



City Council Staff Report

From: City Manager

Report Type: CONSENT CALENDAR

Lead Department: Public Works

Meeting Date: June 17, 2024

Report #:2404-2838

TITLE

Authorization for the City Manager or Designee to Negotiate and Execute a Line of Credit totaling \$31 Million to Address Regional Wastewater Treatment Fund Cashflow as Recommended by the Finance Committee; CEQA Status – Not a Project

RECOMMENDATION

The Finance Committee and staff recommend that the City Council:

1. Direct staff to pursue a line of credit totaling \$31 million to restore a positive cash balance in the Regional Wastewater Treatment Fund, and
2. Authorize the City Manager or their designee to negotiate and execute all agreements, certificates, instruments, and documents necessary to obtain the line of credit.

EXECUTIVE SUMMARY

On May 21, 2024¹, the Finance Committee reviewed the Regional Wastewater Treatment Fund current and forecasted negative cashflow balances and to address the fund's negative cash balance, recommends that the City Council authorize staff to negotiate and execute a line of credit (LOC) totaling \$31 million.

The capital improvement program at the City's Regional Water Quality Control Plant (RWQCP) is entering its peak construction period. Although the City obtained \$212 million in low interest loans for its projects from the state's Clean Water Revolving Fund (SRF), the Regional Wastewater Treatment (WWT) Fund is experiencing short-term negative cash balances. Given the magnitude of the fund's capital costs and timing of reimbursement requests, the WWT Fund is not able to cover the shortage.

¹ Finance Committee, May 21, 2024, Item #2:

<https://portal.laserfiche.com/Portal/DocView.aspx?id=72119&repo=r-704298fc&searchid=9cbe174e-8835-478a-90c5-0e7f4b5cc70b>

Pursuing a \$31 million LOC will restore a positive cash balance in the WWT Fund. During the term of the LOC, the WWT Fund will pay for issuance costs and interest, recovered through periodic billing to the six partner agencies, including the City's Wastewater Collection Fund.

Regarding the City's Debt Policy², the Enterprise Funds have a debt service limit of 15% of operating expense. Issuance of a \$31 million LOC would increase the fund's debt service limit appropriately 0.6 to 1.8 percentage points between FY 2025 and 2027. The estimated debt limit for FY 2025 is 7.6%. The City Council approved an exception to the debt limit on December 5, 2022³ upon approving the budget amendment to fund the Secondary Treatment Upgrade (STU) project using the 2022 SRF Loan. In FY 2028, based on estimated interest cost and forecast budget, the WWT Fund is estimated to exceed the 15% debt limit due to repayment of the 2022 SRF Loan.

BACKGROUND

On May 21, 2024, the Finance Committee voted unanimously to recommend that the City Council authorize staff to negotiate and execute a \$31 million LOC. The Finance Committee's motion is outlined below:

1. *Direct staff to pursue negotiating a line of credit, totaling \$31 million, and*
2. *Authorize the City Manager or designee to negotiate and execute the line of credit*

MOTION PASSED, 3-0

This report to the City Council summarizes the WWT Fund cashflow shortfall and details of the LOC. For detailed background and analysis, please refer to staff's report to the Finance Committee¹ that outlines the RWQCP operating and capital budgets; the primary drivers for the WWT Fund's negative cash balance position; interim borrowing options, including advantages and challenges associated with each option; and future RWQCP CIP projects.

