

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (IBank)

STAFF REPORT

**INFRASTRUCTURE STATE REVOLVING FUND (“ISRF”) PROGRAM DIRECT FINANCING
EXECUTIVE SUMMARY**

Applicant: City of Santa Cruz (“City”)		ISRF Project Type: Sewage Collection and Treatment
Financing Amount: \$30,000,000 (“Financing”)	Financing Term: 30 years	Interest Rate: 2.50% ¹
Source of Repayment: Net system revenues and all legally available amounts in the City’s Wastewater Enterprise Fund (“Fund”)		Existing Debt Rating/Date: S & P AAA, Fitch AAA November 2, 2005
Project Name: UV Replacement and Main Power Projects (“Project”)		Project Location: 110 California Street, Santa Cruz, CA 95060

Project Description / Sources and Uses of Proceeds:
The Project generally consists of a variety of improvements to the City’s Wastewater Treatment Plant (“WWTP”) secondary treatment and recycled water infrastructure.

The Project includes, but is not limited to, the following two main elements:
 1. Ultraviolet Disinfection System Replacement, and
 2. Main Power Distribution System Replacement (“Main Power”)

The second element is further divided into the following: 1)The replacement of the WWTP’s existing electrical system; 2) the replacement of three antiquated Emergency generators; and 3) the replacement of substation 4 switch-gear with a new higher capacity switch-gear.

Use of Financing Proceeds

The Financing would fund all components necessary to complete the Project, including, but not limited to equipping, installation, design, engineering, construction, construction contingency, demolition, permitting, entitlement, construction management, project administration, and general project development activities.

Project Uses	Project Sources		
	IBank	City of Santa Cruz	Total
UV Replacement and Main Power Projects (Project)	\$30,000,000	\$7,532,453	\$37,532,453
Origination Fee		\$300,000	\$300,000
Total	\$30,000,000	\$7,832,453	\$37,832,453

A construction contingency of \$7,717,869 will be set-aside from the Project Sources for cost overruns, unforeseen conditions, and the like. The City will contribute \$7,532,453 of contingency funds and IBank’s financing would contribute \$185,416 of contingency funds and the City would pay IBank’s \$300,000 Origination fee.

¹ Interest Rate quoted July 20, 2020

Credit Considerations:

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

CASH FLOW					
For Fiscal Year Ending (FYE) June 30	2015	2016	2017	2018	2019
Operating Income (Loss)	(\$1,603,389)	\$403,711	(\$444,967)	(\$613,720)	(\$1,101,253)
Transaction Specific Adjustments					
Depreciation and Amortization	\$4,136,944	\$4,261,475	\$4,233,442	\$4,257,130	\$4,248,268
Investment Earnings (Discounted 30%)	223,889	77,134	66,897	106,962	266,224
Transfer Out	(26,085)	(74,712)	(86,458)	(240,765)	(248,055)
Total of all Adjustments	4,334,748	4,263,897	4,213,881	4,123,327	4,266,437
Cash Available for Debt Service	\$2,731,359	\$4,667,608	\$3,768,914	\$3,509,607	\$3,165,184
Debt Service Calculation					
Total Existing MADS Debt Service	\$338,573	\$338,573	\$338,573	\$338,573	\$338,573
Proposed IBank MADS ⁽¹⁾	1,514,788	1,514,788	1,514,788	1,514,788	1,514,788
Total Obligations MADS	\$1,853,360	\$1,853,360	\$1,853,360	\$1,853,360	\$1,853,360
Debt Service Coverage Ratio ⁽²⁾	1.47	2.52	2.03	1.89	1.71
⁽¹⁾ Calculated as \$30,000,000 at 2.50% for 30 years ⁽²⁾ Existing Parity Debt Minimum Required DSCR 1.15					

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 1.47 or greater in the years reviewed. Investment Earnings were discounted 30% to reflect potential fluctuations due to economic factors. Refer to the Cash Flow and Debt Service Analysis section of this Staff Report for further details.

Support for Staff Recommendations:

1. The City has successfully increased rates to maintain its debt service ability.
2. The estimated useful life of the Project is over 40 years, longer than the Financing term.
3. Cash flow demonstrates the Fund’s ability to service the existing debt and proposed Financing.

Rate Challenge:

1. A City utility payer has filed a class action lawsuit alleging generally the City’s sewer rates exceed those permissible by Proposition 218 (“Prop 218”). The lead plaintiff’s allegations are general in nature and provide no factual detail supporting his claims of non-compliant sewer utility rates. The City asserts the plaintiff’s claims have no merit and that its rates comply with Prop 218. Nonetheless, the City contends that even if the plaintiff class were to prevail it has sufficient funds and sufficient ability to adjust rates to ensure payment of all debt service as and when due.

Criteria Waivers:

1. IBank’s Criteria, Priorities, and Guidelines for the Selection of Projects for Financing Under the ISRF Program provides that financings are typically available in amounts between \$50,000 and \$25 million, but that the Board may approve financings over \$25 million. The City has a four-year payment history with IBank on two existing loans that have an outstanding balance of \$28.8 million and paying as agreed. These are unrelated to the City’s Fund.
2. 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 36 months.
3. 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 the Criteria.

IBank Staff: Lina Benedict and John Weir	Date of Staff Report: August 25, 2020
Date of IBank Board Meeting: September 23, 2020	Resolution Number: 20-18
Staff Recommendation: Staff recommends approval of Resolution No. 20-18 authorizing ISRF Program financing to the City of Santa Cruz for UV Replacement and Main Power Projects in an amount not to exceed \$30,000,000.	

PROJECT DESCRIPTION

The City requests ISRF Program Financing in the amount of \$30,000,000 to fund the Project. The Project includes two main elements:

1. Ultraviolet Disinfection System Replacement, and
2. Main Power Distribution System Replacement (“Main Power”)

The second element is further divided into the following components:

- 1) The replacement of the WWTP’s existing electrical system; (2) the replacement of three antiquated Emergency generators; and 3) the replacement of substation 4 switch-gear with a new higher capacity switch-gear.

The Project will ensure the continued reliability and energy efficiency of the WWTP. This facility, which serves approximately 130,000 residents, was originally constructed in 1928 and has been continually updated and improved since then. The Project is the latest of the City’s efforts to continually improve its WWTP.

