THE BOND BUYER

Chicago talks will decide whether DuPage Water Commission pursues pipeline project

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The DuPage County, Illinois, Water Commission said a decision over whether it decides to end its 40-year relationship with Chicago and build its own pipeline to tap directly into Lake Michigan for water hinges on contract negotiations with the city.

A draft consultant's study was presented to the commission board, which serves a region west of Chicago, last month laying out several options for a new water line and supporting facilities that carry price tags ranging from $1.5 billion to about $2 billion. That's before accounting for interest on borrowing.

The commission's decision to explore an alternative water source began in May 2022 over its frustration with a lack of commitment from Chicago to engage in earnest to negotiate on a contract that would replace the existing 40-year deal that expires next March. The commission — Chicago's largest suburban water customer — felt it was taking a backseat with the city more focused on its negotiations with Joliet.

The DuPage County, Illinois, Water Commission’s contract to purchase treated Lake Michigan water from Chicago is up next March. **Bloomberg News**

Chicago announced the deal to bring on Joliet, about 40 miles southwest of Chicago, and neighboring communities participating in a new regional agency last year. It finalized the 100-year, $1 billion deal using a new rate-setting methodology based on industry standards just before Lori Lightfoot's mayoral tenure ended this month.

"Our duty lies to the suburbs and while Chicago has been a good partner for us there has been extraordinary rate increases over the past 10 years and what that creates is a scenario in which it is now financially viable and technically feasible to do a new source water project," Paul May, the commission's general manager, said in an interview earlier this month. "We are paying about twice the value of the water that we are distributing."

The current contract calls for negotiations to begin years before the expiration. "You'd think we'd be a priority but it doesn't seem like it," said James Zay, the commission's board chair.

"We are looking for parity with what's in Joliet's contract. That is what would successfully allow us to work with the city of Chicago and that would make that alternative the preferred alternative over a new source water project," May said.

"Right now mathematically and economically in comparison to Chicago's current rate paradigm, a new source water project is more financially preferable."

Lightfoot's chief financial officer, Jennie Huang Bennett, countered DWC's assertions earlier this month before new Mayor Brandon Johnson was sworn in saying the city has had some discussions with the commission.

Bennett also said the city has made clear that it's transitioning all contracts as they come due to a cost-of-service rate based on American Water Works Association rate-setting methodology from the current uniform rate as employed in the Joliet deal and that would be made clear to DWC. She also said it would be a lengthy and costly process to build a new line and related facilities.

The offering documents published as part of the city's recent $576 million new-money and refunding water revenue bond sale note the rate setting transition begins in 2030.

But the commission said it's not received such direct assurances. "We are hoping to get this relationship on track" under Johnson but "the clock is ticking" with summer deadlines looming over notifications required as to what the commission's intentions are with a hard September deadline in place, Zay said.

DWC, which began operations about a decade after signing its original 40-year contract, has its eye on expanding its own water contracts which would benefit Chicago. It serves 35 customers, most of which are municipalities, and is bringing three new municipalities outside DuPage County on board.

There's "huge potential" to expand westward, Zay said. "We want to be a partner with the city."

Until a contract is in hand, the commission intends to continue its exploration, with the next step being additional work on financial options and discussions with potential suburban partners.

"I would continue to pursue all alternatives concurrently until a document is signed" and if "there's a long-term document with favorably mutually agreeable terms with the city of Chicago then that's the end of the conversation but if and until that happens there's no reason for us not to pursue" the alternative water source.

Suburban customers account for nearly 50% of the city's water sales and DuPage is by far the largest, accounting for $113 million of annual revenue, followed by Oak Lawn at $42 million. Chicago water sales totaled $797 million last year and are expected to generate $809 million this year, rising to $881 million in 2026, according to the water bond offering statements.

The DWC-commissioned consultant's report identified three potential routes for the new pipeline that's designed using accessible right-of-way land.

Funding options include traditional revenue-backed bonds, state revolving fund loans, federal WIFIA loans. The commission has no outstanding debt. Its original debt issued to finance facilities carried top ratings. The preliminary report offering initial feasibility analysis of costs, schedule, and financial evaluation. The next phase includes a more detailed look at legal, regulatory, political, technical and planning, and financial options.

The report lays out scenarios that anticipate that debt and operations costs combined would run between $217 million and $278 million annually depending on the route.

The report lists potential next steps that include the assignment of a project advisory team, project financing discussions, and the evaluation of the easements needed to use railroad, utility, and interstate highway right-of-way to bypass Chicago.

A North route avoids city boundaries but carries the most costly price tag of $2 billion but it also would allow the commission to potentially vie for northern suburbs. A southern route that does go through the city at points carries a $1.9 billion price tag. A central route offers the most affordable at $1.5 billion but it cuts through the city.

A variety of conventional construction permits would be required, but no approvals would be needed as to the allocation of Lake Michigan water rights, according to the commission.

All existing DWC customers already have allocations to Lake Michigan water previously granted by the Illinois Department of Natural Resources, which permits them to access Lake Michigan water from any means.

"This is what has permitted other municipalities which previously purchased water from Chicago to switch providers. Several have switched to Northwest Water Commission/Evanston supply from Chicago, and others have switched from Chicago supply to water supply from Hammond, Indiana, in the last five years," the commission said.

The Chicago water system supplies treated Lake Michigan water to more 494,000 retail customers in the city and 120 suburbs.

Chicago will supply treated Lake Michigan water under its pact with Joliet and its neighbors participating in the Grand Prairie Water Commission, replacing their dwindling aquifer supply through a pipeline Joliet plans to construct. It provides nearly $1 billion in value over its term with $30 million more of annual revenues expected.

"The Joliet contract is a really important part of the credit factors" that helped draw an upgrade, Bennett said last month ahead of the water bond sale.

"Our understanding is that the rate methodology is intended to improve engagement and understanding with key customers and other stakeholders, which, in our view, helps minimize political risk and potential customer discord," S&P Global Ratings said of the rate shift.

The loss of DuPage, if it comes to fruition, could strain the rating.

"A weakening of the wider service area characteristics or loss of significant wholesale revenue that results in a downward revision of the revenue defensibility assessment, reducing leverage tolerance at the current rating," Fitch Ratings said in its report ahead of the city's bond sale.

The water bonds sold with a refreshed indenture and an upgrade in tow from S&P which raised the underlying rating one notch to A-plus in April. The outlook is stable. Fitch assigned its A rating and a positive outlook, and Kroll Bond Rating Agency rates them AA with a stable outlook.