HMC COMMUNITY MEETING

WATER SYSTEM UPGRADE

February 26, 2011

<u>Introduction</u>

The HMC Water System upgrade is the subject of a pending Ballot measure currently before the membership. HMC members assembled at the Community Center on February 26, 2011 to discuss the project and have their questions addressed. The meeting was started after the ferry shuttle brought all HMC Members who were coming to the Island to attend the meeting.

It was announced that the meeting would be tape recorded for those who prefer an audio version of the proceedings. The audio will be available on a CD. This request was made by Linda Moren and no objections were made to this request. Steve Chapin suggested that members contact Linda for a copy of the CD. The meeting was also transcribed by Janet Podell. **Please note**: This transcript is condensed to reflect the questions and answers expressed as closely as possible. It is not intended to be verbatim, but to provide a written record as best as is feasibly possible. This transcript will be migrated to the HMC website within a week. Steve Chapin also suggested that the audience members take their own notes to communicate to the friends and neighbors who were not able to attend, but who call with questions.

The Water Project Committee (WPC) Chairman, Mr. Steve Chapin presided over the meeting and introduced the panel Members and HMC Representatives.

- Claudia Ellsworth (Island Manager)
- Jester Purtteman, E.I.T. (NW Water Systems Consulting Engineer)
- Water Project Committee Members (Steve Chapin, Kathy Deuster, Judy Greinke, Allen Moren, Mike Davis (absent), Claudia Ellsworth)
- Gary Wanzong (Board Member, Asst. Treasurer)
- Janet Podell (Board Member, Scribe)

The issue:

Retention or Release of the HMC Water System and the applicable financing options available to the members.

Legend: Q = Question, A = Answer, C = Comment

Q: Jim Davies asked for clarification about how we would pay H&R Waterworks back.

A: Jester Purtteman explained that H&R is a privately owned water system and is UTC regulated. H&R would take out a loan to construct the upgrade and charge members a surcharge of about $45/mo over the course of the financing. They will go through the Utilities Trade Commission (UTC) for approval to charge members to recover their capital costs.

Q: Linda Moren - What would happen if we blow a well or a pump. Who would be responsible for replacement? (If H&R owns the system.)

A: H&R would be responsible for replacement, as they would own the system.

Q: Dallas Amidon researched H&R online and expressed concern about H&R's ability to fund the project. He felt they should publish a financial statement.

A: Jester Purtteman stated he will request a financial statement from them. He added that they are a well run and healthy company and he does not see a problem.

Q: Frank VanRavenswaay: Is a one-time payment permitted if we choose the H&R solution?

A: Jester Purtteman: Yes, that is an option in their proposal.

Q: Merry Kogut : - if we retain ownership will there be a charge for our water usage? She stated it's been "free" to us in the past.

A: Judy Greinke stated that there will be a charge for running and maintaining the water system. This will be done separately. Those costs will no longer be included in our regular assessment as they are now. The cost will be approximately $20/mo. She added that it has not been free to the membership in the past. Water costs were covered as a line item in our annual assessments. $153 is the estimated amount of the current cost of water in the annual assessments. And yes, there will be a charge for members' actual water usage.

Q: Alan DeGood: Can we get a Dun & Bradstreet report on H&R?

A: They are a privately held company and are not obligated to provide their financials but we will ask. (Following this question Mark Anderson was able to secure a copy of their D&B Report on line. This was printed and made available to any members who were interested in viewing the report.)

Q: Alan DeGood: Will our regular assessment be decreased if water costs are deleted from the current assessment. $20/mo seems low based on his personal experience with small water systems.

A: Jester Putterman: Yes. HMC regular assessment will be probably be decreased by the amount designated to water last year. (Estimated at $153) The proposed estimated water budget for 2011/2012 is covered by about $20 a month per connection. The financing charges would be about $25 per month per financed connection. In accordance with UTC requirements H&R will be able to recover the cost of capital based on the final value of the Water System (Anticipated to be about 9%) which is a requirement by UTC regulation. He went on to describe "Full cost pricing" which means total replacement cost and cost of repairs and maintenance which will need to become part of the HMC budget. He strongly recommends that we project our full lifecycle costs appropriately.

C: Jester Purtteman: He called many owners of water systems in the state seeking to solicit interest in the HMC water system in an effort to find a corporation that might be willing to upgrade and own our system.

Q: Tracy Anspach: If we retain ownership will we be paying any one else to run our water system?

A: Gary Wanzong: Yes. All water costs will be separated by the creation of a separate HMC Water Utility. Washington Water will continue to manage our water system and all water related charges will be charged to the Water Utility except the financing that will be kept separate within our Water Utility accounting system. Up until now all costs have been paid from the General Fund.

Q: Pat Zazzo: Is there an expiration date on our USDA application?

