

SEWER SYSTEM EVALUATION REPORT



TOWN OF PHILLIPSBURG

April 30, 2025
(Revised Version)



PHOENIX
ADVISORS



INTRODUCTION

At the request of the Town of Phillipsburg (the “Town”), Phoenix Advisors has been engaged to review the Town’s municipal sewer utility system (the “Sewer Utility” or “System”) as it relates to a potential sale of the System to a qualified private third-party owner/operator. After analyzing the operations and finances over recent years, the Town has concluded for a variety of reasons (e.g. technical, managerial, and financial requirements, regulatory environment, and customer base) that it should determine if a larger and/or private sector enterprise would be better suited to handle the long-term needs of the System’s customers. We understand the Town’s objectives include: (i) obtain the highest value for the System; (ii) utilize the proceeds, at a minimum, to pay off Town debt and other liabilities; (iii) minimize rate volatility for ratepayers and taxpayers; and (iv) transfer responsibility of expected financial, environmental and regulatory risk to the purchaser.

In order to complete our review, we were provided with: (i) financial operating information for a three (3) year period; (ii) a narrative description of the System; (iii) Town outstanding debt information; (iv) information regarding the user rates and customer base; (v) an Emergent Conditions Report, prepared by the Town engineer, dated January 2025; (vi) a Sewer Inspection & Repair Report prepared by the Town engineer; (vii) service agreements with the neighboring towns; and (viii) a 10-year capital improvement plan. We also had access to various relevant public documents and held various discussions with Town officials and consultants. We have not obtained specific technical details regarding the System inventory, age, cost or specific capital plans, but have relied on general information provided in the various reports prepared by the Town engineers.

This version of the report reflects updated information that has become available since the prior version was produced in January 2025. The information contained herein assumes no material changes to the customer base, service agreements and capital plan beyond what is discussed in this report. The estimated number of accounts referenced herein (5,400) is preliminary and subject to change based on the future availability of additional information as certain accounts may not be currently reflected in this figure. After reviewing the documentation and conducting our own independent analysis of the Sewer Utility, we offer the following report outlining our assessment of the System and recommendations.

THE SYSTEM

The System is currently owned and funded by the Town, but operated and maintained by Natural Systems Utilities (“NSU”) under a long-term O&M contract. NSU is responsible for the overall operations of all facilities, including: management support services, maintenance and repairs, sludge management and disposal, and wastewater analysis required by the NJDEP. The System is comprised of seventy (70) miles of miles of wastewater collection lines, three (3) pump stations and one (1) wastewater treatment plant. We understand that the collection system was originally installed in the early-1900’s, the treatment plant was built in the 1950’s, and that certain specific historical records regarding System components are generally not available due to the age of the System. The Town collects wastewater from its customers and conveys it to the Phillipsburg



Wastewater Treatment Plant for the treatment and disposal of such wastewater. The boundary of the System includes the 3.2 square mile municipal limits of the Town as well as customers from four (4) neighboring towns (Lopatcong, Pohatcong, Greenwich and Alpha) who have entered into service agreements with the Town. Based on the information currently available to us, we estimate the total number of customers served by the System in the Town to be approximately 5,400¹. However, we note that certain accounts may not be included in this figure and that it is subject to change. Any changes in the number of accounts going forward could ultimately impact the potential sales price of the System. The four (4) neighboring towns are billed in bulk based on quarterly flow.

Ratepayers of the System include residential, industrial, commercial, apartment and school customers that are billed quarterly based on a flat unit rate and a usage fee. In 2022, the Town approved a four (4) year rate increase plan, which would increase the quarterly flat fee by \$5 per year and the usage fee by \$0.10/1,000 gallons per year. With respect to a residential user (which makes up 90% of the customer base), the quarterly flat fee will increase from \$15 in 2021 to \$35 in 2025, an increase of 133%, and the usage fee will increase from \$6.10/1,000 gallons in 2021 to \$6.50/1,000 gallons in 2025, an increase of 6.5%. These rate adjustments will have a positive impact on the System's revenue and value as they are enacted. However, in the last 15 years, the Town has only implemented one (1) rate increase for the sending districts, which prompted legal filings by the sending districts to contest the sewer rates.

