Agenda Report

September 30, 2013

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Finance Department

SUBJECT: ADOPTION OF A RESOLUTION AND THE FIRST READING OF AN ORDINANCE AUTHORIZING THE INVITATION OF BIDS FOR THE PURCHASE OF ELECTRIC REVENUE/REFUNDING BONDS, 2013A SERIES OF SAID CITY; APPROVING A NOTICE OF INTENTION TO SELL BONDS, A PRELIMINARY OFFICIAL STATEMENT, A NOTICE INVITING BIDS; AUTHORIZING THE PUBLICATION OF A NOTICE OF INTENTION TO SELL BONDS; AUTHORIZING THE ISSUANCE BY THE CITY OF NOT TO EXCEED $85,000,000 AGGREGATE PRINCIPAL AMOUNT OF CITY OF PASADENA ELECTRIC REVENUE/REFUNDING BONDS, 2013A SERIES, PAYABLE OUT OF THE LIGHT AND POWER FUND, APPROVING THE EXECUTION AND DELIVERY OF AN EIGHTH SUPPLEMENTAL TO ELECTRIC REVENUE BOND FISCAL AGENT AGREEMENT, AN ESCROW AGREEMENT, A CONTINUING DISCLOSURE AGREEMENT, AND AUTHORIZING CERTAIN ACTIONS IN CONNECTION THEREWITH

RECOMMENDATION:

It is recommended that the City Council:

1. Adopt a resolution authorizing the invitation of bids for the purchase of electric revenue/refunding bonds, 2013A series of said city, approving a notice of intention to sell bonds, a preliminary official statement, a notice inviting bids, authorizing the publication of a notice of intention to sell bonds, and authorizing certain other actions in connection therewith; and

2. Conduct the first reading of "**AN ORDINANCE OF THE CITY OF PASADENA AUTHORIZING THE ISSUANCE BY THE CITY OF NOT TO EXCEED $85,000,000 AGGREGATE PRINCIPAL AMOUNT OF CITY OF PASADENA ELECTRIC REVENUE/REFUNDING BONDS, 2013A SERIES, PAYABLE OUT OF THE LIGHT AND POWER FUND, AND APPROVING THE EXECUTION AND DELIVERY OF AN EIGHTH SUPPLEMENT TO ELECTRIC REVENUE BOND FISCAL AGENT AGREEMENT, AN ESCROW AGREEMENT AND A CONTINUING DISCLOSURE AGREEMENT IN CONNECTION THEREWITH.**"

BACKGROUND:

The adopted 5-year (FY 2014–2018) Capital Improvement Program ("CIP") for the electric system approved by the City Council provides for the issuance of revenue bonds and the use of equity contribution to finance additions and improvements to the electric system. The electric system projects in the CIP are primarily driven by the Electric System Distribution Master Plan and the Integrated Resources Plan and it consists of key projects such as the local repowering project, automation and upgrades of substations, expansion of the electric distribution system from 17 kilovolts ("kV") to 34 kV, replacements of electrical components such as transformers, cables and switches, and modernization of the local electricity distribution system.

The local repowering project, which is the largest component of the electric system capital projects, involves replacing the existing Broadway steam generating unit (B-3) with a new 71 megawatt ("MW") natural gas-fired combined cycle electricity generating facility (GT5 Repowering Project). This project is under way, and the City recently entered into a contract with General Electric for the purchase of the Power Island Equipment. The current cost estimate for the Power Island Equipment and related capital improvements to the GT5 Repowering Project, which is expected to begin commercial operations in January 2016, is approximately $132 million.

To finance the power capital projects, including the local repowering project, staff retained the Public Resources Advisory Group (PRAG), a financial advisor, to assist with the development of a financing plan. This plan takes into account the short and long-term impact on user rates, the cost of financing, and interest rate risk and flexibility to adapt to changes in funding requirements. The proposed plan consists of: 1) making a $20 million equity contribution for project costs with $9 million previously received from the settlement with the California Independent System Operator ("CAISO") and $11 million from capital reserves; 2) issuing the 2013A bonds to finance projected funding requirements through the end of 2015; 3) obtaining a line of credit ("LOC") to finance the balance of capital improvements; and 4) refinancing the LOC with fixed rate bonds after the completion of the improvements. This financing plan is the best identified option that balances different priorities and risks.

The designation of $20 million of equity funding for the GT5 project is based on an analysis that included several factors, including potential operations of the plant for wholesale opportunities and the overall five-year work plan requirements for the Power Fund capital improvement program. This level of equity investment will also ensure that sufficient cash balances remain in the Power Fund to maintain ongoing operations and ensure adequate reserves to support rating agency requirements.

The Table 1 below summarizes estimated costs and proposed funding for the GT5 Repowering Project, which is expected to be completed in FY 2016.

