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TO: Scott Niehaus, Paul Grimes, Troy Ishler, John Downs, Kurt Carroll
FROM: William Balling
SUBJECT: Key Elements and Principles of the Oak Lawn and Southwest Customer Agreement
Date: October 15, 2013,

Gentlemen,

This memorandum summarizes the progress and status of the joint negotiations between the five Southwest customers including the Villages of Tinley Park, Orland Park, New Lenox, Mokena, and the City of Oak Forest, with the Village of Oak Lawn to develop a program for comprehensively updating the Oak Lawn Regional Water System serving a total of twelve municipal water customers, and creating a regional water supply agreement which provides the terms and conditions for the construction, financing, and operations of the Regional Water System. Currently the October 11, 2013 draft referred to as the **Regional Water System Water Sale, Purchase, and Service Agreement Between the Village of Oak Lawn, Illinois and Certain of its Municipal Customers**, represents a document very close to final form. This 27th draft version is approximately 90-95% complete as to the Agreement text and approximately 80% complete with regard to the Exhibits to the Agreement. Final work and discussions are continuing so that the Southwest Customers will be able to review, consider, and adopt the Agreement between mid October and the end of November, 2013.

As you are aware, since 2009 our five municipalities, the Villages of Orland Park, Tinley Park, Mokena, New Lenox, and the City of Oak Forest have worked cooperatively with the Village of Oak Lawn and its advisors to define an enhanced regional water system which will provide a safe and reliable source of Lake Michigan water to meet the needs of our residents and businesses for the next 40 to 60 years. We then sought to translate the service, financial, and operational requirements for such a system to an equitable contractual guarantee that the performance and reliability of a modified and enhanced regional water system can be achieved. The process began with a due diligence review of the 2009 **Oak Lawn Water System Master Plan** and moved to the development of the water Agreement. This has been an organized process including incorporating legal, engineering, management, and financial advisors working with our Managers and Administrators, Finance Directors, and Public Works Directors. Of course the Mayors and Presidents met regularly to receive progress reports and to provide policy guidance in our review process. During our discussion and multiple joint meetings Oak Lawn was cooperative and provided information necessary for our analysis. Most recently our team has shared the October 11, 2013 draft Agreement with the five municipal attorneys to obtain their review, feedback, and reaction to the current draft Agreement. This memorandum summarizes our overall progress to date to capture important principles related to the delivery of water and management issues of the Oak Lawn Regional Water System.

The **Regional Water System Water Sale, Purchase, and Service Agreement between the Village of Oak Lawn, Illinois and Certain of its Municipal Customers** represents a comprehensive restructuring of the business terms and conditions between Oak Lawn and its Municipal customers to provide for a significant upgrading of the Regional Water System. The proposed system is broadly based on the 2009 Oak Lawn Water System Master Plan, but through negotiations we successfully obtained modifications to the Master Plan to reflect what our five customer communities referred to as the Southwest customers, believed to be important to the long term operational requirements of the Oak Lawn Regional System. The draft Agreement and design will provide a 40 year operational and service commitment by Oak Lawn to provide Lake Michigan water to its customers meeting best practices in public water utility operations and management. The additions and expansion to the Regional Water System are significant and designed for the long term, 50 years or longer, increasing the benefits to your Southwest community water users. Many of the elements of the present system are 40 years old or older, and continued operations to the regional customers without significant upgrades and enhancements is both inefficient, unreliable, and risky to your current and future water users. For the past 40 months, Oak Lawn and the Villages of Tinley Park, Orland Park, New Lenox, Mokena, and the City of Oak Forest have met to prepare and then negotiate multiple terms and conditions to identify enduring terms of water service and operations to provide predictability and stability to water supply. The draft Agreement stipulates that the Agreement with the Southwest customers will be used as the template for future customer water Agreements with other existing Oak Lawn Regional Water customers including Chicago Ridge, Palos Hills, and Palos Park and in the future, the Villages of Matteson, Country Club Hills, and Olympia Fields. The draft Agreement also provides that no more favorable terms will be offered these customers, without offering any additional favorable terms to the Southwest Customers.

