



Village Manager's Office Memorandum

November 15, 2013

TO: Mayor & Village Board of Trustees

FM: Paul Grimes 

C: Ellen Baer, Annmarie Mampe, Ken Friker

RE: PROPOSED LONG-TERM WATER SUPPLY AGREEMENT

On behalf of Village staff, I am pleased to submit this memorandum and accompanying proposed water supply agreement and support materials for your consideration. The attached binder is the culmination of years of analysis, negotiations, design, and policy decisions along the way by a consortium of five municipalities who share common interests in securing a long-term supply of water for our communities. Those communities are Orland Park, Tinley Park, Oak Forest, Mokena, and New Lenox ("Southwest Customers").

This memo will outline for you several items. First, it will summarize the policy decision and timeline that the Board will be considering for adoption. Second, the memo will summarize the deal terms contemplated in the agreement, along with the various reports and analysis in your portfolios that provide further supporting documentation. Finally, the memo will provide a risk analysis that accounts for key risk factors and the provisions within the proposed Agreement that mitigate these risks.

Policy Analysis and Timeline

The Water Supply Service Agreement that the Village previously entered into with Oak Lawn is expired, and our extension to this agreement expires on Dec. 31, 2013. The public policy question in deliberating the terms of a new agreement is whether the terms of the proposed agreement are fair, equitable, and reasonable for Orland Park water ratepayers in exchange for a 40-year long-term water supply agreement with significant infrastructure improvements to convey Lake Michigan water to Orland Park, reliably, safely, and sufficient to meet our long-term needs.

The objective is for Southwest Customers (Villages of Orland Park, Tinley Park, Mokena and New Lenox, City of Oak Forest) to adopt the proposed agreement in November-December 2013 so that bid packages for commencement of the system improvements can begin in January 2014. It should be noted that a portion of the proposed 60-inch parallel water main will be sited through Forest Preserve District (FPDCC) right-of-way that is also licensed to ComEd for high-tension lines. Approval from Cook County will be required to locate the line below or immediately adjacent to the existing ComEd lines. Minimal impact is expected, and several discussions with Cook County Commissioners and FPDCC staff have already occurred.

Summary of Project and Deal Terms

The Regional Water System Water Sale, Purchase, and Service Agreement between the Village of Oak Lawn, Illinois and the Southwest Customers represents a comprehensive restructuring of the business terms and conditions that existed in the previous agreement between Oak Lawn and the Southwest Customers to provide for a significant upgrading of the Regional Water System. The proposed system upgrade is in accordance with the 2008 Oak Lawn Regional Water Plan, and will provide a 40-year service commitment by Oak Lawn to provide Lake Michigan water to the Southwest Customers meeting best practices in public water utility operations and management. For the past 30 months, Oak Lawn and the Southwest Customers have met to prepare and negotiate multiple terms and conditions to identify enduring terms of water service and provide predictability and stability to water supply. The Village of Oak Lawn has represented that the final Agreement with the Southwest Customers will be used as the template for future customer water Agreements with other existing customers, including Chicago Ridge, Palos Hills, and Palos Park; and in the future, the Villages of Matteson, Country Club Hills, and Olympia Fields. This memorandum represents many of the key elements important and beneficial to the Southwest Customers.

Background

1. Supply of Lake Michigan Water to Customers: Oak Lawn has committed to a 40-year supply of Lake Michigan water to the customers signing the new Agreement. Under the agreement, Oak Lawn will supply customers' full water requirements as reflected in the 2030 IDNR water allocations, meeting a two times (2X) average-day peaking factor for the term of the Agreement by purchasing Chicago water and delivering it to customers in a system fully owed by Oak Lawn. It should be noted that this 2X peaking factor is an increase from the previously contemplated 1.7 peaking factor. The supply of Lake Michigan water from the City of Chicago has already been secured by a long-term water contract between Oak Lawn and the City of Chicago entered in 2013.

There are certain extreme conditions where Oak Lawn will be permitted to deliver less than the customer full water requirements; namely, due to the inability of Chicago to provide water or a disruption of the delivery system owned and operated by Oak Lawn. In those instances, the Customers have reserved the right to use their shallow wells or other sources to supplement water supply. In an emergency under extreme failure to deliver or for needs beyond the 2030 water allocation amounts, customers have the option to seek alternative suppliers. This is not, however, a circumstance expected to occur under the service arrangement negotiated. Oak Lawn does reserve the right to curtail water delivery under certain extraordinary circumstances.

