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PUBLIC UTILITY COMMISSION

RATEPAYERS APPEAL OF THE DECISION BY BEAR CREEK SPECIAL UTILITY DISTRICT TO CHANGE RATES	§ § § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

REBUTTAL TESTIMONY

OF

GARRY KIMBALL

ON BEHALF OF BEAR CREEK SPECIAL UTILITY DISTRICT

EXHIBIT BCSUD-8

NOVEMBER 30, 2020[1]

[1] Pursuant to SOAH Order No. 10 Modifying Procedural Schedule (Nov. 10, 2020), Bear Creek's Rebuttal Testimony was due November 25, 2020. Given that the PUC was closed on November 25, 2020, Bear Creek's Rebuttal Testimony is filed on "the next day on which the commission is open for business", as required by 16 Tex. Admin. Code, §22.4(a).

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REBUTTAL TESTIMONY OF GARRY KIMBALL
WITNESS FOR BEAR CREEK SPECIAL UTILITY DISTRICT

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REBUTTAL TESTIMONY OF
GARRY KIMBALL,
WITNESS FOR BEAR CREEK SPECIAL UTILITY DISTRICT

I. INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT EMPLOYMENT POSITION.

A. My name is Garry Kimball. I am President and Chief Executive Officer at Specialized Public Finance, Inc. My business address is 248 Addie Roy Road, Suite B-103, Austin, Texas 78746.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I have served as a financial advisor since 1993. I represent city, county, school, special district and utility authority clients on a vast array of public infrastructure projects involving both tax-exempt and taxable bond issuance. Our firm represents over 450 municipal issuers across the state of Texas, and I have over 25 years of experience advising on the issuance of municipal bonds. I have experience with public/private project finance, tender option bond repurchases and multi-party conduit financing for regional projects. I have served as lead banker on over 500 separate bond transactions with a total principal value in excess of $5 billion.

Prior to being one of the founding partners of Specialized Public Finance Inc., I was a Senior Vice President with First Southwest Company. During my 15 years with First Southwest Company, I was a regulatory supervisor for the Austin office, a member of the firm's Operating Committee and a member of the firm's Special District Underwriting Committee. I also worked for Dresdner Bank AG in New York and Chicago and the Royal

Bank of Canada in Chicago and Dallas between 1988 and early 1993. I was a member of the Board of Directors of the Municipal Advisory Council of Texas in 2008. I was also the lead financial advisor for the Copperas Cove By-Pass Project, which won the 2012 NADO Excellence in Regional Transportation award for *Innovative Finance & Project Delivery.*

I graduated from the University of Texas at Austin with a Bachelor of Arts and Masters of Business Administration with a concentration in Finance. I am a Securities & Exchange Commission-registered Municipal Advisor Representative and Municipal Securities Principal. A true and correct copy of my résumé is attached hereto as Exhibit GK-1.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS OR THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY?

A. Yes, in 2014 I testified in a proceeding before the Texas Commission on Environmental Quality on behalf of the City of Georgetown in TCEQ Docket No. 2014-0437-UCR and SOAH Docket No. 582-14-3380.

Q. WHAT IS YOUR ROLE WITH THE GREATER TEXOMA UTILITY AUTHORITY ("GTUA")?

A I am the only financial advisor with whom GTUA works. GTUA typically finds the deals. Mr. Satterwhite talks with utility system operators on a weekly basis, both existing GTUA clients and also new clients. He sources the project, so to speak. When Mr. Satterwhite has a client that is seeking funding, he contacts me and I start running debt service schedules, and we begin, together with GTUA staff, working on the financial review, including the financing *pro forma*. The *pro forma* is one of the first documents presented to the client seeking funding. It is presented well before the decision to proceed with financing is made.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of Bear Creek Special Utility District ("Bear Creek").

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I am providing testimony in rebuttal to Commission Staff witness Emily Sears regarding her testimony on debt service coverage. I will explain the rationale for the debt service coverage requirement used in the *pro forma* provided to Bear Creek by GTUA at the time Bear Creek set the rates that are the subject of this appeal and the potential negative impacts of lower debt service coverage as proposed by Ms. Sears.

