



City Council Agenda Item

City Council Meeting Date: April 19, 2022

TO: Dean Albro, City Manager

FROM: Robert Cross, Financial Services Manager
r_cross@ci.lompoc.ca.us

SUBJECT: Adoption of Resolution Nos. 6491(22) and 6492(22) Relating to Funding for Capital Improvements to the Solid Waste Landfill Required by the Central Coast Regional Water Quality Control Board; Adoption of Resolution No. 6493(22) Reinstating the 5th Annual Solid Waste Rate Adjustment Approved by the City Council on June 3, 2014, and Deferred in 2018; Approval of Agreement with KNN Public Finance for Financial Advisor Services for the Solid Waste Utility's Landfill Capital Financing; Introduction and Status Report on City's Solid Waste Rate Study

Recommendation:

Staff recommends the City Council:

- 1) Adopt Resolution No. 6491(22) Declaring the City's Official Intent to Reimburse Itself with the Proceeds of a Future Tax-Exempt Financing for Certain Capital Expenditures for Improvements to the Solid Waste Landfill (Attachment 1);
- 2) Adopt Resolution No. 6492(22) Approving Terms and Conditions of an Internal Construction Loan Advancing Funds to the Solid Waste Fund for Interim Financing for Certain Capital Expenditures for Improvements to the Solid Waste Landfill (Attachment 2);
- 3) Adopt Resolution No. 6493(22) Rescinding, Effective July 1, 2022, the Suspension of Previously Approved Solid Waste Service Charges That Had Been Scheduled to Take Effect on July 1, 2018, and Which Were Previously Approved by the City Council on June 3, 2014 (Attachment 3); and
- 4) Approve and Authorize the City Manager to execute a contract with KNN Public Finance as the City's Financial Advisor for the Solid Waste Utility's Landfill Capital Financing; or
- 5) Provide alternate direction.

Background:

The City provides refuse, recyclables, and organic waste collection services to its residents and businesses. The City also owns and operates the Lompoc Landfill, which is expected to reach full capacity in the late 2030s or early 2040s. Both service types are provided by the City's Solid Waste Utility (Solid Waste).

The City conducts its Solid Waste operations similar to a business. Solid Waste generates revenue to pay for its collection and landfill operations through rates charged to its residents and businesses, and through tipping fees charged to users of the landfill. Solid Waste records its revenues and expenses for its operations in the Solid Waste Fund, an enterprise fund segregated from other City governmental and enterprise activities. The revenues of Solid Waste recorded in the segregated Solid Waste enterprise fund are intended to fully cover the City's current and future solid waste operating and capital costs.

The City most recently conducted a comprehensive rate study for Solid Waste in 2012-2014 resulting in a Public Hearing of the City Council held on June 3, 2014, implementing a set of rate adjustments annually through July 1, 2018. Since the approval of the series of rate adjustments in 2014, several actions have occurred affecting the ongoing and future capital costs of the Solid Waste Utility. The following provides some background on the more significant actions:

Storm Water Requirements for the Lompoc Landfill

Solid Waste operates the Lompoc Landfill, which is located at the terminus of Avalon Drive. The Landfill's location in a valley above Avalon Drive makes it susceptible to storm water runoff both within the boundaries of the Landfill as well as in the valley (or watershed) above the Landfill. During the 2017-19 fiscal budget cycle, the Solid Waste Utility was informed by the Central Coast Water Quality Control Board (Board) that it would begin requiring the City to implement strategies to mitigate storm water runoff originating within the Landfill and, more importantly, in the valley (or watershed) above the Landfill. The Board provided Solid Waste with a Notice of Violation (NOV) on July 6, 2018 (Attachment 4). In the NOV, the Board outlined the information required of the City by October 31, 2018. Following the delivery of the required information, the Board delivered a follow-up notice on October 22, 2020, accepting the report submitted on October 30, 2018 (Attachment 5). The follow-up notice outlined the steps the City would need to address to demonstrate progress towards compliance of the Landfill Water Discharge requirements. Seven specific tasks were outlined, including the final Corrective Action Implementation Report, which was initially due by January 31, 2022. The City has taken several steps towards completing the requirements and has preliminary plans that will address the improvements needed to comply with the Landfill Water Discharge requirements.

