CLACKAMAS COUNTY BOARD OF COUNTY COMMISSIONERS

Sitting as the Governing Body of Water Environment Services

Policy Session Worksheet

Presentation Date: 5/2/2017 **Approximate Start Time:** 11:30a Approximate **Length:** 30 minutes

Presentation Title: Water Environment Services 190 partnership actions and update

Department: Water Environment Services

Presenters: Greg Geist, Doug Waugh, Chris Storey

Other Invitees:

WHAT ACTION ARE YOU REQUESTING FROM THE BOARD?

This report will provide the Board with a six month update on the ramp up of the WES 190 entity, and request direction with respect to two proposed actions:

1) Approval for proceeding to include Surface Water Management Agency of Clackamas County into the Water Environment Services entity.
2) Direction on which of five options to pursue for the improved financial integration of Clackamas County Service District No. 1 into the Water Environment Services entity.

EXECUTIVE SUMMARY:

The issue of regionalization of wastewater and surface water services has been a significant discussion in Clackamas County for many years. It was the impetus for the formation of Clackamas County Service District No. 1 (“CCSD#1”) and the Tri-City Service District (“TCSD”), and their eventual co-location partnership in 1999 and again in 2008.

As the BCC was entering into agreements to allow CCSD#1 to construct facilities at the Tri-City Plant, it directed that a regionally-representative blue ribbon group be formed, consisting of members of the business community, environmental groups, ratepayers, and elected officials from all affected cities including Gladstone, Happy Valley, Oregon City, Milwaukie, and West Linn (the “Blue Ribbon Committee”). This Blue Ribbon Committee participated in a thorough examination of the potential costs and benefits of closer cooperation and partnership. The Blue Ribbon Committee found that: (i) there were significant financial benefits to each of the communities’ ratepayers by making collective investment and management decisions, with millions in projected savings; (ii) there was an equitable fiscal and operational model that ensured fairness for all; and (iii) governance and ratepayer interests of all stakeholders could be addressed in a collective investment and operational approach.

One of the conditions of the Blue Ribbon Committee’s findings was that each community’s ratepayers would be responsible for their prior debt and actions. This condition was recognized by the BCC as crucial in any regional solution.

The concept of regionalization of wastewater efforts was further discussed by the Regional Wastewater Treatment Capacity Advisory Committee ("Regional Committee") over several years. In 2012, after a recommendation from the Regional Committee, CCSD#1 and TCSD agreed to mutually invest and acquire the Blue Heron lagoon and associated Clean Water Act permit, with each sharing equally in all related costs to avoid approximately $80 million in infrastructure expenditures imposed by regulatory requirements. Further investigations and conversations at the Regional Committee in 2015-16 have indicated substantial cost savings to ratepayers through a joint investment strategy for solids handling infrastructure.

After much public debate and some demands from constituent cities for greater control, in November of 2016, the Board of County Commissioners ("BCC") unanimously adopted an ORS 190 agreement (the "Agreement") creating Water Environment Services ("WES"), a separate legal entity in the form of a municipal partnership, on behalf of and including CCSD#1 and TCSD. Both service districts continue to exist, and their boundaries will continue to change and define the scope of the WES entity. However, pursuant to the Agreement, it is the direction of the Board that the management, operations, regulatory affairs, and financial affairs (excepting previously existing debt) be integrated to achieve the savings for ratepayers identified by the Blue Ribbon Committee. The Agreement at this time does not include the third service district managed in the department, the Surface Water Management Agency of Clackamas County ("SWMACC").

The staff of the County's Water Environment Services Department have been working since November to move all aspects of these two county service districts into WES by the end of the transition period target date described in the Agreement of June 30, 2018. The transition period allows time to implement a complex process of integrating and moving the operations and functionalities of both TCSD and CCSD#1 into the WES entity.

Overall, moving TCSD into the WES entity is simpler than moving CCSD#1, and staff feels that this can be accomplished by the end of this fiscal year, which is happily ahead of schedule. As noted below, there are benefits to integrating SWMACC into the WES 190 entity, and that too could be accomplished by the end of this fiscal year, with BCC approval and direction. CCSD#1's outstanding debt requires greater management to ensure compliance with BCC direction and the commitment to not burden other ratepayers with CCSD#1's previously existing debt. Therefore, CCSD#1 remains on a target integration date of July 1, 2018.

