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TRANSMITTAL		0220-04523-0008
TO David H. Wright, Interim General Manager Department of Water and Power	DATE AUG 25 2016	COUNCIL FILE NO.
FROM The Mayor	COUNCIL DISTRICT	
<p>AUTHORITY TO ISSUE \$875 MILLION IN POWER SYSTEM REVENUE BONDS</p> <p>Approved and transmitted for further processing including Council consideration. See the City Administrative Officer report attached.</p> <div style="text-align: right;"> Ana Guerrero MAYOR</div>		

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: August 22, 2016

CAO File No. 0220-04523-0008

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 27, 2016; referred by the Mayor for report on August 4, 2016

Subject: **AUTHORITY TO ISSUE \$875 MILLION IN POWER SYSTEM REVENUE BONDS**

SUMMARY

The Department of Water and Power (DWP) requests approval of the proposed Resolution 4918 (Resolution) authorizing the issuance of \$875 million in Power System Revenue Bonds to finance a portion of the Power System's fiscal year (FY) 2016-17 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 \$875 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 (Procedural Ordinance) governing proprietary department bond resolutions.

The \$875 million bond issuance will be funded by the multi-year rate increase approved by the City Council in March 2016, effective April 15, 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 4918 authorizing Department of Water and Power to issue through private sales, a maximum of \$875 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 fiscal impact to the City General Fund. Approval of the proposed Resolution will authorize the DWP to issue \$875 million of Power 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 Power Revenue Fund. Debt issuance costs are estimated at \$2.6 million consisting of underwriter's discount, bond and disclosure counsels, financial advisor, and ratings agencies fees.

MAS:RR:10170004

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 2016-17 CIP is illustrated in the tables below:

2016-17 Power System Capital Improvements Program	
Power Supply Replacement Program	(\$millions)
Repowering: Local Power Plants – Scattergood, Haynes Units 1&2, and Castaic	\$24
Renewable Portfolio Standard: Renewable Resources - Beacon Solar Projects, Utility Built Solar, Owens Valley Solar Project and Electric System-Gorge Upgrade, Barren Ridge Renewable Transmission Project, and Long-term Transmission Development	\$220
Power Supply Replacement Program	\$244
Power System Reliability Program	
Replace poles, transformers, cables, and overhead circuits. Improve distribution system and expand automation of substations. Integrate smart grid technology.	\$480
Power System Reliability Program	\$480
Power Supply Support/General	
Improve generating stations. Invest in automatic meter reading and fleet acquisition.	\$335
Power Supply Support/General	\$335
Customer Opportunities Program	
Energy Conservation and Incentive Programs	\$204
Customer Opportunities Program	\$204
Operating Support	
Operating Support	\$148
Operating Support	\$148
Customer Service	
Customer Service	\$75
Customer Service	\$75
Total Power System Capital Improvements Program	\$1,486

Capital Program Financing

In order to support an overall planned \$1.5 billion capital improvements program, a combination of borrowings and internally generated funds will be required. The Power System's FY 2016-17 Budget, approved by the DWP Board on May 17, 2016, includes the need to borrow approximately \$875 million of tax-exempt revenue bonds.

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 was 2.5 times coverage in 2015 while the 10-year average is 2.09. The Power System achieved a Debt Service Coverage Ratio (NAR) of 2.4 times while the 10-year average is

2.88. 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)
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
2015	3,542,277	2,445,059	1,097,168	457,933	2.4	1,161,620	2.5

(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.

According to the 2016 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 \$2.6 million for the total \$875 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 \$875 million Power System Revenue Bonds	
Service	Estimated Cost
Rating Agencies	\$ 421,000
Financial Advisor	60,000
Bond Counsel	95,000
Disclosure Counsel	51,000
Underwriter's Discount	2,013
Printing of Official Statements	4,000
TOTAL	\$ 2,643,000

Source: Department of Water & Power - Financial Services Organization

Indebtedness

As of June 30, 2016, the Power System reported approximately \$8.33 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 \$7.16 billion of fixed rate revenue bonds. All debt service payments are payable from the Power Revenue Fund.