

→ Director FUJ

Thelen, Mary Beth (DEQ)

From: Dillon, Andy (Treasury)
Sent: Thursday, March 28, 2013 1:36 PM
To: Stibitz, Brom (Treasury); Wyant, Dan (DEQ); Saxton, Thomas (Treasury); Rustem, William (GOV); Muchmore, Dennis (GOV); Roberts, John (GOV)
Subject: Fwd: DWSD & Flint
Attachments: [Untitled].pdf

FYI

Sent from my iPad

Begin forwarded message:

From: "Fausone, Jim" <JFausone@fb-firm.com>
To: "Dillon, Andy (Treasury)" <DillonA2@michigan.gov>
Subject: DWSD & Flint

Andy - here is the information you requested. Let me know if you need more information. As we move into DWSD 2.0 without federal court supervision, I can hear the chanting "free at last...free at last". Seriously this should make it easier to work things out with Flint and DWSD 2.0 if they want to work it out or get told to do it. Jim

James G. Fausone

[cid:image002.jpg@01CE2BAB.E4A45520]

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FAUSONE BOHN LLP

CITY OF DETROIT
WATER AND SEWERAGE DEPARTMENT
GENERAL ADMINISTRATION

735 Randolph Street
Detroit, Michigan 48226
WWW.DETROITMI.GOV

March 28, 2013

Andy Dillon, State Treasurer
Michigan Department of Treasury
Lansing, Michigan 48922

Dear Treasurer Dillon,

We understand that you are tasked with evaluating the merit for the City of Flint to cede from participation in the DWSD water system. For the following reasons, we represent to you that Flint's continuance in the present system is not only what is best for the City of Flint and Genesee County, but for the entire DWSD customer base.

Background

Water is provided by DWSD to the City of Flint via a 72" water main that runs west from a booster pumping station at Imlay City. Water purchased by Flint is then sold to its customers in the City of Flint and to Genesee County. The City of Flint and Genesee County are evaluating the construction of a new raw water supply system as members of the Karegondi Water Authority (KWA). The decision point is whether the City of Flint is best served by KWA or DWSD. Genesee County is not bound by Flint's decision. For this discussion, however, the emphasis is on Flint which encompasses its customer Genesee County.

The items presented below are based on a brief staff analysis of water quality, system capacity, capital, and financial considerations of the loss of Flint as a DWSD customer.

Water Quality

If the 72" water main is idled, there will be water quality issues for remaining customers on that line.

- ✓ The 72" main to feed Lapeer, Mayfield and Imlay City will need to be modified based on their comparatively low consumption at 12% of the flow. That pipeline will be too large to support the reduced demand which presents water quality issues.
- ✓ System users along the water transmission line in Lapeer, Mayfield, and Imlay City may experience water quality problems due to reduced disinfection levels associated with stagnant water. Solutions include abandoning the 72" main and replacing it with a smaller diameter pipe or adding facilities to re-chlorinate and disinfect the water a second time. The latter option is problematic because re-chlorination results in higher levels of disinfection byproducts.
- ✓ The Lake Huron Plant ("Plant") will require modifications to address water quality issues for Lapeer, Mayfield, and Imlay City. That cost is unknown.
- ✓ The Imlay Booster Station ("Station") will also need modification to feed Lapeer, Mayfield, and Imlay City. An estimated cost is \$1 million.

- ✓ The true water quality impact would need to be confirmed through a study or the master planning effort. These concerns and alternatives are based on a brief analysis.

Excess Capacity of a Public Utility

- ✓ If DWSD is not supplying Flint with water, then there will be three high capacity pumps at the Station which will be significantly underutilized.
- ✓ DWSD currently has treatment capacity of 1.7 BGD, which is easily expandable to close to 2.0 BGD with infrastructure already in place at the Plant. Meanwhile current max day use of the DWSD System is only about 1 BGD.
- ✓ Although more than one DWSD facility is able to provide water to Flint, the reduction in use as represented at the nearest water treatment plant would result in excess capacity of up to 70% at the Plant.
- ✓ The water line servicing Flint is approximately 25 miles long (extending from Inlay City to Flint). That line would have no use if Flint joins KWA.

