

**CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (IBank)**

**STAFF REPORT**

**INFRASTRUCTURE STATE REVOLVING FUND PROGRAM (ISRF) DIRECT FINANCING**

**EXECUTIVE SUMMARY**

<b>Applicant:</b> City of Escondido (City)		<b>ISRF Project Type:</b> Drainage, Water Supply, Flood Control	
<b>Financing Amount:</b> \$15,000,000	<b>Financing Term:</b> 30 years	<b>Interest Rate:</b> <sup>1</sup> 3.00%	
<b>Source of Repayment:</b> Net water system revenues (Net Revenues) and all legally available amounts in the Water fund (Fund)		<b>Fund Rating/Date:</b> Revenue Bonds Series 2012 Affirmed at AA- by Fitch Rating, on January 11, 2016	
<b>Security:</b> The ISRF Program financing (Financing) would be payable from, and secured by a lien on, Net Revenues and all legally available amounts in the Fund. The existing indebtedness of (1) the 2007 Revenue Certificates of Participation (2007 COP) and the 2012 Revenue Bonds Water System Financing (2012 Bonds), and (2) the 2002 Department of Water Resources Loan No. SRF00CRX112 and the 2009 Department of Public Health Loan No. AR09FP27 (collectively, the Loans), are also secured by, and payable from, a lien on Net Revenues and legally available amounts in the Fund. The City will provide evidence reasonably satisfactory to IBank that all parity debt conditions precedent set forth in the financing agreements for the 2007 COP and the 2012 Bonds have been satisfied. The Loans do not include specific parity debt conditions. <sup>2</sup>			
<b>Project Name:</b> Lindley Reservoir Tank Replacement (Project)		<b>Project Location:</b> 720 Hubbard Avenue, Escondido, CA	
<b>Project Description / Sources and Uses of Proceeds:</b> The Project includes, but is not limited to: 1) the removal and replacement of a 2MG reservoir water tank and construction of two 1.5MG partially submerged concrete water tanks; 2) construction of a valve vault, associated structures and facilities, detention basin, and roadways; 3) installation of a water pipeline; and 4) landscaping of the sites. The Project is more specifically described in the Project Description section of this report. <b>Use of Financing Proceeds:</b> The Financing would fund all components necessary to complete the Project, including but not limited to: equipping, installation, design, engineering, construction, construction contingency of 8.5%, demolition, removal, resurfacing, restoration, landscaping, permitting, construction management, project administration, and general project development activities. IBank's loan origination fee is included in the loan amount requested. Contingency will be funded from the Financing proceeds.			
<b>PROJECT USES</b>		<b>PROJECT SOURCES</b>	
	<b>IBank</b>	<b>City of Escondido</b>	<b>Total</b>
Lindley Reservoir Tank Replacement Project	\$14,850,000	\$351,100	\$15,201,100
Origination Fee	150,000		150,000
<b>Total</b>	<b>\$15,000,000</b>	<b>\$351,100</b>	<b>\$15,351,100</b>

<sup>1</sup> As of March 1, 2019

<sup>2</sup> Loan Number AR09FP27 provides that [The City] "agrees that it shall not incur any additional indebtedness having any priority in payment over [the City's] obligations to State under this Agreement ..." and the other Loan uses roughly equivalent language. The Loans specifically preclude senior debt, but could be construed to unconditionally permit parity debt. Refer to the Existing Obligations Payable from the Fund section of this Staff Report for further details.

**Credit Considerations:**

Cash flow and debt service analysis for the Financing is summarized as follows:

HISTORICAL CASH FLOW					
For Fiscal Year Ending (FYE) June 30	2014	2015	2016	2017	2018
<b>Cash Available for Debt Service</b>	<b>10,259,191</b>	<b>9,963,736</b>	<b>7,716,107</b>	<b>9,503,851</b>	<b>7,223,024</b>
Debt Service Calculation					
Total Existing Debt Service MADS <sup>1</sup>	4,010,929	4,010,929	4,010,929	4,010,929	4,010,929
Proposed IBank MADS <sup>2</sup>	804,472	804,472	804,472	804,472	804,472
<b>Total Obligations MADS</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>
<b>Debt Service Coverage Ratio</b>	<b>2.13</b>	<b>2.07</b>	<b>1.60</b>	<b>1.97</b>	<b>1.50</b>

<sup>(1)</sup> Maximum Annual Debt Service

<sup>(2)</sup> Calculated at \$15,000,000 at 3.0% for 30 years.

Analysis of the historical cash flow over the last five years demonstrates the Fund has the capacity to service the proposed Financing with a debt service coverage ratio (DSCR) of 1.50 or greater in all five years reviewed. For further detail, see the Credit Analysis section of this report.

**Support for Staff Recommendations:**

1. Cash flow analysis demonstrates the Fund's ability to service existing debt and the proposed Financing.
2. City has successfully increased rates in order to cover expenses and service its debt.
3. The City estimates the useful life of the Project is at least 30 years, which meets the 30 year term of the Financing.

**Special Terms and Conditions:**

1. In implementing rates and charges, the City will covenant to ensure its rate structure conforms to the requirements of Proposition 218. Further, the City will notify IBank immediately upon the filing of any legal challenge to its rates or charges.
2. The City to provide evidence reasonably satisfactory to IBank that all parity debt conditions precedent set forth in the financing agreements for the 2007 COP and the 2012 Bonds have been satisfied.

**Exceptions:**

1. The City seeks an IBank Board waiver of the Criteria requirement to complete construction within two years. The Project timeline for the completion of construction is three years from start of construction in September 2019.
2. The Criteria provides that contractors should be pre-qualified using the Model Questionnaire detailed in the Criteria. The City intends to use its internally-required contractor pre-qualification questionnaire, which substantially meets the intent of the Model Questionnaire. Therefore, the City seeks a waiver of this Criteria requirement.

**IBank Staff:**

John Lee

**Date of Staff Report:**

April 12, 2019

**Date of IBank Board Meeting:**

April 24, 2019

**Resolution Number:**

19-10

**Staff Recommendation:**

Staff recommends approval of Resolution No. 19-10 authorizing ISRF Program financing in an amount not to exceed \$15,000,000 to the City of Escondido, for the Lindley Reservoir Tank Replacement Project.

