



# **Issue Paper #1: Governance Options for Mason County Utilities February 14, 2011**

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## **1. Introduction**

This issue paper is prepared by FCS GROUP in cooperation with Inslee Best Doezie & Ryder PS and Murray, Smith & Associates, Inc. in order to develop potential alternatives to the current governance of Mason County utilities.

A study of potential governance changes for County utilities should include five steps.

1. **Define the County's goals** in making a change.
2. **Define the options.**
3. **Discuss potential changes** with other agencies and narrow the options.
4. **Evaluate the impacts** of the remaining options.
5. **Define implementation steps.**

This issue paper attempts to carry out the first two of those steps: defining the goals and defining the options, with some narrowing of potential options. However, the options are discussed here at a conceptual level only. Narrowing them further will require discussion with other parties. In addition, before committing itself to a particular direction, the County will want a more careful evaluation of the impact of the changes and what implementation steps would be required. The final section of this issue paper is a discussion of those next steps.

### **Background about Mason County Utilities**

Mason County currently owns and operates a collection of water and sewer systems and solid waste facilities, all operated by the Department of Utilities and Waste Management. In addition, the County has created the legal framework for a stormwater utility, but there is not yet a financial structure to support it. The County's solid waste facilities include a landfill and four transfer stations. Following the divestiture of the Hartstene Pointe water and sewer systems in 2008, the remaining water and sewer systems are the following:

#### *Water Systems*

- ◆ Rustlewood Water System (130 connections)
- ◆ Beard's Cove Water System (405 connections)

#### *Sewer Systems*

- ◆ Rustlewood Sewer System (130 connections)
- ◆ North Bay/Case Inlet Sewer System (1,030 connections)
- ◆ Belfair Sewer System (under development)

There are also other areas along the Hood Canal and Puget Sound that are expected to require sewers in the future in order to protect the environment, with the most immediate need being the Hoodsport/Potlatch area.

As shown in Table 1, Mason County water and sewer utilities now serve about 8% of the unincorporated population. Even in the future, assuming that the entire population in the Belfair and Hoodsport ZIP codes is eventually served, customers of these systems will still represent only about 31% of the unincorporated population in the County.

**Table 1: Population of Areas Served by Mason County Utilities**

	Assumed # residents per connection:	2.5	
	Connections	Estimated Population	% of Unincorp. Population
<i>Existing Areas:</i>			
Rustlewood	130	325	
Beard's Cove	405	1,013	
North Bay/Case Inlet	1,030	2,575	
Total Existing Areas	1,565	3,913	8%
<i>Potential Future Areas:*</i>			
Belfair ZIP code		9,058	
Hoodsport ZIP code		2,016	
Total Existing and Future Areas		14,987	31%
Unincorporated Mason County		48,125	100%

*\* 2010 estimates from Small Area Estimate Program, Washington State Office of Financial Management*

**Why Consider Governance Changes?**

The water and sewer utilities face several challenges, many of them stemming from small size and inadequate capitalization. Current rates are too low for them to maintain long-term financial viability and regulatory compliance, and yet raising rates has been difficult due to the tight economic circumstances of the customer base. The utilities already benefit from shared maintenance and administrative staff, but they are financially and legally separate systems, with separate rates and regulations, and there is not a pool of combined financial resources would make it easier to cover fixed costs, keep up with regulatory demands, and address service expansion needs such as Belfair and Hoodsport.

For the County Commissioners, the water and sewer utilities have been mainly a source of bad news. Currently, they are not truly self-supporting, because the County has drawn on general capital funding sources (such as REET funds) to address capital needs. And because of the low-density development pattern in the County and the lack of a

commercial/industrial base outside of Shelton, there will never be great economies of scale in the utilities that serve unincorporated County residents—it takes a lot of miles of pipe to serve a few customers, and the major fixed cost of a treatment plant must be borne by a small customer base. As a result of these inherent economic disadvantages, even though the County has an amazingly successful track record in securing grant funding, and even though capital costs have been supplemented by general County resources, water and sewer rates still have to be much higher than residents expect to pay.

In addition to these frustrations with the water and sewer utilities, the solid waste function has also had challenges. There has been insufficient funding to improve facilities, continue a high level of recycling, and continue other waste reduction programs. Recently, the waste management utility has been unable to apply for some grants because of lack of funding for the required local match.

