



Rialto Water and Wastewater Concession Agreement: Capital Flows



The City of Rialto, California used a 30-year concession agreement to improve operations of its water and wastewater system and to raise a significant amount of capital from private equity partners and capital finance markets. The initial funds allowed the City to accelerate capital improvements in its water and wastewater system, pay itself deferred utility system lease payments, and fund several strategic reserve funds.

Note: The Rialto Water and Wastewater Concession generated an influx of capital to accelerate capital investments and to improve ongoing operation and maintenance of the water and wastewater system. This profile focuses primarily on the concession structure that Rialto employed to generate the initial outlay of funds; however, it does not cover the details or outcomes of the operating portion of the concession.

Table 1. Key Project Details

Project Title:	Rialto Water and Wastewater Concession
Primary Facility/Service:	Water and Wastewater System
Local Government Entity:	The City of Rialto/Rialto Utility Authority
Primary Partner:	Rialto Water Services Inc., Table Rock Capital (project lead and equity provider), Ullico Infrastructure Fund (equity provider), and Veolia Water (Operator)
City's Primary Advisors:	SAIC (business and technical advisory services), Fulbright and Jaworski LLP (legal services)
Delivery Model:	Concession
Contract Period:	30 years
Population Served:	50,000 (water service), 100,000 (wastewater service)
Major Initial Outlays:	\$177,000,000 of initial capital raised or contributed. Major uses of funds included: initial concession payment, existing debt defeasance, short-term (5 year) capital improvements, funding for reserves, and project development/transaction costs. ¹
Flow of Revenues:	The City is responsible for setting rates that generate revenue to cover capital payments and operating costs associated with the concession. Rialto Water Services (RWS) is responsible for collecting and processing customer payments and disbursing revenue as required to the City. Assets are owned by the City and leased to a utility authority (Rialto Utility Authority) created and controlled by the City. Portions of the collected rates are used to cover the concession payments to RWS and lease payments to the City.

Background

The City of Rialto is located in Bernardino County, California, and as of 2010, it is home to approximately 100,000 people.² The City wastewater system provides wastewater services to the entire City population. The City water system provides water services to approximately 40% of the City population, primarily in the older downtown area, with the remainder of the City served by West Valley Water District and Fontana Water Company.³ After a two and a half year competitive procurement process, in March of 2012 the City entered into a 30-year concession contract with Rialto Water Services.⁴ Prior to entering into the agreement, the City had determined that the water and wastewater system needed a significant influx of capital to continue to provide quality service to current and future customers. The City's wastewater treatment facility had reached the end of its effective life and needed a major upgrade. Further, many aspects of the water distribution and wastewater collection systems needed major capital repairs. In addition to problems associated with the condition of system assets, water contamination issues linked to perchlorate associated with a weapons storage facility had plagued the City. Under the backdrop of these challenges, the City decided to turn to a public-private service delivery model (concession agreement) in order to improve, manage, and operate its water and wastewater assets.⁵

Prior to entering into the concession agreement, the City provided water and wastewater services through a combination of direct city operation and service agreements with private operators. In 2001, the City created another unit of government, the Rialto Utility Authority (RUA), to serve as a system intermediary that would facilitate the City earning a rate of return for the equity it had accumulated in the water and wastewater systems over the years.⁶ Under the arrangement, this was achieved by allocating a portion of revenue from customer charges to pay system operation

¹ *Agenda Report for the City Council/RUA Meeting of March 27, 2012.* City of Rialto. March 22, 2012.

² *About Rialto.* The City of Rialto, California. <http://yourrialto.com/city-hall/about-rialto/>

³ Tom Crowley (City Utilities Manager), telephone interview with author, November 22, 2016.

⁴ *Agenda Report for the City Council/RUA Meeting of March 27, 2012.* City of Rialto. March 22, 2012.

⁵ *ibid.*

⁶ *Agenda Report for the City Council/RUA Meeting of March 27, 2012.* City of Rialto. March 22, 2012.

costs as well as annual lease payments to the City.⁷ Immediately after creating RUA, the City established targeted annual lease payments that were significantly lower than the maximum allowed by California Law based on the valuation of the City’s assets. The revenues collected by the RUA between 2001 and 2010 were only sufficient to pay a portion of the City’s targeted lease payments. The City is also one of approximately 100 local governments in California that assesses a Utility User Tax on water and/or wastewater services. The tax is currently 8% of water and wastewater charges and has to be reapproved every five years. The last voter approval occurred in 2013.⁸ The tax on water and wastewater services was projected to generate approximately \$4.6 million in revenue for the 2016/2017 budget, which includes payments from Rialto Water Services customers as well as West Valley Water, another utility that serves a portion of the City.⁹

In December of 2010, the City entered into a letter of agreement with Rialto Water Services (RWS), a partnership led by Table Rock Capital, a California based Equity Firm and American Water, an international water service provider, to negotiate a concession agreement. The letter of agreement guaranteed the City would reimburse RWS for costs associated with preparing the project (“due diligence”) if a financial agreement was not reached for an amount not to exceed \$1.7 Million.¹⁰ The City of Rialto, RUA and RWS entered into a 30-year concession agreement in March of 2012. Shortly after the agreement was signed, a public campaign was initiated with support from the Utility Workers Union to exclude American Water from the project. Later in 2012, it was announced that Veolia Water would assume the operating responsibility for RWS.¹¹ Figure 1 shows the relationship between the different entities involved in the project.

