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AGENDA ITEM MEMO

BOARD MEETING DATE: July 23, 2024

TO: Board Members

THROUGH: Bryan McMath, Interim Executive Administrator
Ashley Harden, General Counsel
Rebecca Trevino, Chief Financial Officer

FROM: Alexis Lorick, Assistant General Counsel

SUBJECT: Request for Partial Release of Lien on its Certificate of Convenience and Necessity and Approval of Conversion

ACTION REQUESTED

Consider approving by resolution a request from the Springs Hill Water Supply Corporation (Corporation), for a partial release of lien on a portion of its Certificate of Convenience and Necessity (CCN), approval of CCN transfer, approval of conversion from a water supply corporation to a special utility district, and authorization for the Executive Administrator to take all actions necessary to give effect to this approval.

BACKGROUND

On May 31, 2024, representatives for the Corporation submitted a request for a partial release of lien and provided notice of conversion of the Corporation to a special utility district.

KEY ISSUES

Prior to the transfer of the Corporation's interests in real property, the TWDB must release its interests and approve the transfer. In addition, the TWDB must approve the conversion of the Corporation to a special utility district.

Release of Lien and CCN Transfer

The Corporation intends to amend CCN No. 10666 transferring a portion of its service area, lines, and related appurtenances to the City of Seguin (City). The amount to be transferred consists of both active and inactive service area. As of June 14, 2024, the amount of active service area to be transferred to the City is approximately 6,343 acres, consisting of 2,088 service connections. The amount of inactive service area to be transferred to the City is

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Leading the state's efforts
in ensuring a secure
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Brooke T. Paup, Chairwoman | George B. Peyton V, Board Member | L'Oreal Stepney, P.E., Board Member
Bryan McMath, Interim Executive Administrator

approximately 2,880 acres, with zero service connections. The total amount of service area attributable to CCN No. 10666 to be transferred to the City is approximately 9,223 acres.

The Corporation and the City have jointly petitioned the Public Utility Commission of Texas (PUC) to effectuate this amendment and transfer. The petition of transfer for active service area through a petition known as a sale-transfer-merger is favorably approved by PUC staff and an interim order was issued on May 16, 2024. The Corporation stands to realize approximately \$2,500,000 in payments from the City per the terms of a "Water Service Area Transfer Agreement," for the transfer. Approval of the transfer of non-active service area is a petition for approval of a service area contract, which is still pending before the PUC. If approved, the Corporation anticipates receiving \$500,000 in payments for the non-active service area from the City. The Corporation respectfully requests that the TWDB grant a partial release of TWDB's security interest in CCN No. 10666, and related appurtenances, contemplated in the transfer.

Outstanding Debt and Effect of TWDB Action

The Corporation currently has outstanding debt attributable to L1000055 and L100013 in the amount of \$1,687,000 (Outstanding Debt) that are additionally secured by a mortgaged deed of trust. The terms of financing for both loans include promissory notes and deeds of trust issued by the Corporation to the TWDB. The deeds of trust and security instruments, as amended, grant the TWDB a lien on the Corporation's real property, *inter alia*, including permits attributable to the real property of the Corporation. The deeds of trust and loan agreements securing TWDB financing prohibit the Corporation from transferring, selling, disposing, conveying or encumbering any real or personal property subject to the lien and security interest granted to the TWDB without TWDB's prior written consent. TWDB's Financial Compliance staff reviewed the Corporation's request. Repayments on the Outstanding Debt are being made in accordance with associated loan agreement covenants. While the Corporation will see a loss in meters with the transfer to the City, the remaining net income of the Corporation will be sufficient for repayment of the debt and there is no anticipated financial impact to the Corporation with the limited release of lien as requested.

Conversion from Water Supply Corporation to Special Utility District

During the 88th Legislative Session, HB 5305 passed creating the Springs Hill Special Utility District (SUD), authorizing the Corporation to convert to a special utility district. A confirmation election was held by the SUD in May 2024. The SUD is required by law to assume the assets and liabilities of the Corporation and file required notices of dissolution of the Corporation to the Texas Commission on Environmental Quality and the PUC. Once the Corporation ceases to exist, the SUD will become the responsible authority for repayment of L1000055 and L100013. There is no anticipated disruption in repayments to the TWDB as a result of the conversion to a special utility district. The Office of General Counsel recommends approval of the notice of conversion from Springs Hill Water Supply Corporation to Springs Hills Special Utility District.