## PROJECT DESCRIPTION

The City of Escondido (City) requests an Infrastructure State Revolving Fund (ISRF) Program financing (Financing) in the amount of \$15 million (M) to fund the Lindley Reservoir Tank Replacement (Project).

The planned Project generally consists of demolishing and removing the existing 2.0 million gallon (MG), above ground steel Lindley Reservoir Potable Water Tank that is at the end of its useful life and the construction of two 1.5 MG partially buried concrete replacement potable water tanks (Exhibit 1). Since the existing 2.0 MG tank is undersized for current demand, a combined capacity of 3.0 MG is identified for the proposed tanks to provide adequate capacity for potable water storage and distribution, per current industry standards. The Project's construction is scheduled to begin September 2019 and be completed within three years.

The Project includes the following specific elements: 1) demolition and removal of the existing 2.0 MG, above ground, steel Lindley Reservoir Water Tank (and demolition/removal or abandonment in-place of appurtenant facilities such as valves and pipelines), 2) construction of two, 1.5 MG, partially buried concrete water tanks (and related valves, pipelines, etc.), 3) construction of a separate, partially buried valve vault structure and associated structures (retaining walls) and facilities (valves, pipelines, etc.), 4) construction of two asphalt-concrete (AC) access road spurs extending to the proposed tanks and valve vault (with both roadway spurs tying into an existing on-site road that provides access to a buried recycled water tank, TW-1005), 5) installation of a subsurface potable water pipeline extending east from the valve vault to Hubbard Avenue, and then generally northeast along Hubbard Avenue to the intersection with North Ash Street (along with appropriate resurfacing/restoration of roadway intersection areas), 6) construction of a detention basin to provide flow regulation and water quality treatment for applicable project site storm water drainage 7) reclamation (backfilling/re-contouring) of the existing 2.0 MG tank site, and revegetation/landscaping of both the existing and proposed tank sites, 8) other components necessary or desirable in connection with an infrastructure project of this type and that are consistent with the applicable requirements of the Act.

### Public Benefits

The Project would provide a more reliable and efficient water storage and distribution system with an increase in the capacity of water storage; and improve the City's ability to provide safe, reliable, quality water to its residents, businesses and agricultural interests. The City estimates that 14 indirect or temporary jobs will be created by the construction phase of the Project (12 construction jobs and two consulting jobs).

## GENERAL INFORMATION

The City, with a population of 150,760, is in northern San Diego County about 30 miles north of the city of San Diego. Incorporated in 1988, the City is a full-service, general-law city with four elected council members, and a mayor elected at large. The City operates under the Council-Manager form of government. Originally an agricultural center, the City has grown and diversified as the larger San Diego region has expanded.

The City's economy is diversified with many industries such as healthcare, specialty food and beverage manufacturing, agriculture, professional services and precision manufacturing. Retail sales are among the highest in San Diego County due to the presence of the Escondido Auto Park and the Westfield North County shopping mall. Palomar Medical Center, which opened its doors in the Escondido Research and Technology Center in 2012, is the centerpiece of the region's health care system and is recognized as one of the most technologically advanced hospitals in the world. The City is also home to many innovative companies, with one of the highest numbers of recorded patents per capita in the nation.

## SYSTEM DESCRIPTION

### System Infrastructure

The City's Water Division supplies water to approximately 26,000 residential, commercial, and agricultural customers. The water service area is not aligned with the City's incorporated boundary, and includes significant agricultural land uses. The water system consists of approximately 25,000 service meters, 370 miles of pipelines, 50 pressure reducing/regulating stations, five pump stations, 11 reservoirs, and two dams.

The City's potable water system currently utilizes water from two sources: local water and purchased water from San Diego County Water Authority, which supply approximately 20% and 80% of demand, respectively. Local water from the San Luis Rey River watershed is stored on a seasonal basis in the Lake Henshaw, Lake Wohlford, and Lake Dixon reservoirs. Local water is shared with Vista Irrigation District (VID), and delivered to the City via the Escondido Canal and associated pipelines. The Escondido-Vista Water Treatment Plant (WTP) is co-owned by the City and VID, and treats all of the City's raw water supply.

To diversify its supplies and increase local supply reliability, the City is implementing a long-term potable water reuse project that will provide an additional source of potable water in the City's water service area. In addition, the City would increase local storage at Lake Wohlford once a planned dam replacement project has been completed.

### Capital Improvement Plan

The City expects approximately \$141.5M in expenditures for its capital improvement plan (CIP) over the five year planning period. The City's consultant, Raftellis Financial Consultants, Inc., completed its Water Rate Study for the City on January 17, 2017. Following completion of the Water Rate Study, and based on its recommendations and conclusions, the City's Council adopted a Resolution increasing water rates by 5.5% per year for a five year period starting in the City's Fiscal Year 2017. Among other things, the rate increases will help cover CIP expenditures, of which \$75M will be debt funded.

The following table reflects that the Number of Users by Category has remained relatively stable over the five years. The Other category includes the Zoological Society of SD, which is the largest system user of system revenues, as well as the City of Escondido, and a significant number of agricultural users.

NUMBER OF USERS BY CATEGORY					
	2014	2015	2016	2017	2018
Residential	25,970	25,957	25,913	25,982	26,044
Commercial	2,142	2,147	2,145	2,223	2,066
Industrial	7	7	6	5	5
Other	776	776	773	781	909
<b>Total</b>	<b>28,895</b>	<b>28,887</b>	<b>28,837</b>	<b>28,991</b>	<b>29,024</b>
% change		N/A	-0.2%	0.5%	0.6%

Source: Financing Application Addendum

The following table displays Current System Usage and Revenue as of February 25, 2019. Residential customers represent more than 63.4% of the Gross Annual Revenues.

