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Water and Wastewater Contract Operations Outsourcing: A Survey of Small and Medium-Sized Florida Cities

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New research looks at the extent of water and wastewater contract operations in Florida's small and Medium-Sized municipalities.

The master's research project surveyed cities with populations up to 25,000 to determine:

- The extent of utility contract operations in these cities.
- Apparent reasons for choosing or not choosing to outsource.
- If these cities considered outsourcing and the results of those discussions.
- The decision-making process with regards to operations outsourcing.
- The likelihood that city managers would initiate contract operation discussions with the city commission.

SUMMARY OF FINDINGS.

The findings indicate that two in ten (20%) have some level of significant contract operations.

Only one in ten (10.6%) cities in the study group have hired contract operations to operate their water treatment plants. One in twenty (4.7%) have outsourced treatment to another governmental entity, receive bulk water from that entity, but still maintain their own distribution system. Another one in ten (9.4%) have outsourced water distribution or wastewater collection activities to a contractor another city or governmental entity. These two groups in the survey represent the extent of utility contract operations in Florida's small and medium-sized cities.

- Smaller cities are more than twice as likely to outsource than medium-sized cities.
- More than half of cities under 1,000 persons outsource operations; whereas just over one-quarter of cities outsource operations when populations are greater than 10,000 persons.

Six of ten (61.2%) small and medium-sized cities said they do not outsource operations and two in ten (18.8%) indicated that they had limited infrastructure outsourcing (e.g. meter reading, electrical repair, welding, landscaping, janitorial, laundry, payroll, and so forth).

- Twice as many city managers said that they are not interested in than those who would be willing to considering contract operations

- City managers said that the most important issues to them in the decision-making process are: (1) operational; (2) environmental; (3) water quality; and (4) service related issues – these are the essential obligations water and wastewater utilities have to their customers and regulatory agencies.
- When asked, city managers said that the issues of primary importance to city commissioners for choosing or not choosing to outsource are: (1) financial; (2) and managerial.
- Concerns of least importance to both city managers and commissioners are: regulatory; political or partisan; and union organizing concerns.
- While city managers said they are happiest with contract operations services, responsiveness, reliability, and quality; they said outsourcing is too expensive and ***ultimately not worth the price.***
- A majority (two-thirds) of city managers have not discussed outsourcing options with commissioners or mayor, and most of those would not initiate contract operation discussions with municipal governing boards.
- According to the survey city managers are twice as likely to express a negative response about contract operations than a positive one, and given the opportunity they are twice as likely to dissuade their peers from outsourcing.

RESEARCH SURVEY.

This research survey explores the current level of water and wastewater outsourcing in small and medium-sized municipalities in Florida -- results of a Masters of Public Administration project.¹ The survey looked at incorporated cities, towns and villages that have their own water systems and with populations from 500 to 25,000 persons -- 201 municipalities fit within these parameters.

The motivation for this effort is to determine the variety and culture of utility service delivery in Florida's cities, and to ask city managers for their opinions about contract operations. Outsourcing is one of many tools that the city manager, elected official, and utility professional have to accomplish their mission and serve the public.

Small and Medium-Sized Municipalities in Florida with their Own Water Systems. Florida has approximately 407 incorporated municipal entities cities, towns, or villages serving an estimated population of 9.5 million persons, which accounts for about half of Florida's population. Out of the 407 incorporated municipal entities in Florida 289 have their own water system (71%). The study group is comprised of and is defined as those small and medium-

¹ I gratefully acknowledge the assistance of Elain Carroll with proofreading the many drafts of this paper. I also acknowledge the kind assistance of Dr. Stephen Sussman as capstone project advisor; the Florida League of Cities (FLC) as organizational / professional expert / input / mentor; Dr. Melanie Hicks Tozzi as an expert in public-private-partnership arrangements and survey preparation; Dr. John Rushing as survey and research project mentor; and Maggie Bowden as academic advisor.

sized Florida municipal entities with populations between 500 and 25,000 persons, see Table 1 and Figure 1 below.²

Table 1 ~ Number of Cities by Populations Size Filtered by the FDEP Database

Population Size	Cities	Cities with a Water System	Study Group
Under 500 persons	42	20	---
500 > persons > 1,000	42	28	28
1,000 > persons > 5,000	110	83	83
5,000 > persons > 10,000	53	36	36
10,000 > persons > 25,000	75	54	54
25,000 > persons > 100,000	66	50	---
Greater than 100,000	19	18	---
Totals	407	289	201

