

Town of Coventry - Sewer Program

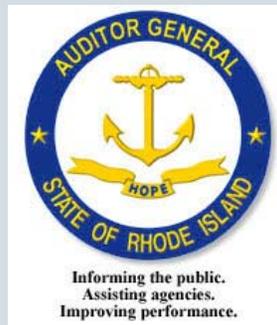
Limited Review performed by the Office of the Auditor General

Presentation to the Coventry Town Council

and

General Assembly members representing the Town of Coventry

May 6, 2019



Objectives of our review

We performed a limited review of the Town of Coventry's sewer program. Our objectives included:

- assessing the operating challenges of the Town's sewer program;
- providing recommendations in the near-term to stabilize the program; and
- developing intermediate and longer-term recommendations for Town leaders to consider as options to sustain future program operations.

Our intent was to provide an objective view of the status of the program and offer recommendations to address the program's current challenges.

We believe the sewer program is necessary for the Town of Coventry to grow economically and to address specific environmental and health/safety issues.

Overview

- The Coventry sewer program's challenges include building a sewer network in established neighborhoods and supporting it financially through assessments/charges from a relatively small group of users.
 - The disparity in population density and property use between the eastern and western sections of the Town results in differing perspectives on the benefits of the program, how it should proceed, and how it should be financed.
- The "fiscal health" of the sewer program has a direct impact on the finances of the town of Coventry. The sewer program must be stabilized in the near-term and supported by a reasonable long-term sustainability plan.
- *Moody's Investors Service* revised the outlook for the Town of Coventry to negative citing: *"Coventry's financial position is sufficient but is challenged by support of its sewer system, which continues to require general fund support and is increasingly burdening the town's general government operations."* A more current update reiterated the same concerns: *"The negative outlook reflects our expectations that the town's finances will continue to be pressured by the need to subsidize its sewer operations"*.
- Advances have been required from the Town's general fund to support the program. Based on current cash flow projections, additional advances will be required in fiscal 2019 and future years absent changes in billing rates and/or operations. Operating deficits are also projected to continue.

Overview

- Sewer rates have not been supported by an appropriate rate setting process. A viable financial plan does not exist to guide the program and to ensure that amounts borrowed, and other operating costs can be supported by sewer fees and connection assessments.
- Coventry has entered into an inter-municipal agreement with the West Warwick Regional Sewer Authority which treats sewer flow from Coventry. Costs paid by Coventry to West Warwick include amounts based on both actual sewer flow and a “reserve capacity” percentage applied to West Warwick’s debt service for facility upgrades. The reserved capacity percentage is in excess of Coventry’s actual proportionate use of the treatment plant.
- The lack of public support for the program and demands that it be suspended, result principally from the high sewer assessments and sewer connection charges for affected homeowners and businesses.
- A realistic and comprehensive sustainability plan must ensure that sewer program costs are equitably shared and affordable. Ultimately, “customer charges” in the form of connection assessments or user fees are the source to repay amounts borrowed by the Town for the program.

Overview – *Report sections*

- Financial Status of the Program
- Inter-municipal Agreement with West Warwick
- Reassess the Need for and Benefits Derived from the Sewer Program from an Economic Development, Health and Safety, and Water Quality Perspective
- Seek Options to Reduce the Financial Impact of Sewer Assessments on Homeowners
- Sewer Rate Setting
- Governance and Administration
- Study Fully Regionalizing the Operations of the West Warwick Regional Wastewater Treatment Facility

Overall the report includes 18 recommendations to improve the program

Financial Status of the Program

- The sewer enterprise fund has not generated sufficient cash flows to meet all sewer related obligations – this has led to \$2.7 million in advances from the Town's General Fund. Based on current cash flow projections, additional cash flow advances will be required in FY 2019.
 - These advances reflected as interfund borrowings, not appropriations
 - The ability of the sewer fund to repay these advances to the Town's General Fund, is very unlikely.
 - One proposal offered by the Town is to offset the advances made from the General Fund against amounts owed by the Town for sewer assessments. This appears to be a practical response to resolve these advances.
- One of the first critical steps for the Town is stabilizing the sewer fund to ensure the timely repayment of debt service without continued cash flow subsidy from the Town. Even with recent debt restructuring, the sewer enterprise fund is projected to require continued cash advances to meet its obligations.
- The “fiscal health” of the sewer program cannot be viewed as separate and distinct from the Town of Coventry overall and consequently must be stabilized in the near-term and supported by a reasonable sustainability plan long-term. Any threatened or actual default would impact the Town's bond rating, future borrowing costs and could also have an impact on borrowing costs for participants in the RI Infrastructure Bank program.

