



City of Galveston

Finance Department
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January 24, 2019

To: Brian Maxwell, City Manager
Honorable Mayor and City Council
From: Michael W. Loftin, Assistant City Manager for Finance

RE: Discuss and consider for action an ordinance authorizing the issuance and sale of the City of Galveston, Texas, Tax and Revenue Certificates of Obligation, Series 2019; Providing for the security and payment thereof; Authorizing the execution and delivery of a purchase agreement and a paying agent/registrars agreement; and enacting other provisions relating thereto.

I. Background

- A. **Previous City Council Agenda item approval:** On December 13, the City Council approved Resolution 18-056 (see Attachment A) that authorized the posting of public notice of the City Council to approve the sale of tax and revenue Certificates of Obligation at its January 24, 2019 meeting. (See Attachment B.) The Resolution also named underwriters, law firms and financial advisor as well as the preparation of a Preliminary Official Statement (See Attachment C.) As of the writing of this Staff Report (January 14, 2019) the sale is on schedule (See Attachment D). The bonds will be priced in the marketplace on Wednesday, January 23, 2019, circulated as soon as they are available to Mayor and City Council and the public via the electronic agenda, as well as email to the Mayor and City Council. **As required by the City Charter (Article VII, Section 15a), approving the sale will require six affirmative votes on the part of Mayor and City Council on January 24, 2019. This number is required regardless of the number of the seven City Council members present and in attendance that day.**
- B. **CIP Financing Need (no change from December 2018 staff report):** The Adopted CIP for FY 2019-2023 calls for the implementation of \$171 million in revenue supported projects, including \$104 million for water system improvements, \$60 million for wastewater system improvements, and \$7 million for airport improvements. The water and sewer programs were approved with a complete financing plan included. This plan anticipated the issuance of \$86 million in future water bonds, and \$32 million in future wastewater bonds, with sales to occur on an as needed basis.

In January, 2017, the city issued \$35 million in water and sewer certificates of obligation, and all of this particular sale's proceeds is expected to be allocated to specific projects by the spring of 2019. The \$35 million sale proposed by this agenda item is expected to fund additional design and/or construction contracts scheduled for award between February 2019 and January 2020.

- C. **Description of the Bonds (no change from December 2018 staff report):** All debt service will be paid with water and sewer revenue through the annual budget process. The sale will be serial in nature with principal paid each year over thirty years and combined annual debt service payments that are flat at approximately \$2 million per year. The estimated interest rate including all costs is approximately 4%. (See Attachment E.)

The CO sale documents legally require that the proceeds of that sale be allocated and expended for waterworks and sewer system improvements. The project list is to show the intended use of funds at the time of sale. The City's CIP process is the primary means by which the city identifies available funds and schedules its capital improvement projects each year. Capital funds are not held in reserve pending the approval of contracts to implement a specific project, but are considered available as of fiscal year end. They then must be allocated annually by Council vote through the budget process in accordance with Article VII, Section 9 of the City Charter until such contracts are approved by Council in the course of the fiscal year.

The use of certificates of obligation (CO's) instead of pure revenue bonds will save the City money by eliminating formal reserve requirements that require the holding of cash for the full life of the bonds. Also, CO's attract a lower interest rate because they require a publication of notice underlying pledge of property tax revenue. Total savings is estimated at \$3 million over the life of the bonds. Accordingly, as required by State law, the city needs to publish a notice of its intention to issue CO's for thirty days prior to approving the sale of bonds. The proposed sale of Certificates of Obligation is being conducted in accordance with the City Charter and State law. **As required by the City Charter (Article VII, Section 15a), approving the sale will require six affirmative votes on the part of Mayor and City Council on January 24, 2019.**

