City of Tacoma | City Council Action Memorandum

TO: Mayor and City Council
FROM: Jackie Flowers, Director of Utilities
COPY: Elizabeth Pauli, City Manager and Doris Sorum, City Clerk
SUBJECT: Tacoma Power Revenue Bonds
DATE: July 20, 2021

SUMMARY:

Tacoma Power's 2021 financing plan involves three components that require approval by the Public Utility Board and the City Council.

This Council Action Memo addresses the authorization to issue up to $320 million of Electric System Revenue and Refunding Bonds under the delegated authority of the Director of Utilities and the Power Superintendent, or their designee, including:

- New 2021 Revenue Bonds to repay the existing $150 million (of which, approximately $140 million is outstanding) Wells Fargo Note Purchase Agreement;
- Potentially issuing 2021 Refunding Bonds to refund the outstanding 2013 Bonds of Tacoma Power;
- The option to identify some, or all, of the Bonds as "Green Bonds"; and
- The enactment of Springing Amendments to the language in the Master Ordinance to reflect current rate-setting practices that are based on forecasts of revenues and expenses, and to enact the option of amortizing debt service of future Tacoma Power Bonds with principal balloon payments.

The proposed Supplemental Ordinance and Resolution authorizing the issuance of the Electric System Revenue and Refunding Bonds and amending the Master Ordinance have been drafted by Tacoma Power's Bond Counsel, Pacifica Law Group LLP (Pacifica), in collaboration with Tacoma Power's Financial Advisor, Montague DeRose and Associates (MDA), Tacoma Power staff and attorney, and the City Assistant Finance Director.

STRATEGIC POLICY PRIORITY:

The strategic policy priority best aligned to this action is to "Strengthen and maintain a strong fiscal management position."

Tacoma Power regularly issues bonds to finance construction and renovation on long-lived capital assets. Debt financing such assets will help maintain financial flexibility and aim to limit rate increases over the next biennium by equitably distributing capital costs of long-lived assets to future ratepayers who are the beneficiaries of those assets. Additionally, amending the Master Ordinance language within the 2021 Bond Series Supplemental Ordinance will improve the financial flexibility of establishing rates to meet the debt service coverage requirements of bond covenants. The amended language allows Tacoma Power to set rates based on forecasted revenues and expenses and allows for the distribution of the cost and impact of large principal balloon payments over many years.

BACKGROUND:

New Bond Issue

Tax-exempt municipal market rates remain near historic lows and Tacoma Power plans to issue up to $150 million in new Electric System Revenue Bonds in September 2021 to repay the outstanding amount on the Note Purchase Agreement with Wells Fargo (New Money Bonds). Working with MDA, the utility completed an RFP in April 2021 to select underwriters for this transaction. Citigroup and KeyBank were selected as Senior Managers, and Goldman Sachs and Siebert Williams Shank were chosen as Co-Managers. The utility is working with MDA and these firms to compare numerous alternatives and to optimize the timing, structure, and planned use of proceeds in relation to the utility's future debt structure.

The utility plans to issue all, or a portion, of the New Money Bonds as Green Bonds using Kestrel Verifiers, a third-party verification company. The New Money Bonds will be structured to mature between 2023 and 2051 to take advantage of the current low interest rate environment while aligning the cost of long-lived capital projects with future debt service payments. Proceeds will reimburse 2017/2018, 2019/2020, and a portion of the 2021 capital expenditures funded with draws on the existing Note Purchase Agreement with Wells Fargo.

In order to conduct this bond sale in the most efficient manner, Tacoma Power seeks approval for the delegation of authority to the Director of Utilities and Power Superintendent, or their designee, to conduct this sale within limits defined by the Bond Ordinance.

Preliminary Terms:

Estimated pricing for the New Money Bonds is as follows:

Total Proceeds: Up to $150,000,000

Total Interest Cost (TIC): 3.215 percent inclusive of issuance costs

Final Maturity: 2051

Maximum Annual Debt Service: $8,500,000

Average Annual Debt Service: $7,900,000

Projected All-In Cost: $650,000 (Underwriters, Bond Counsels, Financial Advisor, Green Bond Verification)

Potential Refunding Bond Issue
Tacoma Power may also refund all, or a portion, of the outstanding 2013A and 2013B Bonds of Tacoma Power if it is determined to be financially prudent, at the advice of MDA and the Underwriters. The refunding bond proceeds needed to refund the outstanding 2013A and 2013B Bonds is approximately $127 million (Refunding Bonds). The potential issuance of the Refunding Bonds and the refunding of the 2013 Bonds will assist in levelizing future debt service payments and maintaining stable rates.

