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REPORT TO COUNCIL

SUBJECT
Adopt a Resolution Authorizing the City to Enter into a Loan Agreement with the United States Environmental Protection Agency up to the amount of $221,000,000 and Authorize the City Manager to Execute the Loan Agreement and Related Documents and Pay All Closing Costs

BACKGROUND
The Donald M. Somers Water Pollution Control Plant (WPCP) is one of the oldest wastewater treatment facilities on the West Coast. In 2016, City Council adopted a Master Plan, which serves as a guide for reconstruction of the WPCP. This Master Plan is now being implemented as the Sunnyvale Clean Water Program, with a total cost of approximately $880 million in the FY 2020/21 Budget.

In 2016, the City successfully secured a $127 million Clean Water State Revolving Fund (CWSRF) loan for the Headworks and Primary Treatment project portion of this Program (Phase 1). Over the life of that loan, the savings in debt service is likely to exceed $40 million relative to traditional municipal bonds. The City is now in the mid stages of design on a group of other projects, budgeted at $450 million over the next six years which comprise the second phase (Phase II) of the Sunnyvale Clean Water Program.

In support of this second phase of the program, the City successfully obtained a Water Infrastructure Finance and Innovation Act (WIFIA) loan for the Clean Water Program from the United States Environmental Protection Agency (EPA). Staff has been negotiating with the EPA, supported by the City's Municipal Advisor, Ross Financial, its Underwriting and Special Structuring consultant, J.P. Morgan, and Jones Hall, Bond Counsel. Negotiations have gone well over the past several months resulting in the Loan Agreement and Term Sheet provided as Attachments 2 and 3.

EXISTING POLICY
Council Fiscal Policy 7.11 Enterprise Fund Policies, 1.1b.1 Capital improvements associated with the existing infrastructure of a utility should be primarily funded from two sources: rate revenue and debt financing.

Council Fiscal Policy 7.11 Enterprise Fund Policies, 1.1b.3 Local, state and federal funding sources, such as grants and contributions, should be pursued for utility-related capital improvement projects consistent with City priorities.

ENVIRONMENTAL REVIEW
The WIFIA loan will fund projects contemplated by the Program Environmental Impact Report for the Sunnyvale Water Pollution Control Plant Master Plan (SCH #2015062037) (Master Plan PEIR), which was certified by the City Council on August 23, 2016. No additional environmental review is required.

DISCUSSION

Staff is recommending that the Council adopt a resolution authorizing the City to enter into a Loan Agreement with the EPA for up to $221,000,000 to fund 49% of the Sunnyvale Cleanwater Program Phase II, which consists of the rehabilitation of the City of Sunnyvale Water Pollution Control Plant's existing secondary and tertiary treatment facilities, construction of new secondary treatment and solids handling facilities, and reconstruction of support facilities (new administration/lab/maintenance building, also referred to as the "Cleanwater Center") necessary to operate the plant. The loan will have a term of 35 years following the completion of construction and be at an anticipated rate of 1.55% based on 30-year Treasury rates at the time of closing. It is being issued on parity with the City's 2017 Wastewater Bonds and the Clean Water Revolving Fund loan from the State of California. The WIFIA Loan allows the City either to draw down funds for construction or, if economically feasible, issue lower cost bond anticipation notes to fund construction.

Security

The Loan Agreement (Agreement) pledges the Net Revenues of the Wastewater System, which is defined as Gross Revenues minus the amount required to pay all operations and maintenance costs. The security follows a waterfall of payments. Once gross revenues are calculated, the City then pays all its operations and maintenance costs first. Second any parity debt obligations. Third any prepayment of parity debt, and lastly any subordinate debt payments.

Rate Covenants.

The Loan Agreement requires that the City adopt a rate covenant designed to assure that Wastewater Rates will be set appropriately to cover all operation and maintenance costs, and all payments for Parity Debt. Net Revenues must cover annual debt service by at least 1.20 times - same as the 2017 Bonds and the CWSRF Loan. Additionally, the City would agree to set rates beginning in FY 2049/50 that are sufficient to pay the average debt service coming due over the subsequent five years. This WIFIA-specific rate covenant is essentially subsumed in the primary rate covenant described above. It is projected that revenues will be sufficient at that time to meet this requirement.

WIFIA Pre-payment Provision

The WIFIA Loan Agreement has two prepayment provisions.

Optional Prepayment. The City has the option to prepay the WIFIA loan at any time during its term without penalty.

Required Prepayment. The City will be required to prepay the WIFIA loan from certain excess reserves as described below, after FY 2034/35. The amount of prepayment is not set and depends on the wastewater enterprise's cash flow following the payment of capital expenditures.

By way of background for this prepayment provision, during the negotiations and analysis regarding this loan, the City worked with J.P. Morgan to model the debt needed for the program over the life of the WIFIA loan. As the term is 35 years from an assumed draw down date of 2025, the model goes well beyond the City's twenty-year planning period. The model indicated that the City's cash balances would grow significantly. Due to the timeline of the model, the cause of the increase in cash is the absence of any yet to be identified significant capital expenditures beyond twenty years. To assure the EPA that the City would not accumulate too much cash without paying off the WIFIA Loan early, the City and the EPA agreed to a prepayment provision.

This provision states that starting on June 30, 2035, if the audited financial statements of the wastewater enterprise show a year-end balance of reserves that exceeds twice the amount of operation and maintenance costs during that Fiscal Year the City shall prepay a portion of the WIFIA Loan Balance in an amount equal to the reserves that are in excess of two times operation and maintenance costs, provided that no prepayment will be required less than $1,000,000. Staff was amenable to these terms as the control remains with the City, and any excess balance is only after the City has fully funded its needs, including reserves.

