

**Review of City of Apalachicola Water and Sewer Fund  
Revenues and Expenditures and Compliance with the  
Clean Water State Revolving Fund  
Debt Purchase Agreement CS12042709P**

**Division of Water Facilities Funding**

**Report: A-1617DEP-032**

**Office of Inspector General**

**Internal Audit Section**

**Florida Department of Environmental Protection**

**November 13, 2017**

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The Office of Inspector General (OIG) conducted a review of the Clean Water State Revolving Fund (SRF) Debt Purchase Agreement CS12042709P (Agreement) between the Department of Environmental Protection and the City of Apalachicola (City).

## **Scope and Objectives**

The scope of this review included City revenues and expenditures from Water and Sewer funds per the period October 1, 2015, through September 30, 2016, as well as current practices as related to Agreement terms. Our objectives were to determine:

- revenues and expenses associated with the City's Water and Sewer Department
- the City's compliance with provisions of the Agreement

## **Methodology**

This review was conducted under the authority of Section 20.055, Florida Statutes (F.S.), and in conformance with the current *International Standards for the Professional Practice of Internal Auditing*, published by the Institute of Internal Auditors. Our procedures included review of the Agreement, Amendments, City financial and billing documentation, as well as interviews with Division and City staff.

## **Background**

In December 1994, the Department awarded a \$7.6 million Clean Water SRF loan to the City for the upgrade of the City's wastewater treatment plant. In addition, the Legislature authorized a \$3,870,000 appropriation for an interest bearing Debt Repayment (Escrow) Account. The Escrow Account earnings were to be used to assist the City's loan repayment.

On November 24, 2008, the Department and City entered into the Agreement to address and support the debt repayment. According to the Agreement, the City was to establish a Debt

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Service Account and make monthly deposits to fund the City's share of the loan debt service.

The semiannual payments due in December and June of each year were \$225,898.16. Of this amount, \$108,822.00 was to be paid from the Escrow Account, and \$117,076.16 was to be paid from the City's Debt Service Account for a period of 25 years.

In 2012, we conducted a prior review<sup>1</sup> of the City's Water and Sewer revenues, expenditures, and pledged revenues. At the time, the Debt Service Account had not been established and the City had not made any payments towards its share of the loan repayment. During each repayment cycle, the full amount of the loan obligation (\$225,898.16) had been withdrawn from the Escrow Account. We recommended operational changes necessary for the City to meet loan repayment funding commitments and establish and make payments to a Debt Service Account as required. We also recommended establishment of an updated repayment schedule. In December 2012, the Department established an updated progressive payment schedule with the City through Agreement Amendment 8. Under the updated schedule, the City's share of semiannual repayments increased over time and decreased funding from the Debt Repayment Account. The City began making the revised required semiannual payments in 2012. However, starting in December 2015, the City reduced its semiannual payment. As of July 2017, the remaining balance of the Escrow Account was \$68,648. According to the SRF Program Administrator, the balance owed on the loan as of June 30, 2017, was \$3,823,382.11.

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<sup>1</sup> A-1112DEP-058 Review of Revenues and Expenditures for the City of Apalachicola Water and Sewer Funds Related to the Clean Water state Revolving Fund Debt Purchase Agreement. (November 20, 2012)

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## Results

For the review period, the revised repayment schedule outlined in Amendment 8 of the Agreement was as follows.

| <b>Clean Water State Revolving Fund Debt Purchase Agreement CS12042709P</b> |                         |                            |                                     |
|---|-------------------------|----------------------------|-------------------------------------|
| <b>Revised Repayment Schedule</b>   |                         |                            |                                     |
| <b>Date</b>   | <b>Total Amount Due</b> | <b>Local Share Payment</b> | <b>Escrow Account Share Payment</b> |
| 6/15/2015   | \$225,898.16            | \$120,000.00               | \$105,898.16                        |
| 12/15/2015  | \$225,898.16            | \$140,000.00               | \$85,898.16                         |
| 6/15/2016   | \$225,898.16            | \$160,000.00               | \$65,898.16                         |
| 12/15/2016  | \$245,898.16            | \$180,000.00               | \$65,898.16                         |
| 6/15/2017   | \$265,898.16            | \$200,000.00               | \$65,898.16                         |

