

# Township of Lower Makefield



## Update to Sewer Transaction Exploration Process

June 17, 2020

### *Presented by:*

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# Sewer Team\*

## ◆ Township Administration

- Kurt Ferguson, Manager
- Greg Hucklebridge – Public Works Director
- Jim Majewski, Director of Planning & Zoning

## ◆ Township Solicitor

- David Truelove, Hill Wallack

## ◆ Authority Engineer

- Fred Ebert, Ebert, Ebert Engineering, Inc.

## ◆ Special Transaction Counsel

- Tom Wyatt, Obermayer
- Nicole Norcross, Obermayer

## ◆ Financial Advisor

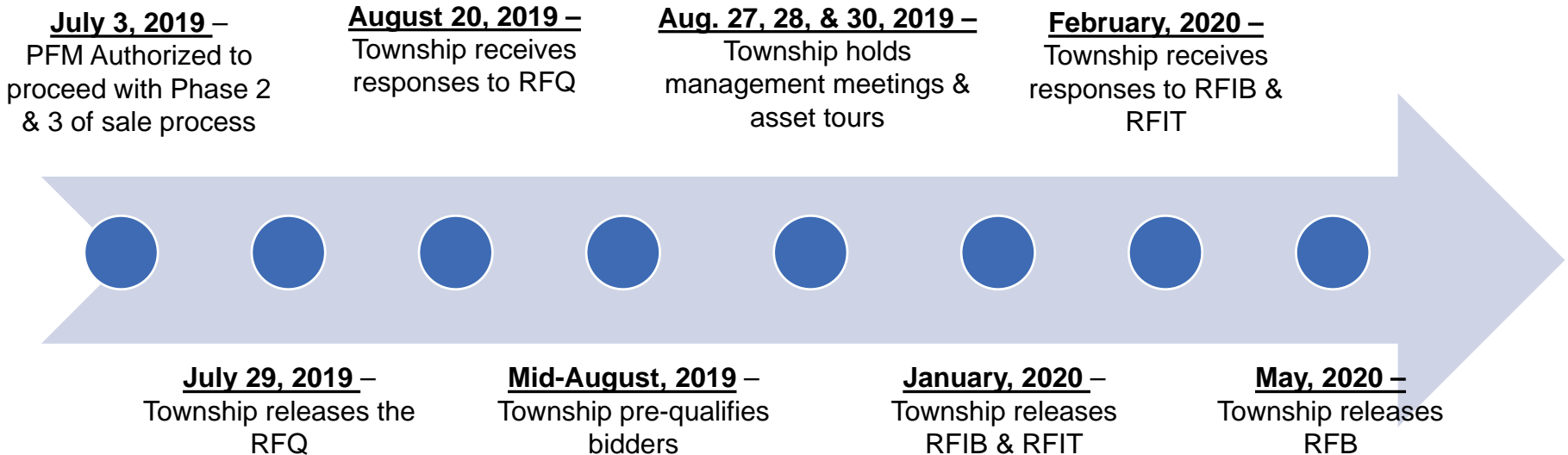
- Scott Shearer, PFM
- John Frey, PFM
- Ben Kapenstein, PFM
- Garrett Moore, PFM

\*Represents the main parties involved from each entity, however others not listed contributed to the process



# Timeline of Events

◆ Work on this transaction has progressed over last year:



**Since receipt of responses to the Township’s RFB the Township has been evaluating the bids received, in order to identify the best overall bid package, as well as, begin exploring the possible use of proceeds.**



## Process to Date – Initial Steps

- Over the past year the Township has been working with its financing team to explore the possibility of exiting the wastewater business and selling the Township's wastewater assets
- After the initial consultation with PFM regarding what the Township's assets could be worth to a buyer the Township decided to move forward in the transaction process by releasing a Request for Qualifications ("RFQ") to gauge the interest in the market.
- On July 29<sup>th</sup>, 2019 the Township released its RFQ to over 100 market participants to gauge the interest in the Township's system.
  - In the RFQ respondents were asked to answer questions pertaining to the capabilities and history in operating wastewater systems and their financial capabilities to name a couple
- During the interim between release of the RFQ and receiving the responses, the Township and its team conducted extensive due diligence regarding a possible transaction and began drafting the legal docs that would be required, should a transaction take place



## Process to Date - Pre-Qualified Bidders

- On August 20<sup>th</sup>, 2019 the Township received four responses to the RFQ from the following firms:
  - PA American – Regulated by the PUC
  - Aqua – Regulated by the PUC
  - Bucks County Water & Sewer Authority – Regulated by the PA Municipal Authorities Act
  - VICO – Interested in a asset lease arrangement
- The Township decided to qualify all four bidders to move forward in the due diligence process until such time that Request for Bids (“RFB”) are released or the Township, at its discretion, decides that one or more of the bidders should no longer continue on in the process.



