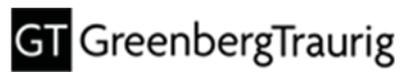


Water and Wastewater Utility Service Providers/MUD Feasibility Analysis

City of Missouri City, Texas

Prepared by:



September 4, 2019

Bill Atkinson
Assistant City Manager
City of Missouri City
1522 Texas Parkway
Missouri City, TX 77489

Subject: Water and Wastewater Utility Service Providers/MUD Feasibility Analysis

Dear Mr. Atkinson:

Greenberg Traurig, NewGen Strategies and Solutions, and Enprotec/Hibbs & Todd are pleased to provide the enclosed report on the feasibility of consolidating water and wastewater service providers in the City of Missouri City and its Extra-Territorial Jurisdiction. This report cites previous analyses by the City of Missouri City on this topic and discusses the methodology, analysis, and conclusions of this study.

Please contact us should you have any questions regarding this report or the analysis discussed within.

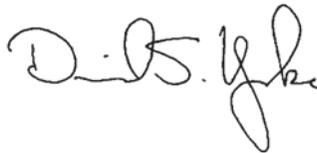
Sincerely,

Greenberg Traurig

Phillip Gildan Digitally signed by Phillip Gildan
Date: 2019.09.04
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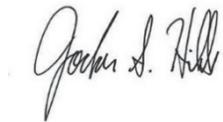
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DEFINITION OF TERMS

CIP	Capital Improvement Plan
City	City of Missouri City, Texas
DBFO	Design/Build/Finance/Operate (type of procurement)
eHT	Enprotec/Hibbs & Todd
ESPC	Energy Saving Performance Contract
ETJ	Extra-Territorial Jurisdiction
FA	Financial Adviser
GRP	City Joint Groundwater Reduction Plan
GT	Greenberg Traurig, P.A
MGD	Million Gallons Per Day
MUD	Municipal Utility District
NPV	Net Present Value
NewGen	NewGen Strategies & Solutions
O&M	Operations and Maintenance
P3	Public Private Partnership
SP	Sienna Plantation
SPJDA	Sienna Plantation Joint Development Agreement
SPA	Strategic Partnership Agreement
Study	This MUD Feasibility Analysis
TCEQ	Texas Commission on Environmental Quality
WCID	Water Control and Irrigation District
2011 eHT Study	2011 Regional Water and Wastewater Planning Study by eHT
2018 eHT Plan	2018 Regional Water & Wastewater Planning Study by eHT

EXECUTIVE SUMMARY

The Study confirmed that the existing Study area's decentralized utility service structure with multiple water and wastewater utility service providers currently works efficiently and cost-effectively, which validates the City Council's initial plan for growing the City's infrastructure through development supporting its own financial weight without burdening existing residents and businesses with the cost of providing new residents/businesses infrastructure services. The Study also confirmed that much of the existing utility infrastructure has or will be reaching the end of its useful life in the near future, and that significant capital expenditures to renew, replace or expand existing utility infrastructure should be expected in the near and mid-term future, which could lead to potential synergies with respect to potential utility regionalization options. Finally, the City Council's initial plan to eventually consolidate utility services after the costs of infrastructure growth had been fully absorbed, by the new residents and businesses causing that growth, would benefit all the City's residents and businesses.

Together with City staff, the Study team developed and examined various options for the City Council to help determine whether the current Study area status quo could be improved upon for the residents and businesses of the City and the City's ETJ (e.g., financially, operationally, cost of service, level of service, etc.). We list those options below without any order of preference or recommendation, as each option has positive attributes but different implementation timing and costs.

Options

- **Status Quo.** Maintaining the status quo would mean eschewing the potential opportunities that consolidation could bring in the form of economies of scale and uniformity of utility rates and charges throughout the City and ETJ for residents and businesses. On the positive side, maintaining the status quo would also allow the MUDs to complete their build-out of utility infrastructure and eventual retirement of debt associated with the development and build-out of the areas served by the MUDs, making an eventual consolidation program in later years more financially feasible.
- **Implement a systematic MUDs dissolution/annexation program.** As MUDs' jurisdictional areas build-out, utility infrastructure is completed through such build-out, and utility infrastructure debt is retired, the City could dissolve (for in-City districts) or annex (for ETJ districts) the MUDs into the City and assume ownership and operation of the MUDs water and wastewater infrastructure. Under this option, the City would also implement their existing ETJ annexation agreements with the individual MUDs as their contractual annexation "trigger conditions" occur over time. This option would also require the City to assume responsibility for not only water and wastewater infrastructure and service, but also all other MUD obligations, including any MUD's non-water and non-wastewater infrastructure (e.g., drainage, levees, parks, fire protection, garbage, etc.).
- **Implement a voluntary dissolution/annexation program.** The MUDs would continue to provide water and wastewater utility service leaving the determination of timing for dissolution/annexation and transfer of water and wastewater utility service to the MUD Boards. Under this option, the City would continue to engage with the MUDs in regional water and wastewater infrastructure development/operations programs when the opportunities arise. The City would facilitate cooperation and consolidation of utility infrastructure by and among existing MUDs in the natural progression of their MUD life cycles. The City would implement ETJ annexation agreements as their annexation trigger conditions occur over time.

- **Implement a voluntary utility infrastructure asset transfer program.** Instead of dissolving or annexing MUDs, the City could initiate a voluntary utility infrastructure asset transfer program, where a MUD could transfer title to its water and wastewater utility infrastructure to the City (either built-out systems or mid build-out systems where the MUD continues implementing utility system infrastructure installation and financing for new development). The MUDs would continue in operation under this program. Under this option, the City would continue having the existing MUD utility operators (e.g., Quail Valley Utility District, Si Environmental, Municipal District Services, Inframark) operate the transferred utility infrastructure during a transition period (e.g., 5 to 10 years). This option does not require the dissolution or annexation of any utility districts, or the termination of existing operations as a condition of transfer of utility assets to the City.
- **Implement a City-wide “wholesale” treatment/supply facilities utility.** This option would contemplate each MUD retaining its retail utility customer facilities while transferring water supply and water and wastewater treatment facilities to the City. The MUDs “wholesale” facilities would be added to the existing City “wholesale” facilities (e.g., Steep Bank/Flat Bank, Surface Water Treatment Plant, Mustang Bayou) with the City providing wholesale utility service to each MUD’s retained retail utility service. Under this “wholesale” program, the City could consider transferring its existing City “retail” utility systems to an appropriate abutting MUD utility service provider, leaving the City with only the “wholesale” utility service obligation. Under this option, the City would continue having the existing MUD utility operators (e.g., Quail Valley Utility District, Si Environmental, Municipal District Services, Inframark) operate the transferred “wholesale” facilities during a transition period (e.g., 5 to 10 years). This option does not require the dissolution or annexation of any utility districts.
- **Implement a Public Private Partnership.** This option would contemplate the City granting a long-term concession to a private operator to operate and finance consolidated utility facilities obtained by the City through any of the consolidation options. This option does not require the dissolution or annexation of any utility district, but does require the City obtain title to the MUDs’ utility facilities from the districts for inclusion in the public private partnership concession offering.

Next Steps

1. **Prioritization of Scenarios, MUDs, etc. to be Considered for Consolidation Purposes.** Based on the Study, the City staff and City Council (with input from the Study team as needed) should evaluate and prioritize those opportunities where a consolidation of MUD(s) with the City water and wastewater utility system may potentially make operational, engineering and financial sense. These decisions should be made in a manner that are consistent with the goals of the City concerning long-term planning for residential and commercial buildout within the City and its ETJ.
2. **Preliminary Discussions with MUDs Identified in Step 1.** Based on any Scenarios and/or MUDs identified in Step 1 above, the City should schedule a series of meetings with any MUDs identified as potential candidates for consolidation to discuss whether there is an interest on the part of the MUDs to consider a consolidation, or under what set of conditions such a consolidation might make sense for both parties to consider such an endeavor.
3. **Develop a Detailed Financial Plan for any Opportunities Identified in Steps 1 and 2.** The analysis completed as part of this Study was conducted at a high-level and relied, in many cases, upon financial data that was available via public information, and the Study team may not have had access to the most detailed, accurate, or recent data that is relevant to the current status of each of the 30 MUDs evaluated as part of this Study. Therefore, if based on Steps 1 and 2 there are

certain MUD consolidation options that appear to create a “win-win” for both entities (City and the MUD), the Study team would strongly encourage that a more in-depth financial analysis be conducted to evaluate the following key assumptions to ensure that all information is as accurate and current as practical:

- Revenues Assumptions (all revenue streams)
- Operating Expenses (including any savings)
- Capital Expenditures (both by MUD and City)
- Capital Financing
- Growth and Buildout Assumptions
- Timing
- Other, as appropriate

It is a necessity that there would be a detailed timeline of key project deliverables, as well as numerous financial, operational and capital related meetings and planning sessions, to ensure that such a consolidation opportunity is successful for all parties.

4. **Develop a Long-Term Plan for Continued Monitoring of Consolidation Opportunities.** Regardless of whether any opportunities are identified in Steps 1 through 3 that would identify any potential MUD consolidation options, the Study team would strongly encourage a long-term plan be put in place to continue to monitor consolidation opportunities on an annual or biennial basis. This plan would put in place a methodology and check-list that would allow the City to identify when certain criteria have been achieved that may make a MUD consolidation scenario feasible (e.g. MUD debt is paid off, or de minimis; certain buildout percentages are achieved; etc.).

