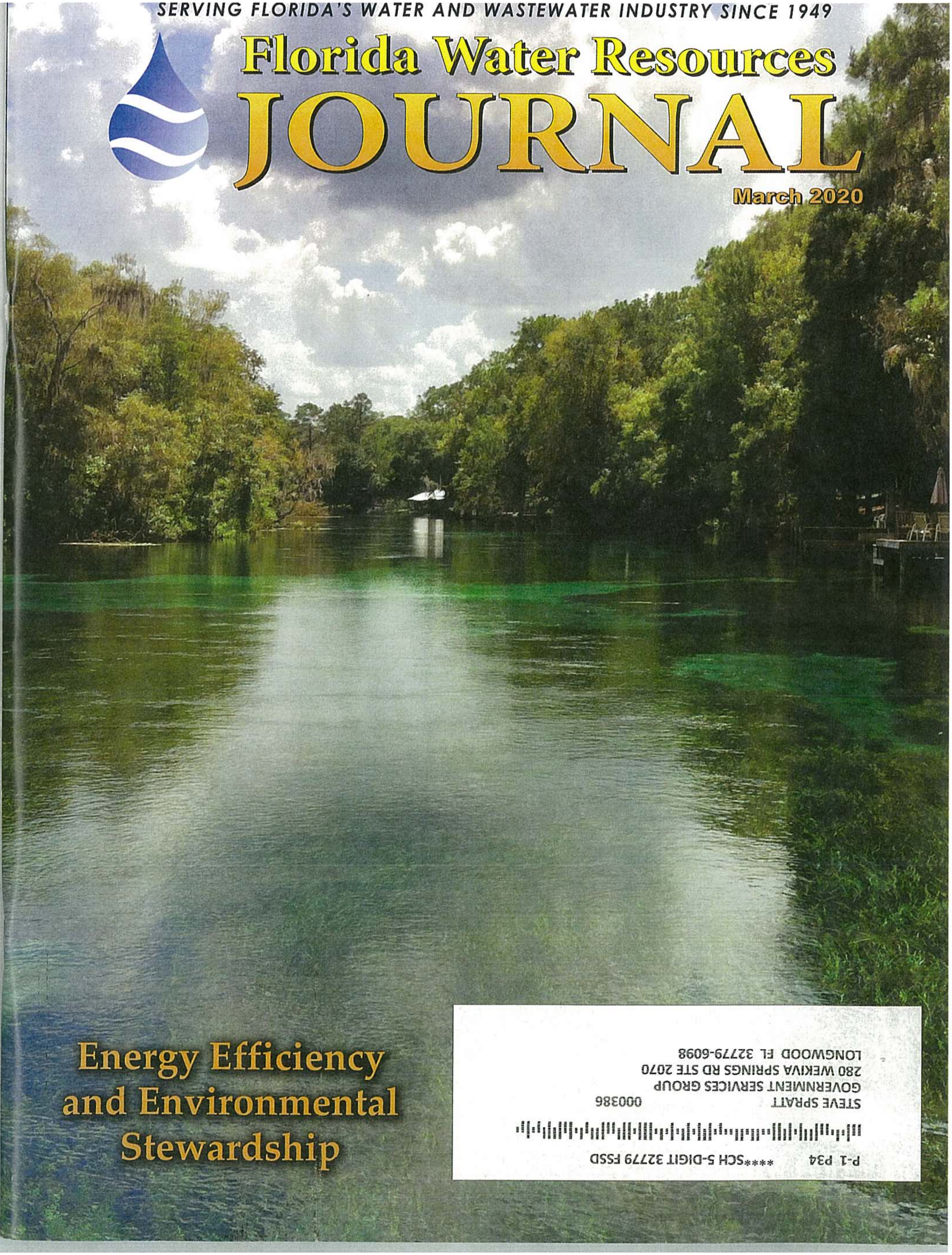
SERVING FLORIDA'S WATER AND WASTEWATER INDUSTRY SINCE 1949

Florida Water Resources JOURNAL

March 2020



Energy Efficiency and Environmental Stewardship

P-1 P34 ****SCH 5-DIGIT 32779 FSSD
STEVE SPRATT 000386
GOVERNMENT SERVICES GROUP
280 WEKIVA SPRINGS RD STE 2070
LONGWOOD FL 32779-6098

It's Time for P4: A Different Way to Manage Utility Services

Honey Rand

The City of Dunnellon had a struggling and costly water and sewer system. Most water and sewer utilities are revenue generators for local governments; Dunnellon, however, had serious challenges and they were piling up.

The Challenges of Growth

In July 2011, the city had 1110 customers; by January 2012, its customer base had swelled to 3205. More than 65 percent of the customers were outside the city limits in acquired formerly private systems. It was planned to place an out-of-city surcharge on those customers to finance the system acquisitions.