## Process to Date - Pre-Qualified Bidders Continued...

- Of the firms pre-qualified to move forward in the bidding process, three were interested in an outright sale of the Township's system (PA American, Aqua, & BCWSA).
- Should a sale to any of the aforementioned firms be the outcome, the winning bidder would be regulated by, either the PA PUC, in the case of PA American or Aqua, or the PA Municipal Authorities Act, in the case of BCWSA.
- VICO, on the other hand, was interested in a asset lease model through which, the Township would lease its system to VICO for a period of up to 50 years in exchange for an upfront payment
- Note that in any asset lease agreement the lessee is not regulated by any public agency/authority, rather they are "regulated" by the lease agreement documents, enforcement and supervision of which would fall on the Township



## Process to Date - Management Meetings/Asset Tours

- ◆ Following the pre-qualification process the bidders were asked to attend a management meeting and asset tour at the Township
  - Meetings were held on August 27<sup>th</sup>, 28<sup>th</sup>, & 30<sup>th</sup>
- ◆ The purpose of the management meetings were to help facilitate conversation between the Township and prospective bidders
  - The meetings began with an overview of the Township's system, goals, and desires, followed by a brief presentation by the bidders
  - These meetings were informal and encouraged dialogue
- ◆ Following the management meetings the bidders went on a tour of the System's assets to better understand the system and what they ultimately would be bidding on.
  - Another aspect of the tours was to help illustrate any development that is, or might be, occurring within the Township



## Process to Date - Request For Indicative Bids (“RFIB”)

- ◆ Per the request of the Township, PFM distributed the RFIB to the three pre-qualified bidders interested in the sale of the Township’s system
- ◆ The RFIB contained two proposal forms, Proposal form 6a and Proposal form 6b, for bidders to submit multiple bids for the Township to consider
- ◆ Proposal Form 6a – ***2-year Rate Freeze Option***
  - Max Price Bid - Provide max purchase price & accompanying indicative rates
  - \$35mm Bid - Provide indicative rates assuming a \$35 million purchase price
- ◆ Proposal Form 6b – ***No Rate Freeze Option***
  - Max Price Bid - Provide max purchase price & accompanying indicative rates
  - \$35mm Bid - Provide indicative rates assuming a \$35 million purchase price

**NOTE: The responses to the RFIB were strictly indicative in nature and non-binding. It was the Township’s position that the RFIB be a tool to help narrow the field of bidders and therefore allow the Township focus its efforts most efficiently**





## Process to Date - Request For Indicative Terms (“RFIT”)

- ◆ Per the request of the Township, PFM distributed the RFIT to VICO, who was interested in an asset lease arrangement
- ◆ VICO was asked to provide the Township with a draft Asset Lease Agreement (the documents that outlines and governs the term of the lease).
- ◆ Following the receipt of VICO’s response to the RFIT, the Township’s team held several virtual meetings with VICO to better understand the terms outlined in their response and the advantages and disadvantages of the asset lease model
- ◆ Ultimately the Township decided to remove VICO from the bidding process for a number of reasons, including but not limited to:
  1. Too many unquantifiable financial risks including, but not limited to, litigation, guarantee of future rates/capital, etc.
  2. The ultimate desire of the Township to exit the wastewater business and not wanting the Township to be burdened with the annual administrative requirements
  3. The lack of an independent 3<sup>rd</sup> party regulator



