[14] This is the sum of revenue estimates for 92 of 95 utilities. Estimates were not available for three utilities.

[15] In addition to capacity, timing has accounted for part of the difference between budgeted and actual revenues. For example, if the County and a utility sign an agreement in 2022 for franchise compensation of a percentage of annual revenue starting in 2023, the County may not receive the first payment until 2024, after the utility reports full year revenues for 2023.

EXHIBIT F: Actual revenues missed budget projections by 46% and 37% in last two biennia.



*Projected revenues are from the County's revised budget for 2021–22 and from its adopted budget for 2023–24, as of April 20, 2023. For actual revenues, we summed franchise compensation invoices and payments expected in 2024 based on franchise agreements as of June 2023.

Source: King County Auditor's Office analysis of county financial data

Recommendation 2

The Office of Performance, Strategy and Budget should work with Real Estate Services to develop, document, and implement a reliable method to create budget estimates for franchise compensation revenue that accounts for staff capacity.

RES lacks revenue targets

RES did not use franchise compensation revenue targets to track program performance, reducing accountability and transparency. According to government accountability standards, management should consider the expectations of legislators when establishing its objectives.[16] RES could use budgeted revenues to track its performance since the budget is a useful tool of legislative oversight and prioritization. However, RES said it did not use budget estimates in this way because it did not know how those numbers were developed. RES included a performance indicator for the proportion of utilities paying franchise compensation in its draft

[16] We refer to the US Government Accountability Office's *Standards for Internal Control in the Federal Government* (also known as the Green Book GAO-14-704G). These standards may be adopted by local government entities.

work plan but did not include a revenue target, making it difficult to use actual or budgeted revenues to assess RES performance.

Recommendation 3

Real Estate Services should establish revenue targets as a key performance indicator for the franchise compensation program.

Revenue estimates are imprecise

RES does not account for population density in its estimates of franchise compensation revenue, adding uncertainty to projections. Government accountability standards state that management should use quality information, which is both accurate and complete. As part of this audit, we looked at eight of the most recent franchise applications to evaluate how customer numbers provided on those applications could affect revenue estimates. We found that revenue estimates for three of the eight applicants were likely to exceed the per customer reasonable cost threshold, which we detail in section 1 and exhibit A. As a result, RES's revenue estimates for these eight franchise agreements may be $400,000 too high.

While RES incorporates customer data into revenue estimates that it uses to enter negotiations, RES does not include them in revenue estimates that PSB uses to develop the budget. Without including customer or population data, which are loosely correlated, revenue estimates may be too high in areas with low population density and high property values. This is because, as discussed in section 1, RES divides its initial revenue estimate by customer numbers to determine whether the potential monetary impact on residents in the franchise area would be reasonable. If it is not reasonable, RES calculates a new estimate based on the number of customers in the area.[17]

[17] The new estimate equals the sum of the product of residential customers times the monthly reasonableness threshold ($5) and the product of non-residential customers times the monthly franchise compensation amount times 12 months. New estimate = (residential customers x $5) + (non-residential customers x (GIS Center revenue estimate/residents/12) x 12 months.

EXHIBIT G: Revenue estimates are imprecise, contributing to uncertainty.

Utility	Estimated Annual Revenue	Negotiated First-Year Revenue	Difference
City of Redmond - Novelty Hill	$830,623	$22,515	($808,108)
Soos Creek Water & Sewer District	$377,881	$277,884	($99,997)
Lake Washington School District	$358	$358	$0
City of Redmond	$4,259	$4,630	$371
Puget Sound Energy	$1,539,118	$2,000,000	$460,882
Seattle City Light*	$730,333	$2,090,756	$1,360,423

*All negotiated first-year revenue amounts are from invoices except for Seattle City Light (SCL), whose first payment is due in 2024. SCL agreed to pay 8 percent of unincorporated county revenue as franchise compensation. Negotiated first-year revenue for SCL is based on a fiscal note attached to the franchise agreement between the County and SCL.

Source: King County Auditor's Office analysis

To further evaluate the precision of revenue estimates, we compared them to revenue collections for the utilities that have agreed to franchise compensation amounts (see exhibit G). All but the lowest two estimates were off by 26 percent or more. Two of the six utilities had estimates that were much higher than negotiated first-year revenues. For example, the revenue estimate for City of Redmond – Novelty Hill was more than $800,000 per year without accounting for the number of residential customers. However, after RES accounted for residents, franchise compensation dropped significantly to just 3 percent of its original figure, or $22,000.[18] To improve its revenue estimates, RES could incorporate customer data from utilities or population data from the GIS Center earlier in the process.

