



# SANTA CLARITA VALLEY WATER AGENCY

Finance Committee Meeting – Infrastructure Financing

August 16, 2021

# TABLE OF CONTENTS

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1. Theories of Infrastructure Financing
2. Fitch Commentary on Borrowing
3. Age of Pay-Go Financing Replacement
4. Sample Funding Concept for Projects
5. Potential Rate Implications

# FUNDING SOURCES FOR INFRASTRUCTURE

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## Cash

Through either reserves or current year revenues

## Debt

Borrow funds from investors to construct projects

## Hybrid

Use of cash and debt

# TO BOND OR NOT TO BOND

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- Fitch Ratings: “...debt affordability is best viewed in the context of a comprehensive assessment of capital needs...identifying [desired] projects creates a basis for prioritizing and seeking possible funding sources....”
- Fitch Ratings: “Quantifying the amount of debt the [rate] base can support enables an entity to determine the scope and limits of immediate, medium-term and long-term capital plans.”
- Fitch Ratings: “...policies [and practices] that do not allow for the funding of essential projects carry risk that Fitch sees in some cases as greater than those of a high debt load. Some possible ramifications [of such] are increased O&M...growing cost of remediating, facilities and inability to provide adequate vital services...”

# BORROWING

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- Paygo programs reduce the amount of debt needed and possibly allows for budget flexibility in years where net revenues are lower than expected.
- Debt is useful for state and local governments with large-scale capital needs

# DIFFERENT CLASSES OF INFRASTRUCTURE

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1. Traditional repair, replacements and some upgrades of infrastructure; tend to have shorter useful lives, manageable costs and an immediate need. These projects are typically better suited for cash funding.
2. Regulatory imposed projects tend to have long useful lives, be costly and with specified timelines for completion; depending on the issuer likely suited for debt funding, or hybrid funding.
3. System-wide capital replacement, or enhancement projects for large scale infrastructure – tend to be costly and suitable for debt.

# GENERAL THEORY UNDERLYING DEBT

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- Allows issuer to leverage its cash flow to generate money upfront, thereby allowing the issuer to construct projects sooner and timely
- Allows issuer to spread the cost of funding infrastructure over the useful life of the asset
  - The asset provides benefits to multiple generations and debt financing results in multiple generations sharing the benefit and cost
- Borrowing with fixed rate loans/securities tends to be less favorable in high inflation environments
  - High uncertainty and interest rates which increase the cost of borrowing
  - Use of alternative products: variable rate and put bonds

# PLANNING HORIZON

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- Decision to bond or not to bond is complex and must be assessed and made on a case-by-case basis.
- Plan to be successful:
  - Create a comprehensive capital improvement program and update annually
  - Prioritize projects by immediate, medium-term and long-term needs
  - Apply appropriate inflation factors to project costs – ENR maybe more relevant than “general inflation” depending on the project
  - Identify projects that are suitable for Paygo and commit to funding and spending
  - Continue updating long-range financial plan annually



