City of Santa Fe, New Mexico

memo

Date: October 29, 2015

To: Chairman and Members of the Finance Committee

From: Oscar S. Rodriguez, Finance Director

Re: Plan for the water utility's financial sustainability

This memo presents a plan to put the Water Utility on a path to financial self-reliance as called for in Resolution 2015-41.

Last May, the City Council approved a resolution directing staff to "assess and develop a plan to make the water utility enterprise financially self-sustaining and determine whether to eventually amend the dedication provision of Section 18-18 SFCC 1987," which currently dedicates ¼ % of the City's gross receipts tax (GRT) as a subsidy to the water utility. This GRT generates approximately $7.9 million annually. About $5.0 million of this amount goes to debt service on the utility's 2006 and 2009 bonds.

Framework

A plan for financial self-sustainability ultimately means eliminating the GRT subsidy so the water utility operates solely with operating revenue. The $7.9 million loss would have to be made up from either or a combination of increased operating revenue and lowered costs. The differential is significant. Operating revenue accounts for $36.9 million of the utility's total income of $44.8 million. GRT makes up the other 18% of total annual income. Although annual operating expenditures of $35.3 million[1] can be covered without it, the GRT subsidy is an intricate part of the utility's debt obligations. It is part of the pledge backing the 2006 and 2009 bonds and part of the recurring revenue that allows the utility to meet the 2x times (200%) debt service coverage. Without this revenue stream, the utility does not receive sufficient annual revenue to show the bond market that it can handily cover its operating costs and debt service. The conservative 2x times coverage ratio is one of the main reasons the city has been able to maintain an otherwise unattainable AAA bond rating.

[1] Includes $900,000 million in non-related personnel costs covered for the General Fund, but not including $3.8 million in excess funds that were transferred this year to the General Fund as a payment in lieu of taxes. Also includes debt service of $14.1 million.

The water utility GRT is restricted. The revenue coming from it can only be used for capital outlay for the water utility, that is, to pay for capital improvement projects or debt service. Furthermore, since it is pledged to both the 2006 and 2009 utility bonds, the City cannot eliminate it without violating a key provision of these bonds' covenants. This means that this GRT must stay in place and intact until all of these bonds are paid off. Until that time, the only legitimate way to pull back the GRT subsidy is through a direct transfer of funds from excess revenue as was done this fiscal year. You will recall that the ordinance that allowed this transfer stipulated that only the funds that remained after the utility paid all of its obligations and set aside 45 days of working capital were subject to the 12% gross sales payment in lieu of taxes. Passed with a sunset effective this fiscal year, this ordinance defines one of the cornerstones of the framework for making the utility financially self-sustaining. It dictates, among other things, that it be assumed that even if the GRT subsidy is eliminated no excess revenue will be transferred out of the water fund.

Another important part of the framework is the utility's capacity for debt backed solely from operating revenue. Without the GRT subsidy, the utility cannot support as big a debt burden as it shoulders today ($135.6 million). Our financial advisor, First Southwest, estimates that the most that utility can support without the GRT subsidy in the short term is $21 million[2] (See attached October 26 letter from First Southwest).

The last cornerstone for a framework for financial self-sustainability is the utility's capital improvement needs. The utility estimates that it needs excess operating revenue of $4-6 million per year to replace and/or rehabilitate old infrastructure and capital equipment[3]. In other words, the utility will have to be generating 6-12% more in operating revenue than it spends in operating costs to be truly self-sustaining[4]. The exact point on this range will depend on the utility's specific capital needs, operating revenue trends, and the amount of debt proceeds it can bring to bear at the time.

Steps Toward Financial Self-sustainability

The utility's current financial structure will not allow it to achieve self-sustainability at once or even in the very short-term. Movement towards this goal will have to be done as a multi-year plan achieved with a series of steps—not one single action. Moreover, the final step may require either a rate increase or debt issuance when the entire GRT subsidy is removed depending on the utility's financial position at the time.