Financial Status of the Program

Town of Coventry - Sewer Fund - Statements of Cash Flows

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
| Cash Flows From Operating Activities | | | | | |
| Cash Received From Customers | \$ 1,888,205 | \$ 2,145,546 | \$ 2,389,073 | \$ 2,726,238 | \$ 2,751,670 |
| Cash Payments to Suppliers for Goods and Services | (1,001,753) | (2,170,357) | (1,479,485) | (1,178,297) | (2,009,358) |
| Other Operating Receipts | 25,047 | 28,973 | 30,517 | 14,880 | 27,193 |
| Net Cash Provided by (used for) Operating Activities | 911,499 | 4,162 | 940,105 | 1,562,821 | 769,505 |
| Cash Flows From Capital and Related Financing Activities | | | | | |
| Additions to Capital Assets | (1,159,256) | (575,386) | (437,340) | (1,663,964) | (573,986) |
| Principal Paid on Bonds, Notes, and Loans | (7,623,153) | (892,806) | (1,120,463) | (1,153,121) | (1,280,218) |
| Note Proceeds | 8,719,531 | 575,386 | 437,340 | 1,023,073 | 1,246,840 |
| Capitalized Bond Cost | (731,741) | (1,486) | (1,515) | (2,051) | (3,818) |
| Transfers to Other Funds | - | - | - | (436,457) | - |
| Interest Paid on Notes | (456,075) | (581,173) | (532,286) | (542,927) | (534,517) |
| Net Cash Provided (used for) Capital and Related Financing Activities | (1,250,694) | (1,475,465) | (1,654,264) | (2,775,447) | (1,145,699) |
| Cash Flows From Investing Activities | | | | | |
| Interest and Dividends on Investments | 1,593 | 1,490 | 1,508 | 2,053 | 5,581 |
| Net Increase (Decrease) in Cash and Cash Equivalents before Interfund Loans | (337,602) | (1,469,813) | (712,651) | (1,210,573) | (370,613) |
| Interfund Loans | (6,725) | 1,469,816 | 712,644 | 1,210,569 | 370,614 |
| Cash and Cash Equivalents at Beginning of Year | 361,721 | 17,394 | 17,397 | 17,397 | 17,393 |
| Cash and Cash Equivalents at End of Year | \$ 17,394 | \$ 17,397 | \$ 17,390 | \$ 17,393 | \$ 17,394 |



Financial Status of the Program

| Town of Coventry - Sewer Fund | | | | |
|--|------------------|------------------|------------------|------------------|
| Statement of Revenues, Expenses, and Changes in Fund Net Position - <i>Pro Forma</i> | | | | |
| | Actual Audited | Pro Forma | | |
| | 2018 | 2019 | 2020 | 2021 |
| Operating Revenues | | | | |
| Sewer Assessments | \$ 1,299,420 | \$ 1,140,738 | \$ 1,097,294 | \$ 1,061,630 |
| Sewer User Fees | 1,294,014 | 1,294,014 | 1,294,014 | 1,294,014 |
| Other Revenues | 27,193 | 27,193 | 27,193 | 27,193 |
| Total Operating Revenues | 2,620,627 | 2,461,945 | 2,418,501 | 2,382,837 |
| Operating Expenses | | | | |
| Contract Services | 60,894 | 262,721 | 270,603 | 278,721 |
| Operations & Maintenance | | | | |
| West Warwick proportionate Debt | 683,388 | 682,301 | 677,815 | 672,320 |
| Coventry (includes WW Use fees pass-thru) | 931,707 | 959,658 | 988,448 | 1,018,101 |
| Depreciation and Amortization | 648,665 | 648,665 | 648,665 | 648,665 |
| Total Operating Expenses | 2,324,654 | 2,553,345 | 2,585,532 | 2,617,808 |
| Operating Income (Loss) | 295,973 | (91,400) | (167,030) | (234,971) |
| Non-Operating Revenues (Expenses) | | | | |
| Interest and Dividend Income | 5,581 | 5,581 | 5,581 | 5,581 |
| Interest Expense | (534,517) | (400,730) | (528,083) | (509,991) |
| Total Non-Operating Revenues (Expenses) | (528,936) | (395,149) | (522,502) | (504,410) |
| Change in Net Position | (232,963) | (486,549) | (689,532) | (739,381) |
| Total Net Position - Beginning | 11,290,307 | 11,057,344 | 10,570,795 | 9,881,262 |
| Total Net Position - Ending | \$ 11,057,344 | \$ 10,570,795 | \$ 9,881,262 | \$ 9,141,882 |



