

Inter-local Water Partnerships in Surry County, North Carolina

A report to the local governments of Dobson, Elkin, Mount Airy, Pilot Mountain and Surry County from the School of Government.

Funded by the Golden Leaf Foundation

January, 2010

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Table of Contents

- Introduction 3
- Background 4
 - Supply and Demand 4
 - Age and Condition of Infrastructure 8
 - Average Cost of Production 10
 - Rates..... 11
 - Rate Sufficiency..... 13
 - Debt..... 14
- Partnership Principles 17
- Options for Increasing and Strengthening Water Service Partnerships 19
 - Bulk Services Sales/Purchase Agreements 20
 - Operations and Maintenance Agreements..... 21
 - Shared Ownership of Assets 21
 - Municipal Owned Utility Providing Service to Customers in Other Jurisdictions..... 22
 - Water/Sewer Authorities..... 22
 - County-wide “Regional” Utility 24
 - Other Options 25
- An Analysis of Existing Water Agreements 28
- Moving Forward..... 29
 - Advisory Committee Purpose 29
 - Composition 29
 - Meetings 29
 - Communication..... 30
 - Technical Support 30
 - Governance 30

Introduction

Drinking water provision is an essential, but expensive and capital intensive service. This service is provided by a mix of local government units including cities, counties, authorities, and districts, as well as non-profit corporations and investor-owned utilities. Inter-local partnerships offer a valuable tool to help local governments capture efficiencies in economies of scale, while offering more leverage to finance infrastructure investments. Partnerships also enhance the ability of local governments to provide high quality services because they expand the technical and managerial capacity within a single system. Finally, partnerships promote financial sustainability for a utility because a larger customer base means more stable and sustainable customer demand and revenues.

The local governments of Dobson, Elkin, Mount Airy and Pilot Mountain, North Carolina all have independent water production and distribution facilities and they each face their own finance and management challenges. One universal challenge is the surplus of production capacity relative to demand. Surry County, on the other hand, has no water production facilities, but does have water distribution assets and some water customers as well as an interest in expanding services to other unincorporated areas often in close proximity to one of the four cities. All of these local governments have the potential to benefit from inter-local partnerships for water service provision.

This report documents the findings and recommendations of an effort, funded by the Golden Leaf Foundation, to promote inter-local partnerships primarily in Surry County and, by example, throughout North Carolina. Over the course of the project, team members from the School of Government at the University of North Carolina at Chapel Hill conducted interviews on the history of partnerships and water services in Surry County, developed detailed financial and customer base profiles of each water system, worked with a special water partnership task force to study key partnership issues, assisted in the development of financial models to promote partnership initiatives and conducted public information sessions. Major findings from each of these efforts are summarized in this report.

The team also hosted a series of inter-local meetings, organized as the Water Partnership Working Group (WPWG), comprising elected officials and city and county staff interested in water issues, with the intention of facilitating the formation of new partnerships. Over the course of the project, the WPWG explored different partnership models available in North Carolina. This report describes three models which may benefit the communities of Surry County the most. The WPWG also developed a set of partnership principles anticipating and preempting potential challenges to new partnerships on issues ranging from the extension of lines and expansion of service areas to rate and fee setting practices. This report also contains a summary of the partnership principles and their ramifications. The principles are general enough such that they address issues in Surry County as well as other communities throughout the State. Finally, the report contains recommendations on 1) enhancing existing agreements throughout the County, 2) partnership models which merit further investigation, and 3) the mission, structure and scope of the WPWG.

Background

This section contains an analysis of the financial and strategic management profiles of each of the five major water and sewer systems in Surry County. The profiles provide a snapshot of performance metrics which are vital for consideration in key partnership questions. Note that, with the exception of the water supply and demand data and the water rate data, all other data refers to combined water and sewer enterprises. Data should be interpreted with caution given that some utilities will have the same number of sewer customers as they have water customers while others may have mostly water customers and only a few sewer customers.

Supply and Demand

Each of the four major cities in Surry County: Dobson, Elkin, Mount Airy and Pilot Mountain own and operate their own drinking water production and distribution facilities. Much of the infrastructure was installed in a time when manufacturing comprised a larger portion of the economy. The subsequent loss of jobs and factory closings resulted in surplus production capacity, relative to demand, in each community. Surplus capacity places an excessive financial burden on remaining customers. This is particularly true in Pilot Mountain where new debt, incurred just prior to the loss of major water customers, must be serviced by the remaining service population.

The demand and supply balance is given in Table 1. Demand most closely matches supply in Dobson, and peak demands most closely match supply in Dobson and Pilot Mountain. Surry County has no production facilities, but maintains or is developing six service contracts with the town of Mount Airy (2 agreements), Dobson (2) and Elkin (2) to provide treated water, maintenance and billing services, variously, to citizens in unincorporated parts of the County.

Table 1: Supply and Demand in Surry County

Community	Permitted Capacity (MGD)	Average Demand (MGD (% of total))	Peak Demand (MGD (% of total))
Dobson	1.5	0.92 (61%)	1.11 (74%)
Elkin	3.0	0.80 (27%)	1.30 (43%)
Mount Airy	8.5	1.94 (23%)	3.40 (40%)
Pilot Mountain	1.6	0.59 (37%)	1.22 (76%)

The financial burdens which result from excessive supply will severely restrict the ability of independent water systems to maintain their assets and make investments for capital projects. Pilot Mountain staff, for example, report that because there are too few customers to service existing debt, water enterprise debt is currently subsidized by the general fund. Consequently, Pilot Mountain has financial pressure to defer priority capital projects both within the water system and within the general fund.

Finding New Customers in Rural Surry County

Excessive supply, however, is not necessarily a liability if other customers can be found. To the extent that services can be extended from the Towns into unincorporated parts of the County, County residents will benefit from safe and reliable drinking water supplies and the Towns will benefit from larger demand and a more stable revenue base for operation of their water systems. The County has

expressed an interest in having services extended to its unserved residents. Rather than building their own system at a great expense, however, the County recognizes that it is much more cost effective to connect with existing municipal systems. Not only would they avoid building redundant treatment facilities, the Towns already have organizational staff to manage the services. For these reasons the County views the Towns’ water systems as a “resource that must be protected” for all County residents, in the words of County Water and Sewer Manager Jack Gardin.

The data in Table 2 suggest that the potential market for water services will continue to strengthen in unincorporated Surry County. Despite the recent downturn in the housing market, Surry County is expected to grow steadily through 2013. This growth will continue to add new potential customers. Note that the growth is proportionally largest in unincorporated parts of the County. Between 2008 and 2013, the expected growth rate is 1.8% per year across all municipalities and 3.8% per year in unincorporated areas. Municipal water producers interested in finding new customers in Surry County have good reason to looking outside their borders for new customers.

Table 2: Projected Growth in Housing Units in Surry County through 2013¹

	Total Housing Units			Percent Change		
	2000	2008	2013	2000 to 2008	2008 to 2013	2000 to 2013
Dobson	594	623	640	4.9%	2.7%	7.7%
Elkin	1,854	1,874	1,897	1.1%	1.2%	2.3%
Mount Airy	4,129	4,162	4,225	0.8%	1.5%	2.3%
Pilot Mountain	644	697	726	8.2%	4.2%	12.7%
Municipal Total	7,221	7,356	7,488	1.9%	1.8%	3.7%
Surry County	31,033	32,911	34,019	6.1%	3.4%	9.6%
Municipal Total	7,221	7,356	7,488	1.9%	1.8%	3.7%
Unincorporated (Difference)	23,812	25,555	26,531	7.3%	3.8%	11.4%

Extending services from the Towns to rural customers requires that they reside near the municipal distribution systems to be cost effective. The next two maps show where growth has been occurring in Surry County. The first map shows the number of new housing parcels per square mile per year over a three year period from 2005 to 2008; darker tracts indicate faster development of new parcels per year.

While some tracts within municipal limits are darker, most dark tracts are found outside municipal limits indicating that faster growth is occurring in unincorporated areas. Many of the fastest growing tracts are near municipal limits or lie along corridors between the municipalities suggesting prime opportunities for expanding the municipal service customer base either by independent municipal action or in partnership with other towns or the County.

