

Pipe Dreams

Three-year water and sewer rate hikes would be just a down payment



By Craig Powell
Inside City Hall

When the utility folks get up to testify at city council hearings, they are typically the last to appear, long after the homeless and Occupy Sacramento activists have left, leaving a weary mayor and city council behind to summon the attention span necessary to ponder the implications of federal clean water mandates and steel-riveted transmission lines. It's a subject that rarely sustains the attention of either politicians or city voters. Inattention, however, has its own special costs in government, as it does in real life.

To say that the city council has exercised inadequate oversight over the city's utility systems would be an understatement. The consequences of its neglect range from the current major snafu in garden refuse pickup to a grand jury investigation and lawsuits two years ago over the city's illegal diversion of millions of dollars of ratepayer funds.

But the most consequential impact of the council's poor oversight has been the city's decades-long neglect of our utility infrastructure, particularly

our sewer and water pipes. It has not been entirely the council's fault. For at least 25 years, utilities managers have trotted out scary-looking photos and actual sections of badly deteriorated pipes before the council in making their case for higher rates, only to spend the increased revenue from rate hikes for other purposes, such as higher employee salaries and benefits.

The department's new interim director, Dave Brent, is a straight-talking water engineer who promises that those bad old days are over. In September, the utilities department launched a PR offensive to rally support for a major new initiative: to replace all of the city's water and sewer pipes every 100 years (the "best practices" standard recommended by utility industry officials), instead of our current pace, which replaces our water pipes every 400 years and our sewer pipes every 650 years. The backbone of the city's 30-year plan is for the city to borrow funds through revenue bonds in the early years while rapidly ramping up water and sewer rates so that in 15 years the city will replace 1 percent of its water and sewer pipes each year—in other words, every pipe will be replaced once every 100 years.

While the utilities department has done a good job of explaining what the plan would do for our infrastructure, it has been hesitant to discuss the higher utility rates the plan would require. Recently, it revealed to the council its proposed water and sewer rate hikes for the next three years: successive 10 percent annual hikes in the water rate and essentially successive 15 percent annual hikes in

Projected 15 Year City Utility Rate Increases

	Year 1	Year 3	Year 5	Year 10	Year 15
Water rates	10%	33%	61%	241%	354%
Sewer rates	15%	52%	98%	326%	474%

the sewer rate, leading to an overall increase in water rates of 33 percent over the next three years and a 52 percent hike in sewer rates over the same period.

But that's only the down payment on the rate hikes anticipated under the city's 30-year plan. Over the next 15 years, the projected hikes include annual water rate hikes of 10 percent through 2018 and annual sewer rate hikes of 14 percent through 2019, after which annual rate hikes for both water and sewer are expected to "moderate" to "single digits" for the remainder of the 15-year ramp-up period.

Anyone with passing familiarity with the magic of compound interest can see the dramatic effect a 15-year unbroken string of rate hikes would have on city water and sewer rates. Assuming that the single-digit rate hikes in the out years are, say, 8 percent, city water and sewer rates would escalate over the 15-year period (see chart.)

Normally, the utilities department's long-term rate hike projections are nothing to get agitated about because the city council retains ultimate control over rates, and the council has a track record

of approving more moderate rate hikes than the department requests. But the city's plan to issue 30-year revenue bonds to supercharge the pace of water and sewer pipe replacement (as well as fund other major projects) changes everything.

To be eligible to issue investment-grade revenue bonds, the city would have to agree to tough bond terms that will require the utilities department to set aside large cash reserves and comply with strict bond covenants, including a requirement that the city maintain a minimum ratio of utilities revenue to bond payments. Compliance with such bond covenants will largely drive future utility rate hikes, locking the council into future rate hikes required to comply with the bond terms or risk an unthinkable bond default.

So the long-term rate hike projections of the utilities department this year are no longer just an "engineer's wish list" but are, instead, critical joint assessments by utilities staff, the city treasurer's office, the city's rate advisory firm and the city's lead underwriter, Goldman Sachs, of the hikes needed to repay

City Hall continued on page 24

From our family to yours –

“May the Holidays be as bright
as your smile!” **44-SMILE**



SUTTER TERRACE DENTAL GROUP
visit us at www.sutterterrace.com

City Hall continued from page 22

bond principal and interest, comply with bond covenants and reserve requirements and directly fund pipe replacements in accordance with the city's 30-year plan.

