SAN DIEGO COUNTY TAXPAYERS EDUCATIONAL FOUNDATION

The Water Project

Phase I: Analysis of Labor Costs at Regional Water Agencies, FY 1999- FY 2009

Part I: Metropolitan Water District

The San Diego Taxpayers Educational Foundation is a nonprofit public benefit corporation created to research government revenue and expenditure policies affecting taxpayers in San Diego County as well as other public policy issues having a direct bearing on county residents and businesses.

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ACKNOWLEDGEMENTS

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EXECUTIVE SUMMARY

As part of a multi-year effort to better understand the region's long-term, strategic water needs, inform ratepayers about water costs, and provide much needed oversight of local water districts, the San Diego Taxpayers Educational Foundation (SDTEF) will issue reports on water-related topics. The first phase of this effort is a study of labor costs at the county's various water districts and wholesalers covering fiscal years (FY) 1999 to 2009. With this project, SDTEF seeks to identify the major components that contribute to total employee costs, both immediate and long-term, funded and unfunded.

This first report focuses solely on labor costs at the Metropolitan Water District of Southern California (also Metropolitan, the Met, the District, or MWD), the larger of two regional water wholesalers. Subsequent analyses will examine labor costs at the San Diego County Water Authority (also the County Water Authority, the Authority, or CWA), the county's other water wholesaler, and the numerous independent water agencies and city-managed water departments that provide water directly to ratepayers.

KEY FINDINGS

- The Total Annual Labor Cost for MWD, as of FY 2009, was over $295 million.[1] This marks an increase of 33% since FY 1999. The estimated labor cost per employee was $149,000, or an increase of 32% since FY 1999.

- The Total Labor-Related Unfunded Liability for MWD as of FY 2009 was over $600 million. The Met had no Labor-Related Unfunded Liability between FY 1999 and FY 2002. Between FY 2003 and FY 2009, however, its total unfunded liability increased by over $570 million.

- The increase in the Total Labor-Related Unfunded Liability was driven by an unfunded retiree healthcare liability, which totaled $409 million in FY 2009 and made up nearly 68% of the MWD's unfunded liability for that fiscal year.

- The Met began the period under review without a pension liability and ended with an unfunded pension liability of over $193 million.

[1]Unless otherwise noted, all numbers in this report are adjusted for inflation (2010 dollars) using the United States Department of Labor's Bureau of Labor Statistics Urban Consumer CPI for San Diego. All calculations are based on those adjusted numbers.

- ❋ The value of a typical pension benefit received by a MWD employee who retires at age 55 amounts to nearly $1.1 million over his/her retirement.

- ❋ For most of the period covered, MWD paid all of its employees' required 7% pension contribution. In FY 2001, it began counting this payment as compensated salary, thereby increasing its pension costs.

- ❋ The cost of the "**pick-up**"[2] increased by 434% between FY 1999 and FY 2009.

- ❋ After shedding 173 employees between FY 1999 and FY 2001, the number of employees at the Met increased a total of 151 persons by FY 2009, an increase of 8%.

[2]Definitions for words in bold are provided in the Glossary.

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INTRODUCTION

FOREWORD

For decades, San Diego County's water fate has been controlled, in large part, by decisions made at the Metropolitan Water District of Southern California. The relationship between the Met and county water officials, particularly those from the San Diego County Water Authority, was relatively cooperative until a drought in the early-1990s when MWD cut water deliveries to the county by one third.[3]

Following that experience, CWA decided to increase its independence from the Met. The CWA has since embarked on a $3 billion capital improvement program that included a new reservoir and upgrades to existing storage infrastructure.[4] The Authority also secured its own supplies of Colorado River water through a long-term water transfer agreement with the Imperial Irrigation District (IID) in Imperial County and conservation projects such as the lining of the All American and Coachella Canals, also in the Imperial Valley.

These IID water transfers are at the heart of a legal fight between the two agencies. In June 2010, CWA filed a lawsuit arguing that MWD was combining its costs for purchasing water from the State Water Project with the costs of transporting IID water to San Diego County, thereby adding tens of millions of dollars annually to regional water costs.[5] This case is still before the courts.

Regardless of the merits of that lawsuit, there is no doubt that the cost of water delivered by the MWD has gone up. The Met itself admits that in both nominal and inflation-adjusted terms, prices for full-service **Tier 1 treated water** have increased 50% since 2007. This follows a decade of stable and even decreasing rates.[6] Last spring, MWD approved a rate hike of 7.5 % that became effective January 2011. An equivalent increase is scheduled for 2012.[7] In 2009, MWD employees negotiated a 25% increase in their pensions. Due to public opposition to the proposed retroactive pension hike, the increase was put on hold and was not included in recently

[3]San Diego County Grand Jury 2010/2011. "San Diego County Water Rates: High Today, Higher Tomorrow." May 31, 2011. P . 2. http://www.sdcounty.ca.gov/grandjury/reports/2010-2011/WaterRatesFinalReport.pdf
[4]ibid
[5] San Diego County Water Authority. "Water Authority Board Approves Filing a Lawsuit Against Metropolitan Water District Challenging Illegal Water Rates." Jun 2010. http://www.sdcwa.org/water-authority-board-approves-filing-lawsuit-against%E2%80%A8-metropolitan-water-district-challenging-illeg
[6]The Metropolitan Water District of Southern California. "Report of the Blue Ribbon Committee." Apr 12, 2011. P. 15. http://www.mwdh2o.com/BlueRibbon/pdfs/BRCreport4-12-2011.pdf
[7]Metropolitan Water District of Southern California. "Minutes, Regular Meeting of the Board of Directors." April 13, 2010. PP. 6-8.

completed memoranda of understanding.[8]

The intent of this phase of the project ("Phase I: Analysis of Labor Costs at Regional Water Agencies, FY 1999- FY 2009) is to give ratepayers a comprehensive picture of labor costs related to the supply and delivery of water in San Diego County by providing not only a dollar figure for total annual labor costs and liabilities at each water agency that operates in the county but also the various elements that make up those costs and liabilities. In some cases, these liabilities, largely unfunded, run into the tens—and even hundreds—of millions of dollars. While labor costs and liabilities alone do not account for recent rate hikes, they deserve scrutiny nonetheless as they are opportunities for ratepayer savings.

[8] E-mail correspondence with Carol Nagai, Principal Administrative Analyst, Office of the General Counsel. Oct 20, 2011.

BACKGROUND

REGIONAL ROLE OF THE METROPOLITAN WATER DISTRICT

The Metropolitan Water District of Southern California was created in 1928 to build the 242-mile Colorado River Aqueduct between Lake Havasu and the MWD's Lake Mathews reservoir in Riverside County. In 1960, Metropolitan was one of 30 other public agencies that initiated the construction of the State Water Project's (SWP) 444-mile California Aqueduct, which transports water from Northern California to Southern California via the Sacramento-San Joaquin River Delta estuary.

Today, the Met serves 19 million people through its 26 member agencies in six counties (Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura counties), making it the largest distributor of treated drinking water in the United States. In addition to the Colorado River Aqueduct, the Met owns and operates an extensive array of capital facilities including 16 hydroelectric facilities, nine reservoirs, nearly 1,000 miles of large-scale pipes, and five water treatment plants.[9]

The Met's largest single customer is the San Diego County Water Authority, another water wholesaler, followed by the City of Los Angeles and the Orange County MWD.[10] As of 2010, the County Water Authority relied on MWD for 53% of its water supply.[11]

PENSIONS

The Met belongs to the **California Public Employees Retirement System (CalPERS)** and offers its employees a **defined benefit pension plan** that specifies the amount to be paid when an employee retires. This benefit, paid largely by the employer, is guaranteed for the life of the retiree and his/her spouse, regardless of the performance of the securities in which the pension contributions have been invested. Any deficiencies must be made up with public (i.e., ratepayer or taxpayer) money. Contrast this to a **defined contribution pension plan** in which an employee contributes to a plan, such as a 401(k), with no risk to the employer (for definitions, please see sidebar on page 12 and the Glossary).

