

ALAMEDA COUNTY WATER DISTRICT'S RATE INCREASES

EXECUTIVE SUMMARY

For most people, water comes out when they turn on a tap – they never think about who provides the water or how the amount they pay each month is calculated. Many are dismayed when their water bills are high despite years of conservation during the drought, but they pay their bills without protest.

The Alameda County Water District has not been completely transparent with the public about the role employee compensation has played in rate increase decisions: regular increases to the salaries and benefits paid under generous labor contracts have made ACWD employees the highest paid within county water districts in California.

Last year, however, ratepayers in the Alameda County Water District (ACWD) were so upset by years of rate increases that they were driven to action: their average water bills had increased at an annualized rate of 6.1% since 2003, even in years when consumption decreased significantly with conservation. As a result, the Grand Jury chose to examine the district's practices to better

understand what drove rate decisions and the role the public can play in the process.

The Grand Jury's investigation showed that, while water rates at ACWD are fairly comparable to those in other districts, ACWD has not been completely transparent with the public about the role employee compensation has played in rate increase decisions: regular increases to the salaries and benefits paid under generous labor contracts have made ACWD employees the highest paid within county water districts in California.

Transparency in this instance is especially important because ACWD, like most other water districts in California, operates as a functional monopoly. It is simply too expensive and too inconvenient for individual consumers to get their water any other way, so they are forced to take what is available. While consumers are offered an opportunity to protest rate increases they believe are unfair, as a practical matter ACWD has the ability to impose rates sufficient to cover whatever costs its board decides are reasonable. The Grand Jury believes the residents of southern Alameda County deserve to know more than they are currently being told regarding why their water bills rise each year.

BACKGROUND

ACWD began its operation as an independent water board on December 30, 1913. Today, it serves 81,000 customers in the southern part of Alameda County including the cities of Newark, Fremont and Union City, representing a population over 350,000. The district's fiscal year 2016-2017 budget for operations and capital expenditures was \$119.6 million, and water sales for that year amounted to \$86.3 million.

ACWD is governed by a five-member board of directors elected to staggered four-year terms. It employs 230 full-time employees. The district has an AAA Standard & Poor's credit rating and an Aa2 Moody's credit rating, both of which are excellent.

After property tax revenue was limited by the passage of Proposition 13 in 1978, local governments began to use special taxes, user fees and benefit-based assessments to raise additional funds for public services like water. In reaction to the increasing property tax bills that resulted, which was what Prop 13 was supposed to fix, Proposition 218, the "Right to Vote on Taxes Act," passed in 1996. Prop 218 requires two-thirds voter approval of local taxes, and property-related assessments, and gives voters the right to repeal or reduce certain local charges by initiative. Agencies – like ACWD – that provide essential public services – like water – are exempt from most Prop 218 restrictions, such as voter approval of increases, but are subject to provisions regulating how ratepayers can protest increases.

As a result, despite the restrictions of both propositions, ACWD and other water agencies can increase rates with a simple vote of their boards. Prior to a vote, they must provide written notice by mail 45 days prior to a public hearing with the following information:

- The amount of the fee or charge proposed to be imposed
- The basis upon which the fees or charges were calculated
- A statement regarding the reason for the new or increased fees
- The date, time and location of the public hearing regarding the fees

Prop 218 provides that a proposed water rate increase may not be imposed if a majority of the owners of identified parcels within the district submit written objections. Of the 81,000 ACWD customers, a majority means that 40,500 must submit written protest letters for a fee increase

to be denied. There is very little probability that such a number would ever be reached, thereby making inevitable any increase the board decides to impose.

INVESTIGATION

In its investigation, the Grand Jury reviewed state reports and websites, newspaper articles, videos of ACWD board meetings, and detailed material provided by ACWD. These documents dealt with governance, finance and budget, comparative practices, current challenges facing water districts in California, transparency of deliberations, decision-making and performance. In addition, the Grand Jury spoke with ACWD board and management representatives.

The central issues of the citizen complaints were:

- Salaries and benefits for the 230 full time ACWD employees are generous, with cost of living adjustments (COLA) and increases given even during years of recession.
- Rates have increased significantly over the past 10+ years, with a lack of transparency as to why.
- Customers do not understand why they are paying higher water bills while using less water, as required in a drought.
- The protocols to object to a rate increase under Prop 218 are difficult, effectively removing any possibility of a successful protest.

