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Solutions-Oriented Consulting

To: Mark Relph, City Manager **Date:** September 8, 2021

From: Jason Mumm

CC: Keith Reester, Director of Public Works

RE Potential Modes of Transferring Littleton's Interests in Wastewater Infrastructure

The purpose of this report is to summarize the options that may be available to Littleton if it were to transition its ownership interest in South Platte Renew (SPR) and related wastewater facilities to one that would reduce its financial obligations and inherent business and regulatory risks. This report is not intended to be an exhaustive examination of the available options. Instead, it is a conceptual evaluation intended to identify those opportunities that are relatively better than the others.

EXECUTIVE SUMMARY

We have examined six (6) conceptual models for ownership transfer. Four of these involve formation of different configurations within a new Special District under Title 32 of Colorado law. A fifth option would involve merging with the Metropolitan Wastewater Reclamation District as a Special Connector or Connecting Municipality. Finally, a sixth option would involve selling Littleton's interest to a private buyer. These alternatives are referred to in the report as:

Option A – Special District Littleton-Only
A new special district that would include only the corporate limits of Littleton.

Option B – Special District Littleton + Littleton Districts
A new special district that would include the boundaries of Littleton and all of its connecting districts.

Option C – Special District Littleton + Englewood
A new special district that would include only the corporate limits of Littleton and Englewood.

Option D – Special District All-In
A new special district that would include the combined service areas of Littleton, Englewood, and all connecting districts served by both entities.

Option E – Merger with MWRD
Littleton and Englewood become Special Connectors or Connecting Municipalities of MWRD.

Option F - Sale to Private Party
Littleton and Englewood sell their interests to a private utility company or other private buyer.

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We evaluated each of the options in seven categories based on how well each option is expected to perform. A rating of "5" means the option is expected to perform extremely well within the category; a rating of "1" means the opposite.

Table 1: Summary of FCS GROUP's Evaluation of Alternatives

Feature / Category	A	B	C	D	E	F
Transfers the Assets	5	5	5	5	3	5
Transfers or Eliminates the Liabilities	5	5	5	5	3	3
Transfers All Future Obligations	5	5	5	5	4	5
Cash Flow to Littleton	2	4	2	4	1	5
Impact on Littleton Ratepayers	4	5	4	5	1	2
Time to Implement	5	3	4	2	1	1
Total Rank (highest is best)	26	27	25	26	13	21

Based on our evaluation, we are of the opinion that Littleton's best approach is to pursue a new special district where it can maximize its leverage with its exclusive connecting districts for additional financial considerations. Option B, which is a special district inclusive of Littleton and the connecting districts it serves exclusively may produce the greatest overall benefit level for Littleton. Option B allows Littleton to accomplish its objectives for transferring the assets and liabilities, and its future obligations, to an entity unaffiliated with the City (i.e., a new sewer district). These benefits could also be accomplished by pursuing Option A. However, Option B seems preferable because the City could use the offer of inclusion in exchange for financial considerations. In our assessment, we think it is likely that Littleton's equity in SPR and related wastewater facilities exceeds that of its connecting districts[1]. It may be possible to adjust these disparities as a condition of inclusion whether through up-front payments or some other financial arrangement. Meanwhile, the connecting districts may be motivated to include in a new district because it would give them a more meaningful role in governance and would allow them an opportunity to replace their District Agreements with new terms of service (notably, eliminating the 20% surcharge they currently pay).

Other options for a special district would include expanding the boundaries to include Englewood and/or its connecting districts as well. Those options are in many ways equally attractive with Option D, the All-in District, being more attractive since it offers the same opportunity for Littleton (and Englewood) to leverage the offer of inclusion in exchange for additional consideration.

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[1] While the connecting districts have no legal equity in the assets, they likely do have a certain level of contributed equity earned from payment of tap fees and other payments over time. Whether a disparity exists between the districts and Littleton is something that should be analyzed further if Littleton decides to move forward.

However, Options C and D probably take longer to accomplish, and neither is attainable unless Englewood agrees.

Merger with MWRD is almost certainly the most expensive option. We estimate that Littleton alone would have to pay a buy-in fee to MWRD of approximately $482 million. Moreover, it does not seem practical for Littleton to pursue a merger by itself. The deal would almost certainly have to include Englewood, which could bring the total buy-in to nearly a billion dollars. Offsets to the buy-in fee may be available, but it is doubtful those credits for in-kind contributions – mostly, the value of the SPR facilities contributed to MWRD in such a merger – would reduce the buy-in fee to a level that would present a positive business case for Littleton or Englewood.

We think it is unlikely that Littleton would be able to sell its 50% interest in SPR to a private third party. Doing so would convey a non-controlling interest. Having a public entity (Englewood) as an equal partner is probably an unappealing outcome for a private buyer, so a realistic sale would likely need to involve both Littleton and Englewood as joint sellers. If a sale were to occur, we believe the buyer may be willing to pay a substantial premium above the book value of the underlying assets, which would probably result in the most cash flow to Littleton of the options we evaluated. However, the private buyer is likely to request rate adjustments from the Colorado PUC that include the acquisition premium. In other words, Littleton's ratepayers would ultimately be the ones paying for both the assets (again) and for the acquisition premium; they would do it by way of higher rates.