In December 2015, the City decreased the funding contribution toward its share of the semiannual loan repayment amount. On August 19, 2016, the SRF Program Administrator sent a letter to the City regarding the past due payments and notified the City that the loan was in default. According to correspondence from the City Administrator on January 11, 2017, *during the 13/14 budget year, the Commission initiated a sewer user fee to help fund the SRF loan obligation. The loan payment had reached the point to where the City could no longer fund the entire City's portion of the loan payment. The sewer user fee was charged to customers connected to the sewer system. The City Administrator stated, during the 15/16 budget year, the total loan payment due was \$451,796.32. The escrow was to pay \$151,796.32 and the City pay \$300,000 plus \$30,000 for the reserve account for a total of \$330,000. The City commission voted to not increase the sewer user fee. The amount collected from the sewer user fee was \$165,000. It was voted to pay \$75,000 for the December payment and \$75,000 for the June payment and put \$15,000 in the reserve account.* This decision was also carried forward regarding the City's Fiscal Year (FY) 2016-2017 budget. The following table shows the SRF loan repayments made since June 2015.

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| <b>Loan Repayment Activity June 2015 – December 2016</b> |                           |                          |                            |                       |                          |
|--|---------------------------|--------------------------|----------------------------|-----------------------|--------------------------|
| <b>Date</b>  | <b>Payment Due</b>        | <b>Actual Payment</b>    | <b>Local Share Payment</b> | <b>Escrow Payment</b> | <b>Carryover Balance</b> |
| 6/15/2015  | \$225,898.16              | \$225,898.16             | \$120,000.00               | \$105,898.16          |                          |
| 12/15/2015   | \$225,898.16              | \$200,897.74             | \$75,000.00                | \$125,897.74          | \$ 25,000.42             |
| 4/13/2016  |                           | \$25,756.06 <sup>2</sup> | \$25,756.06                |                       |                          |
| 6/15/2016  | \$225,898.16              | \$115,898.16             | \$50,000.00                | \$65,898.16           | \$110,000.00             |
| 12/15/2016   | \$362,516.24 <sup>3</sup> | \$140,898.16             | \$75,000.00                | \$65,898.16           | \$221,618.08             |
| 6/15/2017  | \$487,516.24              | \$140,898.16             | \$75,000.00                | \$65,898.16           | \$361,776.76             |

### Revenues and Expenses associated with the City’s Water and Sewer Department

We reviewed the City’s Enterprise Fund General Ledger (Ledger) of Water and Sewer revenues and expenses from October 2015 through September 2016. The following table represents the City’s Water and Sewer revenues, expenses and earnings before interest, taxes, depreciation and amortization from this Ledger.

| <b>City of Apalachicola Revenues and Expenditures Water and Sewer Departments<br/>Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)</b> |                       |
|---|-----------------------|
| <b>Year</b>   | <b>2015-2016</b>      |
| Water and Sewer Revenue   | <b>\$1,613,259.72</b> |
| Prior Bond Obligations: USDA Bond 1983 Sinking Fund; Sinking 2003 Bond Issue (Series1986)   | \$191,560.18          |
| SRF Debt Service Account Deposits   | \$150,000.00          |
| Total Water Department Expenses   | \$524,680.61          |
| Total Sewer Department Expenses   | \$691,604.18          |
| <b><sup>4</sup>Revenues after Operation and Maintenance Expense, and Satisfaction of Prior Bond Obligations</b>   | <b>\$55,414.75</b>    |

Although the City’s semiannual repayments have not been made as required under the Agreement, since our 2012 review, the City’s net Water and Sewer revenues have increased. Based on discussion with the City Administrator, the City has made efforts to meet the SRF loan

<sup>2</sup> Amount includes \$755.64 in late fees.

<sup>3</sup> Amount includes \$6,618.08 in late fees.

<sup>4</sup> Revenues represent earnings before interest, taxes, depreciation, and amortization (EBITDA) This calculation gives a measure of the City’s Water and Sewer Department cash flow position.

