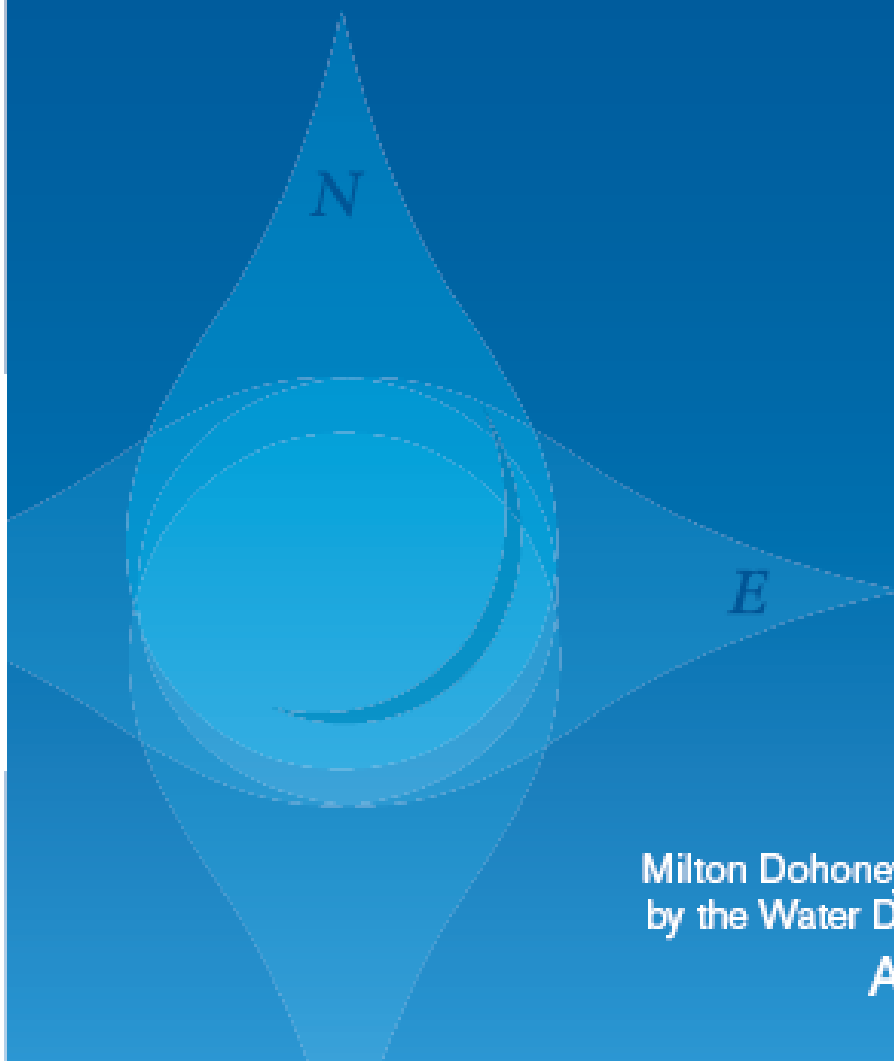


# Feasibility Study to Transition Greater Cincinnati Water Works to a Regional Water District



Prepared for  
Milton Dohoney, Jr., City Manager  
by the Water District Study Group

April 13, 2009

# Greater Cincinnati Water District Feasibility Study Group

Date: April 13, 2009  
To: Milton Dohoney, Jr., City Manager  
From: Greater Cincinnati Water District Feasibility Study Group  
Subject: **Water District Feasibility Study Executive Summary**

## **Acknowledgments**

Thank you for the opportunity to learn more about the Greater Cincinnati Water Works (GCWW) and the feasibility of transforming this system into an independent, locally controlled, public water district which, for simplicity, we are calling the Greater Cincinnati Regional Water District (GCRWD). This report contains our recommendation to you.

We would like to express our appreciation to the GCWW team, who guided our learning process during the course of 14 months and many meetings. All of us were impressed with their professionalism, expertise and unfailing patience. GCWW is well known nationally for its high standards, and efficient and expert management. The residents of the City of Cincinnati and the Cincinnati City Council (“City Council”) are justifiably proud of GCWW.

