

**David Whitaker, Esq.**  
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*Executive Policy Manager*  
**Marcell R. Todd, Jr.**  
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*Commission*  
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*Director, Historic Designation*  
*Advisory Board*

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**LaKisha Barclift, Esq.**  
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**Nur Barre**  
**M. Rory Bolger, Ph.D., AICP**  
**Elizabeth Cabot, Esq.**  
**Tasha Cowen**

# City of Detroit

## CITY COUNCIL

### LEGISLATIVE POLICY DIVISION

208 Coleman A. Young Municipal Center  
Detroit, Michigan 48226

Phone: (313) 224-4946 Fax: (313) 224-4336

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**Christopher Gulock, AICP**  
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TO: Detroit City Council

FROM: David Whitaker, Director   
Legislative Policy Division

DATE: February 12, 2021

RE: Report on Recent and Future Financial Issues of DWSD and GLWA

Council President Brenda Jones requested that the Legislative Policy Division (LPD) prepare reviews of the fiscal operations of the Detroit Water and Sewerage Department (DWSD), and its financial relationship with Great Lakes Water Authority (GLWA).

We thank the DWSD Director, Gary Brown and his staff, the GLWA CEO, Sue McCormick and her staff, for their assistance as we prepared this report. We must especially commend the DWSD Director, Gary Brown and his staff for some of the excellent work that they have accomplished over the past years in several areas. They took a system with billions of dollars in debt, survived through a difficult bankruptcy, a bifurcation with GLWA, and continued providing clean water and safe disposal of sewage.

One of our long-range objectives in providing this report is to make every effort to ensure that our children, grandchildren and future generations have access to safe, clean and affordable water, and safe disposal of waste water including drainage.

This report will provide information on:

- **Highlights of the CAFR for DWSD for FY 2020**
- **Highlights of the CAFR for GLWA for FY 2020**
- **Review of Financial Operations of DWSD for the First Four Months of FY 2021**

- **Review of Long-Standing Policy of Splitting CSO Costs Between Detroit and Others**
- **Looking Ahead, DWSD Planned Increases for FY 2022 for Water and Sewer Charges**
- **Looking Ahead, GLWA Planned Increases for FY 2022 for Water and Sewer Charges**

We begin with a review of the (CAFR) Comprehensive Annual Financial Report for DWSD for the Fiscal Year Ended June 30, 2020. DWSD is issued its own stand-alone CAFR, which is incorporated into the City's CAFR.

**Highlights of the CAFR for DWSD for FY 2020:**

- At June 30, 2020 Water and the Sewage Disposal Funds had unrestricted net positions of \$457.1 million and \$553.9 million, respectively, mainly due to the bifurcation which exchanged the water and sewer regional systems assets and liabilities including long term debt to GLWA for \$50.0 million in annual lease payments over 40 years effective January 1, 2016. The unrestricted net position increased \$186,221 for Water and \$10.8 million for Sewage in FY 2020 from the prior year.
- Considering all funds in FY 2020, the Water and the Sewage Disposal Funds had positive income (Change in Net Position) of \$21.7 million and \$31.5 million, respectively. This is remarkable in light of the economic impact of the COVID-19 pandemic.
- Included in the FY 2020 CAFR is a loan payable to GLWA resulting from their Sewage cash collections being less than their disbursements since FY 2017. Per the MOU (Memorandum of Understanding), GLWA advances DWSD Water and Sewage 1/12 each month of their budgeted expenses. At June 30, 2020, DWSD owed GLWA a balance of \$26.5 million as their cash collections were less than their cash disbursements in FY 2018 and FY 2017. In FY 2019 there was no shortfall.

During FY 2020, sewage collections were \$10.0 million less than disbursements resulting in a shortfall. DWSD has one year to pay-back, or cover this advance. We realize that this may be confusing, but the stipulations of the MOU state that any shortfall not cured by the end of the fiscal year following the year in which they arise shall be repaid in full, in installments over a period not to exceed three fiscal years. The installment payments will include a surcharge based on the three-year U.S. Treasury note plus 150 basis points.

DWSD management believes that commercial and industrial tax lien collections coupled with CARES Act funding from the State of Michigan will assist in clearing FY 2020 and FY 2021 shortfalls.

