

TESTIMONY BY
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NEW YORK WATER BOARD
ON PLAN TO LOWER RATES
AND LIMIT FUTURE DEBT

ST. JOHN'S UNIVERSITY

TUESDAY, JUNE 19, 2007

Good morning, Chairman Tripp and members of the Board.

I appreciate very much your giving me the opportunity to appear before you today to discuss several issues relating to the financial pressures leading to the recent decision by the Water Board to raise water rates in New York City.

Before I begin, I want to draw your attention to the Power Point presentation that my staff has prepared, which you should all have and which tracks with my remarks. It contains several helpful charts that will clarify some of the points I will be making so I encourage you to follow along as I speak.

The new rate hike points to a challenge we now face: how to expand our water capital program while at the same time reducing the burden on rate payers and minimizing debt service.

My office has come up with an innovative plan that could achieve those important goals. The timing could not be more fitting for such an initiative.

As you all know the DEP Capital Program for 2008 to 2017 is some \$19.5 billion. Among other causes, the size of that figure relates to a more rigorous regulatory environment, the rising costs of labor and material, and new needs.

Debt service on the capital program will exceed \$1.5 billion by 2011 – a 70 percent increase over 2007. Operations and maintenance costs are expected to climb some 20 percent over the same period to \$1.2 billion.

The growing debt service obligations are driving a large escalation in rental payments by the Water Authority to the City over the next decade.

The current rent formula was established in 1985. One can argue that the formula used at that time did not anticipate the shifting regulatory and economic environments we face currently.

As you know, that formula stipulates that the rental payment equals either the cost of debt service on General Obligation bonds issued for water purposes OR 15 percent of Water Authority debt service – whichever is greater.

If you look at the chart on page 5 of the Power Point presentation, you'll see that from 1986 to 2004, this formula led to rental payments by the Water Authority in the amount of GO debt service.

Starting in 2005, however, there began to be a growing disparity between rental payments and GO debt service....Rental payments are expected to increase 70 percent between 2007 and 2011 from \$136 million to \$232 million, while GO debt service is expected to decrease to \$57 million.

For the purposes of discussion, we have chosen to call that disparity "excess rent." This excess rent, as I've suggested, stems from growing costs related to the Water Authority's capital program and goes directly into the operating budget of the City to use as it sees fit.

In the chart on page 5, we have run out estimates for the total excess rent over thirty years, using a conservative estimate of 3 percent annual growth between fiscal years 2012 and 2036 – the years following the Mayor's current four-year budget forecast.

As you will see on page 6, by those estimates, over the next thirty years, excess rent is expected to reach close to \$9 billion.

The Water Board is mandated to set water rates to cover the costs of its rental payments, as well as debt service, operations and maintenance.

Due in part to the escalating costs of the City's water capital program, an 11.5 percent rate increase was approved last month and double digit increases are expected from 2009 to 2011.

These increases will have a significant impact on renters and small home owners. In the current economic climate, the housing market has already tightened and as we all know the availability of good, affordable housing is quickly diminishing in our city.

That places a special burden on the City's leaders to find ways to protect our superior credit ratings while alleviating pressure on renters and homeowners. My office has come up with a proposal designed to do just that.

If you look at page 8 of our Power Point presentation, you will see the broad outlines of our plan, which seeks to rebate excess rent to the Water Board to be spent in equal measure on the goals of rate payer relief and pay-go capital spending.

Because excess rent is realized at the end of the fiscal year and applied to the following year, the impact on rate payers is estimated for Fiscal Years 2009 to 2012.

During that period we anticipate that our proposal could free up some \$278 million in cumulative Water Board operating expenses that would no longer need to be raised from rate payers.

The next two slides show the impact on rates in the initial years as the use of excess rent is ramping up. Savings will continue to grow.

At the same time, our proposal would generate an additional \$248 million for pay-go capital between Fiscal Years 2008 and 2011, thereby reducing borrowing and saving money.

My plan doubles the commitment to pay-go spending between 2008 and 2017, with a total pay-go outlay of \$914 million over that period.

As you will see on page 11 of our presentation, we estimate that based on 30-year amortization on Water Authority bonds, the use of pay-go funds through 2036 would save the Authority \$9.7 billion in debt service.

Over the 10-year Capital Strategy, my plan would double pay-go capital spending

We have also developed an alternative scenario that applies 100 percent of excess rent to rate relief. As you can see on pages 13 and 14 of our presentation, this application of excess rent would save rate payers an estimated \$496 million between fiscal years 2009 and 2012.

Whether or not you choose to consider one of the scenarios I have laid out today, I firmly believe that the Water Board should open discussions with the City to renegotiate its lease rental formula.

Why now? As I said at the top of my remarks, the timing could not be more opportune. We are enjoying the largest surplus in the City's history.

At the same time, the Water Authority has the highest ratings it has ever experienced. The use of additional pay-go spending as I have proposed today will further protect those ratings.

Finally, at a time when middle class New Yorkers are being increasingly squeezed, we need a rate structure that gives average taxpayers in our City some breathing room.

I urge you to act now to reduce the water rate burden on New York City property owners.

In addition to keeping costs to taxpayers down, you will decrease our debt service, protect Water Authority credit ratings, and lessen the cost of borrowing while making needed improvements to our capital program.

I appreciate this opportunity to share my views and now I would be happy to answer any questions.