



FAIRFAX COUNTY WATER AUTHORITY
8570 Executive Park Avenue
Fairfax, Virginia 22031-2218
www.fairfaxwater.org

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February 29, 2012

By Email & U.S. Mail

Wyatt Shields, City Manager
City of Falls Church
300 Park Ave.
Falls Church, VA 22046

Falls Church's Request for Expression of Interest

Dear Mr. Shields:

Thank you for the City's "Request for Expression of Interest" in evaluating alternatives to the City's current ownership of its water and sewer systems. Fairfax Water believes that an appropriate agreement between the City and Fairfax Water would enable us to combine our water systems' respective assets, thereby lowering rates for all our respective customers and creating one of the most robust regional water systems in the world.

Response to Request for Expression of Interest (REI)

We answer the numbered questions in your REI as follows:

1. Name and address of our organization

Fairfax County Water Authority, d/b/a Fairfax Water
8570 Executive Park Avenue
Fairfax, Virginia 22031-2218

2. Contact information

Charles M. Murray
General Manager
(703) 289-6011
cmurray@fairfaxwater.org

3. Subject of interest

Merger of our two water systems on mutually agreeable terms

4. Water system operated by Fairfax Water

Fairfax Water is a single-purpose, public, nonprofit water authority created in 1957 by the Fairfax County Board of Supervisors under the Virginia Water and Waste Authorities Act to “establish, operate, and maintain a comprehensive and integrated water system.” It is governed by a ten-member, independent Board appointed by the Board of Supervisors. Fairfax Water is now Virginia’s largest water utility, serving one out of every five Virginians who obtain their water from public utilities. Nearly 1.7 million people in the communities of Fairfax, Loudoun, Prince William, and Alexandria trust Fairfax Water to provide superior drinking water.

We have no operations outside the Commonwealth. As a nonprofit governmental subdivision, our sole mission is to provide our customers the best-quality water at the lowest responsible price.

5. Customers of our water system

We have 233,695 retail accounts corresponding to approximately 835,000 citizens in Fairfax County. We maintain a unified schedule of charges for all of our retail customers. There are no different classes among our retail customers. Our rate schedule is posted on our website: <http://www.fairfaxwater.org/rates/index.htm>.

We also have six wholesale water customers: the Town of Herndon; Virginia-American Water (City of Alexandria and Dale City area of Prince William County); the Prince William County Service Authority; Loudoun Water; Dulles Airport; and Fort Belvoir. In the past we have supplied water on a wholesale basis to the Town of Vienna and the City of Falls Church. We have an agreement in place to supply emergency water to the City of Fairfax.

6. Employees

We have 386 employees.

7. Qualifications of Fairfax Water

We operate two state-of-the-art water treatment plants. The Corbalis Water Treatment Plant has a rated capacity of 225 million gallons per day (MGD) and treats raw water drawn from the Potomac River. We have two intakes in the Potomac River that enable us to withdraw the best-quality raw water according to river conditions. The ultimate capacity of the Corbalis Plant at build-out is anticipated to be 300 MGD. The Griffith Water Treatment plant has a rated capacity of 120 MGD and treats raw water from our Occoquan Reservoir. The ultimate capacity of the Griffith Plant is anticipated to be 160 MGD.

Our treatment plants are the only ones in the region that employ ozone and granular activated carbon filtration. The quality of the finished water from these plants surpasses all current and anticipated federal and state water-quality standards. Disinfection by-products are well below the current standard and any anticipated future standard. Our treatment has also proven effective at addressing emerging contaminants, such as endocrine disrupting compounds.

Our transmission system from these plants is highly integrated, providing essential reliability in the event, however unlikely, that one of the treatment plants should be shut down. We have also recently expended in excess of \$25 million in capital to best ensure our system's ability to withstand power outages like those following Hurricane Isabel.

The large economies of scale that we have achieved by partnering with our wholesale customers have allowed us to produce the region's best-quality finished water at the lowest unit price. Our wholesale customers do not subsidize our low retail rates. By sharing the capital expense of building our treatment plants and transmission system, we and our wholesale customers have been able to share the efficiencies and cost savings made possible by large-scale production. We have passed those savings along to all our customers in the form of the lowest water commodity rates in the region.

Fairfax Water has also been a responsible steward of the region's current and future water supply. We are a signatory to the Potomac River Low Flow Allocation Agreement of 1978, the historic Water Supply Coordination Agreement of 1982, and various regional cost-sharing agreements. Together, these agreements ensure an ample water supply for the entire Washington Metropolitan Area by:

- funding our share of the costs to create and maintain three upstream reservoirs that currently store 17 billion gallons of water supply for release in times of low flow;
- providing for 20-year demand forecasts every five years to determine if our water supply storage is adequate to meet the region's needs; and
- establishing a mechanism to share the costs with the District of Columbia and the Washington Suburban Sanitary Commission to fund the acquisition of new water supply reserves if any 20-year demand forecast identifies a shortfall.

