

**STATE WATER RESOURCES CONTROL BOARD  
BOARD MEETING SESSION – DIVISION OF FINANCIAL ASSISTANCE  
JULY 23, 2013**

**ITEM 3**

**SUBJECT**

CONSIDERATION OF A RESOLUTION ADOPTING A CLEAN WATER STATE REVOLVING FUND (CWSRF) PROGRAM PRELIMINARY FUNDING COMMITMENT (PFC) FOR THE CITY OF STOCKTON (CITY), TUXEDO AVENUE SEWER REHABILITATION PROJECT (PROJECT), CWSRF PROJECT NO. C-06-7085-110

**DISCUSSION**

In accordance with the State Water Resources Control Board's (State Water Board) *Policy for Implementing the CWSRF for Construction of Wastewater Treatment Facilities (Policy)*, amended on March 17, 2009, projects on the adopted priority list need State Water Board approval to receive CWSRF funding. The Project is listed on the CWSRF Program's Project Priority List in Priority Class D. The Project is also included in the CWSRF Program's current Intended Use Plan (IUP).

The State Water Board may approve a CWSRF PFC after issuance of a project Facility Plan Approval (FPA). On January 24, 2012, the Division of Financial Assistance (Division) issued an FPA for the City's Project. In accordance with Section IX.K of the Policy, a PFC may be approved by the Deputy Director of the Division if the Project is routine and non-controversial. The Division issued a PFC for the Project on February 17, 2012, but subsequently placed the City's financing agreement on hold after media reports that the City was considering bankruptcy. The Policy allows the Division to proceed with routine projects, but provides that no bond, loan, or debt defaults may exist as of the date the financing agreement is executed and that prior defaults may be grounds for disapproval, depending on the circumstances.

After the City filed for bankruptcy protection, the Division worked with the City in formulating a revised funding proposal with additional limitations and conditions. The Division issued an Amended FPA for the City's Project on June 10, 2013, and the City agreed with the content and conditions of the Amended FPA. Given the City's bankruptcy filing, the Project is considered non-routine; therefore, even though the current proposal is for 100 percent principal forgiveness, with no repayment, the PFC must be presented to the State Water Board for consideration.

**PROJECT INFORMATION**

The Tuxedo Avenue pipeline is a 6,000 foot long, 36-inch redwood sewer pipeline that is about 90 years old. It is located along the toe of the Smith Canal levee. Over the past 90 years, houses and other improvements have been constructed over the top of the sewer pipeline. Approximately half of the pipeline is located along Tuxedo Avenue, with the other half beneath private backyards, houses, and structures. The pipeline flows in a westerly direction from Pershing Avenue at its upstream end to the east side of Interstate 5 at its downstream end. From there it flows into a 48-inch reinforced concrete pipe under Interstate 5 and into the Smith Canal Pump Station. The City has title to an existing 20-foot easement for the Project.

The City is concerned with the aging sewer pipeline, and the potential consequences that may occur as a result of structural failures. The proposed Project will rehabilitate the aging pipeline to prevent leaks and improve its structural integrity. The Project will use cured-in-place pipe (CIPP) to rehabilitate the existing Tuxedo Avenue sewer. This process will involve the insertion of a flexible, resin-impregnated synthetic fabric liner into the sewer pipe. The liner will be custom fabricated to match the inside dimensions and length of the existing sewer.

## **ENVIRONMENTAL REVIEW**

The City is the lead agency under the California Environmental Quality Act (CEQA), and filed a Notice of Exemption (NOE; State Clearinghouse No. 2009128058) with the San Joaquin County Clerk on September 29, 2009, and the Governor's Office of Planning and Research (OPR) on December 10, 2009. State Water Board staff concurs that the Project qualifies for a Class 2 categorical exemption from CEQA for rehabilitation work within existing sewer pipeline in City streets and residential easements, and involves no expansion of existing use (CEQA Guidelines, Section 15302). State Water Board staff conducted a Tier II environmental review, reviewed the environmental documents submitted by the City, and determined that the Project will not result in any significant adverse water quality impacts.