[9]The Metropolitan Water District of Southern California. "Annual Report for the Fiscal Year: July 1, 2009 to June 30, 2010: General Information." PP. xiii-xiv. http://www.mwdh2o.com/mwdh2o/pages/about/AR/AR10.html
[10]ibid Chapter 1. Table 1-4. P. 16.
[11] San Diego County Water Authority. "Annual Report 2010." P. 5. http://catalog.proemags.com/publication/4772e268#/4772e268/2

Pension payments are determined using a benefit formula. For **miscellaneous employees**, CalPERS members have five formulas from which to choose. In the case of MWD, the formula for most employees is 2% with a minimum retirement age of 55, or 2% @ 55.[12]

CalPERS Retirement Benefit Forumlas

2% @ 60	
2% @ 55	← MWD
2.5% @ 55	
2.7% @ 55	
3% @ 60	

To determine exactly how much a public employee would receive in annual pension benefits upon retirement, the following calculation is used:

Annual Pension Benefit

=

Years of Service

(The number of years an employee has worked at MWD.)

x

Final Compensation

(The average of the final 12-month compensation period.)

x

Benefit Factor

(A multiplier applied to each year of service, in MWD's case 2%.)

To illustrate: A retiring 55-year-old employee who worked 20 years and whose average compensation over his/her last 12 months of employment was $114,157[13] would earn $45,662 a year in retirement (20 x $114,157 x 0.02) plus an annual Cost of Living Adjustments (COLA) of two percent.[14]

Assuming, as CalPERS **actuaries** have recommended, that a 55-year-old employee will live until age 84,[15] after 29 years, with the COLA factored in, the annual pension benefit would be $79,499. Met retirees are not eligible for Social Security.[16]

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[12]Individual CalPERS members are eligible for retirement at age 50 with as few as 5 years of credited service. CalPERS Annual Valuation Report as of June 30, 2009, Appendix B. Issued Dec 2010.

[13]The average annual salary for employees ages 55-59 with 20-25 years of service according to CalPERS Annual Valuation Report as of June 30, 2009, P. 24. Issued Dec 2010. Unless otherwise noted, all dollar figures in "Pensions" section are nominal.

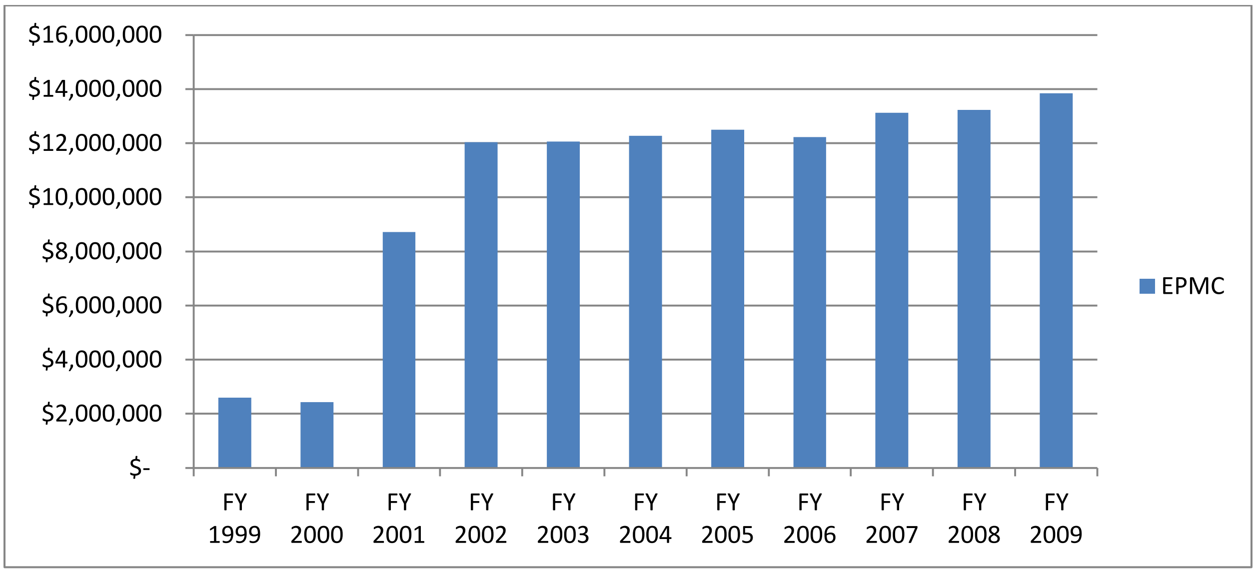
[14]CalPERS. "Miscellaneous Plan of the Metropolitan Water District of Southern California. Annual Valuation Report as of June 30, 2009." Oct 2010. Appendix B-1.

[15]CalPERS Actuarial Office. "CalPERS Experience Study: 1997 to 2007. Apr 2010. P. 27-29. Life expectancy, used for calculations is rounded average for men (82.3) and women (85.3).

[16]CalPERS. "Miscellaneous Plan" op. cit.

A benefit that further increases the final pension payment is the practice of the employer picking up the portion of an employee's salary that the employee is required to pay towards his/her own retirement (the **normal employee contribution rate)** and counting it as additional compensation. The technical name for this payment is the **Employer Paid Member Contribution (EPMC)**. It is also referred to as the "pick-up." In the case of most MWD employees, the employee contribution is 7% of base salary. The Met picks up the entire amount.[17]

Figure 1: MWD "Pick-Up" of Employee Pension Contribution (EPMC) (2010 Dollars)

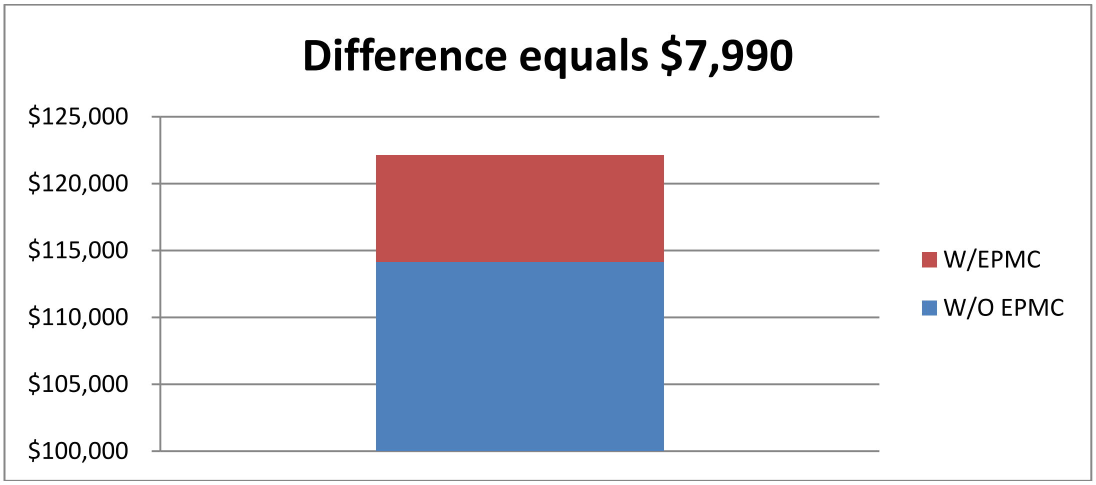


Source: CAFRs, FY 1999-FY 2009. Correspondence with MWD.

Not only does this practice save employees from having to pay retirement costs out of pocket, but, if the employer reports the contribution as "compensation earnable"[18]—which MWD has done since 2001—the amount is added to the final compensation figure used to calculate retirement benefits.

[17]In FY 2002, MWD began paying full employee contribution for all active plan members. Prior to that, payment was limited to certain employees based on job classification and bargaining unit. This accounts for the sharp increase in EPMC between FY 2000 and FY 2001 in Figure 1.
[18]Multiple MOUs between MWD and employee bargaining units.

Figure 2: Final Compensation for Retirement



In the case of our hypothetical worker, this benefit would add $7,990 to the final compensation and $3,197 to the annual pension payment.[19] With both the COLA and the pick-up factored in, at the end of 29 years, the annual pension benefit would be $85,065.

To pay for the pension benefit, employers make contributions to CalPERS. The **employer contribution rate** is determined by **actuaries** and includes the **normal cost** plus a payment on the **amortization** of the **unfunded liability**, expressed as a percentage of payroll. The **employer contribution rate** is then multiplied by the **annual covered payroll**. The resulting figure is called the **Annual Required Contribution (ARC)**.