The plan was challenged in court, and Dunnellon abandoned the surcharge proposal, leaving the city with high debt, strained staffing, revenue constraints, and high rates. The city was in urgent need of improvement, including regulatory and environmental compliance projects. By 2017, its utility was seriously struggling. City leaders hired consultants to assess the situation and recommend strategies for the utility.

The consultants recommended three potential approaches:

- Outsource operations
- Rebuild the city department
- Divest and sell the system to a private utility

The choices came down to two: divesting or outsourcing operations and maintenance (O&M) services. The city council debated the merits of outsourcing or selling, either of which would bring significant rate increases. The utility, however, already had some of the highest rates in the area.

The Privatization Option

In the United States, privatization has never been a favorite option among government water/wastewater service providers. While many local, regional, and state governments outsource some services (including O&M), most prefer to maintain strict control over source water extraction, operations, and distribution and wastewater collection and treatment. About 75 percent of water/wastewater utilities in the U.S. are owned and operated by a government entity.

Dunnellon, a beautiful little community positioned in a spring shed area that includes the Rainbow and Withlacoochee rivers, was concerned about costs for customers, ensuring quality service, and regulatory and environmental issues. Dunnellon wanted—no, needed—to get to the best answer for its community. It needed a way out—a sustainable path going forward.

A New Path Forward

When Robert Sheets established Government Services Group (GSG) more than 22 years ago, his vision was to be a partner with local governments by providing, from the private sector side, quality public sector options, services, and support. In 1999, GSG, in response to requests from local governments, found a solution based on legislation that passed in 1969. That year, the Florida Legislature adopted legislation that allowed for the formation of collaborative utilities.

"All over Florida, governments were telling us about the challenges of dealing with small package plants for water and wastewater service delivery. These facilities were built by developers to serve new construction—sometimes small neighborhoods, sometimes larger areas," Sheets said.

Local governments were plagued by expensive and sometimes poorly functioning small water and wastewater plants, which dotted communities throughout the state. Sometimes, the developers sold the plants to private utilities; occasionally, they were transferred to the users. But consistently, the utilities cost more to operate, maintain, and improve, and struggled to be profitable. This led to maintenance deferrals, customer complaints, and other management issues.

Residents often complained to local governments begging for relief from high rates and low-quality service. In some cases, drinking water quality suffered, and residents were concerned about health and environmental issues.

Searching for affordable and accessible management solutions on behalf of local governments, GSG established the Florida Governmental Utility Authority (FGUA) in 1999.

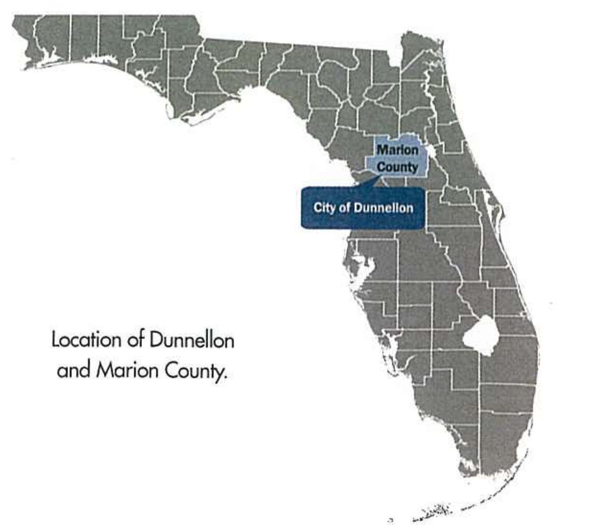
The purpose of FGUA was to create a structure for local governments to work together to acquire and manage these facilities on behalf of the member governments, which initially included Brevard, Lee, Polk, and Sarasota counties.

Since then, FGUA has bonded more than $1 billion in funding for water and wastewater facilities, and currently serves 120,000 customer connections dispersed across Florida in 13 counties and 86 communities.

The FGUA has no employees, though it's a special-purpose govern-

Continued on page 6

City of Dunnellon Wastewater Treatment Plant.



Location of Dunnellon and Marion County.

Continued from page 4
ment held to all of the Sunshine Laws, and the transparency and accountability standards of every local government. It's like an expressway authority or port authority, but for water and wastewater management.

The FGUA board of directors is comprised of government officials appointed by the member governments where the utilities are located. They are not elected officials, but are city or county managers, utility directors, and other executive staff. The board oversees and directs FGUA policies, plans, and operations, but the member governments are not liable for any debt.

Not every FGUA system "host government" decides to join the board, but each has the right to join when the FGUA acquires its facilities. For example, FGUA provides water and wastewater services to 25 systems in Lake County; the county elected not to join the board, but it operates under an interlocal agreement. This model has been so successful that FGUA has been contacted by other local governments to establish similar structures outside of Florida.