- The lease receivable from GLWA on DWSD's financial statements does not agree with the lease payable on GLWA's financial statements. GLWA shows the lease to be \$24.5 million less than DWSD for the Water Fund and \$29.9 million less for the Sewage Disposal Fund. Detailed below is the difference. GLWA and DWSD use a different discount rate which causes the difference in the reported amounts.

|                      | Water    |       |            | Sewer    |       |            |
|----------------------|----------|-------|------------|----------|-------|------------|
|                      | DWSD     | GLWA  | Difference | DWSD     | GLWA  | Difference |
| Receivable From GLWA | \$ 440.9 | 416.5 | 24.5       | \$ 538.9 | 509.0 | 29.9       |

**City Council needs to closely observe the financial performance of the Water and Sewage Disposal Funds every year after the bifurcation to ensure revenues cover expenses, cash collections are equal to, or more than, cash disbursements, and essential services are provided.**

- The following represents information from the “Note 10-Risks and Uncertainties-COVID-19” footnote in DWSD’s 2020 CAFR that discusses the impact of the pandemic on DWSD’s operations:
  - Since the World Health Organization’s identification of COVID-19 as a global health emergency and the subsequent implementation of national, state, and local emergency declarations, significant dislocations in normal economic activity have occurred at all levels. On March 10, 2020, the Michigan Department of Health and Human Services identified the first two presumptive-positive cases of COVID-19, in the state of Michigan (the “State”). Since then, the governor has issued a series of executive orders declaring a state of emergency and a state of disaster in the State in response to COVID-19. The duration, severity, and degree of any impact of COVID-19 is uncertain and difficult to predict at this time due to the dynamic nature of the COVID-19 outbreak.
  - Throughout the pandemic, the Department has continuously monitored the situation and made necessary operational adjustments to ensure the safety of services offered, including the furloughing of employees and temporarily closing certain service centers. Despite these actions, there was no significant impact to how customers are serviced. While COVID-19 has not significantly impacted the Department’s revenue, it did have an impact on the cash collections, especially in the early states of the pandemic. Subsequent to year end, the Department has experienced strong cash collection results, partially due to federal and state funding received by outside agencies that have been used to assist customers with outstanding water and sewerage balances.

**Highlights of the CAFR for GLWA for FY 2020:**

GLWA also issues a CAFR for the same period, or fiscal year, as the City does. During its presentation of the GLWA FY 2020 CAFR, the Top 10 FY 2020 CAFR Highlights were shown by a GLWA representative:

**#1-A Clean Audit Opinion was issued.** GLWA’s auditors stated that in their opinion, the financial statements present fairly in all material respects the financial position of GLWA. This is similar to the opinion that DWSD and the City received for their 2020 CAFRs.

**#2 - Solid Key Financial Performance Measures.**

- Liquidity – 1,086 days cash on hand for water and 593 days cash on hand for sewer.

- Excellent Debt Service Coverage – 1.97 times for Water senior lien bonds and 2.16 times for Sewage Disposal senior lien bonds.
- Revenue Stability – wholesale budgeted revenues within 0.5 percent, \$1.4 million, greater than budget for the water system and 0.5 percent, \$199 thousand, greater than budget for the sewage disposal system.
- Controlled Spending –overall, combined system Operations & Maintenance budget positive variance of \$2.4 million, or 0.78 percent.

### # 3 - Strong Current Ratio – Overall Net Position.

- Current ratio 3.47 (current assets/current liabilities) confirms GLWA’s ability to cover obligations to bondholders.
- Net Position - Remains in a deficit position of \$221.6 million due mainly to the revaluation of assets and acquisition of debt as part of the stand-up of GLWA.
- Asset valuation results in unusually high depreciation expense in the short-term.
- Higher than average debt contributes to relative net deficit position.
- Long-term forecast presently provides for positive net position by FY 2030.

### # 4 - Strong Restricted Assets Meet Financial & Legal Obligations.

- Unrestricted Cash Position - Remains strong primarily due to increased **Improvement and Extension Fund deposits**
- Unrestricted cash increased from the prior year by approximately \$47 million for the Water Fund and \$51 million for the Sewage Disposal Fund Debt Reserves are historically low. There is the potential for additional reductions should bond ratings continue to improve.