An **Unfunded Actuarial Accrued Liability (UAAL)**, also called an unfunded liability**)** is created when actual experience does not match the assumptions used—requiring the respective agency to participate in a payment plan to make up the difference. There are many reasons why actual experience may not match assumptions. These include such factors as anemic investment returns and demographic changes.[20] It should be noted that if CalPERS's forecasting is incorrect and retirement costs exceed MWD's ability to pay, the responsibility for paying the difference would fall on ratepayers.

<u>Employer Contribution Rate</u>: Required contribution of employers into the pension system. Based on a percentage of payroll. It is typically made up of the normal cost of a system and the payment on the amortization of unfunded liability.

<u>Normal Cost:</u> The cost of service for all active employees in the fiscal year.

<u>Unfunded Liability (or UAAL):</u> Shortfall due to demographic changes, actuarial assumptions not equaling actual experience, and higher or lower than expected investment returns. This is amortized and included as a payment within the employer contribution rate.

<u>Annual Required Contribution (ARC):</u> Contribution required to the pension system based upon payroll and actuarial assumptions. It is determined by multiplying the employer contribution rate by the annual covered payroll.

[19]It should be noted that both payment of the EPMC and counting it as additional compensation are common practices at many municipalities and public agencies, not just MWD.

[20] Much of the background on pension funding was obtained from San Diego County Taxpayers Association. "San Diego Pension Plans. Phase 1: CalPERS Contracted Municipalities." Oct 7, 2009. http://www.sdcta.org/Uploads/Documents/Press%20Release%20and%20Phase%20I%20Pension%20Report,%2010-7-09_1.pdf

While most of the discussion about outstanding obligations focuses on pensions, **Other Post Employment Benefits**, or **OPEBs**, are gaining increased attention. In the case of MWD, the OPEB refers exclusively to retiree healthcare benefits. The District offers medical insurance to retirees and their qualified dependents through CalPERS. Available plans include PERS Care PPO, PERS Choice PPO, Blue Shield HMO, and Kaiser HMO. In FY 2010, MWD contributed up to 90% of the basic plan rate for PERS Care PPO members.[21]

Most public agencies, MWD included, have funded their OPEB obligation on a **pay-as-you-go (paygo)** basis. In other words, they pay for the benefit after employees retire rather than as the benefit is earned. In accordance with a relatively new ruling from the **Governmental Accounting Standards Board (GASB)**, beginning in FY 2007, MWD and other similarly-sized public agencies are required to report the true, actuarial costs of retiree healthcare benefits in their annual financial statements, just as they do for pensions—not just their paygo costs.[22] Unlike pensions, however, public agencies are not required to pay the OPEB's Annual Required Contribution, which, as in the case of pensions is made up of both **normal costs** and additional payment toward the unfunded liability.[23] As a result, many government entities that offer retiree healthcare benefits have sizable unfunded OPEB liabilities.

Providing ratepayers with a more complete understanding of the true value of the pension benefit our hypothetical retiree would receive (as detailed above) requires a calculation that shows the value of the benefit if it were paid for today. This can be achieved by determining what the annual pension benefit would be worth in today's dollars (referred to as the Net Present Value) assuming a given rate of return on investment over a period of time, in this case 29 years.[24] Doing so results in the following outcome:

NET PRESENT VALUE OF TYPICAL PENSION BENEFIT FOR HYPOTHETICAL MWD EMPLOYEE*:

$1.1 million

(Not including survivor's benefits, retiree healthcare or deferred compensation/matching contributions)

*Retired at age 55 with final compensation of average salary ($114,157) plus 7% pick-up ($7,990) and annual COLA of 2% with life expectancy of 84 years.

[21] Beginning in FY 2010, employees hired prior to July 1, 2009 were required to pay 2% of their salary (on an after-tax basis) into an OPEB trust fund to pre-fund the costs of their retiree healthcare. Those hired after that date must contribute 7% of their salary to the fund. These contributions will be considered "compensation earnable" by the District. Source: Multiple MOUs, 2009-2014.

[22] Government Accounting Standards Board. "Summary of Statement No. 45: Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." Jun 2004. http://www.gasb.org/st/summary/gstsm45.html

[23] The background on OPEBs comes in part from: San Diego County Taxpayers Association. "Retiree Healthcare '101.'" Apr 22, 2010. http://www.sdcta.org/Uploads/Documents/Backgrounder%204-22-2010,%20JG.pdf

[24] The Net Present Value of the pension benefit is calculated using a 30-year U.S. Treasury bond rate of return of 3.32% (as of Sept 2, 2011). This is the standard rate of return for calculating the value of a stream of payment and is considered "risk free" (as opposed to rates of return based on riskier investment vehicles, such as stocks). CalPERS's long-term assumed rate of return is 7.75 percent. See Appendix for formula.

Again, it should be stressed that the above figure does not represent MWD's pension cost per employee but the estimated current dollar value of the lifetime pension benefit for a MWD employee meeting the selected criteria (age, years of service, final compensation, life expectancy) and subject to existing pension elements (benefit factor, EPMC, COLA, OPEB).

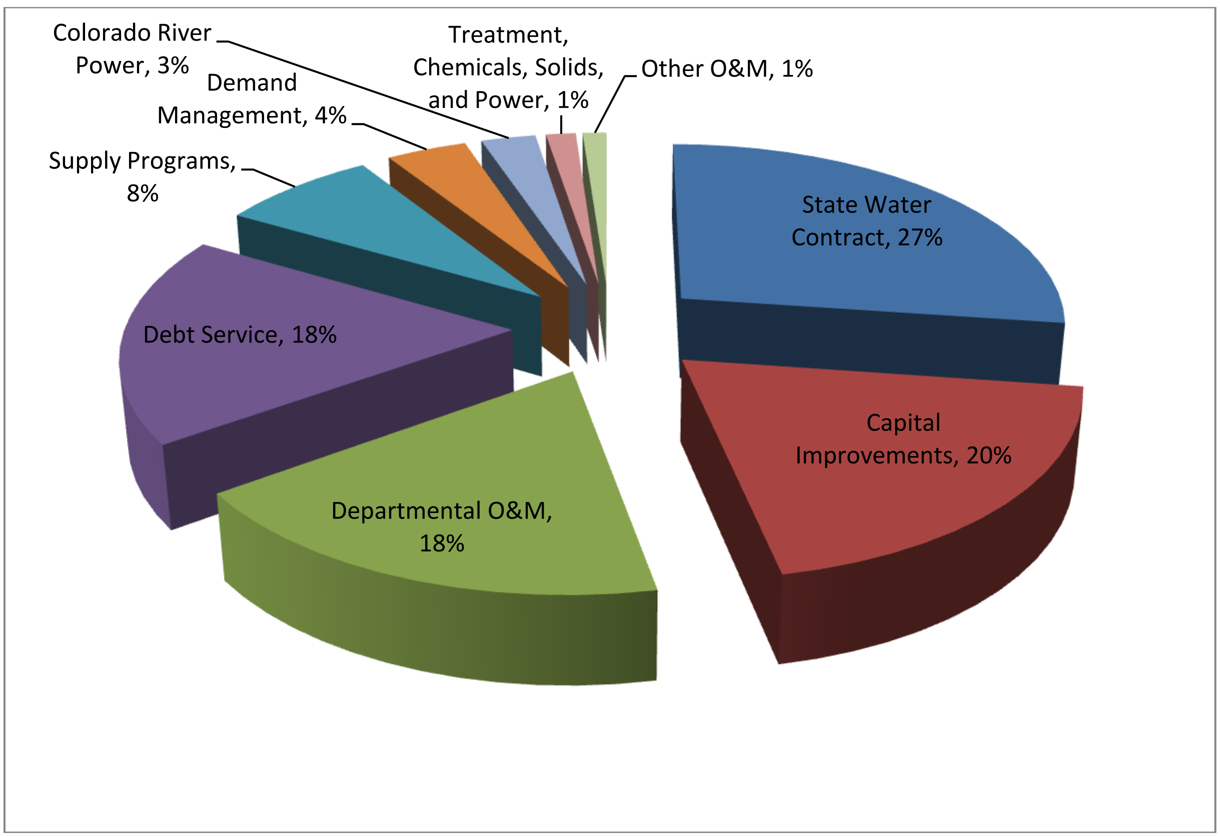
Furthermore, in 2009, Met employees negotiated a 25% increase in their retirement benefits (from 2% @ 55 to 2.5% @ 55). That proposal was shelved after it was met with strong public disapproval. However, if the Met were to adopt this increase in retirement benefits at some future date, the normal member contributions for pensions would grow to 8% of salary (currently 7%). Since the Met has indicated it would continue to cover the total amount, the Met's EPMC would increase by 1%. The increase would contribute to increased pension costs because, as explained above, it would be included as earned compensation and added to the retiree's final compensation figure for the purposes of calculating annual pension benefits upon retirement.[25]

[25]Multiple MOUs, 2009-2014.

