COUNCILMEMBER CARL DEMAIO

FIFTH DISTRICT

CITY OF SAN DIEGO

MEMORANDUM

DATE: September 8, 2010

TO: Mayor and City Council

CC: IROC Members
San Diego County Water Authority "City 10"

FROM: Councilmember Carl DeMaio Carl DeMaio

RE: Water Rate Increases and Wasteful Spending in Water Agencies

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The Mayor has forwarded to the City Council a proposal to increase water rates by 4.69%. If approved and passed through a Proposition 218 noticing process, water rates for the average family will have increased by 65% since February of 2007.

Similar to the rate increase last year, the proposed increase is labeled as a "pass through" of increased charges for water from the San Diego County Water Authority (CWA). This label gives the false impression that nothing can be done to mitigate water rate increases on residents.

I am opposed to the proposed water rate increase – and ask that the Mayor and Council join me in avoiding a rate increase this year.

As an alternative, I suggest that the City of San Diego aggressively pursue all available options toward reducing costs at the three immediate water agencies responsible for delivering water to San Diegans: the City's Public Utilities Department, the San Diego County Water Authority (CWA) and Metropolitan Water District of Southern California (MWD).

The attached white paper outlines disturbing cost trends at each of these agencies – specifically related to the cost of labor - and recommends a series of on-going actions for the Mayor and City Council to ensure that the City has taken all possible actions to prevent water rates from increasing again.

In these tough economic times, I look forward to working with the Mayor and City Council to offer San Diegans some help by avoiding a water rate increase this year.

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Water Rate Increases:
The Need to Curb Wasteful Spending at Water Agencies

September 8, 2010

A Report by

The Office of
Councilmember Carl DeMaio
(District 5)

Water Rate Increases Continue to Threaten San Diego Working Families and Business

The Natural Resources and Culture (NR&C) Committee will consider the latest proposed "pass-through" rate increase at its September 8th meeting. Data from the proposed Proposition 218 notice shows that if this increase goes into effect, the typical single-family residential water bill ("average bill") will have increased by more than 65% since February of 2007.[1]

Typical Monthly Bill Feb. 2007	Typical Monthly Bill Jan. 2011 (Projected)
$43.13	$71.24

Some of the factors driving water rate increases were examined in a report recently released by the Vice Chair of the Independent Rates Oversight Committee (IROC). An excerpt of a section on the cost drivers of water rates if provided below[2]:

> *"Three primary factors…determine the level of water rates…The second factor is the aggregate costs of operating the system each year. These include the supply cost of purchasing water from wholesalers further up the supply chain; and the operating and maintenance of running the system.* ***O&M costs include labor and benefit costs (including pensions)****…Water supply costs are relatively non-controllable while the other costs are more controllable and are based in part on how effectively the organization is run* (Emphasis added).

As the economic downturn continues, the City needs to make every effort to avoid increasing water costs, starting by addressing the cost structure of the Public Utilities Department (PUD).

Unsustainable Costs in Public Utilities Department Contribute to Increased Water Rates

As the report reference above points out, labor costs (including the cost of fringe benefits) at water agencies contribute to the water rates faced by residents and business.

The FY 2011 Proposed Budget shows the significant increase in per unit labor costs in the City's PUD. As the table shows, the cost per position in this department increased by $5,759 (or 6.59%) in just one year (FY 2010 to FY 2011).

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[1] See 2//26/2007 "Proposed Water Service Rates and Charges," and proposed notice for 11/15/2010 Public Hearing Notice. Assumes 14 HCF water use per month. This does not include changes in sewer rates.

[2] Hollingworth, Andrew. "Report on Pending Pass-Through Water Rate Increases: Their Cause and Suggested Policy Solutions."

Public Utilities Department Labor Costs		
	FY 2010 Budget	FY 2011 Proposed Budget
Positions	1613	1651.49
Personnel Expenses	$141,038,805	$153,915,700
Cost per Position	$87,439	$93,198
$ Increase per Position		$5,759
% Increase		6.59%

The IBA review of the proposed budget notes that the cost of fringe benefits in the PUD increased by $14.3 million from FY 2010 to FY 2011, no doubt significantly driven by the increase in the City's pension payment for FY 2011.[3]

Additionally, the City's "Bid to Goal" program continues to move forward, despite a devastating performance audit that found $28 million in unsubstantiated bonuses were awarded since 2006.

Recent presentations from the City's PUD show that the City Council will be asked to approve labor agreements pertaining to the program that in some cases cover 5 fiscal years.[4] While the matter is not currently docketed at a Council committee (as of September 7, 2010), an audit of the goals of the program is slated to be heard by the Audit Committee on September 13, 2010.

