

PRIVATIZATION VS. MUNICIPAL OWNERSHIP: WHICH WAY DO I GO?

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Okay, so you are a New Jersey municipality that owns a public water system and/or sewer system. Every year, you see the rates of your customers increasing. The newspaper reporters and this year's candidates for the Primary keep jumping on the bandwagon called "privatization". That business executive from the Fortune 500 Company who shows up at every meeting is once again asking why the town can't be run more like a business. It's time to run the newspaper advertisement about hydrant flushing again. And you have existing debt on an aging system, which will need additional repairs in the near future. On the other hand, you have a good crew of experienced municipal employees. Being a municipality, you are eligible to receive long term, low interest loans from the United States Government and the State of New Jersey to help you finance your debt. Your town controls its own destiny instead of being at the whims of a private water company or sewer system operator. And you have a sneaking suspicion that the devil you know is better than the devil you don't know.

If you begin a feasibility study to investigate privatization, will the relatives and friends of the existing municipal employees be showing up at your door step to protest the unfair efforts to fire them? Will there be charges of politics and personalities? Then again, if you do not investigate privatization, might you be ignoring an opportunity that the residents, ratepayers and taxpayers of your community deserve? Which way do you go? The answer to this question must be found, of course, in the specific details, which define your particular community. "Privatization", per se, is not an entity that is either right or wrong for the State of New Jersey. Benefits and drawbacks must be weighed for each community. For the Borough of Chester in Morris County, the decision to offer the municipal water system and sewer system for sale did not come without criticism or second guessing, but a careful analysis of the situation helped cut through the guessing game. The process of privatization for Chester Borough's water and sewer systems is presented in this article from the viewpoint of the Municipality, the professional consultant firm hired by the Borough, and the company who was successful in receiving a 20-year contract for operation and maintenance of the municipal wastewater system.

Chester Borough's Point of View, By James R. Doherty, Borough Administrator Clerk:

With a land area of 1.5 square miles and a population of approximately 1500, the user base for Chester Borough's water and sewer service is very small. If all things were equal, the user rates for the water and sewer systems of the Borough would stay competitive with the rates offered by private sector companies. However, all things are not equal.

Two plumes of contaminated groundwater exist in the Borough, which have compromised private wells. Additionally, numerous families are served by individual wells and septic systems on under-sized property lots. In several of these cases, problems with septic systems threaten to contaminate nearby private wells. And on top of that, the existing municipal wells serving the public water system are decreasing their recharge capabilities as the years go by. In times of drought, the Borough's water supply is not sufficient to meet the demands of the existing water users. All of these pressures suggested – actually demanded – the need to expand both the water supply system and the water distribution system of the Borough. The cost of infrastructure improvements, however, would be staggering if it were to be paid by such a small user base.

With reference to wastewater, two residential developments combined with the downtown business sector to create a user base for a municipal sewer system, which has served these areas of the Borough since the late 1980's. Unfortunately, the sewer system had difficulties, which translated into significant cost burden on a very small customer base. The need to replace failed disposal beds, the need to upgrade the treatment plant, and the need to address failing private septic systems by expanding the public sewer system all conspire to create a nightmare of upward-spiraling sewer rates.

In 1996, the governing body for the Borough of Chester asked itself some very humble, yet necessary questions: "Were we too small to be in the water and sewer business? Could some one else do a better job than us?" As indicated by the opening scenario, we really did not know the answer to these questions (and the reference to the Fortune 500 Businessman is entirely fictional. Any resemblance to actual persons who attend Chester meetings is strictly coincidental). We came to the conclusion that the only way to answer to the question was to actually and officially pose the question.

In order to pose the question right, we decided that it would be appropriate to employ the services of an independent party who had no connection with our community, and who could not be accused of having ulterior motives on the issue. After investigating several firms, we chose to enlist the services of Alternative Resources, Incorporated (ARI) a consultant firm with headquarters located in Concord, Massachusetts.

