



COUNTY SANITATION DISTRICTS OF LOS ANGELES COUNTY

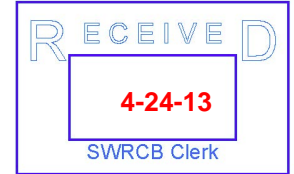
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Via Electronic Mail

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File No. 31-370.40.4D



Ms. Felicia Marcus, Chair & Members of the Board
State Water Resources Control Board
1001 I Street, 24th Floor
Sacramento, CA 95814

Attention: Ms. Jeanine Townsend, Clerk to the Board

Dear Ms. Marcus & Members of the Board:

Amendment to the Policy for Implementing the CWSRF

The Sanitation Districts of Los Angeles County provide wastewater conveyance, treatment, disposal, and water reuse service to over 5 million people in 78 cities and unincorporated territory within Los Angeles County. As a long-time participant in the SRF program, we appreciate the importance of this program and appreciate the opportunity to comment on the recently issued notice of proposed amendments to the *Policy for Implementing the Clean Water State Revolving Fund (CWSRF)*. In preparing our comments, we have recognized and concur with the State Board's goals in amending the policy to protect California's vital water resources through low-cost financing, to promote greater participation in the SRF program by cities and agencies, and to ensure the long-term viability of the SRF program by protecting the principal in the fund.

Many of the proposed amendments will help streamline the SRF financing review and approval process by addressing some of the problem areas that have created delays in the past. However, there are a few key areas, particularly in the area of financial security, which by being overly restrictive could adversely impact an agency's decision to participate in the SRF financing program. This, in turn, could cause the goal of improving and protecting water quality to be compromised. Accordingly, we offer some specific comments in those areas. Additionally, we offer a few suggestions that we believe will further streamline the review process but also enhance the flow of information from applicants to the state staff.

Section IX.B.2.c.ii.(C)(3) — Volumetric Pricing and Water Metering

This section would require *all* applicants to certify compliance with water metering requirements outlined in the State Water Code. However, the Water Code Section cited specifically states, "*any urban water supplier that applies for financial assistance...shall demonstrate that the applicant meets the requirements of this section.*" It is clear that this Water Code Section does not apply to agencies that are solely wastewater treatment providers and do not act as urban water suppliers. While the Districts support water conservation in California, having been a significant long-time producer of recycled water, we are not an urban water supplier. As such, we have no legal authority to compel the water suppliers within our service area to comply with the water metering requirements. The same would be true for any agency that is solely a wastewater service provider. There is no justification to penalize these agencies by

denying them access to the SRF program in the unlikely event that an urban water supplier, over whom they have no control, refused to comply with the water metering requirements in the Water Code.

This section should be amended to read “*All applicants who are urban water suppliers must certify compliance with the water metering requirements.*”

Section IX.B.4.b.i — Reserve Fund Requirement

This section would require applicants to establish and maintain a restricted reserve equal to one year’s debt service (a debt service reserve fund) until the financing agreement is repaid. Furthermore, the applicant would be required to underwrite this fund using its own existing cash reserves. Lastly, this section gives the Division the right to waive this requirement under certain circumstances related to credit or tax considerations. It is not clear whether those circumstances would extend to agencies for which the funding of the reserve requirement would impose an undue financial burden.

Historically, debt service reserve funds have been required to ensure that debt holders would continue to get paid for at least one year in the event of a default by the borrower. This would provide time for the borrower to correct the problems that resulted in the default, prevent future defaults, and keep the lenders whole. More recently, the bond markets have decided that AA credits no longer pose any substantive risk of defaulting and have eliminated the requirement for a debt service reserve fund. This has freed up substantial amounts of money, money that could be better put to use directly addressing water quality issues. We believe this same standard should be applied to the SRF program and that a reserve requirement should not be imposed on agencies with high credit ratings.

However, if a reserve fund is still necessary, the requirement that it be funded using an agencies cash reserves could be a deal breaker for those agencies deciding whether or not to participate in the SRF program. The existing bond markets allow the borrowers to underwrite the reserve fund using a portion of the bond proceeds. This gives them the opportunity to spread the cost of the reserve fund over a 20 to 30 year period. Having to pay for the entire reserve fund in a single year would place a significant financial strain on all agencies, especially in these tough economic times when there is a concerted effort to reduce rates. Thus, if a reserve fund is absolutely necessary, agencies should be allowed to use the SRF program to fund it and repay it over the life of the loan.

Lastly, having the ability to waive the reserve requirement for agencies that have a weak financial condition is punitive to those agencies with good credit and actually places the SRF fund at greater risk (contrary to the goal of providing safety of principal). Agencies with good credit ratings have minimal risk of default and pose no risk to the safety of the SRF fund. Requiring them to tie up a significant amount of money in a reserve fund for 20 years is unnecessary and prevents them from using that money for beneficial water quality projects. Agencies with poor credit ratings and weak financial conditions pose the greatest risk of defaulting and are the very agencies for which a debt service reserve fund should be required. Thus, if absolutely necessary to maintain this section, there should be no waiver of the reserve requirement for agencies on the basis of financial hardship or poor credit rating.

Section IX.B.4.b.ii — Debt Service Coverage Requirement

Although this section deals specifically with debt service coverage, it goes to the broader subject of senior/subordinate status. We recognize, as would be the case with any other lender, that the state wants to maximize its chances of being repaid. This includes the desire to be at the senior level and to have the highest coverages possible to ensure that sufficient rates will be generated to make repayment. However, many agencies may already have existing debt instruments that make it impossible to fully

implement this position or that result in the SRF program, with the proposed modifications, to be a less desirable funding mechanism.

