What if you don't need $5,000,000; what if rate payers want to pay less interest?

Introduction

Without understanding the Water Enterprise financials, you can't really decide if it is a good idea to borrow $5,000,000. What if you don't need $5,000,000? To borrow $5,000,000 only because the lender requires it **would be a more irresponsible financial decision than borrowing $5 million dollars for wireless water meters.**

The staff report is proposing just that. Borrow $5,000,000 from the highest cost lender without data supporting need or justifying the choice of the higher. The higher cost is $3.3MM over the life of the loan.

- **A proper financial analysis shows that $4MM would be sufficient loan amount to meet the proposed capital projects listed in the staff report.**
- **Borrowing at 5% interest (WIFIA) when 2.1% (DWSRF) is available is irresponsible.**
- **A higher loan amount and higher interest add $3.3MM to the cost of the project. This is an unacceptable burden to place on rate payers.**
- **The staff report puts a high value on the option of making no payments for up to five years to allow reserves to be rebuilt.**
- **Assuming EFOC recommendations are implemented, reserves remain well above policy levels**
- **Revenue capacity is sufficient to support the resulting debt service. There is no reason to expect a need to defer loan payments.**
- **The critical element for the financial health of the enterprise is implementing the recommended EFOC Proposition 218 reform proposals.**
- **The impact of EFOC reforms on the General Fund is modest and begins to address the Grand Jury findings.**
- **A rate study will be necessary but not until the sewer master plan is complete and vetted and the final cost allocations are determined using the time tracking data.**

- **Don't trust me - Raftelis could provide updated water financials given the new information at a relatively low cost and take very little time. This may be sufficient for the lender's requirements.**

Where are the financial numbers to support the recommendation?

Without understanding the Water Enterprise financials, you cannot really decide if it is good idea to borrow $5,000,000. What if you don't need $5,000,000? To borrow $5,000,000, if you don't need it, increases the borrowing cost to rate payers. This is irresponsible financial management of Water Enterprise.

This is exactly what the staff report is recommending. Borrow $5,000,000 from the highest cost lender without regard for need or the additional costs to rate payers.

LSCE

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City of Sebastopol – Water Project Funding Recommended

Agenda Item Number 3

- Water System Funding Recommendations:
  - Pursue WIFIA Funding For CIP Water Project Priorities
    - Account for in updated utility rates.
    - Develop projects into design phase.
    - Take advantage of WIFIA funding term flexibility to reduce future rate impacts.

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City of Sebastopol – Water Funding Option Review

Agenda Item Number 3

- Basis For Water System Funding Recommendations (lowest is best):

Water Funding Sources	DWSRF	IBank	WIFIA
Timeliness	3	1	1/2
Interest Rates	1	1/2	1/2
CEQA Requirements	3	1	1/2
Funding Admin. Costs	3	1/2	1/2
Reimbursement flexibility/timing	3	1/2	1/2
Funding Agreement Flexibility	3	2	1
SCORING	16	8.5	8.5

Timing = DWSRF timeliness is poor requiring 2 years for funding approval and agreement execution.
Interest Rates = DWSRF is lowest however costs can increase while waiting for approvals.
CEQA = DWSRF requires additional CEQA submittals (CEQA Plus).
Funding Admin. Costs = DWSRF has significantly higher admin. costs due to program inefficiencies.
Reimbursements = DWSRF quarterly with paper check; others monthly or bi-monthly with funds wired to account.

Criteria 1: Timing Delays

Delays in getting a lower interest DWSRF loan are cited as decision criteria. DWSRF gets the highest (worst) score (3) for timeliness.

- DWSRF is well known for taking up to a year to issue a loan. There may be requirements for CEQA studies, and they issue loans at the end of their fiscal year (June).
- The good news is the city has been working on this now for almost six months (Really the need was identified in 2024).
- Staff report says project is CEQA exempt

Task 3, of the March 26 project approval by city council was to:

"Prepare applications for the State Water Board, Department of Water permit for construction of the well and the CEQA documentation for the construction."

How to deal with the longer lead time for DWSRF loans.