Q. WHAT DOCUMENTS DID YOU REVIEW IN PREPARATION FOR YOUR REBUTTAL TESTIMONY?

A. I reviewed the prefiled testimony and exhibits filed by Drew Satterwhite and Emily Sears in this case. I also reviewed Ms. Sears' discovery responses filed in this case and my records regarding Bear Creek's financing with GTUA.

III. REBUTTAL TO TESTIMONY OF EMILY SEARS

A. SUMMARY

Q. DO YOU AGREE WITH MS. SEARS' TESTIMONY THAT A DEBT SERVICE COVERAGE OF 1.0X IS APPROPRIATE IN THIS CASE?

A. I do not.

Q. WHY NOT?

A. I think she conveniently ignores some very important things. Her testimony and responses to discovery seem to be very, sort of, this minute and static. When I say her responses reflect sort of a static universe, all of those very important things that a utility needs to do to thrive and survive and grow seem to be ignored. Those very things bring into play future access to the bond market, future access to the open market, which brings into play bond ratings; bond ratings are dependent on coverage, and bond ratings are affected by material events, one of which is a draw on reserves. All of these things must be considered at or before the time that an entity seeks financing.

In other words, because there is no pending application for additional financing, I get the impression she assumes that Bear Creek will never need to access the markets again in the future. Her opinion is shortsighted, and it is not in line with my actual experience. Every utility that I have ever advised has a need for future borrowing. Because most utilities must either replace equipment or finance new growth and new equipment, being able to access the bond market in the future is important. And being able to access the bond market in the future brings into play whether you have issued a material event under SEC Rule 15c2-12,[2] which might increase your future borrowing costs. Interest rates can have a significant impact on utility rates. Lower financing costs ultimately benefit utility ratepayers and should therefore be managed with care. Her proposal to simply draw on reserves to make up for what might be less than 1.0x coverage could easily result in issuing a material event notice under SEC Rule 15c2-12, which in turn would cause a likely increase in borrowing costs. Consider the situation where three consecutive years of wet

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[2] 17 CFR § 240.15c2-12 ("Municipal Securities Disclosure").

weather have caused multiple draws on reserves to make bond payments. Without planning for coverage in excess of 1.0x, how are reserves ever to be replenished? Rates could be whipsawed up and down according to the weather, but that would not make for a very stable situation for ratepayers. Setting rates to target a 1.25x coverage of operating expenses and bond payments allows rates to be held stable, allows for a cash cushion to accumulate during hot summers and allows rates to be held stable during prolonged periods of wet weather.

Ms. Sears also seems to conveniently assume that the utility would never refinance its existing debt, and it is very important to note that the Texas Water Development Board ("TWDB") will not buy refinancing bonds. So, if you have financed a project through the TWDB, you cannot go back to them for your refinancing if interest rates go down. That forces you, if you are ever going to take advantage of a decrease in market rates, to go to the open market. So you have to keep the option open to protect your ability to maintain a good bond rating because at some point in the future you might want to refinance your TWDB financing into the open market. This seems to be totally ignored by Ms. Sears' testimony. Finally, in her discovery responses on this issue, she states that Bear Creek does not have any debt with the TWDB, and, while technically true, it is practically and legally false. The SEC defines an obligated person as:

> any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities). [3]

[3] 17 CFR § 240.15c2-12(f)(10) ("Municipal Securities Disclosure").

In layman's terms, an obligated person is someone who is actually bound to make the contract payment that results in the bond payment being made. So, under SEC definitions, Bear Creek would be the obligated person under any borrowing between the GTUA and the TWDB. Therefore, Bear Creek is on the hook. You cannot just say they are not technically the named borrower; they are an obligated person under the law.

