

VISTA RIDGE TO DELIVER 20% MORE WATER

THE INNOVATIVE VISTA RIDGE REGIONAL WATER SUPPLY PROJECT ACHIEVED FINANCIAL CLOSE IN NOVEMBER 2016, THE DAY AFTER THE PROJECT RECEIVED FINAL APPROVAL FROM THE PUBLIC BOARD OF TRUSTEES OF THE SAN ANTONIO WATER SYSTEM. BY **ALLAN T MARKS**, PARTNER, **MILBANK TWEED HADLEY & MCCLOY LLP**.

With a total project cost of almost US\$1bn, the Vista Ridge project is one of the largest public-private partnerships yet in the water sector and a landmark transaction for the United States P3 market. Once built, the project will increase the municipal water supply for the City of San Antonio, Texas – America’s seventh largest city – by roughly 20%. The project’s allocation of risks could be a successful model for other complex infrastructure projects in the water sector, both in the United States and elsewhere.

Project chronology

Thanks to clearly articulated goals from the local government and sustained political will – and to the creativity and tenacity of the developers and banks in managing and reducing risk to meet the city’s goals – the Vista Ridge project was able to overcome changes in the sponsor group and other challenges along the way to a successful close.

Development of the Vista Ridge project began in 2010 when the San Antonio Water System (SAWS) staff first started a public search for novel concepts for diversified water sources. Even with water conservation, the City sought additional supplies to decrease pressure on the sensitive Edwards Aquifer, which is subject to Federal, state and regional pumping regulations.

The City Council approved the Vista Ridge water supply project in October 2014. On November 4 2014, the City of San Antonio, acting through SAWS, entered into the Vista Ridge Regional Supply Project Water

Transmission & Purchase Agreement (WTPA) with Abengoa Vista Ridge LLC, then a wholly-owned subsidiary of Abengoa Water USA LLC (Abengoa Water).

The project’s original developers previously were able to consolidate a pool of necessary wells, leases, water rights and permits. These water assets, as confirmed by independent hydrology studies, should provide a reliable source of fresh water, meeting or exceeding the quantities contemplated to be delivered under the WTPA for decades to come.

Due the financial struggles of Abengoa Water’s Spanish parent, a majority of the equity ownership and all operational control in the project were transferred in summer 2016 to an affiliate of the project’s prime contractor, Garney Companies Inc.

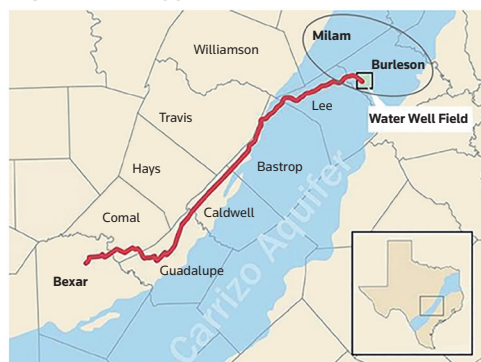
Garney, a Missouri-based construction company specialising in water and waste-water facilities, acquired a controlling 80% interest in Abengoa Vista Ridge, since renamed Vista Ridge LLC, through its wholly owned subsidiary Garney P3 LLC. Garney also assumed the equity funding obligations going forward.

Thereafter, as the myriad project contracts were finalised, Vista Ridge, along with the Central Texas Regional Water Supply Corporation (CTRWSC), obtained non-recourse debt financing for the project under a five-year mini-perm credit facility with a syndicate of nine international banks.

The Board of Trustees of SAWS, including the Mayor of San Antonio, authorised the project to move to financial close and approved final amendments to the WTPA on November 1 2016. Then, the next day and almost two years to the day from SAWS entering into the WTPA, the lenders closed the financing with Vista Ridge and CTRWSC to extend about US\$875m in construction loans, a letter of credit, and long-term interest rate hedges. The bank group was led by Sumitomo Mitsui Banking Corporation (SMBC), which acted as the coordinating lead arranger and structuring agent.

Construction is set to begin in early 2017 and last through to 2019, with water flowing by 2020. SAWS and its customers will pay only for the water that is actually delivered to SAWS.

