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**Discussion Materials Prepared for
the**

**Town of Rising Sun,
Maryland**

*Water and Sewer Utility Pro-Forma
Analysis and Capital Funding Strategies*

September 22, 2009

Overview

1. The Town of Rising Sun has Identified the need to complete Major Capital Improvements to its Wastewater System over the Next Two to Three Fiscal Years.
2. The Town is Required to Complete these Improvements as a Result of Maryland Department of the Environment (“MDE”) Mandate.
3. Other Improvements to Water and Wastewater System may be needed in the Future to Allow for Future System Growth.
4. Davenport, in our Role as Financial Advisor to the Town, was Tasked with:
 - Analyzing the Financial Impact of Funding the Potential Projects on the Town’s Wastewater Utility Fund; and,
 - Providing a Strategic Plan of Finance for the Project(s) .

Goals and Objectives

1. Determine the Overall Affordability of the Mandated Sewer Project(s) Under Two Scenarios:
 - **Scenario One:** MDE allows the Town to move Forward with Upgrades to the Existing Lagoon and the Town elects to do so; and,
 - **Scenario Two:** MDE approves the plan for the new Wastewater Treatment Plant and the Town elects to do so.
2. Develop Strategies to Ensure that the Water and Sewer Utility Funds will be Able to Operate as “Self Supporting” Funds Into the Future (*i.e. Not Reliant on the General Fund for Support*).
3. Develop a Detailed Plan of Finance that Provides the City with as Much Future Cash-Flow Flexibility as Possible Given the Town’s Uncertain Plans for Future Growth and Related Water and Sewer Capital Requirements.
4. Take Maximum Advantage of Below Market / Low Interest Rate Financing.

Key Assumptions

➤ Two Scenarios Analyzed, as Follows:

- **Scenario One: Lagoon Upgrade**
 - Estimated Total Cost = \$4.1 million
 - Assumed Funding Sources Include:
 - \$800,000 MDE Grant.
 - \$3.3 million Funded by Town Borrowing.
- **Scenario Two: New Wastewater Treatment Plant**
 - Estimated Total Cost = \$6 million
 - Assumed Funding Sources Include:
 - \$800,000 from MDE Grant.
 - \$5.2 million Funded by Town Borrowing.

Other Key Assumptions

1. Fiscal Year 2009 Projected Expenditures are Utilized as the Base Year for Projecting Future Cash-Flows.
2. Operational Expenditures Grown as Follows:

Fiscal Year 2010 = 3.0%

Fiscal Year 2011 and Thereafter = 4%
3. Beginning Number of Customer Connections Billed for Usage = 921
4. Existing Rate Structure is Utilized as Base for Projections (*i.e. \$19 per Quarter + \$4.10 per Gallon*).
5. For Purposes of Initial Planning, the Fixed Quarterly Charge and Impact/Connection Fees are Assumed to Remain Constant in the Future.
6. Changes to the Rate Structure for Fiscal Year 2010 are Assumed to be in Effective for 3 months of the Fiscal Year. Rate Adjustments after Fiscal Year 2010 are Assumed to be Effective for a Whole Fiscal Year (*i.e. Effective July 1*).

Other Key Assumptions (cont.)

7. Each Customer Connection is Assumed to Use an Average of 5,500 Gallons per Month.
8. Beginning Fiscal Year 2009 Sewer Reserves (*i.e. Cash on Hand*) is Roughly Equal to \$965,000 .
9. Investment Earnings on Reserves Assumed to be 1.0% in Fiscal Year 2010, 1.5% in Fiscal Year 2011, and 2.0% in Fiscal Year 2012 and Thereafter.

Davenport Modeling Approach

1. Structure Cash Flows of the Fund with the Goal of Maintaining a Reasonable Amount of Reserves (*i.e. Cash on Hand*) During the Next Five to Ten Years (*i.e. At Least 100% to 200% of Annual Expenditures*).
2. If Necessary, Utilize Reserves to Mitigate Future Increases in Debt Service while Revenue Base is Built.
3. Implement Annual Rate Adjustments to Avoid Rate Shock and Limit Operating Deficits.
4. Maintain Debt Service Coverage of at Least 100%, Where Feasible.
5. Ensure that Revenue is Sufficient to Cover all Operating Expenditures and Debt Service without Use of Fund Balance, or Growth Related Monies, Within Five Years.

