The Right Balance: Utility Rates & Aging Infrastructure

2021 ICOM Annual Meeting

Tuesday, August 10th, 2021

1:30 – 2:30 PM

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SRF INDIANA

Rural Development

Panelist – Municipal Advisor/Rate Consultant

Name: Gary Smith, CPA
Title: Partner, Registered Municipal Advisor
Organization: Reedy Financial Group, PC
Primary Practice: Utility Consulting, Municipal Finance, Economic Development
Contact: Phone: (317) 820-3441
Email: gsmith@reedyfinancialgroup.com

Panelist – Bond Counsel

Name: Kimberly Blanchet
Title: Partner
Organization: Barnes & Thornburg, LLP
Primary Practice: Municipal Finance, Structuring Complex Taxable & Tax-Exempt Financings for Cities, Towns, Counties, Regional Water/Sewer Districts, Conservancy Districts, Among Many Others
Contact: Phone: (317) 231-7454
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Panelist – State Revolving Fund

Name: Bill Harkins
Title: State Revolving Fund Program Director
Organization: Indiana Finance Authority
Contact Information: Phone: (317) 234-4862
Email: wharkins@ifa.in.gov

Panelist – USDA Rural Development

Name: Rochelle Owen
Title: Director of Community Programs
Organization: USDA – Rural Development
Contact Information: Phone: (317) 295-5767
Email: rochelle.owen@usda.gov

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Presentation Overview

1. What's Going on With Rates & Charges?	• Presented by: Gary Smith
2. Traditional Utility Project Funding Overview	• Presented by: Kim Blanchet
3. State Revolving Fund (SRF) Program Overview	• Presented by: Bill Harkins
4. USDA – Rural Development Program Overview	• Presented by: Rochelle Owen
5. Working Together – SRF & USDA Co-Funding	• Group Discussion
6. Funding Tools In Summary	• Presented by: Gary Smith
7. Closing Comments	• Group Discussion

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1. What’s Going On With Rates & Charges?

Presented by: Gary Smith, CPA

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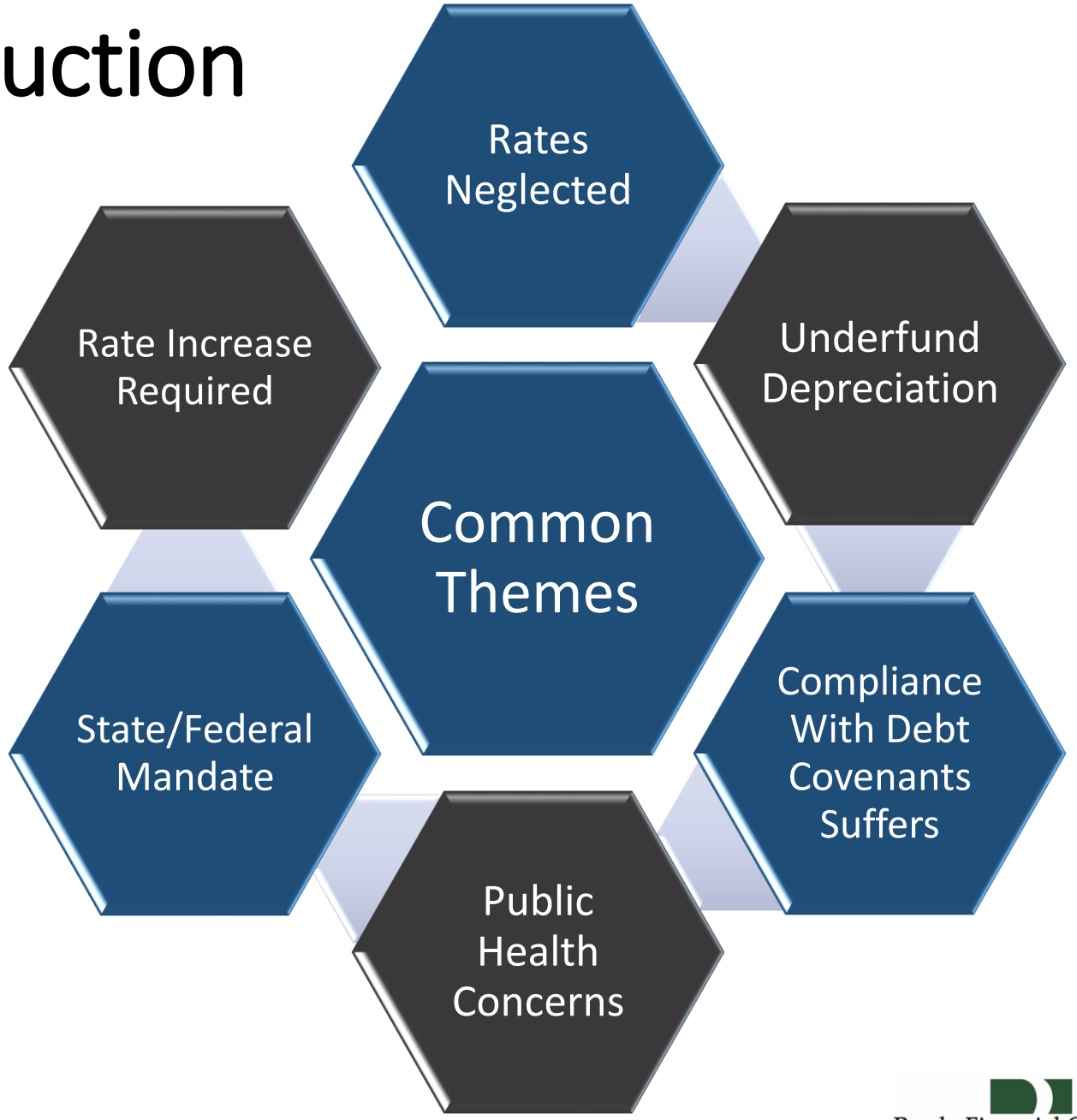
Rates & Charges - Introduction