Section 1 INTRODUCTION

Authorization

On December 2, 2017, the City of Missouri City (“City”) City Council authorized Greenberg Traurig, NewGen Strategies and Solutions, and Enprotec/Hibbs & Todd (“Study team”, “we” or “us”) to undertake a Feasibility Analysis regarding the consolidation of water and wastewater utility service providers for the City of Missouri City (“City”) and the City’s Extra-Territorial Jurisdiction (“ETJ”) areas (the “Study”).

Study Area Description

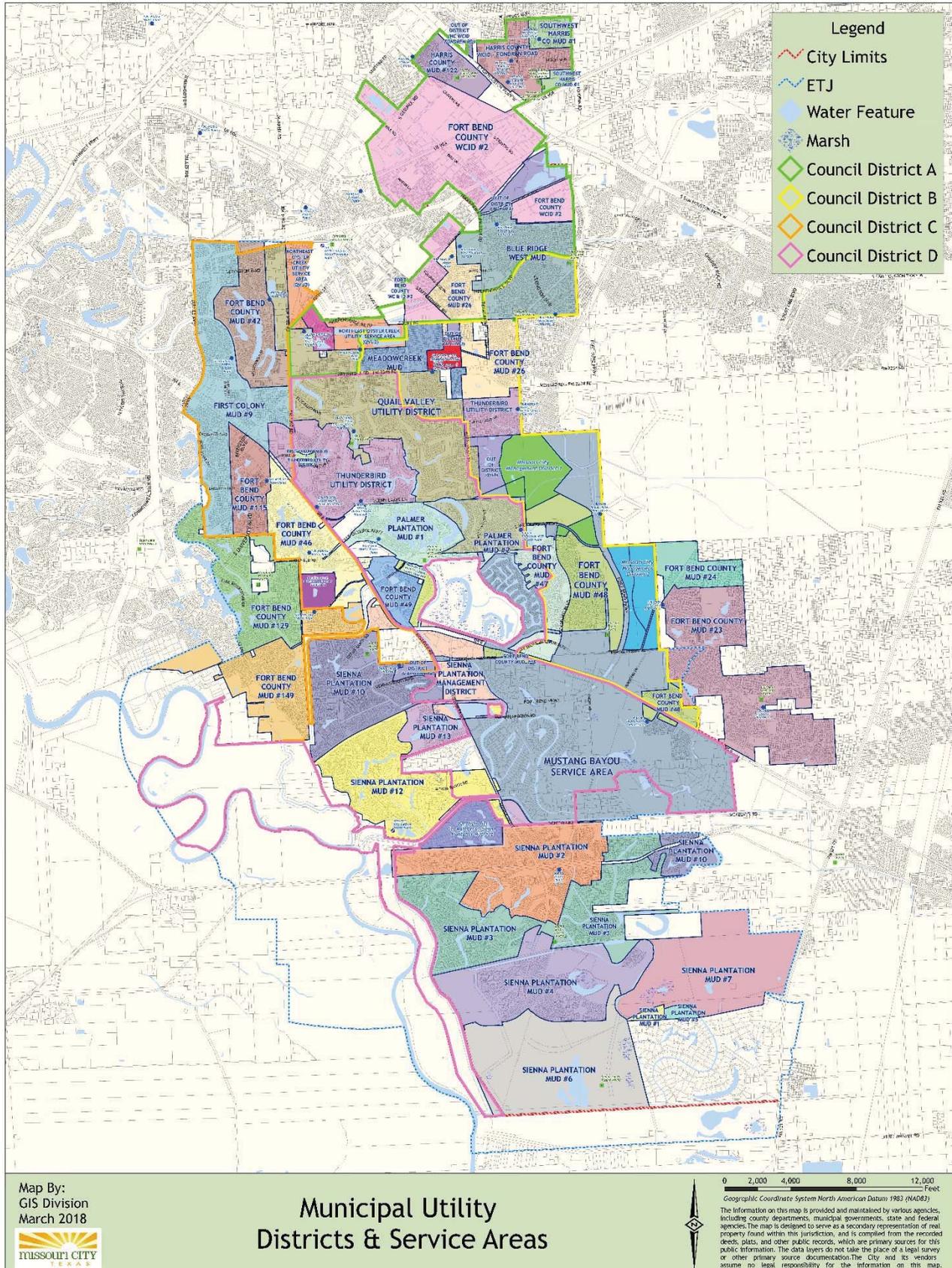
The Study area encompasses thirty-one (31) water and wastewater utility service providers within the municipal boundaries of the City and the City’s ETJ, including the City’s water and wastewater utility. A list of the Municipal Utility District (“MUD”) water and wastewater utility service providers in the Study area is shown in Table 1-1. Three water and wastewater utility service providers in or abutting the Study area were not considered in the Study. Two service providers, Fort Bend County #23 and Fort Bend County #24, are not included in the Study as they both lie within the City of Houston’s ETJ, which is outside the jurisdictional control of the City. A third service provider, Fort Bend County Water Control and Improvement District #2, is not included in the Study because its utility service area encompasses multiple governmental jurisdictions precluding consolidation feasibility. Of the MUD service providers within the Study area, thirteen (13) provide utility service within the City’s ETJ and seventeen (17) provide utility service within the City’s municipal boundaries.

Table 1-1: Study MUD Service Providers

Blue Ridge West	Palmer Plantation #2
First Colony #9	Quail Valley Utility District
Fort Bend County #26	Sienna Plantation #1
Fort Bend County #42	Sienna Plantation #2
Fort Bend County #46	Sienna Plantation #3
Fort Bend County #47	Sienna Plantation #4
Fort Bend County #48	Sienna Plantation #5
Fort Bend County #49	Sienna Plantation #6
Fort Bend County #115	Sienna Plantation #7
Fort Bend County #129	Sienna Plantation #10
Fort Bend County #149	Sienna Plantation #12
Harris County #122	Sienna Plantation #13
Harris County Fondren Road	Sienna Plantation Management District
Meadowcreek	Southwest Harris County #1
Palmer Plantation #1	Thunderbird Utility District

The location of each MUD service provider can be found on the map below. A larger version of this map is included in Appendix A.

Section 1



Previous Studies

The City has undertaken a number of prior studies on consolidating and regionalizing water and wastewater utility infrastructure. These include:

- The 2011 Regional Water & Wastewater Planning Study (“2011 eHT Study”) by Enprotec/Hibbs & Todd (“eHT”), which is attached as Appendix B;
- The March 10, 2015, Feasibility Analysis, Annexation of Sienna Plantation Municipal Utility Districts 2 and 3, which is attached as Appendix C;
- The March 31, 2015 Feasibility Analysis Annexation of Sienna Plantation Municipal Utility Districts 10 and 12, which is attached as Appendix D; and
- The April 20, 2015 Feasibility Analysis of Fort Bend County Municipal Utility Districts 23 and 24, which is attached as Appendix E.

Previous Win/Win Projects

The City has had considerable success in recent years working with MUDs to create joint regional utility infrastructure projects at the treatment plant/wholesale utility service level. These include:

- Surface Water Treatment Plant and Ground Water Reduction Plan
 - 35 public well owners
 - Full compliance with Fort Bend Subsidence District requirements
 - Initially 10 MGD, expanding to 20 MGD
 - Lowest pumpage fee in the region (\$1.72/1,000 gallons)
- Steepbank/Flatbank Wastewater Treatment Plant
 - Currently 7 participants
 - 3 MGD facility, expanding to approx. 4.5 MGD
- Mustang Bayou Utility Service Area
 - Currently 3 participants, expanding to 5 (adding MMD #1 and MMD #2)
 - .95 MGD facilities, expanding to 1.5 MGD

These successful collaborative projects demonstrate one potentially effective option that will be discussed in the Study.

Scope of Study

The scope of the Study was to determine whether the current Study area structure of multiple municipal utility districts providing water and wastewater utility service within their segmented jurisdictional boundaries could be improved upon for the residents and businesses of the City and the City’s ETJ (e.g., financially, operationally, cost of service, level of service, etc.). The Study team was tasked with identifying options and structures for potential enhancement of water and wastewater utility service delivery City/ETJ wide to improve efficiency. Finally, the Study team was tasked with identifying optimal timing for implementation of the various feasibility options (e.g., short term – zero (0) to ten (10) years; long term – ten (10) years and longer).

Section 1

As part of the Study, eHT issued a 2018 Regional Water and Wastewater Planning Study (“2018 eHT Plan”), updating the 2011 eHT Study. The 2018 eHT Plan report is included in Appendix F. eHT identified regionalized water and wastewater infrastructure consolidation options, identifying technical feasibility, capital improvement cost estimates, and life-cycle operating and capital costs for each option. NewGen Strategies and Solutions (“NewGen”) then undertook a financial review of each MUD’s outstanding financial obligations and annual operating statements, applied the regionalization/consolidation and technical/financial projections in the eHT Study, and provided financial scenarios for the various consolidation feasibility options identified by the Study team.

The City coordinated a number of meetings with the Study area utility service providers. The City also created a Utility Operators’ Committee (Operators’ Committee) and held meetings with the Operators’ Committee to exchange information, solicit proposed Study structure options, and receive technical feedback on infrastructure and operational issues. The City also formed a Study Area Utility Service Providers Attorneys’ Committee (Attorneys’ Committee) and held a meeting with the Attorneys’ Committee to exchange information, solicit proposed Study structure options, and receive feedback on the legal feasibility of proposed options. City staff and the Study team held numerous work sessions and strategic planning meetings to review historical practices, current operations, and projected future water and wastewater utility needs for the Study area. Finally, City staff and the Study team provided a draft of the Study to the MUDs, held a work session with the MUDs to review the draft and obtain feedback. In addition to verbal comments at the work session, the City was pleased to receive written comments from the individuals listed in Appendix K. The Study team appreciated these comments and reviewed them carefully. Comments were addressed in the Study, as needed, and are reflected in the final report, as appropriate.