¹ Northwest Piedmont COG http://www.nwpcog.org/Data/PDFs/Surry/Surry_Housing.pdf

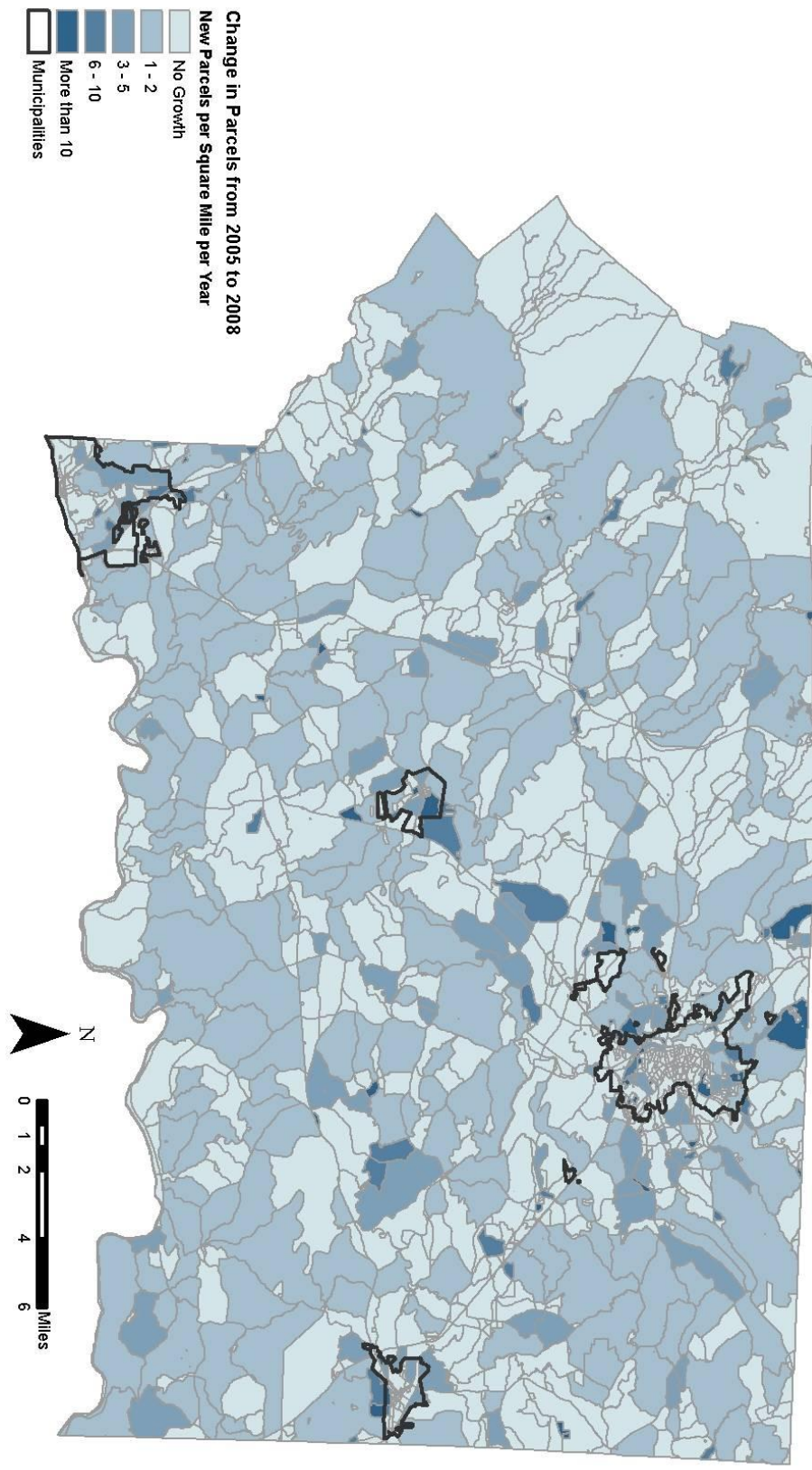


Figure 1 Change in Parcels per Year per Census Tract in Surry County, 2005 to 2008

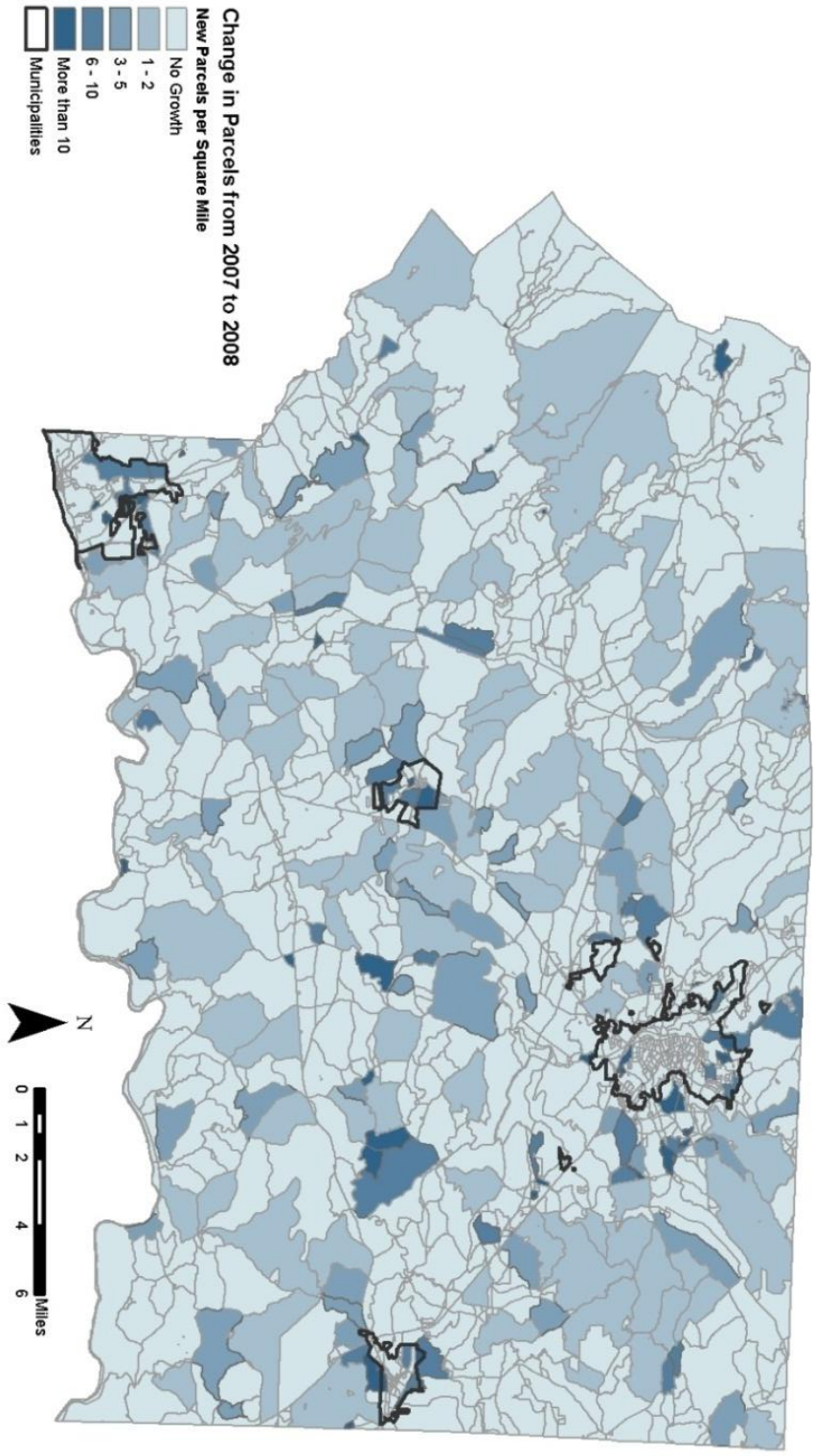


Figure 2 Change in Parcels per Year per Census Tract in Surry County, 2007 to 2008

The second map shows the same data, but over a one year period, thereby compressing the analysis to a more recent time frame. As expected given the recent downturn in the housing market, most tracts are lighter across the map. Several tracts in unincorporated areas, however, show consistently strong growth. Even in a bad economy, growth continues in rural Surry County.

There are multiple advantages to municipal-county partnerships for extending services to rural customers. Chief among these are 1) the large debt leveraging capacity of the County that can be utilized to extend lines from municipal systems which, as discussed elsewhere, is vital given that many municipal systems' growth are constrained by pre-existing debt 2) the power of the County to make assessments against benefitted rural properties to help cover costs and 3) the power of the County to incentivize or even require connections to new service lines thereby guaranteeing the customer base needed to make such projects financially feasible. While some of these options may be difficult to implement, each has the potential to promote the development of efficient and reliable water services throughout the County. The cost of each option should be weighed against the benefits of service provision on a case-by-case basis.

Reducing Redundant Production Facilities

Another solution to the problem of excessive supply is to reduce redundant production capacity. Under a scenario relying heavily on local government partnerships, two or more municipal systems would interconnect so that one system could decommission their treatment facilities and rely on the treatment capacity of the other system. For a system that has older facilities and a large, looming capital replacement budget, investing in a new connection rather than refurbishing their existing system might make more financial sense, particularly if the cost of the interconnection were shared by the future provider. This sort of partnership could be arranged as part of an inter-local agreement involving bulk purchase, capital transfer, and cost sharing. It could also be arranged through the formation of a new water entity such as a water authority which would own multiple production and distribution facilities and could make independent decisions about which facilities to keep in operation.

It stands to reason that the decision about which production facilities to decommission should depend on the relative age and condition of the infrastructure, production capacity, and cost of production. A comprehensive analysis of all of the comparative metrics is beyond the scope of this project and should involve careful engineering evaluation. However a rough, first-cut analysis of operating costs, age and condition of infrastructure, rates and other finance benchmarks are presented in the remainder of this section.

Age and Condition of Infrastructure

Figure 3 shows the average age of water infrastructure according to an analysis of AFIR data reported to the Local Government Commission in 2009. The average age is determined from annual depreciation and accumulated depreciation of capital assets. All systems have roughly the same average age according to this analysis. Dobson has slightly older infrastructure and Mount Airy has slightly newer infrastructure than their peers.