The Grand Jury learned that ACWD customers turned out in record numbers at an ACWD board meeting on February 9, 2017, to protest a proposed rate increase. Many ratepayers objected to the district's lack of clarity regarding the reasons behind the rate increase.

Salaries and Benefits of ACWD Employees

As in any business, employee salaries and benefits are a significant expense. The Grand Jury learned that regular and substantial increases to ACWD employee compensation and the district's decision to prefund generous retirement benefits are significant drivers behind annual water rate increases in the district.

According to a 2016 State Controller's Office report on more than 500 water enterprises in California, ACWD employees have the highest average wages of \$116,623 (the next highest average being \$111,697). Of the 3,063 special districts in the state, ACWD employees have the 12th highest average wages. ACWD justifies the higher compensation because of its proximity to

Silicon Valley. The Grand Jury heard testimony from one district representative who was proud that ACWD employees have never gone on strike or protested with any work stoppages.

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The average cost of benefits per employee at ACWD is \$55,688 per year. The average cost of benefits per year for an ACWD retiree is \$24,000 (primarily healthcare), which is about three times more than what the County of Alameda pays for its retiree benefits. Until July 1, 2014, ACWD paid 100% of medical, dental and vision premiums/coverage for employees and their dependents. Employees currently pay 1% of their salaries for health insurance, with dental and vision still fully paid by the district. Employees are also eligible to receive \$5,000 per year in tuition reimbursement for taking courses related to their employment outside of normal working hours. Union employees currently contribute 8% of their salaries toward their pensions, while management/confidential/professional employees contribute 5.5%.

ACWD cost of living adjustments (COLAs) have been very generous. The following chart compares the ACWD COLAs to those given to social security recipients in the same year; ACWD workers received nearly twice as much over the ten-year period:

Year	ACWD COLA	Social Security COLA	Year	ACWD COLA	Social Security COLA
2008	4.0%	5.8%	2013	2.0%	1.5%
2009	4.0%	0.0%	2014	2.35%	1.7%
2010	4.0%	0.0%	2015	2.5%	0.0%
2011	4.0%	3.6%	2016	3.0%	0.3%
2012	4.0%	1.7%	2017	3.0%	2.0%

District customers complained that these COLAs were unreasonable, especially those awarded during recession years when many ratepayers' salaries as well as those of other public agencies stagnated. ACWD explained that the high COLAs after 2007 were set as part of a long-term contract with the union, signed before the recession. Nevertheless, the Grand Jury understands

the public’s frustration with the lack of “shared sacrifice” on the part of ACWD employees and management during times of financial hardship.

The Grand Jury also investigated ACWD’s management compensation. ACWD’s “minimum” management salaries range from \$149,000 to \$190,000. The “maximum” management salaries for ACWD ranges from \$188,000 to \$236,000.

In summary, ACWD employee compensation is some of the most generous offered in the state. The Grand Jury is concerned that the practice of annually granting relatively substantial increases will mandate annual rate increases for customers, regardless of the other many factors that should affect rates.

Transparency and Clarity of ACWD in its Communications with the Public about Rates

ACWD has raised rates in every year but one for two decades. The average water bill has increased 143% over 15 years (from \$49.41 in July 2003 to \$120.31 in July 2018), including during times of significant conservation by consumers. The table below, derived from ACWD finance department data, describes what the average ACWD customer has been charged each year from 2008 through 2017:

Effective Date	2/1/08	2/1/09	2/1/10	3/1/11	2/1/12	2/1/13	2/1/14	7/21/14	5/1/15	3/1/17
Bi-Monthly Commodity Charge	\$54.92	\$58.21	\$63.34	\$68.40	\$72.50	\$72.50	\$77.58	\$77.58	\$77.58	\$93.08
Bi-Monthly Service Charge	\$10.08	\$10.68	\$11.62	\$12.55	\$14.93	\$29.86	\$31.95	\$31.95	\$41.54	\$49.84
Drought Surcharge	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$10.26	\$10.36	\$0.00
TOTAL	\$65.00	\$68.89	\$74.96	\$80.95	\$87.43	\$102.36	\$109.53	\$119.89	\$129.48	\$142.92
% Increase From Prev. Year	4.5%	6.0%	8.8%	8.0%	8.0%	17.1%	7.0%	8.0%	8.0%	10.4%

Many factors affect water rates, such as increasing capital costs from aging infrastructure and seismic improvements, environmental regulations, sharply reduced revenues from the drought combined with increased costs of purchasing water, electricity and chemicals used to treat water.