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 customer full water requirements up to the current year as IDNR Lake Michigan water allocations with a two times (2x) average day peaking factor for the term of the Agreement by purchasing Chicago Water then delivering it to customers in a system fully owned or controlled by Oak Lawn. 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 in 2013. The peaking factor in the Agreement represents a significant increase from the prior operational capabilities which operated approaching a maximum day of 1.7x average daily consumption. The 2x peaking factor in the Agreement will provide greater flexibility in the ability of customers to meet high peak demand periods. There are certain extreme conditions where Oak Lawn will be permitted to deliver less than the customer full water requirements, for example, 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 and emergency connections with other communities to supplement supply in an emergency and under extreme failure to deliver or for needs beyond the 2030 water allocation amounts customers have options 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 and the customers have negotiated a pro rata share of the reduced or curtailed water supply.

2. Construction of the 2013 Regional Water System Improvements. Oak Lawn has committed to design, finance, and construct a major addition to its water delivery system to meet customer needs in accordance with the modified 2009 Oak Lawn Water System Master Plan. This plan, currently estimated to cost \$171,000,000, will increase the safety, capacity, and reliability of the water system for the benefit of Oak Lawn and all its present customers. The improvements when completed will increase system delivery capacity from its current 56 mgd to 110 mgd, thus assuring customers long term supply which meets 2030 needs and likely well beyond 2030 with a 10% unassigned system reserve. There are numerous operational enhancements provided for in the 2013 regional system improvements program. The customers have negotiated construction activity benchmarks to assure timely completion of the Project. We have also negotiated a customer cost control mechanism so that should be project bid package increase over the cumulative estimate by more than 5%, customer consent will be required to award further work. The customers have reserved a right to terminate the Agreement in the unlikely event that Oak Lawn fails to proceed to construct the Regional System and have established that at least three of the eight bid packages must commence construction within 39 months after the signing of the Agreement. Oak Lawn has further agreed, subject to force majeure, to complete the regional improvements by December 31, 2018.

3. Characteristics of the Regional System: The new improvements will transform the delivery system owned by Oak Lawn by updating the pumping systems, 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 element of the system. The new water transmission mains themselves represents over 71% of the estimated capital investment into the Regional Water System. Many of the present system components exceed forty years of age and are nearing the end of useful life without rehabilitation. In fact in the past 30 months three major transmission water main breaks have occurred on the sole water transmission line serving our communities. In addition the Harker pumping station's power supply, which is used for Southwest customer water delivery became so threatened that temporary leased electrical generators were installed to standby in the event of a failure of the current redundant power source. In addition to meeting the 2030 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 built in a 10 % (approximately 9.8 mgd) reserve capacity into the system to meet needs of additional customers or increased needs of existing customers. Oak Lawn has agreed to split the responsibility and cost of this over sizing with 5% (5mgd) assigned to Oak Lawn and just under 5% (4.8 mgd) assigned to Agreement signers. Water may not be sold to any new customers before one year after substantial completion of the 2013 regional improvements. Oak Lawn has also pledged to operate the system advantageously to the customers, 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 or past Agreement terms with Oak Lawn, and this is a significant

improvement. This requirement ensures water customers that the system is operating and being maintained in accordance with best practices in the industry.

4. Customer Responsibilities and Duties. Agreement signers will also be assuming certain responsibilities including a duty to purchase customer full water supply requirements or pay for each customer's proportionate share of the capital costs and charges if not taken. The guarantee of debt for the regional improvements is common in many 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 even during a current budget year to accept increases in Chicago water rates, even if those cost increases occur in a current budget year.

5. Customer Input and Monitoring of the System and Consents. Oak Lawn has agreed to significant customer monitoring and input and, in some cases, to consents before it takes action on certain proposals. Most of the rights granted regarding customer monitoring, input, and reporting did not exist under the prior agreements. This agreement positions the customers to be much more influential in the operation of the Regional System. While the customer proportionate cost sharing of the Regional System will be more reflective of the customer demands on the system than the earlier arrangement, Oak Lawn has committed in the Agreement to customers also becoming a party to the decision making in many important areas. 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 a (1) 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 providing comments on management and other issues related to the Agreement and operation of the Regional System. Customers will approve the Plan of Finance under the terms of the new Agreement. In addition Customers have been offered to be a member of the Asset Management Team whose responsibility is the development and maintenance of the Asset Management Program. 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.

