

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kerrie Romanow
Julia H. Cooper

SUBJECT: SEE BELOW

DATE: December 15, 2016

Approved

D. P. SyL

Date

12/16/16

INFORMATION

SUBJECT: UPDATE ON CLEAN WATER STATE REVOLVING FUND LOAN FOR REGIONAL WASTEWATER FACILITY PROJECTS

BACKGROUND

On June 2, 2015, Council approved the San José Santa Clara Regional Wastewater Facility¹ (RWF) Capital Improvement Program (CIP) Ten-Year Funding Strategy Report. The Ten-Year Funding Strategy includes a recommendation to use a combination of ratepayer dollars, low interest Clean Water State Revolving Fund (SRF) loans, short-term loans and long-term financing to fund the RWF CIP. On January 12, 2016, staff provided a status report on the Ten-Year Funding Strategy and obtained Council approval on a proposed programmatic approach for obtaining SRF funding.

Consistent with Council direction, staff initiated the application process for SRF loans to finance the Digester and Thickener Facilities Upgrade (Digester) project. The goal was to have the four packages of the SRF application submitted, reviewed, and approved prior to the award of the Digester project's construction contract to allow time for the financial agreement to be executed prior to the start of construction. Based on discussions with staff in the Clean Water Technical Assistance Section (CWTAS) of the State Water Resources Control Board (SWRCB), San José staff was advised that it would take six to nine months for a complete SRF application to be reviewed and approved, and a loan agreement to be finalized and executed.

¹ The legal, official name of the facility remains San Jose-Santa Clara Water Pollution Control Plant, but beginning in early 2013, the facility was approved to use a new common name, the San José-Santa Clara Regional Wastewater Facility.

The Digester project's general application was submitted in February 2015 and staff conducted a kickoff meeting with SWRCB staff in April 2015. Subsequently, staff submitted the project's technical, environmental, and financial packages. The City received sign-off on the technical and environmental packages in January 2016. The financial package was submitted in February 2016 but sign-off was dependent upon the negotiation of terms for two key financial documents that comprise the SRF loan agreement, a master resolution and the installment sales agreement (ISA). The master resolution is a commitment by the loan borrower that it will use incoming funds to repay the amount borrowed. The ISA details the SRF loan agreement including the obligations and loan repayment terms.

SRF funding is available on a retroactive basis for planning and design costs but not for construction costs incurred prior to the execution of the loan agreement. Due to the criticality of the Digester project and time-sensitive interfaces with other CIP projects underway, the City proceeded with the construction award on May 24, 2016, ahead of the resolution of terms and execution of the SRF loan. This decision was based on our understanding that the loan agreement would be finalized by October 2016 and City staff estimated that the construction costs incurred before then to only be \$6 million of the nearly \$108 million construction contract. As each month passes, fewer construction costs are eligible for reimbursement.

On September 12, 2016, the SWRCB project manager informed staff that the City would likely not receive funding for the Digester project this fiscal year. This communication was based on the SWRCB's interest in prioritizing wastewater recycling, small disadvantaged communities, and green projects for SRF loans per the SRF Program's updated Intended Use Plan. Based on this prioritization, the Digester project was not initially one of the projects identified to receive funding this fiscal year; however, in early October 2016, the SRF CWTAS Chief assured staff that given the status of the Digester project application, the project was still slated to receive funding this fiscal year. With this assurance, staff has continued to work with the SWRCB staff on the terms of the master resolution and ISA.

ANALYSIS

Based on a review of SWRCB's comments to the draft master resolution and the ISA, City staff identified several terms and conditions that were not acceptable or presented a challenge to the City. The City's financial staff and advisors have had multiple discussions with SWRCB staff about these terms and have proposed alternate language. One of the SWRCB requirements would result in the City being unable to access short-term financing. This would severely constrain the City's funding options for the remaining CIP projects that the City will need to finance and is not a term the City can agree to. Another key term is related to a rate covenant that would adversely affect the City's ability to effectively use a rate stabilization fund to manage expected rate increases. Other issues include insurance requirements, and the City's warranty about pending litigation and conflicts of interest.

SWRCB staff is currently reviewing the City's proposed modifications to the loan agreement. Unlike other financial institutions, the SWRCB can only offer one interest rate for all SRF borrowers, regardless of credit structures of individual applicants. Since several large wastewater utilities with complex debt structures are now applying for the funding, CWTAS staff is unable to perform the required detailed customized evaluations. In November 2016, the CWTAS Chief shared that the SWRCB has engaged a financial consultant to assist with the evaluation of modifications proposed by wastewater utilities. SWRCB staff is planning to bring forward a discussion on the issues that have been raised by San José and other wastewater agencies to their Board on January 18, 2017.

If the SWRCB is unable to accept the City's proposed modification for the Digester project's SRF loan by January, 2017, the City will need to shift its efforts to begin work on securing short-term financing by September 2017. Finance staff estimates a nine-month timeline to secure short-term financing; thus, the process to obtain this financing will need to commence in January 2017. Furthermore, since the demand for SRF funding currently exceeds the amount of funding available and with the implementation of the project prioritization, SRF funding will likely not be available for a majority of the identified CIP projects scheduled to start construction in the near term. Availability of funding beyond a two to three year timeframe is unclear at this time and will need to be evaluated on a year-to-year basis. Thus, the City will need to plan for approximately \$500 to \$600 million in external funding to fund its share of the CIP, which will likely be comprised of a combination of short term (e.g., Commercial Paper program or a line of credit) and long-term financing (e.g., revenue bonds) to afford the most flexibility and efficiency.

In parallel, staff will pursue advocacy on various fronts to highlight the importance of California's largest advanced wastewater treatment facility, which serves an integral area of the economy, being able to access low cost funding available through state agencies. Staff is also in communication with City of Santa Clara, as co-owner of the RWF, on this topic.

EVALUATION AND FOLLOW-UP

Should the SWRCB approve the City's complete SRF application for the Digester project before the end of January 2017, staff will submit for Council approval a request to accept the SRF loan. If the City and SWRCB are not able to reach mutually acceptable loan terms, staff will initiate the process to secure short-term financing for fiscal year 2017-18. In spring 2017, staff will provide a status update on the Ten-Year Funding Strategy to the Transportation and Environment Committee.

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COORDINATION

This memorandum has been coordinated with the City Manager's Budget Office and Intergovernmental Relations, and the City Attorney's Office.

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/s/
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Director, Finance Department

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