BACKGROUND

Contracts Review

Littleton – City of Englewood Agreement

Littleton entered into an *Agreement Between the Cities of Littleton and Englewood, Colorado for Joint-Use Wastewater Treatment Facilities* (Joint Agreement) in 1982. The Joint Agreement sets forth the basic principles for joint ownership and operations of the facilities of what was then known as the Bi-City Plant, but now known as the South Platte Renew (SPR).

Regarding the operations of SPR, the Joint Agreement established the Supervisory Committee consisting of two employees from Littleton and two from Englewood, each designated by the respective City Managers. The Supervisory Committee has oversight of the operations of SPR. However, the Joint Agreement established Englewood as the operator of record. The costs of operating SPR are distributed to the two cities on the basis of volumes of contributed sewage while all capital improvements were to be shared on a 50/50 basis.

The Joint Agreement has no termination date. Section V.1 states: "this contract shall exist in perpetuity unless terminated by mutual agreement or operation of law…" Moreover, there is no explicit provision in the Joint Agreement limiting either party with respect to assignment of their interests. Subject to an expert legal review[2], we see no reason why Littleton could not assign its entire interest, including all it contractual rights and responsibilities in the Joint Agreement to a third party without the approval of Englewood.

Sewer Service Agreements

Littleton entered into exclusive Sewer Service Agreements with six districts (Littleton Districts) at various times starting in 1983 including Grant Water & Sanitation, Ken Caryl Ranch Water & Sanitation, Meadowbrook Fairview Metropolitan, Platte Canyon Water & Sanitation, Roxborough Water & Sanitation, and Southwest Metro Water & Sanitation. Two other agreements – Columbine Water & Sanitation and Bow-Mar Water & Sanitation – involve joint services with Englewood (Littleton-Englewood Districts). Please refer to Exhibit 1 on the final page of this report for a comprehensive list of districts served by both Littleton and Englewood.

The Sewer Service Agreements (District Agreements) are substantially similar. Among other things, the District Agreements establish Littleton as the publisher of all applicable rates and charges for service, or which there are two types described explicitly in the District Agreements: tap charges, and service charges. In both cases, Littleton has the right to change the charges by City Ordinance.

While no District has the right to assign its interests in the agreement, Littleton retained the explicit right "to assign its rights and obligations under this contract to a Regional Service Authority or other similar entity." Subject to further expert legal review, we see no reason on plain reading of the District Agreements that Littleton could not assign or sell its ownership to a regional entity like those described later in this report.

Englewood serves 12 connecting districts[3] exclusively (Englewood Districts) via similar contracts to the District Agreements, and shares services with the two Littleton-Englewood Districts. However, we did not review Englewood's agreements in writing this report and cannot verify their terms at this time.

Financial Positions

Financial capacities could be a limiting factor in considering any regional authority that might consist of shared interests among Littleton and the Districts. We reviewed financial disclosures made to the Colorado Department of Local Affairs (DOLA) to evaluate two key indicators of financial capacity. The first measure is the net cash position of each entity determined by deducting the long-term debt from the net working capital[4]. The second measure is the operating and total cash flows for each entity. For reasons that will become apparent later, we wanted to evaluate the extent to which

[2] FCS GROUP does not provide legal advice in any capacity whatsoever. Nothing in this report should be relied upon as legal advice.
[3] The Greenwood Village Sewer GID receives service via Southgate Sanitation District. However, because Southgate receives its service from Englewood, we have included Greenwood Village Sewer GID as an "Englewood District" for the purposes of this report.
[4] Net working capital is defined as all current assets less all current liabilities reported on annual financial reports.

the Districts may be able to make cash contributions, either up-front or over time, toward the formation of a new regional entity.

Net Cash Positions

The net cash position is intended to give an indication of current liquidity. In this case, we measured liquidity as the total of all cash, investments, and receivables (the current assets) less all short-term obligations (the current liabilities), and less all long-term debt. The net value demonstrates the cash that could potentially be available after repayment of all short and long-term liabilities. Table 2, below, summarizes the findings from our review of the most financial disclosures posted to DOLA (all values are for the 2019 fiscal period unless indicated otherwise).

Table 2: Net Cash Position ($ in thousands)[5]

Entity Name	Net Working Capital	Long-Term Debt	Net Cash Position	As % of Total Assets
Littleton	$21,635	$15,503	$6,132	7%
Columbine[6]	737	-	737	47%
Meadowbrook[7]	4,616	-	4,616	86%
Bow Mar[8][9]	747	(240)	507	19%
Grant	3,480	-	3,480	36%
Platte Canyon	11,234	(385)	10,849	46%
Roxborough	16,280	-	16,280	13%
Southwest[10]	22,317	-	22,317	36%
Ken Caryl	14,061	-	14,061	46%
Total	**$95,107**	**($16,128)**	**$78,979**	**23%**

The net positions, above, indicate there is a reasonable level of liquidity among Littleton and the Districts. The average net position as a percentage of total assets was 21%, which implies that about a fifth of the total assets could be available for use in forming a new regional entity. Those entities with higher liquid positions as a percentage of total assets may have more financial flexibility to make contributions to a regional authority if necessary.