Section 2

ENGINEERING

At the request of the City and its joint Groundwater Reduction Plan (“GRP”) participants, eHT prepared two regionalization study reports for the City – the 2011 eHT Study and the 2018 eHT Plan. The objectives of these reports were to address the following:

- Establish existing conditions for water and wastewater facilities of the approximately 30 entities in the Study area;
- Identify specific water and wastewater consolidation projects and their associated costs and implementation schedule;
- Prepare an environmental assessment of the recommended consolidation projects; and
- Analyze regional opportunities and the potential funding mechanisms.

In coordination with the City and MUDs, eHT received and evaluated statistics related to the City’s population, water and wastewater connections and demands, and existing water and wastewater infrastructure to help develop recommendations to address the items summarized above. The 2011 eHT Study established the core background for the regionalization opportunities across the City, as well as the environmental impact, cost implications, and funding options associated with the regionalization efforts. The purpose of the 2018 eHT Plan was to consider changes in the underlying statistics that occurred between 2011 and 2018. Correspondingly, the 2018 eHT Plan utilized many of the data analysis methods developed in the 2011 eHT Study to highlight changes to the water and wastewater landscape since 2011. Based on the analysis, wastewater regionalization opportunities became the emphasis of the 2018 eHT Plan, including an updated cost analysis and conceptual implementation strategy.

Section 3 FINANCIAL

MUD Financials

NewGen developed the financial feasibility analyses related to the Study, which included evaluating several regionalization scenarios as developed in consultation with City staff regarding the potential consolidation of several MUDs located in and/or near the City with the City’s existing water/wastewater utility systems. In establishing the scenarios for NewGen to analyze, City staff identified geographically, technically, and developmentally related MUDs to be considered as natural groupings for consolidation. The three main scenarios, and sub-scenarios, are as follows:

Scenario 1: MUDs with Annexation Agreements

- **Scenario 1.1: Riverstone MUDs**
 - Fort Bend County #129
 - Fort Bend County #149
- **Scenario 1.2: Sienna Plantation #1 MUDs¹**
 - Sienna Plantation #1
 - Sienna Plantation #2
 - Sienna Plantation #3
 - Sienna Plantation #10
 - Sienna Plantation #12
 - Sienna Plantation #13
 - Sienna Plantation Management District
- **Scenario 1.3: Sienna Plantation #5 MUDs²**
 - Sienna Plantation #4
 - Sienna Plantation #5
 - Sienna Plantation #6
 - Sienna Plantation #7

Scenario 2: Harris County MUDs

- Harris County #122
- Southwest Harris County #1
- Harris County WC&ID - Fondren Road

Scenario 3: Inside City MUDs

- **Scenario 3.1: Inside City MUDs with No Property Tax Revenue**
 - Quail Valley Utility District
 - Thunderbird Utility District

¹ Sienna Plantation #1 controls the MUDs in Scenario 1.2

² Sienna Plantation #5 controls the MUDs in Scenario 1.3

Section 3

- **Scenario 3.2: Other Inside City MUDs³**

- Palmer Plantation #1
- Palmer Plantation #2
- Blue Ridge West
- First Colony #9
- Fort Bend County #26
- Fort Bend County #42
- Fort Bend County #46
- Fort Bend County #47
- Fort Bend County #48
- Fort Bend County #49
- Fort Bend County #115
- Meadowcreek

A comprehensive report for each of the three scenarios is attached as Appendices G, H, and I.

Methodology and Key Assumptions

As part of the Study, NewGen evaluated the forecasted customer growth, revenue, capital costs, debt service, and operations and maintenance (“O&M”) costs over a 30-year period (FY 2020 – FY 2049) to evaluate the financial impact that a consolidation may have on the City. The customer growth was forecasted from the 2018 eHT Plan, which was validated by City staff. Further, upon acquisition, the City would assume the continuing future obligation to maintain, upgrade, expand and replace the water/wastewater utility system infrastructure acquired, as conveyed in a Capital Improvement Plan (“CIP”). It is assumed that the depreciation (a non-cash item) included within the cash flow forecast would sufficiently fund any necessary capital renewals and replacements.

The relevant water CIP projects were taken from Table 4-20 of the 2011 eHT Study. Since the CIP project costs in the 2011 eHT Study were not in current dollars, NewGen increased the costs taken from the 2011 eHT Study by either approximately 3.6%⁴ per year for interconnection projects or approximately 1.3%⁵ per year for elevated storage tank projects. While the 2011 eHT Study lists 15 different water interconnection and storage projects, for this analysis NewGen focused on the projects directly related to the MUDs in the analysis. In this case, NewGen identified several relevant water projects and allocated the costs to the relevant participants based on build out connection counts and then inflated the costs to 2019 dollars.

For wastewater CIP projects, per input from eHT and City staff, the most cost-effective means of providing wastewater service to the area would be to consolidate down to two master regional wastewater treatment plants as seen in Option 5 in Table 5-1 in the 2018 eHT Plan. Since the costs for this project cannot be pinpointed to each individual MUD, the costs were allocated based on the total build out size of each participant, as found in the 2018 eHT Study.

³ Although Missouri City Management District #1 and Missouri City Management District #2 were originally identified to be included in Scenario 3, these two MUDs were excluded from the Study because they have no current customers and did not have any forecasted customers. Further, they have negligible operating expenses (primarily legal, accounting, or other contractual services) that are primarily offset by advances or loans. Thus, their inclusion was not meaningful to the Study.

⁴ Based on the annualized change in the Handy Whitman Index cost for water mains (NARUC 331) within the South Central region of the country between January 2011 and January 2018

⁵ Based on the annualized change in the Handy Whitman Index cost for elevated steel tanks (NARUC 330) within the South Central region of the country between January 2011 and January 2018

As directed by City staff, NewGen developed its scenario analysis based on two potential consolidation implementation structures – 1) annexation or dissolution of each MUD, title acquisition by the City of each MUD’s assets (including both water/wastewater assets and all other assets of the MUD), and assumption by the City of all of the MUD’s liabilities and obligations (including MUD debt and all operating expense obligations); and 2) voluntary negotiated transfer by each MUD of its water/wastewater utility assets to the City (with each MUD continuing in existence), and no assumption by the City of MUD liabilities and obligations (except continuing utility intergovernmental agreements).

MUD Annexation or Dissolution Option

In the MUD annexation or dissolution option, the MUD would cease to exist as a governmental entity. By law, upon annexation or dissolution of the MUDs, the City would obtain title to all of the MUDs’ assets and assume all the MUDs’ expenses, debts and other obligations. The City would not assume the MUDs’ ability to levy a MUD property tax to fund the expenses, debts and other assumed obligations, and would have to identify other funding sources within the City to pay such assumed obligations. Since most MUDs are using property tax revenue to pay water/wastewater utility debt, and to supplement utility rate revenues to pay operating expenses, the loss of MUD property tax revenue support has a very negative effect on the financial feasibility of this option. Under this option, the former MUD water/wastewater customers would face a lower overall tax burden as the MUD property tax expired, but the City would have to either substantially raise the former MUD customers’ water/wastewater utility rates, or allocate general City tax revenues to subsidize the cost of water/wastewater utility service to the former MUD customers (and if general revenues were not sufficient, the City would have to raise additional general tax revenues City-wide to support such assumed cost burden). In addition, the existing debt of each MUD would have to be paid off by the City via a new debt issuance by the City, with the City funding the debt service either through increased water/wastewater utility rates or City general fund revenues. The City could not assume the MUDs’ existing debt as the debt is secured by MUD property taxes, which the City would have no recourse to. Finally, under this option, the City would have to assume the provision of all other governmental services being provided by the MUDs in addition to water/wastewater services, again without recourse to the MUDs property tax levees currently funding operation of those services.

Asset Acquisition Option

In the asset acquisition option, the MUDs would voluntarily divest themselves of their utility system assets without remuneration from the City, but would continue to exist as governmental entities to provide and fund utility infrastructure for those MUDs still in the development phase, to fund repayment of existing MUDs debt, and to continue to provide non-utility services (e.g., parks, roads, etc.). In this option, MUDs with outstanding development debt would continue to service that debt, and would continue to levy and collect at current levels the MUD property taxes necessary to fund the MUDs’ administrative costs, remaining non-utility operating expenses, and existing and future utility debt service, which would not be assumed by the City. The analysis assumes that the City would initially continue the existing MUD utility rates in place, with annual adjustments to address inflated costs, but would not raise rates to fund the acquisition. The analysis also assumes that the MUDs will continue to collect for water/wastewater operating expenses imbedded in the MUDs property tax levy and transfer those funds to the City for the same purpose (i.e., to defray the water/wastewater operating expenses assumed by the City from the MUDs). For purposes of the financial analyses, we have assumed that the amount the MUD collects from property taxes in excess of its administrative costs, non-utility operating expenses, and debt service is equal to the portion of water/wastewater utility operating expenses currently used in addition to revenues from utility rates to fund its water/wastewater utility service (i.e., the subsidy). This available

Section 3

property tax portion for funding water/wastewater utility operating costs would be transferred annually to the City to pay the water/wastewater operating costs not covered by rate revenues (mirroring the existing funding mechanism of the MUDs so that existing MUDs utility customers would see no utility financial change as a result of the acquisition). Note MUDs property tax transfers would **not** be used to offset or subsidize existing City water/wastewater system operating expenses, which would continue to be funded by the City utilities existing rates.⁶

Table 3-1 summarizes several of the key differences between an asset acquisition and an annexation or dissolution of the MUDs.