City Council deserves recognition for its stewardship of this important utility. The City Manager’s request that our citizens’ group study an independent, locally controlled, public water district is not a reflection upon past or present management by the City of Cincinnati; in fact, we were given our charge by the City Manager because the City Administration and City Council want to ensure that this vital community resource remains healthy and viable for future generations..

Because GCWW is well regarded and provides competitive rates, the question arises, why consider changing? In this report, we explore the reasons why we believe it is wise and timely for City Council to consider change.

## **The Current State: some short definitions and descriptions**

The Study Group learned through our discussions and reviews that a water utility is a complex operation; therefore, we believe a few definitions and short descriptions of the current status might be helpful.

**Current ownership:** Currently, GCWW is owned and operated by the City of Cincinnati. It serves all residences, businesses and institutions within the City limits. GCWW also has separate and independent water service contracts, both retail (i.e., water sold directly to consumers) and wholesale (i.e., water sold to distributors), with 50 jurisdictions or “Customer Communities”. An additional five communities have contracts solely for emergency services. One example of a retail contract is the 30-year agreement with the Village of Arlington Heights, which was recently extended to the year 2047. An example of a wholesale water contract is the 20-year agreement with Butler County, which expires in 2025. All of these contracts include negotiated rates to provide water to these communities.

**Rates:** Today water rates are set by the City Council, based upon recommendations by the GCWW professionals. The residences, businesses and institutions within the city limits enjoy rates that are lower than the rates charged to non-city Customer Communities.

**Employees:** GCWW has approximately 600 employees. Approximately 94% of GCWW’s employees are represented by one of four unions (AFSCME, Teamsters, CODE or Building Trades).

**Regionalism:** GCWW is owned and operated by the City of Cincinnati; however, it is an important regional asset. Daily, it provides water to 50 jurisdictions in addition to the City of Cincinnati. Approximately 85% of the population in the metropolitan Cincinnati area relies upon GCWW for its drinking water supply. Access to safe water is critical to the health and vitality of the citizens everywhere. In addition, stable, competitive rates for this vital service are important to the region’s economic viability and growth.

**Revenue to GCWW:** State law and the City Charter govern how the revenues of GCWW can be used. Any revenues generated by GCWW can only be held in accounts restricted for use by GCWW. GCWW revenue is not co-mingled with other City revenues and cannot be used to fund general City operations or capital projects.

## **Reasons to Consider Change to a Regional Water District**

It is reasonable to question why a change should be considered. Water rates for City residents, businesses and institutions, and Customer Communities are lower than many comparable communities and lower than most local jurisdictions that do not use GCWW services. See Section 9, page 3-1 of this report. Based upon what the Study Group learned, here are some considerations that raise concerns about maintaining the status quo:

- Water consumption within the city and Hamilton County is declining. This is due to the loss of manufacturing and other commercial customers, and declining consumption by residential consumers. A large and growing rate paying base is a benefit to all that use the utility because fixed costs can be shared by a larger number of consumers. If the decline in population, number of businesses, and water consumption continues in the city and Hamilton County, costs will have to be spread among a declining number of consumers — thus diminishing the advantage of economies of scale.

- The oldest part of the GCWW infrastructure is located within the geographic limits of the city of Cincinnati. The costs of maintaining, repairing and replacing these older parts of the utility’s infrastructure are significant now and will grow in the near and intermediate term.
- Without a change in ownership structure, the ability of GCWW to expand the number of jurisdictions it serves is limited by State law. This is discussed further below. Again, new customers benefit all current GCWW customers—both within the city limits and in Customer Communities—because all benefit from the economies of scale.
- There are known trends in public health, environmental management, Homeland Security, and other regulations that will impact GCWW in the near and intermediate term. Compliance with these new requirements will add costs to operating the system. Additionally, the costs associated with needed technologies for water quality research and water services are high. It requires a large customer base to support these costs so that the highest water quality and service can continue to be provided.

