BEFORE THE GUAM PUBLIC UTILITIES COMMISSION

REGULATORY REVIEW OF GWA INTERIM FINANCIAL PLAN UNDER FEDERAL COURT ORDER IN CIVIL CASE 02-35

DOCKET 04-01

FY05 RATE ORDER

Background

By its March 31, 2004 Order, the Guam Public Utilities Commission [PUC] established a protocol and schedule under which Guam Waterworks Authority [GWA] would prepare and submit an Interim Financial Plan [IFP] and petition for FY05 rate relief to PUC for regulatory review.

On August 20, 2004, GWA petitioned PUC for a 10% rate increase. The petition is supported by testimony from GWA General Manager Craddick *[filed 9/23/04]*, GWA CFO Wiegand *[filed 8/30/04]*; and CCU Chairman Sanchez *[filed 9/28/04]*. PUC's regulatory consultant *[Georgetown Consulting Group – GCG]* conducted its analysis of GWA's rate petition and filed responsive testimony on September 27, 2004.

During the period September 30 to October 8, 2004 GWA and GCG meet in regulatory conference to discuss their respective positions regarding GWA's need for rate relief. As a result of this conference process, GWA and GCG entered into a joint stipulation dated October 8, 2004 *[copy made Attachment A]*, which recommends regulatory action in response to GWA's rate application and related matters.

Determinations

After carefully reviewing the Stipulation and considering the parties' presentation and the public comments received at the public hearings, which PUC conducted on October 8, 2004 *[Hagatna]* and on October 11 *[Dededo and Agat]*, the commissioners at a duly noticed public meeting on October 14, 2004 by the affirmative vote of at least four commissioners and for good cause shown, find that:

1. GWA does not require rate relief in FY05 or FY06 to enable it to either meet its duties under the Stipulated Order For Preliminary Relief in

United State District Court – Territory of Guam Civil Case No. 02-35 *[USA v. Guam Waterworks Authority and Government of Guam – the Federal Order]* or to achieve a 1.75x debt service coverage ratio *[coverage ratio]*.

2. GWA intends to access $97.3 million in financing in FY05 and FY06 to fund $70.8 million of capital projects mandated by the Federal Order and $26.5 million of proposed additional capital projects. This financing requires prior PUC approval under 12 GCA 12004. No rate impact from this financing is anticipated in FY05 and FY06 because the proposed loan terms would provide for interest only payments for the first two years of the indenture term. However, this financing will create the need for an FY07 rate increase in the range of 20-30% over current rates.

3. Under generally accepted regulatory principles, such a one-time increase in rates is undesirable. Rather, implementation of gradual, smaller increases reflects more prudent regulatory policy.

4. PUC should implement a rate stabilization plan, under which the anticipated FY07 rate increase would be gradually implemented in FY05, FY06 and FY07. The plan should include the following components:

    a. GWA should be awarded a 6.5% rate increase, effective for services rendered after October 14, 2004. The increase should not apply to lifeline rates, the GPA-Navy surcharge or the Supplemental annuities surcharge.

    b. An amount equal to the additional revenues collected each month from the rate increase *[$217,000 +/-]* should be deposited by GWA into a separate interest bearing account on or before the 15th day of each month commencing November 2004. The account should be named the *"Rate Stabilization Trust Account"*.

    c. GWA should file with PUC a quarterly accounting of the Trust Account, commencing with the quarter ending December 31, 2004.

    d. No funds from the Trust Account should be withdrawn or expended without prior written approval of PUC. During the January 2005 regulatory session, PUC should consider the positions of GWA and GCG regarding under what, if any, circumstances GWA should be permitted access to the Trust Account.

    e. PUC should consider GWA's need for FY06 rate relief during the September 2005 regulatory session.

5. PUC should reaffirm its statutory duty to provide GWA with the rate revenue necessary to enable it to obtain the financing described in determination 2 above.

6. PUC should establish a minimum 1.75x coverage ratio for the purpose of setting just and reasonable rates for GWA.

7. The September 28, 2004 testimony of GCG sub-consultant Bruce Oliver should serve as a framework for regulatory activities, which will lead to PUC's consideration during the September 2005 regulatory session of a GWA restructured user fee system, including appropriate rate design changes, appropriate new user fees and a system development charge. In the interim, GWA should be permitted to petition PUC for the establishment of new user fees in accordance with applicable law and PUC rule.

8. Attachment B to the Stipulation identifies proposed GWA FY05 capital projects, which are subject to PUC review in this rate proceeding. PUC will consider these projects during the January 2005 regulatory session. For good cause, GWA may petition PUC for early consideration of any of these projects.

9. GWA should be authorized to obtain short-term financing to fund vendor payables [$2.3 million], privatization expenses [$3.7 million], and inventory [$300,000]. The loan term should not exceed 5 years. Interest should not exceed 7.5% per annum. GWA should obtain approval of the loan pursuant to 12 GCA 14201.

10. P.L. 27-106 requires GWA to fund the FY05 expense of supplemental annuities and insurance for its retirees *[the unfunded mandate]*. The 1.89% Supplemental annuities surcharge, which PUC established in March 2004 to fund only GWA's retirees' insurance premium expense in FY04 should be increased, effective October 14, 2004 to 2.59% to enable GWA to reimburse itself for the remaining FY04 insurance premium expenses and for said expenses in FY05. GWA should explore all possible legal avenues reasonably available to it to resolve the legality of the unfunded mandate.

11. By copy of this Order, PUC should report to EPA that GWA has made substantial progress in developing an IFP. This progress is represented in PUC's Orders of March 31, 2004, July 20, 2004 and October 14, 2004. An interim GWA debt collection plan was adopted by CCU Resolution 28-004. A restructured GWA user fee system, including a system

development charge, is currently under development and will be considered by PUC in September 2005.

