



TO: Mayor and Council Members

CC: Marc A. Ott, City Manager

FROM: Elaine Hart, Chief Financial Officer, City of Austin
Greg Meszaros, Director, Austin Water

DATE: April 15, 2016

SUBJECT: April 21 Council Agenda Items re Austin Water (AW) Debt

The purpose of this memo is to provide summary information on several agenda items for the April 21 Council meeting related to Austin Water (AW) debt including:

- resolutions authorizing applications for loans from the Texas Water Development Board,
- defeasance of debt using cash accumulated from Impact Fee/Capital Recovery Fee revenue, and
- ordinance authorizing issuance of refunding bonds for cost savings and conversion of commercial paper (short-term debt) to long-term debt to restore commercial paper capacity for future borrowing.

Each of these proposed Council actions will help strengthen AW's financial position. A briefing by City staff and Public Financial Management, the City's financial advisor, is planned for Council's April 19 work session on these items.

Apply for Loans from the Texas Water Development Board (TWDB)

Agenda items # 4 and 5 seek Council approval of resolutions authorizing applications for loans from the Texas Water Development Board (TWDB) as part of the TWDB's State Water Implementation Fund for Texas (SWIFT) program. The SWIFT program, established by the Texas Legislature in 2013, provides affordable, ongoing state financial assistance for projects in the state water plan through low-interest loans and other favorable loan terms. SWIFT's initial funding in 2015 totaled over \$3.8 billion in financial commitments. Click <http://www.twdb.texas.gov/financial/programs/swift/index.asp> for more information about the SWIFT program.

- **Apply for a loan not to exceed \$80,195,000** to fund AW's smart meter project also known as Advanced Meter Infrastructure (AMI). This project will update customer water meters and meter boxes and implement data transmission infrastructure to allow for meter reads via cellular or radio transmission in lieu of manual reads. This project is expected to replace all residential, multifamily and commercial meters in the Austin Water service area.

This AMI system is expected to reduce or eliminate meter reading costs, improve customer service and satisfaction, allow customer notification of potential customer-side leaks, and allow better system diagnostics through improved leak detection, through district metering and/or integrated acoustic leak detection sensors. The increased level of consumption data will enable individual customers to adjust their consumption levels to help reduce water demand and water costs.

- **Apply for a loan not to exceed \$86,980,456** to fund projects in AW's 5-Year Capital Improvements Program (CIP) which improve the filter capacity of two major wastewater treatment plants and expand the reclaimed water system. The Recommendation for Council Action includes a detail listing, description, and cost estimate for these projects.

Initial loan closings are anticipated to occur by December 2016. For loan terms of up to twenty years, the Texas Water Development Board is currently offering a 35% reduction on the interest rates they can obtain based on their AAA bond rating. These reduced interest rates will save AW ratepayers financing costs for funding these projects when compared to AW's traditional bond financing.

Defeasance of Austin Water Debt

Agenda item #12 is a resolution authorizing defeasance of certain Austin Water debt with available cash. A total of \$18.2 million will be used to effectively redeem debt service requirements of about \$21.3 million over the next 13 years.

When referring to municipal bonds, a defeasance relates to methods by which an outstanding bond issue will be paid in full; redeemed both legally and financially. Although a defeasance is generally the outcome of a refunding or refinancing transaction, a defeasance can also be accomplished by using available cash to pay off outstanding debt. The cash is deposited in an escrow account held by a trustee who then makes principal and interest payments on the required payment date for the bonds being defeased.

The source of funds for this proposed defeasance is cash accumulated from prior and current year Impact Fee/Capital Recovery Fee (CRF) collections. Use of CRF collections is restricted by Texas Local Government Code Chapter 395.012. Allowable uses of Impact Fee/Capital Recovery Fee (CRF) revenue include paying costs of constructing capital or facility improvements and pledging for payment of debt service on debt issued to finance capital or facility improvements identified in the Impact Fee Capital Improvements Plan 5-Year Update.

The proposed defeasance will pay off certain maturities including:

- Portions of *City of Austin, Texas Combined Utility System Revenue Bonds, Series 1994* (the "Series 1994 Bonds") attributable to an Austin Water capital appreciation bond maturing on May 15, 2019; and
- Portions of *City of Austin, Texas Water and Wastewater System Revenue Refunding Bonds, Series 2009* (the "Series 2009 Bonds") maturing on November 15 in each of the years 2022, 2023, 2024 and 2028.