Average Age of Assets (Years)

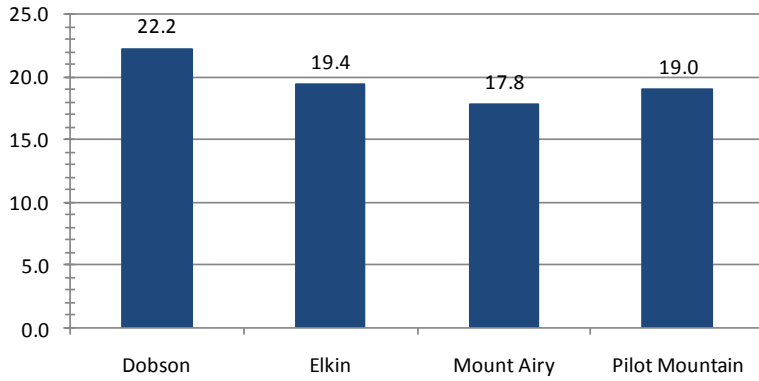


Figure 3 Average Age of Water and Sewer Infrastructure Assets in Years in 2009

A measure of asset condition can be calculated from accumulated depreciation and net assets by dividing accumulated depreciation by the sum of assets and accumulated depreciation. Thus, higher values result from more accumulated depreciation and therefore signal poorer condition. Figure 4 shows that measure for each community. By this measure, the condition of assets in Dobson and Mount Airy is slightly better than the condition in Elkin and Pilot Mountain.

Infrastructure Condition

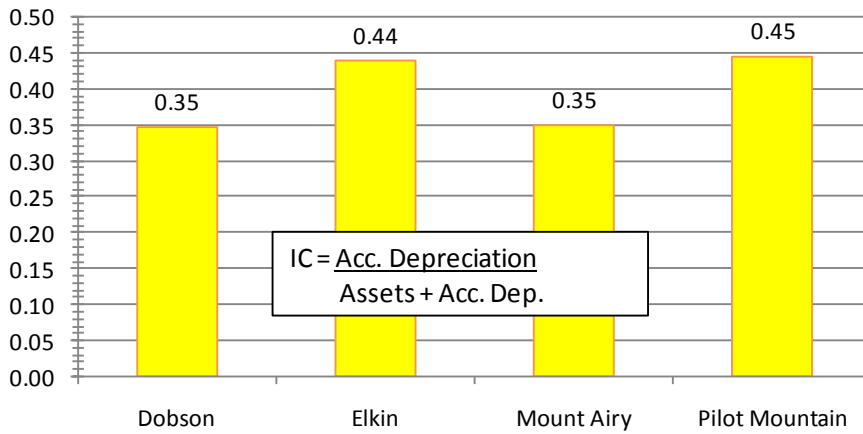


Figure 4 Water and Sewer Infrastructure Condition in 2009

One reason that the infrastructure condition in Dobson is slightly better despite having older assets could be related to grants that Dobson received, augmenting their net assets. If Dobson received infrastructure grants, their assets would increase (thereby improving their asset condition rating) without causing an increase in their accumulated depreciation.

Average Cost of Production

One way to benchmark the efficiency of water and wastewater systems is to calculate the average cost of water production and wastewater treatment. A thorough investigation of average costs is much more involved than the following simplified analysis which divides annual operating expenses by average annual water production and wastewater treatment and yields a dollar amount per thousand gallons produced.

When depreciation expense is included, Dobson has the lowest per unit cost of production and Mount Airy has the highest. When depreciation is excluded from expenses, Dobson and Pilot Mountain have the lowest per unit cost of production and the difference between the lowest and the highest costs is significantly reduced. Interestingly, the two systems with the highest per unit costs also have the most surplus treatment capacity. A surplus will drive up average treatment costs. Note, however, that water and sewer costs are combined and so this interpretation should be taken with caution.

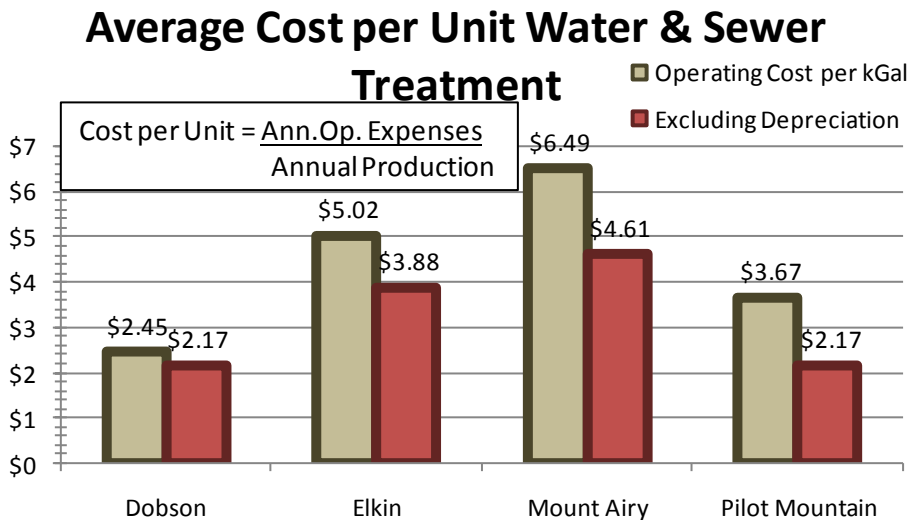


Figure 5 Average Cost of Water Production and Wastewater Treatment

These numbers should be interpreted with caution. Not all systems are investing in their infrastructure to the same extent. A system not investing in its infrastructure may have lower operating expenses, but this should not be interpreted as a sign of good management. Another caveat of this analysis is that expenses reflect the amount of money spent on water production and wastewater treatment, not necessarily the full cost of operations

Another measure of operating efficiency is the cost to provide services per capita in the service population. Figure 6 shows the water and sewer operating expenses per capita in each jurisdiction. The lowest per capita costs are in Elkin and the highest can be found in Dobson. As with the average cost of treatment in Figure 5, these numbers reflect expenses, and not necessarily the true cost of production. An under-invested system will have artificially deflated expenses on paper.

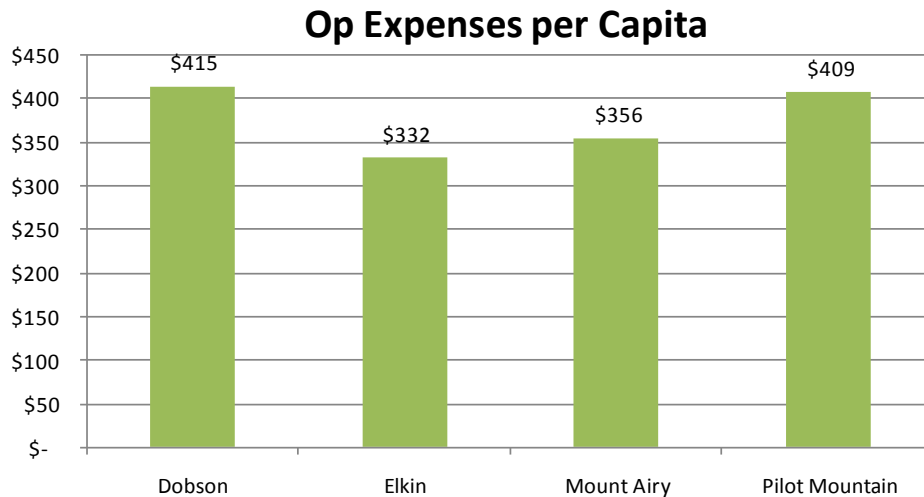


Figure 6 Operating Expenses per Capita in 2009

Rates

When considering partnership options, utilities should consider their rate and fee schedule and that of their potential partners. Utility rates are of vital importance to the financial health of the utility and, though they are only an indirect measure, they are often viewed by rate payers as a measure of finance and management performance. More importantly, from a public relations standpoint, user rates are one of the most visible elements of change when new partnerships are formed. New partnerships may not be successful if one partner's rates must be raised by significantly more than another partner's rates.

In a successful partnership formation, existing customers should perceive little variation (or at least minor improvements) in the quantity or quality of services they receive, but changes in the bill are highly perceivable. Ideally, rates will decrease as a result of new economies of scale in new partnerships, but this in reality savings usually occur as avoided costs rather than outright savings. In other words, customers may actually pay more after the formation of a partnership, but it is still less than they would have paid if the partnership did not occur. Unfortunately, avoided costs are much harder to "celebrate" than outright price reductions. Even if rates must be raised to cover costs associated with partnership formation, over the long term rate hikes will be smaller. An analysis by the newly formed Yadkin Valley Sewer Authority provides a useful case study: in summary, long-term rates are lower for the Authority than they would have been under the three individual systems of Elkin, Jonesville and Ronda. Importantly, though some of the systems' rates benefit more than others (held down to a greater extent), all systems benefit to some extent and total benefit was used to justify the new partnership. Success was the result of focusing on mutual benefits over individual benefits.

Whatever the rate impacts of a new partnership, it is vital to know how rates compare with other systems' and where they are starting out. Figure 7 shows residential rates for each of the four cities plus Surry County (in the Bannertown District, compared with other outside city rates) as compared with each other and with rates for public systems across North Carolina.