Springing Amendments

Tacoma Power has five series of senior lien bonds outstanding under the 1985 Master Ordinance 23514:

- Series 2010B (Build America Bonds, “BABs”),
- Series 2010C (Clean Renewable Energy Bonds, “CREBs”),
- Series 2013A,
- Series 2013B, and
- Series 2017.

➢ Currently, section 9.3 Rate Covenant – Debt Service Coverage in the Master Ordinance requires that Tacoma Power set rates based on a debt service coverage calculated from actual realized net revenue for each year that is in excess of 125% of the debt service expenses. The existing language requires that rates are set at the end of each year to produce revenues and expenses to fulfill the Debt Service Coverage requirement.

  Tacoma Power is requesting to amend this language to reflect current practices of setting rates and charges for the next biennium based on **forecasted or budgeted** net revenues (revenues less expenses) that are expected to be at least 125% of the estimated debt service for each year. This change in the Master Ordinance will allow more financial flexibility in setting rates during future years when revenues or expenses become unpredictable, such as during a pandemic.

➢ Tacoma Power is also requesting to add a section to the Master Ordinance that allows for amortization of Bond balloon debt payments, “Balloon Indebtedness”, in meeting this Debt Service Coverage requirement. Balloon Indebtedness is defined as a series of Bonds with more than 25% of the principal payable in one fiscal year. This will increase the financial flexibility when issuing future Bonds with balloon payments, such as was the case with the 2010 Clean Renewable Energy Bonds. This amendment gives Tacoma Power the option to spread the balloon principal payment(s) over many years, reducing the debt service coverage requirement in any given year. Similar language currently exists in certain revenue bond ordinances for the City of Tacoma, including for the Tacoma Power subordinate revenue bonds and the Department of Environmental Services sewer and solid waste bonds.

ISSUES:
Tacoma Power and MDA note the following considerations concerning the Bond issuance request:
Green Bonds

- The utility plans to issue all, or a portion, of the New Money Bonds as Green Bonds which may broaden the investor base and may result in a reduced issue price. The amount of the Green Bond issue will be based on the value of the qualified capital projects as determined by Kestrel Verifiers, a third-party verification company. Many issuers in the Pacific Northwest have issued Green Bonds and the selected Senior Underwriters, Pacifica, and MDA have experience in issuing Green Bonds.

Springing Amendments

- To amend the debt service coverage requirement language in section 9.3 of the Master Ordinance and add the amortization of identified balloon indebtedness, Tacoma Power must receive consent from over 50% of outstanding bond owners and the current Surety Policy provider, Assured Guaranty. Once Tacoma Power's 2013 Bonds are refunded or redeemed, the utility will likely receive the consent of the requisite amount of owners of the Outstanding Bonds as defined in the Outstanding Bond Ordinances at the time of the next borrowing issuance (currently projected for FY2024) or after the first maturing 2010B principal payment, whichever comes first.

ALTERNATIVES:

Tacoma Power considered many alternatives to the proposed action and if the requested Ordinance is not approved, an alternative will be brought forward for consideration. Some of the alternatives considered involve the size and timing of the 2021 Bond issuance.

- Tacoma Power could reduce the amount of the Bond issue request to up to $160 million and only repay the outstanding balance on the existing Wells Fargo Agreement. The removal of the Refunding Bond component from the requested Ordinance would reduce Tacoma Power's ability to take advantage of current low interest rates and begin levelizing future debt service payments.
- Tacoma Power could also delay the Bond issue one year and pay for capital spending out of revenue, once the remaining $10 million available amount on the existing Wells Fargo line of credit is fully utilized.

If Tacoma Power does not issue new Electric System Revenue Bonds to pay for capital improvements now, Tacoma Power may need to increase near-term rate projections to pay for these costs from rate revenues collected in the next biennium.

RECOMMENDATION:

Tacoma Power recommends the Government Performance and Financial Committee approve the issuance of up to $320 million of Electric System Revenue and Refunding Bond proceeds under the delegated authority of the Director of Utilities and the Power Superintendent, or their designee.

FISCAL IMPACT TO THE CURRENT BIENNIUM:

Biennial expenditures for Bond Counsel and external Financial Advisory services were included in the 2021/2022 budget up to $325,000.

Estimated debt service for a new 2021 Bond issue is included in the 2021/22 Tacoma Power budget. Many of the costs associated with the new Bond issue are rolled into the debt service, such as Underwriter and Verification costs.

ARE THE EXPENDITURES AND REVENUES PLANNED AND BUDGETED? Yes.