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## EXECUTIVE SUMMARY

### FIRST SUPPLEMENT TO WATER SUPPLY CONTRACT BETWEEN THE CITY OF HOUSTON, TEXAS AND THE NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY

This is intended to be a summary of the terms and provisions of the proposed First Supplement to Water Supply Contract (the "Supplement") between the City of Houston, Texas (the "COH") and the North Harris County Regional Water Authority (the "Authority") based on the Supplement draft dated November 25, 2008 and provided to the Board of Directors of the Authority in the meeting packet for the December 1, 2008 meeting. Based on our negotiation sessions over the last 12-14 months with representatives of the COH, the West Harris County Regional Water Authority (the "WHCRWA"), and the North Fort Bend Water Authority (the "NFBWA"), we believe the current draft Supplement to reflect the final terms relating to the funding and financing of the Luce Bayou Interbasin Transfer Project (the "Luce Bayou Project" or "Project"). However, it is likely that several non-substantive revisions to the Supplement will be made prior to the COH's approval of the Supplement, which is currently scheduled to occur at the December 10, 2008 COH City Council meeting. All capitalized terms used in this Executive Summary have the same meaning as those terms reflected in the Supplement and/or the Water Supply Contract between the COH and the Authority, dated December 16, 2002 (the "Contract").

The main purpose of the Supplement is to address the needs of the Authority, and the "Other Authorities", which includes the WHCRWA, NFBWA and the Central Harris County Regional Water Authority (the "CHCRWA"), to increase their Untreated Water Facilities Demand Allocation and accommodate such increases through the construction of the Luce Bayou Project. Simply stated, the Supplement addresses capacity allocation issues and how the Luce Bayou Project costs will be shared and paid by the Authority and the Other Authorities, thereby revising certain provisions of Section 3.02 of the Contract, as such provisions relate to the Luce Bayou Project. The Supplement also makes other revisions and clarifications to the Contract, all of which are reflected in this Executive Summary.

#### Recitals

- The Recitals outline and identify the parties to the Supplement, give a brief history of the Contract, and describe the purpose and intent of the Supplement.

## Section 1. Definitions.

- Identifies the definitions used throughout the Supplement and is an integral part of the Supplement. A majority of the definitions are set forth in the text of Section 1; however, there are other definitions reflected and used elsewhere in the Supplement.
- It should be noted that one of the major changes made to the terms and provisions of the Contract deals with a revised definition of the Authority's "Untreated Water Facilities Demand Allocation ("UWFDA"), which is now known as the Authority's "New UWFDA," now reflected as 159.0 million gallons per day ("MGD") for the Authority.
- Another significant change reflected in the Supplement is an amendment/revision of Article IV of the Contract regarding how Operation and Maintenance Expenses ("O&M Expenses") are calculated and paid and specifically deletes the requirement that an O&M Reserve be maintained. Accordingly, Section 4.04 of the Contract has been deleted by the provisions of the Supplement.

## Section 1A. Coastal Water Authority.

- Identifies the Coastal Water Authority ("CWA") as the sole entity responsible for all decisions and actions relating to the design, development and construction of the Luce Bayou Project.
- COH and CWA will enter into an agreement (the "COH/CWA Agreement") relating to the design, construction and funding of the Luce Bayou Project; such agreement is anticipated to be approved by the COH at the same time the Supplement is approved, such approval date projected to be December 10, 2008.
- Any agreement COH enters with CWA concerning the Luce Bayou Project is to require CWA to regularly communicate with the Authority concerning the design, development and construction of the Luce Bayou Project, including inviting the Authority to participate in development/planning meetings and providing written monthly (unless otherwise agreed) updates regarding the progress, status of contracts and other relevant aspects of the Luce Bayou Project.
- CWA will also be required to invite the COH and the Authority to all meetings between CWA and its consultants and construction contractors where substantive issues that have a financial or project development impact on the Authority or the COH will be discussed.
- COH is to allow the Authority a reasonable opportunity to review/comment on any proposed supplements, modifications or amendments to the COH/CWA Agreement.

## Section 1B. Project Construction.

- Deals with Luce Bayou Project construction and requires approval by the COH Public Works Director of various phases of the Luce Bayou Project.

- Upon Authority request, the COH is to provide copies of documents regarding the design, construction or financing of the Luce Bayou Project.

