Date: February 19, 2019

TO: Mayor William Martin; Council President David Glenn; Council Members Jim Ringsaker, David Martin, Jason Robertson, Casandra Tomarchio and Carolyn Zinner

FROM: Havre de Grace Water/Sewer Commission

SUBJECT: **Annual Report of the *State of the Havre de Grace Water/Sewer Fund 9***

REFERENCE: **City Code Chapter 25 Article XI, Section 25-69B**

Included in this Annual Report are the following elements:

I. State of the Water /Sewer Fund and Summary for Fiscal Year 2018 (FY18)
II. Year to Date Overview of Current Fiscal Year 2019 (FY19)
III. Challenges for Fiscal Year 2020 (FY20)
IV. Recommendations for Fiscal Year 2020 (FY20)

I. STATE OF THE WATER/SEWER SYSTEM FUND (FY18) (July 1, 2017 – June 30, 2018)

Operating Revenue: FY18 ended with the Water/Sewer System (Fund 9) operating revenue at $6,460,337; $1,159,563 below budget expectations. This decrease was the result of deceases in water production and wastewater treatment revenues.

Operating Expenses: The year-end operating expenses (less depreciation) were $5,200,353; $11,647 below budget expectations.
The overall results were an Operational surplus of $1,259,984 which was $1,147,916 below budget expectations.

Capital Cost Recovery Fees (CCRF): CCRF collected for FY18 totaled $3,039,790; $643,444 above current debt obligations or about 126.84% of what was required to meet the debt obligation. Capital Improvements and Debt Expenses: Capital and Debt expenses totaled $3,880,963. Of this amount $2,396,446 was applied to Debt Service obligations, and $1,484,517 to Capital Improvements.

Capital Improvements were less than budget expectations by $2,817,783 due primarily to (1) Grant expectations and (2) WTP Capital Improvements being carried into FY 19 when completed.

Total Capital Improvements and Debt losses for FY18 were $363,707 as compared to $1,565,698 in FY17.

Fund Balance: A fund balance loss of $820,772 was carried over as compared to $2,267,079 in FY 17

CCRF:
FY18 realized a total of 177 new connections, as compared to 95 in FY17. This increase was indicative of the strong housing market in the City (Greenway Farms, Bulle Rock and Scenic Manor), as well as the construction of the new High School Middle School and a fair amount of interest in "in-fill" construction.

While revenues generated from CCRF are intended to support the Capital Improvement Plan (CIP), CCRF revenues have historically been directed to support the debt obligation. Shortfalls would then be supplemented either by the "Debt Service Fee" (which expires at the end of FY18), or contributions funded from Operations which relies on rates to balance its financial obligations. Relying solely on CCRF revenues becomes increasingly risky as the availability of connections in future years lessens due to system capacity, which decreases the availability of revenues to invest in Capital Improvements.

SUMMARY OF FY18

The challenge of the Water / Sewer Commission is to propose ways to generate adequate revenue to: (1) Cover the $2.4M annual debt service payment required to cover the cost of expanding the capacity of the City's owned WWTP by approximately 80% and the additional Enhanced Nutrient Removal costs needed to treat that increased capacity; (2) Cover the $190,000 annual debt payment incurred from the bond issuance for improvements at the WTP; (3) Cover the operational costs at both the WWTP and WTP, and (4) Cover the investment necessary to maintain a Capital Improvement Plan (CIP) that addresses the water distribution and waste water collection infrastructure much of which is approaching the end of its useful life.

Funds to address each of the aforementioned challenges are generated by three distinct revenue sources: (a) Connection fees and CCRF; (b) Rates charged to customers for the purchase of water (which includes a sewage rate component); (c) The 2014 imposed Debt Service Fee (which expired at the end of FY18). All combined, these three revenue sources historically continue to underperform the revenue necessary to meet the City's obligations for debt and for any realistic CIP.
Note: 139 new connections annually are required to meet the current debt obligation.
As stated in previous Water/Sewer Commission Reports, in order to generate additional revenue without increases in rates and/or fees the goal is to increase both usage and connections. Although the implementation of the Debt Service Fee infused much needed revenue into the revenue equation, it by itself only represents about 25% of the total amount of revenue needed to satisfy the current debt obligation, which then becomes dependent upon connection revenues generated from the CCRF. While FY18 enjoyed a very favorable increase in connections, as previously stated in this report, it is well understood that this degree of annual growth is not sustainable.

