



THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

DATE ISSUED: January 15, 2015 REPORT NO: 16-003  
ATTENTION: Budget and Government Efficiency Committee  
SUBJECT: Bond Authorization for 2016 Water Revenue Bonds (Capital Improvement Projects & Advance Refunding Opportunity)

REQUESTED ACTION:

Forward the combined economic refunding of outstanding debt and new capital improvement funding needs proposal to City Council for consideration and approval in accordance with the timeline established for the bond issuance.

STAFF RECOMMENDATION:

Forward the requested action for City Council's consideration and approval.

EXECUTIVE SUMMARY:

**I. Background**

From time to time bonds have been issued and state loans have been obtained to finance portions of the Water Utility's Capital Improvement Program. As of December 31, 2015, the Water Utility has \$701,025,000 in outstanding bonds and \$70,212,940 in outstanding Drinking Water State Revolving Fund ("SRF") loans. This includes:

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|--|-----------------|
| • Water Senior Revenue Refunding Bonds, Series 2009A       | \$148.1 million |
| • Water Senior Revenue Bonds, Series 2009B                 | \$293.9 million |
| • Water Senior Revenue Refunding Bonds, Series 2010A       | \$123.1 million |
| • Water Subordinated Revenue Refunding Bonds, Series 2012A | \$136.0 million |
| • Drinking Water State Revolving Fund Loans                | \$ 70.2 million |

Debt Management staff monitors refunding opportunities as outstanding bonds become callable and the interest rate environment is favorable. Currently, the outstanding 2009A, 2009B, and 2010A Bonds are under consideration for an advance refunding, due to favorable market conditions.

Additionally, the Water Utility estimates that it will require approximately \$80 million in bond funds to support Capital Improvement Program ("CIP") spending for CIP projects.

The proposed financing plan for the Water Utility System includes two components: (i) an economic refunding of outstanding Water Revenue Bonds and SRF loans (“Economic Refunding”), (ii) new money financing Water CIP needs. The goal of the issuance is to combine refunding opportunity that would reduce existing debt service on several series of the bonds.

Combining new money and refunding opportunity provides for a cost effective financing plan. This report discusses the favorable market environment for issuing municipal debt, describes the refunding opportunities and CIP funding needs, the associated debt service under current market conditions, and financing timeline.

## ***II. Economic Refunding of Outstanding Water Bonds:***

Given the current attractiveness of the municipal market coupled with the potential for rate increases later, the City will be best positioned to mitigate future interest rate risk by moving forward with a refunding of the Water Bonds and SRF loans currently outstanding if economic and eligible to be refunded.

At current interest rates, an advance refunding of the outstanding Water Bonds is expected to provide significant economic savings. Currently, Debt Management has identified approximately \$490 million outstanding principal from the Series 2009A, 2009B and 2010A Bonds as most likely to produce Net Present Value (“NPV”) savings at least equal to the 4% savings threshold required for advance refundings required by the City’s Debt Policy. (There is currently \$100.7 million in outstanding principal in the 2009A Bonds, which can be called starting August 1, 2018; \$266.1 million in outstanding principal in the 2009B Bonds, which can be called starting August 1, 2019; and \$123.1 million in outstanding principal in the 2010A Bonds, which can be called starting August 1, 2020.) The maturities selected for the refunding from each of the outstanding series will depend on the interest rates at the time of pricing.

In addition, the outstanding SRF loans are potential candidates to be refunded if the borrowing rate on the bonds are lower than the SRF loan interest rates. Per the City’s Debt Policy, the City will consider conducting a current refunding if net present value savings of at least 3% can be achieved.

Debt Management will be evaluating in consultation with the financing team various structuring opportunities for the proposed offering, including lien level, selection of refunding candidates, enhancement of coverage capacity for the Water System, and release of debt service reserve fund cash to fund CIP or pay down of outstanding debt.

## ***III. Financing of Water CIP:***

The 2016 Water Bonds will also consist of new money financing to fund the Water Utility’s projected upcoming CIP needs. Based on Public Works Department and Public Utilities Department expenditure estimates, the new money portion of the financing is anticipated to be \$80 million which will fund ongoing water CIP projects such as water pipeline projects, pipeline transmission projects, water pump station projects, water storage projects, water treatment plants groundwater projects, recycled water projects, and miscellaneous water projects. Execution of

these CIP projects is managed by the Public Works Department and the Public Utilities Department.

Based on year-to-date expenditure trends and projections, approximately \$40 million is expected to reimburse eligible CIP expenditures since August 2015 through April 2016 that are currently cash-funded. The remaining \$40 million in bond proceeds is expected to meet projected spending needs after bond closing and proceeds are received.

***IV. Financing Timeline:***

After Budget and Government Efficiency Committee approval, Debt Management anticipates docketing the financing ordinance, legal documents, and the financing plan to City Council for review and approval in March 2016 and the Preliminary Official Statement for approval via resolution in April 2016. The proposed bond issue is planned to price and close in May 2016. The refunding portion of the proceeds will be placed in an escrow fund until August 1, 2018/2019/2020, when the outstanding bonds will be redeemed.

CITY COUNCIL AUTHORIZATION

At this time, it is expected that the legal and financing documents for the bond transaction would be presented to City Council in accordance with the respective time-lines provided above. The disclosure documents for each financing will be reviewed by the Disclosure Practices Working Group before they are docketed.

CITY STRATEGIC PLAN GOAL(S)/OBJECTIVE(S):

Goal #1: Provide high quality public service

Objective #1: Promote a customer-focused culture that prizes accessible, consistent, and predictable delivery of services

FISCAL CONSIDERATIONS:

The pricing and closing of the 2016 Bonds would be subject to market conditions and the fulfillment of the City's net present value savings threshold of at least 4% for advance economic refundings for the portion of the 2016 Bonds designated to refund the Outstanding Water Bonds.

As described above, under current market conditions, approximately \$490 million of Outstanding Water Bonds are projected to meet the refunding thresholds and are estimated to produce average annual savings of \$4 million over the remaining term of the bonds (from Fiscal Years 2017-2040). The NPV savings are estimated at \$59 million or 12% of the refunded bonds.

Based on current rates, the cost of borrowing for an estimated \$80 million to fund CIP needs is estimated at approximately 3.7% with an estimated annual debt service of \$4.5 million over 30 years. It is expected that the annual savings from the economic refunding of Outstanding Water debt would pay for a significant portion of annual debt service for the new money borrowing allowing the Water System to maintain the same levels of debt service burden while also implementing priority CIP projects through new bond funds.

The actual size of each of the borrowings, associated debt service and resulting aggregate debt service comparisons will be based on the market conditions at the time of pricing of the bonds.

PREVIOUS COUNCIL and/or COMMITTEE ACTION (describe any changes made to the item from what was presented at committee):

On November 17, 2015, the City Council held a Public Hearing on Water Rates in accordance with Proposition 218. The Public Utilities Department conducted a Proposition 218 noticing process as part of the approval for the rate increases necessary to support the CIP and corresponding bond issuance projections for the Water System.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

The Public Utilities Department conducts community outreach on a project basis.

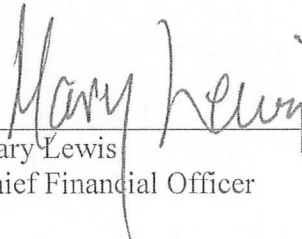
KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Business entities involved in the proposed financings include investment banks, financial advisors, bond and disclosure counsels and trustees. The selected firms will be identified in the Reports to City Council that are issued when the financing and legal documents are docketed for City Council action.

Respectfully submitted,



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