## Section 2. Funding of the Project.

- Addresses project funding for right-of-way and overall Project costs.
- COH will issue (or will cause CWA to issue) bonds, notes or other obligations to pay for all costs of the Luce Bayou Project, except "Project Right-of-Way Costs" and "CWA Interest Amount" (as such terms are defined in the Supplement).
- COH shall ensure any obligations issued by COH or CWA shall only be used to pay for 1) construction, surveying, engineering and permitting of the Luce Bayou Project; and 2) issuance costs related to any obligation issued to fund the Luce Bayou Project.
- The Authority's obligation is to pay the COH, not CWA, for obligations issued by CWA for the Luce Bayou Project.
- COH shall cause CWA to use best efforts to obtain maximum amount of funds and most favorable financial terms available from the Texas Water Development Board's Water Infrastructure Fund ("WIF") program to fund costs for Phase 1 of the Project (excluding Project Right-of-Way Costs).
- No obligation to pay any funds for use on the Project, until COH or CWA obtain \$28,000,000 in WIF funding for the Project with specific terms, including: 1) accrual of zero interest on the WIF funds for up to 10 years or until the Project is completed, whichever occurs first; and 2) no interest or principal payments on WIF funds for up to 10 years or until the Project is completed.

## Section 2A. Lump Sum Payment for Project Right-of-Way Costs and the Payment for CWA Interest Amount.

- Authority to pay COH the "Authority's Pro Rata Share of Payment for Right-of-Way Costs," as well as the "Authority's Pro Rata Share of CWA Interest Amount," as such terms are defined in the Supplement.
- Payment of Authority's Pro Rata Share of CWA Interest Amount, such amount being \$57,734, is due no later than January 31, 2009.
- "Project Right-of-Way Costs" estimated at \$15,000,000.
- Initially, the Authority will make a lump sum payment of its share of Project Right-of-Way Costs in two (2) segments with 1) \$1,600,000 being paid by no later than June 15, 2009; and 2) \$800,000 being paid by no later than June 15, 2010.
- Payments received to be maintained in interest-bearing account and **only** used for Project Right-of-Way Costs.

- If Project Right-of-Way Costs exceed \$15,000,000, each of the participants will be invoiced by COH for the "Authority's Additional Right-of-Way Costs," which invoice shall be paid within 90 days of receipt.
- COH to notify participants that all Project Right-of-Way has been acquired by no later than June 30, 2014.
- Final accounting of Project Right-of-Way Costs to be performed within 180 days of June 30, 2014; Authority has 65 days to review/comment on final accounting; "true-up" of payments to occur based on amounts paid by the Authority and the Authority's Pro Rata Share of Payment Right-of-Way Costs; Authority to either pay COH any shortfall or receive COH refund for any overpayment.

### Section 3. Reservation.

- Increases the Authority's UWFDA from 31 MGD to 159.0 MGD, which is the estimate for the Authority's surface water demand in 2040 and results in a request for a Reservation for the 128.0 MGD water demand increase, which is reflected as the "2008 UWF Reservation."
- The new 2008 UWF Reservation is **not** a Reservation for Treated Water Facilities capacity – any such Reservation is still controlled/governed by the original terms of the Contract.
- "Authority's New UWFDA" = 159.00 MGD and becomes effective once Project is complete.
- COH to cause the Project to be substantially complete and able to deliver water by no later than June 19, 2019.
- Project to be designed, acquired and constructed in two (2) phases: **Phase 1** to include permitting, engineering, surveying, right-of-way and site acquisition at an estimated cost of \$43,000,000; and **Phase 2** to include the construction and related costs (including, but not limited to, construction administration, project representation and materials testing) of the Luce Bayou Project at an estimated cost of \$214,000,000.
- Payment for the Authority's 2008 UWF Reservation and share of Project costs comprised of: 1) payments for Project Right-of-Way Costs and payments for CWA Interest Amount under Section 2A; 2) four (4) Payments for Existing Untreated Water Facilities under Section 4A; and 3) the Phase 1 and Phase 2 Annual Untreated Water Facilities Payments under Section 5.

### Section 4A. Payment for Existing Untreated Water Facilities Formula.

- The formula in Section 3.02(c) of the Contract for calculating the Payment for Existing Untreated Water Facilities will **not** apply to the 2008 UWF Reservation; instead, formulas in Sections 4A and 4B of the Supplement shall apply and consist of four (4)

payments, each with its own formula based on the Authority's water demand needs in 2025, 2030, 2035 and 2040 and each with changing variables.

Section 4B. Payment for Existing Untreated Water Facilities Due Dates.

- COH to provide calculations for payments by no later than October 1<sup>st</sup> of 2011, 2020, 2025 and 2030.
- Authority's 1<sup>st</sup> Payment due within 60 days after receiving COH certification that Project is complete; 2<sup>nd</sup> Payment due earlier of 60 days after sending written notice to COH of water demand need for 2030, or June 30, 2025; 3<sup>rd</sup> Payment due earlier of 60 days after sending written notice to COH of water demand need for 2035, or June 30, 2030; 4<sup>th</sup> Payment due earlier of 60 days after sending written notice to COH of water demand need for 2040, or June 30, 2035.