Q. HOW DO GTUA'S FINANCING DOCUMENTS TYPICALLY ADDRESS THIS OBLIGATION?

A. If you read through a typical bond order between GTUA and the TWDB, throughout that document it notes that GTUA has no revenues, cannot raise rates, cannot levy taxes, and that the sole source of repayment are the contract payments due from the entity on whose behalf GTUA is issuing the debt. In other words, GTUA disavows any and all liability other than from the payment of contract payments when due by the entity seeking the funding, in this case Bear Creek.

Q. AT THE TIME BEAR CREEK MADE ITS DECISION TO INCREASE RATES, WAS BEAR CREEK ADVISED OF THESE TERMS THAT WOULD BE INCLUDED IN THE AGREEMENT?

A. Yes, GTUA does not borrow at all for their own account, so to speak. They only act as a conduit, and the obligation for payments rests on others.

B. THE PRO FORMA (EXHIBIT DS-3) AND COVERAGE

Q. WHAT WAS YOUR ROLE IN DEVELOPING THE *PRO FORMA* ADMITTED AS EXHIBIT DS-3 AND ATTACHED TO DREW SATTERWHITE'S PREFILED DIRECT TESTIMONY?

A. I provided the Excel model to GTUA for use in their funding efforts. I then helped them with the specific data for debt service for each proposed borrowing, which is reflected in the middle column. The important column, and the critical product of the worksheet, is the far-right column, the coverage column. That coverage figure is a calculation, and the formula is embedded in the Excel spreadsheet.

Q. WHAT WAS THE PURPOSE OF THE *PRO FORMA*?

A. The *pro forma* allows GTUA to evaluate whether there is adequate coverage projected for a particular financing. The *pro forma* is a projection of future conditions based on information available as of the date the *pro forma* is developed. In addition, the *pro forma* GTUA uses is a required TWDB schedule for financing from the Drinking Water State Revolving Fund (DWSRF). The TWDB will not issue a commitment for financing or even consider a commitment without this schedule being provided. And if this schedule does not project adequate coverage, TWDB will not approve the credit application even though there is no covenant that requires coverage for a DWSRF financing. Coverage is an important credit aspect to any financing request. So much so that the *pro forma* is a required schedule.

Q. WHAT DO YOU MEAN WHEN YOU USE THE TERM COVERAGE?

A. Coverage is the ratio of available cash to required debt service payments for a given year.

Q. WHY IS COVERAGE SO IMPORTANT?

A. Debt service coverage is a critical component in an investor's decision to purchase a utility revenue bond. Utility revenue bonds are primarily secured by system revenues, meaning that bond repayment is largely a function of the utility's service rate structure and whether those rates will generate sufficient operating cash flow to cover annual expenditures (including annual bond payments). Unlike tax-secured municipal bonds, where the tax base is set each year and the tax rate is adjusted annually to match recurring bond payments, utility systems (especially water systems, where bills are generally a function of water purchased) are subject to swings in the weather. Wet summers can significantly reduce water sales and cause water bills to fall to a point below levels needed to cover the expenses of the system. To the extent that insufficient water sales were to cause a draw on debt service reserve funds, it would trigger a material event notice under SEC Rule 15c212. Such a material event disclosure would have a negative impact on the ability of both GTUA and Bear Creek to access the municipal bond market. Investors view such events as a credit negative and will require higher interest rates on bonds subsequently brought to market.

The *Moody's Investors Service* published guidance on revenue bond ratings states that:

> Debt service coverage is a core statistic assessing the financial health of a utility revenue system. The magnitude by which net revenues are sufficient to cover debt service shows a utility's margin to tolerate business risks or declines in demand while still assuring repayment of debt. Higher coverage levels indicate greater flexibility to withstand volatile revenues, unexpected outflows, or customer resistance to higher rates. Utilities usually enter into a debt service coverage covenant under which they pledge to achieve a given level of coverage each year. The covenant ensures that the utility utilizes its assets to generate sufficient income to pay bondholders. The analysis of a utility system's debt service coverage demands ample context. If debt service escalates in future years, then the utility's current net revenues may be sufficient to cover debt service this year, but not in the

