


RECEIVED
FINANCIAL SERVICES ORGANIZATION
EXECUTIVE OFFICE

SEP 14 2016

TRANSMITTAL		0220-05261-0000
TO David H. Wright, Interim General Manager Department of Water and Power	DATE SEP 13 2016	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT	
<p>AUTHORITY TO ISSUE \$167 MILLION IN WATER SYSTEM REVENUE BONDS</p> <p>Approved and transmitted for further processing including Council consideration. See the City Administrative Officer report attached.</p>  <p>Ana Guerrero</p> <p>MAYOR</p>		
MAS:RR:10170009t CAO 649-d		

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: September 12, 2016

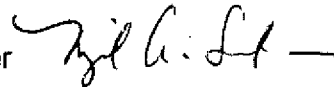
CAO File No. 0220-05261-0000

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 August 3, 2016; referred by the Mayor for report on August 16, 2016

Subject: **AUTHORITY TO ISSUE \$167 MILLION IN WATER SYSTEM REVENUE BONDS**

SUMMARY

The Department of Water and Power (DWP) requests approval of the proposed Resolution 4920 (Resolution) authorizing the issuance of \$167 million in Water System Revenue Bonds to finance a portion of the Water System's fiscal year (FY) 2016-17 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 \$167 million;
- The maximum term of the debt is 45 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 (the Procedural Ordinance) governing proprietary department bond resolutions.

The \$167 million bond issuance will be funded by the multi-year rate increase approved by the City Council in March 2016, effective on April 15, 2016. 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 4920 authorizing Department of Water and Power to issue through private sales, a maximum of \$167 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 fiscal impact on the City or the General Fund. Approval of the proposed Resolution will authorize the DWP to issue \$167 million of Water System Revenue Bonds to finance a portion of its CIP for FY 2016-17. Debt service on these revenue bonds and all projected savings will accrue to the DWP Water Revenue Fund. Debt issuance costs are estimated at \$834,000 consisting of underwriter's discount, bond and disclosure counsels, financial advisor, and ratings agencies fees.

MAS:RR:10170009

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 Water System Capital Program is to ensure the safe and cost-effective delivery of water to its customers. The FY 2016-17 CIP is illustrated in the tables below:

	<i>for fiscal year</i>	2016-17
		<i>(\$millions)</i>
Safe Drinking Water Program		
Reservoir improvements		\$138
Trunk line replacements and additions		111
Groundwater Remediation and Clean Up		44
Chloramination Station Installations		11
Treatment Improvements and Reservoirs and Tank Minor improvements & Other		33
	Safe Drinking Water Program	\$337
Local Water Supply Program		
Water recycling		\$72
Groundwater Management		13
Watershed Stormwater Capture		29
Water Conservation Programs		40
	Local Water Supply Program	\$154
Water Infrastructure Program		
Distribution main replacements (citywide)		\$104
Trunklines and major connections		21
Infrastructure Reservoir Improvements		62
General facilities programs (various building and service yard improvements)		36
Distribution services & meters, meter replacement program, & fire hydrants (citywide)		56
Aqueduct system improvements for both north and south		18
Pump stations		10
Water Services Organization Information Technology		7
Other (Seismic improvements, regulator stations, tools, and equipment)		10
	Water Infrastructure Program	\$324
Regulatory Compliance - Owens Valley		
Owens Lake Master Project		\$20
Owens Valley Dust Mitigation		35
Eastern Sierra Environmental Capital		8
Supplemental Dust Control Development		70
	Regulatory Compliance-Owens Valley	\$133
Customer Service		
Customer Service		\$32
	Customer Service	\$32
Operating Support		
Water System's share of Joint Capital		\$70
	Operating Support	\$70
Total Water System Capital Improvements Budget for Fiscal Year 2016-17		\$1,050

Capital Program Financing

In order to support an overall planned \$1.05 billion capital improvements program during this period, a combination of internally generated funds and borrowings will be required including loans from State Water Resources Control Board, Rate Reduction Bonds through a Joint Powers Authority to be known as Southern California Public Water Authority, and Water System Revenue Bonds. The Water System's FY 2016-17 Budget includes the need to finance approximately \$167 million of capital expenditures through the issuance of tax-exempt water revenue bonds.

The following chart illustrates the Water System's debt service amount, Net Available Revenue Coverage (NAR), and Net Operating Cash Flow (NOCF) Coverage over the last decade. The NOCF coverage was 1.5 in 2015 while the 10-year average is 1.6. The Debt Service Coverage Ratio (NAR) was 1.9 in 2015 while the 10-year average is 2.1. 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 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)
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	1,206,710	770,368	436,193	204,392	2.1	317,305	1.6
2015	1,151,356	733,283	418,073	216,787	1.9	324,791	1.5

(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 2015 Comprehensive Annual Financial Report; February 2016.

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 ^(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; and,
- 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.

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 \$834,000 for the total \$167 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 \$167 million Water System Revenue Bonds	
<i>Service</i>	<i>Estimated Cost</i>
Rating Agencies	\$ 241,000
Financial Advisor	60,000
Bond Counsel	95,000
Disclosure Counsel	50,000
Underwriter's Discount	384,000
Printing of Official Statements	4,000
TOTAL	\$834,000
<i>Source: Department of Water & Power - Financial Services Organization</i>	

Indebtedness

As of June 30, 2016, the Water System reported approximately \$5.022 billion in debt obligations. This consists of \$4.069 billion fixed rate bonds, \$325 million of variable rate bonds, approximately \$478 million loans from California Department of Water Resources and \$150 million drawn from the revolving line of credit.