

Proposed Sewer Service Charges
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PROTEST

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January 23, 2012

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SUBJECT: Proposed Increases in City Sewer Service Charge (SSC)
Written Comments

I have been a resident and homeowner in the City of Los Angeles ("LA") for over 25 years. I work as an Environmental professional, assisting clients in complying with existing and new laws, regulations, and standards. I performed my first Environmental Audit over 30 years ago. I worked for six years for a major public accounting firm, supporting financial audits and internal audit projects. I teach in the Sustainability certificate program at UCLA Extension, and am a sponsor of the Valley Glen Neighborhood Association.

I read the "Notice of Proposed Increases in the Sewer Service Charge (SSC) for the City of Los Angeles" ("Notice") from the Bureau of Sanitation ("Bureau") with great interest. I hereby submit written comments on several matters in the Notice. This letter includes sections for a few brief introductory observations and comments which I believe require adjustment or attention.

OTHER OBSERVATIONS

Observation 1: Things cost money. First, I understand that city services cost money. Most people do not appreciate the extent or complexity of government services, including city sewer services. I do not object to paying for city sewer services, or for construction, system enhancement, Bureau management and staff, training, and all the ancillary activities that are involved in running a world-class organization. I do not object to paying an additional dollar, or \$100, or \$1000 in taxes or fees as a matter of principle. The government – including the Bureau – must do its job, and costs are increasing. I expect diligent use of rate payer funds, proficient and responsible management, and transparency in operational and financial matters.

Observation 2: New/ Emerging Issues. I am aware that there are new and emerging issues in the area of wastewater treatment that are likely to pose significant challenges to the Bureau – and every similar organization worldwide – in the years ahead. Aging infrastructure is one such problem. The emerging knowledge of the extent of low-level concentrations of pharmaceuticals and their by-products, and the effect of these substances on the oceans and rivers is another. Existing wastewater treatment systems

were not designed with these complex chemicals in mind. The Bureau may well be asked (or required) to develop programs or add technology to address this issue in the years ahead. These emerging issues will cost money.

Observation 3: Baseline for Bureau. Figure 1 of the Notice compares LA's typical monthly single family residential sewer service charge to eight other cities across the state. The LA homeowner's costs rank seventh among the nine. San Francisco's extreme costs are an anomaly, given that city's unique geography, climate and cost of living. Although LA's relative costs are favorable as compared to these other cities, the relative costs may not be quite as favorable as this graph depicts. I also note that these are existing costs, and do not reflect the proposed increase in rates as outlined in the Notice.

Observation 4: Timeframe for Proposed Increases. A 10-year timeframe for proposed rates seems reasonable for many of the reasons listed. One proposal with phased increases over ten years avoids multiple proposals. This makes sense when increased costs are predictable; it also reduces administrative costs to manage these proposals.

COMMENTS

I disagree with four issues in the Notice:

1. Leverage/ Debt
2. Loan Assistance Program
3. Commercial water Conservation Adjustments
4. Low Income Subsidies

A synopsis of each issue, my comments, and rationale for each are provided below.

Leverage

Comment 1: The Board's approach includes provisions for far too much debt. The percentage of ratepayers' fees allocated to debt service will increase fivefold in ten years. The Board should prioritize projects, and propose appropriate rates to pay-as-you go. The Board should include a cap on the proportion of revenues allocated to debt service of 5% of revenues.

The Notice indicates that one reason for the long-term approach to SSC is to improve the Bureau's credit ratings, which, in turn, will provide the Bureau with greater ability to leverage costs for anticipated capital projects. Many ratepayers may not understand that "leverage" is a fancy word for "debt." Figure 2 in the Notice illustrates the anticipated use of future revenue. Payment of existing debt service consists of 3% of the revenue; payment of future debt services is another 17% of revenue.

The table below provides one example of how increased debt service provides comparatively little additional benefit.

Table 1, Doug Hileman's Example of How Ratepayer Funds are Used in Scenario Proposed in Notice

Scenario for Typical Household	Household Monthly Sewer Charge	Debt as a % of Total Bureau Costs	Amount Towards Debt	Amount Towards All Other Costs
Current SSC	\$30.00	3%	\$0.90	\$29.10
Increased SSC	\$40.00	20%	\$8.00	\$32.00
Increase, compared to Existing	\$10, or 33%	17%, or 670%	\$7.10, or 788%	\$2.90, or 10%

The increase in debt servicing costs grows explosively, while the net amount available for construction projects or operations increases by a much smaller amount. The Board may have one of two assumptions in proposing leverage to generate quick cash:

1. Cash is required for near-term projects are more substantial and will cost far more money than projects that may arise later during the ten-year term. Revenues from Years 5 – 10 will outpace the Bureau's needs, allowing repayment of debt and reduction of debt loads to current levels of approximately 3%.
2. The Board believes it is acceptable to operate with a debt service level of approximately 20% of revenues on an ongoing basis.