FACTORS CONTRIBUTING TO WATER COSTS

Many factors determine the price member agencies, and ultimately ratepayers, pay for water supplied by the Met. In any given year, about 80% of MWD's expenditures are fixed costs, such as infrastructure and debt service for previous investments in the State Water Project. The District primarily sells "full-service" water (noninterruptible water sold for domestic and municipal uses), which includes the cost of water itself, the conveyance and distribution system, and the power used to pump water through that system. It also includes a surcharge for treated water, a readiness-to-serve charge, and a capacity charge to recover the cost of peaking during periods of increased demand. The Met also has a Rate Stabilization Fund that it uses to offset revenue declines.[26] As of 2010, MWD had not collected sufficient revenues to cover expenses for four of the previous five years.[27] The fund's balance has declined dramatically as a result.[28] Until the 1950s, MWD's largest source of revenue was property tax. By the 1980s that had changed, and water rates were overwhelmingly based on volume and service charges.[29]

Figure 3: MWD Expenditures, FY 2010 (actual)



Source: Metropolitan Water District. "Fiscal Years 2011/12 and 2012/13 Biennial Budget." P. 1. Jun 2011. http://www.mwdh2o.com/mwdh2o/pages/finance/budget/AB2013.pdf

[26]The Metropolitan Water District of Southern California. "Report of the Blue Ribbon Committee." Apr 12, 2011. P. 19-20. http://www.mwdh2o.com/BlueRibbon/pdfs/BRCreport4-12-2011.pdf
[27]Metropolitan Water District. Board Item 8-2. Page 1. Apr 13, 2010.
[28]"Report of the Blue Ribbon Committee." Op.cit. P. 21.
[29]Ibid. P. 17.

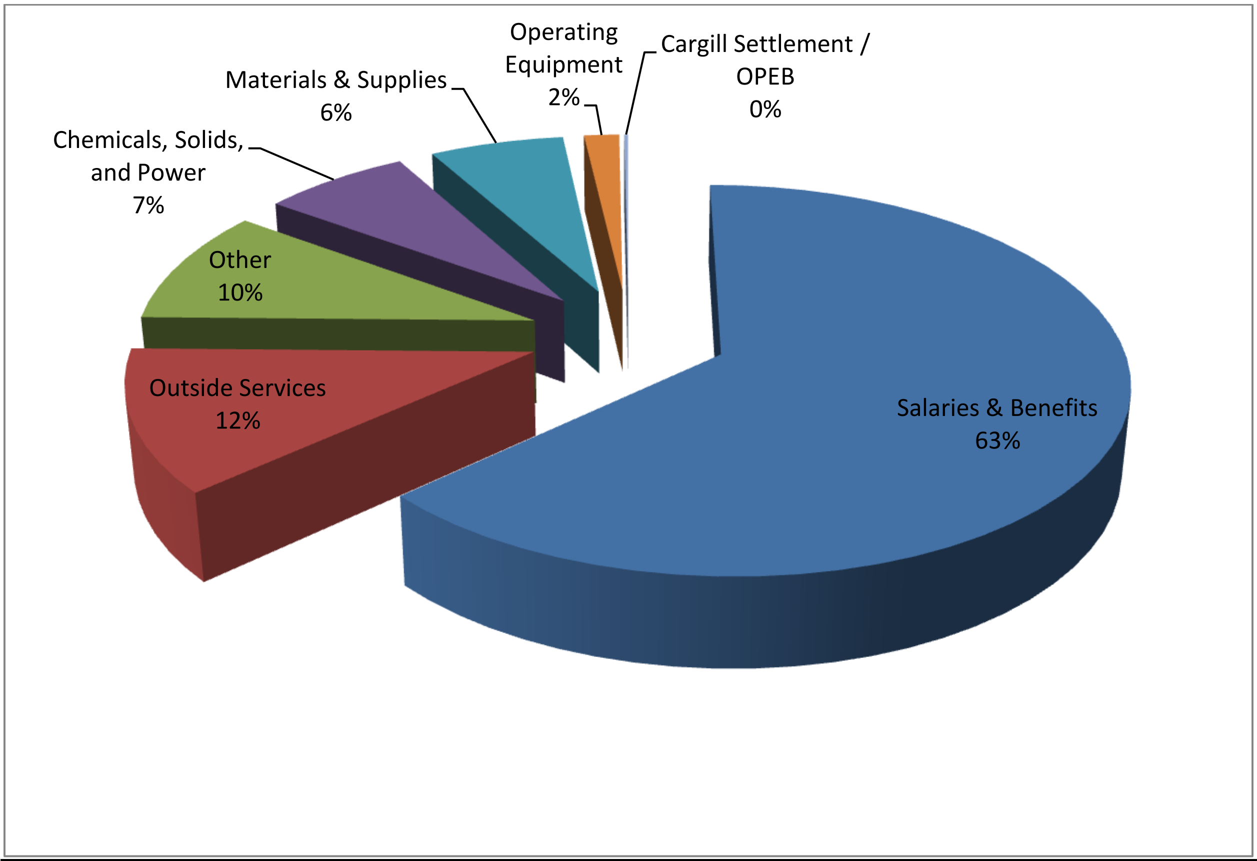
As Figure 3 (above) shows, of its $1.6 billion in expenditures in FY 2010, MWD's largest single expense (27%) was water from the State Water Project.[30] Capital Improvements, Debt Service, and Departmental Operations and Management (O&M) made up the bulk of the remainder. Departmental O&M includes the Met's labor costs (see Figure 4 below for more details). Supply programs include the costs of water transfers and storage. Demand Management consists of payments made by MWD to member agencies for water conservation and development projects.

At the time of its last rate hike in April of 2010, MWD cited several reasons for increased costs of water.[31] Among these were:

> Higher Costs for State Water: Regulations and court orders attempting to protect the Delta smelt and other endangered fish species in the Sacramento-San Joaquin River Delta estuary have cut water supplies and increased costs of water obtained through the State Water Project. The 2010 rate increases included a "Delta Supply Surcharge" to cover these additional costs. At the same time, reallocation of Colorado River water to Arizona and Nevada from California has reduced the region's access to a relatively cheaper alternative.[32]
>
> Debt Service: The Met has an ongoing capital program of over $3 billion. A significant portion of those funds are directed at projects to improve water treatment and repair older infrastructure. This program contributes to sizable interest payments.
>
> Infrastructure: In addition to borrowing money for capital projects, MWD has also committed itself to self-funding "replacement and refurbishment" projects out of revenues. Those costs were expected to increase from $37 million in FY 2010 to $95 million in FY 2011.

[30]All dollar figures for this section are nominal.
[31]Unless otherwise noted, much of the following comes from: Metropolitan Water District. Board Item 8-2. Apr 13, 2010.
[32]San Diego County Grand Jury 2010/2011. "San Diego County Water Rates: High Today, Higher Tomorrow." May 31, 2011. P . 2. http://www.sdcounty.ca.gov/grandjury/reports/2010-2011/WaterRatesFinalReport.pdf

Figure 4: MWD Operating Budget, FY 2010 (actual)



Source: Metropolitan Water District. "Fiscal Years 2011/12 and 2012/13 Biennial Budget." P. 4. http://www.mwdh2o.com/mwdh2o/pages/finance/budget/AB2013.pdf

The Met's Operating Budget (also called the Operations and Maintenance Budget) includes annual labor costs and accounted for $335 million of MWD's $1.6 billion in expenditures for FY 2010, or 20% percent of the total.[33] Labor and Benefits were 63% of O&M. In dollar terms, that was over $212 million, or 13% of its total expenditures (Figure 3).

