

King George County Service Authority

Strategic Considerations



October 3, 2023



Background / History

- Davenport & Company LLC (“Davenport”) serves as Financial Advisor to King George County, VA (the “County”) and the King George County Service Authority (the “Service Authority”).
- The Service Authority was established in 1992 under the Virginia Water and Sewer Authorities Act to supply drinking water and to provide wastewater collection and treatment in certain areas of the County.
- In Virginia, a Service Authority is a separate political subdivision created by the County under the authority of state law.
- The Service Authority is governed by a 5 member Board of Directors. The Board of Directors is appointed by the Board of Supervisors.
- For many years the Board of Supervisors served in the capacity of the Board of Directors. In recent years, the Board of Directors has been comprised of a combination of the Board of Supervisors members (currently 2) and non-Supervisor members that are appointed by the Board of Supervisors (currently 3).



Background / History (cont.)

- As is the case with many water/sewer utilities in rural or growing areas – the Service Authority required support from the General Fund for years in the form of:
 - Direct payments from the General Fund to support expenditures of the Service Authority; and
 - A “Moral Obligation” subject to appropriation pledge to backstop the Service Authority’s debt in the event revenues were not sufficient to make debt service payments.
- In the aftermath of the 2008 financial crisis and subsequent economic recession, the County’s General Fund needed to conserve financial resources to help maintain its financial strength. As a result, a plan was developed to transition the Service Authority to a fully “self-supporting” water/sewer utility.
 - Note: Self-supporting water/sewer utilities are a recognized “best practice” across the municipal industry and help to support the General Fund’s credit ratings.
- The original 2009 plan was successful and the Service Authority has been financially independent (i.e. not reliant on direct payments from the County) for roughly a decade.
 - Note: the County still provides a “Moral Obligation” support to all of the Service Authority’s debt. As long as the Service Authority can demonstrate the ability to remain “self-supporting” on a multi-year basis, this debt backstop does not “count” against the County’s tax-supported debt capacity.



Background / History (cont.)

- In the 2017 time period the Service Authority was put under consent order for a variety of operational / environmental regulatory issues.
- As a result of the need to enhance the operational and capital spending in order to comply with the consent order, Davenport and the Service Authority developed an updated multi-year financial plan in 2018 to allow the Authority to increase its regulatorily related required investment (both operational and capital) in 2019 (the “2019 Plan”).
- The 2019 Plan provided the ability to take on approximately \$15 million of new capital investment while also maintaining the self-supporting nature of the Service Authority while also keeping annual rate increases in line with prior projections.
- Since the implementation of the 2019 Plan, the Service Authority has had several years of strong financial results.



Initial Observations

- The County – by virtue of its strategic location and other factors – is poised to continue to grow into the future.
- This future growth will be heavily influenced by the availability of water/sewer service.
- Thus, the future growth and economic development potential of the County is heavily linked to the availability of reliable water and sewer service.
- Also, the Service Authority's recent strong financial results have been driven – in part – by growth from new connections to the system. New connection-related revenue is always uncertain as to amount/timing. The Service Authority/County have less visibility as to the future of new connection-related revenue versus the past decade.