- D. **Bond Sale Preparation (no change from December 2018 staff report):** To prepare for the issuance of CO's, a Preliminary Official Statement (POS) must be prepared, and the City Manager is authorized to deem it final in accordance with federal and state law. The resolution designates the following team members to prepare the (POS) and fulfill specific responsibilities in completing the transaction:
1. City officials are assigned the responsibility to exercise their official duties in the completion of the bond sale;
 2. Financial Advisor – Hutchinson, Shockey, Erley & Co.;
 3. Bond Counsel – Bracewell LLP;
 4. Disclosure Counsel – Hunton, Andrews Kurth LLP; and
 5. Senior Manager (Senior Underwriter or “book runner” - Estrada Hinojosa & Company; and
 6. Co-Managers or Underwriters - SAMCO Capital Markets, Inc., and Piper Jaffray & Co.
- E. **Revenue Requirements (no change from December 2018 staff report):** The issue of debt service financing is considered annually to ensure that adequate funds are available for maintenance and operation of the city's water and wastewater systems, for payments to the Gulf Coast Water Authority for water treatment and supply, for principal and interest on debt issued directly by the City and for financial reserves that provide a margin of safety for the city, ratepayers and bondholders alike. Accordingly, the



adequacy of water and sewer rates to support all necessary costs is reviewed annually in conjunction with the preparation of the annual budget and CIP.

The last water and sewer rate increase took effect in October 2015. At that time, a new tiered rate structure was put in place through rates that would simultaneously encourage conservation while shielding small residential users from a major increase. Subsequent annual rate studies have indicated that no change in rates was necessary for FY 2017 and FY 2018. However, a seven percent increase in water rates is needed during FY 2019. Sewer rates are still considered adequate, as they have been in the last three years. The combined rate increase expected for FY 2019 is four percent, but no additional increase is projected for FY 2020. That means that no additional increase is needed until October 2020, or FY 2021. (See attached report from rate consultant Stantec.)

II. Current Situation

- A. **Rates Outlook (see Attachment F for Stantec Rate Report):** As recommended by the City’s water and sewer rate consultant and based on a complete review and comprehensive forecast of all of the City’s costs, the following chart summarizes the necessary rate increase for FY 2019 and the subsequent increases that may be required in FY 2021 and beyond.

WATER AND SEWER RATE OUTLOOK DECEMBER 2018 BOND SALES IN \$ MILLIONS

	Feb. 19 - Jan. 20	Feb. 20 - Jan. 21	Feb. 21 - Jan. 22	Feb. 22 - Jan. 23	Feb. 23 - Sep.24	Totals
Baseline: Bonds to be Issued (\$Millions) - Per CIP						
Water	\$19.34	\$15.60	\$30.56	\$15.40	\$0.00	\$80.90
Wastewater	\$14.63	\$5.38	\$2.68	\$5.72	\$16.95	\$45.36
Subtotals	\$33.97	\$20.98	\$33.24	\$21.12	\$16.95	\$126.26
Rate Increases Required for CIP Bond Issues Baseline						
	Feb-19	Oct-19	Oct-20	Oct-21	Oct-22	
Water	7.00%	0.00%	10.00%	8.00%	0.00%	
Wastewater	0.00%	0.00%	4.00%	3.00%	0.00%	
Alternative: Bonds to be Issued for Water and Wastewater Share of Street Projects						
Water	\$3.59	\$2.29	\$0.00	\$0.00	\$0.00	\$5.88
Wastewater	\$5.20	\$1.68	\$0.00	\$0.00	\$0.00	\$6.88
Subtotals	\$8.79	\$3.97	\$0.00	\$0.00	\$0.00	\$12.76
Rate Increases Required for Water and Wastewater Share of Street Included (Alternative)						
	Feb-19	Oct-19	Oct-20	Oct-21	Oct-22	
Water	10.00%	0.00%	11.00%	8.00%	0.00%	
Wastewater	0.00%	0.00%	4.00%	3.00%	0.00%	

The projections above consider:

- a. The effect of reduced water purchases from the Gulf Coast Water Authority as a result of the large water line break repaired in November 2017;
- b. Growth in the customer base,
- c. Reductions in consumption due to the 2015 rate structure;
- d. Financial reserves required to meet operating and debt reserve requirements; and
- e. Two different scenarios with regard to the water and sewer line costs incurred in conjunction with the city’s street and drainage projects approved in May 2017 by the voters.