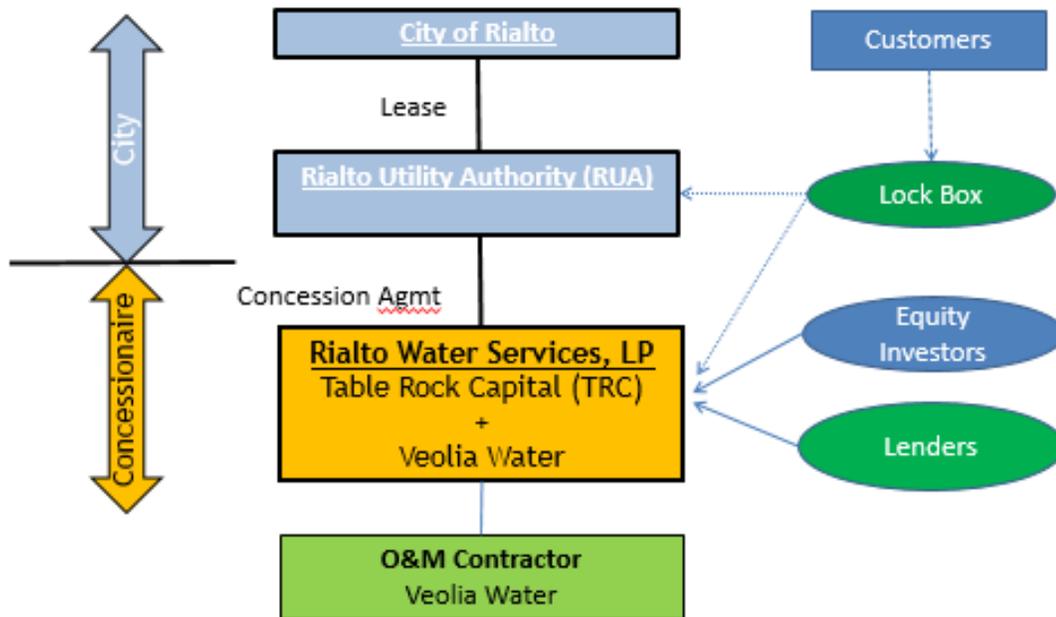


Figure 1. Rialto transaction structure.¹²

⁷ *ibid.*

⁸ Dulaney, Josh. Rialto Voters pass \$11 million utility-users tax. Whittier Daily News. March 6, 2013.

⁹ 2016/2017 budget

¹⁰ *Agenda Report for the City Council/RUA Meeting of March 27, 2012.* City of Rialto. March 22, 2012.

¹¹ Steinberg, Jim. *American Water is out as operator for Rialto.* Pasadena Star News. July 10, 2012.

¹² *A Tale of Two Cities: The Rialto and Allentown Water/Wastewater System Transactions.* City of Rialto, CA, Leidos, PFM, K&L Gates. Presentation at the National Conference for Public-Private Partnerships P3 Connect in Denver, Colorado. July 29, 2014.

Concession Capital Flows

Under the agreement, RWS was responsible for raising over \$170 million in initial capital funds. The funds were generated through private equity (\$26 million) and the issuance of a \$146 million of 30-year fixed-rate privately placed debt. The debt was rated A-. Private equity was provided by Table Rock Capital (\$6 million) and the Ullico Infrastructure Fund (\$19.85 million).¹³ The Ullico Infrastructure Fund is an investment fund of the Union Labor Life Insurance Company, a company created to serve unions and their employees.¹⁴ A schematic in the appendix shows a simplified flow of funds resulting from the agreement for the initial outlays and recurring payments.