In a recent discussion between the Director of Utilities and the Board of County Commissioners, the Commissioners indicated a desire to explore divestiture or other major changes in the form of governance for the County's current group of utilities. This issue paper is in response to that request.

## 2. Goals

Our assumption is that the intent of the County Commissioners in exploring alternative forms of governance is to step back from—or get out of entirely—the business of running water and sewer utilities. The rationale for this change would be that the Commissioners are elected to make decisions about countywide public services, that there are certain “core functions” that are inherently part of a county government. According to this line of reasoning, water, sewer, and solid waste utilities are not among these core functions, and the County should not be involved unless no one else is willing to do so. At the very least, there should be more separation between the Commissioners and management decisions for a specific business that is supposed to be financially self-sufficient and serves a small subset of the County population. Of course, the County does not intend to simply abandon these utilities; instead, someone would need to accept responsibility for them, either an existing entity or one created specifically for that purpose.

In discussing potential changes to the governance of these utilities, we suggest the following goals:

1. The utilities should end up with economically viable service delivery, including sufficient financial capacity to be able to keep up with future regulatory upgrades and capital reinvestment requirements.
2. After the change, there should be more separation than at present between the County Commissioners and the management and financial decisions of the utilities. If possible, the utilities should be independent of the County.
3. The eventual ownership configuration of the utilities should include an explicit designation about who will be responsible for establishing new sewer utilities when they are needed in order to protect the natural environment.

### 3. Initial Analysis

#### Constraints

As the County considers potential changes to the utility management responsibility, it should be aware of the following constraints:

1. Some options might be attractive to the County but not achievable due to lack of a willing partner. This issue paper will describe certain options in general terms, but the key test will come after discussion with other public or private parties, when the County can see who might be interested.
2. In our judgment, virtually any transfer of responsibility for the Belfair service area is likely to be conditioned on the County's completing the system and connecting prospective customers, at least from Phases 1 and 2 and possibly beyond. In other words, even though the County is considering getting out of the utility business, there is no reason to slow down work on the Belfair system.
3. Another possible condition for a transfer of responsibility might be an initial rate increase to get the existing utilities to a sustainable level of rate revenue.
4. The State Department of Health (for water systems) and Department of Ecology (for sewer systems) will continue to have jurisdiction over these utilities. In order for a given transfer of responsibility to move forward, these two agencies might need to be satisfied that the change will not harm people or the environment.
5. The sewer systems will probably be more difficult to transfer than the two water systems and the solid waste facilities, just because there are fewer existing entities providing sewer service. There are private water companies in Washington who own multiple systems but, to the best of our knowledge, there are no multi-site private sewer companies. In addition, Mason County PUD #1 is already in the water business with multiple locations but not presently in the sewer business. There is also an active private sector in the solid waste business.

To see why sewer would be harder to transfer than water, contrast the characteristics of the two businesses. Water systems are typically created as property is developed. Sewer systems are often created after property is developed, and then in response to environmental mandates, not property owner demands. Sewer systems tend to have a higher proportion of fixed costs—a wastewater plant is typically a larger percentage of total sewer cost than supply and treatment facilities are as a share of total water cost. Sewer systems depend on gravity flow, so they often follow river basin boundaries more than jurisdictional boundaries. For all of these reasons, a sewer system is more likely to require a large governmental organization to initiate or coordinate the service—an organization more likely to be sensitive to environmental mandates, and more likely to have initial bonding capacity independent of sewer system revenues. So it is not a surprise that counties more often serve as a centralized provider of wastewater services than as a provider of water services.

## **Potential Partners**

In order to transfer a water or sewer system or solid waste facilities, either an existing entity needs to be willing to acquire it, or a new entity needs to be formed. Following are some existing entities who could conceivably acquire one or more of the utility systems or participate in a new intergovernmental partnership. We have not spoken with any of these organizations and have no information about their level of interest.

**City of Shelton** – The City currently provides both water and sewer service to City residents and to some non-residents. Until recently, the City used a rate multiplier of 1.5 times for non-resident customers. The City is not geographically proximate to any of the current County utility systems.

**Mason County Public Utilities District #1** – In addition to providing electricity service, Mason County PUD #1 is also in the water business. It owns and operates 33 separate water systems with about 1,700 customers throughout the County, including some systems close to Beard's Cove and Rustlewood. It maintains one community drainfield but otherwise is not in the sewer business.

