

SUMMARY OF MINUTES OF A FINANCE/BOND WORKSHOP HELD TUESDAY, OCTOBER 10, 2006, 2:00 P.M., ENERGY SERVICES CENTER.

Members Present: Chairman, Thomas K. Perona; Vice Chairman, Darrell Drummond; Secretary, Pamela K. Cully; Deputy Secretary, Robert W. Summerhays, Jr.

Others present: Director of Utilities; Director of Corporate Services; Director of Electric/Gas Systems; Director of Water/Wastewater Systems; Director of Shared Services; Internal Auditor/Risk Manager.

Chairman Perona called the meeting to order.

The invocation was given by Mr. Frank Varella

The Pledge of Allegiance was recited.

Mr. Thiess explained the purpose of this workshop is to have a primer on financing and bonds. We have our financial consultant and bond consultant here today to make the presentation.

Mr. Mitch Owens with RBC Capital Markets gave a power point presentation to the Board. He introduced Mr. Robert Freeman, bond counsel with the firm of Bryant, Miller and Olive, and Mr. Dwayne Draper, who will be giving the Board additional information. Mr. Owens told the Board they will be giving them a primer on the process of issuing debt, what the necessary steps are, and what happens as you continue to try to keep your name in front of the rating agencies, insurers and potential buyers of your debt in the future. The lower interest rate you pay over the life of the debt, the less expense it will be to you and your company.

The presentation will include an overview of the bond process, finance team, finance plan, refundings, bond ratings, bond documents, pricing and sale, and post-closing, and credit enhancement information.

*(Messrs. Owens, Freeman and Draper's presentation is attached to these Minutes and is not shown here in its entirety. A recorded tape of the entire meeting is retained in the Director of Utilities' office.)*

During the presentation, the following discussions ensued:

Mr. Draper said bond validation is a unique feature in Florida under Chapter 75. It allows you to validate the bonds in front of a Circuit Court Judge before the fact as opposed to having a situation where maybe a bondholder or the IRS comes after the fact to challenge the validity of the bonds and how the proceeds will be used. This is something that is elective relative to the Authority. It is not something that is done as standard fare. Sometimes if there is a controversial political or legal issue, we will advise it would be a good idea in conjunction with your general counsel. Mr. Perona asked if that is part of a marketing ploy to show the validity of the bonds before they go to market. Mr. Draper said it certainly doesn't hurt to have bonds validated. You will always receive an unqualified legal opinion from bond counsel in conjunction with a bond issue. That will speak for two issues: one is the validity of the bonds, themselves, and two, their tax exempt status. An unqualified legal opinion from bond counsel is an extremely high standard. It basically means there are no issues or potential issues, and from that standpoint there is a marketability. As long as you have that opinion, you are fine. Bond validation is, generally, not utilized unless it is needed, because there is a timing implication. Mr. Freeman said we have validated bonds in the past that were issued under the UA's basic resolution adopted in 1985, so the provisions of that resolution have been validated. An example of when it might be beneficial to have bonds validated is if you have controversy associated with a project. If you're going to build a new sewage treatment plant behind a big apartment complex, and the residents will raise the roof about it, that might be a time to have them validated in advance.

Mr. Drummond asked if the bond validation process would actually allow someone to go before the court and bring in issues, such as zoning for a particular project. Mr. Draper said what happens when notice goes out to the citizens, they are allowed to appear before the Judge and talk about why they think the bonds might not be valid. In a zoning issue, the argument might be whether it is collateral or not to proceed into the validity of the bonds. The opportunity is given to all the ratepayers to show up and make their case, and the Judge makes a decision. Mr. Freeman said his experience has been if somebody comes into a bond validation proceeding, they are almost always raising a political issue or a management issue. Case law in Florida states those issues are collateral. It is your responsibility to make those decisions.

Mr. Draper said for your purposes the Official Statement is a document that protects you from liability. You are obligated to tell the investors what they need to know in order to make an investment decision. That is material information. They need to understand about the bonds themselves, the source of security, which is typically net revenues of your system. They need to know how the Authority is doing in terms of its financial condition. Disclosure counsel works with UA staff to put together something that fulfills your obligations. It is a critical document. During the last ten or fifteen years we've seen a step-up in enforcement activities. There is a process of continuing disclosure that has been injected into the marketplace. The secondary market regime was implemented in 1995 and requires they be updated on an annual basis. If your rating is upgraded or downgraded, you have an obligation to tell the market.