[18] The difference in revenue was due in part to fire suppression credits and potentially other aspects of negotiation, but RES did not have documentation to the revenue impact of each factor and emphasized the impact of population density.

Recommendation 4

Real Estate Services should develop, document, and implement a method to increase precision in franchise compensation revenue estimates by incorporating population or customer data.

Program lacks clear risk guidance

FMD lacks clear guidance for managing risk related to franchise compensation, reducing program effectiveness. Responsibility for making decisions about risk appetite lies with department directors, division directors, and senior leaders. Effective risk management increases the likelihood of achieving strategic objectives. A risk appetite statement guides staff on the amounts and types of risk King County is willing to accept to achieve its objectives, allowing staff to understand tradeoffs and identify opportunities to increase value.

When the actions that staff need to take to address risks are conflicting, unclear guidance can lead to delay. In the case of franchise administration, the delay relates to uncertainty around prioritizing franchise negotiations in ways that support various aims. At least until 2022, FMD staff prioritized franchise agreements for negotiation by revenue, starting with those likely to yield the highest compensation, regardless of whether the franchise agreements were current or expired. Budgeted program revenues and the projected shortfall in the General Fund suggest that revenue growth is a priority and, thus, an area where the County may be less risk seeking. However, the County is also risk averse or risk concerned when it comes to health and safety (e.g., the potential for dangerous conditions in the right-of-way) and risk concerned to risk neutral for reputation (e.g., customer experience).

Utilities applying for franchises stated that, by focusing on revenue, King County is likely to delay applications for smaller utilities. Because the County can collect franchise compensation retroactively to 2018, this will not necessarily save smaller utilities money but will add to uncertainty about future costs and rate changes. Similarly, by focusing on utility types with greater potential for safety risks, like oil and gas, revenue and customer service aims may be negatively impacted.[19]

[19] Oil utilities are not subject to franchise compensation, but RES is also responsible for keeping franchise agreements current for oil utilities. At the time of this writing, there was one oil utility operating in unincorporated King County with an expired agreement.

Recommendation 5

In line with King County's risk appetite statement, the Facilities Management Division should work with senior leadership to develop and document a risk appetite statement to guide management of the franchise compensation program.

Current agreements faster to process, but not prioritized

RES has not prioritized current franchise agreements, contributing to delays in collecting revenue for King County. After FMD's approach of prioritizing based on revenue, which included negotiating current agreements, RES's plan is to work through all expired and new franchise agreements before negotiating compensation on current agreements. This is because utilities operating without a franchise agreement or with an expired franchise agreement present more potential risk than utilities with current franchise agreements. At the same time, current agreements have a shorter review process than expired or new agreements. RES estimates that for each current franchise agreement it would take 16 hours to negotiate compensation terms, whereas for each expired or new franchise agreement it would take 132 hours to negotiate in full.[20] This means RES could negotiate compensation on eight current franchise agreements in the time that it takes to negotiate one expired or new franchise agreement.

Three-fourths of current agreements will expire within five years, limiting RES's window to take advantage of these efficiency gains in the future.[21] Negotiating franchise compensation sooner has two financial benefits. First, it reduces the number of years the County has to negotiate for retroactive payment, which can go back to 2018, and it increases the number of years the County can invest the revenues it collects.[22] We counted 40 current franchise agreements with estimated revenues totaling $1.3 million per year.[23] RES could negotiate all 40 of these agreements in 640 hours at the rate of 16 hours per agreement (see exhibit H). However, work effort could increase if the County's limited expertise on fire suppression costs delays negotiations as discussed below.

[20] While different processes, both have the same result. This is because for current agreements, RES and the utility only need to agree to compensation and attach those terms to their current franchise. For new and expired agreements, RES and the utility must go through the entire franchise approval process (outlined in section 1) before compensation begins.

[21] RES would still need to go through the franchise approval process when these current agreements expire; the difference is when the County starts collecting annual compensation.

[22] King County's forecasted discount rate for 2023 was 1.5 percent.

[23] The three highest-yielding agreements account for 74 percent of estimated annual revenue for the 40 current agreements.

EXHIBIT H: Real Estate Services can negotiate current agreements much faster than expired and new agreements.

	NUMBER OF AGREEMENTS	HOURS PER AGREEMENT	HOURS OF WORK
CURRENT	40	16	640
EXPIRED & NEW	65	132	8,580

Source: King County Auditor's Office analysis

Recommendation 6

Real Estate Services should prioritize current agreements for franchise compensation negotiation to speed revenue collection and reduce processing time.