[33] O&M budget includes "Other O&M" and "Treatment Chemicals, Solids & Power" categories from Expenditures.

METHODOLOGY

This study was designed to calculate a single dollar figure for the annual labor costs of MWD as well as to determine outstanding labor-related costs for any given year. The information included in the study focuses on fiscal years 1999 through 2009 and was gathered from Comprehensive Annual Financial Reports (CAFRs), financial statements, annual valuation reports supplied by CalPERS, memoranda of understanding between MWD and various **bargaining units,** and other information supplied by MWD. The Met had the opportunity to review the data used for this report prior to its release and offer corrections for our consideration, which we made.

The decision to look at FY 1999 through FY 2009 was made for a number of reasons. In addition to being the most recent, and therefore most relevant, we wanted a broad timeframe in order to identify relevant trends. Fiscal Year 2010 was excluded from this study because CalPERS's estimates of unfunded pension liabilities for that fiscal year are unavailable (there is a two-year lag on such estimations). Fiscal Year 2011 was similarly excluded because data, in the form of CAFRs, were not yet available.

The formulas for total annual labor costs and labor-related liabilities are as follows:

<u>Total Annual Labor Cost</u>

=

Salaries + Benefits + Miscellaneous Benefits +
Annual Pension Contribution + Annual OPEB Contribution

Annual labor and benefit figures (or salaries plus benefits above) were provided to us by the Metropolitan Water District. In addition to regular pay, the total includes salary supplements and benefits such as:

- Employee incentive plan
- Standby pay
- Diving pay
- Call back pay
- Holiday, bereavement, jury duty, leave pay
- Special pay
- Disability
- Monthly payments to employees who opt out of medical benefits
- Out of pocket medical and drug reimbursements
- Compensated Absences payouts
- Vacation and sick pay used during a given fiscal year
- One time payments[34]

[34] The Met provided one-time payments to its management and professional employees in FY 2005 totaling $420,800 and to its AFSCME employees in 2006 in the amount of $1,438,875.

According to MWD, other benefits—such as medical/dental/vision, Rideshare, life insurance, tuition/mileage/travel reimbursement, payment for professional licenses, workers' compensation, and matching contributions—are not included in the annual benefits figure because they are not paid through Payroll but through Accounts Payable.[35] The costs of these benefits were provided to us by MWD and have been included as Miscellaneous Benefits. MWD failed to provide specific costs of subsidized rent for employees who live in MWD-owned housing.

The Annual Pension Contribution includes the Employer Paid Member Contribution (EPMC) as well as MWD's required pension contribution. As described above, both are determined by CalPERS and must be paid annually. The OPEB contributions are MWD's annual paygo payments for retiree healthcare.[36]

<u>Total Labor-Related Unfunded Liability</u>

=

OPEB Unfunded Liability + Pension Unfunded Liability

The second formula applies to unfunded liabilities. The OPEB and pension unfunded liabilities have been described above ("Pensions"). Unfunded liabilities are cumulative (i.e., they roll over year to year). An unfunded liability is not like a conventional debt. Unlike annual labor costs, it does not need to be paid in any one year. As CalPERS explains, it is an "abstract accounting number that can go up or down significantly over a relatively short period of time, depending on the state of the overall economy and the health of the financial markets."[37]

Another liability is that for Compensated Absences, also commonly referred to as unused vacation and sick days. Because it is a funded liability, we have excluded it from this formula, but it should be noted that the annual Compensated Absences liability increased by 82% between FY 1999 and FY 2009 (from $25.6 million to $46.7 million). Met policy allows employees to receive full payment for all accrued vacation leave up to 475 hours and roughly one-half of accrued sick leave up to 1,000 hours upon leaving the District.[38]

[35]Payroll is paid directly to employees. Accounts payable is paid to vendors (e.g., a health insurance company). Phone call with Hal Soper III, Acting Controller, MWD. Sept 19, 2011.
[36]Technically, the paygo payments are current costs for past employees but have been included because they meet the criteria of being both annual and labor-related.
[37]CalPERS. "Local Elected Official Toolkit Pension Funding and Retiree Health Benefits Funding." March 2011. http://www.calpers.ca.gov/eip-docs/about/pubs/employer/er-pubs/misc-pubs/local-toolkit.pdf
[38]Metropolitan Water District of Southern California. "Comprehensive Annual Financial Report For The Fiscal Year Ended June 30, 2010." Dec 17, 2010. P. 25. Multiple MOUs.

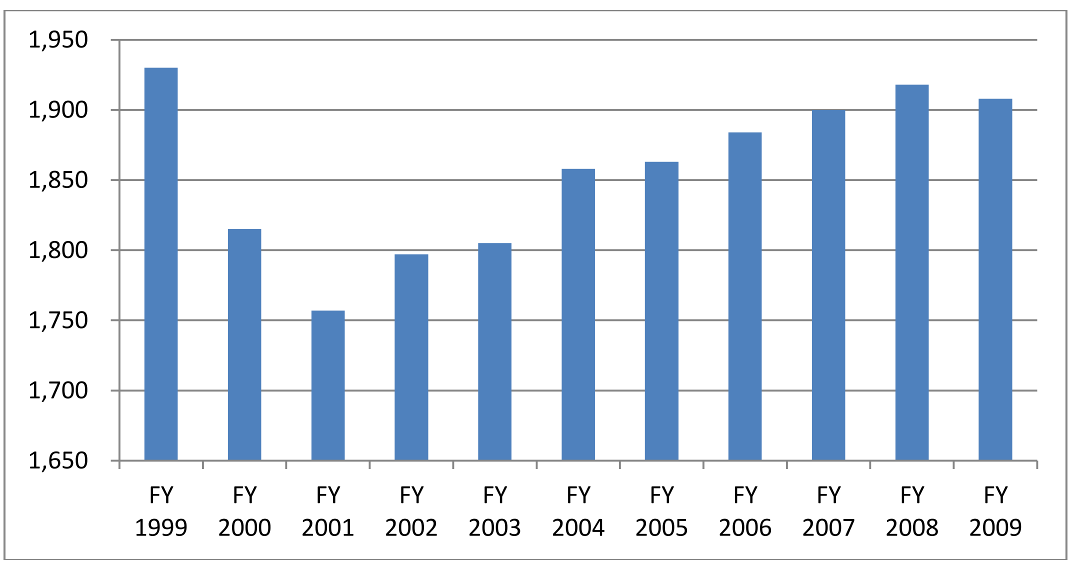
SECTION 1: ANNUAL LABOR COSTS

Calculating annual labor costs can be difficult because salary supplements and benefits for public employees are much more extensive than they are for private sector workers, and they differ agency to agency. On the benefit-side, these include not only standard features such as healthcare, but, in the case of MWD, extras such as tuition reimbursement, subsidized housing and payments for opting out of medical benefits.

In addition to salaries and benefits, annual labor costs also include yearly contributions that must be paid to cover future pension liabilities**.** These contributions include Employer Paid Member Contributions, payments made by employers to cover pension contributions that are actually supposed to be made by employees, as well as the actuarially required pension payments as determined by CalPERS (the ARC).

Many public agencies, including MWD, also provide their employees with health benefits after they retire. Other Post Employment Benefits are financed on a paygo basis. As a result, the true costs of this benefit are consistently underfunded.