Goals and Objectives

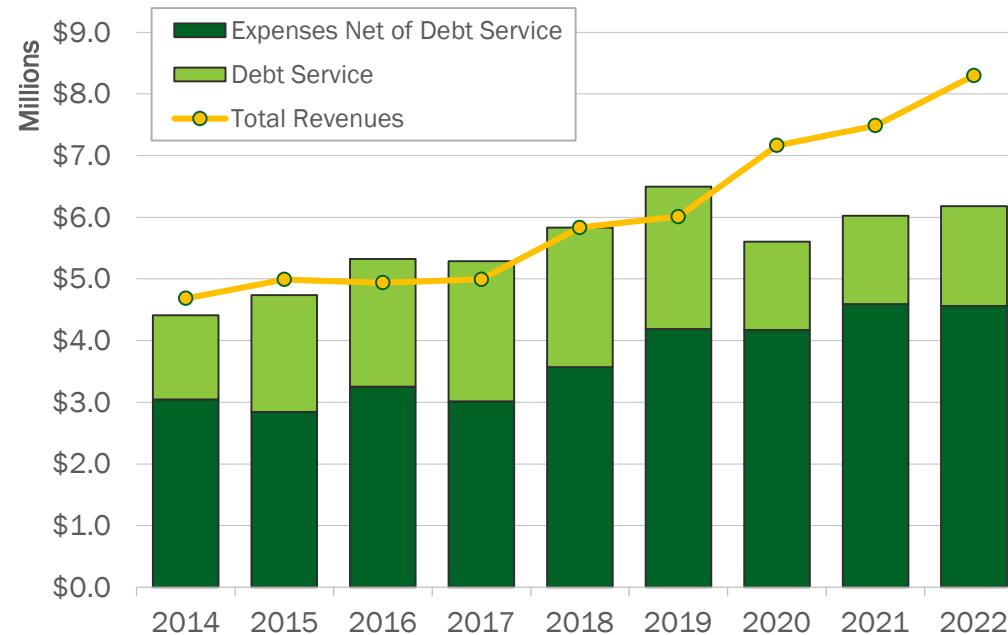


1. Davenport was asked to develop a series of strategic considerations for the Service Authority and the County to consider with respect to the future of the Service Authority including potentially changing the Service Authority into a Utility Department under the direct management of the County.
 2. The relationship between the two entities has a series of important considerations to be evaluated, including but not limited to:
 - 1) Day-to-day operations (County responsibility);
 - 2) Permit / regulatory Related (County responsibility in concert with legal/regulatory counsel);
 - 3) Legal (County Attorney/Bond Counsel/other specialized counsel as necessary); and
 - 4) Financial/Debt Related (County/Davenport/Auditor).
 3. Davenport was asked to present initial observations of the strategic considerations outlined above.

Water & Sewer Fund – Historical Cash Flows



- The Service Authority's Revenues have grown each year for the past 8 fiscal years.
- Expenditures have also increased which were likely driven by the need to regain compliance with a variety of regulatory items related to a consent order.
- As a result of implementing the 2019 Plan, the Service Authority achieved materially better financial results in FY2020 and FY2021 (the first year of the 2019 Plan) than in prior years.
- New connection-related revenues have historically accounted for approximately 20% or more of total revenues. These revenues can be unpredictable and uncertain as to the future amount and timing.



	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Revenues	\$ 4,685,257	\$ 4,989,886	\$ 4,937,477	\$ 4,993,421	\$ 5,833,132	\$ 6,009,687	\$ 7,164,367	\$ 7,486,684	\$ 8,297,686
Expenses Net of Debt Service	(3,048,064)	(2,844,207)	(3,252,410)	(3,012,122)	(3,567,327)	(4,186,772)	(4,172,096)	(4,592,015)	(4,563,316)
Debt Service	(1,361,681)	(1,891,847)	(2,069,743)	(2,276,404)	(2,266,544)	(2,310,964)	(1,433,205)	(1,431,649)	(1,616,863)
Revenues vs. Expenses	\$ 275,512	\$ 253,832	\$ (384,676)	\$ (295,105)	\$ (739)	\$ (488,049)	\$ 1,559,066	\$ 1,463,020	\$ 2,117,507

Note: Excludes depreciation, non-operating revenues and expenses, and capital contributions.