With the assistance of ARI, the Borough put together a task force of local officials, both elected and appointed, for the purpose of creating a "Request for Proposals". The questions began to compound themselves at this point: What if we offer the water system and sewer system for sale, but nobody wants them? Would it be better to lease the systems instead of selling them? How much are the water system and sewer system currently worth? What will be their worth in the future?

As our RFP took shape, we decided to ask all of these questions. We designed the RFP so that interested parties could submit a proposal with respect to the water system, or the sewer system, or both systems. We also invited proposals for a long-term (20-year) contract for operations and maintenance service; or the purchase of the system(s); or the lease of the system(s). Interested parties could submit a proposal for as many, or as few, of the above options as they wished. This made the RFP somewhat confusing to the

average person on the street, but the benefit of following this format was to get all of our questions answered at once. Finally, after much debate and soul searching, we decided to “let the market decide” the value of our systems, rather than pay an outside firm to make an independent evaluation on this matter.

In preparing the RFP, the Borough openly admitted that we did not know which option would be the most advantageous, and that we would not know until we had received and evaluated all of the proposals for the various options presented. The RFP provided in-depth background information to acquaint Proposers with the history and condition of the Borough’s facilities. In addition, Proposers were encouraged to attend a pre-bid meeting (but not required, for fear of losing a live one); to inspect the facilities; and to review all materials on file at the municipal building. The RFP was issued on December 31, 1996. The structure of the RFP placed us under the requirements of various, complex state laws. Additionally, we needed direction regarding how to handle existing public debt upon the sale or lease of the system(s). And finally, once we decided on the option that was best for us, we would face significant legal negotiations on the most important issues in the history of the municipality.

Fortunately, the Borough’s Municipal Bond Counsel fit the bill in meeting all of our legal needs. We therefore entered into a second professional service contract, with the law firm of McManimon and Scotland of Newark, New Jersey.

This, I believe, is one of the most important points of advice I can offer to other municipalities regarding the investigation into privatization: the urge will be strong to “handle this ourselves” for the purpose of keeping down costs, and because you believe that you know your community best, so you should handle this personally and be accountable to your constituents. Good intentions; Bad idea. Don’t do it that way. By all means, you should maintain final decision-making rights, but you should also rely on consultants and legal firms who deal with privatization on a regular basis, and can guide you through the diverse requirements for public notifications, applications to state agencies, and the finer points of negotiations with the corporate attorneys employed by private sector companies. And there is a way to mitigate the costs of your professional consultants: make it a condition of a successful contract with the private companies, that they will reimburse the municipality for the costs incurred. The risk of having to pay for professional advice would then be borne by the municipality only if no sale/lease/contract is awarded.

Consultant’s Point of View: by James Binder, Alternative Resources, Inc.

Alternative Resources, Inc. began providing advisory services to the Borough of Chester in September 1996. A one-day meeting/workshop was held with the Mayor, the Administrator, several Borough Council members, and members of the Water Resources and Sewage Planning Committee. The purpose of the workshop was to explore the potential means by which a public-private partnership could satisfy the Borough’s objectives and to lay out a process by which the Borough could receive private proposals and fully evaluate the potential benefits of such a partnership. After the meeting, the Borough decided to conduct a procurement. Alternative Resources, Inc. was retained to prepare an RFP and to assist in proposal evaluation. The private proposals would be

compared to a scenario in which the Borough continued to provide public services with existing practices; i.e., a benchmark case.

