



BOARD LETTER APPROVAL



JEFFERY L. PELTOLA
Chief Financial Officer



MARCIE L. EDWARDS
General Manager

DATE: October 2, 2015

SUBJECT: Initial Authorization to Establish and Maintain up to a Combined \$500 Million Revolving Line of Credit for both the Water and Power Systems

SUMMARY

As part of LADWP's long-term financial strategy, the Financial Services Organization (FSO) is requesting approval of Resolution No. 4900 (Initial Resolution), which seeks authorization to establish and maintain a Revolving Line of Credit (Line of Credit) of up to a combined maximum of \$500 million for both the Water and Power Systems (collectively, the "Systems"). The Line of Credit is payable from both the Water Revenue and Power Revenue Funds. It will serve as a flexible source of liquidity that can be accessed by either or both Systems to reimburse capital expenditures that were paid out of their respective Revenue Funds; fund current capital expenditures; or fund working capital on a short-term basis when the timing of anticipated revenues and/or other sources of cash flow, such as revenue collections, bond and securitization proceeds, loans, and grants are delayed. The Line of Credit will be an important risk management tool that will provide LADWP with greater flexibility and help to ensure that LADWP maintains the minimum levels of operating days' cash for each System as established by the Board of Water and Power Commissioners (Board) under Board Resolution Nos. 014-216 and 014-217 dated May 20, 2014 for the Power System and Water System, respectively.

Mayoral and City Council approvals are required pursuant to Section 609 of the Charter of the City of Los Angeles (Charter). A subsequent resolution, to be introduced at a future Board meeting, will seek approval of the related bank agreement(s) with one or more credit providers that will be selected through a competitive solicitation process.

RECOMMENDATION

It is requested that the Board adopt the attached Initial Resolution, per City Charter Section 609, authorizing the establishment of a combined Line of Credit of up to a maximum amount of \$500 million.

ALTERNATIVES CONSIDERED

In addition to a Line of Credit, LADWP has also considered a combined Commercial Paper (CP) program for both Systems. Although a CP program could provide similar access to liquidity as that of a Line of Credit, a CP program is administratively more cumbersome and may be less cost-effective as a Line of Credit. There is no need to access the capital markets with a Line of Credit, thus avoiding the time and expense associated with negotiating agreements with CP dealers, obtaining short-term ratings, preparing disclosure documents, and all other related activities. In addition, a subsequent downgrade of the bank providing a Line of Credit would not impact the cost of the established program. Lastly, the current bank regulatory framework allows certain banks to provide more attractive pricing for a Line of Credit compared to liquidity support associated with a CP program.

FINANCIAL INFORMATION

The fee structure for a Line of Credit is comprised of two components: unutilized and utilized (drawn) portion. Indicative pricing for the unutilized fee is approximately 0.125 percent under current market conditions. If utilized as a tax-exempt bridge funding for capital investments, the interest charge is SIFMA, or a percentage (e.g., 70 percent) of 30-day LIBOR plus a predetermined spread; if utilized for taxable working capital, the interest charge is 30-day LIBOR plus a predetermined spread.

The fee for the unutilized portion would be allocated 33 percent to the Water Revenue Fund and 67 percent to the Power Revenue Fund. The repayment of principal and interest expense would be charged directly to the System that benefited from the funds drawn.

BACKGROUND

To meet the increasing regulatory mandates, the Systems' proposed five-year average expenditures budget have increased by up to 65 percent from a year ago. The majority of the funding for such expenditures comes from a combination of customer revenues and long-term debt to fund a portion of capital investments. LADWP forecasts reflect multiple sources of cash including revenues from customers, state loans and grants, securitization proceeds, and proceeds from bond sales going forward. Recent events, such as water conservation and delayed revenue collections resulting from billing issues, have highlighted the need for a flexible source of liquidity. In the event that revenue collection is delayed, access to the capital markets becomes constrained, and/or if other planned sources of funds do not materialize in a timely manner, immediate access to funds is necessary in order to fill the revenue gap or fulfill an obligation on a short-term basis. For the product to provide these benefits, it is important that the funds can be accessed relatively quickly.

Establishing an ongoing short-term liquidity program, such as a Line of Credit, is key to preserving LADWP's credit ratings and to ensure sufficient liquidity in meeting LADWP's

growing needs for working capital and capital investments while maintaining the financial metrics established by the Board.

Advantages

A short-term liquidity program like a Line of Credit has numerous advantages and benefits. The proposed Line of Credit is intended to serve as a flexible and cost-effective short-term liquidity risk management tool that will provide the Systems with ready access to funds on an as-needed basis, mitigating the impact of any unplanned use of reserves. Upon notification, the bank providing the Line of Credit will fund a request for funds in a matter of days. It is not intended to replace LADWP's long-term debt issuance program. A portion or the full amount of the outstanding balance can be repaid within days once the anticipated cash flows have been received without prepayment penalty.