RECOMMENDATION

The Executive Administrator recommends approving by resolution the request of the Springs Hill Water Supply Corporation for a partial release of lien and any related security interest in CCN. No. 10666, approval of the CCN transfer, approval of the notice of

Board Members

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conversion to a special utility district, and authorization to take any actions necessary to effectuate these requests.

LEGAL/SPECIAL CONDITIONS

- The Corporation will bear financial responsibility for all costs of documentation and filing of the documents necessary to complete this request.
- The Corporation will provide to the TWDB copies of all relevant documents relating to this request.

Attachment(s):

1. Proposed Resolution
2. Request from Corporation

A RESOLUTION OF
THE TEXAS WATER DEVELOPMENT BOARD
APPROVING A REQUEST OF
SPRINGS HILL WATER SUPPLY CORPORATION

(24-)

Recitals:

On May 31, 2024, Springs Hill Water Supply Corporation (Corporation) requested from the Texas Water Development Board (TWDB) a partial release of lien in certain collateral and approval of conversion to a special utility district.

The Corporation seeks to transfer certain interests in real property associated with certificate of convenience and necessity (CNN) No.10666 to the City of Seguin (City) pursuant to a mutually agreed upon Water Services Transfer Agreement, and petitions to the Public Utility Commission of Texas (PUC) for a sale-transfer-merger and approval of a service area contract (between the Corporation and the City) of the Corporation's active and non-active service area to the City.

The TWDB holds the outstanding debt (Outstanding Debt) obligations of the Corporation associated with L1000055 and L100013 in the remaining principal amount of \$1,687,000 that are secured by executed and recorded Deeds of Trust and Security Agreements (Deed of Trust), pursuant to which the Corporation granted to the TWDB a security interest in its properties and assets, including all improvements, and any other property, both real and personal described in the Deed of Trust (Trust Estate).

In addition to the foregoing, the Corporation has initiated the process of conversion to a special utility district in accordance with Chapter 7208 of the Special District Local Laws.

Upon dissolution, the Corporation will convert to the Springs Hill Special Utility District, which will assume the assets and liabilities of the Corporation.

The terms of financing for loans L1000055 and L100013 require approval and consent of the TWDB prior to the Corporation transferring, selling, disposing, conveying, encumbering any portion of the of the Trust Estate to another entity without prior TWDB approval.

The Corporation requests that the TWDB provide consent for a partial release of service area, and related appurtenances, in CCN No. 10666 to convey said service area and related appurtenances to the City in connection with orders for transfer from the PUC.

The Corporation also requests approval and acknowledgment of the Corporation's conversion to the Springs Hill Special Utility District.

NOW, THEREFORE, based on these considerations, the TWDB finds and resolves as follows:

1. It is in the public interest for the TWDB to grant the Corporation's requests.
2. The remaining security pledged by the Corporation will be sufficient to ensure repayment of the Outstanding Debt and a partial release of lien by the TWDB from the Trust Estate will neither compromise the security offered by the Corporation nor impair its ability to meet its debt obligations.
3. The request for a partial release of lien and related security interests created under the Deed of Trust related to CCN No. 10666 in order for the Corporation to make a conveyance to the City is approved.
4. The request for approval and consent of conversion to Springs Hills Special Utility District is approved. All related transfers of the Trust Estate necessary to comply with applicable law related to the conversion is also approved.
5. The TWDB authorizes the Executive Administrator, or his designee, to take all actions necessary, including executing necessary documents, to give effect to this Resolution.

Such approval is conditioned as follows:

1. The Corporation is responsible for all costs of documentation and filing of the partial release of lien.
2. The Corporation must provide to the TWDB copies of all relevant documents regarding the partial release of lien.

APPROVED and ordered of record this the 23rd day of July 2024.

TEXAS WATER DEVELOPMENT BOARD

Brooke T. Paup, Chairwoman

DATE SIGNED: _____

ATTEST:

Bryan McMath, Interim Executive Administrator



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Mr. Klein's Direct Line: (512) 322-5818
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May 31, 2024

Texas Water Development Board
 1700 North Congress Avenue, 6th Floor
 Austin, Texas 78711-3231
 Attn: Bryan McMath, Interim Executive Administrator

VIA UPS

Texas Water Development Board
 1700 North Congress Avenue, 6th Floor
 Austin, Texas 78711-3231
 Attn: Alexis Lorick, Assistant General Counsel
Alexis.Lorick@twdb.texas.gov

