



# COUNTY SANITATION DISTRICTS OF LOS ANGELES COUNTY

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Board of Directors  
County Sanitation District No. 34  
of Los Angeles County

Directors:

## **Financial Matters**

The agenda for the June 19, 2018 meeting of the Board of Directors of District No. 34 contains two items regarding financial matters. The first item pertains to the final budget for fiscal year 2018-19. The second item relates to the adoption of various financial policies that were discussed with the Directors at the September 2017 Board meeting.

### FINAL BUDGET FOR FISCAL YEAR 2018-19

Attached is a copy of the proposed budget for FY 2018-19 with a breakdown of the necessary expenditures. The only budget resource for District 34 at this time is payments from the City of La Cañada Flintridge. The budget has been prepared in accordance with the Joint Administration Agreement, which states that districts that do not have an active sewerage system (District 34) shall pay one one-hundredth of one percent of all joint expenses.

### FINANCIAL POLICIES

Investment, debt management, and financial reserve policies provide guidance when preparing budgets, adopting rates, and developing long-term capital programs. All three Policies were brought to the Personnel Committee (comprised of the Chairpersons of all the Districts) for its review and consideration on August 23, 2017. They concurred with the recommendations that staff presented. The following summarizes the information that was provided at that meeting.

District No. 34 has annually adopted an Investment Policy, while the other two proposed policies, with a few exceptions, formalize the practices that have been in place for a number of years and can be utilized when the District becomes active. Use of the Policies will improve financial stability, allow the districts to better weather periods of economic downturn without having to impose significant rate increases, and construct capital projects in a timely fashion despite fluctuations in costs from year to year.

Investment Policy: The Investment Policy, which has been in place for many years, establishes the practices under which the District invests reserves until such time as they are needed to meet expenses. The Policy focuses on three tenets: safety of principal, liquidity, and return on investment. The Policy identifies what types of investments are allowable, how much can be invested in any given investment instrument, and what the maximum term can be.

Funds for meeting day-to-day expenses are held in either the Los Angeles County Pooled Surplus Investment Fund (PSIF) or the Local Agency Investment Fund (LAIF). Both are pooled funds that provide a relatively modest rate of return in exchange for liquidity. Historically, the District has utilized the PSIF more than LAIF because it provides a higher rate of return and allows withdrawals to be made daily as opposed to monthly.

Funds that are not needed in the near-term are placed in specific investments, which usually pay a higher rate of return than either the PSIF or LAIF but have more restrictions on when they may be liquidated. Historically, specific investments have focused on Government Sponsored Enterprises or GSEs (e.g., Fannie Mae and the Federal Home Loan Bank). Under the existing Policy, up to 100% of the District's funds may be invested in GSEs, although no more than 60% can be invested any single GSE. In addition to the GSEs, a small amount of the funds are invested in medium-term corporate notes (MTCN) that are rated at least AA. Under the current Policy, no more than 20% of the District's funds may be invested in MTCNs in aggregate and no more than 5% can be invested in any single MTCN. All of the specific investments have a maximum term of 5 years.

Debt Management Policy: The Debt Management Policy, which is now required by Government Code Section 8855(i), formalizes the practices that have been followed when issuing debt on behalf of the other Districts. The Policy will establish the guidelines under which District No. 34 can take on debt in the future when it becomes active. The Policy focuses on the types of debt instruments that are allowable and provides metrics that can be used to assess the District's level of debt. Some of those same metrics can be used to help determine appropriate service charge rates and maximize the District's credit rating (which provides the lowest interest rates).

Nearly all of the Districts' debt instruments have been either revenue bonds or State Revolving Fund (SRF) loans. Both of these instruments are fixed interest rate securities with pre-established maturities, similar to a fixed rate mortgage. Clean Renewable Energy Bonds (CREBs), which are similar to normal revenue bonds, may only be used for renewable energy projects. It is proposed that the Debt Management Policy continue to incorporate these debt instruments.

Conservative metrics have been developed based on the guidelines promulgated by S&P Global Ratings. The metrics focus on the ability to make the annual debt payments (debt service coverage ratio), the percentage of the O&M budget coming from debt, and the percentage of assets that have outstanding liabilities (debt to capitalization ratio). These are the metrics the Districts have been informally following and which have allowed our overall credit rating to remain excellent (currently rated as AAA, the highest possible credit rating).