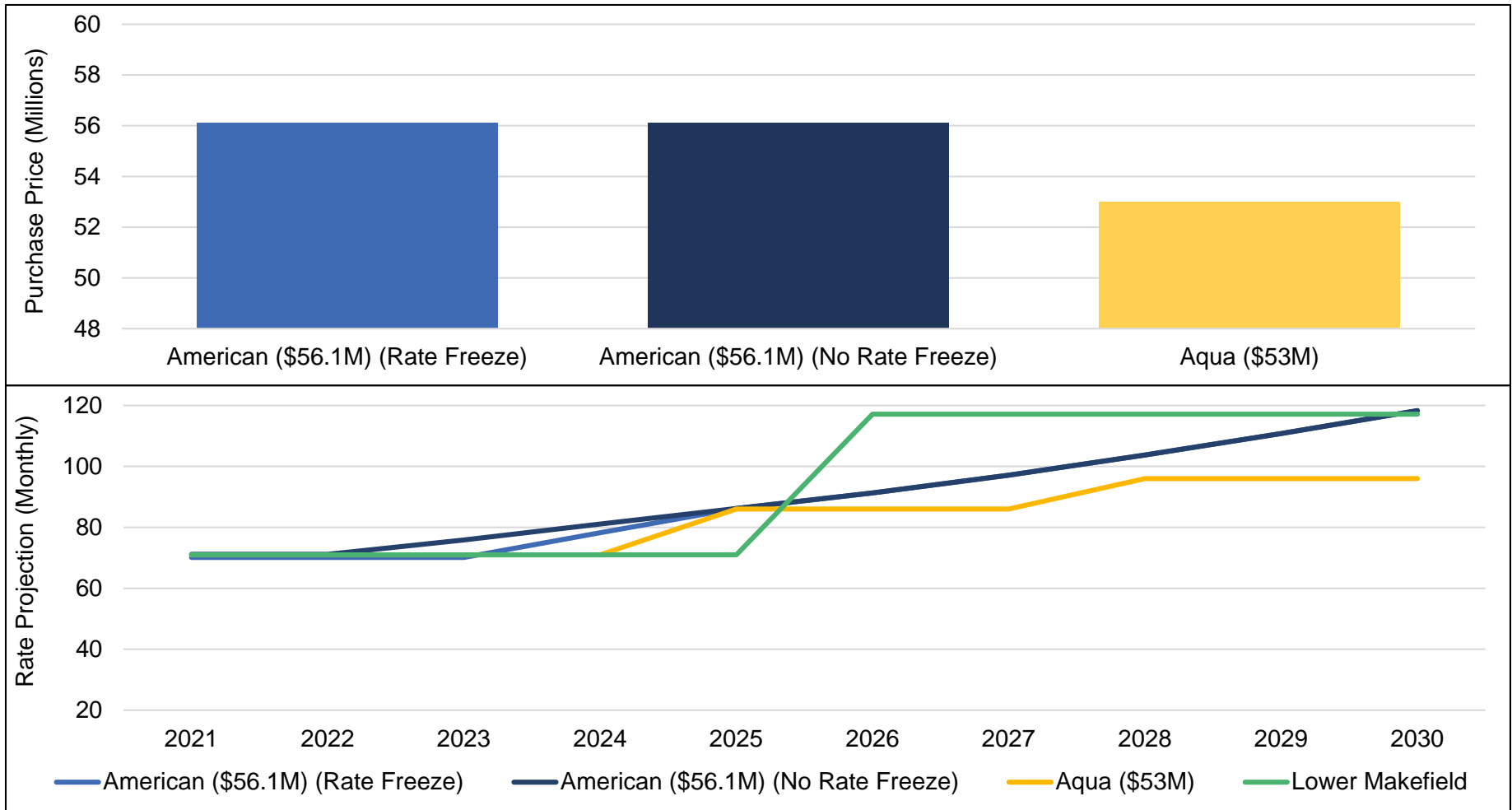
## Process to Date - Request For Bids (“RFB”)

- ◆ Following the RFIB, PFM distributed the RFB to the remaining three pre-qualified bidders
- ◆ The RFB was virtually identical to the RFIB in substance, however, **unlike the RFIB, the RFB is binding in nature**
- ◆ In addition to the quantitative metrics requested, several qualitative questions were asked of the bidders, that were not included in the RFIB, that should be considered in addition to rates and purchase price, such as:
  1. Giving LMT the right of first refusal should the buyer sell the LMT system at some future date?
  2. Would the buyer require a financing contingency in order to raise the capital needed to support their purchase price?
  3. Would LMT be in its own rate zone?
  4. Would the buyer be willing to extend the initial rate freeze past the two years stated in the Asset Purchase Agreement (“APA”)?