Missing expertise on fire suppression could delay negotiations

Staff lack subject matter expertise to negotiate compensation credits with water utilities, which could extend delays in obtaining revenue for King County. Water utilities can claim fire suppression credits to reduce how much they pay in franchise compensation.[24] Two utilities have waived these credits, with one suggesting that the cost of estimating the credit would outweigh any benefit. However, other utilities have suggested that fire suppression credits would cancel out any proposed compensation. Without a way to validate fire suppression costs, RES may have to either delay negotiations with the more than 70 water utilities that need franchise agreements or enter negotiations and risk accepting unfair terms. RES plans to hire a consultant to develop tools to assess the costs of fire suppression.

[24] King County Code 6.27.060.C.2 states that the County will credit costs incurred by a franchisee for fire suppression water facilities against any franchise compensation. Revised Code of Washington 70A.145.020 defines these facilities as water supply transmission and distribution facilities, interties, pipes, valves, control systems, lines, storage, pumps, fire hydrants, and other facilities usable for delivery of water for fire suppression.

Recommendation 7

Real Estate Services should develop, document, and implement a reliable method to assess fire suppression credits toward franchise compensation.

Rules for water, sewer plans outdated

King County Code stipulates more frequent approval requirements for water and sewer plans than does state law, creating work that could delay franchise negotiations. County code requires water and sewer utilities to have system plans that are no more than six years old to get a franchise. In contrast, the Washington State Department of Health allows growing water utilities up to 10 years before updating their plans, while the Washington State Department of Ecology has no specific regular timeline for when sewer utilities must update theirs. Effective in 2017, the Department of Health changed its requirement from 6 to up to 10 years, but the County has not revised its code to reflect this change.

RES has not prioritized utilities based on the status of existing plans, which could lead to longer processing times. As part of the Executive review phase of the franchise agreement process (shown in exhibit C), the UTRC ensures that a water or sewer utility has a current system plan.[25] The Executive review process has a broad time period (from 4 to 12 months) in part because some utilities lack current plans. The UTRC said it can take as little as a week to provide the status on a utility's plan, where a status of "current" would be an indication to continue the franchise agreement process. However, depending on its readiness, a utility without a current plan may need a few months or over a year to get to a "current" status. The timing depends on how quickly a utility provides documentation and responses to the UTRC.[26] The potential for delays at a utility can be due to the high cost of water and sewer system planning, which can require investment in time and consultants that may not be readily available, especially for smaller entities.

Added cost may reduce the likelihood that utilities would be willing and able to do planning more often than the state requires. To avoid planning delays on franchise compensation negotiations, RES could work with UTRC to determine which utilities have current water and sewer plans earlier in the process, or RES could

[25] The UTRC is a county committee made up of staff from various departments whose main purpose is to provide technical review of water and sewer utility plans to ensure consistency with county plans and policies.

[26] The UTRC said that it has approved extensions of plans of up to 10 years at the request of utilities.

identify gas and electric utilities which do not require these plans and prioritize both for processing. We found 16 utilities with expired franchise agreements that either met or were exempt from the planning requirement. Estimated franchise revenue for these 16 utilities would exceed $3 million per year.[27]

Recommendation 8

The Utilities Technical Review Committee should coordinate with stakeholders to propose revisions to King County Code 13.24 to align water and sewer system planning requirements with state requirements.

Recommendation 9

Real Estate Services should work with the Utilities Technical Review Committee to prioritize franchise processing based on water and sewer system planning status.

Financial tracking shows weakness

RES lacks standard operating procedures to ensure payments are complete and accurate per contract terms, increasing the risk of loss to King County. FMD finance staff manually document payments, including compensation and application fees. As RES clears its franchise backlog and the number of utilities paying franchise compensation increases from 6 to 95, the potential loss from any errors will increase significantly. Moreover, staff need to verify compensation against negotiated terms, which vary from flat rates to percentages of revenue and sometimes include regular inflation adjustments. When reviewing invoices for franchise compensation, we found one payment that omitted a month's worth of compensation with no documentation explaining the discrepancy. We also found one utility erroneously included in the list of those paying franchise compensation because it had paid an application fee.

Recommendation 10

Real Estate Services should develop, document, and implement policies and procedures to ensure complete and accurate collection of franchise compensation revenue.

[27] This number would be higher if there are also non-growing water utilities, which do not have the same planning requirements as growing water systems, operating in the county right-of-way.

