



THE CITY OF SAN DIEGO
REPORT TO THE CITY COUNCIL

DATE ISSUED: February 13, 2008 REPORT NO: 08-014

ATTENTION: Council President and City Council, Docket of
Docket of February 19, 2008

SUBJECT: Water System Improvements

REFERENCE: Companion Report – Fiscal Year 2008 Water System Financing

REQUESTED ACTION: Accept this report.

STAFF RECOMMENDATION: Accept this report.

SUMMARY:

Proceeds from the sale of \$150,000,000 of Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Notes, Series 2008A (the 2008 Notes) and a subsequent sale of long-term Water Revenue Bonds, Series 2008B (the 2008 Bonds) are needed in order to fund the continuation of improvements to the water system initiated under financing programs in previous years. Details of the proposed financing plan are discussed in a companion staff report from the Debt Management Department.

BACKGROUND:

On January 16, 2007, the City Council approved actions leading to the issuance of \$57 million of Non-Transferable Subordinated Water Revenue Notes (the 2007 Notes). The proceeds from the 2007 Notes are being used for a variety of capital improvements to the City's Water System to comply with a California Department of Public Health (DPH) Compliance Order – Amendment 11 (Attachment 1), meet Environmental Protection Agency (EPA) requirements for enhanced drinking water treatment systems, improve the reliability of the water system, repair or replace aged infrastructure, expand the reclaimed water distribution system, and increase the capacity of the system. The 2007 Notes proceeds are anticipated to be exhausted by March 2008 (see Attachment 2 as to the anticipated usages and project descriptions for the 2007 Notes). Project expenses after March 2008 will need to be funded entirely with cash if additional debt financing is not available. Affected projects would include the completion of enhancements to the Alvarado Water Treatment Plant, Otay Water Treatment Plant, and the Miramar Treatment Plant as required by Federal Safe Drinking Water Standards; Water Main Replacements, and various other improvements to the water system.

On February 26, 2007, the City Council approved a series of four consecutive annual six and half percent increases to water rates. The additional anticipated revenue generated from the increased

water rates is to support the Water System including, but not limited to, addressing debt service from planned future bond issuances and cash funding contributions to capital improvement projects. The first approved water rate increase went into effect on July 1, 2007.

DISCUSSION:

Under normal circumstances, in order to leverage a portion of the additional revenue generated from the water rate increases, a public bond issuance would coincide with the anticipated exhaustion of the proceeds from the 2007 Notes. However, the City continues to be unable to access the public debt markets pending issuance of the FY 2006 Comprehensive Annual Financial Statements. It is anticipated that the City will be in a position to be able to access the public market by late CY 2008. However, based on construction cost estimates and construction schedules, it is projected that by March 2008, the Water Department will reach a point where it will be unable to continue ongoing projects or unable to initiate new projects without additional financing proceeds being available. At that point, the Water Department will be in jeopardy of falling out of compliance with the DPH Compliance Order. Therefore, the Water Department is requesting short-term financing in an amount not to exceed \$150 million to cover the anticipated Water System Capital Improvements Program needs through December 2008. The anticipated projects, the project types, and the justification for inclusion to the list of capital improvement projects anticipated to receive proceeds from the 2008 Notes are listed in Attachment 3. From the listed projects in Attachment 3, 14 projects, encompassing approximately 74% of the anticipated proceeds or approximately \$111 million, are either required by or related to the DPH Compliance Order. The remainder of the projects listed on Attachment 3 have grant funding or will improve system operations.

Subsequent to issuing the short-term 2008 Notes, the Water Department will seek to issue long-term, public debt (the 2008 Bonds) as soon as possible. This long term debt will refund the short-term notes issued in 2007 (\$57 million) and the 2008 Notes (\$150 million). Portions of the 1998 Certificates of Undivided Interest and the 2002 Water Revenue Bonds may also be refunded to the extent that those refundings are economically feasible. In addition, the long-term debt will provide additional new money to continue the required improvements to the water system. These funds should cover the water system's capital improvement needs through mid-FY 2010. At that point, additional debt will need to be issued to continue the needed improvements.

In order to continue the improvements to the Water System required by the DPH Compliance Order and planned for in the previously approved water rate increases, additional debt financing is required. The Water Department estimates that Water Department capital improvement expenditures for FY 2008 through FY 2011 will total approximately \$585 million. Financing for this program is expected to come from a long-term bond issues in late CY 2008 and a subsequent long term bond issue in FY 2010. The recently approved four consecutive annual water rate increases already reflect the anticipated debt service that will be associated with these bond issuances and the system improvements required by the DPH Compliance Order or to improve the reliability and efficiency of the system.

FISCAL CONSIDERATIONS:

Debt service for the 2008 Notes is estimated at approximately \$4.95 million per year which will be paid from the previously approved four consecutive annual water rate increases that went into effect on July 1, 2007. The 2008 Bonds will refund the 2008 Notes, the 2007 Notes and portions

of the 1998 Certificates of Undivided Interest and the 2002 Water Revenue Bonds. Annual debt service for the 2008 Bonds will be paid from the previously approved annual water rate increases.

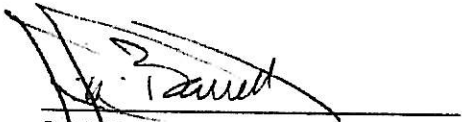
PREVIOUS COUNCIL and/or COMMITTEE ACTION:

None.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

None.

KEY STAKEHOLDERS AND PROJECTED IMPACTS: Residents of San Diego will see continued improvements to that the Water System and on-going compliance with the State Department of Public Health (DPH) Compliance Order.



J. M. Barrett
Director of Public Utilities

Attachments: DPH Compliance Order – Amendment #11
Projects to be funded with proceeds from 2007A Notes
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