A: Steve Chapin and Claudia Ellsworth: No. Our application is in and we are waiting for formal approval. They have completed all HMC reviews and the USDA is waiting for our decision on whether or not to proceed following the results of the membership vote. The only reason we would miss the funding is if someone else's water system fails and they need to move us down the line.

Q: Allen Moren: If that were to happen would they put us in line for the next funding cycle? This would mean another year down the road. That is their history. The application stays viable.

A: Claudia: Yes. Another issue, this is the time to pursue this loan because the government may choose to reduce the amount of the funds available for loans such as this in the future. The interest rate is at 3.375% right now and it is not going to get much lower. Update: USDA is currently attempting to fund as many programs as possible. If the current Federal Budget does not pass, or cuts are made in the USDA budget, funding may disappear. They are estimating that the 2012 budget will have USDA cuts built in. Our best opportunity is to secure this funding this year, and quickly.

Q: Pat Zazzo – Did we shop around for the commercial loan?

A: Judy Greinke: Three years ago we shopped for commercial financing from Bank of America, Venture Bank, and Key Bank. Most recently Key Bank approached us with a proposal to fund our loan obligation as our interim financing company if we go through USDA or commercial financing if the vote goes the other way. If the vote is to retain ownership with private financing, we will again send out a Request for Proposal to other banks to secure the best loan for HMC. Steve Chapin stated that it is important to find a local commercial bank to fund our construction per his discussions with Island member Robert Hayman. Allen Moren reminded us that this is not a traditional loan scenario.

Q: Pat Zazzo – What about payoff in advance? Can we decide to pay our balance mid-way through the life of the loan? (Such as paying it off to sell their property.) Would members be liable for all of the interest for the total of the loan?

A: Judy Greinke: You don't have to clear your financed payment option balance to sell your property. The new buyer would pick that up in the same way assessments are assumed.
Gary Wanzong reminded members that if we retain ownership, HMC would be the ones assuming the loan obligation, and not the individual members. The total infrastructure does not change if one member chooses to pay off their obligation sooner. Because HMC is liable for the interest over the length of the loan, we may require full payment of principal and interest if early payoff is requested. At this time, the finance committee is looking into other loan scenarios for members choosing the financing option and later decide to pay off their balance early.

Q: Dana Gruber – Do we have the option to pay off our portion of the capital costs? And would that reduce the total amount of the loan we have to secure?

A: Yes and yes.

Q: Linda Moren – If we choose to pay cash for the construction what will our liability be for the decline in membership assessments? In other words, would we ever be liable for other members' portion of the capital costs?

A: Judy Greinke**:** No. A recordable document will be provided to all members who pay off their share up front. Mark Anderson addressed the subject about delinquencies and the issue of how it would affect our assessments remains under discussion. That is an open issue; the details of which will be explored later.

Q: Dallas Amidon –If H&R ends up with the system as a result of a vote to release the system, can they lien a member's property? And if the member becomes delinquent will H&R be able to foreclose on the property?

A: Jester Purtteman: No. That is UTC regulated. H&R will not have the right to lien a member's property. If a member does not pay their water bill, they have the right to charge a fee (approx. $150), dig up their lines, and shut off water to their property; which then renders their property worthless. Reinstating water service would come with a high fee.

Q: General Question: Would H&R become a voting member?

A: Jester Purtteman: No. The UTC would not allow H&R to foreclose on a members' property giving them membership voting rights.

C: Tracy Anspach: If a member is delinquent (and we own the water system) we would still retain the right to lien and foreclose on a member's property.

Q: Pat Zazzo – Question about amortization over the life of the loan and when members will know the amount owed for the cost of construction.

A: Judy Greinke: At this point all numbers are estimates. We will have a full cost figure at the end of construction that will then be divided by the number of connections. We don't have a definite timeline, but according to our current timeline, that will not be until Dec. 2011 or, Jan. or Feb. 2012.

Q: Pat Zazzo: In the example water bill posted online, there is a proposed budget for legal services. Why is it only $1000? Shouldn't it be higher? Are the Fees & Permits a repeating expense?

A: Gary Wanzong: This budget was established for forming the water utility only. At this time we cannot predict what legal costs may be when the system is complete and running . An additional comment was made by Claudia Ellsworth that legal fees for the construction, etc., will be included in the total capital cost. Fees & permits will repeat based on County requirements.

Q: Pat Zazzo: Back to the legal question, is there liability in the event of a disastrous event, do we need more legal coverage?

A: No, we have insurance to cover those contingencies.

Q: Steve Drury – Have we considered underground power?

A: Dana Gruber says she recently communicated with Pen Light and they said no. Because Herron Island is such a small customer (not even 1000 homes), we would have to pay them to put our electric lines underground.

