

MINUTES OF SPECIAL CALLED MEETING OF THE
CITY COUNCIL OF THE CITY OF SANFORD
SANFORD, NORTH CAROLINA

A special called meeting of the City Council was held at the Sanford Municipal Center, 225 E. Weatherspoon Street, on Wednesday, December 21, 2011 at 10:00 A.M. in the West Conference Room for the purpose of a Wastewater Study Workshop. The following people were present:

Mayor Cornelia P. Olive	Council Member James Williams.
Mayor Pro Tem Sam Gaskins	Council Member Walter H. McNeil, Jr.
Council Member L. I. "Poly" Cohen	Council Member Rebecca Wyhof
City Manager Hal Hegwer	Council Member Jimmy Haire
City Attorney Susan Patterson	Council Member Charles Taylor
Deputy City Clerk Janice Cox	City Staff

Absent:

City Clerk Bonnie D. White

Mayor Olive called the meeting to order.

Consider Motion to Take from the Table Discussion Regarding the Wastewater Study for the City of Sanford, Pittsboro, and Chatham County –(Exhibit A)

Council Member James Williams made the motion to take from the table Discussion Regarding the Wastewater Study for the City of Sanford, Pittsboro, and Chatham County; seconded by Council Member Walter McNeil, the motion passed unanimously.

Mayor Olive introduced Alexis Warmath, Vice President of Raftelis Financial Consultants, Inc., to review and explain the results of the wastewater study his firm conducted for the City of Sanford. Mayor Olive explained that questions to Mr. Warmath would be limited to the staff and City Council, but advised that Mr. Warmath has business cards available for any audience members who may wish to contact him.

Presenting background information, City Manager Hegwer explained that Sanford and Pittsboro have been pursuing some wastewater treatment options for several years. Currently, we are in a construction phase to increase capacity from 6.8 million gallons a day to 12 million gallons a day. We have taken advantage of funding through the American Recovery and Reinvestment Act (ARRA) which provided us with historically low interest rates and historically low construction prices that were reflected in the bids we received. Pittsboro has received a permit to build or expand a wastewater treatment facility on the Haw River which will give them a capacity of 3.22 million gallons a day in addition to what they now have. They are at the point now with moving on the design and ultimately the construction phase. There have been intermittent conversations over the years about whether there is any benefit in our working together. They are now considering whether there are any benefits-- regulatory, financial, or environmental in moving forward together. They have positioned themselves so that they could

move forward with their project. We have moved along with ours. The study is all about whether there are any benefits that we can achieve together.

Mr. Warmath discussed the process Council might want to go through to look at this opportunity and the basic concepts and issues they need to be aware of and consider as they go through the process. It is his understanding that Pittsboro and Chatham County have commissioned a study to look at their alternatives, comparing the option of building their own plant versus building a line to Sanford, seeking treatment from Sanford. The question is whether or not the City of Sanford would contribute to that study, going forward. That is a common first step in the process. There are a lot of unknowns and a lot of issues to address. The study will provide some key answers or key information. The answer to whether there are regulatory and environmental benefits should come out of the study. It will give the basic information as to the cost difference between Pittsboro building its own plant or laying a line to Sanford. Then, they have to consider what Sanford would be charging for that service. Would that be more or less than the cost of building a plant? Mr. Warmath narrated a slide presentation (Exhibit B) covering the following points and answered council members' questions.

Slide 1: Opportunity to Provide Wholesale Wastewater Service to Pittsboro

The primary objective is to create a win-win situation for both parties with Sanford having short and long-term financial benefits for existing retail customers and for Pittsboro to have a lower cost option (or at least, an equal cost option) for wastewater treatment and to secure commitment for service.

Slide 2: Key Issues to Consider

First, the term of commitment/contract must be determined. This involves defining the term with renewal options; perpetual (very long term)—consideration of the impact on future expansions/capacity/and participation by wholesale customer in next expansion. Second, ownership must be established. This involves rights to capacity vs. ownership of assets; up-front payment for capacity including cost of capacity and reducing rates charged for service. Third, the effect on economic development—whether it will be positive or negative-- must be considered.

