



**BUSINESS OF THE CITY COUNCIL
CITY OF MERCER ISLAND**

**AB 6528
September 3, 2024
Regular Business**

AGENDA BILL INFORMATION

TITLE:	AB 6528: Bond Ordinance Authorizing the Issuance of One or More Series of Limited Tax General Obligation and Refunding Bonds to Finance and Refinance Projects of the Water Utility (Ord. No. 24-09, First Reading)	<input type="checkbox"/> Discussion Only <input checked="" type="checkbox"/> Action Needed: <input checked="" type="checkbox"/> Motion <input checked="" type="checkbox"/> Ordinance <input type="checkbox"/> Resolution
RECOMMENDED ACTION:	Complete first reading of Ordinance No. 24-09. Schedule second reading and adoption for September 17, 2024.	

DEPARTMENT:	Finance
STAFF:	Matt Mornick, Finance Director Jason Kintner, Chief of Operations
COUNCIL LIAISON:	n/a
EXHIBITS:	1. Ordinance No. 24-09
CITY COUNCIL PRIORITY:	n/a

AMOUNT OF EXPENDITURE	\$ n/a
AMOUNT BUDGETED	\$ n/a
APPROPRIATION REQUIRED	\$ n/a

EXECUTIVE SUMMARY

The purpose of this agenda bill is to provide background on Ordinance No. 24-09 (see Exhibit 1), authorizing the issuance of limited tax general obligation and refunding Bonds (the “Bonds”) to finance and refinance capital improvements to the City’s water distribution system.

- The City is in a period of significant capital reinvestment as major components of the City’s water distribution system reaches the end of its useful life. Between 2025 and 2030, the water utility requires an estimated \$74 million (M) in capital spending.
- Staff recommends financing a portion of these investments with proceeds from the Bonds. The Bonds are limited tax general obligations and the City will pledge its full faith and credit to the repayment of such Bonds. Water utility revenues will be used to pay principal and interest on the obligations.
- The City has outstanding \$655,000 of its Limited Tax General Obligation Bonds, issued in 2011 to finance a portion of a water system improvement project in the First Hill neighborhood. The City may have the opportunity to refund (refinance) these outstanding 2011 Bonds for interest rate savings. Staff recommends proceeding with the refunding if it results in savings to ratepayers.

- The proposed Bonds will be issued in October in the aggregate principal amount not-to-exceed \$29 M. This principal amount is based on maintaining the lowest possible annual utility rate adjustment to operate and reinvest in the water distribution system. These Bonds will spread out significant capital investment costs so not to put an undue burden on current ratepayers and position the City to effectively meet federal obligations for tax-exempt Bonds.

BACKGROUND

WATER UTILITY FINANCING

In December 2022, the City Council adopted a six-year Capital Improvement Program (CIP) as part of the 2023-2024 biennial budget. The [2023-2028 CIP](#) outlines the City's strategic financial plan to acquire, expand, or rehabilitate public infrastructure, including the City-owned and operated water distribution system.

Most of the Island's water distribution system was constructed 50 to 75 years ago. Though the City has made investments to effectively operate and maintain the water utility, system components are reaching the end of their useful life and require significant reinvestment over the next six years.

Historically, the funding strategy for the water utility has been to pay for operation and infrastructure needs directly from fees charged for water service. This approach works well during periods with standard operations and typical levels of reinvestment. When large portions of the water system need to be simultaneously replaced, additional funding from outside sources may be required.

The Utility Board, in making their recommendations to the City Council, consistently seeks to balance the many infrastructure investment needs with maintaining a similar year-over-year water utility rate adjustment so as not to put an undue burden on current water utility customers. For the next six years, this approach requires using outside funding – such as debt financing via limited tax general obligation Bonds – for capital projects that cost more than \$2.5 M and have a useful life greater than 20 years.

Debt financing spreads costs incurred in a relatively short period over the useful life of the updated infrastructure, avoiding spikes in annual rate adjustments, and creating generational equity, whereby generations of rate payers who benefit from these investments help pay down the associated costs.

The 8% water rate increase in 2024 assumed a portion of the scheduled water capital projects will rely on debt proceeds. With the \$29 million LTGO Bond issuance in October 2024, staff estimate the annual rate adjustment in 2025 will remain at 8%, pending the Utility Board's review and City Council approval as part of the 2025-2026 biennial budget work this fall.

This estimated 8% rate adjustment provides adequate funding to support ongoing utility operations and the additional debt service payments (principal and interest) resulting from the LTGO Bond issuance. This outside funding is crucial to see through major water system improvements. Without it, \$25 million in capital improvements to the water system would need to be deferred to hold the 8% rate increase over the next two years.

MECHANICS OF A BOND ISSUANCE

When seeking outside funding for significant infrastructure related projects, it is common practice for public utilities to issue debt as revenue Bonds. The City also has the option to issue debt as limited tax general obligations (LTGO). Staff recommends the latter option. LTGO Bonds are general obligations of the City,

payable from and secured by the City’s full faith and credit, and other legally available sources, such as utility revenues.