Q: Frank VanRavenswaay: Shouldn't we trench for underground electrical while our roads are torn up? Allen Moren addressed past discussions with Pen Light on this subject.

A: Jester Purtteman: One of the big challenges is getting fill material to the island and to add electrical conduit would require us to go another foot further down which is a huge cost addition to our project. It was not included in any proposal received to date.

C: Alan DeGood – What about the water rights? If we go to H&R we would be selling our water rights.
C. Steve Chapin then addressed the value of our water rights. In communities like ours there is a prevailing philosophy that "water is the new oil". And it will most likely become increasingly more valuable.

C: Jack Wells – H&R is a for-profit company. HMC would have no control over increasing costs.

Q: Frank VanRavenswaay – Regarding our water rights, do we own the aquifer?

A: Jester Purtteman: Water rights and ownership are very different entities. The Dept. of Ecology assigns all water rights. The age of HMC's water rights is the critical driver. We have rights dating back to the 1950's. The State of Washington technically owns the water but we will never lose those rights. Plus we are at the bottom of the watershed and you want to be as far downhill as possible.

Q: Bettilyn Clingman To Jester - How neutral are you?

A: Jester Purtteman: Jester stated that he is a consulting engineer. His company's business is water. He has no personal stake in the outcome of this effort. He strongly advises us to make our decision based on facts. There are strong benefits and arguments on both side of the equation.

C: Jester Purtteman: H&R gave us a good proposal. And the USDA option is a good one too.

Q: Allen Moren: If not enough members (264) vote to release the system then we automatically retain it right?

A: Gary Wanzong: Yes

There followed some discussion about the age of our wells. Jester stated that wells typically last about 100 years. And 70 years is typical lifecycle for a distribution system. But it is extremely important that we fund reserves for future needs.

Q: Jim Davies: What would happen if our wells go out and we have retained the system. Who pays?

A: Jester Purtteman: HMC would be responsible, however the pipes in the ground are the main cost structure of our system. Wells typically last about 100 years. USDA will require a capital reserve funds to account for that contingency. This will be built into our reserves and because of the long lifecycle of these assets, we would have a long time to build up the reserves.

Q: Shirley Wilks : If we go with USDA will they impose their rules and regulations? And how will the reserves be charged? Will reserve funds be included in our water bills or will it be an additional assessment?

A: It will be included in our water bills.

C: Jester Purtteman: It would be lunacy not to put away sufficient reserve funds for repair.

Q: Debbie Kraft – If our water system were ever to become profitable will it be treated like a Co-op?

A: Gary Wanzong: HMC will own the water system and we are all members. HMC is a non-profit organization and any "profits" would most likely go back to the reserves. The intent is to come as close as possible to billing for true costs, and not to make more or lose money.

Q: Linda Moren: Can the Board pull money out of our water reserves to pay for other things?

A: Claudia Ellsworth: Our water utility will be subject to a separate audit. Utilities are subject to State and federal regulation and we're not allowed to misuse the funds.

Q. Linda Moren: Will the water utility have its own Board of Directors?

A: Claudia Ellsworth: In the absence of a change in the Bylaws, The HMC Board of Directors is the only corporate authority for the association. Mark Anderson concurred with that statement.

Q: Frank VanRavenswaay: Can we write a Bylaw change that prohibits us from moving money from water reserves for any other purpose?

A: Mark Anderson: It could be written that way when the Water Utility is established.

C: Mark Anderson suggested that the Board could also grow in number to include more members. We will look at the bylaws to determine what it would take.

Q: Paul Bray: Is there a requirement for a Back flow Preventer?

A: Jester Purtteman: Back flow preventers are only required for swimming pools, in ground sprinkler systems, hot tubs, etc.

Q: Paul Bray: Is there enough residual pressure in the hydrants to prevent back flow concerns?

A: Jester Purtteman: Yes, the system will be designed and constructed to accommodate this.

Q: Paul Bray: Can individual members have back flow prevention installed during construction?

A: Jester Purtteman: A line item could be added to the final proposal to accommodate individual member requests but the member would have to pay for that separately. At this point it is a gray area. Members could coordinate such a request through Claudia Ellsworth.

Q: Alan DeGood – To Jester - Does his company work with private bonds?

A: Jester Purtteman: He has not worked with corporate bonds and the HMC corporate system does not allow for that.

Q: Merry Kogut: Will the members have the opportunity to see the construction RFP before it goes out?

A: Steve Chapin: The information will be available at the office and on the web at www.herronisland.org. (All documents are always available at the office.)

Q: Merry Kogut: Will there be another company hired to provide oversight of the construction?

A: Steve Chapin & Gary Wanzong: Yes. An Engineering firm will be hired to oversee the construction.

Q: Merry Kogut: Will the system have guarantees for water pressure?

