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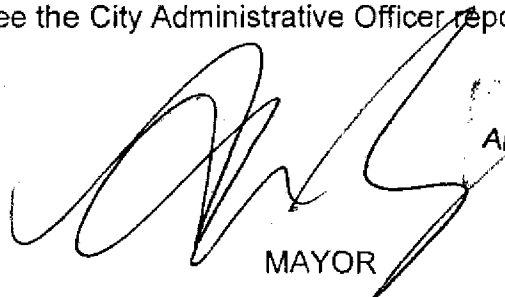
0220-04523-0007

TRANSMITTAL

TO David H. Wright, Interim General Manager Department of Water and Power	DATE AUG 26 2016	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT	

AUTHORITY TO ISSUE \$1 BILLION IN WATER SYSTEM REFUNDING REVENUE BONDS

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


Ana Guerrero
MAYOR

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: August 26, 2016

CAO File No. 0220-04523-0007

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 July 26, 2016; referred by the Mayor for report on August 4, 2016

Subject: **AUTHORITY TO ISSUE \$1 BILLION IN WATER SYSTEM REFUNDING REVENUE BONDS**

SUMMARY

The Department of Water and Power (DWP; Department) requests approval of the proposed Resolution No. 4916 (Resolution) authorizing the issuance of Water System Refunding Revenue Bonds to refinance existing outstanding debt. Approval of the proposed Resolution is intended by DWP to represent a standing authorization of the DWP Board of Commissioners (Board) to issue one or more series of bonds as the Board may determine. This enables DWP to execute multiple refunding transactions while establishing a maximum limit as follows:

- The maximum principal amount is \$1 billion;
- The maximum term of the bonds is 45 years from the date of issuance;
- The maximum interest cost to be incurred through the issuance of bonds is 12 percent¹.

The proposed Resolution also authorizes the private or negotiated sales of the bonds to one or more underwriting firms selected by the Board pursuant to City Charter Section 609 and Los Angeles Administrative Code (LAAC) Section 11.28.4 (the Procedural Ordinance) governing proprietary department bond resolutions.

The purpose of the proposed refunding bonds is to refinance a portion of the higher cost outstanding Water System debt in order to reduce the associated borrowing costs. DWP has established a goal of at least three (3) percent present value savings of the refunded par value (principal amount of the bond) for the refunding transactions.

The proposed refunding bonds will be DWP Water System Revenue Fund obligations and will

not constitute an obligation of the City or the General Fund. The City Attorney has approved the proposed resolution as to form and legality.

RECOMMENDATIONS

That the Mayor:

1. Approve the proposed Resolution No. 4916 authorizing the Department of Water and Power to issue through private sales, a maximum of \$1 billion in Water System Refunding Revenue Bonds to refinance existing outstanding debt, 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 to the City General Fund. Approval of the proposed resolution will authorize the DWP to refinance a portion of the existing Water System bonds. Debt issuance costs are estimated at \$3.37 million for the \$1 billion in refunding transactions. These costs consist of underwriter's discount, bond and disclosure counsels, financial advisor, ratings agencies fees, escrows, verification agent, and printing costs. Debt service on these revenue bonds and all projected savings will accrue to the DWP Water System Revenue Fund.

MAS:RR:10170005

Attachments

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 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 DWP Financial Services Organization (FSO) is seeking approval of Resolution No. 4916 to authorize the borrowing of up to \$1 billion in order to refinance existing Water System Revenue bonds. It is the intent of the Department to reduce its borrowing costs, improve its financial coverage ratios, and potentially increase its borrowing capacity.

The Resolution is intended to represent a standing authorization of the Board to issue one or more series or subseries of bonds at such time or times as the Board may determine. This will enable DWP to execute multiple refunding transactions to maximize the opportunity for debt cost savings. The maximum term of the bonds is 45 years from the date of issuance. The maximum interest cost to be incurred through the issuance of the bonds is 12 percent per annum. FSO has established a refunding goal of three percent present value savings of the refunded par (principal amount of the bond).

Historical Debt Service Coverage - Water System

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 times in 2015 while the 10-year average is 1.61. The Water System achieved a Debt Service Coverage Ratio (NAR) of 1.9 times while the 10-year average is 2.06. 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 1.70 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 and LAAC Article 6.5, Section 11.28.4, the bond Procedural Ordinance governing proprietary bond resolutions, require that the Mayor and City Council approve 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 (CFO) stating the reasons why a private sale will benefit the Department;
- The City Council, after receiving a report from the City Administrative Officer, has approved the sale; and,
- The City 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 CFO and by its financial advisor, the Public Resources Advisory Group (PRAG).

Competitive v. Negotiated Bond Sale

The DWP 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.

- It allows 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;
- It allows DWP to structure specialized bonds to meet specific investor needs;
- It 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 2016), resulting from wide shifts in interest rates and investor demand, through increased flexibility in timing the pricing of debt; and
- It motivates and incentivizes the underwriting pool to continue providing the DWP with cost effective ideas, financing proposals for debt service savings, and competitive credit facilities to support the variable rate debt obligations.

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

DWP estimates the cost of debt issuance to be approximately \$3.37 million for the \$1 billion in refunding transactions. A summary of the services and costs is provided below.

Debt Issuance Costs	
Service	Estimated Cost
Rating Agencies	\$1,005,000
Financial Advisor	202,000
Bond Counsel	285,000
Disclosure Counsel	150,000
Underwriter's Discount	1,700,000
Verification Agent	7,500
Escrow Fee	12,000
Printing of Official Statements	9,000
TOTAL	\$3,371,000

Source: Department of Water & Power - Financial Services Organization

Outstanding Debt Balance

As of June 30, 2016, the Water System reported approximately \$5.022 billion in long-term debt. 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.