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September 1, 2011

Charles R. Hoppin, Chairman  
State Water Resources Control Board  
P.O. Box 100  
Sacramento, CA 95812-0100



Dear Mr. Hoppin:

**RE: 9/20/2011 BOARD MEETING - CONSIDERATION OF A RESOLUTION CLARIFYING THE FUTURE SENIOR DEBT REQUIREMENTS IN THE POLICY FOR IMPLEMENTING THE CLEAN WATER STATE REVOLVING FUND FOR CONSTRUCTION OF WASTEWATER TREATMENT FACILITIES AS RELATED TO PRINCIPAL FORGIVENESS FINANCING**

This letter is to provide your Board with additional information on Item No. 4 from your August 16, 2011 agenda, which has been continued until the next Board meeting. This item requested your consideration of a Resolution clarifying the senior debt requirements in the Policy for Implementing the Clean Water State Revolving Fund (CWSRF) for Construction of Wastewater Treatment Facilities (Policy) as related to Principal Forgiveness (PF) financing.

Back in April 2010, at the request of then California Legislator Dean Flores, representatives from the cities of Los Angeles, Sacramento, and San Francisco met with top State Water Resource Control Board administrators to identify areas of need that were not addressed under the CWSRF Policy. One of the recommendations the City of Los Angeles' (City) Bureau of Sanitation (BOS) made was to establish an "Other" Disadvantaged Communities (DAC) category for urban cities that meet the DAC criteria by census tract data or poverty pocket within an urban city. This recommendation was developed and adopted providing aging Cities with a means to access State Revolving Funds for projects to implement urban renewal and prepare these communities for revitalization and an improved quality of life and to strengthen the local economy.

The City was able to demonstrate a need for this urban renewal assistance and submitted a project that was determined to meet eligibility criteria for a principal forgiveness loan. For our Agency to move forward with this project and to receive the PF loan, we are seeking a waiver from the debt parity requirement. In the unlikely event that the City was unable to complete the project, the City has offered to include the CWSRF investment in its debt service coverage calculations to provide for revenues equal to 1.1 times the annual debt service thereby ensuring that there is sufficient revenue to repay the SWRCB.



The City is applying for a CWSRF loan for the 4<sup>th</sup> Avenue & Slauson Avenue Sewer Rehabilitation project. This is a 75-inch diameter sewer constructed in 1924 and located in a disadvantaged community.

The Policy currently requires that any CWSRF loans be placed on parity with all future debt issued by an agency, with no distinction between traditional loans and PF loans. As disclosed in the June 17, 2011 letter from Assistant City Attorney Marilyn L. Garcia (attached), the City cannot comply with the requirement due to conflicting requirements in our bond covenants. City and SWRCB staff had previously discussed this requirement and mutually believed that it would not be a condition of a PF loan, since in normal circumstances, no repayment of the loan would be required.

The City issues revenue bonds to fund certain construction projects for the Wastewater Program (Program) under the authority of a Senior Lien Resolution and a Subordinate General Resolution. In the Senior Lien Resolution, the City has covenanted that it shall not permit or create a lien on Program revenues ranking prior to or on parity with the charge and lien that secures the Senior Lien Bonds. In the Subordinate General resolution, the City has covenanted that, except to the extent additional Senior Lien Bonds are issued under the terms of the Senior Lien resolution, the City will not grant any priority pledge of Program revenues ranking prior to or on parity with the charge and lien that secures the Senior Lien Bonds.

At the August 16, 2011 State Water Board meeting, SWRCB staff had recommended that the parity requirement be waived for PF loans. Board members opined that it should not be difficult for the City to be able to issue future debt that is subordinate to the CWSRF loan. This is not the case. In order to be able issue debt during the two to three years required for project construction and acceptance, the City would have to develop a new Subordinate-subordinate Resolution, go to the rating agencies with this new scheme, and issue debt that would likely carry higher interest rates. This would involve a significant amount of effort and expense on the part of the City to provide security to the CWSRF program that we believe can be achieved in better ways.