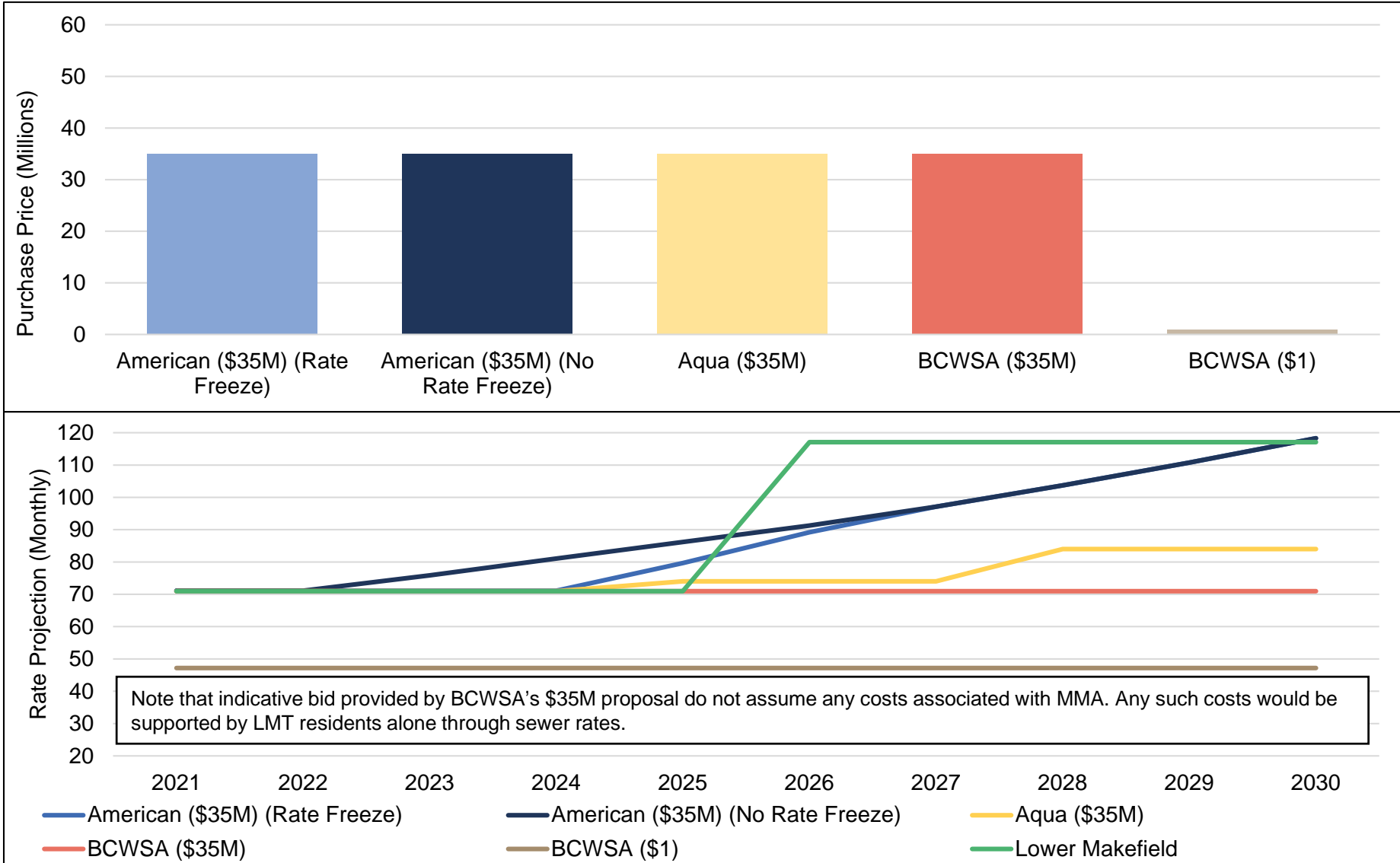
# Summary of Max Bid Price Results

- ◆ The indicative rate graph below *does not* assume any reduction that may be realized as the result of the creation of a Customer Benefit Fund (“CBF” or the “Fund”).





