



## CITY OF BEND

### SEWER SYSTEM FUNDING AND FINANCING

The City of Bend operates its sewer system as an enterprise activity based on full cost recovery through user charges. No property taxes are allocated to the sewer system. Rather, funding for sewer system operations and capital investment needs come from user rates, system development charges and other user related charges. By State law, sewer system enterprise funds cannot be used to supplement other city enterprise or General Funds.

This document discusses the sources of funds and financial policies and processes used by the City to determine the funding and financing for its sewer system.

#### 1. SOURCES OF FUNDS FOR SEWER SYSTEMS

The various sources of funds to pay for sewer system operations and capital needs are as follows:

**User Rates and Charges** – Operating expenses of the system are funded by system wide user rates and charges. Capital improvements that benefit the system as a whole are also funded through system wide user rates and charges or financed with debt and repaid over time through user rates and charges.

**Debt Issuance** – When debt is necessary to finance capital improvements, the City either issues revenue bonds, full faith and credit bonds or obtains loans through state agencies such as the Department of Environmental Quality that offers municipal infrastructure financing programs at lower than market interest rates and with attractive repayment terms. Debt is repaid through user rates and charges and system development charges.

The City may also obtain voter approval for General Obligation (GO) Bonds to finance infrastructure improvements that benefit its citizens. Repayment of GO Bonds is made from property taxes assessed on all properties in the city.

**Grants** – Most grants available from state and federal agencies for sewer infrastructure require target pilot projects and innovative or “green” projects. Grants are typically not available for standard utility infrastructure needs such as replacing sewer mains or building of pump stations to meet on-going demand. The City researches and applies for grants whenever they are available and applicable.

**System Development Charges (SDCs)** - Growth related capital improvements are funded by SDCs which are assessed on new development. The SDC fee is established by methodology studies and increased each year by the Engineering News Record Index. The City last updated its sewer SDC methodology in 2015. The FY 2017-18 sewer SDC for a single family dwelling is \$4,655.

**Private Development Funds** – Sewer infrastructure needed to serve a new residential subdivision or commercial development is typically constructed and funded by the developer and dedicated to the City for on-going maintenance.

**Local Improvement Districts (LIDs) and Surcharges** – Local sewer infrastructure improvements that benefit specific properties in a defined area (such as sewer mains constructed to replace septic tanks) may be funded by LID assessments or surcharges (additional monthly charges on top of the regular monthly sewer charge).

## **2. HOW FUNDING AND FINANCING IS DETERMINED**

The City develops long term financial plans for its sewer system by maintaining a 20-year financial model. Policies and principles adopted by the City Council guide the City in developing the financial model to ensure sound financial management of its sewer business.

### **Financial Policies and Principles**

The following policies and principles adopted by the City Council reflect industry standards and best practices for managing the finances of the City’s utility systems:

1. Utility funds will be self-supporting through user fees.
2. One of the City’s over-arching financial policies is the promotion of intergenerational equity for the City’s ratepayers by spreading the cost of new or upgraded City infrastructure over time so that future generations benefitting from such infrastructure contribute to its cost.
3. Utility rate adjustments will be based on long term financial plans to achieve financial stability. The City will strive to make rate adjustments consistent and more predictable for the customer.

4. System development charges will fund growth related capital needs
5. The City will determine the least costly funding method for its capital projects and will obtain grants, contributions and low cost state or federal loans whenever possible.
6. The City will utilize “pay-as-you-go” funding for capital improvement expenditures considered recurring, operating or maintenance in nature. The City may also utilize “pay-as-you-go” funding for capital improvements when current revenues and adequate fund balances are available or when issuing debt would adversely affect the City’s credit rating or when market conditions are unstable or suggest difficulties in marketing a bond issue.
7. The City will consider the use of debt financing for capital projects under the following circumstances:
  - a. When the project’s expected useful life is sufficient to warrant long term debt financing and comply with the internal revenue code requirements for tax-exempt financing
  - b. When projected annual revenues are deemed sufficient and reliable to service the long-term debt
  - c. When market conditions present favorable interest rates for City financing
  - d. When the issuance of debt will not unduly affect the City’s credit rating and debt service coverage ratios
  - e. When a project is mandated by state or federal government and current revenues or fund balances are insufficient to pay project costs
8. The City will strive to maintain debt service coverage ratios and percentages that uphold the City’s credit rating. Water and Water Reclamation (Sewer) debt coverage ratios should be maintained at a minimum of 1.50 or at a level sufficient to protect the credit rating of the Water and Water Reclamation systems
9. The City will maintain undesignated reserves of at least 25% (or 3 months) of the operating budget for its utility funds. The Water Reclamation Fund will also have rate stabilization reserves no less than \$1 million to protect against volatility of revenues. Ending fund balance and reserves in the Water Reclamation utility fund will be prioritized as follows:
  - a. Required debt service reserves
  - b. Operating reserves
  - c. Rate stabilization reserves
  - d. Repair & replacement (R&R) reserves at a minimum of \$5 million