VIA UPS AND EMAIL

Re: Springs Hill Water Supply Corporation – Request for Partial Release of Lien for ARRA Loan Agreement dated February 4, 2010 (Project No. 62284) and DWSRF Loan Agreement dated April 23, 2013 (Project No. 62532); and Notice of Conversion to Springs Hill Special Utility District

Dear Texas Water Development Board:

I am writing to you on behalf of my client, Springs Hill Water Supply Corporation (“**SHWSC**”), (1) to request partial releases of liens on certain collateral pledged by SHWSC to the Texas Water Development Board (“**TWDB**”) in connection with its above-referenced loan agreements (“**Loan Agreements**”); and (2) to notify you of SHWSC’s likely conversion into Springs Hill Special Utility District (“**SHSUD**”).

Partial Release of Lien

On March 2, 2022, the City of Seguin (“**Seguin**”) notified SHWSC of its intent to provide retail water service to the areas of SHWSC within Seguin’s corporate limits pursuant to Texas Water Code (“**TWC**”) § 13.255. A copy of Seguin’s notice of intent is enclosed herein as **Attachment A** for your information and reference. In order to meet the growing demands for water service in the area, SHWSC and Seguin negotiated a Water Service Area Transfer Agreement (the “**Transfer Agreement**”), contemplating (i) the transfer of a 9,254 acre portion of from SHWSC’s water Certificate of Convenience and Necessity (“**CCN**”) No. 10666 service area (the “**Transfer Area**”) to Seguin’s water CCN No. 10698 and (ii) certain water infrastructure and customers within the Transfer Area. A copy of the Transfer Agreement is enclosed herein as **Attachment B**. Consistent with that Agreement, SHWSC and Seguin filed two applications at the Public Utility Commission of Texas (“**PUC**”). First, SHWSC took the lead in filing an Application for Sale, Transfer, or Merger to transfer 6,364 acres of the Transfer Area, including facilities and existing customers under TWC § 13.301, styled as PUC Docket No. 54832 (“**STM Application**”). Second, Seguin filed a Petition for Approval of a Service Area Contract to transfer the other 2,890 acres of the Transfer Area under TWC § 13.248, styled as PUC Docket No. 54826 (“**13.248**”).

Petition”). Maps of the areas impacted by the STM Application and 13.248 Petition are enclosed herein as **Attachment C**.

SHWSC and Seguin have been waiting for approval from the PUC in the STM Application to close on this transaction, and recently on May 16, 2024, the PUC authorized the parties to close on the conveyance of the 6,364 acres service area transfer, and the water facilities and customers described in the STM Application. A copy of the Interim Order Approving Sale and Transfer to Proceed is enclosed herein as **Attachment D**. The parties anticipate that the PUC will also issue a final order approving the 13.248 Petition soon. The Transfer Agreement provides that the parties have 30 days from the date of the Interim Order to close on the STM Application, but the parties have recently agreed to an additional 60 days to give SHWSC and its lenders additional time to release the liens prior to closing. However, as explained later in this letter, SHWSC and Seguin would like to close as soon as possible to avoid conflicting with or delaying the transfer of assets and liabilities from SHWSC to SHSUD.

SHWSC believes that this transaction will not have a negative impact on its ability to generate revenue or make its debt payments to the TWDB. To the contrary, there is no shortage of demand for water service in SHWSC’s remaining service area, and the transaction will allow SHWSC to free up capacity in its water system to address such pending service requests. Seguin is also compensating SHWSC for the facilities affected by the STM Application, and SHWSC believes there will not be a negative impact on its water distribution system when it conveys the portion of its water facilities contemplated by the Transfer Agreement to Seguin.

The ARRA Loan Agreement grants TWDB an interest in, among other things, certain tracts described in the loan, and all water system improvements upon such real property (the “*ARRA Mortgaged Properties*”). Section 7.8 of the ARRA Deed of Trust and Security Agreement states:

In the event Borrower or any owner of the Mortgaged Properties, without first obtaining approval of Beneficiary (which approval shall not be unreasonably withheld), should sell or otherwise dispose of the Mortgaged Properties, or any part thereof, at any time before this Deed of Trust is fully released and discharged, Beneficiary shall have the option to declare the indebtedness hereby secured due and payable and if the same is not paid within ten (10) days after the same is declared due and payable, Beneficiary may request the Trustee to commence foreclosure proceedings or other action authorized by this Deed of Trust to enforce the liens herein given. Failure to exercise this option shall not be considered as a waiver of the rights conferred in this Deed of Trust, but said option may be exercised at any time.