Impairment of Ratepayer Funded Assets

- ✓ Twenty-five miles of water line would likely be abandoned.
- ✓ Three pumps at the Station would also be idled.
- ✓ The net book value of the water line is at least \$5M.
- ✓ In addition, improvements were completed at the Station in 2012 which serves Flint and other customers. The construction cost was \$44 million.
- ✓ DWSD has in good faith preserved the terms and conditions of the 1965 service agreement with Flint which expired in 2000. Beginning in the 2000s DWSD and its wholesale water customers collaborated on a new model contract. Since that time, DWSD and 73 of its wholesale water customers have entered into new model contracts. The model contract provides for DWSD to recoup the costs of customer specific constructed facilities in the event that the contract is terminated.

Financial Implications to Other DWSD Ratepayers

The estimated immediate impact of the loss of Flint is an increase in rates to address a net revenue shortfall of approximately \$22 million, or 6 percent of total DWSD water revenue. The long-term impact would require further analysis to evaluate the capital investment and increases in cost to address the operational concerns noted earlier. The immediate impact estimate is based on the FY 2013-14 DWSD financial plan as explained below.

- ✓ Flint volume (including Genesee County) represents approximately 7.4% of the suburban wholesale water sales, and 5.9% of the total water sales (including Detroit retail accounts) based on approximately 1.2 million Mcf of water sales.
- ✓ The allocated revenue requirement totals \$24.23 million, which is approximately 8.3% of the suburban wholesale revenue requirement, and 6.6% of the total revenue requirement (including Detroit retail).

- ✓ At most, variable cost savings of not providing service to Flint is 7 to 10 percent, or roughly \$2 million.
- ✓ The City of Flint's and Genesee County's revenue split is approximately equal. Loss of Genesee customers to KWA while maintaining the City of Flint as a customer would reduce the rate and dollar amounts above by half.
- ✓ DWSD ratepayers will incur the cost of operational changes at the Plant and the Station to address the water quality issues noted above, although charges to Flint during the KWA construction period would be evaluated.
- ✓ These amounts exclude the new capital investment for transmission piping for customers in the areas served by the Station and potentially at the Plant. Additional costs would be incurred to resize the water main to assure compliance with water quality standards.

Financial Risk

The ability to manage the financial risk for the City of Flint is especially precarious given its financial condition. As recently as yesterday, the frailty of the City's fiscal capacity is described by the present emergency financial manager in the Bloomberg News. The bottom line is that KWA's optimistic project with a cost of \$272M (\$82M attributable to Flint KWA's proposal) poses an undue financial risk to the public given that a system with reliable, excess capacity is readily available through DWSD. That risk is even greater based on the Tucker, Young, Jackson, Tull report that the KWA costs are underestimated by \$100 million.

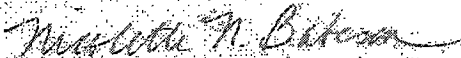
DWSD is undergoing monumental efforts to confront long-term operational and capital costs. The recent water rate adjustment was the lowest in decades, staff at all levels is actively involved in an organizational optimization process facilitated by EMA, there is an increased emphasis in long-term financial planning, and the transparency of these efforts is evident through more than a dozen customer-centric committees. Proactively addressing our borrowing costs and financial outlook is paramount to our mission. We understand the challenges that confront a public utility.

The bottom line is that Flint's financial flexibility will be impaired for generations by abandoning the DWSD system to participate in KWA. Duplicating the available capacity will expose them to a very large fixed cost obligation. As water utilities continue to experience reduced demand, the fixed costs component for capital, operating, and debt decrease the cost sharing base. For this reason, DWSD provides its customers the ability to adjust demand to control their costs.

Going Forward

DWSD is committed to the viability of Flint's water needs. Going forward there may be ways that DWSD can provide technical assistance and collaboration to the City of Flint. This includes methodologies to address its high water loss ratio, shut-off program, and capital planning needs. DWSD has fostered a strong customer community through its outreach program. We encourage Flint to become engaged with these resources. Finally, DWSD has demonstrated an earnest interest by offering service options specifically tailored for Flint's needs through a flexible contract approach. We look forward to reaching a long-term, viable solution to provide Flint a safe, reliable, cost-effective water system.

Sincerely,



Nicolette N. Bateson, CPA

Chief Financial Officer

Detroit Water & Sewerage Department

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