Ultraviolet Disinfection System Replacement

The City disinfects treated wastewater with a Trojan UV4000 medium-pressure UV system. This disinfection system was installed in 1997 and is nearing the end of its useful life. The City is interested in replacing the outdated UV4000 system with a more energy efficient and more reliable UV disinfection system.

The WWTP is located on the coast and discharges directly into the Pacific Ocean. UV disinfection is the final critical treatment process prior to discharge to the Pacific Ocean (Exhibit 1). It ensures no dangerous waste products are discharged to the ocean and preserves the marine environment.

In addition to ensuring continued effective WWTP operations, the UV Disinfection System Replacement will achieve some cost savings. The existing UV system to be replaced is very labor intensive to maintain. The new UV bulbs and controls will reduce energy consumption cost from \$90,000 to \$30,000 per year. Maintenance will be significantly reduced as the bulbs are self-cleaning as opposed to the current manual cleaning needed every month. The existing system parts are difficult to obtain and are costly. The new system will have an excellent warranty policy and guaranteed price list for replacement bulbs.

Main Power Distribution System Replacement

The Main Power Project component will increase the reliability of the WWTP electrical system. This Project component will replace several critical electrical system elements that are either damaged, undersized, obsolete, or nearing the end of their useful life. The new system will emphasize reliability and ease of maintenance. The Main Power component of the Project includes the following three components:

1. The replacement of WWTP’s existing electrical system -21kV Electrical Service Connection. Power for the WWTP is provided through a 21kv service connection from PG&E to the WWTP main switchgear. The power is then distributed throughout the facility via underground duct banks to eight switchgear/transformers. After power is stepped down to 480 volts, and in one process area stepped down to 2400v, it feeds the control panels for the WWTP processes.

The main service connection is water damaged and must be replaced. The Project will include installing a 21kV main service feed, a below-grade service conduit system with watertight connections, a PG&E system interface, and switchgear placed on an elevated pad to avoid flooding, all together with necessary cabling. Following this, all existing cabling will be removed.

2. The replacement of emergency generators

Backup generators are critical to run the facility during power outages. Power loss could impact WWTP operations and prevent it from treating wastewater as it flows into the system. Two of the existing generators are over 25 years old and one is over 50 years old and replacement parts are difficult to procure. The Project includes replacement of all three backup emergency diesel generators with two new more efficient 2-megawatt generators.

3. Replacement of Electrical Substation 4 Switchgear

The switchgear in one of the WWTP's electrical substations is undersized and needs to be replaced due to a recent increase in the flow of electricity from the WWTP's cogeneration facilities. Additionally, the substation itself requires improvements and upgrades to handle the increased flow.

The City is in the process of hiring a consultant to design the Project and put together bidding documents.

The City has determined that the Project ultimately will reduce WWTP operations and maintenance costs. The existing systems being replaced require significant maintenance and repair efforts and the City forecasts the Project will help to reduce these costs.

The City has not yet determined the total operations costs savings from the Project. However, cost savings are only a secondary benefit of the Project. The City is undertaking the Project primarily to ensure the reliability, effectiveness, and efficiency of its wastewater treatment.

PUBLIC AND PROJECT BENEFITS

The primary Project benefit will be to ensure the continued successful operations of the WWTP. Each Project component is necessary for the WWTP to effectively and efficiently treat the daily inflow of raw sewage. Without the Project, WWTP service could be interrupted or diminished. Untreated or partially treated sewage could be discharged to the Pacific Ocean. Needless to say this would both prevent the City's residents' from enjoying their surrounding natural environment and would negatively impact the City's tourism industry. This industry depends on clean beaches made possible by a dependable wastewater facility. Additionally, the City expects the Project to result in a significant reduction in energy usage. The UV system upgrade alone will reduce energy consumption and reduce energy costs from an average of \$90,000 per year to \$30,000 per year.

ECONOMIC BENEFITS

The City anticipates the creation of 50 jobs during the construction period at an average wage of \$50.00 per hour. Additionally, the City expects the Project will reduce WWTP operations and maintenance expenses. The Project will result in new, easier to maintain, and more energy efficient equipment, which should reduce maintenance and repair costs as well as energy costs.

GENERAL CITY INFORMATION

The City is a charter city incorporated in 1866 and located on the northern part of the Monterey Bay, approximately 74 miles south of San Francisco and 30 miles west of San Jose. The City has an area of 12 square miles and an estimated population of 65,070 as of January 2017.

The City of Santa Cruz is governed by a seven member City Council. Currently, Council members are elected

at-large, for four-year terms, with elections occurring biannually in even-numbered years, and alternating between three and four seats up for election each cycle.

The City and County of Santa Cruz are closely tied to the regional economy of the nine-county San Francisco Bay Area and to Silicon Valley. Local private employers include a diverse array of manufacturing, business services, retail, hotel and food services, and biotechnology companies.

In addition to the local private employers, the local economy also benefits from public entities such as the City of Santa Cruz and the University of California Santa Cruz which is the City's largest employer with over 4,200 employees.

The City of Santa Cruz provides a broad range of services including police and fire protection and the operation and maintenance of streets, parks, flood control facilities, and other infrastructure. It also operates municipal utilities for water, wastewater, storm water, and solid waste, and operates a parking facilities enterprise.

SYSTEM DESCRIPTION

The City's Wastewater system utility, which provides wastewater collection and treatment services to the residents of the City and wastewater treatment services to many Santa Cruz County residents living outside the City limits. Revenue from the city's wastewater collection and treatment activities are collected in the Fund.

The WWTP has received numerous awards including the 2013 "State Plant of the Year" award by the California Water Environmental Association. The facility continuously uses methane gas from the treatment process to generate electricity that powers approximately 70% of the facility's needs. The WWTP has been an Environmental Protection Agency ("EPA") Green Power Partner since 2010. The Green Power Partnership is voluntary and helps to achieve clean air by reducing pollution and corresponding health and environmental impacts associated with conventional electricity use. Partners commit to use green power for all, or a portion, of their annual electricity consumption.

The WWTP is a regional wastewater treatment facility. This means it treats wastewater from a geographic region that extends beyond City limits. The WWTP treats approximately eight million gallons of wastewater each day. That includes practically all water used indoors by the 130,000 people who reside in Santa Cruz as well as Live Oak, Capitola, Soquel, Aptos, which are outside of City of Santa Cruz city limits, and at the University of California, Santa Cruz. The Live Oak, Capitola, Soquel, and Aptos areas make up the Santa Cruz County Sanitation District ("SCCSD").