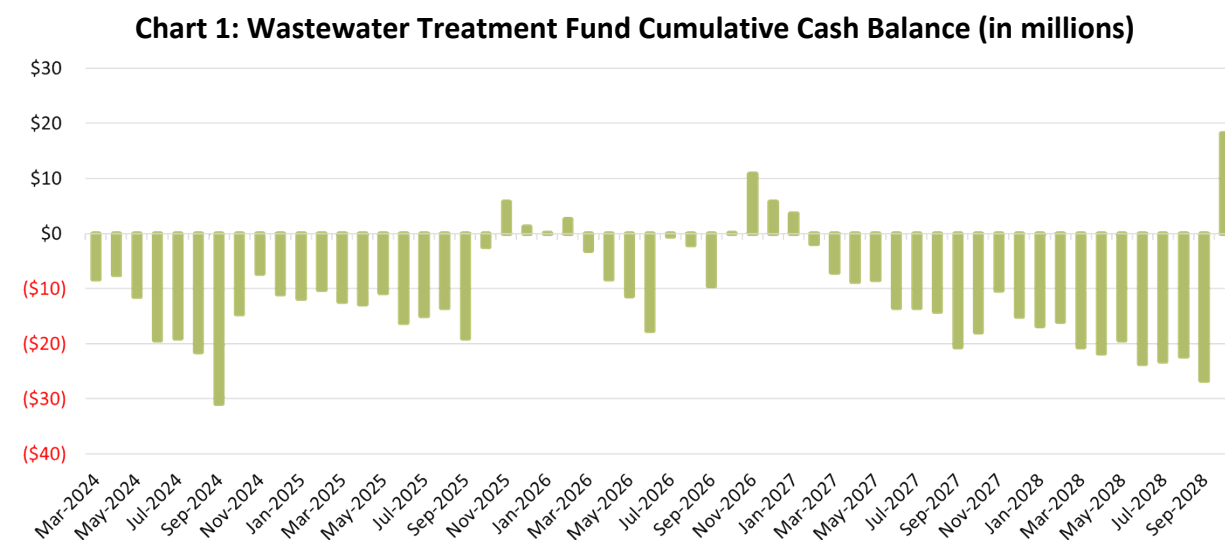
ANALYSIS

As of March 31, 2024, the WWT Fund is currently experiencing a cash shortfall in the amount of \$8.2 million and, based on cumulative forecasted cashflows reaches a peak shortfall of \$31 million (rounded) in October 2024. As SRF loan proceeds flow to the City on a reimbursement basis, this cumulative shortfall declines through November 2025 and is positive for several months. Cash shortfalls are expected to recur thereafter through October 2028. Thereafter, the

² City Debt Policy, dated April 11, 2017: <https://www.cityofpaloalto.org/files/assets/public/v/1/administrative-services/adopted-debt-policy-2017-04-11.pdf>

³ City Council, December 5, 2022, CMR ID 14710: <https://www.cityofpaloalto.org/files/assets/public/v/1/agendas-minutes-reports/reports/city-manager-reports-cmrs/2022/id.-14710-secondary-treatment-upgrades-approval-of-contract-design-contract-amendment-and-partner-agreements.pdf>

WWT Fund cash balance is positive. Chart 1 displays the WWT Fund’s current cash balance and forecast through September 2028.



July 2024: PST Complete

March 2025: Advanced Water Purification System begins

July 2026: Outfall Pipeline begins

April 2028: STU complete

October 2028: 2022 SRF debt service begins; assumes bond proceeds for Headworks Project

Based on these estimates, it is useful to note a couple features of these expected cash shortfalls. First, the amount of borrowing needed fluctuates over time. It reaches a peak of \$30.9 million at the end of the first quarter of FY 2025 (September 30, 2024), decreases thereafter, and peaks again to \$28.1 million in September 2028. Second, there are months without cash shortfalls and it would be advantageous to have no debt outstanding in those months. The draw and repayment flexibility (or lack thereof) offered by an LOC or bond anticipation note (“BAN”) were considered in the context of these fluctuating short-term borrowing needs.

State SRF reimbursement delays are not unique to Palo Alto. In coordination meetings, State staff shared that many agencies struggle with the delays; the issue was also an audit finding⁴ for the SRF program. Other local agencies including Silicon Valley Clean Water in Redwood City, San Jose, and San Mateo have pursued and obtained interim borrowing financing to manage SRF reimbursement delays.