The opportunity to take the first step will come on June 1, 2016. This is the date when the 2006 bonds can be called (refunded and/or paid off before full maturity). Given the accumulation of unrestricted cash in the water fund, currently $88 million, it is feasible to pay off the remaining

[2] Until the 2009 debt is paid off (Bond call date is June 1, 2019). Total ultimate bonding capacity at current revenue levels with the GRT subsidy is $81 million.
[3] Next 10 years assuming no major new capital projects.
[4] Assumes current debt service obligations.

balance of $33.6 million on the 2006 bonds without affecting the utility's funding needs. This will save the utility $3.1 million in annual debt service and lower by an equal amount the recurring excess revenue the utility has to raise each year for debt service times coverage. Again, no matter if this portion of the utility's existing debt is extinguished, the full ¼% GRT rate has to stay in place until all of the outstanding bonds are paid off.

Assuming market conditions do not change significantly from today, paying off the these bonds with cash generates a greater net savings to the City than refinancing them, although refinancing at lower interest rates may also produce savings (See attached First Southwest letter of October 8, 2015).

The next critical date will come three years later on June 1, 2019. This is the earliest date the city can pay off the remaining balances on the 2009 bonds. The City issued two series of bonds for the utility that year: 2009A and 2009B. The principal balance on the 2009A bonds on June 1, 2019 will be $14.2 million. The balance on the 2009B bonds will be $41.9 million on that date. Should the utility have the reserves available on that date, the city can decide to pay off one or both series. Depending on market conditions at the time, the city will also have the option of refinancing the remaining principal on either or both series. There are two further options if the City chooses to refinance. The city can issue refinancing bonds with the same pledge of GRT and operating revenue as what is backing these bonds today or it can issue refinancing bonds solely with operating revenue and hold back the GRT. The bonds' rating will likely reflect this weaker pledge, which may cause interest rates to be higher, but this calculation will have to wait until at least 2018 when market conditions are better known.

Only the decision to extinguish both series either through a cash payment or refinancing will allow the City to eliminate the GRT subsidy. In either case, the utility may have to either raise rates, issue new debt, or keep at least part of the dedicated GRT in place to remain financially sustainable.

Recommended Plan

Given the information known at this time, it is recommended that the city pay off the 2006 bonds in June 1, 2016 with available reserves. This will generate an extra $3.1 million of excess revenues per year, such that by 2019 the utility will have on hand an extra $9.3 million to help pay off the 2009 bonds on June 1, 2019. At that time, it is recommended that the city (1) pay off at least the $14.2 million principal balance on the 2009A series with cash on hand and (2) either pay off the $41.9 million with the remaining cash or refinance all or part of the principal with rate revenue-only bonds. Only this course of action will give the City the option of eliminating the utility GRT and open all the available paths to financial self-sustainability.

With the option of eliminating the GRT subsidy firmly in hand, the City will be able to choose to provide for the utility's capital investment needs through either a rate increase or a smaller GRT rate if necessary. The amount of cash or debt capacity is available to the utility at that time will determine when and how much, if any at all, a rate increase will be necessary. It may also be feasible to blend all of these resource options to minimize any undesirable impact. As a point of reference, half the current rate will yield $3.9 million, which provides the minimum level of excess operating revenue the utility needs to cover its annual capital improvement program. Market conditions and the utility's financial position at that time determine the possibilities. It is recommended that no decision be made on the 2009A&B bonds until at least 2018.

Caveat

The recommendations above are made with the assumption that the City no longer depends on cash reserves to shore up its non-utility budgets. As has been explained in other occasions, those deficits are ultimately balanced with the water utility's unrestricted reserves. Without certainty that the City does not need these reserves to ensure the necessary level of financial liquidity, a plan to use significant amounts of the utility's reserves poses too great a risk to be advisable. It is strongly recommended that the City first establish a 2-3 year plan to eliminate its deficits before drawing down a significant amount of the utility's reserves. This can be achieved through the upcoming budget process, as the date to call the 2006 bonds is still six months away.