According to the Town engineer's report, they have identified approximately \$14 million of necessary repairs to sewer lines throughout the System that will need to be addressed in the near-term in response to the ACO described in the Emergent Conditions Report. These capital items are required to address "emergent conditions" #2 and #3. In addition, the Town engineer identified approximately \$28 million of additional capital projects that will need to be undertaken within the next ten (10) years. These projects are generally in response to "emergent condition" #4, as prior to 2021, the Town completed little-to-no sewer main infrastructure repairs. However, over the last three (3) years, the Town has invested approximately \$2.5 million in sewer repairs in connection with their road program. Further, the Town typically budgets \$100,000 per year for routine maintenance and repairs to the System. At this time, we are not aware of any additional required large capital improvements needed over the next five (5) years. For the purposes of this report, the 10-year capital plan totals approximately \$42 million.

In the opinion of the Town engineer, the System satisfies the requirements of "emergent conditions" #2, #3, #4 and #5 of WIPA, meaning that the System, in short, (i) is a non-complier with NJDEP regulations; (ii) has outstanding deficiencies or violations; (iii) has a lack of historical investment; and (iv) has a lack of financial, technical or managerial capacity to address the foregoing. This characterization of the System serves as the baseline for our analysis.

¹ Preliminary, subject to change based on the availability of additional information.



OVERVIEW OF THE SALE OF MUNICIPAL-OWNED UTILITIES IN THE STATE

Over the past 30 years there have been many efforts in the State of New Jersey (the “State”) and nationally to use public/private partnership models to convert municipal-owned water and wastewater utilities to privately owned or operated status. In the State, private utilities are regulated by the NJ Board of Public Utilities (“BPU”) with a focus on rate justification based upon costs of service, costs of capital and required equity returns. The four (4) major private service providers in the State are: (i) Veolia North America; (ii) New Jersey American Water; (iii) Middlesex Water; and (iv) Aqua Water. Several sewer utility sales have recently been completed, or are in progress, including the Boroughs of Bound Brook, Manville and Somerville and the Township of Long Hill. Below is a brief summary of the various methods available to public entities to transfer risk/ownership to the private sector.

Long-Term Concession. The New Jersey Water Supply and Wastewater Treatment Public-Private Contracting Act (the “Act”), enacted in 1995, provides framework for public entities to enter into long-term contracts (40 years) with private-sector firms for financing, design, construction, improvement, operation, maintenance, administration of a water supply/wastewater treatment system. The Act gives public entities flexibility in terms of allocating the financial and operational risks of the system and specifically defining the private-sector’s role. Public-private water contracts must be approved by both the Local Finance Board (“LFB”) and the BPU, with the Department of Environmental Protection (“DEP”) having the opportunity to review and comment. However, public-private wastewater contracts require only LFB approval, with the DEP having the opportunity to review and comment. These contracts typically involve a concession fee being paid by the private-sector firm to the public entities upfront, on an ongoing basis, or a combination thereof. Generally, the concession fees must be used by the public entity for: (i) the purpose of reducing or offsetting property taxes; (ii) rate stabilization; or (iii) the defeasance of debt related to the system.

Referendum. State law also provides for public sale or lease of a public water supply or wastewater treatment system to a private entity via voter-approved referendum. This method requires a resolution authorizing the sale of the system and advertisement of a comprehensive Request for Bids document. The public entity must choose “highest bidder”, which does not always mean the entity that can operate the system the most efficiently or cost effectively. Proceeds from the sale of the system must be used to retire outstanding debt of the public entity and, to the extent additional funds remain, any other general purposes of the public entity.

Water Infrastructure Protection Act. In 2015, the State passed the Water Infrastructure Protection Act (“WIPA”), which sets a uniform standard for public entities to methodically proceed with the sale or long-term lease of their municipal-owned water and wastewater collection systems. In order to justify the sale of the asset, the public entity must first determine that an “emergent condition” exists. As such, the law identified and defined five (5) conditions in a municipal-owned utility which may be classified as an “emergent condition”. Generally, these conditions involve environmental contamination, lack of historical investment, lack of financial/technical expertise and regulatory non-compliance. Subsequent to this designation, there are numerous procedural steps and legislative actions that must occur, including providing the public with a 45-day window in which they may file a petition protesting the sale and forcing a



referendum. Further, it is necessary to obtain the approval of the LFB, BPU and DEP. Finally, once approved by the various governmental agencies and the 45-day estoppel period has lapsed, a very comprehensive RFQ process must be undertaken. Proceeds from the sale of the system must be utilized in the same manner as prescribed by the Referendum method.

