

# Lincoln Group LLC



September 8, 2017

Milford Board of Selectman  
Town Hall Room 11  
52 Main Street (Route 16)  
Milford, MA 01757-2679

Dear Board of Selectmen,

Please find herein our Final Report: Financial and Business Due Diligence of the Milford Water Company. We have concluded with this review that there is a compelling reason for the Town's acquisition of the Milford Water Company. It is based on our belief that the Town of Milford can ensure proper governance and management of the water company as it relates to the delivery of consistent quality and quantity of water to the consumer at a comparatively acceptable cost. In our opinion, there is sufficient evidence that the Town has demonstrated its ability to manage a similar enterprise successfully -- in the Town's Sewer Department -- in the past. Further, it has been demonstrated that there exists with the Board of Selectmen and among Town officials, a sincere intention and desire to manage the operation in a manner consistent with the long-term needs of the residents and commercial water users of Milford.

The focus of the work Lincoln Group completed for the Town consisted of an analysis of the proposed acquisition, including a review of the Russell Consulting Report and the affordability of the transaction from the Town's perspective. It was revealed that Milford Water Company was only marginally profitable. As a result, it has been limited by what it could afford to spend on capital improvements. A 2010 engineering study, commissioned by the company, presented a 15-year capital improvement plan; 95% of those suggested improvements have not been made, including important short-term upgrades for both water supply and quality. The Town of Milford, however, is in a strong position to double capital expenditures in the next three years to ensure remediation of these important short-term upgrades and deliver consistent long term investment in capital improvements based on its ability to increase rates on a yearly basis and improve customer service through direct public input.

Review of the Russell Consulting Report and an independent analysis of projected revenues and expenses reveals that the Town will require an additional \$12 million in capital improvements over the next 10 years. The Russell Report assumed that the Town would finance the \$63 million acquisition price through a bond and the incremental \$12 million in capital improvements through additional borrowing. Upon further review, the Lincoln Group determined that the ability of the Town to obtain the additional borrowing for \$12 million will likely be limited by certain financial criteria. As a result of evaluating multiple alternatives, the most appropriate answer is to fund the needed additional \$12 Million in capital improvements through a rate increase of up to 30% in 2018 (consistent with Milford Water Company's current requested increase) and subsequent average increases per year of 2-5%. These rate increases will enable the new enterprise to operate on a sound financial basis and provide the company with the ability to invest in sufficient capital improvements including the immediate need for both water supply and quality.

An analysis of publicly owned water companies in the Milford vicinity reveals the fact that Milford rates are average based on normal consumption patterns. Further, average yearly rate increases of publicly owned water companies in the Milford vicinity over the past 17 years have been 5%. As a result, these independent analyses reinforce the assertion that the anticipated rate increases under future Town ownership should keep rates within the boundaries of acceptable and normal limits going forward based on comparable rate analysis. The Town also has the ability to lower the existing cost structure by combining similar operations with the highway and sewer departments, which has the potential to reduce rates.

As a result of the due diligence work completed, there is a strong and valid argument for the acquisition of the Milford Water Company. There is a possibility that combining similar Town owned operations, which should reduce rates over time, can reduce costs. The Town will benefit from ownership in the long term when the debt is retired. In addition, there is a current risk that another private company could potentially acquire Milford Water Company, which would pass along the cost of debt to the consumer without any economic benefit. There are important and immediate needs to increase water supply and quality and longer term needs to consistently improve infrastructure that can be funded by the recommended rate increases proposed.

It has been our pleasure to work with you and your team on this project. We are further available to discuss this report at your convenience.

Sincerely,

Don Wallroth  
Managing Partner

# Lincoln Group LLC

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## Financial and Business Due Diligence of the Milford Water Company

### Final Report

August 31, 2017



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## 1. Executive Summary

As a result of the due diligence work completed by the Lincoln Group, the most compelling argument discovered for the proposed acquisition of Milford Water Company (MWC) is the Town's desire to control the quality and management of operations in a way that will ensure consistency and an adequate investment in capital improvements. In the past, the relatively low level of capital investment, management issues, and revenue lost due to weather led to problems. In addition, there is a current risk that another private company could potentially acquire MWC, which would pass along the new cost of debt to the consumer without any economic return long term. While the argument for an acquisition by the Town of Milford to control quality and management of operations can be justified under these circumstances, the Town should commit its future water commissioners to develop a comprehensive plan for effective management of operations and adequate investment in capital improvements.

Based on a review of similar takeovers of investor owned utilities by local governments there have been several important lessons learned. These lessons include the fact that several towns have failed to deliver rate benefits promised to customers and that there is no sound basis to report that the elimination of profits and taxes (for investor owned utilities) has led to lower rates. A comparative cost analysis was performed for MWC under ownership by the Town versus private ownership and it was determined that the major cost differential between these two ownership structures was the yearly cost for debt. While MWC currently has debt incurred for the new processing plant, the approximate total cost differential is higher for the Town by \$850,000 per year. There are potential means for the Town to lower yearly costs in the future, however, by utilizing alternative financing structures, joint purchasing with other town consortia, and potentially combining similar operational expenses with the highway and sewer departments. In summary, there is no current indication that the Town will see substantially lower rates under Town ownership (although lower rates are possible if cost reductions prove successful) until the debt is retired, which is a compelling economic rationale in the long term.

The most recent analysis of the transaction assumed that the Town could purchase MWC with \$63 million in debt and subsequently borrow an additional \$10 million in debt to cover Capital Improvements for the next ten years with a 2.5% rate increase each year starting in 2018. After review of these assumptions, it was determined that it will be difficult to assume this much total debt based on certain financing restrictions which require that the Town generates sufficient free cash flow to qualify for financing. Assuming that the Town will complete the acquisition of MWC, there is a need to consider alternative mitigating options, which will enable the new Enterprise to operate effectively from a financial, and business perspective including an initial rate increase of 15-30% and subsequent yearly rate increases in the range of 2-5% per year. These rate increases will enable the new Enterprise to operate on a sound financial basis and provide MWC with the ability to invest in sufficient capital improvements for the future.