## **The Issues and Recommendations**

### **1. A regional, independent, locally controlled, public water district**

We were asked to study the concept of transforming GCWW to a regional, independent, locally controlled, public water district, which for simplicity we are calling the Greater Cincinnati Regional Water District (GCRWD). GCRWD would be a local, public agency that would be governed by a Board of Trustees (the “Board”). The Board would hire an Executive Director to run the operations—just as the City of Cincinnati has hired directors to run GCWW over the years. The Board of GCRWD would also approve the operating and capital budgets, and set the rates for the district. The activities of a potential GCRWD would be governed by Ohio Revised Code Chapter 6119, Regional Water and Sewer Districts (“ORC 6119”).

GCRWD would continue to be professionally managed. In fact, Ohio law requires that the employees of GCWW maintain their jobs with GCRWD at the same levels of compensation and benefits as they enjoyed when employed by the City. Employees would be required to have and maintain the same state licenses and certifications they have today, and to upgrade their qualifications as standards evolve.

### **2. Governance**

In the State of Ohio, ORC 6119 governs the procedures for the creation of a public water district. Part of the approval process requires passage by City Council of the appropriate ordinances and authorizing the filing of a petition in the Court of Common Pleas. An integral part of that petition must include the proposed structure of a governing Board.

The Study Group recommends that the Board of a proposed GCRWD have a majority of members appointed by the City of Cincinnati in accordance with the appointment process in existence at the time these appointments are made. A process for adding Customer Community representatives is recommended so that the Board becomes increasingly more regional in its membership over time; however, it is our recommendation that City Council appoint the majority of members during the entire time that the City is receiving payment for the transition of the system to GCRWD (approximately 75 years). We are recommending this governance structure because the City of Cincinnati will have a significant financial interest during the time it is owed payments for GCWW and holds subordinate debt in connection with such payments.

We believe the opportunity for other Customer Communities to appoint members to the Board and participate in governance will be attractive to both existing Customer Communities and potential new ones. It will give them a voice in governance they do not have today.

Accountability is important. The Study Group is comfortable that an independent, public water district can be held accountable through the various provisions outlined in ORC 6119. See Section 6 of this report for a more detailed recommendation on governance and the control City Council will maintain in appointing trustees to the Board.

### **3. Employees**

The dedicated and talented people who serve GCWW customers today are the reasons for its success. It is important to all members of the Study Group that a proposed GCRWD safeguard current employees. Maintaining the current levels of salaries, benefits, and union representation for employees as they now enjoy was considered an important protection by the Study Group. In order to accomplish this core principle, we believe that both the combination of protections provided under Ohio law and the requirements we recommend be included in the petition filed with the Court of Common Pleas to transition to a regional water district. In addition, we believe the stable, more flexible business model of a regional, independent, locally controlled public water district may provide expanded opportunities for employees. As the district expands, new jobs may be created.

Under a proposed GCRWD, current GCWW employees would maintain their seniority and benefits. They would remain public employees. The City of Cincinnati will have to seek a technical correction to state law in order for all GCRWD employees to be eligible for the Cincinnati Retirement System (CRS). CRS membership for GCWW employees should be a prerequisite for transferring GCWW assets to a regional public water district.

GCRWD employees would be covered by the provisions of the State of Ohio Civil Service rules and laws. Levels of compensation and benefits for GCRWD employees would be equivalent to their current compensation as GCWW employees. This is required by statute and is also recommended by the Study Group to be included in the terms of the petition creating the district.

Another issue of importance to our Study Group was the status of the current collective bargaining agreements and representation of employees. Approximately 94% of current GCWW employees are represented by a labor union. The ability of GCRWD employees to unionize should be a prerequisite for transferring GCWW assets to a regional public water district. In addition, we strongly recommend that, if the City of Cincinnati decides to transition GCWW into an independent water district, the terms of that transition include a requirement that the GCRWD recognize the existing unions and their existing representation of GCWW employees. Legal research indicates that this is permitted under State law.

