From: Cathy Green [mailto:ctpgreen@verizon.net]
Sent: Friday, August 18, 2017 1:56 AM
To: Kuperberg, Joel (jkuperberg@rutan.com)
Subject: FW: Poseidon's Comments to Justify Their Proposed 9.57% Equity Return

From: Cathy Green [mailto:ctpgreen@verizon.net]
Sent: Thursday, August 17, 2017 12:16 PM
To: Kuperberg, Joel (jkuperberg@rutan.com)
Subject: FW: Poseidon's Comments to Justify Their Proposed 9.57% Equity Return

From: Kennedy, John [mailto:JKennedy@ocwd.com]
Sent: Tuesday, June 06, 2017 8:40 AM
To: Bilodeau, Denis; Dewane, Shawn; Sheldon, Stephen; Green, Cathy; Sarmiento, Vincent
Cc: Markus, Mike; Kuperberg, Joel; Fick, Randy; Scott-Roberts, Sandy; David M. Moore - Clean Energy Capital (dmoore@cleanenergycap.com)
Subject: Poseidon's Comments to Justify Their Proposed 9.57% Equity Return

Ocean Desalination Ad-Hoc Committee Members.

One of the agenda items at our next meeting on June 12th at noon is to discuss what equity rate of return should be allowed on the Poseidon project. Attached is an email from Poseidon to our consultant David Moore explaining why they think their proposed 9.57% rate of return is reasonable.

John Kennedy
Executive Director of Engineering and Water Resources

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From: Andrew Kingman [mailto:akingman@poseidonwater.com]
Sent: Tuesday, June 6, 2017 5:34 AM
To: David M. Moore <dmoore@cleanenergycap.com>
Cc: Graham Beatty <gbeatty@poseidonwater.com>; Kelly, Jonathan <Jonathan.Kelly@brookfield.com>; Scott Maloni <smaloni@poseidonwater.com>
Subject: Equity Returns

David,

As a follow up to our meetings a couple of weeks ago, Brookfield and Poseidon have been discussing and searching for comparable transactions that have publicly available data to share. Most P3 deals that we are aware of have different development, operating, and entitlement risk profiles (almost all lower in each category that we have in Huntington Beach). As you are aware, the return we've proposed is 9.57%, which is the same return that was ultimately achieved in Carlsbad. We continue to believe that Carlsbad is the best comparable for the Huntington Beach project and do not believe that the ~5 years since the Carlsbad return was agreed significantly influences the required rate of return. In fact, it can be noted, that Brookfield's investment in Poseidon, which was largely done on the basis of developing, funding and owning the Huntington Beach project, placed a great deal of emphasis on the Carlsbad allowed return. Brookfield engages in infrastructure development across the globe and the Carlsbad allowed return is among the lowest we have underwritten. That being said, we acknowledge and understand the Desalination Ad-Hoc Committee's request for further details on other potential comparables.

Based on our review, we see water utilities as the next best comparable (see attached). The water utilities are relevant to the Ad-Hoc Committee's review based on the following:

- Utilities have a published ROE that is objectively determined by a 3rd party regulator, similar to how the Committee will have to get comfortable with the fairness of the ROE of Huntington Beach;
- Utilities have a similar risk-profile in that they have a requirement to supply safe and clean water to their constituents. Huntington Beach has to supply water safely to OCWD;

- The allowed return for water utilities exists to ensure that the utilities are appropriately compensated for investing into their asset base (e.g. for maintenance and growth capital expenditures). Similarly, Poseidon requires an appropriate return on its capital in order to invest this capital into the Huntington Beach project; and,

- The broader framework agreed to-date with the Ad-Hoc Committee is a “cost of service” approach which is very comparable to the approach for compensating utilities.

However, we note that there are some differences between the utility business and the Huntington Beach project:

- Huntington Beach has “single-asset risk” whereas water utilities enjoy a more diversified portfolio of assets and, in most cases, some built in redundancy in case of any single-asset issue. In addition, not only is the Huntington Beach project a single-asset, it is entirely “greenfield” (i.e., is a 100% development project with no existing operations or cash flows), while development risk generally impacts only a fraction of a utility’s operations

- We are proposing a higher percentage of leverage than the water utilities are allowed. We’re doing this to lower the overall cost of capital of the project, to the benefit of OCWD and its rate payers. However, this higher amount of leverage creates greater risk to Poseidon’s equity return, which normally would justify an even higher required rate of return on such equity

- The flip side is that the water utilities have a number of rate payers that pose some collection risk, but for the larger utilities this risk is mitigated by the magnitude of the numbers of rate payers. Given OCWD’s strong rating, Huntington Beach does not face the same collection risk thereby off-setting some, but not all, of the risks posed by the leverage and Huntington Beach being a single-asset.

  - In California, all of the Class A Utilities (Cal Am, San Jose Water, Golden States, Cal Water) have all just filed there rate requests for the next three years and all of them have requested higher return on equity for the next three years (mid to high 10%) than the 9.99% amount granted for the last three years. They all believe that returns need to be higher for the future, not lower to account for the uncertainties in the regulatory, supply and general equity markets.

Lastly, we acknowledge that there may be a desire to consider another potential set of comparables related to transactions where completed (e.g. brownfield) assets are sold. The issue we’ve encountered in trying to uncover the “market return” for these assets is that it’s largely speculative. It’s rare that a buyer will provide their target return when purchasing an asset, especially publicly. We will say that given Brookfield’s breadth of operations and global reach, we see a wide variety of transactions by both geography and asset-type. It is our opinion that the return proposed in our most recent presentation, of 9.57%, is fair and highly defensible in light of the risks related to completing the project. We also acknowledge that, once completed, the project could be valued at a price that reflects a lower rate of return. That is to be expected given the development risk that is currently being undertaken and borne by Poseidon, which wouldn’t be borne by a second owner.

We’d welcome the opportunity to discuss and sorry for the long email.

Regards,

Andy

Office :760.[redacted]