Initial Sewer Results – Scenario 1

➤ **Town Moves Forward with Upgrades to the Treatment Lagoon at a Cost of \$4.0 million.**

- \$800,000 is Covered by the MDE Grant.
- \$3,200,000 is Funded by a Town Issued Borrowing.
- No New Growth in the System is Incorporated.
- Financing Assumes 3 year BAN + **20 year Permanent Financing.**

Projected Sewer Rates and Monthly Bills							
	Current 2009	2010	2011	2012	2013	2014	2015
Sewer Usage Rate (Per 1,000 gallons)	\$4.10	\$4.35	\$4.87	\$5.45	\$6.11	\$6.84	\$7.25
<i>Increase</i>		6%	12%	12%	12%	12%	6%
Base Charge (Shown on Monthly Basis)	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33
<i>Increase</i>		0%	0%	0%	0%	0%	0%
Average Monthly Cost (Assumes 5,500 gpm)	\$28.88	\$30.24	\$33.10	\$36.32	\$39.92	\$43.95	\$46.20
<i>Increase</i>		\$1.35	\$2.87	\$3.21	\$3.60	\$4.03	\$2.26
<i>Projected Net Revenues (1)</i>	\$65,142	\$26,252	\$79,147	\$28,623	\$68,130	(\$52)	\$15,986
<i>Projected Ending Reserves</i>	\$1,030,430	\$1,056,682	\$1,135,829	\$1,164,452	\$1,232,581	\$1,232,529	\$1,248,515
<i>Reserves vs. Expenditures</i>	360%	362%	388%	306%	323%	249%	248%

(1) Operating revenues, less operating expenditures, plus net non-operating revenues, less debt service, less cash-funded capital (if any).

Note: Revised 2010 rates are assumed to be effective for 3 months of fiscal year 2010. Rates assumed to increase at 6% per year after 2015 to cover natural increases in operational costs (i.e. inflation).

Initial Sewer Results – Scenario 2A

➤ **Town Moves Forward with New Plant at a Cost of Roughly \$6 million.**

- \$800,000 is Covered by the MDE Grant.
- \$5,200,000 is Funded by a Town Issued Borrowing.
- No New Growth in the System is Incorporated.
- Assumes 3 year BAN + **20 Year Permanent Financing.**

Projected Sewer Rates and Monthly Bills							
	Current						
	2009	2010	2011	2012	2013	2014	2015
Sewer Usage Rate (Per 1,000 gallons)	\$4.10	\$4.35	\$5.26	\$6.36	\$7.70	\$9.32	\$11.27
<i>Increase</i>		6%	21%	21%	21%	21%	21%
Base Charge (Shown on Monthly Basis)	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33
<i>Increase</i>		0%	0%	0%	0%	0%	0%
Average Monthly Cost (Assumes 5,500 gpm)	\$28.88	\$30.24	\$35.26	\$41.33	\$48.68	\$57.57	\$68.33
<i>Increase</i>		\$1.35	\$5.02	\$6.07	\$7.35	\$8.89	\$10.76
<i>Projected Net Revenues (1)</i>	\$65,142	\$26,252	\$102,923	\$203,496	\$8,038	(\$46,217)	\$63,673
<i>Projected Ending Reserves</i>	\$1,030,430	\$1,056,682	\$1,159,605	\$1,363,101	\$1,371,139	\$1,324,922	\$1,388,594
<i>Reserves vs. Expenditures</i>	360%	362%	396%	521%	253%	191%	198%

(1) Operating revenues, less operating expenditures, plus net non-operating revenues, less debt service, less cash-funded capital (if any).

Note: Revised 2010 rates are assumed to be effective for 3 months of fiscal year 2010. Rates assumed to increase at 6% per year after 2015 to cover natural increases in operational costs (i.e. inflation).