Mr. Drummond told Mr. Draper he gets his attention very quickly when he suggests that they are now very comfortable coming back at local officials from a legal standpoint. The bond issue is based on some underlying assumptions from revenues based on growth projections and rates and things of this nature. Given that there is the possibility that some of those assumptions prove not to be true, and there is a need for increases in rates to maintain the ability to repay that debt from the bonds, we have signed off on this, and he is guessing we would be held accountable. But, we don't have the ability to raise rates, ultimately. Mr. Draper said one of the things we disclose in the offering document is there is a rate covenant, an underlying contractual obligation for the Authority to maintain rates. There is a two step process for raising those rates, the Authority and the City Council. Mr. Draper further stated we often engage an engineer and/or a financial feasibility consultant to append the report that helps show what is going to happen over the next five years in terms of your capital needs and where operating expenses are heading in terms of rate increases that have been implemented or need to be implemented. The rate increases are based upon assumptions, and those assumptions are disclosed to potential investors. We don't rely strictly on the Authority's staff in that case to tell us those are reasonable. That is why we hire financial feasibility consultants. You want to rely on professionals in situations like that. The FEC will appropriately allow you to rely on the financial feasibility consultant in a case like that. There are other pieces of information that the Authority is going to be absolutely responsible for. That might be historical information regarding revenues and expenses.

Mr. Draper said we have not talked about synthetic debt. Another way to talk about that is SWAP or SWAP documents. It is something we haven't been called upon to advise the Authority on in the past, because you haven't utilized SWAP or synthetic or hedge products to lower the cost of borrowing. It would lower your effective borrowing costs, but, on the other hand, they are a little more complicated and there are some intentment risks which need to be understood and managed. There are some administrative issues. The Authority is sophisticated enough to utilize this financing technique, but it is sometimes a balance of cost and benefits. His firm would be in a position to provide SWAP counsel to help negotiate, manage, and help the Authority and general counsel to understand the legal risks and

financial risks. Mrs. Cully asked how is your credit rating affected when you use this method. Mr. Owens said if it is done correctly, it doesn't have a negative effect on your credit rating. Sometimes it can have a positive effect, because you are eliminating certain types of debts and replacing it with a more fixed or finite debt. One thing you would look at would be your ability to handle the typical alternative or product you are using.

Mr. Drummond said given the volatility of the construction market, we are doing an estimate at the time we're issuing the bonds. By the time we actually go out to bid, where are we placing the ability to cover that construction cost should it rise significantly between bond issuance and actual letting of the bid for construction? Mr. Freeman said there is always a tension in terms of how you structure the sizing of your bond issue, the advertisement for construction bids, the receiving and evaluation of bids, and the actual issuance of the bonds. In some cases the sequence in which you do that may not be critical, but he thinks what he generally sees and what will probably become more and more critical in the construction market we're in today, is that if possible, the request for bid proposals has built in a big enough window to do a final bond sizing and allow you to market a bond issue, so that you've got a bond purchase contract signed before you actually sign the construction contract. That way you know you have sufficient bond proceeds to deal with the construction contract, at least if it's a not to exceed dollar amount. Mr. Drummond said we would actually do the bonding after we've gone through the bidding. Mr. Freeman said there are a number of different ways you could deal with that. You could look at the FMPA Pooled Loan as a way to grab additional money if you found you didn't have enough. You have identified an issue that is part of the finance plan.

Mr. Varella said your spend down requirements today from IRS are so strict that when you go out for planned money, you have to plan for two months to two years and use verbiage in your project to give you the flexibility to be able to spend that money down on any legitimate project, so you don't end up giving the federal government back money you don't want to give them. Mr. Drummond asked if there would be language in there that would have flexibility as to the project. Mr. Varella said yes. The way we can do that is by using terms like, "and other utility expansion projects" or "major rehabilitation projects." If we get close to the spend down requirement and we're not there, we can go back and justify it on some other recent expenditure as long as it fits within their window. Another way we do it --- maybe ten to fifteen years ago, it took three to five years to build a wastewater plant. Today it is taking us five to eight years to build one. You have to time your issues to match your spending, so you're not going to the bond market one time to do a project. You go a number of times. You have FMPA in the interim.

Mr. Owens said you want to put together enough mass when you issue debt for economy of scale. You don't want to be doing a \$5 million bond issues and paying all fees that are related, when you know next year you are going to need to issue \$20 million of debt for another project, so you use all alternative vehicles that are available to you, such as a bank loan, an FMPA loan, drawing out of your existing capital improvement program and reimbursing yourself.

Mr. Owens said he would like to talk about rate covenants. Before you can issue debt, you have to have a coverage factor. There is a need to annually review the implications of not being able to follow your rate consultant's suggestions and follow through with rate increases.