Historical financial analysis of MWC's audited financial statements point to marginal returns for current ownership during the past three years including limited dividends for shareholders, low federal taxes paid, and re-investment of profits back into the business to pay for capital improvements. Analysis of operations further reveals that MWC has undergone a recent transition from a period of a low level of capital improvements to a new period of increased capital improvements driven by the new manager that is more appropriate given the yearly needs of the business. Capital improvements, however, are limited each year based on MWC's ability to fund these expenditures from internally generated cash flow from operations and when the company is beset with a combination of lower revenue due to drought or excess rain and increased need for capital improvements, the result is to defer capital improvements to later years. Further, because MWC is currently regulated by the DPU, there is a lag period between the time when the company must spend money on capital improvements and when it can obtain higher rates from the DPU which tends to constrain capital improvements. The Town will not be constrained by the same lag period because it will not be regulated by the DPU and it has the opportunity to provide for more consistent level of capital improvements based on its ability to increase rates on a yearly basis.

Analyses of MWC's asset management metrics reveal positive comparative statistics at an aggregate level. The recent expenditure for the new water treatment plant for approximately \$20 million has led to improved water quality and the recent increase in capital improvements by the new manager has provided needed investment. MWC commissioned a detailed engineering study by Tata and Howard in 2010, which highlighted capital improvements programs for 10-15 years into the future that included specific recommendations for water sources, storage, and improvements for the water mains. Analysis of this study reveals that approximately 25% of the storage and supply recommendations have not been completed, and nearly all of the distribution system recommendations have not been completed. It should be noted that MWC's investment in the new water treatment plant in 2013 was a substantial investment in capital improvements and likely led to the decision to defer many of these recommended improvements based on the company's ability to fund capital improvements as discussed in the previous paragraph. There remains a need to fund high priority capital improvements programs mentioned in the engineering study including the short-term need to increase the existing sources of water supply and improve water quality.

Benchmark analyses of comparative rates by town in 2014 indicate that the current rates for Milford are average compared to surrounding communities. Analysis of 273 communities over 17 years indicate that the yearly rate increases per year were between 2-8% and the average was 5%. Anticipated rate increases for the acquisition of the MWC should keep rates within the boundaries of acceptable and normal limits.

In conclusion, there is a valid argument for the acquisition of Milford Water Company based on the assumption that the Town of Milford can ensure proper governance and management of the water company as it relates to the delivery of consistent quality and quantity to the consumer at a comparatively acceptable cost. There is the possibility that costs can be reduced, which should reduce rates over time. The Town will benefit from ownership in the long term when the debt is retired. There are short term needs to increase water supply and quality which should not be interrupted during the transition of ownership to the Town and long term capital improvement plans should ensure the replacement of assets on a timely basis. Less obvious, is the prospect that another private company could acquire MWC because it appears to be "in play", obtain financing which would be paid by consumers in the form of higher rates and costs, and the private company

would own MWC after the debt was retired. If town officials consider the probability of such a scenario likely, it further strengthens the argument for the town to take control of MWC. As a result of our work, Lincoln Group recommends the following action items:

#### Recommendations

1. Develop a comprehensive business plan and long term Capital Improvements plan for the acquisition of the Milford Water Company based on objectives to provide quality and consistency to consumers.
2. Increase rates by 15-30% in 2018 to provide for adequate cash flow to operate the new Enterprise on a solid financial footing to provide for adequate investment in Capital Improvements.
3. Increase rates by 2-5% per year (adjusted by inflation) after 2018 to provide for adequate investment in Capital Improvements and to provide for consistency in longer-term capital projects.
4. Pursue cost reduction opportunities by utilizing alternative financing structures, joint purchasing with other town consortia, and potentially combining similar operational expenses with the highway and sewer departments.
5. Develop short-term capital improvements plan to address the immediate need to restore and increase water supply and improve quality during the period of transition in 2018.
6. Immediately develop a transition plan for acquisition integration of Milford Water Company and organize a search for an effective new General Manager to assume responsibilities.



## 2. Background, Objective, Scope of Assignment

The Town of Milford has asked Lincoln Group LLC (LGC) to provide an assessment of the proposed purchase of the Water Company from a financial and overall business perspective. The town has entered into a non-binding LOI with the seller and wishes to complete a due-diligence assessment of the proposed purchase. Further, Brown Rudnick has documented a “Summary of Water Company Due Diligence Process”, dated February 20, 2017, which outlined specific requirements for the financial due diligence process. Utilizing the Affordability Analysis conducted by Russell Consulting, LGC in conjunction with the Town’s Financial team, has been asked to review the transaction to determine its impact on the Town finances; risk assessment will also be a key due diligence issue as the purchase of the Water Company may have an impact on both operating and financial risk for the Town. The Town has also asked LGC to review the potential impact of pension contributions, healthcare, and other municipal benefits should the employees of the Company become town employees.

### Scope and Approach

**As outlined in the Brown Rudnick Summary of Water Company Due Diligence Process, LGC included the following major areas for inquiry, analysis, and review to complete the financial and business due diligence:**

- A general overview of the regulated and municipal water sectors as it effects the Town and the proposed purchase of the Company including industry trends;
- Company financial review of the income statement (revenue, expenses, EBITDA, cash flow);
- Review of the Balance Sheet including understanding of the assets, liabilities, and off-balance sheet items, which may not have been considered including pension liabilities, contingent liabilities, etc.;
- Review of the Pending Capital Improvement Program based on the report contracted for the Company by Tata and Howard;
- Employee salary history and benefits (health insurance, retirement/pension liability) and future issues;
- Tax records from the perspective of the Company and the Town.