Initial Sewer Results – Scenario 2B

➤ **Town Moves Forward with New Plant at a Cost of Roughly \$6 million.**

- \$800,000 is Covered by the MDE Grant.
- \$5,200,000 is Funded by a Town Issued Borrowing.
- No New Growth in the System is Incorporated.
- Assumes 3 year BAN + **40 Year Financing (i.e. Rural Development)**.

Projected Sewer Rates and Monthly Bills							
	Current 2009	2010	2011	2012	2013	2014	2015
Sewer Usage Rate (Per 1,000 gallons)	\$4.10	\$4.35	\$5.26	\$6.36	\$7.70	\$9.24	\$9.79
<i>Increase</i>		6%	21%	21%	21%	20%	6%
Base Charge (Shown on Monthly Basis)	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33
<i>Increase</i>		0%	0%	0%	0%	0%	0%
Average Monthly Cost (Assumes 5,500 gpm)	\$28.88	\$30.24	\$35.26	\$41.33	\$48.68	\$57.15	\$60.20
<i>Increase</i>		\$1.35	\$5.02	\$6.07	\$7.35	\$8.47	\$3.05
<i>Projected Net Revenues (1)</i>	\$65,142	\$26,252	\$102,923	\$203,496	\$8,038	\$5,378	\$26,951
<i>Projected Ending Reserves</i>	\$1,030,430	\$1,056,682	\$1,159,605	\$1,363,101	\$1,371,139	\$1,376,517	\$1,403,468
<i>Reserves vs. Expenditures</i>	360%	362%	396%	521%	253%	216%	216%

(1) Operating revenues, less operating expenditures, plus net non-operating revenues, less debt service, less cash-funded capital (if any).

Note: Revised 2010 rates are assumed to be effective for 3 months of fiscal year 2010. Rates assumed to increase at 6% per year after 2015 to cover natural increases in operational costs (i.e. inflation).

Initial Sewer Results – Scenario 2C

➤ **Town Moves Forward with New Plant at a Cost of Roughly \$6 million.**

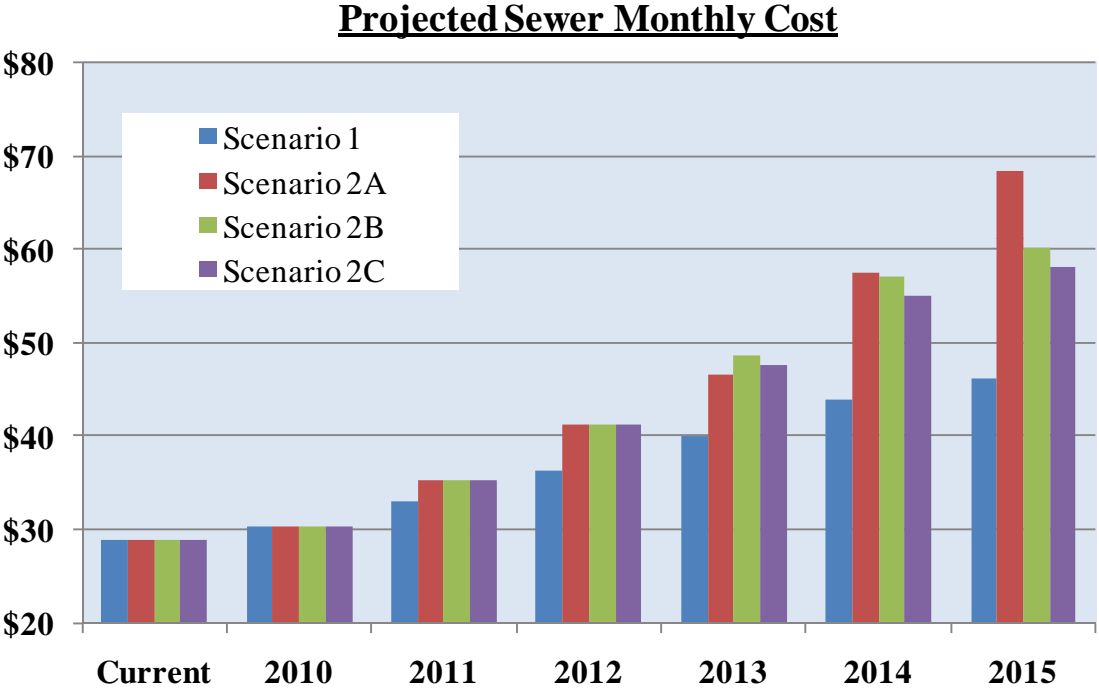
- \$800,000 is Covered by the MDE Grant.
- \$5,200,000 is Funded by a Town Issued Borrowing.
- **Incorporates 100 total New Connections (20 per year from fiscal year 2013 to 2017).**
- Assumes 3 year BAN + **20 year Permanent Financing.**