The Mayor and City Council continued their efforts in recognizing the distressed state of the Water/Sewer Fund, and their planned approach in addressing the shortfalls by implementing the following measures: (1) Legislative action continuing a debt service fee in FY16, FY17 and FY 18; (2) Rethinking the "business as usual" mentality by (a) embracing planned and approved development projects with sensible connection incentives; (b) through the Department of Economic Development- developing a strategy to encourage future economic growth through aggressive efforts to attract high volume water users; (c) focusing on the housing inventory through marketing campaigns and City-wide improvements to draw new residents to the City; (d) discontinuing the Harford County agreement, whereby water sales to the County were at a significant loss; (e) supporting the capital investment plan at the WTP to increase production capacity; (f) completion of the GHD water and sewer distribution and collection system modeling of the entire City, in order to develop both a short and long term CIP; and (g) entering into negotiations with the City of Aberdeen and developing a cost effective water purchase agreement that will be beneficial to both Cities.

While the aforementioned measures continue to be positive steps as demonstrated by the solvency of Fund 9 at the end pf FY18; the Mayor and City Council must continue to be creative as well as diligent in their efforts to generate sufficient funding to meet the operating requirements, the debt obligations and in investment in those capital improvements that have been neglected for so many years. Meeting the revenue requirement can only be accomplished by the following methods (a) raising rates; (b) creating fees; (c) increasing usage (internal or external); and (d) connections or a combination of some or all the aforementioned methods.

II. <u>YEAR TO DATE OVERVIEW OF CURRENT FISCAL YEAR 2019 (FY19)</u>

The Commission remains confident that the challenges in the Water/Sewer Fund are recognized and understood by the Mayor and City Council. This is evident by the acceptance and execution of the FY19 Water/Sewer Commission's recommendation of 6% rate increase and the commitment by the Mayor and City Council to continue addressing strategic initiatives through sound short and long term planning which include the following actions: (a) awarding the WTP improvements contract which will not only invest those bond proceeds from the passage by referendum of a $2.4M bond bill in May 2016 to address the much needed WTP Capital upgrades, but also committing additional funding to address the repair and upgrading of long standing maintenance issues; (b) addressing critical components through the implementation of preventive maintenance repairs of both the Water and Waste Water Systems, including the continuation of a robust valve and hydrant replacement program and the replacement of the sewer line at Warren Street; (c) exploring a more realistic County-City Water Agreement; (d) negotiating the sale of water to the City of Aberdeen; (e) establishing budgetary CCRF projections that are realistic and attainable; (f) the continuation of educating Havre de Grace citizens on the adverse effects from Fats, Oils and Grease (FOG) and Sanitary Wipes that are infiltrating the City's Waste Water Collection System; (g) a $500,000 purchase of new Sewer Truck that will improve efforts in maintaining collection and distribution systems; (h) the completion of a system-wide analysis of the entire water distribution system by GHD; and (i) the development and prioritization of a short and long term Capital Improvement Plan (CIP).

Although there is much more work to be done to maintain solvency in the Water / Sewer Fund, there is evidence that those strategic initiatives identified in FY16 and FY17 continue to produce positive results not only in FY18, but in FY19 as well. While CCRF projections appear to be on target to slightly exceed budget expectations, overall usage is less than expected, even with a reduction in the number of unoccupied housing inventory and the very strong increase in new houses being constructed. Overall economic conditions appear to be improving with the commitment to invest in aggressive marketing and advertising funds budgeted by the City, which have resulted in the attraction of new businesses and home purchases. This is evident by a decrease in downtown retail vacancies; robust sales in new home construction in the Scenic Manor, Greenway Farms and Bulle Rock neighborhoods, as well as an increase in 'in-fill' construction.

To remain solvent in FY19, the Water/Sewer Fund must continue to show favorable progress in operational efficiencies and CCRF to meet the challenges of lower than expected usage revenue and the expected loss in revenue from the elimination of the Debt Service Fee.

III. <u>CHALLENGES FOR FISCAL YEAR 2020 (FY20)</u>

It is critical that a continued commitment in generating the necessary revenue to maintain solvency in Fund 9 is required so that the City's debt obligations are met and equally important is the revenue that is necessary to meet the investment in Capital Improvements of the aging Water distribution and Waste Water collection systems. While there have been small but recognizable strides which have improved the future health of the infrastructure. Failure to continue this practice of investment will prove to place an increased burden on an already antiquated distribution and collection system. Insufficient investment in Fund 9's critical infrastructure creates an increased risk of unplanned and costly emergency repairs at inopportune times.