### # 5 - DWSD Loan Receivable Aligns with 2018 MOU Terms

- FY 2017 Loan: \$9.8 million paid in FY 2020 (with an additional \$639 thousand in interest).
- FY 2018 Loan: \$7.8 million paid in FY 2020 (with an additional \$660 thousand in interest).
- FY 2019: No shortfall loan needed.
- FY 2020: DWSD closed with a net cash receipt shortfall of \$0.9 million in the water fund and \$10.8 million in the sewer fund attributable to unforeseen impacts of the COVID-19 pandemic.
- Agreed-upon terms under the April 2018 Memorandum of Understanding (MOU) state that DWSD has until June 30, 2021 to resolve this shortfall prior to establishment of a loan receivable with GLWA.
- DWSD believes that commercial and industrial tax lien collections coupled with CARES Act funding from the State of Michigan will assist in clearing the FY 2020 shortfalls.
- DWSD is closely managing cash receipts over disbursements for FY 2021 to reduce the risk of a shortfall in the current fiscal year.
- This topic is discussed with executive leadership at quarterly Reconciliation Committee meetings and at regularly scheduled internal DWSD and GLWA management meetings.
- GLWA’s CFO stated that she is cautiously optimistic that these shortfalls can be eliminated.

### # 6 - Long-Term Debt features Ongoing Optimization

- May/June 2020 Refundings and New Money Transactions included \$377.5 million senior lien refunding for the Water System; New money issuance of \$85.6 million for the DWSD

Water System; \$594.9 million senior lien refunding for the Sewage Disposal System, and Additional \$92.5 million second lien refunding for the Sewage Disposal System.

- State Revolving Fund Loans - These low-interest loans continue to be utilized as an important, ongoing means of financing key projects.

#### **# 7 - Legacy Pension – Moderate Impact in FY 2020**

- Legacy Pension Net Pension Liability.
- The GLWA net pension liability stemming from the General Retirement System (GRS) allocation to “DWSD” (that is the total GLWA and DWSD share) increased \$900 thousand from \$132.0 million as of June 30, 2019 to \$132.9 million as of June 30, 2020.
- This is primarily because benefit payments exceeded contributions and interest earnings for the year.
- GLWA’s CFO stated that Legacy Costs of the Pension Liability is her greatest worry, even though the funded status for the GRS Component II plan decreased by 3% from the prior year.

#### **# 8 – Transmittal Letter & MD&A: Past, Present, & Future**

- The Transmittal letter from the auditors stated that FY 2020 was the fourth full 12-month year.
- The MD&A (Management’s Discussion and Analysis) is available to anyone who wishes to read it, is available on GLWA’s website or by contacting the LPD office.

#### **# 9 - Robust Capital Program**

- Capital additions totaled \$125.7 million for the water fund, bringing the total assets to \$2.0 billion, and capital additions totaled \$94.1 million for the sewage fund, bringing the total assets of the sewage fund to \$3.1 billion.

#### **# 10 - Internal vs Audit Results Demonstrates Team Professionalism & GLWA’s Solid Financial Processes**

- Preliminary Results presented to Audit Committee in September 2020 align closely with final audited balances.
- Actuals are within 1% with most categories at/near final amounts.

#### **Review of DWSD Financial Operations for the First Four Months of FY 2021**

- Revenues and expenses are in-line with the budget, however, cash collections continue to lag lower than disbursements for the first four months of FY 2021. Water collections are \$0.5 million less, and sewer collections are \$2.8 million less than disbursements.
- This topic is discussed with executive leadership at quarterly Reconciliation Committee meetings and at regularly scheduled internal DWSD and GLWA management meetings. DWSD is working to address this shortfall resulting largely from this unforeseen COVID-19 pandemic using tax liens on commercial and industrial past due balances and the distribution of CARES Act funding from the State of Michigan.

- The Finance data shown above is provided based on the most recent month reported to the Finance Committee of the Board of Water Commissioners. In this case, it is for the first four months of FY 2021, or October 31, 2020.

### Review of Long-Standing Policy of Splitting CSO Costs Between Detroit and Member Partners:

- GLWA and DWSD initiated a waste water group to review the long-standing method of splitting CSO (Combined Sewer Overflow) costs with Detroit charged 83% and the other member partners being charged 17%.
- This group began meeting a couple of years ago to try to come up with a more equitable way of splitting the cost of the CSOs, or the regional wet weather facilities. Their hope was that a new method could be incorporated into FY 2020 or FY 2021 rates. The 83% - /17% split came about when DWSD was under the oversight of a judge, and the judge stated that the City of Detroit would pay 83%, and the other member partners would pay 17%.
- They explored considerations of peak flows as a replacement of “83/17” for CSO and conveyance costs, as suggested by Raftelis, a national consulting firm.
- It was determined that adequate measures of peak flow were not available at this time, but they acknowledged that existing 83/17 contains an element of peak flow.
- It was acknowledged that the 83/17% is set forth in legal agreements and contracts and changing it may be logistically challenging.
- It was also stated that this percentage split has been negotiated and memorialized in legal documents.
- It was discussed that even if a new percentage split would come about, it would be difficult to implement immediately, as member partners would need several years notice to incorporate newer costs into their rate structure, so we are still with the cost structure that has been in place for years.