<b>CURRENT SYSTEM USAGE &amp; REVENUE</b>				
	<b>Annual Usage (kgal)<sup>(1)</sup></b>	<b>% Annual Usage</b>	<b>Gross Annual Revenue</b>	<b>% Gross Annual Revenue</b>
Residential	2,727,666	57.9%	\$18,367,940	63.4%
Commercial	519,136	11.0%	\$3,814,319	13.2%
Industrial	16,803	0.4%	\$123,188	0.4%
Other	1,444,067	30.7%	\$6,665,938	23.0%
<b>Total</b>	<b>4,707,672</b>	<b>100.0%</b>	<b>\$28,971,385</b>	<b>100.0%</b>

Source: Financing Application

<sup>(1)</sup> Kilogallon

The following table displays the Historical Rate Increases adopted over the past five years, and reflects the City's ability to increase rates in order to meet its operational and capital improvement needs.

<b>HISTORICAL RATE INCREASES PAST FIVE YEARS</b>		
<b>Date Adopted</b>	<b>Date Effective</b>	<b>Percent Increase</b>
February 1, 2017	March 1, 2019	5.50%
February 1, 2017	March 1, 2018	5.50%
February 1, 2017	March 1, 2017	5.50%
February 4, 2015	March 1, 2016	5.50%
February 4, 2015	March 1, 2015	5.50%

Source: Financing Application Addendum

The following table displays the Historical and Current Average Monthly User Charge per Residential Unit and the year-over-year percent increase of the charge since FY 2015. The table also reflects each year's charge as a percent of the County's Median Household Income (MHI) for residential units. The table demonstrates that the percent of MHI is well below the 2% affordability threshold.

<b>HISTORICAL AND CURRENT AVERAGE MONTHLY USER CHARGE PER RESIDENTIAL UNIT</b>					
<b>For Fiscal Year Ending (FYE) June 30</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>
Residential	\$63.65	\$59.50	\$65.56	\$74.00	\$78.94
% change	N/A	-6.5%	10.2%	12.9%	6.7%
% of MHI	1.2%	1.1%	1.3%	1.4%	1.5%

Source: Financing Application Addendum

The following table displays the Projected Average Monthly User Charge per Residential Unit in FYs 2020 through 2023. Although there is no approved rate increase beyond the current adopted rates that go into effect each year through FY 2021 the City projects increasing rates by 5% in FY 2022 and 2023.

<b>PROJECTED AVERAGE MONTHLY USER CHARGE PER RESIDENTIAL UNIT</b>				
<b>For Fiscal Year Ending (FYE) June 30</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>
Residential	\$83.28	\$87.87	\$92.26	\$96.87
% change	5.50%	5.50%	5.00%	5.00%

Source: Financing Application Addendum

The following table displays the City's Average Monthly System User Charge Compared to Nearby Systems as of March 2019, and is based on 3K gallon usage.

<b>CURRENT AVERAGE MONTHLY SYSTEM USER CHARGE COMPARED TO NEARBY SYSTEMS</b>			
<b>System Name</b>	<b>Distance in Miles</b>	<b>Location</b>	<b>Average Monthly Residential Rate</b>
Padre Dam Municipal Water District	31.8	Santee	\$61.42
Rainbow Municipal Water District	16.6	Rainbow, Bonsall, parts of Vista	\$76.06
Valley Center Municipal Water District	10.7	Valley Center	\$59.41
<b>City of Escondido</b>	<b>N/A</b>		<b>\$57.60</b>
Rincon del Diablo Municipal Water District	2.7	San Diego County	\$57.60
Ramona Municipal Water District	11	Ramona	\$55.15
<b>Average Monthly User Charge</b>			<b>\$61.21</b>

Source: Financing Application Addendum

The following table displays the Top 10 System Users and reflects that the City complies with IBank's underwriting requirements that revenues derived from the top ten ratepayers not exceed 50%, and that no single ratepayer generates 15% or greater of the System's annual revenues.

<b>TOP 10 SYSTEM USERS AS OF FEBRUARY 28, 2019</b>				
	<b>User</b>	<b>% System Use</b>	<b>% System Revenues</b>	<b>Customer Class</b>
1	Zoological Society of SD	2.65%	3.32%	Other
2	Bar-B Ranch	1.39%	0.61%	Other
3	Escondido Mobilepark West	0.79%	0.77%	Residential
4	EC & BJ Malone	0.72%	0.31%	Other
5	City of Escondido	0.70%	0.88%	Other
6	A-1 Sunshine Farms LLC	0.65%	0.42%	Other
7	EC & BJ Malone	0.59%	0.26%	Other
8	Henry Ranch	0.46%	0.20%	Other
9	Felicita Village HOA	0.42%	0.40%	Residential
10	ConAm Management	0.41%	0.41%	Residential
	<b>Total</b>	<b>8.78%</b>	<b>7.58%</b>	

Source: Financing Application Addendum

## CREDIT ANALYSIS

### Source of Financing and Security

The ISRF Program financing (Financing) would be secured by a lien on Net Revenues and all legally available amounts in the Fund. The City will provide evidence reasonably satisfactory to IBank that all parity debt conditions precedent set forth in the financing agreements for the 2007 COP and the 2012 Bonds have been satisfied. The 2002 Department of Water Resources Loan No. SRF00CRX112 (2002 DWR Loan) and the 2009 Department of Public Health Loan No. AR09FP27 (2009 DPH Loan) provide for a lien on Net Revenues and all legally available amounts in the Fund but do not include parity debt conditions<sup>2</sup>.

<b>Source of Revenue to Repay Proposed ISRF Program Financing:</b>	Net water system revenues and all legally available amounts in the Water Fund
<b>Outstanding Obligations:</b>	See Debt Table for details: four existing obligations with an outstanding balance of \$55,525,146
<b>Type of Audited Financial Documents Reviewed:</b>	<input checked="" type="checkbox"/> Comprehensive Annual Financial Reports (CAFR) <input type="checkbox"/> Basic Financial Statements (F/S) <input type="checkbox"/> Other:
<b>Fiscal Year Ends:</b>	June 30
<b>Audit Fiscal Years Reviewed:</b>	2014-2018
<b>The auditor's reports for all years indicate that the financial statements present fairly, in all material respects, the financial position of the City, and that the results of its operations and the cash flows are in conformity with generally accepted accounting principles.</b>	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No. [If no, explain]
<b>Adopted Budget(s) Reviewed:</b>	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No. [If no, explain]
<b>Budget Year(s) Reviewed:</b>	2018-2019

<sup>2</sup> The Loans are now administered by, and are assets of, the California State Water Resources Control Board.

