

City of Pontiac Water and Sewer Systems Improvements and the Impact on Water and Sewer Rates

Background: The City of Pontiac will be making critical improvements of \$16 million in its sanitary sewer system and \$5.5 million in its drinking water distribution system. These vital investments will keep the City in compliance with regulations, ensure the safe operation of the water system, and build reliability along with efficiencies into our operations. In order to minimize the cost of the improvements to the customers and rate payers, the City has applied for and received preliminary approval for low interest financing and subsidized payments through the State of Michigan’s State Revolving Fund (“SRF”) and Drinking Water Revolving Fund (“DWRP”) loan programs. These State programs will allow the needed improvements to be completed within the required timeframes and enable the City to minimize its overall costs, especially financing costs.

Through the State programs, the City will be able to obtain financing with a low (below market) interest rate of 2.5% and take advantage of American Recovery and Reinvestment Act (ARRA) funds that provide up to 40% forgiveness of the project costs. Effectively, this means that the City will pay a **lower** amount for the projects than the actual project cost, and the programs will allow the City to spread the cost of financing the projects over as much as 20 years, thereby reducing the impact of the projects on the Water and Sewer Funds. The proceeds from these bonds reduce risk substantially because they will enable capital improvements before there is a crisis or a potential catastrophic situation. Without these bond proceeds the City might not have sufficient funds to cope with a major emergency in these water systems. Also, without this highly favorable bond program the City probably would not be able to borrow through other means because the City currently has bonds that are rated CCC, the second worst category, by Fitch.

Water and Sewer Rate Impact: The City’s water and sewer rates have not been increased since July 2005. A summary of the water and sewer rates, both current and proposed, as well as the projected impact of the increases on a typical household, is shown below:

	Rates			Typical Monthly Costs*		
	<u>Current</u>	<u>Proposed</u>	<u>Increase</u>	<u>Current</u>	<u>Proposed</u>	<u>Increase</u>
Water						
Meter Charge (per month)	\$5.21	\$5.68	\$0.47	\$5.21	\$5.68	\$0.47
Administrative Charge (per month)	\$6.31	\$6.88	\$0.57	\$6.31	\$6.88	\$0.57
Flow Charge (per 100 cubic feet)	\$2.14	\$2.33	\$0.19	\$19.62	\$21.39	\$1.77
Sewer						
Meter Charge (per month)	\$3.59	\$4.66	\$1.07	\$3.59	\$4.66	\$1.07
Administrative Charge (per month)	\$5.69	\$7.39	\$1.70	\$5.69	\$7.39	\$1.70
Flow Charge (per 100 cubic feet)	\$1.86	\$2.41	\$0.55	\$17.06	\$22.14	\$5.08
Totals				\$57.48	\$68.14	\$10.66

*Based on a typical residential customer: 110,000 cubic feet per year and a 5/8” meter

Questions & Answers: The following are answers to what may be some commonly asked questions.

Q: How much are the proposed rate increases for both sewer and drinking water?

A: The City anticipates increasing the drinking water and sewer rate structures as shown on the table above. Over the past eight years, the City of Detroit has raised its rates for drinking water by an average of 14.98%/year. With the new rates for Pontiac, Pontiac will have increased rates for drinking water by an average of 6.19%/year. This is because Pontiac has not raised its drinking water rates in the last three years. In regard to the sewer rates, Pontiac also has not raised these rates over the last three years. With the new rates, Pontiac’s average rate increase over the last eight years will be 8.46%/year.

In addition, the rate increases are needed because both the Water and Sewer funds have incurred large deficits due to inadequate revenue. In fact, over the last two fiscal years, the Sewer fund has generated deficits of \$2.9 million and the Water fund has generated deficits of \$3.9 million. These deficits have left these funds with virtually no available cash aside from that required for reserve amounts.

These water rate increases would be necessitated whether or not the bonds are issued. This is because the capital expenditures necessary on an annual basis would be at least equal to the debt service on the bonds. In addition, we expect that the bonds will actually enable the City to recoup previous spending on water projects (from the bond proceeds) which would not be possible otherwise. These recouped amounts, however, will be in the water funds and will not be available to the General Fund.

Q: What is the history of the City's rate increases?

A history of the City's rate increases over the past several years is shown below:

	<u>2009</u> (Proposed)	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Water	9.00%	0.00%	0.00%	0.00%	15.684%	10.12%	2.44%	5.13%
Sewer	29.80%	0.00%	0.00%	0.00%	5.08%	9.94%	3.21%	8.33%

Q. How do our water and sewer rates compare to surrounding communities?

The City's water and sewer rates are comparable to surrounding communities as outlined below:

Community	Rates (Per 100 CF)	
	Water	Sewer
<i>City of Auburn Hills</i>	\$2.312	\$2.05
<i>W. Bloomfield Twp.</i>	\$3.52	\$2.45
<i>Bloomfield Twp</i>	\$3.10	\$2.92
<i>City of Pontiac</i>	\$2.33	\$2.41
<i>City of Rochester Hills</i>	\$3.68	\$3.69

Q: Does the City have any money that could be used to pay for some of the cost of the new proposed projects?

