

STEPS IN FORMING AND FUNDING RURAL WATER SYSTEMS

USDA Rural Development
2118 West Park Court, Suite A
Champaign, Illinois 61821

The purpose of this paper is to inform the reader of the general steps to follow in forming a rural water system. We will cover the general steps in forming a water system, legal entities that can be formed, means of financing, current operation and maintenance costs, and average bills on recently constructed systems.

We might note that the steps outlined in this paper are those that must be completed by a Rural Development loan applicant; however, the same general steps must be followed regardless of whether the interested group uses a private or a government lender. Listed below in largely chronological order are the necessary steps in accomplishing a project. Many of these actions may be done concurrently. The leadership in such a project must think and plan ahead of the actual execution of much of this work.

1. Idea For the Project

Water projects ordinarily start with an idea on the part of one or more community leaders or local residents based on the need for better water quantity and quality.

These individuals must realize at the inception of the project that due to the sparsity of users in rural areas, increased construction costs, cost of water, and state and federal regulations, the average bill per month to support their system will be higher than those charged in urban areas. Rural Development has financed many projects in Illinois. The average bill on current projects ranges from \$35.00 to \$60.00 or more per user per month. The leaders, when soliciting users during sign-up, should not promise a specific water rate as the final costs of the project cannot be determined until construction bids are obtained.

2. Organize A Steering Committee

As the idea is explored, it soon becomes evident that a steering committee would be appropriate. A steering committee further develops the idea into a more or less preliminary plan of the project.

3. Determine Local Interest And Support

In the case of new systems or substantial extensions of existing facilities, the extent of local interest and support should be determined at an early stage. This can be determined by obtaining agreements from all planned users signifying their intentions to use the services of the facility promptly once it is installed. Rural Development requires on its projects that an advance tap-on fee will be paid by each planned user usually in the amount of one annual minimum bill, typically \$200-\$300. A tap-on fee of this amount will help to determine the number and location of users for the design of the facility and provide a small working fund for necessary preliminary expenses.

4. Retain An Attorney

Before the group goes very far, it is recommended that it obtain the services of an attorney. The attorney's experience is not as critical as his/her willingness and having the time to perform the services required. The attorney should be asked to provide information as to different types of entities and their authority to construct and operate a water system, regulate its use, and obtain adequate financing for its purpose. USDA staff can provide information as well. The steering committee should visit existing established water systems to get a better understanding of how water systems are organized and operated.

5. Notify The Proper Metropolitan Or Regional Clearinghouse And The State Clearinghouse

These clearinghouses have been organized to prevent the overlapping of projects. The State Clearinghouse address is: Illinois State Clearinghouse, Illinois Department of Commerce & Economic Opportunity, Bureau of Policy Development, Planning and Research, 620 E. Adams, 6th Floor, Springfield, IL 62701. Tel: (217) 524-0188 Fax: (217) 558-0473

6. Secure An Engineer

The group's officials should determine what the scope of the project and ask the engineer to prepare a preliminary engineering report.

Using the group's guidelines, user survey and sign-up, the engineer develops a preliminary engineering report to determine the feasibility and costs of the project. The engineer should base the project upon sound considerations regarding the number of occupied dwellings as related to the total project cost. The project may have to be developed in stages if it includes some sparse areas which make the whole project unfeasible. The preliminary report should include a description of the area and expected growth; give the design criteria for the project; cover the available sources of water and the cost of the project with each source; include a realistic and complete cost estimate for the year the project will be built; provide an annual operating budget which includes the average bill required to pay operation and maintenance expenses, repay the loan, and establish a reserve; and discuss means of financing. It should also address potential environmental considerations (known archaeological sites, presence of floodplains and wetlands, indirect project impacts such as future growth on prime/important farmland and other land resources, etc.). An Environmental Report is usually prepared at this time.