By issuing LTGO Bonds, the City can take advantage of its LTGO credit rating which results in more competitive borrowing rates and use the water utility system’s revenue to repay the debt. Table 1 below outlines the City’s current debt service.

Limited Tax General Obligation Bonds	Date Incurred	Final Maturity	Initial Debt Amount	Amount Outstanding as of 12/31/23
2011 LTGO Bonds, First Hill Water Improvements	03/23/11	12/01/30	\$1,500,000	\$655,000
2017 LTGO Refunding Bonds, Sewer Lake Line	08/17/17	12/01/29	6,205,000	3,450,000
Other Non-Voted General Obligation Debt				
2005 Sewer Lake Line, PWTF Loan	01/31/05	07/01/26	\$6,650,000	\$1,208,273
2013 LTGO Refunding Bonds, CCMV Construction	02/06/13	12/01/23	\$1,140,000	\$0
2015 Capital Financed Fire Mini Pumper	06/01/15	06/01/24	\$341,295	\$41,721
2018 Capital Financed Enforcer Pumper	04/19/18	04/09/27	\$732,778	\$354,268
2023 Booster Chlorination System, PWTF Loan	03/01/23	06/01/43	\$3,284,770	\$3,284,770

Table 1

The City’s LTGO general obligation rating by Moody’s is currently Aaa, which is the highest rating category and was affirmed in February 2024. Issuing utility Bonds as LTGO does impact the City’s LTGO debt capacity. For cities with a considerable amount of general obligation debt, this could be an issue. This is not the case for the City of Mercer Island.

As prescribed by State statutes and the City’s Financial Management Policies, based on 1.5% of the City’s 2024 assessed valuation of \$20.3 billion, the City’s remaining available debt capacity is \$295 million.

DECLARATION OF INTENT TO SEEK REIMBURSEMENT

On November 21, 2023, the City made an official declaration of intent to reimburse itself for costs incurred related to major capital projects listed below that are currently underway prior to the issue date of the Bonds (see [AB 6370](#), pursuant to [Resolution No. 1652](#)). The official intent essentially “started the clock” for purposes of the City seeking reimbursements on costs related to qualifying water capital projects.

Because Bond proceeds must be spent within three years of the date of receipt, Resolution No. 1652 extended the reimbursement window to include qualifying hard and soft costs incurred during the 18-months prior to the date the Bonds are issued, tentatively scheduled for October 2024.

This additional timeframe is advantageous. It equips the City to reimburse itself on projects currently underway as well as major projects on the immediate horizon. Given that large-scale capital projects are susceptible to project delays, this strategy also positions the City to effectively spend these resources and meet federal obligations for tax-exempt Bonds.

WATER UTILITY IMPROVEMENTS

The Bond Ordinance attached as Exhibit 1 authorizes the issuance of Bonds to provide \$29 M in funding support for the following capital projects:

- **Water Reservoir Improvements (WU0103)** to the south and north tanks will protect the structural integrity and create a safer working environment. Improvements include seal welding roof plates and rafters, replacing exterior ladders with spiral staircases, adding a guardrail around the tank roof perimeter, and replacing interior linings and overcoating exteriors.

Work began in Q3 2023 following material procurement and permitting. Because only one reservoir can be taken out of service at a time and restricted during high water demand season, this project will take until Q2 2025 to be completed. Total project costs are \$7.1 M in the current biennium ([AB 6211](#)).

Because of the declaration of intent issued by the City Council in November 2023, most of the costs associated with this project are eligible to be paid for with proceeds from the October 2024 LTGO issuance.

- **2023 Water System Improvements (WU0130)** aims to install over 6,600 linear feet of new eight-inch ductile iron water main at six different locations on the northern portion of Mercer Island. Water services and fire hydrants in these areas will also be replaced. Construction began in September 2023. Total project costs are estimated at \$4.7 M in the current biennium.
- **2024 Water System Improvements (WU0131)** is part of the ongoing effort to replace nearly 3,500 linear feet of 4-inch, 6-inch, and 8-inch cast iron water mains with 8-inch ductile iron mains in prioritized locations throughout the City.

Design on this project was completed in 2024 with bid award and construction scheduled for the first half of 2025. Total project costs are estimated at \$4.8 M in the 2025-2026 biennium.

- **Asbestos Cement (AC) Water Main Replacements (WU0135-WU0139)** is an ongoing program to systematically replace approximately five miles of antiquated AC water mains with ductile iron water mains. The replacement program reduces the potential for catastrophic system failure, unexpected service disruptions, and large damage claims to the City.

Staggered capital reinvestment for aging water mains is being accelerated as AC water main ruptures have increased relative to prior years. Between January 2020 and October 2023, 22% of all water main breaks occurred on AC pipe. In the four years prior, there were no breaks on AC water mains. In July 2024, the City Council awarded a construction contract to proceed with WU0135, repurposing nearly \$2 M from the Water Fund for asbestos cement water main pipe replacement.

