



HMC MANAGEMENT

Replacement and Upgrade: Project Funded by USDA Federal Stimulus Funds

Members' Questions & Answers As of March 18, 2010

Through September 2010, the USDA Community Facilities loan program has funds available from the American Recovery and Reinvestment Act ("Stimulus") for the purposes of improving or constructing water systems. HMC had previously considered USDA funds as a source to finance water system replacement in 2007. The current loan terms are an improvement over the earlier ones.

At its December 2009 meeting, the Board of Directors authorized the Island Manager to gather information necessary to apply. The Herron Island Water System qualifies for the USDA funds, and the several necessary application materials are being submitted so that any necessary information can be generated for USDA in a timely manner.

The following are questions and answers submitted by members of the WPC and membership at large. Questions and answers have been reviewed and approved by USDA for accuracy.

As additional questions come in, we will respond to them and add them to this web site.

Tell Us about the Loan?

1. To what government agency are we applying?

US Department of Agriculture, Rural Development

2. What are the terms of the loan?

A maximum rate of 4.25% (**3.25% as of February 23, 2010**) over the 40 year term of the loan; no prepayment penalty. This means that the loan can be paid off early or extra funds paid at any time to reduce the principal balance. Interest accrues once the interim financing is closed and loan documents signed. **HMC must remain owner of the system for the term of financing and loan repayment.**

For comparison purposes, we sought a quote from KeyBank regarding commercial lending availability. KeyBank is the Island's bank. The commercial lending department estimated that they would be able to provide a loan of up to \$3,000,000 for a 20-year term, at 6.35% interest. The loan would need to be renewed every five years.

3. Is the loan with the HMC or individual property owners? It is with HMC.
4. What, if any, collateral is required?

USDA will take a lien against some HMC properties. Their goal, however, in the unlikely event of default, would be to find some method by which we can repay the loan. They are not interested in owning land on Herron Island. Their last ditch effort would be to find someone to take over the system and assume the debt.

4.a. March 16 Question: (re: collateral) - "USDA will take a lien against some HMC properties?" -
~~Our understanding from USDA is that they would lien our water system assets. As the rest of the~~

paragraph says, in the unlikely event of default, they would foreclose on the water system, but only after exploring all alternatives to avoid doing so.

March 15 Question: Is it not a fact: Our entire water system will be "owned" by the US Gov't for 40 years??

Am I wrong in seeing it that way? Will they not "OWN" our water for the duration of the loan (40 yrs) - **until every last dollar is paid-in-full?** **Not to mention all the future water requirements which will no doubt have to be put in place & wouldn't we have to comply since "They" would be the "Owners".....??**

From a layperson's perspective, it could appear that the USDA option would result in the government "owning" the water system. This is similar to the belief held by many people that the banks own their homes when they have a mortgage.

From a legal perspective, however, while the USDA will likely require that they be given a security interest in property owned by HMC Management (including the water system), the USDA will not own that property. HMC Members will continue to own the water system, but the water system would effectively be used as collateral to secure repayment of the USDA loan, just as it could with any loan used to develop the system. As such, we would not be conveying away any part of the water system. (Mark Anderson, Board Member)

5. Will USDA fund our startup and application costs?

Yes. Certain costs associated with filing a complete application can be folded into the loan amount, such as the engineering fees required to give us a better budget estimate, environmental evaluation assistance, rate studies, and so on. To date, no HMC funds have been expended.

6. What funds are available at the beginning of the project?

HMC maintains water system reserves, currently at about \$52,000. Also, USDA can assist us in obtaining interim financing with a local bank, most likely KeyBank, which is the island's bank. The interim loan and interest would be repaid on final USDA loan approval, and folded into the USDA loan.

7. What would be the method of loan payback?

That is yet to be decided by the Board and/or members. Methods include collection via assessment, or folding capital costs into a monthly water bill. Current State law requires water metering by January 2017. USDA/RD would take an interest in real property owned by HMC, but a promissory note and assignment of income from the water revenues is really what will repay the loan. The estimated amount per assessable unit, per month, would be \$22-\$30.

March 16 Question: "" - "USDA would take an interest in 'real property?' **Same thing as under 4, above. We should probably correct that language, as noted. Thanks.**

What is HMC's "real property" - specifically? **HMC's real property consists of all properties in the ownership of the membership, including the parks, ferry docks, North Beach marina, community building, various lots, mainland parking lot, rights of way and so on.**

8. What happens if individuals default?

If individuals default on obligations to HMC, delinquency procedures apply.

March 16 Question: (re: defaults) "...delinquency procedures apply?" If the method of debt repayment is by assessment, then standard assessment delinquency procedures would apply.

Will good-standing members be financially responsible for the delinquencies while the account(s) are in the long process of being settled? HMC (all members) would be responsible for repayment of the debt to USDA. Presumably the method of repayment would include a small reserve for delinquencies, so that there are funds available to service the debt as scheduled. Reserves unused at the end of a year might be factored into future assessments or used to prepay principal.

9. Does HMC Management have to have 10% (or any amount) of the loan value in reserve to qualify?

No. USDA/RD wants us to have a reserve of 25% of our annual O&M costs as reflected in our 2010 budget. Note that this is not a reserve of the capital construction budget. Our 2009-2010 budget for Water Operations & Maintenance is \$25,658 (excluding the amount budgeted for the water reserve fund). Current Water Reserves total \$51,922.74, as of December 31, 2009. RD would also like the system to have a 10% of the loan debt per year set aside for capital improvements.