**Mason County Public Utilities District #3** – Mason County PUD #3 currently provides electricity and cable service only. Although it has the same legal authority as other PUDs (which can include the provision of water and/or sewer service), PUD #3 does not have experience managing a water or sewer utility.

**Kitsap County Public Utilities District #1** – Like Mason County PUD #1, Kitsap County PUD #1 is in the water business but not the sewer business. It owns and operates 53 separate water systems. Two of those systems are near the County line, not very far from Beard's Cove but farther from Rustlewood. Kitsap PUD #1 could be a potential partner, particularly if a multi-jurisdictional entity were to be created that included water service.

**Kitsap County** – The Kitsap County Public Works Department currently operates sewage collection systems and four wastewater treatment plants. It could be another potential partner, particularly if a multi-jurisdictional entity were to be created that included sewer service.

**City of Bremerton** – Since the current Mason County water and sewer systems are all in the eastern part of the county, the City of Bremerton might also be considered a potential partner for acquisition of existing systems or participation in a joint authority.

**Investor-owned water companies** – While we are unaware of multi-site private sewer companies applicable to this type of situation, there are investor-owned water companies operating at multiple sites in Washington. A list of these utilities is on the web site of the Washington Utilities and Transportation Commission. For example, Washington Water Services Company serves about 16,000 customers across five counties, including Mason, Kitsap, and Thurston. H&R Waterworks serves about 3,700 customers in several small systems in Thurston County. Rainier View Water Company serves about 16,000 customers in four

counties, including Kitsap and Thurston. In addition, the Lakeland Village Water Company, which serves about 800 customers in Allyn, could be an interested party, given the relative proximity of the Rustlewood and Beard's Cove systems.

**Tribal governments** – There is a precedent for tribal utilities in the state—the Tulalip Tribe owns and operates a utility with both water and sewer system near Marysville, and the Squaxin Island Tribe just opened a wastewater treatment plant in the past two years, serving the Little Creek Casino and nearby properties. The Skokomish tribe does not have experience managing a water or sewer utility but does have an interest in the development of sewer service for Potlatch.

**West Sound Utility District** – The most likely candidate among the existing water/sewer districts in Mason and Kitsap counties is the West Sound Utility District No. 1, which was formed in 2007 by the merger of a water district and a sewer district. West Sound provides contract operation of wastewater treatment facilities at Alderbrook Resort and Washington State Parks within Mason County, and it operates a treatment facility jointly owned by the District and the City of Port Orchard, which maintains its own collection system.

**Other Water/Sewer Districts** – According to the Municipal Research and Services Center of Washington, the current Chapter 57 water/sewer districts in Mason County are:

- ◆ Belfair Water District No. 1
- ◆ Hartstene Pointe Water-Sewer District
- ◆ Maggie Lake Water District No. 3
- ◆ Tahuya River Valley Water District
- ◆ Trails End Water District No. 2

There are also eight water/sewer districts in Kitsap County besides West Sound.

**Private Solid Waste Management Companies** – There is an active private sector market for solid waste management services, including collection, transport, and disposal. Mason County Garbage Company is the primary collection and transport company in the county. In addition, there are regional companies in the South Puget Sound area such as Harold LeMay Enterprises, Inc. and American Disposal Company. There are also large national companies such as Waste Management Inc., Allied Waste Industries, and Waste Connections, Inc.

#### 4. General Strategies

Four general strategies can be pursued in changing the governance of the County utilities.

**Strategy A:** Break apart, transfer individual systems to someone else.

**Strategy B:** Keep systems together, change governance structure.

**Strategy C:** Keep systems together, merge with another entity.

**Strategy D:** Keep sewer systems together, transfer individual water systems and solid waste facilities to someone else.

*Strategy A* would consist of dealing with each utility system separately or perhaps in logical pairs (such as Rustlewood Water and Rustlewood Sewer.) For each individual water and sewer system, one possible outcome is for the County to help local residents create an independent RCW Chapter 57 district. Another outcome might be for another entity—a private investor-owned utility, PUD, or a municipal utility or tribal government—to acquire the assets and service responsibility. For the solid waste facilities, a potential outcome would be for a private company to purchase the facilities.

