

Presentation to the Task Force on New Orleans
Sewerage, Water and Drainage Utilities
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First I'd like to thank the members of the Task Force for undertaking their work and for the opportunity to contribute background information to the discussions.

I've been asked to provide information on the Sewerage and Water Board's history, so I'll start at the beginning. In answer to the earlier question, the SWB was created by the state in 1899 at the request of voters to address the sewer and water infrastructure needs in New Orleans. Three years later, the City's Drainage Commission and its functions were merged into it.

Although the board is created in state law, it is an independent municipal agency. In relation to city government, it is one of 10 "unattached" boards and commissions placed under the executive branch by New Orleans' home rule charter, meaning it's not attached to a specific department of the city government. Thus, both the city and the state have a say in its powers and governance.

Currently, the board is responsible for the city's sewerage and water systems and part of the local drainage system. Its responsibility for the drainage system is limited to pipes 36 inches or larger in diameter, drainage canals and pumping stations. The City through its Department of Public Works is

responsible for the rest of the local drainage system, including more than 85,000 catch basins and the nearly 1,600 miles of smaller drainage pipes underneath streets, sidewalks and other rights of way.” As a result of this split, DPW is responsible for more than 80% of all drainage lines (including canals) in New Orleans.

This was not always the case. The transfer of responsibility for the subsurface drainage from the SWB to the City occurred in 1991, after voters refused to renew a 2-mill tax that supported the drainage system. No funding source came to the City with its new responsibilities.

Currently the SWB is governed by a 10-member board consisting of the mayor, two members of the Board of Liquidation, and seven citizen members, who must meet various expertise and area-distribution requirements. The citizen members are nominated by a committee consisting of university presidents or their nominees. They serve four-year terms and are term-limited at two. This too was not always the case. Until 2013, the board had 13 members. It included four elected officials, the mayor and three councilmembers, two members of the Board of Liquidation and seven citizen members. There were no nominating process or expertise requirements for them. Terms were for nine years.

The finances of the water, sewerage and drainage systems were separated in 1967 and have been maintained separately since then. However, the S&WB operates the three systems on a consolidated basis.

The SWB has sole responsibility for and control over its management and operations. The city government cannot order the S&WB to take specific actions, nor can it impose specific financial burdens. However, it has significant control over its funding. The S&WB does not have taxing authority; taxes for its benefit are levied by the City Council. It must obtain the approval of both the City Council and the Board of Liquidation before issuing bonds or (with a limited exception) raising sewer and water rates. While the Board of Liquidation generally limits its review to the fiscal soundness of a proposed bond issue or rate increases, the City Council has no guidelines for its review. The Board of Liquidation and City Council cannot modify the rates proposed by the S&WB; they can only accept or reject them. The SWB can override the Council only if the rate increase is necessary to pay existing debt.

The City Council and Board of Liquidation were not always involved in rate setting. Until 1954, the S&WB set its own rates without even a public hearing. However, the rates were capped by law at a very low level, necessitating legislative approval of any rate increases. As a result of this impediment the SWB went for nearly 35 years – from 1913 to 1948 -- without an increase. Finally in 1954, as the SWB struggled to pay for infrastructure in the newly developing parts of the city along the Lakefront and New Orleans East, voters eliminated the cap. At the same time, they added requirements for public hearings and for the Board of Liquidation's approval of rate adjustments.

Four years later, when the SWB was first authorized to issue revenue bonds, voters added a requirement for City Council approval of rate increases.

The resulting arrangement created a misalignment of powers and responsibilities. Responsibility for the system is in the hands of the SWB, and the ultimate control over its revenues is in the hands an elected body with plenty of pressure to keep rates low. As is discussed below, the City Council has on multiple occasions delayed or killed rate increases, despite the S&WB's pressing needs.