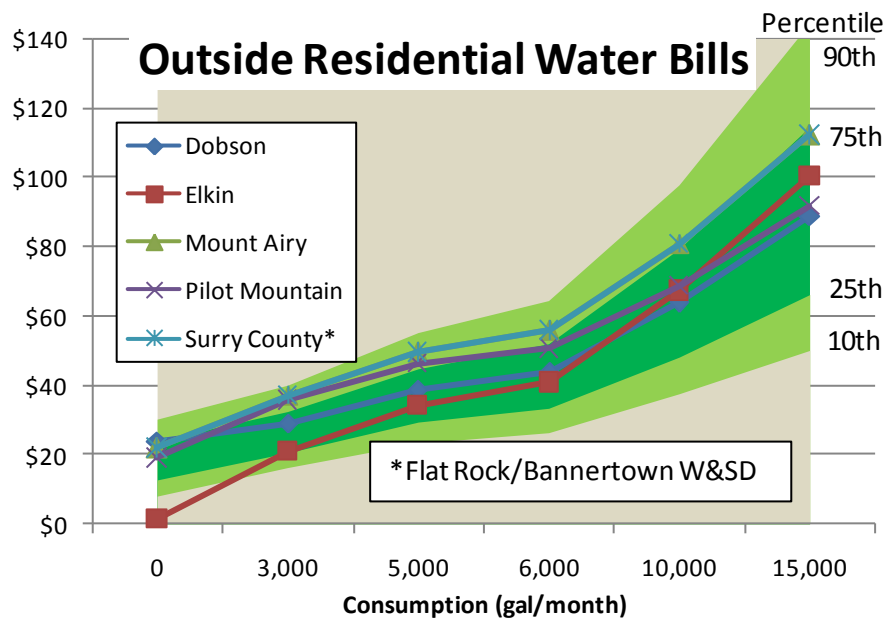
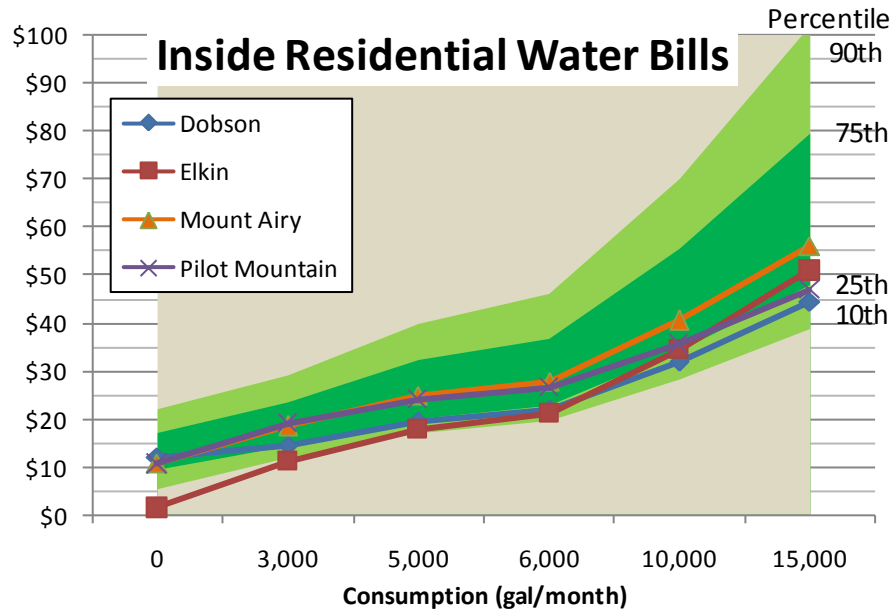


Figure 7 Residential Water and Sewer Rates in Surry County and across North Carolina in 2009-10

Generally, both inside and outside city rates are right in line with what other communities charge their residents. Inside city rates are slightly lower than average, especially for Elkin at low consumption amounts because Elkin has an unusually low minimum charge. Outside city rates, on the other hand, are slightly higher than other communities with the exception of Elkin and Dobson and Mount Airy for large consumption amounts. The difference between how inside rates and outside rates compare with State averages reflects the fact that communities in Surry County charge a slightly higher multiplier for “outside” rates than is found in other parts of the State. Whereas all Surry County communities charge nearly 200% more for customers outside the city, the statewide average multiplier is roughly 177%.

High rates are not a sign of bad utility management. Often, utilities with higher rates than their neighbors will be criticized for inefficient operations by ratepayers when, in reality, most other systems are underfunded. Given that roughly one-quarter to one-half of public water systems in North Carolina have insufficient revenues to pay for operations² many utilities should strive for higher rates than their peers. Nevertheless, there are good reasons, such as the affordability of services for low income customers, for keeping rates down. Affordability of services will inevitably conflict with the need to adequately fund operations. Because partnerships can make services more efficient and cost effective, they can simultaneously address both affordability challenges and the need for adequate funding, thereby reducing the conflict.

Figure 8 gives a measure of the affordability of water services in each community. This metric depends on both income levels and water rates. While there is no general standard for the affordability threshold, the numbers here, which are all below 2.0%, do not raise any red flags. The affordability indicator shows that services are least affordable in the Flat Rock/ Bannertown district of rural Surry County.

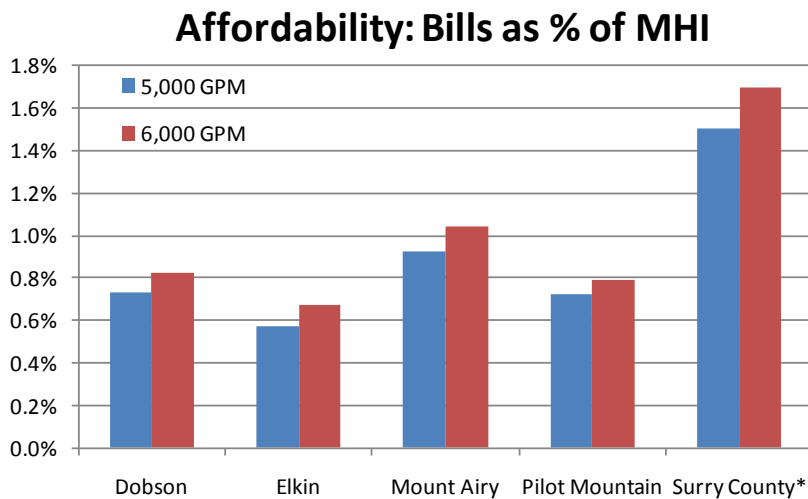


Figure 8 Affordability of Residential Water Service in 2009 Measured as % of 2000 Median Household Income

Rate Sufficiency

Customers often compare rates among systems as a benchmark of efficiency and performance thus decision makers are subjected to political pressure to keep rates relatively low. Whether rates are sufficiently high to cover operating cost, however, is much more important for enterprise sustainability. Full cost pricing for services is an ideal basis for rate setting, yet many systems have revenue streams that are insufficient to cover all of their costs.

The operating ratio (OR), the ratio of operating revenues to operating expenses, is a widely recognized measure of revenue sufficiency. If a system operates at “break even”, the OR is equal to 1.0. A fully funded system will have an OR greater than 1.0 since revenues are needed to cover future costs (like

² Environmental Finance Center analysis of Local Government Commission data
http://www.efc.unc.edu/publications/pdfs/Full_Cost_Pricing.pdf

future capital investments) as well as current expenses. In some cases, especially for older systems with deferred maintenance, the operating ratio should be 1.2 or higher.

Figure 9 gives the OR for all systems (including Surry County) in 2009. By this measure, only Mount Airy has sufficient revenues. All of the other systems are operating at break even or at a significant loss. Successful partnerships depend on the financial sustainability of the partners. If one partner charges too little to maintain their infrastructure, both partners can suffer from degraded infrastructure quality. Furthermore, although partnerships can hold down costs over the long term, new partnerships will be less politically palatable if they require a system which has been historically under-funded to raise rates by a large degree. Therefore, new partnerships are much easier to form if all systems are charging the full cost for services.

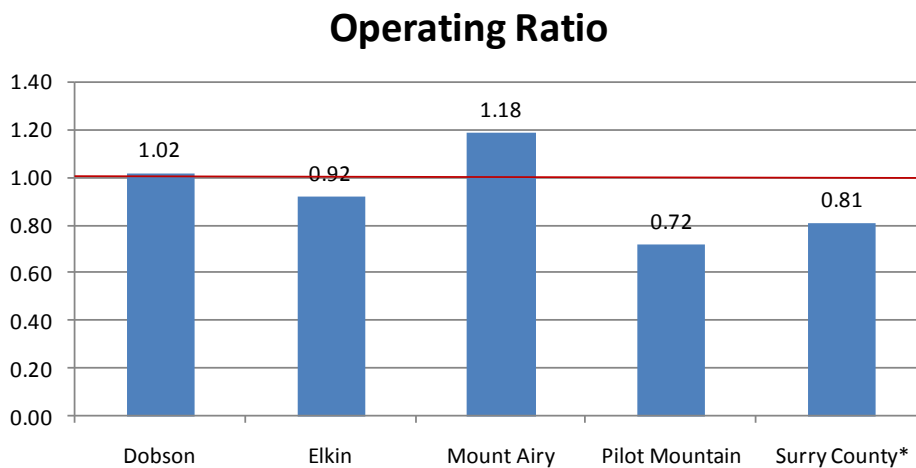


Figure 9 Operating ratios for Water and Sewer Enterprises in 2009

Debt

Debt is one of the single most important factors constraining utility operations and the formation of new partnerships. Systems entering into a partnership should consider their partner's existing debt load and debt carrying capacity as these will determine financial sustainability and whether partners can contribute to infrastructure financing.