I believe both rationales are unreasonable and untenable. Whatever the reasons, the increased burden of debt service is a poor approach for several reasons:

- **Unanticipated Requirements:** Given the physical state of the sprawling sewer infrastructure, new and emerging issues (such as trace amounts of pharmaceuticals, as noted above), cost overruns on many a public construction project, and other factors, it is unreasonable to believe that all significant costs for a 10-year timeframe can be suitably predicted at this time. What if an extreme earthquake causes several key sewer mains to rupture, requiring emergency construction that exceeds the entire annual budget? Or that drops in water table lead to another series of dramatic ruptures in water and sewer lines? The amount of money borrowed will not cover unanticipated projects or costs – then the Bureau will have to borrow more money than anticipated in later years to cover these unanticipated costs.
- **Relative Amount Towards Debt and Construction:** Budgeting 20% of revenues to service debt is irresponsible, especially when the current amount required to service debt is a respectable 3%. The public is in no mood for incurring debt as a standard practice; it should be reserved for extreme or unusual circumstances. Rosy assumptions of revenue and the insufficient attention to debt is currently playing out in the European Union, the housing and financial markets in the U.S., pension funds, the State of California budget, the Los Angeles County budget, and new

places at every turn. There are also substantial administrative costs for preparing bond offerings and auditing repayments – funds that ratepayers would prefer go towards construction projects rather than to bankers and administrators. Los Angeles rate payers have enough challenges servicing our own debt; I believe it is poor public policy to set them up to service an increasing debt load for the Bureau.

I further suggest the Bureau impose a “soft cap” on the amount of money to service debt at 5% of total revenues. If more funds are required in earlier years of the time period covered by the Notice, then justify it and ask for it.

Loan Assistance Program

Comment 2: The Bureau should not launch a loan assistance program. The Bureau should not have any program where it provides money to anyone with the expectation of repayment. This program is not in alignment with the Bureau’s core mission, is likely to incur significant costs and risks beyond the Bureau’s expectations, and has many risks of non-compliance, abuse, or fraud.

The Notice indicates that “the City is frequently asked to provide assistance to customers.....” and that Sanitation is implementing a new revolving fund loan program. The seed money for the program will be 0.5% of the rate adjustment for the first five years.

Ownership of a home or commercial building is an achievement, a privilege, and a responsibility - it is not a right. Property owners must obtain funds for any number of reasons – new roof, new sidewalks, landscaping, plumbing or electrical repairs, etc. Property owners can seek funds from banks, savings, family members, or many other avenues. Low-income loans from the City results in the City (more properly, the other rate payers) subsidizing these property owners.

Perhaps more disturbingly, this puts the Bureau in the role of a financial institution. Many questions for such a loan program are likely to arise:

- How is the program publicized (and at what cost)?
- What are the criteria for receiving loans?
- Who decides who gets the loans – and who doesn’t?
- Is the Bureau prepared to develop and implement policies, programs, and procedures that are applicable to financial institutions – for example, to prevent discrimination that is barred by law?
- If the property owner stops paying the loan, what recourse does the Board have? What will be done, and how much will this cost?

My experience supporting internal and financial audits suggests that the procedures required for the financial audit of a loan program would be in addition to procedures to audit the financial and reporting

related to Bureau's primary business. This would be an additional administrative cost, with no benefit to anyone but the auditors.

Once the Bureau loans money, there is a risk it will not be repaid. Even the largest, most sophisticated financial institutions got it wrong, leading to the current worldwide economic bind. And for banks, this is their primary business, not a program within an agency with the primary mission of collecting and treating sewage! It is easy to imagine the scenario where property owners borrow \$50,000 or more from the Bureau, fail to make the improvements, spend the money on something else, and default on the loan – and their property. The Bureau has lost rate payers' money – and more money (attorneys, etc.) spent trying to collect it.

The Bureau should limit its programs and activities to the core mission of developing and maintaining infrastructure and operations to gather and properly treat sewage; and associated programs to reduce the volume, toxicity, and impact of sewage.