> future. Systems with greater revenue stability can operate comfortably at lower coverage levels. Systems with greater capital needs are likely to incur more debt, which will lead to increased debt service and decreased coverage. The debt service coverage calculation is the basis for a comprehensive analysis of a utility's financial flexibility and trend over the long term.[4]

Q. WHAT HAVE YOU ADVISED GTUA IT NEEDS TO DO IN PREPARING THESE *PRO FORMAS* FOR ITS VARIOUS FINANCINGS?

A. I have advised GTUA that if we cannot get to an average of approximately 1.25x coverage without a rate increase, then we recommend a rate increase. And, it is usually better if the utility adopts the rate increase prior to making the application to the TWDB because it carries more weight when you come to them, application in hand and a rate increase already approved.

Q. HOW DO YOU CALCULATE THE DEBT SERVICE COVERAGE RATIO?

A. The *pro forma* model contains the calculations. You start from the far-left side of the model, which is 2019 operating income in Exhibit DS-3. The next column is the amount generated by a rate increase that may be necessary to service debt and maintain adequate coverage, which is the expected additional income that would result from an increase in rates. That amount is added to the operating income. You then subtract the operating expenses, which are shown in the next column. You also subtract the required reserve payments and the estimated administrative payments. The result of these calculations is the available annual cash to pay for both the proposed debt service payments and the existing system debt service payments. So, basically, we are trying to get to a number that is available cash and then we divide that by the combined debt service payments. Exhibit DS-3 shows that we projected a debt service coverage of 1.64 times the amount of required

[4] Moody's Utility Revenue Bond Rating Methodology (2017).

debt service payments after we netted all of those cash sources and uses against each other in 2019. Subsequent years are calculated the same way and shown in the exhibit.

Q. WHAT IS THE SOURCE OF THE DATA FOR THE OPERATING REVENUES, OPERATING EXPENSES AND EXISTING DEBT SERVICE IN THE *PRO FORMA*?

A. The operating revenues, operating expenses and existing debt service come from the system's financial statements and financial records. Although the table shows the operating income and operating expenses as fixed numbers, they are really not. They are actually anything but fixed. But, for the purposes of the *pro forma*, the TWDB will accept a fixed presentation.

Q. WHY IS IT IMPORTANT THAT OPERATING INCOME AND EXPENSES ARE NOT REALLY FIXED NUMBERS?

A. Because this really gets to why we consider coverage and why it is important for the credit decision. Coverage is extremely important because utility operations are completely unpredictable. Coverage provides security to lenders because utility system revenues and expenses are so unpredictable. Revenues are highly correlated to weather, and expenses are highly correlated to a combination of management expertise and shock events. A utility does not know from year to year whether it is going to have fires, floods, equipment failures, or other similar events. Those situations can drastically change what a utility's expenses are from year to year. Utility system revenues being highly correlated to weather makes those revenues unpredictable. And so, with all of those factors that contribute to an inability to accurately predict what your net operating income will be from year-to-year, the concept of coverage developed.

Q. WHAT IS CONSIDERED REASONABLE COVERAGE?

A. If you take the financing market at face value, anything from 1.1x to 1.5x coverage is in the range of reasonable.

Q. WHY IS THERE SUCH A LARGE RANGE OF WHAT IS REASONABLE?

A. There are very different sized utilities operating across the country. For a utility the size of the City of Austin, 1.1x coverage might mean $50,000,000 of excess revenue on an annual basis, which could be used to make debt service payments in the event of reductions in revenues because of weather or increases in expenses because of shock events. That is a much different scenario from a system with 400 connections, for which 1.1x coverage might be only $15,000 and not very meaningful in terms of protection for the lenders or ability of the utility to continue to make debt service payments in challenging situations. In small system situations, a higher coverage factor is recommended. The smaller the system, the more likely it is going to need coverage in excess of 1.25x, even closer to 1.5x. Larger systems can employ much smaller coverage factors because the actual dollars involved are significant enough to make up for the smaller coverage factor. No utility system can prudently budget to a 1.0x coverage without the ability to predict the weather, which is why the markets have required coverage covenants since long before I entered this business.