<u>IV. RECOMMENDATIONS FOR FISCAL 2020(FY20)</u>

As required by City Code the following are Recommendations for FY19. Chapter 25 Article XI, Section 25-69B.

While Fund 9 is currently solvent, revenues are inadequate to cover normal maintenance and operation (M&O) costs, service the Fund's debt obligations and properly fund the Capital Improvement Plan (CIP). Resulting from significant due diligence over the past years the Department of Public Works has prepared a CIP that recognizes the critical capital improvement needs of the WTP, WWTP and the distribution and collection systems. Movement on implementation of the CIP is critical and strongly recommended while continuing to fully support M&O activities and servicing the debt.

In support of these objectives the commission submits the following recommendations.

1. We commend the Administration in identifying failures, repairing critical components and committing to improvements at the WTP and the continued emphasis on the reductions in operating expenses using best practices.

2. The distribution of employee capital, (i.e. electronic time management system) will better capture where and how employee assets are allocated, specifically between Fund 1 and Fund 9. Implementation will be ready for late FY19 or early FY20.

3. Capital investments in automated monitoring and adjustment systems (i.e. SCADA System) should improve efficiency. This work should continue until completion in FY21.

4. Debt Service - Under the current debt repayment model the intended revenue source is the CCRF. For the CCRF to service the debt it requires 139 new connection in a year in order to cover debt payment. The projection for FY20 is only 80 connections. This represents a projected $1,000,000 short fall (assumed connection fee of $17,200). It is recognized that the additional connections above 80 may occur and the addition of new revenues from the sale of water to the City of Aberdeen could relieve this short fall; however, additional revenue will be required. It is recommended that an aggregate of the following sources of additional revenue be considered. Reference Exhibit A for example revenue increase opportunities.

    a. Increase both the Water and Sewer rates
    b. Implement a Capital Improvement Fee or other type of Fee
    c. Increase the CCRF
    d. Pursue additional water sales

5. The Director of Public Works should continue to perform an in-depth study of the current CIP and create a tiered priority list based on critical infrastructure and component needs with a breakdown of each Project/Cost and identify its relationship by Water Distribution, Sewer Collection and Operations. Fund 9 should no longer consider improvements based solely on Capital Improvement Grants, but rather should initiate a budgetary line item that addresses Capital Improvements based on the developed priorities list.

6. Alternative revenue sources or methods should be considered to include revamping the current strategy of how revenue is generated to meet the current debt, operations and capital needs. Careful considerations should include conversations relative to rate structure variations and alternative fees (such as a Capital Improvement Rate Fee or a New User Fee) as described in the Black & Veatch Report.

7. Black & Veatch recommendations

    a. The Department of Public Works engaged Black & Veatch (B&V), a leading US based global engineering consulting and construction firm to:
        i. Develop a forecast of the renewal and replacement requirements for the water and sewer infrastructure
        ii. Align the existing CIP with the renewal program through a five year financial plan
        iii. Design a rate schedule and fee structure
    b. The reason for commissioning this study was to obtain an unbiased assessment, by an industry subject matter expert, of the age-old issues associated with Fund 9, which include:
        i. Increased funding deficits resulting in revenues not adequate to meet all expenses and capital requirements.
        ii. Constraints to the critical reinvestment in infrastructure, which impact operational performance and cause limitations.
        iii. To measure the material condition of the City's infrastructure, and confirm those portions that are nearing end of life.
        iv. Increases in costly unplanned repairs as the infrastructure continues to fail.
    c. Based on the results of the B&V study the City could then develop an implementation plan that supports meeting the financial requirements of Fund 9, including:
        i. Implementing a CIP.
        ii. Servicing the current debt and future debt obligations.
        iii. Creation of a Rate Stabilization Fund (RSF) that would temper future sharp increases in rates.
        iv. Create a revenue reserve for a catastrophic event.

d. The Water/Sewer Commission congratulates the Administration for the commissioning of the B&V study, and agrees the assessment was thoroughly executed and should be viewed as a road map for addressing challenges of Fund 9. The Commission also is realistic and understands implementing the entire plan and the timetable as written (as Harford County did), would have an adverse immediate impact on our customers. The Water/Sewer Commission does recognize that a partial, phase in implementation with an extended timeline could be considered to begin the process of turning the fund around, with the goal of Fund 9 achieving self-sufficiency (See Exhibit 1). However, extending the timeline has both a financial and operational risk.