The problems created by the misalignment were compounded by the presence of four elected officials on the board. The elected officials, leery of voters' ire, on multiple occasions objected to new rate and tax proposals at the board level. Their objections discouraged proposals from coming forward or foreshadowed the outcome of a Council vote, short-circuiting the process before it even began. Rarely did the other members act in concerted opposition to the elected ones. The latter problem was addressed tin 2013 through changes to state law and the city charter eliminating Council members from the board.

As a result of the governance arrangement that was in place for most of the last 50 years, rate increases were sporadic, with substantial increases following long periods with little or no adjustment. In the interim periods, the system continued to deteriorate, leading to poor services and increased infrastructure costs down the line.

For example, for a 20-year period from early 1987 to late 2007, water rates increased only twice. For a 14-year period running from early 1986 to early 2000, sewerage rates did not change at all, and customer charges declined relative to inflation. These long periods of inactivity were preceded and followed by multiple years of double-digit increases.

Sewer rates.

Sewer rates were first put into place in 1967. Four years later the SWB, facing intense pressure from inflation and more stringent federal regulations of sewerage discharge, sought a 72% increase. The Council responded with a 19% one, which was enough to cover bond obligations for a couple of years but not enough to access the federal funds needed for EPA-mandated sewer upgrades. Under intensifying federal pressure, the SWB came back for another hike, which the council refused to give. Finally, the SWB raised rates unilaterally (I'm not sure how), and the Council caved.

A period of five years with no increases followed. After that there were six years with increases needed to access federal funds and then a 14-year period with none. During that period, the EPA sued the SWB and City, forcing them into a consent decree to clean up the sewer problems. As a result of the consent decree, the SWB sought and obtained approval for annual increases over seven years, ending in 2006. The next set of increases, 10% over each of 8 years, went into effect in 2013 and continues through 2020. Due to compounding, it more than doubles customer bills over that time.

Water

On three occasions in the 1970s, the City Council shot down the water rate increases needed to avoid default on the S&WB's debt. The denials forced the S&WB to exercise its legal authority to raise rates unilaterally to meet its existing debt service obligations.

Two of the proposed increases that the Council denied included a component to support bonds that had already been approved by voters in 1975. Despite the voters' authorization, it took five years to cajole the Council into giving approval. The SWB sent it a dozen rate proposals, but it didn't approve any until 1978 when it allowed a 22% increase, enough to allow the issuance of \$6 million of the \$31 million of authorized bonds. The Council didn't approve the rest of the bonds until 1980, when it signed off on a 70% increase over five years. As the last of those increases went into effect in 1984, the Council approved another five-year series to meet rising costs and fund improvements. This time the SWB itself delayed implementation of two of those increases. The opposition to implementation was fomented by elected officials on the board. It wasn't until 1990 that the fourth of the rate increases was finally forced through by the board's appointed members in an acrimonious battle with the Council members. The fifth increase didn't go into effect until 2002, 18 years after the Council's original approval.

The next series of increases ran from 2007 to 2012. It was followed by the current series.

The S&WB's management coped with the stagnation in water and sewerage rates in the late 1980s and the 1990s— and their decline relative to inflation — by cutting operating costs, deferring system maintenance, funding some capital projects on a pay-as-you-go basis and deferring others. The deferred maintenance and capital investment increased the ultimate costs of repairing the systems and pushed the day of reckoning into the future.

Clearly, this fits-and-starts approach does not comport with best practices, which require increases to keep up with operating costs and fund needed investment. In that regard, BGR took a look in 2012 at how three peer utilities with aging infrastructure and similar revenue sources for water and sewer -- Cincinnati, Louisville and Charleston. It found that all three raised their rates in most years. During the period reviewed, those increases averaged 5% a year for water and 7.5% for sewer. Had New Orleans increased its rates each year on the basis of water/sewer CPI, bills would have been higher than the then-current one, but the system would have been better operated and maintained, and the costs would have been spread more fairly over generations of customers.