We strongly recommend that the status quo in terms of union representation be maintained if GCWW becomes the GCRWD. The present labor relations arrangements seem to work effectively for both the employees and management. There is no hidden agenda at work; the Study Group reviewed the concept of an independent public water district to address business, public health and economic development issues—not to make changes in current labor relations. To reinforce this point, the Study Group recommends that the City and GCRWD be legally obligated to waive their rights to challenge the existing unions' claims to represent the same employees.

To repeat the core principle, the Study Group wants all GCRWD employees to enjoy the same levels of salaries, benefits and union representation as current GCWW employees. However, upon transfer to GCRWD, current GCWW employees would no longer be able to transfer to positions within the City administration because they would no longer be City employees. Because all the other salaries, benefits and union representation remain at the same level, this inability to transfer does not alter our recommendation.

#### **4. Financial assumptions**

The Study Group reviewed complex financial modeling of a potential GCRWD. A detailed description is contained in Section 9 of the report. Our recommendations are based upon the financial model and the information provided by independent experts hired for this study process. Actual financial conditions are subject to change, of course.

In order to create the financial model, certain conservative but realistic assumptions were made. With these financial assumptions, a hypothetical payment structure for the transfer of the assets and a financial feasibility analysis was developed. Below is an outline of some of the key assumptions that were used in the modeling:

- The financial planning assumptions currently used by GCWW concerning items like inflation, community consumption patterns, and investments needed in infrastructure maintenance were used. GCWW's financial planning has been reliable; therefore, these assumptions, which are conservative, were the basis for the financial modeling.
- The revenue assumptions include maintaining service to all current Customer Communities and assume investment interest income of 3.0% – 3.5%.

- The model has assumptions on expenses including a net inflation rate of 3%, certain operational efficiencies being achieved gradually over 10 years, and an interest rate of 5.3% – 6.0% on bonded debt service for capital investments.
- The operating efficiencies are an important part of the assumptions. These have been detailed by the GCWW staff and were reviewed by the Study Group. See Section 8 of this report. They include some of the efficiencies an independent water district would gain in independently managing business support functions such as HR, IT, accounting and purchasing. As described in the operations plan reviewed by the Study Group, 95% of the current business functionality would remain unchanged. The financial model assumes GCRWD would serve three jurisdictions as new customers during the next 15 years. The GCWW administrators have explored this expansion with potential new customers and believe this is highly feasible under the structure of an independent water district.

These assumptions are just a sampling of the entire financial model. Again, for more detail, see Section 9 of this report.

Additionally, the financial model includes these key policy assumptions, which affect the overall value of GCWW's assets:

- Rates to city residents, businesses and institutions would continue to be set at levels that are lower relative to other Customer Communities.
- Rates to Customer Communities would remain in accordance with existing contracts.
- Free water service provided to the Zoo, in accordance with the Municipal Code, as well as free water for municipal purposes to City of Cincinnati-owned properties would continue. Based on the cost of free water in 2007 at \$988,000, free water would cost approximately \$53 million over 75 years. This amount reduces the value of GCWW under the asset-based methods of valuation. If City Council would decide to discontinue free water, the net value of GCWW would increase based upon the method used to determine a price for the transfer of assets.
- The financial criteria needed to maintain an AA+ bond rating would continue, making any debt issued by GCRWD the same high-quality (and therefore advantageously priced) debt as GCWW issues today. GCRWD would issue debt (bonds) under Ohio law similar to the debt GCWW issues today.

The financial model discussed the valuation of GCWW assets and placed it in a range of \$368 million to \$473 million. There are a number of variables that go into determining a payment schedule to the City for GCWW assets. The model assumes a term of 75 years and an interest rate of 3.5%. Using the concept of equal annual payments, the range of payments for the transfer of assets would be approximately \$14 million to \$18 million per year. However, such a payment schedule could not immediately be absorbed by the utility, now operating as a district, without a severe impact on rates.

In order to keep rates stable, the hypothetical payment scenario proposes an alternative payment schedule that increases over time. A payment schedule that initiates lower and increases progressively over time is considered to have the highest likelihood of proving feasible, as it allows time for district growth and anticipated operating efficiencies to develop and yield impact. The presented scenario calls for payments to the City to begin at \$6 million in year 1, increasing to \$15 million by year 12, and then steadily increasing at 0.9% per year for the next 63 years.

