DATE: March 27, 2017

TO: Mayor and Members of the City Council
President and Members of the Estero Municipal Improvement District (EMID) Board of Directors

VIA: Kevin M. Miller, City/District Manager

FROM: Edmund Suen, Finance Director

SUBJECT: FINANCING ALTERNATIVES FOR CITY/DISTRICT'S WASTEWATER TREATMENT PLANT, LEVEE IMPROVEMENTS, AND RECREATION CENTER MASTER PLAN CAPITAL IMPROVEMENT PROJECTS

RECOMMENDATION

Staff recommends that the City Council/Estero Municipal Improvement District (City) receive the attached report (Consultant Report) from the City's municipal financial advisors, Kitahata & Company and William Euphrat Municipal Finance Inc. on financing alternatives for the Wastewater Treatment Plant (WWTP), Levee Improvements, and Recreation Center Master Plan Projects, collectively the "Big 3" projects.

EXECUTIVE SUMMARY

The City has three projects ("Big 3 projects") whose replacement costs are so significant that they require financing alternatives (debt financing and/or use of reserves) outside of the normal Long-Term CIP funding model that will be discussed under a separate report this evening. The City's municipal financial advisors have prepared a report that outlines the financing alternatives for each of these Big 3 projects.

BACKGROUND and ANALYSIS

The City's current CIP includes two (2) very significant projects, the Wastewater Treatment Plant Master Plan Improvements Project (CIP 455-652) and the Levee

Protection Planning and Improvements Project (CIP 301-657) with estimated total project costs of approximately $119.6 and $75 million, respectively. In addition, the City is also considering a Recreation Center Master Plan project with an approximate construction cost of $30 million to replace the current Recreation Center. Due to the large costs of these Big 3 projects, it warrants an evaluation of financing options that includes debt and/or use of reserves. The City's municipal financial advisors, Kitahata & Company and William Euphrat Municipal Finance Inc. have provided a report (Attachment 1) identifying financing alternatives for these projects, both at an individual project level as well as in the aggregate/holistic perspective. The report findings are as follows:

WWTP: Debt financing in the form of wastewater revenue bonds and/or State Clean Water Revolving Loan funds is well suited for this purpose, supported by wastewater rate increases necessary to pay for the associated debt service because users of the system are those who directly benefit. While the use of General Fund Reserves and/or Capital Preservation Fund Reserves ("Reserves") for this project is possible, competing demands of the Levee Protection Planning and Improvements Project and the Recreation Center Master Plan Project, neither of which has a ready source of revenues to pay debt service, make it compelling to use only the Wastewater Fund's cash balances and wastewater enterprise revenue bonds for WWTP capital projects.

Levee Improvements: Either Assessment District, Mello-Roos Community Facility Special Tax (M-R), or General Obligation (G.O.) bonds can be used for this project. However, G.O. bonds are the most cost-efficient form of financing for this type of project because they are the most secure and highly rated form of municipal bond financing, resulting in the lowest interest rate and therefore the lower cost of debt service. Both G.O. and M-R bonds require 2/3 voter approval (compared to a majority protest ballot process weighted by amount assessed for an assessment district), but since the Levee Protection Planning and Improvements Project can be viewed as an essential project that removes the City from a FEMA high risk flood zone, it provides homeowners that have mortgages issued by federally regulated lenders considerable savings compared to having to pay flood insurance (the cost-benefit nexus). The risk for an Assessment District is that it requires a finding of specific benefit and the assessments must be proportional to the "special benefit," which makes it more susceptible to a legal challenge compared to a voter approved tax (i.e., G.O. or M-R) bond. An M-R bond also requires 2/3 voter approval, but is likely to have a higher interest rate compared to the G.O. bond. While the use of Reserves are also possible for the levee improvements, as discussed earlier, there is already a cost-benefit nexus for many taxpayers and the impact of supplementing the project with Reserves would be relatively marginal in dollars terms (see page 4 of Consultant Report).

Recreation Center Master Plan: Either citywide M-R or G.O. bonds can be used for recreation centers. However, both financing vehicles would require 2/3rds voter approval for a project that does not have the public safety benefits or the essentiality such as that of the Levee Protection Planning and Improvements Project. This would suggest a lower likelihood of getting 2/3rds voter approval for either G.O. or M-R bonds. An Assessment District would not be appropriate. This would require a special benefit finding for each property within the assessment district. Developing an assessment formulation impervious to legal challenge would be very difficult for this type of improvement. Further, general benefits must be paid by the City, not by assessees. As a means of overcoming the difficulties with obtaining voter approval or making a finding special benefit to properties, the City may consider General Fund lease revenue bonds, which do not require voter approval, only majority approval of the City Council. However, the downside is that the City's General Fund must pay for annual debt service without any dedicated new source of revenue to pay for debt service, unlike the other forms of financing just described above, each of which has both an authority to issue debt and a new source of revenue to pay debt service. Lease payments would put additional pressure on the General Fund to maintain a balanced budget on an annual basis for the duration of the 30-year bond term. Alternatively, the City may consider using Reserves for this project. The City's General Fund and Capital Preservation Fund Reserve balance is estimated to be $33.4 million (assumes a transfer of $7.6 million to the CIP Fund in FY 2016/2017) and $36.6 million respectively by June 30, 2017. Using Reserves to cash-fund all or a portion of this project would not directly impact the City's taxpayers as taxes would be unaffected by using cash resources, but using Reserves for this purpose would deplete cash resources that might be applied to other or more essential projects.

Timeline for Financing the Big 3 Projects

Costs incurred for the City's share of the Wastewater Treatment Plant Master Improvement Project has thus far been advanced out of the Wastewater Capital Project Fund. Since wastewater revenue bonds do not require voter approval, once the City Council has passed a 5-year annual wastewater rate increase (see separate staff report this evening on the policy decision on wastewater rates), wastewater revenue bonds may be issued at any time based on cash flow requirements. The San Mateo-Foster City Public Financing Authority (formed last year between San Mateo and Foster City) will be submitting its application for low cost loans under the Clean Water State Revolving Funds program. If approved, this will supplement wastewater revenue bond financing.

The City Capital Projects Fund has been advancing funds for costs of the Levee Protection Planning and Improvements Project. As indicated on the attached Levee Work Plan Schedule, City Council direction on a financing method for the project is needed no later than July 2017 in order for a voter ballot measure (i.e. G.O. or M-R bonds) to be included on the November 2017 election. Staff plans to meet with the Levee Subcommittee to further discuss the Levee financing alternatives at a later date.

The Recreation Center Master Plan project is still at its planning stage. There will be a City Council Special Meeting (Study Session) on the Recreation Center Master Plan Next Steps on April 3, 2017. The financing alternatives identified on this report provide options for City Council's reference and consideration.

FISCAL IMPACT

There is no immediate fiscal impact associated with evaluating financing alternatives for the City's Big 3 projects; the fiscal impact can be determined at the time of the selection and approval of the actual financing by the City Council.

Attachments:

- Attachment 1 - Consultant Report on Financing Alternatives
- Attachment 2 - Levee Work Plan Schedule