### Looking Ahead, DWSD Planned Increases for FY 2022 for Water and Sewer Charges:

- In January 2021, the Board of Water Commissioners (BOWC) approved a 2% increase for Water and a 0% increase for the Sewage system for FY 2022. These increases will be effective July 1, 2021.
- **While the above 2% and 0% increases are noteworthy, the drainage fee per impervious acre is projected to increase 8.1%, from \$626 per impervious acre to \$677.**
- Drainage fees, recently changed to the impervious acre rate structure, have increased the accounts receivable of DWSD. Of the 45,249 non-residential sewage accounts, 12,934 (28.6%), are drainage only accounts. These represent vacant parcels, parking lots and other properties with no need for water service. Other properties with large impervious acreage include parking lots of churches, shopping plazas, schools, etc.
- DWSD management believes that commercial and industrial tax lien collections, along with aggressive collection activities will reduce the outstanding accounts past-due.

## **Looking Ahead, GLWA Planned Increases for FY 2022 for Water and Sewer Charges:**

- In January 2021, the Board of Directors was briefed on the FY 2022 rate charges. On February 24, 2021, at a GLWA Public Hearing, the Board will be asked to approve a 2% increase in their water charge, and a 0% increase in their sewage charge for FY 2022. These increases are across the board for DWSD and all member partners, and will be effective July 1, 2021.

## **For Your Information – Recent news reported out of Florida:**

- Officials in Florida announced Monday, February 8, 2021, that a hacker came close to poisoning the city of Oldsmar, FL by boosting caustic chemical levels during a breach of the computer system at the local water treatment plant. A hacker (or hackers) gained remote access to a plant operator's computer Friday, Feb. 5 and within a few minutes had increased the levels of sodium hydroxide dramatically from about 100 parts per million to 11,100 parts per million. Sodium hydroxide, or lye, is used in small amounts to control acidity and remove metals from drinking water. Lye poisoning can cause burning, severe abdominal pain, vomiting, reduced blood pressure and heart rate. Because the plant operator witnessed the incident as it occurred, he took immediate action to reduce the levels back to normal. Had the operator missed the incident, the facility had security redundancies and the water would have been checked for irregularities before it was released, city officials said, affirming that public safety was never threatened directly.<sup>1</sup>
- GLWA immediately on Tuesday, February 9, 2021, responded with a Statement of GLWA's Security/Cybersecurity Protocols in response to the Florida water system Cybersecurity breach, which stated:
  - "The Great Lakes Water Authority (GLWA) takes the security and cybersecurity of the regional water and wastewater system very seriously. In fact, the Authority was one of the first utilities in the United States to complete the risk and resiliency assessment and threat mitigation plan required by the Water Infrastructure Act of 2016. GLWA provides regular security and cybersecurity training to its team members and regularly conducts emergency response tabletop exercises with other area utilities and law enforcement organizations. While GLWA is not at liberty to discuss specific measures it has taken to help protect the security of our system and operations, it is important to note that the Authority's system uses different protections than did the Florida system that was recently attacked."

## **Upcoming FY 2022 Budget Process for DWSD with City Council**

- Since the FY 2022 DWSD water and sewer rates should be approved by both DWSD's BOWC and GLWA's board of directors by end of February 2021, it is very likely that the Mayor's proposed budget for FY 2022 that will be presented to City Council on

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<sup>1</sup> "Hack of Florida water facility highlights critical infrastructure vulnerabilities" by Leandra Bernstein, Tuesday, February 9th 2021, abcnews4.com/nation-world website. It is important to note that this article reported that the levels of sodium hydroxide dramatically increased from about 100 parts per million to "1,100 per million", but LPD used the figure "11,100 per million" since most news stories reported this level of increase.

March 5, 2021 will include an adopted budget for DWSD by the BOWC rather than a placeholder budget subject to amendment at a later date.

Attachment

cc: Gary A. Brown, Director, DWSD  
Thomas Naughton, CFO, DWSD  
Jay Rising, Acting CFO  
John Naglick, Chief Deputy CFO/Finance Director  
Tanya Stoudemire, Chief Deputy CFO/Financial Services  
Eric Higgs, Deputy CFO/Controller  
Steven Watson, Deputy CFO/Budget Director  
Auditor General's Office  
Avery Peoples, Mayor's Office