It was a core principle of the Study Group that the transition to GCRWD not result in dramatic increases in rates. After a lot of discussion and questions, we are satisfied that the financial model of the experts is reasonable. The model shows 1) that rate increases already projected by GCWW in its long-term financial plans would occur as planned; and 2) a possible ½% rate increase to begin annually in 2021 to cover the transfer of assets payments. By the year 2034, this would increase the average residential water bill \$40 per year. Discussions lead us to conclude that there will be opportunities for efficiencies in the first 20 years of the district which could possibly offset the need for the ½% increase.

It is our conclusion that, based on the information provided, a proposed GCRWD would have sufficient revenue to fairly compensate the City of Cincinnati for the water system assets without increasing rates to all current customers beyond what is currently anticipated in GCWW's financial plans, plus a possible annual rate increase of less than ½% to residential customers beginning in 2021. This additional rate increase may be avoided by implementing further operational cost saving strategies.

It is important to remember that GCWW's current financial plan assumes continued growth and expansion of the customer base. Without a GCRWD that would foster this continued growth, rate increases would surely exceed the ½% beginning in 2021 to generate sufficient revenues to maintain the infrastructure and meet drinking water regulations.

Based upon the information provided to us, the Study Group concluded that the payments to the City of Cincinnati could be made while still investing in replacement of the aging infrastructure, meeting regulatory requirements, addressing anticipated inflationary increases, and without compromising service to customers.

One member of the study group expressed a point of view that we want to respectfully acknowledge, although it is not shared by other members of the group. In summary, the member believes that the assets of GCWW were built and maintained with the dollars paid by all ratepayers, including those outside of the city and, therefore, the City of Cincinnati is due only a nominal sum.

Rates are a sensitive topic and were discussed numerous times by the Study Group. The model assumes City of Cincinnati rate payers receiving the same benefits of the lower rate they receive today for the 75-year payout period. We recommend the petition require that, after the 75-year payout period, the Board consider the rate advantage to city rate payers and,

if determined, phase into parity in a gradual way so as avoid drastic increases for city customers.

It should be reiterated that the Study Group is basing its financial conclusions on the financial model and conservative assumptions that were presented herein. We anticipate negotiations to occur on many terms and conditions, both financial and non-financial. The Study Group members are citizens with various professional backgrounds. While we are not experts in public finance and related disciplines, we are comfortable with the processes used by the experts who developed the model that forms the financial assumptions.

We considered many risks during our deliberations, such as the assumptions in the model, the uncertainty of the economy and borrowing conditions, the loss of sole control by the City, the impact of trading assets for a promised income stream, and the potential viewpoints of non-city customers.

In the end, after careful review, we concluded that the potential benefits to the City and region outweighed any risks or drawbacks considered.

#### **5. Stable, long term payments to the City of Cincinnati**

The City of Cincinnati would receive a considerable long-term revenue stream from the transfer of assets of GCWW to an independent, public water district. Over a period of 75 years, depending on the agreed-upon value of the assets, the City could receive an average payment in the range of \$14 million to \$18 million per year. See Section 9 of this report. The experts concluded that a transfer of assets is feasible and gave opinions on what could be a potential financial model. A final determination as to the requirements and terms for transferring the assets would be subject to further investigation and negotiations. However, the assumptions in the model presented are conservative and based upon expert opinion.

The payments received by the City of Cincinnati from the transfer of assets of GCWW would be limited to certain uses under State law. The monies received must be applied to what is defined in the law as “permanent improvements” (infrastructure, roads, sidewalks, bridges, etc.). The Study Group believes this opportunity is worth careful review by City Council.

#### **6. Economic Development (Expanding the customer base)**

The Study Group believes expansion of the customer base is critical to the long-term viability of the successful public water utility we enjoy today. The ability to spread the costs of new environmental requirements, on-going fixed costs, and maintenance and repair of the aging infrastructure (of which the oldest parts are located within the city limits) is important to keep rates low and competitive for all current and future customers.