1. It is not uncommon for municipally owned utilities to neglect rates and charges for years, if not decades.

2. Leading up to COVID, many local units were faced with mandatory rate increases to fund neglected asset replacement programs.

3. Now what? What options are available to minimize the impact to rate payers?



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	2018	2019	2020
Rates & Charges	$ 10,201,000	$ 10,303,010	$ 10,406,040
O & M Expenses	$ (7,068,600)	$ (7,209,972)	$ (7,354,171)
Revenue Available for Debt Service	**$ 3,132,400**	**$ 3,093,038**	**$ 3,051,869**
Max Annual Debt Service	**$ 2,500,000**	**$ 2,500,000**	**$ 2,500,000**
Bond Coverage	**125%**	**124%**	**122%**
Depreciation Funded	$ 632,400	$ 593,038	$ 551,869
Target Depreciation (2% UPIS)	$ 1,000,000	$ 1,000,000	$ 1,000,000
Cumulative Underfunded Depreciation	**$ (367,600)**	**$ (774,562)**	**$ (1,222,693)**

Inadequate Rates: The Impact on Depreciation

1. O & M expenses generally rise from year to year.
2. Costs easily outpace stagnant revenue growth.
   - Depreciation, PILOT, bond covenant compliance, all suffer
3. Depreciation neglect has a cumulative effect