7. Formal Organization

Eventually, a legal entity capable of accomplishing the work planned must be created. In Illinois, there are many types of organizations with varying degrees of authority and responsibility for providing water service. The steering committee should always determine if an existing entity is willing to provide service before forming a new organization.

Each of the following private or municipal corporations has at least some authority to provide water service. Some are more appropriate than others and some have very definite limitations. Based on our experience, we shall simply indicate the advantages, limitations and recommendations for each, leaving the matter of methods of organization, powers and duties, and etc. to the attorney, the steering committee and engineer.

A. PRIVATE CORPORATIONS

(1) General Profit Corporations

The operation of a water system by such a corporation requires approval by the Illinois Commerce Commission of its service area and rate schedule, and the submission of certain reports at periodic intervals.

Advantages - Such a corporation can exercise any powers authorized under its Articles of Incorporation that is not prohibited by general laws or otherwise.

Limitations - It must ordinarily rely on the private money market or individuals to supply its credit needs. Its service area is not protected by law from encroachment by other systems. These corporations are not eligible for Federal or State loan and grant programs.

Recommendations - This type is recommended where a developer chooses to provide the water system to serve his/her own development and wishes to retain control and is able to finance it properly.

(2) Not-For-Profit Corporations

Advantages - This is a very flexible arrangement insofar as providing a service to rural users. Each user becomes a member of the corporation. Any equity in the system accrues to the individual members. It can be very democratic in that its operations are governed by its Board of Directors which in turn are elected by the membership. Such a corporation qualifies for some types of Federal financial assistance, including USDA Rural Development.

Limitations - This type of corporation may be subject to the jurisdiction of the Illinois Commerce Commission in the same manner as a general profit corporation, although usually an exemption can be obtained. Its service area is not protected by law from encroachment by other systems. NFP corporations are not eligible for some types of governmental assistance such as DCEO Community Development Assistance Program Grants (but may have a governmental entity apply on their behalf). Not-for-profits do not have the power or eminent domain to obtain rights-of-way nor are they eligible for the sales tax exemption.

Recommendations - This type of organization is recommended as being appropriate in many situations.

B. PUBLIC BODIES

(1) Units of General Local Government

a. Counties

Advantages - This would provide for county-wide central management and operation of individual systems or segments throughout the county while utilizing an existing unit of government. Assists in general county-wide land use and planning management. Prevents proliferation of additional units of government. Ready access to adequate financing.

Limitations - Members of individual segments of the system may have little representation or voice in its management. County boards have been reluctant to assume additional responsibilities. Due to the many other responsibilities of county boards, the management of the water system may receive less attention than desirable.

Recommendations - Experience of water systems operated by counties in Illinois is limited.

b. Townships.

Advantages - Townships have adequate authority to issue revenue bonds to finance such systems. Utilizes an existing unit of local government.

Limitations - Most rural townships would have no personnel interested in promoting such projects.

Recommendations - We are aware of limited use of this type of organization, and it has been successful.

c. Cities, Villages and Towns

Advantages - Utilizes an existing unit of local government. Adequate authority to provide water service within their corporate limits and immediate environs. Access to adequate financing and ample authority for obtaining financing. Enables the community to provide water in areas of potential future growth of the community.

Limitations - Such a unit of government has no responsibility to provide such service in rural areas outside its corporate boundaries. The customers outside the corporate limits have no control or voice in its management. Such rural users may be subject to a higher rate than the users within its corporate limits; however, this is often justified.

Recommendations - In limited geographic areas, this is recommended if the city/village/town wishes to do so and there is not an existing or proposed entity more suitable to provide such service.

(2) Special Districts and Commissions

a. Public Water Districts.

Advantages - Rather easily organized by circulation of a petition and referendum. Such a district also has authority to operate a sewage system if the need arises. Since the operation of its water facilities is its primary business, it should receive proper attention from its Board of Trustees. Adequate authority to borrow money for construction purposes through issuance of tax exempt bonds. The district has defined boundaries.