This policy session is a check in at the one third point to update the BCC on the work done to date and the public actions required to implement the transition plan further. Each of the service districts, and the WES entity, are discussed separately for clarity.

Surface Water Management Agency of Clackamas County

In the process of evaluating the functionality of the new WES entity and the integration of the operations of both CCSD#1 and TCSD, staff recognized that SWMACC's ratepayers would be best served by also joining into the WES entity to partner on surface water programs, and realize the same regionalization efficiencies as CCSD#1 and TCSD.

The original orders approved by the Board of County Commissioners establishing surface water services in CCSD#1 and SWMACC are substantially the same, and were created to address the same looming regulatory issues facing the county. While surface water quality issues and regulations may vary between the County's watersheds, the programs to address those issues can be implemented consistently by WES. Integrating the services currently provided separately by each district allows for further integration of funding and programs, including capital planning and construction, infrastructure maintenance, rules and standards, regulatory management and reporting, water quality monitoring, and education. The economies of scale benefits arise from reduced redundancy and overlap, and more seamless use of available resources between the districts.

Surface water funds would remain separated from sanitary sewer funds under WES, thus the rate zone for TCSD would be unaffected. The services provided within the boundaries of SWMACC will continue to be limited to surface water services only and will not include sanitary sewer services of any kind. Therefore, staff recommends to the BCC that steps be taken to allow SWMACC to join the WES 190 partnership.

If the BCC agrees, several steps would be necessary to accomplish this. They include:

- WES 190 Agreement Amendment – Necessary to bring SWMACC into WES. Could be accomplished through adoption by the BCC at the May 18, 2017 regular meeting.

- Supplemental Budget – Necessary to provide budget authority for transferring all funds remaining in SWMACC by June 30 into WES. Could be accomplished by adopting a supplemental budget at a public hearing scheduled for June 8. (Note: Adoption of this supplemental budget would occur subsequent to the budget committee for WES approving its budget which will include SWMACC going forward.)

- "Bill of Sale" for All Physical Assets – Necessary to move all of the physical assets of SWMACC into WES. No action is necessary, as the BCC authorized this action in their approval of the WES 190 Agreement, which would apply if amended to add SWMACC.

- Contracts Transferred – Necessary to allow normal contractual activities to transition into WES. This process will occur during the transition period and will not interrupt day-to-day operations.

<u>Tri-City Service District</u>

The integration of TCSD is a directive of the BCC from the Agreement. Staff believes that it can transfer the full functionality of TCSD into WES by end of this fiscal year. This would mean that TCSD would not need a budget for the next fiscal year, since that activity would be through the WES entity. The following steps are necessary to accomplish this integration:

- Supplemental Budget – Necessary to provide budget authority for transferring all funds remaining in TCSD by June 30 into WES. Will be accomplished by adopting a supplemental budget at a public hearing scheduled for June 8.

- "Bill of Sale" for All Physical Assets – Necessary to move all of the physical assets of TCSD into WES. No action is necessary, as the BCC authorized this action in their approval of the WES 190 agreement.

- Contracts Transferred – Necessary to allow normal contractual activities to transition into WES. This process will occur during the transition period and will not interrupt day-to-day operations.

- Regulatory Assignments – work with DEQ to ensure all applicable permits are held by WES, the first step in implementing the improved regional regulatory framework.

As of July 1, 2017, TCSD will continue to exist as a legal entity, but will not have any budget, assets, or activity housed within it. The only area that will continue to be active should be boundary changes. As noted above, WES staff has already tentatively scheduled times for the BCC to consider a supplemental budget for TCSD on June 8th that increases its planned expenditures to allow for the contribution of its ending fund balance into the WES entity.

Water Environment Services

With the integration of TCSD (and potentially SWMACC) ahead of schedule, the WES entity is ready for start-up. While formed in November 2016, WES currently does not have a budget or an accounting structure for this fiscal year. Part of the transfer and integration of TCSD and SWMACC, if approved, would be the creation of an entity prepared to carry out day to day responsibilities. This requires several steps in the startup process, including:

- WES Budget Committee Formation – Necessary to satisfy Oregon Budget Law requirements, which could be constituted from current members of the TCSD and SWMACC budget committees for the 2017-18 fiscal year. For 2018-19 and thereafter, the budget committee will include citizens from SWMACC, TCSD, and CCSD#1, with the normal staggering of terms common to other, similar committees. The formation of this committee will be accomplished through the normal BCC process while honoring the volunteer members of the existing TCSD and SWMACC budget committees.

