

PUBLIC HEARING

before

SENATE ENERGY AND ENVIRONMENT COMMITTEE

on

SENATE BILL 991

(Provides for additional and upgraded wastewater treatment systems)

Held:
April 26, 1984
Room 346
State House Annex
Trenton, New Jersey

MEMBERS OF COMMITTEE PRESENT:

Senator Daniel J. Dalton, Chairman
Senator Catherine A. Costa, Vice Chairwoman
Senator Peter P. Garibaldi

ALSO PRESENT:

Mark T. Connelly, Research Associate
Office of Legislative Services
Aide, Senate Energy and Environment Committee

New Jersey State Library

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SENATOR DANIEL J. DALTON (Chairman): Good morning. We would like to start the hearing now. This will be the second and final hearing with regard to S-991 conducted by the Senate Energy and Environment Committee. To my left is Senator Catherine Costa. I suspect we will have more of our members here as time goes on.

The purpose of the hearing, again, is to attempt to provide this Committee with as much information as possible with regard to the bill and, more specifically, with regard to the concept of privatization. As we all know, it is a major policy initiative. It is something that this Committee is taking very, very seriously. As a result, we want to study it and get as good a handle on it as we possibly can.

I should note that if any of you have prepared statements, we can read them, and we would appreciate it if you would paraphrase and attempt to get to the heart of your statement as quickly as possible. I am just looking down the list of people who wish to testify today, and there are a great number of them. We are going to try to expedite things as much as possible, so we can get out of here sometime before midnight tonight.

The first speaker today will be the Director of the Division of Water Resources, New Jersey Department of Environmental Protection, Mr. John Gaston. John?

JOHN GASTON: Thank you very much, Senator Dalton. This is the second time the Department has had an opportunity to appear before your Committee, and I won't repeat all the things which were covered in Commissioner Hughey's testimony the last time we met. However, I would like to reiterate and highlight the rationale for why we are in strong support of this bill.

As you are aware, the program to complete the publicly-owned wastewater treatment facilities' initiative in New Jersey has a great deal of work to do. The Federal Water Pollution Control subsidies we have depended upon under the current scenario will end in 1985, and we have some \$3 billion worth of municipal needs yet to be addressed, well over \$1 billion of which are in the Camden area, the Hudson County area, and the Middlesex County area. These represent top priorities with respect to the Department's cleanup initiatives.

Last year, faced with the reality of diminished Federal

resources, the Department sought some additional options above and beyond the option of a strict enforcement program -- a stick program -- realizing that in order to have local municipalities address their needs, they needed some viable options on the financial side as well. The infrastructure bank was proposed and, of course, that is under review in other deliberations, and the concept of privatization -- the marrying of public tax incentives with the private sector's ability to perform and do work -- was devised.

I think why it is important to us can be summed up in a few items. In the municipal area, the \$3 billion need we have is manifested when we look at our compliance figures. Municipal compliance figures are fully 20% below the compliance figures on the industrial side. You know, a lot of the public's frustration with environmental compliance is exercised on the part of industry, but the numbers show that municipal compliance runs far below industrial compliance. So, we know that the municipal sector is going to have work to do, and we urgently need mechanisms to bring that about.

We mentioned before the uncertain Federal presence. In order to bring about compliance, we understand that the users and systems need a subsidy of some form or another to make the rates as reasonable as they can be. Without a guarantee of continued Federal participation in the program, we need another viable mechanism. The privatization option represents a viable mechanism for a certain family of programs which exist.

A third element is that the Federal government and the Clean Water Act require that compliance of all municipalities with mandated treatment levels take place by 1988, or sooner. That compliance deadline applies with or without Federal assistance.

We are in the midst of implementing a program called the "Municipal Management Strategy," to systematically look at all the systems which are not in compliance with treatment requirements now, and impose, through the permit system, schedules and requirements to bring about compliance. Included in this process, will be the full implementation of the Department's proposed Sewer Allocation Program, which will put the allocation of capacity into the hands of the municipalities, and a parallel program which will put the institution of sewer bans into the hands of the municipalities.

When the New Jersey Water Pollution Control Act was instituted, or when it was passed by the Legislature, and regulations were promulgated in 1981, that Act turned over to municipalities the responsibility for: (1) meeting their permit standards, and (2), not allowing their systems to be overloaded. We are in the midst of bringing our regulations for the sewer bans and bringing our program for sewer allocations up to speed in that regard. This summer, we will be turning over the responsibility to municipalities for ensuring that their plants meet water quality requirements, that they not become overloaded, and that they take the first initiative, not the Department, to institute curtailments and connections when they reach levels that are close to permitted levels.

For these reasons, the necessity for having some viable alternatives to turn to in implementing financial solutions -- and there are so many of them that need to be implemented -- is urgent and apparent. As the privatization legislation was developed, the Department participated in the development. There are essentially three items included in the legislation that are important in terms of curing problems which exist as to why privatization has not already been implemented. Perhaps some of the people in the audience who are going to testify today will talk a little bit about why they have not moved forward, and about how anxious they are to move forward. But, we found three problems that we needed to cure. One was to clarify the New Jersey statute with respect to the subject of long-term contracts. The second problem which needed to be corrected, was to make it clear that a process of negotiated procurement could be pursued in the context of entering into private/public contracts. Thirdly, there needed to be a mechanism that the public could feel confidence in for rate setting in a long-term fashion.

These items have been addressed in the legislation. We are most anxious to see the bill moved, so that from the Executive side, we will be able to use it as a positive element in our program of bringing about improved compliance and a reduction in the backlog that we continue to have on the municipal side.

SENATOR DALTON: Thank you, John. We have been joined by Senator Peter Garibaldi from Middlesex County. Good morning, Senator.

SENATOR GARIBALDI: Good morning.

SENATOR DALTON: Are there any questions for John from either Cathy or Pete?

SENATOR COSTA: How would private involvement add to the available financing methods?

MR. GASTON: Excuse me?

SENATOR COSTA: How would private involvement add to the available financing methods?

MR. GASTON: The problem that municipalities have is that they frequently either have access, or could get access, to money to build projects. However, the cost of the money and the cost to the users is considered to be prohibitory. In the context of this bill, what we envision is that private entities would put up the capital to construct wastewater facilities, and then to also operate and maintain those facilities on behalf of the municipalities. In return, municipalities would share in the tax benefits which would be available to the private entities for performing such projects, and they would be able to pass those benefits and other incentives along to the users of the system. In that regard, they could pass along lower rates, which is really the bottom-line objective as to why we are pursuing this arrangement.

SENATOR COSTA: What mechanism would be in place to assure that these lower rates would come to the consumer, and not in some way keep the rates high, at the same time they are being promised by having privatization that the rates would be lower?

MR. GASTON: Well, the municipality, or the participating group of municipalities, would have the benefit of knowing what their costs would be at the time they entered into a service contract for the actual implementation of a project. So, the contract, and the formulas that are included in the contract would serve as the mechanism for controlling the fiscal and financial exposure of a community to the project implemented. That contract would spell out how the benefits would be shared between the owner and the beneficiaries, the users of the system.

SENATOR COSTA: Who would be the overseer? Is the government completely out of it?

MR. GASTON: The contracting party would be the municipality or other public entity. The owner of the facility would be the

constructor, the private party.

SENATOR COSTA: And so, the municipality itself would have access to the books, etc. to see that it is all proper?

MR. GASTON: That could be written into the agreement and become a practice, yes.

SENATOR COSTA: Thank you.

SENATOR DALTON: Senator Garibaldi?

SENATOR GARIBALDI: Mr. Chairman and members of the Committee, obviously I missed a portion of your comments, but one thing strikes me right at the outset. What impact would this have on the benefits of municipal bonding and the exempt status with regard to taxation? You know, many investors look to these types of capital funding programs for tax exempt purposes, at least so far as Federal and New Jersey State bonding is concerned. Would this contaminate that prospect, now taking it out of the realm of municipal or governmental bonding and putting it into an area of private enterprise?

MR. GASTON: Well, this is a Federal question, but we have been working very hard to preserve the use of tax exempt bonds to finance this type of project. In that sense, we would have a degree of comparability between a project that was implemented by a municipal entity and a project that was implemented by this kind of an entity in New Jersey. Of course, that is a Federal question which is being actively debated as part of the Deficit Reduction Program down in Washington.

SENATOR GARIBALDI: But, you do not have any specific insights at this time in that connection, do you?

MR. GASTON: Our insights are that we have been working with our legislative delegation down in Washington to preserve the availability of a tax exempt status for these types of projects, on the wastewater side, as well as on the resource recovery side, in any of the bills which move through the legislative process. That is a process that changes day-by-day, so I don't think it is really possible for the record to indicate where it stands right now.

SENATOR GARIBALDI: But, I think that is a question of some import that should be resolved.

MR. GASTON: What will happen is, if we are successful in preserving the tax exempt status, it will make the benefits to the

users greater. If we are not successful, the benefits will not be quite as great, but there will still be some subsidy benefits that will be available. The philosophy we have been pursuing is that any benefits we can extend to the users will be an advantage, when you compare that to the "worst case option," which is the option where the municipality has to put up 100% of its own money, using its own bond rating to implement a project.

SENATOR DALTON: Thank you, Senator. John, could you give us a status report of the tax incentives the Federal government is ready to supply a private entity for engaging, say for instance, in a wastewater treatment plant?

MR. GASTON: There are three principal areas we're talking about: One would be the investment tax credit for any construction; the second would be accelerated depreciation for any construction that might take place; and, the third, which we were just referring to, would be the issue of using tax exempt bonds as the basis for the actual construction to take place. These considerations have been debated in the Deficit Reduction Program. You know, I did not make a call at five o'clock last night to find out where they stood, and literally over the--

SENATOR DALTON: (interrupting) Where did they stand yesterday morning? (laughter)

MR. GASTON: Well, it might be a couple of weeks ago, but we thought we had at least a good chance of preserving all three of them for the purposes of this program. However, we have experienced flip-flopping with respect to that report in the weeks which have passed. Senator Bradley is very much aware of the importance of this; Senator Lautenberg is aware of it. They are working to make sure that, on the Senate side, these are included in any bill that gets reported out.

SENATOR DALTON: So, we are not only concerned about -- as far as the implementation of a privatization program in this State -- this bill, or even the McEnroe bill, but we are also very, very concerned about what the Federal posture will be, because without the Federal government's cooperation in this whole area, what we may do here may be almost irrelevant without these tax incentives. Is that correct?

MR. GASTON: I guess what would happen would be that the benefits of the concept would not be as great. The legislation is structured as being permissive legislation, so it opens the opportunity for a municipality to evaluate it in its particular circumstances. In that regard, we think it is an advantage, because municipalities really need all the options possible in these hard times, and sometimes unique conditions can bring about greater advantages to the municipalities, even though there might not be the same set of potentials because of restrictions at the Federal level.

SENATOR DALTON: So, what you're saying is that the potential will be minimized.

MR. GASTON: The potential might be reduced as a consequence of Federal legislation, but I do not think it will be eliminated, and the value of having a subsidy of some sort, when it is the only subsidy in town, may be of such a nature that some towns would want to elect to utilize it. So, we feel that State legislation ought to be put in place and be the best legislation possible. We, and you, and I think many people in the audience will be working at the national level to make sure that as many of the positive characteristics that are presently available there will be maintained.

SENATOR DALTON: Don't read me wrong, we are going to attempt to move forward. However, I just wanted to draw from you the relationship between what we do here vis-a-vis what is going to be happening in Washington.

MR. GASTON: It is very much a two-part game, and the benefits can really be multiplied if we are successful in Washington. I guess what I have been trying to say is that there are benefits independent of what happens in Washington, but if we are successful in Washington, there are going to be more benefits that can be passed along to the users.

SENATOR DALTON: In a proposed wastewater treatment plant, what is your feeling as to the percentage of money that will be put up front by the private investor?

MR. GASTON: I would say a very substantial percentage, you know, 90% to 95%.

SENATOR DALTON: Ninety to ninety-five percent of the up-front money is going to be put up by the private investor?

MR. GASTON: It could be 100%, as that would be a matter that could be negotiated in the contract. That is a real advantage as far as municipalities are concerned, because they would not have to draw upon sources of equity they might have.

SENATOR DALTON: As a result, the other 5%, or 10% is going to be put up by the local government?

MR. GASTON: It would be a matter of negotiation. If they were not inclined to put up 5% or 10% because of local considerations, they would not have to.

SENATOR DALTON: We'll ask a question later of the audience -- of the private people out there -- if any of you are going to put up 90% or 95%, please raise your hands.

John, I want to thank you very much for coming over. I know this is your second trip here and, as I said, hopefully it will be your last, unless the members of the Committee would like to have you back for any further questioning. Senator Costa?

SENATOR COSTA: I have just one more question. If a private firm puts that much money up and it does have the accelerated depreciation, whose responsibility is it, and how sure are we that the contract will be written so that the best material will be used? As I understand it, after so many years, the whole thing goes back to the municipality itself. Where does the responsibility lie, and how can we be assured that this will be written into the contract -- that the best materials will be used?

MR. GASTON: Well, the contract could specify what the standards might be. The contract could also specify that the requirements of the State's various laws be complied with, in terms of materials which are included in the project. That would be on the building side, as well as on the wastewater facility's construction standards that exist. So, those things can be written into the agreement. It would seem to me that a municipality that was entering into a contract would have its advisers -- professional advisers -- look at the contract, and look at the standards required, from a legal, financial, and engineering prospective. The plans that would be developed, of course, would be reviewable and approvable by our agency. So, there are a couple of levels--

SENATOR COSTA: (interrupting) There is a mechanism for approval by the State agency?

MR. GASTON: That's right.

SENATOR DALTON: Just for clarification, John, when I said up-front costs, let me rephrase that. How much of the total contract cost is the private entity going to put up?

MR. GASTON: Well, it would seem to me they are going to put up the part that deals with the financing of the project itself. There would probably be other costs that might have to be--

SENATOR DALTON: (interrupting) What percentage range would you give? I'm asking for a ball park figure here.

MR. GASTON: Maybe up to 15%.

SENATOR DALTON: Up to 15%?

MR. GASTON: Yes.

SENATOR DALTON: Okay. I guess rephrasing that sort of cleared it up, at least for me and the members of the Committee. Thank you, John.

MR. GASTON: Thank you.

SENATOR DALTON: Is there anyone here from the Division of Local Government Services? (no response) They are going to take part in this whole process, as far as a review of the contract. If we can't get them here today, I would certainly like them here at the next meeting. They are important players here.

The next speaker will be Edward Markus of Arthur Young and Company. Is Ed Markus here? (affirmative response) Mayor Collins, excuse me; you'll be next.

EDWARD J. MARKUS: I have John Laezza, also from Arthur Young and Company, with me.

SENATOR DALTON: Okay, John. How are you?

MR. LAEZZA: Fine, how are you doing?

MR. MARKUS: Senator, we appreciate the opportunity to speak to you today. We would like to just make a few opening remarks, and then answer any questions you may have relative to privatization.

I would first like to identify for purposes of this hearing that there are many communities right now across the country that are pursuing privatization for wastewater treatment facilities. An example is Chandler, Arizona, which has actually signed a contract with a private firm for providing wastewater facilities. Others which are in negotiation stages right now with private entities include: Norco,

California: Orlando, Florida; and, Auburn, Alabama. There are many, many others which are in the planning stages right now. Obviously, the legislative aspects of allowing privatization vary from state to state. In many states right now it is legal; other states are considering legislation, just as New Jersey is at the present time, to allow it to happen.

From our experience to date, there is no shortage of private financing or private-sector interest in wastewater facilities. The number of proposers we have seen on projects which have been advertised to date by communities across the country, I think, are ample evidence of private-sector interest that is out there. In most situations we have been seeing 15 to 20 well-qualified private-sector teams that have been putting in proposals on projects. I think that an important consideration in looking at the proposals and then coming down to a contract negotiation process, points back to the questions that were raised relative to, "How do you structure the contract?", "What type of oversight would the municipality have?", and "How does a community eventually sign a contract with a private firm?"

We believe we have some of the answers, although we do not claim to have all of the answers. I would like to highlight a couple of points we believe are very important. First of all, a contract between the private sector and the public sector has to include adequate provisions for public oversight of the project, not only during the construction phase, but also during the operation of the facilities. That oversight can take many different forms; for instance, allowing your consulting engineer to go in on a periodic basis to check up, in a sense, on the private firm. The oversight also takes the form of a State role in terms of the Department of Environmental Protection, in making sure that the effluent limits are adhered to.

A question was raised a little bit earlier relative to the construction of facilities, and whether there is any way to ensure that quality materials are used and that the project is built according to specification. As John Gaston mentioned, you can specify right up front what the requirements are for the private firm, in terms of materials to be used, the type of process to be used, and so forth, to ensure that a quality project is built. An alternative approach that

is also available, given the current tax laws, is for the municipality to actually go out and build the facility, with a contract to sell it to the private-sector firm at the time the construction is completed, and with the private-sector firm then operating the facility. Under the present tax laws, you can do that and still get the maximum tax benefits, as long as the facility is not in operation. You then have the benefits of a private-sector operation as well. The only thing you could potentially lose is any construction efficiencies, if a private firm were able to accomplish that. We believe there are many approaches that could be used to protect the public sector, while still obtaining a quality project from the private sector.

With regard to structuring the contract, when you think about it, we're talking about combining a construction contract with an operations contract. Historically, construction contracts have, of course, been publicly bid, and you know right up front what your construction costs are going to be. When you go to your long-term financing, you have a defined number of payments over a period of 20 or 30 years, and you have a defined dollar amount. The private sector is going to be offering, in a sense, that same type of scenario to the public sector during the contract negotiations process, so the construction costs, the dollars of the contract related to construction, are going to be fixed up front. Then it comes down to the operations side of it. That is split into two phases. One would be costs that are somewhat fixed over time from the operations side, and then, just as in the case of a municipality operating a sewerage treatment plant, you are going to have variable costs, things that are going to go up over time, such as power costs, labor costs due to inflation and increases due to labor adjustments, chemical costs, and things of that nature.

I think there are examples around the country in what we call the "contract operations area" of wastewater treatment services -- something that has not seen a lot of activity in the State of New Jersey, although I understand that the North Bergen sewerage treatment plant is operated by a private firm on a one-year basis right now -- of firms that are operating facilities on a contract basis for municipalities, where they have signed, say, five-year contracts for operations, with possible extensions, and where they put in various

indicators tying themselves into, say, the consumer price index, tying themselves into actual utility rates, and so forth, so that the ability of the private firm to really adjust the cost to the municipality is very, very minimal, and is very, very restricted as to what they can and cannot do. The private firm is going to be factoring in up front what its rate of return would be on the construction in order to satisfy its investors. It will also be factoring in, almost, a management fee for the operation of the facility.

So, we believe that in structuring the contract, there are many things that can be done to eliminate a lot of the potential for variations which would catch anyone by surprise. I think a municipality, of course, would expect that if inflation started picking up 10% or 15%, that the operations cost relative to a sewerage treatment plant would probably also start going up by that same amount, depending upon what costs are increasing at the time.

It is our belief that if properly approached, if a municipality is given the teeth to go in and oversee the private entity from the construction side, to oversee the operations side and, also, if the contract is properly structured in terms of the dollar costs from the private sector to the municipality-- I would like to add that the private-sector firm, in our belief, should not be charging individual users, but rather should just be charging the municipality or the authority, or whatever public entity is involved there. We believe that if a municipality is given the proper tools to put it together, it can be properly structured so that the risk to the private sector is minimized, so that they are not afraid to come in and invest, and, at the same time, the users are protected.

SENATOR DALTON: John?

JOHN F. LAEZZA: Yes, thank you, Senator Dalton. What we have here we will hand to the Committee so you can read it. It is what we call "A Privatization Overview by Arthur Young and Company." It kind of explains the whole process of how we started with the State of New Jersey to try to respond to some of the needs of financing it. I'll just go over what we perceive to be the public-sector advantages of privatization.

Number one, in responding to the Department of Environmental Protection, it is going to provide what we believe is a timely

answer to environmental and economic development. As indicated in prior testimony by the Commissioner, and today by John Gaston, there is a \$3.2 billion need in the State of New Jersey to be accomplished by 1988, and there are no grant funds that will even come close to that process.

Secondly, we believe it will minimize both Federal and State involvement in local affairs. It will give the locals some opportunity to respond to their needs, and basically at a cost benefit if, in fact, those 75% grants are stopped, and we all know that those 75% grants are, in fact, stopped today.

It will avoid construction delays in compliance with Federal procurement regulations, which we believe collectively could increase the capital costs of any project anywhere from 20% to 50%.

It will permit greater flexibility in a number of key factors, such as the sizing of the treatment works to meet the needs of the area, and building uses for services provided, which would avoid the indirect costs and the headaches of Federal audits.

It may, in fact, provide 100% funding of sewer treatment. In response to the question you asked John Gaston, what we have found in the areas we have been going into is that anywhere from 20% to 25% equity funding by the private investor will still make it a viable project, both for the investor and for the local community.

We have talked about the tax benefits. You have heard about the investment credit, the depreciation, and the ACRS. Most of these treatment facilities are equipment-intensive, five-year operations, and that is what makes them advantageous to the private sector.

We probably feel a little more optimistic than John Gaston regarding the tax laws. We believe, because of our Congressional delegation and our Senatorial delegation, that at least if they cannot get the grant funding, they will get the exemption as it relates to wastewater treatment facilities, as a given anyway, as it relates to these tax benefits. It has been our belief, and we have testified in Washington, that it is really not a tax savings, but it could generate tax revenue to the Federal government if the privatization concept is ultimately put into place.

We believe it is the opportunity that everyone has been seeking for the public and private sectors to work together and,

hopefully, they will work in concert with the IDB, the industrial development bonds. Those laws are, once again, being kicked around a little bit in the Federal government. We believe that if we get into place, they may become more beneficial. Once again, even without those industrial development bonds, we believe it will be an effective way.

We believe the O and M process by the private sector is important in the contracting procedures, because, once again, the private sector has the ability to use multiple facilities. If they have more than one facility, the same employees can be transmitted back and forth, rather than just one municipality working on its own facility. So, those are the cost benefits we think are derived.