Nearly all bonds have an “additional bonds test” that defines the conditions under which a borrower may take on additional debt. The purpose of this test is to ensure that the borrower has sufficient revenue generating mechanisms in place to ensure the new lender will be repaid without jeopardizing the existing lender. The key provision is that, for senior debt, sufficient service charge rates to cover the maximum annual debt service must not only be adopted but must be effective prior to issuing the new debt. In many cases, the maximum annual debt service may not occur until several years after the debt is incurred. If the rates did not have to be effective at the time the debt was incurred, it would allow an agency the opportunity to ramp up the rates over a number of years, lessening the impact in any given year. This would certainly increase the chances of successfully navigating the Proposition 218 process (which goes a long way to ensuring the lenders will get repaid). The additional bonds test for subordinate bonds does exactly that; it only requires that rates be adopted, not that they be effective. Because of the potential significant impact on rate payers in requiring rates to be effective so early, the Districts have elected to effectively seal off any future senior debt and use subordinate debt. Thus, the desire to make SRF loans senior debt may prevent the Districts and other similarly situated agencies from participating. Because the existing SRF loan conditions already prohibit any future debt from being senior to them, there is no need to require SRF loans to be at the senior level.

Many agencies have bonds with debt service coverage requirements of 1.2 times the highest year’s debt service for senior debt and only 1.1 for total debt. This section would require applicants to have minimum coverages of 1.1 for senior debt and 1.2 for total debt. Consequently any borrower with both bonds and SRF loans would have to have coverages of 1.2 on both senior and total debt. This translates to higher user charge rates being needed to generate sufficient revenue. While the dollar impact may be minimal, it could impact an agency’s ability to successfully navigate the Prop. 218 process and implement service charges. For any agency with existing bonds, this creates an undesirable situation and they will be inclined to opt out of the SRF program.

Given the above, it is recommended that (1) there be no requirement for SRF loans to be at the senior level, only that no future debt be senior to it, (2) that applicants be required to have an “additional bonds test” related to the adoption of future rates, and (3) the policy remain with the existing coverage requirements of 1.2 for senior debt and 1.1 for total debt.

Sections XI.A and B — Financing Approval/Execution of Financing Agreement

The proposed amendments to the Policy eliminate the steps related to facility plan approval and preliminary funding commitment. These two steps previously defined the date after which expenditures would be eligible for financing, provided that a financing agreement was ultimately approved. This was an important element because, often times, there would be significant delays in finalizing and approving the financing agreement. By making costs eligible for financing even though the financing agreement hadn’t been signed, agencies could begin earlier construction of vital wastewater infrastructure and avoid costly delays.

These sections continue this concept by calling out an *effective date*, prior to which construction costs would not be eligible for financing. Unfortunately, the proposed amendments do not clearly define how the effective date is established. Since it is no longer tied to the idea of facility plan approval or the issuing a preliminary funding commitment, it is unclear whether this is the date the financing agreement is approved, the date the application has been reviewed and approved, or some other date.

We fully concur that disbursements under the SRF program cannot be made until a financing agreement has been signed. We also recognize that the state cannot preliminarily agree to the concept of financing without certain technical issues (e.g. plans and specs, credit review, CEQA, facilities plan, etc.) having been addressed. However, there are clearly other documents such as preliminary title reports and legal opinions on property rights that, while important for final approval of the financing agreement, are not necessary for approval of the project. Having to wait until the program manager makes the determination on the financing agreement may compromise early construction and cause delays in meeting compliance schedules.

It is therefore proposed that two dates be defined: 1) the date when the state staff has finished its review of the technical documents and has issued a notification to the applicant of this fact, after which all construction costs are eligible for financing, and 2) the effective date of the financing agreement establishes the date after which disbursements can be made. The applicant would also agree to assume the risk for any costs incurred between those dates if a financing agreement is never signed or if some of the costs are determined to be ineligible pursuant to Section IX.C.2.

As indicated above, there have been instances where there have been significant delays in finalizing the financing agreement. This has resulted in the state considering certain information (e.g., financial data, preliminary title reports, legal opinions) to be “stale” or “no longer current”. The unintended consequence is that the state has requested that the information be updated and the review process be recommenced. This, in turn, causes the applicant to incur additional costs on unnecessary paperwork – money that could be better spent on constructing and operating actual infrastructure projects. Thus, it is imperative that a streamlined review process must be developed to help ensure that these delays can be avoided. One of the ways this can be accomplished is to maintain an active financial profile on each applicant, a file that only needs to be updated and not fully reviewed each time a project is submitted for consideration. Accordingly, it is recommended that each applicant be required to submit certain financial information on an on-going annual basis, including copies of its Comprehensive Annual Financial Report (CAFR) and any Continuing Disclosure documents required under its bond covenants, whether or not it has any pending SRF loan applications. Additionally, applicants should be required to notify the state of any material changes that change its financial condition or that could impact its ability to repay all outstanding SRF loans.

In conclusion, the Sanitation Districts again recognize the importance of the CWSRF Program and applaud the State Board’s efforts to improve the Program. We believe that it is an important tool in helping cities and agencies in their ability to comply with environmental regulations and for helping to ensure the sustainability of California’s water resources. Our comments are offered in that spirit and we urge you to incorporate them into the proposed policy to ensure that the CWSRF Program is attractive and marketable to all communities throughout the state.

Very truly yours,

Grace Robinson Chan



David B. Bruns

Assistant Department Head
Financial Management Department