Since being made aware of the new requirements, Solid Waste and the Utility Department have been working to develop a plan that complies with the Board's requirements. The current plan entitled "Stormwater Mitigation Project" (Project) will:

- Mitigate storm water runoff according to Board requirements for any runoff originating within the boundary of the Landfill;
- Divert the runoff from the watershed above the Landfill such that the runoff remains outside of Landfill boundaries, thus eliminating the requirement for mitigation by Solid Waste.

The Project is anticipated to be bid and constructed as early as Spring 2022.

At the time the Biennial Budget Fiscal Years (FYs) 2021-23 was being developed, Solid Waste planned to continue pre-construction planning and design work to be able to implement a project to comply with the Board requirements as outlined in the July 6, 2018, NOV. The FYs 2022-2027 Capital Improvement Program justification for the storm water requirements is shown below:

The State Water Resources Control Board has put forth significant changes forth General Permit for Storm Water Associated with Industrial Activity (Order 2014-0057-DWQ). Some of these changes include increasing minimum Best Management Practices (BMP's), increased training and reporting, Numeric Action Levels (NALs) and NAL Exceedances, Exceedance Response Actions (ERA) which are required to be developed and implemented when annual NAL or NAL exceedance occurs. When this occurs, the City's status is changed from Baseline to Level 1 status, and the City is required to evaluate and revise its BMPs with the assistance of a QISP and submit a report. The second time a NAL exceedance occurs for the same parameter, the City's status is changed from a Level 1 to Level 2 status, and the City would be required to submit a Level 2 ERA Action Plan and a Level 2 ERA Technical Report. The City is currently at a Level 1 status.

Key Legislation and Industry Trends

In addition to the Storm Water requirements for the Lompoc Landfill, there are some important trends in the solid waste industry that are creating significant upward pressure on rates. These trends are recent, and have emerged since the City last adjusted its collection rates.

- **China's Ban on Recyclables** – At the beginning of 2018, China reduced the level of acceptable contamination in the recyclable material it received, and limited the type of recyclable materials it would accept. China's policy for this effort is entitled "National Sword." Prior to this policy, China accepted almost half of all worldwide recycling materials. As a result, the market value of recyclables has decreased dramatically. This market disruption significantly impacted and continues to negatively impact the operating performance of the Solid Waste enterprise fund.
- **Mandatory Commercial Recycling and Organics Recycling** – Assembly Bill (AB) 341, passed in 2011 and effective May 7, 2012, requires that Solid Waste's commercial customers that generate four cubic yards or more of waste per week and multi-family residential dwelling of five units or more arrange for recycling services.

- **Mandatory Commercial Organics Recycling** – AB 1826, passed in 2014 and effective January 1, 2016, requires that commercial customers that generate two cubic yards or more of material per week arrange for organic waste recycling services.
- **Short lived Climate Pollutants** – Senate Bill 1383, passed in 2016 and effective January 1, 2022, requires all jurisdictions to provide recycling and organics recycling services to essentially all commercial and multi-family customers. Beginning in 2024, local jurisdictions will be required to assess penalties on non-compliant waste generators.
- **Employment Costs** – The City's costs related to employee benefits have significantly increased based on actions that occurred subsequent to the implementation of the 2014 study's first four rate implementations with actions taken by the City Council at its June 3, 2020, meeting.

Discussion:

Reimbursement [Resolution No. 6491(22) – Attachment 1]

In the Biennial Budget FYs 2019-21 cycle, Solid Waste budgeted for the Project's anticipated costs from planning and design to construction, also anticipating that the Project would be financed, preserving Solid Waste working capital for operational requirements. Since then, the planning and design work phase has become significantly more complex due to the magnitude of the Project. Substantial progress has been made towards developing plans and specifications that can be assembled into a bid package in the next few months, however, the original draft, which estimated a total Project cost of \$2.2 million, presumed the Project would be much less complex than it has turned out to be. The current construction phase cost estimate for the mitigation Project is \$5 million. Solid Waste resources identified to pay for the initial Project financing was budgeted using financing (borrowing) resources as Solid Waste had, and continues to have, reserve levels inadequate to pay for the entire project.

The Board set a deadline for completing the final plan submission of January 31, 2022. However, Solid Waste staff has requested an extension to the required timeline.

In order to facilitate moving forward with the construction of the Project while pursuing bond or other external permanent financing for the Project, the City Council can, and is recommended to, adopt a reimbursement resolution that will: i) allow the City to incur costs on the Project prior to securing bond proceeds; and ii) allow for those costs to be reimbursed from bond proceeds.