The Grand Jury, however, learned that a key factor behind ACWD rate increases in recent years is increased operating expenses caused by growing labor costs.

The Grand Jury acknowledges that ACWD has significantly increased its public outreach, and has been awarded a Certificate of Transparency from the Special District Leadership Foundation since 2015, which recognizes “its outstanding efforts to promote transparency in its operations and governance to the public and other stakeholders.” In 2016, the ACWD hosted a series of seven well-publicized public workshops to discuss district finances, along with their mailing of Proposition 218 notices to the public, their Aqueduct newsletter and general information included with standard water bills. A concerted effort by ACWD was made to engage the public in the financial and operational status of the water district.

Nevertheless, the Grand Jury remains concerned that the district is far from candid in its communications to customers about why rate increases are needed. In its most recent communications regarding the rate increase, ACWD said that the drought-related water shortage and declining utilization were the principal reasons for the increase. It has regularly told the public that rising “water supply costs” explain why the district’s expenses have increased, but did not make it clear that labor costs are embedded in the water supply figure.

The Grand Jury learned from ACWD records that the two most recent rate increases (20% in March 2017 and 5% in March 2018) will generate approximately \$24 million. Labor-related expenses (salaries and benefits for current employees, post-employment medical benefits for former employees, and pre-funding for future pension and retiree health care benefits) will consume approximately \$11.5 million or about 48% of this additional revenue. Similarly, approximately 40% of the additional revenue generated by rate increases in fiscal year 2014-2015 was used for labor and other employee costs.

If labor costs are addressed at all, the discussion is indirect: the Aqueduct Winter 2015 newsletter from ACWD spoke about “the high cost of doing business in the Bay Area”; the district’s “Notice of Proposed Increase in Water Rates” to residents in late 2016 advanced seven reasons why rates were rising, but only one of its bullet points touched on labor costs by identifying “fund retiree benefits obligations.”

Mostly, however, labor costs are not mentioned. On the rate protest page on its website, the district’s two-page fact sheet does not discuss labor costs; and the message from ACWD’s general

manager in the Aqueduct Winter 2017 newsletter said that rate increases were necessary because of the drought, rising water treatment costs, and aging infrastructure – again, no mention of labor costs.

The Grand Jury acknowledges that, unlike most governmental bodies in California, ACWD has budgeted for advanced funding of pension and retiree healthcare liabilities in an effort to fund these over the next 20 years. Making these payments over a 20-year period instead of 30 will save ACWD’s ratepayers approximately \$58 million in total payments. Once fully funded, the district can limit its annual contributions to these funds to the value of benefits earned during the current year only. We commend ACWD for doing what other California entities have been unable to do; funding these liabilities should reduce pressure on water rates in the long run.

Nevertheless, with such a significant portion of the revenue generated from the recent rate increases allocated to employee compensation and benefits, the Grand Jury concludes that ACWD should have provided this information in a more transparent and easily understood manner than was provided in the numerous recent outreach events, newsletters and notifications of rate increases.

Paying Higher Bills While Using Less Water

It is understandably frustrating for customers to be consuming less of a commodity and paying more for it. It is helpful to have an explanation of why this happens with water use.

Simply put, using less water reduces revenue to the water district by a greater degree than it reduces the expenses of the water district. This has to do with a fee structure that is heavily

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weighted to the rate of consumption that can be highly volatile and expenses that are heavily weighted to the fixed costs of operation. Fixed costs (plant, equipment, labor, debt) are about 70-80% of the

ACWD budget. However, the fixed service charge portion of customer water bills is approximately 30-35%, with the balance dependent on the amount of water used.

This produces the phenomenon that, when consumption is reduced significantly, as it was during the drought, ACWD still has to pay significant fixed costs, while receiving substantially less revenue from customers. Therefore, the per-unit cost of water has to go up to balance the

budget. This fact, though understandable, is nonetheless perplexing to ratepayers who are using less water and paying more for it.

