

DATE: February 24, 2010  
TO: Pewaukee Merger Advisory Committee  
FROM: Christy Cramer, Ruckert/Mielke  
RE: Mr. Melin's Questions and Concerns

This memo summarizes my thoughts regarding Mr. Melin's concerns that were submitted on February 18, 2010. Mr. Melin's document contains 24 groups of questions, many with multiple sub-questions. I have not attempted to draft a complete answer to every question, since I think that may more appropriately be the place of the Merger Advisory Committee and since it seems that a lot of these questions stem from a few major underlying issues or ideas. I am offering my thoughts on those few major issues, with the related questions noted for each comment.

Issue #1 – Ruckert/Mielke is only an engineering firm and therefore has no expertise or authority on this subject (Questions 16, 17, 24)

Our Municipal Economics & Planning Division has a team of five professionals with Masters' Degrees in Urban Planning, Economics and Public Administration. Our specialty is working with municipalities and utilities to set up and administer all types of revenue sources; to study and evaluate the fiscal impacts of proposed programs or actions; and to develop cost-sharing and other types of municipal cooperation agreements. I have more than 13 years experience working with municipalities all over Wisconsin on these issues. Some of our related experience includes the following:

- From 1997 to 2002 our firm worked with 9 municipalities in Racine County evaluating the organizational and cost-sharing agreements for a variety of services from the Racine Zoo and Art Museum, to jurisdiction of local roads, the regional bus system, the regional wastewater treatment plant, consolidated dispatch service and property tax revenue sharing. That work resulted in the signing of a landmark intergovernmental cooperation agreement, which includes one of the largest property tax revenue sharing arrangements in the United States.
- In 2005, under contract to the Southeastern Wisconsin Regional Planning Commission, we prepared a study analyzing the fiscal capacity of every municipality in the 7-county Southeastern Wisconsin region, with and without the various State aids and revenue sharing payments.
- There has been only 1 merger of two municipalities in Wisconsin in recent years, and serious consideration of consolidation has been infrequent. Our firm has worked on 5 such studies in the last 10 years (Big Bend-Vernon, Burke- Windsor, Randall- Twin Lakes, Grand Rapids-Biron, Pewaukee).

- There have been only 4 acquisitions of water utility systems in Wisconsin in the last 10 years (and in the memory of current PSC staff). We were the lead negotiators and financial analysts for 3 out of the 4 (Beloit, Mequon, Racine).
- We are one of the leading consultants in Wisconsin for sewer and water utility financial planning and user charge rate studies. We regularly survey the entire state regarding utility's sewer and water rate practices. We have been leaders in working with the Public Service Commission to develop new water rate structures. For example, we worked with the City of Fitchburg in 2008 to develop the most progressive conservation water rates in Wisconsin. We are currently in the process of preparing rate studies for Oconomowoc, Waukesha, Sussex, Menomonee Falls, Mukwonago, Germantown, and Elm Grove, and have prepared more than 25 of these studies in the last 3 years. This winter, we assisted Menomonee Falls in sorting out their sewer utility finances in order to avoid a more serious downgrade in their bond rating from Moody's, after their CPA and their Financial Advisor were not able to resolve the situation. We are well aware of the issues with reserve balances and bond coverage and the factors that the bond rating agencies look at when doing their ratings for utility revenue bonds.

Issue #2 – This merger should be treated like the acquisition of a business (Questions 16, 17, 24)

This is not like the acquisition of a business. There are no owners that need to be bought out or compensated for their previous investment. This is not like Mequon buying the water utility infrastructure from Wisconsin Gas. In that transaction, Wisconsin Gas walked away and no longer has anything to do with Mequon's water system. In the proposed consolidation of the City and Village of Pewaukee, the citizens of both communities will still be here and will be part of the new community. Neither of the groups of citizens is "selling" its assets to the other. Under current Wisconsin law, when two communities merge, they simply pool their assets (and liabilities), expenses, tax base, population, and so forth, and move forward. All that we are trying to do is find a way to better distribute the savings of a merger so that citizens in each community receive their proportionate share of those savings, and therefore alleviate the negative impacts that a simple pooling of tax base, reserves, expenses, and so forth would have on City taxpayers and Village utility ratepayers.