I am happy to answer any questions you may have.

FirstSouthwest

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George H. Williford
Managing Director

george.williford@firstsw.com

Date: October 26, 2015

To: Oscar Rodriguez

Re: Redemption of Series 2006D Water Utility System/Capital Outlay Gross Receipts Tax Revenue Bonds

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As discussed, attached are schedules illustrating the effect of cash redemption of the $ $33.69 million principal balance of the Series 2006D Water Utility System/Capital Outlay Gross Receipts Tax Revenue Bonds.

The two schedules behind the first page show, respectively: Schedule 1 – Water System debt service as currently outstanding, and Schedule 2 – Water System debt service if Series 2006D was no longer outstanding. In Schedule 1, maximum annual debt service in 2019 is $8,638,653. In Schedule 2, maximum annual debt service is $5,514,929 in 2027.

On the first page, the column labeled 'Current Situation' reflects that coverage of $8,638,653 maximum annual debt service would be 1.40X without pledged Capital Outlay GRT, based upon FY 2014 Water System operations.

The column labeled 'With Redemption of Series 2006D' reflects that coverage of $5,514,929 maximum annual debt service (if Series 2006D bonds eliminated) by Water System net revenues available for debt service would be 2.19X without pledged Capital Outlay GRT.

Of course, the Capital Outlay GRT could not be released until the Series 2009A&B bonds were defeased or retired. However, the illustrated coverage without the Capital Outlay GRT would be pertinent if subsequent financing needs were secured on a subordinated basis, secured solely by Water revenues without the Capital Outlay GRT pledge.

In the case that future capital needs were desired to be financed without pledge of the Capital Outlay GRT, the existing capacity for new issuance would be approximately $21 million. This is based upon total annual Water System debt service not exceeding $6.05 million, so that FY 2014 net revenues available for debt service of slightly over $12 million, without the Capital Outlay GRT, would provide 2X coverage of total annual debt service.

Please call on us with questions, and as we can provide additional information.

Santa Fe, NM
Water System
Operations of Water System

	Fiscal Year End 2014	
	Current Situation	With Redemption of Series 2006D
Operating Revenues:		
User Fees	$ 37,772,523	$ 37,772,523
Other Revenue/Premiums	384,683	384,683
Total Operating Revenues	$ 38,157,206	$ 38,157,206
Operating Expenses	$ 41,522,384	$ 41,522,384
Operating Income (Loss)	$ (3,365,178)	$ (3,365,178)
Total Non-Operating Rev (Exp)	$ 7,342,978	$ 7,342,978
Plus:		
Depreciation and Amortization	$ 10,316,546	$ 10,316,546
Interest Expense	5,402,285	5,402,285
Net Revenue Available for Debt Service	$ 19,696,631	$ 19,696,631
Max Annual Debt/Service	$ 8,638,653	$ 5,514,929
Coverage	**2.28x**	**3.57x**
Less:		
Capital Outlay GRT	$ 7,636,708	$ 7,636,708
Revised Net Revenues Available for Debt Service	$ 12,059,923	$ 12,059,923
Coverage	**1.40x**	**2.19x**