Financial Status of the Program

Sewer Fund financial statements as of June 30, 2018:

| | |
|---|---------------------------|
| Long-term Sewer Assessments Receivable | \$ 7,738,436 |
| Other Assets - debt service reserve funds | 1,759,832 |
| Due from borrowing sources -- unspent bond proceeds | 1,349,327 |
| Bonds and Loans Payable (Current & Noncurrent) - principal only | <u>(18,202,509)</u> |
| Assessments receivable shortfall compared to sewer long-term debt at June 30, 2018 | <u>(7,354,914)</u> |

Other potential sources of funds to meet debt service on sewer debt:

| | |
|--|-------------------------------------|
| Deferred assessments (approximate) - per Tax Collector's reporting system as of December 31, 2018 | 300,000 |
| Pending sewer assessments (approximate) - Arnold Road North project (cost of construction net of federal grant and as of December 31, 2018) | 830,000 |
| Pending sewer assessments (approximate) - Hazard Street project (cost of construction as of December 31, 2018) | <u>330,000</u> |
| Adjusted current assessments receivable shortfall compared to sewer long term debt | <u><u>\$ (5,894,914)</u></u> |

Financial Status of the Program

Recommendations:

- Explore if any sewer program costs can or should be supported through the Town's General Fund.
- Consider offsetting the Town's sewer assessment liability for connecting Town buildings to the sewer system against the General Fund advances that are not likely reimbursable in the near term. If such offsets are not applied, charge interest to the Town's sewer assessment payable to the sewer fund.
- Bill sewer assessments for recently completed work to provide cash flow to meet required debt service payments.
- Utilize remaining unspent bond proceeds to reduce the sewer program's outstanding debt thereby lessening the cash flow deficit in the near term.
- Enact a minimum base sewer use charge to be applied one year after the initial sewer assessment when actual connection and use has not commenced (and no waiver or deferment sought).

Inter-municipal Agreement with West Warwick

- The Towns of Coventry and West Warwick have an inter-municipal agreement that outlines how the debt service on the obligations shall be shared.
- The basis for the amount of proportionate debt service paid by Coventry for certain West Warwick Regional Wastewater Treatment Facility debt reflects negotiated reserve capacity instead of actual usage (flow). Currently, this is more than actual proportionate flow from the Town of Coventry to the West Warwick Regional Wastewater Treatment Facility
- Arguably, Coventry sewer customers are subsidizing other customers of the West Warwick Regional Wastewater Treatment Facility.

Inter-municipal Agreement with West Warwick

| West Warwick Regional Wastewater Treatment Facility | | |
|--|-----------------------|-------------|
| <i>Designed facility capacity flow (MGD)</i> | | 10.5 |
| <i>Coventry reserve capacity flow (MGD)</i> | | 2.25 |
| <i>Total Facility - Actual average daily flow (MGD)</i> | | |
| | 2018 | 6.71 |
| | 2017 | 5.27 |
| | 2016 | 4.94 |
| <i>Annual Flow by Community - 2018 - based on Kent County Water Authority Usage Data</i> | | |
| | Actual CF flow | % |
| <i>West Warwick</i> | 175,309,723 | 82.6% |
| <i>Coventry</i> | 24,435,921 | 11.5% |
| <i>Woodland Manor (1)</i> | 3,016,430 | 1.4% |
| <i>Warwick</i> | 6,197,243 | 2.9% |
| <i>Cranston</i> | 1,479,988 | 0.7% |
| <i>West Greenwich</i> | 1,790,495 | 0.8% |
| Total | 212,229,800 | 100% |
| <i>MGD - million gallons per day</i> | | |
| <i>CF - cubic feet</i> | | |
| <i>Sewer use is billed on 80% of Kent County Water Authority Usage</i> | | |
| <i>(1) - Woodland Manor is in Coventry but is considered part of the West Warwick Reserve Capacity</i> | | |
| <i>source: West Warwick Regional Wastewater Treatment Facility</i> | | |

| <i>Community</i> | <i>Negotiated Reserve capacity</i> |
|-------------------------------------|------------------------------------|
| West Warwick | 73.15% |
| Coventry | 21.38% |
| Warwick | 2.40% |
| West Greenwich | 1.27% |
| Cranston | 1.06% |
| Scituate | 0.74% |
| | 100.0% |
| Source: WWRWTF 2012 Facilities Plan | |

Inter-municipal Agreement with West Warwick

- Revisit the negotiated reserve capacity component of the inter-municipal agreement between the Town of Coventry and the Town of West Warwick. Renegotiate that component to more closely reflect actual usage and intended usage reflecting current estimates of commercial, industrial and housing expansion in the Town of Coventry.

