



Smart Management for
Small Water Systems

Private Water and Sewer Companies

Understanding what their role may be with your system

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2:00 – 3:00 PM EST



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Polling Question 3

What is the role of private companies at my utility?

(choose one)

- They already play a role with my system
- I think there is a role they can play with my system
- I've heard of the concept but don't know enough to say they should play a role with my system
- I don't think private systems should have a role with my system



Prime Objectives

- Who are these private companies?
- How do they work?
- Why are they interested in investing in your system?
- Why you may be motivated letting them invest in your system?
 - What is your role?
- What can they do for you?
- What can't they do for you?
- Questions and answers



Things to keep in mind during the webinar

- We will be talking about some publicly traded companies. Nothing said should be considered investment advice or an endorsement of one company over another
- All progressive utilities (public or private) should be flexible enough to make adjustments to their model
 - One solution does not fit all
- There are good and bad actors in every profession



Private companies are just another tool in the toolbox





Who are private water and sewer companies?



Publicly Traded



Privately Held



Foreign Owned



Publicly Traded



AMERICAN WATER

AQUASM





Privately Held





Foreign Owned





How does the private system work?





What is rate base?

Rate Base		
Plant in Service		\$ 1,200
Accumulted Depreciation		\$ (300)
Net Plant		\$ 900
Fuel Inventories		\$ 90
Materials and Supplies		\$ 30
Cash Working Capital		\$ 10
Deferred Income Taxes		\$ (30)
Total		\$ 1,000



Cost of capital – Science or art?

Cost of Capital			
	Ratio	Cost	Weighted Cost
Debt	50%	10%	5%
Equity	50%	14%	7%
	100%		12%

Revenue requirement – Nothing is guaranteed

Revenue Requirement Calculation				
Existing operating revenues				\$ 660
Operating expenses other than income taxes			\$ 510	
Interest expense required			\$ 50	
Equity return required		\$ 70		
Income tax conversion factor (assume 40%)		\$ 0.6		
Equity return and income tax			\$ 117	
Revenues required				\$ 677
Gross revenue increase required				\$ 17



Why companies use a rate base model

- **Pluses**

- Provides a mechanism for a return on shareholder's equity for prudent investments that benefit the customer
- Incentives companies to make investments in infrastructure
- Allows for long term view of return
- By definition, this model charges the full cost of service

- **Minuses**

- Requires an ongoing dialog with financial regulators so there are minimal surprises in future rate proceedings
- Model can be somewhat foreign compared to non-regulatory accounting
- Lag in time between investments made and impact to rates



Other models

- Operating margin
 - Basically a “cost plus” model
 - Does not provide the same incentive for infrastructure investment
- Contract O&M
 - Moves an in-house expense to an external expense
 - With efficiencies of a larger organization, cost could be less
- Build own operate transfer (BOOT)
 - In some instances, it transfers the construction risk to the private system
 - May allow for a shorter construction timeline
 - In some cases, private companies provide financing



Utility infrastructure investment

Proactive



Reactive





Why are private companies interested in investing in your system?





Motivating factors for private companies

- Large pool of potential partners
 - About 50,000 community water systems in the United States
- Documented need for capital investments
- Investors are looking for a steady predictable revenue stream
- Operations and maintenance partnerships
 - Allow a partner to gain entry into a community
 - Spreads fixed costs over larger customer base
 - Purchasing pool becomes larger



Why may public systems be motivated in letting private systems invest in your system?





The value proposition of a private system

- In the rate base model, if private systems have the regulatory ability to do so, they are interested in paying a fair value for the asset.
- Investors want to see things done correctly.
- Private systems provide quality oversight of their investments.
- Investors have an strong desire to see your system grow and prosper.



What is the reality?

- Water and wastewater is the most capital intensive utility industry
- There is a significant fixed cost that needs to be invested to provide reliable service
- In some areas, growth has demonstrated the need for more reliable sources of supply
- Declining populations, loss of significant customers, reduction in gallons billed hurt all systems but are especially significant for smaller utilities.
- Recent extreme droughts have heightened public awareness of the issues.
- Some people still view water infrastructure as “out of sight and out of mind”
- Private companies have access to capital and need new investment opportunities



Other motivating factors to consider

- There are economies of scale when there is share of fixed costs over a larger customer base
 - Especially important if your customer base or sales are contracting
- Expense increases
- Changing environmental regulations
- Labor
 - Lost of institutional knowledge
 - Many times larger companies can offer more competitive wages and opportunities
- Allows focus on core competencies
- In some instances there is lack of political will to raise rates



What can a private company do for you?

- They can monetize your system allowing you to focus on other priorities or satisfy unfunded obligations
- They bring their own financing (debt and equity) to the partnership freeing up debt capacity
- Many large private companies bring wide ranging technical expertise
- In the regulated model, they bring financial transparency and rates based on full cost of service
- Spread some fixed costs over a larger base



And what can't they do for you?

- Provide long-term pricing that does not reflect the full cost of service
- Guarantee that there will be no changes in how they run the utility business
 - Existing employees may be asked to do more but in many cases will be compensated for the additional duties
- Growth is part of their business model
- Take all risk off the table without the ability to recover costs



What about a partnership?





Polling Question 4

What is your experience with partnerships?

(choose one)

- We are doing it!
- I like the idea and will investigate it more
- I do not want a partner. My system wants to remain independent



What are the potential partnership models?

- Total Asset Purchase
 - Partner purchases all assets and sometimes liabilities of the utility owner.
 - Profit is made
 - If investor owned, most will make their profit based on investment made (rate base).
 - In some instances, the purchaser may operate as an “operating margin” business
 - Regulatory oversight provides protections for the customer



What are the potential partnership models?

- Concession Agreement
 - Public entity pays the partner a monthly operations fee
 - Scope of work is defined in a contract
 - Profit is made
 - “On the margin” (cost plus)
 - Shared savings
 - Investments made in the system
 - A combination of all the above



What are the potential partnership models?

- Hybrids
 - Forming of a joint authority
 - May include multiple public systems with independent governance
 - May also include some participation by private systems
 - Combined ownership
 - Private company purchases assets but public utility retains the ownership of the real estate
 - Investor pays lease payment for use of real estate
 - Allows purchaser to pay seller over time
 - Provides an annuity payment to the seller
 - Special contracts
 - Build own operate Transfer (BOOT)



Preparing for a potential partnership

- Publicly owned systems
 - Keep accurate books including contributed property
 - Be realistic about what you want out of the partnership
 - Understand your partner's motivations
- Private companies
 - Be sensitive to the partners concerns
 - Understand that the relationship is forever
 - The gestation period of a deal is LONG!!
 - Changes in leadership can slow the process
 - One model does not fit all situations. Be flexible



Final thoughts

- Partnerships with private companies should be considered as another tool in the tool box
- Private companies bring their own money to the deal
- Go into all partnerships assuming they are forever
- Both sides need to have realistic expectations
 - Be flexible
- Someone will have to pay for needed infrastructure
- Success depends on having open communication with your partner and your customers



Infrastructure issues are everyone's issues





QUESTIONS & ANSWERS



Thank You!

And please feel free to contact me if you have any questions

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