We just completed -- and I would say it might be opportune, since Senator Costa and Senator Dalton are both here, and you may have been reading about it in your papers -- a financial study of the Camden County Municipal Utilities Authority, and what is going to be the affect on the users of the \$456 million sewer requirements needed in regard to the Authority that Camden County responds to. Their first phase is the only phase that is presently being funded, and it is being funded at a 65% level. If that first phase is completed with funding, it will generate a \$275.00 to \$295.00 user charge. If the balance of the projects are to be completed -- and as Mr. Gaston related to you, those projects do have to be completed by 1988 -- without any further Federal funding, the cost to the users in the Camden County area will increase to \$435.00 -- \$432.00 to \$440.00 per user. That is a substantial affect on the users in the Camden County area.

If the projects stop in Camden County, that \$275.00 figure jumps to \$325.00 immediately, because down through the years -- the last 14 years -- there has been a great deal of borrowing of funding, administrative costs for developing plans, and the like. That debt would have to be paid by those users, and phase one would jump the costs up to \$325.00, without even responding to the wastewater treatment needs of the area, only in one section, and only affecting, partially, 16 communities. If, in fact, privatization can be one of the alternatives, that \$435.00 figure could come down as low as \$375.00 as a given, just as a rough approach. So, in the Camden County area it is very evident. Mayor Collins from Bayonne will give you his thoughts as to what we have been doing in the City of Bayonne, and I think

Executive Director LeFante from the Hudson County Utilities Authority might have something to say.

We would now like to answer any questions you might have.

SENATOR DALTON: Senator Garibaldi, do you have any questions?

SENATOR GARIBALDI: I am a Mayor of a community where, of course, we have similar problems, but perhaps not to the degree of the City of Bayonne or other cities in the State of New Jersey. We have undertaken a posture, at least in our community -- and our present facility is at its capacity now -- where anything in order to improve it, to upgrade it, or to do whatever needs to be done to allow for any additional usage-- We have adopted a policy that any method of financing in order to accomplish that should not impact on the existing users, residents, or whomever. That financing should not impact on those individuals. I do not know what the privatization methods would be along that line. What we are doing is asking any new developers, or anyone who is going to use that facility in the future, to pay for the cost of improving it, upgrading it, or expanding it for the purposes they are developing. If that includes 4,000 units, or an industrial complex, they will provide the necessary contribution, their fair share contribution toward that expansion.

I have to tell you, it's working, and it's not the right way. It stymies growth. It stymies development. But, I do not agree that any method of financing should impact adversely on those who have already paid through their user fees, through municipal financing, bonding, etc. over the years. Now, what difference would privatization make?

MR. LAEZZA: I think we're talking about a different process. I think what you're talking about is a sewer facility in place, or treatment facilities in place. You're talking about the expansion of collector lines.

SENATOR GARIBALDI: No, this is wastewater. As a matter of fact, we have development going on right now.

MR. LAEZZA: They are putting in their own treatment packages?

SENATOR GARIBALDI: No. They have connected into the sewer treatment facility itself, the sewerage plant, and that is filled to

capacity. As a matter of fact, the Department of Environmental Protection has come down and has halted the development, because of the wastewater treatment. You know, we have golf courses out there, and we have been using that wastewater to irrigate the golf courses. They say that the level of contaminants, bacteria, or whatever elements they judge by, is beyond that which exceeds the standard, and they have halted that particular practice. We have a wastewater treatment facility, but it is not doing the job. The DEP has issued an order for us to halt until something is done.

MR. MARKUS: Actually, what you're doing is probably the best approach toward--

SENATOR GARIBALDI: (interrupting) It's an improvisation, to be honest with you.

MR. LAEZZA: That's right, that's what it is. You are, in fact, privatizing.

SENATOR GARIBALDI: We've done it already, without the legislation.

MR. MARKUS: But, there is a little bit of a distinction, in that you are coming up with innovative approaches for raising the local moneys necessary for you to expand the facility publicly. Kind of the best of both worlds would be if you could get private investment in your sewerage treatment facility to lower the net cost, expanding the facility, and then using that private money to come up with your payment to the other private firm which is building the facility. It's kind of two separate processes in a sense. But, the concept you're talking about is something I know EPA and DEP have been pushing for years. Many communities have now been able to undertake it; it is a very good approach.

MR. LAEZZA: We're talking about areas that have no facilities in place.

SENATOR GARIBALDI: Oh, okay.

MR. LAEZZA: Yours is a different problem.

SENATOR GARIBALDI: Yes, but you're talking about a specific area though.

MR. LAEZZA: Well, I talked about Camden, but it is all over.

SENATOR GARIBALDI: No, no, not a specific area geographically, a specific facility. You're talking about wastewater

treatment, not sewerage treatment, right?

MR. LAEZZA: Well, it's the same thing.

SENATOR GARIBALDI: It is the same thing?

MR. LAEZZA: Yes.

SENATOR GARIBALDI: Oh, that is what struck a nerve with me, because of this particular problem we face.

MR. LAEZZA: No one likes the term "waste sewers," Senator.

SENATOR GARIBALDI: Oh, okay. Then it is all the same?

MR. LAEZZA: Yes.

SENATOR GARIBALDI: But, in our particular instance, the problem is not so much the actual sewerage treatment plant. The capacity is there to handle the development; it has already received site plan approval for many, many units, but we have had to halt. We have had to issue a moratorium on any further construction on those units until we have made provisions for the handling of the wastewater. Do you see? So, yours is a combination of the whole facility?

MR. LAEZZA: Yes.

SENATOR GARIBALDI: That is a new insight.

SENATOR COSTA: You spoke of projects in Arizona, California, and Florida. How old are they? How far advanced are they? What are the negatives and what are the positives that they have encountered?

MR. MARKUS: The Chandler, Arizona project is -- they have actually signed a contract with a private firm after going through a competitive procurement process. That project is in the process of being implemented right now.

SENATOR COSTA: Have any of these been implemented as of this date?

MR. MARKUS: No. There are actually a number of reasons for this. Up until 1981, we always had more than enough construction grant money. In fact, it was really a "first-come, first-served" type of program. In 1981, we started having cutbacks in available EPA funds. Prior to that time, there wasn't as much of an incentive for the private sector. Also, the tax laws changed in 1981, and the tax laws were made, I guess in a sense, more attractive to the private sector. That is why realistically there are not a whole lot of plants around the country right now of any size that would illustrate the type of thing we are talking about. We think of 1981 as being the major

turning point in terms of cutbacks to public funds, as well as the enhancement of the tax laws.

SENATOR COSTA: Is this bill based on any of those projects -- the California, Arizona, or Florida projects?

MR. LAEZZA: Is this bill based on those projects? No, it is a bill that we worked out with DEP.

SENATOR COSTA: Is it different than what they have in those states?

MR. MARKUS: What we found in going across the country -- and we have dealt with probably about 30 states thus far -- are wide-ranging abilities of communities right now under various state laws. For example, there is a project that we worked with in the State of Iowa. Iowa has a home rule type of situation. We went down the typical list of legal issues which come up in states, and in the State of Iowa those legal issues are not a factor in any way, shape, or form. A community in Iowa right now can contract, just as we are talking about here, for private-sector construction, ownership, and operation of sewerage treatment facilities. In other states, many of the issues are very similar to what we have seen in New Jersey. In Alabama and Utah right now, there is proposed legislation. I believe Tennessee and Georgia have already passed legislation to make privatization appropriate for their states.

SENATOR COSTA: I was looking for tried and true, but I guess we are all treading on new ground.

MR. LAEZZA: We have copies of those proposed pieces of legislation for your review also.

SENATOR COSTA: In order to attract a private firm to enter into a contract, would a local government really have to assume risks that they would not have to assume at the present time?

MR. LAEZZA: I don't believe so. I believe they have more ability to respond to those risks in this process, than they would in the low-bid, public-contract process, where they have more risks, because having been in government most of my life, the low-bid, public-contract process for capital structures invariably has change orders that are almost more than the cost of the capital construction.

SENATOR COSTA: If I seem to stress these concerns, it is only because I was a Freeholder for 12 years, and we're in the

building business. With all those projects, we always had so much trouble.

MR. LAEZZA: That's right, and you had no control over those contracts.

SENATOR COSTA: That's right, and that is why I want to look for assurances.

MR. LAEZZA: This gives more control monitoring. We believe that this procedure, if a municipality or authority goes into it properly, with the proper professionals, will have a better control mechanism.

SENATOR COSTA: Speaking of proper professionals, we thought we had proper professionals when we hired a consulting firm. If you are aware of what happened in Burlington County at our Courthouse, we finally threw them out, and it cost us twice as much. These are the things that--

MR. LAEZZA: But then, your process was low bid.

SENATOR COSTA: Is that it?

MR. LAEZZA: That basically was your process.

SENATOR COSTA: Okay.

SENATOR GARIBALDI: What do you mean, that the public contract was low bid?

MR. LAEZZA: Yes.

SENATOR GARIBALDI: Oh. What you are suggesting, is that if the public contract is low, it would have to be concurrently--

MR. LAEZZA: Well, no. This amendment basically amends the procedures for procurement purposes for capital projects for sewer facilities and wastewater treatment facilities. It is a qualification criteria, and then a negotiated criteria for the two best selected qualified people, to make a determination who can best enter into a contract to respond to the need.

SENATOR COSTA: What comes across loud and clear is that government, in its efforts to protect, has put so many things in the way that we can't accomplish anything without it costing twice as much. The government has to take a look, and start to--

MR. LAEZZA: (interrupting) It has to get a little bit more business oriented, at least in capital construction.

MR. MARKUS: Senator, I think your concern earlier regarding

the quality of the product you receive-- If you have to go through a strictly low-bid process for sewerage treatment services, you know, you may wind up with something that is only going to last five or ten years. Someone could put something together that would last for just a short period of time. Then, when it is time to turn it over to the municipality, the municipality is going to wind up with something that is almost unusable. The municipality would then be back at square one again.

SENATOR COSTA: I'm tremendously weary because of experience.

SENATOR DALTON: Thank you, Senator. You have a situation, perhaps the Camden situation, or another situation, where an entity is receiving Federal funds initially. Those Federal funds are cut off for various reasons. Now, the government entity wants to involve itself in a contractual arrangement with the private sector. Is that part of a buy-out agreement that is reached, or how would that type of arrangement be accomplished?

MR. MARKUS: In terms of having some Federal funds, and now also having--

SENATOR DALTON: (interrupting) That is correct.

MR. MARKUS: There is a precedent in Puerto Rico, a project where Federal and private moneys have gone into the same sewerage treatment plant. What we see more likely happening is, if there is only a limited amount of Federal dollars available, trying to put the Federal dollars into -- you know, from the private sector's viewpoint -- almost the least attractive portions of the project. If there are portions of the project, whether it be interceptors or collectors, that from the private sector's viewpoint may not have the most attractive tax benefits, the private sector may not be able to save you as much money in construction on a sewer pipe, as they would, say, on a sewerage treatment plant. If we can divert and make the best use of the Federal and State dollars in the areas that are the least attractive to the private sector, we can then use the private-sector money for the areas where they can help out and offer the best for the public sector. That is the way we see it.

SENATOR DALTON: But, how does that come about? Is that an arrangement between the entity itself, the private sector, and the Federal government? Who are the contracting parties in that case?

MR. LAEZZA: The contracting party would probably be the municipality or the authority as it relates to the Federal grant, because that is the way the process works. Their grant would be applied to those areas that they believe would not be of interest to the private sector. So, they would own those lines, if you will.

SENATOR DALTON: What do you suspect, or what has been -- particularly with regard to the Puerto Rico example -- the Federal government's response to this type of thing? The Federal government has an investment in this facility, or say, this partially-built facility. Could you tell me a little bit about that?

MR. MARKUS: I spent six years with EPA prior to joining Arthur Young. I don't claim to speak for them entirely, but I think their viewpoint would probably be that if it is a method that is going to get the facilities up and operational to meet the permit standards and to meet the water quality standards they are looking for, they would be willing to cooperate and look at it as a total financing package. The thing that you can't do is, you can't use private moneys to match Federal dollars. If you have a 55% Federal grant, you can't look to the private sector to put up the remaining 45%, because Federal regulations require the public sector to finance that. But, what you can do, is separate out the 55% and then the State's share and the local share for a piece of the project, and then go private with the remainder.

SENATOR DALTON: As the bill is presently written, would it apply to that type of situation?

MR. LAEZZA: They would allow it, because it goes into the contract process, yes.

MR. MARKUS: That's right.

SENATOR DALTON: Okay. So, the stipulations of this bill would also be relevant to a situation where there was a Federal, private, local unit?

MR. LAEZZA: We believe so.

SENATOR DALTON: Yes, a partnership, so to speak. You are consultants, as I understand it, and have helped Mayor Collins, etc. As a result, how should local government determine what a fair rate of investment, or what a fair return on investment would be for a firm providing wastewater treatment services?

MR. LAEZZA: Well, in the review process, every municipality or authority we have gone to, or talked to, has already gone through their conceptual designs, and they know what the costs would be. We would first determine the feasibility. We would look at it and indicate this is what it is going to cost you to do this project -- we have developed a model -- and we would make a determination. If you ultimately received a 65% grant, and your O and M costs were "X" and "Y," your ultimate user charge would be thus and so. We would then apply our model to the same concept. If you received no grant, we would determine what it would cost the users. If the private people became involved, we would determine what it would cost for the construction of that facility, and we would make a determination in our minds as to what savings could be generated in user costs, probably as much, or maybe a little higher, than if you received a full 75% grant funding. Then that would be our bottom line in going out for the proposals, that you would have to maintain at least that semblance of user costs before we would even talk to you. So, that is the bottom line. If it costs that private entity more to build it, that is their problem, because they have contracted for a bottom line figure with us.

SENATOR DALTON: So, the bottom line answer is that you are going to negotiate it. I mean, that is going to be a matter of give and take.

MR. LAEZZA: Correct.

MR. MARKUS: That's right.

SENATOR DALTON: I have no further questions. Ed and John, I want to thank you very much.

MR. LAEZZA: Senator, here is some literature that you might want to review in your deliberation.

SENATOR DALTON: All right; thank you very much. Our next speaker will be Mayor Dennis Collins from Bayonne, who has spoken to us before.

MAYOR DENNIS P. COLLINS: With me, Senator, is Marvin Eger, who is the Business Administrator and Finance Director of Bayonne.

SENATOR DALTON: Fine.

MAYOR COLLINS: I just want to thank you and the Committee for providing us an opportunity to be heard again. I think perhaps we may have had the same thought. After I left your hearing of

February 6, 1984 and returned home, I made a summary of our participation. I would like your permission, and the Committee's permission, to read that at this time, and that would really be the extent of my commentary.

SENATOR DALTON: That would be fine, Mayor.

MAYOR COLLINS: Thank you. It says: "Dennis Collins and Marvin Eger appeared this date in Trenton, New Jersey, to testify before the New Jersey State Senate Energy and Environment Committee, chaired by Senator Daniel Dalton. Four or five Senatorial members of the Committee were present. Also testifying were Commissioner Robert E. Hughey, Deputy Commissioner Brenda Davis, and John Laezza and Harvey Goldman of Arthur Young and Company.

"Collins testified to the fact that he met with Commissioner Hughey in December, 1983, and requested that the City of Bayonne be given consideration as a model city for the privatization concept of secondary sewerage treatment. He pointed out to the Committee this date that, while Commissioner Hughey indicated he really had no problem with such a designation, it would first be necessary to have legislation that would provide the necessary authorization for cities in the State of New Jersey to enter into privatization contracts.

"For the Committee, he traced the history of the Hudson County Utilities Authority, including the background of the \$105 million bond issue of June, 1981, pointing out that if said bond issue had not been defeased, the financial standing of the County and its cities would have been ruined. He further pointed out that the City of Bayonne is presently permitted, consistent with existing law, to have a bond ceiling of \$21 million. Six years ago, when an estimate was made of what the secondary sewerage treatment costs would be for the City of Bayonne, it was stipulated to be between \$39 million and \$50 million. Mr. Gaston of the Department of Environmental Protection testified on February 6, 1984, before the Committee, that it would now cost Bayonne \$70 million. Coupled with the fact that the present primary sewerage treatment system in the City would require current updating, it is reasonable to add another \$20 million.

"Collins pointed out to the Committee that it was obvious we were talking in terms of an outlay for the City of Bayonne of some \$90 million, with no ability of the community to carry such a

staggering sum. Aware that this situation was confronting the City of Bayonne, we sought alternatives and/or an option that would be cost effective, as well as relieve the people and taxpayers of the aforementioned staggering burden.

"We retained Arthur Young and Company to do a feasibility study of privatization for the Bayonne plant. From the information I have, it appears that the Bayonne primary sewerage treatment system in the City is a good subject for the privatization concept. The population is approximately 66,000. The dry weather flow of the sewerage plant is approximately nine million gallons a day. The feasibility study completed by Arthur Young and Company clearly indicates that privatization is a very viable alternative for the City of Bayonne to embrace.

"In an effort to determine if there were people interested, the City asked for, and received, 15 RFQ's. The RFQ's came from outstanding people, one might say on an international level, not only throughout the nation -- engineers, financiers, architects, and the like. The City of Bayonne has always taken the position that it must be obedient to the mandate of the United States government with respect to improving the quality of water by 1988. However, it is obvious it is imperative that the community look for a better way, without the financial ability to cope with project costs. As a matter of fact, if Bayonne were to use what it is permitted to use under its present bond ceiling limit, that, of course, would leave nothing for the City to utilize in any other capital improvement projects for the benefit of its citizens.

"The location of Bayonne is geographically an advantage with respect to secondary sewerage treatment. Bayonne is known as Region 2 in the County of Hudson, and is probably the only city in the County that can be handled separately and apart. Given the facts that face us with regard to the erosion of funds at Federal and State levels, it is felt by Bayonne that privatization can work."

Mr. Chairman, I might add in that sense, that between 1975 and 1983, Bayonne received a little over \$50 million in Federal and State aid for a variety of projects. In 1978, Bayonne received \$9.2 million in aid from the same two sources. In 1983, Bayonne received four million, fifty-six thousand dollars. Now, I also want to have

the record show that, even taking into consideration that \$2 million of that over \$5 million loss was from CETA, one can readily see that the other is a substantial amount to lose for a City this size.

"The officials of the City of Bayonne feel that the necessary safeguards that would be required over a 40-year contract term can be negotiated, particularly in view of the fact that final approval must come from DEP and the Division of Local Government Services in the Department of Community Affairs. They are satisfied in that sense that there would be sufficient safeguards to protect the principals involved. Further, it seems that the existing employees can be covered under a private contractual agreement, the same as the City would be protected in the same fashion under a service agreement with the Hudson County Utilities Authority. There is no question in my mind that if the City did have the ability to raise the money, or received it from either the Federal or State government, to do it in keeping with the regular procedural steps that are followed, the cost would be more to the taxpayers than the private investment route." I believe John Laezza just very adequately covered that portion.

"It further seems to me in the development of the waterfront in Hudson County, in keeping with the Governor's plan and the present existence of Liberty State Park, that privatization would provide an excellent example of the public/private partnership that we hear so much about these days. Of course, the municipality of Bayonne would not be in a position to receive the tax credits which are given to the private investor, credits which in turn develop some of the spin-off benefit costs for the community. The City of Bayonne is aware at the present time that despite the defeasance of the \$105 million bond issue by the Hudson County Utilities Authority, in the near future Bayonne must come to grips with its share of an already existing incurred debt by HCUA of between \$7 million and \$10 million."

Now, with respect to that debt I might add, if I may please, that Bayonne's share of that is approximately 14%. It is my recollection that at the hearing on February 6, I heard Commissioner Hughey state that out of 238 applications for wastewater treatment facility projects on file in the Department of Environmental Protection during the year 1983, four projects were financed. I believe that statistic says something with respect to the ability of cities to fund

projects of this dimension without Federal and State aid. Thank you very much.

SENATOR DALTON: Thank you, Mayor. Are there any questions from the members of the Committee? (no response) Mayor, thank you very much; we appreciate it.

MAYOR COLLINS: Mr. Chairman, may Mr. Eger be heard briefly? I would appreciate it.

SENATOR DALTON: Sure.

MAYOR COLLINS: Thank you.

MARVIN A. EGER: Thank you very much. After that sort of a summary, there is very little that can be said from the position of Bayonne. However, may I just bring you up to date as to what has transpired since the last time we were here. Basically, almost everything is in place, as the Mayor as indicated, and as John has indicated. The last time we were here, I gave the Committee a listing of the 15 firms which the Mayor referred to. I might add, there is hardly a day that we do not continue to get inquiries from almost each of these firms, wondering just exactly what the status is. They are ready to go through the process that this legislation would provide.

We could not be more pleased with what the legislation would provide. Just in a brief summary that would be, of course, the short listing and the possible negotiation with this list of extremely reputable firms, the protection of the public interest in that there would be a rate-setting mechanism and, also, the variation on the contract law, which would permit us to go out and contract for a longer period of time.

The concern that I think was exhibited by the Senators, and also the City, would be, how do you protect the public interest? That was an extremely sensitive area for all of us to face. I think the legislation does address that to a considerable extent. The remainder of the protection would have to be taken care of in the negotiating process, if that should come about. Of course, there would be adequate performance bonds, there would be construction reviews, there would be operating reviews, and there would be regular rate protection for the City, the user, the bondholder, the entire mechanism that would be necessary for privatization to come into being.

I would just like to briefly mention one other thing. To speak of this generally is one thing; to be on the fighting line is

something else. After all, the City is the one which has been given the mandate. We have been given an order to come into compliance by 1988. Federal and State funds have dried up. The fact is, we are still under that mandate and, as the Mayor indicated, with our complete bonding ability, which might be some \$20 million -- and we are a City of good financial condition -- we could not possibly satisfy the construction of a secondary sewerage treatment plant and still satisfy the remainder of the needs of our City.

So, I would wholeheartedly endorse favorable action on this legislation, which would appear to cover the significant areas that would make privatization possible for us. It could be the most important financial ability we could have to take care of this, again, most important problem. Thank you very much.

