

SCHLEY COUNTY GEORGIA WATER SYSTEM
A DISCUSSION CONCERNING A SHORTFALL OF REVENUE
March 15, 2012



Prepared by:

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General

Disclaimer: This report was prepared by the Georgia Rural Community Assistance Program (GaRCAP) at the request of The Georgia State Office of the US Department of Agriculture, Rural Development. The opinions offered herein are those of the writers and are to be construed as considered opinions and suggestions.

Purpose and Scope:

This document discusses the problem of a substantial shortfall of revenue that is currently being experienced by the Water System of Schley County, Georgia.

The scope of this writing is to offer suggestions for correcting the shortfall and to hopefully arrive at a plausible solution that is short of any court action. Several thoughts aimed at a remediation are presented. While each is positive in intent the report will suggest that no one remedy short of recalling one or both of the loans outstanding and reissuing them with a negotiated lower interest rate, will immediately fix this situation. Even that approach will need complementary support from other lesser acts or actions. Each topic is offered as a suggestion, nothing more. The scope of this document is therefore limited to a discussion of possibilities for improving a critical situation; one that has failed to make conclusive positive movement for the past two and one-half years. Any and all conclusions enacted as a result of the discussion contained herein must remain within the political and administrative domain of the elected and duly appointed officials of Schley County acting in agreement with representatives of the lending agency, the US Department of Agriculture, Rural Development.

Section I

Statement of the Problem

The amount of revenues collected from the sale of the water provided by the system does not meet the needs specified to operate the system and to satisfy the conditions of the contractual agreement as negotiated by all parties to the agreement; that being the County as the borrower and the US Department of Agriculture, Rural Development, as the lender. This shortfall has as of the date of this report extended to the point that more than twenty-nine monthly installments of approximately \$18,342 are overdue. Without considering the additional charges that have accumulated on that which is past due, the delinquent amount is quoted by the Barnesville District Office of Rural Development to be in excess of \$513,576.

Discussion:

An accepted rule of thumb pertinent to this situation is that either revenue must be increased substantially or the expenditures must be reduced drastically. In this case both are needed but realistically neither, individually nor collectively, will provide a timely and satisfactory solution. It appears that the root of the problem is that inexact data was used to justify the amount of the loan that was offered by Rural Development and accepted by the County to fund the construction of the second phase (locally referred to as Phase II) of the Schley County Water system. Assumedly the engineer and the County officials proposed to the lender that the water system would have 960 customers. It began operation with only 363. It was reported the customer count was accepted as a valid number and loan arrangements were based on those data. The count method was verbally reported in two interviews saying that the count was certified by the then County Manager and submitted as fact to the then proposed lender. Field research produced information that was somewhat ambiguous. It was never suitably verified as fact, but the results, the actual dollar numbers of the loan substantiate the premise. If 960 customers had actually been the determining factor and not 363, the loan would have “cash-flowed” as intended. Needed was an interview with the then County Administrator or Manager to corroborate the facts surrounding the determination of intended customers and all attempts to locate the person who certified that count failed to result in any response to written messages sent or verbal ones left via telephone.

Reiterating from above, if initially there had been an actual 960 customers instead of the original 363^[1], and given that the operating and Maintenance (O&M) costs would have been reasonable as predicted, sufficient revenue would have been generated to service the debt of the Phase II loan as it was consummated. The collateral intended to support the issuance of the revenue bond that backs this loan is the dedication of all revenues generated by the sale of the water the system provides or will provide to customers.

^[1] According to most recent data obtained from the County Water Billing Section there are now 420, not 360 customers. This will be discussed in greater detail later in this document.

Background:

There are two outstanding Water Revenue Bonds associated with the Schley County Water System construction; *Series 2003* (issued April 9, 2003) and *Series 2008* (issued September 3, 2008). The earlier one, Series 2003, is and has always been current (never delinquent as this report is written) but the later one, the Series 2008 which funded Phase II, has never been current since its first year when interest only was indeed paid by the County. That loan remains unpaid since October 2009^[2]. Nothing has been paid since. Again, the amount of principal and interest that is currently in arrears on this Series 2008 Bond is \$513,576.00. (March 2012).

Since the inception of the Series 2008 loan the water system has added approximately 68 new customers. According to the County billing records in February 2012 the system now has 431 customers. January 2012 records show the water system collected \$17,787 and that the average collection for the past several months was approximately \$20,200. The debt retirement obligation for both Phases I and II totals \$25,582. To that the cost of O&M must be added.