Public-private partnerships offer an alternative means of designing and constructing new facilities; of pursuing upgrades to existing facilities; and of operating water and wastewater facilities. A partnership is a contractual relationship between the local government and a private party to provide a service. Every partnership is unique, designed to meet the particular needs of each community. Cost savings, risk reduction, and improved performance are the goals of such partnerships. Such partnerships also offer the potential for private financing, thereby allowing the municipality to use its own financing to pursue other community projects. There are many types of public-private. The most common for water and wastewater treatment facilities is contract operations, most of which until recently have been short term; i.e., less than five years. With the 1997 changes in IRS rules, longer-term contracts are now possible without jeopardizing the tax-exempt status of existing bonds and without precluding the use of State Revolving Fund low-interest loans. The recent trend appears to be toward long-term, 20-year agreements, which provide increased incentive to private companies and allow greater public cost savings. Municipalities often find that many of the potential benefits of a sale of facilities can be obtained through a long-term operating contract, without the need to sell assets. There is no right or wrong level of private participation in a public-private partnership. It is based on the needs and objectives of the community.

To determine if a public-private partnership will work, most communities first assess the potential benefits that could result from such a partnership. Such a feasibility study examines the existing condition and cost of facilities and any needs to meet mandated compliance schedules. Potential benefits to continued public services, or more efficient provision of public services, are compared to options and benefits to services being provided privately. Such a comparison most often includes looking at what other communities have done in similar circumstances so as to gain additional perspective on what might be accomplished in your community. If the potential benefits of private service are sufficiently attractive, the next step is to go to the marketplace for competitive proposals.

Procurement is a multi-stepped process. It includes setting objectives, selecting a procurement strategy, defining the service required and key terms and conditions for business arrangements, preparing the procurement document(s), interacting with the prospective proposers, evaluating proposals, selecting a party and negotiating a contract. A successful procurement will attract competitive proposals from qualified parties, obtain attractive terms and meet procurement objectives and result in equitable contract that fairly serves both parties. There are a number of procurement approaches used. These include, but are not limited to: A Request for Qualifications (RFQ); a Request for Proposals (RFP); a combination RFQ/RFP (two steps); and various hybrid approaches such as an Expanded RFP-Menu Approach, which was used in Chester Borough. The most common approach is the RFP.

The objective of an RFP is to seek both technical and cost proposals in a one-step process. The advantage of the RFP is that it allows for open cost competition amongst all proposers,

and provides the qualifications, technical, business, and cost information needed to make a complete evaluation of proposals received.

It is not uncommon for an RFP to be from 50 to over 200 pages, depending upon the complexity of the project, and Federal, state and municipal procurement laws and regulations.

Although not necessary in all cases, it is recommended that separate Technical and Cost Proposals be submitted to allow separate review. In this manner the technical evaluation and ranking can be completed first without cost bias. Technical Proposals should be evaluated in accordance with the process and using the criteria that were spelled out in the RFP. Cost Proposals are typically evaluated on a life-cycle basis and by present worth analysis.

A typical procurement schedule for an RFP process, from preparing the RFP to selection of the proposer, is eight to twelve months. Contract negotiations can take an additional one to six months. In the case of Chester Borough, approximately twelve months were needed from preparation of the RFP to a signed contract.

When conducting a procurement, it is essential to be cognizant of state and local procurement laws and regulations. In New Jersey for Chester Borough, it was necessary to conduct the procurement in accordance with the New Jersey Water Supply Public-Private Contracting Act, the New Jersey Wastewater Treatment Public-Private Contracting Act, and NJSA Section 40:62-1 et seq. for the sale or lease of facilities.

Remember that private companies responding to your RFP will be spending considerable resources to do so. It is not uncommon for a private proposer to spend in excess of \$200,000 to prepare a proposal, particularly if design is required to prepare a cost proposal. Also, for a public-private partnership to work, one should recognize the relationship as a cooperative partnership, not an adversarial relationship. While it is necessary to protect the interests of the community, it is also necessary to recognize that for a successful procurement and relationship one should start with an attitude of trust; adopt an honest and sincere approach conveying that a contract will be awarded if municipal objectives are met; demonstrate that there is a fair and even playing field for all Proposers; and provide a setting for an attractive business relationship for both the buyer and seller by considering a long-term contract. Other ingredients include realistic terms and conditions of contract with a well defined work scope and division of responsibility, attainable performance guarantees, equitable risk sharing, realistic conditions for defaults and remedies, fair termination clauses, and financial terms that keep both the buyer and seller financially whole.