Table 3-1: Relevant Components for Each Option

Asset Acquisition	Annexation/Dissolution
<u>Revenues</u> <ul style="list-style-type: none"> • Water Service • Property Tax Support ^{1,2} • Wastewater Service • Tap Connection & Inspection Fees • Participant Billings • Surface Water Fees 	<u>Revenues</u> <ul style="list-style-type: none"> • Water Service • No Property Taxes • Wastewater Service • Garbage Service (if any) • Other Revenues • Tap Connection & Inspection Fees • Participant Billings • Surface Water Fees • Other Tax
<u>Operating Expenses</u> <ul style="list-style-type: none"> • Treated the same, except excludes "Other" operating expenses, which remain with the MUD 	<u>Operating Expenses</u> <ul style="list-style-type: none"> • Treated the same, except includes "Other" operating expenses
<u>Debt Service</u> <ul style="list-style-type: none"> • Debt Service for new capital projects 	<u>Debt Service</u> <ul style="list-style-type: none"> • Debt Service for new capital projects • Plus MUD Debt defeasance costs • Plus MUD developer reimbursement obligations

1. MUD Property Tax Revenue + Revenues for services retained by the MUD – MUD Debt Service – Expenses for services retained by the MUD = Portion of Tax Revenue Assigned to the City
2. Amount City receives in 2020 is constant throughout the 30-year forecast.

Net Present Value Analysis

NewGen developed a net present value ("NPV") analysis that calculates the payback, if any, from each option over a 30-year period based on the net income after debt service and operating expenses. The NPV analysis takes into account the relative timing of CIP and O&M expenditures and the impact they have on cash flow. If the NPV is negative, it indicates the existing water/wastewater utility revenues (even

⁶ Alternatively, for the purposes of this analysis, the assumption could equally be that the City would be able to increase utility revenues equal to the subsidy in the first year of the forecast. However, factoring in political considerations we believe that option is less likely.

with customer growth and adjustments to rates for inflation) are not sufficient to keep the City from having to financially support the MUDs water/wastewater expenses from utility rate increases and/or general City revenues. In calculating the NPV analysis, NewGen utilized a 5% discount rate.

Tables 3-2, 3-3, and 3-4 summarize the NPV by scenario.

Table 3-2: Scenario 1 – MUDs with Annexation Agreements

Option	NPV	
Scenario 1.1 – Riverstone MUDs		
Asset Acquisition	(\$10,396,835)	unfavorable
Annexation	(\$71,398,108)	unfavorable
Scenario 1.2 – Sienna Plantation #1 MUDs		
Asset Acquisition	\$6,178,851	favorable
Annexation	(\$269,621,643)	unfavorable
Scenario 1.3 – Sienna Plantation #5 MUDs		
Asset Acquisition ¹	\$0	favorable
Annexation	(\$93,942,989)	unfavorable

1. Reflects unique assumptions regarding developer support and capital funding, without which the NPV would be negative \$31.7 million

Table 3-3: Scenario 2 – Harris County MUDs

Option	NPV	
Asset Acquisition	\$ 3,942,434	favorable
Dissolution	(\$12,393,853)	unfavorable

Table 3-4: Scenario 3 – Inside City MUDs

Option	NPV	
Scenario 3.1 – Inside City MUDs with No Property Tax Revenue		
Asset Acquisition	(\$16,058,088)	unfavorable
Dissolution	(\$8,018,183)	unfavorable ¹
Scenario 3.2 – Other Inside City MUDs		
Asset Acquisition	\$11,779,472	favorable
Dissolution	(\$169,120,624)	unfavorable

1. Relatively close to breakeven

Key Findings

Based on our financial analysis, we make the following findings as part of the Study for consideration by the City.

Scenario 1 – MUDs with Annexation Agreements

1. The most feasible option from all three sub-scenarios in Scenario 1 (MUDs with Annexation Agreements) would be an Asset Acquisition from Sienna Plantation #1 and its participating subservient MUDs (Scenario 1.2). This is the only scenario/option in Scenario 1 that has a positive NPV without unique assumptions related to developer support or capital funding. The main concern with an asset acquisition is the necessity of negotiating a voluntary acquisition transaction with the MUDs' Boards in accordance with the transaction assumptions/parameters identified.

One contributing factor to this outcome is that Participant Billings (i.e., revenues reported by Sienna Plantation #1 based on payments by the participant MUDs) were greater than the total of payments to Sienna Plantation #1 (aka, Connection Charges) reported by the participant MUDs in Scenario 1.2 in the most recent financial reports available to NewGen. If this happens to be atypical, or the result of a timing difference in reporting, then the results of this analysis may be misleading.

In Scenario 1.3, Sienna Plantation #5 reported Participant Billings that were somewhat similar in magnitude to what was reported by Sienna Plantation #4 as payments to the master MUD.⁷ However, Sienna Plantation #5 reported \$735,247 in payments to a master MUD that were presumably paid to Sienna Plantation #1. This could be the source of (or a contributing factor to) the incremental Participant Billings reported by Sienna Plantation #1 in Scenario 1.2. The nature and magnitude of Participant Billings and Connection Charges should be more carefully studied and confirmed before the City makes any final decisions with regard to these results.

It is also worth noting that the existing Sienna Plantation #2 debt is due to be paid in full in 2026 and NewGen received indications that Sienna Plantation #2 and Sienna Plantation #3 may be done issuing new debt.

2. An Asset Acquisition from Sienna Plantation #5 and its participating subservient MUDs (Scenario 1.3) could be financially feasible if the unique assumptions regarding developer support and capital funding can be agreed to with the MUDs. Specifically, Sienna Plantation MUD #5 has an agreement with the developer (Toll-GTIS Property Owner) to make contributions to fund any operating shortfalls. This developer advance will be repaid in the future from cash or new debt issues. The MUDs in this scenario are only just beginning to be built out and, therefore, their revenues are understated as compared to what they should be in the future. Thus, the developer advances formulaically eliminate any operating shortfalls in this scenario.
3. All other options in Scenario 1 do not represent a viable financial transaction as they would require substantial increases in utility rates and/or general fund subsidies due to the negative NPV.
4. The requirement to repay all of the MUD's existing debt and developer reimbursement obligations, and the inability to supplement utility rate revenues via MUDs continuing property tax revenues, means that the City would require significant utility rate increases and/or subsidies from the City's general funds under any annexation scenarios (likely regardless of the timing).
5. The City should reexamine the analysis when the Annexation Agreement trigger date allowing annexation of each MUD approaches to evaluate the outstanding debt and developer

⁷ Sienna Plantation MUD #6 and Sienna Plantation MUD #7 did not report any payments to a master MUD in the most recent financials available to NewGen

reimbursement obligations the MUD has at that time. If these obligations have been reduced at that time, it may alter the results of the financial analysis.

Scenario 2 – Harris County MUDs

1. An asset acquisition from the Harris County MUDs represents a viable financial transaction that is forecasted to avoid increases in utility rates or general fund subsidy. The NPV of this option is positive, meaning there is not forecasted to be a financial impact on the current MUDs water/wastewater customers or subsidy cost to the City of pursuing this option for this scenario. The main concern with an asset acquisition is the necessity of negotiating a voluntary acquisition transaction with the MUDs' Boards in accordance with the transaction assumptions/parameters identified. Absent the revenue sharing parameters between the MUDs and the City, which underlie this analysis, this option would be negatively impacted and the NPV would be approximately negative \$7.3 million.
2. A dissolution of the Harris County MUDs does not represent a viable financial transaction as it would require increases in utility rates or general fund subsidies due to the negative NPV. The requirement to repay all of the MUDs' existing debt, and the inability to supplement utility rate revenues via MUDs' continuing property tax revenues, means that the City would require significant utility rate increases and/or subsidies from the City's general funds under the assumptions utilized.

Scenario 3 – Inside City MUDs

1. Although an asset acquisition for Scenario 3.1 has a negative NPV, this is due, in part, to programmatic operating under-recovery strategies by Quail Valley and Thunderbird and current rates not yet reflecting funding of anticipated CIP programs identified by these MUDs, which NewGen assumes will require rate increases in the coming years. Annual revenue increases (or expense reductions) of approximately \$1.0 million per year would yield a breakeven NPV.
2. The dissolution option for Scenario 3.1 has a negative NPV, but is relatively close to breakeven on an NPV basis due, in part, to the absence of outstanding debt or developer reimbursement obligations. Quail Valley and Thunderbird had combined current assets net of liabilities of approximately \$6.4 million on their balance sheets in 2017, so the current assets may substantially offset the negative NPV (if the balances are still similar to what they were in 2017, and these balances when transferred to the City in a dissolution would be available to fund the projected CIP costs for the MUDs).

It is important to point out that the NPVs for the two options for Scenario 3.1 flip-flop depending on the assumptions made with respect to reserves and rate increases for future CIP program costs, such that either option could potentially be feasible depending on direct discussions with the MUDs to understand their anticipated future rate adjustments. There may, however, be a supplemental benefit to the City from the asset transfer option over the dissolution option in that the MUDs stay in existence and can continue to provide operational support for the City and the consolidated utility systems, which would not be available in a dissolution option.

3. An asset acquisition for Scenario 3.2 represents a viable financial transaction that is forecasted to avoid general fund support. The NPV of Scenario 3.2 is positive, meaning there is not forecasted to be a financial impact on the current MUDs water/wastewater customer or subsidy cost to the City of pursuing this option for this scenario. The main concern with an asset acquisition is the necessity of negotiating a voluntary acquisition transaction with the MUDs' Boards in accordance with the transaction assumptions/parameters identified above. Absent the revenue sharing

parameters between the MUDs and the City, which underlie this analysis, this option would be negatively impacted and the NPV would be approximately negative \$112.9 million.