Between 2025-2027, total project costs for AC water main replacements is estimated at \$9.4 M.

- **Meter Replacement Implementation (WU0117)** has replaced approximately 7,900 aging water meters throughout the City as part of the new Advanced Metering Infrastructure (AMI) system. City Council awarded the bid for the installation of this system in July 2022 ([AB 6112](#)). Meter deployment began in March 2024 and was completed August 2024. Work on data collector station permitting and installation is ongoing, with two stations currently operational, one in the permitting process, and three in the early review stage.

When the AMI system is fully operational, the new meters will send water usage data directly to the City's utility billing system and will allow customers to access information about water use, leak notifications, and alerts via an online portal. Total project costs are estimated at \$6.0 M in the current biennium, and approximately \$1.3 M in the 2025-2026 biennium.

- **Pressure Reducing Valve (PRV) Station Replacements (WU0140)** is an ongoing program to systematically replace PRV stations throughout the island. There is a total of 85 PRV stations in the City's water distribution system. With routine maintenance, the life span of a new PRV station is typically 50 to 60

years. Total project costs are estimated at \$2.4 M in the current biennium, with an additional \$6.7 M between 2025-2027.

REFUNDING OPPORTUNITY

As indicated in Table 1, the City has an outstanding debt amount of \$655,000 tied to Limited Tax General Obligation Bonds issued in 2011 to finance improvements to the water distribution system. The City may have the opportunity to refinance these outstanding 2011 Bonds for interest rate savings. Bond refinancing (also known as refunding) is an important debt management tool for state and local government issuers. Refunding Bonds are commonly issued to achieve interest cost savings, remove or change burdensome Bond covenants, or restructure the stream of debt service payments.

City staff recommends proceeding with the refunding if it results in savings to ratepayers. The refunding component of the Bond issue is included in Ordinance No. 24-09 to provide the flexibility and the option to refund the outstanding 2011 Bonds if savings can be achieved. If there is no breakeven savings, the refunding component of the Bonds will not be exercised, and the 2011 Bonds will remain outstanding with the debt service payment schedule currently in place.

ISSUE/DISCUSSION

Ordinance No. 24-09 (Exhibit 1) authorizes the issuance of one or more series of limited tax general obligation and refunding Bonds to finance and reimburse the City for costs of projects for the water distribution system; and, depending on market conditions, refund the outstanding 2011 Bonds for debt service savings; and pay costs of issuance for the Bonds.

The Bond ordinance authorizes the Bonds to be sold by negotiated sale to an underwriter, or by competitive public sale to an underwriter. Like prior larger Bond issues, the City expects to sell these Bonds by a competitive public sale. A competitive sale is a transparent process where issuers advertise specific terms and banks then compete with sealed bids to purchase the Bonds. Competition often drives down interest rates, resulting in the most advantageous Bond sale for the City.

The proposed ordinance is a delegating ordinance, meaning it authorizes the general provisions (maximum amount, maximum interest cost, final maturity date, etc.) of the Bonds and delegates authority to the City Manager and the Finance Director, each acting individually, as designated representative, to approve the final terms of the Bonds on the day of pricing, so long as the final terms fit within the parameters approved via Ordinance No. 24-09.

In the delegating ordinance, the City Council authorizes the sale of refunding Bonds subject to the following parameters (Section 10(d)):

- Aggregate principal (face) amount not-to-exceed \$29,000,000.
- The final maturity date of the Bonds is no later than December 1, 2045.
- The true interest cost for the Bonds of a series (in the aggregate) does not exceed 5.00%.

Note that the not-to-exceed aggregate principal amount of \$29,000,000 is higher than \$28,000,000, which is the expected amount required for this portion of the major capital projects for the water utility. This higher amount would account for the costs of issuing the Bonds as well as allowing for changing market conditions. In all cases, the principal (face) amount of the Bonds issued pursuant to this ordinance will not exceed \$29,000,000.

NEXT STEPS

Staff seeks to answer the City Council's questions related to scheduled capital investments in the City's water distribution system and the issuance of the proposed Bonds. The competitive Bond sale is tentatively scheduled for the week of October 14, 2024. If the competitive sale goes as planned, Bond closing and the delivery of Bond proceeds would tentatively take place October 30, 2024.

While water service was restored following the emergency repair of the 24" Seattle Public Utilities Transmission Line (August 2024), further consideration and discussion is needed to improve system resilience, ownership, and control of the transmission line.

Staff will return to the City Council in October to discuss potential alternatives for this transmission pipe and the potential transfer of ownership from Seattle Public Utilities to the City, including a projected range of potential costs. Given the anticipated range of costs, future Bond sales or outside funding may be needed for this project.

RECOMMENDED ACTION

Schedule Ordinance No. 24-09 for second reading and adoption at the September 17, 2024 City Council meeting.