



COUNCIL MEMORANDUM

DATE: May 15, 2015

TO: Mayor Wilcox & Members of Council

FROM: Tanisha Briley, City Manager

RE: Proposed Letter of Intent (LOI) for Public Private Partnership with Aqua Ohio

As you know, the City faces significant challenges with the water utility. The utility has a projected 2015 deficit of \$3.7 million and like many cities around the nation; our 80-90 year old infrastructure is failing. The City's ability to invest in much needed upgrades has been severely constrained by our fiscal environment which has led to increasingly high levels of non-revenue water. These issues came to a head following the receipt of what seemed to be abnormally high bills for water purchased from the Cleveland Water Department (CWD) in early 2014. Staff conducted an internal investigation that confirmed the accuracy of the bills. In 2013, the City's average monthly CWD bill was approximately \$850,000 and beginning in 2014 we saw an increase of 25% to an average monthly bill of \$1.075 million. In addition to this substantial increase in the water utility's largest expense, purchased water, the utility was not collecting enough revenue from customers to cover the expense.

The City has since been engaged in a yearlong review of the water utility. An outside engineering firm was hired to conduct a detailed evaluation of the system, pinpoint the areas of water loss, and make recommendations for improvement. The study concluded that the water utility had extremely high amounts of non-revenue water (60%) due to inaccurate metering, an outdated billing system, and a severely aged and leaking distribution system.

The City's water utility is in need of major capital investment to address these issues and turn it around; however, given the financial conditional of the water utility and the City as a whole we needed to explore creative financing opportunities. Several possible solutions have been considered including 1) a performance contract that would require the City to borrow \$20 million for initial improvements, 2) turning the system over to the City of Cleveland, and 3) engagement of a private partner.

Among the primary considerations when evaluating options were the needs to:

1. **Resolve the projected \$3.7 million deficit** and cover ongoing losses of the Water Department in 2015;
2. **Secure the necessary capital investments** to immediately improve the system and place the system on track for continuous investment to avoid a reoccurrence of these issues.
3. **Retain an active role** in managing the water system;
4. **Manage financial risks** associated with necessary system improvements;

5. **Maintain high levels of service** to the residents of Cleveland Heights including responsiveness, field work and customer service;
6. **Stabilize rate increases** so that they are predictable and manageable for our residents and businesses;
7. **Respect the Water Department's existing workforce** and their dedication to our City and uphold the labor agreement;
8. **Protect options** for the City's future leadership to extend or rescind any agreement; and

The performance contract option would require the City to borrow \$20 million to complete the recommended improvements and use the additional revenue and savings that would be created from the upgrades to pay back the loan over time. This addressed many of the above-cited considerations but fell short of eliminating the 2015 shortfall. With the City facing a substantial budget deficit next year in addition to the water utility's projected \$3.7 million shortfall, the performance contract was not a viable option.

The second option would turn the water utility over to the City of Cleveland. Cleveland has not yet presented any information for consideration; however, based on what is known about a recent case where another city transferred its system to Cleveland it is unlikely that all eight concerns would be met with this option.

After extensive review we have determined that engaging a private partner through a Public Private Partnership (P3) would best meet the City's needs. A P3 is a collaborative effort between the public and private sectors that accentuates the strengths of each. In a P3 both partners have a role to play in the delivery of services and the risks are shared by each party. P3s are also flexible to allow for customization so that each partner's needs are met.

Based on initial discussions with the company, it is recommended that the City enter into a Letter of Intent (LOI) to explore establishing a Public Private Partnership with Aqua Ohio. The LOI is a non-binding document that authorizes City staff to begin negotiations of a partnership agreement and sets specific parameters, such as the criteria above, for the terms of the agreement. For your convenience, we have also included a fact sheet that outlines key elements of the LOI and other considerations.

Approval of the LOI would be the first of several steps in the formation of a partnership with Aqua Ohio. These steps are expected to take several months to complete and will include opportunities for public engagement, the first of which is a public forum scheduled for Tuesday May 26, 2015 at the Cleveland Heights Community Center from 7:00 to 9:00pm. The second reading and final approval of the LOI is expected June 1, 2015, and the negotiation of partnership terms and presentation of those terms to Council for approval is anticipated to occur later this summer.