Some members of the ACWD Board are considering ways to better align its revenues with actual costs, not overall expenses. There are two downsides to this approach. First the fixed costs – facilities, equipment, etc. – would be covered by higher hook-up fees, developer fees and perhaps even general tax revenue. This is likely to be seen or experienced as a more regressive form of tax or fee collection. Second, variable costs and their corresponding portion of the total fees paid would actually go down, as these costs (including the cost to purchase water and chemicals) are low when compared to the fixed costs. This change would result in a lower cost for additional water consumption, which might discourage much-needed water conservation. One controversial alternative would be to balance this by a sustainable increase in hook-up, developer's fees and general tax revenue to reflect more closely, but not actually capture all of the fixed costs. Another alternative is to tier rates or maintain the portion of the fees that are driven by use, up to a certain level of modest consumption, and increase the fees for excessive use as a way of discouraging wastefulness.

The Grand Jury appreciates this effort on the part of the district and encourages it to pursue this change in an open and transparent manner with the citizens it serves.

Protest Method

Proposition 218, passed by state voters in 1996, established the rules for stopping a rate increase. A majority (50%+1) of property owners or tenants who pay a water bill directly within the service district must submit written protests in order to prevent the provider from raising rates as proposed. Although ACWD received a record number of 6,598 protests this year, it is virtually impossible for the 40,500 threshold to be achieved. By comparison, the total voter turnout in the closely contested 2016 Fremont mayoral election was only 42,000. This threshold, though not created by ACWD, makes customers feel as if the protest method is “rigged,” giving unlimited power to the five-member ACWD board to set rates for all customers.

The Grand Jury commends the ACWD for allowing customers to file a protest electronically via email or by filling out a form on their website. This option is not required by law, but ACWD acknowledged that the online process was more convenient for its customers.

CONCLUSION

When rates need to rise to support higher labor costs, ACWD should make the case on its merits rather than embed these costs under the water supply categorization. ACWD must explain to the public the need to retain quality employees for safety and continuity of care with the district's precious water supply.

The Grand Jury appreciates that ACWD continues to provide a reliable supply of high quality drinking water to its customers, and thanks the district for its cooperation with this investigation. We acknowledge that the business of running a public utility requires specialized knowledge that is not always easily communicated to ratepayers.

Nevertheless, board members are elected to be stewards of this process and stewards of the finances involved. They have a duty to ensure that citizens are paying a fair and equitable price for their water. When rates can be raised through a simple vote of a five-member board, the decision can appear to be out of the public's control. The public deserves assurances from the board that their hard-earned money is being spent as efficiently as possible. While the 230 ACWD employees are entitled to competitive salaries with good benefits, the public deserves assurance that the board is sensitive to the impact of employee costs on rates, and that it negotiates labor contracts in good faith on behalf of the ratepayers who have limited powers to protest a rate increase.

FINDINGS

- Finding 18-35:* The Alameda County Water District is not sufficiently transparent with its customers about the costs of current employee compensation and retiree benefits, and how these impact rate increases.
- Finding 18-36:* Droughts can significantly reduce the revenue of the Alameda County Water District, while the fixed costs of providing quality water remain high.
- Finding 18-37:* The Alameda County Water District has provided overly generous salaries and benefits to its employees over the years, even in times of economic downturns.

RECOMMENDATIONS

- Recommendation 18-33: In all future rate increases, the Alameda County Water District must clearly indicate the percentage of the rate increase revenues attributable to labor and benefit expenses.
- Recommendation 18-34: The Alameda County Water District must educate the public about the impact of droughts on ACWD revenues and the agency's ability to provide quality water and service.
- Recommendation 18-35: The Alameda County Water District must educate the public on the true nature of the fixed and variable costs, the impact of water conservation on rates, and the components of the water bill received by each household.
- Recommendation 18-36: When negotiating future compensation for employees, the Alameda County Water District must justify its negotiating position based on salary and benefit data from other Bay Area government agencies, including cities and counties, and should not look exclusively to compensation paid by other water districts.

RESPONSES REQUIRED

Board of Directors, Alameda County Water District
Findings 18-35 through 18-37
Recommendations 18-33 through 18-36