The WWTP has been treating the SCCSD wastewater for over 40 years. The SCCSD is responsible for their collection system and the transmission pipeline to the WWTP. SCCSD has capacity rights of 8 million gallons per day ("mgd") of the 17 mgd capacity of the WWTP.

The City's wastewater collection system consists of approximately 160 miles of pipeline ranging from 6 to 54 inches in diameter and 17 small to medium pump stations. The entire collection piping system is cleaned approximately every 18 months. Pumps are checked weekly. Most of the medium sized stations have been fully renovated in the last 20 years. Each year, about one to five miles of sewer pipelines are replaced or rehabilitated at a cost of approximately \$1.5 million. The City relates that both the WWTP and the sewer collection system have adequate capacity for the foreseeable future.

Major improvements to the treatment and disposal system have been completed over the last 35 years. In 1987 over two miles of 6-foot diameter pipe was installed along the ocean floor from the beach at Almar and West Cliff to a point over one mile offshore from Terrace Point. This location is ideal for discharging treated wastewater since the discharge location is out of the bay currents and into the open ocean and over 100 feet below the water surface. The cost of this project was \$20 million.

In 1991, a three-year construction project was completed to modernize and improve the WWTP's treatment processes. This was the first major improvement to the WWTP since 1975 and brought the City into compliance with the California Ocean Plan requirements for deep ocean disposal. The cost of that project was \$40 million.

In 1998 the City completed the construction of secondary treatment upgrades. The additional pumps, biological filters and tanks provide treatment to meet the most stringent federal requirements. This project cost \$60 million.

Two of the most innovative systems at the WWTP are the UV light disinfection system and the cogeneration system that generates electricity utilizing methane gas, which is a by-product of the anaerobic digestion of bio solids.

The City's WWTP maintenance staff provides routine preventative maintenance for all plant equipment. This extends the life of the equipment and ensures that the equipment will operate properly.

The City is close to "built out." Wastewater generation has decreased over the last ten years due to a continued demographic shift toward residential land use. Wastewater generation is not expected to see an appreciable increase over the next five years. Demand for service will be mostly residential with an expected annual growth of 2-4%. Over the last 20 years several large water intensive industrial businesses left the city, leaving sufficient capacity in the system for the foreseeable future.

System Capital Improvement Plan (CIP)

As explained above, system capacity is not an issue. Capital improvements focus on maintaining the system's reliability and efficiency. The subject project is included in the 2019-2020 CIP plan.

The City is working with the Regional Water Quality Control Board ("RWQCB") to resolve two issues. First, the City has a total organic carbon ("TOC") discharge limit. This is unusual for wastewater treatment facilities. The discharge limit replaces the more typically used biological organic demand ("BOD") limit. During the last several years, the influent concentration of TOC has increased and the WWTP's effluent has exceeded the TOC limit several times during the last 12 months. The City has implemented several operational changes and some mechanical improvements, but at times still exceeds the limit.

The City is working with the RWQCB to either eliminate the TOC limit and reinstate the BOD limit, which is the standard established by the EPA, or increase the TOC limit based on new empirical data.

Second, the deep ocean outfall has had an intermittent small leak for about 30 years. The leak is located approximately 70 feet below the ocean surface and over half a mile offshore. About 25 years ago, the City determined that the leak was minor and has since been performing monitoring activities such as bacteria testing and has found no indication that the leak has caused any environmental or other problem. Recently, RWQCB requested the City to "address" the leak. The City submitted a report to the RWQCB "addressing": the leak but has not received a response yet. The City anticipates that no construction project will result from its interaction with RWQCB.

Over the next five to 10 years the following smaller projects are planned:

- Upgrade Digester Equipment
- Water piping rehabilitation
- Laboratory modernization

These projects will be funded with the City's cash reserves, service charge revenues, and rate increases as needed.

The following table displays the number of users by category and reflects stability with number of users over 15,366 in the past five years. The table further reflects a high proportion of residential users.

NUMBER OF USERS BY CATEGORY

Calendar Year *	2015	2016	2017	2018	2019
Residential	14,060	14,125	14,126	14,147	14,161
Commercial	1,233	1,241	1,232	1,227	1,228
Industrial	30	30	31	31	30
Other	43	42	42	43	42
Total	15,366	15,438	15,431	15,448	15,461
% change	N/A	0.5%	0.0%	0.1%	0.1%

Source: Financing Application Addendum

* The city of Santa Cruz Municipal Utilities division can only report their users based on calendar year, not fiscal year.

The table below displays current system usage and revenues. Residential users accounted for 69.32% of total revenues and 63.68% of annual system usage.

CURRENT SYSTEM USAGE & REVENUE

	Annual Usage (CCF) ⁽¹⁾	% Annual Usage	Gross Annual Revenue	% Gross Annual Revenue
Residential	1,147,019	63.68%	\$10,623,601	69.32%
Commercial	400,664	22.24%	\$2,293,039	14.96%
Industrial	56,928	3.16%	\$309,610	2.02%
Other	196,561	10.91%	\$2,098,100	13.69%
Total	1,801,172	100.0%	\$15,324,350	100.0%

Source: Financing Application

⁽¹⁾ Hundred cubic feet

Although the table above shows that some groups' percentage costs exceed their percent of system use, nonetheless each group is paying its proportional cost of service because the rates include wastewater strength factors that changes the cost of treatment. For example, a restaurant is charged more per gallon than a stationary store. Similarly, a residence is charged more per gallon than many retail uses, since residential wastewater is generally more expensive to treat.

The City reviews rates on an annual basis and has adopted rate increases in the fiscal years (FY) 2016 through 2020 as shown in the table below. These rate increases were planned to begin the process of raising revenue to construct capital improvements under the CIP. The table displays the Historical Rate Increases adopted over the past five years and reflects the City's ability to increase rates to meet its operational and capital improvement needs. The City has conferred with its attorneys and consultants and believes its current rate structure complies fully with all laws related to setting utility rates, including Proposition 218.