**In addition to the major areas listed above, Lincoln Group reviewed the following list of specific areas:**

- Thorough review of the financial and business model developed by Russell Consulting including the assumptions, calculations, and inputs used to make the decision;
- Analysis of the financing strategy and funding sources to purchase the Company;
- Review the go-forward business model for assuming the Company’s business practices and understand the practical aspects of running this business as it relates to the town and its capabilities;
- Understand and document the issues relating to assuming the current employees within the business including the specific issues relating to benefits and means of assuring employee retention;
- Ascertain the requirements for the transition and integration of the purchase of the Company into current town operations and management oversight required to ensure long-term success;



- Analyze the operating assets being assumed by acquiring the Company; review them from a financial and business perspective including new sources of water in the event that the current sources are depleted;
- Review of the current and future rate setting strategies;
- Articulate the level of risk assumed; present a risk analysis of various components of the purchase;
- Provide an independent evaluation of the affordability of the purchase and key areas of risk for the Town.

As a result, LG has completed its due diligence efforts as outlined above based on a series of intensive interviews with internal and external sources.

### 3. Overview of Regulated and Municipal Water Sectors

#### External Factors

Public and private water systems have come under more scrutiny since the inception of the Safe Drinking Water Act of 1974, which essentially set forth guidelines to ensure that all citizens had access to safe, clean drinking water. Although municipal systems in Massachusetts are not subject to rate setting scrutiny by the MA Department of Public Utilities, they are still subject to review by several outside authorities that do have an impact on the cost and effectiveness of the total system operation.

The safe drinking water standards were originally set by US EPA, but have evolved over time by US EPA, MA Department of Environmental Protection, and the Department of Health. As science has become more sophisticated, testing requirements have increased. Not only have the number of tests required increased, but also the number of contaminants that must be tested for has increased. There are currently 90 tests for contaminants and that list is modified based on public awareness such as the lead contamination in Flint, MI. These standards must be met by all public drinking water systems regardless of size or ownership.

The other major external factor is the capital markets that help to maintain the level of quality and service required under the Safe Drinking Water Act. Capital expenditures (CAPEX) on the treatment plant, constant repairs, replacing, and maintenance on the distribution system and the maintenance and replacement of meters are the major areas that require funding in order to maintain a high quality of water and to avoid issues such as the e coli event of several years ago. Any capital needs being addressed by funding through the capital markets will bring the credit rating agencies in to review the management of the operation and fiscal condition of the enterprise.

The rating agencies will review and opine on the strength of the organizational governance as well as the strength of the management team, and leadership's willingness to raise revenue through increasing rates to ensure that operating costs and CAPEX are covered sufficiently to maintain and improve the system and that there is sufficient cash on hand to cover existing operating costs as well as a potential catastrophic event. This includes any debt service requirements with a debt service coverage ratio of 1.25 times net revenue. If the willingness to set rates appropriately is not evident, the rating will suffer and any access to outside capital markets will be limited and can become more expensive as well.

#### Industry Trends

A major issue that has been evident nationally is decreasing consumption of water by consumers. With CAPEX ranging anywhere from 15% to 40% of revenue, appropriate rate setting to cover those costs has been a challenge with consumption on a steady decline. This trend has been ongoing for the last 10 years. Factors such as weather (drought or excessive rain) and a generally higher understanding of shrinking water supplies and conservation through low-flow appliances and generally changing usage patterns have caused utilities to raise rates at a higher percentage rate from year to year than in the past. Usage is declining and expenditures are increasing causing a wider gap that requires additional funding; as a result, any water system must be aware of these underlying changes to provide for adequate future rates.

### **Historical Milford Water Usage**

The MWC should remain cognizant of the national usage trends, which may continue into the future with usage becoming less or flat, and costs rising, which are not always consistent with inflation. The Water Company, being regulated by the MA DPU, did not have the flexibility to raise rates in smaller increments on a more frequent basis because of the rate setting process with the DPU. Their inability to expand their customer base to raise rates due to a limited supply and limited economic expansion in the area will continue to be an issue for the Company.

Another factor affecting the future of The Company is the potential of a large national/international water concern coming in and acquiring the Company. These purchases can be a double-edged sword in that they have the available capital to maintain the system and their size allows for some economies of scale across the operation, but the rate setting process will continue to be regulated by the DPU and the Town will continue to experience “large” percentage increases periodically as opposed to smaller incremental increases over shorter periods of time. Further, debt expense required to purchase the business will be passed along to the ratepayers and provide no economic advantage for the consumers.

### **Future Water Usage**

Water usage for the water utility will continue to be a major factor in rate setting for the foreseeable future. As usage continues to decline or stay flat, rates will have to continue to rise by at least the rate of inflation to keep pace with operating costs and CAPEX. Inflation may not be sufficient. CAPEX may increase at a higher rate as repairs and replacement costs of the system as it ages increase. Costs of treatment may rise as treatment options change. Personnel costs as it relates to not only wages but also benefits and pension costs as well continue to rise over time.

#### 4. Financial and Business Analysis

Historical MWC audited financial statements show marginal returns for current ownership. Revenues have been stagnant since 2014 due to no rate increases during that time and the drought in 2016 reduced consumption. As a result, MWC's 2016 revenue was almost 8% less than 2014. Net income as a percentage of revenue averaged only 12% for 2014 through 2016. As shown in the table below, MWC's return on capital was subpar for the last 3 years.

