Board of Selectmen

January 10, 2019

7:00pm - Joint Session with the Water Company Acquisition Study Committee, Water Company Sub Committee of the Advisory Committee and the Advisory Committee.

Present:

- Board of Selectmen: Mr. Paul Healey, Ms. Mary Power, Ms. Karen Johnson
- Mr. Tom Mayo, Town Administrator; Ms. Michelle Monsegur, Assistant Town Administrator
- Water Company Acquisition Study Committee: Jonathan Asher, Chair, Joshua Krumholtz, Secretary, Robert Higgins, Edward Siegfried; not present: Joseph Bierwirth
- Advisory Committee Members: Donna Smallwood, Victor Baltera, Dave Anderson, Libby Claypoole, Davalene Cooper, Ed Gaydos, Eric Haskell, and Eryn Kelley. Not attending: Tom Belyea, Bob Curley, George Danis, Nancy MacDonald, Andy McElaney, Evan Sheehan, and Julie Strehle (This was an optional Advisory Committee meeting. Absent members may have viewed the live broadcast or recording of the meeting on Harbor Media.)

Mr. Mayo stated that the Board of Selectmen asked him in October 2018 to engage an independent third party to review the Town's financial model related to Town acquisition and ownership of the water company. The Town engaged Julie Keim from Berry Dunn and Jim Dondero from Andersen Tax.

Ms. Keim introduced herself as a principal at Berry Dunn, a CPA and consulting firm based in Portland, ME, where she leads the telecomm and energy practice working on telephone, electric, water, and public utilities and rate setting. Julie works with investor-owned/for profit and municipal-owned/non-profit utilities and understands both sides. She was asked to comment specifically on five assumptions in the Town's financial model (copied from Ms. Keim's report):

1. The starting Service Area A Operating Revenue amount per the DPU 17-90 Order
2. A three-year frequency for Aquarion rate increases
3. A 10% rate increase of triennial Aquarion rate increases
4. The Mains Replacement Adjustment Mechanism (MRAM) annual surcharge calculation in the DPU 17-90 Order
5. The MRAM capital increment factoring into the next rate case

Ms. Keim went through each one. She tied back assumption #1 as the right place to start. For assumption #2, she stated that the Town's assumption of a rate case every three years is reasonable. The DPU order alludes to five-year rate cases, but she noticed Aquarion does it every three years in Connecticut, so either way is a reasonable assumption. For assumption #3, Ms. Keim believed that a 10% increase for this particular modeling and analysis would be reasonable.

For assumption #4, Ms. Keim stated that the 2% annually cap for MRAM was applied appropriately in the first five years. She noted there could be some double recovery for two and a half years after the five-year period, but it's not a significant amount. The Town used correct amounts in subsequent rate cases.

Finally, for assumption #5, Ms. Keim noted that it would not be unreasonable to assume an MRAM surcharge will be used in future rate cases for eligible capital improvements. She has seen additional surcharges added through similar mechanisms in other states.

Mr. Dondero introduced himself and gave some background about his firm, Andersen Tax, which was founded in 2002 and has about 4,000 people worldwide. He leads the firm's valuation practice in Boston and has over 30 years of experience doing financial modeling and consulting. He was asked by the Town to validate all aspects of the Town's financial analysis, including, but not limited to the following (copied from Mr. Dondero's slides):

a) Confirm that Town financial analysis: is consistent with the facts in the DPU rate case filings and includes costs associated with municipal ownership
b) Assess reasonableness of assumptions contained in Town financial analysis. Recommend modifications as needed and rationale for making them.
c) Identify and analyze differences between Town financial analysis and Aquarion model
d) Identify additional aspects of the Town financial analysis that require analysis or review.

He stated that typically municipal water companies are included in enterprise funds so they do not impact the tax rate – users pay through user fees. To determine which ownership option is best for ratepayers, it is important to focus on ownership structure and to compare "apples to apples." Historical measurements are really good indicators of the future, so past practice is a good place to start.

Mr. Dondero noted that municipal ownership does eliminate some costs, namely income taxes, profit/return on assets, and rate filing costs. Although the Town may have higher wage costs due to prevailing wage laws, the impact is likely immaterial. Municipal entities also have significantly lower borrowing costs.

He stated that the Town's assumptions of Aquarion's rate increases are reasonable.

He noted that Aquarion's inflation assumption of 2.2% is lower than the Town's (3%) and that Aquarion did not build an inflation increase into its 30-year capital expenditure projections. Mr. Dondero stated that Aquarion assumed it can borrow at the same rate as the Town (3.75%). However, Moody's rates Aquarion at Baa2, which gives them a 10-year interest cost of 4.88%. He also noted that Aquarion's model holds rent constant even though the lease agreement increases it and that Aquarion assumes only 75% of rate requests will be approved, which may not be a valid assumption. He stated that many of Aquarion's assumptions are biased toward yielding a lower rate increase over time.

Regarding the Town's analysis, Mr. Dondero stated that having two independent parties come up with quotes for contract operations is a strong approach. The Town's financing assumptions appear reasonable.