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repayment obligations. Water and Sewer rates have increased 3% annually, and in FY 2013-2014, the City added a Sewer Usage Fee to Water and Sewer customer bills to provide additional funding for the semiannual repayment.

**Agreement Compliance**

***Rates and Use of the Water and Sewer Systems, Article 5.01 – Rate Coverage***

Article 5.01 of the Agreement states, *the Local Government shall maintain rates and charges for the services furnished by the Water and Sewer Systems which will be sufficient to provide, in each Fiscal Year, Supplemental Pledged Revenues equal to or exceeding 1.15 times the sum of the Local Government share of the semiannual payments due in such Fiscal Year.*

In the January 11, 2017, correspondence, the City Administrator stated, *the City does have an annual 3% rate increase for both water and sewer, but that just barely covers the increased costs of operations. The City Commission feels it necessary to accommodate the senior citizens within our community by offering them a reduced rate.* We obtained the City’s Billing List for the month of January 2017, which included 2,029 accounts. The following table provides a summary of the types of accounts and account activity.

| <b>January 2017 Billing List Account Activity</b> |                           |                                 |                            |                            |  |                                |
|---|---------------------------|---------------------------------|----------------------------|----------------------------|--|--------------------------------|
| <b>Account Type</b>                               | <b>Number of Accounts</b> | <b>Percent (Total Accounts)</b> | <b>Water Use (Gallons)</b> | <b>Percent (Total Use)</b> | <b>Charge for Service January 2017<sup>5</sup></b> | <b>Percent (Total Charged)</b> |
| Andris Park                                       | 4                         | 0.20%                           | 0                          | 0%                         | \$461.17   | .27%                           |
| Battery Park                                      | 46                        | 2.27%                           | 563,000                    | 4.53%                      | \$5,547.93   | 3.28%                          |
| Scipio Creek                                      | 63                        | 3.10%                           | 27,000                     | .22%                       | \$3,890.00   | 2.3%                           |
| Residential                                       | 1,073                     | 52.88%                          | 4,178,000                  | 33.62%                     | \$73,560.62  | 43.47%                         |
| Residential Senior Discount                       | 556                       | 27.40%                          | 1,887,000                  | 15.18%                     | \$29,425.92  | 17.39%                         |
| Commercial  | 184                       | 9.07%                           | 2,025,000                  | 16.29%                     | \$53,386.82  | 31.55%                         |
| Water Not Billed                                  | 43                        | 2.12%                           | 2,947,000                  | 23.70%                     | \$0  | 0%                             |
| Garbage Only                                      | 4                         | 0.20%                           | 0                          | 0%                         | \$188.11   | .11%                           |
| Water Only  | 56                        | 2.76%                           | 801,000                    | 6.46%                      | \$2,747.43   | 1.62%                          |
| <b>Total</b>                                      | <b>2,029</b>              | <b>100%</b>                     | <b>12,428,000</b>          | <b>100%</b>                | <b>\$169,208.00</b>                                | <b>100.0%</b>                  |

<sup>5</sup> Charges include garbage services.

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From the total, 1,073 residential, 556 residential with senior citizen discounted rate, 56 water only, and 184 commercial accounts contribute to Water and Sewer revenues. Based on review of accounts included on the billing list, we noted the following billing practices and circumstances that may contribute to the City’s challenge in maintaining revenues necessary to meet its obligations for the required semiannual repayment under the Agreement.

Discount Rates for Senior Citizen Accounts

The City provides a significant rate reduction for all residential senior citizen accounts. This discount is not income based. From review of billing schedules from other Water and Sewer municipal providers in the northwest Florida Region, this is a unique discount provided by the City. Using the City’s 2015 rate schedule, we compared cost differences between residential rates and residential senior citizen discounted rates for accounts with minimal use (1,000 gallons) and with high use (8,000 gallons) in the tables below.