Mr. Freeman said the only security the bondholders, who are your lenders, have for repayment of their debt is the revenue stream that you generate from the sale of electric, water, sewer and gas. They are primarily concerned about what you are doing to make sure that revenue stream is going to be there. There are several components of that. You have to maintain a level of rates that gives your

bondholders some comfort, so you have a rate covenant stating you will set rates, fees and charges so that you get net revenues every year after taking out operating expenses, sufficient to make sure your reserve accounts are fully funded, to make sure your renewal and replacements for capital expenditures are fully funded, and so you have enough net revenues to cover your annual debt service by 125%. If you were only at 125%, he can assure you the rating agencies and bond insurers would not be happy. Mr. Owens said they do follow that. The lowest yours has ever been is around 175%. Mr. Freeman said the 125% is the minimum allowed. If you had \$10 million worth of debt out there right now, and \$1 million in annual debt service, you need to have at least 125%, but as far as the bond market is concerned, you really need 200%. If you put another \$10 million in debt on top of that, all those numbers are going to double. You can see how what you do with rates is joined at the hip with what your capital improvement plan looks like.

Mr. Summerhays asked if, for this purpose, net revenues means after the transfer to the City. Mr. Freeman said no. It is before the transfer to the City. Mr. Drummond said he thought the City got theirs off the top. Mr. Freeman said the City transfer, funding of the reserve account and renewal and replacement account has to be covered by 100%. The 125% of net revenues only applies to debt service. The way the resolution is structured, the debt service is the first thing you pay after you pay your operating expenses. As a practical matter, you are not going to pay the City and stiff your creditors. Everybody loses in that situation. Mr. Summerhays asked if there is a provision in our bonds that says the City doesn't get the transfer if we don't have sufficient cash flow. Mr. Freeman said the City is at the end of the flow of funds. Mr. Summerhays said the City is the lowest priority. Mr. Freeman said, right. Mr. Drummond said this is the case even though the transfer is calculated on gross receipts. Mr. Freeman said yes. Mr. Drummond said he doesn't think they know that.

Mr. Freeman said if you think about it from the lenders' standpoint and from the big picture point of view, if the City is down at the bottom of the sequence of who gets paid, that lets the bondholders know that they are in the most secure position they can be in. When the bondholders, rating agencies and insurance companies know they are in the most secure position, you are going to get the lowest interest rates. It's the way it ought to be, and it is the way virtually all the financings he has worked with are where you've got transfers to another governmental body.

Mr. Summerhays said just to clarify, our bond resolutions require 125% coverage, but the market says it better be 200% or we're not buying your bonds. Mr. Owens said he is not sure it is required to be 200%, but it better be more than 125%. They want the comfort of knowing you have enough cushion so that if something dramatic occurred and an emergency arose, you would still be well above your 125% coverage level. Mr. Summerhays asked if the rating agencies have a rule of thumb. Mr. Owens said they look at it individually, based on your size and location and other things. Mr. Varella said they want to make sure you have the cash flow to be able to support your operation.

Mr. Owens said when you go to the rating agencies to give a presentation, you don't want to say we're planning on doing this. They like to see a positive statement. What we have built into certain bond issues by certain bond issuers, is an annual cost of living increase in rates or a minimum annual increase. In this way, the ratepayers feel a small amount every year. If you fall behind in your rates, that is when you start getting into the catch up period. That is very, very difficult.

Mr. Freeman said there are some provisions in the bond resolution that don't need to be on your radar screen, but the provisions you need to be sensitive to have to do with preservation of the revenue stream. They show up in terms of maintaining books and records, annual audits, enforcing collection, cutting people off if they don't pay, trying not to have another competing utility show up and provide

service in your service area, adopting a budget every year, having a consulting engineer who oversees the system, limiting circumstances under which you will issue additional debt, employing a Director of Utilities and things of that nature. You really need to be aware of the covenant section of the bond resolution. You are saying to the bondholders, if you'll lend us money, we'll do everything within our power to make sure this revenue stream, which is going to be the source of repayment, stays in good shape.