Note that State law requires that contracts in excess of \$12.5 million be submitted to the State Comptroller's office for approval. Additionally, pursuant to Executive Order 12803 by President George H. W. Bush in 1992, any Federal grant proceeds used to maintain the System must be repaid to the Federal government on a depreciated basis at the time of sale.

CURRENT OPERATIONS AND PROJECTED FUTURE OPERATIONS

We have modeled the current operations and projected future operations of the Sewer Utility under a series of different scenarios in order to have a better understanding of the potential future impact on ratepayers. If the Town continues to own and operate the System, they will need to implement the 10-year capital plan discussed herein and raise rates accordingly. The following tables will show a preliminary operating pro forma based on retained ownership by the Town, bearing the full cost of operations, and funding the required capital improvements. We also modeled the operations of the System, if it were to be sold to a private third-party or regulated public utility operator for valuation purposes.

Current Operations. Table I sets forth a three (3) year summary of historical financial operations, the operating budget for the current year, 2025, and a one (1) year projection for 2026. The System has typically operated at an annual surplus ranging from breakeven to as much as \$800,000, after accounting for the utilization of Sewer Utility fund balance to help balance the budget, which is a common practice across the State. Additionally, as mentioned above, based on the approved rate increases over the last five (5) years, the sewer rents are projected to increase from \$3.7 million in 2020 to approximately \$4.9 million in 2025. However, due to increasing operating expenses, the Sewer Utility is expected to operate at a deficit in 2025 and 2026 without the utilization of fund balance to help balance the budget. In recent years, fund balance utilization has increased while fund balance levels have declined by \$550,000. As of December 31, 2024, the Sewer Utility fund balance was approximately \$1.06 million.

On the revenue side, sewer rents are the primary source of revenue at approximately 80% and, prior to 2022, averaged approximately \$3.7 million per year. Since 2022, sewer rents have ranged from \$4.5 million to \$4.9 million. Miscellaneous revenues, which typically represent 6-8% of total revenue, consist of interest income and septic billing. As mentioned above, the remainder is comprised of Sewer Utility fund balance to help balance the budget.

On the expense side, the O&M contract with NSU is the primary expenditure at \$2.6 million, with existing debt service at \$1.1 million, pay-go capital at \$50,000 and salaries, wages, insurance and benefits accounting for \$900,000. Combined these costs represent about 80% of total expenditures, on average. Professional services, maintenance and repairs make up the bulk of the remainder. Pay-go capital has ranged from \$50,000 to \$730,000 over the last five (5) years, but is



typically funded at \$100,000 per year, unless other sources of funds are appropriated in the operating budget.

TABLE I - Historic/Current Operations					
	2022 (Actual)	2023 (Actual)	2024 (Actual)	2025 (Actual)	2026 (Projected)
OPERATING REVENUE					
<i>Growth Factor</i>	<i>Per Adopted Rate Schedule</i>				0.00%
Rents	\$ 4,706,000	\$ 4,483,000	\$ 4,717,000	\$ 4,846,000	\$ 4,846,000
Miscellaneous Revenue	365,000	509,000	1,113,000	458,000	467,000
Other	83,000	-	-	-	-
Surplus Anticipated	608,000	778,000	752,000	737,000	850,000
TOTAL REVENUE	\$ 5,762,000	\$ 5,769,000	\$ 6,582,000	\$ 6,040,000	\$ 6,163,000
OPERATING EXPENDITURES					
Salaries & Wages	\$ 379,000	\$ 378,000	\$ 450,000	\$ 425,000	\$ 438,000
Operations/Maintenance	3,038,000	3,971,000	4,225,000	4,258,000	4,386,000
Third Party Treatment	-	-	-	-	-
Miscellaneous Expenses	75,000	78,000	93,000	93,000	96,000
Existing Debt Service	690,000	862,000	860,000	1,085,000	1,068,000
New Debt Service	-	-	-	-	-
Pay-go Capital	100,000	100,000	730,000	50,000	100,000
TOTAL EXPENDITURES	\$ 4,281,000	\$ 5,389,000	\$ 6,358,000	\$ 5,911,000	\$ 6,087,000
NET INCOME	\$ 1,481,000	\$ 380,000	\$ 224,000	\$ 129,000	\$ 76,000
<i>*Figures may not add due to rounding</i>					

Further, we understand that there is currently no direct subsidy to or from the Town's Current Fund, however, the Town routinely allocates a share of certain administrative costs to the Sewer Utility budgets, including a portion of administrative staff salaries and benefits for the share of their duties related to the Sewer Utility, along with certain legal and professional fees. Based on information provided by Town officials, we estimate these costs to total approximately \$1 million per year. It can be assumed that such costs would still be required if the System were sold and therefore they would need to be shifted to and funded out of the Current Fund, assuming no changes to staffing, salaries and insurance/benefits.