Table 1

Repowering Project Work Scope	Estimated Cost
Power Island Equipment	$65,741,000
Project/Construction Management	$3,326,000
Proposed AQMD 1304.1 Fee	$1,500,000
Modular Control Room	$830,000
Balance of Plant Design/Construction & Administrative	$60,425,000
Total Estimated Cost of Repowering project	**$131,822,000**
Proposed Funding for the Repowering Project	
Equity Fund	$20,000,000
Debt (Electric Revenue Bond Issuance) a. 2013A Bonds ....$60,000,000 b. Letter of Credit and subsequent Bond issuance ...$51,822,000	$111,822,000
Total	**$131,822,000**

In addition to the proposed financing plan, staff also analyzed three other funding options. These options included:

1. One bond issue to fund all project costs upfront.

   This option is estimated to cost an additional $6.9 million on a net present value basis and does not provide funding flexibility if there is a change in the timing of cash flows for the project. The additional cost is due to the "negative arbitrage" caused by paying a higher interest rate on the outstanding bonds than will be earned from investment of the proceeds.

2. One series of bonds to fund expenditures for 18 months and another in early to mid-2015.

   This option is estimated to cost an additional $2.5 million and provides only limited funding flexibility for the second phase of the project. The timing for detailed design and construction of the necessary improvements to the GT5 repowering project site are not completely known at this time. Due to the length of time necessary to issue revenue bonds, this option may also have additional costs associated with negative arbitrage if the second series of bonds are issued before the funds are actually needed. This option may include the risk of having insufficient cash available if the bond issuance is not completed to coincide with cash flow requirements.

3. Finance all project costs with an LOC and refinance the LOC upon project completion.

   This option assumes interest rate risk on 100 percent of the financing at a time when interest rates are expected to rise and limits timing flexibility for accessing the market after project completion.

The proposed plan addresses each of the limitations and risks found in the other financing options. Specifically, it minimizes interest rate risk by issuing bonds in the current low interest rate environment for components of the project with greatest cost certainty. It also minimizes the expensive debt carrying cost by providing funding on a "just in time" basis, avoiding negative arbitrage. The LOC is also a low-cost way of funding the balance of the GT5 repowering project even if the timing of construction draws change or are delayed, greatly reducing the financing risk for the project. In addition, an LOC will facilitate the issuance of the correct amount of fixed rate bonds without any insufficiencies or overages, minimizing long- term costs to ratepayers. The typical term for an LOC is one to three years. Interest rates for LOCs are generally significantly lower than long term financing due to the shorter term and lower risks. In the current market, the cost for a three-year LOC is approximately 0.60 percent (subject to a variable indexed rate) compared to a fixed rate of about 4.75 percent for 30-year tax exempt revenue bonds. The LOC will provide a low cost, flexible funding source for the construction phase of the GT-5 Repowering Project. Table 2 further identifies some of the key characteristics of revenue bonds and LOCs.

Table 2

Revenue Bonds	Line of Credit
Fixed amount of bonds issued, remain outstanding until repaid or refunded	Maximum balance established in agreement, drawn down as needed
Long term, generally 30 years	Shorter term, usually 3 years
Fixed rate, 10 year call provision	Rates reset weekly or monthly, depending on index
Competitively bid	Competitively bid
Best for long term projects and permanent assets	Used to meet shorter-term financing requirements
Interest paid on total bonds outstanding	Interest paid only on amount actually drawn down
No annual fees	Annual bank fees of approximately 0.50 percent (less for undrawn amounts)

In addition to financing capital costs, the 2013A bonds may also refinance the remaining outstanding Electric Revenue Bonds, 2002 Series, in the amount of $3,535,000 for economic savings. The 2002 bonds were originally issued for a repowering project of gas turbine Unit 3 and Unit 4 located on the Glenarm property and were previously partially refunded in 2012 to produce debt service savings. The outstanding 2002 bonds bear interest at a rate of 4.75 percent, and the yield for the refunding is estimated to be approximately 3.06 percent, based on current market conditions. The anticipated net present value of the one-time savings from the refunding of $3,535,000 is approximately $330,000 (9.4 percent). The inclusion of the refunding will depend on market conditions at the time of pricing. The refunding of the 2002 bonds will also enable the City to release the parity reserve surety policy provided by National Public Finance Guarantee Corporation (rated Baa1/A) and replenish the parity reserve fund with cash. The surety policy expires in 2022 and, absent a refunding today; the City will have to replace the surety policy with approximately $3.5 million of cash in 2022. A refunding today will allow the City to: 1) fully fund the parity reserve fund (without the need to replenish in 2022); and 2) produce present value savings. The refunding will maintain the same maturity date as the existing debt.

The proceeds of the 2013A bonds will be used to finance a portion of the capital expenditures for fiscal years 2014 through 2016 and refund the 2002 bonds. Expected uses of the proceeds of the 2013A bonds are as shown in the Table 3.

