REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date:	July 21, 2014	CAO File No. Council File No. Council District:	0220-04523-0005 -- --
To:	The Mayor		
From:	Miguel A. Santana, City Administrative Officer		
Reference:	Communication from the Department of Water and Power dated June 13, 2014; referred by the Mayor for report on June 19, 2014		
Subject:	**AUTHORITY TO ISSUE $679 MILLION IN POWER SYSTEM REVENUE BONDS**		

SUMMARY

The Department of Water and Power (DWP) requests approval of the Board of Water and Power Commissioners Resolution No. 4880 (Resolution) which authorizes the issuance of $679 million in Power System Revenue Bonds, in order to finance a portion of the Power System's Fiscal Year 2014-15 Capital Improvements Program. The DWP Power System multi-year capital program focuses on an integrated strategy which includes Power Supply Replacement Program, Power Reliability Program, and Infrastructure Improvements Program. The Department states that the Resolution is an 'initial resolution' of the Board of Water and Power Commissioners (Board), which sets forth the purpose for future indebtedness and establishes the maximum limit as to principal, interest costs, and term. The Resolution also provides for the private or negotiated sale of the bonds to one or more underwriting firms selected by the Board pursuant to City Charter Section 609 (d) and Los Angeles Administrative Code Section 11.28.4 (the Procedural Ordinance). The bonds will be Power System Revenue Fund obligations and will not constitute an obligation of the City or the General Fund.

BACKGROUND

The DWP Power System Capital Program's strategic priority is to transform its energy resources and power generation to meet various state and federal mandates; replace aging infrastructure to ensure a reliable distribution system; and, facilitate customer control of their energy options by offering solar incentives and energy efficiency program funding while maintaining regionally competitive rates for its customers. Funding for the Fiscal Year 2014-15 Capital Improvements Program consists of a number of major components illustrated in the following tables.

2014-15 Power System Capital Improvements Program

Power Supply Replacement Program

	$ in millions
Repowering: Rebuilding Local Power Plants - Castaic Modernization and Continue Repower Scattergood Unit 3	$ 279
Renewable Portfolio Standard: Renewable Resources - SB1 Solar Incentive, Beacon Solar Projects, Utility Built Solar, Owens Valley Electric System-Gorge Upgrade, and Barren Ridge Renewable Transmission Project	349
Energy Conservation	101
Natural Gas Drilling Capital Investments	5
Power Supply Replacement Program	**$ 735**

Power System Reliability Program

Power System Reliability Program: Distribution system reliability, substation reliability improvements and expansion, and substation automation	$ 364
Power System Reliability Program	**$ 364**

Infrastructure Reliability Program

Infrastructure Reliability: Additions and improvements in various generating stations; investments in Automatic Meter Reading; and fleet acquisitions	$ 303
Infrastructure Reliability Program	**$ 303**

Operating Support

Operating Support and Adjustments	$ 74
Operating Support	**$ 74**

Total Power System Capital Improvements Program	**$ 1,476**

Note: Detail may not sum to total due to rounding.

Capital Program Financing

In order to support an overall planned $1.476 billion capital improvements program during this period, a combination of borrowings and internally generated funds will be required. The Power System's Fiscal Year 2014-15 Budget adopted by the Board on May 20, 2014, and transmitted to Council in accordance with Charter Section 684, includes the need to borrow approximately $679 million of tax-exempt revenue bonds. The maximum interest cost to be incurred through the issuance of the bonds is 12 percent[1] per annum consistent with California Code Section 53531; the maximum

[1] Setting a maximum interest rate or cost is a requirement of Section 11.28.1 of the Procedural Ordinance. The 12 percent figure reflects the guidance set forth on a State level through California Government Code Section 53531 that sets forth a statutory maximum bond rate of 12 percent. The requested initial resolution is meant to be a general authorization to be used over an unspecified period for issuing bonds. In this regard the 12 percent provides a way to react to changing market conditions during this unspecified period. The Supplemental Resolutions, which are adopted closer to the time of bond issuance, and typically provide for a much narrower anticipated interest cost. 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 percent per annum; and provided further that the stated interest rate so specified for any 2014 Series C Bond shall not exceed 12 percent per annum."

term for any bond to run is 45 years from the date of issuance. Based on the current market conditions, the interest cost is expected to be in the range of 4.5 percent to 5.5 percent.