# BENEFITS OF BOND FINANCING

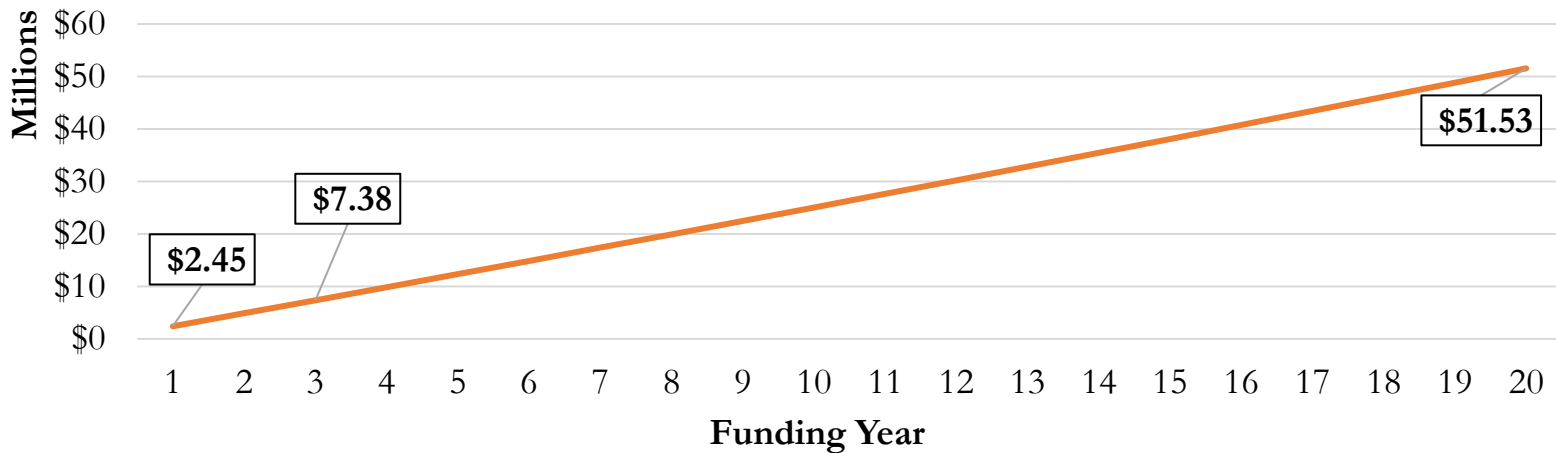
- Generally, using cash to fund long-term capital infrastructure is less practical as it requires increasing rates well in advance of expenditures and investing cash to maintain pace with inflation
- Using bonds to fund large capital projects allows the repayment period of the debt to equal the useful life of the project (infrastructure projects benefit

Cash Funded (Pay-as-you-go) CIP		Bond Funded CIP	
<u>Pros</u>	<u>Cons</u>	<u>Pros</u>	<u>Cons</u>
Avoids interest expense	Potentially depletes reserves; or require annual rate increases to maintain reserve policy levels	Inter-generational equity, requiring multiple generations to pay for the project benefits	Added interest expense
No interest expense	Reduces operational and liquidity flexibility	Lock in current interest rates	Market risk
No interest rate risk	Must start funding project costs (including inflation) in advance of expenditures	More affordable and stable water rate structure	Annually meet bond covenants

# EX. \$50 MILLION PROJECT FUNDING

- Debt financing allows funds to be received day one and spreads cost over life of assets
  - In order to fund same project size at equivalent levels of customer rates; it would take 20 years to fund \$50 million