| <b>Residential and Senior Citizen Residential Billing Rate Comparison<br/>(Usage 1,000 gallons per month)</b> |           |  |                |
|---|-----------|--|----------------|
| <i>Residential Water and Sewer Rates</i>  |           |  |                |
|   | Base Rate | Rate (1,000 gallon usage)                    | Total          |
| Residential Water   | \$8.86    | \$3.33                                       | \$12.19        |
| Residential Sewer   | \$14.78   | \$4.06                                       | \$18.84        |
| Residential Sewer Usage Fee   |           |  | \$10.75        |
| <b>Total Residential for Water and Sewer (1,000 gallon usage)</b>   |           |  | <b>\$41.78</b> |
| <i>Residential Water and Sewer Rates with Senior Citizen Discount</i>   |           |  |                |
|   | Base Rate | Rate (1,000 gallon usage)                    | Total          |
| Senior Water  | \$7.40    | \$1.26                                       | \$8.66         |
| Senior Sewer  | \$15.69   | Base rate includes usage up to 6000 gallons. | \$15.69        |
| Senior Sewer Usage Fee  |           |  | \$5.75         |
| <b>Total Senior Residential Water and Sewer (1,000 gallon usage)</b>  |           |  | <b>\$30.10</b> |
| <b>Difference between Residential and Senior Discount Rates</b>   |           |  | <b>\$11.68</b> |



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| <b>Residential and Senior Citizen Residential Billing Rate Comparison<br/>(Usage 8,000 per month)</b> |           |                           |                |
|---|-----------|---------------------------|----------------|
| <i>Residential Water and Sewer Rates</i>  |           |                           |                |
|   | Base Rate | Rate (8,000 gallon usage) | Total          |
| Residential Water   | \$ 8.86   | \$3.33                    | \$35.50        |
| Residential Sewer   | \$14.78   | \$4.06                    | \$47.26        |
| Residential Sewer User Fee  |           |                           | \$10.75        |
| <b>Total Residential for Water and Sewer (8,000 gallon usage)</b>                                     |           |                           | <b>\$93.51</b> |
| <i>Residential Water and Sewer Rates with Senior Citizen Discount</i>                                 |           |                           |                |
|   | Base Rate | Rate (8,000 gallon usage) | Total          |
| Senior Water  | \$7.40    | \$1.26 up to 1000 Gal.    | \$8.66         |
|   |           | \$1.55 up to 2000 Gal     | \$1.55         |
|   |           | \$2.16 up to 4000 Gal     | \$4.32         |
|   |           | \$2.80 over 4000 Gal      | \$11.20        |
| Senior Sewer  | \$15.69   | Includes up to 6000 Gal.  | \$15.69        |
|   |           | \$2.80 over 6000 Gal.     | \$5.60         |
| Senior Sewer User Fee   |           |                           | \$5.75         |
| <b>Total Senior Residential for Water and Sewer (8,000 gallon usage)</b>                              |           |                           | <b>\$52.77</b> |
| <b>Difference between Residential and Senior Discount Rates</b>                                       |           |                           | <b>\$40.74</b> |

For accounts with monthly water use of 1,000 gallons, the rate difference between residential and residential with senior citizen discounted rates was approximately 28%. However, at higher usage levels, the difference is increased. For accounts with monthly water usage of 8,000 gallons, the difference was approximately 44%. According to the January 2017 billing list, average month water usage for the 1,073 residential customers was 3,890 gallons. The average water usage for the 556 residential customers with senior citizen discounted rates was 3,390 gallons<sup>6</sup>.

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<sup>6</sup> These averages include accounts with zero recorded usage. Average usage omitting accounts with zero usage were 5,000 for residential and 4,000 for senior citizen.

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Other Indicators that Impact Water and Sewer Revenues

During our review of the January 2017 billing list, we noted other circumstances that may impact or diminish revenues. This included accounts representing no usage, residential rates applied to non-residential entities, and proximity use anomalies.