## Comparative Statement of Net Position Analysis

Analysis of the Fund's Comparative Statement of Net Position for the last five fiscal years is as follows:

CITY OF ESCONDIDO WATER ENTERPRISE FUND STATEMENT OF NET POSITION											
For Fiscal Year Ending (FYE) June 30	2014		2015		2016		2017		2018		
Source:	CAFR	%	CAFR	%	CAFR	%	CAFR	%	CAFR	%	
<b>Assets</b>											
<b>Current Assets</b>											
Cash and Investments	\$17,091,277	112%	\$21,792,370	137%	\$13,461,674	83%	\$4,779,229	3.0%	\$28,216,593	17.1%	
Accounts	10,011,273	6.6%	7,796,193	4.9%	8,735,003	5.4%	8,760,110	5.4%	10,412,672	6.3%	
Interest	75,885	0.0%	83,623	0.1%	83,989	0.1%	68,410	0.0%	113,267	0.1%	
Loans			5,574	0.0%	4,040	0.0%					
Due From Other Governments			808,325	0.5%	193,204	0.1%					
Deposits	6,800	0.0%	6,800	0.0%	6,800	0.0%					
<b>Total Current Assets</b>	<b>27,185,235</b>	<b>17.8%</b>	<b>30,492,885</b>	<b>19.2%</b>	<b>22,484,710</b>	<b>13.9%</b>	<b>13,607,749</b>	<b>8.4%</b>	<b>38,742,532</b>	<b>23.5%</b>	
<b>Noncurrent Assets</b>											
<b>Restricted Assets:</b>											
Restricted Cash and Investments	27,196,575	17.8%	27,212,584	17.1%	26,098,615	16.2%	26,175,045	16.2%	45,003	0.0%	
Land Held For Sale	104,573	0.1%	104,573	0.1%	104,573	0.1%	104,573	0.1%			
Prepaid Bond Insurance	119,789	0.1%	114,637	0.1%	109,485	0.1%	104,332	0.1%	99,180	0.1%	
<b>Capital Assets:</b>											
Not Being Depreciated					28,231,112	17.5%	37,879,736	23.5%	36,178,186	21.9%	
Depreciated Net					84,218,413	52.2%	83,390,715	51.7%	89,872,224	54.5%	
Land	1,488,268	10%	1,488,268	0.9%							
Land Improvements	626,162	0.4%	626,162	0.4%							
Buildings	14,849,333	9.7%	14,849,333	9.3%							
Water System	122,968,161	80.5%	123,248,107	77.5%							
Electric System	3,609,179	2.4%	3,609,179	2.3%							
Machinery and Equipment	3,399,345	2.2%	3,418,313	2.1%							
Construction in Progress	6,698,921	4.4%	13,112,894	8.2%							
Depreciation (Net of Accumulated)	(55,539,098)	-36.4%	(59,261,543)	-37.3%							
<b>Total Other Non Current Assets</b>	<b>125,521,208</b>	<b>82.2%</b>	<b>128,522,507</b>	<b>80.8%</b>	<b>138,762,198</b>	<b>86.1%</b>	<b>147,654,401</b>	<b>91.6%</b>	<b>126,194,593</b>	<b>76.5%</b>	
<b>Total Assets</b>	<b>152,706,443</b>	<b>100.0%</b>	<b>159,015,392</b>	<b>100.0%</b>	<b>161,246,908</b>	<b>100.0%</b>	<b>161,262,150</b>	<b>100.0%</b>	<b>164,937,125</b>	<b>100.0%</b>	
<b>DEFERRED OUTFLOWS OF RESOURCES</b>											
Deferred Outflows - Related to Pensions			1,258,588	0.8%	3,185,083	2.0%	3,856,269	2.4%	4,685,276	2.8%	
Deferred Loss on Refundings, Net	1,068,683	0.7%	1,009,873	0.6%	951,063	0.6%	892,253	0.6%	833,443	0.5%	
<b>Total Deferred Outflow of Resources</b>	<b>1,068,683</b>	<b>0.7%</b>	<b>2,268,461</b>	<b>1.4%</b>	<b>4,136,146</b>	<b>2.6%</b>	<b>4,748,522</b>	<b>2.9%</b>	<b>5,518,719</b>	<b>3.3%</b>	
<b>Liabilities</b>											
Accounts Payable	3,901,159	2.6%	5,477,019	3.4%	6,380,382	4.0%	5,781,920	3.6%	4,532,193	2.7%	
Revenue Bonds	475,000	0.3%	495,000	0.3%							
Accrued Expenses	124,456	0.1%	149,024	0.1%	190,676	0.1%	227,759	0.1%	260,268	0.2%	
Accrued Interest	898,586	0.6%	888,085	0.6%	875,602	0.5%	861,002	0.5%	845,802	0.5%	
Long-Term Debt, Due Within One Year					1,376,322	0.9%	5,793,591	3.6%	1,585,296	1.0%	
Certificates of Participation	550,000	0.4%	565,000	0.4%							
Loans	219,613	0.1%	225,154	0.1%							
Employee Leave Benefits	38,149	0.0%	44,136	0.0%							
Retention Payable	29,386								8,088,340		
<b>Total Current Liabilities</b>	<b>6,236,349</b>	<b>4.1%</b>	<b>7,843,418</b>	<b>4.9%</b>	<b>8,822,982</b>	<b>5.5%</b>	<b>12,664,272</b>	<b>7.8%</b>	<b>15,311,899</b>	<b>9.3%</b>	
<b>Noncurrent Liabilities</b>											
Deposits Payable	387,696	0.3%	459,444	0.3%	497,834	0.3%	509,137	0.3%	608,180	0.4%	
Aggregate Net Pension Liabilities			13,604,457	8.6%	14,505,683	9.0%	17,451,904	10.8%	19,882,564	12.1%	
Long-Term Debt, Due In More Than One Year					69,514,712	43.1%	68,119,308	42.2%	66,559,144	40.4%	
Revenue Bonds	31,791,796	20.8%	31,241,604	19.6%							
Certificates of Participation	27,226,877	17.8%	26,653,624	16.8%							
Connection Rights Payable	9,327,594	6.1%	9,321,134	5.9%							
Employee Leave Benefits	343,340	0.2%	397,226	0.2%							
Loans	3,464,849		3,239,695								
<b>Total Noncurrent Liabilities</b>	<b>72,542,152</b>	<b>47.5%</b>	<b>84,917,184</b>	<b>53.4%</b>	<b>84,518,229</b>	<b>52.4%</b>	<b>86,080,349</b>	<b>53.4%</b>	<b>87,049,888</b>	<b>52.8%</b>	
<b>Total Liabilities</b>	<b>78,778,501</b>	<b>51.6%</b>	<b>92,760,602</b>	<b>58.3%</b>	<b>93,341,211</b>	<b>57.9%</b>	<b>98,744,621</b>	<b>61.2%</b>	<b>102,361,787</b>	<b>62.1%</b>	
<b>DEFERRED INFLOWS OF RESOURCES</b>											
Deferred Inflows Related to Pensions			2,449,091	1.5%	2,767,571	1.7%	237,798	0.1%	136,580	0.1%	
<b>Total Deferred Inflows of Resources</b>			<b>2,449,091</b>	<b>1.5%</b>	<b>2,767,571</b>	<b>1.7%</b>	<b>237,798</b>	<b>0.1%</b>	<b>136,580</b>	<b>0.1%</b>	
<b>Net Position</b>											
Net Investments in Capital Assets	53,429,589	35.0%	57,538,791	36.2%	69,548,553	43.1%	79,811,295	49.5%	60,541,689	36.7%	
Unrestricted	21,567,036	14.1%	8,535,369	5.4%	(274,281)	-0.2%	(12,783,042)	-7.9%	7,415,788	4.5%	
<b>Total Net Position</b>	<b>\$74,996,625</b>	<b>49.1%</b>	<b>\$66,074,160</b>	<b>41.6%</b>	<b>\$69,274,272</b>	<b>43.0%</b>	<b>\$67,028,253</b>	<b>41.6%</b>	<b>\$67,957,477</b>	<b>41.2%</b>	