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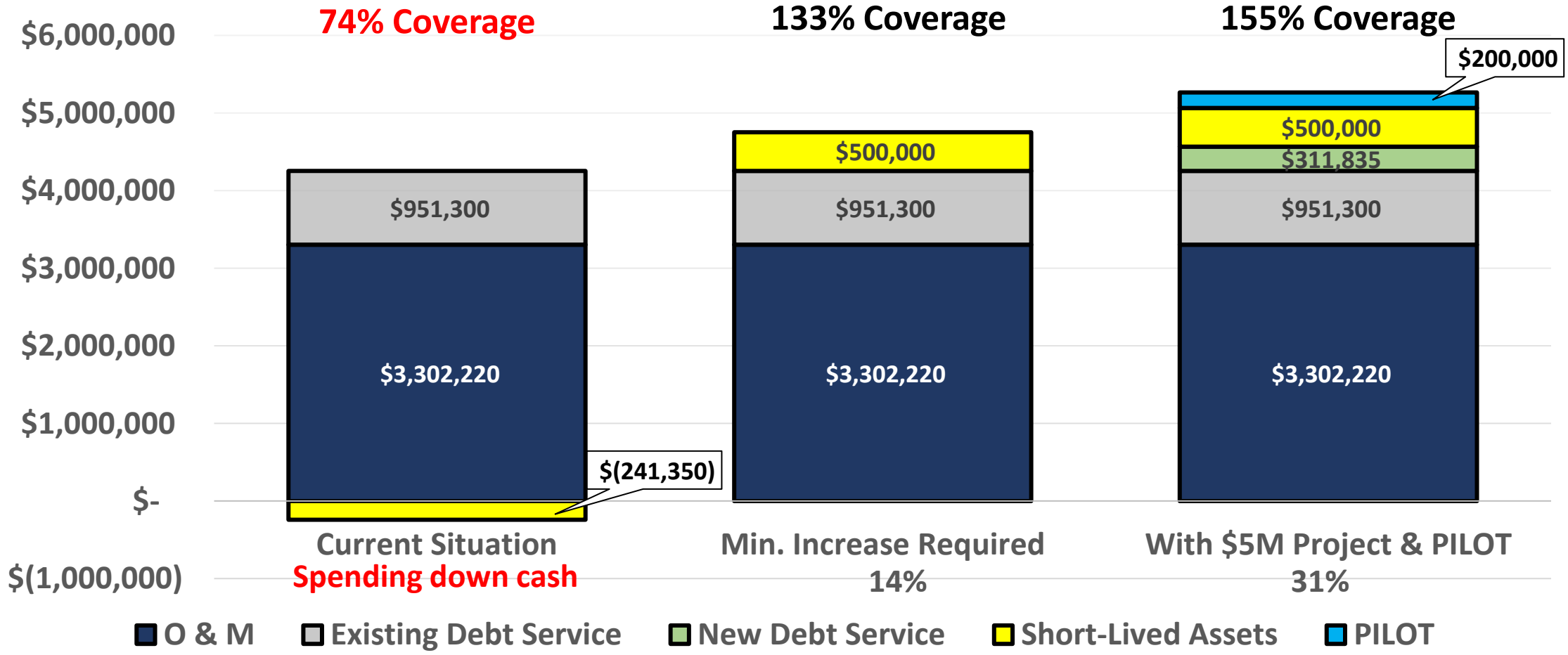
Rate Components

Note: Depreciation/PILOT funded with Utility surplus. Is the surplus adequate?



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Depreciation & Rate Neglect

Public Health

- Crumbling infrastructure (piping for example)
- Short-lived assets have been neglected
- Plant overflow (capacity) not addressed

Economic Development

- No capacity for new industrial users
- No funding source for line extension

Federal/State Mandate

- IDEM/DOJ order
  - Could be from regulation, deferred asset replacement, or plant capacity
- Limited options. Significant rate hikes may be necessary

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Rates & Charges – RFG Best Practices

Review Rates & Charges

- At Least Every 2-3 Years
- Local Ordinance may indicate frequency

Fund Depreciation & PILOT

- Target depreciation funding based on a composite factor
- Fund PILOT and Allocate Eligible City Expenditure to Utility

Adhere to Bond Covenants

- Maintain Adequate Coverage
- Make Required Monthly Transfers

Protect Rate Payers

- Systematic rate review will eliminate double- and triple-digit rate hikes
- Implement new rates and charges in phases