Figure 10 shows the debt service coverage (DSC) ratio which measures the ability of systems to cover their existing debt service requirements. There are many opinions about what constitutes a sufficiently high DSC ratio. Sometimes this number is set out in bond covenants to ensure that the system can make their bond payments. At a minimum the DSC ratio should be 1.00, but in most cases the system should have a DSC of 1.25 or greater. By this measure, only Mount Airy has sufficient debt coverage. Other utilities will need to raise rates to cover their existing debt and are highly constrained in their ability finance additional capital projects.

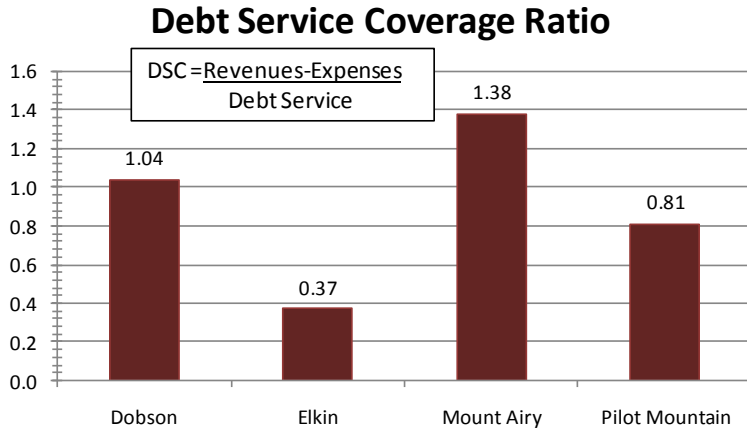


Figure 10 Debt Service Coverage Ratios for Water and Sewer Enterprises in 2009

Figure 11 measures the extent to which existing assets are being leveraged for debt. Systems with a lower debt ratio have lower debt relative to their existing assets and, typically greater capacity for new debt. A low debt ratio does not necessarily indicate that a system has greater capacity for new debt, however. For example, Pilot Mountain has the lowest debt ratio but, as seen in Figure 10, they also have insufficient DSC to take on new debt. Revenues should be raised prior to acquiring new debt.

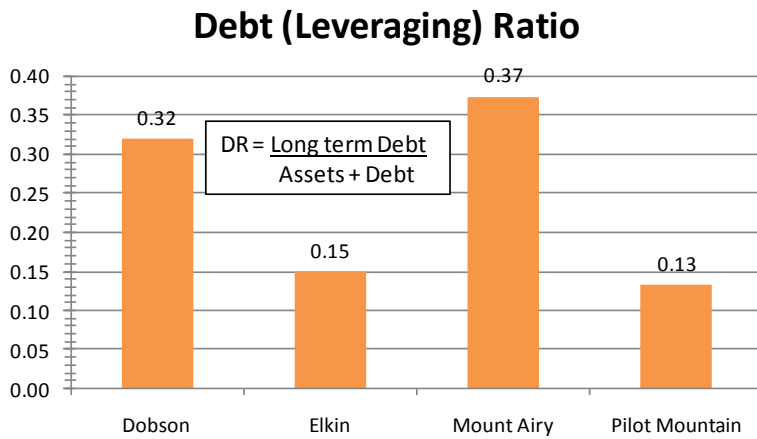


Figure 11 Debt Leveraging Ratio for Water and Sewer Enterprises in 2009

Another measure of the debt carrying capacity of a utility is the per capita debt load. Systems with higher debt per capita will, naturally, have less capacity for new debt. The debt per capita for Surry County systems is given in Figure 12. The lowest debt per capita is Elkin and the highest is in Dobson and Pilot Mountain. As a point of reference, the average per capita water and sewer debt load was \$480 across North Carolina in 2005.

Long Term W&S Debt per Capita

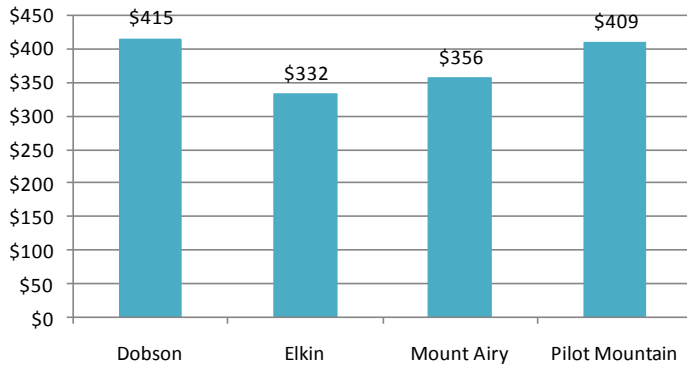


Figure 12 Long Term Water and Sewer Debt per Capita in 2009

Finally, while not a direct measure of debt carrying capacity, bond rating agencies often examine whether a system has sufficient operating reserves to cover debt service in case of an unexpected revenue shortfall. Hence, cash reserves are another partial measure of a systems capacity for debt. Below shows the days of cash on hand calculated as the number of days of operating expenses that can be covered by existing cash reserves. Dobson has the largest reserves and therefore the greatest ability to respond to unexpected revenue shortfalls. Typically, days of cash on hand should be larger for smaller utilities (since they are more vulnerable to demand fluctuations and operating emergencies). As a starting point, some recommend that a system keep one year’s worth (365 days) of cash on hand.

Days of Cash on Hand

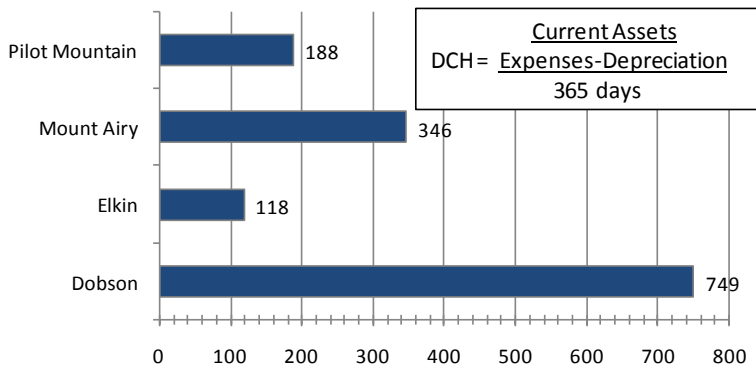


Figure 13 Days of Operating Expenses in Cash Reserves in 2009

The measures presented in the preceding section provide a first pass analysis of key finance and management performance dimensions. Surry County was excluded from these analyses because, as a bulk purchase system and as a county, many metrics are incomparable.

Partnership Principles

The following list of principles was designed based on the stated recommendations and goals of the Water Partnership Working Group (WPWG), an ad hoc committee comprised of managers, staff and elected officials from Dobson, Elkin, Mount Airy, Pilot Mountain and Surry County. The Partnership Principles were written in an attempt to facilitate the development of sustainable, efficient and mutually beneficial inter-local partnerships, of whatever form, for water service provision taking into account the inherent challenges posed by local government partnerships.

It was generally agreed that the principles are not binding rules of engagement, but rather guidelines for best partnership practices. To the extent that adherence to a given principle would compromise the independent objectives of member communities, it was agreed that communities should have the freedom to contravene that principle, but that they would at least consider the principle. Ultimately, however, communities should attempt to adhere to the principles in all of their interactions. Doing so will continue to foster a good environment for the formation of partnerships.

Preamble

Whereas, access to sustainable water and wastewater service is essential to promoting public health, environmental quality and community development and economic development within Surry County.

Whereas, water and wastewater partnerships between local governments often provide local governments and their citizens with substantial benefits. Such benefits include the creation of a larger and more diversified market for water and wastewater services that can more efficiently take advantage of existing capacity and that reduces the potential revenue risk of losing large volume customers.

Recognizing the importance of promoting sustainable partnerships, local governments within Surry County will take into consideration a set of partnership principles designed to guide, but not dictate inter-local agreements and other forms of partnerships.

- 1. Information should be shared freely on capital planning for water, individual water agreements (interlocal in final stages) and water partnerships in order to create a framework for communication.***
 - a) With transparency as a goal, we will coordinate grant funding requests to maximize the support units of government within the county receive and will be open to sharing the benefit of external funding, e.g. a line that adds customers should be considered as valuable to both parties.*

The first principle recognizes that information sharing fosters trust and a willingness to work together on future projects. Information sharing is particularly important in the case of adding customers beyond jurisdictional boundaries.

- 2. It is important that we all benefit, but we will make efforts to avoid having debates over who benefits more keep us from all realizing at least some benefits.***

In the formation of new partnerships, benefits and costs should be shared as evenly as possible. However, given random variations in operating efficiencies, the size and location of utilities' customer bases, etc, some systems will inevitably benefit more than others when new partnerships are formed. This principle seeks to acknowledge this inevitability and reaffirms that mutual benefit are better than no benefits, even if that means that benefits aren't perfectly evenly distributed.