In furtherance of the above 11 determinations and in the exercise of our judgment after considering the record, ALJ's recommendations and the arguments, reasoning and position of the parties and the public comments, and for good cause shown, PUC by the affirmative vote of the undersigned commissioners hereby **ORDERS THAT:**

1. All rulings and orders of the ALJ during the course of this proceeding are confirmed and ratified. All motions not heretofore granted or denied are denied. No other matters currently require discussion.

2. PUC reserves its continuing jurisdiction to review the IFP and to award such additional rate relief as GWA may reasonably require there under, without additional GWA notices under 12 GCA 12001.2. Accordingly, any further rate proceedings incident to the IFP shall be noticed only under 12 GCA 12016.

3. A rate increase of 6.5% on current revenues *[excluding the Navy-GPA surcharge, lifeline rates and the Supplemental Annuities surcharge]* is hereby awarded for services rendered on and after October 14, 2004. This rate increase shall be part of a rate stabilization plan, which shall be subject to the following regulatory controls:

    a. The additional revenues, which are collected each month from the rate increase, shall be deposited by GWA into a separate interest bearing account on or before the 15th day of each month commencing November 2004. This account shall be named the *"Rate Stabilization Trust Account".*

    b. GWA shall file with PUC a quarterly accounting of the Trust Account, commencing with the quarter ending December 31, 2004.

    c. No funds from the Trust Account shall be withdrawn or expended without PUC's prior written approval. During the January 2005 regulatory session, PUC shall consider under what, if any, circumstances GWA should be permitted access to the Trust Account.

4. PUC shall consider GWA's need for FY06 rate relief during the September 2005 regulatory session.

5. The 1.89% Supplemental Annuities surcharge, as established by PUC's March 31, 2004 Order, is hereby increased to 2.59% effective October 14, 2004. The revenues from the surcharge shall be used by GWA only to obtain reimbursement for the balance of FY04 retiree insurance premium expenses and for said expenses in FY05, provided that GWA receives written certification from the Guam Retirement Fund that the funds will be used only for this purpose *[a copy of said certification shall be filed with PUC]*. GWA shall explore all possible legal avenues reasonably available to test the legality of this unfunded legislative mandate.

6. GWA is authorized to obtain short-term financing to fund vendor payables [not to exceed $2.3 million], privatization expenses [not to exceed $3.7 million] and inventory [not to exceed $300,000]. The loan term shall not exceed 5 years. Interest shall not exceed 7.5% per annum. GWA shall obtain approval of the loan pursuant to 12 GCA 14201.

7. The FY05 capital projects listed in Attachment B of the Stipulation shall require PUC approval before the commencement of the procurement process. Unless for good cause shown, PUC will consider these projects during the January 2005 regulatory session.

8. The September 28, 2004 testimony of GCG sub-consultant Bruce Oliver shall serve as a framework for regulatory activities, which will lead to PUC consideration during the September 2005 regulatory session of a GWA restructured user fee system, including appropriate new user fees, rate design changes and a system development charge.

9. PUC reaffirms its statutory duty to provide GWA with the rate revenue reasonably necessary to enable it to obtain the financing described in determination number 2 above.

10. A minimum 1.75x coverage ratio is established for the purpose of setting just and reasonable rates for GWA.

11. GWA has made substantial progress in developing an IFP pursuant to section 28 of the Federal Order.

12. GWA shall strictly observe the requirements of PUC's contract review protocol [PUC December 13, 2003 Order – Docket 00-04], which requires, within the context of this Order, that GWA obtain PUC approval before commencing the procurement process for external financing and third party relationships.

13. PUC's administrative law judge is empowered and directed to oversee all regulatory activities, which in his judgment may be reasonably required to implement this Order and to prepare for future regulatory activities required herein.

14. GWA shall pay for PUC's expenses, including, without limitation, consulting and counsel fees and expenses and the expenses of conducting the hearing process.

Dated this 14th day of October 2004.

Terrence M. Brooks

Edward C. Crisostomo

Gerald M. Woo

Rowena E. Perez

Joseph M. McDonald

R. Lim

Richie T. Lim

Filomena M. Cantoria

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Public Utilities Commission
of Guam

BEFORE THE GUAM PUBLIC UTILITIES COMMISSION

REGULATORY REVIEW OF GWA INTERIM FINANCIAL PLAN UNDER FEDERAL COURT ORDER IN CIVIL CASE 02-35

DOCKET 04-01

Stipulation

Georgetown Consulting Group *[GCG]* and Guam Waterworks Authority *[GWA]*, through their authorized representatives, hereby stipulate and agree as follows:

1. On August 20, 2004, GWA petitioned the Guam Public Utilities Commission [PUC] for a 10% rate increase. After review, GCG has concluded that no rate increase in either FY05 or in FY06 is necessary in order to enable GWA either to meet its duties under the Federal Order or to achieve a 1.75x debt service coverage ratio[1]. However, GCG also recognizes, based on the testimony offered by GWA in this proceeding, that GWA intends to access $97.3 million in financing in FY05 and FY06 to fund $70.8 million of capital projects mandated by the Federal Order[2] and $26.5 million of proposed additional capital projects[3]. This financing will create the need for an FY07 rate increase in the range of 20 - 30% over current rates[4].

2. Under generally accepted regulatory principles, such a large one time increase in rates is undesirable. Rather, implementation of gradual, smaller increases reflects more prudent regulatory policy. The PUC should establish a *rate stabilization plan*, pursuant to which the anticipated FY07 rate increase would be gradually implemented in FY05, FY06 and FY07. Bank of America Securities [BOA], which serves as GWA's financial advisor, has by letter dated October 3, 2004 *[Attachment C]*, supported the

[1] See *Attachment A*, which are schedules, which have been prepared by Georgetown as part of its analysis of GWA's petition.
[2] See page 11 of *Craddick testimony* dated September 23, 2004.
[3] See *Attachment B* for a schedule of these capital projects, which are not mandated by the Federal Order.
[4] No rate impact from the financing is anticipated in FY05 and 06 because the proposed loan terms would provide for interest only payments for the first two years of the indenture term

concept of a rate stabilization plan as an effective way both to avoid rate shock and to improve GWA's creditworthiness in the financial market.[5]

