



November 26, 2013

Mr. Tom Brymer
Town Manager
Town of Westlake
3 Village Circle, Suite 202
Westlake, TX 76262

HAND DELIVERED TO TOWN OF WESTLAKE

NOVEMBER 26, 2013

RECEIVED BY: Sherry Lewis

RE: Westlake Proposal to TCMUD1 on August 19, 2013

Dear Mr. Brymer:

This letter is in response to the Town of Westlake's offer on August 19, 2013. The offer submitted by Westlake included a cash payment of \$1.8 million to be paid over a five year period and recites other "value" to the District. As was previously communicated to you, the District engaged a financial consultant, J. Stowe & Company, to perform a financial analysis of the offer and review the methodology used to formulate the offer. The District also appointed a Citizen's Advisory Committee to perform a financial analysis and determine the financial impact to all District customers.

The District sincerely appreciates the Town's cooperation as we continue to undertake financial and legal analyses on a complex issue. In the course of the District's preliminary analyses, certain issues have been identified for which the District requests clarification from the Town of Westlake. In addition, the District has identified a number of omissions, deficiencies and errors in the Town's methodology. These results are preliminary and further review may reveal additional concerns. The purpose of this correspondence is to request clarification of certain issues raised by the Town's offer, and to bring the preliminarily noted errors, omissions and deficiencies in the Town's offer to your attention.

District Taxation

The Town's offer states that the Town's goal is to "remove the dual tax burden on Solana." The District has been advised by its legal counsel that for so long as the District continues to exist, it must levy equal and uniform taxes on all property within its corporate boundaries. As a result, the District requests that the Town clarify the following:

- (i) If the Town asserts that the proposed payment will relieve Solana from future taxation by the District, please clarify the legal authority for the District to exempt real property in its corporate boundaries from ad valorem taxes levied by the District on other taxable property in its boundaries.

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Trophy Club Municipal Utility District No. 1
100 Municipal Drive, Trophy Club, Texas 76262
(682) 831-4600

- (ii) If instead the Town intends for the District to “deannex” the Solana area from the District’s corporate boundaries upon receipt of the proposed payment, please clarify the legal authority for a municipal utility district with outstanding bonds payable from taxes to release real property from its boundaries.
- (iii) If the Town’s intention is not to remove Solana from the District’s taxing jurisdiction, please clarify the Town’s expectations as to future tax levied by the District.
- (iv) If the Town’s intention is that the “offer” be considered in the context of an agreement that provides for dissolution of the District, please clarify why payment of any sum is of value to an entity that would no longer continue to exist.
- (v) If the Town desires that the District retire its outstanding bonded indebtedness, please clarify the source of funding for defeasance of District debt in excess of the amount paid by the Town.

Allocation of Cash Reserve Funds

The Town’s offer proposes to credit the Town with approximately 17% of the District’s unrestricted cash reserves when calculating the Town’s share of the District’s outstanding debt. A significant amount of the District’s cash and reserves were generated from services furnished by the District to customers in Public Improvement District within the Town of Trophy Club and from the District’s retail customers. The Town of Westlake’s offer does not recognize the source of the District’s cash reserve funds. If Westlake asserts that it should be credited with a share of the District’s existing fund balance, then the Town should modify its offer to properly reflect the source of fund balances.

Allocation of Debt

Exhibit 1 in the Town’s offer allocates a share of the District’s outstanding debt to the Solana area for the remaining term of the IBM/Gibraltar “Agreement” dated July 20, 1982. The Town allocates 12% of the District’s debt to Solana. We have been told by the Town’s staff that this allocation was based on an April 2013 PowerPoint presentation on the District’s website that pertains to the District’s fire O&M tax levy. The District’s fire O&M tax levy includes the Town of Trophy Club’s Public Improvement District (“PID”), which is located outside the boundaries of the District. Since the Town of Westlake’s proposal relates to the proposed allocation of District debt, the methodology should reflect Solana’s proportionate share of the District’s Interest and Sinking (“I&S”) tax levy for such debt, which excludes the PID. Using the latest 2013 Real and Personal Property Tax Assessment data from the Denton County Tax Assessor/Collector’s office, the appropriate percentage should be 19.15% as shown in Table 1 below.

TABLE 1

TAX YEAR 2013 VALUATIONS

Tax Year 2013	Value (\$)	Percent %
Solana	203,286,679	19.15%
Total TCMUD	1,061,551,762	100.00%

In addition, the Town's offer does not properly identify the District's outstanding debt. By way of example, the Town asserts that the outstanding principal amount of the District's Series 2005 Combination Tax Bonds is \$148,000. In fact, the correct outstanding principal amount for these bonds is \$1,148,000. Further, the Town's methodology did not include Fiscal Year 2014 debt service.

The Town proposes to provide payment of a pro rata share of debt in installments, but its methodology provides payment for principal only, and excludes interest. Any allocation of debt service must include associated interest costs over the payment term if payment is to be made in installments.

Net Book Value Calculation

It is not clear to the District what data was used by the Town to calculate the net book value of the Solana area, and it appears to dramatically undervalue the District's assets at \$379,000. Using the Maximus appraisal performed in 2002 and accounting for additional depreciation since the appraisal was performed, the remaining net book value of the Solana area assets would increase by \$289,137 to \$668,137.