Section 3: Franchise Program Lacks Equity Analysis

SECTION SUMMARY

King County has not conducted an equity analysis of franchise compensation, increasing the likelihood of inequitable cost burdens. While utilities decide whether to raise rates for their customers, it is the County's policy goal to spread its fee burden equitably. The County uses a uniform approach to check whether franchise compensation is likely to lead to reasonable cost increases for utility customers, but this equal approach may have inequitable impacts for under-resourced communities. RES has not developed ways to identify and mitigate how franchise compensation may negatively impact residents, increasing the likelihood of inequities. We recommend RES conducts an equity analysis to identify and mitigate inequities in franchise compensation.

Equity analysis missing

King County has not conducted an equity analysis to support decision-making for franchise compensation, increasing the likelihood that compensation will lead to inequitable cost burdens. According to King County's Equity and Social Justice Strategic Plan (2016–2022), an equity analysis should support decision-making for rates, like franchise compensation.[28] Council staff confirmed that the development of the franchise compensation policy did not involve an equity analysis. In instances where the County Council asked FMD to account for equity impacts of franchise compensation, FMD did not report any.

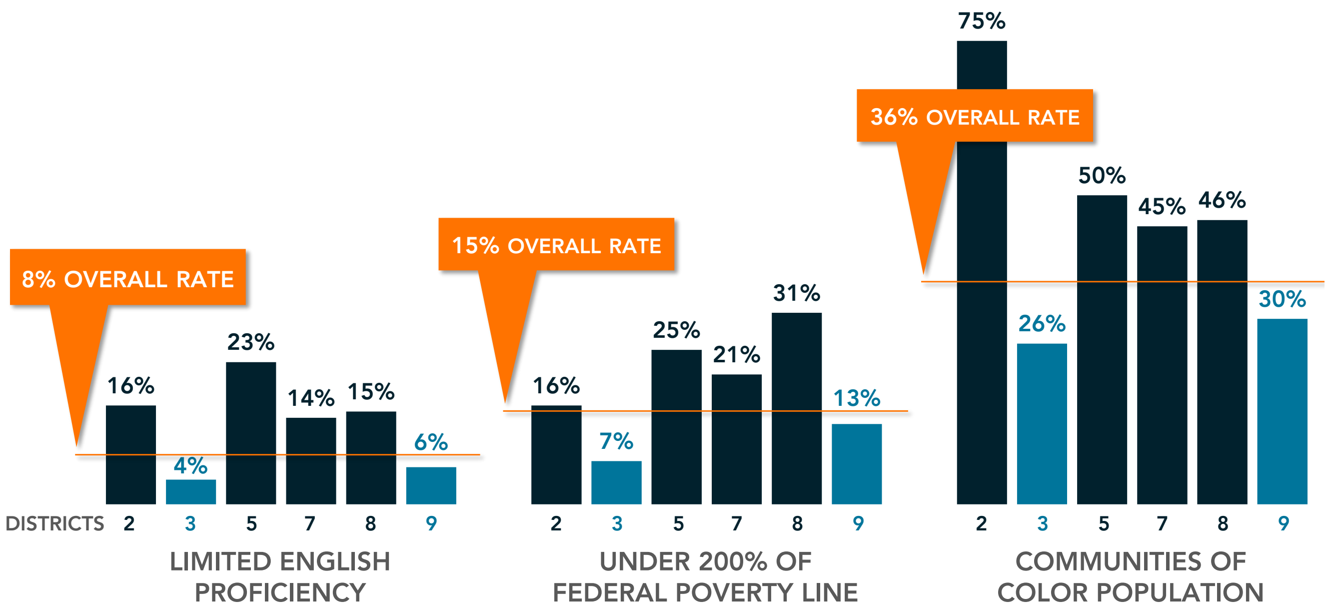
RES uses a fixed rate to determine whether franchise compensation costs are reasonable, which could lead to higher cost burdens for lower income residents. King County Code allows processes for determining franchise compensation to differ depending on the size and complexity of the franchise agreement. Code also allows franchise compensation to come in the form of nonmonetary benefits in lieu of cash. Policies for service charges allow the County to consider variable pricing to support equity and social justice goals.[29] County equity goals require agencies to identify or mitigate negative impacts on communities of color, low-income residents, and people with limited English proficiency. In unincorporated King County, about 15 percent of people earn less than two times the federal poverty line (i.e., are under

[28] At the time of writing, the 2022 plan was King County's most recent Equity and Social Justice Strategic Plan.