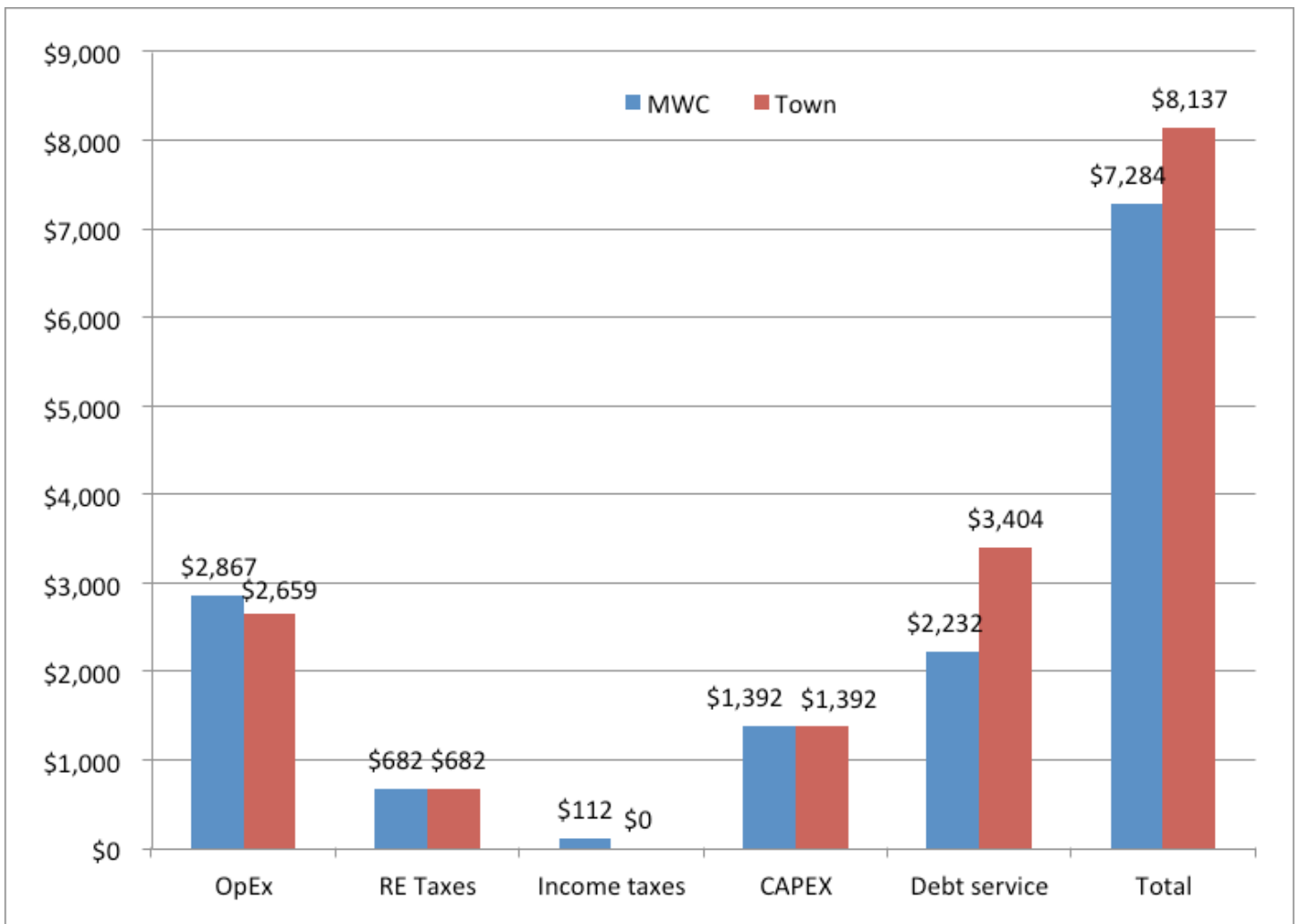
	2016	2015	2014
Net income	818,999	1,067,737	570,555
Net income (before interest expense)	1,756,656	2,062,540	1,575,910
Total average assets	39,526,613	39,267,808	39,488,004
<b>Return on Assets</b>	<b>2.1%</b>	<b>2.7%</b>	<b>1.4%</b>
<b>Return on Assets before cost of borrowing</b>	<b>4.4%</b>	<b>5.3%</b>	<b>4.0%</b>
Net income	818,999	1,067,737	570,555
Dividends	(6,000)	(24,000)	0
Net income less dividends	812,999	1,043,737	570,555
Invested Capital:			
Total stockholders' equity	11,636,478	10,912,613	9,968,023
Total long-term debt	18,410,815	19,675,734	21,154,443
Total short term debt	1,673,387	1,297,373	1,298,140
Cash	(127,613)	(81,848)	(38,585)
	31,593,067	31,803,872	32,382,021
<b>Return on invested capital</b>	<b>2.6%</b>	<b>3.3%</b>	<b>1.8%</b>
<b>Return on Equity</b>	<b>7.3%</b>	<b>10.2%</b>	<b>5.8%</b>

Also, cash flow from operations barely covered MWC's CAPEX and debt service in 2015 and 2016 and was not adequate in 2014.

	2016	2015	2014
Net cash provided by operating activities	2,361,443	2,504,767	1,680,709
Net cash used for investing activities	(1,391,692)	(1,139,377)	(880,118)
Net cash used for financing activities	(923,986)	(1,322,127)	(1,473,573)
Net change in cash	45,765	43,263	(672,982)

MWC has been marginally profitable and marginally cash flow positive for the last few years and is probably in line for a substantial rate increase, which indicates that Milford will also need an additional initial increase in rates. Lincoln Group performed a comparative cost analysis between private ownership and town ownership, and even though town ownership would result in lesser operational expenses, any savings would be outweighed by the increased annual debt service that the town would incur. (See Exhibit 4.1)

Exhibit 4.1

**Pro Forma Cost Analysis – MWC vs. Town Ownership**

## 5. Forecast Model

In order to create a baseline for financial projections for town ownership of the MWC, 2016 actual results for MWC were examined in detail and adjusted to reflect town ownership.

### Revenue:

Actual MWC revenues for 2016 were:

Sales - Total Metered Water	
Water Sales - Residential	\$3,753,299
Water Sales - Commercial	1,073,065
Water Sales - Industrial	315,502
Water Sales - Municipal	167,564
	5,309,429
Other Operating revenue	
Sales - Flat Rate/Residential	810
Sales - Private Hydrants	57,052
Sales - Municipal Hyd (Milford)	810,427
Sales - Misc. Mun Rev/Sprinklers	231,921
Sales - Rent From Property Used	28,126
Misc Oper Rev(Short/Over)	(12)
	1,128,325
Total Operating Revenue	\$6,437,754

Our model is structured so that different rate increases can be applied to these separate categories of revenue. Based on 2017 YTD actuals, total revenue for 2017 was estimated to be \$6.8M. The baseline scenario assumes an annual increase of 2.5% for 2018 and each year thereafter for each revenue category.