A: Jester Purtteman: There will be a minimum of 20 psi at the lowest point of the island during fire flow. Under normal operations minimum pressure will remain above 30 psi.

A: Claudia Ellsworth: The USDA will have oversight of our RFP and our other contractual documents including necessary guarantees. If we opt for commercial financing, the chosen bank will probably require similar oversight.

C: Claudia Ellsworth: The environmental piece of this project will require significant oversight of the construction.

Q: Linda Moren: Who chooses the contractor? Will the government choose in the case of the USDA loan?

A: Claudia Ellsworth: No: We choose the contractor but the government must approve our choice. USDA would be involved in our selection process.

Q: Larry Eccles – What is the fee on the VISA card if we choose to prepay by credit card?

A: Claudia Ellsworth: We'll have to find out and get back to you. (Following the meeting we identified the VISA card fee as 3%.)

Q: Nancy Broeghe: Where is the 3rd financing choice that was mentioned?

A: Steve explained that the 3rd choice is not a financing issue. The "third choice" mentioned earlier is the option of paying "up front" regardless of the ballot outcome. On the ballot however, each member needs to decide to vote to retain or release ownership and then, if the community votes to retain ownership, which financing option you prefer even if you decide to pay up front.

A: Mark Anderson explained that this is really a decision tree. First decision is whether we will keep or release the system. If we retain: do you want to prepay or pay it over 40 years? We still need your input on how you would like to pay over time or pay it up front.
Frank VanRavenswaay suggested that if we would have added a statement that H&R would be financing the whole project the issue would be clearer. Mark suggested that Frank VanRavenswaay write some language for publication on the website to clarify the issue.

Q: Gayle Herman: The Ballot describes a requirement for a vote of 2/3rds of the total membership required to release the system. Has that ever happened?

A: No

Q: Gayle Herman: The ballot states that the Board still reserves the right to abandon the transfer even if enough votes are received. Is this true?

A: Claudia Ellsworth: If the vote is to transfer, HMC would have to negotiate with H&R for an acceptable contract. If negotiations don't work out, HMC needs to retain the right to walk away. This provision of State law gives us negotiating leverage.

A: Judy Greinke: The Board has that veto right for the protection of all HMC members. If transfer of ownership of our water system asset occurs, we must be able to guarantee the quality of service and that all requirements will be met to our satisfaction. This will come through negotiations with H&R.

Q: Linda Moren: Have we picked a date that we would stop waiting for the government loan to pass and just go to Key Bank? If we do not get the government loan do we have to vote again?

A: Claudia Ellsworth: That would be up to the Board. Gary Wanzong: As soon as Congress's budget passes we will know. We currently hold a very high position in line for the USDA loan. Either way we would have to explore all of our options if that situation were to occur.

C: Dallas Amidon: From his perspective time is of the essence and this is the most opportune time to proceed with this project. (Both from construction and financing standpoints) To procrastinate further would do none of us any good.

Q: Linda Moren: Can we ask Dallas his opinion on "payback" options and if it would affect our property or the sale of our properties in the future.

A: Dallas Amidon: Properties that are not often used are a primary concern. When you add the cost of the capital bill on properties that have low value, it may have a negative effect. Only time will tell. Real estate sales have been very slow on the island, so it would be advisable for those members who have the resources to pay up front.

C: Mark Anderson: HMC can provide a formula that identifies any payoff information. See example below:

For a $6,000 loan at 4% interest amortized over 40 years, another $6,000 in interest will have accrued over the 40-year life of that loan. The total cost to each Member who chooses to pay over time would thus be $12,000 ($6,000 for the connection share and $6,000 for the interest). If a Member pays up front, the Member would pay a total of $6,000 and HMC would not have to include this in the amount to be financed. On the other hand, if the Member decides initially to pay for the capital cost over the life of HMC's loan, the Member would be obligated to pay a total of $12,000 over the life of the loan, with payments equally spread out over the 40 year life of the loan. If this Member decides to pay off the Member's balance somewhere after the loan repayment period begins, that Member would be responsible to pay the outstanding balance of that Member's principal (out of the $6,000) plus the interest that would have accrued over the remainder of the 40 years, adjusted downwards for any resulting reduction in the length of the loan (by paying down the principal, the loan would be paid off earlier). To calculate these components (like the interest remaining), we would use a standard amortization calculation and break it down from there. This approach would be the equivalent of HMC giving a Member a $12,000 interest free loan to be repaid over 40 years.

Significant discussion followed on if, why, and how much interest a member would be liable for regardless of what point at which they choose to pay off their obligation. It's important to remember that individual members will not be taking out the loan. They will not be the borrower(s) of record. The Association will be the borrower with the sole obligation to repay according to the terms of the loan.