

Date of Hearing: April 10, 2019

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Cecilia Aguiar-Curry, Chair
AB 305 (Nazarian) – As Amended March 12, 2019

SUBJECT: Public capital facilities: public water or wastewater agencies: rate reduction bonds.

SUMMARY: Makes a number of changes to existing law that allows publicly-owned utilities (POUs) that provide water service to form joint powers authorities (JPAs) for the purpose of issuing rate reduction bonds for specified water projects. Specifically, **this bill:**

- 1) Expands the types of POUs allowed to form JPAs and issue rate reduction bonds pursuant to existing law to include those that provide wastewater service, and expands the types of projects that may be financed to include projects that facilitate the use of wastewater by a POU for conservation purposes, and wastewater recycling.
- 2) Allows rate reduction bonds to be used to refinance the types of projects authorized pursuant to existing law and this bill, as specified.
- 3) Alters the definition of “financing costs” to include water or wastewater revenue bonds or loans of a POU that were issued to finance a utility project, as well as the cost of retiring the principal of such bonds.
- 4) Alters the definition of “rate reduction bonds” in a manner that allows them to refund rate reduction bonds, or to refinance water or wastewater revenue bonds of a local agency or a POU issued to finance a utility project.
- 5) Allows a local agency with a public utility having 500,000 or more retail customers to determine, as a condition of applying for rate reduction bond financing, that the use of rate reduction bonds to finance or refinance utility projects provides substantial benefits to the public utility. These benefits may include, but are not limited to, lower interest rates on rate reduction bonds and more favorable capitalization and debt service coverage ratio treatment that results in gross or present value lifetime savings for the public utility. This determination would be allowed in lieu of an existing requirement that the legislative body of the local agency make a determination that the rates of the POU, plus the utility project charge resulting from the financing of the utility project with rate reduction bonds, are expected to be lower than the rates of the POU if the utility project was financed with bonds payable from revenues of the POU.
- 6) Requires the California Pollution Control Financing Authority (CPCFA) to determine that an issue of rate reduction bonds is qualified for issuance if a local agency has made the alternative determination described in 5), above, instead of the determination required pursuant to existing law referenced above.
- 7) Requires CPCFA to determine that an issue of rate reduction bonds is qualified for issuance solely on the basis of the submitted documentation, and prohibits the determination from being conditional in any respect, including conditional on the submission or review of additional material after the determination.

- 8) Eliminates CPCFA review of the issuance of rate reduction bonds by a public utility if the determinations of the local agency that are required to be made before the agency can apply for rate reduction bond financing are subject to review by a ratepayer advocate or similar entity whose function is to provide public independent analysis of a public utility's actions as they relate to water or wastewater rates.
- 9) Requires, upon the issuance of rate reduction bonds, the financing resolution adopted in connection with the issuance to be irrevocable.
- 10) Clarifies that the imposition of a utility project charge shall comply with the requirements of Article XIII D of the California Constitution, including, but not limited to, the provision of a notice containing the initial amount of the proposed utility project charge and the periodic adjustment method by which the utility project charge amount could subsequently change.
- 11) Clarifies that a JPA, in a financing resolution creating utility project property, may require, in the event of default by the local agency or its POU, in payment of revenues arising with respect to the utility project property, that any court in the state, upon the application by the beneficiaries of the statutory lien, and without limiting any other remedies available to the beneficiaries by reason of the default, shall order the sequestration and payment to the beneficiaries of revenues arising with respect to the utility project property. Existing law provides the authority to order sequestration and payment to the JPA.
- 12) Deletes the December 31, 2020, sunset date on existing law authorizing the rate reduction bond program, thereby making it and the provisions of this bill permanent.
- 13) Makes additional conforming and technical changes.

EXISTING LAW:

- 1) Authorizes, under the Joint Exercise of Powers Act (Joint Powers Act), two or more public agencies (i.e. federal government, any state, any state department or agency, county, county board of education, county superintendent of schools, city, public corporation, public district, and regional transportation commission in any state) to enter into a joint powers agreement to exercise jointly any power common to the contracting agencies that each can do by itself.
- 2) Authorizes a JPA to issue rate reduction bonds for local publicly-owned water utilities to finance projects necessary to comply with water quality, water conservation or water reclamation mandates, as specified.