*Strategy B* would keep the existing group of systems together but change their form of governance. One way would be to create a Utilities Board with decision-making authority while implementing the 2007 system consolidation proposal without Hartstene Pointe. Another way to do this would be to form a Chapter 57 water and sewer district that would have a countywide area (except for areas already served by existing Chapter 57 districts or by PUD #1), with the current group of utilities but its own elected Board. A Chapter 57 district cannot include a solid waste utility. If the County creates a Utilities Board, it can choose to keep the solid waste facilities.

*Strategy C* would keep the systems together but merge with another entity, creating a new system that is larger overall than at present. One way to do this would be by merging all of the Mason County utilities with a Public Utility District or another entity such as West Sound Utility District. Another way would be by forming an intergovernmental partnership similar to the LOTT Wastewater Alliance, which serves (and is governed by) Lacey, Olympia, Tumwater, and Thurston County. Such a partnership could allow participation across county boundaries, and it could be responsible for water, sewer, and stormwater. A bill currently being considered by the Washington legislature would authorize the creation of a Joint Municipal Utility Services Authority; if enacted, it would simplify the process of defining and implementing an intergovernmental partnership for joint utility service. Depending on the organizational focus of the new, merged entity, the solid waste facilities could either stay with the water and sewer systems or be sold to a private firm.

*Strategy D* results from the fact that water systems and solid waste facilities are more marketable than sewer systems. The County could keep the sewer systems together and transfer the individual water systems and solid waste facilities to whichever entity—either public or private—offered the best terms to the County and to current customers. For the sewer systems, the County could either create a Utilities Board with decision-making authority, create a countywide sewer district, or help create a LOTT-style intergovernmental partnership specifically for wastewater management.

### **Impact of General Strategies**

These general strategies differ with respect to two key variables: the scale of the entities in which the current systems would end up, and the complexity of the change process. The relationship between the strategies and these variables is shown in Table 2.

**Table 2: Major Strategies for Changing Utility Governance in Mason County**

	<i>Eventual Scale</i>	<i>Complexity of Process</i>
<b>Strategy A:</b> Break apart, transfer individual systems to someone else	Varies; potentially smallest scale	Requires willing partners; individual negotiations for each system; change may involve creating several new entities.
<b>Strategy B:</b> Keep systems together, change governance structure	Countywide	High degree of control over change process; change may involve creating a new entity.
<b>Strategy C:</b> Keep systems together, merge with a larger entity.	Large service area	Requires willing partners; only one negotiation, but possibly a multi-party negotiation; may require creation of a new entity.
<b>Strategy D:</b> Keep sewer systems together, transfer water and solid waste utilities to someone else.	Varies for sewer, probably large for water/solid waste	Requires willing partners, but packaging is more tailored to probable interests; may require creation of a new entity.

**Scale** – In general, Strategy C leads toward the largest-scale outcomes, whereas Strategy A has the potential for the smallest-scale results. Strategy B falls in between. Strategy D would probably lead to large-scale outcomes for the water systems and solid waste facilities, but it varies for the sewer systems. If an intergovernmental partnership is created, the result would be large-scale for sewer; otherwise, it would leave a smaller entity than at present, because the water and solid facilities would not be able to share the cost of operations and administrative staffing.

In general, larger scale is a positive consideration in this situation, because for Mason County, one of the impediments to economic viability has been the inadequate capitalization of the individual systems. Note that larger scale is not always considered desirable by customers. It is possible—as we saw with Hartstene Pointe—that the attraction of local control can override the desire for economies of scale.

However, there is a tradeoff between local control and efficiency in service delivery, particularly in a capital-intensive business like a water or sewer utility. For example, it would be possible for the current Rustlewood systems to simply spin off and become their own small water and sewer district with 130 residential customers. However, such a scenario would require some determined local property owners and a willingness to absorb high fixed costs over a small customer base. From an economic standpoint, the odds of a successful divestiture are greatest if the Rustlewood area ends up as part of a larger entity—perhaps a PUD, or an investor-owned utility with several systems, or the



continuation of a countywide system under a different governance model. The same is true of the other individual systems.

**Complexity of Process** – The complexity of the change process is another key variable. The more complex the intended changes, the more staff time, consultant costs, and elapsed time would be required in order to make the change.

