

OFFICE OF THE CITY CLERK

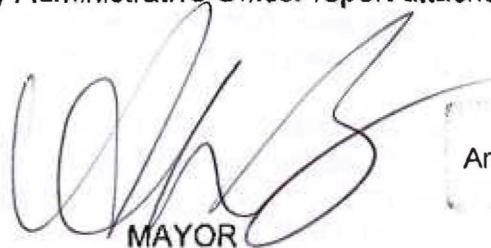
0220-05209-0000

**TRANSMITTAL**

TO Marcie L. Edwards, General Manager Department of Water and Power		DATE FEB 10 2016	COUNCIL FILE NO.
FROM The Mayor		COUNCIL DISTRICT	

**AUTHORITY TO ISSUE \$348 MILLION IN WATER SYSTEM REVENUE BONDS**

Approved and transmitted for further processing including Council consideration.  
See the City Administrative Officer report attached.



Ana Guerrero

MAYOR

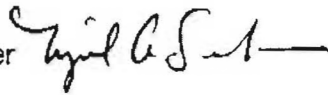
REPORT FROM

## OFFICE OF THE CITY ADMINISTRATIVE OFFICER

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Date: February 8, 2016  
CAO File No. 0220-05209-0000  
Council File No. --  
Council District: --

To: The Mayor

From: Miguel A. Santana, City Administrative Officer 

Reference: Communication from the Department of Water and Power dated January 8, 2016; referred by the Mayor for report on January 20, 2016

Subject: **AUTHORITY TO ISSUE \$348 MILLION IN WATER SYSTEM REVENUE BONDS**

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### SUMMARY

The Department of Water and Power (DWP) requests approval of the proposed Resolution 4904 (Resolution) authorizing the issuance of \$348 million in Water System Revenue Bonds to finance a portion of the Water System's fiscal year (FY) 2015-16 Capital Improvements Program (CIP). The DWP Water System multi-year Capital Program focuses on critical projects necessary to comply with increasing water quality standards, protect existing water supplies, expand and upgrade the existing water distribution system, and develop new water resources. Approval of the proposed resolution is intended by DWP to represent an 'initial resolution' of the Board, which sets forth the purpose for future indebtedness and establishes the maximum limit as follows:

- The maximum principal is \$348 million;
- The maximum term of the debt is 30 years from the date of issuance;
- The maximum interest cost to be incurred through the issuance of bonds is 12 percent<sup>1</sup>.

The maximum legally permissible interest cost that could be incurred through the issuance of the bonds is 12 percent per annum consistent with California Code Section 53531. DWP expects that the current market conditions will provide an interest cost in the range of 4.0 to 5.5 percent.

The proposed Resolution also provides for the private sale of the bonds to one or more underwriting firms selected by the DWP Board of Commissioners (Board) pursuant to City Charter Section 609(d) and Los Angeles Administrative Code (LAAC) Section 11.28.4 (the Procedural Ordinance) governing proprietary department bond resolutions.

The \$348 million bond issuance will be funded by a proposed rate increase approved by the DWP Board on December 15, 2015. The proposed rate increase is pending additional authorization by the City Council with adoption by Ordinance. It is anticipated that the City Council Energy and Environment Committee will consider DWP's proposed rate increase on February 17, 2016.

Without approval of the proposed rate increase, DWP asserts it will reevaluate its financial plans, capital improvement program, and operations prior to issuing the proposed Water System debt.

The bonds will be Water Revenue Fund obligations and will not constitute an obligation of the City or the General Fund. Background information relating to this request is provided in the attached Appendix. The City Attorney has approved the proposed resolution as to form and legality. In compliance with the Responsible Banking Ordinance No. 182138 (RBO), DWP's Pool of Underwriters have disclosed their involvement in charitable programs or scholarships within the City of Los Angeles and internal policies regarding use of subcontractors designated as small business and disabled veteran business enterprises.