Base Case Operations. Table II sets forth a six (6) year summary of projected financial operations if the Town were to continue operation of the Sewer Utility at the status quo with the current level of capital improvements. As noted above, the Town has not kept up with the required levels of capital investment in the System over the last few years and, accordingly, these projections are for presentation purposes only. This scenario does not address the various "emergent conditions" discussed above or in the Emergent Conditions Report. In order to show the System operating on a self-liquidating basis, we removed the use of surplus and connection fees as revenue sources. This results in a \$1 million deficit, which is projected to widen in the coming years to as much as



\$1.6 million due to the aforementioned increases in operating expenses. The ability for the Town to control operating expenses is somewhat limited given the O&M contract with NSU.

On the revenue side, we applied a 2.00% annual inflationary adjustment to miscellaneous revenue. On the expense side, we applied a 3.00% annual inflationary adjustment to operating expenses, kept the capital improvement contribution at \$100,000 and projected forward the Sewer Utility debt service.

TABLE II - Projected Base Case Operations at Status Quo							
	2026 (Projected)	2027 (Projected)	2028 (Projected)	2029 (Projected)	2030 (Projected)	2031 (Projected)	2032 (Projected)
OPERATING REVENUE							
Growth Factor	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Rents	\$ 4,846,000	\$ 4,846,000	\$ 4,846,000	\$ 4,846,000	\$ 4,846,000	\$ 4,846,000	\$ 4,846,000
Miscellaneous Revenue	467,000	477,000	486,000	496,000	506,000	516,000	526,000
Other	-	-	-	-	-	-	-
Surplus Anticipated	850,000	-	-	-	-	-	-
TOTAL REVENUE	\$ 6,163,000	\$ 5,322,000	\$ 5,332,000	\$ 5,341,000	\$ 5,351,000	\$ 5,361,000	\$ 5,372,000
OPERATING EXPENDITURES							
Salaries & Wages	\$ 438,000	\$ 451,000	\$ 464,000	\$ 478,000	\$ 493,000	\$ 507,000	\$ 523,000
Operations/Maintenance	4,386,000	4,517,000	4,653,000	4,792,000	4,936,000	5,084,000	5,237,000
Third Party Treatment	-	-	-	-	-	-	-
Miscellaneous Expenses	96,000	99,000	102,000	105,000	108,000	111,000	114,000
Existing Debt Service	1,068,000	1,152,000	1,147,000	1,144,000	968,000	964,000	964,000
New Debt Service	-	-	-	-	-	-	-
Pay-go Capital	100,000	100,000	100,000	100,000	100,000	100,000	100,000
TOTAL EXPENDITURES	\$ 6,087,000	\$ 6,319,000	\$ 6,466,000	\$ 6,619,000	\$ 6,605,000	\$ 6,767,000	\$ 6,938,000
NET INCOME	\$ 76,000	\$ (997,000)	\$ (1,134,000)	\$ (1,278,000)	\$ (1,254,000)	\$ (1,406,000)	\$ (1,566,000)
*Figures may not add due to rounding							

Debt-Financed Capital. Table III sets forth a six (6) year summary of projected financial operations if the Town were to continue operation of the Sewer Utility under the Base Case Status Quo Operations discussed above and debt finance \$42 million of required capital improvements discussed herein. It also projects the required rate increases needed in order to maintain balanced operations without the use of surplus or reserves. Again, this scenario assumes no material changes to staffing or day-to-day operations. The adjustments to operating expenses and annual inflationary growth are consistent with the assumptions reflected in Table IV. The major difference in this scenario is the inclusion of the above-referenced debt-financed capital over the next ten (10) years in the form of staggered bond issuances. For the purposes of this analysis, we assumed that the Town would issue general obligation bonds through the New Jersey Infrastructure Bank (the “NJIB”) via their “Tier 1” financing program. This represents very attractive financing options, including \$2 million in principal forgiveness per year and up to 75% interest free loans.

