ALLEGHENY INSTITUTE FOR PUBLIC POLICY

December 13, 2017 **Policy Brief: Volume 17, Number 49**

A New Chapter Begins in the Long Running PWSA Saga

Summary: The year 2017 has not been kind, to say the least, to the Pittsburgh Water and Sewer Authority (PWSA). As *Policy Brief Vol. 17, No. 14*, described earlier this year, the PWSA's very old infrastructure has been continually springing leaks that have cost millions of dollars to repair. The mayor proposed leasing the beleaguered authority to a private operator. But given the very high level of debt and the daunting problem of replacing the many miles of water and sewer lines at a cost of several billions of dollars, finding a firm that will enter into a lease agreement on the mayor's terms is not likely to happen. A state auditor general's (AG) report claims that half of all the water treated is lost before it reaches customers.

PWSA's very serious problems caught the eye of the state Legislature which introduced a bill (HB 1490) back in June to place the authority under regulation by the state Public Utility Commission (PUC). After the House passed the bill and sent it to the Senate, HB 1490 was not acted on again for several months. It received legislative approval and was signed into law in late November.

The legislation does two essential things: First, it holds the PWSA accountable for putting together a compliance plan to bring its procedures such as accounting, billing and technology in line with the requirements applicable to other PUC-governed water and wastewater utilities. The authority needs to improve its asset management capabilities so it will know what assets need repair and be able to prioritize those repairs.

Second, it requires the PWSA to create a long-range plan to improve its infrastructure. This plan must include a general description of items needing repair, where they are located and an initial schedule of the planned repairs or replacements. The PWSA will also be required to project annual expenditures to implement the plan and will be allowed to raise rates to pay for the repairs/replacements. The authority will be allowed to update the charge quarterly as appropriate while keeping customers informed about any rate increases. In addition, the PUC will require the authority to submit an annual plan detailing what has been improved or replaced as well as a description of the work to be done in the coming year. This requirement is designed to ensure that the PWSA follows through on the urgent need to replace the outdated and fragile infrastructure.

The legislation gives the authority six months (until May 20, 2018) to present its compliance plan.

In addition to legislative action on the PWSA this year, the AG conducted an audit of the authority (the city controller had performed an audit earlier in the year). The AG audit focused on the leadership of the PWSA and its ties to city government but also provided a useful history of the authority.

A succinct recap of that history follows: The PWSA was established in 1984 under the Municipal Authorities Act of 1945 but was not granted a fully independent status. Indeed, its primary function was to oversee a $200 million capital improvement program to refurbish the entire system. The city would bill the PWSA for any back-office services the authority used and employees remained on the city payroll. In 1995, the PWSA and city replaced the 1984 arrangement by entering into a new agreement in which the authority would lease the system from the city for an upfront payment of $101.4 million to cover the 30 year lease. At the end of the lease, the authority could purchase the system for $1.

However, the 1995 agreement also included a 40-year co-op arrangement in which the city would also provide for a fee the same services agreed to in 1984—telephone and data, vehicle fuel and repair, legal aid, computer services, payroll service and administration of benefit programs. A major change was to move PWSA employees off the city's payroll.

In addition, the PWSA would provide the city with 600 million gallons of water per year at no charge (estimated to be worth $6 million and $6.84 million at 2016 and 2017 rates, respectively). The city would also charge the authority for direct and overhead expenses for any services required (estimated to be worth a total of $7.15 million from 2012 to 2016). Furthermore, the PWSA is required to make equalization payments to city residents not served by the authority and have to get their water from another provider if its water costs more than PWSA water. Over the three years ending in 2016, this requirement cost PWSA an estimated $4.8 million.

Both the 1984 and 1995 agreements placed conditions on the PWSA that doomed it to financial hardship—while providing a bailout for a city that couldn't put its fiscal house in order. The AG quoted a former mayor who claimed that from 1984 to 1995 the PWSA was used to help balance the city's budgets. Revenues were diverted to uses not related to the PWSA system limiting the authority's ability to invest in infrastructure upgrades.

A primary aim of the 1995 agreement was to spin off the PWSA to "focus on rebuilding the system and not use it as a financial tool of the city." The AG's report notes that the city used the $101.4 million payment—which the PWSA had to borrow—to improve its own financial situation. According to the audit, "the City retained ownership of the system, yet pawned the financial and operation responsibilities of the neglected system off on the PWSA."