Reassess the Need for and Benefits Derived from the Sewer Program from an Economic Development, Health and Safety, and Water Quality Perspective

Recommendations –

- Reassess the importance of the sewer program to the Town's overall growth, economic development and health and safety objectives. Utilize that updated assessment to guide various near-term and longer-term decisions regarding the sewer program.
- Implement an information program to educate taxpayers on how the sewer program is integral to the long-term growth and viability of the Town.
- Increase the number of system users/customers strategically by targeting expansion of the system where there is the strongest environmental need, homeowner interest, and a reasonable balance of construction costs to the number of connections/users gained.
- Ensure near-term and longer-term sewer expansion plans are incorporated into the Town's overall planning efforts. Enhance transparency and communication of any sewer system expansion by requiring notification to affected homeowners at least two years in advance of the actual construction schedule to allow that information to be considered by homeowners contemplating installation of a new individual sewage disposal system.

SEEK OPTIONS TO REDUCE THE FINANCIAL IMPACT OF SEWER ASSESSMENTS ON HOMEOWNERS

- Explore options to manage and reduce the high cost of sewer assessments on homeowners to include:
 - Review the components included in the total project construction costs allocated to the homeowners adjacent to the sewer line extension. Consider eliminating street paving costs, police details and any extraordinary, unanticipated construction costs.
 - Subsidize the sewer assessment by recovering a portion of those costs from sewer use charges or a direct subsidy for a portion of the costs from the Town's General Fund or another non-sewer fund source.
 - Reduce the interest rate charged on sewer assessments to approximate the Town's actual costs to borrow.
 - Increase the availability and awareness of lower-cost financing options for homeowners.
 - Adopt a maximum sewer assessment amount ("not to exceed amount") to ensure that sewer assessments to homeowners are equitable and consistent in the various phases (contracts) of the program.

SEEK OPTIONS TO REDUCE THE FINANCIAL IMPACT OF SEWER ASSESSMENTS ON HOMEOWNERS

History of Assessments

| Ordinance | Sewer Assessments | | |
|-----------|--|-------------------------|--|
| Adopted | House | Mobile Home | Commercial |
| 1/13/1997 | \$3,500 per housing unit | \$1,750 per mobile home | \$30 per \$1,000 property valuation |
| 3/24/2003 | \$4,200 per housing unit | \$2,100 per mobile home | \$35 per \$1,000 property valuation |
| 4/26/2004 | \$6,600 per housing unit | \$3,300 per mobile home | \$55 per \$1,000 property valuation |
| 7/6/2009 | \$12,900 per housing unit | \$6,600 per mobile home | \$60 per \$1,000 property valuation plus CPI |
| 1/14/2013 | Interest rate charged on 20-year assessment loans was decreased from 8% to 6% | | |
| | <u>Total Cost of Construction / Total Design Flow of Sewer line = Rate per GPD</u> | | |
| 9/10/2015 | for example: \$60.86 * 3 bedrooms * 115 GPD (per bedroom) = a sewer assessment of \$20,996.70 | | \$80 * Actual (or DEM) Design Flow * GPD (100 GPD min) |

Sewer rate setting

Rate development goals and objectives to be considered:

- Engage a firm to perform a formal sewer use rate study and to provide expert support to the Town in establishing and adopting sewer use rates.
- Re-establish and commit to which costs are being recovered through sewer use fees:
 - Operations only or some cost of building the network
 - Cash flow basis or accrual accounting basis
 - Depreciation basis vs replacement reserve
- Establish an appropriate baseline sewer rate that adequately covers all elements of program cost.
- Adjust the baseline rate for:
 - the results of revisiting the inter-municipal agreement which allocates certain West Warwick debt service based on “reserve capacity” percentage rather than actual usage;
 - add to the baseline rate – the amount needed to fund the known shortfalls between sewer assessments and long-term debt;
 - determine if there is an amount that can be added to the annual usage charge to lessen the amount assessed on individual homeowners; and
 - costs that can be subsidized by the General fund or another non-sewer revenue source.
- Assess how Coventry’s user rates compare to the annual usage charge for other neighboring communities.