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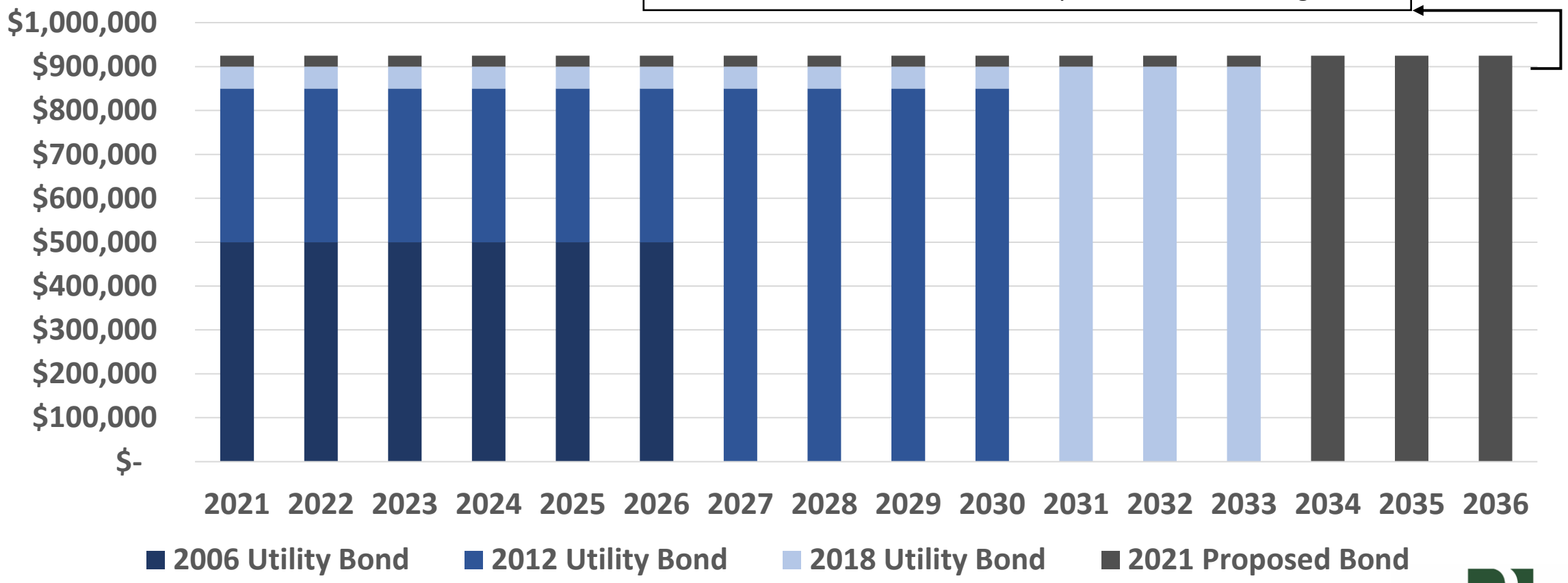
Minimize Rate Impact – Debt "Wrap"

New bond issued. Max Annual Debt Service (MADS) increases from $900k to $925k. Minimal impact on rates & charges.



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Rate Increase – Political Discussion

1. Provide rate comparison data (example)
2. Bond covenant discussion. We raise rates or bond holders will make us raise rates.
3. Failure to address rates is the proverbial “kicking the can down the road”.
4. All other avenues have been explored.

City/Town	Sewer	
Laramie	**$**	**27.56**
Shelbyville	$	29.18
Columbus	$	31.10
Laramie Proposed	**$**	**32.66**
Greensburg	$	37.65
Vincennes	$	39.22
Bloomington	$	40.15
Austin	$	41.20
Frankfort	$	43.96
Martinsville	$	52.41
Washington	$	53.90

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2. Traditional Utility Project Funding Overview

Presented by: Kimberly Blanchet

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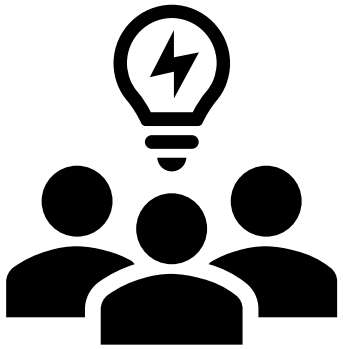
Utility Project Roles - Examples



City Required to Address Utility Rates to Accommodate New Plant Capacity Project

Engineer Assembles Preliminary Engineering Report (PER). If Project Will be SRF Funded, It Must be Designed Accordingly

Bond Counsel puts together Rate Ordinance, Assists with Financing Plan, Coordinates Public Approval Process

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Utility Project Roles - Examples

Rate Consultant Reviews PER, Sizes Financing & Required Rate Increase, Prepares Offering Docs/Due Diligence

Rates Implemented, Bond Purchaser/SRF Funds the Project

Award Bid, Fund Project Fund, Begin Construction

Tip: Don't forget to fund DSR & make monthly B & I transfers (SRF)

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Funding Preliminary Engineering Report

Cash Funded		Bond Anticipation Note (BAN)	
Pros	Cons	Pros	Cons
Less Costly	May not have the cash to fund the design	Funding source when cash is limited	More Costly (carrying costs, costs of issuance)
Award Design Contract Immediately	May need cashflow for other things	Interest only payments for up to 5 years	Need cash flow to make scheduled interest payments
		Provides cashflow to get the project to bid	

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Utility Project Roles - Examples

Introduction of Ordinances — **First Meeting**

City Council introduces a proposed Rate Ordinance. First reading of proposed Bond Ordinance.

10 Day Public Notice

10 days prior to the public hearing for the proposed Rate Ordinance, public notice must be made.