Projected Sewer Rates and Monthly Bills							
	Current 2009	2010	2011	2012	2013	2014	2015
Sewer Usage Rate (Per 1,000 gallons)	\$4.10	\$4.35	\$5.26	\$6.36	\$7.51	\$8.86	\$9.39
<i>Increase</i>		6%	21%	21%	18%	18%	6%
Base Charge (Shown on Monthly Basis)	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33	\$6.33
<i>Increase</i>		0%	0%	0%	0%	0%	0%
Average Monthly Cost (Assumes 5,500 gpm)	\$28.88	\$30.24	\$35.26	\$41.33	\$47.63	\$55.06	\$57.99
<i>Increase</i>		\$1.35	\$5.02	\$6.07	\$6.30	\$7.43	\$2.92
<i>Projected Net Revenues (1)</i>	\$65,142	\$26,252	\$102,923	\$203,496	\$162,435	\$108,353	\$149,347
<i>Projected Ending Reserves</i>	\$1,030,430	\$1,056,682	\$1,159,605	\$1,363,101	\$1,525,536	\$1,633,889	\$1,783,235
<i>Reserves vs. Expenditures</i>	360%	362%	396%	521%	281%	235%	254%

(1) Operating revenues, less operating expenditures, plus net non-operating revenues, less debt service, less cash-funded capital (if any).

Note: Revised 2010 rates are assumed to be effective for 3 months of fiscal year 2010. Rates assumed to increase at 6% per year after 2015 to cover natural increases in operational costs (i.e. inflation).

Summary of Scenarios



Comparison of Current Water/Sewer Monthly Costs

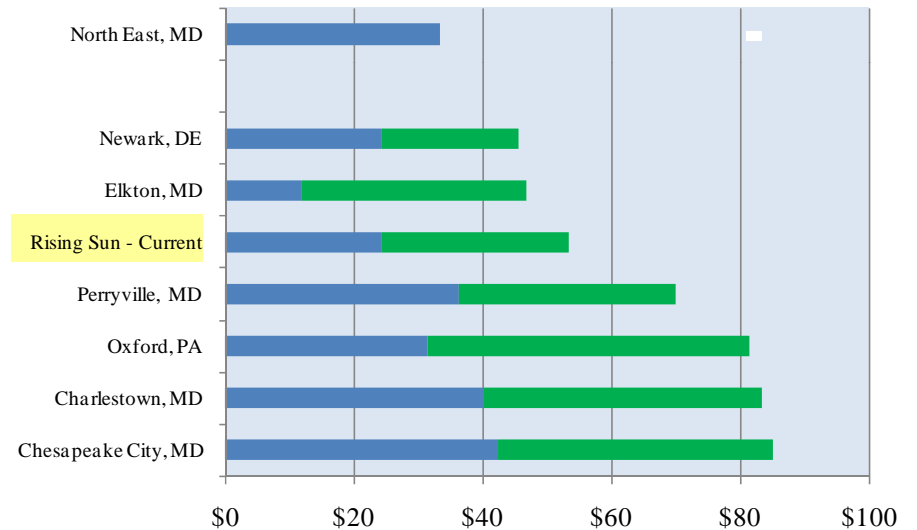
- The Town’s Current Usage Charges for Water and Sewer are Amongst the Lowest in the Region.

