City of Sweet Home
3225 Main Street
Sweet Home, OR 97386
541-367-5128
Fax 541-367-1215
www.sweethomeor.gov

Finance Department

MEMORANDUM

To: Sweet Home City Council

From: Brandon Neish, Finance Director

RE: Debt Options for Capital Projects

During a City Council Work Session held on February 16, 2021, the Council asked the Finance Department to follow up with options to fund capital projects which included, but was not limited to, incurring additional debt at a low interest rate. While interest rates are currently at historic lows, it is my recommendation that the City Council delay the push to add debt to the City's existing debt portfolio for several reasons, which are presented below.

1. **<u>Council will have $725,000 over the next two years to utilize in the water and wastewater systems resulting from debt refinancing.</u>**
   The City recently refinanced approximately $5.7 million in existing debt which was, and is, slated to remain on the books through 2035. The two loans obtained to cover inflow and infiltration expenditures to the wastewater system and the one loan obtained to pay for the existing Water Treatment Plant all included interest rates that exceeded 3.0%. With the recent refinancing, the City was able to secure $5.8 million at an interest rate of 1.38% which will save utility ratepayers $766,000 over the next 14 years. Additionally, *the City structured the new debt payments by deferring the principal payments in such a manner that $725,000 of the $766,000 total savings will be realized in fiscal years 2022 and 2023*. The savings can then be used to cover capital project costs, or the City Council could opt to return the savings to ratepayers in the form of lower or frozen utility rates. The savings could also be used to incur additional debt to cover capital projects. This option is not recommended given the structure of the new debt (more savings up front) and would likely result in additional utility rate increases in the near future (three years from now).

2. **<u>The City agreed it would not incur a debt total over $10 million when it refinanced the old debt.</u>**
   When refinancing the existing debt, the City was asked to decide if the new debt would be "bank qualified." Bank qualified issuances reduce the overall costs of debt and in return, the issuer nets .25-.40% less on the interest rates for the debt issued[1]. To be bank qualified, the City had to state that it would not incur additional debt which would exceed $10 million through the end of 2021. By qualifying the new bonds, the City will save utility ratepayers approximately $125,000 in overall payments on the debt.

3. **<u>The City doesn't currently have the capacity to meet debt regulations for incurred debt.</u>**
   Probably the biggest reason for recommending a delay in increasing the City's debt portfolio is to comply with debt regulations. When obtaining a loan for capital projects, regulations require that 5% of the total principal must be spent within the first six months after issuance and 85% must be spent within the first three years. For illustration purposes, if the City chose to sell $4 million in bonds, $200,000 would need to be spent in six months and $3.4 million would need to be spent within three years. While there is a litany of projects to be completed, the City has not yet finalized

[1] gfoa.org – Bank Qualified Debt

engineered plans to put out for bid to complete these projects. This would make it difficult to meet the necessary timely spending requirements.

4. **<u>Federal funding is forthcoming in the American Rescue Plan Act (ARPA).</u>**
   While considering debt at this present time may not be advisable, another option for capital funding has recently come to light with the passage of the ARPA. Included in the ARPA was funding for local governments (cities and counties). $19.5 billion was allocated to “smaller jurisdictions” or cities with populations less than 50k. According to the League of Oregon Cities, Sweet Home could receive up to $2.0 million in funds from the ARPA. The City would be allowed to allocate this funding to replace lost revenue during the COVID-19 (coronavirus) pandemic and/or the funds could be spent on infrastructure for water, sewer and/or broadband. Half of the allocation is scheduled to be distributed 60 days after the passage of the ARPA (it was signed by President Biden in March 2021) and the other half would be distributed the following year (May 2022). All of the funds must be spent by the end of December 2024.

5. **<u>Rates have changed and are forecasted to change again to our advantage.</u>**
   Further complicating matters is the movement of rates in the municipal bond market. In the last 30 days, municipal bond rates have increased an average of .31% for a ten-year bond. Since January, the average rate for a AAA-rated municipal bond has moved from .68% to 1.01% (Sweet Home’s recent bond rating was AA which would yield a slightly higher interest rate on bonds issued). This is still very low given that rates topped at 2.88% just one year ago. However, recent market concerns in regard to inflation have given rise to bond rates as investors seek security from a potentially overpriced equity market. While this certainly will not last, the short-term effect to rates would result in a higher than necessary interest rate for Sweet Home requiring more money annually to make payments.

With the need to plan specific projects prior to going out to the market for bond issuance and potentially rising rates, coupled with the news of funding from the ARPA, it is my recommendation that the City pause the conversation regarding funding capital projects with new debt. I would recommend reviewing the debt options again after staff and the City’s Engineer of Record has developed a priority list with refined cost estimates, we find out more about federal funds from the ARPA, and we realize the $725,000 debt refinance savings. Delaying the incursion of additional debt would also allow the City to complete the funding package(s) for the Wastewater Treatment Plant and ensure that any new debt would not result in an exponential increase in utility rates that customers cannot afford.