Issue #3 – Accountants/CPAs would be the best suited to analyze this agreement because it primarily has to do with the current value of each entity's assets (see #2) (Questions 16, 24)

The accountant's expertise is in auditing expenditures that have already been made to ensure that they were properly recorded, and in determining the value of assets. The City and Village reserve funds and debt do play a role in this proposed plan, so it would be appropriate to have each community's accountant look at this to ensure that they are comfortable with the estimates of current debt and reserve fund balances. However, since this is not a simple case of one entity buying out the other, there are more factors involved than the current value of each municipality's assets. We have to consider how the merged community would likely provide

services to the combined geographic area and population and what may happen in the future. For example, this process included preparing an estimated budget for a merged community, evaluating the legal mechanisms that could be used to improve the distribution of the savings, looking at how the water systems would physically be connected, evaluating the future costs to expand and maintain each community's utility systems, and estimating the tax rate and utility rate impacts. You can't audit a budget or a projection of future financial impacts, because it's a planning document, not a record of what already happened. Ultimately, this is an exercise in planning, problem solving, cost allocation, and negotiation, not primarily an accounting issue.

Issue #4 – New development represents a revenue stream for the City and is therefore an asset of the City; new development represents more tax base to share “fixed costs” (Questions 1, 2, 3, 12)

Undeveloped land is not an asset of the City. It is an asset of the property owner who can sell it or rent it. The only thing that the City gains from that land is tax revenue, and the tax levy may not exceed the amount of expenses that the local government incurs to provide services. The purpose of general government funds is not to make money. They are specifically prohibited from building up general fund reserves in excess of what is needed for normal operating reserves (generally around 25% of annual operating expenses), unless the reserves are designated for a specific purpose such as a debt reserve or planned capital projects (76 Opinion of Attorney General 77 (1987)).

The other argument is that new tax base will provide a greater base over which to share the “fixed costs” of the municipality, thereby lowering everyone's taxes. Whether that does in fact happen, depends on whether the community in question has excess capacity within its fixed costs to serve more development and more population, or whether new development will result in marginal costs to increase that capacity. Looking at the staffing levels of the City of Pewaukee compared to other communities of its size, my intuition is that the City does not have much, if any, excess capacity in its current structure that would allow it to continue providing the same level of service to an expanding population and/or tax base without adding more staff. In addition it has been shown in the City of Pewaukee and in places like Franklin, Oak Creek, New Berlin, and Muskego that development does not, over the long run, necessarily result in lower taxes. If you look at the tax rates of these other communities, the City and Village of Pewaukee have both done a very good job of keeping their tax rates low.

Issue #5 – The derivation and purpose of the \$5.5 million withdrawal from utility reserves (Questions 4, 16, 21, 23, 24)

There seems to be much confusion about this issue because I have, at different times, referred to various reasons for and purposes of this withdrawal. That is not because I have changed the proposal, but because the withdrawal of the \$5.5 million serves multiple purposes at the same time:

1. It provides a source of funds that Village of Pewaukee taxpayers can bring to the merger to contribute to the general operating expenses in place of some of the property

taxes that they currently pay. This is explained on the handout that was provided to the Committee on February 4.