Establishing a Line of Credit also affords LADWP low rates and provides the flexibility to better time a permanent long-term financing. The "draw-when-needed" nature of this type of financing minimizes, if not totally avoids, negative arbitrage (i.e., borrowing at a higher long-term rate and investing at lower rate while waiting to fully spend borrowed proceeds), which costs approximately \$700,000 under current market conditions, if say, \$75 million of fixed rate bond proceeds are not spent in three months. In addition, credit rating agencies, such as Moody's Investors Service and Fitch Ratings, recognize and regard Lines of Credit as additional liquidity in their credit scoring thereby enhancing LADWP's credit structure.

Risk Factors

A Line of Credit exposes LADWP to the creditworthiness of the provider bank similar to the existing standby bond and direct purchase agreements LADWP already has in place with banks for its Variable Rate Demand Obligations (VRDO) Program. But unlike the VRDO program, a subsequent downgrade of the bank providing the Line of Credit would not impact the cost of LADWP's program.

Another common risk involved with similar bank agreements is renewal risk. Similar to the VRDO program, the bank agreements for the Line of Credit would also have a three-year term. There is also a risk that potential providers may opt not to offer a Line of Credit or that the current provider(s) may elect not to renew their agreements at all or at favorable business terms. Such decisions will be partly driven by market forces beyond LADWP's control and by LADWP's creditworthiness as a borrower. Maintaining favorable credit ratings is a core long-term goal for LADWP; therefore, it is already managing such risk as it pertains to this financial option on an ongoing basis.

In addition, any unpaid balances in the Line of Credit will carry interest rates that are variable in nature exposing LADWP to changes in short-term interest rate indices similar to those associated with its VRDO program. However, existing cash and cash equivalents in LADWP's various revenue and special trust funds provide a natural

hedge for any variable rate exposure from this short-term liquidity program. This means that as short-term rates go up, interest income from these short term funds will likely go up too, offsetting in part (if not fully) the increase in interest costs of the Line of Credit.

LADWP's Line of Credit and Terms

In order to maximize the program's benefits and flexibility and minimize the costs, LADWP will establish a single Line of Credit for both Systems for up to a combined maximum amount of \$500 million. Although a maximum amount of \$500 million is being requested at this time, LADWP anticipates establishing only a \$300 million Line of Credit with a term of three years initially. Any subsequent program expansion will require Board approval. At an estimated fee of 0.125 percent annually to establish a \$300 million Line of Credit, this fee will be approximately \$375,000 annually, split between the Systems.

This Line of Credit can be drawn by either of the Systems depending on their liquidity and funding needs. The undrawn fee would be shared by the Water System and Power System on a ratio of 33 percent and 67 percent, respectively. If drawn, the repayment of principal and interest charge will be paid by the System that used the funds.

The terms of the Line of Credit will be negotiated with credit provider(s) selected through a competitive solicitation process and are expected to be similar to the terms that LADWP previously negotiated with banks to support its VRDO program. A subsequent resolution will be submitted to the Board to approve the agreement with the selected bank provider(s) of the Line of Credit as well as the protocol and delegation of authority relating to any draws from the Line of Credit.

Other Municipal Issuers

Numerous municipal issuers have similar short-term liquidity programs in place - either a CP Program or Line of Credit, or both. In California, they include the following:

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| The State of California | Los Angeles County |
| Los Angeles Wastewater | Los Angeles World Airports |
| Municipal Improvement Corporation of Los Angeles | Port of Los Angeles |
| | Port of Long Beach |
| Metropolitan Water District | Pasadena Electric |
| East Bay Municipal Utility District | San Francisco Public Utility Commission |
| Santa Clara Valley Water District | West Basin Metropolitan Water District |
| City of San Jose | San Diego County Water Authority |
| Anaheim Public Utilities | Imperial Irrigation District |

The program's cost exposure is minimal. The anticipated program amount of \$300 million represents only two percent of LADWP's total direct and off-balance sheet

debt of approximately \$15 billion. Upon each draw, a staff report will be submitted to the Board immediately providing information about the purpose of the draw, its amount and related costs, availability of budgeted funds for repayment of borrowed funds and interest and the anticipated timing of payment. All draws from the Line of Credit must be repaid in full within 12 months from the draw date. Drawn down funds will be deposited directly into an account with the City Treasurer. Depending on its use, the City Treasurer will credit these funds into the Water and/or Power System Revenue and/or Construction Funds. To use these funds, the standard documentation will need to be in place (approved contract/vendor invoice/support that items or services were received) before any payment could be made.

Resolution No. 4900 is an initial resolution of the Board, setting forth the purpose for future indebtedness and establishing the maximum limit as to principal, interest costs, and term. A separate resolution that authorizes the specific terms and conditions for the related Line of Credit agreement will be presented at a future Board meeting.

In accordance with the Mayor's Executive Directive No. 4, the City Administrative Officer's Report is attached.

ENVIRONMENTAL DETERMINATION

In accordance with the California Environmental Quality Act (CEQA), it has been determined that the request for authority to establish and maintain a Line of Credit is exempt pursuant to the General Exemption described in CEQA Guidelines Section 15061(b)(3).

CITY ATTORNEY

The Office of the City Attorney reviewed and approved Resolution No. 4900 as to form and legality.

ATTACHMENT

- Resolution
- CAO Report