3. GWA and GCG, therefore, recommend to the PUC that it establish a GWA rate stabilization plan with the following terms and conditions:

    a. PUC should award an initial rate increase of 6.5%, effective for services rendered after October 14, 2004. This increase should not apply to lifeline rates, the GPA-Navy surcharge or the Legislature surcharge.

    b. An amount equal to the additional revenues collected each month attributable to the rate increase *[$217,000 +/- per month]* should be deposited by GWA in a separate interest bearing account on or before the 15th day of each month commencing November 2004. The account should be named the *"Rate Stabilization Trust Account"*. No funds in the Account should be expended without the express, prior written approval of the PUC. GWA should file with the PUC a quarterly accounting of the Account, commencing with the quarter ending December 31, 2004.

    c. PUC should consider a GWA petition in September 2005 for an appropriate incremental rate increase in FY06 in anticipation of the impact of GWA's increased debt service obligations in FY07 on GWA's revenue requirements, as described in paragraph one above. GWA should file this rate petition, in accordance with the minimum filing requirements previously established by PUC, not later than July 15, 2005. GWA understands the importance of a timely and adequate rate filing to enable GCG to conduct its independent rate analysis and to provide the PUC adequate time for due deliberation.

    d. In its rate order, PUC should reaffirm its statutory duty to provide GWA with the rate revenue necessary to enable it to obtain the financing described in paragraph one above.

    e. PUC should establish a minimum 1.75x debt service coverage ratio for the purpose of establishing just and reasonable rates for GWA.

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[5] See also ***Attachment D***: *Credit Implications of Rate Structure and Rate Setting for U.S. Municipal Water-Sewer Utilities*, by James Wiemken, Director, Standard & Poors Credit Market Services [January 20, 2004].

4. An integral part of GWA's interim financial plan is the creation of a restructured user fee system. On September 28, 2004 GCG's sub-consultant Bruce Oliver filed testimony, which proposes a framework for reviewing and restructuring GWA's user fees. The parties adopt this framework and recommend that PUC authorize its administrative law judge to oversee activities that will lead to PUC's consideration in September 2005 of appropriate rate design changes for GWA's water and wastewater services, including the establishment of appropriate new user fees and a system development charge. In the interim, GWA should be permitted to petition PUC for the establishment of new user fees prior to the September 2005 regulatory session in accordance with applicable law and PUC rules.

5. *Attachment B* identifies GWA's proposed FY05 capital projects, which are not mandated by the Federal Order. Under PUC's December 16 2003 contract review protocol, PUC may review the prudence of all procurements or obligations within the context of a rate proceeding. Accordingly, GCG asserts that these projects should undergo PUC review and approval before the commencement of procurement activities. GCG will commence discovery on these projects based upon the information contained in Mr. Craddick's September 23, 2004 testimony. Unless GWA requires earlier consideration by PUC, the parties will work toward PUC consideration of these projects during the January 2005 regulatory session.

6. On July 26, *2004, GWA* petitioned PUC for review and approval of short term financing of $13 million to fund the purchase and installation of system wide water meters, under the mandate of section 14 of the Federal Order. Under 12 GCA 12004, as implemented by the GWA contract approval protocol, GWA must obtain PUC approval of this financing. The transaction documents include an Amendment Agreement between GWA, Kusakabe Guam, Inc. and Guam Waterworks Facilities Corporation *[Corporation] [draft dated 9/20/04]*; a Purchase Agreement between GWA and Corporation *[draft dated 9/21/04*]; and an Indenture of Trust between Corporation and J.P. Morgan Trust Company, N.A. *[draft dated 9/3/04] [collectively the "Transaction Documents"]*. After review, GCG recommends that PUC approve the financing, subject to the following conditions:

    a. BOA and GCG should advise PUC in writing that the Transaction Documents are reasonable and are consistent with the terms stated in subparagraph [c] below.

b. BOA should advise PUC in writing that it has reviewed the transaction expenses [fees, costs of issuance, credit rating, insurance, etc.] and finds them to be reasonable.

c. The loan terms should provide for interest payments only for the first two years, principal and interest payments during the next three years under an eight-year amortization schedule and a balloon payment due on the fifth anniversary of the loan. The loan terms should not include a prepayment penalty.[6]

GWA supports these conditions.

7. The parties recommend that PUC approve GWA's obtaining short-term financing, under terms not materially different those contained in Mr. Wiegand's August 30, 2004 testimony in this proceeding. The purpose of the financing would be to fund GWA's payment of vendor payables *[$2.3 million]*; privatization expenses *[$3.7 million]*; and inventory *[$300,000]*. GWA should obtain approval of the loan under 12 GCA 14201.

8. Pursuant to section 10 of its March 31, 2004 order in this docket, PUC established a 1.89% surcharge on current rates *[excluding the Navy surcharge and lifeline rates]* to fund the insurance premium requirement for retirees, which GWA is mandated to pay under P.L. 27-29. P.L. 27-106 reimposes this financial burden on GWA for FY05. Accordingly, the parties recommend that PUC increase the current 1.89% surcharge to 2.59% in order to enable GWA to reimburse itself for remaining FY04 insurance premium expenses and for said expenses which it incurs in FY05. PUC's March 31 2004 Order also directed that GWA challenge the legality of this unfunded mandate. GWA has been unable to comply with this regulatory directive because it is not empowered to initiate litigation on its own behalf. Accordingly, the parties recommend that this requirement be suspended until such time as GWA is empowered to file suit in its own name. GWA should, however, continue to explore all possible legal avenues reasonably available to it to resolve the question as to the lawfulness of the unfunded mandate.