Q. LET'S DISCUSS THE OTHER COLUMNS IN YOUR *PRO FORMA*. WHAT IS THE SOURCE OF THE DEBT SERVICE PAYMENT AMOUNTS AND THE RESERVE FUND PAYMENTS?

A. I calculate the debt service payments for the proposed issuance. In this case, the required reserve payment was spread over five years because the TWDB allows five years to accumulate the full reserve amount. The required reserve is equivalent to one-year worth of average annual debt service. The amounts shown in both the column entitled "*PROPOSED DWSRF FUNDS* $7,490,000 DEBT SERVICE," and the column entitled "EXISTING CITY DEBT ON W/S SYSTEM," may be totaled and then divided by the number of years of debt service to calculate the average annual debt service. That amount is then divided by five years, which yields the $74,130 shown in the Reserve Payments column.

Q. WHAT IS THE SOURCE OF THE ESTIMATED ADMIN PAYMENTS COLUMN?

A. That amount is estimated based on GTUA's standard terms for issuing debt on behalf of entities. It is the amount that GTUA charges to act as the conduit.

Q. HOW ARE THE VALUES IN THE RATE INCREASE COLUMN DETERMINED?

A. Frankly, it is a combination of two considerations. First, what would be reasonably anticipated to be acceptable to the customer base in terms of a rate increase. In other words, customer rates cannot just be tripled. A rate increase must be within reason relative to the existing set of rates. Second, the amount must be sufficient to allow the sufficient debt service coverage to be generated, which is reflected in the far-right column. In this case, the proposed rate increases resulted in a debt service coverage that dips as low as 1.18x. I consider that dip acceptable given the fact that for the most part coverage in future years was projected to trends up above 1.20x and 1.25x within the first five years, and subsequently stay at that level.

Q. WHY ARE THOSE PROJECTED COVERAGE LEVELS SIGNIFICANT?

A. If a system does not have enough coverage, the marketplace is going to assign a much lower rating, and the result is a much higher interest rate on the financing.

Q. WHAT IS THE IMPACT OF SEC RULE 15C2-12 ON THIS WHOLE ANALYSIS OF COVERAGE?

A. It basically goes to whether or not an entity will be forced to draw on reserves. It is more likely that a draw on reserves will be needed if the entity budgets 1.0x coverage. The reason, as described earlier, is that utility operations are unpredictable and it is unrealistic to budget 1.0x coverage when one cannot predict the weather or other shock events that might upset the O&M expense column. A 1.0x coverage is a coin flip as to whether or not the entity actually achieves profitable operations or, conversely, is in deficit and needing to draw on reserves.

C. THE TWDB APPLICATION FOR CREDIT

Q. IN THE SITUATION WHERE YOU ARE APPLYING TO THE TWDB, WHAT IS THE IMPACT IF AN ENTITY CAN NOT SHOW ENOUGH COVERAGE IN THE *PRO FORMA*?

A. Most likely, the TWDB will not approve the credit. And even though they are a lender of "last resort," I have been turned down or advised to increase rates many times by their credit analysts for lack of coverage, which demonstrates an inability to repay the debt with some cushion.

Q. WHEN AN ENTITY CONSIDERS APPLYING TO THE TWDB FOR A LOAN, WHAT KIND OF COVERAGE DOES IT NEED TO SHOW TO BE CERTAIN TO GET THE LOAN APPROVED?

A. That entity should aim for 1.25x coverage. In my experience, demonstrating better than 1.25x coverage on average means the application will get approved. Coverage is the singular most important credit aspect to the financing application to the TWDB. In fact, coverage is the single most important credit aspect for the bond rating agencies in a financing deal on the open market. The *pro forma* is a tool to demonstrate coverage – that is its only relevance. It is so interesting that Ms. Sears is so dismissive of coverage and the calculations presented in the *pro forma* when coverage is the most important credit criteria, regardless of whether you are talking about the TWDB or whether you are talking about the open market.