- The typical lead time according to the DWSRF is about one year. There are requirements that need significant lead time but if the city staff and consultants have been moving along since the council approved the project in March, six months of progress should have been achieved.
- One consideration for financing is to seek a bridge loan. Bridge loans are commonly used when you are constructing a new home. Typically, the lender charges only interest and money can be loaned as needed over time to reduce borrowing costs. According to the DWSRF website they do permit bridge loans.
- The cost of a bridge loan could be $200-300,000 depending on how long it is necessary. **This allows you to save rate payers up to $3MM on higher interest costs from other lenders while you wait for DWSRF loan approval and issuance.**

Criteria 2: Interest Costs

DWSRF is scored "1" for interest (rate), presumably that is good. WIFIA gets a 1/2 - (I guess that is almost as good?).

- The interest rate for DWSRF is 2.1%.
- WIFIA is more than double that rate at 5%.
- This difference increases expected loan costs by $3.3MM.
- Payments at 5% would be $325,257. At 2.1% the payment is only $226,330
- **This means you are paying $6,000,000 for your $3,000,000 well.**
- **Correction: sorry, rate payers are paying $6MM.**

Criteria 3: CEQA Requirements

CEQA-plus is listed as a disadvantage of the DWSRF loan. Presumably time and cost to do studies and reports and time for review and approval. Only one problem - The staff report says specifically:

> **"The Well 4 CEQA document reflects the Well 4 Mitigation and Replacement Project is exempt from CEQA" with replacement on the same site with the same capacity, function, and purpose."**
>
> **CEQA is not a factor in the decision.**

Criteria 4: Funding Admin Costs

If Admin cost is a real factor in the decision – consider the interest cost difference between the loans over 30 years is $3,300,000. It would be difficult to imagine administrative costs that could match that difference.

Criteria 4/5: Flexibility?

Flexibility gets a big star and the “low score (1=best)”. The staff report explains why flexibility is compelling to the city:

> “This would allow the City to complete and place multiple priority water projects into service during the five-year capitalization period before beginning debt repayment, providing the Water Enterprise additional time to build reserves and establish the revenue capacity needed to support the resulting debt service.”

<u>The rationale for the all-important flexibility may be a false choice.</u>

- **Assuming the city acts quickly to implement the recommended EFOC reforms, the reserves are maintained well above the 25% requirement.**
- Revenue capacity is sufficient to support the resulting debt service.
- There is no reason to defer payments. The star is misleading and should be ignored.

Delaying payments on a loan is always a poor financial decision. The lender charges interest on the loan amount even as no payments are made. The interest charge is typically added to the loan amount and the payment is recalculated. You pay interest on the interest which you in effect borrowed from the lender. **The water enterprise has no need to delay making payments on this loan for 5 years and the interest cost of that delay would be enormous.**

The staff report also discusses flexibility in the context of the larger capital program:

WIFIA also provides an opportunity to consider Well 4 within the context of the City's broader water capital program rather than treating the replacement well as an isolated project. With the 2026 Water Master Plan Update identifying approximately $10 million in recommended water projects for implementation over the next five to ten years, establishing a financing strategy now will allow the City to consider Well 4 within that larger capital program and potentially use the same financing approach for other high-priority infrastructure.

- Assume this means they can continue to borrow more to do more projects without a great burden to apply for more money.
- Again, the issue is 5% interest over 30 years vs lower interest 2.1%. The savings is approximately $3MM over 30 years.
- The other question is what further financing needs are there? Where is the data. The analysis here suggests $4MM is sufficient to address the priorities in the staff

report. Adjusting rates in FY29-30 will provide additional cash for capital projects.

Why $5,000,000 loan? – Does the water enterprise need this much money?

Probably not.

- Seems to be driven by a lender requirement unique to WIFIA
- The financial analysis below shows a $4,000,000 loan would do the trick.
- Raftelis estimated the loan requirement at $3,800,000 in 2024 when they did the rate study.
- A $4,000,000 loan at 2.1% has a payment of $181,064. This is over $140,000 a year less than borrowing $5MM at 5%
- Interest over the life of the $4MM loan would be only $1,431,920**.**
- **A total savings of $3.3MM compared to the $5,000,000 borrowed at 5%.**

What happened to the lawsuit?

That is one more detail before you launch into borrowing millions of dollars.