Line of Credit (LOC)

A line of credit is a flexible loan, for a defined amount of money, from a financial institution that is accessed to manage cash flow or other short-term financing needs. Unlike a bond issuance,

⁴ The CA CWSRF: Review of the Loan Award and Disbursement Processes, July 2022; PDF pp. 27, 35-6
https://www.waterboards.ca.gov/water_issues/programs/grants_loans/srf/docs/CWSRF-program-review.pdf

the line of credit has terms directly negotiated with the bank and has more flexibility with use of the monies. Under this option, the City would enter into a line of credit with a commercial bank for five years, not to exceed \$31 million. Over that five-year period, the City can draw down funds from the line of credit on an as-needed basis. When SRF reimbursement proceeds are received, the line of credit may be immediately repaid and the full amount, or portion, would be reconstituted. Flexibility is a key attribute of a line of credit; the City may borrow, repay, and re-borrow on a regular frequency, hence the revolving nature of this financing strategy. The LOC also provides flexibility on the use of funds amongst WWT projects during the term, which is relevant as WWT has multiple upcoming projects.

With the assistance of the City’s municipal finance advisor, PFM, a request for proposal would be issued and proposals would be evaluated based on proposed terms and conditions. Issuance costs are approximately \$0.2 million and include the request for proposals, evaluation of proposers, outside counsel legal review, and executing the agreement. A line of credit has both a “utilized” (also known as a Secured Overnight Financing Rate, or SOFR) and an “unutilized” fee. The utilized fee is applied against the amount drawn down from the line of credit. As of the writing of this report, the utilized fee ranges between 3.0 to 5.1% and is applied only to the amount drawn from the line of credit. The rate will reset monthly and under current market conditions, short-term rates are relatively high. In 2024, it is expected that the Federal Open Markets Committee (FOMC) may decrease the federal rate by 0.5%, which would decrease rates on a line of credit. The unutilized fee is applied against the portion of the line of credit that is not drawn or utilized. It is essentially a “capacity” fee that is charged by commercial banks that allows borrowers immediate access to liquidity with one to two days’ notice. As of the writing of this report, the unutilized fee is estimated to be 0.35%.

FISCAL/RESOURCE IMPACT

A \$31 million LOC’s expected expenses for the WWT Fund and partners is shown in Table 1 below. This is based on maintaining a minimum guideline of \$7 million in cash reserves in the WWT Fund.

Table 1: Line of Credit Expected Expenses		
<i>Fiscal Year</i>	<i>Line of Credit (SOFR Current)</i>	<i>Line of Credit (SOFR 5-Year Avg.)</i>
2025	\$0.7M	\$0.4M
2026	\$0.5M	\$0.3M
2027	\$0.4M	\$0.3M
2028	\$0.9M	\$0.5M
2029	\$0.5M	\$0.3M
Total	\$3.0M	\$1.8M

The LOC is expected to be issued late summer 2024. Over the 5-year duration of the LOC, the total cost is approximately \$0.7 to \$1.0 million in the Wastewater Collection Fund. The remaining cost will be covered by contributions from the partners.

STAKEHOLDER ENGAGEMENT

RWQCP meets regularly with partner agency staff to discuss CIP developments and financing scenarios. Public Works staff began communicating the cashflow issue with partners in 2021 as STU Project details came into focus. The most recent partner meetings with partner agencies on cashflow were on March 26, 2024 and May 21, 2024. An interdepartmental team, including Administrative Services, Public Works, Utilities, City Attorney's Office, and City Manager's office staff meets monthly to review and discuss the RWQCP CIP, including the cashflow issue.

ENVIRONMENTAL REVIEW

Council action on this item is not a project as defined by CEQA because capital project financing activities are a government funding mechanism or fiscal activity which does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment. CEQA Guidelines section 15378(b)(4).

APPROVED BY:

Brad Eggleston, Director Public Works/City Engineer