

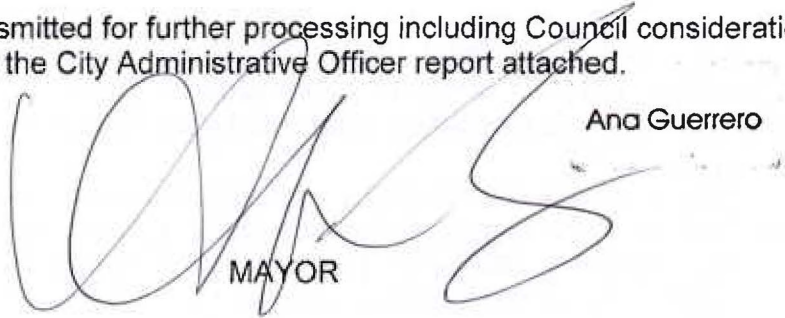
0220-04523-0006

TRANSMITTAL

TO Marcie L. Edwards, General Manager Department of Water and Power	DATE FEB 25 2016	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT	

AUTHORITY TO ISSUE \$428 MILLION IN POWER SYSTEM REVENUE BONDS

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


MAYOR

Ana Guerrero

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: February 25, 2016

CAO File No. 0220-04523-0006

Council File No. --

Council District: --

To: The Mayor

From: Miguel A. Santana, City Administrative Officer

MAS
MS

Reference: Communication from the Department of Water and Power dated February 8, 2016; referred by the Mayor for report on February 10, 2016

Subject: **AUTHORITY TO ISSUE \$428 MILLION IN POWER SYSTEM REVENUE BONDS**

SUMMARY

The Department of Water and Power (DWP) requests approval of the proposed Resolution 4907 (Resolution) authorizing the issuance of \$428 million in Power System Revenue Bonds to finance a portion of the Power System's fiscal year (FY) 2015-16 Capital Improvements Program (CIP). The DWP Power System multi-year Capital Program focuses on an integrated strategy which includes a Power Supply Replacement Program, Power Reliability Program, and an Infrastructure Improvements Program. 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 \$428 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 percent¹.

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 (Procedural Ordinance) governing proprietary department bond resolutions.

The \$428 million bond issuance will be funded by a proposed rate increase approved by the DWP Board on January 19, 2016. 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 in March 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 Power System debt. Furthermore, based on the approved capital budget for 2015-16, the projected cash requirement for the Power System will fall significantly below the DWP Board approved minimum of 150 days of operating cash if the proposed Power Revenue Bonds are not issued by May 2016.

The bonds will be Power 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 selected 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 4907 authorizing Department of Water and Power to issue through private sales, a maximum of \$428 million in Power 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 \$428 million of Power System Revenue Bonds to finance a portion of its CIP for FY 2015-16. This issuance will increase debt service costs of the Power Revenue Fund by approximately \$28.7 million annually. Debt service on these revenue bonds and all projected savings will accrue to the DWP Power Revenue Fund. Debt issuance costs are estimated at \$1.6 million consisting of underwriter's discount, bond and disclosure counsels, financial advisor, and ratings agencies fees.

MAS:RR:10160066

¹ 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.

APPENDIX

The priority of the Power System Capital Program is to transform its energy resources to meet mandates, replace aging infrastructure for reliability, and to support customer incentives for solar and energy efficiency programs. The FY 2015-16 CIP is illustrated in the tables below:

2015-16 Power System Capital Improvements Program	
Power Supply Replacement Program	(\$millions)
Repowering: Local Power Plants - Castaic and Scattergood Unit 3	\$98
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	\$375
Energy Conservation	\$145
Natural Gas Drilling - Capital Investments	\$5
Power Supply Replacement Program	\$623
Power System Reliability Program	
Replace poles, transformers, cables, and overhead circuits. Improve distribution system including the expansion and automation of substations. Integrate smart grid technology.	\$409
Power System Reliability Program	\$409
Infrastructure Reliability Program	
Improvements at generating stations. Investments in automatic meter reading and fleet acquisition.	\$340
Infrastructure Reliability Program	\$340
Operating Support	
Operating Support	\$113
Operating Support	\$113
Total Power System Capital Improvements Program	\$1,485

Capital Program Financing

In order to support an overall planned \$1.5 billion capital improvements program during this period, a combination of borrowings and internally generated funds will be required. The Power System's FY 2015-16 Budget, approved by the DWP Board on May 29, 2015, includes the need to borrow approximately \$647 million of tax-exempt revenue bonds. The current financial plan includes actual financial results of the prior FY ending June 30, 2015, indicates a need to borrow \$428 million, a decrease of \$219 million from the approved budget. The reduction in borrowing is attributable to lower than budgeted capital spending during the prior fiscal year (2014-15) which resulted in (i) \$85 million in unspent bond proceeds and (ii) a Power Revenue Fund cash balance of \$134 million higher than budget.

The following chart 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 3.2 times coverage in 2005 to 2.1 times in 2014 while the 10-year average is 2.16. The Power System achieved a Debt Service Coverage Ratio (NAR) of 2.5 times while the 10-year average is 2.94. Pursuant to the DWP Board action taken on May 21, 2009 as amended on September 12, 2012 and May 20, 2014, the DWP 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)
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	3,288,478	2,308,188	980,290	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
2014	3,495,731	2,363,857	1,131,874	451,253	2.5	942,757	2.1

(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.

According to the 2015 edition of the U.S. Public Power Peer Study published by Fitch Ratings, the financial performance of the DWP appears to be in line with the median of other utilities in the same AA- senior debt rating category. 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 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 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 ^(A)	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.

^(A) 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 \$1.6 million for the total \$428 million new bond issuance. A detail of the services provided and the estimated debt issuance costs are included in the following chart.

Debt Issuance Costs \$428 million Power System Revenue Bonds	
<i>Service</i>	<i>Estimated Cost</i>
Rating Agencies	\$ 325,000
Financial Advisor	60,000
Bond Counsel	95,000
Disclosure Counsel	50,000
Underwriter's Discount	1,070,000
Printing of Official Statements	4,000
TOTAL	\$ 1,604,000

Source: Department of Water & Power - Financial Services Organization

Indebtedness

As of January 1, 2016, the Power System reported approximately \$7.92 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 \$6.75 billion of fixed rate revenue bonds. All debt service payments are payable from the Power Revenue Fund.