Limitations - The district is managed by the Board of Trustees who are appointed by the County Board and may not be as responsible to members of the district as desired. Water districts are limited to supplying water within their corporate limits except as incidental to providing water to the district itself.

Recommendations - Recommended subject to careful evaluation of the density and location of users within the area to be incorporated.

b. Water Commissions

Advantages - Easily organized. This type of organization is especially suited to joint operation of a water source, a water treatment plant or for joining together two or more existing communities for their mutual benefit. Since the commission is governed by a commissioner from each of its member communities, the commission should be quite responsive to the needs of the water users being served. Water commissions have broad authority and may serve communities on a "wholesale" basis and individual users on a "retail" basis. Water commissions have adequate authority to obtain such rights-of-way as required, access to ample financing, and broad authority for obtaining such funds on a revenue secured basis.

Limitations - Water commissions do not appear to be designed to serve primarily individual users over a broad area.

Recommendations - Water commissions are especially recommended for joining two or more systems for a part of their operations, primarily providing water on a wholesale basis to its member systems.

c. River Conservancy Districts

Advantages - River conservancy districts have very broad powers insofar as water related activities are concerned. They have adequate authority to finance improvements and to borrow money through either general obligation bonds, special assessment bonds, or revenue bonds.

Limitations - Most river conservancy districts have been organized primarily for purposes other than distribution of treated water to rural residents, consequently, this activity may not receive the necessary attention from the Board of Trustees. River conservancy districts incorporate a specified area of land which may or may not coincide with the most logical water system development for the area. The trustees may or may not be responsible to the needs and desires of the water users within the district.

Recommendations - We recommend it subject to the limitations mentioned above.

CONCLUSIONS ON ENTITIES THAT CAN BE FORMED

We have touched on only the most obvious or known advantages and limitations of the above organizations. The writers' comments are based on experience in financing water systems in Illinois primarily serving rural residents and farmers. These systems have included: not-for-profit corporations; cities, villages and towns; public water districts; water commissions; townships and river conservancy districts.

8. Explore Means Of Financing

At the present time, Rural Development can make both direct and guaranteed loans for water systems. Rural Development loans are limited to rural areas and incorporated communities with a population of 10,000 or less according to the latest decennial census of the United States.

Rural Development direct loans supplement, but do not to take the place of private credit. Consequently, applicants must establish and certify that such credit is not available. There is no test for private credit for guarantees.

Limited Rural Development grant funding is available to eligible applicants to keep user rates affordable. Entities are encouraged to seek local funds and State and Federal grants to supplement Rural Development financing.

The method of financing a rural water system depends upon the organization itself. The Illinois Statutes provide quite specifically the methods for financing such projects insofar as public bodies are concerned. General profit and not-for-profit corporations finance such facilities in essentially the same way as an individual would. We will discuss each in turn.

A. PROFIT AND NOT-FOR-PROFIT CORPORATIONS

Corporations must depend upon borrowing on a note and mortgage basis from commercial banks or similar lenders, including in some instances one or more government agencies. Repayment is usually based upon income to be generated by the facility. Security for the loan consists of the borrower's Promissory Note and a Mortgage on the facility. Interest rates and terms would be a matter of negotiation between the corporation and its lender. Rural Development can lend to not-for-profit corporations.

B. PUBLIC BODIES

State Statutes are generally quite specific in outlining the methods of financing available to each particular type of entity. The types of financing fall in three categories being: General Obligation Bonds (tax bonds), Revenue Bonds, Debt Certificates and Assessment Bonds. Some municipal bodies can use any or all of these methods. Others can use only one or two. Consequently, it is important that the attorney and the steering committee study this carefully before organization.

(1) General Obligation Bonds

These are bonds to be paid from the collection of the taxes levied against all the assessed property within the corporate limits of the borrowing unit. They are limited to twenty years in length, quite frequently to a maximum interest rate, and to 8.625% of the assessed valuation. In most cases, a referendum is required authorizing such borrowing. The limitations mentioned above curtail the usefulness of this in financing a new project; that is, the 8.625% limitation would provide funds for only a small fraction of the total cost.