- B. Rate Implementation (no change from December 2018 staff report):** *The 7% increase that is recommended to be implemented in February is expected to provide sufficient financial support for water system costs through the end of FY 2020, the next fiscal year ending September 30, 2020.* This rate increase is critical to support the debt service payment on the \$35 million in CO's recommended for sale as CO's in this agenda item. Furthermore, approval of the proposed rates needs to take place as the CO sale finalized on January 24, 2019. This agenda packet includes additional information on the proposed structuring of the water rates themselves.
- C. Baseline and Alternative Bond Issuance (no change from December 2018 staff report):** The Baseline projections above include an additional \$2.6 million for 45th Street water and sewer project costs and \$6 million for contingencies. No other water and sewer costs associated with street projects is included in the \$126 million total. The Alternative approach would allocate \$12.76 million more from water and sewer project costs associated with street projects.

If the city were to continue allocating Water and Sewer CO's to street project that were a part of the May 2017 bond election, this would free up street and drainage bond funding \$12.8 million in cost. If effected immediately, this would require a ten percent increase in rates in 2019 instead of the seven shown under the Baseline. Also, the voter approved GO bonds left unspent would then be available for use on high priority drainage projects. This would include funds for the City's match for grants that might be awarded for major drainage projects such as the drainage pump station project recently announced.

For the time being, the recommendation will be to issue \$35 million in Water and Sewer CO's, while making strategic funding decisions as conditions warrant when street contracts are awarded. The seven percent increase is all that is required to support such a project funding approach.

D. Projects targeted for use of the \$35 million from the recommended sale:

PROGRAM AND CIP NUMBER	PROJECT NAME - ALL CONSTRUCTION	ESTIMATED COUNCIL APPROVAL	TOTALS
WATER			
W1601	10 MILE NEW EST	DEC 2019	\$1,737,500
W1610	PB LAFITTES COVE LOOP	DEC 2019	702,250
W1618	REPLACE WATER VALVES	ONGOING	350,000
W1703	AP PS CONTROLS UPGRADES	OCT 2019	2,743,000
W1701	WELL DISINFECTION / FLUSH	DEC 2019	947,134
W1705	AP PS TANK UPGRADE PH1	SEP 2019	5,765,000
W1802	NON REVENUE WATER MITIG.	ANNUALLY	250,000
W1803	TEICHMAN WL 91ST-96TH	JAN 2020	2,773,000
FD-132	FIRE HYDRANTS	ONGOING	750,000
WWELLS	REHAB WELLS #9, #11	2019	985,000
SUBTOTAL WATER			\$17,002,884
SEWER			
S1701	LS PUMP/ELEC IMPROVE	ANNUAL	\$2,536,000
S1607	PIRATES BEACH WWTP RECONST.	SEP 2019	6,584,400
SSEAWO	SEAWOLF WWTP RECONST.	NOV 2019	1,141,907
S1610	WWTP SLUDGE REMOVAL	2020	5,575,188
ST1806	COUNTY - AVENUE S WL	DEC 2019	1,716,436
ST1807	COUNTY - 23RD WL	DEC 2019	362,600
SUBTOTAL SEWER			\$17,916,531
TOTAL ALL PROJECTS			\$34,919,415



III. Issues (no change from December 2018)

- A. The sale of Certificates of Obligation instead of revenue bonds, as allowed by State law, will result in savings to the City estimated at over \$3 million. Water and sewer revenue will still be used to pay all of the debt service resulting from the sale.
- B. The allocation of Water and Sewer CO proceeds to fund the water and sewer portion of street projects provides additional General Obligation bonding authority for drainage projects beyond the \$12.76 million approved in May 2017.
- C. The bond sale schedule calls for approval of the sale and increased water rates to fund the debt service for the sale, both of which will be on the January 24, 2019 City Council agenda.

IV. Fiscal Impact (no change from December 2018)

- a. Cost of issuance – Will be included in the cost of the sale, approximating one percent of proceeds.
- b. Annual Debt Service – Approximately \$2 million to be paid with water and sewer revenues (see Attachment D).

V. Recommendation

Approve the ordinance approving the sale.