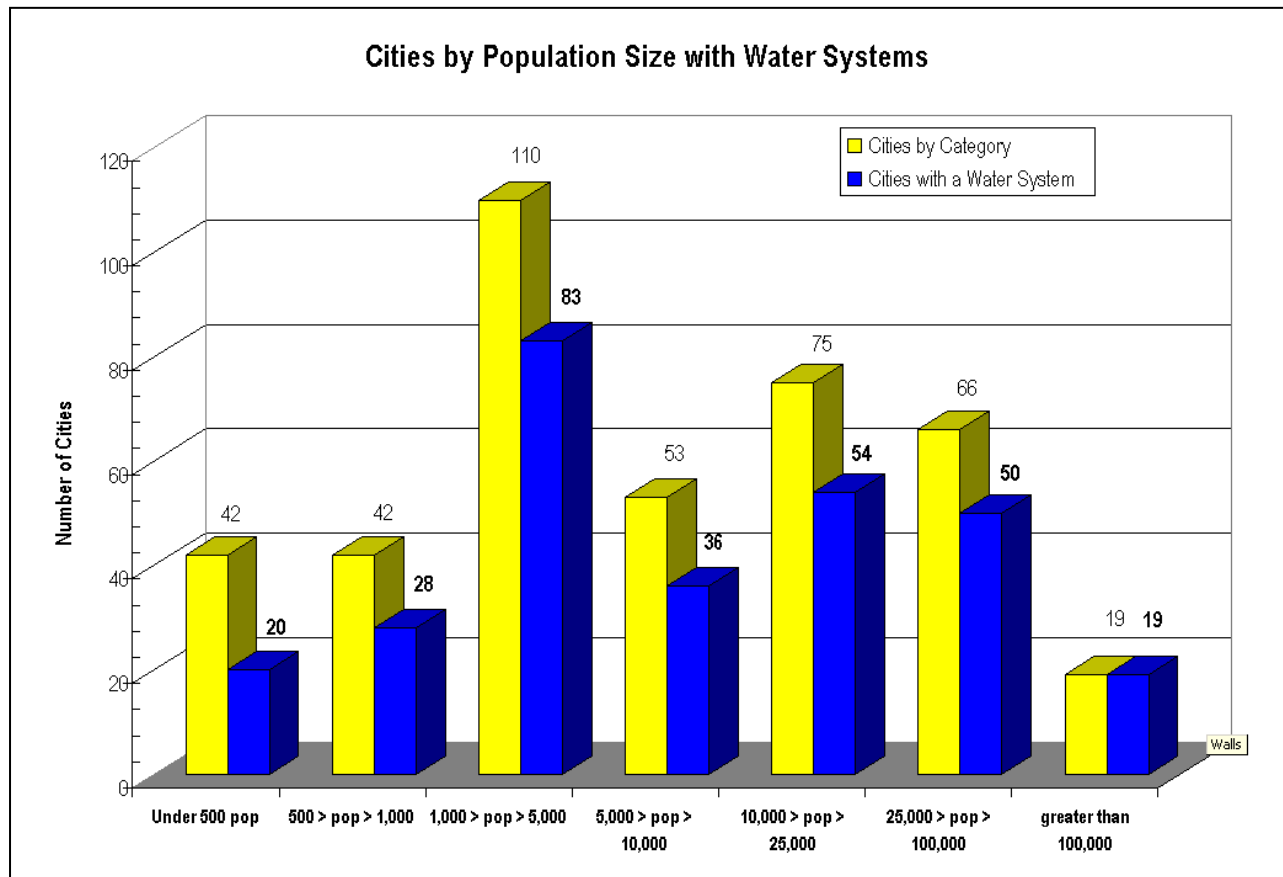


Figure 1 ~ Number of Municipal Entities by Populations Size

Based on a detailed comparison of databases from the Florida Department of Environmental Protection, the Florida League of Cities, and the Florida Department of State, it is estimated

² According to U.S. Census Bureau estimates for 2009 ~ <http://quickfacts.census.gov/qfd/states/12000.html>; and the Florida Department of State database ~ <http://www.floridaleagueofcities.com/Directory.aspx>; <http://dlis.dos.state.fl.us/library/FICollection/FLcities.cfm>

that 201 entities have their own water systems.³ The balance of cities presumably receive water from another governmental group, authority, or special district. Since not all cities have their own wastewater system, the subject group for this research project centers on cities with their own water systems.

Governmental interaction with private entities has greatly increased during the past century. Particularly since the 1980s, contract operations (outsourcing) have grown in spite of bureaucratic and interest group reluctance (Fernandez & Smith, 2006, p.356). This reluctance or inertia continues in these pro-public sector circles (Beckett, 2000, p. 185). Despite negative reports or public employee reluctance, there are communities where the private partner has adopted and shares the goals and objectives of its public partner, a strong outsourcing relationship exists between both parties, and good contract operations exist (Water Partnership Council, 2003).

Outsourcing has always played some role in assisting contemporary governments with the delivery of goods or services to the public (Rosenau, 2000). These relationships are an integral part of contemporary society; vary by public activity, good or service; and differ by governmental level (federal, state or local).

As the structure of society became more complex, particularly around industrial or business centers, so did the water quality requirements, waste disposal needs, public sanitation exigencies, and environmental impacts (Schroeder, 1977). Local governments continue to operate water and wastewater utilities financed by user fees and with direct federal support through grants and low interest loans; and under federal and state regulation.

With each generation of contract operations goes further than the generation preceding it, representing an inverse form of public policy incrementalism.⁴ The classical incremental model of policy is defined as being the systematic growth and continuation of previous government activities or programs (Rabin, 2003). The inverse form of public policy incrementalism is the increase of contract operations and transfer of government activities or programs to the private sector.

Good contracts are those that are built on the appropriate allocation of resources, risks and rewards. As long as these contractual arrangements fill a role and achieve positive purposes, contract operations will be apart of the environment of governance in Florida's cities (Cowdery, 2000, Oct., p.38).

Water and wastewater systems were originally formed for the direct health and safety of the public and to reduce deaths as a result of water borne illnesses in the later part of the 1800s and early 1900s, see Figure 2. Cities were in the forefront in creating water supply systems and public sanitation – other local government entities joined the act in the later half of the 1900s.