FISCAL EFFECT: This bill is keyed fiscal.

COMMENTS:

- 1) **Author's Statement.** According to the author, "AB 305 provides the Los Angeles Department of Water and Power, and other similarly situated public water utilities, the continued use of an important financing tool to fund groundwater clean-up projects. This bill also extends the ability of Joint Powers Authorities to issue rate reduction bonds for qualified projects for waste water systems and refinance public water utility debt issued for qualified projects. The use of rate reduction bonds will result in interest savings and lower local

borrowing costs, which directly benefits our communities by reducing future utility rate increases.”

This bill is sponsored by the Los Angeles Department of Water and Power (LADWP).

- 2) **Background.** California's Joint Powers Act authorizes the joint exercise of powers by federal, state, and local public agencies that jointly perform functions that each entity may perform on its own. This structure allows multiple agencies to collaborate on addressing public needs, such as financing public infrastructure, forming insurance pools, and enhancing planning and regulation. A joint exercise of powers can be limited to a joint powers agreement (akin to a contract) among participating agencies. It can also include the creation of a new, separate entity that administers the joint powers agreement. These are variously called joint powers agencies or joint powers authorities.

POU activities and rates are regulated by locally elected boards and/or city councils. POUs are subject to the Ralph M. Brown Act, the Public Records Act, and Competitive Bid Requirements.

- 3) **Original Authorization to Issue Rate Reduction Bonds.** AB 850 (Nazarian), Chapter 636, Statutes of 2013, allowed JPAs to issue rate reduction bonds to finance projects for POUs with at least 25,000 retail customers that provide water service. Eligible projects must be for conservation or reclamation purposes or must be necessary to respond to or comply with a water quality mandate, such as a mandate under the Safe Drinking Water Act. Bond proceeds were allowed to fund projects that reduce the amount of potable water supplied by the utility or reduce the amount of water imported by the utility. This included projects for storm water capture and treatment, water recycling, development of local groundwater resources, groundwater recharging, and water reclamation.

LADWP sought this financing structure because it qualifies for a higher bond-rating (AAA) than other types of financing available to the utility, thereby reducing interest rates and financing costs and, ultimately, rates for its customers. LADWP argued that the formation of a JPA to issue the bonds was necessary because rate reduction bonds require a special tariff that is dedicated as a secured asset to the rate reduction bondholders. LADWP noted that, like other municipal water utilities with outstanding revenue bonds, it was limited in its ability to pledge a portion of its revenues only to the rate reduction bondholders. A JPA charging the special tariff would not have such restrictions. In addition, the rate reduction bond issuer must be bankruptcy remote from the municipal water utility collecting the special tariff. An entity that is separate from the municipal water utility (such as a JPA) must issue the rate reduction bonds in order to meet this requirement.

This method of securitization allows a lower debt service coverage ratio by the bond rating agencies due to the enhanced security provided by the dedicated special tariff and bankruptcy remoteness. As a result, the amount of funds collected from customers to meet the debt service coverage ratio is reduced. Individual municipal utilities can have debt service coverage requirements of about two times the annual principal and interest payments of the bonds. With the rate reduction bonds, this can be reduced to one times coverage.

The required debt service coverage ratio for the LADWP Water System is a financial metric adopted by the LADWP Board of Commissioners. These metrics are adopted based on

standards of the bond rating agencies, which publish guidelines for financial metrics related to each rating category, as well as specific rating considerations for the LADWP Water System. Rated entities that wish to qualify for a good credit rating need to establish financial metrics consistent with those rating criteria or risk a downgrade, which increases borrowing costs.

LADWP estimated that ratepayers would save as much as \$3 million per year for each \$100 million of financing under the provisions of AB 805. In the case of LADWP, with its planned spending for water quality and local water supply projects, rates were projected to be 2-4% lower during the course of the ensuing five years than they would have been absent the financing approach allowed by AB 805.