Under the stewardship of City Council, GCWW has been entrepreneurial—seeking new services and customers to generate new revenue. For example, today GCWW provides billing services for the Greater Cincinnati Metropolitan Sewer District, other water utilities and other communities. Revenues derived from providing utility billing services to communities outside Cincinnati cover 75% of the cost of billing operations for Cincinnati residents and businesses. As a result of its entrepreneurial approach, GCWW receives 69% of its operating revenues from customers outside the city limits.

This entrepreneurship is a benefit to all GCWW customers—both inside and outside the city limits. An expanded customer base provides more income to GCWW and allows it to spread its costs over a greater number of consumers. These economies of scale result in lower unit costs and lower rates for all consumers.

Today, however, there are limits to the ability of GCWW to grow. A regional, independent, locally controlled public water district would have a more flexible business platform and, therefore, increased opportunities to expand its customer base. With an independent Board that includes representatives from Customer Communities (jurisdictions outside the City of Cincinnati), the new water district has a strong potential to attract additional new customers. This opinion has been confirmed by the GCWW administration in informal talks with potential new customers.

In addition, an independent public water district would not be constrained by specific laws which limit GCWW from purchasing or building water assets outside the corporate boundaries of the city of Cincinnati. Currently under Ohio law, municipal water utilities may sell only “surplus water” outside their corporate limits and may do so only when proving that there is a benefit to its residents. For example, as a City department, GCWW cannot purchase or build a water treatment plant in a neighboring county unless such purchase or construction would benefit city residents and provide water to the municipality and its inhabitants. The alternative of pumping surplus water from existing treatment plants becomes increasingly cost prohibitive the farther out that water must be pumped. GCWW, in its current position as a City department, is constrained today in its ability to grow and to expand its customer base

The alternative of maintaining the status quo is concerning. Without the more flexible business model of an independent, public water district, GCWW will face known cost increases and constraints in its ability to meet these costs without aggressive rate increases. A proposed GCRWD is a preferred way to maintain competitive rates, continue to benefit from economies of scale, and ensure a stable operating environment for this vital public service.

## **7. Protection of the public health and safety**

Clean, safe, affordable, abundant water is important to the health of all our citizens. We believe a proposed GCRWD would employ the same quality of expert professionals employed by GCWW, and their dedication to public health and safety would be no less than that of current GCWW management and employees. To that end, we recommend that public health expertise be represented in the GCRWD Board membership. This is reflected in our Board governance recommendations shown in Section 6 of this report.

GCWW has a long and proud legacy of conducting research to improve water quality and water service to consumers. A large customer base is required to support the high cost of these research and development technologies. Creation of a water district, with its expanding customer base, is seen as a way to guarantee the continuation of the high quality water and services that are provided today.

During our studies we learned that there are significant changes coming in the regulations governing water and water controls. These changes will require capital and on-going investments. Expanding the customer base of the water district will help spread the cost of the changes that the administration both *wants* to do and changes that *will be required* under federal laws and regulations. As discussed previously, a regional water district may be appealing to a number of potential new customers.

Overall, a larger district is better positioned to ensure the public health and safety. A more regional district like the proposed GCRWD has the benefits of economies of scale and can afford the staffing, advanced technologies, and other resources needed to produce high quality water.