There are several reasons why a reimbursement resolution is the preferred and recommended approach compared to the traditional practice of utilizing external finances for capital projects:

- Completing the process to put together a bond financing or secure a privately-placed loan with a bank will take three months or longer to complete. By advancing City funds, the Project can proceed in accordance with the required schedule, but be permanently financed with tax-exempt bond or loan proceeds, saving the City and Solid Waste customers in interest costs. Without a reimbursement resolution, the City's ability to reimburse itself from tax-exempt proceeds is limited.
- The City is currently conducting a rate study for Solid Waste, which should be in final draft form in the second quarter of Calendar Year 2022. The rate study will need to incorporate the Project costs, financing costs and other factors as mentioned above, and the recommendations for any rate adjustments. The rate increases required to fund the Project, as determined by the rate study, will need to be in place to assure that the City, through its Solid Waste Utility, has the capacity to meet all its financial obligations, including this additional borrowing and related debt issue requirements. Collection rate adjustments can only be enacted following the notice and public hearing requirements of Proposition 218. Landfill rate adjustments are not governed by Proposition 218, but are required to be cost based and approved by the Solid Waste governing body, the City Council.
- Solid Waste has outstanding debt financing through the State of California's CalRecycle program at a rate of 0.599%, which is payable annually for 10 years and matures in FY 2028-29. The financing was used to construct the Landfill's current gas collection system as required by the California Air Resources Board and the Santa Barbara County Air Pollution Control District. The City will need to notify, and possibly obtain approval from, CalRecycle of its intent to secure Bond financing as the same revenue stream will be used as collateral for debt service on both financings. Obtaining CalRecycle's approval is likely assured but the process will take time and resources, further delaying the start of construction of the Project if financing is secured in the conventional manner.
- The conventional process for obtaining financing would coordinate the timing of the Project bid award with the award of the bond financing to allow the bond financing to be equal to the required cost of the Project. This would likely delay the process for awarding the bid due to the above constraints.
- While the Central Coast has been experiencing drought conditions, the region is presently in the typical rainy season. The ability to construct the improvements will depend significantly on the weather conditions during the Project's construction period. Being ready to award the Project bid as soon as practical may mitigate the potential weather issues and will allow for construction to occur during the area's typical dry summer period. Using the standard model for financing would further delay the initiation of construction on the Project.
- The Board's current deadline for implementing the mitigation measures has passed. As such, any steps the City can take to show the Board that the City is committed to enacting the required measures in a timely manner, should be looked

upon favorably by the Board in reviewing the City's request for a time extension for implementation of the mitigation measures.

The reimbursement resolution proposed provides for reimbursement of costs from February 19, 2022, or 60 days prior to the implementation date of the resolution (whichever is later); allows the external permanent financing to occur as many as 3 years after the date of the resolution; and allows for reimbursement of Project costs incurred within 18 months of the effective date of the resolution.

Adoption of Resolution No. 6491(22) (Attachment 1) will also allow Solid Waste to continue to work expeditiously to complete the planning, design, construction, and implement the mitigation measures required by the Board.

Internal Construction Loan [Resolution No. 6492(22) – Attachment 2]

Solid Waste currently does not have adequate Unrestricted/Undesignated Fund Equity in order to construct the Project without external financings. Until the anticipated bond proceeds are acquired it is recommended that an internal loan up to \$5 million to the Solid Waste enterprise fund be created to allow for the continued planning, engineering, and construction of the Project on an expedited basis. An internal loan is necessary in order to meet Board requirements and time constraints. In addition, no single City fund has adequate Unrestricted/Undesignated Fund Balance or Fund Equity to permanently fund the Project and to support the loan receivable for the long term period of time necessary to minimize the effect of the debt service to Solid Waste ratepayers. However, the Electric Utility Fund has adequate Unrestricted/Undesignated Fund Equity to fund the Project temporarily through the end of construction, or until bond proceeds are available to reimburse Solid Waste such that it can reimburse the Electric Utility for advanced Project costs and accrued interest, whichever occurs earlier.