9. Section 28 of the Federal Order requires GWA to file an interim financial plan with PUC for its review and approval. This plan is required to include a debt reduction plan, a receivables collection plan, a restructured user fee system, a funding analysis and an interim plan projects and

[6] Recovery of unamortized issuance costs [approximately $1 million] should not be deemed to be a prepayment penalty.

activities report. On September 29 2004, CCU adopted Resolution 28-2004, which approved the draft debt collection plan, as attached to Mr. Wiegand's August 30, 2004 testimony. GWA agrees on or before December 15, 2004 to supplement this plan with a detailed schedule of its outstanding payables and debt and with a plan for addressing the accrued and ongoing liability for retiree pension and insurance benefits. PUC should consider this filing during the January 2005 regulatory session. GWA is also currently working on a receivables collection plan, which should be filed with PUC for review and approval not later than December 15, 2004. Paragraph 4 of this stipulation proposes a framework under which a restructured user fee system will be submitted to PUC for its review during the September 2005 regulatory session. Taken together, the parties believe this stipulation and the GCG and GWA testimonies present the essential elements of an interim funding analysis and project report. Accordingly, the parties recommend that PUC report to EPA that GWA has substantially complied with the requirements of section 28 of the Federal Order, subject to the continued activities discussed in this stipulation.

Respectfully submitted this 8th day of October 2004.

[signature]

Guam Waterworks Authority

for Jamshed K Madan

Georgetown Consulting Group

GUAM WATERWORKS AUTHORITY
Five Year Projection of Financial Operations and Cash Flow

Excludes Interest Income in DSC Ratio

		Growth	FY05 GCG Position (A)	FY05 ProForma (B)	FY06 (C)	FY07 (D)	FY08 (E)	FY09 (F)
1	**OPERATING REVENUES**							
2	Total Water	1.0%	$ 22,553,515	$ 22,553,515	$ 22,779,050	$ 23,006,841	$ 23,236,909	$ 23,469,278
3	Water Increase	1.0%		1,613,513	1,629,648	1,645,945	1,662,404	1,679,028
4	Meter Revenues		300,000	300,000	1,500,000	2,700,000	2,700,000	2,700,000
5	Total Wastewater	1.0%	14,292,150	14,292,150	14,435,072	14,579,422	14,725,216	14,872,469
6	Wastewater Increase	1.0%		1,000,526	1,010,531	1,020,636	1,030,843	1,041,151
7	Surcharge (GPA/Navy Pble)		2,650,346	2,625,961	2,625,961	2,625,961	2,625,961	2,625,961
8	Legislative Surcharge		480,725	739,454	739,454	739,454	739,454	739,454
9	Other	1.0%	100,000	100,000	101,000	102,010	103,030	104,060
10	TOTAL OPERATING REVENUES		$ 40,376,736	$ 43,225,119	$ 44,820,716	$ 46,420,269	$ 46,823,817	$ 47,231,401
11								
12	**TOTAL O&M EXPENSES**	2.0%	31,559,924	31,559,924	31,875,523	32,194,278	32,516,221	32,841,383
13								
14	**OPERATING INCOME (LOSS)**		$ 8,816,812	$ 11,665,195	$ 12,945,192	$ 14,225,990	$ 14,307,596	$ 14,390,018
15								
16	**OTHER INCOME(EXPENSE):**							
17	Grants from US Government							
18	Contributions in Aid of Construction							
19	Grants from Government of Guam							
20	Depreciation		10,700,000	10,700,000	10,700,000	10,700,000	10,700,000	10,700,000
21	Bad Debt	FY05%	481,961	481,961	535,007	554,100	558,917	563,782
22	Contributions from Other Agencies							
23	Interest Income		(1,240,000)	(3,438,499)	(1,761,731)	(501,433)	(501,433)	(501,433)
24	Interest Expense		2,887,625	3,428,595	3,522,822	6,453,919	6,176,138	5,882,049
25			12,829,586	11,172,058	12,996,097	17,206,586	16,933,622	16,644,398
26								
27	**NET INC (DEC) IN Retained Earnings**		(4,012,774)	493,137	(50,905)	(2,980,595)	(2,626,026)	(2,254,380)
28								
29								
30	Net Income		$ (4,012,774)	$ 493,137	$ (50,905)	$ (2,980,595)	$ (2,626,026)	$ (2,254,380)
31	Plus: Depreciation		10,700,000	10,700,000	10,700,000	10,700,000	10,700,000	10,700,000
32	Less: Interest Income		(1,240,000)	(3,438,499)	(1,761,731)	(501,433)	(501,433)	(501,433)
33	Plus: Interest Expense		2,887,625	3,428,595	3,522,822	6,453,919	6,176,138	5,882,049
34	Available for Debt Service		$ 8,334,851	$ 11,183,234	$ 12,410,185	$ 13,671,890	$ 13,748,679	$ 13,826,235
35								
36	Principal Payments		$ 850,740	$ 856,884	$ 1,405,340	$ 4,785,138	$ 5,062,919	$ 5,357,008
37	*Adjustment made to interest*		(230,000)					
38	Interest Expense		2,887,625	3,428,595	3,522,822	6,453,919	6,176,138	5,882,049
39	Total Debt Service		$ 3,508,365	$ 4,285,479	$ 4,928,162	$ 11,239,057	$ 11,239,057	$ 11,239,057
40								
41	DSCR		2.38	2.61	2.52	1.22	1.22	1.23
42								
43	**Cash Flow**							
44	Open Cash		$ 2,578,217	$ 2,578,217	$ 7,881,583	$ 11,369,378	$ 8,547,684	$ 5,802,778
45	Profit/(Loss) (Note 1)		8,816,812	11,665,195	12,945,192	14,225,990	14,307,596	14,390,018
46	Less Principal Payments		(850,740)	(856,884)	(1,405,340)	(4,785,138)	(5,062,919)	(5,357,008)
47	Less: Bad Debt		(481,961)	(481,961)	(535,007)	(554,100)	(558,917)	(563,782)
48	Subt:Operating Reserve Requirement		(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	
49	Subt: Net Interest		(2,229,125)	9,903	(1,761,090)	(5,952,485)	(5,674,704)	(5,380,616)
50	Subt: Surcharge Payments		(2,450,346)	(2,425,961)	(2,425,961)	(2,425,961)	(2,425,961)	(2,425,961)
51	Internally Funded Projects		(1,330,000)	(1,330,000)	(1,330,000)	(1,330,000)	(1,330,000)	(1,330,000)
52	Externally Funded Projects			(15,200,000)				
53	*Meter Program*		*(13,000,000)*					
54	*Transportation Purchases*		*(900,000)*					
55	*USDA Land Purchase*		*(1,300,000)*					
56	ST Debt Proceeds			18,350,000				
57	*MSG Note (net)*		*13,000,000*					
58	*Short Term Note*		*4,450,000*		1,850,000			
59	*Transportation Purchase Note (net)*		*900,000*					
60	"Ban" Proceeds			96,978,064	26,498,064			
61	*FY05/06 Projects*			(70,480,000)	(25,995,000)			
62	*Long Term Bonds (net)*		*70,000,000*					
63	*"USDA Bond")*		*1,300,000*	1,300,000				
64	Construction Fund		(70,000,000)	(26,498,064)	(503,064)			
65	Privatization Consultant		(1,850,000)	(1,850,000)	(1,850,000)			
66	Working Capital Changes			(1,876,926)				
67	*Vendor Payable*		*(2,000,000)*					
68	*Inventory Buildup*		*(700,000)*					
69	*All Other*		*823,074*					
70	Excess Cash		$ 2,775,931	$ 7,881,583	$ 11,369,378	$ 8,547,684	$ 5,802,778	$ 5,135,429