DIAGRAM 1 - THE ROUTE



Project overview

The project consists of 18 production water wells drilled in the Carrizo Formation and the Simsboro Formation in the Carrizo-Wilcox aquifer system, along with approximately 7.5 miles (12km) of collection pipelines. The well field will deliver water through the collection pipeline system to a high service pump station in Burleson County, Texas, where the collected water will be treated.

From there, the treated water will be pumped through a 142 mile (225km) pipeline system, including intermediate pump stations, to the delivery point in north Bexar County, Texas, where it will connect to SAWS' municipal water utility system. At the terminus site, a newly constructed 10m gallon storage tank, owned by Vista Ridge, will receive the product water from the transmission pipeline. The terminus site will also include one or more newly constructed SAWS water storage tanks, a pump station, and additional water treatment facilities.

Innovative commercial risk allocation

After the project is completed in 2020, the WTPA will provide for the production, treatment and delivery by Vista Ridge LLC of up to 50,000 acre-feet (61,674,000 m³) per year of potable water to SAWS. SAWS will be entitled to purchase water from the project for a term of 30 years, with the right thereafter – or earlier, if SAWS opts to exercise its buy-out option – to take over both the pipeline and the associated wells and water rights to ensure decades of additional supply.

The WTPA shifts the risks of supply, right-of-way acquisition, construction, operations, financing and regulation from SAWS to its private sector partners. In contrast to most P3 concessions in the United States with government offtakers, SAWS will pay neither milestone payments during construction nor any

availability payments during operation of the project.

All costs of construction and right-of-way acquisition are being covered by privately raised debt and equity capital. No public funds are needed from the City to build the project. SAWS will pay only for water that is actually delivered and for certain associated operating and maintenance expenses once the project has been built and is operating. The developer of the project, Vista Ridge, takes the risk of water supplies and permits.

Material project contracts

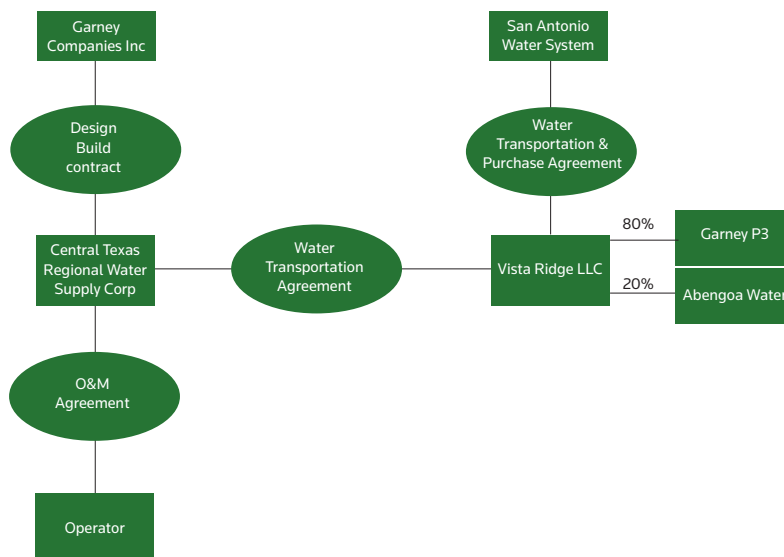
Pursuant to the WTPA, Vista Ridge will deliver fresh water to SAWS for the 30-year contract term, which (at SAWS' option) may be extended for up to 50 years in total.

Vista Ridge is responsible under the WTPA for the acquisition of raw groundwater; design and construction of the project, both well field facilities and the pipeline transmission system; financing, operation, maintenance and management of the project; delivering available potable water to the Product Water Delivery Point, the flange in the pipe between Vista Ridge's storage tank and SAWS storage tanks; and obtaining and maintaining rights to extract raw groundwater and all other governmental approvals to transport the water.

SAWS is responsible under the WTPA to design, construct, finance and maintain interconnection improvements for the receipt of product water delivered by Vista Ridge and to pay for product water delivered by Vista Ridge up to the annual maximum amount of 50,000 acre-feet (61,674,000 m³) per year.

Although Vista Ridge will be acquiring the water from the well field and transporting it to SAWS, the pipeline system will be owned

FIGURE 2 - CONTRACTUAL STRUCTURE



by CTRWSC, a non-profit water supply corporation organised under the Texas Water Code.