Slide 3: Economic Benefit to Sanford Customers

There are incremental costs to be considered. These include cost to provide the next unit or increment of service; most costs are fixed –capital and operating and maintenance; variable costs for O&M—mainly chemicals and electricity with typically 15-25 percent of direct plant O&M costs; and any cost to recovery over the incremental cost provides economic benefit to the retail customers—to offset fixed cost components.

Slide 4: Economic Benefit to Sanford Customers

First, the cost of unused capacity—Debt service and fixed O&M costs currently recovered from existing customer base—small customer base relative to capacity resulting in high average unit costs and a risk of losing a large industrial customer. Second, the objective is to reduce average unit costs by leveraging existing capacity as quickly as possible by growing retail customer base or by serving other communities.

Slide 5: Wholesale Rate Setting (An Example)

Operation and Maintenance Costs –Proportional share of direct costs for wastewater treatment (pro rata); proportional share of indirect costs benefiting the WWTP (pro rata); and excludes costs related to retail only service (local collection system, customer service, billing, etc.) Pittsboro will have these costs for their own system.

Slide 6: Wholesale Rate Setting (An Example)

The Capital Costs (cash needs approach): This would include an allocated share of debt service, plus coverage for the new plant based on capacity allocation or based on usage (pro rata). Wholesale rate is designed to provide equitable cost recovery which would be significantly above the incremental cost of service, but lower than the retail rate.

City Manager Hegwer mentioned that the City has some wholesale water customers who provide some diversity in revenue for us. If a large water customer were to leave, we do have additional revenue from other entities. They supplement the retail base, providing us some stability on the water side; we do not have that on the sewer side. We sell water to Broadway, Chatham County, Carolina Trace, and Goldston-Gulf, for example. He stated that we need to look at providing wastewater-treatment services to Pittsboro to determine if it is feasible and beneficial for both parties.

Slide 7: How the Process Works

Step1: Preliminary Study—Define estimated costs for alternatives; identify environmental and regulatory risks; and assess economic viability.

Step 2: Go/no-go decision—Sanford and Pittsboro

Step 3: Evaluate economic and contractual issues in more detail—evaluate alternative cost allocation approaches.

Step 4: Full study to design and redevelop real costs.

Step 5: Implement wholesale service agreement.

Mr. Warmath explained that, typically, there is a preliminary study, but if the City did not complete this study, they needed to get some indication of how much it will cost to build the line and what type of environmental and regulatory challenges there might be with that versus them building their plant. Until then, neither side can make an informed decision. Mr. Warmath stated that this is an opportunity that he thinks the City should take a close look at, but there are risks associated with it. He stated the City had already done the hard part—raised the rates; addressed the capacity needs; and have the plant being constructed. He advised that Pittsboro will want a long-term commitment.

Public Works Director Vic Czar stated that the potential exists that Pittsboro could build something smaller and start increasing their flow which increases their revenue on the short term. There will be some capital costs, but the potential still exists, so they might not want a long term commitment and that would not necessarily be a bad thing as it would give us our capacity back. We do not know what they are looking for.

Council Member McNeil asked if we enter an agreement with Pittsboro and Chatham County for ten years and they give up their permit and after ten years we need the capacity back, could we withdraw successfully out of this agreement. Mr. Warmath stated that if you sign a twenty year agreement and want the capacity back in ten years, that contract would be binding. Part of the preliminary study should look at growth assumptions and when different configurations of capacity for the combined systems start bumping up against limits and the risks of that. If you go ahead and make a long-term commitment and share the capacity of your plant, the contract should also speak to the next increment of capacity, whether it is five years from now or twenty-five years from now. When you start bumping up against your limit, how much flexibility will Sanford have to expand that plant and how would Pittsboro then share in that expansion. That could provide benefits for Sanford because our customers would not have to bear the entire cost of the expansion; it would be spread over a broader customer base. Then there would be the questions of how much to expand the capacity. If you don't think you can expand the capacity, you would want to enter into a shorter term agreement. They would need to understand that up front and figure out if it makes economic sense to build that line. The study should point in the right direction. If the City left them without treatment, in the least they would be compensated.