6[1].5_Settlement5YearFcstSurchargeAdjusted/5yr RR wo int income

ATTACHMENT A

GUAM WATERWORKS AUTHORITY
Five Year Forecast of Financial Operations and Cash Flow

Includes
Interest Income
in DSC Ratio

		Growth	FY05 GCG Position (A)	FY05 ProForma (B)	FY06 (C)	FY07 (D)	FY08 (E)	FY09 (F)
1	**OPERATING REVENUES**							
2	Total Water	1.0%	$ 22,553,515	$22,553,515	$22,779,050	$23,006,841	$23,236,909	$23,469,278
3	Water Increase	1.0%		1,613,513	1,629,648	1,645,945	1,662,404	1,679,028
4	Meter Revenues		300,000	300,000	1,500,000	2,700,000	2,700,000	2,700,000
5	Total Wastewater	1.0%	14,292,150	14,292,150	14,435,072	14,579,422	14,725,216	14,872,469
6	Wastewater Increase	1.0%		1,000,526	1,010,531	1,020,636	1,030,843	1,041,151
7	Surcharge (GPA/Navy Pble)		2,650,346	2,625,961	2,625,961	2,625,961	2,625,961	2,625,961
8	Legislative Surcharge		480,725	739,454	739,454	739,454	739,454	739,454
9	Other	1.0%	100,000	100,000	101,000	102,010	103,030	104,060
10	TOTAL OPERATING REVENUES		$ 40,376,736	$43,225,119	$44,820,716	$46,420,269	$46,823,817	$47,231,401
11								
12	**TOTAL O&M EXPENSES**	2.0%	31,559,924	31,559,924	31,875,523	32,194,278	32,516,221	32,841,383
13								
14	**OPERATING INCOME (LOSS)**		$ 8,816,812	$11,665,195	$12,945,192	$14,225,990	$14,307,596	$14,390,018
15								
16	**OTHER INCOME(EXPENSE):**							
17	Grants from US Government							
18	Contributions in Aid of Construction							
19	Grants from Government of Guam							
20	Depreciation		10,700,000	10,700,000	10,700,000	10,700,000	10,700,000	10,700,000
21	Bad Debt	FY05%	481,961	481,961	535,007	554,100	558,917	563,782
22	Contributions from Other Agencies							
23	Interest Income		(1,240,000)	(3,438,499)	(1,761,731)	(501,433)	(501,433)	(501,433)
24	Interest Expense		2,887,625	3,428,595	3,522,822	6,453,919	6,176,138	5,882,049
25			12,829,586	11,172,058	12,996,097	17,206,586	16,933,622	16,644,398
26								
27	**NET INC (DEC) IN Retained Earnings**		(4,012,774)	493,137	(50,905)	(2,980,595)	(2,626,026)	(2,254,380)
28								
29								
30	Net Income		$ (4,012,774)	$ 493,137	$ (50,905)	$ (2,980,595)	$ (2,626,026)	$ (2,254,380)
31	Plus: Depreciation		10,700,000	10,700,000	10,700,000	10,700,000	10,700,000	10,700,000
32								
33	Plus: Interest Expense		2,887,625	3,428,595	3,522,822	6,453,919	6,176,138	5,882,049
34	Available for Debt Service		$ 9,574,851	$14,621,732	$14,171,917	$14,173,323	$14,250,112	$14,327,669
35								
36	Principal Payments		$ 850,740	$ 856,884	$ 1,405,340	$ 4,785,138	$ 5,062,919	$ 5,357,008
37	*Adjustment made to interest*		(230,000)					
38	Interest Expense		2,887,625	3,428,595	3,522,822	6,453,919	6,176,138	5,882,049
39	Total Debt Service		$ 3,508,365	$ 4,285,479	$ 4,928,162	$11,239,057	$11,239,057	$11,239,057
40								
41	DSCR		2.73	3.41	2.88	1.26	1.27	1.27
42								
43	**Cash Flow**							
44	Open Cash		$ 2,578,217	$ 2,578,217	$ 7,881,583	$11,369,378	$ 8,547,684	$ 5,802,778
45	Profit/(Loss) (Note 1)		8,816,812	11,665,195	12,945,192	14,225,990	14,307,596	14,390,018
46	Less Principal Payments		(850,740)	(856,884)	(1,405,340)	(4,785,138)	(5,062,919)	(5,357,008)
47	Less: Bad Debt		(481,961)	(481,961)	(535,007)	(554,100)	(558,917)	(563,782)
48	Subt:Operating Reserve Requirement		(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	
49	Subt: Net Interest		(2,229,125)	9,903	(1,761,090)	(5,952,485)	(5,674,704)	(5,380,616)
50	Subt: Surcharge Payments		(2,450,346)	(2,425,961)	(2,425,961)	(2,425,961)	(2,425,961)	(2,425,961)
51	Internally Funded Projects		(1,330,000)	(1,330,000)	(1,330,000)	(1,330,000)	(1,330,000)	(1,330,000)
52	Externally Funded Projects			(15,200,000)				
53	*Meter Program*		(13,000,000)					
54	*Transportation Purchases*		(900,000)					
55	*USDA Land Purchase*		(1,300,000)					
56	ST Debt Proceeds			18,350,000				
57	*MSG Note (net)*		13,000,000					
58	*Short Term Note*		4,450,000		1,850,000			
59	*Transportation Purchase Note (net)*		900,000					
60	"Ban" Proceeds			96,978,064	26,498,064			
61	*FY05/06 Projects*			(70,480,000)	(25,995,000)			
62	*Long Term Bonds (net)*							
63	*Long Term Bonds (net)*		70,000,000					
64	*"USDA Bond")*		1,300,000	1,300,000				
65	Construction Fund		(70,000,000)	(26,498,064)	(503,064)			
66	Privatization Consultant		(1,850,000)	(1,850,000)	(1,850,000)			
67	Working Capital Changes			(1,876,926)				
68	*Vendor Payable*		(2,000,000)					
69	*Inventory Buildup*		(700,000)					
70	*All Other*		823,074					
71	Excess Cash		$ 2,775,931	$ 7,881,583	$11,369,378	$ 8,547,684	$ 5,802,778	$ 5,135,429
72								

