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Title: ***RESOLUTION - 27th amendment to the Annual Appropriation Resolution (AAR) No. 2016-118 to Appropriate \$116,000,000 for Deposit Into an Escrow Account to be used to Partially Defeas the 2008 Sewer System Revenue Bonds (Requires 5 affirmative votes).

Sponsors: Finance Department

Indexes:

Code sections:

Attachments: 1. 17 27th Amend WW Debt Svc SAM.pdf

Date	Ver.	Action By	Action	Result
11/3/2016	1	City Council	approved	Pass

REPORT TO THE CITY COUNCIL

November 3, 2016

THROUGH: BRUCE RUDD, City Manager
RENENA SMITH, Assistant City Manager

BY: MICHAEL LIMA, City Finance Director/Controller

SUBJECT

***RESOLUTION - 27th amendment to the Annual Appropriation Resolution (AAR) No. 2016-118 to Appropriate \$116,000,000 for Deposit Into an Escrow Account to be used to Partially Defeas the 2008 Sewer System Revenue Bonds (Requires 5 affirmative votes).

RECOMMENDATION

Staff recommends that the Council approve the 27th Amendment to the Annual Appropriation Resolution No. 2016-118 to appropriate \$116 million (\$116,000,000) for deposit into an escrow account to be used to partially defeas the 2008 Sewer System Revenue Bonds.

EXECUTIVE SUMMARY

Finance staff continually reviews the City's debt for opportunities to save the City money and enhance credit ratings. Lowering debt service payments provides improved coverage for remaining debt and frees up annual revenues to be

used for other purposes. In the most recent review, staff observed that the Wastewater Division of the Public Utilities Department (Wastewater) has a large amount of cash on hand available to reduce debt. With interest rates on the City's pooled cash being far less than the interest being paid on the bonds, it is fiscally prudent to use the cash to eliminate some of the most of the expensive debt. One of those relatively expensive issues is the 2008 Sewer Bonds, which has an outstanding principal balance of \$159.8 million as of 6/30/16. Staff has determined that placing \$116 million in an escrow account to defease a portion of this debt, when it becomes callable in September 2018, provides the best opportunity for savings, while at the same time leaving sufficient cash on hand to fulfill the operating and capital needs of the Wastewater Division. This approach is estimated to save \$200 million in interest expense currently attached to the debt service.

BACKGROUND

Wastewater has accumulated cash over several years in anticipation of addressing operational, capital and debt service payment needs. While that approach was effective when the City's pooled interest rates were competitive with the cost of borrowing, it is no longer the case in today's environment where the interest earnings on the City's pooled cash is around 1%, and interest rates on Wastewater's two revenue bonds are between 4.5% and 5.25%. Given this disparity, staff analyzed possible uses for Wastewater's cash that involved debt reduction strategies while also assuring that planned capital projects will move forward.

Wastewater currently has two bond issues outstanding: the Series 1993 Sewer Bonds and the Series 2008 Sewer Bonds. The Series 1993 Sewer Bonds have outstanding principal of \$26.7 million as of 10/1/2016. They are scheduled to be paid off on 9/1/2022. However, those bonds currently do not have a call provision, making them ineligible for early payment. The Series 2008 Sewer Bonds have an outstanding balance of \$159.8 million. They are scheduled to be paid off on 9/1/2038. These bonds have a call provision which becomes effective on 9/1/2018. Additionally, the indenture for the Series 2008 Sewer Bonds permits an advance refunding (or, a refunding before the call date). The City's financial advisor KNN Public Finance, Inc. (KNN) along with city staff explored alternatives such as 1) using some of Wastewater's cash for an advance refunding; 2) doing nothing regarding the bonds with Wastewater's cash, waiting until the call date; and 3) using Wastewater's cash to defease all of the bonds on the call date, or placing cash in an escrow account to pay off some/all of the Series 2008 Sewer Bonds. KNN and staff took into consideration future Wastewater revenues, operating expenses, and capital needs as part of its analysis. As a result of the extensive analysis, staff recommends that \$116 million be placed in an escrow account for the purpose of defeasing a portion of the Series 2008 bonds.

Placing \$116 million into an escrow account will produce the following benefits:

- 1) Significantly reduce Wastewater's debt, while preserving cash for existing and upcoming capital needs.
- 2) Allow the City to reflect this debt as "paid" on the FY 17 CAFR: two years before the City would be able to reflect this debt as "paid" were it to wait until the call date.
- 3) Produce a significant savings for the Wastewater Fund. If nothing is done with the Series 2008 Sewer debt, Wastewater will pay approximately \$273 million in interest and principal between today and the maturity date of 9/1/2038. Depositing \$116 million today and using those proceeds to defease debt on the call date of 9/1/2018 will result in remaining interest and principal payments of approximately \$73.3 million between today and the maturity date. Thus, action today will save approximately \$200 million for the Wastewater Fund over the last 20 years of the bonds' scheduled life.

These conclusions have been examined by the City's financial advisor, KNN, who has confirmed the results.

Once the debt is defeased, two different approaches can be used to pay off the remaining Series 2008 Sewer Bonds. The first is to keep the annual debt service at the same currently scheduled level until all the bonds are paid off. Staff estimates that the maturity date will move from 2038 to 2027 using this methodology. The other approach is to retain the maturity date of 2038, but reduce the annual debt service payment. Using this methodology will result in the annual debt service payment going from approximately \$13.5 million/year to approximately \$3.8 million/year. Finance staff will continue to work with Wastewater staff over the next several months to determine which methodology will be best suit their future operational and capital needs.

ENVIRONMENTAL FINDINGS

N/A

LOCAL PREFERENCE

N/A

FISCAL IMPACT

This transaction pays down the Series 2008 Sewer Bond debt early, resulting in approximately \$200 million of interest savings between today and the bonds' scheduled maturity date of September 1, 2038.

Attachments: 27th Amendment to the Annual Appropriations Resolution No. 2016-118