One factor that influences the complexity of the process is the number of negotiations with existing parties that would be required, because the larger the number of decision-makers who have to agree to a change, the greater the risk that a satisfactory agreement will not be reached. With Strategy A there could be as many as five different sets of negotiations over the transfer of responsibility, one for each utility system (counting Rustlewood water and sewer as separate systems). With Strategy A, there is also the risk that there might be takers for some but not all systems, leaving the County still in the utility business but with an even smaller portfolio. With Strategy C there would be a single set of negotiations, but it could be a complex multi-party negotiation if an intergovernmental partnership turns out to be a desirable option to pursue. Strategy B would probably be the simplest in terms of the number of parties involved and the County's control over the process. Strategy D would have 3 or 4 sets of negotiations (depending on whether there would be an effort to create an intergovernmental partnership for wastewater only). The number of negotiations has a bearing on the cost of the process, the time it would take, and the likelihood of a successful outcome.

In addition to the number of negotiations required, some of the options involve creating a new governmental entity, such as a new water & sewer district or an intergovernmental partnership. In general, forming a new governmental entity involves certain procedural requirements and legal costs that are not needed if the County only negotiates with existing entities. However, some existing entities might have procedural costs in order to expand their scope of services; for instance, a PUD might need voter approval in order to offer sewer service if it has not previously been in that business.

**Public vs. Private** – Another variable worth noting is whether each system ends up as part of a governmental entity or part of an investor-owned utility. Under Approach A, one or more of the individual systems might be acquired by an investor-owned utility. Because all of these systems have over 100 customers, all would be under the jurisdiction of the Washington Utilities and Transportation Commission (UTC) if they were acquired by private investors. The UTC regulates rates for water utilities but not sewer utilities. Strategies B and C are less likely to result in private ownership. For Strategy D, one or both water systems might end up as part of a UTC-regulated private utility. If the solid waste facilities were spun off, they would probably end up as part of a private company regulated by the UTC.

## 5. Specific Options for Consideration

Based on these general strategies, following are descriptions of some specific options that can be considered. They are not the only conceivable possibilities, but they are intended to represent a limited number of realistic outcomes.

**Option A1:** Individual Chapter 57 water and sewer districts are created for all areas, with Rustlewood being a combined water and sewer district and the other areas providing only water or sewer services. Solid waste facilities are sold to a private company.

**Option A2:** Individual Chapter 57 sewer districts are created for Rustlewood Sewer, North Bay/Case Inlet, and Belfair; Beard's Cove and Rustlewood Water are acquired by PUD #1. Solid waste facilities are sold to a private company.

**Option A3:** Individual Chapter 57 sewer districts are created for Rustlewood Sewer, North Bay/Case Inlet, Belfair; Beard's Cove and Rustlewood Water are acquired by private utilities. Solid waste facilities are sold to a private company.

**Option B1:** A County Utilities Board is appointed and given decision-making authority; the 2007 consolidation is implemented but without Hartstene Pointe. Solid waste facilities are retained.

**Option B2:** A Chapter 57 Water and Sewer District is created with a separately elected Board to manage all existing water and sewer utilities. The service area is countywide except for those areas managed by other providers. Solid waste facilities are sold to a private company.

**Option C1:** The water and sewer systems as a package are merged with Mason County PUD #1. This would require that PUD #1 be willing and authorized to provide sewer service. The solid waste facilities are sold to a private company.

**Option C2:** The water and sewer systems as a package are merged with West Sound Utility District. The solid waste facilities are sold to a private company.

**Option C3:** An intergovernmental partnership is created to provide water, sewer, stormwater, and maybe solid waste disposal. Potential partners might include cities, counties, and/or PUDs in Mason and Kitsap counties.

**Option D1:** A County Sewer Utility Board is appointed and given decision-making authority; the sewer systems are consolidated. The water systems are transferred to either Mason County PUD #1 or to private water companies, and the solid waste facilities are sold to a private company.

**Option D2:** A countywide Chapter 57 district is created, with a separately elected Board, to provide sewer service within the County boundaries except for Hartstene Pointe and City of Shelton service areas. Water systems are transferred to either Mason County PUD #1 or to private water companies; solid waste facilities are sold to a private company.

**Option D3:** An intergovernmental partnership is created to provide sewer service. Potential partners might include the City of Shelton, Kitsap County, City of Bremerton, and/or West Sound Utility District. Water systems are transferred to either Mason County PUD #1 or to private water companies; solid waste facilities are sold to a private company.