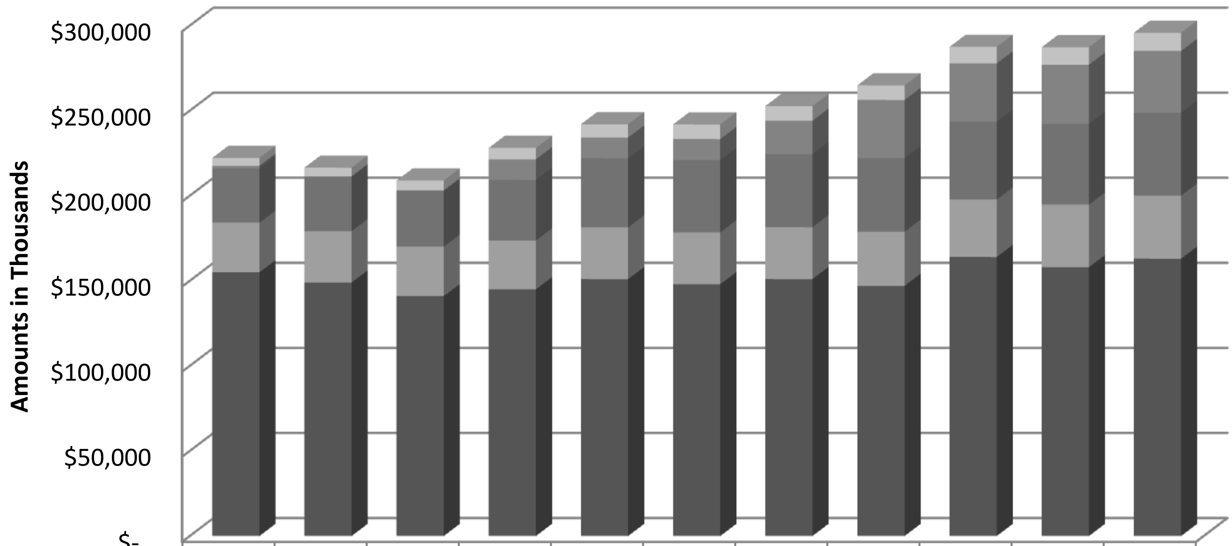
Figure 5: MWD Full Time Equivalent (FTE) Employees



Source: CAFRs, FY 1999- FY 2009. Correspondence with MWD.

Labor costs are also influenced by factors such as the size of an organization's workforce. While MWD's workforce was slightly smaller in FY 2009 than it was in FY 1999, it was 8.5% larger than it was FY 2001, after the Met had reduced its workforce by some 173 **Full-Time Equivalent** (**FTE**) employees over two years.

Figure 6: Total Annual Labor Cost by Category, FY 1999 – FY 2009 (2010 Dollars)



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Annual OPEB	$4,600	$5,100	$5,800	$6,700	$7,800	$8,600	$8,600	$8,600	$9,700	$10,300	$10,700
Annual Pension	$1,400	$-	$-	$12,100	$12,200	$12,400	$19,600	$34,200	$34,300	$34,800	$36,400
Misc Benefits	$32,000	$32,200	$33,000	$35,600	$40,600	$42,400	$43,000	$43,200	$45,700	$47,400	$48,600
Benefits	$29,200	$30,200	$29,100	$28,700	$30,400	$30,500	$30,500	$31,900	$33,800	$36,800	$37,100
Salaries	$155,000	$149,000	$141,000	$145,000	$151,000	$148,000	$151,000	$147,000	$164,000	$158,000	$163,000

Source: CAFRs, FY 1999- FY 2009. Correspondence with MWD.

The Met's Total Annual Labor Cost was over $295 million in FY 2009. This is an increase of 33% over FY 1999. As Figure 6 indicates, this increase was driven in large part by annual pension costs. While MWD had a negligible pension contribution in FY 1999—and none in FY 2000 and FY 2001—its annual pension costs increased from $12 million in FY 2002 to more than $36 million in FY 2009, an increase of 200%.

Benefits (both regular and miscellaneous)[39] also contributed to the growth in labor costs, increasing by 40% during the time period examined. As a proportion of total costs, however, benefits remained flat, growing by only 1% between FY 1999 and FY 2009 (from 28% to 29%). Salaries increased by only 5% between FY 1999 and FY 2009 and actually decreased as a proportion of total labor costs, making up 70% in FY 1999 but just 55% in FY 2009.

Annual payments to cover retiree healthcare (Annual OPEB) were a small portion of overall costs but did increase by 132% and amounted to over $10 million annually by FY 2009.

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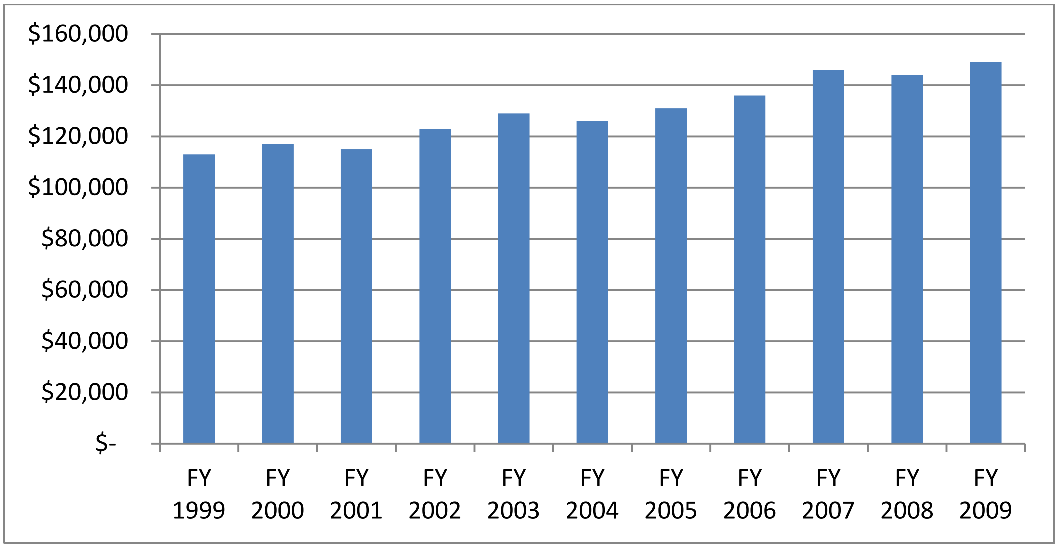
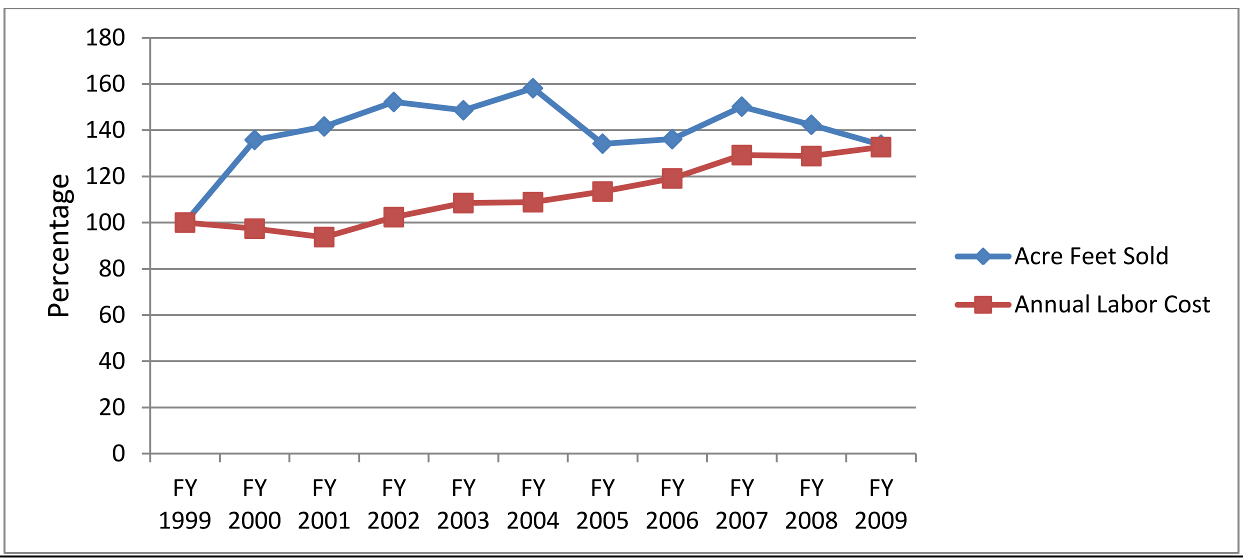
[39]See "Methodology" pgs. 17-18 for an explanation of the differences between the two benefit categories.