Based on discussions with the City Administrator, the City’s water meters had been replaced in late 2016 due to deteriorating meter equipment. However, of the 1,813 commercial, residential, and senior citizen accounts from the January 2017 billing list, 297 (16%) indicated zero usage.

| <b>Water and Sewer Accounts from the January 2017 Billing List</b> |                                |                               |                                   |
|--|--------------------------------|-------------------------------|-----------------------------------|
| <b>Account Type</b>  | <b>Total Accounts (Meters)</b> | <b>Meters with Zero Usage</b> | <b>Percentage of Account Type</b> |
| Commercial   | 184                            | 56                            | 30%                               |
| Residential  | 1073                           | 147                           | 14%                               |
| Senior   | 556                            | 94                            | 17%                               |
| <b>Total</b>   | 1,813                          | 297                           | 16%                               |

In addition, the City Administrator indicated that the City allows certain charitable organizations, such as places of worship to be billed at residential rates. The January 2017 billing list included 30 residential customer accounts that were billed to places of worship. Of these, two appeared to be schools. Of the 30 accounts, 24 indicated usage of 2,000 gallons or less for the month. Multi-unit residential properties that include service for common areas were also billed at residential rates.

The January 2017 billing list included instances of unusual high usage of either a residential or residential senior citizen discount account in close proximity to either a commercial entity account or place of worship account with little to no usage. While the specific

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circumstances of these anomalies are unknown, usage outliers can serve as indicators to the City for research of possible meter, connection, or billing errors.

***Rates and Use of the Water and Sewer Systems, Article 5.02 – No Free Service***

Article 5.02 of the Agreement states, *the Local Government shall not permit connections to or furnish any services afforded by the Water or Sewer System without making a charge therefore based on the Local Government’s uniform schedule of rates, fees, and charges.* We interviewed the City’s Water and Sewer Department manager, who confirmed that the billing system records were the single source of all connection information for the City.

With the exception of connections that serve the City’s municipal purposes, billing records indicated that charges were applied to most Water and Sewer accounts using the City’s uniform rates. However, the City furnishes Water and Sewer services to one private and two City owned marina facilities from which City revenue is generated, but not billed based on its uniform schedule of rates. Revenues and associated expenses from the operation of these facilities are included in the City enterprise fund with Water and Sewer activities, but are accounted separately. The revenues attributed to the use of these facilities include mooring and launch fees in addition to Water and Sewer service. As a result, revenues and expenses specifically attributed to Water and Sewer services could not be determined. According to the City Budget Expense Report for Fiscal Year 2015-2016, net operating revenues were as follows.

| <b>Enterprise Fund Marina Activities<sup>7</sup> FY 2015-2016</b> |                     |                     |                     |
|---|---------------------|---------------------|---------------------|
| <b>Entity</b>   | <b>Scipio Creek</b> | <b>Battery Park</b> | <b>Total</b>        |
| Revenues  | \$36,249.09         | \$59,461.33         | \$95,710.42         |
| Expenses  | \$30,070.89         | \$71,223.97         | \$101,294.86        |
| <b>Net Operating Revenues</b>                                     | \$6,178.20          | (\$11,762.64)       | <b>(\$5,584.44)</b> |

<sup>7</sup> The City Budget Expense Report did not include revenue and expense information for accounts listed as Andris Park.

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Based on the January 2017 billing list, unbilled water use for Battery Park was 563,000 gallons and for Scipio Creek Marina was 27,000 gallons during the month. For this same period the following account information was included in the billing list records.

| <b>Account Activity for Marina Facilities January 2017</b> |                           |                         |                        |                    |                                     |
|--|---------------------------|-------------------------|------------------------|--------------------|-------------------------------------|
| <b>Account</b>   | <b>Number of Accounts</b> | <b>Previous Balance</b> | <b>Current Charges</b> | <b>Total</b>       | <b>Unbilled Water Use (Gallons)</b> |
| Andris Park  | 4                         | \$6,034.44              | \$461.17               | \$6,495.61         | 0                                   |
| Battery Park   | 46                        | (\$6,516.65)            | \$5,547.93             | (\$968.72)         | 563,000                             |
| Scipio Creek   | 63                        | \$15,538.73             | \$3,890.00             | \$19,428.73        | 27,000                              |
|  | <b>71</b>                 | <b>\$15,056.52</b>      | <b>\$9,899.10</b>      | <b>\$24,955.62</b> | <b>590,000</b>                      |

While the need to consolidate services for customer billings of these type of facilities is understood, the activity represents a revenue generating source to the City that is not attributed to Water and Sewer funds.

