

EXHIBIT 5-C



February 5, 2013

Mr. Rob MacLean
California American Water Company
1033 B Avenue, Suite 200
Coronado, CA 92118

Subject: Proposal for a Public Contribution of Funds in A.12-04-019

Dear Rob:

This letter is to better define alternatives for how a public contribution of funds might be crafted for the capital expenditures related to the proposed desalination facility in A.12-04-019.

Alternative 1: Traditional Tax-Exempt Borrowing

Form of Issuance – The simplest form of issuance of public debt would be tax-exempt Certificates of Participation (COPs) issued by the Monterey Peninsula Water Management District (District.) Alternatively, the District could join with the Monterey Peninsula Regional Water Authority (Authority) to form a separate joint-powers authority (JPA) for purposes of the financing, which JPA could issue revenue bonds instead of COPs. For now, let's assume issuance of COPs by the District. The proceeds of the issuance would be contributed to Cal-Am to offset a portion of the cost of building the project.

The COPs will be tax-exempt, but deemed "private activity" under federal tax law, hence subject to the Alternative Minimum Tax (AMT). A volume cap allocation would need to be secured from the California Debt Limit Allocation Committee for issuance of such private activity COPs, which the District would secure far in advance of the need to issue to debt.

Security – The debt will be secured by payments from the District's water supply enterprise Net Revenues. Net Revenues are Gross Revenues minus District water supply enterprise operating expenses. Gross Revenues include a Surcharge collected on the Cal-Am bill, similar to the District's old "User Fee", the District's existing Water Supply Charge, certain permit fees, interest earnings, and amounts in a District Rate Stabilization Fund. It is assumed that the Surcharge is set to equal 100% of debt service due in each future year, but the surcharge for any individual customer would be based on the water consumed on the bill (or a percentage of the cost of water on the bill.) The water used by a customer reflects supply received from the water supply projects, hence the surcharge is a fee directly related to use of water.

The District will covenant to maintain Net Revenues in an amount equal to 125% of debt service required in each year – the Coverage Requirement. District will pledge to enact a Proposition 218 process in the future to maintain the Coverage Requirement, should Cal-Am collections falter and the Surcharge is inadequate. The Proposition 218 process utilizes a majority protest proceeding to enact fees for water service. Investors in California municipal water and wastewater debt are familiar with the risks inherent in future Proposition 218 hearings.

The District will also borrow and maintain a debt service reserve fund equal to one year's debt service.

Although the primary source of revenue for repayment is the surcharge, by pledging its existing and certain future additional revenues which are subject to Proposition 218, it is a public credit and Cal-Am would agree that it would not book the surcharge as a debt. At this time, the District's financial consultants believe this public credit would attain investment grade credit ratings.

Legal Structure – We are cognizant that Cal-Am has requested “no strings” be attached. In light of this goal, but to comply with state law in a manner that allows such a borrowing to occur, we will need to construct an ownership interest in something that can be bought and sold. Our view is that this ownership interest is merely a paper structure and would not affect Cal-Am's financial interests. One way this might be structured is described below.

The financing would be structured using a local “financing entity” which could be a joint powers agency (such as the Authority) or a financing corporation organized pursuant to the Nonprofit Public Benefit Corporation Law of the State of California (Title 1, Division 2, Part 2 of the California Corporations Code.) The financing entity is a common and traditional component of California COP financings, and there are already existing several in Monterey County available for this purpose.

For any public amount proposed to be contributed (“X dollars”), compared to the total cost of the facility (“Y dollars”), a Water Right would be created in the amount $(X \div Y) \times (\text{Plant Capacity}) \times (\text{term of the debt})$. That Water Right is acquired by the financing entity from Cal-Am with the proceeds of the sale of the COPs in the public market. Although the Water Right will be acquired from Cal-Am, Cal-Am will agree to continue to purvey the water in the same manner as other water conveyed through its system.

The mechanics of the financing are otherwise routine for a public debt issuance in California. The District will enter into an Installment Purchase Agreement with the financing entity, whereby the District will sell the Water Right to the financing entity and simultaneously repurchase the Water Right in annual installment payments, equal in amount to the annual principal and interest due on the COPs. At the end of the 30-year term of the COPs, the District would sell all of its interest in the Water Right to Cal-Am for a dollar.

The financing entity will unconditionally grant and assign to a Trustee bank, without recourse, all of its rights to the annual installment payments, for the benefit of the COP investors. The financing entity has no liability to the investors in the COPs. The District will pay its installment purchase payments directly to the Trustee. Thus the financing entity does not have an ongoing role or obligation.

Amount – The District proposes a public contribution up to \$100 million. Ultimately the amount of public contribution should be determined based on the availability of State Revolving Funds and market conditions at the time of permanent take-out financing.

The District has stated a preference for using revenues from a surcharge on the Cal-Am bill as the primary source of repayment, although other District revenues can bolster the pledge for security purposes. The goal would be to utilize the District's existing “User Fee” that has been subject to suspension by the CPUC, but could be reinstated by the CPUC for this purpose. In the District's view, the User Fee has never been terminated, and in fact is still collected from the City of Seaside municipal

water system, as well as from the Pebble Beach Reclamation Project. Collection from Cal-Am, while suspended, remains subject to an open proceeding before the California Superior Court, and a separate review process before the California Supreme Court. As an alternative to using the prior User Fee, the CPUC could also approve a new fee for this purpose.