In basic terms if the addition of new customers (and the new revenues generated there from) is explored here then it follows that the number needed to balance the financial equation will be at least the 960 number originally submitted by the engineer and the County Administrator (Manager) to Rural Development when the loan was negotiated. To compensate the question arises as to the value of increasing the average monthly bill to a point where the situation is solvent.

There is presumably an upper limit to which rates may be raised before existing customers start to drop off line. As they do, rates must in turn increase more to compensate for those currently dropping off. Obviously this act is self-defeating because as more and more cease to be paying customers, the overall financial burden to exacerbate. It is logical to assume that the holder of the loan could call the loan, and that could and probably would result in receivership being imposed by the State attorney General on the county water system. This could result in a court-ordered rate schedule being imposed so as to meet the contractual obligations of the loan and successfully amortize the outstanding principal. This begs the question, would such a conclusion work since presumably, more and more customers would discontinue service. Inexact calculations show that even with no customer dropping off the needed amount to meet the debt requirement is around \$110 per month. This cannot be sustained in a county where the median household income (year 2000 census data) is quite close to the poverty level.

During field interviews held by RCAP staff with various stakeholders several courses of action were suggested ranging from total forgiveness of the loan, to a reduction of the principal or interest rate of the loan, to increasing the tax rate to discharge the loan. Regardless of the sensibility of each, those suggestions will be addressed in this report.

^[2] The Series 2008 Bond issuance was due with the payment due for the first year being paid as interest only. The first actual monthly installment was due and payable on October 1, 2009.

The county officials have stated unequivocally that no increase in property taxes will be considered to alleviate this issue since that would in effect be asking all taxpayers of the County to pay to subsidize the water system whether or not all of those so billed were receiving the benefits of the water system. This is a legal matter but in lay terms it could raise the issue of taxation without representation.

The suggestion that the remaining balance of the principal would be re-amortized so that the new monthly installments are within the capability of the participating customer-base is well beyond the scope of this report and would be limited to negotiations by representatives of the County and those of the lender; the US Department of Agriculture, Rural Development. While this report does not respond to questions of reduced principal, a discussion of re-implementing the loan that is in default at a reduced interest rate will be discussed later^[3].

Section II

Factors Bearing on the Situation

The Schley County Water System is large in physical dimension but its customer base is small. The system supervisor reported the system has 74 miles of water mains plus an elevated tank and two deep wells. The system was originally designed to serve nearly a thousand customers plus the town of Andersonville (a single wholesale customer) which is some twelve miles East of the County Seat. The distance is important in that the connecting water line has fed revenue-producing customers tapped on to it and therefore makes the tie-on of Andersonville economically questionable.

The system initially also served the County Seat, Ellaville, with its 1020 customers while Ellaville was repairing its own well pumps. But the rate charged to Ellaville and to Andersonville was only \$1.65 per 1,000 gallons. This was below cost as calculated by Georgia RCAP staff. (Andersonville still purchases water from the Schley County Water System but the service is now on a limited basis and reportedly Andersonville only purchases enough water to fill its storage tank once per week, or less. Ellaville, having completed repairs of its own water system is no longer a user/customer). On a more positive note, the original customer count for the Schley County Water System has grown from the original 363 in 2008 to 431 in 2012. (19% increase in four years).

But to barely “cash-flow” the system needs as a minimum the originally expected number of customers (960), or it needs both a rate increase and an increase in the number of customers. The existing rates are already above those charged by the two towns of the area.

^[3] A reduction from 4.375% to 2.375% would reduce the monthly installment from \$18,342 to \$13,280. This could make the difference given the fact that the County has experienced rapid growth during the last decennial.

According to a *Georgia Water and Sewer Rate Survey* published in 2011 and conducted by the Georgia Environmental Finance Authority (GEFA) in conjunction with the Environmental Finance Center (EFC) a comparative analysis of user charges for water systems in Georgia^[4] shows that Schley County now charges an average water bill of \$37 with a per 1,000 gallon usage rate of \$3 after the first 1,000 gallons. The survey compares the cost of water by Schley County Water System to that of the town of Ellaville (the County Seat). Ellaville charges an average bill of \$20.20 plus a per 1,000 gallon rate of (only) \$2 after the first **10,000** gallons. Similarly, Andersonville charges an average bill of \$18 and \$3 per 1,000 gallons. The point is the Schley County Water System is already charging rates that are nearly twice what other nearby systems charge with the paradoxical fact that it has in the recent past sold its water to each of those towns listed for costs as low as less than half of what it charges its own. If Schley County does institute a rate increase now, and it should, it will impose a political issue. Still, a part of any solution to this problem will indeed have to have rates increased as a part of the solution, whatever it may or can be..

