RIVERSIDE PUBLIC UTILITIES

Board Memorandum

BOARD OF PUBLIC UTILITIES **DATE:** JANUARY 14, 2019

ITEM NO: 15

SUBJECT: **ISSUANCE OF 2019 REFUNDING ELECTRIC REVENUE BONDS**

ISSUE:

Approve the issuance of up to $400 million of Electric Revenue Bonds for purposes of refunding the previously issued 2008D Electric Revenue Bonds to capture interest rate savings; terminate a portion of the Electric Utility interest rate swaps and refund the associated portions of the previously issued 2008A and 2008C Variable Rate Refunding Revenue Bonds using fixed-rate bonds to reduce financial risk and finance identified Electric Utility capital projects. Proceeds will also be used to pay bond issuance costs.

RECOMMENDATIONS:

That the Board of Public Utilities recommend that the City Council:

1. Approve the City's Financing Team as described herein;

2. Conduct a public hearing to consider the issuance of Refunding Electric Revenue Bonds in an amount not-to-exceed $400 million;

3. Adopt a resolution for the issuance of Refunding Electric Revenue Bonds;

4. Delegate to the City's Financing Team, at the time of Bond issuance, the determination of specific maturities to be refunded, the amount of interest rate swaps to be terminated and the form of new bonds as outlined in Recommendation No. 3 above;

5. Authorize the City Manager, or his designee, to execute all documents related to this transaction; and

6. Upon closing of the 2019 Refunding Electric Revenue Bonds, authorize the Chief Financial Officer to make the necessary budget adjustments and/or appropriations to properly record the refunding and financing expenses in accordance with governmental accounting requirements.

BACKGROUND:

2008D Electric Revenue Bonds

In May 2008, the City of Riverside issued $209,740,000 of 2008D Electric Revenue Bonds to fund the Electric Utility's Capital Improvement Program, including the construction of the Riverside Energy Resource Center Units 3 and 4, two 49 MW peaking units. The 2008D Bonds will mature in 2038 and have remaining coupons ranging from 4.00% to 5.00% and an outstanding principal balance of $191,715,000.

Variable Rate Demand Obligations

The Electric Utility currently has outstanding $107,040,000 million (principal amount) of Variable Rate Demand Obligations (VRDO's) in two separate series of revenue bonds (2008A and 2008C). The VRDOs, in conjunction with the Electric Utility's interest rate hedges (discussed below), have proven to be very effective in lowering the overall debt costs. VRDOs require additional liquidity facility (e.g., line of credit or a bank letter of credit) to ensure timely payment to bondholders. In 2017, the City used Letters of Credit (LOC) for the 2008A and 2008C Bonds provided by Barclays Bank PLC ("Barclays"), at very attractive rates, which would require Barclays to make debt service payments to bondholders should the City fail to make a payment.

Interest Rate Hedge (Swap) Agreements

In addition to the low rates realized using variable rate debt, the City also executed interest rate swap agreements in which the Electric Utility receives 62.68% of LIBOR plus 12 basis point (which offsets/hedges the variable rate the Electric Utility pays to its bondholders) in exchange for fixed interest rates ranging between 3.1% and 3.2%. The Financing Team recommends terminating a portion of the existing hedge agreements as part of 2019 plan of finance as discussed below.

Electric Utility Capital Projects

The City Council approved a five-year Capital Improvement Program for the Electric Utility totaling approximately $178 million, of which $148 million is projected to be funded with bond proceeds with the remaining $30 million funded with a combination of rates, reserves and developer contributions. Additionally, approximately $20 million of capital expenditures from Fiscal Year 2017-18 are eligible to be reimbursed with proceeds of the 2019 Bonds. The Electric Utility Five-Year Rate Plan, approved by City Council on May 22, 2018, supports the bond financing of the capital improvement program.

DISCUSSION:

2019 Refunding Electric Revenue Bonds

The 2019 Electric Utility plan of finance has three components: a refunding component to refinance the 2008D Electric Revenue Bonds for debt service savings; a new money component to finance a portion of the Electric Utility Capital Improvement Program and reimburse prior capital expenditures; and a fixed-rate refinancing component of certain maturities of the 2008A and 2008C VRDOs and partial termination of the associated interest rate swaps.