Figure 7: Annual Labor Cost per Full Time Equivalent (FTE) Employee, (2010 Dollars)



This overall increase in labor costs between FY 1999 and FY 2009 resulted in an increase in the annual cost per employee of 32%. As of FY 2009, a theoretical FTE employee costs the District approximately $149,000 in salaries and benefits, including annual pension costs.[40]

Figure 8: Indexed Rate of Growth, Acre Feet vs. Labor Costs



By comparing the rate of growth in annual labor costs to that of **acre feet** sold by CWA to it member agencies, it is evident that until roughly FY 2004, the increase in labor costs either fell or rose slightly as sales of water increased. After that time, labor costs continued to climb notwithstanding decreases in the volume of water sold.

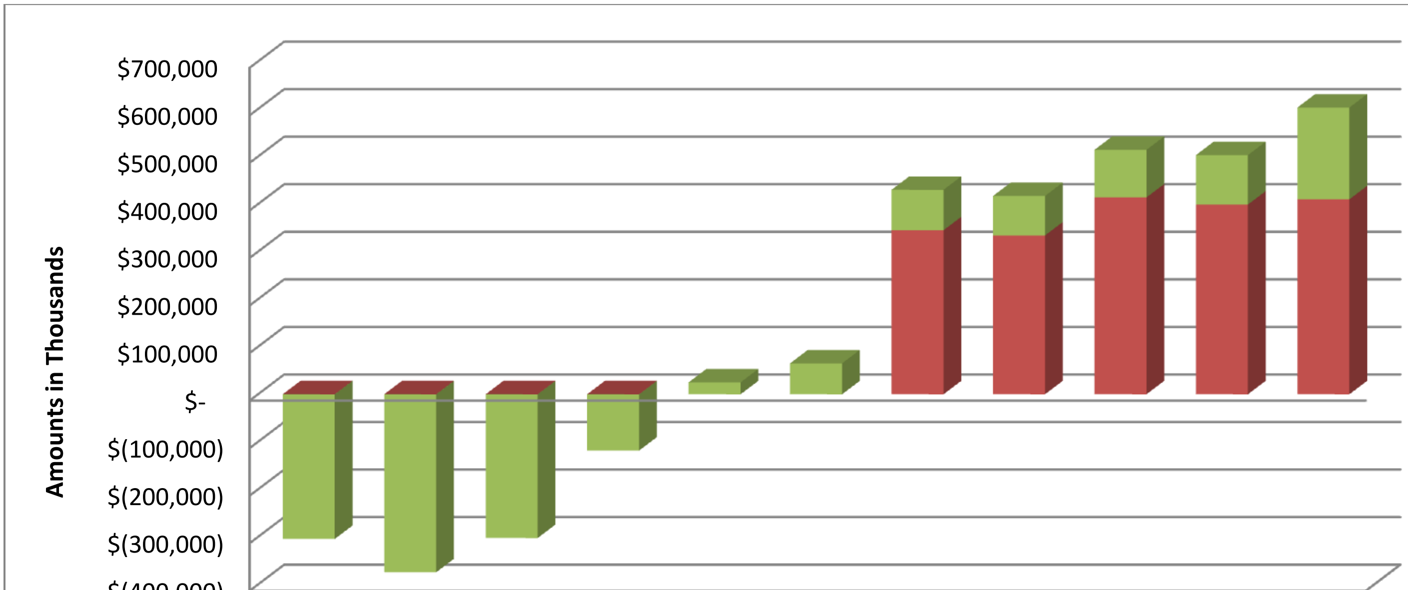
[40] The figures in this graph do not include annual paygo (OPEB) payments for retiree healthcare, which benefit former employees (i.e., current retirees).

SECTION 2: LABOR-RELATED UNFUNDED LIABILITY

For as helpful as they are in understanding MWD's labor outlays, annual labor costs alone, even when they include yearly pension and retiree healthcare payments, do not provide a complete picture of all the labor-related financial obligations public agencies must meet. In addition to yearly labor costs, there exist unfunded, long-term liabilities that must be paid, primarily to retirees, albeit over a longer time horizon.

For most public agencies, the most substantial liability is its pension benefit. The unfunded portion of this liability is the outstanding dollar amount that will be needed to fund the retirements of current and former employees. A typically smaller (but growing) liability is that for retiree healthcare. Accounting rules issued in 2004 (**GASB 45**) required that government agencies providing OPEBs, such as healthcare for retirees and their dependents, make information about the unfunded portion of the benefit available in 2007. That information has been included in determining the labor-related liability.

Figure 9: Total Labor-Related Unfunded Liability by Category, FY 1999 - FY 2009 (2010 Dollars)



	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Pension UAAL	$(304,000)	$(374,000)	$(302,000)	$(118,000)	$25,000	$65,000	$85,000	$83,000	$100,000	$104,000	$193,000
OPEB UAAL	$-	$-	$-	$-	$-	$-	$345,000	$334,000	$414,000	$399,000	$410,000

Source: CAFRs, FY 1999- FY 2009. Correspondence with MWD.

As Figure 9 (above) shows, the greatest factor in the increase of MWD's labor liability is the large unfunded liability for retiree healthcare that was first recorded in FY 2005 as a result of new accounting rules[41]. At nearly $410 million in FY 2009, the unfunded retiree healthcare liability **(OPEB UAAL)** represented 68% of the Met's total annual unfunded liability for that fiscal year. The remainder consists of a $193 million unfunded pension liability. Combined, the Met's total liability, as of FY 2009, stood at $603 million, or one-and-a-half times what it spent on water and power that same fiscal year.

Its pension liability, also nonexistent in the early years of this study, quickly grew from $25 million in FY 2003 to $193 million in FY 2009, an increase of 674%. All told, the Labor-Related Unfunded Liability increased by well over a half-billion dollars between FY 2003 and FY 2009.

[41]The unfunded OPEB liability existed prior to FY 2005 but was unreported in financial documentation provided to the public.

RECOMMENDATIONS

The results of this analysis clearly show that, like many other public agencies, labor costs at the Metropolitan Water District, both annual and long-term, increased dramatically during the decade of the 2000s. While the Met has taken some steps to reduce its labor costs, such as creating a trust fund to help finance future retiree healthcare costs, much more must be done.

The following actions are needed to truly curb labor costs at the Authority:

Eliminate EPMC: Throughout most of the period covered in this study, the Met has paid the total amount employees are required to contribute to help finance their retirements (7% of salary). This adds to labor costs and should be eliminated. While a recently completed MOU eliminates the EPMC for new employees beginning in FY 2012, it was a missed opportunity to have all employees finance more of their own retirements.

Stop treating EPMC as increased compensation: The EPMC also contributes to long-term pension liabilities. Beginning in FY 2002, MWD allowed all retiring employees to count the EPMC as compensation, thereby increasing the final salary figure used to determine a retiree's pension benefit by thousands of dollars. This benefit needlessly inflates the already generous retirement package received by Met retirees.

OPEB Reform: Although beginning in FY 2011 it took steps to curb its retiree healthcare costs by having employees prefund the benefit through contributions to a trust fund,[42] the Met should reduce the percentage (currently up to 90%) that it pays towards premiums on retiree health plans and require current employees to pay a greater portion of their post-employment healthcare costs.

Financial Reporting: While the District's financial reporting is thorough, it fails, as does the reporting of most public agencies, to provide specific details about its labor costs, necessitating reports such as this one. Aggregate numbers, while helpful, do not give the public sufficient information. Such a level of detail is not required by law, but would allow ratepayers to better understand the public institutions that serve them and hold them accountable.

[42] Multiple MOUs, 2009-2014.

Glossary of Terms

Actuary: A person professionally trained in the technical and mathematical aspects of insurance and pensions. The actuary estimates how much money must be contributed to a pension fund each year in order to support the benefits that will become payable in the future.

Amortize: The provision to pay a debt (in the case of pensions, the Unfunded Liability) over a period of time.

Annual Covered Payroll: Payroll eligible for pension benefits; the employer contribution rate is shown as a percentage of the annual covered payroll.

Annual Pension Cost (APC): The Annual Required Contribution plus the Employer Paid Member Contribution.

Annual Required Contribution (ARC): Contribution required to the pension system based upon payroll and actuarial assumptions. It is determined by multiplying the employer contribution rate by the annual covered payroll. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal pension costs each year and amortize any unfunded actuarial liabilities over a defined period, usually 20 years.

Bargaining Unit: Specific group of employees represented by one authorized union or association for purposes of collective bargaining.