The fluctuations in Cash and Investments are primarily attributable to the reimbursement of capital expenditures not occurring in a timely manner. The 2007 COP and 2012 Bonds proceeds were held in trust for the City with the Bank of New York, and accounted for on the Restricted Cash and Investments line item. As capital improvements are paid from the Fund, the City submits a request to the Bank of New York for reimbursement of expenditures. Prior to FY 2018, the City was behind in requesting these reimbursements. According to the City, if the disbursement requests were kept up to date Cash and Investments would have amounted to \$24.4M, \$34M, \$33.9M, and \$30.2M for FYs 2014 to 2017, respectively.

In FY 2015 Accounts decreased 22.1%, primarily attributable to the drought and water conservation, which resulted in a lower receivable balance.

The amount reported in Due From Other Governments for FYs 2015 and 2016 reflect accrued revenue earned from a Proposition 1E grant received from the State Department of Water Resources (DWR) – related to the Lake Wohlford Dam Project. The Restricted Cash and Investments line item includes bond proceeds held in trust with the Bank of New York, which are drawn down as capital projects are completed. The decrease in FY 2018 is primarily due to the completion of bond funded projects. Total Assets increased steadily, amounting to an 8% increase over the five years reviewed, primarily due to the above mentioned line items.

In FY 2016 the City changed the reporting of Capital Assets, whereby Assets Not Being Depreciated include Land and Construction in Progress, and all other capital assets fall under Depreciated Net. Accounts Payable increased 63.6% from FYs 2014 to 2016, primarily attributable to several large capital projects in progress at year-end.

Long-term Debt, Due Within One Year increased approximately \$4.4M in FY 2017, primarily due to a settlement arrangement of \$4.1M payable to the Indian Water Authority as a result of the San Luis Rey Supreme Court decision. Total Liabilities increased 29.9% over the five years reviewed, primarily due to implementation of GASB Statements No. 68 & 71 beginning in FY 2015, which required the recording of net pension liability and pension related deferred inflows and outflows.

In FY 2017 Unrestricted amounted to (\$12,783,042), primarily due to the above noted untimely bond proceeds reimbursement for capital expenditures. According the City, if the reimbursements were timely then Net Investments in Capital Assets would have been \$54.4M and Unrestricted a positive \$12.5M. At the end of the current fiscal year, the unrestricted net position of the Fund amounted to \$7.4M.

The table below shows Accounts receivables summary as of January 2019, and demonstrates that the City considers 97.1% of billing is current.

<b>ACCOUNTS RECEIVABLE AGING</b>			
<b>AS OF JANUARY 2019</b>			
	<b>Current (Under 45 Days)</b>	<b>Over 45 Days</b>	<b>Total</b>
	\$159,639,256	\$4,775,714	\$164,414,970
<b>Percent</b>	<b>97.1%</b>	<b>2.9%</b>	<b>100.0%</b>

Utility Billing, which is a division of the City's Finance Department, is responsible for water billing. Each account is assigned one of five billing cycles, and customers have 45 days from the bill date to pay the balance owed. If no payment is received after 19 days from the billing date, the payment is late and a 10% late penalty is charged on the past due balance.

