



ADMINISTRATION COMMITTEE

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Agenda Report

File #: 2021-1542

Agenda Date: 3/24/2021

Agenda Item No: 8.

FROM: James D. Herberg, General Manager
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SUBJECT:

WASTEWATER REFUNDING REVENUE OBLIGATIONS, SERIES 2021A

GENERAL MANAGER'S RECOMMENDATION

RECOMMENDATION:

Authorize the General Manager to issue new fixed rate Certificates of Participation, to be referred to as Wastewater Refunding Revenue Obligations, in (1) an amount sufficient to refund \$102,200,000 of Revenue Refunding Certificate Anticipation Notes, Series 2018A maturing on August 15, 2021 and (2) an additional amount sufficient to refund, subject to market conditions, up to \$61,575,000 of Wastewater Refunding Revenue Obligations, Series 2011A.

BACKGROUND

Revenue Refunding Certificate Anticipation Notes, Series 2018A

The borrowing cost on the current outstanding Revenue Refunding Certificate Anticipation Notes Series 2018A (2018A CANs) is fixed for 33.5 months and the entire \$102,200,000 plus interest becomes due and payable on August 15, 2021. The Orange County Sanitation District (Sanitation District) is responsible for a total repayment, including interest due, of \$104,755,000 or the Sanitation District could choose to refinance the 2018A CANs. Due to the current near historically low tax-exempt cost of fixed rate debt, staff does not recommend the use of \$105 million of reserves to repay the 2018A CANs.

In March 2006, the Sanitation District issued \$200 million of variable rate Certificates of Participation (COP), Series 2006 (2006 COPs). Alternatively, the Sanitation District could have issued debt, at an estimated cost of 4.54%, on a fixed rate basis in 2006 ("2006 Fixed Rate"). For the initial 27 months through August 2008, the average variable rate on the 2006 COPs was 2.95% or 0.22% less than the SIFMA index (weekly market index of tax-exempt variable rate obligations). As the global financial crisis took hold of the markets in the late summer of 2008, there was a significant increase in the variable rate borrowing cost to the Sanitation District, including many other municipal variable rate borrowers, with the 2006 COPs averaging 4.29% (or 1.56% above the SIFMA index) for the period between September 2008 and December 2008. The amount of the variable rate cost increase above the SIFMA index can be attributed to the weakened financial strength of the bank, DEPFA Bank plc, that was providing liquidity support on the 2006 COPs. Even with the increase in interest rates

during this period of unprecedented stress, the 4.29% average cost was still lower than the 2006 Fixed Rate of 4.54%.

In December 2008, the Sanitation District proactively refunded the 2006 COPs with the fixed rate Refunding COP Series 2008C Certificate Anticipation Notes (2008C CANs) yielding 0.98% for a one-year period to reduce its exposure to then higher and more volatile variable rate costs and to avoid relying on liquidity support from weakening banks. The issuance of the 2008C CANs allowed the Sanitation District to redeem the 2006 COPs at an all-in cost of less than 1.25% and avoid paying a bank rate of 4.75% which would have been effective starting a month later. Since the 2008C CANs issuance, the Sanitation District completed five additional one-year refinancings at progressively lower yields, followed by two 25-month refinancings starting in 2014, and with the most recent 33.5-month refinancing in 2018, as summarized below:

Series	Principal Amount	Maturity	Yield	All-in Cost
2009B	\$ 165,865,000	1 Year	0.370%	0.559%
2010B	154,665,000	1 Year	0.360	0.525
2011B	143,205,000	1 Year	0.225	0.399
2012C	131,700,000	1 Year	0.210	0.410
2013A	129,625,000	1 Year	0.170	0.390
2014B	120,850,000	25.0 months	0.320	0.523
2016B	109,875,000	25.5 months	0.840	1.002
2018A	102,200,000	33.5 months	1.940	2.134

Wastewater Refunding Revenue Obligations Series 2011A

The Sanitation District's Wastewater Refunding Revenue Obligations Series 2011A (2011A Revenue Obligations) are subject to optional redemption on August 1, 2021. As interest rates are now lower than in 2011, there is the potential opportunity to refinance a portion of the outstanding 2011A Revenue Obligations to reduce interest costs for the Sanitation District. Under current market conditions, a refunding of \$61,575,000 of the Series 2011A Revenue Obligations would generate more than 3% net present value savings (the minimum percentage required by the Sanitation District's debt policy).

Shorter term tax-exempt interest rates were consistently low between 2011 and 2016, then these rates steadily increased until 2018. Since 2018, shorter term tax-exempt rates have been in a downward trend as shown in the history for the AAA General Obligation Municipal Market Data Index for 3-year (reflective of the average life of the potential 2011A Revenue Obligations refunding candidates) and 5-year tax-exempt maturities (reflective of the maximum maturity of the potential 2011A Revenue Obligations refunding candidates). Please see Exhibit A on the AAA General Obligation Municipal Market Data Index attachment.

