



AUDIT SECTION REPORT HIGHLIGHTS

April 1995

LONG RANGE FINANCING ALTERNATIVES FOR THE CITY'S WASTEWATER SYSTEM

Findings

After years of sewer spills, lawsuits, and fines against the City, the Council authorized a performance audit of the City's wastewater operations (Resolution 91-308). The Corporation Counsel blocked the audit, claiming that it would jeopardize the City's position in ongoing lawsuits. In response, the Council suspended the audit and instead engaged a consultant, Black & Veatch, to perform a series of reviews of the wastewater system and budget, culminating with the formulation of long range financing alternatives for the City's wastewater system. This included a 10-year projection of system revenues and costs, an assessment of new financing sources, and development of a computer model of wastewater system finances. This report of that effort was prepared by the Office of Council Services with the assistance of Black & Veatch.

We found that over the ten year period ending in fiscal year 2003, operating costs for the wastewater system are conservatively expected to grow from \$75.6 million to \$106.7 million due to inflation alone. Capital spending was more difficult to forecast because the existing wastewater capital program was found to be seriously deficient. Based on the existing program, capital expenditures over the ten years may be expected to total \$580 million in projects. These projects would only replace, renovate and expand wastewater facilities, and not significantly upgrade treatment levels. However, if the projection is based on the department's actual record in implementing capital projects, the ten year capital program could reach \$1.2 billion.

In reviewing current sewer fee and customer growth rates, we found that revenues would not keep pace with the operating and capital costs of the wastewater system. Either new financing sources would need to be developed, or sewer fees would need to be raised, or both. Based on Budget Department projections and the views of bond raters, it appears that the City can continue to issue general obligation bonds reimbursed by wastewater revenues.

Fifteen existing and alternative financing sources were examined. These included revenue bonds, state loans, system facility charges, improvement districts, and community facility districts. Although there

was some merit to each alternative, taken together, these new sources have low or moderate revenue potential at best. Options such as wastewater and sludge reuse, system privatization, and development agreements were also examined but were found to have limited or indeterminable use, or were deemed unreliable as a revenue source. Unfortunately, many of the alternative sources can only finance infrastructure for new development. Since the bulk of the current capital program is to serve existing development, we concluded that alternative financing sources offer little relief to City sewer customers from higher sewer user fees.

Three financing options were then assessed to determine the timing and impact of the wastewater system costs on sewer rate payers. We found that implementing the most viable alternative financing sources, revenue bonds and higher wastewater system facility charges, would have only a slight effect on the bills of the average residence. With these financing sources, the average monthly bill would jump from \$37.71 in 1996, to \$56.88 in the year 2000, and to \$72.98 in the year 2003.

Recommendations and Response

We recommended that the City continue to finance the wastewater system as a self-supporting enterprise, and use sewer fees and reimbursed general obligation bonds as the primary financing sources. The wastewater system facility charge should be increased to better cover the cost of servicing new developments. Other financing options should be pursued, but expectations should be tempered since the effectiveness of these options in avoiding sewer fee hikes would be slight. Priority should be given to improving the wastewater department's capital program to ensure that all necessary projects are included and that the program for each year remains within the department's implementation capacity. Once the capital program is revised, the outlook for applying alternative financing methods may become more promising. Other City departments should ensure that their capital programs are complete and realistic so that a citywide financial plan can be developed and implemented.

The Managing Director stated that the report did not meet the objective of the study to develop a long range financial plan in that the report did not address the impact of the debt for wastewater projects on the City, the 10-year focus of the study was not sufficiently long-term, the use of the wastewater department's capital program may not reflect true funding and expenditure requirements, and the report's conservative assumption of no growth in department personnel was unrealistic.