SENATOR DALTON: Thank you very much; we appreciate your comments. The next witness will be the former Speaker of the Assembly, a former Congressman, now Executive Director of the Hudson County Utilities Authority, Joe LeFante.

JOSEPH A. LeFANTE: Thank you. Good morning, Senators.

SENATOR DALTON: Congressman, excuse me for having you up here so late.

MR. LeFANTE: No problem; I understand. It has been a long time since I have been here. There have been some changes, right, Pete?

SENATOR GARIBALDI: Oh, yes.

MR. LeFANTE: I have condensed my remarks down to about two and a half pages, double-spaced. Some of it will be repetitious of what you have already heard, but I think it bears repetition. It is important enough.

I would like to tell you a little bit about the Hudson County Utilities Authority. You have heard reference made to it here this morning, and to some degree there are people who, to say the least, question its existence. But, I'm here to tell you that the Authority is the agent designated by the United States Environmental Protection Agency and the New Jersey Department of Environmental Protection to plan, design, and construct improved wastewater treatment facilities that will be of and meet the secondary treatment standards by 1988.

Now, bearing that mandatory commitment in mind, the HCUA

proceeded, in good faith, to comply with the Federal mandate of the Clean Water Act. Planning and design was commenced and nearing completion when the United States government began to renege on its previous position as a partner in the financing of wastewater treatment plants.

I might add, gentlemen, that the Authority spent considerable sums of local, Federal, and State moneys for this planning and design stage, probably in the neighborhood of somewhere between \$16 million and \$20 million as an up-front investment.

We, and most of the country's sewerage authorities, were sold a bill of goods, only to see the major partner have second thoughts, leaving us to find alternative financing. The original cost for construction and implementation of the secondary treatment system in Hudson County was in excess of \$300 million, of which Federal and State grant reimbursement would have amounted to approximately \$250 million, or 83% of the costs. To say the least, we are down to about 55% now, and I never saw so many dollars have so many wings, and diminish so rapidly, as what is in that pot right now. If we just take a look at that priority list that Mayor Collins made reference to in his presentation, we know there are some 299 projects eligible for grant funding. Of this total, at the most -- at the outside, exaggerated -- 10 may receive -- may receive -- a partial sum of the grant moneys, but certainly nowhere near the amount we were led to believe was there.

The Hudson County Utilities Authority has received no funding for construction purposes. It has been told to expect \$55 million, at most, and that is even questionable at this time. This is clearly small change, when you consider the magnitude of the task before us. But, I guarantee you that this Authority is going to be in there fighting for its fair share of the grant funds.

The next few remarks I would like to make, I think will be very interesting to you, in view of the fact that the HCUA is currently reassessing the matter in which it can comply with Federal law and provide secondary treatment in the most cost effective and technologically sound way.

The first step has already been taken. The Authority has hired an engineering firm to study, update, and modify the 201 Facilities Plan. For those of you who do not know, that is our Bible.

That is the main planning document that we live by. In this study and modification, they are to find less expensive solutions to the problems which exist. This Authority is presently operating under a mandate from its Commission, particularly to the staff, to find ways and means to allow an economically feasible and efficient wastewater treatment facility for its constituencies. I'm telling you, that without privatization it is not going to be, particularly in the old urban centers that still have wooden lines carrying their flow, and delivering their flow to the service areas, wooden lines carrying a discharge out of those areas, and collapsing on a day-to-day basis. There is absolutely no way it can be done with public funding. Anyone who thinks it can be is only kidding himself.

So, bearing that in mind, the Commission, in the four months I have been on board, has developed an attitude of faith and confidence in its staff. Most times we operate almost with a free hand. We guide the Commission. One of the areas of responsibility designated to us was to find the ways and means to get the job done. In our evaluation -- in our study -- we found Lawlor, Metuski and Skelly, an engineering firm, to be totally committed and dedicated to the goals and to the idealistic problems which exist there. In their approach, they have already been involved in some privatization in upstate New York.

We have found the firm of Arthur Young and Company to be already totally involved, with an excellent staff, almost perfection, which is also involved in these kinds of things. We have hired Lawlor, Metuski and Skelly as our engineering firm, and we have hired Arthur Young and Company as our financial consultant and advising firm. We are presently interviewing for some in-house engineers of equally high quality caliber. So, we are dedicated.

We are involved in the second step now, which is just beginning. We feel, in light of the grant reductions, that we must make every effort to secure whatever funds are remaining, because the potential costs at the local level of this 201 Facilities Plan are so enormous and represent a potential burden to the taxpayers of giant proportions. As you heard here earlier, most municipalities will not even be in a position to bond. So, who's kidding who? The United States government is talking out of one side of its mouth, saying, "You must -- you are mandated to do this, that, and the other thing." The State Department of Environmental Protection is saying, "Hey, look,

we're only following the direction set forth by EPA." In the middle, is the Division of Local Government Services telling these fellows-- Pete, you and I, Senator Dalton, and maybe Cathy and some others, were involved in putting "caps" on these individuals. With the limitations upon them, you can't turn around and tell someone, particularly in an area like Hudson County, which through the years, because of this antiquated system, has been costing the average household \$12.50 per quarter, or \$50.00 per year-- If we go to the local public sector of financing, if it ever becomes permissible, which I doubt because of the bonding capacity, you might be talking about \$700.00 or \$800.00 a year, whereas if you take the State average, it is maybe \$400.00 a year. With privatization, it may be \$300.00 a year. So, for a mayor and a council, or other elected officials, to tell their constituencies they are going from \$50.00 to \$300.00 a year -- that's six times higher -- I wouldn't want to be in that position. In fact, I don't think I would ever offer myself for public office with that behind me, because I don't think the people, particularly those who were used to what it had been through the years, would accept something like that, even though you and I know it would be the bargain of the century if you could get it for \$300.00 a year.

So, gentlemen, and Senator Costa, together with grant funding and local dollars, I think we must explore how private financing can be brought into the picture. Your bill is without a doubt the means by which this can be done.

Privatization is a viable economic alternative to the dwindling grants program. Through various tax benefits and the private sector's ability to produce a quality product at a more economical cost -- and we all know that is true, because we have had experience with it -- we may be in business.

Privatization may allow us to share the benefits of the cost advantage available to the private sector, and that is the trick. The present Administration in Washington -- and I will not debate whether it is good or bad, pro or con -- is making it advantageous for the private sector to go into these businesses. You know what is going on with the "Dill Pickle" bill. We also know, from talking to some of our friends who sit on the Conference Committee, that it is going to be a very viable bill. It is going to be to the advantage of the private

sector, which is the way it should be. We should take advantage of that. We should make their benefits available to the public sector, and you can do that. Hudson County specifically, and New Jersey in general, are in a unique position. Our Hudson River waterfront has recently been dubbed the "Gold Coast of the Northeast." For those of you who have been in the area and who have taken a look at it, you will have to confirm this. You cannot deny it. The developers of the huge residential and commercial complexes are extremely enthusiastic over the opportunities which exist there, right from North Bergen all the way to the tip of Jersey City.

Hudson County and New Jersey are partners, and recognize the need that these developments have for tax rateables and job opportunities. All of us who are concerned, including the Governor's office, through his Waterfront Committee, are working very hard to make this development a reality. However, the development may be stalled for lack of an adequate wastewater treatment system.

Now, if you will just look back at history -- and I'll only be another minute, Senator -- you'll see that almost every Administration leaves something that it can look at and point to with pride. Some leave buildings, or hospitals, or medical universities, or, for instance, this magnificent edifice and structure of the State Complex here. It could be the Turnpike or the Parkway, or it could be the Meadowlands development or the Sports Complex. This Administration, and rightly so -- because of the high rates of unemployment, because of a diminishing tax base, because of the geographical location, because of the aesthetics -- realizes that is the Gold Coast, and I'm telling you, from one who is totally and completely involved on a day-to-day basis, not only with the developers, but with the political parties, there will be no development if we cannot put the wastewater treatment facilities and the infrastructures in place. What that means is hundreds of millions and billions of dollars of taxes lost, and hundreds of thousands of jobs down the drain. You know what the sales tax produces in New Jersey, and you know what the income tax produces in New Jersey. So, the effects of privatization, magnified into what it will actually be producing on a daily basis, blows your mind. It is unmeasurable; you couldn't even measure it.

We need to work with the private sector -- whether we like it or not -- to put all of the pieces of this mosaic together. New Jersey must provide enabling legislation to make privatization work. We can, and must, develop a public/private partnership now -- not tomorrow, not next month, not next year, but now; the time is now -- because if we don't, it is going to be too late. The private financing is available, and all we ask you, ladies and gentlemen, is to allow us to take advantage of it through progressive legislation to establish New Jersey's leadership among state governments. This will do it.

I appreciate the fact that you have been so kind and patient in hearing me. I remember times when I used to sit on that side of the table, and I used to say to myself, "When is this guy going to shut up, for crying out loud?" (laughter) I really appreciate it. This is something that is so important, and I think you are right on the money. Many people who are not involved cannot understand the concept, but some of the questions that Senator Garibaldi asked of the previous witnesses were right on the money. You're in the ball park. When you talk about what you are doing in your local facility, capacity is a very small part of the cost. It is preventive maintenance and maintenance of what you have, plus upgrading the system, and hoping to God that the rubber bands, the Band-Aids, and the chewing gum will keep it together long enough for you to get the money together to keep it going.

We have facilities in this State -- and I am not going to tell you where they are -- where the sewerage doesn't even go through the treatment because they are so bad. It is just going out in a pipe line, right out into the waterways. Yet, we stand here and shake our fists at New York, when New York is doing it legally. The courts have approved New York's dumping in that water because of the ratio. Where there are millions over there, there are only thousands on the other side of the river. They are on line. They are on line with 83% of the money. That plant is going to be opening within the year. It is going to take care of all the problems which exist there, including the new Battery City and the Convention Center. They are going to put it through that complex. That complex has been in the process of being built for 20 years with government money -- 83% of the money. Even if we wanted to do it today, the most we could get -- and it's impossible

because it is not there -- but, if it were there, the most we could get would be 55%. So, you have to bring the private sector in as your partner. People have to begin to recognize this. The City of Bayonne has taken a step with the privatization of their garbage contracts, and this is a tremendous saving -- about \$1 million a year to its taxpayers. It is very efficient. The Mayor sits on top of it. He makes sure that the service is good. The Hudson County Utilities Authority has met with the mayors on a daily basis, and has told them, "Whatever you think is good for your community, this Authority will back." If a mayor thinks privatization is good for his community, the Hudson County Utilities Authority not only endorses it, but is going to get out front with the ball and run interference for him.

Gentlemen, if there are any questions, I would be glad to answer them, if I can.

SENATOR GARIBALDI: It is always nice to listen to you, Joe.

MR. LeFANTE: Well, it's my pleasure.

SENATOR GARIBALDI: Very good.

MR. LeFANTE: With me is George Crimmins, our Comptroller. I don't know if I introduced him, and if I didn't I'm sorry, but he has just a couple of figures he would like to throw at you, and I think they are very important.

GEORGE W. CRIMMINS: Senators, some of the questions you threw out to the speakers are very relevant right here. Senator Costa, you mentioned the government's efforts to protect through the various bidding laws, and how cases have come out where contracts did not necessarily live up to the expectations of the authorities and legislative bodies that issued them. Through this legislation, we will be getting competent firms. Anytime anyone has experience with the public sector versus the private sector, you see the efficiency that is there in the private sector. Construction costs in the industry are generally regarded as 20% to 25% cheaper through the private sector, as opposed to the public sector.

A study by Arthur Young and Company has shown that through the grants program, it may take seven to ten years for a sewerage treatment facility to be constructed. Chandler, Arizona expects theirs to be done, through private financing, in one year. Just factoring in inflation, you can see how changes can come about.

Senator Garibaldi, you mentioned the use of developers to help defray the costs. Because of huge developments on the Hudson River waterfront, Hudson County is expecting to do the same. These developers will find that if their building permits are held up, it will cost them quite a great deal of money. If they are, instead, brought into the planning process, and use their expertise and their dollars, we can develop a partnership which will be cheaper to them in the long run. It will be cheaper to the governments in Hudson County. It will get rateables in the ground that much faster, rather than having vacant land where taxes are just being paid on a vacant piece of property.

Mayor Collins mentioned the budget "cap" for his municipality. Clearly, the money is not there from the Federal government. Clearly, municipalities cannot raise the money on their own. We need privatization legislation. New Jersey can be a pioneer in this industry, and it is just a matter of taking the bull by the horns and going with it. Thank you very much.

SENATOR DALTON: Thank you very much. Mr. LeFante, we appreciate your coming here to give us your frank and comprehensive statement.

MR. LEFANTE: I was glad to do it. Thank you.

SENATOR GARIBALDI: That was a good presentation, Joe.

SENATOR COSTA: May I ask just one question of Mr. Crimmins?

SENATOR DALTON: Surely.

SENATOR COSTA: Mr. Crimmins, what about the concern on the part of a municipality that it would be charged unfair rates because of this monopoly that would exist?

MR. CRIMMINS: Okay. Of course, there is concern, and naturally the profit factor would have to be negotiated between the authority or the municipality and the developer.

MR. LEFANTE: With a regulatory agency overseeing.

MR. CRIMMINS: Okay. But, if you just look at the alternatives when a public municipality-- If a municipality were to finance, say, a \$50 million project totally with local funding, say, at about a 10% interest rate, you would have well over \$100 million of your total cost after a 20-year period.

SENATOR COSTA: What you are stressing though, is the contract once again?

MR. CRIMMINS: Oh, yes. The contract is most important.

MR. LeFANTE: You have the Division of Local Government Services, and you have the Department of Environmental Protection built into the contract. I'm sure if it is going to be a public/private relationship, there should be some control, particularly at the Division of Local Government Services' level.

SENATOR DALTON: Joe, just on that point though, they have 60 days to review the contract. I guess you are as familiar with that Division as anyone in this room.

MR. LeFANTE: Absolutely.

SENATOR DALTON: Do they have the ability, the expertise, to review these kinds of contracts? I mean, I've seen some of these contracts.

MR. LeFANTE: It would require additional staff of knowledgeable -- to say the least -- background. But, I think that can all be a built-in cost that could perhaps be developed through a fee structure to make it self-supporting. To leave them out there on their own is cause for due concern, as far as Senator Costa's position is concerned, which she just expressed. They cannot be left out there on their own. It has to be a partnership. That is the only way it can work, because what you make reference to could, and probably would, happen, because of the monopolistic attitudes displayed by certain hungry contractors, and because of other selfish reasons, without the public sector participating in the system somewhere. You have to build it in so the process can be controlled, not to the extent of the BPU, but I think we should be in a position -- we being the public sector -- to approve budgets and contracts, and to say, "Yes, it is going to cost this. Yes, it is going to cost that." The operating and management costs are so much; depreciation is so much; and, the net profit should be so much. It would be similar to when you go before a rent control board to get the rents on the properties you own reviewed.

SENATOR COSTA: It wouldn't be coming under the BPU, but would the EPA be acting as the regulatory agency?

MR. LeFANTE: EPA is Federal. I think it has to be--

SENATOR COSTA: (interrupting) Or, the DEP acting as the regulatory agency?

MR. CRIMMINS: It would be whomever the contract is basically entered between. If, for instance, a contract was given out

possibly to an agency like a utilities authority, it could be the regulatory agency in this respect.

SENATOR COSTA: I feel that these things have to be addressed, and they have to be addressed at this point, not after it is already passed.

MR. LeFANTE: Well, there is a portion in your bill you could probably amend or modify in the Division of Local Government Services' area. I'm sure with what you have in there already, the expertise of Arthur Young and Company, and similar companies which may be involved, that if you sat down in a private session with them, maybe you could work out some details which would be acceptable to the Committee. It is so important, Senator, that the safeguards be put in now. You do not look at it after it is all through and scratch your head, or wait until it reaches the Governor's desk for him to ask the question. You have to ask it now. You owe it not only to your fellow legislators, but you owe it to the Assembly, the Governor, and your constituents, to try to touch all the bases now. That is one that is very, very serious, and requires, I think, priority attention.

SENATOR COSTA: Thank you.

MR. CRIMMINS: Senator Dalton, backing up to your question about the 60-day review period, I think any municipality or authority which would enter into a contract that would go for a term of quite a number of years -- which we are talking about here under the provisions of your bill -- if they were not bringing in someone from the Division of Local Government Services, if they were not bringing in EPA and DEP officials from the very beginning, not just for 60 days, they would be very foolhardy. It is an enormous undertaking, and to succeed you need quality staffs, you need quality financial advisers, and you need quality firms which would be doing the contracting; but, most importantly, it is a case where you would need input from the State level, from the local level, and from the financial community. So, you should go longer than 60 days, and that could be up to the enactment of the contract.

SENATOR DALTON: That is a good suggestion.

MR. LeFANTE: You know, we take such pains. I remember when I was the Commissioner of the Department of Community Affairs, the time, effort, and money we put into adopting code enforcement -- code

education, regulating, licensing, permitting -- right up the line. If I had a dollar for every hour I spent in Atlantic City watching those things go up and sitting with staff to make sure that the rules and regulations of the codes were complied with-- Most of them were self-supporting in the fee structure, right down to the smallest plumbing inspector in the smallest municipality. Even third-party inspections are self-supporting. Why can't we build something like that into this? Make it self-supporting, whether it be an inspection service, or a policing service, or a rate-structuring service, whatever the case may be. We should consider some sort of a fee structure that could make it self-supporting, where it would not be costly to any agency. You can take that for what it is worth.

SENATOR DALTON: Very good. It's worth a lot. Thank you very much, Joe.

MR. LeFANTE: My pleasure; thank you.

MR. CRIMMINS: Thank you for having us.

SENATOR DALTON: Our next speaker will be Ted Swick from Prudential-Bache Securities.

SENATOR GARIBALDI: Ted, I think you were involved in some of the financing down in our municipality.

THEODORE SWICK: My name is Ted Swick. I am with Prudential-Bache Securities. We are an investment banking firm. I am delighted to have a chance to chat with you. I want to say at the outset that many of the things that I wanted to talk about in my preliminary remarks have been covered very, very well by previous testimony and witnesses. So, I am going to skip that, and if it will be helpful to you, I have some charts with me.

If I get away from the microphone, is it going to destroy the system? I wanted to get into financial mechanisms with you on these charts. That is what I am trying to get at.

SENATOR DALTON: Is there any way, Mr. Swick, that you can take the microphone with you?

MR. SWICK: Does this come out of here?

SENATOR DALTON: Yes.

MR. SWICK: I will give it a try.

(Whereupon member of audience offers assistance)

Thank you. First of all, as you can quickly see, this has some characteristics of resource recovery in it, but it covers the whole privatization process. What I want to try to walk through with you is simply how this thing works, and it won't take that long.

Let me say at the outset there are two things I want to repeat, and they are that in privatization there is more municipal control than there can be under your old system of operation, whether it is a public service operation, or a turnkey type of operation. The strength of your control lies in your contractual arrangements, which we will get into in a second.

As far as cost of service is concerned, it is our experience -- and I think the Arthur Young people have come up with similar numbers -- that when you go the privatization route, and you get private money, in a very broad, general sense you are reducing the cost of delivery of service, whatever it is, by about one-third. So, it has a very significant impact on your cost -- the cost to government. The main reason for this is simply that you are issuing less debt at the governmental level, and the term of the debt is a very significant part of the cost of a project. Reducing it by about 25 percent produces a very significant impact on the delivery-of-service cost.

To go through the chart, if we start up on the right hand corner, it simply shows the old Industrial Development Authority-type financing, and I will come back to that in a moment. But, that basically is the mechanism used to get the debt into the marketplace.

I will stop for a moment, just to comment on the other remarks that were made here, and the other testimony given with regard to the future of IDB's. There is very heavy lobbying going on right now -- particularly by people who are concerned with wastewater -- for the bill that I think it going to go into Committee next week. There is a huge lobbying process going on. But, resource recovery, as you may know, is already an exempt activity in one version of the bill.

I feel certain that the impact of the lobbying going on right this minute is so severe that I think wastewater treatment is going to get an exempt position in that bill. We need it, of course. I am quite optimistic about that.

The difference between your normal public project and privatization is shown in the middle part of the chart, where you see the general partner management box, and, surrounding it, the limited partnership. This is very clearly a tax shelter type thing. There is a great incentive for private industry to put money into a project, because of what they get out of it. It is simply a return on investment which is very attractive.

In this case, HCUA is the Authority in Hudson County which the previous witness just spoke about. It is the control body in this. They set up the arrangement with full service, general partner management, if you will, and that group, working on behalf of the Authority itself -- the governmental agency -- will set up contractual arrangements with various people -- whether it is a designer/builder as one person, or two people; whether they go into an operating agreement; or, whether they want to operate it themselves. We can forget about the landfill and the waste contracts, as far as wastewater is concerned -- obviously.

The people who put this together -- and you will have your normal financing bond counsel, your general counsel, and people like Arthur Young, who are very much involved and very out front on this thing -- are all advising the Authority in the creation of the contracts. And, of course, from my industry, you will have an investment banker looking over your shoulder.

The one thing that has to be dealt with is the disciplines Wall Street demands of a project, in order for it to get the money. This goes to some of Senator's Costa's questions regarding what a fair return for these people would be, and what would attract their money. I don't mind laying it right on the table. I think to get private money in there, you are going to have to think about a return on investment somewhere in the neighborhood of 25 to 30 percent. That is high, but if you don't give it, you are not going to get the money. That is one of the tough things I have to say about that.

If you say, "Well, can't we talk them down to 15 percent?" -- or whatever -- they will go away. There are alternate investments available to these folks, so you have to live with it. I hope that Arthur Young can back this up, but in our calculations, given the need

to attract the money, it still reduces your cost of delivery of service by about one-third. That was in my calculation when I said you could reduce the cost by about one-third.

So, yes, from a political point of view -- if I may use that word -- you have to be concerned about who is making what in this process. But, to get the capital in, you have to give them a return or you are not going to get the capital at all -- and it still works.