RELEVANT STANDARDS

- Sanitation District Debt Policy - Financial Management Policy and Procedure 201-3-1; restructuring outstanding debt is desirable and refunding to achieve debt service savings

PROBLEM

2018A CANs

The 2018A CANs are due and payable on August 15, 2021 in the amount of \$104,755,000. The 2018A CANs were issued with a short-term 33.5-month rate with the expectation that upon maturity the issue would be refinanced.

2011A Revenue Obligations

\$61,575,000 of the 2011A Revenue Obligations are currently accruing interest at rates ranging from 3.25% to 5.00%, which are higher than current market yields, and will soon be available for optional redemption on August 1, 2021.

PROPOSED SOLUTION

2018A CANs

The issuance of long-term fixed rate debt would allow the Sanitation District to repay the 2018A CANs at a low cost (1.51% based on current market conditions as of February 24, 2021) and avoid using \$105 million of reserves for such purpose.

2011A Revenue Obligations

The Sanitation District could refund up to \$61,575,000 of the 2011A Revenue Obligations for net present value debt service savings of approximately \$7.24 million (equal to 11.8% of refunded principal), based on current market conditions as of February 24, 2021, with a matching refunding amortization structure.

TIMING CONCERNS

2018A CANs

The Sanitation District must complete a refinancing by no later than August 15, 2021; otherwise, \$105 million of reserves will be required to repay the 2018A CANs.

2011A Revenue Obligations

The Tax Cuts and Jobs Act of 2017 eliminated the ability of issuers to conduct tax-exempt advance refundings (more than 90 days prior to the optional redemption date). However, the Sanitation District can conduct a current refunding if the 2011A Revenue Obligations are redeemed no earlier than 90 days before the August 1, 2021 optional redemption date. A refunding past August 1, 2021 would result in the Sanitation District continuing to pay interest costs above current market yields.

RAMIFICATIONS OF NOT TAKING ACTION

2018A CANs

Not taking action by August 15, 2021 would cause the Sanitation District to use its reserves to repay the 2018A CANs or cause an "Event of Default" due to the non-repayment to lenders. The economic ramification of an Event of Default would result in a downgrade in credit ratings, reduced access to capital and higher costs of borrowing.

2011A Revenue Obligations

Not refunding the 2011A Revenue Obligations would result in the Sanitation District continuing to pay above market interest costs.

PRIOR COMMITTEE/BOARD ACTIONS

September 2018 - Approved Resolution No. OCSD 18-17, authorizing the execution and delivery by the Sanitation District of an Installment Purchase Agreement, a Trust Agreement and a Continuing Disclosure Agreement in connection with the execution and delivery of Orange County Sanitation District Revenue Refunding Certificate Anticipation Notes, Series 2018A, such Notes evidencing principal in an aggregate amount of not to exceed \$109,875,000, approving a Notice of Intention to Sell, authorizing the distribution of an Official Notice Inviting Bids and an Official Statement in connection with the offering and sale of such Notes and authorizing the execution of other necessary documents and related actions.

December 2016 - Approved Resolution No. OCSD 16-32, authorizing the execution and delivery by the Sanitation District of an Installment Purchase Agreement, a Trust Agreement and a Continuing Disclosure Agreement in connection with the Orange County Sanitation District Wastewater Refunding Revenue Obligations, Series 2017A, authorizing the execution and delivery of such Revenue Obligations evidencing principal in an aggregate amount not to exceed \$91,620,000, approving a Notice of Intention to Sell, authorizing the distribution of an Official Notice Inviting Bids and an Official Statement in connection with the offering and sale of such Revenue Obligations and authorizing the execution of necessary documents and related actions.

ADDITIONAL INFORMATION

2018A CANs

The issuance of long-term fixed rate debt to refund the 2018A CANs will eliminate any future market access risks (ability to issue debt to refinance maturing debt) and interest rate risk (additional costs if rates reset higher or are higher upon a future refinancing). After the issuance of fixed rate debt, the Sanitation District will no longer be exposed to changing market conditions.

Most recently, tax-exempt rates have reached historic lows due to the lack of supply of tax-exempt debt coupled with more municipalities selling taxable debt. Current fixed rates are near historical low yields as shown in the history for the AAA General Obligation Municipal Market Data Index for 10-year (close to the 8.6 year average life of fixing out the 2018A CANs) and 15-year tax-exempt

maturities (reflective of the maximum maturity of fixing out the 2018A CANs). Please see Exhibit B on the AAA General Obligation Municipal Market Data Index attachment.

In 2006, the Sanitation District intended to partially hedge against fluctuating investment portfolio earnings as the variable rates on the 2006 COPs were expected to move in tandem with changes in short-term interest rates. The 2006 COPs and subsequent CANs refinancings have mirrored short-term tax-exempt variable rate costs. The issuance of fixed rate debt to refund the 2018A CANS would remove the interest rate hedge originally desired by the Sanitation District.