The expectation of reliability for public utilities is assumed by the public – but price and efficiency cannot be ignored. Regulatory agencies require utilities to protect public health by

³ Water System statistics from the Florida Department of Environmental Protection, retrieved June 2009, summarized by the author, http://www.dep.state.fl.us/water/drinkingwater/pws_sys.htm. This information is based on a comparison of the Florida League of Cities, Florida Department of Environmental Protection, and the Florida Department of State databases.

⁴ Term coined by author to describe growing governmental reliance on the private work force's expertise, efficiency and effectiveness.

ensuring safe and reliable drinking water and protecting groundwater sources.⁵ Customers expect water systems to provide a safe and reliable supply of high quality water.

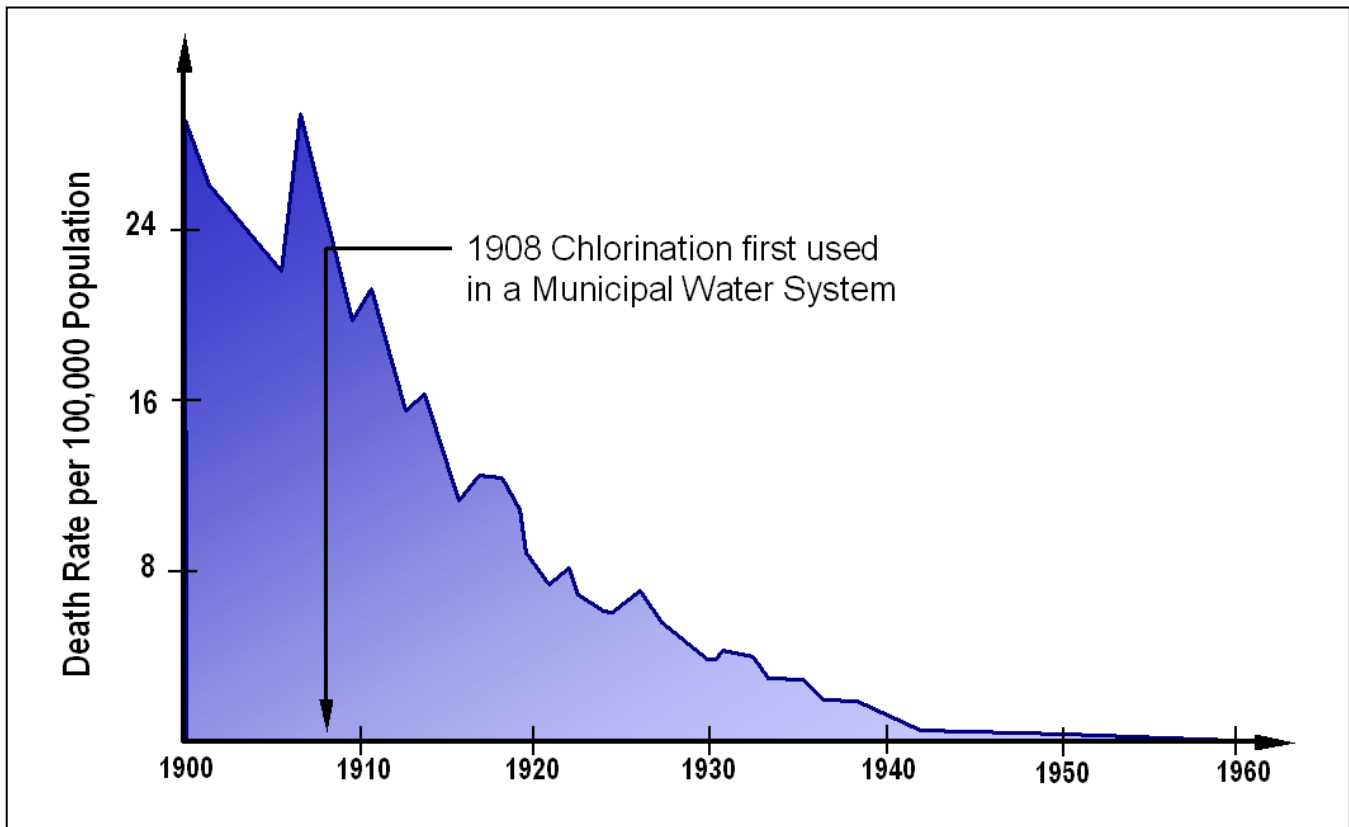


Figure 2 ~ Death Rates for Typhoid Fever in USA
 Source: Centers for Disease Control and Prevention

Cost is an afterthought, but most customers have come to expect low rates, even though infrastructure is crumbling under their feet (pipes, pumps, and plants); there has been a substantial decline in federal and state grants; technology, reliability, and regulation of systems have greatly increased over time; and state water management districts are implementing new consumptive use restrictions.

Cost of water and wastewater amounts to less than two-percent (1.91%) of Floridian’s average household income – complaints of cost are exaggerated (NRWA, 2004). Consumers are far more willing and spend much more on other beverages, such as carbonated soft drinks, beer, beer and bottled water. The EPA says that, “*Compared with other developed countries, the United States has the lowest burden for water/wastewater bills when measured as a percentage of household income.*”⁶ Tap water is a bargain; the cost for bottled water at the local quickie mart is well over \$10 per gallon (even more than gasoline)⁷.