[29] Revenue policies and policy goals are in King County's Comprehensive Financial Management Policies (May 2016).

200 percent of the poverty line). However, when disaggregated by council district, the rates of poverty increase to more than 20 percent of residents in Districts 5, 7, and 8 (see exhibit I). These districts, along with District 2, also have more racially and linguistically diverse residents than unincorporated King County as a whole.

EXHIBIT I: Rates of poverty and diversity vary by council district in unincorporated areas.



Note: Limited English proficiency is for the population ages five and older. Under 200 percent of poverty line is in last 12 months for the federal poverty threshold, which varied based on household size from $13,000 to $60,000 per year in 2021. Communities of color include people who identified as multiple races, Hispanic, Asian, Black, American Indian and Alaska Native, and Native Hawaiian and Pacific Islander. Public Health – Seattle & King County did not provide data for Districts 1, 4, and 6 due to low population size. Map of council districts and unincorporated areas available in appendix.

Source: Public Health – Seattle & King County analysis of US Census Bureau American Community Survey data, 2017–2021, and Washington State Population Interim Estimates, December 2022

The potential negative impact of using a fixed-dollar amount to check for reasonable cost is that as a proportion of revenue, lower income residents will see the same amount as a higher cost burden than higher income residents. For example, while the County used the same reasonableness test for both places ($5 per residential customer per month per utility service), the City of Redmond (including Novelty Hill), operating principally in the wealthier District 3, did not pass on the cost of franchise compensation to its customers. In contrast, SCL increased rates by $7 per household per month in White Center and Bryn Mawr-Skyway, the unincorporated areas it serves in the more racially and linguistically diverse Districts 8 and 2, respectively.

This suggests that the County could have used a higher reasonableness test in the City of Redmond without increasing customer rates as much as SCL. In other words, changing the input from $5 for all franchises to a variable number based on socioeconomic factors could reduce negative impacts in communities less able to afford utility rate increases, without necessarily reducing overall franchise compensation revenue.[30] Variable inputs, as well as differential processes and nonmonetary compensation, could also help mitigate the additive effect of utility rate increases from multiple franchises on the same households.[31]

Recommendation 11

Real Estate Services should conduct an equity analysis to identify and mitigate negative impacts franchise compensation may have on communities of color, low-income residents, and people with limited English proficiency.