Schedule 1 - Current

Santa Fe, NM
Water System
Total Outstanding Debt Service

FYE	Principal	Interest*	BAB Subsidy	Debt Service
2016	$ 4,307,203	$ 5,164,537	$ (840,332)	$ 8,631,408
2017	4,488,382	4,988,993	(840,332)	8,637,043
2018	4,674,886	4,803,363	(840,332)	8,637,917
2019	4,871,720	4,607,265	(840,332)	8,638,653
2020	5,073,892	4,397,981	(840,332)	8,631,540
2021	5,201,408	4,179,453	(840,332)	8,540,529
2022	5,429,275	3,946,125	(840,332)	8,535,067
2023	5,677,500	3,701,939	(840,332)	8,539,107
2024	5,921,090	3,455,202	(840,332)	8,535,959
2025	6,190,053	3,187,530	(840,332)	8,537,251
2026	3,419,396	2,932,573	(840,332)	5,511,636
2027	3,564,127	2,791,135	(840,332)	5,514,929
2028	3,464,253	2,643,052	(840,332)	5,266,973
2029	3,579,783	2,476,167	(792,782)	5,263,169
2030	2,768,752	2,303,171	(743,380)	4,328,544
2031	2,881,527	2,137,336	(690,418)	4,328,446
2032	2,994,358	1,964,626	(635,241)	4,323,743
2033	3,112,245	1,785,039	(577,848)	4,319,435
2034	3,230,190	1,598,264	(518,140)	4,310,313
2035	3,205,000	1,404,300	(456,117)	4,153,183
2036	3,335,000	1,205,590	(391,576)	4,149,014
2037	3,470,000	998,820	(324,417)	4,144,403
2038	3,610,000	783,680	(254,539)	4,139,141
2039	9,030,000	559,860	(181,843)	9,408,017
	$ 103,500,040	$ 68,016,000	$ (16,490,619)	$ 155,025,421

* Includes NMFA servicing fees.

Schedule 2 - If Series 2006D is Redeemed

Santa Fe, NM
Water System
Total Outstanding Debt Service

FYE	Principal	Interest*	BAB Subsidy	Debt Service**
2016	$ 1,587,203	$ 3,514,943	$ (840,332)	$ 4,261,814
2017	1,628,382	3,475,399	(840,332)	4,263,449
2018	1,669,886	3,432,769	(840,332)	4,262,323
2019	1,716,720	3,386,921	(840,332)	4,263,309
2020	1,768,892	3,335,387	(840,332)	4,263,947
2021	1,821,408	3,282,109	(840,332)	4,263,185
2022	1,884,275	3,217,781	(840,332)	4,261,724
2023	1,952,500	3,150,846	(840,332)	4,263,013
2024	2,021,090	3,081,045	(840,332)	4,261,803
2025	2,095,053	3,008,374	(840,332)	4,263,094
2026	3,419,396	2,932,573	(840,332)	5,511,636
2027	3,564,127	2,791,135	(840,332)	5,514,929
2028	3,464,253	2,643,052	(840,332)	5,266,973
2029	3,579,783	2,476,167	(792,782)	5,263,168
2030	2,768,752	2,303,171	(743,380)	4,328,544
2031	2,881,527	2,137,336	(690,418)	4,328,446
2032	2,994,358	1,964,626	(635,241)	4,323,743
2033	3,112,245	1,785,039	(577,848)	4,319,435
2034	3,230,190	1,598,264	(518,140)	4,310,313
2035	3,205,000	1,404,300	(456,117)	4,153,183
2036	3,335,000	1,205,590	(391,576)	4,149,014
2037	3,470,000	998,820	(324,417)	4,144,403
2038	3,610,000	783,680	(254,539)	4,139,141
2039	9,030,000	559,860	(181,843)	9,408,017
	$ 69,810,040	$ 58,469,188	$ (16,490,619)	$ 111,788,608

* Includes NMFA servicing fees.

**Excludes Series 2006D

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George H. Williford
Managing Director

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Date: October 8, 2015

To: Oscar Rodriguez

Re: Possible Refunding of 2006D Water Utility Bonds, and Consideration of Release of Capital Outlay GRT Pledge

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The City has an outstanding principal balance of $33.69 million payable on the Series 2006D Water Utility System/Capital Outlay Gross Receipts Tax Revenue Refunding Bonds. The 2017 through 2025 maturities, totaling $30.97 million, are callable (prepayable) beginning June 1, 2016. The callable maturities have an average coupon interest rate of 4.93%, with seven of the nine maturities at a 5.00% interest rate. Refunding (refinancing) of these callable maturities offers opportunity for the City to realize savings in ongoing annual Water System annual debt service. However, because this issue was a previous refunding, the 2006D issue is not eligible to be refunded until after March 1, 2016.

