

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: April 30, 2015

CAO File No. 067000037

Council File No.

Council District: ALL

To: The Mayor
The Council

From: Miguel A. Santana, City Administrative Officer



Reference: Los Angeles Wastewater System Debt Financing Program

Subject: **ISSUANCE OF LOS ANGELES WASTEWATER SYSTEM REVENUE BONDS,
REFUNDING SERIES 2015**

SUMMARY

The City Administrative Officer (CAO) requests authority to issue Los Angeles Wastewater System ("LAWW") Fixed-Rate Revenue Refunding Bonds (the "Series 2015 Bonds") to: 1) refinance portions of LAWW Revenue Bonds Series 2002A, 2005A, 2009A and 2010A-subordinate, if the refinancing achieves interest savings in accordance with the City's debt policy; 2) issue up to \$110 million to refinance outstanding Commercial Paper ("CP") notes; and, 3) issue up to \$200 million in new money for future capital needs. Authority is requested to issue the maximum amount of refunding bonds that are needed to achieve interest savings, which will be determined at the time of sale, subject to market conditions. The CAO recommends the adoption of two Resolutions (Attachments A and B) that incorporate various documents required for the issuance and sale of the Series 2015 Bonds (Exhibits A to C).

The Series 2015 Bonds will be issued in five series. Series 2015-A in the amount of \$200 million and Series 2015-C in the amount of \$110 million will be new bonds issued for new capital projects and to refinance CP notes, respectively. The remaining series, Series 2015-B, Series 2015-D and Series 2015-A (Subordinate), will be issued to refund bonds for present value savings of approximately \$23 million over the life of the bonds. Series 2015-A and Series 2015-C represent the Wastewater System's inaugural issuances of "Green Bonds." Green Bonds are bonds issued for capital projects that are sustainable or environmentally-focused and are attractive to a growing group of investors who have mandates to invest in socially responsible endeavors.

This Office recommends the sale of the Series 2015 Bonds on a negotiated basis by the following firms selected from the approved qualified list of underwriters for fixed-rate bond transactions (C.F. 10-1763): Bank of America/Merrill Lynch (LBE), Backstrom McCarley Berry & Co. (LBE/MBE), Citigroup Global Markets (LBE), Jefferies & Co., Inc (LBE), J.P. Morgan Securities LLC (LBE), Loop Capital Markets LLC (LBE/MBE) and Siebert Brandford Shank & Co., LLC (LBE/MBE).

To proceed with the LAWW Series 2015 transaction, the Mayor and City Council will need to approve the Twenty-Eighth Supplemental Resolution (Senior Debt - Attachment A) and the Seventeenth Supplemental Resolution (Subordinate Debt - Attachment B). These Resolutions incorporate various documents required to execute the proposed transactions, authorize the issuance of: 1) up to \$300 million in new bonds for future capital projects; and, 2) the maximum amount of refunding bonds that are deemed to achieve interest savings, which will be determined at the time of sale, and authorize the CAO to take certain actions to manage the various transactions.

The Resolutions provide for authority to issue up to \$300 million in new money should circumstances support increasing the amount issued at the time the transaction is priced. Specifically, BOS is currently projecting capital needs of \$140 million in Fiscal Year 2017-18. If economically viable, up to an additional \$100 million may be issued during this transaction to fund a portion of BOS' future capital program.

The Resolutions also incorporate the following documents for each of the proposed transactions (Exhibits A to C):

- Escrow Agreement (Exhibit A);
- Bond Purchase Agreement (Exhibit B); and
- Preliminary Official Statement (Exhibit C);

This transaction will also provide the first step towards enacting a springing amendment to the General Resolution that was initiated in the Series 2010 transactions. The springing amendment provides flexibility with respect to reserve funding levels for future sales and the treatment of federal subsidies received for the Wastewater System's Build America Bonds and Recovery Zone Economic Development Bonds issued as part of the Series 2010 transaction. The springing amendment requires the adoption of a separate Resolution after these transactions close, which will be submitted to the Mayor and City Council for approval prior to Fall of this year.

The Mayor and City Council will also need to approve an Ordinance establishing the special funds for the Series 2015 Bonds, which has been prepared by the City Attorney and will be submitted separately.

The sale of the first series of bonds is planned for late May 2015, with the closing of the transaction in early June 2015. The sale and closing of the second series of bonds is planned for June 2015.

These recommendations are in compliance with the City's Financial Policies.