HISTORICAL RATE INCREASES OF THE PAST FIVE YEARS

Date Adopted	Date Effective	Percent Increase
5/14/2019	7/1/2020	7.0%
5/14/2019	7/1/2019	7.0%
3/11/2014	7/1/2018	2.4%
3/11/2014	7/1/2017	5.9%
3/11/2014	7/1/2016	5.7%

Source: Financing Application Addendum

In May 2019, the City Council passed a resolution increasing wastewater service fees by 7% for years 2020, 2021, and 2022; and 6% for years 2023 and 2024. This is in anticipation of the subject debt and budgeted expenditures.

The following table displays the historical and current average monthly user charge per residential unit and the year-over-year percent increases 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 as of FY 2019. The table demonstrates the percentages paid by ratepayers are all well below the 2.0% of the MHI affordability threshold established by the California Department of Public Health.

HISTORICAL AND CURRENT AVERAGE MONTHLY USER CHARGE PER RESIDENTIAL UNIT					
For Fiscal Year Ending (FYE) June 30	2015	2016	2017	2018	2019
Single Family Unit	\$44.20	\$46.30	\$47.20	\$47.20	\$50.50
Multi-Family Unit	\$35.80	\$37.80	\$38.60	\$38.60	\$41.30
% change	N/A	4.8%	1.9%	0.0%	7.0%
% of MHI (2019 at \$78,041)	0.7%	0.7%	0.7%	0.7%	0.8%

Source: Financing Application Addendum

The following table displays the projected average monthly user charge per residential unit in FYs 2020 through 2023.

PROJECTED AVERAGE MONTHLY USER CHARGE PER RESIDENTIAL UNIT				
For Fiscal Year Ending (FYE) June 30	2020	2021	2022	2023
Single Family Unit	\$54.00	\$57.80	\$61.30	\$65.00
Multi-Family Unit	\$44.20	\$47.30	\$50.10	\$53.10
% change	6.93%	7.04%	6.06%	6.04%

Source: Financing Application Addendum

The following table compares the City's current average monthly system user charge to nearby systems as of June 30, 2020. The table indicates the City's rate is lower than the average of nearby Systems. The SCCSD system charges the highest rate. SCCSD does not have its own treatment facility, as discussed above, it pays to discharge sewage to the WWTP. SCCSD operates a collection system that gathers and conveys sewage over a large geographic area and delivers it to the City's WWTP treatment system. Only a portion of SCCSD's rates derive from the treatment costs it pays to the City.

CURRENT AVERAGE MONTHLY SYSTEM USER CHARGE COMPARED TO NEARBY SYSTEMS		
System Name	Location	Average Monthly Residential Rate
City of Santa Cruz	N/A	\$50.50
Watsonville Wastewater Treatment Facility	City of Watsonville	\$42.84
San Jose-Santa Clara Regional Wastewater	City of Santa Clara	\$44.99
Santa Cruz County Sanitation District	Santa Cruz County	\$65.25
Source: Financing Application Addendum	Average Monthly Charge	\$50.90

The following table displays the Top 10 System Users, each User's Percent of System Revenue as of July 31, 2020. The Table also indicates the user generating the greatest amount of system revenues generates only 12.11% of the total system revenues, which is in compliance with IBank's underwriting criteria that no single user exceeds 15% of system revenues. The table further shows that the City meets another underwriting requirement that revenue derived from the top ten ratepayers does not exceed 50% of total system revenue.

TOP 10 SYSTEM USERS AS OF JULY 31, 2020				
	User	% System Use	% System Revenues	Customer Class (Residential/ Commercial/ Industrial/Other)
1	UCSC	7.45%	12.11%	Other
2	Cypress Point Investment	0.70%	0.77%	Residential
3	Harmony Foods Corp	0.95%	0.66%	Industrial
4	Harmony Foods Corp	0.95%	0.66%	Industrial
5	MHC Acquisition One	0.64%	0.64%	Residential
6	La Posada	0.22%	0.48%	Residential
7	Hidden Creek Apts	0.28%	0.47%	Residential
8	County of Santa Cruz	0.76%	0.43%	Other
9	Barry Swenson Builders	0.18%	0.38%	Residential
10	Baywood at North Shore	0.33%	0.37%	Residential
	Total	12.46%	16.97%	
Source: Financing Application Addendum				

CREDIT ANALYSIS

Source of Financing and Security

The City proposes pledging net System revenues and all legally available amounts in the Fund as the security and the source of repayment for the proposed Financing.

Source of Revenue to Repay Proposed ISRF Financing:	Net System revenues and all legally available amounts in the Fund.
Outstanding Obligations:	J.P. Morgan Chase loan. See Debt Section of this staff report for details.
Type of Audited Financial Documents Reviewed:	<input checked="" type="checkbox"/> Comprehensive Annual Financial Reports (CAFR) <input type="checkbox"/> Basic Financial Statements (F/S) <input type="checkbox"/> Other:
Fiscal Year Ends:	June 30
Audit Fiscal Years Reviewed:	2015-2019
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.	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No. [If no, explain]
Adopted Budget(s) Reviewed:	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No. [If no, explain]
Budget Year(s) Reviewed:	2019-2020

