



Memorandum

To: Dan Jerram, First Selectman

From: Joseph Ridge

Date: April 27, 2016

Subject: Potential Purchase Price for New Hartford systems

The purpose of this memorandum is to provide the Town the range of potential purchase prices for the Town's systems. These are highly speculative, since potential purchasers ("Proposers") are likely to have a very different approach to how they would use the systems. Proposers that can effectively interconnect with the Town's systems (either leverage the Town's infrastructure or provide the service from the Proposer's treatment systems located elsewhere) are likely to be willing to pay more than a Proposer that will operate the Town's system as stand-alone systems.

Proposers are likely to assess the value of the Town's system using two different valuation methods:

- **Original cost net of accumulated depreciation (Net Book Value).** Private proposers who will be regulated by the Connecticut Public Utility Regulatory Authority are unlikely to pay more than Net Book Value. Under PUC rules and procedures, a private entity purchasing the assets of an existing entity generally restrict the additions to the Utility's rate base to Net Book Value. (Rate regulation for private utilities provides those entities the ability to generate profit by setting a rate of return on rate base). Since in theory, the rate payers have already used and paid for the accumulated depreciation of the system, the PUC approach in effect prevents the rate payers from paying for the system more than once. Based on our experience, net book value is likely the upper limit of what Proposers might be willing to pay the Town (assuming little or no land or other assets that have significant value outside their utility use.) Strictly speaking, PUC regulation may only apply to drinking water systems and assets, but we have found that private entities adopt this valuation approach for wastewater systems as well.
- **Income Approach.** Proposers will also value the assets based on the income approach that assesses the capitalized income stream that it can generate from the assets/system. This evaluation becomes more subjective since it depends on what the Proposer believes that they can get approval on the rate side and what actual operating costs and allowed return on rate base will be. This assessment will be especially challenging in New Hartford given that the retail rates are currently very high and the Town is unable to recover all of its costs solely

through its user base. As noted previously, if the Proposer believes that it can provide service to the Town's customers without using the Town infrastructure (e.g., the wells and WWTP) that will significantly impact the assessment of the value under the income approach. As the Town is aware, Torrington Water is already interconnected with the Town's water system and has capacity to meet the Town's demands. Thus, it might evaluate the purchase of the Town system as acquiring the customer base with the intent of mothballing the Town's water supply/treatment facilities. Therefore, Torrington Water's calculation for the value might be different than a proposer that would have to use all of the Town's infrastructure and does not have the ability to leverage other assets. We are not aware of any analogous situation on the wastewater side.

Net Book Value Approach

We have taken the asset data provided by the Town to estimate Net Book Value to provide an upper bound in the range of purchase prices that the Town may see. That data is summarized in the table below which is based on the accounting data provided by the Town. As we discussed, there are likely items missing from the table below and there are a few items where we inferred from the accounting description whether an asset is a water asset or a sewer asset.

Asset type	Utility	Date in service	As of 6/30/2014					Value as of /6/30/16
			Book Cost	Book Prior Depr	Book Current De	Book End Depr	Net Book	
Structures	Both	6/30/1960	217,631	217,631	-	217,631	-	
Water Lines	Water	6/30/2001	19,576	19,576	-	19,576	-	
Structures	Water	6/30/2001	6,751	6,751	-	6,751	-	
Materials and Equipm	Both	6/30/1960	89,236	89,236	-	89,236	-	
Structures	Water	6/30/1999	30,000	16,800	1,200	18,000	12,000	9,600
Water Lines	Water	6/30/1988	13,382	8,399	335	8,734	4,648	3,979
Structures	Water	6/30/1995	1,424,309	648,771	36,058	684,830	739,479	667,363
Structures	Sewer	6/30/1999	548,082	194,367	13,702	208,069	340,013	312,609
Structures	Water	6/30/1999	19,759	6,916	494	7,410	12,349	11,361
Structures	Water	6/30/1999	53,511	18,730	1,338	20,067	33,444	30,768
Structures	Water	6/30/1999	25,207	8,821	630	9,451	15,756	14,495
Structures	Water	6/30/1999	27,828	9,741	696	10,436	17,392	16,000
Structures	Water	6/30/1999	140,931	49,325	3,523	52,848	88,083	81,036
Structures	Water	6/30/1999	5,024	1,759	126	1,885	3,139	2,888
Structures	Water	6/30/2003	1,660,361	415,090	41,509	456,599	1,203,762	1,120,744
Structures	Water	6/30/2003	516,693	129,173	12,917	142,091	374,602	348,768
Water Lines	Water	6/30/2003	255,109	63,777	6,378	70,155	184,954	172,199
Structures	?	6/30/2004	38,400	8,640	960	9,600	28,800	26,880
Structures	Water	1/31/2006	141,733	26,280	3,543	29,823	111,910	104,823
Structures	Water	2/27/2007	364,273	57,676	9,107	66,783	297,489	279,276
Materials and Equipm	Sewer	10/5/2007	26,993	6,208	1,080	7,288	19,705	17,545
Structures	Sewer	12/31/2010	8,046,142	502,884	201,154	704,037	7,342,105	6,939,797
Materials and Equipm	Sewer	5/7/2013	5,500	183	183	367	5,133	4,767
Structures	Sewer	12/31/2013	455,690	-	5,696	5,696	449,994	438,602
			14,132,121	2,506,734	340,629	2,847,363	11,284,758	10,603,501

Based on these assumptions, the net book value of the sewer system as of June 30, 2016 is estimated to be approximately \$7,700,000. The net book value of the water system is estimated to be approximately \$2,900,000. We would expect that these represent the upper end of what

Proposers might be willing to offer the Town and given the economics of the sewer system the net book value is likely significantly higher than Proposers would be willing to offer.

Income Approach

Based on the 2015/16 budget, total WPCA expenses are approximately \$768,500, including \$146,000 in debt service. Annual operating revenues are projected to be \$711,400; gross margin before debt service is approximately \$88,600. Since the Proposer is unlikely to assume the Town's existing debt, that gross margin is an appropriate value for projecting the purchase price that the Proposer might pay.

If the Town's existing income stream is capitalized for a twenty year term, the value and purchase price for the Town's water and sewer system is estimated to be approximately \$850,000. We would anticipate that the value of the water system would be approximately half or more of that amount. The sewer system would represent the balance of that amount. We believe that this estimated value is a more likely indicator of what private entities would propose than that derived from the Net Book Value methodology.

Summary

We would anticipate that the purchase prices that New Hartford could receive is in the broad range of \$850,000 to \$10 million. However, based on the financial status of the sewer system, we would anticipate that the amount paid will be on the low end of that range (less than \$1 million). We did searches for other comparable market transactions and did not find much. We did find a press release from Aqua America announcing that it had acquired several systems in Virginia, Texas, Pennsylvania and North Carolina. From the press release, the systems ranged in size from 100 residents to approximately 1,200 with the purchase prices ranging from \$50,000 to \$600,000. Unfortunately, we were unable to find any detailed information about those transactions, but it does reinforce our sense that the purchase price will be at the lower end of the range noted above.

Ultimately, the bidder's will make a determination of the value of the system to them and their ability to generate a profit from the purchase. The calculus each bidder uses will reflect their assessment of the situation and their unique operating situation and business plan. Until the Town receives proposals, it will not know the outcome of that evaluation. Ultimately, the Town will need to determine if the bid price and the overall business proposal meets the Town's goals and objectives.

cc: Bud Butler – WPCA, Chairman

Timothy Dupuis—CDM Smith