Drainage

Unlike the water and sewer systems, the drainage system is supported by tax revenue, which currently total 16.34 mills. That system too has faced funding obstacles. It has not gained a new revenue source since 1982, and in 1991 actually lost one.

The latter was a two-mill tax that had been in place for 100 years and used in its later years for drainage, including subsurface infrastructure. In 1991, voters twice refused to renew the tax. After that the City and the SWB entered into a CEA transferring responsibility for the subsurface drainage to the City.

The SWB also has in place a three-mill levy that was passed in 1967 and renewed in 2016. Prior to the passage of that tax, the city was obligated to support drainage if the SWB didn't have enough surplus from the water and sewer systems to do so. That requirement was lifted when the tax was imposed. The drainage system also receives revenue from taxes originally levied at six and nine mills.

In 2010, the millage rates were rolled back as a result of a major reassessment in the city. The SWB requested a roll forward but City Council blocked it, even as it rolled forward the City's own taxes.

Twice during the last 30 years – in 1985 and 1998 – the S&WB unsuccessfully proposed supplementing its funding by implementing drainage fees. Both fees would have used a property's size, land use and varying assigned rates to calculate the fee.

The first proposal, which would have generated \$20 million per year for drainage, was rejected by voters. The second time that it sought a fee the S&WB took the

position that the City Council had the authority to impose the fee without a public vote. The proposal died when the Council failed to act on it.

The approval process is, as the above suggests, muddled. Under state law, the S&WB can fix and collect service charges from users of the drainage system, with the approval of the City Council, the Board of Liquidation and voters. Whether this law would be trumped by the City's home rule charter is a matter of debate. At the city level, a murky charter amendment requiring voter approval of certain fees was enacted after the City Council attempted to impose a "real property service charge" and a "road use charge" with flat rates. Whether the drainage fee falls into the realm of those fees is unclear.

The past is not necessarily prologue here. The use of drainage fees has grown dramatically around the country. In New Orleans, there is greater awareness of the limitations on tax capacity and the unfairness caused by massive tax exemptions. This makes fees that can reach those properties a more palatable alternative to property taxes.

Privatization

In February of 2001, the SWB released without formally issuing an RFQ/RFP soliciting proposals to privatize either the management only or the management, operations and maintenance of the water and wastewater systems. The purpose of the privatization was to reduce costs and rate increases.

The solicitation was in the form of a managed competition, meaning that both private firms and the employees of the SWB were invited to submit proposals. The proposed procurement included the sewer collection system, the water distribution system, all treatment plants, billing, collection, meter reading and maintenance. It did not include the drainage system, the power plant or capital repairs and improvements for which the cost of materials exceeds \$10,000. Had it been implemented, it would have been the largest water/wastewater privatization in the US, with an estimated value in excess of \$1 billion.

The SWB started off on a bad foot by giving the public a mere ten days to review and comment on a set of legal and other documents about eight inches high. After pushback, the period was extended by four months. Because of the scope of the proposed privatization and its implications for all citizens, BGR hired experts to conduct an independent evaluation to determine (1) whether privatization was the best way to meet the SWB's financial challenges and improve services, and (2) whether the proposal on the table was structured in a way that would deliver maximum cost savings and other benefits.

The answer to the first question was a qualified yes; the answer to the second was a resounding no. The consultants found that privatization was more likely than internal engineering efforts to reduce costs and produce smaller rate increases. However, if the SWB's governance problems were not remedied, they would diminish the benefits of managed competition.

There were, unfortunately, serious procedural problems with the selection process and serious substantive problems with the terms of the proposed privatization and proposed contract. The procedural ones were of a magnitude that was likely to discourage bidders, and indeed there were only two besides the employee group. The problems included ambiguous selection criteria, lack of detail in the protocols for the selection process and the scoring system, a requirement for firm bids at an inappropriate time, and unusually complicated alternative scenarios (18 in all). In addition, there were other factors, such as the failure to establish an economic baseline for use in evaluating cost effectiveness.