The model also contains a variable for an increase or decrease in metered water sales consumption for each forecast year. The baseline scenario assumes a drought every four years (decrease of 10% with a corresponding increase of 10% the following year).



### Operating Expenses:

MWC's 2016 detailed expenses were examined and adjusted line by line to reflect only expenses that would be applicable to Town ownership:

- Items such as depreciation and amortization, income taxes, interest, insurance, legal and consulting were eliminated.
- Eliminated all MWC payroll amounts and replaced with pro forma adjusted payroll for 15 employees.
  - Adjusted gross annual payroll by approximately \$90K to make employees "whole" due to increased health and pension costs.
  - Eliminated FICA cost to Town of 6.2% and replaced with pension cost of 10%.
- As a result, MWC operating expenses (excluding depreciation) of \$2.87M were adjusted to \$2.66M. This was increased by 2.5% for 2017 in order to set a baseline for the Lincoln Group forecast. The baseline scenario assumes an annual increase of 2.5% for 2018 and each year thereafter for operating expenses.

### Real Estate and Personal Property Taxes:

MWC incurred the following taxes for 2016. The baseline scenario assumes an annual increase of 2.5% for 2018 and each year thereafter for these taxes.

Milford Real Estate Taxes	485,259
Milford Personal Property Tax	145,118
Hopkinton Real Estate Taxes	51,316
Hopkinton Personal Prop Taxes	200
	<hr/> 681,892

### Other Income:

MWC had net merchandising and jobbing income of approximately \$104K in 2016. This represents work performed on Contributions in Aid of Construction property ("CIAC"). CIAC represents contributions from homebuilders and real estate developers to fund construction necessary to extend water utility service to their properties. This was increased by 2.5% for 2017 in order to set a baseline for the Lincoln Group forecast. The baseline scenario assumes an annual increase of 2.5% for 2018 and each year thereafter for merchandising and jobbing income.

### Debt Service - Acquisition Bond:

Assumes approximately \$3.4M annual debt service based on a 30-year amortization of the \$63M purchase price.

### Capital Expenditures:

The baseline scenario assumes that the town will spend \$525K, \$3,117K, and \$2,207K in calendar years 2018, 2019, and 2020, respectively:

### Capital Improvements Plan

		Revised for Town of Milford			
		MWC Plan	Calendar Year	Fiscal Year	
2nd half of 2017	\$924,500		N/A		N/A
2018	2,442,000		525,000	2018	350,000
2019	2,385,000		3,117,000	2019	1,733,500
2020	1,022,000		2,207,000	2020	2,662,000
				1st half of 2021	1,103,500
1/2018 - 12/2020	\$5,849,000		\$5,849,000		\$5,849,000
				2nd half of 2021	700,000
					\$6,549,000
				FY 2021 total	\$1,803,500

The model then assumes that the town will spend approximately 19% of revenues for each year after 2020.

### Baseline Scenario Bottom Line:

Based on the above assumptions, there is a need for additional funding of approximately \$12.8M during the first 10 years of operation by the town (see Exhibit 5.1). Since additional borrowing may not be able to be obtained due to inadequate debt service coverage ratios (should be a minimum of 1.25), etc., it is recommended that the town should increase rates by 15 – 30% for 2018.



## 6. Capital Expenditure Analysis

MWC's low level of capital expenditures ("CAPEX") during the latter part of the last decade was a factor in the quality issues experienced during that time. Accordingly, MWC has since increased the level of CAPEX and over the past three years (2014 through 2016) spent \$3.4M or 17% of revenues on capital expenditures. A sample or similar water systems spend as much as 25-40% of revenues on CAPEX. If the decision is made to move forward, Milford should commit itself to provide effective management and adequate CAPEX to ensure that quality and consistency objectives are met; otherwise, there are increased risks of potential for recurrence of problems and lower service levels.

CAPEX is a significant area of uncertainty and risk for Milford, especially in the early years of ownership. Lincoln Group met with the General Manager of MWC and reviewed MWC's capital improvements plan for the remainder of 2017 through the end of 2020. MWC plans to spend approximately \$1.3M on CAPEX for the calendar year 2017, with \$925K of this being spent during the latter half of 2017 (if the transaction moves forward, Milford should verify this expenditure). Additionally, MWC plans on spending an additional \$5.8M on CAPEX over the next three years (2018 through 2020), representing approximately 27% of revenues, assuming minimal rate increases during that time. (See Exhibit 6.1)

If Milford were to purchase MWC, we identified a number of planned capital expenditures that could be delayed in order to help minimize the stress on cash flow during the initial years of ownership. Further, the Town of Milford should determine if there is a need to increase service levels to influence better quality standards.

The General Manager stated that there are two critical expenditures for 2018, the Godfrey Brook well replacement and upgrades (\$350K estimate to finish work started in 2017) and replacing and recharging two GAC filters (\$175K estimate). According to the General Manager, the Godfrey Brook project would help alleviate future restrictions and is necessary for growth.

We have included the capital expenditure estimates from MWC into Lincoln Group projections as indicated in the attached page. We believe these estimates are reasonable based on experience over the past several years to continue the current level of customer service.

Further, we have reviewed the Tata & Howard engineering study conducted in 2010 and found that 75% of the recommended capital improvement have been made for storage and supply (Exhibit 6.2) and very little of the distribution systems recommendation have been completed. We believe that the reason for the latter is the fact that MWC expended capital for the new processing plant and deferred the long-term recommendation until the company could afford to make these investments. Lincoln Group recommends that the Town develop its own long-term CAPEX plan to incorporate these recommendations for the future.