Public Hearing & Adoption — **Second Meeting**

City Council opens their public meeting for discussion on the proposed Rate Ordinance.

Formally Adopt Rate Ordinance — **Second Meeting**

After discussion, City formally adopts the Rate Ordinance, officially implementing the new rates.

Formally Adopt Bond Ordinance — **Second Meeting**

City formally adopts the Bond Ordinance, outlining the parameters and other specifics of financing.

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Traditional Financing Process

Preliminary Analysis

- Put together timetable
- Update Rate Report with cost estimates and bond sizing
- Determine Impact on User Rates

Offering Document Prep

- Draft Preliminary Official Statement/Term Sheet
- Bond Rating, Bond Insurance, Surety Funded Reserve?
- Project goes out to bid

Bond Sale

- Project bids received
- Bond size and structure is finalized
- Competitive Bond Sale (temporarily changed)

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Bond Costs of Issuance Explained

Consultants Fees

- Bond Counsel – Consults on legal process, prepares legal documentation, tax exempt certificate
- Rate Consultant – Puts together Rate Report, sizes bonds, assists the City in determining most optimal debt strategy
- Underwriter/Placement Agent Fees – Cost of having a third party negotiate directly with retail and institutional investors

Bond Fees

- Bond Insurance – Third party guarantees payment with their AA credit rating, making the bonds more marketable
- Credit Rating – Third party assigning a value to the credit worthiness of the payment source
- Surety Policy Premium – One-time sunk cost in lieu of funding the entire reserve requirement

Other

- Capitalized Interest – Interest accrued before the first payment date that is paid from bond proceeds
- Debt Service Reserve – Required for revenue bonds. Usually max annual debt service.

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3. IFA – State Revolving Fund Program Overview

Presented by: Bill Harkins

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Indiana Finance Authority
State Revolving Fund Loan Program

State Revolving Fund Loan Program

August 10, 2021

State Revolving Fund
100 N. Senate Avenue, Room 1275
Indianapolis, Indiana 46204

wharkins@ifa.in.gov
317-234-4862

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SRF Programs Provide

- Financing for drinking water and wastewater projects
- Federal funds administered by the State
- Below market interest rates
- 20-year repayment period
- 35-year repayment period for pipe projects
- Disbursements as needed

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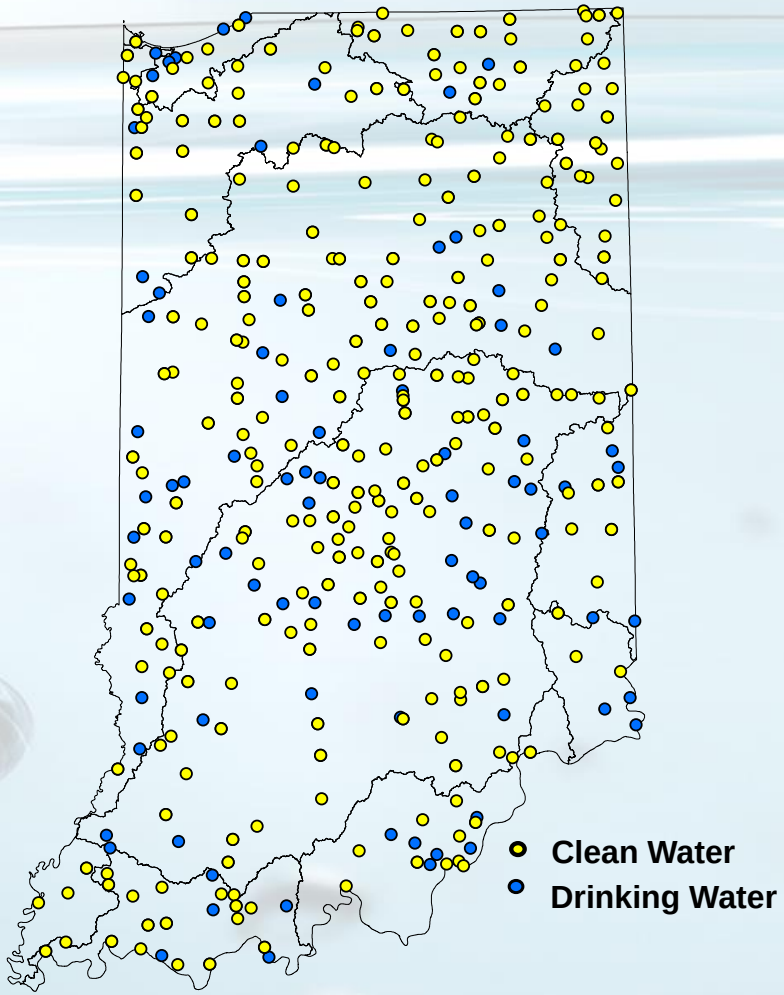
SRF Accomplishments (as of 6/30/2021)