The State Water Board will file an NOE with the OPR following funding approval.

## **FISCAL IMPACT**

### PRINCIPAL FORGIVENESS ANALYSIS

As outlined in the CWSRF IUP, adopted by the State Water Board on November 6, 2012, in Federal Fiscal Year (FFY) 2013, principal forgiveness will be available to two categories of communities: 1) Small, Disadvantaged Communities with Substantial Water Quality Investment; and 2) Other Communities. An estimated \$12 million in CWSRF Program Small Community Grant (SCG) funds is also available in State Fiscal Year (FY) 2012/13.

The City's estimated 2011 population is 298,569 persons. The City's estimated 2011 median household income (MHI) is \$47,365 (approximately 76.9 percent of the statewide MHI). As a disadvantaged community, the City qualifies for Category 2 principal forgiveness, and may receive 50 percent principal forgiveness for eligible Project costs, up to a maximum of \$3 million in principal forgiveness.

### FINANCIAL IMPACT ON APPLICANT

The total Project cost is estimated to be \$3,250,000, with the City paying \$1,625,000 in matching funds towards the Project out of the Wastewater Utility Enterprise Fund. A credit review analyzed the City's ability to enter a CWSRF financing agreement for the amount of \$1,625,000. The credit review provided recommendations regarding the financial agreement terms, maximum CWSRF financing amount, financial capacity and reserve fund requirements for the financing agreement.

The most recent rate increases were approved on August 24, 2010. The City's current wastewater rates are \$34.23/month/dwelling unit equivalent and are scheduled to increase gradually up to \$40.67/month in FY 2014/15. After allowing for the projected operations & maintenance (O&M) costs, estimated at \$35,418,085 for FY 2011/12, the projected net revenues of the Wastewater Utility Enterprise Fund are estimated at \$15,908,109.

The City has two outstanding debts secured by net revenues of the Wastewater Utility Enterprise Fund. The current combined balance for the two Certificates of Participation (COP) is \$90,545,000, and the City has a maximum combined debt service of \$7,375,000. Parity debt may be issued as long as total maximum debt service can be covered at least 1.25 times by net revenues and a reserve fund equal to one year's maximum annual debt service is established. In July 2011, the City paid interest only on the two outstanding debts. The balance due on the 2010/11 payments was paid through a defeasance account. The City has entered into an irrevocable defeasance account held at Wells Fargo Bank for these two outstanding debts, to ensure that all future debt service is paid and debt service coverage requirements are met. Beginning in FY 1978/79, the City began making annual transfers from the Wastewater Utility Enterprise Fund to the General Fund. In October 2006, a lawsuit was filed claiming that the transfers violated Proposition 218 on the grounds that transfers caused utility fees to be used for purposes other than utility services. A judicial settlement was reached in August 2009, and the City started to pay back the Wastewater Utility Enterprise Funds in July of 2010. The Wastewater Utility Enterprise Fund was to be paid over a thirty year period with annual principal and interest payments of \$685,259.81. The first payment was made in July of 2011, but the second payment was postponed until July 2013. This inter-fund loan is considered an unsecured loan in the bankruptcy filing and may be discharged. These funds are not included in the revenue calculations for the proposed Project.

#### COMPARATIVE REVENUE AND EXPENSE ANALYSIS

The audited financial statements for the City's Wastewater Utility Enterprise Fund for the last three FYs, draft financials for FY 2011/12, and projections for FY 2012/13 are summarized below:

Fiscal Year	Audited 2008/09	Audited 2009/10	Audited 2010/11	Draft 2011/12	2012/13 Budget
Operating Revenues	\$35,593,000	\$37,248,808	\$42,597,821	\$50,320,095	\$55,088,025
Interest Income	\$1,509,000	\$1,093,672	\$752,528	\$540,569	\$949,257
Non-Operating Revenues	\$14,000	\$22,212	\$0	\$465,530 <sup>3</sup>	\$0
Total Revenues	\$37,116,000	\$38,364,692	\$43,350,349	\$51,326,194	\$56,037,282
Expenses	\$35,003,000 <sup>1</sup>	\$30,093,839	\$33,326,102	\$35,418,085	\$44,024,752
Net Revenue Available for Debt Service	\$2,113,000	\$8,270,853	\$10,024,247	\$15,908,109	\$12,012,530
Existing Debt Service	\$7,376,000	\$10,277,000 <sup>2</sup>	\$4,478,813	\$7,375,200	\$7,449,673
Debt Service Coverage	0.29	0.80	2.24	2.16	1.61
<sup>1</sup> 2008/09 expenses increased approximately \$5 million from the prior year due to the significant costs related to the wastewater utility taking back operations from OMI Thames. <sup>2</sup> 2009/10 debt service increased an estimated \$3 million due to defeasance of a portion of the FY 2009/10 debt service. <sup>3</sup> Non-operating revenues include any connection fees collected during FY 2011/12					

#### BANKRUPTCY FILING

In February 2012, the City Council approved entering into a 90-day mediation process with creditors, a preliminary step before filing for federal bankruptcy protection. On June 28, 2012, the City filed for bankruptcy protection. The bankruptcy filing was approved by the bankruptcy judge in April 2013. Moody's Analytics Inc. has downgraded several of the City's Bond issues and the Wastewater Enterprise COPs. Moody's also posted the City's future financial outlook as "negative," which means the City's Bond issues and COPs could be further down-graded. It should be noted that the City has paid all outstanding debt secured by the Wastewater Enterprise fund to date.

Although the City's wastewater revenues are expected to be sufficient to cover existing debt service, the City's bankruptcy has cast doubt on the City's overall financial and managerial capacity, two significant factors that the State Water Board must consider in making any CWSRF financing decision. Division staff would like to see this water quality improvement project move forward, but must remain alert to potential risks to the CWSRF.

In order to allow the City to receive principal forgiveness to help make completion of the Project more affordable, the Division has proposed that the CWSRF Program fund 50 percent of the total Project costs, \$1,625,000, with principal forgiveness. The City will cover the remaining \$1,625,000 with funds from the City's Wastewater Utility Enterprise Fund.

To help ensure the CWSRF is protected, the City will establish an escrow account, deposit \$1,625,000, and dedicate the escrow account as security for the proposed CWSRF financing agreement. The funds are to remain in the escrow account until the Project is complete, at which time the CWSRF principal would be forgiven and the Division would authorize release of the funds in the escrow account to the City.

No other existing City debts are or will be secured by the escrow account. The CWSRF Policy requires that net revenues be at least 1.10 times the debt service. However, in this case, so long as the Project is completed, the proposed \$1,625,000 in CWSRF principal will be forgiven; hence there is no future debt service, and the debt coverage requirement is not applicable. Prior to Project completion, the City will provide assurance by holding funds sufficient to repay the total CWSRF principal in an escrow account.

#### FISCAL IMPACT ON CWSRF PROGRAM PRINCIPAL FORGIVENESS

On February 17, 2012, the City received a PFC for the Project, but Division staff placed the financing agreement on hold due to media reports that the City was considering bankruptcy.

The proposed resolution will have no fiscal impact on CWSRF Program principal forgiveness/grants, as the proposed principal forgiveness amount is the same as was originally committed to the Project on February 17, 2012.