Comparative Statement of Net Position

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

CITY OF SANTA CRUZ WASTEWATER (SEWER) ENTERPRISE FUND STATEMENT OF NET POSITION PROPRIETARY FUNDS										
For Fiscal Year Ending (FYE) June 30	2015		2016		2017		2018		2019	
Source:	CAFR	%	CAFR	%	CAFR	%	CAFR	%	CAFR	%
ASSETS AND DEFERRED OUTFLOW OF RESOURCES										
Current Assets										
Cash and Investments	\$13,143,803	116%	\$10,663,531	9.8%	\$14,621,135	13.8%	\$14,733,804	14.4%	\$16,993,727	17.1%
Interest Receivable	62,792	0.1%	22,710	0.0%	39,188	0.0%	50,128	0.0%	75,361	0.1%
Taxes Receivable					438	0.0%	442	0.0%		
Accounts Receivable - Net	2,373,859	2.1%	5,542,129	5.1%	3,016,739	2.8%	3,344,889	3.3%	1,798,257	1.8%
Intergovernmental Receivables - Due Within One Year	1,484,348	13%	1,508,192	1.4%			1,563,340	1.5%		
Notes Receivable - Due Within One Year					1,508,192	1.4%				
Prepaid Items							568,597	0.6%		
Total Current Assets	\$17,064,802	15.1%	\$17,736,562	16.3%	\$19,185,692	18.1%	\$20,261,200	19.7%	\$18,867,345	19.0%
Noncurrent Assets										
Restricted Assets:										
Intergovernmental Receivables - Due in More than One Year	\$4,603,952	4.1%	\$3,095,760	2.8%	\$1,587,568	1.5%			1,526,507	1.5%
Land Improvements	1,496,287	13%	1,496,287	1.4%	1,496,287	1.4%	1,496,287	1.5%	1,526,507	1.5%
Infrastructure	55,618,233	49.3%	55,816,211	51.2%	55,816,211	52.6%	56,479,082	55.0%	58,246,632	58.6%
Buildings	126,734,779	112.3%	126,734,779	116.3%	126,734,779	119.5%	126,734,779	123.5%	126,746,279	127.5%
Lease Improvements-Buildings	70,000	0.1%	70,000	0.1%	70,000	0.1%	70,000	0.1%	70,000	0.1%
Machinery and Equipment	8,536,644	7.6%	9,541,128	8.8%	9,883,470	9.3%	10,039,441	9.8%	10,556,543	10.6%
Software	212,018	0.2%	212,018	0.2%	212,018	0.2%	212,018	0.2%	212,018	0.2%
Construction in Progress	27,702	0.0%	27,702	0.0%	1,025,139	1.0%	1,461,291	1.4%	1,398,701	1.4%
Less Accumulated Depreciation	(101,489,902)	-89.9%	(105,730,700)	-97.0%	(109,918,045)	-103.6%	(114,116,577)	-111.2%	(118,202,090)	-116.9%
Total Capital Assets (Net of Accumulated Depreciation)	91,205,761	80.8%	88,167,425	80.9%	85,319,859	80.4%	82,376,321	80.3%	80,554,590	81.0%
Total Other Non Current Assets	\$95,809,713	84.9%	\$91,263,185	83.7%	\$86,907,427	81.9%	\$82,376,321	80.3%	\$80,554,590	81.0%
Subtotal Assets	\$112,874,515	100.0%	\$108,999,747	100.0%	\$106,093,119	100.0%	\$102,637,521	100.0%	\$99,421,935	100.0%
DEFERRED OUTFLOWS OF RESOURCES										
Deferred Charge on Refunding of Debt	\$254,862	0.2%	\$220,108	0.2%	\$185,354	0.2%	\$150,600	0.1%	\$115,846	0.1%
Deferred Pension Outflows	558,472	0.5%	934,296	0.9%	2,891,734	2.7%	\$3,311,261	3.2%	2,099,424	2.1%
Deferred Outflows-Total Other Postemployment Benefits							62,603	0.1%	57,019	0.1%
Total Deferred Outflow of Resources	\$813,334	0.7%	\$1,154,404	1.1%	\$3,077,088	2.9%	\$3,524,464	3.4%	\$2,272,289	2.3%
Total of All Assets	\$113,687,849	100.7%	\$110,154,151	101.1%	\$109,170,207	102.9%	\$106,161,985	103.4%	\$101,694,224	102.3%
Liabilities										
Accounts Payable and Other Current Liabilities	\$1,296,506	1.1%	\$749,811	0.7%	\$1,492,807	1.4%	\$631,242	0.6%	\$1,315,087	1.3%
Interest Payable	86,251	0.1%	65,223	0.1%	43,857	0.0%	22,147	0.0%		
Compensated Absences Payable	160,488	0.1%	182,946	0.2%	222,084	0.2%	207,544	0.2%	216,737	0.2%
Bonds, Notes, Loans and Leases Payable due in less than 1 year	3,434,164	3.0%	3,491,526	3.2%	3,544,544	3.3%	3,616,374	3.5%	304,712	0.3%
Total Current Liabilities	\$4,977,409	4.4%	\$4,489,506	4.1%	\$5,303,292	5.0%	\$4,477,307	4.4%	\$1,836,536	1.8%
Noncurrent Liabilities										
Other Post Employment Benefits	\$546,582	0.5%	\$634,219	0.6%	\$762,278	0.7%	\$2,256,418	2.2%	\$2,183,942	2.2%
Net Pensions Liability	7,728,620	6.8%	8,712,323	8.0%	11,179,561	10.5%	12,556,410	12.2%	11,203,581	11.3%
Compensated Absences Payable	80,244	0.1%	91,473	0.1%	111,042	0.1%	103,772	0.1%	108,369	0.1%
Bonds, Notes, Loans and Leases Payable due in more than 1 year	11,925,014	10.6%	8,433,488	7.7%	4,888,944	0	1,272,570	1.2%	967,858	1.0%
Total Long Term Liabilities	\$20,280,460	18.0%	\$17,871,503	16.4%	\$16,941,825	16.0%	\$16,189,170	15.8%	\$14,463,750	14.5%
Total Liabilities	\$25,257,869	22.4%	\$22,361,009	20.5%	\$22,245,117	21.0%	\$20,666,477	20.1%	\$16,300,286	16.4%
Deferred Inflows of Resources										
Deferred Pension Inflows	\$2,456,761	2.2%	\$874,712	0.8%	\$300,308	0.3%	\$198,353	0.2%	\$227,485	0.2%
Deferred Inflows Related to OPEB									199,161	0.2%
Total Deferred Inflows of Resources	\$2,456,761	2.2%	\$874,712	0.8%	\$300,308	0.3%	\$198,353	0.2%	\$426,646	0.4%
Net Position:										
Net Investment in Capital Assets	\$76,101,445	67.4%	\$76,462,519	70.1%	\$77,071,725	72.6%	\$77,637,977	75.8%	\$79,397,866	79.9%
Unrestricted	\$9,871,774	8.7%	\$10,455,911	9.6%	\$9,553,057	9.0%	\$7,659,178	7.5%	\$5,569,426	5.6%
Net Position	\$86,973,219	76.2%	\$86,918,430	79.7%	\$86,624,782	81.6%	\$85,297,155	83.1%	\$84,967,292	85.5%
Deferred Outflows of Resources										
Total Liabilities and Fund Balance	\$112,874,515	100.0%	\$108,999,747	100.0%	\$109,170,207	102.9%	\$106,161,985	103.4%	\$101,694,224	102.3%

Current Assets grew 10.5% to \$18.9 million in the period reviewed due to buildup of cash from operations, interest earnings and rate increases.