Q. HOW MANY WATER DEVELOPMENT BOARD APPLICATIONS DO YOU THINK YOU HAVE PARTICIPATED IN DURING YOUR CAREER?

A. Hundreds.

Q. OUT OF THAT NUMBER, HOW MANY HAVE BEEN REJECTED?

A. Probably fewer than ten.

Q. WERE ANY OF THOSE REJECTED FOR REASONS OTHER THAN FAILURE TO MEET COVERAGE?

A. Yes, politics can play a part if it is a very controversial project and you can be turned down for legal reasons, having to do with CCN challenges and such, but that is very rare. The only financial reason for a denial would be coverage.

Q. WHAT HAPPENS IF A UTILITY CANNOT DEMONSTRATE ENOUGH COVERAGE ON ITS APPLICATION TO TWDB?

A. The application will be rejected, and the utility will not get the financing.

Q. WHY IS 1.25X THE AMOUNT OF COVERAGE THAT YOU BELIEVE NEEDS TO BE SHOWN TO TWDB IN ORDER TO MAKE SURE YOUR APPLICATION IS APPROVED?

A. 1.25x coverage is not a hard and fast rule at the TWDB, and you are not going to find anything in their credit criteria that is written down that says that is the minimum. I have more than 25 years of experience asking the TWDB for money and based on my experience that is where I consider the cutoff to be.

Q. YOU ARE TESTIFYING THAT 1.25X IS DESIRED, BUT IN THE COVERAGE COLUMN IN EXHIBIT DS-3 THERE ARE NUMBERS LESS THAN 1.25. WHY WAS THIS OKAY TO GO FORWARD, EVEN THOUGH THERE WERE YEARS WHERE 1.25X COVERAGE WAS NOT SHOWN?

A. Because it is not a strict requirement, and as long as I can get to something close to 1.25x, it should be sufficient. 1.25x is kind of the average for a system like Bear Creek, and I am trying to get above that coverage within a certain number of years. If this were a large system, I would be targeting something much smaller in terms of coverage, but Bear Creek is not a large system, it is an average-size system. The fact is that this type of analysis is not a science. I go by what I think will be approved by the credit analysts at the TWDB and this passed my smell test.

Q. WHY DOESN'T THE TWDB HAVE A STRICT COVERAGE REQUIREMENT?

A. Because they are a lender of last resort. The TWDB has to extend credit in certain situations where coverage has been very tight or almost non-existent, and it does so due to a public policy mandate to provide funding to low-income communities and border towns. A lot of public policy considerations enter the picture. Most of the clientele GTUA serves are not going to be in one of these special consideration baskets. Bear Creek certainly is not. GTUA and its obligated entities are going to be looked at on the financial merit of the application and, in that case, coverage is primary.

Q. WHY DOESN'T THE TWDB WAIVE COVERAGE FOR ALL ITS FINANCING?

A. Because the TWDB gets its money from the open market, the TWDB very much cares about its own bond ratings. And so, in terms of its overall portfolio, it cares very much that it has financially healthy credit in its portfolio of loans. In other words, it cannot make 100% borderline loans to financially distressed communities on the border or its own bond ratings would not be what they are. So they make up for the fact that they have a public policy mandate to lend to disadvantaged communities by making sure they have some very strong and healthy credits in their portfolio and that, then, takes them looking at coverage, where they can.

Q. SO IF BEAR CREEK HAD SHOWN A COVERAGE OF 1.0X, AS MS. SEARS RECOMMENDED, WOULD THE TWDB HAVE APPROVED THE APPLICATION?

A. I do not think so.

D. FUTURE FINANCING IMPACTS

Q. MS. SEARS TALKS ABOUT THE FACT THAT BEAR CREEK DOES NOT HAVE A LOAN FROM THE TWDB, THEREFORE, WOULD NOT NEED DEBT SERVICE COVERAGE FOR ADDITIONAL DEBT. WHAT IS YOUR OPINION ABOUT THAT STATEMENT?