CTRWSC is acquiring the right of way (ROW) for the project, building the pipeline and related facilities, and will retain ownership of the physical assets once built. Under state law, CTRWSC is authorised to exercise condemnation powers, if appropriate, to acquire the needed real property, though most of the land has been or will be acquired through negotiations with landowners.

Pursuant to a Water Transportation Agreement (WTA) between Vista Ridge and CTRWSC, CTRWSC will acquire the ROW, construct, operate and maintain the project, and transport water supplied by Vista Ridge to SAWS in accordance with the WTPA.

The WTA provides for CTRWSC, as owner of the pipeline, to provide water transportation services to Vista Ridge to allow Vista Ridge to fulfill its obligations to SAWS under the WTPA. Vista Ridge still owns the water in transit until it is delivered to SAWS. The WTA is coterminous with the WTPA.

CTRWSC entered into a fixed-price, lump-sum design and build contract (DBC) with Garney for the engineering, procurement, construction, start-up, and commissioning of the project. Under the DBC, Garney is obligated to complete the full scope of the construction period work required under the WTPA other than the ROW acquisition. The DB contract provides for Garney to design, engineer, develop, install construct, commission and complete the project on a fixed-price, lump-sum basis.

In addition to acquiring the ROW and owning the pipeline and physical infrastructure, CTRWSC will contract with a qualified operator to operate and maintain the pipeline for the term of the WTA. Under the WTA, CTRWSC has promised Vista Ridge that the operator will meet the corresponding operation and maintenance requirements to which Vista Ridge is subject under the WTPA.

If SAWS elects, at its discretion, to purchase the project either at the expiry of the WTPA or by exercising its termination rights and its purchase option under the WTPA – whether for convenience or upon a default by the project company – then SAWS has the right to take over the project assets from CTRWSC, subject to SAWS paying the termination payment/purchase price per the contracts in an amount that is sufficient to repay the project debt and, depending on the circumstances, certain other amounts.

Revenue and costs

The revenue source of the project, from which operating costs will be covered and the debt will be repaid, is payments by SAWS for deliveries of product water by Vista Ridge. For the 30-year term of the WTPA, SAWS will pay Vista Ridge a fixed rate of US\$1,606 per acre foot of product water delivered by Vista Ridge.

Each lender and each interest rate swap provider is secured on a pari passu basis by a first priority lien on all of the assets of each of Vista Ridge and CTRWSC

In addition to payments for product water, SAWS compensates Vista Ridge (and Vista Ridge in turn pays CTRWSC, which pays the operator) for certain agreed costs of operation, maintenance and repair of the project on a pass-through basis. These compensable costs are set out in the WTPA and are subject to oversight jointly by SAWS and Vista Ridge.

Financing terms and credit assessment

On November 2 2016, Vista Ridge and CTRWSC, as co-borrowers, entered into a credit facility in the aggregate amount of about US\$875m with a syndicate of nine banks. SMBC led an international bank group including Société Générale, Korea Development Bank, Credit Agricole, CoBank, ING Capital, Commonwealth Bank of Australia, Royal Bank of Canada and Santander in providing the loans.

The floating-rate construction loans are hedged pursuant to long-dated interest rate swaps, which are designed to protect the project from interest rate risk even after the bank loans are refinanced by long-term debt, most likely bonds, when construction is completed and the project begins commercial operations.

The loans were able to achieve favourable pricing due to, among other factors, the strong credit rating of the offtaker SAWS (Aa1/AA+/AA+), Garney's track record as a contractor and its performance security package, the transaction structure and contractual risk allocation, and the positive assessment of the water resource.

Each lender and each interest rate swap provider is secured on a pari passu basis by a first priority lien on all of the assets of each of Vista Ridge and CTRWSC, as well as a pledge by the sponsors of their direct equity interests in Vista Ridge.

Advisers

Société Générale acted as financial adviser to Vista Ridge. Milbank Tweed Hadley & McCloy LLP was legal counsel to the lenders, while Husch Blackwell represented Vista Ridge. RW Harden assessed the hydrology of the aquifer. E3 Consulting served as the lenders' technical adviser. INTECH Risk Management was the lenders insurance adviser. Various Texas firms represented SAWS, CTRWSC and the other parties as local counsel. ■