The recent 19% addition of new customers to the Schley County Water System is promising but the ratio of the number still needed versus the number present is more than 2:1. The basic arithmetic of dividing the full amount of the two monthly loan payments by the number of customers ($\$7240 + \$18,342 = \$25,582$ divided by 431) equals \$59.36 per month on average. But that is the amount needed to satisfy just the debt service component. When the anticipated O&M costs are added the average monthly bill is around \$100 per customer.

Had the originally assumed number of 960 customers actually become manifest the debt retirement factor would have apparently been manageable at \$27. With the O&M added it would have been about \$40. This would have apparently been a manageable number when placed against the data presented in the latest County audit.

The latest County audit (shown on page 30) shows that last year the County made a short-term loan in the amount of \$825,126.00. It also suggests that revenue from the water fund was apparently used to repay the loan. This loan was due and payable by December 31, 2011, and was indeed paid to the local bank. The Georgia Constitution (Article X) prohibits chartered local governments from borrowing with terms extending beyond the end of the current calendar year. As an apparent “work-around”, it is fairly common for small local governments across the state to have such a loan on an almost continuing basis. The loan is paid off just before December 31 and renewed just after January 1. The collateral for such loans are or apparently may be the faith and credit of the local government, or may be a combination of assets including water revenues. The proceeds of the loan discussed now are not specifically identified in the audit. Legal counsel would be needed to determine if any revenue that is generated by the sale of water could be used to pay toward the local loan. Such an arrangement could be a violation of the conditions of the loan extended by Rural Development for the construction of the two phases of the Schley County Water System.

^[4] See www.efc.unc.edu/ratesdashboard/GARatesdashboard or www.GEFA.org for comparative analysis of rates charged in Georgia in 2009.

Two Phases of Water System Construction (Background)

The Schley County Water System was constructed in two separately designed, separately funded, and separately built phases. Phase I was built using funds from a construction loan dated April 9, 2003 in the amount of \$1,584,600. The details of that loan are a 4.5% interest rate over a term of 40 years. The monthly installment is \$7,240. It is stressed that the loan obligation associated with Phase I is current and has remained current from the beginning. This loan was extended by the US Department of Agriculture, Rural Development along with an associated grant offer in the amount of \$4,795,600. The total cost then of Phase I was estimated as the sum, or \$6,380,200.

Phase II carries a loan of \$4,112,400, and is dated September 3, 2008. Phase II has an interest rate of 4.375% and a term of 40 years. The monthly installment on Phase II is \$18,342. This loan was extended by the US Department of Agriculture, Rural Development along with an associated grant offer in the amount of \$3,000,000. The total cost then of Phase I was the sum, or \$7,112,400.

The Phase II loan has remained unpaid since the second installment was due in October 2009. As of February 2012, the loan is in arrears in the amount of \$513,576. The current outstanding balance is \$4,538,569.22. (This is more than the original principal because of 29 unpaid installments and accrued interest). The installment payment due each month for both loans together is \$25,582.

Coincidental with the timing of the first monthly installment on the loan associated with Phase II a new and different Schley County Commission Chairman was elected. The new Chairman inherited an already consummated loan that could not “cash flow” within the revenue that roughly one-third of the planned number of customers could generate. Whether or not the then County Administrator verified and validated the customer-count to be the discussed 960 instead of the actual 363 has been discussed at length above. It is unverified.

Routinely a project such as this one involves signed pledges from prospective customers so that the lender has a bonafide basis for determining the financial parameters of the loan to be offered. Research for this report did not locate any signed pledges by prospective customers although such a signed validated count is reportedly on file with the USDA Rural Development office in Barnesville. And this is the number (customer count) used to develop the loan/grant financial parameters

There was an option put forth in the original terms of the planned Phase II that offered a potential customer to pay a relatively small fee (\$150 was quoted) in exchange for a dry-tap. This may indeed be the Achilles heel of the cash flow deficiency. It could be the difference between the originally planned 960 and the actual 363,

A *Dry tap* is defined herein as having the proper plumbing connection made to the actual water main at the time of its installation (construction) that would then already be in place should the property owner decline service initially but want to tie on to the system

at a later date. No actual service (or monthly bill) would result and therefore no revenue was forthcoming from dry taps. It was apparently an attractive offer for many would-be customers. Those who chose to do this had a form of insurance that would allow them future water service at their discretion at a cost that was probably ten percent of what it would actually have cost later. Reports from the field indicate that there remain approximately 800 pre-sold taps that have not been added to the system