As I said, the contracts can be put together very solidly. They can give you very good protection, and privatization actually spreads the risk away from government, much more than the old way of doing things. The risk is given to others in the form of guarantees: The contractors must perform; the equipment they install must work up to your specifications; the operating expenses and the maintenance expenses are all contracted in from day one; and, if they don't perform, they have to make it work up to "specs." The burden is on their backs to make it work.

I can't say that government will lose all its risk, because there is always a possibility that the person you have contracted with will go bankrupt, or he will just throw up his hands because of some problem, and walk away. You are never going to eliminate that risk 100 percent. You would have to use your selection process to avoid the problem that might develop there. As we have described, you get the RFQ's out, the short listing, and the RFP's, and you examine the people. Then, of course, the biggest thing you look at is experience: What have they done before? Has it worked? What are their financial resources? Can they do what they are promising to do? Because you are going to make them sign on the line, and they do have a walkaway position, which bankruptcy allows. However, I think you can head that off through your selection process.

I want to get back to the cost again, or privatization, and what it may entail. I will just put up this other chart. There is nothing unusual about this; it is a regular revenue project where there are periodic deposits from a facility's operation. Let's say, for the sake of this discussion, it is on a monthly basis. Charges for service all go into a revenue fund. It sits there, and the first place it goes is into operation and maintenance. This is a typical revenue

enterprise system. Then, after O and M, it goes into the retirement of the debt. Then you have certain reserve funds, which are usually set up from the initial financing. They are funded up-front, and if they are invaded for the purpose for which they exist, then they are replenished before the money drops down to the next box.

Again, probably because this is addressed a little bit to resource recovery, you may need a special equipment reserve fund because of the technological risks involved in resource recovery that do not necessarily exist in sewer and wastewater treatment. Sometimes it is appropriate to put in an operating reserve fund.

Again, as the moneys flow down on a monthly basis, the last box is the one I want to comment very briefly on, and that involves funds available for distribution. What happens there is, in the indentures creating the debt you have certain legal things that the enterprise is allowed to do; and, indeed, the funds available for distribution can be used for a lot of things. However, you put this into the debt documents to start with. One of them is the repayment to the host city -- or the host community -- what we call in lieu of taxes; it is called all sorts of things.

You might want to go to early debt retirement on some formula basis, just to reduce that burden and the effect it has on the rates.

Then there is the payment to the equity owners, payments that they are entitled to because of the contribution they made. And then, in some cases, if you go beyond that, you can use the excess money to reduce the rates for service.

I will stop here for a moment and comment that the BPU's -- the "regs" that have come out with regard to resource recovery -- have adopted what is called the levelization approach, in terms of rate charging for resource recovery. I talked to one of the authors about that last week. What they have done is-- Their motive was to reduce the impact of the cost of the resource recovery project by, in effect, subsidizing the rates up-front by using a levelized rate structure. A process without a rate structure would cause the cost of service to decline in later years, as the debt is retired, but it would cause a very significant increase -- a big bulge increase -- in the cost of service at the front end, and their theory was to levelize it.

I kind of laughed with the author a little bit when we talked about it, because what it does is, it makes more money available later on, and the private investor gets more profit out of it, since as the debt requirements go down, there is more money spilling out of the bottom, and the investor is one of the guys who, on a preset formula, is sharing in that profit. In this case, it was their feeling that the money to private industry on the MAC end was thoroughly justified by leveling the rates during the early impact of the rates. It is an approach, and I don't criticize it, but it somewhat addresses the subject of how much you are going to pay these private people.

Now, with this setup, the private investor's money can come in. It doesn't have to be cash. If the full-service contractor you deal with can value his up-front contribution, then he might do an engineering service, such as a design, and a value is put on that and it becomes part of the equity contribution. In other words, instead of billing a project for his services, he contributes them and that becomes an equity contribution. It can cut down significantly on your front-end cost, if he is willing to do it that way. So, it can either come in in services, or it can come in through cash.

Sometimes property is donated to a project by a private individual -- or a location, if you are going into a new plant. So, there are various ways it can come in.

The payments to equity owners, as I said, originally come from the tax benefits which have been described to you: Accelerated depreciation; capital investment; and, the use of tax-exempt financing. Once the tax benefits run out, a cash flow begins to come into the project. In the financial world, in enterprise projects and revenue-producing projects, we require a debt service coverage, which simply means that rates will be set which cause a cash flow that will exceed the fixed fees -- which is O and M and debt retirement -- by some factor, probably 25 percent. So, if the enterprise is working as was designed, there will be, on an annual basis, perhaps 25 percent excess revenues, dropping down the buckets to the bottom every year, as long as everything is running perfectly smoothly. This is a requirement from "we financial guys." We ask that this be built in.

The amount of that coverage figure can vary. With very mature kinds of industries, maybe it doesn't have to be as high as 125. Some of our electric generating things are down to 110, because they have been so successful -- not the nuclear plants, but coal and oil.

I think that is, very quickly, what happens. One of the questions asked was: "What are the financing alternatives?" Let me just comment on that, and then I will stop. There is really only one financing alternative, and that is on the first chart. You have a combination of an equity contribution for profit, and the municipal debt.

Once you start to deal with the debt portion itself, there are a lot of merchandizing, or marketing, things that may come to your attention. I didn't invent the phrase that I like to use to describe them. Those marketing or distribution mechanisms we have invented in the Street, with the help of a lot of other people. You have heard about short notes, long bonds, variable rates, low floaters, high floaters, and all that. They are really mechanisms used to accommodate the cost needs of financing, and trying to, what we call, play the yield curve. Very quickly, the cost of debt is quite low for one or two years, but that line goes straight up as time goes by, and in almost three years it reaches a plateau where it flattens out. Well, with very high interest rates, when we traditionally want to sell 25, 30, or 40-year bonds, it is damn expensive. So, mechanisms have been in variable rates, etc., which, as I said, play the yield curve, and you have a 30 or 40-year maturity on your debt. However, it can be retired under very specific circumstances in a shorter period, so that the investor envisions it as a short investment and he is willing to accept less income and less yield on the investment.

So, I don't call those financing alternatives, as much as I call them marketing mechanisms, which work. The alternative, really, is to have an issuing body with a debt contribution, and with a return on investment. I guess I should point out, very quickly, that the equity contributors do not have any liability on the debt portion. The debt portion belongs to the enterprise, or to government, if they want to shore it up.

One other point is, when your contractual arrangements are well placed and well done, and your contractor is an experienced and acceptable guy, with good assets and a good track record, we then have available a debt service insurance. To oversimplify that, what it means is that every one of these projects, when properly put together, will enjoy a Triple A Rating in our marketplace, because of the availability of debt insurance. That has a very marked effect on the cost of the debt.

That was awfully fast. I would be happy to try to clear up anything that I have confused you with. Thank you very much.

SENATOR DALTON: Senator Garibaldi?

SENATOR GARIBALDI: What you just said, by the way-- In our own experience, when we put out our recent bond issue, Prudential-Bache picked up our whole issue, and they were sold before you even--

MR. SWICK: (interrupting) Do you mean we did it right once?

SENATOR GARIBALDI: Oh, yes. You picked it up at a very decent rate. It was a comparatively small issue. We are talking about a \$15 million issue, which is relatively small. It is not peanuts, but nevertheless, something you said took me back, and that was when you made reference to the investors in the marketplace seeking a 25 percent return on their investment.

MR. SWICK: Including the tax benefits.

SENATOR GARIBALDI: Does that include the tax investment credits, and the various accelerated depreciation mechanisms?

MR. SWICK: Yes.

SENATOR GARIBALDI: Well then, what would be the net?

MR. SWICK: Probably--

SENATOR GARIBALDI: What would you anticipate?

MR. SWICK: The real net, of course, includes his tax situation also -- that is before taxes. So, I would say the net would have to come in about, I would guess, double what the market rate would be for the debt. So, let's say if you sold ten percent bonds, the net might be down around 18 or 20 -- the net return. So, it is still good. It is excellent.

SENATOR GARIBALDI: I wouldn't argue that point, but the fact is, there are going to be costs. Who is going to eventually pick up those costs? That has to impact on the rate, or somewhere.

MR. SWICK: Yes, sir, but this is totally in front of you, on the table, before the deal is ever put together. It doesn't come as a surprise. You see it. It is all worked out ahead of time.

SENATOR GARIBALDI: The point I am trying to make is-- Believe me, as you heard from my remarks before, I think it is the only way we can go. We have done this already in my town, and the legislation is not even in place. We are moving into privatization. But, what I am saying is, if a municipality has the ability to go out into the market and secure funds at a ten percent rate, or, for instance, as in our case -- we went for eight percent and with the insurance it came to eight point four -- why would that municipality not go for the lower bonding circumstance, as opposed to maybe 18 percent?

MR. SWICK: Well--

SENATOR GARIBALDI: Do I understand you correctly? Am I discussing the same circumstance?

MR. SWICK: Number one, the community and its citizens are not paying this guy 18 percent, as against paying a bondholder ten percent.

SENATOR GARIBALDI: Somebody is paying for it.

MR. SWICK: It is built into the transaction, but it is not coming out of the--

SENATOR GARIBALDI: (interrupting) In other words, you are saying that there isn't any direct relationship, insofar as it impacts on the eventual rate user?

MR. SWICK: That's what I am saying.

SENATOR GARIBALDI: Because the Mayor and the Senators here will bear me out -- you know, when something goes wrong, and people flush their toilet, it better flush, because they don't blame the Municipal Utility Authority or Prudential-Bache; they go right to the Mayor.

MR. SWICK: Senator, the economic examination has to be made, and if the community can afford to go with a general obligation debt, and other services do not suffer neglect because you have used up that capacity to bond, it is going to be cheaper for the community that has a good rating.

I mean, anyone who can borrow money at an eight or nine percent rate today has obtained a real bargain. A lot of communities can't afford to issue any debt on a general obligation basis -- where they are going to get that lower rate.

SENATOR GARIBALDI: Okay. You are talking about the financing capabilities.

MR. SWICK: Yes, and what it costs. The cost has to be examined. If the community can use its general credit and issue regular debt, and it is cheaper than privatization, fine. We are not saying, "Hey, everybody jump on the bandwagon."

MEMBER OF AUDIENCE: They can't do it without the grants.

MR. SWICK: I am right on that yield comparison.

SENATOR DALTON: Senator Costa?

SENATOR COSTA: I don't know if you will be able to answer this, but maybe someone here will be able to do so. Who would have the legal responsibility for a malfunctioning plant, or for contamination of streams and loss of service?

MR. SWICK: The operator.

MEMBER OF AUDIENCE: The operator. The contractor, not the municipality. They would be responsible for responding to the environmental needs.

MR. SWICK: And, the way that has been working is -- and resource recovery projects have made a contribution to this -- the insurance industry has entered our lives. In addition to the debt service insurance, which we mentioned a moment ago, we also now have the casualty companies, I guess, willing to insure the contractual promises of the vendors, the operators, and so on. So, if we say to the operator, "If this thing doesn't work, we are not going to pay; you have to pay," he can get insurance on that, and there is backup and comfort in that, and it is a valuable thing.

SENATOR COSTA: Are you saying the private individual is running it?

MR. SWICK: Yes, ma'am.

SENATOR COSTA: Is this spelled out, as per contract?

MR. SWICK: Yes, it would have to be.

SENATOR COSTA: It would have to be? There again, that is another thing that would have to be itemized in that very tight contract.

MR. SWICK: The contract arrangements here are very complicated. There is no question about it. It would be drawn up by a team.

MEMBER OF AUDIENCE: The DEP and the Division of Local Government Services would be reviewing that.

SENATOR DALTON: That doesn't necessarily give this Committee great comfort.

SENATOR COSTA: Yes.

SENATOR DALTON: I think that is what we are trying to point out. What we are concerned about, and what Senator Costa has been driving at for two meetings now, is to try to protect the local entities as much as possible.

MEMBER OF AUDIENCE: I guess we believe this has more protection than a regular contract does.

SENATOR DALTON: Okay. Mr. Swick, somewhere down the line we might elect a person to the White House again who believes it is a Federal responsibility to get involved in the wastewater treatment business, and I am a municipality with a 40-year contract when this person comes along. Am I up the creek?

MR. SWICK: Yes.

SENATOR DALTON: Okay. Thank you.

MR. SWICK: You could probably deal with the debt side -- maybe -- but not with the contracts. You could do something about the debt, probably. It depends on what the Federal regulations would be on that pot of money. But, contracts are tough.

SENATOR DALTON: From your perspective, a contract that would include some sort of a reopen clause, in case a circumstance such as I mentioned happened, would be very unattractive to you, is that correct?

MR. SWICK: Yes, and your lenders would look sideways at that also. One thing they do not want is any surprises, or arbitrary decisions made at a later date.

MR. LeFANTE: Senator, if I may, I know this is irregular, but would it be possible if a 40-year contract were in effect, and

funds did become available, that the funds would trickle down to the agency, and the agency could be empowered to use its reduced bond indebtedness for whatever payments may be due, and that could reflect in the user's rate schedule? That may be one approach. It works with other programs that are in existence in Washington now -- on a much smaller basis, but it does work.

MR. SWICK: I guess we are really saying that if some Federal funds were available, they could be put in as a subsidy rather than a grant.

MR. LeFANTE: Yes.

SENATOR DALTON: Are there any further questions? (no response) Thank you very much, Mr. Swick.

MR. SWICK: Thank you.

SENATOR DALTON: The next speaker will be James Lanard, representing the New Jersey Environmental Lobby and Clean Water Project.

JAMES LANARD: Good morning, Senators. My name is Jim Lanard. I am representing the New Jersey Environmental Lobby. My testimony today is also being presented on behalf of the New Jersey Clean Water Action Project, and the Water Resources Coalition, which, in New Jersey, includes membership in all the Watershed Associations in our State.

I am going to talk about the environment, which is something we have not heard a lot about today. I would like to try to point out a couple of concerns we have, and see whether environmental considerations could be increased in this bill.

When Congress passed the Clean Water Act in the early 1970's, they were concerned about a couple of things. They were concerned about pollution, and they were concerned about promoting the cleanup of pollution. But, they were also concerned about doing that within the context of ensuring adequate public participation, and ensuring that there would not be unnecessary, or unplanned growth. When the Clean Water Act was adopted, and when the regulations were promulgated, there was a guarantee that water planning would be an integral part of any Federal funding that would come down to the State and local governments.

We think that process, which is embodied in many Federal and State laws -- and I will refer to some of them today -- for public participation and planning, must be incorporated in this bill. We do not believe that they are so incorporated at this time.

In Section 3a.-8 of the bill, there is reference made to the Department's approval being dependent upon the Department finding consistency with what is known as the Water Quality Planning Act of 1977. It is a New Jersey law.

That Act includes some of the Federal Water Pollution Control Act's provisions, but we don't think it goes far enough. We would propose that amendments be incorporated to add the following bills to this provision, so that when the Department must determine that a proposal is consistent with State law, it would include the following:

The New Jersey Water Pollution Control Act, which is N.J.S. 8:10a.-1; the Soil Erosion and Sediment Control Act, which is 4:24-39; and the Critical Areas Act, which is 8:11-43. Reference should also be made here to the Federal Clean Water Act. While I don't want to limit the sections in the Federal Clean Water Act, the Department of Environmental Protection should be required to determine consistency. We should look at 201, 208, 303, and 404 as a start.

There were also two Executive Orders, issued under the Carter Administration, that had to do with water quality. One was a Flood Plains Management Executive Order, and the other was a Wetlands Management Executive Order, which also are involved in, and concerned with, water treatment areas.

If you incorporate those laws into Section 3a.-8, what you will essentially be accomplishing is, you will be limiting the privatization options to the priority list, which you have heard so much about today. What you have heard about today is that the Federal government is not funding the programs on the priority list. What this bill does not do, however, is limit privatization to those facilities. And, as you understand, the priority list was developed for Federal review, so that the Federal government could determine which projects to fund, and in which order. The State had to develop a very comprehensive program, public participation, and critical review, in order to determine what the priority list should be, and that list was to be addressed in order -- in numerical order -- for Federal funding.

As we read the law now, we understand that a proposal for a wastewater treatment plant not on that list of 290 -- or whatever the number is now -- will not get private funding for development of a wastewater treatment plant, even though we don't have any identification as of now as to what is on the top 290. You have a potential here of affecting growth in New Jersey, which was not considered by the New Jersey Department of Environmental Protection when they proposed the priority list to the Federal government.

We also think there should be consideration given to other criteria for the Department of Environmental Protection. We understand there is no criteria -- as we read the bill -- for the Department of Community Affairs to use in order to make decisions on how to determine consistency with other state and Federal laws. Two things that we think should be contemplated when considering where these facilities should be built would include population density and growth projection. Are they going to spring up all over the place? Or, are they going to be limited to where there is actual need? And, is the need going to come about after the facility is constructed?

It is also not clear when the Department of Environmental Protection and DCA can reject proposals. I think some consideration also has to be given to how this bill relates to the Mount Laurel II decision.

The bill, because privatization generally relates to very expensive and large facilities, encourages high technology solutions to the wastewater treatment problem. It creates no incentives, nor would there be any likelihood of low-technology, cheap, or small facilities being constructed.

This bill begins to move us toward large-scale growth, growth that was not anticipated nor projected, before the facilities were constructed. We would recommend that some low-technology facilities, and incentives for them, somehow be incorporated in this bill.

I will just give you one example. There are community septic systems, where a small development would use a community septic system for their wastewater treatment. There is nothing in the bill, as we read it, that would encourage privatization for small-scale programs

such as that. We think that maybe there should be some consideration given to that also.

I just have some general points now that are sort of scattered. I will run through them very quickly.

I wonder if there should be any rules? A lot of the concerns, as we have heard today, are going to be included in the contract, but maybe the Legislature would want to recommend that certain provisions, or certain concepts -- at a minimum -- be part of that contract. And, you certainly can do that without getting terribly specific.

For instance, should there be any rules for operation and maintenance of the facility, and operation and maintenance of investments? Once this facility is built, do you want to require that they maintain it adequately? They only need to own it and operate it for five years in order to get all the tax breaks and benefits from the Federal government. What incentive do they have to continue investing in that facility?

How about what the impact would be on existing utilities that have franchise areas? I am treading on territory now that I don't quite understand, but I believe is is an issue. As I understand it, a utility that has a franchise area is sort of guaranteed to get the wastewater from that area if there is development tied into some type of municipal system. What happens if we come on line with a privatized facility within that franchised area, even though the municipal utility authority has contemplated expanded growth and increased discharge that is now going to be diverted to the privatized facility? Will this hurt the municipal authority?

When we looked at the definition, we asked whether communal septic systems would be included, if the understanding of sewage collection systems includes communal septic systems. Maybe that could be described a little bit better, and then we would be clear on the issue.

Let's talk about the size of a privatized facility. Suppose the municipality contracts with the investors, and the investors decide that the need for the facility is seven million gallons a day, based on growth projections, and what not. Suppose something changes, and

growth changes -- whether it is because of the Supreme Court of New Jersey, or the United States Supreme Court, or whether there is some type of economic impact that creates less growth -- and suppose also that the investors counted on seven million gallons a day, and three years into this project, they are only getting four million gallons a day? What is the impact on the consumers? Does the rate of unit-per-waste charge go up? Or, is there a contract provision that says the investor has taken the risk and will assume the risk?

What about labor issues related to privatized facilities? What happens if we have a private company with a labor union working there? What happens if that labor union decides it is necessary to strike? What happens to the operation of that facility?

I think the proposal to make this self-funding is intriguing for certain areas, and we would like to see considerable attention paid to enforcement funding. How are we going to fund enforcement of this facility? It was proposed that possibly local enforcement officers representing environmental and community groups could be paid through some type of fee scale that would guarantee access to the facility. It would be interesting to see whether we could get community organizations, or some type of advisory council, to participate in the oversight, so that we would have another level of involvement to guarantee adequate pollution control.

Commissioner Hughey, when he testified on February 6, talked about -- maybe with somebody else from the Department -- possibly having a call-up provision in the contract. Maybe it was you, Senator Costa, who said that after a certain period of time we could call up the contract, review it, and see whether there had to be some amendments made to the contract. If you have a provision for a call-up that says you can review at some time into the contract, you would have a viable contract that would guarantee the consumer protection from excessive cost.

Something that I don't understand, but which is something that sounds good to me, is whether we could have an insurance policy that would guarantee against higher consumer cost. Either the municipality or the investor would find an insurance company that would guarantee that rates would not go up beyond a certain level.

What about putting something in the bill -- and this was also discussed on February 6 -- that would require a provision in the contract which would allow the municipality to replace the contractor who is operating the facility, if a certain number of, or certain types of violations recur? How will we -- or how will the State Legislature, I guess -- guarantee that if there is going to be expansion, or upgrading, of the facility, it will be done adequately? And, how do you guarantee that you can mandate upgrading, or expansion of the facility? How about if they change, or if the State or Federal Water Quality laws change, and there is need for more investment? What does that do to the contract, and what does it do to 'consumer cost? And, what happens if we find out that the water being discharged from the facility, or the operation of the facility, is causing some type of public health impact? What kinds of provisions would there be in the contract, or in the legislation, to guarantee that the causer of the health problem actually pays for the damage? In this case, it could really be caused by the private owner of a facility. How are we going to make sure that public health issues are compensated for adequately?

Thank you for your attention and for the opportunity to talk with you today.

SENATOR DALTON: Thank you, Jim. Senator Garibaldi, do you have any questions?

SENATOR GARIBALDI: Yes. You brought out some vital questions here, and that is why we are called the Energy and Environment Committee, because our primary concern is the environment.

Initially, I thought -- and I still believe -- the declaratory intent of the legislation Senator Dalton has sponsored was to enhance and provide those components that are necessary to protect our environment, and not necessarily to cause additional problems as a result of growth. As a matter of fact, I find I am reading, with great interest, about a lot of the problems that are happening up in the Passaic River area -- the extent of the flooding and the damage to the homes of the residents. I was up there myself, and I saw the lives of the people-- They were laying out in the streets because of this flooding. Experts are suggesting that this occurrence was as a result of overdevelopment. Those homes may have been constructed in flood

plain areas. Perhaps back when these homes were built, we did not know what the flood plan designated areas were.