This defeasance is the first in a planned series of defeasance transactions using CRF revenue which are an integral part of AW's debt management strategy. Each of the planned defeasances will be brought to Council for approval. These planned defeasances will allow AW to reduce its outstanding debt secured by AW revenue which will improve debt service coverage and AW's financial strength.

Proposed Issuance of Refunding Bonds - Amount not to exceed \$295,000,000

Agenda item #11 recommends that Council approve an ordinance authorizing the issuance of **City of Austin, Texas, Water and Wastewater System Revenue Refunding Bonds, Series 2016, in an amount not to exceed \$295,000,000**, in accordance with parameters set out in the ordinance. The bond sale includes a refunding for cost savings and a conversion of outstanding commercial paper (short-term debt) to long-term debt.

- **Refunding for debt service savings.** A refunding of \$47,605,000 of City of Austin Water and Wastewater System Revenue Refunding Bonds, Series 2006A and \$63,355,000 of City of Austin Water and Wastewater System Revenue Refunding Bonds, Series 2007 will take advantage of currently favorable market conditions to generate savings.
- **Refunding tax-exempt commercial paper.** Refunding bonds will also be issued to convert \$190.0 million of outstanding tax-exempt commercial paper to long-term debt. This refunding will also take advantage of currently favorable market conditions and restore available capacity under the tax-exempt commercial paper program for future borrowing needs.

For refunding bond sales for savings, the City's Financial Policies set a target of present value savings of at least 4.25% of the principal amount of the refunded bonds. As of March 28, 2016, the proposed refunding for debt service savings produced about **\$12.1 million savings or 10.94%** of the refunded bonds, which **exceeds the 4.25% policy target**. The term of the refunding bonds does not exceed the remaining life of the bonds being refunded.

The proposed refunding transaction is a "**parameter**" bond sale, that is, the bond sale will occur after the day Council authorizes the proposed ordinance and be handled in accordance with parameters specified in the ordinance. In order to provide the City the flexibility to quickly respond to changing market conditions, the proposed ordinance delegates authority to the City Manager or Chief Financial Officer ("the Pricing Officer") to complete the refunding bond sale. This delegated authority shall be exercised in accordance with parameters outlined in the ordinance which are also summarized in the Recommendation for Council Action. Most of the City's recent bond sales have been completed as parameter sales, including those approved by Council in 2015.

Utility Revenue Bond Credit Ratings

Strong credit ratings signal better credit quality and allow the utility to issue debt at lower interest rates, thus reducing future debt service costs. The Combined Utility revenue bonds are supported by revenue from both Austin Energy and Austin Water, while Austin Water separate lien revenue bonds are supported by only Austin Water revenue. Current credit ratings and rating outlook are shown in the following chart:

Description	Moody's Investors Service, Inc.	Standard and Poor's	Fitch, Inc.
Combined Utility revenue bonds – prior lien	Aa1	AA	AA
Combined Utility revenue bonds – subordinate lien	Aa2	AA	AA
Utility revenue bonds – Water separate lien	Aa2 Negative	AA	AA- Negative

As you can see from the following credit rating scale, the Combined Utility revenue bonds and Austin Water separate lien revenue bonds are investment grade bonds with strong ratings indicating they should sell at some of the lowest market interest rates. Lower interest rates provide cost savings to help maintain lower rates for utility customers.

CREDIT RATING SCALE					
INTEREST RATE			MOODY'S	STANDARD & POOR'S	Fitch Ratings
Lowest	Investment Grade	Strongest	Aaa	AAA	AAA
			Aa	AA	AA
			A	A	A
			Baa	BBB	BBB
	Non-Investment Grade		Ba	BB	BB
			B	B	B
			Caa	CCC	CCC
			Ca	CC	CC
Highest		Weakest	C	C	C
			C	D	D

I hope this information has been helpful to you. Should you have any questions, please contact me, Art Alfaro (City Treasurer), or Greg Meszaros (Director, Austin Water).

cc: Assistant City Managers
 David Anders, Assistant Director - Finance, Austin Water Utility
 Greg Canally, Deputy Chief Financial Officer
 Ed Van Eenoo, Deputy Chief Financial Officer
 Art Alfaro, City Treasurer
 Georgia Sanchez, Assistant Treasurer