A wastewater system has a more difficult public perception battle than water – since wastewater services are mostly out-of-sight and out-of-mind. Customers have few concerns about their wastewater utility as long as the toilet flushes and sewage never backs up on them,

⁵ Safe Drinking Water Act, 1996 Amendments - Public Law 104-182 104th Congress, <http://www.epa.gov/OGWDW/sdwa/text.html>

⁶ EPA Water & Wastewater Pricing, <http://www.epa.gov/waterinfrastructure/pricing/index.htm>

⁷ Field research -- Aquafina (16 fl. oz) at \$1.29 – \$1.29 / 16 oz x 128 oz / gallon = \$10.32 / gallon

while regulatory agencies require the protection natural systems with the disposal of treated effluent and residuals, and EPA has recently mandated surface water discharges exceed drinking water standards for Florida only.⁸

Public Utility Economics. Public-owned utilities are natural monopolies -- cities should operate them as enterprises separate from nominal governmental activities. Enterprises are self-supporting units of governmental services that are financed by rates or user-fees while the regular business of government is funded by general tax revenue funds (Seppälä, Hukka, Katko, 2001) (Crow, 2008). Different functions and different revenue sources.

Enterprises should be *“based on sound engineering and economic principles. Rates and fees collected must be sufficient to maintain level of service, cover expenses, fund capital outlays, retire debt, and support reserves (debt-service, repair and replacement, minor capital projects, infrastructure reinvestment, and emergencies)”* (Carroll, 2008a, p. 11).

Since enterprise transactions do not use (and should not use) general tax revenues for operations (Carroll, 2008b), they are one of the few governmental activities or services that could be completely privatized, analogous to other private utilities such as telephone, electricity, or cable television (Lobina & Hall, 2008).

Basic Definitions. If management is defined as the art of getting things done through people, and public administration is implementing public policy and providing services to the public (Rabin, 2003), then outsourcing by contract operations (public-private partnerships) is implementing public policy through cooperative ventures between the public and private sectors (Gidman, et al, 1995).

The process of hiring the contractor requires a public bidding process with requests for proposals (RFPs) and a formal contract, which specifies performance standards. All non-engineering contracts are price and qualifications based, and must be performed in the sunshine under Florida statute. Contract operations may replace public employees and requires careful management by the city.

The term privatization is often used interchangeably with outsourcing but can also mean that the ownership of the enterprise or public service has been transferred into private hands from the public sector (government) (Dilworth, 2004, Sept 2). This report avoids the use of the term privatization since it is less accurate, has multiple meanings, and has pejorative connotations in certain contexts and with public employees (Greenough, et al, 1999, p. 41).

Accounts and case studies on outsourcing include both positive and negative opinions.

Negative comments include:

“Corporations offered themselves as the solution for funding, technical and organizational challenges faced by municipalities throughout the U.S., which face stricter standards, diminishing federal funding and a citizenry not keen on rate increases. But these corporations – mainly European multinationals RWE, Suez and

⁸ EPA's Numeric Nutrient Criteria becomes effective October 15, 2010 – this new EPA standard could soon raise your sewer bill \$50-\$100 per month. EPA's own Scientific Advisory Board believe that these stringent regulations are not supported scientifically, but EPA is determined to institute this rule even though it will cause serious economic harm to our state while having uncertain environmental benefit.

Veolia – have produced mixed results. The privatization bubble is bursting. (Food & Water Watch, 2006).

Comments more favorable to contract operations consist of the following:

“Privatization is a feasible and viable option to meet, efficiently and productively, some infrastructure needs. However, in the public-private partnership movement, privatization, at least successful privatization, is a paradox. Rather than reducing government, which it may do in some ways, more fundamentally it brings the private sector into the policy and management structures of the public sector. The private sector becomes more like a public sector than the reverse” (Heilman & Johnson, 1992, p.190).

The research explores complementary and contradictory inferences, weighs the literature, and evaluates the survey results and comments. One city manager provided a detailed response and rationale for passing up contract operations outsourcing:

[Our city] “as well as other cities in this county have been approached by a consultant on numerous occasions to discuss creating a utility authority. This has met with resistance and reluctance due to the huge investment each community has made in these enterprises.

“Each city has some type of utility system, gas, water, sewer. In my opinion cities own these [utilities] for more than just providing a service. These enterprises typically will provide additional revenue to the community [in transfers to the city’s general fund]. Most of the time these enterprises help to fund other activities of the city. The levels of transfer from the utility to the general fund will differ, but I would imagine that every city transfers funds from the utility to the general fund. This is not only typical but necessary to provide the services many citizens want and demand. Therefore, without these enterprises communities would suffer.

“Additionally, I would also comment that in the economic times we find that state funds such as gas tax, sales tax, other revenue sharing have continued to go down. Without the utility enterprise helping to supplement [the city’s general fund] there would be more lay offs than what we read in the paper.”

This survey allows us to quantify the number of small and medium-sized Florida cities that rely on the private sector and to quantify the extent that they use contract operations.

The Contract Operations Continuum as it Applies to Water & Wastewater Infrastructure.

The spectrum of public-private sector arrangements for water and sewer utilities runs from fully public ownership and operations to complete privatization, see Figure 3 below.

The outsourcing continuum runs from fully public operations (left side of figure) to fully private (right side of figure) with categories in between.