Cash Flows

We evaluated cash flow in terms of operating activities, non-capital financing activities, capital activities, and investment activities. In many cases, the Districts' operating cash flows were

[5] Financial results for Littleton are for its Sewer Fund only. In the case of the Districts, the values include results for all activities, not exclusively sewer-related.
[6] A Littleton-Englewood District
[7] Meadowbrook financial results from 2017 Audited Financial Statements (source: DOLA)
[8] A Littleton-Englewood District
[9] Bow Mar financial results from 2018 Audited Financial Statements (source: DOLA)
[10] Southwest financial results from 2020 Audited Financial Statements (source: DOLA)

insufficient to produce long-term solvency, but other inflows, notably from property taxes and investments, made up for the deficits. Table 3, below, summarizes the cash flow values from the most recent financial statements. The table demonstrates how Districts mostly use non-capital and investing activities to subsidize their operations, whereas Littleton does not.

The lack of reliable cash flows from operating and non-capital (i.e., mostly property tax) sources indicates that ongoing financial contributions for a potential regional service authority may meet resistance with the respective boards of directors for the Districts. Any requirement for ongoing payments, above and beyond the current rates charged for services, would have to be funded with either additional rate increases (i.e., more operating cash flow), or increased property tax (i.e., non-capital cash flows. It is unlikely the additional cash flow could come from capital activities or investment activities due to the nature of those sources.

Table 3: Cash Flow Summary

Entity Name	Operating Activities	Non-Capital Financing Activities	Capital Activities	Investment Activities	Total
Littleton	$4,222	$-	$(3,962)	$931	1,191
Columbine	(120)	137	-	15	32
Meadowbrook[11]	215	352	21	37	625
Bow Mar[12]	(231)	302	(38)	2	35
Grant	47	-	2	1,175	1,224
Platte Canyon	(951)	1,760	(1,523)	434	(280)
Roxborough	(964)	770	1,238	312	1,356
Southwest[13]	(285)	-	(232)	6,422	5,905
Total	**$1,933**	**$3,321**	**($4,494)**	**$9,328**	**$10,088**

CURRENT STRUCTURE

The current structure is defined by a combination of the Joint Agreement and the District Agreements. Littleton owns half the SPR while Englewood owns the other half and is the managing agency. Littleton provides service to its retail connections located inside the City's boundaries, and to the Littleton Districts to whom the City charges a 20% premium relative to its retail customers. Sewer rates are established annually by resolution of the Littleton City Council.

The current rates only produce a modest margin that Littleton could apply to its capital needs. In 2018, the rates produced no margin – in fact, a $250k deficit – when compared to operating costs and annual debt payments. Annual capital expenditures tend to exceed the operating margin from year to year, forcing Littleton to rely on tap fees and non-rate revenues to fund those requirements and

[11] Meadowbrook financial results from 2017 Audited Financial Statements (source: DOLA)
[12] Bow Mar financial results from 2018 Audited Financial Statements (source: DOLA)
[13] Southwest financial results from 2020 Audited Financial Statements (source: DOLA)

contribute to reserve levels. Table 4 summarizes Littleton's sewer enterprise revenues from 2017-2019.

Table 4: Summary of Revenue and Expenditures 2017-19 ($-millions)

Item Description	2019	2018	2017
Sewer Charge Revenue	$14.58	$13.97	$13.65
Operating & Maintenance Expenses	(10.01)	(10.95)	(8.90)
Annual Debt Service	(3.27)	(3.27)	(3.28)
Subtotal - Funds Available for Capital Needs	$1.30	($0.25)	$1.48
Capital Outlays	(3.40)	(3.08)	(1.52)
Other Income & Tap Fees	3.82	1.94	1.86
Decrease (Increase) in Reserve Funds	(1.72)	1.40	(1.81)
Subtotal - Net Capital Sources/(Uses)	(1.30)	0.25	(1.48)
Surplus (Deficit)	**$0.00**	**$0.00**	**$0.00**

Future Considerations

SPR is currently in design and construction of enhancements necessary to meet new environmental regulations for nutrient removal. Whereas Littleton's share of capital outlays related to SPR ranged from $1 - $3M for 2017-2019, future capital outlays are expected to be much larger. As those capital needs increase, a larger burden will fall on the rates either from direct expenditures or to support additional debt service. The recent rate study completed by the City of Englewood revealed an expected $99M in new capital projects scheduled between 2020 and 2030. Littleton's share of the CIP costs would therefore come to approximately $5M per year. Additional capital projects are expected in the timeframe past 2030 to meet even more stringent regulations in addition to normal expenditures to maintain and preserve the facilities in good order.

About 18 MGD of the SPR's permitted 50 MGD remains available for growth and other users, of which Littleton would be entitled to approximately 9 MGD[14]. New connections, whether inside the City of Littleton or in any of the Littleton Districts, must pay a sewer tap fee, currently $5,000 for connections inside the city and $5,656 for connections outside the city[15]. The tap fees vary for non-residential connections and multi-family connections. Assuming a demand of 150GPD per residential unit, the City's reserve capacity of 9 MGD is worth at least $300M based on the current inside-city residential tap fee. Realizing this value would, of course, require Littleton to increase its connections whether inside or outside the City. While the potential exists, the prospects of increasing

[14] Based on representations provided by the City of Littleton.
[15] City Code, Title 7-5-18. For Residential connections only.

the number of residential connections by approximately 60,000 units are seemingly limited. Based on representations from the City, growth potential is limited both inside and outside the City as both areas are mostly built out already. A more realistic assumption is that the City will receive a steady if not decreasing level of tap fee income into the future; it may take decades to approach the 60,000 connections available within Littleton's reserve capacity.