Once the city steps onto the escalator of the 30-year program, it will be very difficult to regain control of city utility rates, even if deteriorating future economic conditions make it unthinkable to impose such high rates on a struggling population. In fact, deteriorating economic conditions would likely lead to a further escalation of rate hikes to make up for revenue shortfalls and maintain compliance with the bond's mandatory revenue-to-debt service ratio.

Meanwhile, the city imposes an imbedded 11 percent utilities tax on all city utility bills that will automatically siphon off 11 percent of all future rate hikes and divert the

money into the city's general fund. So the 30-year plan, if approved by the city council, may very well lead to the largest single general tax increase in city history—all without a public vote. In fact, council members will have a perverse incentive to approve the greatest possible increase in city utility rates so as to maximize city taxes. It's almost a perfect tax-raising machine. But it's a cruel burden on Sacramento taxpayers and ratepayers, particularly lower- and moderate-income residents who are hit hardest by highly regressive utility rate/tax increases.

The overall projected cost of the 30-year plan, before interest, is \$2.4 billion, making it the largest single public works project in Sacramento history, six times as large as the proposed sports arena and almost two and a half times as large as the recently constructed terminal at Sacramento International Airport.

There is an added complication. At the same time the city is setting the stage for huge and continuous

increases in city water and sewer rates, Sacramento Regional County Sanitation District is in the process of tripling sewer rates in our region over the next several years to pay for a new \$2 billion sewage treatment plant. If the city adopts the proposed 30-year plan, most Sacramento residents and businesses will be hit with a double whammy: one set of hikes from the city and the other from Regional Sanitation. Many in the business community fear that the hikes will hit Sacramento's already teetering local businesses like a sledgehammer and could smother economic recovery.

What happens if the local economy stalls further and utility revenues fall below projections for several years? A bond default would be a very real possibility, and city bankruptcy would not be out of the question.

The largest, most recent municipal bankruptcies in the country, in Harrisburg, Penn., and Jefferson County, Ala., were brought on by debt-laden utility projects gone horribly wrong.

What are some of the alternatives to the current plan?

- Do not accept largely arbitrary age targets for replacing the city's water and sewer pipes. Instead, base pipe replacement plans on a rigorous examination of pipe failure and leak rates.
- Borrow only to fund large, one-time major projects, like the rehab of the city's water treatment plant, that cannot be funded on a pay-as-you-go-basis. Use current cash flow to fund a long-term program of pipe replacement, eliminating interest costs and the risk of bond-driven rate hikes.
- Avoid scare tactics. The extensive work done in recent years by the city to build a network of underground overflow storage tanks to capture storm runoff has largely controlled the risk of large-scale sewage spills from the sewer/storm water system. The major problem now is breaks in smaller pipes, which pose a risk of highly localized spills, terrible for those affected but not catastrophic in scope.

- Bring down utilities department operating costs through pension reform and rollbacks of recent employee pay raises and benefits.
- Exempt major infrastructure spending in the utilities department from the imbedded 11 percent utility tax. A major infrastructure program should not be used as a pretext for increasing general taxes without a vote of the people.

**We should take the
time to make sure
our choices are the
right ones for our
city and its future.**

- Avoid the use of project labor agreements, which drive up ratepayer costs by effectively excluding nonunion contractors from bidding on infrastructure projects.
- Create a bond oversight commission with teeth to ensure that bond proceeds are spent prudently, legally and only for the specific purposes set forth in the bonds' offering documents.
- Perhaps most importantly, don't ramp up rates while Sacramento remains in the depths of the worst recession since the Great Depression.

We should take the time to make sure our choices are the right ones for our city and its future. The problems we face weren't created in the past year or two, and they won't be solved in just a year or two. The best solutions to big problems take hard work, open minds, thoughtful examination, full public engagement and the cultivation of broad community consensus. Now is a perfect time to start.

Craig Powell is a local attorney, businessman and community activist. He serves as president of Eye on Sacramento, a civic watchdog and policy group. He can be reached at craig@eyeonsacramento.com. ●