



YOUR GUIDE TO UTILITY VALUATION:

Strategies for Maximizing Your Water and Wastewater Asset's Value



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Introduction

A utility valuation can be a critical process for many municipalities and other utility providers.

Cities, towns, villages and utilities tasked with building, buying or selling an asset for their drinking water, sanitary sewer or other utility system may realize they have no basis of comparison when it comes to applying a fair market value to these assets. Those that do recognize they need help don't always know where to turn.

Utility valuation is a niche offering and an important one. It can make or break a sale, either in attracting buyers or in passing regulatory scrutiny. And this is only the beginning of the benefits an updated and accurate utility valuation can provide. Often the process of assigning value to utility assets uncovers forgotten or unlisted assets, making the utility more attractive and investment decisions more strategic.

Few companies are involved or experienced in this very specific type of work and, consequently, few understand the evolving regulatory environment that impacts it. This makes it all the more important to work with a consultant experienced in this type of work. However, understanding the process and what to expect from it is the first step toward seeing a utility effort achieve the greatest possible value for their constituents, residents and rate payers.



CHAPTER ONE:

How a Utility Valuation Can Help

While most people may have a general sense of the market value of a home or business, it's not so easy to apply accurate values to a utility.

Not only do prices change across markets, but decades of adding to these systems may mean municipalities or private owners lose track of built assets sprawling across (and under) a cityscape or rural area.

Although a utility valuation may not be something a municipality seeks out on a regular basis, there are actually a number of beneficial reasons to go through this process. Consider the following five reasons to conduct a utility valuation.

1. MAXIMIZE SALE VALUE

Perhaps the best-known reason to seek a valuation is to get the best price from the sale of a utility asset. Much like selling a house or car, the starting point for a utility sale is understanding how much an asset is worth. And a seller or buyer who consults an industry partner will have a much more realistic sense of the asset's value and be able to plan financing and strategies accordingly. A thorough review of the available reports, inspections and other documents is the first step in honing in on the true value of a utility asset.

2. AVOID TRANSACTION RISKS

When a municipality has a utility valuation, it has a stronger place from which to negotiate in the event of a sale or purchase. The risk of not doing a utility valuation is that the municipality is subject to the terms set by the other side of the transaction. Becoming an educated partner helps sellers determine whether or not they're getting a good deal. Without an accurate valuation, owners could miss out on a significant amount of value from the transaction.

Equally important, an inaccurate sale price could mean beginning a transaction only to have regulatory agencies stop it in its tracks due to an inappropriate market value or a deal that is not considered feasible.

3. CORRECT TAXATION VALUES

A valuation can help a municipality ensure it's levying an appropriate amount in property taxes upon privately-owned utilities and other assets within its corporate limits.

Municipalities rely heavily on property taxes, which are directly related to the value of the assets within their corporation limits. Many utilities, including electric utilities, telecommunications, broadband or even private solar farms, self-report the value of their assets, which then represents their tax burden. An asset valuation performed on behalf of the taxing authority or municipality of those utility assets can serve as a due diligence check to ensure assets are being appropriately taxed for public services, safety, and costs of public education.

4. KNOW BEFORE YOU DIG

Considering building new infrastructure or buying adjacent assets? Considering consolidation, regionalization or other cooperative venture with other nearby systems? Before you begin drawing up those plans and agreements, it pays to take a step back and understand what is already in place. An asset valuation can often demonstrate that it's more cost-effective to buy or consolidate assets than to build them. The reason can be that, in many cases, municipalities are not fully aware of the extent of their assets or other nearby facilities. Part of the valuation work is looking for missing data and potential consolidations or regionalizations— for example, buried or separate assets that have been forgotten over time or weren't documented correctly.

Even if the valuation process doesn't uncover forgotten assets, it can help with new projects. Such an effort can leverage an accurate utility system valuation for more favorable financing conditions for a new build or new partnerships.

5. SECURE ACCURATE COVERAGE

In the event of a disaster, one would assume that insurance will cover the replacement of assets — but this assumption can be a costly mistake for municipalities. By conducting a detailed valuation, municipalities can ensure their assets are appropriately insured. This process can also provide proof of property value and be particularly valuable in making a future claim.

KNOW YOUR VALUE

Ignorance may be bliss, but knowing the full value of owned assets makes for a stronger all-around position from which to make strategic decisions. By doing the legwork today to understand utility asset value, municipalities can make better decisions for their citizens and rate payers.



CHAPTER TWO:

Taking the Right Appraisal Approach for Your Needs

While the usefulness of a utility valuation may now seem clear, how to proceed is often less apparent.

Understanding the right time to use each of the different valuation approaches can help municipalities and utility owners determine their next steps.

There are three typical appraisal approaches to take to understand the value of utility systems. Picking the right approach can help municipalities maximize their value. The three approaches are:

- **Asset-based valuations.** This approach is becoming the standard when it comes to determining value for buying or selling a utility. It explores how much specific infrastructure and equipment is worth based on current prices to replace the systems, age and asset conditions.
- **Enterprise-based valuations.** This approach is particularly helpful in determining the revenue-generating potential of certain assets. This insight can help justify added investments. This approach explores how much revenue or cash flow an enterprise generates and the kind of long-term debt or liability the utility holds.
- **Comparable sales valuations.** This analysis can help determine if the time is right for a sale of assets. It examines the value of similarly situated utilities in similarly situated marketplaces.

BENEFITS OF AN ASSET-BASED VALUATION

In some states, asset-based valuations have become the preferred approach by regulatory agencies prior to a sale. In the past, utility system values were determined by their depreciated original cost. However, states began to recognize the low value derived from this approach presented a barrier to sales and subsequent improvement of these systems.