Refunding of Series 2008D Bonds

The 2008D Bonds, currently outstanding in the amount of $191,715,000, are eligible to be refunded on April 1, 2019. The bond markets continue to experience historically low interest rates for tax-exempt bonds-particularly for high-grade credits such as the Electric Utility (AA-/AA-). From an economic and financial viewpoint, Riverside Public Utilities (RPU) will be able to take advantage of favorable market conditions and refinance the 2008D bonds using fixed-rate bonds at a lower interest rate, generating debt service savings for the Electric Utility. The refinancing will result in lower debt service than the Electric Utility is currently paying on the 2008D Bonds and will not extend the current final maturity of the 2008D Bonds (2038).

New Money Component

The Electric Utility plans to finance approximately $103 million of capital projects as part of the issuance of the 2019 Bonds. This amount consists of $83 million of new projects (of the total $148 million of projects identified in the five-year Capital Improvement Program for bond financing) and approximately $20 million to reimburse the Electric Utility for capital expenditures incurred in Fiscal Year 2017-18. The new money component is expected to be amortized over a period of 30 years, consistent with traditional new money borrowing in the tax-exempt market and prior City practice, on a substantial level annual debt service basis. Level fixed-rate debt service provides for budget certainty and promotes equitable financing of projects among current and future ratepayers.

Fixed Rate Refinancing of VRDOs

VRDOs with interest rate swaps have more risks than fixed rate bonds. Risks could include swap or LOC counterparties being downgraded, LOC renewal costs increasing, difficulty finding a renewal LOC, exposure to market dislocations between the rate paid on the VRDOs and the rate received under the swap agreements, etc. At the time of the issuance of the VRDOs, fixed rates were significantly higher, therefore it was cost effective to the Electric Utility to issue VRDOs backed by LOCs.

VRDOs with a swap typically have a lower interest cost than fixed rate bonds; therefore, it is uncommon to be able to refinance without increasing costs. However, RPU is currently in a unique financial market with very low tax-exempt interest rates, particularly in California, that make it possible to refinance certain maturities of the VRDOs and swap with fixed rate bonds at no additional cost to the Electric Utility and ratepayers. This refinancing has no downside as the fixed rate bonds will have the same debt service costs (including costs of issuance and any payment to the swap counterparty necessary to terminate all or a portion of the interest rate swap) but will lower the associated risk of VRDOs and swaps.

The swap termination payment is equal to the market value of the swap at the time the swap is terminated and will be paid to the swap counterparties (JPMorgan Chase and Merrill Lynch Capital Services) using proceeds of the 2019 Refunding Electric Revenue Bonds, in the event the fixed-rate refinancing of VRDOs component of the financing plan is executed.

The 2019 Refunding Revenue Bonds will be issued as fixed rate bonds and the applicable interest rate swap agreements will be terminated, either in whole or in part, which will mitigate the various risk exposures. The ability to execute this component of the 2019 Plan of Finance is very market-dependent and the amount of VRDOs that can be refinanced at no cost fluctuates daily. Accordingly, the financing team will analyze and determine the best course of action and maturities to be included in the bond transaction with the goal of the VRDO refinancing component of the transaction remaining cost neutral, including bond issuance costs.

Financing Team

A Financing Team has been assembled, consisting of staff from the Public Utilities Department, the Finance Department, and the City Attorney's Office, with PFM Financial Advisors LLC, serving as the Municipal Advisor. This Financing Team has selected Stradling Yocca Carlson & Rauth as bond counsel and Jones Hall as disclosure counsel based on recent favorable experience and knowledge of the City's and RPU's debt resolutions and other relevant legal covenants. The Financing Team has also selected via a competitive bidding process Goldman Sachs & Co., Barclays Capital Inc., and Merrill Lynch Pierce, Fenner and Smith as underwriters to sell the bonds. These firms have participated and provided outstanding service in previous bond transactions. Additional members of the Financing Team include the City's Fiscal Agent, U.S. Bank and a Verification Agent, which will be selected closer to the bond sale via a competitive bidding process. Fees for services will be paid from bond proceeds. Staff recommends approval of the Financing Team, as described herein.