Further Oak Lawn has agreed that customers have a right to consent to various issues before Oak Lawn can take action on elements of the Regional System. These "consents" are both Corporate (the Customer Corporate Authorities) and Executive (the customer Village Managers or Administrators). Here are the Key consent elements assigned to customers:

Corporate Consent required for: (Section 26. B.)

For most items approval by customers holding 51% of the total 2030 allocations except for items" i. and j" where an 80% consent is required.

- a. Approval of the Plan of Finance for the 2013 System Improvements. Section 4. B.

- b.. To depart from the Plan of Finance for New Series Bonds. Section 4. B. (2).
- c. Approval of Future Series Bonds. Section 4. D. (3).
- d. To depart from the Plan of Finance for New Series Bonds for refunding purposes. Section 4.C.(2).
- e. To issue Future Series Bonds other than for emergencies or where specifically permitted Section 4. D. (3).
- f. Issuance of New Series Bonds for refunding purposes which depart from the Plan of Finance. Section 4. C. (2).
- g. Issuance of Future Series Bonds for refunding purposes that depart from a plan of finance or where no plan of finance exists. Section 4. E. (2).
- h. Any route change from the Com Ed/ Cook County Forest Preserve alignment. Section 13. A.
- i. To approve additional customers using not more than 4.8 mgd of the available reserve capacity. Section 21. A. (4).
- j. Adjustment to the formula for the Special Connection Fee. Section 21. B.
- k. Adjustment to the formula for the Old Bonds Special Connection Fee. Section 21.D.

Executive Consent required for: (Section 26.C.)

For most items approval by customers holding 51% of the total 2030 allocations except item" a "which is 75%

- a. Confirm adequacy of excess capacity before water may be sold to others for short term use. Section 6. C.
- b. To initiate system repairs or major capital costs in excess of \$1,500,000. Section 15. C. (3).
- c. To increase the reserve requirements of the Renewal, Repair, and Replacement (RRR) Reserve, beyond those stated in the Agreement. Section 15. C. (3).
- d. To approve 2013 Improvements bid packages which exceed 5% cumulative compared to estimates. Section 13. A.
- e. To extend emergency water service to a non-customer which exceeds the agreement. Section 7. D.
- f. To authorize Future Series Bonds for emergency repairs. Section 4. D. (2). (b).
- g. To approve the Asset Management Program, and any annual updates. Section 8. F.
- h. To approve current year budget changes for electricity, pump station, transmission, and other O/M . Sections 15. A. (2), (3), (4), and (5).
- i. To approve other non-operating charges in excess of the approved budget. Section 15. C. (1)
- j. To approve certain changes to System Costs. Section 1.

6. 2013 Regional Water System Financing. The customers have negotiated the right of approval of the overall Plan of Finance for the 2013 Regional System improvements, which will occur when the Agreement is approved. Oak Lawn will further allow customers to choose one of two preferences of financing structures to be offered by Oak Lawn. All Southwest customers have selected the short term financing option. This option will take maximum advantage of low interest IEPA financing from where Oak Lawn has secured financial commitments. The balance of the financing will be a revenue bond of the Regional System designed to carry an AA rating and a Working Cash Fund line of credit planned at

\$20,000,000 to cover construction contract cash flow requirements. The customer communities have been working with Oak Lawn's Financial Advisor, 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 provide Customer peer review function with respect to the debt structuring.

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

- (1) Operating and Maintenance costs, including the cost to purchase treated water from Chicago.
- (2) Capital Costs of the system, including new capital debt and debt reserves.
- (3) Other non-operating charges.
- (4) Old Debt remaining to be paid off on the current system.