Mr. Warmath stated that, if ten years from now, both have grown more than anybody ever expected and you're out of capacity, the state would be looking at that as a regional plant providing capacity to multiple players, and they would be more inclined to find a way to let you expand your plant than they would if you were on your own. They look favorably at regional approaches. The reality is that it may come down to expansion being only a semi-viable option because of regulatory constraints. They may have you to ramp up treatment capabilities and let you have more flow through it, but you would actually have to discharge less nutrients, etc. That would be a very expensive upgrade to the plant, probably using technology that doesn't even exist today in order to meet those standards. Both would share in the cost of that. Staff needs to look at whether we can expand the plant and if we can accommodate their growth and our growth under several different scenarios. Plot those growth curves and see where they hit your plant capacity and determine what you think the next increment of capacity you can get at that site would be.

Council Member Haire asked how long the preliminary study would take. Mr. Warmath thought it would take about two to three months. Mr. Haire asked if there is an expiration date to their ability to build their own facility. Mr. Warmath stated that there is probably a limitation on that, but now that they have the permit, they have enough time to do this work right. Council Member Taylor asked about how much it would cost per mile to run the line. Mr. Warmath stated there were many variables; it would depend on how far uphill it is, how much pressure you've got, the size of the lines, right of ways, etc.

Council Member Wyhof asked if there is a time frame that Pittsboro has to decide whether to give up that capacity if they go with us or how long do they get a chance to hold on to the right to build their own plant and discharge. Mr. Warmath did not think it was indefinite, but they probably have a year or two to decide if they are going to act on their permit.

Council Member Taylor asked if they started their plant today, how long it would take for Pittsboro to complete it. Mr. Warmath thought it would be less than five years. Mr. Taylor asked, if Pittsboro installed the lines, could they potentially use those lines down the road to supplement their own system. Mr. Czar answered that engineering-wise, the potential exists, but, contractually, you might want to limit that. Mr. Taylor questioned selling capacity if a large company wants to request that capacity in order to locate here. Mr. Czar stated that once you reach 80 percent capacity, you need to start thinking about adding capacity. He stated they would come before Council with options to reduce capacity to Pittsboro or increase capacity at the plant.

City Attorney Susan Patterson stated that most places consider it a permanent allocation to these people that they use, and you go forward with that part being taken; you would not look at it as something you would get back. You could put in the contract terms for separation or how, when certain milestones are met, they would expand if necessary, or how the two of you would provide for the expansion of the plant. Mr. Hegwer stated that we own a utility, so we have two missions. We need to make sure we are looking after building our tax base and have available water to allow for growth.

Mr. Hegwer stated there were some interesting comments from the rating agencies. They pointed out our strengths and our weaknesses. They said that while our system's customer base is currently stable, it appears that the higher paying customers represent the highest percentage of the revenue. Losing one of those customers would have impact.

Finance Director Melissa Cardinali added that the rating agencies would review the City periodically and they have the ability to change our rating. If they do, it will impact the interest we pay in the future. What they pointed out are things we need to watch in the future as long as the bonds are still outstanding and we want to do future projects. Mr. McNeil stated we could look at everything, but if we go into a contract for ten to fifteen years and we need the capacity back, the reality is if they don't want to give back that capacity, the City would be tied up in litigation from now on. Mr. Warmath agreed that if they didn't have an alternative that made sense to them so that they were willing to give up the capacity, then that capacity is gone from your available capacity, and you would have to make plans to expand that plant to meet needs. There are things that can be done to cover that in the contract, such as having them share in the cost of the unused capacity.

Council Member Taylor stated that the premise we had for the expansion was to take care of Sanford and Lee County citizens, and we had increased our rates. He asked how we would sell taking care of Pittsboro now to our citizens. Mr. Hegwer stated that we had lowered the district rate at some point. That shifted the burden to the citizens of the district to help lower their rate because of the tremendous debt service we took on when we absorbed their system. We tried to bring that rate down and continue to do that a bit each year.