1. In the fully public category, the public completely owns, builds and operates infrastructure, and public employees provide all services.

2. The limited infrastructure outsourcing scenario allows only minor private sector involvement in the utility operation, where the private sector provide services that are traditionally provided by public employees – meter reading, electrical repair, welding, landscaping, janitorial, laundry, payroll, and so forth.
3. The next outsourcing category requires basic technical skill for operating and maintaining the water distribution and/or wastewater collection system and requires the public bidding (RFP) process.
4. Outsourcing operations to another city or governmental entity is a cooperative arrangement with an adjacent city.

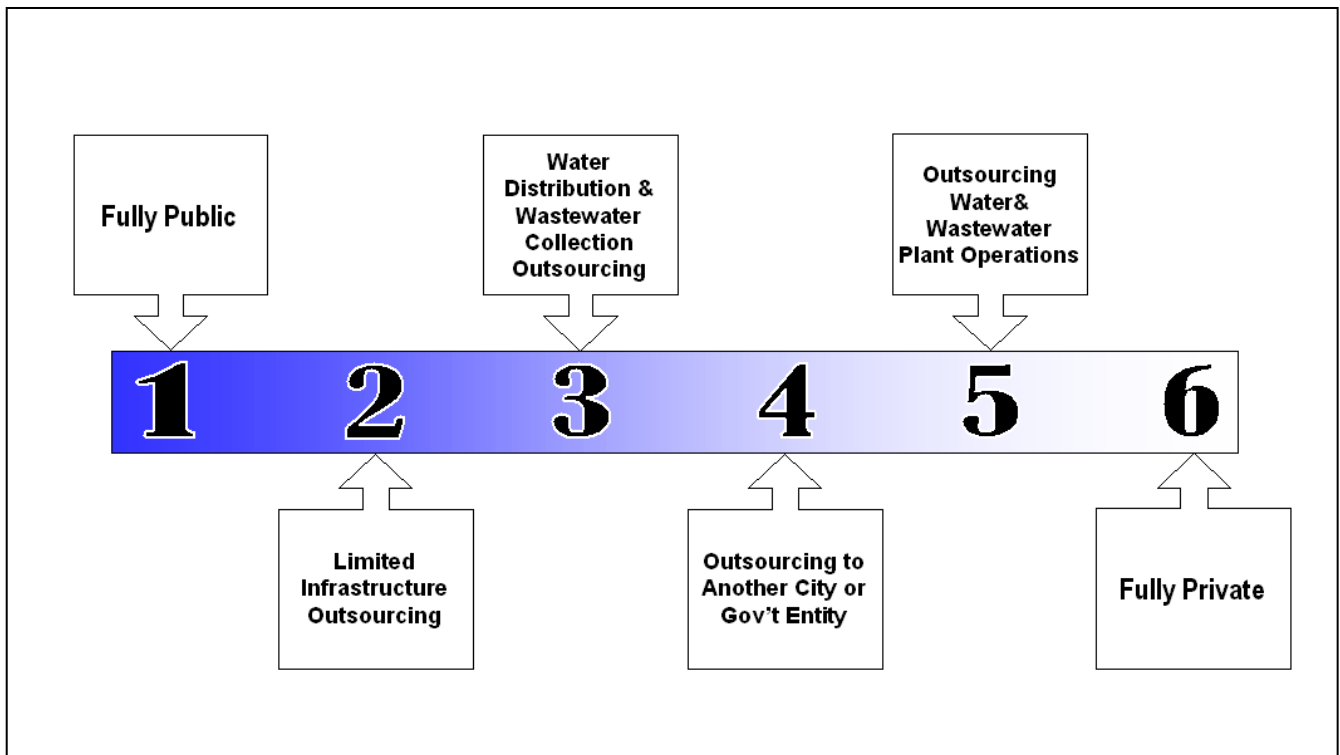


Figure 3 ~ Continuum of Contract Operations / Privatization

5. Water / wastewater treatment plant contract operations outsourcing, represents a significant contract operation that requires technical skills for operating and maintaining treatment plant operation and requires the public bidding (RFP) process.
6. Fully privatized is an extension of other categories. It requires relatively high technical skill for operating and maintaining treatment plants and requires the public bidding (RFP) process. With most arrangements the public owns the infrastructure, only in rare cases the assets are sold to the private partner.
- 6a. Design-Build-Operate is a variation of fully privatized, category 6. The private partner is hired to design, build and operate for a time (long-term for about 10 to 20-years, or short-term for about 6 to 12 months) a water or wastewater plant through a two-step request for proposal (RPF) process: 1) evaluation of bidder's qualifications; and 2) then submission of sealed bids.

SURVEY FINDINGS.

Comparison of Full Public and Public-Private-Partnership Conditions in Florida. The empirical findings shows that most city managers are wary of and have avoided outsourcing. The research revealed simultaneous complementary and contradictory conclusions with respect to the decision-making process; most of wish is somewhat informal. While the current extent of outsourcing is found, additional research might show if the transfer of government activities or programs to the private sector (public-private partnerships) is increasing, stabilizing, or decreasing in Florida's cities.

