

May 2015

## City Plans Reduced Payments from Water Board: Lower Rates for Customers, Less Revenue for the City

In the Executive Budget for 2016, the de Blasio Administration reduced the amount of money the city plans to collect from the Water Board next year for use of the city-owned water system. The reduction of the so-called rental payment has allowed the Water Board to lower the water rate hike set to take effect this July from 3.24 percent to 2.97 percent. In addition to reducing the rental payment in 2016, the Mayor—who called for eliminating the rental payment during his election campaign—plans to phase it out completely by 2023 (all years refer to fiscal years).

While this phase-out will result in savings to ratepayers, because the rental payment makes up just a small share of the water system's overall costs, annual household savings due to the change will be relatively modest—a few dollars a year for the average New York City household. It also means that the city will take in less revenue, as payments from the Water Board flow into the city's general fund.

**Reduction in Rental Payment.** The planned rental payment for 2016 will total \$162 million in 2016, \$41 million less than projected when the water rate was proposed in February. This reduction—the latest in a series of actions in recent years designed to cut the rental payment—actually results from the city returning to the Water Board an even larger share of the rental payment it collected in 2015 than previously planned. The Water Board will then use the returned funds to offset part of the cost of the 2016 rental payment—a savings that is passed on to ratepayers.

In future years, the city will simply request a reduced payment from the Water Board, although the size of the reduction each year will depend on the preceding year's payment. The mechanics behind the reduction are tied to the structure of the rental payments, which result from the terms of a 1985 lease agreement between the city (which owns the water system) and the Water Board (which sets

the water rates and collects payments from households and other users).

The amount of the rental payment in any given year is determined by a share (15 percent) of the annual debt service on New York City Water Authority bonds, which are issued to fund repairs and upgrades of the water and sewer system. (See IBO's [2014 report](#) for details on the rental payment and prior efforts to reduce it.) Although the lease specifies that the rental payment is paid “only to the extent requested by the city, the financing agreements require the Water Board to collect the full 15 percent as a reserve for bondholders, regardless of how much (or how little) has been paid to the city in a given year.

In order to raise enough money for sufficient bond coverage and adhere to bond covenants, the Water Board collects the full 15 percent and pays it to the city each year. In recent years, the city has then returned a portion of the payment the following year to reduce the increase in rates planned for that year. Going forward, the Water Board has agreed to ensure that it has sufficient funds to maintain a surplus to cover the reserve and keep bondholders secure and will not pay the city the full 15 percent.

For example, when the 2016 water rate was first proposed in February, the de Blasio Administration planned to return 20 percent of the \$204 million rental payment it collected in 2015 (\$41 million). These funds would have effectively reduced the 2016 rental payment of \$244 million (the gross rental payment based on 15 percent of debt service) to a net rental payment of \$203 million. (Under this proposal the city planned to return 20 percent of the prior year's payment each year thereafter.) In May, the de Blasio Administration increased the share of the 2015 rental payment the city would return in 2016 from 20 percent to 40 percent, or \$82 million, thereby reducing the



<b>New Rental Payment Reduction Program</b>					
<i>By Fiscal Years, dollars in millions</i>					
	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
<b>Gross Rental Payment</b>	<b>\$204</b>	<b>\$244</b>	<b>\$256</b>	<b>\$269</b>	<b>\$285</b>
Percent for Next Year's Reduction	40%	50%	60%	70%	80%
Amount of Next Year's Reduction	\$82	\$122	\$153	\$189	\$228
Rental Payment Reduction (1-year Lag)	\$31	\$82	\$122	\$153	\$189
<b>Net Rental Payment</b>	<b>\$173</b>	<b>\$162</b>	<b>\$134</b>	<b>\$116</b>	<b>\$96</b>
<b>Incremental Benefit of Additional Reduction</b>	<b>\$0</b>	<b>\$41</b>	<b>\$73</b>	<b>\$102</b>	<b>\$135</b>
<small>SOURCE: New York City Department of Environmental Protection  NOTES: The \$31 million reduction in 2015 resulted from the de Blasio Administration returning 20 percent of the 2014 rental payment. The incremental benefit is based on the de Blasio Administration's previous plan to return 20 percent of the rental payment each year. Totals may not sum due to rounding.</small>					
<i>New York City Independent Budget Office</i>					

gross rental payment in 2016 from \$244 million to a lower net payment of \$162 million, enabling the Water Board to moderate the planned rate hike.

The Mayor plans to gradually phase out the rental payment, completely eliminating it by 2023. Beginning in 2017, instead of charging the full 15 percent and then returning funds, the city will request a reduced payment. However, the amount of the reduction each year will be based upon a similar calculation: Each year the city will first calculate the payment based upon 15 percent of the debt service. It will then reduce that amount by a growing share each year—from 50 percent to finally 100 percent—of the prior year's gross payment, so that the net payment the city requests gradually declines each year. For example, the 2017 gross rental payment (based on 15 percent of debt service) is projected to total \$256 million. The city will then reduce the payment by 50 percent of the gross 2016 payment (or \$122 million) for a net payment to the city in 2017 of \$134 million, which will be the total the city will request. In 2018, the city will reduce the gross rental payment by 60 percent of the 2017 gross payment, and so on.

Over the next four years, the cut in the rental payment is projected to reduce water system costs by a cumulative \$352 million when compared with the de Blasio Administration's original proposal to return 20 percent of the prior year's payment annually. Because the payments from the Water Board flow into the city's general fund, it will

also decrease city revenue by the same amount.

**Impact on Water Rates.** Rising costs have led the Water Board to increase water rates every year since 1995. Over the past decade the rate has increased 131 percent—from a water fee of \$1.60 per 100 cubic feet in 2005 to \$3.70 per 100 cubic feet in 2015. The water rate must be set to cover the total cost of the water system, including maintenance and operations, debt service, and the rental payment to the city. Over the past decade, the increase in water rates has largely been driven by rising debt service costs. From 2005 through 2015, the water system's debt service costs increased by 105 percent and its gross rental payment, which is based on the system's debt service, has grown by 87 percent. Over the same time period, operations and maintenance costs have increased 64 percent.<sup>1</sup>

The recently approved rate of \$3.81 per 100 cubic feet set for 2016 (a 2.97 percent increase over the current rate) is the lowest increase in 15 years. Compared with the Water Board's original proposed rate increase for 2016 prior to the changes in the Executive Budget—3.24 percent—the average New York City household will save about \$1.20 on water this year due to the reduction in the rental payment. When combined with the sewer rate, which is calculated as 159 percent of the water rate, the savings increase to \$2.51 for the year. The average bill in 2015 for a single-family home is \$1,025.

Lowering the rental payment has only a limited impact on reducing the water and sewer rates because, while it has grown over the past decade, the rental payment makes up a relatively small share of the water system's overall annual cost. In 2015, the rental payment is estimated to make up about 5 percent of the system's \$3.79 billion cost. With the reduction, the rental payment is budgeted to comprise slightly over 4 percent of the projected \$3.76 billion water system cost in 2016. Generating more substantial savings in water and sewer costs would require actions such as reducing annual debt service by cutting back capital improvements or by lowering the cost of operations and maintenance.

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## Endnotes

<sup>1</sup>2015 totals are based on the Water Board's estimated budget as of May 8, 2015.

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