## Comparative Statement of Revenues, Expenses, and Changes in Net Position Analysis

Analysis of the Fund's Comparative Statement of Revenues, Expenses, and Changes in Net Position for the last five years follows:

CITY OF ESCONDIDO WATER ENTERPRISE FUND REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION										
For Fiscal Year Ending (FYE) June 30	2014		2015		2016		2017		2018	
	Source:	CAFR	%	CAFR	%	CAFR	%	CAFR	%	CAFR
% Change of Total Revenues		NA		-0.8%		-8.2%		7.8%		12.8%
<b>Operating Revenues:</b>										
Charges for Services	\$53,920,870	100.0%	\$53,511,317	100.0%	\$49,105,084	100.0%	\$52,936,039	100.0%	\$59,696,574	100.0%
<b>Total Operating Revenues</b>	<b>53,920,870</b>	<b>100.0%</b>	<b>53,511,317</b>	<b>100.0%</b>	<b>49,105,084</b>	<b>100.0%</b>	<b>52,936,039</b>	<b>100.0%</b>	<b>59,696,574</b>	<b>100.0%</b>
<b>Operating Expenses:</b>										
Personnel Services	7,278,175	13.5%	7,520,892	14.1%	8,210,368	16.7%	9,690,510	18.3%	11,969,610	20.1%
Purchased Water	24,283,807	45.0%	23,183,794	43.3%	21,493,055	43.8%	21,058,343	39.8%	27,511,621	46.1%
Administrative Expenses	5,338,640	9.9%	5,562,990	10.4%	5,715,530	11.6%	6,352,417	12.0%	6,192,917	10.4%
Supplies	2,351,990	4.4%	2,209,655	4.1%	1,850,963	3.8%	2,188,124	4.1%	2,268,038	3.8%
Repairs and Maintenance	1,269,945	2.4%	1,308,779	2.4%	1,286,172	2.6%	1,720,494	3.3%	1,816,827	3.0%
Utilities	2,514,393	4.7%	2,739,092	5.1%	2,200,615	4.5%	2,787,961	5.3%	3,192,497	5.3%
Professional Services	1,005,355	1.9%	1,102,166	2.1%	989,746	2.0%	1,061,054	2.0%	999,452	1.7%
Insurance Premiums	424,415	0.8%	440,285	0.8%	651,215	1.3%	599,085	1.1%	541,170	0.9%
Rent	310,536	0.6%	324,308	0.6%	338,193	0.7%	352,628	0.7%	367,524	0.6%
Other	440,221	0.8%	584,967	1.1%	464,394	0.9%	733,020	1.4%	577,476	1.0%
Depreciation	3,529,669	6.5%	3,751,074	7.0%	3,767,869	7.7%	3,977,493	7.5%	4,132,922	6.9%
<b>Total Operating Expenses</b>	<b>48,747,146</b>	<b>90.4%</b>	<b>48,728,002</b>	<b>91.1%</b>	<b>46,968,120</b>	<b>95.6%</b>	<b>50,521,129</b>	<b>95.4%</b>	<b>59,570,054</b>	<b>99.8%</b>
<b>Operating Income (Loss)</b>	<b>5,173,724</b>	<b>9.6%</b>	<b>4,783,315</b>	<b>8.9%</b>	<b>2,136,964</b>	<b>4.4%</b>	<b>2,414,910</b>	<b>4.6%</b>	<b>126,520</b>	<b>0.2%</b>
<b>Nonoperating Revenues (Expenses)</b>										
Investment Income	220,284	0.4%	264,981	0.5%	264,337	0.5%	55,053	0.1%	(50,968)	-0.1%
Rents and Concessions	845,134	1.6%	884,026	1.7%	963,147	2.0%	1,118,442	2.1%	1,160,002	1.9%
Intergovernmental			2,146,219	4.0%	1,436,288	2.9%	667,334	1.3%	382,326	0.6%
Interest and Fiscal Charges	(2,805,090)	-5.2%	(2,768,105)	-5.2%	(2,726,003)	-5.6%	(2,677,581)	-5.1%	(2,625,313)	-4.4%
Miscellaneous	632,174	1.2%	182,070	0.3%	186,241	0.4%	64,985	0.1%	130,079	0.2%
Settlements							(4,110,762)	-7.8%	(35,470)	-0.1%
<b>Net Non-operating Revenues (Expenses)</b>	<b>(1,107,498)</b>	<b>-2.1%</b>	<b>709,191</b>	<b>1.3%</b>	<b>124,010</b>	<b>0.3%</b>	<b>(4,882,529)</b>	<b>-9.2%</b>	<b>(1,039,344)</b>	<b>-1.7%</b>
<b>Income (Loss Before Operating Transfers)</b>	<b>4,066,226</b>	<b>7.5%</b>	<b>5,492,506</b>	<b>10.3%</b>	<b>2,260,974</b>	<b>4.6%</b>	<b>(2,467,619)</b>	<b>-4.7%</b>	<b>(912,824)</b>	<b>-1.5%</b>
<b>Capital Contributions and Transfers</b>										
Transfer In			39,810							
Transfer (Out)							(1,948,746)		(12,500)	
Connection Fees	490,380		280,340		583,790		1,937,953		1,854,548	
Developer Contributions	562,199		256,546		355,348		232,393			
<b>Total Contributions and Transfers</b>	<b>1,052,579</b>		<b>576,696</b>		<b>939,138</b>		<b>221,600</b>		<b>1,842,048</b>	
<b>Changes in Net Position</b>	<b>5,118,805</b>		<b>6,069,202</b>		<b>3,200,112</b>		<b>(2,246,019)</b>		<b>929,224</b>	
<b>Net Position at Beginning of Year</b>	<b>69,877,820</b>		<b>74,996,625</b>		<b>66,074,160</b>		<b>69,274,272</b>		<b>67,028,253</b>	
Prior Period Adjustment (=/-)			(14,991,667)							
<b>Net Position at End of Year</b>	<b>\$74,996,625</b>		<b>\$66,074,160</b>		<b>\$69,274,272</b>		<b>\$67,028,253</b>		<b>\$67,957,477</b>	

Charges for Services decreased by \$4.4M, or 8.2% in FY 2016 as the result of State mandated drought restrictions. The line item increased by \$6.8M, or 12.8% in FY 2018 over the previous year, primarily due to an increase in water consumption after the removal of drought restrictions, as well as a 5.5% rate increase effective March 2017. The increase in revenue was offset by an increase in the cost of purchased water.