Most procurements require a level of technical, financial and legal expertise not available through municipal staff. Consultants can provide guidance and information that allows informed decision making and help "steer" a client away from pitfalls. Their independent advice is valuable in setting attainable goals, preparing the RFP, contract negotiations and in dispute resolution. Perhaps most significant, consultants provide the expertise necessary to achieve an even playing field in discussions and negotiations with Proposers all of whom retain sophisticated and highly experienced advisors.

The Borough set as its objectives the following: meeting current and future water and wastewater needs alleviating the existing and potential environmental problems described earlier; meeting state and Federal environmental compliance requirements and reducing the Borough's economic exposure in doing so: reducing cost and potential rate increases; and improving system reliability and performance.

As described earlier, the RFP followed a menu approach, allowing prospective proposers to buy, lease or contract operate facilities. The procurement process was successful in attracting competitive proposals from several private utilities and private companies providing water and wastewater services. Proposals for purchase and long-term contract operation were received. Based on a comprehensive evaluation of proposals and a comparison of those to the option of the Borough proceeding with its existing public practice, the Borough decided to select the option of selling the water system to a private water utility, New Jersey American, and of entering into a long-term, 20-year contract with a private wastewater company, Earth Tech, for improving and operating the wastewater system.

As a result, the Borough will benefit from more than \$9 million of capital improvements to the water system both for water supply and distribution, receive compensation of \$750,000 for sale of the water system, and obtain a 30% discount on current water rates for three years. Thereafter, water rates will be controlled by the Board of Public Utilities. With the long term wastewater operation contract, the Borough will save approximately 30% per year for operation and maintenance of its Wastewater System. In addition, for both the water and wastewater transactions, the Borough was paid a fee by the contractors to reimburse the Borough for its transaction costs; i.e., the cost for technical, financial, and legal advisors used during the procurement process and contract negotiations. The Borough will also receive a fee each year from the contractors to retain an independent engineer to monitor the performance of the contractors and to assure that facilities are being properly maintained.

In closing, from a consultant's perspective, it has been a pleasure working with the Borough of Chester. Advice was requested, informed decisions were made, and the business of the Borough, the taxpayers and the ratepayers was successfully concluded.

Contractor's Point Of View: by Michael P. Kelly III, Regional Manager, Earth Tech, Inc.

When Earth Tech, Inc. first heard of the RFP to be issued by the Borough of Chester, we became excited and pleased that a municipality within New Jersey was seeking a long-term contract for operation and maintenance services. We knew that we could be very competitive in the contracting of the water and wastewater facilities for the Borough, and we knew that we would provide the client with reliable high quality wastewater services with guaranteed costs and performance. We were confident that the Borough would realize that contract operation, maintenance and management of their facilities would be not only cost effective in the short term, but beneficial to the people to whom they represent for a long period of time. We knew from our extensive experience in contract operations that we would realize significant cost savings. In addition to these savings the Borough would

realize the benefits and commitment of a totally integrated company with thousands of professionals with many years of experience in all different disciplines within the water and wastewater fields, as well as other fields of expertise in the engineering arena.

In preparing our response to the RFP, it became apparent that we could not be competitive with regards to the operation and maintenance of the Borough water treatment and distribution system. The reasoning behind this conclusion was the user base of the Borough. The current user base of 164 customer was just not sufficient to carry the financial burden that would be placed upon it as a result of the necessary capital upgrades the system required. As a result of this it was our recommendation that the Borough entertain offers from private water companies to purchase the entire water franchise and system. This recommendation, we felt, was the most cost effective and beneficial means to solving their water treatment and supply difficulties for the residents of the Borough. Subsequently, the Borough negotiated with the New Jersey-American Water Company and sold the water system and franchise in its entirety. The wastewater system turned out to be a different story. The difference between the two systems was quite obvious in our analysis. First the water system was, as previously mentioned, in need of addition raw water supply. The aquifers in the area were contaminated and a source supply was a question. Secondly the surrounding areas of the Borough were serviced by the two private water utilities with distribution mains at the Borough's borders. The capitalization of the system could easily be spread over the entire user base and thus have minimal impact on the citizens.