It should be noted that the Oak Lawn retail water system Oak Lawn will be a "regional customer" of the Regional Water System. Costs associated with Oak Lawn serving as a "retail water provider" to the Oak Lawn businesses and residents have been separated from the Oak Lawn Regional Water System budget. Oak Lawn will have a continuing duty to spend wisely as they will bear a share of the regional costs since any costs applied to Regional Water customers will also be applied to Oak Lawn.

a. **Operating and maintenance costs.** The Operational and Maintenance costs will be developed around a Regional Water system operating budget, which will be separated from the Oak Lawn Retail system budget. Regional Customers, which also includes the Village of Oak Lawn will only be responsible for covering the costs of the Regional System which will be reviewed by customers annually. The Agreement provides that some of the O and M costs will be paid based on proportionate use of the system. These include (1) transmission main maintenance, (2) electricity (3) pump station maintenance. Other System Operations rate components paid on a common usage rate include (1) the costs of the regional system not accounted for in other cost categories, (2) the cost of Chicago water, and (3) the cost of unaccounted for water. Any budget cost overruns, system improvements, and emergencies would be subject to an end of year reconciliation or true up with customers receiving credits or surcharges. These will be calculated by Oak Lawn and reviewed by the customer Working Groups.

b. **2013 Regional Improvement Debt:** This debt, which is likely to include both Revenue Bond debt, IEPA loan debt and line of credit construction loan debt, and all required debt reserves, will be paid on a basis of proportional benefit derived from the use of the regional system and the 2030 allocations. Simply put customers which are projected to use a greater portion of the Regional System will pay proportionately more of the debt. Debt payments are payable four times per year by each customer. Agreement signers will be proportionately responsible for 2013 Debt obligations.

c. **Other non-operating costs.** Other non-operating costs include assessments which provide (1) a reserve for operations and maintenance costs, (2) equitable return to Oak Lawn, (3) Reserves for Insurance purposes, (4) net additional charges required for rate covenants, and (5) the Renewal, Repair, and Replacement (RRR) Reserve Fund. These costs are assessed in a somewhat different manner than O and M costs. The Operations and maintenance reserve is initially funded as a common usage rate but replenished on a proportionate benefit basis with subject to an annual increase minimum of 2% beginning one year following the completion of the regional improvements. The customers have negotiated that up to one full year of Oak Lawn's equitable return must be used first to cover any defaulting member's operating and maintenance costs. The reserves for insurance and rate covenant charges are charged on a common usage rate as is the RRR fund which is also capped at \$1,500,000 in any single year.

a. **Old Debt:** The remaining repayment obligations and schedule from current outstanding debt will continue to be serviced as provided by Intergovernmental Agreement until fully retired pursuant to the terms of previous Intergovernmental Agreements, unless otherwise agreed to by the customers.

e. **Impact on rates for new customers.** Current customers should benefit from additional new customers and we have negotiated the means to recover a portion of our initial capital costs and reduce our operating costs. All new customers will be subject to a special connection fee which will be repaid to current Agreement signers as reimbursement for capital improvement costs from which a new customer will be benefitting. Then because of the proportional cost distribution of many operating and maintenance costs, the impact of Oak Lawn operational costs to Agreement signers should be reduced as well. Oak Lawn is also contractually bound to pursue repayment of any old debt paid by Southwest customers with any new customer Agreement.

The Agreement which will be in final form for consideration in November 2013 represents a significant accomplishment for the Communities you represent who have been deeply interested in locking in a long term supply of Lake Michigan water and upgrading the Oak Lawn owned delivery system to serve the customers for the next half century or longer. By working collaboratively the Southwest communities have negotiated in an organized and strategic fashion and have influenced the scope of the capital improvement project and the water agreement from its form when first presented to you some time ago. In addition the Southwest customers have provided operational system enhancements, and equitable cost assignments to improve manage, and operate the system using best practices. The Agreement for the first time places the customers themselves in a position to exert some level of control on the operation and management of the system without assuming ownership of the system. This Agreement represents a great step forward in water management and you and your staff are to be commended on achieving these objectives.