- 3. Partnerships will be designed considering both long and short term impacts and if there are conflicts between short term and long term impacts, priority will be given to long term impacts.***

As with any long-term enterprise, sustainability often means investing in the future at the cost of the present. Likewise with partnership agreements, short term benefits should be balanced by long term cost recovery and investment strategies.

- 4. Water partnerships among local governments in Surry County (individual agreements) should be as consistent in form, content, and terms as is appropriate in order to promote transparency and good faith.***

Reduced variation in the form and content of agreements will reduce the occurrence of unexpected and irregular stipulations. Consistency promotes trust.

- 5. Controlling availability and the price of water and waste water services is acknowledged as an important component of local government growth strategy. At the same time, the secondary impacts of growth oriented water policies will be considered (e.g. considering how policies designed to promote annexation could impact low wealth customers outside of municipal boundaries that are not likely to be annexed).***

Higher water rates for outside customers are common among municipal water systems in North Carolina. While higher rates for rural customers may incentivize municipal growth through annexation, some rural customers may not be able to afford rates that are two and three times higher than urban customers' rates. Given that the Towns and the County have a mutual interest in bringing services to rural customers, the Towns should balance their intentions to incentivize growth with the need to keep rural services affordable.

- 6. There is a role for both long term capacity sharing as well as short term sharing. Expectations regarding the cost of capacity, however, should be realistic. Purchasers that do not contribute to the capital costs should not expect to count on capacity in the long term. Sellers of short term water supplies should focus on recovering operating and maintenance costs and not recovering capital costs.***

If a contract implies long term provision of services, the agreement should feature a mechanism by which the purchaser contributes to the long term maintenance cost of infrastructure. Conversely, if the agreement is intended for short term water sales only, costs to the purchaser might only include operating expenses (less depreciation) plus some nominal amount over expenses for operating reserves and maintenance.

7. *Past investments and ownership of water assets should be recognized in partnerships. Agreements should include a fair return on equity/capital.*

When existing infrastructure is transferred or becomes shared between partners, cost recovery mechanisms should account for long term investments already made by the asset owner. Metaphorically, just as a new country club member must buy into existing members' equity, so a new purchaser of water system capacity should buy into their partner's past infrastructure investment equity.

8. *The value of a water system goes beyond its book value and should take into consideration future cash flow.*

When determining the value of water production infrastructure for the purchase of capacity, the calculation should include the value of future revenue streams generated by sale of that capacity to hypothetical future retail customers. Systems with few current customers and a weak prospect for future growth may be "worth" considerably less than their book value.

9. *We are open to creative innovative arrangements that take advantage of different statutory authorities and resources of partners.*

WPWG member communities are open to exploring the full range of partnership models from simple agreements to complicated infrastructure purchase and transfer agreements to the formation of new units of local governments such as Authorities.

10. *To prevent service area disputes, communities will agree to communicate about proposed service areas when extending lines and will clearly stipulate service areas in inter-local agreements.*

Particularly important for partners with adjacent service areas, shared planning information on projected service areas will prevent costly and needless disputes.

Options for Increasing and Strengthening Water Service Partnerships

Two or more local governments that wish to work together more in order to provide their citizens with more efficient and effective drinking water and wastewater services may choose among a variety of models and tools. Water partnership options can be thought of as falling along a continuum, from relatively simple new or expanded bulk services purchase agreements on one end, to consolidating existing systems into a new water and sewer authority on the other. These models may be more accurately viewed as strategies for partnering rather than legal/institutional ownership options since in many cases communities may develop partnerships that involve more than one of the models. For example, a region of the state may be served by a combination of a multi-government authority with bulk services agreements with individual local governments. This section is not intended to be an overview of legal options for providing services³ but rather a starting point for local governments and

³ For an overview of water and wastewater service provision models see chapter 13 of County and Municipal Government in North Carolina (<http://www.sog.unc.edu/pubs/cmgl/>)

other water and wastewater service providers interested in expanding current or developing new partnerships.

Common models that can help local governments increase or strengthen their water partnerships are presented below. Brief descriptions of the arrangements and their general prevalence within North Carolina are followed by an outline of general features and examples from North Carolina.

Bulk Services Sales/Purchase Agreements

The most common tool available to water and wastewater utilities wishing to partner involves setting up an agreement to sell/purchase bulk water services or wastewater treatment services to/from another utility. The authority to enter into a bulk services agreement rests with the authority local governments have to enter into interlocal agreements given in Chapter 160A, Article 20⁴ of the North Carolina General Statutes. Specifically, Article 20 states that “any unit of local government in this State and any one or more other units of local government in this State or any other state (to the extent permitted by the laws of the other state) may enter into contracts or agreements with each other in order to execute any undertaking.” This broad authority is the basis of all interlocal agreements in North Carolina including bulk sales agreements.

The bottom-line is that the State of North Carolina gives local governments broad discretion to enter into partnerships, including partnerships for the provision of water and sanitary sewer service. One-third of the local government-owned water systems in North Carolina purchase the majority of water they distribute from another system and many more have interconnections and smaller or emergency purchase agreements.

Bulk services agreements can be designed to achieve a variety of goals. Short term bulk purchase agreements such one between Chatham County and the City of Durham allow utilities that are close to reaching their capacity or that need water in one particular area of their jurisdiction to avoid or postpone costly infrastructure upgrades. Long term purchase agreements such as those between Surry County and Dobson and Mt. Airy are an effective way of sharing treatment capacity among local governments in order to avoid having multiple smaller (and more expensive) treatment facilities.

Many utilities rely on bulk service agreements to provide alternative sources of water or wastewater treatment when their systems encounter problems ranging from temporary equipment failure to drought. It is critical that agreements are tailored to specific goals and circumstances and that they consider a range of key issues. The Environmental Finance Center (EFC) recently produced a document⁵ outlining key issues that utilities should consider when creating new or expanded interlocal agreements including bulk services agreements.

Bulk services agreements enable local governments to share resources, but by definition they are not appropriate for more comprehensive forms of partnerships. Many utilities that rely on bulk service agreements may be able to benefit from other types of arrangements that allow for more extensive

⁴ http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_160A/Article_20.html

⁵ http://www.efc.unc.edu/publications/pdfs/water_partnership_tips.pdf

resource sharing. For example, two small utilities in close proximity to each other with bulk service agreements may only have one treatment facility, but they likely have two customer service operations, two sets of meter readers, two sets of heavy equipment all of which is only partially utilized. Sometimes, additional interlocal agreements (in the form of service contracts) are utilized to reduce such duplication and achieve greater economies of scale. The cumulative result of multiple agreements can be seen as a partnership strategy. The question then becomes to what extent the partnering jurisdictions coordinate the different agreements.

Operations and Maintenance Agreements

In many instances across the state, one utility will operate a function (such as billing) or the management of assets of another utility. Some operations and maintenance (O&M) agreements operate as variations to a more basic bulk services agreement. This is the case in an agreement between Surry County and Mt. Airy to provide full services to the County's Bannertown Water District customers. The agreement covers water provision, maintenance of county-owned lines, and all customer service functions.

In Lee County, The City of Sanford had an agreement (entered into in 1996) with the County to operate and maintain the County's water system. This agreement eventually led to the City of Sanford acquiring the County's system in 2005. Thus one might see some types of O&M Agreements as a possible interim step between separate systems and merging into one (already existing) system. Other simpler O&M agreements that cover some types of mutual aid services (borrowing staff and equipment during emergencies) serve as insurance policies for utilities.

Shared Ownership of Assets

Another partnership model involves the shared ownership and use of capital assets. Here two or more partners pool resources to build and maintain an asset that will provide resources for their respective utilities. For example, the Towns of Cary and Apex jointly own a water treatment facility⁶ on Jordan Lake. The partnership is governed by an interlocal agreement stipulating that all costs, including construction, fees and other direct and indirect costs, are allocated to each party based on its allocation (specified in the original contract as 77% to Cary and 23% to Apex). Independent consultants certify each party's share annually and audit the operating agency's books and management. An advisory committee consisting of the two mayors and town managers select the independent consultants and advises Cary Public Works (the operating agency) on all policy matters pertaining to the facility.

In many circumstances, utilities wishing to share assets can achieve the same goal through a well designed long term (40 year) bulk services agreement. Shared asset ownership arrangements are more typical for new infrastructure or when existing infrastructure requires significant new investments. Shared asset ownership also makes sense when partners both have a significant stake in the asset.

⁶ <http://www.water-technology.net/projects/cary/>

Municipal Owned Utility Providing Service to Customers in Other Jurisdictions

Interlocal agreements can also be crafted to create large regional utilities where the water and/or wastewater infrastructure is provided to multiple jurisdictions by a single municipality. In this situation, a single jurisdiction owns and operates a full-service utility on behalf of other jurisdictions.