## Conclusions

1. The Study Group recommends City Council actively pursue the creation of a regional, independent, locally controlled, public water district and transfer GCWW assets to it.
2. The Study Group commends the City of Cincinnati for its long-term stewardship of GCWW. However, a more flexible business model is needed to help the water utility address issues that will impact the near and intermediate term.
3. The issues GCWW faces include:
  - Declining water consumption by consumers in the city of Cincinnati and Hamilton County.
  - The oldest parts of the infrastructure are within the city limits. The cost of maintaining and repairing these older parts is significant now and will increase in the future.
  - The ability of GCWW to expand its customer base as a municipal utility is constrained by State law.
  - Known trends in public health and environmental management will impact GCWW and add costs to operating the system. Continuing GCWW's strong legacy in the areas of water quality research and water services requires a large customer base to support the high cost of these research and service technologies.
  - The proposed GCRWD is a more flexible business model that will enable the water utility to meet these and other challenges while maintaining competitive and stable rates for all customers.
4. Economies of scale are important to the stability and affordability of the water rates. While economies of scale are enjoyed today, they are threatened by cost increases and a declining customer base. An independent public water district is a more flexible business model that will allow the water utility to spread operating and capital costs over a larger customer base—therefore benefiting all customers and the region.
5. We believe a regional water district, like the one described herein, has benefits for all current stakeholders:
  - The financial model presented by experts in the field indicate payment for the transfer of assets would not increase rates for current GCWW customers beyond those already anticipated in the long range financial plans for GCWW and possibly an additional ½% beginning in 2021. This ½% increase may be eliminated with operational efficiencies gained over that timeframe. This means that city of Cincinnati rate payers will continue to enjoy rates that are lower than other communities served by GCWW and that all customers will continue to enjoy competitive, stable water rates.
  - Under the governance structure recommended by the Study Group, the City of Cincinnati will appoint the majority of the members of the regional water district Board for the period of time (75 years) the City holds the debt and receives payments for the transfer of assets.

- The governance model includes representatives on the Board from Customer Communities outside of the city of Cincinnati. This gives these communities a policy and rate setting voice in the operations of this regional district for the first time.
6. State law and recommended terms and conditions in the petition creating the regional water district will protect the current salaries, benefits, and union representation rights of GCWW employees. Assuming the City can obtain a technical correction from the State of Ohio so that employees can remain eligible to participate in the City Retirement System, the creation of a regional public water district will not disturb the status quo for current employees, other than the ability to transfer to other City departments. We recommend that any necessary changes or corrections to State law related to the Cincinnati Retirement System be a prerequisite to the final transfer from GCWW to a regional water district.

Both current and future employees will potentially benefit from the stability and growth that a water district business model will provide.

7. Based upon the financial model, payment to the City of Cincinnati for the transfer of GCWW assets would be substantial and long term. Depending on the agreed-upon value of the assets, the City could receive an average payment in the range of \$14 million to \$18 million over a period of 75 years.
8. Based upon the financial modeling prepared by national experts and using conservative but realistic assumptions, payment to the City of Cincinnati for GCWW assets can be accomplished without rate increases to customers beyond the normal rate increases anticipated in existing GCWW financial business plans and possibly an additional ½% beginning in 2021. This is based upon an assumption of 5% productivity increase, and an expansion of the customer base by three communities over a 15-year period. Without the more flexible business platform provided by the regional water district, the likelihood of expanding the customer base is less.
9. We believe a regional water district can be operated in a manner that will continue to allow the region to enjoy safe, abundant, affordable water and help guarantee continuation of the high quality water and services that consumers receive today—which is vital to the public health and safety and economic development of the city and region.

Based on all of these reasons, we recommend City Council actively pursue the creation of a regional, independent, locally controlled, public water district and transfer GCWW assets to it.

## Study Group Members

- Mary Asbury Executive Director, Legal Aid Society of Greater Cincinnati
- Robert Clark PhD, Environmental Engineering Consultant; Former Director, US EPA's Water Supply and Water Resources Division
- David Crowley Vice Mayor, City of Cincinnati
- Andrew Kolesar Partner, Environmental Group Leader, Thompson Hine LLP,
- Lynn Marmer Group Vice President, Corporate Affairs, The Kroger Company  
Study Group Chairperson
- Peter McLinden<sup>1 & 3</sup> Regional Director, Ohio AFSCME Council 8
- Jim Sumner Group Environmental Programs Manager, GE Infrastructure – GE Aviation
- Wendell Young<sup>2</sup> Teacher of Government/Public Service, Aiken High School, Cincinnati; Past President, Cincinnati Chapter of NAACP

<sup>1</sup> In June, 2008, Mr. McLinden replaced Mr. Dan Radford, Vice President, Market Development, Union Labor Life Company, who began the study but was unable to remain a member through its conclusion.

<sup>2</sup> Mr. Young was unable to participate as a member of the Study Group through its conclusion.

<sup>3</sup> Mr. McLinden does not support the recommendations contained in this memorandum.