

ALERT: INFORMATION ON HIGH WATER RATES

Dear New Water/Sewer Customer:

The purpose of this pamphlet is to make you aware of the Town's very high water/sewer rates, explaining the reasons why the rates have to be so high, and sharing what actions the Town has taken to address this situation. Hillsborough's out-of-town rates are some of the highest in the North Carolina and thus likely considerably higher from what you've paid in other places you have lived. The Town is trying to make new customers aware of this unfortunate fact, so you will not be surprised when you receive your first bill. The Town hopes by sharing information about this difficult issue it will help new customers understand why the rates are so high and let you know the Town is working hard to improve this situation.

One of the more difficult issues surrounding the high rates is that, as is the policy in most other municipalities, out-of-town customers are charged a higher rate than in-town customers. Until, recently, out-of-town customers paid "double" or 200% of the in-town rate. For years, this policy had not been an issue because rates were fairly low in cost. It is quite common for out-of-town customers (with water and sewer service) to have monthly bills much higher than \$71.73 minimum monthly bill (for 3,000 gallons or less). So, depending on usage, out-of-town customers often see bills double or even triple the monthly minimum if they are medium to high volume water users. The issue of the "double rates" has been debated fervently since September 2000. The Town Board voted to decrease the out-of-town rate multiplier from 200% to 195% effective November 2003. This rate decrease for out-of-town customers was funded by raising in-town rates.

In addition to alerting you to the Town's high rates, the other purpose of this pamphlet is to share information on the financial and operational condition of the utility system, as well as explaining why the high rates are essential. While it is impossible to fully explain a situation of this magnitude in a pamphlet, we hope you find the enclosed information helpful in evaluating some of the issues and problems facing Hillsborough's utility operations. Mayor Phelps, the Town Board, the Citizens' Water & Sewer Advisory Committee, and Town staff are truly concerned about the burden these high rates are placing on Hillsborough's customers, especially those on fixed incomes. The Town is committed to keeping the rates as low as possible, yet still doing what is necessary to run an efficient and environmentally responsible operation, staying financially solvent, and preparing for the future. Fortunately, progress has been made in that no rate increases have occurred in the past two fiscal years, with the exception of the recent in-town adjustment that was made to lower the out-of-town rates. The Town is optimistic that it can at least hold the rates steady and hopefully be able to lower rates sometime in the future. Thank you for your patience and understanding!

Why Are the Water & Sewer Rates So High?

Hillsborough has had the extreme misfortune of having to deal with a variety of financial and operational problems all at the same time. The following list highlights some of the major reasons for the current rate problem.

- In 1993 the voters of Hillsborough approved \$5.8 million in General Obligation Bonds to pay for a reservoir to address long-time water shortages and allow for future growth. Construction on the reservoir project started in 1998. Waiting five years to start the project created inflationary increases in the construction and land costs. This delay combined with additional requirements from the State and lawsuits from property owners whose land was condemned to build the project, resulted in the reservoir costing over \$10.1 million, more than \$4.3 million over budget. Annual debt service payments on the reservoir alone in FY04 are \$692,791. This debt will take another 16 years to pay off and by itself is approximately 13% of the Water/Sewer Fund budget. The overall debt burden for the Water/Sewer Fund is 25% of the annual budget. In addition, the Town had to take approximately \$800,000 from its savings two years ago to pay off the remaining costs and final lawsuits from the reservoir project. This completely depleted the Capital Reserve Fund and put a serious drain on the Water/Sewer Fund's savings level (or fund balance). While the cost and location of the reservoir was a frequently debated topic, it is now completed, Hillsborough needs the water supply, and thus now legally obligated to pay the debt incurred to provide water to the citizens of Hillsborough. Fortunately, the added supply from the reservoir saved the Town from a potentially disastrous situation during the drought of 2002.
- The Wastewater Treatment Plant is 28 years old and has never received a major rehabilitation or upgrade. Partially due to the outdated design and other limitations of this "older" plant, the Town has been fined by the State of N.C. numerous times for violations. The Town recently borrowed \$750,000 to make much needed improvements to the plant that will hopefully delay the need for a major overhaul for another five years. This adds another \$130,000 per year of annual debt for the next seven years.
- The Water Plant is 30 years old and had never received a major upgrade. The Town is in the process of completing an estimated \$4.1 million upgrade to the plant. The Town received a \$2.0 million grant and a \$1.8 million low-interest loan from the State (at half the market rate) to help fund this project. Still, this will add another \$100,000+ in annual debt payments for 20 years. The plant will likely run out of capacity in 7-10 years, necessitating an expansion of both the plant and reservoir at that time (projected cost: approx. \$5.0 million).
- Due to the age of the Town's system, many lines in town are over 70 years old, serious problems exist with leaking from water lines and inflow into sewer lines. While the Town has made quite a bit of progress in recent years

on this matter, it still poses a variety of problems and increases operations and maintenance costs.

