

Mr. Stan Francom, General Manager of the Carefree Water Company, was gracious enough to answer some questions from Water For Pine Strawberry (WFPS) about small water company valuations and operations. Carefree Water Company provides water service to approximately 1800 customers. The Town of Carefree purchased their water company in 1999.

Mr. Francom has owned property in Strawberry Mountain Shadows II for the past 20 years.

WFPS: Rim Country Water is using an average valuation of 2.4 million for the two water companies. This is a third less than the independent average valuation of 3.6 million from 2003 and 55% less than the average valuation of 5.4 million based on updating the 2003 valuation with the 2006 numbers. In your experience, would it be reasonable for a water company to lose that much value in four years?

Mr. Francom: No, at the time of a sale of water company assets they are most normally valued at “reconstruction cost new less depreciation.” Depreciation rates are set by the ACC for a private water company. A reduction in value of the assets of a water company normally would not decrease more than 2 to 3 percent a year if no repairs or improvements to the assets occurred or no additional assets were added.

WFPS: What factors influence the valuation of a water company? Which of those factors do you think would be most significant in valuing PWCo/SWCo?

Mr. Francom: A limited water supply and water storage would be critical factors if I were involved in trying to purchase the water company. I do not know if there is a CAP water allotment but there is little way to utilize that source of water unless an exchange or trade could be made. It has some value on the market but the Government will not allow a profit to be made on the sale if the sale of the water rights could be affected.

WFPS: What is the realistic range for per customer purchase price of a typical small water system? In your estimation, where would the PWCo/SWCo fit in that range?

Mr. Francom: I would think the range of \$ 3,000 to \$ 4,000 per customer is about the going rate for a friendly negotiated price. Cost would go up considerably under a condemnation procedure. Of course there are circumstances such as CAP water allotments, totally new facilities, or a limited water supply that could have either a positive or negative affect on the overall value. I do not know the condition of or the extent of the assets, I do know that with a limited water supply and limited storage and possibly old infrastructure those items would have to be addressed as they would have to be resolved in the near future and would tend to decrease the overall value of the system.

WFPS: PWCo has an allocation of 161 acre-feet per year of CAP water. What would you say the value of that allocation would be?

Mr. Francom: I assume that the allocation is an M&I water allocation. As I indicated previously, because it is an allocation from a Government contract I have been told by CAP legal staff that you can only sell it for cost. That cost is calculated based upon the sum of each years cost for M& I water. The transfer of the allocation will require an environmental impact statement to be made on the affects of the sale as part of the transfer process, public hearings are also required as well as Superior Court approval of the documentation.

WFPS: Carefree's water rates have increased 300% since Carefree purchased their water company in 1998. What factors that drove that increase do you see that are also present in Pine-Strawberry?

Mr. Francom: Rates have increased since the purchase of the Water Company as a result of the following:

1. Carefree Water Company was financed through a sale of bonds which accrue interest and require payment of interest and principal. These payments all funded, from water rates. That same situation would apply in your case. In Arizona, according to WIFA, those water companies that exist under a district type of ownership normally have come about because of their purchase of an existing utility and their rates are normally higher to accommodate the purchase price payback.
2. Carefree Water Company has added about \$ 10,000,000 worth of infrastructure during the interim. Improvements such as upgrading miles of water lines sizes from small 4 and 6" lines to 10 and 12" lines. We have added about 200 fire hydrants to the system as well as a 1,000,000 gallon water tank, upgraded wells by doubling their pumping capacity, purchased an additional 900 A. F. of CAP water allotment and placed standby generators on all of our wells and pressure pumping station as well as replaced and upgraded all of our pumping stations. All this was done to bring the Water Company up to a standard to meet County, State and Federal requirements as well as to provide a reliable and safe water supply system even in times of drought or emergencies. Our system will now be able to provide water on a 100 year assured water supply basis for all or our current customers and all the anticipated development within the service area of the Water Company through total build out of Carefree. We also have the capacity to address emergency drought conditions and the limitation of our CAP water supply from our well pumping and water storage capacities. In addition as a result of using more treated CAP water and recharge in the basin, the water levels in the Carefree-Cave Creek aquifer,, have increased about 30 feet in the past two years thus assuring an ability to pump water to meet our customer's needs if the Cap water supply were to be diminished or cease. All these improvements will provide a continued property value to property owners in Carefree. I am sure that every one of us that own property in Pine would like to have such reliability. Many of these items would probably need to be considered in Pine but not to the same extent nor at the same accelerated time table as we have done. We basically are at a mid point that we have needed to reach because of

the type of water customers that we have, their backgrounds and the type of lifestyle that they feel they need to have.