Comparison of Regional Water/Sewer Monthly Costs

	Water	Sewer	Total
Chesapeake City, MD	\$42.50	\$42.50	\$85.00
Charlestown, MD	40.20	43.25	83.45
Oxford, PA	31.36	50.14	81.50
Perryville, MD	36.33	33.58	69.92
Rising Sun - Current	24.41	28.88	53.29
Elkton, MD	11.83	34.93	46.75
Newark, DE	24.41	21.23	45.64
North East, MD	33.50	N/A	33.50

**Monthly is for in-town residential rates based on monthly usage of 5,500 gallons.*

Water/Sewer Monthly Cost



Note: For purposes of illustration, comparison shown on a monthly basis.
 Source: Offices of the various localities.

Initial Observations

- The Sewer Fund has the Financial Capacity to Responsibly Fund the Lagoon Upgrades or the New Wastewater Plant by using a Multi-Year Rate Increase Plan (*i.e. Avoid Rate Shock*).

- Scenario 1 (*Lagoon Upgrade*) is a Less Costly Option in the Short-Run.
 - However, the Lagoon Upgrade does not appear to Provide the Town with any Ability to Grow its Water and Sewer System.

 - As such, if the Town ever desires to increase the size of the Water and Sewer System to take Advantage of Growth, it will need construct a new Wastewater Treatment Plant.

 - Also, the ability to Obtain Regulatory Approval for the Lagoon Upgrade is uncertain.

- The Water and Sewer Funds have Solid Reserve Levels. Davenport Recommends that the Town Maintain these Solid Reserve Levels (*i.e. at least 100% to 200% of the Budget*).

Initial Observations (cont.)

- Maintaining Solid Reserves will Provide Numerous Benefits to the Town Including, but not Limited to:
 - The Ability to Cover Unexpected Expenditures (*i.e. Equipment Failure*) Quickly without the Need for Potentially Costly Emergency Borrowing;
 - Increased Interest Earnings which will Help to Keep User Rates Low; and,
 - ***Enhance the Credit Standing of the Town when/if it needs to Borrow Money for Capital Projects. This will Result in Greater Access to the Credit Markets and Lower Interest Rates.***

- Davenport understands that the Town and its Auditors may Revise the Allocation of Water and Sewer Reserve Levels.
 - A Significant Re-Allocation of the Reserves Levels versus the Assumptions shown herein may alter the projected Results.

Wastewater Project – Plan of Finance

- When the Town has Selected its Preferred Option and Obtains Approval from MDE, Davenport Recommends the Following Plan of Finance for the Project (*Regardless of Option Selected*):
 - Consider a Shorter Term, Interim Financing (*i.e. Four to Five Years*) for the non-MDE Grant Funded Portion of the Project.
 - The Rationale for this Funding Strategy is as Follows:
 - ***Without a Long-Term Master Plan for Growth in the Town, the Future Growth and Cash-Flows of the Sewer Fund are Uncertain;***
 - The Future Capital Requirements for the Sewer System (*Mandated or Voluntary*) are Uncertain; and,
 - Obtaining Financing in a Short-Term Mode will Allow the Town to Complete the Mandated Project while Providing Maximum Future Cash-Flow Flexibility.

Lagoon Upgrades – Plan of Finance (cont.)

- The Short-Term Financing will Utilize Capitalized Interest and Interest-Only which will Minimize the Initial Cash-Flow Impact to the Sewer System while the Revenue Base is Built.

- The Short-Term Financing will be Able to be Repaid / Refinanced Prior to Maturity. This will Allow the Town to Pay-off and / or Permanently Term-Out the Financing as soon as One Year from Now.

- The Short-Term Financing can be Obtained via a Competitive Process with a Commercial Banking Institution.
 - Davenport will Coordinate a Competitive Bidding Process for the Financing that will Involve and Local, Regional, and National Banking Institutions that are Active in Maryland.

Next Steps / Preliminary Timetable for Action

➤ **September 22, 2009**

Regular Meeting of the Town of Rising Sun

- Davenport Presents Updated Plan of Finance.