**Table 3: Analysis of Options**

Option	Description	Eventual Scale Water/Sewer	Complexity of Process		New Sewer Systems?	Storm- water?	OH Loss
			Negotiations?	New Entities?			
A1	Form individual water/sewer districts; solid waste to private.	Smaller	Yes (1)	Yes (5)	County	County	Yes
A2	Form individual sewer districts; water districts to PUD #1, solid waste to private.	Sewer smaller; water larger	Yes (3)	Yes (3)	County	County	Yes
A3	Form individual sewer districts; water districts and solid waste to private.	Sewer smaller; water larger	Yes (3)	Yes (3)	County	County	Yes
B1	Keep water/sewer together; consolidate; appoint Utilities Board; keep solid waste.	Same as now	No	No	County	County	No
B2	Form countywide water/sewer district; solid waste to private.	Same as now	Yes (1)	Yes (1)	New district	New district	Yes
C1	Keep water/sewer together; merge with PUD #1; solid waste to private.	Larger	Yes (2)	No	Maybe PUD	County	Yes
C2	Keep water/sewer together; merge with West Sound; solid waste to private.	Larger	Yes (2)	No	County	County	Yes
C3	Intergovernmental partnership for water, sewer, storm, solid waste.	Larger	Multi-party	Yes (1)	New entity	New entity	Yes
D1	Consolidate sewer, appoint Sewer Board; water & solid waste to private or PUD #1.	Sewer same; water larger	Yes (3)	No	County	County	Partial
D2	Form countywide sewer district; water & solid waste to private or PUD #1.	Sewer same; water larger	Yes	Yes (1)	New district	New district	Yes
D3	Intergovt. partnership for sewer; water & solid waste to private or PUD #1.	Larger	Multi-party plus 3 others	Yes (1)	New entity	New entity or County	Yes

## 6. Narrowing the List

### Evaluative Comments about the Options

1. If the County wants to get out of the utilities business, the key is to be able to transfer responsibility for the sewer systems, both present and future. A newly created entity can be defined to include sewer service. PUD #1 might be willing to expand its scope if the sewer systems are packaged with the water systems. Private water companies probably would not be willing to do that.
2. If the County divests itself of water systems and solid waste facilities but cannot successfully transfer the sewer systems, it loses the economies of scale that already exist in the operating and administrative staffing. That could leave the County worse off economically than at present. For that reason, if the County decides to pursue an intergovernmental partnership for sewer service, it should not divest of the water systems and solid waste facilities until it is clear whether the new entity will in fact be formed. If interested buyers are allowed to “cherry pick” the water systems and solid waste facilities before the disposition of the sewer systems is known, then if it turns out that a larger-scale entity for sewer service is not achievable, the County could end up still in the utilities business but with an even smaller customer base than at present.
3. None of these options substitute for rate increases that are needed in the short term, regardless of whether an area goes to with a private water company or a PUD or an intergovernmental partnership. Through an improved governance approach, it is possible to improve viability and reduce rate volatility over the long term, but it does not avoid short-term pain.
4. City of Shelton, PUD #3, and the tribes are long shots, as are most of the entities in Kitsap County. It is worth asking the question, but the Mason County systems are far enough away from their current areas of focus—either geographically or functionally or both—that the odds are not high that they will be interested.
5. Options A1, A2, and A3 all leave very small service areas with even worse economic viability than at present. Those options might get the County out of the water and sewer business, but in our judgment, they would not serve the residents of those areas very well over the long run.
6. Option B1 is the equivalent of a default or “no go” option. It provides more autonomy for the utilities but does not get the County completely out of the business. It makes incremental improvements to utility governance with the least amount of cost, and its implementation steps are under the County’s control.
7. Note that in all the options except B1, the County would lose some or all of the overhead revenue it now receives from County-owned utilities. The workload of the central service departments (such as the Auditor’s Office, Treasurer’s Office, or Board of Commissioners) would be reduced, but the revenue to support those offices would also be reduced.