3. Carefree Water Company is a stand alone operation and has no call or financial help from the General Fund of the Town of Carefree. Therefore everything done to improve the system has to be paid for from rates, capacity fees or other utility generated revenues. Your situation would also be directly affected by this issue.
4. Being in the Phoenix area but yet at the outskirts of the development area we still compete in the same employment pool as the bigger cities and towns for certified water operators. Not only does this require us to pay higher wages but our benefit packages are also a tremendous expense. Since the purchase these costs have increased at an enormous rate. Perhaps you would not be saddled with the full extent of these costs.
5. Finally we do not treat our CAP water it is purchased from Scottsdale or Cave Creek Water Co. which makes that portion of our water cost more expensive than pumping water as the water purchase prices included overhead and maintenance cost from those entities to which we add our costs. For you that would not be a factor.

WFPS: Brooke operates multiple water companies in the area. How important are those economies of scale for small water company's costs? Would they tend to outweigh any savings that would result from being publicly owned?

Mr. Francom: Economies of scale are enjoyed when expenses can be shared over several entities. Normally the largest entity picks up an inordinate amount of the expenses because it normally generates more revenue and that is where the administrative costs mostly are accounted for. The largest savings occur in the elimination of property taxes because a district is a quasi-governmental organization and is exempt from property taxes. Administrative costs are also less as usually the billing and other administrative cost are done by only one set of personnel.

WFPS: If Brooke retains most of their staff for their other water companies, how difficult will it be for a new staff that are just handed a set of keys, to be able to operate the water companies? What challenges would they face?

Mr. Francom: It would depend a lot on the type of experience of the personnel who took over the operations and what cooperation they had from the out-going personnel. For example, Cave Creek Water had a very poor relationship with their outgoing personnel when they acquired their water company. They also had absolutely no experience in running a water company and as a result they hired an outside service to run the operations of the water company. Because of the loss of the experience from the previous operations personnel, meter reading, billing and general operations suffered. When leaks occurred the new personnel had difficulty locating turn off valves, and when repairs were required parts had to be obtained after excavation of the line breaks as no information was available as to the type and size of the distribution system. That type of situation can exist under condemnation or forced negotiations when acquiring an existing utility

company. The customers are the ones to suffer in such cases, they still have to pay the water fees but receive diminished services during the time it takes to learn the distribution system and how to properly operate the requirements of providing a safe and consistent water supply. There are a lot of State and Federal regulations that must be met to remain in compliance with the Safe Drinking Water Act, which include sampling, testing, and reporting. One of the critical factors is the knowledge of when, where and the timing of many of those requirements..

The most obvious and first challenge is to have qualified personnel to continue the collection of revenues and the operation of the company. That means having a billing program and a means to read meters, then someone to actually operate the program to produce and issue bills. Next, Pine Water has some unique challenges in providing a continuous water supply to their customers which would need to be addressed. Next, water storage becomes an issue which would also would need to be addressed. With a limited supply of water, operation of the distribution and storage systems becomes extremely more difficult and critical in meeting customer demands during peak periods. Repairs and maintenance are not so much a challenge.

WFPS; Mr. Francom, how much do you know about what has been going on with the K2 project and the recall?

Mr. Francom: I have not been involved in the current processes other than to read the information provided in all the web sites and newspaper articles relating to the well and ensuing recall. I do not consider myself an expert on the specifics of the situation in Pine as I am not totally familiar with the total situation. I do know that many of the consultants that have been used in evaluating the well process are reputable as we have used some of them to do work for us.

WFPS; What is your opinion on the general advisability of the water district purchasing the water companies?

Mr. Francom: It has always been my opinion that an in place water management structure is more efficient to work with than establishing a new one. The reason for establishment of a new Water Company should only be done after an exhaustion of every approach to resolve whatever problem within the confines of the establishment and then taken only as a last resort. I say that because of the anticipated greater costs involved for each customer, the greater amount of time that it will take to accomplish the same results and address the same problems, under the same conditions and probably will come to almost the same conclusions as the prior management..

I do have some concern that if wells in the Pine area exist that are producing water in quantities that have been determined adequate, why then hasn't more consideration been given to drilling a well in those areas where at least the odds would seem to be more favorable for the development of a well that would meet water supply requirements. I have not been able to determine how cooperative the Water Company is to working with the community. Many times personalities get in the way of the best interest of everyone because of some comment or disagreement that is more personal in nature. It appears that people need to realize that the Water Company is in the business of a

business and the way that they look at this situation is not quite the same way as does a customer. Many customers think that they are experts in many areas but the water business really does require a different skill set because of the tremendous amount of expenditure to generate revenues, constant maintenance and surveillance of the system, and dealing with a public that considers that is almost an inherent right to open the tap and have a safe, consistent water supply. That consistent, safe water supply does not happen by chance, it takes real expertise enhanced by experience. It appears to me that the current board has made efforts to work through the existing Water Company and outside consultants , relying on their expertise. Without the knowledge and experience of being water experts themselves that is a normal and accepted approach.