Add to that the 10 well financing of **$70,646/year**

A borrowing scenario of $6,529,555.10/year DSP for the SO projects to encumber in FY05 and FY06 is doable within proposed rate increase.

V. FINANCIAL IMPACT OF NON-STIPULATED ORDER PROJECTS FOR FY05 AND FY06

Q. PLEASE DESCRIBE OTHER PROJECTS THAT WILL BE UNDERTAKEN BY GWA IN FY05 AND FY06 THAT ARE NOT REQUIRED BY THE STIPULATED ORDER AND THEIR PROJECTED COSTS.

A. GWA will encumber projects that are not required by the Stipulated Order and which must be funded from GWA funds in FY 2005 as listed in **Exhibit B**:

	Project Description	Projected Cost
1.	Reservoir Land	10,000,000
2.	Well electrical protection	900,000
3.	Lift Station upgrades	500,000
4.	Collection System Upgrade	800,000
4.	Santa Rita Transmission Line	500,000[3]
5.	Storage additions	800,000
6.	Kaiser Tank Booster	750,000
7.	Water Booster Station Upgrades	500,000
8.	Mangilao Tank Repair	800,000
9.	Ugum Tank replacement	2,200,000
10.	EarthTech Buyout	6,000,000
11.	WW/W Laboratory Modernization	900,000
12.	WW mobile pumping equipment **	400,000
13.	Vehicles and Equipment **	500,000
14.	Land Surveying	900,000
	Long Term Life TOTAL	$25,550,000
	** Short Term Life TOTAL	$900,000
	Grand TOTAL	$26,450,000

There are no non-stipulated order projects scheduled for FY06 at this time.

[3] Legislative Funds and costs not included.

ATTACHMENT B

Municipal Finance
9 W. 57th St., 32nd Floor
New York, NY 10019

Banc of America Securities

Memorandum

October 3, 2004

To: Guam Public Utilities Commission

From: Margaret Guarino, Managing Director
Aulii Taitano, Associate

cc: Consolidated Commission on Utilities
David Craddick, General Manager
Randy Wiegand, Chief Financial Officer

Re: MSG Meter Financing

This memo is in response Georgetown Consulting's "Proposed Worksteps for Meter Financing", as well as several other GWA-related issues.

MSG Financing

We have received Mr. Craddick's testimony relating to the meter financing, however, we did not receive the referenced exhibits. We do agree, however, on Mr. Craddick's & GWA's rationale for proceeding with the meter financing immediately as opposed to waiting for the BAN or long-term financing. Since the average life of the proposed meters is only 10 years, with a guaranteed average life of 5 years (according to GWA), we do not recommend waiting for the BAN or long-term financing to finance the meters. It is a prudent practice that the term of the financing matches the useful life of the asset financed. In our previous letter where we stated that the meters are a possible use of the long-term financing, we were under the assumption that they had a longer average life commensurate with longer term financing. In addition, after discussion with GWA, it is apparent that implementing the meter financing immediately with MSG, will not only show immediate compliance with the EPA stipulated order, it may help GWA recover lost revenue from now until the time that the longer term financing takes place. This could be three to four months, as the rating agency, insurance and overall financing process is somewhat time consuming, especially for a new issuer such as GWA.

We also received new drafts of the MSG documents, dated 09-21-04, last week. Several sections have been amended based on our recommendations to the PUC. As the documents are not yet final, the exhibits have not been completed. We have been assured by GWA, however, that the schedule, to which the documents refer as the prepayment schedule, only includes principal and interest, and does not include an additional prepayment penalty. In addition, we have not reviewed any fees or issuance costs relating to the MSG financing. We can, however, attest to the fact that in comparing the all-in cost of a 10-year fixed rate bond issue to the proposed interest rate cap on the MSG financing, the MSG financing cost was lower. In addition, a comparison of a BAN financing and the MSG financing is not necessarily an apples-to-apples one. The BAN financing contemplates a long-term takeout, which will involve additional issuance costs,

ATTACHMENT C

whereas the MSG financing is a longer-term fixed rate financing of 10 years vs. 2 years. We have proceeded in selecting an underwriter for GWA's larger financing but it has not yet been determined whether a BAN is the best alternative. At this time, BAS, GWA & the CCU are open to other structures, including a longer-term fixed rate financing with a tax call. The schedule for the larger financing is at least three to four months. We caveat that this time frame assumes a cooperative legislature, but that is highly dependent on the outcome of the election next month.