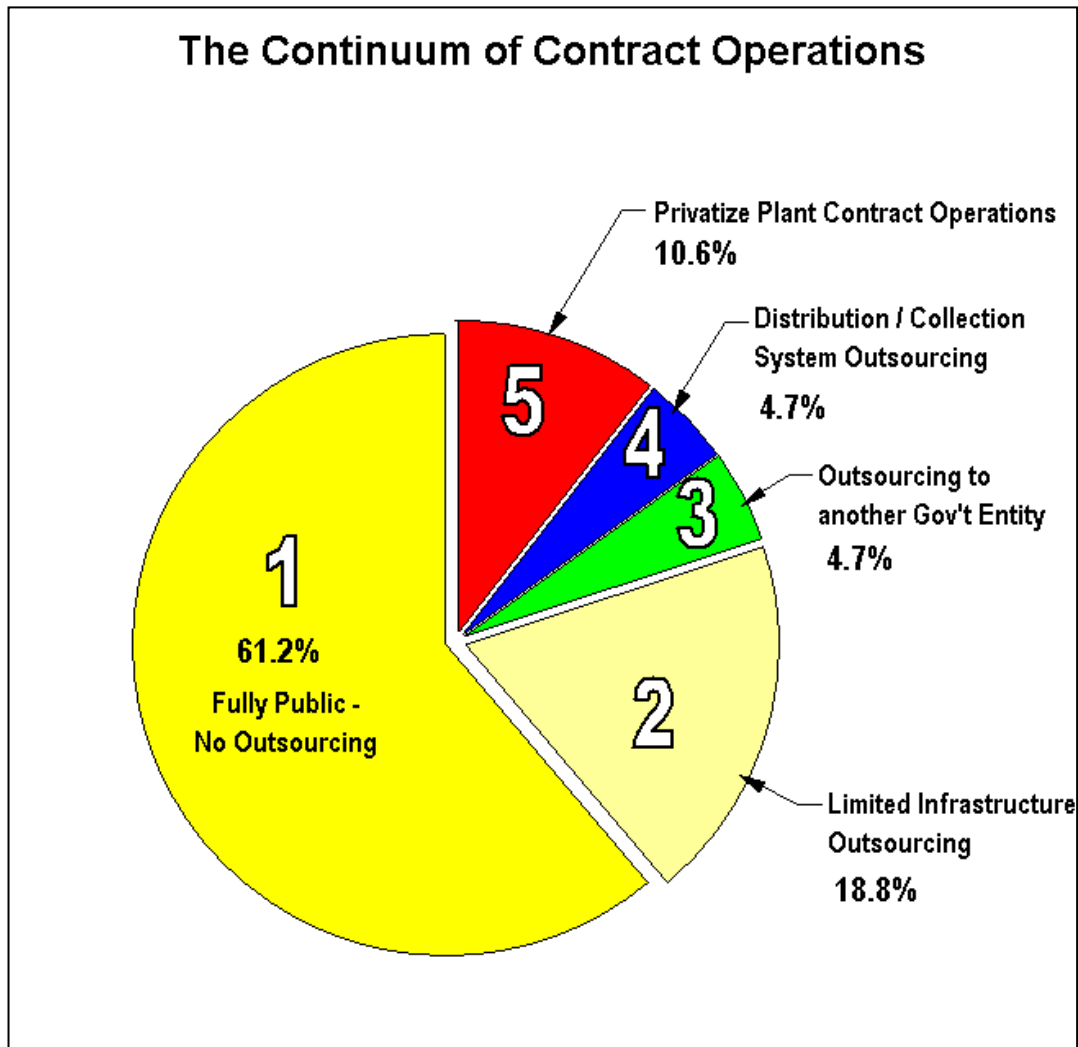


Figure 4 ~ Continuum of Outsourcing in Small & Medium-Sized Florida Cities

Extent of Contract Operations in Florida's Cities. Analysis of the survey shows that 61.2% of respondents are fully public and 18.8% have limited outsourcing – the total, 80% do not have contract operations -- whereas 20% have some level of contract operations outsourcing, see Table 2 and Figure 4. Literature review and professional experience predicted the level of outsourcing at 5% to 10% -- the survey showed these levels to be much higher than anticipated.

Table 2 ~ Actual Breakdown of Public-Private-Partnerships by Continuum Category

Continuum Categories	Public-Private-Partnership Categories	Cities Responding to Survey	Response % by Population Category	
1	Fully Public - no outsourcing	52	61.2%	80%
2	Limited Infrastructure Outsourcing	16	18.8%	
3	Water Distribution / Wastewater Collection Outsourcing	4	4.7%	20%
4	Outsourcing to Another City or Gov't Entity	4	4.7%	
5	Privatize Plant Contract Operations	9	10.6%	
	Totals	85	100.0%	

The nature of providing high quality potable water and public sanitation requires major infrastructure investments (sunk costs⁹) for which government is better suited than private business. Additionally, since these utilities are natural monopolies, it is not feasible to construct parallel networks and facilities to service the same areas and to compete for customers (Seppälä, et. al., 2001).

Likelihood of Water / Wastewater Contract Operations (outsourcing) in Florida. Smaller cities are more likely to outsource operations than medium-sized cities. The study group cities with populations between 500 and 1,000 persons are more than twice as likely to have contract operations outsourced than cities with populations between 10,000 and 25,000 persons, see Figure 5.

Issues Most Important to the Decision-Making Process. City managers¹⁰ said that the issues of primary importance when considering outsourcing are operational, environmental, water quality, and service related issues, these are primary obligations of water and wastewater utilities to customers and regulatory agencies, see Table 3.