➤ **Balance of
Calendar Year, 2009 /
Early 2010**

- Town Selects Desired Wastewater Option.

- MDE Approves Project.

- Complete a Charter Amendment to Allow for “Private Placement “
Transaction (see appendices).

- Consider Putting in Place a “Reimbursement Resolution”

(Note: Per IRS Regulations, this step is Necessary for the Town to be Reimbursed for any Out-of-Pocket Expenditures Related to the Treatment Lagoon from Proceeds of the Interim Financing.)

A Nationally Recognized Bond Counsel Firm should Prepare this Documentation. In addition, the Bond Counsel is Necessary to Provide the Tax-Opinion on the Town’s Tax-Exempt Financing.)

Next Steps / Preliminary Timetable for Action (cont.)

➤ **Balance of
Calendar Year, 2009 /
Early 2010 (cont.)**

- Consider Ordinance to Affect Water and Sewer Rate Increases.
- Authorizes Davenport to Distribute Competitive Solicitation for Interim Financing.
- Davenport Returns to Town with Results of Bidding and Recommended Funding Provider.
- Town Formally Selects Winning Bidder.
- Close on Interim Financing.

Appendices

Private Placement Strategy

- A Bank Qualified Private Placement offers the Town the Most Cost-Effective and Flexible Means of Obtaining the Short-Term Financing.
 - “Bank Qualification” provides Financial Institutions Beneficial Tax-Treatment for Lending to Local Governments that Borrow less than \$10 million (*Historically*) or \$30 million (*for Calendar Year 2009 and 2010*) per Calendar Year.
 - A Private Placement can be Competitively Bid out to Local / Regional / National Banking Institutions.
 - Private Placements Typically Carry Highly Favorable Prepayment Provisions when Compared to an Issuance in the Public Marketplace.
 - Minimal Legal Documentation is Required for a Private Placement versus an Issuance in the Public Markets.
 - Private Placements do not Required Credit Ratings, the Preparation of a Detailed Offering Prospectus, an Underwriter(s), or Bond Insurance.
 - As such, a Private Placements Typically Carry much Lower Costs of Issuance than an Issuance in the Public Marketplace.
 - **Note: In order to Take Advantage of this Strategy the Town will need to Amend/Update its Charter.**

Davenport's Approach to the Assignment

1. Developed, in Consultation with Town Staff, a Pro-Forma Revenue Based Model Which Integrates Operations, Capital, Debt Service, and Reserves.
2. Prepared a Series of Scenarios with Accompanying Revenue Increases, as Necessary, that Demonstrates the Financial Impact of Incorporating the Town's Potential Capital Projects.
3. Recommend that the Town Consider Approving “**Fiscal Policy Guidelines**” for the Utility Enterprise Funds and the General Fund in the Future.

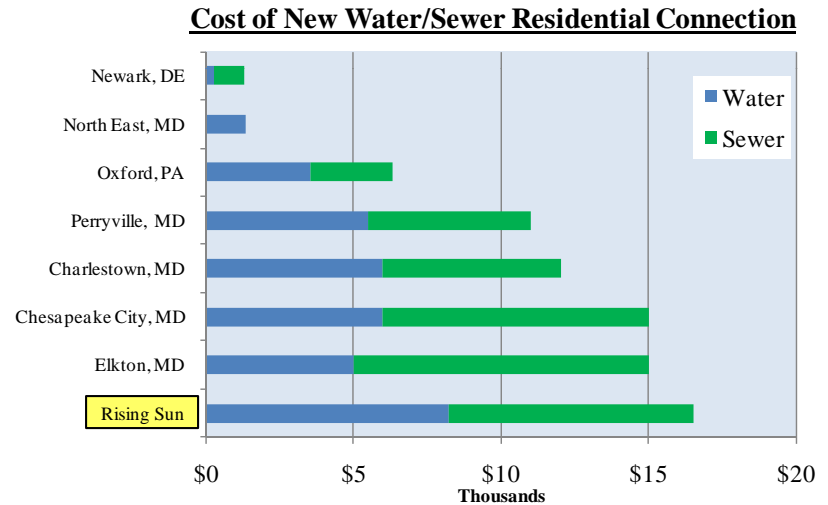
(Note: Healthy, Self Supporting Utility Enterprise Funds will in Turn Safeguard the Town's Overall General Fund and Enhance the Town's Credit Standing for any Overall Capital Requirements – Utility Related or Otherwise.)