- 4) **Role of CPCFA.** The CPCFA is housed in the State Treasurer's office, and provides low-cost financing for projects that control pollution. It also assists with clean-up of contaminated sites. Among other activities, CPCFA assists the California Alternative Energy and Advanced Transportation Financing Authority, which provides financing for facilities needed to develop and commercialize advanced transportation and alternative energy technologies that reduce air pollution, conserve energy, and promote economic development and jobs.

Amendments to AB 805 taken in the Senate required the CPCFA to review each issue of bonds and determine whether the issue is qualified for issuance under the bill's provisions, "in order to allow the state to review the issuance of rate reduction bonds, collect data, ensure transparency, and conduct an independent analysis of the effectiveness of the use of rate reduction bonds." It also required CPCFA to report annually to the Legislature on its activities related to the bill. According to these annual reports, no one has ever submitted an application for review. Every year the report indicates that CPCFA anticipates receiving an application, but that appears not to have materialized.

- 5) **Challenges in Issuing Rate Reduction Bonds.** According to LADWP, the utility has expended and continues to expend significant resources to implement a rate reduction bond program. These activities have included formation of the JPA in October of 2016, stakeholder and city review and approvals, and extensive interaction with CPCFA. LADWP made substantial progress toward issuing rate reduction bonds in 2017, including production of near final documents and opinions which involved extensive feedback on the rating agency requirements. Unfortunately, work on the issuance of the rate reduction bonds stopped as the result of problems with the implementation of LADWP's new billing system, which prevented LADWP from meeting rating agency requirements for the direct billing and collection of the utility project charge.

LADWP has disclosed the intention to issue rate reduction bonds in all of its Water System Revenue Bond official statements since 2013, and expects initial issuance of rate reduction bonds in 2022. LADWP states that all of the changes proposed by this bill are the result of rating agency requirements raised in connection with the attempt to issue rate reduction bonds in 2017, clarifications the rate reduction bond working group realized were needed resulting from LADWP's efforts to implement a rate reduction bond program, or the result of LADWP's interactions with the CPCFA.

6) **Bill Summary.** This bill eliminates the sunset date and makes a number of additional changes to the original provisions of AB 850. These changes, and LADWP's explanation for each, are summarized here:

- a) This bill expands the types of POUs allowed to form JPAs and issue rate reduction bonds to include those that provide wastewater service, and expands the types of projects that may be financed to include projects that facilitate the use of wastewater by a POU for conservation purposes, and wastewater recycling.

LADWP wishes to increase its local water supply and decrease its reliance on imported water. It also must address challenges of groundwater contamination. LADWP is partnering with the City of Los Angeles to recycle all of the city's wastewater by 2035. The utility also must assist the city in meeting a variety of federal and state environmental mandates. Solutions addressing these challenges will cause significant water and wastewater rate increases absent this bill.

- b) This bill allows rate reduction bonds to be used to refinance projects financed with revenue bonds or loans, as well as projects financed with rate reduction bonds, and alters related definitions.

Starting in 2015, LADWP included the issuance of rate reduction bonds in its capital budget to finance qualifying utility projects. As the result of delays in implementing the rate reduction bond program, LADWP was forced to use its Water System Revenue Bond capacity to finance such projects. The proposed changes would provide LADWP with the flexibility of recapturing this capacity by refinancing Water System Revenue Bond with rate reduction bonds, but only if such Water System Revenue Bonds were issued for utility projects and the requirements of existing law and this bill are met, including savings requirements.

Rating agencies currently limit the amount of rate reduction bonds that an issuer can issue, including refunding bonds (generally the utility project charge would be limited to 20% of total billed amounts). Thus, LADWP's ability to refinance its Water System Revenue Bonds will be limited under these new provisions.

- c) Existing law requires the legislative body of an agency that wishes to apply for rate reduction bond financing to make a number of determinations beforehand. One of these is a determination that the rates of the POU, plus the utility project charge resulting from the financing of the utility project with rate reduction bonds, are expected to be lower than the rates of the POU if the utility project was financed with bonds payable from revenues of the POU.