Good Faith Estimates

On October 9, 2017, the Governor approved Senate Bill 450 (SB 450), adding Section 5852.1 to the California Government Code. SB 450 requires, prior to an issuance of bonds, a public agency disclose in a public meeting good faith financing estimates provided by an Underwriter, Municipal Advisor or private lender. These estimates include: 1) the True Interest Cost of the bonds; 2) the total finance charge of the bonds, equal to the sum of all fees and charges paid to third parties; 3) the amount of estimated bond proceeds minus the total finance charge of the bonds, and any reserves funded from proceeds of the bonds; and 4) the total payment amount, which includes the projected sum of all payments the Electric Utility will make to pay debt service on the bonds plus any portion of the finance charge of the bonds that will not be paid with the proceeds of the bonds.

The following information was obtained from PFM Financial Advisors, as Municipal Advisor, and is provided in compliance with SB 450:

1. **True Interest Cost.** Assuming a par amount of $310,000,000 of 2019 Refunding Electric Revenue Bonds is sold and based on market interest rates prevailing at the time of preparation of this information, a good faith estimate of the true interest cost of the bonds, which means the rate necessary to discount the amounts payable on the respective principal and interest payment dates to equal the purchase price received for the bonds, is 3.55%.

2. **Finance Charge.** A good faith estimate of the finance charge of the bonds, which means the sum of all fees and charges paid to third parties, is $840,000 (exclusive of any swap termination payment) or $4,508,000 (in the event the swap termination payment is to be construed as a component of the finance charge). If market conditions permit refinancing the VRDOs and associated swap termination, the swap termination payments will be paid to the swap counterparties using proceeds of the 2019 Refunding Electric Revenue Bonds.

3. **Amount of Proceeds to be Received.** A good faith estimate of the amount of proceeds expected to be received for sale of the bonds less the finance charge of the bonds described in 2, above, and any reserves or capitalized interest paid or funded with proceeds of the bonds, is $351,800,000.

4. **Total Payment Amount.** Assuming a par amount of $310,000,000 is sold and based on market interest rates prevailing at the time of preparation of this information, a good faith estimate of the total payment amount, which means the sum total of all payments the Electric Utility will make to pay debt service on the bonds plus the finance charge of the bonds described in paragraph 2, above, not paid with the proceeds of the bonds, calculated to the final maturity of the bonds, is $520,250,000.

The foregoing information constitutes good faith estimates only. The actual interest cost, finance charges, amount of proceeds and total payment amount may vary from the estimates above due to variations from these estimates in the timing of bond sale, the amount of bonds sold and market interest rates at the time of the bond sale.

The Chief Financial Officer/Treasurer concurs with the recommendations above.

Due to the time sensitivity of the refinancing of the 2008D Bonds and the potential refinancing of 2008A and 2008C VRDOs, the City Council is scheduled to hear this item for consideration on January 22, 2019. If approved by the Board of Public Utilities and City Council, this schedule will allow adequate time to execute the transactions as described above.

FISCAL IMPACT:

The estimated present value savings from refunding of the 2008D Electric Revenue Bonds is expected to be approximately $28 million ($38 million gross savings) based on market conditions in early December 2018, which will equate to an annual cash flow savings of approximately $2 million per year through 2038.

The plan for swap termination/VRDO refunding is for the Electric Utility to remain cost neutral on debt service obligations, but reduce risk factors associated with VRDO's and interest rate swaps by refinancing with fixed rate debt.

Annual debt service payments for the new money (capital projects) component are expected to be $5.8 million and have been included in approved biennial budget for Fiscal Years 2018-19 and 2019-20.

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Approved by:	Todd M. Corbin, Utilities General Manager
Approved by:	Al Zelinka, FAICP, City Manager
Approved as to form:	Gary G. Geuss, City Attorney

Certifies availability of funds:	Aileen Ma, Interim Utilities Assistant General Manager/Finance & Administration

Attachment(s):

1. Reimbursement Resolution No. 22992
2. Reimbursement Resolution No. 23351
3. Presentation