Comparison of Current New Connection Charges

- The Town’s Current Charges for New Connections are in Line with Regional Peers/

Cost of New Residential Connection			
	Water	Sewer	Total
Rising Sun	\$8,200	\$8,300	\$16,500
Elkton, MD	5,000	10,000	15,000
Chesapeake City, MD	6,000	9,000	15,000
Charlestown, MD	6,000	6,000	12,000
Perryville, MD	5,500	5,500	11,000
Oxford, PA	3,529	2,800	6,329
North East, MD	1,375	N/A	1,375
Newark, DE	300	1,000	1,300

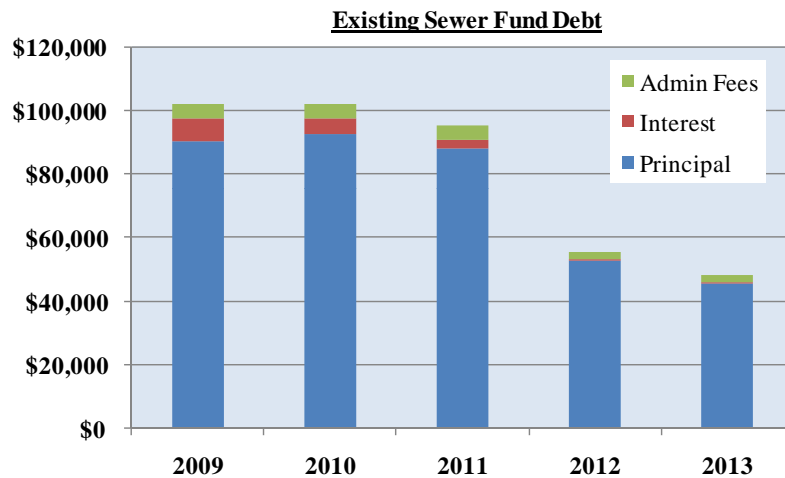
*Quarterly Bill is for in-town residential rates based on monthly usage of 5,500 gallons.



Source: Offices of the various localities.

Existing Sewer Fund Debt Service

- Existing Sewer Fund Debt Service is Repaid Within Four Years.
- This Drop-off Creates an Opportunity to Minimize the Impact of Incorporating New Debt Service.



Fiscal Year	Principal	Interest	Admin Fees	Total
2009	\$90,375	\$6,851	\$4,538	\$101,764
2010	92,509	4,716	4,538	101,763
2011	87,977	2,488	4,538	95,003
2012	52,853	493	2,357	55,702
2013	45,718	229	2,357	48,303
Total	\$369,432	\$14,776	\$18,328	\$402,536

Existing Sewer Debt

Loan	Interest Rate	Outstanding Principal at 6/30/2008
1990 MDE Loan	4.89%	113,875
2007 MDE Loan	0.50%	255,557
Total		\$369,432

Enterprise Funds Policy Guidelines for Consideration

- Maintain Financial Independence from the General Fund by Setting Rates and Charges at a Level that will Avoid the Need for any General Fund Revenues to Support Utility Operations.
- Maintain a Balance of Water and Sewer Cash & Equivalents (*i.e. Fund Balance*) of at Least 100% of the Water and Sewer Fund Expenditures Including Debt Service.
- The Town will set Fees and Charges for the Enterprise Water Fund and Sewer Fund at a Level that will Fully Support the Total Direct and Indirect Costs of the Funds. Indirect Costs Currently Include Debt Service .
- Fees and Charges will be Revised Annually Recognizing the Natural Pressure on Expenditures due to Inflation (*Tied to the Purchase Price of Goods and Services*), as well as Cost of Living Adjustments (*Administrative Costs, Salaries, Health Care and Benefits, Medical Expenses, etc.*).