



THE CITY OF KEY WEST

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MEMORANDUM

EXECUTIVE SUMMARY

TO: Jim Scholl, City Manager
E. David Fernandez, Asst. City Manager

FROM: Jay Gewin, Utilities Manager

DATE: January 30, 2012

SUBJECT: **Approving a Bond Resolution to Authorize the City of Key West to Issue Sewer System Revenue Bonds to Finance Sewer Projects Originally Funded Through the State of Florida Department of Emergency Management, Including Paying Costs Relating to Loan Issuance.**

ACTION STATEMENT:

This resolution and the bond ordinance previously approved will authorize the City of Key West to authorize sewer system revenue bonds, series 2012, to finance sewer projects originally funded by the Florida Department of Emergency Management (FDEM). The City Commission will be presented options to select the amount of the loan. This resolution will also allow the City to pay the costs relating to securing the loan agreement.

City Staff, and Malcolm Pirnie and Public Financial Management, Inc., the City's Rate and Financial Consultants, are recommending executing a 10-year loan with Branch Banking and Trust Company (BB&T) for a total of \$4,065,000 at a 2.07% interest rate. Under this scenario, \$2.2 million would be paid from sewer fund reserves with the City's sewer capital improvement plan modified.

BACKGROUND:

Hurricane Irene hit Key West on October 15, 1999 dumping approximately 9 inches of rain on the island in a 24 hour period. Representatives of the Florida Department of Emergency Management met with City Staff and wrote project worksheets for funding repairs on January 28, 2000 after background information was provided by the City.

Key to the Caribbean – Average yearly temperature 77° F.

\$7,027,292 in FEMA funding was obligated to the City on February 9, 2000 following their review and a conference call with the Governor's Office. Based on these approvals, the City initiated construction projects to repair our sewer system in Sewer Districts F & G on July 7, 2000.

FEMA conducted an audit of the sewer project on September 5, 2003. After their review, the \$7,027,292 in funds was de-obligated January 26, 2004. This meant that the City would be required to repay the state and federal share of \$6,268,629.46. A primary reason for FEMA de-obligating the funds was their opinion that the sewer system was already damaged prior to the hurricane.

The City strongly objected to this de-obligation of FEMA funds, and filed appeals on January 30, 2004 and April 25, 2005. They were both denied.

The City enlisted the assistance of U.S. Representative Ileana Ros-Lehtinen, and also utilized our federal and state lobbyists. However, the position of FEMA and the Florida Dept. of Emergency Management remains unchanged. They are demanding payment of the full \$6,268,629.46. Failure to pay this sum could result in the City being at risk for losing future funding from FEMA for recovery projects resulting from hurricanes or other disasters.

Therefore City Staff firmly believes that we have exhausted all efforts trying to lobby the issue further, and it is now time for the City to resolve this debt in a prompt manner.

PURPOSE & JUSTIFICATION:

If the City were to repay the full amount of \$6,268,629.46 all at once, it would have the decimate our sewer fund reserves, resulting in cuts to our capital program and significant future rate increases to ensure sufficient fund balance to operate the wastewater treatment system. Our existing AA- bond rating would most likely be lowered by the ratings companies such as Fitch.

Staff therefore believes it is in the City's best interest to secure a loan to cover a share of the amount of funds that are owed. This will minimize the negative impact to sewer fund reserves and utility rates for our customers. We have already programmed a \$527,378 payment in the current and extending 19 future years of the rate model in anticipation of resolving this debt to FEMA.

A \$4,065,000/10-year loan being recommended by City Staff and the City's Rate Consultant and Financial Analyst would result in annual payments between \$497,000 and \$502,000. This is close enough to the figure already budgeted to confirm this 10-year loan will not impact sewer utility rates. Under this scenario, we would use \$2.2 million from sewer fund reserves, and modify the sewer capital improvement plan to delay some projects and cancel others. These include:

- WWTP Lightning Protection would be built in-house utilizing OMI staff. Detailed analysis of this project has confirmed that existing staff is able to construct this project. It is the only capital project in the capital plan we determined could be constructed in-house.

- The sewer lift station VFD project will be postponed with project design in FY 2013, and construction in FY2015
- The Pump Station F project will be postponed to FY 2013-2014
- The 2012 N. Roosevelt Sewer Force Main first re-payment under our deferred payment agreement with FDOT will be postponed to FY 2013.