2. It allows the merged municipality to have a lower tax rate than the City's current tax rate so that City taxpayers can benefit from their proportionate share of the savings. The "gap" between the Village's current tax rate and the tax rate that Village taxpayers would pay if they only received their proportionate share of the savings will be made up by the use of utility reserves. (see the February 4 handout)
3. In order to have a designated use for these funds and allow the new City to hold these funds within its General Fund (see Attorney General opinion cited above), they would be designated to pay debt service. Since the City and Village currently levy about \$2.2 million per year for debt service, the use of these funds to pay part of that debt service would reduce the amount that must be levied in property taxes, which would reduce taxes and tax rates.
4. The removal of these funds from the utilities also serves to put the City and Village utilities on more equal footing coming into the merger. Rather than having City utility customers receive a double benefit of savings in capital costs and sharing in the benefit of the Village's higher level of utility reserves, the reserves can be used to cover the Village's share of the general fund expenses in the new City.
5. It also has the effect of shifting some of the benefits of the merger from the City's utility ratepayers to the City's taxpayers. Rather than having taxpayers experience an increase in tax rates while utility ratepayers get benefits described in #4, taxpayers will receive their proportionate share of the general fund savings and water utility ratepayers will still benefit from reduced future capital costs.
6. The analysis of the amount of reserves for the City and the Village utilities did take into account estimates of future expenses for each to maintain, repair, rehabilitate and replace their existing water and sewer systems. We estimated future debt service for each of the utilities for future capital costs, including budgeted expenses for maintenance, repair, rehab and replacement in each utility's 5-year CIP. The amounts we factored in for ongoing repair, rehab and replacement (from the 5-year CIP) were as follows:
  - a. City sewer - \$900,000 (City has 69 miles of sewer main, 11 pumping stations)
  - b. Village sewer - \$1.1 million (Village has 34 miles of sewer main, 6 pumping stations)
  - c. City water - \$202,500 (City has 417,771 feet of water main, 10 wells and 2 storage tanks)

- d. Village water - \$1.9 million (Village has 234,063 feet of water main, 5 wells, 3 elevated storage tanks and 2 ground storage tanks)

Issue #6—Capital cost savings for the Water Utility (Question 22)

Mr. Melin is stating, as a fact, that the figure of \$8.3 million in water utility capital cost savings is wrong and that we've misled the public about the actual cost savings. The \$8.3 million in savings is the best estimate we have at this time of future capital cost savings based on projections of future water demand in the City and the Village. The memo from the City Director of Public Works is not saying that the \$8.3 million estimate is wrong or that the actual savings is lower than this amount. There are no actual savings yet because none of the future activity that was projected in our study has transpired yet. Mr. Weigel's memo is pointing out that some of the estimated savings are more certain than others because they relate to facilities that will be needed immediately. Cost savings that are farther out in the future could be different than what has been projected if future water demands are different than the projections. He also points out that the savings from the avoidance of the City water tower depends largely on the timing of consolidation, and that these savings could be lost if it does not occur very soon.

Issue #7—Fairness (Question 15)

Mr. Melin continues to demand that either we as consultants or the Merger Advisory Committee issue a statement about whether this deal is fair. Fair is a highly subjective judgment and will be different for each person. Personally I think we've done a good job of making this as fair as we can. Whether it is fair and acceptable for citizens of either community is for them to decide. I have been charged with providing factual, unbiased information and I have been trying very hard to do that with integrity. I don't feel comfortable interjecting my personal opinion about whether or not this is fair into information distributed to the public. All I am trying to do is to provide facts for them to consider when they make their decision.

Issue #8 – The role of the Merger Advisory Committee (Question 15, 18)

In my response to Mr. Melin's last set of questions I prefaced it with a few comments about our roles. I said "To clarify, the role of the Merger Advisory Committee and the consultants is not to speak on behalf of the Village Board or the City Council, or to advocate for or against a merger. Our role is to develop, analyze, and present factual information and alternatives to the City Council and Village Board for evaluation." Mr. Melin apparently took my comment about it not being the role of the Merger Advisory Committee *as a whole* to advocate as a statement that individual members of the Committee could not express their opinions. Obviously a Committee could not function if individuals on that committee were not allowed to express their opinions. That is not what I meant. I merely meant to say that the Committee's role is not to campaign for the citizenry to vote in favor of the merger.