The City of Raleigh⁷ provides water and sanitary sewer service for Raleigh, Garner, Wake Forest, Rolesville, Knightdale, Wendell and Zebulon. Most of the other municipalities at one time operated their own utilities, but decided to divest their systems to Raleigh Public Utilities which now functions as a regional water provider. Charlotte-Mecklenburg Utilities (CMU)⁸ is another example of this arrangement. Formally a department within the City of Charlotte, the utility services the City of Charlotte, Mecklenburg County, and the towns of Matthews, Mint Hill, Pineville, Huntersville, Davidson, and Cornelius. There again, existing county and municipal systems divested their assets to CMU. CMU was originally created out of separate City and County utilities in 1972. Then in 1984, agreements were reached with the other six, smaller utilities. In both the Raleigh and CMU cases, interlocal agreements are in place as part of the governance regime. Individual jurisdiction's interests are protected through interlocal agreements between the utility (Raleigh, CMU) and that individual jurisdiction.

These types of agreements can provide enormous finance and efficiency benefits by sharing resources among very large customer bases. Many of these types of large municipal regional utilities often have the lowest water and wastewater rates of any utilities in the state. The trade-off for other units of government that do not own the assets is a lack of control which is why it is so important to develop detailed governance provisions for these arrangements that cover everything from the policies governing system expansion to capacity allocation to rate setting. In some cases, interlocal agreements have crafted customized management bodies and systems to support utility operations.

For this reason, multiple jurisdictions relying on the assets of one jurisdiction may want to consider using special authority to use interlocal agreements to create a joint management entity. For example, the Winston-Salem/Forsyth City/County Utility Commission⁹ is a joint city-county “agency”¹⁰ that was created by interlocal agreement to oversee the management of assets that are owned and operated by Winston Salem.

Water/Sewer Authorities

Water and sewer authorities are special purpose local governments created by the governing body of a single county government, or by the governing bodies of two or more political subdivisions. Local governments are authorized to create authorities under Chapter 162A¹¹, Article 1, of the N.C. General Statutes. There are only approximately a dozen active authorities in North Carolina, but in the places

⁷ <http://www.raleigh-nc.org/putilities/index.htm>

⁸ <http://www.charmeck.org/Departments/Utilities/About+Us/home.htm>

⁹ <http://cityofws.org/Home/Departments/Utilities/UtilitiesComm/Articles/UtilityCommission>

¹⁰ Authority to create these types of joint agency is provided to municipalities through G.S. 160A-462 and for counties Chapter 153A-278.”

¹¹ http://www.ncga.state.nc.us/enactedlegislation/statutes/html/bychapter/chapter_162a.html

where they operate they have provided individual local governments an opportunity to share resources while maintaining a legal share of asset ownership and utility governance.

No two authorities in the state are structured exactly alike. Some authorities provide the full range of services to their customers from operation of treatment facilities through billing. Full service authorities in North Carolina include the Orange Water and Sewer Authority (OWASA), the Onslow Water and Sewer Authority (ONWASA), the South Granville Water and Sewer Authority (SGWASA), the Tuckaseigee Water & Sewer Authority (TWSA) and the newly created Yadkin Valley Sewer Authority (YVSA) serving communities in three counties including Surry County.¹²

In most cases, full service authorities were created by consolidating multiple full-service utilities. For example, in Jackson County, with the assistance of the Southwestern Commission (Council of Governments), the County of Jackson and the Towns of Dillsboro, Sylva and Webster consolidated their water and wastewater utilities in 1992 to form the TWSA. The TWSA is a good example of multiple utilities consolidating into one new authority to achieve economies of scale and otherwise create a more sustainable enterprise.

Some authorities in North Carolina have been created solely to own and operate treatment facilities or provide wholesale services to other utilities. In the case of water, it is usually a cooperative for water supply, where the member jurisdictions maintain their own utilities for distribution (maintaining control over rates, line expansion, etc.).

An example of a wholesale authority in North Carolina is the Piedmont Triad Regional Water Authority (PTRWA).¹³ The PTRWA was established in 1987 by Randolph County, Jamestown, Randleman, Archdale, High Point, and Greensboro. The partnership came together around the recognized need to collaborate around water resources and principally to issue revenue bonds for the construction of the Randleman Dam (completed in 2004). Currently a \$65 million water treatment facility on the lake, along with many miles of pipes to distribute the water to member jurisdictions, is being completed. The plant and future operations is being financed through a “combination of up-front contributions and guaranteed future water purchases by the six local governments.”¹⁴ Although the project has taken a long time and has gone through many ups and downs with controversy and delays, the six local governments will all benefit significantly from co-owning their own secure water source rather than be dependent upon water purchases from others.

The Water and Wastewater Authority of Cabarrus County (WSACC)¹⁵ serves a similar role to PTWRA, but with a focus on wholesale wastewater treatment. WSACC owns and operates centralized wastewater treatment and collection facilities that partner with local government utilities throughout the county (through the use of inter-local agreements).

¹² <http://www.owasa.org>, <http://www.onwasa.com>, <http://www.sgwasa.org>, and <http://www.twsanc.us>

¹³ <http://www.ptrwa.org>

¹⁴ “Turn on the Tap? Not yet, but soon.” Taft Wireback, *Greensboro News-Record*, 9/7/2009, accessed at <http://www.news-record.com/>

¹⁵ <http://www.wsacc.org/>

Special purpose governments such as authorities or Metropolitan Water or Sewerage Districts are advantageous for several reasons. First, due to their authority to issue bonds, they “can become very powerful and effective regional institutions because they can raise capital to finance projects and improvements.”¹⁶ Second, they generate their own revenue streams through fees and can be seen as a step removed from the politics of rate-setting by city and county boards. In other words, where a local board may be more reluctant to set appropriate rates due to a variety of local political circumstances, an authority can be more (for lack of a better term) business-like and set rates according to the sustainability of the enterprise. Third, since the governing boards of the authority are made up of representatives from member jurisdictions, political accountability is maintained. A positive side-effect of this situation may be more regional thinking and (possibly) cooperation on related issues such as land-use, economic development, and so on.

There may also be disadvantages to creating retail service authorities as well. The primary disadvantage is that the nature of the arrangement may create inherent conflicts in the need to be accountable to bond purchasers, customers, and the member jurisdictions all at the same time. Furthermore, while a city or county may enjoy the freedom of not having to be directly concerned about funding the water utility, meeting the financial obligations of operations and maintenance, and planning for capital investments, there is a trade-off with regard to direct political control. Although jurisdictions do have representation on authority boards, the influence is (as mentioned above), one step removed from the direct control of the local board.

It is important to note that the creation of special purpose governments has grown significantly in the past several decades, particularly in areas such as transportation, pollution mitigation, and water supply. These and other aspects of local government service delivery naturally lend themselves to “thinking regionally.” Special purpose governments (like regional water authorities) are growth areas of local government in the U.S. In the last 30 years (from 1977 to 2007), the number of counties nationwide has remained near constant, the number of municipalities has risen slightly (3 percent), and the number of school districts has decreased significantly (14 percent). However, the number of special purpose governments has grown significantly during that time-span (44%), from 25,962 in 1977 to 37,381 in 2007.¹⁷

County-wide “Regional” Utility

Multiple county government governments throughout NC operate what amounts to a “regional” water utility. That is, the county utility services county-wide or multi-county, inclusive of all or many of its municipalities. Harnett County’s Department of Public Utilities¹⁸ operates as a regional provider in multiple counties. Harnett County, like many counties operating county-wide utilities has created semi-autonomous water and sewer districts in Harnett County through authority granted under Chapter 162, Article 6¹⁹ of the North Carolina General Statutes. These districts are owned by the County, but are able

¹⁶ From *Guide to Successful Local Government Collaboration in America’s Regions* (National League of Cities, 2006)

¹⁷ From the Census of Governments, 2007 (see <http://www.census.gov/govs/cog/>)

¹⁸ <http://www.harnett.org/utilities/>

¹⁹ http://www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_162A/Article_6.html

to incur debt linked to each district. The county water and sewer district model also allows the county to set different water service rate (and if necessary, tax) schedules for each district.

Harnett County is a particularly complex model because they provide full services to residents in some municipalities – for example they own the entire water and sewer infrastructure that serves the Town of Erwin. For other municipalities they have entered into bulk services agreements.

From a resource-sharing standpoint, county-wide utilities allow infrastructure to be pooled to serve a wide geographic basis. From a governance standpoint, all citizens within a county being served by a county utility even if they live within a municipality have elected representation in the form of county commissioners. This is not the case for customers served by county utilities that live outside the county boundaries nor is it the case for customers living in one city served by a utility owned by another city as described above.

Other Options

While the options described above are the most common and likely to be the most feasible for many local governments considering different options, there are some other models that in some circumstance could support partnerships.

Metropolitan Water Districts and Sewerage Districts. A cousin to water and sewer authorities, these special purpose units of government fall under different enabling statutes (see Chapter 160A²⁰, Articles 4&5, of the North Carolina General Statutes), but can be created to achieve many of the same outcomes as water and sewer authorities and have many of the same advantages and disadvantages.

Investor-owned Utilities. The private sector is often able to bring an economy of scale to services in a way that individual units of government cannot. For example, several of the state’s large regional landfills are privately owned. In some states, private water utilities play a similar role with one large company providing water services to customers in multiple jurisdictions. There are relatively few examples of entire cities being served by private water utilities in North Carolina, but private utilities such as Aqua North Carolina²¹ do play a major role in serving small unincorporated communities and subdivisions. Companies like Aqua are able to share management and staff resources across small systems such that the tiniest system they operate has access to the same level of operational resources of their largest system. The advantages and disadvantages of private investment in the water area are hotly debated, but in some areas of the state, these large utilities are the only option for allowing customers to benefit from resource sharing.