Therefore, while tap fees will probably continue to provide some level of offset to the annual capital expenditures in the future, it is more likely that sewer charges will have to increase, perhaps significantly, to support the increasing costs.

POTENTIAL ALTERNATIVE STRUCTURES

There is a limited number of alternative structures available to Littleton ranging in their scale, scope, and difficulty levels. We have evaluated three overarching structures: formation of a special district; sale to a private party; and merger with adjoining providers. Any of these could be potential options in meeting Littleton's goals with respect to its ownership under the Joint Agreement.

Formation of a New Special District

The District Agreements specifically allow Littleton to assign its interests to "a Regional Service Authority or similar entity." One of the alternative structures that fits the contractual description of "regional service authority" would be that of a Special District under Title 32 of Colorado law. The specific steps for forming a new Special District are prescribed by law, but include the following basic elements:

1. ***Service Plan*** – the basic service plan should include a description of the area to be included; description of the proposed facilities and services to be provided, including engineering and architectural data; a financial plan with estimated costs and proposed indebtedness; a description of any intergovernmental agreements the new district will rely on for its implementation. The service plan must be approved by the Board of County Commissioners of each county containing any portion of the proposed district boundaries. The service plan could be confined to the services already provided by SPR or could be expansive. For the purposes of this report, we have assumed that any service plan filed would mirror those services already provided.

2. ***District Court Approval*** – Once the service plan has been approved by the appropriate Boards of County Commissioners, a petition is filed with the District Court in the county in which the district is located. The petition must be signed by at least 30% of the taxpaying electors of the district. Individuals may request of the Court to exclude their properties from the proposed district.

3. ***Organizational Election*** - If the District Court finds the service plan is acceptable, it will order an election among the residents of the proposed district. The election will include the question of the organization of the district and the election of the initial board of directors. It may also include voter authorization of a property tax and the issuance of bonds if those elements are necessary for the formation of the district.

Once formed, the new district (Sewer District) is governed by its five or seven-member board of directors. The board would have authority, independent of other governing bodies, to govern the district within the scope of its powers. Certain powers, however, are retained by cities and counties, such as land-use powers (planning, zoning, etc.).

Littleton would have some discretion as to the configuration of the new Sewer District ranging from a Littleton-only district to an expansive district that could include Englewood and all connecting districts as well. We see four (4) realistic structures at this time and have summarized our thoughts for each of them in the following sections.

Option A: Special District - Littleton Only

Summary: Forming the new district would allow Littleton to transfer its sewer-related assets and liabilities to the new Sewer District, and it would alleviate future financial and regulatory obligations for the city. It would <u>not</u> likely result in any significant infusion of cash to Littleton; we estimate about $3 million in restricted fund balances could be retained by Littleton in the transaction.

How would it work?

Littleton would form a new Sewer District by filing a service plan with the boards of county commissioners for Arapahoe, Douglas and Jefferson counties defining the boundaries to include only the corporate limits of Littleton. As part of the service plan, Littleton would submit an intergovernmental agreement that would assign Littleton's interests in the Joint Agreement and District Agreements to the Sewer District. The IGA could further specify other elements related to the transfer of Littleton's assets, repayment of outstanding debts, establishing rates, or other matters of importance to Littleton. The IGA must be filed with the service plan. Assuming the District Court approves of the service plan, the election to organize the new Sewer District would be held among Littleton's eligible voters.

In essence, the Sewer District would become a new enterprise fund, separate and distinct from Littleton. It would inherit Littleton's rights and obligations.

Who would it include?

The boundaries of the Sewer District under Option A would include only the Littleton corporate limits. Districts currently served by Littleton under the District Agreements would continue to receive service under the terms of those agreements, but Littleton's role as provider would be replaced by the new Sewer District's.

What's in it for Littleton?

Forming a new Littleton-only district involves the transfer of Littleton's ownership and contractual rights to the new Sewer District. It will either dilute or eliminate Littleton's ability to influence the strategic direction of SPR, to be replaced with the vision and direction guided by the new Sewer District's board of directors. The transfer of ownership would also transfer Littleton's current and future financial liabilities with respect to the SPR. For instance, debts related to the SPR would be similarly transferred to the new Sewer District through a legal defeasance or similar process[16]. Rates and charges, however, are likely only minimally affected because the customers served, regardless of organizational structure, would remain the same. In other words, Littleton may be able to clean up its balance sheet by reorganizing its interests into a new Sewer District, but the rates paid by its residents and connecting districts would probably remain materially the same.

It is unlikely that reorganizing as a new Sewer District would result in any significant cash infusion for Littleton assuming one of the goals is to keep customers' rates steady. According to its 2019 annual financial report, Littleton had $26.9 million in liquid assets vs. $5.2 million in short-term liabilities, yielding net working capital of $21.7 million. Approximately $1.4 million of that amount appears to be held in a restricted account under the Joint Agreement, leaving $20.3 million of funds held in reserve. It may seem attractive to retain those funds for Littleton rather than transferring them to the new Sewer District. However, the most likely reason those funds are being held in reserve is as a source of funding for future capital projects. If the funds were used for some other purpose, it would result in the new Sewer District having to increase rates to fund those very same projects. In other words, the funds should either be transferred or retained according to their intended use. As of 2019, there was $3 million being held in a restricted account for "Rate Stabilization:" it seems plausible that this portion of the cash could be retained by Littleton, but it is unclear how much if any of the remaining $17.3 million might also be retained after accounting for the intended use of those funds.