In May, I issued a memorandum calling for the elimination of this troubled program unless it was subjected to fair and open competition with private sector bids in lieu of the current "mock bid" approach. I maintain that position, as this program has proven to warrant elimination due to incredible levels of inefficiency documented by independent audits. Further, I believe that there may be other aspects of the Public Utilities Department that may provide opportunities for cost savings and improved service delivery through competitive bidding and/or public-private partnerships.

Requested Action: The City Council should docket the consideration of avenues to reduce costs in the City's Public Utilities Department for ultimate referral to Labor Relations to engage in "Meet and Confer."

Such avenues should include, but not be limited to the following costs in the Public Utilities Department:

- The complete elimination of any remaining discretionary pensions benefits (e.g. retirement contribution offsets and the waiving of mandatory City contributions to SPSP).
- Elimination of suspension of any specialty pay/bonuses (e.g. bilingual pay).

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[3] IBA Report 10-37, pg. 99.
[4] August 9, 2010 Independent Rates Oversight Committee materials.

- Suspension of salary step increases.
- Reductions in retiree health care costs that not only reduce the annual ARC, but provide for budgetary savings using FY 2011 budgeted amounts *and* result in the full payment of the ARC.
- Examination and discussion of available opportunities for fair and open competitive bidding and/or public-private partnerships for various aspects of the Public Utilities Department.

Requested Action: The City Council should eliminate the "Bid to Goal" program in the Public Utilities Department for ultimate referral to Labor Relations to engage in "Meet and Confer." The program should be considered for replacement by fair and open competition.

Another troubling trend that requires further exploration is the consistent transfer of employees from departments within the General Fund to departments in Enterprise Funds, such as the Water Department. While these transfers may help to alleviate costs in the City's General Fund budget deficit, shifting costs between funds seemingly transfers increasing costs of government to residents and businesses in the form of taxes to costs in the form of utility bills.

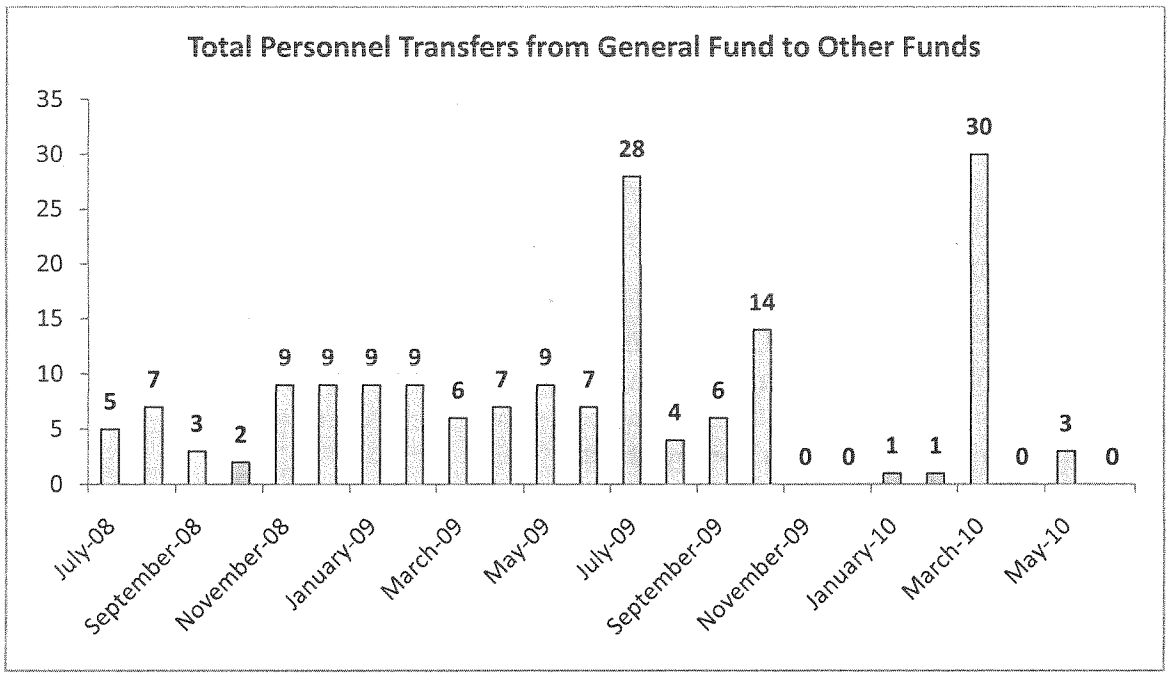
In fiscal years 2009 and 2010, the City transferred 169 employees from the General Fund to other funds, such as Enterprise Funds. This equates to the aggregate movement of approximately $9 million in salary. Of these employee transfers, 38 were moved to the Water Department, and another 29 were transferred to Metropolitan Wastewater.[5]