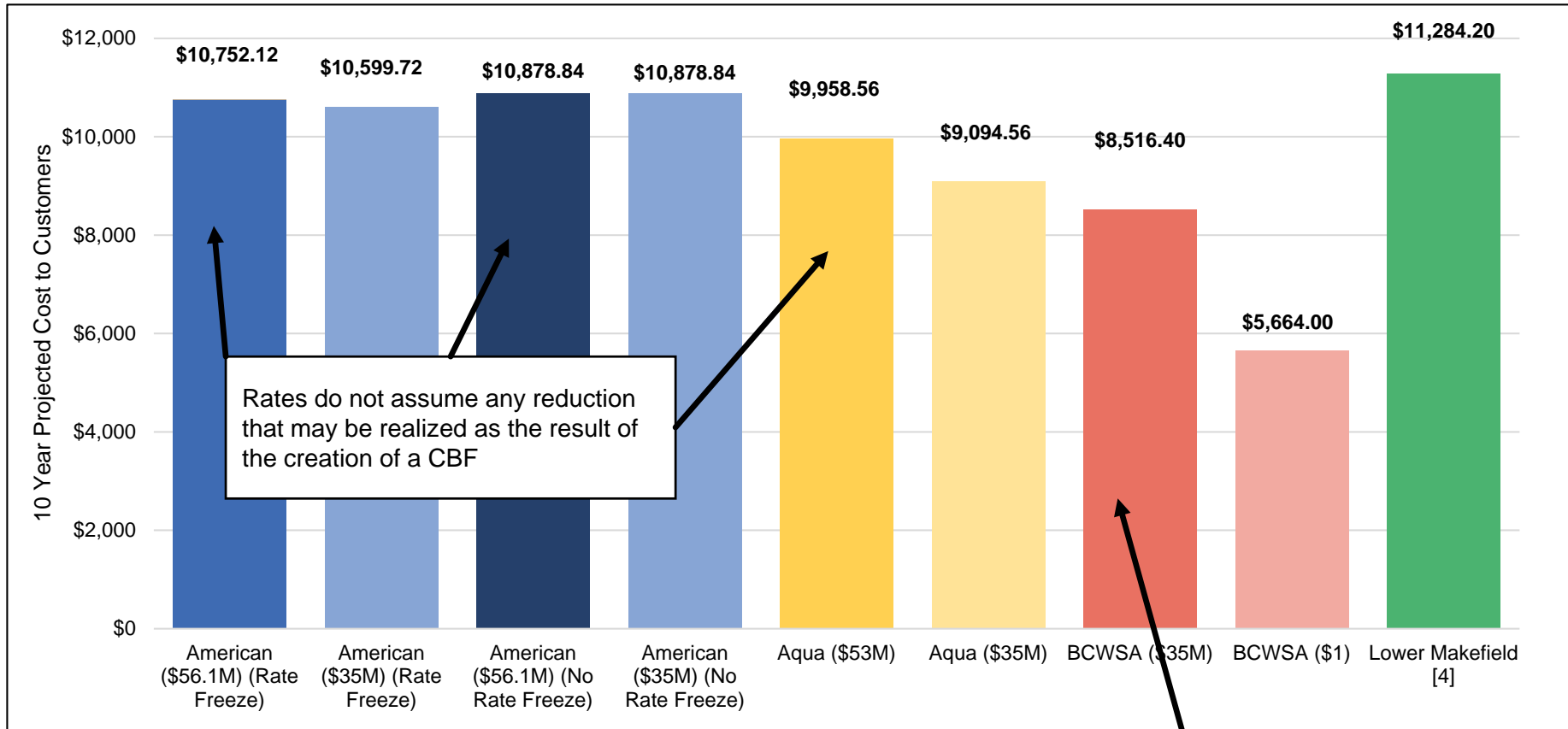
# Summary of \$35mm Bid Results





# Summary of Indicative Rates Comparison

- The graph below shows the estimated total cost an average customer could pay over the 10 year projection in each scenario



NOTE – All the bidders interested in a sale were asked to assume 48,000 gallons/year in the computation of their rates.

Note that indicative bid provided by BCWSA's \$35M proposal do not assume any costs associated with MMA. Any such costs would be supported by LMT residents alone through sewer rates.



# Consideration Point 1: Purchase Price vs Rates

- If the decision is to move forward with a sale of the sewer system, the selection of which bid to accept comes down, in part to, the analysis between purchase price and rates
  - Per the bids received, PAWC offered \$56.1 million, \$3.1 million greater than Aqua's bid of \$53 million, HOWEVER, PAWC's rates are also higher than Aqua's rates
  - Note: Analysis does not factor in any qualitative elements of bids received. Qualitative factors should be considered in conjunction with quantitative analysis

American Purchase Price	\$56,100,000
Aqua Purchase Price	\$53,000,000
Difference	\$3,100,000

Note that in this scenario the additional \$3.1 million in purchase price is not enough to offset the difference in rates

Years	RATES PROVIDED PER RFB									
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
<b>GROSS: American Rates (per RFB)</b>	\$853.56	\$853.56	\$853.56	\$938.88	\$1,034.28	\$1,095.36	\$1,165.44	\$1,244.64	\$1,329.24	\$1,419.60
<b>CBF Balance</b>	\$3,100,000	\$3,162,000	\$3,225,240	\$3,289,745	\$2,323,494	\$2,341,829	\$1,606,805	\$0	\$0	\$0
<b>CBF Earnings</b>		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
<b>CBF Reduction</b>				\$1,011,810	\$27,583	\$766,529	\$1,606,805			
<b>EDU Count</b>	11,598	11,598	11,598	11,598	12,098	12,098	12,098	12,098	12,098	12,098
<b>Growth in EDU</b>		-	-	-	500	-	-	-	-	-
<b>CBF Reduction (to customers)</b>	\$0.00	\$0.00	\$0.00	\$87.24	\$2.28	\$63.36	\$132.82	\$0.00	\$0.00	\$0.00
<b>NET: American Rates</b>	\$853.56	\$853.56	\$853.56	\$851.64	\$1,032.00	\$1,032.00	\$1,032.62	\$1,244.64	\$1,329.24	\$1,419.60
<b>TARGET: Aqua Rates (per RFB)</b>	\$851.64	\$851.64	\$851.64	\$851.64	\$1,032.00	\$1,032.00	\$1,032.00	\$1,152.00	\$1,152.00	\$1,152.00
<b>Difference</b>	(\$1.92)	(\$1.92)	(\$1.92)	\$0.00	\$0.00	\$0.00	(\$0.62)	(\$92.64)	(\$177.24)	(\$267.60)