March 16 Question: "RD would like to have 10% of the loan debt per year "set aside" for capital improvements. Our understanding is that these funds would "accumulate" based on the amount borrowed. The loan is essentially a construction line of credit, and so is drawn down as used, rather than "borrowed" in full at the outset of the project. Repayment begins six months after completion of the project.

This is a very large amount of money. Does HMC have the reserve dollars for this additional amount - each year. Or will there be a "special assessment" for these monies? We don't thoroughly understand this question. I hope that the foregoing clarifies that interest is not accruing on the full amount (perhaps \$2.5 million) from the outset. The amount would accrue over time, as with other reserves.

What capital improvements are likely? The reserve is a hedge against the unforeseen. Like any lender of large amounts, USDA wants to be sure that the property is well maintained during the period of debt repayment. Also, we recently financed a major capital improvement with the installation of our new water tank. This is not likely to need replacing for a very long time.

In a February 3, 2010 email, Bruce Whittle, USDA, stated "The 10% refers to the payment per year...this is the reserve account which can be used by the water system for capital repairs, once you have reached one year's payment (over a 10-year period), then (there is) no further requirement for a reserve....unless you use the reserve account for capital improvements, then you would have to start the deposits over again. If you have a reserve capital fund, then you can use that as your reserve account."

10. When do we begin to pay back the USDA loan?

HMC's repayment begins six months after completion of the project. Member obligations would be repaid on a schedule to be determined after review by the Board and membership.

11. What specific project requirements are tied to this government loan? The specifics are tied to the water system, all persons should be able to hook on (no discrimination).

12. Will the construction project cost more with government financing?

No, it should not. Other large utilities also pay prevailing wages to construction workers, and right now the bidding climate is in our favor. As a smaller agency, we probably have less overhead expense than a larger utility would need to recapture.

13. What would the project timeline be with this loan?

40 years, with no prepayment penalty.

14. Are funds available at the start of the project? Or will we require some type of bridge loan?

Interim financing will be arranged with a local bank, with USDA assistance.

15. Who is our contact? Bruce Whittle, USDA Washington

What are the Schedules and Deadlines?

1. What is the final date we need to submit the application by?

No later than September 30, 2010. Best is AS SOON AS POSSIBLE, because some time is required for final review in the other Washington (30-45 days). USDA/RD has stimulus funds but they will expire 9/30/2010 and so *as soon as possible* for obligating funds. After obligation we would go to bid, then award contract, then set up a time to start and finish and have the contractor start work.

2. Is there an advantage to applying early?

Yes, to get funds committed.

3. How long does the application take to complete?

The preliminary application is complete. We are now in the review phase. We will need preliminary design sometime during the application, final design can be done after obligation of funds. Final design is needed for contractors to bid.

4. What should our deadline be for starting the application process? Today. (Preliminary application was submitted January 28, 2010.)

5. After submitting our application, how long before we are notified of the result?

USDA works with us throughout the approval process to refine our application and answer any areas needing clarification.

6. If our application is approved, how long before funds are available?

Funds are available; Congress approved the American Recovery and Reinvestment Act in early 2009. These funds must be allocated by September 30, 2010.

What Does It Cost to Apply?

1. What is the application fee?

There is no fee for application.

2. What will it cost to pay a consultant to complete the application and submit?

We can complete most of the application, with some assistance from an engineering firm. USDA will advise us when we may need assistance from an engineering firm to support our application or refine construction estimates.

3. Are there any additional costs associated with this process?

Not until we begin the detailed design process with our selected water engineering firm.

4. Are any of these expenses refundable if we are rejected or withdraw? No.

Here Are Some Other Considerations...

1. If we require a consultant to complete our application, what qualifications should they have?
Qualified engineering firm, with background in water project engineering.

2. How many consultants should we consider? **This will depend on the amount and scope of work to be done.**

3. What criteria will be used to make this selection? Scope, References, Qualifications and Cost.

4. Who will make the decision? (The Board? The Island Manager? The WPC?) The Board.

5. How much money should be spent before a community vote is appropriate?

Enough to secure good, objective information for the members.

6. Does the timing allow for an "Advisory vote" on direction before spending money? **This vote is scheduled to occur, asking for member approval of system replacement/upgrade, and the use of current reserve funds to begin the process.**

7. Will this loan have any effect on Island insurance rates, bonding or ability to borrow in the future?

Yes. Should positively affect fire insurance rates for future; may impact ability to borrow money from other than government sources for duration of loan. HMC has no other plans to borrow, and is building reserves annually for major projects, such as the dolphin improvements.

Please contact the Island Manager at hmcmanager@herronisland.org if you have any additional questions or concerns.

Future Maintenance and Operation

Options have been put forward about future system operation and maintenance. The Herron Island Water System has abundant water of good quality. The system's operations and maintenance are in compliance with State law, and resources for quick response to problems are generally available on the Island, under our current service arrangement.

Hopefully, a water system upgrade will result in fewer leaks and reduce the large amount of water lost back into the system as a result of undetected leaks. Responsibilities for maintenance and operation of the system are business decisions that can be made by the Board at any time. A number of providers are available, including Pen Light and Washington Water, who would be interested in providing this service. At this time, however, the system is in compliance and we have water system support on the Island, so there is no apparent need to increase members' costs in this area by contracting off-island.