Option B: Special District - Littleton + The Littleton Districts

Summary: Including Littleton along with the boundaries of the Littleton Districts creates a more inclusive Sewer District but also makes its formation more challenging. However, it may be possible for Littleton to leverage the offer of inclusion in such a district in exchange for additional cash considerations from the Littleton Districts.

How would it work?

Instead of filing a service plan with boundaries confined by the Littleton corporate limits, Option B would expand the boundaries to include the Littleton Districts. Doing so would increase the number of boards of county commissioners from whom the new district would need approval. Based on filings with DOLA, to include the Littleton Districts in the service plan would require approvals from Jefferson, Douglas, Arapahoe, and Denver counties (see Exhibit 1 located on the final page of this report). Assuming the service plan receives commissioner and District Court approval, the organizational vote would have to include all eligible voters within the proposed boundaries. The board of directors for the new Sewer District could be from anywhere within its boundaries. In all other ways, this proposed district configuration would work like Option A.

[16] FCS GROUP does not provide Municipal Advice within the definition of the Securities and Exchange Commission rules and is not a registered Municipal Advisor. Nothing in this report should be construed as Municipal Advice within the meaning of SEC Rule 15B.

Who would it include?

The boundaries under Option B would include all of Littleton as well as the service area boundaries of the Littleton Districts. The Littleton-Englewood Districts would not be included.

What's in it for Littleton?

Adding the Littleton Districts to the service area boundaries for the new Sewer District would make its formation that much harder. It adds another county, Denver, to those that would have to approve the plan, and it increases the voting requirement to organize the district. The larger boundary, while being much more inclusive, also dilutes Littleton's influence in the new Sewer District.

With this approach, Littleton could attempt to require some sort of "buy-in" fee to bring the Littleton Districts' equity in the assets up to a level on relative parity with Littleton. Such a fee may have merit if additional financial analysis[17] were able to demonstrate a disparity in Littleton's equity – net of all contributions and grants – compared to the Districts'. Under that assumption, it may be possible for Littleton to gain additional cash flow considerations under Option B, but only if the Littleton Districts were agreeable to it. Littleton would need their agreement, most likely, before filing the service plan with the various counties. It is unknown whether the Littleton Districts may be agreeable to such a proposal, but they may be motivated to agree to improve their position in the governance of the new Sewer District, and to restructure their District Agreements. Restructuring the District Agreements would allow the Littleton District's to potentially eliminate the 20% surcharge they currently pay to Littleton. The elimination of the surcharge, all else being equal, may result in the rates for Littleton's residents increasing somewhat. We recommend analyzing the impacts on Littleton's rates before proceeding too far with Option B.

The financial background we presented earlier is relevant here. What those results show is that the Littleton Districts have a reasonable level of liquidity to make some amount of cash contribution, but currently lack a reliable source of annual cash flow to make ongoing payments above and beyond the rates. However, some combination of up-front contributions and ongoing payments involving portions of the 20% surcharge seem like viable solutions assuming the Littleton Districts are motivated to be included in the Sewer District rather than simply receiving service from it under the terms of the District Agreements.

Option C: Special District - Littleton + Englewood

Summary: Increasing the boundaries of the new Sewer District to include the corporate limits of only Littleton and Englewood offers the potential for organizational efficiencies but probably no immediate financial benefits other than those already available to Littleton in Option A.

[17] We were unable to conduct the kind of analysis that would be necessary to demonstrate the disparity described here; it would be something that should be examined should Littleton wish to pursue this approach.

How would it work?

This approach would consolidate both Littleton's and Englewood's interests under the Joint Agreement into a single Sewer District. The service plan would include the corporate limits of Littleton and Englewood only, and would not extend to either party's connecting districts. Being located exclusively in Arapahoe County, the addition of Englewood to the service area boundaries would not change the number of counties required for approval of the service plan compared to Option A.

We were unable to review any service agreements between Englewood and its connecting districts, so we are unable to confirm whether Englewood might be able to assign its role in those agreements to a new district as Littleton can.

Who would it include?

The new Sewer District boundaries would include the corporate limits of Littleton and Englewood. Connecting districts would continue to receive service under their existing District Agreements but the roles of Littleton and Englewood would be replaced by assignment with the Sewer District.

What's in it for Littleton?

For Littleton, Option C offers approximately the same challenges and benefits as Option A. Including Englewood into the new Sewer District, may have some additional benefits, however, from an operational and managerial perspective.

Under Option A, the governance of Littleton's interests in SPR is managed separately from SPR itself; it only replaces Littleton's role with that of a new Sewer District. The role of the Supervisory Committee would continue under Option A with Littleton's members appointed by the new Sewer District's board. However, including Englewood in the new district would create an alignment of governance, management, and operations that would be unique to the Joint Agreement relative to its history. Rather than an operator (SPR) governed by two municipalities (Littleton and Englewood), the new Sewer District under Option C would most likely establish SPR as the district's managers with an elected board of directors rather than the cities' staff members.