## Consideration Point 2: Aqua Bid Option 1 vs Bid Option 2

- ◆ In analyzing Aqua's two bids (max price and \$35mm price), it would appear as though the additional \$18 million (difference between their \$53 million proposal and \$35 million proposal) is enough to offset the rate differential
- ◆ Note: Analysis does not factor in any qualitative elements of bids received. Qualitative factors should be considered in conjunction with quantitative analysis

Aqua Purchase Price (\$53mm)	\$53,000,000
Aqua Purchase Price (\$35mm)	\$35,000,000
Difference	\$18,000,000

Note that in this scenario the additional \$18 million would be enough to offset the rate differential

Years	RATES PROVIDED PER RFB									
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
<b>GROSS: Aqua Rates (per RFB)</b>	\$851.64	\$851.64	\$851.64	\$851.64	\$1,032.00	\$1,032.00	\$1,032.00	\$1,152.00	\$1,152.00	\$1,152.00
<b>CBF Balance</b>	\$18,000,000	\$18,360,000	\$18,727,200	\$19,101,744	\$19,483,779	\$18,096,500	\$16,681,476	\$15,238,151	\$13,765,960	\$12,264,325
<b>CBF Earnings</b>		2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
<b>CBF Reduction</b>					\$1,742,112	\$1,742,112	\$1,742,112	\$1,742,112	\$1,742,112	\$1,742,112
<b>EDU Count</b>	11,598	11,598	11,598	11,598	12,098	12,098	12,098	12,098	12,098	12,098
<b>Growth in EDU</b>		-	-	-	500	-	-	-	-	-
<b>CBF Reduction (to customers)</b>	\$0.00	\$0.00	\$0.00	\$0.00	\$144.00	\$144.00	\$144.00	\$144.00	\$144.00	\$144.00
<b>NET: Aqua Rates (\$53mm)</b>	\$851.64	851.64	851.64	851.64	888	888	888	1008	1008	1008
<b>TARGET: Aqua Rates (\$35mm)</b>	\$851.64	\$851.64	\$851.64	\$851.64	\$888.00	\$888.00	\$888.00	\$1,008.00	\$1,008.00	\$1,008.00
<b>Difference</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>

**NOTE:** All rates shown above are annualized sewer rental rates provided by the respective bidders who were instructed to assume an annual residential water usage of 48,000 gal/yr.



## Possible Use Of Proceeds

- ◆ Debt Reduction
- ◆ Replenish other funds that had been depleted
- ◆ Increase the General Fund position
- ◆ Payment of sale related fees
- ◆ Other items to be determined by the Board
  - It should be noted that these additional items do not need to be decided prior to a sale occurring. The PUC approval process of any sale can last upwards of a year, during which time the Township can decide what specifically any additional funds would be used for.





## Customer Benefit Fund

- ◆ Should the Township desire, a portion of the remaining proceeds could be placed into a CBF to help smooth out and/or minimize the impact of any future rate increases.
- ◆ The creation and annual administration of any Fund could be handled by the Township, if desired, with limited administrative burden
- ◆ **Note:** The creation and administration of any Fund would be subject to legal counsel approval



# CBF Glidepath Scenario

- This scenario depicts the outcome should the Township wish to reduce customer bills and manage annual increases, targeting a 5% real increase, such that rates stabilize with Aqua.

Years	RATES PROVIDED PER RFB									
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Gross Average Annual Sewer Bill	\$851.64	\$851.64	\$851.64	\$851.64	\$1,032.00	\$1,032.00	\$1,032.00	\$1,152.00	\$1,152.00	\$1,152.00
Annual Growth		0.00%	0.00%	0.00%	21.18%	0.00%	0.00%	11.63%	0.00%	0.00%
EDUs	11,598	11,598	11,598	11,598	12,098	12,098	12,098	12,098	12,098	12,098
EDU Growth		-	-	-	500	-	-	-	-	-
CBF Balance	\$18,000,000	\$18,360,000	\$18,727,200	\$19,101,744	\$19,483,779	\$18,173,235	\$17,388,211	\$17,166,804	\$16,068,457	\$15,586,841
CBF Interest Earnings	0.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
CBF Reduction					\$1,666,882	\$1,125,969	\$558,011	\$1,413,415	\$787,241	\$129,758
CBF Reduction (to customers)	-	-	-	-	137.78	93.07	46.12	116.83	65.07	10.73
Net Average Annual Sewer Bill	\$851.64	\$851.64	\$851.64	\$851.64	\$894.22	\$938.93	\$985.88	\$1,035.17	\$1,086.93	\$1,141.27
Net Annual Growth	0.00%	0.00%	0.00%	0.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Annual Difference to Gross	\$0.00	\$0.00	\$0.00	\$0.00	\$137.78	\$93.07	\$46.12	\$116.83	\$65.07	\$10.73