Commercial Water Conservation Adjustment

Comment 3: There is insufficient support for changes in the Commercial Water Conservation Adjustment, and for additional Board authority sought in the Notice. The Bureau should redouble efforts to maintain commercial sewer rates at competitive levels to retain businesses in the City. The Bureau should introduce or expand programs to compile more usable site-specific data. The Bureau should justify the need for expanded authority as requested in the Notice, or develop a proposal where no increased authority is necessary.

The Notice explains the current basis of sewer charges for commercial customers. The Notice suggests that water conservation measures are sufficient basis for an increase in the assumed ratio of water discharged to the sewer as compared to purchased water. The Notice acknowledges that some commercial users have better site-specific data on their actual discharge to the sewer. The brief information provided does not appear to provide sufficient information to warrant the increase that is requested. Furthermore, it is not clear that the additional authorization sought by the Bureau is fair, or consistent with public policy or what should be the goals of the Bureau and the Los Angeles Department of Water and Power and other water suppliers.

- The Notice does not indicate how much of the Bureau's revenues are from commercial customers, as compared to residential customers.
- The Notice does not provide examples of a typical commercial user's current charges, and how they would be expected to rise during the next 10 years.
- Some water conservation measures also reduce the amount of wastewater discharged to the sewer (low flow toilets and shower heads, faucet aerators). Other water conservation measures, such as drought-tolerant landscaping, reduce water usage, but not discharge to the sewer.

- It is standard practice to use industry factors such as those provided in the Notice as a convenient, default method for calculations – for air emissions, greenhouse gas emissions, etc. However, it is also standard practice to encourage companies to develop better site-specific data.

I am concerned that the increase in sewer rates will impose undue additional costs on commercial entities in LA, providing another instance of higher cost for groceries, restaurants, offices, Laundromats, and businesses that are already struggling financially. This would seem more reasonable if it were allocated according to actual sewage discharge, and if the Bureau demonstrated that the costs borne by commercial entities in LA were in the lower- to middle-third of comparable cities in California (similar to Figure 1 in the Notice). I also believe the Notice's proposed [new?] authority for the Bureau to change percentage discharges – and, hence, the charges imposed on commercial entities – does not appear to be sufficiently substantiated. I suggest the Bureau establish goals of:

- maintaining commercial sewage rates at or near the mid-point of comparable cities in California;
- encourage commercial entities to install meters to obtain more site-specific data to get more meaningful data for billing
- work more closely in partnership with the LA DWP for programs to encourage reduction in water use, reuse of water where feasible (including use of gray water for landscaping), and other conservation measures that reduce both water consumption and discharge to sewer.

The Bureau should also provide more support of the necessity of increased authority, and justification as to why this approach is the preferred option.

Low Income Subsidy

Comment 4: The Bureau should provide more justification for the increase in the Low Income Subsidy. The Bureau should also describe, implement, or improve systems and controls to prevent and detect fraud, and to ensure that the relief is provided only to individuals in the most dire financial need.

The Notice proposes that the Low Income Subsidy be raised from 0.84% to 1.64% initially, with the Board getting the authority to increase this surcharge to as much as 2%.

There are probably several reasons why an increase is needed. The economic downturn has driven more households into lower-income profiles; people who are at home all day use more water than if they were at work. Nonetheless, the Notice does not provide justification for this increase (it doubles the amount SSC payers will pay to fund low income users), nor any other details on how this increase in funds will be managed, disbursed, and protected from misuse or fraud.

The City of LA Bureau of Sanitation offers relief to low income households for other programs, including water, power, and solid resources fees. The City's website (<http://lacitysan.org/hmd/ssclid.htm>)

describes a control for only one of these programs: solid resource customers must re-certify¹ their eligibility for low-rate solid waste fees once every two years. Households may take on boarders, or move in with family members with sufficient income. Recipients of relief may get employment, or move and sublet their apartments. Although I understand the societal responsibility and the value to public health to treat all sewage, including that of low income households, I also believe that lack of controls, oversight, governance, and enforcement can lead to excessive disbursements through weak management or fraud. I believe the Bureau must provide more justification for this increase, and must convince the ratepayers that there are robust programs to prevent and detect misuse and fraud in this program.

Thank you for the opportunity to comment on the Notice. I hope the comments will influence the Bureau's decisions.

Sincerely,



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Cc: Valley Glen Neighborhood Association
Paul Krekorian, City Council, District 2

¹ There is no mention of a requirement to provide documentation; self-certification is a weak control, and provides no assurance against misrepresentation or fraud.