State legislators are now increasingly shifting regulation to support fair market value pricing, which relies on asset valuation. Today, **MORE THAN TEN STATES HAVE PASSED** fair market value legislation, and others are pursuing it.

A focus on fair market value can be **PARTICULARLY HELPFUL FOR SMALL TO MEDIUM SIZED MUNICIPALITIES** seeking to provide safe, clean water to residents at an affordable price. The outcome is usually a much higher value for the utility as a return on their community's investments.

FIND THE RIGHT PARTNER

The utility valuation process is not straightforward and the shifting legislative landscape makes it particularly important that municipality's work closely with an experienced valuation consultant.

One of the pitfalls municipalities face is opting to work with a consulting firm or attorney with whom they've always worked. Municipalities tend to do this thinking they'll benefit from local knowledge. However, the nuances and complexities of this process and the changing marketplace demand a special type of experience and insight. Ultimately, relying on that local knowledge is going to leave money on the table — bad news for the constituency. It may also mean wasting time and energy running through a process that the state regulatory agency ultimately will stop from proceeding.

Experience counts with these types of assessments. It's not something you can figure out as you go. Before selecting a valuation consultant, consider asking in advance if the consultant:

- Has considerable experience representing buyers and sellers in different situations?
- Has been through adversarial purchases as well as favorable ones?
- Has submitted sworn testimony, and how often?
- Has been subject to cross-examination by regulatory agencies, and how often?

SETTING THE STAGE FOR A STRAIGHTFORWARD PROCESS

With the right approach, and the right partner asking questions and investigating asset value, municipalities can start to feel confident in their utility valuation. We'll discuss in the next chapter that the municipality has a further role to play in ensuring an accurate valuation.



CHAPTER THREE:

Working through the Valuation Process

Once the municipality or private utility has established its goals and selected a partner, it's time to begin the legwork for the actual valuation process. This investigation will uncover all assets and explore as-built and current replacement costs.

While many municipalities are content to turn this process over to their consultant in its entirety, initial input from the local experts who know these systems best can make the process quicker and ultimately more accurate. Input from current utility engineers and operators is particularly valuable. Long-tenured field staff or superintendents often hold in their memory much of the history of their utility systems. Cross-checking data with accounting staff also can prove helpful. Providing time for municipal staff to contribute to the investigation gets the valuation off to a strong start.

ASSESS THE ASSET INVENTORY

The first step of the valuation process is to assess the municipality's asset inventory. The process starts by creating a comprehensive listing of all the underground piping, manholes, fire hydrants, valves, aboveground structures, buildings, vehicles, and so on — all of those components that make up the water, sewer or other utility.

While the valuation team can create this list, the project may move along much quicker if the utility is able to provide at least some of this information. From there, the team conducting the valuation will make site visits. Often the result is a map of the assets, complete with detailed descriptions of component age, material, size, and condition.

CONDUCTING DUE DILIGENCE

If the client does provide an asset inventory, the valuation team should still spend a considerable amount of

time performing due diligence to make sure it's a complete and accurate list. Part of the valuation work is finding overlooked assets or structures that may not be listed correctly in documents. This is particularly common for buried assets. It's tough to remember where everything is, particularly when some of a municipality's assets were buried decades ago. Due diligence should involve both verifying provided information and drilling down further into the details of those assets.

ASSESS COST INFORMATION

The next step is to assess cost information. This involves looking at site- or community-specific information on what the listed assets cost when they were originally installed in their current location, whether that be in the 1890s or the 1980s. The consultant will use whatever information is available to establish the cost of those assets at the time they were installed. This may include material costs as well as costs of engineering, permitting, easement rights, legal fees and the like.

At the same time, the valuation team will gather information via modern construction costs and indexes to understand what that same type of infrastructure would cost to construct and install today should those assets be replaced. This method accounts for the current cost to design and build new facilities similar to the existing systems with equivalent functionality but necessary technological and regulatory modifications. In some cases, the team may look for current cost indexes across various communities — the costs in New York versus the cost for that same infrastructure in Ohio, for example — to help in assigning costs to each inventoried asset.

The next step is to look at depreciation. After all, an asset that was installed 50 years ago is not as valuable as an asset that was installed 10 years ago due to wear and tear. In some cases, the infrastructure may be functionally obsolete but still may have value.

TIME TO DRAW CONCLUSIONS

With this data in hand, it's time to draw some conclusions on value. Typically, the valuation team will focus on three numbers to create a range of valuations:

- The original cost of all the assets in the years that they were installed.
- The replacement cost of what each asset would cost if it were to be installed today.
- The replacement cost less depreciation.

Together, this information provides a final conclusion on value and gives a client certainty in the value of its utility assets.



Conclusion

Because utility valuation is a relatively infrequent occurrence, it's all the more critical that municipalities and private utilities understand the process.

Moreover, today's high operating expenditures for water and wastewater utilities make it particularly important that municipalities clearly understand the current value their assets so they can prepare for changes tomorrow.

A **2018-2027 FORECAST** by an independent research firm predicts water and wastewater utilities' operating expenditures will exceed \$872 billion between 2018 and 2027, topping \$93.8 billion by 2027. Utilities looking to replace aging infrastructure by building or buying new will need accurate insight into the value of their systems. An asset-based appraisal can help a municipality get a clear sense of the value of the often-hidden structures that support its utility. But because regulations are changing fast at the state level, it's important that municipalities work closely with an expert in valuation.

By working with an experienced consultant and adequately preparing for a valuation, a municipality can maximize its asset sale or purchase, ensure they're not overbuilding, and better protect its assets, constituency and rate payers.

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