Proposed Rate Increase

We have been asked by GWA to comment on the PUC's willingness to implement a rate increase now as opposed to implementing a very large rate increase just before the issuance of the larger financing. It is highly probable that GWA will need ***at least*** a 20-30% rate increase over the next several years in order to meet its debt service obligation on the proposed large financing. In order to avoid rate shock in several months, we believe that a small rate increase now will not only help ease the burden on rate payers in the future, but that it will also help show an acknowledgement by GWA and the PUC that rates need to be substantially higher to support GWA's future obligations.

It is important for the PUC to understand that in order for GWA to obtain investment grade ratings on this larger financing, which will help reduce the costs of financing in the long run, they will look to an independent rate study which projects the rate increases needed in order for GWA to pay debt service on the bonds. This rate study must be adopted by the PUC upfront, before the financing takes place, in order to show the rating agencies that the PUC is committed to the rate-setting schedule. This does not necessarily mean that the rates **MUST** be implemented at the time set forth in the study. The PUC can choose to revisit GWA's finances at any time and if it finds that debt service coverage is already met and that a rate increase is not necessary, then it does not need to implement the rates in the future. The PUC's adoption of a 1.75x debt service coverage policy will further solidify its commitment to GWA's obligations but will not satisfy the rating agencies alone.

We hope this helps clarify some of the issues set forth in your recent correspondence. Please feel free to call us with any questions or concerns at 212.933.2255 or 212.933.2254.

[redacted]

CREDIT IMPLICATIONS OF RATE STRUCTURE AND RATE SETTING FOR U.S. MUNICIPAL WATER-SEWER UTILITIES

—James Wiemken, Director, Standard & Poors Credit Market Services, January 20, 2004

As large future capital requirements for many water-sewer utilities become more apparent, whether because of regulatory compliance issues, sprawling growth, aging infrastructure, or simply better awareness of the need for long-term asset management, many utilities face an uphill battle to pay for these improvements due to political pressures and a lack of public understanding. Accordingly, utility credit analysis has moved beyond a point-in-time analysis of current debt service coverage and rates compared to ratepayer's income levels and rates in neighboring communities. Because a variety of factors may affect financing options at the local level, the extent of a utility's ability to implement strategies and policies that address its unique characteristics and allow it to finance needed projects becomes a differentiating factor. Many of the highest credit quality utilities rated by Standard & Poors also face significant capital requirements. The approaches they have taken, however, have allowed them to address these needs without sacrificing bondholder protection and without being hindered by political or public opposition. This article examines the key factors that Standard & Poors considers in relation to rate setting and capital planning when rating water-sewer bonds and uses several examples of utilities around the country which have made great progress in financing infrastructure to date while preparing for additional needs going forward.

Standard & Poors' analysis of rate setting practices centers on the question of whether rates are set such that available revenues are consistently sufficient to meet all of the ongoing needs and obligations of the utility, both now and in the future. While a variety of external factors influence this analysis, including regulatory issues, growth trends, customer concentration, and operational capacity, S&P generally looks for rate stability, rate transparency, and long-term planning as relevant factors that are under some control of utility management. Rate setting procedures that address these issues should help to achieve higher debt ratings, holding other factors constant.

Rate Stability Means Recognizing and Addressing Change

Achieving rate stability requires understanding that (more often than not) the statistic to be managed is the variance of the *changes* in rates over time rather than the variance in the rates themselves. Holding rate levels constant for multiple years does not benefit ratepayers if inflationary increases in operating costs and other expense pressures eventually compound to force a rate increase of such magnitude that rate payers have extreme difficulty in budgeting for this expense. Such patterns of irregular rate increases increase the risk that ratepayers will pressure rate makers to resist needed changes, thus increasing credit risk to bondholders. This is not to say that minimizing any negative economic development consequences of rate increases and pursuit of lower rates from further efficiencies should be ignored; they should be goals that are judged from a long-term perspective rather than exclusive targets to be met in the current year regardless of long-term consequences. When managed from a long-term perspective, sound policies usually benefit both bondholders and ratepayers, and the interests of these two constituencies are more consistently aligned.

Even without large financial pressures, political forces may intervene to delay rate increases, forcing the need for larger increases in the future. Unfortunately, this practice is somewhat

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common during election years for local officials. Such pressure is most damaging, however, when it continues for a multi-year period—often through the entire term of an administration. After several years of neglect, the local service area may face not only a current structural imbalance in its utility operations, but also compounded deferred maintenance, and a realization that the utility is no longer capable of addressing regulatory or growth related issues in a timely or manageable way. Unless credit ratings, auditor opinions, or other reports revealing this neglect receive attention, these practices may continue for several years because many systems have funds set aside for improvements which (in some cases) may be diverted for rate subsidization.

Some utilities have created rate stabilization funds that technically exist to smooth rate increases over a long-term period. While Standard & Poors' generally prefers that rates be regularly set to provide sufficient funds to meet current obligations, such funds can be credit strengths when used appropriately. Whereas the use of capital and other funds for avoiding needed rate increases detracts from the utility's long-term stability, the use of specifically designated rate stabilization funds (generally resulting from surplus moneys) to reduce (but not eliminate) an atypically large rate increase, may benefit a utility. For example, although Boston Water and Sewer Commission will need to continue to raise rates following 8.9% increases at the beginning of both 2002 and 2003 and an additional 3.9% in April 2003, it will use over $20 million of an available $47 million in stabilization funds going forward to keep increases manageable. If the rate stabilization fund use is not a recurring reliance and it gives the utility more credibility in achieving needed rate increases going forward, this practice can be credit strength. It should be noted, however, that rate makers may use rate stabilization funds for political convenience, and the temptation to rely on further subsidization from the fund to meet ongoing expenditure pressures may be great. Even with a fund specifically designated for rate stabilization and funded from surplus moneys, this practice would be considered a credit risk as one-time funds were being used to temporarily meet a long-term expenditure. Without an identified long-term revenue source to make up for the rate subsidization in the following year, the utility's financial structure would be positioned to weaken consistently going forward. S&P stresses the importance of rates producing current revenues to meet current obligations for this reason.