Personnel Services increased by \$2.8M, or 45.8% from FYs 2016 to 2018, primarily due to a noncash entry of \$1.5M for pension expense to record unfunded pension liability, as well as negotiated salary increases. Purchased Water expense increased by \$6.5M in the current fiscal year, mainly due to the removal of drought restrictions, as well as local sources experiencing a below average rainfall as compared to the previous fiscal year.

Intergovernmental revenue decreased by 82.2% from FYs 2015 to 2018, primarily due to fluctuations of both grant funding and reimbursements of VID project funded costs. This revenue includes a state grant to partially fund the Wohlford Dam Capital Project and also VID reimbursement for their share of certain capital improvement project costs. In FY 2017, Non-operating Expenses include a settlement

arrangement of \$4.1M payable to the Indian Water Authority as a result of the San Luis Rey Supreme Court decision. The total settlement payment of \$4.4M was paid in full as of June 30, 2018.

In FY 2017 a Transfer Out of \$1.9M was recorded to the Wastewater Fund. Prior to FY 2017, the Receivable for both the water and wastewater customer fees were recorded in the Water Fund. Beginning in FY 2017, the wastewater portion was moved to the Wastewater Fund and going forward the receivable for wastewater customer fees will be recorded in Wastewater.

The restatement of \$14.9M in FY 2015 is due to implementation of GASB Statement No. 68 to record unfunded pension liability. The Fund’s Net Position has remained relatively stable over the five years reviewed, with the exception of the above noted restatement.

### Existing Obligations Payable from the Fund

The table below shows the basic information for the City’s outstanding obligations payable from the Fund and the proposed Financing for the Project.

WATER FUND OBLIGATIONS					
Debt Issued	Underlying Rating (at issuance)	Date Issued	Amount Issued	Outstanding Balance	Maturity
2002 DWR Loan		2003	\$2,048,125	\$667,887	2024
2007 COP	A	2007	30,440,000	24,615,000	2038
2009 DPH Loan		2009	2,813,324	2,047,259	2032
2012 Bonds	AA-	2012	31,660,000	28,195,000	2042
Proposed IBank Financing			15,000,000	15,000,000	2048
		<b>Total</b>	<b>\$81,961,449</b>	<b>\$70,525,146</b>	

The 2007 COP and the 2012 Bonds (an aggregate outstanding balance of approximately \$52.8M) permit subsequent parity debt upon certain conditions, including satisfying a 1.20 debt service coverage ratio (DSCR), as evidenced by a Special Report of a CPA or an Independent Financial Consultant and Certificate of the City Manager. The 2002 DWR Loan and the 2009 DPH Loan (collectively, the Loans), with an aggregate outstanding balance of approximately \$2.7M, are silent on parity debt. The 2007 COP and the 2012 Bonds treat their respective liens on Net Revenues and the Fund as being on parity with the liens of the Loans, despite the fact that the Loans do not include any parity debt conditions.

IBank’s Financing Agreement will require evidence reasonably satisfactory to IBank that all parity debt conditions precedent set forth in the financing agreements for the 2007 COP and the 2012 Bonds have been satisfied, but as discussed above, there are no stated parity debt conditions for the Loans. The Loans specifically preclude senior debt, but could be construed to unconditionally permit parity debt. The Security section of the 2009 DPH Loan states “[The City] agrees that it shall not incur any additional indebtedness having any priority in payment over [the City’s] obligations to State under this Agreement ...” and the 2002 DWR Loan uses roughly equivalent language. The provision seems to contemplate additional debt and specifically forecloses senior debt, which could lead to the conclusion in any (theoretical) lien enforcement action that the City’s issuance of parity debt was permissible and so each subsequent financing (including the Financing) is on parity with the Loans. Alternatively, a court reviewing the parties’ relative priorities could also conclude that the Loans do not permit anything other than subordinate debt and so each lien granted after the issuance of the Loans is subordinate to the lien created by the Loans.

The potential for subsequent liens (including the lien of the Financing) to be subordinate to the lien of the Loans is mitigated by the following: 1) the Loans are obligations to what is essentially a sister State agency, with similar missions, in part to finance water infrastructure projects, 2) defaults are rare among rated municipal bonds, as evidenced by the low overall U.S Public Finance default rate of 0.04% from

1986-2017, according to the 2017 Annual U.S. Public Finance Default Study by Standard & Poor's Rating Services (S&P), 3) obligations of the Fund (2007 COP and 2012 Bonds) have ratings of AA- as further described below, and 4) the \$2.7M in aggregate outstanding principal of the Loans is significantly less than the \$15M Financing, therefore only 18% of the Financing amount could potentially be considered subordinate to the Loans.

On September 24, 2015 S&P raised its long-term rating to 'AA-' from 'A+' on both the 2007 COP and 2012 Bonds. S&P cited the City's consistently strong historical financial performance as part of their rationale for the upgrade. On January 11, 2016, Fitch Ratings affirmed the AA- rating on the 2012 Bonds, citing the systems sound financial performance, and a healthy all-in DSCR over the previous five years.

## Fund Cash Flow and Debt Service Analysis

Fund cash flow and debt service analysis for the Financing is as follows:

<b>HISTORICAL CASH FLOW</b>					
For Fiscal Year Ending (FYE) June 30	2014	2015	2016	2017	2018
<b>Operating Income (Loss)</b>	<b>\$5,173,724</b>	<b>\$4,783,315</b>	<b>\$2,136,964</b>	<b>\$2,414,910</b>	<b>\$126,520</b>
<b>Transaction Specific Adjustments</b>					
+ Depreciation	3,529,669	3,751,074	3,767,869	3,977,493	4,132,922
+ Investment Income	220,284	264,981	264,337	55,053	(50,968)
+ Rents and Concessions	845,134	884,026	963,147	1,118,442	1,160,002
+ Connection Fees	490,380	280,340	583,790	1,937,953	1,854,548
<b>Total of all Adjustments</b>	<b>5,085,467</b>	<b>5,180,421</b>	<b>5,579,143</b>	<b>7,088,941</b>	<b>7,096,504</b>
<b>Cash Available for Debt Service</b>	<b>10,259,191</b>	<b>9,963,736</b>	<b>7,716,107</b>	<b>9,503,851</b>	<b>7,223,024</b>
<b>Debt Service Calculation</b>					
Total Existing Debt Service MADS <sup>1</sup>	4,010,929	4,010,929	4,010,929	4,010,929	4,010,929
Proposed IBank MADS <sup>2</sup>	804,472	804,472	804,472	804,472	804,472
<b>Total Obligations MADS</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>	<b>\$4,815,401</b>
<b>Debt Service Coverage Ratio</b>	<b>2.13</b>	<b>2.07</b>	<b>1.60</b>	<b>1.97</b>	<b>1.50</b>