This action resulted in the loss of two-thirds of the expected customer base and that quantity somewhat corresponds to the shortfall of revenue initially experienced by the County water system. If the procedure is in fact as represented herein, was there any type of legally binding agreement signed by the originally surveyed potential customers that would obligate them to become paying subscribers/users of the water system when it was completed and on line? Did the USDA/RD then use the originally discussed 960 customers in its mathematical calculations of loan potential only to find the actual number was closer to 360?

Summary:

The loan for Phase II construction cannot “cash-flow” as negotiated without the full complement of revenue sources (customers). In Georgia the USDA, Rural Development, uses an arithmetic method based on year 2000 (for Phase II, year 1990 for Phase I) U.S. Census Median Household Income data as the basis for determining a reasonable amount that may be charged for an equivalent domestic user (EDU), or average user, to ensure that an over-burdening financial situation is not created. This methodology would have worked as planned had the actual count of paying customers been manifest.

The Phase I construction has monthly installments of \$7,240. The Phase II has monthly installments of \$18,342. They total \$25,582. As of February 2012 the Phase II loan is more than \$513,576 in arrears..

These two loans were separately funded by USDA/RD. That agency is often referred to as a lender of last resort, meaning that an approved applicant must have been unable to secure the necessary funding at reasonable terms on the commercial market. In other words, as a federally funded agency USDA/RD avoids competing with the open market yet may offer funding aid once the commercial market declines. Routinely if the allowable amount of loan that the agency considers to be manageable for the community is not enough to complete the approved project, grants may be offered. The State Director of USDA/RD determines the amount of grant that can or may be offered. In the case of Schley County, Phase I received a grant of \$4,795,600. The grant amount of the separately funded Phase II was \$3,000,000. (Loans for each Phase were \$1,594,600 and \$4,412,000 respectively). The total amount of loans for both phases was \$6,006,600. The combined monthly installment to repay the combined loans is \$25,582. (Annually that amounts to \$306,984). Dividing by 363 customers the average customer’s monthly *debt retirement* share would be approximately \$71. Using the March 2012 customer count of 430 customers, that figure adjusts downward to \$60.

Operating and Maintenance (O&M) costs must be included along with the calculated debt retirement costs. The Water Superintendent stated in an interview in 2010 that the average monthly O&M was \$7,000. However, the most recent audit as filed with the Georgia State Bureau of Audits showed an extrapolated figure of \$13,000.^[5] This report uses the following data in its scenario: \$13,000 for monthly O&M and 430 revenue customers. Dividing by 430 customers, O&M adds \$30 to the basic monthly bill. Actual water consumption is another factor to consider. A ten percent increase if the commodity, water actually used, is added. This amounts to an estimated \$9 added to the base charge. The aggregate then is approximately \$100 for the EDU, or average user.

Section III

Discussion of Suggestions and Recommendations by Georgia RCAP Staff

1. ***Increase the customer base:*** The Growth rate for Schley County^[6] between the years 2000 and 2010 is shown on the web to be a remarkable 33%. Even if this phenomenal rate could be sustained, it would take another fifteen to eighteen years of accepting a diminishing but present shortfall before the revenue base could be expected to break even.
2. ***Increase the user charges:*** In order to immediately produce the revenue needed to meet the existing obligation rates would have to more than double what they are now. This would be impractical.
3. ***Forgive a portion of the outstanding loan principal:*** This alternative is cited here because it was discussed during the research for this document. It is a political as well as institutional matter that is beyond the scope of this report.
4. ***Reduce the interest rate on the outstanding loan balances:*** Although also beyond the scope of this report it may be germane to point out that if the outstanding bonded indebtedness could be renegotiated and, for example, if today's lower interest rate of, say, 2% and a traditional (new) term of 40 years were installed on a renegotiated loan for just Phase II or for a new loan for both loans combined, the monthly payment on the 2003 series would drop to around \$4,400 and with the same parameters the series 2008 loan would drop to \$13,745 for Phase II only. Perhaps less if both loans are combined and renegotiated. The total debt service would then be around \$18,000 per month; a reduction of approximately \$7,000.^[7]
5. ***Negotiate the sale of that portion of the Schley County Water System that is in neighboring Sumter County:*** The Georgia Rural Community Assistance Program (GaRCAP) has been