The entire capital cost for the project was initially presented to the City Council as \$177 million and included \$7 million in reserves from RUA. According to a financial analysis presented to the City Council, the project capital structure incorporated a pre-tax return requirement of 19.6% for the equity contribution (13.6% after tax).¹⁵ The overall maximum blended rate (taking into consideration the private activity bond portion) was conservatively presented as 8.6% with the expectation it could be as low as 8.1%.¹⁶

The raised funds were initially presented as covering the following:

- Transaction Related Costs: \$24.3 million
- Debt Defeasance: \$27.4 million
- Due Diligence and Transition Expenses: \$11.2 million
- Catch-up Payments to the City in the form of an upfront concession payment: \$30 million
- Capital investments to improve the water and wastewater system: \$41 million
- Operational Funding: \$43.1 million

The uses presented above were based on expectations prior to the financial close. After the project was underway and financing was finalized, actual uses were reported to be slightly different. For example, the City concession fee was reported to be \$35 million.¹⁷ The concession is structured to reimburse RWS for providing the initial capital through periodic concession capital payments. At the time the concession agreement was approved, the maximum annual payments were presented as \$13 million for wastewater and \$3.25 million for the water system.¹⁸

The City maintains authority for setting rates, but the agreement will influence the City's revenue requirements moving forward and will have a significant impact on what customers are asked to pay. Rates are required to be set at levels necessary to generate revenue sufficient to cover annual concession capital payments, operating costs, lease payments from RUA to the City, funds for operating and capital reserves, and reimbursement for City incurred management costs. Rates also must generate sufficient revenue for debt service coverage requirements for outstanding debt.

At the time the agreement was approved, City staff estimated that the agreement would result in a 115% water and wastewater rate increase over the first four years.¹⁹ After implementing the first three of four planned rate increases, the City decided to defer the last planned rate increase for a year to go into effect in 2017.²⁰ Analyses presented during the project development stage concluded that the rate increase associated with the concession was comparable or even favorable to rate increases that would be needed to provide the same level of service and same lease payment revenue

¹³ Scott, Ed, and Axter, Sonia. *Overview of 30-Year Water and Wastewater Concession in Rialto, CA*. City of Rialto, Ullico. June 2015.

¹⁴ *Supporting the American Worker for More than 85 Years*. Ullico. <http://www.ullico.com/about-ullico/ullico-difference>

¹⁵ *Agenda Report for the City Council/RUA Meeting of March 27, 2012*. City of Rialto. March 22, 2012.

¹⁶ *ibid.*

¹⁷ Scott, Ed, and Axter, Sonia. *Overview of 30-Year Water and Wastewater Concession in Rialto, CA*. City of Rialto, Ullico. June 2015.

¹⁸ *Agenda Report for the City Council/RUA Meeting of March 27, 2012*. City of Rialto. March 22, 2012.

¹⁹ *ibid.*

²⁰ Tom Crowley (City Utilities Manager), telephone interview with author, November 22, 2016.

stream to the City.²¹ The resulting rate was also reported to be equal to or lower than the rate residents who live in areas of the City served by other water utilities pay.²² The 2016/2017 Rialto Annual Budget projects rates will generate lease and contract payments to the City's General Fund of \$3.14 million.²³ Portions of these payments are used to cover the City's concession oversight and remaining water and wastewater responsibilities (e.g. long term capital planning and water resource planning).

²¹ *ibid.*

²² Tom Crowley (City Utilities Manager), telephone interview with author, November 22, 2016.

²³ *Proposed Budget for the Fiscal Year July 1, 2016 – June 30, 2017.* City of Rialto California. 2016.