4. A dissolution of the Scenario 3.2 MUDs does not represent a viable financial transaction as it would require meaningful increases in utility rates or general fund subsidies due to the negative NPV. The requirement to repay all of the MUDs' existing debt and developer reimbursement obligations, and the inability to supplement utility rate revenues via MUDs' continuing property tax revenues, means that the City would require significant utility rate increases and/or subsidies from the City's general funds under the assumptions utilized.

City Financials

The City's financial condition also has a bearing on the analysis. As part of the Study, we solicited input from the City's Financial Adviser, Hilltop Securities, as to the ability of the City to absorb the MUDs' utility related debt and other obligations of the various utility service providers as part of a consolidation of the utility service providers utility systems into the City utility system. In particular we inquired as to the City's debt capacity to issue new debt to fund MUD consolidation transactions, and the effect of such transaction financing on the City's Bond Rating. The answer to these financial questions would be critical to the City Council's deliberations as to the advisability of moving forward with MUDs dissolution/annexation alternatives. Our team held an information gathering meeting with the Financial Adviser and the City's Director of Finance, after which the Financial Adviser provided its written analysis ("FA Analysis"). A copy of the FA Analysis is attached to this Study Report as Appendix J.

City's Debt Capacity

The Financial Adviser made the following determination regarding the City's capacity to issue new debt to finance a consolidation:

There is not capacity to take on the additional [Municipal Utility District] debt and do the general-purpose Capital Improvement Plan of the City.

Bond Rating

The Financial Adviser made the following determination regarding the impact on the City's Credit Rating if it were to issue new debt to finance a consolidation:

Moody's Investor Service lists increasing the net debt burden due to additional issuance absent tax base growth or a reduction in the support from the surface water utility as a factor that could lead to a downgrade [of the City's Credit Rating].

Ad Valorem Bonds vs Revenue Bonds

As noted above, the Financial Adviser determined the City does not have capacity to assume the current ad valorem debt of the MUDs. Under the MUD statutory authority, Title 4. General Law Districts, Chapter 54. Municipal Water Districts, Subchapter A. General Provisions, Section 54.501. Issuance of Bonds, a MUD can issue ad valorem debt to finance (and re-finance) water and wastewater utility infrastructure and levy ad valorem taxes on the properties within the MUD to support that utility financing. The MUDs may also

include water and wastewater utility operating expenses within the MUDs ad valorem tax levees. As noted previously, numerous MUDs in the Study have included some or all of their water and wastewater utility operating expenses in their general fund budgets to be collected through ad valorem taxes, leaving only a small portion of such expenses to be recovered through utility rates.

The City, however, does not have legal authority to continue to exercise a MUD's statutory tax levy authority over property within the MUD after dissolution or annexation of the MUD into the City. That means the City cannot continue levying the MUD tax to pay MUD debt service and operating obligations, but would instead, only be able to resort to general City-wide ad valorem taxes or user fees. In order to assume MUD obligations and refund MUD debt, the City would have to find surplus revenues in its existing ad valorem tax revenues or, if none was available, the City would have to raise the ad valorem taxes on all City residents and businesses to support new debt financing to assume the debt obligations of an annexed or dissolved MUD and to cover assumed MUD operating expenses.

Since the City cannot continue to exercise a MUD's statutory tax levy authority over property within the MUD, this also means that upon an annexation or dissolution of a MUD, the City could also not assume a MUD's outstanding ad valorem tax debt, as the MUD ad valorem taxes are pledged for payment of such MUD bonds (and those taxes disappear with the MUD). Instead, the City would have to issue new City debt financing to refund or defease the existing MUD ad valorem debt, and cannot continue to levy the existing MUD specific ad valorem tax to support that new City debt. The City's only options would be issuance of City-wide ad valorem tax supported bonds (with tax increases as discussed above), or issue non-tax revenue supported debt obligations where the City would have to derive a different alternative revenue source to pay the debt service on replacement bonds.

As the Financial Adviser identified that the City could not issue MUD property owner specific ad valorem tax bonds as a tool to consolidate a MUD's utility infrastructure into the City, the Financial Adviser next discussed the impact of utilizing an alternative non-ad valorem debt financing repayment source for acquiring a MUD's utility infrastructure in a consolidation (i.e., traditional municipal revenue bond financing supported by water and wastewater utility service rates, fees and charges):

Most cities that have essential service utility systems treat them as a business. Therefore, the system is not supported from the levy of taxes but rather from user fees...Because the user fees currently being charged [by MUDs] are supplemented with ad valorem taxes, it is reasonable to assume a large rate increase in user fees would be required to cash flow the operations and debt of the system. This may not be an option the City would consider but it would allow the City to continue with its own capital improvement plan.

If the City were to consider the Financial Adviser's non-ad valorem tax based debt financing alternative supported by water and wastewater utility rates, fees and charges, the City has more structuring flexibility than with ad valorem taxation based debt financing. Unlike with ad valorem tax levees which must be City-wide at a uniform undifferentiated tax rate, the City could theoretically establish differential utility rates for different MUD utility systems to support assumption of the MUD's differential debt and other obligations. Such differential rate making would have to be justified under traditional utility rate making principles based on identifiable and demonstrable distinctions between customers from one MUD system as against other MUD systems (and the City's own existing utility customers). If differential rates could be justified, then the City could issue separate municipal revenue bonds specific to a particular MUD's utility customers net revenue available for debt service, and accordingly keep the financial impact of a

consolidation of a particular MUD isolated to the MUD's utility customers, rather than supported by the tax revenues from all of the City's residents and businesses.

However, as cautioned by the Financial Adviser, the increased utility rate impact on the MUD utility customers arising from such a municipal revenue bond financing plan could place a significant additional burden on the residents and businesses within the MUD. Theoretically, such an increase in utility rates should be offset to a degree by a proportional removal of the MUDs ad valorem tax levy on those same utility customers upon the City refund or defeasance of the MUD's outstanding utility related ad valorem debt. However, as noted by the Financial Adviser, a MUD utility customer might not view such an ad valorem tax offset as financially equivalent to a utility rate increase. It should be noted that there will likely be utility customers whose overall cost burden decreases and others whose overall cost burden increases as a result of such changes, which may raise equity concerns.

Impact of Financial Adviser Conclusions on Feasibility of Consolidation Structure Alternatives

The conclusions of the Financial Adviser regarding the limited City debt capacity and potential bond rating downgrade would suggest that annexations or dissolution of MUDs with significant outstanding debt service may not be financially feasible until that outstanding debt is retired or reaches a de minimis level. The financial analyses by NewGen discussed above supports the conclusions of the Financial Adviser. At this time NewGen has identified six MUDs with no debt as of the date of review (Quail Valley UD, Thunderbird UD, Meadowcreek, Palmer Plantation #1, Sienna Plantation #6, and Sienna Plantation #7) and one MUD with de minimis debt (Fort Bend County #49).

Section 4 LEGAL

In-City MUDs

The City operates under a home rule charter adopted pursuant to provisions of the Texas Constitution and Chapter 9 of the Texas Local Government Code.

There are several distinct types of MUDs that operate within the corporate boundaries of the City. Some of those MUDs existed before the City was incorporated and some of the districts were created after the City incorporated. No matter when the MUD was created, state law provides that the City has the authority to abolish the MUD if the City determines that:

1. The MUD is no longer needed or the services furnished and functions performed by the MUD can be furnished and performed by the City; and
2. the abolition of the MUD is in the best interest of the residents and property of the City and MUD.⁸

These provisions grant the City the ability to make a general determination on what provision of utility service is in the best interest of the residents of the City. However, the law also provides that if the City receives a petition requesting a vote on whether the MUD should be abolished, the City must call an election on the issue and allow the residents of the City to vote to decide whether the MUD should be abolished.⁹ The petition requesting an election must be received before the effective date of the ordinance adopted by the City Council that abolished the MUD; or the petition requesting an election must be received within 30 days after the effective date of the ordinance or publication of the ordinance.

After receiving the petition, the City Council must reconsider the ordinance that abolished the MUD. If the council does not repeal the ordinance, it must schedule an election for the residents to vote on the issue of whether the MUD should be abolished. The election must be held on the next municipal election or at a regular election called by the council. The ordinance abolishing the MUD must receive a majority vote in the election to be effective.

ETJ MUDs

The City has also entered into several Strategic Partnership Agreements (“SPA”) with MUDs in the City’s ETJ.¹⁰ These voluntary development agreements are entered in lieu of annexation and specifically set out the terms and conditions of when and how the City will annex and abolish those MUDs. The legislature created a detailed legislative scheme for cities and MUDs to follow when entering into these types of agreements. As a result, these MUDs are not subject to any citizen voting requirements on whether the MUDs can be annexed and abolished.

Further, if there are other MUDs in the City’s ETJ that have not entered into a SPA with the City, those MUDs and their residents will be governed by state annexation laws. Texas annexation laws were completely revised in 2017 to provide that for most annexations the residents or landowners of the area to be annexed will be required to vote in favor of annexation before the area can be annexed into a city.¹¹

⁸ Tex. Local Government Code, Section 43.074

⁹ Note-Tex. Local Government Code, Section 43.074 **only** applies to WCIDs, Fresh Water Supply Districts, MUDs

¹⁰ Tex. Local Government Code, Section 43.0751

¹¹ See, Tex. Local Government Code, Section 43.0205 through 43.0699

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If an area contains a MUD and the residents or landowners in the areas refuse to vote in favor of annexation the MUD could not be brought into the City and therefore could not be abolished by the City. SPAs do not negate the statutory annexation vote provisions. Before 2017, the general rule was that the City had the unilateral right to bring the residents and landowners into the City and abolish the MUD.