Dunnellon Takes the Plunge

After considering its options, Dunnellon turned to FGUA. It was a fourth option beyond the normal public-private partnership (P3)—a public-public-private partnership, or P4. While every utility transfer and contract is complicated, Dunnellon's situation called for more than due diligence.

In a public meeting, Rick Hancock, Dunnellon's vice mayor, noted that when the city took ownership of the systems in Rio Vista, Rainbow Springs, and Juliette Falls, the city "outgrew" what it had to "effectively manage, control, or afford" the utilities. "We also lost the ability to make these utilities a reasonable value to the utility or user," he added. "Debt costs will be high, and capital replacement could go unfunded. The FGUA option allowed us to get out of excessive debt and out of the management responsibilities."

To effectively manage customer rates, however, FGUA would have to do more than leverage its A-grade credit rating; it would need to seek additional funds from the state or federal government for improvements to lower the cost of the capital and ensure environmental protection. Because the majority of Dunnellon's customers live in unincorporated Marion County, the county would need to sign off on any purchase agreement.

Concerned about its residents, and having already taken a pass on acquiring Dunnellon's water and sewer system, the county was prepared to support the best solution for customers. It already had representatives sitting on the FGUA board, and there are nine other FGUA systems in Marion County.

The P4 alternative from FGUA provided a level of accountability and participation that privatization alone never could. Different from a P3 solution, all of the risk would transfer to FGUA, lifting a considerable expense and liability from Dunnellon. Better still, having acquired so many facilities over two decades, local governments know that FGUA is "one of them." Moreover, FGUA comes with significant financial benefits.

Rainbow River.

As Dunnellon's city council evaluated this opportunity, FGUA began the due diligence process. It took nearly a year to understand and document the system's condition and finances and find appropriate funding. The working plan called for FGUA to execute the priority capital improvement projects, including removing small wastewater plants and septic systems in a fragile spring shed, abandon an outdated wastewater plant in Rainbow Springs, and interconnect that system with an existing environmentally compliant city plant. The FGUA also took over operation of the utility in advance of the acquisition.

National Involvement

The FGUA began pursuing a loan from the U.S. Department of Agriculture Rural Development Loan Program for the acquisition. The loan has very low financing costs that are highly favorable to customers and it would replace the city's higher-cost debt. "By using low-cost loans, we reduce pressure on the system," explained Steve Spratt, GSG vice president for municipal services and FGUA system manager. "If we acquire it, we improve the system, maintain it, and stabilize rates; we also fix many items and overhaul plants. I think we're uniquely qualified to do all of these things and improve the system."

Because it's a government entity, existing and future grants from the Florida Department of Environmental Protection (FDEP) and the Southwest Florida Water Management District could be assigned to FGUA to carry out critical environmental projects.

"We're all very familiar with the poor choices made in the past that have gotten us here," said Hancock. "With this sale, the city should no longer have to apologize for those mistakes, and it's time to turn the page. Dunnellon can now spend its time and energy moving forward to new opportunities. The sale of the city utility is in the public's best interest, and in the interest of all the public partners."

The Deal

The term sheet included no rate increases upon acquisition and a consumer price index adjustment could happen in 2020, but FGUA has said it will decide what to do based on conditions at the time. The rate consultant (before the FGUA acquisition) estimated that, under continued city ownership, rates would have had to increase by 17.45 percent.

The total purchase price was $12.2 million. After paying off $10.8 million in existing debt and other transaction fees, Dunnellon was left with $1.323 million for its general fund to replenish its reserves. The FGUA received all existing cash balances, including a bond construction fund to complete priority capital projects. The FGUA also applied for and received the first-ever Department of Agriculture Rural Development 40-year loan at 2.75 percent interest amortized over 30 years. This new debt structure results in savings to customers of $250,000. The city is eligible for future payments beyond reserved capacity for new connections up to 10 years.

A $2.3 million springs grant from FDEP was reassigned to FGUA as a priority environmental project. The FDEP added an additional $2.7 million for expanded protections. The FGUA will own the facilities for a minimum of five years, after which the city has first right of refusal to reacquire them, and if they pass, Marion County can purchase them.

"This deal represents the best option for the citizens of southwest Marion County who are served by this system," said Walter Green, Dunnellon mayor. "Every effort will be made to continue to work on every grant opportunity that's available through federal and state levels, and all grant money goes right back into the pockets of the citizens."

All contractual items were approved unanimously by the FGUA board, the Dunnellon city council, and the Marion County Commission, and there was no opposition at any public meeting. As it turned out, the search for a solution proved to be one that was win-win-win for everyone involved—especially the customers.

Honey Rand, Ph.D., is an author living in Tampa.