Conclusion

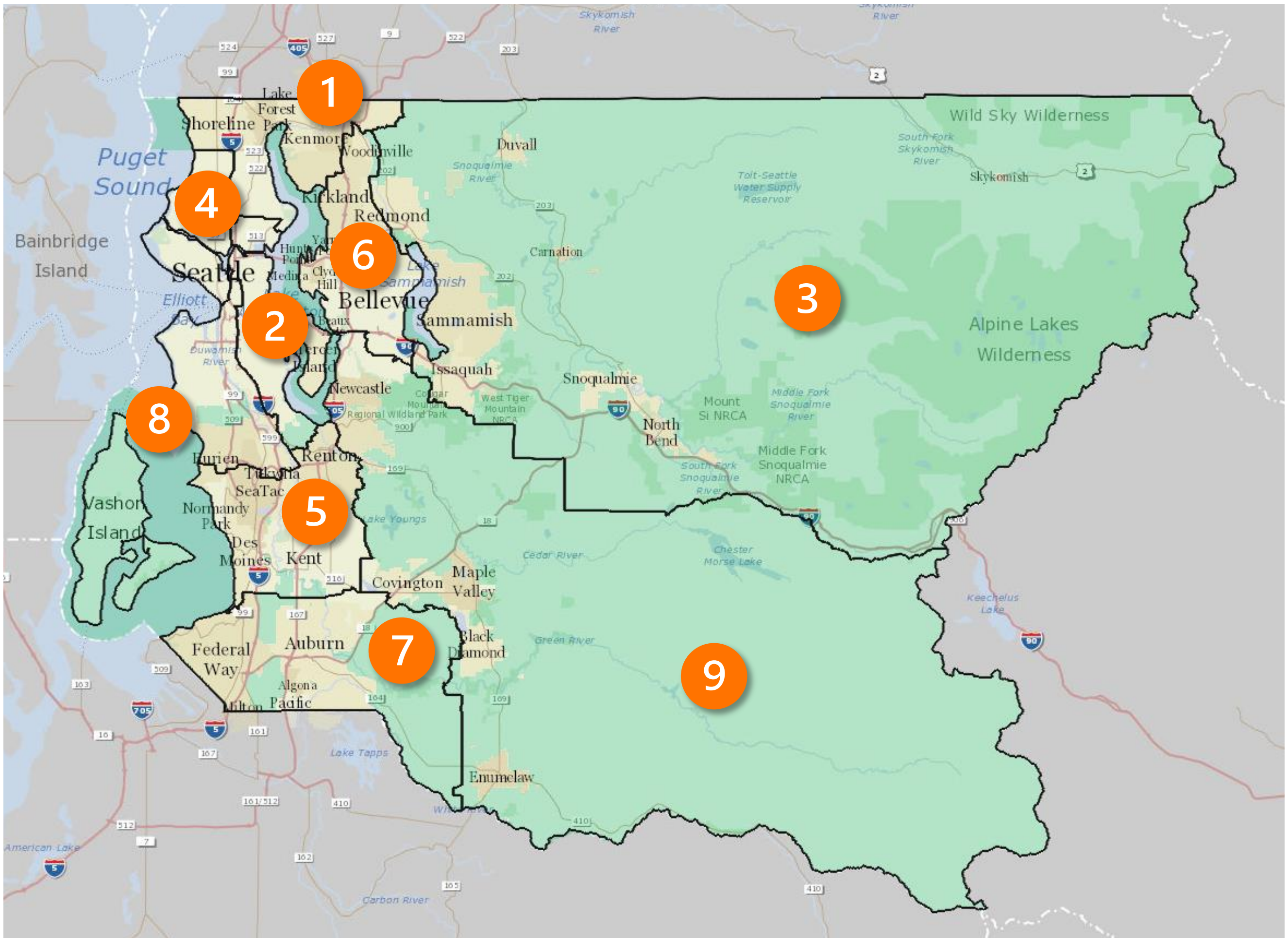
King County is beginning to charge utilities franchise compensation for the right to use public road rights-of-way, but actual revenue has consistently lagged budget estimates. RES has yet to develop a clear method to prioritize its growing backlog of new and expired franchises and, with its limited capacity, may miss opportunities to take advantage of process efficiencies. Utilities have passed on the cost of franchise compensation to customers, and the cost burdens may not be equitable countywide. The County needs to better understand the program from an equity lens to ensure it identifies and mitigates any negative impacts. We recommend that RES establish reliable revenue targets, improve efficiency and revenue controls, and conduct an equity analysis.

[30] Under Rules for Determining Franchise Compensation under KCC 6.27.080 (RPM 9-2), FMD can adjust the dollar threshold it uses to check for reasonableness.

[31] The County has not collected or organized data to determine the number of franchise agreements (and, therefore, potential rate increases) households across the region are likely to face.

Appendix 1: Map of Unincorporated King County

EXHIBIT 1: Unincorporated (green) King County by council district.



Note: Vashon Island and Maury Island are part of King County Council District 8.

Source: King County and King County Auditor's Office analysis

Executive Response

King County

Dow Constantine
King County Executive

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September 8, 2023

Kymber Waltmunson
King County Auditor
Room 1033

Dear Ms. Waltmunson:

Thank you for the opportunity to review and comment on the proposed audit report titled *"Staff Capacity and Project Complexity Limit Right-of-Way-Revenue."*

The enclosed recommendation table outlines responses to each of the eleven recommendations. The Facilities Management Division (FMD) concurs with eight of the recommendations. These recommendations will support FMD and the Real Estate Services Section (RES) in their collective efforts to reduce processing backlog. These recommendations also support improving coordination of franchise program efforts by developing processes and procedures to ensure complete and accurate collection of franchise compensation revenue.

FMD partially concurs with the following three recommendations:

- Recommendation 3: RES should establish revenue targets as a key performance indicator for the franchise compensation program. RES recognizes that revenue targets are a useful tool in measuring outcomes and continues to refine its ability to develop meaningful revenues estimates and targets.

- Recommendation 4: RES should develop, document, and implement a method to increase precision in franchise compensation revenue estimates by incorporating population or customer data. RES continues to refine estimate methodology and is evaluating the level of precision administratively practicable and prudent.

- Recommendation 6: RES should prioritize current agreements for franchise compensation negotiation to speed revenue collection and reduce processing time. RES has expended significant time on investigation of franchise status and developed a robust and adaptable prioritization methodology which recognizes the many contributing County interests in franchise operations.

We appreciate the time and effort your staff have put into this thoughtful audit.