The issues next in importance are financial or managerial issues and represent points of scarcity for most public agencies (utility rates or fees; management, ability or knowledge; utility costs / potential savings; and utility staff performance, ability or knowledge).

The issues of primary importance for city commissioners are financial and managerial. Secondary issues are operational, environmental, water quality, and service related. City managers and city commissioners have contrasting primary and secondary issues.

Concerns of least importance to both groups are regulatory, political or partisan, and union organizing concerns.

⁹ In economics and business, sunk costs are costs that have already been incurred and which cannot be recovered to any significant degree.

¹⁰ Although the title city manager is used in this report, this should be considered a generic term. Some cities, towns, or villages do not have a manager and instead have an administrator, clerk, or other official.

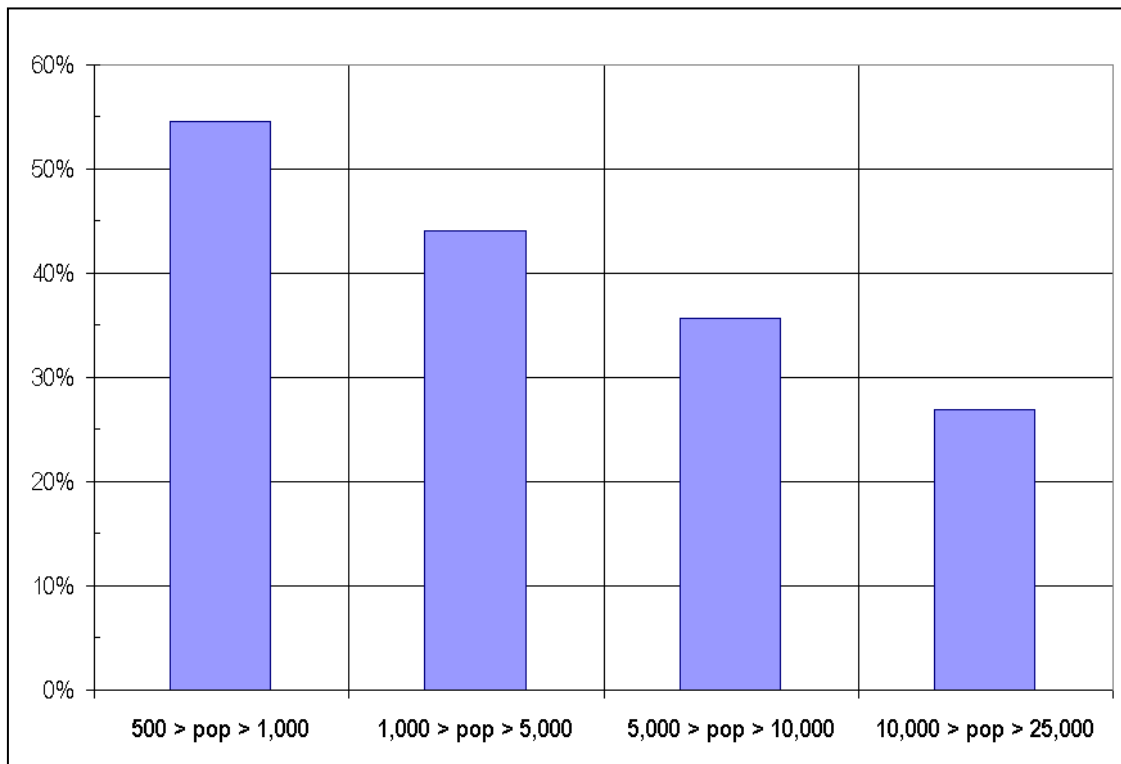


Figure 5 ~ Likelihood of Water / Wastewater Contract Operations

➔ **Smaller cities are more far likely to outsource than medium-sized cities. The conclusion is that cities with populations less than 1,000 persons are more than twice as likely to contract operations than cities with populations greater than 10,000 persons within the study group.**

Table 3 ~ Issues Most Important to the Outsourcing Decision-making Process

Grouping	Issues	Commission Ranking	City Manager Ranking
Financial or Managerial Issues	Utility Costs / Potential Savings	1	5
	Utility Management, ability or knowledge	2	4
	Utility Staff Performance, ability or knowledge	3	3
	Utility Rates or Fees	4	6
OESR	Reliability of water service	5	1
	Water quality or customer complaints	6	2
Other	Political or partisan concerns	7	---
	Union organizing activities	8	7
	Analysis and comparison of choices	Financial or managerial over operational, environmental or service related issues	Operational, environmental or service over financial or managerial issues

Note: OESR = Operational, Environmental or Service Related Issues

The Decision-Making Process. Public administrators may possess the knowledge and ability to perform a quality decision-making process, but may not always use these tools until

circumstance warrants the effort or when they deem it necessary to reach a reasonable and practical solution. The survey found that feasibility studies (internal and external) are used only 11% of the time in the outsourcing decision-making process. Further analysis would need to be performed to find additional correlation to size and outsourcing choices.

Satisfaction with Outsourcing. City managers indicated that the most satisfying services provided by their private partners are responsiveness, reliability, consistency, and quality. It can be assumed that contract operations accomplish the utility mission for these cities; most likely do what cities need done; and are convenient to use. On the down side, in the opinion of most managers, outsourcing is less likely to be competitively priced or not worth the price. Price is an important concern for the managers that responded on this issue and cost seems to carry with it strong negatives.