This bond issue is already funded as part of the approved Fiscal Year 2014-15 Budget, which contemplated interest rates of 5.20 percent. In October 2012, a two-year rate increase for Fiscal Years 2012-13 and 2013-14 was approved by the Board of Water and Power Commissioners and City Council. Revenues from the approved increase are sufficient to support these debt service payments.

The chart below illustrates the Power System's debt service amount, Net Available Revenue Coverage (NAR) and Net Operating Cash Flow (NOCF) Coverage over the last decade. The NOCF coverage has declined, from 3 times coverage in 2004 to 1.8 times in 2013 while the 10-year average is 2.25. The Power System achieved a Debt Service Coverage Ratio (NAR) of 2.5 times while the 10-year average is 3.08. Pursuant to the DWP Board action taken on May 21, 2009 as amended on September 12, 2012 and May 20, 2014, the Department policy is to generally use the following financial planning criteria: 1) maintain a minimum debt service coverage of 2.25 times; 2) maintain a minimum full obligation coverage rate of 1.70 times, 3) maintain operating cash target of 170 days; and, 4) maintain a capitalization ratio of less than 68 percent.

Power 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)
2004	2,437,461	1,771,230	666,231	170,466	3.9	505,187	3.0
2005	2,401,458	1,835,594	565,864	189,105	3.0	611,579	3.2
2006	2,665,535	2,016,080	649,455	223,678	2.9	559,157	2.5
2007	2,799,140	1,996,649	802,491	267,144	3.0	507,934	1.9
2008	2,989,725	2,176,056	813,669	250,484	3.2	469,188	1.9
2009	2,924,155	2,043,192	880,963	270,357	3.3	427,647	1.6
2010	3,387,361	2,287,434	1,099,927	309,349	3.6	741,881	2.4
2011	3,288,476	2,308,188	980,288	400,846	2.4	666,711	1.7
2012	3,267,679	2,235,522	1,032,157	343,093	3.0	851,613	2.5
2013	3,342,586	2,266,249	1,076,337	426,825	2.5	761,079	1.8

(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 2013 Comprehensive Annual Financial Report; February 2014.

In addition, according to the 2013 edition of the *U.S. Public Power Peer Study* published by Fitch Ratings, the financial performance of the DWP, compared to other utilities in the same AA- senior debt rating category, appears to be in line with the median of these utilities. The *Study* is based on several Financial Ratios that measure operating cash coverage, liquidity, and debt burden. A comparison of the DWP Financial Ratios with other Fitch-rated public power utilities is provided in the Attachments.

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 Board has authorized the sale of bonds pursuant to private sale after written recommendation of the Chief Financial Officer stating the reasons why a private sale will benefit the Department;
- 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 has requested 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 the first quarter of 2012 to serve as the Department's underwriting team for a duration of three years expiring in approximately March 2015. The Department will select from the team of underwriters for each individual bond issuance.

