



February 24, 2018

Dear Property Owner and/or Ratepayer:

I was asked by POASH president, Bill Wafford, to put in writing the explanation I provided at the Borough Council meeting on February 21st for the water-sewer utility rate increase that became effective January 1st. I appreciate the opportunity to do so. I recognize that although I have been publicly discussing the water-sewer utility problem for 2+ years, many ratepayers may not have understood the magnitude of the problem until they received their recent bill.

A municipally created utility is an organizational unit created to perform a specific function within the municipality. The utility is required by law to be self-liquidating (self-financing); the utility's revenues must be sufficient on their own to support the utility's expenses in any given budget year. If the utility is not self-liquidating, any year-end deficit must be appropriated in the subsequent year budget. The accounting for utility operations is separate and distinct from the local government's general operating budget (i.e., the budget that contains appropriations for police, court, DPW, general administration, etc.). There are numerous types of self-liquidating municipal utilities in New Jersey including those for water, sewer, water and sewer, electric, parking, harbor, airport, swimming pool, and golf course.

The Borough of Seaside Heights operates two separate utilities: 1.) water-sewer, and 2.) electric. Many municipalities operate a water or water-sewer utility,

but only nine municipalities and the Sussex Rural Electric Cooperative operate their own electric utility.

One of the first conversations I had with the Borough's chief financial officer when I was appointed borough administrator in June 2014 involved her concerns about the solvency of the water-sewer utility. The CFO told me that for many years cash flow has been so bad that she regularly makes temporary transfers from other municipal accounts to the water-sewer utility fund to pay water-sewer utility salaries and bills. She advised me that she repeatedly raised her concerns to prior administrations but no action was taken.

As I prepared my first Seaside Heights budget in 2015 and probed deeper into the water-sewer utility issues, I realized very quickly how big a problem this is. The CFO was not crying wolf.

The former mayor responded by commencing consultations with one of the large private water companies doing business in New Jersey regarding a potential sale of the water-sewer utility. After numerous meetings with the company's representatives, and following the mayor's resignation in mid-2015, the initiative was halted due to concerns by Borough Council that the initiative was neither independent nor transparent. In essence, we had asked a potential purchaser to advise the Borough whether the utility should be sold. And Borough Council, which did not participate directly in the consultations, directed that any future endeavor to sell the utility should involve governing body members and property owners.

As 2015 came to a close I engaged in more detailed conversations about the water-sewer utility issues with the CFO, borough auditor, and present and former utility staff. We concluded the following:

1. The utility has been experiencing cash flow problems for many years; in fact, decades according to the CFO.
2. Revenue has not been covering expenses. The \$51 per quarter fixed rate together with the consumption charges in effect before the new ordinance was adopted were insufficient to cover the utility's expenses.

3. Water-sewer rates have not been raised in at least 10 years. At one point in time the fixed rate (“facilities charge” in the new ordinance) was \$5. At another time there was no fixed rate. And at still another time the rate was based on the number and type of fixtures.
4. The sale of Ortley Beach and Pelican Island water service to a private water company eliminated a substantial revenue source from the utility’s operating budget.
5. In simple terms, the water-sewer utility historically was not operated under a typical utility business model.

The water-sewer utility operating deficits – \$595,000 in the 2016 budget and \$1,000,000 in the 2017 budget – and the loss of \$200 million of property ratables following Superstorm Sandy and the Boardwalk fire, are the chief factors that led Borough Administration to apply for Transitional Aid for Localities in 2016 and 2017. Fortunately, the Borough was awarded \$750,000 in 2016 and \$1.4 million in 2017.

However, pertinent to the structural imbalance in our water-sewer utility budget, the 2017 Transitional Aid Memorandum of Understanding between the Borough and NJ Division of Local Government Services contains specific requirements that the Borough 1.) analyze the water-sewer rate structure and address the problem, and 2.) implement a monthly billing cycle to improve the utility’s cash flow. The state’s position is, quite simply, that as a condition of receiving the 2017 funding and potentially receiving additional funding in 2018, the Borough must fix the structural budget imbalance that is, in large part, creating the need for the funding in the first place.