Mr. Dondero presented a table showing a comparison of costs and revenue requirements for both the Town and Aquarion in 2020 and 2048. Aquarion's operating cost figure of $11.7 million in 2020 includes profit they need to earn, treatment plant lease costs, and income taxes – that is why there is a such a big gap between the Town's and Aquarion's operating costs (Town 2020 operating cost is $5.5 million).

Mr. Dondero then presented a table showing the projected savings/deficit over 30 years for the Town's model of Town ownership, Aquarion's model of Aquarion's ownership, and Andersen Tax's model of Town ownership. Andersen Tax believes ratepayers would see savings of about $50 million over the next 30 years under Town ownership. Once the debt from the initial acquisition is paid off, ratepayers would then see a savings of about $7.4 million per year under Town ownership, starting in 2049.

There were questions and comments from the boards/committees present.

Ms. Power asked about the MRAM surcharge authorized by the DPU for capital improvements. Ms. Keim noted that MRAM is capped at 2% per year on the base revenue of about $8 million and that it's compounding. Typically, once a company gets a surcharge approved and understands the process, they tend to take the same position in future rate cases. It's really to improve the infrastructure. Ms. Power noted that the aging infrastructure needs significant repairs and that they will likely take longer than five years. Ms. Keim commented that if capital investments are made sooner than the projected timeline and MRAM is still capped at 2%, that would drive any company to increase rates sooner than waiting out the five-year period. They are in a business to make a profit and to continue running the business.

Ms. Power asked Mr. Dondero if the $50 million savings under Town ownership for 30 years excludes the MRAM surcharge. Mr. Dondero confirmed that is correct. He views MRAM has a chance to earn a return before another rate increase. Including the MRAM surcharge would translate to additional savings beyond the $50 million.

Ms. Power and Ms. Johnson inquired about the major differences between the Town's and Andersen Tax's savings estimates under Town ownership. Mr. Dondero pointed to the cost increase of capital expenditures, higher capital expenditures, and increasing interest rates on annual capital borrowing in the future.

In answering other questions from the boards, Mr. Dondero stated that the chart on slide 13 showing the $50 million of projected savings under Town ownership is fair, even low, because it doesn't include MRAM.

Libby Claypoole, 25 Mann Street, asked about retirement and other post-employment benefit costs for water employees under Town ownership. Mr. Dondero and Mr. Asher clarified that the Town model contemplates a full-time Water Superintendent and part-time administrative support in terms of municipal employees, so those are the only people who would get those Town benefits.

Pauline Rowe, Hull resident, asked who would decide to implement rate increases when there are capital improvements that need to be made faster than expected and what protections are there for ratepayers under Town ownership? Ms. Johnson referenced the governance presentation on the Town website and stated that the Town plans to hire a full-time Water Superintendent who would be a Town employee. The governance model includes a Citizens Advisory Board that would work with the Superintendent to run through a budget process much like the Advisory Committee is going through now with every other department of the Town. Massachusetts law dictates how you evaluate the expenses of the enterprise fund. It's a combination of state law and our typical budget process, which includes hearings before the Advisory Committee as well as the Board of Selectmen to set rates.

Laura Burns, 96 Hersey Street, asked about the cost of the water treatment plant financing and how Aquarion pays a lease payment and a separate legal entity, also owned by Aquarion, covers it.

Katherine Salisbury, 10 Ridgewood Crossing, asked about the impact on the tax rate since general obligation bonds are proposed for the acquisition and Hull and Cohasset won't have that liability. Mr. Mayo noted that although we would use general obligation bonds for the purchase, the special nature as a utility purchase means it will not affect tax rates. It will be 100% cover by water ratepayers.

Libby Claypoole asked if there would still be exposure to taxpayers because general obligation bonds are backed by the full faith and credit of the Town. Mr. Mayo noted that as Water Commissioners, the Board of Selectmen could increase water rates if needed and taxpayers would be protected. With the enterprise fund, all of the money that comes in through water bills would stay in the water system.

Joshua Ross, 125 Wompatuck Road, asked if there is any legal liability the Town would incur in a "worst case" scenario where something major happens like in Flint, Michigan. Mr. Dondero noted that no matter who owns it, ratepayers are on the hook. Ms. Johnson added that the Town would be hiring a professional water operating company and that the Town would insist on certain capitalization of that company in order to be the successful bidder, so there is some buffer built into the governance model as contemplated.

John Walsh, Vice President of Operations of Aquarion, stated that MRAM is not just a surcharge. It means there are additional capital expenditures, so the Town needs to add that additional capital spending to the Town model. He also asked about making public the two non-binding estimates the Town received for contract operations. Mr. Dondero stated that Andersen Tax used Aquarion's capital plan in their figures, so no further capital expenditures need to be added to the Town model.

Meeting Adjourned at: 9:10pm — Michelle Monsegur
Approved February 5, 2019 — Sally Sinclair

Documents: A complete meeting packet of supporting documentation is on file and available for public review in the Board of Selectmen's Office.