Sincerely,

Dwight Dively
Chief Operating Officer

cc: Jennifer Hills, Deputy Chief Operating Officer, Office of the Executive
Karan Gill, Chief of Staff, Office of the Executive
Loraine Patterson, County Administrative Officer, Department of Executive Services (DES)
Anthony Wright, Director, Facilities Management Division (FMD), DES
Julie Ockerman, Manager, Real Estate Services Section, FMD, DES

Recommendation 1

The Facilities Management Division should determine and document whether it is appropriate to hire temporary employees to reduce backlog processing time and document and implement its decision.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	3/31/2024
Responsible agency	RES
Comment	RES will assess the backlog and examine methodologies to address it after the open FTE recruitment position is filled. This assessment will occur after onboarding as part of the new hire's body of work.

Recommendation 2

The Office of Performance, Strategy and Budget should work with Real Estate Services to develop, document, and implement a reliable method to create budget estimates for franchise compensation revenue that accounts for staff capacity.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	12/31/2024
Responsible agency	PSB/RES
Comment	

Recommendation 3

Real Estate Services should establish revenue targets as a key performance indicator for the franchise compensation program.

AGENCY RESPONSE	
Concurrence	**PARTIALLY CONCUR**
Implementation date	3/31/2024
Responsible agency	RES
Comment	RES values the usefulness of revenue targets as a tool in administering the program. RES continues to refine its ability to develop meaningful revenue estimates and targets. However, initial revenue target estimates are not a reliable indicator of program performance due to the ultimate effect of negotiations and influences beyond RES control on final compensation.

Recommendation 4

Real Estate Services should develop, document, and implement a method to increase precision in franchise compensation revenue estimates by incorporating population or customer data.

AGENCY RESPONSE	
Concurrence	**PARTIALLY CONCUR**
Implementation date	12/31/2024
Responsible agency	RES/GIS
Comment	RES continues to refine its franchise compensation estimate methodology. It requests customer data on franchise applications, however, utilities don't always provide adequate data. This impacts RES' ability to calculate franchise compensation per customer with a consistent degree of precision. In addition, because final compensation is the result of negotiations, RES will balance staffing resources necessary to conduct active negotiations with the recommendation to develop more exact compensation estimate models.

Recommendation 5

In line with King County's risk appetite statement, the Facilities Management Division should work with senior leadership to develop and document a risk appetite statement to guide management of the franchise compensation program.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	12/31/2023
Responsible agency	RES
Comment	RES will work with Risk Management to determine risk factors and prioritization

Recommendation 6

Real Estate Services should prioritize current agreements for franchise compensation negotiation to speed revenue collection and reduce processing time.

AGENCY RESPONSE	
Concurrence	**PARTIALLY CONCUR**
Implementation date	12/31/23
Responsible agency	RES
Comment	RES utilizes a robust and adaptable agreement prioritization methodology which recognizes many County interests in franchise operations. Paramount among these priorities is our responsibility for stewardship of the public road rights of way. High priority considerations for agreement processing include revenue collection, social and environmental impacts, liability, and negotiation complexity.

Recommendation 7

Real Estate Services should develop, document, and implement a reliable method to assess fire suppression credits toward franchise compensation.

AGENCY RESPONSE	
Implementation date	3/1/2024
Responsible agency	RES
Comment	Reliable assessment of fire suppression costs requires additional expertise within RES. RES has been working to identify and aquire a consultant with the appropriate qualifications.
Concurrence	**CONCUR**

Recommendation 8

The Utilities Technical Review Committee should coordinate with stakeholders to propose revisions to King County Code 13.24 to align water and sewer system planning requirements with state requirements.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	12/31/2024
Responsible agency	**Varies**
Comment	RES is working with other County departments as part of the review team on these potential Code amendments.

Recommendation 9

Real Estate Services should work with the Utilities Technical Review Committee to prioritize franchise processing based on water and sewer system planning status.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	12/31/2023
Responsible agency	Varies
Comment	

Recommendation 10

Real Estate Services should develop, document, and implement policies and procedures to ensure complete and accurate collection of franchise compensation revenue.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	12/31/2024
Responsible agency	RES
Comment	RES will work with FMD finance staff to document procedures that align with financial and accounting policies and standards.

Recommendation 11

Real Estate Services should conduct an equity analysis to identify and mitigate negative impacts franchise compensation may have on communities of color, low-income residents, and people with limited English proficiency.

AGENCY RESPONSE	
Concurrence	**CONCUR**
Implementation date	7/1/2025
Responsible agency	RES/OERSJ/PSB
Comment	RES does not have staffing or experience to create or implement this tool. It will seek assistance from OERSJ and PSB to develop and utilize an equity analysis tool.