Most of the contract provisions were reasonable. Some, however, undermined the goal of privatization by continuing the inefficient practices that privatization is supposed to avoid. For example, the draft contract gave the SWB the right to approve all subcontracts for professional services. In addition, there were ambiguities in the scope of work; inadequate treatment of major costs, such as electricity; and flawed pass-through provisions. There were also unusual termination provisions, such as the one for termination for uncontrollable circumstances, which placed an inordinate amount of financial risk on the SWB.

There were also legal clouds, including the Civil Service's claim to have a right of approval.

The process continued for more than a year and a half. During that time, BGR again hired consultants, Raftelis, first to review the process and the evolving draft service agreement, and then to analyze and score the final proposals. BGR

reviewed and submitted detailed comment letters on drafts of the agreement. Many of the problems identified at the outset were never addressed.

In the beginning of the process, the only parties showing up at the hearings were concerned employees and BGR. Over the course of the process interest and opposition grew, and not just at the local level. Public Citizens, an advocacy group in Washington opposed to water privatizations, came on the scene and began grassroots organizing.

In the fall of 2002, the privatization was defeated through a parliamentary maneuver. Mayor Nagin attempted to revive the effort, but it never went anywhere.

In the meanwhile, the City Council had proposed and voters approved a charter amendment that requires voter approval of SWB privatizations over \$5 million. That charter amendment remains on the books.

I note that the operation of the sewerage treatment plant was outsourced before the managed competition and remains outsourced to this day. Veolia is the operator.

Management issues

As noted earlier, the SWB is responsible for the operations, maintenance and improvement of the systems. However, the City Council controls its access to

funding. There are two basic ways to a fully address this misalignment of powers and responsibilities. One is to consolidate the SWB into city government. The other is to make the SWB completely independent of city government by giving it independent funding authority.

In the U.S. most water and wastewater utilities are departments of city or county governments. A 2005 survey found that two-thirds of them were structured that way. Another 30% were stand-alone entities. The remainder took other forms, like cooperatives and privately owned utilities.

While departmental utilities were the most common, independent water agencies have been growing in popularity. There are advantages and disadvantages to both.

In 2011 BGR collected information on the governance of 37 independent utilities nationwide. It found that all but four of them had full control of their rates. Two of the four were regulated by the state public service commission, and the local governing body had the say in the other two.

Sixteen of the 33 utilities with full control of their rates had totally appointed boards. Another four had appointed boards with one ex officio member. In 11 other cases, the public elected all or a majority of the board members. The remaining two boards were comprised solely of elected officials.

While almost all of the stand-alone utilities had full control of their rates, only eight had taxing authority. None imposed taxes for drainage. Three funded it through their sewerage rates, while the other two imposed a separate fee.

There are lesser measures that provide some, though not complete independence. They include giving the SWB limited ratemaking authority tied to an index of some sort, and amending the process by which the City Council considers requests for rate increases, including independent analysis and fixed timelines.

Earlier I flagged problems relating to having four elected officials on the board. This also is unusual. BGR took an in-depth look at the governance structure of 10 well regarded independent utilities. Seven of them were composed exclusively of appointees. Only three had an *ex officio* member, and in all three cases it was the mayor. No member of the local governing board sat on the committee. Appointments were made by the mayor, the city council, or most commonly by the mayor with council's approval.

Finally, there is another fracture in the system that should be addressed.: the division of responsibilities for drainage. Consolidating the SWB into the City is one way to address it. Should the SWB remains an independent entity, transferring the city's drainage to the SWB would also address the problem.

I'll wrap up here to make time for questions and discussion. In closing, I'd like to acknowledge that most of the history and other information contained in this

report comes from reports prepared by the Bureau of Governmental Research over the last two decades. For more detail, I refer you to those reports, which are contained on their website under reports in the subcategory Sewerage and Water Board.