Department of Water and Power Selected Underwriting Team	
• Bank of America Merrill Lynch	• BMO Capital Markets Inc.
• Barclays Capital Inc.	• Cabrera Capital Markets, LLC
• De La Rosa & Co.	• Citigroup Global Markets Inc.
• Goldman Sachs & Co..	• Fidelity Capital Markets
• JP Morgan Securities LLC	• Loop Capital Markets, LLC
• Morgan Stanley & Co., LLC	• Mitsubishi UFJ Securities (USA) Inc.
• RBC Capital Markets, LLC	• Ramirez & Co., Inc.
• Siebert Branford Shank & Co., LLC	• The Williams Capital Group, L.P.
• Wells Fargo Securities	• U.S. Bancorp

Competitive vs. Negotiated Bond Sale

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

- A negotiated sale will allow for DWP to provide substantial involvement of local and regional firms in addition to retail investors who are less sensitive to price compared to institutional investors;
- Negotiated sales allow DWP to structure specialized bonds to meet specific investor needs; and,
- A negotiated bond sale allows DWP to attempt to avoid the recent high volatility in the public capital markets (seen particularly in 2013 as interest rates increased significantly, before settling down through 2014), resulting from wide shifts in interest rates and investor demand, through increased flexibility in timing the pricing of debt.

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 $2.75 million for the total $679 million new bond issuance. A detail of the services provided and the estimated debt issuance costs are included in the chart below.

Debt Issuance Costs $679 million Power System Revenue Bonds

Service	*Estimated Cost*	
Rating Agencies	$	399,000
Financial Advisor		57,000
Bond Counsel		205,000
Disclosure Counsel		50,000
Underwriter's Discount		2,037,000
Printing of Official Statements		4,000
TOTAL	$	2,752,000

Source: Department of Water & Power - Financial Services Organization

Indebtedness

As of June 30, 2014, the Power System reported approximately $7.58 billion in long-term debt obligations and $200 million of commercial paper program. Long-term debt obligations consist of approximately $1.17 billion of variable rate debt and $6.41 billion of fixed rate revenue bonds. All debt service payments are payable from the Power Revenue Fund. The following table identifies recent Power System long-term debt activity.

Power System Long-Term Debt Activity - Recent Issuances

Fiscal Year	*($ in millions) Issuance*		*Rate*	*Purpose*	*Type of Sale*
2014	$322.00	*Tax-exempt*	4.008% Fixed	Capital Improvements	Negotiated
	$200.00	*Tax-exempt*	Variable	Capital Improvements	Negotiated
2013	$27.86	*QECBs Taxable**	4.441% Fixed	Capital Improvements	Negotiated
	$452.14	*Tax-exempt*	3.347% Fixed	Capital Improvements	Negotiated
2013	$527.31	*Tax-exempt*	2.504% Fixed	Refunding Bonds**	Negotiated
	$300.00	*Tax-exempt*	0.958% Fixed(1)	Capital Improvements	Negotiated
2013	$350.00	*Tax-exempt*	4.164% Fixed	Capital Improvements	Negotiated
	$104.08	*Tax-exempt*	2.936% Fixed	Refunding Bonds**	Negotiated

**The Federal Qualified Energy Conservation Bonds were the unused portion of the 2009 City's ARRA funds.*

*** The Refunding transactions yielded a combined present value savings of $130.1 million or 17.5 percent of refunding bonds*

(1) 3-year note

RECOMMENDATION

That the Mayor approve the Board of Water and Power Commissioners' Resolution No. 4880 authorizing the Department of Water and Power to issue through private sales, a maximum of $679 million in Power System Revenue Bonds in accordance with the provisions of Charter Section 609 and Article 6.5 of the Los Angeles Administrative Code Sections 11.28.1 – 11.28.9; and return the Resolution to the Department for further processing, including Council consideration.

FISCAL IMPACT STATEMENT

There is no direct impact on the City's General Fund. Approval of the recommended action will authorize the DWP to issue $679 million of Power System Revenue Bonds to finance a portion of its capital improvements program for Fiscal Year 2014-15. DWP estimates the net impact of this issuance will be to increase debt service costs of the Power System Revenue Fund by approximately $43.7 million annually for 30 years. One-time costs of issuance from the Power System Revenue Fund are estimated at approximately $2.75 million. One-time costs consist of underwriter's discount; bond and disclosure counsels, financial advisor; and ratings agencies fees.

MAS:RPR:10150003

Attachments