2. Construction of the 2013 Regional Water System Improvements. Oak Lawn has committed to design, finance, and construct a major addition to their water delivery system to meet customer needs in accordance with the 2008 Oak Lawn Regional Water Plan. These improvements, currently estimated to at a cost of approximately \$171 million, will increase the safety, capacity, and reliability of the water system for the benefit of Oak Lawn and all its present customers. There are numerous operational enhancements provided for in the 2013 Regional System Improvements program. Oak Lawn will be providing construction benchmarks to its customers to provide customer oversight on the costs and completion schedules. Adequate time to review and provide input to Oak Lawn during the construction period to ensure budget and completion targets are met is being provided. The Regional System will be bid in eight project segments and is planned to be completed by 2018. Customers have reserved a right to terminate the Agreement in the unlikely event that Oak Lawn fails to proceed to construct the Regional System Improvements.

3. Characteristics of the Regional System Improvements: The new improvements will transform the current delivery system owned by Oak Lawn by updating the pumping and control systems, and providing a fully redundant secondary transmission line which will deliver water needs in the event of a catastrophic failure of the present transmission line or other elements of the system. In addition to meeting the 2030 customer water requirements, Oak Lawn must maintain water quality standards to

the satisfaction of its customers or implement regional system remedies to meet quality standards if requested by customers or required by regulatory agencies. There is also a 10% (approximately 10mgd) reserve capacity built in into the system to meet needs of additional customers or increased needs of existing customers. Oak Lawn has agreed to split the cost responsibility of this over sizing with 5% assigned to Agreement signers and 5% to Oak Lawn.

Oak Lawn has also agreed not to extend Agreement terms that are more favorable than those contained in the new Agreement when the current Southeast customers sign onto the new Agreement or, the 5% customer-controlled water is sold to new customers not presently served by Oak Lawn. Oak Lawn has also pledged to operate the system advantageously and efficiently meeting contemporary operating practices. Oak Lawn will prepare and maintain an Asset Management Plan with a capital funding mechanism built into the Agreement to ensure that the system is properly maintained over the 40-year period. Such a plan has not existed under the current terms with Oak Lawn. This is a significant improvement, and it ensures water customers that the system is operating and being maintained in accordance with best practices in the industry.

4. Customer Responsibilities and Duties. Signatory communities will also be assuming certain responsibilities, including a duty to take customer full water supply requirements, or pay for the equivalent volume used if not taken. This provision is common to regional system agreements. Customers also have a duty to provide two times (2X) their average-day water requirements in municipal storage and to maintain their own water systems so as not to interfere with the delivery capabilities of Oak Lawn. Customers also have an obligation to provide Oak Lawn with access and easements to make the necessary points of delivery and connections and install other improvements on Customer property. Customers also have a duty to accept increases in Chicago water rates and electricity costs, even if those increases occur during a current budget year.

5. Customer Oversight of the System and Consents. Oak Lawn has agreed to significant customer input and oversight and, in some cases, to consents before it takes action on certain proposals. The key element of oversight is the creation of a Mutual Cooperation Process contained as an exhibit to the Agreement. Three Working Groups are planned in the mutual cooperation efforts including (1) a Finance and Administration Working Group which will focus on budget and rate issues, (2) an Operations Working Group which will provide input on operational issues, and (3) a Management Working Group to provide comments on management and other issues related to the Agreement and operation of the Regional System. In addition, Customers have been granted oversight and/or approval of: (1) confirming available excess capacity for sale; (2) accepting additional customers in certain cases; (3) expanding the regional system; and (4) initiating expensive capital repairs or modifications. Customers will be assigned to the Asset Management Team whose responsibility is the development and maintenance of the Asset Management Plan. Customers will also have consent on significant capital reserve requirements beyond established levels. Oak Lawn will also be providing full access to records of the Regional Water System and near real-time read access to new SCADA operating data. Most of these customer oversight and reporting requirements do not exist under the current agreements.

6. 2013 Regional Water System Financing. Oak Lawn has agreed to customer approval of the overall Plan of Finance for the 2013 Regional System Improvements, which will occur when the Agreement is approved. As contemplated, the Plan of Finance is designed to take advantage of low interest IEPA financing from which Oak Lawn has secured substantial commitments. The balance of the financing will be one or more series of revenue bonds of the Regional System designed to carry a AA rating. The customer communities have been working with Oak Lawn's financial consultant, PFM, Inc., in evaluating the best debt structure scenarios for the entire system as well as individual communities. In addition, the Customers have retained the public financial advisory firm, Ehlers, Inc., to provide a more tailored debt structure scenario analysis for Customer communities, as well as to provide Customers with an independent peer review function with respect to debt structuring.

