



## New York City's Water and Sewer System: Is the Rent Too Damn High?

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An important, yet obscure, element of municipal finance is a “rental payment” made by the public authority financing the water and sewer system to New York City’s treasury. What was once a declining overhead cost for the water system has become a rapidly growing expense that increased from a low of \$102 million in 2003 to \$234 million in the current fiscal year. The sharp reversal is attributable to the City’s decision to change the basis on which it charges rent and has contributed to the rising price New Yorkers are charged for their water; this price increased at more than twice the rate of general inflation in each of the past six years.<sup>1</sup>

This report provides a history of the rental payment, critiques the current method for setting the rent, and suggests alternative approaches to setting the rent. These options do not necessarily lead to a lower rental charge, but are more appropriate methods for setting the payment. *In brief, the rent is not too damn high – but ain’t quite right.*

## Structure of the New York City Water and Sewer System

New York City's water and sewer system is a network of watersheds, reservoirs, tunnels, aqueducts, water mains, sewers, treatment plants, and pumping stations, including more than 7,000 miles of pipes running from upstate New York to every building in New York City. Day to day operations and maintenance of the system are the responsibility of the New York City Department of Environmental Protection (DEP). Until the mid-1980's, New York City funded operating expenses through a general fund appropriation to the DEP, just as it funded other agencies, and financed necessary capital investments through general obligation (GO) bonds, just as it financed schools, roads, and other facilities. Revenues were generated through a fixed charge based on frontage and number of plumbing fixtures; the charge was added to owners' property tax bills and collections were deposited in the general fund with all other revenues. No funds were earmarked for the water and sewer system.

In 1984, the City sought and obtained approval from the state legislature for a new financing arrangement. The legislation created two new entities: the Water Board and the New York City Municipal Water Finance Authority (WFA). The WFA is authorized to borrow in order to finance capital investments in the water system, and its debt is backed by the water and sewer charges established by the Water Board. Water is no longer billed as a fixed charge; 94 percent of accounts are now billed based on metered consumption.<sup>2</sup>

The Water Board sets rates for charging customers for water and sewer services, and the rates are set to be sufficient to cover the system's expenses, including debt service on bonds issued by the WFA. The DEP retains responsibility for operations and maintenance, but the arrangement makes the water and sewer system "bankruptcy remote" and helped the City regain access to capital markets for both its GO bonds and the WFA bonds after the financial crisis.

All three organizations – the DEP, the WFA and the Water Board— are under the control of the Mayor. The Mayor appoints the DEP Commissioner, who serves at his pleasure, and all seven members of the Water Board, who serve two-year terms. The board of the WFA has seven members, five of whom are appointed by the Mayor (four commissioners serving ex officio and one other) and two by the Governor.

The financial model for the newly designed water and sewer system is straightforward: user fees based on rates set by the Water Board pay for the operating expenses of the DEP and the debt service on WFA bonds. The system is designed to function independent of the City's budget, but the relationship between the two is not entirely separate. The water and sewer infrastructure, which had been built and financed by the City, was transferred to the Water Board as a capital contribution. While the City retains ownership, the assets were eliminated from the City's general fund balance sheet; however, the City retained the liability associated with repaying the GO bonds with which the infrastructure had been built. Accordingly, the legislation authorized the City to collect from the Water Board a "rental payment" that would pay the City for use of assets it had initially created. The City was permitted to charge rent up to the greater amount of either (a) debt service on outstanding City GO bonds for the water and sewer system or (b) 15 percent of the debt service on WFA bonds.

## Rental Payment History

Table 1 shows the actual rental payments and the allowable amounts under the two options for each year since 1995. From 1995 to 2004 the City charged and received a rent equal to the debt service on the relevant GO bonds.

In fiscal year 2005, the City changed the basis for calculating the rent and charged 15 percent of WFA debt service. This method required a rental payment of \$109 million, about \$23 million more than the relevant GO debt service. In subsequent years the difference has grown larger. In fiscal year 2012, the rental payment is budgeted at \$233.7 million, an estimated \$184.7 million more than the GO payment would be.

The rationale underlying the new method has come under scrutiny. In 2008, the Office of the New York City Comptroller questioned the wisdom of following the new approach. His office projected that the gap between the rent under the alternative methods would grow to more than \$280 million in 2020 (about \$300 million for the 15 percent formula versus \$20 million under the GO formula). The Comptroller argued that the City treasury should not gain all that revenue, and recommended that the difference between the two sums in any year be divided evenly between lowered rates for customers and capital investments in the water system financed on a “pay as you go” basis (that is, paid from the current revenue rather than from borrowing using WFA bonds).<sup>3</sup> The Comptroller’s recommendation was not adopted.