Wastewater Financial Reserve Policy: The Financial Reserve Policy will formalize the practices that are already embedded in the budget and rate setting practices for the Wastewater System. The Policy will establish guidelines for accumulating and expending reserve funds, and ensuring that monies are available in a timely manner. In addition to being timely, reserves are used to smooth out rates as expenditures vary from year to year. Lastly, the Policy will guard against adverse financial impacts from unforeseen circumstances such as natural disasters or other emergencies. Because District No. 34 is currently inactive, many of the provisions of this Policy are not being used today; however, they will provide guidance for when the District does become active.

In addition to the general operating fund, the active Districts have both Designated and Restricted Reserves. Both types of reserves place restrictions on what the monies may be used for. In the case of Designated Reserves the Board voluntarily elects to impose the restrictions, while for Restricted Reserves

they are typically imposed through law or administrative action, or by District's Ordinance. The Designated Reserves include the cash flow requirement fund, emergency and natural disaster funds, O&M and capital financial stability funds (formerly the rate stabilization fund) and sinking funds, all of which are currently incorporated into the adopted budgets. The Restricted Reserves include the Capital Improvement Fund (accumulated connection fees) and monies set aside for other post-employment benefits (OPEB).

This proposed Financial Reserve Policy only applies to the Wastewater System. A separate Solid Waste Financial Reserve Policy will be presented at a future date to address the specific needs of the Solid Waste System.

Proposed Improvements: There are currently only three MTCNs that (1) are rated AA (the Districts' standard) and (2) offer investments of sufficient size relative to the Districts' resources. Effectively, this means that the aggregate amount in MTCNs will never be above 15%, even though the Policy allows up to 20%. In order to help maximize the Districts' earnings, it is recommended that the percentage for any single MTCN be raised to 10% while keeping the aggregate for all MTCNs at 20%. This has the potential to slightly increase the District's rate of return with no added risk. The revised limits would still be more restrictive than what is currently allowed under the California Government Code.

The Solid Waste System is required, under state mandate, to maintain closure/post-closure maintenance funds for the Puente Hills and Spadra Landfills for a minimum of 30 years. Because the current Investment Policy limits investments to 5 years, the Districts are foregoing a significant amount of interest that could be earned if those funds were to be invested for longer periods (which have associated higher interest rates). At the same time, the Joint Outfall System has a need for a long-term debt instrument to help fund the construction of the Clearwater Tunnel Project. A structured loan between the two Systems would allow the Solid Waste System to earn a higher rate of return while the JOS could secure its funding without having to go out on the open market and incur a higher cost of issuance. Such an arrangement would be very secure in that both Systems are managed by the same staff and have equal incentive to ensure that no default occurs. All of the funds would be kept locally, with interest payments staying in the region. The Districts' financial advisor or another independent third-party would be used to help establish the terms and conditions of any proposed loan, ensuring that they will be fair to both sides, reflect current market rates, and be completely transparent. The loan agreement would then be brought to the Personnel Committee, and then to District No.2 (representing the Solid Waste System) and each of the JOS Districts participating in the loan for their consideration and approval. It is recommended that both the Investment Policy and the Debt management Policy be amended to allow such a loan to be considered as an option. This change only allows for the possibility; it does not commit either System to enter into such an arrangement.

Two other types of debt instruments that have limited uses are being recommended for inclusion in the Debt Management Policy because they have the potential to offer benefits in unique circumstances. The first is commercial paper, which is a short-term, unsecured note that charges a fixed rate of interest for a term of up to 270 days. Depending on the type of financing ultimately used for the Clearwater Project, commercial paper may be desirable as a source of interim construction financing until it is appropriate to replace it with a long-term debt instrument. The second type of proposed debt instrument is land secured financing utilizing a Community Facilities District. This type of financing is most commonly used in undeveloped areas for funding the construction of the initial infrastructure. Currently, this type of financing would only be practical and useful in the Newhall Ranch Sanitation District, but, for the sake of consistency, has been proposed to be included in the Policies of all of the Districts. Including these types

of debt in the Policies does not constitute approval of the debt; it simply allows for it to be considered in the future. Any such debt issuance will require Board approval.

SUMMARY OF REQUIRED ACTIONS

At the June 19, 2018 Board meeting, it will be recommended that the Board of Directors adopt the budget for FY 2018-19 and authorize appropriations in the sewerage system budget, both as shown on the agenda. It is also recommended that the Board consider adoption of the financial policies.

Very truly yours,



Grace Robinson Hyde

GRH:gc

Enclosures