PUBLIC COMMENT ON THE ABENGOA VISTA RIDGE/SAWS/BLUE WATER DRAFT CONTRACT - SAN ANTONIO CITY COUNCIL

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My name is Michelle McFaddin. I am a licensed environmental/natural resources attorney and have been retained by Texas League of Independent Voters to address the financing aspects of the Abengoa - Vista Ridge project. Between 2007 and 2013, I was employed by the Texas Water Development Board as the lead attorney for water and wastewater infrastructure loan programs. In that capacity, I assisted SAWS in financing its Brackish Groundwater Desalination Project through the state Water Infrastructure Fund program. In my experience, SAWS is a sophisticated borrower with staff that is knowledgeable and experienced in implementing large-scale, complex projects.

My reaction to the 581-page contract is simple - why isn't SAWS financing and implementing this project itself using the heavily subsidized financing options available through state infrastructure loan programs at rates significantly lower than those proposed by Abengoa?

A. <u>SAWS is effectively in control of the project</u>

Although the risk of project financing, design and construction as well as ongoing operation of the groundwater wells, water treatment facilities and transmission line appear to have been allocated to Abengoa affiliates, SAWS retains almost complete control over this project.

- The cost of water to be paid by SAWS to Abengoa will be approximately $2,000 per acre-foot. SAWS keeps saying that this is not a "take or pay" contract - perhaps they are right. It is a take AND pay AND pay contract;

- Not only does SAWS and San Antonio ratepayers get to pay Abengoa a premium for this water, SAWS is going to reimburse Abengoa for the costs of financing and designing this project up to $40,100,000 even if Abengoa can't obtain financing or is unwilling or unable to perform its obligations [§4.6(a) and Appendix 18 of the draft contract];

- SAWS also agrees to reimburse Abengoa for all reasonable costs of operating and maintaining the Project facilities [Art. 17 and Appendix 19 of the draft contract];

- SAWS retains significant control over project financing and implementation as well. SAWS has the option to purchase the initial securities (bonds) that Abengoa intends to issue to finance the project - should it do so, SAWS might save a little on interest, but will bear the risk of default on top of all of the other costs of this project;

- SAWS has the ability to purchase project assets at any time after closing;

- SAWS has the ability to force the design/construction contractor as well as the operating service provider to follow its instructions rather than Abengoa's at any time without cause; and

- SAWS has the ability to terminate the Agreement at any time prior to closing unless there is an offering of securities pending and after closing if Abengoa defaults on its obligations;

● AND SAWS still bears the risk that groundwater cannot be produced up to the baseline amount of 50,000 acre-feet per year and that the groundwater will require extensive treatment before it can be used - and the raw water permitting and treatment costs are not factored into the cost of water under this agreement; these hidden costs may be significant.

B. <u>SAWS or a newly-created Municipal Water District or Regional Utility Authority can obtain financing for this project at significantly lower cost.</u>

● SAWS, a municipal water district or regional utility authority could obtain heavily subsidized financing through the TWDB's tax-exempt water infrastructure loan programs - saving 200-300 basis points. In order to qualify for funding from the state water infrastructure funds, the project needs to listed on the 2017 State Water Plan.

● However, there is no need to get listed on the State Water Plan in order to obtain funding using Texas Water Development funds. Currently, the interest rate for tax-exempt financing under the Water Development Fund (DFund) program is 3.18% as opposed to the max. 6.04% rate proposed by Abengoa.

● SAWS borrowing costs would be substantially less than any rate charged under this draft contract since Abengoa's credit rating is two levels below investment grade.

● Abengoa may not be eligible for or credit-worthy enough to qualify for tax-exempt financing. Its proposed financing options are 1) the issuance of private activity bonds - if these bonds are even available, the actual feasibility of PAB financing is not addressed; 2) the issuance of corporate bonds that do not have any investment grade rating requirements, perhaps like the "Green" Euro bonds issued by Abengoa recently - it should be noted that this offering was not fully subscribed at an interest rate of approx. 5.5%, half of the offering had to be sold at 6.5%, suggesting that SAWS will be looking at the max. 6.04% interest rate; or 3) through the issuance of municipal bonds. Since Abengoa is a privately held company, its eligibility for tax-exempt financing through the issuance of municipal securities is questionable at best.

● Abengoa is a risky choice because Abengoa's ratings with Moody's, Standard & Poor and Fitch are not of investment grade and have been consistently downgraded over the past 2 years.

● SAWS keeps saying that it has been working on this transaction for more than 3 years - unfortunately, during this 3-year period, Abengoa's financial condition has deteriorated significantly.

● According to Abengoa's most recent annual report filed with the Securities and Exchange Commission, it already has a high level of indebtedness (11 billion Pounds total with only 581 million Pounds left for additional corporate borrowing). It is not clear whether the recent "Green" Euro offering used up some of this remaining borrowing capacity.

● Its SEC Form 20-F report also indicates that Abengoa has generated significant negative cash flows in the past three years and that its liabilities at the end of these fiscal years have exceeded its tangible assets. This is not a pretty picture.

● Even worse, should Abengoa default on its obligations under the contract, SAWS only recourse will be to take over the project since any judgment rendered by a U.S. Court based on breach of contract or securities fraud may well not be enforceable in a Spanish Court of law.

C. Conclusion

● In short, SAWS has indicated that Abengoa-Vista Ridge accepts the regulatory risk of making 50,000 acre-feet of groundwater available for the next 30 years but neglects to mention that it has to reimburse Abengoa for its financing, design, construction, treatment and operational costs.

● SAWS still has the risk that it will not be able to acquire 50,000 acre-feet/year of useable quality groundwater.

● SAWS argues that by executing this agreement, it will cap interest rate exposure but neglects to mention that the maximum capped rate of 6.04% under this Agreement is significantly in excess of the tax-exempt interest rates that would apply if the project were being financed through the TWDB's water infrastructure loan programs.

● SAWS keeps saying that it is imperative that it sign a contract RIGHT NOW to ensure that it obtains up to 50,000 acre-feet/year of water for possible delivery as soon as 2019 but has not demonstrated that it needs this entire amount by 2019. SAWS has time to work with the TWDB and, if needed, the legislature to get the project onto the 2017 State Water Plan if it wants to avail itself of the state water infrastructure fund rate subsidies. Or SAWS can utilize the DFund program. SAWS could even go to the market itself and arrange more favorable terms than those proposed in this draft contract.

● If SAWS is unwilling or unable to do the financing itself, there is time to create a water district or regional utility authority that could obtain tax-exempt project financing and implement this project.

● SAWS has argued that it benefits its ratepayers to have a private, third party build the well-field infrastructure, pipeline and related treatment and transfer facilities but is it advantageous if (1) the third party does not possess an investment grade rating for purposes of financing (unlike SAWS which has an excellent investment rating); (2) the third party is in questionable financial condition according to its own regulatory filings; and (3) the third party's American subsidiary is a Delaware-based limited liability company?

● Texas residents have recently experienced significant difficulties with another Spanish company that was brought in to finance and construct an infrastructure project, the Texas Tollways project; the bonds issued to pay for Texas Tollways are in trouble; there has been talk of possible default and ongoing service-related problems. Does San Antonio really want or need these kinds of problems with its future water supply?

I want to thank you for this opportunity to present public comment and would be happy to answer any questions that you might have.