Sewer rate setting

- Sewer rates have not been supported by an appropriate rate setting process.
- A viable financial plan has not been in place to guide the program and to ensure that amounts borrowed and other operating costs can be supported by sewer fees and connection charges.
- External, independent expertise is needed on a recurring basis to help the Town adopt sewer rates that ensure recovery of costs, avoid deficits, and ensure sufficient cash flow to meet obligations as they come due. Additionally, policies for rate setting need to be established and formally adopted to provide the underpinnings of how rates should be developed and what costs they are intended to cover.
- Development of annual sewer rates should be performed in concert with the development of the annual financial plan with multi-year projections for adoption by the Town Council.
- The multitude of sewer use rates is unduly complex. This supports a move towards fully regionalizing the West Warwick Regional Wastewater Treatment Facility. In the interim, external rate-setting assistance can help simplify the variety of rate combinations and ensure all users are paying the appropriate proportionate share of program costs.
- Additional resources in the finance, rate setting, administrative, and engineering areas are likely needed to adequately meet current operational needs and to develop and execute a longer-term sustainability plan.

Sewer Rate Setting

Comparison of sewer user rates across communities - based on an average 3 bedroom single family home

| Town | User Charge Component | Annual Sewer User Charge - single family home - based on 4000 cubic feet |
|------------------|-------------------------------|--|
| West Warwick | Sewer Use | \$ 142.00 |
| | Facility Debt | 135.00 |
| | Total | \$ 277.00 |
| Coventry | Sewer Use | \$ 136.00 |
| | West Warwick user fee & other | 180.00 |
| | Total | \$ 316.00 |
| Warwick | Sewer Use | \$ 191.20 |
| | Renewal and Replacement | 14.00 |
| | Customer Charge | 126.88 |
| | Total | \$ 332.08 |
| Narragansett Bay | Sewer Use | \$ 145.44 |
| | Additional | 225.32 |
| | Total | \$ 370.76 |
| East Providence | Sewer Use | \$ 398.24 |
| | Annual Fixed Fee | 60.00 |
| | Total | \$ 458.24 |
| Cranston | Sewer Use | \$ 458.94 |
| North Smithfield | Sewer Use | \$ 508.53 |
| Barrington | Sewer Use | \$ 330.50 |
| | Sewer Improvement | 203.00 |
| | Total | \$ 533.50 |

Sewer rate setting

Recommendation

- Engage a firm to perform a formal sewer use rate study and to provide expert support to the Town in establishing and adopting sewer use rates. Re-establish and commit to which costs are being recovered through sewer use fees.

Governance and Administration

Recommendations:

- Develop an annual operating plan (budget) for the sewer fund which includes cash flow and capital budgets as well. The annual sewer operating plan should be adopted formally by the Town Council as part of the Town's overall annual budget preparation process.
- Evaluate the need for additional finance and administrative staff for the operations of the Town's sewer program.
- Utilize the separate bank account established for the Town's sewer enterprise fund.
- Acquire an enhanced computer application to facilitate tracking and billing of sewer assessments.
- Enhance controls to ensure that the development of the sewer use charges include and consider all the various components of cost.

Study Fully Regionalizing the Operations of the West Warwick Regional Wastewater Treatment Facility

As part of a longer-term view for the Coventry sewer program, Coventry and the other communities served by the facility should explore having the West Warwick Regional Wastewater Treatment Facility act more independently (possibly more like the Narragansett Bay Commission or Kent County Water Authority model) with representation of the benefitting communities on their governing board.

A regional commission would assume all responsibility for the program eliminating a large part of the functionality which is, to some extent, duplicated in Coventry.

This follows a shared-services model often proposed as a partial solution to the perennial challenges local governments face in providing services within the property tax limitations and increasing commitments for education and public safety expenditures.

Study Fully Regionalizing the Operations of the West Warwick Regional Wastewater Treatment Facility -

Recommendation -

- Create a study group to explore and assess the feasibility of fully regionalizing the West Warwick Regional Wastewater Treatment Facility including representation from all municipalities using the treatment plant.

Contact information

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Report is available on our website: oag.ri.gov