In this scenario, we project that the Town will need to implement a 5-year rate increase schedule comprised of a one-time 26% increase in 2027 and 3-4% annual increases in the other years in



order for the System to be fully self-supporting and absorb the proposed \$42 million capital plan. This would result in the Town's 2035 sewer rates being approximately 1.7x higher than the Town's rates in 2025. The new debt service is projected to reach a maximum of approximately \$1.4 million per year by 2035. We project that the average ratepayer's monthly bill would increase from \$31 today to \$51 in 2035. Again, this assumes the availability of significant principal forgiveness from the NJIB as well as very attractive financing options, neither of which can be guaranteed. Thereafter, the Town would likely need to implement 3% annual inflationary rate increases to rebuild fund balance, keep up with future capital investment and ensure positive future financial operations.

TABLE III - Projected Municipal Operations w/NJIB Financing							
	2026 (Projected)	2027 (Projected)	2028 (Projected)	2029 (Projected)	2030 (Projected)	2031 (Projected)	2032 (Projected)
OPERATING REVENUE							
Growth Factor	0.00%	26.00%	4.00%	4.00%	3.00%	3.00%	4.00%
Rents	\$ 4,846,000	\$ 6,105,000	\$ 6,350,000	\$ 6,604,000	\$ 6,802,000	\$ 7,006,000	\$ 7,286,000
Miscellaneous Revenue	467,000	477,000	486,000	496,000	506,000	516,000	526,000
Other	-	-	-	-	-	-	-
Surplus Anticipated	850,000	-	-	-	-	-	-
TOTAL REVENUE	\$ 6,163,000	\$ 6,582,000	\$ 6,836,000	\$ 7,099,000	\$ 7,307,000	\$ 7,521,000	\$ 7,812,000
OPERATING EXPENDITURES							
Salaries & Wages	\$ 438,000	\$ 451,000	\$ 464,000	\$ 478,000	\$ 493,000	\$ 507,000	\$ 523,000
Operations/Maintenance	4,386,000	4,517,000	4,653,000	4,792,000	4,936,000	5,084,000	5,237,000
Third Party Treatment	-	-	-	-	-	-	-
Miscellaneous Expenses	96,000	99,000	102,000	105,000	108,000	111,000	114,000
Existing Debt Service	1,068,000	1,152,000	1,147,000	1,144,000	968,000	964,000	964,000
New Debt Service	-	199,000	275,000	410,000	546,000	683,000	821,000
Pay-go Capital	100,000	100,000	100,000	100,000	100,000	100,000	100,000
TOTAL EXPENDITURES	\$ 6,087,000	\$ 6,518,000	\$ 6,741,000	\$ 7,029,000	\$ 7,151,000	\$ 7,450,000	\$ 7,759,000
NET INCOME	\$ 76,000	\$ 64,000	\$ 95,000	\$ 70,000	\$ 156,000	\$ 71,000	\$ 53,000
*Figures may not add due to rounding							

However, we note that the NJIB principal forgiveness funds are finite and there is currently some uncertainty about the future of State/Federal funding. If the Town were to debt finance the \$42 million capital plan with typical general obligation bonds, we expect that the debt service could be 2.5x higher than the NJIB debt service shown above (\$1.4 million versus \$3.4 million). This would result in higher required rate increases, ranging from 6% to 31% over the next five (5) years, followed by 3% inflationary increases thereafter.

DEFEASANCE OF EXISTING DEBT

In connection with the sale of the Sewer Utility via referendum or WIPA, State law requires that the Town utilize sale proceeds to defease its outstanding debt, first with respect to all Sewer Utility debt and second with respect to all general improvement debt. Based on our review, as of



December 31, 2024, the Town has approximately \$11.2 million of Sewer Utility debt and \$19.8 million of general improvement debt outstanding. Such debt includes Town general obligation bonds, bond anticipation notes, NJIB loans and green acres loans. We are not aware of any Federal grant proceeds that have been utilized to improve the System.

Outstanding Sewer Debt. Table IV details the Town's \$11.2 million Sewer Utility debt outstanding as of December 31, 2024. This is comprised of approximately \$1.8 million of fixed rate, long-term bonds issued by the Town in 2022 (the "Outstanding Sewer Bonds"), \$4.9 million of NJIB loans and \$4.5 million of short-term bond anticipation notes (collectively, the "Outstanding Sewer Debt"). The Outstanding Sewer Bonds mature in annual installments through the year ending December 31, 2042 and are callable beginning May 15, 2029. The NJIB loans mature in various annual installments as shown below and have various redemption provisions as shown below.