The wastewater plant on the other hand had just gone through an upgrade and had additional capacity to handle the areas of concern that needed collection system expansion. It was our determination that the Borough would benefit most by the long-term contract operation of the wastewater treatment and collection system. The Borough was interested not only in the operation and maintenance of the existing system, but also in future expansions of the collection system to address various problems with potentially failing septic systems. These needs were each fully addressed in our proposal to the Borough, for long-term operations and maintenance and design/build services, which was submitted for their consideration on April 30, 1997.

Shortly thereafter, the Borough advised Earth Tech that it was selected as the preferred Proposer and was invited to negotiate a contract for the operation, maintenance and management of the wastewater treatment plant and collection system. The contract negotiations were to also cover the design/build expansion to the collection system intended to connect 30 single-family homes in the vicinity of the treatment plant whose septic systems were becoming problematic. The Borough was successful in achieving a significant reduction in the cost of providing sewer service to its existing sewer customers. This reduction is achievable through a long-term contract as compared to the previous short 3-year contract. Throughout the contract negotiations, the Borough, with the assistance of its procurement advisors, Alternative Resources, Inc., endeavored to create a comprehensive contract that provides oversight to adequately protect their interests and concerns. This is especially important in a long term contract as the parties on both sides could change and a clear document that provides for equitable resolve will only help to maintain the partnership. An interesting provision of the contract has Earth Tech annually provide funds to allow the Borough to retain an independent professional engineer to

evaluate our performance under the terms and conditions of the contract. We believe that such an annual "report card" will greatly benefit both the client and the contractor by maintaining a performance standard by which we will be judged on a routine basis. This report card also allows for any concerns to be addressed before they become a stumbling block in the partnership.

While the contract was being finalized, the Borough's existing contract with another firm was about to expire. The Borough had requested our assistance in providing operational services on an interim basis until such time as the contract was finalized and duly executed. Accordingly, Earth Tech entered into an interim agreement with the Borough and began operation and maintenance of the wastewater facilities on January 1, 1998. We immediately set to work on improving the operation and appearance of the facility.

Earth Tech entered into a 20-year contract with the Borough on February 1, 1998. We have fully embraced the idea that we are not just a contractor doing business with the Borough, but rather a partner in all sewer matters that may arise at any time. During the first year of the contract, Earth Tech assisted the Borough with several policy matters including the application of sewer connection fees and sewer user fees. We have also assisted the Borough with sewer service applications and sewer lateral repairs. Also, the wastewater treatment plant is situated in the immediate vicinity of several rather upscale single family dwellings. Naturally, there was a real concern over the operation of the facility in such a manner as to prevent the release of those persistent and unpleasant sewer odors that can result from time to time.

Earth Tech has a great many resources in the design of infrastructure improvements, as well as treatment plant efficiency improvements, plant upgrades and other wastewater system improvements. We are one of the leading environmental firms in the Design/Build/Operation of water, wastewater and industrial waste treatment systems throughout the United States. Our Proposal to the Borough included value added services, which are part of a long-term partnership, entered into by the parties. These include engineering services in the area of treatment systems, administrative support, (regulatory reviews, stabilizing rates without compromising compliance. Assuming all responsibility for all regulatory compliance, executing programs that provide long-term benefits and future cost savings.

In summary, Earth Tech is looking forward to working as the Borough's partner in all wastewater matters that may arise over the next twenty years. We are confident that our relationship will be one of success and happiness as we help the Borough grow to become one of the best municipalities in the state of New Jersey.