



## 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:** December 14, 2011

**SUBJECT:** **Approving a Bond Resolution and Ordinance to Authorize the City of Key West to Issue \$6,400,000 in 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 accompanying bond ordinance will authorize the City of Key West to authorize \$6.4 million in sewer system revenue bonds, series 2011, to finance sewer projects originally funded by the Florida Department of Emergency Management (FDEM). This resolution and ordinance will also allow the City to pay the costs relating to securing the loan agreement.

City Staff and Public Financial Management, Inc., the City's Financial Consultant, both recommend executing a 15-year loan with Branch Banking and Trust Company (BB&T) at a 2.65% interest rate.

#### 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.

\$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

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

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 pay the full amount of \$6,268,629.46 all at once, it would have the significantly negative impacts of decimating 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.

Staff therefore believes that it is in the City's best interest to secure a loan to cover the amount of funds that are owed. This will minimize the negative impact to sewer fund reserves and 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.

The 15-year loan that is being recommended by City Staff and the City's Financial Consultants would result in annual payments between \$550,000 and \$555,000. This is close enough to the figure we have already budgeted to confirm this 15-year loan will not impact future rates.

The City has also confirmed from our bond counsel that the original voter approval for sewer bonds in 1999 could authorize us to secure this loan to resolve this debt with FEMA. The sewer projects constructed de-obligated by FEMA is within the scope of work detailed in the bond referendum.

Our bond counsel has gone out for bid to secure the lowest rate obtainable for a loan of \$6.4 million so that we can re-pay the debt in full, and to cover the fees for bond counsel and for the financial services consulting required to secure and obtain the loan for the City. The annual payment for this loan will be incorporated within the future sewer rate models. Please see the report from Public Financial Management, Inc. which details the bid process and their recommendation.

Upon the City's request, BB&T has removed the 1% prepayment penalty after the first 7.5 years of the 15-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 (approximately \$7,000 per year) 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 would cost the City approximately an additional \$50,000 per year. Over 15 years, the City would have to pay an additional \$771,694 to First State compared to the BB&T loan. Additionally, First State Bank is requesting \$50,000 more in fees and expenses to set up the loan than BB&T.

#### **OPTIONS:**

1. Approve the bond ordinance and resolution that will allow the City to resolve the debt with FEMA/FDEM. Accepting the 15-year loan from BB&T would have no impact on rates, sewer fund reserves, and our capital improvement program.
2. The City Commission could recommend the execution of a shorter-term 10-year loan to resolve the debt. This option is not recommended by City Staff or our financial consultant because the annual payment is over \$250,000 beyond the figure we had budgeted to resolve the debt. This would therefore have an impact on future rates, our reserves, and our capital improvement program.
3. The City Commission could recommend the execution of a longer-term 20-year loan. This option is also not recommended by City Staff or our financial consultant. While the annual payments are \$50,000 lower than what we have budgeted, the loan for this period is at a higher interest rate for a longer period of time. This would result in the City paying approximately \$1.2 million more over the duration of the loan.
4. The City Commission could recommend the execution of a 15-year loan from JP Morgan at a slightly lower interest rate than BB&T, at 2.48%. This option is not recommended because the JP Morgan loan includes a clause that would allow them to increase interest rates in the event that capital charges change, or banks' cost of funds change. This could result in a sudden increase in interest rates that could be very significant to the City. If the City was willing to accept this risk, it would only result in an annual savings of around \$7,000 per year. City Staff and our financial consultant believe this minimal savings from the secured-rate BB&T loan is not worth the risk of an increase in loan interest rates that could significantly raise the total cost to the City.

5. Do 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 significantly negative 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 assuredly 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 15-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 this loan is only approximately \$27,000 above what we had budgeted, therefore approving the 15-year loan from BB&T will not have an impact on utility rates.

#### **RECOMMENDATION:**

Staff recommends option # 1, that the City Commission approves the bond ordinance and resolution allowing the City to secure a \$6.4 million 15-year loan from BB&T so that we can resolve the sewer debt issue with FEMA/FDEM.