Lost Revenues

The Town's offer significantly understates lost revenues to the District.

The Town's calculation includes loss of revenue for an 8-year period only, and fails to include loss of future revenues from undeveloped properties. The expiration of the IBM/Gibraltar Agreement does not exempt any property from District taxation. Assuming the Town seeks to "make the District customers whole," as asserted in the offer, then the Town's offer should in fact identify projected lost tax and service revenues for an extended term, discounted for present value. Further, the computation should include reasonable assumptions regarding future buildout, assessed valuation and demands for the property.

The Town's offer does not include any compensation for lost sewer revenues.

The value for lost tax revenues, even assuming an 8-year term, is understated by approximately 50 percent.

The Town's methodology does not provide sufficient compensation for foregoing District assessment revenues for fire service.

Value Calculation

A significant portion of the proposed value in the Town's offer (\$4.6 million) relates to the Town's "release of any claim to assets outside the Westlake Town limits." These assets are owned by the District and Westlake has no legal claim or right to such assets. In other words, the Town's offer erroneously provides \$4.6 million in credit for assets owned by the District.

The Town appears to calculate value for such assets based on a statute that provides for dissolution of a district. If this is the case, then any such "value" associated with a release of claim to assets would represent value to the Town of Trophy Club, not the District.

Omitted Compensation Factors

The Town's offer omits several factors that should be considered in any type of compensation methodology associated with the release of service territory. Although Sections 13.254 and 13.255 of the Texas Water Code are not specifically applicable to the proposed transaction, the statute identifies numerous factors that should be addressed in connection with compensation for the transfer of service territory:

1. Impact of the transfer on the existing indebtedness of the utility and its ability to repay that debt;
2. The value of the service facilities of the utility located within the area in question;
3. The amount of any expenditures for planning, design, or construction of service facilities outside the incorporated or annexed area that are allocable to service to the area in question;
4. The amount of the retail public utility's contractual obligations allocated to the area in question;
5. Any demonstrated impairment of service or increase of cost to consumers of the utility;
6. The impact on future revenues lost from existing customers;
7. Necessary and reasonable legal expenses and professional fees;
8. Factors relevant to maintaining the current financial integrity of the utility;
9. Other relevant factors.

Many of these factors are relevant to the Town's proposal, but are not addressed in the Town's proposed compensation methodology.

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Through due diligence reviews and as we began to discover deficiencies in the offer, an e-mail sent by the Town's consultant and obtained by a District Director began to take on particular significance. A copy of the e-mail is attached. The e-mail leads us dangerously close to the indication that the offer was disingenuous. It is of the utmost importance that any offer provided by Westlake be in good faith. The District has spent considerable time and money to review the offer and public funds and interests are at stake. Please proceed intentionally in this regard. Such communications as are contained in the e-mail are problematic from the standpoint of the Town wishing to be taken seriously and for diplomacy to succeed between our entities.

The District appreciates your attention to the matters raised in this correspondence and looks forward to your prompt response. The District believes correction of the noted errors, omissions and deficiencies will necessitate an increase in compensation of millions of dollars that would be paid to the District. In the event additional issues are identified in the course of the District's continuing due diligence, we will let you know as soon as practicable.

Should you have any questions please call me at (682) 831-4610 or contact me by e-mail at jmcknight@tcmud.org.

Sincerely,



Jennifer McKnight
District Manager

Enclosure

CC: MUD Directors
B. West
P. Liston
T. Corbett
L. Wheat, Town of Westlake
M. Slye, Town of Trophy Club
Senator Jane Nelson
Representative Tan Parker
Representative Giovanni Capriglone

From: Trent Petty
Sent: Friday, June 21, 2013 9:04 AM
To: Tom Brymer
Cc: Stan Lowry
Subject: a legitimate offer for the MUD
Importance: High

Tom,

I have reworked this, and it may be a legitimate offer from Westlake to the MUD (or at least it will appear legitimate to everyone looking on even if the MUD doesn't think so).

We have taken the Solana assessed value (as they have already attested) and apportioned it out against the outstanding debt for the MUD.

The bottom line is this

1. You take over all the customers and assess them your water and sewer rate now
2. You pay off 100% of the outstanding debt that would be apportioned to Westlake (including Solana) using the overage from water and sewer revenues you collect
3. In so doing, you eliminate the MUD from Westlake and thus the taxes on Solana – which equalizes the total burden on Solana and promises overall reduction in water and sewer rates going forward.
4. The MUD will have to treat it as a legitimate offer because it relieves them of having to issue debt to provide Westlake capacity. They have to consider it otherwise you will turn loose the public idea that the MUD had a chance to save their customers money by not issuing additional debt (and you fuel the Town of Trophy Club's reason to enjoin them from issuing any more debt due to the legitimate reduction the Westlake offer yields).
5. The total Debt portion that would be paid in cash up front would be the Westlake Portion of outstanding debt through MATURITY. So, what they would collect until the last piece of current outstanding debt was paid off in 2023.
6. Westlake can use the portion of assets and cash they should receive as leverage with the MUD.

Let me know if you have questions.

tp

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