The AG believes the “City has over-extended authority regarding the PWSA.” Based on the original governing documents (1984 and 1995 leases), the city never intended the PWSA to be a truly independent organization. That starts with the makeup of the board of directors. One seat belongs to city council, two belong to the city finance director and treasurer and the remaining four are appointed by the mayor. The board appoints an executive director. Little wonder the authority agreed to lopsided agreements with the city.

Additionally, to the detriment of the PWSA, the 1995 lease agreement states that the PWSA is to keep the system in “as good condition as it is in on the date hereof, ordinary wear and tear excepted… while also putting all the financial burden on the authority.” The new 1995 agreement stipulates that “the City shall not be liable for any [PWSA] debt payments.” This holds the PWSA responsible for the system and absolves the city of any responsibility even though it still owns the system’s assets. City ownership of the assets and the co-op agreement have limited the steps PWSA could take to accelerate needed improvements. This arrangement designed to benefit the city while hamstringing the PWSA is not remotely akin to good governance.

As mentioned above the AG audit reports that the city receives free water worth close to $7 million, the value of the 600 million gallons allowed under the 1995 agreement. What is not known is how much water the city *actually* uses because the water it uses is not metered. The city does not have a list of all properties that receive free water. However, as the audit explains the known free water users include, “its departments, agencies and instrumentalities (i.e., Pittsburgh Zoo, Phipps Conservatory, National Aviary, and Schenley Golf Course).” Although in a footnote it is explained that the golf course was metered in 2012 and has been paying bills, but for prior years was not.

The PWSA has severely under-invested in its infrastructure in large part due to the heavy debt load incurred over the past 30 years. The audit notes the debt levels (debt, bond and loan debt minus swap debt) increased from $300 million in 1995 to $680 million in 2012 to $750 million at the end of 2016.

High debt levels at the PWSA have critically hampered the authority’s ability to make adequate investments in its infrastructure. For the years 2012-2016, the period of the audit, the PWSA’s average annual capital investment was $31.4 million, ranging from $21.4 million in 2013 to $47.2 million in 2015. The recommended annual capital investment during this time, as noted by a PWSA official, was $200 million. Obviously the actual investment fell well short of what was needed.

Misuse of the PWSA as a source of funding for the city resulted in inadequate expenditures on the crumbling infrastructure. This ill-advised policy has caught up to the authority (and the city) in a big way and it will cost several billions of dollars to fix the problems now staring them in the face.

So where does the PWSA go from here?

Provisions of HB 1490 require the authority to start working on a plan to begin addressing the dreadful condition of its delivery infrastructure. Presumably, the PWSA board is taking the six- month deadline seriously. Moreover, the board and the city should also take the AG's audit to heart and begin to develop a more arms-length relationship wherein the PWSA has greater independence and less influence from city government officials. Perhaps the PUC can help with that effort. While the authority will remain an autonomous entity, its board will be accountable to the PUC and ultimately the Legislature which will undoubtedly be keeping a close watch.

Of utmost importance is to keep the PWSA's critical problem of repairing and/or replacing its very old equipment at the forefront of management thinking. And that project will be very costly—recent estimates place the cost at $5 billion. Unfortunately, with its current debt and revenue levels, the authority will find it difficult to borrow the enormous amount of funding necessary to carry out a long term repair and replace program. Thus, as our earlier *Policy Br*iefs pointed out, customers will be forced to bear the cost of borrowing the funds for the project in the form of substantially higher rates. Note that rate hikes must be approved by the PUC and those increases must conform to the long-term plan.

And what can the city do to help fix the mess it has allowed to develop? While the co-op agreement frees the city from any PWSA debt responsibility, nonetheless the city should take steps to help. First of all it needs to meter all city properties and begin paying for water like any other user. Secondly, city officials should pledge to support the PWSA as it develops a long-term plan as required by law and avoid carping when rate hikes become necessary. Indeed, city officials should help prepare residents and businesses for the likelihood of substantially higher water and sewer bills to come over the next several years. Dealing with this critical problem cannot be avoided any longer. In short, the city must accept the urgent need for a wholesale system upgrade and fully and willingly cooperate and assist in the process.

Frank Gamrat, Ph.D., Sr. Research Assoc. **Jake Haulk, Ph.D., President**

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org