***Rates and Use of the Water and Sewer Systems, Article 5.05 – Maintenance of the Water and Sewer Systems***

Article 5.05 of the Agreement states, *the Local Government shall operate and maintain the Water and Sewer Systems in a proper, sound and economical manner and shall make all necessary repairs, renewals and replacements.* Based on discussions with the City Administrator, the City’s aging utility infrastructure, equipment maintenance, meter replacement, and repair cost had taken financial priority over the increasing SRF loan repayment obligation. From the FY 2015-2016 Ledger, expenditures relating to utilities, repairs, maintenance, testing, supplies, equipment and vehicles were as follows.

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| <b>Water and Sewer Departments Expenditures for<br/>Utilities Repairs, Maintenance, Testing Supplies, and Vehicles (2015-2016)</b> |                     |                     |
|--|---------------------|---------------------|
| <b>Category</b>  | <b>Water</b>        | <b>Sewer</b>        |
| Utilities  | \$35,625.35         | \$117,412.03        |
| Repairs and Maintenance  | \$16,583.84         | \$96,666.65         |
| Testing  | \$4,705.00          | \$23,907.30         |
| Fire Hydrant Maintenance   | \$4,093.87          |                     |
| Water Meter Maintenance  | \$51,668.74         |                     |
| Supplies   | \$60,940.76         | \$77,023.51         |
| Gas and Oil  | \$6,675.89          | \$7,212.80          |
| Equipment  | \$557.36            | \$1,600.22          |
| Vehicle  | \$7,111.27          | \$7,111.27          |
| <b>Total</b>   | <b>\$187,962.08</b> | <b>\$330,933.78</b> |
| Total Department Expenses  | \$524,680.61        | \$691,604.18        |
| Percent of Total   | 35.8%               | 47.9%               |

Overall, related repair and maintenance category expenses represented approximately 43% of total Water and Sewer department costs. This percentage was consistent with the Water and Sewer department expenses included on the City's FY 2011-2012 and 2010-2011 Ledgers obtained during our prior review in 2012.

***Warranties, Representations, and Covenants - Article 2***

Article 2.03(2)(a) of the Agreement states, *In the event that the Local Government expends \$500,000 or more in federal awards in its fiscal year, the Local Government must have a single or program-specific audit conducted in accordance with the provisions of OMB Circular A-133, as revised*<sup>8</sup>. According to the City Administrator, the City did not meet the current threshold for this requirement. However, the City Administrator provided the

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<sup>8</sup> Audit requirements for non-Federal entities that expend Federal funds are specifically outlined in 2 Code of Federal Regulation (CFR) 200.501 *Audit Requirements*. A non-Federal entity that expends \$750,000 or more during the non-Federal entity's fiscal year in Federal awards must have a single or program-specific audit conducted for that year in accordance with the provisions of 2 CFR 200.

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independent audit of the City's Financial Statement for FY 2015-2016, which was conducted by the City's contracted Certified Public Accountant (CPA.).

The independent audit's Schedule of Findings and Responses included finding 2016-003 *Deteriorating Financial Condition*, which related to the City's ability to meet loan repayment obligations under the Agreement. According to the finding, the City's deteriorating condition *resulted in the City determining that they were unable to pay the full amount due on one of their notes payable*. As part of the finding, the CPA recommended, *that the City continue to improve procedures to increase revenues and decrease expenses to improve cash balances and operating results. This will allow for bills to be paid timely and improve the financial condition of the City.*

According to Article 2.01(6) of the Agreement, the City is required to submit an annual *certification that: (a) Supplemental Pledged Revenue collections satisfy, on a pro rata basis, the rate coverage requirement; (b) the Debt Service Account contains the funds required; and (c) insurance, including that issued through the National Flood Insurance Program authorized under 42 U.S.C. secs. 4001-4128 when applicable, in effect for the facilities generating the Supplemental Pledged Revenues, adequately covers the customary risks to the extent that such insurance is available*. For the review period, the City supplied the certification statement signed by the City Administrator on December 16, 2016. Although the certification was submitted as required under the Agreement, the information certified is not an accurate representation of the City's financial activities.