When future financial needs are known, multi-year rate approvals are another tool to protect rate setting from outside influence. If rates are regularly adjusted, then incremental increases should be smaller and thus easier to approve—even as a whole. Approving rates for multiple years at a time often allows a utility to lock in funding for the entire cost of a needed improvement with one effort, rather than having to re-explain the reasons for the project each time a new phase of the rate increase is needed. While statutes and oversight provisions limit this ability in some states, even internal policies or agreements in principle can help build and maintain support for needed increases through politically sensitive periods.

Rate Transparency

Ratepayers will often accept rate increases when they are manageable, but understanding the reasons for needed rate increases becomes more important when larger increases are necessary. While good communication with ratepayers and all stakeholders is generally the best prescription for transparency, many utilities structure their rate setting policies so as to ensure a certain level of transparency. Many local water utilities purchase most if not all of their water pre-treated from another water utility on a wholesale basis. These distribution utilities generally face fewer regulatory burdens and water purchases from the wholesaler may constitute the vast majority of its expenses. Policies which automatically pass through any wholesale rate increases to retail customers allow ratepayers to equate their rate increases with the timing of the wholesale increases, thus creating better understanding.

By communicating the frequency and degree to which retail increases result from wholesale increases, the retail provider may enjoy better support for non-wholesale related increases when the need arises. While insulating retail customers from wholesale increases may be politically popular in the short term, it can have devastating consequences for the long term if an additional long-term savings or another funding source cannot be identified to meet this expenditure pressure.

Anaheim, California takes cost transparency one step further by breaking its water charge into a base charge and a commodity charge, which includes the cost of purchased water and the cost of electricity. Ratepayers can therefore better understand the degree to which their rates are influenced by short- or long-term factors. The use of a base charge can also be a credit strength in that funds anticipated for debt service payments are subject only to fluctuations in the number of customers—not to fluctuations in consumption.

While many utilities focus on the transparency of cost pressures because they most often drive the need for rate increases, the transparency of benefits should not be neglected. Occasionally rate increases are needed for improvements that lead to observable benefits in quality (such as removing taste and odor), but customers may be unaware of the relative benefits they are receiving. Cincinnati, Ohio's water utility has benefited greatly from its reputation for high-quality water. Over time, the utility has grown its service area as neighboring residents actively sought access to this resource. The demand from residents in northern Kentucky was such that the area utility actually chose to tunnel underneath the Ohio River to hook up to the Cincinnati system rather than developing its own treatment systems (cost played a role as well). Such public recognition makes for good relations not only with new customers who have not always enjoyed access to Cincinnati's water, but also with lifelong customers. To date, the city council has never failed to approve a rate increase proposed by the utility.

For those utilities whose water quality may not differ substantially from its neighbors, other performance measures are often used, including rate increases vs. inflation, cost increases vs. inflation, total employees, total customers per employee, and a variety of other services delivered vs. cost measures. Although such measures must often be explained and clarified when system changes occur, encouraging ratepayers to focus on the marginal or relative benefits they receive is helpful in looking beyond a long-term trend of rising rates.

Long Range Planning

Policies encouraging rate stability and transparency over the short- and medium-term horizons may be implemented with some success, but they are likely to prove insufficient without some focus on relating the system's current status to its long-term needs. True rate stability and transparency assumes that a system's current and likely future needs have been measured and are relatively known. The average increase in rates to be targeted over the next decade cannot be known without some idea of the cost pressures a utility may face, and without an honest effort to estimate these needs, it will be extremely difficult to educate and inform ratepayers. Cost pressures to be estimated include those for operations, replacement, regulatory compliance, and accommodating additional growth. The nature of these cost increases should be considered (i.e. whether they are ongoing or likely to be diminished over time) along with their magnitude. Opportunities for savings should also be considered, which could result from technological improvements or administrative restructuring. The components of the revenue stream should also be examined. How much revenue is coming from connection fees and other one-time sources, and how this relates to current and expected growth trends is especially important. If the utility relies on a single commercial or industrial customer, the likelihood of that entity maintaining its current presence in the service area over the next ten to twenty years should be considered, as well as how reliant the utility wants to be on this assumption.

Many utility officials site the impossibility of correctly estimating future economic development trends, regulatory outcomes, and the long-term patterns of various cost pressures. As such, they claim that trying to measure them actually represents a poor use of limited resources, especially for smaller systems that lack the staff or funds for consultants to devote to such studies. While most of these drivers are indeed highly uncertain, Standard & Poors' views a refusal to consider the potential burden of pressures beyond the short to medium term to be a credit risk. Accordingly, even small utilities that have attempted to examine long-term risks and possibilities in limited ways consistent with their resources and capabilities will likely find their rate projections and capital plans more accepted by S&P.

Conclusion

Municipal Water and Sewer utilities are forced to address a variety of short-term and long-term pressures on a regular basis. While a system's current financial status is of some importance to the utility's credit rating, its likely long-term health is the key driver. As the likelihood of significant additional capital needs increases, the current rate, financial, and debt pictures for a utility become less reliable as indicators of long-term credit quality in and of themselves. A utility's ability to implement policies and procedures which garner the support of ratepayers for the additional revenues required to support these needs will become more important to the rating. Such policies should encourage both rate stability and transparency, and should minimize the likelihood of political influence that sacrifices the utility's long-term health for temporary rate freezes. While the exact nature of the future challenges and demands on a utility is impossible to forecast, early efforts to plan for long-term pressures will allow the utility to address the needs over a longer time horizon and in a more manageable way that benefits both ratepayers and bondholders.

For more information, please contact:

James Wiemken, Director
Standard & Poors Credit Market Services
One Prudential Plaza
130 East Randolph St., Suite 2900
Chicago, IL 60601
312.233.7005 Tel
312.233.7051 Fax
james_wiemken@sandp.com