**Table 1**  
**Actual and Allowable Rent Payments,**  
**Fiscal Years 1995-2012**  
**(dollars in millions)**

<b>Fiscal Year</b>	<b>GO Bond Debt Service</b>	<b>Rental Payment</b>	<b>15% of WFA Debt Service</b>
1995	\$154.0	\$154.0	\$58.3
1996	161.0	161.0	62.8
1997	172.5	172.5	71.4
1998	176.5	176.5	87.7
1999	147.9	147.9	83.3
2000	150.5	150.5	103.0
2001	157.3	157.3	104.7
2002	127.1	127.1	120.5
2003	102.1	102.1	114.7
2004	116.6	116.6	112.4
2005	86.2	109.2	109.2
2006	68.8	119.5	119.5
2007	65.3	132.3	132.3
2008	78.3	139.8	139.8
2009	55.8	151.4	151.4
2010	66.7	171.2	171.2
2011	55.7	205.4	205.4
2012	49.0	233.7	233.7

Sources: New York City Municipal Water Finance Authority, *Comprehensive Annual Financial Report*, 1995 - 2011 editions; GO debt service figures from 2005 - 2012 provided by New York City Comptroller's Office.

Note: 15 percent figure prior to 2005 is based on total of: First Outstanding Debt Resolution Debt Service, selected Second Outstanding Debt Resolution Debt Service, Carryforward from prior year used towards debt service, and EFC Subsidy and Capitalized Interest.

## Alternative Methods for Setting the Rent

Rethinking the current policy is appropriate. The 15 percent formula is arbitrary; it has little basis in actual value of service received from the City and it is not related to the liabilities the City has incurred on behalf of the Water System in the past. Since the Water Board was formed in 1985, it has authorized over \$30 billion in capital investment to expand, improve and maintain the system and is projected to commit over \$12.1 billion over the next ten years.<sup>4</sup> Given the scale and growth of capital investment, the WFA's debt service has grown and will grow steadily and significantly for the foreseeable future. This means the rental payment will grow on a parallel track yielding fiscal benefits for the City, but putting an added burden on water customers. An alternative basis for setting the rent rooted in a logic more closely tied to the value of the City's services would have more legitimacy and acceptability for customers.

What might a more acceptable method for determining rent be? Several options can be identified.

1. ***Payment of City-funded GO debt service plus payment for services rendered by the City to the water and sewer system.*** A clear case exists for water rates to cover the cost of debt service on GO bonds previously issued for water system infrastructure. In addition, water rates ought to cover the cost of services provided by City agencies (in addition to DEP) that directly aid the water system. Other municipal water systems use this approach. An analysis by Booz Allen Hamilton in 2009 found that water systems in three large cities in New York State – Utica, Buffalo and Niagara Falls – paid on average 7.5 percent of their revenues toward such city services.<sup>5</sup>

The Water Board already pays the City directly for two expenses incurred on its behalf—judgments and claims awarded against the City for water system related cases (and associated legal fees) and street cleaning services related to sewer overflows. In fiscal year 2011, the Water Board paid the City \$73.8 million for these items.<sup>6</sup> However, other services, such as trash pickup, police protection, fire and security services, are not reimbursed.

2. ***Payment of utility taxes.*** The water and sewer system is similar to other utilities, such as electric, gas and telecommunication services, that have large infrastructure holdings and that charge consumers directly for the cost of their services. For these utilities, the cost of municipal services is covered through their payment of property and income taxes. This approach could be applied to the water system:
  - a. ***The Water Board could make a rental payment equivalent to what it would pay in City property taxes under the rate charged utilities.*** Utilities are assessed at approximately 40 percent of full market value and pay \$12.40 in taxes for every \$100 of assessed value in the current fiscal year.<sup>7</sup> The water system has about \$15 billion in real property assets that could be subject to property taxes, although not all of this property is within City boundaries.<sup>8</sup> Interestingly, the DEP already makes property tax payments to localities

outside New York City on the land and facilities it owns in those jurisdictions; in fiscal year 2010, these payments totaled \$115 million.<sup>9</sup> The Water Board does not report on how much of its real property assets are located in New York City.

- b. *The Water Board could make a rental payment equivalent to what it would pay under the utilities business income tax.* Most utilities are subject to a 2.35 percent tax on gross income. The water system had \$2.96 billion in revenues in fiscal year 2011<sup>10</sup>, which would yield \$69.5 million under this tax.
- c. *The Water Board could make a rental payment equivalent to what it would pay for property and utilities business income taxes combined, as other utilities do.*

Table 2 presents estimates of the rent payment under alternative policies for fiscal years 2011 through 2015. The methods sanctioned under the lease agreement, GO debt service<sup>11</sup> and 15 percent of WFA debt service,<sup>12</sup> are included for purposes of comparison. For the first alternative payment option, GO debt service is actual amounts due, and the cost of services rendered is estimated as 7.5 percent of projected expenses, the average payment ratio for services noted earlier.<sup>13</sup> Estimates for the property tax option are based on the fiscal year 2011 tax rate and the assumptions that 50 percent of the water system assets are taxable property in New York City and that assessments will grow \$449 million annually, approximately the average for the last three years.<sup>14</sup> Estimates for the utility tax option are based on revenues estimated in the Water Board’s financial plan. In each case the estimates are far less precise than the calculations that would be used if new policies were implemented, but they suggest a rough order of magnitude for the rent under different policies.