Appendix A. Simplified Project Financial Flows

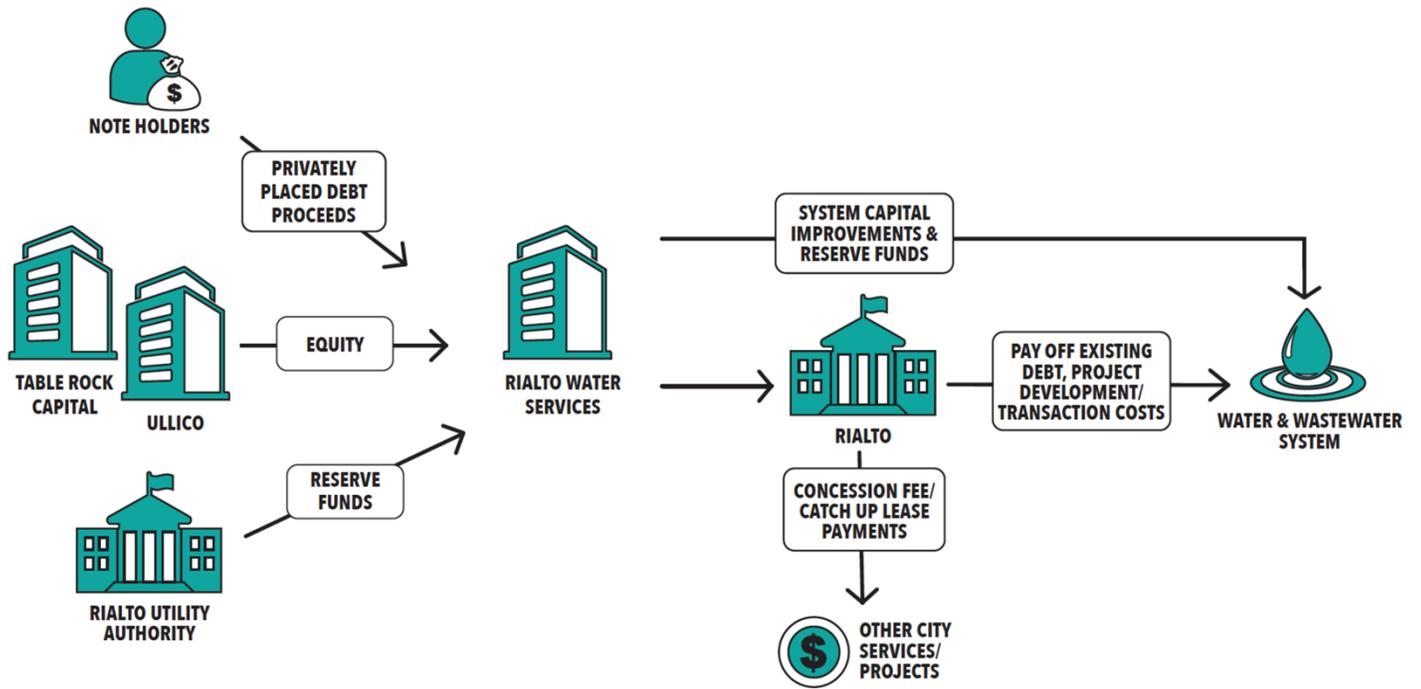


Figure 2. Flow of Initial Project Outlays

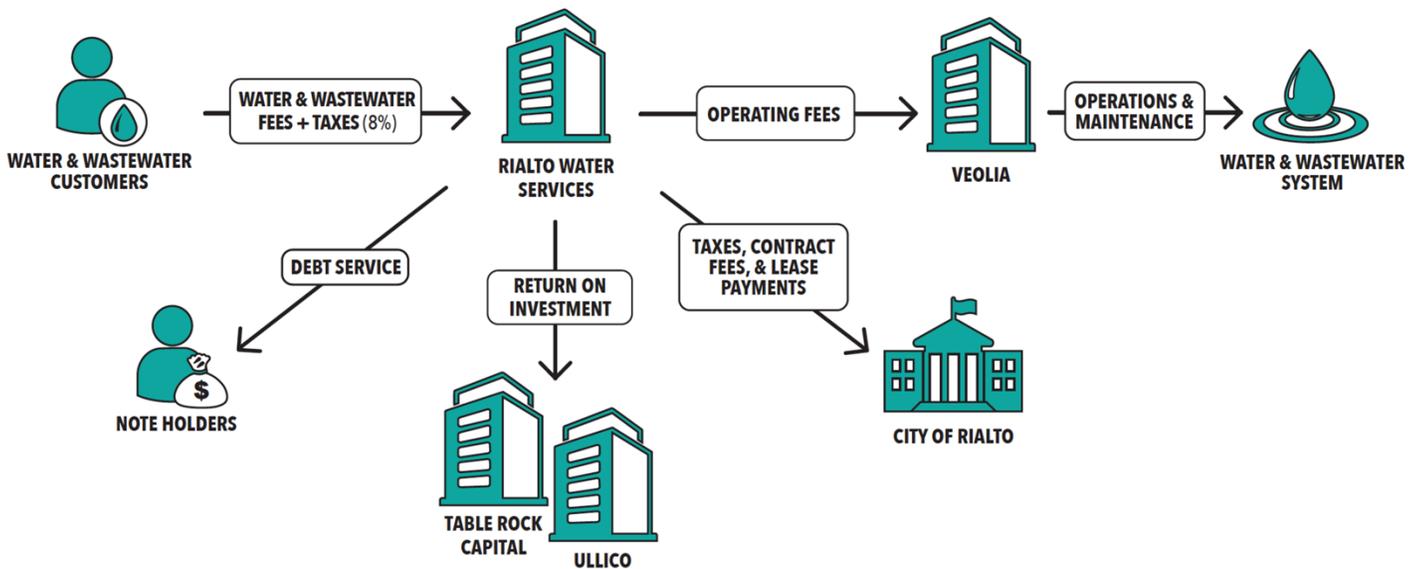


Figure 3. Recurring Financial Flows

Acknowledgements

Written by Jeff Hughes. † November 2016.

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† Jeff Hughes is a member of the United States Environmental Protection Agency's Environmental Finance Advisory Board.

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The Water Infrastructure and Resiliency Finance Center identifies financing approaches to help communities make better-informed decisions for drinking water, wastewater, and stormwater infrastructure that are consistent with local needs.

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