Mr. Warmath responded that as you generate revenue from other customers, that will give you additional revenue so that you can have more money to extend your sewer service out in the county, and it will be expensive to serve those customers surrounding the city without raising the rates as much. This might help not having to keep raising those sewer rates in order

to be able to do that. The other message you would send to them is that you are holding back enough capacity to make sure we keep the capacity we need to address expanding into the county. Council Member Taylor asked that if we were providing city sewer to county residents, allowing us to grow our sewer capacity outside the city, would that mean we are going to offer lower rates to these people in the county. Mr. Czar responded that the only way we would bring something forward for Council to approve would be that there is a financial benefit to the city and to the rate payers. How that money is spent is more of a policy decision-- whether you want new programs, lower rates, or hold rate increases off—that would be a council decision. Mr. Czar stated that the only way they would bring an agreement forward would be a deal with Pittsboro where there is not a significant negative impact in capacity that has a rate that far exceeds our incremental cost and cost of operation and maintenance with a regular return on our investment. That means you have more revenue and the same expenses, so there is more money there to do something with. How to use the money is the council's decision.

Mr. Warmath stated that his point was the city could use that extra revenue on extending the system out into the county faster and not have anything to share with the rate payers, or you could take the pressure off of the wastewater rates and consider changing the county rate and bring it closer to the city rate. The real question is how quickly you plan to grow that system into the county and can you do that in a cost-effective way. If the density is not there to get enough customer base, you will end up driving up your average unit cost for your retail customer base because you put expensive lines out that only serve a few customers. Council Member McNeil asked about the impact if Deep River Forest develops. Mr. Hegwer stated that whether or not we partner with Pittsboro, he does not think it would affect the development of this project, as this project would not benefit any property in Lee County in terms of excess facility.

Mr. Czar stated that he believes we are Pittsboro's lowest cost option except for building their own. Mr. Hegwer stated that we already sell water wholesale, so this is not entirely new to us, but Pittsboro does not have to have us to achieve what they want. If this is implemented, Pittsboro would be our first wholesale sewer customer.

Council Member McNeil asked for clarification, stating that we have the capacity now and Pittsboro is looking to get something from us. It seems that we are going to pay to have the study done, and asked why we should pay to have the study done for their benefit. Mr. Czar responded to see who will benefit because there are a lot of unknowns on both sides. Council Member Taylor agreed with Mr. McNeil, asking why we are paying for the study if we hold all the cards. Mr. Czar stated that we are not holding all the cards and we may benefit. Mr. Taylor stated we could continue to do what we are doing today. Mr. Hegwer stated that it does not have to be done, they were trying to think outside the box and look at things that might benefit us, but it does not have to be done. Mr. Czar stated that is was the first step in a partnership that could have some longevity and it is better to have a good relationship.

Mayor Pro Tem Sam Gaskins asked about an engineering study for selling the water. Mr. Czar stated that was not as involved as this, and a study was not needed.

Mayor Olive responded to a request from the audience reminding members of the audience that they could ask questions of staff following the meeting, but not during this meeting.

Mayor Olive asked how Council wanted to proceed. City Attorney Patterson stated that she could call the question as to how Council would like to proceed; it could be taken up at the next Council meeting; or they can adjourn and make a decision later.

Council Member Taylor stated that he thought it was premature as they had just received the information today and there is a lot to think about. Mr. Hegwer stated the intent was to have a discussion and provide information.

ALL EXHIBITS CONTAINED HEREIN ARE HEREBY INCORPORATED BY REFERENCE AND MADE A PART OF THESE MINUTES.

ADJOURNMENT

Having no further business to come before the Council, Council Member Walter McNeil made the motion to adjourn; seconded by Mayor Pro Tem Sam Gaskins, the motion passed unanimously.

Respectfully submitted,

CORNELIA P. OLIVE, MAYOR

ATTEST:

JANICE COX, DEPUTY CITY CLERK