This bill would instead allow, only for a local agency with a public utility having 500,000 or more retail customers, a determination that the use of rate reduction bonds to finance or refinance utility projects provides substantial benefits to the public utility. These benefits may include, but are not limited to, lower interest rates on rate reduction bonds and more favorable capitalization and debt service coverage ratio treatment that results in gross or present value lifetime savings for the public utility. This bill makes conforming changes to the process by which CPCFA determines that an issue of rate reduction bonds is qualified.

Current law does not reflect the full benefits of the rate reduction bond program to LADWP. If it elects to use the alternative determination, LADWP will include the differential between the expected rating on the rate reduction bonds (AAA) and its water system revenue bonds (in the AA range) as one of the elements in meeting the requirements of the alternative determination. This determination also requires “gross or present value lifetime savings for the public utility,” thus providing protection to ratepayers.

- d) This bill requires CPCFA to determine that an issue of rate reduction bonds is qualified for issuance solely on the basis of the submitted documentation, and prohibits the determination from being conditional in any respect, including conditional on the submission or review of additional material after the determination.

Although LADWP believes the limited nature of CPCFA review and approval is clear in current law, confusion arose in the regulation promulgation process, and the preliminary application regarding the scope of CPCFA review and approval process. Ambiguities and conditions in regulatory approvals will be considered a negative if they exist at the time discussions are initiated with the rating agencies and various market participants, which is when a financing resolution will begin to be prepared and discussed. A conditional determination creates uncertainty and presents marketing and credit rating issues. These changes are intended to clarify and provide better guidance on the review process.

- e) This bill eliminates CPCFA review of the issuance of rate reduction bonds by a public utility if the determinations of the local agency that are required to be made before the agency can apply for rate reduction bond financing are subject to review by a ratepayer advocate or similar entity whose function is to provide public independent analysis of a public utility’s actions as they relate to water or wastewater rates.

The ratepayer advocate would provide an identical review and report in lieu of CPCFA. The Office of Public Accountability’s role was created by the voters of the City of Los Angeles to provide public independent analysis of LADWP actions as they relate to water and electricity rates. It is charged with analyzing proposed increases in water and power rates (which, among other things, review LADWP’s revenue bonds issuance) on a timely and continuous basis and to assure LADWP’s transparency and accountability to its customers and reasonableness of its policies and rates. The OPA functions independently of the LADWP and its management structure, and the City Council, Mayor and City Controller.

- f) This bill requires, upon the issuance of rate reduction bonds, the financing resolution adopted in connection with the issuance to be irrevocable.

LADWP made substantial progress on issuing rate reduction bonds in 2017. As a result, LADWP received substantial feedback from the financing team on rating agency requirements for the rate reduction bonds. The rating agency will require that the statute specifically provide that the financing resolution is irrevocable.

- 7) **Committee Amendments.** This bill eliminates the sunset date on the rate reduction bond authority in existing law as well as the changes this bill makes to that law. Given that no one

– including the agency that requested it – has yet used this authority, it would seem prudent to retain a sunset date to allow the Legislature to review its progress and implementation. LADWP indicates it expects to begin issuing rate reduction bonds in 2022. The Committee may wish to consider amending the bill to re-establish a sunset date of December 31, 2026.

- 8) **Arguments in Support.** LADWP, sponsor of this bill, writes, “AB 305 removes the sunset date in the Joint Exercise of Powers Act of the California Government Code that allows rate reduction bonds to be issued by municipal water utilities that form a JPA. AB 305 also extends this benefit to wastewater utilities and provides clarification to streamline approvals while ensuring ratepayer protection...

“LADWP has embarked on an aggressive sustainability plan to increase its local water supply and decrease its reliance on imported water, while also dealing with significant challenges of groundwater contamination. One example of the City’s ambitious local supply initiative is LADWP’s partnership with the City of Los Angeles...to recycle 100 percent of the City’s wastewater by 2035. Numerous other challenges face the City in the years ahead, including meeting an array of federal and state environmental mandates. Solutions addressing these challenges will cause significant water and wastewater rate increases under the status quo.”

- 9) **Arguments in Opposition.** None on file

REGISTERED SUPPORT / OPPOSITION:

Support

Los Angeles Department of Water and Power [SPONSOR]

Opposition

None on file

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