Years	PROJECTIONS	
	2031	2032
Gross Average Annual Sewer Bill	\$1,267.20	\$1,267.20
Annual Growth	10%	0.00%
EDUs	12,098	12,098
EDU Growth	-	-
CBF Balance	\$15,766,225	\$15,231,797
CBF Interest Earnings	2.00%	2.00%
CBF Reduction	\$833,090	
CBF Reduction (to customers)	68.86	-
Net Average Annual Sewer Bill	\$1,198.34	\$1,267.20
Net Annual Growth	5.00%	5.75%
Annual Difference to Gross	\$68.86	\$0.00

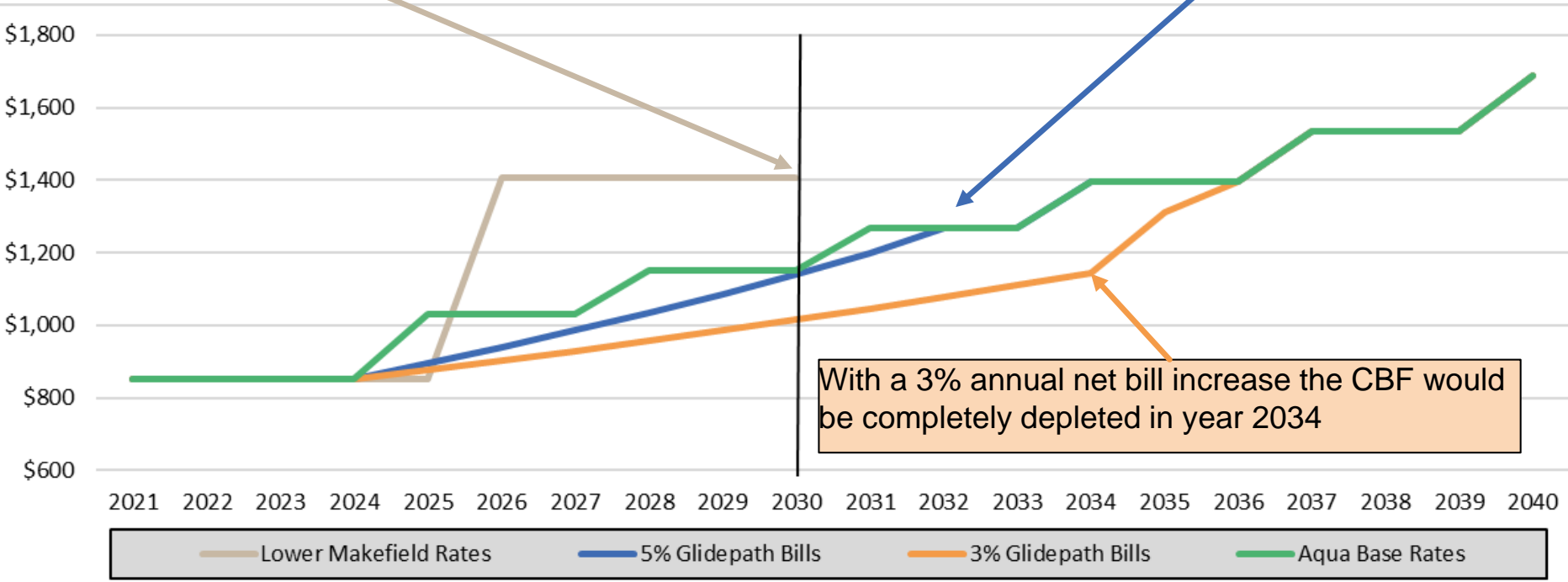
- In this scenario the Township could choose to target an allowable annual net rate increase (in this scenario 5%) and contribute an amount from the CBF sufficient to do so, in order to provide a smooth glidepath to equalize with Aqua's rates.
- Please note that the net annual allowed increase and the length of the glidepath are inverse, meaning that should the Township wish to target a lower net allowable increase it would take longer to reach Aqua's rates
- NOTE: rates projected out past 2030 are based on PFM's internal projections and were not provided by Aqua



# CBF Glidepath Examples

LMT rates are estimates, provided by the Township. Estimated rate increase in 2026 to cover MMA upgrade. It is possible that additional rate increases could follow 2030.

