

What Happens After the Project is Over and the Loan is Closed?

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The new water lines are in the ground and running the clearest water this town has seen in years. The new shiny water tower is up and glistening in the evening sunset with your town's name in a creative script and artwork to identify it to all who pass through. The residents' complaints about brown water are gone along with the old, corroded iron water lines. Everyone exhales a sigh of relief. Well, not everyone. The work of the Municipal Finance Officer, commonly referred to as the Clerk, is still going strong and will for the life of the loan that funded these improvements. This article addresses what really happens in the small-town finance office now that the grass is growing around the new curb stops. We will talk about how the use of surcharges ensures that loan payments are met and all the different funding requirements that may be imposed as a result of accepting state and federal funding.

Ideally the local government, especially the Clerk, was listening to their funders on what stipulations came along with the funding package for their new construction project especially since now the elected officials, guided by the Clerk, must ensure solvency of their new SRF or Rural Development long-term debt.

From my past experience as a municipal finance officer in the state of South Dakota, surcharges are one of the means of ensuring debt repayment. A surcharge is a flat fee that is charged to all the utility's customers to pay their share of the debt incurred for an improvement. If there is water service to a property, whether the water is on at the curb stop or not, the property owner is charged a

surcharge. There is an expectancy of the service to work when needed and having water access improves property value. Therefore, every service connection (commercial and residential) should assist in paying for said improvements. When you take out a loan to purchase a car, the car becomes the collateral for the loan. A surcharge is like the car; it is the collateral for the loan. Your loan's bond book will state how much of a surcharge will be imposed to be used for debt servicing. When setting a surcharge, a utility must carefully consider two things – how much does the surcharge need to be to ensure debt repayment and when does the surcharge need to start being collected.

During the planning phase of any large construction project, the engineer and funders calculate how much the project will cost, how much of the project costs will be funded by grants, how much will be funded by loans, who the funding agencies are, and, if funded by a loan, when the loan repayment will begin. If the project construction time is measured in months, it is important to remember that interest starts accruing on a loan as soon as funds are drawn. Before the monthly or quarterly payments begin, the utility will have to pay off the accrued interest using the in-place surcharge revenue. For example, by the time a utility has drawn down on a \$2.5 million loan over several months (or even years), the accrued interest could be \$50,000 or more. Have your surcharges in place early enough to ensure that this payment can be satisfied. Then the surcharges need to start accumulating to ensure that the first and each consecutive loan payment is properly funded by the surcharge.

Answer these few questions to get started on calculating the amount of a surcharge: How much is the anticipated loan payment (principal and interest)? How often will payments be due (monthly or quarterly)? How many users will be charged this fee? Let's use an example of an SRF loan payment of \$25,000 due every quarter for a system with 640 users. Just to cover the loan payment, the utility must charge each user at least \$13.02/month.

$$\begin{aligned} & \$25,000 \text{ payment} \div 3 \text{ months} \div 640 \text{ users} = \\ & \$13.02/\text{month minimum surcharge fee} \end{aligned}$$

If you have non-residential high-use customers, you may wish to charge them a higher surcharge, which is typically based on the meter size.

Your funder may also require the utility to set aside one payment in advance into a reserve account as another means to ensure debt repayment. Does your utility have late payers or uncollectable accounts? Of course, every utility does. You will need a buffer to cover them. Collecting these fees is crucial for repayment. If you do not already have a collection policy – make one and follow it.

All these funds are to be held by the utility in an interest-bearing account until the loan has been paid back in full. The utility bill to your customer should label the surcharge with a name that identifies the project/debt (i.e., Water Tower Surcharge) and the amount of the surcharge. When collected, this fee should be recorded separately to a designated revenue code identifying it as reserved money to pay down debt and recorded as an asset on the balance sheet as restricted funds (to be used only as designated). One system could have multiple debt service accounts for all the different funders for all different projects over the years. Good record keeping is extremely important because there are very few Clerks that stick with the job until the debt is paid off in 30 years!

After a few months of loan payments, review the surcharge fee to make sure it sufficiently covers the debt service. Do you have enough surcharge revenue to make loan payments? If you feel it needs to be adjusted, either up or down, you must get approval from the funding agency first. I had a project that had unforeseen weather delays during construction and the total project cost was overestimated by over \$1 million! I worked with the funder for approval to reduce the surcharge and paid off an extra \$100,000 toward the loan from the surcharge reserve. That is by no means the norm, but it goes to show that there are a lot of variables to consider when setting a surcharge and that it is not an exact science.

Now that the surcharge amount is set, we also need to revisit the usage rates to ensure that any other loan

Small water systems borrowing money for critical infrastructure projects have several options to generate the revenue needed to repay debt. Many communities use debt surcharges successfully, as is outlined in the article. Other communities have found success by rolling the cost of debt into their base rate, volumetric rate, or both. Each repayment approach can impact the bills of various types of customers differently. We recommend that utilities consider how rate increases for debt repayment will change the bills of customers at many different levels of usage, paying particular attention to the effects on low-use and high-use customers.

obligations are met. A rate covenant is a provision in a municipal revenue bond that requires that the rates are adequate to cover ongoing maintenance and repairs of said facility. Generally, the utility will need to show that their revenue exceeds at least 110% of the operating expenses.

Another reserve that may be required by a funder is money set aside to replace or repair components of the facility which is being financed, known as a short-lived asset. Short-lived assets have a useful life significantly less than the repayment period of the loan. This dollar amount is set by the board during the planning phase and is written into the revenue bond. The Clerk must remember to budget for this reserve allocation every year and keep track of its balance. Although required by the funder, the utility does not need the funder's permission to spend these funds when used properly – replacing a key component such as a master water pump, for example.

Another reserve, Operations & Maintenance, is one month's worth of the expenses set aside to ensure ongoing operations. Again, tracked as an asset on the utility's balance sheet.

Funders will require yearly compliance reporting from the Clerk as agreed upon in the funding package and copies of their audits performed by an independent accounting agency. When used properly, an auditor can be the Clerk's best friend to assist in setting up these reserve accounts and their ongoing maintenance.

Unfortunately, many small-town Clerks do not have the bookkeeping background or the spare time to perform these reporting requirements. And that is when we, as Technical Assistance Providers, may be asked to step in to assist. I hope this brief explanation of all that happens after the construction ends gives you a glimpse of the work that faces the Clerk. Just because the loan is closed does not mean the work of the Clerk stops. The Clerk's job is never done. 