USDA

United States Department of Agriculture

Date 10/23/2019

SUBJECT: Town of New Hartford, CT
WEP Water/Sewer Borrower, various loans/grants
Request for approval of Sale of Asset to For-Profit

TO: George Krivda, State Director
Rural Development MA/CT/RI

FROM: Jen Lerch, Director
Business and Community Programs
Rural Development MA/CT/RI

Background

The Town of New Hartford (CT) contacted the Agency in 2018 concerning their wish to sell a portion of the Town's W/S infrastructure financed with Agency Loan/Grant to Aquarion Water Company, a for-profit company who specializes in privatizing such public infrastructure in various parts of the U.S., largely since 2012. Given the unusual nature of the request, a thorough analysis was conducted to determine reasoning, and to develop position to approve or decline.

Situation Summary

The Town issued a "Request For Proposal" with intent to sell the subject infrastructure to avoid further deterioration of financial performance and related increase in rates to an already burdened user base. Although the Agency was not notified, borrower request for consent is satisfactory notice and consideration; they await our approval.

Four proposals were submitted, with Aquarion Water Co. being high bidder of $8M. Condition of sale includes repayment in full of Agency loans with first priority in the aggregate amount of $3.6M (to be adjusted to closing date). Beyond Agency loan repayment, the Agreement requires that the remaining proceeds will held in escrow, to provide for "engineering services, construction, contingencies, sewer and water customer subsidies and user connection fee assistance to support system upgrade". With such upgrades, the existing users will gain rate relief and the subject area may be developed to the benefit of the community now strained to meet debt service from expanding into an area not previously developed due to recessionary downturn that continued until 2014.

In short, the Agency funded a loan for development on speculation which failed to materialize. This intended expansion of the system will allow for more currently needed connections and in return will positively benefit users by reducing average monthly costs to all. At the time of underwriting system costs are extremely high when considering other Similar System information from Tighe & Bond (an engineering firm working throughout Southern New England), which shows an average annual cost of $225/year compared to New Hartford at more than $1,000/year.

At present, excessive user fees create a sustainability concern for the Agency, with borrower financials confirming hardship. Based on the 5 Year Financial Analysis summary (attached) borrower operations have been negative in each of the past 5 years. 2018 financials show further loss, with default being increasingly imminent. Lastly, the borrower has alluded to intent towards proceeding with the sale to avoid default. With that in mind, the Agency has limited (if any) recourse were we to decline this request if the borrower chooses to proceed with sale.

<u>Material Considerations</u>
Under Executive Order (E.O.) 12803 Infrastructure Privatization, Section 2. (*Fundamental Principles):*
"... adequate and well maintained infrastructure is critical to economic growth and in order to allow the private sector to provide for infrastructure modernization and expansion, State and local governments should have greater freedom to privatize infrastructure assets."

Further, Section 3. (*Privatization Initiative)* dictates that:
"...the Agency shall encourage appropriate privatization of federally financed infrastructure assets owned by state and local governments"

In determining what amount of Agency grant should be repaid, if any, grant repayment amount is also determined by Executive Order (E.O.) 12803. E.O. 12803, which states that:

"... first, state and local governments shall recoup in full their portion of project costs. If proceeds remain the Government shall recoup in full the amount of grant awards, less the applicable share of accumulated depreciation calculated using the Internal Revenue Service ***accelerated depreciation*** schedule for the categories of assets in question. IRS Publication 946 indicates a 15 year depreciation period for a Wastewater Treatment Plant."

The following sets forth consideration of amounts to be repaid:

1. Stated Sale/Purchase Price – Depreciated Value = Excess Value of proceeds from sale
2. Excess Value - (Borrower Recoup) = Remaining Value of proceeds from sale
3. Remaining Value – Agency Loan Repayment = Repayment of Grant to Agency

$8,000,000 Sale/Purchase Amount
<u>($3,248,000)</u> Depreciated value 2020*
$4,752,000 Excess Value of proceeds from sale
<u>($2,556,576)</u> Borrower recoup from P&I payments to Agency on borrower loans since inception
$2,195,424 Remaining Value from proceeds from sale after recoup credit

With all remaining proceeds from sale being directed at Agency Loan repayment of nearly $3.6M, $0 proceeds remain towards Agency grants repayment.

<u>*Accelerated Depreciation (Modified Accelerated Cost Recovery System MACRS) Depreciated Asset Value</u>

$3,248,000 = Current value after depreciation, 60% depreciated (9 years) using Project cost "as built" of $8,950,000 per application and PER, confirmed by Agency Engineer.

<u>Grants</u>
#04) $ 288,700 received on 7/16/1996 for Water and Sewer
#06) $1,132,640 received on 7/19/2000 for Water
#08) $ 360,878 received on 6/27/2002 for Water
#10) $4,026,790 received on 9/15/2010 for Wastewater Treatment Plant

<u>Loans: Balance as of 9/20/2019</u>
$3,557,134.47

<u>Considerations</u>

1. Privatization of asset serves to ensures that the United States achieves the most beneficial economic use of its resources in accordance with Executive Order. 1280 of April 30, 1992 ("Private enterprise and competitively driven improvements are the foundation of our Nation's economy and economic growth").
2. Privatization of asset serves a compelling local government interest.
3. Privatization of asset would result in expansion of system which would positively impact New Hartford's rural population.
4. Privatization of asset is in best interest of Agency as it avoids borrower default of ARRA funded asset.

<u>Recommendation</u>
The Agency has no objection to the proposed sale as the Agency will be reimbursed for the remaining total loan balance and there are no grant proceeds remaining when accounting for the borrower's portion of project cost and the depreciation of the asset.

I have reviewed and approved the sale of the federally funded asset.

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State Director: George Krivda Date