Apart from the potential for organizational efficiencies, there may be no immediate, quantifiable financial benefit to Littleton from pursuing a Littleton-Englewood special district above those benefits already outlined in Option A. Also, it is unclear whether Englewood has any desire to transition its interest in the Joint Agreement to a new special district. Including Englewood in the service plan would obviously require their agreement.

Option C: New Special District – All In

Summary: The All-In district would be the most expansive of those discussed as it would include all of Littleton, Englewood, and all connecting districts. This option offers Littleton the potential to gain organizational efficiencies per Option C with the potential for added financial benefits presented in Option B. While potentially offering the greatest level of overall benefits, but this approach is likely the more difficult one to implement.

How would it work?

The service plan would include a boundary encompassing Littleton, Englewood, and all connecting districts for both cities. It would require approval from four counties: Arapahoe, Douglas, Jefferson, and Denver. The area requiring voter approval would be similarly expanded.

Who would it include?

All entities currently served by SPR.

What's in it for Littleton?

Expanding the Sewer District to include all those entities currently served may offer both Littleton and Englewood the ability to address any disparities in equity that may exist between them and their connecting districts. As we described in Option B, additional financial analysis may indicate that the districts are not on parity with Littleton and Englewood in terms of their equity in the assets. Littleton and Englewood own a 50 MGD facility (25 MGD each), but the districts have only contributed up to some portion of the 32 MGD that is currently used. Thus, the two cities are holding about 18 MGD in reserve capacity, an investment they have paid for that the districts likely have not. If such a disparity exists, subject to future analyses, then addressing it could take a few forms. The "buy-in" fee mentioned with Option B would present a total sum to be paid by each district to reach parity. That sum could be repaid to Littleton and Englewood through various arrangements that could be addressed in the service plan (via IGA submitted with the plan). Although such payments seem viable for the Districts served by Littleton, we have not evaluated the financial capacities of Englewood's connecting districts.

The connecting districts may in fact be motivated to agree to the fees given the alternatives. Having a more direct role in the governance of the SPR ought to appeal to the districts, as would the idea of having their existing service agreements restructured or eliminated. Those options would simply not be available to the districts if they did not agree to an adjustment in equity because Options A and C are easier to implement and would give the districts no role in governance.

Indeed, Englewood itself may be motivated to pursue this option with Littleton. Englewood has recently gone to its connecting districts to enforce a 20% surcharge on their rates, up from a 5% surcharge in the past. The move indicates that Englewood is also looking for cash flow solutions to meet its own financial burdens with respect to SPR. So far, the rate proposal has met with some resistance from Englewood's districts. However, the new All-In District may represent an opportunity for Englewood to reduce its financial obligations – same as Littleton – and to recoup disparities in equity.

Option D: Merger with Metro Wastewater

Summary: A merger with MWRD would trigger potentially massive up-front financial payments from Littleton to MWRD, which by itself would probably be a showstopper. Littleton would potentially have to pay $482 million in buy-in fees, would have get Englewood to agree to the merger, and there would be additional operational challenges to consider too.

How would it work?

It may be possible for Littleton to merge its interest an already existing provider with a similar scope of services. Of the providers that adjoin the combined service area of SPR, only the Metropolitan Wastewater Reclamation District (MWRD) seems to present a fit in terms of technical, managerial and financial scale.

The mechanics of how MWRD might absorb SPR are unknown; MWRD has not acquired a treatment operation like SPR in its history. They have, however, added to the district's membership over the years, and we would expect a merger to take place in a similar fashion. Obtaining service from MWRD, likely as either a Special Connector or Connecting Municipality under the MWRD Rules and Regulations, would require a buy-in fee calculated as the rate per equivalent unit multiplied by the number of equivalent units to be connected. The cost could be prohibitively expensive.

According to Littleton, the current influent levels are at 32 MGD, of which Littleton is responsible for about 49%, or about 16 MGD. The approximate flow per SFRE for MWRD is 148 gpd, which means Littleton has approximately 106,000 SFRE. The current sewer connection fee is $4,550 per single-family residential equivalent (SFRE)[18], which brings an estimated buy-in to the MWRD system to approximately $482 million. It may be possible to reduce this amount for the in-kind contributions that such a merger would bring to MWRD, namely the value of the SPR facilities, but that option would only seem to be viable under the assumption that both Littleton and Englewood agreed to the merger. In that case, the total buy-in is closer to a billion dollars, and the credit for in-kind contributions would depend on the value assigned to the SPR facilities. The book equity appears to about $95 million as of 2019; it may be possible to negotiate a larger value. MWRD calculates its buy-in fees based on current reproduction estimates of its facilities. Using the same method for the SPR facilities may multiply the $95 million figure by 2-4x. At the outside range of values, one might arrive at a value as high as $400 million for the SPR facilities, but that would still leave a roughly $600 million total buy-in payment to MWRD.

There are operational challenges in addition to the significant financial burdens. There's the question of how SPR would continue to function, if at all, in the wake of such a merger (it's possible some or all of the SPR operations would be viewed as duplicative by MWRD). Moreover, a merger would almost certainly fail to materialize if both Littleton and Englewood were not in agreement; there would not be a realistic option for Littleton to proceed with a merger without Englewood alongside. Finally, it is unknown to us whether a physical connection between the SPR and MWRD is readily achieved or if it would require significant additional investment. Then again, it seems unclear whether a physical connection would even be necessary.