The City has expressed possible interest in rescinding the 1/4% Capital Outlay GRT. This GRT component is specifically pledged, along with revenues of the Water System, to secure debt of the Water Utility. The annual amount of the 1/4% GRT is approximately $7.4 million (FY 2014). With inclusion of the GRT revenue, total pledged revenue provides coverage of the total annual debt service of the Water Utility of approximately 2.28 times (X), based upon FY 2014 operations: this was a decline from approximately 3X coverage in FY 2013. Without the GRT revenue, coverage is approximately 1.40X. In order to maintain bond ratings at least in the mid "AA" category, water revenue would need to increase so that net revenues available for debt service provided over 2X coverage of total annual debt service.

Remaining bonded indebtedness of the Water Utility is $56.19 million outstanding Series 2009 A and B Water Utility/Capital Outlay GRT Revenue Bonds. The $52.915 million callable principal maturities of the 2009 bonds (2020 through 2039) are not callable until June 1, 2019. Therefore, advance refunding of the 2009 bonds at this time would actually incur an economic loss and an increase of annual Water System debt service instead of annual savings.

If there is interest in pursuing rescission and release of the pledge of Capital Outlay GRT, a recommended means to initiate this would be to consider refunding of the 2006D bonds through competitive private placement. In this process, bids for purchase of refunding bonds would be solicited from commercial banks which are known purchasers of privately placed tax-exempt municipal debt. A privately placed refunding issue would avoid implications of dealing with the rating agencies regarding release of the Capital Outlay

GRT pledge on the issue, at this time. Although a privately placed refunding issue without the Capital Outlay GRT pledge would have a pledge of Water System revenues subordinate to the pledge securing the 2009 bonds, it is likely that the refunding would achieve justifiable debt service savings.

Based upon approximate current interest rates, and assuming no pledge of the Capital Outlay GRT, refunding of the 2006D issue through private placement is projected to produce over $4.15 million debt service savings, averaging approximately $460,000 per year through 2025. The present value equivalent of the total savings is projected at approximately $3.8 million, or over 12% of the $30.97 million refunded principal amount.

The Council approval process could initiate in January 2016, so that sale of a refunding bond issue could occur in February in order for closing of the refunding issue to occur after March 1, 2016.

If desired and undertaken, the above privately placed refunding of the 2006D bonds would initiate the release of the Capital Outlay GRT, and it would allow the City time and opportunity to implement needed water rate increases in order to provide adequate coverage of annual debt service. As the June 1, 2019 call date approached, the City could undertake potential refunding of the Series 2009 bonds without the Capital Outlay GRT pledge. Upon refunding and defeasance of both the 2006D and the 2009 A & B bonds, without the Capital Outlay GRT pledge, the pledge of the Capital Outlay GRT would be released and the tax could be rescinded.

A question has been raised about using Water Utility cash to redeem the full outstanding principal of the 2006D bonds in lieu of refunding the 2006D bond issue. Use of cash for redemption would exhaust $31 million (to include costs for redemption process) of Water System available funds. This would impact the liquidity position of the Water System. To the extent that those funds were needed in upcoming years to fund capital projects in the planned CIP, it would likely mean that debt financing for that amount would be required: that would subject the City and Water Utility to interest rate risk, based on potentially increased interest rates when financing was needed. In cases of other financial advisory clients, as well as the City, we advocate that use of amounts of cash which would truly be in excess of anticipated upcoming capital needs for the reduction of debt as being appropriate. However, for definitively expected capital needs which will be incurred within the next two to three years, we would advise and recommend planned spending of available cash resources as the most economic means for funding those needs.