Nevertheless, you pointed out that before we commit to the allowance of a mechanism, or method, that can contribute toward expanded growth, and I don't think we are against orderly growth in the State-- As one Senator who is responsible for what happens, at least insofar as the State is concerned, I know that New Jersey is one of the most densely populated States in the nation, and we certainly should be doing things to protect the population and property we now have.

As I see the bill, there are deficiencies. The declaratory intent, as I see it, is well founded. I said at the outset that one of our primary considerations is to upgrade facilities for the purpose of eliminating problems we know exist. I am not an expert in this area, but from what I hear and see, I know the effluent that is emanating from the existing facilities we now have does not meet the minimum standards, and it can present a health hazard -- in addition to other problems. So, that has to be addressed, and the only way we can do it is by upgrading the facilities.

I believe we should incorporate protective devices, but this is not to say we should just open the door to all kinds of growth and development because of the protective devices. Take garbage for example. The more population we have, and the more growth we have, the more garbage we will have. I don't know what to do with the garbage I have in my community now, with our present population, not to mention what to do with it if the anticipated growth expected in the next couple of years takes place.

So, Senator Dalton, I would think we are going to have to address these deficiencies. They are not intentional deficiencies, but we are going to have to incorporate some protective language in this legislation, to at least address some of these problems.

SENATOR DALTON: We are attempting to work out some language in order to address some of the concerns that Jim raised. There is a fine line walked when you are trying to attract investment dollars, and, at the same time, protect what Jim's main concern is -- the public's interest and the public's health. That is what we are attempting to do right now. So, some of the concerns that Mr. Lanard raised are going to be addressed.

MR. LANARD: Senator, if I may respond, I didn't mean to imply that we are against growth -- absolutely not. But, it should be planned growth.

SENATOR GARIBALDI: Orderly.

MR. LANARD: Yes. I am just wondering whether Senator Stockman's bill, which has to do with statewide planning concerns, may somehow tie into this. Maybe the bills could be related to each other, in order to guarantee that type of orderly growth.

SENATOR GARIBALDI: Could you be more specific? Which bill are you talking about?

MR. LANARD: He has a bill that has just been introduced and is being considered. It would require some type of state planning guide.

SENATOR GARIBALDI: Oh, you are talking about addressing the Mount Laurel situation?

MR. LANARD: Yes.

SENATOR GARIBALDI: I have more to say about that, but that will be at another time.

SENATOR COSTA: Jim, you made an awful lot of good points, and I am looking forward to the written record in order to ponder on some of them.

MR. LANARD: So am I, Senator, so I can see what I said.

SENATOR GARIBALDI: I am sure the staff has taken into consideration a lot of things you said.

SENATOR DALTON: I would just like to respond to this, Jim. You know, one of the things we do is, we look at the DEP, and we look at their major responsibility under this bill, and some of the things we would like to include and expand upon as being their responsibility. We are talking about major programs, the Right to Know being one; Solid Waste Management, the McEnroe bill, being another one; and, the whole issue of hazardous waste disposal. Given all of this huge responsibility, and the fact that I think the Department, over the last couple of years, has -- at least this year -- asked for perhaps -- what is it? -- a three percent increase in their budget. How would you respond to that? You are here recommending, to a certain extent, that we increase the responsibilities of that Department under this

bill. We do it constantly. I am certainly no wilting flower, insofar as doing it myself, but the thing is, isn't there also a concurrent responsibility to give them the wherewithal to address these concerns?

MR. LANARD: Senator, I couldn't have set myself up better if I tried. We testified before the Joint Appropriations Committee on Wednesday of this week -- I'm sorry, it was Tuesday; it was two days ago -- and we highlighted the additional responsibilities the Department has assumed, either voluntarily or they have been given them by the State Legislature, and also by the Federal government. We went through about 15 new laws that require considerably more staff. The point that we made was, we did not think the Governor's Management Improvement Program was adequate to compensate for those additional responsibilities without additional funding and additional staff being included.

We talked about certain key areas where we were certain there was a need for greater involvement by the Department, and this week we are preparing recommendations for the Joint Appropriations Committee for the positions we think need to be filled within the Department. There are over 30 vacancies currently existing within the Department, which is very hard for me to accept with all the responsibilities they have now. They said they were creating something like 200 new positions, yet the budget increase is something like -- well, it is very small; maybe just around three percent.

Also, Senator, we are very anxious to see you proceed with the proposal you made when you talked about this Committee's agenda: Doing real oversight of the legislation that has already been enacted, to make sure that the legislative intent is being followed, and that there is no need for amendments or additional resources. That is something we are struggling with, and we are not finding as much information as we would like as to the adequacy and effectiveness of existing laws.

SENATOR DALTON: You can be assured that this Committee is going to take that responsibility seriously. We are going to take a look at some of these programs, because as I look at your recommendations, that was the first thing that struck me: "Here we go again." So, I certainly appreciate your comments, and you can be

assured that we are going to attempt to address some of your concerns with this bill.

MR. LANARD: We are available if you want to set up a meeting with us, or with the Department, or with some of the folks who were here today, in order to talk about the issues.

SENATOR DALTON: I have noticed that you have never been shy as far as meetings are concerned. (laughter)

MR. LANARD: Thank you, Senator.

SENATOR DALTON: Thank you, Jim.

The next speaker we have is Mr. Ed Higgins, from Merrill Lynch.

EDWARD HIGGINS: Thank you, Senators. I appreciate the opportunity to be able to speak today. I am in the Project Finance Department of Merrill Lynch, which is an investment banking firm. I have six years' experience in investment banking; two years' experience as a municipal bond and tax attorney; and a year of experience as a consulting civil engineer.

I would like to focus my remarks on three principal aspects that I think are important from the financing aspect as you look toward development of this bill.

In my remarks, I, like Mr. Swick, have looked for some precedent in the resource recovery area, since it is similar in that privatization has been extensively used, and I think it might be helpful to you in your evaluation of what types of contractual provisions and undertakings you will be looking for.

The first area I would like to touch on is the type of security that is used in projects of this character, and its impact on the overall cost of financing the various security or credit-enhancement devices.

Essentially, as Mr. Swick also pointed out, these projects are structured as revenue-based projects. They don't depend on a credit support to any significant degree, but they look at the asset as an independent revenue-generating facility. It is important to keep that in mind as we go through this, because investors will look at that to some extent, but there are points and risks that they won't want to take on themselves.

The factors in this security structure are: the credit strengths of the private and public participants; who are the communities; and who are the vendors you are going to be looking at -- the organizations that are going to build and operate these projects? The risk acceptance and avoidance philosophies and objectives of both the public and private participants are crucially important.

I know Senator Costa has pointed out the desire to transfer as much risk as possible, while retaining control, and that is key to contractual undertakings in these projects.

The project characteristics themselves -- what are the revenue sources that are available? Is it mostly individuals? Are there large corporate sewage generators that are going to be involved here -- resource recovery, and similar types of considerations? And, what contractual arrangements are possible? What are the financial strengths of each of the parties who can contribute revenues?

There are two principal things you are going to be looking at when evaluating the security structure. One is, who is going to provide the equity? And, the other is going to be, who will be the purchaser of any debt?

Again, as was pointed out earlier, these projects are structured on an IDB, industrial development bond type structure. With tax exempt debt, it should buy a municipality, or a municipal organization, a pass-through entity -- no direct obligation on the municipality; the project itself will pay those revenues. The equity is either contributed by a vendor, or raised through third parties. There is a distinct difference in the market right now between those two. The vendors who attempt to get into this privatization type of activity are large, substantial engineering companies, with a technological and energy business bent. They have large pools of capital. They use tax benefits themselves.

In addition, in approaching these projects, they look not only at their rate of return in the abstract, as a third-party investor would, but they have a construction profit built in, and they have an operating, or service, profit built in, which masks, in many ways, what their overall return is, but also factors in what they are contributing.

I think when you look at these vendors, you should be aware that there is not an inexhaustable supply of them. In the resource recovery area, for example, there are four. As was pointed out by the Mayor of Bayonne and the people from Arthur Young, there is a group of 15 on the privatization of this wastewater treatment system.

You will find that 15 to 20 is the maximum number of people you are going to be getting who are capable of contributing their own equity to the project. That is very helpful, however, since it allows the municipality not to worry about an independent source of where that money is coming from.

If you go to the third-party equity market, you are faced with an extremely credit-sensitive market right now, both institutionally and individually. To date, there has been no third-party equity investment in a resource recovery project, for example -- publicly sold equity investments.

There is a similar situation, so far, on the privatization. The one project that has been done, has been done by an engineering company who made the direct equity investment.

The credit sensitivity puts a burden either on the vendor you are looking at, or on the municipality, depending on who has the requisite strength, since the third-party equity investor wants to be guaranteed, in addition to his tax benefits, a stream of cash flow. He doesn't want to have any risk. He doesn't want to look at the project mechanics at all. That is the advantage of the vendor. The vendor knows the business; he will look at the project economics himself; and he can make an investment decision himself, without having to go to a deep pocket for credit support.

The project securities run the spectrum, from full-credit by a strong private entity or the municipality, to a pure project base. I think most commonly you are going to be building on a hybrid sort of project-directed financing, where there is some indirect credit support, as has been the case with resource recovery. When you run into construction cost overruns, delays, and operating deficiencies, someone is going to be on the line, and it usually has been the vendor -- and it should be the vendor, because that is his business. He contributes, and he agrees to contribute, a set amount of money over

time, to offset any of those deficiencies. That structure has worked very successfully in the tax-exempt bond market in resource recovery, where you can say to the investor, "Here are your basic revenue streams, but if something goes wrong, there is a pool of money sitting over here and you can grab it and reach it." That supplements the revenue flow from the project, and removes the need to put on the people receiving the service the contingent risk, or burden, of supporting revenues that would be provided to cover that contingent risk. So, it offsets and allows you to keep a relatively low service charge, or tipping fee, compared to what you would have to do if it was a pure project financing. I think that is another point you want to keep in mind.

I am moving quickly because I know a lot of this has been covered by some of the other witnesses. Credit enhancement mechanisms range from those which retain the basic project financing structure, including reserve funds for debt service, to reserve funds for contingent costs, and reserve funds for construction period interest.

Operational insurance -- you are all familiar with the casualty-type provisions. They are very accessible. Mr. Swick mentioned new types of insurance. The primary ones are efficacy insurance and resource availability insurance. These are available right now because the insurance companies do not really have other uses for their money. They are underwriting businesses down significantly. I would caution you that those types of insurance are very ephemeral; they move in and out of the market very quickly, and they can disappear at any given point in time.

I think it makes sense, in drafting legislation, to contemplate the flexibility of putting that type of provision into your structure, in the event it is available and it is attractive.

I already mentioned contingent commitments. Usually they are from a private participant, and they are generally from the parent company of the private participant, who will usually participate in these projects through a subsidiary company that has relatively low capitalization to protect themselves with.

The public participant, in some cases -- particularly when he is looking for a strong reversionary interest -- may want to put up

some sort of ad valorem tax revenue, or other tax pledge, to leverage himself into a position of claiming that residual interest.

There are two primary credit enhancement mechanisms that can be used, which really divorce -- at least from the debt side of the project -- what the revenues and mechanics are. One is a letter of credit from a commercial bank. These have been used extensively in the tax-exempt market. They have a limited maturity. Currently, the longest one is about ten years. They are quite expensive -- one percent to one and one-half percent per year, or the amount of the letter of credit, which generally has been the principal amount of the tax-exempt debt, and six to eight months' interest.

Municipal bond insurance was also mentioned. This is available from two principal agencies. You get a Triple A Rating on those securities, as Mr. Swick mentioned. There are size limits. Currently, the municipal bond insurers don't want to go above \$80 million of the principal amount they will insure. They base their premiums on total debt service insured. So, you take the principal amount of \$80 million, plus all the interest over the term of the bonds, which might be a 20, 30, or 40-year bond, add that together, and they take one percent to two percent of the principal amount, generally, as their up-front fee. We have found in our analysis, that unless the interest rate savings that the projects get from the municipal bond insurance are more than half, as a percentage amount, then the two percent fee-- If you are not saving one percent in rate, it is generally not economical to get the municipal bond insurance.

I will mention that all of the credit enhancement mechanisms are subject to market fluctuations. The spread between quality levels in the tax-exempt markets, and also in the equity investment markets, changes with the conditions of the market. Right now, we have a moderate position. You have a differential between a Triple A and a Triple B tax-exempt bond of one and one-quarter percent right now. That has been, in the past two years, more than a 200 point differential in a very bad market, and it has been as close as, say, 75 basis points in a strong market. So, all of these credit enhancement mechanisms, while it is valuable and important to have the flexibility to implement them if necessary, can only be decided upon at the time you go into the market on a particular project.

In looking specifically at some thoughts for the legislation, I think you would want to consider, in any type of service charge or special tax-type provision, providing sufficient flexibility for yourself, to adjust both the amounts and the timing of the adjustments.

A good example is resource recovery. If you have a one-half cent per kilowatt hour change in the energy price, that converts to a \$2.50 per ton change in your tipping fee. That is a very significant change from a very small uncontrollable circumstance, so you need that flexibility.

I think you should incorporate as many provisions as possible for varieties of classes of debt, senior and subordinated. Once you are in a project financing structure, like you will be in with one of these projects, you have tremendous flexibility to access different pools of capital. I think if you have the subordination provision, you might be in a position to attractively finance an extension to your project.

I would also encourage including in the legislation something that would contemplate taxable as well as tax-exempt parity debt, because who knows what this Federal law is going to do down the road? If you want to add something to the project, you might not be able to do it on a tax-exempt basis, and you might have to go back and amend the legislation.

Similarly, as Ted mentioned, I think it would be productive to include all the flexibility on variable rates and variable maturities you can in any legislation you are drafting.

Moving from security, one question you might be addressing is -- I know you are addressing this -- how will this proposed Federal legislation actually affect the project? Some of this has been covered. I will go quickly. I assume that the bill, in its most adverse form, will be passed, and then what would that do to your project, if you were to go ahead with it under the proposed legislation?

There are four principal areas of impact. The first one is, what are the tax benefits that would be available to a private entity?

The first one is a tax credit. The key provision in the bill that could be affected is the recharacterization of a service contract

between your vendor and the municipalities as a lease. If there is a lease to the municipality, you lose the investment tax credit. That would be tremendously disadvantageous to these projects. The investment tax credit is an up-front ten percent benefit, and it would significantly change the economics. I imagine what you are going to be getting, if that is the case, or if that is still uncertain when you go out for a particular project, is a request for indemnification as to that point, certainly by the equity investor. He will probably ask the municipalities for that.

I think the removal of accelerated depreciation deductions, if that were to get passed, would not be significant. As was pointed out by Arthur Young, most of these assets are five-year properties. The change in the depreciation is very small, and would result in a tiny, tiny change in the overall service charges you would be asked to charge.

You could have a State "cap" on industrial development bond financing. New Jersey, in 1983, was \$137 per capita, very close to the proposed limit of \$150. We think that given the potential size of some of these projects, for either wastewater or resource recovery, that cap would have a significant impact on your ability to proceed with the industrial development bond-type structure.

Finally, there are some provisions on advanced refundings that would be carried over from the housing area. I don't think they are going to have a material impact on raising debt or equity for these projects. They will just be a consideration in the mind of the vendor/operator as he proceeds.

So, overall, I think the impact, even if the bill was passed, would be relatively moderate in terms of service charges. It might limit, a little bit, some of your third-party equity investors from coming in because of the risk of recharacterization, and it would require a little more indemnification.

My final point is, how should the rate of return to private entities be measured, or regulated, in projects like this? In approaching this question, which I know is of serious concern, I looked at where we have seen regulation before. It has generally been in the electric utility industry and the transportation industry. Those are

both areas where there are monopolies. And, certainly if you have a contract with a particular vendor for 40 years to do a wastewater service-type contract, that is a monopoly. However, what you don't have in the case of wastewater contracts, is a group in there which is the only group you can deal with, as is the case with both the electric utility industry, generally, and the transportation industry. The fellow who wants to be your wastewater operator isn't a common carrier, where he is the only game in town, and where there is a particular risk, and he is going to charge abusive rates or preferential rates. The municipalities, through this legislation, are in control of what leeway they give him to set those rates. That is true in resource recovery as well.

The contractual provisions, which have been discussed earlier today, can really be defined quite clearly in terms of formulas, and I don't think you will find tremendous ability for a vendor to go outside the bounds of the contract and charge usurious rates. You will be faced, at the front end, with trying to assess what his mix of return is from construction profit -- return from his service charges and his return from tax benefits -- and then seeing what he is getting overall.

I will caution you that it is almost impossible to really do that because what you usually look at, in both determining the contract and in assessing his rate of return, are the projections you are using when going out into the market. And, the vendor, very frequently, has a completely different set of projections, based on his view of what is going to happen over time to his operating costs, and to service charges in general, particularly in the resource recovery area. There is no way to get a common ground on what is in his head with those assumptions. So, you may be looking at an after-tax rate of return that to him is 15 percent -- okay? But, he may, in his mind, think, "Gee, I know my operating costs are going to be going down more than they look like in this analysis, and I am going to probably end up getting 20 percent." It is very hard to contractually tie that down as well, because if you want to take away his potential for getting lower operation and maintenance expenses, he is going to come back and ask you to kick up what is contributed in the event they go up. So, it is a risk balance, and through your advisers and consultants you will try

to develop an appropriate risk profile that you are comfortable with in assessing his rate of return.

I think generally our recommendation has been, don't try to regulate the rate of return. Don't try to get inside the vendor's head too much. Just look at what you are paying under your formulas and your educated guess as to what is going to happen under those formulas, and live with that. Thank you.

SENATOR DALTON: That was an excellent statement. Thank you very much. Senator Garibaldi, do you have any questions?

SENATOR GARIBALDI: No questions.

SENATOR DALTON: One of the things we were wrestling with, and that you have touched on -- you have touched on a lot of the things we are wrestling with in trying to draw a balanced bill -- is an issue that was raised by Jim Lanard. If, in fact, the wastewater treatment facility starts polluting the surface water -- the ground water -- in an area, can one realistically put into a contract that the owner/operator should bear the burden of any costs, fines, etc.? What are your thoughts about that?

On the one hand -- and I can appreciate this -- you don't want us to get involved with defining the rate of return; but, on the other hand, we want to attempt to protect our constituencies as much as possible.

MR. HIGGINS: Generally, I would think you would want to try to incorporate into the contract, provisions that state the vendor -- who has represented himself as competent to conduct these services -- has the responsibility for any misfeasance on his part. I would think that a wastewater treatment and collection facility, which has sewage leaking through the pipes into the groundwater supply, would probably be -- at least on the surface -- a misfeasance type of situation, and he should bear the responsibility.

It is normal in a lot of resource recovery contracts, for example, to have leachate liability, where if residue is improperly disposed in a residue disposal landfill, the burden would be placed on the vendor -- that is where the vendor is in charge of the landfill. Now, if the landfill is retained and owned by the municipality, and it controls and sets the standards for disposition of the waste residue, then the municipality might have the liability.

But, I would think that when it is leaking into the groundwater supply -- which is something it shouldn't do -- you would have a misfeasance. Now, he would probably have some insurance against that, and he would certainly have the right to sue the contractor, if he had subcontracted that part of the work out. However, I don't know if that would immunize the municipality involved from a lawsuit, or the risk of suit. I think the contract would stand up and it would be litigable.

It gets a little to the point where there is a strong reversionary right on the part of the municipality. The question then becomes one of, "Did the owner really own the whole system, or was he more of less a contract operator of the system during this period of time, with his liabilities restricted to contractor liability, rather than full ownership liability?"

SENATOR DALTON: You have certainly given us a lot to think about.

MR. HIGGINS: There sure is a lot to think about in this area, I'll tell you. (laughter)

SENATOR DALTON: If we have any questions, can we feel free to get back to you?

MR. HIGGINS: Absolutely.

SENATOR DALTON: Okay.

MR. HIGGINS: I would be happy to talk with you directly. There are also other people in my firm who work with me in these areas, so don't hesitate to call.

SENATOR DALTON: We really appreciate that. Thank you very much.

MR. HIGGINS: I really appreciate the opportunity to be here today. Thank you.

SENATOR DALTON: Our next speaker will be Mr. David Jackson, President of the New Jersey Builders Association.

Mr. Jackson, do you want to give your testimony in unison with Sean, or would you like to keep your testimony separate? It is up to you folks.

DAVID JACKSON: We would like to testify separately.

SENATOR DALTON: Okay. One of the problems with being Chairman of any Committee is, when you have a hearing like this and about 20 people want to speak, you have to choose who is going to speak, and when. Certainly, I don't want to diminish the importance of your testimony by choosing when you are to speak, because your testimony is as important to us -- without being too politic -- as the first speaker's testimony was.

MR. JACKSON: Good morning. My name is Dave Jackson. I am President of the New Jersey Builders Association. We are a statewide trade association of builders, developers, and affiliated businesses. More important than who I am is, I am a builder. I do the Presidency as an advocacy.

Much of what I wanted to say has already been covered, so I do not want to belabor the subject. I would like to make one comment, however. The Mount Laurel II issue was raised by the gentleman speaking about the environmental issues. I don't think there is any question but that we have a crisis in housing. For example, in Middlesex County, you are growing jobs three times faster than you are building houses of any kind. If we did not have a crisis, we would have had the Mount Laurel II decision.

If you overlay the State Development Guide Plan with the sewer bans in the State, and with the land that has been taken out of the building realm, you will find that we don't have too much land left to build houses on.

So, we see this privatization bill as a mechanism to open up some land that we cannot build on now. It would have a very, very positive effect on the housing crisis that has fostered Mount Laurel II. Therefore, we support the bill wholeheartedly.

We have some concern over how the rates would be established. I think I will just express our concern about that and leave it to you people.

We hope this will serve as a model for other types of privatization concepts regarding other aspects of the infrastructure. We have high hopes in that regard.

Again, I am trying to go pretty fast because, as someone else said, most of this has already been covered. But, there is one new

point that I would like to bring up. Cleaning up our streams is an activity that we, the builders of the State, wholeheartedly support. But, it is not an activity that should be discouraged through taxation.

