



DATE: March 8, 2011

TO: Thomas J. Bonfield, City Manager

THROUGH: Wanda S. Page, Deputy City Manager

FROM: David Boyd, Finance Director
Keith R. Herrmann, Deputy Finance Director

SUBJECT: Water and Sewer Utility System Revenue Bonds, Series 2011

EXECUTIVE SUMMARY

The Finance Department is proposing the issuance of Water and Sewer Utility System Revenue Bonds in an amount not to exceed \$70 million during May 2011. The City's Water Management Department has a multi-year capital plan that includes various projects necessary for the continued growth and maintenance of the City's water and sewer utility system. Water and Sewer Revenue Bonds can be issued on an "as-needed" basis and the proposed issuance of bonds is one among several funding sources that will be used to adequately meet the on-going capital related costs of the system. The proposed issuance also includes a potential refunding of all or a portion of the City's Water and Sewer Utility System Revenue Bonds, Series 2001. A final decision on proceeding with the refunding will be made depending upon market conditions as the sale date of the issuance approaches.

The not to exceed amount of \$70 million consists of approximately \$60 million to fund the projects; approximately \$4 million for the refunding; approximately \$0.6 million for costs and fees; and, approximately \$5.4 million as contingency to accommodate changes to the par amounts or any other unforeseen changes in market conditions. The costs and fees are fair and consistent with the services that are being performed by each participant.

RECOMMENDATION

The Finance Department recommends that the City Council approve the resolution of the City of Durham directing the application to the Local Government Commission for approval of Water and Sewer Utility System Revenue Bonds; requesting Local Government Commission approval of the City's Water and Sewer Utility System Revenue Bonds, Series 2011; and certain related matters. This resolution:

- Authorizes the issuance of the Bonds to finance the costs of various improvements to the City's Utility System, including water supply and storage upgrades; water and wastewater treatment improvements; water line and sewer main extension, repair, and replacement; and water meter upgrades; refund all or a portion of the City's Water and Sewer Utility System Revenue Bonds, Series 2001; fund a reserve fund for the 2011 Bonds, if required; and, pay the costs of issuing the 2011 Bonds.
- Authorizes the Financing Team to be retained and approved.

- Authorizes the Finance Director, with advice from the financial advisor and co-bond counsels, to file an application with the Local Government Commission (LGC) for its approval of the issuance of the Bonds.
- Requests LGC approval of the Bonds.
- Authorizes the LGC to sell the Bonds through negotiation to the Underwriters on such terms as may be agreed on but at a true interest cost not exceeding 6.00%.
- Authorizes the Mayor, City Manager, and Finance Director to do any and all other things necessary to complete the steps to issue the Bonds.

BACKGROUND

The City's Water Management Department has a multi-year capital plan that includes various improvements to the City's utility system, including water supply and storage upgrades; water and wastewater treatment improvements; water line and sewer main extension, repair, and replacement; and water meter upgrades. Water and Sewer Revenue Bonds can be issued on an "as-needed" basis for the continued growth and maintenance of the system. The proposed issuance of Bonds is one component in a series of funding sources that will be used to adequately meet on-going capital related costs of the system. The other funding sources include the use of existing cash reserves; future water and sewer rate revenue; and, capital facilities fees (connection fees and impact fees).

This issuance, of not more than \$70 million, is planned for Fiscal Year 2011 and is the first in a series of issuances. To continue to fund the capital plan, it is anticipated that the City will issue additional Water and Sewer Revenue Bonds every other year in the future, including approximately \$140 million in FY13 and \$50 million in FY15. The issuance of debt will be managed to ensure relatively stable debt service.

ISSUES/ANALYSIS

Interest rates for Water and Sewer Revenue Bonds are currently very attractive. Final terms of the transaction will not be known until the sale date, but based upon estimated market conditions, it is anticipated that the interest rate on the planned issuance could be approximately 5% for the 30 year life of the Bonds. There is also a potential to refund all or a portion of the City's outstanding Water and Sewer Revenue Bonds. A final decision on proceeding with the refunding will be made depending upon market conditions as the sale date of the issuance approaches.

There are several sources of information about the general terms and conditions of the Bonds. The Preliminary Official Statement and Bond Resolution provide the basic structure of the transaction and outline the legal requirements for the use of proceeds and revenues of the Water and Sewer Fund. Copies of both documents will be made available in the City Clerk's Office for reference purposes.