A: No. The City has used all of the excess reserves that it had available in the Water and Sewer Funds.

Q: Why is the timing of this project so urgent?

A: First, most of the projects are critical in nature and needed in order to maintain the systems. Second, the special funding program that is being offered by the State provides that the State will "forgive" up to 40% of the payments but the rules are that spending commitments must be made by December 31, 2009 (only about six weeks away). Third, the State has mandated that some of the projects be completed by the City within set timeframes.

Q: How much will the State financing programs save the City?

A: If the City is able to obtain the entire amount of debt forgiveness, the City would save about \$8.6 million. It is highly unlikely that the City would be able to successfully issue bonds otherwise. With the bond issue, the City will be able to complete the projects within 1-2 years instead of 10-20 years. Through the bond issue the City will be able to pay for the improvements over a 20 year period, thereby substantially reducing annual up-front capital costs. The City also will obtain direct benefits from these capital improvements much earlier. This will be demonstrated in reduced overtime, less maintenance, lower energy cost and greater system reliability.

Q: What has the City already done to minimize the need for rate increases?

A: The City has implemented various cost-saving measures over the last several years in order to minimize system costs. These measures include: (1) "right sizing" staff and equipment; (2) implementing water leak detection and meter change-out programs; (3) improved treatment operations regarding sewage handling and processing; (4) billing collections through new software and data processing; (5) optimizing the filling/usage of our storage tanks (which has significantly reduced our purchase cost of water from Detroit); and (6) revisiting/rebidding materials utilized in the operation and maintenance of the facilities.

Q: Why are we eliminating discounts for senior citizens on their water bills?

A: In order to participate in the SRF and DWRP programs, the City is prohibited by law from providing a discount to any one group. Through the State financing programs it is necessary that all rate programs be equitable to all system customers.

ADDITIONAL INFORMATION

Q: How much will the debt service be and how is the City going to afford this amount of debt service? What are the risks to the City from not being able to pay the debt service in the future?

A: The City seeks to finance through the State programs (SRF and DWRP) up to \$22 million over a period of up to 20 years to complete various water and sewer system improvements. The payments on the debt are expected to be approximately \$820,000 per year. In case revenues fall short, the City has a Bond Reserve Fund, which the City may draw on to meet its debt service payments. However, if the City draws on the Reserve Fund, the City must then take immediate action to increase rates in order to ensure that the Reserve Fund is replenished to the required minimum level.

Q: Why are we considering "regionalizing" the City's sewer treatment plants?

A: Because of collection system and waste water treatment process improvements, as well as a decrease in flows over the last several years, additional capacity is available for use. Further, adjacent communities have been seeking alternative means for sanitary sewage treatment in the region. This has resulted in the City giving consideration to regionalizing the City's treatment plants in order to optimize the existing systems, increase efficiency, and minimize future sewer rate increases to all customers.

Q: Does the City need to issue bonds or raise rates because of the proposed regionalization plan? In other words, would we have to raise rates and issue bonds even if we decided against regionalizing the sewer treatment plants?

A: The regionalization proposal is unrelated to the bonding or the proposed rate increases. The City will need to undertake the projects related to the bonds, and will need to increase rates, regardless of whether regionalization moves forward. Further, the regionalization of the City's treatment plants is not needed to offset the City's costs of the operations for its water and sewer systems. However, the proposed regionalization may offer the City a means to optimize the available existing treatment plant capacities and further reduce costs, which could help minimize future rate increases to all customers.

Q: Why do we need sewer rate increases when we have our own sewer plants and are not subject to rate increases from the City of Detroit?

A: The City's sewer rates are determined based on the overall costs of operating the collection and treatment systems. With the decrease over the last several years of major industry users (General Motors, for example), it is necessary for the City to offset lost revenues through sewer rates in order to cover the basic costs for operations of the sanitary system (collection and treatment). Even with the loss of major users, the City still has the responsibility to maintain the system and plants, as those assets still exist and continue to have operating costs.

Q: How is the City able to issue bonds at this time given the City's low bond ratings?

A: The State of Michigan's financing programs have certain eligibility requirements, which the City is expected to satisfy. As long as the City is able to meet those criteria, it will be able to issue its bonds through the State's programs, despite the City's current low bond ratings.

Q: What will be the amount of revenue generated by the proposed increases this fiscal year and a full year next year?

A: It is projected that the proposed water and sewer rate increases would generate approximately \$850,000 per year in revenues for the Water Fund and \$3 million per year in revenues for the Sewer Fund. These revenues will only be used towards each of the water and sewer systems. The revenues will not be used to supplement the General Fund.