Non-profit Water Corporations. In some respects, non-profit water corporations such as Davidson Water are similar to for-profit companies. These utilities are considered private in that they are not owned or managed by a unit of government. However, unlike investor-owned utilities, these corporations are not regulated by the Utility Commission. The major disadvantage of these utilities is

²⁰ <http://www.ncleg.net/gascripts/Statutes/StatutesTOC.pl?Chapter=0162A>

²¹ <https://www.aquaamerica.com/NorthCarolina/Pages/Home.aspx>

that they have more limited access to capital than many of the government-owned counterparts. The advantage is that they provide a governance structure in which most of their customers have equal voice as each other – something that is harder to create in other models in which one unit of government serves citizens in another unit of government.

Sanitary Districts. In some respects, a sanitary district sounds like the ideal model for regional water or wastewater provision. These special purpose governments, authorized in Chapter 130A, Article 2²², Part 2, of the North Carolina General Statutes, are created to provide water, wastewater, and in some cases other public health and safety services. Unlike authorities, the governing bodies for these utilities are directly elected by customers within their boundaries. Sanitary districts have full taxing authority which they can use to augment their rate-setting authority as needed. While there are many more sanitary districts in the state than authorities, few of these have been created in the last decade, with most jurisdictions interested in regional utilities preferring instead to use one of the options described above. One of the main reasons the state has seen few new sanitary districts is that while they eventually become an independent unit of local government, a county government, working in combination with the State Board of Health, has to take the lead in creating them, and given the range of powers they can eventually pursue (including zoning) they could be seen as potentially challenging county power.

²² http://www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_130A/Article_2.html

Table 3: Overview of Partnership Models

Partnership Strategy	Use of Assets	Ownership of Assets	Operation of Assets	Planning & Coordination (Governance) of Assets
Bulk sales agreements e.g. numerous	Shared	Separate	Separate	a) Separate, or b) Coordinated through informal or formal coordinating structure
Operation and maintenance (O&M) agreements e.g. Mt. Airy - Surry Co.	Shared	Separate	Unified - one entity on behalf of other(s)	a) Separate (O&M entity only), or b) Coordinated through informal or formal coordinating structure
Shared ownership agreement e.g. Cary-Apex facility	Shared	Shared	a) Unified - one entity on behalf of other(s) or b) Shared	a) Separate (O&M entity only), or b) Coordinated through informal or formal coordinating structure
Regional system, single unit on behalf of others e.g. Charlotte-Mecklenburg	Shared	All assets divested to single unit	Single unit does all O&M	a) Single entity (operating within confines of agreements), or b) Coordinated through informal or formal coordinating structure
Regional Authority (treatment facility only) e.g. PTRWA	Shared (facility), Separate (local distribution)	Separate (each entity owns own Dist. Sys., billing, etc.)	Shared	Coordinated through governing board made up of participating jurisdictions
Full-service Regional Water or Sewer Authority e.g. TWSA or OWASA	Shared	Shared	Shared	Coordinated through governing board made up of participating jurisdictions
County-wide "Regional" Utility e.g. Harnett County	Shared	County utility owns assets	County utility does all O&M	County, subject to agreements with partnering jurisdictions

An Analysis of Existing Water Agreements

There are several different forms of water partnerships between local governments within Surry County. These include:

Long term bulk sales agreement combined with operations agreement (Multiple). This form of partnership exists between Surry County and Dobson, Elkin, and Mt. Airy. The agreements covering these partnerships were all negotiated individually with each municipality but follow the same general structure. Each includes a 40 year bulk sales agreement that dictates how treated water will be supplied to lines owned by the County which are interconnected to lines owned by the municipalities. The commodity charge (price per 1,000 gallons), paid by the County, is designed to cover all the operation costs involved in treating and transporting water to the a master meter on the County's lines. The commodity charge also covers a proportion of capital cost related to existing treatment facilities. The agreements stipulate that the County will share costs for future treatment capital costs. The County also contracts separately (or intends to contract) with the municipalities to provide line maintenance and customer billing services. The capital cost associated with the construction of the County's distribution lines are borne by the County and paid for using excess revenues (after water and service costs are paid) from the sale of water to their customers.

Operations agent/Variation of lease to purchase (Flat Rock/Bannertown). The County is involved in another type of partnership form with Mt. Airy to serve its Flat Rock/Bannertown Water District. This interlocal agreement has created a partnership that more closely resembles a lease to purchase arrangement. The County has contracted with Mt. Airy to be their operations agent and provide district customers with the same basic services provided to Mt. Airy customers. District customers are charged twice the rate of Mt. Airy customers with the difference being provided to the County to help offset debt service on their lines. This surplus payment resembles a lease payment, and the contract between the County and Mt. Airy calls for the transfer of the lines from the County to Mt. Airy once the debt service on the lines have been retired. If surplus payments are insufficient to pay debt service, the County is obligated to supplement this revenue with revenue from other county sources of revenue.

Authority (Elkin with Jonesville and Ronda). The Town of Elkin has partnered with municipalities from two other counties to create a Sewer Authority. Under this agreement, infrastructure assets from the three towns are in the process of being transferred to the new authority which will begin providing all sewer services to customers within the member towns.

While the existing interlocal agreements between the Surry County government and Elkin, Dobson, and Mt. Airy all serve the intended purpose of providing access to water in specific areas of unincorporated county, all of the agreements can be improved to tie all of the units together in a more holistic manner.

Differences between the two sets of agreements between the County and Mt. Airy are is likely more of an artifact of the conditions under which the agreements were created than reasoned strategy. In order to support the goal of consistency among similar agreements, local governments should consider using a standard approach such as the approach used between the County and Dobson and Elkin. While the overall approach is similar, there are important differences on, for example, minimum purchase clauses

or on the inclusion of base rates. Having different base rates for water sales is completely appropriate given the different production costs of utilities, but having some agreements include minimum purchase clause and other agreements without clauses should be avoided unless there is clear rationale for these types of differences.

Moving Forward

The previous sections outlined considerations and recommendations on the form and content of contractual agreements and highlighted potential partnership models which would promote healthy, sustainable partnerships in Surry County. Deciding among these partnership models will require a considerable amount of local time and energy that was beyond the scope of this project. To address these issues, the Water Partnership Working Group (WPWG) should be formalized into an Advisory Committee to continue to pursue vital partnership questions.

Advisory Committee Purpose

The primary purpose of a partnership advisory committee would be to assume a leadership role promoting partnerships: weighing costs and benefits, identifying potential efficiencies, investigating roadblocks, seeking practical solutions, and advocating for joint community action. As suggested by this project, some of the most important partnership issues which a committee could address include:

- Develop and design new partnerships
- Seek joint funding for infrastructure projects
- Develop a template for agreements within the county
- Coordinate service area plans

Composition

While the WPWG was an informal body with ad hoc structure and composition, an advisory committee should comprise fixed membership with formal structure. As new partnerships can impact everyone in the County, the Committee should represent all communities equally. Thus, a committee should involve a voting mechanism to ensure equal representation. The following scenario represents one potential structure; other structures may serve the member communities better.

- 10 voting members
 - One staff person and one elected official from each of Dobson, Elkin, Mount Airy, Pilot Mountain and Surry County
- Potential role for other stakeholders (member at-large)
- Single, rotating meeting coordinator
 - Duties include arranging meeting place, food, meeting notices, taking and distributing minutes, leading meetings

Meetings

Regular and frequent interaction is vital for solid partnerships. Meetings should occur with relative frequency to prevent partnership issues from devolving without regular input from impacted communities or allowing momentum on to drop in the face of the many other pressing local governance

matters. Meetings should also represent all communities; the lack of participation by individual communities could diminish the benefits of partnerships for everyone.

- Regularly scheduled meetings, at least bi-monthly
- Mandatory participation; substitutes may be found in the event of scheduling conflicts
- Hosted by a single unit of government member on a rotating basis

Communication

Communication is the foundation of any partnership. Communication must occur within and between communities. It must also involve all stakeholders from the County all the way down to individual retail rate payers.

- Distribute meeting notes and report back to their own governing boards
- Solicit input from governing boards on the direction and purpose of the Committee
- Communicate regularly with the public through press releases, public meetings, etc.

Technical Support

Many core partnership issues will require technical advisory input. The Committee should take full advantage of free public advisory resources, but some questions will require sufficient effort to warrant paid consultation. The Committee should develop a pool of resources, by whatever practical means, to support consulting services on such sufficiently effortful investigations.

- External Advisory Support
 - UNC School of Government (governance)
 - Environmental Finance Center (governance, finance and management)
 - NC Rural Economic Development Center (finance and management)
 - NC Rural Water Association (technical and finance)
 - NC AWWA-WEA (technical)
 - Private Consultants (legal, technical, finance and management)
- Shared financial contribution from member governments to pay for support services and to use as leverage to acquire additional outside resources

Governance

As a formal commitment, member communities should write and mutually adopt a memorandum of understanding establishing the membership, structure, provision of resources and purposes of the Committee.