- Our last city attorney/city manager promised that the lawsuit settlement would pay for replacing this PCE contaminated well.
- **Does anyone on city council want to know what happened? Do you already know. Is this something discussed behind closed doors and not shared with the community?**

What happened to the grants?

- Hoping for grants is a fool's errand. Applying for grants is good practice.
- This well replacement has been on the books since 2024 and seriously moving forward since March 2016.
- What grants have been applied for? Why were they turned down?

FINANCIAL ANALYSIS

Before you make these kinds of financial decisions you should expect to see some numbers.

Below are numbers from the 2024 rate study and for three years of actual/budgets shown in the FY26-27 adopted rate study.

How well did the rate study hold up over the first three years?

The rate study performed rather well. Below are the financial summaries from the rate study and from the FY26-27 Adopted budget.

The top table are the numbers from the 2024 Water Rate Study. The bottom table shows the numbers from the FY26-27 Adopted budget. The FY24-25 numbers are actual. The FY25-26 are estimated actual, and the FY26-27 numbers are budgeted.

Capital Balance - Rate Study	FY24-25	FY25-26 *	FY26-27
Revenue	$ 3,562,142	$ 4,146,336	$ 4,245,785
Operating Expense	$ 2,159,811	$ 2,197,520	$ 2,354,648
Net Operating (surpus/(deficit)	$ 1,402,331	$ 1,948,816	$ 1,891,137
Capital Expenditures	$ 851,888	$ 1,235,199	$ 4,143,449
Debt	$ 318,656	$ 318,656	$ 499,511
Total Capital Financing	$ 1,170,544	$ 1,553,855	$ 4,642,960
			$ (3,800,000)
Annual Surplus/(Deficit)	$ 231,787	$ 394,961	$ 1,048,177
Beginning Captial Balance	$ 13,122	$ 244,909	$ 639,870
Ending Capital Balance	$ 244,909	$ 639,870	$ 1,688,047

Capital Balance - Actual	FY24-25	FY25-26 *	FY26-27	
Revenue	$ 3,379,864	$ 3,479,483	$ 3,109,751	1
Operating Expense	$ 2,171,671	$ 2,361,542	$ 2,489,686	2
Net Operating (surpus/(deficit)	$ 1,208,193	$ 1,117,941	$ 620,065	
Capital Expenditures	$ 50,230	$ 575,600	$ 593,466	3
Debt	$ 52,229	$ 252,657	$ 252,547	
Total Capital Financing	$ 102,459	$ 828,257	$ 846,013	
Well 4 Loan				
Annual Surplus/(Deficit)	$ 1,105,734	$ 289,684	$ (225,948)	
Beginning Captial Balance	$ 531,134	$ 1,636,868	$ 1,926,552	
Ending Capital Balance	**$ 1,636,868**	**$ 1,926,552**	**$ 1,700,604**	
Policy Reserve (25%)	$ 568,533	$ 797,450	$ 833,925	
Excess Reserve available to fund capital projects	**$ 1,068,336**	**$ 1,129,102**	**$ 866,679**	

Revenues are coming in 15% under the plan? Why?

FY24-25 and FY25-26 actual revenue came in under the rate study planned numbers ([1] on table above). It is important to analyze the cause.

- Did the large increase in rates cause water usage to drop? The difference is about 15%, which would be significant.
- Is there an issue with the billing system. Are our water bills correct?

Expenses are within 1% of the plan. Salaries and Benefits are slightly above the planned growth rates.

Operating expenses [2] for all three years are above the plan but within 1%.

Capital expenditures [3] came in well under budget for both FY24-25 and FY25-26. The city provided a CIP plan to Raftelis and then did not execute that plan. Why?

This occurred in spite of the obvious need. The city needs to assess the capabilities of Public Works and Engineering to accelerate capital improvement projects for Water and Wastewater.

Well 4 timing keeps slipping. Why?

The Raftelis rate study anticipated the well 4 loan would be issued in FY26-27.

- It was not planned in the CIP budget until FY27-28.
- Timelines appear to be shifting in the wrong direction given the urgency of replacing this well.

What does the future hold?