CalPERS: California Public Employees' Retirement System, established in 1931. CalPERS offers a defined benefit pension plan for contracted public agencies.

Cost of Living Adjustments (COLA): An annual adjustment in wages (in this case, pension benefits) to offset a decrease in purchasing power as measured by a Consumer Price Index.

Defined Benefit Pension Plan: A pension plan in which **e**mployees and employers make annual contributions into a plan that defines the level of benefit received at retirement.

Defined Contribution Pension Plan: A pension plan in which contributions are specified at a fixed dollar or percentage amount. The benefits of these plans are based upon contributions and investment earnings.

Employer Paid Member Contribution: Share of the required employee CalPERS contribution rate that is picked up by the employer. Also called the "pick-up.

Full-Time Equivalent: Ratio of the total number of paid hours during a period (part time, full time, contracted) by the number of working hours in that period.

GASB: Governmental Accounting Standards Board; provides accounting standards for local and state government reporting.

GASB 45: The rule issue by GASB in 2004 requiring municipalities and other public agencies to account for OPEB costs and unfunded liabilities. Available at: http://www.gasb.org/st/summary/gstsm45.html

Miscellaneous Employee: Employees not classified as public safety (police officers, firefighters, etc.)

Normal Cost: The cost of service for all active employees in a fiscal year.

Normal Employee Contribution Rate: Amount employee is required by CalPERS to contribute into the system. It is based on the pension benefit formula.

Other Post Employment Benefits (OPEB): Benefits paid out after retirement commences, such as retiree healthcare and life insurance.

Pay-as-you-go (paygo): Refers to the practice of paying OPEB liabilities after eligible employees have retired rather than as they are accrued.

Pick up: Share of the normal employee contribution rate or cost that is picked up by the employer. Also called the Employee Paid Member Contribution (EPMC).

Tier 1 treated water: Tier one water rates recover the costs of ensuring a reliable water supply. Full service means it is noninterruptible water sold for domestic and municipal uses.

Unfunded Actuarial Accrued Liability (UAAL): Shortfall or excess in pension or benefit obligations due to demographic changes, unrealized actuarial assumptions, and higher or lower than expected investment returns. Also called an unfunded liability.

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APPENDICES

APPENDIX A: AGGREGATE DATA (NOMINAL AND 2010 DOLLARS)

NOMINAL					Total Annual Labor Cost					TALR Unfunded Liability	
Year	Annual FTE	AF Sold	Annual EPMC	Annual Compensated Absences Liability	Annual Labor Costs	Annual Benefit Costs	Annual Misc Benefits	Annual Pension Cost	Annual OPEB Contribution	OPEB UAAL	Pension UAAL
FY 99	1930	1,529,000	1,824,000	25,657,000	108,988,929	20,578,265	22,543,994	1,009,000	3,259,000		(214,024,000)
FY 00	1815	2,076,000	1,810,000	26,484,000	111,221,045	22,518,041	23,951,235	-	3,778,000		(278,514,000)
FY 01	1757	2,165,000	6,791,000	27,999,000	109,605,417	22,680,457	25,735,281	-	4,545,000		(235,257,000)
FY 02	1797	2,327,000	9,700,000	30,717,000	116,749,849	23,151,826	28,665,322	9,758,000	5,416,000		(94,929,000)
FY 03	1805	2,272,000	10,086,000	33,354,000	125,941,081	25,384,024	33,952,460	10,216,000	6,486,000		20,900,000
FY 04	1858	2,418,000	10,642,000	36,349,000	128,586,170	26,460,799	36,782,518	10,769,000	7,487,000		56,477,000
FY 05	1863	2,051,000	11,236,000	37,347,000	135,552,779	27,403,016	38,656,739	17,642,000	7,742,000	310,461,000	76,025,000
FY 06	1884	2,081,000	11,364,000	39,764,000	136,875,885	29,647,481	40,145,481	31,738,000	8,038,000	310,461,000	77,513,000
FY 07	1900	2,296,000	12,472,000	40,496,000	156,075,085	32,140,037	43,410,807	32,634,000	9,207,000	393,476,000	94,773,000
FY 08	1918	2,176,000	13,060,000	44,914,000	155,554,272	36,282,050	46,769,150	34,334,000	10,152,000	393,476,000	102,519,000
FY 09	1908	2,044,000	13,662,000	46,710,000	160,404,958	36,666,553	47,939,012	35,970,000	10,600,000	404,172,000	190,891,840

REAL					Total Annual Labor Cost					TALR Unfunded Liability	
Year	Annual FTE	AF Sold	Annual EPMC	Annual Compensated Absences Liability	Annual Labor Costs	Annual Benefit Costs	Annual Misc Benefits	Annual Pension Cost	Annual OPEB Contribution	OPEB UAAL	Pension UAAL
FY 99	1930	1,529,000	2,591,009	36,446,006	154,819,783	29,231,616	32,023,952	1,433,294	4,629,440	-	(304,023,074)
FY 00	1815	2,076,000	2,430,470	35,562,738	149,347,717	30,237,245	32,161,739	-	5,073,102	-	(373,988,843)
FY 01	1757	2,165,000	8,718,337	35,945,327	140,712,260	29,117,342	33,039,148	-	5,834,905	-	(302,024,708)
FY 02	1797	2,327,000	12,031,333	38,099,635	144,809,929	28,716,219	35,554,849	12,103,273	6,717,701	-	(117,744,578)
FY 03	1805	2,272,000	12,059,181	39,879,232	150,579,647	30,350,044	40,594,772	12,214,614	7,754,893	-	24,988,785
FY 04	1858	2,418,000	12,275,507	41,928,435	148,323,664	30,522,432	42,428,496	12,422,001	8,636,226	-	65,146,007
FY 05	1863	2,051,000	12,502,418	41,556,410	150,831,040	30,491,632	43,013,771	19,630,444	8,614,607	345,453,304	84,593,838
FY 06	1884	2,081,000	12,229,079	42,791,015	147,295,494	31,904,381	43,201,536	34,154,040	8,649,889	334,094,691	83,413,639
FY 07	1900	2,296,000	13,122,276	42,607,416	164,212,665	33,815,782	45,674,198	34,335,500	9,687,043	413,991,397	99,714,358
FY 08	1918	2,176,000	13,230,540	45,500,496	157,585,530	36,755,828	47,379,871	34,782,340	10,284,567	398,614,085	103,857,713
FY 09	1908	2,044,000	13,842,115	47,325,808	162,519,679	37,149,952	48,571,023	36,444,215	10,739,747	409,500,457	193,408,489

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Appendix B: Pension Net Present Value Formula

Net Present Value of MWD Pension Benefit					
	Discount Rate	**Years**	**COLA**	**Initial Payout**	**NPV**
Pension Benefit	0.0332	29	0.02	45,662	$1,076,712.02
Pension Benefit w/ Pickup	0.0332	29	0.02	48,859	$1,152,097.42
NPV Calculation (NPV of annual growing annuity):					
NPV= [Initial Payout/(Discount Rate-COLA)]*{1-[(1+COLA)/(1+Discount Rate)]^Years}					

APPENDIX C: INDEXED RATE OF GROWTH FORMULA (ACRE FEET FORMULA VS. LABOR COSTS)

			Indexed Rate of Growth	
Year	AF Sold	Total Annual Labor Costs	Acre Feet Sold	Annual Labor Cost
FY 1999	1,529,000	222,138,085	100	100
FY 2000	2,076,000	216,819,803	135.7750164	97.60586675
FY 2001	2,165,000	208,703,654	141.5958143	93.95221652
FY 2002	2,327,000	227,901,971	152.1909745	102.5947314
FY 2003	2,272,000	241,493,970	148.5938522	108.7134473
FY 2004	2,418,000	242,332,819	158.1425768	109.0910728
FY 2005	2,051,000	252,581,492	134.1399608	113.7047224
FY 2006	2,081,000	265,205,339	136.1020275	119.3876052
FY 2007	2,296,000	287,725,188	150.1635056	129.5253753
FY 2008	2,176,000	286,788,135	142.3152387	129.1035418
FY 2009	2,044,000	295,424,615	133.6821452	132.99143
Formula				
Base year (FY 1999) = 100				
Year-to-year growth = (year/base year) *100				