City and Borough of Sitka
Finance Department

Memo

Thru : Mark Gorman, Municipal Administrator

To: City and Borough of Sitka Assembly

From: Jay Sweeney, Chief Financial and Administrative Officer

Date: November 21, 2016

Re: Additional Electric Revenue Bond Questions and Answers

Mayor Hunter and Assembly Members,

Additional questions have been asked in particular reference to Sitka's electric revenue bonds, including exactly what bond proceeds can and can't be used for. The key questions, and corresponding answers, are set forth below.

1. **What exactly can unspent electric revenue bond proceed be used for?**

   The use of electric revenue bond proceeds is governed by Sections 3 and 17 of Ordinance 2013-38, which specifies that *"(in Section 3) if the entire project has been constructed or duly provided for…and Project Bond proceeds remain available, the Assembly may apply Bond proceeds to other capital repairs or improvements to the Electric System or to retiring the Bonds, and, "(in Section 17) money remaining in the project fund after all such costs (of the original project) have been paid shall be applied to other capital improvements of the electric system*".

2. **What can unspent electric revenue bond proceeds not be used for?**

   Unspent bond proceeds may not be used for any other purpose than those specified in the bond ordinance. This limitation means that unspent bond proceeds, for example, could not be used to pay operating costs, could not be used to pay for capital improvements outside of the electric system (wastewater, for example), can't be used to pay interest on the bonds (as interest is an operating cost), may not be transferred into the Rate Stabilization Fund, or transferred to another fund. In addition, since the bonds are tax-exempt, certain other limitations may apply under Federal tax rules.

3. **If unspent electric bond proceeds are used to retire bonds, will it lower the required revenue the Electric Fund must earn?**

   No. The reasons are twofold:

a. The amount of revenue the electric system must earn is specified by Section 21 of the Loan Agreement between the Alaska Municipal Bond Bank Authority and the City and Borough of Sitka, which specifies that "*Net Revenues in each fiscal year will equal at least 1.25 of the annual debt service requirement for such year on the outstanding Municipal Bond and all bonds issued on a parity within, taking into account transfers from the Rate Stabilization Account to the extent permitted under the City Ordinance". "Net Revenue" is defined in Section 2 of ordinance 2013-38 and means "for any period, Revenue of the System less operating expenses for that period, excluding from the computation profit or loss from the disposition...of properties...of the Electric System..."* Unspent bond proceeds can't be counted as part of "Revenue of the System"; thus, even if such proceeds are used to make debt service payments, the 1.25 rate covenant remains in effect, requiring sufficient qualifying revenues to be earned.

b. As previously mentioned in another memorandum, bonds issued by the Alaska Municipal Bond Bank Authority are not callable (can't be redeemed early) for 10 years after issuance. Thus, the first call date would be in 2024. Outstanding bonds could be defeased (as previously described), but doing so would only affect the rate covenant in the year the principal amount is due.

4. **<u>Why do unspent electric revenue bond proceeds exist</u>?**

The reasons are twofold:

a. When the Assembly voted to authorize the issuance of an additional $80,500,000 in electric revenue bonds (Resolution 12-25, October 9, 2012), the plan was to break the total into three separate issuances, to match the overall project cash flow requirements, and to reduce the amount of interest that would be paid on unspent bond proceeds were the issuances combined into one. Lowering costs to the taxpayers was the goal.

b. In the summer of 2014, unspent proceeds from the first two supplemental bond issuances ($61,145,000) were running low. At the same time, the City and Borough was engaged in extensive lobbying action to (1) first try and obtain additional grant funding from the Legislature to prevent having to have a third and final bond issuance, and (2) not having succeeded in (1), attempting to negotiate a loan with the Alaska Industrial Development and Export Authority (AIDEA) for remaining required projects funds. Furthermore, at the same time, the "45-day cut-over period" had not commenced, and, engineers were concerned that adequate contingency amounts be reserved for unanticipated expenses that may occur during the cutover. The loan terms offered by AIDEA were less favorable than bonding rates, and, Sitka hit a funding deadline to either conduct the final bond issuance or risk running out of project funding and delaying the project. Accordingly, Sitka decided in July of 2014 to bond for the remaining $16,325,000, prior to the cut-over, which ultimately did not result in use of the contingency and resulted in unspent bond proceeds.

5. **<u>Why was issuing 35-year bonds requiring interest-only for the first 20 years (for the three supplemental bond issuances) a good thing for Sitka rate payers</u>?**

The reason is the revenue covenant previously mentioned. If Sitka had issued the additional $80,500,000 in revenue bonds with annual principal maturities beginning right away, the required revenue (to come from rates) would have had to be 1.25 x the annual principal. This would have meant an additional annual payment of approximately $4 million in principal, requiring an additional $5 million in user fees. This would have equated to an additional 3.6 cents per kWh, putting the cost of electricity in the 18 cents to 19 cents per kWh range. Thus, true, additional interest must be paid, but Sitka citizens received a substantial current benefit in lower electric rates.