## Exhibit 6.1

Plant Acct	Project	2017	MWC Capital Improvements Plan				Revised for Town of Milford				Revised for Town of Milford - FISCAL YEAR			
			2018	2019	2020		2018	2019	2020		2018 (last 6 months)	2019	2020	2021 (last 6 months)
	per Dave Condey, MWC expects to complete 2017 expenditures by 12/31/2017													
104D	Install New Valve @ Echo Lake	50,000												
105	High Service area upgrades	84,500												
105	Godfrey Brook well replacement	120,000												
105	Clark's Island - Auqua Guard System	25,000												
107	Treatment Plant Upgrades	10,000												
108A	Repair / Replace Gate Valves	20,000												
109A	Replace Lead/Iron Services	400,000												
110	Replace Water Meters	75,000												
610-9	Replace roof MWC W Pine garage	15,000												
105	Replace Clark's Island vacuum system	40,000												
112A	Replace New Hydrants	5,000												
610-3A	Rate Case 2017	80,000												
104D	Rehab Highland Street Tank		500,000				500,000					250,000	250,000	
105	High Service area upgrades		200,000				200,000					100,000	100,000	
105	Godfrey Brook well replacements and upgrades	critical - per D. Condey	350,000				350,000				350,000			
107	New/Replace GAC filters 1 & 2	critical - per D. Condey	175,000				175,000					175,000		
108A	New 12 inch DI water main Central Street from Main St. to Depot St.		480,000				480,000					240,000	240,000	
109A	Replace Lead/Iron Services		500,000				500,000					250,000	250,000	
110	Replace Water Meters		200,000				200,000					100,000	100,000	
117	New Treatment Plant Service Vehicle		37,000				37,000					18,500	18,500	
108A	Clean and line Purchase St. from High Servie boundry to Tanglewood Dr.			930,000						930,000			465,000	465,000
108A	New 12 inch DI water main School St. from Spruce to Walnut St.			250,000						250,000		125,000	125,000	
108A	New 12 inch DI water main South Main Street from Depot Street to Hopedale Line			560,000						560,000		280,000	280,000	
108A	New 8inch DI Main - Myrtle & Poplar Streets			255,000						255,000		127,500	127,500	
110	Replace Water Meters			200,000						200,000		100,000	100,000	
112A	Replace/New Hydrants (5)			30,000						30,000		15,000	15,000	
119	New Dump Truck			80,000						80,000		40,000	40,000	
119	New Backhoe			80,000						80,000		40,000	40,000	
108A	New 12inch DI water main Medway Rd. from Beaver St. to Victory Dr.				430,000					430,000		215,000	215,000	
108A	New 8inch water main West St. from Union St. to Highland St.				400,000					400,000		200,000	200,000	
108A	Repair / Replace Gate Valves			50,000						50,000		25,000	25,000	
112A	Replace/New Hydrants (5)			50,000						50,000		25,000	25,000	
119	New vehicle Manager			38,000						38,000		19,000	19,000	
119	New Service Truck - Crew			54,000						54,000		27,000	27,000	
	ESTIMATE													700,000
	TOTAL	\$924,500	\$2,442,000	\$2,385,000	\$1,022,000		\$525,000	\$3,117,000	\$2,207,000		\$350,000	\$1,733,500	\$2,662,000	\$1,103,500
	Cumulative 2018 - 2020		\$2,442,000	\$4,827,000	\$5,849,000		\$525,000	\$3,642,000	\$5,849,000		\$350,000	\$2,083,500	\$4,745,500	\$5,849,000

## Exhibit 6.2

## Tata &amp; Howard 15 Year Capital Improvement Plan\*

		2010 Dollars		2017 Dollars
		Original Estimate	Remaining	Remaining
Table 7-1	Phase I - Storage and Supply	\$1,172,000	\$322,000	\$383,180
Table 7-3	Phase I - Distribution System	\$2,034,000	\$1,883,000	\$2,240,770
Table 7-5	Phase II - Distribution System	\$6,634,000	\$5,987,000	\$7,124,530
Table 7-7	Phase IIIa - Distribution System	\$1,497,000	\$1,497,000	\$1,781,430
Table 7-8	Phase IIIb - Distribution System	\$11,447,000	\$11,423,000	\$13,593,370
Table 7-9	Proposed Hydrant Locations	\$145,000	\$145,000	\$172,550
		\$22,929,000	\$21,257,000	\$25,295,830

\*Does not include expenditures for water treatment plant or regular yearly maintenance.

## 7. Employee Analysis

Excluding directors and officers, there are fifteen MWC employees. All employees, with the exception of the General Manager have expressed a desire to become town employees if the acquisition were to move forward. According to the General Manager, their main concern is that they remain “whole”, that is, that their net pay remains the same. Health and pension costs are the main differences when it comes to take-home pay. It is estimated that it would cost the town approximately \$90K to adjust MWC employees’ annual salaries in order for them to remain whole.

Pension - MWC employees’ FICA deduction of 6.2% would be replaced by 9% of the first \$30K in salary and 11% of salary in excess of \$30K. There is currently a study being conducted to see if any assumption of pension liabilities by The Town will be necessary.

Health - Listed below is a comparison of the health plans of MWC and Milford. Milford’s premiums are higher, Milford only offers individual or family coverage (no Employee plus one coverage), and Milford employees pay 30% of health premiums and 50% of dental premiums while MWC employees pay only 25% of their respective premiums.

### MWC Health & Dental

#### **Tufts Health Plan Advantage HMO 2000**

#### **Principal Dental & Vision**

	2017 Health (75/25)		2017 Dental (75/25)	
	Monthly Premium	Weekly Deduction	Monthly Premium	Weekly Deduction
Employee	520.35	30.02	24.79	1.43
Employee & Child	962.69	55.54	77.48	4.47
Employee & Spouse	1,040.69	60.04	80.43	4.64
Family	1,483.04	85.56	104.35	6.02



**Town Health & Dental**

**BCBS HMO Blue**

**Delta Dental**

	2017		2017	
	Health (70/30)		Dental (50/50)	
	Monthly Premium	Weekly Deduction	Monthly Premium	Weekly Deduction
Employee	889.91	61.61	43.70	5.05
Employee & Child	2,334.26	161.60	113.44	13.09
Employee & Spouse	2,334.26	161.60	113.44	13.09
Family	2,334.26	161.60	113.44	13.09

## 8. Rate Analysis

The Lincoln Group completed a benchmark analysis of water rates and average cost of water for a typical consumer based on the 2014 Tighe & Bond rate survey of 273 communities. Based on these analysis and updated surveys for 2017, it was determined that the average annual cost for the typical consumer for 273 communities in 2017 was \$584 per year, compared to the Milford rate of \$628. The Exhibit 8.1 below highlights the costs for towns surrounding Milford, which indicates that Milford rates are in the average range for these towns.