## **Sewer Financial Model**

The City maintains a 20-year sewer financial model developed by the City's utility rate consultant and is updated at least twice a year by city staff. The purpose of the financial model is to:

1. Forecast sewer revenues and expenditures over the next 20 years
2. Determine financing requirements for capital needs
3. Determine reserve requirements
4. Establish sewer rates
5. Ensure compliance with City Council adopted financial policies and principles
6. Generate a long term financial plan for the sewer business

Major assumptions for the financial model are developed as follows:

- Customer growth and water consumption assumptions – these assumptions are based on historical and current trends.
- Operating expenditures – these costs are projected as a percentage increase or decrease from prior year costs based on changes in customer accounts and consumption. Any one time expenditures based on specific operating needs are also identified by staff and included in the model.
- Capital expenditures – 20-year capital improvement needs are based on the latest sewer master plan studies and as refined by the City's Engineering staff.
- Debt assumptions – Capital expenditures too large to be funded from available cash are financed with long term debt in the financial model. Interest rate assumptions are based on current projections developed with the City's bond financial advisor.
- Reserve assumptions – The financial model calculates ending reserve balances that are consistent with the City's financial policies discussed above.

Based on the assumptions entered, the financial model will determine how much sewer rates need to be adjusted to provide the revenues necessary to fund expenditures and reserves and to repay debt. As noted above, the financial model generates the city's long term financial plan for the sewer system as it establishes revenue and expenditure projections, identifies long term capital needs, and determines debt and rate requirements in compliance with the City's financial policies and principles.

## **3. DEBT MANAGEMENT**

When issuing long-term debt, the City will ensure that there is sufficient debt capacity and that the debt is financially manageable by adhering to the following principles:

1. Debt is issued only when necessary for capital improvements too large to be funded by current available resources
2. Capital projects financed through long term debt shall be financed for a period not to exceed the useful life of the project
3. Sources of repayment, debt ratios and the affordability of debt will be analyzed prior to issuance of long term debt

### **State or Federal Loan Programs**

The City will also determine the least costly financing available. The City evaluates the cost of issuing debt versus applying for loans available through programs administered by state or federal agencies. Currently the Oregon Business Development Department/Business Oregon and the Department of Environmental Quality (DEQ) offer infrastructure financing programs. These programs may offer loans at low interest rates and if the total cost of obtaining such loans is lower than the total cost of issuing debt, the City will apply for such loans with Business Oregon or DEQ. These loan programs may have a maximum borrowing limit per year and are awarded to communities based on certain criteria determined by the state agencies.

The City has been awarded almost \$119 million in low interest DEQ loans for the following water reclamation projects: collection system master plan, secondary expansion, southeast interceptor, Colorado lift station, plant interceptor, and the north area force main.

### **Bonds Issued by City**

If the City decides to issue debt for its sewer capital improvements, the City works with its financial advisor (Public Financial Management “PFM”) and bond counsel (Orrick Herrington & Sutcliff) to determine debt structure and terms, timing of debt issuance and other requirements of the debt. The City may issue revenue bonds or full faith and credit bonds to finance sewer capital improvements.

Revenue bonds are secured by the revenues of the sewer system and contain covenants and reserve requirements. Covenants typically call for minimum 1.25 debt service coverage ratios, but as noted earlier, the City Council has adopted policies with a more conservative target of 1.50 times the maximum annual debt service.

Full faith and credit bonds are secured by the City’s full faith and credit and do not contain reserve requirements. Full faith and credit bonds issued for sewer capital improvements are repaid from the revenues of the sewer system. Any full faith and credit bonds issued for sewer system needs are on par with revenue bonds issued for the sewer system and as such are subject to the debt service coverage ratio requirements.

## **Credit Rating**

The City strives to maintain debt service coverage ratios and percentages that uphold the City's credit rating. The City's sewer revenue bonds are currently rated Aa2 by Moody's Investor Services.

## **QUESTIONS?**

Most of the financial policies related to operation of the sewer utility system are discussed in this document. For a copy of the City's comprehensive financial policies, please refer to the Finance Department website at the address listed below:

<http://www.bendoregon.gov/government/departments/finance/other-financial-topics/policies>

For additional questions, please contact Sharon Wojda, the City's Finance Director, at (541) 693-2158 or [swojda@bendoregon.gov](mailto:swojda@bendoregon.gov).