The City retained an Unrestricted Cash position fund balance in FY 2019 of \$5,569,426, providing flexibility in handling unexpected expenses.

The Fund has significant assets in Infrastructure (over \$58 million) and Buildings (over \$126 million). As mentioned in the System Description section, the City has invested in wastewater infrastructure and completed upgrades and projects when needed. Total Assets when adjusted for depreciation remained over \$215 million each year. While these assets indicate the system is in good financial shape, they are not indicative of the ability repay IBank's of other debts

In summary, with fluctuations due to increased Other Post Employment Benefits and Net Pensions Liability, the Fund Net Position decreased by \$1 million to \$84 million in the years reviewed.

The table below shows Accounts receivables summary as July 6, 2020.

CITY OF SANTA CRUZ ACCOUNTS RECEIVABLE AGING REPORT AS OF JULY 6, 2020							
	Current	Over 30	Over 40	Over 60	Over 90	Over 120	Total
	\$4,425,467	\$320,955	\$0	\$198,477	\$175,953	\$110,932	\$5,231,783.78
Percent	84.6%	6.1%	0.0%	3.8%	3.4%	2.1%	100.0%

Source: Financing Application Addendum

Santa Cruz Municipal Utilities, a division of the City of Santa Cruz Water Department, bills Users on a monthly basis.

The table above shows a strong collection of accounts receivables with 84.6% collected within 30 days of billing. Only 2.1% is over 120 days past due. This is a minimal past due accrual.

Note – Pre-COVID 19, the City's non-collectibles over 120 days were less than 1.0%.

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

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

CITY OF SANTA CRUZ											
WASTEWATER (SEWER) ENTERPRISE FUND											
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION PROPRIETARY FUNDS											
For Fiscal Year Ending (FYE) June 30	2015		2016		2017		2018		2019		
Source:	CAFR	%	CAFR	%	CAFR	%	CAFR	%	CAFR	%	
% Change		N/A		7%		8%		4%		-6%	
Operation Revenue											
Charges for Services	\$17,241,778	100.0%	\$18,558,180	100.0%	\$20,100,738	100.0%	\$20,976,241	99.8%	\$19,748,997	100.0%	
Other Revenues	2,593	0.0%	595	0.0%			42,318	0.2%	1,172	0.0%	
Total Operating Revenues	\$17,244,371	100.0%	\$18,558,775	100.0%	\$20,100,738	100.0%	\$21,018,559	100.0%	\$19,750,169	100.0%	
Operating Expenses											
Personnel Services	\$ 6,380,659	37.0%	\$ 5,846,183	31.5%	\$ 7,424,047	36.9%	\$ 8,226,368	39.1%	\$ 7,995,914	40.5%	
Services, Supplies, and Other Charges	8,330,157	48.3%	8,047,406	43.4%	8,888,216	44.2%	9,148,781	43.5%	8,607,240	43.6%	
Depreciation and Amortization	4,136,944	24.0%	4,261,475	23.0%	4,233,442	21.1%	4,257,130	20.3%	4,248,268	21.5%	
Total Operating Expenses	\$18,847,760	109.3%	\$18,155,064	97.8%	\$20,545,705	102.2%	\$21,632,279	102.9%	\$20,851,422	105.6%	
Operating Income (Loss)	(\$1,603,389)	-9.3%	\$403,711	2.2%	(\$444,967)	-2.2%	(\$613,720)	-2.9%	(\$1,101,253)	-5.6%	
Nonoperating Revenues (Expenses)											
Intergovernmental Revenue	\$1,108,820	6.4%	\$772,673	4.2%	\$354,146	1.8%	\$848,894	4.0%	\$715,866	3.6%	
Investment Earnings	319,841	1.9%	110,192	0.6%	95,567	0.5%	152,803	0.7%	380,320	1.9%	
Interest Expense and Fiscal Charges	(282,146)	-1.6%	(270,978)	-1.5%	(214,728)	-1.1%	(153,418)	-0.7%	(82,272)	-0.4%	
Debt Issuance Costs	(34,754)	-0.2%									
Gain (loss) on Sale of Capital Assets	2,831	0.0%	4,325	0.0%	2,792	0.0%			1,531	0.0%	
Net Non-operating Revenues (Expenses)	\$1,114,592	6.5%	\$616,212	3.3%	\$237,777	1.2%	\$848,279	4.0%	\$1,015,445	5.1%	
Income (Loss Before Operating Transfers)	(\$488,797.00)	-2.8%	\$1,019,923	5.5%	(\$207,190)	-1.0%	\$234,559	1.1%	(\$85,808)	-0.4%	
Capital Contributions and Transfers											
Transfer In									\$4,000		
Transfer Out	(\$26,085)		(\$74,712)		(\$86,458)		(\$240,765)		(\$248,055)		
Total Contributions and Transfers	(\$26,085)		(\$74,712)		(\$86,458)		(\$240,765)		(\$244,055)		
Increase (decrease) in Net Position	(\$514,882)		\$945,211		(\$293,648)		(\$6,206)		(\$329,863)		
Net Position:											
Beginning Net Assets	\$96,055,835		\$85,973,219		\$86,918,430		\$86,624,782		\$85,297,155		
Pror Period Adjustment (GASB 68)/Change in Accounting Principle	(9,567,734)						(1,321,421)				
Beginning of Year, as Restated	86,488,101										
Ending Net Assets	\$85,973,219		\$86,918,430		\$86,624,782		\$85,297,155		\$84,967,292		

Total Operating Revenues decreased in FY 2019 due to an outstanding invoice for \$1,374,943 by the SCCSD. The City expects SCCSD to pay this outstanding invoice soon. Concurrently, Total Operating Expenses decreased from approximately \$21.6 Million to \$20.8 Million as the City managed efficiencies.