#### **POLICY ISSUE**

Should the State Water Board:

1. Approve a CWSRF PFC of \$1,625,000 in principal forgiveness for the City's Project, under the following conditions:
  - A. The City shall comply with the Special Conditions in the Amended FPA.
  - B. This PFC shall expire if the City does not sign the CWSRF financing agreement by April 30, 2014. In accordance with Section IX.K.3 of the Policy, the Deputy Director of the Division (or designee) may approve up to a 120-day extension for good cause;
  - C. Before execution of the CWSRF financing agreement, the City shall provide an opinion from the City's counsel, documenting that counsel has reviewed the financing agreement, and confirming the following:

- i. The City's authority to execute a legal, valid, and binding financing agreement with the State Water Board, and to pledge funds in the escrow account toward such agreement;
  - ii. No pending or anticipated litigation, audits, or disputes exists against the City that might detrimentally affect the pledged revenue source or the City's ability to implement the Project;
  - iii. The City's wastewater rates were adopted in compliance with applicable state law, including Article XIID of the California Constitution;
  - iv. There is no provision or other legal impediment to the City's authority or discretion to adopt, require, or utilize a project labor agreement that includes the tax payer protection provisions of section 2500 of the California Public Contract Code; and
  - v. The Project is being conducted solely within existing public utilities easements, and that the City has the necessary property rights.
- D. Before execution of the CWSRF financing agreement, the City shall establish an Escrow Account in an amount equal to \$1,625,000 that shall be maintained until released by the Division upon completion of the Project. The Deputy Director of the Division (or Division designee) will be an authorized signatory to the associated Escrow Deposit and Reimbursement Agreement, and the account will require both the Deputy Director and the City's Authorized Representative to sign for any withdrawals from the Escrow Account;
- E. Before execution of the CWSRF financing agreement, the City shall adopt a resolution dedicating the Escrow Account as security for the proposed CWSRF financing agreement. This dedicated source of revenue shall be subject to a lien and pledge as security for the obligation. With respect to this dedicated Escrow Account, the City may not incur future debt;
- F. The State Water Board will not disburse funds under the financing agreement until the City has provided satisfactory evidence to the Division that the Escrow Account has been established, fully funded, and pledged;
- G. The City shall continue to meet the debt service coverage on current outstanding wastewater debt; and
- H. Unless information supporting the credit review changes and a supplemental credit review is performed, the financing agreement shall be limited to a maximum of \$1,625,000 (with a 20-year term, at an interest rate of 1.9 percent), with the principal forgiven upon completion of the Project.
2. Direct Division staff to allocate \$1,625,000 consistent with the construction schedule and availability of funds.

## **REGIONAL BOARD IMPACT**

The Project will help the City to comply with discharge requirements, including the Statewide General Waste Discharge Requirements for Sanitary Sewer Systems, Water Quality Order No. 2006-0003, adopted by the State Water Board on May 2, 2006.

## **STAFF RECOMMENDATION**

The State Water Board should adopt the proposed Resolution.

State Water Board action on this item will assist the Water Boards in reaching Goal 1 of the Strategic Plan Update: 2008-2012 to implement strategies to fully support the beneficial uses for all 2006-listed water bodies by 2030.

# DRAFT

## STATE WATER RESOURCES CONTROL BOARD RESOLUTION NO. 2013-

ADOPTION OF A CLEAN WATER STATE REVOLVING FUND (CWSRF) PROGRAM  
PRELIMINARY FUNDING COMMITMENT (PFC) FOR THE CITY OF STOCKTON'S (CITY'S)  
TUXEDO AVENUE SEWER REHABILITATION PROJECT (PROJECT), CWSRF PROJECT  
NO. C-06-7085-110