RECOMMENDATIONS

That the Council, subject to the approval of the Mayor:

1. ADOPT the Twenty-Eighth Supplemental Resolution and Seventeenth Supplemental Resolution, including various documents required to execute the transactions, and authorizes the City Administrative Officer to take certain actions required to manage the transactions, including costs of issuance;
2. AUTHORIZE the City Administrative Officer to make technical changes to implement the intent of the Council and Mayor.

FISCAL IMPACT STATEMENT

There is no impact to the General Fund as a result of the recommended Los Angeles Wastewater System Refunding Series 2015 bond issue. The debt service on the Wastewater System Revenue Bonds is paid from the Sewer Construction and Maintenance Fund. The costs of issuance will be paid from bond proceeds.

DEBT IMPACT STATEMENT

There is no debt impact to the City's General Fund from the approval of the recommendations in this report. The proposed transactions are expected to generate savings of approximately \$23 million over the life of the bonds for the Sewer Construction and Maintenance Fund. The actual amount of savings will be determined at the time of issuance subject to market conditions and the City's Debt Management Policies.

FINDINGS

1. Background

The City's Wastewater System funds capital improvements on a short-term basis through the periodic issuance of Commercial Paper ("CP"). This CP is paid down through the routine issuance of long-term bonds. The Wastewater System realizes lower all-in borrowing costs using this funding mechanism. The City can also issue new fixed rate bonds to finance capital projects when long-term rates are sufficiently attractive to bypass the CP financing mechanism.

2. Proposed Transactions

This Office regularly monitors outstanding bonds for opportunities to refinance to achieve interest rate savings and has identified several series that are eligible for refunding and likely to achieve savings based on current market conditions of approximately \$23 million over the life of the bonds. The extent of those savings will fluctuate and depend on market conditions at the time of the transactions. Senior Bond Series 2005-A is a candidate for current refunding. Senior Bond Series 2002-A, 2009-A, and 2010-A (subordinate) are candidates for advance refunding in order to lock in attractive rates. All or a portion thereof of these bonds will be refunded, depending on market conditions. In addition to generating present value savings of up to \$23 million, the refundings will also provide the opportunity to restructure payments to level out debt service over the next 30 years. The proposed transactions will also shift certain bonds between subordinate and senior liens to release debt service reserve funds and maximize savings. Maturities will be matched to the refunded bonds, so debt service is not extended beyond original maturity dates.

The transaction will also refinance \$110 million of currently outstanding CP notes and provide \$200 million in new money for future capital projects. The Resolutions provide for authority to issue up to \$300 million in new money should circumstances support increasing the amount issued at the time the transaction is priced. Specifically, BOS is currently projecting capital needs of \$140 million in Fiscal Year 2017-18. If economically viable, up to an additional \$100 million may be issued during this transaction to fund a portion of BOS' future capital program.

This transaction will also provide the first step towards enacting a springing amendment to the General Resolution that was initiated in the Series 2010 transactions. The springing amendment provides flexibility with respect to reserve funding levels for future sales and the treatment of federal subsidies received for the Wastewater System's Build America Bonds and Recovery Zone Economic Development Bonds issued as part of the Series 2010 transaction. The springing amendment requires the adoption of a separate Resolution after these transactions close, which will be submitted to the Mayor and City Council for approval prior to Fall of this year.

The Series 2015 Bonds that are attributable to the advance refunding of bonds will be held by the escrow agent in an irrevocable escrow account. The amount required to redeem the bonds will be verified by a certified public accountant, who serves as Verification Agent.

The funding of a debt service reserve fund, as required for senior lien bonds, will serve as a source of security to bondholders in the event that the City defaults on payment for any reason.

The final amount will be determined before pricing, depending on the lien structure, market conditions and discussions with rating agencies.

Underwriters' discount is the compensation the underwriters receive for marketing the bonds and will be paid from bond proceeds.

Costs of issuance include fees for bond counsel, special tax counsel, disclosure counsel, financial advisors, verification agent, escrow agent, printing, rating agency fees, investor outreach costs, travel for pricing, and other associated costs, will be paid from bond proceeds.

3. Green Bonds

The Series 2015 Bonds will be issued in five series. Series 2015-A in the amount of \$200 million and Series 2015-C in the amount of \$110 million will be new bonds issued for new capital projects and to refinance commercial paper notes, respectively. Series 2015-A and Series 2015-C represent the Wastewater System's inaugural issuance of "Green Bonds." Green Bonds are bonds issued for capital projects that are sustainable or environmentally-focused and are attractive to a growing group of investors who have mandates to invest in socially responsible endeavors.