The City would first like to recommend that instituting the requirements that were in place in 2003 in lieu of the parity requirement would provide essentially the same protection. In 2003, the City entered into a CWSRF agreement for the East Central Interceptor Sewer Project. This was the first time the City applied for a CWSRF because previously there had been parity requirements that violated the City's revenue bond covenants. This requirement had been lifted, as long as the agency maintained at least "A" bond ratings and at least 1.1 times debt service coverage for the CWSRF loan,

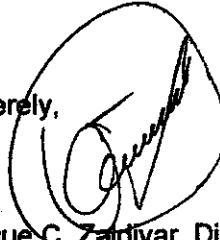
The City's Wastewater Program currently carries senior bond ratings of AA+, AA, and Aa2 from Fitch Ratings, Standard & Poor's, and Moody's, respectively, indicating a stable financial condition. In the letter dated June 17, 2011, the City offered to include the CWSRF amount in its debt service coverage calculations to ensure revenues equal to 1.1 times the annual debt service. This ensures that in the extremely unlikely event that the City was unable to complete the project, there would be sufficient revenue to repay the SWRCB. To date, the City has made over \$86 million in timely payments on this CWSRF loan, showing a strong commitment even without the parity requirement.

If the SWRCB still has concerns about the security of the PF loan, the City could place an amount of \$3 million (equal to the requested PF loan) in a restricted amount until the SWRCB agrees that the project has been successfully completed and there is no longer a financial obligation. While the City is willing to do this, it is not the environmentally preferable option since it means delays to another project that would otherwise be paid from this \$3 million.

The City hopes that the parity issue can be resolved, enabling the Project to move forward and improve the environmental conditions that serve this inner city disadvantaged community.

Should you or your staff wish to discuss any of these alternative security options, please contact Lisa Mowery of my staff at (213) 485-2374.

Sincerely,



Enrique C. Zardivar, Director  
Bureau of Sanitation

ECZ/LBM/

Attachment

cc: Christopher Stevens, SWRCB  
Pat Lam, SWRCB  
Adel Hagekhalil, BOS, Assistant Director  
Lisa B. Mowery, BOS, Financial Management Division  
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**CARMEN A. TRUTANICH**  
City Attorney

June 17, 2011

State Water Resources Control Board  
P.O. Box 100  
Sacramento, CA 95812-0100

To Whom It May Concern:

I am an Assistant City Attorney in the Office of the City Attorney for the City of Los Angeles (the "City") which Office is counsel to the Bureau of Sanitation (the "Bureau") of the City. This opinion letter is provided in connection with the Bureau's application to the State Water Resources Control Board (the "SWRCB") for the Loan administered under the State Revolving Loan Program. Loan proceeds would be used by the Bureau to fund capital costs of the Project. This opinion letter supplements the opinion letter dated February 16, 2011, and the opinion letter dated March 1, 2011 (together, the "Previous Opinions") from the undersigned and addressed to the SWRCB in connection with the Bureau's application for the Loan. All capitalized terms not otherwise defined herein have the same definitions as the definitions in the Previous Opinions.

The Bureau and SWRCB staff informed me that the application process requires completion of CWSRF Application, Attachment 7-Item 14 ("Item 14"), to list the existing debt (the "Existing Debt") issued by the City on behalf of the Bureau which provides financing for a portion of its wastewater system capital improvement program (the "Program"), of which the Project will be a part. Bureau staff will complete Item 14 and submit this information directly to the SWRCB.

The Bureau and the SWRCB staff further informed me that the application process also requires a letter which (1) provides copies of the documents (the "Existing Debt Documents"), (2) states that the undersigned has reviewed the SWRCB financing agreement template to be the form of agreement ("SWRCB Agreement") pursuant to which the Loan would be made, and (3) states whether there are any conditions or

prohibitions in the Existing Debt Documents which would adversely affect the City's ability to meet the obligations under the SWRCB Agreement.