Note that the discussion above addresses the abolishment and/or annexation of MUDs into the City. That discussion would not be applicable if the City elected a consolidation option where a MUD voluntarily transferred its utility assets to the City without the City abolishing or annexing the MUD. The City Charter, Section 2.01. General Powers, specifically empowers the City to acquire property inside and outside the City's boundaries, and to cooperate with any other governmental entity to accomplish such lawful purposes.

Sienna Plantation MUDs

The City entered into the Sienna Plantation Joint Development Agreement on February 18, 1996, with the developer of Sienna Plantation ("SP") to address the Sienna Plantation Master Plan, Land Use and Infrastructure requirements (the "SPJDA"). In Section IV of the SPJDA, the parties agreed on a plan for the ultimate annexation of the SP development into the City. That contractual plan, which remains in effect, governs the City's options with respect to annexations of the SP MUDs (aka Sienna MUDs), and limits the availability of options for consideration by the City in this Study. In particular, Section 4.02 of the SPJDA provides:

The City ... will not annex or attempt to annex, in whole or in part, a Sienna MUD until the following conditions have been met:

- 1) At least 90% of the developable acreage within the Sienna MUD has been developed with water, wastewater treatment, and drainage facilities. Developable acreage means the total acreage in Sienna less acreage associated with land uses 43, 44, 61, 62, 63, 64, and 65 in the Parcelization Plan attached hereto as Exhibit D-13; and
- 2) The landowner developing within the Sienna MUD has been reimbursed by the Sienna MUD to the maximum extent permitted by the rules of the TNRCC [now called the Texas Commission on Environmental Quality or TCEQ] or the City assumes any obligation for reimbursement of the Sienna MUD under such rules.

The SP MUDs utility service structure comprises a master infrastructure MUD (SP #1), which provides wholesale utility service to SP #2, #3, #4, #5, #10, #12, and the SP Management District with various utility infrastructure (temporary and permanent) located throughout the other SP MUDs. At the current time, two SP MUDs (SP #2 and SP #3) have reached Annexation criteria 1. Representatives of the developer and SP have estimated that the remaining SP MUDs will begin meeting the Annexation criteria in 2020 (SP #12) with the remaining MUDs reaching build-out incrementally starting in 2025 (SP #10), 2040 (SP #12) and beyond 2040 (SP #1, #4, #5, #6, and #7). See Table 2-1 of the 2018 eHT Plan.

Fort Bend County #149

The City entered into a SPA with Fort Bend County #149 and the Riverstone community developer. This agreement governs the City's relationship with respect to annexations, and limits the availability of options for consideration by the City in this Study. In particular, Section 3.01 provides:

The City ... will not annex or attempt to annex...the District until the following conditions have been met:

- 1) At least 90% of the developable acreage within the District has been developed with water, wastewater treatment, and drainage facilities....
- 2) The Developer developing within the District has been reimbursed by the District to the maximum extent permitted by the rules of the TCEQ or the City assumes any obligation for such reimbursement of the District under the rules.

At the current time, Fort Bend County #149 has not met either annexation criteria. Estimates by representatives of the developer and the MUD have estimated that the MUD is not anticipated to meet both annexation criteria until approximately 2021 or 2022. See Table 2-1 of the 2018 eHT Plan.

Fort Bend County #129

The City entered into a SPA with Fort Bend County #129 and the Riverstone community developer. This Agreement governs the City's relationship with respect to annexations, and limits the availability of options for consideration by the City in this Study. In particular, Section 3.01 provides:

The City ... will not annex or attempt to annex...the District until the following conditions have been met:

- 1) At least 90% of the developable acreage within the District has been developed with water, wastewater treatment, and drainage facilities....
- 2) The Landowner developing within the District has been reimbursed by the District to the maximum extent permitted by the rules of the TCEQ or the City assumes any obligation for such reimbursement of the District under such rules.

At the current time, eHT does not forecast any additional connections in Fort Bend County #129. Further, representatives of the developer and the MUD indicate the developers have all been reimbursed. Thus, Fort Bend County #129 appears to meet the annexation criteria. See Table 2-1 of the 2018 eHT Plan.

Overlapping Non-Utility MUDs Infrastructure Facilities

In this Study, the Study team was charged to analyze consolidation of the MUDs water and wastewater facilities and service with the City's water and wastewater facilities. However, most of the MUDs in the Study provide additional infrastructure services and maintain non-utility infrastructure, including drainage facilities and, in some instances, levees and water detention/drainage facilities. As noted previously, the MUDs annexation statutes and SPAs do not provide a mechanism for only annexing or consolidating the water and wastewater infrastructure while leaving the drainage/levees infrastructure in place under MUD operations. Accordingly, any MUDs water and wastewater consolidation options that contemplate formal annexation of the MUDs into the City must also include consideration of consolidation of these additional infrastructure facilities and obligations.

Section 5

IMPLEMENTATION OPTIONS

Present to 10 Year Plan Horizon

Update City Code Regarding MUD Life Cycle/Consolidation Planning

As part of the Study we reviewed the existing City Code to determine what guidelines the City currently has in place to facilitate and administer MUD consolidation as a component part of the natural MUD life cycle absent a consolidation plan. We did not find any such Code provisions and believe that developing consolidation planning and administrative guidelines would be beneficial for the City regardless of what consolidation plan the City Council may determine to implement. An example of such guidelines could be:

- 1) Preferably, all MUD debt should be fully paid. At a minimum, the City's annual costs of paying the MUD's bond debt and recurring operation and maintenance expenses after dissolution should be no greater than the amount of revenues the City gains through the ad valorem value of property within the MUD and user fees for infrastructure services to be provided by the City.
- 2) The MUD has fully reimbursed the developer for the developer's cost of installing MUD infrastructure as permitted by Texas law and regulations. At a minimum, the MUD should have already issued debt to fully pay such developer's cost and have cash reserves for such payment that would be transferred to the City upon dissolution of the MUD.
- 3) The MUD is not delinquent in the payment of any other financial obligation that is due prior to the date of dissolution.
- 4) The MUD did not finance and does not own or operate any drainage detention facilities that the City did not specifically approve as a public drainage facility that would become part of the City's public drainage system upon the MUD's dissolution.

Option 1: Maintain the Status Quo

The first option the Study team analyzed was to maintain the status quo during this Study Plan Horizon. The data collected revealed that the current decentralized individual MUDs utility operations work efficiently and maintain utility service related customer charges that are satisfactory. Maintaining the status quo would mean eschewing the potential opportunities that consolidation could bring in the form of economies of scale and uniformity of utility rates and charges throughout the City and ETJ for residents and businesses. On the positive side, maintaining the status quo would also allow the MUDs to complete their build-out of utility infrastructure and eventual retirement of debt associated with the development and build-out of the areas served by the MUDs, making an eventual consolidation program in later years more financially feasible.

Option 2: Implement Systematic Dissolution/Annexation Program

The second option the Study team analyzed was to begin implementation of a systematic MUD dissolution/annexation program. As MUDs jurisdictional areas build-out, utility infrastructure is completed through such build-out, and utility infrastructure debt is retired, the City could dissolve (for in-

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City districts) or annex (for ETJ districts) the MUDs into the City and assume ownership and operation of the MUDs water and wastewater infrastructure. Under this option, the City would also implement ETJ annexation agreements as their annexation trigger conditions occur over time. This option would also require the City to assume not only water and wastewater infrastructure and service, but also all other MUD obligations, including any MUDs' non-water and non-wastewater infrastructure (e.g., drainage, levees, parks, etc.).

There are currently a few MUDs that have built-out their utility infrastructure, and have no (or minimal) current utility infrastructure debt which would meet the criteria for dissolution/annexation at this time (Quail Valley UD, Thunderbird UD, Meadowcreek, Palmer Plantation #1, and Fort Bend County #49).

The other MUDs retire their current infrastructure debt (other than de minimis amounts) on the timetable identified in Tables 5-1, 5-2, and 5-3. These tables reflect current values, which may not reflect obligations incurred subsequent to the date of financial statement review. The debt amounts outstanding are subject to change for those MUDs not yet built-out, like many of the SP MUDs, that are likely to issue additional debt in the future through build-out of their utility infrastructure, and for those MUDs financing renewal/replacement capital projects. The debt maturities are also subject to change over time to the extent that MUDs refinance or re-structure their existing debt with longer maturities.