When the 2006 COPs were issued, the expectation of the Sanitation District was to not only hedge investment interest rate risk, but to also reduce the risk from rising interest rates resets by implementing an Accelerated Rate Management (ARM) program. Between 2006 and 2012 and in 2016, the ARM program used accrued savings, resulting from borrowing at rates lower than the 2006 Fixed Rate of 4.54%, to reduce the outstanding amount of debt at the time of each refinancing. With less outstanding debt, the Sanitation District likewise reduced its interest rate risk (if higher interest rates were to occur, the negative impact would be mitigated as the higher interest cost would be calculated on a smaller outstanding amount). The implementation of the ARM program since the issuance of the 2006 COPs has (1) reduced the outstanding principal by nearly \$30 million compared to a 2006 fixed rate amortization and (2) decreased the interest rate risk to the Sanitation District as the break-even rate (the average future interest rate for the remaining debt which would result in no difference in cost from issuing fixed rate debt in 2006) is now over 15.6%. The original variable rate structure of the 2006 COPs and the past nine CANs refinancings have already saved the Sanitation District over \$68 million compared to the alternative of the Sanitation District issuing fixed rate debt in 2006.

The Sanitation District could refinance the 2018A CANs with another CANs financing as short-term interest rates are currently extremely low and future short-term interest rates may continue to stay low; however, the associated upfront costs of refinancing on a shrinking amount of outstanding principal makes every dollar of cost more impactful. A refinancing of the 2018A CANs with other variable debt products is also possible, but would also require the payment of ongoing costs, most notably the relatively high bank liquidity fees that require periodic renewals (generally every one to five years); in addition, to the risk of rising interest rates. Therefore, staff is recommending the refunding of the 2018A CANs with longer term fixed rate debt having a final maturity date of February 1, 2036 (which is no longer than the final maturity of the original 2006 COPs). The new refunding debt is expected to be structured with level debt service which based on market conditions as of February 24, 2021, is currently estimated to be approximately \$7.61 million per year.

2011A Revenue Obligations

The Sanitation District currently has ten series of debt issuances outstanding (including the 2018A CANs) in the par amount of \$909,620,000 as shown in the table below:

	Outstanding Par Amount ⁽¹⁾
Series 2018A CANs	\$ 102,200,000
Series 2017A Refunding	65,815,000
Series 2016A Refunding	136,830,000

Series 2015A Refunding	127,510,000
Series 2014A Refunding	56,080,000
Series 2012B Refunding	8,170,000
Series 2012A Refunding	100,645,000
Series 2011A Refunding	75,370,000
Series 2010C	157,000,000
Series 2010A	80,000,000
Total:	\$ 909,620,000

(1) As of February 15, 2021

Depending on market conditions, staff is proposing to refund up to \$61,575,000 of the 2011A Revenue Obligations maturing in years 2023 through 2026 with annual coupon rates ranging between 3.25 to 5.00%, as shown in the table below:

Maturity	Principal Amount	Coupon	Call Date
2/1/2023	\$ 14,435,000	4.00%	08/01/2021
2/1/2024	15,055,000	5.00%	08/01/2021
2/1/2025	15,760,000	3.25%	08/01/2021
2/1/2026	16,325,000	5.00%	08/01/2021
Total:	\$ 61,575,000		

Timeline

Assuming that staff receives approval to pursue the refinancings of the 2018A CANs and 2011A Revenue Obligations, staff will return to the Administration Committee in May 2021 with financing documents to complete the refinancings. There is the possibility that interest rates may change before May and, at the time of approval of the financing documents and based on market conditions at that time, staff may recommend different refinancing structures. The refundings of the 2018A CANs and 2011A Revenue Obligations can be combined into one financing which will minimize issuance costs and be sold on a competitive basis in order to obtain the lowest financing cost possible.

Staff and consultants will be available to answer any questions at the Administration Committee meeting.

Following is a chart listing the remaining steps to be completed for the debt refinancings:

<p>May:</p> <ul style="list-style-type: none"> - Board approval of legal and disclosure documents - Financing Corporation approval of legal and disclosure documents <p>June:</p> <ul style="list-style-type: none"> - Request ratings from bond rating agencies - Rating agency discussions
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July:

- Receive ratings from rating agencies
- Marketing and sale through a competitive sale process
- Closing
- Begin debt administration

All costs involved with the refinancings, including costs for Norton Rose Fulbright, Special Counsel and Disclosure Counsel and Public Resources Advisory Group, Municipal Advisor, will be paid from the proceeds of the new refunding issue.

ATTACHMENT

The following attachment(s) may be viewed on-line at the OC San website (www.ocsan.gov) with the complete agenda package:

- AAA General Obligation Municipal Market Data Index