<sup>(1)</sup> Maximum Annual Debt Service

<sup>(2)</sup> Calculated at \$15,000,000 at 3.0% for 30 years.

Analysis of the historical cash flow over the last five years demonstrates the Fund has the capacity to service the proposed Financing with a debt service coverage ratio (DSCR) of 1.50 or greater in all five years reviewed.

## Risk Factors

1. Certain aspects of the City's rate structure are similar to those successfully challenged in a California appellate court case as having violated Prop 218 requirements.
2. The City is not prohibited from incurring additional obligations payable from the Fund.
3. The Loans do not include specific parity debt conditions, therefore there can be no assurance that the proposed Financing would be on parity with the Loans.

## Mitigating Factors

1. In implementing rates and charges, the City will covenant that its rate structure will conform to the requirements of Prop. 218 and statutes implementing it and case law interpreting it. Further, in its financing agreement, the City will covenant to notify IBank immediately upon the filing of any legal challenge to its rates or charges.
2. The City will be prohibited from issuing future debt senior to the IBank financing, and new parity debt would only be permitted if Net Revenues accumulated within the Fund are at least 1.20 times its Annual Debt Service (ADS).
3. Defaults are rare among rated municipal bonds, with a default rate of 0.04% from 1986-2017,

according to S&P and the City's current debt rating is AA-.

### **Compliance with IBank Underwriting Criteria**

The proposed Financing is in compliance with the criteria as follows: 1) revenues derived from the top ten System ratepayers do not exceed 50% of annual System revenues, 2) revenues derived from any single ratepayer do not exceed 15% of annual System revenues, 3) the estimated useful life of the Project is 30 years, which meets the term of the Financing, and 4) the City has the power to establish and enact rates and charges without the approval of any other governing body.

### **Criteria Exceptions**

1. The City seeks an IBank Board waiver of the criteria to complete construction within two years. The Project timeline for the completion of construction is three years from start of construction in September 2019.
2. The City requests that the IBank Board waive the Criteria provision that provides contractors should be pre-qualified using the Model Questionnaire detailed in the Criteria. The City intends to use its internally-required contractor pre-qualification questionnaire, which substantially meets the intent of the Model Questionnaire.

## STAFF RECOMMENDATION

Staff recommends approval of Resolution No. 19-10 authorizing ISRF Program financing to the City of Escondido (City), for the Lindley Reservoir Tank Replacement Project.

1. **Applicant/Borrower:** The City of Escondido
2. **Project:** Lindley Reservoir Tank Replacement Project
3. **Amount of Financing:** \$15,000,000
4. **Maturity:** Thirty (30) years
5. **Repayment/Security:** The ISRF Program financing (Financing) would be secured by a lien on Net Revenues and all legally available amounts in the Fund.
6. **Interest Rate:** 3.00%
7. **Fees:** The City to pay an origination fee of 1.00%, \$150,000, included in the Financing amount, and an annual fee of 0.30% of the outstanding principal balance.
8. **Not an Unconditional Commitment:** IBank's resolution shall not be construed as an unconditional commitment to finance the Project, but rather IBank's approval pursuant to the Resolution is conditioned upon entry by IBank and the City into a Financing Agreement, in form and substance satisfactory to IBank.
9. **Limited Time:** The Board's approval expires June 24, 2019. Thus, the City and IBank must enter into the Financing agreement no later than June 24, 2019. Once the approval has expired, there can be no assurances that IBank will be able to provide the Financing to the City or consider extending the approval period.
10. **ISRF Program Financing Agreement Covenants and Conditions:** The Financing Agreement shall include, among other things, the following covenants:
  - a. The City will be required to maintain rates and charges in an amount sufficient to ensure that Net Revenues produce a minimum 1.20 times aggregate annual debt service ratio for obligations on parity with the Financing.
  - b. The City will be prohibited from issuing future debt senior to the Financing.
  - c. Parity debt will be allowed if Net Revenues amount to at least 1.20 times the Annual Debt Service (ADS) taking into consideration the ADS payable in any Fiscal Year on all existing debt and the proposed parity debt.
  - d. Subordinate debt will be allowed if Net Revenues are at least 1.00 times the sum of the ADS on all outstanding debt, payable from the Fund, including the proposed Subordinate Debt.
  - e. The City will covenant against reducing rates below levels used for all debt service payable from the Fund, and to take actions to increase rates or fund a rate stabilization fund if the debt service coverage ratios fall below required levels.
  - f. Upon implementing rates and charges, The City to covenant to ensure that its rate structure conforms to the requirements of Proposition 218 and those of the statutes implementing it and the cases interpreting it. Further, the City to covenant to notify IBank immediately upon the filing of any legal challenge to its rates or charges.
  - g. The City to comply with the requirements of the Criteria and all applicable laws, regulations, and permitting requirements associated with public works projects.
  - h. The City to provide to IBank annually within 180 days of the end of each of the City's fiscal year a copy of its audited financial statements together with an annual certificate demonstrating compliance with the foregoing covenants, as well as other information as IBank may request from time to time.
  - i. The City to provide evidence reasonably satisfactory to IBank that all parity debt conditions precedent set forth in the financing agreements for the 2007 COP and the 2012 Bonds have been satisfied.

Exhibit 1

**PROJECT SITE**



Source: Final Mitigated Negative Declaration Report