8. Note also that Mason County PUD #1 does not have integrated rates at present. Each of its water areas has separate rates, similar to Mason County's current approach. So simply merging the two does not by itself address the capitalization issue, whereby the customers of individual areas are exposed to the risk of major rate upheavals from even moderate levels of capital reinvestment.
9. Discussions with Kitsap County local governments and the City of Shelton about an intergovernmental partnership could refer to the "Joint Municipal Utility Services Act," a bill that is currently being considered by the State legislature. That act draws on the combined experience of LOTT, the Cascade Water Alliance, and other partnerships across the state to create a useful road map for how an intergovernmental utility partnership could be structured. The response in legislative committees has been positive so far, and we believe the prospects for its adoption are good, either this year or in a future legislative session. (This Act addresses water, wastewater and stormwater services but not solid waste disposal. So if solid waste disposal is included in a partnership, it would have to be done under a separate agreement based on the Interlocal Cooperation Act.)

### **Recommended Top Six Options**

Because of the large number of potential options, we are suggesting that the list be narrowed in order to help the County determine its preferred approach. Of the eleven options presented above, we consider the following six to have the most positive outcomes for both the County and the customers. If any other potential partners (such as the City of Shelton) respond positively to initial inquiries, this list can be modified to add them. It is likely that the initial inquiries will also result in some options being dropped from this list, so that further evaluation of options can focus on those that are most realistic.

**Option B1** – Consolidate water and sewer; create an appointed County Utilities Board; keep solid waste facilities.

**Option B2** – Create a new countywide water and sewer district with countywide scope; sell solid waste facilities.

**Option C1** – Merge water and sewer systems with PUD #1; sell solid waste facilities.

**Option C2** – Merge water and sewer systems with West Sound Utility District; sell solid waste facilities.

**Option C3** – Work to create an intergovernmental partnership for water, sewer, stormwater, perhaps solid waste disposal.

**Option D3** – Work to create an intergovernmental partnership for sewer service only. If a partnership turns out to be successful, then transfer water systems to PUD #1, West Sound, or private parties, and transfer solid waste facilities to private parties.

Options C1 and C2 are similar in effect; both would transfer the water and sewer systems as a package to someone else. Of course, we do not know who the “someone else” might actually be until we talk to other agencies—Mason County PUD #1 and West Sound are just assumptions at this point. The same is true for all the other options except B1—they all require that someone else be interested.

We do not recommend further consideration of Options A1, A2, A3, D1, or D2. In our judgment, Options A1, A2, and A3 would do a disservice to residents by leaving them with such small systems that they would have to have very high rates in order to be financially viable over the long-term. Options D1 and D2 are the “cherry picking” scenarios; they would leave the sewer systems worse off than they are now, because the sewer systems would not be able to share operations and administrative staffing costs with water systems and solid waste facilities.

### **Relationship to Other County Initiatives**

- ◆ **Belfair Sewer** – The Belfair Sewer project should continue full speed ahead, regardless of this governance discussion. Any entity who might accept the Belfair system would probably require that it be a “going concern” self-sustaining utility before taking it on—at least through Phases 1 and 2 and possibly beyond.
- ◆ **County Coordinated Water System Plan** – This plan is also separate from the governance re-structuring effort and need not wait until the final disposition of the current County-owned utilities is known. The CCWS plan is needed in order to coordinate among all the water providers in the county, not just the two water systems owned by the County itself. Even if the two County-owned water systems were to be transferred to someone else, they would still be included in the scope of this study. This study does illustrate one disadvantage of divesting; the County-owned utilities provide a source of funding for utility-related initiatives that fulfill a countywide planning function. With divestiture, that funding would be lost.
- ◆ **Stormwater Utility** – Development of a County stormwater utility is still relevant for the County. Even though the environmental concerns are the same, stormwater involves a separate set of regulatory tools and funding mechanisms to address those concerns. If a new integrated entity is created under strategies B, C, or D, the scope of responsibility can be defined to include stormwater. But until someone else takes it, stormwater management is still the County’s responsibility.
- ◆ **Development of Future Sewer Systems** – Because of the County’s interest in the health of the Hood Canal and South Puget Sound, it will probably continue to play a role in the development of future sewer systems unless another countywide entity accepts that responsibility. The best opportunity to transfer that responsibility is the creation of a new entity, such as an intergovernmental partnership or a countywide water and sewer district. Generally, existing entities would probably not be willing to accept that responsibility as part of acquiring an existing sewer system. A possible exception might be if Mason County PUD #1 were willing to do an across-the-board merger, getting into the sewer business and accepting the County’s sewer systems as well as its water systems.