8. Legislatively mandated annual revenue increases to meet the annual increases in Operating costs to maintain rising employee and chemical costs should be considered. In light of the potential challenges in FY20 with servicing the debt, the administration should be sensitive to any pressure to use water and sewer rate revenue to pay debt. However, consideration must be given to the possibility of additional revenue generated in water sales should a renewed County-City Water Agreement come to fruition in addition to the Aberdeen revenue. Those revenues, along with operational efficiency gains may temper the rise of rates. However, the gap between savings in operational efficiencies and true operational cost is quickly closing, as the Administration has a performed favorably in vetting out cost reduction measures in both labor and materials. As with any service, wage and material costs do not remain static therefore rates must increase systematically to meet those costs. Further stress will push the rates higher to prop up the debt payment and capital requirements since the Debt Service Fee has been eliminated and a CIP was not funded.

9. The Administration should transfer the responsibility for supporting the cost of supplying water lines and hydrants from Fund 9 to Fund 1 as it is a public safety function rather than a water / sewer function.

10. Continued emphasis on an Employee Succession Plan for both the Water Plant and Waste Water Plant needs to be addressed. Many current

employees are certified by the State of Maryland and a possibility exists that the City could lose more of these employees in the near future through retirement and normal attrition. A first step should be to consider the creation of an Apprenticeship program for both facilities.

11. The Administration should continue its efforts in the implementation of a City-wide Fats, Oil, Grease, (FOG) and "Flushable Wipes" (and other foreign matter) reduction and education program. FOG and "Flushable Wipes" are a nationwide problem that also occurs within our collection system.

12. The Administration should be commended for its pro-active approach in marketing to alternative water customers, including those outside of the City of Havre de Grace (Harford County and Aberdeen). These efforts and strategic planning should continue to include:
    a. Aggressively marketing of new businesses that require high volume water use, and consider affordable incentives to attract the same.
    b. Negotiations of the current Harford County / Havre de Grace Water Plant and Water Purchase Agreement to include the possible use of the Route 40 County Water Line, with the primary focus of creating a mutually beneficial relationship.
    c. Annexation of areas along the Route 40 corridor, Maryland Avenue neighborhood, Shawnee Brooke and residences along Chapel Road and Susquehanna River Hills.
    d. Evaluations of current Water and Waste Water capacity allocations and consider placing time tables on Developers.
    e. Considerations of the impacts of the future relocation of the hospital and repurposing of the current Harford Memorial Hospital
    f. Investigation of whether a Waste Water Capacity Credit Sharing Program is viable.

Respectfully Submitted,

Havre de Grace Water/Sewer Commission

Tracy Conaway-Deputy Director of Finance
Fred Cullum– Citizen Member
Steve Gamatoria, Chief of Staff
Teresa Gardner – Director of DPW
Joe Kochenderfer – Citizen Member (term expired October 2018)
Garrett Lyttle – Citizen Member
David Martin, Council Member & Commission Chair
Harry Miller- Citizen Member
Jason Robertson- Council Member
William Russell- Citizen Member
Dan Wusinich – Citizen Member

Exhibit A

The following two tables provide potential rate and fee increases that would provide an estimated $1,000,000 revenue increase.

Quarterly Charges	Current FY	FY20	Percent Increase	Estimated Revenue Increase
Water Rate	$6.20	$7.01	13%	$415,000
Sewer Rate	$9.30	$10.51	13%	$481,000
Capital Cost Recover Fee (CCRF)*	$17,200	$18,500	8.6%	$104,000
Base Service Fee	$18.75	$18.75	0%	-
Debt Service Fee	-	-		-
Total Estimated Revenue Increase				$1,000,000

* Assumes 80 new connections for FY20

Quarterly Charges	Current FY	FY20	Percent Increase	Estimated Revenue Increase
Water Rate	$6.20	$6.57	6%	$190,000
Sewer Rate	$9.30	$9.86	6%	$220,000
Capital Cost Recover Fee (CCRF)*	$17,200	$18,500	8.6%	$104,000
Base Service Fee	$18.75	$18.75	0%	-
Debt Service Fee	-	$21.50		$486,000
Total Estimated Revenue Increase				$1,000,000

* Assumes 80 new connections for FY20