### ***Escrow Agreement and Accounts - Article 3***

According to Article 3.03 of the Agreement, *the Local Government shall establish a Debt Service Account with a Depository and begin making Monthly Deposits no later than the date set*

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*forth for such action in Section 10.07 of this Agreement. Beginning six months prior to each Semiannual Payment, the Local Government shall make six monthly deposits. The first five deposits shall be at least equal to one-sixth of the Local Government Share of the Semiannual Payment. The sixth Monthly Deposit shall be at least equal to the amount required to make the total on deposit in the Debt Service Account equal to the Local Government Share of the Semiannual Payment amount.* Although deposits had not been made as required, we verified the City had established a Debt Service Account with Centennial Bank.

## **Conclusions**

Based on this review, the current level of revenues and expenses associated with the City's Water and Sewer Department do not provide available revenues sufficient to meet the SRF Agreement debt service obligations. Since the required semiannual loan repayments have not been made, the City is not in compliance with the terms of the Agreement, and the loan is in default. While economic challenges impact revenue sources available to meet the City's loan repayment obligation, several of the City's billing policies and practices limit income necessary for its financial solvency. Our finding and recommendation is included in the remainder of this report.

## **Finding and Recommendation**

### **Finding: Agreement Default**

#### Article 6 – Defaults and Remedies

Article 6.01 of the Agreement lists events that constitute a default. As applicable to the circumstances noted above, these include the following:

Review of City of Apalachicola Water and Sewer Fund Revenues and Expenditures and Compliance with  
the Clean Water State Revolving Fund Debt Purchase Agreement CS12042709P  
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1. *Failure to make any Monthly Deposit into the Debt Service Account as required or to make any installment of the Semiannual Payment when it is due and such failure shall continue for a period of 30 days.*

The required monthly deposits to the Debt Service Account have not been made as specified in the Agreement. Beginning in December 2015, the City's contribution to the semiannual loan repayment was less than the required amount. This reduced contribution has continued in all subsequent semiannual repayments. As of the June 2017 semiannual repayment cycle, the balance of the Escrow Account used to assist the City with its obligation for loan repayment was \$68,648.

2. *Except as provided in Subsections 6.01(1) and 6.01(7), failure to comply with the provisions of this Agreement or failure in the performance or observance of any of the covenants or actions required by this Agreement and such failure shall continue for a period of 60 days after written notice thereof to the Local Government by the Department.*

Article 5.01 of the Agreement, requires the City to *maintain rates and charges for services furnished by the Water and Sewer Systems which will be sufficient to provide in each Fiscal Year, Supplemental Pledged Revenues<sup>9</sup> equal to or exceeding 1.15 times the sum of the Local Government Share of the Semiannual Payments due in such Fiscal Year.* Although the City has made efforts to increase Water and Sewer rates by 3% annually and has added a Sewer

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<sup>9</sup> **Pledged Revenues** are defined in the Agreement as *specific revenues pledged as security for repayment of the debt and shall be the funds, including investment income, on deposit in the Debt Repayment Account.*

**Supplemental Revenues** are defined in the Agreement as *the specific revenues in addition or supplemental to Pledged Revenues to the extent necessary for debt repayment, pledged as security for repayment of the debt and shall be generated from the operation of the Water and Sewer Systems after payment of the operation and maintenance expense and the satisfaction of all yearly payment obligations on account of the debt obligations as Water and Sewer Revenue Bonds, Series 1983, and Water and Sewer Revenue Bonds, Series 1986.*



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Usage Fee to Water and Sewer customer bills, rates and charges were not sufficient to provide the supplemental pledged revenues as required under the Agreement. While this revenue is dependent on the limited connections in the City's service area, decisions made by the City regarding customer discounts, application of rates, and alternative billing structure for marina facilities has contributed to this deficiency.

Article 3.03 of the Agreement specifies the City's requirement to make monthly deposits to the Debt Service Account equal to at least one-sixth of the required semiannual repayment amount. Based on our review, these deposits had not been made as required.

3. *Any warranty, representation or other statement by, or on behalf of the Local Government contained in this Agreement or in any information furnished in compliance with or in reference to this Agreement, which is false or misleading.*

Article 2.01(6) of the Agreement requires the City to submit an annual certification with representations regarding Supplemental Pledged Revenues, the Debt Service Account, and required insurance. Although the certification was submitted by the City in December 2016, the information certified was inaccurate.