A. Her position ignores the fact that Bear Creek is actually the obligated party under SEC Rule 15c2-12, and Bear Creek's financial statements are absolutely going to be considered for any future borrowing request. In other words, GTUA is the named party in the bond issue in the amount of $7.49m with the Texas Water Development Board, but without presenting the financial statements of Bear Creek, that request would have never even been considered.

Q. WHAT IS THE IMPORTANCE OF COVERAGE ON FUTURE FINANCING OPPORTUNITIES?

A. Adequate coverage preserves the ability to cash in a refinancing opportunity in the future.

Q. IN MS. SEARS' DISCOVERY RESPONSES, SHE NOTES THAT BEAR CREEK DOES NOT HAVE A BOND RATING, WHICH SEEMS TO MAKE SOME DIFFERENCE TO HER IN RECOMMENDING 1.0X COVERAGE. WHAT IS YOUR OPINION ABOUT THAT FACT?

A. Bear Creek does not have a bond rating today, but if it ever intends to refinance the bonds that were sold by GTUA to the TWDB on Bear Creek's behalf, then it will need a bond rating. GTUA would assist them in obtaining that bond rating in connection with refinancing opportunities that might come about in the future. The future bond rating would be absolutely dependent on the coverage, and 1.0x coverage would not be a good foundation for an investment grade bond rating. 1.0x coverage likely would not get them to the point of an investment grade bond rating. 1.25x coverage would get them to an investment grade bond rating, which would potentially make the difference between a refinancing that made economic sense and one that did not.

E. MATERIAL EVENTS

Q. DO YOU AGREE WITH MS. SEARS' ASSERTION THAT BEAR CREEK COULD SIMPLY DRAW UPON ITS OPERATING RESERVES TO SATISFY ANY DEBT SERVICE?

A. I do not.

Q. WHAT DOES THE MARKET CONSIDER AN APPROPRIATE AMOUNT OF OPERATING RESERVES FOR A UTILITY LIKE BEAR CREEK?

A. It depends on the size of the utility, but for Bear Creek, a minimum of six months of operations and up to a year's worth. A six-month operating reserve can be wiped out with one bad flood or significant equipment failure.

Q. HOW DOES COVERAGE RELATE TO OPERATING RESERVES?

A. If an entity budgets 1.0x coverage, that means, by definition, that it has not budgeted for anything over and above what it needs to operate. Therefore, it would have nothing to draw from to replenish reserves if they were wiped out. Such an approach makes no sense.

Q. IN THIS SITUATION, WHERE BEAR CREEK IS THE OBLIGATED PERSON, THROUGH CONTRACT REVENUE BONDS WITH GTUA, IF BEAR CREEK HAD TO DRAW ON ITS OPERATING RESERVES TO MAKE A DEBT PAYMENT, WHAT IS THE IMPACT UNDER THE SEC RULE 15C2-12?

A. If the draw on reserves was the result of financial hardship or difficulty, it would be a material event. If Bear Creek is budgeting to a 1.0x coverage and three of the last five years it generated deficits because the summer was too wet or equipment failure has caused expenses to go up, such that they could not meet their budget, then we have to decide whether it is in financial difficulty. Has Bear Creek drawn down reserves to a point where they will be difficult to replenish because they are not budgeting to a sufficient excess (which is a proxy for coverage)? If they continually are drawing them, then we are probably going to suggest to GTUA to "issue a material event signaling financial difficulty at the Bear Creek level." That is exactly the problem with 1.0x coverage--if an entity never budgets more than the exact minimum required, how will it replenish the reserves that it drew on if there is a wet summer or three wet summers in a row?