The portion of the existing User Fee that pre-dates Proposition 218 is an amount equal to 7.125% of the Cal-Am customer charges. Based on the Cal-Am notice for the Public Participation Hearings, the proposed annual revenue requirement following implementation of the project is \$102,539,000. Applying a 7.125% factor, the existing User Fee would be \$7.3 million per year. At an assumed interest rate of 3.75% and 30 years, that annual amount could support over \$130 million of COP issuance.

Alternative 2: Tax-Exempt Securitization Borrowing

What is Securitization? – Cal-Am would establish, collect, and adjust from time to time a “non-bypassable” charge on its customers sufficient to pay off the annual securitization payments. The PUC would issue a “financing order” to enable the financing. Under the structure Cal-Am would be required to sell the property right, consisting of the right to impose, collect, and adjust from time to time the “non-bypassable” charge to a Cal-Am subsidiary (a Special Purpose Entity or SPE), or to a governmental entity SPE which is established as bankruptcy remote (i.e., not permitted to file under Chapter 9). The sale of the property right by Cal-Am would be a true sale for bankruptcy purposes. The SPE could be established by the District. Alternatively, the legislation could authorize the State Infrastructure Bank to issue the bonds, as it has done in the past for “stranded cost” financings. The SPE would issue bonds payable from the non-bypassable charge. The bonds should likely be rated AAA by all three rating agencies, and would be tax exempt as well, either through a sale to the District, or the use of a conduit entity to buy Cal-Am’ SPE debt. AAA-rated tax-exempt debt could be the lowest cost source of financing. This would remove the District’s credit from the equation, and the District’s role might simply be in the form of partnering to create the SPE and passing special legislation (see below.)

While most (if not all) utility securitizations to date involve electric utilities, these principles should apply to any regulated utility with a broad customer base. While many prior securitizations have been used to recover the costs of electric deregulation (“stranded costs”), utility securitization has also been used to recover storm or hurricane costs, to finance pollution control facilities, to stabilize customer rates and for other cost recovery. It is noteworthy that in West Virginia, the securitization legislation expressly limited the use of securitization to a utility with less than an investment grade rating; in other words, the purpose of the legislation was to assist a lower rated utility to borrow at an advantageous rate.

Legislation Required – Securitization would require authorization from the California legislature and a “financing order” issued by the California PUC pursuant to the legislation. The legislation would authorize creation of a property right, consisting of the right to impose, collect, and adjust from time to time the “non-bypassable” charge on Cal Am customers sufficient to pay off the securitization. The legislation would authorize the PUC to issue a “financing order” to enable the financing. As discussed above, under the legislation and the financing order, Cal-Am would be required to sell the right to collect the “non-bypassable” to an SPE, or a bankruptcy remote conduit issuer such as the State Infrastructure Bank, or an SPE created by the District.

The legislation would be substantially identical to legislation both previously enacted, or proposed for

California electric utility use. To date approximately \$10 billion of utility securitization have been issued for the benefit of California utilities. The District's Bond Counsel Sidley Austin LLP has drafted legislation which could be readily adopted for this purpose.

Rating Agencies View – Standard & Poor's believes that proceeds of the securitization are expected to be used principally to shrink a utility's total capitalization structure and generate savings that are passed along directly to customers in the form of lower rates. S&P has said "Generally, the amount of rate reduction bonds that the utilities issued was designed specifically to generate a legislatively mandated rate reduction for customers."

Most state statutes specifically provide for securitization of the utility costs through their sale to a financing subsidiary of the utility. In this instance, the sale of the property right might be made to a financing entity formed by the District in order to provide tax-exempt financing. Alternatively, the financing subsidiary of Cal-Am could sell its bonds (instead of the property right) to the District entity, once again to provide tax-exempt financing. The statutes award true sale status to the transfer of the assets to a finance subsidiary. This should help support the legal conclusion that the transfer constitutes a true sale for bankruptcy purposes.

The statutes also provide that any proposal for a securitization of utility costs be approved on an irrevocable basis by the relevant utility regulatory commission, here the CPUC. The CPUC must set a tariff schedule. A tariff would be included in the ordinary bills sent to customers, and would amortize the costs over the life of the proposed securitization. The tariff would be a separate itemized charge on the customer's bill, and could be either a fixed charge or tied to water usage. Where the tariff is tied to usage, predicted customer usage will be important from a credit perspective. Tariffs that are actually collected from customers may fall short of what was originally anticipated. In addition to defaults in bill payments, the customer base might decline due to economic and/or technological factors, or usage might vary from what was originally predicted. These are credit risks that could impact the ability of the tariff to amortize the assets fully. To address these risks, legislatures have created a statutory form of credit support, known as the "true-up" mechanism. The statutes provide that the utility periodically apply to the CPUC for a readjustment of the tariffs. The commission must then readjust the tariffs charged to customers, so that the bond amortization schedule is met. This minimizes credit risk, except in the tail end of the transaction after the final true-up has occurred.

The District's financial consultants, Raymond James, and bond counsel, Sidley Austin, have reviewed these two concepts and can confirm their viability for use in reducing the cost of the desalination project to ratepayers. Certainly, if an insurmountable roadblock reveals itself during the pursuit of either of these, it would occur early enough in the process such that Cal-Am could continue with its traditional financing from American Water Capital Corp without inconvenience.

I look forward to discussing this proposal with you and your team in greater depth going forward.

Sincerely yours,



David J. Stoldt
General Manager