[18] MWRD 2021 Operating Budget Message, p. 6

Who would be included?

MWRD's board would have to approve the application for membership, which would need to be requested by both Littleton and Englewood.

What's in it for Littleton?

It is not very likely that MWRD would be willing to take on Littleton's (or Englewood's) outstanding debts and may even require additional investments in sewer infrastructure before accepting the assets at all. Coupled with the buy-in fees that would almost certainly be required, a merger with MWRD would result in a substantial net cash outflow for Littleton; probably much more than it currently has on hand.

If a merger were completed, however, MWRD would assume all responsibilities for the SPR facilities and for treatment and disposal of all wastewaters from the current SPR service area. Due to MWRD's scale of operations, the average cost of treatment may end up being less post-merger than before, and there may be other efficiencies as well. Littleton would be billed like other members of MWRD, but the city would have to continue billing individual customers because retail billing is not a service MWRD provides.

Option E: Sale to Private Party

Summary: A sale to a private party only seems viable in the event both Littleton and Englewood were joint sellers. Littleton may net a sizable premium from such a sale, but the new owner may receive authorization from the Colorado PUC to set rates at a level that would recover the costs of acquisition from ratepayers.

How would it work?

Littleton would need to approach prospective buyers, perhaps through an RFP process. Potential buyers would submit bids to acquire Littleton's interest in the Joint Agreement with Littleton selecting the best, qualified bid.

The District Agreements allow Littleton to assign its rights to a "service authority" or similar entity, but it does not say whether Littleton can simply sell its rights to a commercial interest. It seems Littleton would require some expert legal advice on this issue if it were to proceed with the idea of a sale. For the purposes of this report, however, we have assumed that Littleton could create the proper legal framework to move forward with such a sale.

Regardless of the contractual challenges, however, it seems unlikely that a private buyer would be willing to acquire only Littleton's interest in the Joint Agreement. Doing so would give the private buyer a 50%, non-controlling interest, in the SPR, which would likely be viewed as an unacceptable business risk (i.e., having a public entity, Englewood, as an equal partner is potentially inconsistent with corporate priorities related to profitability). Accordingly, it would seem necessary for the sale to include 100% of the interest in the Joint Agreement, meaning Englewood would need to be a co-seller.

Who would it include?

Per the above, it seems most likely that both Littleton and Englewood would have to agree to sell the facilities and their respective interests in the Joint Agreement at the same time. The buyers could include any number of private operators (e.g., Suez Water) or privately-owned utility companies (e.g., American Water Works Company, Aqua America, Cadiz, Inc.).

What's in it for Littleton?

A sale to a private party, assuming 100% of the interests were represented, would reasonably command a financial premium above the current book value of the assets involved. It means that Littleton (and Englewood) could probably receive much more in settlement than the $46.7 million in equity that Littleton reported as its stake in the Joint Agreement as of 2019 (assume $93.4 million total book equity between both Littleton and Englewood).

Yet, while the buyers may be willing to pay a sizable premium above book value, the effect on Littleton's ratepayers should be considered. Once a private buyer acquires the operations, it would become subject to regulation by the Colorado Public Utility Commission (CPUC) in setting its rates and charges. The premium paid above book value would represent what's called an "acquisition adjustment" which would increase the regulatory pricing base for the new owner, allowing the firm to adjust rates to recover the cost of the acquisition over time. While some commissions (e.g., Florida) have rejected acquisition adjustments, the CPUC has allowed them as recently as 2020[19]. What it means is that Littleton would receive the proceeds from the sale, but its residents would likely see a substantial increase in their rates. In other words, ratepayers would finance the acquisition through their rates. The rate impacts would most likely be enforced on both the Littleton residents and the connecting districts.

If the acquisition adjustment were not allowed, or if the rate setting process were arranged through some other contractual fashion, the private owner would still be motivated to maximize its return on investment. If there was no rate adjustment, expect the private owner would work vigorously to reduce costs. Often, private utility companies reduce costs by deferring maintenance on the infrastructure, cutting staff levels, and reducing levels of service to those minimally required by law.

FINDINGS

To evaluate the above alternatives, we set forth seven categories of criteria and assigned scores in each based on how well the given alternative could be expected to perform.

[19] Decision No. R20-0108, Recommended Decision of Administrative Law Judge Steve H. Denman Approving Settlement Agreement Without Modification and Granting Verified Application (CPUC Proceeding No. 19A-04009E)

The Categories

Categories are based on our understanding of Littleton's goals and objectives. Admittedly, most of these have been inferred based on the City's request for this report and on our previous experience with other cities with similar requests.

- Transfers the Assets – are the assets transferred to an entity unaffiliated with Littleton?
- Transfers or Eliminates Liabilities – will the proposed alternative assume the liabilities from Littleton or otherwise eliminate those liabilities (e.g., provides sufficient cash flow so Littleton can retire them).
- Transfers All Future Obligations – would Littleton be free of any future financial, operational, or regulatory requirements concerning the wastewater system?
- Cash Flow to Littleton – would the alternative result in an infusion of cash flow to Littleton?
- Impact on Littleton Ratepayers – To what extent would the proposed alternative result in higher rates for Littleton residents?
- Time to Implement – How long would it take and how much complexity is involved in the proposed solution?