- 622 Clean Water loans closed
- 299 Drinking Water loans closed
- Over 600 Communities served
- Over $6.1 Billion in SRF loan closings
- Estimated $322.3 million in interest savings to borrowers in the last 4 years (as compared to market)



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SRF Process

-Community submits project documents

-PER Approved

-Bid Review Complete

-Financial Due Diligence Submitted

-Loan Closing

-Project is constructed and loan drawn down

- Post Loan Monitoring

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Online Calendar

SFY 2020 SRF QUARTERLY CLOSING SCHEDULE

Updated 9.11.19

QUARTER 1

July 1, 2019 - September 30, 2019

	CLOSING DATE	BORROWER	PROGRAM
1	7/31/2019	Golfview POA, Inc.	Wastewater
2	8/8/2019	City of Fort Wayne	Drinking Water
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QUARTER 2

October 1, 2019 - December 31, 2019

	CLOSING DATE	BORROWER	PROGRAM
1	10/1/2019	Town of Greentown	Wastewater
2	10/9/2019	Citizens Water Authority	Wastewater
3	10/15/2019	Town of Hebron	Wastewater
4	10/22/2019	City of Tipton	Wastewater
5	*October*	Town of Cicero	Wastewater
6	*October*	Town of New Ross	Wastewater
7	*October*	Town of Glenwood	Drinking Water
8	*October*	City of Batesville	Drinking Water
9	*October*	City of Crown Point	Drinking Water
10	11/19/2019	Maysville RSD	Wastewater
11	*November*	Town of Mount Etna	Wastewater
12	*November*	City of Richmond	Wastewater
13	*November*	Morgan County	Wastewater
14	*November*	Town of Whitestown	Wastewater
15	*November*	Town of Chandler	Drinking Water
16	*December*	Indianapolis Airport Authority	Wastewater
17	*December*	City of New Haven	Wastewater
18	*December*	Town of Fort Branch	Wastewater
19	*December*	Steuben Lakes RWD	Wastewater
20	*December*	City of East Chicago	Wastewater
21	*December*	Delaware County	Wastewater
22	*December*	City of Evansville	Wastewater
23	*December*	Town of Hymera	Wastewater
24	*December*	City of Huntingburg	Drinking Water
25	*December*	Town of Lizton	Drinking Water
26	*December*	City of Delphi	Drinking Water

QUARTER 3

January 1, 2020 - March 31, 2020

	CLOSING DATE	BORROWER	PROGRAM
1	*January*	City of Jeffersonville	Wastewater
2	*January*	Town of Williamsport	Wastewater
3	*January*	Town of Advance	Wastewater
4	*January*	Town of Windfall	Wastewater
5	*January*	Town of Monroe	Wastewater
6	*January*	City of Berne	Wastewater
7	*January*	City of Elwood	Wastewater
8	*January*	Town of Bluffton	Drinking Water
9	*January*	Town of Prince's Lakes	Drinking Water
10	*February*	Town of Yorktown	Wastewater
11	*February*	City of Carmel	Wastewater
12	*February*	LaGrange County	Wastewater
13	*February*	Adams County	Wastewater
14	*February*	Town of Monroe	Drinking Water
15	*March*	City of Goshen	Wastewater
16	*March*	City of Frankfort	Wastewater
17	*March*	Town of Centerville	Drinking Water
18	*March*	City of Peru	Drinking Water
19			
20			

QUARTER 4 *(BYPASS)*

April 1, 2020 - June 30, 2020

	CLOSING DATE	BORROWER	PROGRAM
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20 Closings Per Quarter

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SRF Scoring and Ranking

Projects are prioritized based on the following items:

DWSRF Scoring	CWSRF Scoring
1. Address the most serious risk to human health, 2. Are necessary to ensure compliance with the Safe Drinking Water Act, 3. Assist systems most in financial need, according to the Authority's disadvantaged community criteria. 4. Bonus points available for including SRF goals (i.e. Regionalization).	1. Address the most serious risk to human health and the environment, 2. Are necessary to ensure compliance with the Clean Water Act, 3. Assist systems most in financial need, according to the Authority's affordability criteria. 4. Bonus points available for including SRF goals (i.e. Regionalization).