Our bond counsel has gone out for bid to secure the lowest rate obtainable for a loan of \$6.4 million, or an amount as low as \$2 million (with amounts in between as additional options), so that we can re-pay the debt in full, and cover fees for bond counsel and for the financial services consulting required for securing and obtaining the loan for the City. The annual payment for this loan will be incorporated within the future sewer rate models.

Upon the City's request, BB&T has removed the 1% prepayment penalty after the first 5 years of the 10-year loan. Previously, a 1% prepayment penalty would have been in effect throughout the entire length of the loan.

City Staff and our Financial Analyst are recommending against selecting the slightly-lower interest rate loan proposals from JP Morgan Chase and SunTrust Bank, because they include onerous provisions that would allow either to raise the interest rate resulting from factors beyond the City's control. City Staff and our Financial Analyst both believe that the minimal annual savings under the JP Morgan and SunTrust proposals is not worth the risk of having our interest rates increased without our ability to object.

First State Bank of the Florida Keys also submitted a bid that is not recommended by City Staff or our financial analyst. The First State Bank loan is at a much higher 3.60% interest rate, and they are requesting significantly more in fees and expenses to set up the loan than BB&T.

OPTIONS: City Staff is proposing three options to the City Commission to consider, that will be explained in greater detail via presentation:

1. Approve the original recommendation from City Staff, and enter into a 15-year loan from BB&T for \$6.4 million, utilizing no sewer fund reserves. While this option would have no impact on rates, sewer fund reserves, and our capital improvement program, City Staff is no longer recommending this option.

At the last City Commission meeting, it was clear there was concern of entering a loan for the full amount of debt, as well as some doubt as to the necessity of having the loan last 15 years. After a detailed analysis of our rate model by City Staff and our consultants, we are now recommending an option that would alter the City's capital improvement plan and use some of the sewer fund reserves, thereby decreasing the amount to be loaned.

2. The City Commission could approve entering into a \$2 million loan over a span of 10-years, with \$4.2 million being paid from sewer fund reserves. This option is not recommended because it drops our reserves to a level where our current AA- bond rating would be jeopardized, and the City's sewer utility would no longer have funds in reserve to pay for the subsequent years' capital improvement projects in advance.

3. The City Commission could approve entering into a \$4,065,000 loan over a span of 10 years, with \$2.2 million being paid out of sewer fund reserves. This option is recommended by City Staff and our Rate Consultant and Financial Analysts.

Under this option, the sewer capital improvement plan would be modified with some projects postponed. The annual payment for the loan would be nearly identical to what we have budgeted, therefore there would be no impact to rates. Additionally, we would not be using reserves under this option to a level that would jeopardize our current AA- bond rating.

4. There is one additional option that will not be part of the presentation, which is to not approve the bond resolution. This option is not recommended, because if the City were to pay the entire \$6,268,629.46 debt at once, it would have a drastic impact on sewer fund reserves, our capital improvement program, and sewer utility rates. Our capital improvement program includes items that are critical to the operation of our sewer system to minimize the chance of sewer spills in our City streets, and to ensure the flow of wastewater to the WWTP.

FINANCIAL IMPACT:

If the City were to pay the entire \$6,268,629.46 debt at once, it would result in a significantly negative impact to our sewer fund reserves. As you recall, our sewer reserves were also impacted by the North Roosevelt Project bid being approximately \$2 million above FDOT's construction estimate.

By securing a \$4,065,000/10-year loan, the sewer utility will be able to pay back the entire debt amount at a rate that will not negatively impact the sewer fund reserves or the capital improvement plan. \$527,378 per year has already been programmed into the sewer budget in account 401-3501-535-71 (principal) and account 401-3501-535-72 (interest) in anticipation of resolving this issue.

The annual payment for the \$4,065,000 loan is about \$25,000 dollars below what we had budgeted annually, therefore approving the 10-year loan from BB&T will not have an impact on utility rates.

RECOMMENDATION:

Staff recommends option # 3, that the City Commission approves allowing City Staff to secure a \$4,065,000/10-year loan from BB&T, with \$2.2 million being used from sewer fund reserves, so that we can resolve the sewer debt issue with FEMA/FDEM.