- Establishing Accounting Funds - Necessary to receive resources from the contributing districts initially and to provide the structure necessary for budgeting expenditure appropriations going forward. Will be accomplished by a resolution adopted at the BCC regular meeting on June 29.

- WES Budget Approval and Adoption – Necessary for the ability to spend financial resources. Will be accomplished through the normal County budget committee process and budget adoption process by June 29.

- Adopting WES Ordinances – Necessary to provide a legal operating structure for WES and maintain compliance with the Clean Water Act. Will be accomplished initially through the adoption of TCSD rules, which address sanitary sewer issues, and SWMACC rules, which address surface water issues. These actions will occur through an emergency ordinance adoption so that it can be completed and applicable by June 30. The first reading will be on June 8 and the second reading and adoption will occur on June 22, with a request that the BCC declare an emergency so they are effective by the new fiscal year. Staff anticipates that a revised set of ordinances covering sewer and surface water, including incorporating CCSD#1 rules, will occur by the end of the transition period on July 1, 2018.

- Department of Environmental Quality Permits Transfer – Necessary to the purpose of WES. A complete inventory of permits is underway and a full transfer will be accomplished by June 30.

After the WES entity is up and running, only WES and CCSD#1 will be budgeted and operating during the 2017-18 fiscal year. It is the direction of the BCC to integrate CCSD#1 by July 1, 2018.

<u>Clackamas County Service District No.1</u>

CCSD#1 will remain as it is for 2017-18. Consequently, it will require the normal budget committee approval and BCC adoption on June 29.

Staff does not recommend integrating CCSD#1 into WES during this fiscal year due to a key issue surrounding the approximately $95 million of outstanding CCSD#1 debt ("CCSD#1 Legacy Debt"). The bond documents for CCSD#1 do not specifically contemplate such a transfer since governments do not regularly integrate with other governments, as we are doing here. Typically when businesses borrow, they have the ability to "pass on" their debt when they partner or sell, which is far more common in the private sector. The overall objective is to transfer the CCSD#1 Legacy Debt to the WES entity, where it will be paid for exclusively by the CCSD#1 rate zone. This transfer will allow for the establishment of a credit history for WES, and ensure that future borrowings are issued on an equal basis with CCSD#1 Legacy Debt.

CCSD#1 does have a Master Sewer Revenue Bond Declaration ("Master Order") which establishes the terms under which CCSD#1 can borrow funds and how it will pay the associated debt. The Master Order does provide four options to change some of these terms under which CCSD#1 has borrowed funds and so allow CCSD#1 and its debt to move into WES. Staff has developed five options with respect to the CCSD#1 Legacy Debt and desires BCC direction on the path the Board prefers.

Option 1: <u>Explicit Vote Solicitation</u>. This process, which is apparently very rare, has the bond issuer, CCSD#1, go out and solicit a vote from the bondholders for explicit permission to transfer the CCSD#1 Legacy Bonds to WES. Finding these owners will be difficult, time consuming, and expensive. There is every likelihood that ownership is widely dispersed (from individuals to large banks). Even if they are identified, they may say no to the move or demand extra restrictions on the finances or additional consideration from CCSD#1 before agreeing. Since the vote requires consent to change the status quo, adding incentives is the only inducement available. The estimated cost of this option is a minimum of $1.5 million. If successful, this option greatly reduces the risk of any potential challenge to the debt integration.

Option 2: <u>Refinance with Explicit Bond Covenant Added</u>. When issuing new debt, it is common for issuers to update their bond covenants. If it sells 51% of the value of the bonds in the refinance, it is taken as the same as a vote (per Option #1 above) and the bond covenants are approved. However, in August of 2016, CCSD#1 completed a refinancing of its debt. This was done prior to the decision to create WES in November of 2016. That refinancing achieved significantly lower interest rates. Refinancing the debt again in order to change the terms of the Master Order will cost between $1.5 million and $7.5 million in additional interest, based on the fact that staff hit the bottom of the market for rates on the first refinancing, and refinancing a second time just months after the first could lead to some of the debt being deemed taxable (and requiring a higher interest rate) instead of the tax exempt status of all current debt. However, if successful, this option greatly reduces the risk of any potential challenge to the debt integration.