Depreciation is used to spread the cost of an asset over its useful life. It is a non-cash expense and typically deducted from income for tax purposes. Also, governmental entities do not pay income tax, so depreciation is added-back to the net Operating Income reported

Existing IBank Debt Details:

The City has two existing loans outstanding with IBank. However, the Wastewater Fund is not the repayment source for either loan. A summary of the IBank loans can be seen in the following table:

Debt Issued	Repayment Source	Date Issued	Maturity	Amount Issued	Outstanding Balance
IBank Loan 15-107	General Fund	3/18/2015	8/1/2024	\$14,130,000	\$5,944,321
IBank Loan 17-115	Water Fund	8/19/2016	8/1/2046	\$25,000,000	\$22,878,148
			Total:	\$39,130,000	\$28,822,469

Loan 15-107 financed a road project consisting of pavement reconstruction, overlay, cape and slurry seal, and asphalt grinding of City arterial and collector roads. Loan 17-115 financed improvements to the City's drinking water infrastructure system and included the replacement and/or upgrade to water pipelines, wells, the water treatment plant, a treated water storage reservoir, and gravity trunk main valves. Both loans have a reliable payment history, and neither loan is on IBank's Watch List.

Concentration and Default Risk:

Applicant Concentration:

The proposed \$30,000,000 loan, when combined with the City's two existing loans, would result in a total IBank outstanding loan balance of \$58,822,469.

The total balance of outstanding ISRF loans is presently \$414 million, including the two loans with the City. The addition of the proposed loan would increase outstanding ISRF loans to \$444 million. The City's potential loan concentration of \$58,822,469 would equate to 13.24% of \$444 million and will therefore not surpass the maximum concentration of 20% for a single borrower.

Primarily due to the large exposure of the City, if there was to be a default on the City's IBank Debt repayment due to a disaster or a significant fire, this could potentially impact our coverage to our ISRF bonds resulting in IBank being out of compliance with ISRF Bond debt service coverage covenant and drop it below 1.20. Staff projects that even if the City were to default on all of its outstanding Loans, other IBank ISRF bond revenues would be sufficient to satisfy IBank bond debt service and exceed the minimum DSCR of 1.20.

However, it should be noted that of the three obligations outstanding from the City (to IBank), the Fund represents the most stable source of repayment. This is exemplified in the fact that with the COVID 19 pandemic, the City has seen less than 2.1% in accounts receivables over 120 days.

Fund Cash Flow and Debt Service Analysis

CASH FLOW					
For Fiscal Year Ending (FYE) June 30	2015	2016	2017	2018	2019
Operating Income (Loss)	(\$1,603,389)	\$403,711	(\$444,967)	(\$613,720)	(\$1,101,253)
Transaction Specific Adjustments					
Depreciation and Amortization	\$4,136,944	\$4,261,475	\$4,233,442	\$4,257,130	\$4,248,268
Investment Earnings (Discounted 30%)	223,889	77,134	66,897	106,962	266,224
Transfer Out	(26,085)	(74,712)	(86,458)	(240,765)	(248,055)
Total of all Adjustments	4,334,748	4,263,897	4,213,881	4,123,327	4,266,437
Cash Available for Debt Service	\$2,731,359	\$4,667,608	\$3,768,914	\$3,509,607	\$3,165,184
Debt Service Calculation					
Total Existing MADS Debt Service	\$338,573	\$338,573	\$338,573	\$338,573	\$338,573
Proposed IBank MADS ⁽¹⁾	1,514,788	1,514,788	1,514,788	1,514,788	1,514,788
Total Obligations MADS	\$1,853,360	\$1,853,360	\$1,853,360	\$1,853,360	\$1,853,360
Debt Service Coverage Ratio ⁽²⁾	1.47	2.52	2.03	1.89	1.71
⁽¹⁾ Calculated as \$30,000,000 at 2.50% for 30 years					
⁽²⁾ Existing Parity Debt Minimum Required DSCR 1.15					

Investment Earnings are ongoing and therefore included as Transaction Specific Adjustments to Operating Income. However, these earnings were discounted 30% to account for potential fluctuations due to economic factors.

Three income sources were not included as adjustments: Gain/Loss on Sale of Capital Assets, which are case specific and therefore unreliable, intergovernmental revenues, which are not necessarily recurring and therefore cannot be counted on to determine debt affordability, and Transfers In, which occurred only once in the years reviewed.

The Fund has one existing loan with J.P. Morgan Chase with total outstanding of \$967,858 and a maturity

date of 11/01/2022. This was the 2013 Wastewater Refund bonds that refinanced the 2005 Wastewater Revenue Bonds and Wastewater Note payable to the State Water Resources Control Board.

COVID Pandemic Impact on revenues and proposed debt service repayment

The current pandemic will have an impact on the City’s revenues. Sales tax, payroll tax, permits for construction, gas tax etc. are all projected to decrease. It is difficult to determine the exact extent of the impact. However, the impact of the pandemic is expected to be primarily on the General Fund and the pandemic is not expected to have a significant effect on the Wastewater Fund.

Additionally, a 10% stress test was performed on the Charges for Services revenues and operating expenses were kept constant. The resulting DSCR is as follows:

CASH FLOW					
For Fiscal Year Ending (FYE) June 30	2015	2016	2017	2018	2019
<i>Debt Service Coverage Ratio ⁽²⁾</i>	1.19	1.95	1.16	1.24	1.09

Note the following: a 10% drop in Charges for Services is not likely and a worst case scenario. Even then, the DSCR is well above 1.0, the amount required to repay the financing.

The Fund has Cash and Investments of \$16.9 million, unrestricted assets of \$5.5 million in the five years reviewed.

Risk Factors

1. Litigation has been filed against the City alleging vaguely that its System rates and charges violate Proposition 218.
2. The City is not prohibited from incurring additional obligations payable from the Fund.
3. Concentration Risk and Default Risk to IBank ISRF bonds. Staff projects that even if the City were to default on all of its outstanding Loans, other IBank ISRF bond revenues would be sufficient to satisfy IBank bond debt service and exceed the minimum DSCR of 1.20.

Mitigating Factors

4. The City has implemented successfully and without challenge prior rate increases.
5. The City asserts that its rates comply with Prop 218 and are the minimum necessary to maintain revenues at levels needed for the City to maintain its ability to meet its expenses and service debt.
6. The City asserts the plaintiff’s claims are meritless and that its rates comply with Prop 218; nonetheless, if the plaintiffs were to prevail the City believes it would be able to satisfy IBank’s debt service without interruption in payment. However, due to the plaintiff’s vague allegations, the City is unable at this time to determine the potential outcomes if the plaintiffs’ claims succeed. If the plaintiff’s claims are successful it is possible the City will be required to pay restitution to the plaintiffs and revise its rate structure, a process which could take 18 or more months to complete. It is possible the City would miss debt service payments during the time it would take to revise its rates. However, upon successfully revising its rates debt service would resume and the City would ultimately repay all money owed IBank.
7. 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 of the status of the current litigation and to inform IBank immediately upon the filing of any new legal challenge to its rates or charges.
8. 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 1.25 times the Maximum Annual Debt Service (MADS).
9. The Significant borrower threshold on the ISRF Bonds is 20% and the Applicant’s concentration is

13.24% of the ISRF portfolio when the proposed loan is included.