With a 5% annual net bill increase there would still be approximately \$15.2 million remaining in the CBF following equalization with Aqua's rates



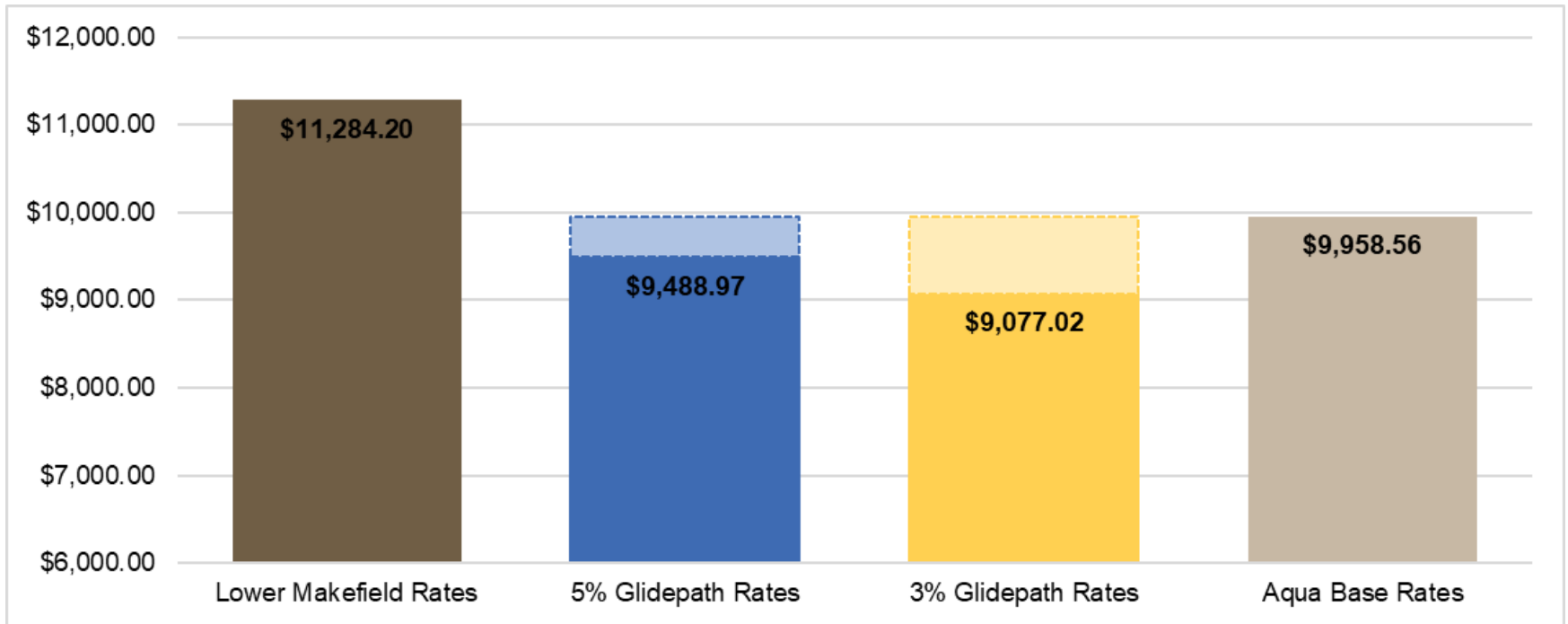
With a 3% annual net bill increase the CBF would be completely depleted in year 2034

Note: Aqua was asked to provide indicative rates through 2030. rate projections following 2030 are PFM's internal projections



# Summary of Indicative Rates Comparison Inclusive of CBF

- The graph below shows the estimated total cost an average customer could pay over the 10 year projection in each scenario assuming different CBF contributions



Remaining CBF Balances	
	\$15,766,543
	\$3,304,410



## Estimated Closing Timeline

- ◆ The closing timeline will be dictated by the type of transaction the Township would like to pursue:
  - Regulated (Aqua/American)
    - Prior to closing an application would have to be made and submitted to the PA PUC
    - Township would be required to obtain an Engineering Assessment report, as well as retain a Utility Valuation Expert (“UVE”)
    - Should the Township decide to pursue a sale to a regulated entity settlement would likely occur in mid 2021 (this assumes the Township makes its decision in the near term).
  - Unregulated (BCWSA)
    - A sale to an unregulated entity would not require PUC approval, therefore shortening the timeline to closing
    - Timeline would likely be dictated on when the unregulated entity is able to enter the capital markets to borrow the funds required to support the purchase price – Typically 3 months



## Disclosure

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