**Table 2**  
**Projected Rental Payment - Existing and Alternative Payment Formulas, Fiscal Years 2012 - 2015**  
**(dollars in millions)**

Fiscal Year	Existing Payment Options		Alternative Payment Options			
	City GO Debt Service	15% of WFA Debt Service	City GO & Services Rendered	Property Tax	Businss Income Tax	Property & Business Income Taxes
2012	\$49.0	\$233.7	\$242.4	\$447.3	\$71.3	\$518.5
2013	33.4	250.4	259.0	459.4	76.5	535.9
2014	32.4	270.4	279.0	471.6	82.6	554.2
2015	33.0	277.2	294.9	483.8	87.3	571.1

Sources: Projected GO debt service figures made available by Office of the New York City Comptroller. Fifteen percent of WFA debt service based on projects in NYC Municipal Water Finance Authority, *Bond Official Statement*, September 26, 2011. Property tax and services rendered calculation projected using NYC Municipal Water Finance Authority, *Comprehensive Annual Financial Report for Fiscal Year 2011*.

Two of the options yield higher rental payments than the current policy of 15 percent of debt service. The highest rent results from treating the water system as a private utility and requiring a rental payment equivalent to a property tax on its local assets and an income tax on revenues earned in New York City. A greater amount than currently required would also come from tying the rental payment to the cost of repaying the GO debt and services rendered by the City. In contrast, a less costly option would be tie the rental payment to what would otherwise be generated under a utility business income tax alone.

A higher rent would translate into marginally higher water rates for customers. For example, the property tax approach would have increased the rent by \$229.7 million in fiscal year 2011; this is the equivalent of about a 7.6 percent increase in the price charged for water. Such an increase would not make New York's water prices unusually high. A March 2011 comparison of water rates in 30 cities found New York rates to be in the middle of the group, ranking seventeenth lowest.<sup>15</sup>

In sum, it is appropriate to question the rent being charged customers for the water system. The current basis for setting the rent is arbitrary and has been a contributing factor to rapidly rising prices in recent years. A better justified basis for setting the rent would make the charge more acceptable to customers, but will likely not lower the rent.