10. The default risk in obligations related to the wastewater fund are very low as explained in the Concentration and Default Risk section and the Impact of COVID Pandemic impact section. Even if there is a total default, DSCR would be above 1.0X and IBank could still pay ISRF bond debt.

Compliance with IBank Underwriting Criteria

- Revenues derived from the top ten System ratepayers do not exceed 50% of annual System revenues.
- Revenues derived from any single ratepayer do not exceed 15% of annual System revenues.
- The estimated useful life of the Project is over 40 years, which is more than the Financing term.
- The City has the power to establish and enact rates and charges without the approval of any other governing body.

Criteria Waivers

1. IBank's ISRF Program Criteria provides that financings available in amounts between \$50,000 and \$25 million, but that the Board may approve higher loan amounts. This Project financing is \$30,000,000.
2. The City is seeking IBank waiver of the Criteria requirement to complete construction within 24 months. The City's Project construction timeline extends to 36 months.
3. 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 the Criteria.

STAFF RECOMENDATION

Staff recommends approval of Resolution No. 21-18 authorizing ISRF Program financing to the City of Santa Cruz for the UV Replacement and Main Power Projects as follows:

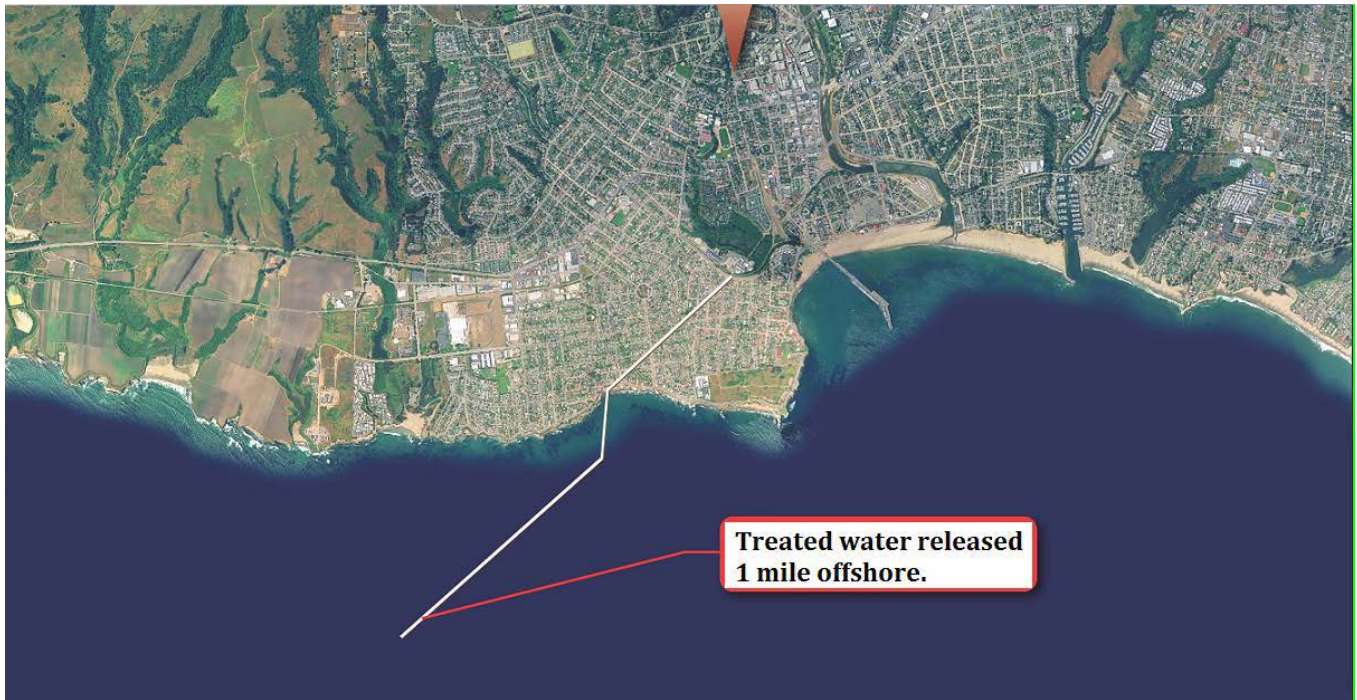
1. **Applicant/Borrower:** City of Santa Cruz
2. **Project:** UV Replacement and Main Power Project
3. **Amount of ISRF Program Financing:** \$30,000,000
4. **Maturity:** Thirty (30) years
5. **Repayment/Security:** ISRF Program Financing would be secured by a lien on parity with the City's existing debt on the City's net system revenues (Net Revenues) and all legally available amounts in the City's Enterprise Fund (Fund).
6. **Interest Rate:** 2.50%
7. **Fees:** City to pay an origination fee of 1.00%, \$300,000, 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 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 on November 30, 2020. Thus, the City and IBank must enter into the Financing agreement no later than November 30, 2020. Once the approval has expired, there can be no assurances that IBank will be able to provide the ISRF Program 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. City will be required to maintain rates and charges in an amount sufficient to ensure that Net Revenues produce a minimum 1.25 times aggregate annual debt service ratio for obligations on parity with the Financing.
 - b. The City has no senior liens and 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 1.25 times the Maximum Annual Debt Service (MADS) taking into consideration the MADS 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 1.10 times the sum of the MADS on all outstanding debt, payable from the Fund, including the proposed Subordinate Debt.
- e. 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, 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, City to covenant to notify IBank immediately upon the filing of any legal challenge to its rates or charges.
- g. City to comply with the requirements of the Criteria and all applicable laws, regulations, and permitting requirements associated with public works projects.
- h. City to provide to IBank annually within 180 days of the end of each of 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.

EXISTING SYSTEM (Exhibit 1)

Outfall Location: Water not used on site is released to this outfall location



Source: City of Santa Cruz

Existing Effluent Filtration System



Source: City of Santa Cruz