Section 5. Formulas for Phases 1 and 2 Annual New Untreated Water Facilities Payment.

- This section of the Supplement establishes the formulas to be used to calculate the Authority's Phase 1 and Phase 2 Annual New Untreated Water Facilities Payments.
- Formulas in Section 3.02(c) of the Contract **not** applicable to the Authority's New UWFDA.
- See each Phase 1 and Phase 2 formulas for details.

Section 5A. Definition of "Annual Outstanding Debt Service."

- Refines definition and establishes basis for determining amount of "Annual Outstanding Debt Service" owed by COH on obligations issued for construction/acquisition of applicable New Untreated Water Facilities.

Section 6. Calculation and Administration of Phase 1 Annual New Untreated Water Facilities Payments.

- Establishes specific structure for the obligations COH or CWA issues to finance Phase 1 costs.
- Establishes administrative process/procedures, including timing, for the annual payments to be made.
- Requires payments to be maintained in interest-bearing account and interest credited against future payments.
- Requires COH to provide annual estimates of information used to calculate payments.
- Payments can only be used by COH/CWA to pay obligations issued for Phase 1 costs.

Section 7. Calculation and Administration of Phase 2 Annual New Untreated Water Facilities Payments.

- Requires COH/CWA to use best efforts to cause obligations issued for Phase 2 costs to be structured such that there is no debt service until after January 1, 2018.
- Further requires financing structure to be similar to Phase 1 financing structure.
- Establishes administrative process/procedures for payment - same as Phase 1 payments.
- Same requirements/limitations as Phase 1 payments.
- Prior to commencement of Phase 2, COH shall "attempt" to obtain Authority's written consent regarding the date COH proposes to begin Phase 2 of the Project.
- No Authority obligation to make Phase 2 payments until consent provided or, if no consent provided by January 1, 2014, COH may commence Phase 2 and Authority has obligation to make Phase 2 payments.

Section 8. Requests to Obtain Water Prior to June 30, 2019.

- Establishes Section 3.02(b) of the Contract as the formula for calculating 1<sup>st</sup> Payment for Existing Untreated Water Facilities if prior to July 1, 2012, the Authority submits a request to receive (prior to Project completion) a portion of the Untreated Water.
- If after July 1, 2012, but prior to June 30, 2019, the Authority submits a request to receive (prior to Project completion) a portion of the Untreated Water, the formula for calculating 1<sup>st</sup> Payment for Existing Untreated Water Facilities shall be that which is reflected in Section 4A of the Supplement.
- Any such payments due in accordance with Section 3.02(b) of the Contract, but with requirement that no payment be made later than 60 days after receipt of Notice of Project completion.
- Any request submitted prior to June 30, 2019 **not** considered as exceeding Authority's New UWFDA.

Section 9. Payment for Untreated Water Facilities Costs Avoided.

- Requires an additional payment if, prior to December 31, 2028, the Authority submits a Reservation request that exceeds the Authority's New UWFDA (159.00 MGD) and such Reservation does not require construction of New Untreated Water Facilities.
- Provides basis for calculating such additional payment.
- Intended to discourage "low balling" water demand allocation amounts.

Section 10. Future Reservations (includes Sections 10A, 10B, 10C, 10D and 10E).

- Provisions **only** apply to 1) future Reservations for water demand allocation that exceed the Authority's New UWFDA (159.00 MGD); or 2) New Untreated Water Facilities other than the Luce Bayou Project.
- Revises various formulas in Section 3.02(c) of the Contract for calculating payments for water demand allocations exceeding the Authority's New UWFDA, depending on whether or not construction of New Untreated Water Facilities is required.
- Any payments due under Section 10 are **in addition** to the Phase 1 and Phase 2 Annual Untreated Water Facilities Payment required under Sections 5 through 7 of the Supplement.
- Deletes certain portions of Section 3.02(c) of the Contract concerning calculation of and procedures for payment and sets forth replacement paragraphs for such deleted paragraphs.
- Annual payments under new provisions now divided into two (2) payments in each Fiscal Year.

Section 11. Bonds, Notes and Other Obligations Issued for the Project.

- Establishes certain base criteria (set forth in Exhibit "A" of the Supplement and attached hereto) for COH/CWA obligations issued to fund the Project.
- Allows refinancing/restructuring of debt **only** to extent that there is no increase of any payments due from the Authority or extension of any time period(s) for payments owed by the Authority.
- Requires annual provision of COH's "Comprehensive Annual Financial Report" to the Authority.