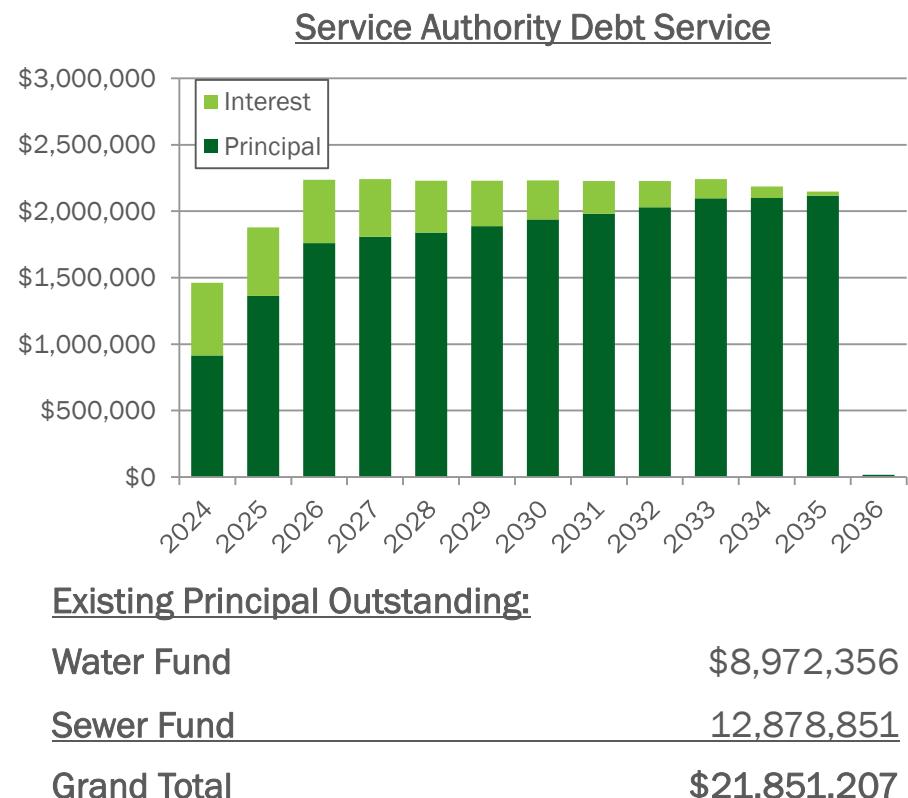
Source: County FY 2014 – FY 2023 Audits.



Existing Service Authority Debt Profile

- The Service Authority's existing debt profile as of June 30, 2023 is shown below.
- In addition, the Service Authority has a \$15 million Line of Credit with a fixed rate of 2.39% through June 25, 2025 that was established to fund needed/required Capital Projects. (Note: *The outstanding balance on the Line of Credit is currently approximately \$99,450*).
- All of the Service Authority's debt is backed by a "Moral Obligation" pledge of the County.

Total Service Authority Debt Service			
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Total	21,851,207	\$3,700,996	\$25,552,203
2024	915,697	545,788	1,461,485
2025	1,362,898	514,692	1,877,589
2026	1,760,121	475,867	2,235,989
2027	1,807,369	433,575	2,240,944
2028	1,839,639	389,076	2,228,715
2029	1,886,934	342,598	2,229,533
2030	1,939,253	293,803	2,233,056
2031	1,981,596	245,256	2,226,852
2032	2,028,964	197,092	2,226,056
2033	2,096,357	144,290	2,240,648
2034	2,098,388	88,479	2,186,867
2035	2,117,323	30,480	2,147,804
2036	16,667	-	16,667



Source: Service Authority Audits and Davenport Debt Model.

Financial / Debt Considerations



- The Service Authority has been financially self-supporting for roughly a decade. This consideration will continue to be a critical underlying assumption if the Service Authority becomes a County operated Utility Enterprise Fund.
 - It is common in Virginia and across the Country for a municipally owned Water/Sewer Utility to be operated as a financially independent Utility Enterprise Fund under the direct oversight of the local government.
 - So long as the Utility Enterprise Fund is not reliant on recurring financial support from the General Fund, the debt associated with the water/sewer utility is not counted against the General Fund's tax-supported debt ratios.
- Users of the system would continue to pay for the system via their regular water/sewer bills and new connection-related charges.
- Transitioning the Service Authority to a County operated Utility Enterprise Fund would allow the County to refund/restructure the existing Service Authority debt to help alleviate potential pressure on the water/sewer system that may be looming as a result of increasing capital costs and uncertain growth related revenues.
- The level, type, and structure of rates/charges could be re-evaluated during the process. This is a best practice for water/sewer utilities and could be done as part of the process.
- Transitioning the system to a County operated Utility Enterprise Fund would help to ensure that the County's decision making with respect to growth and development is in sync with the need for water/sewer service.