In addition to advisability of utilization of available funds for upcoming capital needs, assuming a discount factor of 2.3%, the present value benefit of use of $31 million for cash redemption at this time is actually lower than the above mentioned projected present value savings from refunding of the bond issue. While current short-term investment yields are lower, this discount factor is not unreasonable for a prospective ten year period into the future, and is consistent with the rate used in determining present value benefit of the prospective refunding bond issue.

George H. Williford

George H. Williford

CITY OF SANTA FE, NEW MEXICO

RESOLUTION NO. 2015-41

INTRODUCED BY:

Councilor Joseph Maestas

A RESOLUTION

RELATING TO THE MUNICIPAL CAPITAL OUTLAY GROSS RECEIPTS TAX ORDINANCE, SECTION 18-18 SFCC 1987 AND MANAGEMENT OF THE CITY'S WATER UTILITY'S FINANCES; DIRECTING STAFF TO ASSESS AND DEVELOP A PLAN TO MAKE THE WATER UTILITY ENTERPRISE FINANCIALLY SELF-SUSTAINING AND DETERMINE WHETHER TO EVENTUALLY AMEND THE DEDICATION PROVISION OF SECTION 18-18 SFCC 1987.

WHEREAS, Section 18-18 SFCC 1987 imposes on any person engaging in business in the City of Santa Fe, for the privilege of engaging in business, an excise tax equal to one-fourth of one percent (.25%) of the gross receipts reported or required to be reported by the person pursuant to the New Mexico Gross Receipts and Compensating Tax Act as it now exists or as it may be amended; and

WHEREAS, Subsection 18-18.4 SFCC 1987 dedicates the revenue from the municipal capital outlay gross receipts tax for water systems and facilities including, but not limited to, the development, design, planning, permitting and construction of, and improvements to, new and existing direct diversion projects, water treatment plants and water system infrastructure; the purchase of water rights and rights-of-way for water related facilities; and expenditures related to other water or water-related projects; and

WHEREAS, the Governing Body desires that the water utility enterprise eventually sustain itself financially entirely from operating revenues and not have to depend on the Environmental Gross Receipts Tax,

WHEREAS, the Governing Body desires that state develop a detailed plan and formal financial policy to ensure the utility eventually achieves financial self-reliance.

NOW, THEREFORE, BE IT RESOLVED BY THE GOVERNING BODY OF THE CITY OF SANTA FE that staff is directed to assess and evaluate the a plan including the Municipal Capital Outlay Gross Receipts Tax designated for the water systems and facilities so that the Governing Body may adopt a plan to make the water utility enterprise financially self-sustaining and determine whether to eventually amend the dedication provision of Section 18-18 SFCC 1987.

BE IT FURTHER RESOLVED that such evaluation shall include a complete accounting of general fund support to the public utilities department, including, without limitation, solid waste facilities, water facilities, wastewater facilities, sewer systems and related facilities and an accounting of said enterprises' transfers to the general fund and/or from the general fund to an enterprise fund.

BE IT FURTHER RESOLVED that staff shall develop and present to the Governing Body a fund transfer policy; a working capital policy for all utilities; a financial plan to make said utilities self-sustaining.

BE IT FURTHER RESOLVED that staff shall present their assessment on the financial policies in time to be incorporated into the FY 2015-2016 Budget planning process, if feasible.

BE IT FURTHER RESOLVED that staff shall report their findings of said accounting of transfers between the utility enterprises and the general fund and a comprehensive plan for making the utility enterprises self-sustaining to the Governing Body within 180 days of adoption of this resolution.

PASSED, APPROVED and ADOPTED this 27th day of May, 2015

JAVIER M. GONZALES, MAYOR

ATTEST:

YOLANDA Y. VIGIL, CITY CLERK

APPROVED AS TO FORM:

KELLEY A. BRENNAN, CITY ATTORNEY

Legislation/Resolutions 2015/2015-41Gross Receipts Tax (18_18_4)