(2) Revenue Bonds

Revenue bonds are based upon being repaid from the revenue generated by the facility being financed. These are ordinarily limited to forty years in length. There may be a maximum interest rate limitation. There is no limitation on the amount that may be issued subject only to the feasibility of the system and the lender's judgment. Most water systems are financed through this means. For revenue bonds to be marketable, the system must project sufficient yearly income to pay the operation and maintenance expenses, provide a reserve for depreciation and debt repayment, plus paying the interest and the portion of principal becoming due on the loan. The soundness of the proposal determines the marketability of the bonds.

(3) Debt Certificates

Some units of government have authority to issue general obligation (limited tax) debt certificates with a repayment period of twenty years. The debt is repaid from the general revenue fund of the entity.

(4) Assessment Bonds.

Under this procedure, all the properties to be benefited by the proposed facility are assessed a proportionate part of the total cost. Property owners may pay their assessment in cash or they may be offered from ten to twenty years to pay this on an installment basis. Bonds may be issued in anticipation of collection of these unpaid assessments. The procedures for issuing such bonds are cumbersome and time consuming.

The issuance of any of the bonds mentioned above requires specific legal procedures be followed. The group's local attorney customarily draws on the services of specialized attorneys referred to as bond counsel. Bond counsel will provide the format of the various documents needed to authorize and issue the bonds.

9. Obtain Lender's Concurrence of Preliminary Engineering Report, Engineering Services Agreement and Environmental Assessment
10. Develop an Application and meet any Conditions set forth by the Lender.
11. Develop Final Construction Plans.
Approval of the plans is required from the lender and any applicable State and Federal Agencies.
12. Begin Bond Proceedings.
The attorney and bond counsel must develop the documents and supporting evidence to authorize and issue the bonds (public bodies only).
13. Complete Right-Of-Way and Title Evidence.
The acquisition of rights-of-way, land for structure sites, easements, and other land rights are determined by the final design of the project. The engineer is responsible for providing a map showing the land rights needed. The Board and its attorney are responsible for obtaining the rights.

Rural Development recommends that whenever possible, the group install its lines on private easements rather than township, county or state highway rights-of-way. This prevents a future expense that would be incurred if the road were to be improved or relocated.
14. Advertising for Construction Bids and Opening of the Bids.
15. Close the Loan.
If the project costs are within the available funds, the group may award the contracts, adopt any applicable ordinances, resolutions, or other documents and proceed to conduct the steps necessary to close the loan in accordance with the lender's closing requirements.
16. Construction.
The writer recommends the engineer be retained to provide resident inspection during construction.
17. Final Acceptance by the Owner.
The group's representative, its engineer, lender and other interested parties should jointly make a final inspection before acceptance of the system from the contractor. We suggest the group require a one year warranty on all projects.
18. Operation of the Project.
An operation and maintenance plan or standard operating procedures should have been developed prior to acceptance of the project. It is very important that an operator is selected by the group's board and follows the project through construction so he/she becomes completely familiar with the system's construction and operation.

Each year, a new budget must be made to cover operation and maintenance expenses, loan repayment and reserve requirements. In most cases, an annual audit will be required.

CONCLUSIONS:

The above steps take from nine to twenty-four months or longer, depending upon the complexity of the project, availability of funding and the willingness of all parties concerned (the group's officers, attorney, bond counsel, engineer, and lender's representative) to cooperate and accomplish their assigned tasks in a timely manner.

People seeking connection to a central water system should contact nearby water systems (city or village, rural water districts, etc.) to see if service is possible from them before proceeding to create a new entity.

Rural Development District Offices in Morris, Princeton, Galesburg, Champaign, Effingham, Jacksonville, Harrisburg, Mt. Vernon and the State Office in Champaign (217-403-6214) can provide additional information regarding the subject of this paper including eligibility for and availability of Rural Development funding.

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