Section 12. Terms of Contract.

- Specifies matters over which Supplement controls, rather than the original provisions of the Contract.
- Definitions in Contract remain in full force and effect, except to the extent they are inconsistent with the Supplement.

Section 13. Use Of Water.

- COH's use, sale or transfer of any water from the Project shall not harm or impinge upon Authority's rights under the Contract or the Supplement.
- COH remains obligated to provide the Authority with its Water Demand Allocation (including its UWFDA) under the terms of the Contract and Supplement.

#### Section 14. Existing Payments.

- Makes clear that nothing in the Supplement relieves the Authority of its original payment obligations under the terms of the Contract that have not been revised by the Supplement.

#### Section 15. Term.

- Revises and extends term of the Contract by deleting Article V and provides replacement paragraph.
- The Contract and Supplement expire at 12:00 noon on January 1, 2080 (previously term of 40 years with 20-year extensions possible).
- Authority owns right to use capacity of Untreated Water Facilities and Treated Water Facilities after term of Contract and Supplement expire.

#### Section 16. O&M Expenses.

- Amends Contract provisions to revise how O&M Expenses are paid; now to be paid on a per 1,000 gallons consumption basis.
- Deletes requirement for an O&M Reserve.
- Ninety (90) days prior to delivery of water and 90 days prior to each Fiscal Year, COH to provide Annual O&M Budget showing: 1) estimates of costs/expenses for use in the formula shown in Section 4.02 of the Contract; 2) calculation of estimated O&M Expenses for coming Fiscal Year; and 3) Estimated O&M rate for coming Fiscal Year.
- COH to invoice Authority's share of estimated O&M Expenses on monthly basis using formula prescribed and based on amount of water taken by the Authority during prior month.
- Payment due within 35 days of invoice receipt.
- "True-up" of O&M Expenses payments for prior Fiscal Year to be made in connection with Annual Audit.
- Any underpayments/overpayments to be paid/refunded and will accrue interest at the TexPool Rate.
- On or before January 15<sup>th</sup> of each year, Authority must provide COH with its Anticipated Demand in order for the Annual O&M Budget to be prepared, as required under the Contract.

#### Section 17. Outstanding Debt for Untreated Water Facilities.

- Accounts for and specifies actual Outstanding Debt incurred by COH for certain items originally reflected on Exhibit "E" of the Contract, as contemplated by Section 3.02(a) of the Contract.

## Exhibit "A"

The Annual Outstanding Debt Service for the Project and the bonds, notes, or other obligations issued by CWA or Houston for the Project will adhere to the following:

1. The bonds, notes, or other obligations will have a final stated maturity no earlier than 20 years, and no later than 30 years, after their date of issuance (though serial maturities and sinking fund redemption may be earlier).
2. During the period where debt service is due, the maximum annual debt service payment on any issuance of bonds, notes, or other obligations shall not exceed the average annual debt service payment on that issuance by more than 25%.
3. The bonds, notes, or other obligations shall be optionally callable, without a premium, no later than 15 years after the date of issuance.
4. Any debt service reserve fund for the bonds, notes, or other obligations shall be: (i) funded with proceeds of the bonds, notes, or other obligations; and/or (ii) satisfied with a surety policy acquired from a financial institution with a long term credit rating in the highest generic rating category from at least two nationally recognized rating services.
5. All costs of issuance, including, without limitation, underwriters' discount, bond insurance premium, surety bond policy, rating agency fees, bond counsel and financial advisory fees shall be funded with proceeds of the bonds, notes, or other obligations.
6. None of the issues of bonds, notes, or other obligations shall be sold for less than 95% of par and the net effective interest rate on same, taking into account any discount or premium as well as the interest rate borne on same, will not exceed two percent (2%) above the highest average interest rate reported by the Daily Bond Buyer in its weekly "20 Bond Index" during the one month period next preceding the date of sale of same.

Notwithstanding the provisions hereof, any of the above-provisions of this Exhibit shall be considered modified if a written modification is approved by the Utility Official and 3 out of the 4 boards of directors of the following water authorities: (i) West Harris County Regional Water Authority, (ii) North Harris County Regional Water Authority, (iii) North Fort Bend Water Authority, (iv) Central Harris County Regional Water Authority. The Authority recognizes that if Houston is unable to obtain financing pursuant to the above-provisions of this Exhibit, or if Houston believes that a lower cost alternative to the above-provisions may be reasonably available, Houston will request that the Authority consider modification of one or more of the above-provisions pursuant to the procedure of the preceding sentence.