- As if the aforementioned problems were not enough for the system to deal with, the Town's largest water customer (Flynt Fabrics) closed its operations on September 26, 2000 – this cost the Town approximately \$700,000 per year in revenue. The loss of Flynt forced the Town to take dramatic action to keep the Water/Sewer Fund financially solvent. To prevent bankruptcy by mid-2001, the Town cut over \$450,000 in projects and operating expenditures and had to raise rates an additional 18.75%, this was on top of a 15% increase that occurred just several months earlier.
- Currently, 25% (\$1,370,700) of the Town's Water/Sewer Fund budget is earmarked for debt service payments
- Small towns need larger savings levels, since they deal with smaller amounts of gross funds, in order to be fiscally sound and satisfy criteria established by bond rating agencies. A reasonable "fund balance" or savings is critical to ensure the Town does not have cash flow problems, can handle unexpected revenue shortfalls, expenditure overruns, emergencies, and earn interest income. The Town feels that Hillsborough's minimum fund balance level for the Water/Sewer Fund should never drop below the equivalent of three (3) months of the annual budget or 25%. It is extremely dangerous for the Town risk allowing the fund balance to drop below this 3-month threshold. The current fund balance level is approximately 28% or barely above the minimum target set by the Town. This means the Town does not have the luxury of using its savings to defer future rate increases.

What Does This Mean?

While there are always many different ways to interpret information, the following is one brief analysis. Unlike other systems that may face a few problems at once, Hillsborough is facing several serious challenges at one time. The many "fixed costs" associated with running utility operations limit the opportunities for large-scale expenditure cuts. (i.e., it costs almost as much money to operate Hillsborough's system whether it treats 1.0 million gallons of water per day or 3.0 million). After one reviews the many expenditures that reasonably cannot be "cut" (like debt payments, many operating and personnel costs), the task of finding ways to stabilize or even reduce rates becomes more daunting. These statements were reinforced by the findings of the independent Citizens' Advisory Water & Sewer Task Force that reviewed the Town's utility operations. While they identified problems and reasons for the dilemma of high rates, they felt the operations were currently being managed in a fiscally responsible manner. Ultimately, the loss of Flynt Fabrics, the combination of high debt, low savings, old plants & lines, and high rates means there are no simple, short-term or painless solutions to cure all these problems.

What is the Town Doing to Improve the Situation?

The Town has taken several steps in an effort to stabilize and improve the situation. As was mentioned earlier, there are no "quick-fixes" to the aforementioned problems, as such, the Town is trying to address this situation in a businesslike manner by making decisions that make the most sense over the long haul. A few examples of actions the Town has and is taking are found in the following list:

- The Town upgraded its financial planning process in FY1999 to include a multi-year budget format that combines the elements of a financial forecast, capital improvements plan, and budget into one document. This improved "fiscal radar" is helping the Town to make better decisions by understanding the impact of today's decisions on tomorrow.
- The Town has not had a rate increase over the last two fiscal years.
- The Town's Board of Commissioners appointed a Citizens' Water & Sewer Advisory Task Force to study the situation, after the closing of Flynt Fabrics, in October 2000. The Task Force was composed of Hillsborough water customers, equally split between in-town and out-of-town customers. The Task Force reviewed and made recommendations regarding the Water and Sewer Fund's operations, financial condition, billing practices, and other areas. A copy of the Task Force's report can be found at the Town's website: www.ci.hillsborough.nc.us.
- In September of 2001, the Town's Board of Commissioners made the Water & Sewer Task force a permanent advisory Committee to the Town Board. The Task Force is now called the Water & Sewer Advisory Committee. The Committee meets monthly and their charge is to review the operations and finances, make recommendations to the Town Board and Town staff on policies as well as mechanisms to improve the overall efficiency of the Water and Sewer operations. If you are interested in attending one of the Water & Sewer Advisory Committee's quarterly meetings, please contact the Town's Utility Analyst, Julie Fogleman, at 732-1270 extension 72. Julie serves as the Secretary to the Committee and will be happy to share information on their meeting dates, times, and location.
- New developments, that have not yet been built, have been approved for construction. Additional water and sewer customers will help the Town to take advantage of some economies of scale. Having more customers to share in paying for many of the "fixed" system costs (i.e., the reservoir and improvements to the plants) should help ease the burden on all customers over the long term. While this is positive news, it will likely take years before the full effect of these new developments is felt.
- Most importantly, the Town Board and staff do their best to make sure that all expenditures are reasonable, justified, and needed before the budget is adopted and before the actual dollars are spent. The Town has been successful in regularly bringing its operational expenditures in under budget. The Mayor, Board, and staff are committed to continuing this recent trend.
- The Town has applied for a federal/EPA grant to help address some of the sewer system's inflow & infiltration problems.