TABLE IV - Defeasance of Sewer Utility Debt as of 12/31/2024				
Series	Amount Outstanding	Final Maturity	Redemption Provisions	Est. Cost of Defeasance ⁽¹⁾
Series 2022	\$1,780,000	05/15/42	05/15/29	\$1,723,715
NJIB 2010A	451,000	08/01/29	08/01/26	371,660
NJIB 2010B	359,547	08/01/29	Any time	286,430
NJIB 2014A	1,080,000	08/01/33	08/01/24	986,015
NJIB 2014B	2,418,375	02/01/33	Any time	2,111,594
NJIB 2015A	220,000	08/01/34	08/01/25	203,327
NJIB 2015B	358,081	08/01/33	Any time	314,306
BANs	<u>4,500,000</u>	12/13/24	n/a	<u>4,410,000</u>
	\$11,167,003			\$10,407,048
<i>(1) Assumes net funded escrow using SLGS rates as of April 15, 2025. Based on January 1, 2027 settlement date for presentation purposes.</i>				

Outstanding General Debt. Table V details the Town's \$19.8 million of general improvement debt outstanding as of December 31, 2024. This is comprised of approximately \$7.8 million of fixed rate, long-term bonds (the "Outstanding General Bonds"), \$12 million of short-term bond anticipation notes and approximately \$15,000 of green acres loans (collectively, the "Outstanding General Debt"). The Outstanding General Bonds mature in annual installments through the year ending December 31, 2036 and have various redemption provisions as shown below.



TABLE V - Defeasance of General Improvement Debt as of 12/31/2024				
Series	Amount Outstanding	Final Maturity	Redemption Provisions	Est. Cost of Defeasance ⁽¹⁾
Series 2017	\$2,402,000	08/01/28	08/01/25	\$1,838,146
Series 2022	5,400,000	05/15/36	05/15/29	5,052,291
Green Acres Loans	15,316	07/11/25	Any time	0
BANs	<u>12,005,000</u>	12/13/24	n/a	<u>10,275,000</u>
	\$19,822,316			\$17,165,438
<i>(1) Assumes net funded escrow using SLGS rates as of April 15, 2025. Based on January 1, 2027 settlement date for presentation purposes.</i>				

Debt Defeasance Cost. Also included in Table IV and Table V is an estimated cost to defease (i.e. “pay off”) the Town’s Outstanding Sewer Debt and Outstanding General Debt, based on current investment rates. The projected cost to defease the Town’s outstanding debt is based on a combination of:

- (i) The principal amount outstanding;
- (ii) interest cost payable through the respective redemption date of each series; and
- (iii) available investment rates for the escrowed proceeds.

The Town has the ability to invest proceeds from a potential sale in government obligations, known as State and Local Government Series (“SLGS”) securities, to help offset a portion of the defeasance cost. Based on current market conditions, and assuming a January 1, 2027 settlement date (for presentation purposes), the projected cost to defease all of the Town’s Outstanding Sewer Debt is approximately \$10.4 million and the projected cost to defease all of the Town’s Outstanding General Debt is approximately \$17.2 million. Note that this amount assumes the Town will make all budgeted debt service payments from now until the estimated settlement date.

SYSTEM VALUATION

In order to assess the value of the System, we employ a number of valuation methodologies that look at value from various perspectives in order to produce a reasonable range of potential outcomes. Understanding the potential value of the System is of paramount importance as the Town moves through this process and puts the Town in a strong position to make better decisions for its taxpayers and ratepayers. We typically employ the following asset-valuing methodologies: (i) replacement/original cost approach; (ii) income capitalization approach; and (iii) market comparable approach. With all approaches, we have applied a typical inflationary factor to projected cash flows during the calculation period.

Replacement/Original Cost Approach. When valuing an asset, it is important to consider the amounts that the Town has invested in the System and the potential cost for another entity to recreate the infrastructure needed to operate the System. Based on information in the Town’s audit, we estimate that the Town has invested nearly **\$45 million** into the System. At this time,



specific information regarding the replacement/original cost less depreciation for the System is not available. However, we note that the replacement/original cost approach of valuation typically overstates the potential sales price of the asset.

