Attachment #8

COUNTY OF SAN LUIS OBISPO

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TO: DAN BUCKSHI, COUNTY ADMINISTRATIVE OFFICER

FROM: JAMES P. ERB, AUDITOR-CONTROLLER-TREASURER-TAX COLLECTOR

DATE: MAY 2, 2016

SUBJECT: 2016 ANNUAL DEBT REVIEW

The County's debt management policy contains the following language:
"The County Administrator should report at least once per year to the Board of Supervisors confirming whether the County is in compliance with legal debt limitations and also commenting on the County's overall debt burden as to prudent levels for future budget management and maintenance of strong credit ratings." The Auditor's Office is providing this information pursuant to the debt policy requirement.

Legal Debt Margin:

The County's Comprehensive Annual Financial Report (CAFR) contains a 10 year history of the legal debt margin. As of June 30, 2015, SLO County's legal debt limit was calculated at $567.8 million based on a factor of 1.25% of total assessed values. The County's total debt applicable to the legal limit was only $10.1 million. SLO County is safely under the debt limit. The County was below the legal debt limit for each of the 10 years displayed in the CAFR.

Current Debt Burden:

SLO County has several other types of debt outstanding. These include Certificates of Participation (COPs), Pension Obligation Bonds, and Revenue Bonds of various types. These issues are not directly serviced by a levy of property taxes, and so the legal debt limit does not apply. Nevertheless, it is important to carefully monitor and control the level of these obligations. This is to maintain a strong credit rating and to prevent debt service from absorbing too much of available resources. Accordingly, the adopted budget for the County Administrative Office includes a performance measure with the goal of keeping annual County General Fund backed debt service to no more than 5% of the annual General Fund budget. Bond rating agencies generally agree that 5% or less is an indicator of a manageable debt load. As of June 30, 2015, the outstanding principal balances due as reported in the CAFR are $370.2 million for business type activities, the largest portion of which is $183.8 million for the Nacimiento Water

Pipeline. Business type activities is debt serviced by charges to users or to the contracting cities and districts, not the County General Fund. During the current fiscal year, $7.3 million of business type activities is scheduled to be retired.

As of June 30, 2015, the CAFR reports outstanding principal balances due of $170.9 million for governmental type activities. This is debt of our general and special revenue funds where the repayment is not related to user charges. The largest portion of debt related to governmental activities is $146.2 million of Pension Obligation Bonds (POBs). During the current fiscal year, $6.8 million of this debt is scheduled to be retired.

The County's 2003 Series A POB is scheduled for a final payment in September 2017. The principal balance of the 2003 Series A was originally $48 million. In September of 2018 the County begins making payments on the 2003 Series C Bonds. The principal balance of the 2003 Series C is $44 million and the final payment will occur in 2030. In September 2019 the County will make a final payment on the interest only 2009 Series A (refinanced the 2003 Series B). At that time a principal payment of $42.6 million is due and we are planning to pay all or a significant portion of the principal. Currently we have set aside $19.4 million for that purpose.

For the current 2015-2016 fiscal year, approximately $2.1 million of debt service principal and interest on COPs and $9.6 on POBs is budgeted to be paid from the General Fund, in addition, $485 thousand of COP debt service paid for by the Golf Enterprise fund is backed by the General Fund. This represents about 2.62% of the General Fund budget, significantly within the targeted level of no more than 5%.

Current Status and Outlook:

All scheduled principal and interest payments for fiscal 2015-2016 have been made on time. However, the bonds issued for the Vineyard Drive Interchange were to be repaid annually using development fees. Since 2013 development fees have not been able to fund the entire annual debt service. To date the Roads Fund has assisted with $603 thousand and another $140 thousand is anticipated for this current fiscal year. The receivable is being tracked in the Roads fund and will be repaid once development fees start exceeding the annual debt service requirements. While these funds are not considered a General Fund obligation they are General Fund backed. General Fund contributes to the Roads Fund, those contributions assist with the debt service payment. The Vineyard Drive Interchange bonds were issued in 2008 and the remaining principal balance as of June 30, 2015 was $6.34 million.

As part of a review caused by some pending contract amendments to the Nacimiento Water Delivery Entitlement Contracts, Standard & Poor upgraded the rating on the Nacimiento bonds. Both the SLO County Financing Authority Nacimiento Water Project Revenue Bonds, 2007 Series A and Series B and the SLO County Financing Authority Nacimiento Water Project Revenue Refunding Bonds, 2015 Series A were upgraded from an A rating to an A+.

One of the many requirements to participate in bond issuance is that a biennial credit rating is calculated by an independent rating agency. Credit ratings are used by investors to determine the risk involved on any debt issuance. On April 1, 2016, Fitch Ratings reaffirmed the County's implied general obligation rating of AAA, the highest possible credit rating. The County's Pension Obligation Bonds and Lease Revenue Bonds were also reaffirmed at AA+. This is the highest rating for these types of debt instruments. These ratings denote investment grade debt issuances and the lowest expectation of default risk which are assigned only in cases of exceptionally strong capacity for payment of financial commitment.

Recent and New Debt:

On June 30, 2011, the County entered into financing agreements with the State Water Board for a loan up to $79.9 million to partially fund the Los Osos Wastewater Project. These funds will be drawn down as needed to complete the project. This is not a County General Fund obligation.

In August 2015, the Public Works Department and the County Auditor-Controller-Treasurer-Tax Collector advance refunded $107.1 million of the Nacimiento Water Project Revenue Bonds, 2007 Series A in order to take advantage of lower interest rates. The refunding reduced the annual debt service requirements to the participating agencies by $626,000.

The County is in the process of issuing $6 million of General Fund backed debt for the completion of the Airport Terminal. The annual debt service will be funded from a combination of Airport operations and Passenger Facility Charges. This new issuance will not change the County's ability to remain in compliance with legal debt margins.

Anticipated New Debt:

Debt issuances within the next year or two as reported by Public Works could include a bond sale to the United States Department of Agriculture (USDA) to fund the Arroyo Grande Creek Levee Improvements and to augment the 2013 funding for the water tank replacement and for the purchase of a second water tank in southern Cayucos. However, the timing and amounts are not certain at this time. These also would not be an obligation of the County General Fund.

Within the next two to three years the County may be issuing debt in the amount of $21 to $36 million as needed for the Diablo Canyon Desalination Project. If the project is determined to be feasible and the project proponents decide to move forward a funding source and amount would be determined at that time. This debt will not be a County General Fund obligation.

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A new Animal Services Facility is in the beginning stages of developing a request for proposal (RFP) for design bid responses to determining a final structural design and facility cost. It is anticipated that a new facility will be somewhere in the vicinity of $12 to $14 million with a useful life of 30 to 50 years. Since the County provides animal services for all the incorporated cities it is expected that they would participate in the annual debt service of the new facility.