A rating of "5" indicates that the proposed option would perform extremely well with respect to the category, and a rating of "1" means it would perform poorly. The categories were equally weighted for our evaluation. However, Littleton may wish to both change the categories and the weights attached to them in performing its own evaluation.

Table 5: FCS GROUP Scoring of Options vs. Selected Criteria

Feature / Category	A	B	C	D	E	F
Transfers the Assets	5	5	5	5	3	5
Transfers or Eliminates the Liabilities	5	5	5	5	3	3
Transfers All Future Obligations	5	5	5	5	4	5
Cash Flow to Littleton	2	4	2	4	1	5
Impact on Littleton Ratepayers	4	5	4	5	1	2
Time to Implement	5	3	4	2	1	1
Total Rank (highest is best)	26	27	25	26	13	21

Based on our evaluation, the better alternatives for Littleton seem to be the ones involving formation of a new special district. Specifically, Option B is preferable. We make this observation based on our assessment that this option would accomplish the basic needs – transferring assets, liabilities, and future obligations to another party (the new Sewer District) – while offering advantages for Littleton and its ratepayers by way of potential financial compensation from the connecting districts.

In the previous section, we discussed how Option B may allow Littleton some leverage with the Districts to cause them to voluntarily increase their equity in the assets to a level on parity with Littleton's. The Districts may be motivated to include in the new Sewer District because doing so would grant them more direct participation in its governance, and because being included would obviate the need for the District Agreements (notably, they could eliminate the 20% surcharge they currently pay). We think there likely is a disparity between the City's equity in the assets and the Districts'. However, we recommend further analysis to determine just how much.

Options C and D may also be attractive for some of the same reasons as Options A and B. The difference of course is that Options C and D require Englewood's participation, which may or may not be practical. We don't believe a merger with MWRD would ever present as a viable business case for Littleton given the magnitude of the buy-in fees. Unless Littleton's future obligations somehow could be estimated to cost more than the buy-in fee, merging with MWRD should probably not be considered further. Selling to a private party would almost certainly require both Littleton and Englewood to cooperate as joint sellers. Even if a private sale were completed, we have concerns about what would happen to Littleton's ratepayers should the new buyer seek rate adjustments from the CPUC to include the acquisition premium.

Exhibit 1: Listing of Littleton and Englewood Connecting Districts

District	Address	Servicing City	Counties
Bow Mar Water and Sanitation	8739 W. Coal Mine Ave. Littleton, CO 80123	Littleton & Englewood	Arapahoe, Jefferson
Cherry Hills Heights	3400 S. Clayton Blvd. Englewood, CO 80113	Englewood	Arapahoe
Cherry Hills Village Sanitation	333 S. Bannock St. Englewood, CO 80113	Englewood	Arapahoe
Cherryvale Sanitation	1221 W. Mineral Littleton, CO 80120	Englewood	Arapahoe
City of Cherry Hills Village	2450 E. Quincy Ave Cherry Hills Village, CO 80113	Englewood	Arapahoe
City of Sheridan	4101 S. Federal Blvd. Sheridan, CO 80110	Englewood	Arapahoe
Columbine Water & Sanitation	8739 W. Coal Mine Ave. Littleton, CO 80123	Littleton & Englewood	Arapahoe
Country Homes Metro.	390 Union Blvd. Denver, CO 80228	Englewood	Arapahoe
Grant Water & Sanitation	2922 Evergreen Pkwy. Evergreen, CO 80439	Littleton	Denver, Jefferson
Greenwood Village Sewer GID[20]	10001 E. Costilla Ave. Greenwood Village, CO 80112	Englewood	Arapahoe
Key Caryl Ranch Water & Sanitation	10698 Centennial Rd. Littleton, CO 80127	Littleton	Jefferson
Meadowbrook Fairview Metropolitan	98950 Girton Dr. Littleton, CO 80123	Littleton	Jefferson
Platte Canyon Water & Sanitation	8739 W. Coal Mine Ave. Littleton, CO 80123	Littleton	Arapahoe, Jefferson
Roxborough Water and Sanitation	6222 N. Roxborough Park Rd. Littleton, CO 80125	Littleton	Douglas, Jefferson
Sheridan Sanitation District	4101 S. Federal Blvd. Sheridan, CO	Englewood	Arapahoe
South Arapahoe Sanitation	143 Union Blvd. Lakewood, CO 80228	Englewood	Arapahoe

[20] Services provided by Southgate Sanitation District as of 2010 via Southgate's agreement with Englewood

District	Address	Servicing City	Counties
South Englewood Sanitation	PO. Box 2858 Littleton, CO 80161	Englewood	Arapahoe
Southgate Water & Sanitation	3722 E. Orchard Rd. Centennial, CO 80121	Englewood	Arapahoe, Douglas
Southwest Metro Water & Sanitation	8739 W. Coal Mine Ave. Littleton, CO 80123	Littleton	Arapahoe, Douglas, Jefferson
Valley Sanitation	8739 W. Coal Mine Ave. Littleton, CO 80123	Englewood	Arapahoe, Denver