The Bureau of Sanitation ("BOS") has reviewed its Wastewater System Capital Improvement Program ("CIP") and identified the following categories which encompass all of its bond-funded projects and serve as the framework for the Wastewater System's Green Bond projects:

1. Wastewater Treatment – Projects that support the overall treatment objective of meeting the discharge standards mandated by the System's NPDES permits;
2. Wastewater Collection and Pumping – Projects that reduce sewage spills;
3. Water Recycling – Projects that produce water for groundwater barrier and industrial uses, freeing up water from other sources that can be used by non-industrial customers and for environmental protection purposes;
4. Air Quality – Projects that protect air quality; and
5. Non-project and Other – These expenditures support the construction and operation of the wastewater facilities, indirectly supporting the environmental objectives discussed above.

The Green Bonds will be used to finance new capital projects in accordance with these categories and refinance capital projects initially paid for by CP which also align with these categories. Proceeds will be deposited into a segregated account to facilitate tracking and subsequent reporting. The City will file annual updates regarding the use of these proceeds to EMMA, the official electronic platform for municipal securities disclosure.

4. Underwriting Team

We recommend the sale of the Series 2015 Bonds on a negotiated basis. This recommendation is based on the need to control the timing of the refunding to maximize savings and flexibility, given market conditions and the likelihood that these bonds will be offered without insurance. We recommend the use of five firms selected from the approved qualified list of underwriters for the three fixed-rate bond transactions (C.F. 10-1763): Bank of America/Merrill Lynch (LBE), Backstrom McCarley Berry & Co. (LBE/MBE), Citigroup Global Markets (LBE), Jefferies & Co., Inc (LBE), J.P. Morgan Securities LLC (LBE), Loop Capital Markets LLC (LBE/MBE) and Siebert Brandford Shank & Co., LLC (LBE/MBE). Series 2015-A and Series 2015-B will be senior managed by Siebert, Brandford Shank. Series 2015-C, Series 2015-D and Series 2015-A (Subordinate) will be senior managed by Citigroup.

Recently, large transactions have gone to market with significant retail sales, which helps create competitive pricing on the institutional side. To secure the best pricing for this transaction, we need to successfully access the retail market. The proposed underwriters have well-established retail capabilities, which could be supplemented with a selling group comprised of additional underwriters. The members of the selling group would not be a party to this transaction in that they would not assume any underwriting liability; they would only assist with the marketing and sale of bonds and would be compensated accordingly. There is no increase in costs associated with the use of a selling group. This Office will establish a selling group, if the determination is made that it would be a cost-effective tool to improve retail access.

5. Financing Team

The firms providing financial advisory services for this financing, previously approved by the Mayor and Council (C.F. 14-0412), are Public Resources Advisory Group (PRAG) and Montague DeRose & Associates (Montague).

Bond Counsel and Disclosure Counsel for these transactions are Norton Rose Fulbright LLP (Fulbright) and Hawkins Delafield & Wood LLP (Hawkins), respectively. These firms are on the City's qualified list for legal services for the City's various bond programs, previously approved by the Mayor and Council (C.F. 12-0917).

6. Required Documents

To proceed with the recommended transactions, the Council will need to adopt two Resolutions (Attachments A and B), which provide for the approval of the following:

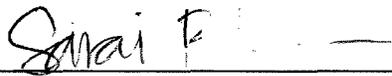
- Escrow Agreements which are agreements between the City and the Escrow Agent to provide for the administration of the bond proceeds to pay the refunded bonds (Exhibit A);
- Bond Purchase Agreements which are agreements between the City and the underwriters for the sale and purchase of the bonds by the underwriters (Exhibit B);

- Preliminary Official Statements which are the primary disclosure and marketing documents for the bonds (Exhibit C).

The City Attorney report and draft ordinance, to be submitted under separate cover, also need to be approved to establish the necessary funds for the Series 2015 bonds.

7. Procedural Ordinance

The documents attached hereto are in substantially final form. If necessary, any technical revisions will be consistent with the intent of the Mayor and Council.



Sarai Bhaga
Senior Administrative Analyst II

APPROVED:

Assistant City Administrative Officer

MAS:SMB:09150178

Attachments:

Attachment A – Twenty-Eighth Supplemental Resolution

- Exhibit A – Escrow Agreement
- Exhibit B – Bond Purchase Agreement
- Exhibit C – Preliminary Official Statement

Attachment B – Seventeenth Supplemental Resolution

- Exhibit A – Escrow Agreement
- Exhibit B – Bond Purchase Agreement
- Exhibit C – Preliminary Official Statement