Income Capitalization Approach. One of the most common ways to value any revenue-producing asset is using income capitalization. With respect to the System, we expect that a private owner will be able to capitalize on various operational efficiencies, resulting in a projected initial net income of approximately \$1.2 million. This net income figure was projected by (i) eliminating various operating expenses that would not apply to a private operator, such as debt service and statutory expenditures; (ii) applying an efficiency factor to the remaining salaries & wages and operating expenses; and (iii) estimating the annual capital needs to maintain the System in a state of good repair.

Phoenix Advisors uses the average of three (3) income approaches to determine the value of the System under this methodology. First, we applied a revenue multiplier of 3.7x, which is based on an average of the multipliers (sales price vs. system revenue) derived from recent similar system sales to the projected 2026 revenue for the System (“Analysis #1”). Second, Phoenix Advisors applied an estimated capitalization rate of 8% (based on the typical allowable returns to public utilities) to the projected 2026 net income to develop a simple valuation (“Analysis #2”). Lastly, we applied the industry standard method of converting net income to a value using a discounted cash flow analysis. This method determines the “present value” of the future projected cash flows to the current year using a risk adjusted weighted average cost of capital of 8% (“Analysis #3”). After performing the three (3) calculations described above, we averaged the results, which is a valuation of approximately **\$16.4 million**, as shown in Table VI.

TABLE VI - Income Capitalization Approach	
Description of Method	Sewer Utility
<u>Financial Summary</u>	
Operating Revenue	\$5,500,000
Less: Operating Expenditures	<u>4,300,000</u>
Surplus/(Deficit)	\$1,250,000
<u>Analysis #1</u>	
System Use Charges (2026 Est.)	\$5,050,000
Revenue Multiple	3.7
Gross Valuation	\$18,600,000
<u>Analysis #2</u>	
Net Operating Income (2026 Est.)	\$1,250,000
Estimated Capitalization Rate	8.00%
Gross Valuation	\$15,500,000
<u>Analysis #3</u>	
WACC Discounted Cash Flow Rate	8.00%
Gross Valuation	\$15,000,000
Average Valuation:	<u>\$16,400,000</u>



Market Comparable Approach. Based on our research, we have identified various recent sales of sewer systems in New Jersey (as shown in [Table VII](#)) and evaluated the sales price in terms of: (i) price per customer; (ii) price per mile of infrastructure; and (iii) price as a multiple of sewer use charges. Notably, we have found that, for similar wastewater systems with treatment plants, the price per customer has been approximately \$3,000, the price per mile of asset infrastructure has been approximately \$250,000 and the price per dollar of sewer rents has been approximately 3.7x. Extrapolating this data and applying it to the System results in an average value of approximately **\$20.7 million**.

TABLE VII - Other NJ Water/Sewer System Sales						
Entity	Year of Bid	System Type	Sales Price	Customers	System Rents	Price per Customer
Haddonfield Borough	2015	Water/Sewer	\$28,675,000	4,500	\$3,677,000	\$6,250
West Milford Township	2018	Water/Sewer	11,300,000	1,700	1,800,000	6,750
Long Hill Township	2019	Sewer	12,700,000	2,900	2,204,800	4,500
Mt. Ephraim Borough	2019	Sewer	1,400,000	1,800	225,000	750
Allendale Borough	2021	Water	18,000,000	2,500	2,100,000	7,250
Egg Harbor City^	2021	Water/Sewer	21,800,000	3,000	2,079,000	7,250
Saddle River Borough*	2022	Water	3,700,000	500	590,000	7,500
Somerville Borough	2022	Sewer	7,000,000	3,800	2,800,000	1,750
Bound Brook Borough	2022	Sewer	5,000,000	2,800	1,700,000	1,750
Manville Borough	2023	Sewer	6,500,000	3,700	1,900,000	1,750
Salem City*	2024	Water/Sewer	18,000,000	4,600	2,600,000	4,000
South Orange Village*	2024	Water	19,700,000	4,600	4,850,000	4,250
Hopewell Borough*^	2025	Water	6,400,000	850	900,000	7,500
*In Progress; ^WIPA						

Estimated Valuation

In summary, we estimate the valuation of the System, in a state of good repair, to be in the range of approximately **\$17 million to \$21 million**, based on the various approaches discussed above and shown in [Table VIII](#). However, due to certain overdue capital improvements, aging infrastructure and the lack of historical information/records regarding the System, the ultimate value may be impacted further.