Therefore, SHWSC is seeking TWDB’s approval to sell, and partial release of any lien from the ARRA Loan Agreement that overlaps with, the 9,254-acre portion of its water CCN, facilities, and existing customers to be transferred to Seguin.

The DWSRF Loan Agreement pledged “all property, rights, privileges and franchises of the Grantor of every kind and description, real, personal or mixed, tangible or intangible, whether now owned or hereafter acquired by the Grantor [except any excepted property]...” (the “*DWSRF Trust Estate*”).¹ The DWSRF Trust Estate includes certain tracts described in the loan, and all improvements upon such real property (the “*DWSRF Mortgaged Properties*”). Section 3.4 of the DWSRF Deed of Trust and Security Agreement states:

¹ DWSRF Deed of Trust and Security Agreement, Section 2.1.

The Grantor shall not sell, lease or transfer any Trust Estate to any person or entity unless and only to the extent permitted in the Credit Agreements.

Section 2.03.G of the DWSRF Loan Agreement provides:

... The Corporation must notify the Executive Administrator prior to taking any actions to alter its legal status in any manner, such as by conversion to a conservation and reclamation district or a sale-transfer-merger with another retail public utility.

Therefore, SHWSC is also seeking TWDB's permission to sell, and partial release of any lien from the DWSRF Loan Agreement that overlaps with, the 9,254-acre portion of its water CCN, facilities, and existing customers to be transferred to Seguin.

Please note that the collateral for both Loan Agreements is also subject to a Parity Agreement between SHWSC, the TWDB, and CoBank, ACB ("**CoBank**"), dated October 8, 2015. SHWSC will be working separately with CoBank to request release of the same land, and it anticipates that CoBank will provide its consent as well.

Conversion to SHSUD

In order to meet the growing demands for water service in its water CCN service area, SHWSC approached its wholesale water providers to acquire additional water supplies. However, in many cases, SHWSC had limited-to-no opportunities to participate in new regional water supply projects because it is a non-profit water supply corporation, and its participation could risk the tax-exempt status of its wholesaler's bonds. Therefore, SHWSC began the process to convert into a special utility district. In 2023, the 88th Legislature of the State of Texas passed House Bill 5303, effective September 1, 2023, creating Springs Hill Special Utility District.² Then, SHSUD held its confirmation and permanent directors election on May 4, 2024, where the voters confirmed the creation of SHSUD and the slate of permanent directors of SHSUD.

According to Special Districts Local Laws Code § 7208.0153, if the transfer of SHSUD is confirmed, SHSUD shall transfer its assets, debts, and contractual rights and obligations to SHSUD. However, Section 2.03(g) of the ARRA Loan Agreement states:

CONVERSION. In the event the CORPORATION (i) converts to a conservation or reclamation district and (ii) desires to sell its obligations to the district, the CORPORATION covenant that no such conveyance and assumption of the Loan shall occur or be effective without the prior approval of the BOARD.

Similarly, Section 2.03.G of the DWSRF Loan Agreement states:

Prior to any action by the Corporation to convey its obligations held by the TWDB to another entity, the conveyance and the assumption of the obligation must be approved by the TWDB. The Corporation must notify the Executive Administrator prior to taking any actions to alter its legal status in any manner, such as by conversion to a conservation and reclamation district or a sale-transfer-merger with another retail public utility.

² SHSUD's enabling legislation is codified in Chapter 7208 of the Special Districts and Local Laws Code.

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Lastly, the DWSRF Loan Agreement states:

The terms and conditions of the financial assistance provided by this Agreement may not be assigned, transferred, or subcontracted in any manner without the express written consent of the TWDB.

Therefore, SHWSC requests that the TWDB provide its written consent to (1) SHWSC's conversion to SHSUD, (2) SHWSC's assignment of the Loan Agreements to SHSUD, and (3) SHWSC's transfer of all of the remaining ARRA and DWSRF Trust Estate (after the sale to Seguin) to SHSUD.

Let us know what we can to expedite this process for you. Please do not hesitate to contact me at (512) 322-5818 or my colleague, Danielle Lam, at (512) 322-5810 if you have any questions or need additional information.

Sincerely,

A handwritten signature in blue ink, appearing to read 'D. Klein', is positioned above the printed name.

David J. Klein

DJK/dsr

Enclosures

cc: Danielle Lam, *of the Firm*