Fiscal Years '09 and '10 Employee Transfers from General Fund to Water and MWWD			
Department	# of Employees	Salary - General Fund	Salary - Enterprise Fund
Water	38	$ (2,016,476)	$ 1,956,332
MWWD	29	$ (1,533,276)	$ 1,506,312

Transfers to these departments included moving employees from a wide variety of General Fund departments, including but not limited to Police, the City Attorney's office, Community & Legislative Services, Fire Rescue, Library and the Ethics Commission.

A timeline of personnel transfers from the General Fund to the Enterprise Funds in Fiscal Years 2009 and 2010 is provided below:

[5] Personnel Department monthly transfer reports available upon request from Council District 5 office.



Requested Action: The NR&C Committee should docket an examination of General Fund to Enterprise Fund transfers at the next available meeting.

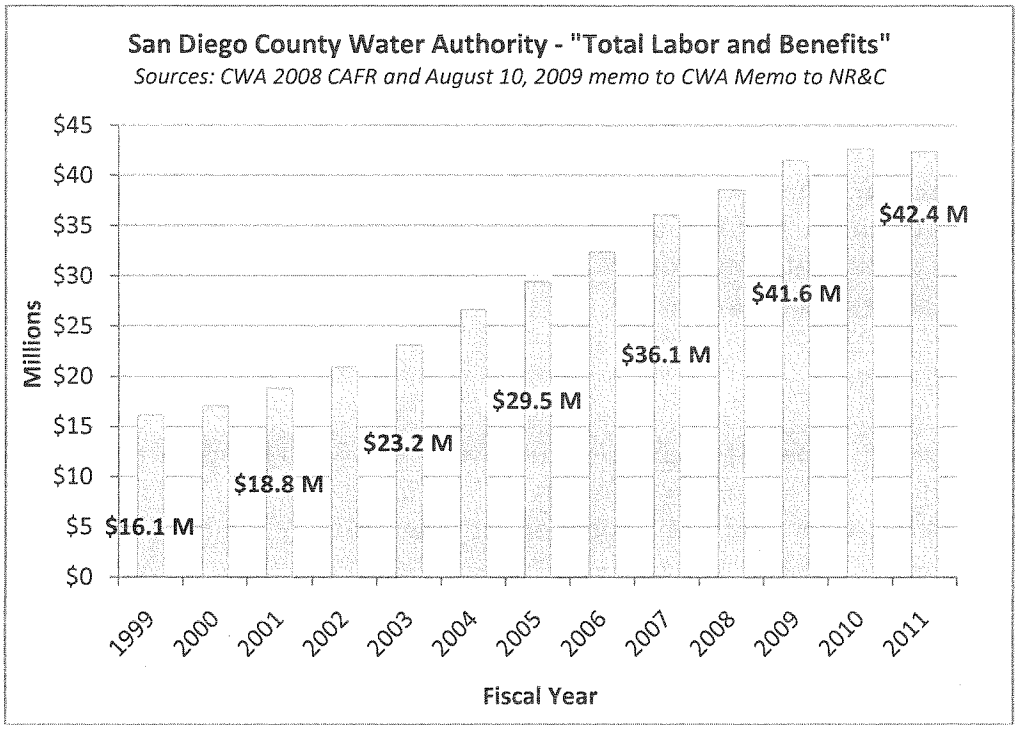
CWA Must Reign in Skyrocketing Labor Costs

The CWA is the next step up the water supply chain for City ratepayers.

The proposed Proposition 218 notice for states, in part:

> *"On June 24, 2010 the San Diego County Water Authority voted to increase several of the rates it charges for imported water beginning on January 1, 2011…Because local water supplies are very limited, the City must buy approximately 85-90% of the water it supplies to its customers from the CWA. Because the City is required to recover the costs for water purchases, it must "pass through" these increased charges to its own customers.*
>
> *The CWA based its increases on* ***the costs for its own infrastructure, operations and maintenance. The CWA increases also reflect the cost it pays to purchase water from…the Metropolitan Water District of Southern California"*** (***Emphasis*** added).