The City's Debt Management Policy (Policy) , adopted by the City Council at its Regular Meeting of October 17, 2017, requires the City to identify certain terms for internal loans and, if the internal loan is intended to be reimbursed from Bond proceeds, to make a statement to that effect. In order to satisfy the Policy, the following terms and conditions are recommended to be approved with the adoption of Resolution No. 6492(22) (Attachment 2) and are stated here as follows:

- Funding Source: Electric Fund No. 752
- Interest Rate: 0.559% in parity with the CalRecycle financing [see note in resolution]
- Interest Calculation Method: Annual (Monthly in the year of repayment)
- Frequency of Payment: Once – upon receipt of Debt proceeds
- Date of Repayment: The end of the month in which Debt proceeds are received
- Prepayment Penalty: None
- Construction Term Funding: Construction draws and interest calculations will be transacted and performed annually as of the

end of each fiscal year in which the Project is in process until the year in which Debt proceeds are received by the Solid Waste Utility

The interest rate, recommended to be set at 0.599% per annum, is the financing rate for the CalRecycle financing on the Landfill Gas Collection System, which is the only external financing of Solid Waste at this time other than employee retirement and post-retirement healthcare debt. This rate is recommended as the City will be required to adhere to the terms of the CalRecycle financing in order to obtain bond financing in addition to the CalRecycle financing. CalRecycle likely does not have specific interest rate requirements on additional debt and the ultimate long-term debt's interest rate will be determined by market forces in effect at the time of issuance.

In the event bond financing is not secured, a permanent internal loan would need to be secured, likely from several funding sources due to the expected cost of the Project, at the time the construction is completed. It is recommended that, in this unlikely event, the Management Services Director have the authority to set the terms and funding source(s) needed to fund the permanent financing for the Project and bring the package to the City Council for approval.

2014 Solid Waste Rate Increase [Resolution No. 6493(22) – Attachment 3]

The 2014 Solid Waste Rate Study was initiated in 2012 and was a coordinated project between the Utility Commission, Solid Waste management and staff, the Finance division's Financial Services Manager and the external independent contractor. The results of the study were presented to the Utility Commission at its March 10, 2014, meeting and to the City Council on April 1, 2014, with a Public Hearing held by the City Council at its June 3, 2014, regular meeting. At the March 10, 2014, Utility Commission meeting, the study approval was motioned by then Commissioner Mosby and approved by the Utility Commission by a unanimous vote of 4-0 with one absence. At the June 3, 2014, City Council meeting, the City Council approved the rate adjustments as motioned by the then Mayor Linn and passed by the City Council after a Public Hearing by a unanimous vote of 5-0. As part of the motion to approve the annual adjustments, each approved adjustment was required to be affirmed by the then City Council prior to implementation.

The 2014 study resulted in approval of five annual cost of living adjustments of 3.6% established by the City Council with the adoption of Resolution No. 5920(14). The cost of living adjustments for 2014-2017 were affirmed by the City Council and implemented as approved. However, the final adjustment that was scheduled to be implemented as of July 1, 2018, was not affirmed by the City Council, but instead was deferred by Resolution No. 6203(18) adopted on August 7, 2018. The deferment of the final approved adjustment resulted in approximately \$~~1.0-06~~ million less revenue over the following four years (FYs 2018-22).

The expected Project's costs are significant in relation to the current financial situation of the Solid Waste Utility. While the in-process rate study will incorporate the expected cost

for the Project in the final report, it is expected that the Project costs, added to other costs as identified in the Key Legislation and Industry Trends section in the Background section above, will assuredly generate rate recommendations significantly greater than the rate adjustments approved based on the 2014 study.

As Solid Waste's final rate adjustment based on its 2014 rate study was deferred by the City Council in 2018, it is recommended that the final 3.6% increase be implemented effective July 1, 2022. The reasons for this recommendation are as follows:

- The Landfill improvement costs are significant compared to Solid Waste's annual revenue. Several key legislation and industry trends, as discussed above, have occurred or been passed since the 2014 Solid Waste study was initiated. Each has either reduced operational revenues or increased operational costs (or caused both to occur). Solid Waste rates have not incorporated any of the activities that are negatively affecting its financial health.
- As forecasted by the 2014 Solid Waste study results, the July 2018 deferral of the approved Solid Waste rate increase resulted in a deficit Net Position each year since FY 2018-19, with the most recent financial statement (FY 2020-21) reporting a deficit of \$989,666.