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SRF Addressing Affordability

1. Interest Rates
    a. Low Interest Rates
    b. Incentives to reduce interest rates:
        i. Lead Line Replacement
        ii. Green Project Reserve
        iii. Nonpoint Source
2. Additional Subsidy
3. Extended Term Financing

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SRF Additional Subsidization

- Eligibility/ need determined based on rates and Median Household Income.
- Administered via a principal forgiveness loan.
- Began as an EPA requirement in 2010
- IFA extended the program outside SRF funding in 2020

Total Additional Subsidization 2010-2021	
SRF Drinking Water	$46,649,000
SRF Clean Water	$104,886,706
Non-SRF Programs	$14,521,486
Total	**$166,057,192**

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4. USDA Rural Development Program Overview

Presented by: Rochelle Owen

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Water and Waste Disposal Loans & Grants
USDA Rural Development

Objective
Provide water, wastewater and storm water financing in rural areas

Purpose and Uses
Build, repair and improve public water systems, and waste collection and treatment systems.
Other related soft costs (engineering, land, legal, etc.)

Applicant
Public Entities
Non-profit Corporations
Water or Sewer Districts

Financing Types
Direct Loan - for rural areas populations of 10,000 & ↓
Revenue, GO, or mix of the two

OneRD Guarantee (up to 80%) – for eligible populations of 50,000 & ↓
Banks apply

When to Apply
Continuous applications every Fiscal Year beginning Oct 1

Cost Savings
Our applicants have limited economy of scale. The subsidy ***is*** the **term** and **rate**, allowing for communities to fulfill asset management/SLA replacement/O&M at full capacity by limiting debt service costs (fixed costs) so the balance of monthly rates can operate their facilities (variable costs).

Water and Waste Disposal Direct Loans & Grants

Direct Loan/Grant

- Direct loan or direct loan and grant
- Service areas with MHI below $55,784 may be considered for grant assistance with high EDU costs above their rural peers

Term & Interest Rates

- Up to 40 Year Term
- Market at **2.25%** (>$55,784),
- Intermed **1.750%,**
- Poverty **1.375%** (<$44,627) with health and sanitary correction
- Interest rates for July 2021 quarter

Eligible Populations

- For rural areas and towns populations of 10,000
  - Utilities apply directly for their customer base
  - Big systems can borrower for the rural customer base

5. Working Together – SRF & USDA Rural Development Co-Funding

Group Discussion

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Rural Development & SRF Joint Project Discussion

Funding Source for Rural Development Construction

Problem: Rural Development loans do not close until the project is complete

Solution: SRF's Interim Financing programs offers a funding solution to get the project to completion.

Minimize Rate Payer Impact

SRF Program

- Utilize 35-year SRF financing for the piping components of a project
  - Benefit from the SRF subsidized rate & 35-year financing
  - May qualify for forgivable loan, subject to monthly user rate thresholds

Rural Development Program

- Utilize 40-year Rural Development for plant upgrade components of a project
  - Benefit from the RD subsidized rate & 40-year financing
  - May qualify for grant dollars

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6. Funding Tools in Summary

Presented by: Gary Smith, CPA

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Funding Tools in Summary

Traditional Funding		SRF Program		Rural Development	
Pros	**Cons**	**Pros**	**Cons**	**Pros**	**Cons**
Straightforward Process to Close	Traditional Bond Fees (Rating/Insurance/DSR /Credit Enhancement)	IFA AAA Subsidized Rates	Complex Process to Close	Subsidized Rates	Complex Process to Close
Quick Timeline: Approval>Bid>Issue Bonds	Bonds May Not Be Marketable – Poor Financials	20-35 Year Amortization Options	More onerous design process	40 Year Amortization Option	More onerous design process
Minimal Post Issuance Compliance	Limited Amortization Options (Usually 20 Years)	Forgivable Loan Dollars Available	Tedious Post Issuance Compliance	Grant Dollars Available	Many constraints on who is eligible
Streamlined Design Process		Many traditional bond fees are avoided		Many traditional bond fees are avoided	
Market Rates – Pro if Credit is Good					

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7. Questions & Answers

Group Discussion

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