I am referring specifically to the sales tax on the materials used in wastewater treatment plants, and the collector systems. If a plant is built by a municipality, or a sewer authority, it would be exempt from the six percent sales tax. But, if it is built by a taxable entity -- for example, one of our developer members -- all materials would be subject to a six percent sales tax. On the basis that this is an activity which should be encouraged rather than discouraged, and because there would be no revenue loss to the State when compared to a tax-exempt entity building the wastewater plant -- a municipality or a sewer authority -- I therefore propose that you include in your bill a sales tax exemption for materials used in this type of project.

With that, I would like to thank you for your attention. If you have any questions, I would be happy to answer them.

SENATOR DALTON: You can be assured we will run this sales tax exemption past some of the folks in the Executive branch. That is obviously going to be a concern of ours. I assure you, we will take a look at that.

Are there any questions from the members of the Committee?

SENATOR COSTA: That is a good point.

MEMBER OF AUDIENCE: Can I make a comment?

SENATOR DALTON: You sure can.

DAVID FISHER: Just for the record, my name is Dave Fisher. I am Staff Director of Environmental Research and Planning for the New Jersey Builders Association.

Just to respond to some of Mr. Lanard's comments very briefly, he expressed concern about a portion of the bill that didn't address other statutes and environmental laws that are on the books. However, I don't really think that is necessary, and the reason for that is, any wastewater treatment facility now approved by the State DEP must receive a New Jersey Pollutant Discharge Elimination System Permit, and that includes an assessment of the sewer allocation, population projections, and every other concern that DEP has

considered, including a consistency determination regarding the 208 Water Quality Management Plan, and the 201 Facilities Plan, developed for that MUA.

In being consistent with those two sections of the Clean Water Act, essentially all the statutes on the books in New Jersey -- the Water Pollution Control Act, and others -- are covered.

Although it was a good point, I think the concern is already addressed when treatment facilities are designed and constructed.

In terms of community systems, he mentioned-- This is really a financing bill, and I believe developers now have the ability, and they do construct their own community systems for small communities of 100 or 200 units. One is being done right now. I think it is the first community system of this type in the State. It has been approved and started in Clinton Township. I don't really see a relationship there, because if developers want to take advantage of that, and they receive approval from DEP, under the N.J.P.D.E.S. requirements, they can do it. So, I don't really understand the connection between community systems and this privatization bill, since MUA's that are not serving an area would be contracting with a private entity to either expand or build the treatment facility. Typically, community systems are built where no treatment facilities exist, nor are they ever likely to exist.

In terms of the enforcement requirements -- as a last point -- DEP, again, as part of that N.J.P.D.E.S. Program, has operation and maintenance requirements. And, of course, they maintain enforcement over the Authority and the waste treatment facility, to assure that the effluent requirements -- the standards -- are being met, and they are not being violated when the plant is discharging.

An interesting point was made earlier by John Gaston: Industrial users have a far better compliance rate than MUA's. That is simply because they are more able, or more accountable, for their actions; whereas, MUA's don't always have the necessary funds. Subsequently, they go under bans and the plants are shut down.

I think it was made clear, from earlier testimony, that the owner/operator would be responsible. They are going to take their actions into account and be responsible for them. Our Department of Environmental Protection will assure that will happen.

SENATOR DALTON: Thank you very much. Sean?

SEAN REILLY: It is not good morning anymore; I have to change my testimony. I will summarize my comments, and use some graphics. I think Senators Costa and Dalton have already seen some of these graphics, but Senator Garibaldi may not have.

My name is Sean Reilly. I am an environmental affairs consultant, and I was retained by the Builders League of South Jersey, which is a chapter of the State builders organization, to study the sewerage facility problem in South Jersey in 1980, because the builders said: "We seem to be constantly running into a stone wall with sewer bans and regulations."

There is no smooth flow, no governmental flow, which enables a builder who needs this facility to be able to predict anything. Other businesses can predict their climates a lot better than a builder can predict when he is going to get this essential facility.

So, I prepared a status report. Unfortunately, what I am reporting to you today is virtually the identical status report I reported to Don Stewart's Agriculture and Environment Committee, in the Assembly, in 1981. The research was done in 1980, so it has been four years, and almost nothing has changed. That is why I am here to speak in support of S-991, because it is an absolutely viable option that is needed. It may do nothing, but at least it is an option. Right now, the options are no different than they were in 1980. I don't think -- with the prospect of the Federal deficit, and all the things you heard about this morning regarding the lack of Federal moneys -- that in the next two years, or five years, much of anything is going to be significantly different.

Dave will assist me in giving you some of the background I gave to Don Stewart. You have to see it, I think, in order to see how important this bill is, in terms of moving it forward.

John Gaston said there were 230 projects this year. Dave, do you want to hold up that first chart? Okay. Just set that there, and then if you would, get the first scroll. These are the 230 projects. I put them in a little different format, just to be dramatic. Those are New Jersey's 230 entities, waiting on line. The red lines on the right are all of the sewerage facilities that are polluting water

supplies right now. That list has been prepared since 1972. This year, the top four-- The order has been changed. Just to give you an idea, that list is the same, virtually; it is almost identical since 1980. The top ten or so have been switched, but only three or four of that 230 will get funded next year. The rest of them will sit there. The green lines across there represent the ones they thought they were going to fund, but they lost the various Federal funds.

Those red lines, on the side, show that at least 50 to 60 percent of all the facilities waiting on line for funds have been polluting the State's waters -- some of them since 1972.

Okay, you can drop that. Now, we will go to the chart. Never before has anyone put that list into perspective. This chart puts the cost of that list into perspective. It shows Federal government funding, from 1971 to 1983. The blue and green lines show Federal and State moneys that were put into the pot.

What I finally did, in 1980, was to say, "We are getting these moneys, but what do they relate to?" That line you see -- the green line over at the left, on the bottom, which is about one inch high -- represents about \$100 million that the State is getting from the Federal government this year. The red line, the \$2.4 billion is today's estimated cost of the fundable share of the projects -- of those 230 projects on the list -- plus, I guess there are 50 more innovative projects, which brings the list up to 290.

So, what you have here is an incredible demand for a limited resource. If Dave would hold up that list again, what this graphic means is that those people who represent the \$2.4 billion are going to stay on-line waiting for money. They don't have an option to get out. They themselves are not going to put out the enormous dollars we heard about this morning -- two and three times beyond bond indebtedness in some municipalities. They are just going to wait, and those red lines, where they are polluting, will increase.

Will you flip that chart around, please, Dave? What this means is, while they are waiting-- You can tell this graphic has been around a long time. It has been carried to more meetings than I can count. What I started to say is, if New Jersey, from 1982 to 1992, gets \$100 million a year from the Federal government, with between four

and eight percent inflation, the debt will grow, by 1992, to an amount greater than it is today, just because of inflation. If we spend one billion, two hundred and fifty million dollars in Federal grants in a decade, the waiting list will be almost as long, but the actual cost of the projects will be greater, simply due to inflation. You cannot make headway by funding four percent of the projects per year, the way the situation stands today.

Okay. The final element on my status report is on this last chart. You can open that up, Dave. That is a bar chart. It represents all the municipalities that are on sewer bans. Going from right to left, the longest line -- down near the bottom -- represents Rockaway Township, which for 13 years, has been on a sewer ban. You get on a sewer ban because you are violating your water quality permit. Almost every one of these is still on the sewer ban list. Why? Because they are waiting on that long line for a Federal handout. They have no other option, other than waiting.

That list was prepared in 1980, so you can add another inch or two to all those lines, because none of them has gotten off the list, in terms of improvement of the situation.

Okay. Thank you, Dave.

That is the status report I gave in 1981. I reported the same status report to Congressman Rose's committee in Washington, D.C. -- the Water Subcommittee of the Public Works Committee -- suggesting that they change the Federal Act.

What has happened to date is -- in the three years since I testified before Congress -- everybody has come up with a different and new idea, or slant, but they have gone nowhere. The Federal Sewerage Facilities Program funding has slipped; it has gone backwards, not forward.

The New Jersey DEP took one of our recommendations and changed the State's share from a pure grant to a loan. They are doing that with some of the bond moneys they have today. They are not too sure they can do it with all of the bond moneys. They tried to reduce the Federal amount -- the Federal grant amount -- to municipalities, in order to spread it to more projects. That was rejected by the Federal government. They said that could not be done under the law. So, the DEP has been struggling to spread the wealth, but it can't.

One of the points raised before, I guess by Senator Dalton, was, what happens if Federal moneys come along later on, after a municipality says, "Forget it; I am getting off the list. We are going to build a facility?"

This is something we have been fighting since 1980; it is called reimbursement. It is prohibited under the Federal statute. The Ways and Means Committee won't hear of it. We don't know why. We petitioned Congressman Dwyer, through several different formats, to give consideration to reimbursement. This means that if a municipality wants to take the bull by the horns, clean up the water pollution, and build with today's dollars instead of waiting until 1992, they get penalized if they do it today. And, if in two years Federal moneys come down the pike, they cannot be reimbursed. So, that is another roadblock. They say to themselves, "We would have to be crazy."

For instance, if you were the mayor of a town and you said, "We are going ahead," their sewer bills would go from \$50 to \$300. If two years later Federal grants then come in -- I mean, there would be a lynching pole in the middle of the town with a scenario such as that.

SENATOR DALTON: I have heard that with this bill there is going to be that possibility, lynching poles are going to go up all over New Jersey.

MR. REILLY: That is one problem with the bill, although it is a red herring. In order for that to happen -- I could relate that to my graphs -- basically the Federal government would have to give New Jersey about \$400 million a year in the next five years -- \$400 or \$500 million dollars a year in the next four or five years. Multiply that times all the states in the country, and it would bankrupt the government, in terms of its ability to balance the budget. That is not politically in the cards to really happen. It might go up. We might get \$150 million, if pressure is really put on, but that extra \$50 million is only going to build a portion of one of these major projects, such as Camden.

So, it is not going to happen. It is really a red herring. It is a theoretical fear, but it is not a realistic roadblock.

Again, I am relating to what is happening today, to get us ahead of the game. Congress is going to review the Clean Water Bill this year, and look at possible greater funding, and possible reimbursement, but, again, these are only "possiblys." Meanwhile, we are sitting here in New Jersey with no options. This is why we are in such strong support of the bill.

The Kean Administration, and the leadership in the Assembly has been trying to do it with the Infrastructure Bank. Up and down, up and down, everybody thought, "This is the option; this is going to do it." It has gone nowhere, and in this new session, we really haven't heard much about the Infrastructure Bank, which may turn out to be a viable concept, but, again, it may be years away. Meanwhile, there is no option.

My conclusion, after all this analysis, is that nothing has changed in four years, except that the cost of the list has gone up by whatever the inflation rate was all of those years. The streams are in worse shape, because the old plants are getting older and they are polluting more. We are not getting ahead of the game.

In conclusion, the system is a failure. Therefore, S-991 has the potential to give us an option out at least -- if it makes sense for a MUA, a municipality, or a county authority to take advantage of it.

We have similar reservations about the rate structure. The death of this concept would be if the first or second municipality that tries it has something go wrong, and the rate structure goes through the roof, or if they pollute the stream and the municipality has to pick up the fine. That would mean death. It would never be repeated again. It would be similar to the Pinelands National Reserve, which was supposed to be a cooperate Federal, State and local effort. It turned out to be very different. I don't think you are going to see another Pinelands National Reserve in the whole country. The concept backfired a little, in terms of a national program.

This would be the same thing, so there must be protections in the bill. The public must see that some public agency is overseeing this process. If they do not feel there is some public scrutiny, public meetings, or public oversight, they will reject it.

Now, the dilemma is that some towns have been paying \$50.00 a year for the past 10 years. They have either not been treating the sewerage properly, or they were using old facilities that were paid off, so all they were doing were operational and maintenance costs. The real cost of renovating that plant, which has to be done every 20, 30, 40 years -- they will have to bear the cost of \$250.00 or \$300.00 when it comes to do it. Whether they do it themselves, or through privatization, it is going to happen. There is nothing this bill can do for that problem. The local political structure has to cope with: We are polluting the water; we have to clean it up; and, this is the cost in 1984. It was not the cost in 1950 when we built the plant, but that is what it is today.

One of the recommendations I have for this bill goes back to this very issue. The budgeting, planning, operation, and maintenance of sewerage facilities is not a popular political subject that is discussed much. It is the last item on the agenda, and it is hidden away in town. Over the years, I have spoken to people in the Division of Enforcement at DEP with respect to why these 90-some municipalities are still on sewer bids. Some of them are waiting for a large regional facility to come on line, and are waiting for that Federal money. Others just really couldn't care less. The facility is out there; it is old; they do not want to put in the money. They are just not interested.

There has never been -- in the 20 years I have been involved in environmental advocacy of various forms or another -- a suit by State government against a municipality for pollution of the water. As John Gaston said here early this morning, 80% of the industrial outfall lines are meeting their permits. Why? Because they get their socks fined off if they do not meet their permits. The Attorney General has no problem going in and slapping a fine on Exxon, or whomever it might be, at \$1,000 a day, or \$25,000 a day, if they are putting something in the water they are not supposed to be. They have never yet done that to a municipality. Politically, at least in my assessment, it is not feasible for that to happen. So, they just keep sending the message, "You are still polluting the water. Please stop it." There is no incentive at all for anyone on that list to get off

that list, if they are not going to be fined or required to clean up the problem.

My suggestion for an amendment is this: The New Jersey Department of Environmental Protection should be empowered -- after 12 or 18 months of ordering a municipality to clean up, if they haven't cleaned up or entered into some kind of a structured agreement with DEP to clean up -- to institute the mechanisms in this bill to privatize the municipal sewerage facilities. DEP would take it through the process, just as is structured in the bill. DEP, in essence, would become the manager of the system until it was privatized, and then would hand it right back to the local MUA. If some concept like that is not put into this bill, I would venture to say I will be back here 10 years from now testifying about the problem of why these plants that were under ban are still under ban, because there is no incentive for them to get off the ban. If they see they are going to be privatized, it will be a whole different ball game. They will look at the possibility of doing it themselves to see if that is more cost effective.

The environment of New Jersey is being hammered by these facilities, and will continue to be hammered by these facilities, if this kind of a mechanism is not structured somewhere. This is the ideal bill to do it in.

Finally, Dave Fisher and I just have a few comments in support of Jim Lanard's comments. I spoke to Jim out in the hall. I think we ought to sit down with Jim, yourself, and some staff to go over a couple of points. I think Jim was misinformed in some of his assumptions with respect to this bill and the environmental aspects of sewerage facilities. This is a financing bill. The environmental end is already an incredibly complex process, and anyone who wants to become involved in this process can't even begin to take a step through the door, unless the entity that he is going to fund, finance, own, or whatever meets the State's permit for sewerage facilities. To get that permit, you have to go through an incredible loop -- regulatory loop. One thing you don't want to do, is add a whole lot of steps in this bill which already have to be done for the permitting, because it just double loops the regulatory process. Bringing in DCA to look at

population growth, or whatever-- I could be here with you another whole day on other problems and on how we have gotten so complex. Commissioner Renna just testified at an Affordable Housing Conference, that in 1972, it took 90 days to get all of your permits to build. Today, it takes 18 months to get all your permits to build.

We want to be very sure that we do not make this bill so intimidating by repeating steps, that the investment community will have no interest in it. Dave and I would be very happy to sit down with you and Jim Lanard to make sure we do not create problems which we do not already have.

Finally, I have another map I will hold up for you. This is a real irony. This map basically shows some of the regulatory districts' jurisdictions in New Jersey. The red areas are the basic sewer ban areas. Ironically, those areas are precisely in the State Development Guide's growth areas. So, we have the dilemma of monstrous portions of New Jersey being taken out for sensitive areas -- wetlands, coastlands, pinelands. DEP is not talking about farmlands. Where you are supposed to go for development is where the sewer bans are. Therefore, we have a real dilemma in New Jersey with providing growth in any kind of a predictable, logical fashion in any area. Where you get away from the sensitive areas, you run into sewer bans, or complex, overlapping planning areas.

That concludes my remarks with respect to this bill. We are in strong support of the bill, and we would be more than happy to sit down and fine-tune the concerns which were heard this morning, which maybe are concerns.

SENATOR DALTON: Okay, thank you. Senator Garibaldi?

SENATOR GARIBALDI: I don't want to become embroiled back and forth, but I do have to take exception with your one proposition that the bill should incorporate language that would make the State "big brother" in overseeing and compelling municipalities, or even fining the taxpayers of the municipalities in my district, for failing to upgrade facilities which your map has indicated are in violation. I don't think the municipalities are unwilling. That is not the question. The fact is, the same big brother, the same State, has imposed these 5% "caps" where we in the municipalities cannot even

provide for day-to-day programs, let alone upgrade costly -- as everyone knows, they are costly -- propositions. So, unless someone can give me some insight here, I would never support anything that would make the State an overseer that would fine municipalities for failing to upgrade their facilities in a timely fashion, unless the State was prepared to subsidize them.

MR. REILLY: On that point, there are fines on the books right now.

SENATOR GARIBALDI: Let me finish. You compared Exxon, for example. Exxon is a profit-making proposition. You know, they come in and they make their profit. If they are going to make a profit at it, they should be prepared to clean up their mess, and not contaminate anything in the town, or in the State. So, you know, when you compare a business circumstance, a commercial enterprise, with a municipality-- We are not even a going concern anymore, such as some of the industrialists in here are. I am not taking them to task, but there has to be a realistic addressing of the problems. I think one of the things I would like you to answer is, out of all these communities you listed which are in violation, or which are in a moratorium status, what was the contributing factor to them reaching that point of violation? Was it because of the oldness of the facilities, or was it because of the extended usage of them? You know, what are the factors which contributed toward this?

I can tell you in my municipality, and you can talk about housing, you can talk about anything-- I happen to be a bricklayer, and I support building. So, don't misunderstand me. I am not against growth. However, there has to be a concurrent addressing of all the problems that come with that growth. I am only familiar with it because I happen to be the Mayor of a 50-square mile township in the State of New Jersey, which is only 25% developed, and which is ready -- the lid is popping off. You guys are lighting fires under it, and you have every right to do that. But, the fact is, you cannot address these problems; you can't just say, "Hey, look, you have to do it." Someone has to go in there, open the door, and build all these things, so that you can go in and build the homes and other buildings. There has to be some joint effort here, and I don't see that answer. Oh,

this is a possible remedy to that circumstance, dependent upon the marketplace and private interest. If they can see that they can make a buck, they are going to come in. As I see it, this is only an attempt to provide some financing for those communities that do not have the financing basis to go in for it.

In cities like Bayonne -- I wish I could have asked the Administrator, why is it they cannot go out and seek financing within their own circumstance? I know there are cities and municipalities in the State whose financing capabilities are very limited. They have exceeded-- Their ratings are not the greatest because of the tax structure, which is another problem that enters into all of this.

Again, to attempt to say, "Well, all of these municipalities" -- do you think they want to pollute? Do you think they are out there breaking the law? To say that the State should pass a law and say, "We are going to penalize you unless you fix it" -- I have to take exception to that. There has to be some other way.

MR. REILLY: There is a qualification to that. I mentioned that the group of municipalities which are in the sewer ban are in the ban because they are waiting for a regional facility to come on line. You cannot penalize them. They are waiting for the governmental system to work. It is some of those on the list that are just isolated systems, where they have basically wrung their hands, and waited for a Federal grant. They choose to do nothing about it. Now, I can understand being a mayor or a representative of a local area, where it is going to cost a significant amount to pay a fair share of what the costs are today. That is going to be a political problem. But, in terms of the structure of the law, right now DEP is supposed to be fining them and telling them to get into line, but it doesn't happen. So, the situation just continues.

However, what you will find -- in closing on this point -- is that if you do have a growth area in your township, the builders in South Jersey -- and Dave Jackson may wish to comment on this throughout the State -- are deciding on sort of a modified privatization, if you will, or coming in and expanding the treatment plant. A group of builders will get together and build the entire expansion of the treatment facility, just so they can build in segments. We are finding that more and more today.

SENATOR GARIBALDI: That is the approach that is happening right now. That is, in fact, what is happening with the builders in my town right now. We have had to issue a moratorium, because the facilities are just not there. They have received their site plan approvals. I do not know if this is a State requirement or not, but I know in our town the Planning Board, or the Zoning Board of Adjustment, cannot render an approval on an application until the Municipal Utility Authority has given at least its preliminary approval, if not its final approval. Nothing can happen there, do you see? But, in this instance, approvals were given to various developments, and now we find they are not in compliance.

MR. REILLY: That is why you have the problem.

SENATOR GARIBALDI: Yes, hence the problem. So, we have had to go back to the builders. You know, it is unfair to ask the ratepayers, because if we did, the rate would shoot right through the ceiling. So, the builders are getting together and there is a cooperative effort. Otherwise, we are going to be stymied, and who is going to lose? Primarily, the builders, do you see? At least it is a cooperative effort, and in that connection, a viable solution.

SENATOR DALTON: Sean, I think you're talking about the folks who are waiting, aside from the municipalities which are waiting for the governmental system to work. You're talking about people who do not choose to go after, in any type of an aggressive way, an alternative financing arrangement to address their pollution problems. The only problem I have. Conceptually, I understand what you're saying. I just don't know how to write it. What criteria do you use to write something like that into a bill like this?

MR. REILLY: I would say, "Ask the Department." (laughter)

SENATOR DALTON: You, of all people, should not be saying to leave it to the Department.

MR. REILLY: I say that, because in reality, if they are going to be the enforcement entity, the Administration has to endorse the concept. Otherwise, it is going to be one of those line vetoes, you know?

SENATOR DALTON: Thank you, Sean. We appreciate it.

MR. REILLY: Thank you.

SENATOR DALTON: We have two more speakers, and the next one will be Mr. Herbert Kaufman. He is a partner in Clinton Bogert Associates.

HERBERT L. KAUFMAN: Senator Dalton, here are copies of essentially what I am going to say, although I may depart a little bit after hearing some of the material that has gone before.

New Jersey does require massive infusions of capital in the near future. I haven't had a chance to review the bill, but I hope it covers sewer water and solid waste facilities as a minimum. One of the better sources -- and you are going to need more than one -- appears to be private investment. That is, the privatization concept, but this requires an adequate return if it is to work.