The rate implementation resolution proposed provides Solid Waste additional resources allowing it to minimize the use of external financing ultimately needed for completion of the Project until the current rate study is completed and brought to the City Council for consideration. Implementation of the final deferred rate adjustment approved by the City Council in 2014, if approved, would be effective July 1, 2022.

Adoption of Resolution No. 6493(22) will also allow Solid Waste additional resources to continue to work expeditiously to complete the planning, design, construction, and implement the mitigation measures required by the Board.

Financial Advisor

In order for Solid Waste to access the bond market to secure the necessary permanent financing for the Project, the City will be required to provide significant documentation and to have access to specialized legal counsel to review the documentation to insure the City qualifies for municipal bond financing rates. In addition, perspective bond are required to be reviewed by rating agencies, underwriters and others before such bonds can actually be sold to investors.

The Debt Management Policy (Policy) adopted by the City Council on October 17, 2017 provides a framework for addressing the above issues in securing municipal financing. As discussed in the Policy, municipal financing requires an extensive array of specialized professional services to secure the financing. The most recent municipal financing the City obtained was for the 2018 Water and Wastewater Refunding Bonds. In order to

secure the financing that saved ratepayers in excess of \$2 million in interest savings, services were provided by the following:

- Financial Advisor services – provided by KNN Public Finance
- Bond Counsel services – provided by Aleshire & Wynder
- Disclosure Counsel services – provided by Jones Hall
- Underwriter services – provided by De La Rosa & Co.
- Rating Agency services – provided by Standard and Poor's
- Trustee services – provided by US Bank

The Financial Advisor works closely with City staff developing the documentation necessary for the issuance of bond or other debt instruments, and provides the specialized financial services needed to complete an offering in the Municipal Bond markets, while insuring the City abides by securities laws related to municipal bond markets. Staff recommends the City Council affirm the authority of the City Manager to secure the services of the City's long-standing financial advisor, KNN Public Finance to facilitate the completion of the financing in a timely manner such that the City can be reimbursed for the costs of the Project. KNN's fee would be \$65,000, contingent upon the closing of the financing, and payable solely from financing proceeds. The proposed contract is attached (Attachment 6).

Fiscal Impact:

There is no fiscal impact from the adoption of the reimbursement resolution or the internal loan resolution [Resolution Nos. 6491(22) and 6492(22)]. However, Project costs will impact the Landfill users and collection system customers in an, as yet unknown amount pending the completion and implementation of the 2020 rate study. The Electric Utility will benefit from the short-term lending of Undesignated/Unrestricted Fund Equity at a rate in excess of the current City investment pool's rate of return.

The rate implementation resolution [Resolution No. 6493(22)], if adopted, will impact the average residential collection customers of Solid Waste by \$1.55 per month. Customers that are eligible to use the 64 gallon level of service would experience an increase of \$1.11 per month. Revenue to the Solid Waste Fund, on an annual basis, would increase by approximately \$250,000, beginning with FY 2022-23. The additional resources are approximately 3% of annual operating costs or 5% of the current estimated cost of the Project.

Bond issue costs, including the contingent fee for the Financial Advisor, are payable from bond proceeds at the time the bonds are sold. The determination of the overall bond interest rate includes those costs.

Conclusion:

A reimbursement resolution is a relatively common tool used by municipal agencies to accelerate the construction process for large projects in which financing is indicated to

protect ratepayers from immediate or untenable rate increases, and when the agency doesn't have adequate reserves, as is the case with Solid Waste. In addition, an internal loan from the Electric Utility Fund is preferable to external financing as a bridge to when bond financing is secured. Finally, the implementation of the existing approved rate increase that was deferred in 2018 will address current deficit balance reported by Solid Waste and help mitigate future recommended increases that are expected to be presented later this year.

Respectfully submitted,

Robert Cross, Financial Services Manager

APPROVED FOR SUBMITTAL TO THE CITY MANAGER:

Christie Donnelly, Management Services Director

APPROVED FOR SUBMITTAL TO THE CITY COUNCIL:

Dean Albro, City Manager

- Attachments:
- 1) Resolution No 6491(22)
 - 2) Resolution No 6492(22)
 - 3) Resolution No 6493(22)
 - 4) Notice of Violation dated July 6, 2018
 - 5) Response from Central Coast Water Quality Control Board dated October 22, 2020
 - 6) Municipal Advisory Services Agreement with KNN Public Finance