This letter responds to such requests for information. Because this letter identifies certain conditions and restrictions in the Existing Debt Documents which would adversely affect the City's ability to meet the obligations under the SWRCB Agreement, this letter also serves as a request to the SWRCB to waive and modify such conditions and restrictions in the SWRCB Agreement to the extent necessary to permit the City to enter into and perform pursuant to the SWRCB Agreement. The responses to the SWRCB requests for information are as follows:

**1. Existing Debt Documents**

The basic Existing Debt Documents are a Wastewater System Revenue Bonds General Resolution (the "Senior Lien Resolution") adopted by the Council of the City on November 10, 1987, and a Wastewater System Subordinate General Resolution (the "Subordinate General Resolution" and together with the Senior Lien Resolution, the "Resolutions") adopted by the Council of the City on March 26, 1991. Copies of the Resolutions are attached hereto.

Pursuant to the Senior Lien Resolution the City issues bonds (the "Senior Lien Bonds") that have a senior lien on Program net revenues. Pursuant to the Subordinate General Resolution the City issues bonds (the "Subordinate Bonds" and together with the Senior Lien Bonds, the "Bonds") that have a lien on Program net revenues subordinate to the lien of the Senior Bonds.

**2. Review of SWRCB Agreement**

The undersigned has reviewed the SWRCB Agreement.

**3. Conditions and Restrictions in Existing Debt Documents**

In the Senior Lien Resolution, Section 2.03, the City has covenanted that it shall not permit or create a lien on Program revenues ranking prior to or on a parity with the charge and lien which secures the Senior Lien Bonds. In the Subordinate General Resolution, Section 2.03, the City has covenanted that, except to the extent additional Senior Lien Bonds are issued under the terms of the Senior Lien Resolution, the City will not grant any priority pledge of Program revenues ranking prior to or on a parity with the charge and lien which secures the Subordinate Bonds.

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Section 3.7(b) of the SWRCB Agreement requires that the Obligation (*i.e.*, the City's obligation to make payments under the SWRCB Agreement) shall be secured by a lien on and pledge of Net Revenues (as defined in the SWRCB Agreement, which definition is consistent with the definitions for such terms in the Resolutions) in priority as specified in Exhibit F of the SWRCB Agreement. In light of the City's obligation in Section 2.03 of the Subordinate Resolution, the City would only be able to enter into the SWRCB Agreement if Exhibit F provides that the Obligation is *subordinate* to both the Senior Lien Bonds and the Subordinate Bonds. To the extent that the standard text of Exhibit F does not permit this subordination, waiver and approval of the same is hereby requested of the SWRCB.

Assuming the SWRCB approves permitting Exhibit F to provide that the Obligation is subordinate to both the Senior Lien Bonds and the Subordinate Bonds, attention is called to Section 3.7(e) of the SWRCB Agreement. Section 3.7(e) provides in part that the City's future debt may not be senior to the Obligation and may be on a parity with the Obligation. The City plans to issue additional Bonds before the Project is completed (at which point the obligations under the SWRCB Agreement would be fulfilled and its requirements no longer applicable). Although the City could comply literally with the Section 3.7(e) requirement by issuing Subordinate Bonds during the time the Obligation is outstanding, the City could not do so in light of Subordinate Resolution, Section 2.03. Therefore, it is hereby requested that the requirements of Section 7.3(e) of the SWRCB Agreement be modified to permit the City to issue debt senior to CWSRF debt.

The City believes the security for the CWSRF debt and the Obligation can be protected to the same extent as in the standard text of Section 3.7(e) if it is modified by adding a further requirement. The City proposes adding an additional provision to Section 3.7(e) to include the Obligation and CWSRF debt in the debt coverage of 1.1 times the highest year's debt service applicable to future debt in the standard text of Section 3.7(e). Adding this additional requirement would cause the modified requirement to accomplish the same debt service coverage ratios as does the standard text of Section 7.3(e).

Very Truly Yours,

CARMEN A. TRUTANICH,  
City Attorney

By:

  
Marilyn L. Garcia, Assistant City Attorney