MEMORANDUM

DATE: June 25, 2018

TO: William Stowe, CEO and General Manager

FROM: Peggy Freese, CFO

SUBJECT: Regionalization Financing Impact

When DMWW issues water revenue bonds, we agree to a number of bond covenants. To understand how these covenants might impact the asset transfer model currently under consideration in regionalization discussions, Rick Malm and I met with our bond advisors, Speer Financial, and our bond counsel, Mark Cory of Alhers & Cooney. They confirmed that one of our bond covenants prohibits the transfer of assets. This includes all DMWW assets, not just those constructed from the proceeds of the outstanding bonds. A violation of bond covenants would constitute a default on our bonds. Our outstanding SRF debt has the same covenants.

There are several ways to retire bond debt earlier than the scheduled maturity date: calling the bonds (refunding), advance refunding, or defeasance. Our outstanding bonds are not callable until 2021 (Series 2012A and Series 2012B.) They cannot be advance refunded as they have already been advance refunded and that is a one-time option. The bonds can be defeased, and this would be the only way to avoid default if there is an asset transfer. Defeasance is similar to advance refunding with one important distinction--defeasance requires cash. That is, new bonds cannot be issued to raise the funds. The SRF debt can be called, with permission from the SRF. Speer Financial, has worked with clients to call SRF debt and has never been denied early redemption from the SRF

Summary of Outstanding Bonds

DMWW has three issues of debt outstanding:

- SRF 2003 – Proceeds used for Polk City feeder main and pumping station
- 2012A – Proceeds used to refinance the 2004A bonds that financed an ASR well, an additional radial collector well at Maffitt, and a portion of radio frequency meter reading installations

- 2012B – Proceeds were used to refinance the 2006 bonds that were used to finance purchased capacity contributions for Saylorville WTP, purchase of Southeast Polk Rural Water District, and the Pleasant Hill portion of the joint east side tower

	Original Issue	Original Amount	Maturity	Balance @ 12/31/2017
SRF 2003	2003	$ 2,492,000	2022	$ 739,000
2012A	2004	4,605,000	2023	2,470,000
2012B	2006	39,400,000	2025	24,515,000
Total		**$ 56,747,000**		**$ 27,724,000**

This balance is partially offset by the existing bond reserve fund of $4,400,000, leaving about $23,324,000 which would be needed to defease or pay off the debt to effectuate any asset transfer from DMWW.

The 2003 SRF and the 2012A bonds are the obligation of DMWW. The 2012B bonds are primarily the obligation of our some of our wholesale and full-service customers.

Additional Consideration

If asset transfer occurs, DMWW will likely experience a downgrade in their credit ratings from Moody's and Standard and Poor's as there will be less growth potential for the utility. This will result in higher borrowing costs in the future.

Asset transfer will increase future financing costs for water infrastructure in the region. Any new regional entity will not likely be able to obtain a bond rating for a significant period of time while it establishes an operating history, and thus will need to issue any bonds in negotiated transactions, which generally involve higher borrowing costs. Moreover, when a rating is obtained for the new regional entity, the initial rating will not likely be as favorable as DMWW's existing rating, as it takes time to establish a high credit rating. If asset transfer occurs, DMWW and WDMWW will likely experience downgrades in their credit ratings from Moody's and Standard and Poor's as there will be less growth potential for their remaining systems. The net effect of bond ratings issues will likely be to increase the cost of financing future regional infrastructure needs for a substantial period of time.

Summary

- DMWW cannot transfer any assets while it has bonds and SRF debt that will remain outstanding after the asset transfer, unless the outstanding bonds are defeased. This will require significant cash to be made available to DMWW as part of any asset transfer. Bond issue debt and SRF debt fall into different categories (discussed below), but the basic idea is applicable to both.

- If we expect the bonds will be defeased as a part of a transfer of assets, DMWW would be limited in its ability to issue any new debt until after the transfer takes place. New debt would have to be issued with the same maturity date as the existing bonds due to the covenant that pledges all system assets. The shortened maturity time frame would result in higher annual debt service payments. The debt service schedule would have to be managed carefully in order to meet the bond covenants related to Debt Service Coverage. Short-maturity bonds (1-5 years) are typically not callable. Any new debt would also have to be defeased before any assets could be transferred due to the asset pledge covenant.