7. Water Rates and Rate Growth. There will be two overall rate components used with the Regional System:

- (1) Capital Costs of the System
 - a. New Capital Debt and Reserves
 - b. Old Debt remaining to be paid off on the system
- (2) Operating and Maintenance Costs.
 - a. Operational and Maintenance Costs developed around a Regional Water System operating budget, which will be separated from the Oak Lawn Retail system budget.
 - b. Other Non-Operating Charges including various reserves and guaranteed returns, an O&M reserve, a Repair & Replacement Reserve, and an equitable return amount, as well as other reserves as deemed appropriate.

Capital Costs of the system, including principal and interest payments on Regional System Improvements Debt and any applicable reserves required by the issuance of debt, will be paid outside of Oak Lawn's rates and paid through each Customer's local water rates.

Agreement signers will be guaranteeing the debt payments for other Agreement signers and customers, and Oak Lawn will be responsible for any operational default costs which may occur in the course of the operation of the regional system. It should be noted that Oak Lawn will be a "regional customer" of the regional system as well as a "retail provider" to the Oak Lawn businesses and residents.

a. Old Debt: The remaining repayment obligations and schedule from current outstanding debt will continue to be serviced as provided by ordinance until fully retired.

b. 2013 Regional System Improvement Debt: This debt, which is likely to include both Revenue Bond debt, IEPA loan debt, and possible construction loan debt, as well as any required reserves, will be paid on a basis of proportional benefit derived from the use of the Regional System in 2030. Simply put, customers which use a greater portion of the Regional System will pay proportionately more of the debt. Orland Park's share of that debt will range from 22.549% to 26.421%, with the variability attributed to the timing of the Southeast Customers entering similar agreements with Oak Lawn. As the Southeast Customers renew their agreements with Oak Lawn, (agreements that do not expire for several years), the Southwest Customers will recover a portion of the debt they have previously paid through the payment of a Special Connection Fee to be paid by all future connecting customers. As new customers come online, pay their Special Connection Fee, and begin paying debt on a going forward basis, Orland Park's share of the overall debt will decrease and the proportional benefit percentage applicable to Orland Park will be adjusted downward.

Reserves, with some exceptions, will be funded in a somewhat different method using a Common Usage rate whereby all customers pay a common rate per 1,000 gallons consumed. Debt reserves are set in accordance with proportional benefit. Debt payments are outside the rate structure of Oak Lawn and are payable four times per year.

c. Operating and maintenance payments. Customers will only be responsible for covering the costs of the Regional system and will be reviewed by customers annually. Oak Lawn has agreed that while some of the O&M costs will be paid based on proportionate benefit received, such as transmission main maintenance, pump station maintenance, and electricity, other rate components will be paid the same rate for gallons consumed. Costs subject to the Common Usage rate include (1) the costs of the Regional System not accounted for in other cost categories, (2) the cost of Chicago water, (3) the cost of unaccounted for water, (4) the insurance reserve, (5) the O&M reserve initial funding, up to \$5,000,000, (replenishment based on proportionate benefit received), and (6) equitable return.

Further, Oak Lawn has agreed to use up to one full year of its equitable return (\$500,000 minimum) to cover and fund any operational and maintenance shortfall of any defaulting customer. Defaults beyond that limit would be carried by all Agreement signers which is a result of a defaulting member on a proportionate cost basis.

The levels of the major reserve funds (Renewal, Repair & Replacement Reserve [3R], Operations & Maintenance Reserve, and Insurance Reserve) have been developed through negotiation. Budget increases and rates are subject to customer review and input, and certain other rate escalators to fund reserves and other charges will be established as the Producer Price Index for Manufactured Goods. A 2% or PPI annual increase has been agreed to for the Equitable Return, and does not begin until the Regional System Improvements are complete.

d. Impact on rates for new customers. Oak Lawn has structured a financial incentive for future customers by requiring a special connection fee that increases over time and assigning proportionate benefit to cover capital costs. In a similar fashion, new customers for the 5mgd reserve capacity controlled by the Regional System will carry the same economic benefit for all Agreement signers.

It should also be noted that nothing in the agreement precludes the Customer communities, wholly or individually, from engaging water conservation initiatives or pricing that can serve to mitigate water usage.