Cash Funding \$50 million project at \$2.4MM Annually

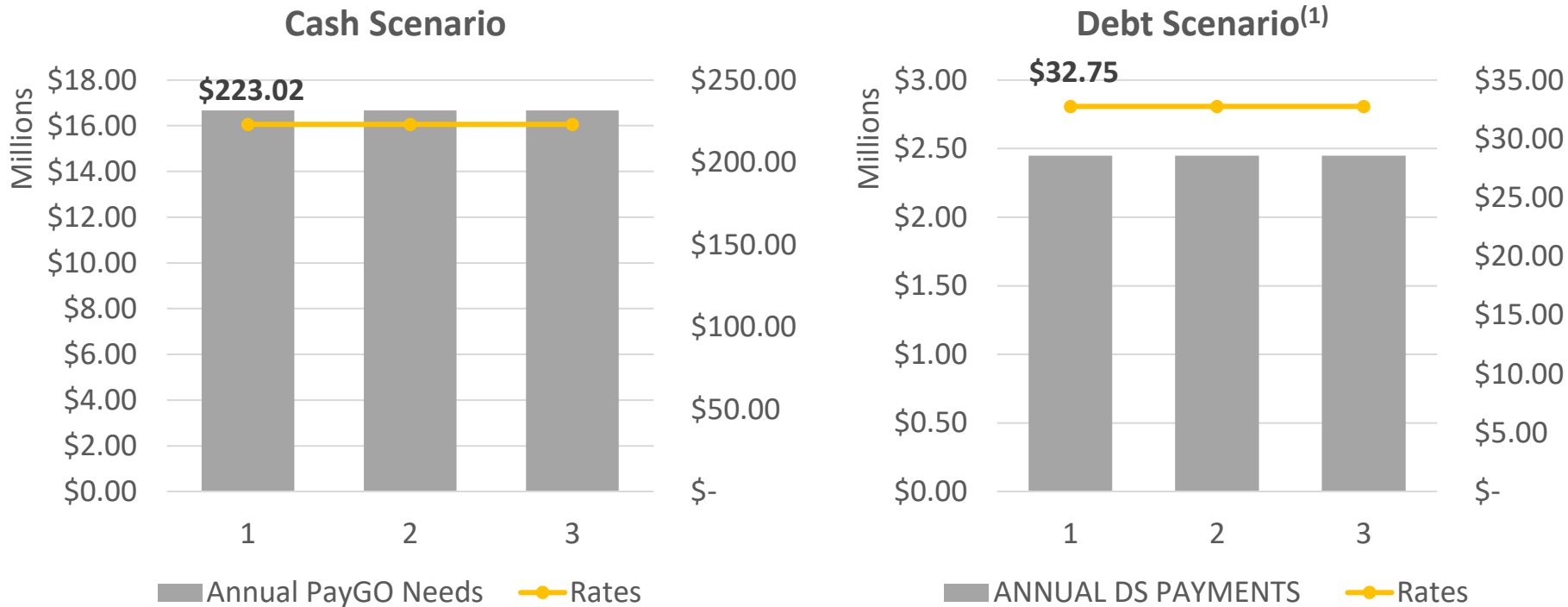


Debt Financing Scenario					
<i>Funding Year</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
Beginning Project Fund	\$50,000,000	\$33,333,333	\$16,666,667		
End Project Fund	\$16,666,667	\$16,666,667	\$0		
<b>ANNUAL DS PAYMENTS<sup>(1)</sup></b>		\$2,447,585	\$2,447,585	\$2,447,585	\$2,447,585

(1) Results in total estimated debt service costs of \$73.3 million.

# SAMPLE BOND VS. CASH FUNDING

- In order to cash fund a \$50 million project over three years, on average a service connection would need to pay ~\$223 in comparison with ~\$33/service connection on a debt financing



(1) Results in total estimated debt service costs of \$73.3 million.

# SAMPLE HYBRID APPROACHES

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- Use \$11.2MM to issue bonds with a 25 year final maturity
- Use \$11.2MM to reduce annual debt service

	25 YEAR	30 YEAR
CASH CONTRIBUTION	\$ 11,200,000	\$ 11,200,000
PAR AMOUNT	\$ 34,190,000	\$ 34,715,000
PROJECT PROCEEDS	\$ 50,000,000	\$ 50,000,000
AVERAGE ANNUAL D/S	\$ 2,027,020	\$ 1,814,774
TOTAL D/S	\$ 50,591,031	\$ 54,367,590
TRUE INTEREST COST	2.090%	2.271%

# S&P REPORT JULY 10, 2020

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- S&P assigned a rating of AA+ to the Agency's senior lien debt and AA to all other outstanding debt
- Summary of the Agency's credit profile:
  - *extremely strong all-in debt service coverage exceeding 1.7x through 2024.*
  - *Extremely strong liquidity position...about 1,250 days cash on hand*
  - *The debt profile is moderately leveraged with a pro forma [at] 39.2% debt-to-capitalization ratio with the expectation that this will rise slightly over the next five years.*
  - *Strong financial management assessment...adequate policies in all key areas.*

# FITCH REPORT JULY 9, 2020

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- Fitch assigned a rating of AA with a Positive Outlook to the Agency's Senior Lien debt and AA- to all other outstanding debt
- Summary of the Agency's credit profile:
  - [Has] *moderate net leverage and is expected to remain near current levels in the near term even with proposed borrowing amounts*
  - *Rates are considered affordable for the vast majority of the population*
  - [Has] *a very low cost burden and moderate life cycle investment needs supported by adequate capital investment*

# RATING SCALES

Moody's	S&P	Fitch	Credit Worthiness
Aaa	AAA	AAA	An obligor has <b>EXTREMELY STRONG</b> capacity to meet its financial commitments.
Aa1	<b>AA+</b>	AA+	
Aa2	<b>AA</b>	<b>AA</b>	An obligor has <b>VERY STRONG</b> capacity to meet its financial commitments. It differs from the highest rated obligors only in small degree.
Aa3	AA-	AA-	
A1	A+	A+	
A2	A	A	An obligor has <b>STRONG</b> capacity to meet its financial commitments, but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
A3	A-	A-	
Baa1	BBB+	BBB+	
Baa2	BBB	BBB	An obligor has <b>ADEQUATE</b> capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments
Baa3	BBB-	BBB-	

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**THANK YOU!**

**UPCOMING FINANCE  
COMMITTEE MEETING IN  
SEPTEMBER**