Mr. Drummond said based on the rapid growth projection, would the bond counsel or the team have to demonstrate what plans in that five years we have done to be able to meet the growth? Our Capital Improvement Plan must demonstrate that we are attacking it. Mr. Draper said yes. Mr. Drummond said he is thinking if it is a requirement that we do that, it almost necessitates that we have to go into the market place in order to meet those capital improvements, which, then, necessitates that we must have a rate increase in order to do it. It is almost like we are driven to do it even if we didn't want to. Mr. Draper said that is right. You want to paint a picture of what is going to happen over the next five years to be able to preserve capacity, meet regulatory requirements, and keep up with growth. You have to show how you're going to do that, financially. The two issues there are possible needs for rate increases and possible needs to go back out into the market for debt. The five year big picture Mr. Drummond is alluding to is what we have to paint in the disclosure documents, so that potential investors and insurers and rating agencies will understand what they are buying. Mr. Varella said the way we've completed rate studies in the past is we have done multi-year studies, going out five years and when we take a resolution to the Board and the City Commission, there were step increases over the next several years so that all of that would be in place so when we did go before Wall Street and explain our stand, we would have the rates in place that would justify the expenditures that we were showing.

Mr. Summerhays asked if we have a restriction on asset sales. Mr. Draper said yes. Mr. Freeman said, essentially, what it says is if you have assets that aren't productive of net revenues, you can get rid of those, but if you have assets that are productive of net revenues, you can get rid of them if you get a certification that getting rid of them isn't going to hurt you, or you can get rid of them if you take the proceeds and get rid of the related debt.

Mr. Freeman said he knows there is a concern about the rate increases here. He would like to give an example of the other end of the spectrum. He cited a situation where one of the UA's sister cities in Florida decided they did not want to have any debt outstanding. There was a desire to be completely debt free at some point in the future. It wasn't too many months before representatives from the local Chamber of Commerce showed up at the utility, and said they were having a real hard time getting people to move there, because the rates are so high. Because they were trying to get to the point where they had no debt, the rates were so high that they could not compete in the marketplace for new business and relocations. In a sense, what you are doing when you finance and put rate increases into effect, you are creating a situation where the growth is going to finance the improvements to the utility system, because they are going to pay a share of those increased rates and increased obligation to pay that, otherwise, if you decided you were not going to expand, it would not be to the benefit of your current ratepayers at all. Because you are issuing debt, you have a rate covenant, so rates have to go up a little bit, but nothing like they would be if you were trying to run the system on a cash only basis.

Mr. Drummond said, ultimately, what Mr. Freeman is suggesting is there is no question there will be rate increases, it is just a matter of how large they will be. Mr. Freeman said yes. The question is are we just going to use rate increases to pay off what we've already got or are we going to finance

“roads” to bring people in here to help pay the bill. Ultimately, hopefully, we will all end up with a lower bill.

Mr. Perona said that is where we are right now. The UA hasn't raised rates in electric for ten years, and we are trying to hold hands with the City Commission as we try to do what our rate advisers have told us to do. When we leave the business arena of the utilities and go into the political arena, their issues are not based on rate covenants. They are based upon their elections and campaign programs and whether or not they're going to get elected. They assimilate the power adjustment we've had into the rate increase. They are throwing it all into the same sack and making decisions that can hamper our efforts to comply with good business practices according to our bond covenants and resolutions. He doesn't think anyone on the Board, today, has sat through a rate increase, and it is interesting that we are having to campaign to the political entities to make them aware of how important this is and how it fits into what the utilities is. What Mr. Freeman has said is by raising rates at a calculated pace a little bit at a time, essentially, saves you bigger dollars over a longer period of time. If you go into a cash position, you'd be looking at charging an enormous amount for services. It is good business procedure to go out and borrow money through the bond process and let growth pay for itself. If we don't keep our rates at a certain level, all of a sudden our ratings may be affected, because our cash position changes. It is all important that we keep these things maintained over a period of time, and we probably haven't. In the last couple of years this place has blown wide open with growth and we're having to gear up for it now and move everybody forward. You can't have the same mindset you had before.

Mr. Varella said in the late 80's and 90's we were actually experiencing decreases in our customer base. Our revenues were decreasing, therefore, we had to increase rates to keep up with the loss of revenues we were experiencing from homes and businesses closing. Then, all of a sudden in 2004, people discovered the jewel of the Treasure Coast, Fort Pierce, and things went ballistic. There was a ten to fifteen year period if growth wasn't going up from zero to one percent, we were actually losing customers.

Mr. Owens said you've created part of your own problem, because you've been so efficient management-wise. You have run the utility like a business and have created a mindset with elected officials that there is no need to raise rates, that you can continually do it through operational issues and standards or refinancing. You have done all that. There is only one solution now. Mr. Summerhays said in reality, the stagnation made it mandatory and easy. We had a net reduction in employees and on and on and on. Every penny got pinched until it was deformed. Unfortunately, growth costs a lot of money for any kind of business. That is what we are facing.

There being no further business, the meeting was adjourned.

ATTEST:

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Secretary

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Chairman