Now, when Mr. Swick indicated 25% as being the return, what he was really talking about was pre-tax return. The people I have spoken to indicate that an after-tax return of somewhere between 10% and 15% over the long haul would be quite desirable. That is basically what it boils down to. In addition to that, you are not talking about that kind of a return on 100% of the money. You are really talking about that much of a return on the private equity, which may be between 20% and 30%. As long as you can use industrial development bonds, that is ameliorated to some extent.

The money required just for sewer water and solid waste facilities in this State is estimated at about \$5.3 billion. The amount that is available in public funds, appropriated or contemplated, is only \$825 million, leaving a shortfall in this State of \$4.5 billion. About \$2 billion of that shortfall is in sewerage, about \$1 billion in water, and about \$1.5 billion in solid waste. If our needs are typical of those in the nation, that means the total investment required would be about \$127 billion for the nation. If we have 50% grant money overall, and I think that is probably much too high at the Federal level, that would require a commitment of something like \$65 billion today -- not inflated costs, but today's costs. I don't think anyone in power is going to consider putting that kind of a grant program in. Basically, what I am saying is that after Fiscal Year 1986, I think we had better recognize that the grant program will be pretty much dead. Frankly, having been involved in the grant

program and having gotten the first grant in New York State for sewerage works back in 1954, I am not sorry. I think the grant program is a luxury we cannot afford, and I am not alone in that opinion. I'm skipping around in my statement, because I know the time is getting late.

All I can say is -- and I support Mr. Reilly's statement -- that at the present funding level, by the end of Fiscal Year 1986, with inflation, any reasonable amount of inflation, we are going to need to have more money for the necessary sewerage works improvements than we do now. So, we need a massive infusion and we need it now. This also applies to water and solid waste facilities.

It is also important that the 81 amendments of the Federal Clean Water Act change the emphasis in the Construction Grants Program for Sewerage Works to reduce local dependency on Federal grants and increase local accountability. Now, that would be good. There appears to be no prospect of significant Federal funding for water and solid waste facilities. Future financing simply has to come from alternate sources, and this privatization thing is a promising source. Furthermore, I suggest the State use its influence to retain those laws for the basic utilities required to keep and restore urban areas to livable conditions. I'm talking about things like the Pickle Act and some of the other taxation acts which are being sponsored, in fact, by Senator Bradley. I think those could be disastrous to this program.

Also, the infrastructure bank, if properly financed, is another source, and you are not going to be able to get by with just one source. The needs are simply too great. You would have to have too many alternatives.

The current program for sewerage works construction is a classic example of what can go wrong when reliance for funding is placed on the Federal government. The program has not proven to be an appropriate vehicle for providing the necessary funds to permit this work to proceed at a reasonable or acceptable pace. I think Mr. Reilly made that point very clearly. You know, I have lived with this program since 1954, when the first grant came out. Some frustrating things happened when an intelligent, conscientious EPA employee -- whom I will not name, because I have respect for the man -- responded to me

some time ago that the Congress did not much care how the money for this program was spent. All they wanted to know was where it was spent. That statement was made to me in confidence when I was arguing with him about some unnecessary non-cost-effective rules and regulations.

My frustration with this program is not mine alone: it is throughout the industry. The Federation of Sewage Works Associations has recommended that this program be phased out. As consulting engineers, we used to be able to complete a job in about three years, from start to finish. Our fee used to be about 15%. Right now, the best we can do on any job, because of the morass of rules and regulations -- which are well-intentioned, but which are really, in some cases, absolutely silly -- is to take at least 10 years. Our fees have increased, and all non-construction costs have increased to 25% or 30% of the inflated costs of these projects.

Now, this is because of delay. I can tell you some stories that are hair-raising. We had a \$35 million project delayed one year because a sewer 30 feet in the ground was declared an archaeological resource. In frustration, I suggested that what we would do would be to build kiosks at each end of the sewer, and provide it as a honeymoon haven. The archaeologist was very annoyed with me, and said I had no appreciation of the action of our engineers. I do have appreciation of what our engineers have done in the past, but I also know there are literally thousands of miles of similar brick sewers in the country, and that we had this one fully documented.

That is not the end of the cost, by the way, on this thing. The inflation of one year on a \$35 million project at a time when inflation was running at 10% is only part of it, because with the relocation of an improvement sewer to get over the archaeological problems, they are going to have to move a six-lane highway out into a river, where they have problems with flooding right now. With those flooding problems, I think the total cost of that one-year delay, in addition to the \$3.5 million for construction of the treatment program, is probably going to be an additional \$20 million by the time they get ready to build the highway. Now, these are some examples of things that are wrong with the grant program.

I want to say that privatization, or the leasing of sewerage works, makes sense. It reduces local costs, because remember, the man responsible for privatization is interested in the bottom line. What is he actually going to have to charge the municipalities in order to stay in business? Our present grant program does not provide for that. Our present grant program goes through so many machinations that we have forgotten entirely -- almost entirely -- in the cost of this program, what the capital cost influence is, because we have essentially eliminated it, particularly with the 75% grants and the 8% State grants. That is what has made the capital costs nonessential really. The private developer cannot do that.

With respect to water, the largest city in New Jersey -- Newark -- is required to build a water filtration plant. The design of that plant has been completed for, I think, almost 10 years. It is sitting on a shelf. The City cannot build it because it hasn't got the money. A private developer could go in and build that plant. It happens to be a well-designed plant, since we did it, but that is beside the point.

As far as municipal solid waste facilities are concerned, they are capital intensive. In some instances, resorting to energy plants is very important. They are the only things you can have with high-intensity urban development. In some of the remote areas, there are better alternatives to that. Privatization would bring out those better alternatives, because the man, or at least the entity, the investor in the privatization program, is going to want to get the lowest bottom line at which he can make a profit. So, that goes back to my initial saying that privatization will result in lower costs.

Actually, I think the way you ought to look at privatization -- I'm departing from my statement because I know you can all read as well as I can-- I think you have to look at privatization in this respect. It is basically a grant, particularly with the tax savings, but it is a grant that doesn't have to go through Washington, and you reduce the terrific load of the Washington bureaucracy -- and it is terrific -- off the backs of the local taxpayers.

Contrary to often made statements, utilities were frequently -- in fact they were almost always -- started initially under private

ownership. Two of the largest water utilities in the State, the Hackensack Water Company and the Elizabethtown Water Company, are privately owned. They are examples of enlightened planning, management, and operation. The conversion of private to public ownership of water companies was accelerated by the depression years of the 1930's, when cheap financing -- and we're talking about 2% or 2-1/2% public financing in interest through public borrowing -- became possible, and when the purchase price of these facilities was depressed by the dreadful economic times of that period. What I mean by that, is that the purchase price was fixed by reproduction costs, less depreciation. If you recall -- although I don't think too many of you can recall -- during the 1930's, you could go out and buy a week's supply of groceries for \$8.00, and a \$30.00 a week salary was a living salary. Now I think you have to make about \$30.00 an hour in order to make a living. That may be a facetious remark. However, all I'm saying is that we have the Passaic Valley Water Commission simply because it was taken over during the depression at an unrealistically low price. That happens to be the case with many of these privately-owned water utilities.

Over the past 30 years, the development of major privately-owned sewerage facilities has been discouraged by the availability of construction grants to public systems. You simply cannot compete with the grant. But, that is not in the picture anymore. Of course, electricity, gas, and telephone utilities have been privately operating for God knows how long, and they have been giving us pretty good service.

Private ownership and financing have demonstrated advantages over a long time period. The legislative changes required for privatization would not, or should not, impose an additional tax burden upon the citizens of the State. In other words, we are going to have to buy these things anyway, and it may be cheaper -- I think it would be cheaper -- to do it under privatization. It would simply introduce another vehicle for government units to tap the markets for capital formation that can no longer be developed through traditional tax-backed and revenue-backed obligations. I think we are all familiar with how heavily financed most of our communities are at this time. We

have all been before local finance boards and, of course, privatization would eliminate that problem.

The utilization of private-sector financing encourages an efficient and effective use of private capital in the public interest, while placing these public improvements on a sound, user-financed basis. I don't think there is any other way you can think of these, other than utilities.

To date, we have had almost no recent private-sector investment in New Jersey's public utility infrastructure, except for the water companies, even though the technical feasibility has been demonstrated. That is because of the uncertainties of our existing statutory framework. The Local Public Contracts Act, as well as the enabling legislation for municipalities and authorities in the State, are inadequate. Of paramount concern is the lack of specific authorization for a local government agency to designate a private developer of its choice for the facility development, the duration of such authorization -- which is very critical, because you cannot finance these things unless you have a long-term contract -- and the ability of the local unit to set forth the terms and conditions of such development. Because neither the Local Public Contracts Act, nor the establishment of the Board of Public Utilities' jurisdiction, contemplated such a public/private partnership, efforts to develop them are just "no go" at this point.

The new legislation should provide for the selection of private-sector owner/operators in a method that fosters competition, permits a local government agency the flexibility to provide the desired utility services in the best possible manner to its particular service area, and protects the interests of both the users and the private sector. That is important; that is the two-way protection that is required. Section 120-W of the General Municipal Law of New York does this. However, this law has not been all that successful, because the state also provides special legislation to set up specific authorities with the power to procure any and all services for resource recovery projects without competitive bidding, to issue industrial development bonds, and to perform other functions to successfully implement such projects. Incidentally, I think the limitation on

industrial development bonds should be opposed in Washington at the State level, because there just isn't enough money in the State. That "cap" will be serious as far as the State is concerned. I know that has been said before, but I would like to emphasize that.

The only way we are going to get our environment back and bring continued development to the State, is to build the necessary infrastructure projects. Privatization is one of the elements that will help that, because right now there just isn't enough GO bonding capacity to permit that to continue.

Now, that was a summary. There are a couple of other things I would like to address, since listening to the preceding speakers.

SENATOR DALTON: Mr. Kaufman, I have to be at an appointment in seven minutes, and we have another speaker. Okay? So, I appreciate your remarks, and I do not want to seem rude, but we have been here for almost four hours.

MR. KAUFMAN: I know. Okay.

SENATOR DALTON: Thank you very much.

MR. KAUFMAN: You're welcome.

SENATOR DALTON: Mr. Robert Starosciak -- and I hope I am pronouncing that correctly -- from the New Jersey Alliance for Action.

ROBERT STAROSCIAK: Senator, thank you for the time. With this statement, you will be out in less than seven minutes.

My name is Robert Starosciak, and I represent the New Jersey Alliance for Action. The Alliance is a coalition of over 350 business, industry, labor, professional, and governmental organizations that promotes economic development and the creation of jobs, and helps to reduce excessive governmental regulations. Our Association sees a need to explore the concept of privatization, which would utilize the private sector in the development of key infrastructure areas, particularly wastewater treatment facilities. The need to protect the environment, coupled with the need to promote growth and improve pollution control facilities, is critical to the State of New Jersey. Alternative financial options must be encouraged.

Privatization is an idea which is timely, given the financial restrictions placed upon State and local governments. By utilizing the expertise of the private sector, services can be provided which are in the public interest both financially and environmentally.

The encouragement of private-sector investment in the construction and/or operation of wastewater treatment facilities is an alternative that should be carefully considered. The fact is, these important infrastructure systems need upgrading to improve the quality of water and life in our State. It is critical to the economic vitality of New Jersey and its growth potential that privatization be seriously examined.

We feel that the cooperation of the public and private sectors is important, not only to the development of wastewater facilities, but to the economic, social, and environmental health of the State of New Jersey.

Again, we thank you for the time you have given us to let our views be heard.

SENATOR DALTON: Okay, very good. Thank you.

MR. STAROSCLAK: Thank you.

SENATOR DALTON: That concludes this hearing.

(HEARING CONCLUDED)

APPENDIX

TESTIMONY
OF
SEAN M. REILLY, SR.
SEAN M. REILLY & ASSOCIATES
ON BEHALF OF
THE BUILDERS LEAGUE OF SOUTH JERSEY
BEFORE THE
NEW JERSEY SENATE ENERGY & ENVIRONMENT COMMITTEE
CONCERNING
S-991
"A BILL TO ENCOURAGE THE PRIVATIZATION OF
PUBLIC WASTEWATER FACILITIES"

APRIL 26, 1984

SEAN M. REILLY & ASSOCIATES

Chairman Dalton and members of the committee -- Good Morning.

My name is Sean Reilly. My firm name is Sean M. Reilly and Associates. I am an environmental affairs consultant, specializing in government regulation and legislation.

I am appearing before you this morning to testify on behalf of the Builders League of South Jersey in support of Senate Bill S-991. The Builders League of South Jersey is the principle builders trade association in southern New Jersey and a local chapter of the New Jersey Builders Association.

Bill S-991 is a bill whose time has come and is in fact long overdue. I say it is long overdue because of what has not happened since I testified before a committee of this Legislature in 1980 on the subject of sewerage facilities construction.

In 1980, I presented the attached testimony to the Assembly Agriculture and Environment Committee, then chaired by Assemblyman Donald Stewart.

I will summarize that testimony for you today which will clearly demonstrate the need for S-991 as a necessary option where other approaches have failed.

1. There are 230 projects on the state's sewerage facilities funding priority list. Only 3 will be funded this year. Most of these projects are so vast that they will continue to take all the federal grant money until it is reauthorized. (present scroll)
2. The cost of the priority list versus the available funds shows a disparity which will never be bridged by federal grants. (present chart)
3. Inflation will push up the cost of the list faster than the grants can reduce it. (present chart)
4. 92⁺ municipalities are on sewer bans due to malfunctioning plants. Some have been on the list 13+ years. (present chart) These facilities continue to pollute the state's waters while they wait for government handouts. Ironically, most of these facilities are in the state's supposed growth areas where the court mandated state development guide said growth and low and moderate cost housing should go - but cannot. (show map)

The major thrust of the testimony was to change the faltering state-federal sewerage facilities construction program from a grant to a low interest loan program.

The New Jersey Department of Environmental Protection has subsequently tried this approach with its federal funds and has been rejected by the United States Environmental Protection Agency. The New Jersey Department of Environmental Protection has also tried reducing the individual grant amount in order to spread the wealth and has been rejected by the United States Environmental Protection Agency.

The Department, to its credit, has persisted in changing the state's sewerage facilities construction assistance program from an 8 percent grant to an 8 percent loan program

So, four years later, we have virtually the same number of unfunded sewerage facilities on the waiting list and the same number of sewer plants under ban and polluting the state's waterways.

In 1981, I presented virtually the same testimony for revision of the federal sewerage facilities construction grants program to the House Public Works Committee of the United States Congress, Congressman Robert Roe, Chairman. For some as yet unknown reason, the feedback we got from this idea is that the House Ways and Means Committee was not in favor of a loan program; they would rather give the taxpayers' money away.

Furthermore, the Committee will not allow federal grant reimbursement for project applicants who decide to forge ahead and build their facilities in anticipation of grants. In essence, the grantee is penalized for moving ahead and removing a pollution problem in addition to keeping the cost of the project down by doing it with today's dollars.

The result is that three years later, nothing has changed. The New Jersey Department of Environmental Protection's hands are still tied to handing out grants to 3 to 4 projects on the 230+ projects-in-waiting list.

This year Congress will review the Federal Clean Water Act again and may make some modifications to the law which will improve the program. However, we cannot sit by and do nothing in the blind hope that Congress will solve the dilemma.

In 1983, Senators Bradley and Gephardt introduced legislation which would have created a federal infrastructure bank (fund). This bank (fund) would grant money to state infrastructure banks which would create revolving loans to build various state infrastructure. This legislation has not moved.

At the same time, the Kean Administration and the Legislature embarked on an effort to create a state infrastructure bank which could use existing grants and bond issues to initiate the revolving no or low interest loan program. This has also stalled.

The sad conclusion is that, from the realization in 1980, there would never be enough federal money to fund New Jersey's priority list, to the present, four years later, nothing has changed.

The year, 1984, the New Jersey Department of Environmental Protection will be able to fund 3 projects out of 280. The total estimated cost of the New Jersey priority list is \$2.4 billion. The state's federal grant for 1984 is \$100 million or about four percent of the need. With inflation at four to eight percent, the cost of waiting projects will grow faster than the ability of funds to offset inflation alone, unless there is a massive new federal investment in the program. Given the federal budget deficit problems, it does not appear likely that Congress will increase this program's funding in the near future. However, if Congress were to double the grant program tomorrow, New Jersey would make about five percent real reduction of the priority list. At this rate, it would take 20 years to finish the list at which time it will be necessary to begin rebuilding the ones funded at the start of the program in the 1970s.

Conclusion

The present system of providing government assistance for sewerage facilities construction is a failure in that it is creating a false hope which postpones constructive local action, thereby exacerbating surface water pollution and stalling economic growth where it should logically proceed.

Obviously, we need new options to begin funding municipal sewerage facilities construction. Senator Dalton's bill S-991 is one option which should be made available to see if it can be utilized to the public's benefit.

I have one suggested amendment for the bill. The New Jersey Department of Environmental Protection enforcement section has for years been issuing orders to towns to fix treatment facilities which are polluting waterways.

When push comes to shove, the Attorney General never takes a town to court in order to force compliance for whatever reason - and the pollution continues.

I recommend a new section in the bill which after some specified time, such as 12 to 18 months, that if a sewerage treatment entity has made no good faith efforts to abate its pollution problem that the Department of Environmental Protection be empowered to use the provisions of this bill to contract for and oversee privatization of the municipal sewerage services. At the completion of the process, the local authority would be required to pick up its new management role with limited Department of Environmental Protection oversight.

Without the threat of a public interest agency intervening in this process, it is unlikely some townships will ever pay their fair share to properly steward their portion of the state's water resources.

Thank you for this opportunity to comment in support of bill S-991.

T H E P R I V A T I Z A T I O N C O N C E P T

Remarks by Harvey Goldman, Partner,
Arthur Young & Company

to various communities considering
Privatization.

INTRODUCTION

Privatization, public/private partnerships to meet municipal wastewater treatment needs, is a relatively new concept in this country. Many people believe that the publicity attached to the concept and the early results of its implementation signify a future trend. That may be the case. However, any change from traditional approaches must be handled carefully. My purpose today is to acquaint you with the subject in a manner which hopefully will answer many questions you may have regarding the concept.

By way of background information, there are over 5,000 communities in need of new or upgraded facilities with more than \$118 billion of wastewater treatment construction needs. We believe that privatization can provide a significant source of funds. Grant programs at their present levels clearly are insufficient to meet our nation's clean water goals. If grant programs continue to dry up, and if the initial privatization projects demonstrate the concept's expected benefits, privatization could emerge in the future as a leading method for financing and managing the delivery of wastewater treatment services. In order for this to happen, a number of important issues, including legal, regulatory, institutional, political and financial must be satisfactorily addressed.

Arthur Young & Company is credited with developing the privatization concept through a study our firm had the privilege of conducting for the New Jersey Department of Environmental

Protection. The study was designed to explore the viability of the privatization concept to help meet the state's significant funding need for facilities. Among the study conclusions were the following four key points:

1. Privatization is economically viable
2. The private sector is enthusiastic
3. Enabling legislation is required
4. Public education is essential

Point 1 Privatization is economically viable. I will elaborate on point 1 for a few minutes, and then briefly address points 2, 3, and 4. In the absence of grant funding, a properly structured privatization transaction may be the most cost effective alternative available to a local community, as measured by the user fees necessary to establish and operate a self-sustaining utility. In most cases, the economics of privatization should compare very favorably to the economics of grant funding. In some cases, it may be possible to combine grant and private monies in the same facility.

The favorable economics of privatization are primarily attributable to two factors: construction savings and tax benefits.

Construction Savings

From our studies to date, we believe it reasonable to conclude that compared to a treatment facility built through the grants program, construction savings will be approximately 20% of

the project's cost and sometimes even higher. The construction savings are realized by saving time and avoiding costs not absolutely essential to providing treatment capability. A typical plant built through the grants program requires 5 to 7 years from conceptual design to completion. While EPA and the states have taken steps which should streamline the process, there are still many time consuming tasks and expenditures required, because public money is being spent. Publicity has been given to a number of situations, such as communities in Tennessee, Pennsylvania, and Colorado where needed facilities were put into service in periods ranging from 9 to 18 months after conceptual design. Avoiding many of the delays and extra costs necessitated by federal and state funding, (in such areas as construction and procurement regulations) saves time, effort, and money. Even without direct private investment, communities have demonstrated that it is possible to solve their local needs and put extremely cost-effective facilities into service without grant funding.

Tax Benefits

Coupled with construction savings, bringing private sector tax benefits to the transaction enables transactions to be structured in a most cost-effective fashion. In such situations, the economics of privatization, as measured by user fees, compare favorably to approaches which include grant funding, if such funding were available. The 1981 tax laws have been referred to as the "Magna Charta" of privatization. As you will hear later, the ACRS depreciation benefits (which provide rapid depreciation writeoffs for qualifying property) are a significant incentive for private ownership of wastewater treatment facilities.

Other tax related incentives include an investment tax credit, deductibility of interest expense, and an energy tax credit in certain circumstances.

The economics of privatization are also influenced by other factors which will be addressed today, such as the creativity demonstrated in structuring the project financing and the possibility of further savings through contract operations. The use of tax-exempt financing vehicles, such as industrial development bonds and other water pollution control financing instruments must be considered by anyone interested in owning these facilities. Personally, I believe that the full service approach, where the private sector designs, constructs, owns and operates a facility (or a portion of a facility) through a service contract approach, will be the most prevalent form of privatization. I also believe that most of the transactions will be structured with an eye towards financial creativity (in total compliance with the tax laws) so that a community may take over ownership, should it so desire, at some point in the future.

Contract Operations

Contract operations by the private sector makes sense in a number of cases, as when a community cannot attract and retain the necessary talents to operate a treatment facility in compliance with discharge permit standards. In other cases, through assumed economies of scale, a private operator may be able to operate a facility at a cost less than the public operating mode, even considering a profit allowance. Centralized administration, centralized maintenance, bulk ordering of chemicals and supplies, sharing key personnel among

multiple facilities, etc., all contribute to economies of scale. The party who has primary responsibility for operating the facility is one of the factors which has a major impact on the applicability of the investment tax credit. I should point out that the existence of a capable public works department does not necessarily detract from privatization or contract operations. However, the matter must be addressed in an equitable manner, so that different options to best utilize the capabilities of the public works department are explored.