^[5] Appendix B – Schley County Water System Income Statement for 2011

^[6] <http://census-statistics.findthedata.org/1/520/Schley-County-Ga>

^[7] See Appendix A - Amortization Calculator

working with the City of Americus, County Seat for adjacent Sumter County, to determine the feasibility of creating a new water authority in Sumter County. The kernel of this new system would be that portion of the Schley County Water System that is in northern Sumter County. If this strategy is to be successful it will be several years before it can be implemented. The intent would be the purchase of that part of the Schley system by a newly formed water authority with the funds of the purchase being paid directly to USDA/RD to reduce Schley County's obligation for delinquency on its Phase II loan. Some details follow:

The City of Americus, as a prime member of the newly formed water authority would be represented on the newly created board of governors of the authority and the new system's new customers would at the beginning purchase water from Schley County. Those already on the existing Schley County Water System would continue to be supplied by Schley County but they would become customers of the newly formed authority.

If the city of Americus were to extend its water service into the county, not as the loan/grant ineligible City of Americus but as the newly formed water authority, that authority would make application to the USDA/RD for loan and grant aid to both purchase (a part) and construct the new system. Americus has a population that is greater than the ceiling imposed by USDA/RD (10,000). Since the plan must include some form of grant aid, and since Americus is ineligible because of its population size, the water authority is the mechanism to get the water service extended to this part of the rural county. The Sumter County Commission has declined to get in to the water business.

APPENDIX A

This Spreadsheet Shows an Example of the Payment Reduction on Phase II if the Interest Rate is Reduced to 2%

Loan Amount	\$4,538,569						
Annual Interest Rate	2.00%						
Payment Period (months)	1						
Number of Periods	480						
Payment Period	Payment Amount	Cumulative Payments	Interest	Current Period Principal	Cumulative Principal	Principal Balance Paid	
1	\$13,743.95	\$13,743.95	\$7,564.28	\$6,179.67	\$7,564.28	\$6,179.67	
2	\$13,743.95	\$27,487.90	\$7,553.98	\$6,189.97	\$15,118.26	\$12,369.64	
3	\$13,743.95	\$41,231.85	\$7,543.67	\$6,200.29	\$22,661.93	\$18,569.92	
4	\$13,743.95	\$54,975.80	\$7,533.33	\$6,210.62	\$30,195.26	\$24,780.54	
5	\$13,743.95	\$68,719.76	\$7,522.98	\$6,220.97	\$37,718.24	\$31,001.51	
6	\$13,743.95	\$82,463.71	\$7,512.61	\$6,231.34	\$45,230.86	\$37,232.85	
7	\$13,743.95	\$96,207.66	\$7,502.23	\$6,241.72	\$52,733.08	\$43,474.57	
8	\$13,743.95	\$109,951.61	\$7,491.82	\$6,252.13	\$60,224.91	\$49,726.70	

To show altered projections for the Schley County loan double-click anywhere on the spreadsheet and change the data in the Loan Amount, Interest Rate, Payment Periods and/or Number of Periods.

APPENDIX B

Comparison of Revenue, to Operation & Maintenance Expenses and Debt Service Expenses

The following tables represent a snapshot of the past calendar year from Jan – Dec 2011. Included are Revenue, O&M and Debt Service expenses for the Schley County Water System.

(Source: County Audit dated July 2011 and Income Statements July 2011 – Jan 2012)

Expenses for O&M and Debt Service exceed total revenue nearly \$232,000 for the year.

Revenue

Water Sales	\$242,400.00
TAP Fees	<u>6,000.00</u>
Total Revenues	\$248,400.00

Debt Service

2003 USDA	\$86,880.00
2008 USDA	220,104.00
Local Loan Interest	<u>15,000.00</u>
Total Debt Service	\$ 321,984.00

Expenses

Salaries	\$ 35,000.00	Telephone	\$ 3,770.00
Payroll Tax	1,600.00	Insurance	10,000.00
Worker's Comp	3,000.00	Utilities	28,394.00
Chemicals	24,370.00	Pipe Fittings	12,184.00
Water Fund Supplies	5,086.00	Bank Charges	40.00
Legal Expenses	1,780.00	Postage	1,774.00
Gas/Fuel	18,250.00	Repairs	10,294.00
Training/Travel	2,254.00	Computer Support	<u>299.00</u>
Total Operating and Maintenance (O&M) Expenses			\$158,295.00^[8]

^[8] By the month O&M average cost \$13,191.00