In addition, Lincoln Group completed a benchmark analysis of comparable towns' rate increases from 2000 – 2017 and concluded that the average percentage increase each year is 5% per year as indicated in Exhibit 8.2.

Exhibit 8.1

### Average Annual Water Bills in Other Communities

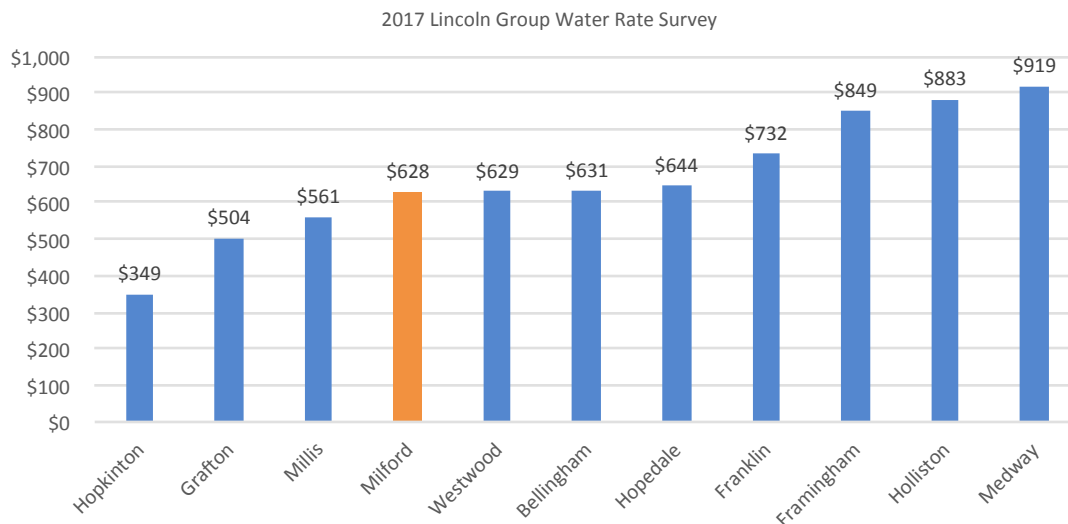
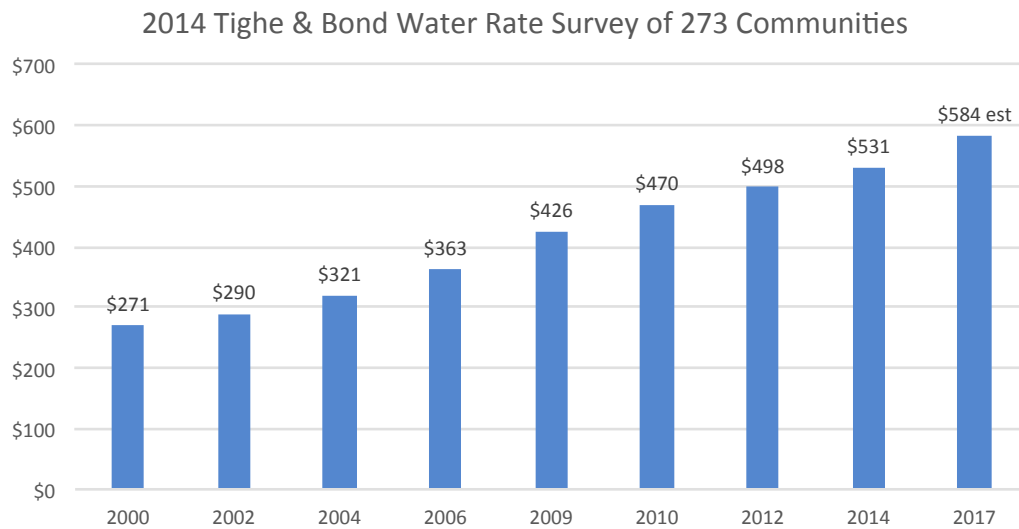


Exhibit 8.2

## Annual Average Cost of Water



Average cost increase of 5% per year

## 9. Other Considerations

The major consideration in this transaction is that the Town will be in control of its water supply, control over its water quality and control over its ability to maintain and increase its access to high quality water resources as the town grows. To this end, the following additional considerations are important topical areas for review.

### Financing of CAPEX

Given the current capital plan as provided herein, it was revealed funding these projects through additional debt might not be feasible given the size of the projects. Bonding for small projects is not typically acceptable. Small projects like these are typically funded on a pay-as-you-go basis, as they are significantly less expensive. One financing option that is available to the Town is cost effective is the MA Clean Water Trust that administers the Safe Drinking Water State Revolving Fund. Funding is applied for each year by submitting the project needing funding to MA Department of Environmental Protection (MA DEP) where it is evaluated and scored based on a variety of criteria. If the project's score is high enough, the Clean Water Trust will finance the project and the Trust favors towns versus private ownership.

CAPEX is the mechanism for ensuring that the quality of water is at the highest level possible and that the probability of another contamination event is minimized. Reducing the amount of CAPEX in an effort to minimize rate increases raises the risk level of the quality of the water. Using reserves to fund CAPEX limits the utility's ability to be ready should it experience a catastrophic event.