Statement of Compliance, Scope, Objective & Methodology

Statement of Compliance with Government Auditing Standards

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Scope of Work on Internal Controls

We reviewed internal controls as they related to the goals of collecting revenue in line with budget and agreements, reducing risk, and mitigating negative impacts on communities.

Scope

This audit will review the implementation of franchise compensation, per King County Code 6.27.080, among water, sewer, gas, and electric utilities operating in the rights-of-way of county roads since 2018.

Objectives

1. To what extent has the County made progress in collecting franchise compensation and what barriers exist?
2. To what extent does the Real Estate Services (RES) Section effectively prioritize applications for processing?
3. To what extent does franchise compensation affect county residents?

Methodology

To understand revenue collection, we compared franchise revenue data (actuals and budgeted) from King County's central finance system to collected revenue recorded by RES. We further compared the revenue collected to invoices and franchise agreements stipulating the payment terms. We also interviewed staff at RES and the Finance and Business Operations Division. Relevant criteria include the *Standards for Internal Control in the Federal Government*, known as the "Green Book" and the King County budget.

To assess process barriers and prioritization, we conducted interviews, document review, and data analysis. We interviewed staff at RES, the Office of Risk Management Services, Roads Services Division, Prosecuting Attorney's Office, Utilities Technical Review Commission, King County Information Technology's Geographic Information Systems (GIS) Center, and the King County Council. Documents we reviewed included King County Code and associated rules, agency websites, franchise applications, franchise templates and agreements, program planning documents, and aggregated franchise information. Data analysis focused on the status of franchise agreements and utilities operating in the rights-of-way of county roads. We worked with full data sets provided by RES, as opposed to samples, and referenced the legislative record and Municipal Research and Services Center to look for utilities and franchises that may have been missing or decommissioned.

To determine the extent to which franchise compensation affects county residents, we interviewed RES and council staff, and reviewed utility websites, court rulings, county revenue policies, and equity goals. To understand demographic characteristics of unincorporated King County, we relied on analysis of US Census Bureau data by Public Health – Seattle & King County. Public Health – Seattle & King County noted that the source data relies on a sample of survey respondents and, therefore, are estimates. The agency also noted that matching US Census Bureau tracts to council districts and areas of unincorporated King County introduced a degree of error.

List of Recommendations

Recommendation 1

The Facilities Management Division should determine and document whether it is appropriate to hire temporary employees to reduce backlog processing time and document and implement its decision.

Recommendation 2

The Office of Performance, Strategy and Budget should work with Real Estate Services to develop, document, and implement a reliable method to create budget estimates for franchise compensation revenue that accounts for staff capacity.

Recommendation 3

Real Estate Services should establish revenue targets as a key performance indicator for the franchise compensation program.

Recommendation 4

Real Estate Services should develop, document, and implement a method to increase precision in franchise compensation revenue estimates by incorporating population or customer data.

Recommendation 5

In line with King County's risk appetite statement, the Facilities Management Division should work with senior leadership to develop and document a risk appetite statement to guide management of the franchise compensation program.

Recommendation 6

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Advancing Performance & Accountability

KYMBER WALTMUNSON, KING COUNTY AUDITOR

MISSION Promote improved performance, accountability, and transparency in King County government through objective and independent audits and studies.

VALUES INDEPENDENCE • CREDIBILITY • IMPACT

The King County Auditor's Office is committed to equity, social justice, and ensuring that King County is an accountable, inclusive, and anti-racist government. While planning our work, we develop research questions that aim to improve the efficiency and effectiveness of King County government and to identify and help dismantle systemic racism. In analysis we strive to ensure that communities referenced are seen, not erased. We promote aligning King County data collection, storage, and categorization with just practices. We endeavor to use terms that are respectful, representative, and people- and community-centered, recognizing that inclusive language continues to evolve. For more information, see the King County Equity and Social Justice Strategic Plan, King County's statement on racial justice, and the King County Auditor's Office Strategic Plan.

ABOUT US The King County Auditor's Office was created by charter in 1969 as an independent agency within the legislative branch of county government. The office conducts oversight of county government through independent audits, capital projects oversight, and other studies. The results of this work are presented to the Metropolitan King County Council and are communicated to the King County Executive and the public. The King County Auditor's Office performs its work in accordance with Government Auditing Standards.

AUDIT

This audit product conforms to the GAGAS for independence, objectivity, and quality.