Our economies of scale, prudent fiscal policies, and efficient management have also enabled us to achieve and maintain triple-A bond ratings from all three major rating bureaus. Our favorable bond rating helps our current and future customers by allowing us to finance our capital projects at very low interest rates (3.02% in our most recent bond refinancing).

In sum, should the City choose to join us, Fairfax Water is well qualified to provide superior water service to your existing customers at significantly reduced cost.

8. Our proposal

We believe that your customers and ours would be best served by a system merger in which the City of Falls Church becomes a member of Fairfax Water, combining the water assets of the two systems and giving you a seat at the table in our governance structure. Merger would yield huge benefits:

- Significantly lower water costs. Your inside and outside customers would pay significantly less for water. The quarterly charge for an average City customer is currently \$86.50, compared to \$57.31 for Fairfax Water (\$60.19, as of April 1, 2012).

As part of a merger agreement, we would establish a schedule to reduce the rates paid by your existing customers and a timetable for creating a single, unified-rate for the entire system.

- Robust, critical water-system backup. A merger would provide critical water supply backup that the City currently lacks. At present, the City's water system depends on a single, 50-year old, 36-inch transmission main connecting it to the Washington Aqueduct. Although the City once planned to build a second Potomac River crossing to increase capacity and provide redundancy, we understand the City deleted that from its Capital Improvement Program (CIP) as cost-prohibitive. The director of the City's water system testified in 2009 that, as a result of that decision, the City's only realistic long-term backup plan is to rely on Fairfax Water in the event of a failure of the Aqueduct's treatment plant or the transmission line.

Merger, of course, would alleviate any need for you to build a second river crossing. Combining our systems would provide the City and its customers with the indispensable backup water supply that it needs and alleviate water-pressure problems in portions of the City's existing system.

- Large savings in the City's CIP. Combining our two systems could save tens of millions of dollars that your CIP and Master Plan currently commit you to spend on projects that could be avoided in a merger.
- Participation in our governance structure. A merger would add a Falls Church seat to Fairfax Water's ten-member Board. The Falls Church member would represent the City's 13,000 citizens. By contrast, each of our existing members represents approximately 120,000 Fairfax County citizens.

In short, the benefits of merging our two systems would be extraordinary. Not only would your existing customers pay significantly less for their water, but our joint water system –

with two independent water treatment plants in Virginia and one in the District of Columbia – would be the most robust and reliable in the world.

Section 15.2-5112 of the Virginia Water & Waste Authorities Act provides for a locality to join an existing water authority. Approval of such a merger would require a three-way agreement between the Fairfax Water Board, the Fairfax County Board of Supervisors, and, of course, the City of Falls Church. Provided all parties were motivated, the transaction would be relatively easy to consummate.

We have heard comments in some quarters that the City should simply sell its system to the highest private bidder in the hope of turning a “non-performing asset” into a cash payment to benefit Falls Church citizens, perhaps at the expense of the City’s “outside” customers in Fairfax County. We also understand that the City is soliciting interest from investor-owned utilities. While we know you will reach your own conclusions, should you receive interest from a private buyer, we would be surprised if you concluded that that option benefited either your own citizens or your Fairfax County customers.

There are at least three reasons why selling to a private buyer would be detrimental to your customers’ interests. First, the City’s customers would forego the system-reliability benefits of joining our system and gaining two state-of-the-art treatment plants as part of an integrated water supply.

Second, your customers would pay a lot more for water. An investor-owned utility would have to charge higher rates to recover not only its purchase cost, but also the profit margin and tax obligations that a governmental utility like ours does not have. Foregoing a merger means losing the opportunity to lower customer rates through cost-reducing economies of scale and the elimination of huge capital expenses that would be unnecessary if the systems were combined.

Charging such higher rates would be unfair to all your customers because it would make them pay again for a water system for which they have paid at least once before. For the most part, the City’s water system was built either by developers (who deeded the facilities to the City) or on a pay-as-you-go basis. The City’s existing customers paid for the system when they bought their properties, effectively repaying the developers who advanced the connection fees and built the water lines. The customers repaid the City for its outlays through the commodity charge for water. They also funded the reserves that the water system held in the past, as well as the \$28.4 million in cash and cash equivalents that, according to your latest financial report, the system continues to hold. Indeed, the City’s customers paid for your system, perhaps several times over, as a result of decades of paying water rates that included accelerated depreciation as well as a substantial return on equity that was transferred to the general fund. Since any purchaser of your system would have to recoup the acquisition costs through higher commodity rates, your customers essentially would be forced to pay for the water system yet again.