Q. DO YOU REVIEW THOSE FINANCIAL REPORTS FROM GTUA'S OBLIGATED ENTITIES EVERY YEAR?

A. Yes, and they are required to be filed with the Municipal Securities Rulemaking Board annually.

Q. WHAT WOULD BE THE IMPACT OF A MATERIAL EVENT ON BEAR CREEK?

A. On Bear Creek, it means when we go to the market at some future point, for whatever reason – be it a new project that they decide not to take to the TWDB or refinancing of an existing project, we are going to have to go talk to Standard & Poors or Moody's. Those entities have access to all of the prior material event notices and they are going to factor that into their decision when it comes to assigning a bond rating and that bond rating will determine the interest rate at which they borrow. It is all about trying to make that interest rate as low as possible, because that benefits the ratepayers, ultimately.

Q. WHAT WOULD BE THE IMPACT TO GTUA OF A MATERIAL EVENT CAUSED BY BEAR CREEK'S FAILURE TO HAVE ADEQUATE COVERAGE?

A. It would reflect poorly on GTUA. It is difficult to quantify the negative impact that might flow over to GTUA, but there would be some, because part of what the market sees when looking at GTUA as a borrower is how well is it managing exposure to these obligated persons, like Bear Creek. If GTUA goes into the market on behalf of another entity, but has five other obligated entities that have defaulted over thc past ten years, then there will be a penalty in the market for the new financing because of that. GTUA has an obligation to all of its borrowers to make sure every borrower is meeting its coverage requirements. It is a discipline that the market expects to be followed. There is no way to discuss financing of utility system infrastructure without assessing coverage. They are joined at the hip. The market understands the inability to predict what operations will do in a forward looking 12-month period, which is why the concept of coverage emerged.

IV. CONCLUSION

Q. DO YOU HAVE ANY CONCLUDING THOUGHTS?

A. The biggest failing of Ms. Sears' testimony is ignoring that a utility is an ongoing enterprise and that it probably will nced to go to the market at some point in the future, whether to refinance existing debt or to finance new projects to enable growth. Because of that, the entity has to consider the potential for a bond rating in the future, it must consider that repeated material event notices will impact that bond rating, and it must consider future access to the bond market. Ms. Sears' testimony totally seems to ignore that. For her, it is all here, now and yesterday, which is not a prudent way to run a utility. In my experience, the future does matter and must be planned for. GTUA's *pro forma* and the rate increase recommended at that time were based on solid principles of finance and utility operations using the information that was available to Bear Creek at the time the decision to adopt the rate increase was made.

In addition, it is important to remember that there is no way to get to a bond rating for future issuance of debt without considering coverage. Every bond rating request that I have been a party to over the past 25 years has included a discussion on adequate coverage. And 1.0x is not coverage – it is the definition of no coverage.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Exhibit GK-1

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Mr. Kimball has served as a financial advisor since 1993 He has represented city, county, school, special district and utility authority clients on a vast array of public infrastructure projects involving both tax-exempt and taxable bond issuance. Mr. Kimball also has experience with public/private project finance, tender option bond repurchase and multi-party conduit financing for regional projects. Mr. Kimball has served as lead banker on over 500 separate bond transactions with a total principal value in excess of $5 billion

Exhibit GK-1

Prior to joining the founding partners of Specialized Public Finance Inc , Mr Kimball was a Senior Vice President with First Southwest Company. During his 15 years with this firm, he was a regulatory supervisor for the Austin office, a member of the firm's Operating Committee and a member of the firm's Special District Underwriting Committee Mr Kimball also worked for Dresdner Bank AG in New York and Chicago and the Royal Bank of Canada in Chicago and Dallas between 1988 and early 1993 Mr Kimball was a member of the Board of Directors of the Municipal Advisory Council of Texas in 2008 Mr Kimball was also the lead financial advisor for the Copperas Cove By-Pass Project, which won the 2012 NADO Excellence in Regional Transportation award for Innovative Finance & Project Delivery

Mr Kimball graduated with high honors from the University of Texas at Austin with a Bachelor of Arts degree in Government He also received his Master of Business Administration degree with a concentration in Finance from the University of Texas at Austin He is a Series 50 Municipal Advisor Representative and Series 54 Municipal Advisor Principal with the Securities and Exchange Commission