Just as labor costs in the City's PUD contribute to water rates, so do the labor and other operational costs at CWA. The chart below shows the increasing nature of CWA labor costs from 1999 to 2011:



CWA explains that the cost increases are at least partially attributable to the addition of "several new facilities,"[6] also stating that recent budgets "shift…the distribution of [labor costs] from CIP to Operating…as a result of the Water Authority's transition from building to operating and maintaining new facilities."[7]

However, a snapshot of staffing and labor costs of "Administrative Services" at the CWA in the FY 2004/2005 budget versus the same department in the FY 2010/2011 budget raises significant concern that per unit labor costs at CWA have been escalating at an unsustainable rate, to the ultimate detriment of ratepayers.

CWA Administrative Services Department Budget Summary[8]	Annual Budgeted Costs	
	FY 2004/2005	FY 2010/2011
Budgeted Cost of "Labor & Benefits"	$3,548,799	$4,875,515
FTE	33.5	35
Budgeted Cost of "Labor & Benefits" per FTE	$105,934	$139,300

As the table above indicates, the budgeted cost of "Labor & Benefits" per position in CWA Administrative Services in the FY 2010/2011 budget is **$139,300,** versus $105,934 in the FY 2005 budget.

[6] SDCWA Memo to Councilmember Donna Frye, August 10, 2009.
[7] SDCWA Adopted Budget for Fiscal Year 2010 and 2011, pg. 25.
[8] See pg. 134-135 of CWA FY 2010/2011 budget and pg. 48 of FY 2004/2005 Operating Budget). This comparison has been verified by CWA staff.

Requested Action: The IROC should conduct a review of the CWA cost structure, including an in-depth review of labor costs, and provide a report to the CWA Board of Directors and CWA agency customers (such as the City of San Diego) with recommendations for increased efficiency and reduced costs.

Requested Action: The Mayor and City Council should request that City representatives on the CWA Board of Directors initiate an independent performance audit and review of CWA operating costs, including but not limited to the CWA labor cost structure.

MWD Cost Structure

CWA costs are also impacted by the cost structure at MWD. To this point, the Vice Chair of the IROC recently released a report on "the reasons for past and projected future increases in water rates with a focus on the operations" of the MWD.[9]

The report found that the decreasing quantity of water sold while the "costs of supply paid to wholesalers was increasing...would tend to increase water rates." However, this cost driver was found as only partly to blame. The report calls out other cost-increasing factors:

1) MWD's Level of Employee Compensation – "specifically the levels of wages and benefits [paid to] their labor force under agreements negotiated with their public employee unions.

2) MWD's scheduling of their CIP program and the use of pay-as-you-go funding financed from current year water rates to pay for the program.

3) MWD's alleged misallocation of water supply costs paid by the SDCWA and ultimately San Diego ratepayers."

The issues related to excess employee compensation levels at MWD were also highlighted last September when the governing board halted the pursuit of a 25% pension benefit increase to employees following public outcry. Despite this positive action for ratepayers, the IROC report indicates the presence of an already unsustainable compensation structure, noting that "**MWD…provides a guaranteed annual salary increase, two pensions (a regular pension plus a district match to an employee's 401k account) and a vested employer financed retiree medical plan**" (Emphasis added.)

The report recommends that the "Mayor and Council contact San Diego County state legislators and seek the inclusion of language in the state budget mandating an in-depth

[9] Hollingworth, Andrew. "Report on Pending Pass-Through Water Rate Increases: Their Cause and Suggested Policy Solutions."

outside review of the [MWD's] rates and cost structure with specific recommendations over how those rates and cost structure can be restructured to mitigate future water rate increases until the California economy has recovered."

The report goes on to recommend that such actions be taken in conjunction with support for the CWA's lawsuit against the MWD and any action "regarding retail Public Utilities District (PUD) rate increases in an attempt to address the underlying cause of these increases."

Requested Action: The Mayor and City Council should engage the City's state legislative delegation in an effort to pursue the recommendations of the Hollingworth report.

Requested Action: The Mayor and City Council should pass a resolution in support of the CWA lawsuit and negotiations with MWD to address improper cost allocations.

Requested Action: The NR&C Committee should establish a standing agenda item once per quarter to review the progress on reform of the cost structures at the City PUD, CWA and MWD.

San Diego businesses and residents ultimately bear the burden of increased water rates. The City must avoid increasing rates further while immediately deploying its available resources toward reducing the cost structures in place at its own Public Utilities Department, the County Water Authority and Metropolitan Water District of Southern California. The Mayor and City Council have the ability to mitigate further water rate increases on San Diegans, and I encourage City officials to do so as I suggest above.