Article 6.02 of the Agreement lists remedies available to the Department in the event of default. These include the following.

1. *By mandamus or other proceeding at law or in equity, cause to establish rates and collect fees and charges for use of the Water and Sewer Systems, and to require the Local Government to fulfill this Agreement.*
2. *By action or suit in equity, require the Local Government to account for all moneys received from the Department or from the ownership of the Water and Sewer Systems and to account for the receipt, use, application, or disposition of the Pledged Revenues.*

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3. *By action or suit in equity, enjoin any acts or things which may be unlawful or in violation of the rights of the Department.*
4. *By applying to a court of competent jurisdiction, cause to appoint a receiver to manage the Water and Sewer Systems, establish and collect fees and charges, and apply the revenues to the reduction of the obligations under this Agreement.*
5. *By certifying to the Auditor General and the Chief Financial Officer delinquency on repayments, the Department may intercept the delinquent amount plus six percent, expressed as an annual interest rate, penalty of the amount due to the Department from any unobligated funds due to the Local Government under any revenue or tax sharing fund established by the State, except as otherwise provided by the State Constitution. Penalty interest shall accrue on any amount due and payable beginning on the 30th day following the date upon which payment is due.*
6. *By notifying financial market credit rating agencies and potential creditors.*
7. *By suing for payment of amounts due, or becoming due, with interest on overdue payments together with all costs of collection, including attorneys' fees*
8. *By accelerating the repayment schedule or increasing the Financing Rate on the unpaid principal of the Loan to as much as 1.667 times the Financing Rate for a default under Subsection 6.01(1).*

**Recommendation:**

We recommend the Division work with the City to revise its rates and charges for the services furnished by the Water and Sewer Systems to a structure that is sufficient to provide the required revenues for semiannual loan repayments. If the City chooses to maintain its current billing policies and practices regarding customer discounts, application of rates, and alternative billing structure, the Division should take progressive steps to enforce its rights through remedies provided in Article 6.02 of the Agreement.

Review of City of Apalachicola Water and Sewer Fund Revenues and Expenditures and Compliance with  
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*To promote accountability, integrity, and efficiency in state government, the OIG completes audits and reviews of agency programs, activities, and functions. Our audit was conducted under the authority of Section 20.055, F.S., and in conformance with the International Standards for the Professional Practice of Internal Auditing, published by the Institute of Internal Auditors, and Principles and Standards for Offices of Inspector General, published by the Association of Inspectors General. The audit was conducted by Valerie J. Peacock with assistance from Christine Cullen. The audit was supervised by Candie M. Fuller.*

*Please address inquiries regarding this report to the OIG's Audit Director by telephone at (850) 245-3151. Copies of final reports may be viewed and downloaded via the internet at <http://www.dep.state.fl.us/ig/reports.htm>. Copies may also be obtained by telephone (850) 245-3151, by fax (850)245-2994, in person or by mail at Department of Environmental Protection, Office of Inspector General, 3900 Commonwealth Boulevard, Mail Station #41, Tallahassee, FL 32399.*

*Valerie J. Peacock,  
Director of Auditing*

*Candie M. Fuller,  
Inspector General*



# Florida Department of Environmental Protection

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Rick Scott  
Governor

Carlos Lopez-Cantera  
Lt. Governor

Noah Valenstein  
Secretary

## Memorandum

**TO:** Candie M. Fuller, Inspector General

**FROM:** Trina Vielhauer, Director of the Division of Water Restoration Assistance

**SUBJECT:** Preliminary Report A-1617DEP-032 – Apalachicola SRF Loan Agreement

**DATE:** November 6, 2017

A handwritten signature in black ink, appearing to be "TV", is located to the right of the "FROM:" line.

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Thank you for completing the review of the debt purchase agreement between the Department and the City of Apalachicola.

The Division agrees with the Recommendation on page 16 of the referenced report. The Division has corresponded with the City of Apalachicola regarding the matter, will continue to evaluate options regarding the Division's next course of action, and will follow up with the City accordingly.

Please contact me if you have any questions.