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When Consolidation Makes Cents

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DOES IT EVER make sense to consolidate waterworks? Would there be any advantages or disadvantages of consolidation? This article considers some of these questions.

Consider a hypothetical waterworks that was constructed through a government grant in the mid 1950's. This waterworks chose to only pay for their operations cost and not save any money to replace its infrastructure in the future. When water leaks equal half of the water produced, they decide to do something about the problem. Not having enough savings, the waterworks looks to outside funding sources. They obtain a government funding offer with 30% grant and 70% loan that still leaves them with considerable debt. The debt repayment forces them to raise their water rates to 1.5% of their Median Household Income (MHI). They use this funding to replace half of the piping in the distribution system. This corrects the largest part of the leaks and for several years they go back to business as usual. Finally the leakage from the other half of the distribution system has climbed to an unacceptable level; at the same time their water filtration plant needs major upgrades.

Still having no savings, they turn once again to outside funding sources. The lenders determine that the waterworks is already spending more money to pay the debt payments than they spend on daily operations. The lenders are unable to finance any new projects because the high debt payments represent a credit risk. Furthermore, the community finds raising the water rates to pay for new debt payments very difficult because their rates are already the highest in the area. When combined with sewer rates, the total utility rates equal 4% of the total MHI of their residents. Many of the



residents are retirees on fixed incomes and are already unhappy with the current rates, as they feel they are extremely high. The waterworks chooses to do nothing until significant leaks cause a water outage and Boil Water Advisory from the Department of Health. Now customers demand that something be done. However, there are insufficient funds to correct the problem and little ability to increase revenues. Since revenues cannot cover expenses, the community considers budgetary options. One of those options is consolidation with a neighboring waterworks.

Consolidation involves the merging of the community's waterworks with other nearby waterworks. Sometimes this includes an actual connection through a pipe, and at other times it just includes the operation and management of both waterworks by a single combined staff using combined resources. Either situation takes advantage of "economies of scale," or spreading costs over more connections and sharing of equipment and staff so that each customer pays a smaller percentage of the total costs. One researcher suggests consolidation may decrease costs by 20%. Another

researcher indicates that waterworks realize “the majority of savings due to capital, labor, and materials.” (Shih, et al, 2006) More specifically the cost savings was attributed to decreased production costs through efficiencies in areas such as “labor and energy,” and decreased materials and service costs through better leverage to negotiate lower prices. (Shih, et al, 2006) There may even be the option of eliminating one of the water treatment plants if there is sufficient quantity of water

for the entire consolidated waterworks without it. This would eliminate the cost of operating that treatment plant including any proposed cost of upgrading it. The question is when are the benefits to a waterworks from these savings enough to consider consolidation?

Whenever a waterworks has limited ability to take on new debt and/or to raise rates, it should consider consolidation as an option. Likewise, whenever a waterworks is facing an enormous cost for water treatment improvements and

the neighboring waterworks has excess capacity that can be obtained for a fraction of the cost, consolidation may be the best answer. Whether or not it is the best answer may be determined in the details of the negotiation with the other waterworks involved in the consolidation.

There are many things a waterworks should consider during consolidation negotiations with neighboring waterworks. The Washington County Service Authority (WCSA) in Abingdon Virginia and the Western Virginia Water Authority (WVWA) in Roanoke, Virginia, have both been involved in their fair share of consolidation negotiations. They were recently asked what types of issues waterworks should consider when consolidating. Here are some of their answers.

WCSA (Cornett, et al., 2014)

- Waterworks considering consolidation can request that rates are stable for a certain period of time (rate stabilization), or that rates are adjusted so that all customers pay the same rates (rate equalization) ensuring their customers don't pay a higher rate than the other waterworks. If rates have to be raised they can ask that this equalization be slowly phased in after a period of stable rates.

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- If they are not already, the waterworks considering consolidation may wish to ensure they are fairly represented on the governing Board of the other waterworks so that their future interests are properly considered.
- They should also consider what happens to current employees, including salaries, benefits, vacation time, work schedules, and duty locations.

WVWA

- These waterworks should consider how consolidation limits or enhances future economic development. It may be possible to negotiate some of the details about the future availability of water for industry or residential growth.
- In some smaller communities the utility bills constitute the only revenue sources available. In these instances the consolidated waterworks may include a utility tax on customers' water bills that can be transferred back to the community to pay for

the expenses every small community must plan for. Some communities have even used these funds to pay for the Town Manager's salary, electric bill for Town Hall, etc.

Consolidation is not right for every waterworks. However, there are certain situations that warrant its consideration. If a favorable agreement can be reached

with the other waterworks involved in the consolidation, it may be the best option. Consolidation may protect customers from higher rates, lower the cost of providing utilities for communities, provide better quality water, offer more options for future economic development, and better futures for current employees. **Sometimes consolidation makes cents.** 💧

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