Option 3: <u>No Adverse Finding Amendment</u>. The Master Order has a specific provision to allow for amendments so long as "…in the reasonable judgement of the District, [it] does not materially and adversely affect the rights of the owners of any Outstanding Bonds…”. The transfer of the CCSD#1 Legacy Debt to WES would result in the same rate zone paying the same debt, but in a lower overall operating cost and with lower future obligations due to the efficiencies gained by regionalization. Therefore, it is quite reasonable to determine that this specific transfer does not have a material adverse impact on bondholders, who will continue to receive their full payments. To implement this, CCSD#1 would craft a very specific amendment to the Master Order describing the new WES entity and its enhanced ability to pay the debt of CCSD#1. This option will cost staff time and possibly the costs of a qualified consultant to demonstrate the enhanced financial status of the new WES, as well as rating agencies (to evaluate the financial health of the new WES). The total cost would be approximately $100,000 in consultant support. If successful, this option would result in a full integration of CCSD#1 into WES; however, it carries some risk that bondholders may challenge the amendment because they may not think it is “reasonable.”

Option 4: Asset Only Integration. A provision of the Master Order allows “most” of the assets of CCSD#1 to be transferred to WES if justified by a report of a qualified consultant. Most does not mean all. WES would become the entity that manages all operations for the combined districts but some assets would be held by CCSD#1. CCSD#1 would remain as a much reduced entity that 1) collects its revenues, 2) pays the annual debt service on its outstanding bonds, 3) transfers remaining revenues to WES to finance the departments operations and to help pay for future capital-related borrowings, and 4) holds certain assets, which could impair the regulatory integration of WES. This option will cost staff time as well as the cost of qualified consultants, estimated to be ~$80,000-$100,000. It may also end up with significant additional interest costs on future borrowings, as they could be viewed as subordinate to the CCSD#1 Legacy Debt. Additionally, CCSD#1 will remain an operating entity alongside the new WES, adding complexity to the financial and legal management of the department and putting at risk the comprehensive regulatory approach that yields savings to ratepayers.

Option 5: Status Quo. An additional option is to leave CCSD#1 as it is currently configured. This option leaves two separate entities through which the department would operate, much as it does now, for the term of the CCSD#1 Legacy Debt, or approximately 20 years. It does not achieve the goal of integrating CCSD#1 into WES.

FINANCIAL IMPLICATIONS:

Is this item in your current budget? ☒ YES ☐ NO

What is the cost? Staff time, implementation costs of CCSD#1 debt strategy.

What is the funding source? FY16-17 CCSD1, TCSD, SWMACC Budgets

STRATEGIC PLAN ALIGNMENT

This aligns with several of WES’ Strategic Goals:

- Achieve sewer improvements to support the expected regional 20-year growth horizon.
- Priorities and policy recommendations will reflect optimum economies of scale.
- A decision will be made regarding the governance and/or co-investment strategy, allowing for the districts to benefit from the maximum practical economy of scale.

This aligns with the County's Strategic Goals in that it helps build a strong infrastructure.

LEGAL/POLICY REQUIREMENTS:

There would be extensive legal requirements as noted above for the adoption of supplemental budgets for SWMACC and TCSD to allow their integration into WES.

There would be significant implementation requirements for any of options #1 – 4 for the CCSD#1 integration strategy.

PUBLIC/GOVERNMENTAL PARTICIPATION:

OPTIONS:

Question 1: Should SWMACC be integrated into the WES entity?

Option A – Yes, integrate.

Option B – No, leave SWMACC as a standalone entity.

Question 2: What Strategy should be pursued to integrate CCSD#1 into WES financially? The options are described in greater detail above.

Option 1 – Explicit Permission by Vote for Amendment.

Option 2 – Refinance and Explicit Permission by Amendment.

Option 3 – No Materiality Amendment.

Option 4 – Asset Only Transfer.

Option 5 – Status Quo.

RECOMMENDATION:

Question 1: Should SWMACC be integrated into the WES entity?

Recommendation: Option A. Yes. It improves the service level and opportunities for surface water customers in both CCSD#1 and SWMACC.

Question 2: What Strategy should be pursued to integrate CCSD#1 into WES financially?

Recommendation: Option 3, the no materiality amendment. It has the least cost and the highest chance for success in creating a complete WES entity.

ATTACHMENTS:
None

SUBMITTED BY:
Division Director/Head Approval _______DW____
Department Director/Head Approval ____GG_____
County Administrator Approval __________________

For information on this issue or copies of attachments, please contact Doug Waugh at 503-742-4564