Next Steps

- Should the County's Board of Supervisors and Service Authority Board of Directors move forward in transitioning the Service Authority to a County Utility Enterprise Fund:

1. Fall 2023:

- Identify / update anticipated Capital Funding Requirements taking into account regulatory requirements, growth requirements, and economic development related requirements (i.e. Amazon);

2. Fall 2023:

- Confirm FY2023 year-end financial results and mid-year FY2024 financial status;

3. Winter 2024:

- Update a multi-year Financial Plan of Finance for the Water/System. Perform a Rate Study/Cost of Service Study as part of this process;

4. Winter/Spring 2024:

- Results of Multi-Year Plan of Finance and Rate Study Complete

5. Summer 2024 (i.e. FY2025):

- Results of Multi-Year Plan of Finance and Rate Study Complete



Municipal Advisor Disclaimer

The enclosed information relates to an existing or potential municipal advisor engagement.

The U.S. Securities and Exchange Commission (the "SEC") has clarified that a broker, dealer or municipal securities dealer engaging in municipal advisory activities outside the scope of underwriting a particular issuance of municipal securities should be subject to municipal advisor registration. Davenport & Company LLC ("Davenport") has registered as a municipal advisor with the SEC. As a registered municipal advisor Davenport may provide advice to a municipal entity or obligated person. An obligated person is an entity other than a municipal entity, such as a not for profit corporation, that has commenced an application or negotiation with an entity to issue municipal securities on its behalf and for which it will provide support. If and when an issuer engages Davenport to provide financial advisory or consultant services with respect to the issuance of municipal securities, Davenport is obligated to evidence such a financial advisory relationship with a written agreement.

When acting as a registered municipal advisor Davenport is a fiduciary required by federal law to act in the best interest of a municipal entity without regard to its own financial or other interests. Davenport is not a fiduciary when it acts as a registered investment advisor, when advising an obligated person, or when acting as an underwriter, though it is required to deal fairly with such persons.

This material was prepared by public finance, or other non-research personnel of Davenport. This material was not produced by a research analyst, although it may refer to a Davenport research analyst or research report. Unless otherwise indicated, these views (if any) are the author's and may differ from those of the Davenport fixed income or research department or others in the firm. Davenport may perform or seek to perform financial advisory services for the issuers of the securities and instruments mentioned herein.

This material has been prepared for information purposes only and is not a solicitation of any offer to buy or sell any security/instrument or to participate in any trading strategy. Any such offer would be made only after a prospective participant had completed its own independent investigation of the securities, instruments or transactions and received all information it required to make its own investment decision, including, where applicable, a review of any offering circular or memorandum describing such security or instrument. That information would contain material information not contained herein and to which prospective participants are referred. This material is based on public information as of the specified date, and may be stale thereafter. We have no obligation to tell you when information herein may change. We make no representation or warranty with respect to the completeness of this material. Davenport has no obligation to continue to publish information on the securities/instruments mentioned herein. Recipients are required to comply with any legal or contractual restrictions on their purchase, holding, sale, exercise of rights or performance of obligations under any securities/instruments transaction.

The securities/instruments discussed in this material may not be suitable for all investors or issuers. Recipients should seek independent financial advice prior to making any investment decision based on this material. This material does not provide individually tailored investment advice or offer tax, regulatory, accounting or legal advice. Prior to entering into any proposed transaction, recipients should determine, in consultation with their own investment, legal, tax, regulatory and accounting advisors, the economic risks and merits, as well as the legal, tax, regulatory and accounting characteristics and consequences, of the transaction. You should consider this material as only a single factor in making an investment decision.

The value of and income from investments and the cost of borrowing may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions or companies or other factors. There may be time limitations on the exercise of options or other rights in securities/instruments transactions. Past performance is not necessarily a guide to future performance and estimates of future performance are based on assumptions that may not be realized. Actual events may differ from those assumed and changes to any assumptions may have a material impact on any projections or estimates. Other events not taken into account may occur and may significantly affect the projections or estimates. Certain assumptions may have been made for modeling purposes or to simplify the presentation and/or calculation of any projections or estimates, and Davenport does not represent that any such assumptions will reflect actual future events. Accordingly, there can be no assurance that estimated returns or projections will be realized or that actual returns or performance results will not materially differ from those estimated herein. This material may not be sold or redistributed without the prior written consent of Davenport.

Version 01.01.23 GB | AS | KL