## RECOMMENDATIONS

That the Mayor:

1. Approve the proposed Resolution 4904 authorizing Department of Water and Power to issue through private sales, a maximum of \$348 million in Water System Revenue Bonds in accordance with the provisions of City Charter Section 609 and Article 6.5 of the Los Angeles Administrative Code Sections 11.28.1 – 11.28.9; and,
2. Return the proposed resolution to the Department for further processing, including Council consideration.

## FISCAL IMPACT STATEMENT

There is no impact on the City or the General Fund. Approval of the proposed Resolution will authorize the DWP to issue \$348 million of Water System Revenue Bonds to finance a portion of its CIP for FY 2015-16. This issuance will increase debt service costs of the Water Revenue Fund by approximately \$24 million annually. Debt service on these revenue bonds and all projected savings will accrue to the DWP Water Revenue Fund. Debt issuance costs are estimated at \$1.4 million consisting of underwriter's discount, bond and disclosure counsels, financial advisor, and ratings agencies fees.

MAS:RR:10160051

<sup>1</sup> Setting a maximum interest rate or cost is a requirement of Section 11.28.1 of the Procedural Ordinance. The 12% figure reflects the guidance set forth on a State level through CA Government Code Section 53531 that states a statutory maximum bond rate of 12%. The initial resolution is a general authorization to be used over an unspecified period for issuing bonds. As such, the 12% provides flexibility to adjust during to changing market conditions during this unspecified period. The Supplemental Resolutions are adopted closer to the time of bond issuance. In recent Supplemental Resolutions, the Board has approved lower not-to-exceed amounts for each individual issuance. For example, in the Twenty-Seventh Supplemental Bond Resolution authorizing the issuance of the 2014 Series C Power System Bonds, a proviso is included that states "provided, however, that the true interest cost to be incurred through the issuance of the 2014 Series C Bonds shall not exceed 6% per annum; and provided further that the stated interest rate so specified for any 2014 Series C Bond shall not exceed 12% per annum."

**APPENDIX**

The goal of the Water System Capital Program is to ensure the safe and cost-effective delivery of water to its customers. The FY 2015-16 CIP is illustrated in the tables below:

	<i>for fiscal year</i>	<b>2015-16</b>
		<i>(\$millions)</i>
<b>Safe Drinking Water Program</b>		
Reservoir improvements		\$97
Trunk line replacements and additions		142
Chloramination Station Installations		11
Treatment Improvements and Reservoirs and Tank Minor Improvements & Other		45
	<b>Safe Drinking Water Program</b>	<b>\$295</b>
<b>Local Water Supply Program</b>		
Water recycling		\$48
Groundwater Management		9
Groundwater Remediation & Cleanup		40
Watershed Stormwater Capture		33
Water Conservation Programs		37
	<b>Local Water Supply Program</b>	<b>\$167</b>
<b>Water Infrastructure Program</b>		
Distribution main replacements (citywide)		86
Trunkline Major Construction		33
Infrastructure Reservoir Improvements		27
General facilities programs (various building and service yard improvements)		14
Distribution services & meters, meter replacement program, & fire hydrants (citywide)		46
Aqueduct system improvements for both north and south		15
Pump Stations		14
Water Services Organization Information Technology		6
Other (Seismic improvements, regulator stations, tools, and equipment)		10
	<b>Water Infrastructure Program</b>	<b>\$252</b>
<b>Regulatory Compliance - Owens Valley</b>		
Eastern Sierra Environmental Capital		\$7
Owens Valley Dust Mitigation & Master Project		41
Supplemental Dust Control Development		151
	<b>Regulatory Compliance-Owens Valley</b>	<b>\$199</b>
<b>Operating Support</b>		
Water System's share of Joint Capital including Customer Service		\$70
	<b>Operating Support</b>	<b>\$70</b>
<b>Total Water System Capital Improvements Budget for Fiscal Year 2015-16</b>		<b>\$983</b>

### Capital Program Financing

In order to support an overall planned \$983 million capital improvements program during this period, a combination of financings including loans from State Water Resources Control Board, and Water Revenue Bonds, and internally generated funds will be required. The Water System's FY 2015-16 Budget, approved by the DWP Board on May 19, 2015, includes the need to finance approximately \$285 million of capital expenditures through the issuance of water revenue bonds. The current financial plan includes actual financial results of the prior FY ending June 30, 2015, indicating a need to borrow \$598 million, an increase of \$313 million from the approved budget. The increase in borrowing from \$285 million to \$598 million is attributable to the following:

	Amount	Description
<b>Approved Budget (May 2015)</b>	<b>\$285</b>	<b>New money Revenue Bonds issuance</b>
Adjustments:		
State Loans	47	Increased borrowing resulting from reduced estimates of state loans to reflect timing of funding
Water JPA	168	Increased borrowing due to delay in the JPA approval process.
Increased Conservation	50	Increased borrowing due to reduced water consumption versus the approved budget level to reflect Mayor's conservation goal
Beginning Cash Balance	48	Increased borrowing to compensate for lower actual year-end revenue than forecasted in the approved budget
Current Financial Plan	<u>\$598</u>	Total borrowing necessary to fund capital program
Revolving Credit	(250)	Funded through a drawdown from the Revolving Line of Credit
<b>Updated Budget (December 15, 2015)</b>	<b><u>\$348</u></b>	<b>Revised New money Revenue Bonds issuance</b>

The following chart illustrates the Water System debt service amount, Net Available Revenue Coverage (NAR), and Net Operating Cash Flow Coverage (NOCF) since 2005. The NOCF coverage has declined, from 2.9 times coverage in 2005 to 1.6 times in 2014 while the 10-year average is 1.7 times. The Water System achieved a NAR Coverage Ratio of 2.1 times in 2014 while the 10-year average is 2.25. Pursuant to the DWP Board action taken on May 21, 2009 as amended on September 12, 2012 and May 20, 2014, DWP's policy is to use the following financial planning criteria: 1) maintain a minimum debt service coverage of 1.7 times; 2) maintain operating cash target of 150 days; and 3) maintain a capitalization ratio of less than 65 percent.

**Water Revenue Fund Revenue Bonds and Notes  
Pledged Revenue Coverage  
Last Ten Fiscal Years  
(Dollar amounts expressed in thousands)**

Fiscal Year	Operating Revenues (1)	Less: Operating Expenses (2)	Net Available Revenue	Debt Service (3)	Net Available Revenue Coverage	Net Operating Cash Flow	Net Operating Cash Flow Coverage (4)
2005	590,751	387,264	203,487	71,851	2.8	210,129	2.9
2006	625,995	394,543	231,452	95,681	2.4	251,198	2.6
2007	717,145	442,962	274,183	122,928	2.2	231,297	1.9
2008	799,706	523,657	276,049	133,354	2.1	132,714	1.0
2009	825,168	581,587	243,581	116,026	2.1	189,718	1.6
2010	858,201	584,382	273,819	134,106	2.0	152,044	1.1
2011	831,771	540,041	291,730	167,371	1.7	290,206	1.7
2012	875,909	544,824	331,085	178,468	1.9	238,099	1.3
2013	1,091,710	672,462	419,248	192,885	2.2	347,264	1.8
2014	1,206,561	770,368	436,193	204,392	2.1	317,305	1.6

(1) Operating revenues include capital contributions, net non-operating revenues and allowance for funds used during construction.

(2) Operating expenses do not include depreciation and amortization expenses.

(3) Debt service includes principal and interest payments on bonds and commercial paper notes.

(4) Net operating cash flow coverage is presented to show the Funds' ability to generate sufficient cash flow to cover debt service costs.

Source: Office of the Controller, City of Los Angeles, FY 2014 Comprehensive Annual Financial Report, March 2015.

In addition, a 2013 peer review study of California water and sewer utilities published by Fitch Ratings indicates that the AA senior debt rating of the DWP Water System is in line with the average rating of other water utilities in California. The study, which is provided as an attachment, is based on financial ratios that measure operating cash coverage, liquidity, and debt burden. However, no specific data is provided for comparing DWP to other California water utilities.