Future revenues might not seem so rosy given the recent rate changes – turns out not so bad as expenses are decreased by the EFOC reforms

- The FY26-27 revenues are below the plan due to the de-tiering and rate freeze.
- However, because capital improvement projects did not take place at the planned rate the ending capital (reserve) balance in FY26-27 will be very close to the Raftelis plan.
- **Assuming you implement the EFOC proposed reforms immediately expense reductions largely offset income reduction – this was the message from the EFOC finance presentation**

-

The table below repeats the FY 26-27 columns discussed above and

- Projects FY27-28 and FY28-29 which are the last two years of the current rate study.
- Growth assumption are the same as used in the 2024 rate study.

Capital Balance - Rate Study	FY26-27	FY 27-28	FY28-29
Revenue	$ 4,245,785	$ 4,328,222	$ 4,400,507
Operating Expense	$ 2,354,648	$ 2,455,300	$ 2,702,982
Net Operating (surpus/(deficit)	$ 1,891,137	$ 1,872,922	$ 1,697,525
Capital Expenditures	$ 4,143,449	$ 2,032,132	$ 899,391
Debt	$ 499,511	$ 499,511	$ 499,511
Total Capital Financing	$ 4,642,960	$ 2,531,643	$ 1,398,902
	$ (3,800,000)		
Annual Surplus/(Deficit)	$ 1,048,177	$ (658,721)	$ 298,623
Beginning Captial Balance	$ 639,870	$ 1,688,047	$ 1,029,326
Ending Capital Balance	$ 1,688,047	$ 1,029,326	$ 1,327,949

Capital Balance - Actual	FY26-27	FY 27-28	FY28-29
Revenue	$ 3,109,751	$ 3,129,151	$ 3,110,151
Operating Expense	$ 2,489,686	$ 2,425,481	$ 2,504,349
Net Operating (surpus/(deficit)	$ 620,065	$ 703,670	$ 605,802
Capital Expenditures	$ 593,466	$ 4,774,074	$ 907,230
Debt	$ 252,547	$ 99,545	$ 99,545
Total Capital Financing	$ 846,013	$ 4,873,619	$ 1,006,775
Well 4 Loan		$ (4,000,000)	
Annual Surplus/(Deficit)	$ (225,948)	$ (169,949)	$ (400,973)
Beginning Captial Balance	$ 1,926,552	$ 1,700,604	$ 1,530,655
Ending Capital Balance	**$ 1,700,604**	$ 1,530,655	$ 1,129,682
Policy Reserve (25%)	$ 833,925	$ 1,824,775	$ 877,781
Excess Reserve available to fund capital projects	**$ 866,679**	**$ (294,120)**	**$ 251,901**

Revenue remains steady as rates are frozen. Small changes are in other revenue items such as interest.

- Overall, revenue is down but stable (reliable) and as we shall see, lower expenses are sufficient to meet the debt service requirements for at least the next 2 years as long as you implement the EFOC reforms.
- Perhaps the new rate study is not necessary, just a tweak or two.

At the same time revenues are down, operating expenses are reduced in FY27-28 due to a proposed modest reduction in allocated general fund expenses. The chart below shows the proposed changes.

These proposed reductions are a place holder until time tracking is sufficient to support a re-analysis of the full cost allocation methodology.

COST ALLOCATION	FY26-27	% of Dept Exp	FY 27-28	% Dept Exp	FY28-29	% Dept Exp
City Council	$ 43,050.00	16%	$ 41,500	15%	$ 42,745	15%
City Manager	$ 186,481.00	30%	$ 94,631	15%	$ 97,470	15%
City Attorney (Legal)	$ -	0%	$ -		$ -	0%
ACM / City Clerk	$ 37,707.00	12%	$ 46,777	15%	$ 48,180	15%
Admin Svs (Finance)	$ 280,177.00	18%	$ 236,222	15%	$ 243,308	15%
PW - Corp Yard	$ 153,521.00	4%	$ 158,127	4%	$ 162,870	4%
PW - Engineering	$ 75,239.00	11%	$ 77,496	11%	$ 79,821	11%
PW - Gov't Bldg	$ 6,719.00	2%	$ 6,921	2%	$ 7,128	2%
Non-Departmental	$ 7,147.00	1%	$ 7,361	1%	$ 7,582	1%

Grand Jury Responses – EFOC reform recommendations

In addition to adjusting the cost-allocation there are several other reforms proposed by the EFOC that offset the revenue impact of the rate reductions. They are listed on the table below:

Grand Jury Responses	FY26-27	FY 27-28	FY28-29
Refund legal fees 25-26 that did not get delivered	$ 128,677		
Refund City Manager charges due to vacancy for entire yr	$ 142,600		
Syserco loan foregiveness payment		$ 210,741	$ 210,741
Syserco loan payment transferred to General Fund		$ 168,592	$ 168,592.00
Cost allocation reductions		$ 144,708.00	$ 149,050.00
Total Prop 218-26 concessions	$ 271,277	$ 524,041.00	$ 528,383.00

- Refunds of legal fees and city manager charges are due to egregious differences between the allocation amounts and actual expenses.
- The Syserco loan was an irresponsible decision by the City Council to purchase non-essential equipment rather than invest in the more critical infrastructure such as well 4 (25 years over expected life) or the pleasant hill loop (potential for catastrophic system failure) which were priorities since 2005.
- EFOC proposed that the loan payment be transferred to the general fund, and prior loan payments are refunded over a four-year period.

It is important to note that the total impact on the general fund is about $500,000. This decreases to about $300,000 by FY32-33 when the Syserco loan forgiveness payment is complete.

<u>This is not the financial catastrophe that has been predicted at past council meetings.</u>

Capital Infrastructure Costs and Timing Drive Budget Decisions

Capital Expenditures for FY 27-28 have been updated below using the current CIP plan in the Adopted budget and adjusting for the cost estimates shown in the staff report. Below are the planned projects and costs.

Capital Projects/Purchases/Transfers detailed in budget	FY26-27	FY 27-28	FY28-29
Florence Water Line Replacement Design (South)			
Florence Ave Water Line Project Mgmt			
Florence Water Line Replacement Design (North)			
Florence Ave Water Line Project Mgmt			
Parquet St Water line replacements (Construction			
Parquet project management			
Well 4 Pump Motor Variable Speed Drive Replacement	$ 25,500		
Well 7 CO2 Injection Replacement			
Well 6 Pump Motor Variable Speed Dirve Replacement (2)	$ 25,000		
Well 6&8 Roof repairs/Replacemnt	$ 42,000		
Water System Master Plan Updte			
Well 4 Replacement	$ 389,000	$ 2,709,500	
First Street Tanks Assessmetn	$ 154,350		
Seismic retrofit study first street tanks	$ 171,810	$ 1,895,000	
Automated flow meter water tower	$ 76,690		
Pleasant Hill Loop		$ 122,700	$ 858,950
Water main 500 south main street replacement			
Total Planned projects	$ 884,350	$ 4,727,200	$ 858,950
Vehicle replacement			
Flatbed Dump Truck 1/2 costs			
1/4 Ton Pickup (split 2 ways)	$ 14,000		
Backhoe Tractor (Split 3 ways)	$ 54,000		
Total Vehicle Purchases	**$ 68,000**	$ 46,874	$ 48,280
Total Capital Expenses Budgeted	$ 952,350	$ 4,774,074	$ 907,230

Debt Costs rise only slightly due to the transfer of the Syserco loan payments to the General Fund

Debt costs are net of the Syserco refund payments from the general fund and shown below. Lending decisions consider total debt burden. **The Water Enterprise has a very realistic debt burden according to this plan.**

Debt Service (From Adopted Budgets	FY26-27	FY 27-28	FY28-29
Well #7 Loan	$ 83,955	$ 83,955	$ 83,955.00
infrastructure Lease			
Energy Conservation Measure Tax Exempt Lease Purchase	$ 168,592	$ -	$ -
Proposed Well 4 Debt		$ 226,331	$ 226,331.00
Total Debt Service Budgeted	**$ 252,547**	$ 310,286	$ 310,286
Syserco Forgiveness payment (		$ 210,741.00	$ 210,741.00
Debt Payments actual/budgeted (from Adopted Budgets)	$ 252,547	$ 99,545	$ 99,545.00

Total debt service costs (before Syserco refunds) will increase from $252,547 to $310,286. This is an amount any lender should find acceptable.

How much do you need to borrow?

