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Dieguez comments on Feb. 2, 2023 Rate Study Agenda Item

9 messages

Gregg Dieguez <gadieguez@gmail.com> Thu, Feb 2, 2023 at 4:18 PM
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Gregg Dieguez Comments on Feb. 2, 2023 Rate Study Preliminary Analysis

Dear Board Members:

There is much detail in this agenda's supporting rate study material, but what is missing is as important as what is included. What is missing is an updated assessment of the asset inventories in use for Water, Sewer, and at SAM. Recent storms have made it clear that there will be large, short term capital replenishment expenditures, certainly at SAM, which are not reflected in the assumptions in this analysis. Further, the analysis lacks a relevant metric for analyzing the adequacy of MWSD reserves (including SAM obligations). Until the asset inventories in all 3 areas are analyzed at current replacement cost with expected remaining useful lives, no rate study can adequately assess the fiscal sustainability of MWSD.

One easy, summary method of analyzing the necessary reserves for MWSD is detailed in two articles here:

https://www.coastsidebuzz.com/public-works-deficits-how-deep-is-the-hole/

https://www.coastsidebuzz.com/assessing-public-works-fiscal-sustainability/

As a first step, that methodology can be used to ballpark the size of the reserve deficits in under one or two hours. Going forward, the District can decide how much more detailed analysis of the assets and their conditions/remaining useful lives is merited. Based on 6/30/21 data, and including the District's share of ownership in SAM, the 2021 analysis showed MWSD short $41M on reserves required to fund replenishment without borrowing *(MWSD had ~$9M, needed $50M to fund reserves on an actuarial basis comparable to unfunded pension liabilities)*.

Funding without borrowing is an important consideration in the current financial climate. One quote from the B&W analysis is misleading *"annual debt service per each $1 million of project funding is currently about $60,000 per year."* While likely accurate, that comment fails to note that at current mortgage rates of 6.7% borrowing **adds** 142.5% to the cost of a financed asset, plus issuance costs. At 5%, borrowing adds 103% plus issuance costs. On top of the intergenerational equity issues raised by borrowing, the financial dynamics in play will show clearly that paying more than half your capital funding to lenders will seriously undermine the fiscal sustainability of MWSD.

Speaking of financial dynamics, a few years back I created a financial model/spreadsheet of MWSD and sent it to you. That model, or an improved successor should: a) be used to analyze the impacts of any rate studies, and b) should be the ongoing property of the District, usable without retaining a consultant for financial projections. (Consultants should still play a role in assessing capital project requirements, borrowing opportunities, etc.)

Some detailed comments on why the current materials presented to the Board are inadequate for immediate consideration of any rate increases (though it is clear such increases are needed):

1. From the agenda packet: *"Prior analysis by SRT Consultants estimated that over the long-term the water enterprise would need to fund roughly $2 million ... etc."* Show the prior analysis! It is likely out of date. Update it in concert with assessing the asset inventories in Water and Sewer enterprises.
2. Provide an analysis of the replacement cost of current assets, including SAM.
3. Where's the metric for fiscal sustainability - by enterprise? MWSD needs to revisit the

algorithms and amounts for each type of reserve for each enterprise, and demonstrate via the financial model that following those reserve policies is adequate to purpose. I submit that such an analysis will show current reserve policies are inadequate.

4. Consider using a fixed charge for the Sewer enterprise, as you do in part with the Water System Reliability Charge (WSRC). Note that several cities have completely FIXED charges for sewer (e.g. Hillsborough). Whether a drop or a deluge, the same infrastructure is required to support each dwelling unit and the vast majority of costs are fixed.
5. Recall that the Board voted to adopt HALF the recommended WSRC when it was introduced. Consider raising the amount further, sooner, as well as when the debt burden expires on the District's formation bonds. The financial model will allow the Board to assess the tradeoffs in ratepayer burden vs. fiscal sustainability vs. borrowing.
6. Make asset-based fees continuously adjustable based on Calif. construction cost index.
7. Include connection fees in this analysis. IMMEDIATELY raise connection fees to be based on a pro rata share of the asset foundation supporting each enterprise based on current replacement costs, and index those fees to the CA construction cost index for public works (or other suitable public metric). *[The district did just include that construction cost inflation in justifying a recent prior year's increase in those fees.]* Failure to base connection fees on the current replacement cost of the current asset foundation allows New Joiners to avoid paying their fair share, which is a problem for public works agencies everywhere, but particularly unfair given the longstanding bond payments ratepayers have been funding to create MWSD. Such increase will also generate material funds for the capital replenishment (my 2019 analysis showed a combined fee of $130,000 per combined water/sewer connection was justified/required).
8. The CIP projection for sewer is lacking the current SAM asset burden – it seems WAY low. Also the Sewer cash flow seems to have VERY low SAM WWTP improvements *(which I assume include the IPS?)*. The analysis must show the detailed derivation of those capital amounts before going any further in proposing rate increases. I suggest an update from SAM management after the storm damage and fines are assessed is relevant to any rate decisions.
9. Debt service coverage on the Sewer Cash Flow is unclear: explain
10. Why is the time frame shown only 5 years for Water and 10 years for Sewer? As mentioned, about 5 years ago SAM began making 20 year projections. Given that public works assets can last 60 or 80 years, no less than a 20 year projection would seem the minimal standard of care, coupled with the actuarial analysis described earlier in these comments to handle the longer term.

In conclusion, tonight's B&W preliminary comments on the rate increase are necessary but insufficient to adequately analyze the burdens and solutions facing MWSD. In part, MWSD got into this position by allowing low rate increases for some time – as did many other agencies. The common problem in the industry is using asset valuations which are decades old (and often further reduced by depreciation) as a basis for financial decisions which must of necessity deal with the current replacement costs of assets failing under our feet. It is past time to strengthen the financial analysis to reflect this underlying reality.

I am ready to assist the District in improving this analysis.

Sincerely,

Gregg A. Dieguez

Midcoast Community Council Chairman *(writing as an individual)*

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