TABLE VIII - Valuation Summary	
Valuation Method	Sewer Utility
1. Cost Approach	\$45,000,000
2. Income Capitalization Approach	16,400,000
3. Market Comparable Approach	20,700,000
Estimated Valuation Range	\$17 to \$21 Million



Additionally, the WIPA legislation passed by the State in 2015 supports the “fair market value” pricing for the sale of water and wastewater utility systems rather than the prior approach based on the original cost/depreciation of the asset and/or traditional asset valuation methods. Nationally, the outcome usually results in a higher sale price than municipalities would otherwise typically receive under the prior methodology. The BPU incorporates the sale price into the operator’s rate base across the State, thus considering the revenues and rates of the private operator outside of the subject municipality. In short, by spreading the potential costs and revenues across the private operator’s rate base, the purchase price to municipalities has generally been significantly higher. Due to the “fair market value” approach to pricing, the ultimate sales price is dependent on a number of factors that are unique to the buyer and not always transparent. As noted above, Egg Harbor City is the only municipality in New Jersey to complete a sale under WIPA and their sales price was at the high end of the per customer range.

CONCLUSION

The decision-making process regarding the potential sale of the Sewer Utility involves a number of considerations, both financial and otherwise. As a result of a lack of historical investment in the System and the outstanding ACO, the Town is facing a significant amount of capital needs in the short-term as well as facing other challenges from the various “emergent conditions” described herein. The recent rate increases are certainly a mitigating factor, but the Town will continue to face various financial, technical, regulatory, operational and managerial challenges going forward. Conversely, the sale of the System would result in a loss of rate-setting control for the Town as well as the likelihood of higher rates in the long term. Typically, investor-owned public utilities will agree to a set rate schedule for 5-7 years, followed by the implementation of the Town’s rate into the owner’s State rate base.

It should be noted that State law requires any proceeds from the sale of a municipal-owned utility to be generally applied as follows: (i) first, to retire bonds issued for the purposes of the System and retire any outstanding liabilities related to the System; (ii) second, to retire any other bonds issued by the municipality; and (iii) third, for any other general purpose of the municipality, including capital/community projects. Based on our understanding, this requirement is consistent with the Town’s intended use of potential sale proceeds. The estimated System value should provide for (i) the defeasance of all of the Outstanding Sewer Debt; and (ii) the defeasance of a portion of the Outstanding General Debt (in aggregate the total of these two (2) items is estimated to be approximately \$27.6 million).

Particularly of note to the Town is the potential negative impact on the Current Fund budget if the Town were to sell the System. As noted herein, we understand that there is currently no direct subsidy to or from the Town’s Current Fund, however, the Town routinely allocates a share of certain administrative costs to the Sewer Utility budgets. Based on information provided by the Town and the methodology described herein, we estimate this cost to be approximately \$1 million and includes: salaries and wages, health benefits/insurance, administrative costs and certain professional services. These costs, assuming they are maintained at the current levels, will need to shift to and be funded by the Current Fund. Further, Town properties would begin paying for



sewer services since they currently receive such services for free. These items would likely need to be offset by a combination of tax increases, reductions to appropriations and/or debt defeasance savings, should the Town eliminate the ability to share costs with the Sewer Utility.

However, as mentioned above, excess sale proceeds after the defeasance of the Outstanding Sewer Debt can be applied to defease the Outstanding General Debt and then may be allocated to any municipal purpose or capital/community projects. The elimination of the Outstanding General Debt would provide direct savings to the current fund budget and would likely offset the increased costs referenced above. Based on our defeasance analysis discussed herein, if the excess proceeds were to defease all of the Outstanding General Debt (except for the bond anticipation notes), it would result in annual savings of approximately \$2.6 million per year relative to the 2025 budgeted debt service figures. This is based on a preliminary defeasance analysis described in Table V. Note that this does not include the \$12 million bond anticipation notes that will need to be permanently financed into long-term debt over the next few years. However, based on this analysis, the sale of the System should result in a positive surplus of funds when accounting for the potential debt defeasance savings, shifting of costs routinely paid by the Sewer Utility over to the Current Fund, permanent financing of the existing notes and the potential for additional sale proceeds. Please note that this is only a preliminary estimate and the actual amount of Outstanding General Debt that can be defeased and the resulting savings from the defeasance can only be determined after a sale of the System.