## 7. Next Steps

If the Board wants to continue pursuing divestiture, discussion is needed with other agencies and the public, and further analysis is needed. We suggest that the decision-making proceed in two stages. The first stage is to receive input from other agencies and the public and then narrow the possibilities to a preferred option and up to two alternate options. The second stage is to evaluate the impact, conduct negotiations if applicable, and prepare an implementation plan for the remaining options.

### Stage 1 – Development of Preferred and Alternate Options

1. Develop Board/management strategy. Before discussing the possibilities with other agencies, the County needs to have agreement on what would constitute a favorable outcome and what its approach should be. The intent of this issue paper is to help develop that strategy, by surveying the landscape based on what we now know and suggesting some possible directions. Further internal discussion might be needed in order to reach agreement about what the County wants to achieve.
2. Conduct a multi-agency planning/scoping workshop, to explain the background, share information about organizational goals and scope of responsibility, and see if there is preliminary interest on the part of those who choose to attend.
3. Conduct one-on-one meetings with potential partners to ascertain their interest in:
  - a. Development of an intergovernmental partnership
    - i. For all utilities
    - ii. For sewer only
  - b. Acquisition of existing County utility systems
    - i. Any single system
    - ii. A package of water and sewer systems

Because dealing first with sewer systems is important for the County's ability to achieve divestiture, no offers should be made at this stage, just an assessment of interest. Private water and solid waste companies need not be contacted at this stage, because they are less likely to be willing to acquire sewer systems.

4. Conduct one or more public meetings to ascertain the goals of current customers. What kind of interest would there be in forming a countywide water and sewer district with a separately elected Board of Directors? We could also explain the basic tradeoff between economies of scale and local control and then ask their preferences about the scale of their utility provider. In this issue paper, we have been assuming that a very small-scale outcome would not be favorable for them, but maybe they would see it differently. Would they be willing to pay higher rates in order to have a smaller, more neighborhood-oriented water/sewer district?
5. Summarize the possible outcomes following the input from the public and other agencies. Update the list of potential options and the County's goals; prepare an action plan for evaluating the remaining options and negotiating agreements.

6. The Board should then select a Preferred and up to two Alternate options to be the subject of an impact evaluation, negotiations, and implementation planning.

For the first stage, consultant support would be primarily provided by FCS Group, with additional assistance from a public facilitator for the public meetings.

**Stage 2 – Evaluation, Negotiation, and Implementation Planning**

The Stage 2 tasks would be done for the Preferred and Alternate options if applicable. Not all steps apply to all options. The parentheses indicate which consulting firm would be best qualified to perform a particular task. We are assuming Murray, Smith & Associates (MSA) for engineering tasks, Inslee Best Doezie & Ryder (IB) for legal analysis, and FCS GROUP (FCS) for financial and management analysis.

Stage 2 Tasks and Applicable Options	B1	B2	C1	C2	C3	D3
7. Define capital assets to be transferred. Determine age, expected useful life, and reproduction cost of infrastructure for each system to be transferred. Identify intangible assets such as water rights, discharge permits, & planning documents. (MSA)		X	X	X	X	X
8. Determine fund balances, outstanding debt, cash and investments, revenues and expenses applicable to each system to be transferred. (FCS)	X	X	X	X	X	X
9. Determine fair value for each system to be transferred, including market and income analyses and asset value net of depreciation. (FCS)		X	X	X	X	X
10. Define procedural requirements for forming new entities and constraints on their authority. (IB)		X			X	X
11. Update 2007 consolidation analysis without Hartstene Pointe to create a baseline scenario. (FCS)	X	X	X	X	X	X
12. Develop forecast showing impact of governance change on rates, outstanding debt, and financial reserves compared with baseline scenario. (FCS)		X	X	X	X	X
13. Estimate impact on County overhead revenue. (FCS)		X	X	X	X	X
14. Support negotiations by evaluating the cost of alternative negotiating positions and impact on existing County customers. (FCS)			X	X	X	X
15. Identify organizational implementation steps that may be needed as part of governance change, including adjustments to salaries, benefits, leave policies, customer databases, rate design, engineering standards, retirement obligations, IT systems, risk management policies, operating & maintenance practices. (FCS)		X	X	X	X	X