## Endnotes

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- <sup>1</sup> Albert F. Moncure Jr., *Minutes of the Annual Meeting of the Meeting of the New York City Water Board*, New York City, May 13, 2011, p. 7-8, Accessed on September 12, 2011 from [http://www.nyc.gov/html/nycwaterboard/pdf/minutes\\_and\\_resolutions/20110513\\_water\\_board\\_minutes.pdf](http://www.nyc.gov/html/nycwaterboard/pdf/minutes_and_resolutions/20110513_water_board_minutes.pdf)
- <sup>2</sup> At the end of fiscal year 2011, 94 percent of accounts were billed on a metered basis, and 100 percent of accounts are expected to have meters installed by the end of fiscal year 2012. See New York City Municipal Water Finance Authority, *Water and Sewer System Revenue Bonds, Adjustable Rate Fiscal 2012 Series A. \$200,000,000*, New York City, 2011, p. 39, Accessed on November 1, 2011 from [http://nycbonds.org/NYW/pdf/2012/NYW\\_2012\\_A\\_AR.pdf](http://nycbonds.org/NYW/pdf/2012/NYW_2012_A_AR.pdf)
- <sup>3</sup> Marcia Van Wagner, *Rethinking the Water System Rental Payments*, Presented at University Neighborhood Housing Program Summit, New York City, 2008, Accessed on November 2, 2011 from [http://www.unhp.org/pdf/WaterForum\\_Comptroller.pdf](http://www.unhp.org/pdf/WaterForum_Comptroller.pdf)
- <sup>4</sup> New York City Water Board, *Public Information Regarding Water and Wastewater Rates: April 2011*, 2011, p. 12, Accessed on October 11, 2011 from [http://www.nyc.gov/html/nycwaterboard/pdf/blue\\_book/bluebook\\_2012.pdf](http://www.nyc.gov/html/nycwaterboard/pdf/blue_book/bluebook_2012.pdf)
- <sup>5</sup> Booz Allen Hamilton, *Evaluation of Expenditures, Revenue Sources, and Alternative Water, Wastewater and Stormwater Rate Structures in New York City: Final Report*, New York City, 2009, Accessed on November 7, 2011 from [http://www.nyc.gov/html/dep/pdf/water\\_board/waterboard\\_rate\\_study\\_12182009.pdf](http://www.nyc.gov/html/dep/pdf/water_board/waterboard_rate_study_12182009.pdf)
- <sup>6</sup> New York City Water and Sewer System, *Financial Statements as of the Years Ended June 30, 2011 and 2010, Required Supplementary Information, and Independent Auditors' Report*. New York City, 2011, p. 29, Accessed on November 22, 2011 from [http://www.nyc.gov/html/nyw/pdf/nyw\\_fs\\_2011.pdf](http://www.nyc.gov/html/nyw/pdf/nyw_fs_2011.pdf)
- <sup>7</sup> Citizens Budget Commission, *5 Year Pocket Summary: New York City and New York State Finances Fiscal Year 2011-2912, 64th Edition*, November 2011, Table IV.
- <sup>8</sup> This figure represents capital assets according to the Water Finance Authority (net of accumulated depreciation) as of June 30, 2011. The figure includes water supply and wastewater treatment systems, water distribution and sewage collection systems, and building capital assets, but not vehicles and equipment asset classes. See New York City Water and Sewer System, *Financial Statements as of the Years Ended June 30, 2011 and 2010, Required Supplementary Information, and Independent Auditors' Report*. New York City, 2011, p. 41, Accessed on November 15, 2011 from [http://www.nyc.gov/html/nyw/pdf/nyw\\_fs\\_2011.pdf](http://www.nyc.gov/html/nyw/pdf/nyw_fs_2011.pdf)
- <sup>9</sup> Amawalk Consulting Group, *Report on the Cost of Supplying Water to Upstate Customers for the 2011 Rate Year*, New York City, 2010. Accessed on November 7, 2011 from [http://www.nyc.gov/html/nycwaterboard/pdf/blue\\_book/fy2011\\_upstate\\_rate\\_report.pdf](http://www.nyc.gov/html/nycwaterboard/pdf/blue_book/fy2011_upstate_rate_report.pdf)
- <sup>10</sup> Gross revenues include all revenue from operations in New York City only.
- <sup>11</sup> Figures for City GO Debt Service projections provided by the Office of the New York City Comptroller.
- <sup>12</sup> Rental figure for 15 percent method taken from WFA bond official statement labeled as "Rental Payment to the City of New York". See New York City Municipal Water Finance Authority, *Water and Sewer System Revenue Bonds, Adjustable Rate Fiscal 2012 Series A. \$200,000,000*, New York City, 2011, p. 39, Accessed on November 10, 2011 from [http://nycbonds.org/NYW/pdf/2012/NYW\\_2012\\_A\\_AR.pdf](http://nycbonds.org/NYW/pdf/2012/NYW_2012_A_AR.pdf)
- <sup>13</sup> The average used for Utica, Buffalo, and Niagara Falls is an unweighted mean of the cost of city services provided as percentage of revenues. These services differ by city, but in all cases include trash pickup, police and fire department services. The same report noted that the Water System received insurance and liquidity support for paying rental payments; Utica, Buffalo, and Niagara Falls did not receive these benefits. See Booz Allen Hamilton, *Evaluation of Expenditures, Revenue Sources, and Alternative Water, Wastewater and Stormwater Rate Structures in New York City: Final Report*, New York City, 2009, Accessed on November 10, 2011 from [http://www.nyc.gov/html/dep/pdf/water\\_board/waterboard\\_rate\\_study\\_12182009.pdf](http://www.nyc.gov/html/dep/pdf/water_board/waterboard_rate_study_12182009.pdf)
- <sup>14</sup> The assumed growth in assessed value is based on a fiscal year 2008 baseline of capital assets limited to buildings, water supply, and wastewater distribution. Growth in these three categories of capital assets from investment were reduced by the depreciation in each category of capital assets over the period from 2009-2011. See New York City Water and Sewer System, *Financial Statements as of the Years Ended June 30, 2011 and 2010, Required Supplementary Information, and Independent Auditors' Report*. New York City, 2011, p. 7, Accessed on November 22, 2011 from [http://www.nyc.gov/html/nyw/pdf/nyw\\_fs\\_2011.pdf](http://www.nyc.gov/html/nyw/pdf/nyw_fs_2011.pdf)
- <sup>15</sup> New York City Municipal Water Finance Authority, *Water and Sewer System Revenue Bonds, Adjustable Rate Fiscal 2012 Series A. \$200,000,000*, New York City, 2011, p. 41, Accessed on November 12, 2011 from [http://nycbonds.org/NYW/pdf/2012/NYW\\_2012\\_A\\_AR.pdf](http://nycbonds.org/NYW/pdf/2012/NYW_2012_A_AR.pdf)