Ratepayer Impacts

In connection with the WIFIA loan process, J.P. Morgan as special structuring consultant, prepared a cash flow model that encompasses the term of the WIFIA loan, including all projected operations and maintenance expenses, capital expenditures and anticipated bonding needs for the entire wastewater system. The model projects annual rate increases that are different than what is currently projected in the City's twenty-year plan. The following table reflects the changes.

Fiscal Year	Increase included in FY 2020/21 Budget	Increase included in the WIFIA Model	Difference
FY 2020/21 (actual)	4%	4%	0%
FY 2021/22	3%	6%	3%
FY 2022/23	3%	6%	3%
FY 2023/24	4%	6%	2%
FY 2024/25	4%	6%	2%
FY 2025/26	4%	4%	0%
FY 2026/27	4%	4%	0%
FY 2027/28	4%	4%	0%
FY 2028/29	4%	4%	0%
FY 2029/30	4%	4%	0%
Average from FY 2030/31 to FY 2039/40	3.2%	3%	(0.2%)

Under the adjusted rates, staff had to project higher rates in the front of the plan to ensure that the City meets the Additional Bonds Test mentioned above that is required to issue additional debt, which the FY 2020/21 Budget did not include. This results in higher near-term rates and lower long-term rates.

It is important to note, that to the extent capital expenditures are delayed from the plan, the rate increases will likely be lower than projected above. Staff reviews the twenty year projection each year, and under the WIFIA Loan must also update the financial model each year and will recommend rates that are the minimum needed to meet the City's needs and the Additional Bonds Test.

Additional Bonds Test and Imputed Debt Service

The City is permitted to issue additional bonds on parity with the WIFIA Loan (i.e., additional bonds that are paid on the same basis as the loan) under certain restrictions. The most important restriction is that at the time of issuance of such parity bonds, historical Net Revenues, with certain adjustments, must equal at least 120% of the aggregate maximum aggregate debt service outstanding and the new proposed parity debt issue. This calculation is called the Additional Bonds Test and it is provided in the Indenture for the 2017 Bonds.

Due to the very favorable terms on the WIFIA Loan, the Additional Bonds Test is easily met as the City will only make interest payments on the loan during the period that the 2017 Bonds are outstanding. In order to ensure there are sufficient revenues to cover the loan to term, the City and EPA agreed to impute a WIFIA debt service for the purposes of the additional bonds test. The imputed debt service assumes the principal is amortized over 25 years starting in June 2035.

Reporting Requirements

The Loan Agreement includes several manageable reporting requirements for the duration of the agreement. These include an annual update of the financial model, the disclosure of the City's annual financial statements, design and construction documents, and a Public Benefit Report due at the conclusion of the project.

The details of all the provisions of the loan are contained within the Loan Agreement (Attachment 2) and Summarized on the Terms Sheet (Attachment 3).

FISCAL IMPACT

The loan benefits the City's wastewater ratepayers in several significant ways. First, it allows the City to borrow money over a very long term at a very low rate (the 30-year United States Treasury Rate, currently 1.42%). By contrast, a tax-exempt borrowing in the current market would produce a true interest cost of approximately 2.70%, would mature in 30 years rather than 35 years and generally would require level debt service payments during the life of the Bonds. Taking this approach is the lowest cost option for financing this project and provides the City and its Clean Water Program the greatest degree of flexibility. While they are two very different financing structures, utilizing the WIFIA loan is estimated to avoid upwards of $100 M in interest costs over a similar traditional financing. As the Program has become more tightly defined through the validation process, the projected cost has been adjusted upwards. Use of this cheaper financing alternative will help to mitigate the impact on rate payers.

Senate Bill 450 (Chapter 625 of the 2017-2018 Session of the California Legislature) ("SB 450") requires that the governing body of a public body obtain prior to authorizing the issuance of bonds or other obligations with a term of greater than 13 months, a good faith estimate of the following information in a meeting open to the public. This staff report, which is informed by the financial model generated by J.P. Morgan as special structuring consultant, satisfies SB 450.

The estimated true interest cost of the WIFIA Loan is based on an assumed rate of 1.52%, although the interest rate as of September 1, 2020 is 1.42%.

Estimated transaction costs for the WIFIA Loan are approximately $350,000 and will be paid from wastewater revenues. These costs include rating agency fees, EPA fees (including its legal and financial consultants), the City's municipal advisor, bond counsel and special structuring consultant.

Total debt service on the WIFIA Loan, based on the assumed rate of 1.52%, is estimated at

$346,700,000, assuming no prepayments. Additionally, the City will be responsible for paying EPA an annual servicing fee that will be approximately $8,000 per year during the operating period and $15,600 during the construction period.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, Sunnyvale Public Library and Department of Public Safety. In addition, the agenda and report are available at the Office of the City Clerk and on the City's website.

ALTERNATIVES

1. Adopt a Resolution Authorizing the City to Enter into a Loan Agreement with the United States Environmental Protection Agency up to the amount of $221,000,000 and Authorizing the City Manager to Execute the Loan Agreement and Related Documents and Pay All Closing Costs.
2. Do not adopt the Resolution and direct staff to use an alternative financing mechanism.

STAFF RECOMMENDATION

Alternative 1: Adopt a Resolution Authorizing the City to Enter into a Loan Agreement with the United States Environmental Protection Agency up to the amount of $221,000,000 and Authorizing the City Manager to Execute the Loan Agreement and Related Documents and Pay All Closing Costs.

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Reviewed by: Ramana Chinnakotla, Director of Environmental Services
Reviewed by: Teri Silva, Assistant City Manager
Approved by: Kent Steffens, City Manager

ATTACHMENTS

1. Resolution
2. Sunnyvale WIFIA Loan Agreement
3. Term Sheet - Sunnyvale WIFIA Loan