Table 5-1: Current Obligations – Scenario 1 (MUDs with Annexation Agreements)

Scenario	MUD	Debt Maturity Year	Principal Outstanding ^{1,2}	Total Remaining Debt Service Payments ^{1,3}	Current Developer Reimbursement Obligations ^{1,4}
1.1	Fort Bend County #129	2035	\$ 19,065,000	\$ 25,605,157	\$ 824,070
1.1	Fort Bend County #149	2041	25,145,000	36,068,280	-
1.2	Sienna Plantation #1 (master)	2049	25,010,000	34,622,418	497,982
1.2	Sienna Plantation #2	2026	14,335,000	16,403,300	-
1.2	Sienna Plantation #3	2032	31,890,000	41,724,860	-
1.2	Sienna Plantation #10	2040	56,985,000	80,377,351	1,936,170
1.2	Sienna Plantation #12	2041	55,030,000	78,424,481	14,861,749
1.2	Sienna Plantation #13 ⁵				
1.2	Sienna Plantation Management District	2042	31,280,000	45,551,572	11,410,210
1.3	Sienna Plantation #4	2043	27,800,000	40,150,280	17,860,294
1.3	Sienna Plantation #5 (master)	2043	9,645,000	14,225,449	21,034,992
1.3	Sienna Plantation #6		-	-	-
1.3	Sienna Plantation #7		-	-	-
			\$296,185,000	\$413,153,148	\$ 68,425,467

Notes:

- 1) As of the most recent financial statement available for NewGen's review
- 2) Sum of all future principal payments from 2020 until maturity
- 3) Sum of all future principal and interest payments from 2020 until maturity
- 4) Does not include committed developer reimbursement obligations that are not yet reflected on the MUDs' balance sheets (because the projects are not yet complete)
- 5) Financials for "the Woods" are consolidated and reported with the financials for Sienna Plantation #1

Table 5-2: Current Obligations – Scenario 2 (Harris County MUDs)

Scenario	MUD	Debt Maturity Year	Principal Outstanding ^{1,2}	Total Remaining Debt Service Payments ^{1,3}	Current Developer Reimbursement Obligations ^{1,4}
2	Harris County Fondren Road	2030	\$ 2,255,000	\$ 2,619,711	\$ -
2	Southwest Harris County #1	2027	1,450,000	1,729,841	-
2	Harris County #122	2031	1,220,000	1,534,535	-
			\$ 4,925,000	\$ 5,884,087	\$ -

Notes:

- 1) As of the most recent financial statement available for NewGen's review
- 2) Sum of all future principal payments from 2020 until maturity
- 3) Sum of all future principal and interest payments from 2020 until maturity
- 4) Does not include committed developer reimbursement obligations that are not yet reflected on the MUDs' balance sheets (because the projects are not yet complete)

Table 5-3: Current Obligations – Scenario 3 (Inside City MUDs)

Scenario	MUD	Debt Maturity Year	Principal Outstanding ^{1,2}	Total Remaining Debt Service Payments ^{1,3}	Current Developer Reimbursement Obligations ^{1,4}
3.1	Quail Valley Utility District		\$ -	\$ -	\$ -
3.1	Thunderbird Utility District		-	-	-
3.2	Meadowcreek		-	-	-
3.2	Palmer Plantation #1		-	-	-
3.2	Palmer Plantation #2	2026	4,525,000	5,233,775	-
3.2	Fort Bend County #26	2029	8,800,000	9,877,256	1,096,156
3.2	Fort Bend County #42	2026	6,155,000	6,859,300	-
3.2	Fort Bend County #46	2027	9,790,000	10,525,262	3,051,002
3.2	Fort Bend County #47	2034	5,390,000	6,940,003	4,179,370
3.2	Fort Bend County #48	2038	15,010,000	19,024,256	7,083,109
3.2	Fort Bend County #49	2030	470,000	626,529	-
3.2	Fort Bend County #115	2028	8,740,000	10,141,167	-
3.2	First Colony #9	2035	6,645,000	7,637,088	-
3.2	Blue Ridge West	2041	2,250,000	3,230,587	-
			\$ 67,775,000	\$ 80,095,223	\$ 15,409,637

Notes:

- 1) As of the most recent financial statement available for NewGen's review
- 2) Sum of all future principal payments from 2020 until maturity
- 3) Sum of all future principal and interest payments from 2020 until maturity
- 4) Does not include committed developer reimbursement obligations that are not yet reflected on the MUDs' balance sheets (because the projects are not yet complete)

A key factor for a successful implementation of this option will be transition planning. Each of the MUDs currently operate their utilities (and other infrastructure) through seasoned internal operations employees (e.g., Quail Valley UD) or through experienced contract operations with third party providers (e.g., Si Environmental, Municipal District Services, Inframark). In contrast, the City has a small utility

management/operations staff, and as a result has elected to contract with Quail Valley UD's experienced utilities team to operate a number of the City's existing utility facilities. Accordingly, any acquisition will necessarily require an initial interim operations transition of a minimum of three to five years, where the City would contract to have the current MUDs' utilities operators continue operations of the dissolved/annexed utilities acquired by the City on a status quo basis. During the interim period, the City could consider the economic and technical feasibility of the City developing its own robust fully-staffed internal utility operations group, versus continuing with contract operations past the interim period.

Such interim period contract operations would have the benefit of assuring continuity of level of service for the MUD residents and businesses. It would also have the added benefit of assisting the City in normalizing utility cost recovery methodologies among and between utility systems (a small number of MUDs use only utility rates to meet utility expenses, while the majority of MUDs use ad valorem taxes or a combination of ad valorem taxes and utility rates to meet utility expenses).

Option 3: Implement a Voluntary Dissolution/Annexation Program

A third option the Study team analyzed was a variation on the second option. In this option, each MUD Board would determine the optimal time to dissolve their districts or annex their districts into the City, and to transition to City ownership and control of the utility systems. For ETJ MUDs with annexation agreements with the City, the transitions would occur over time as set forth under the terms of the annexation agreements. The same transition planning as under Option 2 would be implemented. Under this option the City would continue to engage with the MUDs in regional water and wastewater infrastructure development/operations programs when the opportunity arises. The City would continue to facilitate cooperation and consolidation of utility infrastructure by and among existing MUDs in the natural progression of their MUD life cycles.

Under this option, the MUD Boards would continue to provide utility service, continue to build-out their utility infrastructure, and continue to finance development growth and expansion as anticipated in their original charters throughout build-out of the MUDs jurisdictional territories while implementing planned capital improvements programs. As noted above, each MUD Board would determine if and when the MUD had outlived its statutory usefulness to its residents/constituents, and at the end of the MUD's life cycle, the MUD could petition the City to annex/dissolve/consolidate the MUDs infrastructure and services into the City.

Under this option, the City would not mandate any MUD annexation or dissolution, but would set up a transition planning program to be prepared to accept voluntary annexations or dissolutions of MUDs upon the MUD Board's determination. From City sponsored meetings with MUD representatives in the course of this Study, the consensus of those MUDs present at the meeting was to support this option. Some general comments from the MUD representatives echoed the same refrain that the current system works well for the residents/constituents of the MUDs, provides quality service, and fairly allocates the costs among the residents/constituents receiving the services without subsidizing other residents/constituents or putting any additional financial burdens on the City General Fund. This option, however, would tend not to optimize the regionalization program identified by eHT, with the benefits of regionalization deferred or more slowly implemented.

Option 4: Negotiate a Voluntary Asset Transfer

A fourth option the Study team reviewed is the possibility of MUDs voluntarily transferring their water and wastewater utility assets to be consolidated by the City in furtherance of the eHT regionalization program. The MUDs would not be dissolved or annexed, but would continue in operation, and the City would continue having the existing MUD utility operators (e.g., Quail Valley Utility District, Si Environmental, Municipal District Services, Inframark) operate the transferred utility infrastructure during a transition period (e.g., 5 to 10 years), while the City determined whether to create a fully-staffed City utility or continue with privatized operations. The MUDs would continue to service outstanding water/wastewater debt, would continue to levy and collect at current levels the MUD property taxes to fund the MUDs' administrative costs, remaining non-utility operating expenses, and existing and future utility debt service, which would not be assumed by the City, and would continue providing the MUD residents the non-utility services currently being provided. As with Option 3, the MUD Boards would determine the optimal timing of any eventual voluntary annexation/dissolution process. The analysis assumes that the City would initially continue the existing MUD utility rates in place, with annual adjustments to address inflated costs, but would not raise rates to fund the acquisition. The analysis also assumes that the MUD will continue to collect the water/wastewater operating expenses imbedded in the MUDs property tax levy and transfer those funds to the City for the same purpose.

Option 5: Create Wholesale Treatment Utility/Utility Service Providers

A fifth option the Study team reviewed is the implementation of a City-wide "wholesale" treatment/supply facilities utility. This option would contemplate each MUD retaining its retail utility customer facilities (e.g., water distribution and wastewater collection systems), and customer relationships while transferring water supply, water and wastewater treatment and storage facilities, and major transmission/force main systems to the City. The MUDs' "wholesale" facilities would be added to the existing City "wholesale" facilities (e.g., Steep Bank/Flat Bank, Surface Water Treatment Plant, Mustang Bayou), with the City providing wholesale utility service to each MUD's retained retail utility service. The MUDs would fund the operating, maintenance, capital program, and renewal and replacement costs of the City's "wholesale" facilities through MUD ad valorem taxes, retail utility charges, or a combination of both, which would be paid to the City, as currently done for the existing City "wholesale" facilities. This option would allow implementation of the eHT regional consolidated capital improvement plan, and benefit from the economies of scale identified by eHT. Under this option, MUD Boards would remain active and would not necessitate dissolution or annexation of any MUDs, though MUD Boards could voluntarily elect to dissolve or be annexed on their own timeline pursuant to the Option 3 protocol.

Under this "wholesale" program, the City could consider transferring its existing City "retail" utility systems to an appropriate abutting MUD utility service provider, leaving the City with only the "wholesale" utility service obligation. Under this option, the City would continue having the existing MUD utility operators (e.g., Quail Valley Utility District, Si Environmental, Municipal District Services, Inframark) operate the transferred "wholesale" facilities under the direction of the City (like it currently does with Quail Valley Utility District).

Option 6: Public Private Partnership to Facilitate Consolidation

A sixth option the Study team reviewed would implement a Public Private Partnership (“P3”) to facilitate a consolidation of utility infrastructure and the provision of utility service. This option would contemplate the City granting a long-term concession to a private operator to operate and finance consolidated utility facilities obtained by the City through any of the other consolidation options. This option does not require the dissolution or annexation of any MUD, but does require the City obtain title to the MUDs’ utility facilities from the MUDs for inclusion in the public private partnership concession offering.