### Charter Section 609 Compliance

City Charter Section 609 requires that the City Council and Mayor approve the issuance of debt for the proprietary departments. Although the City's Debt Management Policy states that the issuance of debt shall be through a competitive sale whenever feasible, Section 609(d) allows the private sale of bonds subject to the following conditions:

- The DWP Board has authorized the sale of bonds pursuant to private sale after written recommendation of the Chief Financial Officer (CFO) stating the reasons why a private sale will benefit DWP;
- The Council, after receiving a report from the City Administrative Officer, has approved the sale; and,
- The Council is provided an opportunity, as set forth in the Procedural Ordinance, to disapprove the selection by a department of the underwriting firm(s) for the private sale of bonds.

Pursuant to the Procedural Ordinance, the recommendations for private bond sale (Attachments) have been made by both the DWP's CFO and by its financial advisor, the Public Resources Advisory Group (PRAG).

In developing a method of financing the Capital Program, DWP requests authority to conduct private, negotiated sales of bonds to one or more investment banking firms. Pursuant to the Procedural Ordinance, listed below are the firms selected by the Board in May 2015 to serve as the Department's underwriting team for a duration of three years expiring in approximately May 2018. DWP will select from the team of underwriters for each individual bond issuance.

**Department of Water and Power Selected Underwriting Team**

Senior Managers	Co-Managers
Bank of America Merrill Lynch <sup>(A)</sup>	Cabrera Capital Markets, LLC
Barclays Capital Inc.	Fidelity Capital Markets
BMO Capital Markets GKST Inc.	Jefferies LLC
Citigroup Global Markets Inc.	J.P. Morgan Securities LLC
Goldman, Sachs & Co.	Loop Capital Markets LLC
Morgan Stanley & Co. LLC	Mischler Financial Group, Inc.
RBC Capital Markets, LLC	Raymond James & Associates, Inc.
Samuel A. Ramirez & Co., Inc.	Stern Brothers & Co.
Siebert Brandford Shank & Co., LLC	Stifel, Nicolaus & Co., Inc.
Wells Fargo Bank, N.A.	U.S. Bancorp Investments, Inc.

<sup>(A)</sup> Legal name: Merrill Lynch, Pierce, Fenner & Smith Inc.

**Competitive v. Negotiated Bond Sale**

The DWP proposed request for the use of a negotiated or private bond sale is based upon the determinations made by the CFO in consultation with its financial advisor. The rationale for recommending a negotiated sale is provided below.

- Allows for DWP to encourage significant involvement of local and regional firms in addition to retail investors who are less sensitive to price compared to institutional investors;
- Allows DWP to structure specialized bonds to meet specific investor needs;
- Provides DWP increased flexibility in timing the pricing of debt to attempt to respond to volatility in the public capital markets resulting from wide shifts in interest rates and investor demand; and,

Furthermore, a negotiated bond sale can provide DWP an opportunity to communicate directly with investment firms regarding potential concerns including, but not limited to, operations,

developments, challenges, and mitigation efforts, which can be effective for ensuring appropriate borrowing rates.

**Debt Issuance Costs**

Debt issuance costs are estimated by the DWP at approximately \$1.4 million for the total \$348 million new bond issuance. A detail of the services provided and the estimated debt issuance costs are included in the following chart.

<b>Debt Issuance Costs \$348 million Water System Revenue Bonds</b>	
<i>Service</i>	<i>Estimated Cost</i>
Rating Agencies	\$ 337,000
Financial Advisor	60,000
Bond Counsel	95,000
Disclosure Counsel	50,000
Underwriter's Discount	870,000
Printing of Official Statements	4,000
<b>TOTAL</b>	<b>\$1,416,000</b>

*Source: Department of Water & Power - Financial Services Organization*

**Indebtedness**

As of January 1, 2016, the Water System reported approximately \$4.34 billion in long-term debt which consists of \$3.556 billion fixed rate bonds, \$325 million of variable rate bonds, and approximately \$456 million of loans from the California Department of Water Resources. Additionally, there is \$250 million of short term notes outstanding.

If DWP were not authorized to sell the bonds, the DWP Board might be unable to approve contracts for developing local water supply and water quality projects this year. Furthermore, it is possible that DWP would fail to meet regulatory compliance deadlines.