Now let's return to other conclusions we reached in our study for the NJDEP.

Point 2 The private sector is enthusiastic about the business opportunity of designing, constructing, owning and operating wastewater treatment facilities. In those cases where "requests for privatization" have been formally advertised, the number of responses from blue-chip private sector groups has been greater than anticipated. There appears to be no shortage of interest by the private sector in pursuing this business opportunity.

Point 3 Enabling legislation is often required to create an environment conducive to the privatization concept. In "home-rule" states such as Texas, privatization perhaps may take place without clarification of or changes in state laws. In states with a high degree of control over local affairs, such as New Jersey, procurement laws, public contracting laws and the

role of the Public Utilities Commission are among the various factors which needed to be addressed.

Point 4 Public education is essential. Local officials and other key personnel representing a community's interests need to be educated about the advantages of the privatization concept. A listing of the apparent advantages to the public sector taken from our N.J. report, is included as Attachment 1. Other groups need education as well.

In an effort to provide you with some of the nuts and bolts of privatization, I would like to provide a few answers to questions Arthur Young is most often asked with regard to privatization. The questions are:

- 1) How did we get involved with the privatization concept?
- 2) Where and when will the market for privatization happen?
- 3) What is the most important advice we have to give?

Question 1

How did Arthur Young get involved?

I have already described our work for the State of New Jersey.

A number of events took place shortly after our report was completed which served to thrust the concept and Arthur Young's

work into the public eye. The N.J. report was issued in June, 1982.

In August the Association of State and Interstate Water Pollution Control Administrators asked us to make a presentation on privatization at its annual meeting. That presentation was given national press coverage in Engineering News-Record. A few months later, the theme for ENR's annual water issue was "financing for clean water", and privatization was covered in depth. In mid-November the National Water Symposium, sponsored by 13 key trade groups and associations, was held in Washington, D.C. The introduction to the executive summary of the proceedings states that the nation's existing water facilities are in a state of disrepair and deterioration, requiring major reconstruction. "The greatest challenge is financing the improvements, not building them", it reads. Based primarily upon the group's prior thoughts on the subject and a luncheon speech I delivered, private sector involvement in owning and operating needed facilities become one of the group's recommendations. Specifically the recommendations relating to privatization are that:

- "In order to control costs, public utilities should consider utilizing the private sector to provide operation and maintenance services."
- "Federal and state laws, where necessary, should be revised to:
 - Provide for the creation of profit or non-profit organizations or corporations for the purpose of pooling public and private funds to finance water infrastructure.
 - Authorize the exploration of use of the private sector through tax benefits, tax credit transfers, and leasebacks."

The weight of these recommendations lies in the stature of the organizations which sponsored the symposium. The symposium was sponsored by:

- American Consulting Engineers Council
- American Public Works Association
- American Society of Civil Engineers
- National Society of Professional Engineers
- Water Pollution Control Federation

in cooperation with:

- Council of State Governments
- International City Management Association
- Municipal Finance Officers Association
- National Association of Counties
- National Conference of State Legislatures
- National Governors' Association
- National League of Cities
- U.S. Conference of Mayors

The affiliated cosponsoring and cooperative organizations were as follows:

- American Water Works Association
- American Society of Agricultural Engineers
- Association of Metropolitan Sewerage Agencies
- Association of State and Interstate Water Pollution Control Administrators
- Council of State Planning Agencies
- Ductile Iron Pipe Research Association

- Interstate Conference on Water Problems
- Miller Brewing Company
- National Association of Conservation Districts
- National Association of Urban Flood Management Agencies
- National Food Processors Association
- National Utility Contractors Association

Interest in privatization continues to grow. In the past twelve to eighteen months, as our work in privatization continued and we refined the concept and the methodology for its implementation, the requests for speeches, presentations and articles has been overwhelming. Perhaps one reason why Arthur Young gets asked to do so many articles and speeches is the fact that people recognize our role as financial and management consultants. We are not interested in designing, constructing, owning, or operating facilities.

One public sector request came from the President's Private Sector Survey on Cost Control (PPSSCC). We were asked to prepare a white paper on wastewater treatment privatization. A recommendation from the PPSSCC Task Force report on privatization reads, "Private construction and ownership of wastewater treatment plants is a viable way to reduce state and local dependence on Environmental Protection Agency Construction Grants."

State and local governing units

For the public sector, we have honored requests for privatization presentations from city and county governments, state

departments of environmental protection, governors' task forces on infrastructure financing, state-wide municipal seminars and state-wide agencies such as leagues of municipalities and leagues of state legislatures, cities and counties. In total, we have and are formally assisting state and local governments to evaluate and/or implement privatization in more than two dozen states.

Trade groups and journals

Of course, key players in getting the privatization concept to those who need it are industry groups, trade organizations and journalists.

Among the well known groups to which we have made presentations are national conferences and/or various chapter meetings of the:

- Water Pollution Control Federation
- American Consulting Engineers Council
- Association of General Contractors
- Water and Wastewater Equipment Manufacturers Association
- Association of Metropolitan Sewerage Authorities
- Association of City Planners
- American Public Works Conference

Publications which have requested and printed articles from and about our firm on privatization include:

<u>Publication</u>	<u>Date</u>
• Engineering News-Record	August 1982
• Water/Engineering and Management	February 1983
• Constructor	June 1983
• The Military Engineer	June 1983
• Southwest & Texas Waterworks Journal	June 1983
• Consulting Engineer	October 1983

In addition, an editorial supporting privatization appeared in Public Works Magazine, in April 1983.

Question 2

Where and when will the market for privatization happen?

In some locations, it is possible that the privatization market is right around the corner, but it is integral that a number of events fall in place to keep the concept on track. Several states have taken steps to commit themselves to the privatization concept to meet wastewater treatment needs, or at a minimum, to facilitate the approach should local communities determine to pursue it. Here are a few examples:

1. The State of New Jersey - The privatization concept is incorporated within the state's proposed infrastructure bank concept, although privatization may work somewhat independently of the Bank. the state has distributed AY's report on privatization to communities in need of facilities and has demonstrated its willingness to meet with private sector groups interested in becoming privatizers. The Camden County Municipal Utilities Authority was the first public body in the country to formally advertise for "Requests for Qualifications" for privatization, and, as the legal issues are addressed, could be one of

the first communities in the country to take advantage of the concept.

2. The State of Tennessee - Tennessee's Governor Lamar Alexander has had steps taken to create a favorable host environment for privatization. AY worked directly with the governor's cabinet on several occasions to identify steps necessary to make privatization work. The state has passed certain laws, such as legislation enabling up to 40 year periods for wastewater treatment service contracts. In addition, in conjunction with the State Municipal League, a two-day seminar for 700 attendees from the public sector was held to review the privatization concept. AY personnel presented the opening briefing on the privatization concept and the methodology to pursue its use.
3. The State of Utah - We have worked directly with Governor Scott Matheson and his staff and are currently conducting feasibility studies for communities in Utah. The state authorized our firm to assist in advertising for qualifications from private sector groups interested in making wastewater investments in Utah. In addition, the State has already established and funded a revolving fund infrastructure bank. However, part of the process, as we understand it, of applying for a loan to construct a facility requires a community to show evidence that it considered the privatization concept to reduce the demand for public funds.
4. Other locations - AY is currently working at the state government level and/or with specific local communities in more than 20 other states. Given all the recent publicity, it is hard for public officials faced with infrastructure financing needs to ignore the privatization concept.

Since every state has a significant funding shortfall for needed facilities, we believe that once the concept is satisfactorily demonstrated as usable and desirable, many additional

locations will have an increased comfort level. From our work to date, it appears that there are five primary factors that appear to be influencing the growth and acceptance of the privatization approach. The primary issues are:

1. Legal climate
2. Regulatory climate
3. Public sector willingness
4. Private sector approach
5. Doing the first one right

1. Legal climate

I addressed the legal climate somewhat earlier in my presentation when I discussed home-rule states and their relative flexibility compared to state-controlled environments like N.J. However, even in a home rule state, and there are many states in that category, legality is only one aspect of the matter.

2. Regulatory climate

States where there is a strong tendency to promote and enforce compliance with water quality standards typically are good candidates to either facilitate or promote the consideration of privatization.

3. Public sector willingness

This is influenced by a number of factors which include the community's experience in dealing with private sector contract services in the past, general attitudes about

the private sector, and most importantly, advice and counsel given by existing advisors. Consulting engineers and financial advisors to communities need to be educated as well as public officials. More often than not, these existing advisors may be in a key role to influence the community's receptiveness towards privatization. A community in need of a facility to meet economic development objectives and environmental protection standards may often be an ideal candidate, especially in the absence of grant funding. Other ideal candidates would include sophisticated organizations which view privatization as a way to have facilities put into service at the lowest possible cost to system users.

4. Private sector approach

Establishing a public/private partnership is not an easy task. The manner in which a private sector firm approaches a community and a potential privatization opportunity will be a determining factor in a project's success. A community considering privatization must feel that the private sector firm is conscious of the community's needs and sensitive to its particular situation. This relates to the public/private partnership concept.

5. Doing it Right

The fifth point, doing the first one right, refers to the first privatization project in a region of the country, a state, a community or even the first project for a particular private sector firm. One must remember that privatization is a relatively new concept and examples will be

sought of where it has been done right and where it has been done wrong.

In summary, the hardest privatization project to get off the ground will be the first in the state, but the market will be more easily opened and/or widened when the climate in the state is appropriate and when there is a successful privatization project in the area that can be used to show the benefits of privatization. But what is the right way to privatize a project? That brings us to the last question presented earlier, and the toughest one to answer.

Question 3

What is the most important advice we have to give?

There are two major recommendations I would like to offer as advice. First, whether you are representing the public or the private sector in a potential transaction, the approach taken to pursuing privatization must be orderly and thorough, and it should draw upon the collective intelligence of individuals with various skills and disciplines. Second, if it is determined that a privatization approach makes sense and is to be further pursued, one must be able to establish a spirit of partnership between the public and private sector. Let's address each of these in greater detail.

In order to draw upon the collective intelligence of individuals with various skills and disciplines within our organization, AY has developed a proprietary approach to privatization process consulting. A schematic flowchart of the process is included as Attachment 2, Our approach is supported

by detailed checklists of factors, which our consultant team must evaluate when assisting either the public sector or a private group to evaluate a potential privatization transaction. The methodology is also supported by a series of internally developed computer models which test and rank facility user charges under a variety of technical and financial approaches to providing the needed treatment services for an area.

Others no doubt will or have developed their own methodologies to pursue privatization. Regardless of the name of the approach or who is conducting the study, we believe, as our flowchart indicates, that seven major issues have to be studied in the analysis phase. These issues address the following types of concerns:

- A. What are the current and future treatment needs of the area and what technologies should be considered to meet those needs? We have seen that privatization approaches may provide somewhat different answers to this question than do grant-funding approaches. Some of the differences focus upon more closely flow-matching the sizing of a facility to current needs, modular designs and sequential investments to meet future needs. Also surfacing are considerations regarding innovative and alternative technologies, as well as the elimination of what may be considered by some to be redundancies or over-designs of typical grant-funded facility. However, no prudent "privatizer" is willing to risk not meeting plant performance standards. Whatever technological approach is selected, both the public and private partners must be satisfied that the plant will work.

- B. What are the key institutional factors, laws and regulations which must be addressed?

Generally speaking, all privatization studies involve a thorough examination of factors such as:

- State laws and local ordinances governing items such as bid procedures, procurement policies and contracting rules.
- Regulatory issues such as potential rate regulation by a PUC, the role of the environmental regulatory group, etc.
- Federal, state and local tax issues regarding items such as income taxes, tax credits, tax deductions, sales taxes, property taxes, real estate taxes, etc.
- Other institutional factors such as local development objectives, labor contracts, contracts with users of the proposed facilities, etc.

- C. What are the financial alternatives?

Evaluation of financial alternatives involves developing an understanding of the various approaches to financing the needed facilities, with or without privatization. Typical issues which surface when evaluating financing approaches include:

- How best to structure the transaction so that public credit, such as tax exempt financing vehicles, can be merged with private ownership and/or operation to take advantage of key tax benefits and/or potential operating cost efficiencies. The transaction must also be structured to enable the public sector, if desired, to take eventual ownership of the facility. In addition, approaches to achieve adequate levels of user fee rate stability also need to be considered.

- What approaches should be considered to generate revenues from treatment plant facilities above and beyond user fees. Potential sales of treatment by-products or potential services provided to other customers besides the municipality may enable user fees to be lower than originally anticipated while still maintaining satisfactory returns on investment dollars.

D. What are the secondary impacts which need to be addressed?

Secondary impacts to some extent is a catch-all category which includes factors such as public education, and trading upon privatization to exert local control over growth. In addition, communities privatizing wastewater facilities do not have to follow the EPA user charge regulations that every user be charged according to the strength and quantity of the discharge. Another equally important issue to be addressed here is the establishment of a mechanism to protect the public's interests in the transaction. Performance bonds, construction reviews, operating reviews, rate protection, etc. are such mechanisms.

Privatization involves establishing a facility to provide an ongoing service, not a one-time sale. A buyer-seller relationship will not suffice. Given all the planning, negotiating, constructing and operating gates through which we must pass to have the service provided, the relationship that must be established is a partnership with appropriate checks and balances to protect each party's interests. Treatment standards may change, facility expansion may be required, costs will change and other events will undoubtedly occur in the future after a facility is put into service. The spirit of partnership is essential if these events are to be properly and equitably addressed.

This attitude of partnership is important, because once the feasibility of privatization has been established and local officials make a number of decisions related to the privatization objective regarding ownership, operation, management and oversight of the facility, the process can move on to negotiations. The negotiations process will be smoother if both parties enter the transaction with a mind-set of partnership. This is because throughout the whole privatization process, both public and private partners must realize that there are risks to contend with. These risks may be associated with financing, construction or provision of the service. While most of these risks can be managed and minimized once they have been identified, some will inevitably remain and can only be resolved by a spirit of partnership, which necessitates trust, open-handedness, and cooperation.

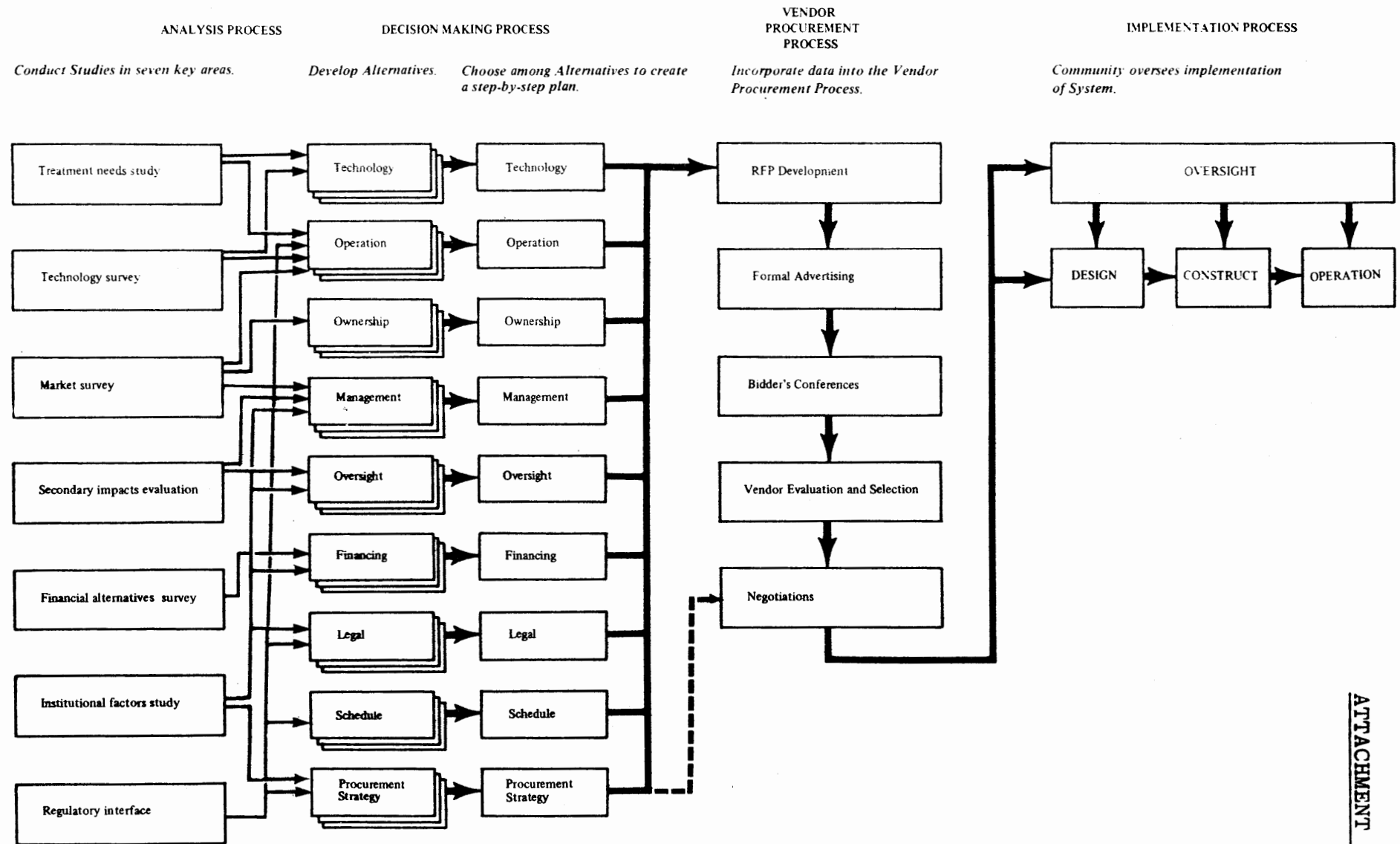
On balance, privatization is a viable solution to the wastewater treatment needs dilemma facing many communities. Privatization concepts can also be successfully employed to solve a number of the capital intensive service delivery needs of the public sector. But a structured approach must be taken to successfully privatize any project. If the appropriate approach to privatization is taken and a true spirit of partnership established, both the public and private sectors can benefit. Properly done, both sides win.

ADVANTAGES OF PRIVATIZATION
PUBLIC SECTOR PERSPECTIVE

- Provides a timely answer to environmental and economic development needs.
 - Minimizes federal and state involvement in local affairs.
 - Avoids construction time delays and compliance with federal procurement regulations, which collectively may increase the capital cost of a facility by 20% to 50%.
 - Permits greater flexibility in key factors such as flow-matched sizing of the treatment works, billing users for services provided, and avoids indirect costs of grant administration and potential headaches of grant audits.
 - Privatization may provide 100% funding of sewage treatment plant construction costs, thereby preserving local debt capacity for other essential purposes. Grant program, in contrast, provides a percentage of funding for eligible costs only, and eligible costs are typically determined at the time a local project is placed on a state priority list, not when construction costs are actually incurred. Time delays may, therefore, significantly raise the local share.
 - Tax benefits which the private sector is capable of using should result in lower user fees than local debt financing would necessitate. Tax benefits available to private sector include:
 1. Investment tax credit - 10% of eligible project cost.
 2. Depreciation of machinery and equipment over 5 years.*
 3. Depreciation of structural components over 15 years.*
 4. Deductibility of interest expense.
- * New in 1981 tax laws; carried forward in 1982 tax laws.
- Opportunity for community/private sector organization to work together towards the issuance of industrial development bonds would further lower the interest cost financing by the private sector, and, may in fact equate the interest rate borrowing cost of the private group with that of the local community.
 - For many communities proper O&M of sewage treatment facilities is best achieved through private sector contractor. Community difficulties include pay scales to attract and retain key technical talent and limited career growth opportunities.

- Private sector should experience significant economies of scale in operation of multiple facilities, thereby resulting in lower user fees for O&M compared to even the best run Publicly Owned Treatment Works. Reasons include factors such as:
 - Ability to share licensed operators among multiple plants.
 - Ability to centralize/consolidate common services such as preventative maintenance, accounting and administration, laboratory services, spare parts, etc.
 - Profit incentive for cost/efficient operations and search for revenue generating capability of treatment plant resources in addition to local user fees.

OVERVIEW: PRIVATIZATION™



COMMUNITIES INVOLVED IN PRIVATIZING
WASTEWATER TREATMENT FACILITIES

Camden County, New Jersey - The Camden County Municipal Utilities Authority has issued a request for qualifications for financing, construction and operation of two wastewater pollution control facilities.

Bayonne, New Jersey - A request for qualifications was issued by the City of Bayonne for a secondary wastewater treatment facility.

Orlando, Florida - For implementation of a large wastewater treatment facility, the city has issued a request for qualifications from private firms.

Chandler, Arizona - The City of Chandler has awarded a contract for acquisition, ownership and operation of a proposed wastewater reclamation facility.

Salt Lake City, Utah - The city has issued a request for qualifications for the privatization of sewage treatment facilities.

U.S. Virgin Islands - The government has issued a request for proposals for construction and operation of a solid waste resource recovery and desalination facility.

EXAMPLES OF PRIVATIZED RESOURCE RECOVERY FACILITIES

PRIVATE OWNERSHIP WITH DEFERRED EQUITY

- North Andover, New Hampshire
- Onondaga County, New York
- Boston Resource Recovery District, Massachusetts

PRIVATE OWNERSHIP WITH UP FRONT EQUITY

- Baltimore Resource Recovery District, Maryland
- Westchester, New York
- Portland, Oregon

THIRD PARTY LEVERAGED LEASE

- San Francisco, California
- Detroit, Michigan

LIMITED PARTNERSHIP - INSTITUTIONAL PARTNERS

- Oyster Bay, New York
- Rhode Island Resource Recovery District

LIMITED PARTNERSHIP - INDIVIDUAL PARTNERS

- Savannah Resource Recovery District, Georgia
- Davis County, Utah
- Portsmouth, New Hampshire



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