### WHEREAS:

1. The State Water Resources Control Board (State Water Board), on March 17, 2009, adopted amendments to the *Policy for Implementing the CWSRF for Construction of Wastewater Treatment Facilities* (Policy);
2. The Project is listed on the CWSRF Program Priority List in Priority Class D;
3. In accordance with the CWSRF Intended Use Plan for Federal Fiscal Year (FFY) 2013, adopted by the State Water Board on November 6, 2012, principal forgiveness is available. As a disadvantaged community, the City may receive 50 percent principal forgiveness for eligible Project costs, up to \$3 million in principal forgiveness.
4. The Division of Financial Assistance (Division) issued an Amended Facility Plan Approval (FPA) for the City's Project and the City agreed with the content and conditions of the Amended FPA;
5. The City is the lead agency under the California Environmental Quality Act (CEQA) for the Project, and complied with CEQA and CEQA Guidelines. The City prepared a Notice of Exemption (NOE; State Clearinghouse No. 2009128058) for the Project;
6. The City filed an NOE with the San Joaquin County Clerk on September 29, 2009, and the Governor's Office of Planning and Research on December 10, 2009;
7. The City's environmental documents provided an adequate disclosure of the environmental relationships of all water quality aspects of the Project. The Project will not result in any significant adverse water quality impacts;
8. The Project qualifies for a Section 15302 (Class 2) categorical exemption from the CEQA Guidelines; and
9. The City filed for bankruptcy protection on June 28, 2012; therefore, the City's Project is considered non-routine and the Preliminary Funding Commitment must be presented to the State Water Board for approval.

### THEREFORE BE IT RESOLVED THAT:

#### The State Water Board:

1. Approves a CWSRF PFC of \$1,625,000 in principal forgiveness for the City's Project, under the following conditions:

# DRAFT

- A. The City shall comply with the Special Conditions in the Amended FPA.
- B. This PFC shall expire if the City does not sign the CWSRF financing agreement by April 30, 2014. In accordance with Section IX.K.3 of the Policy, the Deputy Director of the Division (or designee) may approve up to a 120-day extension for good cause;
- C. Before execution of the CWSRF financing agreement, the City shall provide an opinion from the City's counsel, documenting that counsel has reviewed the financing agreement, and confirming the following:
  - i. The City's authority to execute a legal, valid, and binding financing agreement with the State Water Board, and to pledge funds in the escrow account toward such agreement;
  - ii. No pending or anticipated litigation, audits, or disputes exist against the City that might detrimentally affect the pledged revenue source or the City's ability to implement the Project;
  - iii. The City's wastewater rates were adopted in compliance with applicable state law, including Article XIID of the California Constitution;
  - iv. There is no provision or other legal impediment to the City's authority or discretion to adopt, require, or utilize a project labor agreement that includes the tax payer protection provisions of section 2500 of the California Public Contract Code; and
  - v. The Project is being conducted solely within existing public utilities easements, and that the City has the necessary property rights.
- D. Before execution of the CWSRF financing agreement, the City shall establish an Escrow Account in an amount equal to \$1,625,000 that shall be maintained until released by the Division upon completion of the Project. The Deputy Director of the Division (or Division designee) will be an authorized signatory to the associated Escrow Deposit and Reimbursement Agreement, and the account will require both the Deputy Director and the City's Authorized Representative to sign for any withdrawals from the Escrow Account;
- E. Before execution of the CWSRF financing agreement, the City shall adopt a resolution dedicating the Escrow Account as security for the proposed CWSRF financing agreement. This dedicated source of revenue shall be subject to a lien and pledge as security for the obligation. With respect to this dedicated Escrow Account, the City may not incur future debt;
- F. The State Water Board will not disburse funds under the financing agreement until the City has provided satisfactory evidence to the Division that the Escrow Account has been established, fully funded, and pledged;
- G. The City shall continue to meet the debt service coverage on current outstanding wastewater debt; and



# **D R A F T**

- H. Unless information supporting the credit review changes and a supplemental credit review is performed, the financing agreement shall be limited to a maximum of \$1,625,000 (with a 20-year term, at an interest rate of 1.9 percent), with the principal forgiven upon completion of the Project.
- 2. Directs Division staff to allocate \$1,625,000 consistent with the construction schedule and availability of funds.

## **CERTIFICATION**

The undersigned Clerk to the Board does hereby certify that the foregoing is a full, true, and correct copy of a resolution duly and regularly adopted at a meeting of the State Water Resources Control Board held on July 23, 2013.

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Jeanine Townsend  
Clerk to the Board