8. **Orland Park Infrastructure.** The Village will see several significant improvements to our own water system as a result of the Regional System Improvements.
 - a. **Crosstown Connection:** As a result of retiring debt in 2012, the Village will take title to the Crosstown Main that connects the Central Avenue water main to our Main Pump Station on Thistlewood, generally along 151st Street. The Village will license usage of this asset to the Village of Oak Lawn but will retain ownership.
 - b. **Spur 1:** The segment of the Crosstown Main that continues from approximately 80th Avenue and 151st Street will remain in Village ownership, but a license agreement will be provided to Oak Lawn to operate the system.
 - c. **Spur 2:** A new secondary feed line will be constructed south of 151st Street along the ComEd corridor to Wheeler Drive, and then westward to ultimately connect to our reservoirs on Thistlewood. This will provide the Village with substantial local redundancy via a new looped system and will eliminate a single point of failure.

Risk Factor Analysis

The proposed agreement is the result of extensive engineering peer review, analysis and negotiations over the past five years. Staff is confident that this agreement is the best way for the Village to (1) secure a long-term supply of Lake Michigan water; (2) maximize water system reliability, redundancy, and efficiency; and (3) minimize the impact on water rates and village finances over the term of the agreement.

The proposed agreement is a result of a negotiating coalition of Orland Park, Tinley Park, Mokena, Oak Forest, and New Lenox, who combine to make up 80% of the water customers for the Village of Oak Lawn's wholesale water system. This coalition has enabled the five communities to bargain deal terms that likely would not have been possible if each community negotiated individually.

Risk Factors to Village	Agreement Provisions to Mitigate
Project cannot be built at estimated costs	Oak Lawn is agreeing to complete the water system improvements at a cost that is within 105% of the \$171m cost estimate. If the system cannot be constructed at that amount, Oak Lawn must obtain consent from the corporate authorities of the Customer Communities.
The system cannot deliver the water that was promised in the agreement	Sec. 6 of the proposed agreement details numerous performance and flow requirements that Oak Lawn is obligated to perform. Failure to perform, if not cured, results in default (Sec. 29).
The debt required to finance the project exceeds tolerance levels	Customer Communities have been careful to evaluate the impact on rates to finance the significant capital improvements. The current system is not sufficient to meet future needs, and the proposed investment is the most cost effective way to meet those needs over the long term. The proposed agreement requires a Plan of Finance to be approved as part of the agreement. All Customer Communities have agreed that maximizing low-interest IEPA loans is the best way to mitigate rate impacts and also be mindful of the interest costs for future ratepayers in the years ahead. It should be noted, however, that each Customer Community can choose to pay its share of the capital debt in whatever way is best for that community (i.e., through rates, connection fees, or combinations).
FPDCC does not allow use of their existing ComEd easement	If the Forest Preserve District does not approve use of the land under the existing ComEd high tension lines, the alternate route would impact the overall cost project. Thus, Oak Lawn will need approval for an alternate plan by the corporate authorities via an amendment to the agreement.
The system is not big enough to meet long-term water supply needs	The system is designed to provide additional reserve capacity of 10%. The 2030 IEPA allocations factor in growth potential and most of those growth projections were attenuated due to the Great Recession. Moreover, with increases in Chicago water rates, it is expected that aggressive water conservation programs (and pricing) will allow water demand to remain well within system design capacity. The design engineer and the Customer Communities' peer review engineer are both confident that the proposed design is large enough to meet long-term water supply needs.
Oak Lawn cannot build the system that is contemplated in the agreement	Oak Lawn is under agreement to complete the regional system improvements by Dec. 31, 2018. They must complete in accordance with the schedule in Exhibit C, and they cannot exceed 5% of the \$171m cost without approval of corporate authorities. (Reference Sec. 13)
Operation of the system does not meet industry best practices	There are a set of advisory and working groups (Exhibit P) that are established, in part, to ensure that the system is operated in accordance with industry best practices. Moreover, there are levels of approvals to changes, either operationally, financially, or through system design for which approval is explicitly set forth in the agreement.
The proposed system does not spread costs among Southeastern and new customers and we have to carry that debt	This scenario was considered and addressed by creating a financial incentive for Southeastern customer communities to enter agreement. (Sec. 21). Through a formula for determining "buy-in rates," the agreement

Risk Factors to Village	Agreement Provisions to Mitigate
	provides a lower cost of entry for the Southeastern communities in the early years, and a higher cost of entry (to pay for carried capital costs) as the years progress. In addition, the agreement contemplates potential new customers through "special connection fees" that are distributed among all regional system customers.

Summary

The current water supply agreement with Oak Lawn has expired, and our extension expires on December 31, 2013. The proposed water agreement contemplates a 40-year Lake Michigan water supply agreement that substantially adds to system capacity, reliability, redundancy, and efficiency. Moreover, the management and system oversight marks a significant improvement over the incumbent agreement. It is the opinion of staff that this agreement represents the best agreement and terms available to secure Orland Park's water supply over the long term.