Table 3

	Expected Uses of the 2013A Bonds Proceeds	Amount
1.	Replace the existing Glenarm Power Plant steam generating Unit B3 with a new natural gas-fired combined-cycle unit known as the Gas Turbine Unit 5 ("GT5 Repowering Project")	$60,000,000
2.	Fund a portion of the capital improvement program of the electric distribution system	
	a. switchgear and substation upgrades,	$2,970,000
	b. 4kV to 17kV system conversion,	$4,000,000
	c. capacity and reliability improvements	$5,945,000
3.	Refinance the outstanding 2002 bonds	$3,535,000
4.	Fund a parity reserve fund	$8,250,000
5.	Fund costs of issuance of the 2013A bonds	$300,000
	Total	**$85,000,000**

Principal will be deferred for three and a half years to allow the full operating efficiencies of the project to be phased in and thereafter will be repaid in 27 years based on a level debt service amortization.

Staff is requesting authorization to issue up to $85 million of electric revenue bonds which includes an amount associated with the refunding. Together with the proceeds of the bonds, $9 million from the CAISO and cash reserves set aside for the project are expected to be spent down by the third quarter of fiscal year 2014. Following the issuance of the bonds, staff will work to secure an LOC with a bank, on a competitive basis, in an amount sufficient to provide funds to complete the GT5 Repowering Project and other electric system capital improvement projects through fiscal 2016. It is anticipated that an LOC may be secured 3-6 months prior to the depletion of the 2013A bond proceeds. Prior to entering into any LOC agreement with a bank, staff will bring forth such agreement to the City Council for its approval.

The resolution and ordinance authorize the issuance of and approve the various documents in connection with the issuance of the Electric Revenue Bonds, 2013A Series, with a principal amount not to exceed $85 million and at a true interest cost not to exceed 6 percent. The resolution also appoints Sidley Austin LLP as bond counsel, Fulbright & Jaworski, LLP as disclosure counsel, and Public Resources Advisory Group as financial advisor.

COUNCIL POLICY CONSIDERATION:

This action supports the City Council's strategic goal to maintain fiscal responsibility and stability.

FISCAL IMPACT:

The 2013A bonds will be sold on a competitive basis with a maximum term of 30 years and will bear fixed interest rates. It is estimated that the bonds will have an average life of 19 years with final maturity in fiscal year 2043. The true interest cost is estimated at 4.74 percent based on current market rates, which is subject to change until the actual bidding is complete on the scheduled November 18, 2013 date. The refunding is estimated to generate $330,000 of net present value savings, based on current market conditions. Debt service payments will be made from the Light and Power Fund. Interest on the capital expenditure portion will be addressed by utilization of current and future appropriation in Power Capital Improvement Program Budget number 3194-Local Generation Repowering Project. Interest on the refunding portion will be addressed by utilization of existing budgeted appropriations in account #8677-841910-0427 and funds are available from currently approved rates. The attached Exhibit A is the estimated sources and uses of funds based on today's market interest rates.

Respectfully submitted,

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Director of Finance

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Attachments: (2)

1) Sources and Uses of Funds (Exhibit A)
2) Preliminary Official Statement

SOURCES AND USES OF FUNDS

Pasadena Water & Power
Electric Revenue Bonds, 2013A
Preliminary & Subject to Change
Assumptions and Rates as of August 14, 2013

Sources:	2013 New Money	2002 Refunding	Total
Bond Proceeds:			
Par Amount	76,880,000.00	3,460,000.00	80,340,000.00
Premium	4,470,128.90	498,759.00	4,968,887.90
	81,350,128.90	3,958,759.00	85,308,887.90
Other Sources of Funds:			
Equity Contribution	20,000,000.00		20,000,000.00
Accrued Interest		932.85	932.85
	20,000,000.00	932.85	20,000,932.85
	101,350,128.90	3,959,691.85	105,309,820.75

Uses:	2013 New Money	2002 Refunding	Total
Project Fund Deposits:			
Project Fund	92,870,000.00		92,870,000.00
Refunding Escrow Deposits:			
Cash Deposit		3,550,391.98	3,550,391.98
Other Fund Deposits:			
New Money DSRF	7,853,578.56		7,853,578.56
Refunding DSRF		382,180.40	382,180.40
	7,853,578.56	382,180.40	8,235,758.96
Delivery Date Expenses:			
Cost of Issuance	238,398.75	11,601.25	250,000.00
Underwriter's Discount	384,400.00	17,300.00	401,700.00
	622,798.75	28,901.25	651,700.00
Other Uses of Funds:			
Additional Proceeds	3,751.59	(1,781.78)	1,969.81
	101,350,128.90	3,959,691.85	105,309,820.75

Exhibit A