The City Council charged us to review opportunities for use of a P3 as a mechanism for facilitating consolidation of the MUDs utility systems for the City. A P3 is a contractual mechanism in which a private sector participant partners with a governmental entity to jointly accomplish a public infrastructure project. A P3 is not technically a legal partnership in the sense that two or more parties join as co-owners of a business and share in the businesses profits and losses, but generally is a contractual arrangement where a private enterprise with expertise in public infrastructure design, development, operations and/or finance undertakes a project for a governmental entity in lieu of the governmental entity utilizing a traditional project procurement method (e.g., design, bid, build, finance, operate). P3s, in appropriate circumstances, can provide a mechanism to accomplish a public project that otherwise could not be implemented as a result of technical, structural, risk or financial limitations of the governmental entity.

As noted previously, the City’s Financial Adviser advised that the City has financial limitations that would negatively impact the City’s ability to assume the debts and obligations of the MUDs in a consolidation. As noted in the 2018 eHT Plan, implementation of the consolidation in conjunction with regionalizing the water treatment and wastewater treatment facilities would yield operational savings and would yield capital savings over anticipated capital costs of non-consolidated operations.

Those two factors suggest that a P3 could be potentially advantageous as a component part of a MUDs’ consolidation. However, a private participant in a P3 could not likely implement a consolidation without the participation of the City, because only the City could exercise the governmental rights to trigger a consolidation of MUDs’ water and wastewater utility infrastructure and customers, or negotiate a voluntary transfer of infrastructure from the MUDs to the City. Given that, a potential P3 could likely only be practical in conjunction with, and subsequent to, the City triggering a consolidation in accordance with one of the potential options identified above. The P3 options discussed below make the assumption that the City would first acquire the consolidated MUDs’ water and wastewater utility infrastructure and customers as the first step in a P3 transaction implementation.

Energy Savings Performance Contract

An energy savings performance contract (“ESPC”) is a P3 that utilizes operational energy savings resulting from constructing upgrades and improvements to existing infrastructure and technologies (in this instance the regionalization projects identified by eHT). Those energy savings (and other indirect attendant operational savings) can be used as revenues to support private financing of the regionalization projects. The Texas Local Government Code, Title 9, Subtitle C, Chapter 302, provides a mechanism for local governments to implement ESPCs. Whether an ESPC would be effective in the City’s MUDs consolidation would be identified through an ESPC procurement process as outlined in Chapter 302.

Design/Build/Finance/Operate

A design/build/finance/operate (“DBFO”) form of P3 could be an advantageous option for consideration by the City to implement the MUDs consolidation and simultaneously implement the regionalization of utility infrastructure proposed by eHT as the most cost advantageous alternative for the MUDs utility

customers and the City. As the DBFO sounds, this form of P3 would entail a privately owned entity or team of entities that would contract with the City in a single agreement to design the regionalization infrastructure, provide private project financing to pay the cost of building the infrastructure, provide the private construction contractor to build the infrastructure, and then provide the private utility operator to operate the new regionalized utility system (and potentially operate the consolidated system acquired from the MUDs during construction of the regionalized utility system).

If proposals were deemed feasible, technically and financially, then the City could award a DBFO contract (sometimes also referred to as a “concession”) to the proposer that presented the best value to the City. Note that a component part of the DBFO process would be the requirement that a stable and predictable revenue stream be identified to support the financial objectives of the selected DBFO vendor (project finance debt service, operations and maintenance costs, renewal and replacement costs, and return on equity). This predictable revenue stream could be in the way of guaranteed levels of utility rates, fees, and charges, or limited ad valorem backed subsidies or “shadow rates” payable from the City’s General Fund.

Note also that typically the City would have a lower cost of capital than would a private P3 participant. Tax-exempt debt issued by the City would likely be 150 to 300 basis points (100 basis points equals 1%) lower than taxable debt issued by the P3 participant. Likewise, the P3 participant would be looking for a reasonable return on the equity portion of its investment, typically 8% to 12% on utility transactions. The P3 participant would generally also be subject to sales taxes on all construction materials/equipment and operations/maintenance supplies/chemicals, which the City would generally not be subject to. Blending the P3 participant’s higher taxable debt cost and required return on equity could yield a blended cost of capital of up to 400 to 500 basis points higher than the City’s cost of capital. This means that a P3 participant would have to be able to realize a significantly lower cost of design, construction and operations than the City could otherwise realize to overcome the higher cost of capital and taxes. Whether that could be accomplished would be revealed during the P3 procurement process.

For instance, Mr. Yanke of NewGen was involved in a P3 analysis for the City of Fort Worth several years ago. He assisted in the drafting of the procurement document requesting private water companies to submit proposals to takeover operation and control of the City of Fort Worth’s water and wastewater utility. He then managed the evaluation of the proposals that were received from the private vendors. During the conduct of the analysis it was determined the privatization of the Fort Worth water and wastewater utility would require the defeasance of over \$700 million in debt that was currently on the utility’s balance sheet, with the debt replaced with bonds that were 150 to 250 basis points (or more) greater in cost. Based on the analysis of the bids from the private vendors, when compared to the City of Fort Worth’s cost of operating the utility, it did not make financial sense for the City of Fort Worth to move forward with considering privatization of the water and wastewater system. It should also be noted that none of the private vendors challenged the analysis as completed by Mr. Yanke.

10 Year to 30 Year Plan Horizon

Assuming that the City Council determined not to exercise any of the global MUD options identified in the 10 Year Plan Horizon, then for the options for the 10 to 30 Year Plan Horizon remain the same, with the exception that some of the outstanding MUDs’ debt will have matured (see Tables 5-1, 5-2, and 5-3 for the current debt maturity dates for each MUD with outstanding debt), at various times in the next planning horizon.

Maintain Status Quo

The City Council can continue to maintain the status quo as previously discussed.

Enter into Strategic Partnership Agreements with MUDs to Effectuate Consolidation of Maturing District to Core City Utility System

As noted previously, a large number of MUDs' currently outstanding debt is scheduled to come due in the 10 to 30 year plan horizon, and build-out of the MUDs development is also anticipated to occur. Under this option, the City could enter into current negotiations with each of the MUDs to develop strategic partnerships to effectuate the consolidation of the maturing MUDs to the core City utility system, as (and when) development is complete and development debt is fully retired or reduced to a manageable amount that could be absorbed by the City without materially negatively impacting then existing City residents and utility customers.

Execute Existing ETJ Annexation Agreement as They Mature

As noted previously, the City entered into a number of ETJ annexation agreements, which have contractual triggers as to when the City can annex the ETJ MUDs into the City. Most of these ETJ annexation agreements are expected to mature in the 10 to 30 year plan horizon. Under this scenario, as ETJ annexation agreement triggers occur, the City would undertake the financial analysis of impacts on the City from such annexations and determine an appropriate timeframe for effecting the annexations. Depending on the amount of then outstanding MUD debt for the community represented by the ETJ, the timing of such annexation may be immediately financially feasible, or may require deferral until all or most of the outstanding debt is retired.

Section 6 NEXT STEPS

This Study has provided the City with a comprehensive analysis of a variety of options that are available to the City with regard to how the City may wish to approach any potential consolidation discussions with some of the MUDs, whether located within the City or for those within the City's ETJ. Based on our analysis and experience the Study team would provide the City with the following next steps for consideration:

1. **Prioritization of Scenarios, MUDs, etc. to be Considered for Consolidation Purposes.** Based on the Study, the City staff and City Council (with input from the Study team as needed) should evaluate and prioritize those opportunities where a consolidation of MUD(s) with the City water and wastewater utility system may potentially make operational, engineering and financial sense. These decisions should be made in a manner that are consistent with the goals of the City concerning long-term planning for residential and commercial buildout within the City and its ETJ.
2. **Preliminary Discussions with MUDs Identified in Step 1.** Based on any Scenarios and/or MUDs identified in Step 1 above, the City should schedule a series of meetings with any MUDs identified as potential candidates for consolidation to discuss whether there is an interest on the part of the MUDs to consider a consolidation, or under what set of conditions such a consolidation might make sense for both parties to consider such an endeavor.
3. **Develop a Detailed Financial Plan for any Opportunities Identified in Steps 1 and 2.** The analysis completed as part of this Study was conducted at a high-level and relied, in many cases, upon financial data that was available via public information, and the Study team may not have had access to the most detailed, accurate, or recent data that is relevant to the current status of each of the 30 MUDs evaluated as part of this Study. Therefore, if based on Steps 1 and 2 there are certain MUD consolidation options that appear to create a "win-win" for both entities (City and the MUD), the Study team would strongly encourage that a more in-depth financial analysis be conducted to evaluate the following key assumptions to ensure that all information is as accurate and current as practical:
 - Revenues Assumptions (all revenue streams)
 - Operating Expenses (including any savings)
 - Capital Expenditures (both by MUD and City)
 - Capital Financing
 - Growth and Buildout Assumptions
 - Timing
 - Other, as appropriate

It is a necessity that there would be a detailed timeline of key project deliverables, as well as numerous financial, operational and capital related meetings and planning sessions, to ensure that such a consolidation opportunity is successful for all parties.

4. **Develop a Long-Term Plan for Continued Monitoring of Consolidation Opportunities.** Regardless of whether any opportunities are identified in Steps 1 through 3 that would identify any potential MUD consolidation options, the Study team would strongly

Section 6

encourage a long-term plan be put in place to continue to monitor consolidation opportunities on an annual or biennial basis. This plan would put in place a methodology and check-list that would allow the City to identify when certain criteria have been achieved that may make a MUD consolidation scenario feasible (e.g. MUD debt is paid off, or de minimis; certain buildout percentages are achieved; etc.).