### Risk Analysis

#### Financial risk:

The additional debt service of this transaction and the length of the amortization of said debt will factor into any future ability the utility will have to issue debt in the future. Without an adequate increase in rate the current rate structure, the utility will not be able to maintain a strong fiscal picture and possess the key metrics of cash on hand and debt service coverage ratios that will enable the Town to access the capital markets available to the utility.

#### Water Usage and Supply Risk:

With water usage at historical lows and potentially continuing to decline or remain flat, rates will need to be adjusted upward on a regular basis to maintain enough revenue to cover rising operating costs such as personnel costs, heat, lights, power, telephone, chemicals for treatment, and insurance. The same issue applies to CAPEX spending. The alternatives to raising rates is expanding the customer base which is driven by the Town's economic development plan, which would allow for certain types of development and growth within the Town.

There is a supply risk within the utility as MWC has explored options to develop new sources but has found it both time and cost intensive. There are very limited options and the alternatives to finding new sources are to

enter into a purchase agreement for water with a nearby system in the event that the utility's supply is inadequate. This option would be a potential cost to the utility.

**Capital Improvement Risk:**

The risk is that if the necessary improvements are not made in a timely fashion, the system is facing at a potential contaminant event or a catastrophic event where there is a system failure because the distribution system has not been maintained. There could also be an excessive leak causing higher levels of lost water, potential sinkholes or street collapses, and health issues.

## 10. Sensitivity

Lincoln Group performed a sensitivity analysis of the baseline model using several different scenarios. The baseline scenario results in a need for an additional \$12.M in funding through 2027.

### Baseline Model Assumptions:

- An annual increase of 2.5% for 2018 and each year thereafter for each revenue category.
- A drought every four years (decrease of 10% with a corresponding increase of 10% the following year).
- An annual increase of 2.5% for 2018 and each year thereafter for operating expenses.
- An annual increase of 2.5% for 2018 and each year thereafter for real estate and property taxes.
- 2018 transition/implementation costs of \$750K for 2018 representing transaction costs, start-up working capital, etc.
- An annual increase of 2.5% for 2018 and each year thereafter for other income (merchandising and jobbing income).

### Scenarios:

1. Baseline scenario with Year 1 metered water rate increases of 15%, 5% for 2019 through 2021, and 4% annually thereafter
2. Baseline scenario with Year 1 metered water rate increases of 20%, 5% for 2019 through 2021, and 4% annually thereafter
3. Baseline scenario with Year 1 metered water rate increases of 25%, 5% for 2019 through 2021, and 4% annually thereafter
4. Baseline scenario with Year 1 metered water rate increases of 30%, 5% for 2019 through 2021, and 4% annually thereafter

As the summary in Exhibit 10.1 illustrates, the best outcome (given the inputs assumed above) is Scenario 4 with a 30% metered water rate increase in Year 1. Based on the underlying assumptions of the model, additional funding would not be required.

**Baseline Scenario with Year 1 Rate Increases**  
**PLUS increased Annual Raises compared to Baseline**

Financial Ratios Summary											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	
Baseline	Metered water sales rate increase	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	
	Metered water sales consumption increase (decrease)	0.0%	0.0%	0.0%	0.0%	(10.0%)	10.0%	0.0%	(10.0%)	10.0%	
	Revenue	6,970	7,144	7,323	7,506	7,092	7,824	8,020	8,220	7,768	8,569
	Additional funding needed for CAPEX	344	2,849	1,847	945	1,484	882	818	756	1,347	690
	Cumulative additional funding needed	344	3,193	5,040	5,986	7,470	8,352	9,170	9,926	11,273	11,963
Forecast 1	Metered water sales rate increase	15.0%	5.0%	5.0%	5.0%	4.0%	4.0%	4.0%	4.0%	4.0%	
	Metered water sales consumption increase (decrease)	0.0%	0.0%	0.0%	0.0%	(10.0%)	10.0%	0.0%	(10.0%)	10.0%	
	Revenue	7,635	7,979	8,339	8,716	8,304	9,300	9,646	10,006	9,526	10,678
	Additional funding needed for CAPEX	0	2,014	831	0	272	0	0	0	0	0
	Cumulative additional funding needed	0	1,693	2,525	2,260	2,532	1,938	1,130	101	0	0
Forecast 2	Metered water sales rate increase	20.0%	5.0%	5.0%	5.0%	4.0%	4.0%	4.0%	4.0%	4.0%	
	Metered water sales consumption increase (decrease)	0.0%	0.0%	0.0%	0.0%	(10.0%)	10.0%	0.0%	(10.0%)	10.0%	
	Revenue	7,901	8,258	8,632	9,024	8,592	9,630	9,989	10,362	9,860	11,059
	Additional funding needed for CAPEX	0	1,735	538	0	0	0	0	0	0	0
	Cumulative additional funding needed	0	1,148	1,686	1,114	1,097	174	0	0	0	0
Forecast 3	Metered water sales rate increase	25.0%	5.0%	5.0%	5.0%	4.0%	4.0%	4.0%	4.0%	4.0%	
	Metered water sales consumption increase (decrease)	0.0%	0.0%	0.0%	0.0%	(10.0%)	10.0%	0.0%	(10.0%)	10.0%	
	Revenue	8,167	8,537	8,925	9,332	8,880	9,959	10,332	10,719	10,193	11,441
	Additional funding needed for CAPEX	0	1,455	245	0	0	0	0	0	0	0
	Cumulative additional funding needed	0	603	848	0	0	0	0	0	0	0
Forecast 4	Metered water sales rate increase	30.0%	5.0%	5.0%	5.0%	4.0%	4.0%	4.0%	4.0%	4.0%	
	Metered water sales consumption increase (decrease)	0.0%	0.0%	0.0%	0.0%	(10.0%)	10.0%	0.0%	(10.0%)	10.0%	
	Revenue	8,433	8,817	9,219	9,640	9,168	10,289	10,675	11,076	10,527	11,823
	Additional funding needed for CAPEX	0	1,176	0	0	0	0	0	0	0	0
	Cumulative additional funding needed	0	57	9	0	0	0	0	0	0	0