



DATE: December 3, 2024

TO: Mayor and City Council

FROM: Director of Public Works and Utilities

SUBJECT: Adopt a Resolution Appropriating Funds from the Wastewater Operating Fund to 1) Prepay the 2016 Clean Water State Revolving Fund Loan Related to the Financing of the Recycled Water Project in an Amount Not-to-Exceed \$14.1 million and 2) Establish an Interfund Loan to Finance the Prepayment

RECOMMENDATION

That Council adopts a resolution (Attachment II):

1. Appropriating funds from the Wastewater Operating Fund 610 and approving prepayment of the 2016 Clean Water State Revolving Loan (2016 SRF Loan) related to financing the Recycled Water Project in an amount not-to-exceed \$14.1 million.
2. Establishing an interfund loan to finance the prepayment.

SUMMARY

The City's Wastewater Enterprise periodically pursues loans to finance major capital projects. In 2016, the City sought a low interest loan through the Clean Water State Revolving (SRF) Loan program to finance the construction of a new recycled water system. Payments on the 2016 SRF Loan, *secured by the Wastewater Enterprise*, are paid by the newly established Recycled Water Enterprise. The 2016 SRF Loan has a current balance of approximately \$14.1 million.

The City is now pursuing a loan through the federal Water Infrastructure Finance and Innovation Act (WIFIA) program to finance a set of wastewater capital projects, collectively known as the Water Resource Recovery Facility Improvements – Phase II Project (Phase II Project). The City seeks to maintain flexibility to operate the recycled water improvements, financed by the 2016 SRF loan, either as a separate enterprise or as part of the City's Water Enterprise in the future. As such, staff is recommending that the Wastewater Enterprise pay off the remainder of the 2016 SRF Loan to remove its debt obligation related to the Recycled Water Enterprise. Staff is also recommending the establishment of an interfund loan for the Recycled Water Enterprise to repay the Wastewater Enterprise, with interest, over a period of twenty years.

BACKGROUND

2016 SRF Loan (Financing the Recycled Water Project)

In 2016, the City sought financial assistance from the State Water Resources Control Board (Water Board), through the SRF loan program, to construct a new recycled water system. The Recycled Water Project included the construction of a storage tank and pump station at the wastewater treatment facility, as well as the installation of distribution pipelines and customer connections. Since the Recycled Water Enterprise did not yet exist, the City pledged net revenues from the Wastewater Enterprise Fund to secure the SRF Loan and construct the recycled water system. The City uses funds from the Recycled Water Enterprise to make payments on the loan. The 2016 SRF Loan, amended in 2018, currently has a balance of approximately \$14.1 million.

Anticipated WIFIA Loan (Financing the Phase II Project)

In 2019, the San Francisco Regional Water Quality Board announced new nutrient reduction requirements for the 3rd Nutrient Watershed Permit (Order No. R2-2024-0013, adopted in July 2024). The City's Water Resource Recovery Facility (WRRF) must undergo significant upgrades to meet these new regulatory requirements. As such, the City is designing a set of capital projects, collectively referred to as the Phase II Project, mainly to meet the new mandates for reducing nutrient discharge into the San Francisco Bay by approximately 50% by May 1, 2034.

The City plans to fund the Phase II Project using a mix of cash, revenue bonds, and a federal loan through the WIFIA program, which is administered by the U.S. Environmental Protection Agency. In July 2024, the City submitted the WIFIA Loan Application to borrow \$243.7 million, with plans to pledge net revenues from the Wastewater Enterprise for the loan. The City initially anticipated that the WIFIA loan would be issued on a senior lien basis, on parity with the 2016 SRF Loan that finances the Recycled Water Project.

DISCUSSION

The WIFIA Loan, as well as future revenue bonds, are all expected to be issued on a senior lien basis, secured by the same wastewater net revenues as the 2016 SRF Loan. In order to improve the City's creditworthiness, remove concerns about the Recycled Water Enterprise benefiting from the Wastewater Enterprise, and preserve the City's ability to operate the recycled water improvements as a separate enterprise (or as part of the City's Water Enterprise in the future, if it so chooses), staff is recommending that the City prepay the loan from the Wastewater Operating Fund prior to securing additional financing for the Phase II Project.

The Wastewater Operating Fund 610 currently has approximately \$56.8 million available in working capital. While the balance decreases over the next several years, a sufficient amount would remain available in the Fund. The balance on the 2016 SRF Loan is approximately \$14.1 million. There is no penalty for prepaying the remaining balance on the 2016 SRF Loan.

Additionally, staff is recommending the establishment of an interfund loan so that the Recycled Water Enterprise can repay the Wastewater Enterprise with interest. The interest rate will be equal to the City's investment earnings rate to ensure that the Wastewater Operating Fund will not forego any investment earnings as a result of the loan.

ECONOMIC IMPACT

This agenda item has no economic impact.

FISCAL IMPACT

The Wastewater Enterprise Fund will benefit from removing this debt service obligation prior to issuing revenue bonds and closing the WIFIA loan (both planned for spring 2025). The Wastewater Operating Fund has a working capital of approximately \$56.8 million, which is sufficient to prepay the outstanding balance on the 2016 SRF Loan while maintaining appropriate levels of reserves in the Wastewater Enterprise. While the balance decreases over the next several years, a sufficient amount would remain available in the Fund.

The Recycled Water Enterprise Fund will not be significantly impacted by this action. The annual payment on the 2016 SRF Loan, funded by the Recycled Water Operating Fund, is approximately \$612,000. If the City establishes an interfund loan so that the Recycled Water Enterprise repays the Wastewater Enterprise over a twenty-year period, then the annual payments will be similar to the current annual debt service payments.

STRATEGIC ROADMAP

This agenda item supports the Strategic Priority of Invest in Infrastructure. Specifically, this item relates to the implementation of the following project:

Project N22: Design Water Pollution Control Facility Phase II upgrade

SUSTAINABILITY FEATURES

There are no Sustainability Features directly associated with this item.

PUBLIC CONTACT

No public contact is required for this item.

NEXT STEPS

If approved by Council, staff will initiate the prepayment process for the full remaining balance on the 2016 SRF Loan, using funds from the Wastewater Operating Fund 610. Additionally, staff will establish an interfund loan from the Wastewater Operating Fund 610 to the Recycled Water Operating Fund 630, to finance the prepayment over a twenty-year period.

Prepared by: Sharon Hu, Management Analyst II

Recommended by: Alex Ameri, Director of Public Works

Approved by:

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Dustin Claussen, Interim City Manager