Thus, the Borough Council authorized me early in 2017 to retain an independent consultant to perform a water-sewer rate study and to recommend alternatives for the utility to become self-liquidating. The “Lerch Vinci & Higgins Study” was received by the Borough in October 2017 and is available from the Borough website.

Furthermore, I directed the borough engineer to prepare a sewage flow evaluation and report (inflow/infiltration study) for the benefit of the rate study. The report indicates that infiltration costs the utility approximately \$460,000 per year and that the estimated cost to line the Borough's 1,427 laterals is \$6,400,000. The engineer's report is also available on the Borough website.

Borough Council authorized me to address the cash flow problem by implementing shutoffs for delinquent accounts. Remarkably, the utility hadn't been doing shutoffs even though most public and private utilities have such a policy. Instead, it was common practice in Seaside Heights for many ratepayers not to pay their water-sewer bills until the annual lien sale in December.

Borough Council also adopted an ordinance implementing monthly billing and a new leak adjustment policy. Both changes were aimed at improving cash flow and were based on business practices adopted by many other public and private utilities.

How was the new rate structure developed?

As noted above, the Borough retained the services of a consultant to examine revenue and expenses of the utility together with present and anticipated capital outlays and debt service, and provide recommendations for the utility to become self-liquidating during one-year and two-year scenarios.

While the consultant's study was being performed, Borough staff collected and reviewed the rates and operating procedures of numerous municipal utilities, authorities, and private water companies. These rates and operating procedures were compared and contrasted with the recommendations contained in the consultant prepared study. The final ordinance, a one-year self-liquidation plan, was recommended by water-sewer utility staff and Borough Administration to the Borough Council as the most compatible fit for Borough ratepayers.

There is no disagreement that the fixed rate increase is substantial and in some cases a genuine financial hardship. The new rates affect municipal employees who reside in the Borough, governing body members, new residents and longtime residents, business owners, family, and friends. Under better circumstances, absent Superstorm Sandy and the boardwalk fire, the Borough would have chosen to incrementally increase the rate to get the operating deficit under control.

Unfortunately, those of us who are working for you today and have to confront this problem today do not have that option, especially given the state's directive in our MOU.

What is a facilities charge?

Every service we use in our homes or businesses - whether it's cable/satellite television, natural gas, propane or telephone/cell phone - has some form of a monthly charge to cover the cost of providing the service. It might be called a service charge, basic charge, fixed charge or minimum charge. For the Seaside Heights Water & Sewer Utility, this monthly charge is called a facilities charge in the new ordinance. It is a fair share investment that assures there is water and sewer service when it is needed.

The expenses incurred by the water-sewer utility for equipment and main/lateral maintenance, metering and billing services, and debt service are relatively fixed; they do not vary according to your water use levels. By recovering a portion of these necessary expenditures through the facilities charge, instead of through water usage charges (which do vary by levels of use), the costs are distributed more fairly among customers.

Why is there a per unit charge?

We found that many public and private utilities, including Seaside Park and Lavallette, use a per unit charge as a fair way to distribute the utility's fixed costs. Before the new ordinance was adopted by Borough Council the owner of a single-family home was paying the same quarterly minimum charge as many owners of multi-unit apartment complexes and condominiums, restaurants and bars, and lots containing more than one building.

What is the outlook?

The Borough's financial team anticipates that the 2017 annual financial statement will reveal another large operating deficit \$800,000+. However, our projections for 2018 using the new rate structure and monthly billing result in positive cash flow and a small operating surplus. Borough Council is committed to reviewing revenue in November and December against our projections and making a determination whether the rates should be maintained in 2019 or may reasonably be reduced to provide some relief.

We were able to successfully utilize the water-sewer revenue losses in our request that FEMA cancel repayment of the Borough's Community Disaster Loan in the amount of \$3.9 million. So, there is a little sunshine peeking through the clouds.

I encourage any property owner or ratepayer who has questions or comments about the new water-sewer rates to please contact me directly. I assure you that either Brian Hoffnagle, the Borough's licensed water operator, or I will take as much time as necessary to discuss these issues in more detail in person or over the phone.

Best regards,

Christopher J. Vaz

Christopher J. Vaz
Borough Administrator