Among other things, the terms and conditions include a specified coverage ratio. The coverage ratio is a measure of the amount of financial cushion that the City has within its Water and Sewer Fund to adequately meet the on-going operational and maintenance related costs of the system and to pay debt service on all of the obligations of the fund on an annual basis. The coverage ratio is important because it is one of the driving forces behind the credit ratings issued by the credit rating agencies (Moody's, S&P, and Fitch) that investors use when deciding to purchase the Bonds or not and at what interest rate. The City has a solid track record of financial performance with solid coverage ratios, and it has

historically achieved a high credit rating that helps the City to minimize its overall debt service costs.

ALTERNATIVES

City Council could choose to forego or delay this debt issuance; however, alternative funding sources have not been identified. Additionally, it is anticipated that interest rates will begin to increase later in this calendar year and a delay in the issuance could increase the interest costs of a future debt issuance.

FINANCIAL IMPACT

Unlike General Obligation Bonds, Water and Sewer Revenue Bonds do not require voter approval and are secured by the revenues produced from the water and sewer system. The City pledges to maintain rates and fees in a manner sufficient to repay the Bonds in a timely manner. The issuance of debt for the projects will result in annual debt service payments for the next 30 years.

Based upon estimated market conditions the impact on future water and sewer rate increases is expected to be moderate. Rate increases are anticipated to be held at a maximum of 5% during 2012 and in the near term. It is also important to note that if market conditions are appropriate at the time of sale to proceed with the refunding opportunities, then the debt service associated with the refunded issuance will be decreased thereby offsetting some of the projected increases associated with the new money issuance.

The members of the **Financing Team** retained for this transaction, and a brief description of the services they will provide, are listed below:

Co-Bond Counsels: The law firms hired to represent that City's legal interests in the transaction and to ensure that the Bonds have been issued in compliance with state and federal laws and regulations. The co-bond counsels are Parker Poe Adams & Bernstein LLP, Raleigh, and The Banks Law Firm, P.A., Durham.

Financial Advisor: The firm hired to represent the City's financial interests in the transaction with extensive experience in the issuance of municipal bonds. The financial advisor is Stephens Inc., Charlotte.

Underwriters: The underwriters purchase the entire issue from the City and then distribute the Bonds to individual buyers. The managing underwriters are Citigroup Global Markets Inc., Charlotte, and Merrill Lynch, Pierce, Fenner and Smith (Bank of America Merrill Lynch), Charlotte will serve a more limited role as co-manager.

Underwriters were selected through a Request for Proposal (RFP) that was distributed to more than 20 firms nation-wide in March 2010. A committee consisting of Finance and EO/EA Department personnel and the City's Financial Advisor (Stephens Inc.) evaluated the 16 responses received. Based on the evaluation, the field was narrowed to five firms. The committee completed interviews of the five firms and identified three firms to include in a pool of senior managers for use in upcoming financings. The firms of Citigroup, Wells Fargo/Wachovia Securities, and Robert Baird were selected to serve as the City's managing underwriters for prospective transactions.

The firm of Citigroup was selected to be the manager of the proposed Water and Sewer Revenue Bonds transaction because of their extensive experience in underwriting Water and

Sewer Revenue Bonds in North Carolina, its marketing plan, its financial ability to purchase any unsold bonds for their own inventory in the event the sale is not completed, and its competitive fees. Bank of America Merrill Lynch is also included as a co-manager on the proposed transaction.

Underwriters' Counsel: The law firm that represents the underwriters' legal interests in the transaction. The underwriters' counsel is Robinson Bradshaw & Hinson, P.A., Charlotte.

Trustee: The firm that is a representative of the bond holder, acts as the paying agent for interest and the repayment of principal, and that would assume additional responsibilities in the event of a default. The trustee is U.S. Bank National Association, Charlotte.

Feasibility Consultant: The firm that helps the Water Management Department to develop the water and sewer financial model including rates, cash flow, planning targets, and coverage calculations. The feasibility consultant is Raftelis Financial Consultants, Inc., Charlotte.

SDBE SUMMARY

There are no SDBE issues with regard to this item.

Attachment:

Resolution of the City of Durham, North Carolina, directing the application to the Local Government Commission for approval of Water and Sewer Utility System Revenue Bonds; requesting Local Government Commission approval of the City's Water and Sewer Utility System Revenue Bonds, Series 2011; and certain related matters.