Looking at the table below, **borrowing $4,000,000 [1] is sufficient to maintain reserves well above policy [2] levels through FY28-29. There is no reason to incur the additional borrowing cost of a $5,000,000 loan as proposed by the city staff.**

Capital Balance - Actual	FY26-27	FY 27-28	FY28-29	
Revenue	$ 3,109,751	$ 3,129,151	$ 3,110,151	
Operating Expense	$ 2,489,686	$ 2,425,481	$ 2,504,349	
Net Operating (surpus/(deficit)	$ 620,065	$ 703,670	$ 605,802	
Capital Expenditures	$ 593,466	$ 4,774,074	$ 907,230	
Debt	$ 252,547	$ 99,545	$ 99,545	
Total Capital Financing	$ 846,013	$ 4,873,619	$ 1,006,775	
Well 4 Loan		$ (4,000,000)		1
Annual Surplus/(Deficit)	$ (225,948)	$ (169,949)	$ (400,973)	
Beginning Captial Balance	$ 1,926,552	$ 1,700,604	$ 1,530,655	
Ending Capital Balance	**$ 1,700,604**	$ 1,530,655	$ 1,129,682	
Policy Reserve (25%)	$ 833,925	$ 1,824,775	$ 877,781	
Excess Reserve available to fund capital projects	**$ 866,679**	**$ (294,120)**	**$ 251,901**	2

Will there be a need for rate increases in the future?

- Yes. FY28-29 does show a modest deficit of $400,973. The reserves still have $251,901 more than required by city policy.
- The Syserco loan forgiveness payment will expire 2 years into that period which would increase that operating deficit to about $600,000 going forward.
- That assumes the $900,000 in capital expenditure continues into the next rate period. It is likely a rate increase will be necessary, but it should be in the range of $1-$2.

Is a full-rate study necessary now?

- The current rate study has worked very well, and it has 2 years left**. It just needs a tweak for the rate changes and the EFOC proposed reforms,** and you are good for 2 more years. A Tweak would be much less costly than a full study and take days instead of years. The forecast could be extended to meet lender requirements.
- **Rushing to do another full rate study without a firm number for cost allocation and no sewer master plan is <u>a waste of money</u>.** Without the time-tracking you can't make a meaningful cost allocation plan. Without the sewer study you can't do a rate study.

Conclusion:

- Replacing Well 4 is urgent. The well is 73 years old and was designed for a 40-year lifespan. It is contaminated with PCE that requires special treatment.
- DWSRF was the original preferred choice for a loan back as far as 2024 and more recently confirmed in the March 16, 2026, staff report. It is logical given the dramatically lower interest rates and related costs. Savings total as much as $3.3MM to rate payers.
- Decision criteria such as CEQA and Flexible payment plans are distractions – project is CEQA exempt and the Wate finances will be healthy if all EFOC reforms are implemented.
- Decision criteria related to Admin Costs are dwarfed by the savings difference between an interest rate of 5% and one of 2.1%.
- No need to borrow $5,000,000 - $4,000,000 will do the trick. DWSRF has a much lower minimum loan amount. This lowers borrowing costs and payments for rate payers.
- The staff report makes the argument that it is urgent to move ahead with a new rate study. The financial analysis above may not be perfect (only public data is used) but it makes the argument that the Water Enterprise financials are stable through the current rate period.
- Instead of a full rate study, ask Raftelis for a cost to update the current study with the new assumptions and an extended forecast using current assumptions. This took me 1.5 days, so the cost should be minimal.
- Raftelis could also provide a projection for a total of five years to support the loan application if necessary.
- Implementing the EFOC proposed reforms, the Water Enterprise financials are healthy even with the significant rate reductions.
- **The EFOC reforms are not likely to be catastrophic to the General Fund.** From FY27-28 to FY28-29 the reforms cost about $500,000. After that the Syserco refund payments are complete and the General Fund impact is approximately $300,000. There is no reason to delay the decision to implement the reforms.

Next steps

1. **Get clarity on why DWSRF was dropped from consideration – address issues – saving $3.3MM is important to rate payers.**

2. **City Council to approve all EFOC proposed reforms – implement as soon as possible to minimize impact of rate changes on reserves.**

3. **Suspend the RFP for a new Rate Study**

    - **Get a cost from Raftelis to update the existing study with the new assumptions with an extended forecast.**
4. **Present a report on current time tracking data – will help to ensure that correct data is being tracked to support decision making.**