Respondents seemed eager to comment about recent outsourcing experiences. One said, *“We outsourced solid waste and plan to take it back once the contract expires. [We are making this decision because of] loss of control, although the service is adequate and good most of the time now that we’ve complained.”* Another city manager stated that outsourcing is *“very efficient at operating water plant in the last city I managed.”*

To conclude a manager indicated that the jury is still out, *“We have just merged our fire department with [the] County so that will be our first experience of outsourcing a city function. Ask me next October and I will have an answer. I will tell you it is hard for a city to give up the control, because things can happen beyond what the city can control that can affect your citizens.”*

Opinion of Contract Operations Outsourcing. According to the survey, city managers have overall negative opinions about contract operations, and given the opportunity they would discourage their peers from using outsourcing. When city managers were asked, *“Would you outsource operation services to another governmental entity or a private contractor in the future?”* they answered negatively (probably not or definitely not) 45% of the time, in contrast they answered positively (definitely or probably) only 22% of the time. City managers are twice as likely to give a negative response than a positive one.

When those same managers are asked, *“Would you recommend outsourcing by another governmental entity or a private contractor to other cities or colleagues?”* they answered negatively 38% of the time, and positively only 25% of the time – they are fifty-percent more likely to give a negative response than a positive one.

The most positive respondent said, *“I know from experience that outsourcing can be very beneficial.”* But most are negative about the likelihood of outsourcing:

“As with any decision, circumstances would dictate need. However, unless there were dire fiscal problems associated with retaining city systems, it is always best to maintain control of the utilities, primarily because you don’t want your city and your residents at the mercy of a private contractor monopoly in which excessive rates and/or substandard service may result. Unlike the private sector, the public sector is supposed to serve the best interests of the residents of the community at the most reasonable cost. In contrast, the private sector is only profit motivated and services and quality may suffer as result of the private sector

maximizing profits...at the expense of the community. Further, once the baton has been passed and control is relinquished, it is VERY difficult and expensive for your city to resume utility operations IF the private sector outsource option turned out to be a failure.”

Another city manager indicated that *“with economic times as they are, we may have to look at this.”* One city expressed that *“We are unhappy with the current provider.”*

Opinions about outsourcing include this comment, *“Private contractors are required to make a profit, whereas government agencies are required to break even. The profit margin for private contractors usually comes at the expense of maintenance, customer service, and infrastructure.”* Another city manager opined, *“If it can be handled in house, it should be.”* Finally, *“Loss of control for government can be a big issue. Citizens want the best service at the least cost. Most of the time government appears to do that better.”*

Several managers expressed more neutral comments – one expressed that it *“would depend on economy and elected officials;”* another said *“We are not sure, we feel that we are backed into a corner and may not have a choice but to outsource to another city;”* and one more stated, *“At some point, the City Commission may wish to explore the possibility.”*

Discussing Outsourcing with Staff or Elected Officials. City managers are fifty-percent more likely to discuss outsourcing operations with utility management or staff (42% positive answers) in contrast to discussing the same issue with the mayor or the commission (28% positive answers).

Conclusions. This research project measures the current penetration of water and wastewater contract operations outsourcing of small and medium-sized municipalities in Florida. The literature review is used to provide models for analyzing the results, prepare survey questions, and describing the current configuration of contract operations.

The survey finds that 80% of municipalities are fully public or have limited infrastructure outsourcing whereas 20% have some level of outsourcing, with a high degree of confidence. The response rate for this survey is 42.3% and has a high statistical accuracy with a 95% confidence level and a +/- 8% margin of error and an excellent correlation to population categories.

Smaller cities (with populations between 500 and 1,000 persons) are more than twice as likely to have contract operations than medium-sized cities (populations

City managers said that while they are happy with their private partners’ responsiveness, reliability, consistency, and quality – they are of the opinion that outsourcing is *not worth the price.*

The issues most important to city managers in the outsourcing decision-making process are operational, environmental, water quality, and service related issues – primary obligations of water and wastewater utilities to customers and regulatory agencies. Financial or managerial issues are secondary.

In contrast city commissioners consider financial or managerial issues to be primary, and operational, environmental, water quality, and service related issues to be secondary.

According to these managers the following issues are not found to be significant: political or partisan concerns, union organizing activities, or regulatory concerns. Additionally the choice is made without benefit of a feasibility study in the decision making process.

According to the survey city managers are far more likely to give a negative opinion of contract operations outsourcing and are less likely to offer a positive recommendation to their peers. City managers said that while they are happy with their private partners' responsiveness, reliability, consistency, and quality – they are not as pleased with pricing. It is the opinion of most managers that outsourcing is not worth the price.

It is not likely that the 20% penetration rate for Contract Operations with small and medium sized municipalities will significantly increase unless the negative opinions about contract operators are overcome. The segment of municipalities (80%) that are fully public or have limited infrastructure outsourcing may actually grow, if comments provided by city managers provide a realistic measure. Further study might provide an indication if outsourcing is increasing or decreasing amongst these cities or if demographic and economic factors are at play in the decision-making process. The factors used in the decision-making process are varied and somewhat informal. This survey demonstrates that water and wastewater public-private partnerships are truly a mixed bag.